

# Economic Update Russia

11 March 2013

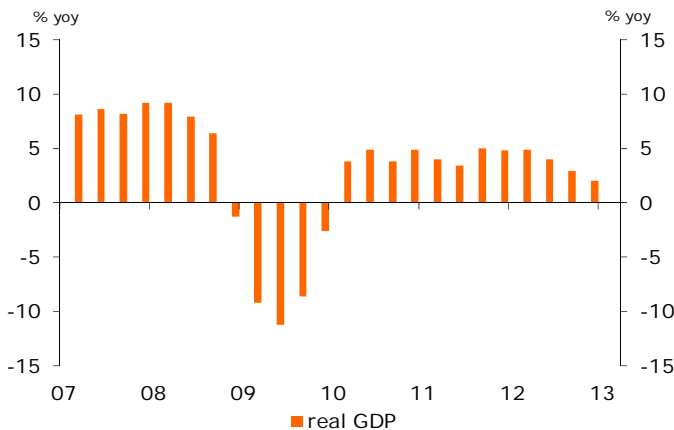
## Lower trend growth

<b>GDP</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
World	3.9	3.2	3.5
US	1.8	2.3	2
Euro area	1.4	-0.4	-0.2
<b>Russia</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
GDP	3.8	3.9	4.1
Inflation	5.3	6.5	6.7
Unemployment	6.2	6.1	5.8
Budget balance	-0.8	-1.0	-1.0
Public debt	8.1	8.4	8.7
Current account	4.4	2.8	2.3

Preliminary data shows that the Russian economy grew by 3.4% yoy in 2012. However, this masks the fact that the economy slowed fairly sharply over the course of the year and growth will remain subdued at 3% in 2013. Crucially, trend growth in Russia has slowed and the government needs to boost fixed investments to push it back up. Even though economic growth is slowing, the central bank is resisting government pressure to lower interest rates, since inflation is on the rise. Meanwhile, unemployment recorded historical lows in 2012, but is expected to pick up again.

Source: IMF WEO update

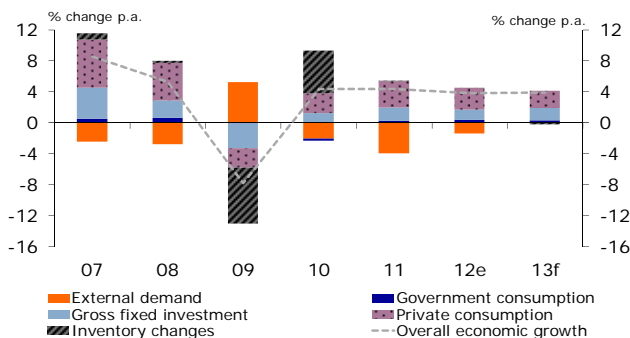
## Quarterly GDP slowed in 2012



Russia's preliminary GDP growth release by Rosstat of 3.4% yoy in 2012 was lower than the 4.3% GDP growth recorded in 2011. This was the result of the deepening of the Eurozone crisis last year and the fact that European countries such as the Netherlands, Germany and Italy are Russia's main export partners. However, a key point is that growth slowed sharply over the course of the year. While 1Q12 GDP growth was 5% yoy, economic activity is estimated to have slowed to less than 2% yoy in 4Q12. GDP growth is estimated at 3% in 2013, as we expect the troubles in the Eurozone to continue this year, which will weigh on the economies of Russia's European export markets.

Source: Reuters EcoWin

## 2012 GDP breakdown



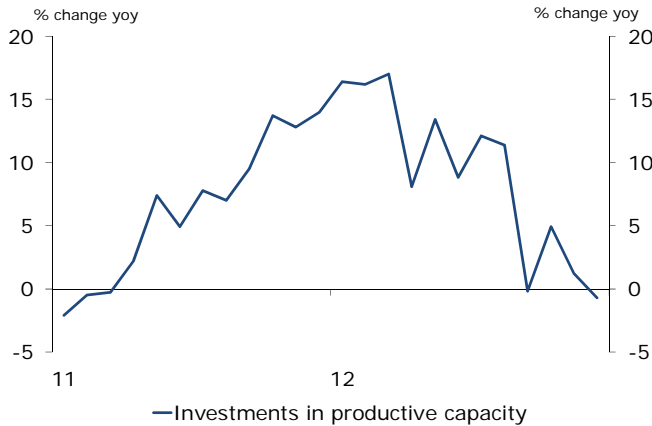
In Russia, private consumption historically is the largest structural growth driver. In 2012, especially household spending was the key growth driver. This will continue in 2013. Private consumption rose by 6.6% yoy in 2012. The surplus of the trade balance fell to 9.5% of GDP in 2012, down from 10.5% in 2011. Given the troubles in Russia's European export markets, the trade balance surplus is expected to decline in 2013. Government expenditures remained roughly the same in 2012 as in 2011. However, investment growth slowed sharply, growing only by 6% in 2012, down from 10.2% in 2011. The decline in investment growth is a very worrisome development for the Russian economy.

Source: Reuters EcoWin

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## Fixed investments falling



Source: Bloomberg

The fall in fixed investments is exactly the opposite of what Russia needs. In the past, Russia relied on making better use of underutilized resources to generate growth. Since 2000, capacity utilization has risen sharply and over the next decade economic growth will have to be driven by an expansion of productive capacity, which requires much greater investment. The government appears to recognize the importance of raising investment. Recent efforts included encouraging Russian businesses to invest domestically instead of overseas and trying to boost Russia's international reputation. Failing to raise investments significantly would imply a markedly lower GDP trend growth of 3% from 6-7%.

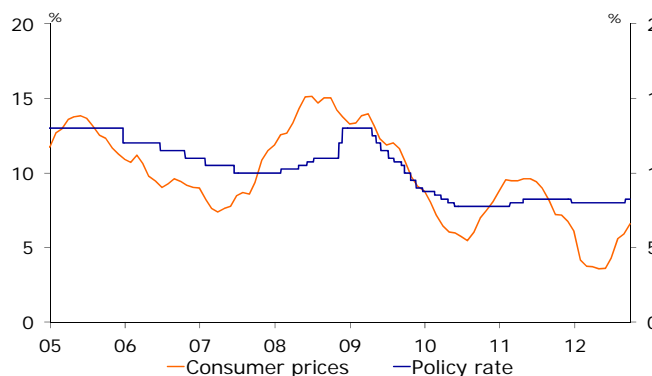
## Unemployment at records lows



Source: Reuters EcoWin

The unemployment rate fell to a historic low of 5.1% in 1H12. This is partly attributable to the shrinking population and low life expectancy. We expect the rate of reduction to recede and unemployment could pick up again. This is because we expect a substantial restructuring of Russian enterprises in the medium term. Firms will strive to maintain competitiveness in most sectors since Russia's accession to the WTO in 2012 means more foreign competition. In the long term, there will also be recognition of former President Medvedev's plan to reduce the large public sector payroll, but the plan has been put on the back burner by President Putin for now.

## Interest rates and inflation



Source: Reuters EcoWin

The central bank of Russia (CBR) has kept its main policy rate unchanged at 8.25% at the February policy meeting for the fifth month in a row. The CBR is not expected to yield to pressure from the government to lower interest rates to spur economic growth. The CBR stated that it is independent in its policy from the government and targets inflation and not economic growth. Moreover, inflation spurred to a 15 month high of 7.1% in January. Inflation rose in 1H12 on the back of a hike of utility tariffs and rising food prices, to average 5.3% in 2012. Inflation is expected to remain elevated in 2013 to average 6.5%.

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