KSE | Institute

KSE Institute Russia Chartbook

External Environment Turning More Supportive, Fiscal Outlook No Constraint for Russia's War

April 2024

Benjamin Hilgenstock
Senior Economist
bhilgenstock@kse.org.ua

Yuliia Pavytska
Manager of the Sanctions Programme
ypavytska@kse.org.ua

Vira Ivanchuk
Research Analyst
vivanchuk@kse.org.ua

KSE | Institute

Executive Summary

1. **External environment becoming more supportive.** Russia is significantly benefiting from higher global oil prices. In March 2024, the trade surplus stood at $16.8 bn—more than double its average in January-February ($7.3 bn)—, while the current account surplus increased from $4.2 bn on average in January-February to $13.4 bn in March. At the current rate, Russia's foreign currency inflows would increase from $51 billion in 2023 to more than $100 billion in 2024, resulting in a dramatic reduction of macroeconomic vulnerabilities and a significant increase in policy space to manage the economy and continue the brutal war in Ukraine.
2. **Energy sanctions regime facing credibility issues.** Price cap compliance is likely minimal as prices for key Russian crude oil grade lie significantly above the $60/bbl threshold. Urals averaged $66/bbl in Q1 2024 and currently trades around $78/bbl, while the respective numbers for ESPO are $76/bbl and $85/bbl. Effective enforcement is being hindered by long-standing issues surrounding the pricing information provided through the attestation system. In addition, Russia's ability to grow and maintain its shadow fleet—despite recent OFAC vessel designations—is fundamentally undermining the leverage of the current energy sanctions regime.
3. **Fiscal financing pressure low due to strong revenues.** Budget revenues from oil and gas are benefitting from sharply higher oil prices, the still-weaker ruble, and tax regime changes (+79.1% vs. Q1 2023). At the same time, Russia's war-spending driven economic growth is fueling non-O&G revenues (+43.2% vs. Q1 2023), which allows the regime to fund higher expenditures (+20.1% vs. Q1 2023). In Q1 2024, the budget deficit stood at 0.8 trillion rubles and fiscal pressure will likely remain contained.
4. **Macro buffers constrained but currently not needed.** Due to the improved fiscal situation, the Russian government has not had to rely on its significantly-diminished sovereign wealth fund this year so far, and borrowing in the domestic market has also remained stable and moderate. While close to $300 bn in reserves remain immobilized in sanctions coalition countries, the more supportive external environment is reducing pressure on the ruble and, in turn, on inflation, which means that the CBR has not been forced to tighten monetary policy further in recent months. Altogether, this means that sufficient liquidity is being provided to the economy.
5. **A call to action for Ukraine's allies.** Sanctions noticeably eroded Russia's macroeconomic stability in 2023, but if the objective is to undermine the country's ability to conduct its war of aggression in Ukraine, much more will be needed in the coming months.

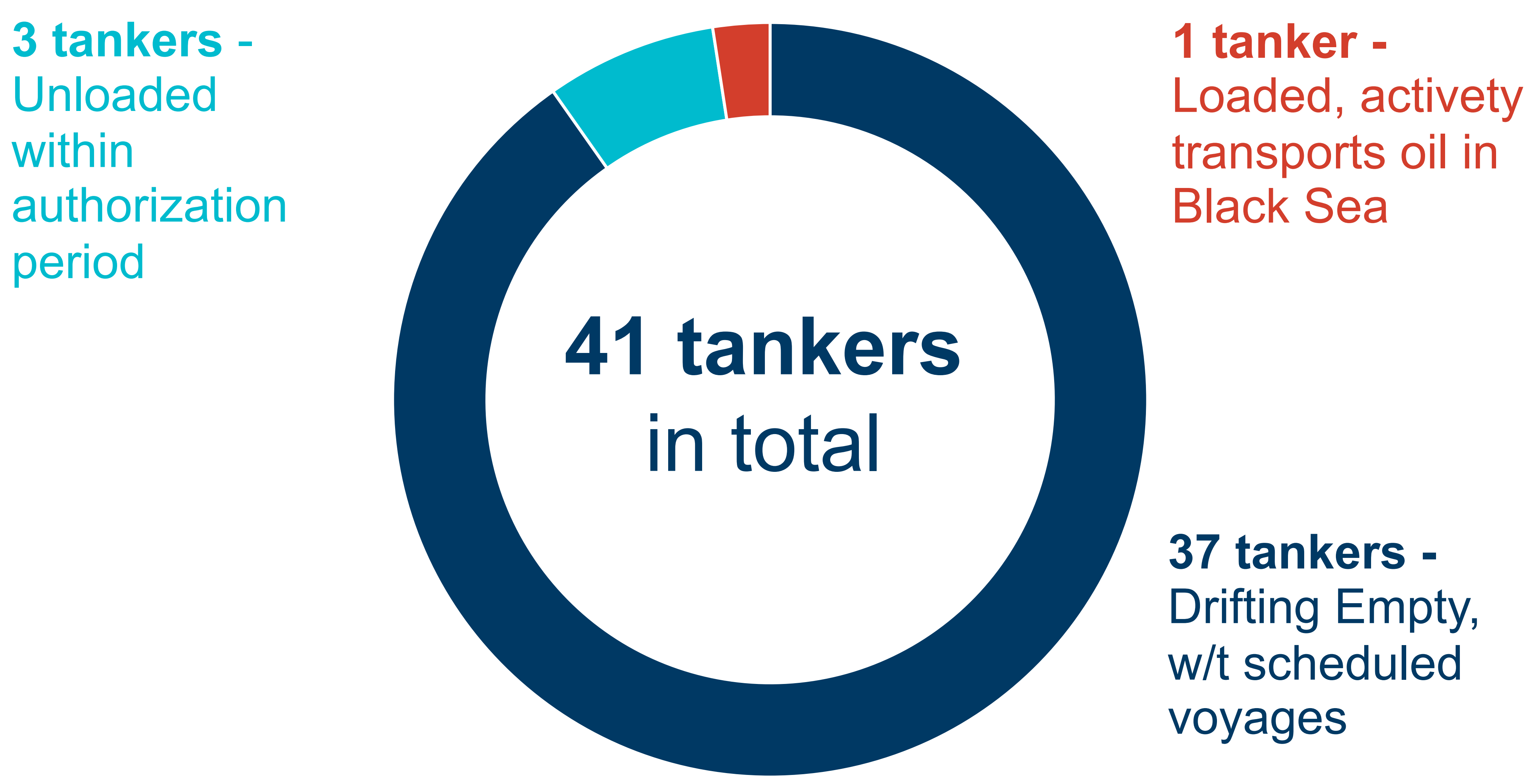
KSE | Institute

Energy: further action is critical to constrain Russia’s energy revenues.

Strategy of vessels designation requires scaling up to increase pressure.

- The U.S. Treasury Department (OFAC) has listed 41 vessels as assets of sanctioned entities in recent months.
- Most of the tankers are drifting empty; only one was found to still be actively transporting oil in the Black Sea.
- This enforcement strategy can and should be scaled up to increase pressure on Russia’s shadow fleet.

OFAC-designated vessels remain out of the market



Source: Kpler, KSE Institute

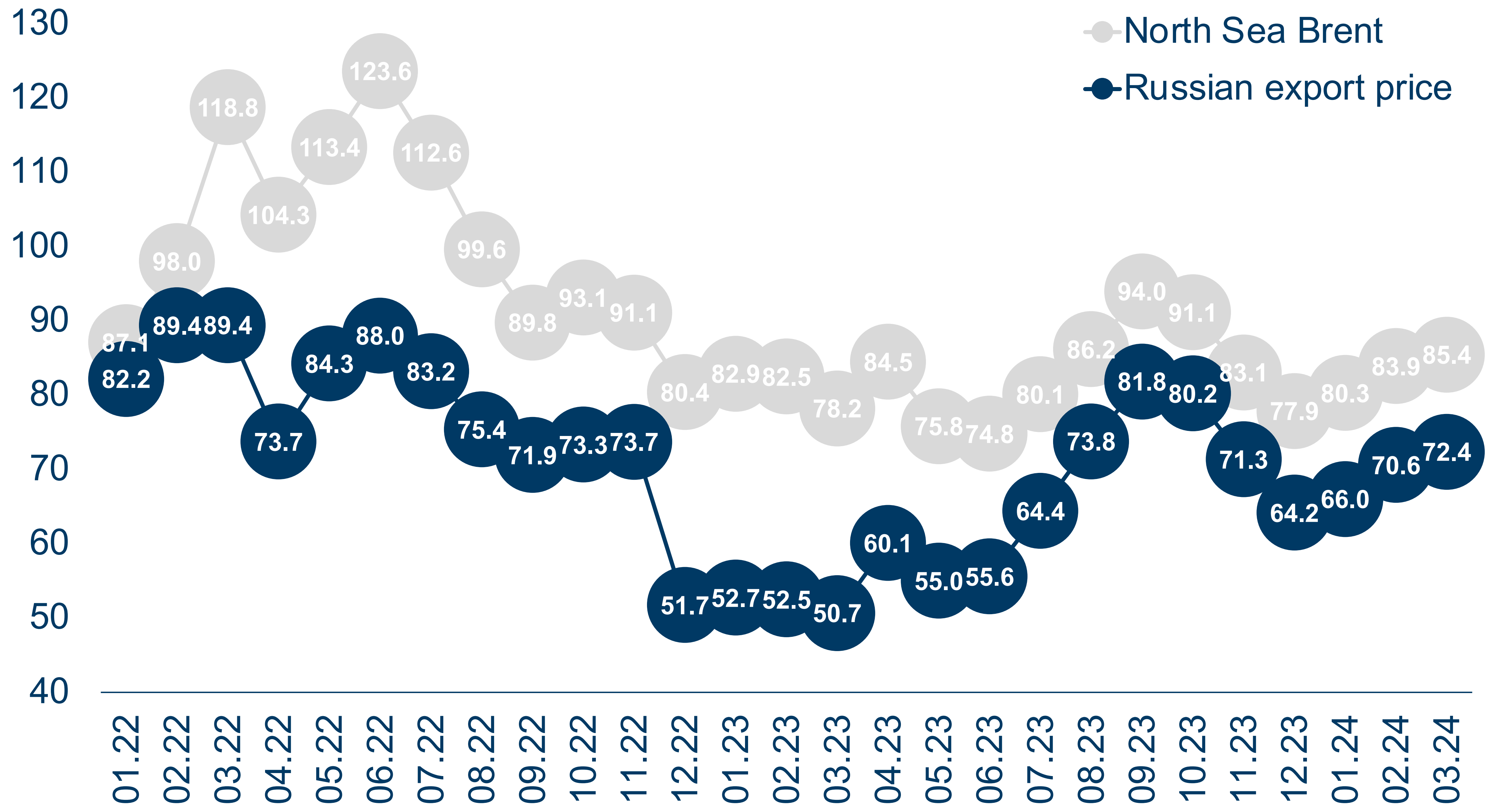
One active designated vessel: the Sanar-15

Source: Kpler, KSE Institute

Rising global prices will require more decisive steps.

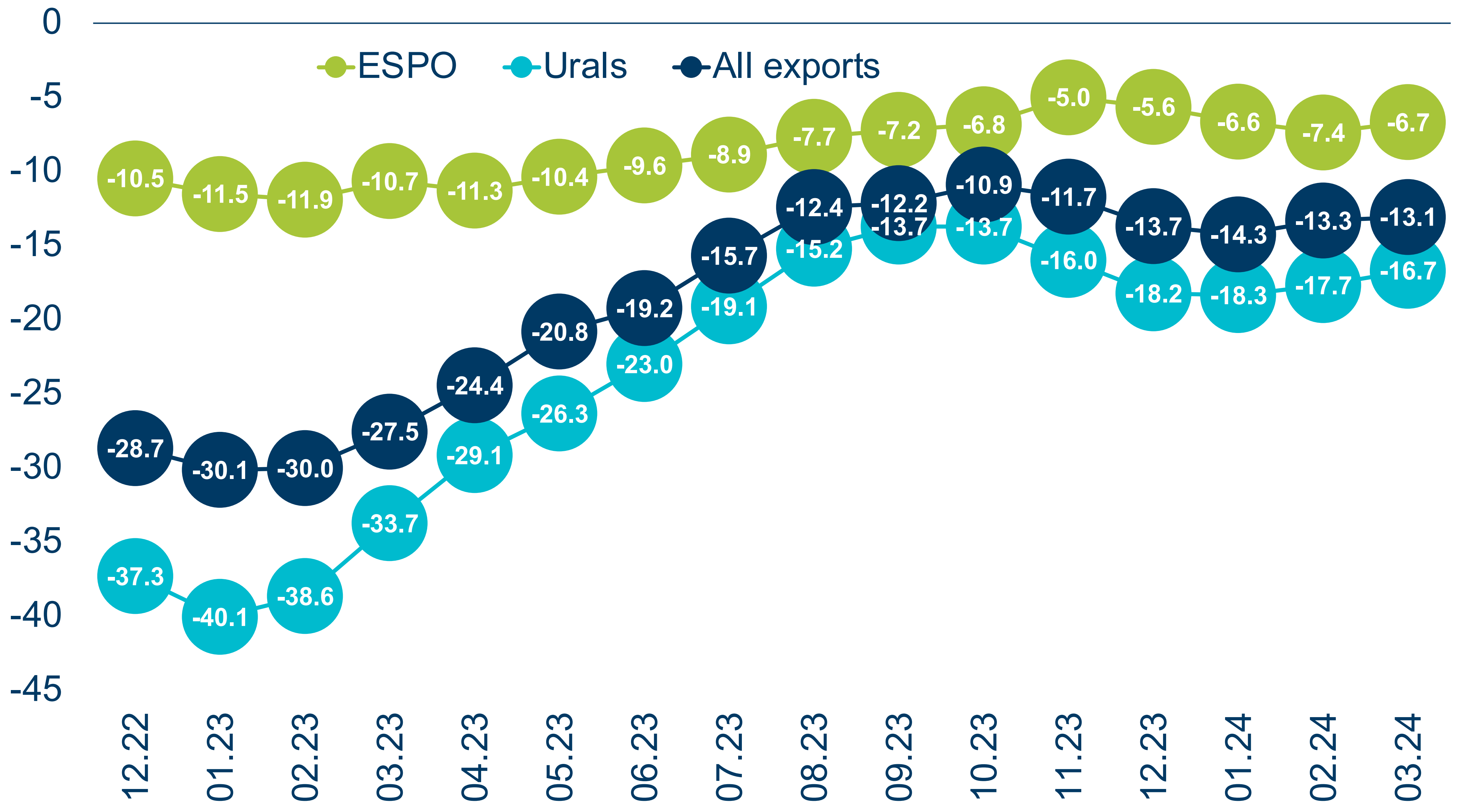
- Energy sanctions, in particular the EU embargo, weighed on Russian export earnings via wider price discounts.
- Recent G7/EU enforcement efforts are having an impact, with the Urals discount widening to ~$16-18/barrel.
- However, these carefully-calibrated enforcement actions have been more than offset by higher global oil prices.

Crude oil prices, in U.S. dollar/barrel*



Source: Federal Customs Service, International Energy Agency, KSE Institute
*export price until November 2022 from Russian customs, all other numbers from IEA

Discount of Russian export prices vs. Brent, in U.S. dollar/barrel

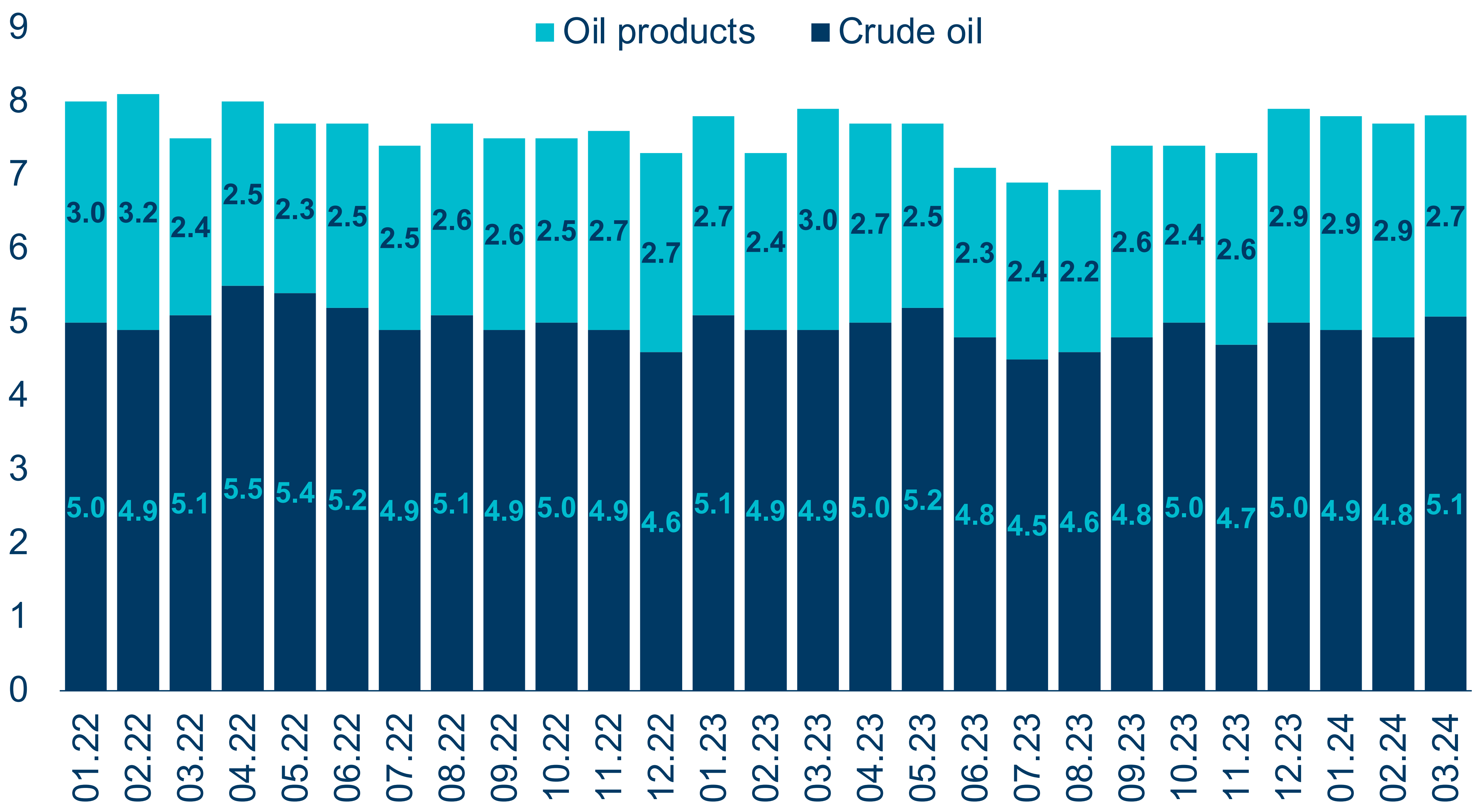


Source: International Energy Agency, KSE Institute

Russia boosted crude oil exports to compensate for loss in oil products.

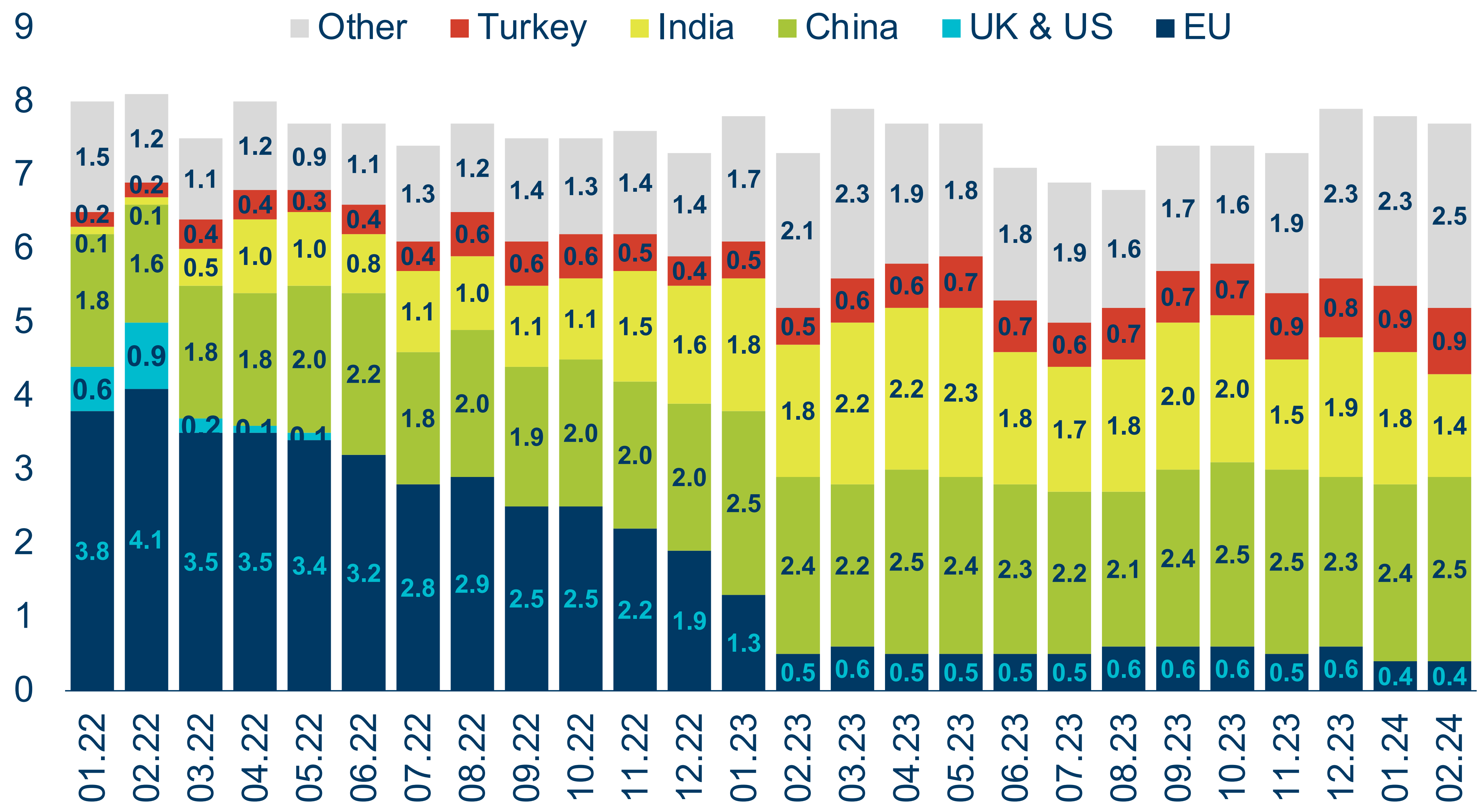
- Attacks on refineries affected Russian exports: products dropped by 7%, while crude oil increased by 6% vs. February.
- China, India, and Turkey remain the largest buyers of Russian albeit Indian imports have decreased in recent months.
- More broadly, the price cap regime has succeeded at keeping Russian oil on the market and prevent price shocks.

Russian oil export volume by type, in million barrels/day*



Source: International Energy Agency, KSE Institute *March 2024 = KSE Institute estimate

Russian oil export volume by destination, in million barrels/day*



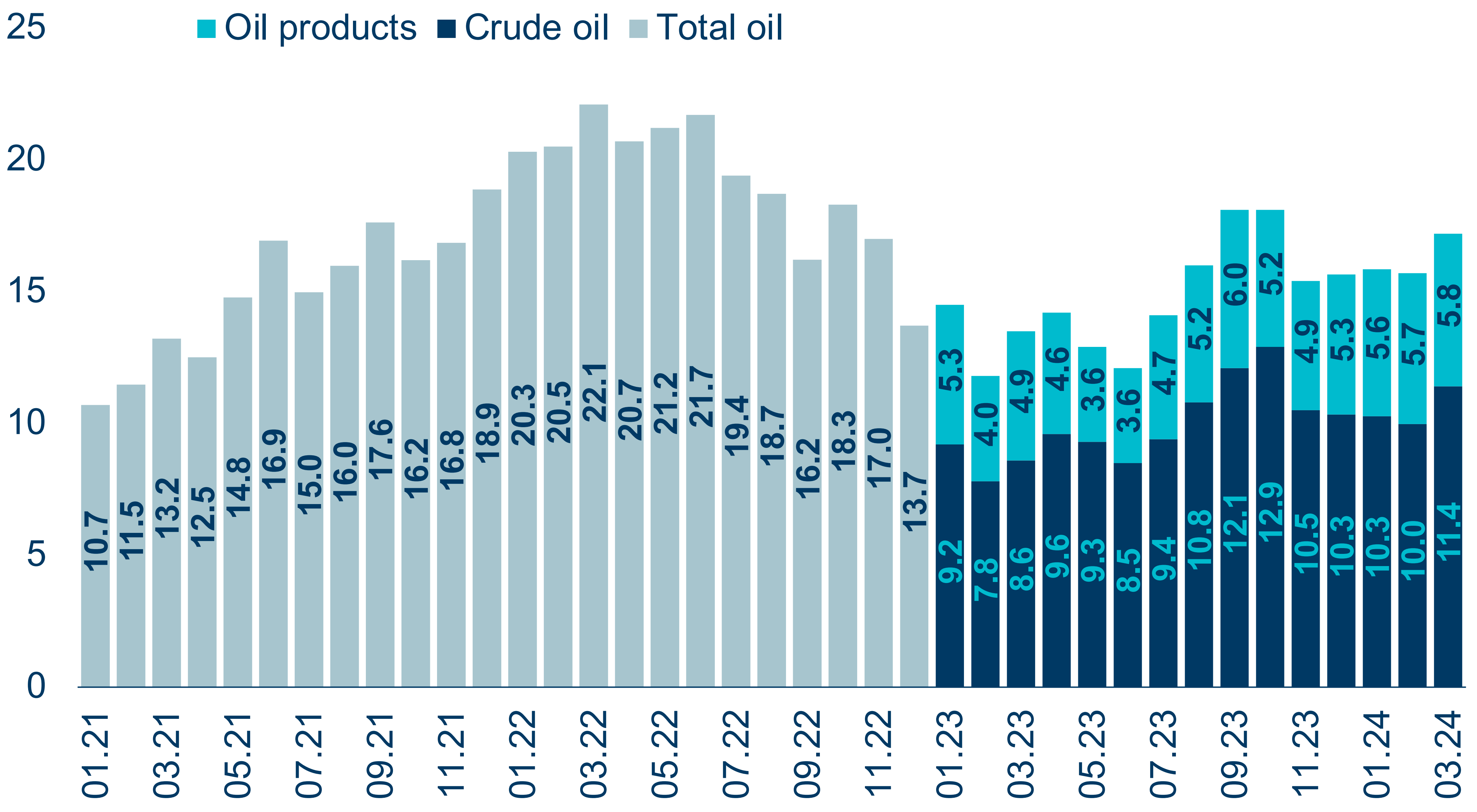
Source: International Energy Agency, KSE Institute *no March data from IEA

KSE | Institute

Higher prices continue to support exports and budget revenues.

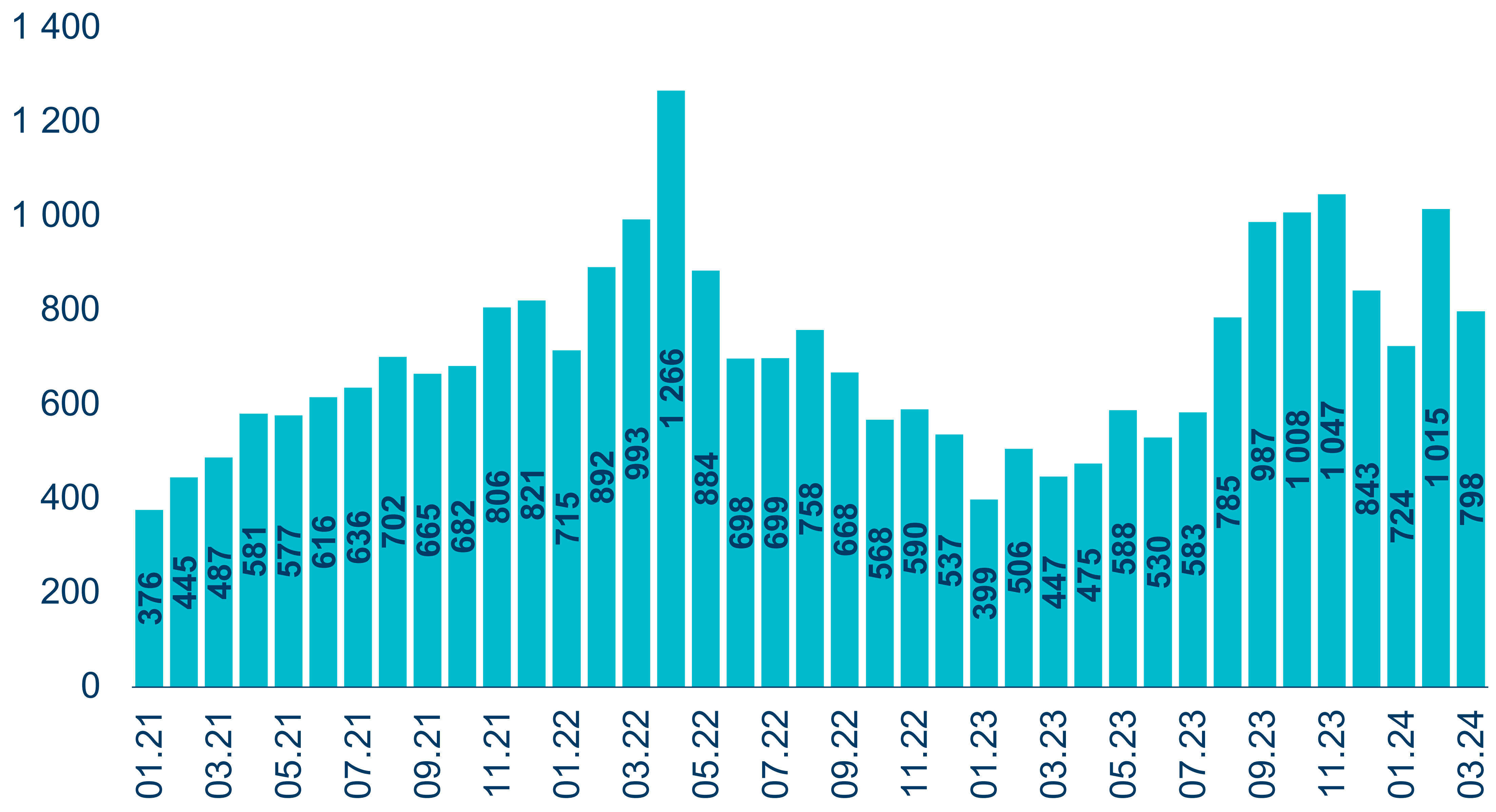
- After reaching close to $18 billion in the fall, Russian oil exports hovered around $15-16 billion in recent months.
- Somewhat higher volumes in addition to higher prices resulted in $17 billion in export earnings for Russia in March.
- Budget revenues from oil have increased since the second half of 2023 and were up 88% year-over-year in Q1 2024.

Oil export earnings, in U.S. dollar billion



Source: Federal Customs Service, International Energy Agency, KSE Institute
*2021 data from Russian customs service, 2022-23 data from IEA

Federal budget oil revenues, in ruble billion*



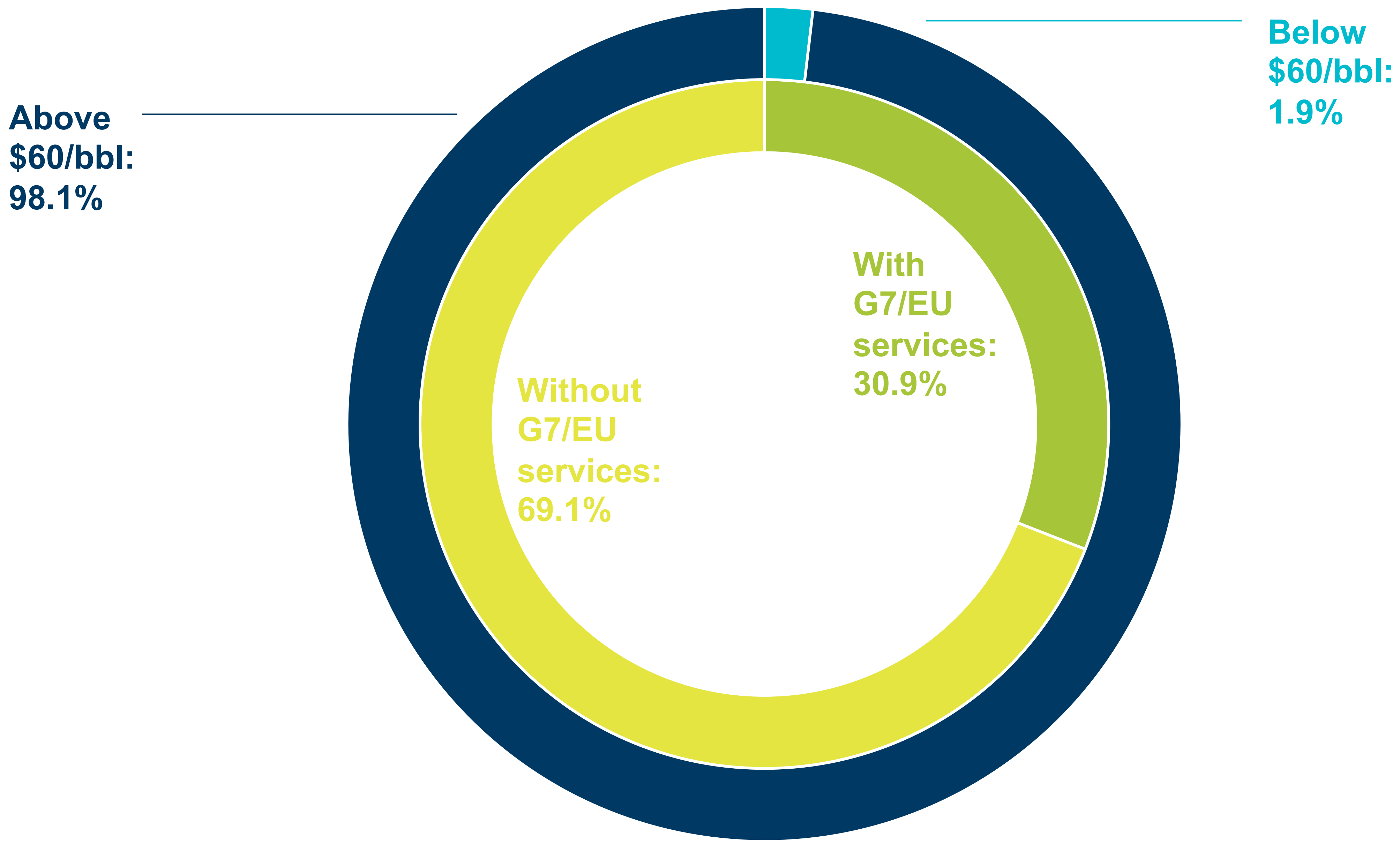
Source: Ministry of Finance, KSE Institute *includes extraction tax and export duty

KSE | Institute

Price cap challenges: violations and the shadow fleet.

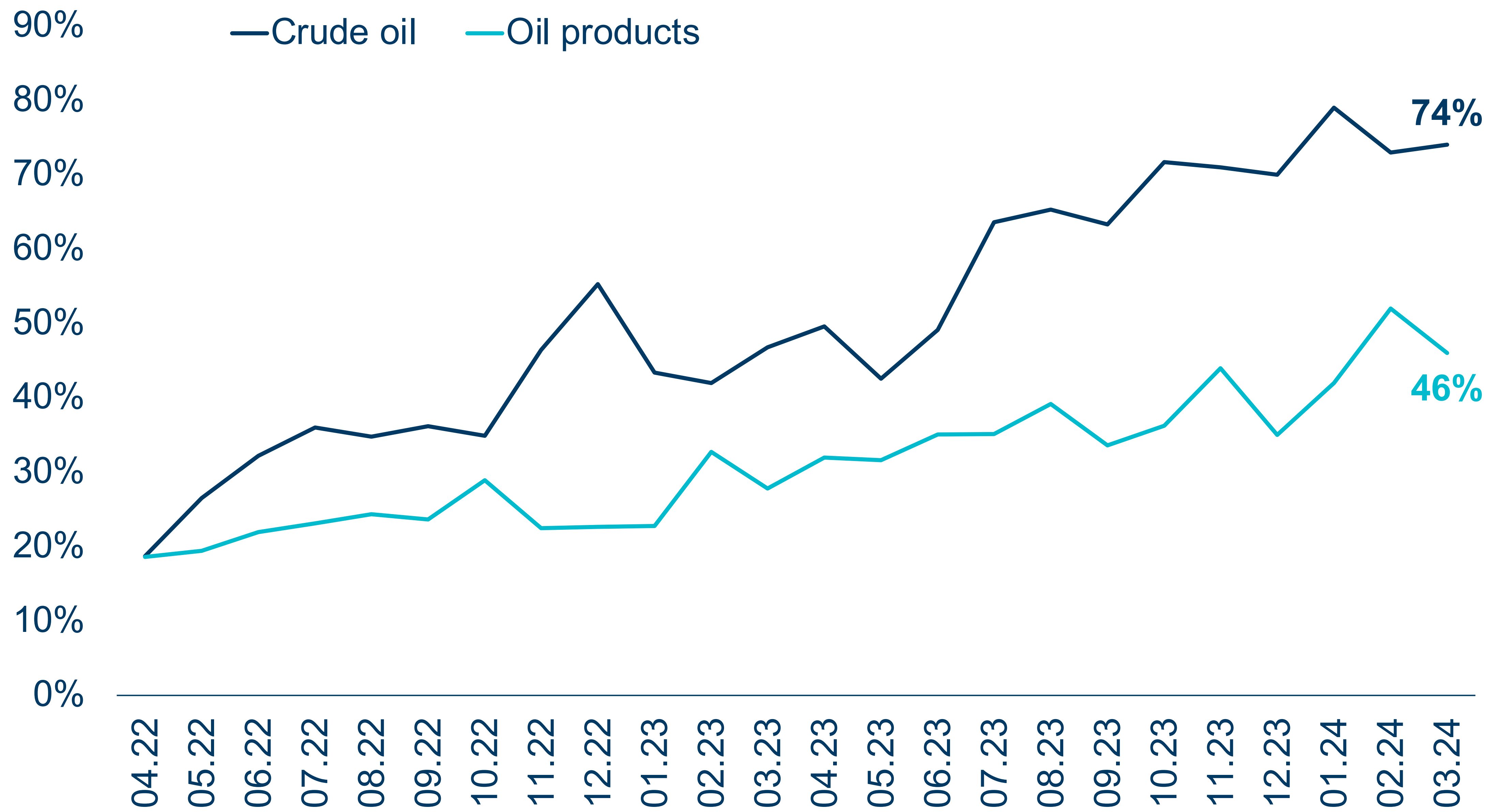
- The price cap continues to face two key challenges: compliance remains low, and the shadow fleet threatens its leverage.
- In Q4 2023, only ~2% of seaborne crude oil exports took place <$60/barrel, while G7/EU services played a role in ~30%.
- The volume share of the shadow fleet stood at 74% in March 2024 for crude oil and 46% for oil products.

Composition of Russian seaborne crude oil exports in Q4 2023, in %



Source: Kpler, P&I Clubs, KSE Institute

Volume share of the Russian shadow fleet, in %



Source: Kpler, P&I Clubs, KSE Institute
Read KSE Institute's March 2024 Russian Oil Tracker.

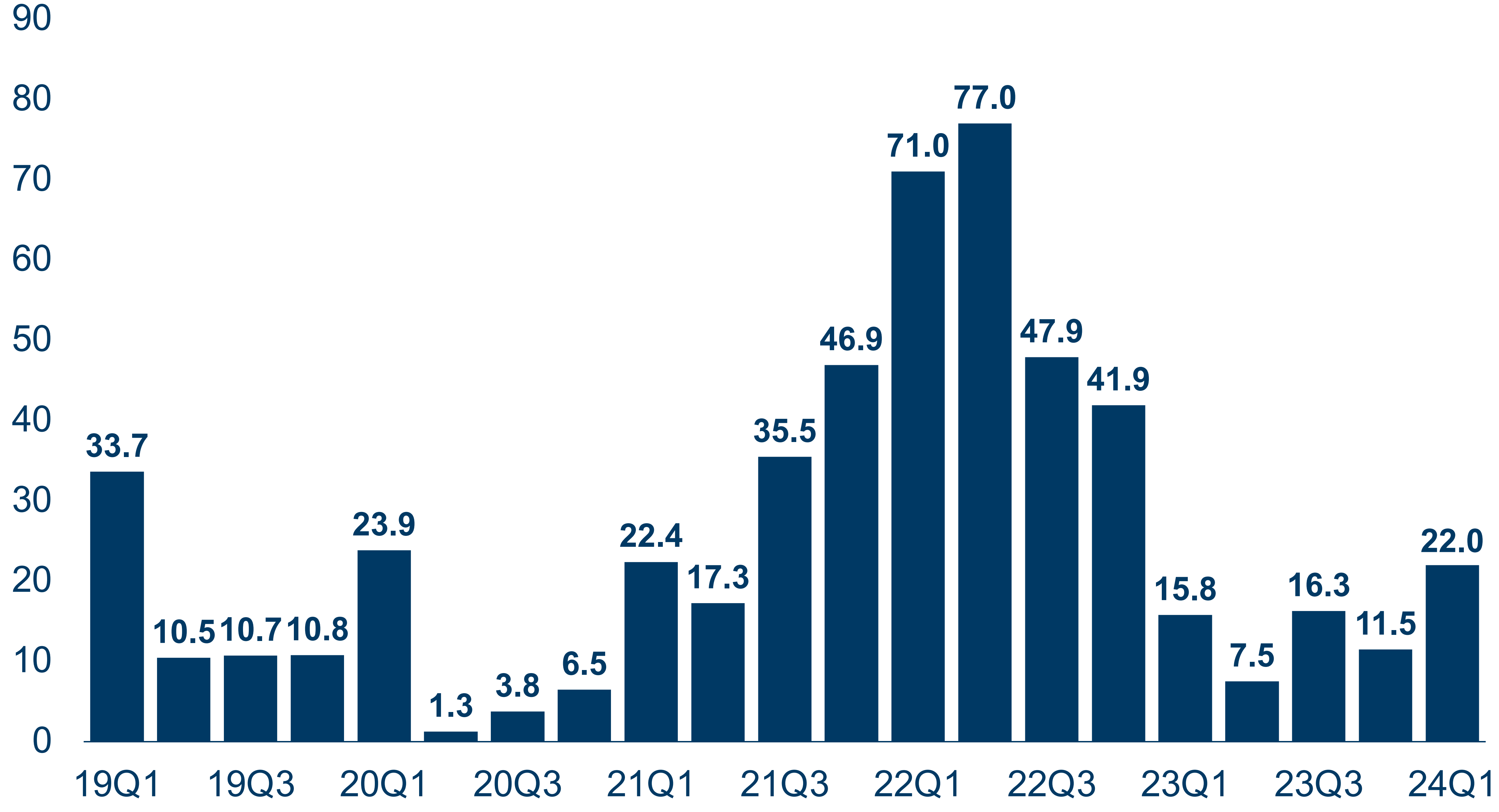
Trade: improved external environment in Q1 2024 means that Russia could earn more than expected.

KSE | Institute

Current account surplus grows on the back of stronger exports.

- In Q1 2024, the current account surplus reached $22 billion—the highest reading since Q4 2022.
- Goods exports, the trade balance, and the current account balance all improved markedly in March.
- At the current rate, the full-year current account would reach ~$140 billion (vs. ~$51 billion in 2023).

Quarterly current account balance, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

Composition of the current account, in U.S. dollar billion

		C/A	Goods			Services			Income & transfers		
	Time period	Bal.	Bal.	Exp.	Imp	Bal.	Cred.	Deb.	Bal.	Cred.	Deb.
	Oct. 2023	5.1	10.6	34.2	23.5	-2.3	3.3	5.6	-3.3	3.3	6.6
	Nov. 2023	5.0	9.2	33.6	24.4	-1.8	3.3	5.1	-2.4	3.0	5.3
	Dec. 2023	0.4	10.9	38.6	27.6	-4.1	4.5	8.6	-6.4	4.2	10.6
	Q4 2023	*10.5*	*30.7*	*106.4*	*75.6*	*-8.2*	*11.1*	*19.3*	*-12.1*	*10.5*	*22.5*
	Jan. 2024	3.4	6.8	28.0	21.3	-2.2	3.3	5.5	-1.2	3.2	4.4
	Feb. 2024	5.2	7.7	30.3	22.6	-0.6	4.1	4.7	-1.8	2.9	4.7
	Mar. 2024	13.4	16.8	39.6	22.9	-1.9	3.6	5.5	-1.4	3.5	4.9
	Q1 2024	*22.0*	*31.1*	*97.9*	*66.8*	*-4.7*	*11.0*	*15.7*	*-4.4*	*9.7*	*14.0*
Memorandum	*2021*	*122.1*	*190.3*	*494.4*	*304.0*	*-20.4*	*55.6*	*75.9*	*-47.8*	*96.3*	*144.1*
Memorandum	*2022*	*238.0*	*315.6*	*592.1*	*276.5*	*-22.2*	*48.6*	*70.9*	*-55.3*	*51.5*	*106.8*
Memorandum	Oct. 2022	12.8	18.9	44.1	25.2	-3.4	3.4	6.8	-2.7	4.4	7.1
Memorandum	Nov. 2022	14.2	18.8	45.1	26.3	-2.0	3.8	5.8	-2.6	4.0	6.6
Memorandum	Dec. 2022	14.7	25.1	54.8	29.7	-3.0	5.1	8.1	-7.4	5.8	13.2
Memorandum	*Q4 2022*	*41.7*	*62.8*	*144.0*	*81.2*	*-8.4*	*12.3*	*20.7*	*-12.7*	*14.2*	*26.9*
Memorandum	Jan. 2023	5.2	9.4	33.6	24.1	-2.4	3.2	5.6	-1.9	3.5	5.4
Memorandum	Feb. 2023	2.9	8.0	30.6	22.5	-2.1	3.2	5.3	-3.0	3.8	6.9
Memorandum	Mar 2023	7.3	12.9	40.9	28.0	-3.1	3.4	6.5	-2.5	4.0	6.5
Memorandum	*Q1 2023*	*8.5*	*17.7*	*64.3*	*46.6*	*-4.5*	*6.4*	*10.9*	*-4.7*	*7.3*	*12.0*

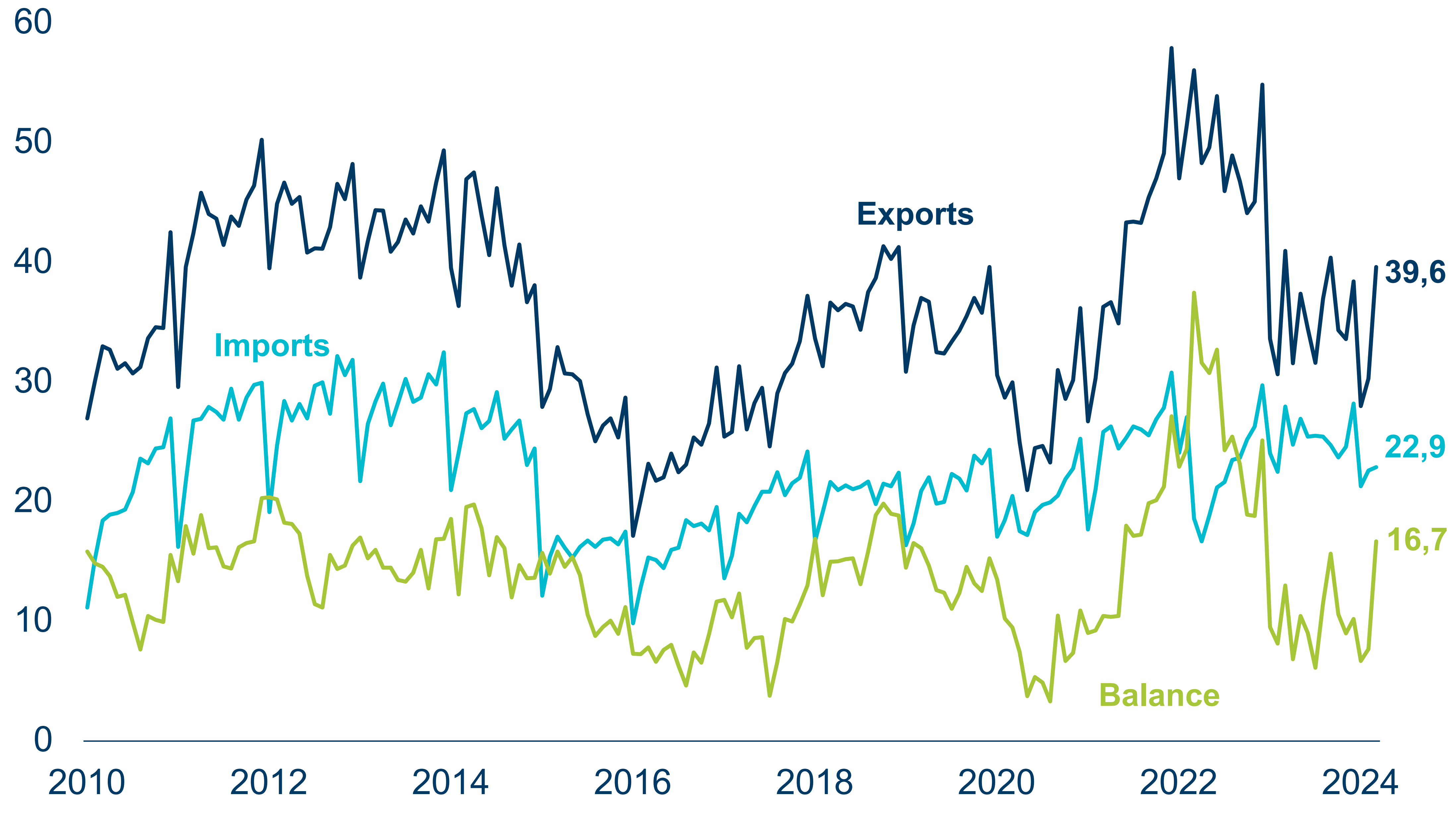
Source: Bank of Russia, KSE Institute

KSE | Institute

Foreign trade has settled in at a new post-full scale invasion baseline.

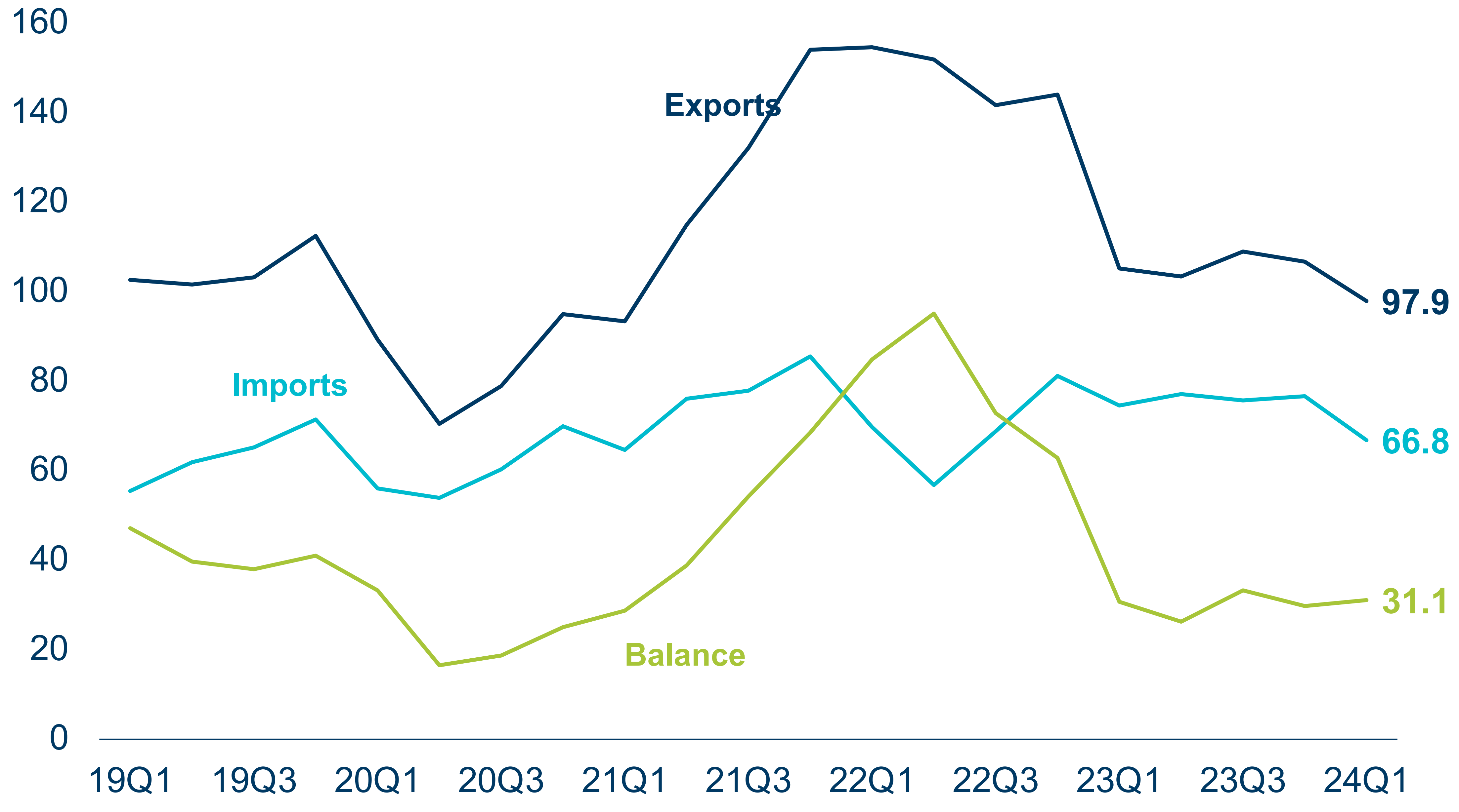
- Russia’s foreign trade has stabilized at a new baseline of ~$100 billion in exports and ~$75 billion in imports per quarter.
- Fundamentally, sanctions and moderating commodity prices have fully reversed the exports boom late 2021 and 2022.
- However, risks are clearly to the upside as Russia benefits from insufficient price cap enforcement and higher oil prices.

Monthly trade statistics, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

Quarterly balance of payments statistics, in U.S. dollar billion

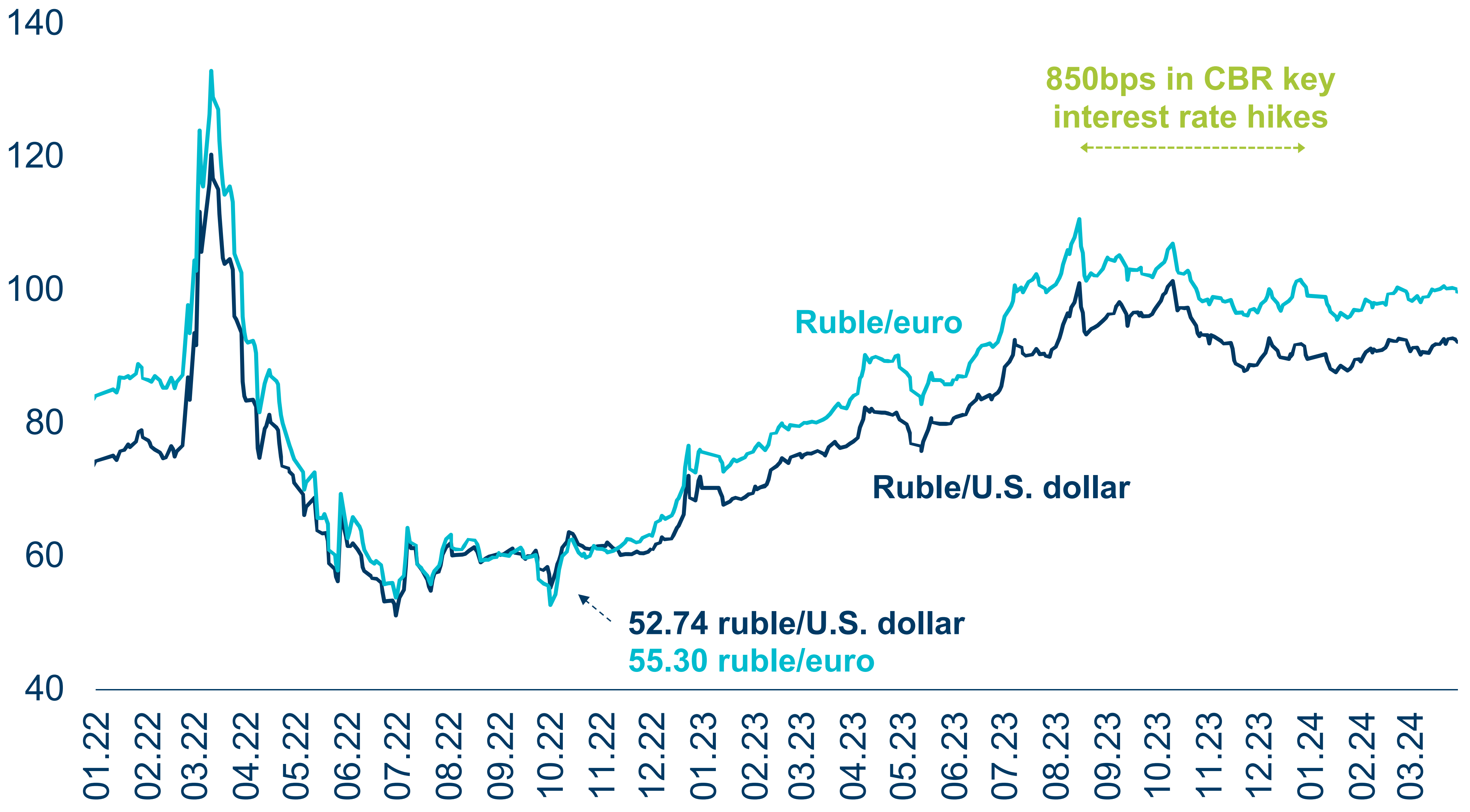


Source: Bank of Russia, KSE Institute

Ruble has stabilized, but future CBR approach unclear.

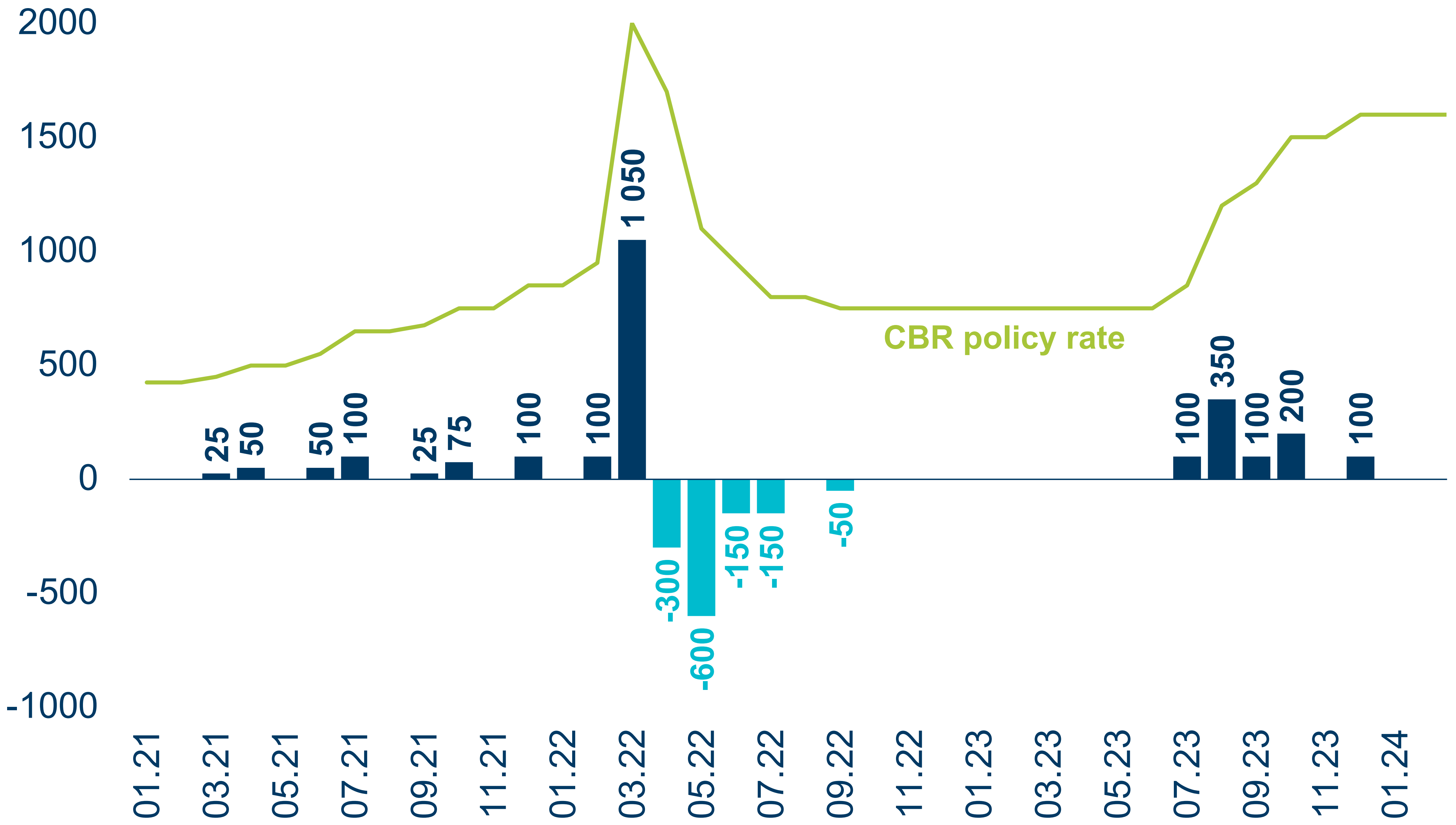
- Since October 2022, the ruble has lost 41% of its value against the U.S. dollar and 48% against the euro.
- The re-introduction of capital controls and additional CBR interest rate hikes have led to some stabilization.
- It is possible that the CBR will allow the ruble to depreciate with the presidential “election” now concluded.

Ruble exchange rate vs. U.S. dollar and euro



Source: Bank of Russia, KSE Institute

CBR policy rate and MPC decisions, in bps



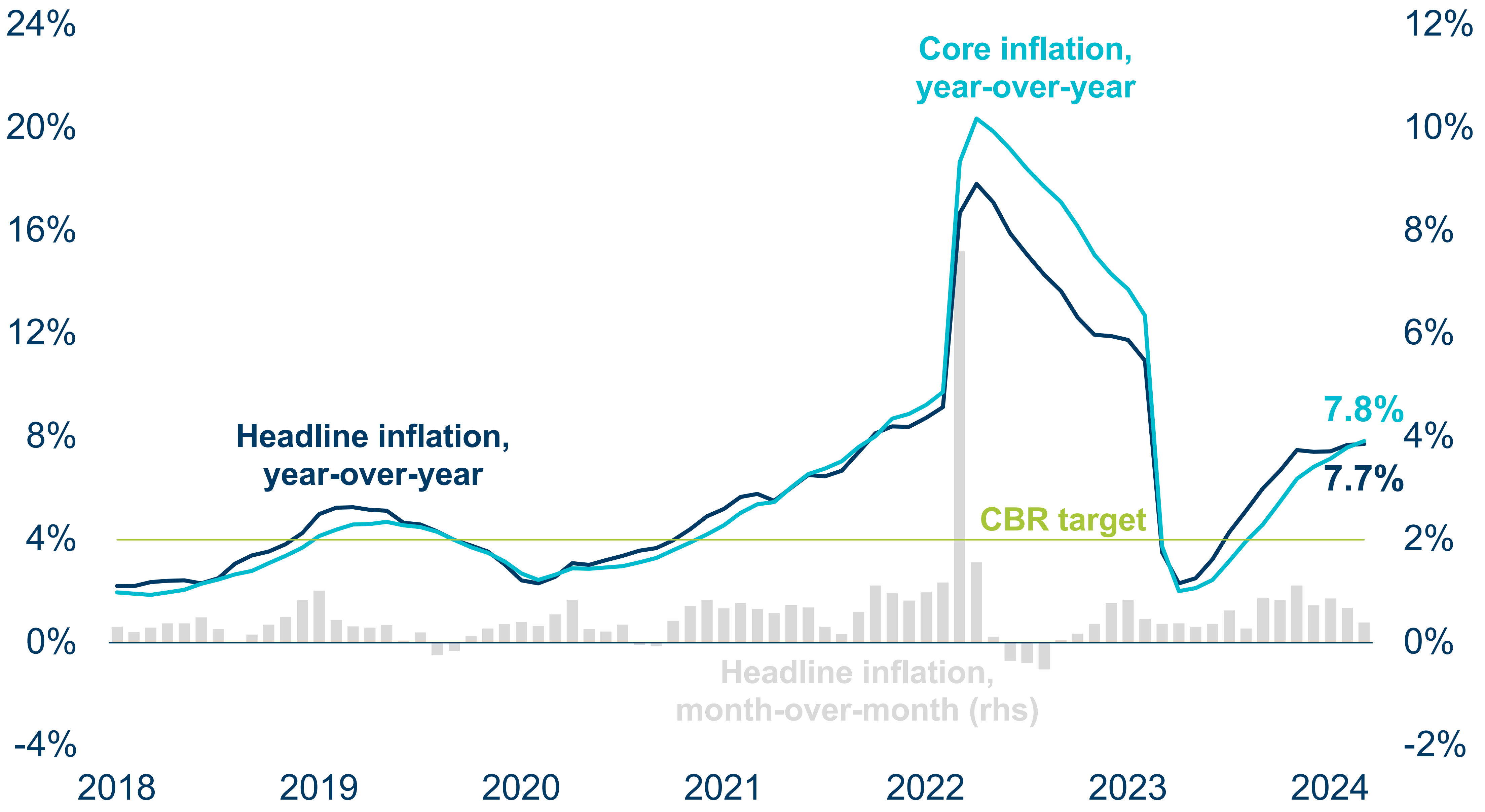
Source: Bank of Russia, KSE Institute

KSE | Institute

Headline and core inflation remain elevated.

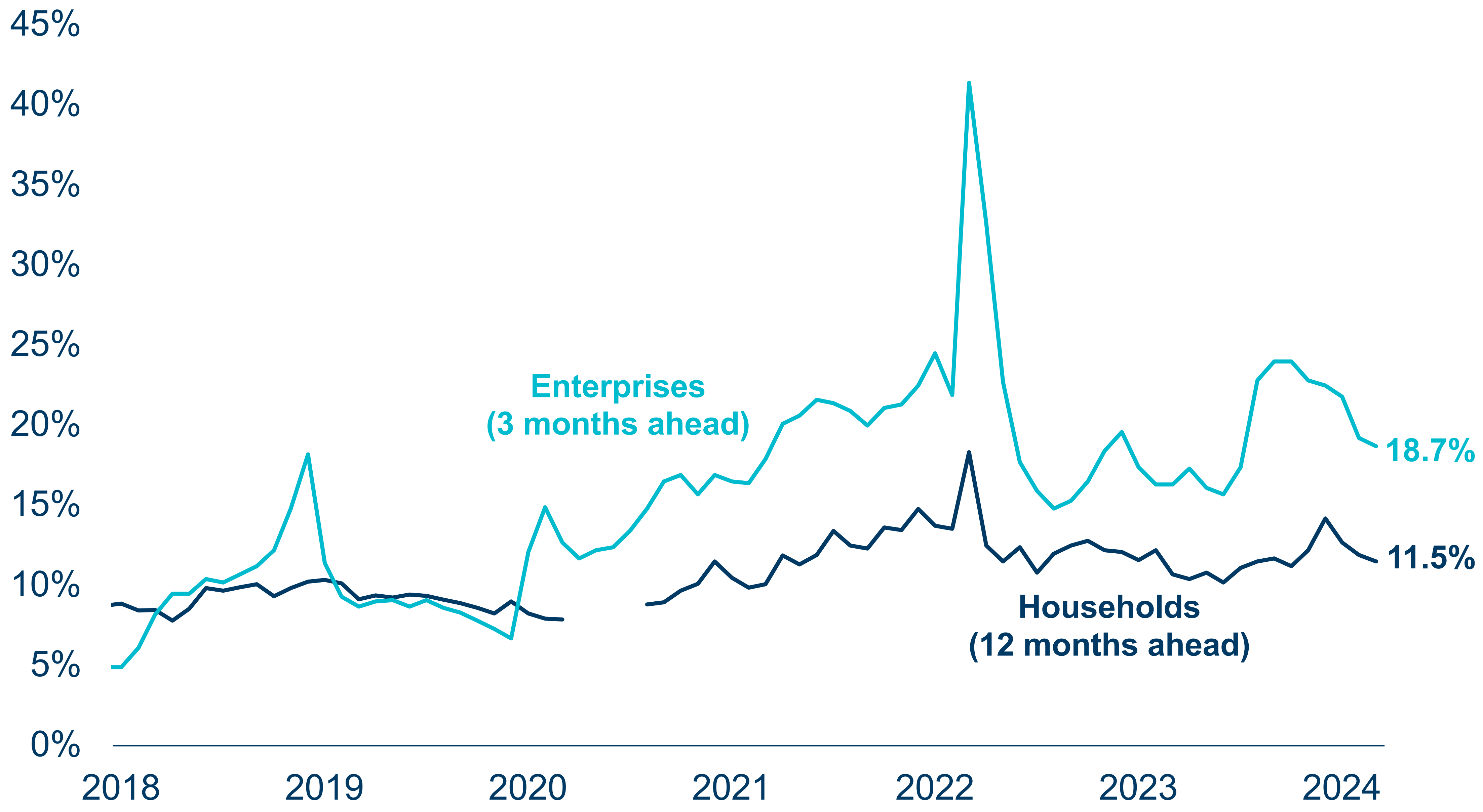
- Following a base effects-driven drop in spring/summer 2023, both headline and core inflation are rising again.
- Based on current month-to-month dynamics, headline inflation could reach double-digits again in H2 2024.
- The CBR believes that the peak of inflation pressures has passed, which is reflected in inflation expectations.

Inflation, in %



Source: Bank of Russia, KSE Institute

Inflation expectations, in %



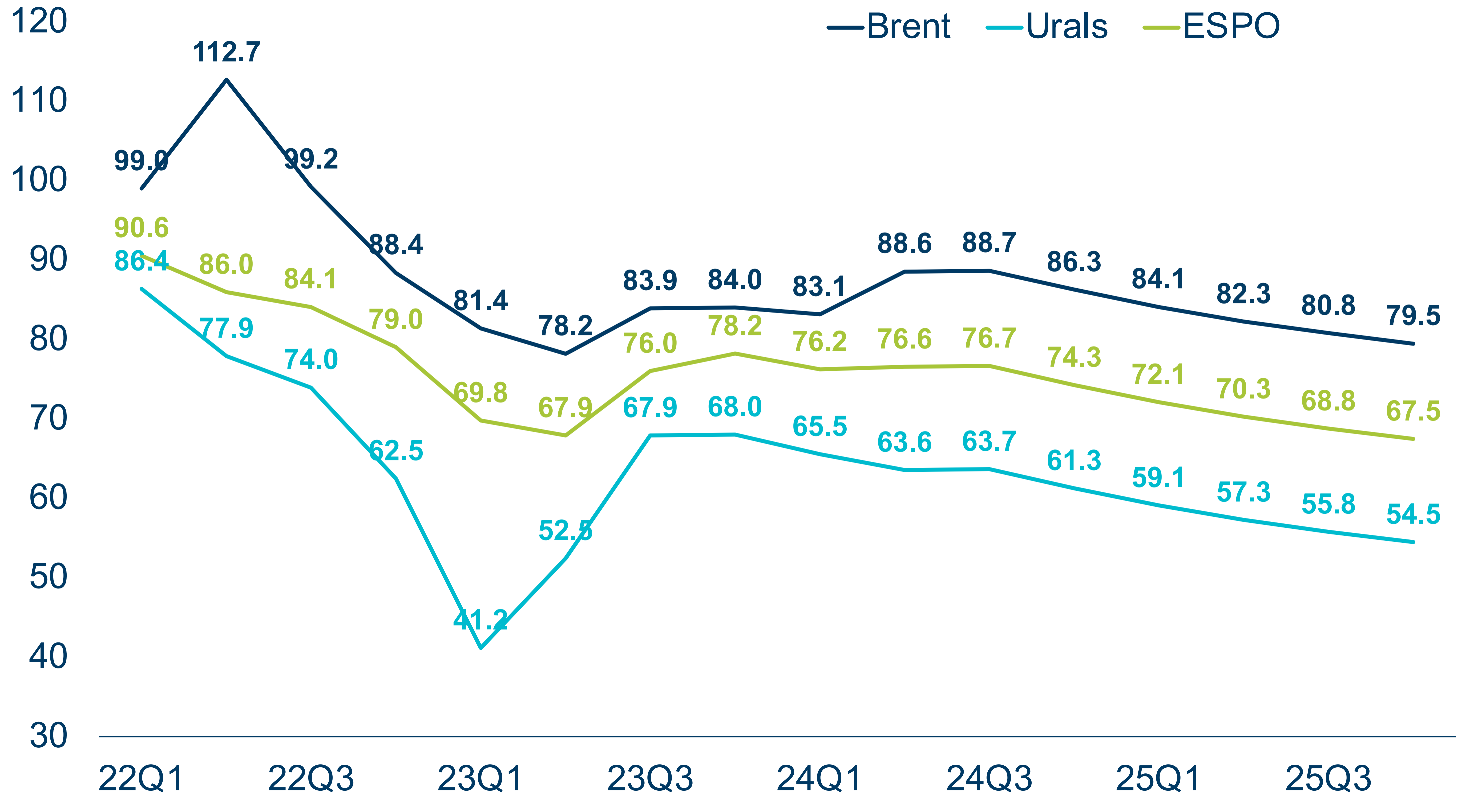
Source: Bank of Russia, KSE Institute

KSE | Institute

Wider discount on Russian oil to reduce export earnings in H2 2024.

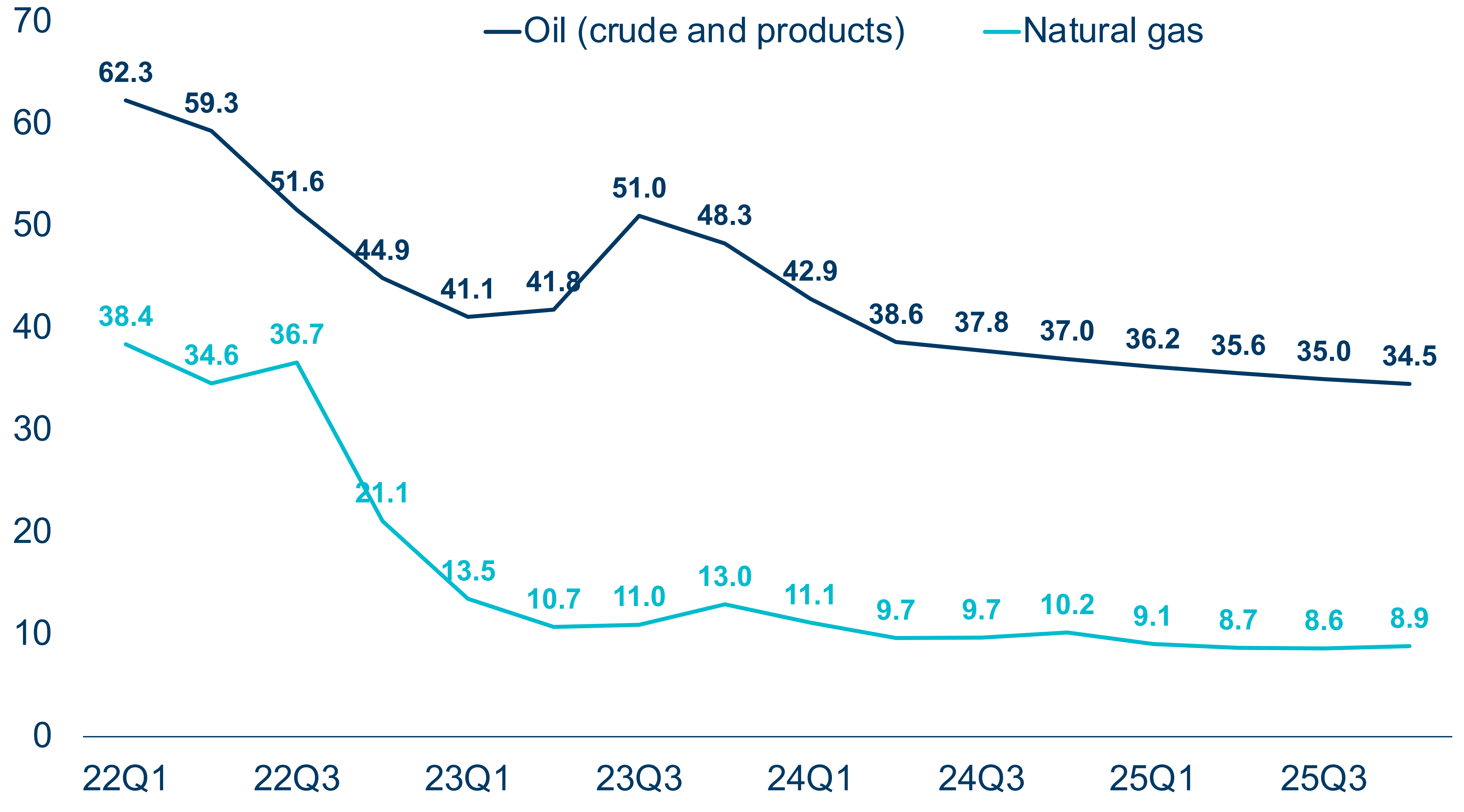
- In our base case, Urals and ESPO discounts vs. Brent will widen in H2 2024 as price cap enforcement is stepped up.
- This would largely offset higher global oil prices and help constrain Russia's export earnings despite a tighter market.
- Natural gas exports are unlikely to recover from failed weaponization of flows to Europe since the second half of 2022.

Oil prices, in U.S. dollar/barrel



Source: KSE Institute

Oil and gas export earnings, in U.S. dollar billion

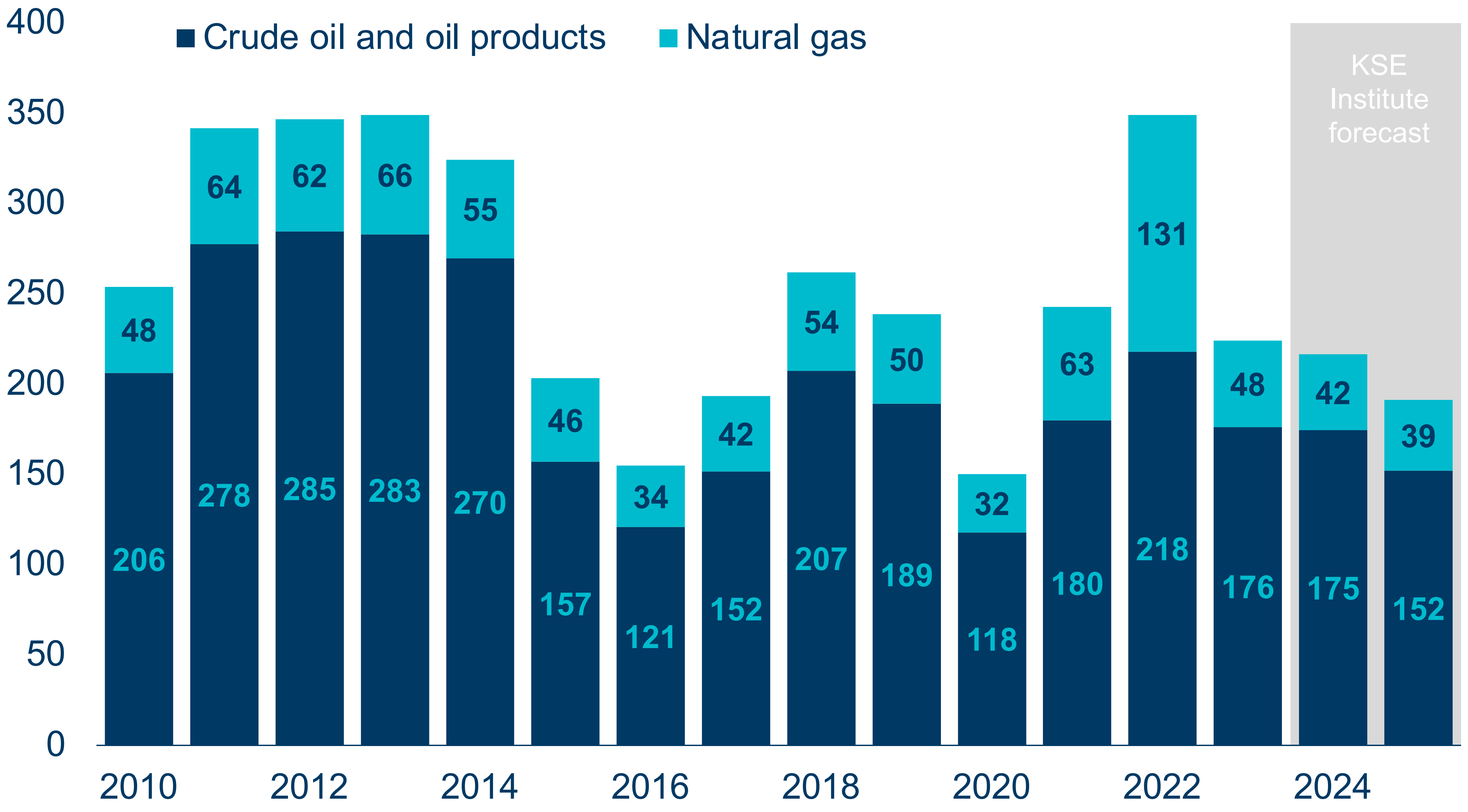


Source: KSE Institute

Current account surplus to remain at suppressed levels in 2024-25.

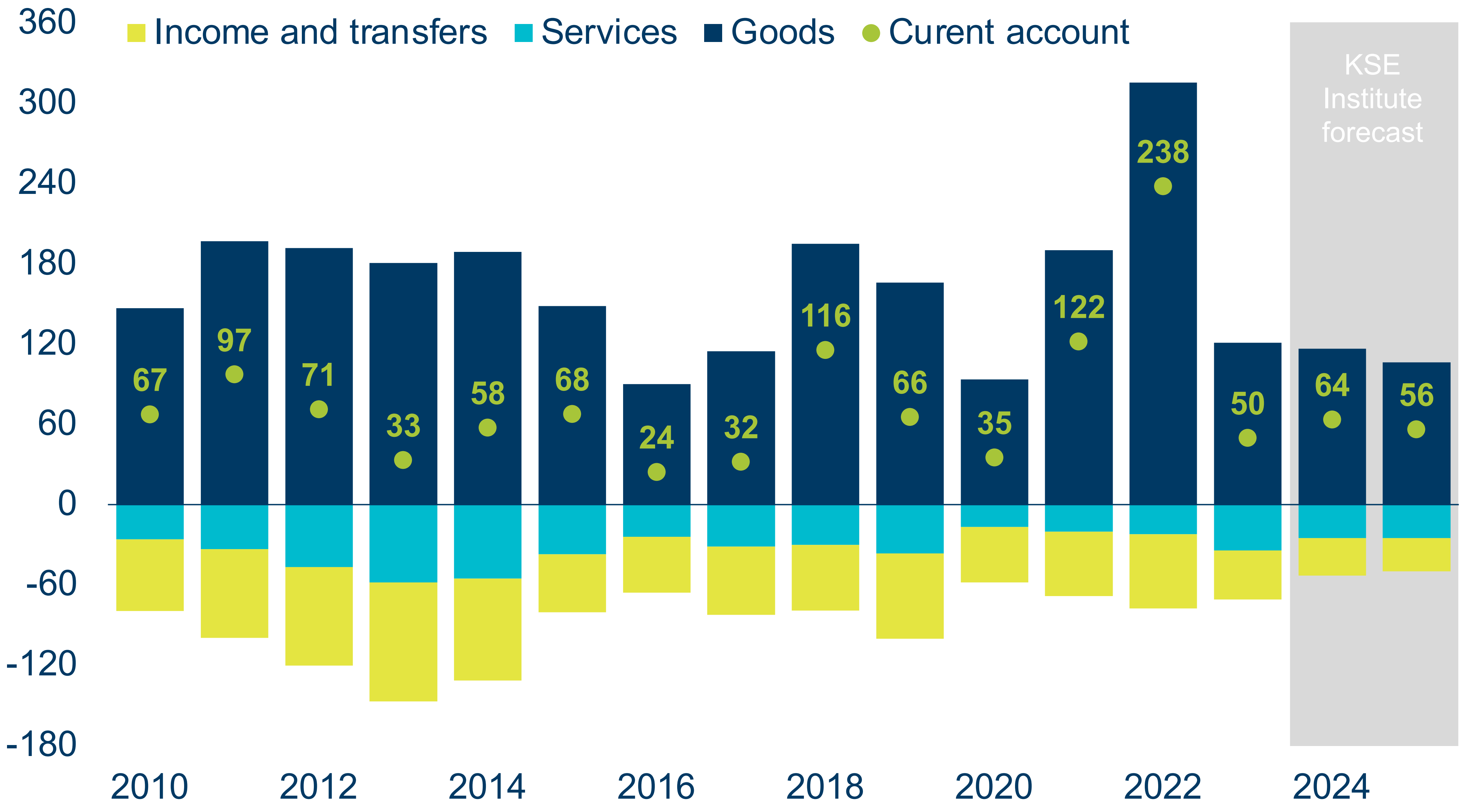
- O&G exports reached $224 billion in 2023 and are projected to drop to $217 billion in 2024 and $191 billion in 2025.
- The numbers for 2024-25 represent upward revisions of $13 billion and $12 billion, respectively, due to higher prices.
- We project a current account surplus of $64 billion and $56 billion in 2024-25, respectively, with risks to the upside.

Oil and gas earnings, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

Current account and components, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

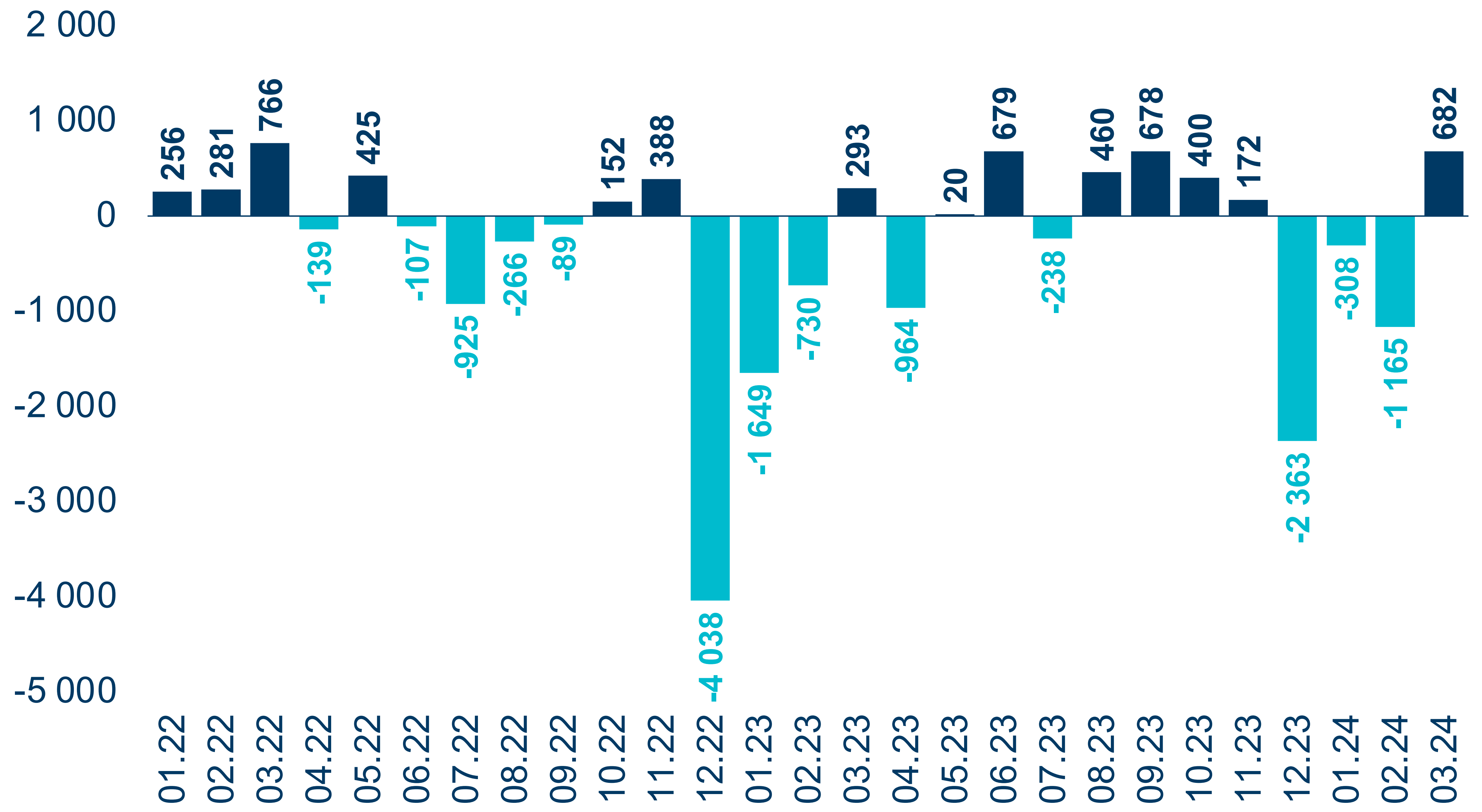
KSE | Institute

Budget: higher revenues in January-March offset higher war expenditures—deficit decreased to 50% of full-year plan.

Sharp rise in revenues significantly improved fiscal situation.

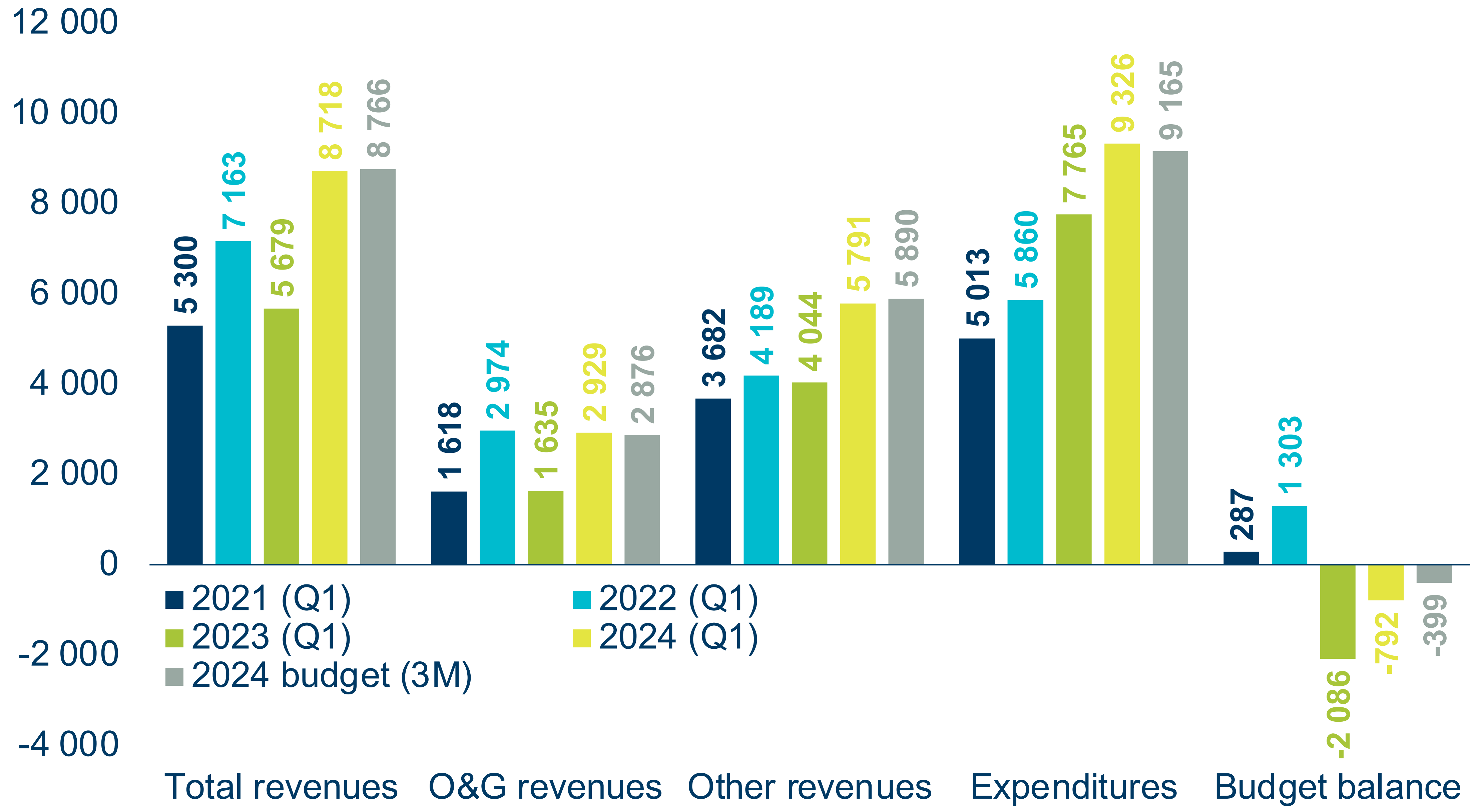
- In January-March 2024, Russia's federal budget deficit reached 0.8 trillion rubles, 50% of the full-year plan.
- O&G revenues were 79%, non-O&G revenues 43%, and expenditures 20% higher vs. January-March 2023.
- This means that Russia is unlikely to face any serious fiscal constraints that would affect military spending.

Federal government balance, in ruble billion



Source: Ministry of Finance, KSE Institute

Revenues and expenditures, in ruble billion

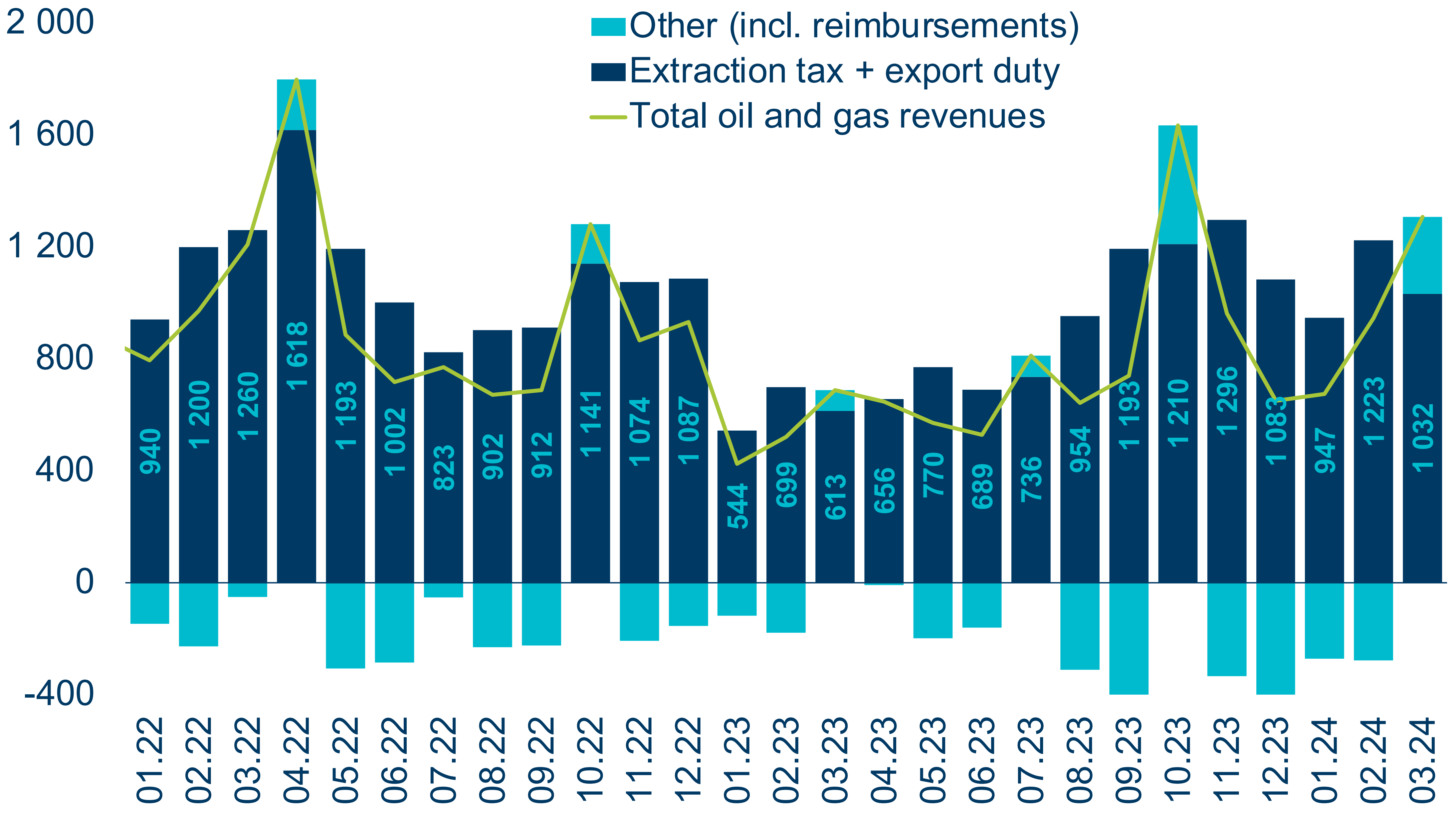


Source: Ministry of Finance, KSE Institute

Russia’s oil and gas revenues grew in February-March.

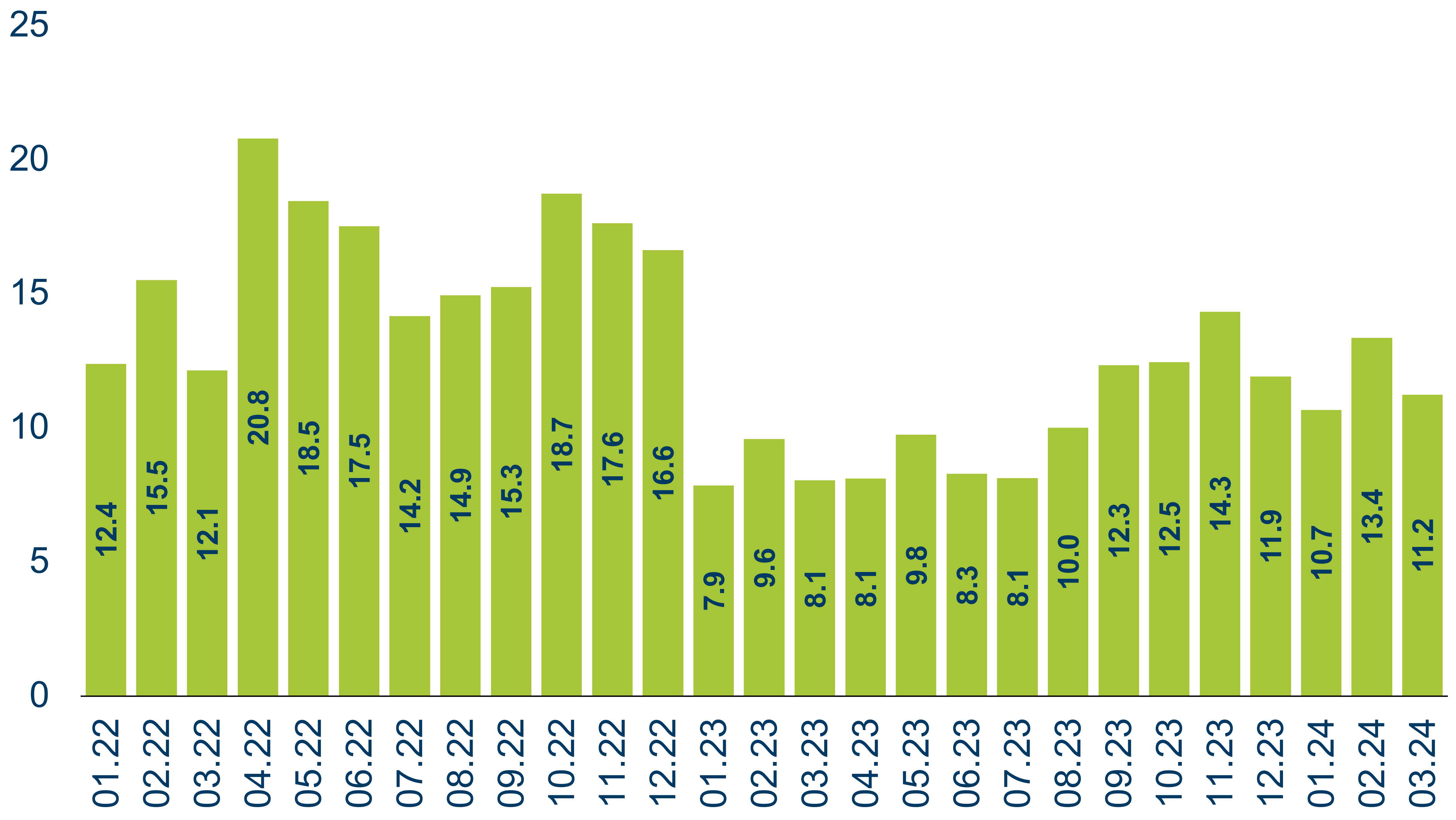
- Oil and gas budget revenues rebounded in February-March 2024 and were up 79% in Q1 year-over-year.
- While the weaker ruble supported the budget in the second half of 2023, revenues also rose in dollar terms.
- Ukrainian attacks on refineries and a temporary ban on gasoline exports may affect revenues in coming months.

Federal oil and gas revenues, in ruble billion



Source: Ministry of Finance, KSE Institute

Federal oil and gas revenues, in U.S. dollar billion*



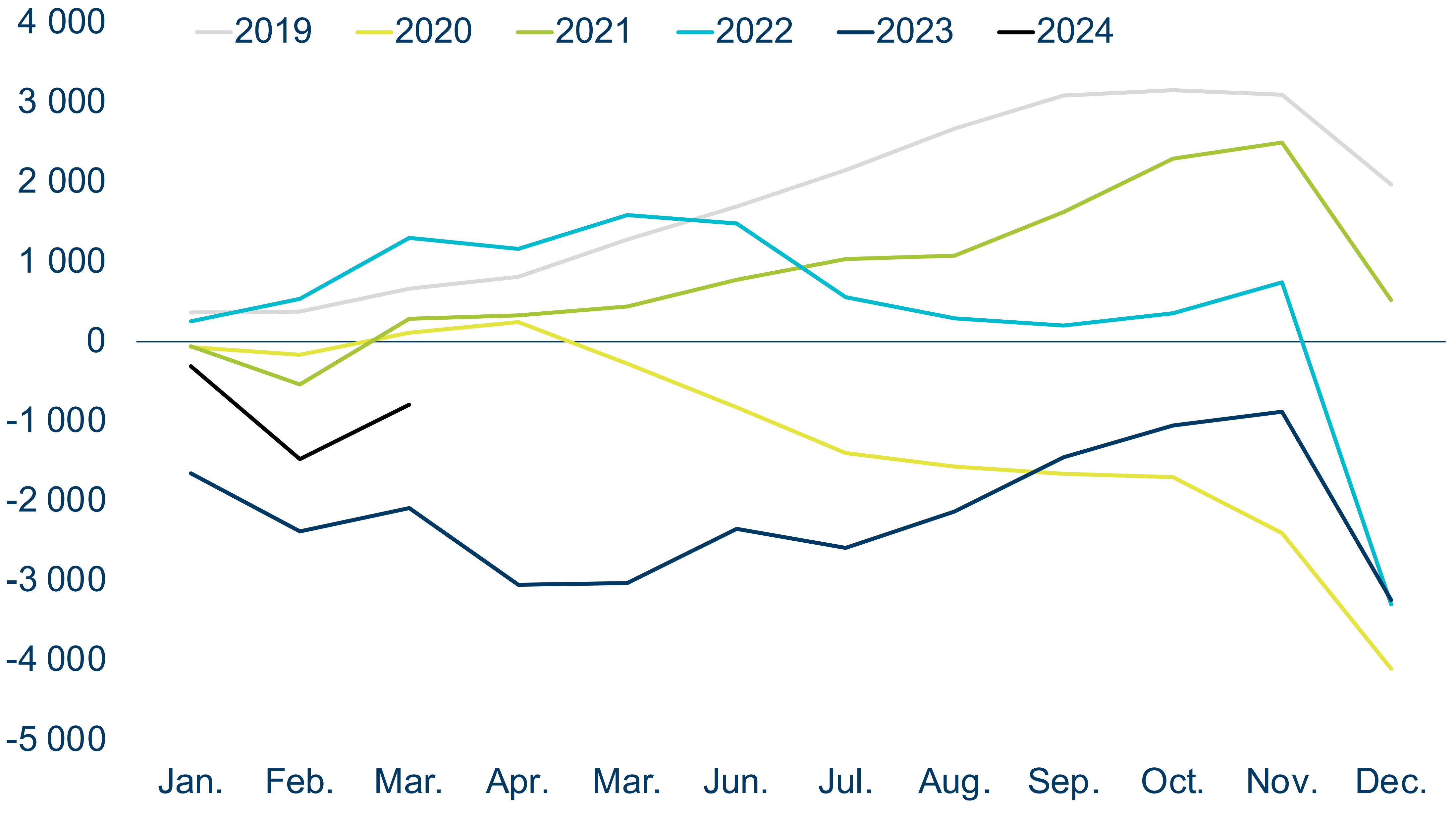
Source: International Monetary Fund, Ministry of Finance, KSE Institute
*includes extraction tax and export duty; calculated with monthly average exchange rate

KSE | Institute

Contained budget deficit means financing is not a challenge.

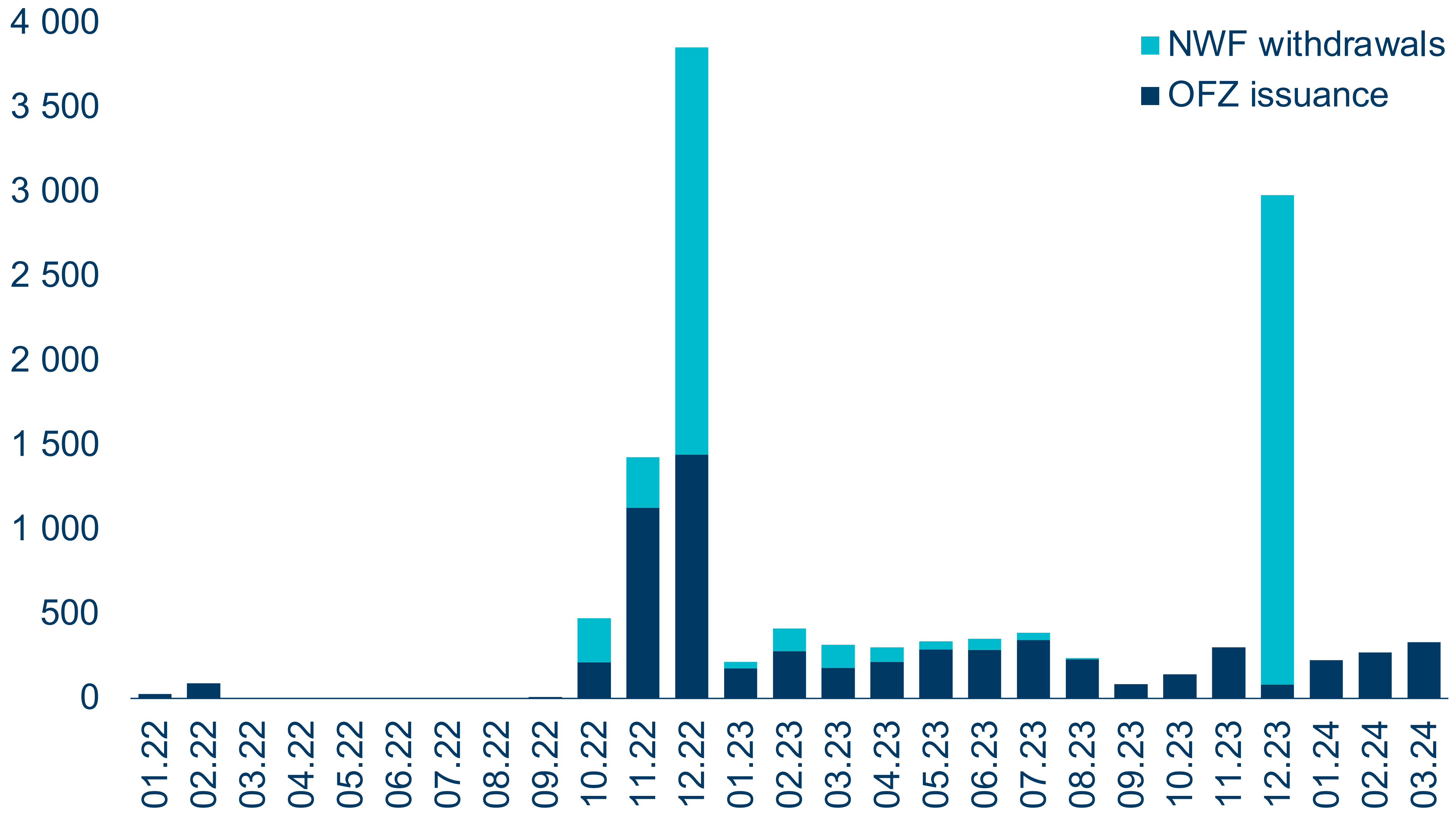
- The Q1 2024 deficit is significantly smaller compared to Q1 2023, albeit expenditures are up sharply due to the war.
- Due to the improved fiscal situation, Russia has been able to finance the budget via moderate domestic debt issuance.
- Unless energy sanctions enforcement is stepped up, Russia will likely be able to stay within its budget target this year.

Cumulative federal budget balance, in ruble billion



Source: Ministry of Finance, KSE Institute

Key fiscal financing channels, in ruble billion



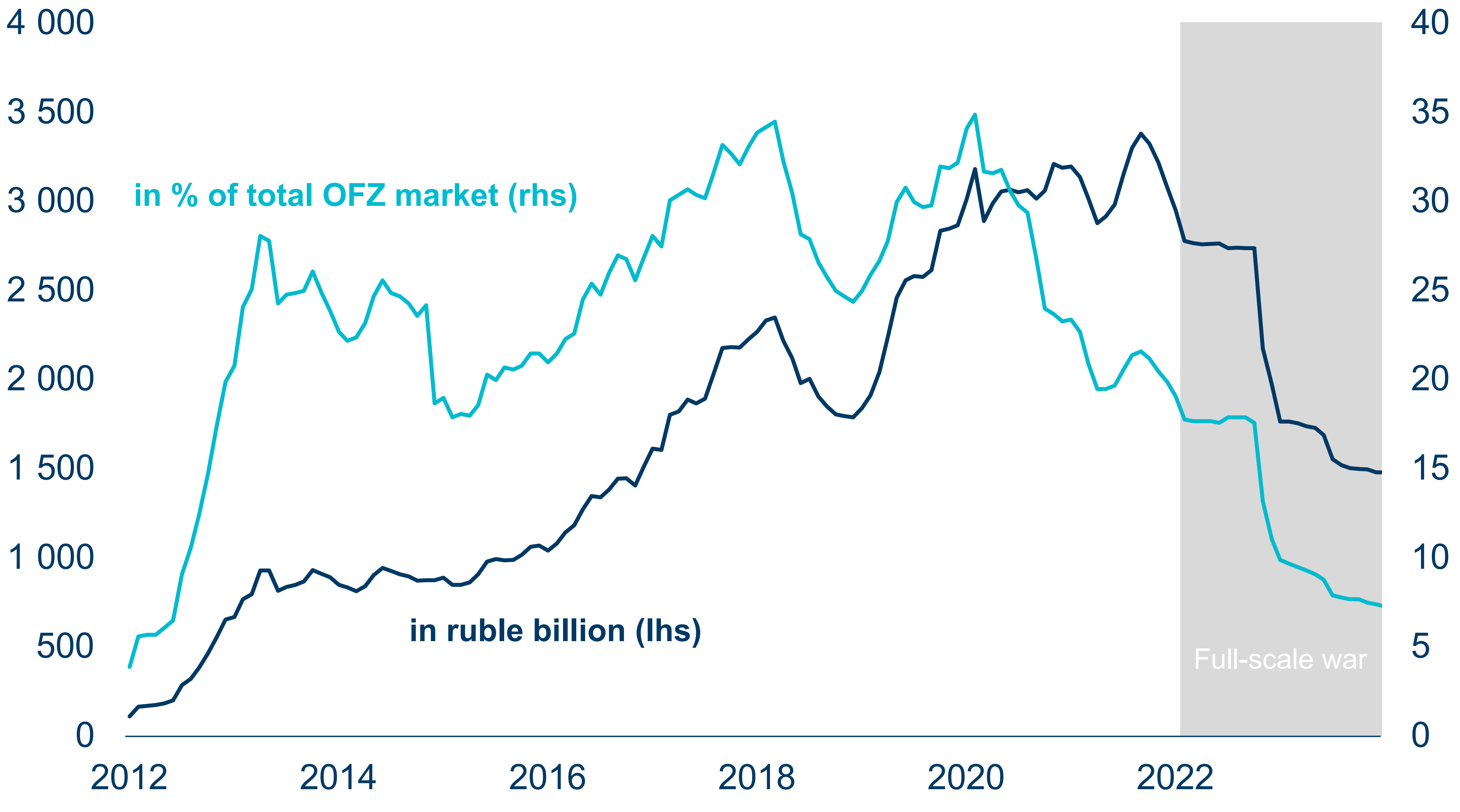
Source: Ministry of Finance, KSE Institute

KSE | Institute

Domestic banks are the only remaining buyers for OFZs.

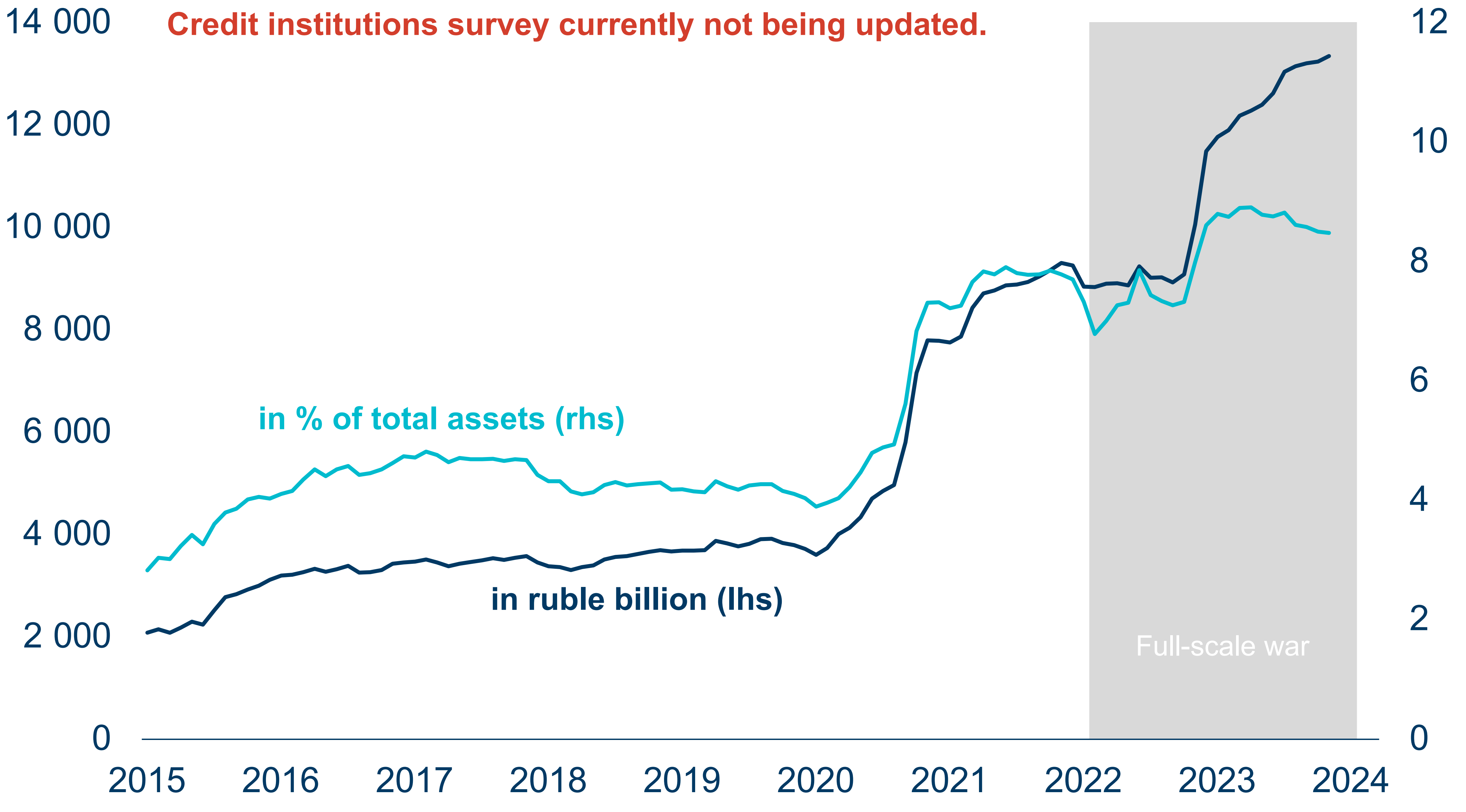
- Foreigners have largely disengaged from the Russian sovereign debt market since the start of the war.
- Non-resident holdings have dropped 1.3 trillion rubles (or 47%) since October 2022 as bonds matured.
- Credit institutions’ holdings have risen by close to 4.3 trillion rubles (or 47%) since the fall of 2022.

Non-resident OFZ holdings



Source: Bank of Russia, KSE Institute

Credit institutions OFZ holdings



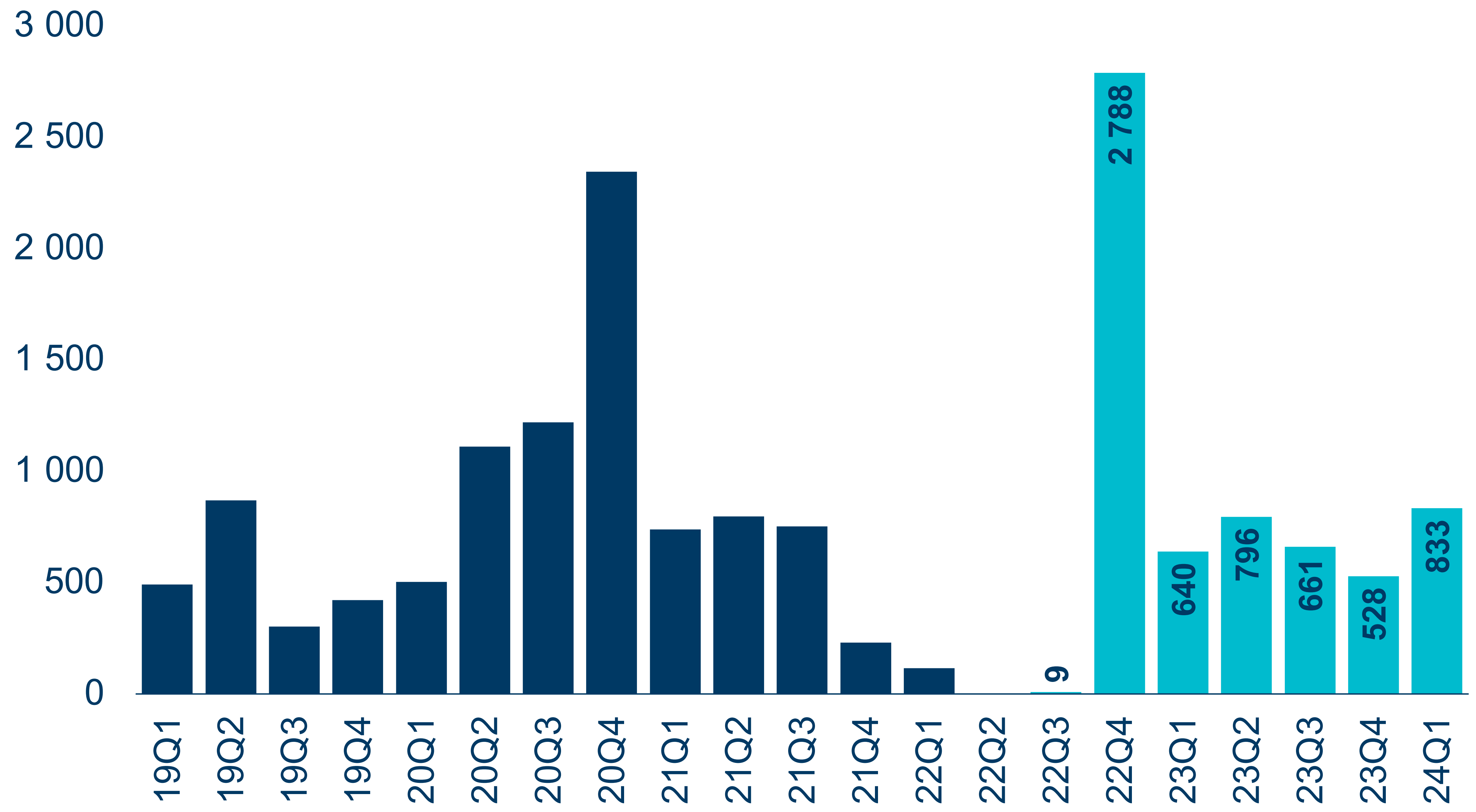
Source: Bank of Russia, KSE Institute

KSE | Institute

Domestic borrowing remains stable.

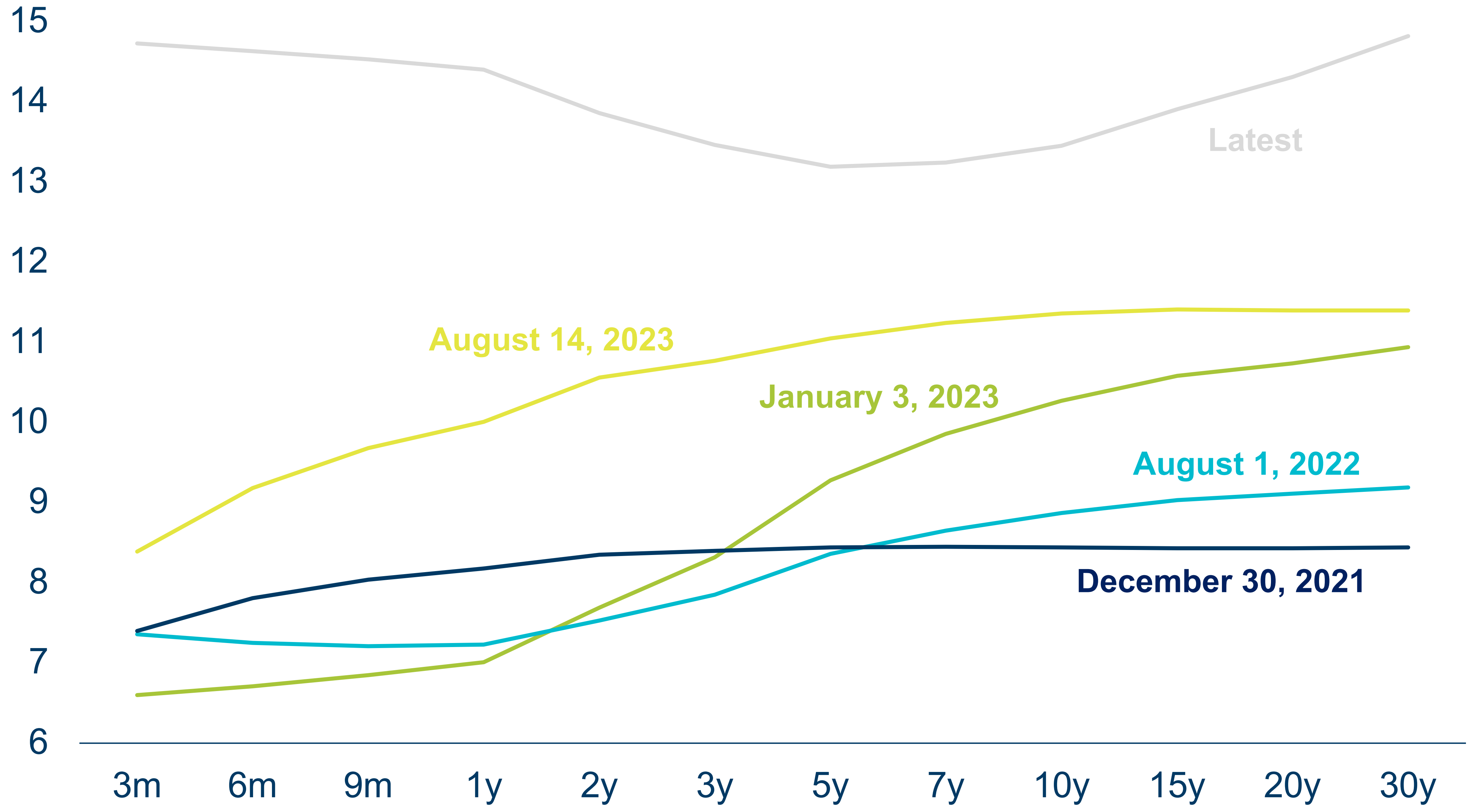
- Borrowing in the domestic market has been broadly stable in the last five quarters.
- The OFZ yield curve reflects the recent CBR rate hikes (of cumulative 850bps).
- Funding costs are, thus, higher but limited in their impact due to the small budget deficit.

New domestic debt (OFZ) issuance, in ruble billion



Source: Ministry of Finance, KSE Institute

OFZ yield curves, in %



Source: Bank of Russia, KSE Institute

KSE | Institute

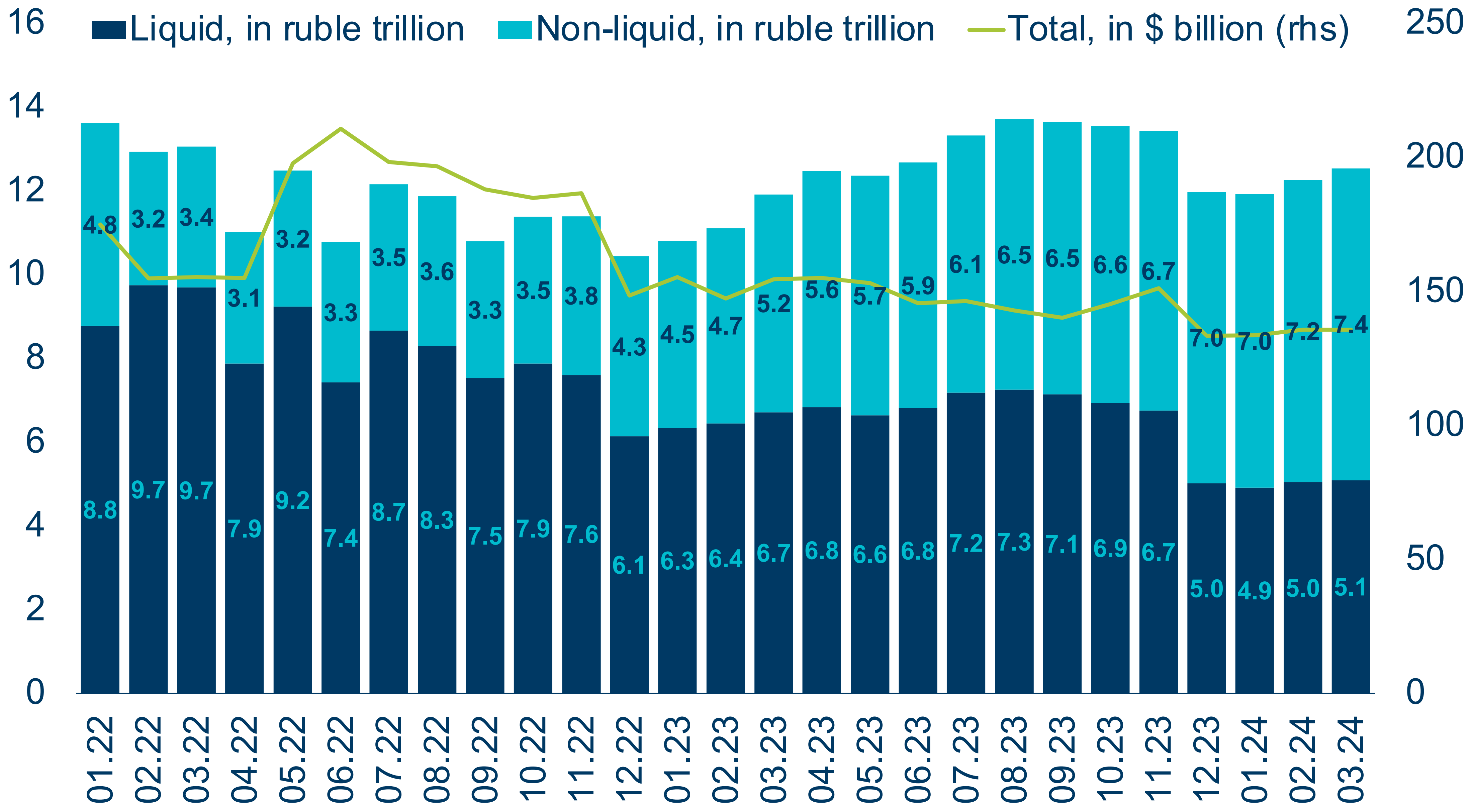
Macro buffers: Russia has used up half of the NWF’s liquid assets; access to reserves seriously constrained.

KSE | Institute

Half of the NWF’s liquid assets have been used up.

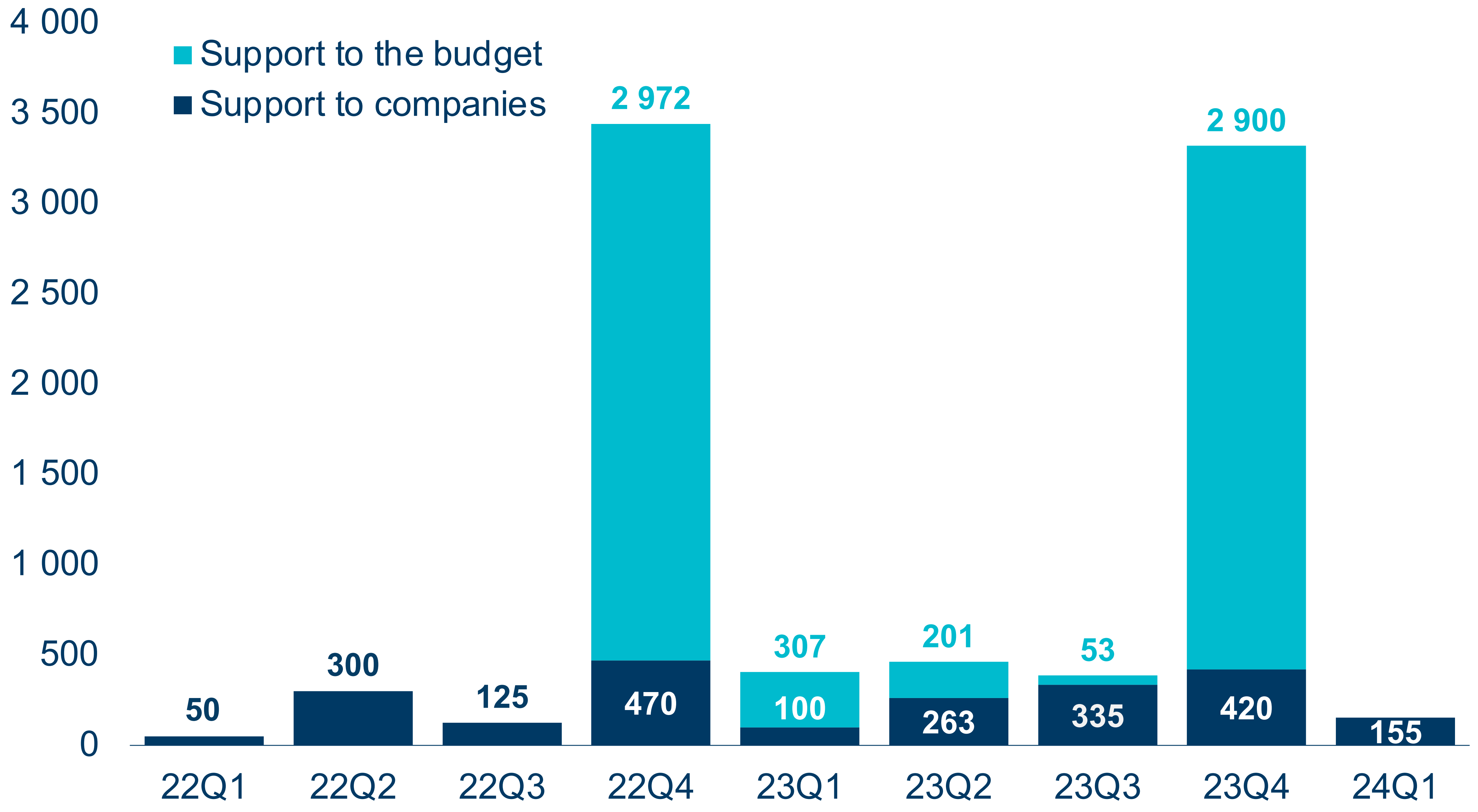
- Total assets of the National Welfare Fund stood at 12.5 trillion rubles ($135.7 billion, 7.0% of GDP) in March 2024.
- The liquid portion now only accounts for 41% of the total as funds were withdrawn for budgetary support in December.
- Since the start of the full-scale invasion, Russia has, thus, used up almost half (~4.7 trillion) of the NWF’s liquid assets.

Assets of the NWF, in ruble billion and U.S. dollar billion



Source: Ministry of Finance, KSE Institute

Utilization of the NWF, in ruble billion



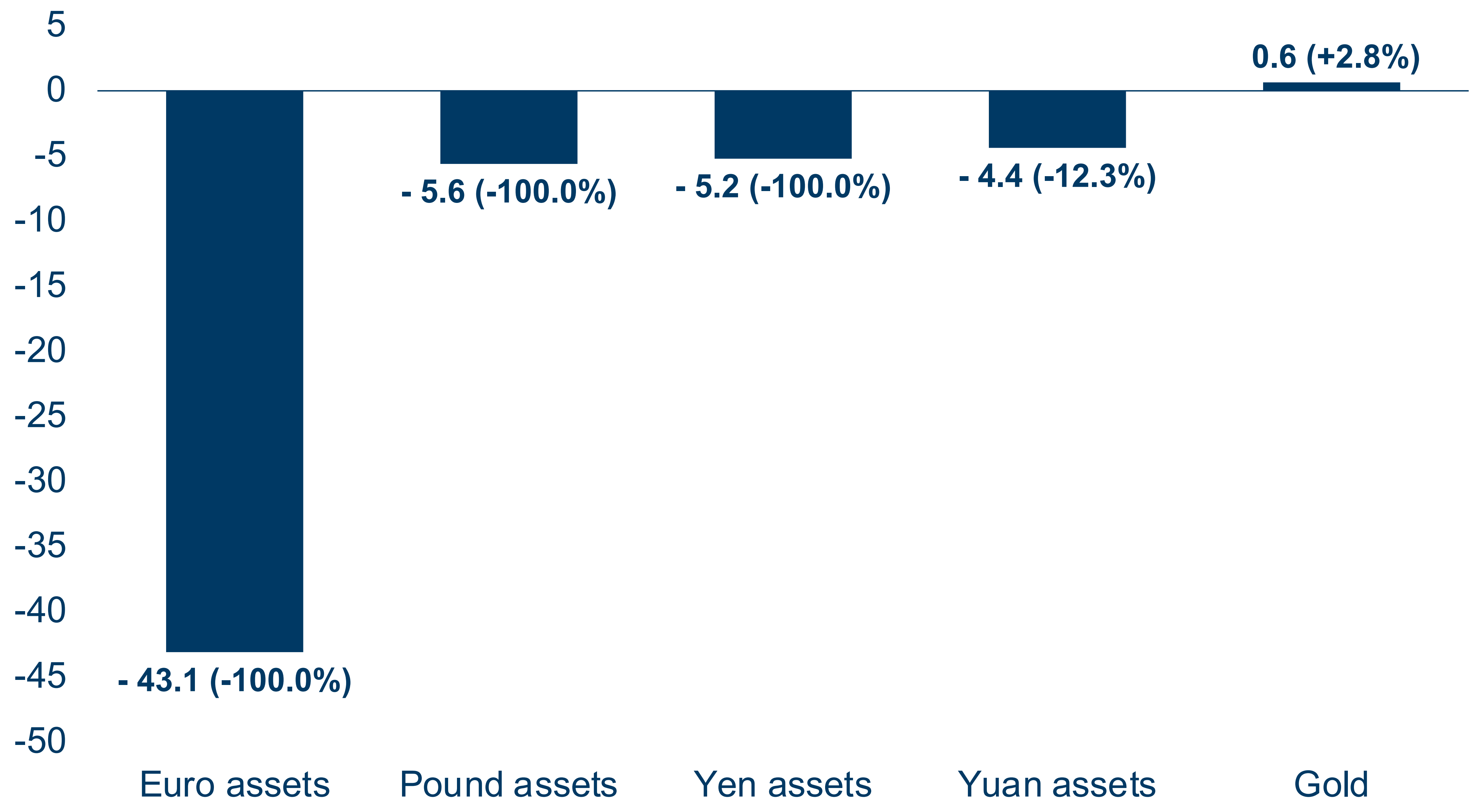
Source: Ministry of Finance, KSE Institute

KSE | Institute

Headline NWF numbers conceal that hard currency assets are gone.

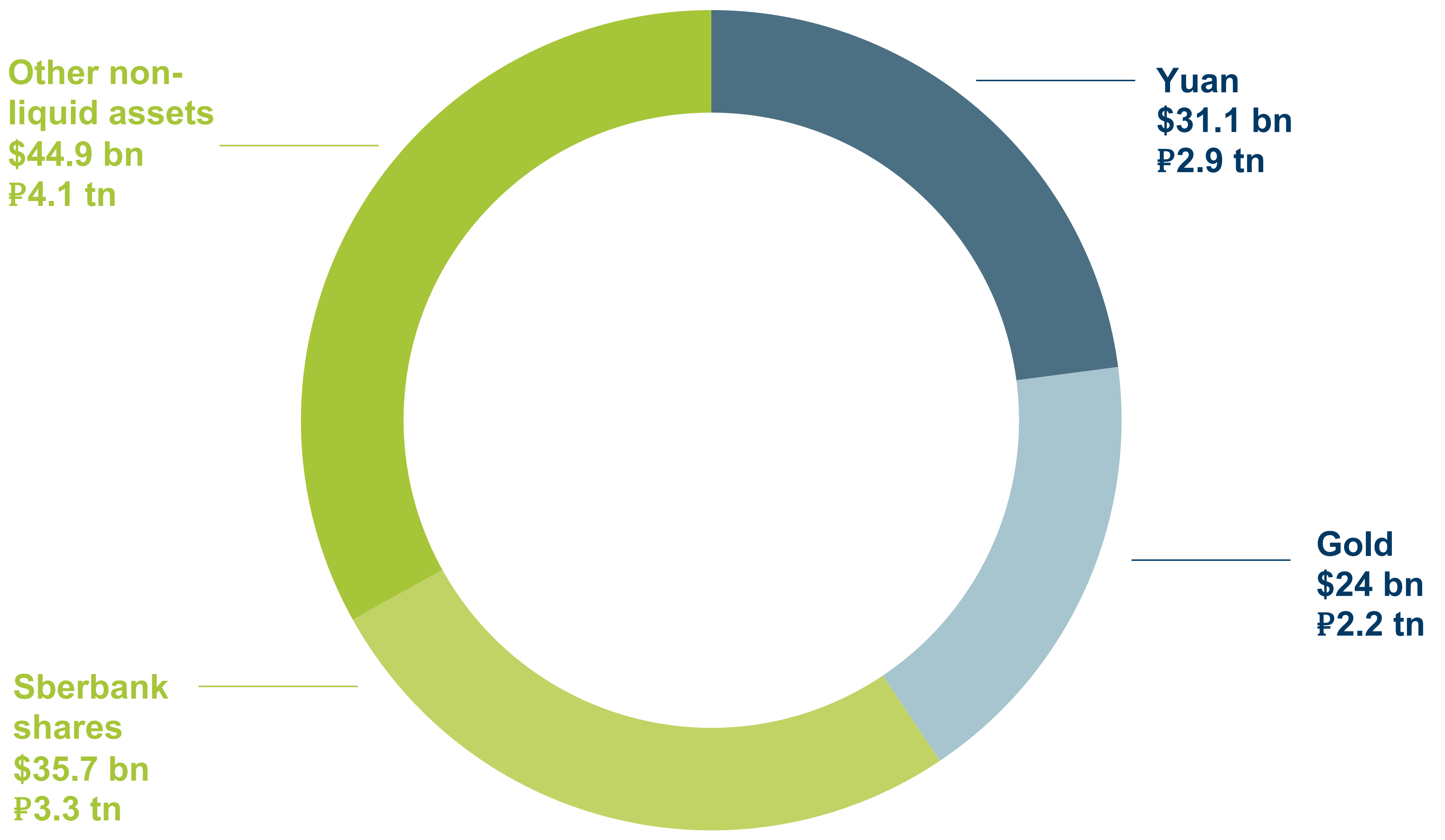
- Russia has depleted all hard-currency holdings of the NWF, with euro assets falling to zero in December 2023.
- Only yuan-denominated assets and gold remain in the liquid portion, totaling 5.0 trillion rubles (or $55 billion).
- As these are more difficult to use, at least at scale, budgetary funding via the NWF will become more challenging.

Change in liquid assets (Mar. 2024 vs. Jan. 2022), in U.S. dollar billion



Source: Ministry of Finance, KSE Institute

Composition of NWF assets as of April 1, 2024*



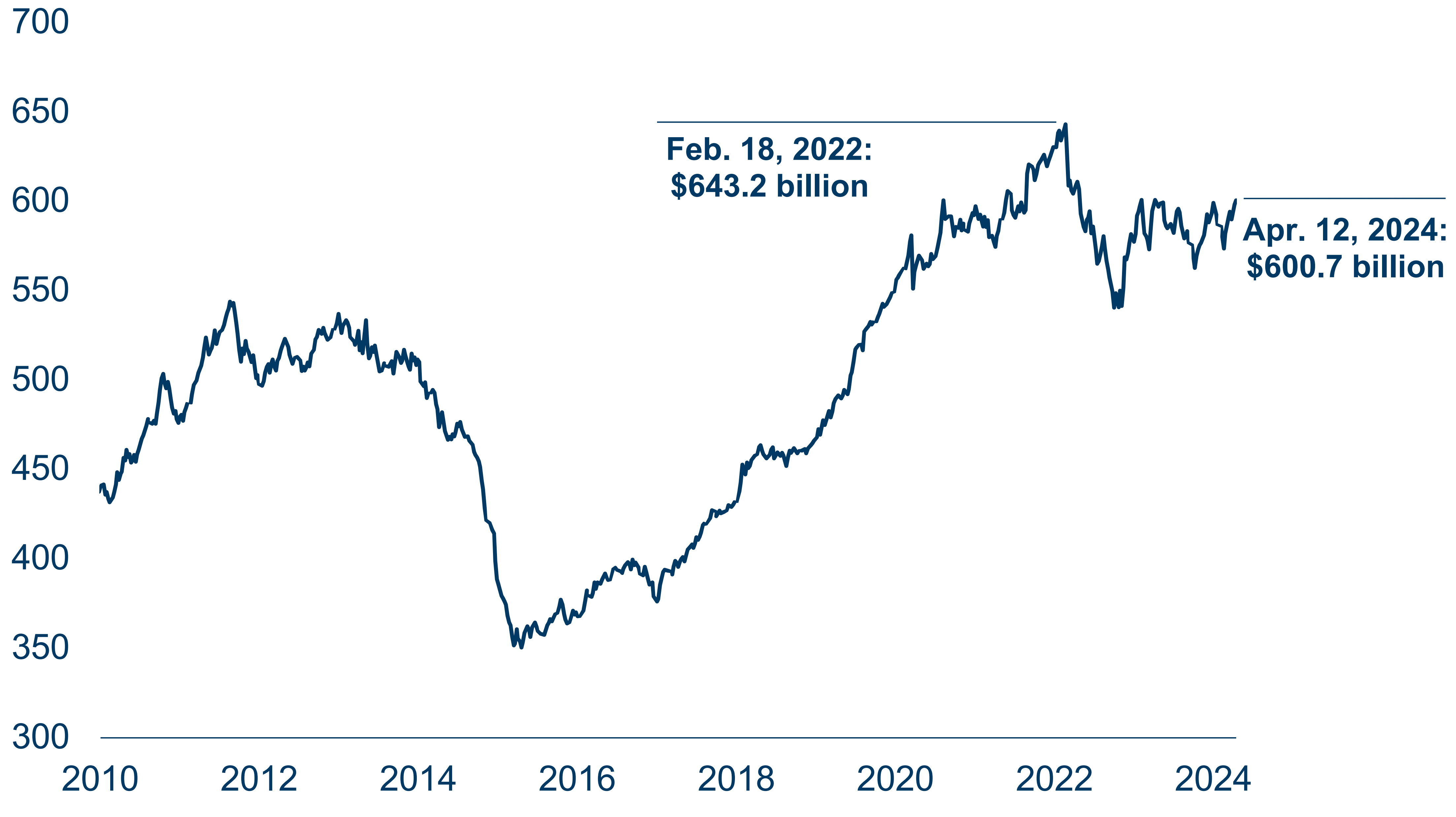
Source: Ministry of Finance, KSE Institute *based on market exchange rates/prices

KSE | Institute

A substantial share of international reserves remain immobilized.

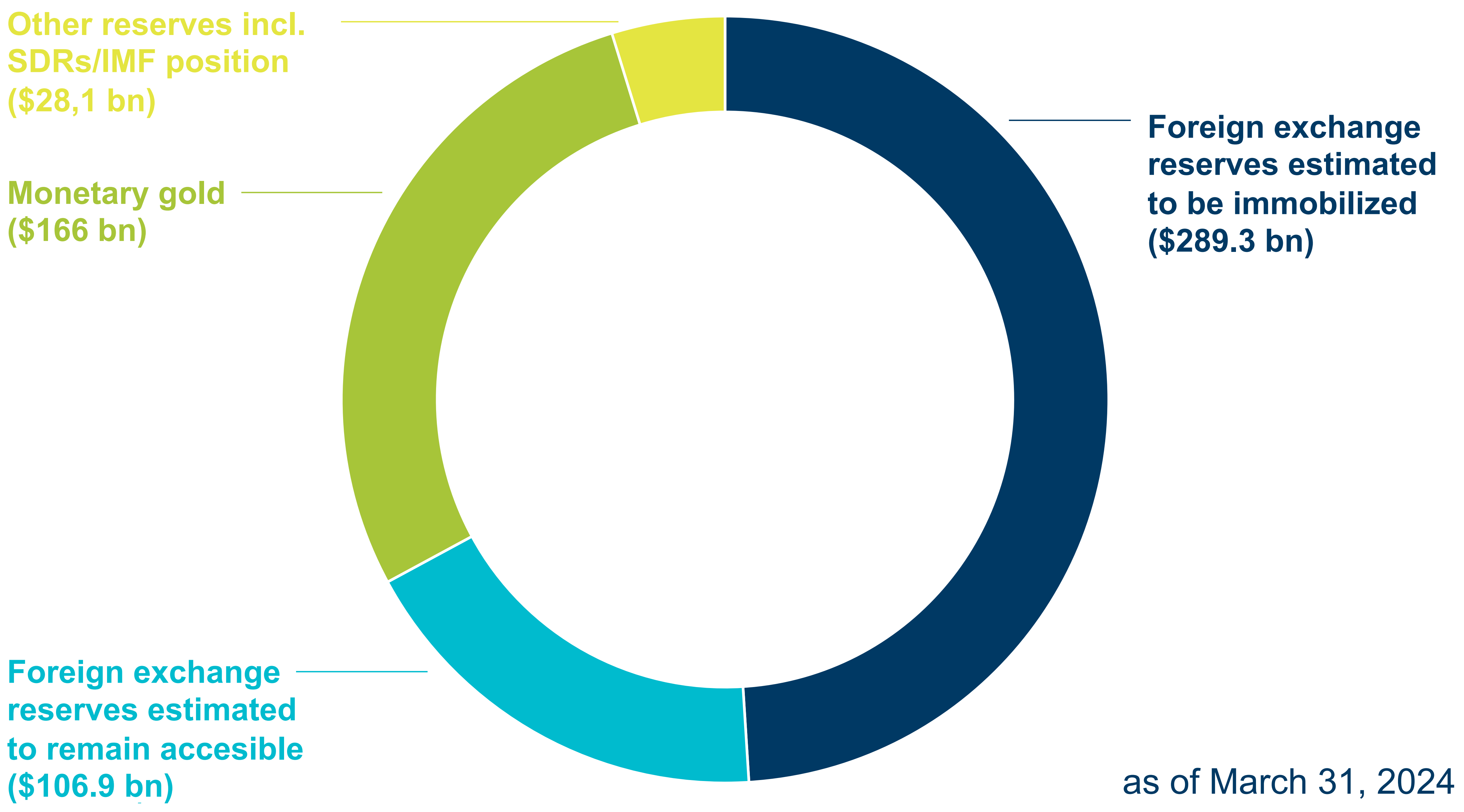
- Before the invasion, Russia held $634 billion in international reserves, part of what is described as *“Fortress Russia”.*
- We estimate that around $289 billion are currently immobilized due to international sanctions on CBR and NWF.
- This leaves Russia with access to $166 billion in monetary gold and roughly $107 billion in FX assets (largely yuan).

Total reserves, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

Estimated composition of reserves, in U.S. dollar billion



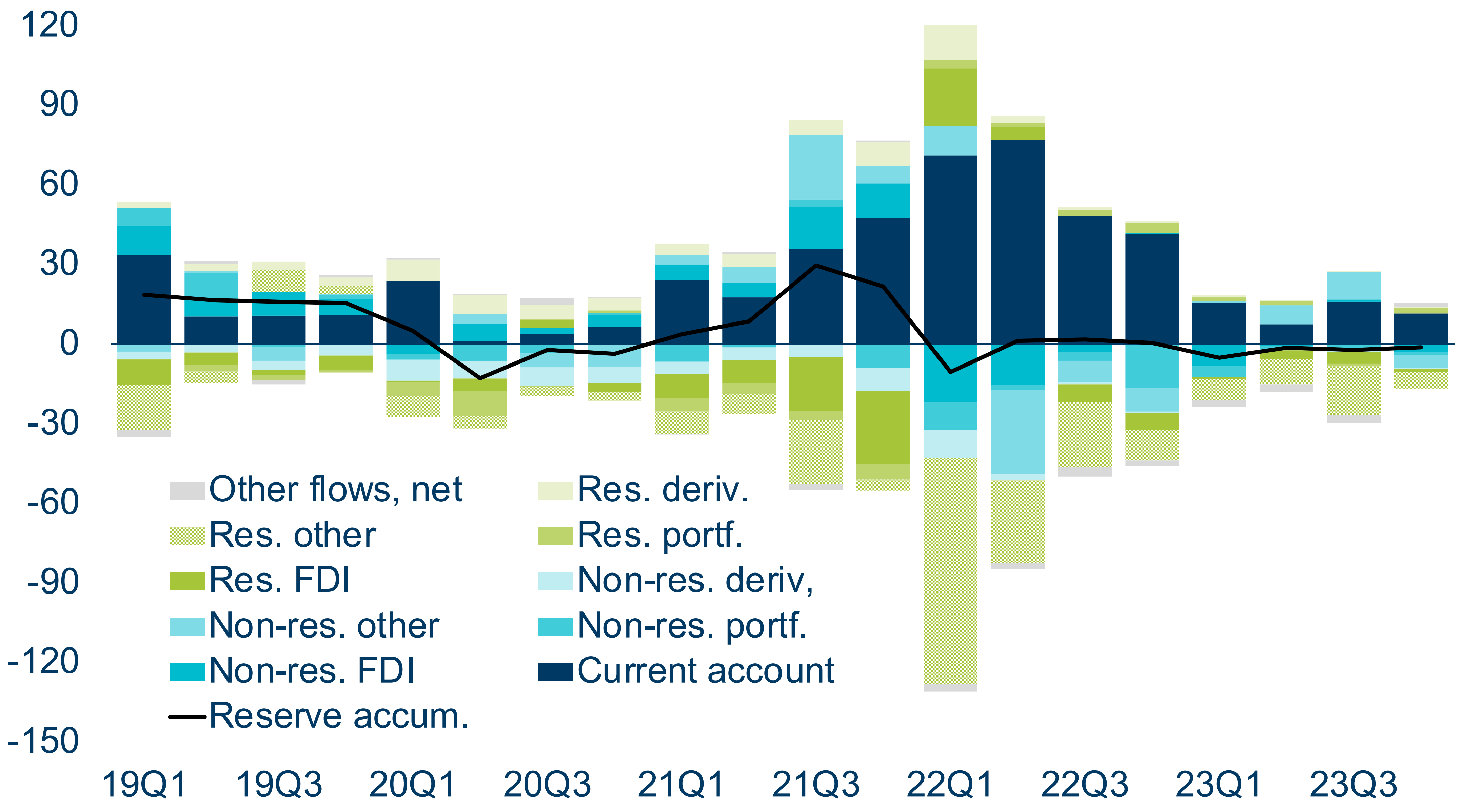
Source: Bank of Russia, KSE Institute

KSE | Institute

Significant accumulation of new foreign assets in 2022-23.

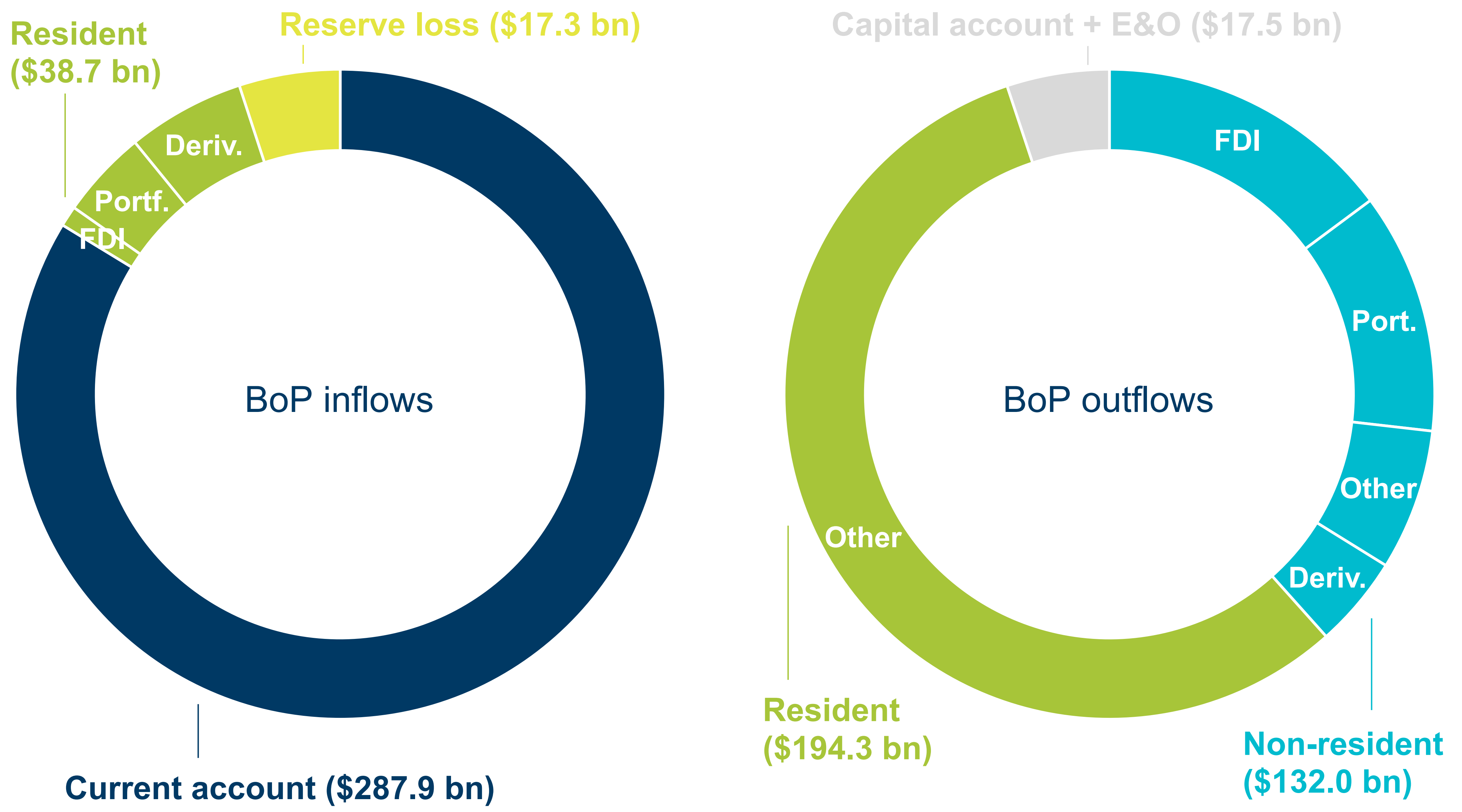
- It is time to focus attention on foreign assets that Russia has been able to accumulate due to favorable BoP dynamics.
- Non-resident capital outflows partially ate up the large current account surplus and resident inflows in Q1 2022-Q4 2023.
- But Russian banks and corporates were able to acquire $194 billion in assets abroad, which need to be kept out of reach.

Balance of payments, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

2022Q1-2023Q4 balance of payments flows, in U.S. dollar billion



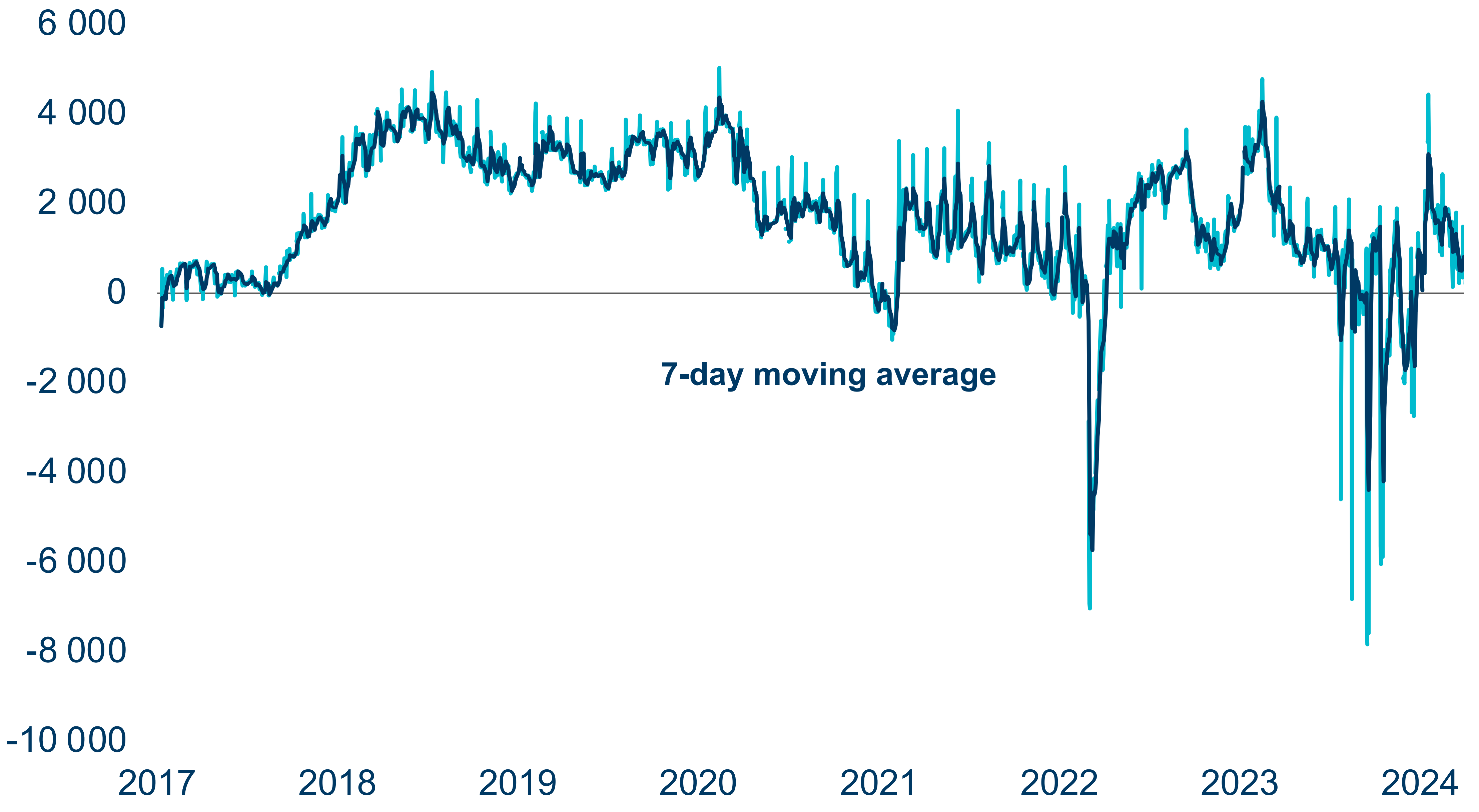
Source: Bank of Russia, KSE Institute

KSE | Institute

CBR rate hikes have impacted banking system liquidity in recent months.

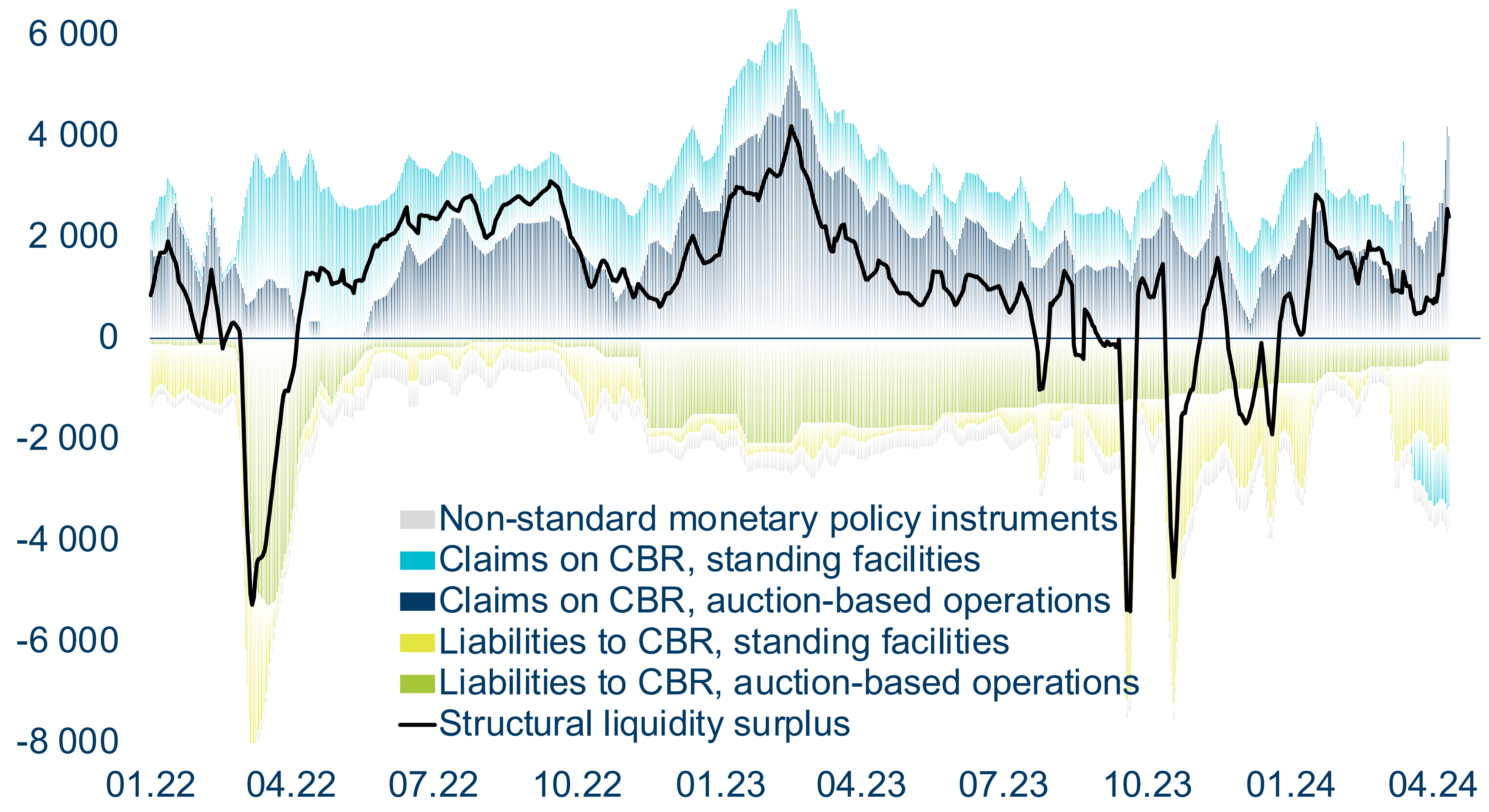
- Liquidity conditions recovered quickly after the initial shock from the full-scale war and imposition of sanctions.
- A closer look at the composition of the structural liquidity surplus points to some stress in the interbank market.
- The data clearly shows the effects of the CBR's monetary tightening in July-December 2023 (cumulative +850 bps).

Banking system structural liquidity surplus, in ruble billion



Source: Bank of Russia, KSE Institute

Composition of structural liquidity surplus, in ruble billion*



Source: Bank of Russia, KSE Institute *7-day moving average

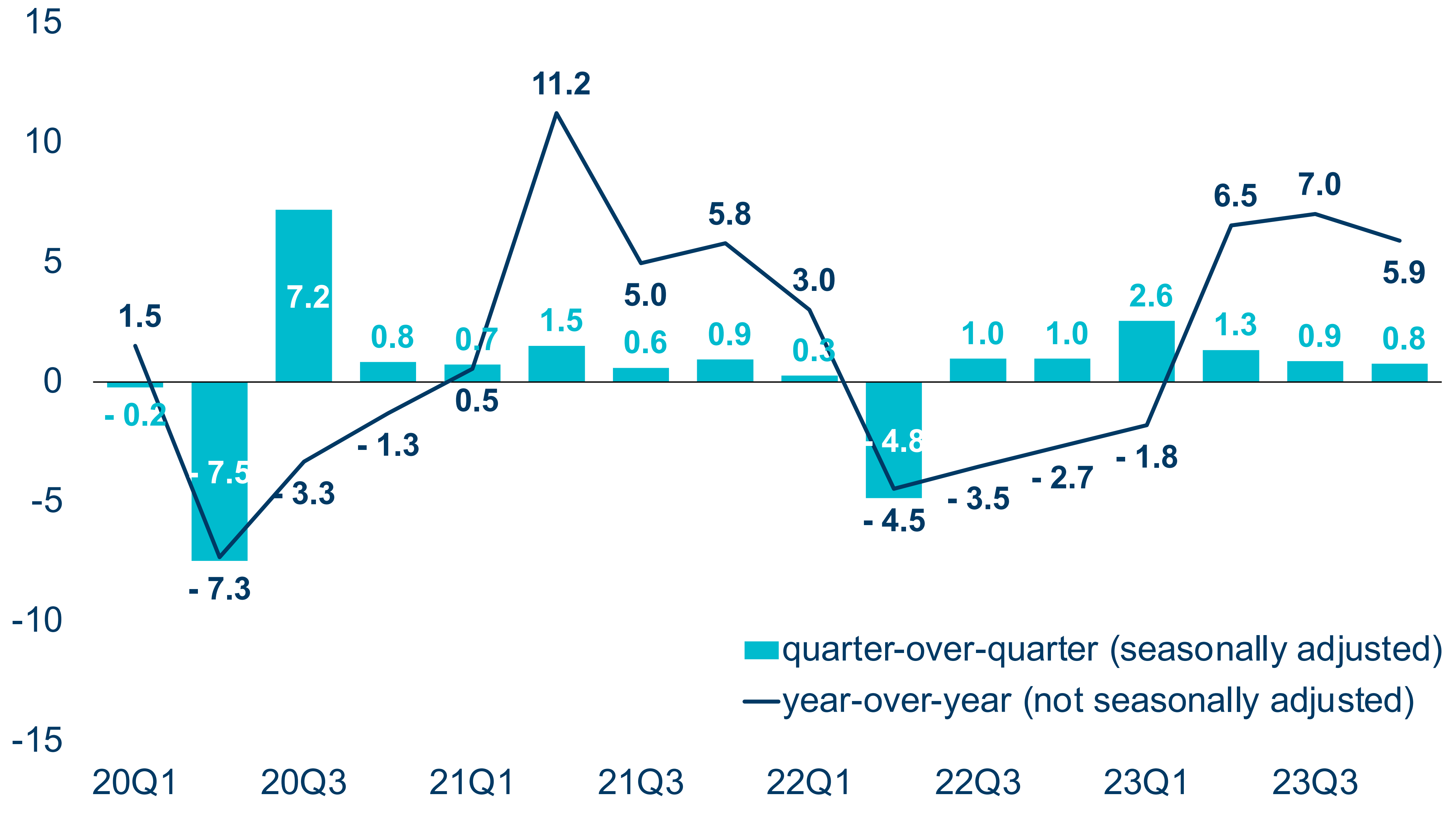
Economic activity: robust growth in 2023-24 due to large fiscal stimulus from military spending.

KSE | Institute

Russian outlook revised up as war spending keeps boosting the economy.

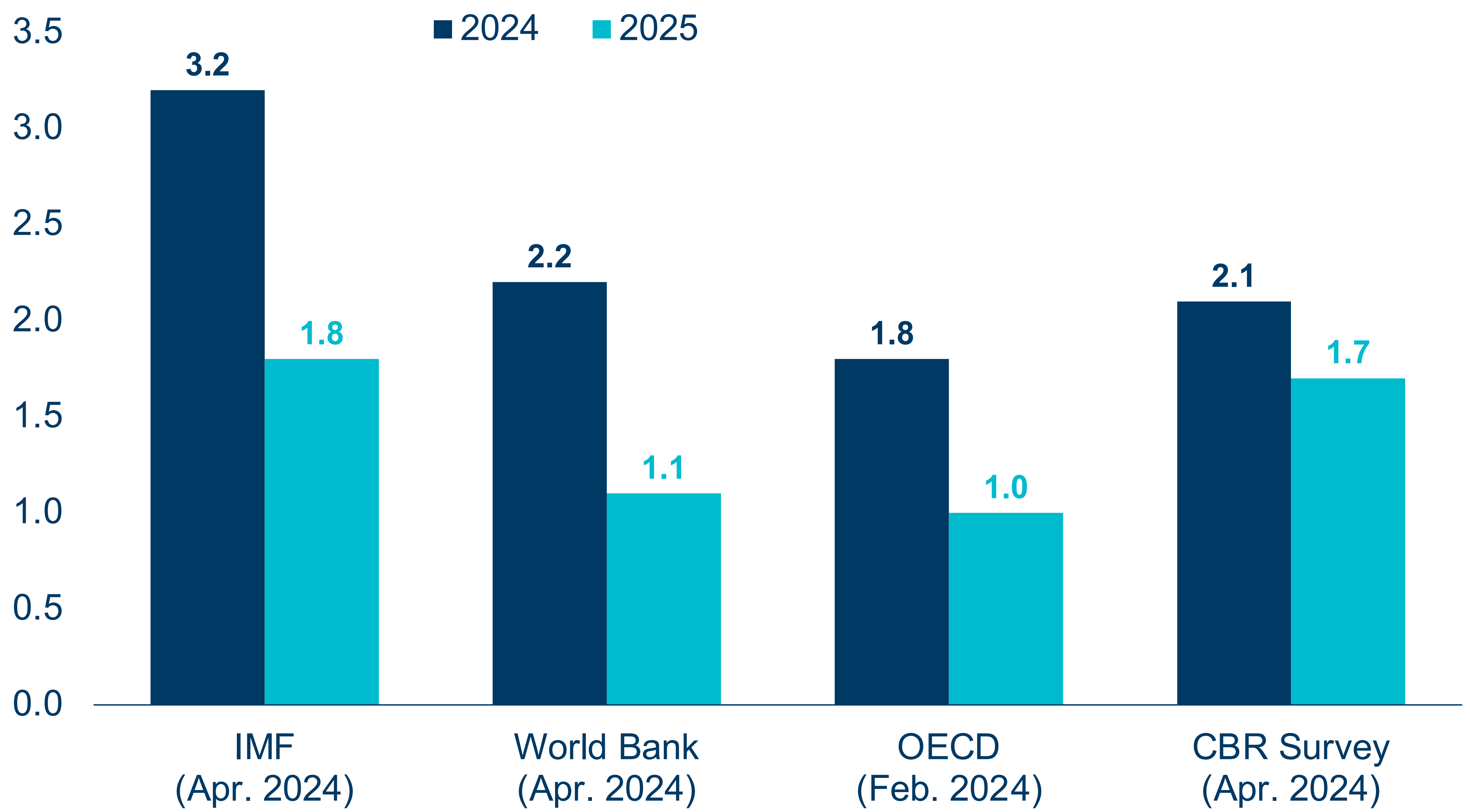
- Rosstat revised 2022 real GDP growth up to -1.2% (from -2.1%) and estimates 2023 growth at 3.6%.
- Key factors: strong fiscal stimulus from high defense spending and robust private sector credit growth.
- IMF, World Bank, and other international organizations are also expecting higher growth in 2024-25.

Quarterly real GDP dynamics, in %



Source: Rosstat, KSE Institute

2024-25 forecasts for Russian real GDP, in % year-over-year



Source: Bank of Russia, Bloomberg, IMF, OECD, World Bank

KSE | Institute

Previous editions of KSE Institute's Russia Chartbook

- March 2024
- February 2024
- January 2024
- December 2023
- November 2023
- October 2023
- September 2023
- July 2023
- May 2023
- April 2023
- March 2023
- February 2023
- December 2022