Russia[1]

Highlights

- **Cracks are beginning to show in the economy's resilience.** Falling energy prices have eroded the large current account surplus that helped the economy weather the storm of sanctions in 2022, and recent months have seen a significant weakening of the rouble, which has caused inflation to rise.
- **Growing economic imbalances are posing difficult policy choices.** The ongoing war on Ukraine implies significant expenditure, and cutting non-military spending is politically difficult. Government revenues are declining as oil prices fall. The central bank has, therefore, increased policy rates significantly to reduce domestic demand and discourage imports.
- **Structural reforms remain largely stalled.** Russia's increased isolation is already having a negative impact on productivity and growth. The authorities' focus on the ongoing war means that much-needed reforms continue to be postponed.

Key priorities for 2024

- **No meaningful reform progress is possible until Russia ends its invasion of Ukraine and seeks to re-establish itself as part of the global economy.** Such a step remains unlikely in the short term, as there is no sign of any move by the Russian authorities in this direction.
- **Beyond the conflict, a concerted effort to promote private-sector development is needed to boost growth, entrepreneurship and competitiveness.** From a structural perspective, the Russian economy continues to suffer from a lack of diversification. It is heavily dependent on commodity exports, with a dominant public sector and a challenging business environment – all trends that have been exacerbated by the war.
- **Efforts are needed to promote innovation, digitalisation and technological development.** The loss of vital technology imports as a result of sanctions has seriously damaged the manufacturing sector, and ongoing efforts to develop domestic alternatives are unlikely to compensate sufficiently.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.2	-2.7	5.6	-2.1	1.6
Inflation (average)	4.5	3.4	6.7	13.8	5.3
Government balance/GDP	1.9	-4.0	0.8	-1.4	-3.7
Current account balance/GDP	3.9	2.4	6.7	10.5	3.4
Net FDI/GDP [neg. sign = inflows]	-0.6	-0.2	1.4	1.2	1.4
External debt/GDP	29.0	31.3	26.3	17.0	n.a.
Gross reserves/GDP	32.7	40.0	34.3	25.9	n.a.
Credit to private sector/GDP	53.2	60.3	55.3	56.4	n.a.

1. The EBRD announced on 4 April 2022 that, following the invasion of Ukraine, its Board of Governors had formally suspended Russia's access to EBRD funding for projects or technical cooperation.

Macroeconomic developments and policy response

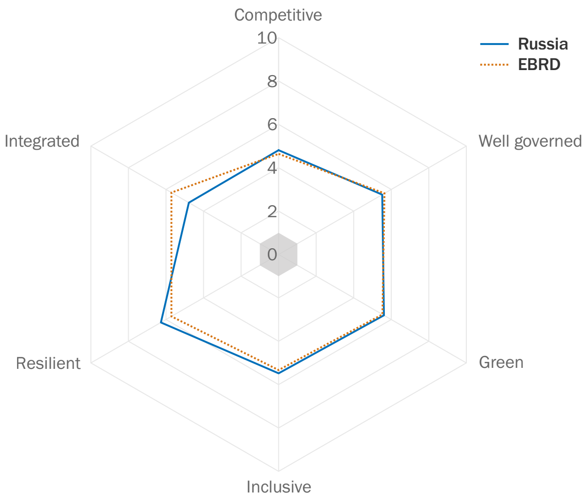
The Russian economy proved resilient to sanctions in 2022, but cracks are developing. The economy contracted by 2.1 per cent in 2022, much less than had been expected given the wide-ranging sanctions imposed. Stimulus in the first half of 2023 is likely to result in the economy returning to growth for the year as a whole. Its resilience in 2022 was largely due to significant growth in the current account surplus, which reached US$ 227 billion (€211.4 billion), or 10 per cent of gross domestic product (GDP). The surplus was driven by high energy prices, which boosted Russia's terms of trade and helped export revenues boom, particularly as Russia managed to diversify its export markets away from the West in response to the sanctions. These trends strengthened the rouble and helped lower inflation, from almost 18 per cent in March 2022 to around 2 per cent in April 2023.

Loose fiscal policy has resulted in overheating in 2023. The economy has seen a growing output gap in the context of a tight labour market due to military mobilisation and high rates of capacity utilisation. Faced with expenditure demands arising from the ongoing invasion of Ukraine, the authorities are finding it challenging to tighten fiscal policy, especially as cutting non-military spending would be politically unpalatable. For the time being, the National Welfare Fund and local bond issuance have enabled them to maintain expenditure levels.

A significant decline in the current account surplus in 2023 is a major cause for concern. Loose fiscal policy has drawn in imports, while falling energy prices and European Union-imposed price caps on Russian oil and oil-derived products have hit export revenues, shrinking the current-account surplus significantly. The surplus was US$ 25 billion (around €23.5 billion) in the first seven months of 2023, an 85 per cent decrease from the same period in 2022. As much of the central bank's foreign-exchange reserves are frozen and private capital inflows are minimal, a worsening balance-of-payments situation is a major concern. These challenges have weighed on the rouble, which weakened by more than 30 per cent against the US dollar between December 2022 and October 2023, further adding to inflationary pressures. In response, the central bank has been tightening monetary policy to try to stem domestic demand and thereby cut import demand. A 100 basis-point hike in the policy rate in July 2023 was followed by a 350 basis-point jump in August, another 100 basis-point increase in September and a 200-basis point increase in October, bringing the policy rate to 15 per cent.

The short-term outlook for growth is weak. Although policy tightening is causing the economy to slow significantly in the second half of 2023, the stimulus-driven growth of the first half of the year should result in a GDP growth rate of around 2 per cent for the year as a whole. The outlook for 2024 will depend very much on how the war on Ukraine and the related economic sanctions evolve; at this stage, economic growth is forecast at around 1 per cent. The outlook is likely to remain bleak in the absence of a peace agreement that results in a loosening of sanctions. Meanwhile, the economy's shift towards autarky and the loss of qualified workers to emigration mean that long-term growth potential will remain significantly eroded.

Assessment of transition qualities (1-10)



Structural reform developments

Structural reform has been extremely limited in 2023. Russia's war on Ukraine has left the country isolated and barred from accessing much western technology. This is hindering the country's ability to diversify away from oil.

Implementation of the National Projects scheme has slowed significantly. The ongoing conflict has resulted in a diversion of government expenditure, hampering progress on implementing the National Projects, a series of 13 large-scale infrastructure and social development projects set out by the president in 2019. There has been no progress of note over the past year.

The authorities are continuing their comprehensive review of business regulations, known as the "regulatory guillotine". This involves a review of more than 20,000 business regulations and requirements. Many regulations, some of which date back to the Soviet era, are being abolished or replaced based on cost-benefit analysis. The scheme is supposed to improve the business environment by cutting red tape and aligning regulations more closely with the needs of businesses.