BOFIT Forecast for Russia
16 September 2021

BOFIT Russia Team

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The forecast for the Russian economy has been revised upward on improved prospects for global economic growth and Russian exports. Oil prices and the expectations are also higher than in March. GDP should rise more than 3.5 % this year from last year's low basis, before settling in 2022−2023 to slightly over 2.5 % p.a. on average. Several uncertainties surround the forecast. There could be unexpected changes in the course of the covid pandemic, global growth and oil prices. The return of international travel and the release of assets piled up by households last year can also significantly affect private consumption. Improved government revenues create opportunities for more generous budget spending.

After recovery now, growth remains moderate

The Russian economy has come back from last year's rather moderate downturn (−3 %) with GDP recovering in the first half of this year to slightly above 1H19 levels before the pandemic and collapse in oil prices. Russia's surge in covid cases in early summer turned down soon, but infection rates have remained high. Russia's covid restrictions have remained quite mild compared to spring 2020, even if the vaccination rate is low. Oil prices are up and year-to-date about 60 % higher than a year earlier.

In raising our growth projection from our March forecast, we now expect GDP growth to reach 3.7 % this year as higher growth of the global economy and relaxation of production ceilings under the OPEC+ agreement support Russia's export volumes and higher oil prices help the economy. Pensioners especially received one-time stimulus payments this month, which will provide a temporary push in household consumption.

Fundamentals of the economy will slow growth towards its long-term growth prospects because wider systemic market-enhancing reforms that could lift growth during the forecast period are not in sight. Russia's GDP growth is thus projected to slow to slightly over 2.5 % p.a. in 2022−2023 on average.

A range of other factors, however, affect the projected annual growth figures for 2022−2023. Covid is currently expected to restrain growth still next year, and market expectations see oil prices turning this year to a gradual slide and averaging about $65 a barrel in 2023. On the other hand, global economic growth should stay unusually brisk next year, and the outlook for Russian oil & gas exports has improved. Government plans for financing selected investment projects should move forward, and part of the one-time payments to pensioners could be spent next year. Entering the out years of this forecast, covid should subside and international travel return both ways from very deep downturns. This will support the economy and especially lift imports.

Higher private consumption and increased government financing of fixed investment

Private consumption has recovered this year to a level slightly higher than two years ago. Even so, real household disposable incomes are still slightly smaller than two years previous as is the number of people employed. The increases in spending on social supports during the 2020 recession are now behind. The rise in consumption reflects a rare steep decline in net household saving, which has been a countermovement to the extremely large asset accumulations by households during last year's covid recession.

Improving employment and rising household incomes on the economy's growth will increase private consumption. We expect private consumption to slightly exceed 2014 levels in 2023. The scheduled pension increases for 2019−2024 provide lifts in pensions that exceed the expected inflation by a couple of per cent. Russian pensioners and selected groups of public officials received one-time payments in September, which were announced 2−3 weeks before the Duma election on September 19. The lump-sums will give temporary bumps to consumption this year and possibly next year. Moreover, we expect support to consumption also because most of the assets built up by households during 2020 have not actually been unwound. Russian foreign tourism, which dwindled to extremely thin levels last year, is expected to rebound solidly in the later part of the forecast period.

Even with last year's government investment wave now largely past, fixed investment has recovered markedly this year and is well up from pre-pandemic levels two years ago. The recovery in fixed investment continues and should finally reach 2012−2014 levels in 2023. Growth in fixed investment is not expected to be particularly high as e.g. utilisation of industrial capacity remains quite low. On the other hand, the record-low capacity utilisation in extractive industries, which is dominated by the heavily investing oil & gas production and related services, could see a rapid recovery on higher output of oil & gas. Salient increases in fixed investment should arise in the next few years from the government's plans to provide loans and other financing from the National Welfare Fund (NWF) to selected investment projects. The intention is also to get firms along to invest in the projects, which may provide further increases to the extent that the projects do not crowd out firms' own investment plans.

Brisk export growth and good import growth

This year has seen some signs of recovery in the Russian export volumes as exports of natural gas and other basic commodities recovered this spring from last year's lows. Crude oil exports have been subdued by the OPEC+ production agreement. With the production ceilings raised this summer, experts now see Russia's oil exports contracting much less this year than expected in March and recovering rapidly next year. Estimates of the pace of gas export recovery this year have been upgraded considerably. Improved forecasts for the global economy also bode well for Russia's other goods exports. Russia's revenues from tourism (over 2 % of export earnings in 2019) are expected to revive in the later part of the forecast period.

Russia's total imports of goods and services have also recovered this year to levels seen in 1H19. After last year's quite moderate dip, goods imports have rebounded to levels even well in excess of pre-recession levels. Travel remains very small. Goods imports and imports of other services than Russian foreign travel are expected to increase quite well during the forecast period with rising GDP. The growth in imports is limited by the ruble real exchange rate, which this year has been several percent lower than last year. The real exchange rate is expected to remain fairly unchanged as Russian inflation should continue to only slightly outpace the inflation of its trading partners. Spending on foreign tourism should recover well towards pre-pandemic levels in the out years of this forecast (it accounted for 10 % of Russia's total imports in 2019 before it collapsed). The distance of Russia's total imports of goods and services to the 2012−2014 peaks is foreseen to narrow to around one tenth. Russia's current account surpluses will remain notable throughout the forecast period.

Government stimulus spending over, inflation has accelerated

Government budget revenues recovered quickly from last year's depths. The rebound in oil prices has helped lift oil & gas tax revenues, and other budget revenue streams have grown on the recovery of the economy and imports as well as further improvements in tax collection. Last year's slump-driven spending stimulus is over, with government spending this summer even lower in real terms than in summer 2020. The government budget deficit has shrunk to less than one per cent of GDP.

There are no signs that Russia is contemplating changes to last year's plan to reduce the deficit, which was also pursued following the 2009 and 2015 recessions. The rise in budget revenues and improved revenue outlook due to current expectations of higher oil prices are helping the government in its efforts to reduce the deficit. This will provide a possibility for relaxing the plan's strict spending estimates, which was recently proposed by the economy ministry. At the same time, pressures to increase spending are for some part reduced by the government plans to provide project financing from the NWF. Total assets of the NWF amounted to almost 12 % of GDP in the middle of this year, of which liquid assets equalled more than 7 % of GDP. The government's debt was about 18 % of GDP.

Inflation remains high. Consumer prices and producer prices in extractive industries, manufacturing and agriculture have risen since last autumn at a pace not seen in several years. This has bitten the purchasing power of various actors in the economy. Since early spring, the Bank of Russia has gradually increased its key rate, which currently stands at 6.75 %. Some of the price restrictions introduced late last year, which are temporary and targeted especially on select agricultural products, have been extended (e.g. export tariffs on certain of the agricultural products have been stretched to the end of this year or next summer).

Risks for deviations from the forecast continuously significant

This forecast is surrounded by several significant risks. The covid pandemic may not subside as expected. Deviations from the expected growth of the global economy or oil prices would be reflected e.g. in Russian exports, government budget revenues and imports. Inflationary pressures could arise from global markets and on Russia's relatively non-integrated markets, which would create risks for increased erosion of the purchasing power of households, firms and the government.

Investment growth could see more increases than anticipated if the planned financing from the NWF draws companies along in a manner that increases the total investments of corporates. Even with the deficit-reduction targets set, an improved revenue outlook means the government budget is on track to gain considerable room to increase spending from the plans so far, if seen necessary.

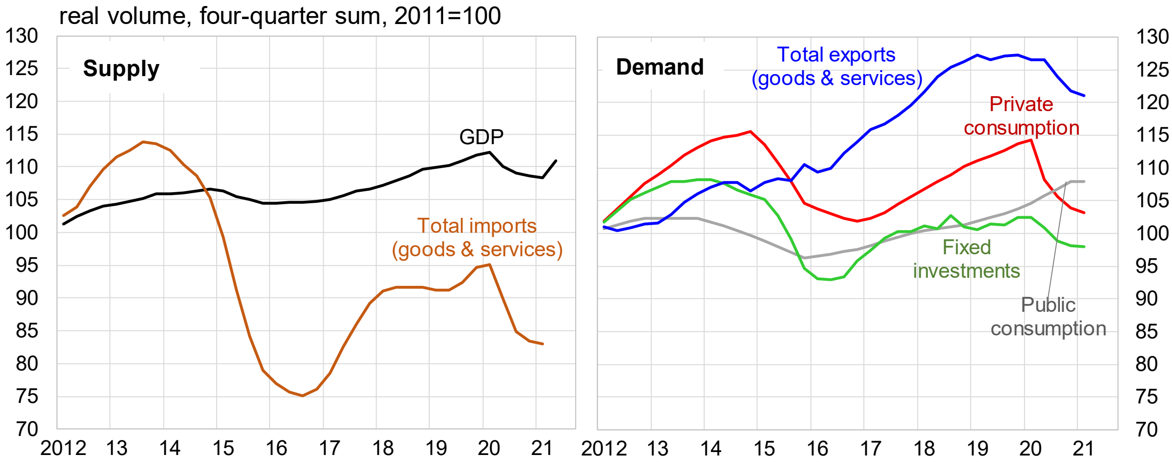
Certain branches and parts of the Russian economy have not proceeded to proper upturns after last year's recession. The tempos of recoveries ahead are hard to foresee. The covid situations influence the pace at which national borders reopen and facilitate the recovery of international tourism that has a particularly large impact on Russia's total imports and private consumption. Tangent to this, surprising humps may emerge in consumption with the unwinding of last year's abnormally large build-up of household savings.

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

	2018	2019	2020	2021f	2022f	2023f
GDP	2.8	2.0	-3.0	3.7	2.8	2.4
Consumption	3.5	2.9	-5.2	3.5	2.5	3.0
Fixed investment	0.6	1.5	-4.3	3.0	3.7	2.5
Exports	5.6	0.7	-4.3	4.5	5.0	4.5
Imports	2.7	3.4	-12.0	6.5	4.5	6.5
Brent oil price (bbl), $*	71	64	42	68	68	65

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

Figure. Trajectories of supply and demand components of the Russian economy in 2012–2021



Sources: Rosstat, BOFIT.