BOFIT Forecast for Russia
11.9.2008

BOFIT Russia Desk

BOFIT Forecast for Russia 2008-2010

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The growth forecast for Russia for 2008–2010 has been revised slightly upwards in response to higher oil prices. Economic growth is expected to remain close to 8% this year and to slow to just over 6% by 2010. Both consumption and investment demand will grow rapidly, but economic growth will gradually moderate as the price of oil stabilises and capacity constraints press harder. Imports will continue to grow much faster than exports.

The uncertainty in the international financial markets and slower global growth seem not to have had a major impact on the Russian economy. Economic growth has hovered around 8%, bolstered by rising oil prices. The economy has showed signs of overheating, but in the summer a slight slowing of growth was witnessed in nearly all sectors. Although economic growth does not actually derive from the oil sector itself, oil revenues are clearly reflected in other sectors and hence in the overall performance of the economy. On the basis of futures markets, the price of Urals oil is projected at somewhat over USD 100 per barrel over the years 2008–2010.

Domestic demand as the engine of growth

Consumption continued to grow at an annual rate of over 10% in the first quarter. Slower growth in retail trade and real income in the second quarter also points to a slight decline in private consumption growth. Growth of private consumption is sustained by a strong increase in income, a favourable employment situation and continued brisk, albeit slackening, growth in private borrowing. Growth prospects are, however, tempered by higher inflation. Hence, the strong growth in private consumption should continue, albeit at a gradually declining rate. Growth in public demand is also expected to ease over the next few years, given the more moderate increase in spending provided for in the budgetary ceilings adopted by the government.

The rate of rise in investment climbed to 19% in the first quarter. Investment growth seems to have moderated in the second quarter, which is also reflected in some slowing of growth in the construction and processing industries. Growth in investment demand is projected to continue at a brisk pace but to slow from last year's rate of 21%. Investment growth is sustained by the economy's huge investment needs and the favourable trend in corporate profits, but it will gradually subside over the next few years.

Imports still growing much faster than exports

Measured in quantities, export development has been sluggish this year. In the first half of the year, crude oil exports shrank by 5%. Crude oil production has not increased this year, and there is a huge need for new investments in the sector, as existing oil fields are gradually depleted. However, investment has been constrained eg by high taxes on oil companies and political risks. Export volumes of raw timber and cereals also declined in response to higher export taxes. The increases in export taxes on cereals were temporary, but a considerable further increase in the tax on raw timber is slated for the beginning of next year, so that raw timber exports could come to a standstill. Consequently, export growth is expected to slow further over the next few years.

In contrast, Russian imports have continued to grow at a brisk pace. In the first quarter, imports increased in real terms by 27% year on year, posting a growth in value of over 40% also in the summer. The robust consumption demand in particular cannot be satisfied by domestic output, which is either insufficient or not sufficiently competitive. Expansion of domestic output is also being restrained by tighter capacity constraints due to rapid economic growth, above all by a shortage of skilled labour. Brisk import growth is expected to continue over the forecast horizon but to ease gradually with the slowing of growth in demand.

Inflow of foreign currency and food prices have sustained a high rate of inflation

As imports are projected to grow much faster than exports and the price of oil to remain relatively stable, the current account surplus is set to move close to zero within the next few years, unless exchange rate adjustments reverse the trend. However, the surplus has widened again this year in response to record-high oil prices. Although less than the year before, capital imports have also contributed to the inflow of foreign currency. Corporate borrowing from abroad has increased despite some slowing, and foreign direct investment in Russia has also expanded. Capital flows have, nevertheless, been highly volatile.

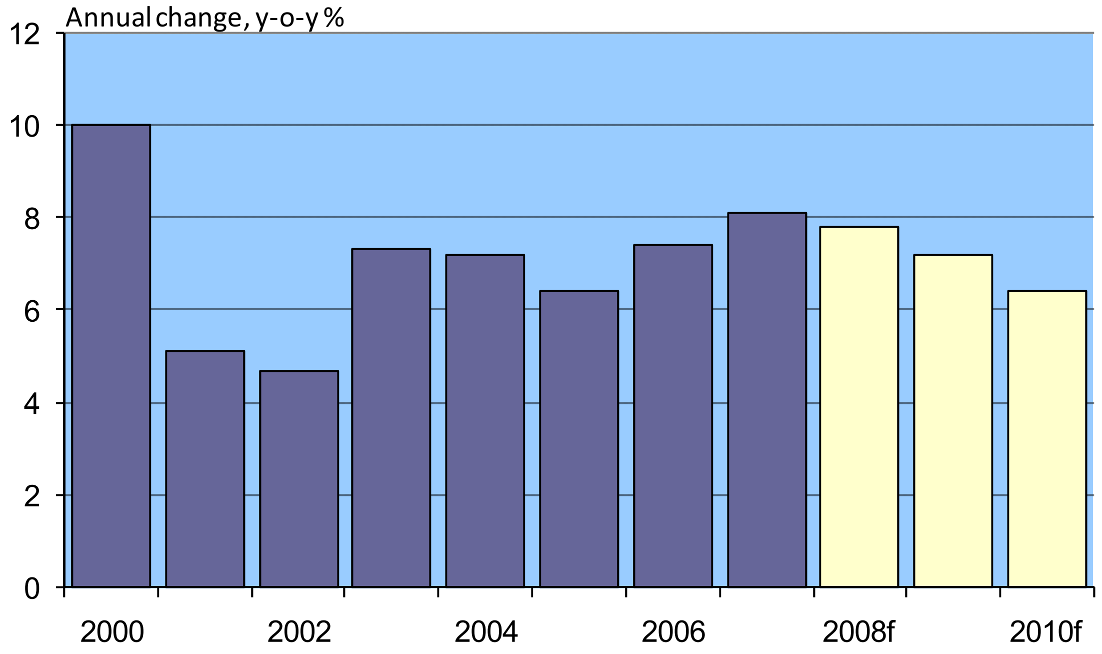
The inflow of foreign currency has also posed challenges for Russian monetary policy. The central bank has continued to strive to keep the rouble's nominal exchange rate fairly stable, although the aim is to gradually move to an inflation target. In August, the rouble's real trade-weighted exchange rate had appreciated 3.3% from the beginning of the year. Although monetary policy has been tightened several times this year, efforts to constrain monetary growth in the economy have not been entirely successful. In the summer, annual growth of M2 did slow to 30%, having been nearly 50% at the end of last year.

The rate of inflation has picked up during the past year, hovering around 15% in the summer. The upward trend in world market prices for food has also been strongly reflected in the rate of inflation in Russia, given the weight of food (40%) in the consumer basket. The slight slowing of economic growth will reduce inflationary pressures, which are being maintained eg by continued strong increases in wages and planned increases in regulated prices for the next few years.

Risks

The near-term outlook for the Russian economy remains quite favourable. The sustained high oil prices will bolster economic growth, and the effects of any price declines could, in the short term, be muted by oil revenues accumulated in the reserve fund. Consumers' purchasing power and expectations are, however, weakened by the fairly high rate of inflation. Growth in domestic output is restrained by firming capacity constraints. Several production sectors, and the strong growth centres above all, are already experiencing a shortage of skilled labour. Particularly over the longer term, growth prospects and economic diversification are also impaired by an infrastructure and machinery which are deficient or outdated in many respects. If the liquidity crunch persists in international financial markets, this may also exacerbate the financial position of Russian companies. Moreover, the Georgian conflict has brought greater uncertainty to the Russian financial markets and operating environment.

Yearly changes in Russian GDP, 2000–2010



Sources: Rosstat 2000–2007, BOFIT forecast 2008-2010

Annual real growth forecast for Russian GDP and imports, %

	2007	2008f	2009f	2010f
GDP	8.1	7.8	7.2	6.4
Imports	27.3	26.0	22.0	17.0

Sources: Rosstat 2007, BOFIT forecast 2008-2010