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Golden Days of Being a Net Saver Are Over

By Martin Gilman

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Sometimes through a combination of good policies and some good luck, countries may acquire safety margins as insulation from the financial vicissitudes of the global economy. In circumstances that Russia enjoyed for much of the previous decade, the harsh masters in the form of the international capital markets could be largely ignored. Unfortunately, this long period of good fortune is rapidly coming to an end. Starting in 2011, Russia's margins, on current trends, will be exhausted, and the country will be exposed to similar pressures that are felt by most countries further to the West.

Russia has been a net saver for more than a decade as evidenced by annual current account surpluses in its balance of payments. This excess of savings over investment is estimated to cumulate to $676 billion between 2000 and 2010. These savings were by definition lent to the rest of the world, and the assets for the most part were held in the foreign exchange reserves of the Central Bank.

Whether it made sense for a country like Russia, with its enormous needs for more productive investment, to be a financier for the rest of the world is questionable in the abstract. But in view of Russian realities, where good intentions are too often sidetracked, it is not clear that higher investment — and hence lower net savings — would have been well-spent. As it was, becoming a major international creditor country, although not in the same league as China, provided Russia with an ample margin for maneuver in policy terms, a luxury that many countries could only envy.

One of the ironies of the fallout from the global financial crisis in fall 2008 was that there was a sudden credit crunch in Russia despite its status as a major creditor country. The problem is that Russian capital markets are relatively unattractive to investors with the result that the country's savings are generally held offshore, and it is foreign banks that profit from intermediating this money back to large Russian borrowers who also find the local markets inadequate for their needs. So in the end, Russians were borrowing their own money and paying for the privilege. No wonder that financial market development has belatedly become an important policy priority.

In the past decade, the government helped Russia become a net saver. Having been burned by the 1998 default — when an unsustainable budget was confronted by unforgiving capital markets, which is also seen in the current sequel to this scenario in the euro-zone periphery — the Russian government got religious. That is, the budget was in surplus from 2000 through 2008, and public debt was substantially reduced. These funds were available to soften the blow when the global crisis did hit.

For two years now, the government has run a budget deficit. It seemed until last summer that this dip into deficit was just a temporary response to the impact of the global crisis. The Russian government had a plan to get back to a balanced budget and wean it away from dependence on oil as a key source of financing. But sustained high oil prices and irresolute leadership in the face of conflicting demands led to a weakening in fiscal discipline. Whereas the budget could have balanced in 2005 with an oil price of $35 per barrel — in fact the oil price was $50 per barrel and the surplus equaled almost 8 percent of gross domestic product — now it would take an oil price of $100 per barrel. This is clearly a high-risk approach since the major macroeconomic risk ahead is the excessive dependence of the budget on the oil price.

For the past two years, the government was able to live off of its accumulated savings to finance its deficits and so remained insulated from market constraints. With a much diminished oil fund and continuing budget deficits in prospect in coming years, it means that financing will come to depend on steady access to domestic and international capital markets on reasonable terms. In 2011, for the first time in a decade, Russia will confront the rigors of the capital markets.

The greatest change coming, however, is that sometime in 2011, Russia's external current account will slip into a deficit.

Even assuming an oil price of $80 per barrel, as against $78 per barrel this year and $75 per barrel in the 2011 budget, and import growth of only 20 percent, as against almost 30 percent this year, it is unlikely that, for the year as a whole, the current account surplus would exceed about $40 billion. Owing to the growth of imports through the year, in fact the current account could start to turn negative in the second half of 2011. The Central Bank puts the day of reckoning farther into the future, in 2013, by assuming higher exports and more of a slowdown in the rate of growth of imports.

High oil prices alone are no longer sufficient to produce a surplus of savings. Too many years of relatively low and unproductive investment in the nonoil economy and too many years where a loose monetary policy has fueled a massive increase in imports will produce a balance of payments where Russia, for the first time in a decade, will have to depend on net capital inflows to finance a negative current account of goods and services.

This sea change in Russia’s fortunes does not result from the crisis and in many ways it has long been expected. Nevertheless as the new year looms, the implications of this new reality need to be considered.

This will require a different approach to macroeconomic management, where domestic inflation and interest rates will become more important, as well as the domestic investment climate. In this new era, investors will no longer be able to rely on a positive current account but will need to put faith in the quality of domestic policymaking. Maybe this will serve as a wake-up call to a political elite whose policy drift, if anything, has become increasingly populist in recent months amid inflated expenditures, excess liquidity in the system and threats from accelerating inflation.

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