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Western Sanctions Freeze Russia's Economic Growth, IMF Says

By The Moscow Times

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ST. PETERSBURG — Sanctions imposed on Russia over Ukraine have brought growth to a standstill, had a "chilling effect" on investment and could force Moscow into economic isolation, the International Monetary Fund said Tuesday.

The international lender's report chimed with words from Russia's Central Bank head, Elvira Nabiullina, who told a banking conference that growth was not only unsatisfactory but was putting the country in a difficult situation.

Russia has been hit by sanctions from the U.S. and European Union, prompting investors to pull out of a country where leaders have used the punitive measures to call for a more self-sufficient, or patriotic, course for the economy.

With the Fund keeping its growth forecast at 0.2 percent this year, and the Central Bank's at 0.4 percent, both undercut the Economic Development Ministry's hopes that its 0.5 percent estimate would be beaten this year and come in closer to 1 percent.

"Even without the escalation [of the Ukrainian crisis], prolonged uncertainty and the resulting deterioration of confidence could lead to lower consumption, weaker investment, and greater exchange rate pressure and capital outflows than assumed under the baseline," the IMF said in a report.

"Moreover, this risks derailing the reform agenda and a shift toward more emphasis on economic self-reliance rather than integration with the rest of the world," the report said.

President Vladimir Putin has called for business leaders to repatriate their assets and reduce their dependence on Western financial markets after Russian officials, many of them his close allies, were targeted by the sanctions, which included asset freezes and visa bans.

But measures to try to protect the economy failed to stop Russia losing $80 billion in capital flight in the first five months of the year, the ruble losing 10 percent of its value against the dollar and inflation spiking.

Nabiullina said that economic growth was too low and causing concerns about investing in Russia.

"The ruble's long-term stability is possible only by lowering the outflow of capital," Nabiullina said Tuesday.

Some officials have played down the impact of sanctions on the economy, but the IMF said the "chilling effect" would hurt an economy at a crossroads when it might dump attempts to diversify away from its oil dependence.

Capital Leaves

"This comes at a crucial moment when the old growth model based on energy and use of spare capacity has been exhausted, and moving to a new growth model based on diversification requires new investment, including foreign technology," the IMF said.

Antonio Spilimbergo, the IMF's mission chief to Russia, underlined the message to journalists on the sidelines of the St. Petersburg banking conference, saying that Moscow should not retreat.

"It is very important to be more integrated with the rest of the world, both financially and economically," he said. "Now, the recent events are problematic ... because it would be a big pity if this takes a toll on investment in the longer term."

Firms are not spending on tangible assets, such as building and infrastructure, and capital expenditure has been falling month after month, down 2.6 percent in April.

Instead, money is flowing out of the country. The IMF estimates that capital outflows could reach $100 billion this year, in line with the Russian government's estimates.

The Fund said fiscal budget reserves, of about 0.3 percent of GDP last year, would cushion the overall budget balance from Crimea-related spending on infrastructure.

The government revised down its budget surplus forecast on Tuesday to 0.4 percent. "Under the baseline scenario, general government debt is expected to remain sustainable and low," the IMF said.

Russia's sovereign debt to GDP ratio stood at about 12 percent last year, while many developed countries, such as Italy or Japan, carry a burden of 100 percent or more.

The IMF urged the Finance Ministry, however, to remain prudent in spending and when assuming the base oil price for budgetary purposes.

The energy sector accounts for one-fifth of Russia's gross domestic product, two-thirds of exports and about one-third of general government revenues.

"Additional fiscal measures, if needed, should be temporary and of high quality and be set in a medium-term framework that ensures sustainability," the IMF said. "But additional fiscal consolidation in outer years is needed to rebuild buffers."

The Finance Ministry manages two sovereign funds, the Reserve Fund and the National Wealth Fund, which stand at $87 billion each. The Reserve Fund, which is to cover budget shortcomings, is meant to ultimately reach 7 percent of GDP.

Last year, it stood at 4.3 percent.

"With the Reserve Fund below its target, the authorities risk pro-cyclical fiscal adjustments in the event of large and lasting oil price decline," the IMF said. "This risk is heightened given the already high level of oil prices. Staff argued for more prudent oil-price assumption during the budget process to generate more savings."

The IMF says the Central Bank should raise rates to try to curb inflation, which it expects at 6.5 percent by the end of the year, above the Central Bank's estimate of about 6 percent.

The Central Bank's general target is 4.5 percent.

"Higher rates would also help reduce capital outflows that have emerged amid geopolitical tensions, global liquidity tightening and rate hikes by major emerging markets' central banks," the report added.

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