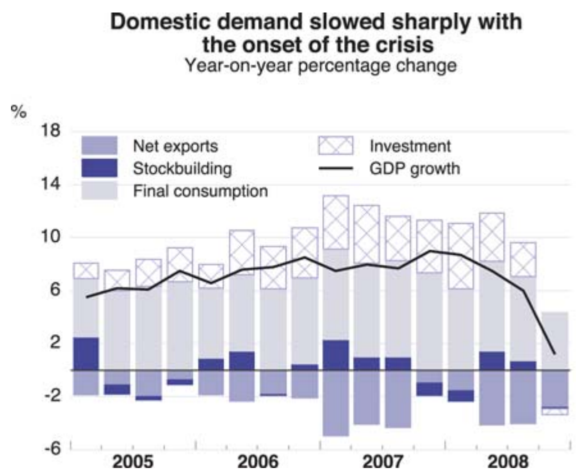
OECD Economic Outlook: Russian Federation

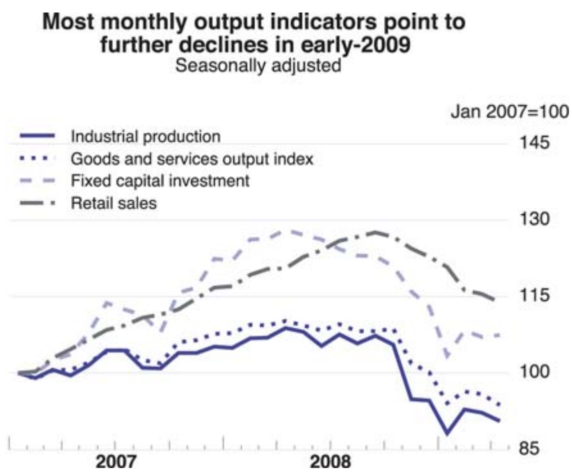
Russia is suffering a severe recession, but the rebound in commodity prices and the expected effects of policy stimulus point to some recovery through 2009 and into 2010. If oil prices remain around recent levels the current account will remain in surplus and net private capital outflows will ease, allowing the exchange rate and foreign exchange reserves to consolidate their recent recovery. Inflation is expected to decline this year and next.

The delay in delivering fiscal stimulus aggravated the initial impact of the economic crisis; the budgeted increases in expenditure should now be implemented quickly, in particular for social protection and active labour market policies. Any windfalls in oil revenues relative to budget assumptions should, however, be saved. More public assistance may be needed for banks as non performing loans rise, but less emphasis should be placed on supporting individual non financial enterprises, and further resort to protectionist measures should be avoided.

The economy has been hard hit by the crisis, but the worst may be past

In the last few months of 2008 Russia experienced a collapse of domestic demand, with private consumption and investment falling after years of strong growth. A massive swing in net capital flows combined with, and partially triggered by, a sharp deterioration in the terms of trade undermined the two main sources of previous growth in demand. Despite a positive contribution from government consumption, seasonally adjusted real GDP growth in the fourth quarter was negative for the first time since 2003. The fall in output accelerated in the first quarter of 2009 according to preliminary GDP estimates, and unemployment has risen sharply. Transitory factors explain some of the extreme weakness in the first quarter of the year, however. Some indicators, including industrial production, exports and investment suggest that overall activity may have bottomed out in January.





Source: OECD calculations based on Russian Federal Service For State Statistics.

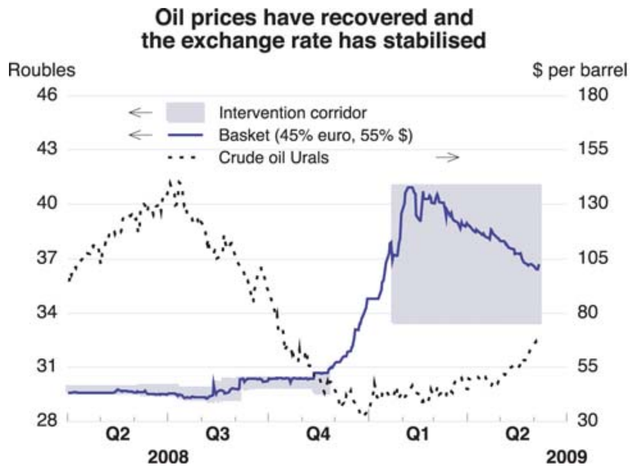
Macroeconomic Indicators

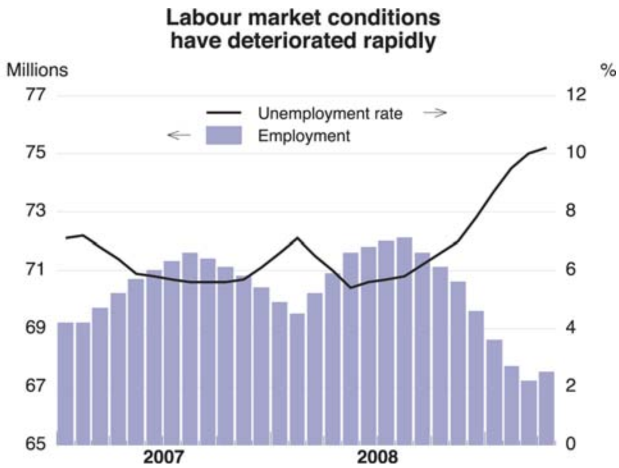
	2006	2007	2008	2009	2010
Real GDP growth	7.7	8.1	5.6	-6.8	3.7
Inflation	9.0	11.9	13.3	8.0	6.5
Fiscal balance (% of GDP)[1]	8.4	6.0	4.8	-6.0	-4.0
Current account balance (% of GDP)	9.5	5.9	6.1	3.3	2.9

Source: Data for 2006-08 are from national souorces. Data from 2009-10 are OECD estimates and projections.

The balance of payments has stabilised

Comparing the half year period April September 2008 to October 2008 March 2009, the loss of current account receipts resulting from the fall in oil prices, combined with the swing from large private capital inflows to even larger outflows, was equivalent to nearly 20% of GDP. As a result, from August 2008 through January 2009 the central bank spent about a third of its huge reserves defending the rouble from an abrupt devaluation, while allowing increasingly frequent small step depreciations against the dollar euro basket, which cumulatively amounted to about 30%. Since late January, the establishment of a new wide target range, together with the recovery in oil prices, succeeded in stemming capital outflows, so that reserves and the exchange rate have both stabilised and even strengthened.





[1] Between late November 2008 and 23 January 2009 the central bank formally widened the corridor in increasingly frequent steps, but de facto there was no binding limit in that period.

Source: Central Bank of Russia, Russian Federal Service for State Statistics and Datastream.

Inflation has begun to moderate

Inflation in early2009 was subject to conflicting forces, with pass through of the depreciation of the rouble and large administrative price increases being offset by the falling money supply, lower producer prices and weak demand conditions. The main administrative price increases for the year have now taken place, however, and the rouble has appreciated against the basket since early February. Monthly inflation eased in April and May, and the annual rate is expected to continue to fall through 2009 and 2010.

The global environment matters, mainly via oil prices

The recent rebound in oil prices changes the near term outlook for the Russian economy significantly. Stronger current account inflows help maintain international reserves and the value of the rouble, which tends to improve sentiment towards rouble assets. Less negative (and perhaps again positive) net private capital flows lessen one major source of weakness in domestic demand, raising the probability of a resumption of growth. International capital market conditions are less important than oil prices, but nevertheless affect domestic demand. To the extent that a recovery in risk appetites allows emerging market private sector debt to be rolled over rather than repaid, Russian enterprises will have more resources for domestic expenditures.

The second phase of anti-crisis measures is underway

At the onset of the crisis the authorities were quick to address the impact on the banking sector, and resisted the downward pressure on the rouble, allowing enterprises and banks to acquire foreign exchange for debt service without suffering major valuation losses. Measures were also taken to lighten the tax burden on corporations, especially oil companies suffering from the dramatic oil price decline. It was not until April 2009 that anti crisis fiscal measures were approved by the Duma, however, and the federal budget was broadly in balance in the first quarter. As deficit spending comes through in the rest of 2009, fiscal policy should be more supportive of demand. Interest rates were raised in late 2008 to help defend the rouble, which contributed to a tightening of monetary conditions. With the rouble strengthening against the dollar euro basket since early February, the central bank reduced interest rates by 50 basis points three times between late April and early June, and more rate cuts should be possible as inflation and capital outflows subside.

As in some other countries, Russia's anti crisis measures rely to a large extent on supporting existing (mostly large) enterprises, rather than boosting demand generally. From a structural policy perspective, this may dampen competition and hinder efficiency–improving adjustment. Also, some measures taken since the onset of the crisis have had a protectionist flavour (e.g. the raising of tariffs on car imports), which is unhelpful in the context of Russia's efforts to join the World Trade Organisation, and which is misguided as an approach to combating the crisis.

The recession will end this year, while inflation will continue to fall

Reflecting extreme weakness in early 2009, growth for the year as a whole will be sharply negative. Output declines may end as early as the second quarter, however, and positive growth is expected to continue through 2010. Inflation is likely to fall to single digits this year and to decline further in 2010. Exports and imports will both begin to grow again during 2009, and the current account will probably remain in surplus, with stable or rising reserves.

Risks are balanced, depending mostly on global factors

Risks have become less skewed to the downside, and are now fairly evenly balanced. Bad bank loans are likely to carry on rising, which may require the injection of further public capital into the banking system to sustain the provision of credit. If the global recession is more severe than expected, oil prices could weaken sharply again, triggering further capital outflows and withdrawals of bank deposits and putting renewed pressure on the rouble. On the other hand, a continuation of recent more favourable trends in commodity prices and international financial conditions would likely result in a stronger pick up in economic growth this year and next.