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IMF Likely to Slash Russian Growth Forecasts

By The Moscow Times

April 29, 2014

The International Monetary Fund said on Tuesday that central, eastern and south-eastern Europe faced "an unusual constellation of risks" as the fund prepared to cut its forecasts for Russian growth for the second time in less than a month.

In a new report, the IMF said the region was expected to benefit as the euro zone recovers from its debt crisis, but the tension over Ukraine and market concern as the U.S. reduces monetary stimulus were creating high uncertainty.

"An unusual constellation of risks clouds the outlook," the Fund said in its spring Regional Economic Issues report.

"Geopolitical tensions surrounding Russia and Ukraine, more challenging global financial conditions as monetary policy in advanced economies normalizes, and the possibility of protracted weak growth in the euro area could take a toll on the region's growth prospects."

Although the bulk of the region was forecast to see growth almost double this year to average 2.3 percent, Russia and Turkey — the region's two biggest economies — were instead expected to slow.

Aasim Husain, the deputy head of the IMF's European department, said tension between Russia and the West over Ukraine and the potential impact of sanctions were being studied now by an IMF team. That team is in Russia and due to report this week.

Only this month, the Fund cut its 2014 Russian growth for the third time running, to 1.3 percent. Its original projection was around 3 percent.

"The impact is not so much from the sanctions themselves but the confidence effects that arise from what future sanctions might look like," Husain told reporters. "... I am not going to offer a guess as to how much of downward revision [in the growth forecast] there will be, but I am almost certain we will see a downward revision."

The United States froze assets and imposed visa bans on seven Russians close to President Vladimir Putin on Monday. It also sanctioned 17 Russian companies in reprisal for Moscow's actions in Ukraine.

President Barack Obama said the moves, which add to measures taken when Russia annexed Crimea last month, were to stop Putin fomenting rebellion in eastern Ukraine — an allegation Moscow denies.

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Some effect on other countries in the region from the escalating tensions was likely, Husain said, but the financial links with Russia and Ukraine were "not large," except in a few cases like Moldova and Belarus.

He added, though, that for central and eastern Europe, "The concern is what happens if the Russian economy slows. Sanctions and counter-sanctions and the related confidence effects would be a huge dampener on investment prospects in Russia."

Inevitably, the biggest worry was energy. About 40 percent of Europe's gas comes from Russia, and even more goes to central and south-eastern Europe. Russia also supplies about a third of Europe's oil.

Another issue the IMF raised was the region's above-average government debt, much of which is held by international investors. Foreign investors tend to pull out faster in times of tension, and rising interest rates in more predictable economies like the U.S. are beginning to tempt them. That creates a risk of outflows on top of higher borrowing costs.

"We have high frequency data ... those show outflows re-emerging in Q1 and going into Q2," Husain said. "Judging from that, it would not surprise me to see negative portfolio flows for the region as a whole in the first half of the year."

Some countries in the region may also face more reductions in bank lending. The European Central Bank's checks on euro zone banks could put further pressure to de-leverage on those banks that have significant exposure to the region.

On the other hand, as long as ECB sticks to its promise to keep its interest rates near zero, it could help protect the region from the full impact of rising U.S. interest rates, which tend to drive global borrowing costs.

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