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Facing Sanctions and Crashing Oil Prices, Russia's New Budget Looks for Silver Linings

By The Moscow Times

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Finance Minister Anton Siluanov is trying to stay optimistic as Russia's economy is buffeted.

Russia's newly approved budget rests on optimistic GDP forecasts as well as high oil prices, forcing the government to work hard to meet its projected growth rates, Finance Minister Anton Siluanov said.

The 2015-17 budget, Russia's tightest since the global financial crisis and its first since the Ukraine crisis erupted, was approved last week. It forecasts gross domestic product growth of 1.2 percent next year, and 2.3 percent and 3 percent in the following years.

"There are risks to economic growth rates. It is a rather optimist forecast; there are risks to oil price," Siluanov told the Reuters Russia Investment Summit.

"Without a doubt, this and the next year we will have to try very hard to ensure the planned growth rates."

Russia's economy has slowed sharply this year, partly due to large flows of capital out of the country and the trade and financial sanctions imposed by the United States and European Union in response to Moscow's role in Ukraine.

Delivery of the budget presents the greatest challenge for 51-year-old Siluanov since he replaced Alexei Kudrin, a veteran fiscal hawk popular with investors, three years ago.

It also tasks the government of President Vladimir Putin with leading the country prudently through the crisis, ignoring calls for more state spending to stimulate an economy that may grow by 0.5 percent at most this year.

"We are preparing and working on different scenario options, including a worst-case scenario," Siluanov said.

Tightening the Belt

The West imposed sanctions in retaliation for Russia's annexation of Crimea in March following the fall of a pro-Moscow Ukrainian president and later tightened them to target the financial, oil and defense sectors. Russia has taken counter-measures, including a ban on many U.S. and EU food imports.

The 1.2 percent growth forecast for next year is based on the assumption that the sanctions will slowly start to ease. Kudrin said this week that Russia would flirt with recession next year.

Risks to the budget also come from uncertainty over crude prices as oil and gas provide about half the government's revenues. Many economists see benchmark Brent crude, which usually trades at a slight premium to Urals — Russia's chief blend — at $90 per barrel by the end of next year.

"Today, crude trades already at $92-$93," Siluanov said. "And we balanced our budget at a price of $100 per barrel."

Urals traded at around $93.80 per barrel on Friday.

The government may also find it hard to raise debt, which is needed to ensure the deficit keeps to a planned 0.5 percent of GDP. The Finance Ministry wants to borrow $7 billion abroad next year and 1.1 trillion rubles ($28.8 billion) at home.

The domestic sum is twice this year's planned amount, which the ministry is already struggling to fulfill. "1.1 trillion rubles is a very big amount," Siluanov said, but would not comment on Russia's ability to borrow abroad, saying only that his ministry would "monitor the situation."

The key to ensure implementation of the budget, he said, was to control spending and under no circumstances overdo stimulus.

"We have to start living in a new paradigm, move toward a new understanding of the economic situation," he said. "We need to shrink, we need to build an economic model based on a new macroeconomic situation."

The Economic Development Ministry has called on the Central Bank to lower borrowing costs and on the Finance Ministry to boost spending, but Siluanov said both the government and the ministry supported the Central Bank's tight monetary policy.

"We need a hard-line approach toward budget and monetary policies," he said. "As soon as the Central Bank lowers rates in this situation, or budget spending increases, this will negatively affect the balance of payments."

This, he added, could lead to a further weakening of the ruble and send inflation up. Consumer price inflation has already overshot all forecasts, and is expected to climb well above 7 percent this year. "And that means again high rates, and off we go again," Siluanov said.

There are risks that revenues will fall short. "We would not want to raise taxes," Siluanov said. "This is an extreme measure, which we do not envisage implementing."

Instead, he said, his ministry might do what many economists fear: tap into one of its oil windfall revenue funds, the Reserve Fund. Set up with the goal of covering budget shortfalls, this fund stood at nearly $92 billion on Sept. 1.

The 2015-17 budget allows for use of up to 500 billion rubles from the Fund next year. On Wednesday the World Bank urged prudence in spending cash from the Reserve Fund and its sister, the National Wealth Fund.

"In the early stages, we would definitely use the Reserve Fund [rather than raise taxes]," Siluanov said.

He added that Russia needed a current account surplus of about 4 percent of GDP to make up for capital outflows, which are likely to exceed $100 billion this year. The current account surplus is projected at around 3 percent of GDP in 2014.

"In times of sanctions, it is necessary to have a strong balance of payments and a strong budget so as not to allow external factors, such as oil price, sales volumes of crude and crude products, to hinder our obligations," he said.

Sanctions and counter-sanctions threaten the broad global economy, he said. This could mean the goal, set by the Group of 20 leading nations, to boost growth by 2 percent above what's planned for the next five years, will not be achieved.

"It will not happen if we keep on introducing mutual restrictions or sanctions," he said. "Restricting trade has a negative effect on investment, both in Russia and in other countries. Therefore, it is certainly a bad tool for solving problems. Political issues must be resolved through negotiations."

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