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INFORMATION DISCLOSURE

This Review includes a detailed description of the current internal and external macroeconomic setting and an agreed set of forecasts that takes into account the interrelationships between the economies of the EDB operating region and the external sector.

The forecasts of the main macroeconomic indicators were prepared by the EDB jointly with the EEC using an integrated system of models based on a multi-country structural dynamic macroeconomic general equilibrium model. More detailed information about the structure of the integrated system of models, its main components, and its use for analysis of the macroeconomic situation and forecasting is contained in a joint EDB and EEC report entitled “Forecasting System for the Eurasian Economic Union”.

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LIST OF ABBREVIATIONS

CPI – Consumer Price Index
EAEU – Eurasian Economic Union
ECB – European Central Bank
EDB – Eurasian Development Bank
EEC – Eurasian Economic Commission
FCS – Federal Customs Service of the Russian Federation
FRS – U.S. Federal Reserve System
GDP – Gross Domestic Product
GFCF – Gross Fixed Capital Formation
HH – Household
MIACR – Moscow Interbank Actual Credit Rate
NFO – Non-financial organization
OFZs – Federal Loan Bonds
OPEC – Organization of Petroleum Exporting Countries
pp – percentage point
RF – Russian Federation
RF CB – Central Bank of the Russian Federation
RF MED – Ministry of Economic Development of the Russian Federation
RF MF – Ministry of Finance of the Russian Federation
Rosstat – Federal State Statistics Service of the Russian Federation
SG – State Governance
U.S. or USA – United States of America
VAT – Value Added Tax
% – per cent
% YoY – Year-on-Year growth rate
SUMMARY

The economic development of the Russian Federation in 2019 progressed against a somewhat difficult external setting. Global economic growth slowed down, largely due to tensions in world trade that undermined investment demand and business confidence. An uncertain global outlook put pressure on commodity prices: most of them trended down last year.

Early this year the Russian economy found itself operating in even more challenging external conditions. The spread of coronavirus has disrupted production chains and worsened economic sentiment. The EDB’s base case projections envisage stabilization of the epidemic during the year; nevertheless, it will lead to a global economic slowdown. The unexpected outcome of the negotiations in the OPEC+ Ministerial Committee, which failed to reach consensus to extend the oil production reduction agreement, caused oil prices to fall. We expect the weak price situation in the world energy market to prevail in the coming months. In the medium term, the weakening of the coronavirus epidemic’s negative effects and recovery of demand for hydrocarbons will support oil prices.

In 2019, Russia’s economic growth decelerated to 1.3%, down from 2.5% the year before. The key factor behind the slowdown was a deterioration in net exports, as external demand weakened and the ruble’s real effective exchange rate strengthened. In the first semester, GDP was additionally constrained by the VAT rate rise and the ensuing temporary acceleration of inflation. In the second half of the year, Russian output began showing signs of recovery, assisted by fiscal and monetary easing.

The EDB projects GDP to grow by 1.3% in the current year. We have reduced the estimate by 0.5 pp compared with the previous one to account for the expected negative impact of the spread of coronavirus and fall in oil prices. Economic activity will be supported by implementation of the national projects’ main stages and by household income stimulation measures. In 2021 and 2022, GDP growth is projected to accelerate to 1.9% as the situation in the world economy and commodity markets stabilizes and domestic structural reforms are implemented.

The Russian ruble strengthened against the U.S. dollar in 2019, supported by the recovery of non-residents’ demand for OFZs as the return on Russian assets was relatively high. Early this year, the ruble was pressurized by the fall in oil prices and mounting fears of a negative impact from the coronavirus epidemic on the world economy. Those factors are likely to persist in the coming months, and the national currency’s exchange rate versus the U.S. dollar will stay close to its current levels. We expect the ruble to partially regain lost ground later, as oil prices gradually recover and the world economic situation stabilizes.
Inflation slowed down to 3.0% YoY in 2019, which is below the Central Bank’s target of 4.0%. This was facilitated by a strengthening ruble, moderate consumer activity and increasing supply of food items. The said factors’ effect will gradually weaken in the current year as household demand strengthens and the Russian currency weakens. The resultant 2020 inflation will be 3.8% according to EDB calculations, which is 0.2 pp lower than previously projected. The revision is mainly due to the indicator’s sharper than expected slowdown in late 2019 and early 2020. In 2021–2022 inflation is projected to keep close to the Central Bank’s target.

With the balance of risks shifting to the disinflationary side, in the second semester of 2019 and early 2020 the Bank of Russia continued to reduce its policy rate, which reached 6.0% at the end of February. The EDB’s base case projection is for the indicator to stay at its current level this year. The measures already taken by the authorities, along with the decrease in exchange rate pass-through to inflation in recent years, will restrict the contribution of the Russian ruble’s weakening to consumer price acceleration. Given the currently low level of inflation, we believe it can be kept within the target range without tightening monetary policy. In the medium term, there remains potential for a policy rate reduction.

The federal budget’s surplus decreased to 1.8% of GDP in 2019, down from 2.6% the year before, which is primarily attributable to a considerable decline of oil and gas revenues because of lower energy prices than the previous year’s. We believe that fiscal policy adopted a stimulative nature in the second half of the year as expenditures on the implementation of national projects grew, and we expect this to remain so in the medium term.
STATE OF THE ECONOMY

Economic Activity

Economic Growth Slows Down in 2019

GDP grew by 1.3% in 2019 after 2.5% in the previous year. We estimate that the key factor behind its deceleration was a decrease in physical exports amid the global economic slowdown and strengthening of the ruble’s real effective exchange rate. Households’ consumer demand declined, possibly due to a temporary acceleration of inflation in the first half of the year as well as due to a slowdown in retail lending. The economy was supported by an increase in the stocks of tangible working assets and by the expansion of public consumption and gross fixed capital formation, the latter possibly driven by active implementation of the national projects in the second half of the year.

The country’s GDP growth was uneven in 2019. In the first semester, GDP was additionally constrained by the VAT rate increase and the ensuing temporary acceleration of inflation. In the second half of the year, Russian output began showing signs of recovery, assisted by fiscal and monetary easing.

Figure 1. Economic Activity

Source: Rosstat, calculations by the authors, EEC
External Demand
Weakening Limits
Output Growth

In terms of sectoral breakdown, our calculations show non-primary activities, mainly administration and ancillary services and real estate transactions, to have reduced markedly their contribution to GDP growth in 2019. The said sectors may have been affected by the increasingly uncertain outlook for the global economy, that worsened business sentiment as well. External demand deceleration was also a factor behind the decrease in the wholesale trade’s contribution to GDP growth (by 0.15 pp, according to our estimates\(^1\)). Construction and the electricity sector also constrained output in the reporting period.

Economic growth was supported in 2019 by the mining and manufacturing industries, as well as financial services. Agriculture and hunting also contributed more to GDP growth, which is mainly attributable to last year’s better harvest.

Figure 2.
GDP Growth Rate Decomposition (period’s growth rate year-on-year)

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP Growth Rate, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>1.8</td>
</tr>
<tr>
<td>2018</td>
<td>2.5</td>
</tr>
<tr>
<td>2019</td>
<td>1.3</td>
</tr>
</tbody>
</table>

Source: Rosstat, calculations by the authors

Consumer Demand Decelerates

Household final consumption expenditures grew by 2.3% in 2019 after 3.3% the year before. According to our calculations, the indicator’s resultant contribution to GDP growth decreased by 0.5 pp from the preceding year's level. Retail trade growth slowed down considerably (to 1.6% in 2019 from 2.8% in 2018), in particular, non-food retailing. The volume of paid services to individuals decreased by 0.9% after 1.4% growth in the preceding year. Consumer activity was constrained in 2019 by a decline in lending to individuals after the Bank of Russia enacted its new macroprudential

\(^1\) Wholesale trade, except trade in motor vehicles and motorcycles.
Investment Activity Strengthens

Updated data on GDP utilization in 2018–2019 point to an increase of investment demand in the reporting period (Box 1). Gross accumulation grew by 2.4% in 2019 (after a 1.1% decrease the year before), including a gross fixed capital formation (GFCF) increase of 1.4% (vs. 0.1% in 2018). A rise in investment activity was observed in the second half of the year that may be explained by the increased public spending on the implementation of the national projects, as well as by monetary policy easing.

Since 1 October 2019 a new risk parameter, debt burden index, has been calculated for loans to individuals. It was introduced so that banks can better assess borrower risks and limit lending to heavily indebted persons. To this end, on four occasions since the beginning of 2018 (in addition to measures that took effect on 1 October 2019) the Central Bank has raised the premiums to the risk coefficients depending on the loans’ effective interest rate. For more information see the Report of the Bank of Russia entitled *Accelerated Growth of Consumer Loans in Bank Lending Structure: Causes, Risks, and Measures by the Bank of Russia* (June 2019).

For more information, see the Bank of Russia report *Inflationary Expectations and Consumer Sentiment*
Increased inventory stocks were a significant contributor to gross accumulation growth in 2019, as shown by the indicator’s faster growth than GFCF. According to Rosstat, the stocks increased due to significant growth of goods-in-process inventories. The higher harvest of 2019 may have had an effect on the data as well. The indicator is highly volatile and frequently subject to revisions, which precludes a definitive judgment about the factors behind its change.

Box 1. Statistics on Russia’s 2018 GDP Revised

In early February, Rosstat published its first estimate of 2019 GDP and updated annual data for 2014–2018. Russia’s 2018 GDP growth rate was revised upwards, to 2.5% from 2.3%. The change in the indicator is mainly explained by a considerable upward adjustment of both households’ and public authorities’ final consumption expenditures, which according to our calculations increased their contribution to annual GDP growth to 2 pp (from 1.3 pp before the update). In turn, gross fixed capital formation growth was revised significantly downwards (from 2.9% to 0.1%). The updated data thus point to moderate investment activity in 2018, with consumption now accounting for the contribution to GDP growth that was previously ascribed to the former.

2018 GDP Components’ Growth Compared by the Income Use Method

A. Growth Rate vs. 2017

B. Contribution to Annual GDP Growth

Source: Rosstat, calculations by the authors
Industrial Output Continues to Support Economic Growth

According to revised data from Rosstat, industrial output increased by 2.3% in 2019 (vs. 3.5% the year before). The indicator slowed down as both domestic and external demand weakened. In addition, the OPEC+ oil production reduction agreement that was in force led to a slowdown in the production of mineral resources (to 2.5% in 2019, from 3.8% the year before).

Manufacturing output grew by 2.6% in 2019 (vs. 3.6% the year before). The global economic slowdown limited the export potential of industry. Moreover, the industrial sector’s growth may have been constrained by businesses’ worsening economic sentiment⁴ amid uncertain prospects for world trade. The overall contribution of industrial output to GDP growth in 2019 was 0.43 pp according to our calculations.

Agricultural output grew by 4.0% during the year. Output accelerated in the second semester due to a higher harvest than the previous year’s. Thus, 2019 saw a higher gross output and yield of most staple crops, including grains (wheat, barley, corn, millet, and rice), sugar beet, flax, vegetables, and sunflower. Output of the main livestock products also showed a positive trend in 2019.

Figure 4.
Production Activity
(period’s growth rate year-on-year)

Source: Rosstat, RF MED

Net Exports of Goods and Services Deteriorate

Foreign trade was a key factor behind the economic growth deceleration in 2019. Physical exports of goods and services decreased by 2.1% compared with the previous year’s (after a 5.5% increase in 2018), while physical imports grew by 2.2% (after 2.6% in 2018). As a result, we estimate

⁴ See: IHS Markit. Russia. Manufacturing PMI.
net exports to have reduced the year’s GDP growth by 1.1 pp (after contributing 0.9 pp in 2018). The indicator deteriorated largely on account of external demand weakening amid the global economic slowdown. The strengthening of the ruble’s real effective exchange rate was an additional constraint.

Figure 5. Foreign Trade Volumes
(period’s growth rate year-on-year)

Source: Rosstat, calculations by the authors

The Labor Market

Households’ real disposable incomes grew by 0.8% in 2019 (after 0.1% in 2018). The indicator accelerated in the second half of the year, driven in particular by faster growth of real wages. The resultant share of wages in the structure of monetary incomes increased to 58.1% in 2019, from 57.4% in 2018. According to the RF MED, real disposable income growth was constrained by increasing loan interest payments. The recovery of the growth in real disposable incomes in the second half of the year drove consumer purchasing.

Lower Unemployment

Unemployment was 4.6% as of the end of 2019, down from 4.8% in 2018. Its decrease was accompanied by a decline in the workforce size amid adverse demographic trends, i.e. population ageing and a deteriorating age structure.

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The CPI growth rate was 3.0% YoY in December 2019, down from 4.3% YoY in December 2018. Core inflation slowed down to 3.1% YoY, from 3.7% YoY the year before. The factors behind the inflation slowdown included strengthening of the national currency and moderate consumer demand growth. CPI decelerated largely on account of a greater supply of agricultural produce after the higher harvest in 2019. The raised VAT rate’s impact on inflation proved temporary and limited, in particular thanks to the monetary policy measures implemented in the second half of 2018.
**Food Inflation Slows Down**

Prices of foodstuffs grew by 2.6% YoY in December 2019 after 4.7% YoY in December 2018. They slowed down considerably in the second half of the year, largely due to the advent of the new harvest. The Russian ruble’s strengthening against major currencies and moderate food retail turnover growth were additional constraints on price growth in this category.

**Moderate Demand and Strengthening Ruble Slow Non-Food Prices**

Non-food goods appreciated by 3.0% YoY in December 2019 (vs. 4.1% YoY in December 2018). Inflation in this segment of the consumer basket decreased visibly in 2Q–4Q after accelerating early in the year. This trend may be attributable to weak consumer demand and strengthening of the ruble. Further, the previous year’s high base had an additional disinflationary effect in late 2019, resulting from price rises amid anticipation of the VAT rise.

Service price growth was 3.8% YoY in December 2019, virtually the same as the year before (3.9% YoY in December 2018). The increase in utility charges, passenger fares and communication tariffs was offset by a slowdown in the prices of sanatorium stays and rehabilitation services, education and foreign travel.

**Inflationary Expectations Decline**

According to the Bank of Russia, households’ inflationary expectations declined in 2019 after mounting in the second half of 2018 and early 2019. In January 2020, the population expected 8.3% inflation in the following twelve months, which was 2.1 pp below the local peak of January 2019.

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**Figure 8. Inflation Components**

*(the last month in a quarter vs. the last month of the same quarter a year before)*

*Source: Rosstat, RF CB, calculations by the authors*
The External Sector

Smaller Surplus on Current Account of Balance of Payments

The current account surplus was USD 70.6 billion (4.2% of GDP) in 2019, USD 42.9 billion (or 2.6% of GDP) less than in the preceding year. The change resulted from the decreased trade surplus and expansion of the services and investment income deficit. With respect to financial account transactions (excluding the international reserves), the Russian Federation was a net borrower in 2019 (after being a net lender in 2018) on account of a smaller outflow of private sector capital and a growing inflow of non-residents’ funds into OFZs and Eurobonds.

Figure 9. Balance of Payments (four quarters’ moving total)

![Graph showing the balance of payments over four quarters.]

Source: Rosstat, RF CB, calculations by the authors

Exported Goods Decline

The trade surplus was USD 163.1 billion in 2019, USD 31.3 billion less than in the preceding year. The key factor behind the decrease in the foreign trade balance was the decline of Russian goods exports (by USD 25.2 billion, or by 5.7%). The decrease in sales of Russian commodities abroad (mineral products, metals and metal products), largely caused by the deteriorating world market, was their main driver. Exports of most other goods categories, primarily machinery and equipment as well as chemical products, also decreased in 2019. Their trend was shaped by external demand’s deceleration and the strengthening of the Russian ruble’s real effective exchange rate.
Russian goods exports to both the EAEU and third countries declined in 2019. Against the backdrop of a quicker fall in sales to states outside the Union, the significance of mutual trade for Russia increased somewhat after a marked decrease at the end of the previous year. As a result, the share of EAEU countries in Russian goods exports grew to 8.9% in 2019, from 8.5% in 2018.

Mutual Trade within EAEU Grows in Significance

Imported goods increased in value by USD 6.1 billion (or by 2.5%) in 2019. Their growth was mainly driven by an increase in imports of chemical products that was probably temporary, as pharmaceuticals imports surged due to expectations of compulsory labeling of medicines being introduced in 2020. Other key product groups (machinery and equipment, foods, and metals and metal products) largely followed domestic demand: a decrease...
in the first half of the year gave way to a recovery in the second semester as consumer and investment activity grew.

**Lower Capital Outflow**

According to Bank of Russia estimates, private sector capital outflow from Russia was USD 26.7 billion in 2019, USD 36.3 billion less than in the previous year. The indicator’s change mainly results from the buildup of non-bank entities’ liabilities as the flow of foreign direct investment into the country increased. The decrease in banks’ foreign assets may also have served to reduce capital outflow.

Non-residents’ demand for OFZs also rose in the reporting period, with the return on Russian assets relatively high and macroeconomic stability maintained.

**Gold and Foreign Currency Reserves Increase**

The Russian Federation’s international reserve assets amounted to USD 554.4 billion as of 1 January 2019, a USD 85.9 billion increase since the beginning of the year. The growth of the gold and foreign exchange reserves, mainly replenished by the Bank of Russia buying foreign currency under its budget rule, was supported by the country’s balance of payments staying in surplus. The volume of international reserves was above the traditional adequacy criteria.

**Figure 12. International Reserve Assets of the Russian Federation**

Source: RF CB, calculations by the authors

**The Fiscal Sector**

**Smaller Budget Surplus**

The federal budget’s surplus was 2 trillion rubles (1.8% of GDP) in 2019, down from 2.7 trillion rubles (2.6% of GDP) the year before. The smaller surplus mainly resulted from a considerable decrease of oil and gas revenues (by
1.4% of GDP) as energy prices were lower than in the previous year. Non-oil-and-gas revenues grew by 1.2% of GDP, mainly on account of growing VAT volume after the tax rate was raised in early 2019. Expenditures grew by 0.6% of GDP last year, with increased spending on the national economy accounting for nearly half of the growth.

Budget execution largely drove economic activity in 2019. In the first semester, the increased fiscal load limited the expansion of investment and consumer demand. In the second half of the year fiscal policy took on a stimulative nature as expenditures on the implementation of national projects grew.

Public Debt Low

According to our estimates, the Russian Federation’s public debt increased to 12.4% of GDP as of 1 January 2020, up from 12.1% at the beginning of 2019. Its rise resulted from the growth of the country’s domestic debt liabilities, fostered in particular by active raising of funds via OFZs. The debt burden remains low in general.

Russia’s Sovereign Credit Rating Raised

In 2019 Fitch and Moody’s, two leading international agencies, raised the Russian Federation’s sovereign credit ratings to BBB and Baa3, respectively, with a stable outlook. These are investment grades. The ratings improved on account of balanced monetary and fiscal policies being pursued that supported macroeconomic stability and helped make the economy far less dependent on the commodity market. The improved ratings may have additionally supported investors’ demand for the Russian market’s debt instruments.
In the second half of 2019 the Bank of Russia continued to reduce its policy rate, which reached 6.25% p.a. by the end of the year. The rate thus decreased by 1.5 pp over the year. The key factors behind such decisions included an emerging trend towards inflation slowing and a shift in the balance of risks towards disinflation. We estimate the policy rate to have been at a near-neutral level in late 2019.

Source: RF MF, calculations by the authors

Monetary Conditions

Bank of Russia Reduces Policy Rate

In the second half of 2019 the Bank of Russia continued to reduce its policy rate, which reached 6.25% p.a. by the end of the year. The rate thus decreased by 1.5 pp over the year. The key factors behind such decisions included an emerging trend towards inflation slowing and a shift in the balance of risks towards disinflation. We estimate the policy rate to have been at a near-neutral level in late 2019.

Source: RF MF, calculations by the authors
The short-term interbank loan rates remained near the policy rate in 2019, with a small negative spread resulting from a structural surplus of liquidity in the banking sector. Returns on ruble OFZs also decreased in the reporting period, but the bonds were still attractive for investors amid the global downward trends in interest rates. Bank lending terms eased as well in the second half of the year, which facilitated the recovery of economic activity.

In 2019, bank lending slowed down. The year’s rate of growth in loans to non-financial organizations and individuals was 6.5% (vs. 13.9% in 2018). The increased issue of corporate bonds (up 12.8% over 2019, according to the Bank of Russia), whose yields fell at a faster pace than loan rates, may have been a factor behind the decrease in the corporate sector’s demand for loans. Retail lending’s deceleration was driven by the prudential measures taken by the Bank of Russia and by the increased debt burden on households. The negative revaluation of foreign currency assets, as the Russian ruble strengthened against the U.S. dollar, was a significant factor behind slower growth of the banks’ credit portfolios.

There was a continued trend towards a lower share of foreign currency in non-bank organizations’ bank loans, which accounted for 24.8% as of 1 January 2020 (down from 28.8% a year before). The displacement of bank contracts denominated in foreign currency may have a positive effect on the functioning of the monetary policy transmission mechanism and facilitate a gradual reduction in non-financial organizations’ exposure to foreign exchange risks.
Russian Ruble Strengthens

In 2019 the Russian ruble strengthened against the world’s major currencies. The national currency was supported by recovering inflows of non-residents’ funds into OFZs amid the relatively high return on Russian assets and macroeconomic stability. Expectations of a policy rate reduction that made current investments in Russian securities more attractive in comparison with the future may also have boosted investors’ demand for the ruble.

Ruble’s Real Effective Exchange Rate Overvalued

The Russian ruble’s real effective exchange rate strengthened following the nominal rate in 2019. As a result, we estimate the national currency to have moved into overvalued territory in 4Q2019, which made a significant contribution to the deceleration of inflation.

Figure 17. Russian Ruble Exchange Rates (period’s growth rate year-on-year, + = ruble strengthening)

Source: RF CB, calculations by the authors
ECONOMIC OUTLOOK

Background

Activity in the world’s major economies slowed down in 2019. The Eurozone’s aggregate GDP growth declined to 1.2%, from 1.9% in 2018; the U.S. economy grew by 2.3% after 2.9%, and China’s grew by 6.1% after 6.6%. The slowing global trade and worsening economic sentiment amid mounting trade protectionism constrained production and investment activities and were only partially offset by stimulative domestic policies.

The external setting remained highly uncertain early this year. On the one hand, the Phase 1 trade agreement entered into by the USA and China reduced the risk of global recession. On the other hand, the spread of the coronavirus may offset the positive effect of emerging progress in the settlement of their trade conflict. The EDB’s base case projection is for the epidemic to gradually stabilize this year but that it will still depress economic activity worldwide.

We estimate China’s economic growth to slow down to 5.0% in 2020. The key factor will be the coronavirus epidemic’s effects on consumer and manufacturing activities. The shock is supposed to be temporary and the Chinese economy should begin recovering this year, supported by monetary and fiscal stimuli. It should be noted that the assessment of the current situation’s impact on business activity is far from certain.

Economic growth in the Eurozone is projected to slow down in 2020. Late 2019 and early 2020 data point to continued weakness of the German industrial sector, and the consequences of the spread of coronavirus will have an additional negative effect. The Eurozone’s economy will stay supported by its soft monetary policy; in conjunction with a recovery of global trade, projected for the medium term, this will serve to accelerate the zone’s GDP growth.

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The weaker fiscal impetus will slow U.S. economic growth in the medium term and cause it to stabilize at its near-potential level. The worsening global economic situation and the problems faced by Boeing Corporation\(^7\) may be additional constraints in 2020. We estimate U.S. monetary policy to retain its stimulative nature throughout the projection period.

**Lower Oil Prices in 2020**

The uncertain global outlook put pressure on commodity prices in 2019, with most of them depreciating. The fall of energy prices accelerated early this year because of the negative effect of the spread of coronavirus on energy consumption predicted by international organizations, as well due to the unexpected outcome of negotiations in the OPEC+ Ministerial Committee, which failed to reach consensus to extend the oil production reduction agreement. We expect a weak price situation in the world energy market to prevail in the coming months. In the medium term, the weakening of the coronavirus epidemic’s negative effects and recovery of demand for hydrocarbons will support oil prices.

**External Inflation**

Consumer price index growth in the Eurozone and USA is projected to be lower than the ECB and FRS targets throughout the time horizon, amid moderate economic activity, decreasing energy prices and low inflationary expectations. Inflation in China is expected to slow down gradually after accelerating in 2019 as the meat price shock effect peters out.

**Structural Measures**

It remains the projection’s key domestic assumption that the Government of the Russian Federation will take structural measures to raise the country’s economic growth potential. These primarily include the implementation of national projects and a set of measures to improve the business climate in Russia, as well as initiatives set out in the Russian President’s address to the Federal Assembly\(^8\) in January 2020 aimed at stimulating households’ incomes and invigorating investment activity. According to calculations by the Russian Ministry of Finance\(^9\), the fiscal reserves built up are sufficient to fund the State budget’s expenditures in the medium term.

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\(^8\) For more information see: [Address by the President to the Federal Assembly](https://www.kremlin.ru/events/2020/01/15/61610).

The above measures are expected to exert an effect on economic activity primarily through faster growth in investment demand, which will stimulate the economy to raise productivity and help diversify its growth factors. The structural reforms are projected to produce their maximum effect in the long run.

**Table 1. Forecast Key Foreign Economic Indicators**

<table>
<thead>
<tr>
<th></th>
<th>Average annual Urals oil price (USD per barrel)</th>
<th>Euro Zone real GDP growth rate, %</th>
<th>China real GDP growth rate, %</th>
<th>Inflation in the Euro Zone, % (at end of year)</th>
<th>Inflation in China, % (at end of year)</th>
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<td>2020</td>
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<td>5.0</td>
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<td>2022</td>
<td>52.8</td>
<td>1.4</td>
<td>5.9</td>
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*Source: calculations by the authors, EEC*

**Economic Activity**

**2020 Economic Growth to Stay at Last Year’s Level**

In 2020, the GDP growth rate is projected to be 1.3%, like the year before. Investment and consumer demand will be supported by the implementation of the national projects’ main stages, and by household income stimulation measures. Russian non-energy producers may derive additional competitive advantages from a weakening ruble. On the other hand, the said factors’ positive contribution to economic growth may be offset by the adverse consequences of the spread of coronavirus and fall of oil prices, resulting from the weakening of external demand for Russian exports and worsening economic sentiment. That may limit investment activity and the expansion of net exports in the current year. Further, the measures being taken by the authorities to contain the spread of the disease in the world’s major economies are quite likely to disrupt production chains, particularly in Russia. Monetary policy’s contribution to GDP is projected to be close to neutral in the current year.

The above factors will lead to a small negative output gap in 2020, that may contain inflationary consequences from the national currency’s weakening.
We have reduced the estimate of 2020 GDP growth by 0.5 pp compared with the previous one\textsuperscript{11} to reflect the expected adverse effect of the worsened external setting on the Russian economy. Risks of more moderate growth in economic activity prevail in the short run. This primarily results from the fact that the implications of the spread of coronavirus for the world economy are currently hard to predict due to uncertainty as to the scale and duration of this epidemic. We expect its adverse effects to be concentrated on the demand side and to have no significant impact on production capacity. Otherwise it may have stronger and more protracted consequences for the Russian economy. There is also a probability of oil prices staying low for a long time and having a stronger impact on economic agents’ expectations and investment demand than assumed in the base case.

\textbf{Short-term Risks Shifted Towards Growth Deceleration}

\textbf{Figure 18.}\textsuperscript{10} \textbf{Real GDP} \\
\textit{(period’s growth rate year-on-year)}

\textbf{Figure 19.} \textbf{Output Gap}

\textit{Note:} seasonally adjusted data.  
\textit{Source:} calculations by the authors, EEC

\textsuperscript{10} Here and elsewhere the chart ranges correspond to the 10%, 50% and 75% confidence intervals.  
\textsuperscript{11} See EDB Macroreview, October 2019. Russian Federation: Trends and Forecasts.
Economic Growth to be Near Potential in 2021–2022

In 2021 and 2022, Russia’s annual economic growth will accelerate to 1.9% as the world economy and commodity markets stabilize and domestic structural reforms are implemented. We expect the strengthening of investment activity and a gradual rise in labor productivity to create the right conditions for steady growth of household incomes, which will support consumer demand. As global economic growth recovers, increasing external demand will drive up exports, primarily of non-energy goods.

Risks to Economic Growth to Persist

The mid-term risks to Russian GDP emanate from both the external sector and the domestic economy. There remains a probability of a harsher global slowdown than assumed in the base case, which would probably lead to a weakening of Russian exports and investment activity. The stimulative effect of the domestic fiscal policy measures may be limited, in particular due to restrained economic sentiment. There also remains some uncertainty as to the speed and efficiency of the implementation of the national projects.

Inflation

Inflation in Russia continued to slow down early this year. Consumer price index growth slowed to 2.4% and 2.3% YoY in January and February, respectively. Disinflationary factors remained dominant, associated with the effects of the Russian’s ruble's strengthening late last year passing through to prices, moderate consumer activity and an expanded supply of agricultural produce after a large harvest.

2020 Inflation to be Near Target

We project the above factors’ effects to weaken during this year, mainly on account of national currency depreciation that will have a pro-inflationary effect. On the other hand, given the currently low level of inflation and the reduction of exchange rate pass-through to inflation in recent years, we expect growth of the consumer price index in 2020 to stay within the target range of the Bank of Russia (3.8% with a 4.0% target).

Compared with our previous projection, we have reduced our estimate of inflation in 2020 by 0.2 pp. This mainly results from the indicator’s sharper than expected slowdown in late 2019 and early 2020. There are both pro-inflationary and disinflationary risks in the short-term. The former result from

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12 For more information, see the EDB Special Report Exchange Rate Pass-Through Effects on Inflation in EDB Member Countries.
In February this year, the Bank of Russia continued its round of monetary policy easing by reducing its policy rate by 0.25 pp, to 6.0%. The decision was explained by an inflation slowdown early this year that was sharper than the regulator had expected. In our opinion, there remains potential for further rate reduction. On the other hand, the pro-inflationary risks grew in March amid mounting volatility in the world financial and commodity markets. In this situation, the EDB projection’s base case assumes the policy rate will stay

![Figure 20. Inflation](period year-on-year)

Note: seasonally adjusted data.
Source: calculations by the authors, EEC

**2021–2022 Inflation to be Near Target**
In 2021–2022, inflation is projected to vary near the Bank of Russia target. Acceleration of economic growth will be accompanied by the expansion of production capacity, which will result in a neutral effect of economic activity on the change in consumer prices. Exchange rate movements will follow an equilibrium path without exerting any upward or downward pressure on inflation.

**Pro-Inflationary Risks to Persist in Mid-Term**
The mid-term risks remain shifted to the pro-inflationary side. The population’s expectations, which are sensitive to price fluctuations in individual items, remain unanchored. Harsher sanctions rhetoric by Western countries and greater capital outflow in the case of a further worsening of the external setting may lead to temporary acceleration in the weakening of the national currency, which will have an impact on inflation.

**Monetary Conditions**

**Neutral Interest Rate Policy**
In February this year, the Bank of Russia continued its round of monetary policy easing by reducing its policy rate by 0.25 pp, to 6.0%. The decision was explained by an inflation slowdown early this year that was sharper than the regulator had expected. In our opinion, there remains potential for further rate reduction. On the other hand, the pro-inflationary risks grew in March amid mounting volatility in the world financial and commodity markets. In this situation, the EDB projection’s base case assumes the policy rate will stay
at the 6.0% level till the end of the current year. According to our estimates, this will ensure a near-neutral contribution of monetary policy to GDP growth and help to keep inflation within the Bank of Russia target.

The potential for policy rate reduction to 5.5% may be achieved in the medium term as the situation in financial and commodities markets stabilizes. We estimate this level to be consistent with inflation remaining consistently near its target level, with economic activity and the Russian ruble’s exchange rate near equilibrium.

**Figure 21. MIACR (the period’s average)**

![Figure 21](image)

Source: calculations by the authors, EEC

**Russian Ruble to Weaken in 2020**

Early in the current year, the ruble was pressurized by the fall of oil prices and mounting fears of a negative impact from the coronavirus epidemic on the world economy. Those factors are likely to persist in the coming months, and the national currency’s exchange rate versus the U.S. dollar will stay close to its current levels. Then we expect the ruble to partially regain lost ground, as oil prices gradually recover and the world economic situation stabilizes. The national currency will be supported by the authorities’ domestic economic policy aiming to maintain macroeconomic and financial stability.\(^{14}\) As a result, we estimate the exchange rate to average around RUB 68.5 per USD.

**National Currency Exchange Rate to Adjust to Equilibrium Level in 2021**

If the events follow our base case, then starting from the second half of 2020 we can expect investors’ interest in Russian financial assets to recover as the return on them stays relatively high. This factor may additionally support the national currency and stimulate the exchange rate to adjust to the equilibrium level during 2021.

\(^{14}\) On 9 March this year, the RF Ministry of Finance stated it would conduct foreign currency sale transactions in the domestic market in accordance with its budget rule if oil prices are below the base level (USD 42.4 per barrel in 2020). On 10 March the Bank of Russia started preemptive sales of foreign currency in the domestic market under this mechanism.
The main risks to the exchange rate still emanate from the external sector. There remains a probability of the negative trends in the world economy aggravating, which may trigger further depreciation of key Russian export goods and provoke investors to cut their demand for emerging markets’ assets. The Western countries’ policy of sanctions against Russia also remains a risk factor for the national currency.

Source: calculations by the authors, EEC

Table 2. Key Macroeconomic Indicators of the Russian Federation

<table>
<thead>
<tr>
<th>Indicators</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020F</th>
<th>2021F</th>
<th>2022F</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP in constant prices (% growth YoY)</td>
<td>1.8</td>
<td>2.5</td>
<td>1.3</td>
<td>1.3</td>
<td>1.9</td>
<td>1.9</td>
</tr>
<tr>
<td>Consumer price index (% growth in December to previous year’s December)</td>
<td>2.5</td>
<td>4.3</td>
<td>3.0</td>
<td>3.8</td>
<td>3.9</td>
<td>4.0</td>
</tr>
<tr>
<td>Nominal MIACR rate in national currency (the year’s average % per annum)</td>
<td>9.0</td>
<td>7.1</td>
<td>7.2</td>
<td>6.0</td>
<td>5.6</td>
<td>5.6</td>
</tr>
<tr>
<td>Nominal Russian Ruble to U.S. Dollar Exchange Rate, RUB per USD (the year’s average)</td>
<td>58.3</td>
<td>62.5</td>
<td>64.7</td>
<td>68.5</td>
<td>68.0</td>
<td>69.8</td>
</tr>
</tbody>
</table>

Source: calculations by the authors, EEC