RUSSIA: Self-inflicted stagnation

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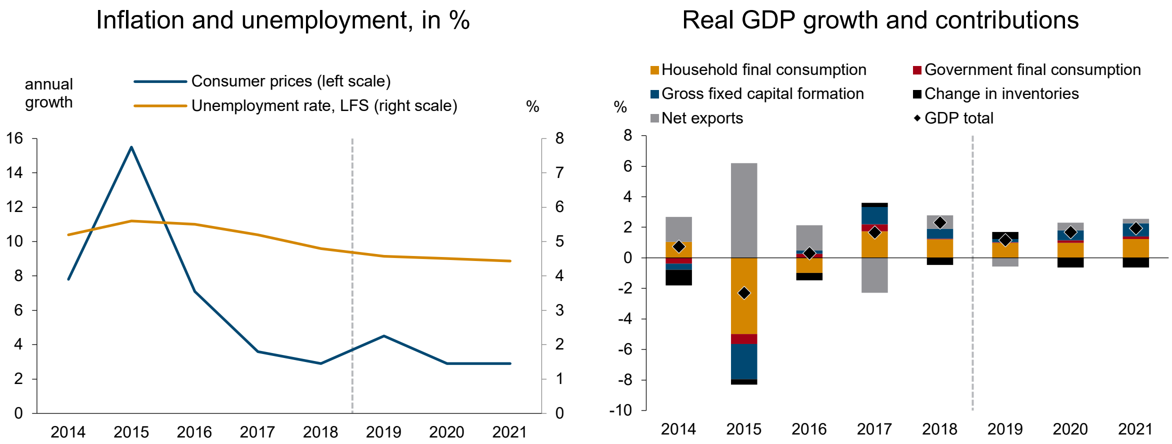
Growth in the first half of the year decelerated sharply, largely on account of weaker investment activity and declining net exports. Private consumption remains weak, constrained not least by the tight fiscal policy, although monetary policy has been softened in response to recent disinflation. Even with the planned start of infrastructure projects and increased social spending, it is difficult to see the Russian economy growing above 2% p.a. in the medium term.

Figure 5.18 / Russia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

In the second quarter of 2019, economic growth picked up to 0.9% year-on-year from 0.5% in the first quarter. This was to a large extent due to the basis effect: the second quarter of 2018 saw a moderation of government spending after the presidential elections held in April. Still, GDP growth in the first half of 2019 was only 0.7% - a marked slowdown compared to the first half of last year (+2.1%), largely on account of weaker investment activity and declining net exports. Viewed from the supply side, growth was driven primarily by extraction industry (+3.8%), while manufacturing rose by only 0.6%, construction was flat, and agriculture and trade declined by 0.4% and 1.8% respectively (all in value-added terms). Overall, the growth performance of the Russian economy remains lacklustre and on an annual basis it is the second worst in the CESEE region (after Turkey).

The main reason for the lacklustre growth performance has been flat domestic demand. In January-August, the retail trade turnover picked up by only 1.5%, while the volume of market services to households declined by 1%. The weakness of private consumption is hardly surprising given the ongoing downward trend in incomes. Real disposable incomes of households have been declining almost invariably since 2014 (by around 9% in total between 2014 and 2018) and dropped by another 1.3% (yoy) in the first half of this year. Investment dynamics remains disappointing as well. In the first half of 2019, gross fixed capital formation dropped by 0.5% (after a relatively strong 2.9% growth last year). The reluctance to invest may come across as surprising, given the strong rise in corporate profits (by 37% in nominal terms in the first five months of the year), and is partly due to the low levels of capacity utilisation.[24]

The weakness of consumer demand has contributed to fast disinflation… CPI jumped markedly at the start of the year (by 1 pp in January alone) because of the hike in the VAT rate from 18 to 20%. However, given the weak domestic demand, businesses found it ultimately difficult to shift the entire burden of higher VAT taxation on consumers, and price growth has been progressively losing momentum. By September, CPI inflation declined to 4% on an annual basis, matching the 4% inflation target of the Central Bank.

… prompting the Central Bank to cut the policy rate. Over the past few months, the latter was cut in three steps by a combined 75 basis points, to 7%. This should lower the interest rates on loans and thus ease the financial burden on borrowers, but may also fuel credit demand which is already running high, especially for consumer credit. Although the peak of credit expansion to households appears now to have been passed, it still hovers at around 23% on an annual basis. 57% of the stock of household loans is accounted for by consumer credit, typically at high interest rates of around 10%. Coupled with (at best) stagnant real incomes, fast credit expansion at high interest rates results in a growing share of incomes being spent on servicing debt, with potential sustainability risks in the medium term. This danger is well acknowledged by the authorities, which have recently tightened regulations on consumer lending.[25]

High credit growth is driven above all by the necessity to make up for the falling incomes, which are constrained not least by the tight fiscal policy. In the first half of 2019, general government budget surplus reached 5.2% of GDP – 2 pp more than in the first half of 2018, reflecting a strong fiscal consolidation effort. On top of that, the sovereign National Welfare Fund (NWF), which accumulates 'windfall' profits from energy exports, reached 7.6% of GDP by 1 August – the highest level in the past three years.[26] The tight fiscal policy is meant to reduce further the public debt to GDP ratio (from the already very low level of 12%) and make the Russian economy even more resilient to western sanctions. However, the current fiscal stance appears to be overly restrictive, weighing heavily on growth. It is conceivable that the government would have room for some fiscal relaxation without jeopardising stability or resilience – for instance, by borrowing domestically.

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24 According to the assessment by the Institute of Economic Forecasting of the Russian Academy of Sciences, capacity utilisation stands at around 80% in extractive industries, less than 65% in the production of consumer goods, and around 50% in the production of investment goods.

25 As of 1 July 2019, the authorities introduced caps on the interest rates charged on short-term consumer loans by micro-financial organisations (at maximum 1% per day) and on the volume of the overall debt repayment (the latter cannot exceed twice the size of the original loan). Besides, as of 1 October banks need to take into account the 'coefficient of credit burden' when taking a lending decision.

26 Under the new 'fiscal rule', any revenue from oil prices higher than USD 41.6 per barrel is being accumulated in the NWF. This year, oil prices have been generally hovering at USD 60-70 per barrel, translating into ample liquidity inflows into the NWF.

The contribution of net exports to GDP growth has declined, but external surplus remains solid. In the first nine months of 2019, imports of goods stagnated, while goods exports declined by 5% (in US dollar terms) on account of lower oil prices and Russia's oil supply cuts commitments within the framework of the OPEC+ deal. These trends were largely mirrored in the dynamics of real exports and imports, resulting in declining contribution of net exports (of goods and services) to GDP growth. However, the trade and current account surpluses remain comfortably high. The latter reached USD 57 billion in January-September 2019, contributing to the growth of foreign exchange reserves by USD 51 billion over the same time period. By the end of September, the stock of Russia's foreign exchange reserves reached USD 532 billion, corresponding to 19 months of imports (of goods and services) and making the country the fourth largest holder of foreign exchange globally. Similarly to tight fiscal policy, the accumulation of forex reserves is part of the government strategy to withstand western sanctions and reduce external vulnerability.

In August, the US announced a new package of sanctions against Russia, formally linked to the attempted poisoning of former Russian-British double agent Sergei Skripal and his daughter in the UK last year. The direct impact of the newly imposed sanctions will be at best limited. They prohibit assistance by international financial organisations (which Russia hardly needs anyway), ban the purchase of Russian sovereign debt by US banks in the primary (but not in the secondary) market, and restrict exports of selected technological products from the US to Russia. Similarly to earlier sanctions packages, the main damage to the Russian economy is likely to be indirect, contributing to higher perceived risks (not only in the US) of doing business with Russia and limiting the inflows of foreign investment. Meanwhile, the EU has been refraining from imposing additional sanctions on Russia, although those imposed back in 2014 have been regularly prolonged so far.

The local elections held in September 2019 exposed cracks in the popular support of the ruling United Russia party. This was most visible in the Moscow city council, where the party lost nearly half of its seats and retained only a thin majority. This, and especially a recent wave of popular protests across the country, is a manifestation of the declining popularity of the incumbent authorities, fuelled in part by the economic stagnation and the falling living standards. The authorities' response to the growing popular discontent has been mixed, ranging from brutal crackdowns on protests to selected concessions, including a release of several high-profile detainees, whose arrests had been widely perceived to be politically-driven. In the medium run, keeping popular dissatisfaction in check will almost certainly require noticeable economic improvements – something which is currently not in sight.

After a dip in 2019, economic growth will likely pick up somewhat over the next few years. In the second half of 2019, economic dynamics is likely to improve somewhat. However, given the weak first half, our growth forecast for the year as a whole has been cut once again: by 0.2 pp compared to the summer forecast, to 1.1%. Over the next two years, growth is projected to speed up a bit thanks to the planned implementation of large-scale infrastructure and other 'national' projects (such as in health care, education, etc.) in line with the development targets, which aim at making Russia one of the five biggest world economies by 2024 – the year of next presidential elections. However, even with a modest additional fiscal stimulus, economic growth will likely stay below 2% p.a., owing to structural bottlenecks (especially institutional weaknesses) and the difficult geopolitical climate. The overall economic policy mix will remain by and large restrictive, prioritising stability and resilience against western sanctions over growth. At the projected growth pace, Russia will continue falling behind in the global economic context.

Russia's economic prospects are dependent on how the geopolitical conflict with the West evolves. The recent signs of détente with Ukraine following the change in the Ukrainian leadership earlier this year have been encouraging. However, the implementation of the Minsk agreement on the status of Donbas – a crucial pre-condition for easing EU sanctions on Russia – will not be an easy process, given the strong opposition to it in large parts of the Ukrainian society. Besides, US sanctions will likely stay in place regardless, constraining the inflows of investments into Russia and the badly needed modernisation and restructuring of its economy.

Table 5.18 / Russia: Selected economic indicators

	2015	2016	2017	2018 1)	2018 January-June	2019 January-June	2019 Forecast	2020 Forecast	2021 Forecast
Population, th pers., average	146,406	146,675	146,842	146,831	146,836	146,748	146,750	146,700	146,700
Gross domestic product, RUB bn, nom.	83,094	86,014	92,101	103,876	47,262	50,675	111,400	117,800	124,900
annual change in % (real)	-2.3	0.3	1.6	2.3	2.1	0.7	1.1	1.7	1.9
GDP/capita (EUR at PPP)	18,100	17,500	18,200	19,500	.	.	.	.	.
Consumption of households, RUB bn, nom.	43,242	45,317	48,136	50,851	23,991	25,740	.	.	.
annual change in % (real)	-9.4	-1.9	3.3	2.3	2.3	2.2	2.0	2.0	2.5
Gross fixed capital form., RUB bn, nom.	17,326	18,911	20,571	22,237	8,371	9,113	.	.	.
annual change in % (real)	-10.7	1.0	5.2	2.9	3.9	-0.5	1.0	3.0	4.0
Gross industrial production 2)									
annual change in % (real)	-0.8	2.2	2.1	2.9	3.0	2.5	2.7	3.0	4.0
Gross agricultural production									
annual change in % (real)	2.6	4.8	2.4	-0.6	2.0	1.2	.	.	.
Construction output 3)									
annual change in % (real)	-4.8	-2.1	-1.2	5.3	6.2	0.1	.	.	.
Employed persons, LFS, th, average 4)	72,324	72,393	72,142	72,532	72,250	71,519	71,800	72,000	72,200
annual change in %	-0.4	0.1	-0.3	0.3	0.5	-1.0	-1.0	0.3	0.3
Unemployed persons, LFS, th, average 4)	4,264	4,243	3,967	3,658	3,733	3,522	3,440	3,400	3,350
Unemployment rate, LFS, in %, average 4)	5.6	5.5	5.2	4.8	4.9	4.7	4.6	4.5	4.4
Reg. unemployment rate, in %, eop 4)5)	1.3	1.2	1.0	0.9	0.9	1.0	.	.	.
Average monthly gross wages, RUB 6)	34,030	36,709	39,167	43,445	42,522	46,159	46,500	49,300	52,800
annual change in % (real, gross)	-9.0	0.7	2.9	6.8	9.2	3.2	2.5	3.0	4.0
Consumer prices, % p.a.	15.5	7.1	3.6	2.9	2.4	5.2	4.5	2.9	2.9
Producer prices in industry, % p.a. 7)	13.5	4.2	7.7	11.9	8.5	7.8	5.0	4.0	4.0
General governm.budget, nat.def., % of GDP									
Revenues	32.4	32.8	33.7	35.9	35.5	36.7	37.0	37.0	37.0
Expenditures	35.8	36.4	35.2	33.0	32.3	31.5	33.0	35.0	37.0
Deficit (-) / surplus (+)	-3.4	-3.7	-1.5	2.9	3.2	5.2	4.0	2.0	1.5
General gov.gross debt, nat.def., % of GDP	13.2	12.9	12.6	12.1	11.6	12.2	12.0	11.0	10.0
Stock of loans of non-fin.private sector, % p.a.	7.6	-6.9	3.5	13.9	8.5	11.4	.	.	.
Non-performing loans (NPL), in %, eop 8)	5.3	5.2	5.2	4.7	5.4	5.7	.	.	.
Central bank policy rate, % p.a., eop 9)	11.00	10.00	7.75	7.75	7.25	7.50	6.75	6.25	6.00
Current account, EUR mn 10)	60,952	22,094	28,726	96,254	39,419	39,182	76,200	92,500	96,400
Current account, % of GDP	5.0	1.9	2.1	6.8	6.0	5.7	5.1	5.9	6.0
Exports of goods, BOP, EUR mn 10)	307,040	254,371	312,779	375,946	173,758	180,648	375,900	394,700	414,400
annual change in %	-18.2	-17.2	23.0	20.2	13.0	4.0	0.0	5.0	5.0
Imports of goods, BOP, EUR mn 10)	173,585	172,911	211,161	210,995	99,852	104,203	222,100	228,700	240,200
annual change in %	-25.4	-0.4	22.1	-0.1	1.1	4.4	5.3	3.0	5.0
Exports of services, BOP, EUR mn 10)	46,418	45,729	51,050	54,828	25,287	27,088	57,700	60,600	63,600
annual change in %	-6.6	-1.5	11.6	7.4	1.3	7.1	5.2	5.0	5.0
Imports of services, BOP, EUR mn 10)	79,829	67,363	78,716	80,227	37,071	39,639	86,100	90,400	96,800
annual change in %	-12.7	-15.6	16.9	1.9	0.4	6.9	7.3	5.0	7.1
FDI liabilities, EUR mn 10)	6,163	29,381	25,296	7,453	8,385	14,622	27,000	.	.
FDI assets, EUR mn 10)	19,861	20,149	32,559	26,620	15,084	12,703	26,000	.	.
Gross reserves of NB excl. gold, EUR mn 10)11)	292,467	301,871	297,823	333,617	325,521	367,192	.	.	.
Gross external debt, EUR mn 10)	474,121	486,489	433,412	397,516	422,012	421,436	391,400	377,000	352,300
Gross external debt, % of GDP	38.7	42.0	31.0	28.3	30.0	28.0	26.0	24.0	22.0
Average exchange rate RUB/EUR	67.76	74.26	65.87	73.87	71.81	73.83	74.0	75.0	78.0

Note: Including Crimean Federal District (growth rates for LFS employment and real wages from 2016).

1) Preliminary. - 2) Excluding small enterprises. - 3) In 2015 according to NACE Rev.1. - 4) From 2018 population 15+, population 15-72 before. - 5) In % of labour force (LFS). - 6) From 2017 improved coverage of small enterprises. - 7) Domestic output prices. - 8) According to Russian Accounting Standards overdue debt is defined as debt service overdue, therefore the data are not fully comparable with other countries. - 9) One-week repo rate. - 10) Converted from USD. - 11) Including part of resources of the Reserve Fund (until 2017) and the National Wealth Fund of the Russian Federation.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.