Structural challenges for the Russian economy

During the period preceding the global economic crisis of 2008-2009, the economy of the Russian Federation enjoyed several years of buoyant economic growth (figure 1) with per capita income more than doubling. However, the crisis severely affected the country through lower oil prices, weak external demand and a sharp outflow of capital. Although the economy returned to growth in 2010, growth averaged at about 4 per cent in 2010-2012 and noticeably slowed in 2013 (figure 1). The economy entered a technical recession in the second quarter of 2013 and is likely to expand at less than 1.5 per cent for the year as a whole. Lower investment growth is responsible for most of the slowdown, as investment is held back by high interest rates, and high inflation impedes monetary easing.

In November 2013, the country’s Ministry of Economic Development released a downward revision to its long-term forecast, according to which the economy will expand at an average rate of 2.5 per cent a year by 2030, a rate below world GDP growth and well below the average growth rate of the BRICS. Such a scenario may lead to potential macroeconomic vulnerabilities.

In the near term, the Russian Federation has sufficient protective buffers to cope with cyclical shocks. Thanks to high commodity prices, the country has accumulated high levels of foreign exchange reserves and about $87 billion in the National Wealth Fund and about $86 billion in a separate Reserve Fund. The level of government debt is low, less than 9 per cent of GDP, which alleviates fiscal risks (although the non-oil fiscal deficit is high).

However, the economy faces serious structural problems in the long run as it is dominated by the energy (oil and natural gas) sector, which is responsible for about 70 per cent of export revenues. The continuous appreciation of the currency in real terms acted as a drag on the non-oil economy, leading to high levels of imports and the country’s sizeable current-account surplus has been persistently shrinking (figure 2). To maintain production in the oil sector in the longer run, less accessible areas must be explored and in the long run oil output may decline. Natural gas exports, on the other hand, may come under stiff competition from the shale gas industry. The share of fixed investment in GDP (at about 20 per cent) is lower than in many other emerging markets, while the country has outdated production facilities in many sectors and needs to diversify its investment away from the energy sector.

There are also demographic challenges. The working age population is declining. Despite the tight labour market, hidden unemployment is a problem and the quality of human capital is deteriorating, as investment in education and research remains inadequate.

Sustaining potential output growth at a level above 3 per cent annually and diversification are therefore a priority. Against the backdrop of unfavourable demographic trends, a continuous increase in total factor productivity is needed, which in turn will require active, and possibly unpopular, economic policies.