

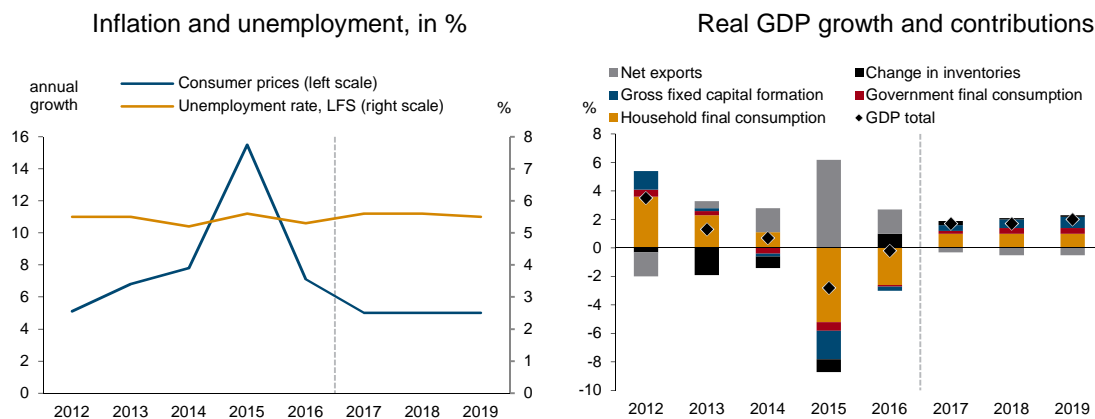


RUSSIAN FEDERATION: A shallow recovery, external risks remain elevated

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The Russian economy is slowly emerging from recession. With oil prices more or less flat, financial and trade sanctions expected to remain largely in place, and in the absence of any marked institutional reforms, economic growth will stay sluggish – below 2% – even in the medium term.

Figure 49 / Russian Federation: Main macroeconomic indicators



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

After two years, the Russian economic recession has finally come to an end. The adjustment to the collapse in oil prices and sanctions was, by and large, completed during 2016 (the fourth quarter of 2016 witnessed positive economic growth on an annual basis); the economy has thus now stabilised at a new 'near-stagnation normal'. A preliminary flash official estimate reduced the 2016 GDP decline to just -0.2%, less than previously reported (-0.6%). Both nominal figures and GDP data for 2015 were revised upwards as well. The largest upwards revisions were reported for real estate and trade activities, on the use side for changes of stocks.

The stabilisation relates to both the economy and domestic politics, while the external risks (Trump presidency, aftermath of Brexit, EU disunity, Ukraine conflict, etc.) persist and – in some instances have perhaps even increased (see Special Section on uncertainties in this Report). The speedy and complete lifting of sanctions is not expected, any 'deal' with Trump will be difficult to reach and implement, and the fragile ceasefire in Donbas may not be sustained. The EU's largely hostile

stance towards Russia will not change markedly, at least so long as Ms Merkel remains the German chancellor and Russia stays in Crimea and continues to support insurgency in Donbas.

Despite some improvement, the 2016 economic performance was largely disappointing. Apart from agriculture (which reported a 3.5% expansion, largely thanks to Russian counter-sanctions restricting food imports and thus boosting domestic food processing), there are few signs of a sustained recovery, and some indicators continue to point to further contraction. Financial services grew by 2.3% and the manufacturing industry by 1.4%. Even after data revisions, the construction industry, retail trade and catering contracted by nearly 5%. On the demand side, household consumption contracted by 5% in 2016, and gross fixed investment by 1.4%. A shallow investment recovery resulted solely from the accumulation of stocks. The volume of exports grew by 2.3%, while that of imports shrank by 5% in real terms. Trade with the EU and Ukraine contracted more than average; meanwhile trade with China expanded (China strengthened its position as Russia's biggest trading partner). Net exports thus once again contributed positively to GDP growth in 2016 (1.7 percentage points (pp) up in 2016, after more than 6 pp in 2015).

After a huge contraction (exports: -40%, imports: -35%, both in nominal EUR terms) between 2012 and 2016, foreign trade is recovering (helped by oil prices). Also, foreign direct investment (FDI) is no longer falling and the exchange rate is appreciating – even in nominal terms. Russia is again accumulating foreign exchange reserves: the Central Bank of Russia (CBR) is purchasing part of oil export revenues when the price exceeds USD 40 per barrel (forex reserves grew from EUR 302 billion at the end of 2016 to EUR 370 billion as of March 2017). Financial investors seem to be returning slowly to Russia on the back of strengthening oil and metals prices and possibly in the expectation of better prospects for relations with the USA. However, the current account surplus dropped to a record low – below 2% of GDP in 2016 – and will stay there in the coming three years.

No major economic reforms are on the horizon, and a muddling through of sorts is thus to be expected. The CBR is likely to maintain its restrictive monetary policy stance, focusing on disinflation and discouraging credit expansion by maintaining highly positive real interest rates. With oil prices expected to remain flat (yet higher than last year's average of USD 44 per barrel) and given the reluctance of the government to borrow, there will be limited room for manoeuvre in fiscal policy. Despite frequent calls from the domestic expert community for more expansionary measures, in particular for a substantial increase in fixed investments (from the current 21% of GDP to 25-28% of GDP in the medium term), we do not expect such a policy shift – at least not in the next two years (before the presidential elections scheduled for 2018). Even a breakthrough in relations with the West – which we do not see as likely – would not result in a substantial increase in FDI inflows, due to lasting institutional bottlenecks that adversely affect the investment climate.

There seems to be consensus that Russia is facing a prolonged period of (near) stagnation in economic, political and social developments alike. The damaged links with most of the 'near abroad' in both the west and the south – Ukraine in particular (but most recently also Belarus) – will be hard to restore, and conflicts may even escalate. At the same time, Russia managed to resume (at least partly and in relative terms) its role as a global player (Syria, Balkans) and is happily reaping windfall gains from US (Trump) and EU (Brexit) failings and the resulting Western split.

Overall, our current assessment of Russian economic prospects remains broadly unchanged: the mild (milder than expected) recession in 2016 was officially confirmed, and a gradual, yet rather modest, GDP growth acceleration is forecast for the coming three years. Though we have revised our GDP growth forecasts for 2017 slightly upwards, largely thanks to newly available data, we still expect economic growth to stay below 2% and investment to be weak even in the medium term. Inflation will return to low single digits, household consumption will grow again and unemployment will stabilise at close to 5%.

Table 20 / Russian Federation: Selected economic indicators

	2012	2013	2014	2015	2016 ¹⁾	2017	2018	2019
						Forecast		
Population, th pers., average	143,202	143,507	146,091	146,406	146,692	146,500	146,500	146,500
Gross domestic product, RUB bn, nom.	66,927	71,017	79,200	83,233	85,881	90,000	95,200	102,000
annual change in % (real)	3.5	1.3	0.7	-2.8	-0.2	1.7	1.7	2.0
GDP/capita (EUR at PPP)	19,100	18,700	18,700	17,700	17,200	.	.	.
Consumption of households, RUB bn, nom.	34,334	38,068	42,037	43,263	43,830	.	.	.
annual change in % (real)	7.4	4.4	2.0	-9.8	-5.0	2.0	2.0	2.0
Gross fixed capital form., RUB bn, nom.	13,522	14,357	16,746	17,261	18,147	.	.	.
annual change in % (real)	6.0	0.9	-1.0	-9.4	-1.4	2.0	3.0	4.0
Gross industrial production ²⁾								
annual change in % (real)	3.4	0.4	1.7	-3.4	1.1	2.0	3.0	4.0
Gross agricultural production								
annual change in % (real)	-4.8	5.8	3.5	2.6	4.8	.	.	.
Construction output								
annual change in % (real)	2.5	0.1	-2.3	-4.8	-4.3	.	.	.
Employed persons, LFS, th, average	71,545	71,392	71,539	72,324	72,393	72,100	72,300	72,500
annual change in %	1.0	-0.2	0.2	-0.4	0.1	-0.4	0.3	0.3
Unemployed persons, LFS, th, average	4,131	4,137	3,889	4,264	4,243	4,300	4,300	4,200
Unemployment rate, LFS, in %, average	5.5	5.5	5.2	5.6	5.3	5.6	5.6	5.5
Reg. unemployment rate, in %, end of period ³⁾	1.4	1.2	1.2	1.3	1.2	.	.	.
Average monthly gross wages, RUB	26,629	29,792	32,495	34,030	36,703	39,700	43,400	47,800
annual change in % (real, gross)	8.4	4.8	1.2	-9.3	0.6	3.0	4.0	5.0
Consumer prices, % p.a.	5.1	6.8	7.8	15.5	7.1	5.0	5.0	5.0
Producer prices in industry, % p.a. ⁴⁾	6.8	3.3	6.1	12.4	4.0	3.0	4.0	4.0
General governm.budget, nat.def., % of GDP								
Revenues	34.5	34.4	33.8	32.3	32.3	32.0	33.0	33.0
Expenditures	34.1	35.6	34.9	35.7	36.0	35.5	36.0	36.0
Deficit (-) / surplus (+)	0.4	-1.2	-1.1	-3.4	-3.7	-3.5	-3.0	-3.0
Public debt, nat.def., % of GDP	9.7	10.6	13.0	13.2	12.9	13.0	14.0	15.0
Stock of loans of non-fin.private sector, % p.a.	19.1	17.1	25.9	7.6	-6.9	.	.	.
Non-performing loans (NPL), in %, Dec ⁵⁾	3.7	3.5	3.8	5.3	5.2	.	.	.
Central bank policy rate, % p.a., end of period ⁶⁾	8.25	5.50	17.00	11.00	10.00	8.00	6.00	6.00
Current account, EUR mn ⁷⁾	55,452	25,164	43,477	62,052	20,046	23,500	17,900	13,800
Current account, % of GDP ⁷⁾	3.3	1.5	2.8	5.1	1.7	1.7	1.3	0.9
Exports of goods, BOP, EUR mn ⁷⁾	410,300	392,827	375,561	307,083	252,105	301,500	328,700	351,700
annual change in %	10.9	-4.3	-4.4	-18.2	-17.9	19.6	9.0	7.0
Imports of goods, BOP, EUR mn ⁷⁾	261,202	256,901	232,739	173,525	172,826	210,500	231,600	254,800
annual change in %	14.2	-1.6	-9.4	-25.4	-0.4	21.8	10.0	10.0
Exports of services, BOP, EUR mn ⁷⁾	48,495	52,787	49,700	46,532	45,148	52,500	55,100	57,900
annual change in %	16.4	8.8	-5.8	-6.4	-3.0	16.3	5.0	5.1
Imports of services, BOP, EUR mn ⁷⁾	84,736	96,643	91,487	79,694	67,090	78,000	81,900	86,000
annual change in %	29.0	14.1	-5.3	-12.9	-15.8	16.3	5.0	5.0
FDI liabilities, EUR mn ⁷⁾	39,353	52,107	16,655	5,826	27,100	.	.	.
FDI assets, EUR mn ⁷⁾	37,980	65,120	43,151	19,954	15,200	.	.	.
Gross reserves of NB excl. gold, EUR mn ⁸⁾	367,323	341,787	279,383	292,467	301,871	.	.	.
Gross external debt, EUR mn ⁷⁾	480,440	530,481	493,861	474,057	493,057	456,900	426,300	437,100
Gross external debt, % of GDP ⁷⁾	28.7	31.6	31.7	38.6	42.6	33.0	30.0	30.0
Average exchange rate RUB/EUR	39.9	42.3	50.8	67.8	74.3	65.0	67.0	70.0

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. - 3) In % of labour force (LFS). - 4) Domestic output prices. - 5) According to Russian Accounting Standards overdue debt is defined as debt service overdue, therefore the data are not fully comparable with other countries. - 6) From 2013 one-week repo rate, refinancing rate before. - 7) Converted from USD. - 8) Including part of resources of the Reserve Fund and the National Wealth Fund of the Russian Federation.

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