EUROJÄRJESTELMÄ
EUROSYSTEMET

Focus/Opinion
Expert view
7/2009 • 4.9.2009

Vladimir Miklashevsky: Russia's struggle with the financial crisis continues

The world economy has been in a steep dive for a year now. However, some signs of stabilisation have recently appeared. The anti-crisis measures adopted by various governments have served to moderate the fall to some extent.

Also the Russian government introduced anti-crisis measures last fall, as the economic situation began to deteriorate. Still, the Russian economy has contracted substantially. While the annual growth rate for industrial output was still 6% in September 2008, the figure for January–July 2009 was –14%. The rate of construction growth was around 10% in September 2008 but fell by nearly one-fifth year-on-year in the first half of 2009. According to some sources, Russia may spend as much as 10–12% of GDP on anti-crisis measures.

The most recent analysis of international consultants PKF (Moscow) indicates that Russia's anti-crisis measures have been the second most ineffective (following Ukraine) of eight countries analysed. In addition to Russia and Ukaraine, the countries analysed were Great Britain, Canada, Kazakhstan, France, Germany and the United States. In the review period, July 2008 to May 2009, the measures of Great Britain and France have been the most effective, with the United States ranking somewhere in the middle. The comparison was based on several macroeconomic variables, such as GDP, investment, output, foreign trade, price developments, unemployment and stock indices. Comparisons between these countries are, however, impaired by the large structural differences in their economies and diverging effects of policy measures.

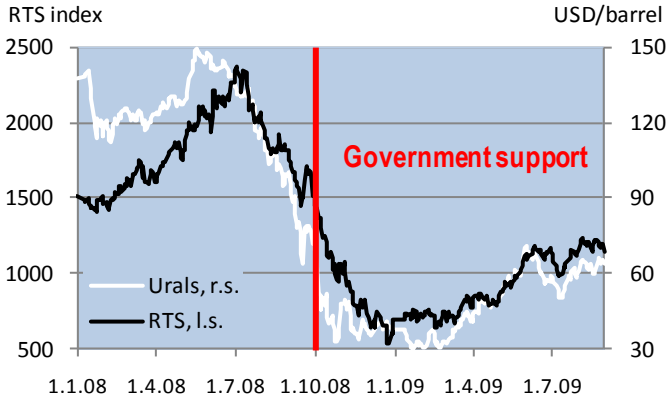
Immediate financial market support in response to the crisis

When the economic crisis hit, the Russian central bank took swift measures to increase its bank financing and ease the terms, while the Russian government proceeded to grant loans to banks from budget sources and make investments to support the stock market. Support to the stock market was channelled through the government-owned VEB Bank, which started to line its portfolio with corporate shares and bonds. To this effect, the government drew 175 billion roubles (ca 4 billion euros) from the national welfare fund to invest in the bank.

In spite of these support measures, share prices plummeted on Russian stock exchanges. In fact, nowhere in the world did government support measures succeed in stabilising stock indices. However, it remains to be studied whether the situation would have been even worse without these measures.

The deepening of the crisis was reflected in Russia's credit ratings. For example, Standard & Poor's lowered the credit rating on Russian debt instruments already last December.

Changes in Russian stock indices and Urals crude



Source: Bloomberg, RTS.

Government bolsters economy via the banks

Last winter Prime Minister Putin announced that troubled banks would not be directly nationalised but that the government would support their capitalisation. Out of the national welfare fund, 450 billion roubles (ca 10 billion euros) was invested in VEB Bank to be lent out as long-term principal loans to the 100+ best Russian commercial banks, on condition that the bank is able to obtain an equivalent principal loan elsewhere. In spring, the loan terms were amended so that VEB will provide three times the amount raised elsewhere. Eligibility was limited to banks that had already been granted a principal loan.

In July 2009, a law was passed entitling the state to issue bonds for the purpose of acquiring bank shares. Banks may use the bonds as collateral for the financing from the central bank.

According to some experts, Russian banks may need financial support in the total amount of 40 billion dollars to ride out the crisis.

Bank support has been crucial for the economy as a whole. Considering that there has been no flight of deposits or bankruptcies to speak of, the support has at least been a partial success.

Problems of monetary policy

Inflation has been a long-standing problem for the Russian economy. Galloping inflation has hindered the use of monetary policy to stimulate the economy, and nominal interest rates have remained high. In order to stimulate financial markets, the Russian central bank has done some cautious cutting of interest rates in the course of the spring and summer, reducing the refinancing rate to 10.75% in August. The real interest rate charged to banks is negative, as the current rate of annual inflation is around 12%.

Rouble depreciation in late 2008 and early 2009 has contributed to the rise in inflation. Between last summer and February this year, the rouble's nominal exchange rate was devalued by more than one-third against the euro-US dollar basket. However, the high rate of inflation has eroded Russia's competitiveness, and so the real exchange rate has strengthened in the past few months. Contrary to the experience of other economies, the economic crisis has not had a dampening effect on inflation in Russia.

Companies also getting support

Since the onset of economic crisis, interest rates have increased and availability of credit has been considerably curtailed, as banks are reluctant to take on additional risk. In spring, President Dmitri Medvedev called on the central bank to supervise the interest rate margins of commercial banks, after which Russia's largest bank, Sberbank, lowered its interest rates. The credit market is, however, practically at a standstill, with only the best companies currently able to obtain bank financing. The real interest rates charged to companies by banks are clearly positive.

In February, Government decided to support major companies by issuing state guarantees on their bank loans. The guarantees are available to some 1,500 vital businesses overall, including the strategic companies serving the defence industry. The guarantee scheme totalling 300 billion roubles (nearly 7 billion euros) was scheduled for launch already in the spring, but the first guarantees were not issued until July. At first, banks were reluctant to resort to the scheme because the methods of debt recollection and guarantee payment were too arduous. In June, Prime Minister Putin approved the rules for the new guarantee mechanism, which got the scheme running.

The scheme has been criticised for involving a high risk that most of the qualified companies leave their loans unpaid. In fact, the scheme threatens to further add to the growth in government expenditure.

Government support is no help for structural problems

According to projections of the Russian Ministry of Finance, this year around 9% of budgetary expenditure will be spent on tackling the financial crisis. The budgeted figure for next year is only just under 1%, but a corresponding fall in crisis management expenses is not expected; rather these expenses are incorporated in the normal spending categories of the budget. Reserve funds set aside for restoring fiscal balance are expected to be depleted next year.

The budget for the current year includes 300 billion roubles for bank support, 370 billion roubles for industrial support, 150 billion roubles for additional regional support, 50 billion roubles for railway support, and 35 billion roubles for provision of veterans' housing. The total amount of support will exceed 900 billion roubles (ca 21 billion euros). It should be kept in mind that many of the support measures will not bring swift results.

The Russian government is now better aware of the depth of the crisis than it was last autumn. According to the Ministry for Economic Development, the crisis will be overcome by high oil prices, credit growth and lower interest rates.

Russia is not, however, in a position to influence oil prices. Despite the crisis, the country should endeavour to reduce its dependence on commodities by diversifying the economy and undertaking public investment to improve infrastructure that is crucial for economic development. Further ingredients could be promotion of healthy competition, attraction of foreign investment and development of areas of innovation.

This has not been encouraged by the crisis. In May, President Medvedev announced that the government would continue to support commodity production, as commodities represent the main revenue item of the budget. By contrast, support to construction, roadworks and non-financial companies will be cut next year.

Vladimir Miklashevsky was employed in BOFIT as a trainee economist in summer 2009.