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Russian Federation: growth peak is already over

Russian economic growth was once more over 6% in 2006 – according to the first official estimate 6.7%. Since the year 2000, the cumulated GDP growth has exceeded 40%. In 2006, GDP growth was again driven by the surging private consumption. The latter expanded by 11% in real terms, its share in GDP is now close to 50%. Investment grew even slightly faster, by 13%, yet its contribution to GDP growth was smaller owing to a lower share (21%) in GDP. The volume of exports is rising slowly, by about 3% in 2006, while that of imports expands at double-digit annual rates. The contribution of real net exports to GDP growth has been negative already since 2003. However, the boom in nominal export revenues continued in 2006 for the third consecutive year. Thanks to the high energy prices (the average price of Urals oil was 21% higher than in 2005) export revenues increased by 25% and exceeded EUR 240 billion in 2006. The sizeable (+30%) expansion of imports notwithstanding, the trade surplus reached EUR 112 billion (more than 15% of GDP); the current account ran a record surplus of almost EUR 77 billion (10% of GDP). Given significant improvements in the terms of trade, Russian domestic absorption has been growing much faster than GDP in the past couple of years – even with rising trade and current account surpluses. Also the government budget is enjoying huge surpluses (close to 8% of GDP in both 2005 and 2006) and the foreign exchange reserves exceeded EUR 240 billion at the end of 2006. In the Stabilization Fund, established in 2004 and fed from a portion of windfall energy export revenues, nearly EUR 70 billion were accumulated. The Fund's assets are being invested mainly in dollar- and euro-denominated government bonds (each 45% of the Fund, the rest in British pounds) and the operations are managed by the Central Bank. The possibility to invest the Fund's assets in equities is under consideration.

The real sector of the economy remains sluggish. The growth of industry, agriculture and transport was again unimpressive in 2006, only the construction sector is benefiting from rising investment, in particular in housing. However, market services (trade, telecommunications, financial intermediation and the real estate) are booming. Domestic consumer and investment demand is increasingly covered by imports. The latter are surging not only because of better quality, but more and more also due to deteriorating price competitiveness of domestic producers. The sizeable rouble appreciation (especially against the euro), in both nominal and even more so real terms, fosters the import substitution even more. Domestic production costs are rising as wages grow much faster than labour productivity; unit labour costs (ULCs) are soaring. According to wiiw estimates, Russian ULCs (euro-adjusted) have been rising by about 25% on average during the past five years: this implies that they more than trebled between the years 2000 and 2005. In 2006, ULC growth has continued as a combined result of rising nominal wages (+24%),

rouble appreciation (+6%) and only modest productivity growth (5%, all figures year on year).

Symptoms of a Russian Dutch disease variety are thus becoming apparent as the bulk of export revenues originates from resource-based industries (revenues from energy exports already account for nearly two thirds of the total; metals exports account for a big part of the rest). The related huge foreign exchange inflows strengthen the appreciation pressure and boost money supply (M2 increased by more than 30% during the year) – even though half of them is being sterilized by the Stabilization Fund. Both the record foreign exchange inflows (with the related money supply expansion) and the strong growth of consumer demand keep inflationary pressures alive. Nevertheless, the average consumer price inflation dropped below 10% in 2006, for the first time since transition had started. wiiw expects consumer price inflation to remain close to 10% next year as well. Growing incomes and employment (and declining unemployment) make Russia attractive to foreign migrant workers who help to mitigate the effects of adverse demographic trends. However, last year's crackdown on the Georgian minority and the recent tightening of registration rules for migrant workers (not to mention the pogroms on Chechens in Northern Russia) is not only extremely disturbing but will have adverse economic effects as well (such as labour shortages in construction and higher prices at food markets in cities).

Reforms have stalled in the past couple of years. Economic policy decisions are being increasingly overshadowed by politics – both apparently related to the looming issue of Putin's successor in 2008. With presidential elections approaching, the domestic political climate is becoming rougher. In this context, the assassinations of prominent journalists and bankers are tragic enough. Yet the above-mentioned conflict with Georgia (which might easily escalate over the secession from Georgia demanded by Abkhazia and South Ossetia and could even spread near to the EU border over a similar demand by Transnistria) has potentially even graver consequences for Russia – as well as for the EU. The latter is concerned mainly with energy supplies, which were interrupted at the beginning of 2007, this time due to the price dispute with Belarus. With growing economic strength, Russian external policies are becoming also more assertive. In particular, the Kremlin is gaining confidence that it can regain a foothold in the former Soviet republics (or at least prevent a more intensive involvement of the EU in this region). The strategy seems to bear some fruit, such as in Ukraine but also elsewhere, as the influence of Russian investments is rapidly increasing.¹ Meanwhile, Gazprom, Rosneft and other large state-owned (or controlled) corporations are going global while consolidating their control over domestic assets and strategic resources. Russian energy and metals giants acquire assets abroad, not least in the former Soviet republics. Simultaneously, the inflows of FDI to

¹ Without much notice in the West, Russian capital already dominates energy and telecommunication sectors on the post-Soviet space – see 'Russian Investment in the CIS', by P. Vahtra and P. Zashnev, INDEUNIS Working Paper (WP3), 2006, available at <http://indeunis.wiwi.ac.at/>.

Russia are rising fast (in 2006 FDI inflows more than doubled in USD terms), thanks to both returning Russian offshore capital and the country's improved credit rating. The repeatedly delayed WTO accession now seems to be imminent after a deal with the USA has been completed. The future of EU–Russian relations after the expiry of the Partnership and Cooperation Agreement is unclear, but energy will doubtlessly play a dominant role.

Broadly speaking, the economic outlook remains positive with both consumption and investments (including FDI) growing rapidly. But taking into account the negative contribution of real net exports to GDP, wiiw expects growth to settle between 5% and 6% in the coming years. With more money and power consolidation at home, Russia's self-confidence will grow further. However, sustainable and broader-based long-term growth will require even more investment as well as the related economic restructuring and substantial improvements in the transparency of legal regulations.

Table RU

Russia: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 ¹⁾	2007	2008
	forecast								
Population, th pers., end of period ²⁾	146304	145649	144964	144168	143474	142754	142000	141500	141000
Gross domestic product, RUB bn, nom.	7305.6	8943.6	10830.5	13243.2	17048.1	21614.7	26621.3	31000	35000
annual change in % (real)	10.0	5.1	4.7	7.3	7.2	6.4	6.7	5.4	5
GDP/capita (EUR at exchange rate)	1915	2345	2514	2641	3310	4288	5486	.	.
GDP/capita (EUR at PPP - wiiw)	5970	6440	6940	7510	8280	9040	9890	.	.
Gross industrial production ³⁾									
annual change in % (real)	11.9	2.9	3.1	8.9	8.3	4.0	3.9	4	3.5
Gross agricultural production									
annual change in % (real)	7.7	7.5	1.5	1.4	3.1	2.0	2.8	.	.
Construction output total									
annual change in % (real)	17.0	9.9	2.7	14.4	10.1	10.5	14.5	.	.
Consumption of households, RUB bn, nom.	3295.2	4318.1	5408.4	6540.1	8405.6	10625.8	12880.0	.	.
annual change in % (real)	7.3	9.5	8.5	7.5	12.1	12.7	10.7	11	10
Gross fixed capital form., RUB bn, nom.	1232.0	1689.3	1938.8	2432.3	3130.5	3848.4	4795.4	.	.
annual change in % (real)	18.1	10.2	2.8	12.8	12.6	8.3	13.7	10.5	8
LFS - employed persons, th, avg.	65070	65123	66659	66432	67275	68169	68872	.	.
annual change in %	3.4	0.1	2.4	-0.3	1.3	1.3	1.0	.	.
Reg. employment in industry, th pers., avg. ⁴⁾	14543	14692	14534	14345	14301	14593	.	.	.
annual change in % ⁴⁾	1.7	1.0	-1.1	-1.3	-0.3	-0.9	.	.	.
LFS - unemployed, th pers., average	7699.5	6423.7	5698.3	5959.2	5674.8	5262.8	5336.0	.	.
LFS - unemployment rate in %, average	10.6	9.0	7.9	8.2	7.8	7.2	7.2	7	6.5
Reg. unemployment rate in %, end of period	1.4	1.6	2.1	2.3	2.6	2.5	2.3	.	.
Average gross monthly wages, RUB	2223.4	3240.4	4360.3	5498.5	6739.5	8550.2	10736.0	.	.
annual change in % (real, gross)	20.9	19.9	16.2	10.9	10.7	10.2	13.5	.	.
Consumer prices, % p.a.	20.8	21.6	16.0	13.6	11.0	12.5	9.8	8	7
Producer prices in industry, % p.a.	46.6	19.1	11.8	15.6	24.0	20.7	12.4	11	9
General governm.budget, nat.def., % GDP									
Revenues	28.7	30.0	32.5	31.3	31.9	39.7	39.4 ^{HX}	.	.
Expenditures	26.8	27.1	31.6	29.9	27.4	31.6	28.3 ^{HX}	.	.
Deficit (-) / surplus (+), % GDP	1.9	3.0	0.9	1.3	4.5	8.1	11.1 ^{HX}	.	.
Public debt, nat.def., in % of GDP ⁵⁾	57.1	44.1	37.0	28.6	21.7	14.9	.	.	.
Refinancing rate of NB % p.a., end of per.	25	25	21	16	13	12	11	.	.
Current account, EUR mn ⁶⁾	50618	37885	30788	31330	47457	66971	76685	60000	55000
Current account in % of GDP	18.0	11.1	8.4	8.2	10.0	10.9	9.8	6.5	5.2
Gross reserves of NB, excl. gold, EUR mn	26139	37026	42290	58531	88663	148094	244190	.	.
Gross external debt, EUR mn	172903	169530	147067	148776	157423	217647	211696 ^{IX}	.	.
Gross external debt in % of GDP	61.6	49.5	40.3	39.0	33.1	35.5	.	.	.
FDI inflow, EUR mn ⁶⁾	2933	3069	3660	7041	12422	11910	23000	.	.
FDI outflow, EUR mn ⁶⁾	3433	2828	3736	8606	11085	9890	14000	.	.
Exports of goods, BOP, EUR mn ⁶⁾	113510	113744	113468	120265	147357	195709	242487	252000	260000
annual growth rate in %	60.1	0.2	-0.2	6.0	22.5	32.8	23.9	4	3
Imports of goods, BOP, EUR mn ⁶⁾	48483	60022	64470	67304	78327	100682	130508	150000	170000
annual growth rate in %	30.7	23.8	7.4	4.4	16.4	28.5	29.6	15	13
Exports of services, BOP, EUR mn ⁶⁾	10337	12773	14393	14359	16373	19818	24144	26000	.
annual growth rate in %	21.5	23.6	12.7	-0.2	14.0	21.0	21.8	8	.
Imports of services, BOP, EUR mn ⁶⁾	17540	22967	24848	23997	27131	31670	36818	42000	.
annual growth rate in %	40.0	30.9	8.2	-3.4	13.1	16.7	16.3	14	.
Average exchange rate RUB/USD	28.13	29.17	31.35	30.69	28.81	28.30	27.34	27	26.5
Average exchange rate RUB/EUR (ECU)	26.03	26.13	29.65	34.69	35.81	35.22	34.08	33.7	33.1
Purchasing power parity RUB/USD, wiiw	7.17	8.15	9.27	10.35	12.09	13.98	15.66	.	.
Purchasing power parity RUB/EUR, wiiw	8.34	9.52	10.74	12.20	14.31	16.70	18.90	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) Resident population. - 3) From 2001 according to NACE. - 4) From 2005 according to NACE. - 4) wiiw estimate. - 5) Converted from USD to EUR at the official cross exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.