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*By your side*

# The Development of the Russian Economy in the New Environment

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## Goal: Accelerate Growth As Well As Survive the Crisis

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- The crisis is serious, triggered by a combination of internal factors and a major external shock
- The recession will be both prolonged and deep
- Risks of material deterioration of 'qualitative' economic parameters more important than 'quantitative' manifestations of recession
- 'Rapid response' measures in the crisis management plan must help through the hot phase of the crisis
- But our goal is greater in scale: it is about putting us on a path of steady growth, which requires structural and institutional transformations
- We consider a reform of government to be the paramount element creating preconditions for success of institutional reform elsewhere and helping growth along

# Factors Determining Economic Development

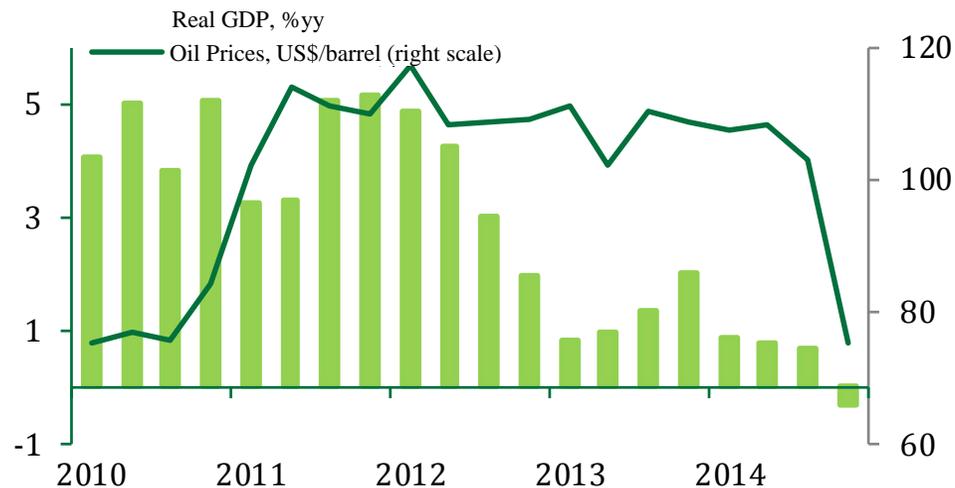
## 1 Accumulated structural imbalances

The slowdown was considerably enhanced by external factors, i.e.:

## 2 Sharp drop-off in oil prices

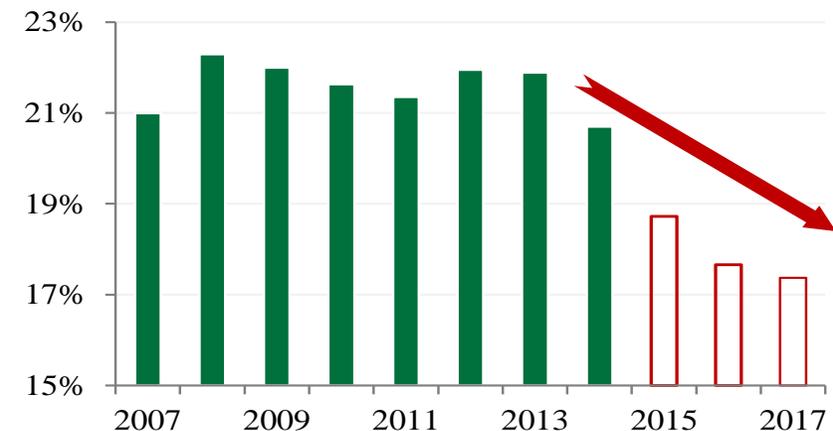
## 3 Geopolitical tensions and uncertainties

**Economic slowdown began with oil prices still high**



Source: Bloomberg

**Investments as Share of GDP (% GDP)**



Sources: Rosstat, Sberbank Research

# How Is This Crisis Different?

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## 1 Optimists calling not to monger crisis scare (as in 2009). But in 2009 :

- In 2009 we fell with the global economy, and recovered with it, too
- The sizeable quantitative easing pushed price levels up along with global growth
- Crisis only lasted 6 months

## 2 Now the environment is essentially different. The most optimistic geopolitical scenario sees:

- External markets closed
- Borrowing growing expensive
- Investment inflow lower
- Equity markets discredited
- Access to technology limited

## 3 Macroeconomic stability and resource levels – all a lot smaller

- Indexation of pensions
- Indexation of salaries to budget funded public servants to increase propensity to consume domestic products

## 4 Greater focus on working with domestic investors to exit the crisis

- A comprehensive system is required – shifting the paradigm and re-building confidence

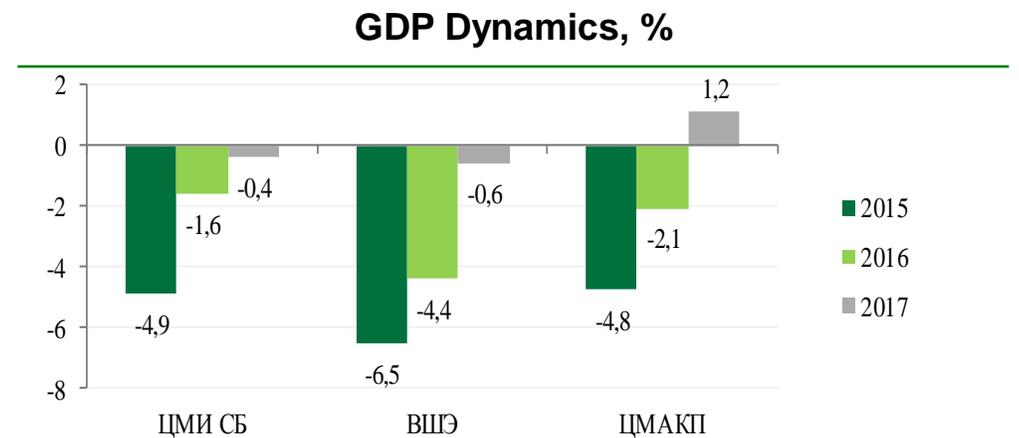
# Most Plausible Scenario – A Deep and Protracted Recession

1 A major contraction in 2015 – a consensus of all forecasts reviewed

2 Recession is highly likely to be prolonged (2-3 years)

3 Quantitative indicators fail to reflect the depth of crisis

Macroeconomic Indicator	Source				
	Sberbank	Ec.Dev. Ministry	Ministry of Finance	HSE	CMASF
Oil Price, \$/barrel	50	50	50	50	54
Capital outflow, \$bn.	130	115	95	135	н/д
GDP growth, %yy	-4.9	-3.0	-4,0	-6.5	-4.7
Inflation, % (annual average)	13.6	15.8	14.4	13.4	15.8
Capital Investments %yy	-14.0	-13.7	-15.0	-21.8	-13.2
Real wages, %yy	-9	-9.6	-9.5	-10.3	-6.5
Current account, \$ bn	51	56	75.0	74.8	no data
US\$/RUR(annual average)	61.6	61.5	61.5	83.7	no data



Sberbank and HSE forecast recession for the length of 2015-2017, while CMASF expects some growth in 2017.

# Main Challenge – Economy Deteriorating in Quality

## Relations with the West soured for long

- **Imports of advanced technologies** grew complicated => chronic trailing of developed nations
- **Limitations on access for Russian companies to international markets** (incl. financial) => qualitative and structural degradation of the economy.
- Given a **weaker competition against imports**:
  - Quality of manufactured goods to fall, goods to grow 'simpler'
  - Weaker stimuli to modernize and cut costs
  - A growth in concentration and monopolization
- **Dependence on resource exports** (oil prices) continues to grow

## Investments in free fall

- **No inflow of external investments** (an additional discount for Russian assets)
- **Domestic investors not rushing** into long-term projects (business sentiment chronically downbeat, no improvement factors in sight so far)

## People growing dramatically poorer

- 2015-16 will see **real income fall** 6.3% (to the levels of 2011), salaries –15.2% (levels of 2010)
- In 2013 30% of income was spent on food, **2015 will see 40-50% spent** – which is worse than in Eastern Europe or Belarus

# Stick Without Carrot: 2013-14 Saw Investment Climate Deteriorate Consistently

## Worsening of Doing Business Environment

- 1 **Dismantling of Funded Element to Pensions**
  - ❑ Funded element nationalized in 2013-15
  - ❑ 'Silent' contributors mandated back into the distribution pension system
- 2 **New powers of the Investigative Committee:** criminal cases can be instigated for tax offenses
  - ❑ "Nightmare of Business": expectation of more tax cases instigated
- 3 **Tighter anti-offshore law**
  - ❑ A year given to change ownership structures
  - ❑ Criminal liability
- 4 **Tax maneuver in the oil industry**
  - ❑ Accelerated inflation
  - ❑ Petrol output shrinking
  - ❑ More complicated tax administration

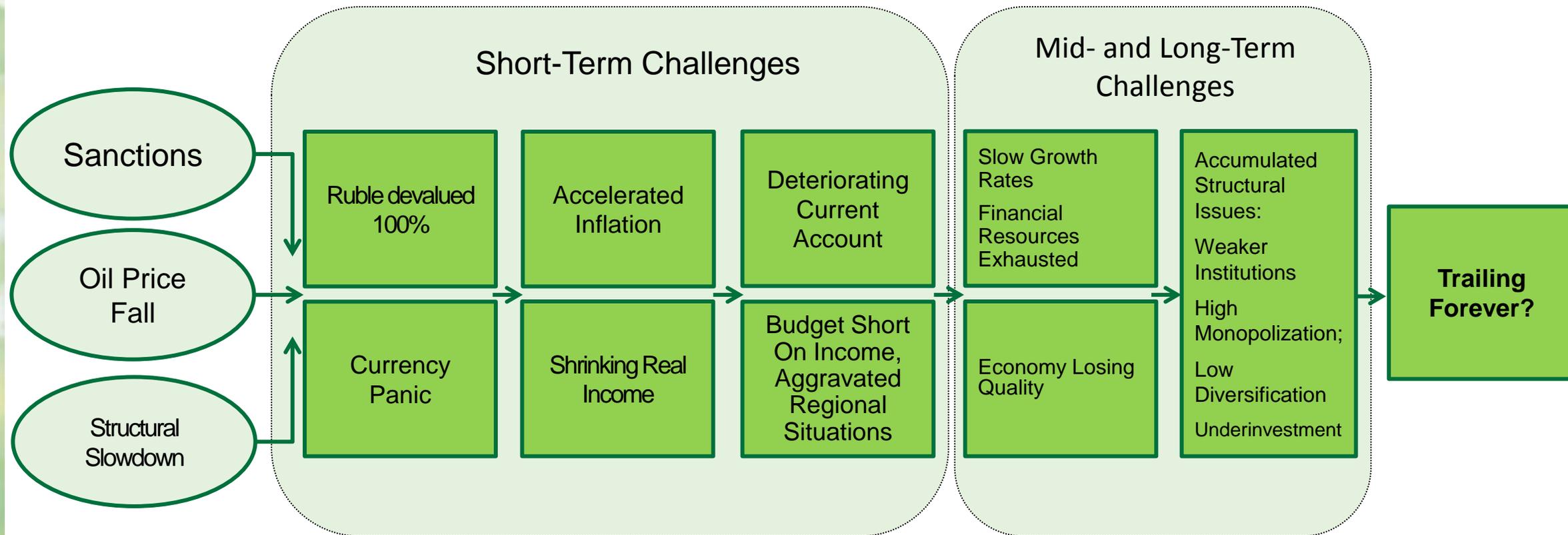
## Growing Tax Burden

*Official forecasts of tax benefits are generally inflated twice (!)*

- 1 **Property tax:** transition from an inventory valuation to a cadastre valuation
  - ❑ A burden on trade/office centres: +RUR22bn annually
- 2 **Introduction of a trade levy** in federal size cities
- 3 **Dividend tax:** up from 9% to 13%
- 4 **New method to calculate contributions into Mandatory Medical Insurance Fund (FOMS) :**
  - ❑ +RUR187bn in 2016
- 5 **Raised minimum salary threshold for employer pension contributions** to RUR52,000
  - ❑ New burden on businesses: +RUR70bn in 2015

**Imminent recession will scare off short-term investors,  
a deteriorating investment climate will put off the longer-term ones**

# Crisis Expansion Mechanism



# The Two Anti-Crisis Toolkits

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## An urgent anti-crisis tool kit

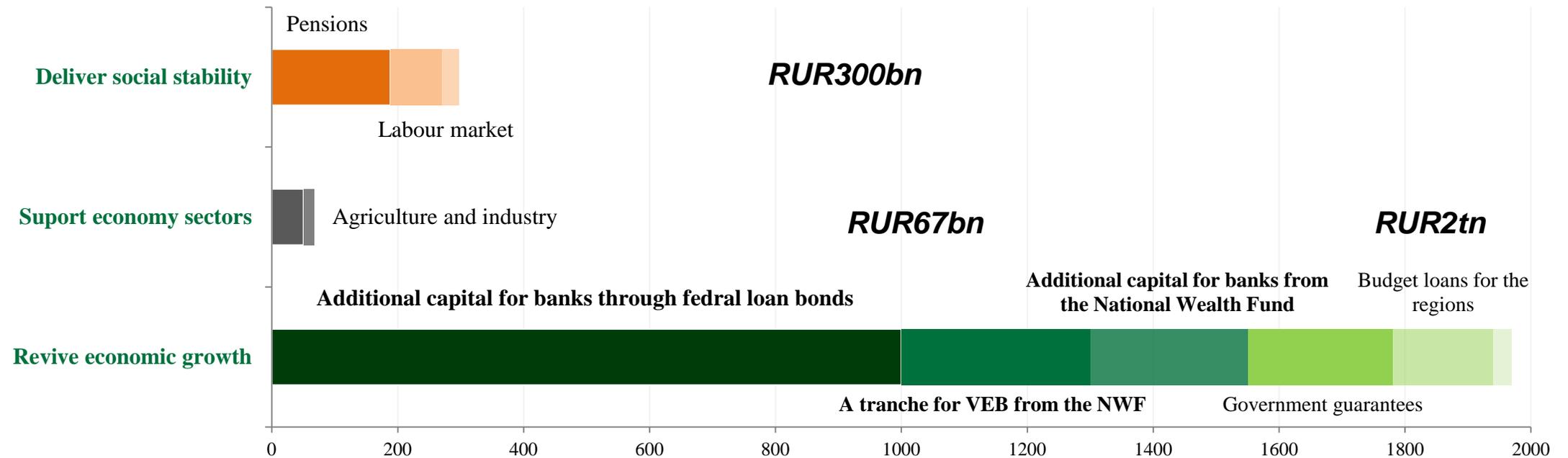
- **Kit Purpose:** 'Put out the fire', overcome the aftermath of external shocks, get through the acute phase of the crisis with minimum loss
- **Measures:** Distribute the Government aid
- **Problem:** The resource is limited, so the approach has to be selective
- **Risk:** (A) The aid will fall to about 200 largest companies (both 'strong' and 'weak'), but propping up the 'weak' will not help to deliver future growth  
(B) Corollary effect: more concentration and monopolisation

## A kit of mid-term structural changes

- **Kit Purpose:** Embark on a path of long-term growth through development of market mechanisms
- **Measures :** better management efficiency, economic liberalisation and structural reform
- **Problem:** The required actions will be postponed
- **Risk :** (A) A failure to deliver will discredit the idea as such  
(B) Resource limitations

# The Approved Anti-Crisis Plan

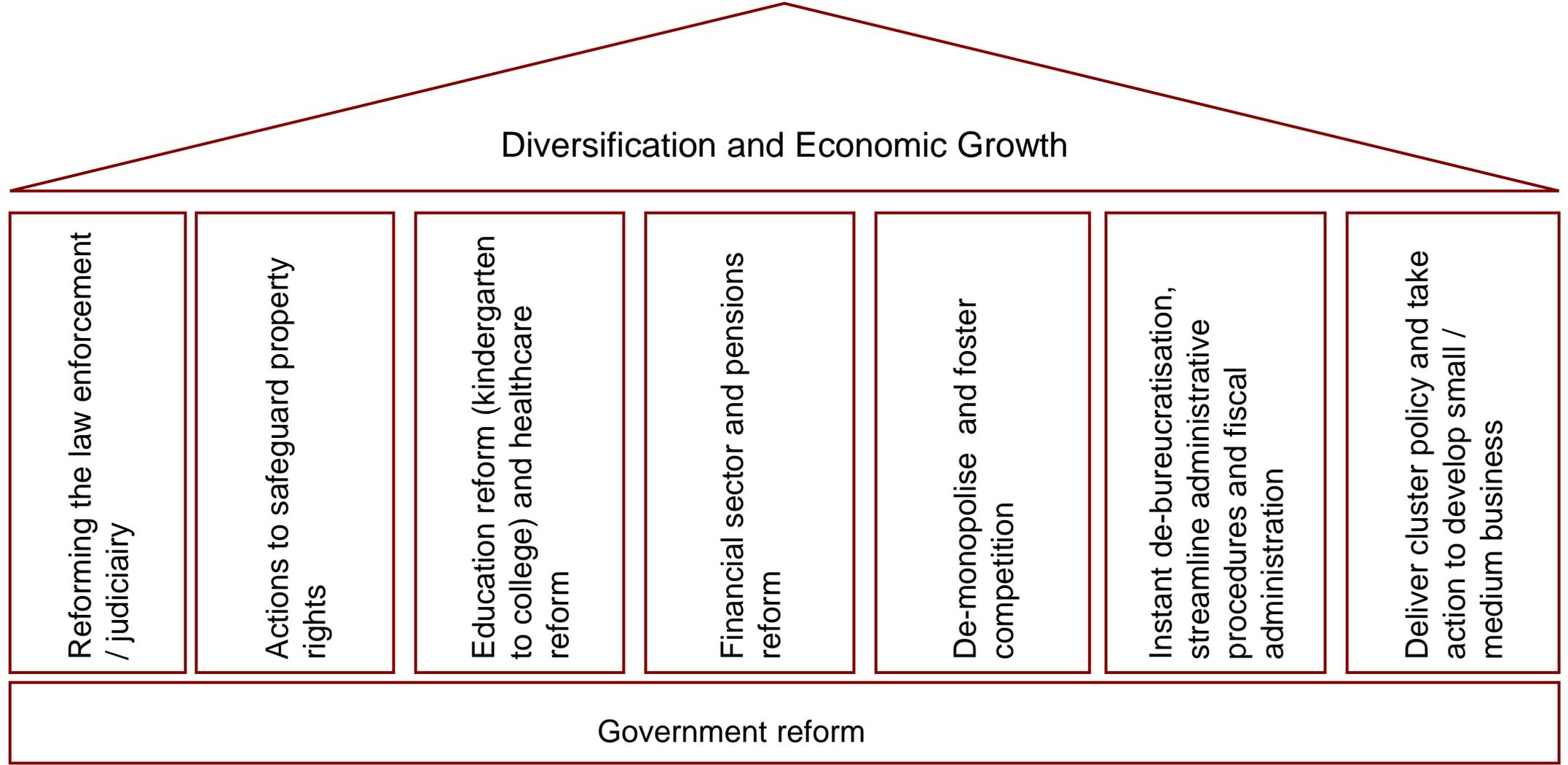
## 3 Tracks:



**Total expenditures: RUR2.3tn – 3.5% of GDP**

**This plan will help to mitigate the consequences of the crisis but will not solve structural problems**

# Structural actions



# Structural Actions: Laying the Groundwork For Long-Term Growth

## Improving the investment climate

### 1 Streamline administrative procedures

- Connecting to utility grids, obtaining construction permits and technical specifications, upgrading technical regulations

### 2 Put a stop to the practice of pension savings seizures, complete the pension reform, reinforce the savings pillar

### 3 De-monopolise and privatise companies in the key sectors (Aeroflot, Rosneft, Rostelecom, airports, etc.)

### 4 Reform the customs service

- Reduce the number of checks and customs clearance times
- Establish a single data base

### 5 Reform the judicial system

- Establish mechanisms for law enforcement monitoring

# Conclusions

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