RUSSIA: GDP growth will fall back after an unexpected uptick in 2018

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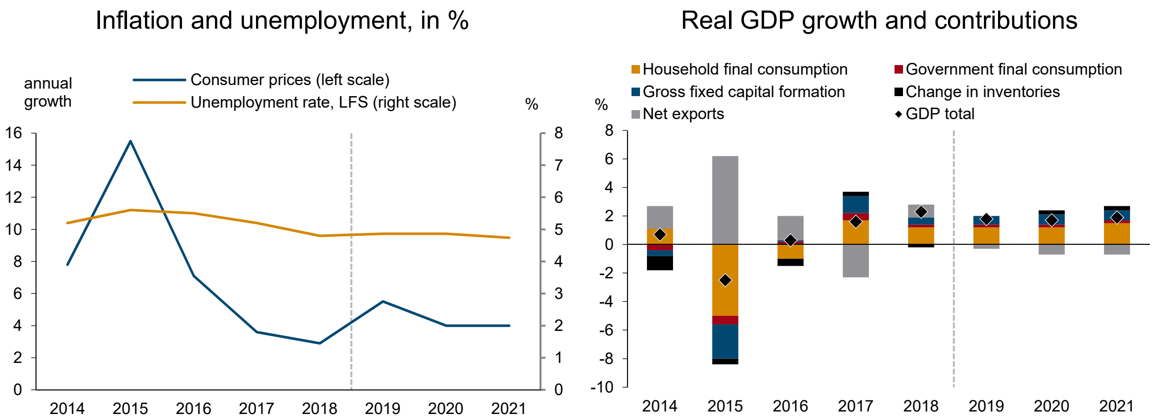
GDP growth for 2018 surprised everybody. Net exports and investments were the main drivers, the record current account surplus and a low inflation among the cheerful passengers. But neither the pace of growth nor the size of the current account surplus is sustainable and will be maintained. Still, the accumulated reserves and cautious economic policies will serve as a buffer mitigating external risks. Stability and weak growth will thus characterise Russian developments in the coming years.

Figure 6.18 / Russia: Main macroeconomic indicators



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

Russia's GDP growth reached a six-year high in 2018, according to a first estimate released by Rosstat on 4 February. Defying all earlier forecasts and expectations (including those of the Ministry of Economy and the Central Bank of Russia), the revealed 2018 GDP growth was 2.3%. The growth was driven by net exports and gross capital formation on the demand side, and by construction, mining, hotels, restaurants and financial intermediation on the production side. These and other official data are puzzling and partly inconsistent (implying inter alia a huge reduction in stocks and a huge jump in construction in December), and will be surely revised (there was another revision of national accounts data three years back recently).

Industry grew by 2.9% (manufacturing by 2.6%) in 2018. Drought-affected agricultural output fell by 0.6% (grain and sugar beet harvests were down by nearly 20%), interrupting the period of robust agricultural performance during the past five years. Construction output recovered strongly (+5%, reportedly due to the completion of the LNG plant on the Yamal Peninsula), after a period of protracted crisis, but gross investment fell by 0.5%. Retail and wholesale trade, as well as goods transport, increased by some 2.5%. Consumer price inflation reached a record low in 2018 (just 2.8% on annual average), but the PPI and the GDP deflator jumped to double digits (12% and 10%, respectively, fuelled by rouble depreciation and higher commodity prices). Real wages picked up strongly in 2018 (+6.8%) owing to lower inflation and wage increases in the public sector. Nevertheless, real disposable incomes of the population stagnated in 2018 and a part of rising household consumption was financed by credits (consumer credits grew by more than 20% during the year). Employment (but also labour shortages) has been rising, unemployment declining.

The external surplus rose substantially in 2018. Export revenues grew by 20% in nominal EUR terms, largely thanks to higher oil prices, while imports were nearly flat. Apart from energy revenues, the last year witnessed also a huge increase in grain exports. Owing to the record trade surplus, the current account surplus reached 7% of GDP (about EUR 100 billion) in 2018. Also fiscal revenues increased, and the government budget was in surplus. External debts (both public and private) are being repaid – partly even ahead of schedule – owing to both sanctions-related refinancing problems and efforts to reduce vulnerability. While overall foreign exchange reserves grew by EUR 30 billion in 2018 (to EUR 410 billion as of the beginning of 2019), the Central Bank has been reducing its USD-denominated holdings in foreign exchange reserves – a likely response to current and expected future US sanctions. Foreign direct investment is one of the main victims of the sanctions: FDI inflows diminished further in 2018 and there has been again a net outflow of capital from Russia, not least owing to the high debt service payments (more than USD 60 billion scheduled for 2019), but also due to the poor investment climate owing to the sanctions.

Russia has been confronted with volatile US sanctions policies that elevate risks, though the sanctions and the related conflict with the West, lasting already for at least five years, have become a ‘new normal’. New rounds of US sanctions announced in April and August 2018 increased uncertainty as they target ‘Russian oligarchs and entities in response to worldwide malign activity’. However, US sanctions on Rusal and other companies linked to the ‘Kremlin-close oligarch’ Oleg Deripaska were lifted in January 2019, after the requested shares’ swap that reduced Mr Deripaska’s controlling package in Rusal below 50% was completed. EU sanctions related to Crimea and Eastern Ukraine were once again formally prolonged by another year in September 2018; in December 2018, 9 more persons were added to the sanctions list because of their involvement in the so-called ‘elections’ in the so-called ‘Donetsk People’s Republic’ and ‘Luhansk People’s Republic’ – despite increasing difficulties to reach the necessary consensus among the EU Member States on the sanctions issue. New US sanctions may affect private Russian oil companies (Novatek).

Sanctions-related uncertainties impact adversely not only the investment climate and related capital flows, but also the rouble exchange rate and inflationary expectations. The Russian Central Bank raised the key rate to 7.75% in mid-December 2018 and left the rate unchanged in February 2019. VAT was raised by 2 p.p. on 1 January 2019 (to 20%), excise taxes on motor fuel were lifted as well. Owing to high fiscal revenues, the government budget was in surplus last year and will stay in the black in 2019 as well. Under a new ‘fiscal rule’, any revenue from oil prices higher than USD 40 per barrel is being accumulated in the National Wealth Fund, which is part of Russia’s foreign exchange reserves and serves as an insurance buffer for a crisis (the average Brent oil price was USD 71/bbl in 2018, and is expected to fall to some USD 60/bbl in 2019).

President Vladimir Putin's approval ratings have been falling – especially after the unpopular pension reforms were announced in August 2018. The sluggish economic performance and dismal growth prospects erode Putin's ratings as well (the latest polls from January 2019 suggest a drop in Putin's approval ratings to around 60%). The pension reform aims at lifting the retirement age for women to 60 years and for men to 65 years. In addition, in his annual address in February 2019, President Putin announced more support for families. There were some sporadic protests against the pension reform, yet the reform was both expected and necessary owing to demographic developments and sustainability of the pension system. There is no other substantial economic reform in sight; the confrontation with the West will continue and the investment climate will continue to suffer. Russia is pursuing rather conservative economic policies: accumulating reserves, paying back foreign debts and being cautious in spending. As for import substitution, protectionism and trade reorientation to the East (China), these are strategies that Russia will follow with even more vigour in future. But current account surpluses will diminish in the coming years, to some 4-5% of GDP by 2021, as oil prices are expected to fall.

After a surprisingly robust performance, GDP growth is expected to fall back in 2019 – definitely below 2% – as the export surplus will diminish and the recovery of investment stall. Inflation will temporarily pick up slightly, but return to low single digits soon. With stagnating employment and without sufficient modernisation and restructuring investment that would increase total factor productivity, a stronger economic recovery is unlikely. With forecast GDP growth rates below 2% even in the medium term, Russia will not meet Putin's ambitious target to become the world's 5th largest economy by the end of his current presidency. Russia's estimated GDP in 2020 – USD 1,525 billion – will be nominally about the same as it was in 2010. A number of external risks (EU parliamentary elections, presidential election in Ukraine, an escalating global trade war, the imposition of new financial sanctions by the US, and oil price fluctuations being the most obvious ones) may affect Russian economic development already in the coming months. Still, the population longs for stability and the government assembled sufficient buffers to mitigate and handle potential future crises.

Table 6.18 / Russia: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020	2021
							Forecast	
Population, th pers., average	146,091	146,406	146,675	146,842	146,837	147,000	147,000	147,000
Gross domestic product, RUB bn, nom.	79,200	83,387	86,010	92,089	103,627	111,800	118,200	125,300
annual change in % (real)	0.7	-2.5	0.3	1.6	2.3	1.8	1.7	1.9
GDP/capita (EUR at PPP)	19,000	18,600	18,000	18,400	19,000	.	.	.
Consumption of households, RUB bn, nom.	42,016	43,337	45,413	48,165	50,755	.	.	.
annual change in % (real)	2.0	-9.4	-1.9	3.2	2.2	2.5	2.5	3.0
Gross fixed capital form., RUB bn, nom.	16,828	16,942	18,861	20,571	22,120	.	.	.
annual change in % (real)	-1.8	-11.2	0.7	5.5	2.3	3.0	3.0	3.0
Gross industrial production [2]								
annual change in % (real)	2.5	-0.8	2.2	2.1	2.9	3.0	3.0	4.0
Gross agricultural production								
annual change in % (real)	3.5	2.6	4.8	2.4	-0.6	.	.	.
Construction output [3]								
annual change in % (real)	-2.3	-4.8	-2.2	-1.4	5.3	.	.	.
Employed persons, LFS, th, average [4]	71,539	72,324	72,393	72,142	72,532	72,400	72,400	72,400
annual change in %	0.2	-0.4	0.1	-0.3	0.3	-0.2	0.0	0.0
Unemployed persons, LFS, th, average [4]	3,889	4,264	4,243	3,967	3,658	3,700	3,700	3,600
Unemployment rate, LFS, in %, average [4]	5.2	5.6	5.5	5.2	4.8	4.9	4.9	4.7
Reg. unemployment rate, in %, eop [4][5]	1.2	1.3	1.2	1.0	0.9	.	.	.
Average monthly gross wages, RUB [6]	32,495	34,030	36,709	39,167	43,445	47,200	51,100	55,300
annual change in % (real, gross)	1.2	-9.0	0.7	2.9	6.8	3.0	4.0	4.0
Consumer prices, % p.a.	7.8	15.5	7.1	3.6	2.9	5.5	4.0	4.0
Producer prices in industry, % p.a. [7]	6.4	13.5	4.2	7.7	11.9	8.0	5.0	5.0
General governm.budget, nat.def., % of GDP								
Revenues	33.8	32.3	32.8	33.7	35.6	37.0	36.0	37.0
Expenditures	34.9	35.7	36.4	35.2	32.5	37.0	37.0	37.0
Deficit (-) / surplus (+)	-1.1	-3.4	-3.7	-1.5	3.1	0.0	-1.0	0.0
General gov.gross debt, nat.def., % of GDP	13.0	13.1	12.9	12.6	12.1	11.0	10.0	10.0
Stock of loans of non-fin.private sector, % p.a.	25.9	7.6	-6.9	3.5	13.9	.	.	.
Non-performing loans (NPL), in %, eop [8]	3.8	5.3	5.2	5.2	4.7	.	.	.
Central bank policy rate, % p.a., eop [9]	17.00	11.00	10.00	7.75	7.75	7.50	7.00	6.00
Current account, EUR mn [10]	43,477	60,952	22,138	29,472	97,480	41,300	44,300	43,900
Current account, % of GDP	2.8	5.0	1.9	2.1	6.9	2.7	2.8	2.7
Exports of goods, BOP, EUR mn [10]	375,561	307,040	254,371	313,173	376,175	350,100	374,600	390,200
annual change in %	-4.4	-18.2	-17.2	23.1	20.1	-6.9	7.0	4.2
Imports of goods, BOP, EUR mn [10]	232,739	173,585	172,911	210,932	211,249	233,700	252,400	265,400
annual change in %	-9.4	-25.4	-0.4	22.0	0.2	10.6	8.0	5.2
Exports of services, BOP, EUR mn [10]	49,700	46,418	45,759	51,137	55,400	55,600	58,300	60,200
annual change in %	-5.8	-6.6	-1.4	11.8	8.3	0.4	4.9	3.3
Imports of services, BOP, EUR mn [10]	91,487	79,829	67,331	78,681	81,021	89,600	95,000	98,000
annual change in %	-5.3	-12.7	-15.7	16.9	3.0	10.6	6.0	3.2
FDI liabilities, EUR mn [10]	16,655	6,163	29,381	25,296	12,700	.	.	.
FDI assets, EUR mn [10]	43,151	19,861	20,149	32,559	33,900	.	.	.
Gross reserves of NB excl. gold, EUR mn [10][11]	279,383	292,467	301,871	297,823	333,617	.	.	.
Gross external debt, EUR mn [10]	493,861	474,121	486,489	433,320	396,659	407,900	425,500	433,700
Gross external debt, % of GDP	31.7	38.5	42.0	31.0	28.3	27.0	27.0	27.0
Average exchange rate RUB/EUR	50.77	67.76	74.26	65.87	73.87	74.0	75.0	78.0

Note: 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. - 3) Until 2015 according to NACE Rev.1. - 4) From 2018 population 15+, population 15-72 before. - 5) In % of labour force (LFS). - 6) From 2017 improved coverage of small enterprises. - 7) Domestic output prices. - 8) According to Russian Accounting Standards overdue debt is defined as debt service overdue, therefore the data are not fully comparable with other countries. - 9) One-week repo rate. - 10) Converted from USD. - 11) 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.