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**RUSSIAN ECONOMY IN 2015**  
**TRENDS AND OUTLOOKS**  
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R95 **Russian Economy in 2015. Trends and Outlooks. (Issue 37) /**  
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The review provides a detailed analysis of main trends in Russia's economy in 2015. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit spheres; financial sphere; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

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### Decomposition of Russia's GDP growth rates, 2015–2016<sup>1</sup>

Russia's officials made multiple statements in 2015, saying Russia had hit the bottom of its recessionary valley. For example, a few top members of Russia's government and representatives of the Russian business community (in particular, First Vice-Prime Minister Igor Shuvalov and Sberbank CEO/Chairman German Gref) said in May 2015 the current crisis in Russia had reached its peak and the economy was expected to see some recovery. In late 2015, Russia's Minister of Economic Development Alexey Ulyukaev said the recession was over and the bottom was hit. At the same time, Russia's Ministry of Economic Development (MED) and some other international organizations – such as Bank of America, JP Morgan, IMF and World Bank – upgraded (not for long though) their 2015 forecast for Russia. The Ministry of Economic Development made similar statements, in particular in July and October 2015. Andrei Klepach, Chief Economist of Vnesheconombank, questioned these statements, noting in late August that the bottom was still to be reached, and he expected Russia to continue facing a downturn in investment and construction sectors, while budget and consumer demand ceased to be the drivers of positive growth rates in economy. As early as December, Herman Gref predicted that Russia's economy would face a downturn in 2016, and then it might “decay” unless across-the-board reforms are undertaken.

In November 2015, Russia's Ministry of Economic Development released an updated forecast for the socio-economic development in Russia for 2015–2016, which affords a basis for drafting the 2016 federal budget. The forecast includes baseline, conservative and target scenarios.

The baseline scenario for 2016 “describes the basic macroeconomic parameters of economic development against the backdrop of conservative trends towards changes in external factors, and a conservative fiscal policy in place.”<sup>2</sup> For example, this scenario expects GDP in 2016 to pick up 0.7% from 2015 (in other words, the economy is expected to come out of the recession at weak positive growth rates), the yearly average Urals crude price to stay at \$50 a barrel, fixed investment to drop 1.6% year-on-year, the number of employed to change insignificantly. Hence, the baseline scenario for 2016 relies on the assumption that the Russian economy continues to follow the current trends, and that no other economic growth drivers are expected to emerge.

Russia's Ministry of Economic Development noted that the conservative scenario expects Russia to face extremely troublesome global economic trends (the yearly average Urals crude price is down to \$40 a barrel), investment to drop further (6.4% over 2015) and consumer demand to weaken, inflation rate to hike and some other economic sectors (industry and retail sales) to be driven by negative dynamics. In other words, this scenario expects Russia's consumer sector and investment to be hit hardest. The conservative scenario of economic development in 2016 is therefore worse than the other scenarios, and it expects GDP in 2016 to drop 1.0% over 2015.

The target scenario, which is more optimistic, aims to comply with the Executive Order of the President which requires the economic authorities to ensure that the Russian economy enters

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<sup>1</sup> Author of this section: Drobyshevsky S. – Gaidar Institute for Economic Policy, Kazakova M. – Gaidar Institute for Economic Policy.

<sup>2</sup> <http://economy.gov.ru/minec/about/structure/depmacro/20151026>

a path of growth equal to the world's average long-term growth and is steady in the long term, and to achieve a macroeconomic equilibrium on the back of low inflation rate and enhanced labor productivity. This scenario actually suggests switching to a new model of economic growth based on optimizing and enhancing the effectiveness of federal budget expenditures and revising state programs in order to achieve the target parameters of the socio-economic development of Russia. The target scenario expects economic growth rates in 2016 to increase 2.3% from 2015, fixed investment to resume growth (up to 3.1%), inflation rate to be low (4% or less), and labor productivity to increase. The Ministry of Economic Development highlighted some factors that would “contribute most to accelerating economic growth rates in 2016–2020:

- growth of investment in production expansion and production infrastructure;
- growth of investment in boosting exports of non-primary commodities and stimulating exports of high-tech products;
- increase of the total factor productivity by boosting investment in innovation sectors of economy;
- introducing resource and cost saving measures, including labor costs and natural monopoly tariffs;
- SME development, creating better conditions for entrepreneurship, and some other factors.”<sup>1</sup>

The scenarios of Russia's socio-economic development for 2016 contain forecasts for oil prices, fixed investment dynamics and the number of population involved in the economy, which let us decompose, using our own algorithm, the forecast GDP growth rates under the foregoing three scenarios of economic development of Russia. We used a method based on breaking down macroeconomic indicators into structural, foreign-trade and cyclical components (business cycles and random shocks) to see the effect of the key factors on GDP growth. This method is applied in developed countries (OECD), and we modified it to capture the specifics of the Russian economy, that is, heavy dependence on foreign trade terms approximated through the dynamics of global oil prices.<sup>2</sup>

Rosstat published in late January 2016 the preliminary results of 2015<sup>3</sup>: GDP fell 3.7% from 2014 (in absolute terms, this is slightly less than MED's official forecast); fixed investment dropped 8.4%; global Brent crude prices in 2015 averaged \$52.4 a barrel, according to IMF.<sup>4</sup>

*Fig. 12–15* show the 2015 actual, structural and foreign-trade growth rates of GDP in Russia, as well as the cyclical component (i.e., the sum of the components of business cycles and random shocks), and the three scenarios forecasting the development of the Russian economy for 2016.

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<sup>1</sup> <http://economy.gov.ru/minec/activity/sections/macro/prognoz>

<sup>2</sup> The method of decomposing Russia's GDP growth rates, as well as our interpretation of the results obtained, are described in detail in *Sinelnikov-Murylev S., Drobyshevsky S., Kazakova M. Decomposition of Russia's GDP growth rates in 1999–2014. Ekonomicheskaya Politika [Economic Policy]. 2014. No. 5. PP. 7–37, as well as <http://iep.ru/ru/publikacii/7125/publication.html>.*

<sup>3</sup> [http://www.gks.ru/bgd/free/B15\\_00/Main.htm](http://www.gks.ru/bgd/free/B15_00/Main.htm)

<sup>4</sup> <http://www.imf.org/external/np/res/commod/index.aspx>

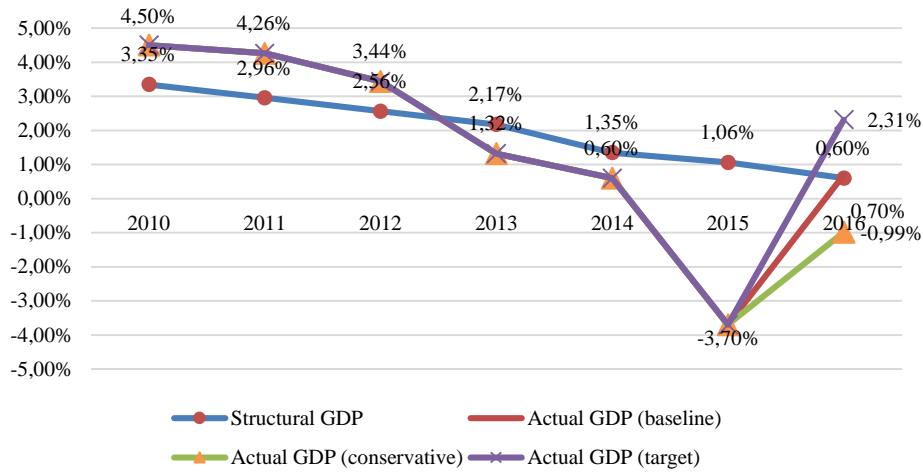


Fig. 12. Year-on-year actual and structural growth rates of GDP in Russia, 2010–2016 (all the forecast scenarios)

Sources: Rosstat, Ministry of Economic Development, IMF, own calculations.

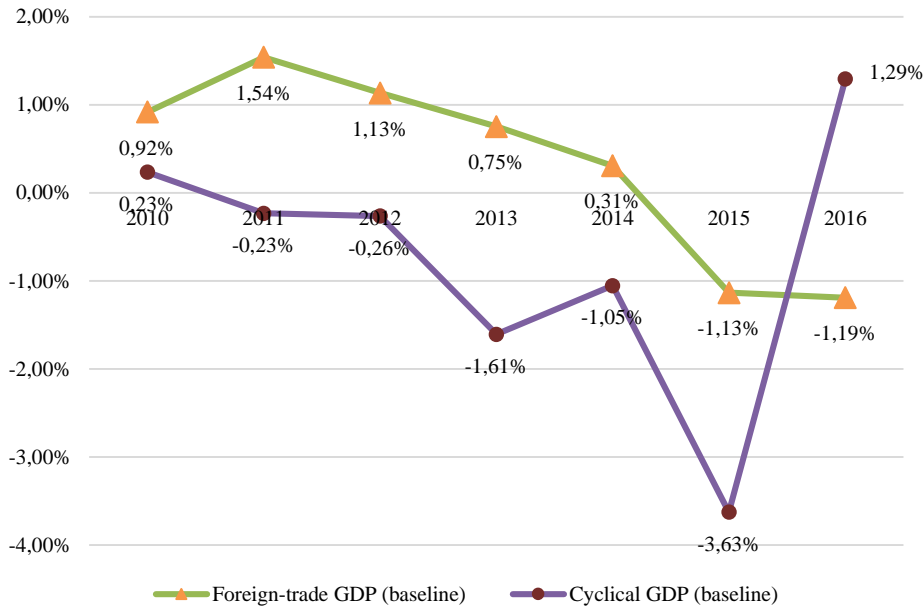
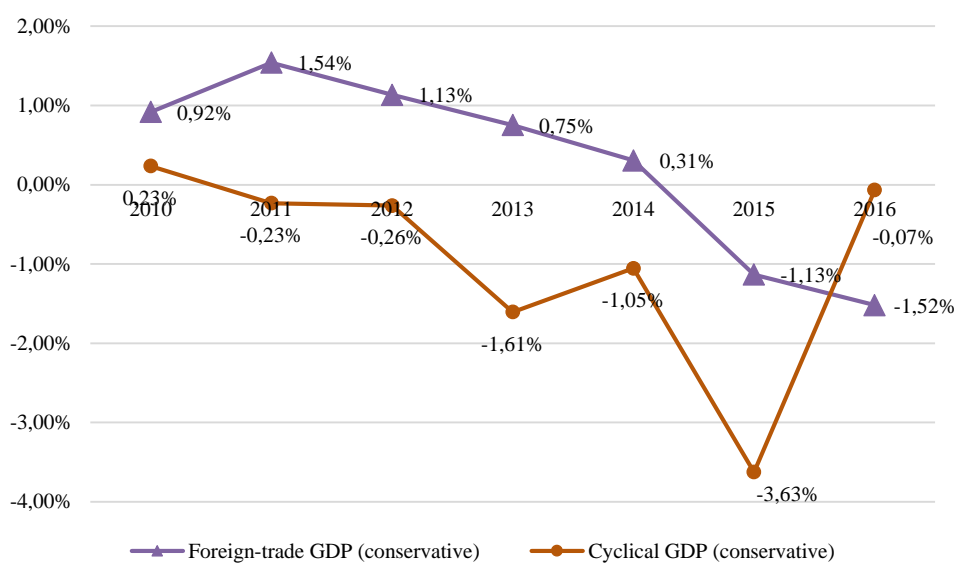


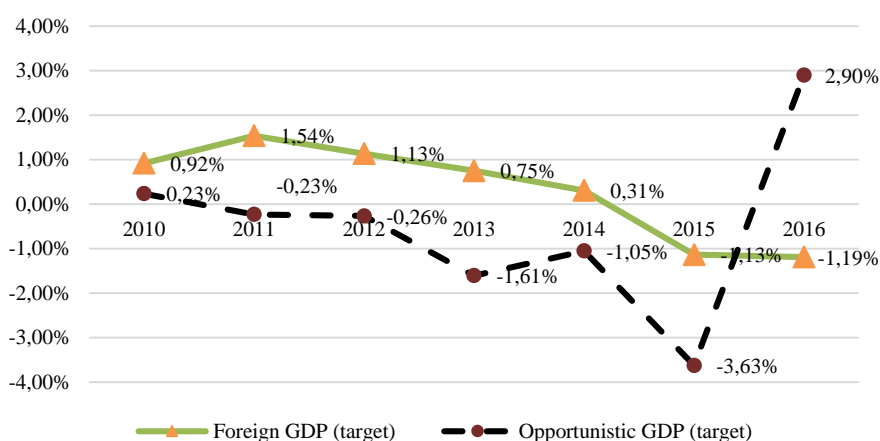
Fig. 13. Year-on-year foreign-trade and cyclical growth rates of GDP in Russia, 2010–2016 (baseline scenario)

Sources: Rosstat, Ministry of Economic Development, IMF, own calculations.



*Fig. 14.* Year-on-year foreign-trade and cyclical growth rates of GDP in Russia, 2010–2016 (conservative scenario)

Sources: Rosstat, Ministry of Economic Development, IMF, own calculations.



*Fig. 15.* Year-on-year foreign-trade and cyclical growth rates of GDP in Russia, 2010–2016 (target scenario)

Sources: Rosstat, Ministry of Economic Development, IMF, own calculations.

We estimate that in 2016 the forecast structural component of GDP growth will continue to decline under all the scenarios (from 1.1% in 2015 to 0.6% in 2016, see *Fig. 12*). Just like in prior years, this is determined by the negative dynamics of fundamental growth factors (a reduction in the number of economically active population due to demographic trends and in the volume of capital due to its retirement amid negative investment dynamics), as well as a decline of total factor productivity.

With oil prices in the 2015–2016 scenarios being lower than average long-term prices (\$80–85 a barrel, see *Fig. 16*), the foreign-trade component of Russia’s GDP growth rates in 2016 is

expected to become negative under all the scenarios (-1.2% under the baseline and target scenarios, and -1.5% under the conservative scenario).

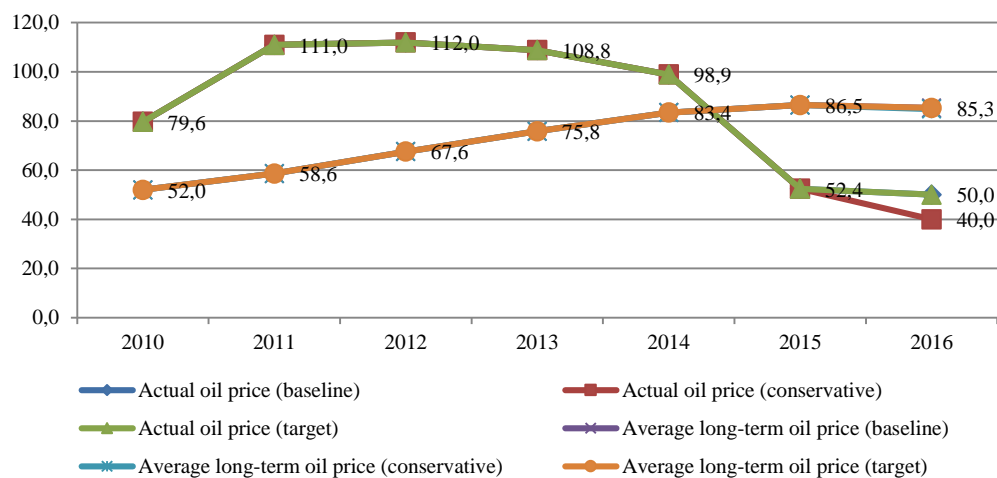


Fig. 16. Actual and average long-term Brent crude prices, US dollars a barrel, 2010–2016 (forecast)

Sources: IMF, own calculations.

The cyclical component of Russia’s GDP growth rates in 2015 is still negative, whilst the cyclical downturn was possibly deepened by a negative shock estimated 2.5–3.0 percentage points of GDP growth. This shock is a combination of the adverse effects of Western economic sanctions and Russia’s countersanctions, increased uncertainty and risks in economy amid an extremely volatile ruble, increased inflation and limited access to capital markets.

Continuing with the decomposition of Russia’s GDP growth rates in 2016, it is worthy of note that the forecast GDP growth rates for Russia may hold true under the three scenarios amid relatively low oil prices and no growth of the total factor productivity, provided that the cyclical component increases sharply, from -3.8% in 2015 to 2.9% in 2016 under the best-case scenario and from -3.8% in 2015 to -0.07% in 2016 under the worst-case scenario. The cyclical component may see such growth, provided that the cyclical GDP accelerates abruptly on the back of the “died-down” negative shock of 2015, or assuming that the economy remains at the bottom of the business cycle – a marked positive shock – whose nature seems uncertain.

At the same time, our results (and, accordingly, conclusions) are based on the 2000-2014 model-based estimates of the total factor productivity (see Fig. 17 and 18) and hence model-based Russia’s GDP structural growth rates facing a steady downtrend (see Fig. 12).



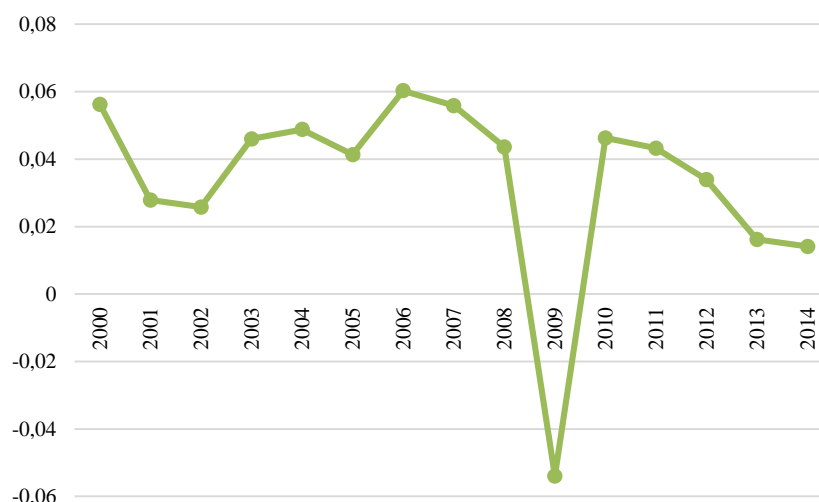
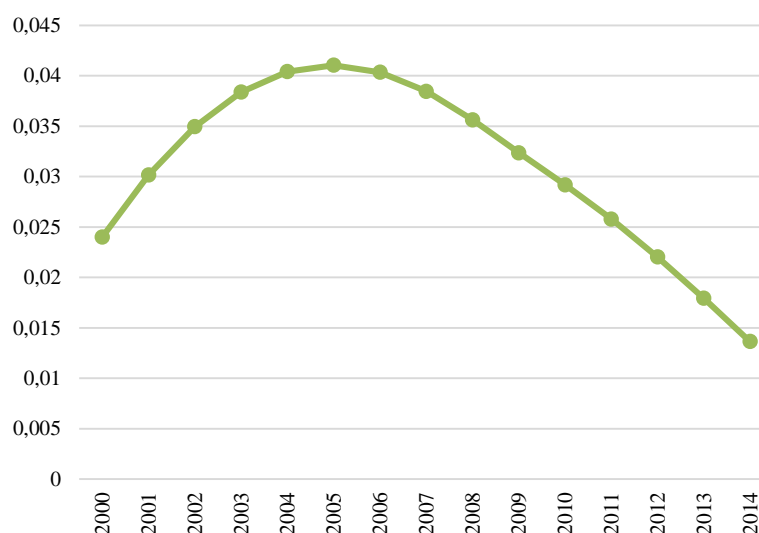


Fig. 17. Total factor productivity of Russia's economy, percentage points YoY, 2000–2014

Sources: Rosstat, Ministry of Economic Development, IMF, own calculations.

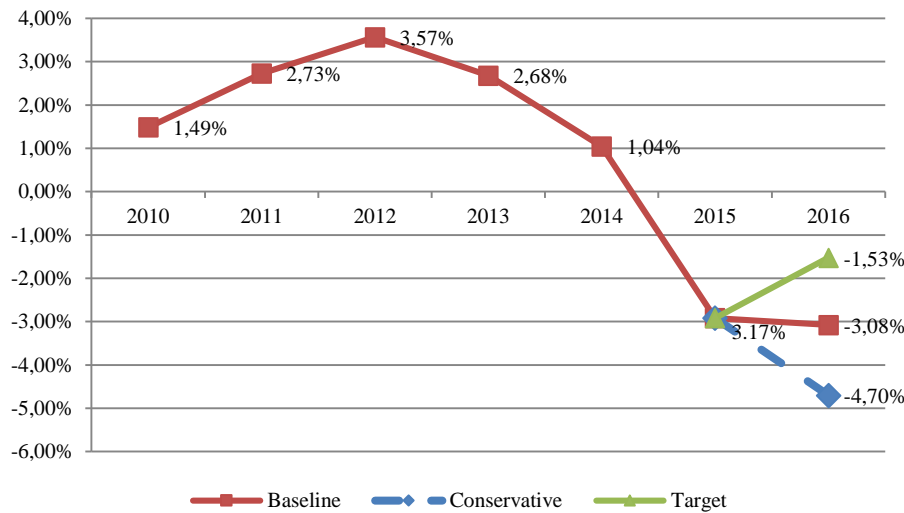
Supposing that the dynamics of total factor productivity has changed and Russia's structural GDP growth rates have stopped declining (e.g., due to a boost in competitiveness of the domestic production sector after the ruble's devaluation or economy's enhanced performance, during the current crisis, on the back of a few bankruptcies, nonmanufacturing cost cuts, partial labor saving and "clean-up" of the banking system), then a part of the 2016 forecast growth of GDP may be attributed to this very component. In this case, the dynamics of the cyclical component (within a range of -1.5 and 2.0 percentage points of GDP growth) seems logical in the context of the died-down negative shock of 2015 and the progressive movement towards the upward phase of business cycle (in the target scenario – boosting the cyclical component by switching to a new model of growth). The econometric data of the change in structural growth rates can only be assessed by adding new actual annual observations of GDP, i.e., in at least 1–2 years, in the simulated series.



*Fig. 18. Total factor productivity of the Russian economy (smoothed), percentage points YoY, 2000–2014*

Sources: Rosstat, Ministry of Economic Development, IMF, own calculations.

The results of decomposition of Russian economic growth rates provide a way of estimating an output gap of the Russian economy for 2015–2016, which in 2015 turns negative due to a negative contribution of the foreign-trade and cyclical components, the latter has been negative for five straight years since 2011) amid decreasing structural growth rates. Note that the output gap is still negative in 2016, even under the MED’s best-case (target) scenario (see *Fig. 19*).



*Fig. 19. Output gap in Russia (%), 2010–2016 (forecasted under the three scenarios)*

Sources: own calculations.

Thus, the actual output for 2015–2016 is below the potential output in all the scenarios. In terms of economics, incentive monetary and fiscal measures may have a positive effect on the economy in at least the short term. However, structural rates stemming from fundamental growth factors and total factor productivity should be increased first in order to accelerate economic growth rates in a longer term. In modern economic environment, this implies making foreign capital and foreign direct investment available for Russian companies, increasing investment from Russian companies, and relaxing the limits on available labor resources.

The above listed measures will enhance the efficiency of using production factors (i.e., TFP will grow). Good institutions is the only way of stimulating new production factors and structural reforms (including diversification of the economy and making it a less resource-based economy), and investment in the economy (transport infrastructure, social protection, etc.) will accelerate economic growth and ensure that steady growth rates are maintained in the long term. Note that no such changes are assumed under the scenarios, except for the target scenario, of Russia’s Ministry of Economic Development.

Today, it is widely believed that Russia was hit by crisis before 2014, and external political developments turned the spotlight on the internal problems accumulated during past periods, including the “fat” period between 2000 and 2007. Indeed, an intriguing picture was observed over the past few years: on the one hand, global oil prices stood at a very high level until late

2014 (\$102 a barrel on average in the period between 2010 and 2014); on the other hand, not only did economic growth rates see no growth after the crisis of 2008–2009, but they also began to slow down steadily, from 4.5% y-o-y in 2010 to -3.7% in 2015.

The collapse of oil prices in late 2014 stirred a discussion on how Russia's economy will be functioning amid low oil prices. Weakly positive growth rates that followed the economic overheating of 2008 were maintained on the back of favorable terms of trade, although their role was declining progressively, but now high oil prices will contribute less than before to growth. Anyway, is there a chance for Russia to take a different track and cease to be an “oil-dependent state?”

On the one hand, economic growth can be accelerated by undertaking serious structural reforms and by switching, at least in part, the focus from the extracting sector to other higher value-added sectors. On the other hand, bad institutions (high level corruption, politicized judicial and law enforcement systems, weak protection of property rights, inefficient system of public administration) hamper reforms and lead to useless (in terms of economic development) spending of natural resource revenues.

Ultimately, speaking of possible ways of developing the Russian economy, a few scenarios may be outlined. The first scenario assumes a status quo is maintained, that is, the economy depends heavily on terms of trade while the oil-and-gas and industrial sectors are kept down. This scenario assumes no slump, but rather a slow stagnation or a weakly positive growth (about 0.5%) while the crude oil price is on the rise.

The second scenario assumes Russia will undertake structural reforms by adopting the practice of major developing economies (such as Brazil, India or China). This scenario assumes the economy is diversified and aimed at achieving high growth rates in the long term. In other words, energy export revenues can be spent to either maintain or improve the current state of economy.

Under the third scenario, Russia may benefit from its resource-dependence by counting on upgrading the oil-and-gas sector (as a reminder, this sector is not less (if not more) innovative than, say, manufacture of cell phones). Thus, the “resource curse” may be turned into a blessing for this country.