

ONLINE MONITORING OF RUSSIA'S ECONOMIC OUTLOOK

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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MAIN TRENDS AND CONCLUSIONS

Experts, governments and businesses were thrown into confusion by rapid and major changes to economic backdrops in December 2015 and January 2016. The backdrops are hopelessly guessed crude prices and stock-market quotations: alternatively, it may either refer to a market rush boosted by a confluence of circumstances, or to fundamental factors.

For example, there was no dearth of forecasts that crude prices would slide to \$30, 25, 20 and 15 a barrel. And many concomitant circumstances were indeed a tailwind for this. The following circumstances coincided with each other: 1) the Chinese slowing economy; 2) a Fed rate hike; 3) OPEC's half-disintegration; 4) lifted sanctions on Iran; 5) record oil production in Saudi Arabia and Russia; 6) the first Europe-bound oil tankers filled with US crude. At the same time, it remains to answer the question of which price level is fundamentally unacceptable for oil producers when the most efficient of them are no longer be able to replace gradually crashing out outsiders. This appears to be the moment when the global market will face a more or less equilibrium price, providing, of course, that there are no surprises on the demand side, first of all having in mind China's hard landing.

These suspicions remain in full force not only because of a record capital flight from Russia, but also because they are heavily supported by an extremely sharp response of the stock markets of advanced economies to another stock market slump and Yuan devaluation in China. Economists are asking themselves the question they cannot answer: "Why global markets are so feverish as China has no "severe nightmares" after all? The markets can feel something what others cannot (like animals can feel when a thunderstorm is coming)? Market quotations are packed with all the fears and the worst possible scenarios?

Should Russia be viewed in this context, the slumping market has prompted consideration of the worst-case options, that is, rock-bottom prices of hydrocarbons, no matter how trivial it is. Not only is this approach adequate under the circumstances, but also it cannot be avoided. One could plainly see that the approach turns previous baseline scenarios into super optimistic scenarios, stress scenarios into baseline scenarios, and new stress options are most likely to be restricted for public access. It is also apparent that the turn is so fast that it leaves little time for some tactical answers even within the economic policy in place. More importantly, there is also the need for strategic answers beyond this policy.

Our experts have concluded in their forecast for 2016–2017 that this period will see the recession continue. The conclusion is based on the fact that preliminary data on Russia's economic results of 2015, as well as the current trends in the global energy market, give grounds for revising down the scenarios for the next two years.

The forecast is based on the assumption that 2016 will see the Urals yearly average price at \$35 a barrel (not higher than \$30 in the first quarter) and \$40 in 2017. An optimistic scenario anticipates that crude will trade at \$50 in 2016 and \$55 in 2017. Additionally, the bulk of Western sanctions and Rus-

sia's counter-sanctions are expected to stay in force at least till the end of 2016. If so, the recession is anticipated to continue for two years: GDP will lose 1.4% in 2016 (down 0.4% under the optimistic scenario) and 0.3% in 2017 (GDP is expected to gain 0.9% after a year, providing that crude prices are higher than \$50–55). The authors of the forecast emphasize that these trends stem from slow structural reforms and crude downtrend.

The dynamics of oil production by the major oil-producing countries does not allow for concluding firmly about its potential effect on the oil market. Slashed oil production in the regions with high production costs (Canada, Mexico, the North Sea, US shale oil and gas fields) is offset by mounting production in Saudi Arabia, Iraq, Russia and, inevitably, Iran. Also, Russia in 2015 produced 533 million tonnes of crude oil, hitting the highest level since 1990. Total exports of crude oil and refined petroleum products in the past year capped 400 million tonnes, reaching an all-time high, according to preliminary estimates. Thus, the major oil-producing countries with low oil production costs seek, first, to maintain (and, in some cases, increase) their market share and, second, to offset falling raw material prices by boosting physical volumes of supplies. The global oil market will most likely keep facing low prices (not necessarily equal to the January prices).

Both the federal budget and regional budgets were affected by the decline in oil revenues and the ongoing recession, especially as the regions used federal budget resources (interest-free budget loans) to restructure their debt. In the first 11 months of 2015, the share of budget loans of the regional debt structure increased 38.3%, up 7.3 percentage points, thus replacing expensive commercial loans. During the same period regional and municipal budgets' debt increased 4.9% and 1.5%, respectively. The pace is relatively slow, many times slower than years ago. Additionally, the consolidated budget deficit of the constituent territories of Russia accounted for 0.3% of GDP, twice as small as that in 2014. However, first, these indicators may increase in the final month of a year. Second, it is well known that many regions sacrificed both investment and some social programs. And, third, the sources of revenues of these budget systems will most likely shrink in 2016, including personal income tax revenues (critical for the regions), which are unlikely to grow, not to mention they will not grow in real terms.

Steadily sliding real wages and income (which, according to the foregoing forecasts, will continue in 2016) have encouraged individuals to shift to a saving behaviour pattern. In the first 11 months of 2015, retail bank accounts and deposits increased in volume by 10.7% (by almost Rb 2 trillion). In contrast, retail customers withdraw Rb 400bn from banks in the same period of 2014. However, savings in 2015 accounted for 17.9% of households' cash income (14.2% in the same year-earlier period). Cash and foreign exchange demand weakened. According to estimates, in January–November 2015 foreign cash on hand decreased by more than \$11bn, whereas bank foreign currency deposits increased merely \$6bn. To compare, in 2014, mostly during the last few months of the year, foreign cash on hand increased \$28bn. It may be assumed that in late 2015 and early 2016 individuals regained their interest in foreign cash, though in a lesser degree than before. The non-food sector saw purchases increase in early 2016, when consumers purchased mostly imported goods in an effort to save on prices that were expected to hike due to the rouble devaluation, but there was no such a buying rush as was seen in December 2014.

The level of inflation was affected by foreign policy factors. The ban on food imports from Turkey was bound to be reflected in retail prices of the sanctioned products. First, prices of Turkish products are in most cases lower than prices of the same products imported from other countries. Second, prices of Turkish products are also lower than prices of domestic products of the same type (1.5–3 times in off-season). Russia may also face risks of Turkish counter-sanctions against Russian imports of foods and agri-products to Turkey. Furthermore, Russia's supplies of food grains and feed grains, sunflower and sunflower oil to Turkey are bigger in volume than Turkish agri-food supplies to the Russian market. Additionally, since none of the EEU (Eurasian Economic Union) member states has joined Russia's sanctions against Turkey, Turkish foods may just as well be re-exported to Russia via some of the member states. Anyway, this has been evidenced by large-scale attempts to supply the sanctioned European products to Russia via Belarus. ●

1. 2016–2017 FORECAST: RUSSIA'S RECESSION CONTINUES

S.Drobyshevsky, V.Petrenko, M.Turuntseva, M.Khromov

Preliminary data on Russia's economic results of 2015, as well as the current trends in the global energy market, give grounds for revising down possible scenarios for Russia's economy in 2016–2017. For instance, a scenario of yearly average oil prices staying at \$35 a barrel in 2016 is now the baseline scenario, whereas \$50 a barrel is considered optimistic (Russia's 2016 budget was made on the assumption of \$50 a barrel). Simulation of the key macroeconomic indicators in 2016–2017 under the selected scenarios have revealed that Russia's recession will continue during the projection period, and growth can only be expected if oil prices are steadily above \$50–55 a barrel.

The second half of 2015 saw new signs of a worsening economic slowdown in Russia. Rosstat, Russia's Federal State Statistics Service, reports that real GDP in the third quarter declined slightly slower than in the second quarter, down 4.1% from Q3 2014. In our view, however, it is too premature to wait for a reverse trend. The other indicators showed negative dynamics too. Industrial output contracted by 4.2%, investment were down 6.8%, retail sales turnover declined 9.5%, real disposable income shrank by 3.9%. The Consumers Price Index stood at 1.7% in the third quarter and at 10.3% in the first nine months of 2015. Crude oil saw further decline in price. Another headwind is the worsening geopolitical context due to the conflict between Russia and Turkey over the downed Russian warplane in Syria.

The Urals yearly average price was \$51.1 a barrel, and GDP, according to our estimates, was down 4% at the 2015 year-end. GDP decomposition using a method developed at the Gaidar Institute¹ has shown that the 2015 decline in GDP can be attributed to the foreign trade component (down 1.3 p.p.) (oil prices are currently below the years-long average), cyclic economic slowdown (down 1.6 p.p.), economic impact of Western sanctions (down 1.5 p.p.), mounting uncertainty and negative expectations due to the rouble devaluation between 2014 and 2015 (down 0.7 p.p.). The structural component of GDP growth rates in 2015 was not higher than 1.1 p.p.

The forecast is based on the assumption that the Urals crude price will average \$35 a barrel in 2016 (not higher than \$30 in Q1 2016) and \$40 in 2017. Note that the assumption implies that Russia's economy will face troublesome terms of trade in the next two years, oil prices will be lower than the years-long average and rebound (in constant dollars) to the level seen in the early 2000s. The optimistic scenario assumes that the Urals yearly average price will go up to \$50 a barrel in 2016 and then see some growth to \$55 in 2017.

Given these preconditions, we anticipate that under the baseline scenario Russia's economy in 2016 will shrink further by 1.4% and by 0.4% under the

¹ Methodology of the decomposition of Russia's GDP growth rates as well as interpretation of the results are given in S.Sinelnikov, S.Drobyshevsky, M.Kazakova. "The Decomposition of Russia's GDP Growth Rates in 1999–2014". *Ekonomicheskaya politika*. 2014, № 5, pp. 7–37 as well as.

optimistic scenario. The negative dynamics (down 0.3%) in the baseline scenario will remain in 2017, whereas the optimistic scenario expects a small growth of 0.9% on condition that relatively favourable developments are seen in 2017. All these trends in the Russian economy stem from slow structural reforms and the lack of foreign trade's extra contribution to the economic growth amid relatively low crude oil prices.

Additionally, our estimates show that the structural component of GDP growth will continue to decline, down to 0.4–0.6 p.p. a year, in response to a working capital contraction by 5–10 p.p. (due to a contraction of new investment, inability to replace retired fixed assets, a decline in fixed asset utilization) and a 2m workforce shrinkage within two years, a decline of 2.5% from 2015. Additionally, we assume that the bulk of Western sanctions and Russia's retaliatory sanctions will remain in place at least until late 2016.

The rest of the economic activity characteristics behave in the same manner. In 2015, fixed investment are expected to decline by 8.6%, retail sales turnover by 10%, real disposable cash income by 4%. The baseline scenario anticipates all these indicators to decline further in 2016 (fixed investment are expected to fall by 4.9%, retail sales turnover by 4.1%, real disposable income by 3.6%) and in 2017 (fixed investment and retail sales turnover are down 3% and 0.5%, respectively), except real disposable cash income (slightly up 0.4%). The optimistic scenario predicts that the same indicators will see a smaller decline in 2016: fixed investment (down 1.2%), retail sales turnover (down 1.8%) and real disposable cash income (down 2.2%), but in 2017 they are expected to grow up by 1.2%, 1.4% and 1.7%, respectively.

The Consumers Price Index in 2015 stood at 12.9%, according to Rosstat. The CPI is expected to stay at 9.5% in 2016 and at 7% in 2017 under the baseline scenario and it will be 6.2% and 5.5%, respectively, under the optimistic scenario.

In 2015, export and import volumes of goods and services were worth \$389.3bn and \$280.8bn, respectively. Both scenarios anticipate that exports and imports will decline further in 2016 to respectively \$288.9bn and \$234.4bn under the baseline scenario and to \$337.8bn and \$268.4bn under the optimistic scenario. Export and import volumes in 2017 are expected to be worth \$314.6bn and \$231.9bn, respectively, under the baseline scenario and \$368.8bn and \$305.9bn, respectively, under the optimistic scenario.

Interest rates will remain high in 2016–2017. The Bank of Russia will lower the key rate with a time lag behind inflation, and the key rate will also depend on the foreign exchange market (the central bank will tighten its monetary policy amid lower crude oil prices and high pressure on the rouble). The baseline scenario predicts that the CBR key rate will not be higher than 9.0% per annum by the end of 2016 and 6.25% by the end of 2017. The optimistic scenario anticipates that Russia's central bank may lower the key rate to 6.5% in 2016 and to 5% by the end of 2017. The nominal interest rate on rouble-denominated loans in 2015 is therefore estimated at 15.7% per annum (the real interest rate at 0.5%). The nominal interest rate will be set at 12.2% in 2016 and 11.4% in 2017 (the real interest rate at 2.3 and 3.4%, respectively) under the baseline scenario and 10.6% and 8.7% under the optimistic scenario (the real interest rate at 2.6% and 3.0%, respectively). Higher real interest rates on loans will mirror still high risks of lending to real sector borrowers amid a recession.

The yearly average nominal rouble exchange rate in 2015 was 60.9 roubles per dollar. The rouble will see further depreciation in 2016 regardless of which of the scenarios is selected: 69.4 roubles per dollar under the baseline forecast and 64.6 roubles per dollar under the optimistic scenario. The rouble will strengthen in 2017 to a yearly average of 65.7 roubles per dollar under the baseline scenario and to 60.5 roubles per dollar under the optimistic scenario. Considering inflation changes in Russia, the real effective exchange rate in 2015 lost 7.6%. Both scenarios predict that the real exchange rate will begin to grow as early as next year, up 4.1% in 2016 and 6.8% in 2017 under the baseline scenario. The optimistic scenario forecasts that the real exchange rate will increase 10.9% in 2016 and 3.6% in 2017.

Since it is assumed that the Bank of Russia will hold on to an inflation targeting regime and pursue a tight monetary policy, we forecast a moderate growth in the money aggregates for both scenarios. The money supply (M2) in 2015 is preliminary estimated at 4.6%, and the monetary base decreased by 2.9% from 2014. In 2016, the money aggregate M2 will increase 8.3% under the baseline scenario and 8.4% under the optimistic scenario, and in 2017 it will be up 10.8% and 11.9%, respectively. Both scenarios expect the monetary base increase 4.5% and 6.1%, respectively.

Baseline scenario (Urals: 2015=51, 2016=35, 2017=40)	2015				2016				2017	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	year	year
	actual	actual	actual	forecast	forecast	forecast	forecast	forecast	forecast	forecast
Urals crude	52.0	61.4	49.3	41.8	30.0	35.0	35.0	40.0	35.0	40.0
GDP										
billion roubles	16.565	17.491	19.305	20.518	17.324	18.800	20.787	21.915	78.826	85.270
physical volume index on a year-over-year basis, %	97.8	95.4	95.9	95.4	98.5	99.5	100.5	96.0	98.6	99.7
Deflator	109.6	106.0	107.6	107.9	106.2	108.0	107.1	111.3	108.2	108.5
Fixed investment										
physical volume index	91.2	92.6	91.9	90.4	91.7	93.7	95.9	96.8	95.1	97.0
Retail sales turnover										
on a year-over-year basis, %	93.6	90.9	90.5	84.9	96.1	95.0	96.5	96.0	95.9	99.5
Real disposable cash income										
on a year-over-year basis, %	98.7	95.6	96.1	93.5	96.9	95.7	96.5	96.7	96.4	100.4
Exports										
billion US dollars	101.3	104.2	91.6	92.1	64.5	71.4	73.3	79.7	288.9	314.6
Including										
Exports of goods	89.5	91.1	78.4	80.4	55.8	61.6	62.9	70.0	250.3	277.6
Exports of oil and gas	54.2	54.9	45.8	43.1	30.0	30.2	29.6	33.5	123.3	134.0
Other exports	35.3	36.2	32.6	37.3	25.9	31.4	33.3	36.5	127.0	143.6
Exports of services	11.7	13.1	13.2	11.7	8.6	9.9	10.4	9.7	38.6	37.1
Imports										
billion US dollars	65.4	70.9	75.4	69.8	45.3	60.3	61.0	67.8	234.4	231.9
Including										
Imports of goods	45.3	48.2	50.1	51.0	29.9	41.4	40.8	48.5	160.6	165.2
Import of services	20.2	22.7	25.3	18.8	15.4	18.9	20.2	19.3	73.9	66.8

Baseline scenario (Urals: 2015=51, 2016=35, 2017=40)	2015					2016					2017	
	Q1	Q2	Q3	Q4	year	Q1	Q2	Q3	Q4	year	year	year
	actual	actual	actual	forecast	forecast	forecast	forecast	forecast	forecast	forecast	forecast	forecast
Urals crude	52.0	61.4	49.3	41.8	51.1	30.0	35.0	35.0	40.0	35.0	40.0	40.0
CPI												
as a % over the previous period	107.4	101.0	101.7	102.3	112.9	103.9	102.2	101.1	102.0	109.5	107.0	107.0
Period-average rate on rouble-denominated loans, % per annum												
real interest rate	1.5	0.8	-1.2	0.1	0.3	3.4	1.4	1.9	2.3	2.3	3.4	3.4
nominal interest rate	18.6	16.2	14.3	13.0	15.5	12.8	12.1	11.9	12.0	12.2	11.4	11.4
Dollar-Rouble exchange rate												
average nominal for the period	62.2	52.6	62.8	65.9	60.9	70.9	70.3	68.9	67.7	69.4	65.7	65.7
Rouble's real effective exchange rate												
Period end as a % over the previous period end	-10.8	20.3	-13.7	-0.2	-7.6	-3.7	2.4	2.4	3.1	4.1	6.8	6.8
Monetary base												
trillion roubles	9.7	9.7	9.8	11.0	11.0	10.0	10.2	10.2	11.5	11.5	12.2	12.2
Money aggregate M2												
At period end, trillion roubles	31.6	32.5	33.0	33.6	33.6	33.0	33.8	34.0	36.4	36.4	40.3	40.3
gain as a % over the previous period	-1.5	2.7	1.4	2.0	4.6	-1.7	2.5	0.5	7.0	8.3	10.8	10.8

Optimistic forecast (Urals: 2015=51, 2016=50, 2017=55) Urals crude	2015				2016				2017	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	year	year
	actual	actual	actual	forecast	forecast	forecast	forecast	forecast	forecast	forecast
GDP										
billion roubles	16.565	17.491	19.305	20.518	17.338	19.121	21.173	22.459	80.090	83.990
physical volume index on a year-over-year basis, %	97.8	95.4	95.9	95.4	99.5	100.3	99.4	99.2	99.6	100.9
Deflator	109.6	106.0	107.6	107.9	105.2	108.9	110.4	110.3	108.9	103.9
Fixed investment										
physical volume index	91.2	92.6	91.9	90.4	93.3	96.4	100.0	101.5	98.8	101.2
Retail sales turnover										
on a year-over-year basis, %	93.6	90.9	90.5	84.9	98.3	97.2	98.8	98.5	98.2	101.4
Real disposable cash income										
on a year-over-year basis, %	98.7	95.6	96.1	93.5	97.2	96.5	98.3	99.1	97.8	101.7
Exports										
billion US dollars	101.3	104.2	91.6	92.1	67.8	84.3	89.9	95.8	337.8	368.8
<i>Including</i>										
Exports of goods	89.5	91.1	78.4	80.4	59.0	73.6	78.3	84.8	295.7	326.4
<i>Exports of oil and gas</i>	54.2	54.9	45.8	43.1	33.1	42.3	45.1	48.4	168.9	183.2
<i>Other exports</i>	35.3	36.2	32.6	37.3	25.9	31.3	33.2	36.4	126.8	143.1
Exports of services	11.7	13.1	13.2	11.7	8.8	10.7	11.6	11.1	42.1	42.5
Imports										
billion US dollars	65.4	70.9	75.4	69.8	51.3	67.2	72.2	77.7	268.4	305.9
<i>Including</i>										
Imports of goods	45.3	48.2	50.1	51.0	35.0	47.2	50.3	56.9	189.4	225.6
Import of services	20.2	22.7	25.3	18.8	16.4	20.0	21.9	20.8	79.1	80.3

Optimistic forecast (Urals: 2015=51, 2016=50, 2017=55) Urals crude	2015				2016				2017	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	year	year
	actual	actual	actual	forecast	forecast	forecast	forecast	forecast	forecast	forecast
CPI	52.0	61.4	49.3	41.8	35.0	54.0	54.5	56.5	50.0	55.0
as a % over the previous period	107.4	101.0	101.7	102.3	103.2	101.6	99.9	101.3	106.2	105.5
Period-average rate on rouble-denominated loans, % per annum										
real interest rate	1.5	0.8	-1.2	0.7	3.9	1.7	2.1	2.7	2.6	3.0
nominal interest rate	18.6	16.2	14.3	13.8	12.8	11.0	9.6	9.1	10.6	8.7
Dollar-Rouble exchange rate										
average nominal for the period	62.2	52.6	62.8	65.9	67.9	67.5	61.5	61.2	64.6	60.5
Rouble's real effective exchange rate										
Period end as a % over the previous period end	-10.8	20.3	-13.7	-0.7	-0.5	1.7	8.2	1.3	10.9	3.6
Monetary base										
trillion roubles	9.7	9.7	9.8	11.0	10.0	10.2	10.2	11.5	11.5	12.2
Money aggregate M2										
At period end, trillion roubles	31.6	32.5	33.0	33.6	33.1	34.2	34.0	36.4	36.4	40.7
gain as a % over the previous period	-1.5	2.7	1.4	2.0	-1.6	3.3	-0.5	7.1	8.4	11.9

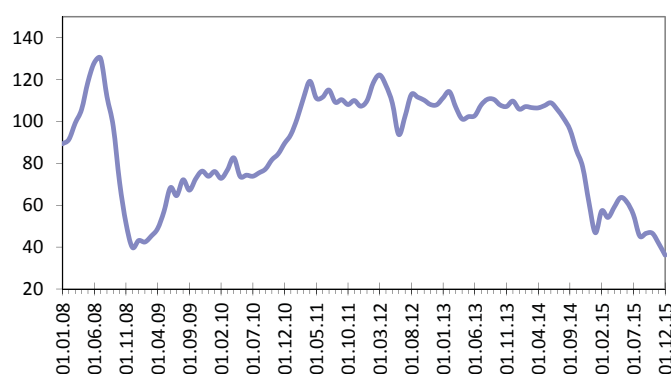
2. OIL MARKET: NEW REALITY

Yu.Bobylev

Amid low crude oil prices resulting from the excessive supply over demand, oil production at high-cost deposits began falling, drastically decreased investments in the development of non-traditional deposits including shale oil in US. However, falling oil production at the high-cost deposits is offset by the oil production growth in leading OPEC member states, which aim for expanding their oil market share. Russia has also increased oil supplies: in 2015, its oil production peaked its maximum over the period since 1990 and the oil export has reached its all-time record. Moreover, due to the lifting of sanctions on Iran one should expect a significant increase of supplies from that country. On the whole, the oil market outlook is characterized by predominance of factors, which will contribute to preservation of low world oil prices.

Recently, the world oil market boasts of a sustainable excessive crude oil supply over demand, which resulted in a significant reduction of oil prices. Production of shale oil in the United States is the main factor of the global supply growth. It was due to application of the latest production technologies and high oil prices over previous years.

Furthermore, despite price reduction the OPEC refused to cut the oil output quota proceeding to the policy of maintaining their share of the global crude oil market. As a result, in 2015, Urals crude oil price averaged \$51.2 per barrel, which was nearly half (by 47.6%) the price of the previous year (*Table 1*). In the meantime, in January, August and September 2015 Urals crude oil price averaged \$45–47 per barrel and in December averaged \$36.2 per barrel (*Fig. 1*). In January 2016, the oil price decline continued. In mid-month, it dipped below \$30 per barrel. Thus, the low oil prices became the new normal of the crude oil market.



Source: OECD/IEA.

Fig. 1. Price of Urals in 2008–2015, \$/bbl.

Table 1

WORLD OIL PRICES IN 2012–2015, \$/ BBL.

	2012	2013	2014	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2015
Brent crude oil, Great Britain	112.0	108.8	98.9	54.0	62.1	50.0	43.4	52.4
Urals crude oil, Russia	110.3	107.7	97.7	52.8	61.4	49.1	41.5	51.2

Sources: IMF, OECD/IEA.

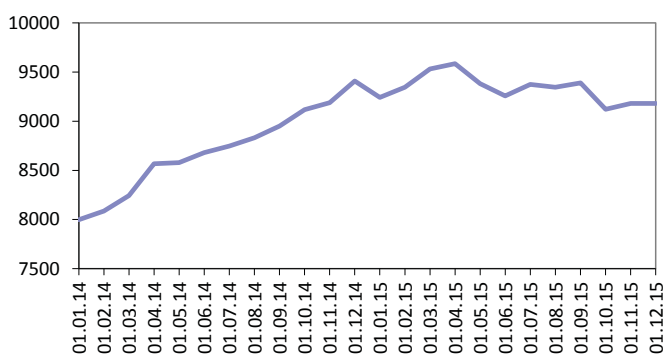
The latest data demonstrate that in 2015 amid low crude oil prices output at the high-cost deposits was terminating. The investment activity fell sharply. The US reached peak oil output of 9.585 mn barrels per day in April 2015,

thereafter its production began falling to 9.18 mn barrels per day in December or by 4.2% in comparison with the April maximum (*Fig. 2*). Oil production is falling in other high-cost regions: Norway, Great Britain and Mexico.

In the wake of low crude oil prices investment in the development of the most high-cost unconventional deposits: shale oil in the US, oil-bearing sand in Canada, deep-water fields in various regions, fell sharply. For example, the rig count in US, which represents the investment activity indicator peaked 1,596 in October 2014, whereupon steady decline began (*Fig. 3*) to 537 rigs in December 2015. In other words, the rig count shrank by 66% over this period. This will result in further decline of crude oil production in US.

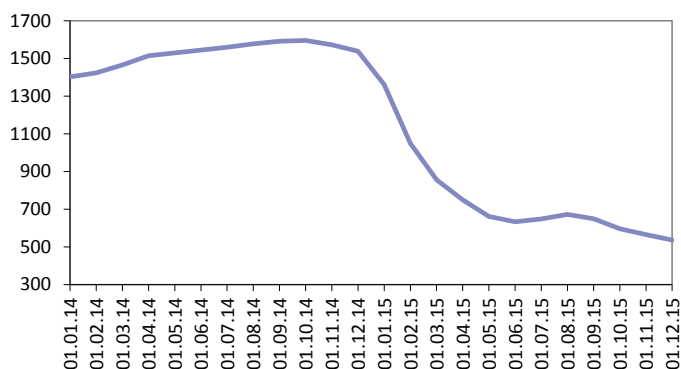
Contraction of high-cost oil production could have reduced excessive oil supply and create preconditions for the increase of the world oil prices. However, the serious issue is represented by the OPEC policy aimed at expanding their oil market share. For the countries whose income mainly depend on the oil export, low crude oil prices strengthen incentives for the expansion of their market share. By increasing their supply volumes, they tend to offset at least partly the revenues contraction due to falling prices. As a result, contraction of crude oil output in the high-cost regions in currently offset by an increase of crude oil production by the OPEC member states.

In Q4 2015 in comparison with the same period of the previous year, total crude oil production by Saudi Arabia and Iraq, leading OPEC member states by production volumes, has gone up by 1.28 mn barrels per day, including by Saudi Arabia – by 0.44 mn barrels per day, in Iraq – by 0.84 mn barrel per day (*Table 2*). As a result, there is a sustainable excess of the production quota set by the OPEC member states (30 mn barrels per day). Moreover, in the near future due to the lifting of sanctions on Iran the latter will increase oil supply, which is the third largest OPEC oil producer.



Source: US EIA.

Fig. 2. Oil production in US in 2014–2015, thousand barrels per day



Source: Baker Hughes.

Fig. 3. Number of active rig count in US in 2014–2015

Table 2

OIL PRODUCTION IN US AND OPEC IN 2014–2015, MN BARRELS PER DAY

	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	2015 Q4
USA	8.14	8.61	8.84	9.25	9.49	9.50	9.43	9.30
OPEC, total	30.01	29.70	30.28	30.34	30.32	30.96	31.34	31.19
Saudi Arabia	9.80	9.65	9.70	9.63	9.73	10.07	10.22	10.07
Iraq	3.26	3.29	3.28	3.53	3.57	4.03	4.33	4.37

Source: US EIA.

Russia has also increase crude oil supply on the world market. Despite the fall of oil prices and imposition of financial and technological sanctions on Russia, oil output maintains positive dynamic (*Table 3*). In 2015, Russia produced 533 mn tons of crude oil, which is the maximum level since 1990. Positive impact on the oil production was due to significant investments over recent years, ruble devaluation as well as tax burden reduction following the decline of world oil prices. Total export of oil and petroleum products in 2015 according to preliminary estimates exceeded 400 mn tons, which is all-time high.¹ Increase of Russian oil export is due both to growth of oil production and contraction of domestic consumption amid economic slump. At the same time, one should note positive impact of the tax maneuver² implemented in the oil sector. It resulted in significant reduction of fuel oil export and increase of crude oil export, which is more productive for the state budget than fuel oil export.

Table 3

PRODUCTION AND EXPORT OF OIL AND PETROLEUM PRODUCTS IN RUSSIA
IN 2012–2015, IN % TO CORRESPONDING PERIOD OF PREVIOUS YEAR

	2012	2013	2014	2015 January– November
Oil production including gas condensate	101.3	100.9	100.7	101.3
Crude oil export	98.2	98.6	94.4	107.6
Primary crude oil processing	104.9	102.7	104.9	97.2
Production of regular gasoline	104.3	101.3	98.8	102.3
Production of diesel oil	98.7	103.1	107.4	98.5
Production of fuel oil	101.6	103.3	102.0	91.5

Sources: Rosstat, Ministry of Energy of Russia.

Russia's potential in sustaining crude oil production to a significant degree will depend on the level of world oil prices. In particular, development of new deposits will depend on this factor.

The current oil market outlook is characterized by a number of factors, which will contribute to the preservation of relatively low oil prices. Among the most significant ones are: considerable deposits of shale oil in US, which will be rapidly developed and will increase supply in case of the world oil prices above \$60 per barrel; slowdown of economic growth in China; falling discipline in OPEC; increased tension between Saudi Arabia and Iran as well as increased crude oil supply by Iran resulting from lifting of sanctions linked to the realization of its nuclear program. In this context, the most feasible prospect for the oil market will be low world oil prices in the years to come.

According to the latest forecast of the US Energy Information Agency released in January 2016, in the current year Brent crude oil price will average \$40.15 per barrel. In the event of the realization of this forecast, the price of Urals crude oil will average \$39 per barrel in 2016. ●

1 See: Yu. Bobylev. "Development of Russia's Oil Sector". *Voprosy ekonomiki*. 2015. № 6, pp. 45–62.

2 See: G. Idrisov, S. Sinelnikov-Murylev. "Modernization or Conservation: the role of the export duty on oil and petroleum products". *Ekonomicheskaya politika*. 2012. №3, pp. 5–19; Yu. Bobylev. "Tax Maneuver in the oil sector". *Ekonomicheskoe razvitiye Rossii*. 2015, №8, pp. 45–49.

3. REGIONS' DEBT BURDEN: AWAITING BUDGET LOANS

A.Mamedov, E.Fomina

Over 11 months of 2015, regional debt growth came to nearly 5% against the turn of the year. Municipal debt growth during the same period constituted 1.5%. By the period-end for the entire year, the debt volume will increase further. However, growth rates, most likely, will slow down compared to 2014. By the end of 11 months, the budget loans share went up by 7.3 p.p. to 38.3% with simultaneous decline of the commercial loans share by 5.6 p.p. and state bonds by 1.4 p.p. in the debt structure. However, the situation significantly differs in various regions: there are regions with public debt growth due to mainly commercial loans with already high level of accumulated debt.

Data on the public debt volume of the subjects of the Russian Federation and municipal debt from 2010 through 1 December 2015 is provided in Table 1. These data show that the upward debt growth trend of regional and municipal budgets continued in 2015 (data for 11 months). Nominal increment of the debt volume of regional and municipal budgets against the turn of the year constituted nearly 5%, and without Moscow and Moscow region – 7%. Municipal debt growth over the same period came to 1.5%. By the period-end for the whole 2015 (12 months) one can expect further public and municipal debt growth. 2012–2014 showed that precisely by the year-end debt grows by 15–20% (which is due to unevenness of the budgetary expenditure and the need to meet all liabilities before the year-end). At the same time, taking into account the fact that the deficit of the consolidated budgets of the subjects of the Russian Federation at year-end 2015 came to 0.3% of GDP (preliminary data) against 0.6% of GDP in 2014, the regional debt growth rates are slowing down. This is both due to favorable dynamic of regional budgets' tax revenues in the nominal terms (although a decline in real terms) and to containment of expenditure growth (according to preliminary data their volume was executed barely by 93% of the plan by the year-end 2015)¹.

Overall, the regional debt dynamic during recent years shows sustainable growth trend from 1.6% of GDP in 2010 to 3.0% of GDP as of 1 December 2015. If we estimate the volume of the regional debt in terms of the budgetary system and the economy as a whole, then its volume is not so high.

It should be noted that if historically two RF subjects – Moscow and Moscow region accounted for the main regional debt share (as of 1 January 2011 estimated 40.7% of the total regional debt) then as of 1 December 2015, they account for nearly 11% of the total debt volume. This fact reflects increasing during recent years difficulty with the execution of regional budgets, which forced separate and many regions to resort to borrowing and often not for finance investment but to cover current expenditures.

¹ For further information on retrospective analysis of regional budgets' trends please refer to Sergey Sinelnikov-Murylev, Arseny Mamedov "Regional Budgets – 2015: three ways for resolving the deficit issue". (<http://www.forbes.ru/mneniya-column/vertikal/272987-region-alnye-byudzhety-2015-tri-sposoba-resheniya-problemy-defitsita>).

Table 1

STATE AND MUNICIPAL DEBT OF SUBNATIONAL BUDGETS IN 2010–2015

	Year-end 2010 Volume, Rb bn.	Year-end 2011		Year-end 2012		Year-end 2013		Year-end 2014		During 11 months 2015	
		Volume, Rb bn.	growth, % (or pp of GDP)	Volume, Rb bn.	growth, % (or pp of GDP)	Volume, Rb bn.	growth, % (or pp of GDP)	Volume, Rb bn.	growth, % (or pp of GDP)	Volume, Rb bn.	growth, % (or pp of GDP)
Regional budgets, total	1096	1172	6.9	1355	15.6	1738	28.2	2090	20.3	2191	4.9
Regional budgets, total (less Moscow and Moscow region)	650	832	28	1069	28.5	1474	37.9	1825	23.8	1953	7.0
Regions' debt, % of GDP	1.6	1.8	0.2	2.0	0.2	2.6	0.6	2.9	0.3	3.0*	0.1
Municipal budgets, total	170	216	26.9	245	13.8	289	17.8	313	8.4	318	1.5

Note: when calculating the indicator we used forecast GDP volume for 2015 provided by the Ministry of Economic Development in "Main Indicators of Socio-Economic Development Forecast of the Russian Federation through 2018" of 26 October 2015.

Source: Finance Ministry of Russia, author's calculations.

Increased debt burden in many RF subjects is reflected by the data broken by regions (Table 2). However, because only data for 11 months is available, it is premature to jump to conclusions regarding debt dynamic broken by separate regions.

Table 2

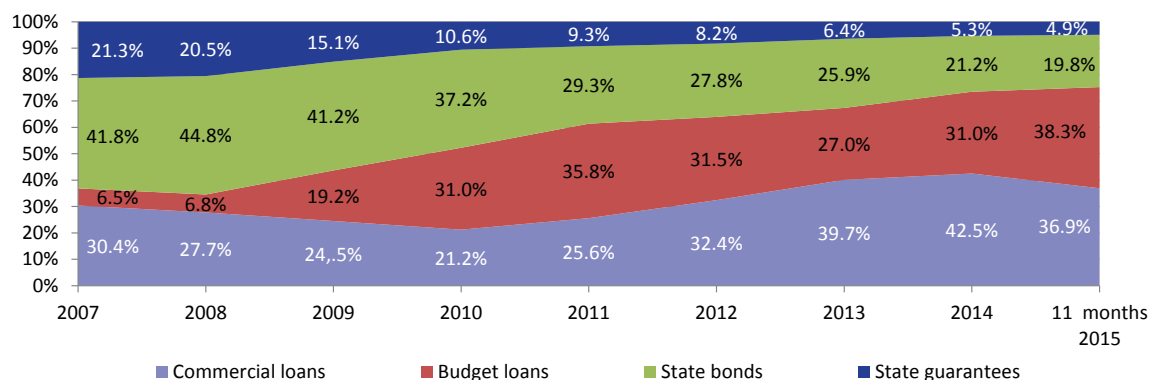
DYNAMIC OF STATE DEBT OF RF SUBJECTS FOR 2008–2015
(IN NOMINAL TERMS)

	Number of RF subjects					
	Growth by over 50%	Growth from 15 to 50%	Growth less than 15%	Reduction by less than 15%	Reduction from 15 to 50%	Reduction by over 50%
2008	21	20	10	6	12	9
2009	37	18	11	6	4	2
2010	29	24	8	11	7	0
2011	21	27	13	14	6	0
2012	18	29	14	8	10	1
2013	31	36	8	6	1	0
2014	12	44	18	5	1	2
11 months 2015	2	17	35	21	6	0

Note. Arkhangelsk region and Nenets Autonomous Region are presented as a single subject; data without Crimea federal okrug; data on Sakhalin region is n/a.

Sources: Finance Ministry of Russia, authors' calculations.

While analyzing debt structure of the RF regions for 11 months of 2015, one can observe budget loans upward trend (Fig. 1). The budget loans share has gone up to 38.3%, which is by 7.3 p.p. higher than its volume as of the start of 2015. At the same time, budget debt growth was accompanied by the reduction of commercial loans share (-5.6 p.p.) and state bonds (-1.4 p.p.). Contraction of the commercial share of the RF subjects' debt (state bonds and commercial loans) constituted estimated Rb 56bn in nominal terms. Thus, we can speak about the commercial loans substitution with the budget loans regarding regional budgets as a whole, which reflects priorities of the federal

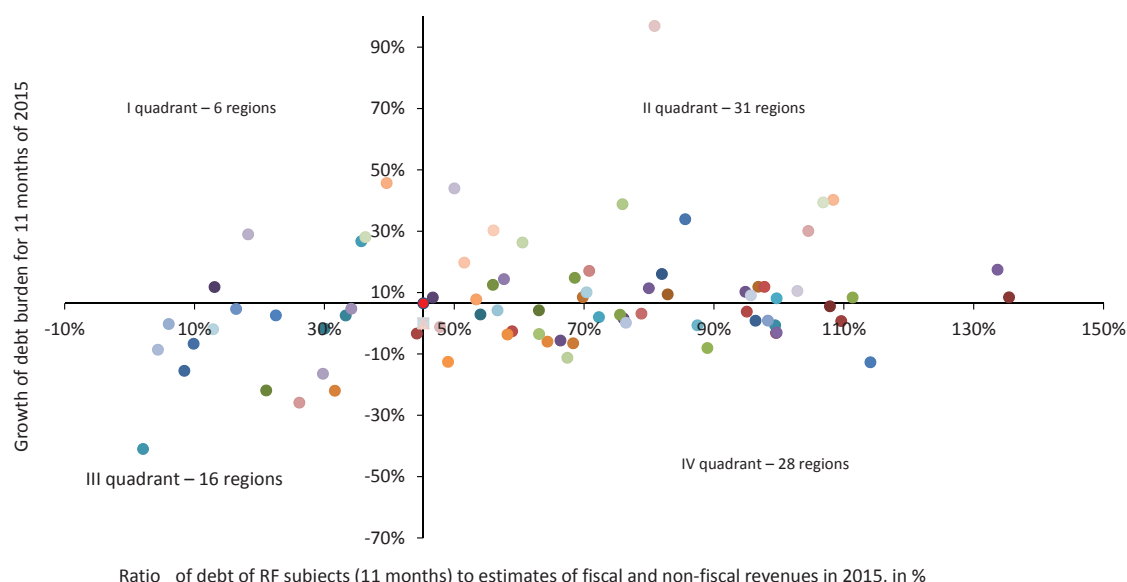


Note. Data less Crimean federal okrug.

Fig. 1. Structure of the public debt of the RF subjects for 2007-11 months 2015

center's current policy in relation to regions. However, as will be shown below the situation significantly differs regarding separate regions, which can make it necessary to further increase the budget loans share (for those regions, which still register commercial debt growth). This fact creates risks of increasing dependence of the RF subjects on the federal budget loans, which in its turn will increase political pressure on the Finance Ministry of Russia to take decision on writing off or 'freeze payments' on budget loans. Such measure looks like a simple one for resolving the RF subjects' debt can significantly undermine budget discipline on the regional level.

Fig. 2 provides distribution of RF subjects depending on dynamic of the debt burden and the debt growth rates for 11 months of 2015. The RF subjects in II quadrant are the most vulnerable from the point of view of their budget sustainability. For example, there are 32 regions in the risk zone (II quadrant).



Notes. 1) Intersection of axes in the point where debt burden and debt growth of RF subjects for 11 months of 2015 take average across Russia value (45.2% and 6.5%, respectively without Moscow); 2) The figure does not reflect: Tyumen region (0.95%, 280.7%), Republic of Mordovia (184.7%, 21.7%).

Sources: Federal Treasury, Finance Ministry of Russia, authors' calculations.

Fig. 2. Debt burden and change of state debt of RF subjects in 2015

Their level of debt burden (ratio of debt total to estimates of regional budget revenues less transfers) and debt growth rates during 11 months of 2015 turned out to be above average Russian volumes (without Moscow). The most difficult situation from the point of view of general indicators (without debt structure) is observed in the following regions: Republic of Mordovia (growth rate for 11 months of 2015 +21.7%, level of debt burden as of 1 December 2015 – 184.7%), Republic of North Ossetia (+17.5% and 133.7%), Kostroma region (+8.5% and 135.4%), Republic of Khakasia (+40.3% and 109.6%), Jewish autonomous Region (+39.4% and 106.8%), Zabaikalsky Krai (+30.1% and 104.5%), Chukotka Autonomous region (+10.5% and 102.8%) and Astrakhan region (+8.4% and 111.4%).

It is important to analyze not only general debt dynamic but also its structure in order to estimate regional budget sustainability. Analysis of debt structure in RF subjects which are in II quadrant demonstrated that the most tens situation exists in 21 regions (out of 31) where during 11 months of 2015 the volume of commercial loans and bonds went up. In remaining 10 subjects the volume of the regional debt moved up due to budget loans and state guarantees. Analysis of data for 11 months of 2015 demonstrates the most acute situation in 4 regions: Magadan region (growth of commercial loans in nominal terms +91%), Republic of Mordovia (+83%), Republic Mary El (+56%), and Republic of Khakasia (+56%). ●

4. SAVINGS BEHAVIOUR PATTERN: FORGET THE CURRENCY

M.Khromov

In 2015, the population has turned to the savings pattern. It is reflected among other in the renewal of the savings rate on bank deposits, which was characteristic of 2012–2013 and simultaneous repayment of bank debts. At the same time, prior to December 2015, there was no significant demand for foreign currency and downward trend for cash demand remained.

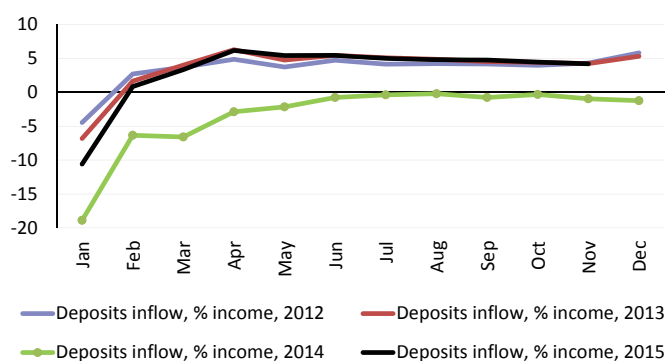
In 2015, the population returned the savings pattern, which characterized 2012–2013 following sharp decline in retail bank deposits registered in 2014. Over 11 months of 2015, the volume of retail bank deposits and accounts has moved up by 10.7% (by Rb 1.9 trillion). Over the same period of 2014, the dynamic of the retail bank deposits was negative. The population withdrew Rb 400 bn from the banks (2.4% of their volume). In 2012–2013, the deposit base growth was less robust (11.7–12.5%) with lower volumes (Rb 1.5–1.7 trillion over 11 months). This is explained both by the economy of scale and by a shift in the economic outlook.

From the point of view of the savings rate, the share of households money income allocated on bank deposits and accounts has not practically changed compared to the two-three year old situation. Over 11 months of 2015, retail bank deposits have constituted a little bit over 4% of the money income of the population.

However, the nominal volume of the households' money income has been increasing slower than the nominal deposits volume growth. For the period of 11 months of 2015, the population's income turned out to be by 19% higher than over the corresponding period of 2013. Meanwhile, the volume of retail deposits went up by nearly 30% in the nominal terms including due to the revaluation of currency deposits in the wake of the ruble devaluation. In these circumstances, sustaining the savings rate at the 2013 level has led to the somewhat slowdown of retail bank deposits growth rates.

2015 has also seen the corresponding shift in the structure of the households' income and expenses. The households have significantly increased the volume of their savings on bank accounts and deposits. Meanwhile, they repaid loan debts. At the same time, the share of consumer expenses both on goods and services and on purchase of foreign cash.

Over January–November 2015, assets flow between the households and the banking sector has changed to an opposite one. Over the same period of 2014, as a year before, the population was the net borrower in relation to the banking sector. Indi-



Sources: Bank of Russia, Rosstat, IEP's estimates.

Fig. 1. Retail deposits on bank accounts and deposits from the turn of the year

viduals were accumulating debt on bank loans by Rb 1.3 trillion, which was equivalent to 3.0% of the households' income. At the same time, the volume of bank deposits fell by Rb 0.4 trillion which matched 1.0% of money income. Thus, during the first 11 months of 2014, households got from the banks Rb 1.7 trillion. In 2015, either channel of transfer of financial assets worked in the opposite direction. Contraction of the credit market resulted in the contraction of the population's bank debts by Rb 0.9 trillion (1.8% of money income)¹, and the bank deposits as was noted returned to the positive dynamic.

Consequently, it is obvious that the population returned to the savings pattern regarding the banking sector, which is characteristic for the period of income reduction. Similar trends were observed in 2009. Then, amid increased inflow of bank deposits, the population also cut loan debt.

It should be noted that the reduction of the population's loan debt allowed the households to reduce the share of income allocated for mandatory payments and contributions. Overall, its share fell from 11.6% in January–November 2014 to 11.0% in January–November 2015. Open data of banker books allow to set aside quarterly interest payments on bank loans, which ratio to the population's money income during three quarters of 2015 shrank by 0.4 p.p. in comparison with the same period of 2014 (from 4.0 to 3.6%).

Table 1

MAIN ITEMS OF HOUSEHOLDS' SPENDING AND SAVINGS
IN JANUARY–NOVEMBER 2013–2015, % OF MONEY INCOME

	2013	2014	2015
Spending on goods and services	72.1	74.2	71.1
Mandatory payments and contributions	11.4	11.6	11.0
Bank operations	-1.1	-4.0	6.0
Inflow of bank deposits	4.2	-1.0	4.2
Rubles	3.5	-0.6	3.5
Foreign currency	0.7	-0.3	0.7
Attraction/payment of loan debt («-» – debt growth)	-5.4	-3.0	1.8
Cash increment	0.1	1.7	-1.8
Rubles	0.3	-0.2	-0.8
Foreign currency	-0.2	1.8	-1.0
Total bank and cash operations	-1.0	-2.3	4.2

Sources: Rosstat, Bank of Russia, IEP's estimates.

Analysis of various items of the households' spending confirms the population's transition to the savings behavior pattern. For example, the simplest savings definition as a difference between disposable income and consumer spending provides that during the first eleven months of 2013 nearly 16.5% of the population's money income were allocated for savings. Over the same period of 2014, due to the impact of increased consumer activity the savings rate shrank to 14.2%. In addition, in January–November 2015, the gap between disposable income and consumer spending of the population has already reached 17.9% of the population's money income, which, obviously,

1 For further information on the 2015 lending market contraction please refer to Michael Khromov "Retail lending: deduction from demand". Online Monitoring of Russia's Economic Outlook №15, 2015.

speaks about the reduction in consumption and increase in savings due to a decrease of consumer purchasing power of the population¹.

The following features of the population's savings behavior pattern in 2015 should be noted separately. First, reduction of demand for cash. Typically, the peak cash growth falls on December. However, during the first eleven months, as a rule, the cash volume increases compared with the start of the year. However, both in 2014 and in 2015 the cash volume in circulation failed to recover by the first of December to the level of the start of the corresponding year. Besides in 2015, this reduction was much more pronounced at about Rb 400 bn or 0.8% of the population's money income. As a result, in 2015 the share of cash in the ruble money mass has reached its absolute minimum of 20.4%.

Moreover, despite a highly unstable dynamic of the national currency exchange rate, 2015 does not register a significant demand of the population for foreign currency. Over 11 months 2015, according to our estimates, the volume of foreign currency owned by the population fell by more than USD 11bn. Meanwhile, foreign currency bank deposits increased over the same period by nearly USD 6bn. One can assume that practically total demand for foreign currency by the population was satisfied in 2014 when the volume of foreign currency went up by USD 28bn mainly during the last months of the year. In 2015, in the wake of falling real income the population did not dispose of additional financial assets for investment in foreign currency. Part was transferred into the non-cash money and the rest, most likely, was used on current spending. ●

1 For further information on decline of income and fall of consumer demand please refer to A. Burdyak, E. Grishina "Population's Income and Consumer Crediting Is in the Red".

5. TURKISH LESSONS: EMBARGO-RELATED RISKS

V.Uzun

Russia's embargo on food imports from Turkey will trim Turkey's exports to Russia by some \$1bn, nearly 60% of Turkey's total agri-food exports to Russia. Produce exports will be hit hardest. The embargo may have a severe impact on Russia's tomato, grape and tangerine markets. Turkish supplies accounted for 34–50% of Russia's imports of these products. Turkish supplies represented 11% of Russia's yearly average consumption of tomatoes. The share was reportedly much bigger at various months.

Furthermore, the embargo may also pose the risk of Turkish counter-sanctions against food imports from Russia (Russia's food supplies are bigger in value than Turkish supplies to Russia). Additionally, substitution of imports from Turkey with supplies from other countries or with domestic produce may boost prices in the Russian market. None of the EEU allies has joined Russia's food embargo, which is fraught with strained relations between Russia and some of the EEU member states over supplying the sanctioned products to the Russian market.

Agri-food trade relations between Russia and Turkey has recently been growing steadily (Table 1). Turkish supplies during the period under review accounted for about 4% of Russia's total food imports, whereas Russian supplies represented 10.6–12.5% of Turkey's food imports.

Table 1

RUSSIA–TURKEY IMPORTS/EXPORTS OF FOODS AND AGRICULTURAL PRODUCE

	2012	2013	2014	January–October 2015
Russia's imports from Turkey, million US dollars	1515	1752	1765	1038
Russia's exports to Turkey, million US dollars	1938	1721	2369	1390
Turkish share of Russia's imports, %	3.7	4.0	4.0	4.9
Russian share of Turkish exports, %	9.9	10.3	9.8	7.7
Turkish share of Russia's exports, %	11.6	10.6	12.5	10.8

Sources: the calculations hereinafter rely on the data released by Russia's Customs Service: <http://stat.customs.ru/>; the data released by the Turkish Statistical Institute: http://www.turkstat.gov.tr/PreTablo.do?alt_id=1046.

In the first 10 months of 2015 Russia total food imports, including from Turkey, were curtailed drastically. Nevertheless, the Turkish share of Russia's imports increased to 4.9% during the same period.

The situation changed drastically after 24 November 2015¹, when Russia's President issued a Decree on 28 November 2015, No. 583, introducing economic measures targeted against Turkey. The Russian government issued an executive order² containing a list of agricultural produce and foods subject to a food import ban to come into force on 1 January 2016. The list includes the following foods and products:

1 On 24 November 2015, Turkish Air Force shot down a Russian warplane in Syria.

2 Russian government executive order No. 1296 of 30 November 2015.

- turkey and chicken meat cuts and meat offal, frozen;
- vegetables (tomatoes, cucumbers, onions, cauliflower);
- fruits (oranges, tangerines, grapes, apples, pears, apricots and peaches (including nectarines));
- fresh cloves.

The ban covers the foods which in 2014–2015 accounted for nearly 60% of Russia's food imports from Turkey (*Table 2*).

Table 2

THE SHARE OF SANCTIONED FOODS/PRODUCTS OF TOTAL VALUE
OF IMPORTS FROM TURKEY

	2014		January–October 2015	
	million US dollars	%	million US dollars	%
Russia's imports from Turkey	1765	100	1038	100
including sanctioned foods and products,	1074	60.9	614	59.2
of which: fruits	502	28.5	270	26.1
vegetables	544	30.8	324	31.2
flowers	2.9	0.2	5.2	0.5
meat and meat foods	25.1	1.4	15	1.4

Turkey's cumulative losses will worth nearly \$1bn due to the Russian sanctions. The bulk of the losses will be caused by banned produce imports. Imports of products worth \$600–700m are not subject to sanctions. These are basically fish, tobacco, produce offal as well as various types of fresh produce. It is noteworthy that the ban covers the products of insignificant value and volume (e.g., fresh cloves, certain types of meat foods), but no ban was applied to imports of the products of significant export volumes and value (e.g., grapefruits – 40,000 tonnes or 5% of Turkey's total grapefruit production).

Tomatoes is the principal item of Turkish food exports to Russia. In 2014, 366,000 tonnes of tomatoes worth \$439m were supplied from Turkey (3.1% of Turkey's total tomato production). This accounted for 43% of Russia's total tomato imports or 11% of Russia's tomato consumption. The share of Turkish tomatoes of Russia's consumption increased considerably in off-season period.

The ban on Turkish supplies may disarray considerably the Russian tomato market if the Turkish niche is not occupied by other importers. For now it is impossible to provide such a volume of import substitution. Furthermore, Russian greenhouse tomatoes are priced much higher than Turkish ones.

Tangerines is the second important Turkish export item covered by the ban. Turkey was the principal exporter of tangerines to Russia. In 2014, Russia imported 847,000 tonnes of tangerines worth \$206.7m, including 286,700 tonnes from Turkey (34% of total imports). In 2015, tangerine imports from Turkey shrank most compared to other countries: the Turkish market share shrank to 25% in volume terms and to 18.7% in value terms. To offset the lost volumes, Morocco – the second largest exporter after Turkey – should increase its export volumes to Russia 2.4 times, to 500,000 tonnes. Such a scenario is unlikely to realize.

Grape imports from Turkey (more than 50% of Russia's imports) more than doubled the Russian production of table grapes. A new supplier is therefore needed to maintain supply volumes, because imports in this case can only be substituted in the long term. New vineyards have to be planted, and it takes four years until they can be harvested.

The decision to ban imports of certain types of Turkish foods will pose some risks for Russia. The main risks are as follows:

1. Turkey's counter-sanctions on imports of foods and agricultural produce from Russia. Given the fact that Russia's food exports to Turkey are bigger than Turkey's food exports to Russia, Turkish counter-sanctions would bring about heavy losses on the Russian agrarian sector. Such sanctions would first of all hurt Russian producers and exporters of food grains and feed grains, sunflower and sunflower oil.

2. Re-export of Turkish foods to Russia via EEU member states. None of Russia's allies within the Eurasian Economic Union has joined Russia's sanctions against Turkey. Businesses of EEU member states will not wait to reap benefits from re-exporting Turkish foods to Russia. The re-export risk is likely to heighten because it is difficult to identify the country of origin for many types of produce.

It has been known from the past experience that the risk is not improbable. For example, after Russia banned food imports from the EU, U.S. and some other countries, many of the sanctioned foods were re-exported via Belarus. Before sanctions, Russia in 2013 imported 86,000 tonnes of apples from Belarus and 706,000 tonnes from Poland. In 2015 no apples were imported from Poland, whereas 318,000 tonnes of apples were supplied from Belarus (according to the data on the first 10 months of 2015). It is highly unlikely that Belarus within a year could have planted and harvested tens of thousands of hectares of gardens.

Spain and Greece were major exporters of peaches (including nectarines) to Russia before sanctions were imposed. In 2013, Russia imported 155,000 tonnes of peaches (including nectarines) from these countries. No peaches and nectarines were imported from Spain and Greece in 2015, whereas 121,000 tonnes were supplied (in the first 10 months of 2015) from Belarus, which in 2012 supplied to Russia merely 1,000 tonnes of these fruits.

The same thing happened to wild and garden strawberries: Russia in 2015 closed down major exporters (Greece, Poland, Spain) from its markets, whereas Belarus supplied to Russia 27,000 tonnes of these products (compared with merely 0.1 thousand tonnes in 2012). In 2015, the Republic of Belarus also represented a big share of Russia's imports of kiwi fruits (20%), date plums (10%), cherries and sour cherries (31%), whereas as early as two years ago the share was nearly zero (less than 1%).

To assess this risk, one should remember that Turkish businesses maintain close trade and commercial relations with their counterparts from Kazakhstan, Kyrgyzstan, Azerbaijan, meaning that new channels may be used for supplying the sanctioned products.

3. Russian consumers face higher produce prices. Turkish foods are in most cases priced lower than foods from other countries (*Table 3*), except perhaps grapes from the Republic of Moldova. However, Moldovan grape exports to Russia include mostly vine grapes, which are lower in quality and cheaper than table grapes. Quite apparently, Russian consumers will have to pay higher price if Turkish foods are replaced with foods of the same type and comparable quality from other countries.

Table 3

IMPORT VOLUMES AND AVERAGE PRICES OF IMPORTED FOODS

Types of foods and top suppliers	2012		2013		2014		January–October 2015	
	volumes, thousand tonnes	price, USD per tonne	volumes, thousand tonnes	price, USD per tonne	volumes, thousand tonnes	price, USD per tonne	volumes, thousand tonnes	price, USD per tonne
1. Tomatoes:								
Turkey	361	994	335	1346	366	1202	301	958
China	79	1175	81	1303	91	1320	72	1303
Morocco	62	1440	71	1426	78	1424	35	1401
2. Cucumbers:								
Turkey	55	1179	44	1382	65	1107	17	1016
Iran	55	1291	64	1318	62	1307	31	1337
China	30	1213	30	1285	31	1283	20	1270
3. Tangerines:								
Turkey	159	1060	201	1019	287	721	97	662
Morocco	192	941	222	928	223	946	77	978
China	87	930	87	981	80	988	32	1021
4. Fresh grapes:								
Turkey	146	1285	144	1297	168	1076	100	980
Chile	33	1585	38	1589	25	1589	18	1586
Moldova	21	972	25	846	28	815	14	876

4. Import substitution may boost produce prices. The Russian government took measures to partially substitute the sanctioned foods and products with domestic ones. However, domestic produce were often priced higher than imported ones (*Table 4*).

Table 4

PRICES OF DOMESTICALLY PRODUCED FOODS
AND IMPORTED TURKISH FOODS (2015)

	Agricultural producer prices, roubles per kilo (earlier in the month)		Prices of imports from Turkey, roubles per kilo	
	Greenhouse cucumbers	Greenhouse tomatoes	Cucumbers	Tomatoes
January	105.0	93.0	66.5	60.9
February	139.9	139.7	67.0	65.5
March	145.8	156.8	61.9	58.0
April	118.7	153.3	50.3	53.4
May	100.3	137.7	46.2	49.4
June	80.9	109.8	32.7	46.7
July	45.7	67.7	0.0	48.4
August	38.9	55.5	0.0	56.9
September	37.1	48.0	0.0	51.3
October	44.0	52.3	52.8	54.8

Turkish products were 1.5–3 times cheaper than domestic ones throughout the entire off-season period, except the summer and fall of 2015, when Russian and Turkish suppliers offered comparable prices. ●

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