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Russian Federation: Oil-fuelled recovery stalls

Russian economic growth rebounded strongly in late 2009 along with the recovery of oil prices. With a time lag of about two months, the rising oil price brought about first stabilization and then an economic upswing fuelled by surging export revenues. A robust export-led recovery continued during the first half of 2010, helped by the low statistical base effect. GDP growth slowed down in the third quarter of 2010 as heat, drought and forest fires hit large parts of central Russia. Growth has accelerated in the final months of the year again. Preliminary official data published in January 2011 put the GDP growth for the whole year 2010 at 4% – identical to the wiiw forecast from June 2010. The official estimates confirm that domestic demand remained subdued as both consumer expenditure and gross fixed investments grew by just about 3%. Yet the overall gross investment jumped by more than 20% owing to the replenishment of inventories whereas, surprisingly, real net exports contracted by more than 25%. Such wide fluctuations in the two latter components of GDP (both account for about 30% of nominal GDP) are not quite unusual. In 2009, both components moved in the opposite direction as inventories were cut during the crisis and the export surplus surged by more than half. Needless to say, such large swings, related to valuation and other statistical problems, leave much room for uncertainty and future adjustments. On the supply side, the manufacturing industry largely recovered from the crisis whereas the contraction of construction continued (the latter accounts for about half of total investment outlays). Yet employment started to rise again and the unemployment rate has been gradually declining.

The latest economic data provide a mixed picture: the growth of industry, goods transport, exports has been fluctuating yet generally high; construction output is still contracting (albeit at a reduced speed); consumption expenditure is somewhat strengthening, yet still unimpressive. In both instances the statistical base effects play a role. The inflation slowdown (and the producer price deflation) which occurred during the 2009 crisis was short lived. Inflation remains stubbornly high and even accelerated in late 2010 – though annual and monthly data again present a mixed picture. There are huge producer price fluctuations, especially the prices of energy and metals shot up at the end of 2009-early 2010. In addition, the poor harvest resulted in rising food prices during the final months of

2010, especially prices of fruits and vegetables (grain exports were restricted by a government decree). Last but not least, as a by-product of surging export revenues, the rouble has appreciated again after a short-lived downward adjustment during the peak of the crisis at the turn of 2008-2009. The real appreciation – by some 15% against euro since the beginning of 2010 – has been one of the factors behind surging imports. Foreign exchange reserves are being gradually replenished; though the capital flight again accelerated towards the end of 2010. The banking sector has consolidated: both deposits and credits have been growing, bank profits have likely reached the pre-crisis level in 2010. The share of non-performing loans hovers at around 7% (though at least one third of credits is restructured); the volume of new mortgages more than doubled.

The crisis has not been used as a stimulus for an overhaul of economic policies. Restructuring, modernization and the ‘innovation development’ preached by the authorities already for a couple of years have so far been just slogans (see below). The anti-crisis measures announced and implemented from late 2008 resembled the standard fiscal packages adopted in the West. The aim was to improve the liquidity of the banking sector and restore the confidence, to support the exchange rate and domestic consumption. The costs of these measures added up to some 10% of GDP; judging by the sharp fall in consumption and particularly of investment during 2009, the effects of the measures adopted have been rather disappointing.

The government’s long-term strategic target of economic diversification and modernization remains high on the agenda, yet it is facing numerous difficulties. President Medvedev’s priority modernization areas, apart from the four “I’s” (innovations, institutions, infrastructure and investments) announced already in early 2008 before the crisis hit, include energy, nuclear technologies, global information technologies, medical equipment and pharmaceuticals sectors. These modernization fields are allegedly backed by specific implementation plans which also count on the participation of foreign companies and researchers, including the highly publicized innovation centre Skolkovo near Moscow. Indeed, as one of the foreign policy breakthroughs, the EU–Russia summit in Rostov on Don in June 2010 adopted a joint statement on the Partnership for Modernization, with both parties pledging to encourage the sectoral dialogue and the implementation of specific joint projects. The trilateral meeting of President Medvedev with his French counterpart Sarkozy and German Chancellor Merkel in October 2010 confirmed the will to ‘reset’ EU–Russia relations as well. The invitation of Polish President W. Komorowski from February 2011 that Russia joins the “Weimar Triangle” (together with France and Germany) underlined the improved climate between Russia and Poland. Russia’s

accession to WTO (postponed once more in June 2009 on the pretext of forming a Customs Union with Belarus and Kazakhstan first) came back on the agenda.

The recent foreign and domestic policy advances (the latter including the sacking of Moscow's mayor Yuri Luzhkov) may have been instrumental in improving the investment climate, potentially consolidating and broadening the economic recovery. On the other hand, the outcome of Khodorkovsky's trial in December 2010, the terrorist attack at the Domodedovo airport in January 2011 and the anxiety surrounding the forthcoming Duma (December 2011) and presidential elections (March 2012) fuel uncertainty.

At the latest World Economic Forum in Davos (January 2011) President Medvedev, who attempts to strike a more liberal tone than the Prime Minister Putin, once again reiterated and summarized priority areas of his modernization agenda for Russia:

- Large scale privatization, even of some previously considered "strategic" assets such as banks (Sberbank, VTB) and energy companies (Rosneft);
- Establishment of a sovereign investment fund with the participation and risk sharing with foreign investors;
- Financial sector development, establishing Moscow as a regional financial centre;
- Accession to WTO and OECD in 2011, establishment of the common economic space with the EU;
- Establishment of Skolkovo innovation centre;
- Energy sector innovations;
- Technology transfer efforts;
- Development of broadband internet;
- Development of human resources, reversing brain drain, etc;
- Infrastructure projects, including Sochi Olympic Games 2014 and the Football World Cup 2018, using public-private partnership schemes and engaging foreign investors.

While containing hardly any news, a possibly interesting new political accent is the increased stress on integration and engagement of foreign capital and know-how in the envisaged Russian modernization.

The current wiiw forecast reckons with continued, yet unspectacular GDP growth during 2011-2013. Growth will be much lower than in the pre-crisis period and will be based on stabilized oil prices (Urals costing not more than USD 100 per barrel). This baseline

scenario assumes no abrupt policy changes or external shocks. Both private consumption and investment are expected to grow a bit faster than GDP. Real exports will continue to be sluggish at best since the volumes of exported oil and gas will hardly increase in the forecasting period (and there will be not much else to export since the progress in export diversification will be limited), while imports will grow at a faster rate as household consumption and investment will pick up, fuelled by real currency appreciation. This implies hardly any contribution of real net exports to GDP growth in the coming years and, in nominal terms, a gradual reduction of the trade and current account surpluses. The current account surplus will gradually drop below 3% of GDP by 2013. The annual CPI inflation may stay in single digits and the budget deficit will soon turn into a surplus again.

The effects of the crisis on employment have so far been rather modest. They are being mitigated by demographic factors as the domestic labour supply is shrinking. Our previous assessment thus remains largely unchanged both regarding GDP growth prospects, sources of growth and labour market developments: GDP growth will stay below pre-crisis levels, labour shortages are likely to reappear soon and will definitely put a brake on economic growth already in the medium run. The chances for a successful modernization and restructuring of the economy remain slim – at least in the forecasting period up to 2013.

Table RU

Russia: Selected Economic Indicators

	2005	2006	2007	2008	2009	2010 ¹⁾	2011	2012	2013
	Forecast								
Population, th pers., average ²⁾	143114	142487	142115	141956	141902	141000	139500	139000	138500
Gross domestic product, RUB bn, nom. ³⁾	21609.8	26917.2	33247.5	41264.9	38797.2	44491.4	49500	55000	61000
annual change in % (real) ³⁾	6.4	8.2	8.5	5.2	-7.8	4.0	4.1	4.2	4.3
GDP/capita (EUR at exchange rate)	4300	5500	6700	8000	6200	7800	.	.	.
GDP/capita (EUR at PPP - wiiw)	10000	11200	12500	13200	12000	12700	.	.	.
Consumption of households, RUB bn, nom. ³⁾	10652.9	12974.7	16031.7	19968.1	20981.4	23130.2	.	.	.
annual change in % (real) ³⁾	12.2	12.2	14.3	10.6	-4.8	2.7	4.5	5	4.5
Gross fixed capital form., RUB bn, nom. ³⁾	3836.9	4980.6	6980.4	9196.8	8530.7	9348.8	.	.	.
annual change in % (real) ³⁾	10.6	18.0	21.0	10.6	-14.4	3.5	6	8	7
Gross industrial production									
annual change in % (real)	5.1	6.3	6.3	2.1	-9.3	8.2	5	6	5
Gross agricultural production									
annual change in % (real)	2.3	3.6	3.4	10.8	1.4	-11.9	.	.	.
Construction industry									
annual change in % (real)	10.5	18.1	18.2	12.8	-13.2	-2.3	7	8	5
Employed persons - LFS, th, average	68169.0	68855.0	70570.5	70965.1	69284.9	69803.0	69500	69300	69000
annual change in %	1.3	1.0	2.5	0.6	-2.4	0.7	-0.4	-0.3	-0.4
Unemployed persons - LFS, th, average	5262.8	5312.0	4589.0	4791.5	6372.8	5645.0	5500	5300	5000
Unemployment rate - LFS, in %, average	7.2	7.2	6.1	6.3	8.4	7.5	7.3	7	6.8
Reg. unemployment rate, in %, end of period	2.5	2.3	2.0	2.0	2.9	2.1	.	.	.
Average gross monthly wages, RUB	8554.9	10633.9	13593.4	17290.0	18795.0	21090.0	23500	25800	28500
annual change in % (real, gross)	12.6	13.3	17.0	10.3	-2.8	4.2	4.1	4.5	5.2
Consumer prices, % p.a.	12.5	9.8	9.1	14.1	11.8	7.1	7	5	5
Producer prices in industry, % p.a. ⁴⁾	20.7	12.4	14.1	21.4	-7.2	12.2	10	8	8
General governm.budget, nat.def., % GDP									
Revenues	39.7	39.5	40.2	38.6	34.8	35.5	.	.	.
Expenditures	31.5	31.1	34.2	33.8	41.1	35.5	.	.	.
Deficit (-) / surplus (+), % GDP	8.1	8.4	6.0	4.9	-6.3	0.0	-2	0	0
Public debt, nat.def., in % of GDP ⁵⁾	15	9	7	6	8	9	10	10	10
Central bank policy rate, % p.a., end of period ⁶⁾	12.0	11.0	10.0	13.0	8.8	7.8	.	.	.
Current account, EUR mn ⁷⁾	67858	75474	56818	70732	35507	55013	50000	45000	40000
Current account in % of GDP	11.1	9.6	6.0	6.2	4.0	5.0	4.1	3.4	2.8
Exports of goods, BOP, EUR mn ⁷⁾	195545	241960	258930	321792	218221	301588	320000	343000	372000
annual growth rate in %	32.7	23.7	7.0	24.3	-32.2	38.2	6	7	8
Imports of goods, BOP, EUR mn ⁷⁾	100608	130948	163282	199148	137960	188530	210000	240000	270000
annual growth rate in %	28.4	30.2	24.7	22.0	-30.7	36.7	11	14	13
Exports of services, BOP, EUR mn ⁷⁾	20028	24791	28681	34889	29883	33417	40000	45000	50000
annual growth rate in %	20.9	23.8	15.7	21.6	-14.3	11.8	20	13	11
Imports of services, BOP, EUR mn ⁷⁾	31077	35643	42481	51495	44185	54104	60000	70000	80000
annual growth rate in %	16.1	14.7	19.2	21.2	-14.2	22.4	11	17	14
FDI inflow, EUR mn ⁷⁾	10336	23675	40237	51177	26434	35000	50000	55000	60000
FDI outflow, EUR mn ⁷⁾	10240	18454	33547	37934	32004	40000	40000	45000	40000
Gross reserves of NB, excl. gold, EUR mn	148094	224305	318840	291916	290432	335191	.	.	.
Gross external debt, EUR mn	216516	237669	316903	340688	325697	364951	.	.	.
Gross external debt in % of GDP	34.3	30.6	34.3	34.2	36.4	33.1	.	.	.
Average exchange rate RUB/EUR	35.26	34.11	35.01	36.43	44.14	40.30	41	42	42
Purchasing power parity RUB/EUR, wiiw ⁸⁾	15.06	16.93	18.73	22.03	22.81	24.90	.	.	.

1) Preliminary and wiiw estimates. - 2) Resident population. - 3) FISIM reallocated to industries, real growth rates based on previous year prices. - 4) Domestic output prices. - 5) wiiw estimate. - 6) Refinancing rate of Centralbank. - 7) Converted from USD with the average exchange rate. - 8) wiiw estimates based on the 2005 International Comparison Project benchmark.

Source: wiiw Database incorporating national statistics. Forecasts by wiiw.