REVERSING THE SLUMP.
MACROECONOMIC FORECAST FOR 2016–2018[1]
V.Averkiev, S.Drobyshevsky, M.Turuntseva, M.Khromov

According to our forecast, the period 2017–2018 will see renewed growth of practically every main socioeconomic activity index, even under the scenario geared to a persistently unfavorable external situation. The economy will be able to show only weak growth at a rate of 2% в per annum. Inflationary and budgetary risks will persist. Sustainable growth can only be achievable if a consistent and predictable economic policy is implemented in order to improve the domestic business and investment climate, carry on structural reform, and eliminate the macroeconomic destabilization risks.

As shown by the period-end results for Q2 2016, a significant number of socio-economic indices were still displaying a negative movement pattern by comparison with Q2 2015; nevertheless, their rates of decline had become slower.

The lowest point has been passed

In Q2 2016, the rate of GDP decline amounted to 0.6% (relative to Q2 2015); investment in fixed assets dropped by 3.9%, retail turnover – by 5.6%. Meanwhile, the industrial production index (IPI) increased by 1.0% on the same period of 2015. The agricultural sector continued to display growth (at a rate of 2.5%, as a year earlier); besides, since early 2016, freight turnover had also increased (+1.0% in Q2).

The volume of foreign trade continued to slide. Thus, in Q2 2016, exports and imports in US dollar terms dropped by 23.5% and 9.8% respectively on Q2 2015.

Over the course of Q2 2016, the consumer price index was moving slightly above its last year's level – it increased by 1.2% (vs. by 1% in Q2 2015). Correspondingly, in Q2, the average interest rate on ruble-denominated loans stood at 12.9% per annum in nominal terms, or 5.1% in real terms. The monetary base over that quarter slightly contracted to Rb 10.8 trillion, while ruble money supply (M2) increased to Rb 36.5 trillion due to an increase of the money multiplier from 3.2 to 3.4.

In Q2 2016, the average nominal ruble-to-USD exchange rate stood at Rb 65.9, thus having gained 11.7%. The real effective exchange rate of the ruble over Q2 2016 gained 11.3% on Q1 2016.

So, the movement patterns displayed over the course of Q2 by the major macroeconomic indicators confirmed our prediction[2] that in mid-2016, the Russian economy would pass through the lowest point of the current crisis (if no new negative shocks occurred in the nearest future). At the same time, at present there are no indications that a sustainable growth trajectory may indeed establish itself, and low economic activity can be expected to persist at least for the next few months.

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Two scenarios

When assessing the development prospects for the Russian economy over the period until 2018, we considered two possible scenarios. We expect that under each of these scenarios, the year-end results of 2016 will indivate a further shrinkage of the Russian economy and a decline in the major macro-economic indicators in real terms. Later on, in 2017–2018, the Russian economy can be expected to gain a positive growth rate, even if the external situation should follow the conservative pattern of development. Besides, both scenarios rule out the possibility that the economic and financial sanctions introduced against Russia and Russia's retaliatory sanctions against the USA and the EU can be abolished before 2018.

Under the basic scenario, it is expected that, in 2016–2018, the average annual price of Urals crude oil will amount to $40 per barrel[1]. At that price level, it would be unrealistic to hope that the Russian economy may indeed face a significant improvement of its foreign trade conditions.

Under the second (optimistic) scenario it is expected that, by the end of 2016, the price of Urals crude oil will amount to $42 per barrel, and then it will further rise to $50 per barrel in 2017 and to $60 per barrel in 2018. The average nominal ruble-to-USD exchange rate under the basic scenario will be Rb 67.5 in 2016, Rb 65.3 in 2017, and Rb 64.9 in 2018. Under the optimistic scenario, the average nominal ruble-to-USD exchange rate over the period 2016–2018 will amount to Rb 67.1, Rb 60.8, and Rb 57.3 respectively. Thus, the real effective exchange rate of the ruble in 2016 will increase by 7.2% under the basic scenario, and by 8.7% under the optimistic one. Thereafter it will continue to be on the rise under both scenarios: at an approximate rate of 3.5% per annum under the basic scenario, and by 7% per annum under the optimistic one.

We expect that the year-end results of 2016 will demonstrate a plunge of GDP by 0.7–0.8% in real terms. In 2017, the decline will give way to growth of 0.5% to 0.9%, and in 2018 – 1.5% to 1.9%.

The movement pattern of the industrial production index will give more reason for optimism, and this will be made evident already by the year-end results of 2016 – its decline will halt (100% on 2015). We expect that in 2017 and 2018, the IPI will display growth by 1.1% and 1.8% respectively under the basic scenario, and by 1.4% and 2.0% respectively under the optimistic one.

Similar behavior patterns will also be displayed by the other economic activity indicators. In 2016, investment in fixed assets will drop in real terms by 2.2–2.3%, retail turnover by 4.9–5%, and real disposable income by 3.8–3.9%. For 2017, it is forecasted that retail turnover will follow a rickety trajectory (somewhere between 0.3% and +0.1%), alongside growth of investment (by 1.5–1.7%) and real disposable income (by 0.6–0.8%). In 2018, growth will be demonstrated by all these indicators: investment will increase by 0.6–0.8%, retail turnover by 0.9–1.4%, and real disposable money income by 1.9–2.4%.

Inflation (measured as CPI) in 2016 (vs. 2017/2018) will amount to 6.3% (vs. 5.7%/5.1%) respectively under the basic scenario, and to 5.9% (5.3%/4.8%) under the optimistic one. Over the period 2017/2018, the growth rate of CPI will continue to slide under the two scenarios: to 5.3–5.7% and to 4.8–5.1% respectively. So, according to our estimates, by 2017 inflation may remain at

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[1]   We treat this scenario as a basic one, for a possible comparison with the forecast worked out by the RF Government.

a level approximately 1 p.p. above the RF Central Bank's inflation target due to eased constraints on the demand-side.

Under the basic scenario, the forecasted exports of goods will amount, in 2016, to $271.9bn, and imports to $184.8bn; thereafter, in 2017 (2018), these two indicators will display some growth – to $281.7bn ($288.1bn) and $205.1bn ($216.9bn) respectively. Under the optimistic scenario, exports and imports will demonstrate a somewhat similar movement pattern: $276.9bn and $185.7bn in 2016, followed by more robust growth to $313.7bn ($350.5bn) in 2017 and to $216.4bn ($244.8bn) in 2018 respectively. Thus, a positive current account balance will be observed throughout the entire three-year period under both scenarios.

The existence of factors like persisting inflation risks (CPI above its target value), federal budget deficit and a slow financial recovery pace reported by businesses may confirm our assumption that interest rates will remain rather high. Thus, in particular, the RF Central Bank will follow a cautious approach to its policy of reducing the key rate. Under the basic scenario, the nominal interest rate on the ruble-denominated loans is forecasted to be at an average level of 12.2% per annum in 2016 (vs. the real interest rate of 4.9% per annum); 10.5% per annum in 2017 (vs. the real interest rate of 4.3% per annum); and 9.5% per annum in 2018 (vs. the real interest rate of 4% per annum). Under the optimistic scenario, the nominal interest rate in 2016, 2017 and 2018 will be at 12.1%, 10.2% and 9.1% per annum respectively (vs. the real interest rate of 4.9%, 4.5% and 4% per annum respectively).

Nevertheless, as can be seen from the estimates cited above, nominal interest rates in 2018 will plunge to their level typical of the period 2011–2012 (approx. 9.0% per annum), when the lending sector was recovering after the 2008–2009 crisis. However, due to the declining inflation in real terms, the interest rates will remain at their current high level.

The Bank of Russia's tough monetary policy, the low demand for bank loans in the real sector and a slow recovery of real disposable personal income will translate into a moderate growth of money aggregates. Thus, in particular, the monetary base's growth rate will amount to 10.2–10.9% in 2016, to approximately 6.6% in 2017, and to approximately 6.0% in 2018. Money supply (M2) will increase by 7.6–8.2% in 2016, by approximately 9% in 2017, and by approximately 11% in 2018. The main source of money supply growth in 2016, similarly to 2015, will remain the Reserve Fund. In 2017–2018, as it is spent up, we expect that the Bank of Russia will again start to refinance the banking sector at an increasing rate by conducting operations in the secondary market for government securities, thus covering budget deficit by way of domestic borrowing.

Adaptation to external conditions and economic growth
Overall, both scenario point to the economy's successful adaptation to the shocks produced by plunging oil prices, economic sanctions and the cyclical decline trend. The reversal of the downward trend within a two-year period (2015–2016) in face of a continually unfavorable external situation (under the basic scenario) and the global economy's slow growth at an unstable rate appears to be a good result. Judging by these developments, we may assume that the Russian economy may indeed enter a new growth trajectory at an annual rate of up to 3–4%. However, for such a scenario to become reality, it will be necessary to improve the business climate, implement structural reform, consistently reduce inflation and achieve stabilization in the budgetary system.

Table

MAIN SOCIOECONOMIC DEVELOPMENT PROJECTIONS

Basic scenario	2016					2017					2018
	Q1	Q2	Q3	Q4	Year-end	Q1	Q2	Q3	Q4	Year-end	Year-end
	actual	actual	estimated	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted
Urals, USD per barrel	32.6	44.4	44.0	39.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0
GDP											
bn Rb	18 561	19 832	22 370	23 384	84 147	19 491	21 260	23 649	24 784	89 184	94 094
physical volume index, as % of corresponding period of previous year	98.8	99.4	99.2	99.3	99.2	99.9	101.2	100.5	100.4	100.5	101.5
deflator	103.1	104.8	105.9	106.9	105.0	105.1	105.9	105.2	105.6	105.4	104.0
Industrial production index											
as % of corresponding period of previous year	99.4	101.0	100.0	99.4	100.0	100.4	102.5	100.7	100.7	101.1	101.8
Investment in fixed assets											
physical volume index	95.2	96.1	99.5	99.8	97.7	100.9	102.2	102.1	100.8	101.5	101.6
Retail turnover											
as % of corresponding period of previous year	94.2	94.4	95.4	96.0	95.0	98.7	99.5	100.0	100.5	99.7	100.9
Real disposable money income											
as % of corresponding period of previous year	96.3	94.0	96.2	98.0	96.1	99.1	100.3	101.0	101.9	100.6	101.9
Exports											
bn USD	68.8	79.9	82.1	85.7	316.5	75.3	80.8	80.7	85.1	321.9	327.2
Including											
Exports of goods	59.3	67.2	70.6	74.8	271.9	66.6	70.2	69.9	74.9	281.7	288.1
oil and gas exports	31.5	36.3	36.8	36.6	141.2	34.3	33.6	32.4	34.6	134.9	130.8
other exports	27.8	30.9	33.8	38.2	130.8	32.3	36.7	37.5	40.3	146.8	157.3
Exports of services	9.5	12.7	11.5	10.9	44.6	8.7	10.6	10.8	10.2	40.3	39.1
Imports											
bn USD	52.1	63.3	71.9	72.3	259.6	59.8	66.6	75.2	77.2	278.9	292.4
Including											
Imports of goods	37.8	45.5	49.5	51.9	184.8	44.8	49.0	54.4	56.9	205.1	216.9

Basic scenario	2016					2017					2018
	Q1	Q2	Q3	Q4	Year-end	Q1	Q2	Q3	Q4	Year-end	Year-end
	actual	actual	estimated	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted
Imports of services	14.3	17.8	22.4	20.4	74.8	15.0	17.6	20.9	20.3	73.8	75.5
CPI											
as % of previous period	102.1	101.2	101.1	101.8	106.3	101.9	101.1	101.1	101.6	105.7	105.1
Average interest rate on ruble-denominated loans over given period, as % per annum											
real	5.7	5.1	4.3	4.4	4.9	4.3	4.5	4.1	4.4	4.3	4.0
nominal	13.3	12.9	11.4	11.0	12.2	10.7	10.7	10.2	10.3	10.5	9.5
Ruble-to-USD exchange rate											
average nominal, for period	74.6	65.9	64.6	65.0	67.5	65.5	65.3	65.1	65.4	65.3	64.9
Ruble's real effective exchange rate											
period-end value, as % of previous period-end value	-8.3	11.3	3.1	1.9	7.2	0.7	0.9	0.8	0.8	3.3	3.7
Money base											
trillion Rb	11.0	10.8	10.9	12.2	12.2	11.5	11.6	11.7	13.0	13.0	13.9
Money supply (M2)											
period-end value, trillion Rb	35.4	36.5	36.6	38.5	38.5	38.9	38.7	39.5	42.2	42.2	47.2
growth, as % of previous period	-1.0	3.0	0.4	5.2	7.6	0.8	-0.5	2.0	6.9	9.4	11.9
Industrial production index											
as % of corresponding period of previous year	99.4	101.0	100.0	99.4	100.0	100.4	102.5	100.7	100.7	101.1	101.8
Unemployment											
% of total labor force	5.9	5.7	5.2	5.6	5.6	5.7	5.2	4.8	5.2	5.2	4.8

Optimistic scenario	2016					2017					2018
	Q1	Q2	Q3	Q4	Year-end	Q1	Q2	Q3	Q4	Year-end	Year-end
	actual	actual	estimated	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted
Urals, USD per barrel	32.6	44.4	44.0	47.0	42.0	50.0	50.0	50.0	50.0	50.0	60.0
GDP											
bn Rb	18 561	19 832	22 370	23 650	84 413	19 663	21 358	23 766	24 765	89 552	95 695

Optimistic scenario	2016					2017					2018
	Q1	Q2	Q3	Q4	Year-end	Q1	Q2	Q3	Q4	Year-end	Year-end
	actual	actual	estimated	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted
physical volume index, as % of corresponding period of previous year	98.8	99.4	99.2	99.6	99.3	100.4	101.9	100.7	100.6	100.9	101.9
deflator	103.1	104.5	105.9	107.9	105.2	105.5	105.6	105.5	104.1	105.2	104.9
Industrial production index											
as % of corresponding period of previous year	99.4	1010	100.0	99.6	100.0	100.8	103.5	100.7	100.8	101.4	102.0
Investment in fixed assets											
physical volume index	95.2	96.1	99.5	100.0	97.8	101.2	102.3	102.3	101.2	101.7	102.3
Retail turnover											
as % of corresponding period of previous year	94.2	94.4	95.4	96.5	95.1	99.0	100.0	100.5	100.9	100.1	101.4
Real disposable money income											
as % of corresponding period of previous year	96.3	94.0	96.2	98.3	96.2	99.5	100.5	101.2	102.0	100.8	102.4
Exports											
bn USD	68.8	79.9	82.1	91.0	321.8	83.6	89.6	89.7	93.7	356.6	395.4
Including											
Exports of goods	59.3	67.2	70.6	79.8	276.9	74.3	78.4	78.3	82.8	313.7	350.5
oil and gas exports	31.5	36.3	36.8	41.6	146.2	42.0	41.7	40.7	42.4	166.8	192.9
other exports	27.8	30.9	33.8	38.2	130.8	32.3	36.7	37.5	40.4	146.9	157.6
Exports of services	9.5	12.7	11.5	11.2	44.9	9.3	11.2	11.5	11.0	42.9	44.9
Imports											
bn USD	52.1	63.3	71.9	73.4	260.7	61.4	69.2	79.5	82.3	292.4	326.6
Including											
Imports of goods	37.8	45.5	49.5	52.9	185.7	46.2	51.2	58.0	61.1	216.4	244.8
Imports of services	14.3	17.8	22.4	20.6	75.0	15.2	18.1	21.5	21.2	76.0	81.8
CPI											
as % of previous period	102.1	101.2	101.1	101.4	105.9	101.8	101.2	101.1	101.1	105.3	104.8
Average interest rate on ruble-denominated loans over given period, as % per annum											
real	5.7	5.1	4.3	4.6	4.9	4.9	4.7	4.0	4.3	4.5	4.0

Optimistic scenario	2016					2017					2018
	Q1	Q2	Q3	Q4	Year-end	Q1	Q2	Q3	Q4	Year-end	Year-end
	actual	actual	estimated	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted	forecasted
nominal	13.3	12.9	11.4	10.8	12.1	10.7	10.6	9.9	9.8	10.2	9.1
Ruble-to-USD exchange rate											
average nominal, for period	74.6	65.9	64.6	63.3	67.1	61.6	60.8	60.3	60.5	60.8	57.3
Ruble's real effective exchange rate											
period-end value, as % of previous period-end value	-8.3	11.3	3.1	3.3	8.7	3.0	1.8	1.2	0.5	6.6	7.6
Money base											
trillion Rb	11.0	10.8	10.9	12.2	12.2	11.5	11.6	11.7	13.0	13.0	13.9
Money supply (M2)											
period-end value, trillion Rb	35.4	36.5	36.6	38.8	38.8	39.0	38.8	39.4	42.2	42.2	46.7
growth, as % of previous period	-1.0	3.0	0.4	5.7	8.2	0.6	-0.5	1.7	6.9	8.9	10.7
IPI											
as % of corresponding period of previous year	99.4	101.0	100.0	99.6	100.0	100.8	103.5	100.7	100.8	101.4	102.0
Unemployment											
% of total labor force	5.9	5.7	5.2	5.5	5.6	5.6	5.1	4.8	5.2	5.1	4.7