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Wirtschaftswissenschaftliche Abteilung

The financial crisis hits the real and social sector: Russia in spring 2009

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The triple shock

In Russia, a home-made financial crisis started already in August 2008. In reaction to the growing state-interference in the economy and the South-Ossetian war, growing amounts of foreign and domestic capital began to leave the country. During September stock markets plunged 53%. Some weeks later, the international financial crisis hit Russia's financial system; the interbank money market contracted in a "crisis of trust". To stabilize the banking system, banks were equipped with additional liquidity, several banks were recapitalized, and deposit insurance was raised substantially from 400.000 to 700.000 roubles. The rouble came under severe pressure; massive interventions of the central bank could not stabilize the currency which devaluated by about 35% within the last six month**.** In December 2008 sovereign debt credit ratings for Russia were decreased for the first time since January 1999 to BBB with a negative outlook by S&P. International reserves of the Central Bank, partly held in the Stabilization Fund, eroded from nearly 600 bn USD at the beginning of the crisis to 384 bn USD in April 2009. In the same period the price for oil, one of Russia's main export goods, fell 67%.

Thus, the Russian economy since late August 2008 was exposed to three major shocks: the Georgian conflict, the spill-over from the international financial crisis, and the plunge in oil prices. GDP growth predictions of 7% formulated by the Ministry of Economic Development (MoE) in early August 2008, eroded to minus 2.2% published in late March 2009 by the same institution. Latest IMF forecasts of -6%are even more pessimistic whereas the World Bank estimated end of March -4.5%, down from -1,7% predicted in November 2008.

Russia in spring 2009

GDP Growth: Even the pessimistic growth assumptions of international finance institutions might underestimate the growth effects of the triple crisis on Russia. According to the preliminary overview of the economic situation in Russia for the first quarter of 2009 published on 27th of April by the Russian MoE, Russian GDP is estimated to have shrunken by 9.5% from January to March compared to the same period of previous year. While a collaps of the Russian banking system could by avoided thanks to massive state interventions, the real sector of the economy, depending on exports and being still weakly diversified, is suffering hard. Although the recent economic indicators turn out to be worse than the officially predicted growth rates, no new estimates on the expected growth rates have been published by governmental institutions as yet.

Table 1: **Main economic indicators of Russia in the first quarter of 2008 and 2009 (compared to same period of previous years, in %)**

	2008 January-March	2009 January - March
GDP	8,7	-9,5
Index of consumper prices	4,8	5,4
Industrial production	6,5	-14,3
Processing industry	8,7	-20,8
Agricultural production	5,5	2,1
Capital investment	23,6	-15
Construction	28,9	-19,3
Disposable income of population	8	-2,3
Real wage	13,4	-2,3
Export January-February, custom statistics	55	-48
Import, January-February, custom statistics	49,7	-37,8
Average price of crude oil, USD/barrel	93,6	43,5

Source: Ministry of Economic Development of the RF

Prices: Since half of consumer demand is covered by imported goods, the devaluation of the rouble translates into higher consumer prices, although reduced demand has a dampening effect on prices. Thus the consumer price index for the first quarter amounted to 5.4%. But the underlying downward trend of prices is expected to persist as disposable income diminishes further. However, the trend of falling producer prices as observed from September 2008 throughout January 2009, reversed in February in spite of plummeting producers demand. According to the MoE, monopolistic price setting, reduced competition induced by protectionist anti-crisis measures, and corruptive practices in the construction sector are hold responsible for this unfavourable development.

Production: Industrial production in the first quarter fell by 14.3 percentage points in comparison to the same period in 2008, with processing industry showing the worst results (-20.8%). Output fall is reported in nearly all subcategories of processing. Main contributor to industrial contraction is the export-driven metallurgy (-27.3%), followed by transport industry (-35.5%). Lacking investment demand caused a sharp decline in production of machinery and equipment (-25.7%), with production cuts up to 90% in building equipment. Lacking consumer demand is most visible in decreased production of cars (-62.9%). Verifiable data for stocks of unsold production in this sector, as for any other sectors, are not available. It is not only the processing sector, however, who is reporting a decline on broad basis, also the production of natural gas and coal came down by 15% and 19% respectively. Construction activities, which had contributed to high growth rates over the last years, decreased 19.3% owed to the crisis in the real estate market. The second pillar of national demand, retail trade , suffered a reversal of the long lasting growth trend in February; within the first quarter, turnover of this sector fell 1,1% compared to last year . Agrarian production in comparative prices rose 2.1%, whereas in physical terms, many subcategories show a decrease.

Foreign Trade: Custom statistics show a sharp decline in exports (-48%) as well as imports (-37,8%) for January-February 2009 compared to previous year. The trade surplus decreased by 57% from 36 bn USD to a mere 15,3 bn USD. The trade surplus decreased from 49.9 bn USD to 21.7 bn USD. The plummeting exports of oil (-54.2%) and metal and metal products (-42.1%) reflect the erosion of crude oil and steel prices with physical export volumes nearly unchanged, while the decrease of gas exports (-55.9% in value terms and -59% in physical terms) is driven by the Ukrainian gas crisis in January and lower demand of CIS neighbouring countries. In January-February, these product groups accounted for 79.2% of all exports, which leaves the structure of export nearly unchanged. For imports, an erosion of investment demand is revealed in decreased import of machinery and equipment (-46.9%), with car imports alone down by 63.1%.

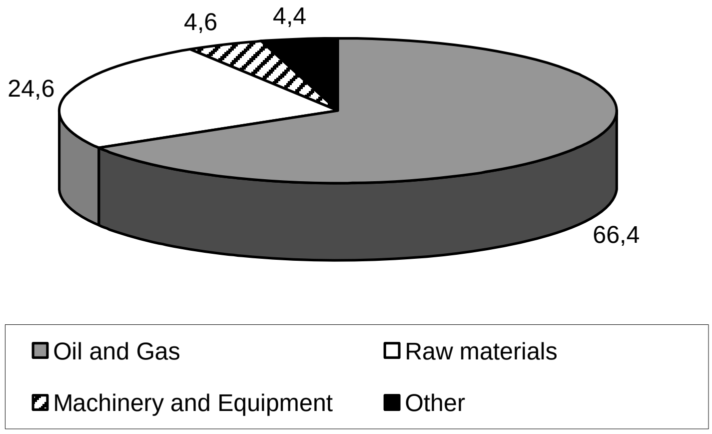

Figure 1: **Export Januar-February 2009 (% of total)**

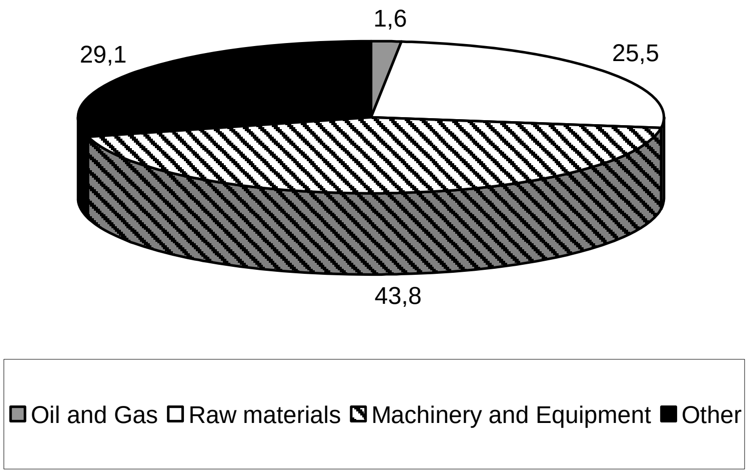

Figure 2: **Import Januar-February 2009 (% of total)**

Investment and Finance: Capital investment came down by 15% for January and February in comparison to last years investments. Due to persisting inflationary pressure, the central bank only end of April began to lower the prime rate marginally from 13% to 12.5%; lending rates of commercial banks still range from 15-16%. The risk exposure of the banking sector remains high. The amount of overdue credits is estimated between 10% (Ministry of Finance) and 3-4% (Central Bank).

Social indicators: By now, the economic crisis visibly transforms into an erosion of social indicators. During the first quarter of 2009, unemployment according to ILO definition rose by 33.9% compared to the first quarter of the previous year to 7.1 Million people or 9.5% of the economic active population. Most lay-offs took place in the metallurgical and machinebuilding sectors. In the same period, real wages, which had risen 10.3% throughout 2008, fell by 2.3%, driven by inflation and nominal wage cuts mainly caused by short-time work in the chemical and metallurgical industries. The overdue wage debt, amounting to 2% of the wage sum, almost doubled from 4.6 bn roubles in January 2009 to 8.8 bn roubles in April. In contrast to the transition period where the wage debts were concentrated in the budget sphere it is now an economy wide phenomenon. Wage indebtedness in, , the budget sphere is now only a minor part of total indebtedness (5,5%).

According to preliminary official data, the disposable income of the population fell by 2.3%. However, enterprise surveys, which also reviewed the payment of bonuses, show a much stronger decline. In addition, the whole sphere of unofficial payments, privileges and income from corruption is not captured by the data at all. Thus, the deterioration of the social situation of vast layers of the population might be de facto much more severe than indicated by social indicators.

Anti-Crisis program: On April 6th, the Russian Government published a blown-up program of anti-crisis measures, which according to statements of Prime Minister Putin amounts to 4.5 % of GDP and even 12% of GDP if financing of the central bank is accounted for (with GDP 2009 estimated at 44 trillion roubles). While these calculations are hard to trace, the main measures foreseen in the program for 2009 sum up to 2.93 bn roubles including losses of budget income due to lowered tax rates. The administration of money to be distributed to the economy rests in the hand of the central government; decentralized measures in the regions remain restricted to co-financing of labour-market programs, closing of regional budget deficits (300 bn roubles), and participation in housing reconstruction programs. While the priorities as described in the analytical part of the program should focus on development of human capital and restructuring of the economy, the lions share of money will flow to the banking sector (up to 1055 bn roubles) , conservative measures preserving enterprises identified to be of systemic importance (up to 300 bn roubles), and social measures like covering of deficits of the pension fund (315 bn roubles), financing of additional joblessness (44 bn roubles), and support to the housing sector. The deficit-running state-owned railroad company will receive 50 bn roubles, the agricultural sector is stimulated with 70 bn roubles, of which 45 bn are additional capital for the Russian Agrarian Bank. State purchases directed to support the national automotive industry amount to 32.5 bn roubles, defense industry is subsidized by a set of different measures amounting to 70 bn roubles. Construction will be pushed by additional public demand, favourable credit conditions, and higher deductibility in the private sphere with 104 bn roubles.

With respect to the substantial amounts of measures foreseen, the budget deficit of 2009 is planned to reach about 8% of GDP or 3 bn roubles. The 18% VAT, which was envisaged to be lowered already in 2008, will remain unchanged in 2009 and most probably throughout 2010. According to the program, approximately 2751.5 bn roubles will be spent from the Stabilization Fund to finance the mentioned measures.

While only a part of these measures are encouraging business and structural change, the stimulation of enterprises through lowered corporate taxation (from 24% to 20%) and the introduction of favourable depreciation schemes for certain investments, depriving the budget of about 350 bn roubles, are a step in the right direction. Plans to increase the so-called social tax, which covers all wage deductions directed to social funds, from 26 to 34% have been postponed to 2011, which is quite favourable for business. However, tax reductions and tax breaks are not sufficient to push restructuring if further incentives for future-oriented investment are lacking. The financing of active measures to encourage the development of small and medium enterprises remains limited with 30 bn roubles. The percentage of future-oriented investment as measures of labour qualification and the improvement of human capital cannot be identified in the program, because the amount of 77.6 bn roubles directed to labour market measures comprise an unspecified amount of financing of short-time work. Thus, only a minor share of the program is devoted to the main structural problems of the Russian economy – lacking diversification and innovation and a lack of qualified labour supply.

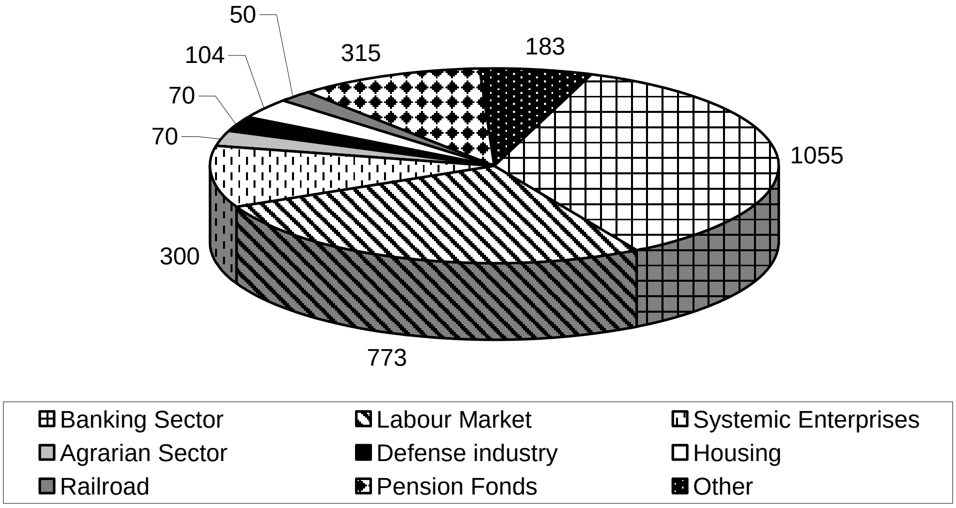

Figure 3: **Measures of the Anti-Crisis-Program 2009 (% of total)**

Politics . The economic crisis in Russia bears both a political risk stemming from the population deprived of their incomes, and a dangerous potential for intensified centralization and state influence on the economy. Averting the already materialized and expected future social unrest from the central government, on March 16th President Medvedev accused the banks of “corporate egoism”. He called them to expand lending to enterprises and to agree to moratoria of enterprise debt repayment to avoid bankruptcies and growing joblessness. These signals for bailing-out of enterprises, if taken serious by banks, could result in the revival of the system of soft loans known in early transition. On contrast, Minister of Finance Kudrin blames the government for not having sterilized the massive money inflows earned with oil and gas, which financed bubbles in the economy. Regarding depth and duration of the crisis, he takes the most pessimistic position warning of a second cycle of the banking crisis coming up with the growing amount of overdue credits, while the Ministry of Economics and especially the central bank already mid of March saw an end of the crisis.

The struggling for influence over additional budget amounts waiting to be distributed is offering many possibilities for renewed activities by oligarchic structures and grand corruption. In addition, the influence of the state is strengthened. A prominent example is the deal with Oleg Deripaska´s holding, which while seeking support from the government in restructuring debts was asked to provide a 25% stake of Norilsk Nikel as collateral. According to the governmental program, the 295 enterprises identified to be of systemic importance can enjoy additional crediting only if they cut managerial bonuses substantially, provide full information on all operational accounts and agree to the “regulation of their relations with suppliers and contractors”. The latter phrase evokes soviet-style planning mechanisms. Line ministries, long deprived of their channels of influence over “their” enterprises, thus might regain access to intra-enterprise information, control over assets, and regain a part of their former strength. The same holds true for the selected state banks, which are distributing and administering the governmental programs and loans