August 11, 2014

Economics Group

Jay H. Bryson, Global Economist
jay.bryson@wellsfargo.com • (704) 410-3274

Russian GDP Growth Remained Lackluster in Q2

The rate of real GDP growth remains more or less flat, and significant acceleration does not seem likely as long as uncertainties related to the Russia-Ukraine crisis continue to linger.

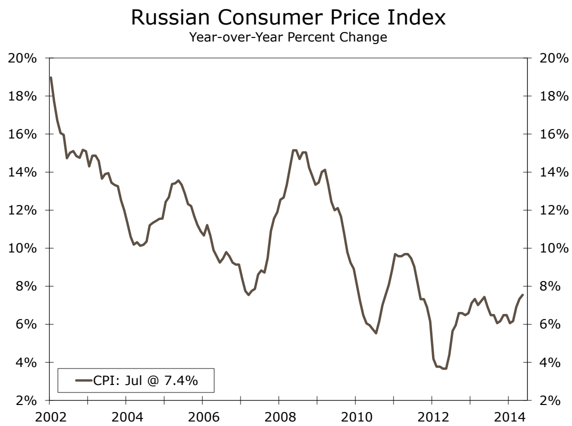
Russian Economy Essentially Dead in the Water

Data released today showed that real GDP growth in Russia edged down to 0.8 percent in Q2-2014 from 0.9 percent during the previous quarter (top chart). A breakdown of the real GDP data into its underlying demand components will not be available for another month, but it is likely that growth in most major spending components was weak in the second quarter. For starters, monthly data show that growth in real retail spending was cut in half from 3.6 percent in Q1 to 1.8 percent in Q2. Uncertainties related to the ongoing Russia-Ukraine crisis may be contributing to the apparent deceleration in consumer spending, but there probably is a more measurable factor at work. That is, the rise in CPI inflation in recent months (middle chart) which reflects, at least in part, the effects of previous currency depreciation, would have eroded real income growth. Slower growth in real income, in turn, weighs on growth in real consumer spending.

Real investment spending was down 7.0 percent in the first quarter on a year-ago basis, and it is likely that capex remained weak in the second quarter. Not only would uncertainties related to the crisis tend to weigh on investment spending, but higher borrowing costs undoubtedly have helped to depress investment spending as well. In an attempt to ward off downward pressure on the currency and to keep inflation expectations in check, the central bank has jacked up its main policy rate by 250 bps since late February. The 3-month interbank lending rate currently exceeds 10 percent. Borrowing costs faced by individual consumers and businesses surely are much higher.

Looking forward, we share the consensus view that the year-over-year rate of real GDP growth in Russia will remain below 1 percent for the remainder of the year. Assuming that the crisis with Ukraine does not deteriorate further, Russian GDP growth should slowly pick up next year but remain well below the 7 percent per annum growth rates that characterized the 2003-07 period. Arguably, the Russian economy will never grow at those supercharged rates again, at least not on a sustained basis. In a scenario in which the crisis escalates further and the West levies further sanctions, the Russian economy would likely weaken even further. In that event, Russia could enact its own sanctions on western economies. (For further reading, see "*Russian Economic & Financial Leverage on the West*," which is posted on our website.)

As noted above the ruble has depreciated, losing about 8 percent of its value vis-à-vis the euro and 10 percent versus the dollar since the beginning of the year (bottom chart). The Wells Fargo currency strategy group forecasts that the ruble will remain on the defensive versus the U.S. dollar for the foreseeable future.



Source: IHS Global Insight and Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah Watt House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Michael T. Wolf	Economist	(704) 410-3286	michael.t.wolf@wellsfargo.com
Zachary Griffiths	Economic Analyst	(704) 410-3284	zachary.griffiths@wellsfargo.com
Mackenzie Miller	Economic Analyst	(704) 410-3358	mackenzie.miller@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Cyndi Burris	Senior Admin. Assistant	(704) 410-3272	cyndi.burris@wellsfargo.com

WELLS FARGO SECURITIES