41. RUSSIAN FEDERATION

Russia's economy is set to rebound in 2023 on the back of stronger-than-earlier expected domestic demand underpinned by fiscal stimulus. Nevertheless, reflecting tight monetary policy, growth is projected to ease again in 2024 due to weakening domestic demand (household spending), production bottlenecks, especially labour shortages, and a deteriorating economy's growth potential. The government budget is expected to remain in a deficit and public debt is forecast to slightly increase.

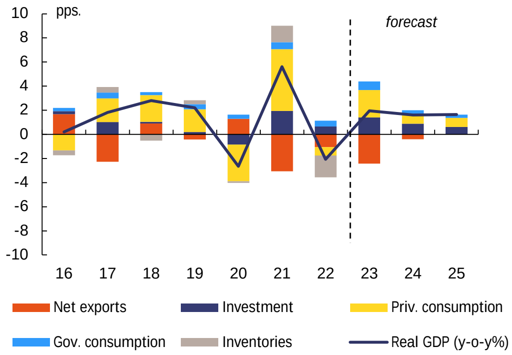
Domestic demand drives the rebound in 2023

After the 2022 contraction, Russia's economy rebounded strongly in the first half of 2023 amid a significant fiscal stimulus for the war-oriented sectors as the war of aggression against Ukraine continued. The government's social programmes and interest rate subsidies, accompanied by rising real wages on the back of a tight labour market, boosted households' spending. Investment picked up too, supported by increased military production and ongoing efforts to establish new trading routes and supply chains. While Russia stopped publishing trade data, the mirror statistics of Russia's trading partners suggest that exports faltered in the first half of the year, while imports recovered as Russia found ways to circumvent some of the trade sanctions.

Economic activity is expected to cool in the second half of 2023 amid slowing domestic demand growth as the government reins in spending and inflation weighs on households' real income, constraining their purchasing power. Russia succeeded in diverting a large share of its exports, especially commodities, to willing buyers, notably China and India. However, voluntary oil production cuts and difficulties in replacing lost European markets for gas are expected to continue limiting the export recovery in the second half of the year. Overall, real GDP is forecast to grow by 2% in 2023.

War economy is set to lose momentum

Graph II.41.1: Russia - Real GDP growth and contributions



Growth in the coming years is expected to continue to be driven by domestic demand but is set to decelerate as capacity bottlenecks kick in. Various surveys suggest that by mid-2023, Russia's capacity utilisation hit historical highs. In addition, companies face labour and skill shortages. The diminishing labour supply due to the pre-war demographic decline has been further aggravated by the war on the back of a partial mobilisation in September 2022 and a large-scale emigration of especially highly skilled people. The unemployment rate fell to a historical low of 3% in July and has remained there since. Although the tight labour market is expected to support wage growth, household consumption is set to decelerate as high interest rates and macroprudential measures are likely to restrain bank lending, which supported household spending in 2023. While public investment projects and further expansion of trading infrastructure towards Asia, are expected to continue, residential construction is projected to slow down amid cooling demand for housing, reflecting tighter monetary policy. The external side is set to contribute negatively given the ongoing dependence of Russia's industries on imports, leading to only a gradual deceleration of imports' growth. The economy's growth is forecast to decline to 1.6% in 2024 and remain broadly unchanged in 2025.

Inflation pressures continue in 2023 before gradually easing

Inflation declined to a three-year low of 2.3% in April, mainly due to base effects, but started accelerating in the following months, fuelled by high wage growth in a tight labour market and the strong recovery of domestic demand (mainly driven by the fiscal expansion). Given the ongoing inflationary pressures and weakening ruble on the back of a shrinking current account surplus, the Central Bank of Russia has hiked its benchmark rate by 750 basis points so far this year to reach 15% in October. Nevertheless, the high (double-digit) growth of producers' prices indicates that inflationary pressures have not yet abated, and consumer inflation is projected to reach 6.0% in 2023. Tight monetary policy and a slowing economy are expected to bring inflation down in the coming years, to 4.6% in 2024 and 4.0% in 2025.

Public finances stabilise, but figures remain in red

After a rapid deterioration at the start of the year, the widening government deficit stabilised in the third quarter, mainly thanks to a slowdown in spending. The revenue downfall due to a plunge in oil and gas prices stopped by September, as strong domestic consumption pulled up non-oil revenues. Nevertheless, the deficit is set to reach 2½% of GDP, exceeding the 2023 target of 2% of GDP, as war-related spending pressures persist. In 2024, defence spending is expected to soar to about 6% of GDP, constituting about one-third of the total budget. Despite this, the budget is set to remain largely under control as the government has proven its ability to address revenue shortfalls through a range of windfall taxes, especially on energy companies. In addition, tax revenues are expected to benefit from rising oil prices, helping the deficit narrow to about 2% of GDP in 2024. Modest GDP growth and conservative fiscal policy are projected to contribute to a further narrowing of the deficit in 2025.

So far, the government has partly covered its financing needs from the National Wealth Fund, which has limited the impact of the latest deficit on public debt. As the government aims to reinstate the temporarily abandoned fiscal rule, which requires saving a part of oil revenues in the Wealth Fund, public debt is set to increase in the coming years, reaching 16% of GDP by 2025.

In the high-uncertainty environment related to war, risks to the growth outlook are tilted to the downside. A faster-than-expected withdrawal of the government's loan support schemes and a stronger pass-through of higher interest rates and other credit growth restricting measures may limit consumption growth. In addition, stronger enforcement of trade sanctions against Russia could limit production in sectors that remain dependent on imports.

Table II.41.1:

Main features of country forecast - RUSSIA

	2022			Annual percentage change						
bn RUB	Curr. prices	% GDP	04-19	2020	2021	2022	2023	2024	2025
GDP	153435.2	100.0	2.9	-2.7	5.6	-2.1	**2.0**	**1.6**	**1.6**
Private Consumption	74110.5	48.3	4.9	-5.9	9.9	-1.4	**4.7**	**1.5**	**1.5**
Public Consumption	27106.3	17.7	0.9	1.9	2.9	2.8	**4.0**	**2.0**	**1.4**
Gross fixed capital formation	31783.7	20.7	4.3	-4.0	9.1	3.3	**6.8**	**3.8**	**2.5**
Exports (goods and services)	43251.7	28.2	3.7	-4.2	3.3	-13.9	**-3.4**	**1.7**	**2.4**
Imports (goods and services)	23913.2	15.6	5.9	-11.9	19.1	-15.0	**9.4**	**4.6**	**3.0**
GNI (GDP deflator)	150385.5	98.0	2.9	-1.8	5.6	-1.7	**1.9**	**1.6**	**1.7**
Contribution to GDP growth:	Domestic demand		3.6	-3.5	7.5	0.7	**4.4**	**2.0**	**1.6**
	Inventories		-0.1	-0.1	1.4	-1.8	**0.0**	**0.0**	**0.0**
	Net exports		-0.4	1.3	-3.1	-1.1	**-2.4**	**-0.4**	**0.0**
Employment			0.5	-1.9	1.3	0.4	**-0.1**	**0.3**	**0.3**
Unemployment rate (a)			6.2	5.8	4.8	3.9	**3.2**	**3.4**	**3.7**
Compensation of employees / head			:	:	:	:	**:**	**:**	**:**
Unit labour costs whole economy			:	:	:	:	**:**	**:**	**:**
Saving rate of households (b)			:	:	:	:	**:**	**:**	**:**
GDP deflator			10.4	0.9	19.0	15.8	**3.6**	**4.3**	**4.1**
Consumer price index			8.5	3.4	6.7	13.7	**6.0**	**4.6**	**4.0**
Terms of trade goods			1.5	-22.9	35.2	27.1	**-14.7**	**-2.3**	**-1.9**
Trade balance (goods) (c)			10.0	6.2	10.3	13.6	**7.9**	**7.1**	**6.7**
Current-account balance (c)			5.1	2.4	6.7	10.4	**3.9**	**3.1**	**2.7**
General government balance (c)			1.9	-2.8	2.4	-2.2	**-2.5**	**-1.9**	**-1.7**
Structural budget balance (d)			:	:	:	:	**:**	**:**	**:**
General government gross debt (c)			12.6	19.2	16.5	14.7	**14.9**	**15.4**	**16.0**

(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.