Russian Federation: Growth Scenarios for 2006-2009

1. Assuming that the Russian government sticks to its basic economic policy commitments, the Russian economy should continue to exhibit significant growth throughout the CPS period, although capacity constraints may increasingly limit the pace of expansion. For the CPS period, oil prices present the primary source of uncertainty for both for the pace and nature of future growth. Three scenarios considered below are projected for different oil price trajectories. In the medium and longer term, growth prospects will depend greatly on economic policy and reforms. This especially concerns the effective maintenance of macroeconomic stability, the development of infrastructure and energy, and measures to improve the climate for private investment, competition, and entrepreneurship. Growth prospects also depend on external factors other than oil. Higher international interest rates, for example, could deprive Russian enterprises of their current sources of relatively cheap finance, with implications for profitability and growth. As most foreign inflows come from oil and gas, Russia's macroeconomic position is not as vulnerable in the short term relative to most other countries in the region to changes in investor sentiment about emerging markets.

2. The table below presents base case, high oil price and low oil price projections for the Russian economy through 2009. In the base case, the oil price declines gradually from an average price of 65 dollars to 55 dollars a barrel by 2009. The high case scenario assumes an increase of the oil price to 95 dollars a barrel in 2009. Finally, a low case scenario assumes a significant declining trend in the price of oil, down to 35 dollars a barrel by 2009.

Table : Economic scenarios: 2006 – 2009

		2005	*2006*	*2007*	*2008*	*2009*
Oil price, $/bbl		55				
	base scenario		*65*	*60*	*56*	*55*
	high price		*70*	*77*	*85*	*95*
	low price		*60*	*50*	*40*	*35*
GDP growth, %		6.4				
	base scenario		*6.8*	*6.0*	*5.5*	*5.0*
	high price		*6.8*	*6.5*	*6.5*	*6.5*
	low price		*6.5*	*5.0*	*5.0*	*4.5*
Inflation (CPI), %		12.6				
	base scenario		*10*	*8*	*6*	*5*
	high price		*10*	*10*	*10*	*10*
	low price		*10*	*8*	*7*	*7*
General government fiscal balance, % GDP		7.6				
	base scenario		*7.7*	*6.2*	*5.2*	*5.0*
	high price		*9.0*	*10.4*	*11.2*	*13.8*
	low price		*6.7*	*4.7*	*2.8*	*0.9*
Current account balance, % GDP		10.9				
	base scenario		*9.7*	*5.2*	*2.9*	*2.0*
	high price		*11.7*	*9.8*	*8.7*	*7.8*
	low price		*8.5*	*4.3*	*1.6*	*0.4*

Source: World Bank estimates and projections.

3. All three scenarios are consistent with the continuation of economic growth, macro-stability, and both fiscal and current account surpluses. Yet, they pose different sorts of policy challenges. Under the low case scenario, fiscal and current account surpluses largely evaporate by 2009. This scenario would most likely also be accompanied by a substantial weakening of the capital account. Quite probably, such a decline in oil prices would shake up the Russian financial sector and create serious problems in some commercial banks. The Central Bank should manage to isolate these problems in a handful of problem banks with high oil price or foreign exposure, and thereby prevent a general financial crisis. In this low oil price scenario, the manufacturing sector of the economy would receive a much-needed boost in competitiveness, but might also find itself more liquidity constrained in the short due to the problems in the financial sector. Due to this factor and slower growth in domestic demand, economic growth would be lower. Inflation would be higher than in the base case oil scenario due in part to ruble depreciation and higher prices for imports.

4. The high oil price scenario presents a challenge in the form of even larger balance of payments inflows. In order to keep inflation under control (at still 10 percent) and protect tradable sectors of the economic from an extremely rapid real exchange rate appreciation, the government would be compelled to generate ever greater federal budgetary surpluses, up to 14 percent of GDP in 2009. In this scenario, economic growth accelerates slightly to 6.5 percent of GDP, but this would be accompanied by an even more rapid decline in employment in manufacturing, with the movement of labor and other assets to non-tradable sectors. Restrictive macroeconomic policy would be essential for maintaining macroeconomic stability and preventing the overheating of the economy. An extremely rapid accumulation of reserves (By 2009, US$ 690 billion in gross currency reserves and a Stabilization Fund of over US$ 600 billion) would challenge the government to minimize the opportunity costs of delays or inefficiencies in the investment of this money in a diversified international portfolio.

5. In the base case scenario, the current account and balance of payments moves gradually toward equilibrium, and pressure on the ruble subsides somewhat. Annual GDP growth continues at five percent through 2009, and inflation falls to 5 percent. Thus, of the three scenarios, relative stability in oil prices presents the best opportunity for reducing inflation.