RUSSIAN FEDERATION

Table 1	**2018**
Population, million	144.3
GDP, current US$ billion	1657.0
GNI per capita, US$ (Atlas method)[a]	9230
International poverty rate ($1.9)[b]	0.0
Lower middle-income poverty rate ($3.2)[b]	0.3
Upper middle-income poverty rate ($5.5)[b]	2.7
Gini index[b]	37.7
School enrollment, primary (% gross)[c]	102.1
Life expectancy at birth, years[c]	71.6

WDI, MPO, Rosstat, and Bank of Russia.
Notes:
(a) Most recent WDI value (2017).
(b) Most recent value (2015), 2011 PPPs.
(c) Most recent WDI value (2016).

Real GDP growth in the Russian Federation surpassed expectations in 2018, reaching 2.3 percent. However, this was mostly due to one-off effects in non-housing construction. A downgraded forecast for GDP growth in 2019 reflects lower oil prices; the medium-term outlook remains modest. Poverty rates eased in 2018, but the government's goal of halving the poverty rate in six years will require the mobilization of additional resources and better targeting of social spending.

Recent developments

Supported by robust global growth, higher oil prices, one-off construction projects, and Russia's hosting of the FIFA World Cup, GDP growth accelerated to 2.3 percent in 2018 from 1.6 percent in 2017. In the first half of the year, manufacturing drove growth in the tradable sectors. The relaxation of the OPEC+ agreement in June 2018 provided a growth boost to mineral resource extraction and related non-tradable sectors (transportation and storage) in the second half of the year. The construction sector grew by 4.7 percent (compared with a contraction of 1.2 percent in 2017), driven by the completion of energy sector construction projects.

The current account surplus widened to about 7 percent of GDP in 2018 (from 2.1 percent of GDP in 2017), supported by higher commodity prices and robust export volume growth. Difficult external financial conditions for emerging markets and elevated geopolitical tensions boosted net capital outflows to $72.1 billion (about 4.8 percent of GDP) in 2018 and led to a depreciation of the real effective exchange rate of 7.7 percent. At $468.5 billion at end-2018, international reserves were $33.7 billion higher for the year (compared to an increase of $15.4 billion in 2017), due mainly to foreign currency purchases under the fiscal rule framework.

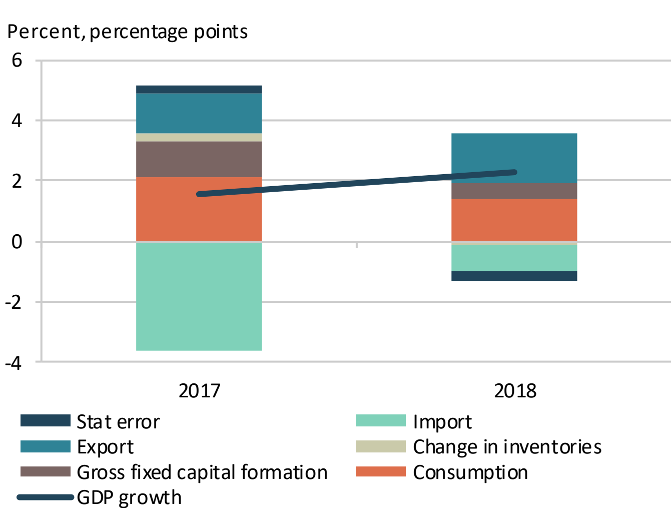
Average annual consumer price inflation decreased to 2.9 percent in 2018 (from 3.7 percent in 2017). However, consumer price inflation has been on the rise since July 2018 reflecting ruble depreciation, a weaker harvest, higher gasoline prices, an upcoming value added tax (VAT) rate increase, and a narrowing of the output gap. In December 2018, the Central Bank increased the key policy rate by 25 basis points to 7.75 percent citing elevated inflationary risks.

Higher oil prices, combined with a weaker ruble, a better tax administration, and a conservative fiscal policy further improved fiscal balances at all levels of the budget system in 2018. In 2018, the general government posted a surplus of 2.9 percent of GDP, compared to a deficit of 1.5 percent of GDP in 2017.

New development goals announced by the President in May 2018 ordered increased government spending on education, health, and infrastructure starting in 2019. Revenue will be boosted through a VAT rate hike and tax maneuver in the oil sector. The fiscal rule has been temporarily relaxed to accommodate higher spending. While these measures will raise fiscal risks, these will remain modest thanks to Russia's low public debt.

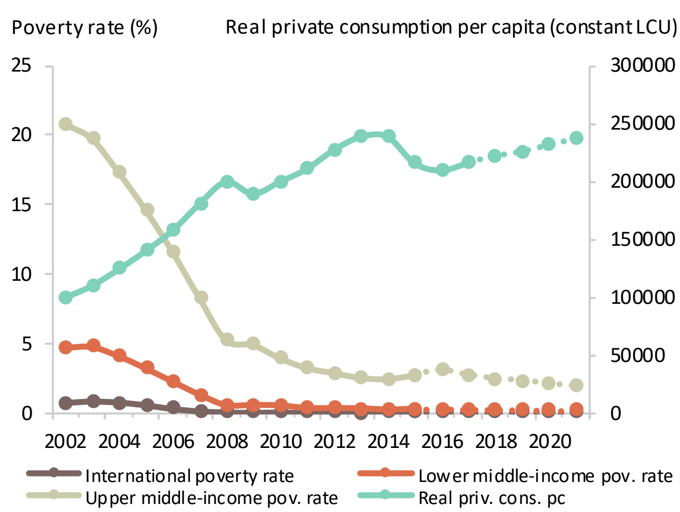
Despite recent bailouts, Russia's banking sector remains relatively weak with a lower capital adequacy ratio (12.3% in December 2018) and a higher ratio of non-performing loans (10.4%) than other emerging markets, leaving the sector vulnerable to macroeconomic shocks. However, the situation is stabilizing, and lending activity is recovering. In 2018, household credit grew at double-digit rates, prompting the Central Bank to tighten prudential requirements to slow unsecured consumer lending.

FIGURE 1 Russian Federation / Real GDP growth and contributions to real GDP growth



Sources: Russian Statistical Authorities and World Bank staff calculations.

FIGURE 2 Russian Federation / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see table 2.

The unemployment rate fell to 4.8 percent in 2018 from 5.2 percent in 2017. Rising real wages in 2018 reflected low average inflation and higher public sector wage growth. Real disposable incomes, however, remained unchanged compared to 2017, suggesting a contraction in real terms of some unobserved components (informal earnings, for example). Nevertheless, incomes at the bottom of the distribution grew slightly faster than at the top, possibly driven by the higher minimum wage and new family benefits.

The poverty rate under the national definition (population share with income below 10,088 rubles/month in 2017) fell by 0.5 percentage points (from 13.8 to 13.3 percent) in the first nine months of 2018, as the poverty line grew below the rate of inflation and incomes rebounded at the bottom of the distribution. Poverty also declined under the World Bank's upper-middle-income country poverty measure (population share with per capita consumption under $5.5/day in 2011 PPP, equivalent to 4,351 rubles/month in 2017), falling from 2.6 percent in 2017 to 2.4 percent in 2018. Income inequality remained broadly unchanged.

In May 2018, the President announced a target of halving the official poverty rate over the next six years. The current forecast of average annual GDP growth of about 1.7 percent does not support the achievement of this goal. Additional budget funding and improved targeting of social protection programs will be needed to supplement the poverty reduction impact of GDP growth. Failing to introduce these reforms will jeopardize the achievement of the government's poverty reduction target.

Outlook

Russia's overall growth prospects for 2019–21 are modest given low growth potential. Supported by relatively high oil prices, the general government budget is expected to remain in surplus in 2019–21. Inflation is forecast to accelerate in 2019 on the back of the VAT rate increase and ruble depreciation pass-through, but return to the Central Bank's target of 4 percent in 2020–21. The forecast of a narrower external surplus reflects lower oil prices and a pick-up in import spending. Stable economic growth, wage growth in the private sector, and the indexation of pensions to inflation should support disposable incomes and contribute to a gradual decline in the poverty rate in 2019–21. However, many Russians lack formal employment, and many households will remain close to the poverty line.

Risks and challenges

Downside risks to Russia's growth outlook stem from the potential expansion of sanctions, a deterioration in financial market sentiment, and a dramatic drop in oil prices. Investment growth is subject to the successful and efficient implementation of government infrastructure investment initiatives. The recent expansion in household credit may pose a risk to financial stability in the case of a deterioration in the macroeconomic environment.

In addition to expanding the labor force by raising the retirement age, lifting Russia's potential growth rate will require the implementation of reforms that support total factor productivity growth. The continuing presence of high price-cost margins and lower-than-average market entry rates point to the limits to competition, which is essential for improving productivity.

TABLE 2 Russian Federation / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	0.3	1.6	2.3	1.4	1.8	1.8
Private Consumption	-1.9	3.2	2.2	1.1	1.7	2.0
Government Consumption	1.4	2.5	0.9	1.0	1.0	1.0
Gross Fixed Capital Investment	0.7	5.5	2.3	2.8	3.9	3.9
Exports, Goods and Services	3.2	5.0	6.3	3.9	4.0	4.0
Imports, Goods and Services	-3.6	17.4	3.8	4.2	5.3	5.8
Real GDP growth, at constant factor prices	0.4	1.6	2.2	1.4	1.8	1.8
Agriculture	2.2	1.4	-2.0	1.7	1.7	1.7
Industry	2.2	0.8	2.8	1.4	2.0	2.0
Services	-0.7	2.0	2.3	1.4	1.7	1.7
Inflation (Consumer Price Index)	7.1	3.7	2.9	5.2	4.0	4.0
Current Account Balance (% of GDP)	1.9	2.1	6.9	6.2	5.4	4.6
Net Foreign Direct Investment (% of GDP)	0.8	-0.5	-0.5	-0.5	-0.5	-0.5
Fiscal Balance (% of GDP)[a]	-3.7	-1.5	2.9	1.7	1.6	1.5
Debt (% of GDP)	15.7	15.1	14.3	14.8	15.6	16.5
Primary Balance (% of GDP)[a]	-2.8	-0.6	3.8	2.4	2.3	2.2
International poverty rate ($1.9 in 2011 PPP)[b,c]	0.0	0.0	0.0	0.0	0.0	0.0
Lower middle-income poverty rate ($3.2 in 2011 PPP)[b,c]	0.3	0.3	0.2	0.2	0.2	0.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[b,c]	2.9	2.6	2.4	2.3	2.2	2.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Fiscal and Primary Balance refer to general government balances.
(b) Calculations based on ECAPOV harmonization, using 2015-HBS. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021.
(c) Projection using neutral distribution (2015) with pass-through = 0.87 based on private consumption per capita in constant LCU.