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Russia's budget for 2025: war above all

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On 21 November, the State Duma approved, at the third reading, the draft federal budget for 2025 and the general parameters of the 2026–27 budgets. Expenditure will increase for another consecutive year, primarily due to spending on national defence rising at a double-digit rate and internal security. These two categories, which fund the requirements of the army and measures to maintain supervision of society, will account for more than 43% of the budget, while funds for the military are also concealed in other budget chapters. The ongoing war will increasingly be financed by businesses and citizens, as the Kremlin plans to increase the tax burden while reducing expenditure on social welfare and human capital.

The 2025 budget demonstrates the Kremlin's determination to wage war regardless of the costs and growing economic challenges. Last year, the government planned for the largest funds to be allocated to the military campaign in 2024, with the aim of reducing war expenditure in subsequent years. It anticipated Ukraine's defences would collapse and the intensity of military operations would at least diminish. However, this optimistic scenario has not materialised, necessitating a further drain on the national economy and citizens. Despite this, Vladimir Putin is hoping that the West's readiness to support Kyiv will run out faster than Russia's financial resources.

To finalise the budget approval procedure, the Federation Council is still required to approve the document, and Putin must sign it. This should occur in the coming weeks.

Funding the war is a priority

In 2025, the state's expenditures are expected to increase to 41.5 trillion roubles (approximately $415 billion at the current exchange rate), representing a 5% rise compared to 2024 spending as estimated by the government. Notably, this year's spending has already been increased twice (in July and October) and is expected to reach 39.4 trillion roubles, which is 2.7 trillion roubles more than the amount defined in the budget law enacted in November 2023. This means that this year's budget outlays will be as much as 18% higher than last year's expenditure. Most likely, the majority of the additional funds will be allocated to the military, although no details of their distribution have been revealed.

In accordance with Russia's usual practice, real spending can be significantly adjusted during a given fiscal year, depending on the Kremlin's current priorities. Thus, the government plans for the 2025–27 budget should be regarded as general concepts rather than specific tasks (see Chart 1).

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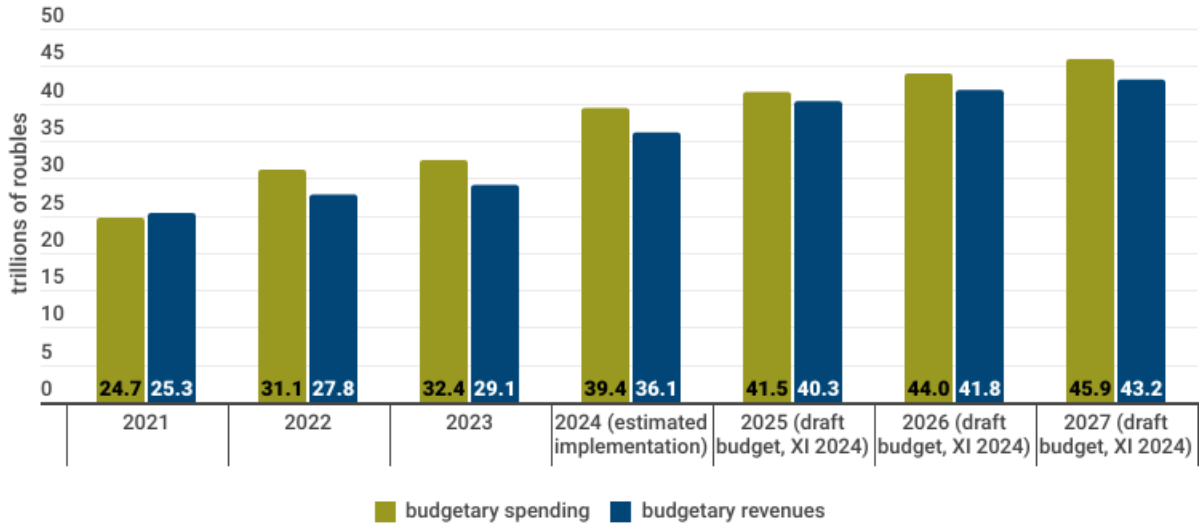
Chart 1. Budgetary spending and revenues from 2021 to 2027



Source: Russian State Duma; Ministry of Finance of the Russian Federation.

In 2025, war-related spending will increase significantly. The largest rise in expenditure is planned in the "**national defence**" section, reaching 13.2 trillion roubles (approximately $132 billion), compared to 10.8 trillion roubles allocated for this purpose in the 2024 budget (a 22.2% increase). This sum is also more than 55% higher than the planned spending on this category in 2023. According to the budget law for 2024–25, which was adopted in November 2023, national defence expenditure had been expected to decrease to 8.5 trillion roubles in 2025.

It should be noted that the funds allocated to "national defence" will not only represent the largest item (accounting for almost 33% of total expenditure) but also the most confidential one in the 2025 budget. As much as 85% of these funds have not been earmarked for specific tasks. The document merely outlines their general purpose as "equipment for the armed forces, financial allowance payments, and support for companies operating in the military-industrial complex" (see Chart 2).

In 2025, expenditure in the "**internal security**" chapter is also expected to increase (by 2% year-on-year), with this item accounting for 10.5% of the budget. It funds various institutions, including those directly involved in the war, such as the National Guard and the Federal Security Service, as well as those responsible for repression and societal control (the police and the prison service).

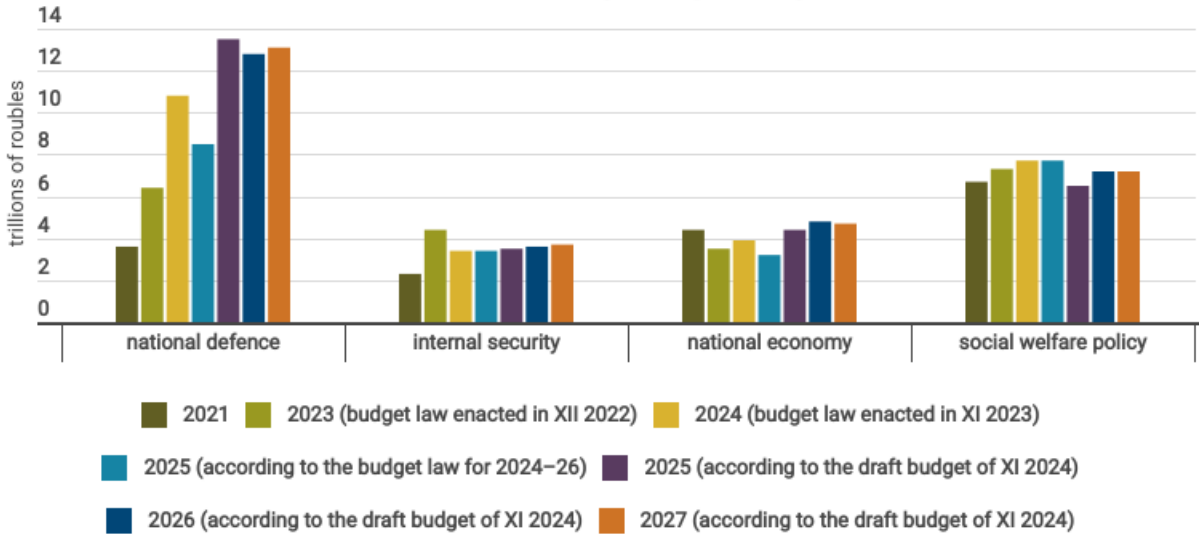
Spending on the **national economy** is likewise expected to rise (by approximately 13% year-on-year). This aims to support businesses, including state-controlled companies, as well as fund import substitution programmes and infrastructure projects. Most of these funds will be directed towards defence sector companies and businesses operating in the occupied regions.

In parallel, spending on **social welfare policy** is projected to decrease (by nearly 16% year-on-year). In 2025, 25% of the planned funds, roughly $17 billion, will be allocated to military pensions and housing, while $14 billion will be designated for social welfare benefits for newborns and their upbringing. Starting from 2024, this spending category no longer

represents the largest item in the federal budget. Moreover, the funds allocated to it are expected to be more than 50% smaller than the amount assigned to the military. Funding for healthcare and education will increase only nominally, remaining significantly below the rate of inflation. The government is also gradually withdrawing from several costly programmes. For instance, in July 2024, it cancelled the widely available preferential mortgage loans, retaining this lending option solely for families with children. Additionally, it has shifted an increasing share of spending on human capital and social welfare policy to the regions, while reducing the transfers they receive from the federal budget.

In spring 2022, citing national security concerns, the government ceased publishing detailed information on the actual budget expenditures – now, it only provides the total amount of spending, without breaking it down into specific categories. Since then, the only available information has been the planned allocation of funds to specific items, as outlined in the budget laws, while actual spending may differ significantly from these plans (this is particularly true for national defence).

Chart 2. The federal budget's spending structure



Źródło: Ministerstwo Finansów FR.

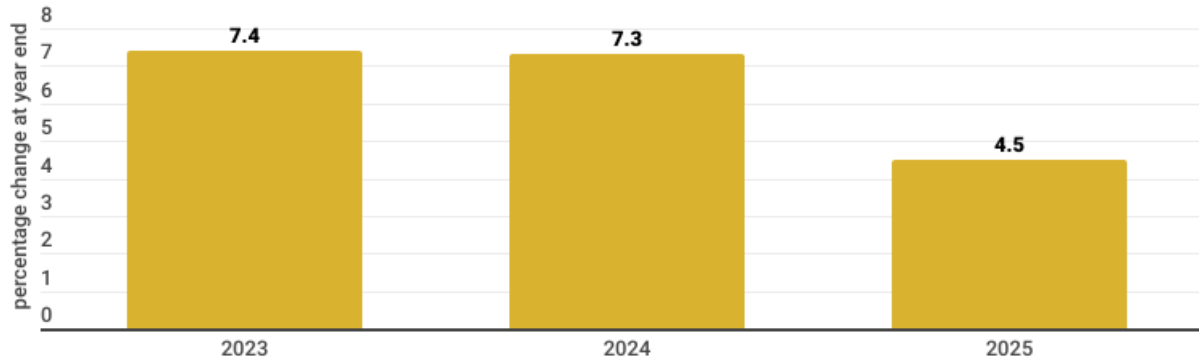
Increased tax burden

The rising costs of the war have compelled the Kremlin to continue shifting the burden onto society and businesses. According to government plans for 2025, state budget revenues are expected to increase by 12%, reaching 40.3 trillion roubles (approximately $420 billion, based on the exchange rate assumed in the 2025 budget). The government anticipates receiving an additional 2.5 trillion roubles through higher taxes. Nearly 65% of this amount will result from an increase in the corporate tax rate to 25% (up from 20%), while a further 20% will come from higher personal income taxes, following the reintroduction of a progressive tax scale. Excise duties on petrol, alcohol, and cigarettes will also rise. Furthermore, the government plans to increase the prices of utility services (including communal housing, water, gas, and transport) beyond the official inflation rate. Consequently, the share of non-oil-and-gas revenues in the budget will rise to 73% (up from 69% in 2024 and 61% in 2019).

In 2025, oil and gas revenues are projected to decline by approximately 3% year-on-year, to 10.9 trillion roubles (approximately $113 billion). The government has assumed an average annual price of $69.7 per barrel of exported oil (compared to $70 in 2024). However, due to changes in the method used to estimate the average export price of oil, which serves as the basis for calculating corporate tax rates, the actual price may exceed the revenue effectively earned from oil exports.

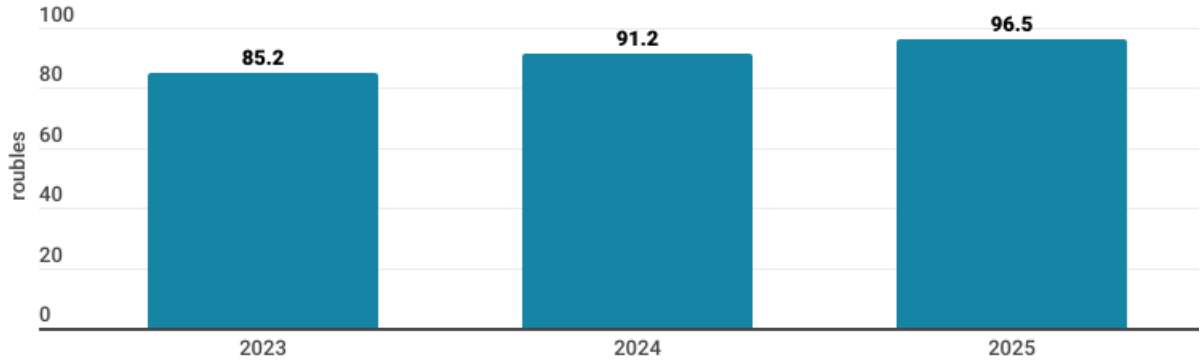
Inflation and the depreciation of the rouble are also expected to benefit the revenue side of the budget. According to the government's socio-economic development scenario for Russia in 2025, which forms the basis for next year's budget, prices are forecast to rise by 4.5% (see Chart 3), and the rouble is projected to depreciate by approximately 6% against the dollar (see Chart 4).

Chart 3. Inflation



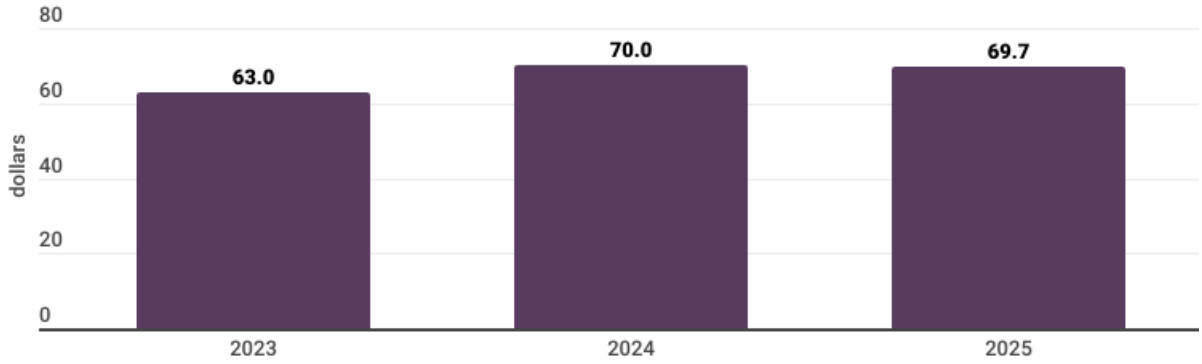
Source: Rosstat, the government of the Russian Federation.

Chart 4. Average US dollar to rouble exchange rate



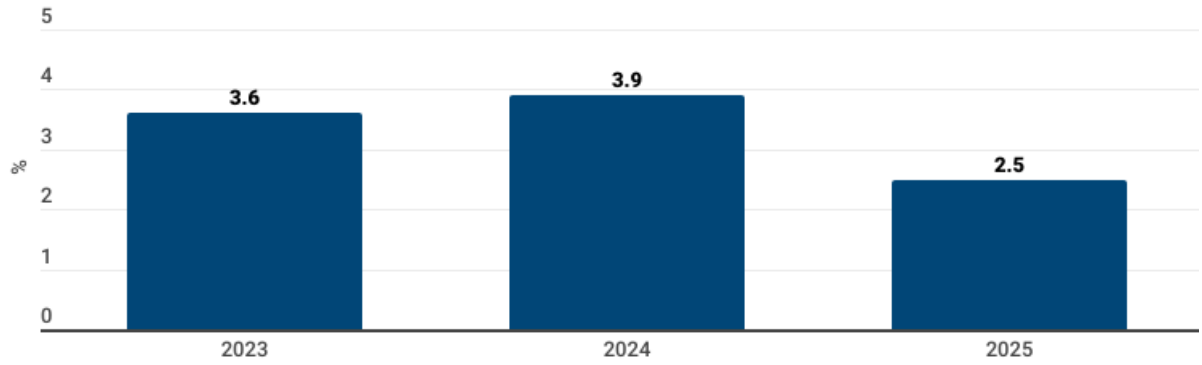
Source: Central Bank of the Russian Federation; the government of the Russian Federation.

Chart 5. Average export price of a barrel of oil



Source: the government of the Russian Federation.

Chart 6. GDP growth



Source: Rosstat, the government of the Russian Federation.

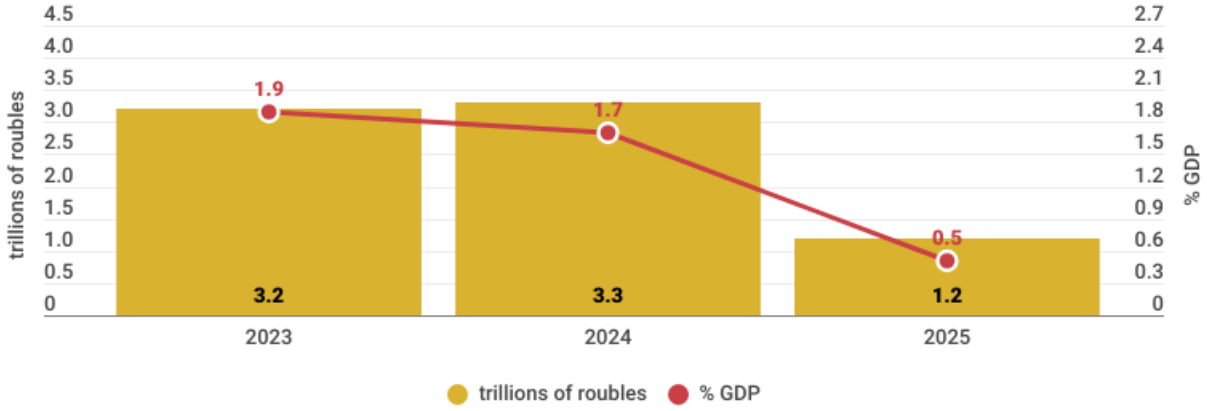
Funding the budget deficit

For another consecutive year, the government plans to reduce the deficit, which in 2025 is expected to amount to 1.2 trillion roubles (approximately $12.5 billion). Although, according to the budget law adopted in November 2023, the deficit for 2024 was projected to be 1.6 trillion roubles (0.9% of Russia's GDP), it more than doubled due to the need to finance the war (see Chart 7). Consequently, it is unlikely that the deficit will be reduced in 2025. The deficit will primarily be financed through debt financing on the domestic market. By the end of 2024, total debt is expected to rise to 15.7% of GDP and further to 16.5% in 2025, with government bonds being predominantly purchased by state-controlled banks, as sanctions have cut Russia off from foreign markets.

Meanwhile, the rising basic interest rate (currently 21%) is causing a dynamic increase in debt servicing costs. In 2024, 5.8% of budget expenditure is expected to be allocated for this purpose, rising to to 7.7% in 2025. The liquid assets of the National Welfare Fund (NWF) are forecast to decline by 10% in 2024, to 5.3 trillion roubles (2.7% of GDP). This reduction will result from the depreciation of the rouble (the liquid assets held in the Central Bank's accounts have been invested in yuan and gold) and the consistent rise in the average price of exported oil above $60 per barrel, which allows the government to use additional

revenues to purchase yuan and channel them into the NWF. Consequently, the NWF is projected to receive 7.3 trillion roubles in 2025, equivalent to 3.4% of Russia's GDP.

Chart 7. Federal budget deficit



Source: the government of the Russian Federation.

The Kremlin demonstrates its determination

The budget parameters, including those related to defence spending, reflect a significant shift in the Kremlin's plans. In the budget for 2024–26, which was adopted in December 2023, a reduction in state spending was initially anticipated for 2025, particularly in defence. However, escalating wartime demands have compelled the government to significantly raise expenditure in both 2024 and 2025.

Defence and internal security will account for over 43% of the officially planned budget expenditure. However, the actual public costs of the war will effectively be higher, as some military spending has been concealed within other budget items (for example, in the "economy" section that funds weapons development and the expansion of the military-industrial complex's production capacity). Consistent with usual practice, a significant proportion of federal budget spending (approximately 30% in 2025) remains classified, with most of it allocated for military purposes.

The significant increase in defence expenditure for 2025, contrary to the initially planned reduction, indicates that the Kremlin was overly optimistic about the prospects of breaking Ukraine's defences in 2024 and at least reducing the intensity of military operations in the subsequent years (or even ending them after achieving certain political objectives). Currently, the Russian government appears to be preparing for a prolonged war.

In 2026, spending on national defence is expected to remain high at approximately 12.8 trillion roubles (around $138 billion), compared to the 7.4 trillion roubles planned in 2023. This may be interpreted as a signal of Moscow's resolve to pursue the war until achieving victory. This message is likely intended for Washington and its key allies, pressurising them to explore ways to freeze the conflict in exchange for significant concessions from Kyiv.

Given the increasingly slow pace of economic growth due to the depletion of production capacities, achieving the projected GDP growth in 2025 may prove unattainable. Current forecasts from the Central Bank of Russia are more pessimistic than those issued by the

government, as they predict GDP growth to be just 0.5–1.5% and year-end inflation of 5.5%. This implies the continuation of restrictive monetary policies and high borrowing costs, likely discouraging investment.

The rouble exchange rate may also turn out less favourable than expected. Data for 2024 shows that US sanctions tightening typically results in a decline in both import and export revenues, with imports falling faster than exports. This has a negative impact on the current account balance and creates a currency shortage in the domestic market. Consequently, difficulties in meeting revenue targets could arise, potentially necessitating an increase in the deficit.