38. RUSSIAN FEDERATION

Even though the pandemic and lower oil prices hit Russia hard in 2020, the real GDP decline was still moderate reflecting relatively light lockdown restrictions, the use of macroeconomic policy buffers, and the small share of contact-intensive services in the economy. Nevertheless, the structure of the economy and renewed geopolitical tensions also imply only a moderate rebound over the forecast horizon.

Contained real GDP slump in 2020 amid plunging imports and strong public consumption

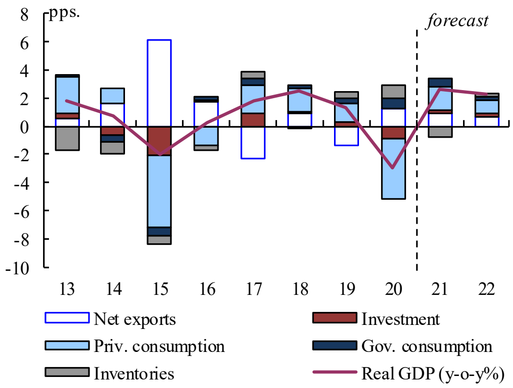
Real GDP in Russia declined by a relatively moderate 3% in 2020, as net exports and public consumption partly offset contracting private demand. Private consumption dropped sharply as household income declined and uncertainty increased in particular for households working in the large informal sector. Investments, already low in recent years given the weak business environment, decreased further in 2020, amid a shortage of financing for SMEs, lockdowns hitting the service sector, and worse prospects for the oil sector. At the same time, public funding was redirected rapidly from large-scale investments in national projects that were slowly rolled out, towards public consumption, supporting growth. On the external side, oil production cuts undermined exports' growth, but non-oil exports, in particular agricultural exports, held up well due to a good grain harvest, a weaker rouble and rising global food consumption. Imports were down by a staggering 12% year-on-year, reflecting lower consumption, the depreciating rouble and the abrupt decline in outbound tourism.

Muted recovery expected amid sluggish investment and consumption growth

Despite the recent increase in household savings which is expected to be unwound going forward, private consumption recovery in 2021 is set to be held back by continued uncertainty and weak disposable income growth as well as by slower credit growth as mortgage subsidies are set to be phased out. Slow progress with vaccinations is likely to cloud the outlook for the service sector for the remainder of 2021, as well. However, domestic consumption is set to be supported by continued social transfers and restrictions on outbound tourism.

Investment is expected to recover only slightly in 2021 and in 2022 as the medium-term outlook for the oil-market does not encourage capital spending, the overall investment climate remains muted and the space for expansionary macroeconomic policy is shrinking amid rising inflation. At the same time, geopolitical factors are expected to make financing of large investments more difficult, and the increasing 'de-coupling' of the Russian economy channels investments to less-productive sectors, undermining long-term growth. The rise in public investment and consumption is likely to be moderate as fiscal policy is expected to get more restrictive due to worsening financing conditions following US sanctions and the desire to preserve buffers. Exports are expected to grow faster than imports in both 2021 and 2022, as energy exports are set to increase and the weak rouble supports non-energy exports. At the same time, the import substitution policy, the weak rouble and the negative income trend are likely to curb imports.

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



Simultaneously, the macroeconomic framework with flexible exchange rates and a fiscal rule centred on a fixed oil price, make Russia less vulnerable to external pressures. In addition, the increase of reserve buffers even in crisis times and the payback of foreign currency denominated debt as well as the declining role of foreigners in the government debt market further insulate Russia from international financial trends. However, this greater macroeconomic stability does not automatically lift growth prospects, given structural weaknesses and bottlenecks in the economy. Taken together, real GDP is expected to grow by 2.7% in 2021 and 2.3% in 2022, taking GDP above the pre-pandemic level in the course of 2022.

Accommodative monetary policy supports growth for the time being

From 2017 to July 2020, interest rates declined by 500 basis points to 4.25% as inflation pressures remained contained until late 2020. However, with inflation hitting 5.8% in March 2021, firmly above the Central Bank's 4% target, rates were increased by 75 basis points to 5% in March and April. Going forward, base effects might cause inflation to decline towards the end of 2021, but price pressures, especially outside services, remain elevated. Real interest rates are firmly negative for the moment, but as the Central Bank's recent actions and more hawkish tone suggest, real interest rates are likely to increase going ahead, causing potential problems for investments and the housing sector.

Fiscal stimulus targeted and effective

Fiscal packages of around 3% of GDP, including increased social transfers and support measures for corporations contributed to mitigating the impact of the crisis. While the size of the packages might have not been large compared to other economies, it followed a relatively long phase of restrictive fiscal policy, increasing its impact. After a surplus of 2.6% of GDP in 2019 the budget turned into a deficit of 4.7% of GDP in 2020. Going forward, the deficit is expected to be significantly lower in 2021 at around 3½% of GDP and 2½% of GDP in 2022 reflecting higher oil-related revenues, leaving some room for a moderate rise in expenditures.

Downside risks to the forecast dominate

Downside risks on the external side are related to uncertainty around oil demand and oil prices as well as further escalation of geopolitical tensions, including the possibility of further sanctions. On the upside, higher oil revenues might boost incomes, consumption and investments more than expected as output restrictions are lifted. Higher demand for technology sectors during the pandemic could result in a more efficient use of technology and therefore in higher productivity growth.

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	-3.0	2.7	2.3
Private Consumption		55436.8	50.4	5.7	3.7	3.3	2.5	-8.5	3.4	1.8
Public Consumption		20141.7	18.3	0.8	2.5	1.3	2.2	4.0	3.0	1.5
Gross fixed capital formation		22545.7	20.5	5.6	4.4	0.4	1.6	-4.3	1.0	1.3
of which: equipment		0.0	:	:	:	:	:	:	:	:
Exports (goods and services)		31157.4	28.3	4.6	5.0	5.5	-2.3	-4.3	6.3	5.8
Imports (goods and services)		22846.7	20.8	7.6	17.3	2.6	3.4	-12.0	3.6	4.5
GNI (GDP deflator)		106607.3	96.9	3.5	1.9	2.7	0.7	-2.0	2.5	2.4
Contribution to GDP growth:	Domestic demand			4.2	3.4	2.1	1.9	-4.4	2.5	1.4
	Inventories			-0.1	0.5	-0.2	0.5	0.9	-0.7	0.1
	Net exports			-0.4	-2.3	0.9	-1.4	1.3	0.9	0.7
Employment				0.9	-0.1	0.3	-0.8	-2.5	0.1	0.4
Unemployment rate (a)				6.4	5.0	4.6	4.4	6.0	5.7	5.7
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	0.6	6.3	3.9
Harmonised index of consumer prices				11.0	3.7	2.9	4.5	3.5	4.7	4.3
Terms of trade goods				0.3	12.6	17.4	-2.4	-14.2	7.8	-0.5
Trade balance (goods) (c)				10.7	7.3	11.7	9.7	7.7	9.9	10.4
Current-account balance (c)				5.9	2.1	6.8	3.8	3.2	5.4	5.8
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				5.3	2.1	6.8	3.8	3.2	5.3	5.8
General government balance (c)				1.7	-0.6	3.2	2.6	-4.6	-3.6	-2.4
Cyclically-adjusted budget balance (d)				:	:	:	:	:	:	:
Structural budget balance (d)				:	:	:	:	:	:	:
General government gross debt (c)				15.0	14.3	13.5	14.0	19.4	20.5	20.9

(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.