

## 5. RUSSIAN FEDERATION

### The first recession in a decade

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More than ten years after the 1998 crisis and after a decade of robust growth (averaging 6.8%), Russia is facing a recession in 2009: real GDP is forecast to contract by -3.8% in 2009, before recovering to 1.5% in 2010.

In common with other emerging economies, Russia has suffered from the contraction in international liquidity, as well as from the substantial fall in commodity prices that accompanied the decline in global economic activity. Growth in 2008 fell to a still robust 5.6%, from 8.1% in 2007, but data on economic activity started to show a truly major economic slowdown from October 2008 onwards: the GDP growth rate fell from 9.5% in the last quarter of 2007 to a still respectable 6.2% three quarters later, and to an estimated mere 1% in the last quarter of 2008. Other indicators like the “basic sectors”<sup>7</sup> and industrial production indexes collapsed between September 2008 and March 2009, from, respectively, +7% to -12.5% and +6 to -13.7% y-o-y. On the demand side, the main cause of the deceleration is investment, which is anticipated to fall from the double digit positive growth rates of 2007 to a 17% contraction in 2009. Consumption, on the other hand, is to face a smaller fall, while unemployment is seen as almost doubling, to close to 10% in 2009. The 2010 recovery is expected to be driven by rather mild resummptions of both investment and consumption growth.

#### Loss of reserves and capital outflows

After record net inflows in 2007, the Central Bank

of Russia (CBR) estimates show a net capital outflow during 2008 of USD 130 billion (gross outflows reached USD 217 billion), while hard currency reserves fell by over USD 170 billion from their 2008 peak. Further reserves losses were observed during early 2009, leaving foreign currency reserves at USD 384 billion in mid-April, which is 36% lower than their mid-2008 peak.<sup>8</sup> According to CBR figures, Russia still ended 2008 with both a significant trade surplus (at USD 177 billion) and also a current-account surplus (of USD 99 billion). The forecast is for a fall in the trade surplus from around 10% of GDP in 2008 to 5.1% in 2009, recovering to 6.3% in 2010, while the current-account surplus is expected to fall from 6% in 2008 to 1.4% in 2009, albeit rising to 2.7% of GDP by 2010.

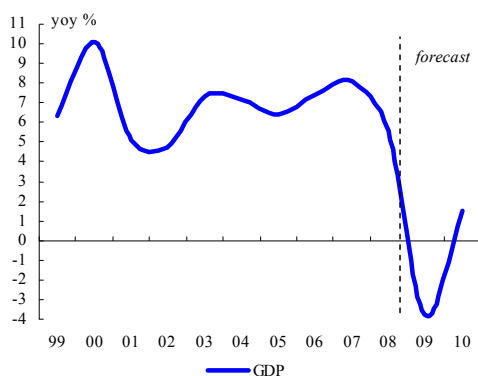
#### Changes in the exchange rate policy

The CBR previous aim was to stabilise a nominal euro-dollar currency basket (set at 0.45 cents of the EUR and 0.55 cents of the USD). In November 2008, faced with the need to adjust to both a terms-of-trade shock (the fall in commodity prices), which was reflected in a significant reduction of the trade surplus (of 50% in y-o-y USD nominal terms in January 2009), and to significant capital outflows, the CBR rouble policy changed towards greater flexibility. In November 2008, the CBR introduced a policy of periodic rouble “mini devaluations” against the basket, of around 1% per step, which progressively gained speed: from once per week in November 2008, they reached three devaluations per week in December 2008, and four by mid-January 2009. On 22 January 2009, the CBR announced another change, to an apparent “dirty float” with a wide band (26 to 41 to the basket) within which it would let the rouble float. Until early February 2009, the Russian currency suffered an additional depreciation, approaching the lower limit of the band, and stabilising close to it afterwards. The total depreciation to the basket since November 2008 has reached around 33%.

#### Sharp fiscal swing, while inflation stagnates

The budget surplus reached an estimated 4.1% of GDP in 2008. Due to the fall in oil prices and in economic activity (after energy export taxes, VAT is the other main source of tax revenues in Russia), plus the significant package of fiscal measures to

Graph 4.5.1: Russia - GDP growth



support the economy (see below), this figure is expected to swing into a deficit of 6.5% in 2009 and 2.7% in 2010. Importantly, these fiscal deficits are to be largely financed by drawing on the oil stabilisation funds. CPI inflation reached 13.4% in 2008 (year end), up from 11.9% in 2007, on the back of the rouble devaluation. The pass-through of the devaluation should be contained by the fall in economic activity and in commodity prices. Inflation is expected to stabilise in 2009, falling slightly below 10% by 2010.

### Policy measures

An extensive set of policy measures to cushion the downturn has been enacted by Russian policy makers. They include the provision of liquidity (domestic and external – i.e., replacing international capital, both short-term and long term), direct support to the banking sector and stock markets, other support measures for companies and households and flexibilisation of the exchange rate regime (as described above). The combined value of all the measures listed above is estimated at 14% of Russian GDP, though the large majority are of a *quasi-fiscal* nature. Also, they are spread out through 2008-2010.

### Overall prospects for 2009 and 2010

Following the global economic downturn, Russia's growth is expected to be negative in 2009 (-3.8%) and moderately positive in 2010 (1.5%). Inflation should remain at double-digit levels, decelerating slightly from almost 14% to around 10%, as the fall in economic activity and the reduction in commodity prices cushion the inflationary effects of the rouble devaluation. The budget is expected to swing sharply from a hefty surplus to large deficits, of respectively 6.5% and 2.7% of GDP, due to the reduction in commodity prices and in economic activity, plus the large fiscal stimulus packages. Russia is also forecast to see a significant fall in both its trade and current-account surpluses in 2009 and 2010, to, respectively, 5.1% and 6.3%, and 1.4% and 2.7% of GDP.

<sup>7</sup>This index is calculated on the real changes in the production volume of 1) agriculture, 2) mineral output, 3) processing manufacturing, 4) production and distribution of electrical power, gas and water, 4) construction, 5) transport and 6) retail and wholesale. It is considered as a good GDP proxy.

<sup>8</sup>Those figures include Russia's two oil stabilisation funds, the Reserve Fund and the National Welfare Fund, which together reached USD 220 billion (or 14% of GDP) as of 1 March 2009.

Table 4.5.1:

#### Main features of country forecast - RUSSIA

	2007		Annual percentage change							
	bn RUB	Curr. prices	% GDP	92-04	2005	2006	2007	2008	2009	2010
GDP at previous year prices	32987.4	100.0	-	-	6.4	7.7	8.1	5.6	-3.8	1.5
Private consumption	15990.5	48.5	-	-	11.3	11.1	13.5	9.0	-3.5	1.5
Public consumption	5820.4	17.6	-	-	1.3	2.4	3.4	4.5	3.7	1.8
Gross fixed capital formation	7286.7	22.1	-	-	10.6	18.0	21.1	8.6	-16.9	0.4
of which : equipment	2616.3	7.9	-	-	-	-	-	8.9	-16.0	0.5
Exports (goods and services)	10067.3	30.5	-	-	6.5	7.3	6.4	3.0	-8.0	3.0
Imports (goods and services)	7224.9	21.9	-	-	16.6	21.3	26.6	13.2	-20.0	2.0
GNI at constant prices (GDP deflator)	32181.9	97.6	-	-	6.0	7.1	8.7	6.0	-2.9	1.4
Contribution to GDP growth :										
Domestic demand			-	-	7.8	9.1	11.1	7.0	-4.9	1.2
Stockbuilding			-	-	-	-	-	-	-	-
Foreign balance			-	-	-1.4	-2.0	-3.4	-2.0	1.9	0.3
Employment			-	-	0.6	0.6	0.8	-0.5	-1.3	0.6
Unemployment rate (a)			-	-	7.1	6.7	5.6	5.9	9.5	8.4
Compensation of employees/head			-	-	-	-	-	-	-	-
Unit labour costs whole economy			-	-	-	-	-	-	-	-
Real unit labour costs			-	-	-	-	-	-	-	-
Savings rate of households (b)			-	-	-	-	-	-	-	-
GDP deflator			-	-	19.2	15.5	13.9	18.6	0.2	9.4
General index of consumer prices			-	-	12.7	9.7	9.0	14.1	13.3	9.1
Terms of trade of goods			-	-	-	-	-	-	-	-
Trade balance (c)			-	-	15.5	14.1	10.1	10.8	5.1	6.3
Current account balance (c)			-	-	11.0	9.5	5.9	5.9	1.4	2.7
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-	9.4	9.5	5.1	-	-	-
General government balance (c)			-	-	-	-	-	4.1	-6.5	-2.7
Cyclically-adjusted budget balance (c)			-	-	-	-	-	-	-	-
Structural budget balance (c)			-	-	-	-	-	-	-	-
General government gross debt (c)			-	-	-	-	-	5.1	7.5	8.9

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