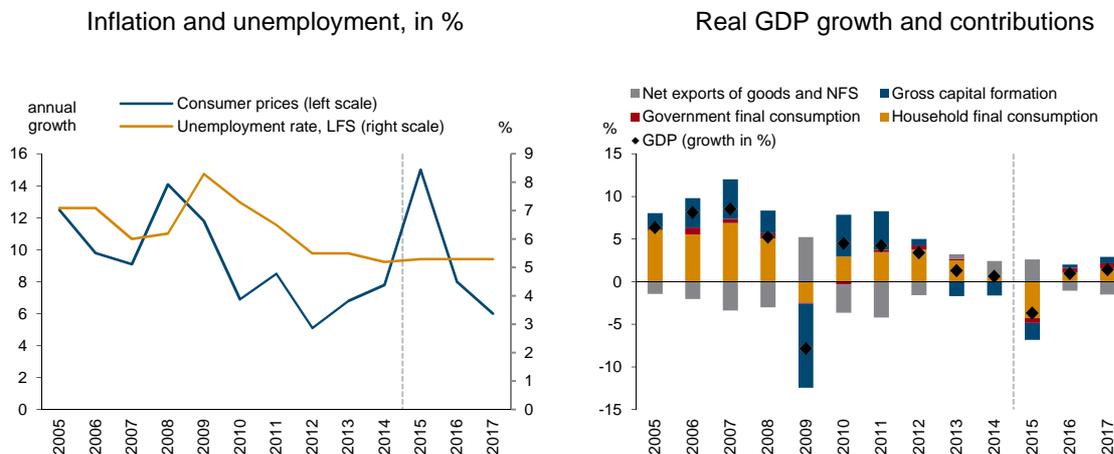


RUSSIAN FEDERATION: Recession already over?

PETER HAVLIK

The Russian economy plunged into a full-blown recession in 2015. Both exports and (even more so) imports were slashed, while the current account surplus surged upwards. The recession may have already bottomed out by mid-2015, yet there is no consensus as to the country's future prospects. Depending on the oil price, Russia may face another mild GDP decline in 2016, although stabilisation or even a modest growth seems more likely. Nevertheless, growth will remain unimpressive even in the medium term since restructuring will not materialise.

Figure 56 / Russia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The Russian economy plunged into a full-blown recession in 2015, even though not as severe as many observers originally expected. According to Rosstat data released in early September, real GDP dropped by 3.4% in January-June 2015 year-on-year, industrial production by nearly 3%, investments by 6% and real wages by nearly 9%. Consumer price inflation surged to double digits (see Table RU). The plunge in the oil price and the associated rouble devaluation starting in late 2014 resulted in an additional sharp contraction of foreign trade: exports dropped by more than 10% in January-June 2015 (in nominal EUR terms), imports were cut by almost a quarter.⁵³ In volume terms, there was a modest

⁵³ Owing to EUR/USD exchange rate movements, the trade contraction was much more pronounced when expressed in USD terms. However, trade with the EU contracted more than average: exports dropped by 34% in the first half of 2015,

expansion of exports (+5%) while real imports fell by about 20%. The trade and current account surpluses nearly doubled in terms of GDP in the first half of 2015; the estimated contribution of net exports to GDP growth was strongly positive.

The main puzzling economic unknown is now whether the bottom of the recession has already been reached by the second quarter of 2015, and there is no consensus in this respect. Obviously, the official expectation is that both low energy prices and a 'difficult geopolitical environment' are here to stay for some time (mutual sanctions have been prolonged and expanded, respectively, in mid-2015 and the government's working assumption was that sanctions will last until 2018). Given these circumstances, both the government and the Central Bank of Russia (CBR) elaborated several scenarios of economic growth with prospects being scaled down during the summer since earlier, more optimistic assumptions regarding oil prices have become less likely. Neither is the oil price now expected to return to its previous level (USD 98/bbl for Urals on average in 2014) nor will sanctions be rapidly abolished (although the latter factor impacts GDP growth forecasts much less than the oil price). Both these factors make the current outlook very much different from that in 2009 when oil prices quickly recovered and no sanctions were in place.

In view of reduced energy export revenues – in rouble terms partly compensated by devaluation – government expenditures have been slashed by some 10% in 2015 (except defence, some social benefits and agricultural subsidies) and the budget turned to a deficit in the first half of 2015. The draft federal budget for 2016 reckons with a deficit below 3% of GDP, sets limits for internal and external government debts (RUB 9,000 billion and USD 55.1 billion as of 1 January 2017, respectively). Additional funds will be raised by issuing new government bonds and by taxing windfall profits of energy exporters due to rouble devaluation.

The latest (September 2015) CBR baseline forecast scenario for 2016-2018 works with an oil price of 50 USD/bbl during the whole period.⁵⁴ In the CBR baseline scenario, GDP is projected to fall also in 2016 (by nearly 1%), to stagnate in 2017 and to grow slowly in 2018 (by 2-3%). In the optimistic CBR scenario, GDP growth should become slightly positive already in 2016 and gradually accelerate to 2.5-3.5% by 2018. Both scenarios reckon with a very slow expansion of exports and final consumption; GDP growth should be driven mainly by investments. Forecasts released in September 2015 by the respected Gaidar Institute are even more pessimistic: GDP and investments will stagnate at best in 2016. The baseline scenario assumes a constant oil price at 55 USD/bbl in 2016 and reckons with a drop in GDP (-1.6%) as both investments and exports will continue to decline.⁵⁵

imports by even 45% (both in USD terms). The cumulated import contraction has thus been already close to a scenario which was viewed as extreme in 2014 (see Havlik, 2014).

⁵⁴ Alternatively, the optimistic variant reckons with an increase in the oil price to 70-80 USD/bbl until 2018, while the pessimistic (risk) scenario works with an oil price staying below 40 USD/bbl in the whole period – see Central Bank of Russia, Draft Macroeconomic Development Scenarios, September 2015 (www.cbr.ru).

⁵⁵ In the CBR 'risk' scenario, the additional shortfall in export revenues would result in a recession lasting through 2016 and even beyond. Similarly pessimistic views regarding medium-term growth prospects are shared by some other analysts, e.g. the Development Center at Moscow's Higher School of Economics or the Institute for Forecasting, Russian Academy of Sciences. Even the optimistic scenario (oil price 70 USD/bbl) elaborated recently by the Gaidar Institute reckons with a weak consumption-led recovery in 2016 while investments will again slightly fall – see <http://iep.ru/ru/publikacii/7690/publication.html>.

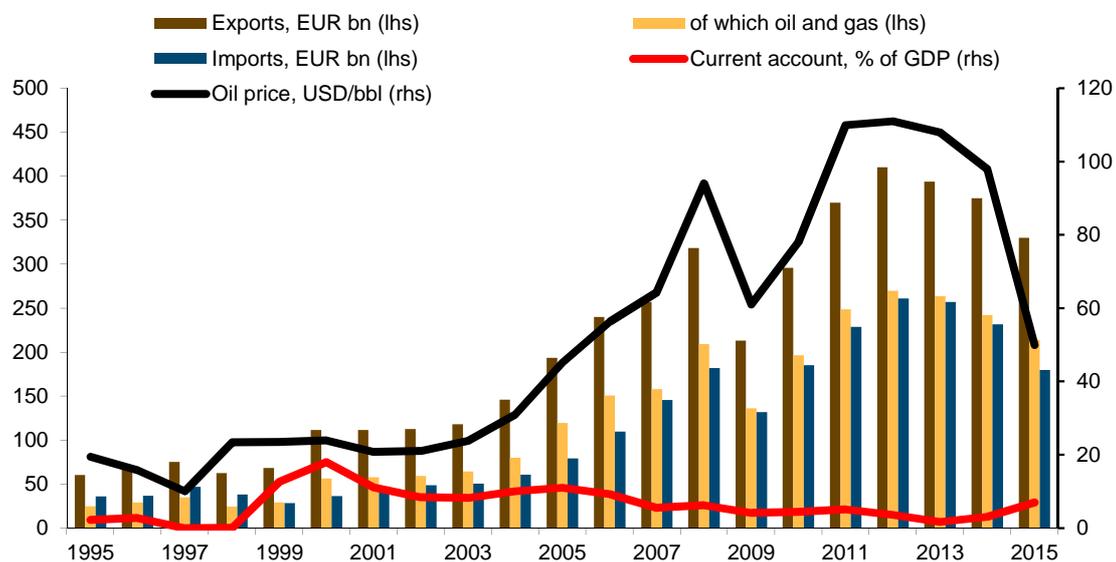
None of the existing scenarios are particularly encouraging regarding economic developments even in the medium and long term. Obviously, without cooperation and integration with the EU (now apparently abandoned or at least much more difficult), economic growth is likely to remain more or less flat in the foreseeable future. An inward-looking development strategy, even under the working assumption that the current financial and trade sanctions will be eventually lifted, will hardly yield the envisaged (and urgently needed) modernisation results at least in the medium term (admittedly, low energy prices over a sustained long period might support the necessary reform pressure on economic diversification). Russian prospects thus remain gloomy (and not only in economic terms). The economy has been suffering from long-lasting structural deficiencies, especially regarding the excessive dependence on energy, and from serious institutional bottlenecks which deter investments and stimulate capital flight. Recently, more assertive external policies represent another bottleneck for economic development.

Nevertheless, and despite rising tensions, Russia succeeded in launching the Eurasian Economic Union (EAEU) on the basis of the Single Economic Space and Customs Union with Belarus and Kazakhstan in January 2015. Besides the free trade in goods (with some important exceptions such as energy), the EAEU agreement envisages also free movement of labour, capital and services among the participating countries (Armenia already joined the EAEU in January 2015 and Kyrgyzstan joined in mid-2015 as well). In theory, coordinated economic policies among EAEU members will use 'Maastricht-like' indicators such as limits on budget deficit, government debt, inflation and interest rates. In practice, however, the EAEU is facing a lot of frictions and bureaucratic obstacles; even the free trade in goods is not fully implemented, there are many non-tariff barriers, etc.⁵⁶ Needless to say, Russian policies towards Ukraine and the unilateral (without the consent of other EAEU partners) imposition of import restrictions on Western foodstuffs elevated the conflict potential in EAEU integration. The current recession affecting all EAEU member states and trade disruptions due to unilateral Russian actions have not been instrumental to a smooth functioning of the EAEU either.

Summing up, Russia is facing a recession (GDP is expected to drop by nearly 4% in 2015) and prospects for sustainable recovery have markedly deteriorated given the geopolitical factors and oil price prospects. While inflation will gradually subside barring additional external shocks, economic growth will remain unimpressive – if there is any growth at all.⁵⁷ Apart from lasting Western sanctions – resulting in a sharply deteriorating investment climate, higher risks and capital outflows – it is especially the collapse of the oil price and the associated rouble depreciation which has caused the most immediate economic damage. Even barring a further escalation of the Ukraine conflict, modernisation ambitions will doubtlessly suffer also in the medium and long term due to lower FDI inflows and reduced imports of advanced technologies – despite efforts to mobilise additional domestic resources and import substitution programmes which may bring some (weak) growth stimulus. In any case, the serious and most likely lasting damage to Russian external relations with Ukraine and the West will be very difficult to repair, hindering the future development of the whole post-Soviet space.

⁵⁶ In fact, trade with the EAEU dropped just as much as total trade in the first half of 2015.

⁵⁷ For more detailed arguments and a comprehensive analysis see Havlik (2015).

Figure 57 / Russian Federation: External surpluses thanks to energy

References

Havlik, P. (2014), 'Economic Consequences of the Ukraine Conflict', *wiiw Policy Notes and Reports*, No. 14, November.

Havlik, P. (2015), 'Russian Federation 2015: From Stagnation to Recession and Back', *wiiw Research Reports*, No. 406, September.

Table 22 / Russia: Selected economic indicators

	2011	2012	2013	2014 ¹⁾	2014 January-June	2015	2015 Forecast	2016 Forecast	2017
Population, th pers., average ²⁾	142,961	143,202	143,507	146,091	146,056	146,291	146,000	146,000	146,000
Gross domestic product, RUB bn, nom.	55,967	62,176	66,190	71,406	32,754	34,056	78,000	85,000	90,000
annual change in % (real)	4.3	3.4	1.3	0.6	0.6	-3.5	-3.7	1.0	1.4
GDP/capita (EUR at exchange rate)	9,600	10,900	10,900	9,700	.	.	7,600	7,800	8,200
GDP/capita (EUR at PPP)	17,000	18,300	18,900	19,400	.	.	.	.	.
Consumption of households, RUB bn, nom.	27,193	31,019	34,672	38,037	17,590	.	.	.	.
annual change in % (real)	6.8	7.8	5.0	1.3	2.1	.	-8.0	2.0	3.0
Gross fixed capital form., RUB bn, nom.	11,950	13,639	14,460	14,706	5,351	.	.	.	.
annual change in % (real)	9.1	6.7	0.9	-2.0	-3.2	.	-8.0	3.0	3.0
Gross industrial production ³⁾									
annual change in % (real)	5.0	3.4	0.4	1.7	1.4	-2.6	-2.5	3.0	3.0
Gross agricultural production									
annual change in % (real)	23.0	-4.8	5.8	3.7	3.0	2.9	.	.	.
Construction output									
annual change in % (real)	5.1	2.5	0.1	-4.5	-5.7	-7.0	.	.	.
Employed persons, LFS, th, average ²⁾	70,857	71,545	71,391	71,524	71,135	71,919	71,000	71,500	72,000
annual change in %	1.3	1.0	-0.2	0.2	0.0	1.1	-0.7	0.7	0.7
Unemployed persons, LFS, th, average ²⁾	4,922	4,131	4,138	3,889	3,968	4,314	4,000	4,000	4,000
Unemployment rate, LFS, in %, average ²⁾	6.5	5.5	5.5	5.2	5.3	5.7	5.3	5.3	5.3
Reg. unemployment rate, in %, end of period ²⁾⁴⁾	1.7	1.4	1.2	1.2	1.1	1.3	.	.	.
Average monthly gross wages, RUB	23,369	26,629	29,792	32,495	31,537	33,175	34,800	38,700	42,300
annual change in % (real, gross)	2.8	8.4	4.8	1.2	3.0	-8.5	-7.0	3.0	3.0
Consumer prices, % p.a.	8.5	5.1	6.8	7.8	7.0	16.1	15.0	8.0	6.0
Producer prices in industry, % p.a. ⁵⁾	17.3	6.8	3.4	6.1	6.2	11.7	12.0	7.0	5.0
General governm.budget, nat.def., % of GDP									
Revenues	37.3	37.1	36.9	37.5	38.7	37.4	37.0	38.0	39.0
Expenditures	35.7	36.7	38.2	38.7	35.4	40.0	40.0	40.0	41.0
Deficit (-) / surplus (+)	1.5	0.4	-1.3	-1.2	3.3	-2.6	-3.0	-2.0	-2.0
Public debt, nat.def., % of GDP ⁶⁾	9.0	10.0	10.5	11.8	9.8	10.3	15.0	14.0	13.0
Central bank policy rate, % p.a., end of period ⁷⁾	8.00	8.25	5.50	17.00	7.5	11.5	10.0	8.0	6.0
Current account, EUR mn ⁸⁾	69,855	55,452	26,197	43,968	27,649	42,960	78,000	67,000	60,000
Current account, % of GDP ⁸⁾	5.1	3.6	1.7	3.1	4.1	8.1	7.0	5.9	5.0
Exports of goods, BOP, EUR mn ⁸⁾	370,131	410,300	393,911	374,555	186,143	162,901	330,000	330,000	350,000
annual change in %	25.0	10.9	-4.0	-4.9	-3.1	-12.5	-11.9	0.0	6.1
Imports of goods, BOP, EUR mn ⁸⁾	228,764	261,202	256,951	231,782	111,636	83,816	180,000	200,000	220,000
annual change in %	23.5	14.2	-1.6	-9.8	-8.9	-24.9	-22.3	11.1	10.0
Exports of services, BOP, EUR mn ⁸⁾	41,680	48,495	52,787	49,471	23,644	22,499	45,000	47,000	50,000
annual change in %	12.5	16.4	8.8	-6.3	-6.2	-4.8	-9.0	4.4	6.4
Imports of services, BOP, EUR mn ⁸⁾	65,706	84,736	96,643	91,066	42,198	38,237	80,000	80,000	85,000
annual change in %	15.8	29.0	14.1	-5.8	-3.1	-9.4	-12.2	0.0	6.3
FDI liabilities (inflow), EUR mn ⁸⁾	39,557	39,353	52,107	17,199	17,976	5,978	20,000	.	.
FDI assets (outflow), EUR mn ⁸⁾	48,008	37,980	65,120	42,431	20,919	6,513	50,000	.	.
Gross reserves of CB, excl. gold, EUR mn ⁹⁾	350,786	367,323	341,787	279,383	316,970	282,782	.	.	.
Gross external debt, EUR mn ⁸⁾	416,416	480,440	530,481	493,153	537,712	501,941	501,400	453,300	396,000
Gross external debt, % of GDP ⁸⁾	30.4	30.9	33.9	34.8	38.0	45.0	45.0	40.0	33.0
Exchange rate RUB/EUR, average	40.9	39.9	42.3	50.5	48.0	64.4	70.0	75.0	75.0
Purchasing power parity RUB/EUR ¹⁰⁾	23.0	23.7	24.4	25.2	.	.	.	.	.

Note: Data for population, GDP and its components, budget from 2014 (employment thsd. persons, nominal wages from 2015) including Crimean Federal District.

1) Preliminary. - 2) According to census October 2010. - 3) Excluding small enterprises. - 4) In % of labour force (LFS). - 5) Domestic output prices. - 6) wiiw estimate. - 7) From 2013 one-week repo rate, refinancing rate before. - 8) Converted from USD and based on BOP 6th edition. - 9) Including part of resources of the Reserve Fund and the National Wealth Fund of the Russian Federation. - 10) wiiw estimates based on the 2011 International Comparison Project benchmark.

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