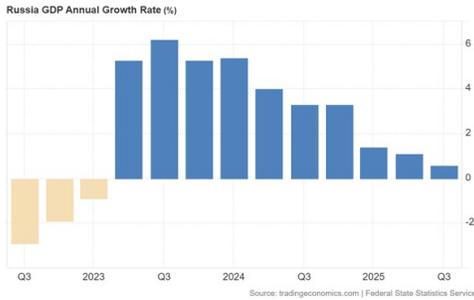


RUSSIA ON TENTERHOOKS

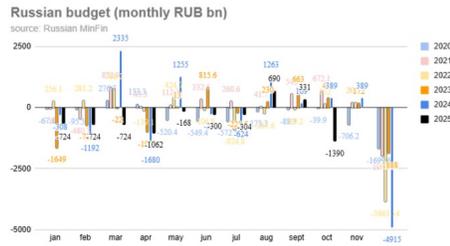


The Imploding Russian Economy

As the global economy pivots toward the uncertainties of 2026, the Russian Federation stands at a critical juncture. The narrative of “Fortress Russia”, a self-sufficient economy immune to external pressure, buoyed by record high reserves of gold and sovereign resilience has faced its most rigorous stress test in the fourth quarter of 2025 in terms of highly volatile energy markets and depleting forex reserves. The economic vitality observed throughout 2023 and 2024, characterized by robust GDP growth rates of approximately 4.1% and 4.3% respectively, was not the result of organic productivity gains or structural reform. Rather, it was a massive, state-directed injection of fiscal liquidity into the defense industrial base (DIB), financed by the liquidation of the National Wealth Fund (NWF) and high commodity revenues.



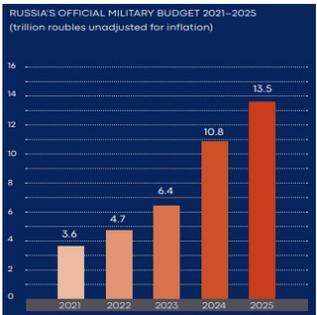
Source: tradingeconomics.com



Source: Russian Ministry of Finance

By December 2025, this growth model has demonstrably exhausted its capacity. The Russian economy has transitioned from a phase of temporary war-fueled boom (2023 & 2024) to a state of slow growth, high inflation and increasing disorder. According to the Macroeconomic Survey of Bank of Russia, GDP is projected at 0.9% in 2025 and 1.1% in 2026, a stark change from 4.3% (actuals) in 2024. The sharp deceleration from the wartime highs signals that the economy has hit hard physical constraints: the labor force is fully utilized (and shrinking), industrial capacity utilization is maxed out at inefficient levels, and access to capital has been strangled by a key interest rate hovering near 16%.

According to preliminary documents by Finance Ministry, the defense budget for 2026 (fifth year of war), is expected to be 13 trillion rubles. The divergence between the defense sector and the civilian economy has created a two-speed reality that is fundamentally unsustainable. While defense manufacturers continue to operate on triple shifts, subsidized by the federal budget, the civilian sector is withering under the twin pressures of labor cannibalization and prohibitive borrowing costs. The “War Boom” is effectively over and the Stagnation Trap has begun.



Source: VSD

Demographic Chaos & Labor Market Disruption

The single most binding constraint on the Russian economy in late 2025 is the demographic crisis, exacerbated to a breaking point by the ongoing conflict. Unemployment figures, often cited as a proxy for economic health, tell a darker story in the Russian context. The official unemployment rate has fallen to a historic low of 2.2%. In a functioning market economy, this would indicate full employment and wage robustness. However, in Russia's war economy, it represents a catastrophic supply-side bottleneck.

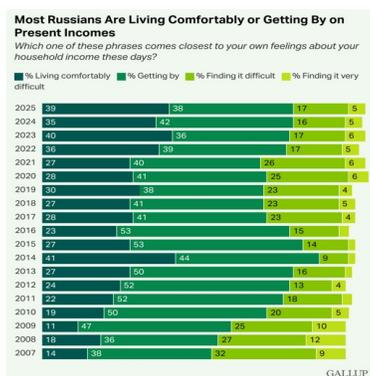
The mobilization of hundreds of thousands of working-age men, combined with the exodus of the IT and technocratic class to hubs in Dubai, Belgrade, and Central Asia, has hollowed out the productive core of the workforce. The remaining labor pool is the subject of a fierce bidding war between the state-backed military complex and the private civilian sector. This competition has driven nominal wage growth to a 16-year high, fueling a wage-price spiral that disconnects income from productivity.

Table 1: Structural Shift in Labor and Inflation Dynamics (2021–2025)

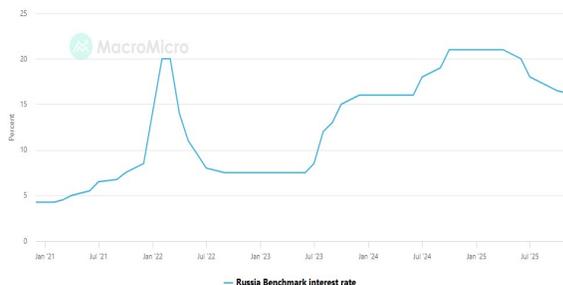
Indicator	Pre-War Baseline (2021)	War Economy Peak (2024)	Current Status (Dec 2025)	2026 Forecast	Trend Analysis
Unemployment Rate	4.8%	2.4%	2.2%	2.0%–2.5%	Severe Labor Shortage
Nominal Wage Growth	~9.0%	~14.0%	16-Year High	Decelerating	Wage-Price Spiral
Real Disposable Income	Stable	Rising (Base Effect)	Eroding	Negative	Inflation Erosion
Inflation (CPI)	8.4%	9.1%	6.3%–9.5%	Sticky >7%	Persistent
Key Policy Rate	8.5%	21.0%	16%	13-15%	Restrictive

Source: Rosstat, Central Bank of Russia, Interfax

Estimates from an early 2025 polling from Gallup, indicated that 39% of Russian households felt comfortable financially a lagging indicator driven by military payouts and death benefits. However, according to Zvonovsky, a sociologist, the current sentiment is rapidly deteriorating. The inflation rate, fluctuating between 6.3% and 9.5% depending on the basket of goods, is proving incredibly sticky because the defense sector is insensitive to the interest rates and on the other hand the civilian activity is negatively impacted causing a massive fall in supply but no reduction in demand. The influx of fiat currency into the economy via defense spending is chasing a shrinking volume of goods and services, neutralizing the Central Bank's monetary efforts.



Source: Gallup



Source: MacroMicro

The Central Bank of Russia (CBR), under the stewardship of Elvira Nabiullina, has historically been the technical anchor of the Russian state. However, the events of 2025 have pushed the CBR into a monetary dead end. Throughout late 2024 and 2025, the CBR pursued an aggressively hawkish policy, raising the key rate to peaks of 21% before settling around 16% in December 2025. The theoretical aim was to cool aggregate demand and rein in inflation. In practice, the transmission mechanism of monetary policy has broken down due to the fiscal dominance of the war effort. The defense sector, which is the primary driver of overheating, is interest-rate insensitive; its funding comes from direct budget allocations, not commercial credit. Therefore, the high rates disproportionately punish the civilian economy—retail, construction, and SME manufacturing—which relies on commercial loans.

This has resulted in a zombie economy phenomenon. State-connected enterprises with access to subsidized credit or budget transfers continue to expand, while efficient, market-based private enterprises are starved of capital (crowding out). According to CBR, the bigger companies which represent two-fifth of the Russian GDP are in increased risk of bankruptcy because of liquidity problems and a sharp rise in interest rates. Also, the outlook for 2026 from CBR looks bad, the best case scenario in which the rates average around 14% would result in the proportion of firms with unmanageable debts burdens rise to 63.8%. The CBR can no longer fight inflation without collapsing the private sector, nor can it lower rates without triggering hyperinflationary pressure given the supply constraints.

Trump, Sanctions & Shadow Fleet

A critical geopolitical pivot point arrived with the inauguration of the Trump administration in 2025. For years, Moscow operated under the assumption that a Trump presidency would bring transactional diplomacy and a relaxation of the liberal internationalist sanctions regime. This calculation has proven disastrously incorrect. Instead of relief, Russia faces a new doctrine of Aggressive Mercantilism- a strategy where Trump is using the US economy to extract leverage and force Russia into doing what it wants.

The new administration has eschewed the complex, coalition-based consensus of the G7 Price Cap (which was porous and difficult to enforce) in favor of unilateral, high-impact tariffs and secondary sanctions. The directive is clear: nations facilitating Russian trade evasion are subject to immediate punitive tariffs on their exports to the United States. This has increased risk premiums for countries doing trade with Russia.

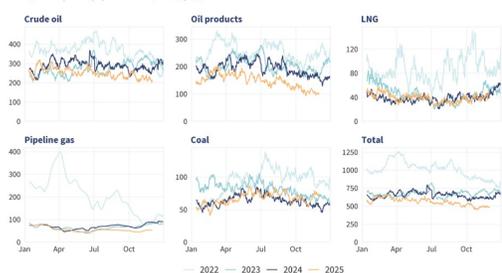
Key Policy Shift: The Tariff Weapon

Direct Threat: The US administration explicitly threatened and implemented tariffs ranging from 25% to 50% on goods from India. Further, punitive tariffs were also levied on Chinese goods.

Impact on Neutrality: This forces the neutral states to make a binary commercial choice: continue with the Russian trade burdened by sanctions, high insurance premiums, steep currency risk or preserve access to the high-value US consumer market. As the data from late 2025 shows, commercial interests are winning out over geopolitical alignment.

Although Russia maintains a trade surplus, the trend is narrowing as compared to 2024. According to the Bank of Russia, average monthly trade surplus is around \$11.1 billion and the cumulative (Jan-Oct'25) is around \$101.5 billion down from \$109.6 billion in the same period last year. This surplus is mainly due the contraction in imports rather than growing exports which still faces headwinds due to lower oil prices and sanctions. Consequently, the current account surplus has also tightened totaling \$37.1 billion for the first ten months of 2025, compared to \$52.7 billion in 2024. A major recent development which will impact the trade statistics sharply is to be seen from 1st Jan, 2026 when EU will completely ban new contracts on imports of Russian pipeline gas and LNG. All the existing short and long term contracts will be phased out systematically in 2026 and 2027 respectively.

Russia's fossil fuel export revenue by fuel
14-day moving average | Million EUR per day | By year



Source: CREA analysis based on Kpler, Marine Traffic, ENTSOG and customs data.

CREA

Russia's seaborne oil export revenue with enhanced price caps
Pricing scenario | Million EUR per day



Source: CREA analysis based on Kpler, Marine Traffic and customs data.

CREA

Source: CREA

Russia's primary mechanism for evading the 2022–2024 oil embargoes was the Shadow Fleet—a disparate aging old fleet operating outside the G7 insurance and maritime services umbrella. For nearly three years, this fleet allowed Russia to maintain export volumes despite Western restrictions. However, by late 2025, this logistical lifeline is fraying under the weight of operational attrition and renewed Western enforcement.

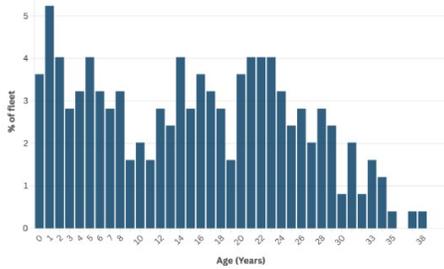
In late 2025, the EU intensified these restrictions with its 19th sanctions package expanding its target beyond crude oil including LNG. The focus also shifted to fleet's enablers designating additional vessels and sanctioning registries and brokers that facilitate their movement. The enhanced ability to detain vessels based on insurance verification is also causing a lot of deterrence in the shadow fleet movement.

The shadow fleet is comprised primarily of vessels at the end of their operational lifecycles. Analysis indicates that the average Russian shadow tanker is 3–4 years older than even the sanctioned Iranian fleet. These vessels, often lacking proper classification society certification, are prone to mechanical failure.

The Incident: In January 2025, the M/V Eventin (a Panamanian-flagged shadow tanker carrying 100,000 tons of Urals crude) lost power and steering in the Baltic Sea, drifting dangerously close to the German coast.

The Reaction: The vessel was seized by German authorities, citing immediate environmental hazard. This set a legal precedent: European coastal states (Denmark, Sweden, and Germany) are now using environmental safety regulations and the UN Convention on the Law of the Sea (UNCLOS) to intervene and detain shadow fleet vessels.

Age distribution of the large cruise ships fleet

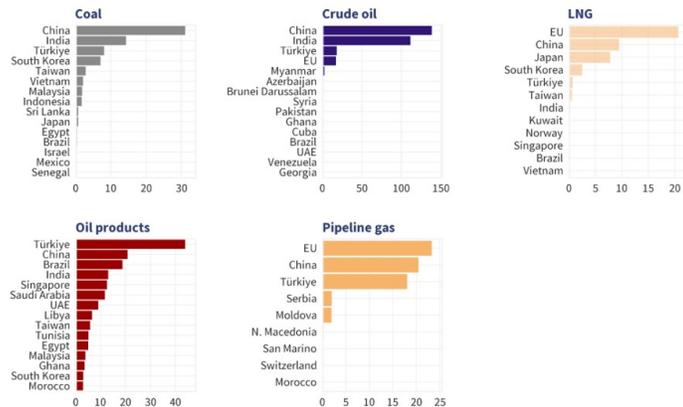


Source: Refintiv, VesselFinder, Carnegie Endowment

Furthermore, the 19th sanctions package included bans on exports of electronic components, additional metals, oxides and alloys used for military systems, construction materials, articles made of rubber, tubes, tyres, etc. The union has identified forty-five new organizations that support Russian military complex which will now come under stricter export restrictions. Interestingly, for the first time, “A75A5” a cryptocurrency pegged to ruble that was used extensively to circumvent restrictions will be banned throughout EU and sanctions will be imposed on the developers, platform operators and Kyrgyz issuers. With all these additional measures, the EU is attempting to further increase economic and political pressure on Russia in order to continue raising costs of continuing war.

Who bought Russia's fossil fuels after EU bans | Billion EUR

Shipments arriving since EU oil bans until end of November 2025

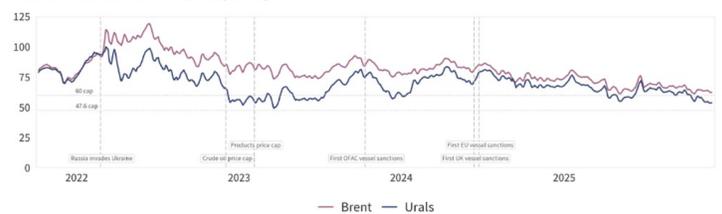


Source: CREA analysis based on Kpler, Marine Traffic, ENTSOG and customs data.



Urals and Brent oil prices over time

Price of oil (USD/bbl) with 7 day rolling average



Source: tradingeconomics.com

Dashed data is missing and estimated based on the last known value



By November 2025, the combined effect of US secondary sanctions on vessel owners and the physical intervention by European navies caused a 21% month-on-month drop in oil shipments via shadow tankers. Furthermore, Ukrainian asymmetric naval drone warfare has effectively targeted Black Sea oil terminals, reducing seaborne exports from that region by nearly 50% in November 2025 alone. The Shadow Fleet is no longer a ghost; it is a target.

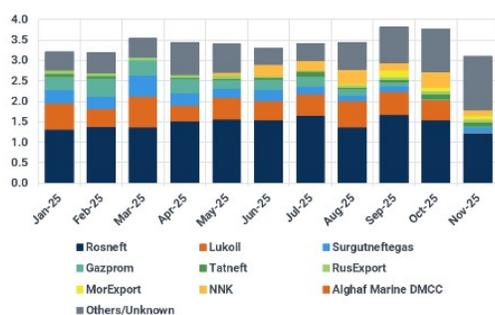
The ability of the shadow fleet to navigate key choke points—specifically the Danish Straits (Baltic exit) and the Turkish Straits (Black Sea exit)—is contingent on insurance verification. Throughout 2025, Denmark and Turkey faced immense pressure to enforce insurance requirements more strictly.

The M/V Eventin incident provided the political cover for Denmark to begin inspecting paperwork with rigor. Since most shadow vessels carry dubious insurance from non-IG (International Group) clubs or sovereign Russian guaranties that are not recognized internationally, this has led to queues and long delays. The frictional cost of Russian oil exports has skyrocketed. Every day a tanker waits at anchor for inspection, it erodes the netback price received by the Russian producer, widening the discount spread even further.

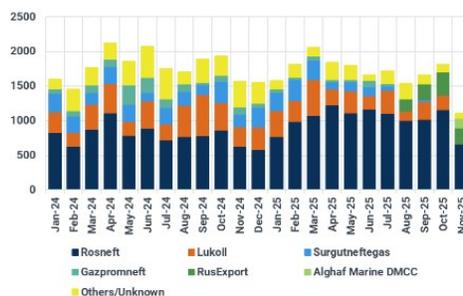
In September 2025, Russian and Chinese officials finally signed a "legally binding memorandum" for the construction of the Power of Siberia 2 (PS-2) gas pipeline. While the Kremlin propaganda machine hailed this as a strategic victory that would replace the lost European market (roughly 150 bcm/year), a forensic analysis of the deal reveals a strategic defeat. The economic terms reveal a massive disparity between what Russia lost and what it has gained: while European buyers previously paid between \$350 and \$500+ per cubic meter, China has secured a rate of just \$120–\$150, which is close to Russian domestic pricing. Additionally, the new pipeline's capacity of 50 bcm/year replaces only one-third of the ~150 bcm/year volume lost in Europe. Consequently, projected annual revenues are capped at a modest \$2.5–\$4 billion, a fraction of the high-margin income previously generated by Gazprom's western exports.

China utilized Russia's desperation to secure terms that are overwhelmingly favorable to Beijing. It turns Gazprom into a utility provider for Chinese industry rather than a profit center for the Russian state. Despite the reduced revenue potential, Gazprom is forced to bear the entire cost of construction, estimated at \$13.6–\$25 billion. With Western capital markets closed and Chinese banks avoiding secondary sanctions, Russia must self-finance this massive capital-intensive project using its own dwindling reserves, which creates a significant opportunity cost by crowding out investment in the civilian economy. The pipeline requires traversing difficult terrain through Mongolia. Construction estimates place the operational start date between 2033 and 2035—a timeline of 8 to 10 years. This creates a decade-long revenue valley where Russia has lost Europe but has not yet connected to China. The gas remains stranded in Western Siberia.

Russia seaborne oil exports by sellers, Mbd



Russian oil exports to India by sellers, kbd



Source: Kepler

The strategic pivot to the East has resulted in a near-total dependence on the Chinese economy. By late 2025, China accounts for roughly 30% of Russia's exports and 35% of its imports. This relationship has shifted from partnership to vassalage. The Russian financial system is now "Yuanized." The Yuan is the primary settlement currency and reserve asset. However, this imports Chinese economic volatility into Russia. Furthermore, as Chinese banks restrict payments to comply with US sanctions, Russian importers face periodic liquidity crunches. In late 2025, the cost of Yuan liquidity in Moscow spiked repeatedly, causing the ruble to devalue sharply against the Chinese currency, fueling imported inflation.

Technological Degradation

A silent crisis is unfolding within Russian manufacturing, i.e., the forced simplification of production processes and end-products due to the unavailability of advanced Western components and technology. As pre-war stockpiles of spare parts are exhausted, Russian industry is regressing to lower technological standards.

This is not merely about a lack of luxury goods; it is about the fundamental efficiency of the industrial base. Without Western machine tools (CNC machines), ball bearings, and software, factories are becoming less productive and more prone to accidents. The import substitution program, touted since 2014, has largely failed to produce high-tech equivalents, forcing a reliance on re-badged Chinese imports or inferior domestic substitutes. The investigations by Economic Security Council of Ukraine reveal that over 62% of Russia's CNC machines are supplied by the Chinese. One of the most visible technological rollback can be seen

in the automotive sector where the government was forced to issue Decree No. 855 legally permitting the manufacture of cars without ABS, airbags, and with emissions standards downgraded to 1990 Euro-2 standards. The systemic nature of this crisis was effectively confirmed by the Central Bank of Russia itself, which reported that 65% of industrial enterprises have faced blocked access to equipment, resulting in a "structural transformation" where foreign high-tech capital is replaced by labor-intensive, lower-efficiency alternatives. Another most visible and terrifying manifestation of this situation is in the civil aviation sector. Russia's geography makes aviation an essential utility, not a luxury. The fleet, dominated by Boeing and Airbus aircraft, is disintegrating.

According to an article published in The Moscow Times, by late 2025, the practice of cannibalization—stripping parts from one aircraft to keep another flying has reached a critical threshold. The aviation chief Dmitry Yadrov stated that the country could lose 339 aircrafts over the next five years in the worst-case scenario including 109 foreign made planes.

The safety margins are evaporating.

Incident Rate: According to an independent newspaper Noyaya Gazeta, Russian airlines logged over 800 technical malfunctions in 2025, a fourfold increase compared to the previous year. The aviation accidents doubled from 8 in 2023 to 17 in 2024, the number of fatalities thus far increased by three times from 12 to 37 and 53 till 2025 (440% increase from 2023).

Regulatory Response: In a desperate move, Rostransnadzor (the transport oversight agency) launched mass inspections of 51 regional airlines in late 2025. Although, the findings are classified, but the grounding of carriers like Angara Airlines suggests systemic negligence.

For the first three years of the war, Russia successfully utilized a grey market of intermediaries in Turkey, the UAE, and Central Asia to import Western semiconductor chips. In 2025, this loophole began to close. In a landmark development, a series of lawsuits were filed in Texas state courts in late 2025 against major US chipmakers (Intel, AMD, Texas Instruments) and distributors (Mouser Electronics). The plaintiffs, Ukrainian victims of missile strikes, allege gross negligence by these firms in allowing their products to be diverted to Russia. Terrified of liability and reputational damage, the Western tech firms have implemented draconian KYC protocols. They are cutting off distributors who show even a hint of connection to Russia.

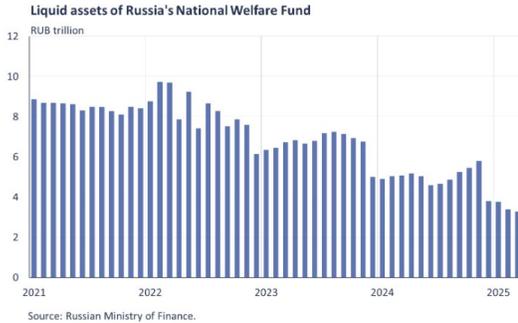
Although the supply has not stopped the risk premium has exploded. As per industry sources, the Russian defense companies are paying exorbitant markups for chips that are frequently counterfeits or low-grade consumer electronics repurposed for military use. This drives up the cost of every missile and drone produced, reducing the volume of fire Russia can sustain for a given budget.

The Dark Future

The outlook of the Russian economy remains highly uncertain and three likely probable outcomes can take place- the slow grind envisions a stagflationary situation where the war persists at lower intensity. In this scenario, GDP stagnates (0.5%–1.0%), inflation remains sticky at 8%–9% despite high rates, and the ruble undergoes a controlled devaluation to 105–110 Usd/Rub, slowly eroding living standards. The fiscal fracture anticipates perfect storm where oil prices crash and US tariffs severe energy lifelines. This would trigger a massive budget deficit, rapid depletion of National Wealth Fund (NWF) and hyperinflation (>20%) as the state monetizes debt potentially breaking the social contract. Lastly, the geopolitical concession sees a negotiated pause due to exhaustion which would cause an immediate demobilization recession shock. It prevents total collapse and allows for slow but eventual reintegration into the global economy.

The fiscal analysis of the second scenario was drafted on opportunistic assumptions are now obsolete. According to an investment banker, Yevgeny Kogan, every \$1 drop in the price of oil costs the budget roughly 160 billion rubles (\$1.9 billion) in annual revenue. With Urals currently trading ~\$20 below the budget assumption, the projected shortfall is approximately 3.2 to 4.0 trillion rubles. Financing options are critically limited: the liquid portion of the NWF has been drained covering 2023–2025 deficits, and international markets remain closed. Domestically, with the key rate at 16%, debt servicing is exorbitant. This

leaves the government with only two dangerous tools: politically risky sequestration of social spending or an inflationary tax via money printing.



USD/RUB



In the past 12 months ruble has posted strong appreciation against US dollars. According to a Bloomberg report, the reason behind this is a tight monetary policy and reduced demand for foreign currencies in Russia. The support can also be seen from Bank of Russia and Ministry of Finance's operations of foreign exchange sales and disposing of yuan from National Wealth Fund (NWF) respectively. But the winds for 2026 seems to be changing as oil prices further falls, interest rates eases and fresh sanctions from EU makes it difficult for the ruble to sustain this appreciated levels. However, Alexandar Shokhin, the head of Russian Union of Industrialists and Entrepreneurs, expressed concerns regarding the strong appreciation stating that a weaker ruble could benefit not only the exporters and the budget but also the entire economy.

The assumption that the world's dependence on Russian resources was inelastic and that the Russian economy could endlessly substitute capital for labor has been shattered. The world led by the transactional opportunism of India and China—has proven it will only buy Russian resources at distress prices. The Trump Factor has introduced a level of enforcement risk that makes even those transactions perilous. Domestically, the economy is eating itself: the defense sector is cannibalizing the labor and capital needed to sustain the civilian population. The stagnation trap is the current reality and for 2026, the risk is that the stagnation turns into a full blown systemic failure of fiscal budget, aviation crisis or banking sector.

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