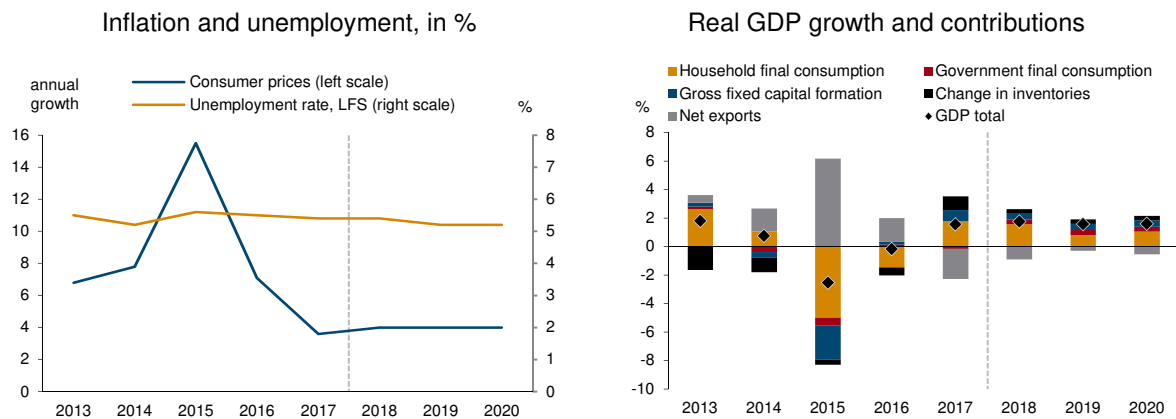


RUSSIAN FEDERATION: Falling behind peers on meagre growth

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The Russian economy has returned to growth. The inflation target of 4% has been comfortably met, and the rouble has been appreciating. However, in the absence of reforms, GDP growth will not exceed 2% even in the medium run – lower than the country’s European peers. No major changes in economic policies are expected, as stability at home coupled with external threats is cherished over reform risks. Sanctions and a poor investment climate are here to stay. Higher oil prices are once again serving as both a buffer and a deterrent to reform.

Figure 56 / Russian Federation: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The Russian economy emerged from recession in 2017. Preliminary data indicate that GDP increased by some 1.6%, owing to a recovery in household consumption and in investment (both grew by 3.5%). Government consumption dropped by 1%. Along with rising domestic demand, the contribution of real net exports to GDP growth was negative, as import volumes grew much faster than exports. On the supply side, industrial production (particularly the extraction industry), transport and business services are growing again, while construction has stagnated. Agriculture was again one of the better performers: its output has expanded by a cumulative 10% since 2014, when restrictions on Western food imports were introduced.

The inflation target envisaged (annual average of 4%) was reached as early as mid-2017. In fact, the annual CPI inflation in December was just 2.5%, and the key interest rate of the Central Bank of Russia (CBR) was reduced to 7.75% p.a. Both employment and unemployment remain stable (and the latter low); there are sectoral/regional labour shortages, especially in higher-skill segments. These shortages are aggravated by outward migration and can hardly be mitigated by inflows of foreign workers.

Thanks to rising oil prices in 2017 (+25% in USD terms compared to a year earlier), export revenues grew by more than 20% (EUR based). The share of energy in exports exceeded 60%. In relative terms, trade turnover with the EU is declining, while with China it is increasing, and indeed China has become Russia's single most important trading partner. The rouble appreciated in both nominal and real terms by around 10% compared to the previous year with respect to both the US dollar and (a bit less) the euro. As a consequence, imports recovered strongly as well: the import volume is estimated to have increased by about 17% in 2017; that of exports by 5%. The growth contribution of net exports was thus negative and is expected to remain negative in the coming years as well.

The federal budget for the period 2018-2020 was approved by the Duma at the end of November 2017. It reckons with annual inflation of 4% and is based on a conservative forecast of the oil price (below USD 44 per barrel (bbl)). The federal budget deficit for 2018 is projected to be 1.3% of GDP, with subsequent further reductions below 1% of GDP in the rest of the decade – despite planned cuts in revenues, related to rather conservative expectations of oil price developments. Also the CBR is rather cautious with respect to oil price expectations: its basic scenario from December 2017 rests on the assumption of an oil price of USD 55/bbl in 2018 and USD 45/bbl afterwards. Even with a higher oil price (USD 60/bbl), the projected GDP growth is unlikely to exceed 2% in the forecast period.

A major reason for the disappointing growth prospects is that no substantial reforms are on the horizon, even after the presidential elections in March (which Vladimir Putin is poised to win).

The Russian economy has seemingly adjusted to the 'new normal' of depressed oil prices, sanctions and mediocre growth. After the recent bankruptcies of several major companies and banks, the government stepped in to rescue them and took the remaining assets under its control. The huge FDI flows officially reported in 2016 (both inflows to and outflows from Russia – see Table 26) reflected transactions with offshore destinations. Nothing similar was reported in 2017, and yet the share of Cyprus and other offshore tax havens in total FDI stocks remains extremely high (around 50% of the total). This is a reflection, inter alia, of the poor domestic investment climate, including sanctions. The net capital outflow of the private sector in 2017 exceeded USD 30 billion, largely owing to operations of the banking sector related to debt repayments. Indeed, Russian banks and top businessmen have been increasingly nervous in anticipation of the new wave of US financial sanctions (the list of 210 top government officials and leading businessmen published on 30 January is largely symbolic and threatens no immediate impact, but it further poisons the already bad US-Russian relations).

The overall assessment of Russian economic prospects has not changed very much in the last couple of years, although the current growth forecast for 2018 was revised slightly upwards, owing to the price of oil being higher than previously expected. Still, GDP growth will remain sluggish (below 2%) in the medium term, too, constrained by shortages of labour, capital and especially economic and institutional reforms. Owing to the lack of investments (domestic and especially foreign), the structure of the economy will not change and will remain skewed towards the extraction sector. The

CBR will proceed with a prudent monetary policy and with cleaning up the banking sector. Even with an oil price above USD 60/bbl and associated higher export and fiscal revenues, substantially higher GDP growth (above 2% per year) is unlikely in an environment of rising autarky and international isolation. Most importantly, with this meagre growth rate the Russian economy will not catch up with its more advanced EU-CEE peers – to say nothing of China. Nor will it help to underpin the country's aspirations to (re)gain geopolitical parity with the USA. The next presidential term of Mr Putin may thus resemble closely the late Soviet period of stagnation under Leonid Brezhnev. It remains to be seen whether it will be followed by a Gorbachev-like 'perestroika' or otherwise.

A revival of dialogue with the EU could happen in the wake of the new coalition government in Germany, yet a normalisation of Russia's relations with its neighbours (especially Ukraine, but also Poland and the Baltics) will be difficult, and the damage incurred so far will be lasting. A revival of the Minsk process and an agreement on more OSCE involvement in Ukraine would be helpful. Whether Putin's next presidency brings any change in domestic economic policies remains to be seen. With respect to external policies, no major turnaround is expected, and many uncertainties and associated risks (relations with the EU and the US, Donbas, the future of the Eurasian Economic Union, etc.) will persist.

To sum up, the forecast GDP growth will remain at below 2% per year in the medium term, and the process of economic convergence will thus stall. This is a disappointing performance for an emerging economy with aspirations to regain its superpower status – especially given the fairly robust growth in the US, EU, China and elsewhere.

Table 26 / Russian Federation: Selected economic indicators

	2013	2014	2015	2016	2017 ¹⁾	2018 Forecast	2019 Forecast	2020
Population, th pers., average	143,507	146,091	146,406	146,675	146,841	146,400	146,300	146,200
Gross domestic product, RUB bn, nom.	73,134	79,200	83,387	85,918	92,082	97,400	103,900	110,800
annual change in % (real)	1.8	0.7	-2.5	-0.2	1.5	1.8	1.6	1.6
GDP/capita (EUR at PPP)	19,300	18,800	17,900	17,000	17,300	.	.	.
Consumption of households, RUB bn, nom.	38,465	42,016	43,337	44,901	47,955	.	.	.
annual change in % (real)	5.2	2.0	-9.4	-2.8	3.4	3.0	1.5	2.0
Gross fixed capital form., RUB bn, nom.	15,926	16,828	16,942	18,403	19,944	.	.	.
annual change in % (real)	1.3	-1.8	-11.2	0.8	3.6	2.0	2.0	2.0
Gross industrial production ²⁾								
annual change in % (real)	0.4	1.7	-0.8	1.3	1.0	2.0	3.0	3.0
Gross agricultural production								
annual change in % (real)	5.8	3.5	2.6	4.8	2.4	.	.	.
Construction output ³⁾								
annual change in % (real)	0.1	-2.3	-4.8	-2.2	-1.4	.	.	.
Employed persons, LFS, th, average	71,392	71,539	72,324	72,393	72,142	72,300	72,200	72,200
annual change in %	-0.2	0.2	-0.4	0.1	-0.3	0.2	-0.1	0.0
Unemployed persons, LFS, th, average	4,137	3,889	4,264	4,243	3,967	4,100	4,000	4,000
Unemployment rate, LFS, in %, average	5.5	5.2	5.6	5.5	5.2	5.4	5.2	5.2
Reg. unemployment rate, in %, eop ⁴⁾	1.2	1.2	1.3	1.2	1.0	.	.	.
Average monthly gross wages, RUB	29,792	32,495	34,030	36,709	39,085	42,300	46,200	50,500
annual change in % (real, gross)	4.8	1.2	-9.3	0.8	3.4	4.0	5.0	5.0
Consumer prices, % p.a.	6.8	7.8	15.5	7.1	3.6	4.0	4.0	4.0
Producer prices in industry, % p.a. ⁵⁾	3.3	6.4	13.5	4.2	7.7	5.0	5.0	5.0
General government budget, nat.def., % of GDP								
Revenues	33.4	33.8	32.3	32.8	35.0	35.0	35.0	35.0
Expenditures	34.6	34.9	35.7	36.5	37.5	38.0	38.0	37.5
Deficit (-) / surplus (+)	-1.2	-1.1	-3.4	-3.7	-2.5	-3.0	-3.0	-2.5
General gov.gross debt, nat.def., % of GDP	10.3	13.0	13.1	12.9	13.0	14.0	15.0	16.0
Stock of loans of non-fin.private sector, % p.a.	17.1	25.9	7.6	-6.9	3.5	.	.	.
Non-performing loans (NPL), in %, eop ⁶⁾	3.5	3.8	5.3	5.2	5.2	.	.	.
Central bank policy rate, % p.a., eop ⁷⁾	5.50	17.00	11.00	10.00	7.75	6.50	6.00	6.00
Current account, EUR mn ⁸⁾	25,164	43,477	61,898	23,064	35,609	49,900	44,800	39,200
Current account, % of GDP ⁸⁾	1.5	2.8	5.0	2.0	2.5	3.4	3.0	2.4
Exports of goods, BOP, EUR mn ⁸⁾	392,827	375,561	307,040	254,498	313,308	336,000	352,800	366,900
annual change in %	-4.3	-4.4	-18.2	-17.1	23.1	7.2	5.0	4.0
Imports of goods, BOP, EUR mn ⁸⁾	256,901	232,739	173,585	172,996	210,732	222,000	233,100	247,100
annual change in %	-1.6	-9.4	-25.4	-0.3	21.8	5.3	5.0	6.0
Exports of services, BOP, EUR mn ⁸⁾	52,787	49,700	46,491	45,648	51,465	54,200	57,500	58,600
annual change in %	8.8	-5.8	-6.5	-1.8	12.7	5.3	6.1	1.9
Imports of services, BOP, EUR mn ⁸⁾	96,643	91,487	79,694	67,163	78,216	80,900	85,000	89,200
annual change in %	14.1	-5.3	-12.9	-15.7	16.5	3.4	5.1	4.9
FDI liabilities, EUR mn ⁸⁾	52,107	16,655	6,163	29,381	18,100	.	.	.
FDI assets, EUR mn ⁸⁾	65,120	43,151	19,861	20,149	21,300	.	.	.
Gross reserves of NB excl. gold, EUR mn ⁸⁾⁹⁾	341,787	279,383	292,467	301,871	297,823	.	.	.
Gross external debt, EUR mn ⁸⁾	530,481	493,861	474,681	488,752	442,504	436,100	455,000	481,700
Gross external debt, % of GDP ⁸⁾	30.7	31.7	38.6	42.2	31.7	30.0	30.0	30.0
Average exchange rate RUB/EUR	42.27	50.77	67.76	74.26	65.87	67.0	68.5	69.0

Note: From 2014 including Crimean Federal District (for LFS and wages from 2015, growth rates for employment and real wages from 2016).

1) Preliminary and wiiw estimates. - 2) Excluding small enterprises. Until 2014 according to NACE Rev.1. - 3) Until 2016 according to NACE Rev.1. - 4) In % of labour force (LFS). - 5) Domestic output prices, in 2013 according to NACE Rev.1. - 6) According to Russian Accounting Standards overdue debt is defined as debt service overdue, therefore the data are not fully comparable with other countries. - 7) One-week repo rate. - 8) Converted from USD. - 9) Including part of resources of the Reserve Fund (until 2017) and the National Wealth Fund of the Russian Federation.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.