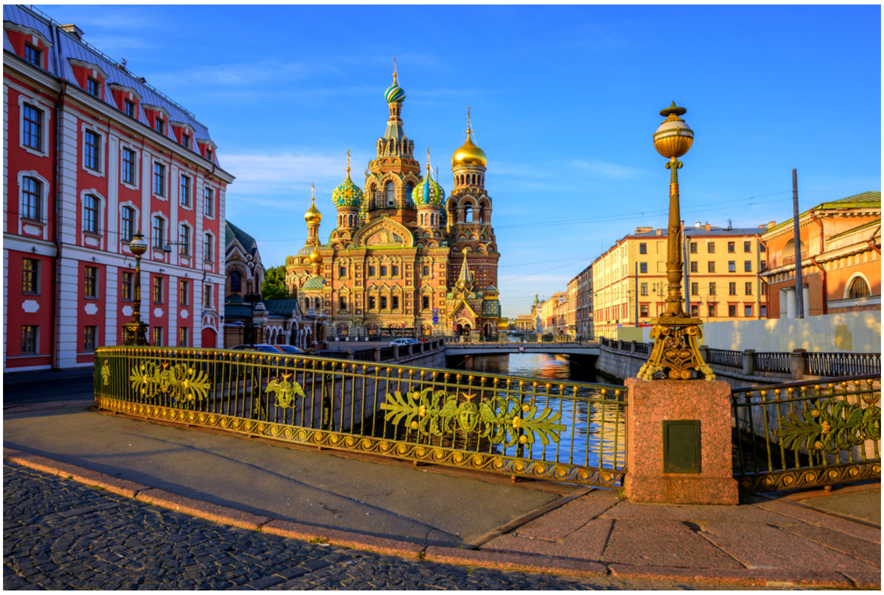
Russia: Facing lean Christmas due to stringent budget

The 2018 budget surplus could exceed the official RUB2.1 trillion target thanks to non-fuel revenue growth and restrained spending. If not for the risk of sanctions, this would have been a nice gift for rating agencies and bondholders, while local consumers and producers are clearly looking at a lean Christmas



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RUB3.4tr

11M18 budget surplus

3.7% GDP

Higher than expected

The Russian federal budget was executed with a RUB3.4 trillion (3.7% GDP) surplus, which is higher than consensus and our expectations by RUB0.3 trillion. Around one-third of the outperformance was caused by the acceleration in non-fuel revenue growth from an already high

15% year-on-year (YoY) in 10M18 to 23% YoY in November. The remaining two-thirds was a result of a surprising 2% YoY drop in expenditures in November after a very modest 1% YoY growth for 10M18.

Based on the strong 11M18 performance, we expect the full-year surplus to total RUB2.6 trillion, which is RUB0.5 trillion higher than the recent target set by the Finance Ministry. Given that the outperformance is not related to oil prices but rather reflects a tightening in tax collection efficiency and stringent cost control, this result is positive news for fiscal and overall macro stability.

We consider the conservative approach to budget policy, which allows for a budget breakeven oil price of around US$50/bbl, the lowest level since 2007, as adequate for the external risks faced by Russia. With a high budget surplus and low state debt within 15% of GDP, Russia has one of the strongest fiscal positions among Emerging Markets and some commodity peers. Had there been no risk of additional sanctions, Russia's budget policy would have been a strong argument for a more favourable view from the rating agencies and bond investors.

The flipside of the tight budget policy, which the government is looking to continue into 2019-2021 (breakeven expected to remain at US$50/bbl, expenditures to remain at a modest 17% of GDP, VAT and oil taxation to be increased), suggests little support to economic activity unless structural measures are taken. As the latter is not our base case scenario, the near-term economic trends both on producer and consumer sides are likely to remain under pressure, with GDP growth likely to decelerate from 1.6% in 2018F to 1.0% in 2019F. As a result, one of the key local policy dilemmas for 2019 will be between preservation of the macro buffers or using the budget as a tool to support growth.

Russia 2019: Risk-averse mode https://think.ing.com/articles/russia-2019-risk-averse-mode/

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