Outlook for selected CESEE countries

Boom in CESEE-6 has peaked, stable but moderate growth in Russia[1, 2]

We predict GDP growth in the CESEE-6 countries[3] to reach 3.9% per annum in 2018 and to moderate to 3.4% and 3.1% in 2019 and 2020, respectively. Over the entire projection horizon, Poland and Romania will be the growth leaders, while Croatia will see the lowest growth rates (below 3%). Economic growth is broad-based, benefiting from favorable internal and external conditions: strong wage growth supports private consumption, favorable financing conditions for households and corporates underpin lending, and the inflow of EU funds supports gross fixed capital formation especially in 2018. In addition, growth prospects for the euro area – the main trading partner of the CESEE-6 – have been revised upward since our last forecast. Downside risks to the outlook for the region emanate from both domestic and global factors and have increasingly been building up. Despite a strong growth momentum on the back of robust euro area growth, income convergence with the euro area will slow down to 1.4 to 1.5 percentage points over the forecast horizon from 2.3 percentage points in 2017.

We expect Russian[4] GDP to increase by 1.8% in 2018, which represents a slight upward revision from our previous forecast, given higher oil prices. Over the projection horizon, economic growth will ease somewhat to come to 1.5% in 2020. Private consumption growth and investment activity will expand moderately. In a similar vein, public spending is expected to augment relatively slowly due to a new budget rule. Export growth will be dampened by the strong Russian ruble, while import growth will pick up on the back of stronger domestic demand.

Table 1

OeNB-BOFIT GDP projections for 2018–2020 in comparison with other forecasts

	Eurostat/ Rosstat	OeNB-BOFIT April 2018 forecasts			IMF April 2018 forecasts			wiiw March 2018 forecasts		
	2017	2018	2019	2020	2018	2019	2020	2018	2019	2020
	Year-on-year growth in %									
CESEE-6	4.9	3.9	3.4	3.1	4.1	3.3	2.9	3.9	3.4	3.3
Bulgaria	3.7	3.5	3.2	3.0	3.8	3.1	2.8	3.6	3.5	3.4
Croatia	2.8	2.9	2.9	2.9	2.8	2.6	2.4	2.7	3.0	3.0
Czech Republic	4.6	3.5	3.2	3.2	3.5	3.0	2.5	3.5	3.2	3.2
Hungary	4.2	3.5	3.0	2.6	3.8	3.0	2.6	3.8	2.6	1.7
Poland	4.7	4.0	3.5	3.3	4.1	3.5	3.0	3.8	3.5	3.3
Romania	6.8	4.5	3.7	3.2	5.1	3.5	3.1	4.7	3.8	4.2
Russia	1.5	1.8	1.6	1.5	1.7	1.5	1.5	1.8	1.6	1.6

Source: OeNB-BOFIT April 2018 projections, ECB, Eurostat, IMF, Rosstat, wiiw.

Note: 2017 figures based on seasonally adjusted data.

[1] *Cut-off date for data underlying this outlook: March 26, 2018. The projections for the CESEE-6 countries were prepared by the OeNB, those for Russia were prepared by the Bank of Finland in cooperation with the OeNB. All projections are based on the assumption of continued recovery in the euro area in line with the March 2018 ECB staff macroeconomic projections for the euro area. This implies real annual GDP growth of 2.4% in 2018, 1.9% in 2019 and 1.7% in 2020 in the euro area.*

[2] *Compiled by Antje Hildebrandt with input from Katharina Allinger, Stephan Barisitz, Markus Eller, Martin Feldkircher, Thomas Reininger, Tomáš Slačík and Zoltan Walko.*

[3] *CESEE-6: Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania.*

[4] *The oil price assumption used by the Bank of Finland is based on quarterly data for Brent futures. The cut-off date for the oil price assumption was February 28, 2018. We expect an average oil price of USD 64 to USD 65 per barrel in 2018 (18% higher than in 2017) and a modest decline to USD 60 per barrel until 2020.*

1 CESEE-6: favorable internal and external economic conditions

In 2017, economic growth accelerated by 4.8% in the CESEE-6 countries. Hence, economic activity was much stronger than expected in the fall of 2017 despite the fact that our projections were already more optimistic than most CESEE-6 forecasts by other institutions. Additionally, GDP growth in 2017 turned out to be well above the 2016 outcome as domestic demand gained momentum. A stronger use of EU funds in particular pushed up investment activity, and favorable labor market conditions supported private consumption. Sentiment indicators confirm the overall optimistic economic momentum in the CESEE-6.[5] Over the projection horizon (2018 to 2020), we expect GDP growth to moderate but to remain robust overall. Growth will be broad-based: exports continue to be supported by a positive external environment, while domestic demand continues to be driven by still favorable labor market conditions and a high use of EU funds.

Monetary policy expected to remain rather accommodative

The overall accommodative monetary policy stance is expected to prevail over the projection horizon despite somewhat stronger inflationary pressures in some countries as the CESEE-6 economies are operating close to full capacity. However, until now most of the inflation-targeting central banks project that their respective country's inflation rate will remain within the target bands over the coming months. In addition, the (still) favorable financing conditions and ongoing progress in cleaning up banks' balance sheets support lending.

No noticeable fiscal tightening so far

Positive economic growth prospects have not induced noticeable fiscal tightening so far, despite high (and rising) structural deficits in some CESEE-6 countries. According to Romania's 2018 budget, the government is planning another year of procyclical fiscal policies. In Hungary, we expect a weakening of public consumption over the forecast horizon following accelerated public spending ahead of parliamentary elections in April 2018. For Poland, we do not forecast a strictly countercyclical fiscal policy stance over the projection horizon. In the remaining CESEE-6 countries, the fiscal stance is rather neutral or restrictive.

Strong private consumption growth set to continue

Against this background, private consumption will remain strong over the projection horizon, but some emerging developments may have a dampening effect. We expect wages to continue to grow robustly in light of favorable economic conditions, but some moderation will take place due to the strained labor market and base effects from earlier (substantial) minimum wage increases. Furthermore, stronger inflationary pressure will lower real disposable income. This will be particularly noticeable in Romania in 2018. In addition, the higher wage bill will not translate into proportionally higher consumption growth because a comparatively smaller share of income is expected to be used for consumption purposes and a larger share will be going into savings.

Mixed picture for public consumption growth

In most CESEE-6 countries, public consumption will be stronger in 2018 than in 2017 and will be supported, to a large extent, by public wage growth. This will be the case in Bulgaria and the Czech Republic. In Poland and Romania, public consumption growth will slow down – in Poland due to a freeze of the public wage bill in 2018 and in Romania due to fiscal consolidation needs.

Investment growth expected to remain robust in 2018

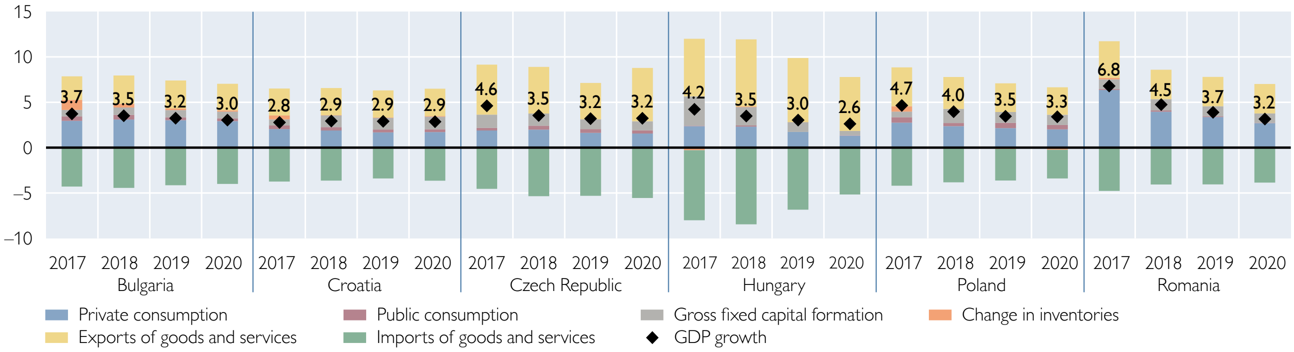
Investments in the CESEE-6 countries are strongly linked to the use of EU funds as a large share of investments (in particular in Bulgaria, Hungary and Romania) is (co)financed by EU transfers, which are expected to be utilized to a high degree

[5] *See the "Recent economic developments" section for more details.*

Chart 1

CESEE-6 GDP growth and contributions for 2018 to 2020

Percentage points, year-on-year GDP growth in %



Source: Eurostat, OeNB.

in 2018. In addition, further (labor-saving) private investment activity could kick in on the back of high capacity utilization rates and pressing labor shortages. Poland, for instance, will see much higher growth in gross fixed capital formation in 2018 than in 2017 because of carry-over effects from the fourth quarter of 2017. Apart from the base effect, which adds to exceptionally strong growth in 2018, investment activity in 2019 and 2020 will slow down also due to some frontloading of EU funds (as in Hungary) and potentially more restrictive financing conditions. In Croatia, investment growth will remain robust over the entire projection horizon because of a stronger absorption of EU funds.

Export activity clearly benefits from favorable euro area developments

Generally, export growth will be even stronger in 2018 than in 2017, before decelerating somewhat amid the expected gradual moderation of economic activity in the CESEE-6's main trading partners. In the Czech Republic and Romania, we expect a somewhat different picture. Export growth will slow down in 2018 – albeit from high levels – which is possibly attributable to the fact that these countries are already touching certain capacity constraints. Furthermore, rising unit labor costs in the manufacturing sector might weigh on export growth over the projection horizon. Import growth will remain firm, reinforced by robust private consumption and export-led demand for investment goods. From 2019 onward, however, import growth will weaken somewhat in line with the expected moderation of domestic demand. The contribution of net exports will remain negative in most CESEE-6 countries over the projection horizon. In the Czech Republic and Hungary, by contrast, the negative contribution will turn positive from 2019 onward.

Downside risks to growth in the CESEE-6 countries have clearly intensified since fall 2017

A number of downside risks to the forecast emanate from the current external environment. The implementation of frequently announced protectionist measures by the U.S. administration clearly takes center stage in our risk assessment. The U.S. has announced to impose tariffs on aluminum and steel imports, but as things stand, the EU countries will be exempt from these tariffs. Protectionist countermeasures by affected countries, like China, are difficult to predict at the current stage. An escalation into a trade war with tariffs being imposed on a wider range of goods poses an immediate risk to our forecast for the CESEE-6, which are all highly open economies. At this stage, however, we do not expect direct negative effects from U.S. steel tariffs on the CESEE-6 countries. Clearly, the picture would change if U.S. tariffs were enforced on cars as this would heavily affect the car components industry and hence intra-European production networks.

Geopolitical tensions surrounding Ukraine or the Middle East continue to be seen as a downward risk to our CESEE-6 forecast. Further external risks relate to sudden financial market corrections, like those witnessed in early 2018 in the U.S.A., which might disrupt global economic expansion. Furthermore, stronger-than-anticipated monetary tightening in the U.S.A. could dampen global GDP growth via a tightening of financial conditions. In addition, given the high indebtedness of the private and public sectors in several advanced and emerging economies, vulnerabilities might surface which could have a dampening effect on global growth prospects.

Major challenges at the EU level – largely provoked by the Brexit decision – are considered another downside risk to our forecast. Assuming the target date for the U.K. leaving the EU to be at the end of March 2019 and the transition period to last until the end of 2020, we expect that the CESEE-6 economies will be directly affected by Brexit after the projection horizon via trade, migration and the flow of EU funds. However, political uncertainty related to recent election outcomes and their implications for the future European integration process remains a downside risk to our forecast.

Further major political risks stem from domestic developments in the CESEE-6 region. In some countries, repeated discussions with the EU on issues concerning regulation or amendments to laws, transparency or corruption have increasingly become a factor of uncertainty for foreign investors. Moreover, uncertainty about the political stance on integration in general and rising public protest in some countries could dampen (foreign) investment growth and consumer confidence in an adverse scenario.

Economically, heightened labor market constraints in all CESEE-6 countries represent a major risk factor for our forecast. Capacity constraints could dampen output growth beyond the deceleration envisaged in our baseline. Higher wages and demand-pull factors might push up inflation pressure. This could induce stronger-than-anticipated monetary tightening and dampen the revival of lending activity in the CESEE-6. Furthermore, higher inflation rates would curb real disposable income to a greater degree than expected. Unit labor costs in the manufacturing sector accelerating further or even more strongly might put external competitiveness at risk. For Romania and – to a much lesser extent – for the Czech Republic, we also see a (slight) danger of economic overheating. A hard landing would dampen economic growth toward the end of the projection horizon to a much higher degree than expected.

Turning to upside domestic risks to our forecast, we still see further room for increasing the absorption rate of EU funds for most CESEE-6 countries, despite the fact that investments were pushed up strongly by EU funds already in 2017. While, on average, around 50% of funds under the current EU financial framework are allocated to projects, the actual utilization rate is still below the rate that prevailed at the end of the fourth year of the previous framework.

With respect to external factors, the major upside risks to our forecast are currently a stronger economic upswing in the euro area – on the back of brighter-than-expected economic sentiment or additional fiscal loosening – or a more pronounced expansion of the global economy along with increasingly buoyant global trade.

2 Projections for Bulgaria, Croatia, the Czech Republic, Hungary, Poland and Romania

Bulgaria: domestic demand continues to drive economic growth

Compared to our fall 2017 forecast, real GDP growth in 2017 came in a bit stronger than expected. This can be traced back i.a. to revisions of official national accounts data as well as to a stronger-than-expected expansion of inventories and gross fixed capital formation in the second half of 2017. We slightly upgrade our 2018 and 2019 GDP growth projections and maintain the overall expectation that GDP growth continues to be predominantly driven by domestic demand and to decelerate somewhat until 2020.

Private consumption growth increases in the short run on the back of higher disposable household income and improved consumer sentiment. But dried-up labor markets – with employment and activity rates already above pre-crisis levels – could prove a stumbling block for further acceleration in the years to come. Public consumption growth is expected to accelerate in 2018, reflecting the government's target to raise public wages significantly in 2018 (especially in the education sector). However, we expect some moderation in the medium term, in line with slight budgetary surpluses envisaged by the government for 2019 and 2020.

In line with government plans to strongly raise public investment spending in 2018 coupled with increasing EU fund absorption, gross fixed capital formation is projected to expand considerably more strongly than in the past few years. Growth will lose some momentum over the forecast horizon as tightening global financial conditions could make it harder to deal with crisis legacies, such as the comparatively elevated levels of nonfinancial corporate debt and nonperforming loans. Moreover, an increasing labor shortage (especially of skilled workers) might also limit investment growth in the near future (as suggested by recent firm-level survey results of the European Commission).

External demand assumptions for 2018 have improved considerably. As a result, we expect export growth to accelerate significantly this year but to lose some steam by the end of the forecast horizon. Imports, on the other hand, are fueled by vivid domestic demand. In particular, investment-related imports are expected to push up import demand. By contrast, decelerating domestic demand over the forecast horizon will result in a slowdown in import growth. Still, the contribution of net exports to GDP growth is expected to remain negative.

Croatia: growth slows despite strong private consumption

Recent developments have prompted us to revise our GDP forecast for Croatia moderately downward. We now expect a growth rate of 2.9% per annum year on year over the whole forecast horizon.

Private consumption growth – the main growth driver throughout 2017 – is expected to remain strong in 2018 as high consumer confidence was reported in the first months of the year, lending to households is growing and positive labor market developments are expected to continue. Public consumption will continue to grow but decelerate over the forecast period. Although Croatia exited the EU's excessive deficit procedure in 2017, fiscal consolidation will remain important as Croatia is moving toward euro adoption.

Gross fixed capital formation grew by 3.4% year on year in 2017, making a positive contribution to GDP growth. Investment growth is expected to accelerate this year to around 6% year on year. In this respect, the debt settlement plan for Agrokor and accelerated EU fund absorption may have positive effects. Regarding the former, a final settlement might reduce the uncertainty that has clouded the investment climate in Croatia. Moreover, while EU fund absorption is still low, the Croatian government made progress in terms of speeding up tender calls and project contraction in 2017, setting the ground for faster absorption in the coming years.

Export growth is expected to slow down mildly over the forecast horizon, while import growth will continue to be reinforced by strong domestic demand growth. We expect a negative contribution of net exports to growth over the forecast horizon despite expectations of a record tourist season like in 2017.

Czech Republic: mildly overheated economy will cool down gradually

On the back of strong domestic demand, the Czech economy expanded by a buoyant 4.5% in 2017. While economic expansion remains solid, it has passed its peak and is expected to slow down gradually over the forecast horizon. Private consumption and investment will remain the key drivers of economic growth, spurred by consumers' and firms' optimism. The latter is fueled by still low interest rates, significant wage growth and positive expectations with respect to future demand developments.

The peaking economic cycle is most visible in the labor market. The unemployment rate hovers at historical lows (also in comparison with other EU countries), which largely results from demographic developments. Vacancies are expected to outnumber jobless persons in 2018. Scarce labor, in particular skilled labor, is becoming a bottleneck for the entire economy and is increasingly likely to dampen output growth and to force firms to raise wages and employ foreign workers.

Therefore, higher household incomes will continue to stimulate private consumption, which is projected to peak this year and to decelerate gradually thereafter amid rising interest rates. In the same vein, a rising wage bill in the government sector, backed by strong economic growth, will be one of the main determinants underlying strong public consumption. In addition, the shortage of labor is an incentive for firms to invest in automation and labor-saving technologies. Against this background, investment will remain solid over the forecast horizon, spurred also by rising external demand and a higher drawdown of EU funds. However, these positive factors will be countered by rising interest rates in the medium term. The fast growth of both the domestic economy and wages has pushed inflation to the upper half of the tolerance band. However, according to the Czech National Bank, these effects will fade away and inflation is expected to return to the 2% target toward end-2018 and to hover just below this rate thereafter.

Export expansion will remain robust despite a continuously appreciating Czech koruna. The automobile industry, a key sector, will benefit from moderately growing global demand. Hence, flagship carmaker Skoda, for instance, expects sales to increase further after record sales and profits in 2017. This might imply significant investment in infrastructure and new capacities on the one hand but also further pressure on the labor market on the other. Highly import-intensive exports and strong domestic demand will also continue to boost import growth. Against this background, the relatively significant contribution of net exports to GDP growth in 2017 is expected to neutralize or even turn slightly negative this year before it starts to recover gradually from 2019 onward.

Hungary: front-loading of EU fund absorption will cause investments to slow sharply

For Hungary, we still expect relatively strong GDP growth of 3.5% in 2018, followed by a slowdown to 3% in 2019, and to below this rate in 2020, when the investment cycle will be drawing to an end as EU funds will be exhausted. Furthermore, wage and employment growth will moderate, and fiscal and monetary policy will become neutral or tighten slightly.

Strong income growth, supported by further minimum wage hikes and a tight labor market, will keep private consumption growth elevated in 2018. However, as labor reserves are being exhausted, we expect employment gains to diminish gradually over the forecast horizon. Real wage growth is also likely to slow down from 2019 onward as nominal wage growth is set to moderate to more sustainable levels and inflation will pick up to reach the central bank's 3% target. As a result, we expect household consumption growth to slow markedly to around 3% in 2019 and 2.5% in 2020. Public consumption picked up sharply in the second half of 2017, possibly in connection with the April 2018 parliamentary elections. We expect slower public consumption growth over the remainder of 2018 and a stagnation in 2019 and 2020 amid a neutral fiscal policy stance.

Growth in gross fixed capital formation will deteriorate strongly in 2018 compared with 2017, but the inflow of EU funds as well as monetary and fiscal policies will continue to underpin investment growth. Corporate investment activity will additionally benefit from record highs of capacity utilization rates, favorable economic prospects, very strong industrial confidence and large investment projects in selected industries (e.g. in the car and car-related industries and in the oil industry). Emerging labor shortages and ongoing strong wage growth may additionally generate some capital-for-labor substitution in specific areas. Strong income growth and more generous housing subsidies support household investment. We expect investment activity to slow again substantially in 2019 and 2020 as – given the frontloading of disbursements – the inflow of EU funds will fall sharply. Tightening financing conditions, the completion of large investment projects and the withdrawal of fiscal stimuli (no further broadening of housing subsidies, scheduled rise in the currently preferential VAT rate on home construction) also point to a deceleration.

We expect export growth to accelerate modestly in 2018, supported by the recovery of euro area imports and new export capacities becoming operational. Export growth should ease again in 2019 and 2020, mirroring a slowdown in euro area import growth and some worsening of Hungary's cost competitiveness following the boost in wages on the one hand and the impact of additional new export capacities on the other. Since we expect moderating domestic demand to slow down import growth, the contribution of net real exports should gradually improve over the forecast horizon and should be positive in 2019 and 2020.

The main domestic downside risk to our forecast arises from the question of how quickly the absorption of EU funds will slow down toward the end of our forecast horizon.

Poland: growth declines gradually as stimuli fade

Poland's GDP growth will decline from the high rate of 4.6% in 2017 to 4.0% in 2018 and slow down further to 3.5% in 2019 and 3.3% in 2020. The main factor behind this deceleration is the slowdown of private consumption growth. In 2019 and 2020, export growth will slow modestly in line with a moderation of foreign demand.

Private consumption growth will decline to 4.0% in 2018 and to 3.4% in 2020 as the sizeable positive base effect of the pronounced increase in child benefits, higher personal income thresholds for the application of the lowest tax rate and the hike of official minimum wage rates will fade out. In addition, private consumption will be dampened by the slow growth of average retirement pensions, the lower statutory retirement age in force since October 2017, the general freezing of the wage bill for central government institutions in 2018 and the – albeit moderate –

pickup in inflation. Still, private consumption growth will continue to expand at robust rates on the back of strong wage and (gradually declining) employment growth, improved consumer sentiment and historically low interest rates on loans for consumption purposes. Public consumption growth will remain substantially below GDP growth in 2018, reflecting the freeze of the public sector wage bill, but will likely increase again in the 2019 election year (a continuation of that freeze has not been announced).

Gross fixed capital formation growth will accelerate strongly in 2018, partly because of a carry-over effect from the strong final quarter of 2017, and will moderate somewhat thereafter. Public and private investments will continue to rebound in line with an increasing absorption of EU funds. Furthermore, private investment will benefit from strong domestic consumption and foreign demand, already high capacity utilization, the favorable financing situation with respect to both own funds and external funds, and the knock-on effects of stronger public investment. Housing investment will continue to expand considerably in 2018, given favorable income developments and financing conditions; in 2019, however, the completion of the state-subsidized housing program for young people will dampen housing investment growth.

Export growth will remain close to 7% in 2018, somewhat diminished by the rise in manufacturing unit labor costs. In 2019 and 2020, export growth will moderately decelerate, given the slowdown in euro area and global imports.

The main domestic risks to our forecast are, on the downside, heightened political uncertainty undermining the pickup in investment and, on the upside, increased fiscal stimuli ahead of elections that could lift growth in 2019.

Romania: rising uncertainty over effects of recent policy measures

For Romania, we maintain our expectation that GDP growth will decelerate over the forecast horizon. However, we have mildly revised upward our forecasts for 2018 and 2019 to 4.5% and 3.7%, respectively.

Private consumption growth is expected to remain the main driver of overall GDP growth. However, growth is expected to slow down for a number of reasons: the outlook for disposable income is uncertain as the government has passed a number of controversial measures with unknown consequences, such as shifting the obligation to pay social security contributions from employers to employees. Moreover, inflation has been accelerating rapidly over the past months and is expected to remain above the Romanian central bank's target rate for most of 2018. The central bank has already responded by increasing its policy rate by 25 basis points in both January and February and will most likely take further measures. Higher policy rates should also translate into tighter credit standards for households. These developments are also reflected in consumer confidence, which has deteriorated markedly since October 2017.

Gross fixed capital formation growth picked up noticeably in 2017, partially driven by base effects. Going forward, investments should be supported by strong GDP growth, supportive financing conditions and the acceleration of EU fund absorption toward the end of the 2014 to 2020 budgetary period. Net exports are expected to contribute negatively to growth over the entire forecast horizon. We expect export growth to remain supported by strong euro area demand but to be outpaced by import growth. The latter is expected to decelerate from 2018 onward in line with the slowdown in consumption growth.

The main risks to the forecast stem from Romania's fiscal stance and recent policy measures, especially in the labor market. For instance, there is a considerable risk that the Romanian government will not be able to keep the general government deficit below the EU's threshold of 3% of GDP in 2018. Uncertainty regarding future labor market developments is high due to recent policy changes. With effect from January 1, 2018, the Romanian government shifted the obligation to pay social security contributions from employers to employees. While the effects of this measure are partially mitigated by previous income tax changes and strong increases in minimum wages, for most employees, a pronounced increase in gross wages will be necessary to maintain their level of net wages. Such an increase is not mandated by law, however, and depends on negotiations with employers. Moreover, in 2018, the unified wage law is set to come into effect. This law aims at increasing the efficiency of the public remuneration system and will result in higher public sector wages. The government's policy stance could also have negative implications for the pace of EU fund absorption as cofinancing for EU projects is crowded out by other expenditures, such as higher public sector wages.

3 Russia: slow recovery continues

In 2018, we expect Russian GDP to increase by 1.8%. In the following years, Russian growth will ease to 1.6% in 2019 and to 1.5% in 2020 as the oil price is expected to gently decline to around USD 60 per barrel.

Private consumption will expand moderately, based on a rather slow growth of disposable income, low inflation and stepped-up growth of household lending. The rise of corporate sector wages is expected to remain reasonable relative to productivity adjustments. Fixed investment will increase as the country's relatively worn-out capital stock requires upgrading for replacement and production is close to capacity constraints. Capital formation may also slightly benefit from some further key interest rate reductions, which can be expected in 2018, given the low inflation rate that has been achieved. However, investment expansion will probably not shift into high gear as a number of large energy and infrastructure projects are approaching completion and appetite for new investment is still weakened by the poor business environment.

Public spending is expected to increase relatively slowly due to the authorities' new fiscal budget rule. Nevertheless, government revenues will grow notably in 2018, based on the trajectory of oil prices and on the continuing economic recovery, before rising at a lesser speed in the following years. The fiscal rule limits federal budget expenditure i.a. to a revenue frame which is determined by the price of Urals crude oil over the next few years. Should the basic calculation price of USD 41 to USD 42 per barrel be surpassed, which is highly probable, excess revenue is to be placed in the state reserve fund (National Welfare Fund). If the oil price remains roughly at its current level and spending is limited according to the fiscal rule, the budget seems on track to deliver a surplus.

Growth in the volume of Russian exports is expected to slow from brisk rates achieved last year as the Russian ruble remains fairly strong and Russian energy exports are likely to increase slowly, i.a. on the back of continued OPEC-Russia output restraints. We have slightly raised this year's import forecast from last fall as higher oil prices will increase domestic demand by raising oil-related incomes and will boost the country's export revenues. The recovery in imports, however, will continue to decelerate significantly this year, and at a moderate pace in the coming years, as the increase in export earnings is fading.

Risks to the forecast for Russia

Oil prices represent a continuous risk to Russian economic growth. A higher-than-expected oil price could boost growth by improving export revenues, whereas a price drop would have the opposite effect. Partly connected to this, there are risks facing the global growth outlook: significant unexpected geopolitical events and other international incidents have come to the fore, and developments in the next few years may affect the Russian economy directly or via the global economy. In particular, the latest U.S. sanctions against Russia pose a sizeable downward risk to our forecast.

In the light of developments in recent years, growth in Russia's exports of basic commodities outside the energy sector could exceed expectations. However, as capacity utilization in Russia is near its earlier peaks, production capacity could constrain Russia's staple exports as well as the economy's growth more strongly than expected. This could be reinforced by the ongoing uncertainty surrounding productive capital formation.