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Russian Federation: lower GDP growth despite surging trade surplus

During the past five years – in Putin's era – the Russian economy expanded at an average annual rate of nearly 7%. The main drivers of growth have been booming private consumption and large export surpluses, the latter resulting mainly from surging oil export revenues. The government budget has been in a sizeable surplus, foreign exchange reserves increased fivefold and external debt has been reduced. In addition, the Stabilization Fund (established in 2004 and fed from a portion of windfall oil export revenues) reached RUR 860 billion (EUR 23.5 billion) by April 2005. The accumulated funds enabled Russia to repay part of its external debt (to the IMF and recently also to Paris Club creditors) ahead of schedule. At the same time, the pace of structural reforms has recently slowed down substantially and the investment climate has deteriorated. The Russian variety of Dutch disease symptoms is becoming increasingly apparent as more than half of all export revenues stem from energy carriers (another 30% of exports represent metals). With a roughly constant nominal exchange rate over the period (28 RUR per USD) and persisting, albeit somewhat declining, double-digit annual inflation the rouble has strengthened by nearly 50% in real terms against the US dollar since 2000 (the real appreciation against the euro was much less pronounced). The year 2004, when the GDP increased by about 7%, might well have been the last one of robust economic growth – high world market commodity prices notwithstanding.

Indeed, GDP growth decelerated already in the closing months of last year and even more markedly in the first quarter of 2005 (Table RU). The slowdown was recorded in industry, transport and construction whereas output growth of some services (especially retail trade and telecommunications) accelerated. Agricultural production was flat. On the demand side, investment growth was somewhat disappointing, reflecting the growing uncertainty on the part of economic agents regarding the future outlook – despite robust household consumption as mirrored in growing retail sales. Exceptionally high world market prices of the main Russian export commodities (particularly of energy carriers and metals) represented once again the key growth stimulus during the first quarter of 2005. Due to the combined effects of high foreign exchange inflows, expanding money supply, robust economic growth, and price hikes in energy and services, disinflation came to a halt. Consumer price inflation accelerated to nearly 13% on an annual average in the first quarter of 2005. Still more disturbing is the fact that producer price inflation has been even higher, exceeding 23% in the first quarter of 2005, mainly as a result of surging domestic prices of energy and metals. Given the further envisaged adjustments of administered prices, e.g. of electricity and gas, it is obvious that permanently rising producer prices will

eventually translate into higher consumer price inflation as well. Rapid disinflation is therefore highly unlikely: consumer prices will increase by about 12% in 2005 and not much less in 2006.

Goods exports were up by more than 34% in EUR terms during the first quarter of 2005 (+41% in USD terms) compared to a year earlier, largely thanks to a jump in energy revenues. Imports of goods increased by nearly 20% (+25% in USD terms), with machinery and transport equipment (in particular passenger cars) imports rising faster than average. The export surplus reached a new record in early 2005: more than USD 28 billion in the first quarter, as compared to 18 billion a year earlier, and the current account surplus (USD 22.4 billion) amounted to nearly 14% of GDP. Despite the prevailing expectation of lasting high world market commodity prices (and moderately growing Russian production and exports), the growth in export revenues will most likely fall due to the bottoming out of energy prices (and export capacity constraints) while imports, fuelled by robust domestic demand and the ongoing real appreciation of the rouble, will continue to rise. Although the trade and current account surpluses will remain large, the contribution of net exports to GDP growth will gradually diminish.

Apart from net exports, the main growth pillar during the last couple of years has been private consumption. The share of investments in GDP is still rather low (about 18% of GDP) and their growth has slowed down – despite rising profits. Indeed, the situation of most Russian companies, in particular those engaged in export activities, is quite comfortable (except Yukos, which is facing liquidation after its main asset Yuganskneftegas was sold to a subsidiary of Gazprom), and they can easily finance investments from own resources (or credits, as was the case in Gazprom's recent acquisition of Yukos assets).

The deterioration of the investment climate in Russia, in part related to the protracted Yukos trial and the announcement of new tax claims on other companies, is reflected in lower overall investment growth: 7.6% in the first quarter of 2005, as compared to 13.5% in the same period of the previous year. Curiously, there has been an increase in registered FDI, by about 30%, in particular in raw materials production and the processing and trade sectors of the economy (so far not confirmed by balance of payments data). The total stock of foreign investments in Russia is estimated to amount to about USD 85 billion (less than 15% of GDP), of which around half (USD 38 billion) represent FDI. Compared to most other transition economies, the FDI penetration of Russia is extremely low and outflows of capital are high. Contrary to other transition countries, and to China, foreign investors are not particularly welcome in Russia and, as recently announced by the government, the access of foreign investors to the most attractive ('strategic') sectors will remain restricted to minority participation.

Despite predominantly positive economic indicators, the prospects for sustainable long-term growth are blurred considering the lagging reform progress, insufficient transparency of legal regulations and, last but not least, the structural imbalances in the economy which is excessively dependent on the fluctuating world market commodity prices. In line with most observers and even the official government forecasts, wiiw expects Russia's GDP growth to slow down in both 2005 and 2006 (the Russian government is more optimistic with its recently revised forecast for GDP growth to less than 6% in both 2005 and 2006). Yet there is a broad consensus – both in- and outside Russia – that even the current rate of economic growth is unsustainable unless the pace of structural, institutional, legal and banking sector reforms (and especially their implementation) speeds up substantially. After the lacklustre implementation of public sector administration and tax reforms, the latest example was the botched attempt at social benefits reform.

The favourable price developments on world commodities markets and the related huge 'twin surpluses' make an acceleration of liberal reforms in Russia unlikely – notwithstanding public declarations, such as in President Putin's latest annual address. On the contrary, a tendency towards increasing state intervention in the economy (particularly in strategic sectors such as energy and metals) and exerting more influence on decision-making at the regional level, is becoming more apparent. Increasing bureaucratic hurdles and less efficiency may be the outcome. The recently announced relaxation of fiscal policies, aimed at the stimulation of domestic demand, will certainly make disinflation more difficult; it will also increase the pressure on real appreciation. This may lead to even higher imports, lower trade surplus and eventually to lower GDP growth as well.

Table RU

Russia: Selected Economic Indicators

	2000	2001	2002	2003	2004 ¹⁾	2004 1st quarter	2005	2005 forecast	2006 forecast
Population, th pers., end of period ²⁾	144819	143954	144964	144168	143400	143527	143300	143000	142500
Gross domestic product, RUB bn, nom.	7305.6	8943.6	10830.5	13243.2	16751.5	3485.5	4364.9	20300	24000
annual change in % (real)	10.0	5.1	4.7	7.3	7.2	7.6	5.2	5.3	5.0
GDP/capita (EUR at exchange rate)	1928	2365	2539	2641	3253	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	6030	6480	7010	7530	8300	.	.	.	.
Gross industrial production									
annual change in % (real)	11.9	4.9	3.7	7.0	6.1	7.6	3.9	4.5	4.5
Construction output total									
annual change in % (real)	17.0	9.9	2.7	14.4	10.1	13.8	5.3	.	.
Consumption of households, RUB bn, nom.	3295.2	4318.1	5408.4	6559.9	8010.7	1780.1	.	.	.
annual change in % (real)	7.3	9.5	8.5	7.5	11.3	9.7	.	8	7
Gross fixed capital form., RUB bn, nom.	1232.0	1689.3	1938.8	2407.6	3002.1	465.5	509.8	.	.
annual change in % (real)	18.1	10.2	2.8	12.8	10.8	13.1	7.6	7.5	7
LFS - employed persons, th, avg.	64255	64400	66071	65800	67383	66067	66200	.	.
annual change in %	2.8	0.2	2.6	-0.4	2.4	2.4	0.2	.	.
Reg. employment in industry, th pers., avg.	14543	14692	14534	14345	14130	.	.	.	.
annual change in %	1.7	1.0	-1.1	-1.3	-1.5	.	.	.	.
LFS - unemployed, th pers., average	7515	6416	5712	6231	5988	6672	6011	.	.
LFS - unemployment rate in %, average	10.5	9.1	8.0	8.6	8.0	9.2	8.3	8.5	9
Reg. unemployment rate in %, end of period	1.4	1.6	2.1	2.3	2.6	2.3	2.8	.	.
Average gross monthly wages, RUB	2223.4	3240.4	4360.3	5498.5	6828.0	6167.0	7634.7	.	.
annual change in % (real, gross)	20.9	19.9	16.2	11.0	10.8	15.0	7.4	.	.
Consumer prices, % p.a.	20.8	21.6	16.0	13.6	11.0	10.8	12.9	12	10
Producer prices in industry, % p.a.	46.6	19.1	11.8	15.6	24.0	18.6	23.3	20	15
General governm.budget, nat.def., % GDP									
Revenues	28.7	30.0	32.5	31.3	32.4	30.0	39.3	.	.
Expenditures	26.8	27.1	31.6	29.9	27.9	25.5	24.3	.	.
Deficit (-) / surplus (+), % GDP	1.9	3.0	0.9	1.3	4.5	4.5	15.0	.	.
Public debt, nat.def., in % of GDP ³⁾	57.1	44.1	37.0	31.7	23.5	.	.	.	.
Refinancing rate of NB % p.a., end of period	25	25	21	16	13	14	13	.	.
Current account, EUR mn ⁴⁾	50619	37885	30789	31330	48347	10213	17097	58000	50000
Current account in % of GDP	18.0	11.1	8.4	8.2	10.3	9.6	14.3	10.0	7.5
Gross reserves of NB, excl. gold, EUR mn	26139	37026	42290	58531	88663	65187	103142	.	.
Gross external debt, EUR mn	172903	169530	147067	148536	155148	155521	.	.	.
FDI inflow, EUR mn ⁴⁾	2933	3069	3660	7041	9388	3929	.	.	.
FDI outflow, EUR mn ⁴⁾	3433	2828	3736	8606	7722	3388	.	.	.
Exports of goods, BOP, EUR mn ⁴⁾	113510	113744	113468	120265	147555	29815	40092	174000	169000
annual growth rate in %	60.1	0.2	-0.2	6.0	22.7	3.0	34.5	18	-3
Imports of goods, BOP, EUR mn ⁴⁾	48483	60022	64470	67304	77462	15697	18688	90000	103500
annual growth rate in %	30.7	23.8	7.4	4.4	15.1	5.4	19.1	16	15
Exports of services, BOP, EUR mn ⁴⁾	10337	12773	14393	14359	16320	3116	3358	17600	19100
annual growth rate in %	21.5	23.6	12.7	-0.2	13.7	9.5	7.8	8	8.5
Imports of services, BOP, EUR mn ⁴⁾	17540	22967	24848	23997	27106	5114	5572	29800	32800
annual growth rate in %	40.0	30.9	8.2	-3.4	13.0	7.2	9.0	10	10
Average exchange rate RUB/USD	28.13	29.17	31.35	30.69	28.81	28.63	27.88	28	29
Average exchange rate RUB/EUR (ECU)	26.03	26.13	29.65	34.69	35.81	35.83	36.52	35	36
Purchasing power parity RUB/USD, wiiw	7.16	8.15	9.27	10.39	12.02	.	.	13.5	15
Purchasing power parity RUB/EUR, wiiw	8.32	9.53	10.74	12.17	14.04	.	.	16.2	17

Notes: 1) Preliminary. - 2) Resident population; from 2002 according to census October 2002. - 3) In 2000 wiiw estimate. - 4) Converted from USD to EUR at the official cross exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.