Outlook for selected CESEE countries:

Solid growth in CESEE-6 but no bright spots in Russia[1, 2]

Annual economic growth in the CESEE-6[3] region will reach 3.3% per annum from 2016 to 2018, implying some softening compared to 2015. This represents a marginal upward revision in 2016 and 2017 compared to our October 2015 projections, following the much better than expected outcome for 2015 and lower energy prices than previously assumed. In contrast, export growth has been revised downward in line with a more pessimistic outlook for the euro area. Cross-country heterogeneity will decline somewhat over the projection horizon. In all countries, domestic demand will be a major growth driver, fueled mainly by private consumption. With EU funding petering out, investment activity will lose some speed in 2016 but will strengthen over the projection horizon. The second major growth driver, export growth, will weaken somewhat in 2016 and will gradually quicken again in line with the external assumption on euro area growth. The growth differential to the euro area will amount to almost 2 percentage points in 2016 and will shrink to around 1.5 percentage points in 2017 and 2018.

The low oil price combined with Western sanctions will continue to weigh heavily on the Russian economy. We forecast Russian GDP to decrease by 3% in 2016. Domestic demand will shrink in 2016. Private consumption will be curbed by high inflation, frozen public wages and the indexation of pensions at a rate below predicted inflation. Investment activity is in a sorry state. Government expenditure will also be cut. With demand weak, imports are expected to decline in

Table 1

GDP and import projections for 2016 to 2018

	GDP				Imports			
	Eurostat/ Rosstat	OeNB/BOFIT forecasts			Eurostat/ Rosstat	OeNB/BOFIT forecasts		
	2015	2016	2017	2018	2015	2016	2017	2018
	Year-on-year growth in %							
CESEE-6	3.5	3.3	3.3	3.3	7.1	6.5	7.4	7.1
Bulgaria	2.8	2.6	2.7	2.8	4.5	4.3	4.9	5.4
Croatia	1.6	1.8	1.9	2.2	8.6	4.3	4.7	4.7
Czech Republic	4.3	2.4	2.6	2.6	8.1	6.5	8.9	8.3
Hungary	2.9	2.5	2.8	3.1	7.8	7.0	6.8	6.7
Poland	3.6	3.7	3.8	3.5	6.0	6.2	7.4	7.0
Romania	3.8	4.0	3.7	3.7	8.7	8.3	7.3	7.0
Russia	–3.7	–3.0	0.0	1.0	–26.0	–10.0	0.0	5.0

Source: OeNB-BOFIT April 2016 forecast, Eurostat, Rosstat.

[1] *Compiled by Antje Hildebrandt with input from Stephan Barisitz, Martin Feldkircher, Mariya Hake, Mathias Lahnsteiner, Thomas Reininger, Caroline Stern and Zoltan Walko.*

[2] *Cut-off date for data underlying this outlook: March 17, 2016. 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 a continued recovery in the euro area in line with the March 2016 ECB staff macroeconomic projections for the euro area. This implies real annual GDP growth of 1.4% in 2016, 1.7% in 2017 and 1.8% in 2018.*

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

2016. Export growth will be negatively affected by the low oil price. Along with some recovery of the oil price, growth will be zero in 2017 before it starts to revive somewhat in 2018. We assume that oil prices will rise steadily over the projection horizon from an average of USD 40.6 per barrel in 2016 to USD 49 per barrel in 2018.[4]

1 CESEE-6: robust economic growth largely driven by an upswing in private consumption

In 2015, economic growth in the CESEE-6 region mounted to 3.5% compared to 2.9% in 2014. The outcome came as a surprise on the upside. Overall, we expect economic performance to remain solid throughout 2016 to 2018 even though growth will decelerate somewhat compared to the remarkable 2015 outcome. Domestic demand will be the main growth driver in all CESEE-6 countries over the entire projection period. Only in the Czech Republic is the contribution of domestic demand expected to slump in 2016 compared to 2015, largely in the wake of lower investment activity. We see some other beneficial factors for the CESEE-6 economies over our forecast period. For instance, Croatia and Hungary have implemented measures to promote SMEs. Also, procyclical fiscal policy measures in most CESEE-6 countries, taken partly to deliver on election pledges, as well as minimum wage hikes in Bulgaria and Romania are expected to boost private consumption.

Leading indicators generally show a positive picture, but some moderation has set in most recently. Retail trade was very strong at the end of 2015 in all CESEE-6 countries, but decreased somewhat at the beginning of 2016. Similarly, industrial production mounted steadily in 2015 and early 2016 but moderated thereafter. In most CESEE-6 countries, economic and consumer sentiment indicators reached their all-time post-crisis high in late 2015 or early 2016. Compared to the average capacity utilization rate in 2015, capacity utilization augmented further in all CESEE-6 countries in the first quarter of 2016, climbing to almost 80%. Only in the Czech Republic, the country with the highest degree of capacity utilization among the CESEE-6 countries, did the rate drop slightly in early 2016.

Tighter labor market adds to wage pressure

The robust economic development has had a powerful impact on labor market developments throughout the CESEE-6 region, with unemployment rates diminishing and employment rates increasing in all countries. More precisely, the CESEE-6 average unemployment rate declined by more than 1 percentage point to below 7% in January 2016 compared to the same period of 2015. All countries covered in our forecast except Croatia display unemployment rates below the EU-28 average.

The labor market has become much tighter in recent months, as shown for instance by increasing vacancy rates particularly in the Czech Republic and Romania. The favorable situation on the CESEE-6 labor markets adds to wage pressure. Higher minimum wages in some CESEE-6 countries further exacerbated the rise in nominal labor cost. In some countries, unit labor costs in manufacturing already accelerated in 2015 and could negatively affect price competitiveness in the

[4] *The oil price assumption used by the Bank of Finland is based on the Brent future price of March 9, 2016. We further assume that the current sanctions related to the Ukraine-Russia conflict will remain in place over the entire projection horizon.*

medium term if higher labor costs are not compensated by exchange rate movements.

Monetary policy stance remains supportive for growth

At the moment, prices are declining in most CESEE-6 countries. The deflationary or low inflation environment is certainly conducive to economic growth because it provides room for expansionary monetary policy and supports private consumption. We expect monetary policy to continue to be supportive for economic growth. The Czech National Bank (CNB), for instance, communicated that it will keep its exchange rate commitment at least until the beginning of 2017. Furthermore, Magyar Nemzeti Bank (MNB), the Hungarian central bank, announced measures to support lending activity and a further reduction of the banking tax. However, the advantage of accommodative monetary policy could be partly offset by the increase in the real debt burden of some highly leveraged economic sectors given corresponding rises in real interest rates and in real interest rate expectations.

Private consumption growth will gain speed in 2016 in all countries or will at least remain constant, like in Hungary. Romania and Poland are expected to show the strongest growth of private consumption in the CESEE-6 region on the back of fiscal measures. In both countries, however, private consumption growth will lessen over the projection horizon. Beyond fiscal measures, private consumption will certainly continue to benefit from higher purchasing power and declining unemployment rates in the CESEE-6 region, as in 2015. The contribution of public consumption will only be minimal in the CESEE-6 countries (between 0.1 and 0.3 percentage point over the projection period). In the Czech Republic and Poland, public consumption will add somewhat more to growth (between 0.4 and 0.6 percentage point) due to increasing public wages (Czech Republic) and substantially higher child benefits (Poland).

Investment activity to weaken in 2016

In 2014 and 2015, most CESEE-6 countries took advantage of the EU fund disbursements under the 2007–2013 multiannual financial frameworks. Therefore, gross fixed capital formation (GFCF) accelerated strongly over those two years. Largely because the EU funding overlap will end, we expect GFCF to weaken by almost 2 percentage points to 3.6% in 2016. In 2017 and 2018, increasing utilization rates within the new EU funding framework will lift GFCF growth to 5.0% by the end of the projection horizon. The Czech Republic is most affected by the ups and downs of utilizing EU structural and cohesion funds; GFCF growth will almost stall in 2016 after expanding rapidly by 7.5% in 2015. By contrast, GFCF growth will remain in negative territory in Bulgaria in 2016 before a modest recovery materializes in 2017 and 2018. Investment activity in Bulgaria is to a large part restrained by the debt-ridden corporate sector and a high ratio of nonperforming loans. Yet the deleveraging process of the corporate sector decelerated substantially at the end of 2015 and in early 2016.

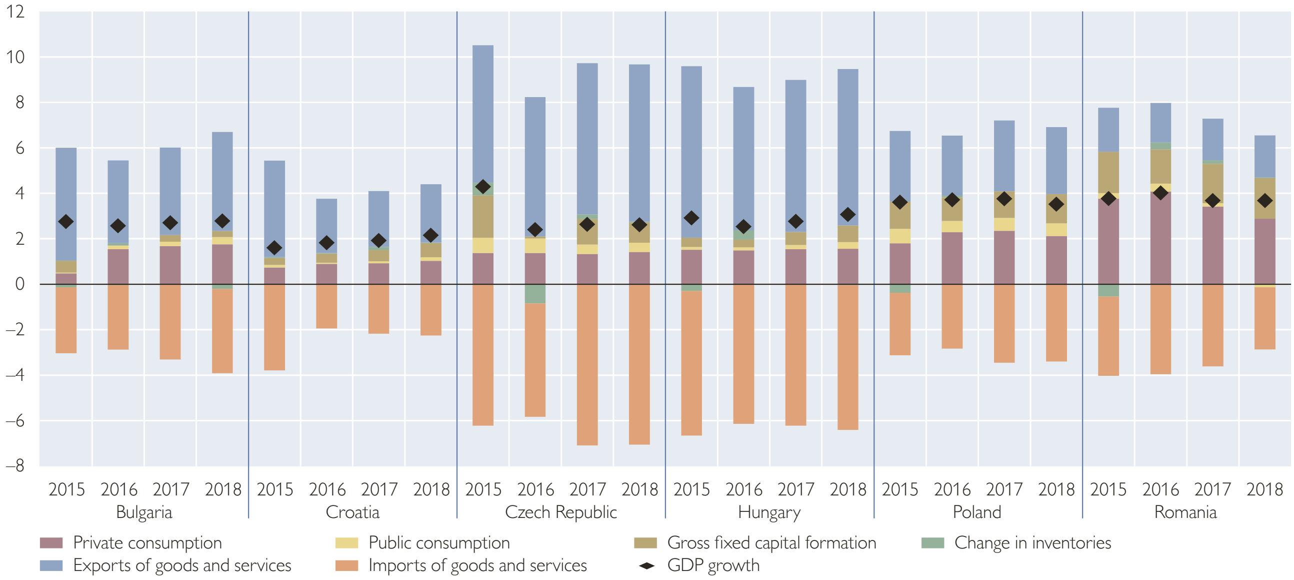
Export growth takes a dip in 2016

The outlook for euro area growth has weakened since our last forecast, in particular for 2016, implying a worsening of the external conditions for the CESEE-6 region. Predicted weaker external demand from the euro area, the main trading partner for the CESEE-6 countries, will have a negative impact. Thus, we expect export growth to dip marginally from 6.4% in 2015 to 5.7% in 2016. For 2017 and 2018, we see some rebound of export growth in accordance with the external assumptions. Turning to imports, we expect import growth to remain strong over the projection period, spurred by high domestic demand despite some weakening

Chart 1

GDP and GDP components: projections for 2016 to 2018

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



Source: Eurostat, OeNB.

Note: Actual data for 2015; projections for 2016 to 2018.

of the CESEE-6 aggregate in 2016. In 2016, net exports will make a strongly negative contribution to GDP growth only in Romania. In the remaining CESEE-6 countries, the contribution of net exports will move around the zero mark, whereas it will reach more than 1 percentage point in the Czech Republic. We expect the contribution of net exports to continue to hover around zero in 2017 and 2018. In Romania the negative contribution will be more than cut in half by 2018.

Risks to growth continue to be tilted to the downside and have increased over the past months

As the CESEE-6 countries' economies are strongly interlinked with the euro area economies, we see a weaker than expected recovery of the euro area as one of the major downside risks to our forecast. Likewise, a further slowdown of global growth, inter alia in emerging market economies, as well as of global trade, would affect the CESEE-6 region adversely. A deterioration of the external environment would particularly beleaguer the most open CESEE-6 countries, namely the Czech Republic and Hungary. Moreover, turbulences in international financial markets have accelerated lately, adding to the uncertainties surrounding the prospects for the world economy. Rising oil prices and increasing wages could intensify upward pressure on the currently low or negative inflation in the CESEE-6 region over the projection horizon. Inflationary developments could eventually result in a less accommodative monetary policy stance in the CESEE-6 region; they could also erode domestic demand. We also see some downside risks to our forecast stemming from adverse political developments in several CESEE-6 countries[5] and from setbacks in the European integration process. Policy uncertainties and the rise in national sentiment could have adverse effects on business and consumer confi-

[5] *Highlighting political risks, the credit rating agency Standard & Poor's unexpectedly downgraded Poland's credit rating on January 15, 2016.*

dence. Geopolitical tensions between Ukraine and Russia or in the Middle East also imply downside risks for the CESEE-6 countries. A few upside risks are conceivable. A more robust recovery of the euro area poses an upside risk to our growth forecast. Also, a continuation of stronger than anticipated accommodative national monetary policies would be conducive to economic growth. A further upside risk stems from a (partial) lifting of sanctions against Russia.

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

Bulgaria: economy driven by exports and private consumption

In Bulgaria, economic growth almost doubled to 2.8% year on year in 2015, mainly driven by higher exports to EU partner countries in the last quarter. We expect that the predicted economic slowdown for the euro area in 2016 will have some impact on Bulgaria's GDP development, which will soften to 2.6% in 2016 before gradually increasing again to 2.8% in 2018. Reduced euro area import demand will dampen Bulgaria's previous positive export development. But we see exports recovering in 2017 and 2018 in line with stepped-up import demand from the euro area.

Over the forecast horizon, GDP growth will be dominated by private consumption on the grounds of decreasing unemployment rates (from 11.4% in 2014 to 9.4% in 2015), increasing employment rates, rising minimum wages (up from BGN 360 to BGN 420 per month effective from January 2016) and the recent positive evolution of consumer confidence. With private consumption picking up, imports will augment and thus reduce the positive contribution of net exports to GDP growth. We do not expect imports to grow faster than exports, so that the current account deficit will improve. The growth contribution of net exports should stay slightly positive over the whole forecasting period.

Turning to investments, we forecast a slightly negative contribution of this aggregate to GDP growth in 2016. Public investment will be significantly lower, as the 2007–2013 EU program period, under which projects were concentrated on 2013 to 2015, has ended. It will take some time before the projects under the new EU program (2014–2020) are implemented. Private investment will not be able to compensate for the lack of public investment, as investors are still reluctant, given the unsupportive business environment in Bulgaria. Furthermore, highly indebted businesses together with an ineffective insolvency regime constrain investments even more. However, in 2017 and 2018, public sector investment should pick up again and result in an increase in overall investment.

Croatia: possible switch to more sustainable growth

The Croatian economy has finally bounced back and has returned to positive territory, with GDP growth posting 1.6% in 2015, prompting a sizable upward revision compared to our October forecast. Although the modest pickup was broadly based, a stellar boost of external demand was the key driver of GDP growth.

The recovery in 2016 is projected to remain broadly based, with GDP growth reaching 1.8%, slowly accelerating to 1.9% in 2017 and coming to 2.2% in 2018. The recovery of private consumption is set to continue, albeit at a pace of 1.7% over the projection horizon, held back by lackluster credit growth and only a slow reduction of unemployment. On the upside, the conversion of Swiss franc loans might additionally stimulate the consumption of households. Public consumption, however, will still be constrained by consolidation efforts under the EU Excessive

Deficit Procedure. Consequently, according to the 2016 budget draft as presented on March 10, 2016, the general government deficit is to be brought down to 2.2% of GDP on the back of expenditure-led consolidation.

Public investment activity is projected to gradually accelerate, which is related to an enhanced absorption of funds under the new EU medium-term budget. Corporate fixed capital formation is projected to strengthen as well, not least due to a planned stimulus package for SMEs effective as from 2016. We expect the contribution of net real exports to gradually decline over the projection horizon but to remain positive overall. The temporary deterioration of the growth prospects of the external environment in 2016 might be partly offset by the opportunity to increase tourism exports in the light of geopolitical tensions in other major tourist regions. The pickup in investments depends heavily on the impact of austerity measures and the commitment of the new government to reforms, not least to implementing the privatization agenda.

Czech Republic: growth eases but remains solid

In the Czech Republic, GDP growth in 2015 amounted to a stellar 4.2% (in year-on-year terms) and was fueled by a strong absorption of EU funds. With the effects of EU cofunded investment fading, growth is forecast to be more modest over the next three years, amounting to 2.4% in 2016 and to 2.6% in 2017 and 2018.

Domestic demand remains the main driver of Czech real economic activity, even against the background of temporarily muted investment growth in 2016. For this year, investment growth is expected to stall, since the drawdown of EU funds in the new program period will start only gradually. With the absorption of EU funds gathering momentum, investment growth will accelerate, coming to 4.3% in 2017 and 3.4% in 2018. Government consumption is forecast to remain elevated in 2016 (3.2%) and to be more modest in 2017 and 2018 (2.1%). The higher support of government consumption for overall growth in 2016 is driven by a pronounced increase in the compensation of employees due to a rise in the public sector wage bill. Private consumption is projected to grow by about 3% over the forecast horizon, supported by comparatively low energy prices, easy monetary conditions and a tight labor market. Accelerating wage dynamics on the one hand and a gradual unwinding of the drop in import and oil prices on the other hand will drive up inflation and, in turn, short-term interest rates over the longer term.

The Czech National Bank (CNB) announced that it would not discontinue its exchange rate commitment to weaken the koruna before 2017. This should cushion a potential loss in external competitiveness brought about by a widening interest rate differential to the euro area and should bolster exports, which are expected to grow by about 7% to 8% over the forecast horizon. The high import content of investment in the Czech Republic will slow down imports and will drive up the contribution of net exports in 2016. Due to an investment-driven increase in imports, net exports are expected to be balanced over the longer forecast horizon.

Hungary: new policy measures help sustain solid economic expansion

After robust GDP growth in 2014 (3.6%), the expansion of Hungary's economy slowed to 2.9% in 2015; it was supported primarily by household consumption but also by net real exports. We expect a further temporary slowdown in growth to around 2.5% in 2016 due to the lower utilization of EU funds and the recent deterioration of external demand conditions. Consequently, we expect primarily investment activity to decelerate, mainly during the first half of 2016, as the inflow of EU funds is likely to fall substantially before picking up again in the second half of the year. Similarly, the end of the central bank's Funding for Growth and Funding for Growth Plus loan schemes at end-2015 may point to some slowdown of economic activity in 2016.

At the same time, various factors should partially counteract these growth-reducing effects and support also a reacceleration of growth in 2017 and 2018 (to 2.8% and 3.1%, respectively):

Private consumption growth should benefit from additional expected employment gains and the 1-percentage-point cut in the personal income tax rate to 15% effective since the beginning of 2016. We expect an additional impetus from the conversion of almost all remaining foreign currency loans of households into local currency loans at the end of 2015. This conversion should further bolster households' financial position and should reduce the need for precautionary savings, although not nearly as strongly as in early 2015. Also, consumer confidence will continue to strengthen.

The central bank has announced a more active use of its nonstandard measures if needed to support lending activity. In addition to the Growth Supporting Programme and the Market Based Lending Scheme, the significant reduction in the bank tax from the beginning of 2016 and the planned further reduction in 2017 are also expected to contribute to the gradual easing of credit constraints in the economy. High capacity utilization rates in industry, healthy economic sentiment and improving export prospects in 2017 should also aid new investments. Households' investment activity is expected to receive a boost from the temporary reduction of VAT (from 27% to 5%) for newly built homes and the further substantial extension of housing subsidies and subsidized loan programs, particularly for young couples, from the start of 2016.

As in the previous forecast, we expect public consumption to grow only moderately in 2016 and 2017 in line with fiscal objectives. However, with elections approaching in 2018, we expect an election-related increase in public outlays from the second half of 2017 onward.

We expect the GDP growth contribution of net real exports to decline in 2016, given temporarily dimmer export prospects and the strong expansion of domestic demand (also including some restocking). The contribution should increase anew in 2017, backed by improving foreign demand, and remain stable in 2018.

Poland: higher social benefits support private consumption, foreign demand decelerates

In Poland, GDP growth will accelerate slightly to 3.7% in 2016 (from 3.6% in 2015), mainly as a result of stronger private consumption growth. By contrast, annual export growth will slow to 5.6%, in parallel to the weakening of foreign demand that will reflect, inter alia, lower euro area import growth. Still, exports will remain the single most important component of total final demand growth. Private consumption growth will accelerate to 3.9% as a result of the strong rise of households' real disposable income on the back of strong wage and employment growth, the large increase of child benefits in particular for lower-income households as of April 1, 2016, the persistent supply side-driven deflation, and the support (already agreed under the previous government) for distressed borrowers that tend to have lower income. Moreover, the current strongly positive consumer sentiment raises consumption propensity and may encourage demand for consumer loans. Public consumption will slow, given the partial wage freeze in the public sector.

Corporate fixed investment will expand at a lower rate, reflecting the weaker knock-on effects of exports, the rise of uncertainty about both foreign demand and domestic economic policy developments and somewhat more difficult external funding (the impact of the bank tax on loan supply, the new EU medium-term budget). Conversely, relatively high capacity utilization and favorable internal financing conditions support corporate fixed investment.

Housing investment will also expand at a slightly lower pace, as tighter supervisory regulations on housing loans entered into force on January 1, 2016, on top of more restrictive loan supply. But households' income growth and the state-subsidized housing program for young people remain supportive of housing investment.

Public investment will suffer from the only gradual absorption of funds under the new EU medium-term budget. Overall, we expect GFCF growth to slow to 4.8%. At the same time, inventory buildup will stabilize, so that its negative contribution to GDP growth will vanish. Weaker export and investment growth will prevent import growth from accelerating. However, as import growth will outpace export growth, the contribution of net exports to GDP growth will turn slightly negative.

In 2017, GDP growth will continue to accelerate slightly to 3.8%, as export growth will recover to 6.5% in line with stronger euro area and in particular German demand. Higher growth will, in turn, underpin corporate fixed investment growth. Total GFCF growth will additionally benefit from the higher absorption of EU funds and will rise to 5.4%. At the same time, private consumption growth will remain strong and will even accelerate somewhat, as the full impact of higher child benefits and larger general tax allowances will play out, while deflation should be overcome by early 2017. Both higher export growth and stronger domestic demand will push up import growth to 7.4%, and the contribution of net exports to GDP growth will remain slightly negative over the projection horizon.

Romania: domestic demand drives growth, but some rebalancing likely from 2017

We expect that after coming to 3.8% in 2015, economic growth in Romania will accelerate to 4% in 2016 before leveling off at 3.7% in 2017 and 2018. GDP growth will be driven largely by domestic demand, particularly by private consumption. Yet, starting from a high level, the contribution of domestic demand will gradually decrease over the forecast horizon, as the impact of supportive fiscal and wage policy measures will abate. In turn, the negative contribution of net exports will also diminish somewhat, as import growth will decline alongside domestic demand, while export growth will likely remain moderate.

Private consumption will be boosted by the carryover effects of measures taken in 2015 (in particular the cut of the VAT rate for food products in June 2015, the hike of the minimum wage in July, the 25% health sector wage increase taking effect from October 2015), measures taken or planned in 2016 (cut of the standard VAT rate by 4 percentage points to 20% from January 2016 and a further minimum wage hike from May 2016) and their positive impact on real disposable income. Private consumption will also be supported by positive tendencies on the labor market and by the expansion of leu-denominated consumer loans.

We expect that after picking up in 2015, GFCF growth will remain robust, supported by the improved lending capacities of banks (cleanup of bank balance sheets) and low credit costs. A downside risk emerges from the giving-in-payment law, which could increase uncertainty over economic policymaking, negatively impact investor confidence and dampen credit growth in general. Nevertheless, public investment growth is likely to slow in 2016, as EU fund absorption is likely to drop temporarily (new EU fiscal framework). With increasing fund utilization within the new framework, annual GFCF growth will rise again from 2017.

Romanian export growth will benefit from accelerating euro area import growth. Yet, unit labor costs in the manufacturing sector will continue to rise, given the further minimum wage hike, and are likely to prevent export growth from accelerating markedly.

3 Russia: shrinking economy in 2016, slow recovery after 2017

Induced by an oil price plunge in the second half of 2014, the Russian economy shrank by 3.7% in 2015, and we expect Russia's GDP to dip further in 2016 on the back of a renewed oil price slump in the second half of 2015. We then expect oil prices to stabilize and to recover slightly, contributing to a turnaround of the Russian economy in 2017 and a weak recovery in 2018.

During the forecast period (2016 to 2018), world economic growth and trade will improve somewhat. Western sanctions, Russian countersanctions and uncertainties are assumed to stay unchanged, while the oil price remains the overwhelming determinant of the forecast. The previous forecast (of September 2015) had already predicted that the large oil price fall in the second half of 2014 would continue to depress the economy as late as in 2016. As a second blow, the oil price (Brent) declined further in the second half of 2015 to reach a (provisional) low of around USD 30 per barrel in early 2016; we now assume that it will recover only gradually and will attain an average of USD 40.6 per barrel in 2016, i.e. notably lower (–23%) than the annual average of 2015. The average oil price is expected to continue to rise moderately to USD 49 in 2018. GDP is therefore projected to shrink by about 3% in 2016 and to remain unchanged in 2017. In 2018, the economy will revive, though only slowly (+1%), as uncertainties relating to the economy and systemic developments will limit Russia's long-term growth to a slow tempo.

The low oil price will also continue to reduce Russia's export earnings in 2016. Together with the shrinking economy, these low export earnings will induce a further downward adjustment of Russia's imports. Imports may drop by one-tenth of their 2015 volume in 2016, and the meager GDP forecast for 2017 may entail stagnant imports.

Domestic demand in Russia is expected to shrink further, dropping quite significantly in 2016. Inflation is forecast to remain high in 2016 (at about 8% for the annual average of consumer prices), which will further erode the purchasing power of the private and public sectors. At the same time, corporate profitability and prospects of private sector wage increases are expected to be modest. Restraints on and freezes of public sector wage increases will continue, and the inflation indexation of pensions has been lowered (partly to 4% and partly to zero). Based on current decisions, government expenditures will also decrease in real terms, thus taking a bite out of public consumption and investments. In addition, Russia's leadership is planning to scale down expenditures further, as the low oil price is hitting government revenues quite drastically. Investments are anticipated to shrink further, as there is free capacity, and investment conditions are uncertain. Inventories are likely to decrease further. The volume of exports will be constrained among other things by the oil sector, where exports will at best grow much more moderately than in 2015.

Risks to the forecast for Russia remain large but are rather balanced now. Deviations of the oil price from the track envisaged would naturally have an impact on the ruble, inflation, domestic demand, imports, and, of course, economic growth. Geopolitical tensions may ease or intensify. There is an ever-present risk of other events that could induce increased capital flows from Russia and exert downward pressure on the ruble and on imports. Despite the declared aims of restraining and cutting expenditure, increases in government spending may materialize, as State Duma elections (in September 2016) and presidential elections (in March 2018) are approaching. Such spending would provide only a relatively short-lived boost to the economy, though, and could entail even stronger fiscal adjustment later. A notable upside risk stems from a possible halt to, or reversal of, last year's large shift to precautionary saving by households, as it would considerably improve the prospects for private consumption and imports already in 2016. Another upside risk is that the Bank of Russia could cautiously resume cutting interest rates if inflation declined more quickly than currently expected, which would have a favorable impact on banking activity.