FORECAST 2016–2017:
RUSSIA'S ECONOMY TO ENTER A STABILIZATION ZONE[1]
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Developments that unfolded in Q1 2016, particularly the decline of crude oil prices down to a 12-year low, may result in worse-than-expected outcomes at 2016 year-end. Unlike the forecast that we made in January, we have revised down our 2016 baseline scenario for GDP growth rates from -1.4% to -2.0%. In recent two weeks the IMF and the World Bank have downgraded their forecasts for Russia's economy growth rates, too. At the same time, if oil prices in 2017 stay at $40 a barrel, then output is expected to stabilize or even edge up. In other words, it is highly likely that Russia's economy will move out of a recession in 2016, and in 2017 Russia's output will enter a zone of positive growth rates. However, this is a stagnation rather than growth scenario due to uncertainty. Furthermore, the forecast dynamics of other key macroeconomic parameters in 2016 suggest that Russia's economy will stabilize and that the economic downturn, high inflation and high volatility of the Russian rouble will stop.

The release of first assessments of the outcomes of Russia's economic development in 2015 and analysis thereof early in 2016 have revealed a picture that is largely negative. 2015 saw serious deterioration of nearly all the key macroeconomic indicators. In real terms, GDP dropped by 3.7%, investment by 8.4%, real disposable cash income by 3.9%, retail trade turnover by 9.7%. The annualized consumer price index stood at 12.9% in December 2015, and the 2015 average annual consumer prices were up by more than 15% from 2014. Accordingly, the average annual interest rate on rouble-denominated loans increased to 15.7% per annum in nominal terms, whereas in real terms it was as little as 0.5% per annum. The 2015 year-end monetary base remained unchanged, staying at Rb 11 trillion. The rouble money supply (M2) saw an annual increase of 11.5% to Rb 35.8 trillion.

The foreign trade in dollar terms saw a major decline over 2014: exports dropped by 30.9%, including a decline of 39.1% in oil and gas exports, and imports fell by 34.5%.

The rouble to US dollar nominal exchange rate in 2015 averaged 60.9 roubles per dollar, meaning that the rouble weakened by nearly 40% over the average annual value seen in 2014. On the other hand, the rouble's real effective exchange rate dropped in 2015 as little as 7.7% (Q4 2015 over Q4 2014) because the US dollar firmed up (at slower pace) against most of foreign currencies.

Like in January 2016,[2] we built two possible scenarios to look into prospects that Russia's economy may face in 2016–2017. The baseline scenario predicts the Urals crude annual average price to stay at $35 a barrel in 2016

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2   See *Drobyshevsky S., Petrenko V., Turuntseva M., Khromov M*. 2016-2017 forecast: Russia's recession continues // Online Monitoring of Russia's Economic Outlook. Socio-economic trends and challenges, 2016. No. 1(19), January.

and at $40 in 2017. With such oil prices, Russia's economy should not expect better terms of foreign trade for the two ensuing years. The best-case scenario anticipates the Urals crude annual average price to rise to $50 a barrel in 2016 and to edge up to $55 a barrel in 2017. With such presuppositions, the baseline scenario anticipates the rouble to US dollar annual average exchange rate to stay at 68.1 roubles per dollar in 2016 and 63.3 roubles per dollar in 2017 while the best-case scenario suggests that the rouble will be traded at 65.8 roubles per dollar in 2016 and 59.7 roubles per dollar in 2017. The rouble's real effective exchange rate in 2016 is expected to increase 10.9% under the baseline scenario and 16.1% under the best-case scenario, and both scenarios suggest a minor decline in 2017 by 1% and 1.7% respectively.

In 2016 we expect real GDP to continue to fall under both scenarios: by 2% under the baseline scenario and by 0.1% under the best-case scenario. The fall is expected to stop in 2017, with GDP expected to grow by 0.8% under the best-case scenario and to remain unchanged under the baseline scenario. In nominal terms, Russia's economy is expected to continue to grow in 2016–2017 under both scenarios due to price growth driven by growth of the GDP deflator index.

The rest of the economic activity indicators are expected to behave in the same manner. The baseline scenario predicts in 2016 fixed investment in real terms to fall by 3.8%, retail trade turnover by 5.8%, real disposable income by 3.3%; in 2017 investment are forecast to fall further by 0.2% and trade turnover by 1%, with real disposable income expected to see a minor growth not higher than 0.1%. Households consumption is expected to grow at slower pace than the dynamics of households income due to expectations about further contraction in the consumer lending market and because households continue to follow a savings pattern.

The best-case scenario suggests that all the above-mentioned indicators will decline in 2016: investment is expected to fall by 1.8%, trade turnover by 4.8%, and income by 2.4%; however, a growth of 2.2% is anticipated in 2017; by 0.1% and 2% respectively. Inflation (on CPI inflation) in 2016 (in 2017) is expected to stay at 7.9% (6.7%) under the baseline scenario and at 6.8% (5.8%) under the best-case scenario. Hence, it is unlikely that Russia's central bank will reach the target inflation value (on CPI inflation) of 4% per annum by the end of 2017.

In 2016, the volume of foreign trade operations is expected to continue to shrink due to sinking average annual prices of crude oil, metals and other resource-based commodities of Russia's exports. The baseline scenario anticipates export and import volumes to stay at $305.3bn and $248.3bn respectively, with a minor growth in 2017 to $324.6 and $263.1bn respectively. The best-case scenario suggests the same dynamics of exports and imports: decline in 2016 to $353.4bn and $263.8bn respectively, and a minor growth in 2017 up to $381.1bn and $284.9bn respectively.

The forecast inflation dynamics predetermines high level of nominal interest rates in Russia's economy. The baseline scenario anticipates nominal interest rates on rouble-denominated loans to average 12.5% per annum (the real interest rate to average 4.2%) in 2016 and 10.9% (the real interest rate 4%) in 2017. The best-case scenario forecasts the nominal interest rate on loans to non-financial institutions to stay at 12% in 2016 and at 10.5% in 2017 (the real interest rate at 4.3% and 4.7% respectively). The level of real interest rates on loans is expected to continue to be high due to credit risks

in real economy and a lack of serious enhancements in the quality of banks' credit portfolios. At the same time, the Bank of Russia key rate will be cut as early as Q2 2016, and it is expected to stay at 8.0–8.5% under the baseline scenario and at 7.0–8.0% under the best-case scenario, and it is expected to reach 5.5–6.5% in 2017 under both scenarios.

Such dynamics of the Bank of Russia key rate suggests a strict monetary policy and moderate growth of money aggregates. The baseline scenario expects the money supply (M2) to grow by 9.6% and the monetary base by 10.9% in 2016; the best-case scenario predicts growth of 11.5% and 11.8% respectively. In 2017, M2 is expected to continue to grow by 14.2% under the baseline scenario and by 15.1% under the best-case scenario), while the monetary base is anticipated to increase 8.2% under the baseline scenario and 11.4% under the best-case scenario. Like in 2015, the Reserve Fund will remain the key source of money supply in 2016. In 2017 we anticipate the Bank of Russia to increase refinancing of the banking sector due to switching to using domestic loans to finance the federal budget.

Baseline forecast (Urals: 2015=51, 2016=35, 2017=40)	2015					2016					2017
	Q1	Q2	Q3	Q4	year	Q1	Q2	Q3	Q4	year	year
	actual	actual	actual	actual	actual	forecast	forecast	forecast	forecast	forecast	Forecast
Urals crude	52.0	61.4	49.3	41.8	51.1	32.0	35.0	35.0	38.0	35.0	40.0
GDP											
roubles in billions	18.210	19.284	21.294	22.016	80.804	18.643	20.405	21.654	23.804	84.506	91.243
physical volume index as a percentage change over the previous year	97.2	95.5	96.3	96.2	96.3	97.6	99.2	96.4	98.7	98.0	100.0
Deflator	109.3	107.0	108.4	106.4	107.7	105.6	107.7	106.6	109.6	106.7	107.9
Fixed investment											
physical volume index	95.2	91.2	87.0	93.6	91.6	94.9	95.9	96.7	96.5	96.2	99.8
Retail sales turnover											
as a percentage change over the previous year	93.6	90.8	90.4	86.5	90.3	94.0	94.2	93.1	95.4	94.2	99.0
Real disposable cash income											
as a percentage change over the previous year	98.1	95.6	95.1	95.7	96.1	93.1	98.4	97.7	97.6	96.7	100.1
Exports											
dollars in billions	101.3	104.2	91.6	92.1	389.2	68.8	77.2	77.0	82.3	305.3	324.6
Including											
Exports of goods	89.6	91.1	78.4	80.4	339.6	59.3	66.9	66.4	72.3	264.9	286.4
Exports of oil and gas	54.2	54.9	45.8	43.1	198.0	31.5	31.2	29.9	33.1	125.7	135.6
Other exports	35.4	36.2	32.6	37.3	141.5	27.9	35.7	36.5	39.3	139.4	150.8
Exports of services	11.7	13.1	13.2	11.7	49.7	9.5	10.3	10.6	10.0	40.4	38.2
Imports											
dollars in billions	65.0	70.6	75.4	69.8	280.9	52.1	61.8	66.2	68.2	248.3	263.1

Baseline forecast (Urals: 2015=51, 2016=35, 2017=40)	2015					2016					2017
	Q1	Q2	Q3	Q4	year	Q1	Q2	Q3	Q4	year	year
	actual	actual	actual	actual	actual	forecast	forecast	forecast	forecast	forecast	Forecast
Urals crude	52.0	61.4	49.3	41.8	51.1	32.0	35.0	35.0	38.0	35.0	40.0
Including											
Imports of goods	45.0	48.0	50.1	51.0	194.1	37.8	42.9	45.5	50.0	176.2	191.7
Imports of services	20.1	22.6	25.3	18.8	86.8	14.3	18.9	20.7	18.2	72.1	71.4
CPI											
as a percentage change over the previous period	107.4	101.0	101.7	102.3	112.9	102.1	101.7	101.7	102.2	107.9	106.7
Period-average rate on rouble-denominated loans, % per annum											
real interest rate	1.5	0.8	-1.2	0.7	0.5	5.1	4.0	3.9	4.0	4.2	4.0
nominal interest rate	18.6	16.2	14.3	13.7	15.7	12.9	12.5	12.3	12.3	12.5	10.9
Dollar-Rouble exchange rate											
average nominal for the period	62.2	52.6	62.8	65.9	60.9	74.9	69.5	66.1	62.0	68.1	63.3
Rouble's real effective exchange rate											
At period-end, as a percentage change over the previous period-end	-10.8	20.3	-13.7	-0.3	-7.7	-10.0	8.3	5.7	7.6	10.9	-1.0
Monetary base											
roubles in trillions	9.7	9.7	9.8	11.0	11.0	10.3	10.7	10.8	12.2	12.2	13.2
Money aggregate M2											
At period end, roubles in trillions	31.6	32.5	33.0	35.8	35.8	35.3	36.4	37.0	39.2	39.2	44.8
growth, as a percentage change over the previous period	-1.5	2.7	1.4	8.7	11.5	-1.5	3.3	1.5	6.1	9.6	14.2

Best-case forecast (Urals: 2015=51, 2016=50, 2017=55)	2015					2016					2017
	Q1	Q2	Q3	Q4	year	Q1	Q2	Q3	Q4	year	year
	actual	actual	actual	actual	actual	forecast	forecast	forecast	forecast	forecast	Forecast
Urals	52.0	61.4	49.3	41.8	51.1	32.0	55.0	55.9	57.1	50.0	55.0
GDP											
roubles in billions	18.210	19.284	21.294	22.016	80.804	18.340	21.008	22.406	24.666	86.419	93.953
physical volume index as a percentage change over the previous year	97.2	95.5	96.3	96.2	96.3	97.9	102.5	98.7	100.4	99.9	100.8
Deflator	109.3	107.0	108.4	106.4	107.7	103.5	107.3	107.6	111.8	107.0	107.9
Fixed investment											
physical volume index	95.2	91.2	87.0	93.6	91.6	94.9	97.0	99.2	99.7	98.2	102.2
Retail sales turnover											
as a percentage change over the previous year	93.6	90.8	90.4	86.5	90.3	94.0	95.4	94.3	96.9	95.2	100.1
Real disposable cash income											
as a percentage change over the previous year	98.1	95.6	95.1	95.7	96.1	93.1	99.0	99.0	99.2	97.6	102.0
Exports											
dollars in billions	101.3	104.2	91.6	92.1	389.2	68.8	89.4	94.3	100.9	353.4	381.1
Including											
Exports of goods	89.6	91.1	78.4	80.4	339.6	59.3	78.3	82.4	89.5	309.5	337.2
Exports of oil and gas	54.2	54.9	45.8	43.1	198.0	31.5	42.6	46.0	50.2	170.3	186.6
Other exports	35.4	36.2	32.6	37.3	141.5	27.9	35.7	36.4	39.2	139.2	150.6
Exports of services	11.7	13.1	13.2	11.7	49.7	9.5	11.0	11.9	11.5	43.9	43.9
Imports											
dollars in billions	65.0	70.6	75.4	69.8	280.9	52.1	66.4	71.3	74.0	263.8	284.9

Best-case forecast (Urals: 2015=51, 2016=50, 2017=55)	2015					2016					2017
	Q1	Q2	Q3	Q4	year	Q1	Q2	Q3	Q4	year	year
	actual	actual	actual	actual	actual	forecast	forecast	forecast	forecast	forecast	Forecast
Urals	52.0	61.4	49.3	41.8	51.1	32.0	55.0	55.9	57.1	50.0	55.0
Including											
Imports of goods	45.0	48.0	50.1	51.0	194.1	37.8	46.7	49.8	54.9	189.2	208.9
Imports of services	20.1	22.6	25.3	18.8	86.8	14.3	19.6	21.5	19.1	74.5	75.9
CPI											
as a percentage change over the previous period	107.4	101.0	101.7	102.3	112.9	102.1	101.3	101.1	102.1	106.8	105.8
Period-average rate on rouble-denominated loans, % per annum											
real interest rate	1.5	0.8	-1.2	0.7	0.5	5.1	4.1	3.8	4.2	4.3	4.7
nominal interest rate	18.6	16.2	14.3	13.7	15.7	12.9	12.2	11.3	11.4	12.0	10.5
Dollar-Rouble exchange rate											
average nominal for the period	62.2	52.6	62.8	65.9	60.9	74.9	69.5	60.4	58.3	65.8	59.7
Rouble's real effective exchange rate											
At period-end, as a percentage change over the previous period-end	-10.8	20.3	-13.7	-0.3	-7.7	-10.0	7.9	14.1	4.7	16.1	-1.7
Monetary base											
roubles in trillions	9.7	9.7	9.8	11.0	11.0	10.3	10.7	10.9	12.3	12.3	13.7
Money aggregate M2											
At period end, roubles in trillions	31.6	32.5	33.0	35.8	35.8	35.3	37.1	37.5	39.9	39.9	46.0
growth, as a percentage change over the previous period	-1.5	2.7	1.4	8.7	11.5	-1.5	5.2	1.3	6.3	11.5	15.1