

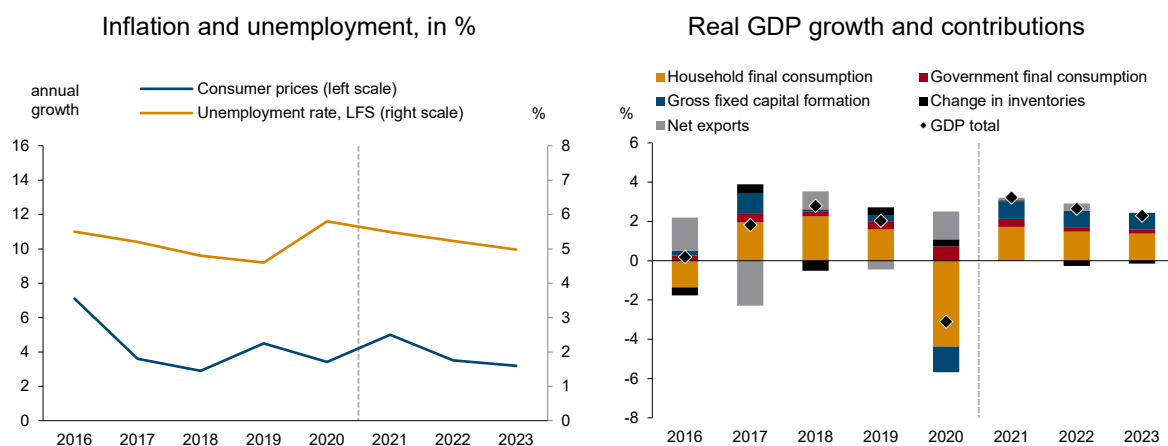


RUSSIA: Recession contained at the expense of health outcomes

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Few restrictions in response to the second wave of the pandemic have resulted in a sharp rise in infections and deaths, but have also mitigated the extent of economic downturn. GDP declined by only 3.1% last year, of which 1 pp was due to oil production cuts. In the baseline scenario, we project a recovery of 3.2% this year, while growth should gradually revert to the long-term average of around 2% in the years thereafter.

Figure 4.18 / Russia: Main macroeconomic indicators



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

Russia has been hard hit by the COVID-19 pandemic, especially its second wave which broke out in autumn 2020. Officially, the number of COVID-related deaths in 2020 was put at around 58 thousand. However, excess mortality (compared to 2019), which rose sharply by the end of the year, reached 324 thousand, suggesting that the true situation was likely much worse.²⁵ High mortality was the main reason for the natural decline in population by nearly 700 thousand last year – the steepest decline recorded since 2005. It also implies that at the time of writing this report, more than half of the Russian population may have already contracted the virus, which is not far from the threshold required for herd immunity. This may partly explain why the number of new infections has been declining in the past few months, despite lax restrictions and the sluggish vaccination campaign.²⁶ The latter is all the more surprising, since Russia has been a front-runner in developing COVID-19 vaccines, three of which are now officially registered in the country, and the country has signed a number of export contracts.

²⁵ According to official statements, 80% of excess mortality should be attributed to COVID-19.

²⁶ Another reason may be that COVID-19 mutations have not (yet) spread much in Russia, unlike elsewhere in Europe.

The high pandemic toll has been partly due to government policies which prioritised the economy over public health. Unlike during the first wave of the pandemic, the restrictions imposed during the second wave were generally very mild (albeit varying by region). No general lockdown was imposed, and even restaurants remained largely open. Mainly thanks to this, real GDP decline was contained at 3.1% last year. Besides, around 1 pp of this decline was not due to the pandemic per se but to oil production cuts under the OPEC++ deal, which was agreed in May 2020 (value-added in the mining sector dropped by 10.2% as a result). The structure of the economy played a role as well: the small business sector, which has been the worst affected by the pandemic, accounts for only 20% of GDP, compared to 55-60% in the advanced economies.

Private consumption was the main drag on GDP growth last year: it plunged by 8.6%, reflecting lower incomes, rising saving propensity, and increased uncertainty. The decline of other final demand components was less spectacular: gross fixed capital formation dropped by 6.2% and real exports of goods and services by 5.1% - much less than imports (-13.7%), resulting in a positive contribution of net exports of 1.4 pp to headline GDP growth. Public consumption went up by 4% on account of increased social spending and other anti-crisis measures. Across sectors, the sharpest decline in value-added was registered unsurprisingly in hospitality and catering (-24.1%), followed by entertainment (-11.4%) and transportation (-10.3%). The dynamics in agriculture, manufacturing and construction were flat, while the financial sector emerged as the biggest winner of the pandemic (+7.9%).

Despite the positive contribution of real net exports, external balances deteriorated last year on account of the oil price shock. Nominal exports of crude oil, oil products and natural gas plummeted by 41%, 34% and 40% in US dollar terms, respectively, while exports of other goods were unchanged. This led to a situation for the first time in modern Russian history when the share of hydrocarbons in the structure of Russian exports fell below 50%. (This is however not a sustainable situation, as this share will rebound back this year in line with much higher energy prices.) Another interesting development was that for the first time Russia recorded a trade surplus in food: agriculture has been an undisputed success story over the past years, hugely benefitting from Russian counter-sanctions on western food imports imposed in 2014. Still, because of the oil price shock, overall exports of goods contracted by 21% last year, whereas imports only by 6%. The trade deficit in services improved especially because of a sharp drop in foreign travel, but this was not enough to prevent a deterioration in the current account. The current account surplus halved in absolute terms and was over-compensated by net capital outflows.

With the government package of a mere 4% of GDP, Russia's fiscal response to the pandemic has been rather modest, both by international comparison and given the country's excellent fiscal fundamentals. Also, it has differed in several important ways from the measures adopted in the EU. The bulk of wage support to businesses was channelled in the form of subsidised credit rather than subsidies, and there has been no short-time work scheme akin to that implemented in EU countries. Besides, many of the support programmes were not prolonged after 1 October 2020. Nevertheless, government expenditures went up by 13% in nominal terms last year, and the budget closed the year with a deficit of 4% of GDP (after a surplus of 1.9% recorded in 2019), covered primarily by domestic borrowing. Thanks to government support measures, the decline in the overall wage bill was contained at 1% (despite a nearly 2% drop in employment), and social transfers increased by 7.6% (both in real terms). Other types of household income did not fare as well: income from property and entrepreneurship and 'other', essentially grey, income (which has a high weight) contracted at double-

digit rates. All in all, real disposable incomes shrank by 3.5% last year (while they posted modest growth in the euro area).

Inflation has risen markedly over the past few months, largely on account of food prices. On an annual basis, consumer price inflation climbed to 5.7% in February – far above the 4% inflation target. The main reason has been a sharp increase in food prices (+7.7% year on year in February), prompting the authorities to impose export restrictions and urge producers and retailers to set ‘voluntary’ price caps on selected products such as butter, sugar, and poultry.²⁷ Besides, the pass-through from last year’s rouble depreciation, disruptions in supply chains because of COVID restrictions and higher transportation costs on account of higher oil prices have pushed up input prices, which have been shifted to consumers given the improved demand conditions. Due to the acceleration of inflation, the policy interest rate turned negative in real terms by the end of last year, prompting the Central Bank to end its earlier easing cycle.²⁸ In March, it raised the policy rate by 25 bp, to 4.5%, and further hikes are likely in the remainder of the year, bringing monetary policy more in line with its usual hawkish stance. At the same time, since most of the factors which have caused the recent spike in inflation are of a one-off nature, it will probably subside regardless, to around 4% by the end of the year.

The latest high-frequency data suggest that the economic recovery has been gaining momentum. The Purchasing Managers Index has recovered to pre-pandemic levels and is comfortably hovering above the 50-line, which separates expansion from contraction. Inventories accumulated during the acute phase of the pandemic have been depleted to meet rising demand, and employment in the services sector marginally expanded in February for the first time in six months. However, on an annual basis retail trade turnover in January-February was still marginally negative (-0.7%), household services were down by 7.4% and gross industrial production down by 2.8%, held back especially by mining (-8.1%) on account of the still binding OPEC++ quotas. Economic growth will only turn positive on an annual basis starting from the second quarter of 2021, helped by the low statistical base.

For 2021 as a whole the economy is projected to rebound by 3.2% in the baseline scenario, which assumes no further lockdowns. The recovery will be driven primarily by domestic demand, while the contribution of net exports will likely turn negative. Higher oil prices, now projected to average some USD 65 per barrel, will support the Russian rouble and domestic demand, export volumes will be still constrained by the OPEC++ restrictions, which will be eased only gradually (although Russia, along with Kazakhstan, has negotiated some increase in its oil production compared to the previous quota). In the medium term, growth should gradually revert to the long-term average of around 2%, as the long-standing (above all institutional) structural bottlenecks become increasingly binding. The deadline for the implementation of ‘national projects’ – flagship government programmes in a wide range of areas, from infrastructure to demography – has now been pushed back from 2024 to 2030 because of the pandemic.

The Navalny case has exposed social tensions and marks another low point in Russia-Western relations. The recent arrest of the opposition politician and corruption fighter Alexey Navalny (who received a 2.8-year prison sentence) has triggered a wave of mass protests, the largest Russia has seen in a decade. They also had an economic component and were a manifestation of the dismal living standards of the population, whose real incomes have plunged by nearly 11% since 2013. In response to the Navalny

²⁷ The bird flu epidemic in poultry farms in southern Russia and some other European countries has played a role as well.

²⁸ Last year the policy rate was cut by a total of 175 basis points, and credit to the real economy picked up by 12.4% in nominal terms.

case, the EU and the US have announced new sanctions on Russia, targeting selected high-ranking officials and research institutes believed to be involved in the case. Besides, the possibility of US sanctions against Russian sovereign debt (which were dropped by the previous Trump administration over concerns about their broader economic impact) is reportedly on the agenda again. On a positive note, the change in the US administration has enabled a speedy prolongation of the Strategic Arms Reduction Treaty (START) with Russia for another five years, which reduces the chances of a renewed nuclear arms race. But apart from that, it is hardly realistic to expect any improvement in Russia-Western relations in the near term, let alone their return to the pre-Ukraine crisis state.²⁹

²⁹ In the wiiw Monthly Report from January 2021, Tatiana Romanova outlines five reasons why one should not expect an improvement in EU-Russia relations anytime soon: <https://wiiw.ac.at/monthly-report-no-1-2021-p-5546.html>

Table 4.18 / Russia: Selected economic indicators

	2017	2018	2019	2020 ¹⁾	2021	2022	2023
					Forecast		
Population, th pers., average	146,842	146,831	146,765	146,493	146,400	146,450	146,500
Gross domestic product, RUB bn, nom.	91,843	103,862	109,193	106,607	117,200	125,100	132,600
annual change in % (real)	1.8	2.8	2.0	-3.1	3.2	2.7	2.3
GDP/capita (EUR at PPP)	17,800	18,770	18,880	18,600	.	.	.
Consumption of households, RUB bn, nom.	48,178	51,884	55,440	52,374	.	.	.
annual change in % (real)	3.7	4.3	3.2	-8.6	3.5	3.0	2.8
Gross fixed capital form., RUB bn, nom.	20,189	21,452	23,088	22,761	.	.	.
annual change in % (real)	4.7	0.6	1.5	-6.2	4.2	4.0	4.0
Gross industrial production ²⁾							
annual change in % (real)	3.7	3.5	3.3	-2.9	2.5	2.5	2.2
Gross agricultural production							
annual change in % (real)	2.9	-0.2	4.3	1.5	.	.	.
Construction output							
annual change in % (real)	-1.2	5.3	2.1	0.1	.	.	.
Employed persons, LFS, th, average ³⁾	72,142	72,532	71,933	70,601	70,600	70,650	70,700
annual change in %	-0.3	0.3	-0.8	-1.9	0.0	0.1	0.1
Unemployed persons, LFS, th, average ³⁾	3,967	3,658	3,465	4,321	4,100	3,900	3,700
Unemployment rate, LFS, in %, average ³⁾	5.2	4.8	4.6	5.8	5.5	5.2	5.0
Reg. unemployment rate, in %, eop ⁴⁾	1.0	0.9	0.9	3.7	.	.	.
Average monthly gross wages, RUB	39,167	43,724	47,867	51,083	55,700	59,700	63,500
annual change in % (real, gross)	2.9	8.5	4.8	3.2	4.0	3.5	3.0
Consumer prices, % p.a.	3.6	2.9	4.5	3.4	5.0	3.5	3.2
Producer prices in industry, % p.a. ⁵⁾	7.7	12.1	2.0	-3.8	8.0	4.5	4.0
General government budget, nat.def., % of GDP							
Revenues	33.8	35.9	36.2	35.5	36.0	36.0	36.0
Expenditures	35.3	33.0	34.2	39.5	38.5	37.5	37.0
Deficit (-) / surplus (+)	-1.5	2.9	1.9	-4.0	-2.5	-1.5	-1.0
General gov.gross debt, nat.def., % of GDP	12.6	12.1	12.4	17.8	19.7	20.0	20.0
Stock of loans of non-fin.private sector, % p.a.	3.5	13.9	6.5	12.4	.	.	.
Non-performing loans (NPL), in %, eop ⁶⁾	5.9	5.3	6.0	6.1	.	.	.
Central bank policy rate, % p.a., eop ⁷⁾	7.75	7.75	6.25	4.25	5.00	5.50	5.50
Current account, EUR m ⁸⁾	28,504	98,142	57,861	28,443	43,700	51,900	55,300
Current account, % of GDP	2.0	7.0	3.8	2.2	3.2	3.6	3.6
Exports of goods, BOP, EUR m ⁸⁾	312,636	376,612	374,854	288,369	320,900	340,200	353,800
annual change in %	22.9	20.5	-0.5	-23.1	11.3	6.0	4.0
Imports of goods, BOP, EUR m ⁸⁾	211,161	211,127	227,313	210,128	219,200	228,000	237,100
annual change in %	22.1	0.0	7.7	-7.6	4.3	4.0	4.0
Exports of services, BOP, EUR m ⁸⁾	50,970	54,845	55,275	38,945	42,600	44,700	46,900
annual change in %	11.5	7.6	0.8	-29.5	9.4	4.9	4.9
Imports of services, BOP, EUR m ⁸⁾	78,716	80,366	88,081	54,961	62,800	65,900	69,200
annual change in %	16.9	2.1	9.6	-37.6	14.3	4.9	5.0
FDI liabilities, EUR m ⁸⁾	25,296	7,453	28,548	1,200	.	.	.
FDI assets, EUR m ⁸⁾	32,559	26,620	19,574	5,500	.	.	.
Gross reserves of CB excl. gold, EUR m ⁸⁾⁹⁾	297,823	333,617	396,378	372,318	.	.	.
Gross external debt, EUR m ⁸⁾	433,606	397,860	438,727	382,979	388,400	400,000	408,600
Gross external debt, % of GDP	31.1	28.3	29.1	29.6	28.5	27.5	26.5
Average exchange rate RUB/EUR	65.87	73.87	72.51	82.39	86.0	86.0	86.0

Note: Including Crimean Federal District.

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

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