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Russian devaluation in 2014–2015: Falling into the abyss or a window of opportunity? ☆

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Abstract

Falling oil prices are leading to a reduction in domestic demand and lowering of the ruble exchange rate, thus enhancing the price competitiveness of Russian producers and stimulating the supply side of the economy (especially in foreign markets unaffected by the recession). Indeed, all of this create the possibility of offsetting the decline in domestic demand to a varying degree through increased net exports. However, the present study shows that, taking into account all of the structural problems of the Russian economy, the devaluation of the ruble may lead to a more severe recession than anticipated by most experts in their estimates, judging by average consensus forecasts (as of the end of September 2015).

JEL classification: E29, E39, E52, E65.
Keywords: devaluation, real exchange rate, Marshall-Lerner condition, resource curse, economic policy, Russia.

1. Introduction. One year after the Russian exchange rate shock: an overall balance of short-term effects

The devaluation of the Russian ruble, which followed falling oil prices and the imposition of financial sanctions in 2014 and 2015,[1] is having a controversial impact on the Russian economy. On the one hand, the reduced inflow of foreign currency

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[1] Hereinafter, we interpret the term "devaluation" both as a devaluation per se, caused by a sharp decline in the nominal exchange rate of a national currency during the transition from a fixed to a floating exchange rate, and as a depreciation due to its falling nominal exchange rate under conditions of the free floating regime.

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and increasing inflation are causing a reduction in aggregate demand. Moreover, as nearly always occurs during a shock devaluation, existing financial problems have become more acute. In particular, foreign debt payments are becoming more expensive in ruble terms. On the other hand, in the tradable sectors of the economy, prices and expenses are decreasing in currency terms against trading partners under the effect of the ruble devaluation, improving the competitiveness of domestic producers and, consequently, offering potential for growth in the proportion of exports in output and for a reduction in the proportion of imports in domestic demand.

The net impact on the economy, i.e., the balance between the negative impact of falling oil prices and the positive influence of improved competitiveness, is currently unclear. For example, although retail turnover fell by 8.2% y-o-y in January–August 2015, total investment contracted by 6%, and industrial production and GDP declined by 3.2% and 3.5%, respectively. Meanwhile, the decreasing real exchange rate of the ruble is creating nothing more than mere potential economic growth in the future. It would require considerable time and effort to revamp the business models and geographic and sectoral production configurations and to enter foreign markets with new products.

On the whole, according to the Bank of Russia, in January–August 2015 the real effective exchange rate of the ruble dropped by 18.6% y-o-y (Fig. 1), whereas according to our estimates, unit labor costs fell by approximately 27% in currency terms across the industry in general and by 26% in manufacturing over the first half of the year (Fig. 2). In industrial sectors, where output continues to grow despite the general recession (chemicals, food, oil products, non-fuel mining and minerals), unit labor costs have contracted to an even greater extent, and this contraction may prove to be a factor that encourages growth.

The basic indicators of the Russian economy's competitive performance, i.e., the real exchange rate of the ruble and unit labor costs, returned to 2004–2005 levels (see Fig. 1 and Fig. 2), when the explosive growth of oil prices stimulated demand, although this undermined the economy's international competitiveness. The latter was manifested in the strengthening of the real effective exchange rate of the ruble by an annual average of 5% from 2004 to 2013 (equivalent to

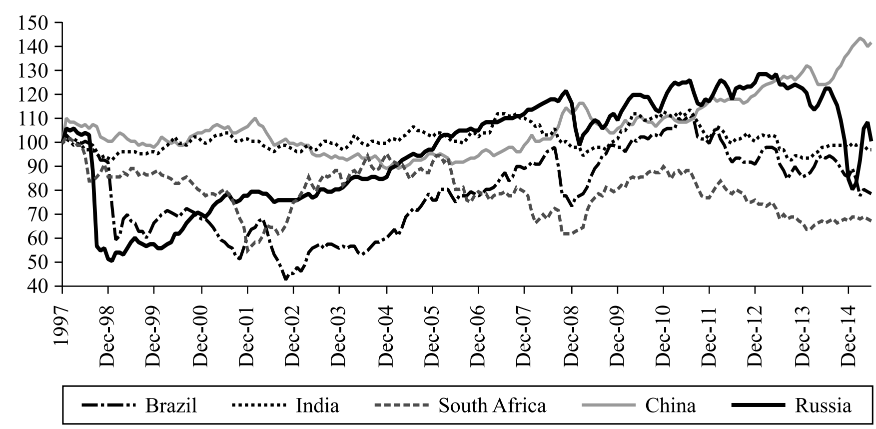

Fig. 1. Real effective exchange rates of the ruble and BRICS currencies from 1998 through August 2015 (1997 = 100%).

Sources: Bank for International Settlements; author's calculations.