RUSSIA

Highlights

- **The economy is recovering from a moderate contraction in 2020.** Russia's economy proved resilient to the shock of the Covid-19 pandemic, thanks to strong fiscal and external buffers. Higher commodity prices and the lifting of Covid-19-related restrictions are supporting growth in 2021, despite the uneven pace of vaccination and resurgence of infections.
- **Monetary policy has turned from accommodative to tight amid a sustained rise in inflation.** The Central Bank of Russia (CBR) reversed its loose policy and undertook a series of policy rate hikes in response to inflation rising to a five-year high, driven by an improving labour market, a depreciating Russian rouble and higher global food prices.
- **The government is taking steps to reduce red tape.** The authorities are implementing a "regulatory guillotine", a universal review of business regulations aimed at cancelling or replacing superfluous ones. Meanwhile, progress on the infrastructure-oriented "national projects" scheme remains slow.

Key priorities for 2022

- **Steps are needed to increase the role and competitiveness of the private sector.** Russia's economy is being held back by a dependence on commodity exports, a dominant public sector and a challenging business environment. Reducing the role of the state in the economy through privatisations, addressing anti-competitive regulations, improving the business environment by reducing regulatory burdens and pursuing infrastructure development would help boost growth, entrepreneurship and competitiveness in the private sector.
- **Efforts to promote innovation, digitalisation and technology development need to be intensified.** Promoting the development of new technologies and digitalisation through incentives and investment would improve the productivity of the private sector and foster the growth of the manufacturing and services sectors. Hastening the digitalisation of public services would also have the benefit of cutting red tape and improving the business environment.
- **Transparency and impartiality in public governance need to be improved.** Steps need to be taken to address corruption in the public administration, while the impartiality of the judiciary needs to be ensured to provide a level playing field and predictable business environment for all businesses.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	1.8	2.8	2.0	-3.0	4.3
Inflation (average)	3.7	2.9	4.5	3.4	6.4
Government balance/GDP	-1.5	2.9	1.9	-4.0	-0.6
Current account balance/GDP	2.0	7.0	3.9	2.4	5.7
Net FDI/GDP [neg. sign = inflows]	0.5	1.4	-0.5	-0.2	0.5
External debt/GDP	32.9	27.5	29.1	31.8	n.a.
Gross reserves/GDP	27.5	28.2	32.9	40.2	n.a.
Credit to private sector/GDP	52.1	51.2	52.7	60.0	n.a.

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Covid-19: macroeconomic implications

The economy has been resilient and weathered the Covid-19 pandemic relatively well. As a result of years of prudent macroeconomic policies, the economy entered the Covid-19 pandemic with strong fiscal and external buffers. This provided enough room for an increase in government consumption, which, together with rising non-oil net exports (helped by a weaker Russian rouble), offset part of the contraction in household consumption. A rebound in oil prices since the end of 2020 and improving labour market conditions are supporting a return to growth in 2021; gross domestic product (GDP) grew by more than 10 per cent year-on-year in the second quarter of 2021.

A surge in inflation has led the CBR to adopt tighter monetary policy. Inflation has more than doubled since the start of the Covid-19 pandemic, reaching 7.4 per cent in September 2021, driven by rising global food prices, supply chain problems, a strengthening labour market and the depreciation of the rouble. In response, the CBR has undertaken six consecutive rate hikes, of a cumulative 325 basis points, since the start of 2021.

Despite uneven progress in vaccination and a resurgence of the Covid-19 pandemic, growth is expected to be relatively high in 2021. The authorities have avoided nationwide lockdowns despite a sharp rise in infections during the summer of 2021. Meanwhile, the rate of vaccination has picked up after a slow start early in 2021. As a result, private consumption and investment are expected to continue driving the recovery, despite the tightening monetary policy. At the same time, rising commodity prices and the relaxation of the Organization of the Petroleum Exporting Countries plus (OPEC+) production quotas will continue supporting net exports. As a result, the economy is forecast to grow by 4.3 per cent in 2021, followed by 3.0 per cent in 2022. The forecast is subject to upside and downside risks, depending on progress with the Covid-19 pandemic, the path of oil prices and the outcome of several geopolitical issues.

Policy response to Covid-19

Policy response has shifted towards measures to support households. In April 2021 the president announced a series of social spending measures, including one-off payments of up to RUB 10,000 (US$ 130) per child to families, which is estimated to cost around 0.3 per cent of GDP. While most regulatory measures to promote lending and the restructuring of loans to small and medium-sized enterprises (SMEs) were phased out early in 2021, hiring incentives offered to Covid-19 pandemic-affected businesses have been extended until the end of the year.

Efforts to increase the resilience of the economy are limiting the size of potential stimulus measures. Despite the fiscal room offered by a budget returning to surplus, the authorities' emphasis on reducing the sensitivity of the economy to sanctions means that future measures are unlikely to entail substantial spending.

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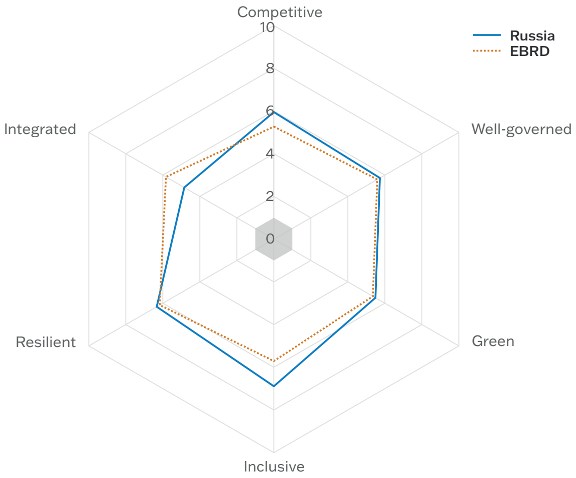
Assessment of transition qualities (1-10)



Structural reform developments

The authorities are undertaking a comprehensive review of business regulations. As part of the "regulatory guillotine" scheme, public agencies are reviewing more than 20,000 business regulations and requirements in consultation with the private sector. A large number of regulations, some of which date back to the Soviet era, are being cancelled or replaced based on cost-benefit analyses. The scheme is expected to improve the business environment by cutting red tape and aligning regulations more closely with the needs of businesses.

The government and businesses are preparing a new high-tech economy plan. Among other things, this involves the digitalisation of government services and SMEs.

Implementation of the "national projects" scheme remains behind schedule. Government expenditures were diverted from investment to consumption and social transfers during the early stages of the Covid-19 pandemic, slowing progress in implementing the national projects, a series of 13 large-scale infrastructure and social development projects set out by the president in 2019. Nevertheless, the authorities have stated that the government will tap into the US$ 186 billion National Welfare Fund to help finance planned investments in the future.

Legislation aimed at reducing greenhouse gas emissions was signed into law. While short of setting a deadline for net zero emissions, the new law, which entered into force in July 2021, aims to cut emissions to 70 per cent of 1990 levels by 2030. The law introduces reporting requirements and emission limits for large greenhouse gas emitters and creates a carbon credit system for companies to offset their emissions with climate-friendly investments and initiatives such as reforestation. Also, the issuance of green bonds continues to develop.

The authorities are revising tax treaties with major foreign direct investment (FDI) source countries. The government has adopted a more restrictive stance on double taxation, seeking to limit exemptions to withholding taxes on interest and dividends earned by foreign entities in Russia. Tax treaties with Cyprus, Luxembourg and Malta were updated over the past year following renegotiation, while the authorities have terminated the double taxation treaty with the Netherlands, which accounts for 9 per cent of the FDI stock in Russia.