ACRA

MACROECONOMICS | RUSSIA

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SANCTIONS AND STRUCTURAL TRANSFORMATION

RESEARCH

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MAIN CONCLUSIONS

— **ACRA has adjusted its macroeconomic forecast for 2022–2024.** The Agency has analyzed the possible consequences of sanctions, new economic policy regimes, and leading indicators of economic activity. Taking into account all available data, the Agency expects business activity to decline by 7–9% in 2022, and quite a long period of time will be needed to overcome this decline.

See page 4 for more details on the stages of transformation.

— **The period of structural rebuilding of the economy will be accompanied by higher inflation and a materialization of credit risks,** which over the forecast horizon will increase the average level of nominal interest rates for all periods relative to the level that was previously perceived as equilibrium (plus 2–4% for terms over three years).

— **Restrictions on exporting energy to Europe will lead to a decline in the total physical volumes of production and exports,** even taking into account the refocusing of part of sales to countries that are not participating in sanctions.

See page 5 for more details on the experience of sanctioned countries.

— **Restrictions on technology imports will depress the country's average labor productivity:** some activities will no longer be possible, and a significant part of investments will be directed toward replacing current technology with analogues that are not subject to sanctions, instead of increasing efficiency. There are risks of excessive compliance by global suppliers who are formally not limited by sanctions. All these factors reduce potential economic growth compared to the previous assessments of 1.5–2% a year to 0.0–1.0% over the medium-term horizon. The total physical volumes of imports will also significantly decrease.

— **The ruble exchange rate will depend heavily on the severity of external barriers to trade as well as internal capital controls** (a forced measure and a consequence of the sanctions regime). ACRA proceeds from the assumption that barriers will continue to soften, but will not fully dissolve over the entire forecast horizon. In addition, the Agency assumes that a new form of sterilizing excess foreign currency revenues will emerge in the economic policy toolkit, which will in the future help lower the exchange rate volatility of the ruble. Capital outflow in general will become more state-centric and will depend more on intergovernmental agreements, and the plans of state-owned companies and banks. If at the same time a floating exchange rate regime is de jure maintained, then the elements for manually managing it will grow.

— **Government spending priorities will likely change.** Over the next two or three years, the budget will be stimulatory and take on a significant part of expenses to support Russia's too-big-to-fail companies in the real sector, as well as additional social obligations. This will be financed using ruble balances and additional oil and gas revenues without seriously resorting to new borrowings.

— **Uncertainty in the key assumptions of the analysis is very high,** and therefore a point forecast makes less sense now than it did before. At this stage, we should talk about the formation of expectations regarding the order and direction of changes. ACRA will continue to refine the forecast as new data becomes available.

Table 1. Base case scenario of the macroeconomic forecast from 2022 to 2024

INDICATOR		UoM	ACTUAL			ESTIMATE 22.06.2022	FORECAST	
			2019	2020	2021	2022	2023	2024
Key external environment indicators	Urals crude oil price (annual average)	USD per barrel	63.4	42.1	68.1	**80.0**	75.0	75.0
	Global GDP[1]	%, y-o-y	2.6	-3.3	5.5	**2.5**	2.2	1.8
	US GDP	%, y-o-y	2.3	-3.4	5.7	**3.0**	2.2	1.9
	China GDP	%, y-o-y	6.0	2.2	8.1	**4.1**	4.5	4.3
	EU GDP	%, y-o-y	1.8	-5.9	5.3	**2.7**	2.3	1.5
Production indicators	GDP (current prices)	RUB bln	109,608	107,390	131,015	**137,320**	144,743	154,672
	GDP (fixed prices)	%, y-o-y	2.2	-2.8	4.7	**-8.2**	0.1	1.5
	Fixed investments	%, y-o-y	2.1	-0.5	7.7	**-18.5**	0.9	3.1
	Industrial output index	%, y-o-y	3.4	-2.1	5.3	**-5.7**	-0.4	1.8
	Retail turnover	RUB bln	33,624	33,874	39,257	**43,165**	46,220	50,163
Balance of payments indicators	Exports	USD bln	420	333	494	**421**	373	345
	Imports	USD bln	254	240	304	**245**	230	235
	Annual average USD exchange rate	RUB/USD	64.7	72.1	73.7	**75.0**	82.4	87.1
	Annual average EUR exchange rate	RUB/EUR	72.4	82.4	87.2	**81.0**	90.6	97.6
Income and labor market	Average wage	RUB/month	47,420	51,017	56,501	**61,812**	68,773	76,328
	Real disposable income	%, y-o-y	1.2	-2.0	3.0	**-5.5**	-1.1	-1.0
	Unemployment (annual average)	% of EAP[2]	4.6	5.8	4.8	**6.2**	6.0	5.5
Financial market prices and indicators	Inflation (CPI)	%, Dec/Dec	3.0	4.9	8.4	**16.9**	7.8	5.5
	Key interest rate (as of end of year)	%	6.25	4.25	8.5	**9.0**	8.25	8.0
	Key interest rate (annual average)	%	7.3	5.1	5.7	**11.2**	8.4	8.1
	5-year zero-coupon OFZ rate (as of end of year)	%	6.1	5.5	8.4	**9.5**	8.9	8.3
	5-year zero-coupon OFZ rate (annual average)	%	7.3	5.6	7.0	**10.1**	9.2	8.5
Budget	Federal budget balance	% of GDP	1.8	-3.8	0.4	**-2.3**	-1.8	-1.4

Source: ACRA

[1] Real growth rate according to the World Bank's methodology.

[2] Economically active population.

STAGES OF STRUCTURAL TRANSFORMATION

The changes to internal and external conditions that took place in 2022 were serious enough for processes to be launched in Russia that are very rare in most economies on a significant scale. In the coming years, the processes specified below, in ACRA's opinion, will dominate in most areas of activity, and their results will determine the future structure of the economy.

Short-term processes and challenges (one year)

1. The search for alternative suppliers of components, services and licensed software in order to carry out existing plans and meet contractual obligations.
2. The search for new routes to ship goods under existing agreements.
3. Retaining highly qualified personnel.
4. The search for ways to make payments without counterparties being threatened by secondary sanctions.
5. Real growth of variable costs at most companies.

Medium-term processes and challenges (from two to three years)

1. The search for new sales markets in countries that are not restricting exports from and imports to Russia.
2. Companies entering the market and using production methods that would not be competitive in the absence of barriers to trade and without the exit of multinational companies from the market.
3. Departure from the market of companies that fundamentally cannot exist in the new reality when all the possibilities for finding solutions (from those listed above) have been exhausted. Consolidation in shrinking markets.
4. Changing priorities and content of state economic policy.

Long-term processes and challenges (more than three years)

1. The search for new sources of complex science-intensive means of production.
2. The flow of labor resources and the change in the structure of education caused by the change in the structure of demand for labor.

IMPACT OF SANCTIONS ON FOREIGN TRADE VOLUMES AND NATIONAL WEALTH

ACRA has analyzed the experience of other large countries with a similar foreign trade focus that have faced embargoes and prolonged sanctions. The following countries and episodes were recognized as relevant to the forecast for Russia:

1. **South Africa (1962–1971)**: De-facto weak restrictions on oil imports from OPEC countries and arms imports; partial barriers for international cooperation in culture, sports, and education.
2. **South Africa (1986–1994)**: Strong restrictions on imports from the EU, US, Japan and a number of other countries; medium restrictions on exports of the main goods categories; transnational companies cease investment activities and wrap up their operations.
3. **Iran (1979–1989)**: Freeze of foreign currency reserves and privately owned foreign assets; secondary US sanctions against companies that carry out business and make investments; continued restrictions on exports of oil products; Iran-Iraq War.
4. **Iran (2010–2022)**: Ban on imports of oil production and refining technologies and arms from the EU; ban on investments and lending to the government; banks are switched off from SWIFT; oil embargo (EU + US); freeze of foreign currency reserves.
5. **Venezuela (2014–2022)**: Freeze of assets of the central bank and commercial banks; restrictions on exports of main goods categories (US); restrictions on arms imports from the EU; continued deep economic and political crisis.

For more details on sanctions regimes, see *Table 2*.

Similarities. All of these episodes have features of an embargo by one of the leading trading partners, which is likely to apply to Russia on the forecast horizon (exports of oil and petroleum products to the EU). Like Russia, at the beginning of the restrictions all the reviewed countries belonged to the group of countries with medium incomes (ranked 40–80 in terms of GDP per capita by PPP in the corresponding year), and were relatively poorly open to foreign trade (foreign trade turnover was 30–40% of GDP). The share of countries that de jure joined the main sanctions in the global GDP was in all cases comparable at the peak of the severity of restrictions (>50%).

Differences of Russia. Compared to the other reviewed countries, at the beginning of the sanctions, Russia had a more diversified industrial sector and a larger economy (by two to seven times), and it possessed more natural resources and food production capacity. In addition, before the restrictions began, economic policies in Russia seemed to be noticeably more advanced. On the other hand, before the introduction of restrictions, the Russian economy had no prospects of using a demographic dividend to support economic growth, while the speed of the introduction of the most of tough sanctions was significantly higher, as it took several months instead of years.

Table 2. Main indicators of sanctions regimes for the reviewed countries

	INDICATORS	South Africa	Iran	Venezuela	Russia
Sanctions details	Introduction year/year of the most toughest restrictions	1962/1985	1979/2012	2014/2019	2014/2022
	Export-import restrictions	+	+	+	+
	Financial restrictions	+	+	+	+
	Global GDP share of countries that de jure joined most restrictions	>50%	>50%	>50%	50–55%
	Year when most restrictions were lifted	1994	-	-	-
Positions before sanctions/at the time of the strictest sanctions	Relative volume of economy (GDP by PPP, % of the largest economy)	3%/4%	3%/9%	3%/1%	23%/?
	Relative wealth (ranked by GDP per capita by PPP)	48/81	61/56	50/97	41/?
	Trade openness (external trade turnover, % of GDP)	32%/29%	33%/33%	40%/?	38%/?
	Trade balance (% of GDP)	0.0%/6.1%	11.9%/1.7%	8.3%/?	9.5%/?
	Main groups of exported goods	Non-ferrous metals, gold	Oil, petroleum products	Oil, petroleum products	Oil, petroleum products, gas
Maximum sanctions effects on the 5–10-year horizon[3]	Size of the economy (GDP in fixed prices)	-10–15%	-15–20%	-10–25%	?
	Relative wealth (ranked by GDP per capita by PPP, in 2011 prices)	-10th–15th place	-10th–15th place	?	?
	Trade openness (external trade turnover, % of GDP)	-	-	-	?
	Main groups of exported goods	No changes	No changes	No changes	?

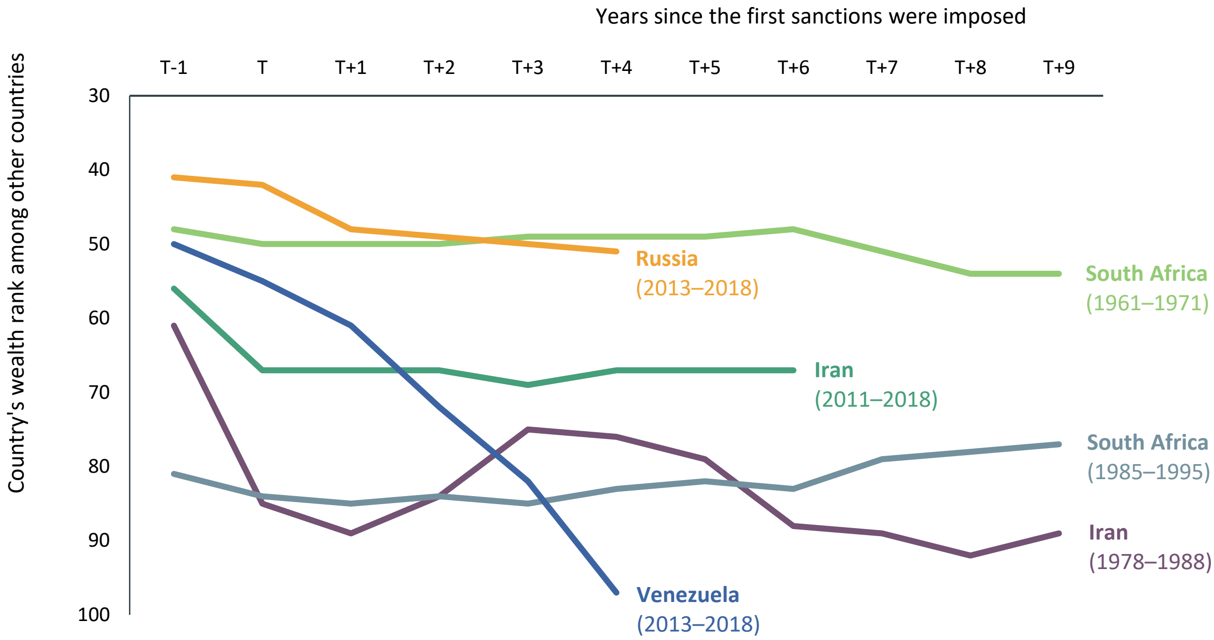
Sources: World Bank, local statistics agencies and central banks, ACRA

Conclusions derived from the comparison of episodes applicable to the 5–10-year forecast:

1. Generally, sanctions become de facto tougher over time, even without their legal toughening (provided that the political status quo is maintained).
2. Harsh sanctions can result in a 10–20% decrease in the size of the economy and business activity compared to the alternative “no-sanctions” scenario.
3. Even taking into account the reorientation of deliveries to other markets, the embargo may reduce the physical volumes of both exports and imports, however, import restrictions can be longer-term and more pronounced (losses of up to 40%).
4. About half of the negative economic effects in countries subject to severe sanctions cannot be directly associated with sanctions. Such effects may be associated with decisions in foreign and domestic policies that were taken before sanctions and not in response to restrictions. Thus, the lifting of sanctions does not always make it possible to compensate for the lag in wealth accumulated during the period of the sanctions regime.

[3] To assess the effect of an event, the synthetic control method was used: for the real GDP of countries and their relative wealth, hypothetical dynamics were constructed (weighted average of the dynamics in the relevant similar countries), provided there were no sanctions. The difference between these dynamics and the actual dynamics was considered the effect of sanctions.

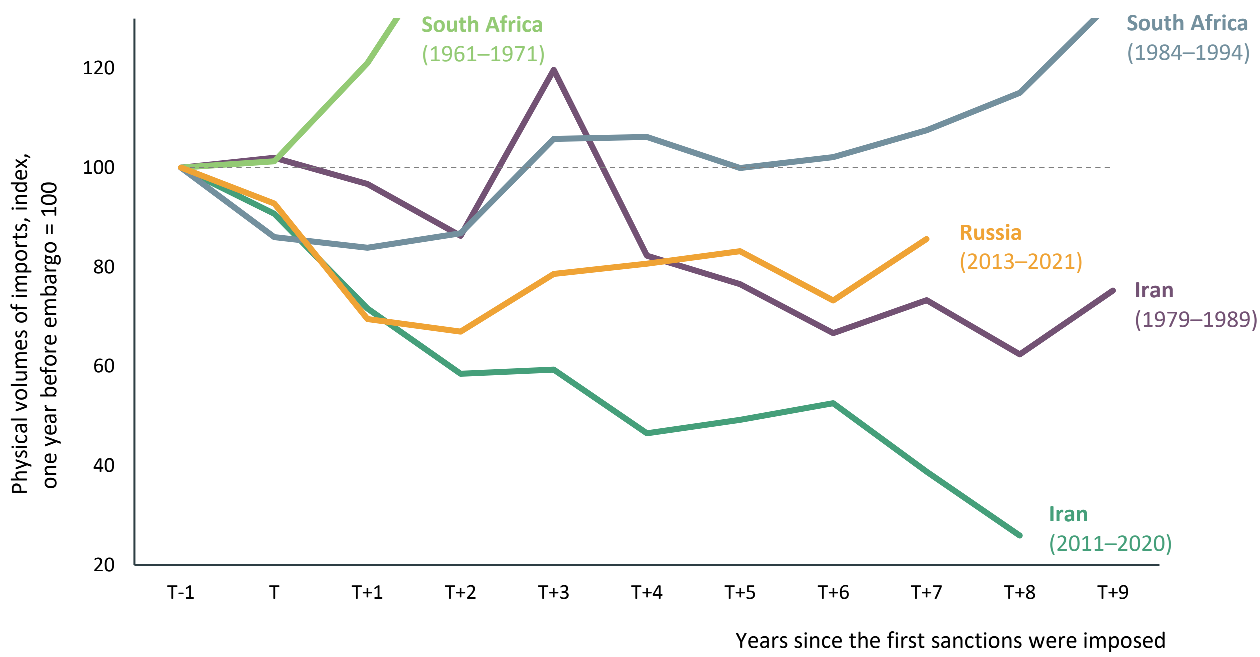
Figure 1. Relative wealth declined in the countries after introduction of sanctions*



* But, most probably, not exclusively because of sanctions. For example, in the 1980s, Iran was also affected by the Iran-Iraq War; Venezuela began to feel the economic crisis before 2014. Russia experienced a payment balance shock in 2014, which was by more than a half associated with changed expectations for future oil prices.

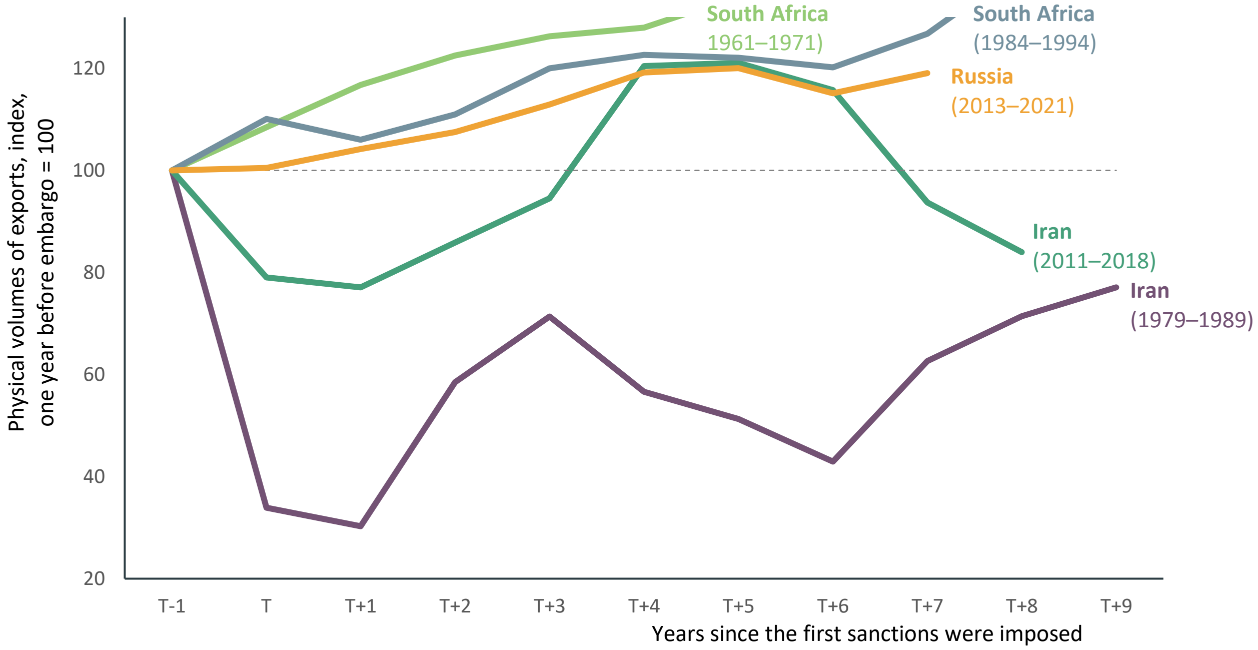
Sources: Penn World Tables, ACRA

Figure 2. Losses in physical volumes of imports after the imposition/toughening of sanctions



Sources: national statistics agencies, ACRA

Figure 3. Losses in physical volumes of exports after the imposition/toughening of sanctions



Sources: national statistics agencies, ACRA

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