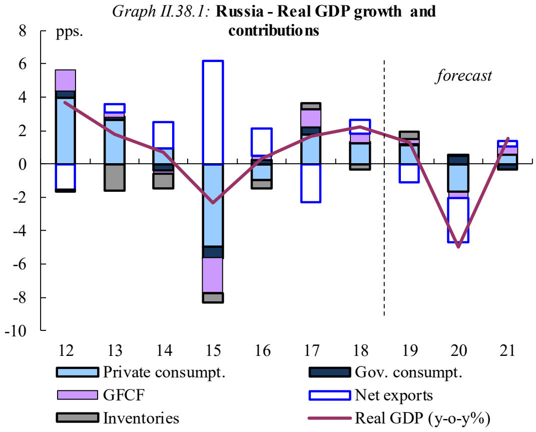
38. RUSSIAN FEDERATION

Russia faces a double hit from sharply lower oil prices and lockdown-driven deceleration in domestic demand in the context of the COVID-19 outbreak. Against this backdrop a sharp slump in economic activity is expected in the first half of 2020. Authorities, aware of the limited size of the fiscal buffers in the current environment of very low oil prices and a global pandemic, are unlikely to opt for a major fiscal boost to prop up the economy.

Channels of economic contagion are manifold

The economic activity slowed down to 1.3% in 2019, as investments and external demand were sluggish. Still, public investments into national projects, a major programme of mostly infrastructure spending to stimulate potential growth, accelerated towards the end of 2019 resulting in a gradual pick up of economic activity.

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



Real GDP growth was expected to strengthen further in 2020, but the negative economic impact of the virus outbreak will be significant. First, oil prices collapsed to 18-year lows in March amidst a 25% plunge in global oil demand and the breakdown of the OPEC+ agreement to cut supply. Confronted with the price shock of this scale, oil producers, including Russia, finally agreed in April to cut production by 10%. Second, in end-March the authorities announced a quarantine in Moscow and some other regions, requiring non-essential businesses to close and people to remain indoors. The lockdown is expected to last at least until the end of April, significantly curtailing domestic demand. Third, global demand and prices for metals also dwindled limiting further non-oil export revenues. Finally, tourism, a rapidly growing but still relatively small sector is set to be hampered by strict travel restrictions.

Real GDP growth falls on oil price collapse and demand destruction due to the virus

The lockdown measures were originally less severe than in other countries, but were sharpened with accelerating infections in April. These measures have a significant negative effect on consumption that is expected to decline sharply, as most outside activity is curtailed. However, fiscal measures are likely to cushion part of the slump as automatic stabilisers start to work and social spending is expected to rise. At the same time, corporate and household incomes are set to dwindle. Oil revenues might shrink by half if current price trends continue, putting further pressure on export-related incomes. Private investment is set to be subdued in 2020, as the situation of SMEs is deteriorating rapidly and the energy sector is unlikely to spend in the current circumstances.

On the external side, exports are set to plummet, as commodity prices fall and foreign demand shrinks, although imports are projected to fall less reflecting their lower dependence on consumption. All in all, contribution of external trade is set to turn highly negative before recovering towards the end of the forecast horizon. Against this backdrop, real GDP is likely to fall by 5% in 2020, more than in 2015 (-2.3%) when the previous oil price crisis and Western sanctions battered the economy.

Recovery in 2021 is likely to be subdued with real GDP growing by 1½% as income losses and uncertainty among consumers are set to continue hampering consumption. Investments are expected to be held back by a cautious attitude of Russian authorities, while recovering external demand is likely to boost trade.

Fiscal expansion is limited

Since 2015, fiscal policy has been tight and buffers have been rebuilt, though the situation changed in 2018 when the authorities announced the sizable public investment program. However, due to crisis-related revenue losses and the desire to protect reserves, given the scale of the current economic crisis and the turbulences in the oil markets, a lower-than-previously-planned execution of investment plans is expected for 2020 and 2021. At the same time, authorities announced a limited fiscal expansion (3% of GDP). It will include higher compensation for healthcare workers, increased sick leave benefits, interest rate subsidies and tax deferrals for SMEs and childcare lump sum benefits. Overall, together with automatic stabilisers kicking in, this additional spending is set to turn recent fiscal surpluses into deficit over the forecast horizon.

Monetary policy has already been eased

Monetary policy has been eased recently as the central bank cut interest rates from 7.75% in May 2019 to 5.5% in April 2020 in lockstep with rapidly falling inflation. In parallel, the central bank conducted some credit and regulatory easing measures. Going forward, further rate cuts are possible, supporting the economy, despite inflation temporarily exceeding the target at the end of 2020, before subsiding in 2021.

Risks to the forecast more on the downside

The major risk to the downside is a possible market exit of SMEs at a larger scale than anticipated accompanied by massive job losses. On the upside, world oil demand could rebound earlier than expected on swifter recovery of the global economy resulting in higher export revenues and a boost to domestic demand.

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	**1.3**	**-5.0**	**1.6**
Private Consumption		51283.7	49.4	6.4	-1.9	3.3	2.3	**2.3**	**-3.3**	**1.1**
Public Consumption		18049.3	17.4	0.9	1.5	2.5	0.3	**2.8**	**-1.8**	**0.8**
Gross fixed capital formation		21383.0	20.6	6.6	1.0	5.1	2.4	**1.4**	**-1.8**	**2.0**
of which: equipment		-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)		31932.6	30.7	5.0	3.2	5.0	5.5	**-2.1**	**-16.5**	**3.9**
Imports (goods and services)		21574.3	20.8	9.8	-3.6	17.4	2.7	**2.2**	**-9.7**	**2.3**
GNI (GDP deflator)		101542.5	97.8	4.2	0.3	1.9	2.5	**1.2**	**-5.2**	**1.6**
Contribution to GDP growth:	Domestic demand			4.7	-0.5	3.3	1.8	**1.9**	**-2.4**	**1.2**
	Inventories			0.4	-0.5	0.3	-0.3	**0.4**	**0.0**	**0.0**
	Net exports			-0.7	1.7	-2.3	0.9	**-1.1**	**-2.6**	**0.4**
Employment				0.7	0.1	-0.1	0.1	**-0.3**	**-1.3**	**0.1**
Unemployment rate (a)				7.2	5.7	5.2	5.0	**5.1**	**6.2**	**6.0**
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	**3.0**	**-0.2**	**4.5**
Consumer-price index				-	7.0	3.7	2.9	**4.6**	**4.0**	**4.0**
Terms of trade goods				3.7	-18.0	13.0	17.3	**-4.9**	**-17.2**	**2.9**
Trade balance (goods) (c)				11.6	7.0	7.3	11.8	**9.5**	**3.5**	**4.2**
Current-account balance (c)				6.8	2.0	2.0	6.9	**4.0**	**-2.7**	**-2.1**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				6.6	2.0	2.0	6.9	**4.0**	**-2.7**	**-2.1**
General government balance (c)				-	-3.7	-1.5	2.9	**1.7**	**-2.7**	**-2.7**
Cyclically-adjusted budget balance (d)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (d)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				19.7	16.3	15.6	14.3	**15.7**	**21.2**	**23.6**

(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.