The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

No Threat of Recession, But Few Are Cheering

By Martin Gilman

May 29, 2013

There has been considerable hand-wringing about Russian economic performance and prospects in recent months. Rumors have been circulating of a recession in the fall or even of a new full-blown crisis. Prime Minister Dmitry Medvedev's report to the State Duma on government policy to revive the economy last month even noted that a recession could occur if global commodity prices continued to weaken.

Medvedev's lament came in the context of a wrenching drop in oil prices from about $118 per barrel in mid-February to $102 per barrel by mid-May. Hence the idea spread that if this decline continues, there will inevitably be both budget and exchange-rate crises brewing after the summer.

Perhaps concerned that the pervasive sense of pessimism could become self-fulfilling, Medvedev then tried to attenuate such worries, saying in a May 20 interview with Komsomolskaya Pravda that there was no need to panic. "I am confident we will succeed in avoiding a crisis like that of 2008-09. There is no need to stockpile canned meat, soap, matches and salt!" Medvedev said.

On the face of it, the numbers have been troubling. Last year's average growth in gross domestic product of 3.4 percent masked a decline from a 4.8 percent growth rate in the first quarter of 2012 to only 2.1 percent in the last quarter. What's more, the initial GDP growth number was only 1.1 percent for the first quarter of this year. This decline led to fatalism among some analysts including at the Economic Development Ministry, which revised its economic growth forecast for 2013 downward by a third to 2.4 percent.

Earlier this month, the European Bank for Reconstruction and Development added its voice to the gloom when it cut its growth forecast for Russia this year by half to 1.8 percent, citing poor internal and external demand. It also called for stimulus spending to boost growth.

Fortunately, most of this seems to be casual extrapolation from a few data points. The initial numbers obviously worried the Kremlin enough to discuss possible measures to stimulate the economy, and a task-force was created to find solutions to reverse this downward trend.

The reality, however, is more nuanced.

This pessimism about Russia's short-term economic prospects seems misplaced. For one thing, the data are not miserable. Subsequently, the first quarter GDP growth estimate was revised upwards to 1.6 percent. While somewhat technical, probably the main reason for the weaker growth indicators and higher inflation in the first quarter, which are likely to continue through this quarter ending in June, is because of base effects. Growth in the corresponding periods of last year was very strong and inflation was low. Just as it reversed in the latter half of last year, it is likely that a similar reversal will occur, thus allowing for higher growth and lower inflation from the middle of this year. So the underlying factors driving growth, namely robust domestic consumption and lackluster investment, will continue as before, but the statistical reflection will appear better in the last six months of the year.

In addition, there is a neighborhood problem. Russia is still one of the few European economies growing at more than 3 percent. In fact, according to International Monetary Fund estimates, it may be in the rare group to even register positive growth at all. China is also slowing, with a deleveraging effect on the demand for commodities. The Kremlin is correct that Russia's slowdown is not homegrown. That is not to say that, given the right policies, Russia could not be doing even better.

Not all analysts have joined a consensus of gloom. For instance, Goldman Sachs downgraded its forecast for 2013 though not by much. At the start of the year, the bank was predicting growth of 3.8 percent this year, and now it shows a rate of 3.1 percent.

In fact, seen in a broader context, Russia is coping reasonably well. In its latest projections for the world economy published last month, the IMF maintained GDP growth at 3.4 percent in 2013, or the same as last year. In contrast to their colleagues at the European Bank for Reconstruction and Development, the IMF note that a higher rate is not feasible in the short run because the output gap is essentially closed and growth is running close to potential.

Unemployment is expected to decline further to 5.5 percent of the labor force this year from 6 percent last year. Understandably, the Kremlin is reluctant is add extra spending at this time because inflation is running too high. (It has been 7.3 percent in 2013 through May 20.) A rising price level is one of the key concerns raised in opinion polls, and presumably the Kremlin is even more concerned to lower inflation than to attempt to boost demand in an economy already near full employment.

The Central Bank noted that higher-than-targeted inflation was driven by food prices and regulated tariffs increases. But given the current policy stance, stable inflation expectations and the absence of adverse food prices shocks, it sees inflation reverting to the target range of 5 percent or 6 percent on an annualized basis in the second half of 2013.

Then, it will be a case of waiting to see if the base effects on both growth and inflation do actually make the difference that the more positively oriented economists are expecting. If inflation does start to fall from June, then the Central Bank will have further scope to cut its benchmark discount rate in September.

So while the prognosis for the rest of the year is no doubt better than many expected even a few weeks ago, the longer-term prospects for the country's economy remain highly uncertain. The external environment is unlikely to stay benign. There are simply too many accidents waiting to happen in economic and financial terms, whether in the eurozone, the Middle East, Japan or elsewhere. More fundamentally, if Russian policymakers cannot summon the political will to allow a thriving private sector, then productive investment as the critical source of long-term sustainable growth will not materialize. Either way, it's hard to be optimistic.

Martin Gilman, a former senior representative of the International Monetary Fund in Russia, is a professor at the Higher School of Economics.

Original url:
https://www.themoscowtimes.com/2013/05/29/no-threat-of-recession-but-few-are-cheering-a24500