Russia: Positive past, cloudy future

The acceleration of GDP growth from 1.6% in 2017 to 2.3% in 2018 is a positive surprise, but its concentration in the oil and gas sector and persistent weakness in investment growth - even after upward revisions - suggest we shouldn't get too excited about 2019

Source: Shutterstock

2.3%

Better than expected

2018 GDP growth

vs. 1.6% in 2017

The first official estimate of Russian GDP growth for 2018, at 2.3%, came as a positive surprise. Even after incorporating the previously announced upgrade of construction growth, we and the consensus did not expect the full-year figure to exceed the 2.0% level. The key reason for this outperformance seems to be a higher than expected revision to investment growth, which is the only component that showed improvement in the full-year estimate compared to the nine-month figure (2.3% vs. 1.9%). However, there are several reasons why this seemingly positive statistical take on Russia's recent past does not warrant an improvement in the outlook for its future:

- Even after several upward revisions, investment remains Russia's weak link. Despite a number of large state-sponsored infrastructure projects and investments in the oil and gas industry, overall investments slowed materially from the 5.5% rate seen in 2017 and their annual volume in real terms barely reached the level seen in 2008 (while private consumption, despite weakness in 2015-16, is still 16% above its 2008 levels).
- Consumption growth, even after accounting for cross-border e-commerce, showed a material deceleration from 3.0% in 2017 to 1.9%, confirming a weakening in local demand, which is unlikely to reverse any time soon given the VAT hike and slowdown in salary and retail lending growth seen at the end of 2018.
- The only component that positively contributed to the acceleration of GDP growth in 2018 vs. 2017 was net exports, which was in part due to a strong slowdown in import growth (from 17.4% to 3.8% due to weakness in the rouble and local demand) and also in part thanks to an acceleration in export growth (mainly oil and gas), from 5.0% to 6.3%, which is now in doubt because of Russia's OPEC+ commitments.
- GDP growth is not broad-based, as around 50% of 2018 GDP growth was due to sectors that account for only 25% of the economy, including commodity extraction, construction (of oil and gas infrastructure), transportation (of oil and gas products), the financial sector (servicing the flows of the external sector), and state administration.

Overall, given the structure of 2018 GDP growth and the upcoming headwinds to domestic demand, we continue to believe that any growth above 1.0% in 2019 should be considered a positive surprise.

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