

22 September 2017
Opinion

Go Russia, surprise further!

Economic recovery has proved far more durable than many expected

It was a positive surprise when the Russian state agency Rosstat upgraded GDP growth for 2015 to -2.8% from -3.7% and saw a mild 0.2% recession in 2016. This coincided with a shift to the new EU-compliant methodology, fuelling talks about proper 'data management.' The fact the 0.5% expansion in 1Q17 accelerated to 2.5% in 2Q17 proved it was a real recovery.

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The two percent growth in the MinEco forecast for 2017, widely criticised for being excessively optimistic earlier in the year, started looking attainable. The decent 2Q17 print drove a tiny upgrade to 2.1% in 2017, but a bigger one of 2.1 - 2.2% vs 1.5% initially planned for 2018-2019. We at ING are sticking to a slightly more conservative call for 2017 growth at 1.7%. But next year's 2% promise fits well with our expectations of consumption and investments taking the front seats.

Domestic demand is king again

A major positive is the long-awaited investment spree observed over the first half of the year. It did benefit from some one-off projects in public construction and procurement in 2Q17. But the core story was a textbook reaction to improved profitability, easing financial conditions and RUB strength forcing corporates to start spending money on postponed capex. This is likely to continue under the supportive environment.

Nobody invests for nothing, so improving consumption is key here.

Personal spending should gain steam further over 4Q17-2018 as expected public wages hikes could augment the already positive momentum from stronger consumer confidence, falling inflation and recovering incomes and lending. However, excessive optimism is not a good thing as sustainable consumption recovery is only possible with healthy income growth, i.e. wages following, not leading gains in productivity, especially when real pension growth will be near zero.

An underside of this is a surge of imports after years of tightening belts and import-substitution. But rising energy and, especially, non-energy exports provides some compensation with more companies discovering the benefits of selling abroad. It will take years and extra government efforts to have a broader base and diversify, but the process has already begun.

Are you kidding, why have all these happened?

No, we aren't. The positives stem from three pillars:

- A floating rouble since 2014 in spite of the effects of Western sanctions and plunging oil prices, finally putting external balances in order already in 2H15.

- Orthodox inflation targeting with the Central Bank of Russia keeping real policy rate positive since 4Q17 (a slowly decreasing), which bear fruits in 2017 with inflation already at 3.1%, i.e. below the 4% target ahead of the plan. Hence the CBR is set to cut rates further
- A prudent fiscal policy with breakeven oil price down to US\$60/bbl in 2017 intending to reach US\$40/bbl by 2020 vs US\$95-105/bbl in 2012-13.

The above have served as a basis for macro stabilisation, so it's now time for growth-accelerating initiatives.

Sanctions! What sanctions?! Investors were paid well

The economy mostly adjusted to the 2014-sanctions and the expanded US restrictions don't seem to have shaken investors' minds. The companies which stayed in Russia and started localising finally became stronger. Investors were paid well too with RUB and rouble bonds finishing in the emerging markets outperformers list.

