

# ***RUSSIAN ECONOMIC REPORT #18***

*Refocusing policy on households*



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IN THE RUSSIAN FEDERATION

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*UK Embassy*

*Thursday, April 2, 2009*

*Association of European Businesses*

*Moscow, Russia*



- I. Worst global crisis since WWII
- II. Recent developments in Russia
- III. Fiscal policy response

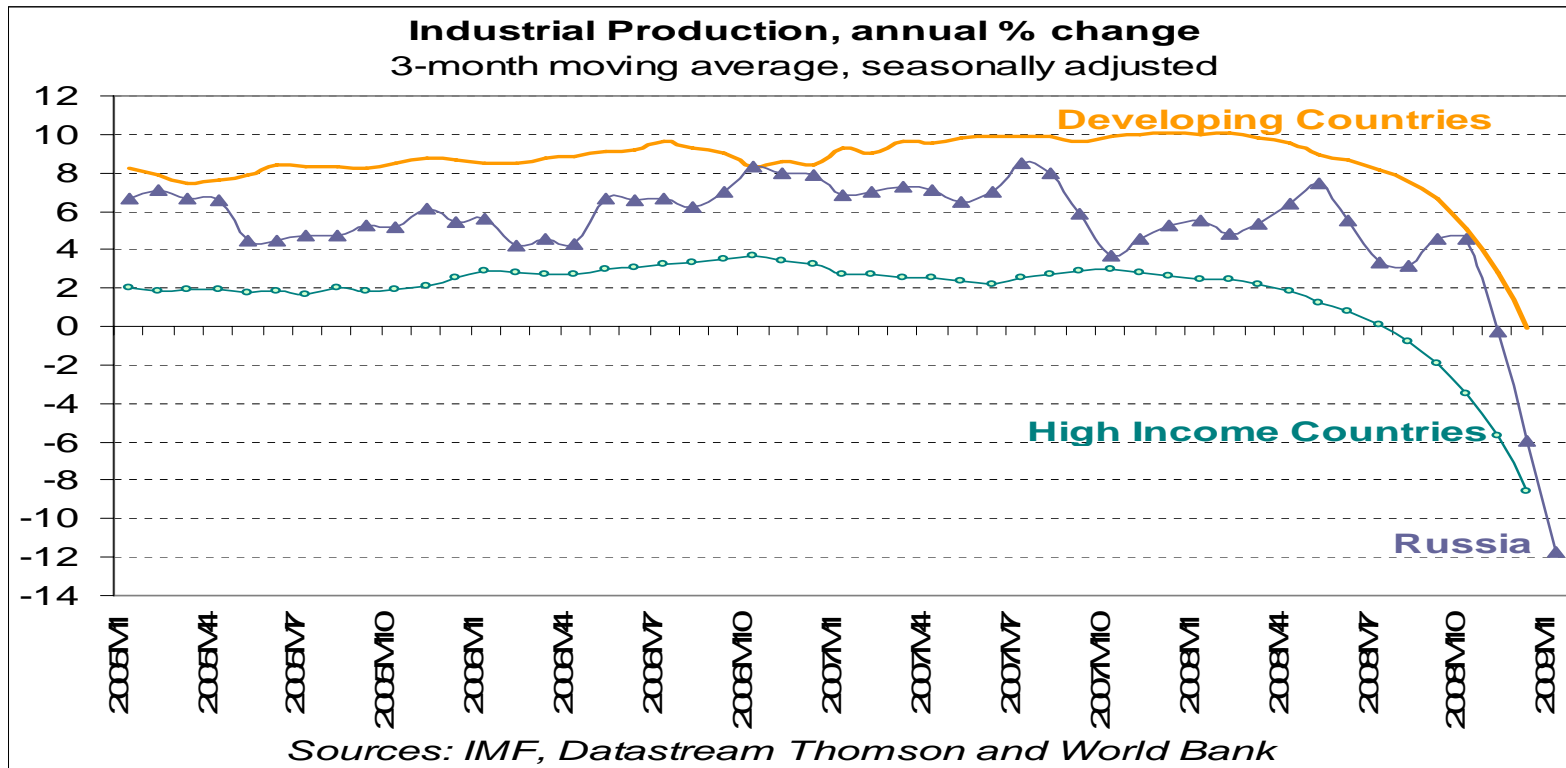


# I. The worst global crisis since WWII

- Global demand, output, trade, industrial production (especially manufacturing), capital flows collapsing around the world since November 2008
- Highly synchronized, global crisis
- Trends continue in early 2009



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# Global Economic Outlook for 2009-10: Grim

- Real GDP growth
  - -1.7% (2009)
  - +2.3% (2010) (recovery possible but uncertain)
  - High-income countries about -2.9% (2009) and developing countries +2.2% (2009), major downward revisions from previous forecasts
- World trade
  - -6.1% (2009)
  - +3.9% (2010)
- Oil prices
  - USD 47.8 (2009) [ Urals: \$45 ]
  - USD 52.7 (2010) [ Urals: \$45 -\$48]

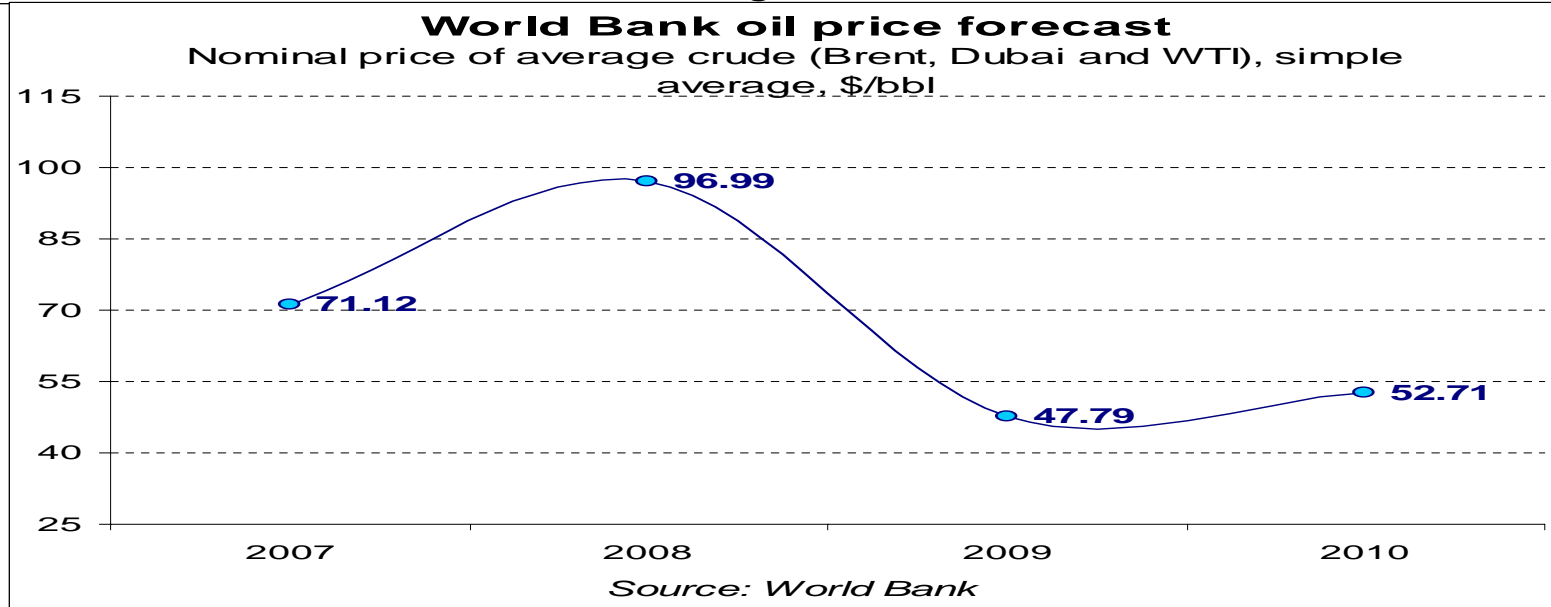
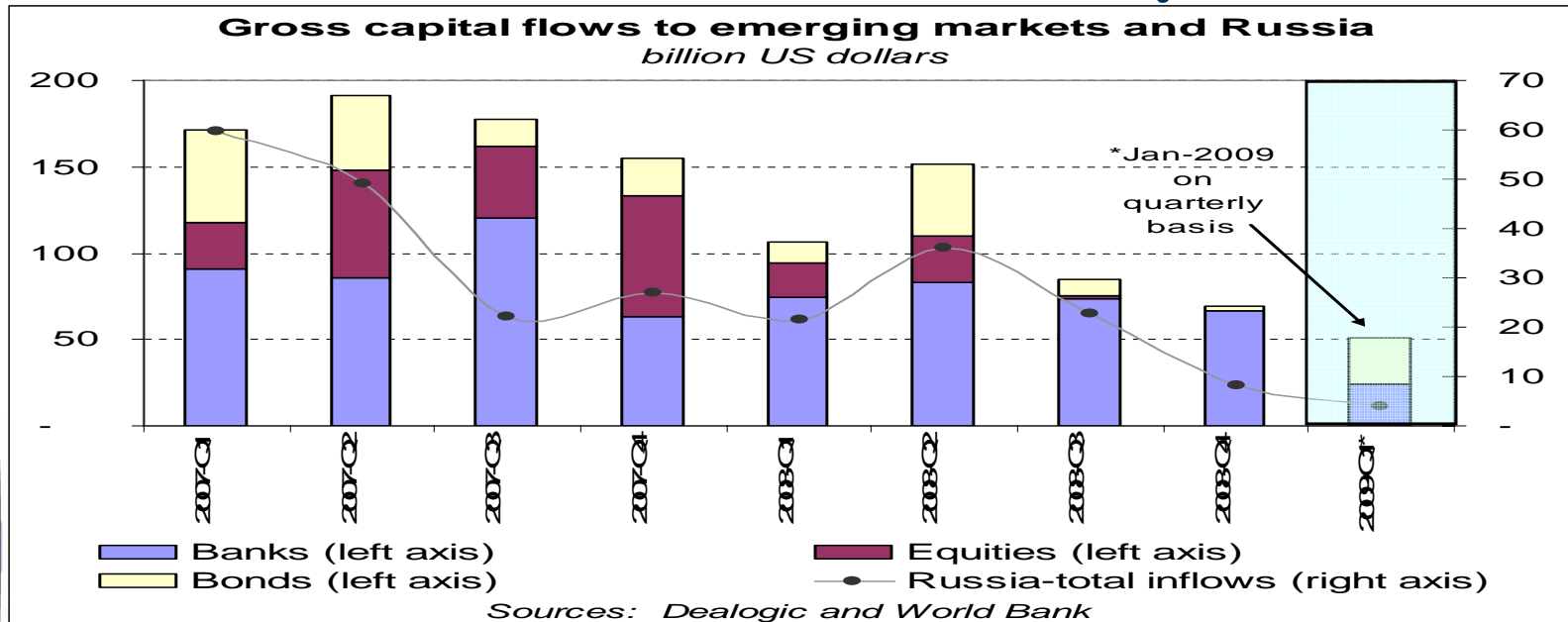


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# Capital flows to developing countries drying out, oil prices likely to remain low



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## II. Recent Developments: Russian economy is hard hit

**Table 1.1: Main macroeconomic indicators, 2003-08**

	2006	2007	2008	IV Q 2008	Jan-09	Feb-09
GDP growth, %	7,7	8,1	5,6	1.1***	-8.8*	-7.3*
Industrial production growth, y-o-y, %	6,3	6,3	2,1	-6,1	-16,0	-13,2
Fixed capital investment growth, %, y-o-y	16,7	21,1	9,8	-2,3	-15,5	-14,1
Federal government balance, % GDP	7,4	5,5	4,0	4,0	15,0	2,6
Inflation (CPI), % change, e-o-p	9,0	11,9	13,3	13,3	2.4**	4.1**
Current account, billion USD	95,6	76,6	98,9	8,1	n/a	n/a
Unemployment, %	7,2	6,1	6,3	7,1	8,1	8,5
Memo: Oil prices, Urals (USD/barrel)	61,2	69,5	95,1	54,9	44,2	43,1
Reserves (including gold) billion USD, e-o-p	303,7	478,8	427,1	427,1	386,9	384,1

Source: Rosstat, CBR, Ministry of Finance, Bloomberg

\* Preliminary estimate by ministry of economy

\*\* Cumulative from end 2008

\*\*\* Preliminary estimates by the WB staff



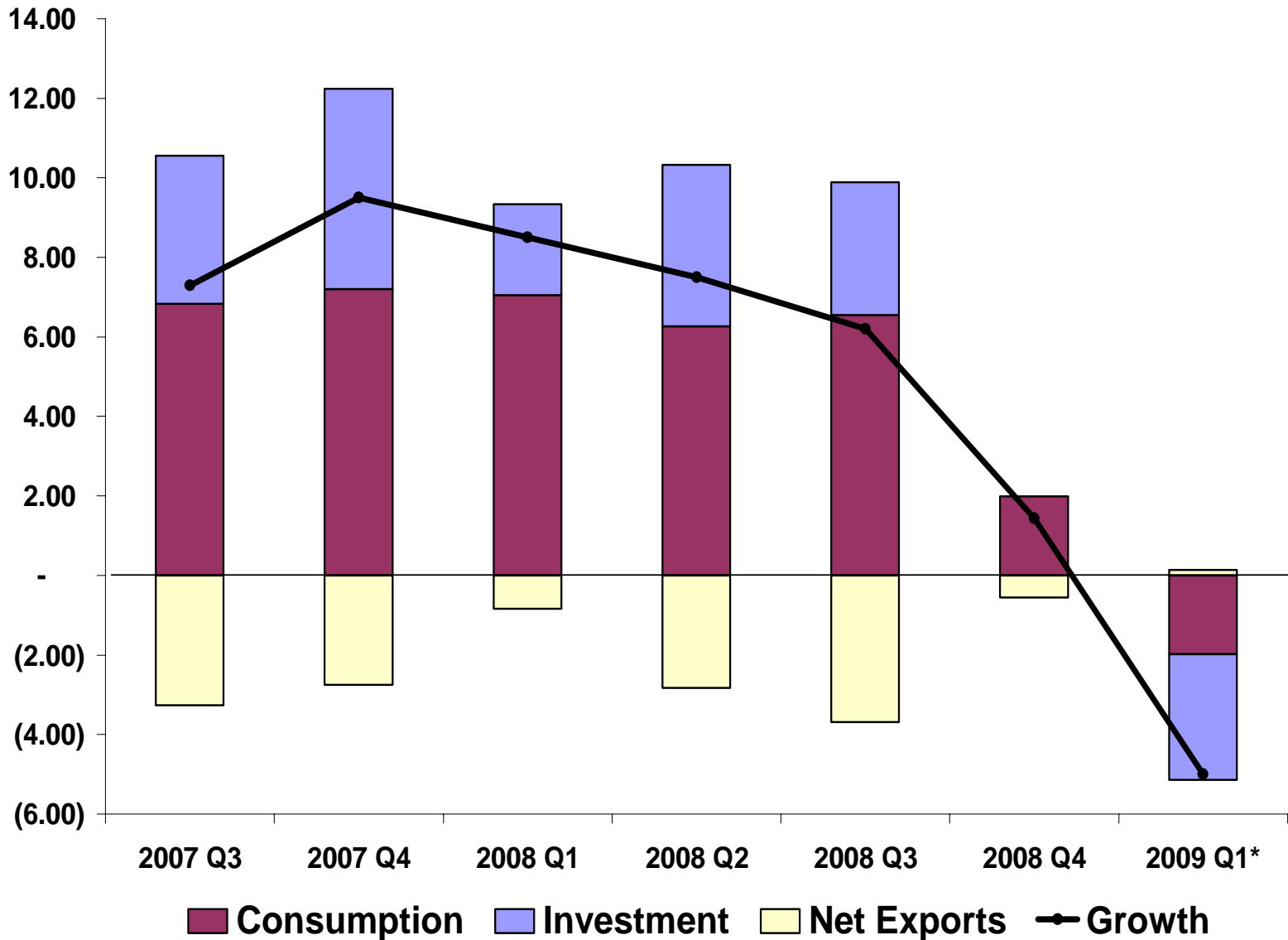
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# Why was the impact on Russia so strong?

- Dependence of the economy on
  - Oil prices
  - Capital inflows
  - External borrowing by banks and enterprises
- Small size of the small and medium size enterprise sector
- Narrow economic structure
- Low competitiveness
- Unexpectedly strong drop in world demand



## Demand sources of Russia's growth (in percent)



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# Across-the-board, general slowdown, then deep recession in 2009

- Both tradable and non-tradable sectors accelerated their slowdown in Q4 with industry and manufacturing registering sharp decline in final months of 2008
- Dramatic deterioration in early 2009.
  - Construction: -18.8% in January-February '09
  - Transport: -18.2% in January-February '09
  - Retail trade: +3.1 percent in January, but -2.4% in February 2009
  - Manufacturing: -24.1 percent in January 2009, -18.3 percent in February. The most significant decline was registered in production of electro-technical and optical equipment (-46.6%), other non-metal products (-33.3%), and transport and transportation equipment (-31%).



# Labor markets—adjusting rapidly

**Table 1.3. Labor productivity, Disposable Income, Wages, and Unemployment**

	2006	2007	2008	Q4 2008	09-Jan	09-Feb
GDP growth, %, y-o-y	7.7	8.1	5.6	1.1**	-8.8*	-7.3*
Total employment, million people	68.8	70.5	71	70.6	69.6	69.2
Employment growth, %, y-o-y	0.8	2.4	0.6	-0.3	-0.4	-0.4
Labor productivity growth, %, y-o-y	6.8	5.6	5	1.4	n/a	n/a
Real disposable income growth, %, y-o-y	13.5	12.1	2.7	-5.8	-10.2	-4.7
Real wage growth, %, y-o-y	13.3	17.2	10.3	5	1.9	0.1
Average monthly wage, USD	392	532	694	668	544	524
Unemployment (% , ILO definition, e-o-p)	7.2	6.1	6.3	7.1	8.1	8.5

*Source: Rosstat.*

\* - preliminary estimate of the Ministry of Economy

\*\* - preliminary estimate by the WB staff



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# Balance of payments—weakening due to terms of trade shock and capital outflows

**Table 1.4 Balance of payments (USD billions)**

	2006	2007	2008 <sup>a</sup>
Current Account Balance	94.5	76.2	98.3
<i>Trade Balance</i>	<i>139.2</i>	<i>130.9</i>	<i>176.6</i>
Capital and Financial Account	11.9	85.9	-128.4
Errors and Omissions	1.1	-13.2	-15.8
Change in Reserves (+ = increase)	107.5	148.9	-45.3

Source: CBR.

a. Preliminary estimates.

**Table 1.5. Net capital flows (USD billions), 2006-08**

	2006	2007	2008	4Q 2008 <sup>a</sup>
Total net capital inflows to the private sector	41.9	81.2	-129.9	-130.5
Net capital inflows to the banking sector	27.5	45.9	-57.5	-56.2
Net capital inflows to the non-banking sector	14.4	35.4	-72.5	-74.3

Source: CBR.

a. Preliminary estimates.



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# Monetary-Exchange and Fiscal policy—aiming to limit the impact of the crisis

**Table 1.6. Consolidated budget of the Russian Federation**

General Government (consolidated budget)	% of GDP					Percentage point change in GDP over previous year	
	2005	2006	2007	2008	2009	2008	2009
Revenues	39.7	39.7	40.2	38.5	24	-1.7	-14.5
Expenditure	31.5	31.3	34.1	33.7	32	-0.4	-1.7
Balance (surplus/deficit)	8.1	8.4	6.1	4.8	-8	-1.3	-12.8
Non-oil balance	-2.1	-2.6	-2.7	-5.8			
Primary non-oil balance	-1	-1.8	-2.2	-5.3			
Financing	-	-	-	-	8		
Drawdown from reserve fund					7		
Domestic borrowing					1		
<i>Memorandum item</i>							
Stabilization funds /1	5.6	8.7	11.7	-			
Reserve fund /1	-	-	-	9.7			
National welfare fund 1/	-	-	-	6.2			

Source: Ministry of Finance; preliminary; World Bank estimates.

1/ End-of-period stock.



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# Outlook for Russia, 2009-10

**Table 1.7. Outlook for 2009-2010**

	<b>2009</b>	<b>2010</b>
World growth, %	-1.7	2.3
Oil prices, Urals, USD/brrl	45	45
GDP growth, %	-4.5	0.0
Federal government balance, %	-7.4	-6.0
Current account, USD bln.	31	16
Net capital outflows, USD bln.	170	90

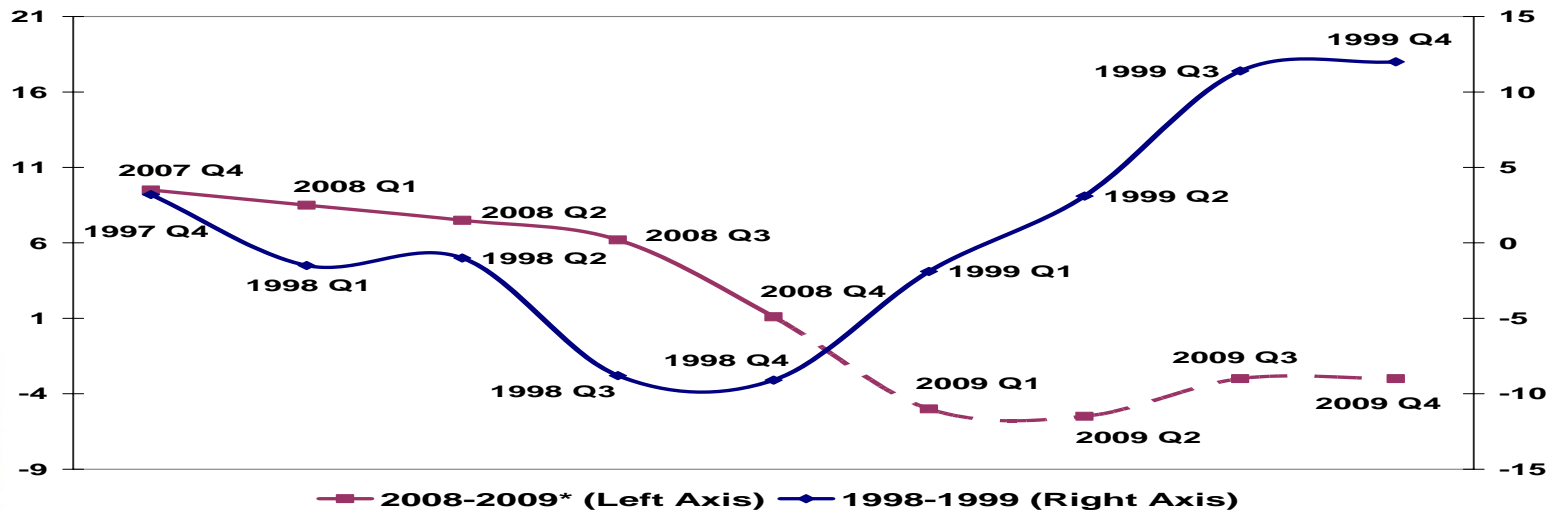
*Source:* World Bank projections.



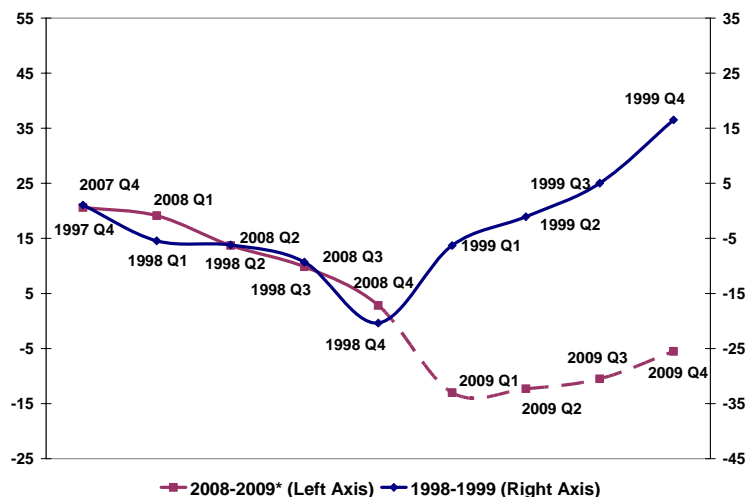
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# Fraternal twins: Russia's two crises 1997-98 and 2008-09

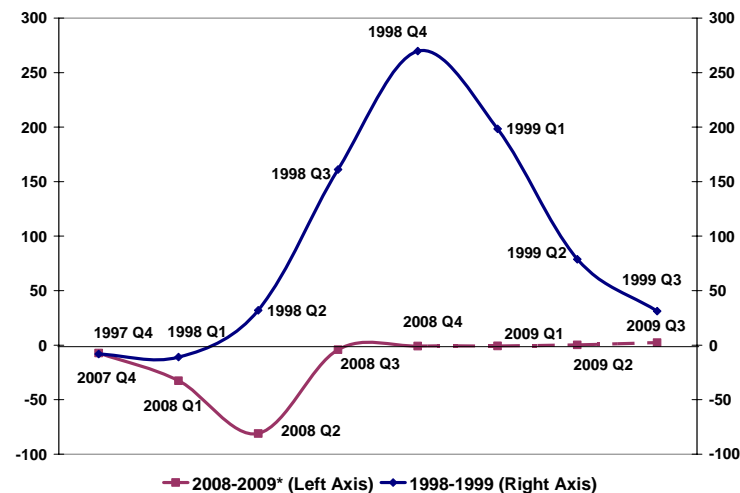
Box figure 1. Quarterly growth rate (year-on-year) in percentage, 1997-99 vs 2007-09



Box figure 2. Quarterly growth of investment in percentage, 1997-99 vs 2007-09



Box figure 3. Quarterly growth of net exports in percentage, 1997-99 vs 2007-09



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### III. FISCAL POLICY RESPONSE—initially supporting banks and enterprises

Table 2.1. Summary of fiscal anti-crisis measures—introduced in 2008 and announced for 2009

	Billions of rubles			Total as a share of GDP	Distribution of each policy measure as percentage of total		
	2008	2009	Total		2008	2009	Total
Strengthening the financial sector	785	625	1410	3.28%	72.08%	34.06%	48.23%
Supporting the real economy	304	798.3	1102.3	2.50%	27.92%	43.51%	37.70%
Protecting the vulnerable	-	111.5	111.5	0.25%	0.00%	6.08%	3.81%
Transfers to regions	-	300	300	0.67%	0.00%	16.35%	10.26%
Total	1089	1834.77	2923.77	6.69%	100.00%	100.00%	100.00%
<b>% of GDP</b>	<b>2.62%</b>	<b>4.07%</b>	<b>6.69%</b>				

Source: World Bank staff estimates, Government of Russia

Note: Excludes quasi-fiscal and monetary measures, state guarantees in the amount of 300 billion rubles planned for 2009, measures that were planned before the crisis, such as increase in the minimum wage and indexation of pensions, as well as external crisis related lending to CIS countries and Mongolia.



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# Fiscal support to the financial system

## Fiscal measures aimed at the financial system—introduced in 2008 and announced for 2009

	Billions of rubles			Total as a share of GDP	Distribution of each policy measure as percentage of total		
	2008	2009	Total		2008	2009	Total
<b>Recapitalization and other direct support</b>	335	70	405	0.96%	42.68%	11.20%	28.72%
Recapitalization of Deposit Insurance Agency	200	0	200	0.48%	25.48%	0.00%	14.18%
Recapitalization of AHML <sup>1</sup>	60	0	60	0.14%	7.64%	0.00%	4.26%
Recapitalization of banks	75	45	120	0.28%	9.55%	7.20%	8.51%
Recapitalization of Rosagrolizing	0	25	25	0.06%	0.00%	4.00%	1.77%
<b>Subordinated loans<sup>2</sup></b>	450	555	1,005	2.31%	57.32%	88.80%	71.28%
<b>Total</b>	785	625	1,410	3.28%	100.00%	100.00%	100.00%



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# Supporting the real economy—using direct support and easing the tax burden

**Table 2.3. Summary of “fiscal stimulus” measures aimed at supporting the real economy—introduced in 2008 and announced for 2009**

	Amount in RUR (billions)			Total as a share of GDP	Distribution of each policy measure as percentage from total		
	2008	2009	Total		2008	2009	Total
<b>Fiscal stimulus aimed at firms</b>	<b>272</b>	<b>763.27</b>	<b>1,035.27</b>	<b>2.35%</b>	<b>89.47%</b>	<b>63.09%</b>	<b>68.39%</b>
Sector specific support <sup>1</sup>	52	276.67	328.67	0.74%	17.11%	22.87%	21.71%
Small and medium enterprises <sup>2</sup>		6.2	6.2	0.01%		0.51%	0.41%
Export industries		6	6	0.01%		0.50%	0.40%
Decrease in tax burden <sup>3</sup>	220	474.4	694.4	1.58%	72.37%	39.21%	45.87%
<b>Fiscal stimulus aimed at households</b>	<b>32</b>	<b>146.5</b>	<b>178.5</b>	<b>0.40%</b>	<b>10.53%</b>	<b>12.11%</b>	<b>11.79%</b>
Purchase of housing units for military and vulnerable groups	32	35	67	0.15%	10.53%	2.89%	4.43%
Labor market policies (including an increase in unemployment benefits)		111.5	111.5	0.25%		9.22%	7.37%
<b>Fiscal stimulus aimed at regions</b>		<b>300</b>	<b>300</b>	<b>0.67%</b>		<b>24.80%</b>	<b>19.82%</b>
<b>Total</b>		<b>1,209.7</b>					
	<b>304</b>	<b>7</b>	<b>1,513.77</b>	<b>3.42%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>
<b>Total (as a share of GDP)</b>	<b>0.73%</b>	<b>2.68%</b>	<b>3.42%</b>				

*Note:* Excludes quasi-fiscal and monetary measures. In addition to fiscal measures to support firms that amount to more than 900 billion rubles in 2009, the government is planning to issue state guarantees of 300 billion rubles (not reflected in the budget).



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# Some features of fiscal support to enterprises

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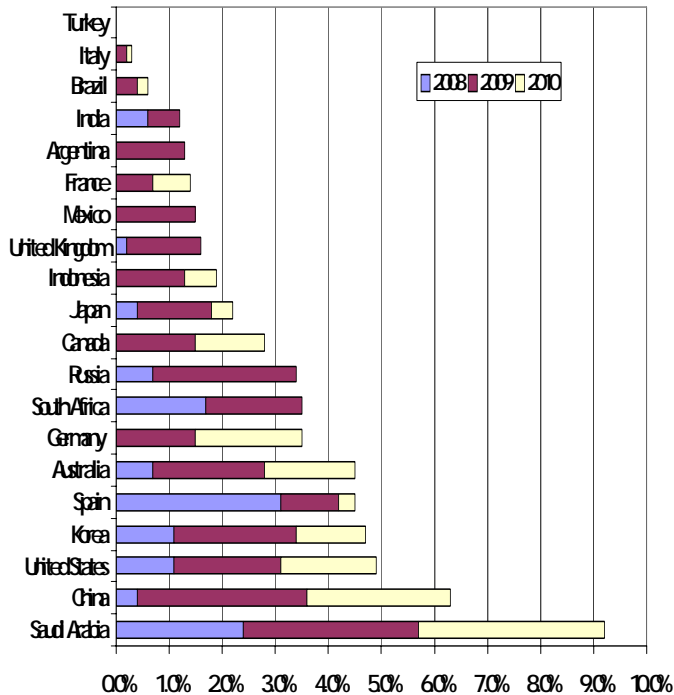
- Large emphasis on tax reduction
- Limited infrastructure spending
- Limited support to SMEs
- Limited interventions in the labor market
- Potential support to “strategic enterprises



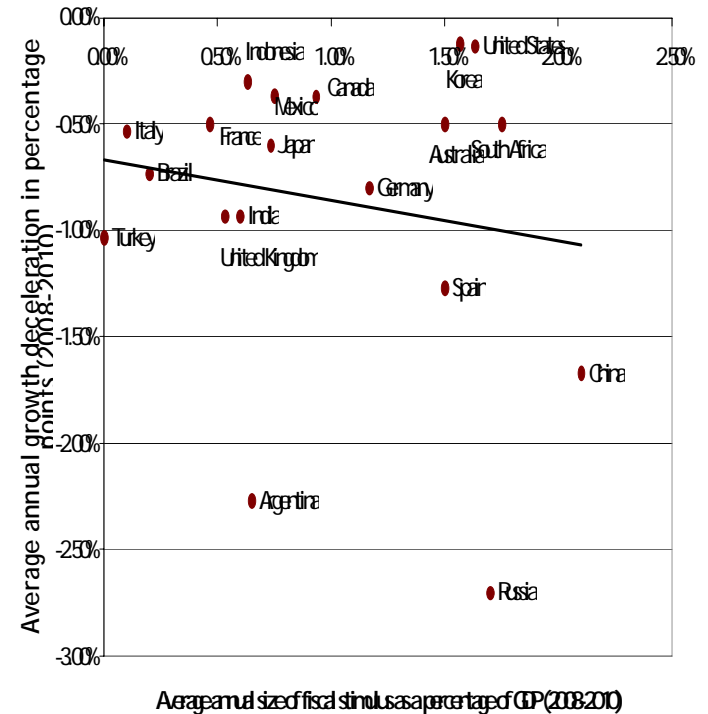
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# How does Russia's fiscal stimulus compare with G-20 countries?

Box Figure 1. Estimated size of fiscal stimulus measures in G-20 countries



Box Figure 2. Estimated size of fiscal stimulus and growth deceleration in G-20 countries



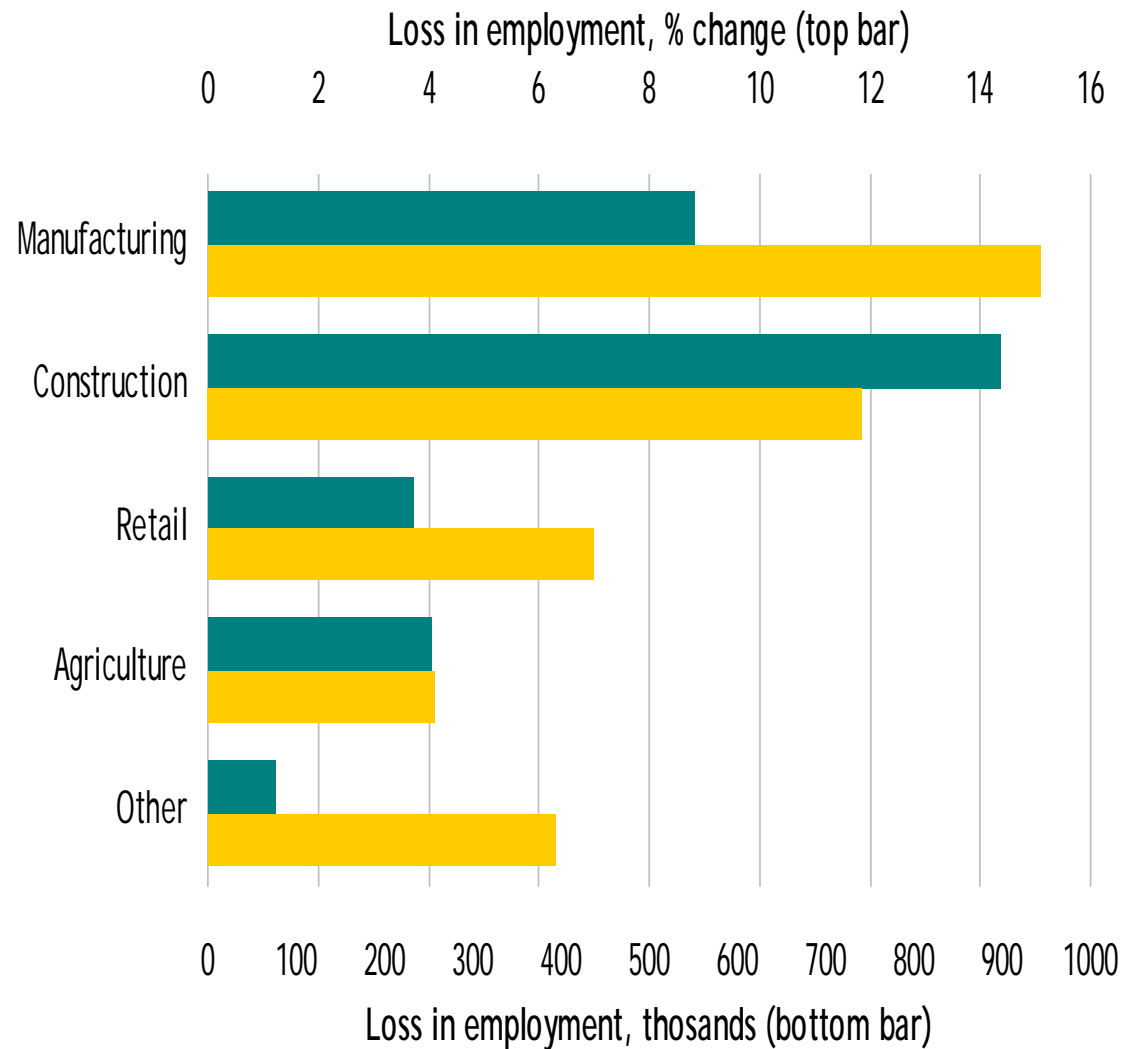
Source: Data for non-Russia G-20 countries, IMF (based on packages announced through late February). The figures do not include (i) below-the-line operations, (ii) measures that were already planned for, (iii) banking-sector support measures. Estimates of planned expenditures for 2010 are not available for Russia, Argentina, India, Mexico, and South Africa.



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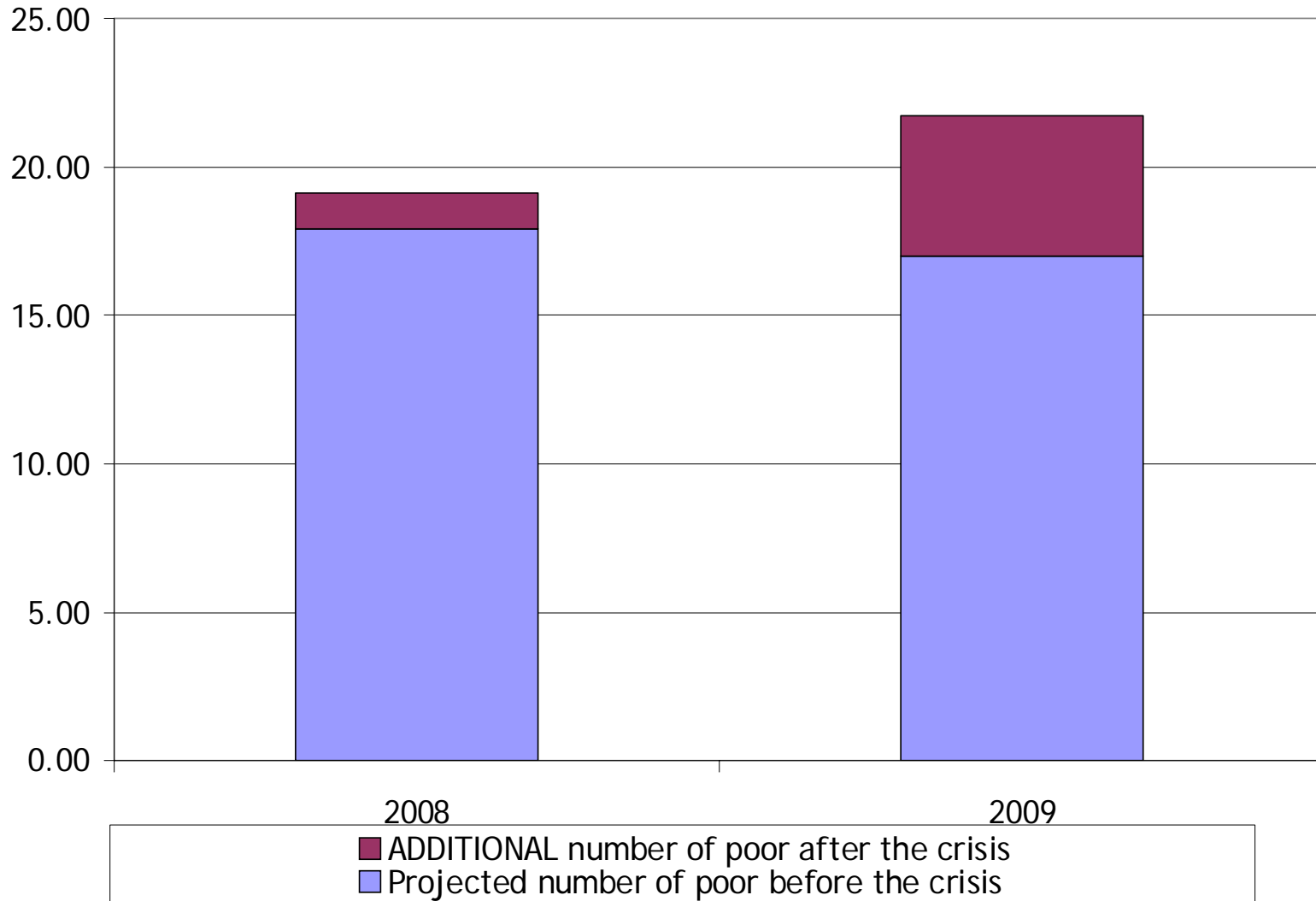
# Social impact—spreading fast

Figure 2.2 Projected loss of employment in Russia in 2009



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# Projected amount of poor people before and after the crisis (in millions), 2008-09



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# What more can future policy do?

- Adjusting the Fiscal Policy Response—targeting households, infrastructure, and small and medium enterprises
- Additional package must be:
  - Fiscally affordable
  - Cost efficient in alleviating poverty
  - Possible to scale up through simple reforms
  - Compatible with existing level social safety net mechanisms

**Table 2.4. A social protection stimulus package of 1 percent of GDP, implemented in a period from April 2009 to March, 2010 could help move 4.1 million people out of poverty compared with a no-program scenario**

	Cost of the program as a share of GDP	Reduction in poverty rate, percentage points	Reduction in poverty, million people
Child allowance	0.28	0.8	1.13
Low-end pensions	0.59	1.8	2.54
Unemployment benefits	0.14	0.3	0.42
Total	1.00%	2.9	4.09

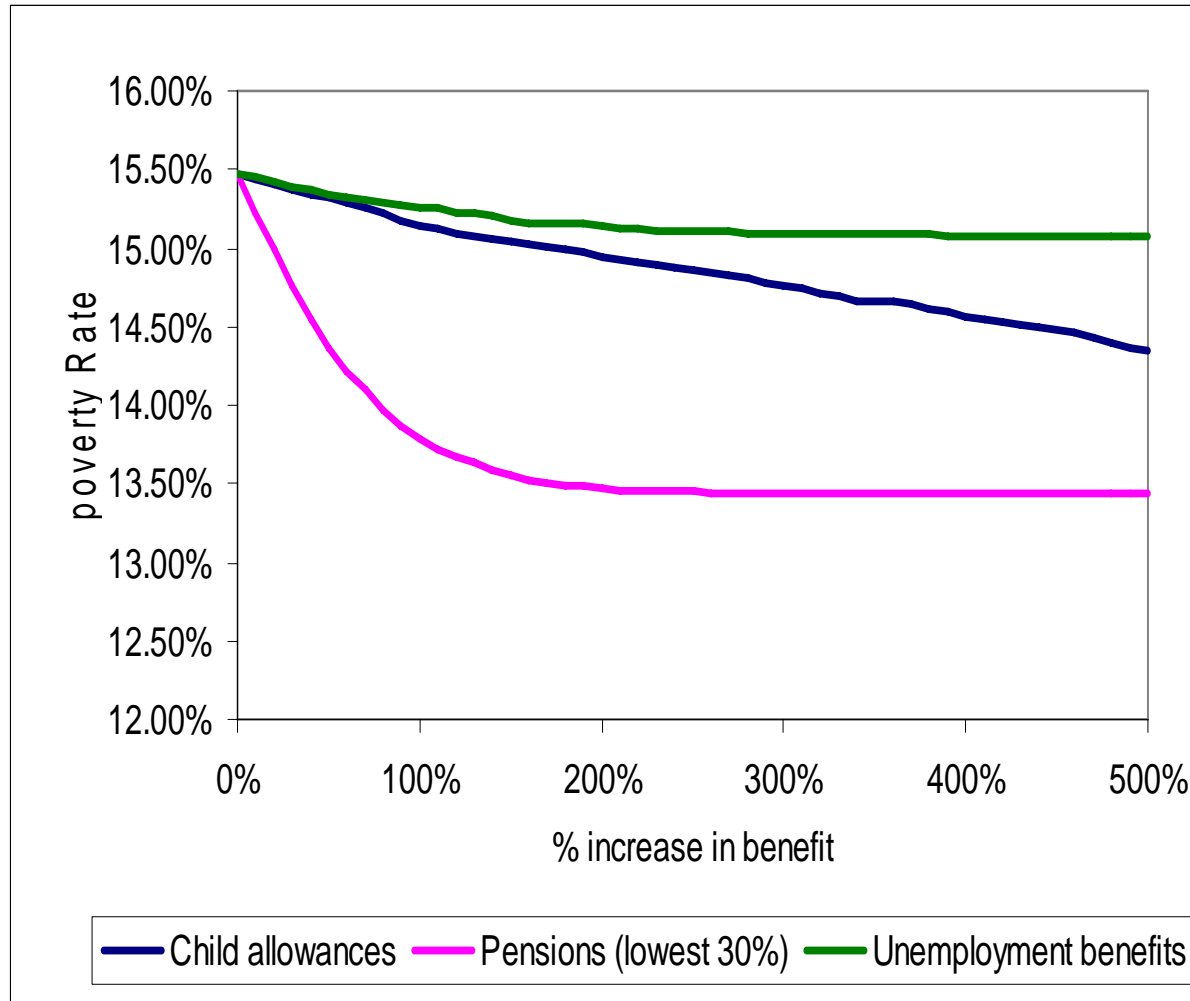
*Source:* World Bank estimates.



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# The additional social package is constructed so as to maximize impact on poverty

Figure 2.6. Impact on poverty reduction for a given increase in program budget



Source: World Bank staff estimates.



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## What more? Additional modest support for infrastructure bottlenecks and SMEs

- Supporting recovery and medium-term growth (0.5% of GDP):
  - Infrastructure bottlenecks
  - SMEs

*IN SUM, we propose in the short term:*

- Social protection package (1% of GDP)
- Infrastructure and SMEs (0.5% of GDP)
  - Over April 2009-April 2010 period.
  - This could help the economy cushion the large social impact and prepare it for a more sustained economic recovery later on.



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# Back to the future: Accelerating structural reforms.

- Even during the crisis, long-term structural reform agenda should not be forgotten.
- Critical to long-term growth.
- More competitive international business climate and fewer resources after crisis
  - Banking sector modernization
  - Public administration and governance reform
  - Improving investment climate
  - Infrastructure
  - WTO agenda
  - Improving effectiveness and targeting of the safety net



# DOWNSIDE RISKS FOR THE WORLD ECONOMY AND RUSSIA REMAIN

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- Social impact and associated social tensions, especially in select, vulnerable regions
- Second round effect of real economy on financial sector
- Prolonged *depression* of global demand
- Therefore, policy must remain vigilant, flexible and ready to respond quickly to changing conditions.
- **THEREFORE**, In a downside scenario, well designed and implemented public works programs may be needed.

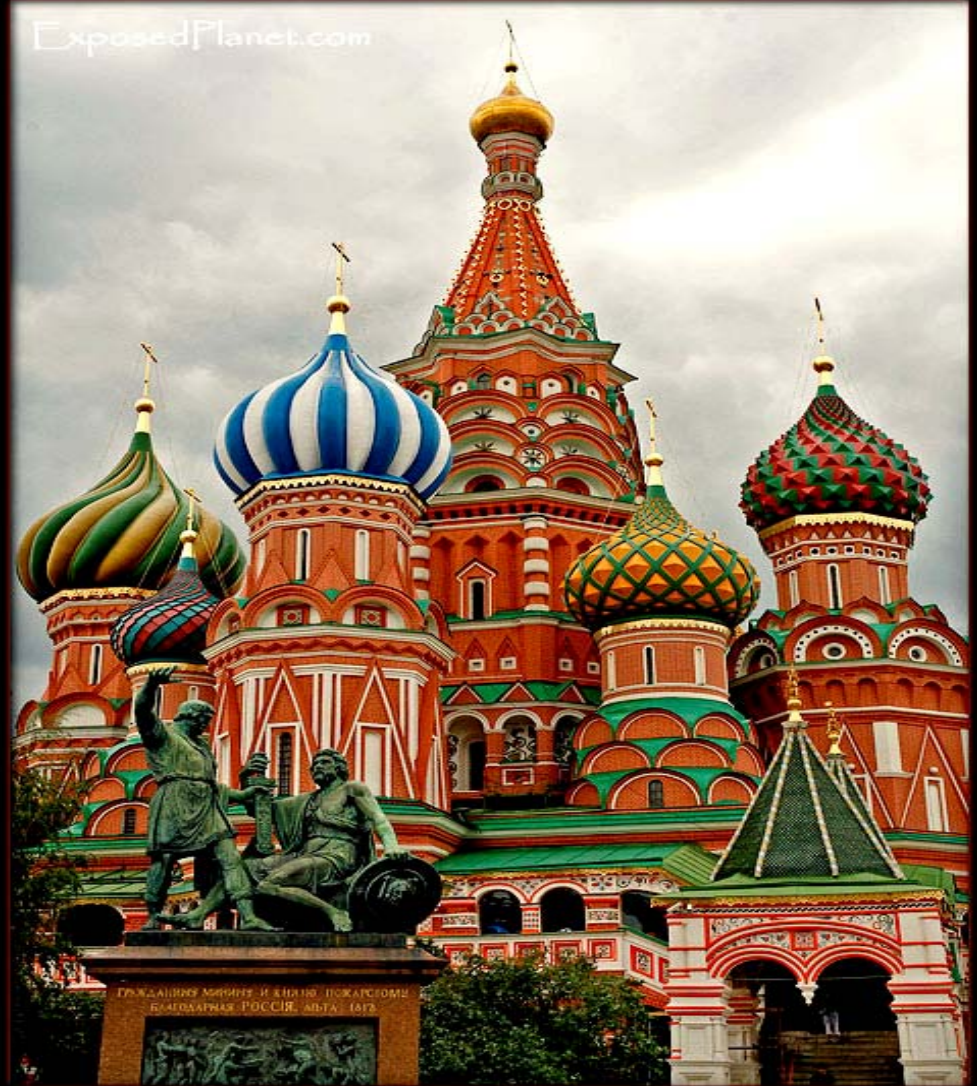


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Thank you!



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Saint Basil's Cathedral, Red Square  
by Flatty Kikstra