

ASSESSING RUSSIA'S WAR-FINANCING CAPACITY

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Executive Summary

Russia has so far been able to finance its war against Ukraine without triggering acute fiscal or financial instability, but doing so is becoming increasingly difficult and costly as key financing channels become less dependable. Financing the budget deficit now requires increasingly costly trade-offs; no matter what path the government takes, there will be economic, social, and/or political pain. And while Russia's ability to pay for the war is not immediately threatened, the room for maneuver is limited: an adverse shock such as a drop in global energy prices or an erosion of confidence in the financial system could quickly destabilize the fragile equilibrium. This report assesses Russia's capacity to sustain war financing as the federal budget deficit widens, fiscal buffers are depleted, and pressures on the financial system increase. It examines Russia's financing needs, the remaining capacity of its principal financing channels—the National Wealth Fund (NWF), Treasury cash, and domestic borrowing—and the banking system's ability to support the war economy and government borrowing. Finally, it explores future financing options, presents scenarios illustrating how different policy choices affect Russia's financing capacity, and identifies measures Ukraine and its allies can take to further constrain its war-financing capacity.

- **Russia's approach to financing the war has undergone major shifts since 2022 as the availability and attractiveness of different channels have changed.** During the first years of the full-scale war, the government relied on a combination of NWF withdrawals and domestic borrowing, while shifting part of the war's costs off budget through an exceptional expansion of corporate credit. As liquid NWF assets declined, financing shifted toward domestic borrowing supported by substantial Central Bank of Russia (CBR) liquidity provision. In 2026, disruptions to OFZ issuance led to greater reliance on Treasury cash, before large-scale domestic borrowing resumed in September at considerably higher costs. At the same time, the wartime credit boom has largely run its course, increasingly shifting the financing burden back onto federal and regional budgets.
- **Traditional budget-financing channels remain available, but each is becoming increasingly constrained.** Treasury cash balances have fallen markedly in 2026 and are approaching levels needed to manage ordinary mismatches between revenues and expenditures, leaving limited room for further withdrawals. Liquid NWF assets have also declined substantially since early 2022, while much of the remaining non-liquid portfolio would be difficult or costly to mobilize. Domestic borrowing therefore remains the most important source of financing, and the September resumption of OFZ issuance demonstrates that this channel remains open, including for fixed-rate debt. However, borrowing costs are high, and the particularly large September 2 placement required favorable instrument design and substantial CBR liquidity support. Banks' capacity to absorb continued large-scale issuance therefore remains an important constraint.
- **The banking system is facing mounting pressure from the combined effects of elevated government financing needs, a structural liquidity deficit partly driven by increasing household cash holdings, and the legacy of rapid wartime credit expansion.** Banks are carrying a substantially larger corporate loan book, with growing indications of deteriorating asset quality, while their reliance on CBR refinancing has increased markedly as they are simultaneously being called upon to absorb government debt. Reported capital adequacy, profitability, and asset-quality indicators remain relatively strong, but are backward-looking and likely obscure emerging stress due to regulatory forbearance (including explicit measures exempting military-industrial complex borrowers from standard loss recognition practices), provisioning and valuation practices, and state support. An increasingly interdependent financing system places growing demands on bank balance sheets and increases reliance on CBR refinancing, including against non-marketable collateral. Because Russia's broader financial system remains shallow, banks are the dominant source of both corporate financing and demand for government debt, limiting the scope to shift these financing needs elsewhere. Deterioration in the banking system could therefore ultimately create additional costs for the state, particularly as the state simultaneously extracts bank capital through dividend distributions: banks requiring recapitalization or other support would themselves become an additional claim on increasingly constrained fiscal resources.

- **Russia retains substantial capacity to extend war financing, but doing so will require increasingly costly and potentially destabilizing measures.** Continued disruption in global energy markets delay—but do not resolve—Russia’s underlying structural issues. The least disruptive path is to sustain market-based domestic borrowing through more attractive OFZ terms and additional CBR liquidity provision (as it did in early September), while revenue increases, including through higher taxes, rent extraction from businesses, or deliberate weakening of the ruble, or spending cuts could reduce financing needs. Beyond these options, authorities could resort to increasingly coercive measures to generate demand for government debt, monetary financing, mobilization of household savings, external financing, reserve sales, or asset seizures. The September resumption of large-scale domestic borrowing extends the financing horizon, but the unusually favorable terms and substantial CBR liquidity support required for the particularly large September 2 placement underscore the growing cost of this channel. Fiscal adjustment or more coercive measures could allow Russia to sustain large deficits for considerably longer, but at growing economic, financial, social, and political costs. These timelines are inherently uncertain as a loss of confidence in the financial system or a major external shock, such as a marked drop in energy prices, could accelerate the emergence of financing constraints well before available resources are mechanically exhausted.
- **Ukraine’s allies should seek to increase Russia’s financing needs, constrain the resources available to meet them, and raise the economic and financial costs of war financing.** Priorities include reducing energy revenues, preventing foreign participation in the sovereign debt market, and targeting banks that play a disproportionate role in absorbing government debt. Sanctions should also exploit vulnerabilities in bank balance sheets and increase the macroeconomic costs of CBR liquidity support, while Russian reserves must remain immobilized and the liquidation of sovereign gold constrained. Remaining foreign banks should also be required to exit Russia. Finally, additional measures should seek to facilitate legitimate private capital outflows and challenge confidence in the stability of Russia’s increasingly strained and interdependent state-financing system.

I. Budget Dynamics and Financing

Russia’s ability to finance the war is coming under increasing pressure as budget deficits widen and financing becomes more difficult and costly. The federal government has relied on a combination of National Wealth Fund withdrawals, domestic borrowing, and Treasury cash balances, but the relative importance and availability of these channels has shifted markedly since 2022. At the same time, the official budget captures only part of Russia’s financing needs, as regional budgets have increasingly absorbed additional expenditure pressures, while an exceptional expansion of corporate credit has shifted part of the burden onto banks and companies. Together, this has allowed the authorities to meet rising expenditures thus far without acute fiscal or financial disruption. However, liquid NWF resources have declined, Treasury cash balances are being drawn down, large-scale domestic debt issuance increasingly requires favorable terms and CBR liquidity support, and the banking system’s capacity to provide additional off-budget financing has become increasingly constrained. Mobilizing additional resources is therefore becoming progressively more difficult and costly.

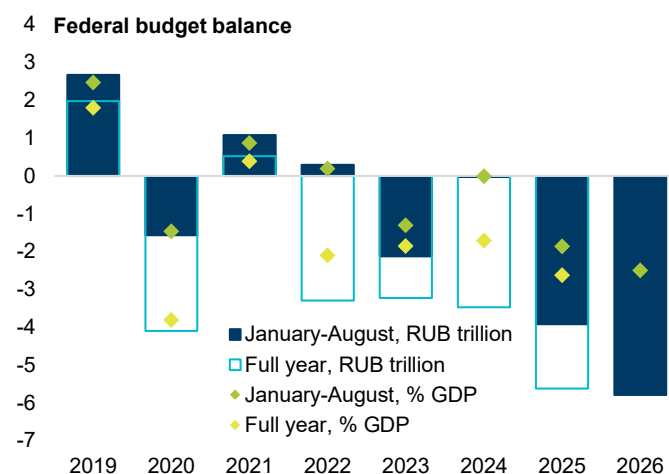
Fiscal Dynamics: A Marked Deterioration

Russia’s budget situation has worsened significantly in the last two years, putting considerable pressure on a limited number of financing channels. Over January–August 2026, the federal budget deficit reached RUB 5.8 trillion—48% higher than in January–August 2025, 3% higher than the full-year deficit in 2025, and 20% above the already-revised 2026 target¹ of RUB 4.8 trillion (see Figure 1). The increase in the deficit is driven by a decline in oil and gas revenues (-17% year-over-year in January–August) and higher expenditures (+15%), while non-oil and gas revenues continue to grow (+18%), albeit at a slower rate than in previous years as the economy slows. Markedly elevated oil prices stemming from the war in the Middle East

¹ Based on the [revision](#) of expenditures from RUB 44.1 trillion to RUB 45.1 trillion and originally budgeted revenues of RUB 40.3 trillion.

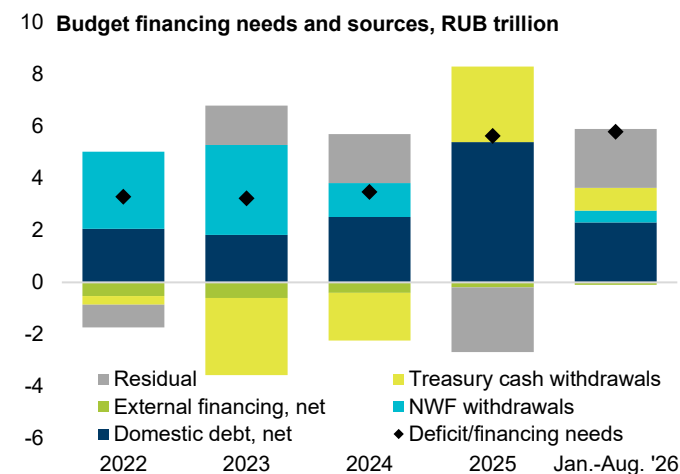
have provided some relief to oil and gas revenues in recent months; compared to a hypothetical scenario of constant revenues at the January–February level, Russia earned an additional RUB 1.7 trillion (or USD 22.5 billion). However, the effect was partially offset by higher fuel-price and energy-industry subsidies (due to higher global prices and Ukrainian attacks), wider discounts on Russian oil prices, and a stronger ruble. Altogether, Russia has not been able to fully capitalize on extremely supportive external conditions, with Ukraine’s long-range strike campaign on Russia’s oil industry and logistics hubs contributing materially to this outcome. The deficit could shrink with oil prices likely to remain elevated in the near future and a handful of proposed² revenue-raising measures—thus far, windfall taxes, a tax hike on passive income, and a doubling of taxes on foreign companies’ dividends—though structurally mismatched revenues and expenditures, Ukrainian strikes, and an eventual return to normalcy in the oil market all preclude a durable improvement.

Figure 1: Russia’s federal budget balance has deteriorated considerably in 2025–26.



Source: Ministry of Finance, KSE Institute

Figure 2: The composition of budget financing has shifted to debt and Treasury withdrawals.



Source: CBR, Ministry of Finance, Treasury, KSE Institute

In GDP terms, the deficit reached 2.5% over the first eight months of the year, which is marginally higher than in 2025. Focusing on deficits as a share of GDP can be misleading, however, for several reasons. *First*, cross-country comparisons of deficit-to-GDP ratios overlook the particular constraints Russia faces in financing its budget. With effectively no access to external financing, it must rely on withdrawals from the NWF, drawdowns of Treasury cash balances with the CBR and commercial banks, or borrowing on the domestic market, where the pool of potential buyers of government debt (OFZs) is largely limited to banks. *Second*, debt-to-GDP numbers do not reflect the relative cost of borrowing and debt service. *Third*, comparisons over time obscure the fact that the government does not finance its deficit in percent-of-GDP terms, but in absolute ruble amounts with financing channels that do not move together with GDP.

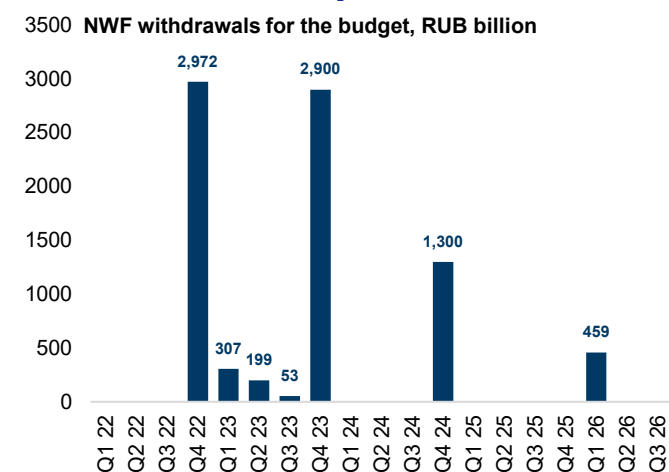
It is likely that Russia’s federal budget deficit will grow significantly over the remainder of the year, but a precise forecast is complicated due to geopolitical uncertainty and volatile spending patterns; persistently high oil prices present a particularly relevant downside risk. Most importantly, Russia tends to spend a large share of its annual expenditures towards the end of the year—Q4 accounted for 35–37% of total spending and December alone for 17–23% in 2022–24. Last year was somewhat of an outlier, with December spending considerably lower (14% of the annual total), as Russia shifted expenditures into the new year in order to reach its 2025 budget target. Assuming that revenue and expenditure dynamics remain the same over the remainder of the year—i.e., applying the year-over-year growth rate over January–August to the full-year 2025 numbers, and barring significant expenditure reductions—the deficit would reach RUB 8.1 trillion by the end of 2026 (~3.7% of GDP). However, this is closer to a lower-bound estimate as December spending could be significantly higher than last year. For instance, Russia accumulated a deficit of RUB 3.4 trillion over September–December 2024, a year with a less unusual December spending pattern. But even the conservative estimate would imply a deficit RUB 3.3 trillion above the revised target and financing needs of RUB 2.4 trillion over the remainder of the year.

² FT, “Russia raises taxes to fund its war in Ukraine”

Budget Financing: Rising Challenges

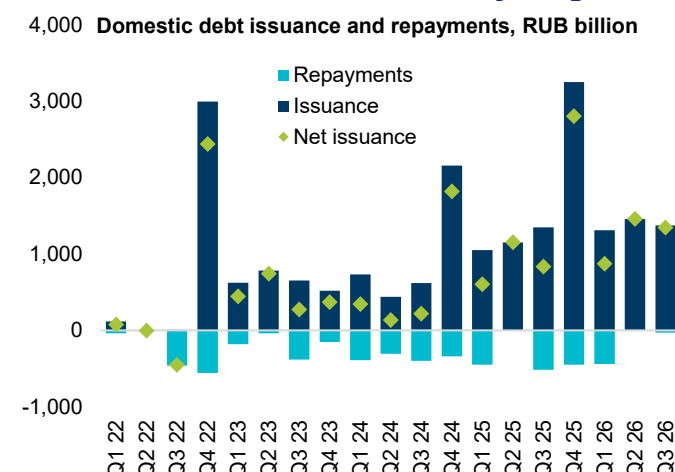
Russia's budget financing approach has changed considerably in recent years, with increasing reliance on domestic borrowing and withdrawals from the Treasury's cash reserves. During the first three years of the full-scale war, Russia financed its federal budget largely through a mix of withdrawals from the NWF and domestic borrowing, with a gradual shift towards the latter in 2024 as a significant portion of liquid NWF assets had been used up (see Figure 2). During these years, Russia raised more financing than required to cover its budget deficits, resulting in an increase in its Treasury's cash balances. The financing approach shifted decisively towards domestic borrowing in 2025, when net issuance of OFZs increased by 115% compared to 2024, reaching RUB 5.4 trillion, and no NWF funds were used for the budget (see Figure 3). The Ministry of Finance also drew RUB 2.9 trillion from the Treasury's cash balance, especially in the first half of 2025 (RUB 3.1 trillion), after which a small amount was returned. The significant increase in domestic debt issuance in 2025 (see Figure 4), largely stemming from RUB 3.3 trillion in Q4, was enabled by significant provision of liquidity to banks by the CBR through repo operations (see Figure 5)—the level of outstanding repos increased by RUB 2.6 trillion during 2025³—and higher real yields, which rose by 140–150 basis points for 5-year and 10-year bonds between mid-2025 and the end of the year (see Figure 6).

Figure 3: NWF withdrawals for the budget have fallen considerably after 2023.



Source: Ministry of Finance, KSE Institute

Figure 4: September OFZ issuance offset failed and canceled auctions in July–August.



Source: Ministry of Finance, KSE Institute

The first eight months of 2026 saw further reliance on cash balances, as domestic borrowing became increasingly challenging amid failed and canceled auctions. NWF withdrawals for the budget amounted to only RUB 460 billion (all of which occurred during Q1 when oil prices were low), net domestic borrowing reached RUB 2.3 trillion (new issuance reaching 50% of the annual target), and a drawdown of Treasury cash balances amounting to RUB 1.1 trillion took place. The difficulties with domestic borrowing culminated in an almost two-month period of severely disrupted OFZ issuance beginning in early July. During this period, auctions were repeatedly canceled or failed to result in meaningful placements—an unusual development that represented a significant departure from the authorities' efforts to maintain normal functioning of the domestic government debt market. Russian banks' capacity to absorb additional government debt has become increasingly constrained by the banking system's structural liquidity deficit, while investors have demanded substantially higher compensation for interest-rate risk. Liquidity provision has also failed to keep yield dynamics in check, with real yields for longer-maturity bonds rising markedly.

The resumption of issuance in September demonstrates that the domestic borrowing channel remains open but also highlights the increasingly high costs of mobilizing demand. On September 2, the Ministry of Finance placed RUB 1.0 trillion of a new floating-rate OFZ at a substantial discount to par (7.5%), providing investors with additional returns while shifting interest-rate risk toward the state; the placement coincided with substantial CBR repo liquidity provision (of RUB 940 billion). The Ministry subsequently returned to fixed-coupon issuance, placing RUB 90.7 billion on September 9, with

³ Based on monthly average volumes for December 2024 and December 2025.

the longer-maturity bond yielding 15.97%, up from 14.79% at its previous placement in May despite a decline in the CBR's key rate over the same period. On September 16, it placed another RUB 139.6 billion across two bonds, which attracted RUB 172.2 billion in bids and cleared at weighted-average yields of 16.0–16.3%. On September 23, another RUB 128.7 billion was placed across two fixed-coupon bonds, which attracted RUB 281.7 billion in bids and cleared at weighted-average yields of 16.14–16.44%. Taken together, the September auctions show that the domestic borrowing channel remains open, including for fixed-rate debt, but at increasingly high borrowing costs. Large-scale issuance has so far required particularly favorable instrument design and substantial CBR liquidity support.

Figure 5: CBR repo operations have increasingly supported banks' OFZ absorption.*

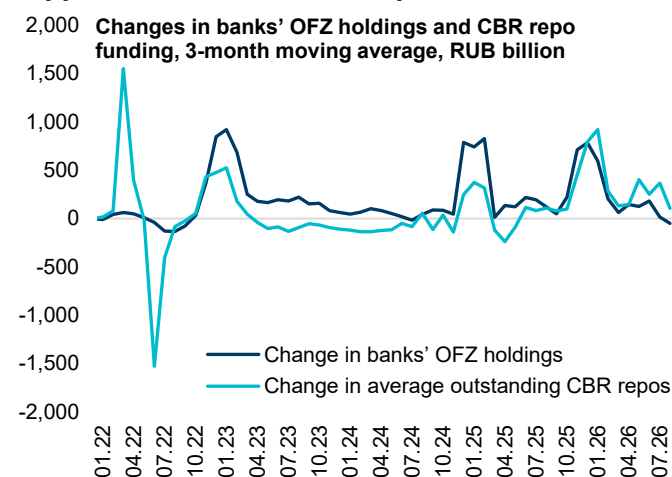
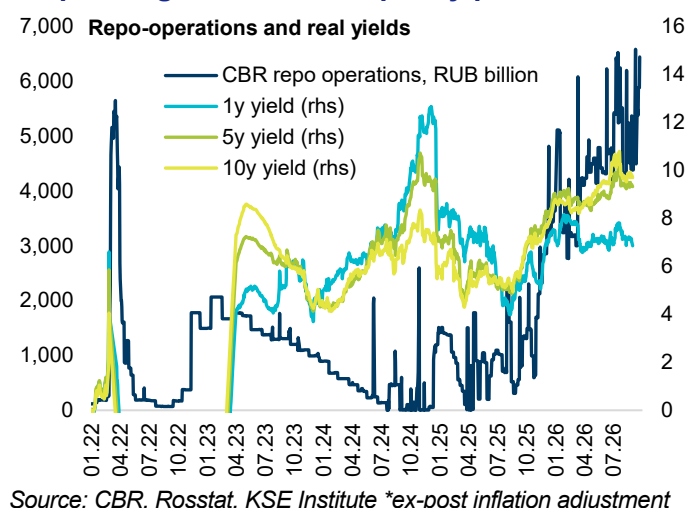


Figure 6: Real yields* have increased since 2025 despite large-scale CBR liquidity provision.



Financing Needs: Federal Budget and Beyond

The federal government is not bearing the cost of the war on its own, and regional budgets have seen a marked deterioration—but this may ultimately feed back into federal financing needs. In 2025, Russia's regions recorded an aggregate deficit of RUB 1.5 trillion (see Figure 7) as revenue growth weakened while expenditure pressures remained elevated, including from war-related and federally mandated spending. The increase is noticeable in absolute ruble terms but even more striking relative to regions' tax and non-tax revenues, with the deficit reaching 7.1% in 2025—exceeding even the pandemic-driven shortfall (of 6.3%) in 2020. In GDP terms, the regions' aggregate deficit amounted to 0.7% in 2025. Regional budget dynamics in 2026 closely track those over the same period last year and fundamentally differ from 2022–24 when regions accumulated significant surpluses before the typical year-end spending spike (December deficits reached RUB 1.4–1.8 trillion in 2023–25).⁴ Based on current dynamics, an aggregate regional deficit similar to that of 2025 is likely. Regional budget deficits were broad-based last year—71 out of 83 regions⁵ recorded deficits. Regions have limited options for financing these deficits, relying primarily on accumulated cash balances, borrowing from banks and domestic bond markets, and loans from the federal government. Shifting an increasing share of the war's fiscal burden to the regional level may therefore provide only temporary relief to the federal budget, as mounting regional financing pressures ultimately feed back into federal financing needs.

Federal support has helped ease these constraints. Since 2025, the government has allowed regions to write off up to two-thirds of eligible budget loans owed to the federal government, provided that the resulting fiscal space is used for specified purposes. The scheme potentially covers around RUB 1.1 trillion in regional debt, with more than RUB 277 billion forgiven for 68 regions in 2026 alone.⁶ Eligible spending has included certain war-related payments and benefits, further illustrating how the federal government is

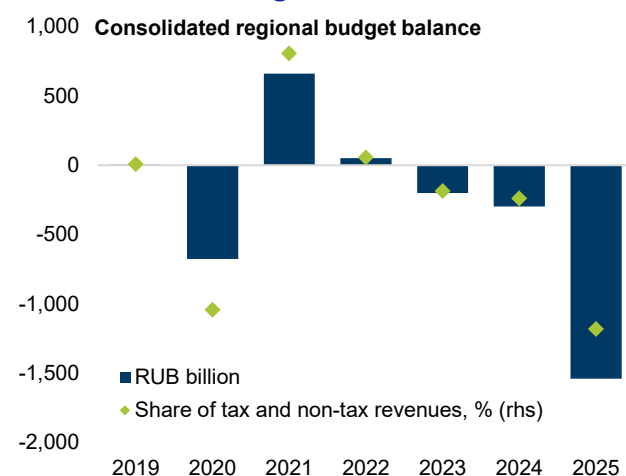
⁴ [KSE Institute, Russia Chartbook](#)

⁵ Excluding six fully- or partially-occupied Ukrainian territories that are included in Russian regional budget numbers. See ["Implementation of regional budgets for the year ending 2025"](#)

⁶ Details of the program, as well as the manner in which the government obscures its connection to the war, are explored by Janis Kluge [here](#). Since the program began in 2024, it has written off more than 500 billion rubles, with plans for the total sum to reach 1.1 trillion rubles by 2030, according to [Russian media](#).

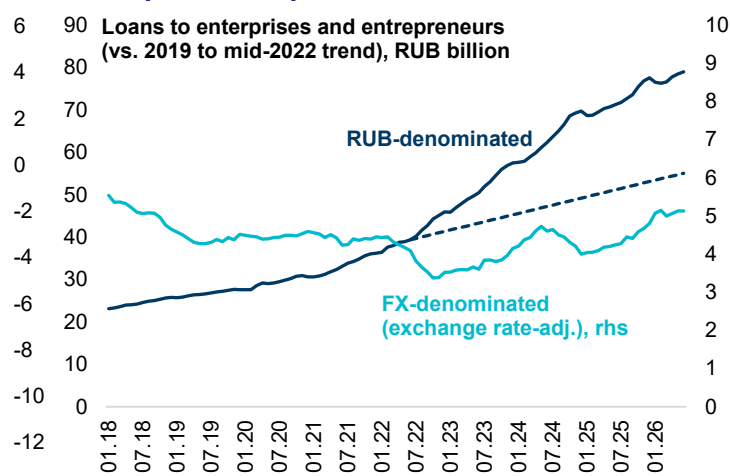
supporting regions as they absorb part of the war's fiscal burden, including through exorbitant sign-on bonuses to financially incentivize citizens to join the war effort. At the same time, the state is financing the federal budget deficit from Treasury cash, which could include some regional deposits with the CBR.⁷

Figure 7: Regional deficits widened sharply as the war burden grew and was shifted.



Source: Treasury, KSE Institute

Figure 8: Ruble credit expansion has far outpaced the pre-2022 trend.



Source: CBR, KSE Institute

While the analysis of budget dynamics and financing is important, it is only part of the picture concerning Russia's overall financing needs. Beginning in 2022, Russia has relied heavily on bank lending to the private sector to provide funds to the war effort and boost overall economic activity. In essence, Russia managed to keep the official budget deficit relatively contained, while shifting the true costs of the war onto the balance sheets of banks and state-controlled companies.⁸ Since mid-2022, outstanding ruble-denominated loans to legal entities and entrepreneurs increased by 100% in nominal terms (19% of 2025 GDP, see Figure 8) and by 54–63% when adjusted with CPI or the GDP deflator. Comparing nominal dynamics to the previous trend (for January 2019–June 2022), we find that “excess lending” made up 60% of the total increase.⁹ Researchers have sought to identify the extent to which the credit expansion is war-related, but such estimates are inherently difficult given the broad sectoral classifications in OKVED2 data.¹⁰ Five OKVED2 groups¹¹ containing sub-sectors associated with the military-industrial complex (MIC) (chemicals and chemical products, fabricated metal products, electronics and optical products, other transport vehicles, and engineering activities) accounted for 40% of excess loans. It is important to emphasize, however, that these results are extremely dependent on the selection of “MIC-related” sectors, and that the true MIC figure is lower.

The ability of the banking system to continue providing off-budget funding appears to have reached a limit. New loans to the private sector dropped sharply in 2025, driven by non-financial corporates and households, with real credit growth coming to a halt for an extended period starting in mid-2025 (see Figure 9).¹² To a large extent, this reflected the CBR's monetary tightening and efforts to rein in subsidized lending schemes, which had compromised the monetary policy transmission mechanism amid rising inflationary pressures. Borrowing conditions remained restrictive even as the CBR subsequently began easing policy, reflecting both deteriorating credit risks and a declining role of preferential lending

⁷ See the methodological note [here](#).

⁸ [Craig Kennedy, "Russia's Hidden War Debt"](#)

⁹ Volumes of outstanding FX-denominated loans do not explain the acceleration of ruble-denominated loans observed since 2022. FX-denominated loans to enterprises and entrepreneurs were RUB 0.7 trillion higher in mid-2026 vs. January 2022 in exchange rate-adjusted terms, and all loans by depository corporations to nonfinancial corporations only RUB 2.3 trillion lower. The precise estimate of excess lending is sensitive to the choice of reference period, but the finding of a substantial acceleration in credit growth after mid-2022 is robust to alternative benchmarks.

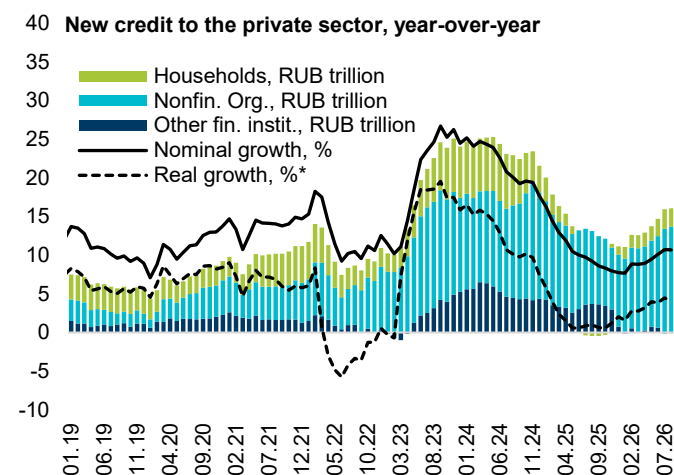
¹⁰ Craig Kennedy (forthcoming); [Kiel Institute for the World Economy, "Endgame: The State of the Russian Economy"](#)

¹¹ OKVED2 categories 20, 25, 26, 30, and 71.

¹² This aggregate slowdown masks substantial differences across sectors: in the five OKVED 2 sectors with MIC-linked elements, lending increased by 26.2% in the 12 months through June 2026, accounting for around 45% of the increase in corporate lending over the period (approximately USD 50 billion). See Kennedy (forthcoming).

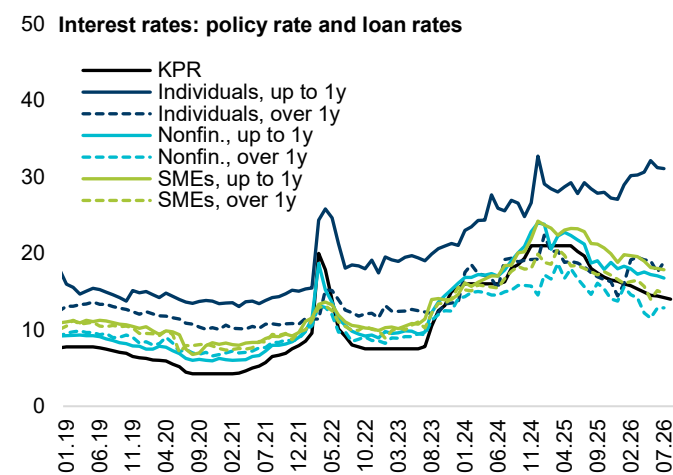
(see Figure 10).¹³ Moreover, rising short-term rates reveal signs of distress in the consumer market. The banking system's liquidity situation has also changed significantly, with a surplus of RUB ~1.6 trillion in May 2025 evolving into a deficit of RUB ~3.0 trillion in September 2026 (see [Chapter III](#)). In addition, military and MIC-adjacent companies have accumulated substantial debt and their cash flows and debt-service capacity has deteriorated, which reduces their ability to take out new loans and banks' capacity to provide them. While credit growth has marginally increased in recent months, it is unlikely that the strategy of shifting the costs of the war onto the banking system can be employed to a significant degree going forward. This will force authorities to shift more of the financing burden back onto the federal budget.

Figure 9: Real credit growth collapsed in 2025 and has only partially recovered.



Source: CBR, Rosstat, KSE Institute *ex-post inflation adjustment

Figure 10: CBR monetary tightening coincides with higher rates and lower borrowing.



Source: CBR, KSE Institute

The state has managed to fulfill rising budgetary needs thus far, but buffers are being depleted and the overall costs of generating the necessary funds are rising. In the following chapters, we will discuss the current financing channels—Treasury cash, NWF withdrawals, and domestic debt—in detail, as well as what authorities may be forced to do as conventional financing options become increasingly constrained.

II. Assessment of Current Financing Channels

Russia's traditional sources of budget financing are becoming increasingly constrained. Treasury cash balances have been drawn down sharply in 2026, while the remaining buffer is approaching levels needed to manage ordinary mismatches between revenues and expenditures. Liquid assets in the National Wealth Fund have fallen by more than 60% since early 2022, and much of the non-liquid portfolio would be difficult or costly to mobilize. Domestic borrowing remains the most important source of financing, but liquidity-constrained banks now carry most of the burden. Recent failed and canceled OFZ auctions—and the high borrowing costs at which issuance resumed in September—underscore the difficulties of raising the required volumes. While Russia's debt stock remains low by international standards, the central challenge is increasingly the ability of the domestic financial system to absorb additional debt issuance.

Treasury Cash Balances: A Finite Resource

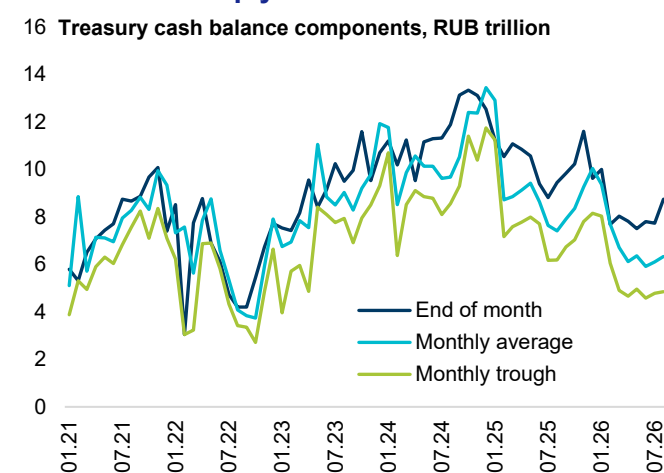
Recent Dynamics and Remaining Resources

Russia has relied on the Treasury's cash reserves during January–August 2026, while struggling with domestic debt issuance and attempting to preserve the National Wealth Fund. As a result, total available

¹³ The increase in average long-term retail lending rates in 2026 partly reflects changes in the composition of mortgage lending. Total mortgage issuance spiked to RUB 811 billion in December 2025 before plummeting back to below-average volumes (RUB ~300–350 billion per month) in 2026. The share of mortgage volumes with subsidized rates fell from ~80% in 2025 to ~55% in 2026, coinciding with lower total volumes. Further reforms to mortgage subsidies—namely, subsidies for families—were initially slated for implementation in July (leading to a spike in total issuance in June) but were delayed until October. See Russian media coverage on reforms to subsidized programs [here](#) and [here](#), and CBR data [here](#).

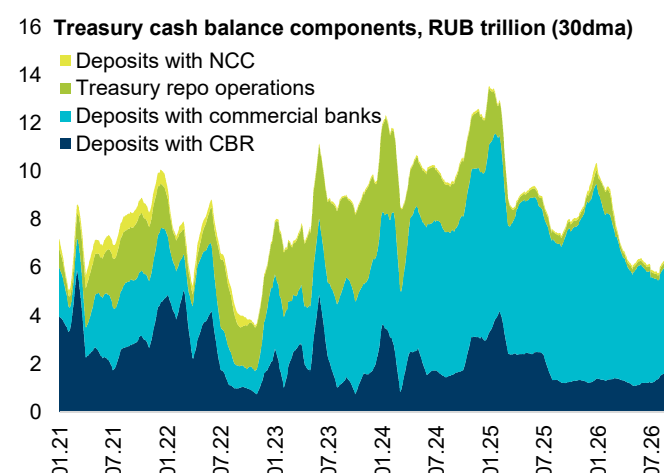
funds—which consist of Treasury deposits with the Bank of Russia, commercial banks, and the National Clearing Center (NCC, or “central counterparty”), as well as Treasury repo operations¹⁴—fell by RUB 1.1 trillion since the end of 2025 and stood at RUB 8.6 trillion at the end of August. Monthly averages (RUB -3.7 trillion) and troughs (RUB -3.3 trillion) recorded even larger declines and lower current levels (see Figure 11). Looking at 30-day moving averages, Russia retains around RUB 7.1 trillion, largely in the form of deposits with commercial banks (see Figure 12). The use of these accounts is not unusual during the first half of the year (see Figure 13), but the ability to protect or rebuild cash buffers depends on significant domestic debt issuance over the remainder of the year. After severe disruption in July–August, OFZ issuance resumed in September, including fixed-coupon issuance, although at high borrowing costs and, in the case of the large September 2 placement, with particularly favorable terms and substantial CBR liquidity support. The improved access to domestic borrowing reduces the immediate need to draw further on Treasury cash, but the ability to rebuild cash buffers will depend on whether issuance can be sustained at sufficient volumes. It is also important to emphasize that this significant use of finite cash balances occurred even during a period of high energy prices stemming from the conflict in the Middle East and severe disruption of oil and gas flows.

Figure 11: Treasury cash balances have fallen sharply in 2025–26



Source: CBR, Treasury, KSE Institute

Figure 12: The Treasury now holds most of its funds in accounts with commercial banks.



Source: CBR, Treasury, KSE Institute

Minimum Cash Buffers and Future Financing Capacity

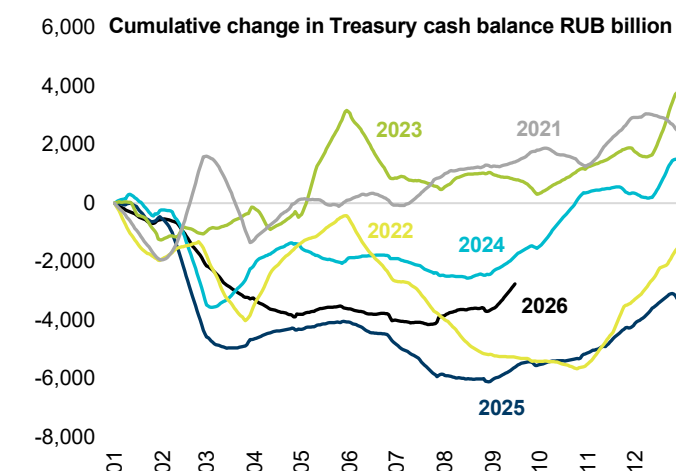
While Russia retains significant funds in its Treasury's accounts, the ability to use them is severely limited. Fundamentally, these deposits are not a budget financing channel but represent liquidity buffers to smooth mismatches between the timing of revenue generation and expenditure needs. Maintaining them allows spending to proceed despite temporary revenue shortfalls or uneven expenditure schedules, thereby reducing the need for short-term borrowing or other financial adjustments. Thus, a certain level of funds must be preserved. One approach to determine where this threshold lies is to look at budget expenditures relative to cash buffers (see Figure 14). In Russia's case, expenditures have risen considerably and a 12-month moving average of monthly expenditures currently stands at RUB 3.9 trillion. With federal budget spending up 14.7% year-over-year in January–August 2026 and the big year-end spending spike looming,¹⁵ these

¹⁴ Daily data for Federal Treasury deposits with commercial banks and the central counterparty are available for the period of November 2020 to mid-July 2026. For **deposits with commercial banks**, the series is extended forward using daily changes from the CBR's banking system liquidity data (изменение задолженности банков по депозитам Федерального казначейства). For the **deposits with the central counterparty**, the series is extended forward by assuming a constant level of RUB 100 billion as the series has had a stable maximum level since fall-2022 (mean of 93, median of 100). For **Federal Treasury repo operations**, daily data are available for the period of September 2022 to mid-July 2026, and the series is extended backwards and forward using daily changes from the CBR's banking system liquidity data (изменение задолженности банков по операциям репо Федерального казначейства). Data for **deposits with the CBR** are available on a monthly frequency from the central bank (negative net claims on the general government plus claims on the federal government minus NWF liquid assets). A daily series is calculated using these monthly anchors and the daily change in general government accounts with the CBR from the CBR's banking system liquidity data (Изменение остатков средств на счетах расширенного правительства в Банке России и прочие операции). There are two methodological issues with this approach: *First*, this indicator captures *general* government accounts; *second*, the daily data include other items (net), which are undefined and cannot be distinguished from government deposits.

¹⁵ Taking into account below-expectations federal spending in December 2025.

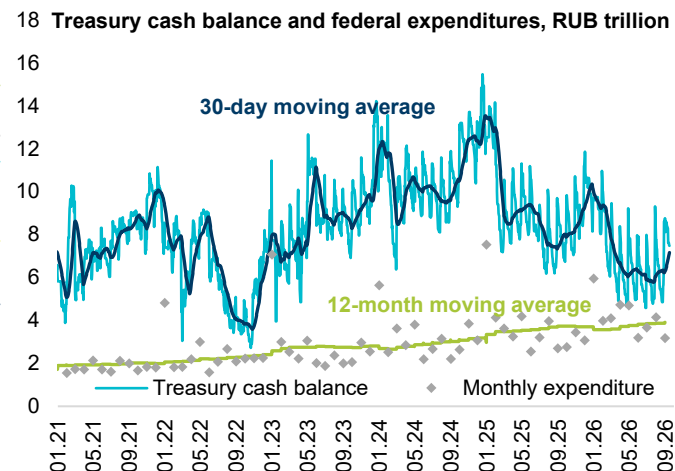
numbers will continue to rise. As the within-month trough in the Treasury balance approached expenditures in recent months, there is limited room to withdraw further funds without compromising this buffer's fundamental purpose. The specific minimum threshold is difficult to determine and ultimately a policy decision; for the purposes of our assessment of budget financing sources, we assume that an additional RUB 1 trillion can be withdrawn. Another consideration is that, with the Treasury now holding most of its cash as deposits with commercial banks, a further drawdown will also exacerbate the banking system's liquidity challenges.

Figure 13: The future trajectory of cash deposits depends on budget and OFZ issuance dynamics.



Source: CBR, Treasury, KSE Institute

Figure 14: Total funds are not far from minimums required to facilitate smooth budget execution.



Source: CBR, Ministry of Finance, Treasury, KSE Institute

National Welfare Fund Withdrawals: Depleting a Critical Buffer

Recent Dynamics and Remaining Resources

Russia has relied on the National Wealth Fund for budget financing to a significant extent since the full-scale invasion, with total withdrawals amounting to RUB 8.2 trillion (USD 103.9 billion). Usage of the NWF was heavily concentrated at the end of years when Russia's budget deficit tends to be particularly large: 81% of all withdrawals occurred in December 2023, 2024, and 2025 (see Figure 3). Importantly, usage declined along with falling liquid assets: NWF budget financing in 2024 was 62% smaller than in 2023, and no NWF funds were used in 2025 with financing shifting almost entirely to domestic borrowing. In early 2026, when fiscal problems escalated on the back of low oil prices and high spending needs, a limited amount of NWF funds (RUB 460 billion) was directed to the budget once again. It is clear, in our view, that the Ministry of Finance prefers to preserve a substantial buffer of liquid assets for as long as possible. Ultimately, however, this is a question of relative pain, as the early-2026 episode illustrates. Compared to other financing options, withdrawing from the NWF is less painful in the short term.

Use of the NWF for budget financing has reduced liquid assets considerably. As of July 2026, the NWF amounted to RUB 13.2 trillion (USD 154.1 billion), of which RUB 4.0 trillion (USD 46.7 billion) consisted of liquid assets, i.e., funds placed in deposits and current accounts with the CBR (see Figure 15). Compared to February 2022, liquid assets declined by more than RUB 5.7 trillion (or 59%). Since then, Russia sold all hard-currency assets (with an original value of RUB 4.5 trillion or USD 54 billion)—largely euros but also British pounds and Japanese yen¹⁶—leaving only RMB-denominated assets (RUB 2.4 trillion) and gold (131.5 metric tons worth RUB 1.5 trillion).¹⁷ Russia has also sold (in net terms) CNY 43 billion¹⁸ (19% of the January 2022 holdings) and 274 tons of gold (-68%). Notably, the total value of the liquid portion of the NWF is propped up significantly by elevated gold prices; at prices before the 2024–25 rally, the remaining gold in the NWF would be worth under USD 10 billion, compared to the current value of close to USD 18 billion.

Russia has shifted funds from the liquid to the non-liquid portion of the NWF to invest in infrastructure projects, support bank capitalization, and provide financing to selected industries.

¹⁶ All USD assets had been sold by mid-2021.

¹⁷ At times, Russia also holds very small amounts of liquid assets in RUB.

¹⁸ Assets are sold for budgetary purposes, but purchases are also made under the fiscal rule and transferred to the NWF.

Valuation changes also play a role, particularly for the large NWF holdings of Sberbank shares. Altogether, the non-liquid portion amounted to RUB 9.2 trillion (USD 107.4 billion) in August 2026 (see Figure 15). In our assessment, non-liquid assets can be separated into five categories with the values reflecting July data (see Figure 16): RUB 3.7 trillion in infrastructure and strategic financing (e.g., deposits with VEB.RF and holdings of Russian corporate bonds), RUB 3.1 trillion in Sberbank shares, RUB 1.5 trillion in other equity (public or preferred/non-public), RUB 620 billion in bank capital support, and RUB ~250 billion in foreign assets.

Figure 15: The NWF's liquid portion has shrunk and now consists of RMB and gold.

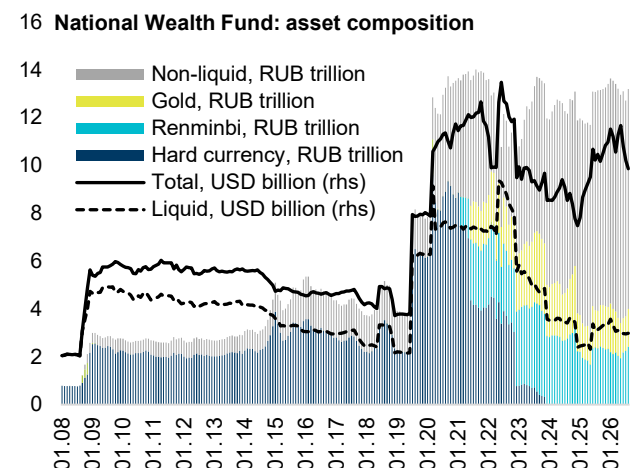
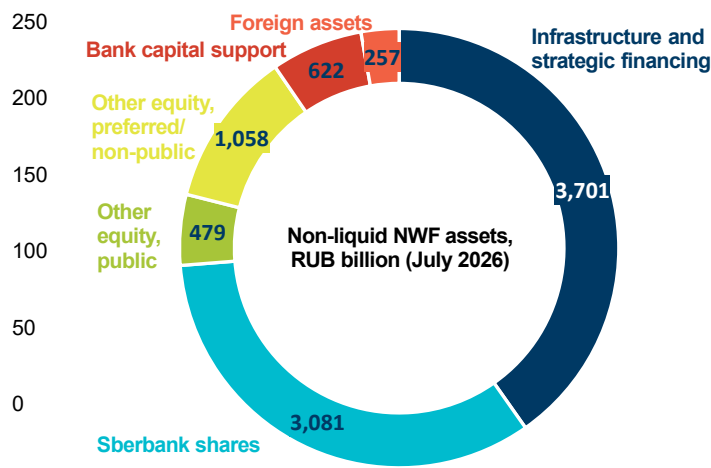


Figure 16: Non-liquid assets largely consist of long-term investments and Sberbank shares.



Potential Future Mobilization of NWF Assets for the Budget

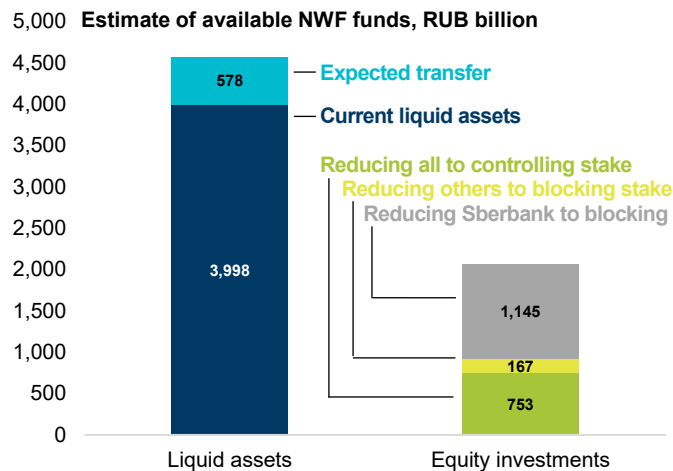
The use of NWF funds is very much a policy decision, driven not only by immediate fiscal needs but also the desire to preserve a separate financing channel for as long as possible. Additionally, drawing NWF funds down to a functional minimum would likely raise future borrowing costs, as the government signals to bond market participants that fiscal buffers are becoming increasingly constrained and that it would have little choice but to accept less favorable terms (e.g., higher rates or discounts). Not knowing how the government will opt to confront this dilemma makes it difficult to predict to what extent Russia will withdraw additional funds in the coming months. Nonetheless, we can estimate the maximum amount that would be available (see Figure 17). *First*, Russia could sell the remaining RUB 4.0 trillion in liquid assets, although future gold price dynamics may impact the amount ultimately generated for the budget. *Second*, purchases of foreign currency under the fiscal rule since March (totaling RUB 578 billion) will likely be transferred to the NWF, together with further purchases carried out during a period of high oil prices (see Figure 18).¹⁹ As Russia has repeatedly modified or suspended its fiscal rules during the full-scale war and energy price dynamics are extremely dependent on the situation in the Middle East, projecting future transfers to the NWF is not feasible. If oil prices return to market fundamentals in the coming months, the fiscal rule would mandate sales of foreign currency but may be suspended once again. *Third*, some of the assets in the non-liquid portion could be liquidated if budget needs are exceptionally high. As the relative liquidity levels of the individual assets differ considerably, a closer look is warranted:

- USD 3 billion (RUB 257 billion) in **foreign assets** consists of Ukrainian government debt, which the NWF purchased in 2013 as part of an agreement with then-president Yanukovich. Ukraine has refused to repay this debt following Russia's illegal annexation of Crimea and military aggression in the Donbas, leaving the claim embroiled in a legal dispute, which makes this asset effectively illiquid.
- RUB 3.7 trillion in **infrastructure and strategic financing**, including RUB 1.3 trillion in deposits with VEB.RF and RUB 2.4 trillion in holdings of Russian corporate bonds (e.g., Avtodor, Rostec, NLK Finance, GTLK), is also difficult to liquidate. We therefore consider these funds unusable. As VEB.RF has used the NWF deposits to extend long-term loans for infrastructure projects, their withdrawal would trigger a severe liquidity shortage at the bank. As for the corporate bonds, there are effectively no

¹⁹ FX purchases made in the period up to February 2026 were already [transferred](#) to the NWF in June 2026.

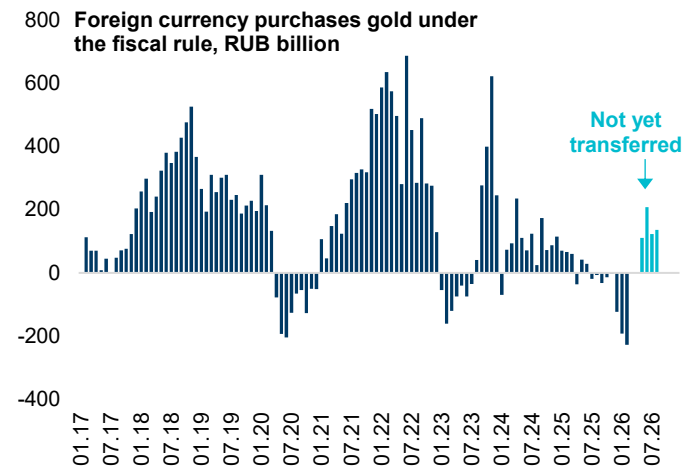
buyers due to the bonds' very long maturity periods and preferential coupon rates. With OFZ yields around 15–17%, corporate bonds delivering 5% (e.g., VEB.RF) or below (e.g., Rostec) are not an attractive investment. Furthermore, the market most likely lacks the liquidity to absorb the bonds.

Figure 17: Mobilizing RUB 4.6 trillion from the NWF would effectively eliminate this buffer.



Source: KSE Institute

Figure 18: At least RUB 578 billion will likely be transferred to the NWF in the coming months.



Source: Ministry of Finance, KSE Institute

- RUB 622 billion in **bank capital support** to VTB, Gazprombank, Sberbank, and Sovcombank is held in deposits placed in banks to replenish their liquidity, which the banks, in turn, lend out for unprofitable infrastructure projects. While these funds could theoretically be withdrawn, this would have negative implications for these institutions at a time when the Russian banking system is already struggling with a liquidity deficit. The use of these funds is extremely unlikely in our view.
- This leaves RUB 4.6 trillion in **equity investments**, of which RUB 3.1 trillion is in Sberbank shares, RUB 479 billion in publicly traded stocks, and RUB 1,058 billion in preferred or non-public stocks. Theoretically, the **Sberbank shares** could be sold. However, it is important to note that the government holds the bare minimum controlling stake (50% + one share). Thus, any sale of shares would mean losing control over the country's main bank at a time when the banking system plays a crucial role for budget financing and props up Russia's war economy with loans to the private sector. Of course, Russia can always restore state control over important institutions, but the prospect of future nationalization will likely repel potential buyers. Moreover, dumping such a massive volume of shares would likely trigger a severe crash in the stock price and, thus, reduce the value of the remaining position. **Other publicly traded stocks** could be sold and, incidentally, the government is currently in the process of reducing its Aeroflot stake from 74% to 50% + one share.

Other preferred or non-public equity could also be sold, but only with a significant discount in our view; especially for companies not publicly traded, the real market value of their shares is unknown. We estimate that the Ministry of Finance could generate RUB 750 billion if it aimed to retain controlling stakes and RUB 2.1 trillion if it accepted blocking stakes. As these calculations incorporate various assumptions regarding discounts on current valuations that would need to be accepted in order to liquidate shares, they should be read with caution.²⁰ Given the implications of selling Sberbank shares, the upper range estimate is more theoretical than practical and, thus, the potential budget impact is limited.

²⁰ For **public companies**, the calculation is based on the current market price per share. We calculate the market value of the specific percentage of the company being sold and apply a dynamic discount within a range of 20–50%. The discount increases linearly with the percentage of total shares being sold (e.g., selling 25% of the company adds a 7.5% penalty). In reality, the Ministry of Finance will not be able to simply sell these shares on the open market and likely resort to forcing oligarchs or large corporations to buy them out via block trades. Estimating the exact real-world mechanism for Sberbank—where a 50% stake is worth roughly 3.5 trillion rubles—is challenging to say the least. For **preferred shares**, the situation is simpler. All of such assets in the NWF portfolio belong to non-public entities (e.g., Russian Railways or Gazprombank). Since preferred shares do not grant voting rights, the government can theoretically sell 100% of these holdings without losing control over the companies. For these, we take the initial investment amount (book value) and apply a strict 50% illiquidity discount. Russian legislation (Federal Law No. 178-FZ “On the Privatization of State and Municipal Property”) clearly outlines the mechanism for selling illiquid or unwanted state-owned assets. If an asset fails to sell at a standard auction, the state employs a procedure known as “sale via public offer.” Under

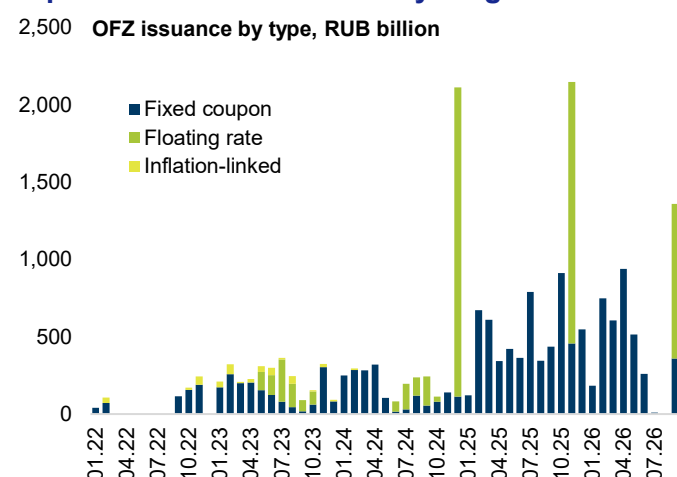
Altogether, Russia could mobilize RUB 4.6 trillion in liquid assets, thereby, however, completely exhausting a critical secondary budget financing channel and eliminating the option to draw from macroeconomic buffers at times of domestic borrowing challenges. It is more likely that NWF withdrawals will be stretched out over a longer period of time, with the exact timeline dependent on the capacity to issue domestic debt. While we estimate that the partial liquidation of equity investments (excluding Sberbank shares) could generate an additional RUB 920 billion, these calculations are subject to considerable uncertainty, and we do not see this as a course of action that the Ministry of Finance would take until pressures increase further.

Domestic Borrowing: Limited Absorption Capacity

Issuance Dynamics and Market Performance

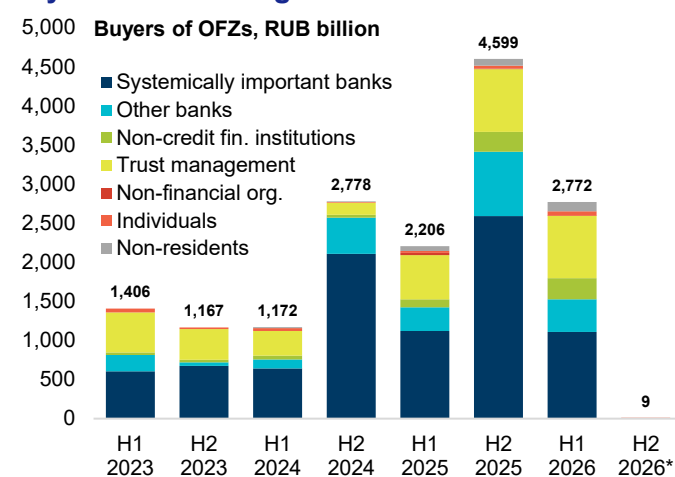
Recent months have seen serious challenges in placing domestic government debt on terms acceptable to the Ministry of Finance. After several months of strong issuance in February–May 2026, volumes fell in June before the Ministry of Finance canceled the June 24 and July 8 auctions,²¹ citing heightened volatility and a need to stabilize the market; it sold only RUB 9 billion on July 1, rejected all bids on July 17,²² and canceled auctions indefinitely²³ on July 20 (see Figure 19). The resumption of issuance in September (see [Chapter I](#)) demonstrates that the domestic borrowing channel remains open, including for fixed-rate debt, but at relatively high borrowing costs. Large-scale issuance has so far required particularly favorable instrument design and substantial CBR liquidity support through repo operations.

Figure 19: OFZ auctions restarted in September after a break in July–August.



Source: Ministry of Finance, KSE Institute

Figure 20: Banks are the most important buyers of Russian government debt.²⁴



Source: CBR, KSE Institute *Sep. issuance not included

Domestic banks have consistently been the primary buyers of Russian government bonds but withdrew from the market in July–August before returning in September as issuance resumed at high borrowing costs and with increased CBR liquidity support. From 2023 to mid-2026, banks identified by the CBR as “systemically important credit institutions” (SICIs)²⁵ accounted for 55% of all OFZ purchases (see Figure 20), while other banks accounted for 15%. Another important category consists of non-credit financial institutions, which buy bonds either on their own behalf (5%) or acting as asset managers for their

the law, the starting price is progressively lowered during such sales, but the “cut off price” (the minimum acceptable sale price) is set at exactly 50% of the initial valuation. Thus, the state legislatively acknowledges a 50% loss in value as the standard lower limit for the sale of illiquid assets. For non-public companies (ordinary shares), numbers are calculated in a similar way, but with a twist. We calculate the implied 100% book value based on the government’s initial investment, multiply it by the specific percentage of the company it intends to sell, and apply the same 50% discount. This is a very rough estimate.

²¹ [Kommersant, “The Ministry of Finance has cancelled OFZ auctions for the second time this month in order to stabilise the market”](#)

²² [Expert.ru, “The Ministry of Finance has announced the suspension of auctions for the placement of OFZs”](#)

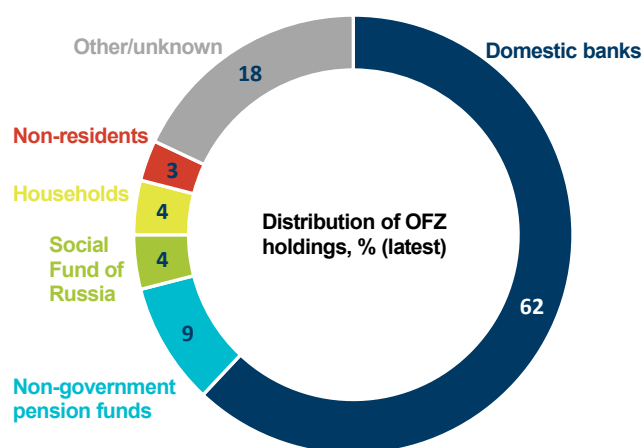
²³ [Interfax, “Russia’s Finance Ministry suspending federal bond auctions to stabilize market situation - press release”](#)

²⁴ This breakdown is not available before 2023. The composition of purchasers of government debt is published on a monthly basis, meaning that September issuances (as seen in Figure 19) are not yet available for Figure 20.

²⁵ According to the CBR, these are Sberbank, VTB, Gazprombank, Alfa-Bank, Rosselkhozbank, PSB, Moscow Credit Bank, Sovcombank, DOM.RF Bank, T-Bank, Raiffeisenbank, and UniCredit Bank. The last two, despite being foreign-owned, are classified as Russian-resident credit institutions for the purposes of the OFZ purchase statistics. Together, the 12 institutions account for about 80% of total banking system assets. See [“List of systemically important credit institutions as at 7 October 2025”](#)

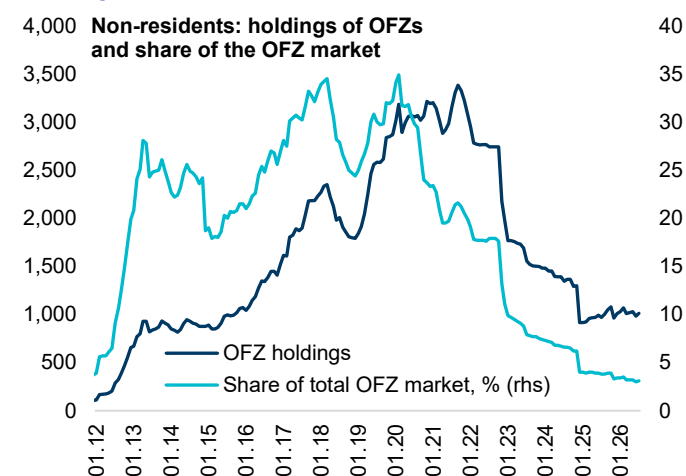
clients (22%). Non-residents, individuals, and non-financial organizations are largely absent from the primary OFZ market, together accounting for below 4%.²⁶ While purchases by non-bank financial institutions have been broadly stable over 2025–H1 2026, banks' purchases have fluctuated significantly, rising in the later months of each year when issuance spikes to finance year-end spending needs. In late 2025, this was primarily enabled by a large increase in CBR repo operations (see [Chapter I](#)). Banks largely withdrew from the primary market in July–August (when auctions only amounted to RUB 9 billion) and became net sellers of OFZs in the secondary market, with the CBR attributing a RUB 0.2 trillion decline in holdings in July specifically to sales to other market participants.²⁷ The September restart represented a sharp reversal, with banks returning to the primary market as the Ministry of Finance accepted higher borrowing costs, while CBR repo financing expanded to support banks' capacity to absorb new issuance. The current stock of OFZ holdings reflects absorption dynamics in recent years (see Figure 21): banks account for 62% of outstanding OFZs,²⁸ non-government pension funds for 9%, the Social Fund of Russia for 4%,²⁹ households for around 4%, and non-residents for 3%, with other investors responsible for the remainder.

Figure 21: Banks remain the most important holders of Russian domestic sovereign debt.



Source: CBR, KSE Institute

Figure 22: Non-resident OFZ holdings dropped sharply after the imposition of sanctions.



Source: CBR, KSE Institute

The Narrow Investor Base for Domestic Borrowing

The universe of potential buyers of OFZs has narrowed significantly since the start of the full-scale war and the imposition of sanctions on Russian sovereign debt, which forced most non-resident investors to exit the market.³⁰ Their holdings fell by almost RUB 1.9 trillion (66%) between January 2022 and June 2026, now standing close to the lowest level in more than a decade at RUB 1.0 trillion (see Figure 22). The non-resident share has fallen from 19% in January 2022 to just 3.1% in mid-2026, driven both by an absolute decrease and the significant growth of the stock of outstanding OFZs.³¹ As transactions with Russian sovereign debt are prohibited in most sanctions coalition jurisdictions, the departure of foreign investors occurred primarily via the amortization of the securities that they held, which explains why the considerable drop did not take place until several months later.

²⁶ Absolute numbers for purchases were derived by applying CBR-published monthly shares to total issuance.

²⁷ [Central Bank of Russia, "On the development of the banking sector of the Russian Federation in July 2026"](#)

²⁸ The bank share is approximated using banks' holdings of ruble-denominated government debt, as the CBR's banking-system survey does not provide an OFZ-specific breakdown. The measure may therefore include other ruble-denominated government securities.

²⁹ For non-government pension fund and Social Fund of Russia holdings, see ["Overview of key indicators for non-state pension funds for the first quarter of 2026"](#)

³⁰ The sanctions regime on Russian sovereign debt tightened progressively before becoming effectively prohibitive for Western investors after February 2022. The first important restrictions date to [2019](#), when the US prohibited its financial institutions from participating in the primary market for non-ruble-denominated Russian sovereign debt; in [June 2021](#), the US broadened this prohibition to new ruble-denominated debt, including OFZs, while still permitting secondary-market transactions. In [February 2022](#), the US tightened the regime again: from March 1, 2022, US financial institutions were also prohibited from purchasing Russian sovereign bonds issued after that date in the secondary market. The EU prohibited transactions in transferable securities issued after March 9, 2022, by Russia, its government, or the CBR, as well as new lending to them, while the UK introduced comparable restrictions on financing the Russian state.

³¹ The share of non-resident holdings had peaked in February 2022 at close to 35%. However, the higher share was due to a much smaller overall market size. With the Covid-driven borrowing spree in 2020–21, the share fell to around 19%, while total holdings only declined marginally (by RUB 230 billion between early 2020 and early 2022).

Sovereign debt sanctions remain extremely important to constrain Russia's access to financing. If foreign investors returned to their pre-February 2022 level of OFZ holdings, they would generate inflows of RUB 1.9 trillion, while a return to their relative share of total outstanding OFZs at today's market size would result in RUB 5.3 trillion in funding. Investors from non-coalition countries have been hesitant to engage with Russian government bonds. For instance, Chinese asset managers have little incentive to buy OFZs because the sanctions and compliance risks outweigh the potential returns: Russian sovereign debt is subject to extensive restrictions, and Chinese financial institutions with international operations remain wary of jeopardizing access to Western markets or counterparties. Moreover, ruble-denominated OFZs are embedded in Russia's increasingly isolated financial infrastructure, which creates currency, settlement, liquidity, and exit risks that make them considerably less attractive than comparable Chinese or emerging-market assets.

Russia's domestic financial system outside of banks lacks the depth to absorb more OFZ issuance at scale. Cross-country data on the assets of different segments of the financial system in percent of GDP—deposit banks, nonbank financial institutions, mutual funds, insurance companies, and pension funds—are only available for 2021. As far as deposits at banks are concerned, Russia ranked close to the median with assets of 66% of GDP, but considerably below other large emerging markets such as China, Malaysia, Thailand, the UAE, Brazil, and Türkiye (see Figure 23). It should be noted that Russian depository corporations' assets have risen to close to 90% of GDP since then. For nonbank financial institutions, assets of 34% of GDP placed Russia in the top quartile and ahead of many emerging market peers, with only South Africa and Thailand considerably ahead. However, with regard to mutual funds (4.5% of GDP), insurance companies (3.2%), and pension funds (4.3%), Russia ranks at the bottom. Thus, it is no surprise that deposit banks and non-credit financial institutions accounted for more than 75% of OFZ absorption since 2024. It should be noted, however, that trust managers (i.e., non-credit financial institutions) have played a meaningful role in OFZ absorption in recent years.

Figure 23: Russia's financial system lacks depth outside of banks.

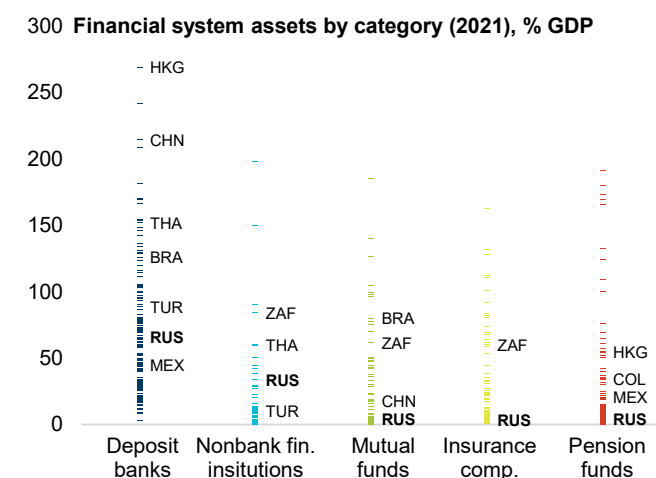
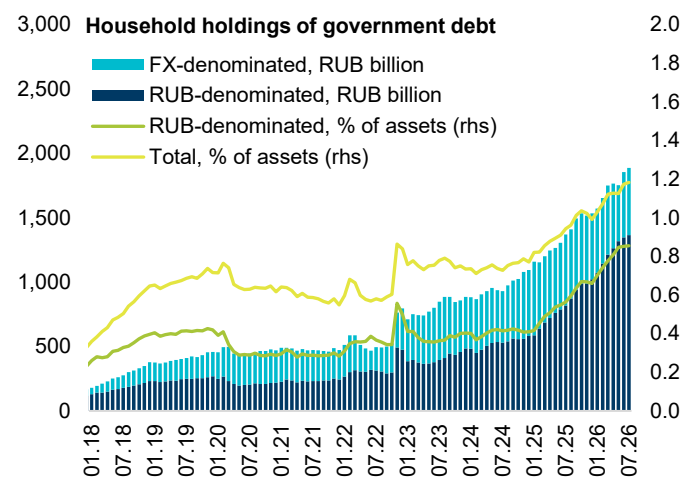


Figure 24: Households have only been marginal participants in Russian domestic debt.



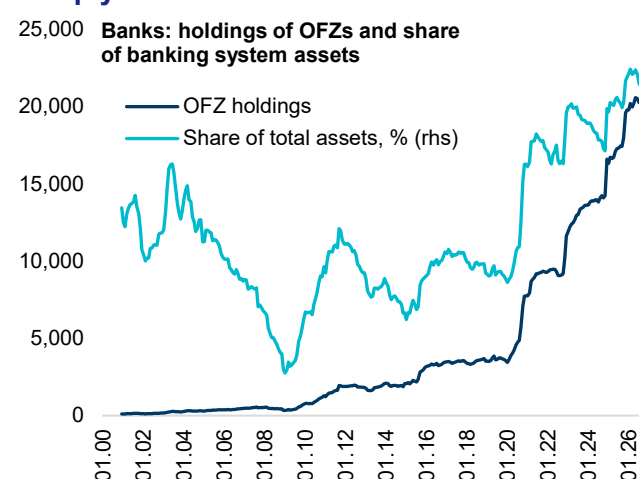
Households are currently not playing a meaningful role in the market for Russian sovereign debt. While their holdings of ruble-denominated government debt have increased since early 2022—by RUB 1.1 trillion or ~400% (see Figure 24)—their holdings amount to less than 1% of total household assets (1.2% including FX-denominated debt). The notable increase since early 2025 was likely driven by exceptionally high household savings (i.e., available funds) and attractive yields during an episode of sharp monetary tightening. There is certainly room for higher household participation in the sovereign debt market, but, so far, this investor pool has not materialized to a significant extent. Since 2023, households only accounted for 1.4% of total OFZ issuance absorption. Incentives or coercive measures could change that, if other financing options ran out (see [Chapter IV](#)). Current household cash dynamics also do not point to interest in longer-term investments, including government bonds.

The Russian central bank has not been an active participant in the market; instead, it has opted to support banks' OFZ purchases through the provision of liquidity. Before the full-scale war, the CBR held

only RUB 252 billion in federal government securities, equal to 1.6% of the outstanding stock in January 2022. While it has not been active in the primary market since—it is generally prohibited by law from purchasing government securities in the primary market³²—the CBR announced in March 2022 that it would buy OFZs on the secondary market to ensure a balanced liquidity position in the securities market and prevent excessive volatility.³³ In April, the CBR stated that “the amount of such operations was small.”³⁴ Direct monetary financing of the budget through bond purchases would be an option in case demand from other investors (i.e., banks) remained insufficient, but would require legal changes if done in the primary market (see [Chapter IV](#)).

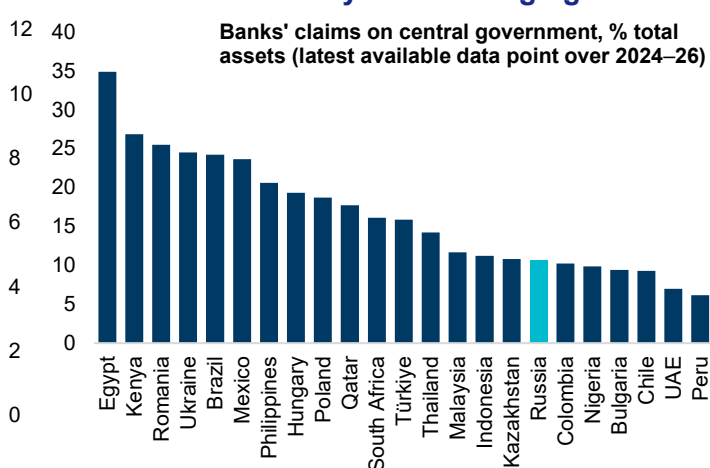
In the absence of meaningful purchases from other investors, banks have absorbed most of the rising OFZ issuance. As of August 2026, they held RUB 20.4 trillion in ruble-denominated government debt, which represents around 62% of all outstanding OFZs. This is a significant increase in holdings compared to January 2022 (RUB 11.1 trillion or +119%), and, as a result, the share of such debt in total banking system assets has risen from 8.2% to 10.2% (see Figure 25). It should be noted, however, that this is not a significantly elevated level historically—although it is twice the level of the pre-Covid decade—and is rather low in international comparison (see Figure 26). Thus, any challenges with banks’ capacity to absorb further OFZ issuance stem not from the size of their current positions, but from more fundamental issues in the banking system, including exposure to low-quality loans and a lack of liquidity. The critical role played by a small number of systemically important banks means that, within the banking system which carries most of the financing burden, the state relies on an even narrower pool of potential buyers.

Figure 25: Banks’ OFZ holdings have increased sharply in absolute and asset-share terms.



Source: CBR, KSE Institute

Figure 26: Banks’ holdings of government debt are lower than in many other emerging markets.



Source: IMF, KSE Institute

Constraints on Future Domestic Borrowing

Russia’s borrowing capacity is not primarily constrained by the size of its debt stock, nor does its debt service burden truly represent a binding limitation. Rather, the challenge lies in the limited capacity of the domestic financial system to absorb additional issuance. While the government likes to point to a comparatively low debt-to-GDP ratio—around 15% in Q1 2026 despite a rapid expansion of domestic debt in recent years (see Figure 27)—to create the appearance of fiscal resilience, this does not mean that Russia can borrow easily. It also does not properly reflect the cost of the existing debt stock; interest on state and municipal debt is expected to account for close to 9% of federal budget expenditures³⁵ this year—a sharp increase compared to 2021 when it was roughly half of that (see Figure 28). Of course, this also took place during a period of soaring overall spending, meaning that debt service in absolute

³² [Article 22](#) of the Federal Law on the Central Bank prohibits the CBR from purchasing government securities at their primary placement, except where such purchases are explicitly provided for in the federal budget law. [Article 94](#) of the Budget Code similarly excludes CBR purchases of government securities at issuance as a source of federal budget-deficit financing.

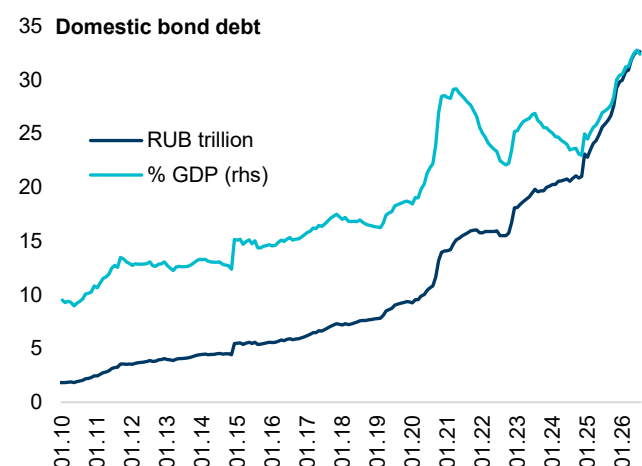
³³ [Central Bank of Russia, “Bank of Russia’s comment on operations in public debt market”](#)

³⁴ [Central Bank of Russia, “Banking Sector Liquidity and Financial Markets”](#)

³⁵ While interest payments include obligations towards non-residents, which Russia could suspend, the low non-resident share in the overall OFZ market indicates that this is unlikely to have a significant effect on expenditures. Non-resident investors also include those in countries supportive of Russia, whose investors the country may not want to repel.

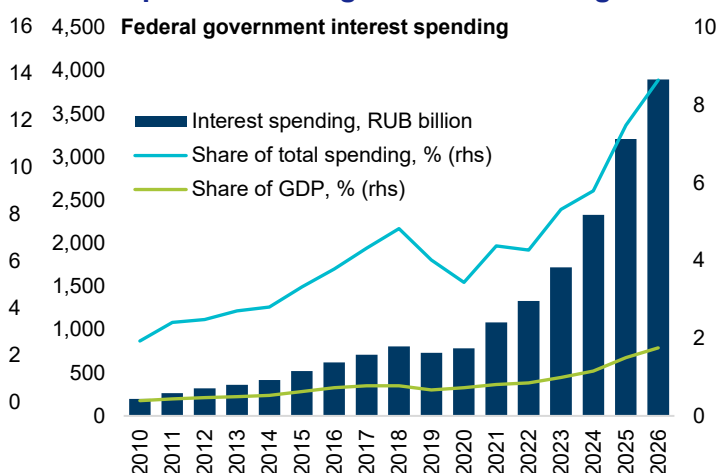
terms has grown by 260% over this period. To what extent this represents an actual constraint on further domestic borrowing is ultimately a question of relative costs. The cancellation of auctions in July–August took place not because there was no demand for OFZs but because the demanded terms (i.e., yields) were not acceptable to the Ministry of Finance. **The September resumption of issuance illustrates the trade-off: as other financing channels have become increasingly limited, the Ministry of Finance has accepted higher borrowing costs to secure funding.** A regime that has demonstrated its willingness to prioritize the continuation of its war of aggression against Ukraine over prudent economic management may opt to secure budget financing now and accept a higher debt service burden later. In the next chapter, we assess the state of the financial system and its absorption capacity in detail.

Figure 27: Domestic bond debt has more than doubled since the start of the full-scale war.



Source: Ministry of Finance, Rosstat, KSE Institute

Figure 28: Interest spending has surged and takes up an increasing share of the budget.



Source: Ministry of Finance, Rosstat, KSE Institute

III. Limits of Financing: The State of the Banking System

Russia's banking system is facing mounting pressure as large government financing needs, a growing structural liquidity deficit, and the legacy of rapid wartime credit expansion place increasing demands on bank balance sheets. Banks are carrying a substantially larger corporate loan book, and there are growing indications that the quality of those assets is deteriorating even as regulatory treatment likely delays or prevents the recognition of some of the underlying stress. Their reliance on CBR refinancing is increasing at the same time as they are being called upon to finance large government borrowing needs. While household funding remains substantial and reported capital adequacy, profitability, and asset-quality indicators continue to appear relatively strong, these headline measures provide an incomplete—and likely misleading—picture of underlying resilience. Many of them are inherently backward-looking and tend to remain strong during periods of rapid credit expansion, before deterioration in borrower performance and credit losses fully materializes. Regulatory forbearance, provisioning and valuation practices, and direct state support further obscure emerging losses. Russia's state-financing system is becoming increasingly interdependent, with additional war financing placing growing demands on bank balance sheets, CBR liquidity provision, and ultimately the sovereign itself.

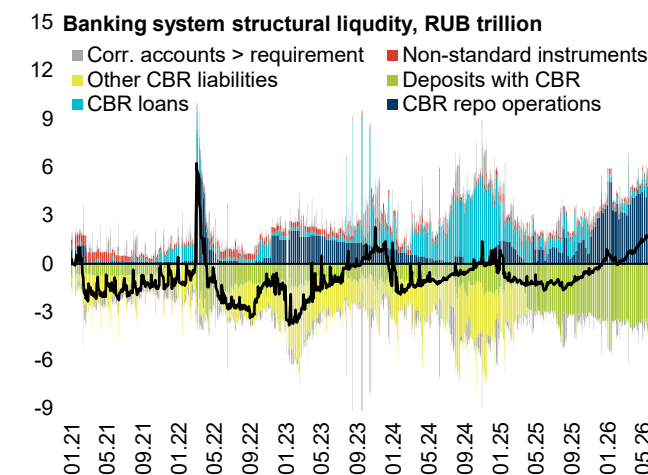
Liquidity Challenges and Their Impact on Debt Absorption Capacity

Banking System Structural Liquidity

Russia's banking system has moved from a structural liquidity surplus into a sizeable and growing deficit, increasing banks' reliance on CBR funding. The deficit reached RUB 3.0 trillion by mid-September 2026, its largest level since the disruption that immediately followed the full-scale invasion and the imposition of sanctions, including on the Russian financial system (see Figure 29). The CBR has also progressively raised its projections for the liquidity shortfall, most recently expecting a structural deficit of

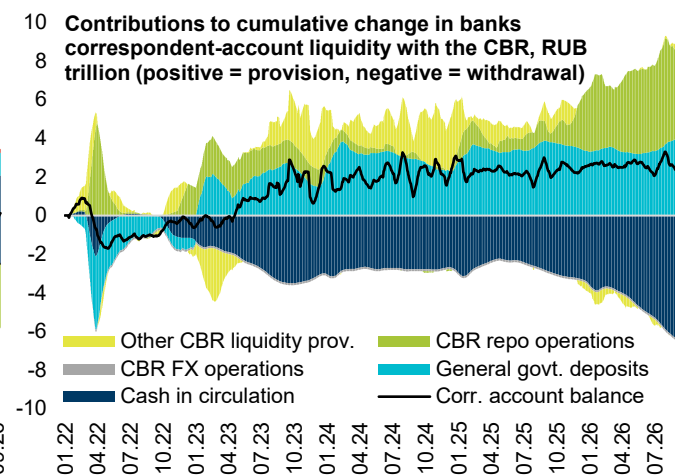
RUB 4.0–5.2 trillion³⁶ during the December 2026 reserve-averaging period (revised up in August 2026 from the January projection of RUB 1.9–3.0 trillion, an increase of RUB 2.2 trillion), and expects structural deficits to persist over the coming years.³⁷ The central bank now expects banks to borrow RUB 8.0–9.2 trillion at its auctions in 2026, up from 5.3–6.4 trillion in the January outlook.³⁸ At the same time, the CBR notes that the structural deficit remains insignificant relative to banking sector assets, standing at 1.2%—markedly lower than the levels observed between the second half of 2012 and early 2016.³⁹

Figure 29: The banking system has shifted into a growing structural liquidity deficit.



Source: CBR, KSE Institute

Figure 30: Significant cash withdrawals are offset by CBR liquidity provision.



Source: CBR, KSE Institute

The deterioration of liquidity reflects several interacting factors, with cash in circulation as the largest and most persistent drain on banking-system liquidity. Since the start of the full-scale war, around RUB 7.8 trillion have been withdrawn to satisfy demand for cash (see Figure 30). The data shows three distinct phases: a period of rising cash holdings from late 2022, a roughly two-year period of stabilization and moderate reversal, and a re-acceleration of cash withdrawals approaching RUB 4.0 trillion since mid-2025, with RUB 1.4 trillion in June–August 2026 alone. The underlying causes are discussed in the [following section](#). The accumulation of government deposits initially absorbed liquidity, before their subsequent drawdown provided an increasingly important offset for rising cash in circulation from 2023 onward. However, this dynamic has reversed in recent months due to high fiscal financing needs: government funds in banks were down 21% year-over-year in July, to RUB 8.5 trillion.⁴⁰ Liquidity constraints also likely reflect the need for banks to continue funding existing corporate borrowers, including increasingly stressed borrowers whose access to credit is supported by regulatory forbearance.

Liquidity buffers have also become thinner across a larger share of the banking system. In July, banks with liquidity coverage ratios of 11–20% accounted for 73% of sector assets, up from 65% in June, while the share held by banks in the 21–50% range fell from 25% to 17%. Bringing banks in the 11–20% group up to a 20% coverage ratio would require RUB 3.4 trillion in additional liquid assets, up from RUB 2.9 trillion a month earlier; banks below 10% would require a further RUB 0.6 trillion (vs. RUB 0.5 trillion in June).

Central Bank Liquidity Support

The CBR has responded to the banking system's growing needs with a substantial expansion of liquidity provision, particularly through repo operations. Outstanding CBR repos have risen sharply since mid-2025 when they were negligible, reaching more than RUB 6 trillion in July 2026 and currently standing around RUB 6.4 trillion (see Figure 31), while total bank borrowing from the CBR reached RUB 7.4 trillion by late September, up 185% year-over-year. The composition of support has also shifted toward regular main-auction repos, while longer-term facilities had played an important role at different

³⁶ Central Bank of Russia, "Monetary Conditions and Monetary Transmission" (August 2026)

³⁷ Central Bank of Russia, "Monetary Policy Guidelines for 2026–2028"

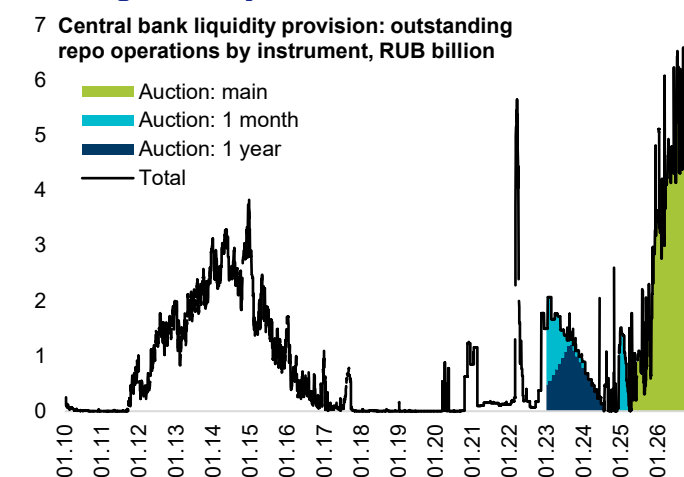
³⁸ Central Bank of Russia, "Monetary Conditions and Monetary Transmission" (January 2026)

³⁹ Central Bank of Russia, "Monetary Conditions and Monetary Transmission" (August 2026)

⁴⁰ Central Bank of Russia, "On the development of the banking sector of the Russian Federation in July 2026"

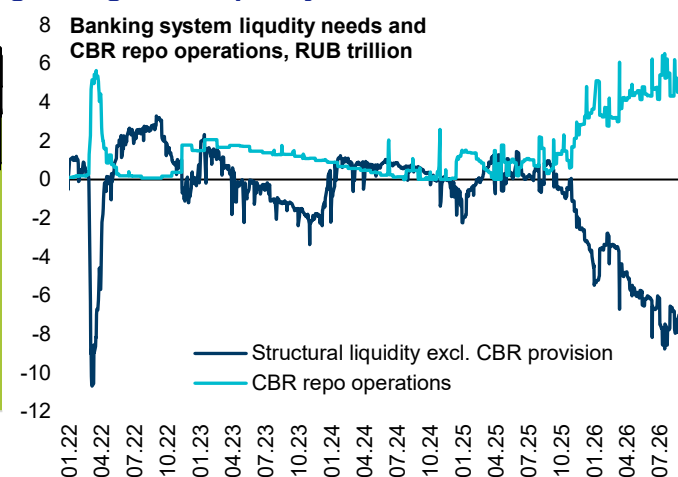
points since 2022 but no longer do. By late August 2026 the entire outstanding repo book sat in the one-week main auction, with one-month, one-year, and standing facilities all at zero. Such a liquidity provision term profile does not prevent banks from using CBR funding to finance OFZ holdings, but requires them to continually roll short-term central-bank funding against much longer-duration government debt. Overall, the CBR has increasingly accommodated the liquidity shock (see Figure 32) rather than losing control of the money market (see [below](#)). The CBR also helps banks meet regulatory requirements: roughly half of the July increase in total borrowing from the CBR took the form of loans secured by non-marketable assets, which, according to the CBR, individual banks used specifically to comply with the national liquidity ratio.⁴¹ Allowing banks to collateralize loans with non-marketable assets or, in the future, without collateral, should be understood as an indicator of growing stress in the system.

Figure 31: CBR repo operations have risen significantly since mid-2025.



Source: CBR, KSE Institute

Figure 32: Repo operations address growing bank liquidity needs.



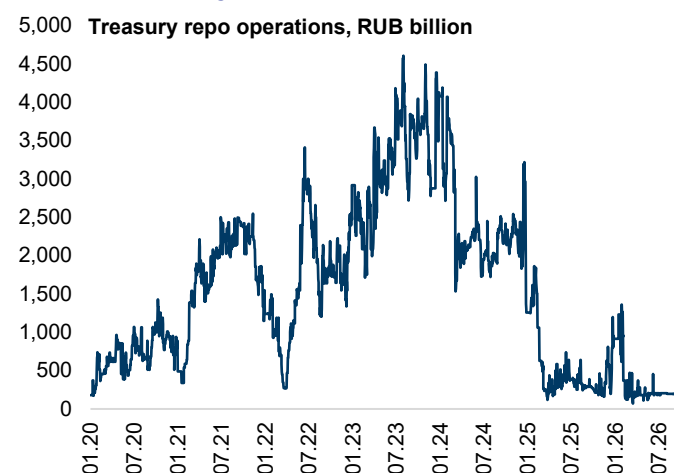
Source: CBR, KSE Institute

Part of the CBR's liquidity provision appears closely associated with domestic banks' absorption of government debt. The timing of major repo operations has closely coincided with large OFZ placements (especially at the end of the year to fulfill exceptionally high financing needs) and increases in banks' government-bond holdings (see Figure 5). However, in July–August, continued liquidity provision through repo operations did not result in OFZ absorption when auctions were cancelled. In early September, auctions resumed and the Ministry of Finance placed RUB 1.0 trillion, with banks subsequently using almost the entire amount as collateral for CBR repos. Altogether, we see a mechanism of indirect monetary financing of the budget: CBR refinancing increases banks' capacity to absorb OFZ issuance, while government securities themselves provide collateral for repo borrowing. The relationship is not one-for-one and does not imply that all CBR repo funding finances OFZ purchases, but it indicates that central-bank liquidity has become an important support for banks' capacity to finance the government. Importantly, with the entire outstanding repo book now sitting in the one-week main auction segment, the funding behind bank holdings of long-duration government debt is rolled over at the central bank's discretion every seven days.

The Federal Treasury has historically provided an additional source of banking-system liquidity, but its role has diminished sharply. Outstanding Treasury repos frequently amounted to RUB 2–4 trillion during 2022–24, before falling substantially during 2025 and remaining at almost negligible levels in 2026 (see Figure 33). One exception was a short episode in early-2026 when Treasury repos temporarily rose above RUB 1 trillion. Importantly, such operations do not create additional system-wide liquidity as they result in simultaneous reductions in Treasury deposits with commercial banks.

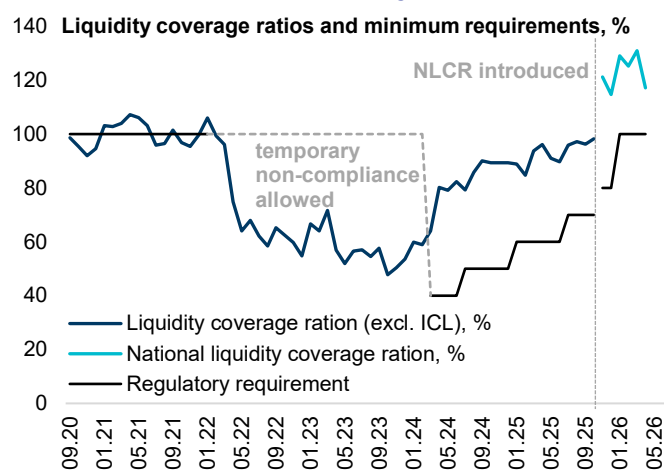
⁴¹ [Central Bank of Russia, "On the development of the banking sector of the Russian Federation in July 2026"](#)

Figure 33: Treasury repos now play a negligible role for liquidity provision to banks.



Source: CBR, KSE Institute

Figure 34: Regulatory changes have complemented direct liquidity provision.



Source: CBR, Treasury, KSE Institute

Regulatory policy has complemented direct liquidity provision. Following substantial easing after February 2022, liquidity requirements were restored only gradually (see Figure 34). The CBR initially allowed banks to fall below the 100% Liquidity Coverage Ratio (LCR) requirement where sanctions-related outflows, shortages of high-quality liquid assets (HQLA), or difficulties rolling over longer-term funding prevented compliance.⁴² It also permitted banks to use pre-sanctions parameters from February 18, 2022, for certain HQLA eligibility and impairment criteria.⁴³ Starting from March 2024, systemically important banks using the CBR's Committed Liquidity Facility (CLF) were required to meet only 40% independently of that facility, with this threshold scheduled to rise thereafter.⁴⁴ But the CBR subsequently relaxed that path, holding the requirement at 50% until June 30, 2025 rather than raising it to 60% in January 2025 as originally planned. In late 2025, systemically important banks transitioned to the domestically focused National Liquidity Coverage Ratio (NLCR), which broadened the definition of eligible liquid assets; its minimum requirement increased from 80% initially to 100% in January 2026.⁴⁵ Actual liquidity ratios have remained above the applicable regulatory thresholds throughout the period shown, but compliance is increasingly supported by central-bank credit. In July 2026 the average NLCR across systemically important banks fell 8 pp to 115%, and the CBR reports that individual banks drew on loans secured by non-marketable assets specifically in order to meet the requirement.⁴⁶ This regulatory flexibility, alongside expanded refinancing operations, has given banks additional room to operate despite tighter underlying liquidity conditions.

Liquidity Concentration and Market Segmentation

Aggregate indicators conceal considerable differences in reliance on central bank funding across bank groups. The largest banks have consistently relied more heavily on CBR funding than most smaller institutions, and this dependence has increased again since 2025, with CBR loans reaching roughly 3–4% of assets for the top five banks (see Figure 35).⁴⁷ The data suggest concentrated rather than system-wide dependence on CBR funding, with the largest institutions accounting for much of the recent increase. Household funding also remains highly concentrated in the largest banks. The top five now hold ~75% of individuals' funds, up moderately from two-thirds before 2022, while the shares of most smaller bank groups have declined.⁴⁸ This concentration gives the largest (predominantly state-controlled) banks a substantial funding advantage and leaves smaller institutions more exposed to tightening system-wide liquidity conditions.

⁴² Central Bank of Russia, "Bank of Russia's measures to support financial sector amid elevated volatility"

⁴³ Central Bank of Russia, "2022 Annual Report"

⁴⁴ Central Bank of Russia, "Bank of Russia establishes procedure for exiting from liquidity coverage ratio easing and provides irrevocable credit lines"; Central bank of Russia, "Bank of Russia's decisions on banking regulation"

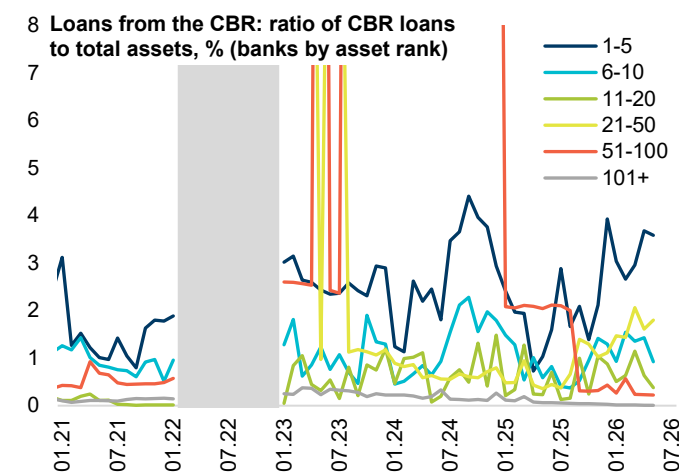
⁴⁵ Central Bank of Russia, "National liquidity coverage ratio for SICs: calculation procedure"; Central Bank of Russia, "Bank of Russia introduces new national regulation to manage liquidity coverage risk"

⁴⁶ Central Bank of Russia, "On the development of the banking sector of the Russian Federation in July 2026"

⁴⁷ Extreme readings for some smaller-bank groups in 2023–24 largely reflect the movement of NB TRUST between asset-rank categories and should therefore not be interpreted as evidence of generalized stress.

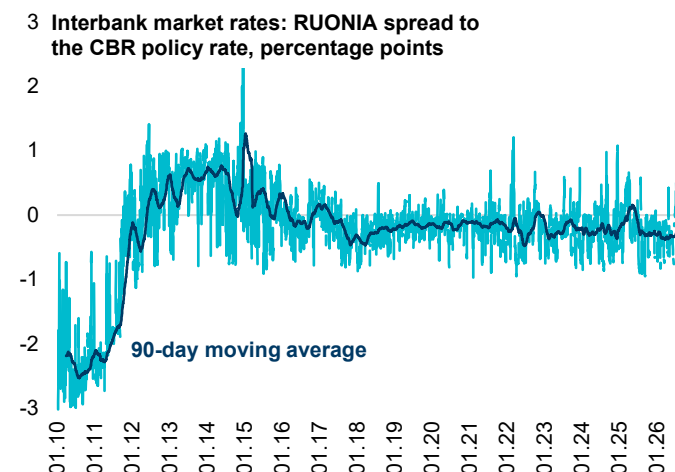
⁴⁸ See the CBR's data on credit institutions performance [here](#).

Figure 35: The reliance of large banks on CBR liquidity is comparatively high and rising.



Source: CBR, KSE Institute

Figure 36: The interbank rate remains closely anchored to the CBR's policy interest rate.

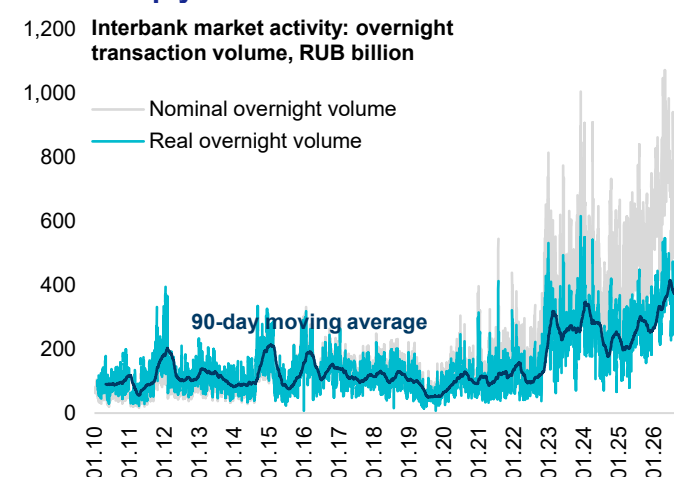


Source: CBR, KSE Institute

Despite the uneven distribution of liquidity, interbank-market indicators show little evidence of generalized dysfunction. In late September 2026, banks simultaneously held RUB 3.99 trillion of deposits at the CBR and owed it RUB 7.38 trillion, a net borrowing position of RUB 3.4 trillion that reflects a distribution problem rather than a critical system-wide shortage. The interbank rate (RUONIA) has remained closely anchored to the CBR policy rate since the disruptions of early 2022 (see Figure 36). At the same time, real overnight transaction volumes have increased substantially, particularly since 2023, indicating an increasingly active market rather than withdrawal by participants (see Figure 37). Dispersion between rates also remains relatively contained and, on a 90-day moving-average basis, remains below 2025 levels (see Figure 38).

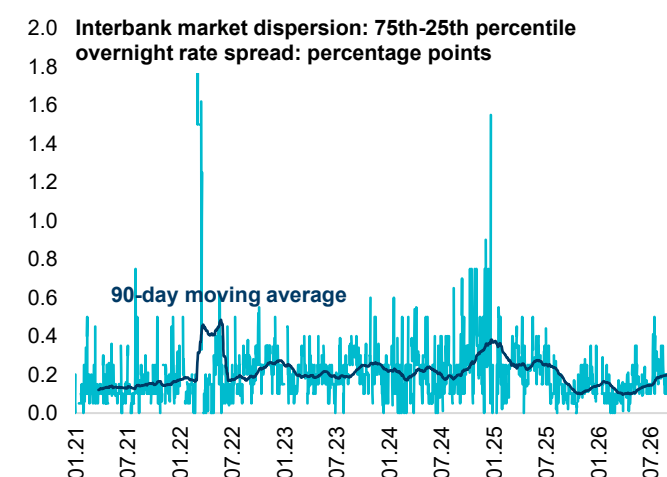
There are nevertheless signs of increasing pressure as the system has moved deeper into a structural liquidity deficit. RUONIA traded above the policy rate for almost three consecutive weeks between July 2 and July 21, 2026, exceeding it by up to 75 bps and peaking at 15% against a 14.25% key rate, before falling back below it to 13.70% by July 28. In September, there were also episodes with RUONIA exceeding the policy rate (by up to 0.4 pp). Moreover, the dispersion between rates has risen in recent months. Together with the use of CBR liquidity-provision and absorption instruments shown in the preceding section, these developments appear to represent liquidity segmentation rather than broader impairment of the interbank market itself.

Figure 37: Interbank transaction volumes have risen sharply in nominal and real terms.*



Source: CBR, KSE Institute *ex-post adjustment using CPI

Figure 38: Dispersion in interbank interest rates remains contained.



Source: CBR, KSE Institute

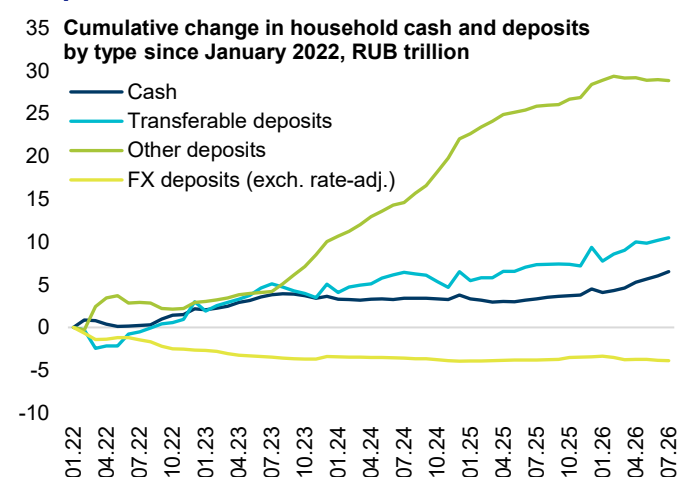
The growing structural liquidity deficit has increased banks' reliance on CBR. Thus, banks are increasingly dependent on central-bank liquidity at the same time as they are being called upon to **fund a substantially larger corporate loan book** and large government borrowing needs. The shift does not in itself imply banking-system distress: the CBR is performing its normal role of supplying reserves when the banking system faces a structural shortage. It does, however, represent an important change

in the system's funding environment. Whether this becomes a meaningful constraint will depend on banks' ability to attract funding and collateralize additional CBR borrowing.

Confidence in the Banking System: Potential for Disruption

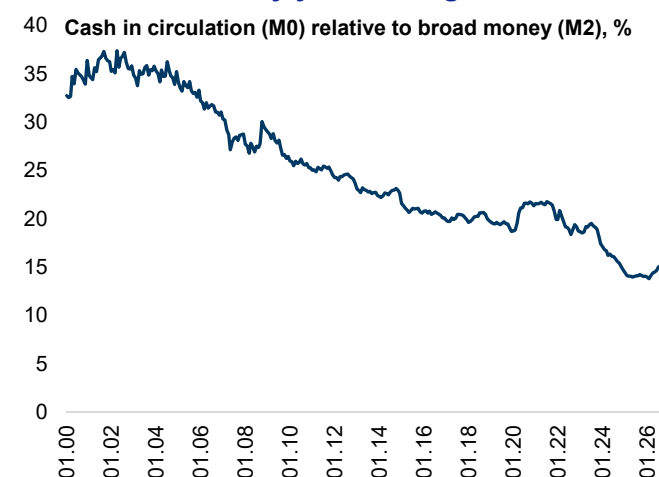
While there is little evidence for a widespread loss of confidence in the banking system, the current equilibrium remains vulnerable to disruption. Since January 2022, household holdings of transferable and other ruble deposits have cumulatively increased by around RUB 40.3 trillion, vastly outweighing the roughly RUB 7.5 trillion increase in cash holdings (see Figure 39). In August, the volume of cash in circulation increased by another RUB 0.4 trillion, exceeding the levels seen in previous years.⁴⁹ The initial flight into cash following the full-scale invasion was quickly reversed, while the subsequent period of high interest rates produced particularly strong growth in other—predominantly term—deposits. Confidence can erode quickly, however, especially in a system that is under strain from various directions—including sanctions, the ripple effects of a massive wartime credit expansion, and increasingly effective Ukrainian attacks on key industries—and in which the quality of macroeconomic management has deteriorated and policy space is increasingly limited. Confidence could weaken if households and businesses begin to doubt the state's ability to manage these competing demands: sustaining war-related spending, supporting sectors affected by war disruptions and sanctions, bailing out banks that struggle with deteriorating credit quality, and, importantly, refraining from mobilizing private funds to fill budget gaps as other financing sources become increasingly constrained.

Figure 39: Household deposits remain strong despite a recent shift towards more cash.



Source: CBR, KSE Institute

Figure 40: The cash-to-M2 ratio is historically low but distorted by years of high interest rates.



Source: CBR, KSE Institute

More recently, household deposit dynamics have become less uniformly positive. Growth in other deposits has stalled and partially reversed as interest rates declined, while transferable deposits and cash holdings have continued to increase. In July 2026 household term deposits fell by RUB 28 billion while current-account balances rose by RUB 349 billion. For now, this represents a shift toward more liquid forms of household savings rather than a broad withdrawal from the banking system, and should be put into the context of a total stock of deposits which stood at RUB ~68 trillion in June. However, compositional shifts could become material for banks if contractually stable funding is converted into balances withdrawable on demand. The rise in cash has become more pronounced, contributing to the structural liquidity drain discussed [above](#) and the CBR itself identifies it as one of the key drivers of recent liquidity dynamics.⁵⁰ While it has been argued that cash withdrawals may be early signs of a fundamental weakening of confidence in the banking system,⁵¹ they are more likely a result of recurring disruptions to cashless payments⁵² and also reflect adaptation to tax changes and tighter scrutiny of transactions.⁵³

⁴⁹ Central Bank of Russia, "Monetary Conditions and Monetary Transmission" (August 2026)

⁵⁰ Central Bank of Russia, "On the development of the banking sector of the Russian Federation in July 2026"

⁵¹ The Washington Post, "Russians pull billions from banks, fearing Kremlin will seize deposits for war"

⁵² Central Bank of Russia, "Cash or non-cash: Russians' preferences in 2025"

⁵³ Central Bank of Russia, "Statement by Bank of Russia Governor Elvira Nabiullina in follow-up to Board of Directors meeting on 19 June 2026"

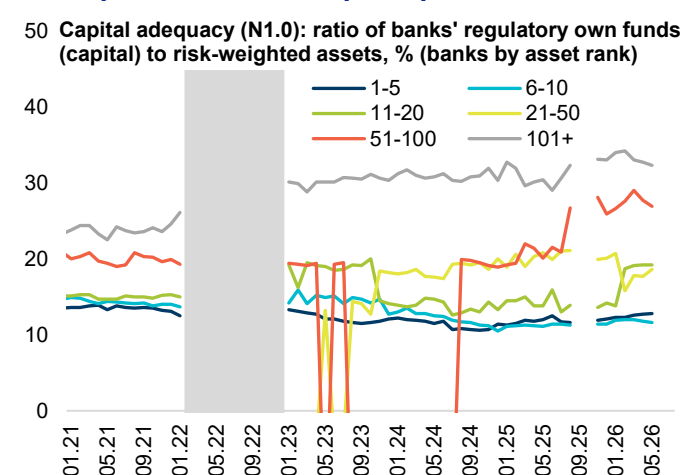
Foreign-currency deposits adjusted for exchange-rate movements have remained broadly stable after the initial de-dollarization episode in 2022 (see Figure 39). Overall, dollarization of household deposits remains at a historic low: 4.5% in July, against 5.2% a year earlier.⁵⁴ At the same time, recurring rumors about possible deposit freezes have not (yet) translated into verified restrictions on household withdrawals or a generalized deposit run. Of course, should such a measure be taken, it would be extremely disruptive to the system (see [Chapter IV](#)). Pointing to a historically low share of cash in broad money (M2), the CBR stated⁵⁵ that it does not see a deterioration of confidence (see Figure 40). However, the cash-to-M2 ratio has been mechanically depressed by four years of exceptionally high policy rates, which inflated the deposit denominator rather than reducing cash demand. As that effect unwinds—annual growth in household deposits slowed from 22.8% at the beginning of the year to 9.5% to July 2026—the ratio will rise even at unchanged cash demand. What matters for bank liquidity and functions as an indicator of confidence in the banking system is the flow into cash, rather than the cash-to-M2 stock ratio. A ratio measured against a stock of deposits accumulated over four years says little about changes in confidence and the drain a bank must fund going forward. Overall, household funding remains substantial, but the recent shift away from less-liquid deposits warrants attention.

Banking System Health: Headline Numbers vs. Underlying Weaknesses

Capital Adequacy: Headline Ratios Mask Underlying Weaknesses

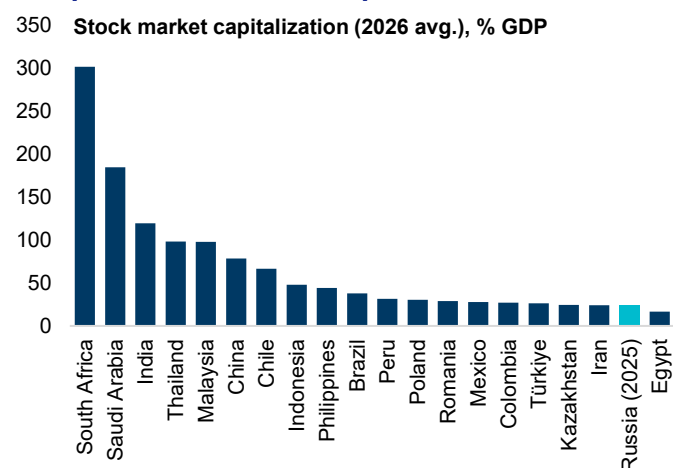
Reported capital adequacy remains relatively strong, but the official ratios provide an increasingly incomplete picture of banks' underlying loss-absorption capacity. Official headline indicators show little evidence of systemic stress; capital adequacy remains relatively comfortable across bank-size groups and has generally strengthened since 2022 (see Figure 41). Among the largest banks, the N1.0 ratio has been broadly stable around 11–12%, while systemically important banks run somewhat thinner buffers than the sector average and ratios among smaller institutions are considerably higher. The extreme readings for some groups in 2023–24 appear to reflect the movement of a specific institution (NB TRUST, a state-controlled “bad bank”) between groups rather than actual deterioration. More recently, however, sector-wide N1.0 fell by 0.5 pp to 13.5% in July after banks declared RUB 0.9 trillion in dividends, reducing balance-sheet capital by RUB 0.5 trillion to RUB 21.8 trillion.

Figure 41: Reported capital adequacy ratios provide an incomplete picture.



Source: CBR, KSE Institute

Figure 42: Capital market depth is low compared to the most-important EMs.



Source: IMF, World Federation of Exchanges, KSE Institute

The apparent strength of capital ratios partly reflects their backward-looking nature as well as regulatory treatment that can delay loss recognition and reduce measured risk-weighted assets. Reported capital ratios may therefore provide limited information about banks' ability to absorb losses as the credit cycle turns. Strong capital (and profitability) indicators are not unusual during periods of rapid credit

⁵⁴ Central Bank of Russia, “On the development of the banking sector of the Russian Federation in July 2026”

⁵⁵ Central Bank of Russia, “Statement by Bank of Russia Governor Elvira Nabiullina in follow-up to Board of Directors meeting on 19 June 2026”

expansion, when borrower performance remains relatively strong and credit losses have yet to materialize. In Russia, this limitation is compounded by regulatory forbearance, accounting treatment, and state support, which can further delay the recognition of deterioration in reported indicators. Several mechanisms are in place: direct state injections into banks, regulatory forbearance that suppresses provisions on defense and restructured loans, and accounting relief that keeps some unrecognized securities losses out of reported capital ratios. For instance, the International Financial Reporting Standards (IFRS) and Russian Accounting Standards (RAS) differ in their approach to the timing of loss recognition: IFRS incorporates expected credit losses, while RAS relies more heavily on losses recognized under Russian regulatory rules. This distinction is particularly relevant because the Russian prudential framework has been calibrated to defer the recognition of some emerging credit losses. This difference is visible at Promsvyazbank (PSB) and Credit Bank of Moscow (MKB), where IFRS reporting has revealed large losses that were less apparent under RAS. Thus, aggregate reported measures may respond only gradually to emerging credit stress and therefore need to be considered alongside more granular measures of loan quality and borrowers' debt-servicing capacity.

State support further complicates the interpretation of reported capital adequacy, particularly at strategically important institutions, as the state supports them via direct injections into charter capital and NWF disbursements to state-owned banks. PSB, the designated State Defence Order (i.e., defense procurement) bank, saw its charter capital rise from RUB 221.3 billion to RUB 427.1 billion between June 2024 and July 2026—a near-doubling in just two years, with budget documents linking the injections explicitly to maintaining the bank's capital adequacy ratio on lending extended pursuant to presidential instruction and to accepting defense-industry loans by cession from other banks. NWF disbursements to state-owned banks and institutions reached USD 11.3 billion in 2025, over 90% of the fund's investment spending. The largest single tranche (USD ~4.5 billion) went to VEB.RF, a development corporation outside the banking sector, via subordinated deposits rather than to bank Tier 1 capital.⁵⁶ Thus, the figure overstates classic recapitalization.

At the same time, the restoration of tighter capital requirements is increasing the amount of capital that banks need to maintain existing buffers and continue expanding their balance sheets. Headline indicators may overstate the underlying resilience of bank balance sheets as comfortable capital adequacy at the aggregate level partly reflects the only gradual restoration of prudential requirements relaxed after February 2022. As these requirements tighten, capital constraints could become more visible. The CBR has already begun rebuilding macroprudential buffers while major banks themselves have highlighted the scale of their additional capital needs. VTB, for example, has estimated that it will require RUB 1.7 trillion of additional capital over five years,⁵⁷ illustrating the potential tension between continued balance-sheet expansion and the restoration of increasingly demanding capital requirements. Russia's relatively shallow domestic equity market may constrain the ability of multiple large institutions to raise substantial amounts of new capital simultaneously. MOEX's total market capitalization stood at RUB 50 trillion (or slightly above 23% of GDP) at the end of 2025 and continued to decline in 2026 as the MOEX index fell to multi-year lows in July (see Figure 42).⁵⁸ This is markedly lower than capital market capitalization in almost all other major emerging markets.⁵⁹

Government policy creates an additional tension by simultaneously relying on bank capital to support lending and OFZ absorption while extracting part of that capital through dividends. Bank profits are increasingly being managed as a source of budget revenue. The CBR argues that rising profits allow banks to restore the macroprudential buffers, but the government has shown that it is willing to distribute the accumulation: banks declared RUB 912 billion in dividends in July 2026 alone,⁶⁰ four and a half times the year-to-date injections into charter capital and more than twice the month's comprehensive result. RUB 425.1 billion from Sberbank's record RUB 850.2 billion distribution reached the federal budget on August 24, 2026.⁶¹ The state needs banks to absorb more OFZ and more defense credit risk, yet it

⁵⁶ [Interfax, "PSB increased charter capital by RUB 27.4 billion"; Rambler Finance, "Authorities recapitalized PSB for the fourth time in 2026"; Interfax, "PSB is planned to be recapitalized by RUB 30 billion"; UNITED24 Media, "Kremlin Channels \\$11.3 Billion to State Banks Amid Mounting Loan Defaults"](#).

⁵⁷ [Reuters, "Russian banks' main challenge in 2026 will be raising capital, VTB CEO says"](#)

⁵⁸ [MOEX, "Moscow Exchange announces 2024 financial results"; NAUFOR, "Development of the Russian Capital Market 2025-2030"](#)

⁵⁹ Based on data from the World Federation of Exchanges.

⁶⁰ [Central Bank of Russia, "On the development of the banking sector of the Russian Federation in July 2026"](#)

⁶¹ [PRIME, "Federal budget received RUB 425.1 billion in dividends from Sberbank"](#)

simultaneously extracts their capital as budget revenue. Within a consolidated state balance sheet, these are competing claims on the same resource. Dividend distribution suggests that the authorities do not yet treat bank capital as a binding constraint, even as fiscal claims on bank profits remain substantial.

Securities holdings create another source of potentially understated capital pressure, as valuation rules and access to CBR refinancing can prevent losses from being fully reflected in reported ratios. Banks' growing holdings of government securities can therefore create significant interest-rate and duration risk that is not necessarily fully reflected in current profitability or capital indicators. The CBR's stated reason why this poses no significant risk is that banks need not sell the paper at a loss but can instead raise funds against it through repo transactions. This is the regulator explicitly identifying the central-bank repo channel as the mechanism that allows banks to avoid realizing mark-to-market losses on government debt, making the significance of those losses partly dependent on continued access to CBR refinancing rather than immediate asset sales. The increasing use of floating-rate OFZs reduces this risk for banks but effectively transfers more of the interest-rate exposure to the federal budget.

Taken together, the available indicators do not point to an immediate system-wide capital shortage, but they provide considerably less reassurance about banks' effective capacity to absorb future losses than the headline ratios suggest.

Bank Profitability: Robust, but Reliant on Non-Core Income

Reported profitability remains strong across most of the banking system, with returns still well above pre-2022 levels and losses concentrated among relatively small institutions. Return on assets increased sharply following the disruption in early 2022 and remains well above pre-full-scale war levels for most bank groups (see Figure 43). The largest banks have consistently recorded positive returns of around 2%, while profitability among several smaller-bank groups has been particularly high. In July, 232 banks were profitable and 68 loss-making, unchanged from June, with profitable banks accounting for 94% of sector assets.⁶² Distress therefore remains concentrated in small institutions for the time being.

Figure 43: Robust profitability dependent on income outside of core banking.

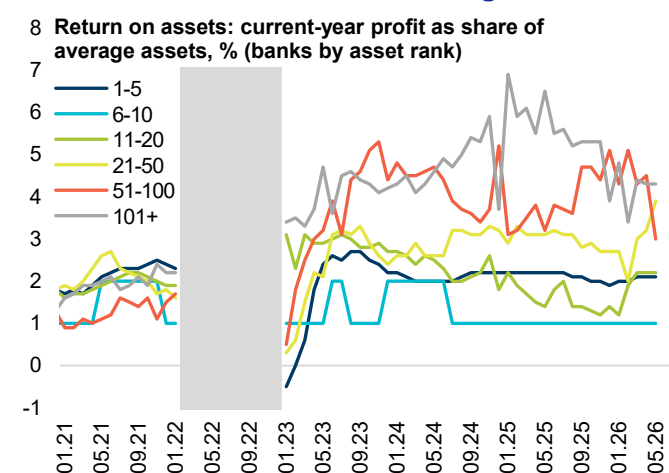
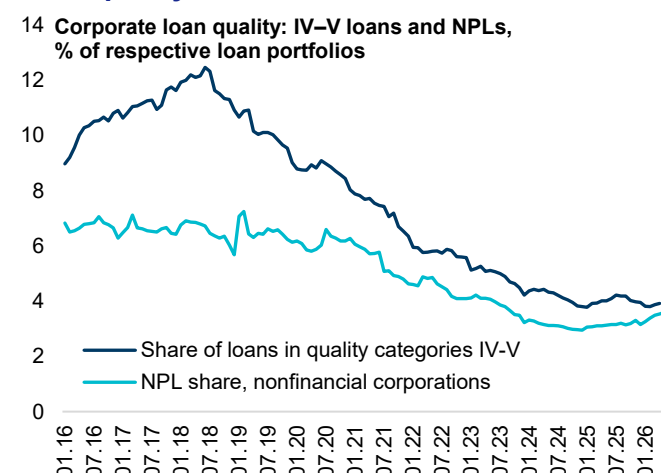


Figure 44: The informational value of headline asset quality indicators is limited.



Recent profits have depended heavily on provisioning decisions and valuation effects rather than core banking income, making headline earnings a less reliable indicator of underlying profitability. The drivers of profitability vary from month to month, with recent results heavily influenced by non-core factors. June's net result depended on FX revaluation (+RUB 66 billion),⁶³ while the July 2026 profit of RUB 443 billion (+18% month-over-month, ROE 23.6%) was boosted substantially by a 40% fall in provisioning charges. The CBR stated plainly that individual banks released provisions after borrowers "updated their business plans to reflect income growth."⁶⁴ According to our calculations, holding provisioning at June's level, the July profit would

⁶² Central Bank of Russia, "On the development of the banking sector of the Russian Federation in July 2026"

⁶³ Central Bank of Russia, "On the development of the banking sector of the Russian Federation in June 2026"

⁶⁴ Central Bank of Russia, "On the development of the banking sector of the Russian Federation in July 2026"

have been about RUB 329 billion, below the previous month. Earnings whose composition changes every month and that depend on discretionary provisioning decisions and valuation swings provide less assurance of sustainable internal capital generation as regulatory requirements are restored.

Securities valuation provides another important boost to reported earnings, while regulatory treatment allows some accumulated losses to remain unrecognized. Falling interest rates generated positive securities revaluations in 2025, while part of the negative revaluation accumulated on ruble bond portfolios remained unrecognized.

Credit Exposure and Asset Quality: Mounting Stress in an Expanded Corporate Loan Book

The exceptional expansion of corporate lending since 2022 has left banks with substantially larger credit exposures than before the full-scale invasion. Ruble lending to legal entities and individual entrepreneurs roughly doubled between mid-2022 and mid-2026. Even after adjusting for inflation, the increase remains large (see Figure 8). While the CBR's loan statistics in broad OKVED 2 categories do not allow for a precise estimate of how much of the additional lending was directly related to the war, the data nevertheless demonstrate the exceptional scale of the credit expansion absorbed by banks' balance sheets. State-owned companies continue to account for a disproportionate share of new corporate lending, providing recurring evidence of state-directed credit. With the largest SOEs responsible for about 30% of the July 2026 portfolio increase (+RUB 0.4 trillion; in June the share was roughly half),⁶⁵ they are effectively the marginal borrower.

The key vulnerability is not the credit expansion itself, but the quality of the assets accumulated during a period of rapid lending growth and increasingly difficult borrowing conditions. Banks now carry a much larger corporate loan book accumulated during a period of rapid credit growth, extensive state involvement, and high borrowing costs in more recent years. Any deterioration in corporate borrowers' ability to service this debt would therefore have correspondingly greater implications for bank asset quality and capital.

Reported headline asset-quality indicators remain relatively benign, but their informational value is limited by regulatory treatment (discussed below), while broader measures increasingly point to a buildup of corporate credit stress. The share of corporate loans in the weakest quality categories (IV–V) remains close to historical lows, while the conventional NPL ratio has only recently begun to edge slightly upward (see Figure 44). However, broader measures show a clearer deterioration (see Figure 45): high-risk restructurings have risen from around 3% of the corporate portfolio at end-2024 to 4.6% by Q1 2026, while other problem loans have also increased. On the CBR's own aggregate measure, problem corporate loans reached 11.8% of the portfolio, or RUB 11.5 trillion, at the end of June.⁶⁶ Coverage by provisions and quality collateral stands at only around 50%, leaving RUB 5.8 trillion uncovered—which the CBR itself describes as up to 60% of the sector's capital buffer above regulatory minima. Together, these categories suggest that stress is building beyond what is currently reflected in conventional NPL measures.

Reported provisioning, likewise, provides little indication of broad balance-sheet deterioration so far, although this reflects the pace at which credit deterioration is recognized for regulatory purposes as much as the underlying quality of the loan book. Provisions as a share of assets have remained broadly stable since 2022 for the largest banks and not increased systematically across groups (see Figure 46). In July 2026, provisioning charges actually fell by 40%, including RUB 103 billion (-77%) in the corporate segment, as individual banks released provisions after borrowers "updated their business plans to reflect income growth" (discussed above). This is counterintuitive in a situation of a stalling economy and significant costs due to Ukrainian attacks and potentially points to a systematic underestimation of risks.

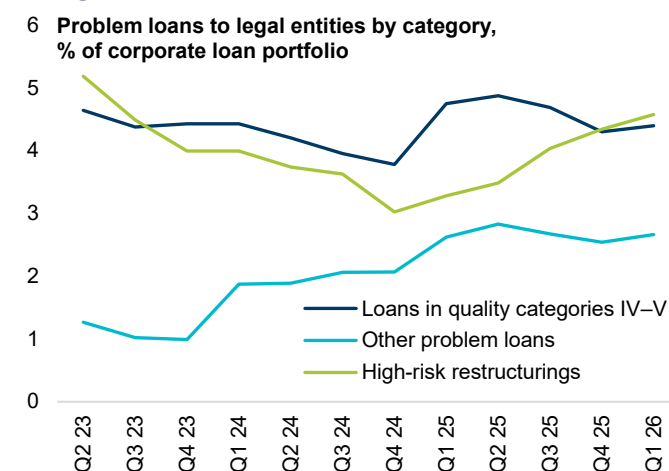
Deterioration is also increasingly visible in borrowers' underlying capacity to service their debt, particularly among smaller companies. Forward-looking default rates for SMEs have increased markedly since 2023 (see Figure 47). The increase is especially pronounced for microenterprises, where the expected 12-month default rate has risen to around 10%, while default rates for small and medium-sized firms have also approximately doubled from their 2021–23 lows. More recent CBR commentary suggests that this deterioration has continued, with the default rate for small and microbusinesses rising

⁶⁵ [Central Bank of Russia, "On the development of the banking sector of the Russian Federation in July 2026"](#)

⁶⁶ [Central Bank of Russia, "On the development of the banking sector of the Russian Federation in July 2026"](#)

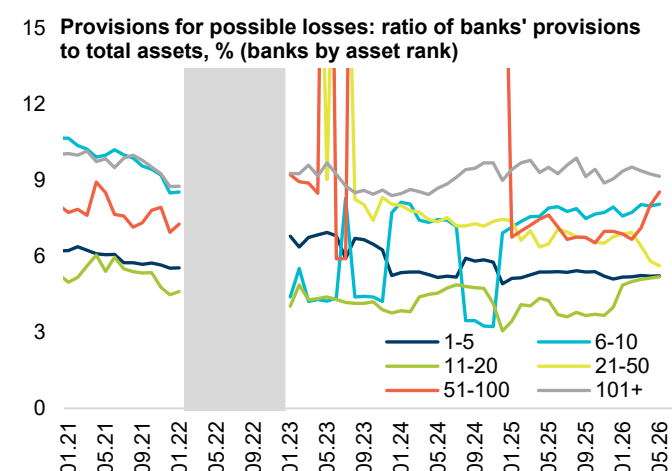
by a further 2 pp over the past year to 10%.⁶⁷ This is consistent with higher interest rates and weaker economic conditions increasingly affecting borrowers' debt-servicing capacity.

Figure 45: Broader measures show rising corporate debt problems.



Source: CBR, KSE Institute *not available before Q2 2023

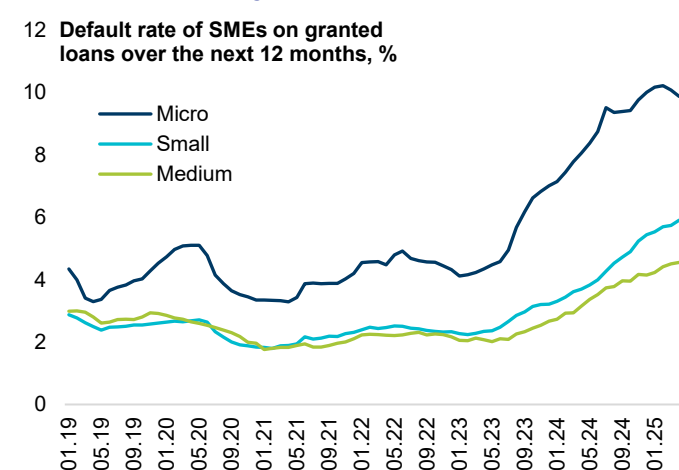
Figure 46: Reported provisions have yet to reflect broader credit deterioration.



Source: CBR, KSE Institute

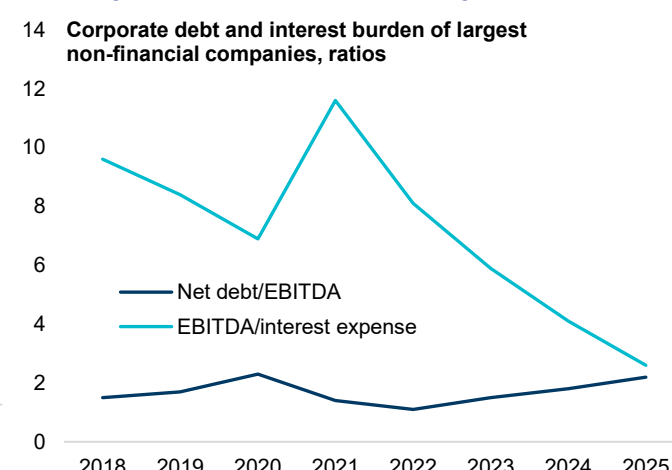
The rising debt-service burden provides further evidence of corporate borrowers' reduced capacity to absorb higher financing costs. Among the largest non-financial companies, aggregate net debt relative to EBITDA has increased from 1.1 in 2022 to 2.2 in 2025, indicating a gradual increase in leverage (see Figure 48). The deterioration in interest coverage has been considerably more pronounced: aggregate EBITDA covered interest expenses 8.1 times in 2022, but only 2.6 times in 2025. While leverage itself remains around levels previously observed in 2020, the sharp decline in interest coverage suggests that higher financing costs are consuming a substantially larger share of corporate earnings—at a time when the stalling economy is weighing on revenues, taxes are rising, and borrowing costs remain elevated despite CBR monetary easing. This deterioration in debt-servicing capacity leaves borrowers increasingly vulnerable to further earnings weakness or persistently high interest rates.

Figure 47: SME default rates have risen sharply since 2023.



Source: CBR, KSE Institute

Figure 48: Corporate debt servicing capacity has deteriorated sharply.



Source: CBR, KSE Institute

Official asset-quality measures likely understate deterioration because regulatory forbearance can delay or prevent the recognition of problems in parts of the corporate loan book. Most importantly, lending related to state defense procurement benefits from special treatment under Regulation 590-P that weakens some of the mechanisms through which deterioration in borrowers' financial condition would ordinarily translate into poorer loan classifications and higher provisions. Under specified conditions, restructuring does not necessarily lead to a deterioration in debt-service classification, while exceptions to

⁶⁷ Bank of Russia, "Запас прочности у ряда компаний снизился, но большинство остаются устойчивыми," April 27, 2026.

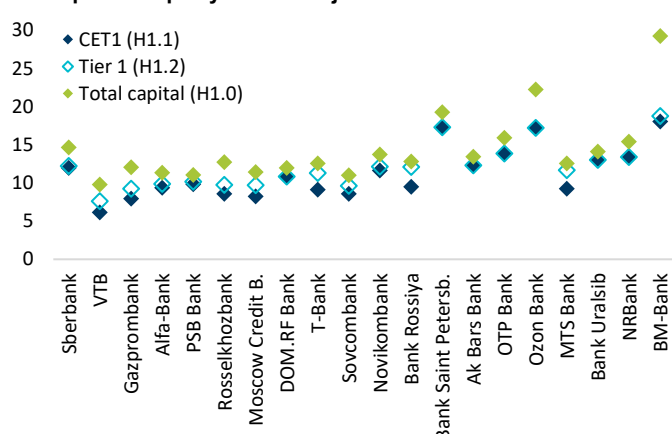
normal financial-condition assessments and other requirements can permit more favorable treatment of higher-risk exposures.⁶⁸ As a result, underlying deterioration in defense-related lending may be less visible in reported asset-quality indicators. Forbearance is neither confined to defense-related lending nor to the immediate post-2022 period. In mid-2026, the CBR extended relief on provisioning for restructured loans of borrowers experiencing temporary difficulties until October 1, 2026. The emerging deterioration in corporate credit quality should therefore be viewed in the context of both the unusually large post-2022 expansion in lending and a regulatory framework that can delay or prevent the recognition of some forms of stress. The key question is increasingly not whether reported NPLs are currently high, but how much underlying credit stress is not (yet) reflected in conventional NPL measures.

The Situation of Individual Financial Institutions

Pressures at major banks remain uneven, with some institutions showing increasingly narrow capital or asset-quality buffers while others remain considerably stronger. VTB's group capital adequacy ratio (N20.0) stood at 10.7% on July 1, 2026, against a 10% regulatory minimum, having recovered from 9.8% at the start of the year through securitization of its retail portfolio and disposals of non-strategic assets rather than through earnings; the minimum rises to 10.75% in January 2027. By contrast, Sberbank appears considerably stronger on reported profitability and capitalization metrics, although its own problem-loan indicators have begun to worsen. Net profit rose by 19.8% y-o-y in January–July 2026 to RUB 1.16 trillion, with ROE at 22.9%, while reported capital ratios remained comfortably above regulatory minima despite the RUB 850 billion dividend for 2025 reducing Common Equity Tier 1 capital by 4.1% in Q2.⁶⁹ The divergence reinforces the limitations of interpreting aggregate banking-system indicators as representative of individual institutions.

Figure 49: Reported capital adequacy masks narrow buffers at some major banks.

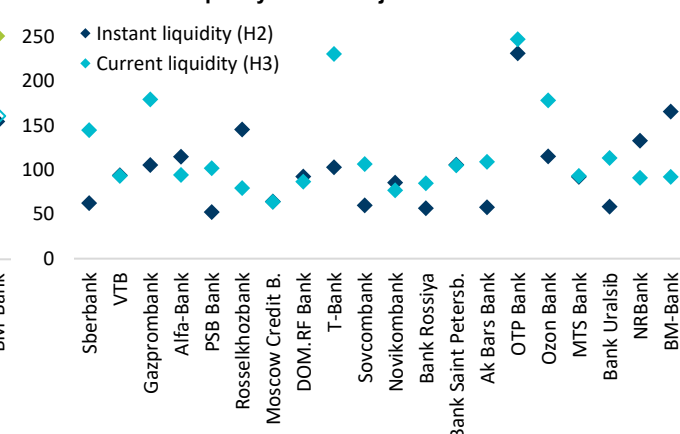
35 Capital adequacy across major Russian banks



Source: CBR, KSE Institute

Figure 50: Liquidity positions remain highly uneven across major banks.

300 Short-term liquidity across major Russian banks



Source: CBR, KSE Institute

A broader comparison of major banks confirms that pressures remain uneven rather than generalized. Reported capital adequacy remains comparatively strong across the largest domestically owned banks, with the three capital ratios above their respective base regulatory minima at most institutions, although buffers vary considerably across banks (see Figure 49). Short-term liquidity positions show even greater dispersion (see Figure 50), but the 20 largest domestically owned banks remain above the regulatory minima for both instant and current liquidity. The cross-sectional evidence therefore supports the broader picture of a banking system that continues to meet headline regulatory requirements, but also reveals substantial differences in the strength of individual institutions.

⁶⁸ Regulation 590-P provides several forms of special regulatory treatment relevant to lending associated with state defense procurement. Under specified conditions, banks may refrain from worsening debt-service assessments following loan restructuring, while exceptions to normal financial-condition assessments and related requirements can weaken the link between deterioration in a borrower's financial position and the resulting loan classification and provisioning. Certain forms of state support may also be taken into account when determining loan quality. Taken together, these provisions can delay or reduce the extent to which deterioration in underlying credit quality is reflected in reported classifications and provisions. See ["Provisioning for potential loan losses"](#) and ["Measures to support the financial sector"](#)

⁶⁹ [Kommersant, "Net profit of Sberbank rose 19.8% year-on-year in January-July 2026"; Interfax, "Sberbank's H1 net profit under IFRS rose to RUB 1.019 trillion"](#)

PSB illustrates how financial pressure at a strategically important institution can be absorbed through direct state support rather than appearing as bank failure. As the designated bank for the military-industrial complex, it plays a central role in financing state defense procurement.⁷⁰ After reporting a RUB 19.2 billion loss in 2025 amid sharply higher provisions, the bank has received increasingly frequent capital injections from the federal government.⁷¹ Its charter capital rose from roughly RUB 221 billion before the June 2024 recapitalization to RUB 427 billion by July 2026—almost doubling in just over two years—with at least four capital increases reported during the first seven months of 2026 alone.⁷² The budgetary justification explicitly links recapitalization to maintaining capital adequacy in connection with lending under presidential instructions and the acquisition of defense-related loans from other banks.⁷³ While PSB's particular institutional role makes it an unusual case, its situation illustrates an important qualification to the broader assessment of banking-system resilience: stress at strategically important institutions does not automatically translate into failure or immediately appear in system-wide indicators because the state can recapitalize banks directly, while guarantees and other support mechanisms can absorb or share part of the associated credit risk. The state's capacity to absorb such stress is increasingly constrained, however, as bank recapitalization competes with other demands on fiscal resources.

An Increasingly Interdependent State-Financing System

The combination of rising sovereign financing needs and increasing pressure on bank balance sheets is creating a progressively tighter sovereign-bank linkage. Banks already hold the majority of domestic government debt and remain the principal source of additional demand as foreign participation has largely disappeared. Primary-market demand is particularly concentrated among systemically important institutions, leaving the government increasingly dependent on a relatively small group of large—predominantly state-controlled—banks to absorb new issuance.

The changing composition of government borrowing illustrates the constraints on this model. As yields rose and demand for conventional fixed-rate debt weakened, the Ministry of Finance increasingly relied on floating-rate OFZs and large placements with state banks during periods of outsized financing needs, particularly at the end of 2024 and 2025 (see Figure 19). The composition is cyclical rather than a one-way shift, however: in June 2026, the Ministry placed predominantly long fixed-coupon paper at a weighted average yield of around 14.6%, as expectations of further easing made duration attractive. Floaters make additional sovereign exposure more attractive to banks by transferring interest-rate risk from banks to the federal budget: when the policy rate remains high, government debt-service costs increase accordingly. CBR repo provision further expands banks' capacity to absorb issuance, as discussed above, but does not eliminate the underlying balance-sheet exposure to government debt.

More recently, banks' absorption of additional government debt has become more costly and dependent on the terms offered by the Ministry of Finance. Banks turned net sellers of government debt in July 2026, reducing their OFZ holdings by RUB 0.2 trillion to RUB 19.2 trillion through sales to other market participants. Of the five auction days scheduled for July, only July 1 went ahead, raising RUB 8.8 billion at a weighted average yield of around 15.0%, of which Russian banks took just 19.3%, compared with 49.7% of the June placement. The auctions of June 24 and July 8 were cancelled, while that of July 15—an OFZ-PK floater, an instrument specifically designed to appeal to banks—was declared void due to the absence of bids at acceptable prices. On July 20, the Ministry of Finance suspended primary auctions indefinitely, the first such suspension since 2022, and all four August auction days were lost. This marks a notable change from earlier periods in which large additional placements could be absorbed by banks, including with support from CBR refinancing. The recent absence of bank purchases suggests that unassisted market absorption has become increasingly difficult and that even support for banks' OFZ demand via official liquidity provision cannot be assumed to provide a continuous source of financing.

⁷⁰ Federal Law No. 275-FZ of 29 December 2012 "On the State Defense Order" (as amended, current version)

⁷¹ [The Moscow Times, "Russian 'Military Bank' Posts 2025 Loss Amid Rising Defaults"](#)

⁷² [Interfax, "PSB increased charter capital by RUB 27.4 billion"; Rambler Finance, "Authorities recapitalized PSB for the fourth time in 2026"](#)

⁷³ [Interfax, "PSB is planned to be recapitalized by RUB 30 billion"](#)

Issuance resumed in September, first with the RUB 1.0 trillion floating-rate placement on September 2 and subsequently with fixed-coupon placements on September 9, 16, and 23. This demonstrates that banks remain willing to absorb additional government debt, but at relatively high borrowing costs and, for the particularly large September 2 placement, with substantial CBR liquidity support.

This creates the potential for a sovereign-bank feedback loop. The state relies on banks to finance widening budget deficits, while banks may themselves increasingly rely on the state and the CBR for liquidity, capital, and support for impaired borrowers. Additional government borrowing, accompanied by dividend distributions, can therefore consume bank balance-sheet capacity at precisely the point when credit losses may require additional capital; conversely, bank recapitalization or the assumption of corporate credit losses would create additional costs for the sovereign.

The banking system remains functional, but absorbing additional financing demands is becoming increasingly costly and may require greater CBR and/or state support. Further war financing therefore comes with increasing monetary, fiscal, and financial-stability costs.

IV. Future Financing Options: Increasingly Costly and Risky

Russia retains substantial capacity to finance continued large federal budget deficits, but doing so is likely to require increasingly costly and potentially destabilizing measures as conventional financing options become more constrained. The least disruptive path is to sustain market-based domestic borrowing through more attractive terms and additional CBR liquidity provision to banks. The government could further reduce its financing needs through revenue increases and expenditure cuts, although such fiscal adjustment would carry growing economic, social, and political costs. Beyond these options, a range of increasingly interventionist crisis-financing measures could mobilize additional resources but at progressively greater economic, financial, and political cost. Another prolonged interruption in domestic borrowing could leave available fiscal buffers insufficient already in 2027; continued market-based borrowing would extend the financing horizon, while combining it with fiscal adjustment or more coercive financing measures could allow Russia to sustain large deficits for considerably longer. The relevant constraint is not a fixed date at which Russia becomes unable to finance the war, but the progressively greater economic, financial, and political costs—and associated risks to financial stability and confidence—required to maintain that financing.

From a Market-Based Approach to Crisis Financing Mechanisms

Russia has, for now, opted to prolong the domestic banking system's capacity to finance the budget by combining more attractive OFZ terms with additional liquidity provision. The September resumption of large-scale issuance illustrates this approach: the Ministry of Finance accepted more favorable terms, while the particularly large September 2 placement was almost entirely financed through CBR repo operations. With the banking system already facing a substantial structural liquidity deficit, sustaining additional OFZ absorption is likely to require continued CBR support. While this path remains available, it is becoming increasingly costly and risky. More attractive borrowing terms increase future debt-servicing costs and can add to pressures on banks' balance sheets, while using CBR liquidity to facilitate additional deficit financing can amplify inflationary pressures. The difficulties encountered in June–August and the terms and liquidity support required for the September resumption of large-scale issuance suggest that sustaining this approach will require increasingly costly policy support.

Beyond sustaining the existing borrowing channel, the government could reduce its financing needs or mobilize additional resources. The most conventional options are further tax increases and cuts to non-military expenditure, while financing pressures could also be shifted off-budget or additional resources generated through asset sales and exchange-rate depreciation. All of these options remain available, but their economic and political costs are increasing: they would weigh on households and economic activity, transfer pressures elsewhere in the economy, or sacrifice future resources for immediate fiscal relief. They could therefore extend Russia's financing capacity but would not eliminate the underlying resource constraints.

Proposals in the 2027–29 draft budget—tax hikes on passive income, windfall taxes on gold and metals producers, and more than doubling the tax on dividends paid into Type C accounts (for companies from “unfriendly” countries) from 15% to 35%—are clearly insufficient but send a signal of what is to come.

If conventional financing channels became insufficient, Russia could turn to more interventionist measures to mobilize additional resources and sustain large budget deficits. These include measures to generate captive demand for government debt, more direct monetary financing, mobilization of household savings, foreign financing, reserve sales, and asset seizures. Such measures could extend Russia’s financing capacity considerably, but would entail progressively greater economic and political costs, including financial repression, inflationary pressures, distortions to the financial system, erosion of property rights, and potentially a loss of confidence in the state and banking system.

The Limits of Russia’s War-Financing Capacity: Scenarios

Next, we present scenarios outlining how Russia’s financing capacity changes under different assumptions. The scenarios vary in terms of budgetary decisions—i.e., revenue increases and/or expenditure cuts—as well as the degree of incentives and coercion to place domestic debt. Across the scenarios, we assume that Russia can realistically **use RUB 4.6 trillion in liquid NWF assets**, including FX purchases under the fiscal rule that have yet to be transferred to the NWF. Liquidation of some equity investments remains possible but difficult and, regardless, would not materially alter the financing timeline. It should be emphasized that the full depletion of the NWF’s liquid assets is in itself an extreme assumption; so far, Russia has deliberately decided to preserve the flexibility provided by the existence of a secondary budget financing channel (discussed in detail in a [previous chapter](#)). We further assume that **no more than an additional RUB 1.0 trillion can be withdrawn from the Treasury’s cash balance** without fundamentally compromising its ability to smooth revenue and expenditure mismatches—a concern that already emerged earlier this year.⁷⁴

- The **stress case** illustrates the implications of another prolonged interruption in OFZ issuance, in which the budget deficit would have to be financed entirely from the NWF and Treasury cash balances. Following the resumption of substantial OFZ issuance in September, this is not a baseline scenario, but it illustrates how quickly financing pressures would intensify if access to domestic borrowing were disrupted again. Assuming a monthly deficit of RUB 600 billion—slightly below the average of the last twelve months—remaining buffers would be exhausted and **financing sources would no longer be sufficient to cover fiscal needs by June 2027** (i.e., within a year). Clearly, Russia cannot afford another prolonged interruption in domestic borrowing without jeopardizing its ability to fund the state. There is a considerable downside risk, as well: a resolution to the situation surrounding the Strait of Hormuz would create significant pressure on global energy prices and, thus, Russian budget revenues.
- **Scenario 1** assumes that Russia will continue to rely on a **fundamentally market-based approach to increase the domestic system’s OFZ absorption capacity**—i.e., the Ministry of Finance will accept higher yields and the CBR will step up the provision of liquidity to the banking system via repo operations—and achieve monthly net OFZ issuance of RUB 300 billion. This is considerably lower than issuance over the last twelve months and below the pace achieved in September, but it assumes that issuance can be sustained rather than merely achieved in individual auctions. While this approach carries some costs—accepting a higher debt (service) burden for the future and inflationary pressures—it is far less risky than the significantly more coercive measures. In this scenario, we assume that the government will **opt not to increase revenues or cut expenditures**, leaving **monthly financing needs of RUB 600 billion**. In this scenario, Russia would **run out of sufficient budget financing by early 2028**. It bears repeating that this would still entail a complete drawdown of NWF liquid assets and reduction of Treasury cash balances to potentially problematic levels.
- **Scenario 2** assumes that Russia combines continued market-based domestic borrowing with **revenue-enhancing and expenditure-reducing measures** to reduce its financing needs. The extent to which

⁷⁴ [Bloomberg, “Russia Was Forced to Cut Spending After Running Out of Cash”](#)

such measures could reduce the deficit is highly uncertain and depends on their scale and composition. However, meaningful fiscal adjustment could **extend Russia's financing horizon considerably beyond that in Scenario 1** by slowing the depletion of remaining buffers and reducing the amount of additional borrowing required. This would come at considerable political, social, and economic costs. In addition to constraining an already stagnant economy, cuts to social expenditures would bring the war home to Russian society in a way that the government has gone to great lengths to avoid.

- **Scenario 3** assumes that, instead of undertaking fiscal consolidation, the **government will opt to generate additional demand for OFZs through increasingly coercive measures** such as those discussed above. Such measures could likewise **extend Russia's financing horizon considerably beyond that in Scenario 1**, potentially allowing the government to sustain large deficits for an extended period. This approach also comes with significant costs; coercive measures to generate OFZ absorption could lead to serious distortions of the sovereign debt market, undermine the stability of domestic banks, or trigger a crisis of confidence in the entire financial system. **These risks could materialize well before Russia mechanically exhausts its available financing resources.**

In conclusion: We find that another prolonged interruption in domestic borrowing would trigger serious budget financing troubles within a year, while a market-based approach could provide funding until early 2028 if authorities were willing to accept the implications of higher yields and stepped-up repo operations, while depleting remaining macroeconomic buffers. If, however, Russia were willing to accept the significant negative side effects of more coercive measures—higher inflation, financial repression, greater financial-stability risks, and erosion of central-bank credibility—or the painful implications of budgetary adjustments—lower household incomes, weaker economic activity, and cuts to public services—it could extend its financing horizon considerably further.

As already mentioned above as well as in [Chapter III](#), these scenarios inevitably **cannot fully incorporate** one key factor: the **role of confidence in the financial system and, more broadly, the state**. The relative stability of the Russian state-financial system during the war is fundamentally built on the **belief that the state will live up to its commitments**: sustaining war-related spending, supporting sectors affected by war disruptions and sanctions, bailing out banks that struggle with deteriorating credit quality, and, importantly, refraining from mobilizing private funds to fulfill budget needs. However, **confidence can erode quickly**, especially in a system that is under strain from various directions—including sanctions, the ripple effects of a massive wartime credit expansion, and increasingly effective Ukrainian attacks on key industries—and in which the quality of macroeconomic management has deteriorated and policy space is increasingly limited. Several potential **triggers for a crisis of confidence** come to mind, including, first and foremost, a sharp drop in global energy prices should the Strait of Hormuz be fully reopened and oil and gas flows out of the Persian Gulf restored. In such a scenario, the **timeline for running out of fiscal financing options could be seriously accelerated**.

In the following chapter, we assess how measures by Ukraine's allies can exacerbate Russia's financing challenges and undermine the capacity to fund its war of aggression and threat to European security.

V. Policy Implications: Targeting Russia's War-Financing Capacity

Ukraine's partners have significant leverage over the elements that determine Russia's war-financing capacity. Measures that reduce revenues directly widen the budget deficit, while lower oil and gas earnings also limit fiscal-rule inflows into the NWF and constrain policy space by adding to macroeconomic pressures. At the same time, financial sanctions restrict Russia's access to external financing, leaving it dependent on domestic borrowing and a banking system in which additional OFZ absorption is becoming increasingly costly and dependent on policy support. Policies should seek to reinforce these constraints simultaneously, increasing financing needs while limiting the resources available to meet them and increasing the costs of doing so. To this end, the following measures should be considered:

- **Ukraine's partners should intensify efforts to reduce Russia's oil and gas revenues.** Lower energy revenues would widen the budget deficit, limit future NWF accumulation, and add to

macroeconomic pressures, simultaneously increasing financing needs and weakening Russia's ability to meet them. Sanctions priorities include ending remaining coalition purchases of Russian energy, increasing pressure on major buyers of Russian oil and gas, and targeting the shadow fleet and its ecosystem. These measures are discussed in greater detail elsewhere in KSE Institute's work.⁷⁵ Restoring stability to global energy markets by resolving the situation surrounding the Strait of Hormuz must also be a priority, as elevated global energy prices fundamentally undermine sanctions pressure.

- **Foreign investors must remain effectively excluded from the Russian sovereign debt market.** Existing sanctions on Russian sovereign debt should be maintained, preventing coalition-country investors from returning as a source of demand for OFZs. The United States should consider using secondary sanctions against third-country financial institutions that undertake or facilitate purchases of Russian government debt. Other coalition countries should similarly leverage their still-dominant role in the global financial system to force foreign institutions to choose between participating in Russia's sovereign debt market and retaining access to their markets and financial systems.
- **Financial sanctions should target the banking system's role in financing the government.** Banks that play a disproportionate role in absorbing OFZ issuance should be prioritized for the strongest available financial restrictions, particularly measures that complicate their cross-border payments, access to correspondent relationships, foreign-currency transactions, and dealings with third-country financial institutions. Coalition countries should also use their leverage over foreign counterparties to raise the cost of maintaining relationships with these banks, especially where those relationships facilitate broader international activity. The United States should consider using secondary sanctions to deter third-country institutions from transacting with these banks, while other coalition countries should use access to their markets and financial systems as leverage to discourage such relationships. The objective would not be to prevent domestic OFZ purchases directly, but to increase the external costs borne by institutions that provide the government with critical financing capacity.
- **Sanctions should exploit the Russian banking system's balance sheet vulnerabilities.** So far, efforts to constrain Russia's ability to continue waging its war against Ukraine have largely (and correctly) focused on industries most critical for the generation of export earnings (e.g., the oil and gas sector) or actors directly involved in the war effort (i.e., the military-industrial complex). Given the already deteriorating quality of assets at a time when domestic banks are asked to absorb large domestic debt issuance, sanctions should also target sectors and entities to which the banking system has large or particularly vulnerable exposures. This is the economic statecraft equivalent to what has become known as "kinetic sanctions"—Ukraine's increasingly effective targeting of key sectors of the Russian economy. Damage to refineries has not only triggered a domestic fuel crisis but also created large funding needs for repairs and the management of disruptions to business activity. Once companies' ability to shoulder them is exhausted, the state will either need to provide support or accept the burden that this puts on the banking system, which will, in turn, undermine budget financing.
- **Sanctions should make it more costly for the CBR to accommodate government financing.** The CBR can create essentially unlimited ruble liquidity, but its ability to do so without undermining price and exchange-rate stability depends on the broader macroeconomic environment. Measures that weaken the external balance and increase inflationary pressures therefore narrow the CBR's room to support the banking system and, indirectly, government borrowing. While it would not directly constrain domestic liquidity provision, it is also worth noting that the CBR is not subject to a full asset freeze in the EU and UK; instead, specific transaction bans and other financial restrictions apply. A full asset-freeze designation should therefore remain an option for further increasing pressure on the CBR.
- **Russian reserves must remain immobilized and the liquidation of gold reserves hindered.** Immobilized CBR reserves represent a substantial external buffer that must remain inaccessible to Russia. Sanctions should continue to prevent their release, while restrictions on transactions involving

⁷⁵ [KSE Institute, "Sanctions and the Russian Economy: 2026 Mid-Year Assessment](#)

Russian sovereign gold should limit the ability to mobilize another major reserve asset. The separate question of confiscating immobilized assets for the benefit of Ukraine should remain firmly on the table.

- **Regulators in coalition countries must set a timeline for the exit of all remaining foreign banks.** More than four-and-a-half years after the full-scale invasion, several European and American financial institutions remain active in the Russian market—carrying out cross-border transactions and providing stability to the system. In addition to prohibiting certain activities, regulators should change the incentive structure by emphasizing that the foundational elements of the sanctions regime, including financial sanctions, will remain in place for the foreseeable future and that waiting for a normalization of relations is not a viable course of action. Specifically, foreign banks and their subsidiaries should be required to fully write down the value of their Russian assets by the respective regulators.
- **The coalition should explore ways to facilitate private capital outflows from Russia.** Financial isolation and Russia's own capital controls have helped trap household savings and corporate funds inside the country, supporting the domestic deposit base and limiting pressure on the ruble. Coalition policies should explore whether legitimate private funds can be given additional avenues to leave Russia. Any such approach would need to maintain strict safeguards against sanctions evasion and exclude sanctioned persons, state-linked entities, and illicit funds. Facilitating capital outflows from the legitimate private sector could weaken bank funding, increase demand for foreign currency, and force the CBR to devote greater resources to maintaining financial and exchange-rate stability.
- **The coalition should use strategic communications to challenge confidence in Russia's financial system.** Its stability critically depends on households' and businesses' willingness to hold their savings in domestic banks. Publicizing credible information about deteriorating asset quality, the increasing reliance of weak institutions on state support, the erosion of the prudential framework through regulatory forbearance, the increasing subordination of bank balance sheets to the state's financing needs, and concerns about the security of private assets could draw attention to vulnerabilities and make it more difficult for the authorities to sustain confidence through reassuring headline indicators.