38. RUSSIAN FEDERATION

An abrupt fall in real GDP following military aggression against Ukraine and Western sanctions are set to set back output levels by at least a decade, as Russia is forced to change its economic model and move closer to autarchy. In addition, living standards are expected to collapse, accentuating their long-term decline. High commodity prices could somewhat cushion the economic decline and allow for some limited fiscal stimulus.

War puts an end to strong recovery

Improving terms of trade, fiscal support packages, limited lockdowns and higher real wages fuelled a rebound of private consumption in 2021. This, together with strong investment, supported the recovery of the Russian economy, with real GDP growing by 4.7% in 2021. The invasion of Ukraine and the subsequent sanctions implemented by the international community halted these trends abruptly, as Russia was cut off from most Western production inputs. At the same time, inflation, already running high despite an early tightening of the Central Bank of Russia (CBR), shot up as the ruble plunged, the availability of imports deteriorated, supply chains inside Russia were disrupted and demand for imported products temporarily surged.

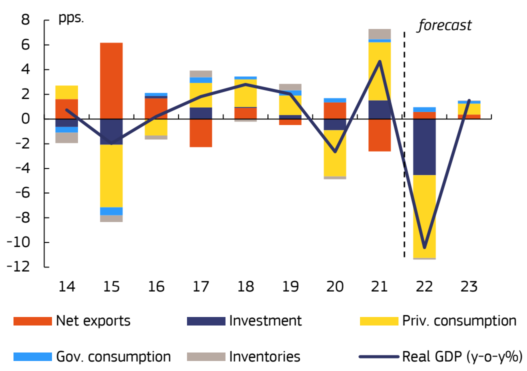
Commodity exports save Russia from economic disaster but the outlook is dire

High inflation expectations, rising job insecurity, a loss of purchasing power and scarcity of imported goods are projected to cause a large fall in private consumption this year. Although government consumption is set to increase moderately and partially stabilize the economy, the fiscal stimulus is expected to be limited to preserve scarce resources. At this point, it is particularly difficult to predict the development in 2022 of export-related revenues, which are a crucial revenue source for the budget.

Private investment is forecast to dramatically fall by more than 20% in 2022, given extremely low appetite for new investment in the current environment amid withdrawal of foreign companies. Isolated pockets of investment to cater for import substitution are likely to emerge in some sectors but investor confidence is projected to remain depressed over the forecast horizon and a modest increase in public investment is not expected to compensate for the fall in private investment.

Imports are set to decline steeply reflecting plummeting private demand due to the deteriorating economic situation and limited access to imported goods due to sanctions and payment restrictions. Existing sanctions and self-sanctioning of the private sector, which hamper market access for Russian goods, are expected to reduce exports, although at a slower rate than imports leading to a modest positive contribution of net exports to growth in 2022. Assuming no escalation of sanctions beyond those in place on 29 April and continued exclusion of energy exports, commodity exports will be the main anchor for the economy in these circumstances. Thanks to high prices and strong demand for commodities, export revenues are projected to be strong, increasing the current account surplus to 14% of GDP in 2022. This will enable the government to support the ruble, vulnerable groups and the economy, limiting the decline in real GDP to 10.4% in 2022.

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



For 2023, the economy is forecast to stabilise as it adjusts to the new normal of severed ties to the West. However, real GDP growth is expected to remain subdued, reaching 1.5%, as ongoing import substitution due to departure of foreign companies will cause inefficiencies. Uncertainty regarding the nature of future economic ties with the rest of the world will continue to hamper investor confidence and seriously limit the growth potential of the economy.

Monetary policy fights for financial stability

Already before the invasion of Ukraine, the CBR increased interest rates by 525 basis points to 9.5% in less than a year. However, in early 2022 inflation was still running high due to rising food prices and the import substitution policy. After the invasion of Ukraine, the CBR reacted quickly and more than doubled its policy rate to 20%. Together with stringent capital flow restrictions and state guarantees for deposits, this was sufficient to stabilise the financial system, but increased headwinds for the economy. Therefore, following appreciation of the ruble to pre-invasion levels, the CBR cut rates in two steps to 14% in April. However, inflation in the first 100 days of the year was sufficient to put inflation at 10% in 2022 even in absence of further price increases. Inflation is projected to exceed 20% in 2022 due to supply side bottlenecks and rising import prices. In 2023, inflation is set subside to 10% as purchasing power declines and consumption patterns change.

Fiscal policy, the card blanche in 2022

In 2021, a combination of continued conservative fiscal policies and rising energy prices, which translated into high fiscal revenues, led to a small budget surplus of ¾% of GDP. The reaction of the fiscal policy to current circumstances is highly uncertain. Still, it is forecast that fiscal revenues will be supported by energy exports while expenditures will increase to support the economy. A projected small deficit of ½% of GDP in 2022 is set to widen to 1½% of GDP in 2023 as easing commodity prices and limited Russian ability to export them curtails revenues. The public debt-to-GDP ratio is projected to increase moderately due to declining GDP. However, at less than 16% of GDP, it is set to remain much lower compared to other emerging market and advanced economies.

Risks to the forecast are exceptionally large

Uncertainties are atypically large in the current circumstances. Downside risks are dominated by trade compression, an accelerating brain drain, stronger-than-expected production disruptions, higher military costs and lower business confidence. Upside risks include higher-than- expected volumes of exports and commodity prices, which would further boost fiscal revenues and support the economic rebound.

Table II.38.1:

Main features of country forecast - RUSSIA

	2021			Annual percentage change						
	bn RUB	Curr. prices	% GDP	02-17	2018	2019	2020	2021	2022	2023
GDP		130312.8	100.0	3.4	2.8	2.0	-3.0	**4.7**	**-10.4**	**1.5**
Private Consumption		63329.6	48.6	5.4	4.2	3.1	-7.3	**9.5**	**-13.8**	**2.0**
Public Consumption		23871.3	18.3	1.0	1.3	2.4	1.9	**1.2**	**2.2**	**1.0**
Gross fixed capital formation		26893.7	20.6	5.2	0.4	1.6	-4.4	**7.0**	**-22.0**	**0.0**
Exports (goods and services)		40204.0	30.9	4.7	5.6	0.7	-4.1	**3.2**	**-16.1**	**3.9**
Imports (goods and services)		27930.4	21.4	7.5	2.7	3.4	-12.1	**16.7**	**-25.8**	**5.4**
GNI (GDP deflator)		127237.5	97.6	3.3	3.0	1.3	-2.2	**4.7**	**-9.7**	**1.6**
Contribution to GDP growth:		Domestic demand		4.1	2.5	2.3	-4.3	**6.5**	**-10.8**	**1.1**
		Inventories		-0.2	-0.5	0.4	-0.2	**0.8**	**-0.1**	**0.0**
		Net exports		-0.4	0.9	-0.5	1.4	**-2.6**	**0.6**	**0.4**
Employment				0.7	0.3	-0.8	-1.9	**1.3**	**-2.2**	**0.3**
Unemployment rate (a)				6.6	4.8	4.6	5.8	**4.8**	**5.9**	**5.6**
Compensation of employees / head				:	:	:	:	**:**	**:**	**:**
Unit labour costs whole economy				:	:	:	:	**:**	**:**	**:**
Saving rate of households (b)				:	:	:	:	**:**	**:**	**:**
GDP deflator				11.4	10.0	3.1	0.9	**16.4**	**26.1**	**7.1**
Consumer price index				9.9	2.9	4.5	3.4	**6.7**	**20.5**	**10.0**
Terms of trade goods				1.3	17.5	-5.7	-22.7	**31.8**	**18.9**	**-13.4**
Trade balance (goods) (c)				10.3	11.8	9.8	6.1	**10.0**	**15.9**	**12.6**
Current-account balance (c)				5.4	7.0	3.9	2.2	**6.7**	**13.7**	**10.1**
General government balance (c)				1.5	3.5	3.7	-3.8	**0.8**	**-0.6**	**-1.5**
Structural budget balance (d)				:	:	:	:	**:**	**:**	**:**
General government gross debt (c)				15.0	13.6	13.8	18.4	**13.5**	**14.6**	**15.6**

(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.