Economic Review 1999

Russian Banking Sector

Overview

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Russia's political scene in 1999 was among the most tumultuous of all the post-Soviet years. Ending abruptly with the resignation of Russian President Boris Yeltsin on December 31, 1999, the year was characterized by considerable political instability as Russia went through three successive prime ministers (Yevgeny Primakov, Sergei Stepashin and Vladimir Putin), endured a divisive presidential impeachment process in the spring, launched a second war in Chechnya in September, and was finally subjected to a raucous campaign for elections to the State Duma, Russia's lower house of parliament, in December. With such an impressive array of political developments to grapple with, and a pervasive sense of moving from crisis to crisis, there was little time or attention left to deal with economic reforms in any meaningful way.

All things considered, the Russian economy nevertheless managed to perform reasonably well in 1999. The main feature of Russia's economic performance in 1999 was a reversal of the negative consequences of the August 1998 financial crisis and the achievement of favorable conditions for positioning the country on the path of economic growth. Russia's economic performance indicators for 1999 are uniformly positive, largely due to increased domestic production arising from strong global oil and commodity prices, and meaningful improvements in the Russian government's fiscal and monetary policies.

Real economic growth

In 1999, Russia showed significant economic growth for the first time in the post-Soviet period. Official government figures show that gross domestic product (GDP) rose 3.2% in 1999, in comparison with 1998 – 2.7% higher than the level attained in 1997. Similarly, industrial production surged 8.1% in 1999 in comparison with 1998. The major factors behind such strong dynamics were the rouble devaluation, which caused imports to fall, and continuing high global prices for oil and ferrous metals, leading to greater revenues. The consequence of the rouble's devaluation on the domestic market was that demand shifted towards import-substituting commodities, which lead to growth in domestically-oriented industrial sectors: non-ferrous metallurgy, machine-building, chemicals and petro-chemicals. Global price increases for Russia's main exports, as well as declining costs of production, fueled growth in export-oriented industries, namely oil & gas and ferrous metals production. Declining real household incomes prompted consumer demand to switch to domestically-produced goods, which in turn lead the growth in light and food industries. A major reason for optimism is an increase of 4.5% in fixed capital investment in 1999 (y-o-y).

Relatively stable exports, coupled with a dramatic fall in imports (31% down from 1998), were reflected in a trade surplus of $32.6 bln for 1999, and a strong current account surplus of $20.7 bln. These positive dynamics are likely to continue throughout 2000 and beyond. However, there still remain substantial obstacles to sustained economic growth, such as high investment and credit risks, structural inefficiencies, outdated technological infrastructure, and inadequate legislation in most economic areas (taxation, bankruptcy, foreign investment, etc.).

Stable monetary policy

The monetary policy of the Central Bank (CBR) in 1999 was directed mainly towards keeping inflation down and maintaining the newly-weakened rouble within a stable range, thus requiring careful manipulation of the few remaining monetary tools at the CBR's disposal.

The monetary base inflated by 54% in 1999 due to an increase in cash in circulation by nearly 42%. Money supply growth (M2) was 57.2%, exceeding the CBR's own annual target of a maximum 26%. There were two main reasons for this: first, the increased demand for money resulted from growth in the real sector and rising cash transactions during the course of the year. This is a very positive development, given that barter has always been one of the anchors of the Russian economy. Besides, payments of wage arrears – which began under the Primakov government in early 1999 – contributed to a greater demand for cash. A negative development is that the money supply in 1999 became dependent on the size of the government's upcoming payments: the need to rebuild Russia's financial credibility and meet its debt servicing obligations forced the CBR to purchase hard currency by printing roubles. The resulting vast liquidity growth in the banking system gave cause for concern, however: the rise in commercial bank balances with the CBR resulted in considerable pressure on the rouble. Thus, the CBR had to balance its monetary emissions by increasing obligatory reserve requirements twice within one year. The speculative pressure on the rouble was also partly offset by the trade surplus. In addition, the CBR employed administrative controls to fend off pressure on the rouble during 1999. One of these included raising the level of compulsory hard currency sales of Russian exporters, which was hiked from 50% to 75%. Furthermore, in April 1999, the CBR imposed a further administrative measure forcing domestic importers to make rouble deposits against import contracts concluded on a