

## Economics Group

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# Russian GDP Growth Remains Very Weak

*Growth fundamentals in Russia remain anemic and further weakness in coming quarters appears likely. We look for the ruble to depreciate modestly versus the dollar as the year progresses.*

### Russian Economy Decelerated in First Quarter

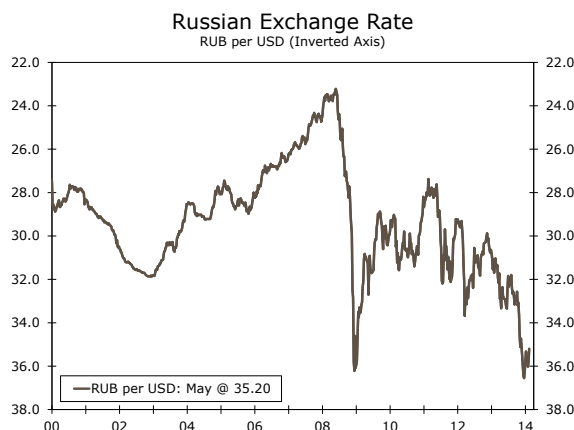
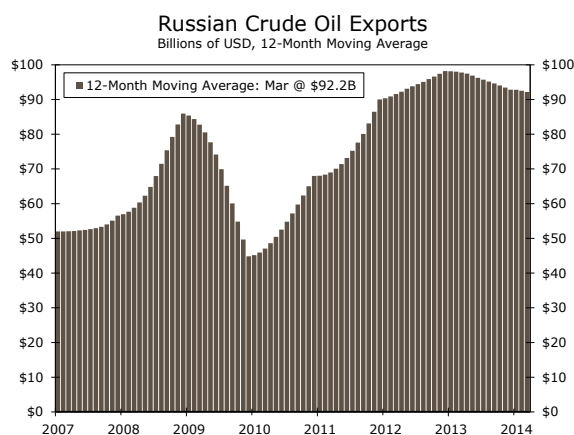
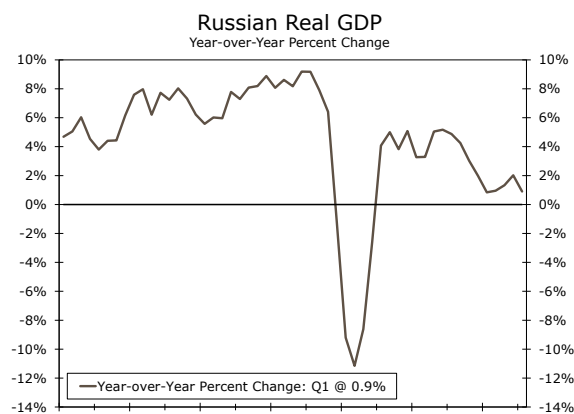
Recently released data show that real GDP in Russia rose only 0.9 percent on a year-ago basis in Q1-2014. Although the print was a bit above the market consensus forecast, the outturn reversed a slight uptrend in the rate of growth that had been in place over the previous few quarters (top chart). The rate of real GDP growth in Russia has generally been very depressed over the past few years, and we believe that economic growth will remain weak for the foreseeable future. The forecast that we completed earlier this month looks for real GDP to grow only 1.0 percent in 2014 and 2.5 percent next year. Because growth in the first quarter was weaker than we had projected, we may need to lower our numbers when we update our forecast in a few weeks.

A breakdown of GDP into its underlying demand components will not be available until mid-June, so it is difficult to pinpoint the exact sources of the deceleration in the first quarter. That said, monthly data offer some clues. The value of Russian oil exports trended lower in the first three months of the year (middle chart), making it likely that overall export growth weakened further during the quarter. The year-over-year growth rate in real retail spending was essentially unchanged between Q4-2013 and Q1-2014, making a pick-up in overall personal consumption expenditures, which include services as well as retail spending on goods, seem unlikely. As discussed below, the depreciation of the Russian ruble helped to lift CPI inflation from 6.1 percent in January to 7.3 percent in April, which will weaken growth in real disposable income and should exert some headwinds on consumer spending.

With growth in exports and consumer spending remaining weak, growth in capital spending, which rose only 0.5 percent on a year-ago basis in Q4-2013, probably remained anemic. Due to uncertainties spawned by the Ukrainian crisis and to monetary tightening (discussed below), outright contraction in capital spending in coming quarters appears likely.

The combination of Fed “tapering” and deterioration in Russian economic fundamentals have led to an outflow of capital that resulted in a significant depreciation in the value of the Russian ruble vis-à-vis the U.S. dollar (bottom chart). Indeed, the ruble plunged to an all-time low against the greenback earlier this year. This depreciation of the currency in conjunction with its inflation-inducing effects led the central bank to hike its main policy rate by 200 bps over the past 3 months.

The ruble has stabilized in recent weeks as the Ukrainian crisis has moved to the background. We look for the ruble to weaken modestly vis-à-vis the dollar in coming quarters as Russian economic fundamentals remain weak and the Federal Reserve moves towards less accommodative policy.



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