

## RUSSIAN FEDERATION

GDP is projected to fall by around 3% in 2015, and to grow less than 1% in 2016. This weak turnaround is supported by the recovery of oil prices, better international relations achieved in the first half of 2015 and on the success of import substitution programmes. A spike in consumer price inflation, which has peaked at around 17%, resulted in a sharp fall in real wages, weighing on private consumption. The current account remains in surplus because lower revenues from oil and gas exports are more than offset by falling imports, which reflect weak domestic demand and sanctions.

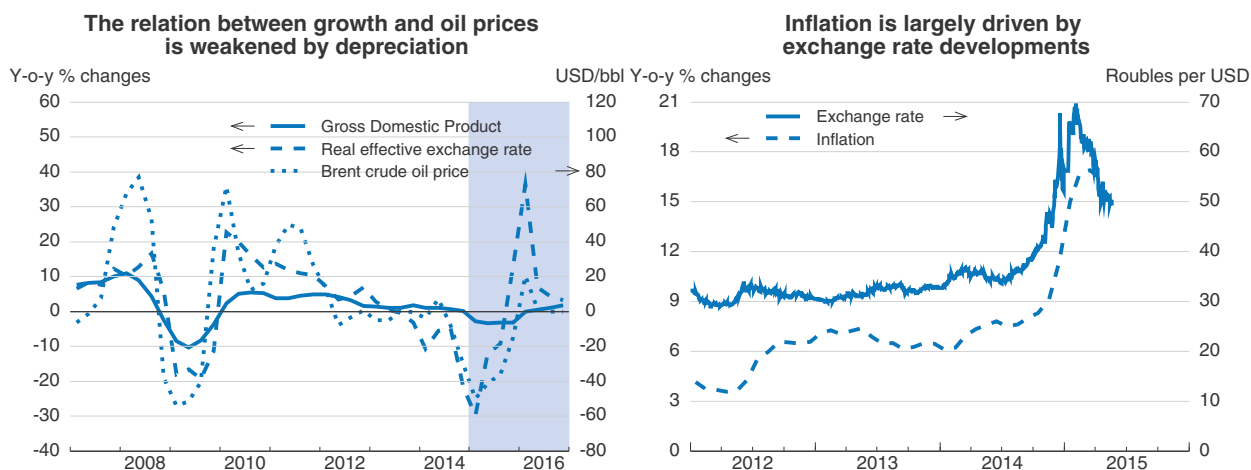
The planned widening of the budget deficit, which is due to the automatic stabilisers, is appropriate. Particular care is needed to protect those with low income against the risk of poverty in the wake of the large fall in real wages. Reserve funds should be refilled by enacting postponed privatisation plans. Monetary policy needs to continue to pay close attention to financial sector stability and therefore a quick return to the inflation targeting framework could be premature. Monetary policy should be further eased in view of the exchange rate appreciation. Measures to reign in corruption reduce the role of the state in the economy and make the rule of law more effective should be swiftly implemented.

Investment is falling in the wake of sanctions that imposed constraints on long-term financing, which are especially binding for SMEs. The government is planning to support investment projects to replace imports. In the absence of effective implementation of reforms improving the environment for doing business, boosting investment activity dependent on public support will likely have negative consequences for productivity and potential growth.


### The economy has contracted and structural policies are focused on import substitution

GDP fell by about 2% at the beginning of 2015. Consumption spending was hit by a large decline in real wages and tighter financing conditions for consumer loans.

#### Russian Federation



Source: OECD Economic Outlook 97 database; Central Bank of Russia; and Datastream.

StatLink  <http://dx.doi.org/10.1787/888933221259>


Russian Federation: **Demand, output and prices**

	2011	2012	2013	2014	2015	2016
Current prices						
	Russian Ruble billions	Percentage changes, volume (2008 prices)				
<b>GDP at market prices</b>	55 967.2	3.4	1.3	0.6	-3.1	0.8
Private consumption	27 426.6	7.7	4.9	1.2	-4.7	0.2
Government consumption	10 102.8	2.6	1.1	-0.1	0.0	0.5
Gross fixed capital formation	11 469.0	7.0	0.6	-2.1	-18.5	5.0
Final domestic demand	48 998.4	6.5	3.1	0.2	0.1	0.0
Total domestic demand	51 190.7	5.5	1.2	-1.0	-8.5	1.1
Exports of goods and services	16 940.9	1.1	4.6	-0.1	0.6	2.1
Imports of goods and services	12 164.4	8.7	3.8	-7.9	-14.1	4.2
<i>Memorandum items</i>						
GDP deflator	—	7.4	5.0	7.2	10.8	7.1
Consumer price index	—	5.1	6.8	7.8	16.3	7.0
Private consumption deflator	—	5.8	6.4	8.3	16.3	7.0
General government financial balance <sup>1,2</sup>	—	2.0	0.6	0.4	-3.7	-1.2
Current account balance <sup>1</sup>	—	3.5	1.7	3.3	3.7	3.5

1. As a percentage of GDP at market value.

2. Consolidated budget.

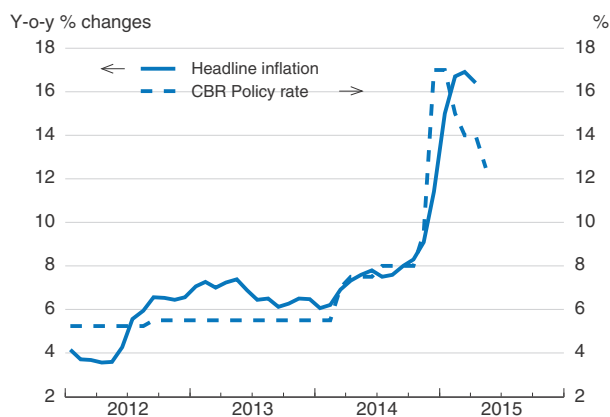
Source: OECD Economic Outlook 97 database.

StatLink  <http://dx.doi.org/10.1787/888933222396>

Investment spending, including in real estate, declined strongly because of general uncertainty, high financing costs and limited access to long-term international finance. Exports held up well while imports contracted sharply. Economic activity declined in particular in retail trade, financial services and construction, while mining, basic goods

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## The central bank has started to reduce interest rates




## Imports from sanctioning countries are falling more strongly



1. Imports from the European Union, United States, Canada, Japan, Australia, Norway and Ukraine.

Source: Rosstat; Central Bank of Russia; and Federal Customs Service.

StatLink  <http://dx.doi.org/10.1787/888933221266>

industries as well as food industries and agriculture benefited from the sharp depreciation of the exchange rate. Car manufactures experienced a collapse of sales and have reduced production.

Inflation apparently peaked in April 2015 at around 17%. Food prices increased even more. Wages moved up by only 6.5% at the beginning of the year, resulting in a sharp fall in disposable real household income. On the other hand, pensions have been increased by 13%, limiting the erosion of the purchasing power of the – usually poorer – elderly.

The current account remains positive, in spite of lower oil prices. Capital outflows have been substantial since the outset of the Russia-Ukraine crisis, initially because of a loss in confidence, but more recently because of a more orderly reduction of international indebtedness.

The sharp fall in oil prices is an adverse shock for the Russian economy, mainly through sharply lower government revenues. The central bank has cushioned the economy by allowing the rouble to depreciate, thereby reducing the cut in government oil and gas revenues in rouble terms. However, given the uncertainty related to the Russia-Ukraine crisis, capital flight soared and the central bank had to hike interest rates in December 2014. Since then exchange rates and oil prices have recovered somewhat.

Sanctions are significantly reducing the access of Russian enterprises to international financial markets. In particular, private SMEs find it difficult to finance investment and expansion. The situation is different for big firms and state-controlled enterprises, which have access to government funding. The ban on dual-use goods adds further uncertainty, because in some cases these are needed for maintenance of already installed equipment. The Russian ban on imported agricultural and food items has contributed to large price increases, but has also stimulated import substitution. This is being aided by a shift in the focus of structural policy to remove infrastructure bottlenecks, boost import substitution and encourage technological upgrading.

### **The central bank is constrained by external developments, but automatic fiscal stabilisers can work**

The Russian central bank has started to ease after increasing its key policy rate to a 10-year record high of 17% in late 2014. Since the beginning of 2015, the exchange rate has appreciated somewhat. If inflation falls, as expected, the central bank will be able to further reduce interest rates. The central bank should continue to be vigilant with respect to liquidity provisions for banks with foreign currency obligations and avoid propping up insolvent institutions. In this context a transparent “bail-in” regulation would be useful.

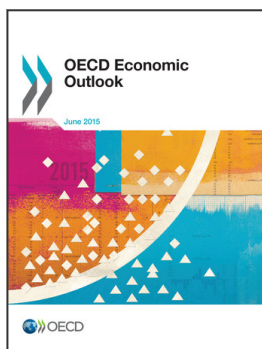
The Duma has passed a budget for 2015 with a revenue shortfall of nearly 4% of GDP. It is appropriate to let automatic stabilisers fully operate. Indeed, the planned reduction of the budget deficit to below 2% of GDP in 2016 may be premature. The pension indexation was carried out as planned in February 2015, but will still not be sufficient to prevent the real value of old age income replacement from falling. The government should therefore prepare a means-tested heating benefit before the next winter.

The current government has started to make progress on achieving its goal to reign in corruption, ease regulatory red tape and improve tax collection. However, more recently progress in these areas has slowed because of the overall deterioration of the economy.

## Growth will reappear

Economic growth is projected to rebound in the second half of 2015, and GDP to increase by 0.8% in 2016. The recovery will be mainly driven by investments in the import substitution programmes and higher oil and gas exports.

Growth depends on the evolution of geopolitical tensions. If they eased significantly, investment and growth would increase, but if they were to deteriorate the Russian economy would face further pressures. A downside risk is that scarce resources will be wasted in the import substitution programmes. On the upside, a fast start of the activities of the newly established Asian Infrastructure Investment Bank could generate new business opportunities for Russia with eastern and south-eastern neighbours. Likewise, deeper integration within the Eurasian Economic Union could revive traditional business ties and mobilise dormant productivity-increasing opportunities for the division of labour. Higher oil prices would lead to appreciation, lower inflation and higher growth of private consumption spending, while lower oil and gas prices would mean the opposite.



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