

A Putin victory may spur some structural reforms, but not enough to boost Russia's subdued growth



Scope
Ratings

Polls for the Russian presidential elections indicate a comfortable win for President Vladimir Putin. Scope expects continuity in economic policies supporting the country's macroeconomic framework. However, the timing and content of broader reform initiatives to achieve higher growth remain uncertain.

Russia will elect its next president on Sunday, March 18th, 2018. While, as polls suggest, Putin will face no real competition due to the lack of credible alternative candidates, Scope believes that his re-election ensures policy continuity and predictability of political priorities.

Russian presidential elections: a foregone conclusion?

With President Putin's approval rating topping 80% and Russia's major pollsters predicting between 63%-70% support for him, Scope anticipates Putin will win a first-round victory to ensure his fourth presidential term. The results of the regional and local elections held on 10 September 2017, in which the ruling United Russia party won all 16 gubernatorial races, supports this thesis. Opposition candidates performed strongly only in Moscow's municipal elections, winning 262 out of 1,502 local-council seats (17.4%).

Figure 1: Opinion polls for the Russian presidential election, as of 11 March 2018

Putin	Zhirinovskiy	Grudinin	Sobchak	Other
64.9%	6.7%	6.2%	0.7%	21.5%

Source: FOM

As evidenced in former elections, however, support for Putin won't be uniform. He is expected to perform best in regions with higher unemployment rates and lower per capita incomes.

Scope believes that the high level of state involvement in the economy (with state connections to 70% of economic output in 2015, up from 35% in 2005, according to the Federal Antimonopoly Service¹) has led to Putin's perceived omnipresence among local households. This, combined with the economic dependence derived from working for the Russian state, could also serve as an incentive to vote for him.

Putin's policy platform: more of the same?

Many of the government's security, political and economic strategies have been worked out with a longer-term perspective, i.e. well beyond 2018. Scope expects continuity in Russia's conservative approach to the economy, characterised by the country's flexible exchange rate regime reform, stable budget outcomes and continued accumulation of foreign-exchange reserves, supporting resilience against shocks.

For example, Russia's conservative economic policy is underpinned by the new fiscal rule which requires the assumption of an oil price of USD 40 a barrel in the budgeting process, despite current oil prices lingering above USD 60 a barrel. The required savings of extra oil revenues above the USD 40 a barrel benchmark improves fiscal sustainability and supports domestic investment.

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¹ <https://www.vedomosti.ru/economics/articles/2016/09/29/658959-goskompanii-kontroliruyut-ekonomiki>

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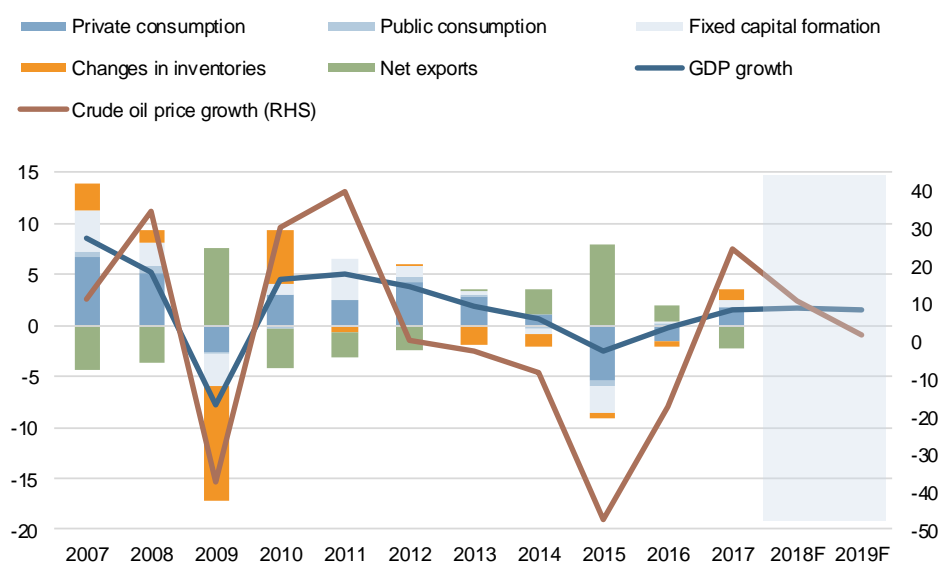
Going into the elections, Putin has pledged to allocate more money to infrastructure, education and healthcare. He has also promised a more rigorous fight against corruption and improved governance. While increased investment in domestic infrastructure is in line with a macroeconomic strategy to strengthen domestic production, essential economic reforms, including fair competition with minimal government regulation and scrutiny, have failed to gain traction.

Will continuity support stronger growth?

Russia's economic growth is projected to continue its moderate pace, around 2% in 2018 and 1.5% in 2019. The forecast GDP expansion, which is close to estimates of Russia's long-term growth potential, reflects stable oil prices, improved credit conditions and business sentiment supporting investment and consumption.

While Russia's short- to medium-term economic growth outlook has improved, long-term growth prospects of around 1.5% p.a. are subdued, due to international sanctions and the structural challenges posed by weak infrastructure, glaring regional differentials in income and unemployment, as well as the state's competition-crimping control of administrative resources in local markets.

Figure 2: Growth in GDP and oil price



NB. GDP growth is also shown by percentage-point contributions from components. Source: Federal State Statistics Service, EIA, IMF, Scope Ratings GmbH

What are Russia's fiscal prospects after the elections?

Russia's fiscal balance improved to -1.5% of GDP in 2017, from -3.7% of GDP in 2016² driven by recovering energy-related revenues as well as non-oil revenue collections. Going forward, fiscal consolidation will be further underpinned by continued increase in fiscal buffers mitigating budgetary volatility arising from oil price fluctuations.

Over the medium term, the threat of material fiscal risks will be low given the accumulated fiscal savings, recovering oil prices and the incorporation of conservative spending and revenue assumptions into the three-year budgeting framework (2017-2019).

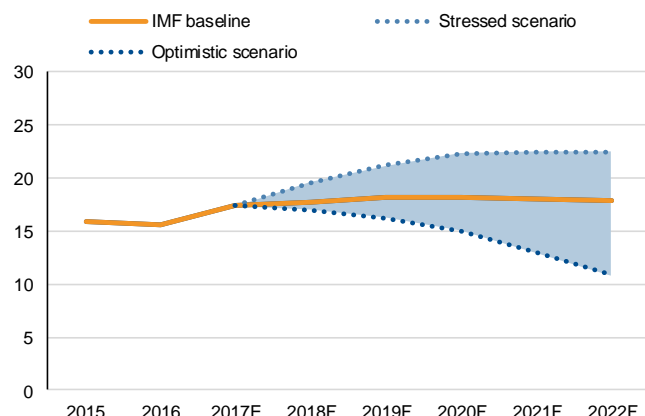
**Robust public finances
underpinned by new fiscal rule**

² Ministry of Finance of the Russian Federation

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A key risk to Russia's public-debt sustainability remains a protracted period of low growth, in Scope's view. However, based on Scope's stressed scenario in which we assumed weaker economic and fiscal outcomes than the IMF baseline, Russia's public debt would nonetheless still remain at moderate level under a threshold of 23% of GDP in 2022.

Figure 3: General government gross debt, % of GDP



Source: IMF, calculations Scope Ratings GmbH

Figure 4: Debt sustainability scenarios

Scenarios	Time period	Real GDP growth (%)	Primary balance (% of GDP)	Real effect. interest rate (%)	Debt, end period (% of GDP)
History	2013 - 2017	0.3	-1.9	-3.2	17.4
IMF baseline	2018 - 2022	1.5	0.2	-0.4	17.9
Optimistic Scenario	2018 - 2022	2.0	0.7	-1.5	10.8
Stressed scenario	2018 - 2022	0.5	-0.8	1.7	22.5

Source: IMF, Scope Ratings GmbH

Sanctions to remain an important factor over 2018

What will be the impact of Putin's re-election on Russia's complex geopolitical relations?

In Scope's view, international sanctions – and the risk of additional US sanctions and/or UK/EU punitive measures – will remain an important downside risk in 2018, as evidenced moreover by ExxonMobil's recent abandoning of a joint venture with Russia's Rosneft, a project worth USD 500bn³. However, Scope notes that the Western response towards Russia, in terms of economic sanctions and international isolation, has paradoxically helped Putin sustain domestic popularity and helped him secure public approval for an interventionist foreign policy.

Recent geopolitical successes have made Russia a key player in the Middle East, for example, abetting Russia's status as a global power. Furthermore, Putin has made clear that he is ready to defend Russian interests against the threat of NATO expansion. Scope does not expect any major shift in the geopolitical risks stemming from the ongoing conflict in Ukraine.

Macroeconomic stability as a key success indicator for Putin

Putin's strategy to retain power: what are the challenges ahead?

The anticipated re-election would mark Putin's fourth term in office, extending his time in power to a quarter of a century by 2024. Over the longer run, however, Scope anticipates that the limited visibility surrounding the possible succession of power could reduce the predictability of economic policy priorities.

The ultimate success of President Putin's strategy will depend on the future macroeconomic stability of the Russian economy in the face of external and internal challenges. In his Federal Assembly address, Putin discussed some reforms such as implementing measures to improve weak infrastructure using private investments, indexing pension hikes to inflation, tackling unfavourable demographics, and gradually disposing of financial assets that came under state control following economic restructuring processes. While these measures, if implemented, will be a step in the right

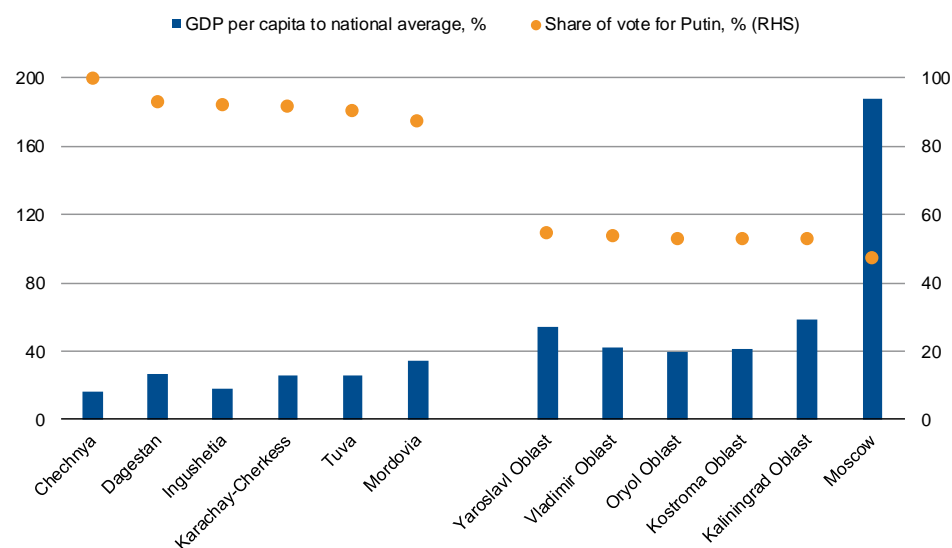
³ <https://www.ft.com/content/7e6a3212-1d1c-11e8-956a-43db76e69936>

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direction and mitigate some structural constraints to growth, the timing and content of broader reforms necessary for higher growth remain uncertain, according to Scope.

Regional economic inequalities reflected in strong income and employment disparity, and weak infrastructure, alongside the state's use of administrative resources in local markets undermining competition, remain structural challenges weighing on the country's economic outlook, according to Scope.

Figure 5: Top and bottom 6 regions by the share of vote for Putin in 2012



Source: Central Election Commission of Russia, Federal State Statistics Service

Elections not expected to have any effect on Russia's ratings

Does the election impact the investment-grade sovereign rating?

In Scope's view, the outcome of the Russian presidential elections will not affect Russia's BBB-/Stable sovereign ratings. Russia's ratings balance strengthening macroeconomic stability, an improving external balance sheet and liquidity position, as well as strong public finances, against subdued long-term growth prospects, commodity cycle dependence, weak governance and geopolitical risks.



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