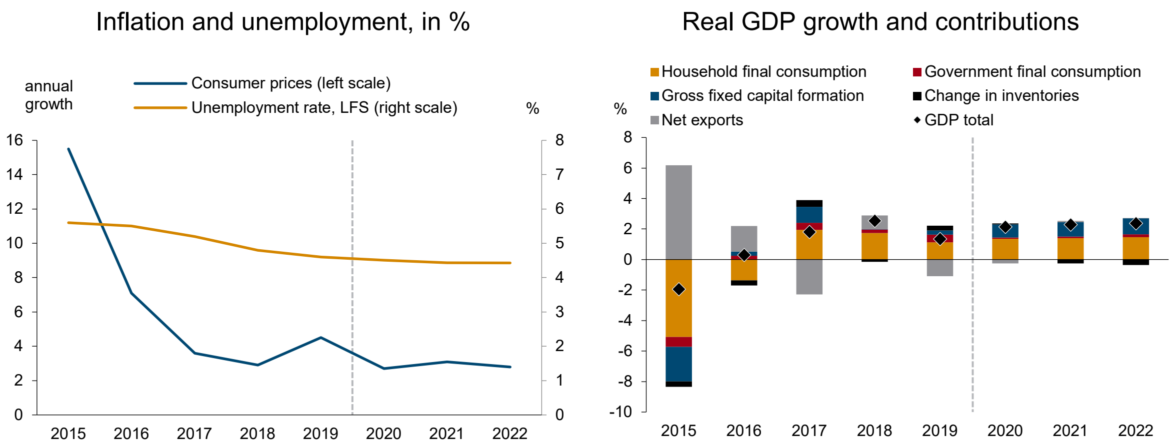
RUSSIA: A shift to pro-growth policies

VASILY ASTROV

Last year, growth slowed to a mere 1.3% on the back of weakening private consumption and export decline. However, following a recent shift to a more expansionary fiscal and monetary policy, GDP growth is expected to pick up to above 2% in 2020-2022. The constitutional changes recently proposed by President Putin suggest that he will not seek another re-election in 2024, although he will likely retain his political influence in a different capacity.

Figure 6.18 / Russia: Main macroeconomic indicators



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

On 15 January 2020, Russian politics reverberated with President Putin's announcement of constitutional amendments and the subsequent resignation of the government headed by Dmitry Medvedev. The proposed constitutional amendments (still to be formally approved in a popular referendum scheduled for April) include, most importantly, a prohibition on more than two presidential terms for the same person and a partial shift of presidential powers to parliament, which would obtain the right to form the government. These amendments suggest that Mr Putin will not seek re-election in 2024 (which he is not allowed to do anyway under the current constitution), but will – like Kazakhstan's president, Nursultan Nazarbayev – try to retain political influence in a different capacity, possibly as head of the State Council, whose status will be upgraded from its current advisory role.

The government resignation is to be seen in the context of Russia's mounting economic and social problems. With the effects of foreign policy achievements (Crimea, Syria) gradually fading, domestic economic and social problems have been coming increasingly to the fore. These have undermined support for the ruling party United Russia (which has become deeply unpopular) and were a major factor behind the wave of last year's popular protests. By and large, the Russian economy has adapted to the environment of sanctions reasonably well, and the agricultural sector, in particular, has even benefited from them, raising its output by a cumulative 15% since 2015. Macroeconomic stability and resilience to Western sanctions have crucially been helped by Russia's continuous foreign debt deleveraging and persistent external surpluses (as well as budget surpluses in the past two years), while inflation has been declining rapidly. However, these achievements have come at the expense of dismal growth performance and falling incomes. Over the five-year period 2015-2019, real GDP picked up by only 3.9%. Consumption-oriented sectors, such as the retail trade, have suffered most, mirroring the decline in real disposable incomes by a cumulative 7.5% over the same period (although real disposable incomes recovered by 0.8% last year). Parallel to that, poverty has been on the rise and now affects 14% of the population.

In 2019, real GDP growth slowed to a mere 1.3% (from 2.5% in 2018), albeit with some marked acceleration in the course of the year: from 0.7% in the first half of 2019 to 1.7% in the third quarter and over 2% in the fourth quarter, year on year. The main reasons for the slowdown were weakening private consumption (which grew by only 2.3%, compared with 3.3% in 2018) and declining (net) exports. Real exports (of goods and services) dropped by 2.1%, while real imports still recorded a 2.2% increase. The decline in net exports was partly due to rouble appreciation (by 2.5% in real effective terms). In nominal terms, the drop in merchandise exports last year (of 5.7% on a US dollar basis) was also due to a 9% decline in the oil price. By contrast, gross fixed capital formation rebounded by 1.4% after near-stagnation the year before, while the growth in public consumption accelerated to 2.8% (from 1.3% in 2018). On the supply side of the economy, financial services soared by nearly 10% in value-added terms last year, with all other sectors lagging far behind. Besides, the share of the extractive industry in GDP went up at the expense of manufacturing – contrary to the government's stated diversification goals.

The main task of the new government of Prime Minister Mikhail Mishustin is to boost economic growth, which should also help tackle social problems. This would be a welcome policy change: as we have argued on several occasions,[39] Russia's fiscal stance over the past few years has been overly restrictive and a drag on economic growth. To this end, the government is planning to step up the implementation of 12 'national projects', with envisaged combined allocations of RUB 25.7 trillion (some 23% of GDP) up until 2024 – the year of the next presidential elections. The concept of national projects dates back to 2018 and envisages increased government spending on infrastructure and social issues;[40] but their implementation has so far been lagging behind.

The planned fiscal stimulus is to be financed from the current budget, as well as by tapping the National Welfare Fund (NWF). In January, state expenditure was already surging by 53% year on year (albeit starting from a low basis), which may be interpreted as the first evidence of fiscal loosening. In addition to the current allocations, the government is reportedly planning to tap the unused funds from previous years, worth some 1% of GDP. As for the NWF (which accumulates windfall proceeds from energy exports), its size had reached 7.1% of GDP by 1 January. The planned allocations from the NWF for national projects for 2020-2023 are reportedly to the tune of 0.3% of GDP per year. Another 0.3% of GDP per year is to be used for social spending (such as maternal capital), financed via the purchase of a 50% stake in Sberbank from the Central Bank, using NWF funds, with the Central Bank sharing part of the proceeds with the government.[41] Thus, the overall fiscal stimulus should be at least some 0.6% of

39 See, for instance, 'Russia: Self-inflicted stagnation', wiiw Forecast Report, Autumn 2019, pp 105-109.

40 More specifically, the 12 areas targeted by national projects include demography, health care, education, living conditions, ecology, roads, labour productivity, science, digital economy, culture, small business, and international cooperation.

41 Such a scheme should allow the 'budget rule' to be circumvented; this prohibits windfall oil revenues being used for current spending until the *liquid* part of the NWF reaches 7% of GDP (which is currently not yet the case).

GDP per year for 2020-2023, and possibly larger, although this obviously depends on progress in implementation of the planned measures.

Monetary policy has become more pro-growth, too. Since summer 2019, the Central Bank has cut its main policy interest rate by a combined 1.75 percentage points, to 6%, with the last cut taking place on 7 February. Officially, monetary policy easing has been justified by rapidly declining inflation. Russia has a formal inflation-targeting regime, with a target rate of 4%; but by January 2020, inflation had fallen to a mere 2.4% on an annual basis, largely on the back of depressed consumer demand. However, it is likely that concerns over the slow pace of economic growth have increasingly been playing a role behind the interest rate cuts as well – and will continue to do so even more, following President Putin's recent requirement that the government and the Central Bank should work in tandem to speed up economic growth. Therefore, even if inflation stabilises at the current (rather low) level, monetary policy easing is likely to continue, with the policy interest rate possibly lowered to 5.5% by the end of this year.

A more pro-growth policy mix should bring Russia's growth to above 2% per year in the coming years. However, the government target of 2.7% growth this year and 3.5% in 2021 appears unrealistic. In particular, private-sector investments may remain anaemic, dragged down by a poor investment climate, while badly needed structural reforms (notably in the areas of property rights and the legal system) are hardly on the government agenda. Even with the projected mild acceleration, the Russian economy will grow more slowly than the global economy, and will thus continue to fall behind in relative terms. Finally, as always, oil price volatility is a factor of risk for Russia, especially if the current slump in the oil price (partly related to the spread of the coronavirus) turns out to be more long-lasting than currently assumed. Should the oil price fall below the USD 40 per barrel required to balance the budget, the financing of national projects and other social spending might be endangered, with negative repercussions for economic growth this year.

Russia's geopolitical stand-off with the West has shown fragile signs of détente recently. Given the widening rift between the EU and the US, the rhetoric of French President Emmanuel Macron and German Chancellor Angela Merkel towards Russia has become somewhat more accommodative. At the same time, the leaders of Russia and Ukraine have at least started talking to each other, and have agreed on a prisoner swap, as well as on implementation of the so-called 'Steinmeier Formula', which stipulates the sequence of steps required for settlement of the Donbas conflict (in October 2019). Also, the latest replacement of Vladislav Surkov, a notoriously hawkish Russian official in charge of policy towards Ukraine, by the Ukrainian-born Dmitry Kozak can be interpreted as a positive sign.[42] Yet, a political solution to the Donbas conflict – and thus the possibility of EU sanctions against Russia being eased or lifted (which would have positive repercussions for the Russian economy, in terms of increased investment and technology transfer) – is still a long way off. Besides, the US sanctions against Russia are likely to stay for the foreseeable future, and may even be broadened, regardless of any EU-Russia rapprochement.[43]

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42 Mr Kozak is seen as more dovish, and is known for his plan (back in 2003) to reintegrate Transdniestria into Moldova (although the plan ultimately failed, because Moldova refused to sign under Western pressure).

43 The construction of the Nord Stream 2 gas pipeline across the Baltic Sea, which should bring Russian gas to Europe, is an example of the divergence of interests between the United States and at least some EU member states, such as Germany, France and Austria. While the latter are interested in long-term supplies of Russian gas, the United States has sanctioned companies that are involved in Nord Stream 2 construction, resulting in delays to its completion.

Table 6.18 / Russia: Selected economic indicators

	2015	2016	2017	2018	2019 1)	2020	2021 Forecast	2022
Population, th pers., average	146,406	146,675	146,842	146,831	146,763	146,700	146,700	146,700
Gross domestic product, RUB bn, nom.	83,087	85,616	91,843	104,335	109,362	115,600	123,000	130,900
annual change in % (real)	-2.0	0.3	1.8	2.5	1.3	2.1	2.3	2.4
GDP/capita (EUR at PPP)	18,100	17,200	18,100	19,900	20,500	.	.	.
Consumption of households, RUB bn, nom.	43,456	45,245	48,178	51,360	54,969	.	.	.
annual change in % (real)	-9.5	-2.6	3.7	3.3	2.3	2.7	2.8	2.9
Gross fixed capital form., RUB bn, nom.	17,126	18,734	20,189	21,290	23,202	.	.	.
annual change in % (real)	-10.6	1.3	4.7	0.1	1.4	4.0	4.5	5.0
Gross industrial production 2)								
annual change in % (real)	-0.8	2.2	2.1	3.5	2.3	2.7	3.5	4.0
Gross agricultural production								
annual change in % (real)	2.6	4.8	2.9	-0.2	4.0	.	.	.
Construction output 3)								
annual change in % (real)	-4.8	-2.1	-1.2	5.3	0.6	.	.	.
Employed persons, LFS, th, average 4)	72,324	72,393	72,142	72,532	71,933	72,000	72,200	72,300
annual change in %	-0.4	0.1	-0.3	0.3	-0.8	0.1	0.3	0.1
Unemployed persons, LFS, th, average 4)	4,264	4,243	3,967	3,658	3,465	3,400	3,350	3,350
Unemployment rate, LFS, in %, average 4)	5.6	5.5	5.2	4.8	4.6	4.5	4.4	4.4
Reg. unemployment rate, in %, eop 5)	1.3	1.2	1.0	0.9	0.9	.	.	.
Average monthly gross wages, RUB 6)	34,030	36,709	39,167	43,724	47,400	50,100	53,700	57,400
annual change in % (real, gross)	-9.0	0.8	2.9	8.5	3.8	3.0	4.0	4.0
Consumer prices, % p.a.	15.5	7.1	3.6	2.9	4.5	2.7	3.1	2.8
Producer prices in industry, % p.a. 7)	13.5	4.2	7.7	11.9	2.0	4.0	5.0	4.5
General governm.budget, nat.def., % of GDP								
Revenues	32.4	32.9	33.8	35.8	35.8	36.0	36.0	36.0
Expenditures	35.8	36.6	35.3	32.9	33.8	34.8	35.2	35.3
Deficit (-) / surplus (+)	-3.4	-3.7	-1.5	2.9	2.0	1.2	0.8	0.7
General gov.gross debt, nat.def., % of GDP	13.2	13.0	12.6	12.1	12.4	12.5	12.0	11.0
Stock of loans of non-fin.private sector, % p.a.	7.6	-6.9	3.5	13.9	6.5	.	.	.
Non-performing loans (NPL), in %, eop 8)	5.3	5.2	5.2	4.7	5.4	.	.	.
Central bank policy rate, % p.a., eop 9)	11.00	10.00	7.75	7.75	6.25	5.50	5.00	4.50
Current account, EUR mn 10)	60,952	22,094	28,726	96,254	63,034	56,400	56,000	58,300
Current account, % of GDP	5.0	1.9	2.1	6.8	4.2	3.5	3.4	3.3
Exports of goods, BOP, EUR mn 10)	307,040	254,371	312,779	375,946	373,112	380,600	395,800	415,600
annual change in %	-18.2	-17.2	23.0	20.2	-0.8	2.0	4.0	5.0
Imports of goods, BOP, EUR mn 10)	173,585	172,911	211,161	210,995	227,492	241,200	253,200	265,900
annual change in %	-25.4	-0.4	22.1	-0.1	7.8	6.0	5.0	5.0
Exports of services, BOP, EUR mn 10)	46,418	45,729	51,050	54,828	56,784	59,100	62,000	65,100
annual change in %	-6.6	-1.5	11.6	7.4	3.6	4.1	4.9	5.0
Imports of services, BOP, EUR mn 10)	79,829	67,363	78,716	80,227	87,765	93,000	99,500	106,500
annual change in %	-12.7	-15.6	16.9	1.9	9.4	6.0	7.0	7.0
FDI liabilities, EUR mn 10)	6,163	29,381	25,296	7,453	27,000	.	.	.
FDI assets, EUR mn 10)	19,861	20,149	32,559	26,620	26,000	.	.	.
Gross reserves of NB excl. gold, EUR mn 10)11)	292,467	301,871	297,823	333,617	396,378	.	.	.
Gross external debt, EUR mn 10)	474,121	486,489	433,412	397,516	429,848	417,400	398,900	384,000
Gross external debt, % of GDP	38.7	42.2	31.1	28.1	28.5	26.0	24.0	22.0
Average exchange rate RUB/EUR	67.76	74.26	65.87	73.87	72.51	72.0	74.0	75.0

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

1) Preliminary and wiiw estimates. - 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.