

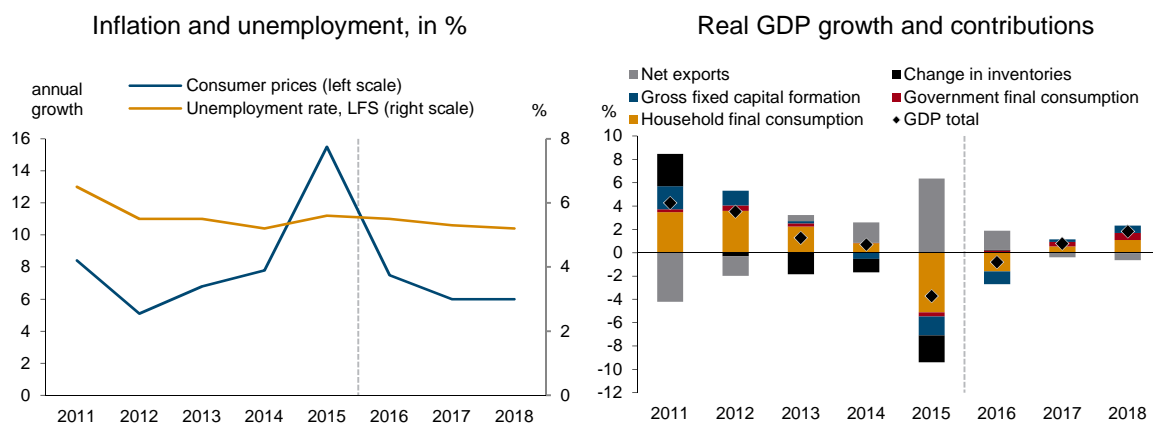


RUSSIAN FEDERATION: Stagnation becomes the 'new normal'

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The renewed plunge in oil prices at the beginning of 2016 has resulted in lower export and budget revenues, prompting a delay in stabilising the economy. Only since mid-2016 has the Russian economy seemingly begun to emerge slowly from recession. With oil prices more or less flat, financial and trade sanctions remaining in place and structural and institutional reforms absent, economic growth will stay sluggish – at less than 2% – even in the medium term.

Figure 39 / Russian Federation: Main macroeconomic indicators



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

The Russian economic recession is slowly coming to an end. By mid-2016, the adjustment to the collapse in oil prices and the subsequent devaluation of the rouble, as well as the imposition of Western sanctions and Russian counter-sanctions in the course of 2014-2015, have been by and large swallowed. The multiple shocks that hit domestic demand and foreign trade have thus been largely over and the economy has now seemingly stabilised at a new 'stagnation normal'. The exchange rate stabilised (and even appreciated somewhat in the course of the year), inflation is receding to single-digit levels. Yet signals of an emerging recovery are still feeble and contradictory: agricultural production, the extraction industry and transport are modestly growing (the former thanks to better harvests and the food import ban), while the remaining sectors – in particular, manufacturing industry, trade and especially construction industry – shrank anew in the first half of 2016. In nominal terms, the Russian

GDP contracted by more than EUR 500 billion (by more than one third, to the level of 2010, largely due to rouble devaluation) between 2013 and 2016; previous levels of nominal GDP will not be reached for years.

External shocks and related overall adjustments have been most spectacular in trade with the EU: Overall Russian goods exports dropped by nearly 30% in the first half of 2016 (in nominal EUR terms, after a drop by almost 20% in 2015) and the share of the EU in the total dropped below 50%, largely owing to lower energy prices. At the same time, imports from the EU fell even more: by nearly 40%, mostly due to the devaluation of the rouble. Due to the conflict, Russian trade with Ukraine shrank by more than 60% and the share of Ukraine in Russian exports dropped below 3%. By contrast, export shares of the Eurasian Economic Union (EAEU), the United States, China, Japan and Turkey increased by 0.4, 0.7, 1.5, 0.5 and 0.8 pp, respectively, between 2013 and 2015 – reflecting the relative shift away from the EU against the background of the overall trade decline (which continues in 2016). In 2016, both exports and imports are expected to decline by another 20% and 10%, respectively. Trade and current account surpluses will narrow accordingly, the latter will drop below 3% of GDP.

Amendments to the 2016 federal budget announced in October reckon with somewhat lower revenues (2.8%) while simultaneously increasing expenditure by about the same amount. While state-supported investment outlays and the financing of regional programmes (including subsidies to Crimea and Kaliningrad) will be curtailed, defence expenditures will apparently be increased (details have not been revealed yet).

In addition to domestic investment cuts, FDI inflows nearly dried out in the course of 2015 (and turned even negative in the first quarter of 2016). FDI stocks had been drastically reduced during the last two years – by more than EUR 200 billion between end-2013 and end-2015 (to USD 343 billion). The reduction in FDI flows results from recession, Western financial sanctions and the associated worsening of the investment climate; part of the disinvestment can also be attributed to the official 'de-offshorisation' campaign (launched in 2014, aiming at returning Russian flight capital home and implemented since the beginning of 2015). A part of the capital outflow can be attributed to debt service payments. A massive reduction of investments – domestic as well as foreign – is definitely no good sign for modernisation and diversification prospects.

The results of the parliamentary elections in September 2016 reflect resignation – a fragile domestic stability of sorts – which may be easily shaken by the growing number of external political and economic risks. The latter relate mostly to the oil price while the former are connected with deteriorating relations with the West (especially the United States) which have reached their lowest point at least since before the launch of Gorbachev's perestroika 30 years ago. After the recent collapse of the Syrian truce, the Dutch-led commission's suggestion that Russia was directly involved in downing the MH17 flight in eastern Ukraine, and Putin's withdrawal from the 2010 plutonium deal with the USA because of 'unfriendly US actions towards Russia', a new round of dangerous escalation of the conflict cannot be ruled out.

Increasingly assertive Russian external policies (Ukraine, Turkey, Syria), as well as the sanctions' tug-of-war with the West, have been associated with the inward-looking, import-substitution and more 'eastern-focused' (China and Japan) economic policies. Domestically, the rather cautious monetary policy stance pursued by the Central Bank and the fiscal restraint of the Ministry of Finance remain in

place, despite the recent lowering of the CBR policy rate. The modestly rising budget deficit reflects the shortfall of tax revenues, rather than a more accommodative fiscal policy stance. As usual, these policies face harsh domestic criticism from both conservative (presidential adviser S. Glazyev) and liberal (former Finance Minister A. Kudrin) corners. The outcome of these disputes will likely remain inconclusive while any radical change in economic policy would be rather risky, at least before the forthcoming presidential elections in 2018. A muddling through of sorts is thus to be expected.

We share the assessment of both the Government and Central Bank medium-term forecasts from September 2016 which reckon with sanctions staying in place. In their baseline scenario (with the oil price hovering at around USD 40/bbl) GDP will grow less than 1% in 2017 and below 2% p.a. in 2018-2019. Inflation is expected to drop to low single digits (4% at the end of 2017). Investment growth should gradually recover, but is expected to stay below 2% in 2017 and between 3-4% per year during 2018-2019 – a rather conservative growth scenario. Even the ‘Strategic long-term forecast until 2035’ elaborated by the Economics Ministry and recently leaked to the press does not envisage significant growth acceleration: GDP growth of 2.6% per year during 2016-2020 and less than 4% per year thereafter.

With sanctions remaining in place and partly even widening (e.g. Russia banned the state procurement of foreign food products in August 2016, the EU and USA expanded the list of sanctioned Russian entities), prospects for modernisation cum restructuring are bleak due to the shortage of available investment resources and other institutional bottlenecks – even in the medium term. There seems to be a consensus that Russia is facing a prolonged period of stagnation in both economic and societal developments. Turning inwards and continuing with more assertive policies is not helpful – though obviously popular at home as evidenced by the results of the recent Duma elections. The attempted change of the pivot to the East (China, Japan, South Korea and Vietnam) cannot compensate for the trade and investment setbacks with the EU. So far, there have been little visible signs of import substitution – even in the sanctions-protected food processing industry. The damaged links with most of the near neighbourhood in both west and south, Ukraine in particular, will be hard to restore and the conflict with the West may even escalate. Also the recently established Eurasian Economic Union flagship integration project has been adversely affected by a number of ill-considered unilateral steps on the part of Russia (food sanctions, restrictions on Ukrainian transit trade, etc.).

Overall, our current assessment remains unchanged: the expected mild recession in 2016 is confirmed and a gradual, yet rather modest, GDP growth acceleration is forecast in both 2017 and 2018. Economic growth will stay below 2% and investment weak even in the medium run. Inflation will return to single digits and unemployment will fall.

Table 22 / Russia: Selected economic indicators

	2012	2013	2014	2015 ¹⁾	2015 January-June	2016	2016 Forecast	2017 Forecast	2018
Population, th pers., average	143,202	143,507	146,091	146,406	146,291	146,600	146,500	146,500	146,500
Gross domestic product, RUB bn, nom.	66,927	71,017	77,945	80,804	37,494	38,541	84,000	90,000	95,000
annual change in % (real)	3.5	1.3	0.7	-3.7	-3.7	-0.9	-0.8	0.8	1.8
GDP/capita (EUR at exchange rate)	11,700	11,700	10,500	8,100	.	.	7,600	8,000	8,100
GDP/capita (EUR at PPP)	19,100	17,800	18,700	18,600	.	.	.	.	.
Consumption of households, RUB bn, nom.	34,334	38,068	41,611	43,331	20,699	21,092	.	.	.
annual change in % (real)	7.4	4.4	1.5	-9.6	-7.5	-4.8	-3.0	1.0	2.0
Gross fixed capital form., RUB bn, nom.	13,522	14,357	16,651	17,668	6,534	6,774	.	.	.
annual change in % (real)	6.0	0.9	-2.6	-7.6	-6.9	-6.7	-5.0	1.0	3.0
Gross industrial production ²⁾									
annual change in % (real)	3.4	0.4	1.7	-3.4	-2.6	0.2	0.5	2.0	3.0
Gross agricultural production									
annual change in % (real)	-4.8	5.8	3.5	3.0	2.9	2.6	.	.	.
Construction output									
annual change in % (real)	2.5	0.1	-2.3	-7.0	-6.9	-5.7	.	.	.
Employed persons, LFS, th, average	71,545	71,392	71,539	72,324	71,919	71,850	72,500	73,000	73,500
annual change in %	1.0	-0.2	0.2	-0.4	-0.4	-0.1	0.2	0.7	0.7
Unemployed persons, LFS, th, average	4,131	4,137	3,889	4,264	4,314	4,404	4,200	4,100	4,000
Unemployment rate, LFS, in %, average	5.5	5.5	5.2	5.6	5.7	5.8	5.5	5.3	5.2
Reg. unemployment rate, in %, end of period ³⁾	1.4	1.2	1.2	1.3	1.3	1.3	.	.	.
Average monthly gross wages, RUB	26,629	29,792	32,495	34,030	33,175	35,708	36,200	39,500	44,000
annual change in % (real, gross)	8.4	4.8	1.2	-9.3	-8.7	-0.2	-1.0	3.0	5.0
Consumer prices, % p.a.	5.1	6.8	7.8	15.5	16.0	7.9	7.5	6.0	6.0
Producer prices in industry, % p.a. ⁴⁾	6.8	3.3	6.1	12.4	11.8	4.1	6.0	5.0	5.0
General governm. budget, nat. def., % of GDP									
Revenues	34.5	34.4	34.3	33.3	34.0	32.5	31.4	32.0	33.0
Expenditures	34.1	35.6	35.4	36.8	36.4	35.2	35.0	35.5	36.0
Deficit (-) / surplus (+)	0.4	-1.2	-1.1	-3.5	-2.4	-2.8	-3.6	-3.5	-3.0
Public debt, nat. def., % of GDP ⁵⁾	9.3	9.8	10.8	10.6	9.9	10.4	14.0	15.0	15.0
Central bank policy rate, % p.a., end of period ⁶⁾	8.25	5.50	17.00	11.00	11.50	10.50	10.00	8.00	6.00
Current account, EUR mn ⁷⁾	55,452	25,164	43,477	62,052	41,531	12,287	18,000	13,600	15,000
Current account, % of GDP ⁷⁾	3.3	1.5	2.8	5.2	7.1	2.5	1.6	1.2	1.3
Exports of goods, BOP, EUR mn ⁷⁾	410,300	392,827	375,561	307,083	162,036	114,864	228,800	241,000	262,500
annual change in %	10.9	-4.3	-4.4	-18.2	-12.8	-29.1	-25.5	5.3	8.9
Imports of goods, BOP, EUR mn ⁷⁾	261,202	256,901	232,739	173,525	82,381	75,152	158,600	168,600	180,400
annual change in %	14.2	-1.6	-9.4	-25.4	-26.2	-8.8	-8.6	6.3	7.0
Exports of services, BOP, EUR mn ⁷⁾	48,495	52,787	49,700	46,532	22,128	20,682	44,800	47,200	49,100
annual change in %	16.4	8.8	-5.8	-6.4	-6.4	-6.5	-3.7	5.4	4.0
Imports of services, BOP, EUR mn ⁷⁾	84,736	96,643	91,487	79,694	38,045	30,501	64,900	68,400	69,700
annual change in %	29.0	14.1	-5.3	-12.9	-9.8	-19.8	-18.6	5.4	1.9
FDI liabilities (inflow), EUR mn ⁷⁾	39,353	52,107	16,655	5,826	1,405	6,033	8,000	.	.
FDI assets (outflow), EUR mn ⁷⁾	37,980	65,120	43,151	19,954	7,251	13,409	15,000	.	.
Gross reserves of CB, excl. gold, EUR mn ⁸⁾	367,323	341,787	279,383	292,467	282,782	297,124	.	.	.
Gross external debt, EUR mn ⁷⁾	480,440	530,481	493,861	474,139	501,442	472,350	448,000	385,700	356,300
Gross external debt, % of GDP ⁷⁾	28.7	31.6	32.2	39.8	42.1	42.2	40.0	33.0	30.0
Exchange rate RUB/EUR, average	39.9	42.3	50.8	67.8	64.4	78.4	75.0	77.0	80.0
Purchasing power parity RUB/EUR ⁹⁾	24.4	27.8	28.6	29.6	.	.	.	.	.

Note: From 2014 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) In % of labour force (LFS). - 4) Domestic output prices. - 5) wiiw estimate. - 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. - 9) wiiw estimates based on the 2011 International Comparison Project benchmark.

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