FRF THINK TANK

BRIEF

RECORD DEFICITS, INFLATION, RECESSION FEARS - A MOMENT OF RECKONING?

Russian Economy and Sanctions Brief
May 2025

By Vladimir Milov

Free Russia Foundation
2025

Table of contents

Summary

April and early May 2025 turned to be a "moment of reckoning" of sorts for the Russian economy - the situation has notably (and predictably) deteriorated, with many negative trends coming together at once:

> **Significant increase of the federal budget deficit,** which currently exceeds the remaining cash reserves in the National Wealth Fund;
>
> **Rapid slowdown of the economy,** with talks of possible recession intensifying;
>
> **Inflation remaining high,** with no prospects for significant easing of monetary policies by the Central Bank in sight;
>
> **Dashing hopes for rapid lifting of the U.S. sanctions** by the Trump administration.

Explosive budget deficit is arguably the most consequential of these developments as far as Russia's ability to further wage war against Ukraine and Europe is concerned.

Budget under pressure

April turned to be bad news for the Russian federal budget on several fronts. On one hand, falling international oil prices have undermined Russia's oil & gas revenues, which fell by 12% year-on-year; price of Urals export crude oil was $53-54 per barrel on average in April[1].

But oil price decline wasn't the only problem: at the same time, federal spending, mainly driven by war, increased by 21% year-on-year, reaching nearly RUR 16 trillion from January to April (around $190 billion), an all-time high for the first four months of the year[2].

Table 1. Russia's federal budget balance in January-April, by year[3]

	2018	2019	2020	2021	2022	2023	2024	2025
Russia's federal budget January-April revenue, RUR trillion	5,5	6,4	7,0	7,5	10,0	7,8	11,7	12,3
Russia's federal budget January-April spending, RUR trillion	5,4	5,7	6,9	7,4	8,9	10,8	12,8	15,5
Russia's federal budget January-April surplus/deficit, RUR trillion (numbers may not add up due to rounding)	+0,2	+0,7	+0,1	+0,2	+1,2	-3,0	-1,1	-3,2

Federal budget deficit after the first quarter of 2025 equals nearly all the remaining cash in the liquidity part of the National Wealth Fund (RUR 3,3 trillion, or $40,4 billion[4]). But what is worse, due to plunge in oil prices and growing spending, the Russian Government was forced to introduce amendments to the federal budget law for 2025 with serious upward revision of budget deficit - to RUR 3,79 trillion, as opposed to RUR 1,17 trillion signed by Putin just in December 2024[5].

The new revised deficit figure is 15% higher than the remaining cash in the National Wealth Fund. (We have already explained earlier that the remaining non-liquidity part of the $145bn worth National Wealth Fund consists of investments in securities of the state-affiliated companies and other assets that are not easily recoverable, which is why these funds can't immediately be used to finance the budget deficit[6].)

Where will Putin find the money to continue financing the war effort on the background of these developments? This issue is discussed further in this brief.

However, widening budget deficits threaten to derail the Central Bank's efforts to contain inflation. Previously, the Russian Central Bank has stressed multiple times that it guarantees to bring down inflation over time only if the approved budget parameters - including modest federal budget deficit of RUR 1,17 trillion - are respected[7]. As can be seen, this is very far from being the case.

In the recently published minutes of the April 25th Central Bank Board meeting on key interest rate, the Bank outlined a "widening budget deficit" as one of the key pro-inflationary factors[8].

From stagnation to recession: economy slowing down more rapidly than expected

In our previous reports, we have noted that the Russian economy has been rapidly slowing down in January-February, leading to discussions about stagflation scenario materializing (near-zero growth accompanied by high inflation). However, March data seems to be significantly worse, stoking fears not just of stagflation, but of outright recession.

The government-linked Center for Macroeconomic Analysis and Short-Term Forecasting (known under Russian abbreviation CMAKP), founded by current Russian Defense Minister Andrey Belousov, speaks about civilian industries (not associated with military production) already "entering recession", contracting in March by 1,6% year-on-year[9]. Market analysts and Institute of Economic Forecasting of the Russian Academy of Sciences point out that the Russian economy has either contracted or shown minimal growth in Q1 2025 as compared to Q4 2024 - the first possible quarterly contraction since Q2 2022[10].

Russian Central Bank estimates Q1 2025 economic growth at 2%, a much more optimistic number, but still significantly lower than the reported 4,3% GDP growth in 2024. Notably, the 2% GDP growth in the first quarter of 2025 is largely driven by January growth figure, with February and March numbers being notably lower - take a look at the rapid slowdown of industrial growth, or growth in retail sales or real wages.

Table 2. Slowdown of Russia's key economic indicators

	2024	Jan 2025	Feb 2025	Mar 2025
Industrial output growth, % year-on-year	4,6%	2,2%	0,2%	0,8%
Retail sales growth, % year-on-year	7,2%	5,4%	2,2%	2,2%
Real wages growth, % year-on-year	9,1%	6,5%	3,2%	N/A
GDP growth, % year-on-year	4,3%	3,0%	0,7%	1,4%

Data: Rosstat (industrial output, retail sales, real wages[11]), Ministry of Economy (GDP)[12]

Even sticking to a moderate GDP growth figure for the first quarter of 2025, the Russian Central Bank acknowledges in its comment to the medium-term forecast[13] that GDP growth rate will further slowdown in Q2 2025, and is forecasted to be within the range of just 1,0-2,0% in 2025 and 0,5-1,5% in 2026.

As can be seen from the table 2 above, economic cooling causes rapid slowdown in growth of real wages and retail sales. This was the key engine behind Russia's post-sanctions economic recovery of 2022-2024 - now this phenomenon clearly seems to be over. The figures of decline in non-food products demand are striking. Passenger car sales fell by 27% in January-April[14]; in Q1 2025, non-food retailers faced a 30-35% sales decline[15].

Inflation remains high

Although there are some signs of inflation slowdown, annualized inflation remains above 10%, and the Central Bank notes in its minutes of the April 25th Bank's Board meeting on key interest rate that the slowdown in prices was almost exclusively driven by sharp contraction of prices for non-food products, while food and services prices continued to grow at a rate above 10%[16].

The Russian Government has considerably revised upwards the forecast for inflation in 2025 in the draft amendments to the federal budget introduced to the State Duma on April 30th - from 4,5% to 7,6%[17]. The Central Bank made an upward revision for its 2025 inflation forecast accordingly, to 7-8%[18].

Because of persistent inflation, the Central Bank can't really proceed with interest rate cuts. With only one Board meeting left in the first half of 2025 (on June 6th), it's clear that, if any interest rate cuts will happen, it will only have an effect on banks' interest rates further into the second half of the year, and some possible interest rate cuts - if any - will be barely noticeable for business, which probably needs rates to fall below 10% to make a difference for investment decisions.

But that won't happen any time soon: Central Bank now has elevated the lower threshold for interest rate for 2025 from 19% to 19,5%, forecasting average interest rate for 2025 within the 19,5-21,5% range, and for 2026 - within 13-14% range[19]. This is insufficient to re-start economic growth.

Also, with such heavy budget deficits, inflation may likely increase again soon, beating Central Bank's forecasts.

Where will the Government find the money?

This is a million-dollar question on the background of sharply increasing deficits, and no easy answer is available. Despite relatively low public debt, Russia is cut off from international financial markets due to sanctions, and domestic borrowing makes no sense under the current interest rates: high Government bond yields offset the money raised through Ministry of Finance's OFZ bonds.

With current 10-years OFZ yields above 16%, the net amount raised in January-April net of principal and interest payments was negative (minus RUR 130 billon despite OFZ worth RUR 1,7 trillion placed during four months of 2025[20]).

Remarks by Finance Minister Siluanov made after recent announcements on sharp budget deficit upward revision offer little clarity as to how the Government will manage to handle the deficit. Siluanov vaguely hints that Government will neither spend the remaining National Wealth Fund reserves (except for a RUR 0,5 trillion fraction of them), nor issue new debt, and will focus on "collecting the non-oil revenue" to offset falling oil prices[21].

The latter appears to be problematic, as the economic slowdown clearly opens the prospect of domestic tax revenues shrinking accordingly. The trend is already visible after four months of 2025: the non-oil revenue collection grew by 13,5% year-on-year, down from 26% growth in 2024, much less than 18,4% growth envisaged by the approved federal budget for 2025[22].

For VAT collection, it's even worse: increase by just 1,3% after 4 months of 2025, as opposed to 21,6% in 2024, and 16,8% increase envisaged by the approved federal budget for 2025. So, the non-oil tax collection is already going considerably slower as opposed to plan - despite tax hikes worth 1,5% of GDP coming into effect from January 1st, 2025, already significantly contributing to the economic slowdown, as per feedback from entrepreneurs.

Further tax increases may exacerbate economic slowdown, whichever form they may take - general taxes increase, imposition of one-time windfall taxes on largest companies, or simply tightening the screws in terms of tax collection methods (officially called "improving tax collection administration").

In 2022-2024, total federal non-oil tax revenue collection has already increased by 2,4% of GDP, from 10,3% of GDP in 2022[23] to 12,7% of GDP in 2024[24], reflecting the various forms of gradually increasing tax pressure on domestic businesses, from outright tax hikes to increased "tax collection administration" pressure forcing business to pay larger share of their revenues to the Government.

What options remain besides depletion of the National Wealth Fund, domestic borrowing, tax hikes, and more exotic means like an unlikely large-scale privatization? As we have noted in our previous reports, the Government has been more and more often resorting to monetary emission as means to fill the revenue gap: in December 2024, it used the "repo scheme", when top state banks bought OFZ bonds from the Ministry of Finance worth RUR 2 trillion, and were allowed to subsequently borrow the comparable amount of money from the Central Bank through monthly repo auctions re-launched around the same time.

Although the Central Bank explained that the repo auctions scheme was "temporary", only needed to fill the banks' situational liquidity gap, and will be canceled soon, auctions continue to roll over to this day, with only the format having changed from monthly to weekly repo auctions. On May 13th, 2025, for instance, banks borrowed over RUR 1 trillion in another repo auction[25].

The repo scheme looks much like a de-facto emission - literally the Central Bank's credit to the Government, similar to what Russia had seen in the 1990s. It was already used in December 2022 and December 2024 to fill the budget revenue gaps (when banks bought Government OFZ bonds but received parallel loans from the Central Bank).

It is highly likely that the Government will keep resorting to this scheme again - giving the growing tolerance in official public rhetoric to high inflation, which is "still lower than in Turkey or Argentina anyway". It’s clear from rhetoric by Putin and his officials that they don't see a couple of extra percentage points of inflation as much of a problem, when its necessary to print the money to close the budgetary spending gap.

However, it is well known how lax monetary policy may lead to inflation spiraling out of control. Deficit spending linked to financing the war has already produced high inflation currently experienced by Russia.

Since the full-scale invasion of Ukraine in 2022, the money supply has grown rapidly: the M2 aggregate has doubled, from RUB 62 trillion in December 2021 to RUB 118 trillion in March 2025, increasing from 46% to 56% of GDP; as Andrey Gangan, the Russian Central Bank's Director of Monetary Policy, put it:

> In the last 25 years, there hasn't been a single episode of such a sharp increase in the money supply over such a short period[26]

If the Russian Government switches to emission as main way to finance the budget deficit - which seems to be the most likely scenario - high inflation will become persistent, and the Russian authorities may as well forget about meeting the 4% inflation target.

That will have major negative consequences for an already dire economic situation - including for the federal budget, for which interest expenditures (related to various loan subsidies indexed along with high Central Bank interest rate) are a major spending driver alongside the war.

Impact of budget crisis on the war in Ukraine

As a result of the recent developments, pressure on Putin to significantly scale back - or end - combat operations in Ukraine will intensify.

This pressure was already visible before. Continuing the war requires permanent increases in spending - military salaries and payments require permanent indexation, as well as procurement of army supplies, and the military industrial complex permanently asks for more money, citing financial shortcomings. Top military industry officials like Rostec CEO Sergey Chemezov constantly complain about the lack of funds to deliver the amount of weapons and ammunition required (see below).

Just an example of war costs getting out of control - in April 2025, Russian Ministry of Finance has published a draft law on execution of the federal budget for 2024, which indicates that only the non-classified expenditures of the Russian Ministry of Defense (about a quarter of overall military budget, three quarters of which are classified) increased during the course of 2024 from planned RUR 2,6 trillion to RUR 5,6 trillion, or nearly by 2,2 times[27]. The amount of total military spending is unknown, but it’s clearly higher than previously approved, and keeps growing.

In these conditions, it’s really hard for the Russian Government to find sources of funding for permanently growing military expenditure, at the same time, it visibly can't be capped - war requires more and more money.

In 2025, the official figure of military spending was indexed in the federal budget only by 26%[28] - the slowest rate since the beginning of Russia's full-scale invasion of Ukraine, much slower than in 2024 (around 70% increase) or 2022-2023 (35-40% annual increase), clearly reflecting financial limitations to further military budget expansion.

Here are just some major constraints which recently became visible for Russia's military machine due all the above cited problems. First, Russian regions have considerably slowed increases in sign-up bonuses for signing a contract with Ministry of Defense to fight in Ukraine, and some began reducing payments due to budget constraints[29].

That happened on the background of federal financial transfers to the Russian regions reducing for second year in a row in 2024[30].

Second, Russian military industries experience major financial constraints - last year, Rostec CEO Sergey Chemezov has admitted that average profitability of military enterprises stood at just over 2%[31]; as a result of 2024, it will probably be below 2%, according to Rostec's executive director Oleg Yevtushenko[32].

At April's meeting of the Military Industrial Commission, top governmental body chaired by Putin and responsible for most important decisions on development of the Russian military industrial complex, Putin openly admitted that Russian army "lacks sufficient firepower"[33] at the battlefield in Ukraine, and called for military producers to ramp up output. However, in March 2025, year-on-year output growth in weapons and ammunition (included in the "Finished metal products" nomenclature as per Rosstat) was just 5,8%, as opposed to 35,3% in 2024; in computers, electronics and optics (also heavily includes military-purpose production) - 13,6% as opposed to 28,8%[34], demonstrating a notable slowdown as a result of high interest rates and under-financed budgets.

In March 2025, speaking at the Federation Council, first Deputy Minister of Industry and Trade Vasily Osmakov admitted that salaries in the military industries have stopped growing, and capital investments are also zeroing out due to high interest rates[36].

As can be seen, sanctions and Russian economic woes are imposing severe constraints on the Russian military and military industrial complex. These problems are likely to rapidly and severely exacerbate due to recently growing financial difficulties - to the extent that Russia will either be forced to cap or reduce military spending (with major consequences for its combat abilities in Ukraine), or to switch to emission to finance budget deficit, further fueling inflation and complicating monetary policy easing.

Strategic policy choices made by Putin will become more visible in August-September, when the Government will come out with proposals for a draft federal budget for 2026, which will demonstrate Putin's way of thinking on how to handle budget deficits, call for growing military expenditures, etc.

Impact of Trump policies

While Donald Trump administration has refrained from imposing any new sanctions on Russia since January 2025, it also did not lift any of the sanctions, and is not immediately intending to, given the current trends regarding the Russia-Ukraine peace process. Early hopes of Russian officials and businesses for swift relaxation of the U.S. sanctions regime have dashed.

It is not known how the U.S. administration will behave vis-a-vis Russia in the coming months, but, as we have noted in our previous briefs, potential lifting of the U.S. sanctions against Russia has limited potential to improve the economic situation for Putin (although some positive potential is there), and much more here depends on Europe, Russia's traditional main trade and investment partner before Russia's full-scale invasion of Ukraine. As the Financial Times reported recently[36], Western businesses will still consider Russia toxic if the U.S. lifts some of the sanctions, but will continued to be sanctioned by the EU, UK, and others.

The mere fact that Russian economy at this moment finds itself in an increasingly difficult economic situation, as described above, without new U.S. sanctions imposed in the past four months, can be considered as proof that the Western sanctions imposed against Russia in the past years are working, and gradually producing the desired effect (although more can be done).

What about strong ruble?

Ruble has miraculously strengthened by about a third since the beginning of 2025, defying all economic difficulties, and even the falling oil price.

But, much as in the first half of 2022, when the Russian economy severely contracted as a result of sanctions, strengthening of the ruble is not an indicator of anything positive. It is worth noting that suddenly strong ruble puzzles even top Russian officials, who have no clear explanation as to why it happens - see, for instance, recent headlines like the one in Interfax: "Participants of Central Bank rate discussion disagreed on the reasons for the strengthening of the ruble"[37].

Over-appreciated ruble is also not doing any good neither to the Russian exporters, nor to the Russian budget - as reflected in other headlines like that of the recent RBC TV broadcast titled "Strong ruble: maybe enough?"[38].

One of the most widely popular explanations is the collapse of goods imports related to the plunge on demand for non-food products as explained above. In March 2025, monthly contraction of imports reached 10%. There is a wide consensus that ruble will begin to weaken very soon[40], and current strong ruble rate is not indicative of any positive developments in the Russian economy.

Conclusions

Western pressure on Russia has really began to bite in 2025, and Putin's resources are running out. Putin's "economic miracle" and "resilience" in 2022-2024 was largely based on depletion of financial reserves accumulated before the full-scale invasion of Ukraine on funding his economy and war machine. But this potential is essentially over, and Russia's difficulties are coming down all at once - economic stagnation potentially slipping into recession, uncontrolled budget deficits, depleted cash reserves, persistent inflation.

Putin still has resources to continue his war effort and confrontation with the West, but its getting more and more difficult for him by the day. The moment nears when he will have to seriously reconsider his actions because of insufficient resources to continue as before.

The most likely breaking point in this regard will be upcoming discussion on the draft federal budget for 2026, that is to take place in the coming months, beginning in August-September 2025. This discussion, and the policy approaches proposed by the Russian Government on dealing with the resource crisis and economic downturn, will shed more light on Putin's further tactics on the background of current resource depletion.

Most likely, Putin will choose to continue his war effort so far, but this will require applying methods which will further harm the economic situation (raising taxes, printing the money, etc.). We will continue to monitor these developments in the coming months.

Things to watch in the near future

These forthcoming events of data will shed more light on the dynamics of the Russian economy:

New statistics emphasizing continuing inflation and economic cooling (next batch is expected by end-May and in June);

Meetings of the Central Bank's Board of Directors on key interest rate (next meeting is scheduled for June 6, 2025);

Discussions on the draft federal budget for 2026 to take place later this year, from August-September.

Endnotes

1. https://www.interfax.ru/business/1023849
2. https://minfin.gov.ru/ru/press-center?id_4=39699-predvaritelnaya_otsenka_ispolneniya_federalnogo_byudzheta_v_yanvare-aprele_2025_goda
3. https://www.kommersant.ru/doc/7711364
4. https://www.interfax.ru/business/1025184
5. https://www.interfax.ru/business/1023674
6. Free Russia Foundation, "Can Donald Trump Save The Russian Economy? Economy and Sanctions Brief - February 2025" (https://thinktank.4freerussia.org/economics/can-donald-trump-save-the-russian-economy/)
7. https://www.interfax.ru/business/1018079
8. https://cbr.ru/dkp/mp_dec/decision_key_rate/summary_key_rate_12052025/
9. http://www.forecast.ru/_ARCHIVE/Analitics/PROM/2025/PR-OTR_2025-04-24.pdf
10. Kommersant, "Analysts expect technical recession in Russia", https://www.kommersant.ru/doc/7712457
11. Rosstat, "Socio-economic situation in Russia, January-March 2025", https://rosstat.gov.ru/storage/mediabank/osn-03-2025.pdf; industrial output growth - page 21, retail trade growth - page 89, real wages growth - page 183
12. https://www.rbc.ru/rbcfreenews/6812a53a9a794715711e731d
13. https://cbr.ru/Content/Document/File/175398/comment_12052025.pdf, page 7
14. https://www.autodaily.ru/news/681a08299a7947871a8c42d6
15. https://www.retail.ru/news/v-i-kvartale-neproduktovye-riteylery-stolknulis-s-snizheniem-prodazh-na-30-35-12-maya-2025-264410/
16. https://cbr.ru/Content/Document/File/175428/summary_key_rate_12052025.pdf, page 2
17. https://www.kommersant.ru/doc/7713390
18. https://www.interfax.ru/business/1022770
19. https://tass.ru/ekonomika/23783227
20. https://minfin.gov.ru/ru/perfomance/public_debt/internal/data/
21. https://www.interfax.ru/russia/1024371
22. Source: see footnote 2
23. https://www.interfax.ru/russia/911100
24. https://www.interfax.ru/business/1003826
25. https://www.moscowtimes.ru/2025/05/13/banki-rf-privlekli-na-nedelnom-auktsione-repo-tsbr-104-trln-r-pri-sprose-217-trln-r-a163212
26. https://www.kp.ru/online/news/6129781/
27. https://minfin.gov.ru/ru/om/obs/npa_projects/?id_57=9433-ob_ispolnenii_federalnogo_byudzheta_za_2024_god, see attachment 2 to the draft law
28. https://www.vedomosti.ru/politics/news/2024/09/30/1065492-iz-byudzheta
29. https://echofm.online/stories/regulyarnoe-povyshenie-vyplat-za-podpisanie-kontrakta-s-minoborony-pohozhe-ostalos-v-proshlom-regiony-nachali-zametno-sokrashhat-predlagaemye-summy
30. https://raexpert.ru/researches/regions/regional_budgets_2024/#part3

Endnotes

31. https://tass.ru/ekonomika/20826837
32. https://tass.ru/ekonomika/22625783
33. https://www.mk.ru/politics/2025/04/23/putin-zayavil-o-nekhvatke-na-svo-glavnogo-sredstva-porazheniya.html
34. Rosstat, "Socio-economic situation in Russia, January-March 2025", https://rosstat.gov.ru/storage/mediabank/osn-03-2025.pdf; pages 56-58
35. https://www.pnp.ru/economics/zarplaty-v-oboronke-perestali-rasti-investicii-tozhe-mogut-sokratitsya.html
36. https://www.ft.com/content/6c6404ae-d142-4124-9127-bcd3d46a2c3b
37. https://www.interfax.ru/business/1025180
38. https://www.youtube.com/watch?v=aGQefkEuAQk
39. https://www.interfax.ru/business/1020479
40. https://tass.ru/ekonomika/23934573

FRF
THINK TANK

thinktank.4freerussia.org