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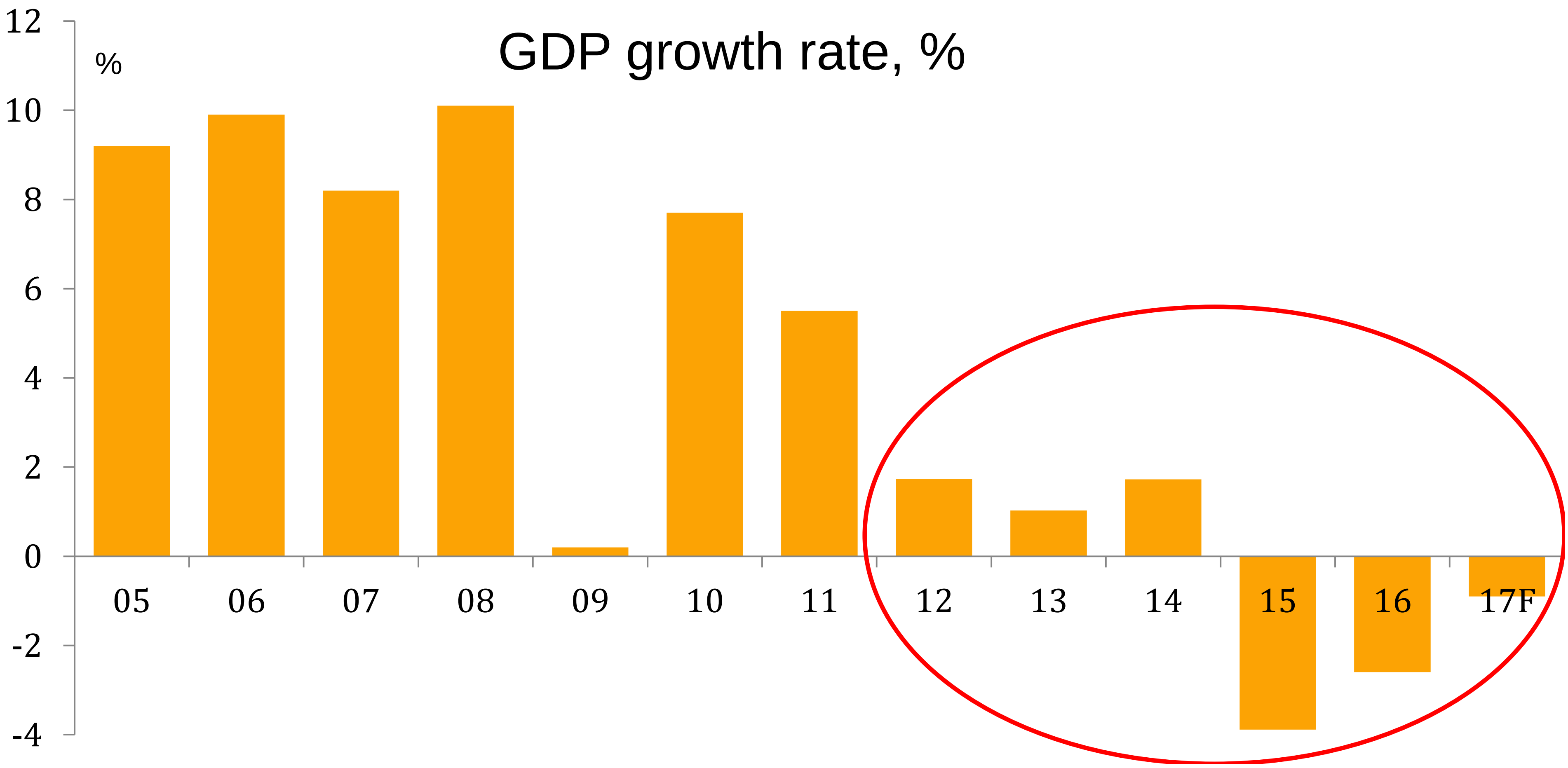
Macroeconomic environment and policy dilemmas

Since 2012 the economy has sunk into long-term stagnation



2015: a turning point for macroeconomic policy mix

Before 2015 г.	2015-2016
Direct stimulation of consumer expenses (through wage policy)	‘Directed’ balance of wages and productivity
Expanding directed lending, i.e. stimulating capital expenditures	Shrinking directed lending
Relatively soft monetary policy	Relatively tight monetary policy
Pegged exchange rate	Floating exchange rate

Some gains in price and financial stability vs. stagnation and recession is a reasonable outcome

Economy before 2015	Economy in 2015-2016
High external deficit	CA deficit under 3% of GDP
High inflation	Lowering inflation rate
Steadily overestimated exchange rate	Actual XR coincides with the equilibrium one
≈ Full employment	*Growing unemployment*
GDP growth (although lowering)	*Stagnation and recession*

However, new policy mix have not become a trigger for changes of the model itself

- State property keeps on dominating, in plenty of cases due to artificial support
  - direct subsidies (e.g. agriculture); indirect interventions (e.g. machinery and wood-working); specific regulations (e.g. ‘price scissors’ between agriculture and food manufacturing)
- Quasi-fiscal activities and soft budget constraints persist
  - the share of directed loans in banks’ portfolio is still huge (43.6% as of 01.01.2017 vs. 44.6% as of 01.01.2016); in 2016 energy non-payments as a channel of QFA strengthened
- The ‘archaic’ mechanisms of state property management mainly persist

Moreover, old challenges not just disappeared … they transformed into new ones

- Weak environment of long-term growth ➔ low expected returns on capital ➔ depressed capital investments
- Inflation expectations, dollarization, low international reserves ➔ financial fragility, high actual interest rates, poor maneuverability for monetary policy
- High debt vs. lowering output ➔ growing debt burden (for both public and private sector) ➔ deteriorating quality of debts and NPL growth

Summary

- Changes in policy mix does not mean changes in the model

- Old model + new policies = ?
  - Short-term view:
    - Recession + gains in price and financial stability
  - Medium-term view:
    - Stagnation + episodes of financial fragility (given relatively favorable external environment)
    - Prolonged recession + financial turmoil (given new external or domestic shocks)