The Russian Economy in Spring 2021: Recession and Dubious Prospects

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COMMENTARY

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By Alexander Chepurenko (National Research University Higher School of Economics, Moscow)

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Macro Data: Recession

The available statistics on the overall state of the Russian economy indicate a recession. In February 2021, Russia's GDP was 2.8% lower compared to February 2020, a larger gap than January's (2.2% lower than January 2020). Moreover, in February 2021, industrial production fell 3.7% year-on-year, and the annual headline consumer price index (CPI) inflation increased to 5.7% year-on-year. Labor market data continued to improve in February, with an unemployment rate of only 5.7%. The federal budget deficit increased to 645 billion rubles in January–February 2021. Such developments have pushed the Central Bank to raise the key interest rate on March 19th by 25 bp to 4.50%, the first increase since December 2018. Moreover, the Central Bank officials proclaimed the return to a neutral monetary policy, being open to further increases in the key rate in the coming months. The recovery of the economy after the pandemic may be rapid, so the Central Bank expects the achievement of a pre-COVID economic state by the end of 2021. However, the sources of the expected further growth are uneven.

Where Can the Growth Effect Come From?

As regards the state of private business, the Composite PMI stood at 54.6 points in March, while the Manufacturing PMI stood at 51.1 points, and the Services PMI at 55.8 points. The business confidence index fell slightly in March (–0.3 index points).

The situation of households was even worse: consumer confidence decreased in the first quarter of 2021 by 21 index points, and the retail sales index decreased by 1.9% in February compared to January, standing at a deficit of 1.3% compared to February 2020.

Foreign investments stood at USD 3.886 billion in the 4th quarter of 2020, which is a rather modest amount compared with the GDP of USD 322.197 billion (constant prices) in the same 4th quarter or even with exports, which stood at USD 29.268 billion (February 2021).

Thus, it seems that neither private business, nor households (due to a significant decrease in purchasing power and financial reserves of families), nor foreign investment (taking into consideration the worsening of relations with the West and the dubious prospects of attracting FDI from elsewhere) can become drivers of economic growth of Russia in the near term.

State Economic Policy: Shift towards a Direct Regulation of Markets?

Given this macroeconomic background, Russian authorities, being worried by the steady increase in prices of food and related articles, began a series of measures to 'decouple' domestic prices from international market trends. The first precedent was established in the beginning of 2021, when the government, for the first time in modern Russian history, started to enforce significant duties on a number of agricultural crops while also bringing into force export quotas and capping the prices of certain foodstuffs. For the period March 1 to June 30, Russia introduced an export duty on wheat of 50 euros per ton, and from March 15 for corn (25 euros) and barley (10 euros). The authorities insisted that this was necessary to containing food price inflation. But such measures would hit farmers' incomes in the new season.

Furthermore, the government began regulating the prices of sugar and sunflower oil after criticism of Vladimir Putin in December 2020 concerning price inflation. According to an agreement with the manufacturers, until April 1, sugar should be sold to retailers at a price of no more than 36 rubles per kilogram and bottled sunflower oil at no more than 95 rubles per liter, respectively. Unfortunately, at the end of March the government decided to extend the agreement on sugar prices until June 1, and on sunflower oil prices until October 1, while promising subsidies to manufacturers of 10 rubles per liter of oil and 5 rubles per kilogram of sugar. However, on April 1, the subsidy regulations were not yet published, leading many sugar manufacturers to stop shipments to retail chains while they waited for the promised state support.

Another manifestation of the same tendency might be found on the real estate market. In Russia as a whole, the primary market prices of residential real estate have risen by 12% year-on-year, and in some regions by as much as 19% to 30%. This increase in prices was spurred by the concessional mortgage, now at an annual rate of 6.5%, which is very cheap by Russian standards. Another reason is lack of competition among developers in some local markets where the population is poor, and thus development projects are very risky. Reacting to this trend, Putin instructed the Federal Antitrust Service (FAS) to "check the validity of the increase in the cost of apartments in new buildings in the country".

Perspectives

The authoritarian state was in 2020 in some aspects more efficient than the Western democracies in combating the Covid-19 pandemic. However, taking into consideration that the pandemic and its outcomes might plague economies and societies longer than expected, autocratic tendencies can find even more support in public opinion. In addition, the growing role of the state and semi-state owned monopolies, and now also of direct state interventions, into the process of price formation and competition on different markets is a sign of a new stage in the backslide transition in Russia: growth expectations being too closely connected with state investment activity and public-private partnerships will be dangerous for the Russian economy in the long run.

About the Author

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»Fortress Russia« Effective in the Corona and Sanctions Environment Short-Term, More Stagnation and Sanctions Ahead

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Russia has come fairly well through 2020 and 2021 in the real economy. With a decline of 3%, output slumped less than the global economy and only about half as much as in Western Europe. This remarkable 2020 performance was a result of Russia seeking short-term and opportunistic cooperation with OPEC. Domestic oil production was curtailed under the OPEC+ agreement. Oil output dropped by 8.5% year-on-year in 2020, lowering GDP growth by 1.0 pp.

Satisfactory Economic Performance Due to Structural and Cyclical Factors

The satisfactory performance has to do with economic structures, policy responses and a better-than-expected global environment. The low complexity of the Russian economy with a low share of services, which are sensitive to Covid-19 restrictions, has prevented a deeper collapse. Moreover, proactive fiscal countermeasures have been taken, with a federal budget deficit of 4.5% of GDP. For the first time, the government reacted to a crisis by upping expenditures and temporarily blocking the budget rule. Rapidly recovering commodities supported exports, while imports dropped sharply. Lower oil and gas exports were partially offset by growing gold and wheat shipments (exports: –5.1% yoy) while imports declined by 13.7% yoy. Therefore, net exports added +1.4 pp to GDP dynamics.