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Forecast for 2009: stagnation, inflation and inaccessible loans

24/11/2008 MOSCOW. (RIA Novosti economic commentator Oleg Mityatyev) - On November 19, Central Bank governor Sergei Ignatyev and Finance Minister Alexei Kudrin came to parliament to answer questions regarding options for weathering the financial crisis.

Reserves and policy

Some time ago, many MPs and Russians were shocked to learn that Russia's international reserves (gold and foreign currency) were deposited abroad. They wondered if this was wise, but soon everyone agreed that investing reserves in reliable foreign securities and bank deposits was the only way to safeguard them.

Ignatyev has assured the deputies that the strategy of investing international reserves changed after the financial crisis had spread from the United States to other countries. The bank has cut the share of dollar-denominated assets, including U.S. mortgage bonds, and increased the share of the euro and European securities.

Nevertheless, the financial crisis has bitten a large chunk off Russia's international reserves, which have decreased 24% from $597.5 billion in August to $453.5 billion by mid-November.

The Central Bank governor said reserves dropped $97.6 billion in September and October, with $57.5 billion spent on maintaining the value of the ruble. The rest was lost to exchange rate fluctuations or spent on assistance to the banking system.

Ignatyev refused to say if the Central Bank would continue to support the ruble at its current level to maintain income, or if it would gradually devalue it to maintain the international reserves. Unfortunately, lack of reliable information is motivating depositors to withdraw their ruble accounts to buy foreign currency, thereby delivering another blow to the banking system.

Judging by what the two officials said in parliament, the Russian economic authorities plan to invest the reserves in the banking and real economic sectors. Ignatyev said the Central Bank had promised Russia's 250 largest banks to compensate their potential losses in the inter-bank loan market. The list of recipients may be subsequently increased.

Kudrin said 200-400 billion rubles ($14.5 billion) of the $134.6 billion Reserve Fund, which is part of the international reserves, could be used to increase assistance to the regions next year. In all, the government may take 500 billion rubles ($18.1 billion) or even more from the fund in 2009, the Finance Minister said.

Even if the Reserve Fund does not grow on high oil prices, it would suffice for seven to 20 years, Kudrin said, using some unfathomable reasoning.

Inflation and rates

Ignatyev said inflation would amount to 13%-14% in 2008, which is considerably more than the target figure. The previous government forecast of 11.8% annual inflation became reality on November 10. This means that the interest rates of commercial banks, which cannot be below inflation, will be very high.

The CBR governor said there was a silver lining to this storm cloud, because high rates, which will also be applied to deposits, may help halt the flight of capital from the country and its banking system. The Central Bank has contributed to the process by raising its refinance rate by 1%, to 12% on November 12, thereby seriously worsening loan conditions in Russia.

As if ignorant of Ignatyev's words, Kudrin said inflation would be kept to 8% in 2009, which is extremely strange. The minister voiced support for the introduction of trade barriers to protect Russian producers from cheap imports, but at the same time said, "The prices of everything are falling."

He shocked economists by saying that the Central Bank's refinance rate could be lowered in the second half of 2009, when Russia overcomes the liquidity crisis. It is a complete mystery how Kudrin and Ignatyev will accomplish this goal if they intend to raise the rate and make loans even more inaccessible.

Way out of the crisis

Ignatyev and Kudrin looked like a two-man fire brigade running around trying to put out scattered fires. They provided a good backdrop for Economics Minister Elvira Nabiullina, who presented a long-term solution to the problem.

She said Russia needed a new economic model, because the global financial crisis had proved that the current system, which had helped the Russian economy to boom, had exhausted its potential.

It was based on high oil prices and availability of long-term foreign loans to Russian banks and companies. As a result, the Russian economy was moving lopsidedly, becoming increasingly dependent on the export revenue of several non-tradable sectors. Meanwhile, the financial sector was not developing fast enough.

Judging by Nabiullina's report, to overcome the crisis the Russian economy needs to adapt to reduced export revenues, rely on domestic resources, cut outlays, review expensive commodities projects, and raise productivity in manufacturing, which must eventually become "the engine of Russia's industrial growth."

Forecast for 2009

On November 18, the World Bank published its 17th Russian Economic Report. After considering the effects of the global crisis on the Russian economy and the authorities' measures, the Bank lowered its forecast for the growth of Russia's GDP to 6% from 6.8% in 2008 and to 3% from 6.5% in 2009.
The World Bank said, "Most of the impact is concentrated in the last quarter of this year when economic activity is expected to slow to about 2%. Unemployment is expected to rise moderately to 5.9% (from 5.3%) by yearend, reflecting employment losses in labor-intensive sectors such as construction, trade and services as well as the financial sector undergoing restructuring."

The Russian government's target GDP for 2008 was 7.8%, but it has lowered it to 7%-7.3%. It has not yet made public its official forecast for 2009, but it may be very close to the World Bank's figure. Some government officials say off the record economic growth may be as low as 2% next year.

This is logical, as Russia is part of the global economy, and the World Bank expects world growth to slow to 0.93% in 2009.

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