

BOFIT Forecast for Russia
13.9.2012

BOFIT Russia Team

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for Russia 2012–2014



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While the Russian economy enjoyed growth of about 4.5 % per annum in the first half of 2012 and witnessed fairly good growth in imports, our forecast sees GDP growth tapering off in the second half of this year and settling at above 3.5 % p.a. this year and in 2013. Growth will be slightly lower in 2014. Our prognosis of slowing growth is based on an assumption that oil prices will not rise. Import growth will also moderate to around 10 % p.a. this year and around 5 % in 2013 and 2014. The rise in private consumption will slow, but it will still remain brisk. The uncertain outlook for oil and gas exports will subdue growth in the volume of Russian exports. Both international and domestic uncertainty will weigh on growth in fixed investment this year, but investment growth will revive next year.

Economic growth slows but is still relatively high

Having clawed its way back to 2008 pre-crisis levels, the Russian economy showed rapid growth in the first half of 2012. GDP climbed 4.5 % p.a. in the first half, although growth was lower in the second quarter (4 %). Growth in private consumption exceeded 7 %, supported by large hikes in public sector wages. In contrast, public consumption continued to experience plodding growth and export growth was quite tepid due largely to a drop in natural gas exports. Strong import growth early this year helped imports rise fairly well in the first half overall, but growth cooled in spring.

Russian export prices turned downwards in spring. Oil, petroleum products, natural gas and metals, which account for over 20 % of Russian GDP, have seen their prices slide on the export markets. However, part of the impact accruing from changes in prices for these Russian main exports is channelled via the state budget, as a large share of revenues from their exports is collected in the form of export tariffs directly to the budget (a third of those export revenues in 2011 and 1H2012). The net outflow of capital from Russia has continued, for almost two years now. Economic growth has been buoyed by the cut in the mandatory social contributions for employers at the start of this year (a reversal of the social contribution hike in January 2011).

GDP growth this year is anticipated to slow to 3.7 % for the year as a whole. Downward effects on growth arise from the increased uncertainty in the global economy and trade, a slight decline of oil prices, as well as a significant reduction in Russia's harvests this year. On the other hand, the estimate for public sector spending has gone up and points to a notable increase in spending.

In 2013 and 2014, growth of the economy will face a downward impact from the oil price that we assume to drop slightly (less than 10 %) in the course of the forecast period. Growth next year, however, should maintain the 2012 pace as it is supported by an expected recovery in the global economy and trade, and a normalisation of Russian agriculture production after the crop failures this year. Growth in 2014 will slow as the oil price declines.

Uncertainties in Russia that concern the delineation of the leadership's policies and action as regards the business climate, especially the conduct of officials, have not diminished much. In the midst of expectation, a concrete event was the realisation of Russia's

long-negotiated WTO membership in August. Initially, WTO accession will provide some boost to imports; over the longer run, Russian domestic production should begin to benefit from increased confidence and greater competition.

Consumption growth slows but remains robust, modest export growth

Private consumption (about half of GDP) will remain the driver of economic growth and import growth. There are signs that rapid growth in consumption is abating. Russian consumers have started to hold slightly more weakly on to the expectations that the situation in their own household is headed in a positive direction, and household savings have started rising gradually, reminiscent of the early part of the 2009 economic downturn.

Consumption growth should slow slightly during the forecast period, although it will still be brisk. Gains in private sector wages are supported by unemployment having receded to 6 %, the same level as at the bottom of the pre-recession economic boom. President Putin has made public sector wage increases a part of his policy lines, while it is also likely that pensioners could hardly be left much behind the general trend to higher wages. The rapid growth in household borrowing is expected to calm even if the level of household indebtedness is still low and high interest rates have so far not deterred borrowing.

Russian inflation is expected to stay at nearly 6 % during the forecast period; thus, slower inflation will not be there to support purchasing power. Near-term inflation will be maintained by the accelerated rise of food prices stemming from crop failures in Russia and elsewhere. Moreover, after lower hikes this year, in 2013 and 2014 official hikes of household energy tariffs are to return close to the pace seen in previous years.

As the rapid growth in public sector spending will most clearly go to increasing public sector wages and social spending that will support private consumption, public consumption is expected to remain roughly as slow as until now. Russia's rather persistently high inflation in public consumption does not seem to abate and largely devours nominal increases in public consumption spending.

Growth of the export volume has fluctuated this year, and low growth is projected for the rest of the forecast period (exports of goods and services correspond to more than 30 % of GDP). Exports of crude oil and petroleum products remain limited by constrained production growth compared to the briskly growing domestic demand for oil and petroleum products. Estimates of growth in Russian gas exports in the next few years have been toned down this year. Russian natural gas exports are challenged by new issues as elsewhere production of shale gas and transport of gas in liquefied form (LNG) are gaining ground.

Corporate fixed investment is still at a level slightly below the pre-crisis peak of 2008, and further recovery in investment is expected to slow this year. Utilization of production capacity this year has remained near the pre-crisis peak, but company estimates of adequate capacity for the next six months have remained unchanged. Uncertainty surrounds other aspects of investment. Real interest rates on corporate borrowing are quite high. Growth of the economy is also restrained by the ending (last winter) of the very powerful wave of post-crisis growth in inventories. In 2013 and 2014, fixed investment growth should return as uncertainties in the global economy and international trade are expected to ease gradually. Rising demand will also start calling for larger additions to capacity. Measures to improve the investment climate are being planned in Russia, while the pace of implementation remains to be seen, and partly for that reason, also to what extent such measures might affect investors during the forecast period.

Imports – from front-loaded rebound to more moderate growth

We forecast substantially lower import growth compared to the very rapid post-recession recovery seen during the past three years (which meant Russia's usual propensity of GDP growth feeding into imports was vastly surpassed). Nevertheless, due to the jump in imports early this year, import growth is expected to score about 10 % in 2012. In 2013 and 2014, import growth should settle to around 5 %. Growth in imports is limited by the share of imports in the economy as it is already the same as in the pre-crisis boom years.

The ruble's real exchange rate is expected to stay fairly unchanged, although it faces uncertainties. The difference in inflation rates between Russia and its main competitors is expected to remain small as in the last two years. Appreciation pressure on the ruble's nominal exchange rate will subside with the shrinking of the current account surplus over the forecast period. On the other hand, a turn to an influx of private capital into Russia would return appreciation pressures that, judging by the central bank's more flexible exchange rate policy during the past couple of years, would not be fought against to any large extent.

Wide demand side risks

Most of the risks in our forecast are downside and relate to uncertainty in the global economy. Aggravation of the problems looming in the global economy could depress oil prices. But global oil supplies also have their uncertainties which contain a possibility of an increase in oil prices that would benefit Russia. A stronger-than-expected slowing of growth in the global economy could depress the volume of Russian exports, which could also be constrained more severely than assumed by uncertainties in Russia's energy production.

Increases in global problems could erode the confidence of Russian consumers more tangibly than so far and delay the anticipated strengthening of fixed investments. If the food prices continued to rise rapidly for an extended period, due e.g. to further crop failures, that would eat more into consumer purchasing power (in Russia, food items account for 37 % in the consumption basket).

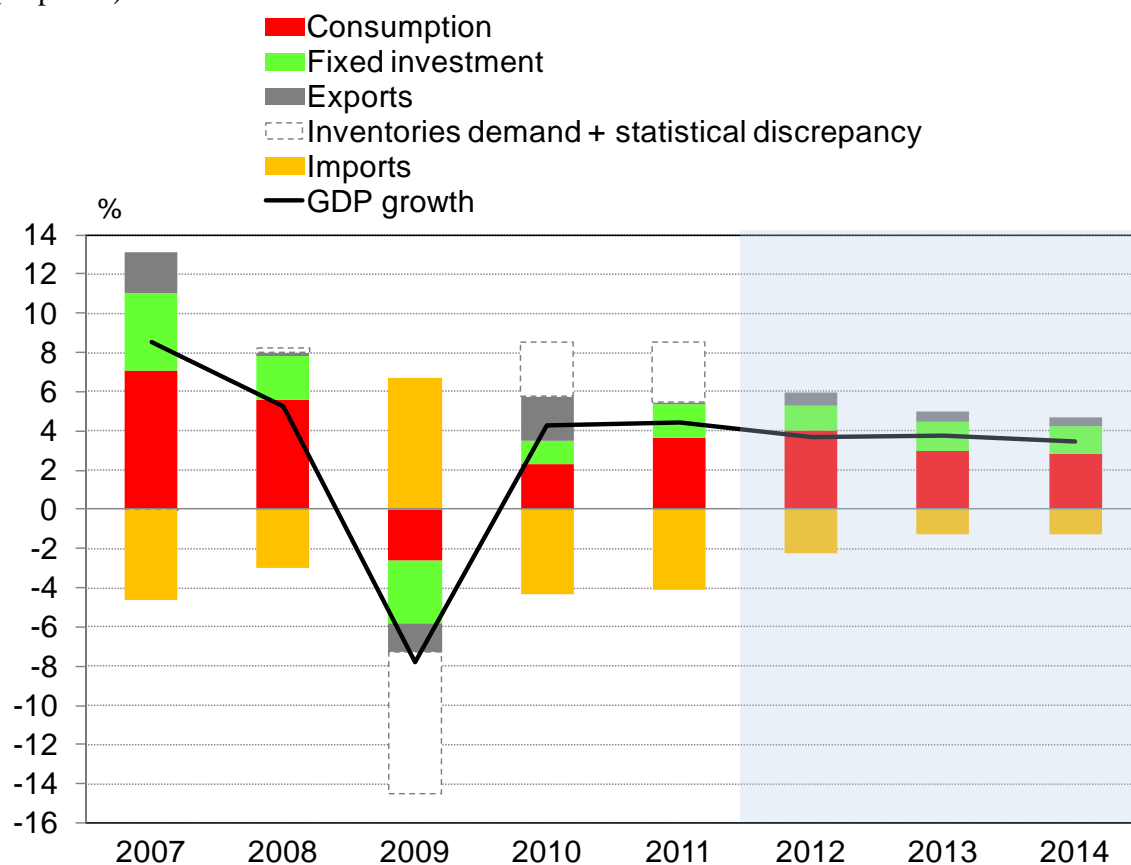
The commitment of Russia's leadership to economic stimulus to stave off any emerging recession by various means can hardly be doubted as the importance of economic, social and political stability is continuously underlined.

Russian GDP and import volume growth, % (includes BOFIT Forecast for Russia 2012-2014)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012e | 2013e | 2014e |
|---------|------|------|------|------|------|-------|-------|-------|
| GDP | 8.5 | 5.2 | -7.8 | 4.3 | 4.3 | 3.7 | 3.7 | 3.4 |
| Imports | 26 | 15 | -30 | 26 | 20 | 10 | 5 | 5 |

Sources: Rosstat, BOFIT Forecast for Russia 2012–2014

Russian GDP growth (%) and the share of demand components and imports in GDP growth (%-points)



Sources: Rosstat, BOFIT Forecast for Russia 2012–2014