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KSE Institute Russia Chartbook

Macroeconomic Pressure on Russia Remains Moderate

June 2024

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Executive Summary

1. **Elevated oil prices and insufficient price cap enforcement support Russian exports.** While global oil prices declined somewhat in May with Brent falling to $82/barrel, they remain higher than at the end of 2023 and more then offset the wider Urals discount as a result of OFAC's vessel designation strategy. There are additional challenges emerging: First, Russia has already replaced close to 90% of the tanker capacity that was removed. Second, some of the vessels in question appear to be returning to commercial service. OFAC will need to start enforcement action against entities interacting with the vessels or their cargo to maintain credibility.
2. **Improved external dynamics help maintain macroeconomic stability and strengthen the ruble.** Russia's trade surplus remained stable in May, which helped the overall current account to reach $38.1 billion for the first five months of the year. This represents a more than 80% increase vs. the corresponding period in 2023 and means that the full-year surplus could approach ~$90 billion (vs. $50.2 billion in 2023) if current dynamics persist The more supportive external environment, together with the CBR's monetary policy response (cumulative 850 bps in interest rate hikes), has led to a moderate recovery in the ruble exchange rate.
3. **Russia is not facing meaningful fiscal constraints despite higher spending due to robust revenues.** Over the first five months of the year, Russia's federal budget deficit reached 1.0 trillion rubles—62% of the full-year target but less than one third of the corresponding number in 2023. Sharply higher revenues (+46%)—both O&G (+74%) and non-O&G (+34%)—more than offset higher spending (+19%) as Russia is executing higher war expenditures. The country remains on track to reach its 2024 target, and, at current oil export prices, it is unlikely that Russia will experience any meaningful external imbalances or budgetary constraints. Nevertheless, the government is considering significant tax increases to reduce its reliance on oil and gas revenues.
4. **Vulnerabilities exist due to reduced macro buffers as sanctions constrain access to reserves.** Should stepped-up economic sanctions succeed at reducing energy revenues in the coming months, Russia's underlying vulnerabilities could resurface quickly. After spending almost $54 billion of the NWF's liquid assets since the start of the full-scale invasion, only gold and yuan remain, which cannot easily be used at scale to finance the budget. This would force the regime to rely on higher domestic debt issuance and further drive-up borrowing costs. At the same time, immobilization of close to $300 billion in CBR reserves seriously constrains policy space.

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

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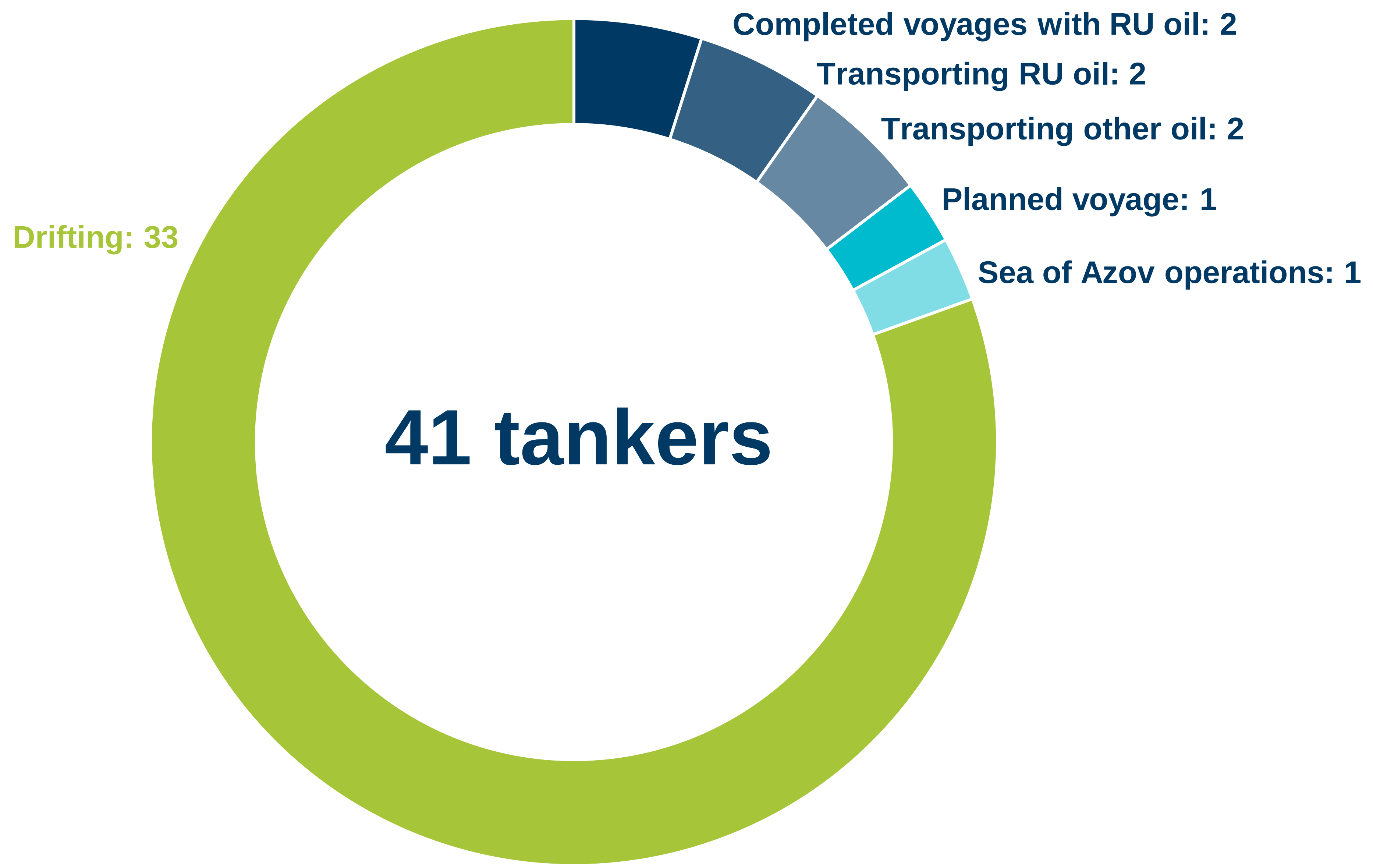
Sanctioned vessels may return to service, strategy requires scaling up.

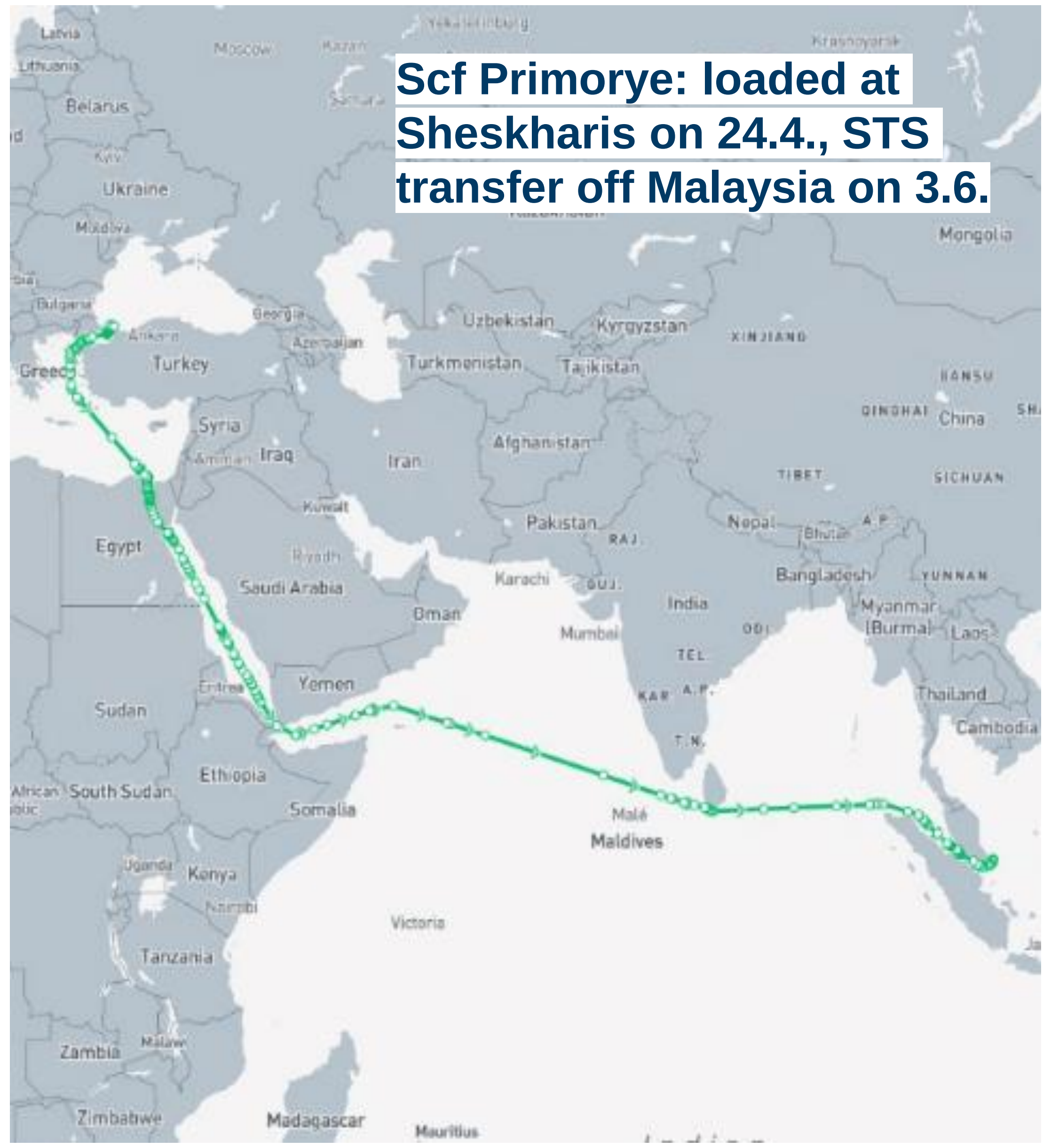
- The U.S. Treasury Department has listed 41 vessels as assets of sanctioned entities in recent months.
- Some appear to be returning to service; OFAC needs to target entities interacting with the vessels/cargo.
- The vessel designation campaign can and should be scaled up to increase pressure on the shadow fleet.

Some OFAC-designated vessels return to service



Source: Kpler, KSE Institute

Designated vessels to monitor: Scf Primorye and Hs Glory



Source: Kpler, KSE Institute

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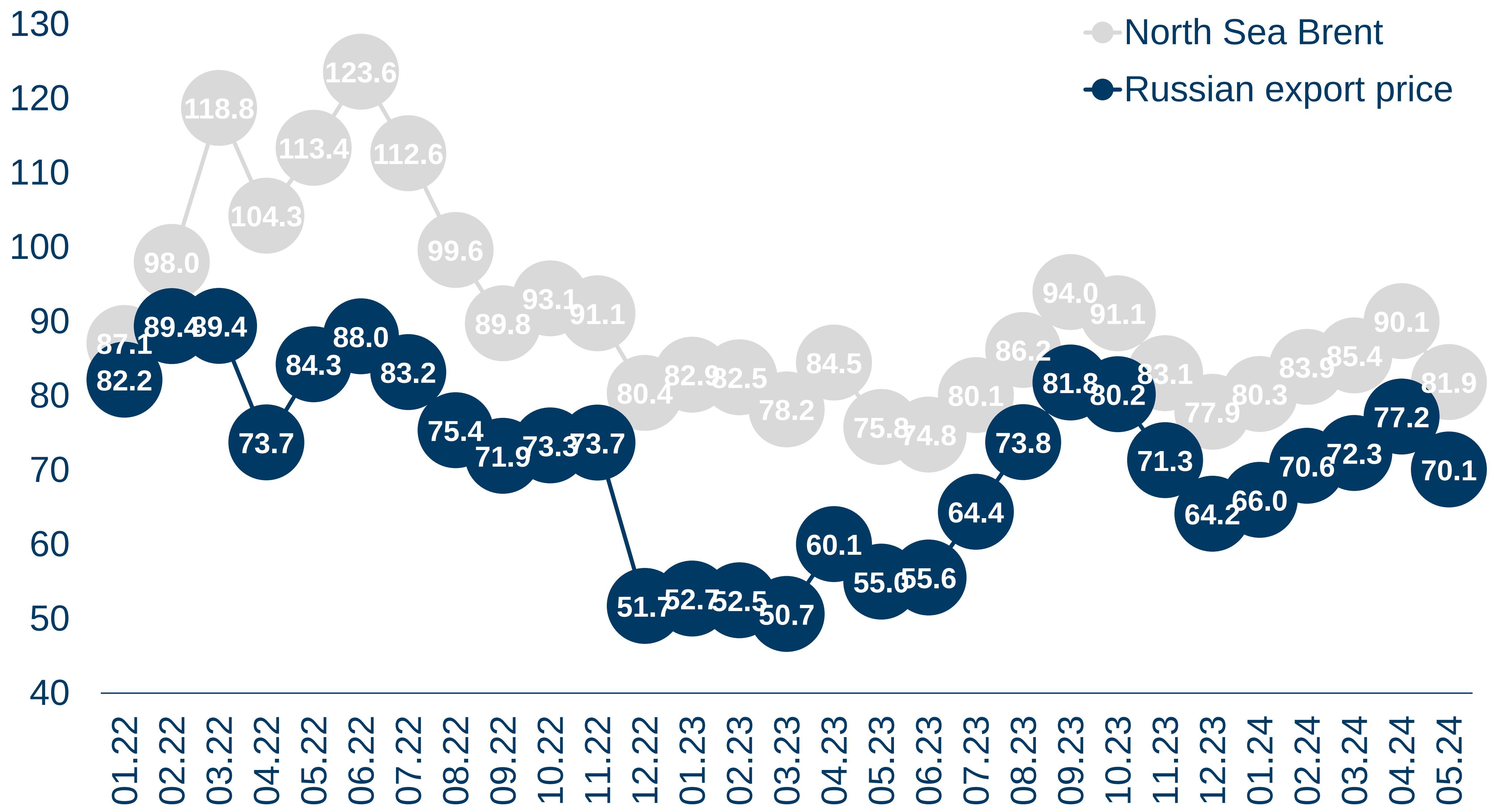
High global prices continue to offset wider price discounts vs. Brent.

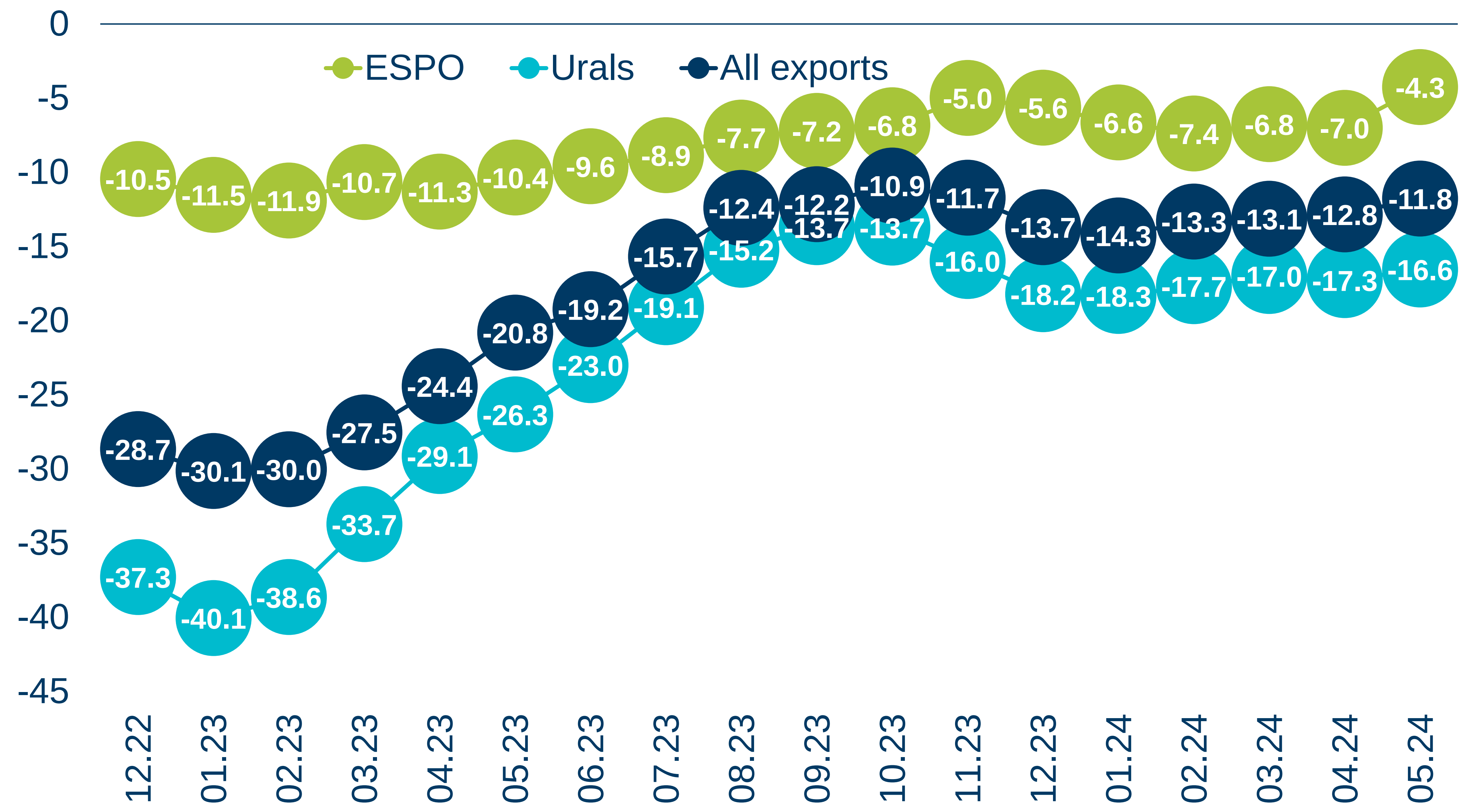
- Energy sanctions, particularly the EU embargo, have weighed on Russian export earnings via price discounts.
- The widening that occurred in the fall of 2023 due to OFAC's vessel designation campaign is now slowly dissipating.
- The pause in the designation campaign has allowed Russia to largely (~90%) replace the lost tanker capacity.

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

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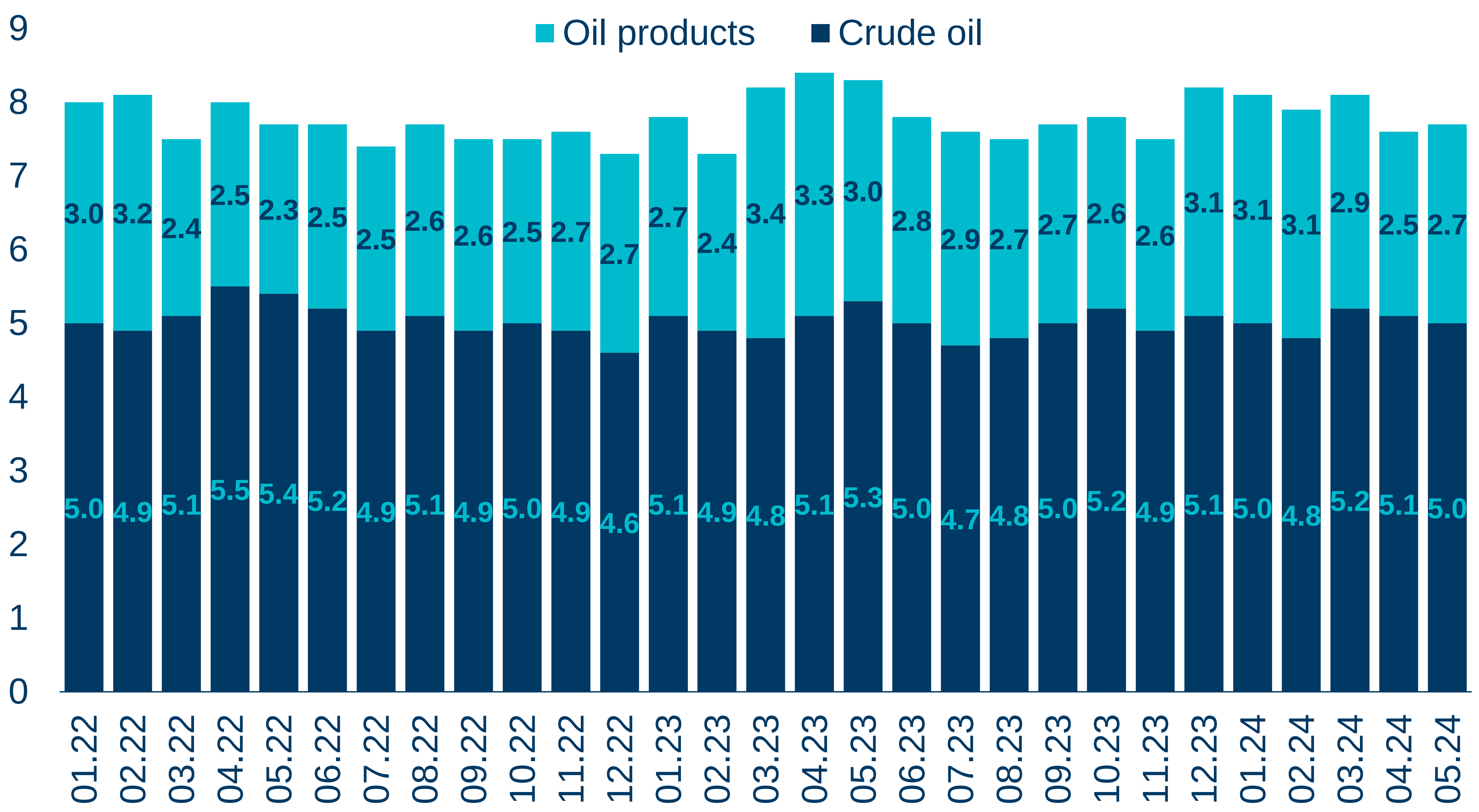
Drone attacks have not impacted the supply of Russian oil to the market.

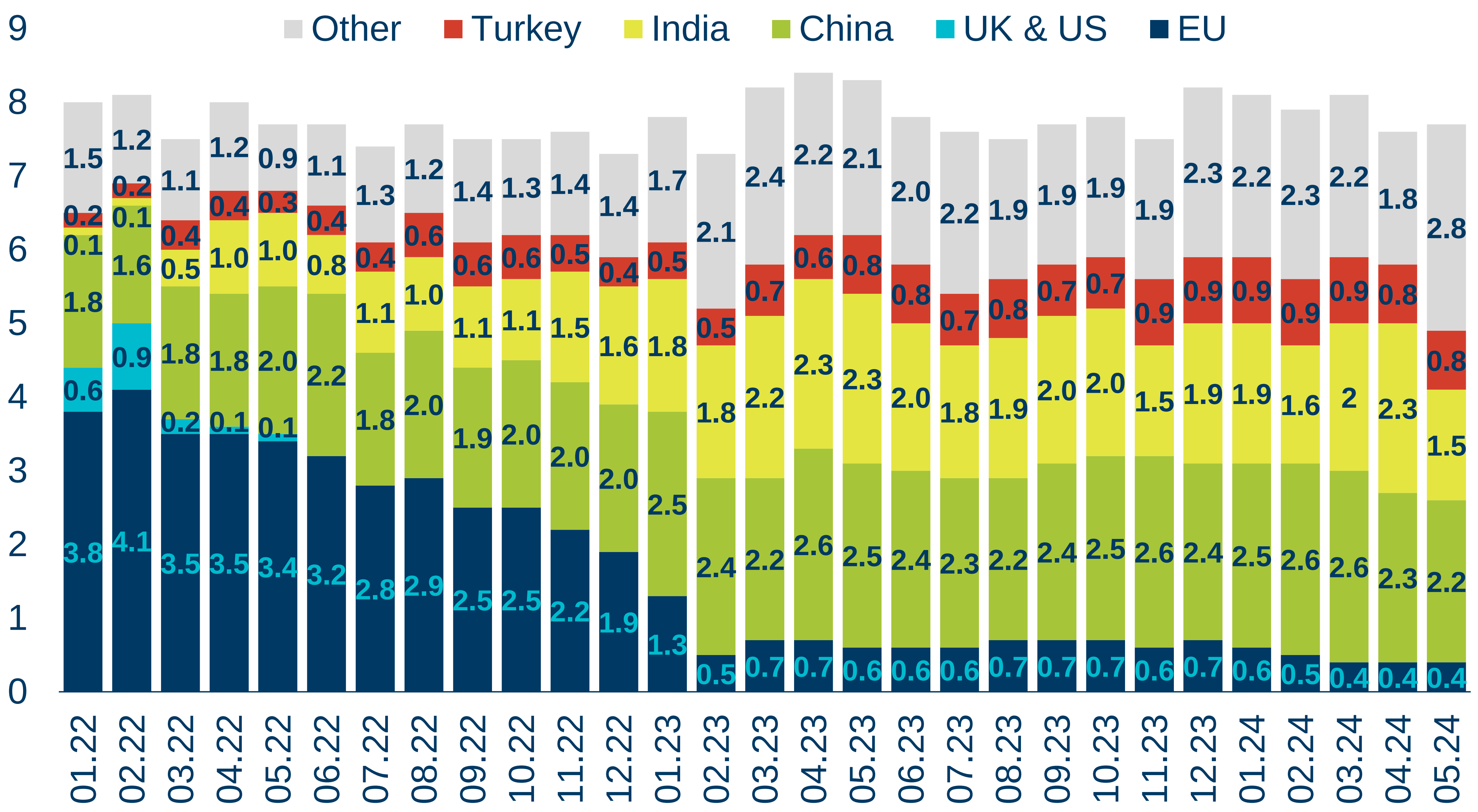
- Russian oil export volumes have been remarkably steady over the course of the last two years despite sanctions.
- This means that the price cap has succeeded at keeping Russian oil on the market and prevent supply issues.
- Oil products exports have declined somewhat in recent months because of Ukrainian drone attacks on refineries.

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

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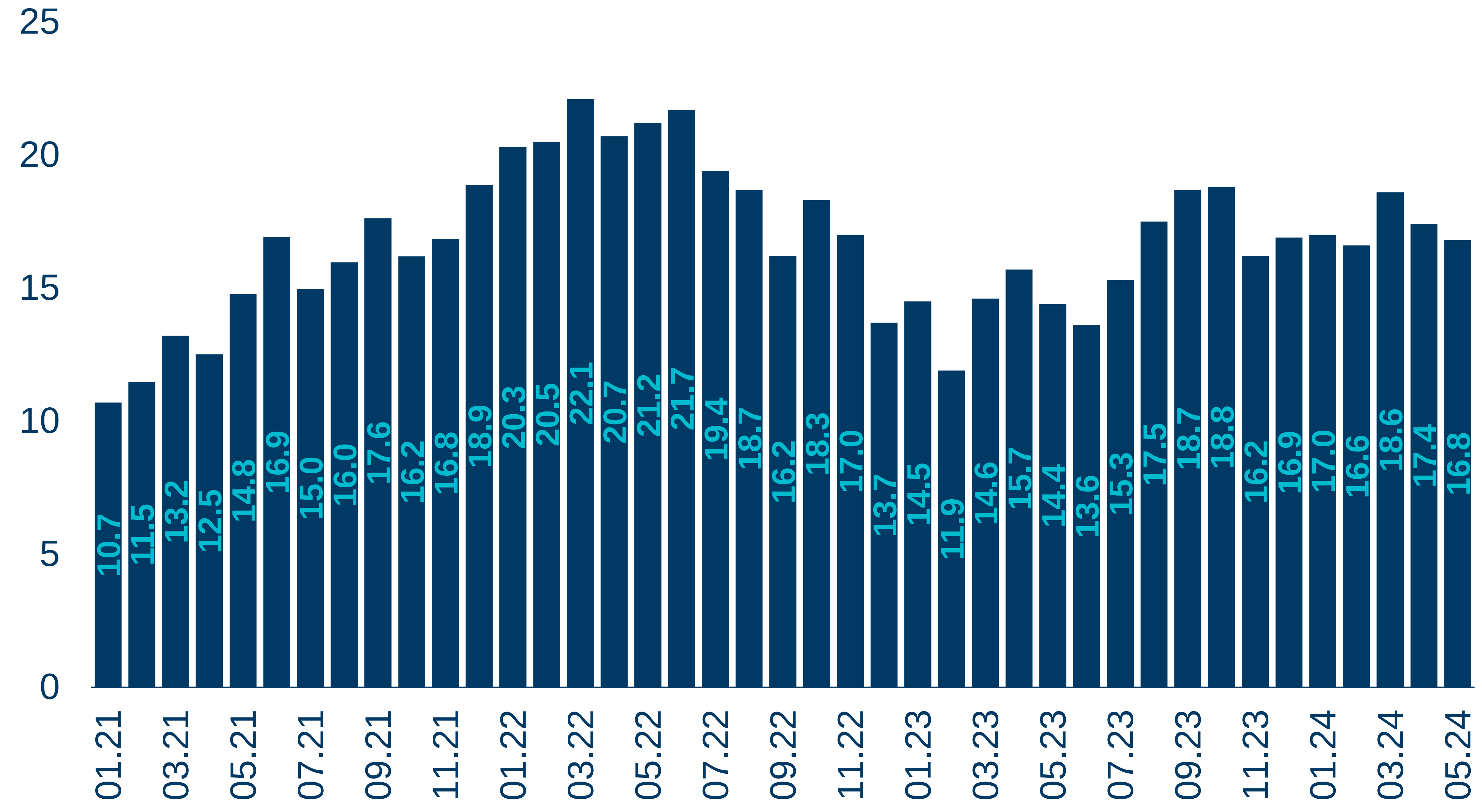
Insufficient enforcement helps Russia with exports and budget revenues.

- Over the first five months of the year, oil export earnings have averaged $17.3 billion (vs. $16.7 billion in H2 2023).
- Budget revenues have remained broadly stable and stood at 870 billion rubles on average in January-May 2024.
- The increase in January-May 2024 vs. H1 2023 is pronounced—22% for exports and 76% for budget revenues.

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

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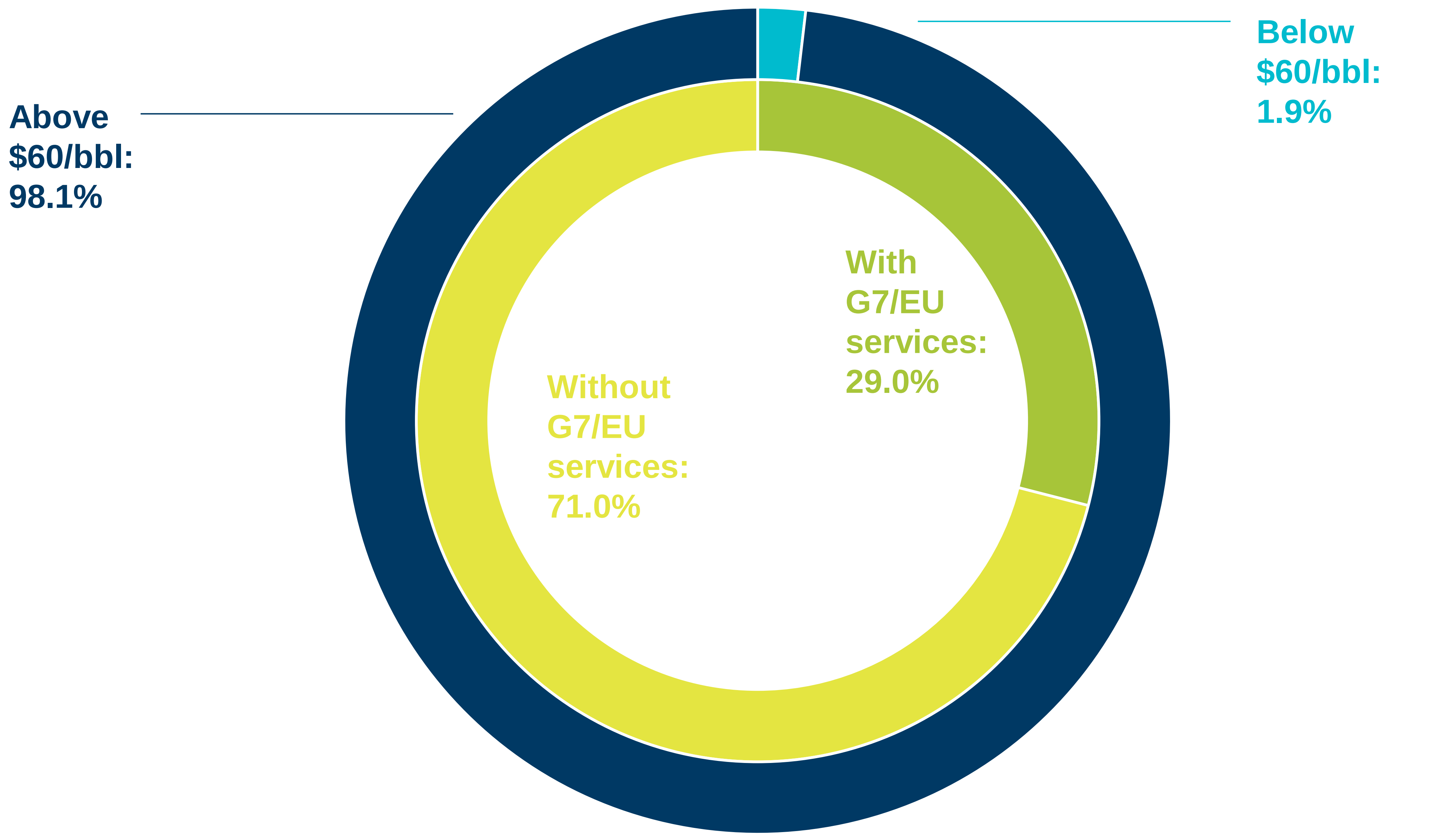
Price cap challenges: violations and the shadow fleet.

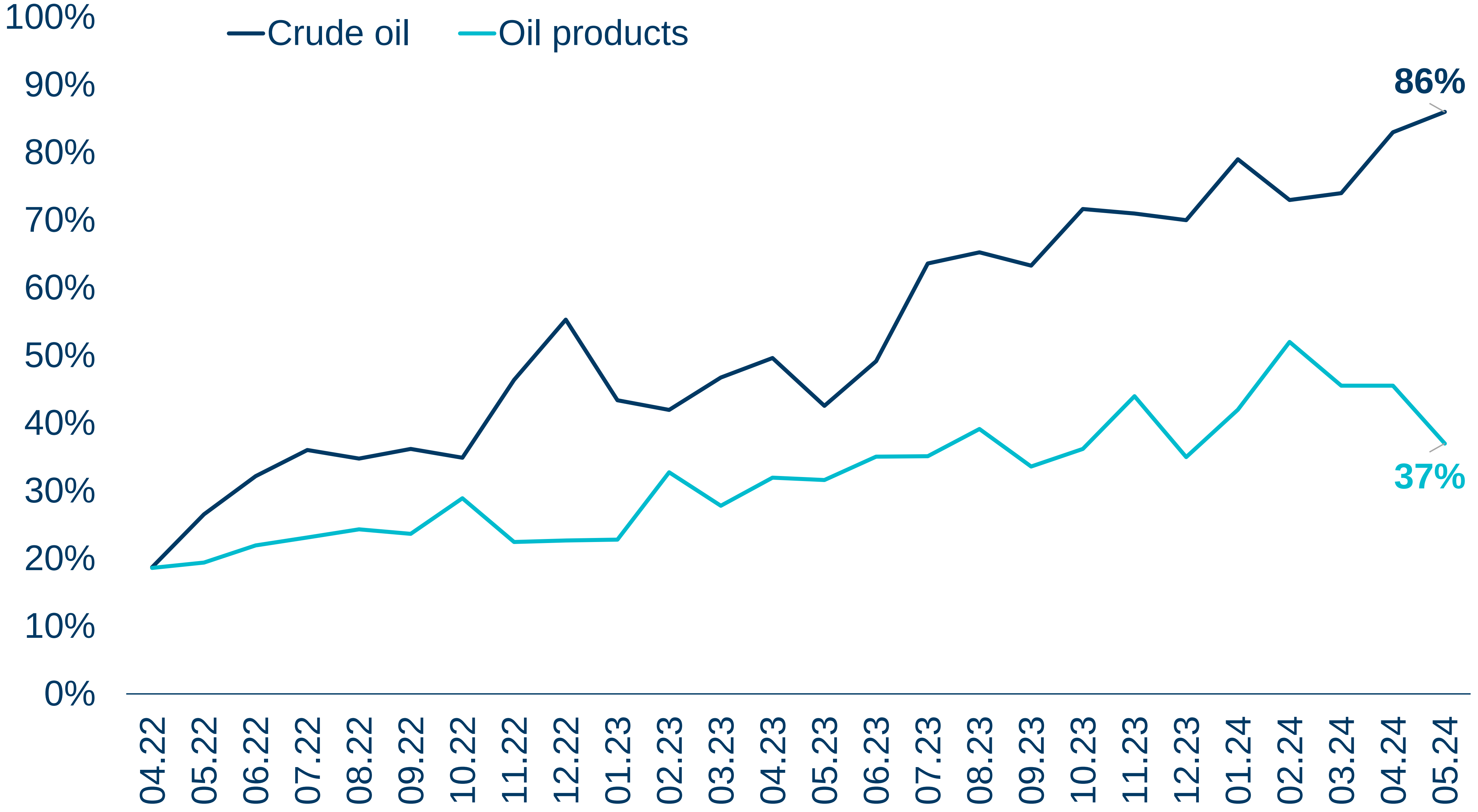
- Price cap compliance was largely absent in Q4 2023, and overall price dynamics indicate this is likely still the case.
- Fundamentally, oil traders//brokers falsify pricing information on the attestations which are required under the regime.
- A more fundamental issues is the Russian shadow fleet, which is increasingly eliminating the price cap's leverage.

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 means that Russia could earn more than expected.

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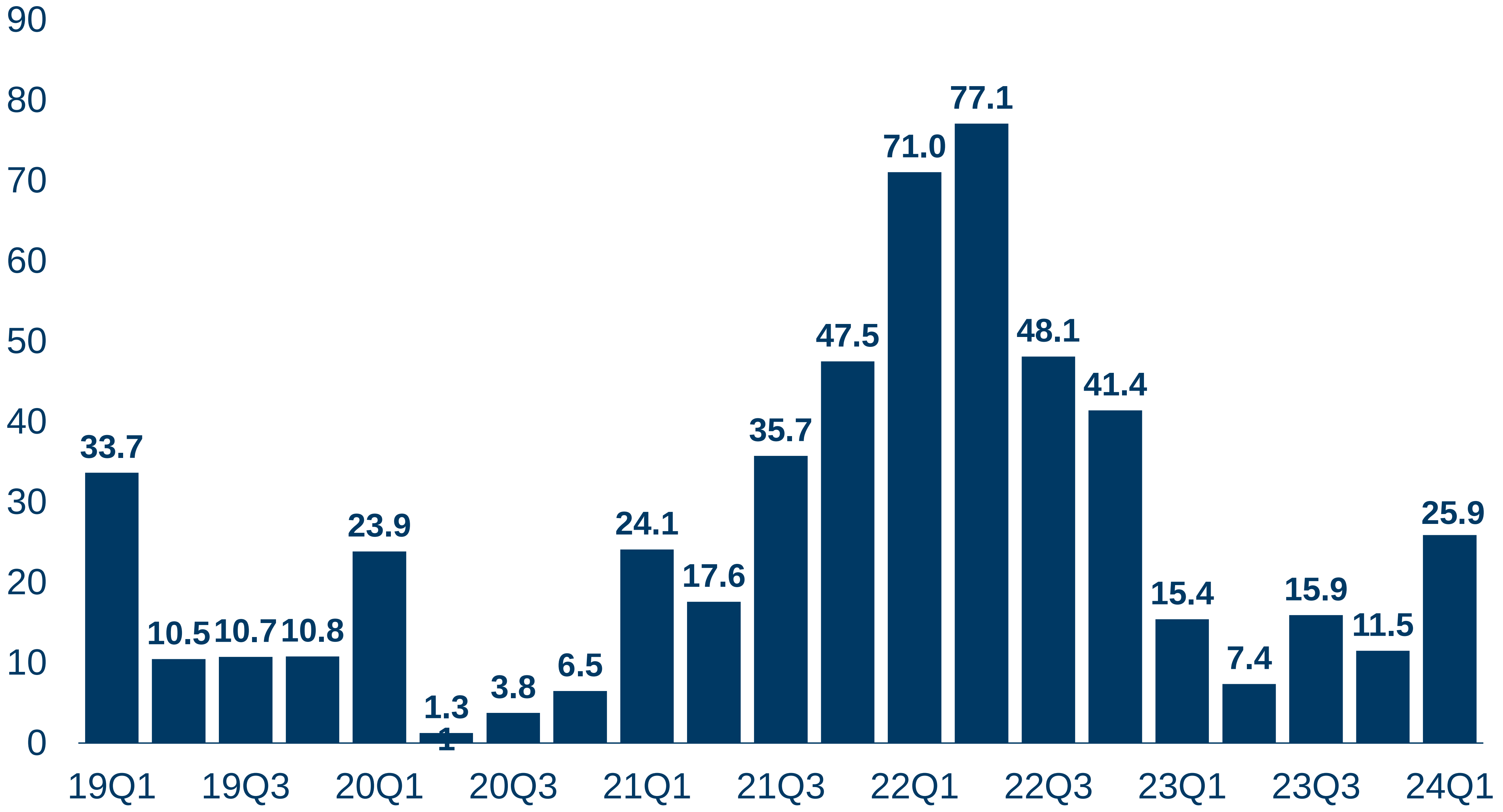
External environment has become more supportive in 2024.

- In Q1 2024, the current account surplus reached $25.2 billion—the highest reading since Q4 2022.
- At the rate of January-May, the full-year surplus would reach ~90 billion (vs. ~$51 billion in 2023).
- Supportive global oil prices and insufficient sanctions enforcement mean that risks are to the upside.

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.
Q1 2024	25.9	34.8	101.5	66.8	-4.8	10.5	15.4	-4.0	8.4	12.4
Apr. 2024	7.1	10.7	33.2	22.5	-2.1	3.1	5.1	-1.4	3.5	4.9
May 2024	5.1	10.6	34.8	24.2	-2.7	3.2	5.8	-2.9	3.9	6.8
Jan.-May 2024	38.1	56.0	169.5	113.4	-9.6	16.7	26.4	-8.3	15.8	24.1
Memorandum										
2021	125.0	193.1	494.2	301.0	-20.3	55.6	75.9	-47.8	96.3	144.1
2022	237.7	315.6	592.1	276.5	-22.2	48.6	70.9	-55.6	51.1	106.8
2023	50.2	120.9	424.2	303.3	-34.1	41.2	75.3	-36.6	44.7	81.3
Q1 2023	15.4	30.4	105.1	74.7	-7.6	9.8	17.6	-7.4	11.4	18.7
Apr 2023	0.2	6.8	31.6	24.8	-2.5	3.3	5.8	-4.1	4.1	8.2
May 2023	5.3	10.4	37.4	26.9	-3.1	3.4	6.5	-2.0	3.7	5.7
Jan.-May 2023	21.0	47.6	174.0	126.4	-13.2	16.6	29.7	-13.5	19.2	32.6

Source: Bank of Russia, KSE Institute

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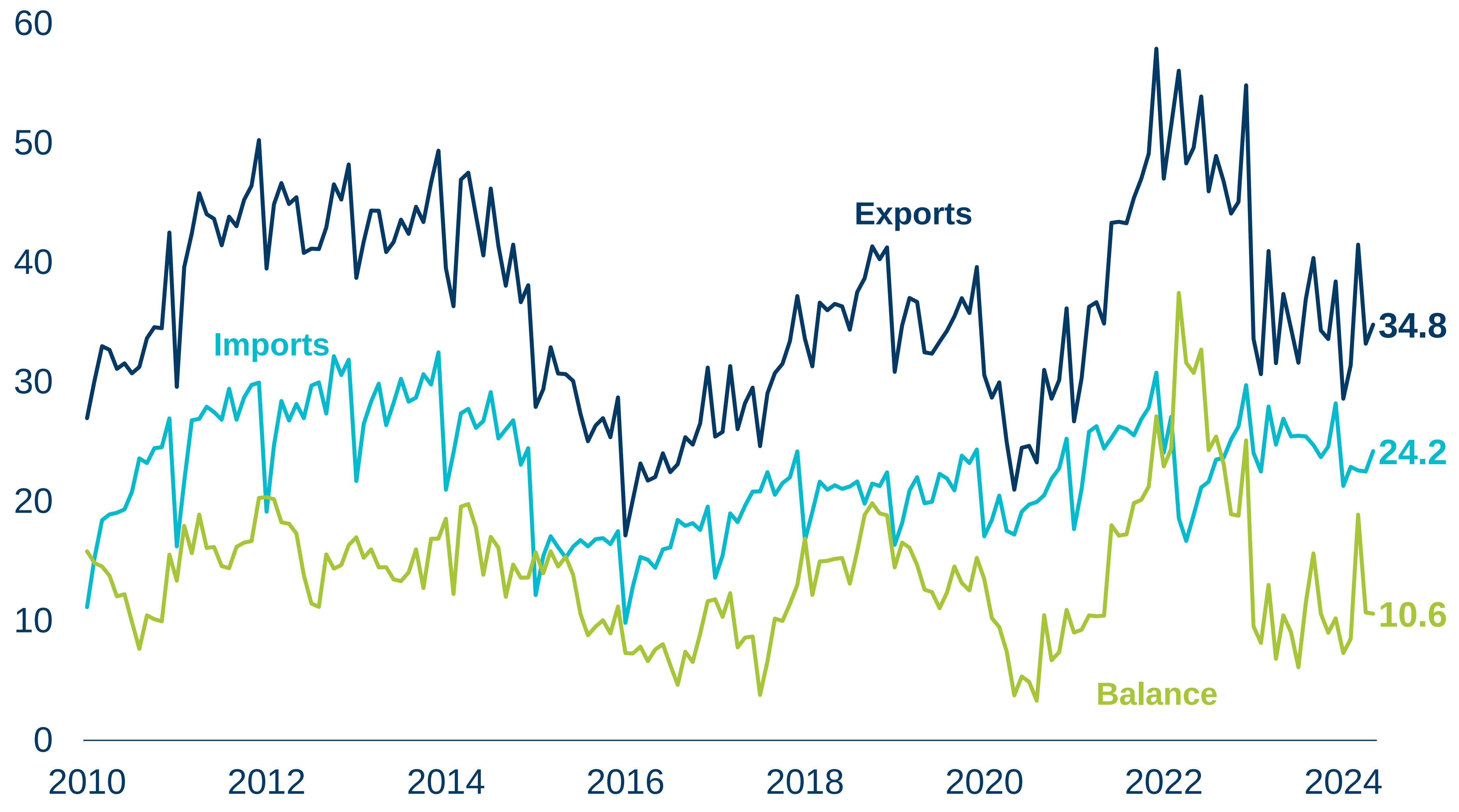
Foreign trade has settled in at a new post-full scale invasion baseline.

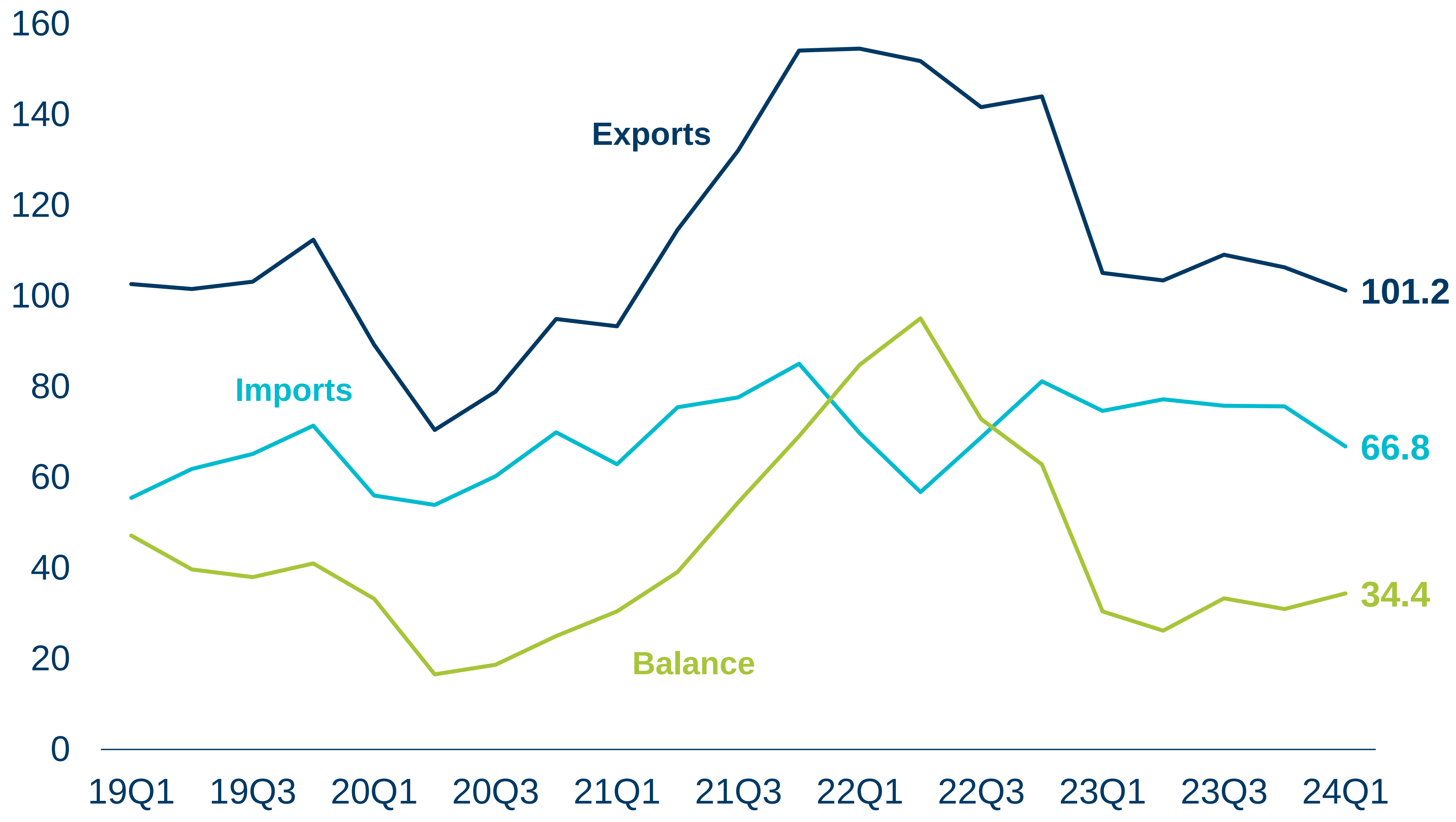
- Russia's foreign trade has stabilized at a new baseline of ~$100 billion in exports and ~$75 billion in imports per quarter.
- Fundamentally, sanctions and moderating commodity prices have fully reversed the exports boom late 2021 and 2022.
- Somewhat weaker imports in Q4 2023 (of $66.8 billion) led to a marginal increase in the trade balance (to $34.4 billion).

Monthly trade statistics, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

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

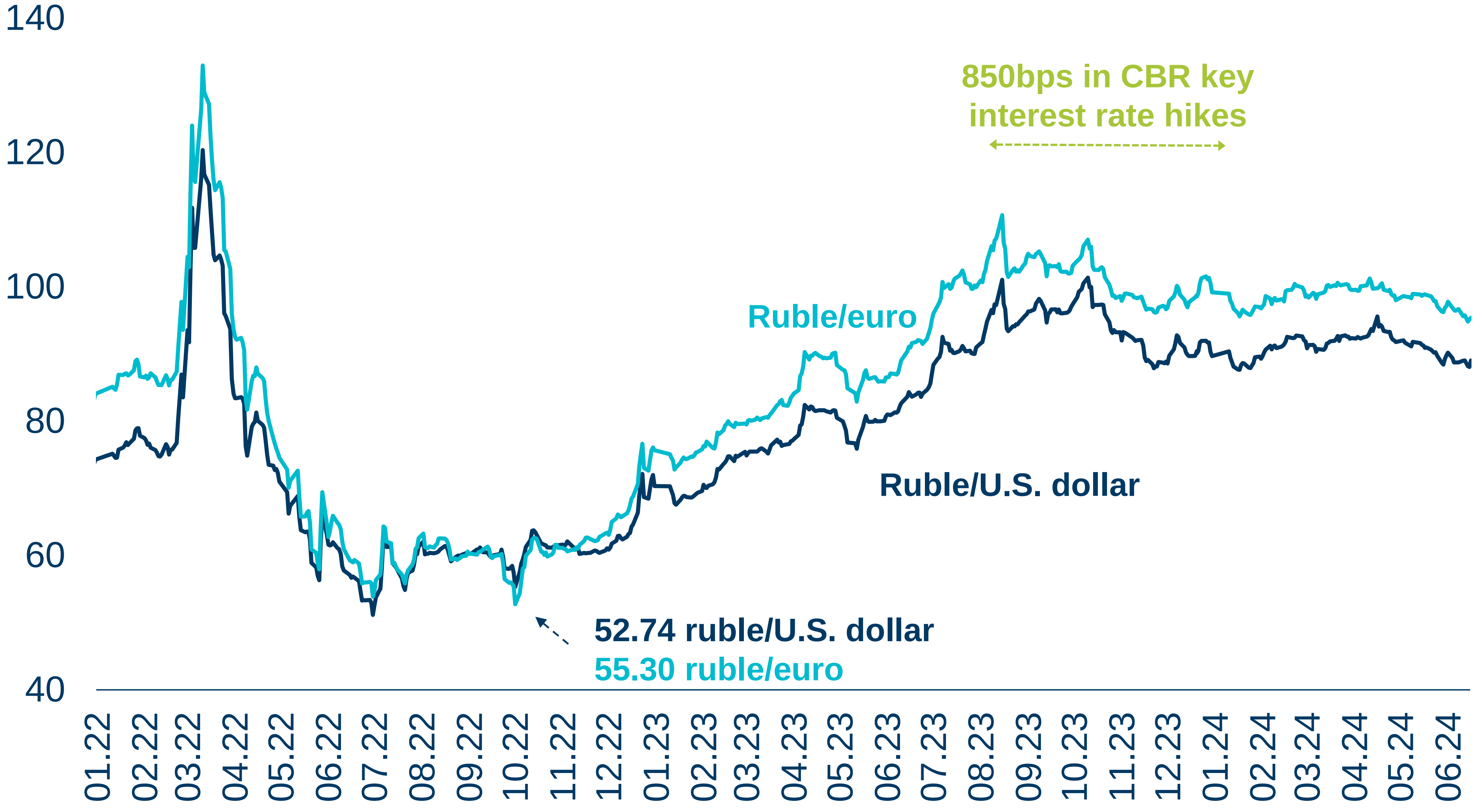


Source: Bank of Russia, KSE Institute

Ruble has stabilized, but future CBR approach unclear.

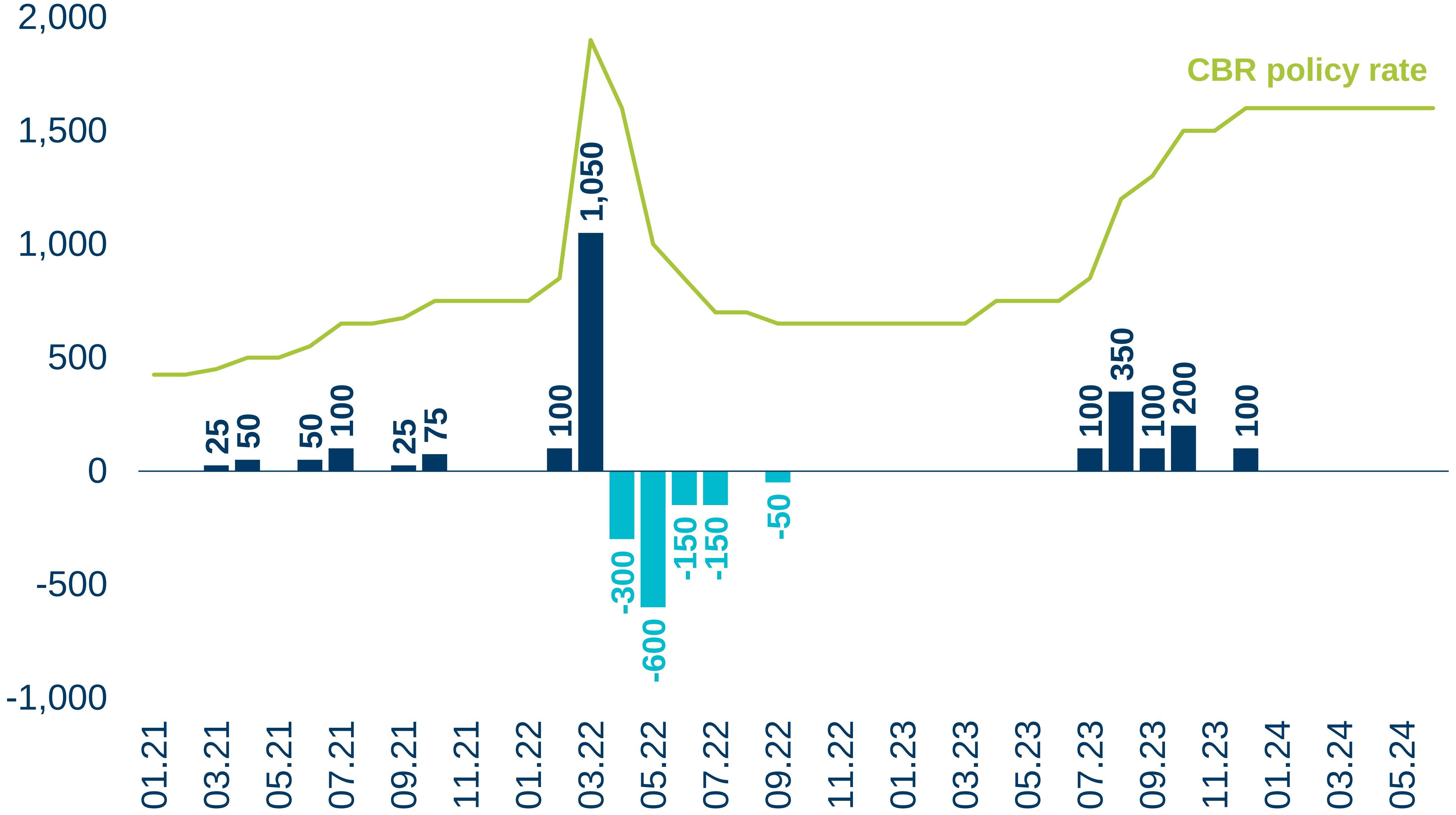
- Since October 2022, the ruble has lost 37% of its value against the U.S. dollar and 45% against the euro.
- Interest rate hikes by the CBR and the re-introduction of capital controls have led to some stabilization.
- The central bank has signaled that another interest rate hike could take place at coming MPC meetings.

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

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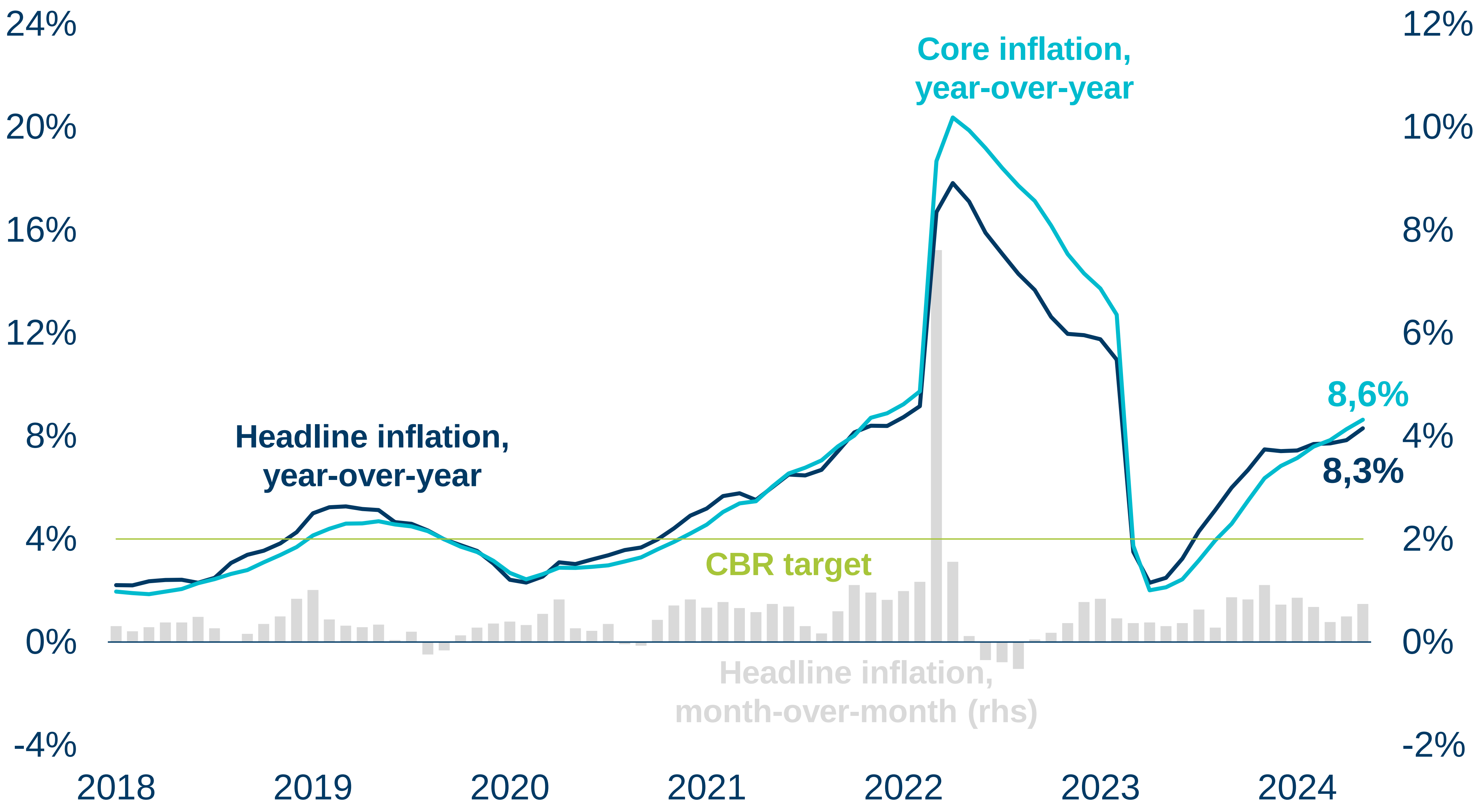
Headline and core inflation remain elevated.

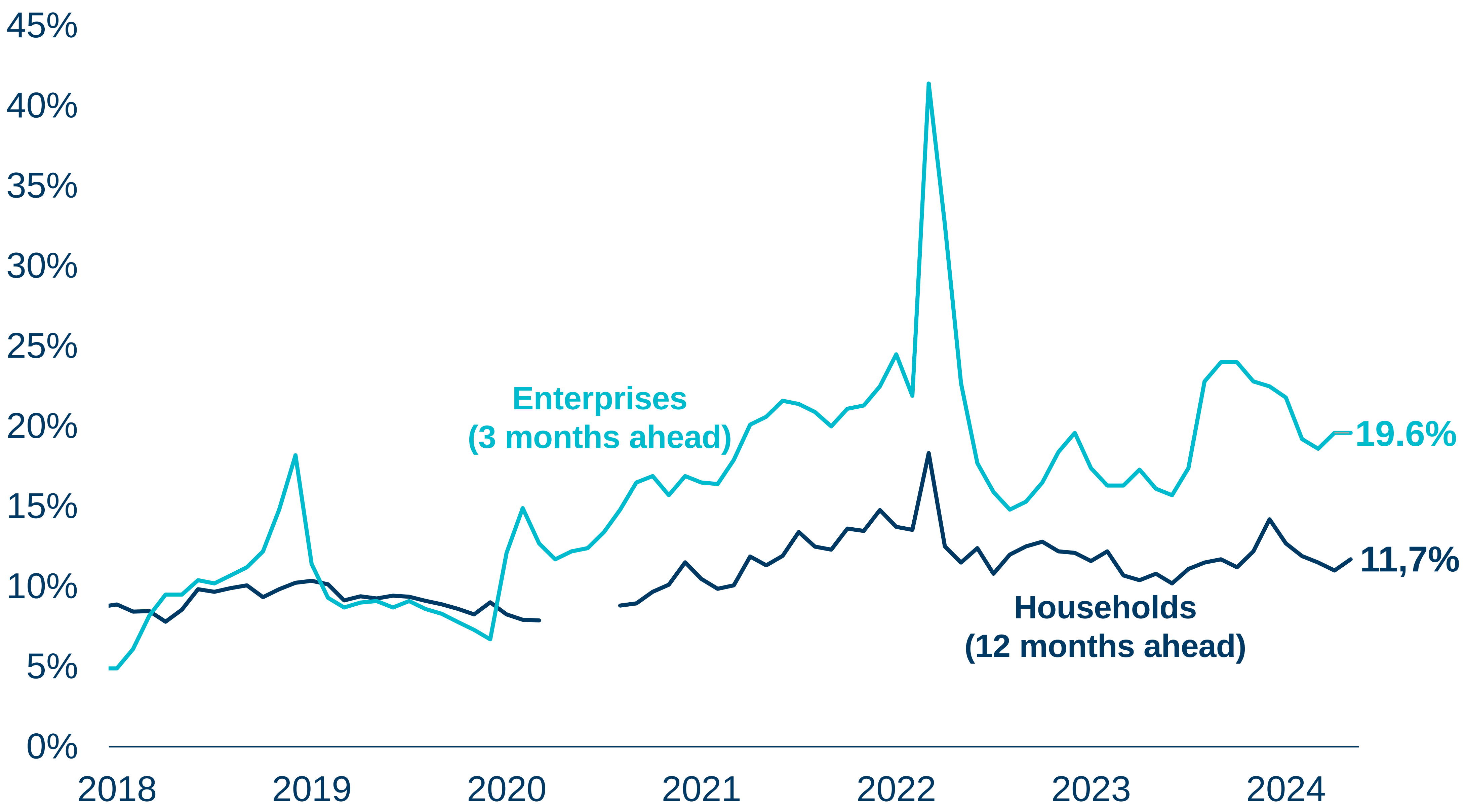
- Following a base effects-driven drop in spring/summer 2023, both headline and core inflation are rising again.
- Based on current month-to-month dynamics, headline inflation could approach double-digits again in the fall.
- Inflation expectations of enterprises have moderated in recent months after a meaningful pickup in late 2023.

Inflation, in %



Source: Bank of Russia, KSE Institute

Inflation expectations, in %

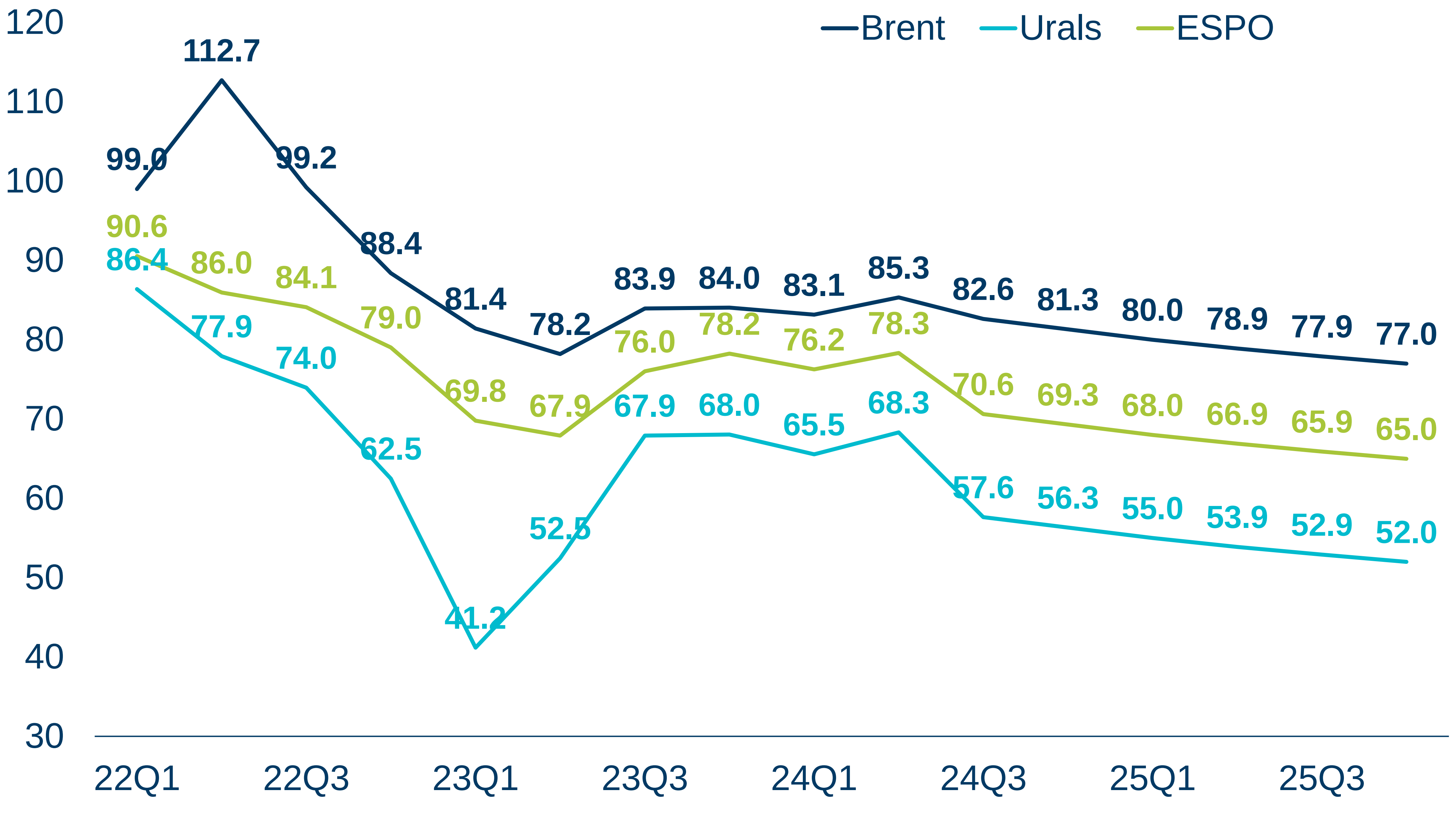


Source: Bank of Russia, KSE Institute

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

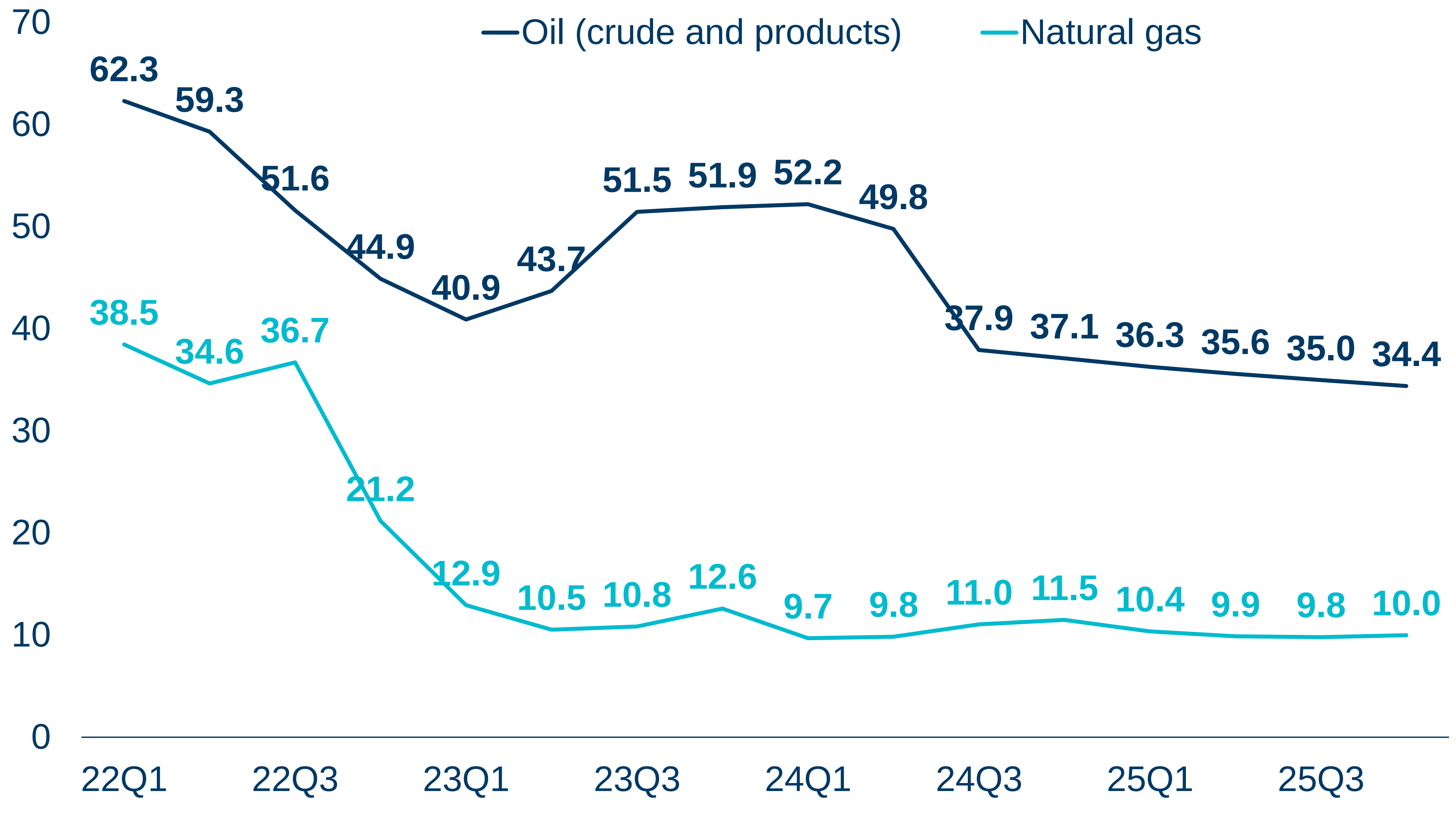
- In our base case, Urals and ESPO discounts vs. Brent will widen somewhat in H2 2024 as enforcement is stepped up.
- This would largely offset higher global oil prices and help constrain Russia's export earnings despite a tighter market.
- Natural gas exports are unlikely to recover from failed weaponization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

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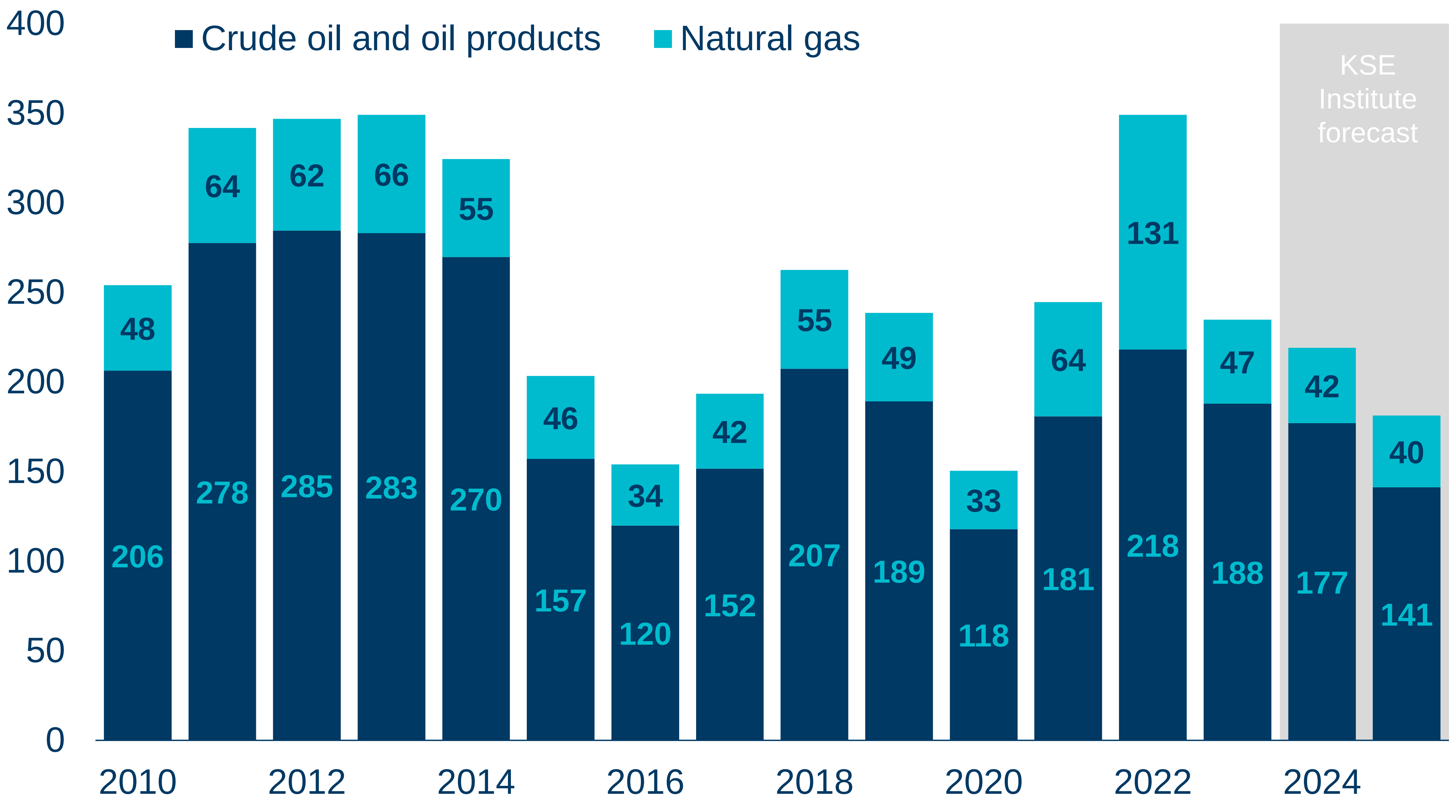
Current account surplus at suppressed levels in 2024-25 in base case.

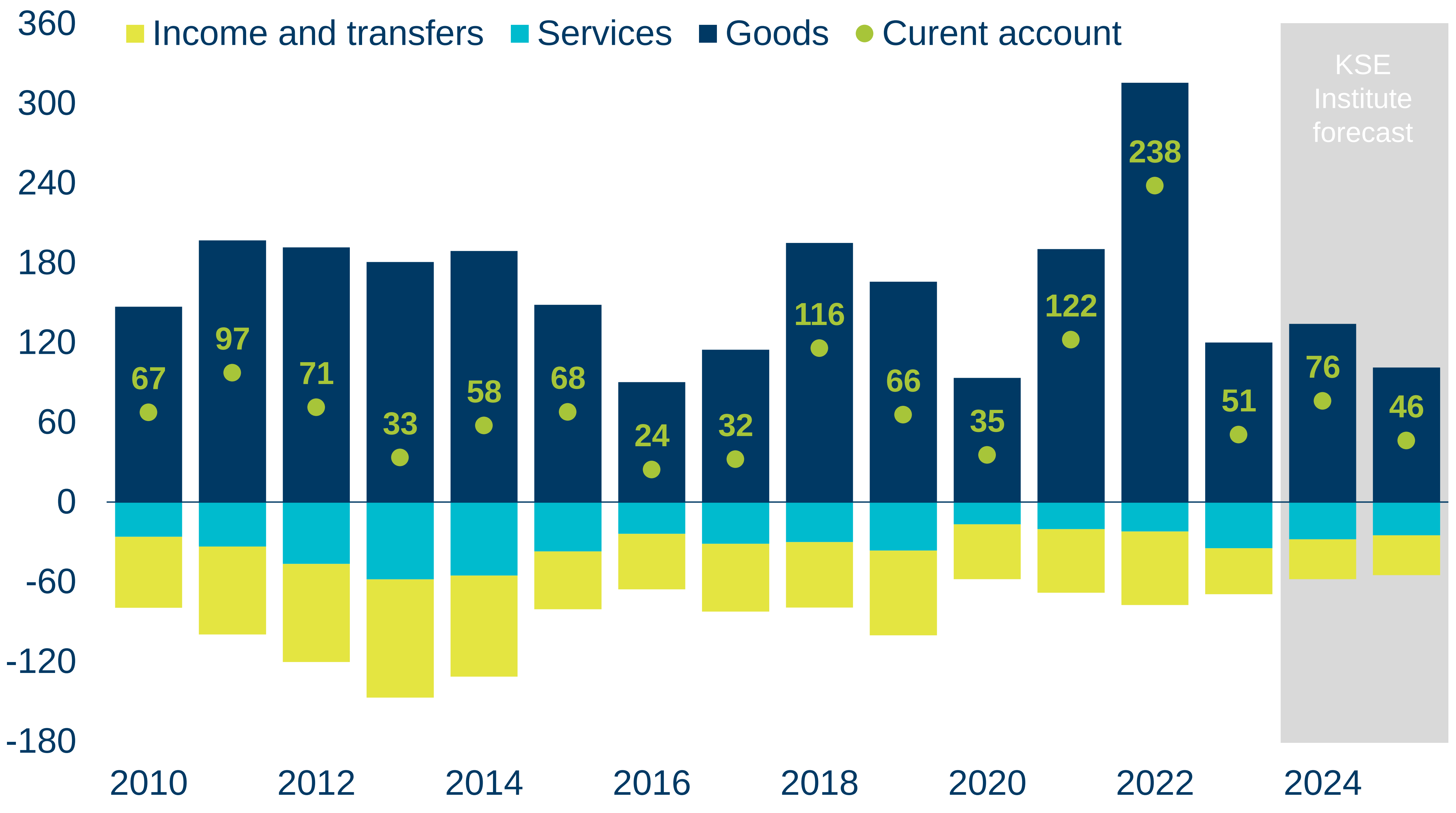
- O&G exports reached $234 billion in 2023 and are projected to drop to $214 billion in 2024 and $181 billion in 2025.
- We project a current account surplus of $76 billion and $46 billion in 2024-25, respectively, with risks to the upside.
- Should energy sanctions not be enforced effectively, earnings could grow by $20 billion this year and $45 billion next.

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

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Budget: Russia is unlikely to face serious fiscal constraints.

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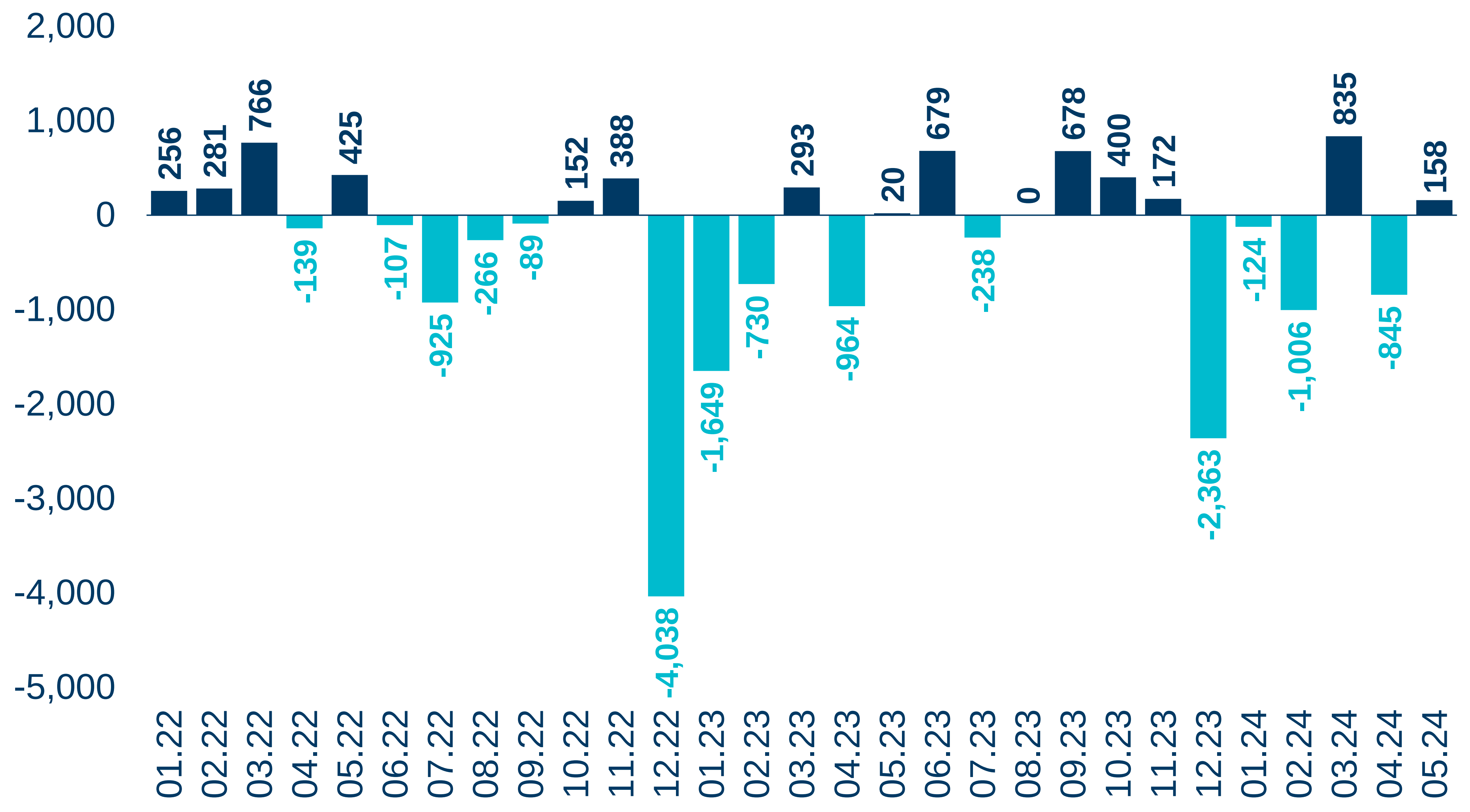
Sharp rise in revenues significantly improved fiscal situation.

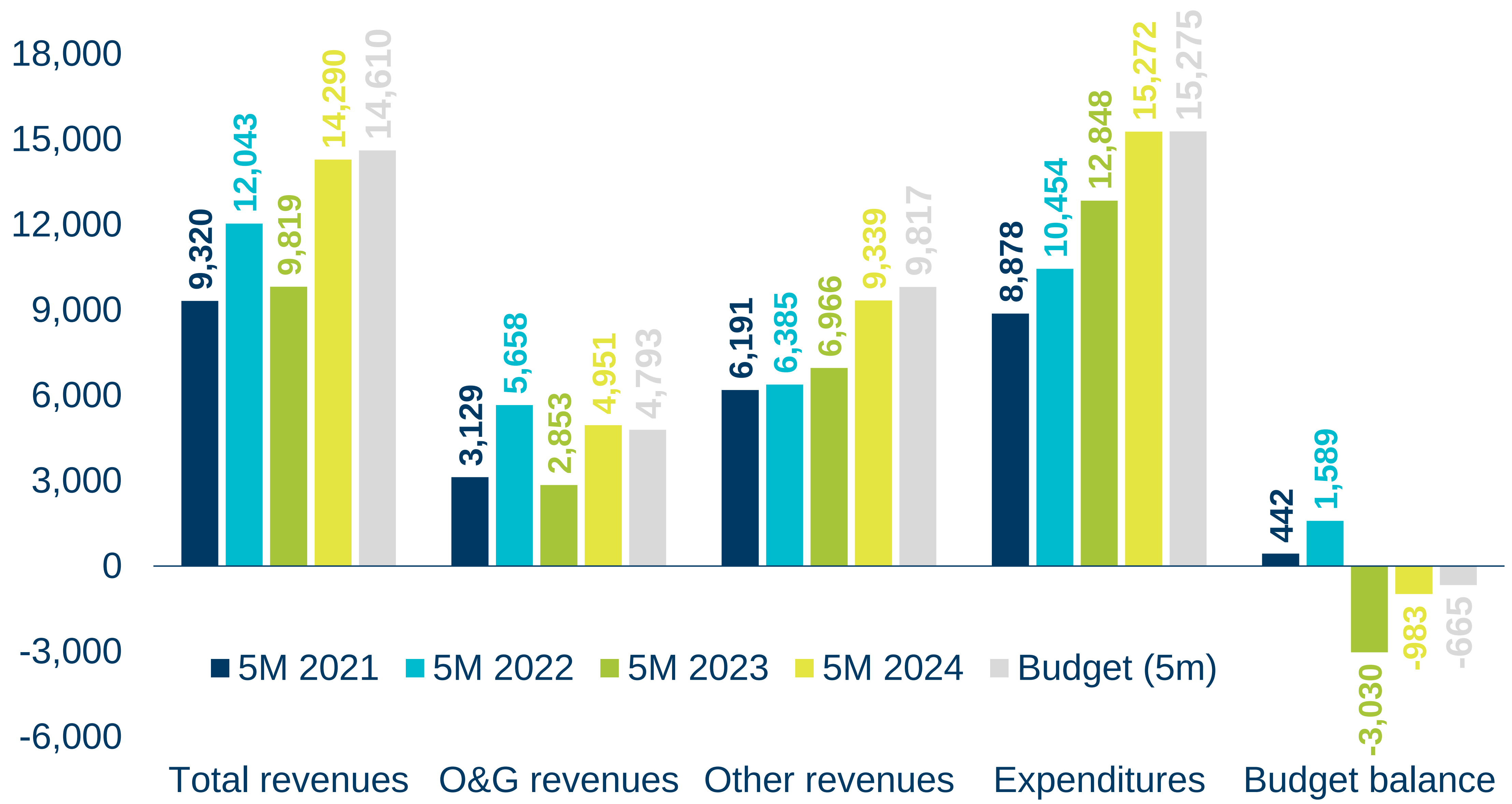
- In January-May 2024, Russia's federal budget deficit reached 1.0 trillion rubles, 62% of the iinitial full-year plan.
- O&G revenues were 74%, non-O&G revenues 34%, and expenditures 19% higher vs. January-May 2023.
- It is unlikely that Russia will face any serious fiscal constraints that would affect planned 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

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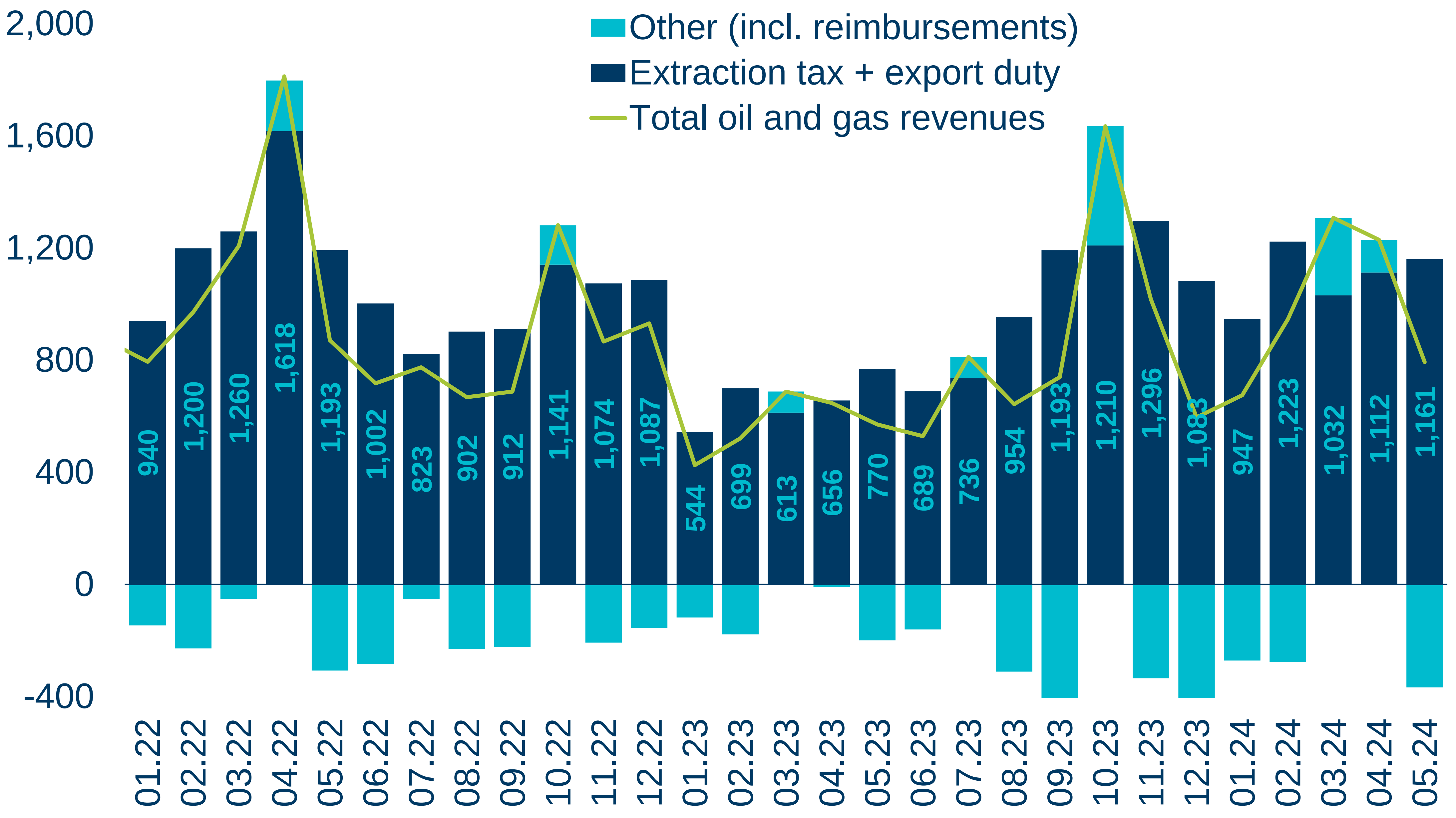
Russia’s oil and gas revenues grew in February-May.

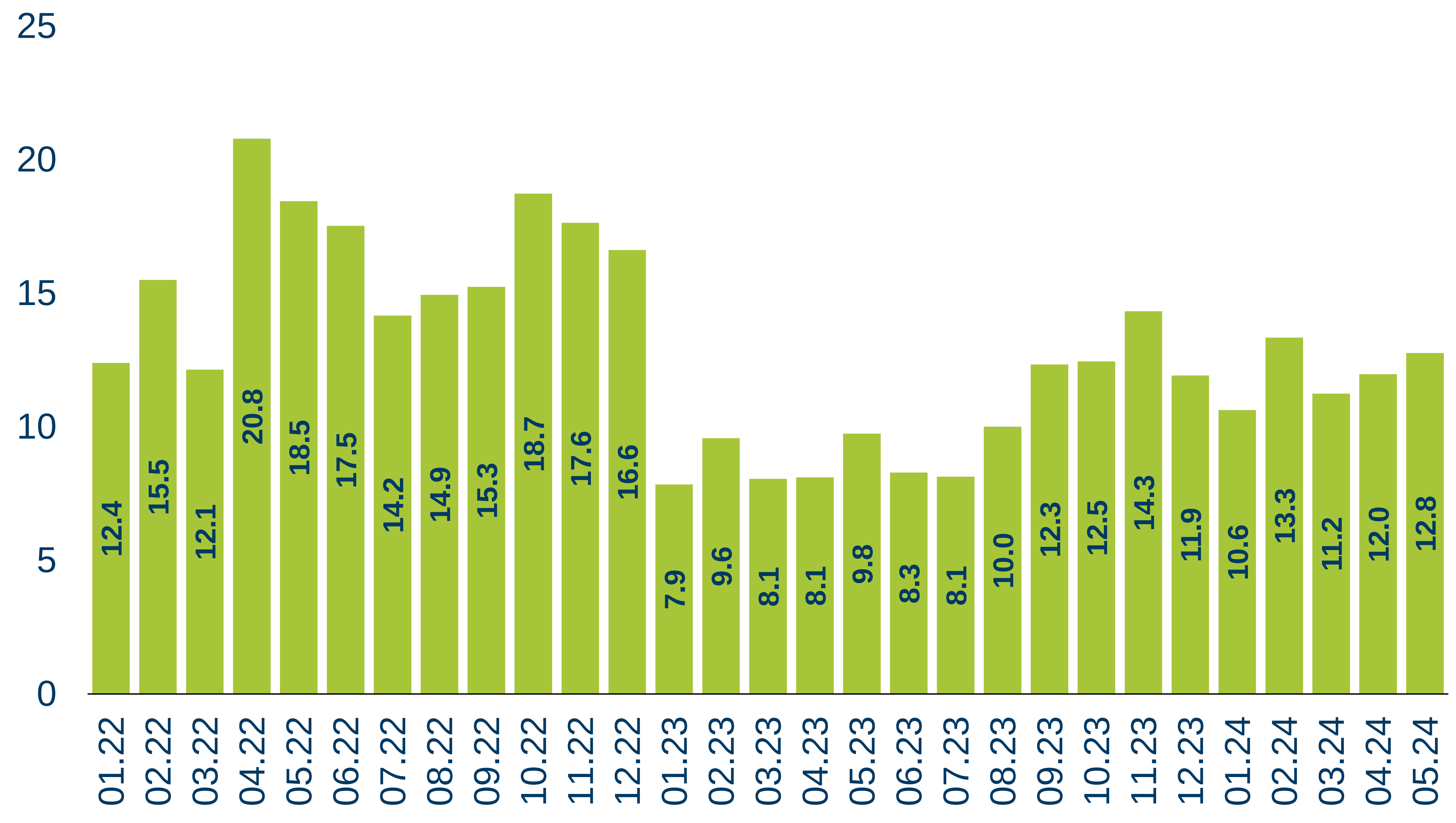
- O&G revenues rebounded in February-May 2024 and have returned to pre-price cap and embargo levels.
- While the weaker ruble has provided support, revenues also rose in dollar terms due to higher oil prices.
- With export prices at current levels, it is extremely unlikely that the Russian budget will come under pressure.

Federal oil and gas revenues, in ruble billion



Source: Ministry of Finance, KSE Institute

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

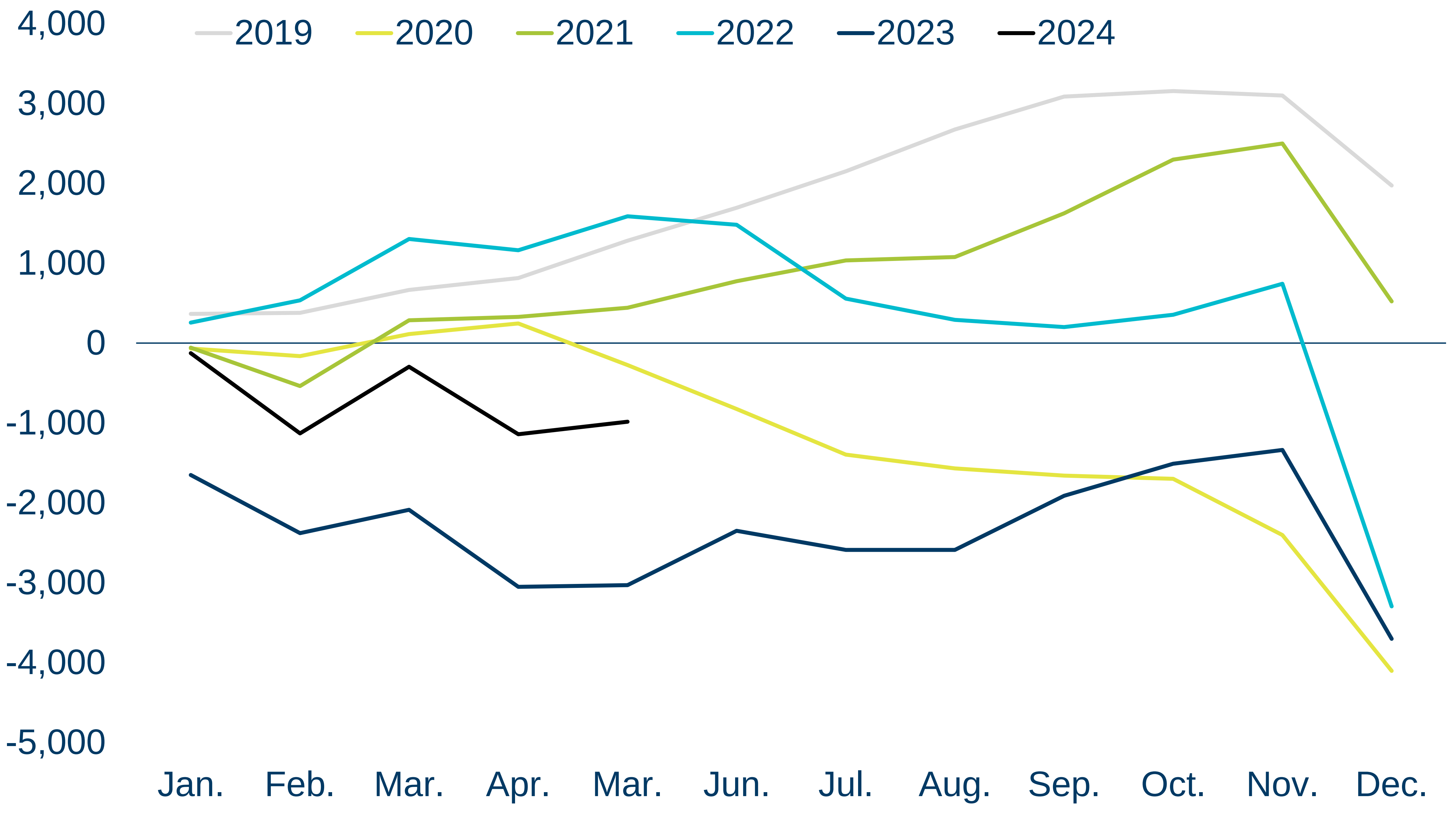


Source: International Monetary Fund, Ministry of Finance, KSE Institute
*includes extraction tax and export duty; calculated with monthly average exchange rate

Contained budget deficit means financing is not a challenge.

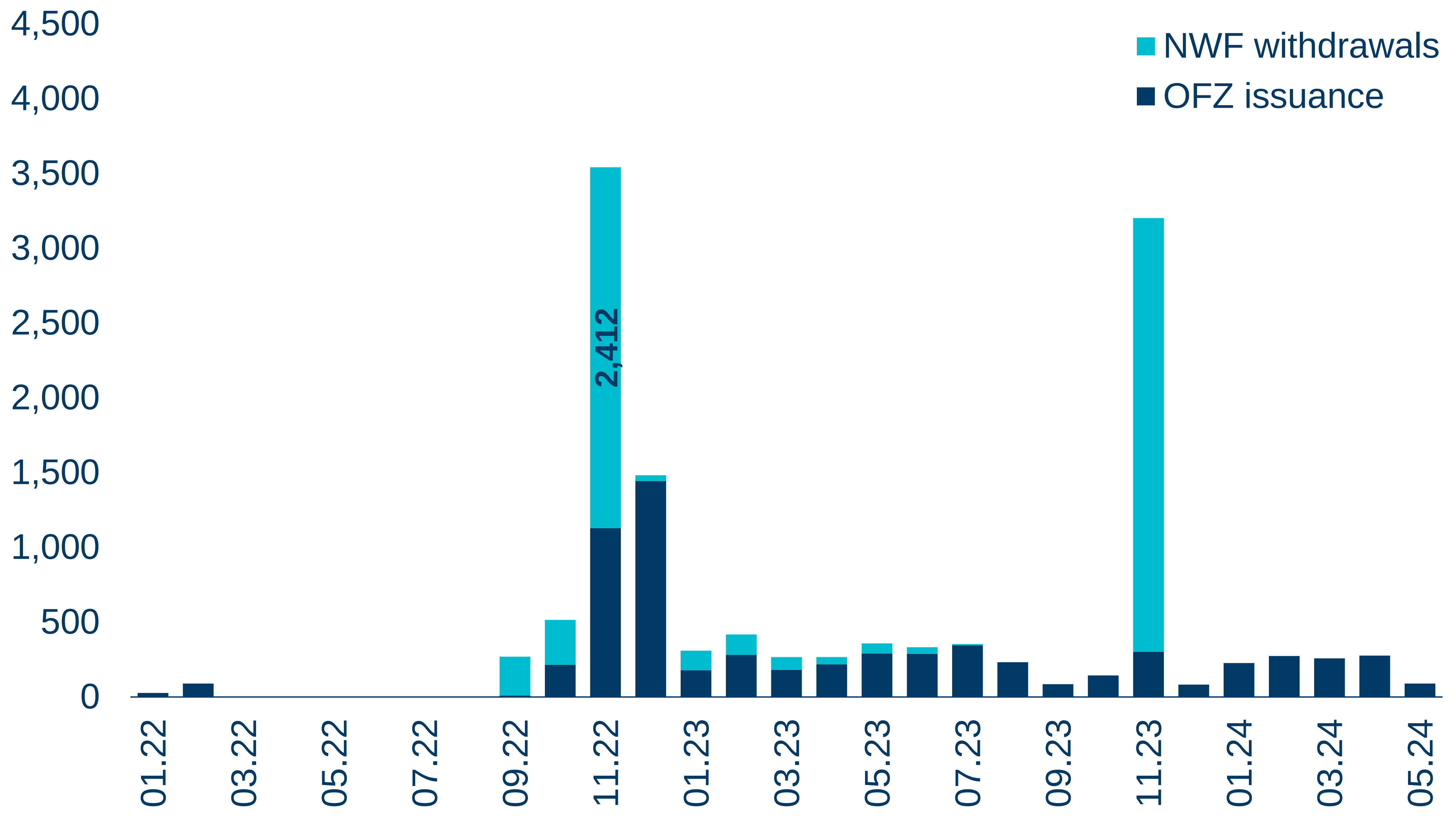
- The January-May 2024 deficit is 68% smaller compared to 2023, albeit expenditures are up sharply due to the war.
- Due to the improved fiscal situation, Russia has been able to finance the budget via moderate domestic debt issuance.
- Unless energy sanctions enforcement is stepped up, Russia will likely 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

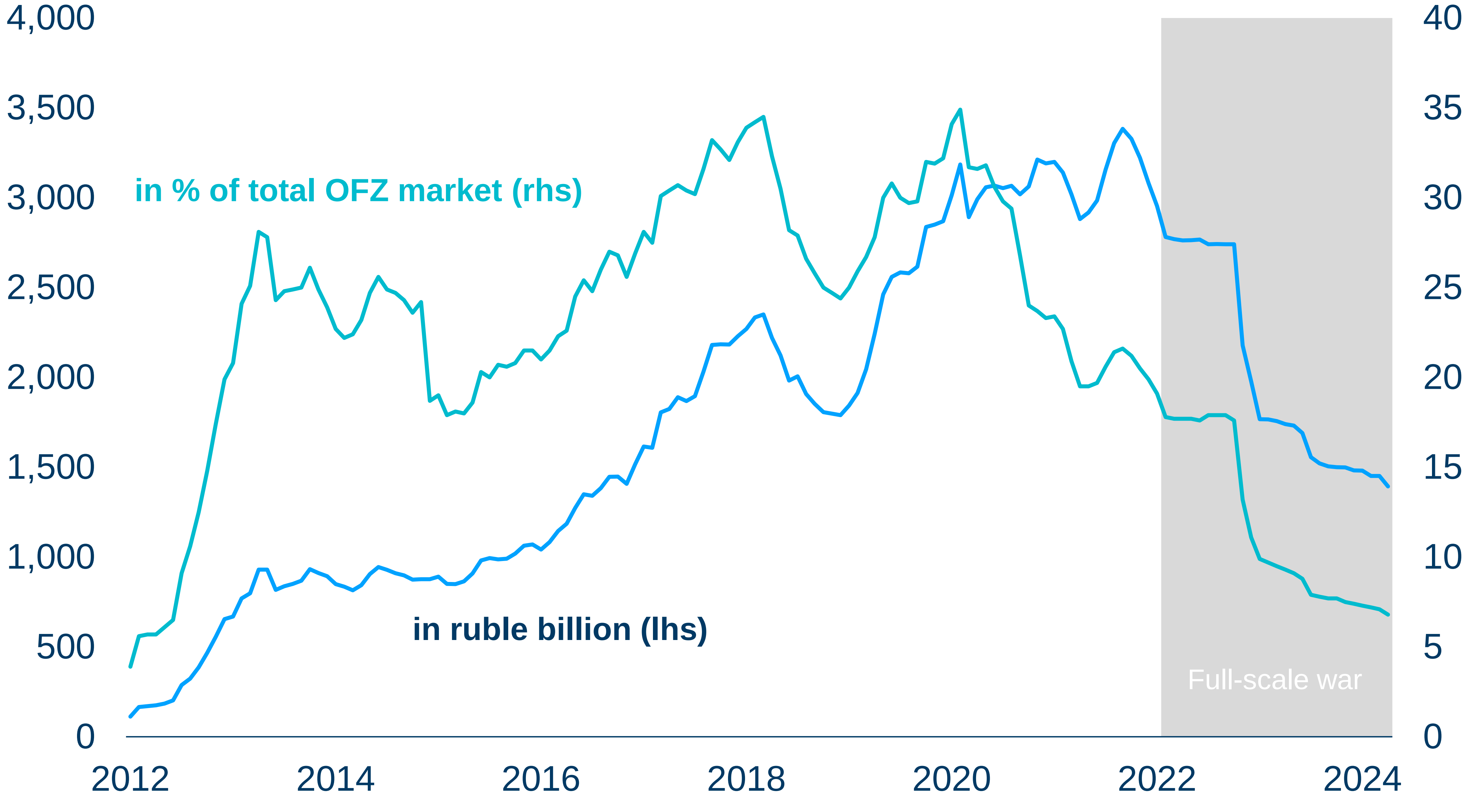


Source: Ministry of Finance, KSE Institute

Domestic banks are the only remaining buyers for OFZs.

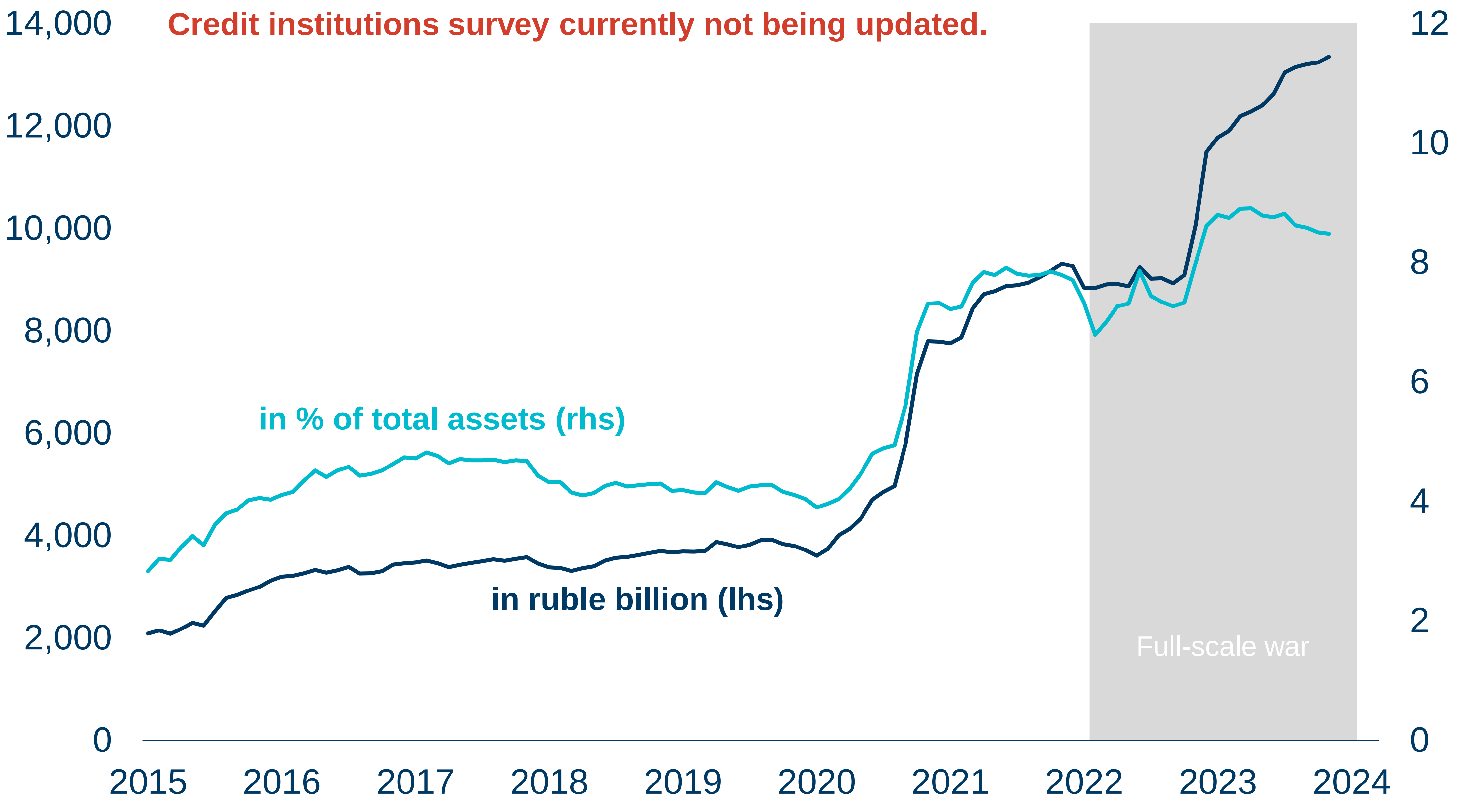
- Foreigners have largely disengaged from the Russian sovereign debt market since the start of the war.
- Non-resident holdings have dropped 1.35 trillion rubles (or 49%) since October 2022 as bonds matured.
- Credit institutions’ holdings of OFZs, on the other hand, have risen significantly over the same period.

Non-resident OFZ holdings



Source: Bank of Russia, KSE Institute

Credit institutions OFZ holdings



Source: Bank of Russia, KSE Institute

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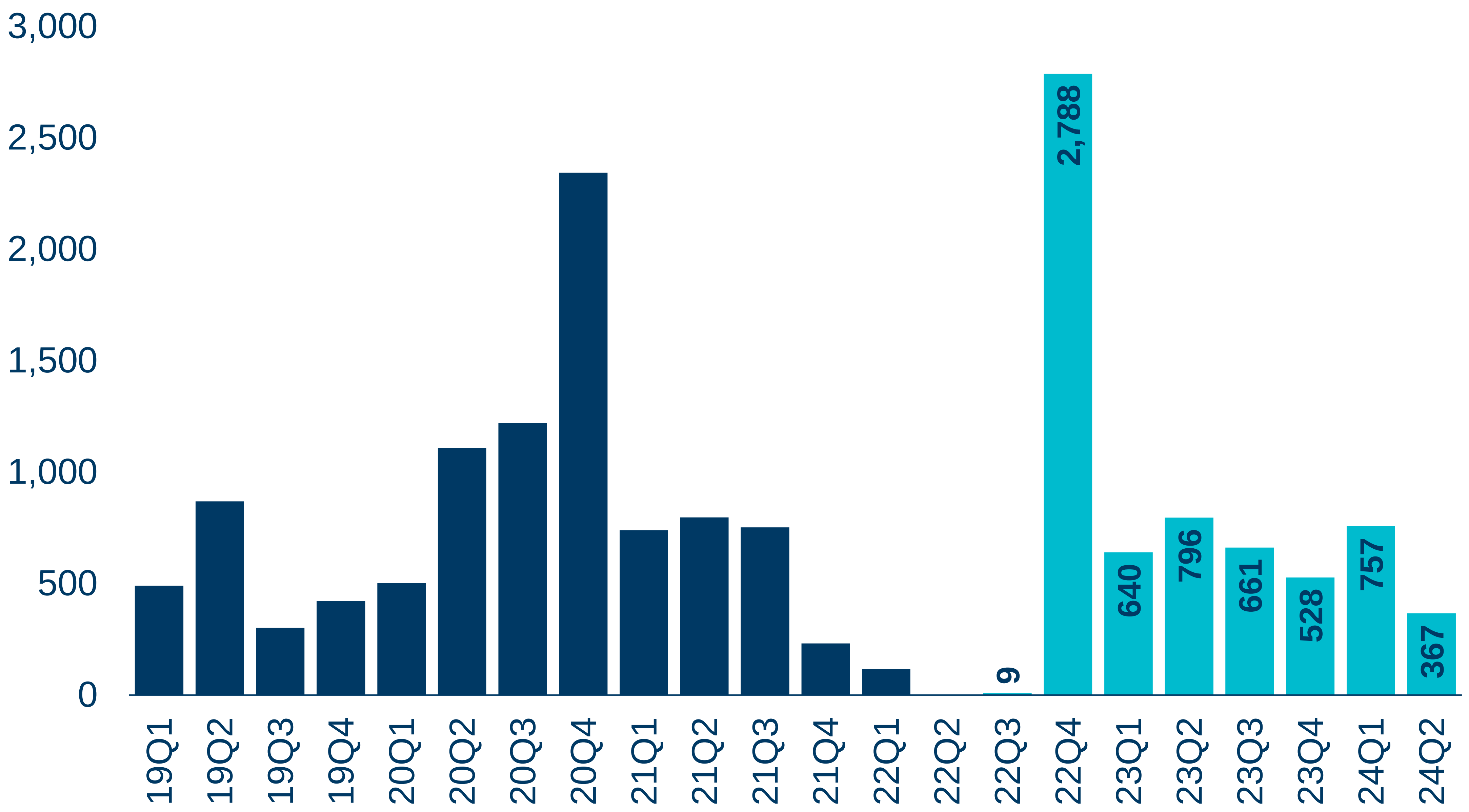
Domestic borrowing remains stable due to limited fiscal pressure.

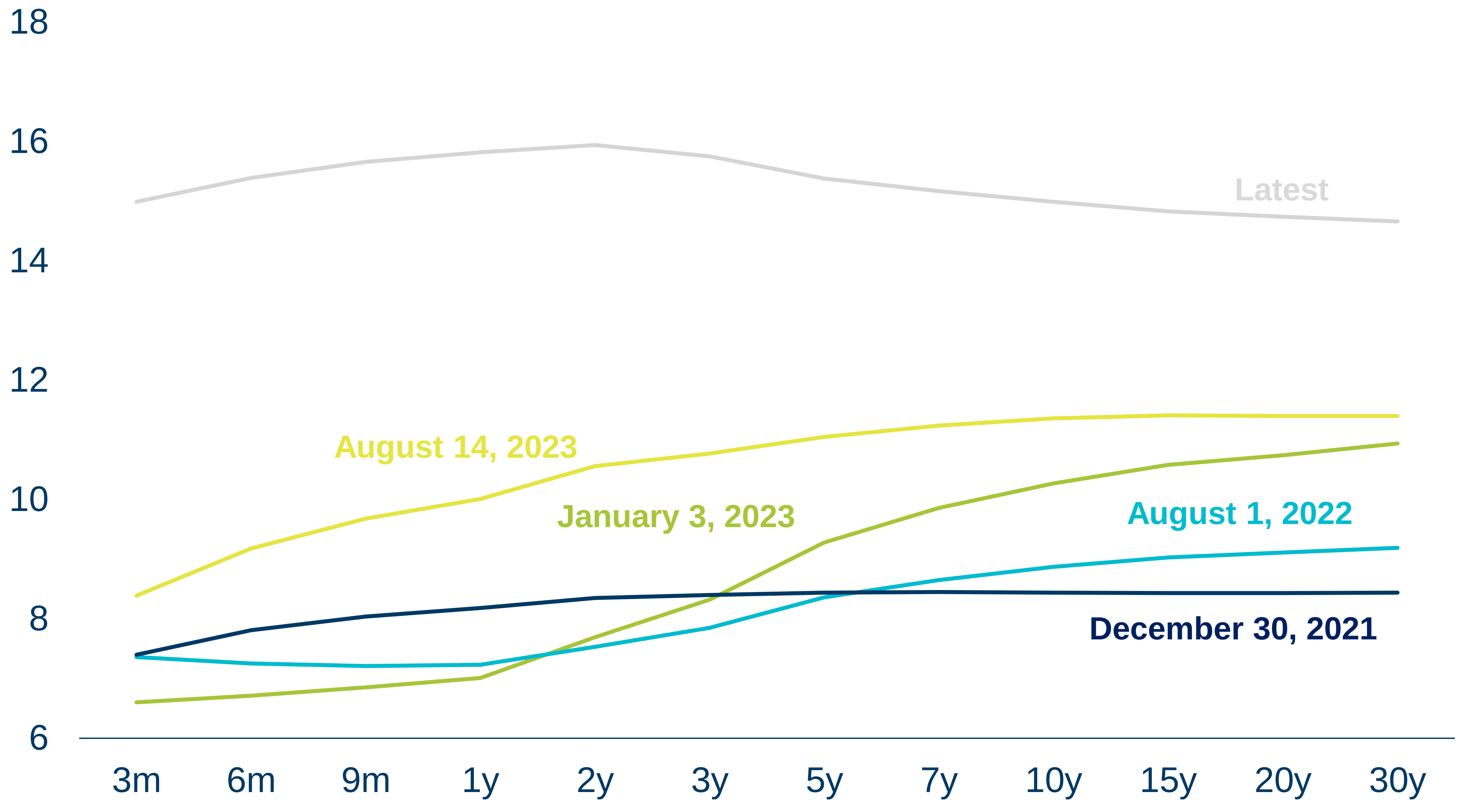
- Borrowing in the domestic market has been broadly stable in the last 1.5 years.
- The OFZ yield curve reflects the recent CBR rate hikes (of cumulative 850bps).
- Funding costs are, thus, higher but limited in their impact due to the small budget deficit.

New domestic debt (OFZ) issuance, in ruble billion



Source: Ministry of Finance, KSE Institute

OFZ yield curves, in %



Source: Bank of Russia, KSE Institute

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

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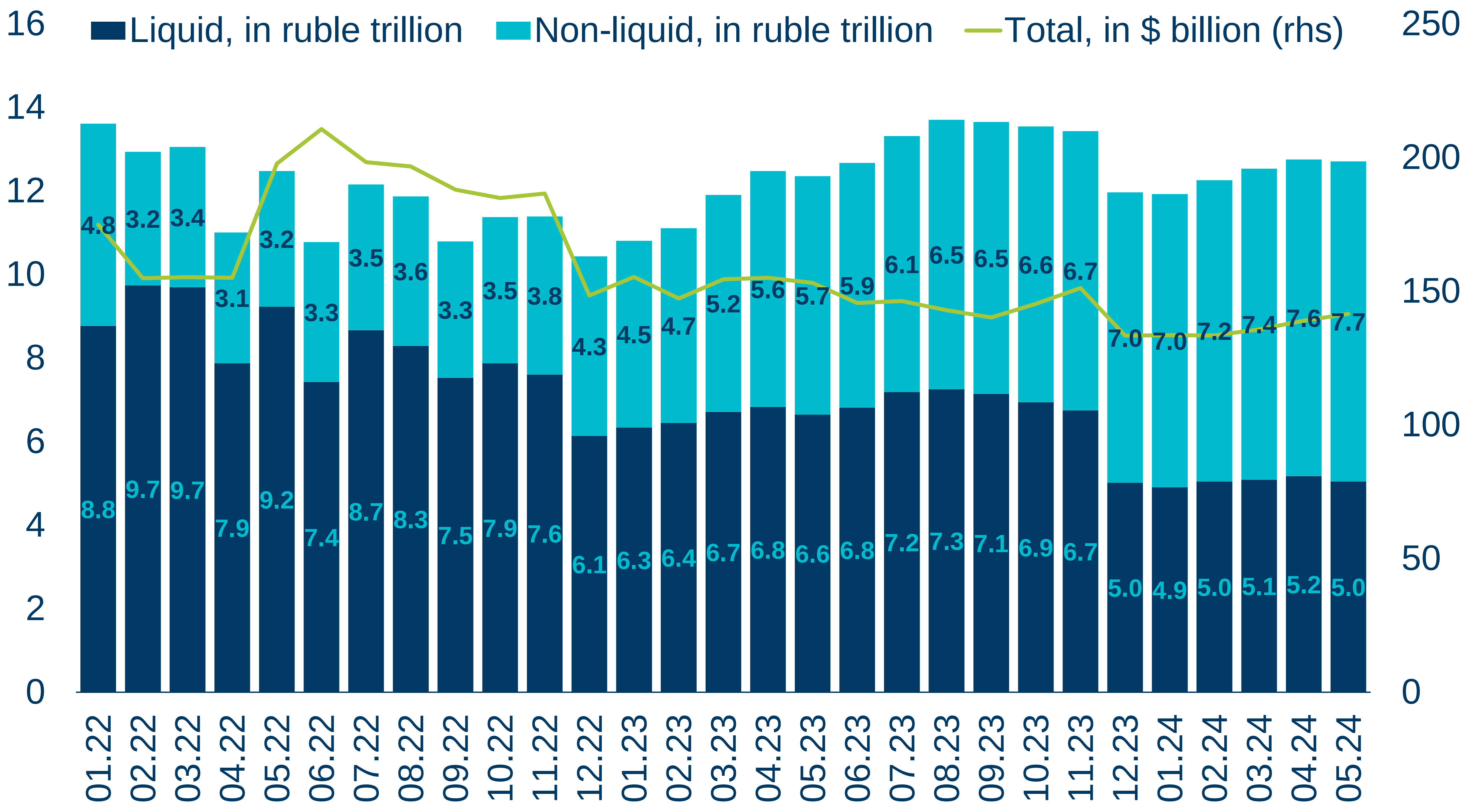
Half of the NWF's liquid assets have been used up.

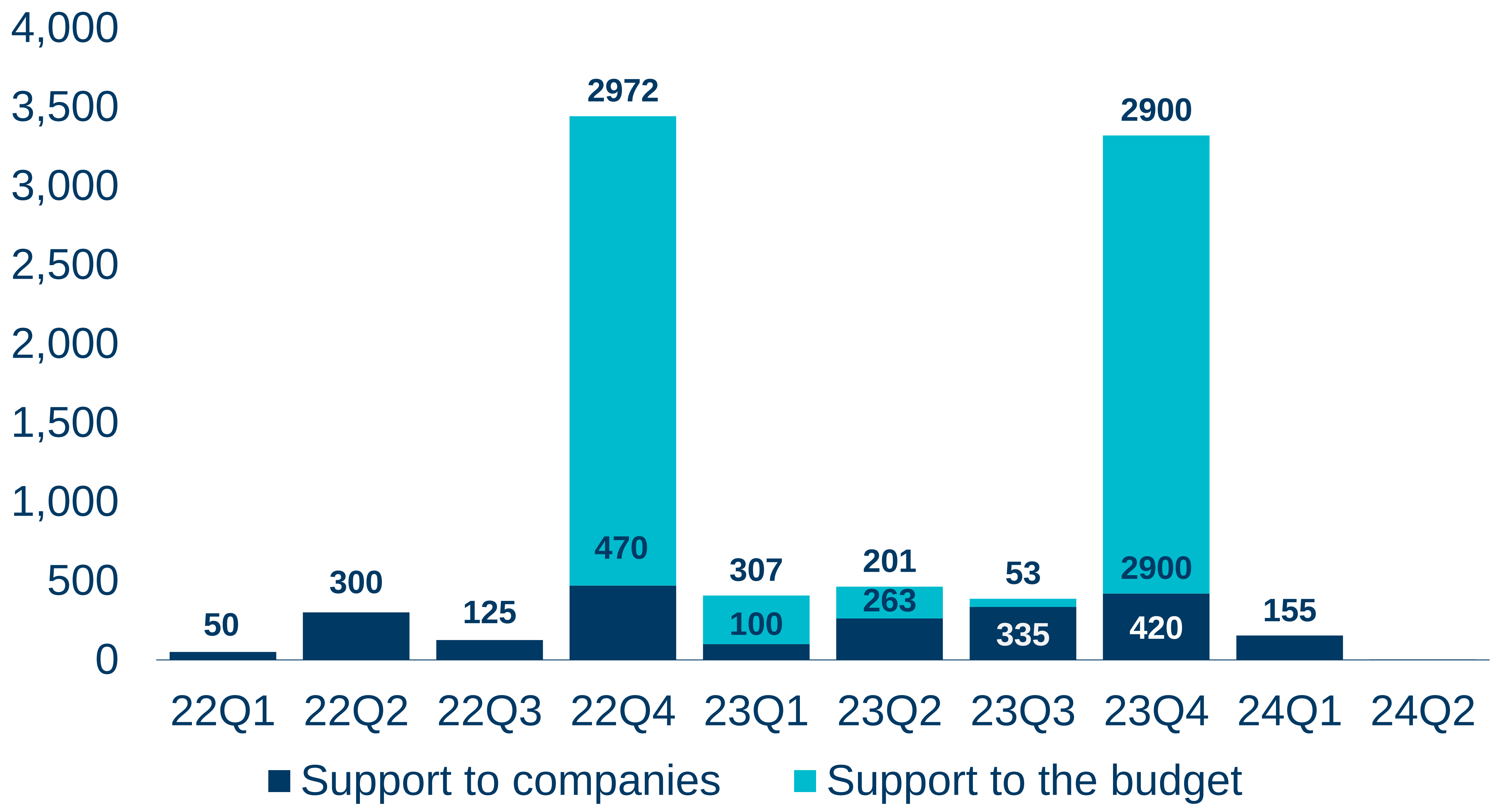
- Total assets of the National Welfare Fund stood at 12.7 trillion rubles ($142 billion, 7.1% of GDP) in May 2024.
- The liquid portion now only accounts for 40% of the total as funds were withdrawn for budgetary support in December.
- Since the start of the full-scale invasion, Russia has, thus, used up almost half (~4.6 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

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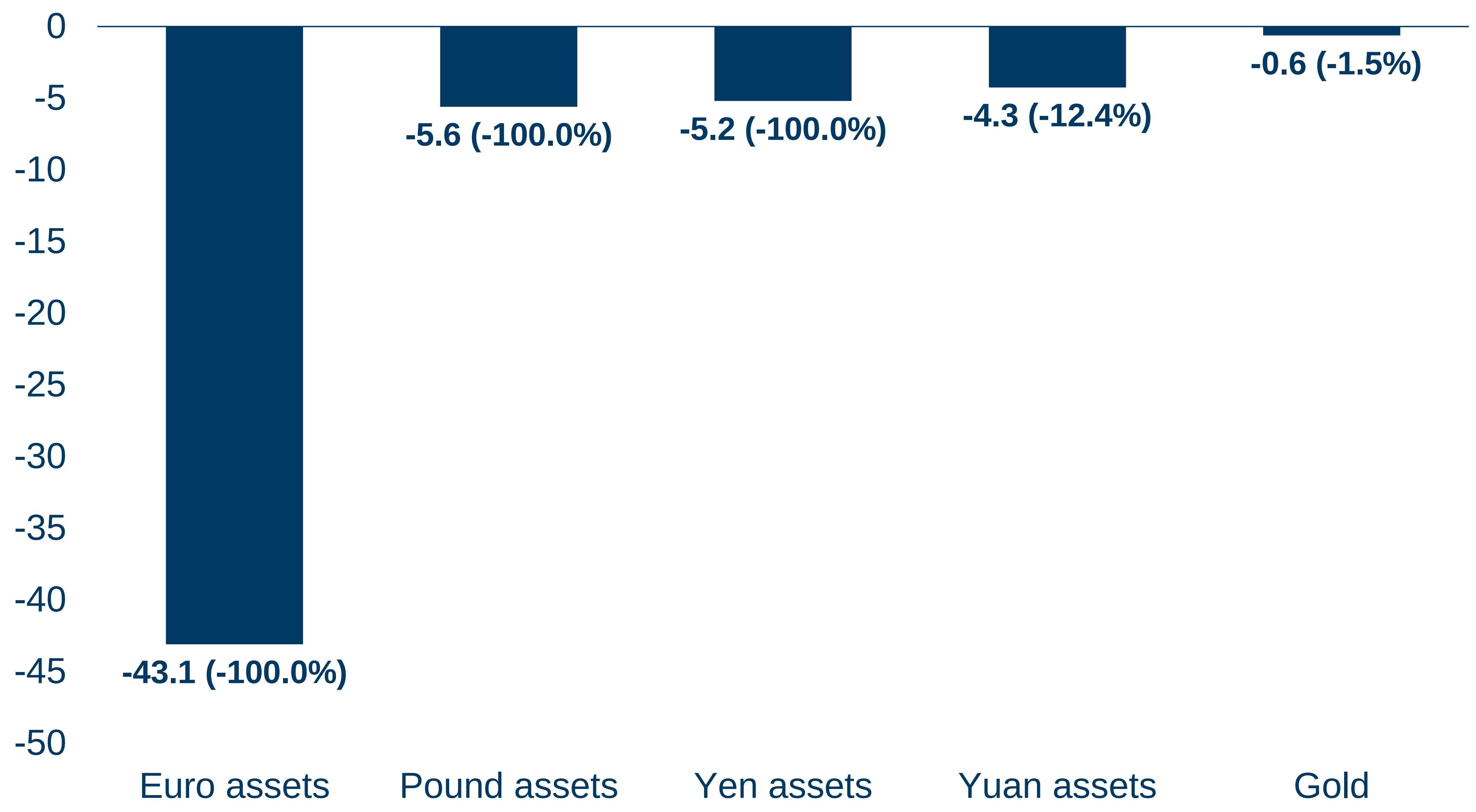
Headline NWF numbers conceal that hard currency assets are gone.

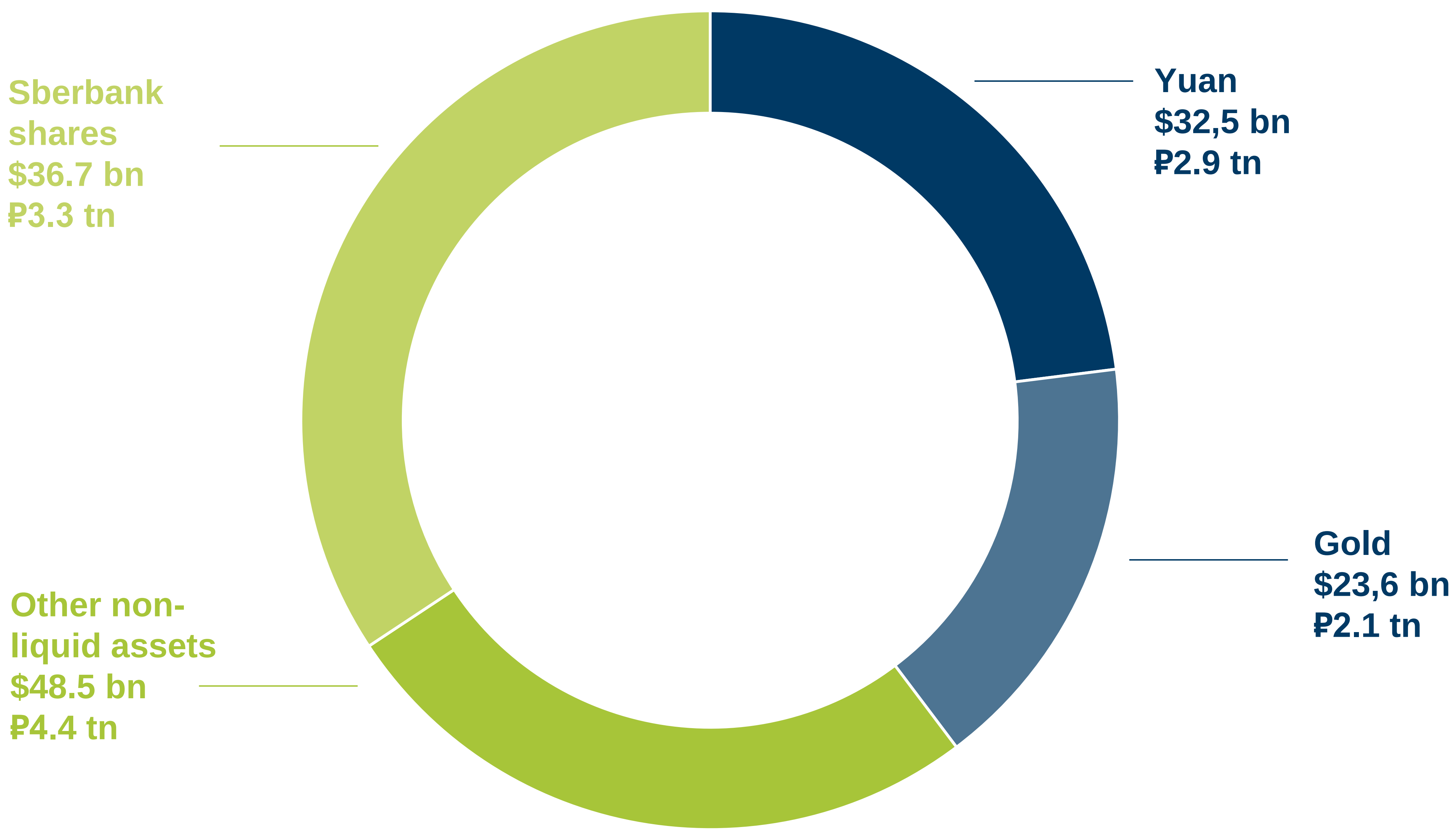
- Russia has depleted all hard-currency holdings of the NWF, with euro assets falling to zero in December 2023.
- Only yuan-denominated assets and gold remain in the liquid portion, totaling 5.0 trillion rubles (or $56 billion).
- As these are more difficult to use, at least at scale, budgetary funding via the NWF will become more challenging.

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



Source: Ministry of Finance, KSE Institute

Composition of NWF assets as of May 1, 2024*



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

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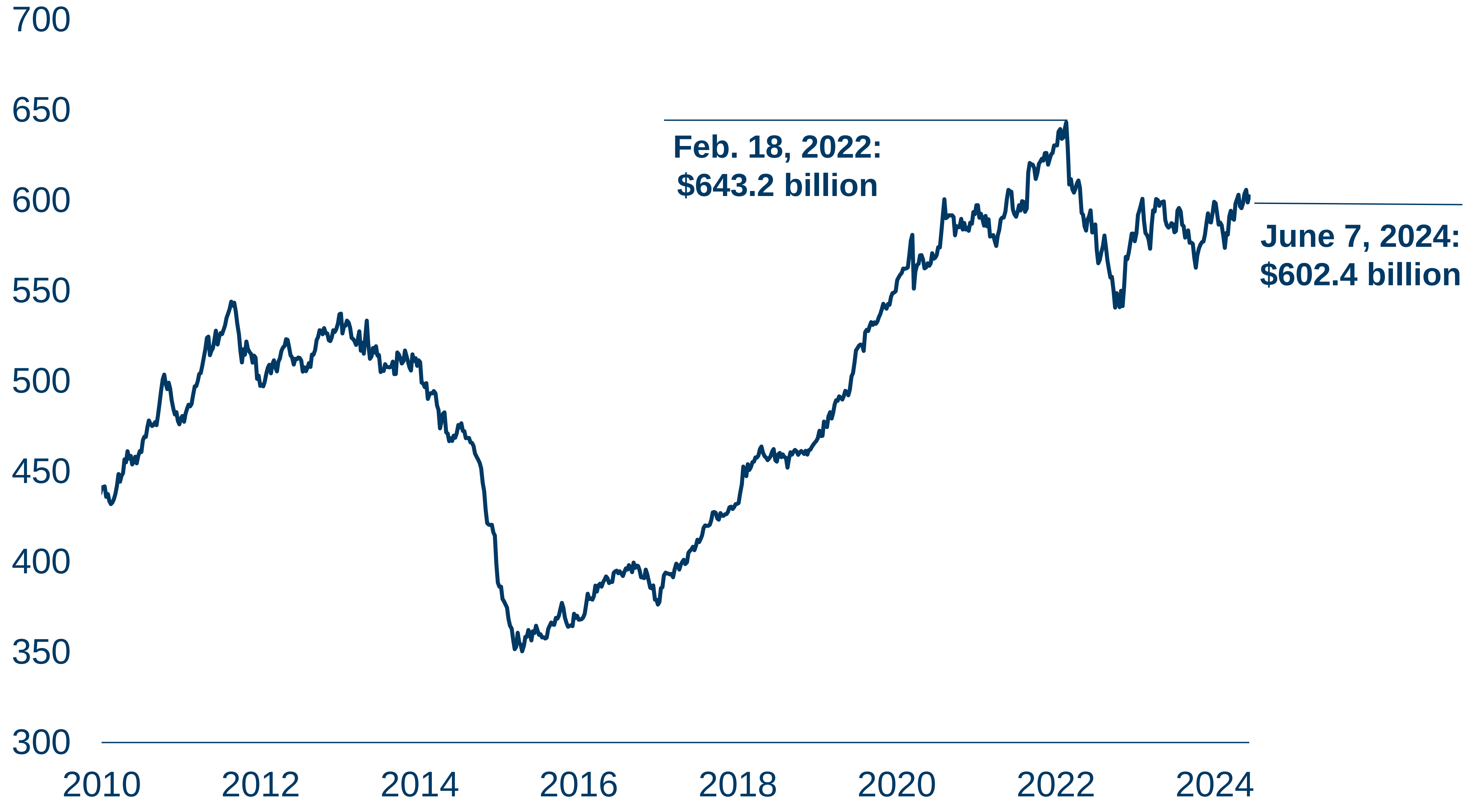
A substantial share of international reserves remain immobilized.

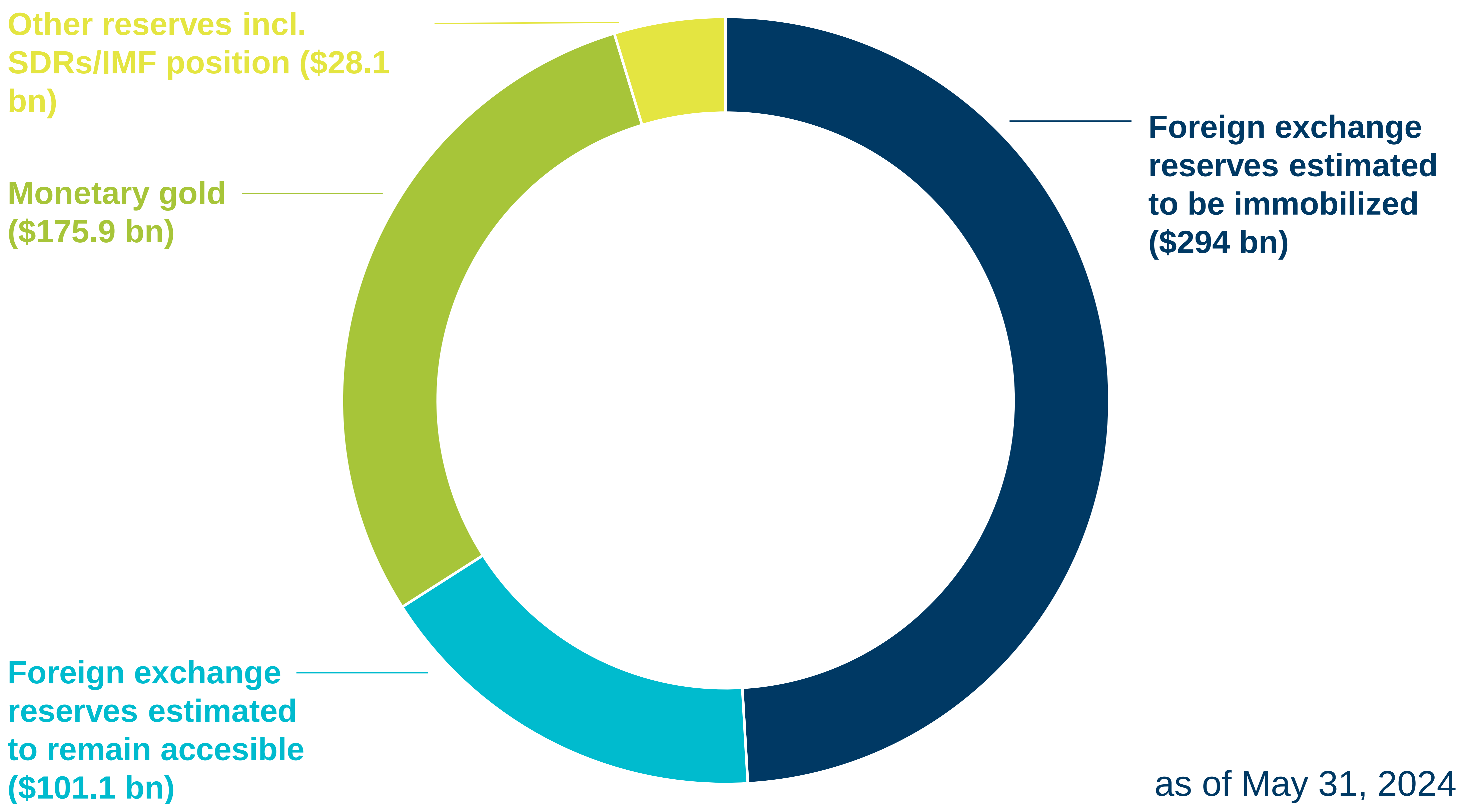
- Before the invasion, Russia held $643 billion in international reserves, part of what is described as *"Fortress Russia".*
- We estimate that around $294 billion are currently immobilized due to international sanctions on CBR and NWF.
- This leaves Russia with access to $176 billion in monetary gold and roughly $101 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

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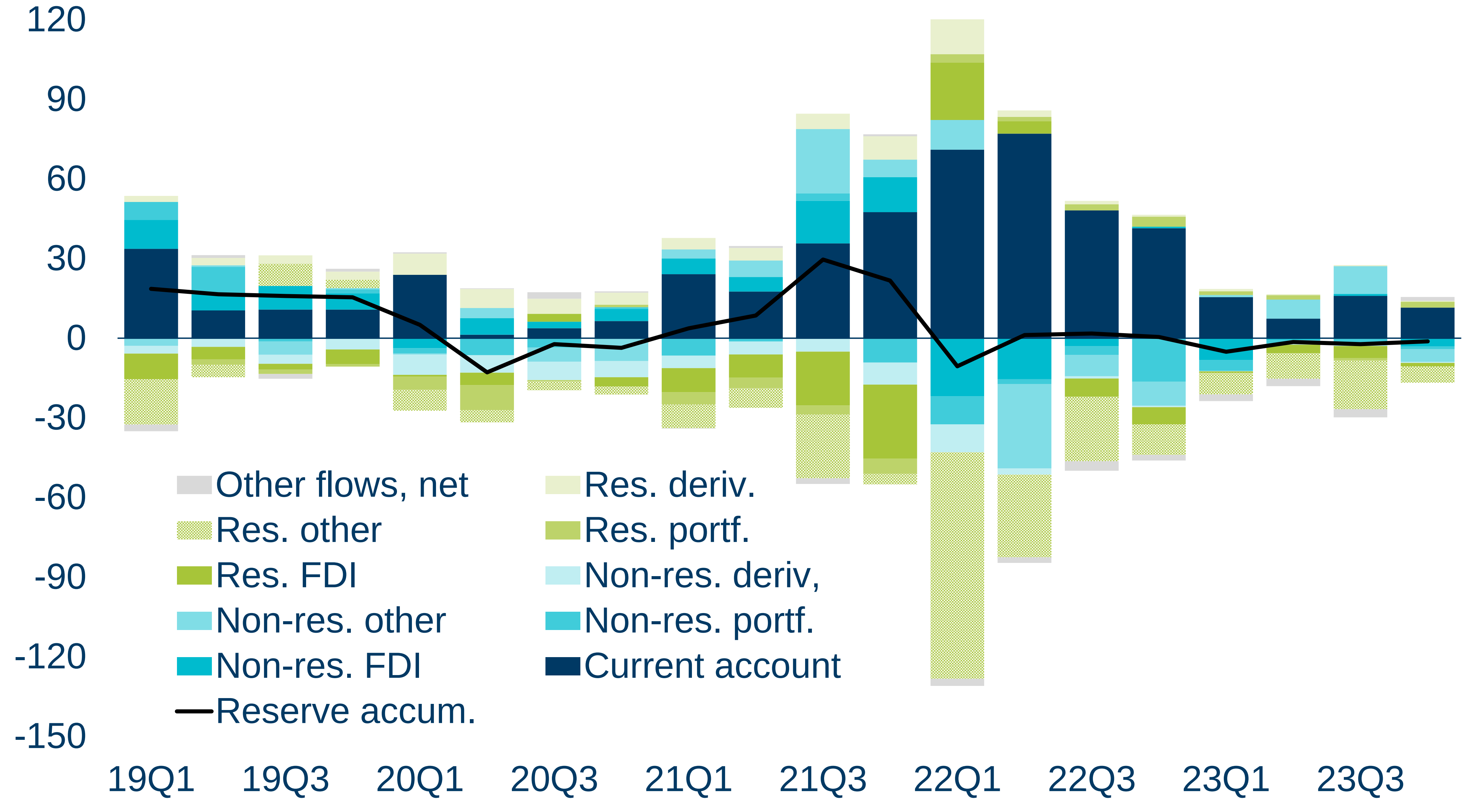
Significant accumulation of new foreign assets in 2022-23.

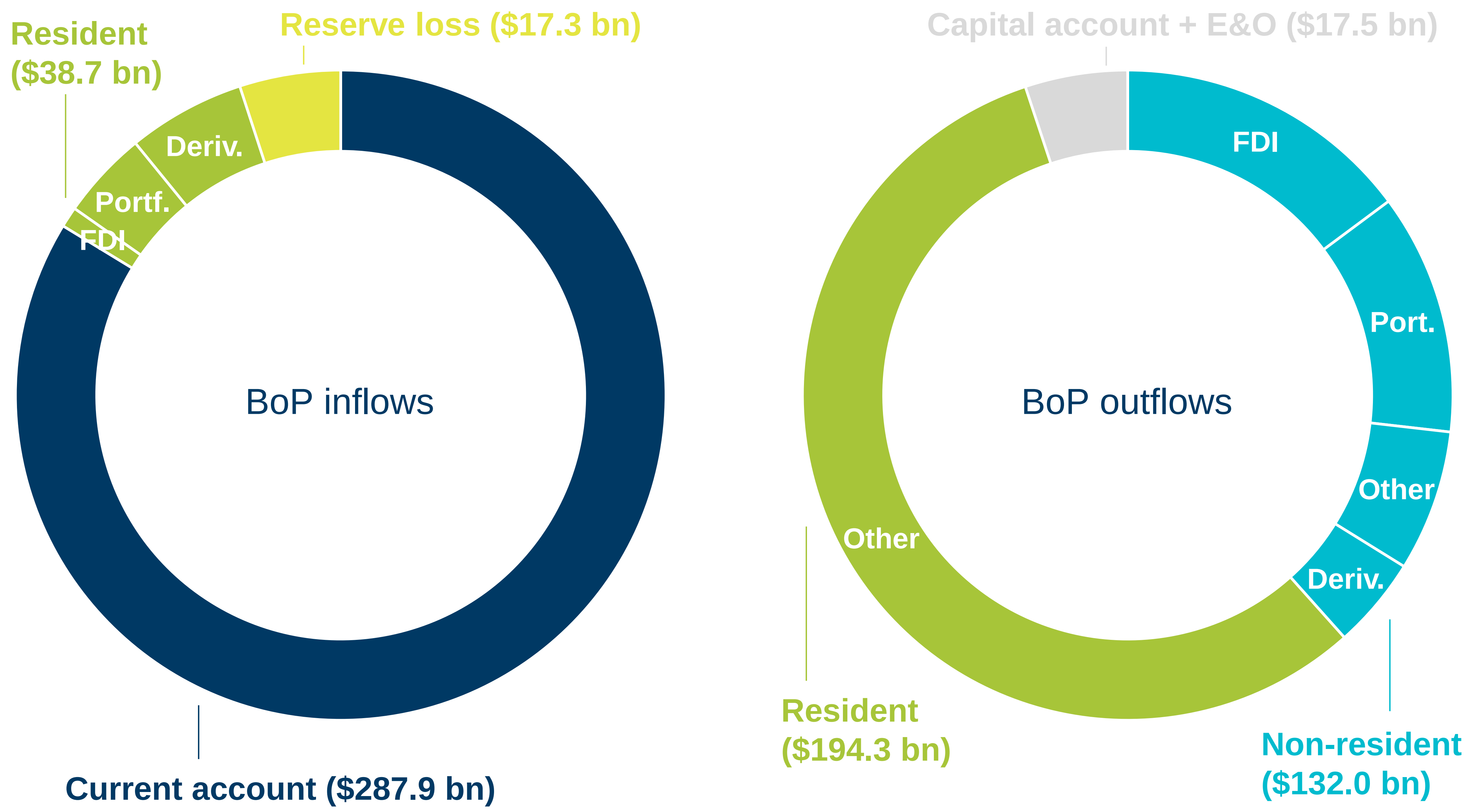
- It is time to focus attention on foreign assets that Russia has been able to accumulate due to favorable BoP dynamics.
- Non-resident capital outflows partially ate up the large current account surplus and resident inflows in Q1 2022-Q4 2023.
- But Russian banks and corporates were able to acquire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

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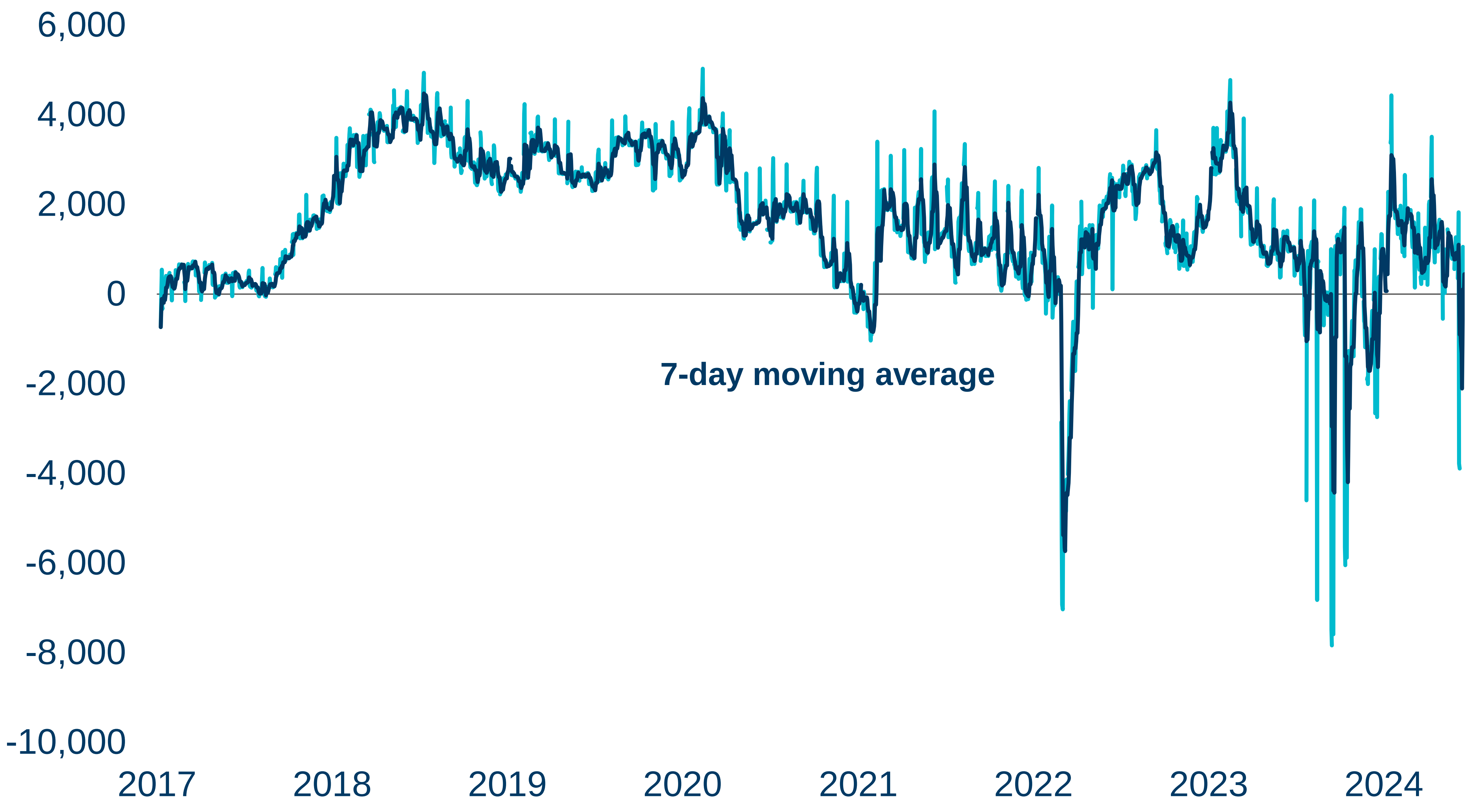
CBR rate hikes have impacted banking system liquidity in recent months.

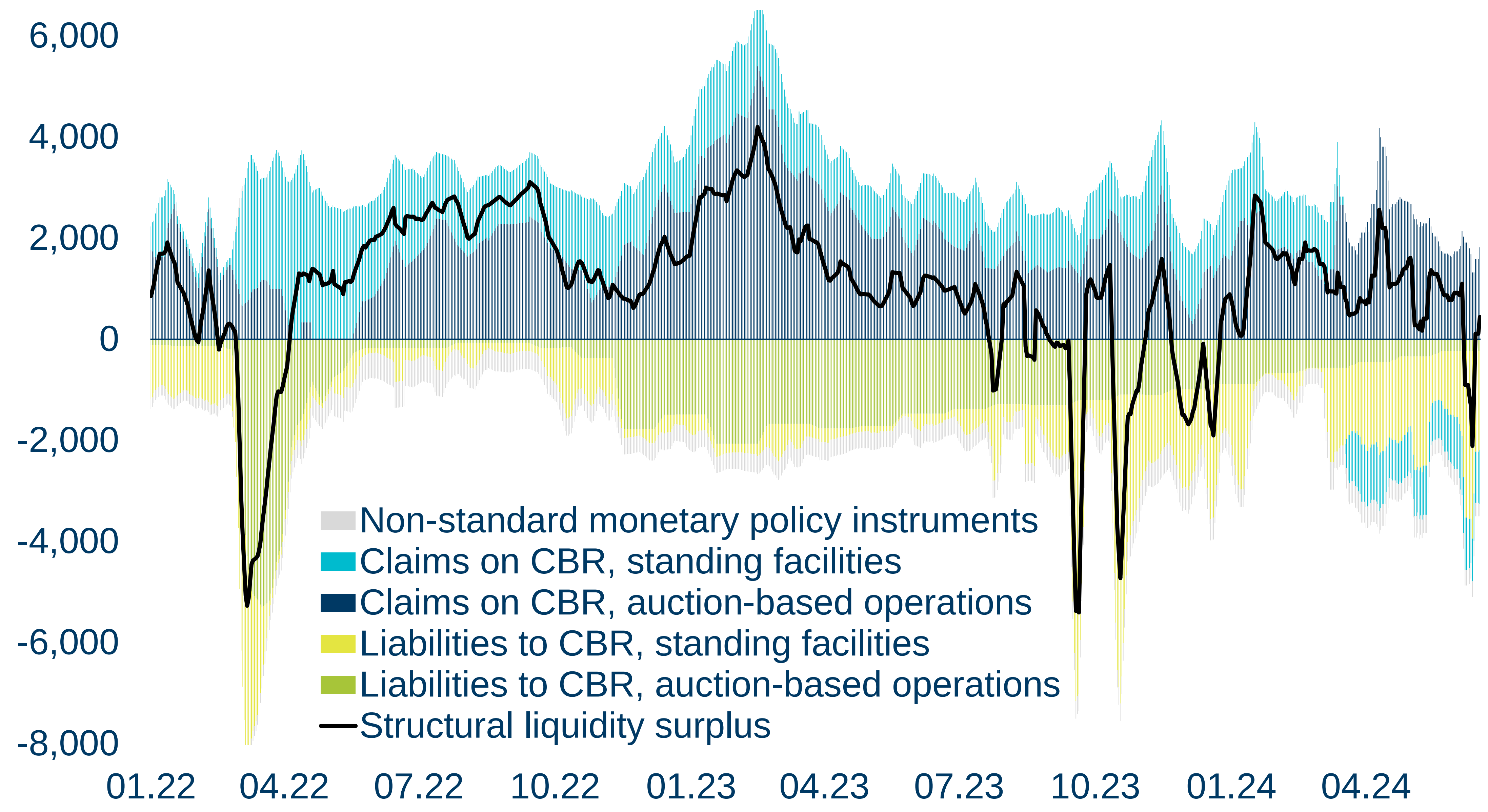
- Liquidity conditions recovered quickly after the initial shock from the full-scale war and imposition of sanctions.
- A closer look at the composition of the structural liquidity surplus points to some stress in the interbank market.
- The data clearly shows the effects of the CBR's monetary tightening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

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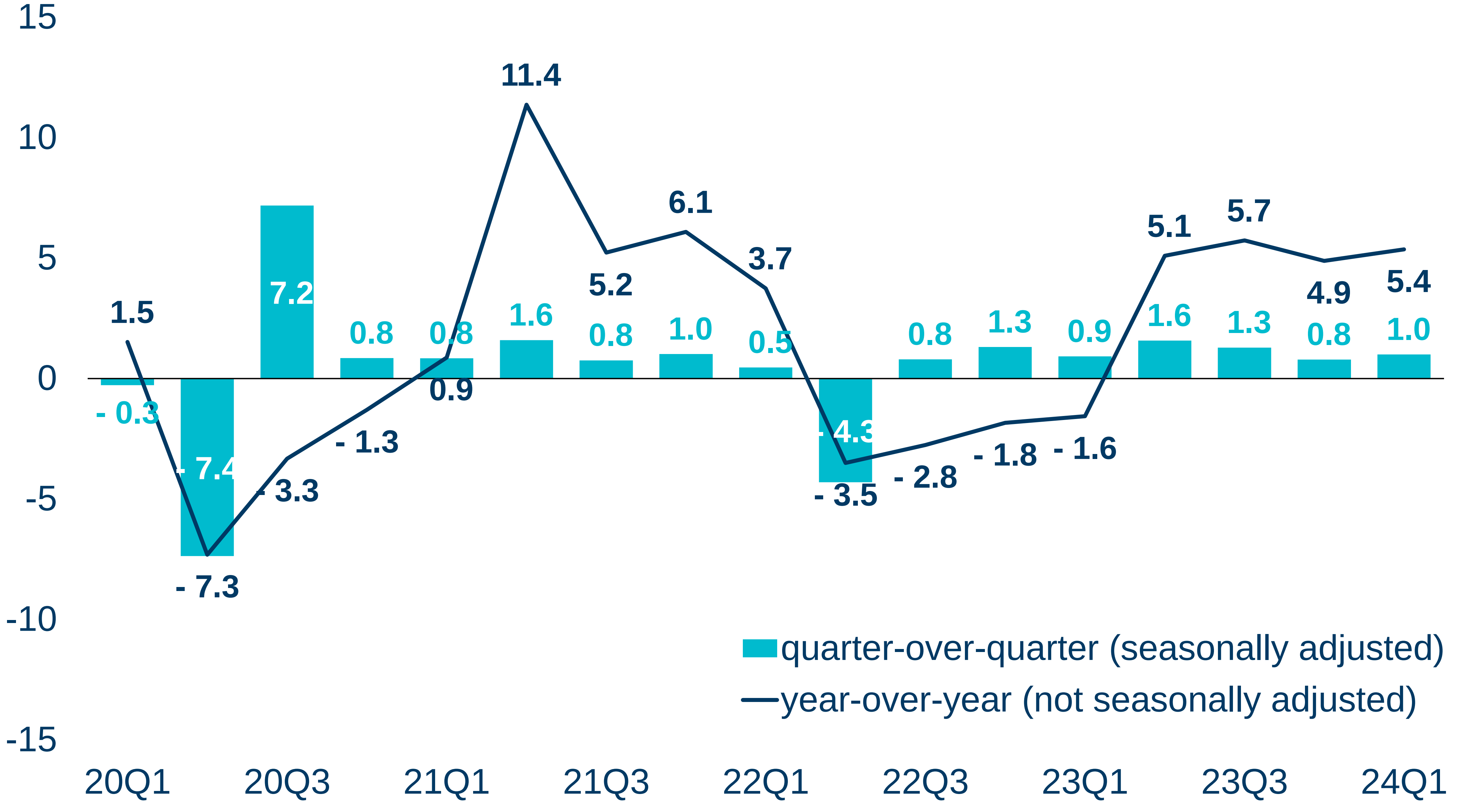
Russian outlook revised up as war spending keeps boosting the economy.

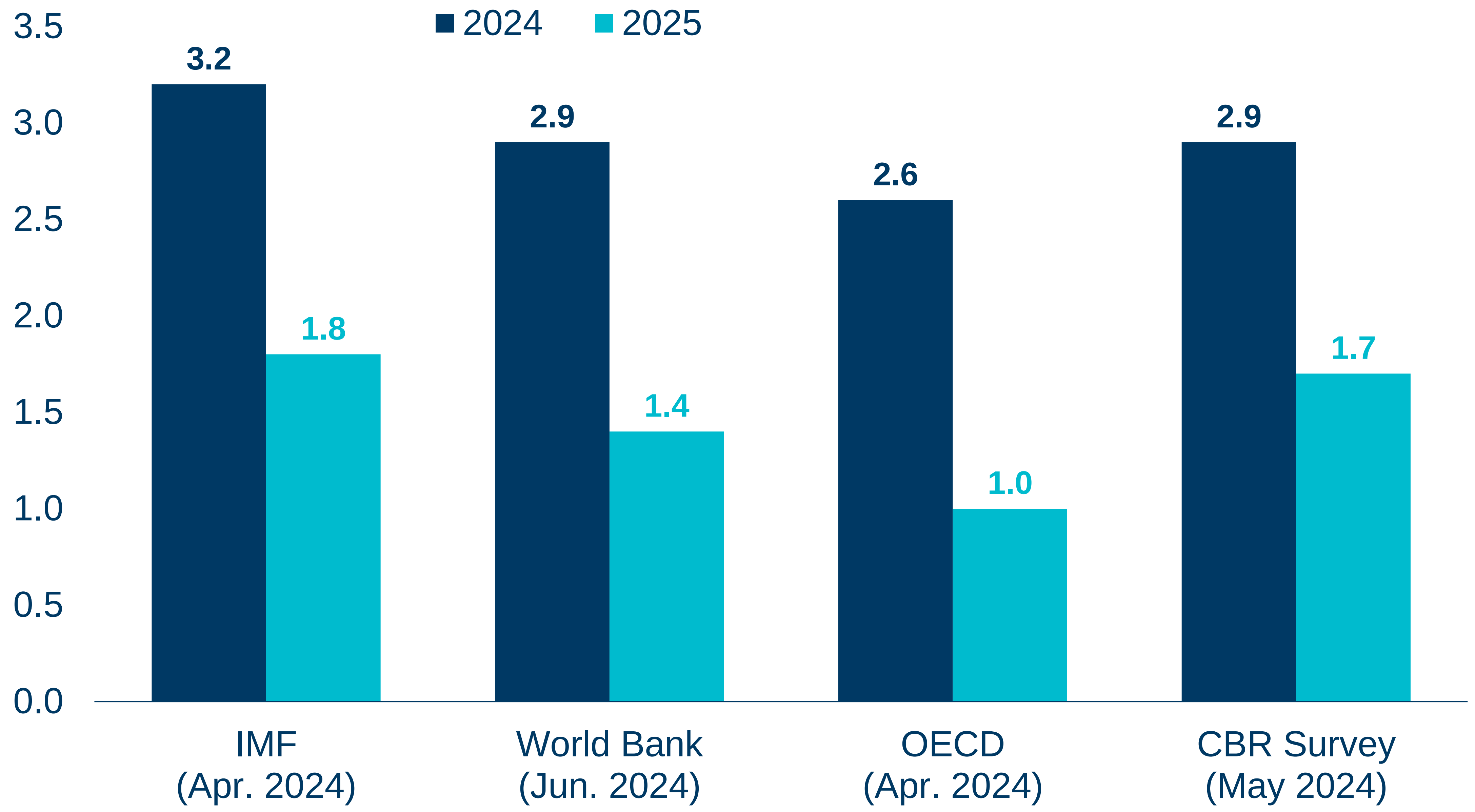
- Rosstat revised 2022 real GDP growth up to -1.2% (from -2.1%) and reported 2023 growth at 3.6%.
- For Q1 2024, the statistics agency estimates year-over-year growth of 5.4% (vs. 4.9% in Q4 2023)
- Key factors: strong fiscal stimulus from high defense spending and robust private sector credit growth.

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

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