

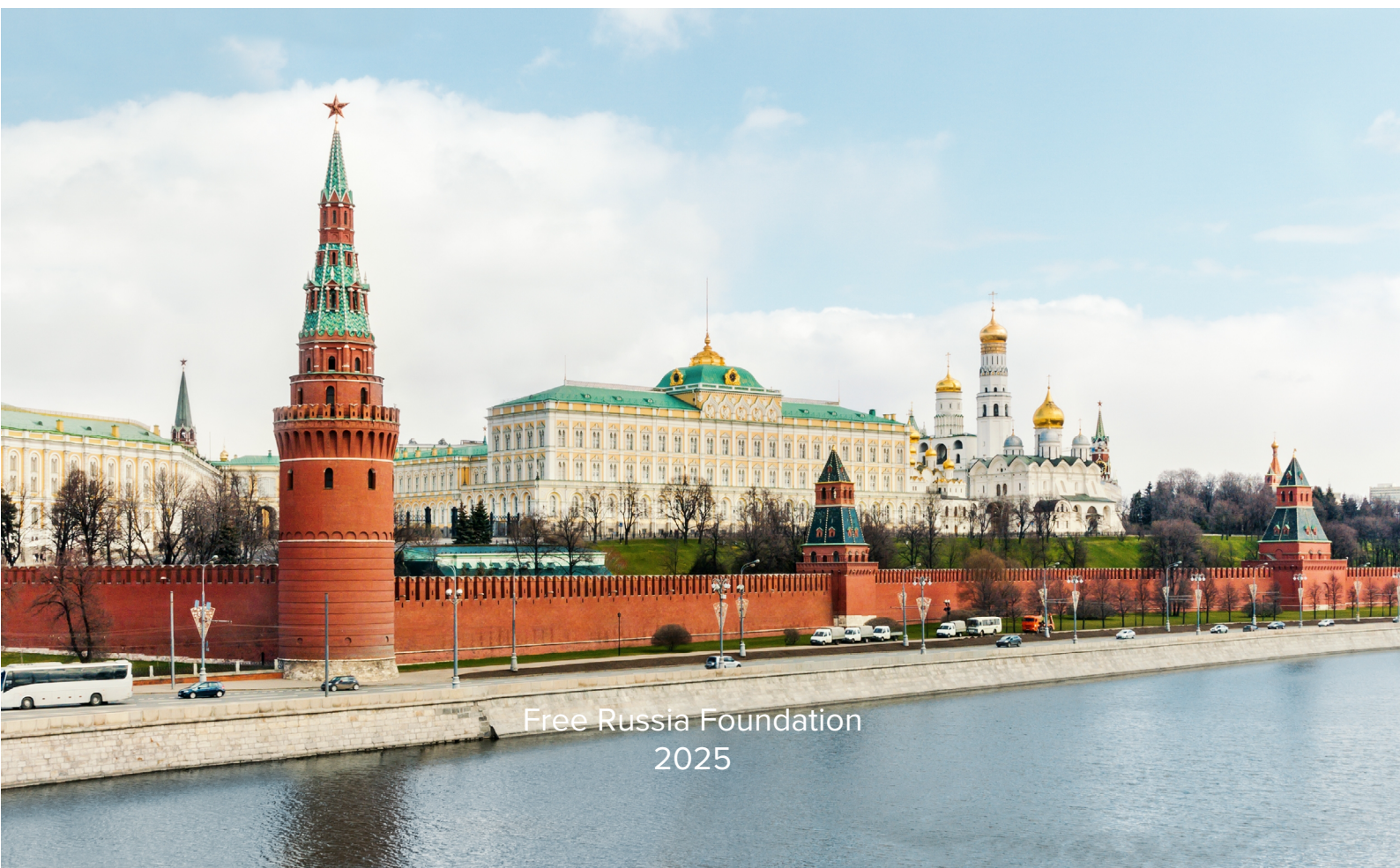
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# WHAT'S HAPPENING TO THE RUSSIAN ECONOMY?

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Western commentary on the Russian economic dynamics has been somewhat confusing lately. On one hand, one can still read a lot of analysis promoting the narrative of Russia's «economic resilience.»

On the other, the newsfeed from Russia itself suggests negative trends are progressing rapidly - top Russian officials are openly speaking about economic stagnation and balancing on the brink of recession, budget deficits have reached record levels, inflation still hasn't been tamed despite years of tough monetary policies by the Central Bank, and interest rate hikes. What is really happening? Let's have a brief look.



# **WHAT'S HAPPENING TO THE RUSSIAN ECONOMY?**

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# A perfect storm: budget crisis, looming recession, inflation

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There are no miracles, and Putin's much-hailed «economic resilience» since the beginning of the full-scale invasion of Ukraine was largely explained by three simple factors:

1. Depletion of government's financial reserves available by early 2022 to finance the budget deficit;
2. Picking up the easiest available, low-hanging fruit options for import substitution and pivot to trading with China and other countries of the Global South;
3. Delayed effect of Western sanctions (some of the most painful of which, like EU's oil embargo, didn't fully begin to have an impact until at least 2023).

By the middle of this year, Russia has reached a point of expiry of all three, which led to a rapid slowdown of economic growth (with the economy swiftly sliding into stagnation at best), an unprecedented budget crisis, and persistent inflation requiring tight monetary policies and maintaining high interest rates (which in turn lead to larger budget spending and lower growth). This downward spiral continues, with no good prospects in sight.

While the Russian economy is not on the brink of «collapse» (a false prospect often put forward rhetorically to denigrate the real and visible effects of sanctions), the difficulties are so significant that the current economic model clearly looks unsustainable, and will require major rethinking already in the short-term future. While ending the war in Ukraine doesn't appear to be one of the options currently considered by Vladimir Putin just yet, it may become a realistic policy option for him if current negative trends exacerbate, more international pressure is put on Russia, and after all other options have been tried with no positive results for Putin.

# Economic cooling reaches critical point

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After an impressive 4,1% GDP growth in both 2023 and 2024<sup>1</sup> - citing which was the primary source of hailing Putin's «economic resilience» against sanctions - the Russian economy has predictably slowed down as of mid-2025, and the growth continues to slide. The government's forecast of annual GDP growth for 2025 has been downgraded as of early September 2025 to just 1,2% against 2,5%, which was a baseline scenario forecast at the time of adoption of the federal budget for 2025; GDP growth of 2,5% in 2025 was still declared as a valid forecast by the Russian government as late as in April.<sup>2</sup>

Russian statistics agency (Rosstat) has reported 1,4% GDP growth in the first quarter of 2025,<sup>3</sup> and 1,1% in the second quarter<sup>4</sup> - both lower by 30-40% than the forecasts by the Russian Central Bank, which remained valid until the actual data by Rosstat was published. As can be seen, the Russian government and the Central Bank remain excessively optimistic about Russia's economic growth prospects, even though the real situation on the ground is quite different - it wasn't difficult to predict that the actual figures will be much lower. However, optimistic assessments by Russian official sources are often uncritically quoted by Western commentators, contributing to a build-up of the «resilience» narrative about the Russian economy.

It is worth noting that the Central Bank's current GDP forecast for 4th quarter of 2025 is 0,0-1,0%.<sup>5</sup> Bearing in mind that the Bank's forecasts turned out to be too optimistic in the first half of 2025, the Russian economy may well slide into negative territory soon.

The situation is rapidly deteriorating from month to month, and the current point of official economic debate in Russia is whether the economy has already slipped into a recession territory, or is simply stagnant. Here are some of the latest figures and comments:

- The Russian Ministry of Economic Development assesses GDP growth in July 2025 as just 0,4%,<sup>6</sup> the worst since March 2023;
- Maxim Reshetnikov, Minister of Economic Development, admitted at the Eastern Economic Forum in Vladivostok in early September that «the pace of economic cooling exceeds expectations»<sup>7</sup>;
- German Gref, CEO of Sberbank, claimed that the Russian economy has reached a «technical stagnation,» showing near-zero growth in the past months<sup>8</sup>;
- Andrey Klepach, chief economist of state VEB bank and former Deputy Minister of Economic Development, claimed that Russia's seasonally adjusted GDP has been contracting for two consecutive quarters (Q1 and Q2 of 2025), effectively showing a technical recession<sup>9</sup>;

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- CMAKP, the leading Russia's macroeconomic think tank created by current Russian Defense Minister Andrey Belousov and chaired by his brother Dmitry, states that the Russian civilian industrial production cleared from military output is in recession since the beginning of 2025, contracting by as much as 2,3% in July 2025<sup>10</sup>;
  - The Institute of Economic Forecasting of the Russian Academy of Sciences points out to just 0,2% GDP growth in July 2025 and stagnation of seasonally adjusted GDP since the beginning of 2025; «economic growth effectively halted» as per the Institute's experts.<sup>11</sup>

On top of this, investments have nearly stopped: in the second quarter of 2025, annualized growth of fixed investment was just 1,5%,<sup>12</sup> as opposed to 7-10% from 2022-2024, and 8,7% in the first quarter of 2025. Investment decline in many of the civilian industries has reached such a level that it can't be offset to any further extent by the massive growth in investment spending in military industries; the latter also appears to be losing steam (see also below on this in more detail).

As per Forbes Russia, «the decline in investment activity does not allow for the creation of a basis for growth in non-commodity sectors in 2026-2027»<sup>13</sup> - while at the same time commodity exports are under pressure due to sanctions and global economic uncertainty.

# Russia's budget crisis

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On the background of rapid slowdown of economic activity, Russia is plunging into a budget crisis of scale previously unknown for decades. This is complicated by the near depletion of the government's financial reserves. Since 2004, various versions of the Russian government's rainy day fund («stabilization fund,» «reserve fund,» «national wealth fund») have shielded the state's finances from budget crisis, allowing it to draw reserve funds to cover the budget deficits. But this option is no longer available. The liquidity part of the National Wealth Fund (NWF), which was actively used during previous years to cover the budget deficit, has shrunk from \$116.5 billion in February 2022 to just \$49 billion as of September 1, 2025,<sup>14</sup> or about 7% lower than the currently recorded federal budget deficit after 8 months of 2025 (\$53 billion,<sup>15</sup> or about 2% of the projected annual GDP).

There's also a non-liquidity part of the NWF, which is worth roughly \$115 billion on paper, but these are largely investments into shares and bonds of state-affiliated corporations and banks that are hardly recoverable, and it will be difficult for the government to use them to finance current budget deficits (this issue was discussed in more detail in one of our recent reports)<sup>16</sup>.

Western sanctions and the war had a tremendous impact on the Russian government's inability to keep budget deficits under control due to reduced revenues and permanently increasing spending (part of which was caused not only by war, but also by the effects of sanctions - this is discussed below in more detail). As can be seen from the table below, Russia was never able to keep the federal budget deficit even remotely near planned figures - it routinely broke out of control, being close to 2% of GDP each year starting from 2022 (as opposed to plans to keep it below 1% of GDP), while the National Wealth Fund reserves continued to deplete.

It is widely expected that the final federal budget deficit for 2025 may reach 9 trillion rubles or more<sup>17</sup> (over \$110 billion) - exact figure will only be known in January 2026. Some observers, including former First Deputy Chairman of the Russian Central Bank Oleg Vyugin, go as far as to say that such a deficit can only be covered «through monetary means» (by printing the money)<sup>18</sup>. That means higher inflation.

Recently, Finance Minister Anton Siluanov, answering the question about approaches to cover the budget deficit for the end of 2025, admitted that the government is planning to increase domestic borrowing to higher levels than planned<sup>19</sup>.

At the same time, with the current government bond yields (over 14% for 10-year Minfin's OFZ bonds), Russia is spending such large amounts on servicing the debt that the actual net raised amount turns out to be near-zero (it was just \$3 billion after 7 months of 2025, as per Minfin).

**Table 1. Russia's federal budget deficit in 2022-2025 vs. remaining reserves**

	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>
Deficit planned during the initial budget adoption, RUR trillion	1,33	2,93	1,60	1,17
Actual deficit during the relevant fiscal year, RUR trillion (* - as of September 1, 2025)	3,30	3,23	3,49	4,19*
Remaining cash in the liquidity part of the National Wealth Fund at the beginning of period (* - as of September 1, 2025), RUR trillion	8,80	6,13	5,01	3,93*

Siluanov admits in his above-mentioned interview that, at current rates, borrowing is «too expensive,» and that debt servicing costs has already reached 8% of the total spending of the federal budget at current rates.

What Siluanov is likely referring to is another case of an OFZ buyout by state banks, which, in turn, will receive extra cash from the Central Bank through repo auctions. This scheme is a little different from the Central Bank providing credit directly to the government (this is how actual monetary emission looks like and what happened in Russia in the early 1990s).

Such OFZ-repo hidden emission scheme with the involvement of state banks as intermediaries was already used in December 2022 and December 2024 to close the budget deficit gap.<sup>20</sup> This time, it will probably be used on a much larger scale, contributing to higher inflation.

In December 2024, Andrey Gangan, director of the Russian Central Bank's monetary policy department, expressed deep concern about growth in monetary supply by 65% in three years since the beginning of 2022 - «in the past 25 years there has not been a single episode of such a sharp increase [of monetary supply] in such a short period of time,» said Gangan.<sup>21</sup> As of July 2025, M2 monetary supply stood at a level two times higher than in December 2021, and is increasing further.



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A highly pro-inflationary debt emission scheme remains the most likely way for the Russian government to close the budget deficit gap. Another option is to raise taxes. According to media reports (it will be known for certain by early October, when the government is expected to present the draft federal budget for 2026), Russian authorities are mulling tax hikes to close the budget deficit gap, including the potential increase of VAT from 20% to 22%.<sup>22</sup> Needless to say, new tax hikes will further hamper economic growth.

# Inflation: you ain't seen nothing yet

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Annualized inflation in Russia slowed to just over 8% as of mid-September 2025,<sup>23</sup> and gave way to several weeks of deflation in late summer. However, the deflation process was very uneven, mostly concentrated in seasonal contraction of prices for fruits and vegetables. In services, as well as food items other than fruits and vegetables, annualized inflation in August stood as high as over 11%,<sup>24</sup> and even in non-food goods has started to pick up lately after a sharp decline in the first half of 2025 driven by a Central Bank-induced consumer credit crunch (which led to plunging sales of cars, home appliances and electronics).

Most of the current trends remain pro-inflationary: increasing budget deficit, prospects for further weakening of the ruble and an acute labor shortage. Russians largely understand this, which is why inflation expectations are increasing<sup>25</sup> - new inflation spikes are widely expected. In the words of the Central Bank's Deputy Chairman and monetary policy czar Alexey Zabotkin, «increasing inflation expectations clearly show that citizens understand very well that the seasonal decline in prices for vegetables and fruits» and «understand very well that this seasonal decline should in no way affect their opinion about sustainable inflationary pressure and future price growth».<sup>26</sup>

On the background of this, the Russian Central Bank has been lowering its key interest rate since June - from a peak of 21% to 17% now. However, current interest rates still remain prohibitively high for economic revival, and the Central Bank is very concerned about inflation's comeback in the near future and constantly stresses that it may reverse the interest rate cuts should inflation climb back again (which is the most likely scenario). The Central Bank's board meeting on September 12th failed to deliver on market expectations - while many expected another aggressive rate cut from 18% to 16%, Central Bank has only lowered the rate only to 17%, accompanying with tough policy signals - deep concerns about increasing budget deficit, high inflation expectations, limited seasonal nature of the recent deflation.<sup>27</sup> The pressure of pro-inflationary factors are so high that the Central Bank's board hasn't even considered lowering key interest rate to 16% on September 12th - only keeping in unchanged at 18% or lowering the rate by just 1 basic point to 17%.<sup>28</sup>

After Central Bank's board meeting on September 12th, hopes for swift interest rate cuts to more investment-friendly levels of 12% and below have been largely dashed - much more cautious policy from the Central Bank, as well as potential resurgence of inflation, are to be expected.

# Can lower interest rates revive investment?

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If one listens to the current commentary of Russian officials and the business community, it becomes clear that lowering the Central Bank's interest rate is currently the only remaining bet on revival of economic activity. However, it doesn't appear that lower interest rates (if they even occur, which is questionable given the persistent inflation risks) may act as a significant factor that will stop and reverse the economic downturn.

First, rates will remain high for quite a protracted period, despite recent symbolic cuts. Sberbank's CEO German Gref at the Eastern Economic Forum in Vladivostok in early September suggested that revival of investment activity will not be possible before the Central Bank's lowers the key interest rate below 12%.<sup>29</sup> Even this figure is questionable, because lowering of the key interest rate to 7,5% in 2022-2023 did not help to dramatically boost investment activity beyond just the state-financed military sector. However, the current Central Bank's forecast, wary of persistent inflationary risks, doesn't envisage that the interest rate will become lower than 12% before 2027 (and even that will happen only if inflation will be brought down to target goal of 4%).<sup>30</sup> After Central Bank's board meeting on September 12th, as explained above, swift interest rate cuts in the coming months became even more unlikely.

Second, the overall share of credit in financing capital expenditures was traditionally low in Russia. It was within 10-15% of the total capital expenditure financing from 2022-2025. Over 60% of capital expenditure is being financed through companies' own profits. Here is the bad news for hoping for Russia's economic revival: net corporate profits in Russia shrank by 7% in 2024,<sup>31</sup> and by another 8,4% in the first half of 2025.<sup>32</sup> Continuous decline in profits is driven by rising operating costs and falling revenues due to sanctions, global economic uncertainty, and weaker domestic demand.

Another interesting consequence of the recent moderate interest rate cuts is that it may have the opposite effect than the Central Bank hopes for: since June, bank deposit rates have swiftly gone down, making deposits less attractive, while credit began expanding again. This may lead to a repeat situation of 2022-2023: too swift interest rate cuts added a massive credit stimulus to an already significant budget stimulus, resulting in higher inflation. Mass withdrawal of bank deposits on the background of rapid deposit rate cuts can also be a contributing factor: since the beginning of interest rate hikes in mid-2023, the total amount of household deposits has grown from about 22% to 30% of GDP, driven by higher deposit rates. Now the situation is quickly reversing, and this money may well end up at the consumer market, also becoming a major pro-inflationary factor.

# Sectoral crises multiplying

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While the economic situation in Russia remains uneven from one sector to another, there's a growing number of sectors of the economy that continue to be marred by major problems or even outright deep crises:

- Coal industry, which faces major losses (over \$2 billion of the coal sector's net losses in the first half of 2025)<sup>33</sup> and mass closure of enterprises<sup>34</sup>;
- Steel industry facing significant output contraction due to sanctions and fierce international competition with Chinese steel (over 10% year-on-year output contraction in July 2025)<sup>35</sup>;
- Carmaking industry also facing contracting demand and tough competition with Chinese counterparts, with output contracting by over a quarter in 2025<sup>36</sup>;
- Real estate sector troubled by falling demand and excessive unsold housing, with commissioning of new buildings contracting by as much as 22% year-on-year in June 2025<sup>37</sup>;
- New emerging problem spot is the export-oriented forest industry, which was badly hit by sanctions, growing expenses and high interest rates - although output here is still in the positive territory, industry expects serious deterioration soon without massive state aid<sup>38</sup>.

The Russian agricultural sector is also not doing well, which may seem surprising due to the fact that a major domestic import substitution niche opened after the rift with the West. However, Russian agricultural output has been largely stagnant since 2021, and is quite likely to fall after recent major contraction in investment.<sup>39</sup> It is being learned the hard way that key factors of success of the agricultural business are international cooperation and access to best available technology.

China is greatly contributing to the difficulties of Russia's troubled industries, contrary to the conventional wisdom about «no limits partnership» between Moscow and Beijing. China refuses to abolish tariffs against Russian coal imports introduced in 2024, which have greatly contributed to the above-mentioned troubles of Russia's coal producers.<sup>40</sup> Russian steel is losing competition to Chinese steelmakers, which is a main factor of steel output contraction.<sup>41</sup> China prohibits imports of Russia's winter wheat, main Russian agricultural exports (despite buying wheat in large amounts from Ukraine or Kazakhstan) - in the words of Russia's agricultural Minister Oksana Lut, «we don't really understand the nature of this [Chinese] refusal to accept [Russia's] winter wheat»<sup>42</sup> (the negotiations on the possible opening of Chinese market to Russian winter wheat have been going on for years, but China still refuses to buy Russia's wheat). Russian carmakers openly accuse Chinese competitors of price dumping and blame them on drastic decline in production of Russian cars.<sup>43</sup> So, most of the Russia's sectoral crises are connected to problems in relations with China.

## Is the banking crisis real?

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On the background of all these negative trends, the problems of the Russian banking sector are growing, too. It is not on the brink of a major banking crisis yet, because bank profits are high and capital is still sufficient. But, as the Russian Central Bank has been noting consistently, the Russian banking sector is in a vulnerable position after being cut off from international capital markets due to sanctions - which leads to the current profits remaining the only source of capital. Should the situation deteriorate rapidly, banks may face double pressure - from growth in toxic assets to shrinking profits. As past crises show, banking sector problems may mount very fast following rapid crisis developments in the real sector of the economy. This time, the significant difference is in the fact that Russian banks can't raise capital abroad.

In the banking sector review for Q2 2025, the Russian Central Bank has notably downgraded the assessment of a cost of credit risk, reflecting the mounting problems for corporate borrowers. The Central Bank notes that some banks «have significantly accrued additional buffer reserves for companies in the metallurgical and coal industries, as well as in the real estate sector, due to the deterioration of their financial position».<sup>44</sup>

While this situation is not critical for banks just yet, problems may worsen suddenly if the situation in the real sector of the economy rapidly deteriorates. As past crises have also shown, Russian banks tend to underestimate the level of credit risk in the face of potential economic difficulties, effectively hiding the real extent of toxicity of their assets until the last moment.

## Adverse effects of a strong ruble

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Although the ruble has been weakening again since early September, many observers were puzzled by its remarkable strengthening since the beginning of 2025: the ruble has strengthened by about a third since early January, to around 80 rubles per dollar as opposed to over 100 rubles per dollar in the beginning of 2025.

However, there's almost universal expectation of the ruble depreciating again quite soon, and recognition that the strengthening was temporary, which also did more harm than good to exporters, and the budget.<sup>45</sup> CMAKP macroeconomic center states<sup>46</sup>:

*“Currently, the ruble exchange rate is over-strengthened relative to its fundamental level; ... its weakening in the second half of 2025 towards weakening is very likely. The current deviation of the actual exchange rate from the fundamental level is largely associated with expectations of its further strengthening and the effect of the “Kudrin spiral”.*<sup>47</sup>

## A “military economy”?

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As can be seen from the recent economic dynamics, the model of a “military economy,” much-hailed by many Western commentators, wasn’t able to fix Russia’s economic woes. First, military production is still a relatively small portion of the Russian economy - within 10% by various merits, be it GDP, industrial output, workforce, fixed investment, etc. There’s simply not enough scale and thrust to provide liftoff to the rest of the economy. Take the crisis in the steelmaking industry - how can it possibly happen in a “military economy” driven by high steel demand for arms production? This example shows that the scale of Russia’s “military economy” is limited, and this term in itself may be good for flashy headlines, but neither good to allow capacity-building for launching a full-scale offensive against Ukraine along the current frontline (which Russia failed to do during this summer, limiting offensive operations to 5-6 narrow front sections only), nor to allow Putin to create a sufficient economic multiplier for the remaining civilian economy.

Second, the military industrial complex has its own problems. As admitted by Sergey Chemezov, CEO of Rostec, Russia’s largest arms producer,<sup>48</sup> in his recent interview to RIA Novosti, Russian military manufacturing companies face great financial difficulties: “the profitability of military production remains low, and somewhere even zero, if not negative”, leaving “not too many funds for development”; production and investments “nearly completely depend on the state budget” given the dramatic contraction of arms exports from 2022-2025; and sanctions and expensive credit are also taking its toll.<sup>49</sup>

Under-financing, expensive credit and lack of access to technology, as mentioned by Chemezov, have contributed to a significant slowdown in output growth for items reported by Rosstat<sup>50</sup> that include military production:

- Output for “Finished metal products” (includes weapons and ammunition) has contracted to 16% year-on-year in the second quarter of 2025 and further to 6% in July 2025, as opposed to 28-32% in 2023-2024;
- Output for “Computers, electronics and optics” (includes radar devices, radio electronics) has contracted to 18% year-on-year in the second quarter of 2025 and further to 8% in July 2025, as opposed to 28% growth in 2023-2024;
- Only in production of “Other transport vehicles” (includes military aircraft, tanks, and armored vehicles) significant output growth was recorded - 49% year-on-year in July 2025, and 25-33% in the first and second quarters of 2025 (following 28-32% year-on-year growth in 2023-2024).

However, a surge of production in battlefield vehicles can be explained by the fact that these items are relatively expensive, and just a few newly produced items can lead to significant output additions on the books.

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For instance, in 2025, Russia has commissioned two new submarines, Perm of the Yasen-M class and Knyaz Pozharsky of Borei-class, which have added several percentage points to the overall increase.

Recent analysis by the Institute of Economic Forecasting of the Russian Academy of Sciences confirms the “gradual slowdown in growth of output in sectors related to the military-industrial complex”.<sup>51</sup>

Military output growth slowing down and leadership of military industries complaining about financial difficulties and lack of ability to expand demonstrate that **Russia is probably close to reaching its limits in expanding military production** since the beginning of full-scale invasion of Ukraine in 2022.



# Impact of sanctions

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All of the above cited problems are a direct product of Western sanctions. Just this fact alone is sufficient to put the debate about sanctions being “ineffective” to rest once and for all. Here are the main ways the sanctions are impacting the Russian economy:

1. Lack of access to Western technology and financial markets constraints output;
2. Calls for more compensatory state aid plus military expenses drive government spending much higher;
3. Revenues, in turn, are declining due to sanctions and commodity discounts in the Asian markets;
4. Constrained output contributes to what the Central Bank calls “positive output gap” (output constrained by lack of access to foreign investment and technology unable to catch up with demand fueled by heavy wartime spending), which is considered to be the main factor fueling inflation;
5. Inflation constrains investment and pushes interest rates up;
6. This further increases budget spending, exacerbating the budget crisis, etc.;
7. At the same time, Russia is cut off from international financial markets, doesn't have access to international borrowing and FDI, which means that the only ways to go forward remain to finance the deficit with monetary emission (further sliding into high inflation), or ending the war.

These mechanisms are explained in more detail in the recent report by Free Russia Foundation “The evolution of the US-Russia sanctions regime. Structure, composition and ways to improve effectiveness”,<sup>52</sup> which provides a more comprehensive analysis of the impact of the sanctions regime on Russia from 2022-2025.

# How Putin's ability to wage war is affected?

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The answer to this question depends on the nature of warfare Putin may be conducting. **As far as a major large-scale offensive against Ukraine along large sections of the frontline is concerned, Russia's abilities are already largely exhausted** - as can be seen from the experience of Russia's "Summer offensive" of 2025, the best that Russia can do is carry out limited offensive operations focused only on 5-6 points along the 1,000 km frontline. Neither a full-scale offensive compared to that of February-March 2022, nor assault on Kyiv, Kharkiv or other major Ukrainian cities seem possible. Sanctions have probably achieved the goal of halting Russia's ability to conduct large-scale offensive operations, as the summer of 2025 has shown.

However, Putin may continue the current tactics of a "terrorist warfare" for an indefinite period of time (resources for this kind of tactic are available) with:

- Heavy aerial bombardments of Ukraine with missiles and drones;
- Limited offensive operations at several points across the frontline, concentrating large forces there and making some tactical gains (albeit with heavy losses) which can then be amplified through propaganda to portray Russia as a "winning party" to the war.

Recent Russian proposals to Donald Trump that Ukraine voluntarily gives up parts of Donbas unoccupied by Russia indirectly prove Russia's admission that it can't reasonably expect to conquer these lands militarily in the foreseeable future (or can at an extreme cost), and that it wants to create a propaganda-induced impression of the Russian military "advancing on the battlefield," to gain control over these territories through negotiations using deception and intimidation tactics.

**According to the Institute for the Study of War:**

*"Kremlin is pursuing a multi-pronged informational effort aimed at deterring Western support for Ukraine and undermining European participation in the peace process. The Kremlin has recently been intensifying three rhetorical lines aimed at influencing Western decision-making in the Kremlin's favor: accusing European states of prolonging the war in Ukraine, levying nuclear threats against Western states, and claiming that Russian victory in Ukraine is inevitable. ... These various rhetorical lines seek to bolster the Russian Ministry of Defense (MoD)'s recently intensified effort to falsely portray Russian victory in Ukraine as inevitable. The MoD attempted to use large amounts of qualitative data to make claims about Russian advances – data and claims which ISW assesses are inflated."<sup>53</sup>*

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Russia's ability to further increase its military budget to amass a large-scale attack force against Ukraine or Europe is severely limited by budgetary constraints - at best, Russia can afford to maintain the current level of intensity of combat.

## Which sanctions shall be adopted next?

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The much-debated “secondary tariffs on goods from countries buying Russian oil” seem to be a totally ineffective way forward in terms of increasing pressure on Russia. Russia has over 10% of the world’s oil production, and disappearance of its oil from global markets will cause immense shock. Consumers will be so eager to find replacing barrels that Russian oil will find its way to end-users one way to another, with the only difference being a surge in global oil prices.

“Secondary tariffs” may also not work if the countries buying Russian oil simply choose to face them head-on, as happened in the case of India facing Donald Trump’s additional tariffs linked to India’s continued imports of Russian oil. Nearly two months since these extra tariffs against India were introduced by the Trump administration, they had little or no effects - temporarily increasing discounts for Russian crude at best (it is also questionable what caused this to a greater extent, U.S. tariffs or EU’s 18th package of sanctions which also targeted Indian refiners).

A more effective way to go is what the EU is currently doing: lowering the oil price cap for Russia, and, thus, aiming at minimizing Russia’s oil export revenues without major disturbances to the global oil market. However, enforcement of the lowered oil price cap of \$47,6 per barrel will require a robust mechanism of detailed monitoring of vessel traffic, ownership, trading and insurance operations involving Russia’s “shadow oil tanker fleet” - currently, the EU is seriously understaffed to more effectively perform that task on scale comparable with the U.S. Office of Foreign Assets Control (OFAC). The U.S., unfortunately, appears disengaged from enforcement of the lowered oil price cap of \$47,6 per barrel.

### What else can the EU do?

An absolute must is the implementation of the European Commission’s “Roadmap towards ending Russian energy imports” - a plan to completely phase out Russian gas, oil and uranium by 2028. In 2024, the EU imported over €20 billion worth of Russian oil and gas - mainly pipeline imports by countries like Hungary and Slovakia which continue to oppose toughening of Russia sanctions, and liquified natural gas (LNG) imports by Western European countries like France, Belgium, and Spain. These imports are an important - and also very profitable and taxable - sources of export revenue for Russia. Oil and gas exports to Asia aren’t even remotely comparable in profitability for Russia, given higher costs and price discounts.

Also, disconnecting more Russian banks from SWIFT will be necessary to complicate Russian trade with countries of the Global South. Currently, over 200 Russian banks are still connected to SWIFT,<sup>54</sup> only several dozen of the largest banks were cut off.

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Therefore, Russia can still continue to facilitate cross-border financial transactions by simply moving them to smaller banks (albeit with increasing transaction costs). More action on disconnecting Russian banks from SWIFT is needed.

# Conclusions

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The current Russian financial and economic difficulties effectively undermine its ability to wage large-scale offensives against Ukraine - not to mention achieving “victory” over Ukraine. However, Russia has sufficient capabilities to wage “terrorist warfare” (bombardments of Ukraine with drones and missiles, combined with active offensive operations at several limited points along the frontline) combined with propaganda and psychological warfare aiming at convincing the West that it is “winning” in Ukraine. But, from a purely financial standpoint, Russia’s ability to wage large-scale offensive wars is seriously undermined by sanctions and economic difficulties, and the situation is likely to deteriorate even more in the coming months - the clearer picture will emerge in early October 2025, when the Russian government will publish a draft federal budget proposal for 2026, which will allow a more precise judgement about Putin’s current intentions and their viability against the real-life economic situation.

Western sanctions against Russia are working. They are depriving Russia of vital revenues, exacerbating the budget crisis, halting investment and development of military and other industries, and fueling high inflation, which, in turn, leads to expensive interest rates and hampers economic development.

Denigrating the effects of Western sanctions, and distracting the attention toward marginal, untested and questionable ideas like “secondary tariffs against importers of Russian oil” is counterproductive. These debates divert attention from focused implementation of the real effective sanctions, which have already yielded certain visible results.

Consistent implementation of sanctions, effective enforcement and combating sanctions circumvention, as well as adoption of new sanctions (implementation of the European Commission’s “Roadmap towards ending Russian energy imports,” disconnecting more Russian banks from SWIFT) is necessary to increase economic pressure on Russia.

## Next things to watch

- Draft federal budget for 2026 indicating Putin’s plans for military spending and managing the budget deficit and economic woes for the months ahead (expected around October 1, 2025);
- Economic results for the 3rd quarter of 2025 showing further signs of economic cooling (expected after October 20, 2025);
- The Central Bank’s decisions on key interest rate and the relevant public commentary (next board meeting is scheduled for October 24th, 2025).



# Sources of Data

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1. Revised figure by the Russian government; earlier estimates were lower
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47. “Kudrin spiral” is a term explaining a spiral of ruble strengthening caused by exporters drive to sell as much currency as possible fast, expecting further ruble strengthening
48. According to Chemezov, Rostec supplies about 80% of the weapons used by Russia at the battlefield in Ukraine
49. See Chemezov’s most recent interview to RIA Novosti: <https://ria.ru/20250822/chemezov-2036752484.html>
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51. <https://ecfor.ru/publication/kratkosrochnyj-analiz-dinamiki-vvp-sentyabr-2025/>, page 3
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