

What's Next for Russia's Economy?

Analysts predict low growth, low inflation and a strong stock market in the final two months of the year.

By [Jake Cordell](#)

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The Russian stock market is up 33% so far this year, despite low growth and ongoing pressure on household budgets. **Sergei Fadeichev / TASS**

A fresh roster of forecasts and data on the Russian economy suggests slow growth and low inflation coupled with robust corporate performance will mark the final two months of the year.

Meanwhile, economy-watchers remain fixed on a crucial Central Bank meeting in December and are divided over whether Bank of Russia governor Elvira Nabiullina will deliver a further [rate cut](#) before the New Year.

Growth outlook

A Reuters poll out today found economists are predicting the Russian economy will record growth of 1.1% in 2019. This is slightly up from last month's forecast of 1%, but still solidly below analysts' expectations and the government's hopes at the start of the year.

Analysts also cut their outlook for 2020 on the back of weak consumer confidence, expecting the economy to grow by 1.6% next year — down from the most recent prediction of 1.8%.

"GDP growth should remain subdued given the delayed implementation of [the government's] National Projects," said Deutsche Bank senior economist Peter Sidorov in a research note.

A study [published](#) earlier this week by Oxford Economics said the effect of spending by the government on its National Projects infrastructure plan would be "close to zero" this year, after accounting for the tax hikes which have been introduced to pay for it.

Fears over a slow end to the year were compounded Friday by a weak reading on the influential purchasing managers' index (PMI). The index showed that conditions in the Russian manufacturing industry declined for the [second](#) consecutive month, coming in at 47.2 on a scale where scores below 50 mark a contraction in the sector.

"Manufacturers across Russia continued to register strong falls in output and new orders, with client demand declining at the sharpest pace since April 2009," said Sian Jones, economist at IHS Markit.

While holding back growth, slow spending by the government on infrastructure projects could boost the Russian government's own already-impressive balance sheet. The government's risk of a default, as measured by the price for credit default swaps (CDS), hit its [lowest](#) level since before the global financial crisis last week, and Loko Invest's Kirill Tremasov highlighted the state's strong finances, which look set to trigger another [upgrade](#) for its sovereign credit ratings over the next few months.

Some analysts are also suggesting that Russian growth might be underestimated. In a technical research note, VTB Capital highlighted that the Russian construction industry is probably doing a lot better than the stagnation shown by official statistics. The same mismatch last year led to annual GDP growth being revised upwards by 0.3 percentage points once the statisticians caught up.

Where next for interest rates?

Expectations for slow growth are coupled with a downbeat outlook for inflation. The consensus forecast is for inflation to come in at an annual rate of 3.5% over the final quarter of the year, and fall to 3% at the start of 2020 — both well below the Central Bank's [official](#) 4% target.

With this comes talk of further interest rate cuts from the bank. Last week, the key rate was slashed from 7% to 6.5%, and many analysts believe there is plenty of scope for another cut when the bank's rate-setting committee meets next in mid-December.

“The tone of the central bank’s commentary does little to suggest we are at the end of the easing cycle, and we continue to see scope for more reductions,” said ING’s Dmitry Dolgin.

The consensus forecast is for a cut of 25 basis points to 6.25%.

“We expect continued easing by the central bank, seeing the December meeting a close call between a 25 basis point cut [to 6.25%] and another 50 basis point move to 6%,” Deutsche Bank said in a research note. “If not in December, we would expect the key rate to fall to 6% in early 2020, with potential for the central bank to reach a terminal rate slightly below 6% in the first half of next year.”

Loko Invest’s Tremasov, who used to compile economic forecasts for both the Central Bank and the Economics Ministry, highlighted how volatile interest rate predictions have been in recent weeks.

“Just one month ago, interest rates were forecast to be 6.75% at the end of the year. Two months ago, the forecast was 7% at the end of the year,” he said. Analysts “go from one extreme to the other. As overly conservative as the forecast was a month ago, it is becoming overly optimistic now. In order to say that rates will go down sharply, we need more information — which may or may not materialize.”

Strong business sector

Despite slow growth, ongoing sanctions risks and weak consumer confidence, the Russian corporate scene has enjoyed a strong year — a fact that is likely to hold for the final few months.

The Russian stock market reached new record highs in October, and has so far delivered a 33% return since the start of the year. A number of key companies, including energy majors, Sberbank, Yandex and Mail.Ru reported [earnings](#) in third quarter above expectations, and one-off good news stories such as Denmark [approving](#) the construction of Gazprom’s Nord Stream 2, has supported a strong start to the final quarter of the year.

Sergey Deineka, financial analyst at brokerage BCS Premier highlighted that November is usually a quiet month on the Russian stock market, and with the short-term risk of the U.S. introducing more anti-Russia sanctions fading, the index looks set to “consolidate” recent gains.

Looking to the rest of the year, December is usually a bumper month for the stock markets. Research by Raiffeisenbank found over the last 25 years, the final three months of the year — dubbed the “Santa Rally” by market-watchers — are more likely to deliver positive returns to investors than any other quarter.

In particular, the end of 2019 could be one of the final chances for Russian banks to continue boosting profits. Profitability has soared to reach seven-year highs in the sector, Deutsche Bank highlighted, but analysts cite the prospect of falling interest rates — which put pressure on the profit banks can make on their own lending to customers — and a slowdown in demand for consumer loans, could prove stumbling blocks in 2020.

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