



Reviewing the Russian Economy a Year After the Invasion of Ukraine

Piotr Dzierżanowski

The sanctions imposed on Russia after its full-scale invasion of Ukraine were unlikely to cause an immediate collapse of the economy. However, they have affected Russian supply chains and harmed its industry, including the defence sector. The sanctions also have curbed revenues from the export of energy resources that facilitate financing of the war. In the medium term, sanctions may bring the expected results and, therefore, it is advisable not only to maintain them and ensure their correct application but also to tighten them.

Western countries' reaction to Russia's invasion of Ukraine in February 2022 included sanctions [limiting Russian imports of advanced technologies and exports of raw materials](#), the [imposition of restrictions on Russian banks to hinder transactions](#), and [freezing the assets of the Russian Central Bank outside the country](#).

The short-term goal was to cause panic among Russia's political and business elites. It was hoped that the unprecedented decision on sanctions would put a halt to the hostilities. The severance of economic ties (especially in the energy sector) was also intended to prevent Russia from exerting pressure on the most dependent Western countries. Should the war continue, the sanctions were to limit Russia's ability to finance military activities (medium-term) and permanently weaken its economy and make it more difficult to start subsequent wars (long-term).

Consequences of the War on the Russian Economy. The lack of reliable data makes it difficult to assess the effects of the war on the Russian Federation. Russian authorities have stopped publishing certain information about economic indicators and those still available may be manipulated. This causes discrepancies in opinion, also in the West: quantitative analyses from the International Monetary Fund (IMF) present a more positive picture for the Russian Federation than those of other research centres, such as the Yale University research group focusing on a qualitative

examination of particular industries, which is easier to conduct without using official Russian data.

Nevertheless, Russia's macroeconomic situation is better than expected immediately after the aggression. The decline in GDP in 2022 was assessed to be between 2.2% (according to the IMF) and 3.9% (according to the OECD) against last year's forecasts by, among others, the World Bank, which predicted around a 10% drop at least. The situation was improved by military procurement stimulating the economy and state aid. Moreover, in October 2021, before the aggression, the IMF forecasted a 3% increase in the Russian GDP in 2022, so any decrease should be assessed against this level. Raising interest rates prevented uncontrolled inflation in Russia, which in December 2022 still reached around 12% year on year. In January 2023, unemployment was reported to drop to 3.7%. However, this data does not take into account hidden unemployment or underemployment and treat conscripts as employed. This signal is also not unambiguously positive for the Russian economy as the country has been facing labour shortages for years.

The sanctions on Russian imports and the withdrawal of foreign companies from Russia have affected supply chains. In the short term, this has meant disruptions for industrial production, and in the longer term, it may translate into technological regression—the use of lower quality substitutes and primitivisation of production processes. The inability to import Western components is already a problem

for a number of industries: automotive, where production fell by 68% year on year (December 2022); aviation, where out-of-order aircraft are used as a source of spare parts; electronic; pharmaceutical; and defence, where the lack of imported chips remains a problem. The economic situation is further complicated by Russia's partial mobilisation (conscription), which has caused an outflow of employees, including highly qualified specialists, which caused downtime in factories, and in the long term will add to demographic problems and labour shortages.

The sanctions on the export of energy resources, crucial to the Russian budget, in the short term contributed to an increase in oil and gas prices. Coupled with the fall in imports it resulted in a current account surplus in 2022. However, since the outbreak of the war, Russian Urals oil has been sold below the world price (about \$30 cheaper than Brent crude, i.e., about \$50 per barrel) and below the level of \$70 per barrel assumed in the Russian budget. Together with the increase in spending on internal security and defence by about 25%, and on social policy (vital for the preservation of the social order) by about 13% in the 2023 budget, this will force the Russian authorities to increase the budget deficit.

Attempted Counteraction by Russia. To ensure the continuity of imports, in April 2022 the Russian authorities allowed parallel imports (without consent of the intellectual property rights-holder) of certain categories of products, such as chemicals, pharmaceuticals, or electronics. Unofficial information indicates an increase in the smuggling of sanctioned goods without any reaction on the part of Russian authorities. Russia also pursues import-substitution policies. The scale of subsidies in this area is unknown, but they certainly contributed to a slight increase in the investment rate in Russia in 2022. Measured against the backdrop of huge state intervention in the economy, however, this cannot be understood as a sign of investor confidence. Russia also has expanded incentives for investments in the field of emerging technologies.

[To sustain exports, Russia is trying to find new markets for energy resources, vital for state revenue.](#) According to the International Energy Agency, the supplies of Russian oil to India have increased several times, and to China, starting from a higher initial level, by several dozen percent. Due to infrastructural limitations (shortage of gas pipelines directed to the east and inadequate LNG infrastructure capacity), Russia has had more problems with redirecting natural gas, which has resulted in a 25% drop in its exports in 2022.

The Russian authorities have taken steps to balance the budget. They imposed a one-time tax of RUB 1.2 trillion (about \$16 billion) on Gazprom and an additional RUB 50 billion (about \$650 million) per month for the next three years. The authorities were also forced to draw from the National Welfare Fund (where profits from trade in raw

materials are accumulated) to cover the budget deficit in December 2022. They also intervened in the currency and financial markets by introducing capital controls and taking political action, including attempts to force payments for natural gas to be made in roubles. Currently, the official currency exchange rate has returned to the pre-war level of about 75 roubles to the U.S. dollar (in March 2022, 1 dollar was up to 130 roubles), although the black market rate is even up to 50% higher. The situation of the Moscow Stock Exchange is similar: even though the restrictions prevented a crash, the main index is still more than 35% below the pre-invasion levels. The Russian authorities prevented a macroeconomic catastrophe, but continuing the intervention means costs for the budget and the economy.

Conclusions and Perspectives. The short-term goals of the sanctions have not been met. However, an immediate halt to hostilities as a result of a sanctions-induced economic panic was unlikely. Even weakened by the asset freeze, Russia remains one of the world's largest economies, and the authorities retain the ability to counter sanctions by using financial reserves and administrative interventions in the economy. This does not mean that the sanctions are ineffective—they were introduced in subsequent tranches and often provided for transitional periods, so their medium- and long-term effects are only just unrolling.

Cutting off Russian industry from Western technologies should gradually reduce Russia's ability to continue the war. The technological regression and unpredictable actions of the Russian government on the energy markets will permanently hurt the country's global economic standing. The growing budget deficit might make it difficult to maintain social stability due to decreases in the real incomes of the population and the limited ability of the central authorities to buy loyalty of the elites, including local strongmen. In case of the depletion of reserves and lack of external support (especially from China), a macroeconomic collapse is likely to occur. This would exacerbate the problems of the Russian economy and force the authorities to turn their attention to domestic problems. In that scenario, Russia's ability to continue the war against Ukraine would be significantly limited, although any readiness to withdraw completely would still not be certain.

Western and other states' actions against Russia, although they have not forced it to end the aggression, have the potential to weaken the Russian economy and budget. Therefore, in the coming months, it will be crucial to strengthen compliance, for example, through inquiries into how EU Member States and other countries that have joined EU sanctions enforce their application, and how third countries (China, Iran, Belarus) might be helping Russia to avoid them.