Russia Construction Forecast

4 Feb 2025

Key View: *After estimated growth of 2.7% in 2024, we expect the Russian construction sector to experience growth of 0.9% in 2025 and 0.1% in 2026. This is a sharp slowdown from the growth rates observed during the 2021-2023 period (average: 6.3%). The Russian construction sector faces a confluence of near-term headwinds - redirection of public finances to the war effort, difficulties procuring imported materials, labour shortages and tight monetary conditions. These slowdowns mark the beginning of a prolonged stagnation resulting from negative structural changes in the economy.*

Latest Developments

- After estimated growth of 2.7% in 2024, we expect the Russian construction sector to experience growth of 0.9% in 2025 and 0.1% in 2026. This represents a sharp slowdown from the growth rates observed during the 2021-2023 period (average: 6.3%).

- The Russian construction sector faces a confluence of near-term headwinds - redirection of public finances to the war effort, difficulties in procuring imported materials, labour shortages and tight monetary conditions.

- Key domestic financiers will see their activities curtailed by sanctions, which, given the industry's broad reliance on domestic financiers, will result in broad upheaval for both existing and potential project financing arrangements.

- The composition of Russia's project pipeline, with a majority of projects across all sectors at pre-construction, leaves the market particularly vulnerable to project slippage as the pressures on the industry persist.

- Tight monetary conditions, in addition to the continued strain of sanctions, will act as a drag on gross fixed capital formation, with the public and private sectors' ability to invest in key sectors badly impacted. This will also impact funding for non-residential building projects.

Construction And Infrastructure Industry Data (Russia 2024-2034)

Indicator	2024e	2025f	2026f	2027f	2028f	2029f	2030f	2031f	2032f	2033f	2034f
Construction industry value, RUBbn	8,731.1	9,432.2	9,942.3	10,495.0	11,102.0	11,748.7	12,323.8	12,912.6	13,506.4	14,161.9	14,882.5
Construction industry value, real growth, % y-o-y	2.7	0.9	0.1	0.3	0.7	1.0	0.6	0.8	0.6	0.8	1.0
Construction industry value, % of GDP	4.7	4.6	4.5	4.4	4.3	4.3	4.2	4.2	4.2	4.2	4.2
Infrastructure industry value, RUBbn	5,247.64	5,704.16	6,100.52	6,518.40	6,939.02	7,362.22	7,776.93	8,191.02	8,629.18	9,091.71	9,578.42
Infrastructure industry value real growth, % y-o-y	3.1	1.5	1.6	1.5	1.3	1.3	1.3	1.3	1.3	1.3	1.3

e/f = BMI estimate/forecast. Source: Goskomstat, BMI

Structural Trends

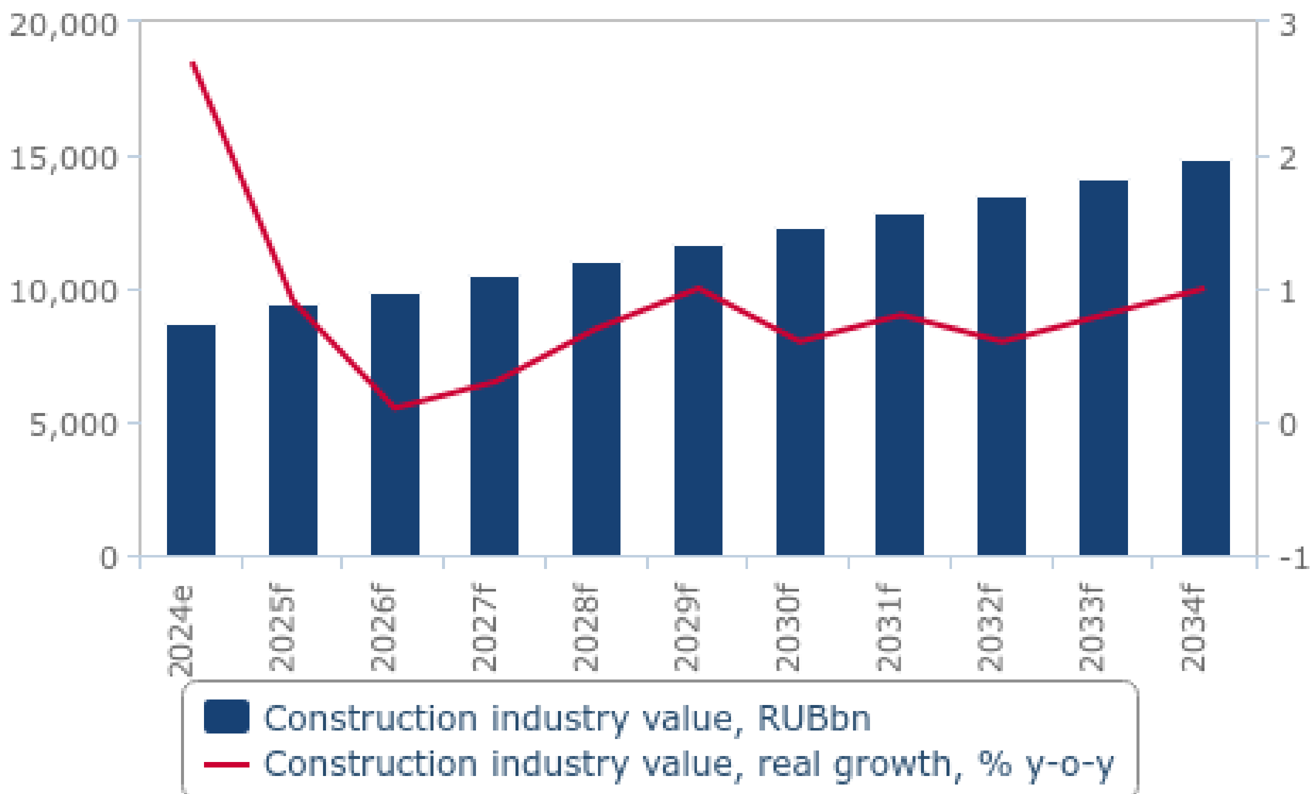
During 2022, the primary investment focus was on infrastructure construction for war efforts in areas close to Ukraine and military production hubs. In 2023, investments were directed more towards upgrading capacity in productive enterprises, notably in war-associated industries and machinery repairs, mirroring the trend from 2021. Growth rates in the period were high, averaging 6.3%, as wartime government stimulus spurred construction activity. This growth model was unsustainable.

We expect the construction sector to experience very limited growth over our forecast period, averaging 0.7%. This slowdown is attributed to stretched labour supply, production capacity constraints and tighter sanctions that limit access to critical technologies. The construction sector will experience deceleration, mirroring broader economic trends, as fixed investment growth slows, particularly in non-military sectors. Despite strong consumer demand and public sector consumption, high inflation and restrictive monetary policy will pose significant challenges. The need to restore Russia's ageing and degraded infrastructure will be sidelined to create budgetary space for war-related expenditures.

Our Country Risk team projects real GDP growth of 1.7% in 2025 and 1.5% in 2026. For the remainder of our forecast horizon, Russia will struggle to achieve growth above 2%.

Return To Weak Growth

Russia - Construction Industry Value & Real Growth (2024-2034)



e/f = BMI estimate/forecast. Source: Rosstat, BMI

The construction sector, which heavily relies on imported materials and machinery, has faced significant logistical challenges. The inability to secure high-quality and technologically sophisticated imports has resulted in increased costs and compromised the quality and efficiency of construction activities. Moreover, the switch to alternative suppliers, often from non-sanctioning countries, has not fully compensated for the lost imports, leading to persistent supply shortages. The push for domestic production and import substitution has seen limited success, with many companies unable to meet the high demand for quality domestic alternatives.

Key domestic financiers are seeing their activities curtailed by sanctions, which, given the industry's broad reliance on domestic financiers, will result in broad upheaval for both existing and potential project financing arrangements. We have outlined our expectations for sanctions implemented by Western governments to risk broad disruption to projects in Russia, particularly amid reduced access to financing and capacity to invest on the part of Russian firms. VTB Bank, Sberbank and VEB have, in recent years, been among the most active project financiers in Russia's infrastructure competitive landscape, largely only alongside development banks such as the Asian Infrastructure Investment Bank (AIIB) and the Eurasian Development Bank. Direct sanctions against these Russian entities will directly contribute to project disruption. The withdrawal of funding for Russian activities by institutions like the AIIB, aimed at mitigating the potential reputational damage of operating in the market, is rapidly reducing the pool of project financiers that would support Russia's construction activity in the medium term.

The deteriorating state finances will impact state-funded infrastructure projects over the coming quarters. While Russia’s response has seen increased military spending, which boosts aggregate demand, this also takes away resources from long-term development goals and the building of crucial buildings and infrastructure. This will likely lead to a slowdown in projects currently under development and delays to projects currently under planning. Following President Vladimir Putin's re-election in 2018, the government drafted an ambitious spending plan focused on increasing infrastructure and social spending between 2019 and 2024 (National Projects). As Russia now faces a major financial burden prosecuting the war in Ukraine, we believe that the plan will fall short of its ambitions, providing very moderate support to growth. This has already been evident in the extension of the initiative's deadline from 2024 to 2030.

Unprecedented spending on the war at the expense of other sectors will have long-term negative consequences. High defence spending will limit much-needed investment in ageing power, wastewater and transportation infrastructure, as well as the development of rural areas, which could improve quality of life and enhance economic productivity. As highlighted by our Country Risk team, Russia is set to remain in deficit over the next decade, averaging 2.0% of GDP between 2025 and 2034. Financial needs will be met through a combination of domestic debt issuances and withdrawals from the National Wealth Fund (NWF) in the short term. However, the increased military spending is drawing down the NWF, and Russia will need to rely more heavily on either the domestic debt market or investors in Asia over the medium term.

Oil and gas revenues are a central component of overall government revenues in Russia and accounted for about 43% of total revenues from 2012 to 2022. In terms of oil revenues, Russia has been relatively successful in diverting trade from the EU to Asia. With oil prices set to decline over the coming years, the domestic scope for capital spending will become more limited, as will the appetite for foreign investment in the market amid ongoing sanctions and counter-sanctions. Particularly concerning for Russia's fiscal health is chronic underinvestment in the oil industry, which could degrade mid-term production and further impact state funding capacity for construction and notably infrastructure projects.

Building And Energy Infrastructure Project Pipelines Most At Risk

Russia - Share Of Project Pipeline Threatened By Sanctions, %

Note: A project is at 'Higher Risk From Sanctions' if it involves US, EU or UK companies. Source: BMI Infrastructure Key Projects Data

The composition of Russia's project pipeline, with a majority of projects across all sectors at pre-construction, leaves the market particularly vulnerable to project slippage as the aforementioned pressures on the industry persist. According to our Infrastructure Key Projects Data, just 35% of Russia's project pipeline is currently under construction, with 60% at pre-construction and 5% suspended.

The energy and utilities infrastructure sector is particularly vulnerable to project slippage, with 65% of projects at pre-construction and 10% of projects suspended. In particular, the USD3.5bn Kursk II Nuclear Power Plant stands out as the largest power infrastructure project at significant risk of disruption due to a reduction in Western firms' involvement, with French Framatome having been awarded a contract to manufacture and install a reactor protection system for the plant by 2025. The sector most likely impacted by the sanctions regime is the non-hydropower renewables sector, for which our Power team had been optimistic prior to the invasion of Ukraine. Our Power team expects the lack of access to essential components produced in Western markets will delay numerous wind and solar power projects in Russia over the near term.

Overall, much of our forecast remains dependent on the evolution of the Russia-Ukraine conflict, the evolution of sanctions imposed on Russia, and the impact this will have on Russia's economic health. Our Country Risk team projects average growth of 2.0% in Russia's real GDP over the next decade (2025-2034). The baseline growth projections assume that the Russian economy will remain sanctioned out of the international economy to some degree over this period. They assume that over the forecast period, the Russian economy will continue to face a fairly strict economic sanction regime, with energy trade with Europe declining to near-zero levels by the end of the forecast period. Continued sanctions will place a severe drag on gross fixed capital formation, with the public and private sectors' ability to invest in key sectors badly impacted. However, should this evolve, growth could surprise to the upside or downside, which would have an impact on the building sector.

Satellite imagery suggests that considerable construction activity is taking place in Russian-occupied areas of Ukraine, particularly in Mariupol. These projects involve significant financial capital. In September 2024, Deputy Prime Minister Marat Khusnullin announced that the construction of a road around the Sea of Azov will require RUB500bn-600bn, with the project planned to be completed by 2030. The plan includes bypasses around Mariupol (Occupied Ukraine) and Novoazovsk (Occupied Ukraine) and improvements to access roads to the sea. Additionally, the project involves roads from Krasnodar (Russia) through Temryuk (Russia) to the Crimean Bridge (Occupied Ukraine) and the M-4 'Don' road in Rostov Oblast (Russia). We do not factor such activity into our views. However, the reconstruction of certain areas of occupied Ukraine may obscure the priorities of the Ministry of Construction.