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Russian Federation: gaining strength, some muscle and more fat

Russia's GDP increased by slightly more than 6% last year, roughly maintaining the average growth rate of the past five years. In 2005, the main driver of growth was rising domestic demand (both private consumption and investments grew by more than 10%) while the contribution of real net exports to GDP growth was again negative. However, export revenues boomed for the second consecutive year in nominal terms, largely thanks to the surging energy prices. The sizeable expansion of imports notwithstanding, the trade surplus reached EUR 100 billion (more than 16% of GDP) and the current account surplus nearly EUR 70 billion (11% of GDP) in 2005. Due to significant improvements in the terms of trade, Russian domestic absorption could thus grow much faster than GDP – even with rising trade and current account surpluses.¹ The government budget also recorded a record surplus in 2005 (more than 8% of GDP) and foreign exchange reserves reached EUR 150 billion at the end of 2005 (an increase by EUR 60 billion within one year). After repaying all outstanding IMF credits (USD 3.3 billion) at the beginning of 2005, the government agreed with the Paris Club creditors in summer to pay back some USD 15 billion of debt ahead of schedule. The Stabilization Fund, established in 2004 and fed from a portion of windfall oil export revenues, reached nearly EUR 40 billion by the end of 2005. The Ministry of Finance announced in September its intention to repay all remaining debt to the Paris Club – USD 28 billion – in the course of 2006.

Nevertheless, growth of GDP and particularly of industry has decelerated since 2003. The slowdown was recorded in both extraction and manufacturing industries as well as in transport, whereas the output growth of some services (in particular retail trade and telecommunications) accelerated. Agricultural production has been nearly flat since 2002. Industrial production grew by 4% only (of which manufacturing, especially transport equipment and electrotechnical industry for domestic use, by 6%). The pace of structural reforms has slowed down substantially. State interventions in the economy are increasing, the resulting bureaucratic obstacles and corruption being blamed as the main culprits for the poor investment climate. Gazprom, Rosneft and other large state-owned (or controlled) corporations are acquiring new assets (such as the oil companies Yukos and Sibneft, the power engineering conglomerate Silovye Machinery, the car manufacturers Avtovaz and Kamaz, etc.). While launching new state investment programmes (in health, education, housing and transport) and establishing special economic zones with tax privileges and legal guarantees, the government restricts access of foreign investors to 'strategic' sectors.

¹ Real exports grew by less than 4% in 2005 while imports expanded by nearly 18%. The real contribution of net exports to GDP growth was thus negative for the second year in a row. The estimated terms of trade gains amounted to 6.6% of GDP.

Nonetheless, inflows of FDI are rising, the country's credit rating is improving and the Russian Stock Exchange boomed during 2005 as well. Symptoms of a Russian Dutch disease variety are becoming apparent as a growing part of export revenues stems from resource-based industries – revenues from oil and natural gas exports account for more than 60% of the total – and huge foreign exchange inflows exert appreciation pressures on the rouble. With a roughly constant nominal exchange rate over an extended period (around 28 RUR per USD) and persisting double-digit annual inflation (more than 12% in 2005), the rouble has strengthened by some 50% in real terms against the US dollar since 2000 (real appreciation against euro was much less pronounced). The share of the euro in the CBR's currency basket was increased to 40%.

Due to the combined effects of high foreign exchange inflows, expanding money supply, robust consumer demand and price hikes in energy and services, disinflation came to a halt. Consumer price inflation even accelerated on an annual average in 2005. Even more disturbing is the fact that producer price inflation was even higher, more than 20%, mainly as a result of surging domestic prices of energy and metals. Given the further envisaged adjustments of administered prices, e.g. of electricity and gas, it is obvious that permanently rising producer prices will eventually translate into higher consumer price inflation as well. As rapid disinflation is unlikely, wiiw expects consumer prices to hover around 10% in 2006.

Instead of net exports, the main growth pillar during the past few years has been private consumption and, increasingly, also investment. The share of investment in GDP is still quite low (about 20% in 2005), yet investment growth may again exceed 10% in the coming years. The situation of most Russian companies, in particular those which are engaged in export activities, is quite comfortable and they can easily finance investments from own resources (or from bond issue and credits – as was the case in Gazprom's recent acquisition of Yukos and Sibneft assets). Russian outward FDI is also rising, partly at the expense of capital flight. Given the surging government revenues, the recently adopted federal budget reckons with expenditures rising by 25% in 2006 (to 17.5% of GDP). Even with these planned spending increases (targeting investments, salaries of health and education personnel, housing construction and agriculture), the next year's budget envisages a surplus of 3.2% of GDP. (The actual outcome may well be twice as high owing to the rather conservative oil price assumption – USD 40 per barrel – in the budget.) wiiw reckons with GDP growth around 6% in the coming years. With more cash and power consolidation, Russian assertiveness is on the rise (as illustrated by the recent gas pricing disputes). However, sustainable and broader-based long-term growth would require more investments and economic restructuring, both not to be expected in the absence of stepped-up reforms and improved transparency of legal regulations (a separate issue is the looming threat of labour shortages and the danger of an oil price collapse).

Table RU

Russia: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 ¹⁾	2006	2007
	forecast								
Population, th pers., end of period ²⁾	145559	144819	143954	144964	144168	143500	143250	142500	142000
Gross domestic product, RUB bn, nom.	4823.2	7305.6	8943.6	10830.5	13243.2	17008.4	21665.0	25300	29000
annual change in % (real)	6.4	10.0	5.1	4.7	7.3	7.2	6.4	6.2	6
GDP/capita (EUR at exchange rate)	1256	1928	2365	2539	2641	3302	4294	.	.
GDP/capita (EUR at PPP - wiiw)	5460	6020	6490	7010	7500	8260	9000	.	.
Gross industrial production									
annual change in % (real)	11.0	11.9	4.9	3.7	7.0	6.1	4.0	4.5	5.0
Gross agricultural production									
annual change in % (real)	4.1	7.7	7.5	1.5	1.3	1.6	2.0	.	.
Construction output total									
annual change in % (real)	6.0	17.0	9.9	2.7	14.4	10.1	10.5	.	.
Consumption of households, RUB bn, nom.	2526.2	3295.2	4318.1	5408.4	6540.2	8132.2	10161.1	.	.
annual change in % (real)	-2.9	7.3	9.5	8.5	7.5	11.6	11.1	10	10
Gross fixed capital form., RUB bn, nom.	694.0	1232.0	1689.3	1938.8	2432.2	3106.5	3926.1	.	.
annual change in % (real)	6.4	18.1	10.2	2.8	12.8	11.3	10.5	11	11
LFS - employed persons, th, avg. ³⁾	62475	64255	64400	66071	65800	67417	68200	.	.
annual change in %	6.9	2.8	0.2	2.6	-0.4	1.6	1.2	.	.
Reg. employment in industry, th pers., avg.	14297	14543	14692	14534	14345	14130	.	.	.
annual change in %	1.0	1.7	1.0	-1.1	-1.3	-1.5	.	.	.
LFS - unemployed, th pers., average ³⁾	9323.0	7515.0	6416.0	5712.0	6231.0	5988.0	5628.9	.	.
LFS - unemployment rate in %, average ³⁾	13.0	10.5	9.1	8.0	8.6	8.2	7.6	7.5	7
Reg. unemployment rate in %, end of period	1.7	1.4	1.6	2.1	2.3	2.6	2.5	.	.
Average gross monthly wages, RUB	1522.6	2223.4	3240.4	4360.3	5498.5	6831.8	8530.0	.	.
annual change in % (real, gross)	-22.0	20.9	19.9	16.2	11.0	10.8	9.7	.	.
Consumer prices, % p.a.	85.7	20.8	21.6	16.0	13.6	11.0	12.5	10	8
Producer prices in industry, % p.a.	58.9	46.6	19.1	11.8	15.6	24.0	20.7	15	13
General governm.budget, nat.def., % GDP									
Revenues	25.2	28.7	30.0	32.5	31.3	32.4	35.3 ^{I-X}	.	.
Expenditures	26.1	26.8	27.1	31.6	29.9	27.9	26.6 ^{I-X}	.	.
Deficit (-) / surplus (+), % GDP	-0.9	1.9	3.0	0.9	1.3	4.5	8.6 ^{I-X}	.	.
Public debt, nat.def., in % of GDP ⁴⁾	94.2	57.1	44.1	37.0	28.6	21.9	20.5 ^{I-X}	.	.
Refinancing rate of NB % p.a., end of per.	55	25	25	21	16	13	12	.	.
Current account, EUR mn ⁵⁾	23100	50619	37885	30789	31330	47104	69584	60000	50000
Current account in % of GDP	12.6	18.0	11.1	8.4	8.2	9.9	11.3	8.3	5.9
Gross reserves of NB, excl. gold, EUR mn	8387	26139	37026	42290	58531	88663	148094	.	.
Gross external debt, EUR mn	176298	172903	169530	147067	148776	157423	189241 ^{I-X}	.	.
FDI inflow, EUR mn ⁵⁾	3105	2933	3069	3660	7041	10315	20000	.	.
FDI outflow, EUR mn ⁵⁾	2071	3433	2828	3736	8606	8322	10000	.	.
Exports of goods, BOP, EUR mn ⁵⁾	70898	113510	113744	113468	120265	147358	197100	210000	220000
annual growth rate in %	8.5	60.1	0.2	-0.2	6.0	22.5	33.8	7	5
Imports of goods, BOP, EUR mn ⁵⁾	37102	48483	60022	64470	67304	78327	100519	115000	130000
annual growth rate in %	-27.1	30.7	23.8	7.4	4.4	16.4	28.3	14	13
Exports of services, BOP, EUR mn ⁵⁾	8509	10337	12773	14393	14359	16320	19525	20000	22000
annual growth rate in %	-21.6	21.5	23.6	12.7	-0.2	13.7	19.6	2	10
Imports of services, BOP, EUR mn ⁵⁾	12529	17540	22967	24848	23997	27132	31256	35000	40000
annual growth rate in %	-13.2	40.0	30.9	8.2	-3.4	13.1	15.2	12	14
Average exchange rate RUB/USD	24.62	28.13	29.17	31.35	30.69	28.81	28.30	28	27
Average exchange rate RUB/EUR (ECU)	26.24	26.03	26.13	29.65	34.69	35.81	35.22	35	34
Purchasing power parity RUB/USD, wiiw	5.54	7.17	8.15	9.27	10.38	12.18	14.20	14.8	16
Purchasing power parity RUB/EUR, wiiw	6.04	8.34	9.52	10.74	12.21	14.31	16.81	18.5	20

Notes: 1) Preliminary. - 2) Resident population; from 2002 according to census October 2002. - 3) From 2004 according to census October 2002. - 4) wiiw estimate. - 5) Converted from USD.

Source: wiiw Database incorporating national statistics; wiiw forecasts.