RUSSIAN FEDERATION

The post-crisis economic recovery has been solid but unspectacular, and growth over the projection horizon of 4-4½ per cent is expected to reduce the degree of slack in the economy, with the output gap closing in 2012. Inflation has been pushed higher by a food price shock, but underlying pressures are likely to remain contained. The current account surplus is projected to roughly halve between 2010 and 2012 as import volume growth outstrips that of exports by a large margin. Public expenditure restraint is expected to shrink the budget deficit to near zero by 2012, with public debt levels remaining low.

The planned cut in real public spending will restrain domestic demand growth but is appropriate. As long as the food price spike, resulting from the effects of extreme weather in the summer, does not give rise to second-round effects, monetary policy can remain accommodative until the output gap has narrowed further. As the recession fades into the past and as economic slack dissipates, structural policy reforms to raise potential growth rates should be given renewed prominence. To that end, fiscal consolidation should focus on eliminating subsidies extended in the context of anti-crisis measures.

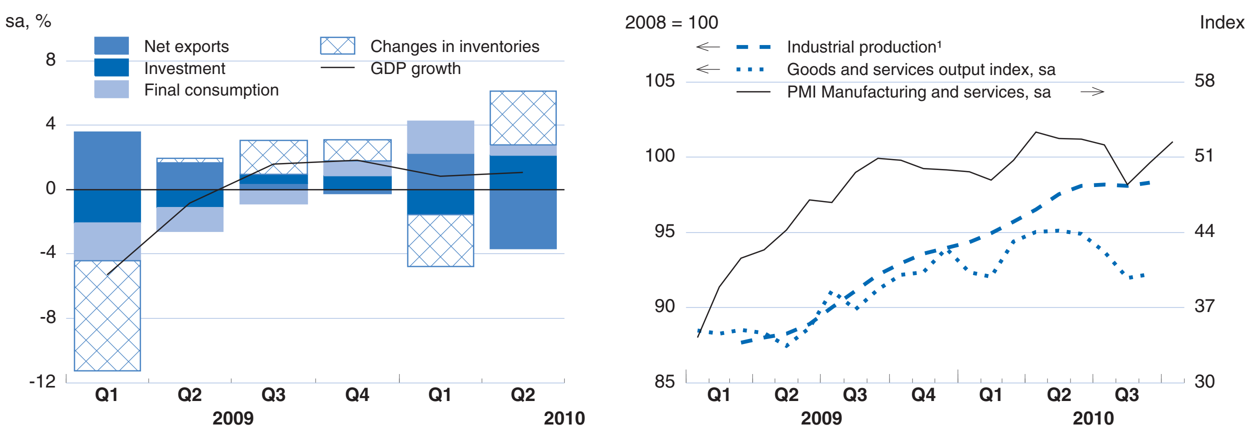
The recovery stuttered in the third quarter

Since output growth resumed in the third quarter of 2009, the recovery has been reasonably strong, albeit slowing, with annualised output growth easing from an average of 6.9% in the last two quarters of 2009 to 3.8% in the first two quarters of 2010. The recovery was initially export-led, consumption followed and investment made a sizable positive contribution to growth for the first time in the second quarter of 2010. The heat wave and wildfires which struck in July-August dented the momentum of real GDP growth *via* lost agricultural output and shutdowns of firms in areas affected by the heat and smog. Most leading and coincident indicators point to stagnation or worse in the third quarter. Despite the slowdown, however, sentiment indicators generally show continued improvement since the crisis, and credit growth has been

Russian Federation

Domestic demand is increasingly driving the recovery
Contributions to growth over previous period

The recovery slowed in the third quarter



1. Seasonally and working-day adjusted, 3-month moving average.

Source: OECD calculations based on OECD Quarterly National Accounts database and Markit.

StatLink http://dx.doi.org/10.1787/888932346230

Russian Federation: **Macroeconomic indicators**

	2008	2009	2010	2011	2012
Real GDP growth	5.2	-7.9	3.7	4.2	4.5
Inflation (CPI), period average	14.1	11.7	6.8	7.7	6.0
Fiscal balance (per cent of GDP)[1]	5.7	-5.3	-2.7	-2.0	-0.9
Current account balance (per cent of GDP)	6.1	3.9	5.7	3.6	2.7

1. Consolidated budget.

Source: OECD Economic Outlook 88 database.

StatLink http://dx.doi.org/10.1787/888932347978

picking up markedly, spurred by a large and sustained reduction in interest rates.

Slack in the economy helped to bring down inflation

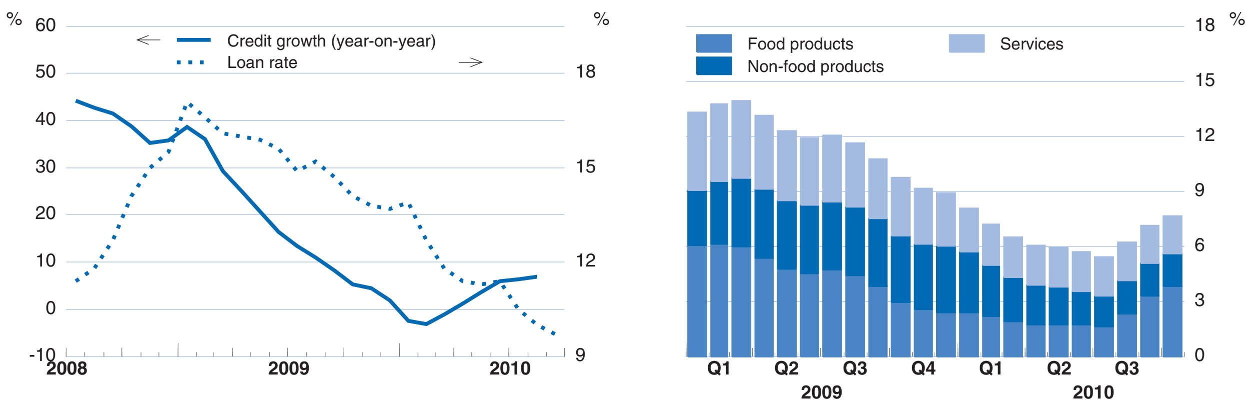
The 11% fall in output during the recession of 2008-09 opened a negative output gap that remains sizeable, notwithstanding the recovery to date. Employment in August 2010 was still nearly 2% below its pre-crisis level and the unemployment rate stood at 7%, up from 5.8% in August 2008. The output gap, combined with a strong rouble, helped to produce a large decline in consumer price inflation from early 2009 through mid-2010. Inflation reached a post-Soviet-era low of 5.5% in July, but the damage to Russian grain harvests from the summer heat wave and fires has led to an upsurge in food prices, which have a high weight in the consumer price index.

Russian Federation

Lower interest rates have revived bank lending growth

A surge in food prices has reversed the decline in inflation

Contributions to CPI growth over same period previous year



Source: OECD calculations based on Russian Federal Service For State Statistics and Central Bank of Russia.

StatLink http://dx.doi.org/10.1787/888932346249

Russian Federation: **External indicators**

	2008	2009	2010	2011	2012
			$ billion		
Goods and services exports	522.9	343.7	445.4	477	504
Goods and services imports	367.7	251.4	312.7	366	402
Foreign balance	155.1	92.4	132.7	111	103
Invisibles, net	- 52.8	- 43.4	- 48.7	- 52	- 54
Current account balance	102.4	49.0	84.0	59	49
			Percentage changes		
Goods and services export volumes	0.6	- 4.7	5.1	4.0	5.4
Goods and services import volumes	14.8	- 30.4	14.5	13.9	9.0
Terms of trade	15.6	- 29.9	13.9	0.3	- 0.3

Source: OECD Economic Outlook 88 database.

StatLink http://dx.doi.org/10.1787/888932347997

Positive growth momentum is likely to reassert itself

Despite the slowdown in growth in the first half of 2010 and the negative shock from the summer heat wave, underlying growth momentum appears to be robust, sustained by easier credit conditions, high oil and gas prices, improving confidence, rising real wages and falling unemployment. Also, from the onset of the recession in the third quarter of 2008 through the second quarter of 2010 inventories had declined by more than 3 percentage points of GDP, leaving scope for a near-term boost to growth from restocking.

Monetary policy will be the key to maintaining macroeconomic balance

After a major expansion of public expenditure in 2009 to support domestic demand, the government is planning to cut spending in real terms in both 2011 and 2012, on top of a small real decline in 2010. This fiscal consolidation is intended to safeguard fiscal sustainability and reduce the vulnerability of the public finances to swings in oil prices by providing a stronger starting position in the event of a negative oil price shock. Monetary policy will therefore be the main instrument for steering economic activity towards its potential level. With a still-substantial output gap and growth having been only around potential on average in the first three quarters of 2010, there appears to be scope for interest rates to stay low well into 2011, so long as the food-price-induced pick-up in consumer price inflation resulting from the heat and fire damage to grain harvests fades as expected. As the recovery continues and the output gap narrows, monetary policy can be progressively tightened. Among the many structural policy measures that could improve potential output growth over the longer term, scaling back the subsidies extended as an anti-crisis measure is among the most pressing. Completion of the long process of WTO accession would also bring significant long-term growth benefits.

Growth should be sufficient to eliminate the output gap in 2012

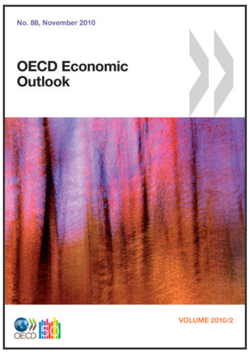
Output growth is projected to rebound after the weather-affected third quarter, remaining at a pace slightly above the potential growth rate from the final quarter of 2010 through 2012, with domestic demand leading the way. The output gap is projected to disappear towards the end of the projection horizon. Import volume growth is projected to remain brisk in 2011 and 2012, reflecting Russia's high income elasticity of imports, the real appreciation of the rouble since early 2009 and the scope for a continued rebound from the huge decline during the crisis: the volume of imports of goods and services in the second quarter of 2010 was still some 25% below its pre-crisis highs. Export volumes are constrained by capacity in oil and gas (which account for about two thirds of total exports), and should therefore grow at a more moderate pace, close to that of real GDP. As a result, the current account surplus will shrink in 2011 and 2012 unless export prices rise strongly – the projections are based on unchanged oil prices.

The recent upturn in inflation is expected to prove to be temporary

Notwithstanding the food-price-driven upturn in inflation that began in August 2010, price pressures are expected to be moderate over the next two years. Annual average inflation is likely to be below 7% in 2010, the lowest rate recorded in the post-Soviet era, although the year-on-year rate is projected to rise from the July low of 5.5% to about 8% by December. Once the effect of the food price shock has fallen out of the year-on-year comparisons, inflation is projected to settle back to around 6% in the second half of 2011 and 2012.

The Russian economy is sensitive to changes in the external environment

A stronger-than-expected global economic recovery that raised commodity prices would fuel stronger domestic demand in Russia, particularly as it would be likely to be accompanied by private capital inflows. In such an event the output gap would close more quickly and inflation and interest rates would be higher, while there would be a revenue windfall for the budget, narrowing the budget deficit more quickly. The government estimates that each 10 dollar-per-barrel move in oil prices affects annual real GDP growth in the short term by about half a percentage point, which suggests that a return to oil prices in excess of $100 a barrel would be associated with growth of over 5%. Of course the vulnerability of growth to a large decline in oil prices, for example associated with a weaker-than-expected global recovery, remains considerable.



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