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Russian Economy Likely to Enter Recession in Q2

By The Moscow Times

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KALININGRAD — The Russian economy will probably enter recession by the end of the second quarter, the economic development minister said Tuesday, as investment and financial markets suffer from the Ukrainian crisis, the worst standoff with the West since the Cold War.

Gross domestic product might fall 0.0 to 0.1 percent in April-June, after shrinking on a quarter-on-quarter basis by 0.5 percent in the first three months of the year, Economic Development Minister Alexei Ulyukayev said Tuesday.

A technical recession "is possible," Ulyukayev said. The common definition of recession is two consecutive quarters of declining GDP. It would be the second recession in five years for Russia.

Ulyukayev would not specify the causes behind the ebbing of the economy, but other government officials have admitted that sanctions imposed against Moscow have hurt the economy and that geopolitical risks related to Ukraine are hindering growth.

The Economic Development Ministry has warned that investment — once a pillar behind growth — is falling dramatically. Analysts expect investment by Russian companies in tangible assets to fall 2.5 percent this year and 5 percent in April alone.

Ulyukayev's GDP forecast follows a similar warning earlier this month from the Finance Ministry. It is in line with the view of the International Monetary Fund, which said in late April that Russia was "already experiencing recession."

"Russia's economy … will dampen further in the face of a deteriorating political situation, tougher sanctions, falling investor confidence and a business climate worsened by fears of retaliation against western companies that produce in or sell to Russia," analysts at IHS, which offers economic and financial analysis, said in a note Tuesday.

The economic downturn comes despite relatively high oil prices, Russia's main export and a huge source of income. Crude prices have stayed above $100 a barrel so far this year.

Russia's annexation of Crimea from Ukraine, however, spurred capital flight that in the first three months exceeded last year's total, reaching $63.7 billion. The losses weighed on the ruble, which has fallen 6 percent against the dollar this year.

Moscow stocks also tumbled. Most assets have recovered some ground, but Russian equities and the ruble are still undervalued compared with many emerging market peers.

Economic consequences emerging from Russia's involvement in the Ukrainian political crisis also include higher inflation, which Ulyukayev said may peak at 7.5 to 7.6 percent by the end of this month or in June, above the Central Bank's recently raised forecast for the year of 6 percent.

Inflation, a long-time plague for Russia, has been pushed higher by the weakening of the ruble. The rate is broadly expected to decline in the second half of the year when food prices fall after the harvest and tight monetary policy restrains spending.

Ulyukayev, a former deputy governor at the Central Bank, said the Central Bank should lower its key lending rate, which the bank was forced to raised by a cumulative 200 basis points in the past two months to 7.5 percent to stem capital flight.

"I would do it [cut rates], based on the economic situation and on the basis of the forecast for inflation," he said. He estimates inflation may come at between 6 to 6.5 percent this year. But most analysts polled by Reuters do not expect the Central Bank to cut rates anytime soon, with risks of escalation of the Russia's standoff with the West still very high.

"We see the Central Bank as biased to hike, since we see a further hike in the event of escalation, and no cutting in a de-escalation scenario," analysts at Morgan Stanley wrote in a recent note.

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