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The kopek drops : Vladimir Putin's money machine is sputtering

After years of resilience, Russia's economy is slowing down

PHOTOGRAPH: GETTY IMAGES

Full text:

FROM KALININGRAD to Vladivostok, something has changed. A high-frequency index produced by Goldman Sachs, a bank, suggests that, since the end of last year, Russia's annualised economic growth has fallen from around 5% to around zero (see chart). VEB, the Russian development bank, finds similar trends in its estimate of monthly growth. A high-frequency measure of business turnover compiled by Sberbank, Russia's largest lender, has dipped. Although more circumspect, the government acknowledges that something is up. In early April the central bank noted that recently "a number of sectors recorded lower output because of plummeting…demand".

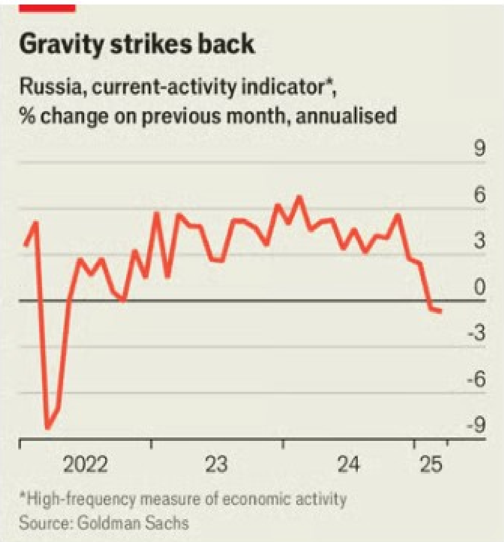

CHART: THE ECONOMIST

Russia's worries come after three years in which its economy outperformed almost all forecasts, owing to the combination of a fiscal splurge, high commodity prices and the militarisation of the economy. Following the full-scale invasion of Ukraine in 2022, economists predicted a contraction in annual GDP of up to 15%. In the event, GDP fell by 1.4% that year, before expanding by 4.1% in 2023 and 4.3% in 2024. Consumer confidence neared record highs. As it started to seem that Donald Trump, America's president, might give Vladimir Putin what he wants to end his war on Ukraine, some expected Russia's economy to accelerate even further in 2025.

What is behind the sudden slowdown? Three explanations stand out. The first relates to what Russia's central bank euphemistically calls the "structural transformation" of the economy. Having previously faced towards the

West and accepted private enterprise (within limits), it has since 2022 become a war economy that faces the East. This transformation has required vast investment, not only in weapon and ammunition factories but also in new supply chains enabling more trade with China and India (as well as more production at home). By the middle of 2024 real spending on fixed capital was 23% higher than in late 2021.

That adjustment, says the central bank, is now complete. Military expenditure is following a similar pattern. Julian Cooper of the Stockholm International Peace Research Institute, a think-tank, estimates that this year military spending will grow by just 3.4% in real terms, a screeching slowdown from the 53% increase of last year. Weaker spending on "structural transformation" means slower growth—but that should not worry Mr Putin if it frees up investment for productive uses. "As strange as it may sound, given the macroeconomic realities, we don't need such growth yet," he said in December.

The second factor is monetary policy. Russian inflation has been above the central bank's target of 4% year on year for months, even surpassing 10% in February and March. Gung-ho military spending is one cause, but so is a shortage of labour caused by conscription and the emigration of skilled workers. Last year nominal wages rose by 18%, forcing companies to put their prices up. In response the central bank has tightened the screws. On April 25th it opted to keep its benchmark interest rate at a punishing 21%, its highest level since the early 2000s.

Its super-hawkish stance may finally be paying off. High rates have encouraged capital to flow into the rouble; a stronger currency, in turn, makes imports cheaper. Russians' expectations for inflation over the next 12 months are softening, from a recent peak of about 14% to around 13%. High-frequency data suggest that inflation is edging down. The flipside of disinflation is slower growth. Rather than spending it, Russians are putting their money into savings accounts. High rates further discourage capital investment.

Were that the whole story, perhaps Mr Putin would remain content. For Russia's government, a small, gradual deceleration may be a price worth paying if that means taming inflation. The problem is that the slowdown is neither gradual nor small. This is because, in recent weeks, a third factor has come to dominate all others—external conditions have soured. As America's trade war has escalated, global growth forecasts have plunged, and oil prices have followed. Economists are particularly concerned about China, the largest buyer of Russian oil. The IMF has cut its expectations of Chinese GDP growth in 2025 from 4.6% to 4%.

Falling oil prices are causing Russia all sorts of trouble. They have hit the stockmarket, where oil companies account for a quarter of capitalisation. The MOEX index, which tracks the share price of the top 50-odd listed firms, is down by a tenth from its recent peak. As export receipts decline, sliding oil prices directly affect the real economy, too. Already the government's coffers are feeling the pinch: in March oil-and-gas tax revenue fell by 17% year on year. And on April 22nd Reuters reported, citing official documents, that the government is expecting a sharp slowdown in oil-and-gas sales this year. Mr Trump may be well disposed towards Mr Putin, but with his trade war he has kicked him in the teeth. ■