

RUSSIA'S ECONOMIC CRISIS: How Deep? How Wide? How Lethal?

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THE FINANCIAL CRISIS

MAIN SYMPTOM

- Oligarchs in trouble
- Why?
- The plunging stock market (Figure 1)

THE FINANCIAL CRISIS (cont.)

BAILOUT

- \$50 billion for rescuing oligarchs via the state-owned Foreign Economic Bank (VEB)
- Bailout features *a la* Putin
- Where is Barney Frank?
- Will the state buyback of oligarchs' shares be permanent?
- Putin's statement

OTHER FEATURES

- Outright purchase of stock (\$20 billion)
- Bank capitalization
- **TOTAL BAILOUT FIGURE AT \$200 BILLION (13% of GDP)**

POLICY IMPLICATIONS OF OTHER CRISIS SYMPTOMS

- Declining ruble because of flight from the ruble into dollars. Loss of foreign exchange reserves from \$600 billion to \$453.5 billion by mid-November.
- Managed downward float of the ruble in small steps. So far the Central Bank of Russia has avoided imposing exchange control on dollar outflows.
- A sharp devaluation will add to domestic inflation which is running at an annual rate of about 14 percent. It may also prompt households to withdraw their bank deposits
- The discount rate is 12% so the real interest rate is negative with serious implications for lending activity. This is a major handicap for Russian policy makers who are caught between controlling inflation and pumping liquidity in the economy.
- Crisis impact on Ivan Ivanov. Less serious than if the economy were more diversified. It will reduce the pressure on rising wages of recent years. Worker layoff will appear over time.

IMPACT ON GROWTH PROSPECTS OF THE DECLINING OIL PRICES

- High oil prices plus revived oil production contributed to annual growth rates averaging 7% in the past seven years (Figure 2).
- The budget will run into deficit. The off-budget Stabilization Fund will have to be drawn for supporting defense outlays (Figure 3) and infrastructure upgrading.
- In contrast to oil, the natural gas situation is less precarious in the immediate future. European clients import oil mainly for generating electricity.
- As oil prices revive and the next cycle of price rise begins, the price of oil per barrel will go up because, in the intervening period, global investment in the oil sector will remain low according to a report of the International Energy Agency.

IMPACT ON GROWTH PROSPECTS OF THE DECLINING OIL PRICES (cont.)

- **Russian strategy:**
 - Do not collude with OPEC oil production cutbacks. Rather, piggyback
 - Agreement with China to supply 300,000 barrels a day via a pipeline to be completed in 2009 in an agreement involving Chinese credit of \$25 billion
 - Continue selling military hardware

- Considering everything, 2009 and 2010 GDP growth rates will be in the average range of annual 3 to 5 percent. Not lethal but worrisome

CONTINUING PROSPECTS FOR RUSSIA- “OLD EUROPE” ECONOMIC COOPERATION

- **Germany**
 - Energy swaps
 - Up to 4,600 middle-level German companies are involved in infrastructure upgrade
- **France**
 - Sarkozy’s call: “Create a common economic space between Russia and EU”
 - TOTAL in Shtokman natural gas project
- **Italy**
 - ENI unit to supply pipelines for the Baltic natural gas pipeline
- **Britain**
 - Will Gordon Brown turn less confrontational?

Figure 1: Russia's Benchmark RTS Stock Index

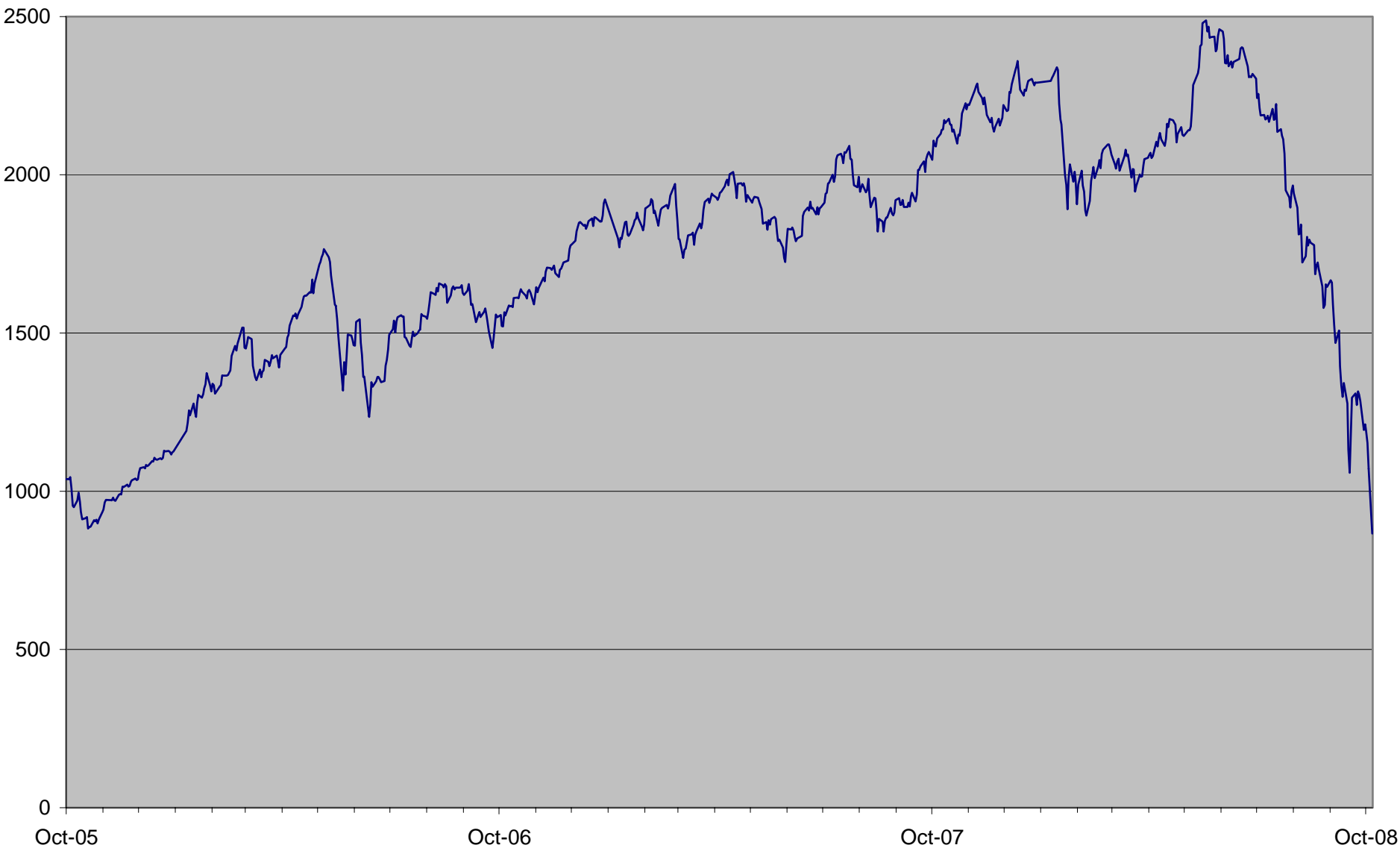
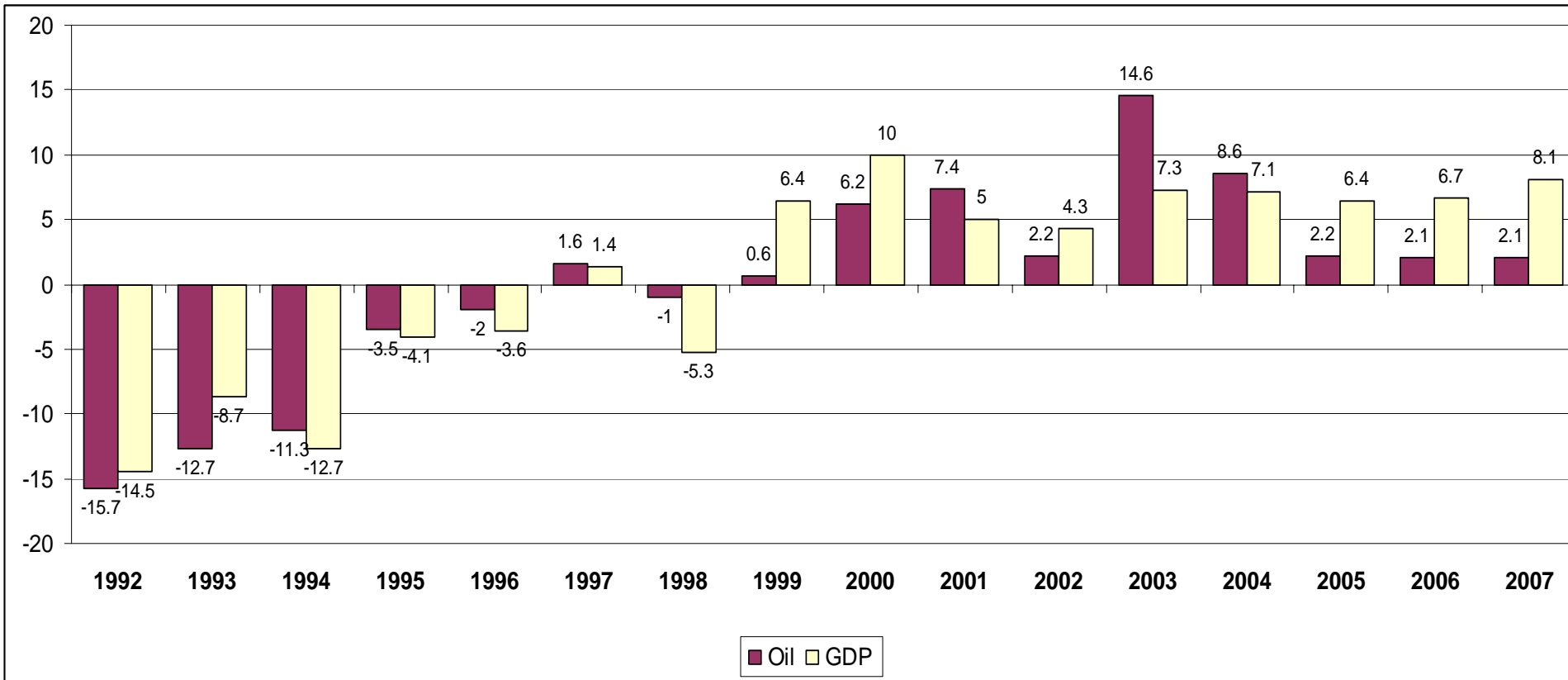


Figure 2: Russian Oil Production & GDP (% change)



Source: Marshall I. Goldman, *Petrostate: Putin, Power, and the New Russia*, (Oxford University Press, 2008).

Figure 3: Russia's Defense Spending



Source: GlobalSecurity.org

Figure 4: Europe's Reliance On Russian Gas (Bill. M3), 2006

	Total consumption	Total imports	Imports from Former USSR	% of total consumption	% of imports
Europe	539	416	131	24	31
Germany	99.8	94.5	39.3	39	42
Italy	84	77.4	23	27	30
Turkey	31.2	30	19.3	62	64
France	44.5	45.9	6.8	15	15
Poland	16.4	10.9	10	61	92
Austria	8.9	10.2	10.2	135	100
Greece	3.3	3.3	2.7	82	82
Hungary	14.3	11.7	10.6	74	91
Czech Republic	9.3	9.8	7.3	78	74
Slovakia	6	6.4	6.4	107	100
Finland	4.8	4.8	4.8	100	100
Estonia*	0.97	0.97	0.97	100	100
Latvia*	1.75	1.75	1.75	100	100
Lithuania*	2.93	2.93	2.93	100	100

*Data for Estonia, Latvia, and Lithuania are from 2004.

Source: IEA Statistics, *Quarterly Statistics*, Third Quarter, 2007.