

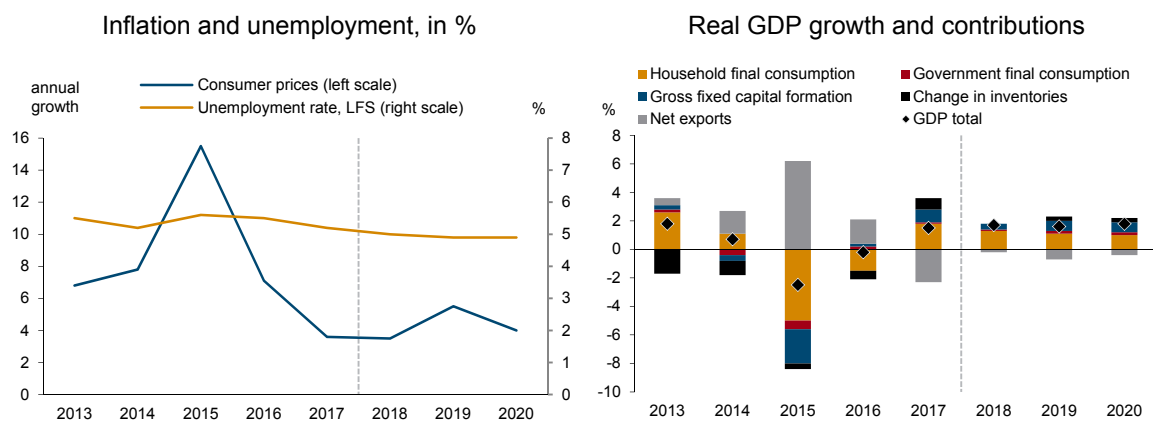


RUSSIAN FEDERATION: Sailing slowly between sanctions and high oil prices

PETER HAVLIK

The Russian economy continues to grow at a slow pace. The unimpressive performance is forecast to last even in the medium term since no improvements in either domestic or external conditions for development are expected. High oil prices currently mitigate the adverse impacts of geopolitical tensions, though both investments and economic restructuring suffer. Chinese-Russian relations are likely to strengthen further.

Figure 52 / Russian Federation: Main macroeconomic indicators



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

Russian GDP growth consolidated in 2018, yet the economic recovery remains sluggish. Growth is well below 2% year on year, in line with earlier expectations. In the first half of 2018, GDP grew by about 1.7%. Industry (including manufacturing), as well as goods transport and retail trade, are expanding somewhat; construction is flat and the output of agriculture, affected by a drought, even fell. On the demand side, household consumption expanded by nearly 3% in the first eight months of the year – in line with similar growth of retail trade and personal services. Private consumption and retail trade were boosted by the spending of football fans attending the World Cup in June/July. A successful disinflation process from late 2017 ended in early 2018, as consumer price inflation picked up during the summer, fuelled by rouble depreciation and rising energy prices. The official inflation target of 4% for the year as a whole will probably only be missed by a small margin in 2018: the annual CPI inflation was just 3.1% in August. Yet the producer price inflation has been much higher – more than 10% year on year in

January-August 2018 – and will eventually fuel consumer prices as well (inflation will also be fuelled by the announced VAT increase by 2pp at the beginning of 2019). The Russian Central Bank promptly reacted to rising prices and inflationary expectations, increasing the key interest rate by 25 basis points (to 7.5%) in mid-September.

The usual link between the oil price and rouble exchange rate developments seems to have reversed owing to the recently escalating ‘sanctions carousel’, as the rouble has depreciated since March, despite a simultaneous increase of oil prices. On balance, higher oil prices and the associated increase in export and budget revenues probably outweigh the adverse impact of sanctions. The state budget may even end with a small surplus in 2018, and the draft federal budget for 2019-2021 reckons with a surplus as well. In 2018, the current account surplus will surge to nearly 6% of GDP. Indeed, export revenues grew by nearly 30% in nominal USD terms in the first eight months of 2018, largely thanks to higher oil prices. At the same time, imports expanded (+11%) as well, yet their real growth was tamed by a relatively weak domestic demand and a depreciating rouble (the latter is largely unrelated to the global emerging market crisis).

Real wages grew strongly in the first eight months of 2018; disposable income by just 2% in the same period. Employment is essentially flat and overall labour shortages are rising, while unemployment is declining. The forthcoming pension reform – raising the retirement age – that provoked popular protests in late summer should also be viewed in this context. President Vladimir Putin’s approval ratings dropped by more than 10pp after the announced pension reform in August and several pro-Kremlin nominees lost to opposition candidates in the subsequent regional elections. A revised pension reform was adopted by the Duma in September, after Mr Putin had announced adjustments to the original blueprint that will mitigate some of the adverse social impacts. According to the revised pension bill, the retirement age will be raised to 60 for women (instead of originally envisaged 63) and to 65 for men. In addition, women raising three or more children can retire earlier and seniors in the pre-retirement age (within 5 years of reaching the new retirement age) will be entitled to receive additional benefits and job protection guarantees. These amendments, adopted by the Federation Council in early October, will adversely affect part of the expected positive fiscal effects of the reform.

After the diplomatic spat with the West related to the ‘Skripals affair’ and other Russian ‘malign activity’ early this year, a new wave of US sanctions was announced and introduced in August. This increased uncertainty for foreign investors (the previous round of US sanctions against ‘Kremlin-linked’ Russian oligarchs was announced in April). As expected, EU sanctions related to Ukraine were also prolonged by another year in early September. The repeated waves of sanctions have an adverse impact on the investment climate, reduce capital inflows – including FDI -, weaken the rouble and raise inflationary expectations. Foreign investors have been selling Russian government bonds in the expectation of further US sanctions: since the beginning of the year, the share of non-residents in total Russian government bonds has dropped to 26.6% of the total – by more than RUB 440bn (about USD 33bn). External government debt dropped to USD 485.5bn as of July (about 30% of GDP). Future purchases of Russian debt instruments by foreigners will likely be even more curtailed. Sanctions are likely to stay, and the US sanctions may even be broadened in the coming months. A special department established at the Ministry of Finance at the end of September will coordinate ‘anti-sanction’ responses. However, the scope for Russian manoeuvre is limited except for further diplomatic and economic steps in the Chinese direction.

Apart from the controversial pension reform mentioned above and the planned VAT increase in 2019, there have been hardly any new reform measures so far. Instruments and policies needed for achieving the ambitious social policy goals, including economic modernisation, restructuring, diversification of exports and SME development, announced by Mr Putin after his re-election in March are yet to be elaborated. The adverse investment climate, uncertainty regarding sanctions and fluctuating oil prices are taking a toll on future growth prospects. Moreover, since the oil price is projected to decline from the current level of more than 80 USD/bbl in the next two years, the external growth drivers will weaken as well. Next year's GDP growth is expected to slow down, not least given the fact that no major push in domestic demand is expected. The forecast GDP growth rates for 2019-2020 have been adjusted downwards by a fraction of a decimal point owing to persisting uncertainties and the expected weakening of energy prices.

Import substitution, more protectionism and the fostered trade reorientation towards the East are the main defensive policy responses that Russia will follow with even more rigour in future. Both foreign and domestic investments will remain constrained as the Chinese investments and markets will not fully compensate for lost opportunities in Europe. With expected GDP growth rates below 2% per year even in the medium term, Russia will not meet Putin's ambitious target of becoming the 5th largest world economy by the end of his current presidency. On the contrary, it will fall further behind not only its peers and allies, but even behind its adversaries in the West.

Table 27 / Russian Federation: Selected economic indicators

	2014	2015	2016	2017 ¹⁾	2017 January-June	2018	2018 Forecast	2019 Forecast	2020
Population, th pers., average	146,091	146,406	146,675	146,842	146,796	146,836	147,000	147,000	147,000
Gross domestic product, RUB bn, nom.	79,200	83,387	86,149	92,037	42,585	47,086	101,100	107,800	114,100
annual change in % (real)	0.7	-2.5	-0.2	1.5	1.6	1.6	1.7	1.6	1.8
GDP/capita (EUR at PPP)	19,000	18,700	18,300	18,800
Consumption of households, RUB bn, nom.	42,016	43,337	44,965	47,872	22,677	23,822	.	.	.
annual change in % (real)	2.0	-9.4	-2.8	3.4	2.4	2.6	2.5	2.2	2.0
Gross fixed capital form., RUB bn, nom.	16,828	16,942	18,403	19,967	7,407	7,930	.	.	.
annual change in % (real)	-1.8	-11.2	0.8	4.3	5.4	1.3	2.0	3.0	3.0
Gross industrial production ²⁾									
annual change in % (real)	1.7	-0.8	2.2	2.1	3.7	3.0	3.0	3.0	3.0
Gross agricultural production									
annual change in % (real)	3.5	2.6	4.8	2.4	0.5	2.2	.	.	.
Construction output ³⁾									
annual change in % (real)	-2.3	-4.8	-2.2	-1.4	-3.3	-1.0	.	.	.
Employed persons, LFS, th, average	71,539	72,324	72,393	72,142	71,722	72,250	72,300	72,300	72,300
annual change in %	0.2	-0.4	0.1	-0.3	-0.2	0.5	0.2	0.0	0.0
Unemployed persons, LFS, th, average	3,889	4,264	4,243	3,967	4,077	3,733	3,800	3,700	3,700
Unemployment rate, LFS, in %, average	5.2	5.6	5.5	5.2	5.4	4.9	5.0	4.9	4.9
Reg. unemployment rate, in %, eop ⁴⁾	1.2	1.3	1.2	1.0	1.1	0.9	.	.	.
Average monthly gross wages, RUB ⁵⁾	32,495	34,030	36,709	39,144	38,029	42,521	42,500	46,200	50,000
annual change in % (real, gross)	1.2	-9.0	0.7	3.6	2.7	9.2	5.0	3.0	4.0
Consumer prices, % p.a.	7.8	15.5	7.1	3.6	4.3	2.4	3.5	5.5	4.0
Producer prices in industry, % p.a. ⁶⁾	6.4	13.5	4.2	7.7	9.2	8.5	10.0	10.0	5.0
General governm.budget, nat.def., % of GDP									
Revenues	33.8	32.3	32.7	33.7	34.1	35.6	37.0	37.0	36.0
Expenditures	34.9	35.7	36.4	35.2	33.9	32.4	36.0	37.0	37.0
Deficit (-) / surplus (+)	-1.1	-3.4	-3.6	-1.5	0.2	3.2	1.0	0.0	-1.0
General gov.gross debt, nat.def., % of GDP	13.0	13.1	12.9	12.6	12.5	12.0	14.0	15.0	16.0
Stock of loans of non-fin.private sector, % p.a.	25.9	7.6	-6.9	3.5	-1.4	8.5	.	.	.
Non-performing loans (NPL), in %, eop ⁷⁾	3.8	5.3	5.2	5.2	5.4	5.4	.	.	.
Central bank policy rate, % p.a., eop ⁸⁾	17.00	11.00	10.00	7.75	9.00	7.25	7.5	7.0	6.0
Current account, EUR mn ⁹⁾	43,477	60,952	22,138	29,472	21,187	40,790	79,800	61,400	49,200
Current account, % of GDP	2.8	5.0	1.9	2.1	3.1	6.2	5.9	4.3	3.3
Exports of goods, BOP, EUR mn ⁹⁾	375,561	307,040	254,371	313,173	153,895	173,841	359,500	372,200	375,900
annual change in %	-4.4	-18.2	-17.2	23.1	33.8	13.0	14.8	3.5	1.0
Imports of goods, BOP, EUR mn ⁹⁾	232,739	173,585	172,911	210,932	98,716	99,780	213,900	228,100	239,500
annual change in %	-9.4	-25.4	-0.4	22.0	31.7	1.1	1.4	6.6	5.0
Exports of services, BOP, EUR mn ⁹⁾	49,700	46,418	45,759	51,137	25,021	25,663	52,800	54,700	57,400
annual change in %	-5.8	-6.6	-1.4	11.8	21.2	2.6	3.3	3.6	4.9
Imports of services, BOP, EUR mn ⁹⁾	91,487	79,829	67,331	78,681	36,898	37,369	80,500	87,500	91,900
annual change in %	-5.3	-12.7	-15.7	16.9	21.5	1.3	2.3	8.7	5.0
FDI liabilities, EUR mn ⁹⁾	16,655	6,163	29,381	25,296	16,917	8,448	12,700	.	.
FDI assets, EUR mn ⁹⁾	43,151	19,861	20,149	32,559	14,301	15,192	33,900	.	.
Gross reserves of NB excl. gold, EUR mn ⁹⁾¹⁰⁾	279,383	292,467	301,871	297,823	300,675	325,521	.	.	.
Gross external debt, EUR mn ⁹⁾	493,861	474,121	486,489	433,320	461,363	421,923	404,400	397,200	400,100
Gross external debt, % of GDP	31.7	38.5	41.9	31.0	33.0	31.3	30.0	28.0	27.0
Average exchange rate RUB/EUR	50.77	67.76	74.26	65.87	62.70	71.81	75.0	76.0	77.0

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

1) Preliminary. - 2) Excluding small enterprises. - 3) Until 2015 according to NACE Rev.1. - 4) In % of labour force (LFS). - 5) From 2017 improved coverage of small enterprises. - 6) Domestic output prices. - 7) According to Russian Accounting Standards overdue debt is defined as debt service overdue, therefore the data are not fully comparable with other countries. - 8) One-week repo rate. - 9) Converted from USD. - 10) 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.