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Economics Group

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Russian Economy on the Long, Slow Road to Recovery

The 4.1 percent year-over-year decline in Russian real GDP was less sharp than many expected, but it was anything but a "positive" report. Low oil prices and Western sanctions will continue to hinder the recovery.

Domestic Demand Still Under Significant Pressure

Data released this morning showed that real GDP in Russia contracted 4.1 percent from a year earlier in the third quarter. While the contraction was not quite as deep as most analysts expected, the Russian economy is clearly facing significant challenges at present.

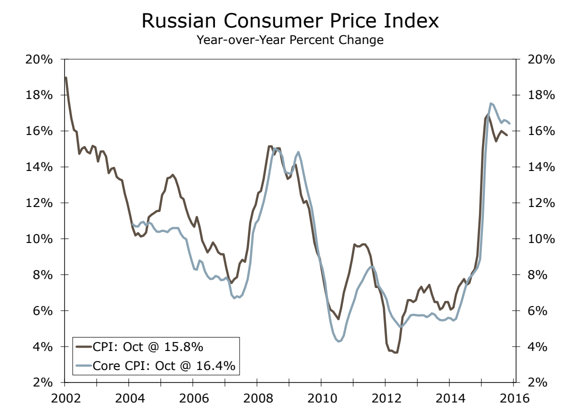
A breakdown of real GDP into its demand side components will not be available for another month or so, but higher-frequency indicators suggest consumer spending weakened further in the third quarter. Real retail sales fell 10.4 percent on a year-ago basis in September, the sharpest year-over-year contraction since 1999. While retail sales do not include spending on services, which may have offset some of the downturn in goods spending, real personal consumption expenditures likely were among the weakest components of real GDP in Q3.

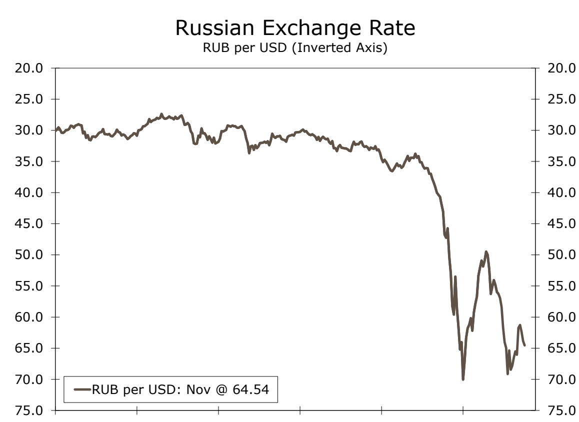
Economic Prospects Remain Closely Tied to Oil Prices

While Russia's current economic woes reflect a confluence of factors, the situation is largely rooted in the collapse in oil prices that began last year. In particular, falling crude prices led to a commensurate decline in the value of the ruble vis-à-vis the dollar, which subsequently pushed up CPI inflation well into double-digit territory (middle chart). Faced with runaway inflation, Russia's central bank jacked up its main policy rate 750 bps to 17.00 percent late last year. Fortunately, signs that CPI inflation had topped out gave the central bank scope to cut its policy rate by 600 bps since the start of the year. More recently, the ruble has shown signs of stabilizing, which should cause CPI inflation to recede going forward.

That said, the central bank's policy rate remains elevated at 11.00 percent and, despite having stabilized, CPI inflation continues to run in the high double digits. The combination of relatively tight monetary policy and soaring inflation has weighed significantly on domestic demand. Real wages in Russia fell nearly 10 percent on a year-over-year basis in September, likely a key contributor to the weakness in real retail spending. Data on fixed investment spending for Q3 are not yet available, but with interest rates at current levels, it seems unlikely that real investment improved significantly over the past few months. Adding to the Russian economy's challenges have been the sanctions imposed by Western nations, which have weighed on foreign investment and constricted trade flows.

The near-term outlook for Russia's economy remains dim, but the seeds are slowly being sown for an eventual recovery. Indeed, we expect real GDP growth to return to positive territory in 2016. However, with oil prices projected to remain at or near current levels for the foreseeable future, the recovery in Russian economy activity is likely to be relatively modest. Moreover, with Western sanctions unlikely to be lifted in the near term, a return to the supercharged growth rates of the prior decade is likely out of reach for the Russian economy.





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