

Russian Federation

Despite extremely favourable shifts in the terms of trade, real GDP growth has slowed in 2005 and is set to decelerate gradually over the projection period. This is largely the result of a policy-induced deterioration in the investment climate at a time when capacity constraints were already starting to affect performance.

In these circumstances, mounting pressure for further fiscal easing should be resisted. The cut in the value-added-tax now being considered by the authorities would be particularly ill advised, as it would needlessly stimulate already booming consumption, fuelling inflation and undermining competitiveness. A renewed structural reform effort, underpinned by fiscal discipline, could boost investor confidence and contribute to increasing potential output.

Preliminary official data show real GDP growth slowing from 7.2% in 2004 to 5.9% in the first three quarters of 2005. This was principally the result of a further gradual deceleration in the growth of fixed investment and of a sharp slowdown in export growth. The role of domestic demand in driving growth thus continues to increase. Consumption growth is being sustained by rapidly rising real incomes and by explosive growth in consumer credit, which is estimated to account for around one-third of the growth of private consumption in January-September.

Growth has slowed somewhat in 2005...

On the production side, the slowdown has been widespread, with the growth of manufacturing and resource extraction both decelerating markedly. Construction also slowed but appears to have rebounded strongly in recent months. The slowdown in oil-sector investment in 2004 has been reflected in sluggish growth of oil output and exports. The growth of market services has held up much better, on the back of strongly rising domestic demand, and managerial surveys suggest that service-sector growth continues to be very robust.

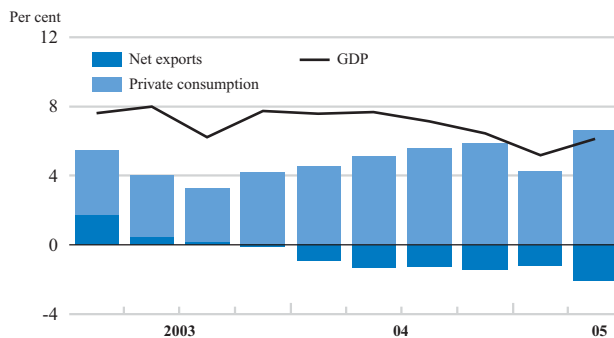
... with services and construction becoming more important recently

Consumer price inflation is certain to exceed the authorities' target range in 2005. Core inflation has been running below the headline measure – which also reflects the impact of sharp increases in regulated prices – but is proving extremely difficult to bring down, given rapid money supply growth on the back of large forex

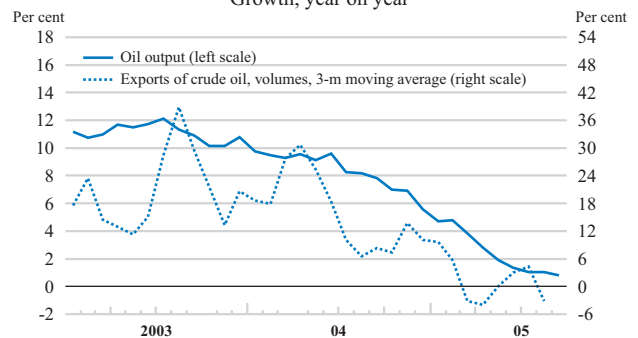
Disinflation is proving difficult given demand-side pressures

Russian Federation

Growth is overwhelmingly consumption-driven



Oil-sector growth has slowed markedly
Growth, year on year



Source: Russian Federal Service for State Statistics.

Projections for the Russian Federation

	2004	2005	2006	2007
Real GDP growth	7.2	6.1	5.7	5.3
Inflation	11.7	11.3	10.7	10.0
Fiscal balance (per cent of GDP) ¹	4.5	7.3	4.0	2.5
Primary fiscal balance (per cent of GDP) ²	5.6	8.3	4.8	3.2
Current account balance (\$ billion)	60	91	81	57
Current account balance (per cent of GDP)	10.3	12.3	9.2	5.5

1. Consolidated budget.

2. Federal budget only.

Source: Data for 2004 are from national sources. Data for 2005-07 are OECD estimates and projections.

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inflows, wage increases in industry that exceed productivity gains, and fiscal stimulus, particularly the rapid growth in budget-sector wages and pensions.

Fiscal policy is being loosened

Fiscal policy has been relaxed somewhat in 2005, with a further loosening planned for 2006, when further sharp rises in public sector wages and pensions are envisaged. The extent of fiscal easing has so far been limited – this year has seen substantial sterilisation of oil windfalls via early debt repayment and the accumulation of the bulk of surplus revenues in the fiscal stabilisation fund. However, the decision to spend a much larger share of oil windfalls than hitherto comes amid signs that capacity constraints are starting to make themselves felt, so higher fiscal spending will add to inflationary pressures. Given the reduced role for fiscal sterilisation of oil windfalls, the central bank will probably have to tighten monetary policy and accept a faster rate of rouble appreciation if it is to get inflation back on a downward path. The pressure on monetary policy would be reduced if the authorities were to implement the finance ministry's recent proposal to channel surplus revenues derived from natural gas royalties and export duties on gas and petroleum products into the stabilisation fund during periods of high oil prices. This would help reduce inflationary pressures while simultaneously mitigating somewhat the upward pressure on the exchange rate.

Structural reform has stalled and state intervention increased

Structural reform has largely stalled, and there seems at present to be little reason to expect any renewed reform impetus in the near term. In general, implementation of those reforms legislated during 2002-03 continues, albeit at uneven rates, but little has been done about the remaining items on the government's structural agenda. Instead, there has been further movement towards expanding the direct role of the state in "strategic" sectors, including power-generation machines, aviation, oil and finance. Given the Russian state's abysmal record when it comes to owning and operating businesses, this trend hardly bodes well for growth.

Growth will moderate but will remain relatively strong

The economy appears to remain on course for growth of around 6% for the year. Assuming a slight decline in oil prices, supply-side constraints should become more apparent and growth should decelerate over the projection period. This will be partially offset if investment growth picks up somewhat after the sharp slowdown seen in 2004 – 05. Import growth will remain at fairly high levels throughout the projection period, though it should moderate somewhat in 2007 as oil prices weaken, particularly if the authorities adhere to their medium-term fiscal strategy, which envisages a slowdown in expenditure growth in 2007. However, further fiscal easing is entirely possible and would tend to boost domestic demand, import growth and inflation, while undermining the competitiveness of the tradable sector.

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Conventional signs

\$	US dollar	.	Decimal point
¥	Japanese yen	I, II	Calendar half-years
£	Pound sterling	Q1, Q4	Calendar quarters
€	Euro	Billion	Thousand million
mb/d	Million barrels per day	Trillion	Thousand billion
..	Data not available	s.a.a.r.	Seasonally adjusted at annual rates
0	Nil or negligible	n.s.a.	Not seasonally adjusted
–	Irrelevant		

Summary of projections

	2005	2006	2007	2005		2006		2007		Fourth quarter			
				Q4	Q1	Q2	Q3	Q4	Q1	Q2	2005	2006	2007
	Per cent												
Real GDP growth													
United States	3.6	3.5	3.3	3.7	3.3	3.5	3.5	3.3	3.2	3.2	3.7	3.4	3.1
Japan	2.4	2.0	2.0	1.7	1.9	2.1	1.9	2.0	2.0	2.1	3.2	2.0	2.1
Euro area	1.4	2.1	2.2	2.2	1.9	2.0	2.2	2.1	2.2	2.2	1.8	2.1	2.2
Total OECD	2.7	2.9	2.9	3.1	3.0	2.8	2.6	2.9	3.2	2.9	3.0	2.8	2.9
Inflation													
United States	2.7	2.5	2.3	2.9	2.2	2.3	2.3	2.3	2.6	2.2	2.9	2.3	2.2
Japan	-1.1	-0.1	0.6	-0.2	0.0	0.1	0.3	0.5	0.6	0.7	-1.3	0.2	0.8
Euro area	1.8	1.7	1.9	1.9	1.5	1.5	1.5	1.8	2.0	2.1	1.9	1.6	2.0
Total OECD	2.1	1.9	1.9	1.5	1.4	2.1	2.4	2.0	1.7	1.8	1.9	2.0	1.9
Unemployment rate													
United States	5.1	4.8	4.7	5.0	4.9	4.9	4.8	4.8	4.7	4.7	5.0	4.8	4.7
Japan	4.4	3.9	3.5	4.3	4.1	4.0	3.9	3.8	3.7	3.5	4.3	3.8	3.3
Euro area	8.7	8.4	8.1	8.6	8.5	8.5	8.4	8.4	8.3	8.2	8.6	8.4	8.0
Total OECD	6.5	6.3	6.0	6.4	6.3	6.3	6.2	6.2	6.1	6.1	6.4	6.2	5.9
World trade growth	7.3	9.1	9.2	9.3	8.8	8.8	8.9	9.1	9.3	9.4	8.1	8.9	9.3
Current account balance													
United States	-6.5	-6.7	-7.0										
Japan	3.4	3.9	4.7										
Euro area	-0.2	-0.2	-0.1										
Total OECD	-1.8	-2.0	-2.0										
Cyclically-adjusted fiscal balance													
United States	-3.6	-4.2	-3.9										
Japan	-6.3	-6.1	-6.4										
Euro area	-2.2	-2.1	-2.0										
Total OECD	-3.1	-3.3	-3.2										
Short-term interest rate													
United States	3.5	4.8	4.9	4.2	4.6	4.9	4.9	4.9	4.9	4.9	4.2	4.9	4.9
Japan	0.0	0.0	0.7	0.0	0.0	0.0	0.0	0.0	0.3	0.6	0.0	0.0	1.0
Euro area	2.2	2.2	2.9	2.2	2.2	2.2	2.2	2.3	2.6	2.8	2.2	2.3	3.3

Note: Real GDP growth, inflation (measured by the increase in the GDP deflator) and world trade growth (the arithmetic average of world merchandise import and export volumes) are seasonally and working-day-adjusted annual rates. The "fourth quarter" columns are expressed in year-on-year growth rates where appropriate and in levels otherwise. The unemployment rate is in per cent of the labour force while the current account balance is in per cent of GDP. The cyclically-adjusted fiscal balance is in per cent of potential GDP. Interest rates are for the United States: 3-month eurodollar deposit; Japan: 3-month certificate of deposits; euro area: 3-month interbank rate.

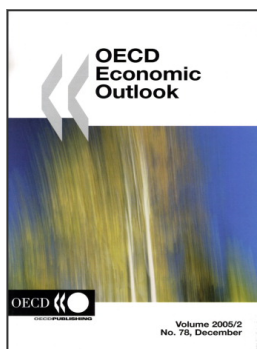
Assumptions underlying the projections include:

- no change in actual and announced fiscal policies;

- unchanged exchange rates as from 11 November 2005; in particular 1\$ = 118.00 yen and 0.85 euros;

The cut-off date for other information used in the compilation of the projections is 22 November 2005.

Source: OECD Economic Outlook 78 database.



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