RUSSIA

The economy is projected to rebound from a deep recession on the back of stronger oil prices, higher wages and lower interest rates, which will boost household consumption and business investment. Structural bottlenecks hamper the diversification of production, and the relatively strong rouble and continued sanctions will restrain non-oil exports. The poverty rate will gradually decline as the labour market strengthens and inflation abates further.

Monetary policy should be eased to support growth, but cautiously to avoid a rebound of inflation. Fiscal tightening, due to spending cuts, might jeopardise the recovery. Additional revenue could come from a higher VAT rate, taxes on the oil and gas sector, and real estate, as well as by broadening the personal income tax base. At the same time, funding is needed for large public investments in education, innovation and infrastructure. Institutional reforms would help lift longer-term growth.

The economy remains relatively closed, as international sanctions hamper higher value added in non-oil activities. The gains from globalisation rest on oil revenues which are unevenly distributed across regions and income groups. Reforming the tax system and investing the gains from higher oil prices in education and infrastructure would help diversify the economy, create more quality jobs and make globalisation beneficial for all.

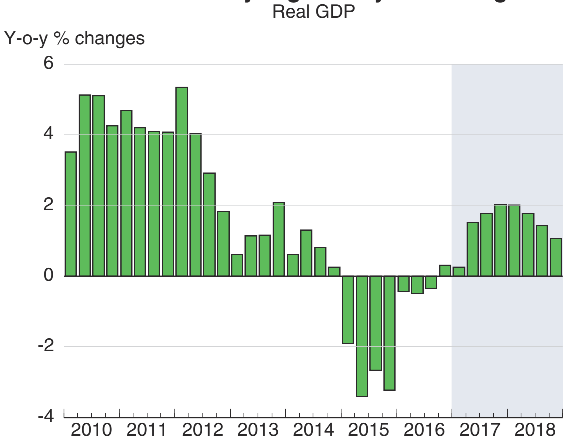
The recovery remains fragile

The economy has begun to turn around, thanks to higher oil prices and increasing external demand. Consumer price inflation and interest rates continue to decline, fostering both investment and consumption. Business sentiment is improving, and investment is rising after a contraction that lasted almost three years. Consumption is picking up on the back of higher real wages, although household confidence is still weak. Unemployment has declined further and is now about 5.5%. Rising wages and falling unemployment have also brought poverty rates down slightly.

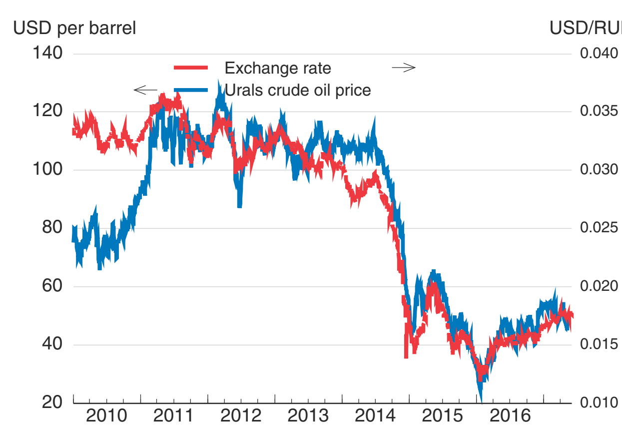
However, the upturn is fragile as it rests mainly on the rebound of commodity prices. Most structural and policy obstacles to higher sustainable growth remain in place.

Russia

The economy is gradually recovering
Real GDP



Oil prices and the exchange rate are closely linked



Source: OECD Economic Outlook 101 database; and Thomson Reuters.

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Russia: **Demand, output and prices**

	2013	2014	2015	2016	2017	2018
	Current prices RUB trillion	Percentage changes, volume (2011 prices)				
GDP at market prices	70.9	0.7	-2.8	-0.2	1.4	1.6
Private consumption	38.3	2.0	-9.7	-4.5	1.2	2.7
Government consumption	14.0	-2.1	-3.1	-0.5	-0.5	-2.5
Gross fixed capital formation	13.8	-1.1	-9.7	-2.2	2.0	1.6
Final domestic demand	66.1	0.5	-8.4	-3.2	-0.5	0.0
Stockbuilding[1]	0.9	-1.0	-1.3	0.8	1.1	0.0
Total domestic demand	66.9	-0.6	-9.5	-2.3	2.2	1.3
Exports of goods and services	18.9	0.6	3.6	3.1	3.4	3.0
Imports of goods and services	14.9	-7.1	-26.0	-4.0	5.0	2.2
Net exports[1]	4.0	1.7	6.3	1.7	-0.2	0.3
Memorandum items						
GDP deflator	_	10.7	8.2	3.5	7.7	3.6
Consumer price index	_	7.8	15.5	7.0	4.2	4.0
Private consumption deflator	_	8.2	14.1	6.5	4.4	4.2
General government financial balance[2,3]	_	-1.0	-3.4	-3.7	-3.3	-2.7
Current account balance[2]	_	2.8	5.1	1.9	4.0	3.7

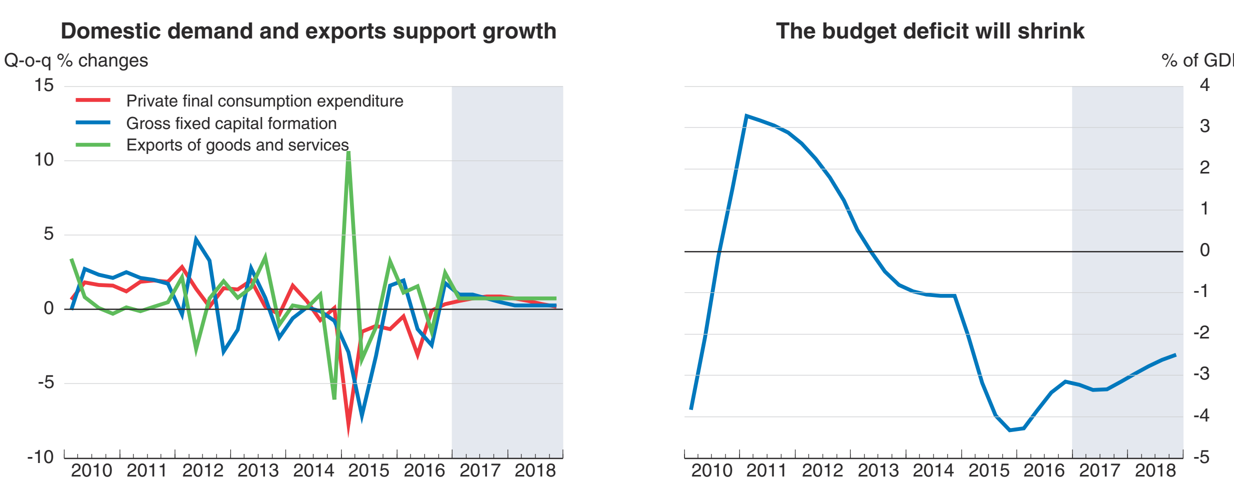
1. Contributions to changes in real GDP, actual amount in the first column.
2. As a percentage of GDP.
3. Consolidated budget.

Source: OECD Economic Outlook 101 database.

StatLink http://dx.doi.org/10.1787/888933506284

Institutional uncertainty and the lack of structural reforms damp the business climate and the creation of start-ups. The international sanctions restrict access to financial markets, and transport bottlenecks hamper inter-regional trade. An appreciating rouble strains the non-oil export sector and keeps the economy in an oil-dependency trap. Finally, income inequality remains distinctly above the standards of large OECD economies.

Russia



Source: OECD Economic Outlook 101 database.

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Monetary policy is accommodative, while fiscal policy is tightening

Rapidly declining inflation has allowed monetary policy to become more accommodative. The new mechanism linking foreign exchange interventions to oil prices is likely to reduce rouble volatility and exposure to external shocks. The current intervention threshold - USD 40 per barrel - is a sign that the authorities will address further rouble appreciation more activity. The authorities should also closely monitor equity and credit market developments.

Fiscal policy is tightening. The federal budget adopted in December 2016 reduced planned government spending and the deficit by around 1 percentage point of GDP in both 2018 and 2019; this projection assumes less contraction than in the budget. Still, at this point fiscal contraction risks jeopardising the recovery and, as productive spending is being cut, longer-term growth. Given low and still decreasing interest rates and low debt levels, the authorities may want to create additional fiscal space for investment in research, education and infrastructure for a more resilient and inclusive economy.

The inclusiveness of the recovery and, more generally, benefits of globalisation will largely depend on how the gains from higher oil prices are shared among income groups and territories of this large country. The trickle-down of the recovery so far has been modest; income inequality remains high, and regional disparities are deepening. Reforms to the tax system, as suggested by the authorities, could strengthen inclusive growth. A broader-based income tax, an increase in real estate taxes and a more efficient taxation of the oil sector against lower social security contributions could foster efficiency and bring in more revenues, while benefitting the population more evenly.

Weak institutions restrain the pick-up in growth

Economic growth is projected to rebound to around 1½ per cent in 2017 and 2018. A stabilised exchange rate and lower interest rates will boost business confidence and investment. Lower inflation and an increase in real wages, on the back of stronger business activity and lower inflation, will support household spending, although saving will also increase. Export growth will be boosted by higher oil prices and stronger world trade. However, overall growth will remain moderate as the lack of structural reforms impedes the diversification of the economy and fiscal tightening will weigh on growth in 2018. The rise in the poverty rate is expected to decline, as growth will trickle down to the lowest income groups.

Weak institutions hamper a resilient and more inclusive rebound of the economy. Property rights are not always enforced, governance of state-owned enterprises is opaque, and the government is overly centralised. Corruption is declining but remains an issue for investors. Structural weaknesses, such as low spending on research and development and an overstrained infrastructure, weigh on growth and competitiveness outside the oil sector. With public-worker pay and pensions still frozen, income inequality will remain elevated.

Risks – both on the upside and downside – relate to oil prices and the geopolitical environment. Revenues from oil exports and overall growth may increase if oil producers achieve permanent supply restrictions and an ensuing price increase. Oil prices may, on the other hand, decline again if supply agreements break down and/or if swing producers are in a position to react swiftly to supply shortages. On the geopolitical side, sanctions are projected to remain, with both a possibility that they are strengthened if the Ukrainian crisis escalates, but also a possibility that they are lifted once a durable peace agreement is negotiated.