

## Russia's economy: heading towards recession?

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Preliminary estimates indicate that in the first quarter of 2026, Russia recorded a decline in GDP for the first time in three years. This points to a deterioration in the negative economic trends observed since the end of 2024. The decline in activity affects virtually all civilian sectors and industries, while slower growth is also evident in sectors supporting the military. Despite these trends, which stem from Russia's aggression against Ukraine and Western sanctions, the Kremlin continues to pursue its current policy. It is increasing war expenditure and making it more difficult for businesses to operate by introducing further market regulations. Consequently, the public finance deficit is widening. Cut off from inexpensive foreign credit, the Russian government must borrow on the domestic market. To a large extent, this takes place through rouble issuance, which increases inflationary pressures and exacerbates existing difficulties.

An important source of support for Russia's budget has been the rise in the price of Russian oil exports, recorded since March 2026. Even if prices remain at their current level, the budget will most likely still end the year in deficit, although the shortfall is likely to be far smaller than suggested by the results for the first four months of 2026. The improvement in conditions on global energy markets does not, however, resolve the structural problems facing the Russian economy.

**The slowdown in economic activity in Russia has led to stagnation.** According to official statistics, GDP grew by 1% year-on-year in 2025 as a whole, meaning that economic growth was almost five times lower than in the previous year. However, preliminary estimates by Russia's Ministry of Economic Development for GDP **in the first quarter of 2026 indicate a year-on-year decline of 0.3%** (Rosstat does not publish monthly data and estimates for the full quarter have not yet been released). At the same time, it should be noted that there are numerous reservations regarding the reliability of Russian statistics.

Negative trends were observed across all components of demand, including investment, household consumption, and exports.

**Retail trade**, the main component of consumer demand, declined significantly as early as 2025 and remained weak in the first quarter of 2026. In real terms, after accounting for inflation, its value most likely declined. Greater caution in consumer spending was accompanied by changes in purchasing behaviour, with shoppers increasingly seeking cheaper goods on online platforms. Consequently, retail outlets began closing on a large scale: in 2025, their number fell by 5% in Moscow and by 4% in St Petersburg. The textile sector has been particularly affected. In 2025, the number of clothing retailers declined by 12%, while most of the roughly 20 clothing brands that ceased operations in Russia were

domestic producers.

Rosstat data continue to show strong nominal growth in turnover in the catering sector, rising by 8.7% year-on-year in 2025 and by a further 10.9% year-on-year in the first two months of 2026. This contrasts with reports from private restaurant operators, who have been forced to scale back their operations. In March 2026, the number of restaurants and bars in large cities was 5% lower than a year earlier.

Russia's shrinking revenues are also having a negative impact on investment capacity, which not only constrains development but also makes it more difficult for businesses to adapt to changing market conditions. **In 2025, investment in fixed assets in Russia declined by 2.3% year-on-year**, marking the first fall since 2020, although a slowdown in investment growth had already become evident in 2024. This negative trend is expected to continue in 2026: the government forecasts a decline in investment of 0.5% year-on-year, although assessments prepared by the business sector are far more pessimistic. For example, Russian Railways, one of the country's largest investors, has found itself in a particularly difficult position. In 2025, it reduced capital expenditure by more than 40% year-on-year and has planned a further reduction of 17% for 2026. Last year, the oil company Rosneft also reduced investment spending by 6% year-on-year, although no information has been released regarding planned expenditure for 2026.

**Negative trends are visible across all areas of the economy, and even sectors supporting the military are showing slower growth in output.** Strong growth is being maintained mainly in the production of military transport equipment, including drones, classified under the category 'production of other means of transport', while the production of ammunition and firearms, included under 'production of finished metal products', began to decline in the first months of 2026. A discussion on military drone production organised by Russia's Ministry of Industry and Trade, which was hacked by a Ukrainian prankster,<sup>[1]</sup> revealed that 90% of the materials required for drone production, including electronics as well as cables and plastics, come from China, as no Russian substitutes exist.

Across virtually all sectors and branches of the Russian economy, the number of companies facing a deteriorating financial situation is increasing. In 2025, the share of enterprises reporting losses exceeded 27%. This reflects both declining turnover and the steadily rising cost of debt servicing.

**The automotive industry remains in a severe crisis**, particularly the heavy goods vehicle (HGV) segment, where output fell by more than 30% year-on-year in 2025 and by a further 30% in the first quarter of 2026. Kamaz, Russia's largest truck manufacturer, which also fulfils orders for the military – accounting for approximately 30% of total production in 2024, with no more recent data available – ended 2025 with a net loss of almost \$0.5 billion, 11 times higher than a year earlier. Like other Russian automotive manufacturers, the company operated on a reduced four-day working week for most of the second half of 2025.

**The metallurgy sector is also sinking deeper into crisis.** Although output in the sector declined by only 2.1% in 2025, largely thanks to the performance of non-ferrous metallurgy, including gold production, demand for steel fell by 15% year-on-year during the same period and continued to decline at a similar rate in the first quarter of 2026, primarily due to the

slowdown in construction. This led to a collapse in the steel industry. For example, production of pipes for the oil and gas sector fell by more than 21% year-on-year in 2025, while stainless steel output declined by 17%. Consequently, the net profit of Severstal, Russia's largest steel producer, fell 4.7-fold year-on-year in 2025 to approximately \$400 million. In the first quarter of 2026, the company still managed to generate a marginal profit, but its revenues fell to their lowest level since 2021.

**The extractive sector**, particularly the energy industry, **is also facing serious difficulties**, recording a decline of 1.8% year-on-year in 2025. The slight increase of 0.8% year-on-year in the first quarter of 2026 was largely the result of a low base effect from the previous year. Although the reduction in extraction volumes was limited, the fall in global commodity prices in 2025 affected the financial position of companies in the sector. Lukoil, Russia's second-largest oil company, recorded a record net loss of almost \$13 billion in 2025. Its results were affected primarily by the need to write down the value of foreign assets lost as a result of US sanctions. Surgutneftegaz also ended the year with a net loss of \$3 billion, while the other two major Russian energy companies, Rosneft and Gazprom Neft, still managed to post profits, although these were respectively 3.5 times lower (\$3.5 billion) and twice as low as (\$3 billion) a year earlier. A major challenge for Russia's oil sector remains the continuing Ukrainian drone attacks on Russian refineries and transport infrastructure.<sup>[2]</sup> These attacks, including those targeting export terminals, have continued since mid-2025 and intensified in the first quarter of 2026. Consequently, Russia's export transport capacity has been reduced, which has, among other effects, forced cuts in oil production. For now, however, it is difficult to estimate the scale of these reductions, as the Russian government has not published such data since 2022.

**In 2025, the coal industry entered a state of crisis**, as low export prices for coal coincided with rising logistics costs, driven mainly by steadily increasing rail transport tariffs in Russia. Consequently, the entire sector ended the year with a net loss, while more than 65% of coal companies recorded negative financial results. In the first quarter of 2026, the sector's difficulties deepened further and output declined by more than 5% year-on-year.

Although the value of construction work carried out in 2025 was 2.5% higher than in the previous year, **in the first quarter of 2026 the sector recorded a 10% year-on-year decline for the first time since 2020**, although the result was also likely affected by the exceptionally harsh winter. Stagnation is particularly evident in the housing sector. In 2025, the same volume of residential floor space was completed as in the previous year, but in the first quarter of 2026 the figure was already almost 30% lower year-on-year. In addition, the share of apartments sold relative to those under construction remains low, at just over 30%. Approximately 20% of projects are also completed with delays of at least six months.

According to data from the Central Bank of Russia (CBR), banks issued only 968,000 mortgage loans in 2025, more than 25% fewer than in 2024 and 50% fewer than in the record year of 2023, marking the weakest result since 2016. At the same time, more than 80% of these loans were granted on preferential terms (with annual interest rates of around 8%, compared with market rates of approximately 20–30%), under government support programmes for families with children and for military personnel involved in the war in Ukraine, as well as their families. The total value of these loans was only 9% lower year-on-year, reflecting the sharp increase in property prices. In the first quarter of 2026, the number of mortgage loans issued increased by more than 65% year-on-year, although it remained

more than 40% lower than in the final quarter of 2025. This was linked to a further tightening of the rules governing preferential mortgage lending introduced in February 2026. At the same time, the gradual reduction in interest rates led to an increase in the number of mortgages granted on market terms. In March, interest rates on such loans fell below 20%, compared with almost 30% a year earlier. Consequently, the share of market-based mortgages rose to 40% of the total value of mortgage loans issued in March 2026.

**High debt servicing costs have led to an increase in the share of overdue mortgage loans.**

In March 2026, for the first time since 2018, their share exceeded 1% and was double the level recorded a year earlier. In 2025, demand for loan restructuring in Russia, including requests for repayment deferrals and extensions of repayment periods, increased by 50%.

**The slowdown in economic activity has been felt particularly strongly in the transport sector.** Although freight volumes, measured in millions of tonnes, across all modes of transport, remained at the previous year's level in 2025 and declined by 2.6% in the first quarter of 2026, **rail transport in particular entered a difficult period**, with freight volumes falling by 5.7% and 3.1% respectively. Thanks to further increases in transport tariffs, the state-owned Russian Railways managed to end last year with a profit. However, this was 95% lower than a year earlier and amounted to 2.3 billion roubles, or approximately \$27 million. The company's debt reached a record 3.8 trillion roubles (approximately \$45 billion), representing an increase of more than 25% year-on-year. In addition, the state-owned company reduced investment by around 40% last year and, as part of cost-cutting measures, cut staffing levels at its central administration by 15%.

**In 2025, both exports and imports declined, by approximately 4% and 1.5% respectively, in dollar terms. Export performance was affected primarily by the fall in the price of Russian oil, which had been declining since the beginning of 2025.** This was linked both to global market conditions and the continuing oversupply of crude oil on world markets, as well as to sanctions imposed by the United States in October 2025 on Russia's two largest energy companies, Rosneft and Lukoil. Consequently, buyers from third countries became reluctant to cooperate with Russian entities for fear of secondary US sanctions. This significantly widened the discount on Russian oil exports, with Urals crude trading at around \$30 per barrel below Brent. In December 2025, the price of a barrel of oil at Baltic ports fell below \$40 and did not exceed \$45 until the end of February 2026, compared with around \$60 in mid-2025 and an average of \$68 in 2024.

**With the outbreak of war in the Persian Gulf, not only did oil prices rise sharply, but demand for Russian oil also increased, leading to the near elimination of the discount on Russian exports** (according to calculations by the Russian government, the average price of exported crude reached \$77 per barrel in March 2026 and almost \$95 in April). However, the revenues generated by higher global oil prices will materialise with a delay of up to two or three months due to the sanctions-related extension of financial transaction procedures. At the same time, a major source of support for exports in 2025 was the sharp increase in global gold prices, which rose by approximately 65% year-on-year. The upward trend also continued in the first months of 2026.

The slowdown in imports was driven primarily by weaker economic activity in Russia, but also by the government's protectionist policies, which have led to higher prices for imported goods and a decline in demand for them.

From mid-2025, the effects of the central bank's efforts to curb inflation began to become apparent. Consequently, inflation fell to 5.9% year-on-year in March 2026. However, it remained higher than at the end of 2025, largely due to the two percentage point increase in value added tax (VAT) introduced in January 2026. Prices for services rose the fastest, increasing by as much as 9% compared with a year earlier. Although food prices overall rose by only 5% year-on-year, the price of bread increased by more than 10%, as did prices for alcoholic beverages. Prices for some industrial goods also rose sharply, with petrol prices increasing by more than 12% year-on-year and medicines by 9%. At the same time, it should be noted that Rosstat's methodology for calculating inflation has been heavily criticised and raises numerous doubts. According to consumers, price growth is far higher than the official rate. In a survey commissioned by the Central Bank of Russia in March 2026, respondents estimated inflation at 15.6% and expected prices to rise by a further 13.4% over the following 12 months.

The slowdown in inflation was largely the result of the **restrictive monetary and lending policy pursued by the Central Bank of Russia** since the end of 2023, which sharply limited access to financing and thereby suppressed demand. The slower pace of price growth enabled the CBR to begin **gradually easing** this policy in June 2025. Consequently, after the eighth consecutive rate cut, the key interest rate fell to 14.5% in April 2026, down from 21% in June 2025. Despite this substantial reduction, the rate remains high and continues to severely restrict access to capital. It should also be noted that since 2022, when sanctions cut Russia off from cheap Western credit, Russian entities have become dependent on domestic sources of financing.

The CBR is taking a cautious approach to the possibility of further interest rate cuts. In its assessment, strong inflationary pressures persists in the country, currently driven by three main factors: labour shortages, the war in the Persian Gulf destabilising global markets and, above all, Russia's rising budget expenditure.

**Since the beginning of 2025, imbalances in the public finances have increased significantly.** Low export prices for oil led to a substantial reduction in oil and gas revenues, which fell by more than 20% year-on-year in 2025 and by almost 40% year-on-year in the first four months of 2026. The rise in oil prices in March 2026, linked to the US and Israeli strikes on Iran, was reflected in Russia's budget only in April. Meanwhile, the slowdown in domestic economic activity meant that growth in non-oil revenues, despite the heavier tax burden imposed on the economy, proved weaker than the government had expected.

**At the same time, the Kremlin was rapidly increasing expenditure, primarily to support the war effort.** According to a statement by Russia's Defence Minister Andrei Belousov in December 2025, 11.1 trillion roubles, or approximately \$133 billion, were allocated directly from the federal budget to the needs of the armed forces deployed in Ukraine in 2025, equivalent to 5.1% of GDP and 25% of total budget expenditure. The war therefore absorbed 70% of the funds allocated in the budget for national defence as a whole, which totalled 15.9 trillion roubles, or 7.4% of GDP. Most likely, however, these estimates do not include spending on institutions such as the National Guard, the FSB or the prison service, all of which are also involved in operations in the occupied territories. This means that actual defence spending exceeded the level envisaged by the government in the budget law by approximately 20%. Overall, roughly half of all budget resources were directed towards the



law enforcement sector. Consequently, the federal budget deficit in 2025 increased fivefold compared with the government's original projections.

**The actual gap in the public finances was far larger, amounting to 8.3 trillion roubles, or approximately \$100 billion, equivalent to 3.9% of GDP.** This was largely due to the regions and social welfare funds, whose expenditure also significantly exceeded revenues, while the federal government did not provide additional support. Consequently, they were forced to increase borrowing, mainly from commercial banks. The consolidated deficit of Russia's regional budgets increased fivefold year-on-year in 2025, reaching 1.5 trillion roubles. A total of **74 out of 89 regions**, including six in the occupied territories of Ukraine, **recorded budget deficits**. Their revenues grew far more slowly than expenditure, which was driven by one-off payments for signing military contracts and by support measures for the families of soldiers participating in the war against Ukraine. Deficits also emerged in the budgets of social welfare funds, primarily the pension fund.

This negative trend continued in the first four months of 2026. Despite a year-on-year decline in revenues of around 4.5%, the government increased expenditure, with spending on public procurement, primarily for defence purposes, rising by almost 16% year-on-year to nearly 5.7 trillion roubles, or approximately \$77 billion. **Consequently, the deficit after the first four months of 2026 reached 5.9 trillion roubles, exceeding the level planned for the whole of 2026 in the budget law, which amounted to 3.8 trillion roubles.**

**The public finance deficit was financed through rising debt**, as the Kremlin sought to preserve the reserves accumulated in the National Welfare Fund (NWF). After four years of war, the value of its liquid assets has shrunk by more than half. These resources are now largely used to subsidise state-owned companies and infrastructure projects. In March 2026, the government suspended the budget rule until May, as it had done in 2022. Under this mechanism, funds from the NWF are used to cover shortfalls in oil and gas revenues if the average export price of oil remains below the benchmark price set by the government at \$59 per barrel for 2026. If prices exceed this level, surplus revenues are directed towards replenishing reserves.

**The government financed the growing deficit by increasing public debt and borrowing on the domestic market** through bond issuance. Last year, public debt rose by 20%, or more than 6 trillion roubles, approximately \$70 billion, reaching 18% of GDP. Government bonds are largely purchased by banks, primarily state-owned institutions, using funds borrowed from the central bank. In practice, this amounts to printing money and increases inflationary pressures.

Although the overall level of public debt is not high, borrowing by the Russian authorities is extremely costly, with yields on 10-year government bonds standing at around 14%. Consequently, debt servicing costs are substantial. In 2025, they amounted to around 1.7% of GDP, equivalent to approximately 7.5% of total budget expenditure, and are expected to rise further in 2026, with public debt potentially exceeding 19% of GDP by the end of the year.

**In this situation, a major source of support for the public finances was the sharp increase in the export price of Russian oil**, which forms the basis for taxation of the oil and gas

sector, **following the US strike on Iran**. If prices remain at their current level until the end of the year, the government will be able to secure the revenues projected in the 2026 budget law and may even exceed them.<sup>[3]</sup> However, the strong rouble exchange rate – with the dollar trading at an average of below 80 roubles in the first four months of 2026, compared with more than 92 roubles assumed in the 2026 budget law – is limiting budget revenues from this source, as oil and gas companies pay taxes in roubles calculated on the basis of the average export price of oil expressed in dollars.

Meanwhile uncertainty remains over the future development of other budget revenues. For now, their growth rate remains below the government's projections, standing at 10% compared with the expected 12.5%. This weak performance reflects both the economic slowdown and the authorities' policies, including increased market regulation, such as higher tax burdens and the mandatory labelling of certain goods to enable tracking. It also reflects the Kremlin's growing control over the internet and widespread internet shutdowns, which have intensified in major cities since the beginning of 2026. These measures primarily increase the cost of doing business in Russia and suppress demand by making it more difficult for companies to communicate with customers and carry out cashless transactions.

**Although favourable conditions on international energy markets have allowed the Russian government to avoid the spending cuts that would otherwise have been necessary this year, they have so far not made it possible to balance the budget.** The authorities are working on amendments to the budget that will most likely permit further increases in expenditure, potentially keeping the deficit at a high level. At the same time, the Kremlin is searching for new sources of financing. In March, Russia's wealthiest businessmen, including Suleiman Kerimov and Oleg Deripaska, pledged 'voluntary' additional contributions to the budget of approximately 100 billion roubles each. The government is also planning to impose a windfall tax on companies in the non-ferrous metals sector, primarily gold and platinum producers, which benefited from exceptionally favourable market conditions in 2025.

**Labour shortages persist on the Russian labour market**, while unemployment remains exceptionally low, at 2.2%. **The labour market continues to face pressure from the ongoing recruitment of young men for the war against Ukraine.** In 2025, between 330,000 individuals, according to independent estimates, and more than 400,000, according to Putin, signed contracts with the armed forces. In the first quarter of 2026, the pace of recruitment most likely slowed, possibly by around 20%.<sup>[4]</sup> However, the drain on the labour market remains substantial, especially as intensifying Ukrainian drone attacks are forcing businesses to provide protection for their facilities. Consequently, employment in the security sector is increasing, with guards tasked, among other things, with countering drone attacks and preventing sabotage and other subversive acts.

**Although the economic slowdown has reduced demand for new employees**, leading to a decline in the number of vacancies per unemployed person, **shortages of skilled workers persist**, particularly in healthcare, agriculture and transport. Russian businesses have traditionally been reluctant to lay off workers, fearing difficulties in recruiting them again later. Consequently, during periods of weaker economic conditions, such as the current one, companies tend to prefer reducing working hours and lowering wages rather than cutting jobs altogether. This means that labour costs continue to rise, although the pace of growth

slowed markedly last year.

The **continued strong growth in Russians' real incomes**, which exceeded the level recorded in 2024, was driven primarily by income from property ownership, including interest on deposits, dividends and rental income. At the same time, income inequality continued to deepen over the past year, not only between the wealthiest and poorest individuals, but also between regions. In February 2026, the average wage in the richest regions stood at around 200,000 roubles, compared with approximately 50,000 roubles in the poorest regions. Consumer sentiment surveys conducted on behalf of the Central Bank of Russia also indicate that, since the end of 2024, the share of respondents reporting a deterioration in their financial situation has been increasing. Until October 2024, this figure had remained at around 25%, but by February 2026 it had risen to 32%.

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[1] *'Евген Вольнов aka майор Чернобаев'*, Telegram, 17 April 2026, [t.me/prankota\\_ch](https://t.me/prankota_ch).

[2] F. Rudnik, *'Ukrainian attacks on Russia's oil export infrastructure'*, OSW, 1 April 2026, [osw.waw.pl](https://osw.waw.pl).

[3] W. Rodkiewicz, F. Rudnik, I. Wiśniewska, *'Gains amid mounting challenges: the consequences of the war in Iran for Russia'*, OSW Commentary, no. 722, 1 April 2026, [osw.waw.pl](https://osw.waw.pl).

[4] J. Kluge, *'Russian recruitment fell by 20% in Q1/2026'*, Russianomics, 12 April 2026, [janiskluge.substack.com](https://janiskluge.substack.com).