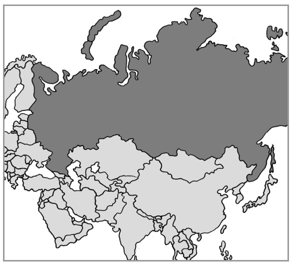

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Russian Federation:
'V-shaped' recovery underway

The global crisis hit Russia particularly hard and the vulnerability of the economic development model based on excessive dependence on energy became even more obvious. GDP growth virtually collapsed in the fourth quarter of 2008 and the economy plunged into a deep recession for almost one year. The stabilization and even (fragile) recovery in the fall of 2009 notwithstanding, GDP contracted by nearly 8% in 2009 – mainly due to the collapse of investment. Foreign trade, with falling exports and sharply reduced imports (in both nominal and real terms), mitigated the overall economic decline: the real contribution of foreign trade to GDP growth was positive in 2009, after several 'negative' years. Whereas manufacturing output and construction fell at double-digit rates, agriculture, trade and other services served as supply-side growth stabilizers. Preliminary figures indicate a 40% decline in FDI inflows and a reduction of the current account surplus (to about 3.8% of GDP). At the same time, CPI inflation slowed down (the GDP deflator even fell below 3%) and the unemployment rate increased by about 2 percentage points. After the managed and costly depreciation at the turn of 2008/2009, the rouble has been strengthening since mid-2009 again as oil prices, export revenues and foreign exchange reserves started to recover.

Due to the crisis the majority of the ambitious investment plans was discarded and the budget planning had to be thoroughly revised. Similar to the USA, Western Europe and China, the Russian government adopted various rescue and stimulus packages already in the fall of 2008. The aim was to improve the liquidity of the banking sector and restore confidence, to support the exchange rate and domestic consumption. The revised federal budget for 2009 entailed a huge fiscal stimulus as it reckoned with a nominal rise of expenditure by 7% despite falling revenues. As a result, the budget shifted from a surplus (5% of GDP in 2008) to a deficit of 5% of GDP. In sum, the costs of various anti-crisis measures may add up to 10% of GDP but their effects are hard to measure; judging by the sharp fall in consumption and investment, they have been rather disappointing. Critics point to the usual 'Russian'dangers of misappropriation and corruption; they also expect that mainly the large (or well-connected) banks and companies stand to gain disproportionately. It is wondered – so far with some justification – whether the money really reached those companies facing the liquidity squeeze. Indeed, the steep fall in investments during 2009 (by at least 20%) indicates not only tightened credit, but a deterioration of business confidence and the correction of the housing bubble (construction dropped by 16%). The share of investment (gross capital formation) fell to 20% of GDP in 2009 – a rather low figure compared to other transition countries and definitely insufficient for the urgently needed development of infrastructure and modernization of capital stocks.

From this perspective, the government's long-term strategic target of economic diversification and modernization is obviously getting out of reach. President Dmitry Medvedev returned to the modernization agenda in a policy declaration from September 2009. In his address ('Russia Forward') Mr. Medvedev enumerated five priority areas for overcoming Russia's 'historic' ills (the latter identified as in economic backwardness, widespread corruption and paternalist feelings in the society). Medvedev's priority modernization areas for Russia are:

(1) efficient production, transport and use of energy;
(2) development of nuclear technologies;
(3) development of global information technologies;
(4) development of ground- and space-based infrastructure for the transmission of information services;
(5) production of medical equipment, diagnostic tools and pharmaceuticals required for the treatment of viral, cardiovascular, cancer and neurological diseases.

The above modernization fields are allegedly backed by specific implementation plans which also count with the participation of foreign companies and researchers. The chances for the success of an 'innovation development' scenario have never been particularly high and we share the scepticism of other observers regarding the actual outcomes of the announced modernization plans. The success chances have diminished in the aftermath of the war with Georgia in August 2008 at the latest. The collapse of the oil price and the effects of the global crisis have radically curtailed financial resources initially earmarked for modernization programmes. At the same time, the limits of the resource-based growth scenario has become even more obvious. The deterioration of relations with the EU (as well as with Georgia, Ukraine and recently also with Belarus) represents another growth bottleneck as it also has serious repercussions for the future path of Russian economic reforms. It may strengthen the inward-looking, autarkic development strategy which is doomed to fail.[1]

The accession to WTO, one of the few potential modernization drivers, was postponed once again in June 2009, this time after the agreement about forming a Customs Union with Belarus and Kazakhstan had been finalized.[2] However, the Customs Union (formally in force since January 2010) is apparently not working – at least judging by the oil price and export tariff disputes between Russia and Belarus in January 2009.

The Russian authorities, as well as the IMF, OECD, the World Bank and others (including wiiw) have been busily revising GDP forecasts for 2009 downwards in the course of last year. In mid-2009 the range of GDP growth forecasts for the year 2009 fluctuated between -2% and -10%, largely depending on assumptions regarding the level of oil prices. The preliminary official estimate of the GDP decline in 2009 (-7.9%) turned out even lower than the revised wiiw forecast from autumn

1 On the other hand, new privatization initiatives (e.g. in the exploration of the Yamal gas deposits) were launched as well. In external relations, Russia has become increasingly assertive. Dangers of escalating external conflicts (e.g. a confrontation with Ukraine over the Crimea) are being recognized.

2 Russia has never been too enthusiastic about joining the WTO (in fact, the recently envisaged Industrial Policy tools could well be in conflict with WTO rules).

(which reckoned with GDP contracting by about 6-7%), largely as a consequence of sharply falling exports and reduced investments (stocks in particular).

Nevertheless, fragile signs of recovery have been visible already since late summer 2009. These include a modest increase in output, rising export revenues (thanks to higher oil prices), improving consumer confidence and the stabilization of inflation. Indeed, GDP growth resumed in the fourth quarter of last year, not least thanks to statistical base effects, with modest (up to 4% per year) growth acceleration possible in 2010-2012. The domestic financial market is likely to stabilize and even recover fairly soon, yet the investment climate (including financing conditions) will remain challenging. After the huge contraction of foreign trade in 2009, both exports and imports are expected to resume growth again (this forecast reckons with an oil price of 70-80 USD per barrel). A GDP growth slowdown thus appears inevitable in the medium term, before any (highly uncertain) modernization and diversification efforts start to bear fruit.

The wiiw forecast for 2010-2012 is based on the assumption of modestly recovering oil prices (Urals costing around USD 70-80 per barrel) and no abrupt policy changes or external shocks. Both private consumption and investment are expected to grow faster than GDP; real exports will continue to be sluggish at best since the volumes of exported oil and gas will hardly increase, while imports will grow at a faster rate – roughly in line with private consumption and investment. This implies a small negative contribution of real net exports to GDP growth and, in nominal terms, a gradual reduction of the trade and current account surpluses. In fact, the current account surplus will gradually diminish (below 3% of GDP). GDP growth will not exceed 5% and inflation will remain stubbornly close to 10% in both 2010 and thereafter. Unemployment has been on the rise during 2009, albeit not dramatically. Apart from a few ‘monocities’ which depend on the fate of a single big plant (such as the troubled car factory Avtovaz in Togliatti), the employment effects of the crisis have so far been rather modest. They are being mitigated by demography as the domestic labour supply is diminishing. In fact, labour shortages are likely to reappear soon and will definitely put a brake on economic growth already in the medium run. Needless to say, another wave of the crisis cannot be ruled out either.

Table RU

Russia: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1)]	2010	2011 Forecast	2012
Population, th pers., average [2)]	143821	143114	142487	142115	141956	141000	140000	139500	139000
Gross domestic product, RUB bn, nom.	17048.1	21625.4	26903.5	33111.4	41256.0	39016.1	42500	47000	51000
annual change in % (real)	7.2	6.4	7.7	8.1	5.6	-7.9	3.4	4	4.3
GDP/capita (EUR at exchange rate)	3300	4300	5500	6700	8000	6300	.	.	.
GDP/capita (EUR at PPP - wiiw)	9200	10000	11100	12400	13200	12400	.	.	.
Consumption of households, RUB bn, nom.	8405.6	10590.0	12887.9	15900.9	19752.8	20979.5	.	.	.
annual change in % (real)	12.1	11.8	11.4	13.7	10.7	-8.1	4	5	4
Gross fixed capital form., RUB bn, nom.	3130.5	3836.9	4980.6	6982.5	9200.3	7863.2	.	.	
annual change in % (real)	12.6	10.6	18.0	21.1	10.6	-18.2	5	7	10
Gross industrial production									
annual change in % (real)	8.0	5.1	6.3	6.3	2.1	-10.8	5	5	5
Gross agricultural production									
annual change in % (real)	3.0	2.3	3.6	3.4	10.8	1.2	.	.	.
Construction industry									
annual change in % (real)	10.1	10.5	18.1	18.2	12.8	-16.0	.	.	.
Employed persons - LFS, th, average	67274.8	68169.0	68855.0	70570.5	70965.0	69400	69000	69000	68700
annual change in %	.	1.3	1.0	2.5	0.6	-2.2	-0.6	0	-0.4
Unemployed persons - LFS, th, average	5674.8	5262.8	5312.0	4589.0	4791.0	6420	6400	6000	6000
Unemployment rate - LFS, in %, average	7.8	7.2	7.2	6.1	6.3	8.5	8.5	8	8
Reg. unemployment rate, in %, end of period	2.6	2.5	2.3	2.0	2.0	2.9	.	.	.
Average gross monthly wages, RUB	6739.5	8554.9	10633.9	13593.4	17226.3	18785.0	.	.	.
annual change in % (real, gross)	10.6	12.6	13.3	17.0	10.3	-2.8	.	.	.
Consumer prices, % p.a.	11.0	12.5	9.8	9.1	14.1	11.8	6	7.5	8
Producer prices in industry, % p.a. [3)]	24.0	20.7	12.4	14.1	21.4	-7.2	5	7	10
General governm.budget, nat.def., % GDP									
Revenues	31.9	39.7	39.5	40.4	38.8	35.5	.	.	.
Expenditures	27.4	31.5	31.1	34.4	33.9	40.9	.	.	.
Deficit (-) / surplus (+), % GDP	4.5	8.1	8.4	6.0	4.9	-5.4	-5	-3	0
Public debt, nat.def., in % of GDP [4)]	21.6	14.9	8.6	7.2	5.7	8.1	10	10	10
Base rate of NB % p.a., end of per.	13	12	11	10	13	9	.	.	.
Current account, EUR mn [5)]	47867	67858	75474	56266	69871	34200	40000	35000	32000
Current account in % of GDP	10.1	11.1	9.6	5.9	6.2	3.9	4.2	3.4	2.9
Exports of goods, BOP, EUR mn [5)]	147358	195545	241960	258930	321792	218000	260000	275000	300000
annual growth rate in %	22.5	32.7	23.7	7.0	24.3	-32	19	6	9
Imports of goods, BOP, EUR mn [5)]	78327	100608	130948	163282	199148	139000	170000	200000	225000
annual growth rate in %	16.4	28.4	30.2	24.7	22.0	-30	22	18	13
Exports of services, BOP, EUR mn [5)]	16564	20028	24791	28798	35008	30000	35000	38000	42000
annual growth rate in %	15.4	20.9	23.8	16.2	21.6	-14	17	9	11
Imports of services, BOP, EUR mn [5)]	26774	31077	35643	43151	52101	45000	55000	60000	70000
annual growth rate in %	11.6	16.1	14.7	21.1	20.7	-14	22	9	17
FDI inflow, EUR mn [5)]	12422	10336	23675	40237	49732	30000	35000	45000	50000
FDI outflow, EUR mn [5)]	11085	10240	18454	33547	35911	25000	35000	40000	45000
Gross reserves of NB, excl. gold, EUR mn	88663	148094	224306	318840	292483	290431	.	.	.
Gross external debt, EUR mn	156687	216553	237687	321743	340234	327409	.	.	.
Gross external debt in % of GDP	34.8	34.2	30.7	34.9	34.2	36.4	.	.	.
Average exchange rate RUB/EUR	35.81	35.26	34.11	35.01	36.43	44.14	45	46	46
Purchasing power parity RUB/EUR, wiiw [6)]	12.92	15.06	16.99	18.80	22.09	22.35	.	.	.

1) Preliminary and wiiw estimates. - 2) Resident population. - 3) Domestic output prices. - 4) wiiw estimate. - 5) Converted from USD with the average exchange rate. - 6) wiiw estimates based on the 2005 International Comparison Project benchmark.

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