

The Russian Economy A look into the future

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THE BELGIAN-LUXEMBOURG CHAMBER OF COMMERCE, 28/04/2005

Outline

- A look into the past
- A look into the present: current state of the Russian economy
- How to secure further growth??

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Growth has exceeded forecasts

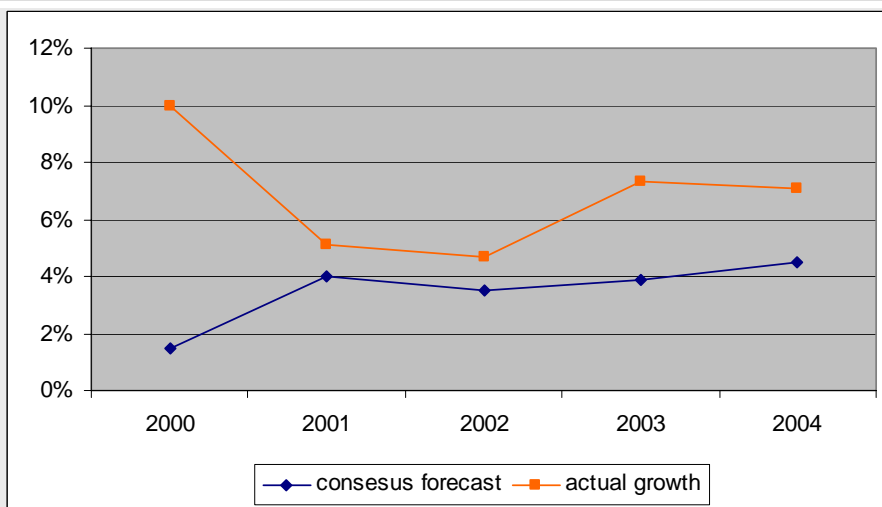
Table 1.1. GDP: forecast vs. outcomes

	Consensus forecast		OECD		Actual
2000	1.5	(Dec-99 - Jan-00)	1.0	EO66, Dec-99	10.0
2001	4.0	(Jan/Feb-01)	4.0	EO68, Dec-00	5.1
2002	3.5	(Jan/Feb-02)	5.0	EO70, Dec-01	4.7
2003	3.9	(Jan/Feb-03)	4.5	EO72, Dec-02	7.3

Source: Russian Development Centre (Concensus forecast); OECD Economic Outlook.

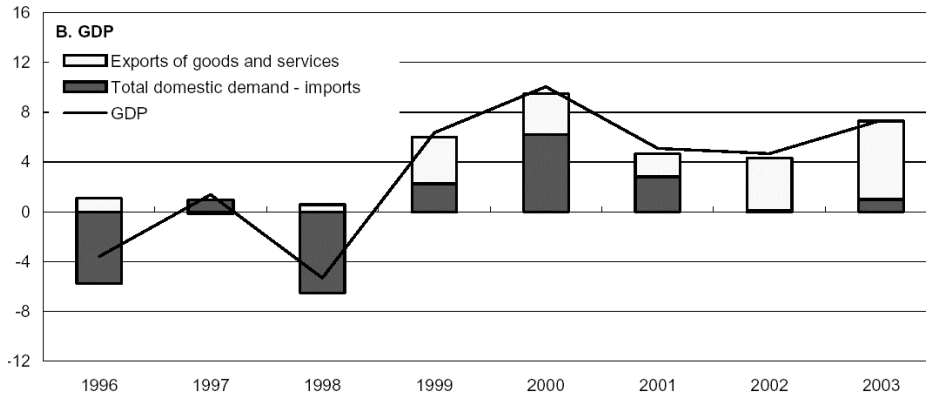
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Russian growth outperformance



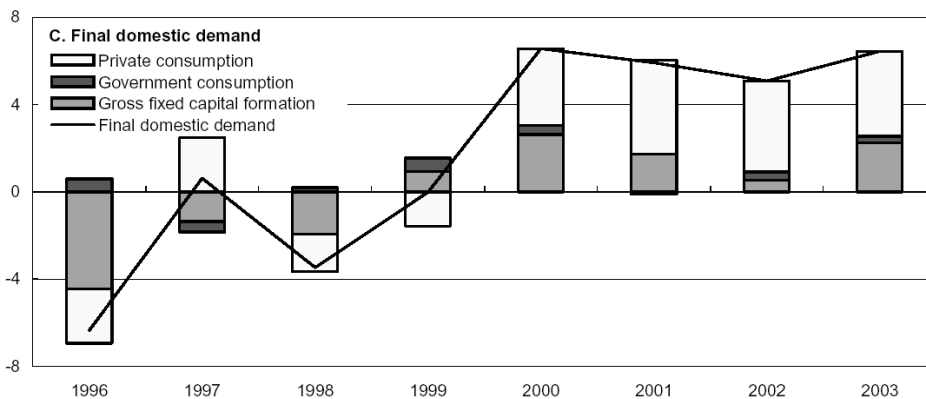
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Contributions to GDP growth, expenditure side view I



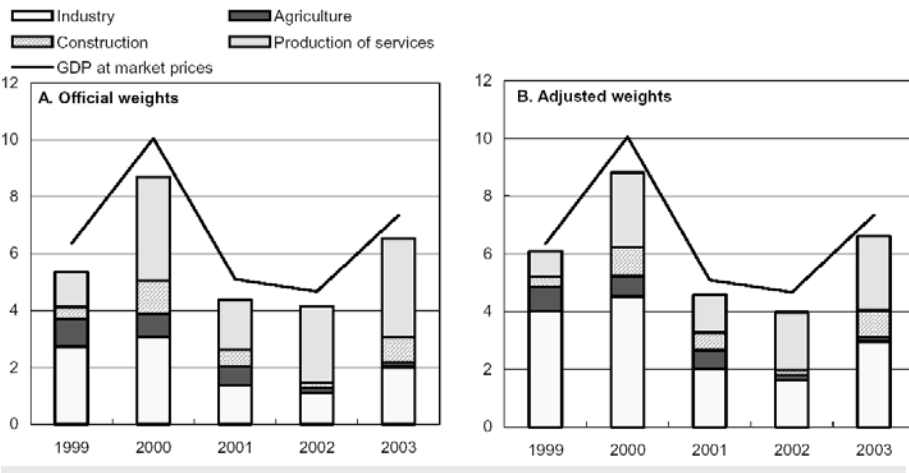
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Contributions to GDP growth, expenditure side view II



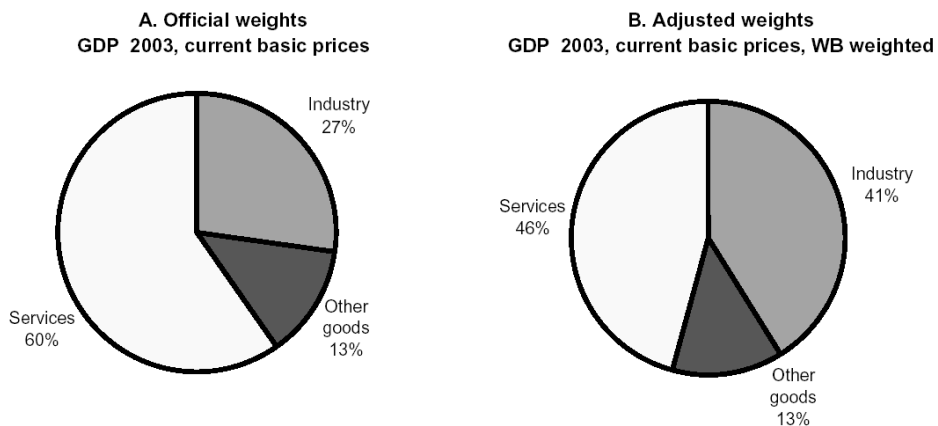
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Contributions to GDP growth, production side view



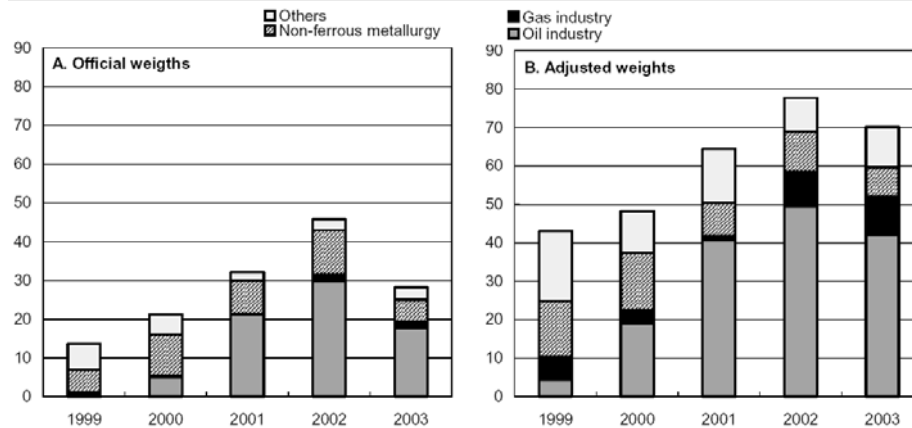
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Structure of GDP



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Contribution resource related sectors to industrial production growth in %



Source: Goskomstat, World Bank and OECD calculations.

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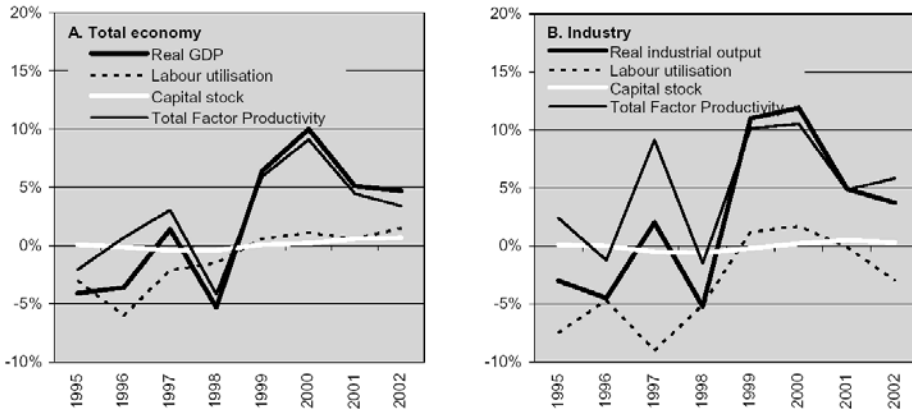
Growth and oil prices



- Oil and gaz are important in industrial production
- Level of oil price
 - Determines terms of trade
 - Cannot affect economic growth in the long run
- Changes in the oil price
 - Increases in oil prices lead to higher growth
 - Decreases in oil prices lead to lower growth
 - The Russian economy still very vulnerable to negative oil price shocks
 - The Russian economy urgently needs investment in oil and gaz sectors to keep growth

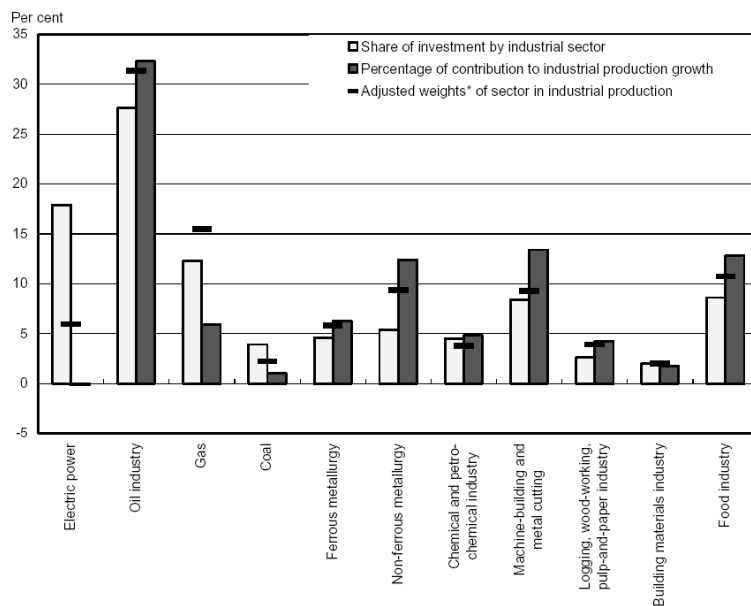
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Decomposing growth



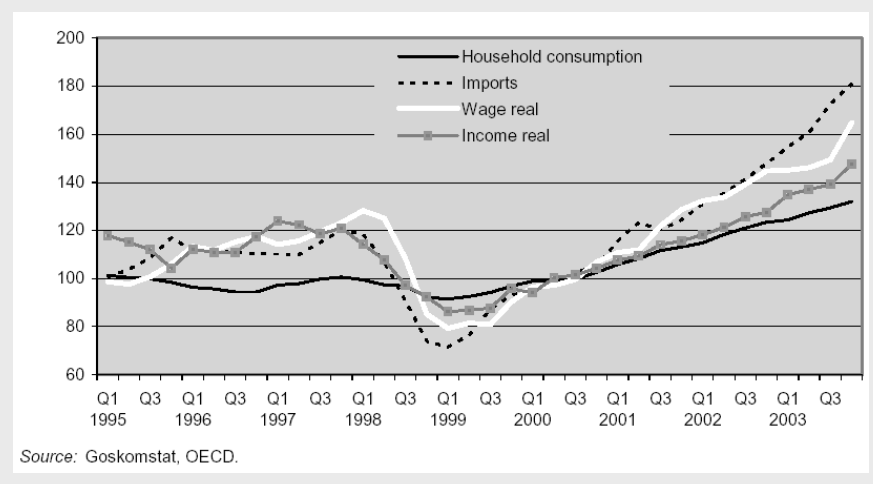
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Investment and growth



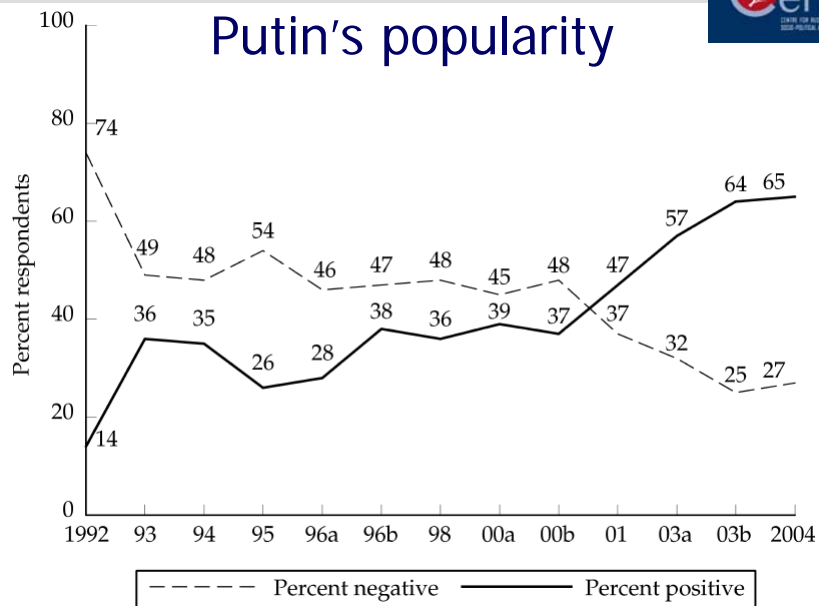
2005

Income, consumption and imports



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Putin's popularity



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Sources of popularity

- Pro
 - Macroeconomic Stability
 - Higher real income, lower inflation
 - Initially Chechnya
- Contra
 - Increasing autocratic tendencies (but Russian citizens accept more autocracy than Western Europeans)
 - Media
 - Power of military and Sint-Petersburg
 - Heavily contested social reforms
 - Paralysis in Chechnya

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Fiscal revenues and the oil price: sterilization

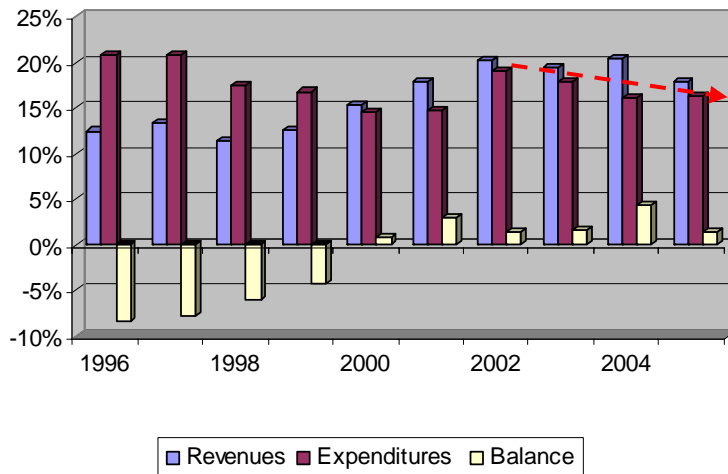
As a share of GDP

	1997	1998	1999	2000	2001	2002	2003
Actual revenues (excluding Social tax) (1)	10.8	9.2	12.8	15.5	17.8	17.2	16.7
Revenues assuming average oil price (2) (\$19-Urals)	12.6	10.4	13.2	14.1	16.2	15.3	15.0
Oil windfall (3) = (1) - (2)	-1.8	-1.2	-0.4	1.4	1.6	1.9	1.7
Actual budget balance (4)	-7.4	-5.0	-1.1	1.4	3.0	1.7	1.7
Budget balance assuming average oil price :							
(\$19-Urals)	-5.6	-3.9	-0.7	0.0	1.4	-0.2	0.0
(\$12-Urals)	-6.0	-4.4	-1.9	-1.0	0.0	-2.1	-2.0
Actual budget surplus as a % of oil windfall ((4) / (3))				103	190	88	100

Source: Economic Expert Group, OECD calculations based on Kwon (2003).

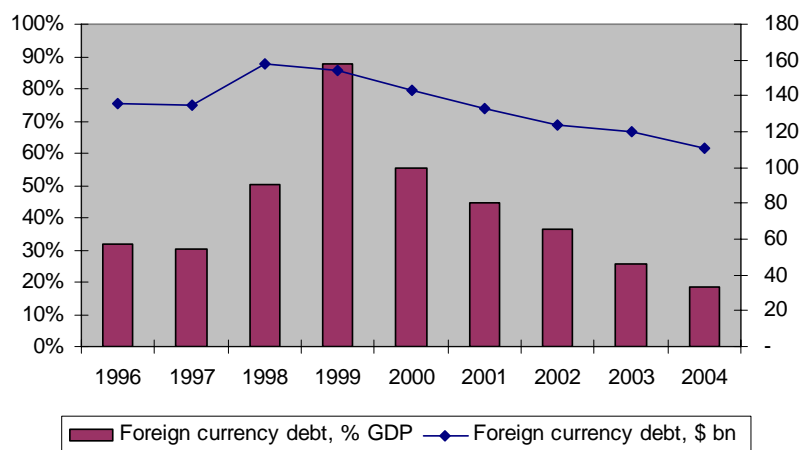
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Healthy fiscal situation



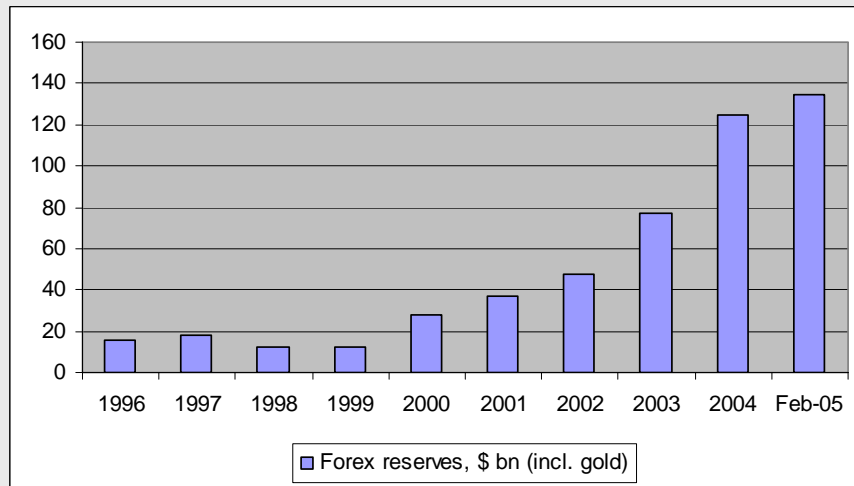
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Healthy debt situation



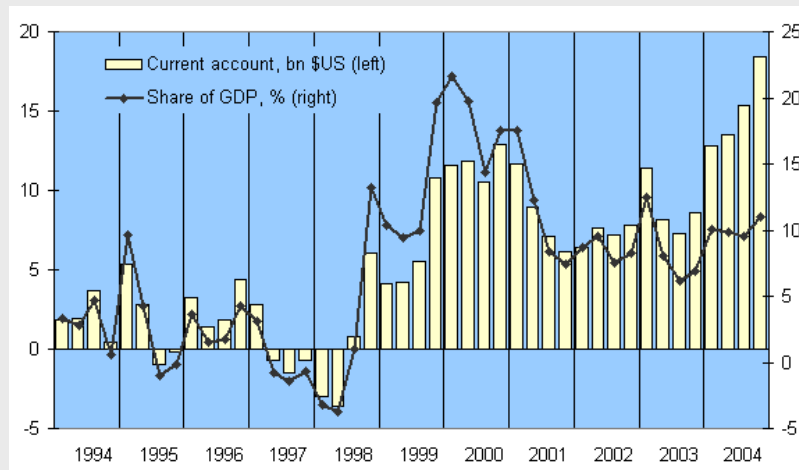
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Foreign reserves sky-rocket



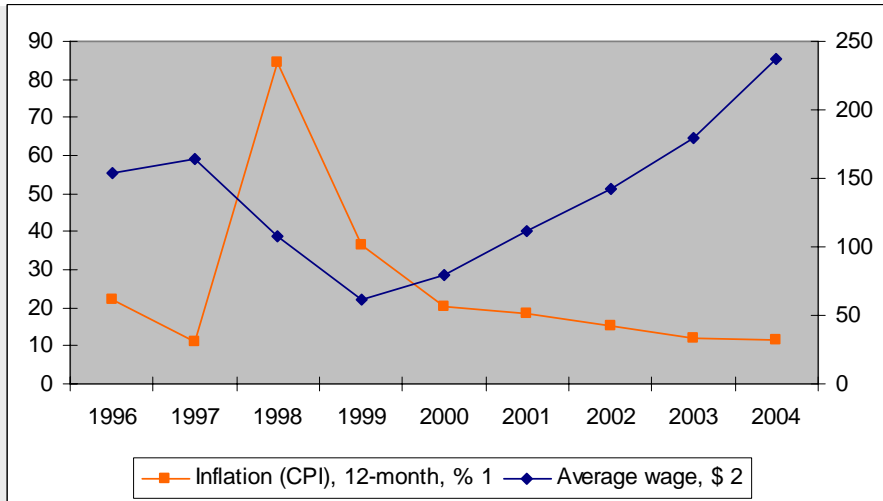
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Russian current account 1999-2004, quarterly



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Wages and inflation



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Characteristics of Russian elite



	Yel'tsin's elite, 1993	Putin's elite, 2002
Average age (in years)	51.3	51.5
Women	2.9	1.7
Of rural origin	23.1	31.0
With a higher education	99.0	100.0
With a higher degree	52.5	20.9
With a military education	6.7	26.6
With an economic or legal education	24.5	25.7
With an elite higher education	35.4	23.4
From St. Petersburg	13.2	21.3
Business representatives	1.6	11.3
Military/security representatives	11.2	25.1

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The Share of the Military in Elite Groups (in percent)

	National leadership	Government	Regional elite	Upper house of parliament	Lower house of parliament	Average by cohort
Gorbachev cohort, 1988	4.8 ^a	5.4 ^b	0 ^c	4.7 ^d		3.7
Yel'tsin cohort, 1993	33.3 ^e	11.4 ^f	2.2 ^g	2.5 ^h	6.3 ⁱ	11.2
Yel'tsin cohort, 1999	46.4 ^j	22.0 ^k	4.5 ^l	7.3 ^m	6.8 ⁿ	17.4
Putin cohort, 2003	58.3 ^o	32.8 ^p	10.2 ^q	14.9 ^r	9.4 ^s	25.1

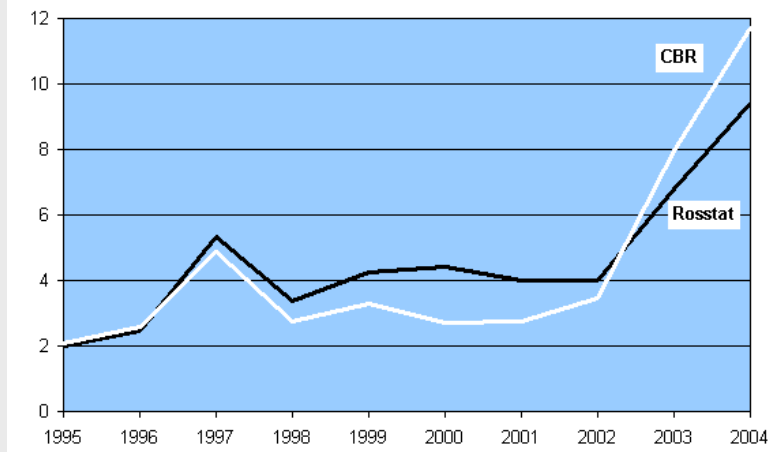
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Yukos, TNK-BP Has Putin scared off investors?

- **Foreign investors: no**
 - FDI has flocked to Russia in 2003-2004
 - Large amount is reimported capital flight
 - Largest source of FDI is currently Cyprus
 - Not even top ten in 1995
- **Domestic investors: maybe?**
 - Investment remains relatively low
 - As percentage of GDP lower than in developed economies
 - Capital flight is still high

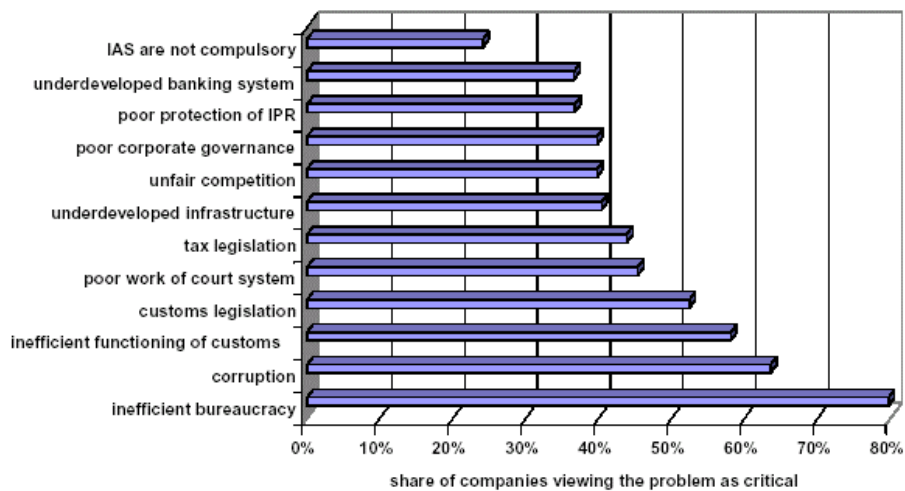
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FDI inflows according to the CBR and Rosstat, US\$ bn



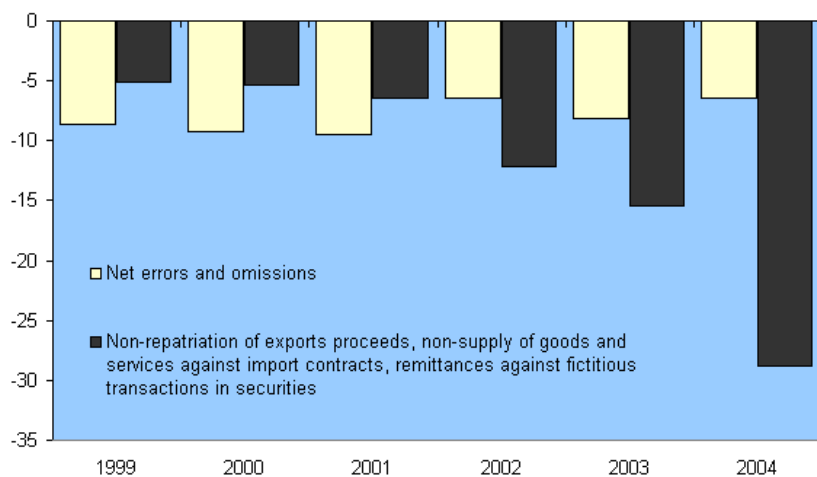
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Barriers to FDI



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Russian capital flight in US \$bn



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What to do in the future?



- Oil and gaz sector will remain important
 - Need for investment
- Diversification of the economy is necessary
 - Service sector offers very interesting possibilities
 - Small and medium enterprises are crucial
 - Corruption is very detrimental for SME development
 - Banking sector restructuring is very important here
- Rule of law and less corruption becomes more important
- Need for better infrastructure and utilities
- Russia is still vulnerable for oil price swings
 - industrial production and exports
 - Stabilization fund is very important

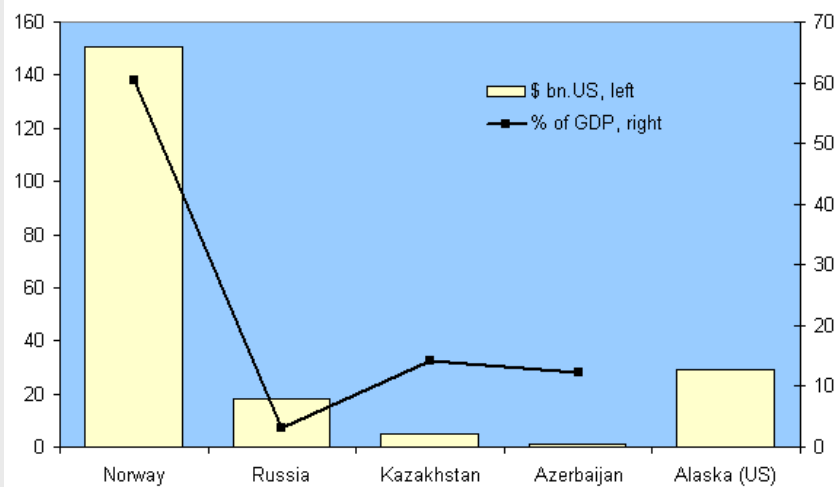
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The stabilization Fund

- Revenues due to a higher than budgeted oil price go to a special fund until 500 billion rubles are reached
- Set-up of the fund
 - Function of the current urals crude price (treshold just increased)
 - Should instead be a function of the average oil price over time
- Currently not very high (500 billion rubles)
 - Only two years of low oil prices
 - Needs to be increased
- How to spend the excess money
 - Debt pre-payment
 - Pension funds
 - No consumption

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Size of natural resource based stabilisation funds in end of 2004



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Risks

- **Renewed political instability?**
 - Not before 2008
 - In the long run, the party system is very unstable.
 - Chechnya problem is there to stay.
- **Renewed economic instability?**
 - Not in the near future
 - Problems with the utilities sectors linger on
- **Resource economies have their problems**
 - Dutch disease because of appreciation
 - Rent seeking behavior to control the resources
 - Less domestic investment in other industrial sectors

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Summary

- **My expectations?**
- **We will see more of the same**
 - Growth driven by oil and gaz, less by other sectors
 - Political and economic stability, but autocracy
 - Gradual improvements in the rest of the economy
 - Growth between 4% and 8%
 - Inflation between 10% and 15%
- **Structural reforms may lead to higher growth**
 - Utilities reforms
 - Administrative reforms

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