BOFIT Forecast for Russia
26.9.2011

BOFIT Russia Team

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This year, the Russian economy has grown more slowly and imports recovered front-loaded at a more accelerated rate than forecast. GDP growth expectations have been scaled down, in particular for this year. The economy is expected to grow fairly briskly during the forecast period and imports to increase rapidly, although the growth rate of both is expected to slow. GDP growth is predicted to slow from below 4.5% for 2011–2012 to below 4% in 2013, even if the oil price is assumed to decrease only slightly in the forecast period. The demand growth in Russia continues to be directed strongly towards imports, which is expected to increase 20% this year and just below 10% for 2012–2013. For its part, this propensity to import is limiting GDP growth. GDP is expected to rise to the peak seen in the pre-crisis year of 2008 this autumn and imports to reach the respective peak in winter.

Relatively brisk economic growth to slow

The Russian economy's recovery from deep recession has continued over the course of the year, albeit slower than forecast. There was 3.7% year-on-year growth in GDP for the first half of the year (4% in 2010). Private consumption showed relatively brisk growth (ca. 5–6%), however public sector consumption showed almost no signs of increasing. In the early part of 2011, exports remained unchanged at the levels seen a year earlier. There continued to be variable and delayed recovery in investments (3% year-on-year growth). Moreover, following the pattern already seen in 2010, imports continued to recover at a faster-than-forecast rate.

A trebling in the price of oil, from the bottom of the recession in 2009 until spring this year, bringing price levels back to the peak of 2008, has not supported Russia’s economic growth as strongly as earlier since the government, which is taxing most of the rise in oil prices, has not increased budgetary expenditure at nearly the same rate as before the recession. Similarly, unlike in the pre-recession years, the rise in oil prices has not been accompanied by a net inflow of capital but a notable outward flow from last autumn through to the beginning of summer. Domestic output growth is also likely constrained by the sizable increase in companies' wage-related social security contributions at the beginning of this year (their base rate rose in one swoop from 26 per cent to 34 per cent, after being postponed by one year but otherwise precisely as Prime Minister Putin pre-announced on the brink of recession in autumn 2008).

This year, economic growth is estimated to still recover temporarily. GDP is expected to reach peak 2008 levels during the autumn and overall annual GDP growth is anticipated to reach 4.4%. Private consumption is supported by the deceleration in inflation (to 8% after having been at about 9.5% in the first half of the year), which is due to an easing of the previous upward wave in foodstuff prices. Thus inflation is eating less into household purchasing power than in spring, when households' real income fell slightly from a year earlier. The forward-looking consumer confidence indicators improved in the second quarter of the year in Russia. The need for investment increases as production capacity utilisation rates have already risen relatively close to pre-recession levels. For the entire year 2011 growth is supported by the recovery in cultivation production from the slump of last year.

However, economic growth in Russia is forecast to slow down fairly soon even if the price of oil is assumed to fall only slightly during the forecast period, dropping from USD 110 to USD 105 a barrel (Brent crude). GDP growth is expected to be at the 4.4% level in 2012, partially due to the low GDP level experienced this year and the above-mentioned wage-related social security contributions that will come down again at the beginning of the year (to 30 per cent). By 2013 GDP growth is expected to drop to below the 4 per cent level, approaching close-to-trend growth.

Consumption pull expected to continue and investment to pick up

Private consumption will maintain its key position as the engine of economic growth in Russia (over 40% of total demand), and is forecast to continue growing at a brisk rate. Private sector wages are predicted to rise relatively rapidly as unemployment levels gradually decline, even if the rise in wages is not expected to be as generous as before the recession, when the rise in real wages far outstripped the rise in productivity for many years. Inflation will gradually decelerate further, which will support purchasing power. From the end of last year, the central bank has attempted to counteract the accelerated rise of consumer prices of non-food goods and services by gradually tightening its monetary policy (by making more moderate use of foreign exchange purchases which are aimed at keeping the rouble from appreciating, and by raising the banks' reserve deposit requirements and some key interest rates). In addition, the government is borrowing from the domestic market this year independent of whether the budget shows a deficit or surplus, and budget guidelines give that option for the following years as well. Households' savings wave bolstered by the recession has receded and credit granted to households by banks is expected to continue to rise.

On the other hand, consumption growth is limited by public sector wages which are scheduled to be raised only in line with inflation and pensions slightly above that. There is also a lack of expectations in growth of employment due to the increase in excess manpower in companies during the recession and a declining work force.

The very sluggish growth in public consumption witnessed over the past two years will take an upward turn, in light of the most recent policy guidelines of public finances. According to these guidelines, public sector budget expenditure for next year will increase by at least 13% – in real terms about 6% – and for the period 2013–2014 by an average of 8% annually. Public finances are expected to be in balance this year but the government is prepared to make a deficit thereafter although, thanks especially to the rise in the level of budget revenue this year, it expects the deficit for 2012–2014 to remain at 1–2 per cent of GDP, as long as oil prices stay above the USD 100 level. In order to remain within the scheduled deficit levels, certain taxes will be raised part of which is to happen after the Duma elections in December and Presidential elections in March.

Behind the stagnation of aggregate export volume growth this year, and due to the continuing increase in domestic consumption of oil products in Russia, there has been greater-than-forecast drop in crude oil exports (-5% from the first half of 2010) and, against expectations, fuel oil exports are also down (-7%). Although the exports of natural gas and some of Russia’s other core export commodities continue to grow at a rapid rate, overall exports are expected to grow fairly slowly.

Investment revived promisingly during the spring and this recovery is anticipated to be fairly brisk as the economy grows and the need for capacity increases. The banking sector's liquidity remains good and real interest on rouble-denominated corporate loans with over a one-year maturity period has dropped to a couple of per cent (although long-term loans can still be costly).

Imports deemed to have made a front-loaded rebound - growth to slow but still rapid

Russian imports are considered to have recovered in a front-loaded fashion from the depths of the particularly deep recession (26% growth in 2010 and 23% for the first half of this year, year-on-year), with the unravelling of pent up demand for consumer durables showing the greatest rebound. The growth in imports is forecast to slow towards the end of the year while anyway achieving the pre-recession peak during the coming winter. Imports are expected to grow by 18% this year and by 8–9% for 2012–2013.

The increase in economic demand in Russia is forecast to support imports to such a degree that, for the entire forecast period, the economy's propensity to import is almost as strong as in the pre-recession boom years. This growth in imports starts to be limited by the overall share of imports in the economy, which has risen to pre-recession levels. To some extent, imports continue to be supported by the appreciating real exchange rate of the rouble, which has exceeded the previous crest reached in 2008. On the other hand, the difference of inflation rates in Russia and its trading partner countries is envisioned to gradually narrow and upward pressures on the nominal exchange rate of the rouble will decline as the surplus recorded in the current account is forecast to shrink to a relatively small level, mainly as a result of import growth, towards the end of the forecast period.

Variety of risks

The forecast is based on expectations of relatively brisk growth in the global economy and trade. The main risks within the Russia forecast are downward. Related to the world economy, there is a risk of a decline in the prices of oil, Russia's other energy exports and other core export commodities. If the risks were to be realised, the blow to the Russian economy would be similar to the previous recession, while Russia’s public sector finances would now show a deficit instead of surpluses and the state reserve funds are considerably diminished – true, the state has scope to take on loans as it is virtually free of debt in net terms and the gross debt is also small. A weakening in the global economy would also have a certain effect on Russian export volumes. Due to the prevailing situation in the world economy, capital flows between Russia and the rest of the world are affected by a greater-than-normal degree of uncertainty

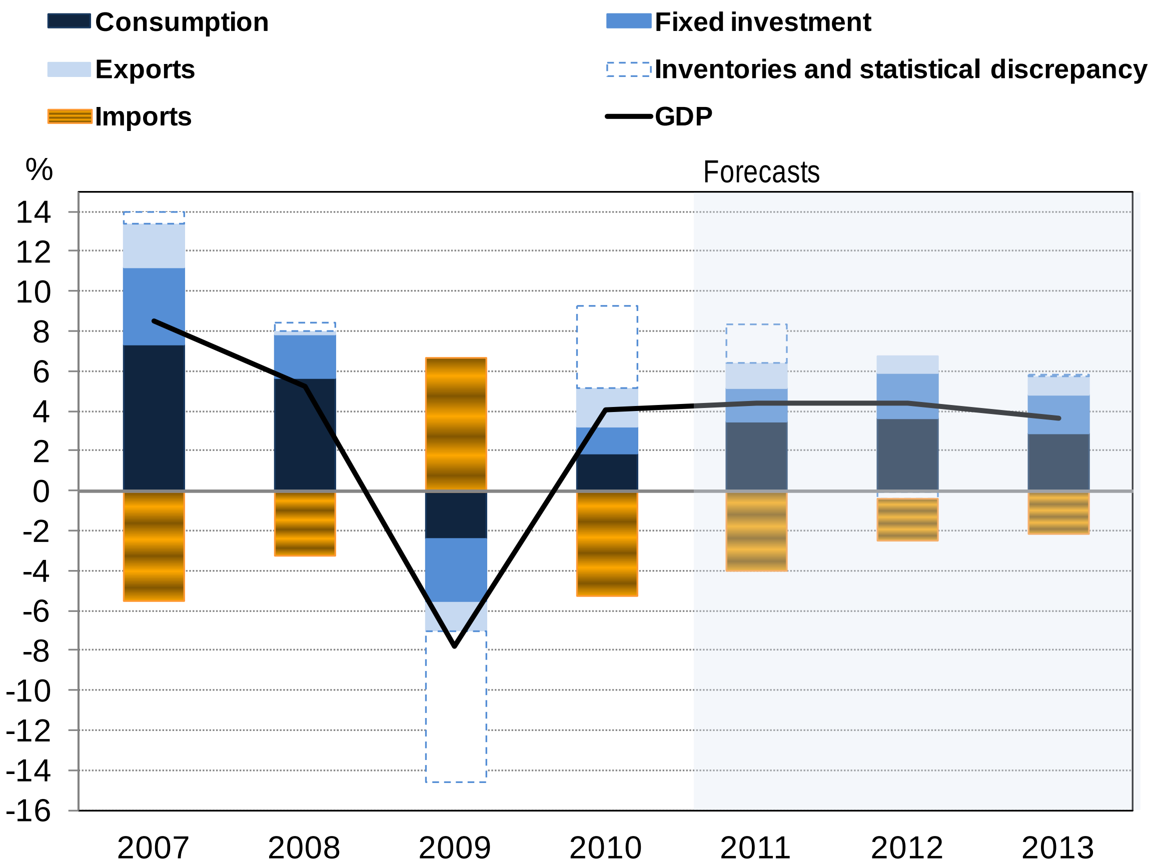
If the prevailing uncertainty in the global economy causes Russian consumers to become more cautious, the anticipated pick-up of the Russian economy this year may remain unfulfilled, even in passing. A new wave of price rises of food worldwide would again face Russia with a period when inflation would eat away consumers' purchasing power more voraciously, as foodstuffs still represent close to 40% of the average Russian's consumer basket. Only a slow growth may be seen in consumer credit if real interest rates, which, even after decreasing from the recession-induced peak are at a higher level than at any time since the end of the 1990s, do not fall sufficiently rapidly. Consumption for the forecast period might be bolstered by larger-than-scheduled hikes to public sector salaries and pensions, which Prime Minister Putin has hinted at in addition to the already promised upward adjustments.

A recovery in investments in Russia could be delayed due to such factors as external uncertainties, possible additional uncertainties in the business environment arising from the period preceding the elections of the Duma and the President as well as such domestic uncertainties not necessarily clearing at a sufficient pace following the elections. State enterprises' role as investor is notable, which however – for example, in the light of this year's experience – has not dispelled uncertainties relating to the implementation of their investment plans.

It is possible that there will be a higher-than-forecast growth of imports, as consumer durables are expected to show a strong growth within the range of imports, growth against which domestic industry is inadequately empowered to compete.

If market economy reforms were to be clearly revived in Russia, they would serve to support economic growth, whereas most notably their effects would likely be felt beyond the forecast period, even if the reforms were to be taken up relatively soon, for example, immediately following the elections.

Russian GDP growth and contributions of demand components and imports, %



Source: Russian statistical office (Rosstat) and BOFIT forecast 2011-2013