RUSSIA

Economic growth is projected to continue its moderate pace. Assumed stable oil prices, better business sentiment and improved credit conditions will support investment and consumption. Unemployment will remain low, but inflation will decline further on the back of sluggish demand and low import prices. However, low productivity, a shrinking workforce, a relatively strong rouble and international sanctions weigh on the outlook. Income inequality and poverty remain high.

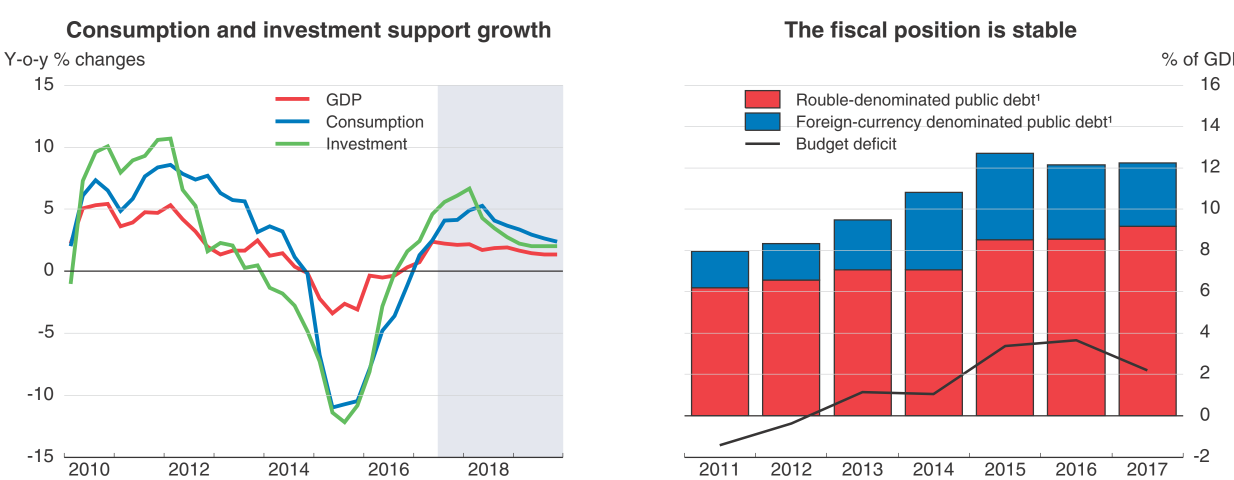
The central bank has space for further easing. The new fiscal rule will reduce budgetary volatility stemming from oil price fluctuations. The announced fiscal tightening is projected to be gradual. This should limit the impact on growth and inequality, but there is scope for more spending, especially to raise growth and well-being. A higher VAT rate and lower labour taxes would reduce informality and improve productivity. Energy sector tax reform would help increase revenue, and fund infrastructure investment.

Household borrowing has picked up in line with the economic recovery, while corporate borrowing is sluggish. Better domestic and external conditions have decreased both rouble and foreign-denominated overdue loans. The high loan-to-income ratio among households with low incomes could pose a vulnerability. The central bank should actively use macro-prudential tools. The central bank's takeover of two major private banks in mid-2017 helped maintain stability, but increased the already large state influence in the banking sector.

Growth continues but some drivers are temporary

The economy has continued to grow slowly. Investment and consumption have picked up on the back of higher oil prices and low inflation. With business confidence improving, firms have started to invest. Households have reduced saving and are consuming more thanks to the economic recovery and improved credit conditions. Both inflation and

Russia



1. The 2017 numbers are projections based on debt-to-GDP ratios for the first half of the year.
Source: Ministry of Finance of the Russian Federation; OECD Economic Outlook 102 database; and OECD calculations.

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Russia: **Demand, output and prices**

	2014	2015	2016	2017	2018	2019
	Current prices RUB trillion	Percentage changes, volume (2016 prices)				
GDP at market prices	79.2	-2.8	-0.2	1.9	1.9	1.5
Private consumption	42.3	-9.7	-4.4	3.0	4.5	2.8
Government consumption	14.2	-3.1	-0.5	0.3	-0.2	-1.9
Gross fixed capital formation	16.2	-10.4	-2.5	4.7	4.3	2.1
Final domestic demand	72.7	-8.6	-3.2	0.8	0.0	0.0
Stockbuilding[1]	1.4	-0.8	0.9	0.7	-0.3	0.0
Total domestic demand	74.1	-9.3	-2.2	3.4	2.9	1.6
Exports of goods and services	21.4	3.7	2.4	5.5	3.5	3.3
Imports of goods and services	16.4	-25.8	-3.1	14.6	8.8	4.5
Net exports[1]	5.1	6.3	1.3	-1.6	-0.9	-0.1
Memorandum items						
GDP deflator	_	8.2	3.6	5.6	4.2	3.1
Consumer price index	_	15.5	7.0	3.7	3.8	4.0
Private consumption deflator	_	14.0	6.4	3.3	3.9	4.0
General government financial balance[2] (% of GDP)	_	-1.5	-3.7	-2.2	-1.4	-1.0
Current account balance (% of GDP)	_	5.0	1.9	1.7	1.2	1.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consolidated budget.
Source: OECD Economic Outlook 102 database.

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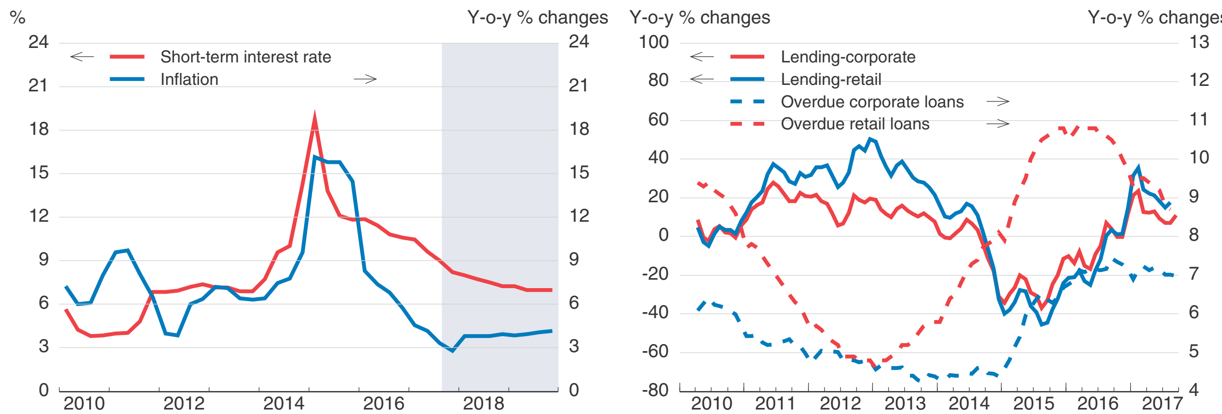
unemployment reached historical lows in the second half of 2017. Increased oil and gas revenues have reduced the budget deficit substantially.

The recovery is partly driven by temporary factors. Investment growth was led by a surge of public infrastructure spending in the first half of 2017. Consumption is driven by rising credit rather than real income growth. Industrial production is stagnating and trade competitiveness has decreased because of the strengthening of the rouble. Despite some wage increases, real household incomes continue to decline slightly. Inequality is high and poverty is declining only slowly especially as pensions and other social benefits remain low. The ongoing budget consolidation limits social spending.

The Russian banking system shows some signs of vulnerability. In mid-2017, the central bank took over two private banks, including the fifth-largest one, in a move to avoid systemic risks. Lower interest and mortgage rates have stimulated the credit market. Credit performance has improved, and the percentage of overdue loans has declined. Household debt is low and largely rouble-denominated, although low-income households are highly indebted. The corporate sector is less exposed to foreign-exchange risks as the share of foreign currency denominated corporate debt has substantially declined since 2015. The central bank should continue using macro-prudential tools to address imbalances in the financial system, while maintaining a level-playing field between public and private banks.

Russia

Low inflation allows for gradual monetary easing | **Credit is expanding**



Source: Central Bank of the Russian Federation; and OECD Economic Outlook 102 database.

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Fiscal policy is too tight

Inflation has undershot the 4% target, allowing the central bank to cut interest rates further. Low inflation is driven by sluggish demand and low growth in import prices on the back of a strengthening rouble. However, in the context of slack being eliminated, low unemployment and high volatility of food prices, inflationary pressures may reappear. Monetary policy should thus continue to ease gradually but remain vigilant.

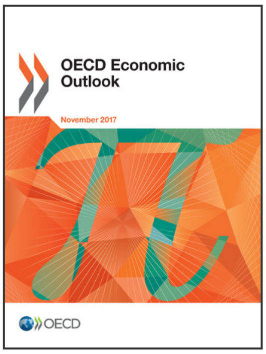
A new fiscal rule will underpin fiscal consolidation in 2018 and 2019. The rule is also expected to shield the budget from oil price fluctuations. Oil and gas revenues are budgeted on a USD 40 per barrel benchmark and extra revenues have to be saved in the sovereign wealth fund. The public debt-to-GDP ratio is low and stabilising. Therefore, the budget cuts in 2018 and 2019 may be too contractionary. More gradual fiscal tightening would be appropriate to foster growth and to reduce inequality and poverty.

The labour force will continue to decline, labour productivity will remain low and international sanctions will limit trade, competition and the acquisition of new technologies. To enhance potential growth and productivity, considerable investments in infrastructure and education are needed over time. Fiscal reforms, including higher value-added taxes to finance lower social insurance contributions or an energy tax reform, could also support productivity and investment.

Growth is projected to be moderate

Growth is expected to be around 2% in 2018 and 1.5% in 2019. Investment will continue to recover but at a slower pace. High real interest rates will continue to boost capital inflows. Household consumption will increase, backed by real income growth and improved access to credit. Fiscal consolidation will weigh on GDP growth. The strong rouble bears on competitiveness and the growth of non-oil exports. Higher domestic demand will translate into stronger import growth. Real incomes will increase and poverty will decline; however, the share of vulnerable households will remain high.

Risks stem from adverse oil price developments and other external conditions. The "OPEC+" agreement may not be sustainable after March 2018 or may fail to maintain a high oil price. The oil price heavily influences the financial cycle as it affects both the exchange rate and capital inflows. Global monetary tightening could slow down global growth and hurt Russian exports. Finally, the outlook assumes that sanctions remain in place, with an equal probability that they are either strengthened further or lifted.



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