

Impact of Economic Sanctions on the Russian Economy

(As of October 17, 2022)

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This report analyzes the impact of economic sanctions on the Russian economy, as of October 17, 2022. On the one hand, there are significant influences visible in the production of some goods and imports. On the other, impacts on the price index and national currency seem temporary, and their influence on national finances currently seems ambiguous. While state revenues are supported by oil and gas exports, increases in military expenditures, although hidden by the fiscal authorities, are about to outpace revenues.

GDP

Russia's GDP grew by 3.5% in January-March but decreased by 4.1% in April-June compared to the previous year (Chart 1). In January-March, it appears that the favorable economic conditions of 2021 remained in place. Growth rates were high in key sectors: mining, manufacturing, construction, and transportation. However, the apparently high rates were also accentuated by poor performance in the first quarter of 2021. In April-June, decreases were recorded in sectors such as wholesale and retail trade, manufacturing, and transportation. Forecasts for Russia's economic growth in 2022 by the Ministry of Economic Development of the

(in percent of the corresponding quarter of the previous year)

	2021				2022	
	Q1	Q2	Q3	Q4	Q1	Q2
GDP at basic prices	-0.3	10.5	4.0	5.0	3.5	-4.1
Agriculture, forestry and fishing	-0.8	-0.6	-5.6	4.7	1.5	1.7
Mining	-7.4	7.3	8.2	9.7	8.6	-0.8
Manufacturing	0.1	10.2	3.1	4.6	5.1	-4.0
Construction	2.6	10.4	3.3	6.1	4.7	3.4
Wholesale and retail trade; repairs	1.7	21.2	5.6	5.7	3.7	-14.1
Transportation and warehousing	-2.4	20.0	8.2	6.4	5.4	-3.9
Finance and insurance	6.9	12.7	7.5	5.3	6.6	4.4
Real estate	-0.3	2.5	0.8	0.7	0.2	1.4
Professional, scientific and technical service	-1.4	6.5	5.5	7.3	4.8	-2.3
Public administration and defense; social security	0.5	0.5	1.0	2.5	0.9	1.1
Education	-0.8	1.3	0.9	0.5	0.0	-0.4
Health and social work	-0.6	4.9	0.4	0.4	0.0	-0.5

Sources: Compiled by the author from Rosstat's website.

Chart 1. Growth rate of Russia's GDP by industry

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Russian Federation, the Central Bank of Russia, the IMF, and the World Bank are generally in the range of negative 3-6%.

Industrial Production

Industrial production increased 0.9% in the period from January to August but fell 0.1% in August compared to the same period the previous year, indicating that economic sanctions have had an impact (Chart 2). The breakdown for August shows a 0.8% decline in the manufacturing sector. Looking at August's production in the mining sector, natural gas and coal production had respective decreases of 22.3% and 0.5%, while LNG and crude oil production increased 59.2% and 2.1% respectively. In the manufacturing sector, output in August fell 42.9% in automobiles, showing that the withdrawal of Western companies from Russia has had a significant impact. In addition, other transportation equipment fell 7.2%, chemicals 4.3%, and food 2.3%. The impact of the Western ban on exports of high-tech components and other products is also expected to emerge in the future.

	2022			2022	
	August	Jan-Aug		August	Jan-Aug
Industrial production	-0.1	0.9	Crude oil	2.1	3.1
Mining	1.0	2.4	Natural gas	-22.3	-10.4
Manufacturing	-0.8	0.0	LNG	59.2	13.5
Food products	-2.3	0.2	Coal	-0.5	-1.6
Petroleum products and coke	-1.1	-0.7			
Chemicals	-4.3	-3.0			
Pharmaceuticals	14.3	22.7			
Rubber and plastic products	-0.7	3.8			
Other non-metallic mineral products	4.1	0.8			
Metallurgy	16.0	5.0			
Metal products	5.9	12.1			
Computing, electronic and optical equipment	-0.9	4.8			
Electrical equipment	0.9	-4.1			
General machinery and equipment	9.1	6.7			
Automobiles	-42.9	-42.3			
Other transport equipment	-7.2	-2.0			

Sources: Compiled by the author from Rosstat's website.

Chart 2. Growth rate of Russia's industrial production by industrial sector

International Trade

The Federal Customs Service of Russia has not released any trade-related statistics since April, and the website remains inaccessible. The Central Bank of Russia has not released a detailed balance of payments since April. The information on trade and current account available at this point is almost limited to information in Chart 3. This year's performance shows a marked increase in exports, leading to a substantial increase in the trade and services account as well as current account surpluses compared to the same period last year. The current account

surplus in the first half of this year (146.5 billion dollars) has already surpassed its surplus recorded in the whole year of 2021 (122.0 billion dollars) which was the largest since Russia's independence in 1991. The increase in exports is mainly due to the sharp rise in oil and gas prices. On the other hand, imports fell both in the second quarter and the first half of 2022 due to the restrictions on exports to Russia imposed by the EU and other countries. Whether the increasing trend in the trade and services balance and the current account balance will continue depends on oil and gas exports.

	2021				2022			
	Jan- March	April	May	Jan-May	Jan- March	April	May	Jan-May
Current account	22.5	5.1	4.5	32.1	58.2	37.6	14.5	110.3
Trade and service account	25.8	9.4	9.4	44.5	66.3	40.2	17.8	124.3
Export	104.8				156.7			
Import	79.0				90.4			
Primary and secondary income	-3.3	-4.3	-4.8	-12.4	-8.1	-2.6	-3.3	-14.0
Receipt	16.6				22.5			
Payment	19.8				30.6			
Capital account	0.2				0.0			
Financial account	22.7				58.0			
Net errors and omissions	0.0				-0.3			

Sources: Compiled by the author from CBR's website.

Chart 3. Current account of Russia, in billion dollars

Exchange Rate

The exchange rate for the Russian ruble plummeted from the end of February to the end of March 2022 (Chart 4), falling 38% from 74.7 rubles to the US dollar on February 11 to 120.4 rubles to the dollar on March 11. However, the ruble appreciated rapidly thereafter and returned to its pre-invasion value by around April 9.

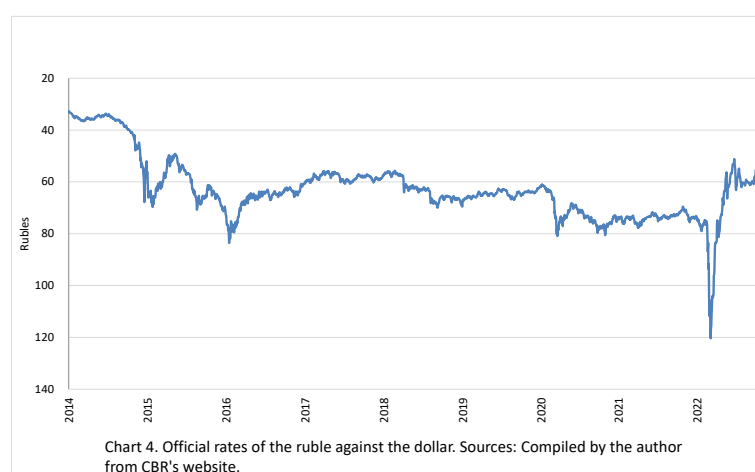


Chart 4. Official rates of the ruble against the dollar
Sources: Compiled by the author from CBR's website.

One of the major factors contributing to this recovery was the introduction of a measure obliging exporters to sell 80% of their foreign currency earnings (Presidential Decree No. 79, February 28). The continued export of oil, gas, and other commodities, added with soaring oil and gas prices, has resulted in an abundant inflow of foreign currency into the foreign exchange market.

On May 26, the ruble exchange rate rose to 56.3 rubles to the US dollar, the standard around February 2018. Given the high inflation rates, this means that ruble has strengthened considerably in real terms. Taking these circumstances into account, the mandatory sale of foreign currency was reduced from 80% to 50% of foreign currency on May 23 and virtually abolished on June 9 (Presidential Decrees No. 303, May 23 and No. 360, June 9). As long as exports of oil, gas, and other commodities continue, another collapse of the ruble is unforeseeable.

Foreign Exchange Reserves

Russia's foreign exchange reserves reached an all-time high of over \$630 billion in 2021 (Chart 5). This is the fourth highest level in the world after China, Japan, and Switzerland. In 2022, the reserve peaked at \$643.2 billion on February 18 and has been declining, falling by \$90 billion from the beginning of the year to the beginning of October.

The Central Bank of Russia announced it would begin intervening in the foreign ex-

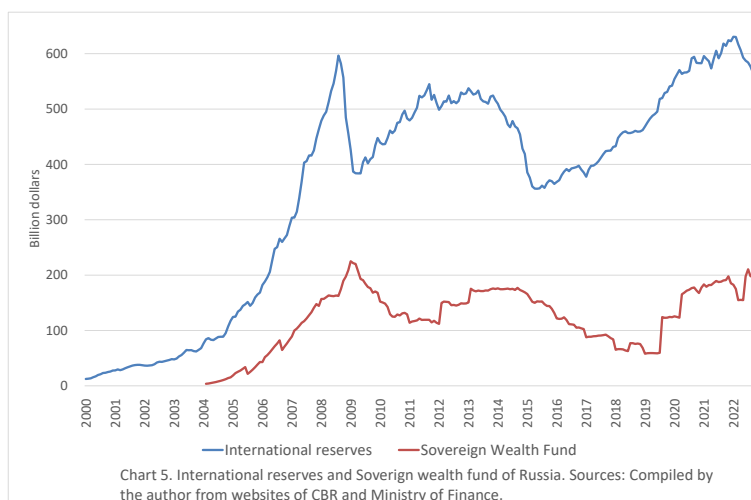


Chart 5. International reserves and Sovereign wealth fund of Russia
Sources: Compiled by the author from websites of CBR and the Ministry of Finance.

change market, which they officially have not done since August 2015. The data is available on the Bank's website (https://www.cbr.ru/hd_base/valintbr/) and shows that intervention took place on February 25 and 28 for a total intervention amount of \$1.2 billion.

Because the Bank has stopped releasing data on the breakdown of foreign exchange reserves since March, the reason of their decrease is not clear.

Inflation

The inflation rate remained at the same level as the previous year until February 2022 (8.4% in 2021) but jumped sharply in March. On a year-on-year basis, inflation was 9.2% in February, 16.7% in March (Chart 6). On a month-to-month basis, there was an unusual increase of 7.6% in March (Chart 7). Particularly notable was the increase in non-food prices, which rose 11.3% in March. This rise may have been due to Russians’ panic shopping, reacting to

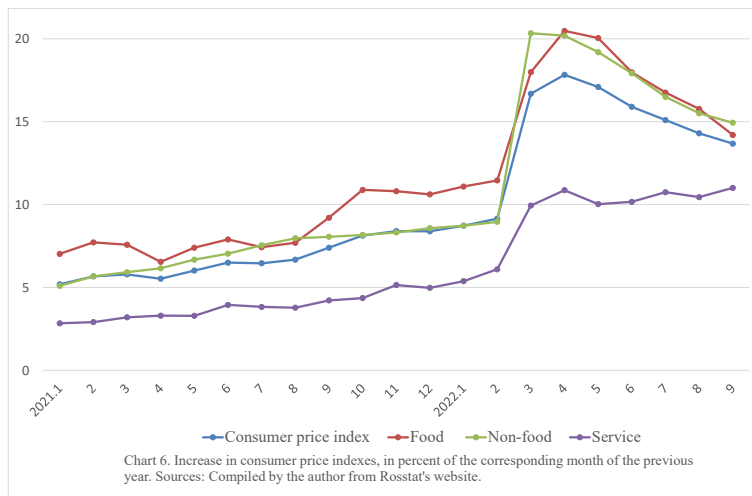


Chart 6. Increase in consumer price indexes, in percent of the corresponding month of the previous year Sources: Compiled by the author from Rosstat’s website.

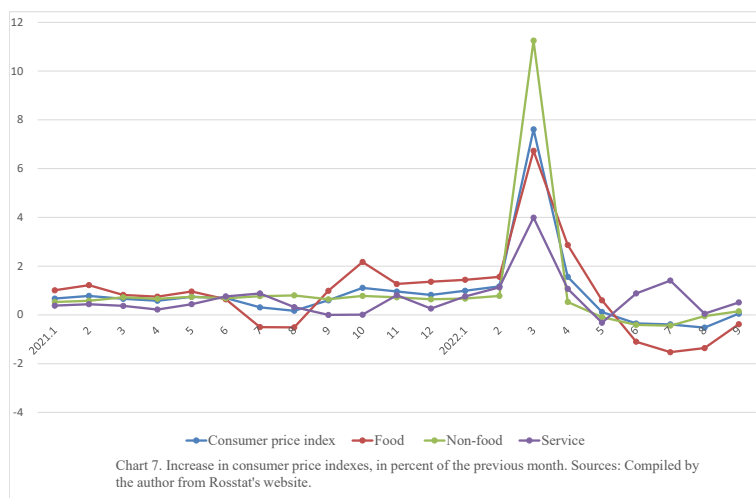


Chart 7. Increase in consumer price indexes, in percent of the previous month Sources: Compiled by the author from Rosstat’s website.

the implementation of sanctions. The ruble's depreciation during the same period, which led to increasing prices for imported goods, also contributed to the inflation.

In contrast to this March spike, monthly inflation rate has fallen substantially since April. This suggests that the March inflation rate spike was temporary. However, because of the sharp increase in March, the annual inflation rate for 2022 will be as high as 14%, supposing that the monthly rate of price increase after October is the same as last year's.

Public Finance

Since April, the Federal Treasury has ceased to publish federal budget performance and the Ministry of Finance has also restricted its publications. Some of the data in Chart 8, including expenditure data, are obtained from reports published by the Economic Expert Group (EEG), a think tank of the Russian Ministry of Finance.

According to Chart 8, total revenue increased by 12.2%. This is due to a considerable increase in oil and gas revenues. As shown in Chart 9, most oil and gas revenues come from mineral extraction taxes and export duties. Compared to the same period of last year, total oil and gas revenues in January-September 2022 increased by 37.5%, while mineral extraction taxes and export duties grew by 55-56%. The first reason for this increase is the rise in oil and gas prices. Second, the West did not reduce its imports of oil and gas from Russia as much in January-September. On the other hand, non-oil and gas revenues decreased by 4.3% (Chart 8).

	Jan-Aug of 2011		Jan-Aug of 2022			
	Billion rubles	Share (%)	Billion rubles	Share (%)	Increase, billion rubles	Increase rate (%)
Total revenue	15,697.8	100.0	17,606.9	100.0	1,909.1	12.2
Oil and gas revenue	5,465.7	34.8	7,818.3	44.4	2,352.6	43.0
Non-oil and gas revenue	10,232.1	65.2	9,788.6	55.6	-443.5	-4.3
Corporate tax	991.2	6.3	1,163.0	6.6	171.8	17.3
Value-added tax	5,716.5	36.4	5,861.0	33.3	144.5	2.5
Other (calculated value)	3,524.4	22.5	2,764.6	15.7	-759.8	-21.6
Total expenditure	14,620.7	100.0	17,469.4	100.0	2,848.7	19.5
National business	1,041.0	7.1	818.0	4.7	-223.0	-21.4
National defense	1,824.1	12.5	914.0	5.2	-910.1	-49.9
Security	1,346.4	9.2	1,053.0	6.0	-293.4	-21.8
National economy	2,102.4	14.4	2,176.0	12.5	73.6	3.5
Housing and public business	316.7	2.2	498.0	2.9	181.3	57.2
Environmental protection	277.3		213.0	1.2	-64.3	-23.2
Social and cultural measures	6,337.3	43.3	6,794.0	38.9	456.7	7.2
Government debt interest payment	675.3	4.6	890.0	5.1	214.7	31.8
Transfer to regional finance	700.3	4.8	712.0	4.1	11.7	1.7
Other (calculated value)	-0.1	0.0	3,401.4	19.5	3,401.5	
Budget surplus	1,077.0	...	137.4	...	-939.6	-87.2

Sources: Compiled by the author from websites of Federal Treasury, Ministry of Finance, and EEG.

Chart 8. Federal budget performance of Russia, in billion rubles

In the January-August period, total expenditure increased by 19.5%. Although national defense expenditures halved this year in Chart 8, this was due to changes in definition of these expenditures. Since May of this year the Ministry of Finance published small figures for national business, national defense, and security. As a result, volume of “Other” increased tremendously, which had been almost zero until March of this year. It is clear that the fiscal authorities are trying to hide the inconvenient figures.

In this period, total revenue slightly surpassed total expenditure. However, since June there have been recorded deficits of the federal budget every month. The overall finance in 2022 is expected to face a deficit, the scale of which depends on what happens to oil and gas revenues in the future.

In Russia, budget deficits have in the past been compensated for by drawing down the National Welfare Fund, a sovereign wealth fund, rather than by government bonds. This fund’s primary role is to cover budget deficits when oil prices are low, and is formed by accumulating a portion of oil and gas revenues when oil prices are high. As seen from Chart 5, the Fund has been increasing since 2019. As of the beginning of October 2022, its volume was 10.8 trillion rubles or 7-8% of GDP of this year. It may be depleted within a couple of years, if annual deficits are in the range of 2-3%.

	2021	2022		
	Jan-Sept	Jan-Sept		
	Billion rubles	Billion rubles	Increase, billion rubles	Increase rate (%)
Total	6,184.6	8,506.5	2,321.9	37.5
Mineral extraction tax	4,918.4	7,662.4	2,744.0	55.8
Crude oil	4,337.4	6,880.4	2,543.0	58.6
Natural gas	413.2	489.5	76.3	18.5
Gas condensate	167.9	292.3	124.4	74.1
Export duty	1,406.1	2,187.3	781.2	55.6
Crude oil	485.6	487.7	2.1	0.4
Natural gas	658.3	1,493.8	835.5	126.9
Petroleum product	262.4	205.7	-56.7	-21.6
Additional income tax on mining of hydrocarbon raw materials	642.5	1,373.9	731.4	113.8
Excise tax on oil materials	-782.6	-2,717.0	-1,934.4	247.2

Sources: Compiled by the author from Minfin’s website.

Chart 9. Oil and gas revenues of Russia