

From: [REDACTED] >

To: Jeffrey Epstein <jeevacation@gmail.com>

Subject: from The Economist

Date: Tue, 07 Oct 2014 11:36:56 +0000

Russia's economy

On the edge of recession

The West's sanctions are hitting a contracting economy

Oct 4th 2014 | MOSCOW | [From the print edition](#)

-  Timekeep
-
-



SIGNS of Russia's economic problems appeared long before the annexation of Crimea or the war in the Donbas region in Ukraine. The country's previous growth model, in which profits from oil and gas sales were funnelled into the consumer economy, petered out around the time Vladimir Putin returned to the presidency in 2012. But Mr Putin in effect rejected a new model, based on innovation and investment, because of its troublesome political implications.

This state-imposed stagnation is made much worse by the combined effect of the West's sanctions, a lack of access to financing, capital flight and a climate of uncertainty, which is locking Russia into a sustained period of near-zero growth. The economic spillover of the Ukraine crisis reveals "the downside of state capitalism", says Alexander Kliment of Eurasia Group, a think-tank. When things are going well, he says, the power of the market helps strengthen the state. But when the state starts to have problems with the outside world, the economy suffers—dramatically.

Foreign firms such as Blackstone, a private-equity group, and Adobe, a software maker, are leaving Russia. The rouble continues to depreciate. On September 30th reports of possible controls on capital outflows pushed it to 39.7 against the dollar, a record low (see chart).

Alexei Kudrin, a former finance minister, warns that growth may be one percentage point lower in each of the next three years. "We will be balancing on the edge of recession all the time," he said at a gathering of investors. Mr Putin is betting that he can do enough to shield his core electorate—state workers and inhabitants of

provincial cities—from the effects of economic slowdown, while raising the costs for the elite of turning against the system, says Mr Kliment. The Kremlin will blame the West for its hardship and prioritise spending on salaries, defence and other parts of the state sector. Military spending alone will reach 4% of GDP in 2015, an increase of more than \$80 billion from this year.

Last month the Russian government unveiled a new budget for 2015-17 based on a number of assumptions that seem unrealistically optimistic: inflation of 6% (several analysts put it closer to 8%), GDP growth at 1.2% (the World Bank's most optimistic scenario puts growth next year at 0.3%) and a global oil price of \$100 a barrel (prices fell below \$95 a barrel this month and further decreases are all too plausible). Studies by the Economic Expert Group, a Russian consultancy, show that a \$1 drop in the oil price per barrel leads to a loss of \$2.3 billion in budget revenue. Because oil and gas make up around half of government income, the Kremlin's ability to buy itself social and political stability is at stake.

The risk is of a cycle of low or zero growth, high inflation and rouble devaluation. All told, sanctions “dramatically accelerated the worst-case scenario,” says Natalia Orlova of Alfa Bank. With less money to go around, a geopolitical standoff with the West gives momentum to those voices surrounding Mr Putin who favour state-led consolidation. The country's political and business elite is finding itself in a position of “more demand for less money”, says Ms Orlova. The impulse to control resources, she adds, is not based on the desire to “allocate this money more efficiently, but to make sure it goes to a certain circle of companies and banks”.

The demands of national security are a convenient excuse for sidelining critical voices. A new law limiting foreign ownership of media companies will in effect see the dismantlement of the Russian edition of *Forbes*, an American weekly, and *Vedomosti*, a daily part-owned by foreigners. National security has become “a universal way to push through all sorts of stupidity”, says Tatiana Lysova, *Vedomosti's* editor.

Greed masquerading as patriotic duty may also explain the troubles of Vladimir Yevtushenkov, the billionaire boss of Sistema, a holding company, who now finds himself under house arrest. Igor Sechin, a longtime Putin confidant, who is in charge of Rosneft, a state-owned oil giant, is said to covet Mr Yevtushenkov's oil company, Bashneft, as a way of shoring up declining production at Rosneft.

Western sanctions are making it difficult for Rosneft to pay off its looming debts and finance new investment, and export controls have largely cut it off from the technology it needs to drill in the Arctic. With prosecutors calling for Bashneft to be handed back to the state, the prospect of a campaign for nationalisation is perhaps not far off. Russia may finally settle on a new economic model—but not one that would offer much prospect for revived growth in the foreseeable future.