RUSSIA

Growth is projected to continue at a moderate pace. Private consumption and investment will benefit from a boost to confidence from higher oil prices and sound macroeconomic policies which have improved financial conditions. Limits on oil production from the OPEC+ agreement will constrain export growth. Modest income growth keeps inequality and poverty high. Oil price uncertainty, international sanctions, and the post-presidential election agenda weigh on the outlook.

Fiscal policy has been tight due to financing constraints on account of sanctions and the exhaustion of the Stabilisation Fund. Consolidation is enforced by a new fiscal rule, which sets spending and deficit based on revenue corresponding to a USD 40 per barrel oil price. Over time, spending on education, health and infrastructure should be increased to reduce inequality and poverty. Monetary easing will support demand as inflation expectations are contained. Fiscal and pension reforms are needed to boost potential growth given a declining labour force and low productivity.

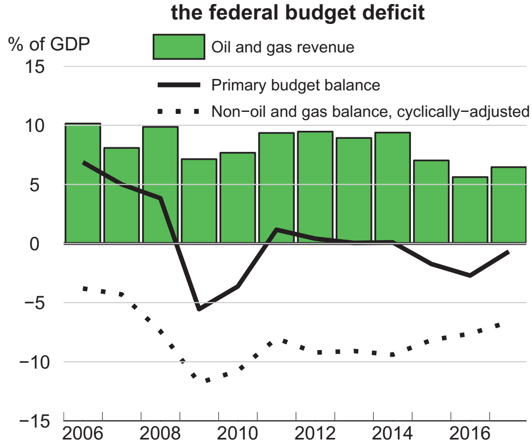
Household consumption is supporting growth

Growth is driven by stronger domestic demand. With improved business confidence and financial conditions, private investment has rebounded. Private consumption was boosted by exceptional increases in public sector wages and better household expectations. The upcoming soccer world cup has temporarily lifted public spending. Oil production limitations set in the OPEC+ agreement have restricted export growth. After a large downward adjustment to real wages in the wake of global oil price declines, real incomes have started to rise again. However, they remain 12% below their 2013 level and large parts of the population have incomes below or close to the subsistence minimum, contributing to large inequality. Thanks to the rouble appreciation and lower food prices, inflation stands at 3.5%, below the 4% target. Unemployment is at a historical low.

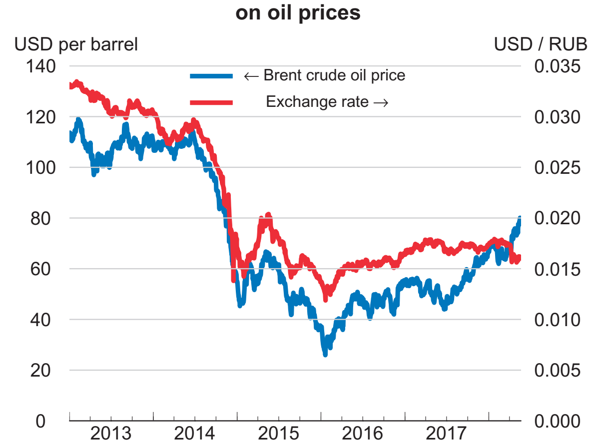
Sanctions and countersanctions have had mixed effects on the economy. Import substitution is growing, but mostly in the agrofood sector, while dependence on foreign

Russia

Consolidation efforts and higher oil prices have reduced the federal budget deficit



The exchange rate has become less dependent on oil prices



Source: Ministry of Finance of the Russian Federation; OECD Economic Outlook 103 database; and Thomson Reuters.

StatLink http://dx.doi.org/10.1787/888933730484

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	-0.1	1.5	1.8	1.5
Private consumption	42.3	-9.7	-2.3	3.3	3.5	2.1
Government consumption	14.2	-3.1	0.8	0.4	-0.8	-1.1
Gross fixed capital formation	16.2	-10.4	1.7	4.3	3.6	2.0
Final domestic demand	72.7	-8.6	-0.8	2.9	2.7	1.5
Stockbuilding[1]	1.4	-0.8	-0.5	0.3	-0.3	0.0
Total domestic demand	74.1	-9.3	-1.4	3.1	2.3	1.4
Exports of goods and services	21.4	3.7	3.2	5.2	3.9	3.1
Imports of goods and services	16.4	-25.8	-3.8	15.1	8.2	2.9
Net exports[1]	5.1	6.3	1.7	-1.8	-0.7	0.2
Memorandum items						
GDP deflator	_	8.4	3.4	5.6	4.1	3.1
Consumer price index	_	15.5	7.0	3.7	2.9	4.0
Private consumption deflator	_	14.3	6.2	3.7	2.9	3.9
General government financial balance[2] (% of GDP)	_	-1.5	-3.6	-1.5	0.3	0.3
Current account balance (% of GDP)	_	4.9	1.9	2.1	3.0	3.1

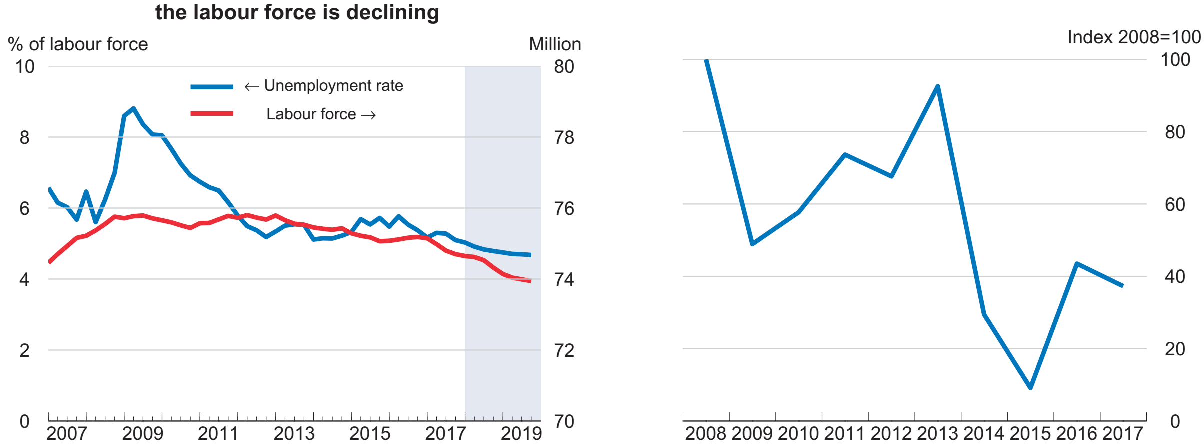
1. Contributions to changes in real GDP, actual amount in the first column.
2. Consolidated budget.
Source: OECD Economic Outlook 103 database.

StatLink http://dx.doi.org/10.1787/888933731415

machinery and equipment is high and imports recovered swiftly after the 2015 drop. The cost of finance is higher as links to international financial markets have been severed. Foreign investment has declined, in particular in key export-oriented sectors such as oil and gas and metallurgy.

Russia

Unemployment is at a record low and the labour force is declining — **FDI inflows have fallen¹**



1. Index based on foreign direct investment(FDI) in USD.
Source: Central Bank of the Russian Federation; OECD Economic Outlook 103 database; and Rosstat.

StatLink http://dx.doi.org/10.1787/888933730503

Monetary policy can support activity while fiscal adjustment will restore sustainability

The central bank has gradually lowered interest rates as actual inflation and inflation expectations have declined. While room for further loosening to support investment exists, the tight job market, volatile food prices, the recent decoupling of the rouble exchange rate from the oil price, and uncertainty around international sanctions call for caution. The central bank will also need to monitor closely the continuing restructuring of the banking sector, and resolve failing banks to maintain confidence in the Russian banking system.

With the exhaustion of the reserve fund and severed access to external finance due to sanctions, fiscal consolidation was necessary to maintain confidence in public finances. Fiscal policy is governed by a new fiscal rule anchoring the 2018 and 2019 budgets to an oil price of USD 40 per barrel. Beyond this threshold extra oil and gas revenues are saved in the National Welfare Fund. In addition, foreign exchange interventions by the Ministry of Finance are meant to reduce rouble volatility and stabilise oil and gas fiscal revenue. With the current oil price well above the USD 40 per barrel threshold and strict limits on spending, the 2018 budget is expected to reach a surplus. Consolidation supports budget sustainability and confidence, but should be gradual and weighed against its potential adverse impact on the ongoing recovery and long-term growth.

Future growth will be affected by a declining labour force and low productivity gains, calling for structural reforms and investment in education, health and infrastructure. The ongoing reforms to increase efficiency in the energy sector are welcome and should be continued. Tax reforms, including a shift from high social security contributions to a higher value-added tax, could support productivity and investment and boost work incentives. Improving the business environment with better protection of entrepreneurs' rights and greater competition, with a reduction in the share of government activity in the economy, would boost investment and productivity. A reform of the pension system to raise the very low pension level – a third of the average wage – would reduce old-age poverty and make growth more inclusive.

Growth will be moderate

Growth is projected to reach 1.8% in 2018 and to slow to 1.5% in 2019 as investment continues to recover only slowly following sanctions. Real income growth and improved access to credit will continue to raise household consumption. Growth of non-oil exports will remain moderate as uncertainty around sanctions remains considerable. Foreign exchange interventions set by the fiscal rule will contain rouble appreciation and maintain competitiveness, at least partially. Fiscal consolidation will weigh on GDP growth, especially in the second half of 2018 when the spending boost related to the soccer world cup fades. Poverty will decline as social transfers and real wages rise, but moderately, and the share of vulnerable households will remain high. A key risk to the outlook stems from oil price developments, with a potential breakdown of the OPEC+ agreement in the face of rebounding shale gas production in non-OPEC countries bringing down oil prices. The recent tightening of international sanctions and expected counter-sanctions pose a downside risk. Lastly, the fiscal stance and the reform agenda envisaged in the outlook might change with the new presidential cycle, with risks to growth being balanced on the upside and the downside.

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