Kremlin prepares for a second economic crisis

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As a result of the stagnation in the eurozone, the economic crisis in Russia has worsened considerably. Faced with a looming recession, the Kremlin is preparing massive cuts in social spending.

The signs of an incipient recession have been mounting in recent months. Due to falling oil prices, the rouble has fallen against the dollar since March by a total of about 13 percent. For this reason, there was a run on foreign exchange offices in Moscow in early June. The shares of several large companies and banks, including those of state-owned Gazprom, crashed on stock markets by up to 20 percent.

Some 50 percent of the Russian state budget depends on revenues from gas and oil exports, of which a major part go to the eurozone. Given the deepening of the international crisis, oil prices have fallen dramatically since the beginning of the year, and in June amounted to less than $90 per barrel for the first time in 19 months. Russia is relying on an oil price of at least $117 per barrel in order to balance the budget this year.

In the first half of the year, Gazprom, which provides more than 20 percent of the Russian state budget, exported 9.5 billion cubic meters less gas to Europe than a year ago. The massive withdrawal of capital that began with the crisis has intensified further, and according to the finance ministry will reach $90 billion this year.

The Russian Central Bank also recently warned of a credit bubble in the markets, which could affect the banking sector. According to the IMF, Russian GDP has risen twofold in the last ten years, while lending has tripled. Cheap loans were primarily made to retailers and the narrow urban middle class layer to buy cars. This allowed domestic consumption to grow, which after commodity exports is the main engine of economic growth in Russia.

Experts now reckon with a decline in economic growth by a factor of 1.5 to 3 percent in the second half of 2012, and with even lower growth in 2013.

Numerous disaster scenarios are being contemplated in the event that the euro area falls apart. The investment bank "Renaissance Capital" estimates that GDP would fall in 2012 by 2.7 percent and 5 percent in 2013 should Greece and Spain withdraw from the eurozone. Another study by Russia's Sberbank and Bank of America Merrill Lynch concludes that a breakup of the eurozone would lead to a sharp rise in unemployment in Russia, stagnant wages, a further weakening of the rouble and a fall in oil prices to $60 per barrel on the world market.

The Kremlin is preparing for a possible second wave of crisis with a rescue fund for banks and large corporations and cuts from the state budget.

In mid-June, President Vladimir Putin announced the provision of up to 30 billion euros to bail out "systemically important" banks and corporations. This year, the government has taken on guarantees worth up to €4.4 billion in loans for floundering companies.

According to Bloomberg, during the first wave of the crisis in 2008-2009, the Kremlin had spent around €200 billion to rescue insolvent banks and oligarchs. It can be assumed that in the event of a new wave of banking and corporate bankruptcies, the Russian government will provide them far larger sums, at the expense of working people.

Meanwhile, the Duma (parliament) is negotiating a new state budget for 2012-2014. The budget adopted under President Dmitry Medvedev at the end of 2011 already calls for the halving of social spending, while spending on the military has doubled. These massive cuts in social spending will now be stepped up. According to the business daily *Vedomosti*, which had access to the finance ministry's budget plans, the new savings will be achieved only by a pension reform and cuts in military spending. The high defence expenditures planned under Medvedev are very controversial among the elites.

A pension reform has been widely discussed in ruling circles for months. The possibility of increasing the retirement age has been advanced for a long time, but polls show 82 percent of the population opposed to this measure. Meanwhile, other variants such as a change in pension calculations are being discussed. But they all amount to massive cuts in pensions.

Although pensions in Russia are very low, for the majority of the impoverished population they form an important contribution to a tight family budget. About 50 percent of the population depends on pension payments either directly or indirectly. The government will make a final decision on the pension reform by 1 October.

As part of the intensified attacks on living standards, the cost of living—gas, heating, electricity, etc.—was increased dramatically from July 1. The cost of living price increases traditionally implemented at the beginning of the year were postponed because of the presidential elections in March, but in the end were significantly higher than usual.

Gas prices rose by more than 10 percent, heating and electricity costs by 6 percent. Heating costs are also to rise by a further 6 percent on 1 September. Overall, costs for household energy supplies will rise by 12 percent, well above the inflation rate of around 4 percent, officials from the ministry of finance predict. In particular, increases in gas prices provoke broad anger among the population. The gas monopoly Gazprom is the world's highest earning company, and last year recorded a net profit of €85.4 billion.

The excise tax on tobacco was also increased by about 11 percent. Penalties for illegal parking and traffic violations were raised fivefold in the big cities; in St. Petersburg and Moscow increasing from 300 to 3,000 roubles (about €70).

These price increases will lead to a significant increase in inflation. In the first half of the year, the official inflation rate was around 3 percent, the lowest in Russia’s entire post-Soviet history. By the end of the year, inflation is set to reach more than 7 percent.

For the majority of the population, who earn 10,000-20,000 roubles (about €250 to €500), these price increases mean a drastic reduction in living standards.

The already glaring social inequality in Russia has assumed explosive proportions since the crisis began. While ever broader sections of the population live in abject poverty, according to a report in the *Washington Post*, 20 percent of gross domestic product is concentrated in the hands of the 96 richest Russians. The Kremlin's austerity measures will further exacerbate these social tensions.