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# BANK OF FINLAND BULLETIN

## BANK OF FINLAND ARTICLES ON THE ECONOMY

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BLOG

# Rough times for the Russian economy

Today – Russian economy

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Russia marks the fourth anniversary of its full-scale war of aggression on Ukraine on February 24. Although Ukraine entered the conflict ill-prepared to sustain a long defensive war, it nevertheless managed to stop Russian progress and retake large swathes of occupied territory in the first year of the invasion. Russian forces have now settled into a pattern of aerial bombing of civilian targets, while throwing waves of prisoners and contract soldiers from poorer regions into the frontline meat-grinder to break through Ukraine's defences.

Russia's efforts to overrun Ukraine, Europe's poorest country in terms of GDP per capita, have hardly gone to plan. While the fierceness of the Ukrainian response to the 2022 invasion surprised many in the West, it was Moscow that seemed caught on the back foot. Russia's military planners had apparently not considered that the brief "special military operation" in Ukraine could potentially become a multi-year quagmire leading into large fiscal deficits, changes in the economic structures and the country's international standing, as well as unrelenting labour shortages.

Russia's failure to take Kyiv and the imposition of exceptionally broad economic sanctions by Western nations reduced Russia's economic activity in 2022 to such an extent that Russian GDP contracted. Russian GDP then grew rather briskly over the next two years as the government turned to heavy spending increases. Having now reached the limits on economic growth imposed by the war, however, Russia finds itself constrained to annual growth rates near its long-term potential rate of around 1 %. Both external and internal risks have risen significantly, making recession a very real possibility. Russia is not doing well. As we enter yet another year of Russia's quest to occupy Ukraine, four impacts on the Russian economy deserve mention.

## 1. War has sapped Russian resources

Russia has doubled its spending on defence and domestic security. In pre-invasion 2021, Russian military spending amounted to 3.6 % of GDP. By 2025, the budget allocated the equivalent of 7.2 % of GDP to the war effort (Cooper, 2025). Indeed, the actual amount of spending on the war last year was likely higher. Moreover, the war effort is supported via other budget categories such as education, social benefits and maintenance and construction of civil infrastructure. The total costs may be closer to ten percent of GDP. Money spent on warfare is not available for public goods and services that could go to supporting the welfare and quality of life of Russian citizens. Economic growth would likely be higher with a smaller share of government spending on the military (Simola, 2025a).

Beyond budget spending, the government has provided support to the economy through the banking sector. Housing loans for households and loans to corporations operating in priority sectors have benefited from hefty interest subsidy programmes, while defence industries have enjoyed implicit government loan guarantees. Other branches, in contrast, must struggle for credit and face high debt-servicing costs that erode their balance sheets. The incentives for market-driven investment in civilian production are negligible at best.

To sustain the current war effort, Russia must send an additional 30,000 able-bodied working-age men to the front each month. Following the partial mobilisation of reserves in autumn 2022, most new soldiers have been individuals enticed by substantial signing bonuses or prisoners offered release in exchange for joining the military. By some estimates, the war has cost Russia roughly 1.5 million people (killed, wounded or fled the country). Given the low unemployment levels before the invasion of Ukraine, losses of soldiers and decreased immigration to Russia have made the labour market tighter than ever.

## 2. Sanctions have worked

A coalition of Western countries have targeted Russia with a large range of economic sanctions. Although the sanctions have not been implemented consistently at the international level, measures focused on the financial markets have been highly effective by shutting Russia out of international markets. Both the Russian government and Russia's largest corporations have been forced to finance their operations out of pocket or by raising funds from domestic lenders. Borrowing from domestic lenders is more expensive than raising funds on international markets.

Russian imports of goods and services relative to GDP have decreased. The selection and prices of consumer goods in Russia have been particularly affected by the drop in imports. Western export restrictions and financial market sanctions have made it impossible for Russian companies to import directly certain items, thereby raising transportation costs and forcing consumers to accept lower-quality substitutes. Since the invasion, few, if any, industries have succeeded at import-substitution.

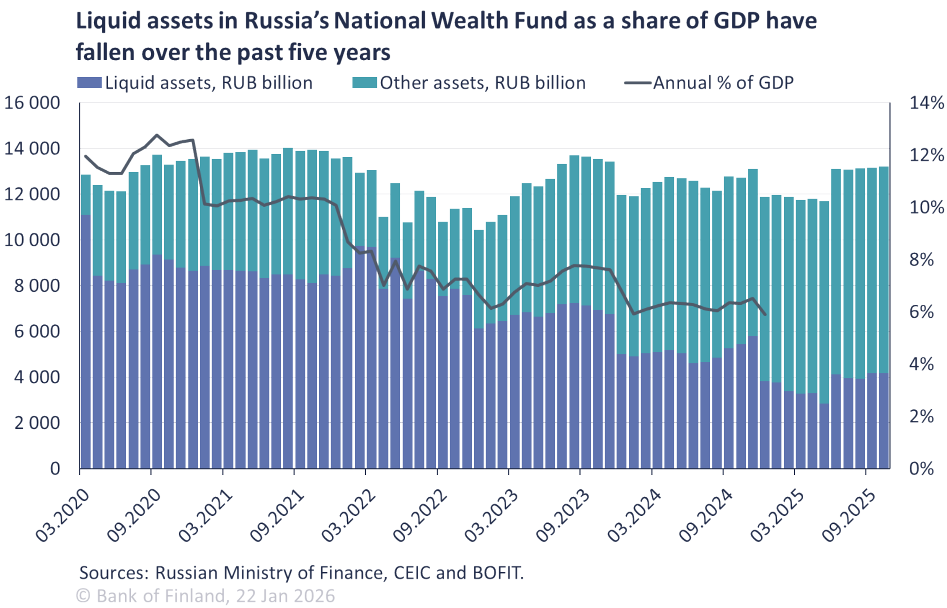
Sanctions have forced Russia to discount prices of its main export products. The clearest example is the export price of crude oil. Even with the shadow fleet and various schemes to circumvent sanctions, in 2024-2025 Russia's key export variety, Urals, was sold on at $14 below the benchmark Brent oil price. Prior to the 2022 invasion of Ukraine, the Urals-Brent price difference was typically $1–2 per barrel. The latest round of sanctions imposed in late 2025 drove the spread to over $20 a barrel. The current average Urals price (below $40 a barrel) is likely to increase budget deficit by roughly 1.5 % of GDP (Simola, 2025b).

Sanctions are a daily burden on the economy, reducing government revenues and raising the costs for all participants. War has also ended cooperation of companies and universities with many of their foreign counterparts, isolating Russia more than ever.

## 3. Russia doesn't have a war chest

Like many petrostates, Russia established a sovereign wealth fund for its surplus hydrocarbon earnings. Despite being a leading global oil exporter, Russia's sovereign wealth fund is relatively smaller than those of other oil-producing nations. In the end of 2021, the total value of Russia's National Wealth Fund was 10 % of Russian GDP. In comparison, the value of Saudi Arabia's pension fund is about 85 % of the country's GDP and the value of the Government Pension Fund of Norway corresponds to roughly 400 % of Norway's GDP. The assets in Russia's National Welfare Fund are mainly invested in supporting domestic corporates and banks. Most of the liquid funds that could be mobilised quickly have already been used to cover the 2024 and 2025 budget deficits.

Chart 1.




The 2026 budget sees federal revenue growing by almost 9 %, while spending increases by just 4 %. This implies a decline in government spending in real terms. The budget also calls for a nominal reduction in defence spending, an unlikely event unless Russia's ceases its war very soon. Government expectations of revenue growth seem quite optimistic, and this year's federal deficit may well be on par with last year's deficit, i.e. about 3 % of GDP.

Russia must finance its burgeoning government spending with the conventional measures available to most countries – raising taxes, requiring larger payments from state-owned businesses and increased government borrowing on bond markets. If needed, certain public expenditures can be cut. For the government, most of what remains is a matter of resource allocation, who gets what. Russia's war chest, if it ever existed, has long been empty.

## 4. Russia's financial problems alone are insufficient to end the conflict, so support for Ukraine must continue

Russia, despite its huge land area, has struggled to find the resources, strategy and military skill to tame Ukraine. The political will for waging the war, however, seems unwavering. Supporting the war effort has become a key priority of Russian economic policies. It is likely the authorities would further transfer economic resources to sectors that support the war if necessary. A recession or dissatisfaction of the average voter is hardly unlikely to change this equation, but decision-making at the top becomes more complicated and nastier as economic conditions degrade. Moreover, the Russian public today seems to have low enthusiasm for fighting imaginary Euro-Nazis on Ukrainian soil. For the moment, tight control, censorship and propaganda seem sufficient to keep the remnants of political opposition quiet.

Russia has poured labour and capital into its war on Ukraine. While the costs of the war to Ukraine's public finances, infrastructure and population have been enormous, it is worth noting that Ukraine's supporters have made only minor economic sacrifices at this point. The Kiel Institute for the World Economy, for example, finds that since the 2022 invasion only six EU members have provided bilateral aid to Ukraine in excess of one percent of their 2021 GDP. [1]

Sanctions can still be further tightened and their implementation made more effective. In addition, the amount of aid provided to Ukraine can be increased many times without destabilising the EU economy. The European members of NATO are committed to increasing their annual defence budgets to 5 % of GDP. What if a tenth of this spending would annually be diverted to defending Ukraine? A half a percent of EU GDP corresponds to about 4.5 % of Russian GDP.[2] Political will, not lack of money, will be the factor that ends this war.

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1. The countries are Denmark, Estonia, Lithuania, Latvia, Sweden, Finland and the Netherlands.
2. The GDP of the EU in 2024 was roughly €18 trillion, while Russian 2024 GDP was about €2 trillion.

## Tags

Russia, sanctions