38. RUSSIAN FEDERATION

The recession in Russia is set to be somewhat milder than in most other G20 countries. This is due to the recently revamped macroeconomic framework centred on flexible exchange rates as well as due to the relatively closed and static nature of the economy. Still, the recovery is set to be tepid reflecting the structure of the economy and the longstanding structural challenges.

COVID-19 and oil shock bring GDP back to 2016 level

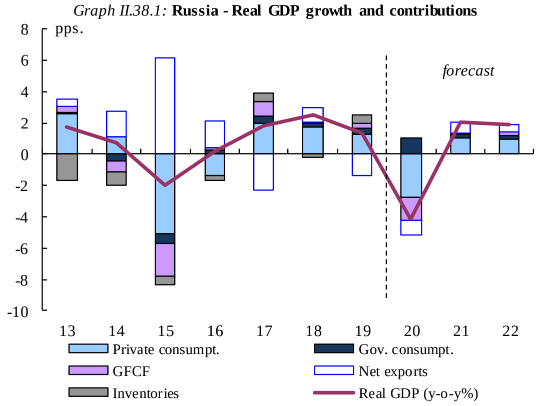
After growing by 1.3% in 2019, real GDP declined in the first half of 2020 by 3.4% y-o-y amid rapid spread of the virus, introduction of containment measures, tumbling oil prices and falling oil and gas production. Services were strongly affected amid abrupt changes in consumer behaviour and a fall in disposable income. However, the relatively small size of the service sector mitigated the recent slump. At the same time, the outsized role of the public sector in the economy cushioned the negative impact on employment and disposable income so far. The macroeconomic framework, centred around a flexible exchange rate, also served the economy well. Currency depreciation led to strong import compression and supported budget revenues, but did not limit the monetary policy space much given a low pass-through to goods-price inflation and downward inflationary pressures from services.

Contained slump, but sluggish recovery

For the year as a whole, real GDP is expected to shrink by about 4¼% in 2020, following the fall in the first half of the year and a cyclical rebound thereafter. Given the underlying assumption that further lockdowns are avoided, a relatively strong quarterly growth is expected towards the end of 2020 and in 2021, as oil prices and production recover. However, a weak investment climate and the limited scope for strong consumption growth limit a sharp recovery in 2020 and 2021. At the same time, the macroeconomic policy mix is set to be favourable as real interest rates might decline further and fiscal policy remains supportive. Overall, real GDP is set to increase by 2% in 2021.

Private consumption is unlikely to provide much support going forward due to falling real disposable income, the precarious wealth situation of households and their already low savings rate that inhibits any spending surge in the near term. Although the official unemployment rate remains relatively low, insecurity in the informal sector, the return of migrant workers to their home countries and downward wage pressure weigh on consumption. Investment is set to remain depressed for the remainder of this year and to grow only slowly in 2021 and beyond, as the investment climate remains negative and many SMEs lack access to finance. At the same time, the uncertain outlook for the oil sector is expected to dampen investment in the energy sector.

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



After a strong start of the year driven by the rollout of national infrastructure projects, public investment stalled as the authorities reprioritised resources toward public consumption. Looking ahead, public consumption is expected to remain elevated while public investment is not projected to regain traction over the forecast horizon.

In recent years growth was held back by widespread property rights issues, the outsized role of the energy sector and SOEs in the economy, obstacles to SMEs as well as a general lack of competition, economic openness and innovation. These structural challenges are likely to be a more limiting factor to growth under current circumstances of lower oil prices and subdued global demand. At the same time, the revamping of the macroeconomic framework after the 2014/15 crisis helped to stabilise the economy but it was insufficient to lift potential growth. Consequently, only moderate growth of around 2% in 2022 is expected.

Accommodative monetary policy supports growth

The macroeconomic framework in its current form enabled interest rates to be slashed by a cumulative 500 basis points to 4.25% since 2017, as inflation pressures remained contained and headline inflation remained below the 4% target for most of the last 3 years. Headline inflation reached a trough in February (2.3%) due to base effects and past ruble appreciation, but rebounded to 3.7% in September. As a result, real interest rates dropped significantly in 2020. Nevertheless, Russia remains one of the few major economies with positive real interest rates. Going forward, inflation is expected to stay below the target as good harvest this year puts a lid on food prices in the near term, private consumption remains subdued and favourable base effects kick in in 2021.

Fiscal stimulus helped in the acute phase of the crisis.

In response to the COVID-19 crisis, the authorities announced fiscal stimulus measures (2½% of GDP) including support to the underfinanced health system, increased social expenses and a limited support to SMEs. As a result, expenditures rose by 28% year-on-year in the first eight months of 2020. Budget revenues were down by 12% over the same period, mostly due to lower oil-related income. As a consequence, the fiscal deficit is set to reach 4¼% of GDP after a surplus of 0.4% in 2019.

Going forward, the deficit is expected to shrink to about 3¼% of GDP in 2021 and 2% in 2022, as expenditures are set to decline given lower immediate pandemic-related needs, and new taxes, mainly on mining, are introduced. The higher spending in 2020 required adjustments to several budget rules and a strong rise in the issuance of domestic bonds to finance growing public debt, which is set to increase from 14% of GDP in 2019 to 22½% of GDP in 2022.

Risks to the forecast are broadly balanced

Major downside risks come from oil markets as a worsening pandemic could further suppress both oil demand and prices. In addition, the investment climate could turn even more negative, as taxes rise and fiscal support will be limited. The major upside risks include a firming oil market, a waning pandemic and more fiscal support.

Table II.38.1:

Main features of country forecast - RUSSIA

	2019		Annual percentage change						
bn RUB	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP	110046.1	100.0	3.6	1.8	2.5	1.3	**-4.2**	**2.0**	**1.9**
Private Consumption	55436.8	50.4	5.7	3.7	3.3	2.5	**-5.5**	**2.0**	**1.8**
Public Consumption	20141.7	18.3	0.8	2.5	1.3	2.2	**5.5**	**1.0**	**1.2**
Gross fixed capital formation	22545.7	20.5	5.6	4.4	0.4	1.6	**-7.0**	**0.5**	**1.3**
of which: equipment	-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)	31157.4	28.3	4.6	5.0	5.5	-2.3	**-13.3**	**6.3**	**5.7**
Imports (goods and services)	22846.7	20.8	7.6	17.3	2.6	3.4	**-13.4**	**3.6**	**4.7**
GNI (GDP deflator)	106607.3	96.9	3.5	1.9	2.7	0.7	**-2.1**	**2.1**	**1.0**
Contribution to GDP growth: Domestic demand			4.2	3.4	2.1	1.9	**-3.2**	**1.3**	**1.4**
Inventories			-0.1	0.5	-0.2	0.5	**0.0**	**0.0**	**0.0**
Net exports			-0.4	-2.3	0.9	-1.4	**-1.0**	**0.7**	**0.4**
Employment			0.9	0.0	-0.1	-0.2	**-1.9**	**0.1**	**0.9**
Unemployment rate (a)			6.4	5.2	4.8	4.6	**6.2**	**5.8**	**4.8**
Compensation of employees / head			-	-	-	-	**-**	**-**	**-**
Unit labour costs whole economy			-	-	-	-	**-**	**-**	**-**
Real unit labour cost			-	-	-	-	**-**	**-**	**-**
Saving rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			12.1	5.3	11.1	3.8	**-0.2**	**4.2**	**3.9**
Consumer-price index			-	3.7	2.9	4.5	**3.5**	**3.7**	**4.0**
Terms of trade goods			0.3	12.6	17.4	-2.4	**-15.9**	**2.9**	**0.0**
Trade balance (goods) (c)			10.7	7.3	11.7	9.7	**5.0**	**6.1**	**6.4**
Current-account balance (c)			5.9	1.7	6.5	3.4	**0.9**	**1.8**	**2.3**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			5.3	1.7	6.5	3.3	**0.9**	**1.8**	**2.2**
General government balance (c)			-	-2.2	2.1	0.4	**-4.3**	**-3.2**	**-2.0**
Cyclically-adjusted budget balance (d)			-	-	-	-	**-**	**-**	**-**
Structural budget balance (d)			-	-	-	-	**-**	**-**	**-**
General government gross debt (c)			16.9	14.3	13.5	13.9	**18.7**	**21.2**	**22.5**

(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.