Ruble Plunge and Russian Economic Turmoil

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The rapid oil price drops have greatly shaken the Russian economy. On December 16, the Russian ruble plunged to this year’s new low of 78 rubles to the dollar, losing more than 60% from the beginning of the year. On the day, the Russian central bank raised its policy interest rate from 10.5% to as high as 17% to defend the ruble that was accelerating its fall over the past month. But the rate hike has failed to stop the ruble’s plunge. Russia’s RTS stock market also declined substantially, expanding overseas capital outflow. “Russia selling” is accelerating.

It may be needless to say that the remarkable oil price declines have been behind the ruble plunge. The recent oil price falls have come as a great shock to the Russian economy that has suffered Western countries’ economic sanctions triggered by the Ukraine problem and a slowdown in the European economy as Russia’s major trading partner. The oil price declines have a great impact on the Russian economy that depends heavily on the oil/gas sector, with oil/gas exports accounting for some 70% of its total exports. At the crude oil price of $60 per barrel, Russian gross domestic product in 2015 would contract 4.5% (as estimated by the Russian central bank). Under such situation, the currency and stock market plunges symbolize Russian economic turmoil.

As crude oil prices are expected to test lower ground and remain weak for the immediate future, the situation will continue to be severe for Russia. The ruble will remain under downward pressure. If the Russian central bank continues buying rubles to support the currency, Russia’s foreign exchange reserves will decline. The policy interest rate hike may further dampen the Russian economy. As Western economic sanctions are being toughened to make it even more difficult for Russian companies to raise funds in Western countries, concerns and risks are lingering about Russia’s external debt repayment. The coming year 2015 will see difficult and severe economic conditions for Russia.

The grave economic problem for Russia could have a great negative impact on the world economy. As “Russia selling” continues, Russia’s economic turmoil or recession and its credit fears are expected to spill over to the world. The Russian economic slowdown will naturally exert direct
negative effects on companies and regions that have close economic relations with Russia.

If external debt repayment concerns and default risks arise amid the economic deceleration, and currency and stock market weakness, credit fears may not be limited to Russia but spill over to Russia’s Western lenders and the entire world. As the 1997 Asian currency crisis, the 1998 Russian financial crisis and the 2008 Lehman Shock have indicated how grave credit fears and financial risks can affect the world economy, financial market players have grown nervous about the Russian economy.

Economic risks triggered by the oil price falls have first emerged in Russia and are spilling over to other resource-rich emerging countries (Brazil, Indonesia, Turkey, etc.) conceived as plagued with heavy dependence on resources and other challenges similar to those for Russia. If financial and commodity market risks grow, risk-avoiding moves may accelerate to further lower or destabilize these markets. In this sense, the ongoing Russian economic turmoil may have to be recognized as a grave destabilizer for the world economy.

Russian economic problems are important not only for the world economy but also for Russian domestic and international politics. Russia’s tough external stance after the emergence of the Ukraine crisis has encouraged Western countries to toughen economic sanctions on Russia, making the environment severer for Russia. Within Russia, however, approval ratings for President Vladimir Putin and his administration have exceeding 80%, indicating that President Putin has taken advantage of the crisis for gaining high domestic popularity. If the economy decelerates growth or suffers a substantial contraction to aggravate financial and credit fears, with the ruble’s decline and price hikes affecting civil life seriously, however, the domestic politics and the popularity of the government will be affected. Economic destabilization could politically shake Russia. In this sense, we must closely watch how the Russian government would overcome the current economic difficulties.

As noted in my previous report titled “A Japanese Perspective on the International Energy Landscape: Positive and Negative Impacts of Rapid Oil Price Drops,” the crude oil price falls have a net positive impact on the world economy. If the falls are too rapid and substantial, however, negative impacts may grow greater and diffuse wider to outdo positive impacts. What’s happening in regard to Russia now represents a situation where huge negative impacts of oil price falls are shaking the world economy.

Regarding the international oil market, the Russian economic turmoil could either a) lead to an oil demand decline by affecting the world economy; or b) prompt oil producing countries to cut oil supply in response to an unexpectedly serious development. In this sense, the problem is a major
factor influencing the future course of the oil market. In 2015, we will have to closely watch Russian developments in anticipating the international energy market.

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