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RUSSIA

No growth in sight

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The Russia-Ukraine conflict and its economic repercussions represent a considerable additional drag on the Russian economy. Even before the current crisis, structural problems had already contributed to an appreciable slowdown in growth. In the short-term there is little prospect of the economy improving: the weakness in investment already evident for some time has worsened further. At the same time private households are proving far more reluctant to spend than just a few years ago. In 2015 the Russian economy looks likely to shrink for the second time since the 1998 Russian crisis.

First, a look back: Since the crisis in 1998, which culminated in the Russian sovereign default, the Russian economy has enjoyed a protracted phase of very dynamic growth. Over the last 15 years real gross domestic product (GDP) grew by an average 5% a year, even taking into account the massive slump of almost 8% seen in 2009. This vigorous growth is also reflected in the size the Russian economy has now reached: in 2013 nominal GDP stood at just under USD 2,100bn, a tenfold increase since 1999. Driving this development were rising oil prices, growing utilization of both labor and capital, along with a successful macroeconomic stabilization. At the end of 2013 currency reserves amounted to almost USD 470bn, providing comfortable import cover of more than ten months. And government debt also provides scant cause for concern. In relation to GDP, overall public-sector debt stands at a mere 11%.

Slowdown in growth largely due to structural factors

However, in recent years the Russian economy has gradually been losing steam. In 2010 real GDP still notched up an increase of 4.5%. In 2013 the increase was a mere 1.3% – low by emerging market standards. This gradual slowdown is only partly due to cyclical factors. It stems above all from the fact that the Russian growth model, which has served up buoyant growth for many years, has reached its limits. The production factors labor and capital are now well utilized and the oil price, having drifted more or less sideways between mid-2012 and mid-2014, has fallen sharply in recent months.

Essential now would be the implementation of a sweeping economic policy reform agenda in order to raise the medium and long-term growth potential of the Russian economy appreciably again. In our view a sustained improvement in the business climate is of pivotal importance. Urgent action is also needed in investment in human capital, the diversification of the Russian economy away from the oil and gas sector, reform of the pension system and of the fiscal policy framework. In our estimate, the willingness of Russian policymakers to enact radical reforms is currently on the limited side. Without an end to the conflict between Russia and Ukraine it is hard to picture an improvement in the Russian business climate. All told, we are not assuming that substantial parts of the reform agenda sketched out briefly above will be implemented in the near future. Over the medium to long term, this means that economic growth of significantly more than 2 to 2½% a year is highly unlikely.

No growth in sight in the short term

The short-term outlook is overshadowed entirely by the economic repercussions of the Russia-Ukraine conflict. Particularly hard hit are private consumption and investment activity. Since the beginning of the year the ruble has plummeted (despite hefty intervention by the Russian central bank), to date sliding by 30% against the US dollar. The depreciation is stoking already chronically high inflation. In October consumer prices were 8.3% up on a year earlier (January 2014: +6.1%). Rising consumer prices erode real incomes and hence real private consumption. Both are likely to increase by no more than 1.5% in 2014. Nor do we see any improvement in 2015, with increases of only 1% on the cards. By way of comparison: last year both real wages and real private consumption rose by around 5%.

Uncertainty about the political and economic outlook is weighing especially heavily on Russian business investment. This year real gross fixed investment looks set to tumble by around 5%. The economic sanctions imposed on the financial sector in the summer of this year are doubtless also playing a role, hampering access to the European capital market for many Russian banks and companies. In the third quarter of 2014 Russia's overall foreign debt fell by almost USD 53bn compared with the previous quarter. Russian banks saw a particularly marked slide, with foreign liabilities down by almost USD 17bn to USD 192bn. Even if a political solution to the conflict with Ukraine is found in the course of next year, investment activity in 2015 as a whole is likely to drop further. It will doubtless take some time before optimism in the business sector has firmed up sufficiently for companies to start investing again.

All told, the Russian economy is likely to record marginal growth of 0.2% this year. Next year we expect real output to decline by 0.5%. This forecast assumes that the conflict between Russia and Ukraine does not escalate further and, hence, that the economic sanctions on Russia are not tightened further.

These assessments are, as always, subject to the disclaimer provided below.