Summary

Trends:

• The slowdown of GDP growth in the 1\textsuperscript{nd} half of 2019 to 0.7\% YoY
  ✓ Weak foreign demand
  ✓ Increase in the fiscal burden

• The formation of trend to slow down inflation after acceleration in late 2018 – early 2019
  ✓ Strengthening of the national currency
  ✓ Hesitant domestic demand

• Reduction of policy rate to 6.5\% at the end of October 2019 from 7.75\% at the beginning of the year

• Budget surplus expands
  ✓ Increase in the fiscal burden
  ✓ Decrease in capital expenses

Forecast 2019-2021:

• GDP growth in 2019 – 1.1\%
  ✓ Growth of state budget’s capital expenses at the 2\textsuperscript{nd} half of 2019
  ✓ Effect of the reduction of the policy rate by the Bank of Russia

• GDP growth in 2020–2021 – around 2\% per year

• Deceleration of inflation to 3.5\% by the end of 2019.

• Inflation in 2020–2021 will be close to the CB RF’s targets

• A potential for further policy rate reduction to 6\% in the medium term
Real Sector. Economic Activity slows down

Russia’s GDP grew by 0.7% YoY in January to June 2019 (2.2% YoY and 2.7% YoY in 3Q and 4Q 2018, respectively):

- Weak foreign demand (deterioration of net exports of goods and services)
- Restrained consumer and investment activity

There was a negative output gap in 2Q 2019, which, along with other factors, caused inflation to slow down quickly after accelerating early in the year.

Source: Rosstat, authors’ calculations, EEC
Inflation. Formation of the Trend of Inflation Slowdown

Inflation in June 2019 – **4.6% YoY** (4.3% in 2018):

- The increase in the VAT base rate from 18% to 20%

In Q2 2019 price growth began to slow down rapidly (4.6% YoY in June after 5.1% YoY in March):

- Weak consumer demand
- Russian ruble strengthening
- Slower growth of fuel prices
- Earlier sales of fresh fruit and vegetable produce

Source: Rosstat, CB RF
External Sector. Smaller Surplus on Current Account

The current account surplus decreases
- Lower oil prices
- Temporal problems with oil transit via Belarus
- Slowdown of external demand
- Russian ruble strengthening

Non-residents’ demand for OFZs rose over January to June 2019
+ Expectations of policy rate cut
+ Macroeconomic stability

Increased international reserves

Source: Rosstat, CB RF
The federal budget’s surplus was **3.3% of GDP** in January to June 2019:

+ The VAT rate was raised at the beginning of 2019 (an increase of VAT revenues by 17.5% YoY in the first half of this year)
+ The expenditure side of the federal budget in January to June 2019 remained virtually unchanged (1.3% YoY growth), which is attributable in particular to the decrease in capital expenses

We assess the fiscal policy’s influence as a constraint on economic activity in the country in the first semester

Public debt remains low (around 13% of GDP)
Monetary Sector. Reduction of Policy Rate

Reduction of policy rate to 6.5% at the end of October 2019 from 7.75% at the beginning of the year:
- Sustainable downward inflation trend
- Diminution of pro-inflationary risks

Russian ruble strengthening:
+ Relatively high yield on Russian assets
+ Macroeconomic stability
+ Expectations of monetary policy easing in developed countries

Source: CB RF, authors’ calculations
Forecast. Acceleration of GDP Growth

The GDP growth rate over 2019 is projected at **1.1%**. Economic activity recovery in the 2nd half of 2019 due to:

- **Budget’s capital expenses growth**
- **The effect of the reduction of the policy rate by the Bank of Russia**

Economic growth to be near potential around 2% per year in 2020–2021

Efficient implementation of national projects may be conducive to a higher potential growth rate in the medium term

Source: authors’ calculations, EEC
Forecast. Inflation to Slow Down by End of 2019

Inflation may decrease to 3.5% over 2019:

- Slack consumer demand
- Ruble strengthening
- Exhaustion of the VAT increase effect

In 2020–2021 inflation is projected to be close to the Bank of Russia target

- Neutral effect from economic activity
- Exchange rate will follow its equilibrium path

Source: authors’ calculations, EEC
Forecast. Interest Rate Policy to Remain Neutral

There remains a potential for further policy rate reduction to 6% as inflation stabilizes near its target and the risk premium on investment in Russian assets decreases. We generally expect interest rate policy to remain near-neutral in the projection horizon.

In the medium term the Russian ruble is expected to gradually weaken as inflation in Russia remains higher than in main trade partners. It is fairly likely that the equilibrium rate of devaluation of the national currency will slow down as the potential economic growth rate strengthens.

Source: authors’ calculations, EEC
# Forecast. Key Macroeconomic Indicators

## Key Macroeconomic Indicators of the Russian Federation

<table>
<thead>
<tr>
<th>Indicators</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019F</th>
<th>2020F</th>
<th>2021F</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP in constant prices (% growth YoY)</td>
<td>0.3</td>
<td>1.6</td>
<td>2.3</td>
<td>1.1</td>
<td>1.8</td>
<td>2.0</td>
</tr>
<tr>
<td>Consumer price index (% growth in December to previous year’s December)</td>
<td>5.4</td>
<td>2.5</td>
<td>4.3</td>
<td>3.5</td>
<td>4.0</td>
<td>4.0</td>
</tr>
<tr>
<td>Nominal MIACR rate in national currency (the year’s average % per annum)</td>
<td>10.6</td>
<td>9.0</td>
<td>7.1</td>
<td>7.2</td>
<td>6.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Nominal Russian Ruble to U.S. Dollar Exchange Rate, RUB per USD (the year’s average)</td>
<td>66.9</td>
<td>58.3</td>
<td>62.5</td>
<td>65.0</td>
<td>65.8</td>
<td>67.7</td>
</tr>
</tbody>
</table>

*Source*: calculations by the authors, EEC