

# Flash Comment

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## Russia: Q3 GDP numbers disappoint

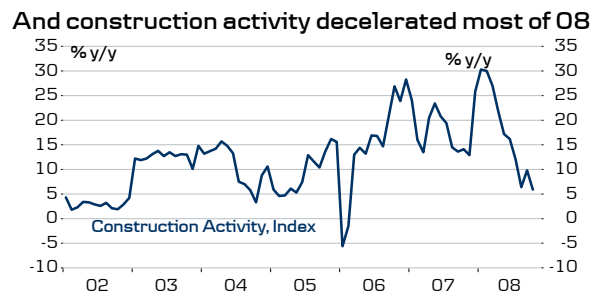
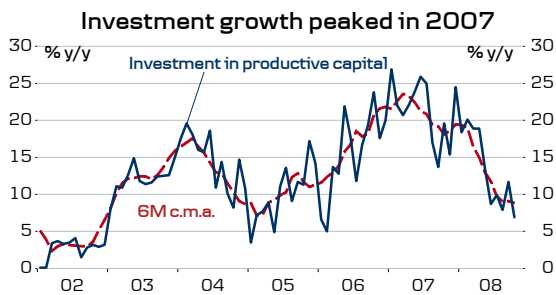
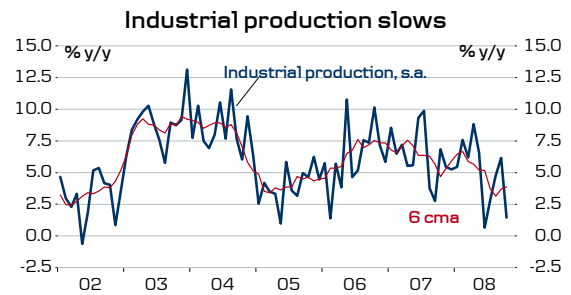
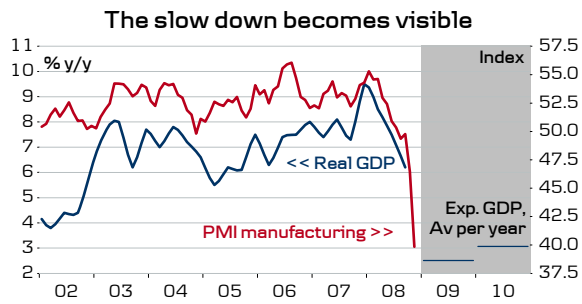
Russian GDP expanded 6.2% y/y in Q3 2008, down from 7.5% y/y in Q2 2008, according to the Federal Statistics Service. This preliminary estimate was somewhat below the consensus expectation of 6.8% y/y and our forecast of 6.9% y/y, and it indicates that the slowdown was already substantial in Q3. Today's reading shows the weakest GDP expansion in Russia since Q3 2005. Details reveal that construction activity in particular slowed a lot – measured by production. However most other production sectors also decelerated.

Looking at GDP expansion by production, it is notable that the expansion in the construction sector slowed to 9.3% y/y in Q3 from 18.7% y/y in Q2, as activity was squeezed by the liquidity shortage and higher funding costs. Data further shows that growth in the manufacturing sector fell to 5.9% y/y from 5.6% y/y in the previous quarter, while extraction of raw materials contracted by 0.4% y/y. Activity in trade and transport & communication also declined.

While we had expected to see a fairly sharp economic downturn in Q4 given the recent developments in manufacturing PMI's, industrial production, oil prices, and the overall liquidity situation, we are a bit surprised by the sharp deceleration in Q3. Going forward, we believe that the slow down in growth will be relatively broad based with especially the construction sector looking weak as funding possibilities have narrowed. Overall, the outlook for oil production has deteriorated with Ural oil prices hovering around USD 40 a barrel. Even though oil export tariffs have been reduced, we expect oil production to gradually decline in the coming years due to years of underinvestment.

Overall, today's numbers and the recent very weak manufacturing PMI numbers indicate that we could see a very sharp slow down in GDP growth in the coming quarters. Consequently we see downside risks to our 2.5% y/y growth forecast for 2009, and the question is whether there will be any economic growth at all in Russia next year. Obviously the authorities will loosen fiscal policy to accommodate growth, and Vladimir Putin already announced a 34% rise in pensions, which should increase purchasing power among pensioners immediately. He also promised to speed up infrastructure investments and thus boost employment in the troubled construction sector. This measure should gradually stimulate growth in 2009 and could create some positive momentum in H2, but for now, indicators points towards a couple of quarters with a very negative economic outlook.

*See charts overleaf:*



Source: EcoWin, Reuters and own forecasts

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