Economics Group

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.

Source: IHS Global Insight and Wells Fargo Securities, LLC
Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg  Global Head of Research, Economics & Strategy  (704) 410-1801  diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.  Chief Economist  (704) 410-3275  john.silvia@wellsfargo.com
Mark Vitner  Senior Economist  (704) 410-3277  mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.  Global Economist  (704) 410-3274  jay.bryson@wellsfargo.com
Sam Bullard  Senior Economist  (704) 410-3280  sam.bullard@wellsfargo.com
Nick Bennenbroek  Currency Strategist  (212) 214-5636  nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.  Senior Economist  (704) 410-3273  eugenio.j.aleman@wellsfargo.com
Anika R. Khan  Senior Economist  (704) 410-3271  anika.khan@wellsfargo.com
Azhar Iqbal  Econometrician  (704) 410-3270  azhar.iqbal@wellsfargo.com
Tim Quinlan  Economist  (704) 410-3283  tim.quinlan@wellsfargo.com
Eric Viloria, CFA  Currency Strategist  (212) 214-5637  eric.viloria@wellsfargo.com
Sarah House  Economist  (704) 410-3282  sarah.house@wellsfargo.com
Michael A. Brown  Economist  (704) 410-3278  michael.a.brown@wellsfargo.com
Erik Nelson  Economic Analyst  (704) 410-3267  erik.f.nelson@wellsfargo.com
Alex Moehring  Economic Analyst  (704) 410-3247  alex.v.moehring@wellsfargo.com
Misa Batcheller  Economic Analyst  (704) 410-3060  misa.n.batcheller@wellsfargo.com
Michael Pugliese  Economic Analyst  (704) 410-3156  michael.d.pugliese@wellsfargo.com
Donna LaFleur  Executive Assistant  (704) 410-3279  donna.lafleur@wellsfargo.com
Cyndi Burris  Senior Admin. Assistant  (704) 410-3272  cyndi.burris@wellsfargo.com

Wells Fargo Securities Economics Group publications are produced by Wells Fargo Securities, LLC, a U.S broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes these publications directly and through subsidiaries including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Advisors, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC ("WFS") is registered with the Commodities Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. Wells Fargo Bank, N.A. ("WFBNA") is registered with the Commodities Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. WFS and WFBNA are generally engaged in the trading of futures and derivative products, any of which may be discussed within this publication. Wells Fargo Securities, LLC does not compensate its research analysts based on specific investment banking transactions. Wells Fargo Securities, LLC’s research analysts receive compensation that is based upon and impacted by the overall profitability and revenue of the firm which includes, but is not limited to investment banking revenue. The information and opinions herein are for general information use only. Wells Fargo Securities, LLC does not guarantee their accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company © 2015 Wells Fargo Securities, LLC.

Important Information for Non-U.S. Recipients

For recipients in the EEA, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority. The content of this report has been approved by WFSIL a regulated person under the Act. For purposes of the U.K. Financial Conduct Authority’s rules, this report constitutes impartial investment research. WFSIL does not deal with retail clients as defined in the Markets in Financial Instruments Directive 2007. The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. This report is not intended for, and should not be relied upon by, retail clients. This document and any other materials accompanying this document (collectively, the “Materials”) are provided for general informational purposes only.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE