BOFIT Forecast for Russia
25.3.2011

BOFIT Russia Team

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Recovery of the Russian economy from one of the world's most severe recession-induced declines in output slowed down temporarily in autumn 2010 but continued in winter. The forecast envisions (as in core of the late-summer forecast) brisk recovery and growth of the economy and even faster growth of imports. GDP growth is expected to slow gradually from about 5% pa in 2011–2012 to ca 4% in 2013, assuming an oil price of about USD 100 a barrel over the course of the forecast period. GDP growth will be subject to a dampening effect from continuing rapid growth of imports – ca 15% in 2011 and 10% pa in 2012–2013. GDP is expected to match the pre-recession peak level of summer 2008 in the autumn of this year and imports around the end of the year.

Economy recovering - forecast calls for brisk but slightly slowing growth

Russia's economic recovery has been slower than forecasted in 2010: GDP increased by 4%. This was mainly because of a faster-than-expected rebound of imports and an output loss especially in agriculture due to the historically hot and dry summer. After an autumn respite, the economy revived in the winter supported by a rise of export prices in oil, metals as well as gas. Seasonally-adjusted GDP at year-end was about 5% below the pre-recession peak, which had been preceded by an 11% decline between autumn 2008 and summer 2009. This loss in output was among the largest in the world in connection with the economic and financial crisis.

The core of the forecast is unchanged from the late-summer forecast. GDP is expected to grow at the rapid pace of 5.5% in calendar 2011, thanks to the rise of export prices so far and the low base of 2010, and by 4.7% in 2012. Starting in the first half of this year, GDP growth should ease gradually over the course of the forecast period, since the effect from the earlier rise of export prices will fade while over the forecast period the export prices are assumed to be relatively unchanged from the level of the first months of this year; the assumption for the world oil price is about USD 100 a barrel. For 2013, GDP is projected to increase by just over 4%. By autumn of this year, we should see a return of the GDP to the pre-recession peak level of summer 2008.

Consumption and investment expectations

Private consumption revived grudgingly in 2010 (growth less than 3%); household real income made a better recovery (ca 4%), households continued to accumulate bank account balances while they also increased their borrowing from banks notably. Consumption growth is predicted to pick up and to drive the economy. Among other things, this will help the agriculture in rebounding from a sharp drop in 2010. The rise in the wage level is expected to continue at a brisk pace, albeit not as fast as in several years before the recession. Wages and pensions in the public sector are not likely to rise as fast as in previous years, although higher inflation and approaching elections (Duma in Dec 2011 and President in

Mar 2012) will engender mounting pressure for adjustments above the approved amounts in the 2011-2013 federal budget, particularly as regards the current year. Moreover, the household savings rate is expected to decline – on the heels of a considerable increase during the recession – while borrowing from banks increases, albeit under the constraint of a very high average real interest rate.

On the other hand, the growth of purchasing power is constrained by inflation, which has risen to an annual rate of nearly 10%, especially due to a rise in food prices stemming from the loss in Russian agricultural production last summer and rising food prices in world markets. The rise in the inflation rate has led to monetary tightening. This year could see a slight easing of inflation. Inflationary pressures have been reinforced by a huge increase in companies' wage-related social security contributions at the start of this year, from 24% to 34%, although companies may ease part of that pressure by trying to press for smaller wage increases and raise the share of grey payment of wages. The growth of consumption is further constrained by the sluggishness of the decline in unemployment, as the relatively small rise in unemployment during the recession means that companies now have larger shares of underemployed workers.

Government consumption expenditures did not increase in 2009–2010, but slow growth is expected for the forecast period. This is based on additional government revenue that would flow from a higher price of oil than assumed in the 2011-2013 budget. Additional revenues have already reduced the consolidated government deficit (the combined deficit of federation, regions, local governments and state social security funds was 6.3% GDP in 2009 and 3.6% in 2010) and are furthering the process towards the government leadership's stated goal of balancing government finances by 2015.

Russia's export volume recovered rapidly in 2010 following a recession-induced decline and an exceptional drop-and-disturbance in gas exports at the start of 2009. Exports are expected to increase at a slower rate than world trade as a whole, as growth is not indicated for crude and fuel oil exports (which have accounted for about 45% of revenue from goods and service exports since 2005). Exports of natural gas and other basic commodities are expected to increase and to partly offset the gap.

As expected, investment is recovering from the recession with a lag, and growth in 2010 was moderate (less than 4%) compared to a sizeable decline in 2009. Full-fledged recovery is expected to occur in 2011 and further in 2012, as during the latter part of 2011 usage of production capacity can be foreseen to rise back to the same level as in the pre-recession boom. With bank deposits having recovered already in the early part of 2009 and growing rapidly, the banks have an abundance of liquidity to meet the demand for investment funding. The average real interest rate on corporate loans has receded since last summer following its rise to a lofty level as the rouble depreciated in winter 2008-2009.

As in Russia's previous economic recession and recovery in 1998-2000, inventories have had an exceptionally large effect on GDP changes in 2009-2010, at first dropping dramatically and then increasing sharply. The forecast assumes that the downward-upward inventory cycle is mainly over.

High propensity to import expected to decline gradually

Russian imports picked up considerably faster than forecasted in 2010. The volume of imports increased 25% after a sharp (30%) decline in 2009 and partly offset some domestic production problems experienced in the summer. During the winter months, import growth has levelled off. The growth is expected to slow down in the course of the forecast period, as was envisioned in the end-summer forecast. Despite this, the volume of imports should increase by some 15% in 2011 and 10% pa in 2012-2013. Imports are set to reach the pre-recession peak around the end of this year.

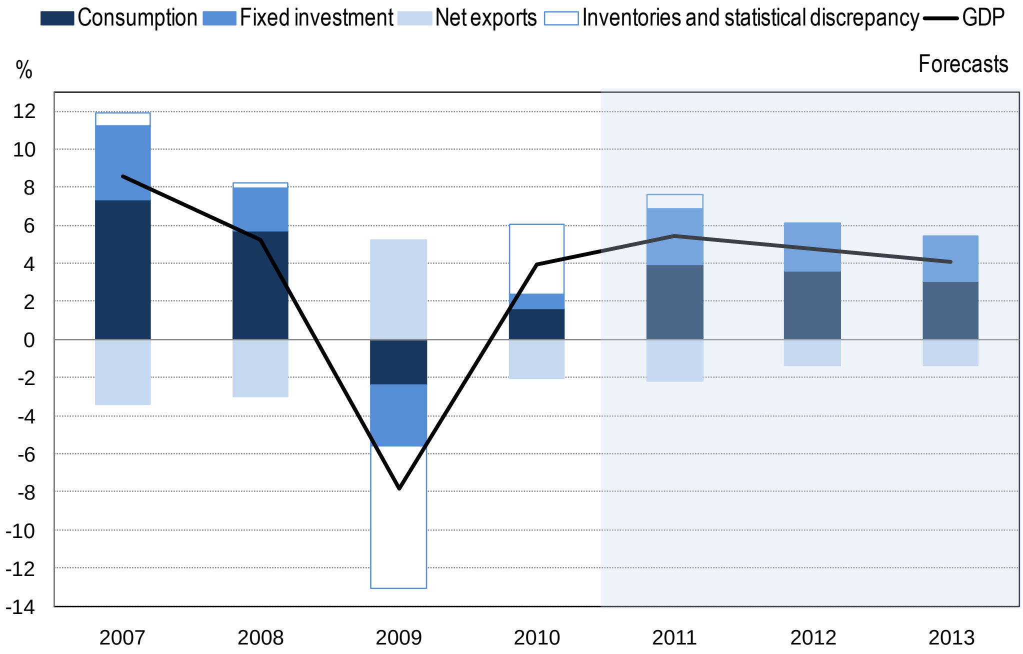
The propensity to import is thus projected to remain high, albeit slightly lower than before the recession, and to decline gradually. The rise in the share of imports in the economy will set limits to the pace of import growth. On the other hand, imports are supported by the rise in the rouble’s real exchange rate; vis-à-vis Russia’s trading partners the real exchange rate has exceeded its pre-devaluation peak reached at the end of 2008. It is expected that the rise in the real exchange rate will continue, as domestic inflation is running ahead of that in trading-partner-countries, and the current account surplus entails upward pressure on the rouble’s nominal exchange rate. The current account should continue to post at least modest surpluses during the forecast period – supported by high oil prices and in spite of rapid import growth – even if import prices should rise notably.

Risks attached mainly to prices

As in the late-summer forecast, the current forecast is based on a prognosis of strong growth of the global economy and world trade. The assumption of a high (albeit flat) oil price as well as high prices of Russia’s other key commodity exports - fuel oils, natural gas and metals - introduces a large amount of forecast uncertainty, as exports account for 30% of GDP. The risk may be weighted more to the upside from Russia’s perspective, as the prices could rise even further due to uncertainties concerning the extent and timing of supply reactions to growing demand. At the same time, the effect of upward export prices on the economy may be delayed, as the government is taxing most of the rise of the oil price especially via an export duty that is progressively linked to the export price (the rise of gas and metals prices is taxed less heavily) and will channel the extra revenue to public expenditure gradually. The uncertainties in the world economy could cause wide gyrations in capital flows between Russia and the rest of the world.

Should Russia’s inflation remain higher than expected, for example via food imports, this would further shrink the growth base for private consumption, which is the primary demand component. Although investment growth is continuously associated with notable uncertainties in demand prospects and companies’ operating environment, it is possible that the recovery of investment from the recession will be more robust than expected. It is also possible that imports will grow faster than expected, e.g. due to the real exchange rate; that would dampen GDP growth more than forecasted.

Russian GDP growth and contributions of demand components, %



Sources: Russian statistical office (Rosstat) and BOFIT forecast 2011–2013