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Russia Has a Budget Problem. Borrowing Its Way Out Won't Be So Simple.

By Moscow Times Reporter

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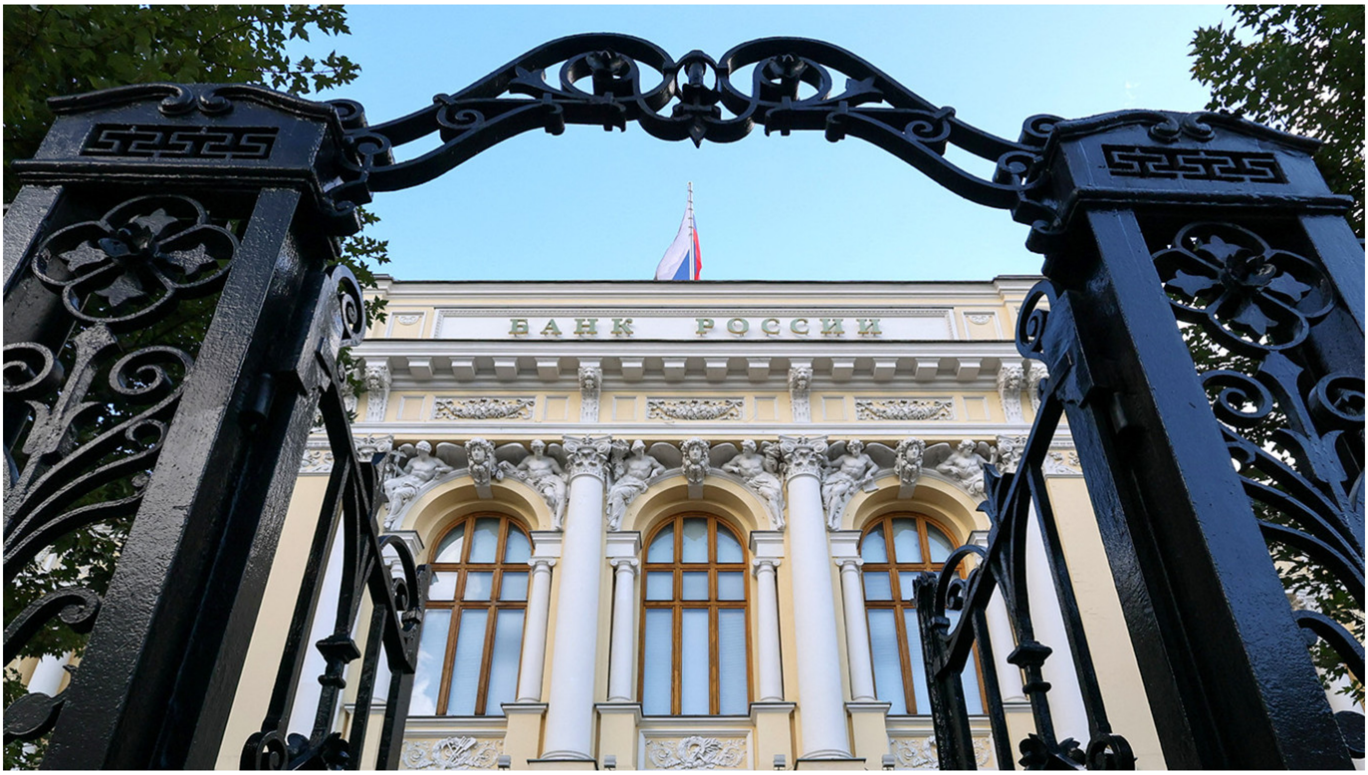

A flag flies above the Russian Central Bank headquarters in Moscow. **REUTERS / Shamil Zhumatov**

Russia's government debt stands at about 19% of gross domestic product, a figure President Vladimir Putin uses to reassure Russians as the country's budget deficit widens.

The federal budget deficit reached 5.8 trillion rubles ($68.4 billion), or 2.5% of gross domestic product, in the first eight months of 2026, exceeding the 3.8 trillion rubles ($44.8 billion) planned for the entire year.

"There is a deficit, but it is not critical given that we have one of the lowest levels of government debt in the world," Putin said in early September.

Indeed, Russia's debt-to-GDP ratio is far below the levels seen in major economies such as China, the U.S., France and Britain, and that low debt ratio gives Russia some room to borrow.

But high interest rates, sanctions and a limited pool of domestic buyers make using that room an expensive option.

With years of war spending straining the budget, those borrowing costs are helping drive the government toward tax increases and spending cuts that analysts say could weaken growth.

Embed:

Yields on 10-year Russian government bonds (OFZs), have stood at around 14% to 16% in 2025 and 2026. That compares with an average yield of about 4.3% on 10-year bonds across the Group of Seven economies.

Sanctions have largely shut foreign investors out of Russia's debt market, leaving the government reliant on domestic buyers, particularly the major banks.

This reflects the shallow pool of buyers for Russian debt due to sanctions. The Central Bank's key interest rate, which it has kept high to curb inflation driven largely by heavy war spending, also raises the returns investors expect.

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To attract domestic investors, the government has issued high returns and floating-rate OFZs.

These floaters are linked to RUONIA, an overnight interbank rate that broadly follows the key rate, and protect buyers against the risk of rising interest rates but leave the government exposed to higher debt servicing costs.

Those costs are expected to approach 4 trillion rubles ($47.2 billion) this year. That is roughly a tenth of federal spending and more than the federal education and healthcare budgets combined.

By comparison, Germany spends about 6% of its federal budget on debt servicing, despite its debt standing at around 64% of GDP, which is roughly three times Russia's debt-to-GDP ratio.

This burden is restricting Moscow's ability to borrow more. Even doubling Russia's modest debt on current terms would push debt servicing costs to around a quarter of the budget.

Russia's debt burden would not necessarily double if it borrowed twice as much, as the cost would depend on interest rates and the terms of new bonds. But borrowing heavily at current rates would push debt servicing costs to around a quarter of the budget.

Finance Minister Anton Siluanov has pointed to Russia's limited financial market and high borrowing costs as reasons to keep debt low.

“If we keep increasing debt, it will crowd out all other spending. We will have less money left for our priorities,” he said.

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With its fiscal reserves depleted by years of war spending, Moscow is seeking other ways to contain the deficit. Its budget plans for 2027 include higher taxes and about 2 trillion rubles ($23.6 billion) in spending cuts.

The proposed measures include raising taxes on income from property sales and deposit interest to as much as 22%, imposing 22% value-added tax on online purchases from abroad and introducing a 100-ruble ($1.18) customs fee on parcels worth less than 200 euros.

While this could help Moscow avoid more expensive borrowing, Moscow-based analysts warn that they risk weakening business activity and investment even further.

Fixed investment fell 9.9% from a year earlier to 16.2 trillion rubles ($191.2 billion) in the first half of 2026, according to figures cited by analyst Kirill Rodionov, who said earlier increases in corporate profit tax and VAT had left businesses with less money to invest.

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“A higher tax burden will inevitably push up prices and make investment less attractive,” analyst Boris Kopeykin said.

With government spending accounting for roughly 40% of GDP, the tax burden is becoming “an increasingly significant constraint on growth,” he said.

Analyst Anastasia Rusakova said the new measures could temporarily discourage stock market investment and increase demand for cash as more businesses seek to avoid taxes by operating in the informal economy.

Introducing VAT on foreign goods could also push up prices on online marketplaces by at least 5% to 10%, she said.

“We cannot rule out an inflationary effect. Some goods will become more expensive for consumers,” Rusakova said.

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