On the ropes

Russia on the brink of recession

by William Baunton

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Russia is edging ever closer to recession. The government of the oil- and gas-producing nation has warned of economic contraction over the next two years. The rouble has lost half its value in the last 12 months and banks continue to be cut off from western markets due to the sanctions imposed over the Ukraine conflict. Further sanctions against Russia were announced by US President Barack Obama this week. However President Vladimir Putin attempted to put a brave face on Russia's position at this press conference on Thursday, when he said, 'Our economy will get out of this crisis. How long? Maybe two years, but after that, growth is inevitable.' The MICEX index, comprising the 50 most liquid stocks in Russia, plunged to 1,450 from its peak of 1,623 at the beginning of December. Oil prices continue to drop with Brent Crude dropping below $60 a barrel this week from around $115 in June (and at $125 in 2012), rising slightly above $60 a barrel this morning. The rouble's decline is hurting imports and increasing food prices (inflation is moving beyond 9%) and the cost of servicing foreign debt. Apple has stopped online sales in Russia and French car maker Renault has raised the prices of its cars sold in Russia by 8%. Russia's sole compensation from the declining oil price and weakening rouble is that the reduction in tandem marginally softens the pain. As the Chart indicates, oil exports continue to bring in roughly the same revenue in rouble terms; one barrel brings in fewer dollars but the same number of roubles. Russia raised interest rates to 9.5% from 8% in October, and then again to 10.5% last week. The central bank used 'shock and awe' tactics at the start of the week, raising interest rates to 17% in a bid to halt the currency's decline. This was the largest interest rate increase since the 1998 financial crisis. Two weeks ago, the central bank announced that it intervened once more in the markets to support the rouble. It spent $4.5bn, bringing its total for the year to $70bn. On Monday it sold another $2bn of foreign currency reserves. A further $70bn in intervention may be needed, according to a survey of economists. The Finance Ministry has joined the cause, swapping dollars for roubles and beginning to sell off its $7bn of foreign reserves, which are significantly lower than the central bank's $420bn of international reserves. The central bank, led by Elvira Nabiullina, one of 19 female central bank governors around the world, plans a move to a fully-floating rouble in 2015, relinquishing its moving peg against the dollar and the euro. Russia's 15-year growth spell (aside from a brief dip during the 2008-09 financial crisis) is almost certainly coming to an end and capital is flowing out of the country. The government has displayed questionable priorities. Rosneft, Russia's largest oil company, issued $11bn of rouble-denominated corporate bonds after repeatedly requesting (and being denied) $49bn from the oil revenue-funded National Welfare Fund. The bonds were bought at lower interest rates than similarly structured government debt and all were purchased by state banks. Many see this as the government supporting Rosneft at the expense of sound economic policies. The fallout is spreading, with almost every bullish rouble option contract becoming worthless, wiping out holders' positions. Brokers both sides of the Atlantic are no longer taking rouble trades. The sudden interest rate rise and market interventions may underpin the rouble but it could reinforce the sentiment that Russia is facing a long period of stagnation and relatively high inflation.

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