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After a tough 2015, how may 2016 shape up?

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No matter how you slice and dice 2015, it was a tough year for Russia Inc. While much less frenetic and with fewer dramatic events than was the case in 2014, it was a year when the economy certainly suffered the fall-out from the actions of the preceding year. It felt more like the hangover kicked-in and the headache stayed all year. It is fair assumption that most people will be glad to see the back of 2015 if the sentiment heard at many of the leaving parties of the past year is anything to go by. Most would prefer greater business predictability and employment stability to the short-term currency boost.

It is a feature of all developing economies that when expats and investors are forced to leave they will almost always then view prospects for the country as a glass half empty, i.e., further gloom is only just around the corner. Those who remain are constantly accused of unrealistically viewing the glass as half full. As always, the reality is usually parked in the neutral zone in the middle.

So, in the firm hope that the reader's reaction will be balanced between a temptation to accuse one of wishful thinking and of being too conservative, what may be expect in 2016? Specifically what may be the most important factors, whether internally driven or external, which could affect the economy, the business climate and, ultimately, whether we will be attending more farewell parties – if not hosting one! – in the coming year.

• **The rouble.** The big change in government policy in 2015 was the move away from supporting the rouble towards a declared weak rouble policy. What that means, according to the Central Bank, is that they will no longer try to support the rouble against a falling oil price but will block the currency from rallying past 55-58 against the dollar even if the oil price recovers strongly. In practical terms that means if the price of Brent drops to $35 per barrel then expect the rouble to trade between 75 and 80 against the dollar. But if oil were to recover to, say, $100 per barrel, the rouble will not cross 55 to the dollar.

• **Oil price.** The price of oil looks more likely to stay weak at least until the autumn of 2016, unless there is a major escalation in war or terrorism in a big oil export country. Supply is staying strong because US shale producers have compensated for the oil price with technology gains. The ending of sanctions against Iran is expected to add between 400,000 and 600,000 barrels of extra crude to the market as that country goes for cash flow irrespective of the price. The demand outlook looks poor at best. So, there is a risk of Brent below $40 this winter and a recovery to $60 seems unlikely until late 2016.

• **Ukraine.** The fighting in Donbass has, thankfully, stopped. There seems a real determination on the part of Moscow and the major European capitals to ensure a political solution is now pursued. The rhetoric and actions are at least encouraging although there are still plenty of risks and the legacy of conflict will remain as a negative backdrop for many years.

• **Syria.** The events in Syria are moving very fast which makes it very difficult to call. But, if Russia's involvement is seen to be a net positive in respect of defeating, or containing, IS or bringing an end to the EU refugee crisis, then Moscow's involvement may help to repair some of the political damage caused by the Ukraine crisis. But the uncertainty and risks are clearly very high.

• **Sanctions.** While it was the oil price collapse which brought the economy into recession, it will require an end to the sanctions against the financial sector to allow growth return to the targeted level of at least 4 percent annually. The hope is that progress in respect of eastern Ukraine, and a positive view of Russia's role in Syria, may allow the EU to start easing these sanctions from the spring or summer. The US position is more difficult and is unlikely to change much. Still, an easing by the EU will indicate the passing of the high water-mark and that should allow non-sanctioned entities easier access to external debt and at more competitive rates than currently available. The sanctions imposed after the Crimea referendum are here to stay 'indefinitely' but have no impact on the economy. The sanctions against the oil sector and those which block the sale of dual-use technology are also unlikely to be eased in 2016. These, however, are the sanctions which are more easily worked around, e.g. alternative sourcing. The US, for example, still has the sanctions imposed against China after the events in Tiananmen Square (1989) but work-arounds have rendered them irrelevant.

• **US Fed action.** Despite the delay and procrastinating, the US Fed is expected to raise its interest rate either by year-end or early in 2016. That will be a largely symbolic act as the pace of growth in the US economy is too slow to allow for much higher debt service costs. However, the action will provide a further boost to the exchange rate for the US dollar against most other currencies and that will add further downward pressure on oil and other commodity prices.

• **Eurozone.** It is an understatement to say that Europe seems to be in a mess politically, economically and socially. Without dwelling on the various scenarios, it is a reasonable conclusion to make that the dollar will reach parity against the euro over the medium term which means that the rouble will lose less ground against the latter than the former until mid 2016, at earliest.

• **China growth**. If China's growth slows even more then the impact will be felt on the price of oil and other commodities, especially metals. That will have an indirect negative impact on the rouble. The volume of trade outside of extractive industries is too small for a slowdown or a decline in the value of the Yuan to have any other impact on Russia.

• **Duma elections.** Because the elections have been brought forward to early September, it means that there will be a more subdued pre-election period in the summer. That should reduce the anti-western rants and nationalist rhetoric. Still, we can expect to get some of that in the months ahead of the election. Thick skins should be enough to survive that.

• **Olympics.** If Russia is excluded from the summer Olympics, i.e., two months before the Duma elections, then the ranting will be more aggressive. Uncomfortable as that may be, the government is expected to retain the pragmatic stance and measured responses seen since early 2014 in respect of western businesses and investment.

This is the third economic crisis in Russia since I arrived almost eighteen years ago. It is the sixth in which I have been involved since starting my career in emerging markets. And no, I don't consider myself to be either a Jonah or just suffering from bad luck. Periods of crisis are a natural part of the evolution of developing countries and economies; you need one every so often to force a change of direction and to weed out bad practices and complacency. Russia's 1998 and current crisis certainly rank amongst the most extreme, partly because of geo-politics, history and the impact of such a huge influx of hydrocarbon wealth over such a short period of time. But while the nature and scale of crisis is different in Russia, the fact that they occur is not.

As always, it will be the strength of political conviction as much as external factors which will determine whether this crisis is the one which positions the economy for another period of growth or condemns it to a lengthy stagnation. The optimists have enough evidence of pragmatic monetary and budget actions over the past year to support their viewpoint. The pessimists are always right until they are proven wrong.