# MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

## TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

## No. 1(39) January 2017

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# MAIN TRENDS AND CONCLUSIONS

The moderately optimistic economic situation that had emerged in December 2016 did not undergo any significant changes in January 2017, excepting one circumstance that has become the focus of so much attention lately. Nowadays, the lifting of the old sanctions seems to become less likely, while the introduction of new ones – slightly more so.

In all its other aspects, the economic situation looks even better than it did a month ago. It is also true both of the economic results of last year, their preliminary nature notwithstanding, and of the economic forecasts for the current year. All these forecasts are practically unanimous in this respect, especially the forecasts for Russia's GDP growth, which were upgraded by both foreign (the World Bank and the largest Western banks) and Russian economists. However, they are equally unanimous in predicting that over the next one or two years, Russia is not going to initiate any serious structural and institutional reforms capable of significantly changing the dynamics of its economic growth.

In particular, the authors of the macroeconomic forecast for 2017 and 2018, presented here, note that in the framework of their scenarios they do not consider the consequences of implementing any of the currently designed programs of Russia's socio-economic development. Provided that there are no new external shocks, Russia is practically guaranteed a period of positive growth rates – however modest.

The forecast considers two scenarios. According to the conservative scenario, Urals crude oil will stay at $40 per barrel in both 2017 and 2018. According to the baseline scenario, it will stay at $50 in 2017, and at $60 in 2018 (it is noted that it is the conditions assumed for the baseline scenario 'that fully reflect the positive trend in oil prices that has emerged in recent months and would seem most likely to exist in the next two years'. Both scenarios predict real GDP growth: under the conservative scenario, it is expected to be approximately 0.6% in 2017 and 1.7% in 2018, while the baseline scenario is much more optimistic, predicting real GDP growth climbing to 1.4% in 2017 and to 2.2% in 2018. The growth rates of some other important indicators (investment, real personal incomes etc.) closely resemble that of GDP. The authors believe that in absence of structural reform, any rise in the growth rates of GDP, investment and personal incomes will only become possible if oil prices should resume their steady annual growth to a level of $100 or more. However, they consider the development of such a scenario unlikely in the medium term. Moreover, 'in the event of its implementation, there will be a sharp rise in the risks of a new economic crisis in Russia, if oil prices stabilize and reforms are delayed until a later time'.

Practically every economic forecast treats Russia's inflation having reached a historic low in 2016 as a major success and a positive factor, which will make it possible to more confidently appreciate the prospects for this country's economic development. Our experts have looked at the set of factors that contributed to the achievement of such a result, including the strengthening of the ruble, the monetary policy of the Bank of Russia (e.g. the maintenance of a high level of the key interest rate) and the persistently low demand; they

note that the positive situation with regard to food prices (in December 2016 they increased by just 4.6% relative to December 2015, vs. by 14.0% in December 2014 relative to December 2014) was determined, in the main, by the strengthening of the ruble and a good harvest.

Nevertheless, inflation expectations remain high. Potentially, prices could come under upward pressure from growing wages and demand, as well as from the softening of budgetary policy expected at the beginning of the oncoming political cycle. Also, one cannot completely rule out the possibility of negative dynamics of oil prices and of a toughening of the US Federal Reserve System's policy. Therefore, the authors do believe, on the whole, that the prospects of achieving the 4% inflation target are rather dim at the moment. According to their point of view, the RF Central Bank will pursue a policy of gradually decreasing its key interest rate until it becomes 'confident that its inflation target has been achieved'.

Our experts' analysis indicates that the gap between the RF Central Bank's key interest rate and the interest rate on ruble-denominated credits has shrunk to 2 p.p. from 3.5 p.p. in 2015 (the interest rate on ruble-denominated credits itself dropped from 13.4% in early 2016 to 12%.1% in October of that year). According to our experts, these facts indicate that Russia's lending market is ready at last for a further reduction of the key interest rate.

On the whole, according to the results of the first 11 months of 2016, the amount of loans issued by the Russian banking system to the corporate sector has increased purely symbolically – by just 1.6%. The issuance of ruble-denominated loans was a little bit more active, while the amount of newly issued FX loans continued to decline. At the same time, it should be said that the lending market avoided shrinkage only due to its transactions with big business, while the amount of loans issued to small and medium-sized enterprises was even smaller than in 2015. On the other hand, judging by all appearances, bad debts may be past their peak – in recent months, the share of past-due debt in all categories of credits has been on steady decline.

The RF Ministry of Agriculture continues to seek government aid in the form of loans issued to the Russian agrarian sector. The logic behind the Ministry's requests that such an aid should be maintained and further expanded is crystal clear: the government must support a growing and successful industry.

Our experts have come to the conclusion that Russia has ample potential for developing its agrarian sector and, 'if current trends continue', Russia's food exports will exceed food imports (sharply reduced due to the ruble's devaluation) already in the course of this year, which will mean that Russia will become a net exporter. In 2015, Russia became the world's second largest exporter of wheat, barley and sunflower oil and the world's largest exporter of buckwheat, having pushed China into second place. If Russia manages to surpass the international rates of development of agriculture and food-processing industries, it will be able both to increase its traditional exports and to enter the global market with new products such as poultry meat, pork, sugar, potatoes, melons, gourds etc.●

# 1. AN ONSET OF CYCLICAL GROWTH. MACROECONOMIC FORECAST FOR 2016–2018
### V.Averkiev, S.Drobyshevsky, M.Turuntseva, M.Khromov

*In Q 3-4 2016, Russia's economy entered the phase of cyclical growth from the lowest point of the business cycle, its typical feature being the unstable movement patterns of the main socioeconomic development indicators. Inflation hit its historic low. The ruble's strengthening boosted the confidence of the population and businesses in the Russian national currency's sustainability. Nevertheless, the past year saw a decline of the majority of macroeconomic variables. In 2017–2018, cyclical growth is expected to continue, but it will be sustained neither by a favorable external situation, nor by the implementation (as of the present moment) of a government reform program. In absence of any new external shocks, this can be practically viewed as a guarantee, for Russia, of a low but positive growth rate, with an exit, towards late 2018, from negative output gap zone.*

In Q3 2016, the rate of GDP decline became somewhat slower, amounting to 0.4% relative to Q3 2015. Industrial production shrank by 0.1%, retail turnover by 4.7%, and real disposable personal income by 5.7%. At the same time, in Q3 2016, for the first time in a two-year period, investment in fixed assets gained 0.3% on the same period of 2015. The year-end Consumer Price Index (CPI) for 2016 amounted to 5.4%, which is its record low of the entire observation period in post-Soviet Russia. From our point of view, such movement patterns displayed by these indicators are suggestive of the onset of a cyclical growth phase from the lowest point of the business cycle, although the year-end values of the majority of indices are still indicative of their negative dynamics.

The movement of international prices of Urals crude oil remained positive throughout the entire year, having risen from $32.6 per barrel in Q1 2016 to 48.8 per barrel in Q4 2016. As a result, the average annual price of Urals crude oil in 2016 amounted to $43.0 per barrel, which is below its 2015 level ($51.3 per barrel).

In our forecast, we envisage two possible scenarios of economic development over the next two years. The parameters plotted for these scenarios have been chosen (in addition to other considerations) so as to ensure their comparability with the initial parameters suggested in the official forecast prepared by the RF Ministry of Economic Development.

In the conservative version of our forecast, the average annual price of Urals crude oil is expected to stand at $40 per barrel both in 2017 and in 2018. This assumption suggests that, over the next two years, the terms of trade for the Russian economy will be slightly less favorable than in 2016. Nevertheless, a scenario with similar parameters was chosen by the RF Government as a baseline for the law 'On the RF Federal Budget for 2017 and the Planning Period 2018–2019'.

Under the basic scenario, it is expected that the average annual price of Urals crude oil will rise to $50 per barrel in 2017, followed by its further growth to $60 per barrel in 2018. These parameters reflect the positive trend displayed by oil prices over the past few months, and we believe that they are most likely to persist over the next two years.

So, the external conditions and parameters suggested in our scenarios have remained the same as in the previous version of our forecast[1]; meanwhile, their values *per se* have somewhat changed, to reflect the newly released actual data on the state of affairs in the RF economy in Q3-4 2016.

As before, its decline in 2016 by 0.6% notwithstanding, we expect that real GDP in 2017 and 2018 will be on the rise under both scenarios. Even given the somewhat worsening external situation envisaged in the conservative scenario, it predicts that in 2017, real GDP will gain 0.6%. Under the basic scenario for 2017, real GDP will display a more robust growth by 1.4%. In 2018, the forecasted economic growth rate will increase to 1.7% under the conservative scenario, and to 2.2% under the basic one. The behavior of the industrial production index (IPI) points to the onset of its growth as early as 2016: we estimate its year-end value to stand at 0.1%. Under the conservative scenario, its growth rate is expected to amount to 1.1% in 2017 and to 2.1% in 2018; under the basic scenario – to 1.7% in 2017 and to 2.3% in 2018 respectively.

The behavior of the majority of other economic activity indicators will mimic that of real GDP. We estimate that in 2016, investment in fixed assets will decline by 2.0%, retail turnover by 5.0%, and real disposable money income by 4.3%. Under the basic scenario, all these indicators are expected to increase both in 2017 and 2018 (investment in fixed assets by 1.8% and 2.5%; retail turnover by 0.3% and 1.5%; and real disposable money income by 1.5% and 2.7% respectively). The conservative scenario is not so optimistic: it predicts that in 2017 and 2018, investment in fixed assets will gain 1.7% and 2%, and real disposable money income - 0.9% and 1.6% respectively. Retail turnover is going to remain practically unchanged in 2017 (with a slight plunge of 0.1%), and then to increase by 1% in 2018.

The Consumer Price Index (CPI) will amount to 4.9% in 2017 and to 4.5% in 2018 under the conservative scenario, and to 4.6% and 4.2% respectively under the basic one. Thus, according to our estimations, under both scenarios the inflation index will get close to its target value, although it is unlikely that the Bank of Russia's nominal inflation target is going to be actually reached.

In 2016 , the average annual nominal ruble-to-USD exchange rate stood at Rb 67.1. Under the conservative scenario, in 2017 the ruble will continue to climb against the US dollar at an average annual rate of 64.8, and then, in 2018, it will somewhat weaken to 66.3 (if oil prices remain low, the upward trend produced by the ruble's strengthening after its downfall in late 2015 – early 2016 will also persist in 2017; in case of persistently low oil prices, the ruble's exchange rate will once again begin to decline in 2018). The real effective exchange rate of the ruble over the same two-year period will gain 0.5% and 1.7% respectively. Under the basic scenario, in 2017 and 2018 alike, the ruble will gain in nominal terms, rising to 60.9 and 57.3 respectively. Its real effective exchange rate will gain 6% in 2017 and 7.15% in 2018.

In 2016, the volume of exports amounted to $325.4bn, and that of imports – to $261bn; thus, their shrinkage on 2015 was 17.2% for exports and 7.2% for imports. Under both scenarios, both exports and imports will display growth as early as 2017. Under the conservative scenario, exports will gain only slightly, increasing to $326.2bn in 2017 and to $333.5bn in 2018. Under the basic scenario, exports will increase to $358.9bn in 2017 and to $404.1bn

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1    *V. Averkiev, S. Drobyshevsky, M. Turuntseva, M. Khromov.* Macroeconomic Forecast for 2016–2018. Russian Economic Developments, 2016, No.10, pp. 3–9.

in 2018. As for imports, in 2017 their volume will increase to $284bn under the conservative scenario, and to $286.6bn under the basic one. In 2018, the volume of imports is expected to amount to $280bn under the conservative scenario, and to $319.6bn under the basic one.

The rapid inflation decline will ensure that interest rates on loans will stay at a sufficiently high level in real terms, in spite of their gradual decline in nominal terms. In 2016, the average interest rate on ruble-denominated loans was estimated to stand at 12.5% per annum in nominal terms (vs. 5.5% in real terms). In 2017 and 2018, it will amount to 10.9% and 9.7% in nominal terms (vs. 5.2 and 4.8% respectively in real terms) under the conservative scenario, and to 10.4 and 9.3% respectively under the basic one (vs. 5% and 4.7% respectively in real terms).

Growth of money supply (M2) in 2016 will amount to 10%, and that of the monetary base – to 14.2% relative to 2015. In 2017, M2 will gain 7.7% under the basic scenario, and 9.2% under the conservative one; the corresponding indices for 2018 are 9.7% and 11.1% respectively. The monetary base will gain 5.7% in 2017 and 7.3% in 2018 under the conservative scenario, and 4.7% and 6.8% respectively under the basic one. The principal factor responsible for money supply growth in 2017 (similarly to 2016) will be the tapping of the RF Reserve Fund by the RF Ministry of Finance in order to cover the federal budget deficit. In 2018, as the exhausted Reserve Fund gives way to loans on the domestic market as a major source for covering the federal budget deficit, money supply will once again be sustained in the main by loans issued by the Bank of Russia to commercial banks, with government securities pledged as collateral thereof.

Thus, according to our forecasts, the year 2017 will see the onset of cyclical recovery growth in the Russian economy; the predicted oil price corridor (of $40–50 per barrel) will produce a relatively neutral effect on that growth: its bottom value is fraught with no danger of a new external shock, while its ceiling is still far below the multiyear average of $75–80 per barrel). At the same time, the output gap will remain negative in 2017 (a situation that is also expected to persist over 2018 under the conservative scenario). The cyclical growth phase in the Russian economy will continue into 2018, and under the basic scenario, the output gap will amount to zero.

However, it should be noted that, as in the framework of our scenarios we do not estimate the potential consequences of any of the socioeconomic development programs that are currently being elaborated, to be launched from 2018, the structural growth rate across the economy[1] is expected to be very low, and so growth will occur only due to its cyclical component. Under such conditions, a growth rate above 2% per annum, as well as higher growth rates of investment in fixed assets and real disposable money income, can only be achievable if oil prices should resume their stable year-on-year growth to a level of $100 per barrel or higher. However, from our point of view, such a course of events is unlikely in the medium-term perspective. If it should become reality, the risk of a new crisis in the Russian economy will surge, in face of oil price stabilization and postponement of the much-needed reforms.

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1    For the description of our methodology for estimating structural growth rates, see Sinelnikov-Murylev S., Drobyshevsky S., Kazakova M. *Decomposition of Russian GDP Growth Rates in 1999–2014*. Economic Policy (in Russian). 2014. No.5. P. 7–37.

| Conservative forecast | 2016 | | | | | 2017 | | | | | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Year-end | Q1 | Q2 | Q3 | Q4 | Year-end | Year-end |
| | actual | actual | actual | actual/ estimate | actual/ estimate | forecast | forecast | forecast | forecast | forecast | forecast |
| **Urals, USD per barrel** | 31.9 | 43.6 | 43.9 | 48.0 | 41.9 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 |
| **GDP** | | | | | | | | | | | |
| bn Rb | 18 561 | 19 979 | 22 190 | 23 341 | 84 072 | 19 208 | 20 701 | 22 985 | 23 911 | 86 804 | 90 865 |
| physical volume index, as % of corresponding period of previous year | 98.8 | 99.4 | 99.6 | 99.7 | 99.4 | 100.3 | 101.3 | 101.1 | 99.9 | 100.6 | 101.7 |
| deflator | 103.1 | 104.2 | 104.7 | 105.7 | 104.0 | 103.1 | 102.3 | 102.5 | 102.6 | 102.6 | 102.9 |
| **Investment in fixed assets** | | | | | | | | | | | |
| physical volume index | 95.2 | 96.1 | 100.3 | 100.3 | 98.0 | 100.3 | 101.1 | 102.1 | 102.3 | 101.7 | 102.0 |
| **Retail turnover** | | | | | | | | | | | |
| as % of corresponding period of previous year | 94.2 | 94.1 | 95.3 | 96.4 | 95.0 | 98.3 | 99.9 | 100.3 | 100.9 | 99.9 | 101.0 |
| **Real disposable money income** | | | | | | | | | | | |
| as % of corresponding period of previous year | 96.3 | 94.2 | 94.3 | 97.9 | 95.7 | 98.8 | 100.1 | 101.9 | 103.0 | 100.9 | 101.6 |
| **Exports** | | | | | | | | | | | |
| bn USD | 68.8 | 80.5 | 84.4 | 91.7 | 325.4 | 77.2 | 81.6 | 81.8 | 85.6 | 326.2 | 333.5 |
| *Including* | | | | | | | | | | | |
| exports of goods | 59.3 | 67.9 | 70.9 | 79.6 | 277.7 | 68.0 | 70.8 | 70.4 | 74.8 | 284.0 | 293.0 |
| *oil and gas exports* | 31.5 | 36.8 | 38.7 | 42.2 | 149.2 | 36.0 | 34.1 | 32.5 | 33.9 | 136.5 | 136.7 |
| *other exports* | 27.8 | 31.1 | 32.2 | 37.4 | 128.5 | 32.0 | 36.7 | 37.9 | 41.0 | 147.5 | 156.3 |
| exports of services | 9.5 | 12.7 | 13.5 | 12.1 | 47.7 | 9.2 | 10.8 | 11.5 | 10.8 | 42.2 | 40.5 |
| **Imports** | | | | | | | | | | | |
| bn USD | 52.1 | 64.4 | 72.9 | 71.6 | 261.0 | 59.8 | 66.4 | 73.6 | 74.9 | 274.7 | 280.0 |
| *Including* | | | | | | | | | | | |
| imports of goods | 37.8 | 45.6 | 52.1 | 52.1 | 187.7 | 44.8 | 48.4 | 53.7 | 55.3 | 202.2 | 207.0 |
| imports of services | 14.3 | 18.7 | 20.8 | 19.5 | 73.3 | 15.0 | 18.0 | 19.9 | 19.6 | 72.5 | 73.0 |
| **CPI** | | | | | | | | | | | |
| as % of previous period | 102.1 | 101.2 | 100.7 | 101.3 | 105.4 | 102.6 | 101.1 | 100.1 | 101.1 | 104.9 | 104.5 |
| **Average interest rate on ruble-denominated loans over given period, as % per annum** | | | | | | | | | | | |
| real | 5.7 | 5.1 | 5.5 | 5.9 | 5.5 | 5.1 | 5.2 | 5.2 | 5.5 | 5.2 | 4.8 |
| nominal | 13.3 | 12.9 | 12.2 | 11.6 | 12.5 | 11.3 | 11.3 | 10.6 | 10.6 | 10.9 | 9.7 |

| Conservative forecast | 2016 | | | | | 2017 | | | | | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Year-end | Q1 | Q2 | Q3 | Q4 | Year-end | Year-end |
| | actual | actual | actual | actual/ estimate | actual/ estimate | forecast | forecast | forecast | forecast | forecast | forecast |
| **Urals, USD per barrel** | 31.9 | 43.6 | 43.9 | 48.0 | 41.9 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 |
| **Ruble-to-USD exchange rate** | | | | | | | | | | | |
| average nominal, for period | 74.6 | 65.9 | 64.6 | 63.5 | 67.1 | 63.4 | 65.0 | 65.0 | 65.9 | 64.8 | 66.3 |
| **Ruble's real effective exchange rate** | | | | | | | | | | | |
| period-end value, as % of previous period-end value | -8.3 | 11.3 | 3.4 | 3.9 | 9.7 | 1.5 | -0.9 | 0.0 | -0.2 | 0.5 | 1.7 |
| **Money base** | | | | | | | | | | | |
| trillion Rb | 11.0 | 10.8 | 11.5 | 12.6 | 12.6 | 11.8 | 12.0 | 12.2 | 13.3 | 13.3 | 14.3 |
| **Money supply (M2)** | | | | | | | | | | | |
| period-end value, trillion Rb | 35.4 | 36.5 | 36.9 | 39.4 | 39.4 | 39.0 | 39.3 | 40.5 | 43.0 | 43.0 | 47.8 |
| growth, as % of previous period | -1.0 | 3.0 | 1.2 | 6.7 | 10.0 | -1.0 | 0.7 | 3.1 | 6.2 | 9.2 | 11.1 |
| **IPI** | | | | | | | | | | | |
| as % of corresponding period of previous year | 99.4 | 101.0 | 99.9 | 99.9 | 100.1 | 101.0 | 102.1 | 100.8 | 100.7 | 101.1 | 102.1 |
| **Unemployment** | | | | | | | | | | | |
| % | 5.9 | 5.7 | 5.3 | 5.5 | 5.6 | 5.6 | 5.2 | 4.8 | 5.2 | 5.2 | 4.7 |

| Basic scenario forecasted | 2016 | | | | | 2017 | | | | | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Year-end | Q1 | Q2 | Q3 | Q4 | Year-end | Year-end |
| | actual | actual | actual | actual/ estimate | actual/ estimate | forecast | forecast | forecast | forecast | forecast | forecast |
| **Urals, USD per barrel** | 31.9 | 43.6 | 43.9 | 48.0 | 41.9 | 50.0 | 50.0 | 50.0 | 50.0 | 50.0 | 60.0 |
| **GDP** | | | | | | | | | | | |
| bn Rb | 18 561 | 19 979 | 22 190 | 23 342 | 84 072 | 19 541 | 21 010 | 23 274 | 24 215 | 88 040 | 93 661 |
| physical volume index, as % of corresponding period of previous year | 98.8 | 99.4 | 99.6 | 99.7 | 99.4 | 101.0 | 102.1 | 101.8 | 100.7 | 101.4 | 102.2 |
| deflator | 103.1 | 104.2 | 104.7 | 105.7 | 104.0 | 104.2 | 103.0 | 103.0 | 103.0 | 103.3 | 104.0 |
| **Investment in fixed assets** | | | | | | | | | | | |
| physical volume index | 95.2 | 96.1 | 100.3 | 100.3 | 98.0 | 100.3 | 101.2 | 102.2 | 102.5 | 101.8 | 102.5 |
| **Retail turnover** | | | | | | | | | | | |
| as % of corresponding period of previous year | 94.2 | 94.1 | 95.3 | 96.4 | 95.0 | 98.6 | 100.2 | 100.7 | 101.5 | 100.3 | 101.5 |
| **Real disposable money income** | | | | | | | | | | | |
| as % of corresponding period of previous year | 96.3 | 94.2 | 94.3 | 97.9 | 95.7 | 99.0 | 100.7 | 102.5 | 103.7 | 101.5 | 102.7 |
| **Exports** | | | | | | | | | | | |
| bn USD | 68.8 | 80.5 | 84.4 | 91.7 | 325.4 | 83.6 | 89.8 | 90.7 | 94.9 | 358.9 | 404.1 |
| *Including* | | | | | | | | | | | |
| exports of goods | 59.3 | 67.9 | 70.9 | 79.6 | 277.7 | 74.1 | 78.4 | 78.6 | 83.5 | 314.5 | 357.9 |
| *oil and gas exports* | 31.5 | 36.8 | 38.7 | 42.2 | 149.2 | 42.1 | 41.7 | 40.6 | 42.4 | 166.9 | 200.9 |
| *other exports* | 27.8 | 31.1 | 32.2 | 37.4 | 128.5 | 32.0 | 36.7 | 37.9 | 41.0 | 147.7 | 157.0 |
| exports of services | 9.5 | 12.7 | 13.5 | 12.1 | 47.7 | 9.5 | 11.3 | 12.1 | 11.4 | 44.4 | 46.3 |
| **Imports** | | | | | | | | | | | |
| bn USD | 52.1 | 64.4 | 72.9 | 71.6 | 261.0 | 61.0 | 68.6 | 77.1 | 80.0 | 286.6 | 319.6 |
| *Including* | | | | | | | | | | | |
| imports of goods | 37.8 | 45.6 | 52.1 | 52.1 | 187.7 | 45.8 | 50.2 | 56.6 | 59.6 | 212.3 | 239.6 |
| imports of services | 14.3 | 18.7 | 20.8 | 19.5 | 73.3 | 15.2 | 18.3 | 20.5 | 20.4 | 74.4 | 80.0 |
| **CPI** | | | | | | | | | | | |
| as % of previous period | 102.1 | 101.2 | 100.7 | 101.3 | 105.4 | 102.6 | 100.9 | 100.1 | 101.1 | 104.6 | 104.2 |
| **Average interest rate on loans over given period, as % per annum** | | | | | | | | | | | |
| real | 5.7 | 5.1 | 5.5 | 5.9 | 5.5 | 4.8 | 5.0 | 4.9 | 5.1 | 5.0 | 4.7 |
| nominal | 13.3 | 12.9 | 12.2 | 11.6 | 12.5 | 11.0 | 10.8 | 10.0 | 9.9 | 10.4 | 9.3 |

| Basic scenario forecasted | 2016 | | | | | 2017 | | | | | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Year-end | Q1 | Q2 | Q3 | Q4 | Year-end | Year-end |
| | actual | actual | actual | actual/ estimate | actual/ estimate | forecast | forecast | forecast | forecast | forecast | forecast |
| **Urals, USD per barrel** | 31.9 | 43.6 | 43.9 | 48.0 | 41.9 | 50.0 | 50.0 | 50.0 | 50.0 | 50.0 | 60.0 |
| **Ruble-to-USD exchange rate** | | | | | | | | | | | |
| average nominal, for period | 74.6 | 65.9 | 64.6 | 63.5 | 67.1 | 62.0 | 60.9 | 60.4 | 60.5 | 60.9 | 57.3 |
| **Ruble's real effective exchange rate** | | | | | | | | | | | |
| period-end value, as % of previous period-end value | -8.3 | 11.3 | 3.4 | 3.9 | 9.7 | 3.0 | 1.7 | 0.6 | 0.6 | 6.0 | 7.1 |
| **Money base** | | | | | | | | | | | |
| trillion Rb | 11.0 | 10.8 | 11.5 | 12.6 | 12.6 | 11.8 | 11.9 | 12.0 | 13.2 | 13.2 | 14.1 |
| **Money supply (M2)** | | | | | | | | | | | |
| period-end value, trillion Rb | 35.4 | 36.5 | 36.9 | 39.4 | 39.4 | 39.1 | 39.0 | 40.1 | 42.4 | 42.4 | 46.5 |
| growth, as % of previous period | -1.0 | 3.0 | 1.2 | 6.7 | 10.0 | -0.8 | -0.1 | 2.8 | 5.7 | 7.7 | 9.7 |
| **IPI** | | | | | | | | | | | |
| as % of corresponding period of previous year | 99.4 | 101.0 | 99.9 | 99.9 | 100.1 | 101.7 | 102.7 | 101.1 | 101.2 | 101.7 | 102.3 |
| **Unemployment** | | | | | | | | | | | |
| % | 5.9 | 5.7 | 5.3 | 5.5 | 5.6 | 5.5 | 5.0 | 4.6 | 5.0 | 5.0 | 4.5 |

## 2. INFLATION: 2016 RESULTS
### A.Bozhechkova, P.Trunin

*Last year, the Bank of Russia pursued conservative monetary policy aimed at reducing inflation. As a result, the inflation was 5.4% (December 2016 compared to December 2015), being significantly lower than it had been in 2015 (12.9% in December 2015 compared to December 2014). It is now the new historical minimum – previously, the lowest indicator was 6.1% in 2011.*

**Factors reducing inflation**

The slowdown in inflation from 12.9% in December 2015 (compared to December 2014) to 5.4% in December 2016 (compared to December 2015) took place against the background of high values of inflation in 2015, when prices rose sharply as a result of ruble depreciation (*Fig. 1*).

During the whole last year, the ruble was strengthening (by 17%, up to 60.6 rubles for a dollar in December 2016), which made it possible to maintain price stability. Ruble appreciation was due to 1.8-fold rise in oil prices in the period from January to December 2016 and the inflow of foreign capital (*Fig. 2*).

The reason no less important for the slowdown in inflation was the Bank of Russia's monetary policy: during the year, it was only twice that the Russian Central Bank lowered the key rate (the Russian Central Bank's policy rate) – on 14 June and 19 September (by 0.5 p.p.), which resulted in it reaching 10% per annum. This moderate decrease of the key interest rate meant growth of the real money market rate. Maintaining a positive real interest rate helps curb rising prices by increasing the attractiveness of savings and decreasing the lending, but at the same time carries risks of lowering economic activity.

In addition, the continued low aggregate demand was another factor for reducing inflation. On average, in January–November 2016, real income of the population decreased by 5.4% (month to month of the previous year), while retail turnover decreased monthly by 5.2% on average (month to month of the previous year).

At the same time, note the acceleration of growth in M2 money supply caused by the increasing monetary base as the Reserve Fund was spending money to finance the budget deficit. The M2 growth rate in January–November 2016 was 11.5%, while during the same period of 2015, it did not exceed 6.1% (*Fig. 3*).
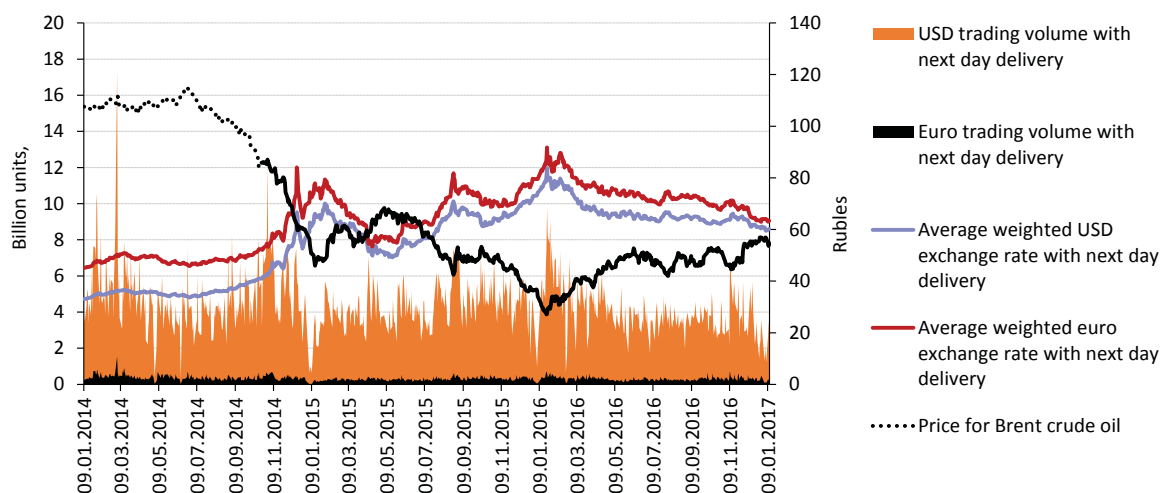
The increase in the monetary base due to spending of the Reserve Fund exceeds its decline due to reduction of the banking system's debt to the Central Bank and due to deposit auctions held by the Bank of Russia. Consequently, in Q1 and Q2 2016, despite the key rate being stable, there was a
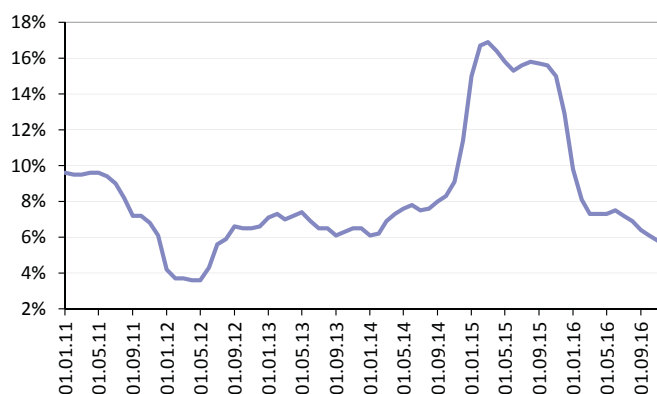


*Source:* Rosstat.
*Fig. 1. CPI growth rate in 2011–2016, % per annum*

*Source:* Bank of Russia, Finam.

*Fig. 2. Exchange rate dynamics (dollar and euro to ruble), trading volume in the foreign exchange market, price for Brent crude oil*

decline in market interest rates. For example, interest rates on individuals' deposits up to 1 year decreased from 8.53% per annum in January 2016 to 6.22% per annum in October 2016.

**Prices for consumer goods and paid services**

Generally, from January to December 2016, the rate of consumer price growth was significantly lower than that in 2015 (4.6% in December 2016 compared to December 2015 against 14.0% in December 2015 compared to December 2014). Ruble appreciation, as well as a good harvest in 2016 were significant contributions to reducing food prices growth rate. The growth rate of prices for non-food products slowed down from 13.7% in 2015 to 6.5% in 2016, which was also due to ruble appreciation in the context of Russian market's high dependence on foreign supplies. Paid consumer services in December 2016 got more expensive compared to December 2015 by 4.9% (10.2% compared to December 2014).

**Inflation expectations**

Inflation expectations are going down more slowly than inflation. According to the survey conducted by "INFOM" and published monthly by the Bank of Russia, the median expected inflation rate for the year ahead in 2016 significantly exceeded the actual inflation in the previous 12 months (by 5.7–7.4 p.p.) and was close to the actual inflation in 2015, lagging behind only 1.6 p.p. on average. This result shows that inflation expectations are inertial. High inflation expectations and their inertial nature remain among the main obstacles to the loosening of monetary policy.

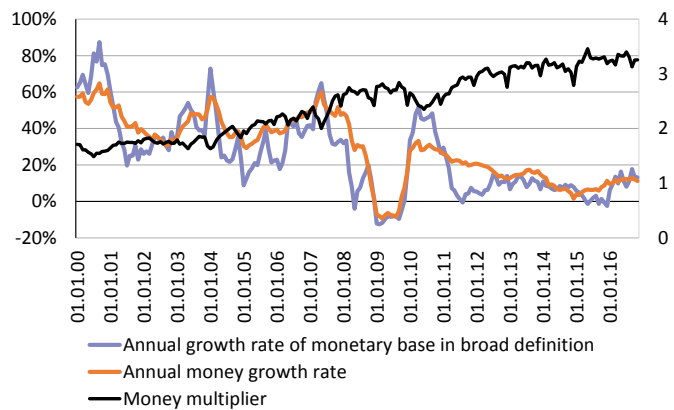**Factors behind the possible acceleration of inflation**

Despite the success in reducing inflation, the prospects of the Bank of Russia achieving its goal in 2017 (4% at year-end) are ambiguous so far. In our opinion, one of the possible sources of inflation acceleration in the future will be the restoration of aggregate demand, which ceteris paribus can lead to upward pressure on consumer goods prices. In particular, both in Q1 and Q2 2016, nominal wage increased by 7.7%, and in Q3 it grew by 8.1%, com-

pared to the same periods of 2015. In September–December 2015, this indicator grew on average by only 3.4% in annual terms. In 2016, real wages growth rate was positive for the first time since Q3 2014, amounting to 0.3% and 1.2% in Q2 and Q3, respectively. At the same time, slowdown in the fall in real incomes was observed. In 2017, indexation of pensions according to the actual inflation in 2016 (5.4%) will be resumed, and funding of expenses aimed at achieving the target values of salaries in particular sectors of the economy (which were outlined in the president's May decrees) will be continued.



*Source:* Bank of Russia.

*Fig. 3. Dynamics of monetary aggregates and money multiplier in 2000–2016*

Soft fiscal policy may be an additional source of inflation acceleration this year: in spite of the legally approved reduction of budget deficit, the growth in oil and gas revenues due to the possible increase in energy prices may lead to rising expenditures, especially given the current phase of the political cycle.

One shouldn't completely ignore exchange rate risks associated with possible worsening of the terms of trade. Among the factors that may contribute to ruble depreciation, there are the uncertainty about oil prices dynamics (including that due to the problems in the Chinese economy) and tightening of the US Federal Reserve System monetary policy.

Given that inflation expectations are staying high (12.4% in December 2016), the possibility of reducing the key rate will be considered by the Bank of Russia only in Q1 or Q2 2017. In our view, the Central Bank in 2017 will have to find a delicate balance between achieving the inflation target and preventing the negative impact of its policy on economic activity. These circumstances create risks of failure to reach the inflation target at the end of 2017. In our opinion, the Russian Central Bank will keep slowly reducing the key rate until its management is sure that the inflation target would be achieved.●

# 3. CORPORATE LENDING BY BANKS: THE ONGOING STAGNATION
## M.Khromov

*In 2016, corporate credit exposure growth rates dropped to zero. Origination of new loans declined against the volumes of economic activity. In recent months, a reduction of past-due payment was observed across all loan categories.*

For 11 months 2016, Russian banks extended corporate loans totaling to Rb 30.3 trillion. This is 1.6% more than for the corresponding period of 2015. However, such modest growth does not offset the 2015 failure, when for the same period the loan volumes shrank by 12.3% compared to 2014 when the lending market posted maximum volumes. Total decrease of corporate loans origination constituted 10.9% over two years.

Loans denominated in rubles grew somewhat faster. During the intervening period of 2016, loans denominated in rubles totaled to Rb 27.5 trillion. This is by 4% more than a year earlier. However, two-year contraction remains significant all the same. In 2016, the ruble segment of the lending market shrank by 6.9% in comparison with 2014.

Loans denominated in foreign currency continue to contract at a pacy rate. Over 11 months of 2016, banks extended such corporate loans totaling to $41 billion. This is by 26.3% less than during the same period of 2015. In 2015, loans denominated in foreign currency contracted more significantly by 53.2%. Over two years, banks reduced extension of credits denominated in foreign currency by around two thirds – by 65.5% if measured in US dollars. The ruble equivalent of corporate lending was also falling by 17.7% in 2016 in comparison with 2015 and by 38.0% in comparison with 2014.

The lending volumes are falling not only in absolute terms but also against the scale of economic activity. At the peak of Russian banks' credit activity the economy received new loans in volumes comparable to 30–31% of organizations' turnover (in 2013 – first half 2014). By year-end 2015, this ratio fell to 25%, mainly due to a significant slump on the lending market posted at the beginning of 2016. During 11 months of 2016, the banks extended corporate loans to the tune of 23% of the organizations' turnover for the same period (*Fig. 1*).

Reduction of lending volumes gradually resulted in a decrease of banks' lending portfolio growth rates. After a growth by 15% posted in 2014, in 2015, corporate debt moved up barely by 5% and by 11 months-end of 2016, its growth rates declined to a zero (-0.1% in annual terms).

Large business segment remains a driver of the lending market. For
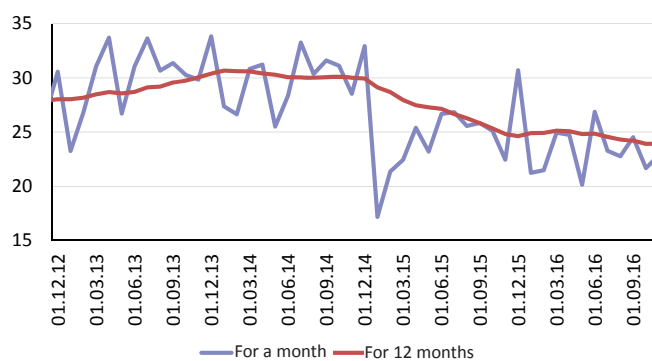


*Sources:* Bank of Russia, Rosstat, own calculations.
*Fig. 1. Ratio of extended corporate loans and organizations' turnover, %*

11 months of 2016, banks' corporate clients who represent large business obtained new loans totaling to Rb 25.5 trillion or 84% of the total volume of new loans. In comparison with the same period of 2015, the volume of loans extended to big business went up by 2.4%, which does not offset the decline registered in the previous year. In comparison with 2014, the volume of new loans contracted by 5.6% in 2016.

The dynamics of large business lending can be characterized as relatively stable but medium and small business lending is continuing to shrink. During 11 months of 2016, this segment of the lending market originated new loans totaling to Rb 4.7 trillion, which is by 2.9% less than during the corresponding period of 2015 and nearly by a third (31.7%) than in 2014.

In 2016, the quality of corporate loans practically stabilized. The share of past due debt in the total volume of corporate debt came to 7.1% by November-end 2016. This is a little more than at the turn of the year – 6.8%. However, during last three months, the share of past due debt was falling from the peak mark of 7.5% by August-end 2016.

The quality of loans denominated in rubles remains a little worse that on the market as a whole. The share of past due obligations denominated in rubles by November-end 2016 decreased to 8.5% from its peak level of 8.8% registered in the end of August 2016. Foreign currency loans remain more risk free for the banks. The share of past due debt denominated in foreign currency came to barely 3.1%. At the same time, quality improvement of this type of loans was ongoing throughout the year starting with March when the peak level of past due debt on foreign currency loans was reached at 4.0%.

Risks growth has triggered the slowdown of lending on the whole by the banking system. Credit risks remain paramount in case of the ruble loans but the foreign currency risks account for a decrease of foreign currency lending. These risks have become too big owing to enhanced ruble exchange rate volatility.

Noticeable gap in the portfolio credit quality remains depending on the borrower's business size: between large borrowers and medium-size and small businesses. Debt service quality in case of large clients remains higher than on the average across the market. The share of past due debt in credit exposure of large corporate clients came to 5.8% by November-end of 2016, reaching maximum level of 6.2% throughout 2016. The past due debt of medium-sized and small businesses in the overall debt exposure peaked 15.6% in mid-2016, however, during recent months decreased to 14.2%. Thus, depending of the borrower's business size a link in observed between dynamics of the corresponding segment of the lending market and the credits' quality on that segment.

Interest rates on corporate ruble loans were falling throughout 2016 broadly following the Bank of Russia key rate reduction and even overtaking it a bit (*Fig. 2*). In October 2016, the interest rate on ruble loans decreased to 12.1% per annum down from 13.4% posted at the turn of the year. The gap between the Bank of
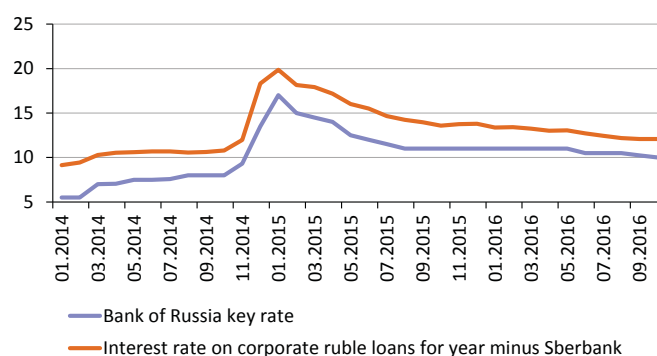


*Source:* Bank of Russia.

*Fig. 2. Interest rate on corporate ruble loans and Bank of Russia key rate*

Russia key rate and the interest rate on ruble corporate loans decreased to 2 p.p., meanwhile in 2015 it exceeded 3.5 p.p. This is an indirect evidence of an overshooting of the regulator's key rate: the lending market is ready for its further decrease.

On the whole, the situation on the corporate lending market continues to remain complex. Despite marginal growth of new loans origination, corporate clients' debt has stopped increasing. This signifies that taking into consideration interest payments, the economy does not receive additional resources from the lending market at present. The only positive signal is the termination of past due debt growth, which can afford ground for more intensive reduction of lending rates and resumption of lending growth in the near future.●

## 4. WILL RUSSIA BECOME FOOD NET EXPORTER?
### V.Uzun, D.Loginova

*In 2017, there is a chance for Russia to become a net exporter of food. In order to obtain a positive balance, it is necessary to use competitive advantages of domestic producers: increase exports of traditional type of products (grains, vegetable oil), get to international market with new types of export produce (poultry meat, pork, sugar, etc.)*

World production of agricultural products has been constantly growing. According to the World Bank estimates, global added value of agricultural produce moved up from $1,084bn in 1990 to $ 3,186bn in 2015. However, Russia's share in the cost of global agricultural produce sagged from 7.4% to 1.7% over this period. Such sharp reduction can be partly explained by an overvalued exchange rate of the Soviet ruble, which was not a convertible currency. In 1990s, the share of Russia was drastically falling to 1.1% posted in 1999. Then it began growing and by 2008 increased to 2.8%. In recent years, the share of Russia in the global agricultural production resumed a downward trend and fell to 2.2–2.3% (*Table 1*). In 2015, it shrank to 1.7%, which was due to a sharp ruble's devaluation.

*Table 1*

DYNAMICS OF ADDED VALUE OF AGRICULTURAL PRODUCE IN THE WORLD AND RUSSIA, USD BN

| Year | RF | World | Share of RF, % | Year | RF | World | Share of RF, % |
|------|------|--------|------|------|------|--------|------|
| 1990 | 79.9 | 1083.6 | 7.4 | 2003 | 23.7 | 1271.0 | 1.9 |
| 1991 | 71.3 | 1061.6 | 6.7 | 2004 | 29.0 | 1447.2 | 2.0 |
| 1992 | 33.4 | 1013.5 | 3.3 | 2005 | 32.5 | 1508.9 | 2.2 |
| 1993 | 32.9 | 973.8 | 3.4 | 2006 | 38.2 | 1630.2 | 2.3 |
| 1994 | 24.1 | 1077.0 | 2.2 | 2007 | 49.1 | 1934.9 | 2.5 |
| 1995 | 26.5 | 1180.7 | 2.2 | 2008 | 62.3 | 2242.1 | 2.8 |
| 1996 | 25.7 | 1245.9 | 2.1 | 2009 | 49.9 | 2194.3 | 2.3 |
| 1997 | 23.8 | 1204.9 | 2.0 | 2010 | 51.0 | 2559.8 | 2.0 |
| 1998 | 13.8 | 1156.8 | 1.2 | 2011 | 69.5 | 2968.2 | 2.3 |
| 1999 | 12.9 | 1136.0 | 1.1 | 2012 | 68.2 | 3066.0 | 2.2 |
| 2000 | 14.9 | 1123.8 | 1.3 | 2013 | 74.2 | 3272.2 | 2.3 |
| 2001 | 18.0 | 1108.5 | 1.6 | 2014 | 74.9 | 3331.5 | 2.2 |
| 2002 | 19.2 | 1130.8 | 1.7 | 2015 | 55.2 | 3185.7 | 1.7 |

*Source*: http://data.worldbank.org/indicator/

Russia's population accounts for around 2% of the world population. Russia's per capita GDP (in 2015 comes to $ 9,1000 according to the World Bank estimates) corresponds to worldwide average level ($ 10,000). With this income level, it is natural to assume that spending on food consumption will also correspond to the worldwide average level. Owing to the fact that per capital agricultural production in Russia is somewhat higher than global average than our country can become a net exporter of agricultural products.

However, export surplus can be ensured by agricultural growth rates surpass worldwide average indexes.

Actually, Russia's share in the global agricultural imports surpasses the country's share in world population and in agricultural production. During recent three years, this share has nosedived due to the ruble's devaluation and a decrease of population's income. Regarding agricultural exports, despite a rather explosive growth of its volume and value, Russia's share in global exports stayed put during recent four years (*Table 2*).

*Table 2*

EXPORTS AND IMPORTS OF AGRICULTURAL PRODUCTS
(COMMODITY ITEM CODES 1-24, USD BN.)

| Year | World | | Russia | | Share of RF, % | |
|---|---|---|---|---|---|---|
| | imports | exports | imports | exports | in imports | in exports |
| 2011 | 1447.2 | 1406.0 | 39.2 | 11.3 | 2.7 | 0.8 |
| 2012 | 1459.3 | 1433.1 | 40.6 | 16.7 | 2.8 | 1.2 |
| 2013 | 1524.4 | 1512.6 | 43.2 | 16.2 | 2.8 | 1.1 |
| 2014 | 1567.6 | 1548.6 | 39.9 | 19.0 | 2.5 | 1.2 |
| 2015 | 1428.2 | 1384.9 | 26.5 | 16.2 | 1.9 | 1.2 |

*Sources:* Own calculations based on data released by ITC, Electronic resource. Food products: Commodity item codess1-24.

Nevertheless, the country has taken leading positions across certain types of products. In 2015, Russia was second in the world in the export volumes of wheat, barley, peas, chickpea, sunflower seed oil, flax seeds, presscakes and protein meals, first in export of buckwheat and beet-chips (*Table 3*).

*Table 3*

RUSSIA'S PLACE IN GLOBAL EXPORTS OF CERTAIN TYPES OF PRODUCTS (2015)

| Type of products | Exports | | Share in global exports, % |
|---|---|---|---|
| | Thousand tons | Place in global exports | |
| Wheat | 21234 | 2 | 12.4 |
| Barley | 5294 | 2 | 13.8 |
| Buckwheat | 37 | 1 | 22.3 |
| Peas | 588 | 2 | 11.1 |
| Chickpea | 326 | 2 | 13.4 |
| Sunflower seed oil | 1445 | 2 | 15.1 |
| Flax seeds | 322 | 2 | 19.7 |
| Presscakes and protein meals | 1253 | 2 | 17.0 |
| Beet-chips | 859 | 1 | 24.3 |

*Sources:* own calculations based on data released by ITC. Electronic resource: http://www.trademap.org

Promotion of Russia in ratings of wheat is due to its production fall in the USA: from 24.5 mn tons registered in 2014 down to 21 mn tons registered in 2015, meanwhile Russia's production volumes remained unchanged. The situation is similar with regard to buckwheat: number one China cut buckwheat exports by one fourth (from 41 thousand tons down to 30 thousand tons), and Russia's production volumes again changed insignificantly. The situation is similar with regard to peas market: Canada, the biggest player, still accounts for more than half of the total exports, meanwhile the USA ceded the first place to Russia: the US's peas exports fell by around 20% and Russia's exports went up almost twice in comparison with 2014.

Back in the early 1990s, exports imports balance was negative except 1997–1999 when imports of agricultural products fell almost to zero point

and exports stayed just above zero. Russia stopped being any player in global imports and exports of agricultural products. Following the 1998 default, the economy grew, population's income went up, and imports exceeded $ 40 bn. However, exports gradually moved up (*Table 1*)[1].

During recent years export were growing faster than imports and in 2014–2016 imports were contracting, which allowed the negative exports imports balance to decrease: in 2013 it came to $ 26.9bn, in 2014 – $20.9bn, in 2015 – $10.3bn, and in 2016 – 6.26bn (January–October). In case dynamics of imports exports balance remain the same as in the recent years, then Russia can become net exporter of agricultural products and foodstuffs in 2017 (*Fig. 2*).

Ukraine's experience demonstrates possibility for Russia to achieve a positive exports imports balance. The former is Russia's main competitor on the world food market: we have the same types of exported and imported products; our countries compete for shares in the same segments of the world market. After accession to WTO, Ukraine's food trade balance is persistently positive and boasts of an upward trend (*Fig. 3*).

In order to expand exports imports positive balance Russia needs to increase of agricultural development and food processing industry to above world levels, use to the utmost competitive advantages of domestic producers, increase exports of traditional types of products (grains, vegetable oils), get to the world market with new types of export products: poultry, pork, sugar, potatoes potato products, melons and gourds, certain types of field vegetables.●
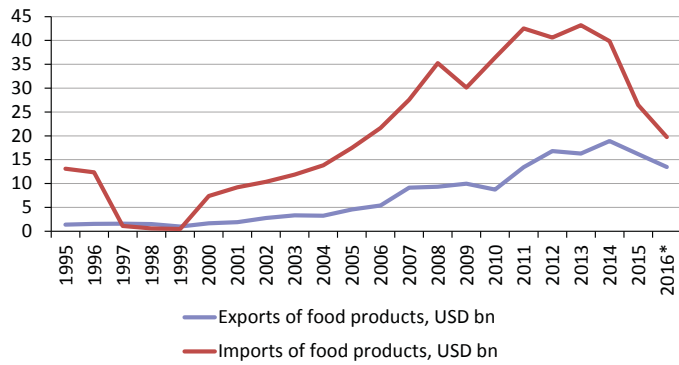


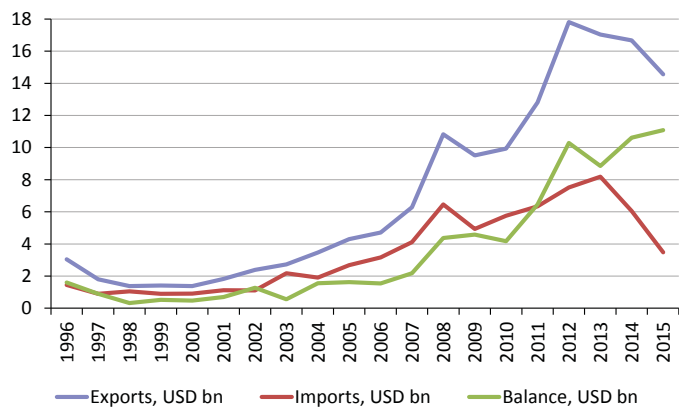*shown are amounts of exports and imports across commodity item codes 1-24 for January-October 2016.
*Sources:* own calculations based on data released by FCS, and Rosstat.
*Fig. 1. Russia's exports and imports of food products*
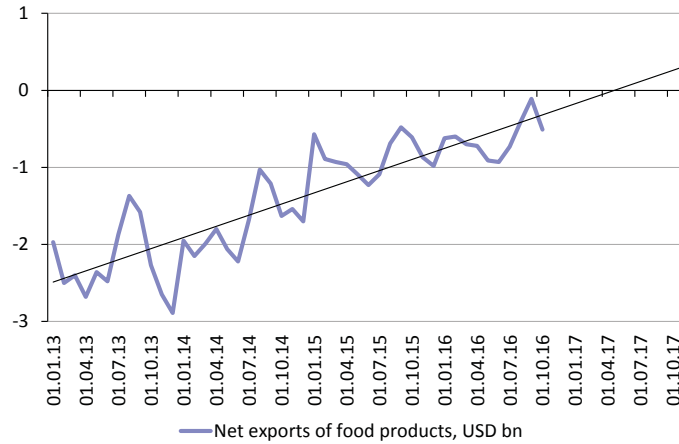


*Source:* own calculations based on data released by FCS.
*Fig. 2. Medium-term trend of net exports of food products from Russia*



*Source:* Comtrade, total across commodity item codes 1-24.
*Fig. 3. Ukraine's exports imports food trade balance growth after accession to WTO*

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1    *Maltsev A.A.* Export-import flows of agricultural products and agricultural raw materials: comparative analysis of Soviet and Russian models. Russia's Agrifood Policy. 2014, No.4 (16), pp. 2–13; *Bulatov D.S.* Exports of Russian Food Products: prospects and potential. Food processing industry. 2016. No.11 pp. 8–10.

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