NATIONAL RESEARCH UNIVERSITY HIGHER SCHOOL OF ECONOMICS DEVELOPMENT CENTER

Commentary on State and Business

142

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1. *Consensus forecast – inflation under control but outlook remains weak*

The Development Centre conducted its latest survey of 26 professional forecasters on 26th October-7th November. Compared with the last survey conducted in August, the results are slightly more optimistic. Growth this year is now forecast at 1.8%, compared with 1.4% previously, following stronger than expected performance in the first three quarters (1.8% year on year, according to the preliminary estimate of the Ministry of Economic Development). The consensus forecast assumes that the growth rate will be sustained in the fourth quarter.

However, half of those surveyed expect the growth rate to slow in 2018. Almost a third expect growth in 2019 to be lower than in 2018. In all these cases, the differences are of the order of tens of a percentage point. None of the experts anticipate an acceleration in growth in the Russian economy; even in seven years' time, the consensus forecast remains at 2%.

The forecasters expect a gradual depreciation of the rouble in by an average of 2.5% a year in the near term, and by around 1.5% a year in the medium term. Given the differences in the inflation rate in the US and Russia, the real exchange rate to the dollar will be virtually unchanged.

The most notable change from the latest survey is the cut in the inflation forecast for 2017 by 0.9 percentage points (to 3.3%). This reflects the actual trajectory of prices over the year to date. Inflation continues to be forecast at around 4% in the coming years, in line with the inflation target. It appears that the Central Bank of Russia (CBR) has succeeded in convincing the expert community that the inflation target is achievable.

The CBR is expected to cut its policy rate by a further 0.25 percentage points by the end of the year, and by 1 percentage point in 2018. Monetary policy easing will slow after this, and the real interest rate will be held at around 2-2.5%. Thus, the macroeconomic conditions for a pick-up in growth should be in place. Judging by the growth rates forecast, the experts surveyed are sceptical as to whether this will be sufficient.

The oil price projection of the Ministry of Economic Development from 2018 is $10-15/barrel below that of the Consensus Forecast. This is significant, as the forecast of the Ministry of Economic Development forms the basis of the federal budget projections. The risk of shortfall in federal revenue and a subsequent destabilisation of the financial system appears to be low.

2. The Composite Leading Indicator – all hopes again on oil?

In October 2017 the Composite Leading Indicator (CLI) was slightly above zero (0.3%). A weakly positive growth dynamic verging on stagnation appears to be the most likely scenario for the Russian economy.

In October 2017 the most positive impulse for growth came from oil prices. Urals averaged $57/barrel, 18% higher than in October last year. The RTS index also rose relatively significantly (by 12.6%) compared with October 2016, indicating that investors have a more positive view of the Russian economy, than a year earlier. However, given that oil prices have averaged over $50/barrel since December last year, the base effect will soon disappear. If oil prices remain significantly above $60/barrel, this will give a further positive boost to the economy, but this scenario does not appear likely.

Domestic demand remains weak; in October indicators measuring new orders and inventories were both negative. Without a revival in domestic demand there is unlikely to be an acceleration in growth. The CLI is likely to remain weakly positive, indicating a slowdown in the already relatively weak rate of growth.

3. The Composite Index of Regional Economic Activity – some regions continue to suffer from the crisis

In September 2017 the Composite Index of Regional Economic Activity (REA) rose slightly, and remained above the critical 50% mark separating growth from contraction. The economy is slowly improving, but at a very slow rate.

In September 2017 the REA rose from 53.7% to 54.1%, which did not signify any significant qualitative changes. The indicator for three of five key sectors was over the 50% mark, and the index exceeded 50% in five of eight federal regions; problems thus remain on both a sectoral and geographic level.

The industrial REA stood at 60% in September, pointing to a sustained rise in economic activity in this sector of the economy. Retail trade (78%) is performing particularly strongly, after a more than two-year decline. However, paid services (44%) continue to struggle and construction (38%) is far from overcoming the decline affecting the sector since the end of 2012. Wholesale trade recorded an intermediate score (51%), but is evidently continuing to struggle.

On a federal district level, the worst score was recorded in the Southern Federal Region (45%), and the Far East Region Siberian Federal Regions (47-48%). Economic activity rose compared with last year in all other federal regions, particularly in the North-Caucasus Federal Region (71%).

On a regional level the REA exceeded 50% in September, indicating a rise in economic activity in 46 of out of 82 federal subjects. The number of regions where output was contracting in all five or four out of five sectors fell from 13 to 10. The number of regions recording expansion in four or five sectors rose from 18 to 20. However, the proportion of regions recording an expansion in four or five sectors is significantly lower than is usually the case during a phase of strong economic growth. Although economic conditions are clearly improving (in particularly compared with mid-2015), the recovery is advancing slowly. A significant proportion of Russian regions are stagnating or are even in recession.

The worst performing region was Ryazan Oblast, where all five sectors recorded a contraction. Output contracted in four of five sectors in a further 9 regions. These ten regions in total accounted for 5.4% of Russia's Gross Regional Product (GRP). The recession has ended in several major regions, in particular Moscow, which accounts for 21% of total GPR.

The most successful regions include Bryansk Oblast and Murmansk Oblast, and the Udmurt Republic, where all five sectors recorded growth. A further 17 regions recorded growth in four out of five sectors. These 20 regions accounted for 18% of GRP.

51 regions recorded rising economic activity "on average" over the past three months (July-September 2017), or 62% of the total. The least successful regions (with a REA score no higher than 20% over the past three months) were Novogorod, Kurgansk and Tomsk oblasts, and Zabaikal Krai. The most successful (an average REA over the past three months above 80%) were Bryansk and Murmansk oblasts, Sevastopol, the Ingush Republic, and Primorskii Krai.