BOFIT Russia Team

BOFIT Forecast for Russia 2021–2023

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We have raised our economic forecast for Russia from last autumn to reflect the rise of oil prices and price expectations. The impacts of covid-19 on Russia were also less severe than anticipated. We see Russia's GDP recovering from last year's dip to growth of almost three per cent this year and next. Significant uncertainties continue to surround the outlook. Russia and the rest of the world may struggle longer with covid, oil markets remain sensitive, and, like many economies, the Russian economy is at an inflection point with regards to recovery. Growth will slow after next year, approaching its long-term future trajectory.

After a moderate 2020 economic dip, Russia's recovery is underway

The Russian economy last year faced a triple-whammy of covid-19 lockdowns, a crash in global oil prices in the early spring and a fall of oil output due to production cuts imposed under the OPEC+ agreement. Even so, GDP contracted only a bit more than 3 %, less than in forecasts. One saving feature was the structure of the Russian economy. The biggest declines were in services branches, which only had a modest impact on GDP as their share in the Russian economy is small compared to many other economies. The Russian economy was essentially supported by a strong increase in government sector spending. Government support measures also helped maintain increases in bank lending. Nearly all of the economy's demand components, however, contracted quite sharply. Private consumption was down by almost 9 %, fixed asset investment by 6 % and export volume by 5 %.

The Russian economy began to recover in the third quarter as restrictive covid measures were relaxed in Russia and elsewhere in the world. Oil prices had rebounded from spring lows and the government had pushed ahead with budget spending stimulus. Recovery then paused due to much larger second covid waves, though public health restrictions reimposed in Russia were much less intensive than in the first wave.

The Russian economy is expected to recover this year, and growth should continue over the next few years at a couple of per cent a year. The pace of growth next year should be increased slightly by a revival of Russia's oil production along with the expiration of the OPEC+ agreement. Growth will then slow, approaching its future long-term trajectory. The covid pandemic is expected to ease when next year sets in. The forecast is also affected by the oil price, which, after rising in recent months is expected by markets to start declining gradually to clearly below $60 a barrel in 2023. Growth of the global economy should remain good. If Russian government sector spending follows present plans, it should decline slightly in real terms. Reforms in a scale that would significantly improve economic growth are not presumed, concerning e.g. the functioning of officials.

Gradual recoveries in private consumption and fixed investment

Private consumption plunged by nearly 9 % last year. Besides covid-19 and restrictions, households saw their incomes reduced, especially in the case of entrepreneurs and share owners. Contraction of the wage sum of households in real terms was impacted more by a decline in employment than in earlier recessions. Social supports were increased to cover part of income losses. Similar to earlier recessions, the pull-back in consumption was considerably due to increased household saving and building up their other assets. A special feature of the covid recession has been the near-complete suspension of foreign travel by Russians. Some of that spending was diverted to consumption in the homeland.

The recovery in private consumption stalled last autumn but will continue from this year. Private consumption in 2023 should reach a level comparable to the peaks of 2014 and 2019. Higher consumption is supported by reviving employment and income growth. The general increase in government sector wages is expected to be similar as in recent years, i.e. they should keep pace with inflation. On the other hand, under a policy decision taken a couple of years ago, pension hikes will exceed the annual inflation rate by about 2 %. At least part of the household funds set aside during the crisis will get spent possibly this year already, thereby helping the recovery in consumption. The same applies to the possible return of Russians to foreign travel.

Fixed investment fell by 6 % last year, dragged down by a slightly larger drop in corporate fixed investment. Government fixed investment was strongly increased, but its share of total fixed investment is not large. The recovery in fixed investment, which began in late 2020, is expected to continue. On the other hand, the pace of growth could remain fairly temperate as there should not be compelling needs this year to invest in capacity, which last year and early this year remained at low levels not seen for about ten years. As a fundamental issue, a central survey found that an ever larger share of firms sees factors that limit investment, including uncertainty in the economy and investment risks.

More investment than expected would e.g. enhance future growth of the economy. However, fixed investment last year was down by about 10 % from the peak years of 2012−2014. In subsequent years, fixed investment was also significantly lower than in the first half of the 2010s. This is a major factor that has further diminished Russia's long-term growth prospects slightly.

Exports return to growth, while the recovery in imports remains tepid

After many consecutive years of increase, the volume of exports declined by 5 % last year, largely on reduced exports of oil & natural gas. In addition, the almost complete drying up of revenues from foreign travellers had a significant impact. Given the uncertainties connected with Russian energy exports and tourism, the expected recovery in exports overall this year could be somewhat slow. Export growth next year should be supported by the expiration of the OPEC+ agreement on production ceilings. The growth expectations for exports in coming years are limited by projections for the energy sector, which currently see the level of petroleum product exports remaining largely unchanged and a rather moderate increase in natural gas exports.

Russia's total imports of goods and services plunged 14 % in 2020. This was to a large extent a reflection of the almost complete collapse in Russian tourism abroad (10 % of total imports in 2019). While imports of goods also declined on weak domestic demand and the ruble's falling exchange rate, the dip was relatively small. Russia's total imports are expected to recover partly this year, while the timing of the resurgence in Russian tourism abroad will impact significantly the pace of recovery. The revival of imports is supported by the recent rise of oil prices that lead to higher export earnings for Russia. The pace of recovery, however, could be rather moderate as the ruble's real exchange rate remains low (down 7 % last year from 2019). The real rate is not expected to appreciate as Russian inflation should remain reasonable and oil prices start to slide down gradually. Imports will remain significantly lower than in 2011−2014. Russia's current account surplus, which shrank to around 2 % of GDP last year, is expected to remain solid this year and in the next few years.

Plans to leave behind government stimulus spending

The Russian economy last year was propped up and stimulated by large increases in government budget spending that followed a pattern similar to those of 2009 and 2015 recessions. Spending increases outpaced the relatively slow inflation by so much that the real growth in spending hit all-time highs. The largest increases focused on social support. In a move quite rare, the government simultaneously boosted other spending as well such as corporate subsidies, procurements, fixed investment and wages. The government's spending impulses and drop in revenues shifted the government sector's consolidated budget from surplus to a deficit of about 4 % of GDP. The reversal of the balance nearly matched the 2009 record.

Growth in government sector spending has slowed since last summer. Last autumn's plan to reduce the government budget deficit through slight spending cuts in real terms this year and next still holds. Higher oil prices should help reduce the deficit as the prices are expected to be higher than assumed in the government budget plan. That gives to the budget higher oil tax revenues than expected. There is also other wiggle-room as the amount of government debt last year after financing the budget deficit was still below 20 % of GDP. Moreover, the state reserve fund (National Welfare Fund) holds liquid assets equivalent to about 8 % of GDP.

The Bank of Russia has kept its key rate at 4.25 % since last summer. In reaction to a pick-up in inflation in late autumn caused by rising food prices, the government quickly implemented temporary price restrictions on certain food items and farm products. The government has continued with loan support programmes intended to encourage bank lending through interest-rate support and guarantees for selected types of loans directed especially to small and mid-sized firms, as well as buyers of newly built homes. The supports have helped corporate lending and housing loans increase in the midst of a recession. The central bank has extended certain of the relaxations of banking rules that were introduced last spring.

Significant upside and downside risks

Of the many risks surrounding the current forecast, the biggest is a prolonging of the covid-19 pandemic, vaccination roll-outs and covid restrictions. Economic recovery in Russia and elsewhere in the world could turn out to be weaker than expected. Shifts in global economy and oil market conditions are reflected in oil prices; any significant decline in oil prices would press down both the private and public sectors of the Russian economy as well as imports.

The Russian economy is in an inflection point with regards to recovery. This involves risks to the economy this year and next for performing better or worse. The speed of recovery in oil & gas production from last year's dip will significantly affect the pace of GDP recovery. Private consumption and Russian imports, particularly Russian tourism abroad, could turn around over a relatively short time with the lifting of restrictions and the release of pent-up household demand and their funds built up during the pandemic.

Higher oil prices should help ease stress on government finances. The government's current tight line on budget spending could be relaxed quickly if the need to provide supports arises from, for instance, a weakening economy. Elections may also affect here. Relaxation could focus on social spending, and like in previous years, supplemental wage hikes for selected government-sector workers. This would support consumption. Fixed investment funded by the government could also bring temporary substitutional relief in the bleak overall outlook for fixed investment.

Table. On-year Russian GDP growth, realised and forecast (f), %

	2018	**2019**	**2020**	**2021f**	**2022f**	**2023f**
GDP	2.8	2.0	-3.1	2.7	3.1	2.0
Consumption	3.5	2.9	-5.2	2.6	2.8	2.0
Investment	0.6	1.5	-6.2	3.0	3.5	2.0
Exports	5.6	0.9	-5.1	3.0	5.0	3.0
Imports	2.7	3.5	-13.7	5.0	4.5	3.0
Oil price (Brent, bbl)*	$71	$64	$42	$65	$61	$58

* Forecasted oil prices based on the average for oil futures contracts for the ten days preceding March 16, 2021. The price of Urals crude in 2019−2020 averaged 0.99 that of Brent crude.
Sources: Rosstat and BOFIT.