BOFIT Russia Desk

BOFIT Forecast for Russia 2010–2012

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Following an exceptionally severe recession, the Russian economy has returned to a path of growth. The economy is expected to continue to post high growth rates over the forecast period, in line with the BOFIT forecast of winter 2010, even if the projected growth for the current year has been lowered because of a slower-than-expected recovery. We also look for rapid growth of imports. While the forecast calls for a slight moderation of both economic growth and imports in the course of the forecast period, the economy should continue to post annual growth rates of nearly 5% almost until the end of the forecast period. Meanwhile, imports are likely to increase at more than 10% pa. To be sure, the projected growth does not match the robust rates of the protracted pre-recession period of 2000-2008. GDP should climb back to its level of 2008, the year immediately preceding the recession, around the middle of next year.

Consumption driving the economy

After a severe decent in the period of autumn 2008 to summer 2009, Russian GDP grew in the second half of 2009. The economic recovery was set back somewhat in the early and middle part of this year, largely because of an exceptionally hard winter, and a very hot and dry summer. Robust growth is projected for the later part of the year. This year's growth is supported by last year's steady rise in the price of oil. After the recovery from severe recession, GDP growth is likely to slow down to less than 5% pa early next year and further towards 4% pa at the end of the forecast period. For calendar year 2010, the GDP growth figure will be below 5%. Although growth will ease next year, the growth figure for calendar 2011 should be about 6% because of the comparatively low GDP level in 2010.

Economic growth is expected to continue to depend largely on consumption. Growth of private consumption (which accounts for half of GDP) is presaged by a number of factors. The first half of 2010 saw increases in both real wages and especially pension payments. Unemployment has declined and consumer confidence indicators are approaching pre-recession levels. That consumers are regaining confidence is also reflected in a slight improvement in household lending, which could continue because of the low level of household indebtedness. The rise in real wages is projected to continue apace and the government is expected to adhere to its plan to keep pensions on an upward path almost on a par with wages. The propensity to save is not expected to increase beyond the relatively lofty level already reached during the recession. The small decline in employment during the recession (2-3%) has sharply reduced labour productivity, ie companies have a larger surfeit of employees. This is likely to restrain employment growth in the near term.

As noted in the forecast of last winter, investment growth is expected to commence at a slower pace than consumption growth, partly because companies have more unused capacity than before the recession. The first half of the year has been in line with the forecast, as investment so far has not posted notable growth. The outlook is for a pick-up in investment in the latter part of the year, but we are not likely to see robust growth until next year. It is estimated that banks will be able to accommodate at least in part the resulting increase in credit demand for investment purposes.

Our projection is that, despite mounting pressure to reduce public spending, government consumption expenditure will increase slightly this year in connection with crisis-related measures, but that in the period 2011-2012 this spending will remain flat in real terms. In spite of a large public deficit (about 5% of GDP in 2010), the Russian government is virtually free of debt, and its credit rating is good. For this reason there is no immediate need to balance the government's budget. Nonetheless, the central government as well as the regions and local governments have reduced their total spending this year, in real terms. But parliamentary elections set for December 2011 and a presidential election for March of 2012 are not likely to leave room for substantial cuts in public consumption.

Russia's export volume was some 10% higher in the first half of this year compared to the year-earlier period, largely because natural gas exports have recovered from the sharp drop a year earlier. Despite rapid growth in the world economy, Russian export volume is expected to continue its relatively slow rise, as exports of crude oil and oil products increase only slightly, due to sluggish production increases. Prospects for natural gas exports have improved. Crude oil, oil products and gas account for 55-60% of Russia's total goods and services exports.

Import growth easing slightly

Preliminary data indicate that the volume of imports increased by more than 20% in the first half of 2010 compared to the depressed level of the year-earlier period, which followed a decline of more than a third. Quarterly figures reveal that imports declined in the first quarter of this year but expanded fast in the second quarter. Imports are expected to increase at a slightly slower pace in the latter part of this year and in the following years, but we still anticipate a growth rate in excess of 10% because of consumption growth and, starting in 2011, a resurgence of investment. This year's weak first quarter will also affect import growth figures for calendar years 2010 and 2011. It is expected that in 2012 imports will exceed the pre-recession level.

The economy's propensity to import (ratio of import change to GDP change) is expected to be high, as it was before the recession, but to decline slightly over the course of the forecast period. In volume terms, imports are increasing so much faster than exports that, during the forecast period, the net effect of foreign trade on GDP growth will be a significant negative one. In other words, the rapid growth of imports will dampen GDP growth, as was the case before the recession.

Imports are receiving support from a strengthening of the rouble's real exchange rate. Since spring of this year, the real exchange rate has been at its level of late 2008, prior to the devaluation of the rouble. The real exchange rate will strengthen gradually, due to Russia's current account surplus, though the surplus is expected to shrink during the forecast period. The surplus is fairly sensitive to the rate of import growth as well as to the price of oil. Inflation is expected to be slightly higher in the latter part of this year and over the course of 2011 compared to the relatively subdued rate of the past summer, and this will strengthen the rouble's real exchange rate. The higher inflation will derive not only from firmer demand but also from the food-price impact of Russia's poor grain harvest this year. The total weight of food products in Russia's consumer price index is nearly 40%.

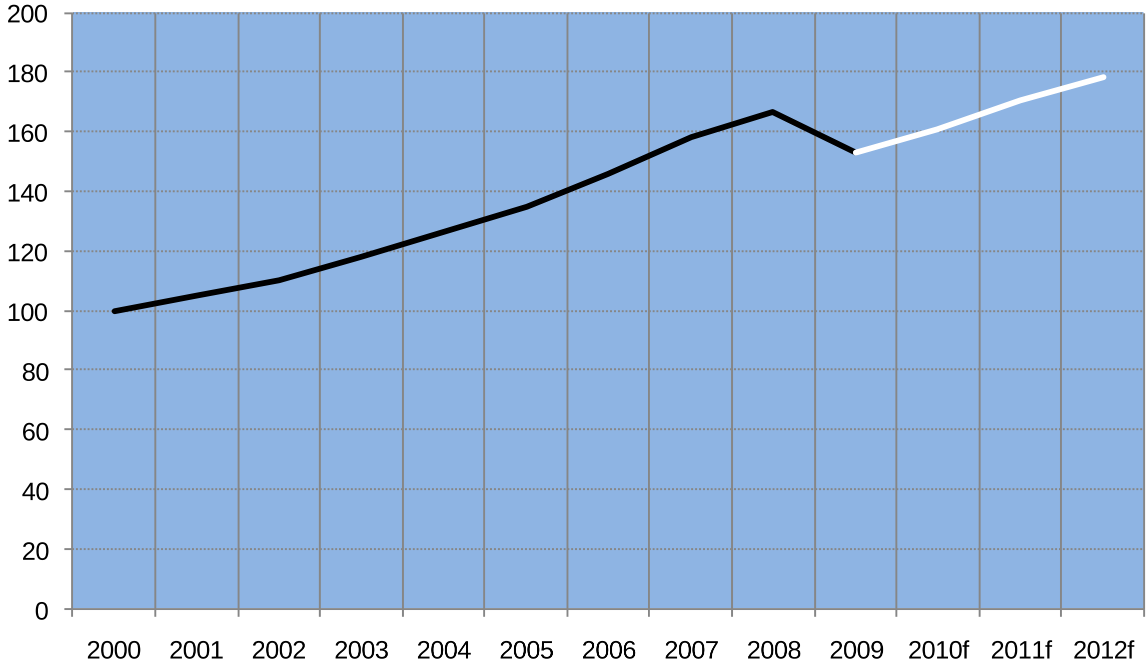
Large risks

The forecast is based on a view of the world economy and trade that includes rapid growth and a gradually rising oil price. But the forecast risks are exceptionally large. During the forecast period, all the uncertainties of the global economy will be directly reflected in the performance of the Russian economy, especially via the prices of raw materials and developments in the international financial markets. The uncertainties connected with the volume of Russian exports are also significant in this context, as exports account for some 30% of GDP.

A fall in the price of oil could powerfully change the course of the Russian economy, especially in light of the fact that also in Russia the possibilities for government stimulus afforded by previous budget surpluses and a build-up of reserve funds have become more limited. In contrast to the pre-recession surpluses, government finances are now clearly in the red, and the central government has used half of the reserve funds, mostly to finance the deficits. The two reserve funds together contain about EUR 100 billion (9% of GDP). Of the total, nearly EUR 70 billion is in the national welfare fund, which is intended mainly for the pension system. In the midst of all the uncertainty, monetary flows can easily change course, even dramatically, because of the continual abundance of liquidity worldwide as well as in the Russian banking sector. From the Russian perspective, even positive shocks are possible, eg in connection with the price of oil or foreign financing.

The recovery of investment in Russia is subject to substantial risks. As regards private investment, these risks are still related to the uncertain outlook for demand, the sluggishness or stoppage of market-economy reforms, as well as the proclivity of the state (ie politicians and civil servants) to intervene in companies' operations and its partly short-sighted reactions to the recession-induced uncertainties, including its support and protection measures. The latter tendencies of the state were apparent even prior to the onset of the recession. Larger-than-usual risks attach to inventory operations of Russian companies: even in more normal times, inventory changes (generally increases) have usually had a substantial impact on Russian GDP growth. If the economy's propensity to import proves to be larger than estimated, GDP growth will fall short of the forecasted rate.

Russian GDP volume in 2000-2009 and BOFIT forecast for 2010-2012 (yr 2000 = 100)



Sources: Rosstat 2007–2009, BOFIT forecast for 2010–2012.

Russian GDP and import volume, yearly change 2007-2009, and BOFIT forecast for 2010-2012, %

	2007	2008	2009	2010f	2011f	2012f
GDP	8.5	5.2	-7.9	5	6	5
Imports	26	15	-30	15	16	12

Sources: Rosstat 2007–2009, BOFIT forecast for 2010–2012.