38. RUSSIAN FEDERATION

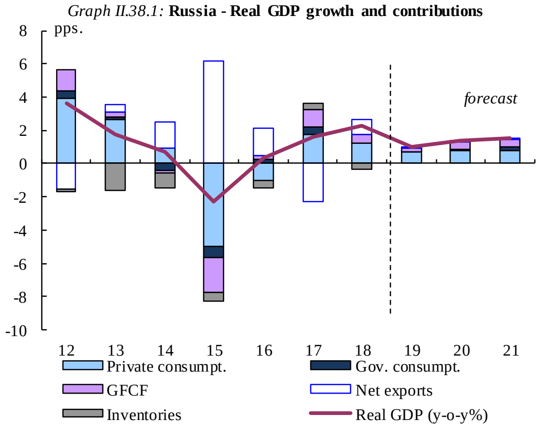
Growth picks up on a higher public spending

Economic activity is set to decelerate in 2019, hampered by the increase in VAT rates, rising uncertainty and softening global demand. The macroeconomic policy mix is gradually turning more accommodative, as fiscal buffers have been rebuilt and the policy framework has been strengthened. Going forward, real GDP is expected to rebound moderately in line with gradually improving potential growth and accelerating public investments.

Economy slows amid a weak external demand and a rise in VAT

After the strong real GDP growth upturn to 2.3% in 2018 spurred by transient factors related to the completion of major infrastructure projects, economic activity slowed to 0.7% year-on-year in the first half of 2019, amid sluggish private demand growth and contracting exports. Private consumption was weakened by an increased VAT burden, relatively tight monetary policy and weak wage growth. Investment growth was hampered by delays in the implementation of public investment projects. Exports suffered from weakening global demand for hydrocarbons and metals, last year's below-average grain harvest, and temporary disruption of oil flows through the Druzhba pipeline.

Graph II.38.1: **Russia - Real GDP growth and contributions**



Economic activity is set to rebound moderately in the second half of 2019 as the significant public investment programme is gradually being implemented. However, prospects of a stronger rebound are dampened by a confluence of domestic and external headwinds. Low global oil prices and weak demand for oil and gas hamper the outlook for exports. At the same time, sluggish growth of disposable incomes, slowing consumer credit growth and uncertainty related to possible additional US sanctions limit the scale of domestic demand growth.

Overall, real GDP growth is projected to decelerate to 1% in 2019 and to edge up to 1.4% in 2020 and 1.5% in 2021, reflecting higher public investment spending and a marginal pension-reform-induced improvement in labour force participation.

Public spending accelerates

Private consumption growth is likely to remain sluggish in the medium term, reflecting limited real wage gains and faltering consumer credit growth. Elevated uncertainty related to the deteriorating global trade outlook and geopolitical situation, relatively high real interest rates and deteriorating environment for foreign investors are likely to undermine the private investment outlook. However, the acceleration of public infrastructure investments in the second half of 2019 and thereafter is expected to support overall investment growth rates.

On the external side, import growth is likely to pick up only marginally from 2019 lows amid accelerating public investments. Export growth is set to remain moderate hampered by soft global demand overall and particularly for commodities. Overall, the contribution of external trade to real GDP growth is forecast to remain marginally positive over the forecast horizon.

Macroeconomic policy mix becomes supportive

Headline consumer price inflation peaked at 5.2% in February-April 2019, reflecting rising consumption tax rates and effects of past exchange rate depreciation. In line with these trends, annual average inflation is expected to accelerate from 2.9% in 2018 to around 4½% in 2019. It is set to subside slightly below the central bank target of 4% in 2020 thanks to the base effects and remain around this level towards the end of the forecast horizon. The central bank started to tighten monetary policy in 2018, raising the main interest rate to 7¾%, amid increasing exchange rate pressures and accelerating inflation. However, the dovish turn among global central banks and subsiding inflationary pressures gave the monetary authorities some space to ease policy and the headline interest rate was cut to 6.5% over the summer.

On the fiscal side, a high fiscal surplus of 2.9% of GDP in 2018, driven by rising oil revenues and improving non-oil tax collection, is forecast to decline to 2.1% of GDP in 2019, as spending on infrastructure, human capital and social support picks up more strongly than VAT-related extra revenues. Going forward, fiscal surpluses are expected to gradually decline, amid accelerating public expenditures to above 1% of GDP in 2021. At the same time off-budget fiscal buffers in the National Welfare Fund (accumulating windfall oil revenues) are likely to reach the legal minimum of 7% of GDP soon, with a rising probability that any additional inflows could be used to boost investments in the domestic economy

Risks to the forecast are broadly balanced

On the external side, the major risk on the upside, particularly pertinent for Russia, relates to higher oil prices due to intensification of geopolitical tensions in the Middle East. On the downside, the intensification of US economic sanctions that would negatively affect investments and foreign trade remains a risk. On the domestic side, previous strong retail credit growth could lead to a build-up of impaired assets and impinge upon consumption growth, while slower implementation of the infrastructure programme might limit the pace of the investment rebound.

Table II.38.1:

Main features of country forecast - RUSSIA

	2018			Annual percentage change						
	bn RUB	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP		103875.8	100.0	4.1	0.3	1.6	2.3	**1.0**	**1.4**	**1.5**
Private Consumption		51283.7	49.4	6.4	-1.9	3.3	2.3	**1.4**	**1.5**	**1.6**
Public Consumption		18049.3	17.4	0.9	1.5	2.5	0.3	**0.3**	**0.8**	**1.0**
Gross fixed capital formation		21383.0	20.6	6.6	1.0	5.1	2.4	**1.0**	**2.0**	**2.2**
of which: equipment		-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)		31932.6	30.7	5.0	3.2	5.0	5.5	**0.2**	**1.3**	**1.4**
Imports (goods and services)		21574.3	20.8	9.8	-3.6	17.4	2.7	**-0.1**	**1.4**	**1.7**
GNI (GDP deflator)		101542.5	97.8	4.2	0.3	1.9	2.5	**1.0**	**1.4**	**1.5**
Contribution to GDP growth:		Domestic demand		4.7	-0.5	3.3	1.8	**0.9**	**1.3**	**1.4**
		Inventories		0.4	-0.5	0.3	-0.3	**0.0**	**0.0**	**0.0**
		Net exports		-0.7	1.7	-2.3	0.9	**0.1**	**0.1**	**0.1**
Employment				0.9	0.1	-0.1	0.1	**-0.3**	**0.1**	**0.1**
Unemployment rate (a)				7.1	5.7	5.2	5.0	**5.1**	**4.9**	**4.7**
Compensation of employees / head				-	-	-	-	**-**	**-**	**-**
Unit labour costs whole economy				-	-	-	-	**-**	**-**	**-**
Real unit labour cost				-	-	-	-	**-**	**-**	**-**
Saving rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				14.2	3.2	5.4	10.3	**2.8**	**3.3**	**3.7**
Consumer-price index				-	7.0	3.7	2.9	**4.5**	**3.7**	**4.0**
Terms of trade goods				3.7	-18.0	13.0	17.3	**-4.9**	**-0.5**	**-0.5**
Trade balance (goods) (c)				11.6	7.0	7.3	11.8	**10.5**	**10.1**	**9.7**
Current-account balance (c)				6.8	2.0	2.0	6.9	**5.2**	**4.6**	**4.0**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				6.6	2.0	2.0	6.9	**5.2**	**4.6**	**4.0**
General government balance (c)				-	-3.7	-1.5	2.9	**2.1**	**1.5**	**1.1**
Cyclically-adjusted budget balance (d)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (d)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				19.7	16.3	15.6	14.3	**15.3**	**15.7**	**16.3**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.