MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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THE SCENARIOS OF RUSSIA'S MACROECONOMIC DEVELOPMENT IN 2020 AND MACROECONOMIC POLICY PROPOSALS

The first assessments of the effects of the coronavirus epidemic suggest that the extent of global recession may exceed economic losses brought about by the global 2008–2009 crisis. However, it is not yet clear for how long a sharp slowdown of the global economic activity is going to last and forecasts are based on the assumption that the economy recovers back to normal in a few months.

The first statistical data show that China's GDP could have shrunk by 10–11%, while some forecasts for 2020 predict a slowdown of the Chinese economy from 6% to 1–2%. Other countries' economic losses, with a lockdown taken into account, can be comparable. According to the data of business surveys carried out in the EU and the US in March 2020, the sales sector saw a dramatic reduction in the economic activity and the industry, a slower decline, but these assessment will change for the worse as restrictions continue.

However, in case of the baseline or optimistic scenarios most **leading outlooks** (the IMF, the OECD and the ECB) predict a 1.0 p.p. slowdown of the global economy as compared with the forecasts for 2019 (2–2.5% a year). In a pessimistic scenario, global GDP growth may slow down to zero or even fall further (-3%), but in our view it is unlikely.

In the current situation, the Gaidar institute regards as **the main development scenario for 2020** a decrease in prices for oil in Q2 2020 to $20–25 per barrel and their stabilization at the level of $30–35 per barrel in H2. In terms of noneconomic conditions (the spread of the coronavirus COVID-19), we believe that the pandemic will gradually come to naught in global economic centers (the European Union, the USA, the BRICS countries, East and South-East Asia and the EAEU) by summer 2020, the fatality rate will be within the range of 3–3.5% of the number of those infected with the coronavirus and most quarantine measures limiting the economic activity, travelling and movement of goods will be lifted from the end of Q2 2020.

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At the same time, we believe that **a return to negotiations with the OPEC member-countries** and resumption of the OPEC+ deal regardless of the specific parameters of a decrease in oil supply on the global market is a preferable policy scenario for Russia providing the RF government with more space for maneuver in the domestic economic policy, as well as reducing the risks of a failure to attain the national goals of development in 2024.

It is noteworthy that this situation is similar to that seen on the oil market in 1998–1999 when a lack of a single position and agreement within the OPEC frameworks amid the crisis and a fall in demand for energy commodities in South-East Asia led to a drop-in oil prices to $8–9 per barrel early in 1999, that is, below the cost of oil production with many oil producers. In 2020, a slowdown of the global economy because of the spread of the coronavirus may bring about similar spillovers for the oil market. However, we do not consider the repetition of the scenario of 1999 and a drop-in prices for oil to $15 per barrel (the equivalent of $8–9 per barrel in prices of 1999) or below.

Separation of spillovers caused by the spread of the coronavirus and a fall in oil prices for the global oil market and the Russian economy is quite a complicated task, particularly in a rapidly developing situation. The more so that a decline in oil prices began on the back of slowdown of China's economy and higher risks of slowdown of other economies because of the spread of the coronavirus, while the failure of the OPEC+ deal complicated the situation even further. So, we are not making an attempt to identify these effects separately.

In terms of the main spillovers for the social and economic development of the Russian Federation, both the scenarios are quite similar, differing only in the extent of deviation of new predicted values from the scenarios developed in January 2020.

The main findings are as follows:

- The effects of the two external negative shocks (growth in uncertainty and a slowdown of the global economy on the back of the spread of the coronavirus and a decrease in prices for oil) on Russia change dramatically the external environment for Russia's economic development and its economic policy agenda. Under current conditions, Russia cannot afford a substantial mitigation of the monetary and fiscal policies simultaneously, much less start speeding up economic growth above the funding incorporated in the 2020–2022 federal budget (with amendments included).
- One has to take into account the fact that with a dramatic decrease in global GDP growth rates non-oil and gas exports will fall in volume and value terms. As in 2008–2009, demand and prices for some other goods which are attributed to traditional Russian exports (coal, timber, ferrous and non-ferrous metals and fertilizers) are likely to fall. According to our calculations, taking into account the experience of the 2008–2009 crisis, with slowdown of global GDP growth rates, say, to 0.5%, export revenues from the sale of such goods on global markets may fall by 10–25% depending on the category. An overall decrease in exports in value terms may amount to about $20 bn, including ferrous metals ($4 bn), coal (around $2.5bn) and non-ferrous metals ($2 bn).
- The monetary policy's short-term priority consists in stabilizing the domestic foreign exchange market and mitigating a surge in consumer inflation on the back of the pass-through effect of the exchange rate to prices and decreased confidence in the Russian ruble. By our estimates, the fundamentally justified exchange rate of the ruble to the US Dollar with the price for oil being equal to $30–35 per barrel amounts to Rb74–

76 per $1, while with the oil price of $45–50 per barrel, to around Rb70 per $1. Accordingly, foreign-exchange policy measures should be aimed at preventing a substantial long-term deviation of the exchange rate from these levels on the back of the development of panic sentiments because in case of a dramatic depreciation of the ruble the foreign exchange market may stabilize only with the much weaker ruble, thus bringing about a sharp deviation of the inflation rate from the target, revaluation of country risks and a large-scale capital flight. At the same time the Central Bank of Russia should not defend specific levels of the exchange rate in order to prevent speculative attacks on the national currency.

• It is noteworthy that at present (unlike the situation of 2008 and 2014) there are no grounds on the eve of a fall in oil prices to regard the exchange rate as the one being above the fundamentally justified values. In 2008 and 2014, waiving a stable exchange rate and preservation of international reserves were necessary for a more rapid switchover to a new level which was consistent with changes in the external environment and a macroeconomic balance in the Russian economy. At present, such an adjustment is feasible owing to a free-floating regime and the monetary authorities have to prevent an "overshooting" of the exchange rate in case of panic sentiments on the market.

- With an additional factor in terms of a global uncertainty and decreased confidence in emerging markets because of the spread of the coronavirus taken into account, by our estimates, further depreciation of the ruble may amount to 15–20%. In other words, a peak depreciation in the exchange rate of the ruble may amount to Rb90–95 per $1 in April-May and its return to the level of Rb75–80 per $1 is expected by the end of the year.
- Operations on sale of foreign currency out of the international reserves of the National Welfare Fund (apart from the sale of foreign exchange within the frameworks of the budget rule for financing the deal on purchasing by the government of the Sberbank) can become an additional instrument, which use has been declared by the RF Central Bank, for reducing panic sentiments on the foreign exchange market. By our estimates, the sum of additional support of the currency may amount to $30bn, which in combination with sales within the budget rule (over $20bn with the price for Urals oil being equal to $25 per barrel) increases supply of foreign currency on the market by over $50bn, thus making it feasible, proceeding from the balance of payments of the Russian Federation, to stabilize the foreign exchange market. In particular, the overall volume of OFZ securities held by non-residents does not exceed $50bn at the exchange rate as of March 1, 2020. It is noteworthy that such a practice in the short term is in agreement with the inflation targeting regime and keeps the exchange rate of the ruble close to the fundamentally justified level, particularly with taking into account a substantial decrease in the private sector's foreign debt in the past few years and a decline in households' propensity to dollarization of assets.
- However, in case of increased pressure on the ruble and a threat of panic on the foreign exchange market, the RF Central Bank may tighten its monetary policy and increase the key interest rate. At the same time, the extent of such an increase is very difficult to calculate amid a high uncertainty. By our estimates, with increased pressure on the ruble, the key interest rate will have to be increased to 9–12% in 2020[1], however, by the end of the year the key rate may be reduced to 7%. It should be remembered that

as seen from the 2014 experience the tightening of the monetary policy may be insufficient for preventing a sharp weakening of the national currency. One cannot exclude, as it happened in December 2014, an introduction of a temporary requirement for mandatory sale of a portion of foreign currency export earnings on the domestic foreign exchange market and a "manual" mode of regulation of this market (based on individual agreements with the main market participants).

- By our estimates, with a 30% depreciation of the ruble against the US Dollar at year-end 2020, the consumer price index (CPI) will not exceed 5–6%, that is, the inflation rate will go beyond the targeted level, but remains under the monetary authorities' control. Consequently, at present the RF Central Bank's decision to leave the key interest rate unchanged is quite justified. At the same time, a dramatic decline in economic activity will keep inflation in check, while a slowdown of economic growth below the potential level may, on contrary, require a stimulating policy as the situation on financial markets stabilizes. The key rate can be raised only in case of a marked worsening of sentiments and a large-scale capital outflow.[2] It is noteworthy that with the key rate maintained at a low level in the current situation, it is impossible to restrain growth in market interest rates in the economy as they are guided by the extent of depreciation of the ruble exchange rate and, consequently, fail to stimulate investment and consumer activities.
- Importantly, the cited fundamentally justified values of the exchange rate (and relevant CPI values) will make it possible to stabilize the balance of payments. Owing to a fall in prices for oil and Russia's other main export commodities (gas, LNG, coal, metals and fertilizers), exports are going to decrease markedly to $310–320 bn. With the expected annual average devaluation of 30%, imports in value terms will fall by 30–35%, as well (in 2014 the depreciation of the ruble real exchange rate was equal to about 11% and imports decreased by 9%; in 2015 the devaluation

1 Received on the basis of evaluations of the implicit rule of the RF Central Bank's monetary policy in 2014–2019.

2 The indices of the exchange rate pass-through are received on the basis of economic evaluations of the exchange rate pass-through to prices in the Russian Federation in the 2000s with the effect of an asymmetric pass-through reaction on the weakening and strengthening of the nominal exchange rate of the ruble against the US Dollar.

of the real exchange rate was equal to about 30% and imports fell by 35%). In other words, imports fell from $255 bn to $180–190 bn. On the back of it, the trade commodity balance will remain at the 2019 level, that is, around $160–165 bn. At the same time, the balance of trade in services has markedly improved owing to a decline in the Russians' travelling abroad: from the level of (-$35 bn) to (-$20–25 bn). Other items of the balance of payments are not expected to change considerably. Thus, the current account surplus may also increase from $70 bn to $80–85 bn. At the same time, the financial account deficit is unlikely to exceed $100bn in the worst-case scenario (in 2014 and 2008 it was equal to -$130 bn and -$140 bn, respectively, however, as stated above, Russian economic agents' foreign debt has largely decreased and, consequently, demand for foreign currency to refinance it declined, too). It means a possible decrease (maximum $20 bn) in international reserves, apart from the sale of the foreign exchange in the interests of the RF Ministry of Finance within the frameworks of the budget rule.[1]

- As regards the budget policy, we believe that owing to the 2016–2018 fiscal consolidation the level of public spending has adapted to oil prices in the range of $40–45 per barrel. However, the implementation of national projects started in 2019 and approval by the RF State Duma on March 12, 2020 of the Law on Amendment of the 2020–2022 Federal Budget formalizing additional long-term social obligations have raised the price of federal budget balancing up to $53 per barrel (with the exchange rate of about Rb67 per $1). Consequently, the federal budget will be run with a noticeable deficit in 2020. It is obvious that amid the coronavirus epidemic measures to support the economy and population should be the priority in 2020.
- With the annual average price for oil being equal to $32–33 per barrel and the annual average Ruble/US Dollar exchange rate of Rb75 per $1, federal budget revenues are expected to fall from Rb20.6 trillion2 (of which oil and gas revenues amount to Rb7.5 trillion) to Rb15.9 trillion (of which oil and gas revenues amount to Rb3.2 trillion). Further, in case of this scenario the federal budget deficit is forecasted at Rb3.8 trillion (against the surplus of Rb0.9 trillion in compliance with the law on the federal budget); the public debt is expected to grow from Rb11.3 trillion as of the beginning of 2020 to Rb14.0 trillion late in 2020; the National Welfare Fund (NWF) is expected to decrease from $126 bn as of the beginning of 2020 to $107 bn by the end of 2020 (without counting in the sale of the foreign exchange for purchasing Sberbank equities).
- However, in our view, no tightening of the budget policy (revision of the budget rule or sequester of spending) is needed because the NWF has enough liquid funds and the capacity of the internal public debt market

1 The spillovers from depreciation of prices for oil and changes in the ruble exchange rate across the items of the balance of payment are received on the basis of econometric models of exports and imports and the countable model of the overall equilibrium for the Russian trade developed by the RANEPA and the Russian Academy for Foreign Trade of the RF Ministry of Economic Development.

2 In accordance with the Federal Law of March 12, 2020 "On Amendment of the Federal Law "On the Federal Budget in 2020 and the 2021-2022 Planned Period".

is sufficient enough to fund a shortfall in oil and gas revenues. In both the scenarios reduction in budget spending is highly undesirable because it aggravates the situation with a fall in overall demand in the economy (consumer spending on services has already decreased, exports have shrunk on the back of the coronavirus epidemic and depreciation of prices for oil and investment spending is expected to decline owing to growing uncertainties and depreciation of the ruble exchange rate). On the contrary, it is expedient to carry out a focused anti-crisis budget policy which both prevents the worsening of the financial situation of enterprises and various economic sectors hit the hardest by the crisis (the travel industry, freight companies and other) and supports the level of household consumption by means of budget transfers (for example, through advanced indexation of social transfers, introduction of temporary benefits for workers whose enterprises halted operations for the duration of the lockdown and other). If spillovers of the current economic shock are mid-term, the volumes and structure of federal budget expenditures in 2021 and 2022, including the criteria of priority budget spending will have to be revised.

- As regards implementation of national projects in the current situation, non-financial measures stimulating the private sector activity and improving the business and investment climate become increasingly important; they include: upgrading and digitalization of public administration and document management, deregulation, implementation of the road map on business climate transformation, expert and consulting support and other.
- As seen from the preliminary assessments of the momentum of macroeconomic indices in 2020, in the above scenario Russia's GDP will decrease by 1–2% in 2020. Consequently, capital investments may fall by 5–8% and households' spending on ultimate consumption will be equal to 4–5% (the actual decrease in consumption depends on the extent of the ultimate devaluation of the ruble). At the same time, in our view, the effect on the rate of unemployment with the natural trend in the decline in the number of the gainfully employed population taken into account will be temporary and by the end of the year, even with a decrease in real GDP, unemployment growth will not exceed 1–1.5 p.p., that is, this index may increase from 4.5% to 6.0% of the gainfully employed population, in other words, less than in the 2014–2015 crisis.[1]

The results of the forecast of Russia's main economic indicators in 2020 are shown in the table.

1 Estimates of the main macroeconomic indicators describing the social and economic situation of the Russian Federation in 2020 for both the scenarios were received on the basis of the mid-term model of macroeconomic forecasting in the RF and the model of balanced financial indicators of the Gaidar Institute.

Table

Forecast of Russia's Main Macroeconomic Indicators in 2020.

Annual average price for Urals oil, USD per barrel	32–33
Exports, billion USD	310–320
Real GDP index, %	98–99
Index of investments in capital assets, %	92–95
Index of households' real consumption, %	95–96
Level of unemployment, % of gainfully employed population	6.0
CPI, %	105.0–106.0
Russian Ruble/US Dollar nominal exchange rate as of the end of 2020	75–80
RF Central Bank's key interest rate as of year-end, %	6.0
Federal budget deficit, trillion Rb	3.8