Alfa-Bank

22 April 2019

Macro Insights

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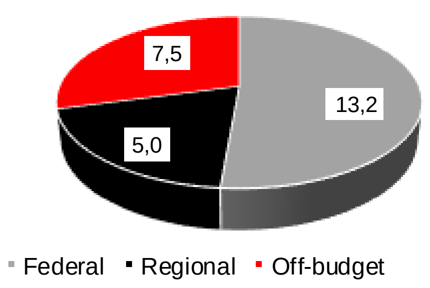
National projects

Building the case

The ambitious national projects package of RUB25.7tn raises questions about their implication for the GDP growth outlook. Their direct effect is likely to reach only 0.2% of GDP per year and indirectly will be up to 0.1% of GDP. That said, as 60% of the spending is related to infrastructure, the effect on the 2019 growth outlook should be limited. The main positive is that the national projects plan could boost potential growth from the current level of 0.7% to 1.6% by 2024: however, this will still be below 2.0% potential growth of G7 nations and only half of the 3.0% actual GDP growth rate the Russian cabinet targets by that time.

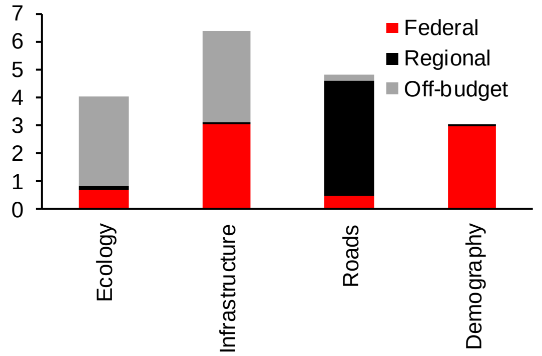
The cabinet plans to spend RUB25.7tn on national projects in 2019-24, with around 70% of spending going to four directions: The Russian cabinet recently issued a detailed roadmap to implement 13 national projects (including an integrated plan for infrastructure development) in 2019-24. Total spending of RUB25.7tn is planned: half of the funding will come from the federal budget (RUB13.2tn), 30% from off-budget sources (RUB7.5tn) and 20% from regional budgets (RUB5.0tn) (see Figure 1). Out of the 13 projects presented, around 70% of the expected spending will be allocated to just four areas: demographics (12%), ecology (16%), roads (19%) and infrastructure (25%). These four areas fall under the responsibility of different budgets (see Figure 2). The federal budget will primarily concentrate its efforts on infrastructure development and demographic support – around RUB6.0tn out of RUB13.2tn will be spent there in 2019-24. Some 84% (RUB4.1tn) of the regional allocation will be directed to road construction over the same period. As for off-budget funds, their key focus will be on ecological projects (RUB3.2tn) and infrastructure (RUB3.3tn); both areas will consume up to 90% of the off-budget spending. All in all, around 60% of the RUB25.7tn spending will be related to infrastructure.

Fig. 1: National projects by source of spending, RUB tn in 2019-24



Sources: Economy Ministry, Alfa Bank

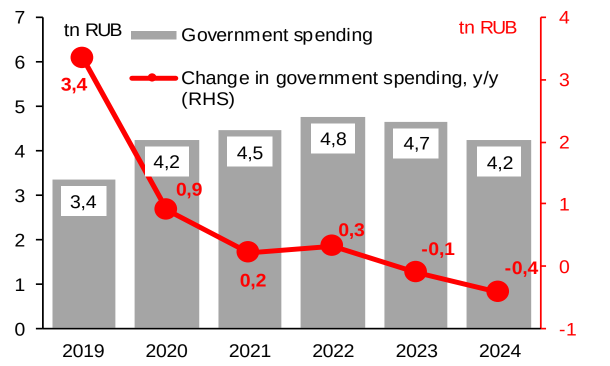
Fig. 2: Four key areas of the national projects in 2019-24, RUB tn by sources of spending



Sources: Economy Ministry, Alfa Bank

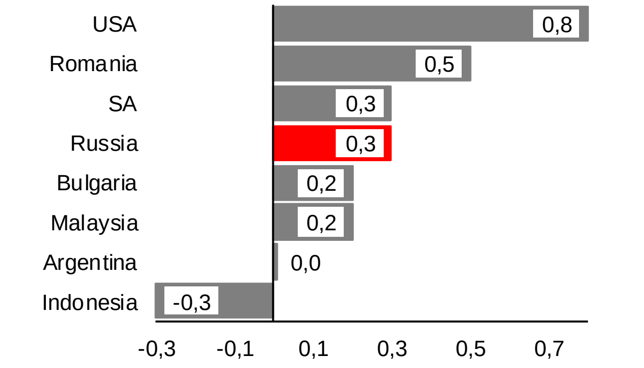
The national projects framework implies that the main stimulus should come in 2019-20: The impressive six-year spending plan creates the impression of strong stimulus to come; the main jump in spending is due in 2019-20. Taking 2018, as a base, in 2019 some RUB3.4tn, or 3.2% of GDP, of extra spending should be executed under the national projects plan. A smaller increase in spending can be expected in 2020, when the amount of spending will rise by RUB0.9 tn from the 2019 level, or 0.8% of GDP, to reach RUB4.2 tn. For the rest of the period, however, the cabinet will just maintain the scale of annual spending at an average of RUB4.5tn, providing no additional support to growth (see Figure 3).

Fig. 3: Annual government spending vs change in government expenditure, RUB tn



Sources: Government, Alfa Bank

Fig. 4: Cross-country fiscal multiplier

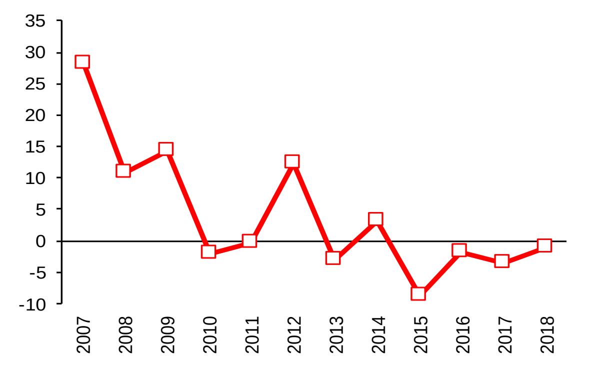


Sources: IMF, Alfa Bank

Direct effect of national projects is equivalent to 0.2% of GDP per year … The economic support from the national projects will include a combination of direct spending and its multiplier effect on growth. The direct effect takes into account the scale of the net stimulus created to economic activity, which could be limited as opposed to gross spending should new spending be covered by tax hikes or by cuts in other expenditures. We believe its scale could be assessed through the dynamics of the budget breakeven oil price at the consolidated budget level: from 2018, the consolidated budget breakeven dropped to $47/bbl, but it will start to move up by $2/bbl per year in 2019-21. So despite the national project plan implying annual gross spending of 4.2% of GDP in 2019-21, the net direct stimulus will be equivalent to only 0.2% of GDP per year.

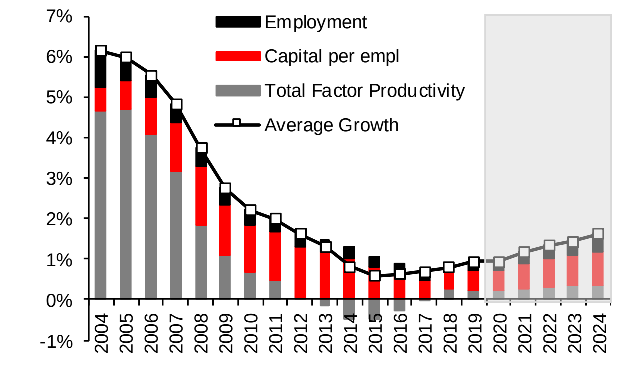
… while the indirect effect could be up to 0.1% of GDP: On top of the direct implication for growth, the fact of spending this money to solve the structural bottleneck could create a positive multiplier effect. In 2018, the CBR assessed the average multiplier effect on general government spending at around 0.5. However, based on the estimated industry-specific multiplier, lately aggregated into one, we rather utilize a ratio of 0.3, implying an up to 0.1% of GDP boost to annual growth. This size of fiscal multiplier for government spending in Russia still corresponds to the average multiplier range in EMs, which is at 0.1 to 0.3 (see Figure 4), although it is lower than in developed economies, where according to IMF research it represents 0.6 on average.

Fig. 5: Real federal budget expenditures growth, % y/y



Sources: Finance Ministry, Alfa Bank

Fig. 6: Potential output growth, %



Source: Rosstat, Alfa Bank

National projects will start to impact growth only after 2019: An important point is that we do not anticipate the effect of the national projects to emerge early enough to affect 2019 growth. First, 60% of the national projects spending this year will be infrastructure related and the effect of these projects will come with a lag. Second, the execution of national projects is lagging behind the plan – the Account Chamber reported in March, that execution of their spending is at only 6% of the full-year target. Third, in the short run, Russia is likely to suffer from a fiscal consolidation: real term expenditures were down 3.5% y/y in 2017 y/y and 1.1% y/y in 2018 at the federal level (see Figure 5). Due to the above-mentioned reasons, we stay with a cautious outlook for 2019 GDP growth. An indirect confirmation of our view that the stimulus effect will not be strong is the fact that the Economy Ministry is sticking with its 1.3% GDP growth forecast for this year, a figure that was not upgraded despite the announcement of the national projects plan.

National projects could boost potential growth from 0.7-1.3% currently to 1.6% in 2024: Another important question is to what extent the national projects will affect Russia's potential growth rate. In our previous publication (*Russian growth case: Challenging the potential growth consensus*, December 20, 2018), we presented our estimates of potential growth in a range of 0.7-1.3% versus the 1.5% consensus view. The investment plan under the national projects could boost this figure to 1.6% by 2024, assuring a higher investment and productivity contribution to the growth (see Figure 6). This will represent a sizeable acceleration from current levels; at the same time, it will still be below the 3.0% average potential growth of BRICS countries and 2.0% average potential growth of G7. This figure, should it be reached, would also stay at around half the 3% actual growth rate targeted by the Economy Ministry by 2024.

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This document is published on a quarterly basis.

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