

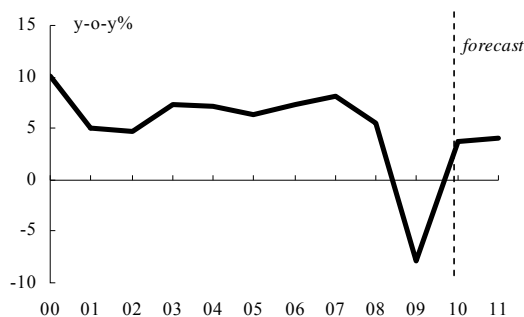
35. RUSSIAN FEDERATION

Seemingly V-shaped recovery has started

The Russian economy experienced a contraction estimated at -7.9% in 2009 (after the 5.6% growth in 2008). It will experience an almost V-shaped recovery, with growth rebounding to an expected 3.7% in 2010 and to 4% in 2011.

This sharp downturn was the result of the twin shocks that hit the Russian economy in 2008-09, namely the sudden stop in international capital flows and the sharp fall in commodity prices. In addition, some specific features of the initial policy response may have contributed to the depth of the contraction.⁽⁸²⁾ By contrast, the recovery will be underpinned by the stabilisation in international capital markets, the increase in energy prices and a more supportive and balanced policy mix (especially on the monetary side). Domestic demand (investment and consumption), which collapsed in 2009, is also set to rebound.

Graph II.35.1: Russia - GDP growth



This fall in GDP was accompanied by a reduction of the current-account and trade surpluses, and by a swing from large fiscal surpluses to significant fiscal deficits.

The budget experienced a deficit of around 6% of GDP in 2009, due to the reduction in commodity prices and in economic activity, and the large fiscal stimulus package. Nevertheless, these deficits are forecast to be significantly reduced, to below -2% in 2010 and 2011, and are expected to be *fully* financed from one of the Russian Oil Stabilisation Funds. This means that there will be no significant increase in the stock of domestic and

⁽⁸²⁾ The 2009 contraction was somewhat mitigated by net exports, which posted a positive contribution to GDP growth for the first time since 2006.

foreign sovereign debt, which is in any case set to remain around 10% of GDP.⁽⁸³⁾

While both the current-account and trade surpluses fell in 2009, both remained strongly positive. Respectively, the current-account surplus is expected to grow from around 3.5% to 4.0% and then fall to around 2.0%, while the trade surplus is expected to grow from 9.1% in 2009 to almost 10% in 2010, falling to 8% in 2011. This is due to the petering off of the effects from the increases in commodity prices and the rouble devaluation.

It is noteworthy that a sharp nominal fall in trade of around 30% has not affected Russia's position as the EU's third most important trading partner, with close to 8% of the EU's total external trade. Equally, the EU's position as the most important trade partner of Russia (with around 50% of its total trade) was also not affected by the crisis.⁽⁸⁴⁾

Unemployment by end-2009 reached 8.2% (a 50% increase on the 2008 figure), but is seen as falling towards 6.5% by 2011. Inflation is expected to slow from around 12% to below 8% in 2011, as the deep economic contraction counteracted the inflationary effects of the rouble devaluation.

Financial and real sector developments

The Central Bank of Russia (CBR) targets a nominal USD-EUR currency basket (set at 45 cents of the EUR and 55 cents of the USD). Faced with the 2008 terms-of-trade shock, the CBR eventually opted for greater flexibility, announcing in January 2009 a 26-41 rouble "band" to the basket in which the currency has been allowed to float mostly freely.⁽⁸⁵⁾ While the rouble is still 14%

⁽⁸³⁾ In late April 2010, Russia tapped into the sovereign Eurobond market with a placement worth around EUR 4 bn, the first in a decade. This was seen more as an attempt to create a benchmark for Russian public debt than reflecting actual fiscal financing needs.

⁽⁸⁴⁾ This dominant position of the EU in Russian external trade is seen by some as "non-optimal", as model estimates indicate that the EU share should be around a third. This largely reflects the still underdeveloped state of Russian trade relations with China, which is due to transport infrastructure constraints.

⁽⁸⁵⁾ The economic rationale behind the initial defence of the peg was to allow Russian banks and companies an orderly and staggered deleveraging of their external liabilities. As far as that no major bankruptcies were observed and that the Russian private sector significantly cut their external exposure, this strategy did achieve its aims.

down against the basket since mid-2008, the exchange rate appreciated by almost 18% between the introduction of the band and late April 2010. As a matter of fact, the CBR even had recently to counteract what it perceived as excessive appreciation, by both limited market interventions and by pushing downward the “intra-band” intervention reference triggers.

Russian hard currency reserves fell from a peak of almost USD 600 bn in the summer of 2008 (mostly due to the CBR’s attempt to defend the peg), but have been increasing again since early 2009, reaching over USD 456 bn by mid-April 2010, and are still the third largest in the world (after China and Taiwan).

After massive liquidity provisions by the CBR, the overnight “Mosprime” interest rates declined from the highs of 25% to 3.5% by late-April 2010. Parallel to that and to the fall in inflation, the CBR reduced its own overnight rates thirteen times between April 2009 and late April 2010, resulting in a cumulative fall of 500 basis points. They had been hiked in late 2008, as part of its initial strategy to defend the peg.⁽⁸⁶⁾

Nevertheless, this reduction in interest rates has yet to spur a true resumption of bank lending activities, and that in spite of the relatively solid position of the Russian banking system: its capital adequacy ratio rose from just below 13% in mid-2008 to around 21% by January 2010. On the other hand, “bad and problem” loans indeed rose significantly, from 2.5% in early 2008 to 9.6% in early 2010, albeit this figure seems largely manageable due to the capitalisation ratio.

Recovery in real variables started in mid-2009. The “Basic Sectors” monthly index, a composite

indicator that proxies GDP, hit its nadir in mid-2009, with double-digit falls, recovering progressively and re-entering into positive territory only by year-end. Initial estimates show a year-on-year GDP growth of 4.6% in March 2010. Industrial production shows a similar pattern.⁽⁸⁷⁾

Similarly to other countries, Russia enacted an extensive set of anti-crisis policy measures, from the provision of liquidity to direct support to the banking sector, the more flexible exchange rate described above and a discretionary fiscal stimulus. Some of these were discontinued as the economic situation stabilised, notably, the auctioning of fiscal funds by the Ministry of Finance to banks and the provision of uncollateralised short term funds by the CBR. The additional *announced* headline fiscal impulse for 2008-10 is estimated at around 6% of the 2008 GDP, and included a significant component of social expenditures. Nevertheless, it was plagued by several delays in the actual disbursements.⁽⁸⁸⁾

Policy issues and overall prospects till 2011

Russia was significantly affected by the global downturn, albeit a clear recovery is foreseen for 2010-11. Russian policies used to counteract the downturn are very similar to the ones pursued in more mature economies, with the notable difference of the initial use of interest rate hikes to defend the peg.

With the recovery phase of the crisis now under way, different policy concerns come to the fore. One of those are the implementation of the so called “exit strategies”, which are also part of a G20 discussions and commitments, undertaken by Russia as a G20 member. Essentially they are about a coordinated and staggered withdrawal of the monetary and fiscal stimuli, so also about the use of a consistent “policy mix”.

As an example of that, the *net* external liabilities of the Russian banking system fell from USD 130 bn in mid-2008 to USD 1.3 bn by September 2009. Given this enormous adjustment it was only possible to avoid widespread bank failures by the massive transfer of hard currency reserves from the CBR to the Russian banking system. As a matter of fact, the figure for the net reduction of external liabilities of Russian banks closely mirrors the one for Russia’s loss of hard currency reserves.

⁽⁸⁶⁾ The use of high interest rates to defend the peg, parallel to persistent devaluation expectations in late 2008/early 2009 led to a significant contraction of money supply. The low point of the contraction was April 2009, when money supply was a remarkable 23% below the January 2009 value: only by December 2009 did the monetary base regain the January amount. This monetary contraction has also been partially blamed by some analysts for the strength and duration of the downturn.

⁽⁸⁷⁾ The Russian Statistical Office (Rosstat) changed the methodology it uses to calculate the industrial production index in January 2010, but still has not published revised series for the previous years. This makes any comparison between the 2010 data and the previous one difficult. This said, industrial production rose 5.7% y-o-y in March 2010.

⁽⁸⁸⁾ Some commentators also link the scale of the economic contraction to these perceived deficiencies of the support package. Additionally, similarly to other regions, there is a large difference between the announced amounts of the stimulus and the totals actually committed. For instance, the values of capital injections in the banking sector are around 40% of the ones announced, while for the purchase of assets and lending by the Ministry of Finance, this is even lower, at around 31%.

Concerning the monetary stimulus, beyond the interest-rate reductions, which seem set to continue (again, in a contrary timeframe to what was observed globally), the CBR has begun already to roll back part of the additional liquidity measures. The more flexible exchange-rate framework is also expected to make the conduct of monetary policy easier going forward, although the appreciation pressures related to the increased commodity prices do pose some policy challenges.

Concerning the fiscal part of the “exit strategies”, the Russian government has approved a relatively conservative budget for 2010-12. Russia has a rolling 3-year budget framework, a so-called Medium Term Expenditure Framework or MTEF. This framework, beyond facilitating fiscal planning, can also be an effective tool in conveying to economic agents a progressive fiscal retrenchment path. All in all, the Russian fiscal frameworks (the Oil Funds and the METF) performed according to plan during the crisis, and the underlying fiscal position and low debt stock will also facilitate the coming adjustment.

Additionally, there is a part of the “exit strategies”⁽⁸⁹⁾ which relates to the still ongoing reform of the

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international financial architecture, a multilateral effort under the aegis of the G20.

In a longer-term perspective, that perennial question for Russia, economic “modernisation”, was again raised by policy announcements, including high-profile plans announced by the Russian President in late 2009.⁽⁹⁰⁾ Modernisation in Russia is also understood as implying a reduction in its dependency on primary sectors.

Unfortunately, necessary components of the modernisation agenda related to further international trade integration and liberalisation seem at a deadlock. The Russian WTO accession (which has now the dubious distinction of being the longest one on record) was further complicated by a sudden announcement in mid-2009 that Russia would aim for a joint WTO entry with Belarus and Kazakhstan. Such a process has never been attempted in the WTO’s history. Also, in January 2010 Russia formed with those two countries a customs union, within the framework of the so-called Eurasian Economic Community (EURASEC). The late April agreement reducing export duties on gas delivered to Ukraine equally shows Russia’s considerable regional weight.

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Table II.35.1:

Main features of country forecast - RUSSIA

	2008			92-05	Annual percentage change					
	bn RUB	Curr. prices	% GDP		2006	2007	2008	2009	2010	2011
GDP	41256.0		100.0	-	7.7	8.1	5.6	-7.9	3.7	4.0
Private consumption	19964.7		48.4	-	11.2	13.8	10.6	-8.5	4.8	5.3
Public consumption	7142.0		17.3	-	2.4	3.7	2.9	1.9	1.5	1.0
Gross fixed capital formation	9595.6		23.3	-	18.0	21.1	10.6	-21.0	4.5	5.5
of which : equipment	3445.3		8.4	-	-	-	-	-20.0	5.0	6.0
Exports (goods and services)	12980.4		31.5	-	7.3	6.3	0.6	-8.1	3.4	2.0
Imports (goods and services)	9140.4		22.2	-	21.3	26.6	14.9	-17.9	5.7	3.3
GNI (GDP deflator)	40034.8		97.0	-	7.2	8.8	5.0	-7.7	1.9	4.2
Contribution to GDP growth :										
Domestic demand				-	9.2	11.2	7.8	-8.7	3.6	3.9
Inventories				-	-	-	-	-	-	-
Net exports				-	-2.0	-3.5	-3.1	1.4	-0.2	-0.1
Employment				-	0.6	1.3	0.6	-2.9	0.6	0.0
Unemployment rate (a)				-	6.7	5.7	7.0	7.5	7.0	6.5
Compensation of employees/head				-	-	-	-	-	-	-
Unit labour costs whole economy				-	-	-	-	-	-	-
Real unit labour costs				-	-	-	-	-	-	-
Savings rate of households (b)				-	-	-	-	-	-	-
GDP deflator				-	15.5	13.8	18.0	5.4	9.8	5.9
General index of consumer prices				-	9.7	9.0	14.1	11.7	9.0	7.8
Terms of trade of goods				-	-	-	-	-	-	-
Trade balance (c)				-	14.1	10.1	10.8	9.1	9.9	8.0
Current account balance (c)				-	9.6	5.9	6.2	3.5	3.9	2.2
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	9.6	5.2	6.2	-	-	-
General government balance (c)				-	-	-	-	-5.1	-1.6	-1.8
Cyclically-adjusted budget balance (c)				-	-	-	-	-	-	-
Structural budget balance (c)				-	-	-	-	-	-	-
General government gross debt (c)				-	-	-	-	7.3	9.8	10.4

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.