



**WORLD BANK**

# Russia Economic Report No. 20

*From Rebound to Recovery?*

.....  
Klaus Rohland

Country Director for  
Russia

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*AEB*

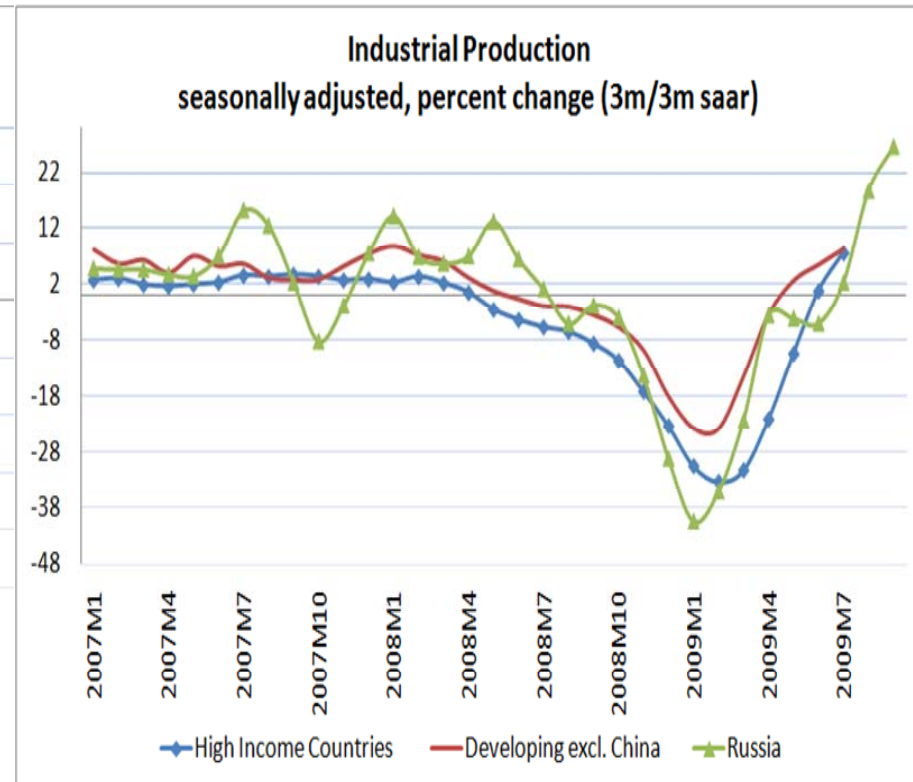
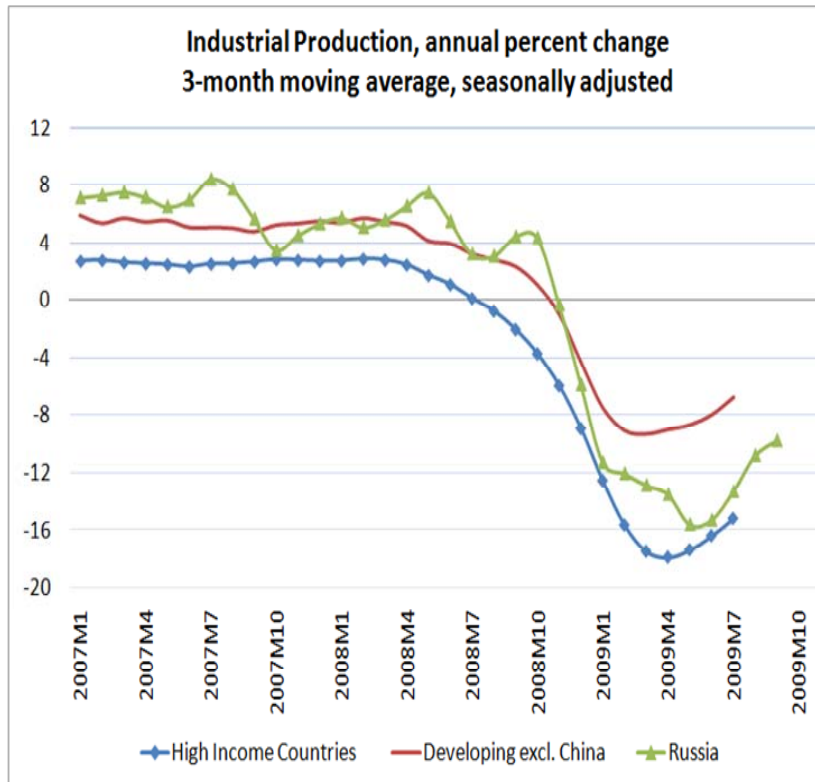
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- I. The global environment
  - II. Recent developments in Russia
  - III. Russia's economic and social outlook for 2009-2010
  - IV. Russia's policy challenges

# *I. The global environment: Key messages*

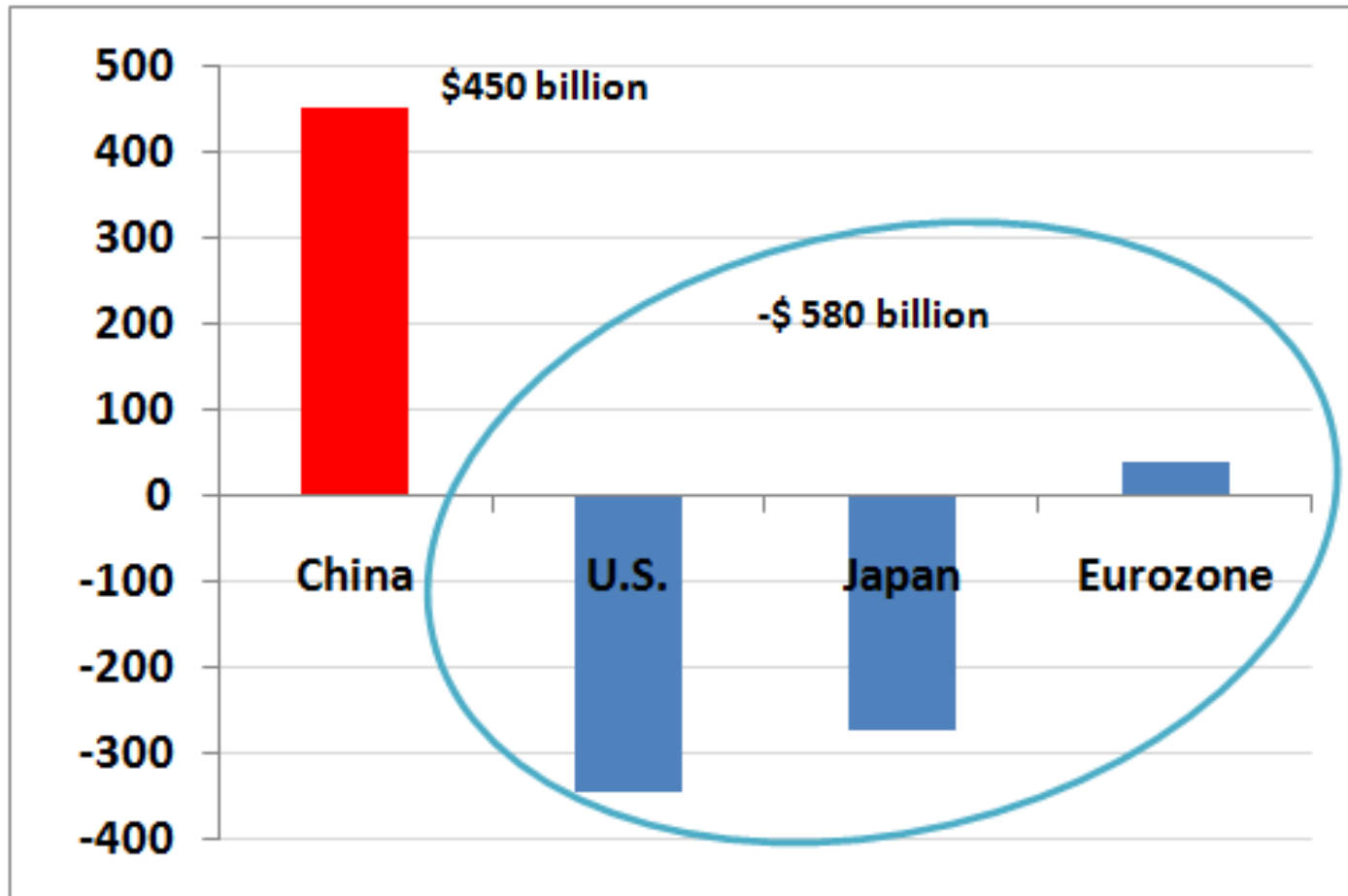
- *Signs of global recovery:*
  - *IP bottoming out*
  - *capital flows to emerging markets surging in Q3*
  - *Recovery in commodity prices*
- *But there are substantial global risks*



# *By mid-2009, global economy show clear signs of recovery, in both developed and developing countries*



# China Offsets Three-Quarters of Output Loss in G3 Countries



## *Capital flows to emerging markets down sharply in H1 2009, but surging in Q3*

| <b>Gross capital flows to developing countries</b> |              |             |           |                |              |           |           |                |
|--|--------------|-------------|-----------|----------------|--------------|-----------|-----------|----------------|
| <i>\$ billion</i>                                  | <b>2007</b>  | <b>2008</b> |           |                | <b>2009</b>  |           |           |                |
|  | <u>Total</u> | <u>H1</u>   | <u>Q3</u> | <u>Jan-Sep</u> | <u>Total</u> | <u>H1</u> | <u>Q3</u> | <u>Jan-Sep</u> |
| Total  | 652          | 258         | 82        | 340            | 390          | 110       | 97        | 207            |
| Bonds  | 146          | 53          | 9         | 62             | 65           | 36        | 37        | 73             |
| Banks  | 312          | 151         | 63        | 214            | 257          | 40        | 22        | 63             |
| Equity   | 194          | 54          | 10        | 64             | 68           | 33        | 38        | 71             |
| Lat. America                                       | 156          | 61          | 18        | 80             | 90           | 37        | 32        | 69             |
| Bonds  | 45           | 17          | 1         | 18             | 20           | 15        | 21        | 36             |
| E. Europe  | 247          | 99          | 35        | 134            | 157          | 22        | 25        | 47             |
| Bonds  | 64           | 27          | 7         | 35             | 35           | 13        | 11        | 24             |
| Asia   | 188          | 69          | 18        | 88             | 98           | 44        | 32        | 76             |
| Bonds  | 23           | 7           | 0         | 7              | 7            | 6         | 3         | 9              |
| Others   | 61           | 28          | 11        | 38             | 45           | 7         | 8         | 15             |

*Source: The World Bank*



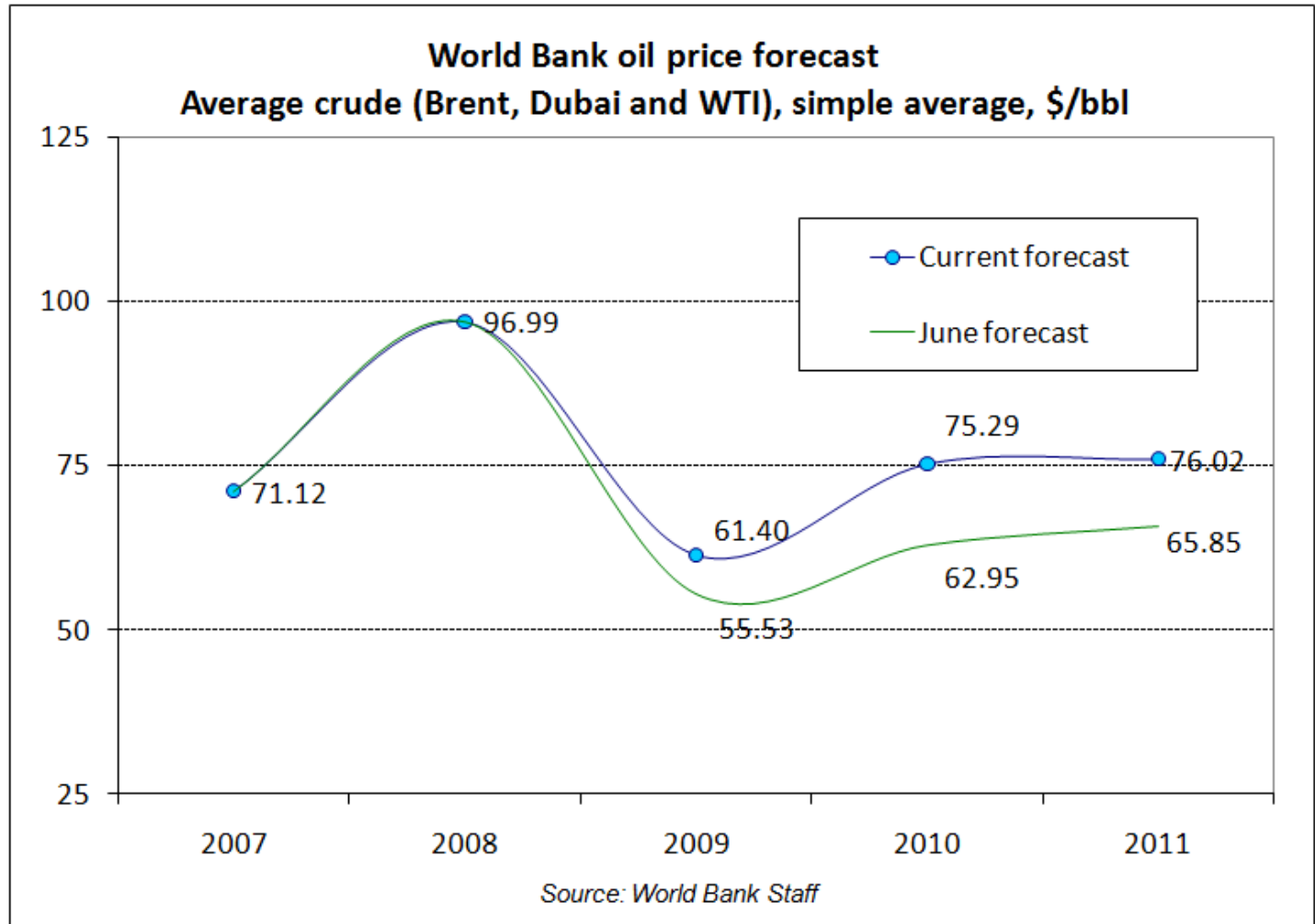
# ***Sovereign CDS spreads have come down significantly***

**Sovereign CDS spreads on 3 year sovereign bonds in basis points**

|            | Nov 3, 2008 | Nov 3, 2009 |
|------------|-------------|-------------|
| Bulgaria   | 414.63      | 199.35      |
| Estonia    | 357.30      | 273.66      |
| Hungary    | 306.26      | 176.34      |
| Kazakhstan | 744.14      | 250.34      |
| Poland     | 165.00      | 92.50       |
| Romania    | 446.00      | 277.00      |
| Russia     | 656.72      | 192.82      |
| Turkey     | 467.86      | 153.74      |
| Ukraine    | 2,441.00    | 1,321.29    |



# *Oil prices higher but projected to reflect slow recovery in demand and high stocks*





## ***But strength and durability of global recovery uncertain***

- *In the short-term:*
  - *Inventory cycle to be short-lived*
  - *Growth impulse from fiscal stimulus will wane*
  - *Large fiscal adjustment will be required*
- *In the medium-term:*
  - *Banking-sector,*
  - *Household debt consolidation,*
  - *Public debt will act as drag on growth  
(especially in high-income countries)*



## II. RUSSIA'S RECENT ECONOMIC DEVELOPMENTS

- *Output and investment—modest improvement*
- *Labor markets—downward adjustment has moderated*
- *Balance of payments—improvement with rising oil prices*
- *Monetary policy – Easing monetary conditions but no lending*
- *Fiscal policy - reducing the deficit and increasing efficiency*



## *Tradables were the hardest hit by the crisis*

Table 1.2: GDP growth by main sectors (value added): 2006-2009

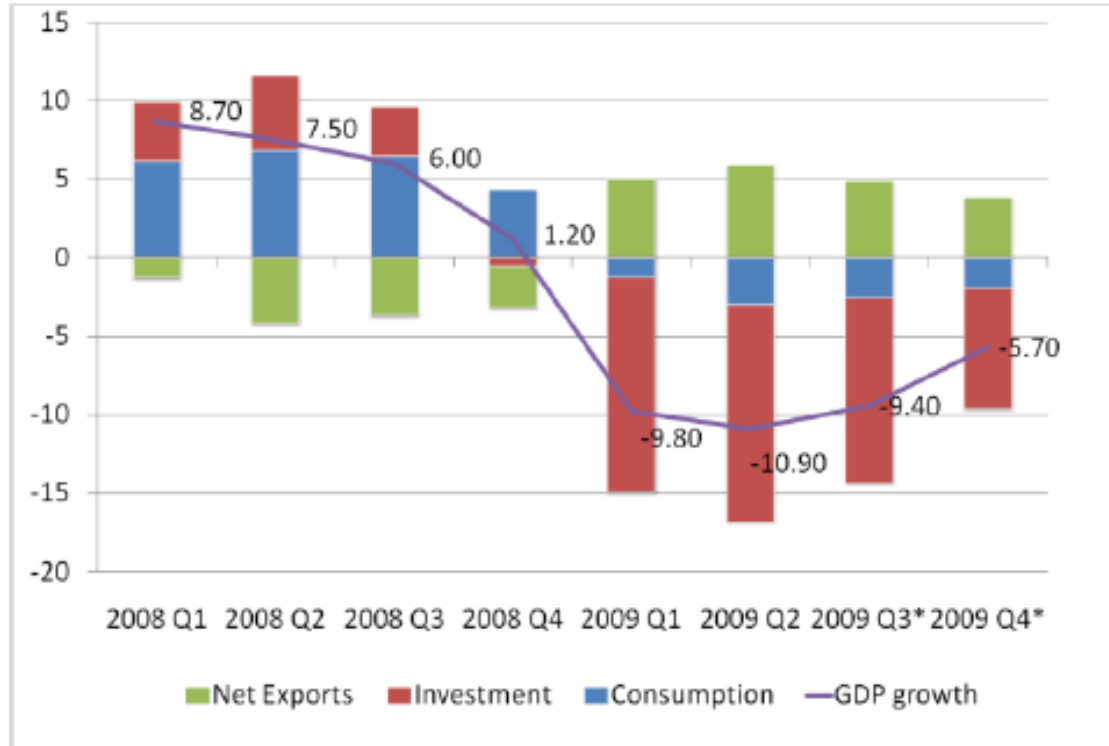
|   | 2006        | 2007        | 2008       |             | 2009       |              |              |
|---|-------------|-------------|------------|-------------|------------|--------------|--------------|
|   | Jan-Dec     | Jan-Dec     | Jan-Dec    | Q1          | Q2         | Q1           | Q2           |
| <b>GDP growth</b>                                   | <b>7.7</b>  | <b>8.1</b>  | <b>5.6</b> | <b>8.7</b>  | <b>7.5</b> | <b>-9.8</b>  | <b>-10.9</b> |
| <b>Tradable sector</b>                              | <b>3.4</b>  | <b>3.8</b>  | <b>2.0</b> | <b>4.9</b>  | <b>4.3</b> | <b>-14.4</b> | <b>-12.6</b> |
| Agriculture, forestry                               | 3.8         | 2.6         | 8.5        | 4.3         | 5.6        | -2.4         | -1.8         |
| Extraction industries                               | -3.3        | -2.7        | 0.4        | 1.7         | 2.2        | -2.2         | -5.1         |
| Manufacturing                                       | 7.3         | 8.1         | 1.2        | 6.6         | 5.1        | -23.5        | -18.7        |
| <b>Non-tradable sector</b>                          | <b>10.1</b> | <b>10.4</b> | <b>7.8</b> | <b>10.4</b> | <b>8.9</b> | <b>-5.7</b>  | <b>-8.6</b>  |
| Electricity, gas, water production and distribution | 5.7         | 0.4         | 1.0        | 4.1         | 5.1        | -5.3         | -6.7         |
| Construction  | 11.8        | 13.7        | 13.2       | 31.3        | 18.1       | -20.9        | -20.5        |
| Whole sale and retail trade                         | 14.1        | 12.5        | 8.4        | 14.2        | 9.7        | -4.9         | -11.3        |
| Transport and communication                         | 9.7         | 3.4         | 7.4        | 10.6        | 9.5        | -7.4         | -10.2        |
| Financial services                                  | 10.3        | 12.5        | 6.6        | 8.6         | 7.8        | 0.3          | -5.4         |

Source: Rosstat, World Bank.

## Domestic demand – recovery in Q3 2009

*Output and investment—moderate improvement in Q3, led by the gradually improving global demand and a start of inventory restocking cycle*

**Figure 1.2. Demand sources of Russia's real GDP growth, by quarter, 2008-09 (% change y-o-y)**



Source: World Bank decomposition and estimates based on Rosstat data.

# ***Labor markets—downward adjustment has moderated***

*Sharp downward adjustment in the labor market, continued through February 2009, moderated and then reversed, partly due to seasonal factors*

**Table 1.3. Labor productivity, disposable income, wages, and unemployment**

|  | 2006  | 2007  | 2008  | Q1-2009 | Q2-2009 | Q3-2009 |
|--|-------|-------|-------|---------|---------|---------|
| GDP growth, %, year-on-year              | 7.7   | 8.1   | 5.6   | -9.8    | -10.1   | -9.4*   |
| Total employment, million people         | 68.8  | 70.5  | 70.9  | 68.2    | 69.4    | 70.4    |
| Employment growth, %, year-on-year       | 0.8   | 2.4   | 0.5   | -2.3    | -2.9    | -2.1    |
| Real disposable income growth, %, y-o-y  | 13.5  | 12.1  | 2.9   | -0.1    | 2.6     | -5.1    |
| Real wage growth, %, year-on-year        | 13.3  | 17.2  | 11.5  | -0.8    | -3.9    | -5.4    |
| Average monthly wage, USD                | 392.5 | 533.2 | 692.1 | 497.7   | 578.5   | 597.6   |
| Unemployment (% , ILO definition, e-o-p) | 6.9   | 6.1   | 7.8   | 9.2     | 8.3     | 7.6     |

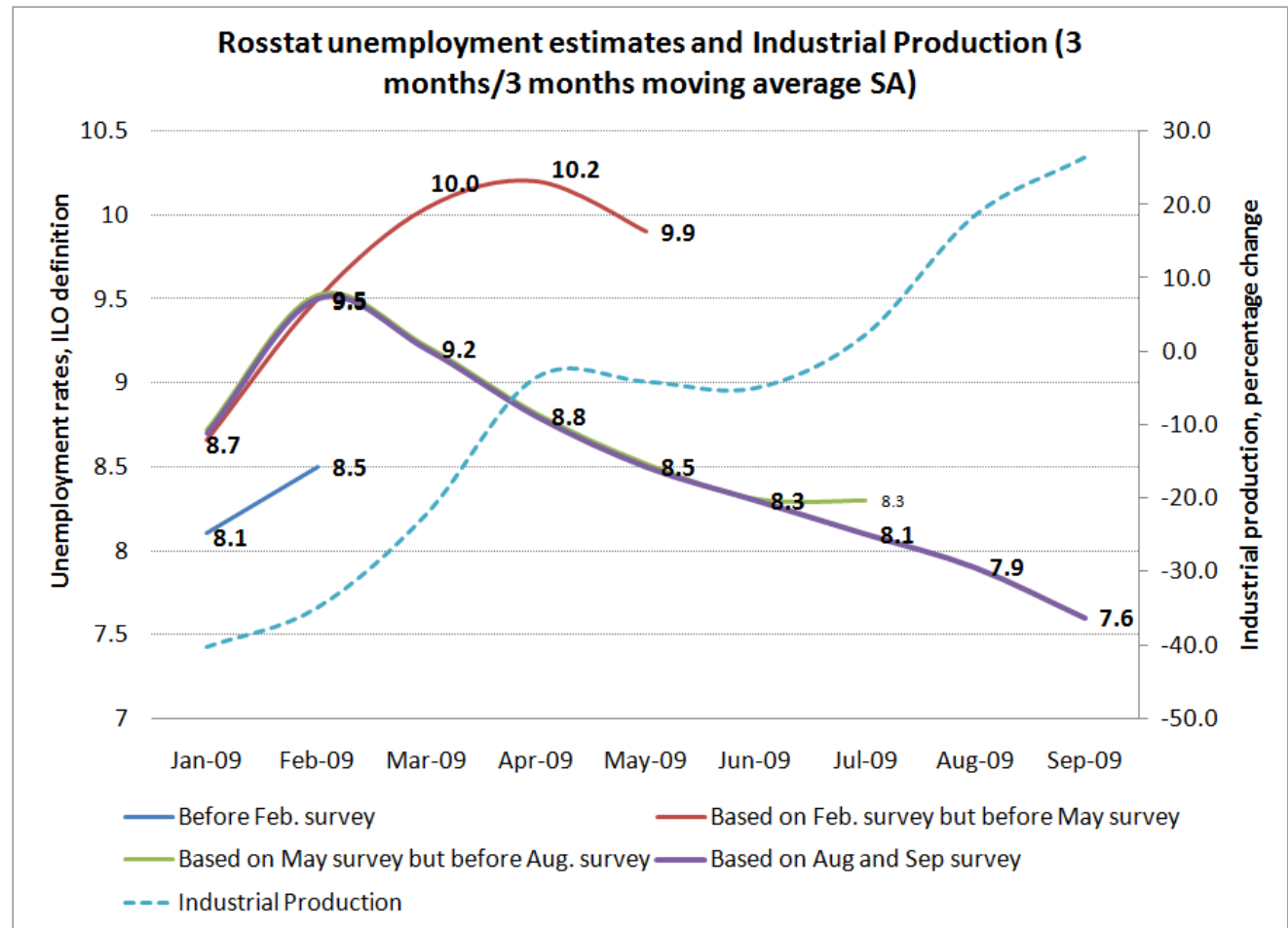
Source: Rosstat.

\* Preliminary estimate by Ministry of Economic Development.



# Labor market dynamics have changed

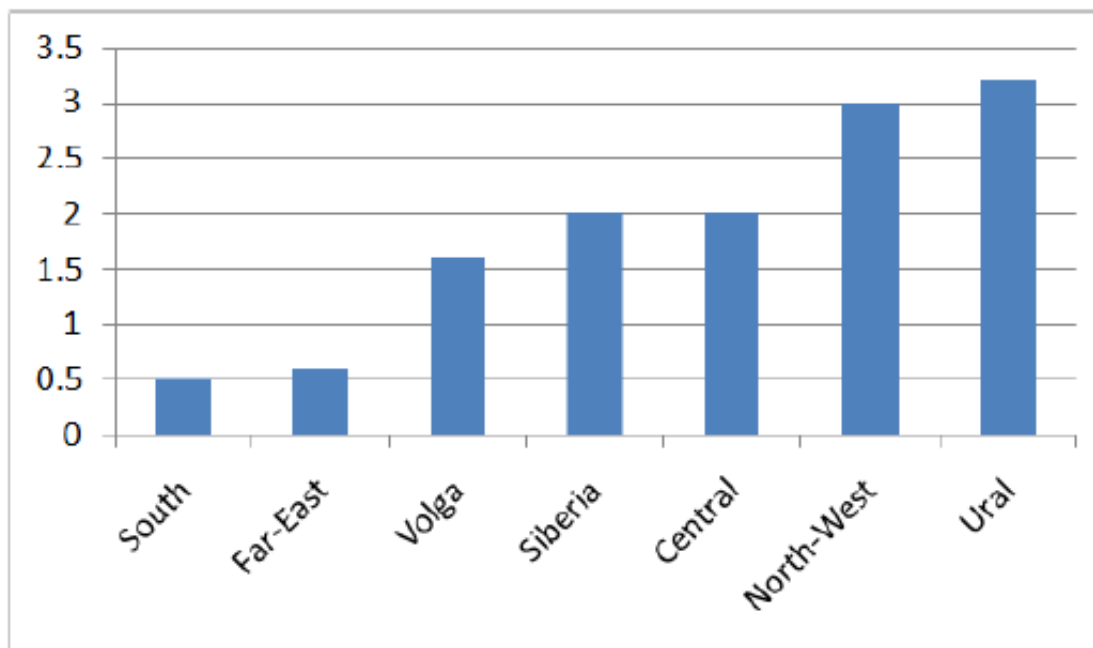
*Early phase—firing of labor;  
Current phase--reduced working hours and unpaid and lower wages;  
Seasonal increase in employment*



## *Disparities in regional unemployment impact remain very large*

*Unemployment increase is higher in regions with more manufacturing, and where industrial production accounted for a larger share of GDP.*

**Box Figure 1. Changes in the Unemployment Rates in percentage points, by federal districts, (August 2009 vs August 2008)**



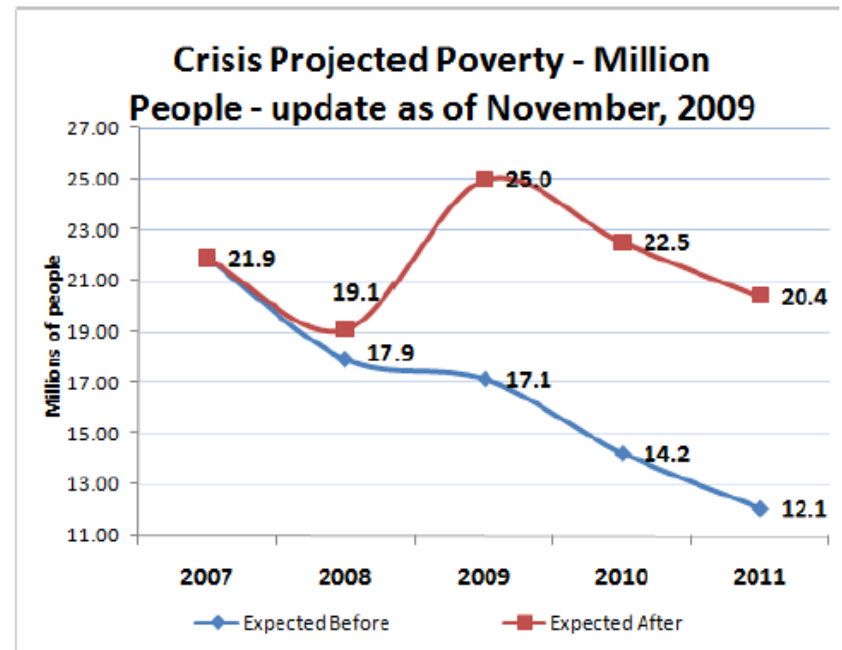
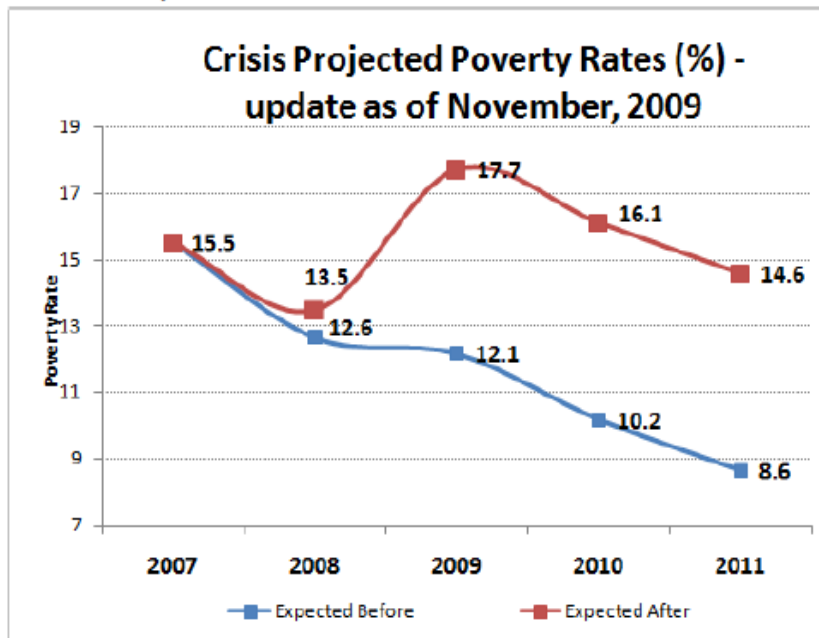
Source: ROSSTAT, October 2009.

Note: The figures are for the January-August period each year

# *The social impact of the crisis remains significant*

*While weak recovery is underway, poverty will remain high for awhile*

Figure 1.11 Projected impact of the crisis on the poverty rate, percentage of people with income level below minimum subsistence, 2007-2011



Source: World Bank staff estimates based on aggregate output forecast and household survey data on employment and incomes.



# Balance of payments—improvement with rising oil prices

Table 1.4. Balance of payments (USD billions), 2006—third quarter 2009

|                                   | 2006  | 2007  | 2008   | Q1-09 | Q2-09 | Q3-09 | Q1-Q3-09 <sup>a</sup> |
|-----------------------------------|-------|-------|--------|-------|-------|-------|-----------------------|
| Current Account Balance           | 94.7  | 77.0  | 102.4  | 9.4   | 7.6   | 15.0  | 32.1                  |
| <i>Trade Balance</i>              | 139.3 | 130.9 | 179.7  | 19.1  | 24.4  | 31.4  | 74.8                  |
| Capital and Financial Account     | 3.3   | 84.8  | -135.8 | -32.5 | 10.0  | -23.7 | -46.1                 |
| <i>Errors and Omissions</i>       | 9.5   | -12.9 | -11.9  | -8.0  | 3.7   | -3.5  | -7.9                  |
| Change in Reserves (+ = increase) | 107.5 | 148.9 | -45.3  | -31.1 | 21.3  | -12.1 | -21.8                 |

Source: CBR. <sup>a</sup> Preliminary estimates.



# *Capital flows remained volatile, reflecting uncertainty in global demand and commodity prices*

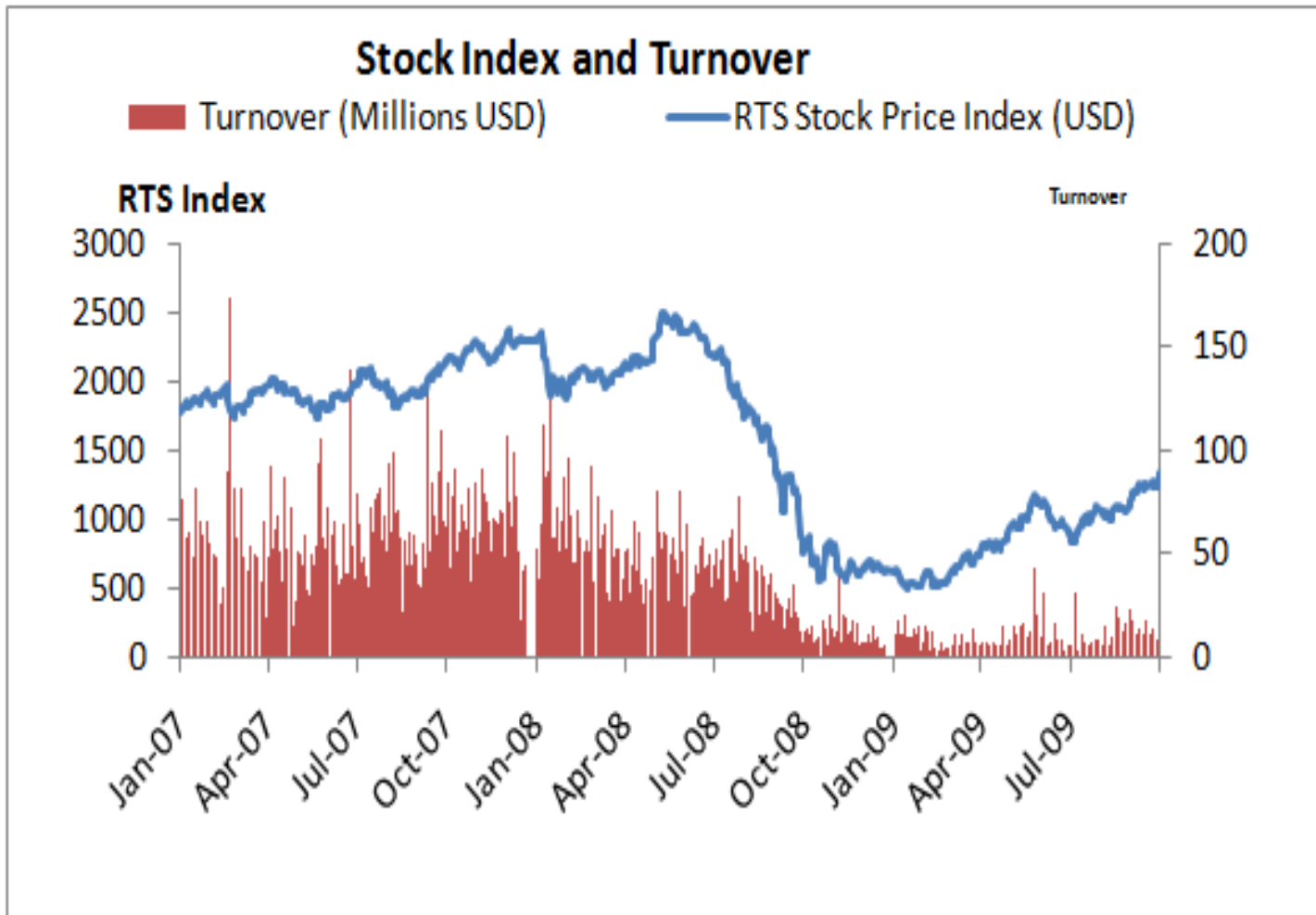
**Table 1.5. Net capital flows (USD billions), 2006-third quarter 2009**

|   | 2006 | 2007 | 2008   | Q4- 2008 | Q1- 2009 | Q2-2009 | Q3-2009 |
|---|------|------|--------|----------|----------|---------|---------|
| Total net capital flows to the private sector | 41.4 | 82.4 | -132.8 | -130.5   | -35.2    | 4.4     | -31.5   |
| Net capital flows to the banking sector       | 27.5 | 45.8 | -56.9  | -55.6    | -6.8     | -5.8    | -28.5   |
| Net capital flows to the non banking sector   | 13.9 | 36.6 | -75.8  | -74.9    | -28.4    | 10.2    | -3.0    |

Source: CBR.

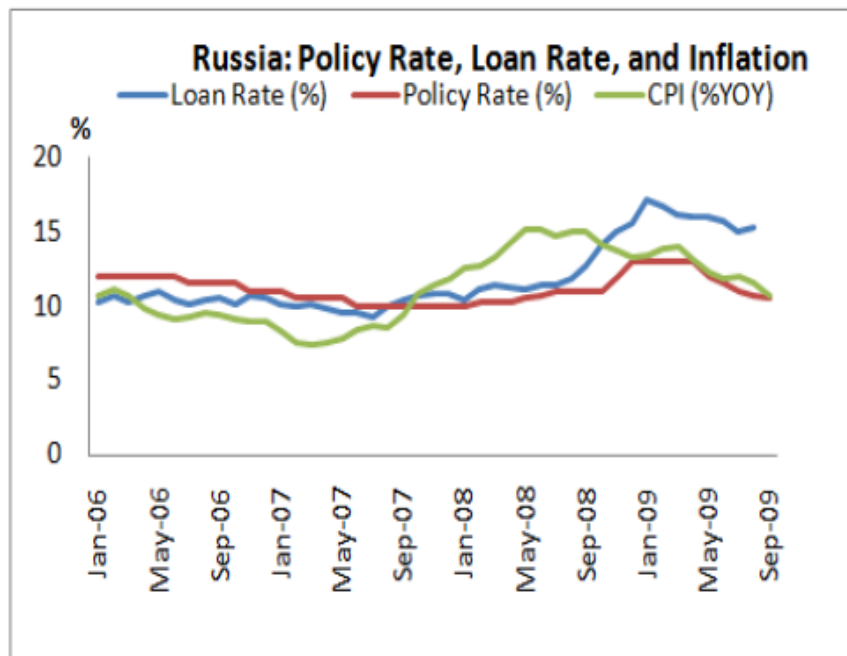


# *Stock market rebounds but trading is weak.*



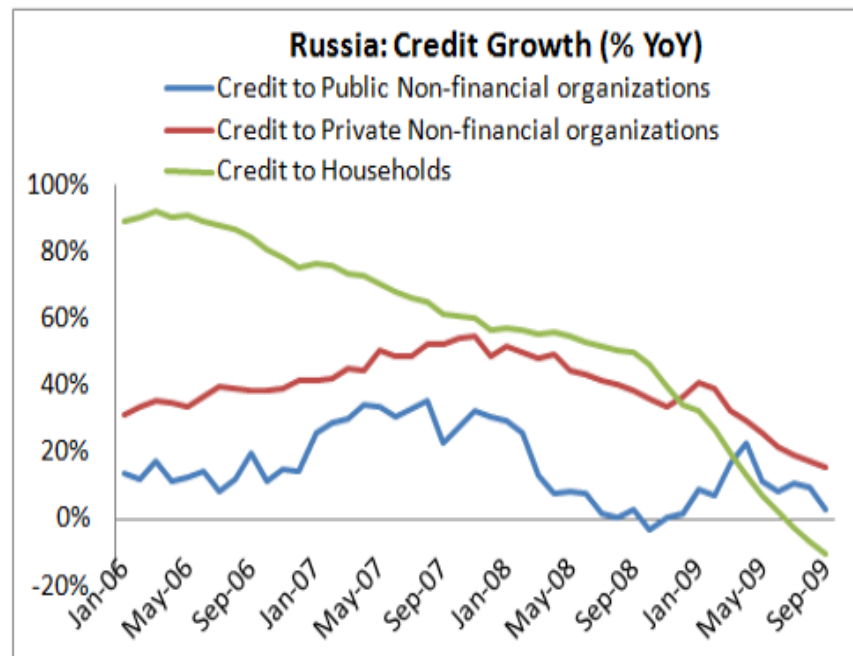
# Easing of monetary conditions, but no significant lending

Figure 1.8: Lending rates and inflation in Russia  
2006-2009



Source: CBR, World Bank staff estimates.

Figure 1.9: Credit growth in Russia  
2006-2009



## *Fiscal policy—focusing on reducing the deficit and increasing expenditure efficiency*

**Table 1.6. Consolidated budget: revenues, expenditures, and the fiscal surplus, 2007-09**

|                            | 2007<br>(actual) | 2008 (actual) | Federal Budget<br>Law (Nov) | Federal<br>Budget Law<br>Revised (Apr) | 2009 Jan-<br>September<br>(actual) |
|----------------------------|------------------|---------------|-----------------------------|--|------------------------------------|
| <b>Consolidated budget</b> |                  |               |                             |  |                                    |
| Revenues, % GDP            | 40.2             | 38.5          | n/a                         | n/a                                    | 30.6                               |
| Expenditure, % GDP         | 34.1             | 33.7          | n/a                         | n/a                                    | 33.1                               |
| Surplus, % GDP             | 6.1              | 4.8           | n/a                         | n/a                                    | -1.9                               |
| Non-oil balance, % GDP     | -2.9             | -5.8          | n/a                         | n/a                                    |                                    |
| <b>Federal budget</b>      |                  |               |                             |  |                                    |
| Revenues, % GDP            | 23.6             | 22.3          | 21.2                        | 16.6                                   | 18.7                               |
| Expenditure, % GDP         | 18.1             | 18.2          | 17.5                        | 24.0                                   | 22.7                               |
| Surplus, % GDP             | 5.4              | 4.1           | 3.7                         | -7.4                                   | -4.0                               |
| Non-oil balance, % GDP     | 0.6              | -6.4          | -5.4                        | -12.5                                  | -11.0                              |

Source: Ministry of Finance, Economic Expert Group (EEG).



## ***2010-12 budget proposal indicates plans for austerity measures, but significant fiscal deficit remains***

**Table 1.7. Key characteristics of Federal Budget of the Russian Federation 2009-2012, percentage of GDP**

|                        | <b>2009*</b> | <b>2010*</b> | <b>2011*</b> | <b>2012*</b> |
|------------------------|--------------|--------------|--------------|--------------|
| Revenues               | 17.2%        | 16.10%       | 15.50%       | 15.00%       |
| Expenditures           | 25.5%        | 22.90%       | 19.50%       | 18.00%       |
| Balance                | <b>-8.3%</b> | <b>-6.8%</b> | <b>-4.0%</b> | <b>-3.0%</b> |
| <i>Non-oil balance</i> | -14.90%      | -14.20%      | -10.90%      | -9.50%       |

Source: Ministry of Finance.

\* Draft law on the Federal Budget 2010-2012 (1<sup>st</sup> reading).



# III. Economic and Social Outlook for Russia, 2009-10

Table 1.9. Outlook for 2009-2010

|                                      | 2009 | 2010 |
|--------------------------------------|------|------|
| World growth, %                      | -2.2 | 2.6  |
| Oil prices, average, USD/bbl         | 61.4 | 75.3 |
| <b><i>Russia</i></b>                 |      |      |
| <i>GDP growth, %</i>                 | -8.7 | 3.2  |
| <i>Federal government balance, %</i> | -6.9 | -4.4 |
| <i>Current account, USD bln.</i>     | 46   | 41   |
| <i>Capital account, USD bln.</i>     | -30  | 20   |

Source: World Bank projections.



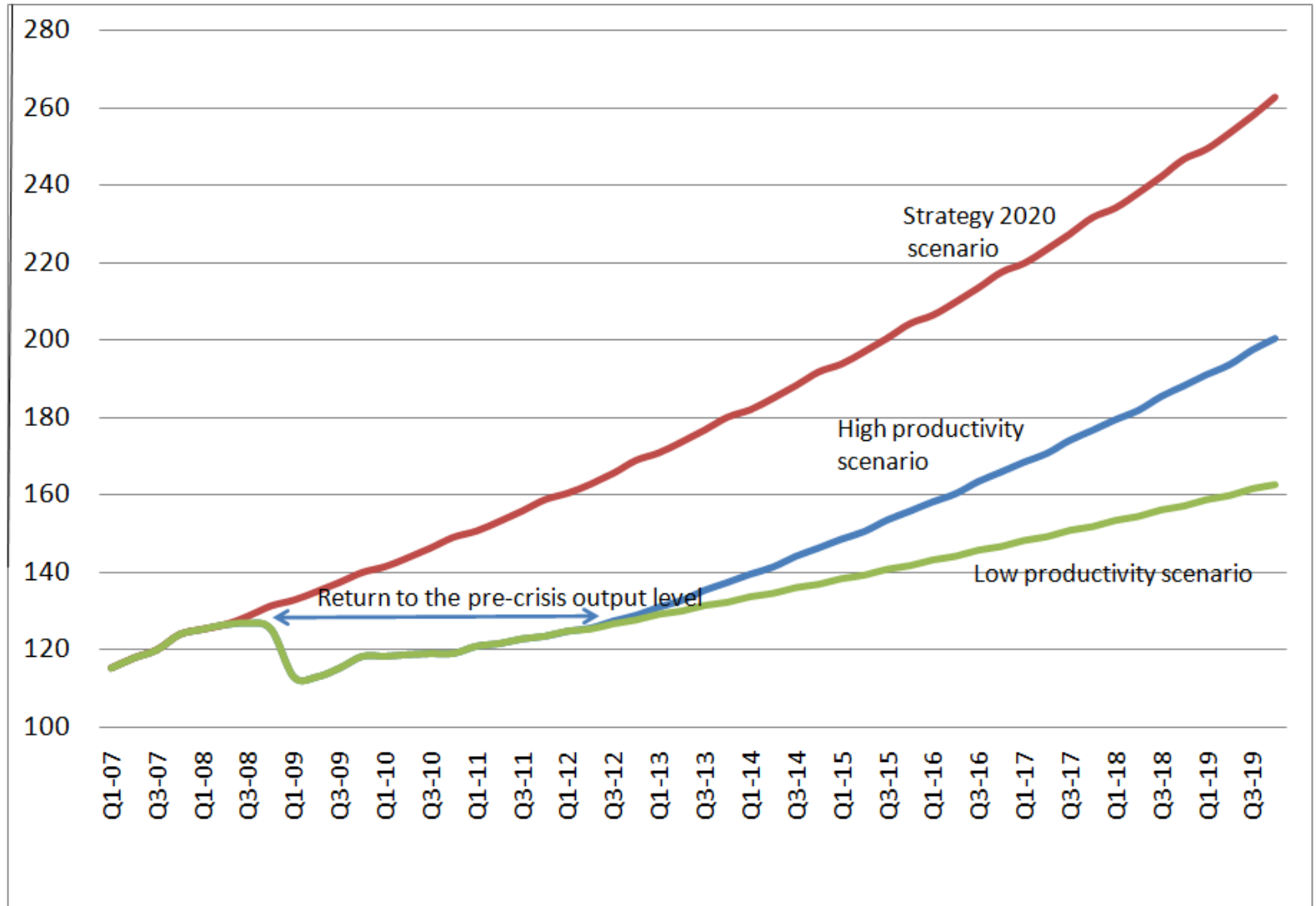
# IV. Policy challenges going forward

- **Fiscal:** *reducing the deficit while supporting recovery and cushioning the impact on the poor and vulnerable.*
- **Financial:** *How to revive credit activity to support the economic recovery in the context of rising non-performing loans and high credit risks.*
- **Social:** *Unemployment and poverty will remain key social challenges, requiring sustained, mitigating policy measures.*
- **Rethinking the growth model:** *From no-budget constraint towards hard budget constraint environment—the role of productivity , investment climate, SMEs, infrastructure to eliminate key bottlenecks to growth.*





# The long term impact of the crisis on Russia's growth



Thank you!



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