INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/275

RUSSIAN FEDERATION

September 2018

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2018 Article IV consultation with the Russian Federation, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 7, 2018 consideration of the staff report that concluded the Article IV consultation with the Russian Federation.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 7, 2018, following discussions that ended on May 23, 2018, with the officials of the Russian Federation on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 17, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.

The documents listed below have been or will be separately released

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

Press Release No. 18/346
FOR IMMEDIATE RELEASE
September 12, 2018

International Monetary Fund
700 19th Street NW
Washington, DC 20431, USA

IMF Executive Board Concludes 2018 Article IV Consultation with the Russian Federation

On September 7, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Russian Federation.

Russia's economy is recovering from the 2015–16 recession, thanks to the authorities' effective policy response and higher oil prices. Output increased by 1.5 percent in 2017 on the back of robust domestic demand, but short of expectations. Inflation has fallen well below the CBR's 4 percent target since July 2017, driven by a weaker-than-expected recovery, tight monetary policy, as well as temporary effects on food and energy prices.

Growth is projected at 1.7 percent in 2018, supported by rising credit and disposable incomes. Headline inflation is projected to bounce back during the second half of 2018 to 3.5 percent at year-end, supported by the ongoing domestic demand recovery, passthrough from the recent ruble depreciation, and the fading of temporary factors. The medium-term outlook remains muted, due to structural bottlenecks and the lingering impact of sanctions. Absent structural reforms, growth is expected to settle around 1.5 percent, while monetary policy stabilizes inflation around 4 percent by end-2019. The main risks to the outlook stem from geopolitical tensions as well as the new government's policy plans.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for establishing a strong macroeconomic policy framework that has strengthened economic resilience. Directors noted that despite the ongoing recovery, the medium-term outlook remains subdued. This reflects uncertainty stemming from geopolitical tensions and shifting global trade and financial conditions. The large footprint of the state, governance and institutional weaknesses, and insufficient infrastructure constitute structural reform priorities. Directors emphasized the importance of implementing structural reforms to boost productivity and the supply of labor and capital to enhance medium-term growth.

---

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.
[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm

Directors agreed that the fiscal rule helps shield the economy from fluctuations in oil prices and anchors fiscal policy. They emphasized the importance of preserving the hard-won credibility of the macroeconomic policy framework. Directors encouraged continued fiscal consolidation to rebuild buffers and reach a position consistent with sharing equitably Russia's natural resources with future generations.

Directors welcomed the authorities' plans to boost spending on health, education, and infrastructure, with most emphasizing that this could be achieved within the confines of the fiscal rule. They supported the authorities' plans for parametric pension reform, which could help to offset negative demographic trends. Directors called for better targeting of expenditure on social assistance and strengthening tax compliance and reducing tax expenditures. They encouraged the authorities to engineer a growth-friendly shift from social security contributions to consumption taxes which could incentivize labor supply, reduce labor informality, and attract new investment.

Directors welcomed the Central Bank of Russia's (CBR) plans to maintain its gradual and data-driven approach in setting monetary policy, as inflation expectations are not yet firmly anchored and risks to the inflation outlook have increased. They broadly agreed that further monetary easing could be appropriate if headline inflation remains below the 4 percent target and underlying inflationary pressures stay low. Continued efforts to refine the CBR's communications strategy were encouraged.

Directors commended the progress made to restructure the banking sector. However, they noted last year's failure of several large banks and pointed to significant shortcomings in the sector. In this regard, Directors urged the authorities to complete the cleanup of the banking sector, close the gaps in bank supervision and regulation, including addressing related-party lending, and further efforts to complete the asset quality evaluations. They underscored the importance of having a credible strategy for returning rehabilitated banks to private hands in a way that is consistent with increasing competition and efficiency. Continued efforts to strengthen the AML/CFT framework were also encouraged.

Directors noted that raising growth requires stronger competition in domestic markets, a leaner state, and a more vibrant private sector. They supported measures to reduce the footprint of the state, particularly in banking and other sectors with limited rationale for public ownership in a gradual manner in line with a strengthened institutional architecture. Directors recommended strengthening transparency, accountability, and governance standards in state-owned enterprises and the corporate sector more generally to improve the business environment. They noted that the authorities could accelerate productivity growth by persisting with their efforts to strengthen competitiveness, promote trade integration, and further diversify exports.

It is expected that the next Article IV consultation with the Russian Federation will be held on the standard 12-month cycle.

Russian Federation: Selected Macroeconomic Indicators, 2015–19

	2015	2016	2017	2018	2019
				Projections	
Production and prices					
Real GDP	-2.5	-0.2	1.5	1.7	1.5
Consumer prices					
Period average	15.5	7.1	3.7	2.9	4.0
End of period	12.9	5.4	2.5	3.5	4.0
GDP deflator	8.0	3.5	5.2	5.2	4.4
Public sector[1]		(Percent of GDP)			
General government					
Net lending/borrowing (overall balance)	-3.4	-3.6	-1.5	2.2	2.9
Revenue	31.8	32.7	33.3	36.2	35.3
Expenditures	35.1	36.4	34.8	33.9	32.4
Primary balance	-3.1	-3.2	-1.0	2.8	3.4
Nonoil balance	-11.3	-9.7	-8.7	-8.4	-6.8
Federal government					
Net lending/borrowing (overall balance)	-2.3	-3.4	-1.4	2.4	3.0
Nonoil balance	-9.5	-9.0	-8.0	-7.2	-6.0
		(Annual percent change)			
Base money	-4.3	3.8	8.6	7.3	6.3
Ruble broad money	11.3	9.2	10.5	7.5	6.5
External sector					
Export volumes	6.4	2.6	7.8	1.3	2.2
Oil	7.0	-1.2	-2.5	0.0	0.5
Gas	6.5	7.1	5.8	4.0	1.0
Non-energy	-8.0	-3.2	8.5	2.1	4.5
Import volumes	-25.2	1.5	11.4	5.0	1.8
	(Billions of U.S. dollars; unless otherwise indicated)				
External sector					
Total merchandise exports, fob	341.4	281.8	353.0	435.7	442.0
Total merchandise imports, fob	-193.0	-191.6	-238.0	-256.1	-263.9
External current account	67.7	24.4	35.2	99.6	96.9
External current account (in percent of GDP)	4.9	1.9	2.2	6.1	5.7
Gross international reserves					
Billions of U.S. dollars	368.4	377.7	432.7	498.3	559.8
Months of imports[2]	15.7	17.0	15.9	17.0	18.5
Percent of short-term debt	441	423	434	512	565
Memorandum items:					
Nominal GDP (billions of U.S.D)	1,368	1,285	1,578	1,641	1,702
Exchange rate (rubles per U.S.D., period average)	60.9	67.1	58.3	…	…
World oil price (U.S.D. per barrel)	50.8	42.8	52.8	70.2	69.0
Real effective exchange rate (average percent change)	-17.4	-1.2	14.6	…	…

Sources: Russian authorities; and IMF staff estimates.
1/ Cash basis.
2/ In months of imports of goods and non-factor services.

INTERNATIONAL MONETARY FUND

RUSSIAN FEDERATION

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

July 17, 2018

KEY ISSUES

Context: The Russian economy is recovering from the 2015–16 recession. Over the past few years, the authorities have put in place a strong macroeconomic policy framework that has reduced uncertainty and helped weather external shocks. However, Russia's convergence to advanced economy income levels has stalled and its weight in the global economy is shrinking.

Near-Term Macroeconomic Policy Mix. The current policy mix is tight. Fiscal policy is appropriately focused on rebuilding fiscal buffers. Monetary policy has been geared toward supporting disinflation and anchoring inflation expectations. With the output gap closing and inflation expectations increasingly anchored by the 4 percent target, monetary policy needs to complete the transition to a neutral stance.

Medium-Term Policy Challenges. The recently introduced fiscal rule has already helped to anchor the fiscal path and shield the economy from oil price volatility. The recovery in oil prices should not delay much-needed fiscal adjustment and a growth-friendly shift in public spending. Last year's failures of several large private banks raise questions about the adequacy of banks' financial statements and underscore the importance of completing the cleanup of the banking system, and of further strengthening the financial stability framework. Accelerating economic growth requires focusing policy efforts on structural challenges that remain unaddressed, including a large footprint of the state, excessive regulation, lack of competition, governance and institutional weaknesses, and inadequate infrastructure.

Approved By
Jörg Decressin (EUR) and Zuzana Murgasova (SPR)

Discussions for the 2018 Article IV consultation were held in Moscow during May 14–23, 2018. The mission comprised Mr. Ramirez Rigo (Head), Ms. Taheri Sanjani, Mr. Arena, and Mr. Slavov (all EUR), Mr. Culiuc (SPR), and Mr. Di Bella (Res. Rep.). Mses. Dynnikova (local senior economist) and Chebotareva (local economist) assisted the mission. Mr. Mozhin, Executive Director, participated in the discussions. The mission met with Central Bank Governor Nabiullina; Minister of Economic Development Oreshkin; Deputy Ministers of Finance Kolychev, Moiseev, and Storchak; other senior officials; and representatives of financial, academic, and business institutions. Support was provided by Mses. Mahadewa and Meng (both EUR), and Mses. Rubina and Chernisheva (Moscow office).

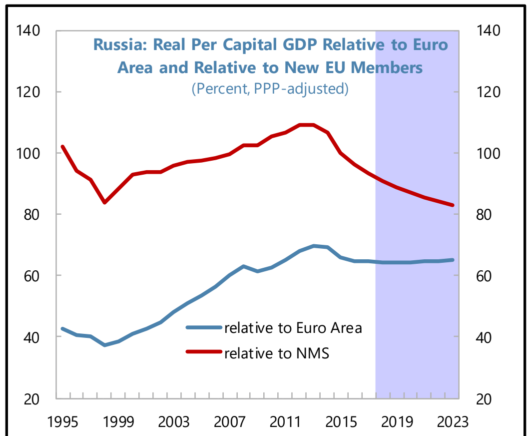
CONTENTS

TABLES

ANNEXES

CONTEXT: LOW GROWTH RATES UNDERSCORE THE URGENCY OF REFORMS

1. **Russia's convergence to advanced economy income levels has stalled,** with recent growth and prospects falling short of those in peer countries in Eastern Europe. A combination of factors is at work:



Sources: World Bank WDI database; and IMF staff calculations.

- **Structural constraints,** which include a large footprint of the state, high economic concentration, excessive regulation, governance and institutional weaknesses, and inadequate infrastructure.

- The fall in oil prices, as well as the 2014 sanctions and subsequent geopolitical tensions raised uncertainty and dampened domestic and foreign private investment.

- **The policy response to those shocks** necessarily involved tight monetary policy to bring inflation down and anchor expectations, as well as fiscal adjustment in response to significantly lower oil prices. The authorities put in place a strong macroeconomic policy framework, including a prudent fiscal rule, inflation targeting, and a flexible exchange rate.

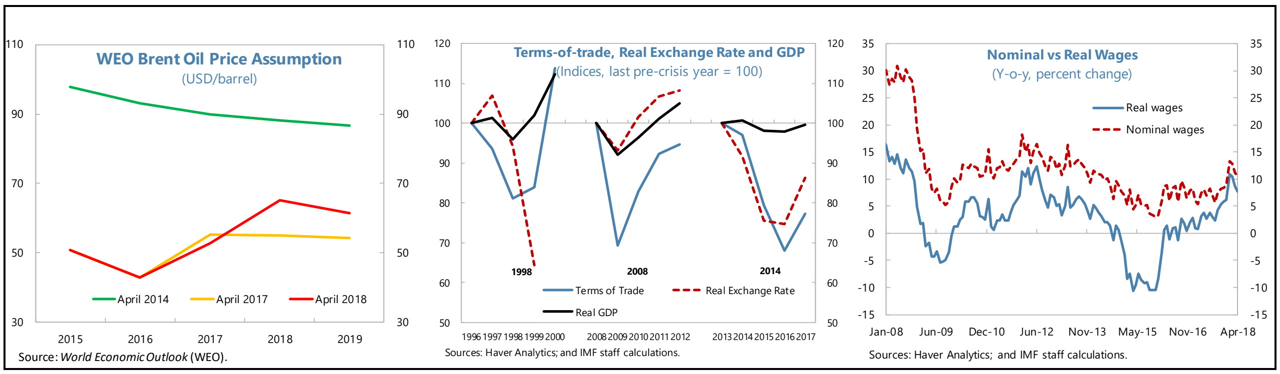
2. **The macroeconomic policy mix has been tight, successfully stabilizing the economy in the face of major shocks.** With the output gap closing, fiscal policy is appropriately focused on adjusting to lower oil prices (compared to pre-2014) and on rebuilding fiscal buffers which remain essential for reducing Russia's vulnerability to external shocks. Monetary policy has also remained tight to support disinflation and anchor inflation expectations.

3. **The new government has articulated a set of ambitious policy objectives for the next six years.**[1] These include raising GDP growth above the global average and cutting poverty in half by 2025. Investment should increase to 25 percent of GDP, from 21–22 percent now. To achieve these objectives, public spending on infrastructure, health, and education would increase, and the state's footprint in the economy would fall, particularly in the banking sector.

[1] President Putin won re-election in March and his new six-year term in office started in May 2018.

RECENT ECONOMIC DEVELOPMENTS AND NEAR-TERM OUTLOOK

4. The Russian economy is recovering from the 2015–16 recession, thanks to the authorities' effective policy response and higher oil prices (text charts and Figure 1). Output increased by 1.5 percent in 2017 on the back of robust domestic demand, but fell short of expectations. Real activity grew strongly in the first half of 2017 supported by one-off public investment projects, including those related to the 2018 World Cup and the Power of Siberia natural gas pipeline. However, momentum slowed down considerably in H2 of 2017, when the OPEC+ oil extraction deal and weakness in the manufacturing sector depressed industrial production. Growth is expected to reach 1.7 percent in 2018, supported by domestic demand due to rising disposable income and credit.



5. Inflation has fallen well below the CBR's 4 percent target since July 2017 (Figure 2). In May 2018, headline and core inflation were at 2.4 and 2.0 percent, respectively, near post-Soviet record-low levels. The broad-based disinflation was driven by a weaker-than-expected recovery, falling inflation expectations (in response to tight monetary policy and a stronger monetary policy framework), as well as a stable exchange rate, a bumper harvest, and lower energy prices in 2017. However, headline inflation is projected to bounce back during H2 of 2018, supported by the ongoing domestic demand recovery, passthrough from the recent ruble depreciation, and the fading of temporary effects on food and energy prices. End-2018 inflation is projected at 3.5 percent.

6. Recovering oil prices have contributed to an increase in the current account surplus and external buffers (Figure 3). External debt fell by 7 percent of GDP in 2017, due to continued private sector deleveraging and an appreciating ruble. The REER has remained broadly stable between June 2017 and March 2018, in part because much of the oil windfall was sterilized under the new fiscal rule.[2] Reserves increased steadily, reaching 264 percent of the ARA metric at end-2017, compared to 247 percent a year earlier. Staff assesses the external position in 2017 to have been

[2] The new fiscal rule targets a zero primary balance by 2019 at the benchmark oil price of $40 (in real 2017 terms, adjusted for US inflation). If actual oil prices exceed the benchmark, the fiscal authorities are required to purchase FX equal to the excess fiscal revenues (relative to the benchmark price) and save it in the National Welfare Fund (NWF). The Reserve Fund was merged with the NWF in early 2018.

moderately weaker than suggested by fundamentals and desirable policy settings (see Annex II). New US sanctions introduced in April 2018 resulted in a 5 percent real effective depreciation, bringing the REER closer to fundamentals.

MEDIUM-TERM OUTLOOK AND RISKS

7. **Binding structural constraints limit Russia's growth potential.** The medium-term outlook remains muted, due to structural bottlenecks, the lingering impact of sanctions, and adverse demographic trends. Absent structural reforms, growth is expected to settle around 1.5 percent over the medium run, while monetary policy stabilizes inflation around 4 percent by end-2019. To accelerate potential growth, the authorities need to shift their focus to structural reforms.

8. **Both short- and medium-term risks to the outlook have shifted but remain generally tilted to the downside (Annex I).** Risks from persistently lower oil prices have diminished. Tighter global financial conditions are not expected to have a significant impact as public financing needs are modest and most corporates have enough FX to cover their short-term needs. However, risks related to geopolitical tensions and the retreat from cross-border integration have increased, as illustrated by the new round of US sanctions on Russia and new US tariffs on finished steel and aluminum products. The new sanctions have increased uncertainty, which may weaken investment. Russia is the third most exposed steel and aluminum exporter to the US market. While the new tariffs impact directly only about ½ percent of Russia's exports, second-round price effects could affect a non-trivial share of Russian industry. A potential intensification of global trade tensions could affect the benign global environment that Russia, as a commodity exporter, is benefiting from.[3] On the domestic side, higher oil prices could weaken the authorities' resolve to implement structural reforms, with negative implications for investment, TFP, and growth. In addition, a delay in completing the cleanup of the banking sector and a re-acceleration of credit growth, in particular of unsecured household credit, could lead to a build-up of non-performing assets if growth slows down.

9. **Unless geopolitical tensions escalate further, spillovers from the April 6 sanctions are likely to be limited.** Russia has larger FX reserve buffers and a stronger policy framework in place compared to 2014, and the terms of trade are better as well. A depreciating exchange rate is likely to be the main spillover channel to Russia's neighbors. Among those, countries with thin FX reserves and dollarized financial systems are likely to be the most significantly affected if the ruble's depreciation were to be extended and sustained. At this point, staff does not anticipate a repeat of the 2014–15 large drop in remittances to neighboring countries.

10. **The new government's policy plans pose two-sided risks to the outlook.** The authorities' commitment to boost spending on infrastructure, health, and education by RUB 8 trillion over the next six years (about 1.1 percent of GDP *per annum*, on average) could substantially change the baseline forecast, depending on how the package is structured and financed. The infrastructure

---

[3] In addition, Russia's largest aluminum company was severely affected by the latest round of US sanctions imposed on April 6.

spending and the associated expansionary fiscal impulse could result in faster growth of both potential and actual GDP over the next few years. However, it might also create risks to the inflation outlook since the output gap appears to be closing,[4] and thus the fiscal impulse could be largely offset by monetary tightening and an appreciating exchange rate. Furthermore, it might weaken the credibility of the fiscal adjustment and the resolve to undertake other structural reforms.

Authorities' Views

11. The authorities broadly shared staff's views on the economy's cyclical position, the growth outlook, and risks. They expect the recovery in consumption to be driven by easing financial conditions, rising household disposable incomes, and improving confidence. They agreed that in the absence of structural reforms, growth prospects would remain subdued. The CBR shared staff's assessment that the output gap is closing, while noting uncertainties around the fiscal path and its impact on cyclical conditions. The authorities believe that risks to the economy have diminished, given the strong macroeconomic policy framework put in place. The authorities agreed that the impact of the latest US sanctions has been limited so far, and believe that these sanctions need to be addressed at the micro level. To that end, they have set up a unit to work on case-by-case responses. Furthermore, they concurred that the external position was somewhat weak in 2017, although they estimate the current account norm to be lower than staff (in the range of 0 to 1 percent of GDP at the benchmark oil price under the fiscal rule). The authorities considered the ruble to be aligned with fundamentals currently, following the exchange rate depreciation in early April 2018.

POLICY DISCUSSIONS: SEIZING THE OPENING FOR REFORMS TO INCREASE RUSSIA'S WEIGHT IN THE GLOBAL ECONOMY

Discussions focused on the urgency of reforms, including (i) persisting with fiscal consolidation, while engineering growth-friendly shifts in taxes and spending; (ii) continuing with monetary policy easing towards a neutral stance and refining the central bank's communication strategy; (iii) further strengthening supervision, improving the bank resolution framework, and lowering the state's footprint in the financial sector while reducing concentration; and (iv) restarting structural reforms to tackle long-standing weaknesses, find new sources of growth, and strengthen competitiveness.

[4] Uncertainty about the magnitude of the output gap is compounded in Russia's case by the impact of sanctions and lower oil prices. While low inflation points to a negative output gap, a tight labor market, real wages outpacing productivity, and high capacity utilization all indicate that the output gap is not too far from zero.

A. Fiscal Policy: Engineering Growth-Friendly Shifts in Taxes and Spending, While Persisting with Consolidation

12. The authorities are implementing an ambitious expenditure-based fiscal consolidation (Figure 4). The general government's overall budget deficit fell from 3.6 percent of GDP in 2016 to 1.5 percent in 2017, due to expenditure restraint and higher fiscal revenues from oil and gas. The 2018–20 budget aims to continue with fiscal consolidation and targets a zero primary balance by 2019 at the benchmark oil price (see footnote 2 above). Given that actual oil prices are substantially higher than that benchmark, the general government is likely to run a large primary surplus as early as 2018.

13. The new government is preparing various policy initiatives which are expected to be finalized in the fall, in time for the 2019–21 budget discussions.[5] They aim to increase spending on infrastructure, health, and education by an average of about 1.1 percent of GDP *per annum* over the next six years. While there is a consensus on these objectives, the authorities are still discussing how they will be financed. One option under discussion is to raise more revenues, by increasing the main VAT rate from 18 to 20 percent and by completing the shift in oil sector taxation from export duties to mineral extraction taxes (MET). A second option would be to re-prioritize spending, including some of the savings from raising the retirement age, although the new government has also committed to increasing pensions in real terms. A third option on the table is to temporarily relax the fiscal rule. While policy discussions are still ongoing, Box 1 discusses a hypothetical alternative scenario under which the fiscal rule is temporarily relaxed and additional spending on infrastructure, health, and education is financed by a combination of revenue and expenditure measures, as well as new public debt.

14. Staff cautioned against revisiting the fiscal rule so soon after its implementation. Russia has some fiscal space due to the low level of public debt and limited financing needs. However, in staff's view the consolidation should continue to rebuild fiscal buffers which reduce Russia's vulnerability to external shocks. The fiscal rule shields the economy from fluctuations in oil prices, facilitates the diversification away from oil, and helps to share Russia's finite resource wealth with future generations. Relaxing the rule before it has even fully come into force would weaken the hard-won credibility of the authorities' macroeconomic framework. In addition, a deficit-financed increase in spending with the output gap closing would be procyclical and could require a tightening in the monetary policy stance. Staff also argued that the pace of fiscal adjustment envisaged in the 2018–20 plan is appropriate given the closing output gap, even though the quality of the measures could be improved. As currently planned, the adjustment relies excessively on across-the-board spending freezes which are suboptimal and unlikely to be sustainable. However, over the medium term, further consolidation of 0.5–1.5 percent of GDP is needed to reach a nonoil primary balance consistent with intergenerational equity in sharing Russia's resource wealth.

[5] The staff's baseline fiscal projections and macroeconomic framework are based on the authorities' approved 2018–2020 budget, and do not include any of the fiscal reforms under discussion.

Box 1. Alternative Scenario

The authorities are considering a package of measures to increase public expenditure on infrastructure, health, and education. This box sketches out an alternative scenario under which such a package is implemented, discusses its impact on the macroeconomic framework, and presents the authorities' views. Based on available information, staff assumes that public spending on health and education will increase permanently in 2019, by about 0.6 percent of GDP annually, and this will be financed mostly by a higher main VAT rate but also by some of the expenditure savings from a parametric pension reform. In addition, public infrastructure expenditure increases by about 0.5 percent of GDP over 2019–24 and will be entirely financed by new public debt, which will require a temporary relaxation of the fiscal rule.

The table below presents a macro framework that embodies these assumptions, and compares it to staff's baseline scenario. Staff is unable to estimate the impact of the package on potential GDP, given the current lack of detail about particular measures and projects, and given the difficulties surrounding the proper identification of high-return projects as targets for public sector investment. Thus, potential GDP is assumed to be unchanged from the baseline scenario in the table below. The expansionary fiscal impulse would push growth above potential in 2019–21 and open a positive output gap. The fiscal multiplier is around unity initially, but gradually declines as wages and prices increase and monetary policy tightens in response. Inflation accelerates substantially above the CBR's 4 percent target, due to the higher main VAT rate and also demand pressures. Monetary policy responds only to demand pressures, and due to transmission lags, inflation converges gradually to the target by 2025 as growth falls back below potential and starts to close the output gap. The current account surplus is slightly lower than under the baseline, as some of the boost to aggregate demand leaks out into higher imports. Finally, the overall fiscal balance deteriorates by about 0.5 percent of GDP over 2019-24 and, as a result, public debt increases just above 20 percent of GDP by 2025.

Russia: Comparison of Projections between Baseline and Alternative Scenarios

(Percent of GDP, unless otherwise indicated)

	Scenario	2018	2019	2020	2021	2022	2023	2024	2025
Real and external									
Real GDP growth (%)	baseline	1.7	1.5	1.5	1.5	1.5	1.5	1.5	1.5
	alternative	*1.7*	*2.0*	*2.0*	*1.7*	*1.2*	*1.2*	*1.2*	*1.2*
Output gap (%)	baseline	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	alternative	*0.0*	*0.5*	*1.0*	*1.2*	*0.9*	*0.6*	*0.3*	*0.0*
Average CPI inflation (%)	baseline	2.9	4.0	4.0	4.0	4.0	4.0	4.0	4.0
	alternative	*2.9*	*5.8*	*5.0*	*5.0*	*4.8*	*4.6*	*4.3*	*4.0*
Current account	baseline	6.1	5.7	4.9	4.7	4.5	4.1	4.0	4.1
	alternative	*6.1*	*5.6*	*4.8*	*4.5*	*4.4*	*4.0*	*3.9*	*4.1*
Fiscal									
General government revenue	baseline	36.2	35.3	34.8	34.5	34.3	34.1	34.0	33.9
	alternative	*36.2*	*35.8*	*35.3*	*34.9*	*34.8*	*34.6*	*34.5*	*34.4*
General government expenditures	baseline	33.9	32.4	32.4	32.7	33.0	33.1	33.2	33.3
	alternative	*33.9*	*33.4*	*33.4*	*33.6*	*33.9*	*34.0*	*34.1*	*33.7*
Net lending/borrowing (overall balance)	baseline	2.2	2.9	2.4	1.8	1.3	1.0	0.8	0.6
	alternative	*2.2*	*2.4*	*1.9*	*1.3*	*0.8*	*0.5*	*0.3*	*0.6*
Public debt	baseline	16.1	15.6	15.5	15.6	15.8	16.0	16.2	16.4
	alternative	*16.1*	*16.0*	*16.4*	*17.2*	*18.0*	*18.9*	*19.8*	*20.3*

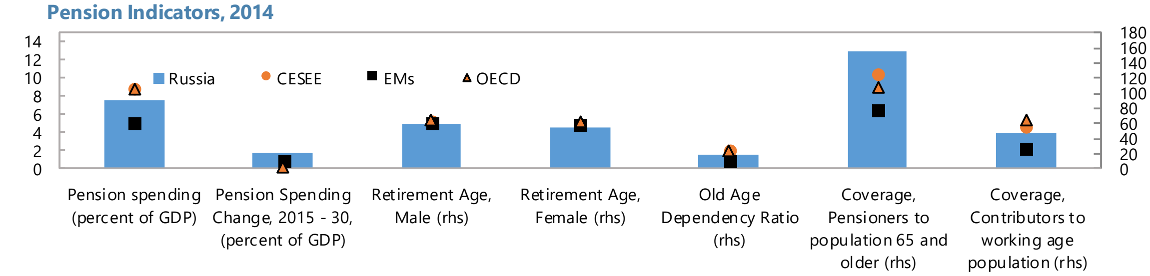
Source: IMF staff estimates and projections.

The authorities expect the extra infrastructure investment and the improved spending mix to have a positive impact on potential GDP. However, they agreed that given the scarcity of information about the composition of additional spending, staff's assumption of no impact on potential GDP is understandable. The authorities also pointed out that given the CBR's track record in monetary policy implementation, a substantial inflation or output gap is unlikely for an extended period of time.

15. Staff agreed that higher spending on physical and human capital is desirable to lift productivity (text charts below). Russia faces substantial infrastructure gaps, especially for roads but also for air transport and ports. While public health expenditure is relatively low and should increase, this should go together with increasing the efficiency of such spending. Staff argued that the additional spending be allocated within the confines of the fiscal rule. To that end, the authorities could focus on eliminating tax expenditures (around 2.8 percent of GDP)[6] as well as reprioritizing spending.

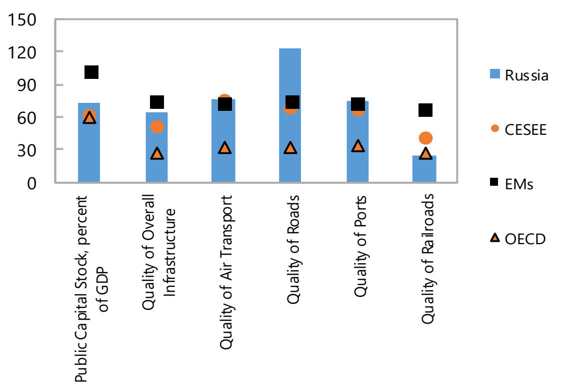
Selected Indicators for Public Spending on Infrastructure, Health, Education, and Social Assistance

Pension Indicators, 2014



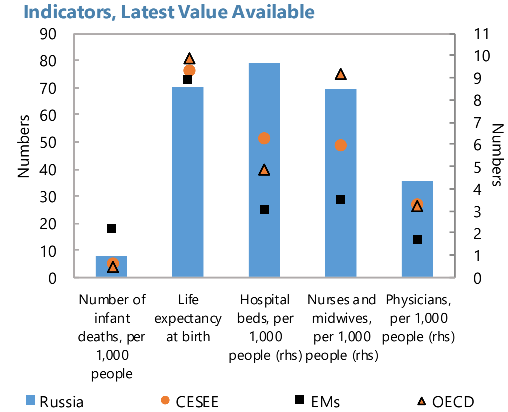
Sources: : IMF FAD Expenditure Assessment Tool (EAT), World Economic Outlook, ASPIRE, and IMF Pension Indicators.

Capital Stock and Infrastructure Quality, Latest Value Available



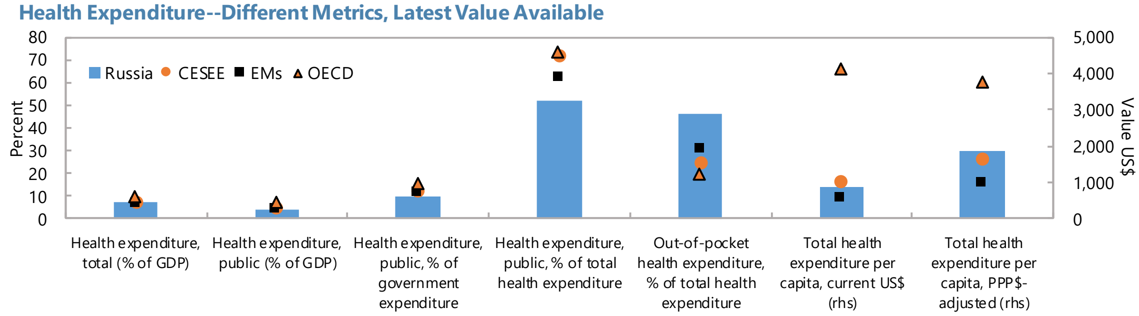
Sources: IMF FAD Expenditure Assessment Tool (EAT), World Economic Outlook, World Development Indicators, IMF Investment and Capital Stock Dataset, and World Economic Forum.

Health Indicators and Health System Characteristics Indicators, Latest Value Available



Sources: IMF FAD Expenditure Assessment Tool (EAT), World Bank, World Health Organization.

Health Expenditure--Different Metrics, Latest Value Available



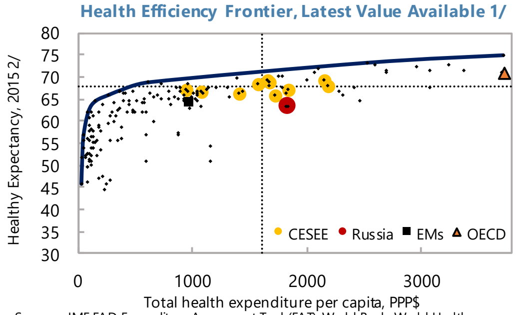
Sources: IMF FAD Expenditure Assessment Tool (EAT), World Bank, World Health Organization.

---

[6] The authorities' survey excludes additional tax expenditures under PIT, including various deductions and exemptions.

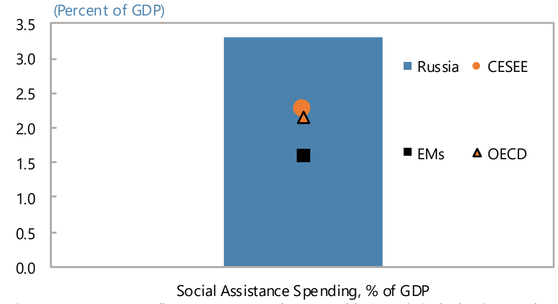
Selected Indicators for Public Spending on Infrastructure, Health, Education, and Social Assistance (concluded)

Health Efficiency Frontier, Latest Value Available 1/



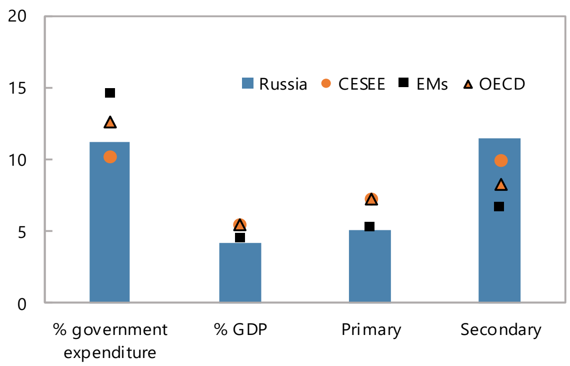
Sources: IMF FAD Expenditure Assessment Tool (EAT), World Bank, World Health Organization.
1/ Dashlinse are the average of CESEE.

Social Assistance Spending, Latest Value Available
(Percent of GDP)



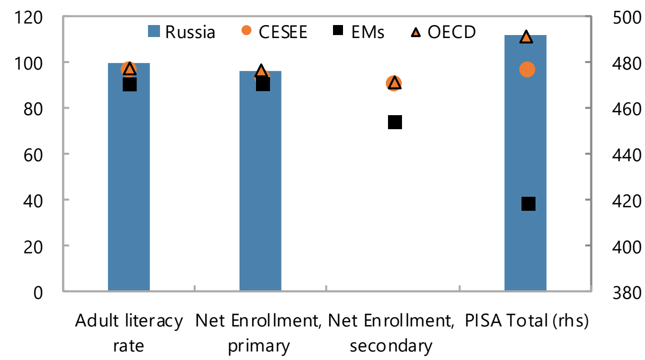
Sources: IMF FAD Expenditure Assessment Tool (EAT), World Economic Outlook, ASPIRE, and IMF Pension Indicators.

Government Education Expenditure, Latest Value Available



Sources: IMF FAD Expenditure Assessment Tool (EAT), World Bank.

Education Indicators, Latest Value Available



Sources: IMF FAD Expenditure Assessment Tool (EAT), Workd Bank.

Note: The chart on capital stock and infrastructure quality is partially based on the World Economic Forum's Global Competitiveness Index. Their rankings of infrastructure quality are based on perceptions, and should be interpreted with caution given the standardized assumptions, the limited number of respondents and geographical coverage, and the underlying uncertainty around point estimates. Furthermore, these rankings reflect relative (rather than absolute) performance.

16. **Staff emphasized that parametric pension reform, including raising the statutory retirement age and limiting early retirement, remains critical for intergenerational equity (text charts above).** While current pension spending does not seem out of line with other countries, it is projected to increase significantly. The current retirement ages (55/60 years for women/men) are low by international standards and have not been adjusted for decades. Early retirement provisions are generous, leading to an average effective retirement age substantially below the statutory one. As a result, the number of pensioners is high by international standards, while the number of contributors into the system is relatively low, thus threatening the system's sustainability.[7] Furthermore, expenditure on social assistance is relatively high and appears to be thinly spread. Thus, social benefits could be better targeted toward reducing poverty, given the constrained fiscal space.

[7] For further details, see Eich, Soto, and Gust (2012).

Authorities' Views

17. The authorities re-affirmed their strong support for the fiscal rule, particularly for maintaining the current benchmark oil price. But they are discussing temporarily relaxing the requirement for a primary fiscal balance at the benchmark oil price, to pay for needed infrastructure spending. They agreed with staff that there is some fiscal space, but believe that additional debt-financed spending on infrastructure of around 0.5 percent per year is unlikely to weaken the credibility of the fiscal framework or result in overheating, as the multiplier is low. While they are discussing various further changes in the tax system, they emphasized the need to have a balanced package of tax reforms, which precludes eliminating certain tax expenditures under VAT and PIT. They are committed to implementing parametric pension reform and to means-testing any new social assistance programs, although they will maintain the overall level of social spending in order to reduce poverty. Finally, they are determined to complete the shift in oil sector taxation over the next six years, which they expect to be revenue-enhancing.

B. Monetary Policy: Easing Should Continue

18. The CBR has been gradually easing its policy stance (Figure 2). Since June 2017, the CBR has cut its policy rate by a cumulative 200 bps, to 7.25 percent. The CBR paused its monetary easing in April and June 2018, which was in line with market expectations following the April 6 round of US sanctions. The CBR now estimates the neutral policy rate to be closer to the upper bound of the 6–7 percent range, and therefore the policy stance to be moderately tight. The CBR has also signaled that it will complete the transition to a neutral stance, but needs to proceed at a slower pace, given upside risks to the inflation outlook. Finally, the CBR has continued strengthening its inflation targeting framework, and decided not to make any horizon-bound commitments for now, but instead seek to keep inflation close to 4 percent at all times. In May 2018, the CBR released its first information notice about its key rate decision-making process, which is aimed at strengthening further its communication policy.

19. Given the inflation outlook, staff recommended that the CBR complete the transition to a neutral policy stance. Assuming the current tight fiscal stance is sustained, the new fiscal rule supports disinflation by containing domestic demand growth. However, the CBR should maintain its gradual and data-driven approach, as inflation expectations are not yet firmly anchored and could drift up again if inflation picks up due to the recent ruble depreciation, higher energy prices, strong growth in real wages, or possible changes in the fiscal stance. By the same token, the CBR will need to ensure that inflation expectations do not move persistently below the target, as in many other economies since the 2008 crisis.

20. Staff argued that the CBR could refine further its communication strategy. Inflation expectations have been declining over the past 18 months, reflecting the central bank's strengthening effectiveness and credibility. The CBR could continue reinforcing the message that its policy decisions are targeting inflation forecasts rather than current inflation. Such a forward-looking approach should reduce inertia in the formation of inflation expectations over time, especially for households. In addition, the CBR's communication strategy would benefit from elaborating what deviations from the inflation target are acceptable and over what time horizon.

Authorities' Views

21. The authorities agreed on the need to pursue a gradual easing of monetary policy towards a neutral stance. The CBR argued that monetary policy normalization in advanced economies and country-specific factors have both shifted the equilibrium real interest rate up, consistent with the neutral policy rate inching closer to the upper bound of the 6–7 percent range. This implies that the needed reduction of the policy rate to reach a neutral stance has shrunk. Regarding communication, the CBR indicated that they consistently refer to their 4 percent inflation target in their explanations of monetary policy decisions, to anchor inflation expectations. In addition, using its regional office network, the CBR has developed a communication program to explain current economic conditions and its monetary policy decisions to a broader audience, to influence the formation of inflation expectations. Finally, the authorities do not see a need for now to publish a path for projected interest rates.

C. Macro-Financial Policies: Pursuing Reforms to Foster the Sector's Resilience and Reduce the State's Footprint

22. The failures of three large private banks in the second half of 2017 weakened the banking sector's overall performance (Figure 5). Aggregate profits declined for the first time since 2015, mainly due to additional provisioning for NPLs by the banks under resolution. NPLs increased from 9.7 percent in March 2017 to 10.7 percent in March 2018. Aggregate capital adequacy dipped below 13 percent in late 2017, but has recovered in recent months (13 percent in March 2018, against a regulatory minimum of 8 percent). The CBR has continued the cleanup of the banking system, by closing another 62 credit institutions in 2017 (compared to 110 in 2016), which brings the total number of credit institutions to 561 at end-2017, down from 923 at end-2013. In addition, the CBR implemented temporary regulatory forbearance for loans to borrowers affected by the new US sanctions until end-2018. The CBR believes this will provide banks with sufficient time to fully gauge the impact of new sanctions on their clients.

23. Credit is expanding at a differential pace across various segments. Overall private sector credit grew by about 11 percent in April 2018 in nominal terms (8.5 percent in real terms). Lending activity in the retail sector has been expanding rapidly since mid-2016, with a growth rate of about 17 percent y-o-y. Consumer lending, excluding real estate and car loans, grew at about 14 percent, while mortgage lending expanded at a faster pace of around 18 percent. To contain the buildup of financial risks, in March the CBR approved an increase in risk weights on consumer loans and mortgage lending. Lending to the corporate sector has picked up in recent months (with 9 percent growth y-o-y, adjusted for exchange rate valuation effects). However, SME lending is still declining.

24. Macro-financial risks have diminished over the past few years, as the economy has adjusted to the twin shocks of lower oil prices and sanctions (Figure 6). The profitability of the tradable and non-tradable sectors has picked up on the back of strengthening economic activity and higher oil prices, despite some declines in H2 of 2017. Overdue corporate loans in rubles and FX have not shown a clear downward trend in recent months, but this is due to increases in the volume of bad debts in banks undergoing open resolution. FX risks for banks and corporates remain low as their short-term liabilities are sufficiently covered by their liquid external assets. Finally, deleveraging over the past two years has strengthened balance sheets, while domestic and external borrowing has been relatively stable.

25. The CBR rescued several private banks using the new resolution framework which provides equity capital injections via the Banking Sector Consolidation Fund (BCF). As a result of the takeovers, the CBR has become the owner of several former private banks. Financial stability has been maintained but at a significant cost to the authorities (estimated at over 2 percent of GDP), including through the use of the CBR's backstop funding for deposit insurance payouts and CBR funds for liquidity and capital injections into banks undergoing open bank assistance. The takeovers have also raised questions about the quality of bank financial statements, the adequacy of supervision, and the growing footprint of the state in the sector.

26. The CBR plans to use a "bad bank" strategy to deal with the impaired assets of banks in open resolution. A distressed asset fund will be established using a subsidiary of one of the large rescued banks. The fund will become the "bad bank" and will handle the bad assets of the large failed private banks, which are estimated at 2.1 trillion rubles (around $34 billion or 2.1 percent of GDP). The "bad bank" would be privately managed, potentially by an equity fund. The "bad bank" is expected to become operational in the second half of 2018.

27. The authorities have taken further actions to support financial stability. Through the recently created Risk Analysis Service, the CBR has initiated some elements of an Asset Quality Review (AQR) for the banking system. A new regulation came into effect in January 2017 which limits related-party exposures at 20 percent of banks' total regulatory capital. A draft federal law prescribing communication protocols between auditors and the CBR passed a first reading in the State Duma in December 2017. The CBR continues to take measures to improve the AML/CFT framework. With respect to macroprudential policies, a new federal law authorized the CBR to increase risk weights for certain types of assets to mitigate threats to financial stability. Furthermore, the calculation of payment-to-income ratios will become mandatory in January 2019, which would make it possible to limit financial stability risks on household loans even in the case of relatively low interest rates. Finally, the CBR continues developing and refining its stress-testing methodologies, including for macroprudential stress-testing.

28. State-owned banks (SOBs) appear to be less profitable and less efficient than their private sector counterparts, while they enjoy more market power (Box 2). SOBs dominate Russia's banking system, with the three largest ones accounting for 54 percent of the system's assets in 2017. State-owned banks have healthier balance sheets than privately owned banks, but they are less profitable (except for Sberbank). Structural analysis indicates that foreign-owned banks behave more competitively than either private or state-owned banks. In addition, results from Data Envelopment Analysis suggest that Russian banks are far from the efficiency frontier when compared to peers with similar bank-dominated financial systems, and are showing no signs of convergence. Private banks appear to be closer to the efficiency frontier than most SOBs, even as the latter benefit from cheaper funding and from having most large SOEs as clients.

Box 2. The Role of the State in the Russian Banking Sector[1]

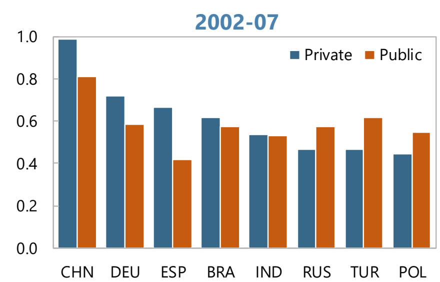
Over two-thirds of Russia's banking system is state-owned, and there has been an increase in the state's share in recent years due to government bailouts of several private banks. In general, state-owned banks (SOBs) enjoy a competitive advantage over private banks: they benefit from implicit and explicit state guarantees as well as access to government deposits, all of which tend to lower their funding costs compared to private banks.[2] Despite these advantages, many state banks (excluding Sberbank) generate either losses or small profits and have higher default rates.

Profitability, Average (2008-2017)

		Russia	Poland	Germany	China	India	Brazil	Spain	Thailand	Turkey
ROA (return on assets)	State (exl. Sberbank)	**0.1**	1.5	0.1	1.2	0.5	1.0	0.1	1.2	2.0
	Sberbank of Russia	**2.1**								
	Private	**1.2**	1.3	0.2	1.2	1.5	1.7	0.6	1.7	1.9
	System	**1.0**	1.4	0.2	1.2	1.0	1.3	0.5	1.5	1.9
ROE (return on equity)	State (exl. Sberbank)	**(0.8)**	12.3	1.5	19.9	8.7	18.9	(2.2)	13.2	20.6
	Sberbank of Russia	**18.8**								
	Private	**19.6**	11.4	5.3	20.2	14.9	21.2	8.7	16.1	16.0
	System	**13.8**	11.8	3.4	19.9	11.4	20.0	7.4	15.0	17.5
Net Interest Margin	State (exl. Sberbank)	**1.9**	2.0	0.4	1.4	0.6	1.9	0.6	1.8	2.3
	Sberbank of Russia	**3.3**								
	Private	**2.5**	1.5	0.5	1.5	1.0	3.3	1.1	1.6	2.2
	System	**2.4**	1.7	0.4	1.4	0.8	2.6	1.0	1.7	2.2
Operating Expense / Operating Income	State (exl. Sberbank)	**94.0**	61.5	111.2	45.3	66.5	81.3	105.0	67.6	51.9
	Sberbank of Russia	**63.7**								
	Private	**77.3**	64.2	86.8	51.5	57.2	72.5	76.5	54.9	56.8
	System	**74.2**	62.2	86.6	45.8	64.6	76.1	77.2	59.0	55.8

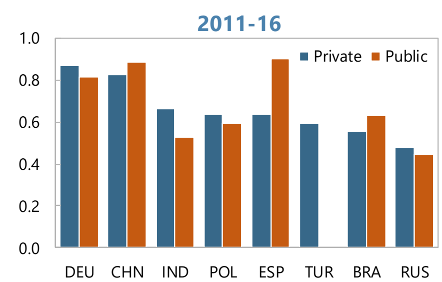
Sources: Fitch Connect; and IMF staff calculations.

To assess the degree of competition in Russia's banking sector, we used a structural approach (as in Panzar and Rosse, 1987). We looked at the extent to which a change in factor input prices is reflected in revenues earned by a specific bank (the so-called "H-statistic"). Using annual bank-level data covering the period 2005–16, we found that foreign-owned banks behave more competitively than either private or state-owned banks.



Sources: Fitch Connect and IMF staff calculations

Finally, to assess the efficiency of Russian banks vis-à-vis peers, we used Data Envelopment Analysis which estimates distance to the efficiency frontier. The analysis, using bank-level data for eight comparator countries with bank-dominated financial systems, suggest that Russian banks are far from the empirical efficiency frontier, and are showing no signs of convergence over time. Among Russian banks, public banks have been drifting away from the frontier over time, relative to private ones.



Sources: Fitch Connect and IMF staff calculations

[1] See Selected Issues Paper, "The Role of the State in the Russian Banking Sector."

[2] Banking sector analysts suggest that recent returns generated at some state-owned banks are one-off events related to the provision of government support.

29. Staff argued that additional efforts are needed to strengthen bank supervision and regulation. The establishment of the Risk Analysis Service, a special CBR unit responsible for independent asset quality evaluations, is welcome, but more efforts are needed to swiftly complete the evaluations and to also ensure their alignment with best international practices. The legal framework for related party exposures and the draft law upgrading the framework for banks' external auditors could be strengthened further.[8] Supervision could be enhanced by enabling the CBR to exercise professional judgment as part of an explicit early intervention mechanism. Moreover, the CBR could strengthen the *ex post* communication of the rationale behind its bank resolution decisions. It is also important to have a credible strategy for returning rehabilitated banks to private hands in a way that is consistent with increasing competition and improving the allocation of capital. The CBR's stress-testing capacity could substantially benefit from improved internal cooperation, by ensuring that the Banking Supervision and Financial Stability Departments have seamless access to all supervisory/macroprudential reporting and modeling. Finally, as discussed in previous years, improving further the effectiveness of the AML/CFT system, including in relation to politically exposed persons and the transparency and availability of beneficial ownership information of legal persons, will support the authorities' efforts to address financial crimes related to tax evasion and corruption.

30. Staff suggested that the structure and governance of the banking system should evolve toward greater efficiency, more competition, and better governance. The authorities could target improvements in the governance and risk management practices of SOBs. Policies should seek to reduce concentration in the sector and to level the playing field between private and state-owned banks, which currently enjoy lower funding costs due to cheap government deposits and implicit government guarantees. Looking further ahead, gradually reducing the significant footprint of the state in the banking sector would help to increase competition and efficiency. However, staff recognizes that in the current environment it would be difficult for the authorities to seek out responsible stewards for bank privatization, including reputable foreign investors with long-term interests, and this will only be possible in the long term.

Authorities' Views

31. The authorities argued that they have made substantial progress both with the cleanup of the banking sector and with the implementation of structural reforms in the sector. In their assessment, compared to 6–12 months ago, the health of the banking sector and financial supervision have improved. Initiatives like the establishment of the Risk Analysis Service have made a major positive contribution. The authorities believe that improvements in the regulatory framework have enabled a further deepening of financial markets. In addition, they argued that the implementation of special programs to develop financial technology will increase competition. At the same time, the authorities agreed that to enhance supervision, the CBR needs to be able to exercise professional judgment. This, in turn, requires legal immunity for supervisors which the State Duma is currently reluctant to grant. Finally, the authorities noted that they are working on changes to the legal constraints on purchase and assumption (P&A) transactions.

[8] With respect to related-party exposures, regulations could include a legal prohibition on performing related party transactions on more favorable terms than corresponding transactions with non-related counterparties. With respect to external auditors, regulations should provide that an external auditor is sufficiently independent and meets eligibility criteria, including professional standards. Rotation policies and grounds for dismissal should also be articulated in regulations.

32. The authorities believe that the cleanup of the banking sector will be completed within three years. They emphasized that the extension of open resolution under the BCF to a non-systemic private bank was done to continue a resolution process that was started under the old DIA resolution scheme.[9] With respect to the divestment of the rescued banks, the authorities' current plan is to merge those banks and sell the merged bank in a public offering to multiple small investors.

33. Finally, the authorities appreciated staff's analytical work on the role of the state in Russia's banking sector and agreed on the need to improve the banking system's performance. However, they emphasized the substantial heterogeneity in performance, efficiency, and competitive behavior among both public and private banks. The authorities also noted that, given recent failures of private banks, performance assessments should account for differences in banks' risk profiles and business models.

D. Structural Reforms: Re-Kindling Structural Reforms to Lift Potential Growth

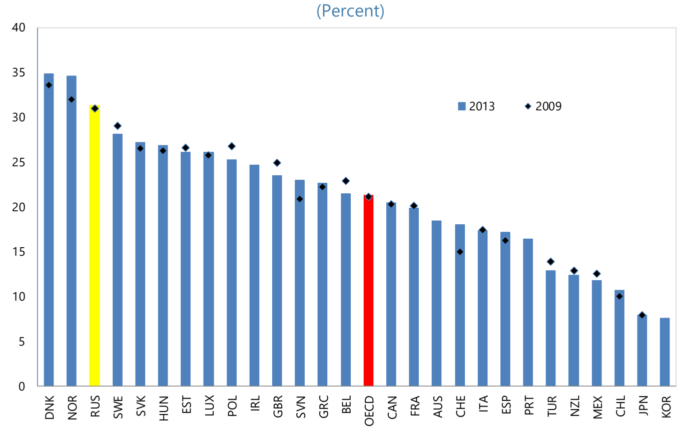
34. Russia's stalled convergence to advanced economy income levels underscores the urgency of structural reforms. Long-standing weaknesses include inadequate infrastructure, excessive regulation, governance and institutional weaknesses, and adverse demographic trends. The large footprint of the state might be yet another important driver of the weak dynamism in Russia's economy (Box 3). Staff estimates that the state's share in the economy is around 30–35 percent, and that it has increased in the banking and oil and gas industries in recent years. The Russian state accounts for close to 40 percent of formal sector activity and for 50 percent of formal sector employment. SOEs are active in just about every sector of Russia's economy. Cross-country data on the public sector's employment share suggest that the Russian state is large by international standards. The large public sector leaves a footprint in the form of lower efficiency in the use of resources. It also contributes to reduced market competition and increased concentration in a number of sectors. However, concentration is high even in sectors with low state presence, underlining the need for revamped and more effective public policies to promote market competition.

[9] The newer framework provides for capital injections via the BCF, while the older one provides for loans at below-market rates from the Deposit Insurance Agency (DIA).

Box 3. The State's Footprint in the Economy[1]

There has been widespread speculation about the size of Russia's public sector in recent years. Some sources estimate it at around 70 percent of GDP, twice the level a decade ago. However, the 70 percent number is based on a misinterpretation of the findings of FAD's 2014 Fiscal Transparency Evaluation.[2] The EBRD estimated Russia's public sector to be 35 percent of GDP in 2010, up from 30 percent in 2004. However, the series were discontinued after 2010, due to data limitations. Public sector employment according to official sources has declined from 50 percent in 2000 to 28 percent in 2016, with most of the decline taking place in the early 2000s. Nevertheless, the public sector's share in total employment is high by international standards.

Share of Public Sector Employment in Total Employment, 2009 and 2013
(Percent)



Sources: OECD; and Rosstat.

The state's footprint in the economy was estimated by calculating its share in value added (VA). Staff estimates suggest that the state accounted for about one-third of Russia's VA in 2016, smaller than suggested by the mainstream narrative but nonetheless large. The state's share in VA was approximated by its share in sales for market activities, and by its share in employment for non-market activities. Estimates include within the state's perimeter the resident subsidiaries of the 20 largest state-controlled non-financial companies, which are generally classified as private in official data. In the last five years, the state's share in VA increased significantly in energy and banking, but only slightly overall (from 31 to 33 percent of GDP). However, the state accounted for about 38 percent of formal sector VA.

Russia: The State's Share, 2016

Economic Sector	Raw Sales Shares	Adjusted Sales Share	Assets Share	Labor Share	Total
Market Sectors					
Agriculture, Hunting, Forestry, Loggin	2	2			
Fishing, hatcheries, and related servic	2	2			
Mining and Extraction	4	**44**			
Manufacturing	19	**21**			
Electricity, gas, steam and hot water	36	**52**			
Construction	4	4			
Wholesale and retail trade; Repairs	4	9			
Hotels and Restaurants	3	5			
Transport and Communications	34	**48**			
Finances			**59**		
Real estate, renting and related servic	9	9			
Non-Market Sectors					
Public Administration, Defense, Social Security				**99**	
Education				**92**	
Health and Social Work				**87**	
Other Communal and Personal Services				**48**	
Households with employed persons				0	
Gross Value Added					**33**

Sources: IMF staff and Rosstat.

The relatively large Russian state contributes to concentration in several economic sectors, though concentration is high even in sectors with low state presence. Comparing the top 15 most concentrated economic activities with the 15 least concentrated ones shows that the state has a stronger presence in the former than in the latter. The presence of SOEs is large in strategic sectors (energy, defense) and natural monopolies (electricity, gas, water, railway transportation), but also in the financial sector. Even in sectors in which the state's presence is not large, economic concentration is high, despite the efforts of the Federal Anti-Monopoly Service (which administers and enforces anti-monopoly legislation).

Russia: Market Concentration and State Ownership

15 Most Concentrated			15 Least Concentrated		
Economic Sector (2-digit level)	Gini	State's Share	Economic Sector (2-digit level)	Gini	State's Share
1 Telecommunications	0.95	22	1 Waste Disposal	0.70	26
2 Management Consulting	0.95	40	2 Security and Investigation	0.71	16
3 Insurance-Pension Funds	0.95	53	3 Hotels	0.78	5
4 Postal-Courier Services	0.95	73	4 Sewage	0.78	34
5 Electricity, Gas, Steam	0.94	57	5 Restaurants	0.79	6
6 Metallurgical Production	0.94	3	6 Employment and Recruting	0.81	0
7 Land-Pipeline Transport	0.94	69	7 Production of TV, Films	0.82	2
8 Chemicals Production	0.94	14	8 Building Maintenance	0.82	6
9 Beverage Production	0.94	5	9 Coal Mining	0.82	3
10 Motor Vehicles	0.93	2	10 Forestry	0.83	3
11 Oil and Coke Refining	0.93	15	11 Real Estate	0.84	8
12 Air Transport	0.93	47	12 Specialized Construction	0.84	2
13 Crude Oil and Gas Extraction	0.93	67	13 Furniture Production	0.84	0
14 Research and Development	0.92	51	14 Polygraphic-Copying Information	0.85	3
15 Other Transport Equipment	0.92	55	15 Veterinary Activity	0.85	1
Median	**0.94**	**46.5**	**Median**	**0.82**	**3.2**

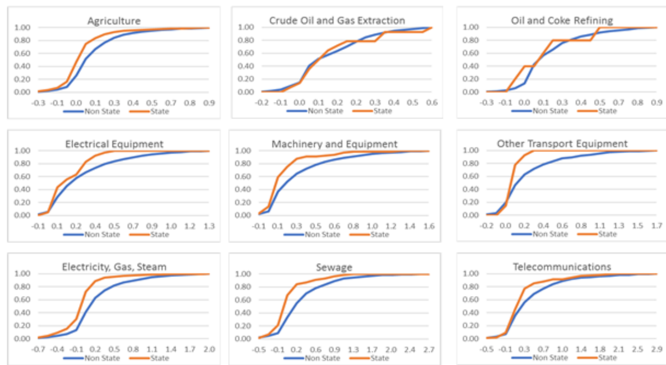
Source: IMF Staff on the basis of official data.

Box 3. The State's Footprint in the Economy[1] (concluded)

Given the state's substantial footprint in the economy, procurement policies are essential to promote competition. Existing legislation recognizes that the state's demand for goods and services can have a significant impact on the economy. However, most SOE procurement occurs through non-competitive methods and supplier concentration is high. Moreover, the law allows for SME quotas to be used by subsidiaries of larger firms and for the unconstrained use of price advantages for domestic suppliers. These provisions limit market access, efficiency, and value chain development.

SOEs appear to underperform relative to non-state firms in a variety of economic activities. A comparison of gross returns on assets in various market activities at the two-digit level between state and non-state entities for 2016 shows that the cumulative distribution of returns for SOEs is often to the left of that for non-state entities.

Figure 2. Russia: Economic Performance and State Ownership
(Selected Market Activities in 2016 - Cumulative Frequency Distribution of Gross Return over Assets, Percent)



Note: A Curve that is to the left indicates lower cummulative returns

Source: IMF staff on the basis of official data.

Lower competition and efficiency are not the only channels through which the state's footprint may be negatively affecting long-term growth. The state's large presence in the financial sector (see Box 2) may result in a biased allocation of savings that benefits large players, both state and non-state. There is some evidence that public procurement (both by government and SOEs) may be playing a similar role. In this context, public institutions regulating and promoting competition need to do more to steer the economy to a better equilibrium.

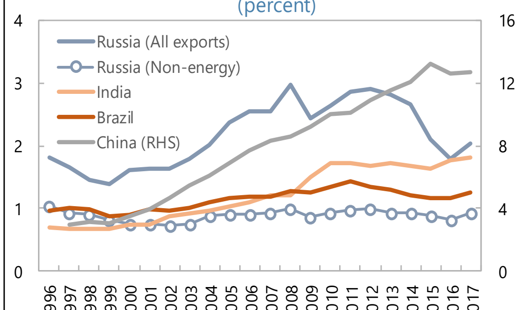
---

[1] See Selected Issues Paper, "The State's Footprint in the Economy."

[2] The FTE added up the gross revenues and gross expenditures of the general government to those of the 26 largest public corporations. The report estimated gross revenues and gross expenditures of the public sector to be at least 68–71 percent of GDP. However, interpreting these numbers as the public sector's share in the Russian economy would be misplaced. Adding up all companies' gross revenues or gross expenditures in an economy would give a number exceeding 100 percent of GDP, as these measures overstate value added.

35. **Despite some progress, the authorities continue to face structural obstacles in improving competitiveness and diversifying the economy.** The large REER depreciation in 2014 has boosted import substitution, and exports of agricultural products and machinery registered double-digit growth in 2017.[10] However, as discussed in the [2016](2016) and 2017 Article IV Selected Issues Papers, structural rigidities continue to dampen the response of the economy to changes in relative prices. In addition, high localization requirements (second only to Brazil among BRICS) may also have the unintended consequence of keeping Russia outside of global supply chains (text chart below).

Share in Global Exports of Goods
(percent)



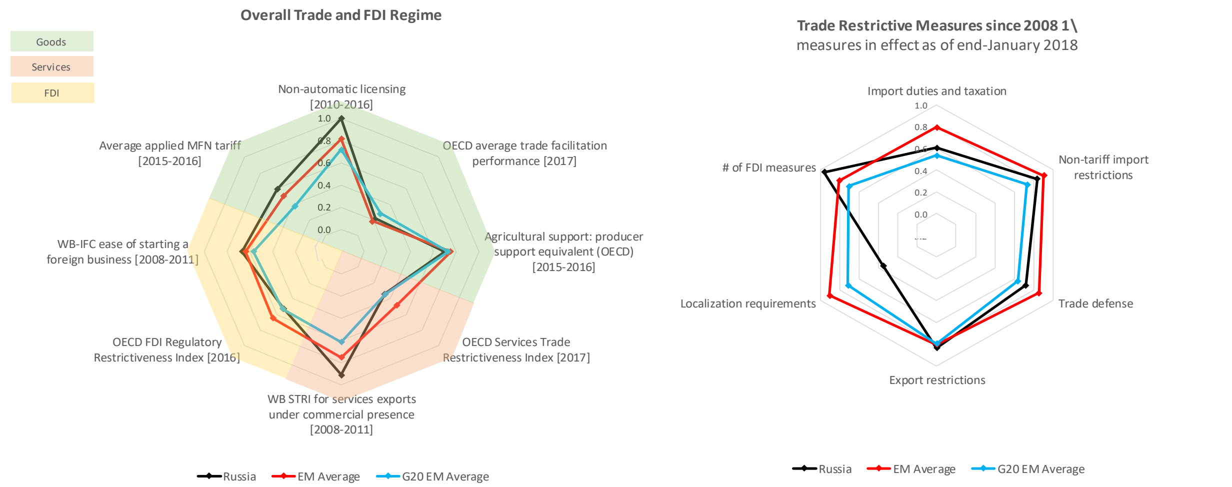
Sources: World Economic Outlook (WEO); and IMF staff calculations.

---

[10] In the case of agriculture, it is impossible to separate the impact of the REER depreciation from that of counter-sanctions imposed by Russia on select imported agricultural products.

Selected Trade Policy Indicators

(0 = least open country in G20; 1 = most open country in G20)



Notes: The indicators reflect no judgment as to WTO compliance of underlying measures, nor whether certain measures (such as trade defense) are an appropriate response to the actions of other countries. The "ease of starting a business" indicator is based on perceptions as part of an established IFC survey process.

Sources: Tariff data are from the WTO, *World Tariff Profiles;* the import licensing measure is based on UNCTAD TRAINS and COMTRADE data; the average trade facilitation performance, agricultural support measure, Services Trade Restrictiveness Index (STRI), and FDI Restrictiveness Index are from the OECD; WB STRI is from the World Bank; the post-GFC indicators are from Global Trade Alert.

1\ Import (export) coverage ratio, except for the case of FDI (number of measures).

36. **To boost potential growth and re-ignite convergence, the authorities should reduce the state's footprint over the medium term.** Actions need to be carefully sequenced, as outright privatization will likely result in more economic concentration. Efforts should be first geared at enhancing competition (by promoting market entry) and leveling the playing field in public procurement (by reducing supplier concentration and facilitating SME development). Out of about 32,500 SOEs, around 500 represent more than 85 percent of revenues, suggesting a large potential for consolidation and efficiency gains through better management of state property. As a more competitive marketplace develops and SOE management becomes more efficient, a clear exit strategy needs to be developed for those sectors where there is no economic rationale for state ownership, including the banking sector. The strategy should be competition-enhancing, as economic concentration is already high in most market segments. The authorities should also tackle long-standing institutional and governance issues, including excessive regulations and customs procedures that complicate trade integration. Advancing decisively in these areas is essential given the additional risks the current geopolitical context entails.

37. **In the short term, reform priorities should focus on measures that are feasible and have a high productivity impact.** The proposed boost to investment in physical and human capital is welcome, but should be undertaken in a deficit-neutral manner. A parametric pension reform currently under discussion could raise the statutory retirement age, ease pressures on the budget, and help temporarily offset negative demographic trends. In the short term, it could also dampen pressures that are building up in the labor market. The planned shift in the taxation of the oil sector could reduce distortions and implicit fuel subsidies. A broader fiscal maneuver from direct to indirect

taxation could incentivize labor supply, reduce informality, and attract new investment.[11] To accelerate TFP growth, the authorities should persist with their efforts to strengthen competitiveness, promote trade integration, and diversify exports, including by reducing barriers to trade and FDI. In that vein, steadfast implementation of the new fiscal rule should continue, as it has weakened the impact of oil prices on the real exchange rate (Figure 2) which should help facilitate export diversification.

38. In addition, there is a range of measures to address long-standing weaknesses in governance which should boost human and physical capital accumulation. The authorities could strengthen transparency, accountability, and governance standards in the SOE sector, in line with the recommendations of the 2014 Fiscal Transparency Evaluation (FTE).[12] In the financial sector, the authorities could strengthen further supervision and limit connected lending, to ensure credit flows to the more productive projects. Finally, reducing informality would increase the returns on training and R&D spending.

Authorities' Views

39. The authorities highlighted the initiatives laid out in the May 2018 presidential decree, which aims to raise GDP growth above the global average. They argued that the proposed ramp-up in infrastructure, health, and education spending is key for boosting potential growth. They believe that additional infrastructure expenditure—estimated at about 3.5 percent of GDP spread over six years—could improve productivity if project selection targets the right sectors. They are committed to implementing a pension reform and agreed on the need to increase the retirement age, although key parameters are still under discussion.

40. The authorities welcomed the analysis on the state's footprint. While they acknowledged that the relatively large state contributes to economic concentration and that concentration is high even in sectors where the state's presence is low, they pointed out that this was the case elsewhere around the world. The authorities took note of the relatively weaker performance of SOEs vis-à-vis private companies in most sectors of economic activity. They thought that stricter key performance indicators are needed to improve SOE efficiency, and wondered whether a multiplicity of SOE objectives might be contributing to below-par performance. The authorities are committed to creating a more transparent, standardized, and competitive market environment, including by leveling the field in public procurement. They are doubtful whether stricter criteria to fill SME quotas

[11] Higher indirect taxes might feed into inflation. However, assuming that second-round effects on inflation expectations and wages are contained, that would be a one-off. Also, inflation is currently well below the CBR's target.
[12] The FTE recommended strengthening aggregate reporting on the financial position and performance of the public corporations sector. To improve financial oversight, all public corporations should publish audited financial statements and present their financial statements in a format which facilitates consolidation. To strengthen understanding of the full extent and cost of fiscal activity, public corporations should be required to disclose and quantify in their financial statements the cost of any provision of goods and services at below-market prices, any public service undertakings, or any other quasi-fiscal activities. The authorities should start maintaining a database covering all SOEs and publishing an annual report with consolidated data on the fiscal performance, prospects, and risks of the public corporations sector. The FTE further recommended clarifying the boundary between general government and public corporations, given the large number of public corporations which do not appear to meet a market test.

in state procurement would be an effective way to increase competition, but are open to analyzing the international experience. The authorities acknowledged the need to reduce the state's footprint, particularly in the banking sector. They agreed that the right sequencing of reforms is essential, and that privatizing without first strengthening competition would most likely result in more concentration.

STAFF APPRAISAL

41. Despite the ongoing recovery, the medium-term outlook remains weak. With the projected growth rates, Russia would lag behind peers in Eastern Europe and not catch up with per capita incomes in advanced economies. A combination of factors likely is at work, including insufficient infrastructure, a large footprint of the state, as well as governance and institutional weaknesses which have increased economic concentration and stifled dynamism. In addition, Russia's integration in the global economy is progressing slowly, thus weakening incentives to improve performance and reducing positive spillovers from foreign technological change. Uncertainty due to geopolitical tensions is affecting negatively private investment. Furthermore, the external position in 2017 was moderately weaker than suggested by medium-term fundamentals and desirable policy settings.

42. The authorities have established a strong macroeconomic policy framework, including a prudent fiscal rule, inflation targeting, and a flexible exchange rate. This will continue to help address uncertainty, which has increased recently due to renewed geopolitical tensions and turbulence in emerging markets. However, to accelerate potential growth, the focus must shift to structural reforms to boost productivity and the supply of labor and capital.

43. The fiscal rule shields the economy from fluctuations in oil prices and should facilitate economic diversification. In addition, it has anchored fiscal policy by providing a credible fiscal path. Thus, the authorities should resist the temptation to revise the rule, as this would be procyclical at this juncture and could also weaken the hard-won credibility of the macroeconomic framework. Fiscal consolidation should continue in line with the rule, in order to rebuild fiscal buffers. These remain essential for reducing Russia's vulnerability to external shocks. The pace of adjustment over 2018–20 is appropriate, but its quality could be improved, as it relies excessively on across-the-board spending freezes, which are suboptimal and likely unsustainable. While Russia's public debt is sustainable, further consolidation of 0.5–1.5 percent of GDP is needed over the medium term to reach a nonoil primary balance consistent with sharing equitably Russia's natural resources with future generations.

44. The authorities are encouraged to engineer a growth-friendly shift in spending and taxes within the confines of the fiscal rule. A well-designed and deficit-neutral shift from social security contributions to consumption taxes could incentivize labor supply, reduce labor informality, and attract new investment. Staff welcome the authorities' plans to boost spending on health, education, and infrastructure. To finance these priorities, the authorities could consider re-prioritizing other spending, strengthening tax compliance, and reducing tax expenditures under VAT and PIT. In addition, although expenditure on social assistance is high, it is too thinly spread. To have a meaningful impact on reducing poverty, it needs to be better targeted. Long-delayed parametric pension reform could help to offset negative demographic trends, at least temporarily, and could also provide additional fiscal space.

45. With headline inflation below the 4 percent target and low underlying inflationary pressures despite a closing output gap, further monetary easing appears appropriate. However, the CBR should maintain its gradual and data-driven approach, as inflation expectations are not yet firmly anchored and external and fiscal risks have increased. The central bank should continue to refine further its communication strategy to strengthen its credibility and reduce inertia in the formation of inflation expectations.

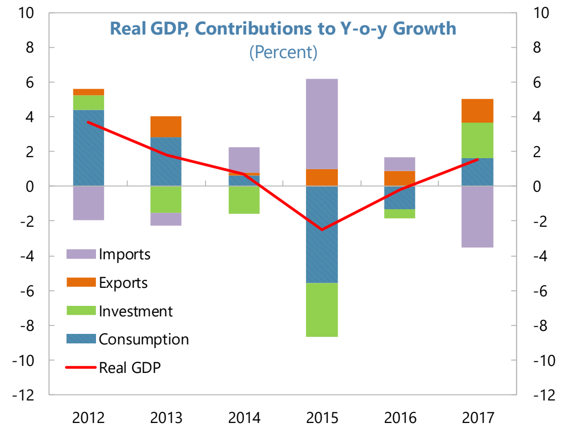
46. The financial sector needs to play a stronger role in channeling savings to the most productive companies. However, last year's failure of several large banks has placed a non-negligible quasi-fiscal burden on public finances and pointed to significant shortcomings, such as excessive risk concentration and lending to connected parties rather than to the most competitive firms. This needs to be addressed by a renewed effort to close the gaps in bank supervision and regulation, as well as in the provision of accurate financial statements. The bank failures also underscored the importance of completing the cleanup of the banking sector. The supervision of risks should be intensified, with a focus on related-party lending. The establishment of a special division within the Central Bank of Russia (CBR) responsible for independent asset quality evaluations is welcome, but more efforts are needed to swiftly complete the evaluations and to also ensure their alignment with best international practices. Supervision could be enhanced further by enabling the CBR to exercise professional judgment. Moreover, the CBR could strengthen the *ex post* communication of the rationale behind its bank resolution decisions. It is also important to have a credible strategy for returning rehabilitated banks to private hands in a way that is consistent with increasing competition and improving the allocation of capital.

47. Boosting growth requires stronger competition in domestic markets, a leaner state, and a more vibrant private sector. The footprint of the state, estimated at around a third of the economy, needs to be reduced, particularly in banking and other sectors with limited rationale for public ownership. However, sequencing is critical. The first step should be to strengthen the institutional architecture to avoid further concentration of economic power after privatization. In particular, the authorities should enhance competition, including by facilitating entry/exit. Despite formal procedures to support competition in public procurement, more can be done to use state purchases to promote market contestability and the development of SMEs. The authorities should also strengthen transparency, accountability, and governance standards in the corporate sector, particularly for SOEs, to raise efficiency in the use of state resources. By persisting with their efforts to strengthen competitiveness, promote trade integration, and diversify exports, the authorities could accelerate productivity growth.

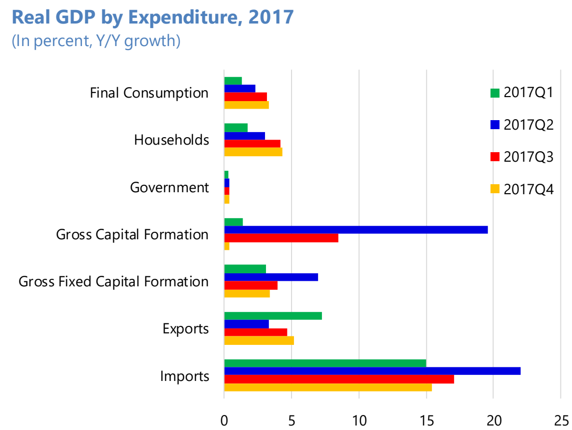
48. The next Article IV consultation should be held on the standard 12-month cycle.

Figure 1. Russian Federation: Real Sector Developments, 1996–2030

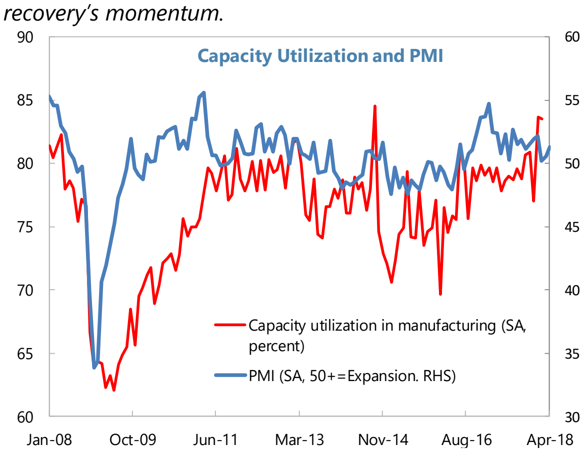
The cyclical recovery is driven by higher domestic demand…



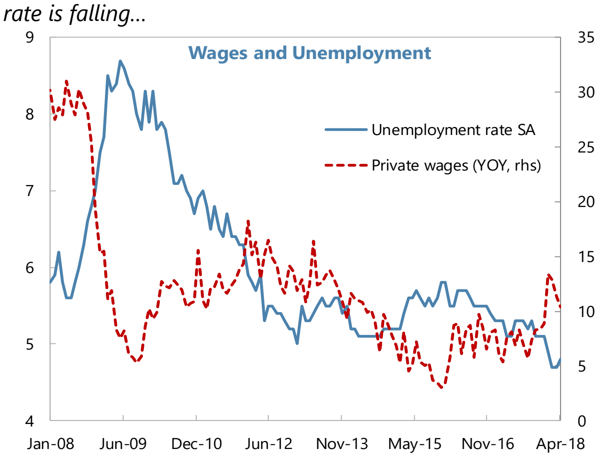
…some of which has leaked into higher imports.



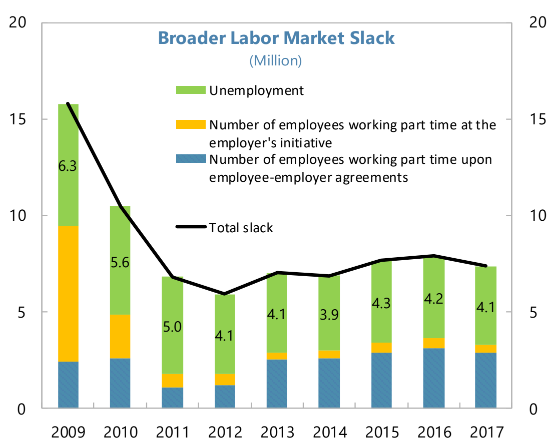
High-frequency indicators point to the fragility of the recovery's momentum.



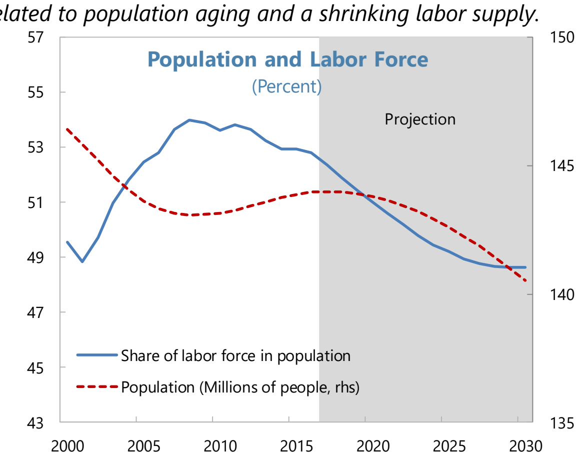
However, wages are growing and the headline unemployment rate is falling…



…as are broader measures of labor market slack…



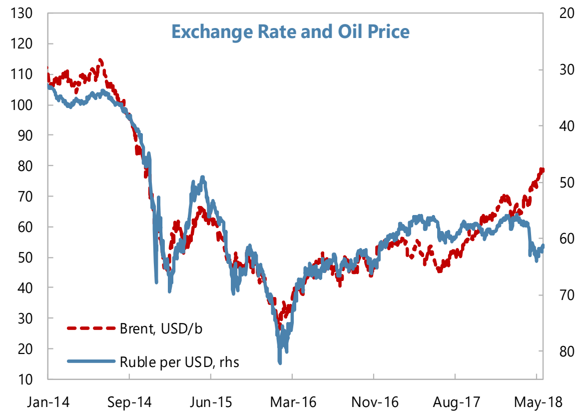
…in part reflecting structural features of the labor market related to population aging and a shrinking labor supply.



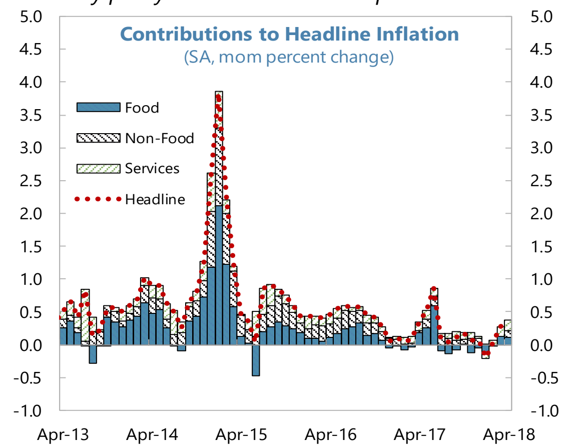
Sources: Rosstat; and IMF Staff calculations.

Figure 2. Russian Federation: Inflation and Monetary Policy, 2013–19

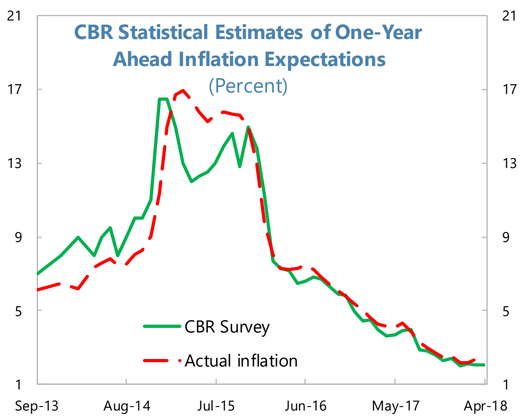
The recovery of oil prices since February 2016 led to a ruble rebound...



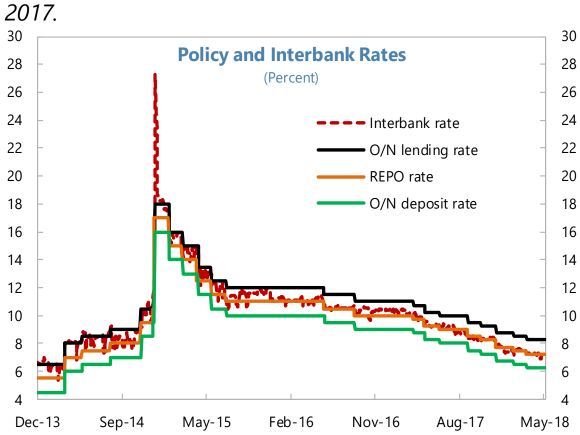
...which has supported disinflation, together with tight monetary policy and a better-than-expected harvest.



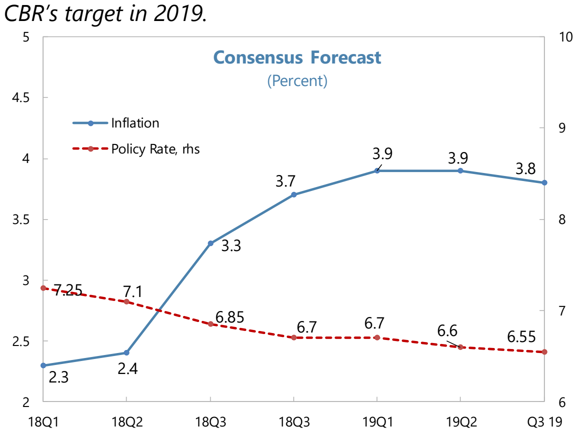
Inflation expectations have continued to fall...



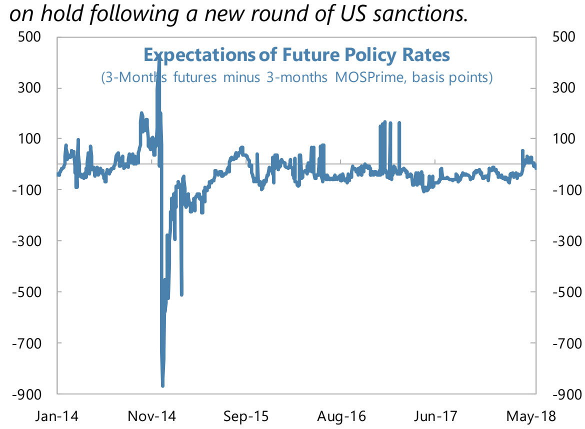
...leading the CBR to cut its key rate by 200 bps since June 2017.



The consensus forecast shows that inflation will reach the CBR's target in 2019.



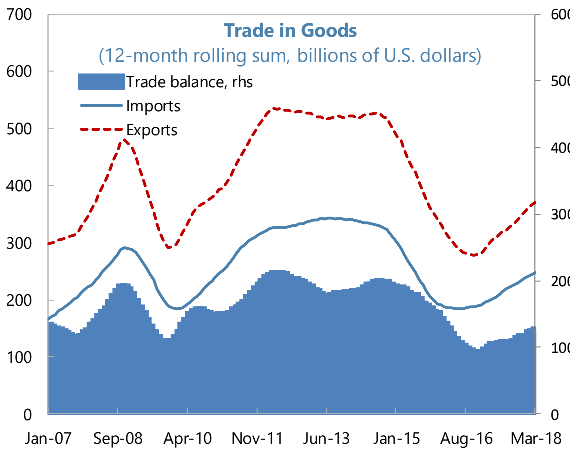
Market expectations for further policy rate cuts were put on hold following a new round of US sanctions.



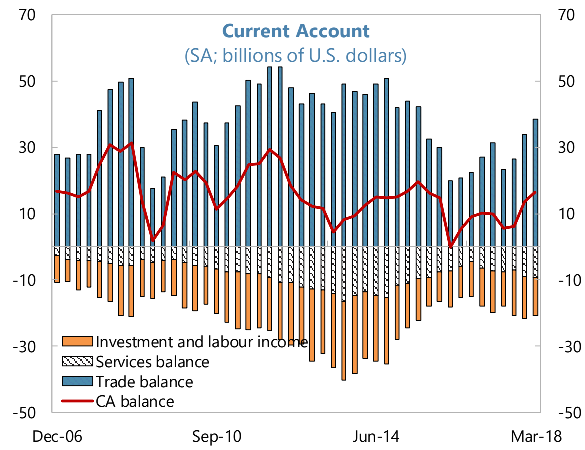
Sources: Central Bank of Russia and Public Opinion Foundation Survey; Russia Economic Barometer; Bloomberg Financial Market L.P.; and IMF staff calculations.

Figure 3. Russian Federation: External Sector Developments, 2006–17

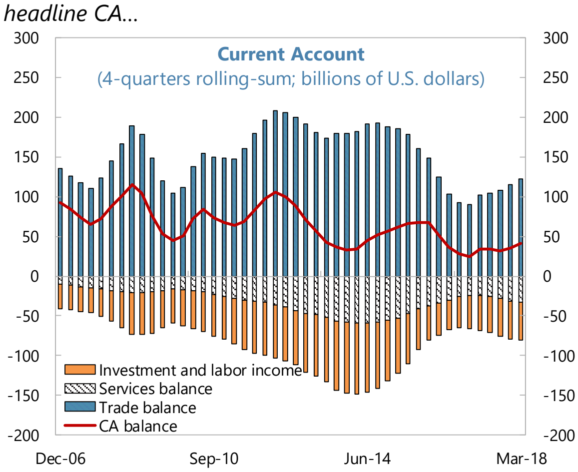
Trade is rebounding together with economic activity…



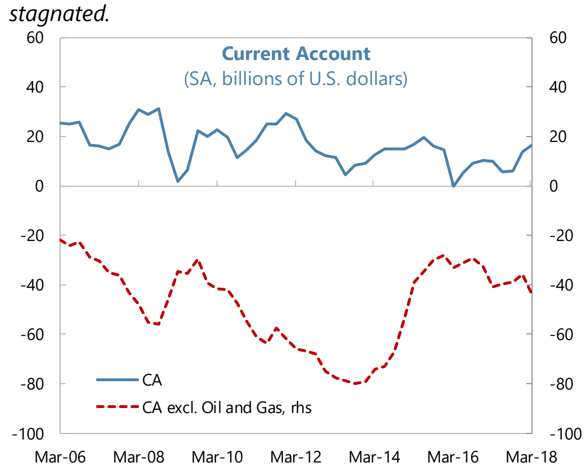
…and the current account is on the rise as well.



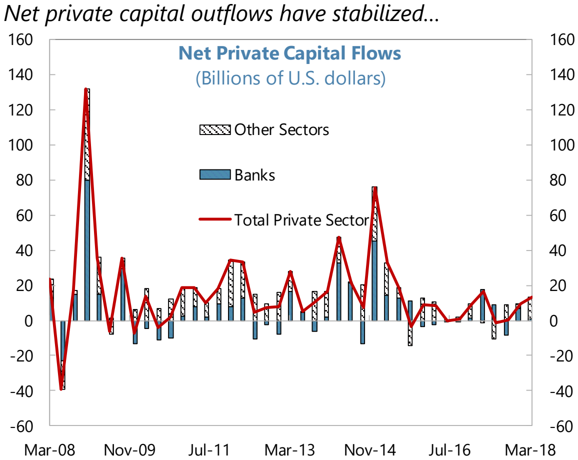
The trade balance is supporting the improvement in the headline CA…



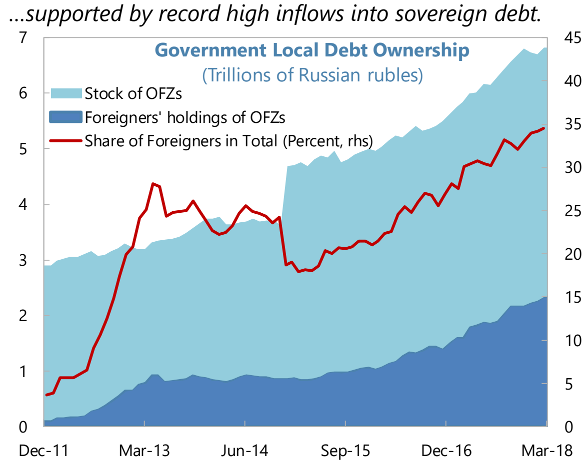
…but the non-energy current account balance has stagnated.



Net private capital outflows have stabilized…



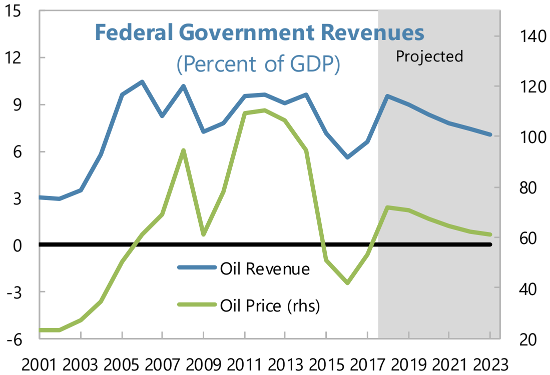
…supported by record high inflows into sovereign debt.



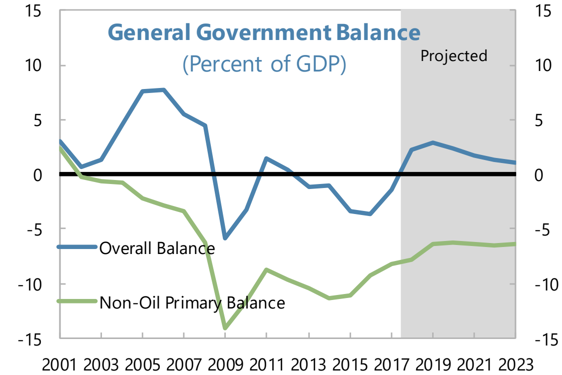
Sources: Rosstat; and IMF staff calculations.

Figure 4. Russian Federation: Fiscal Policy, 2001–23

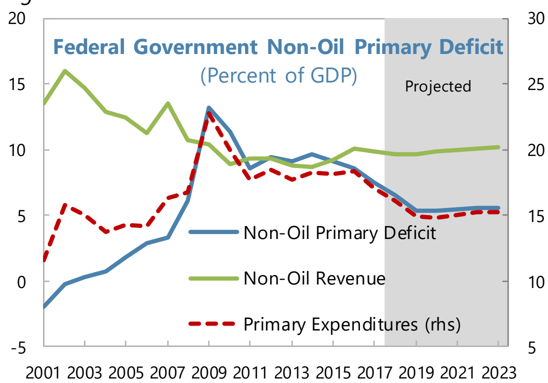
Oil prices and related fiscal revenues have stabilized at lower levels.



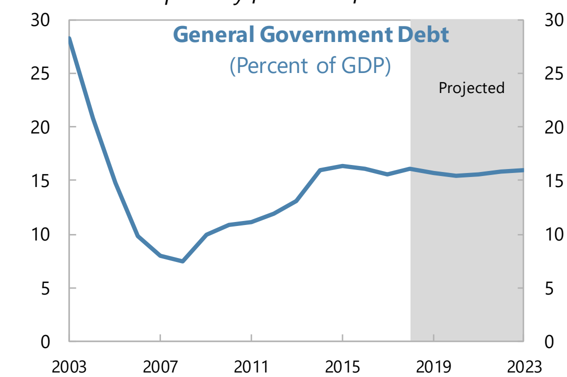
The authorities are in the midst of an ambitious fiscal consolidation…



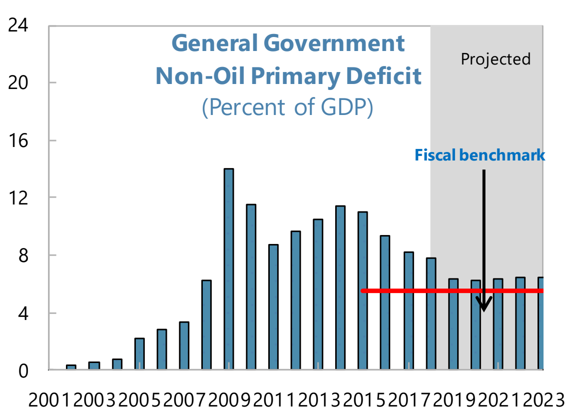
…which has mostly relied on the expenditure side of the budget.



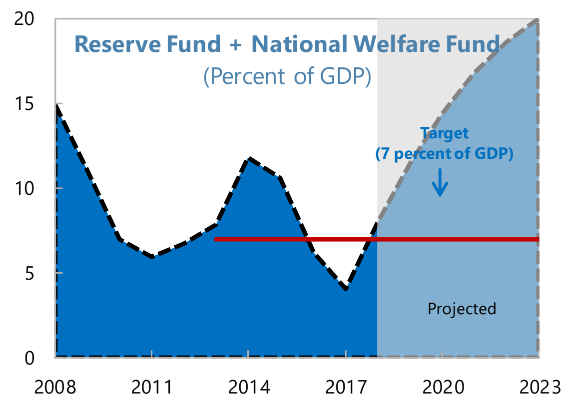
Gross government debt remains low, due to the use of the Reserve Fund to partially finance deficits in 2015–17.



Further fiscal consolidation could bring the non-oil deficit closer to a level consistent with intergenerational equity…



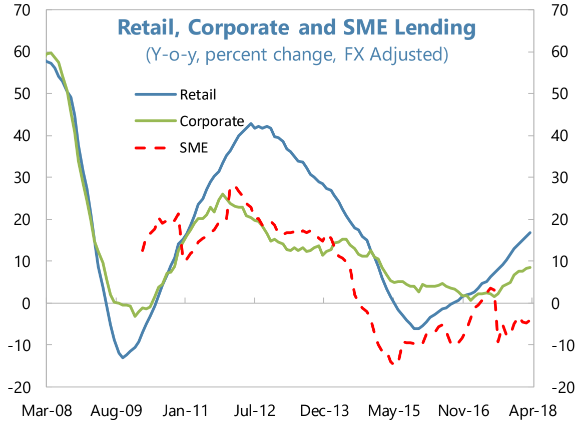
…and gradually rebuild fiscal buffers.



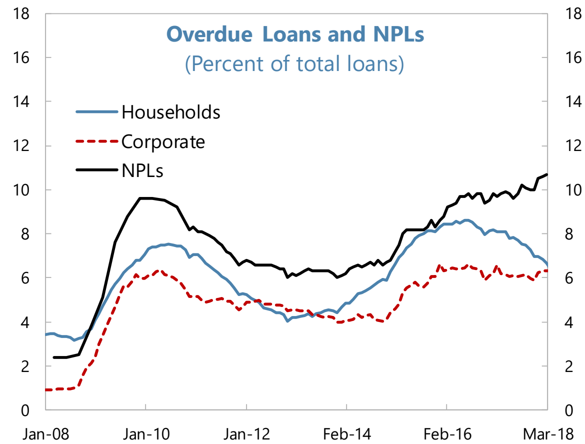
Sources: Russian authorities; and IMF staff calculations.

Figure 5. Russian Federation: Banking Sector Developments, 2008–18

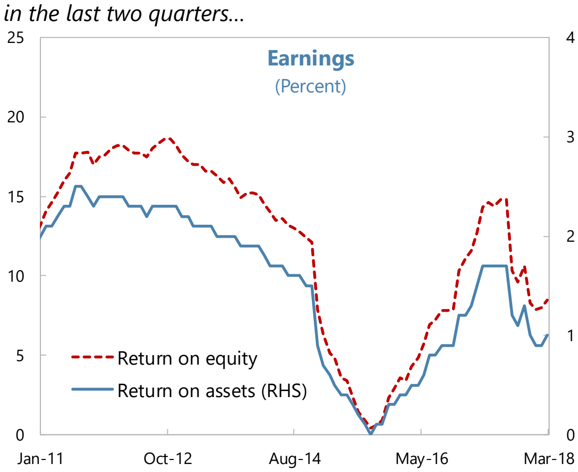
Retail and corporate credit growth are recovering…



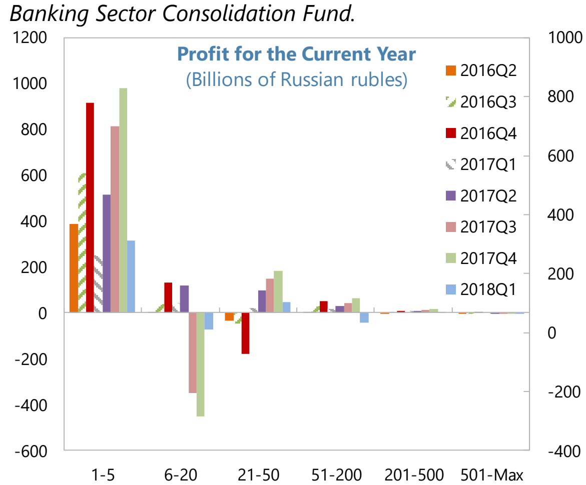
…while NPLs for the household sector are falling.



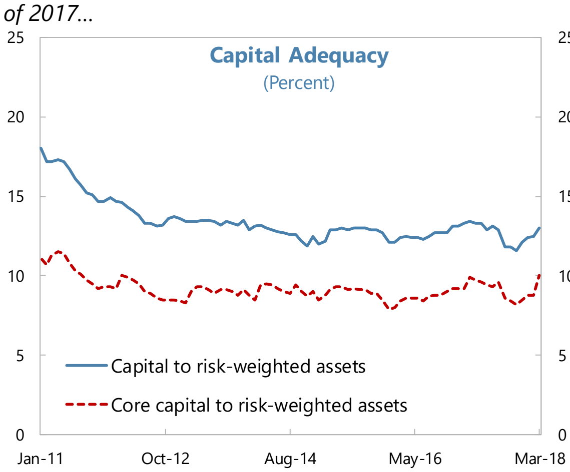
Banks' profitability is recovering as well, despite a decline in the last two quarters…



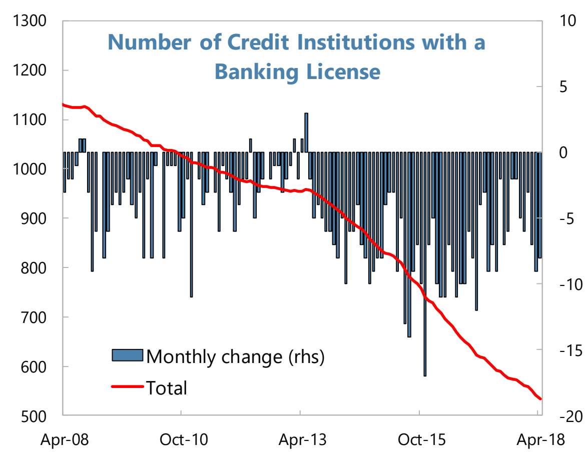
…as three large private banks were taken over by the new Banking Sector Consolidation Fund.



As a result, capital ratios dipped slightly towards the end of 2017…



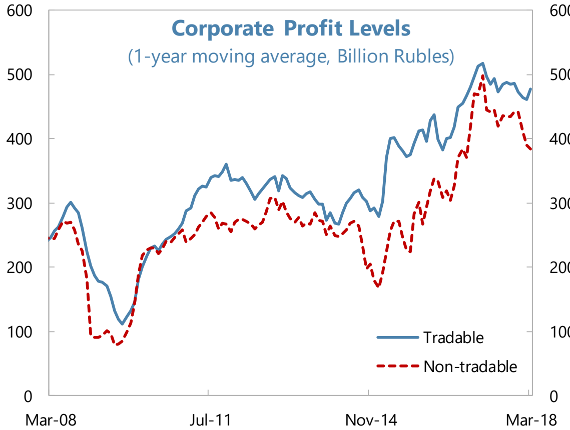
…while the CBR continues cleaning up the banking system.



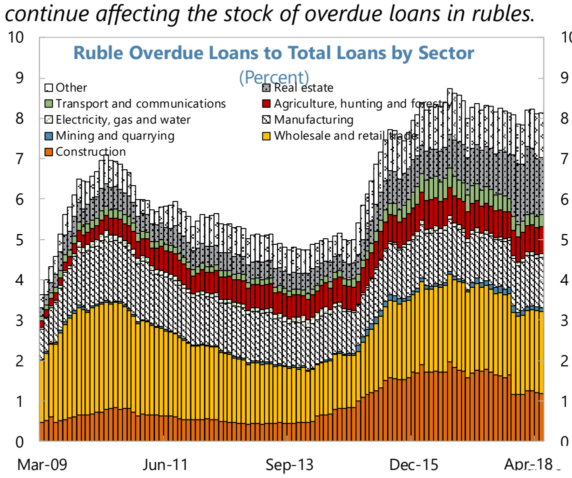
Sources: Central Bank of Russia; and IMF staff calculations.

Figure 6. Russian Federation: Macro-Financial Developments, 2008–18

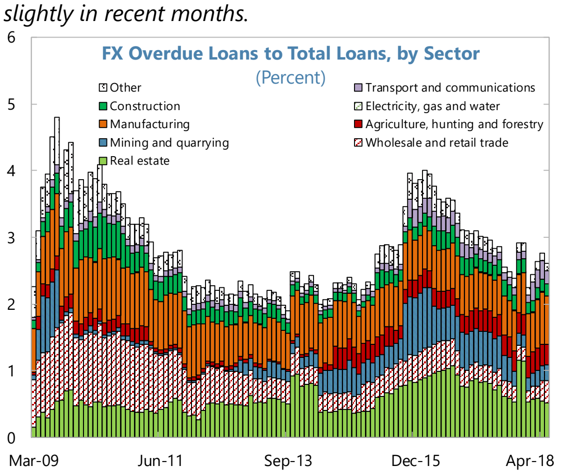
After a strong recovery, profitability of the non-tradable sector declined in Q4 of 2017…



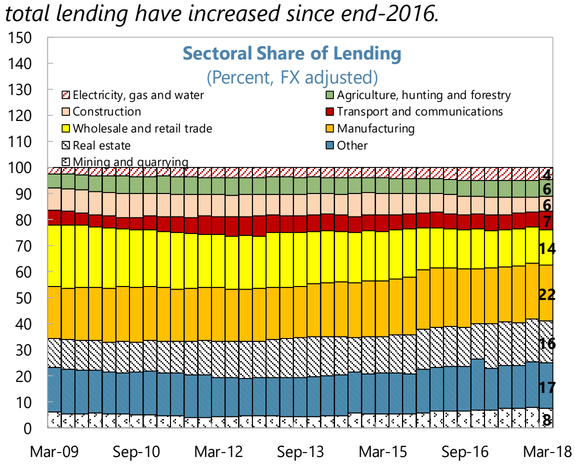
Legacy issues, especially for banks in open resolution, continue affecting the stock of overdue loans in rubles.



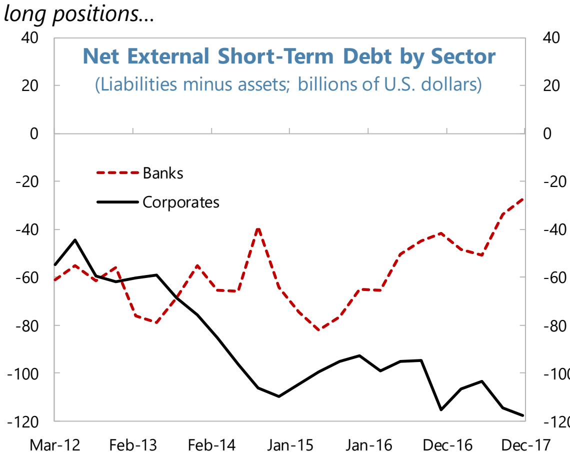
Overdue loans in FX declined in 2017, but have increased slightly in recent months.



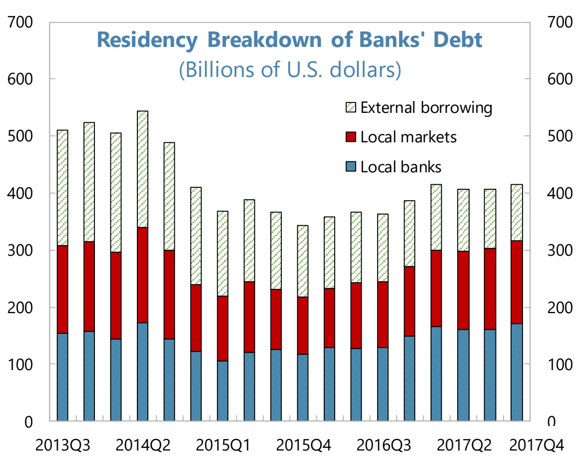
The shares of manufacturing, transport, and real estate in total lending have increased since end-2016.



FX risks for corporates and banks remain low given their long positions…



… while borrowing has remained relatively stable.



Sources: Central Bank of Russia; and IMF staff calculations.

Table 1. Russian Federation: Selected Macroeconomic Indicators, 2015–23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Projection					
				(Annual percent change)					
Production and prices									
Real GDP	-2.5	-0.2	1.5	1.7	1.5	1.5	1.5	1.5	1.5
Real domestic demand	-8.9	-1.9	3.7	1.8	1.3	1.3	1.3	1.3	1.3
Consumption	-7.8	-1.9	2.6	1.8	1.4	1.4	1.4	1.4	1.4
Investment	-12.3	-1.9	7.4	2.1	1.0	1.0	1.0	1.0	1.0
Consumer prices									
Period average	15.5	7.1	3.7	2.9	4.0	4.0	4.0	4.0	4.0
End of period	12.9	5.4	2.5	3.5	4.0	4.0	4.0	4.0	4.0
Core CPI									
Period average	16.3	7.5	3.5	2.9	3.7	3.7	3.7	3.7	3.7
End of period	13.6	6.0	2.1	3.7	3.7	3.7	3.7	3.7	3.7
GDP deflator	8.0	3.5	5.2	5.2	4.4	3.6	3.9	3.9	3.9
Unemployment rate	5.6	5.5	5.2	5.5	5.5	5.5	5.5	5.5	5.5
				(Percent of GDP)					
Public sector 1/									
General government									
Net lending/borrowing (overall balance)	-3.4	-3.6	-1.5	2.2	2.9	2.4	1.8	1.3	1.0
Revenue	31.8	32.7	33.3	36.2	35.3	34.8	34.5	34.3	34.1
Expenditures	35.1	36.4	34.8	33.9	32.4	32.4	32.7	33.0	33.1
Primary balance	-3.1	-3.2	-1.0	2.8	3.4	2.7	2.1	1.5	1.2
Nonoil balance	-11.3	-9.7	-8.7	-8.4	-6.8	-6.5	-6.6	-6.7	-6.6
Nonoil primary structural balance	-9.9	-9.0	-7.9	-7.8	-6.4	-6.2	-6.3	-6.5	-6.4
Federal government									
Net lending/borrowing (overall balance)	-2.3	-3.4	-1.4	2.4	3.0	2.5	1.9	1.4	1.1
Nonoil balance	-9.5	-9.0	-8.0	-7.2	-6.0	-5.8	-5.9	-6.0	-5.9
				(Annual percent change)					
Money									
Base money	-4.3	3.8	8.6	7.3	6.3	5.8	5.6	5.5	5.3
Ruble broad money	11.3	9.2	10.5	7.5	6.5	6.0	5.8	5.7	5.5
Credit to the economy	8.4	-1.6	7.7	7.1	6.7	6.5	6.3	6.1	6.0
External sector									
Export volumes	6.4	2.6	7.8	1.3	2.2	2.4	2.5	2.6	3.3
Oil	7.0	-1.2	-2.5	0.0	0.5	1.2	1.2	1.2	2.3
Gas	6.5	7.1	5.8	4.0	1.0	1.0	2.0	2.0	2.0
Non-energy	-8.0	-3.2	8.5	2.1	4.5	4.0	4.0	4.0	4.4
Import volumes	-25.2	1.5	11.4	5.0	1.8	1.6	1.8	1.7	2.5
				(Billions of U.S. dollars; unless otherwise indicated)					
External sector									
Total merchandise exports, f.o.b	341.4	281.8	353.0	435.7	442.0	447.2	456.1	467.6	476.1
Total merchandise imports, f.o.b	-193.0	-191.6	-238.0	-256.1	-263.9	-270.7	-278.2	-285.6	-295.3
External current account	67.7	24.4	35.2	99.6	96.9	84.7	82.2	81.3	76.8
External current account (percent of GDP)	4.9	1.9	2.2	6.1	5.7	4.9	4.7	4.5	4.1
Gross international reserves									
Billions of U.S. dollars	368.4	377.7	432.7	498.3	559.8	613.3	660.7	701.3	738.5
Months of imports 2/	15.7	17.0	15.9	17.0	18.5	19.8	20.7	21.5	21.8
Percent of short-term debt	441	423	434	512	565	638	679	716	757
Memorandum items:									
Nominal GDP (billions of rubles)	83,387	86,149	92,037	98,432	104,315	109,734	115,708	122,059	128,670
Nominal GDP (billions of U.S. dollars)	1,368	1,285	1,578	1,641	1,702	1,727	1,762	1,801	1,865
Real per capita GDP (2014=100)	97.4	97.2	98.7	100.3	101.9	103.5	105.2	106.9	108.7
Exchange rate (rubles per U.S. dollar, period average)	60.9	67.1	58.3	…	…	…	…	…	…
Oil exports (billions of U.S. dollars)	157.0	119.8	151.6	203.7	202.0	199.2	198.3	198.8	194.3
Brent oil price (U.S. dollars per barrel)	52.4	44.0	54.4	73.3	72.5	68.7	66.0	64.1	62.8
Urals crude oil spot price (U.S. dollars per barrel)	51.2	41.9	53.0	71.8	71.0	67.2	64.5	62.6	61.3
Real effective exchange rate (average percent change)	-17.4	-1.2	14.6	…	…	…	…	…	…

Sources: Russian authorities; and IMF staff estimates.

1/ Cash basis.

2/ In months of imports of goods and non-factor services.

Table 2. Russian Federation: Balance of Payments, 2015–23

(Billions of U.S. dollars, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Projection					
Current Account	67.7	24.4	35.2	99.6	96.9	84.7	82.2	81.3	76.8
Trade Balance	148.4	90.3	115.0	179.6	178.1	176.5	177.9	182.0	180.8
Exports	341.4	281.8	353.0	435.7	442.0	447.2	456.1	467.6	476.1
Non-energy	142.6	130.8	163.3	178.2	186.4	196.7	207.6	219.1	232.1
Energy	198.8	151.1	189.7	257.4	255.6	250.5	248.5	248.5	244.0
Oil	157.0	119.8	151.6	203.7	202.0	199.2	198.3	198.8	194.3
Gas	41.8	31.3	38.1	53.7	53.6	51.3	50.2	49.7	49.7
Imports	-193.0	-191.6	-238.0	-256.1	-263.9	-270.7	-278.2	-285.6	-295.3
Services	-37.3	-24.1	-31.1	-26.1	-27.7	-29.2	-30.3	-30.9	-32.9
Income	-37.7	-35.5	-39.5	-44.3	-43.5	-52.3	-54.6	-58.6	-59.4
Public sector interest (net)	0.1	-0.3	-0.4	1.4	1.5	-2.1	-3.4	-4.8	-6.2
Other sectors	-37.8	-35.2	-39.1	-45.7	-44.9	-50.2	-51.2	-53.8	-53.2
Current transfers	-5.7	-6.3	-9.2	-9.6	-9.9	-10.3	-10.7	-11.3	-11.7
Capital and financial account	-69.2	-11.6	-16.3	-34.1	-35.4	-31.2	-34.8	-40.7	-39.6
Capital transfers	-0.3	-0.8	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Financial accounts									
Federal government	-9.9	3.9	12.0	11.6	18.7	19.2	18.1	18.4	18.8
Portfolio investment	-6.9	5.2	15.5	13.6	20.6	21.1	20.0	20.2	20.6
Loans	-1.8	-0.3	-2.6	0.1	0.1	0.1	0.1	0.1	0.1
Other investment	-1.2	-0.9	-0.9	-2.1	-2.0	-2.0	-2.0	-2.0	-2.0
Local governments	0.1	-0.4	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Private sector capital	-60.7	-14.9	-27.3	-47.1	-55.3	-51.7	-54.2	-60.3	-59.6
Direct investment	-15.2	10.2	-10.7	-17.6	-17.5	-22.0	-27.5	-28.8	-30.2
Portfolio investment	-7.7	-3.5	-9.6	-10.8	-12.6	-13.2	-12.3	-12.8	-13.4
Other investment, commercial banks	-33.0	1.7	-24.9	-13.0	-9.8	-11.0	-12.4	-13.4	-13.2
Assets	27.5	30.5	0.3	-8.1	-7.5	-9.9	-13.5	-16.7	-16.5
Liabilities (loans, deposits, etc.)	-60.6	-28.8	-25.2	-4.9	-2.2	-1.1	1.1	3.3	3.3
Loans, corporations	21.0	-4.3	-3.6	-0.7	3.4	5.4	5.5	6.8	6.6
Disbursements	101.3	46.2	55.8	64.0	70.3	72.6	73.2	74.2	72.0
Amortizations	-80.3	-50.5	-59.4	-64.7	-67.0	-67.3	-67.7	-67.4	-65.4
Other private sector capital flows	-25.8	-19.0	21.5	-4.9	-18.8	-10.8	-7.5	-12.1	-9.5
Errors and omissions, net	3.3	-4.5	3.8	0.0	0.0	0.0	0.0	0.0	0.0
Of which: valuation adjustment	18.8	-1.1	-32.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	1.7	8.2	22.6	65.5	61.6	53.5	47.5	40.6	37.2
Financing	-1.7	-8.2	-22.6	-65.5	-61.6	-53.5	-47.5	-40.6	-37.2
Net international reserves	-1.7	-8.2	-22.6	-65.5	-61.6	-53.5	-47.5	-40.6	-37.2
Arrears and rescheduling	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Current account (percent of GDP)	4.9	1.9	2.2	6.1	5.7	4.9	4.7	4.5	4.1
Non-energy current account (percent of GDP)	-9.6	-9.9	-9.8	-9.6	-9.3	-9.6	-9.4	-9.3	-9.0
Gross reserves 1/	368.4	377.7	432.7	498.3	559.8	613.3	660.7	701.3	738.5
(months of imports of GNFS)	15.7	17.0	15.9	17.0	18.5	19.8	20.7	21.5	21.8
(percent of short-term debt) 2/	441.0	422.7	434.1	511.7	564.8	637.5	678.5	716.0	756.7
Real growth in partner countries (percent change)	2.3	2.4	3.5	3.3	3.1	2.8	2.7	2.7	2.7
Net private capital flows (percent of exports of GNFS)	-15.4	-4.5	-6.6	-9.3	-10.8	-9.9	-10.2	-11.1	-10.8
Net private capital flows, banks	-30.3	5.5	-21.0	-9.0	-5.6	-6.9	-8.3	-9.3	-9.1
Public external debt service payments 3/	5.5	6.6	7.7	7.4	7.3	14.3	13.3	16.6	19.1
(percent of exports of goods and services)	1.4	2.0	1.9	1.5	1.4	2.8	2.5	3.1	3.5
Public external debt 4/	42.2	51.2	70.3	84.1	104.8	126.0	146.1	166.5	187.2
(percent of GDP)	3.1	4.0	4.5	5.1	6.2	7.3	8.3	9.3	10.1
Private external debt	476.3	460.5	448.6	445.5	451.3	459.7	470.5	485.4	500.4
(percent of GDP)	34.8	35.8	28.4	27.1	26.7	26.8	26.8	27.1	27.0
Total external debt	518.5	511.7	518.9	529.6	556.1	585.7	616.6	651.8	687.6
(percent of GDP)	37.9	39.8	32.9	32.3	32.8	34.1	35.2	36.4	37.0
Brent oil price (U.S. dollars per barrel)	52.4	44.0	54.4	73.3	72.5	68.7	66.0	64.1	62.8
Urals oil price (U.S. dollars per barrel)	51.2	41.9	53.0	71.8	71.0	67.2	64.5	62.6	61.3
Terms of trade (percent)	-18.1	-14.5	13.8	18.9	-2.0	-2.1	-1.4	-0.9	-2.3

Sources: Central Bank of Russia; and IMF staff estimates.

1/ Excluding repos with non-residents to avoid double counting of reserves. Including valuation effects.

2/ Excludes arrears.

3/ Net of rescheduling.

4/ Includes repo indebtedness by the monetary authorities.

Table 3. Russian Federation: External Financing Requirements and Sources, 2018–23

(Billions of U.S. dollars)

	2018	2019	2020	2021	2022	2023
			Projection			
Gross financing requirements	6	6	-8	-8	-10	-13
Current account balance	100	97	85	82	81	77
Debt amortization	-94	-91	-93	-90	-91	-90
Public sector	-4	-2	-4	0	-2	-2
Central Bank						
General government	-4	-2	-4	0	-2	-2
Banks	-25	-23	-22	-22	-22	-22
Corporates	-65	-67	-67	-68	-67	-65
Sources of financing	60	56	62	55	51	50
Capital account balance (net)	0	0	0	0	0	0
Foreign direct investment (net)	-18	-18	-22	-27	-29	-30
RUS investment abroad	-48	-51	-58	-67	-72	-78
Foreign investment in RUS	31	33	36	40	44	48
New borrowing and debt rollover	85	96	102	100	105	104
Borrowing	85	96	102	100	105	104
Public sector	1	6	8	4	5	6
Central Bank						
General government	1	6	8	4	5	6
Banks	20	20	21	23	25	25
Corporates	64	70	73	73	74	72
Other	-8	-23	-18	-17	-25	-23
of which: Net errors and omissions	0	0	0	0	0	0
GIR change	66	62	53	47	41	37
Financing gap	0	0	0	0	0	0

Sources: Central Bank of Russia; and IMF staff estimates.

Table 4. Russian Federation: Fiscal Operations, 2015–23[1]

(Percent of GDP, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Projection					
General government									
Revenue	31.8	32.7	33.3	36.2	35.3	34.8	34.5	34.3	34.1
o/w Oil revenue	7.9	6.1	7.3	10.6	9.7	8.9	8.4	8.0	7.6
o/w Nonoil revenue	23.9	26.6	26.0	25.6	25.6	25.8	26.1	26.3	26.4
Taxes	22.8	22.0	24.2	27.2	26.2	25.5	25.0	24.7	24.4
Corporate profit tax	3.1	3.2	3.6	4.0	3.6	3.5	3.5	3.5	3.5
Personal income tax	3.4	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
VAT	5.1	5.3	5.6	5.5	5.5	5.5	5.6	5.6	5.7
Excises	1.3	1.6	1.7	1.6	1.5	1.5	1.6	1.6	1.6
Custom tariffs	4.0	3.0	2.8	3.6	3.5	3.3	3.1	3.0	3.0
Resource extraction tax	4.1	3.7	4.9	7.0	6.7	6.2	5.8	5.5	5.2
Other tax revenue	1.9	1.6	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Social contributions	6.4	7.0	7.1	6.9	6.9	7.0	7.0	7.1	7.2
Other revenue	2.6	3.7	2.0	2.1	2.2	2.3	2.4	2.5	2.5
Expenditure	35.1	36.4	34.8	33.9	32.4	32.4	32.7	33.0	33.1
Expense	30.6	31.6	31.0	30.3	29.0	29.0	29.3	29.6	29.6
Compensation of employees	4.3	4.3	4.1	4.0	3.9	3.9	3.8	3.8	3.8
Use of goods and services	3.3	3.4	3.0	2.9	2.7	2.7	2.8	2.8	2.8
Interest	0.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Subsidies	6.9	7.2	7.5	7.2	6.8	6.8	6.8	6.9	6.9
Grants	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social benefits	13.2	13.8	13.7	13.5	13.1	12.9	12.9	13.0	13.0
Other expense	1.9	1.8	1.6	1.7	1.5	1.7	1.8	2.0	2.0
Net acquisition of nonfinancial assets	4.6	4.7	3.8	3.6	3.4	3.4	3.4	3.4	3.4
Net lending (+)/borrowing (-) (overall balance)	-3.4	-3.6	-1.5	2.2	2.9	2.4	1.8	1.3	1.0
Non-oil primary structural balance	-9.9	-9.0	-7.9	-7.8	-6.4	-6.2	-6.3	-6.5	-6.4
Gross financing requirements	7.4	8.3	5.3	-1.4	-1.8	-1.2	-0.7	-0.2	-0.1
Federal government 3/									
Revenue	16.4	15.6	16.4	19.2	18.7	18.1	17.7	17.5	17.2
o/w Oil revenue	7.1	5.6	6.6	9.5	9.0	8.3	7.8	7.4	7.0
o/w Nonoil revenue	9.3	10.0	9.8	9.7	9.7	9.8	10.0	10.1	10.2
Expenditure	18.7	19.1	17.8	16.9	15.7	15.6	15.9	16.1	16.1
Expense	15.5	15.6	15.3	14.4	13.4	13.4	13.6	13.8	13.8
Net acquisition of nonfinancial assets	3.2	3.4	2.6	2.4	2.3	2.3	2.3	2.3	2.3
Net lending (+)/borrowing (-) (overall balance)	-2.3	-3.4	-1.4	2.4	3.0	2.5	1.9	1.4	1.1
Non-oil primary structural balance	-8.9	-8.4	-7.2	-6.5	-5.4	-5.3	-5.5	-5.6	-5.5
Gross financing requirements	3.6	4.2	2.6	-2.0	-2.2	-1.7	-1.1	-0.6	-0.4
Memorandum items:									
General government nonoil primary balance	-11.0	-9.3	-8.2	-7.8	-6.4	-6.2	-6.3	-6.5	-6.4
General government nonoil overall balance	-11.3	-9.7	-8.7	-8.4	-6.8	-6.5	-6.6	-6.7	-6.6
Federal government nonoil primary balance	-9.2	-8.6	-7.5	-6.5	-5.4	-5.3	-5.5	-5.6	-5.5
Federal government nonoil overall balance	-9.5	-9.0	-8.0	-7.2	-6.0	-5.8	-5.9	-6.0	-5.9
World oil price (U.S. dollars per barrel)	50.8	42.8	52.8	70.2	69.0	65.0	62.1	60.1	58.8
Urals prices (U.S. dollars per barrel)	51.2	41.9	53.0	71.8	71.0	67.2	64.5	62.6	61.3
Oil funds 2/	10.6	6.2	4.1	8.0	11.5	14.4	16.9	18.6	20.1
General government debt	16.3	16.1	15.5	16.1	15.6	15.5	15.6	15.8	16.0
GDP (billions of rubles)	83,387	86,149	92,037	98,432	104,315	109,734	115,708	122,059	128,670

Sources: Russian authorities; and IMF staff estimates.

1/ Cash basis.

2/ Balances reflect staff estimates based on projected oil savings.

3/ Expenditures reflect the authorities budget; oil revenues are Staff's estimates.

Table 5. Russian Federation: Monetary Accounts, 2015–23

(Billions of Russian rubles, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Projection					
Monetary authorities									
Base money	8,746	9,076	9,854	10,570	11,233	11,881	12,543	13,231	13,930
Currency issued	8,522	8,790	9,539	10,231	10,873	11,498	12,139	12,803	13,479
Required reserves on ruble deposits	224	286	315	339	361	382	405	428	451
NIR 1/	26,255	22,418	24,520	29,770	34,447	39,110	43,558	47,431	50,976
Gross reserves	26,850	22,918	24,986	30,236	34,913	39,577	44,024	47,897	51,442
Gross liabilities	595	501	466	466	466	466	466	466	466
GIR (billions of U.S. dollars)	*368*	*378*	*434*	*499*	*561*	*614*	*662*	*702*	*740*
NDA	-17,509	-13,341	-14,666	-19,200	-23,214	-27,230	-31,015	-34,200	-37,045
Net credit to general government	-9,182	-6,254	-5,609	-9,034	-12,355	-15,457	-18,339	-20,905	-23,375
Net credit to federal government	-8,019	-5,031	-4,725	-8,692	-12,545	-16,010	-19,186	-21,976	-24,582
CBR net ruble credit to federal government 1/	-798	-1,373	-1,711	-1,513	-1,281	-862	-344	147	605
Foreign exchange credit	276	222	202	202	202	202	202	202	202
Ruble counterpart	-7,497	-3,881	-3,216	-7,381	-11,466	-15,350	-19,045	-22,325	-25,388
CBR net credit to local government and EBFs	-1,163	-1,222	-884	-342	190	553	848	1,071	1,207
CBR net credit to local government	-759	-864	-640	-97	435	797	1,092	1,315	1,451
CBR net credit to extrabudgetary funds	-404	-359	-244	-244	-244	-244	-244	-244	-244
Net credit to banks	2,289	54	-2,167	-1,067	-50	1,277	2,950	4,657	6,765
Gross credit to banks	4,441	2,723	2,632	800	900	950	950	952	954
Gross liabilities to banks and deposits	-2,152	-2,669	-4,800	-1,867	-950	327	2,000	3,705	5,811
Of which: correspondent account balances	-1,594	-1,823	-1,931	-1,827	-1,946	-2,063	-2,182	-2,307	-2,434
Other items (net) 2/	-10,617	-7,142	-6,889	-9,099	-10,810	-13,050	-15,627	-17,953	-20,435
Monetary survey									
Broad money	51,371	50,903	54,667	58,768	62,216	65,556	68,962	72,488	76,062
Ruble broad money	35,180	38,418	42,442	45,626	48,596	51,507	54,494	57,600	60,768
Currency in circulation	7,239	7,715	8,446	9,080	9,671	10,250	10,844	11,463	12,093
Ruble deposits	27,941	30,703	33,996	36,546	38,925	41,257	43,650	46,138	48,675
Forex deposits 1/	16,191	12,485	12,225	13,142	13,620	14,049	14,468	14,888	15,294
Net foreign assets 1/	32,900	27,449	29,744	34,715	39,179	43,562	47,602	50,943	53,923
NIR of monetary authorities	26,255	22,418	24,520	29,770	34,447	39,110	43,558	47,431	50,976
NFA of commercial banks	6,645	5,031	5,223	4,945	4,731	4,451	4,044	3,511	2,948
NFA of commercial banks (billions of U.S. dollars)	91	83	91	82	76	69	61	51	42
NDA	18,471	23,454	24,924	24,053	23,037	21,994	21,360	21,546	22,139
Domestic credit	46,127	48,454	52,032	53,530	54,237	55,445	57,399	59,922	63,009
Net credit to general government	-5,648	-2,491	-2,831	-5,236	-8,454	-11,306	-13,565	-15,353	-16,807
Credit to the economy	51,775	50,944	54,864	58,766	62,691	66,751	70,964	75,275	79,815
Other items (net)	-27,656	-25,000	-27,109	-29,477	-31,200	-33,451	-36,039	-38,376	-40,869
Memorandum items:									
Accounting exchange rate (ruble per U.S. dollar, eop)	72.9	60.7	57.6	…	…	…	…	…	…
Nominal GDP (billions of rubles)	83,387	86,149	92,037	98,432	104,315	109,734	115,708	122,059	128,670
CPI inflation (12-month change, eop)	12.9	5.4	2.5	3.5	4.0	4.0	4.0	4.0	4.0
Ruble broad money velocity (eop)	2.3	2.3	2.2	2.2	2.1	2.1	2.1	2.1	2.1
Ruble broad money velocity (eop, s.a.)	2.4	2.4	2.3	2.3	2.2	2.2	2.2	2.2	2.2
Annual change in velocity	-7.0	-1.2	-4.5	-1.9	-0.5	-0.7	-0.3	-0.2	12.0
Real ruble broad money (rel. to CPI, 12-month change)	-1.4	3.6	7.8	3.9	2.4	1.9	1.7	1.6	1.4
Nominal ruble broad money (12-month change)	11.3	9.2	10.5	7.5	6.5	6.0	5.8	5.7	5.5
Base money (12-month change)	-4.3	3.8	8.6	7.3	6.3	5.8	5.6	5.5	5.3
Real credit to the economy (12-month change)	-4.0	-6.6	5.0	3.5	2.6	2.4	2.2	2.0	2.0
Ruble broad money multiplier	4.0	4.2	4.3	4.3	4.3	4.3	4.3	4.4	4.4

Sources: Russian authorities; and IMF staff estimates.

1/ Data calculated at accounting exchange rates.
2/ Inclusive of valuation gains and losses on holdings of government securities.

Table 6. Russian Federation: Medium-Term Framework, 2015–23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Projection					
	(Percent of GDP, unless otherwise indicated)								
Macroeconomic framework									
GDP growth at constant prices (percent)	-2.5	-0.2	1.5	1.7	1.5	1.5	1.5	1.5	1.5
Consumer prices (percent change, end of period)	12.9	5.4	2.5	3.5	4.0	4.0	4.0	4.0	4.0
Gross domestic investment	21.9	22.8	23.9	21.8	22.0	22.2	22.0	21.7	22.2
Private sector	18.0	18.6	20.5	18.6	19.0	19.1	19.0	18.7	19.1
Public sector	3.9	4.2	3.4	3.2	3.0	3.0	3.1	3.1	3.1
Gross national savings	26.8	24.7	26.1	28.0	27.7	27.0	26.7	26.3	26.3
Private sector	26.3	24.2	24.2	22.5	21.8	21.7	21.9	22.0	22.2
Public sector	0.5	0.6	1.9	5.4	5.9	5.4	4.8	4.3	4.1
External current account balance	4.9	1.9	2.2	6.1	5.7	4.9	4.7	4.5	4.1
Fiscal Operations									
Federal government									
Net lending/borrowing (overall balance)	-2.3	-3.4	-1.4	2.4	3.0	2.5	1.9	1.4	1.1
Nonoil balance	-9.5	-9.0	-8.0	-7.2	-6.0	-5.8	-5.9	-6.0	-5.9
General government									
Net lending/borrowing (overall balance)	-3.4	-3.6	-1.5	2.2	2.9	2.4	1.8	1.3	1.0
Revenue	31.8	32.7	33.3	36.2	35.3	34.8	34.5	34.3	34.1
Expenditure	35.1	36.4	34.8	33.9	32.4	32.4	32.7	33.0	33.1
Nonoil balance	-11.3	-9.7	-8.7	-8.4	-6.8	-6.5	-6.6	-6.7	-6.6
Primary balance	-3.1	-3.2	-1.0	2.8	3.4	2.7	2.1	1.5	1.2
Gross debt	16.3	16.1	15.5	16.1	15.6	15.5	15.6	15.8	16.0
	(Billions of U.S dollars; unless otherwise indicated)								
Balance of payments									
Current account	67.7	24.4	35.2	99.6	96.9	84.7	82.2	81.3	76.8
Trade balance	148.4	90.3	115.0	179.6	178.1	176.5	177.9	182.0	180.8
Exports (f.o.b)	341.4	281.8	353.0	435.7	442.0	447.2	456.1	467.6	476.1
Of which: energy	198.8	151.1	189.7	257.4	255.6	250.5	248.5	248.5	244.0
Imports (f.o.b)	-193.0	-191.6	-238.0	-256.1	-263.9	-270.7	-278.2	-285.6	-295.3
Services and transfers, net	-43.0	-30.3	-40.3	-35.6	-37.7	-39.5	-41.1	-42.1	-44.6
Capital and financial account	-69.2	-11.6	-16.3	-34.1	-35.4	-31.2	-34.8	-40.7	-39.6
Capital account	-0.3	-0.8	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-68.9	-10.9	-16.1	-34.1	-35.4	-31.2	-34.8	-40.7	-39.6
Private sector capital	-60.7	-14.9	-27.3	-47.1	-55.3	-51.7	-54.2	-60.3	-59.6
Errors and omissions	3.3	-4.5	3.8	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	1.7	8.2	22.6	65.5	61.6	53.5	47.5	40.6	37.2
Memorandum items:									
Gross reserves (end of period)									
Billions of U.S. dollars	368.4	377.7	432.7	498.3	559.8	613.3	660.7	701.3	738.5
Percent of short-term debt (residual maturity)	441.0	422.7	434.1	511.7	564.8	637.5	678.5	716.0	756.7
Months of prospective GNFS imports	15.7	17.0	15.9	17.0	18.5	19.8	20.7	21.5	21.8
Trade balance (percent of GDP)	10.8	7.0	7.3	10.9	10.5	10.2	10.1	10.1	9.7
Terms of trade (y-o-y change, percent)	-18.1	-14.5	13.8	18.9	-2.0	-2.1	-1.4	-0.9	-2.3
Excluding fuel	7.2	-3.2	11.1	4.3	-1.2	0.6	0.6	0.6	0.6
Export volume, goods (y-o-y change, percent)	6.4	2.6	7.8	1.3	2.2	2.4	2.5	2.6	3.3
Import volume, goods (y-o-y change, percent)	-25.2	1.5	11.4	5.0	1.8	1.6	1.8	1.7	2.5
Brent oil price (U.S. dollars per barrel)	52.4	44.0	54.4	73.3	72.5	68.7	66.0	64.1	62.8
Output gap	-1.6	-1.0	-0.3	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Russian authorities; and IMF staff estimates.

Table 7. Russian Federation: Financial Soundness Indicators, 2014–17

	2014	2015	2016	2017
Financial Soundness Indicators				
Capital adequacy				
Capital to risk-weighted assets	12.5	12.7	13.1	12.1
Tier 1 capital to risk-weighted assets	9.0	8.5	9.2	8.5
Credit risk				
NPLs to total loans	6.7	8.3	9.4	10.0
Loan loss provisions to total loans	6.5	7.8	8.5	9.3
Large credit risks to capital	246	254	220	226.1
Distribution of loans provided by credit institutions				
Agriculture, hunting and forestry	3.5	3.5	4.0	4.1
Mining	4.2	4.9	5.6	6.2
Manufacturing	15.5	17.1	15.4	15.3
Production and distribution of energy, gas and water	2.5	2.5	3.1	3.2
Construction	5.3	4.8	4.5	3.9
Wholesale and retail trade	13.3	11.3	10.9	9.5
Transport and communication	4.4	4.2	4.2	4.2
Other economic activities	21.2	24.1	23.1	22.6
Individuals	30.1	27.5	29.1	30.9
Of which: mortgage loans	9.4	10.1	12.1	0.0
Geographical distribution of interbank loans and deposits				
Russian Federation	53.6	54.0	68.8	73.0
United Kingdom	13.9	12.3	7.5	5.5
USA	4.9	4.5	3.2	1.7
Germany	0.4	0.8	0.3	0.2
Austria	7.3	4.9	1.1	0.7
France	1.8	1.8	1.4	1.2
Italy	0.0	0.0	2.0	2.2
Cyprus	4.9	9.2	5.3	5.9
Netherlands	1.3	0.8	0.5	0.7
Other	11.8	11.8	9.9	9.0
Liquidity				
Highly liquid assets to total assets	10.4	10.6	10.5	11.0
Liquid assets to total assets	22.0	24.6	21.8	23.2
Liquid assets to short-term liabilities	80.4	139.3	144.9	118.5
Ratio of client's funds to total loans	92.8	59.0	107.5	111.1
Return on assets	0.9	0.3	1.2	1.0
Return on equity	7.9	2.3	10.3	8.3
Balance Sheet Structure, in percent of assets				
Total asset growth rate	35.2	6.9	-3.5	6.4
Asset side				
Accounts with CBR and other central banks	4.2	3.0	3.8	5.6
Interbank lending	8.9	10.4	11.4	11.5
Securities holdings	12.5	14.2	14.3	14.5
Liability side				
Funds from CBR	12.0	6.5	3.4	2.4
Interbank liabilities	8.5	8.5	10.7	10.9
Individual deposits	23.9	28.0	30.2	30.5

Sources: Central Bank of Russia; and IMF staff calculations.

Table 8. Russian Federation: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

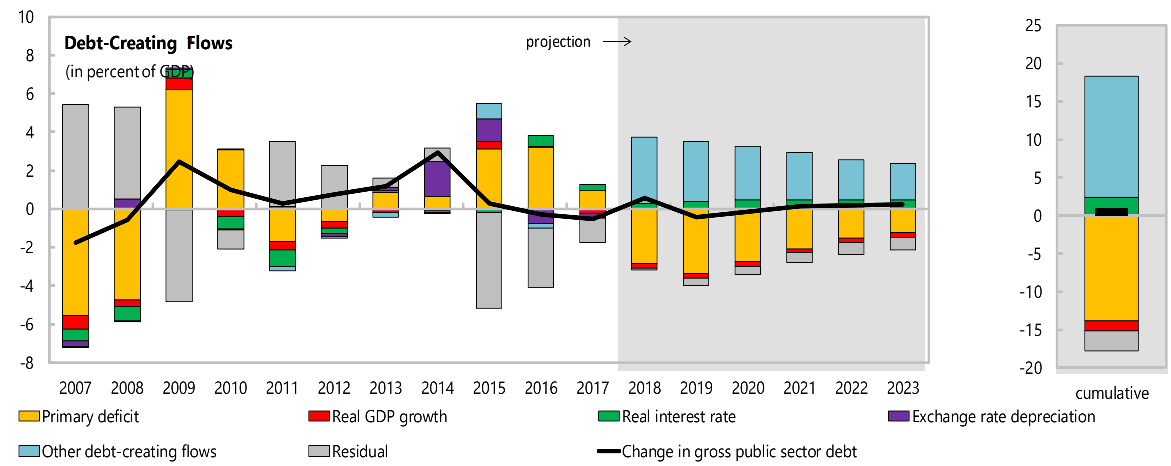
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections						As of June 07, 2018		
	2007-2015 [2]	2016	2017	2018	2019	2020	2021	2022	2023			
Nominal gross public debt	11.6	16.1	15.5	16.1	15.6	15.5	15.6	15.8	16.0	Sovereign Spreads		
Of which: guarantees	1.6	3.2	2.3	2.4	2.4	2.4	2.3	2.3	2.3	EMBIG (bp) 3/		161
Public gross financing needs	2.1	8.3	5.3	-1.4	-1.8	-1.2	-0.7	-0.2	-0.1	5Y CDS (bp)		150
Real GDP growth (in percent)	2.1	-0.2	1.5	1.7	1.5	1.5	1.5	1.5	1.5	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	10.4	3.5	5.2	5.2	4.4	3.6	3.9	3.9	3.9	Moody's	Ba1	Ba1
Nominal GDP growth (in percent)	12.9	3.3	6.8	6.9	6.0	5.2	5.4	5.5	5.4	S&Ps	BBB-	BBB-
Effective interest rate (in percent) [4]	6.8	7.2	7.3	7.1	6.9	6.8	7.0	7.1	7.1	Fitch	BBB-	BBB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing
Change in gross public sector debt	0.7	-0.3	-0.5	0.6	-0.5	-0.1	0.1	0.2	0.2	0.5	primary
Identified debt-creating flows	0.0	2.8	0.8	0.7	-0.1	0.3	0.6	0.8	0.9	3.2	balance [9]
Primary deficit	0.1	3.2	1.0	-2.8	-3.4	-2.7	-2.1	-1.5	-1.2	-13.8	2.2
Primary (noninterest) revenue and grants	33.7	32.2	32.9	35.9	34.9	34.3	33.9	33.6	33.4	206.0	
Primary (noninterest) expenditure	33.8	35.5	33.9	33.1	31.6	31.5	31.8	32.1	32.1	192.2	
Automatic debt dynamics [5]	-0.1	-0.1	-0.1	0.0	0.1	0.2	0.2	0.2	0.3	1.1	
Interest rate/growth differential [6]	-0.5	0.6	0.1	0.0	0.1	0.2	0.2	0.2	0.3	1.1	
Of which: real interest rate	-0.3	0.6	0.3	0.3	0.4	0.5	0.4	0.5	0.5	2.5	
Of which: real GDP growth	-0.2	0.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.4	
Exchange rate depreciation [7]	0.4	-0.8	-0.2	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	-0.3	-0.1	3.5	3.2	2.8	2.5	2.1	1.9	15.9	
General Government: Net privatization Proceeds (negative)	-0.1	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Change in cash balance of EBF	0.1	0.2	0.0	-0.6	-0.5	-0.3	-0.3	-0.2	-0.1	-1.9	
Transfers to RF and NWF	0.0	0.0	0.0	4.0	3.7	3.1	2.7	2.3	2.0	17.9	
Residual, including asset changes [8]	0.7	-3.1	-1.3	-0.1	-0.4	-0.4	-0.5	-0.6	-0.7	-2.7	



Source: IMF staff estimates.

1/ Public sector is defined as general government and includes federal guarantees.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

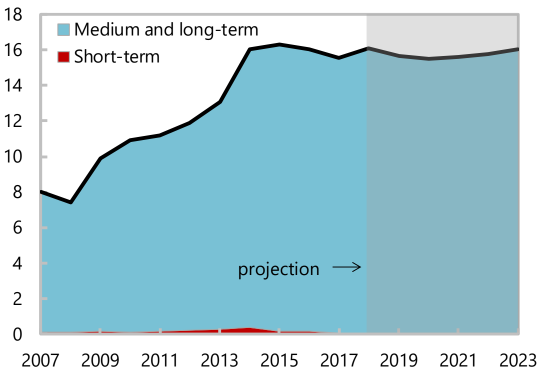
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 9. Russian Federation: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

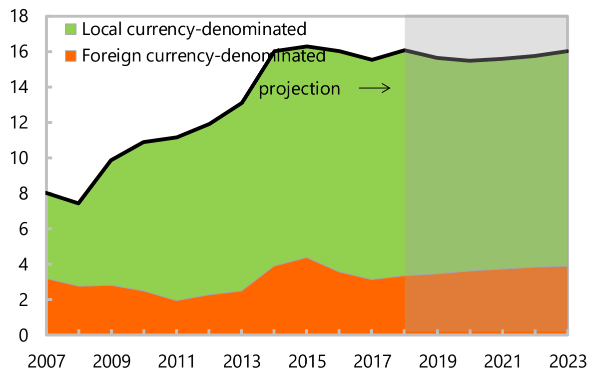
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

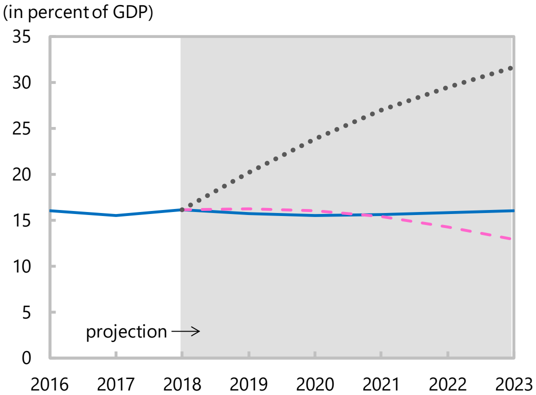


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

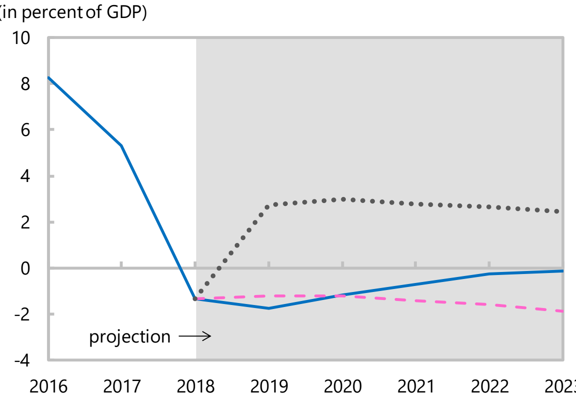
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	1.7	1.5	1.5	1.5	1.5	1.5
Inflation	5.2	4.4	3.6	3.9	3.9	3.9
Primary Balance	2.8	3.4	2.7	2.1	1.5	1.2
Effective interest rate	7.1	6.9	6.8	7.0	7.1	7.1
Constant Primary Balance Scenario						
Real GDP growth	1.7	1.5	1.5	1.5	1.5	1.5
Inflation	5.2	4.4	3.6	3.9	3.9	3.9
Primary Balance	2.8	2.8	2.8	2.8	2.8	2.8
Effective interest rate	7.1	6.9	6.8	7.0	7.1	7.1

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	1.7	1.2	1.2	1.2	1.2	1.2
Inflation	5.2	4.4	3.6	3.9	3.9	3.9
Primary Balance	2.8	-1.1	-1.1	-1.1	-1.1	-1.1
Effective interest rate	7.1	6.9	5.4	4.8	4.4	4.0

Source: IMF staff estimates.

Table 10. Russian Federation: External Debt Sustainability Framework, 2013–23

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2013	2014	2015	2016	2017			2018	2019	2020	2021	2022	2023	Debt-stabilizing non-interest current account 6/
Baseline: External debt	31.7	29.1	37.9	39.8	32.9			**32.3**	**32.6**	**33.8**	**34.9**	**36.1**	**36.8**	**-0.8**
Change in external debt	2.9	-2.7	8.8	1.9	-6.9			-0.6	0.3	1.2	1.1	1.2	0.7	
Identified external debt-creating flows (4+8+9)	-0.5	0.9	9.5	4.1	-7.5			-5.6	-4.4	-3.0	-2.7	-2.4	-1.9	
Current account deficit, excluding interest payments	-0.1	-1.4	-3.3	-0.3	-1.4			-5.0	-4.3	-3.1	-2.7	-2.4	-1.9	
Deficit in balance of goods and services	-46.2	-48.0	-49.3	-46.6	-46.8			-52.2	-51.3	-51.5	-51.6	-51.8	-51.3	
Exports	25.8	27.3	28.7	25.9	26.0			30.8	30.1	30.0	30.0	30.1	29.6	
Imports	-20.4	-20.8	-20.6	-20.7	-20.7			-21.4	-21.2	-21.5	-21.6	-21.7	-21.7	
Net non-debt creating capital inflows (negative)	-0.4	-1.1	-0.7	0.9	-0.7			-1.1	-1.0	-1.3	-1.6	-1.6	-1.6	
Automatic debt dynamics 1/	0.0	3.4	13.4	3.5	-5.4			0.5	0.9	1.4	1.5	1.6	1.6	
Contribution from nominal interest rate	1.3	1.4	1.7	1.6	0.9			1.0	1.4	1.8	2.0	2.1	2.2	
Contribution from real GDP growth	-0.5	-0.2	1.1	0.1	-0.5			-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	
Contribution from price and exchange rate changes 2/	-0.8	2.2	10.7	1.8	-5.8			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	3.5	-3.6	-0.7	-2.2	0.5			5.0	4.7	4.2	3.8	3.6	2.6	
External debt-to-exports ratio (in percent)	123.1	106.6	131.9	153.9	126.3			104.8	108.4	112.8	116.4	120.0	124.2	
Gross external financing need (in billions of US dollars) 4/	229.0	203.7	106.2	100.4	81.8			34.4	47.7	77.9	84.2	91.5	100.1	
in percent of GDP	10.0	9.9	7.8	7.8	5.2	10-Year	10-Year	2.1	2.8	4.5	4.8	5.1	5.4	
Scenario with key variables at their historical averages 5/								**32.3**	**36.0**	**38.3**	**40.4**	**42.4**	**43.9**	**0.2**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	1.8	0.7	-2.5	-0.2	1.5	1.2	4.0	1.7	1.5	1.5	1.5	1.5	1.5	
GDP deflator in US dollars (change in percent)	2.1	-10.8	-32.0	-5.9	20.9	1.8	18.9	2.3	2.4	0.0	0.5	0.7	2.0	
Nominal external interest rate (in percent)	4.8	4.0	3.8	4.0	2.7	4.3	0.7	3.3	4.5	5.7	6.0	6.1	6.2	
Growth of exports (US dollar terms, in percent)	0.4	-5.0	-30.1	-15.4	23.6	3.4	25.1	23.0	1.5	1.2	2.0	2.6	1.9	
Growth of imports (US dollar terms, in percent)	5.6	-8.7	-34.3	-5.6	22.8	4.3	24.2	7.6	3.1	2.6	2.8	2.7	3.4	
Current account balance, excluding interest payments	0.1	1.4	3.3	0.3	1.4	2.2	1.4	5.0	4.3	3.1	2.7	2.4	1.9	
Net non-debt creating capital inflows	0.4	1.1	0.7	-0.9	0.7	0.1	0.9	1.1	1.0	1.3	1.6	1.6	1.6	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,

e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

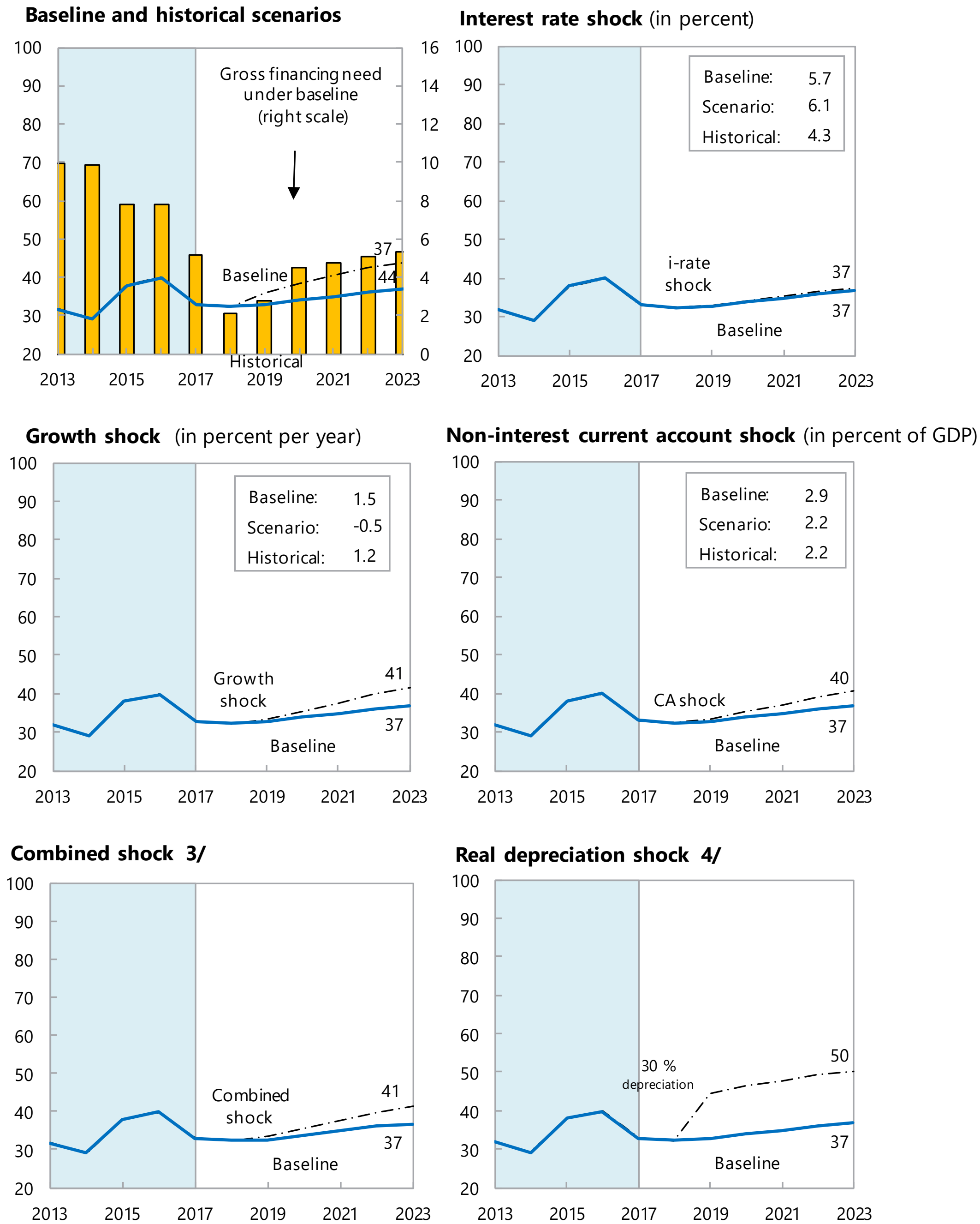
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 11. Russian Federation: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2010.

Annex I. Implementation of Past IMF Recommendations

During the 2017 Article IV consultation, Directors commended the authorities' effective policy response which helped exit a two-year recession. They emphasized that in order to sustain the fiscal adjustment, it should be underpinned by a credible fiscal rule, durable and well-targeted measures, and growth-enhancing spending. Directors encouraged further efforts to increase the resilience of the financial system. They stressed the need to reduce the economy's dependence on oil and rekindle structural reforms to support new sources of growth and overcome demographic challenges.

Key recommendations	**Implementation status**
Fiscal Policy	
Implement a well-designed fiscal rule to anchor consolidation efforts, re-build buffers, and contain Dutch Disease.	**Substantial progress.** The new fiscal rule is expected to fully come into force in 2019, and requires a zero primary balance at the conservative benchmark oil price of $40 per barrel. However, the design of the rule could have been improved further by incorporating oil futures prices, increasing the fiscal target to ensure intergenerational equity, and adding an expenditure target.
Improve the quality of fiscal adjustment measures. Implement parametric pension reform, including raising the statutory retirement age. Improve the balance between current and capital spending.	**Some progress.** Fiscal consolidation efforts continue to rely on across-the-board spending freezes. Parametric pension reform is currently under discussion. The authorities have proposed an additional cumulative 3.5 percent of GDP in infrastructure spending over the next six years.
Rebalance from direct to indirect taxes, to reduce informality.	**In progress.** Various ideas for tax reforms are under discussion, including raising the main VAT rate from 18 to 20 percent.
Ensure that the fiscal federalism framework incentivizes regional revenue mobilization and private sector development.	**Some progress.** A tourism tax was piloted in May 2018 in two regions. Regions have been given the right to grant profit tax preferences for new investment in 2018.
Monetary Policy	
Continue easing monetary policy gradually, given risks to the inflation outlook.	**Implemented.** The CBR has reduced its main policy rate gradually, by a total of 200 basis points since June 2017, down to 7.25 percent.

Improve the central bank's communication strategy, by shifting to a time horizon beyond end-2017 and by elaborating what departures from the inflation target are acceptable and over what horizon.	**Substantial progress.** The 4 percent inflation target is now seen as applying to an indefinite period of time (as opposed to end-2017). The inflation target is now around or near 4 percent (as opposed to the previous target of exactly 4 percent). The CBR decided against an explicit band. The communication strategy would benefit from elaborating what deviations from the inflation target are acceptable and over what time horizon.
Financial Sector Policy	
Tighten further the limit on related party lending.	**Implemented.** The definition of related parties has been broadened and the limit on individual exposures was set at 20 percent of a bank's equity capital.
Improve the bank resolution framework, to make it consistent with international standards. Replace CBR funding with federal government funds. Provide explicitly for statutory bail-ins. Remove impediments to purchase & assumption transactions. Accelerate the introduction of explicit early bank intervention procedures.	**Partly implemented.** The authorities have introduced a new resolution mechanism, which provides for equity capital injections (instead of CBR loans), as well as limited bail-in. A new mechanism to finance the costs of banking resolution has also been identified, but it does not explicitly provide for the use of public funds. There are still some impediments to purchase & assumption transactions, which should eventually start separating the good and bad assets of problem banks and transferring the latter at market (rather than book) values. The authorities need to introduce additional resolution powers and safeguards recommended by international standards (e.g., well-defined early intervention procedures).
Strengthen the AML/CFT framework, including through measures related to politically exposed persons and entity transparency.	**In progress.** The authorities continue enhancing the AML/CFT framework and are at an early stage of strengthening the measures related to politically exposed persons and entity transparency.

Structural Policies	
Expand Russia's preferential access to large markets. Improve customs procedures to reduce the burden on businesses. To facilitate the reallocation of resources, increase the labor market's flexibility and strengthen the financial system. Strengthen property rights and governance. Continue implementing the commitments made at the May 2016 London anti-corruption summit. Refocus state intervention in the economy to areas with positive spillovers for productivity and competition. Invest in innovation and infrastructure.	**In progress.** The Ministry of Economic Development has prepared a comprehensive plan which includes measures to attract FDI, promote special economic zones, reduce the state's footprint in the economy, and improve governance. The cleanup of the banking system is well-advanced, but more needs to be done (see above). The authorities have proposed an additional cumulative 3.5 percent of GDP in spending on infrastructure over the next six years.

Annex II. External Sector Assessment

	Russia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) at end-2017 was at 18 percent GDP (marginally higher than in 2016 and up from 10 percent in 2013, the last pre-crisis year). Gross assets were at 88 percent of GDP and liabilities—split evenly between equity and debt—constituted 70 percent of GDP, both lower than in 2016 on account of higher dollar GDP and private sector deleveraging. Total external debt was at 34 percent of GDP at end-2017, a 6 percentage point reduction from the year before. 1/ There are no obvious maturity mismatches between the gross asset and liability position. Historically, the NIIP position has not kept pace with the CA surpluses due to unfavorable valuation changes and the treatment of "disguised" capital outflows. 2/ **Assessment**. The projected current account surpluses suggest that Russia will continue to maintain a positive IIP, which lowers risks to external stability. Moreover, official external assets have been increasing rapidly since the introduction of the new fiscal rule. The recent external deleveraging by the private sector reduces risks further.	**Overall Assessment**: *The external position in 2017 was moderately weaker than suggested by fundamentals and desirable policy settings. Since then, worsening geopolitical tensions have weakened the exchange rate. While this has not altered the overall assessment, the correction likely brought the REER closer to fundamentals.* Since 2016, the REER has recovered as oil prices rebounded, economic uncertainty declined, and appetite for Russian government assets recovered. However, the evolving nature of economic sanctions against Russia and their structural implications create exceptional uncertainty when assessing the external position. **Potential policy responses**: Russia's moderately weaker external position and lingering uncertainty suggest the need for greater diversification and prudence. Fiscal policy should operate within the parameters of the new fiscal rule to reduce impact of oil price volatility on the non-oil sector, while government expenditure should be rebalanced to capital spending, while leaving space for higher health spending. This rebalancing—coupled with a renewed emphasis on structural reforms to invigorate the private sector—would help increase savings on a net basis, and yet create some room for somewhat higher private and public sector investment over the medium term.
Current account	**Background**. Following a decade of continuously shrinking surpluses, the Current Account (CA) balance temporarily surged on the back of an oil price shock to 5 percent of GDP in 2015, as reduced oil export revenues (approximately 7 percent of GDP) were more than offset by falling absorption. However, demand recovery has reduced the surplus to 1.9 percent of GDP in 2016, before recovering energy prices marginally raised it to 2.3 percent of GDP in 2017 (despite a further deterioration of 0.2 percent of GDP in the non-energy CAB). In the medium-term, the authorities' fiscal consolidation plans should support a gradual increase in the CAB (mostly on account of a rising non-oil balance). **Assessment**. The EBA CA model yields a norm for 2017 of 3.7 percent of GDP, compared to a cyclically adjusted CA surplus of 3.3 of GDP, resulting in a CA gap of –½ percent of GDP. 3/ There are substantial uncertainties about the external assessment when volatile oil prices play a dominant role in the economy. The impact and duration of sanctions is also difficult to quantify but, on balance, staff assesses that they create long-lasting uncertainty, raising the CA norm both through higher precautionary savings and lower investment. Staff assesses the 2017 CA gap at –1¼ percent, with a confidence interval between –2½ and 0 percent. The fiscal gap accounts for most of the CA gap. Thus, in the medium term, fiscal policy should be tightened—while raising infrastructure and health spending—to rebuild buffers and save more of the oil wealth for future generations. The new fiscal rule provides a reasonable mechanism for achieving this goal.	
Real exchange rate	**Background**. Following the dual shocks of oil prices and sanctions, and the floating of the ruble in November 2014, the REER depreciated by over 35 percent between mid-2014 and February 2016. Part of this depreciation represented an overshooting that was corrected in 2017, when the REER appreciated by 16 percent. The REER remained broadly stable since mid-2017 at a level some 15 percent below the pre-crisis level. By April 2018, the REER has depreciated by 8.5 percent relative to the 2017 average, in part due to the imposition of new US sanctions in April. **Assessment**. Both EBA Level and Index REER models indicate a small undervaluation of around 5 percent. Staff assess that the 2017 REER was between 0 and 10 percent above its equilibrium level, in line with the staff-assessed CA gap.	
Capital and financial accounts: flows and policy measures	**Background**. Net private capital outflows continued in 2017, though at a significantly slower pace than in 2014–15, as confidence has returned. Private sector external deleveraging has continued in the face of limited access to international capital markets. Nonetheless, volatile oil prices will continue to weigh on the outlook. Over the medium term, structural outflows are expected to decline but only provided that Russia improves its investment climate. **Assessment**. While Russia is exposed to risks of accelerated capital outflows because of geopolitical uncertainties, the floating exchange rate regime and large international reserves provide substantial buffers to help absorb such shocks.	

	Russia (continued)
FX intervention and reserves level	**Background**. Since the floating of the ruble in November 2014, FX interventions have been limited. International reserves rose to US$457 billion at end-March 2018, up from U$378 billion at end-2016, due to valuation effects and MoF's FX purchases in line with the provisions of the new fiscal rule, which attempts to shield the non-oil economy from oil price volatility. In response to geopolitical volatility in early April, FX purchases were temporarily backloaded. **Assessment**. International reserves at end-2017 were equivalent to 264 percent of the Fund's reserve adequacy metric, considerably above the adequacy range of 100–150 percent. Taking into account Russia's vulnerability to oil price shocks, an additional commodity buffer of $58 million is appropriate, translating into a ratio of reserves to the buffer-augmented metric to 195 percent, a level still considerably above the adequacy level, but justifiable given the high degree of uncertainty related to sanctions. 4/ Large FX interventions should be limited to episodes of market distress.
Technical Background Notes	1/ Russia's foreign assets are mostly in foreign currency (over 93 percent as of end-2017), while liabilities are predominantly in rubles (64 percent). However, about three-quarters of external debt is denominated in foreign currency. The 19 percent increase in the dollar GDP in 2017 (on account of rebounding oil prices and ruble appreciation) explains most of the reduction in assets- and liabilities-to-GDP ratios. 2/ Unfavorable valuation changes arise because the Russian stock market has performed very well in the last 15 years as the oil price soared, boosting the valuation of foreign-owned assets. "Disguised" capital outflows include transactions such as pre-payments on import contracts where the goods are not delivered, repeated large transfers abroad that deviate from standard remittances behavior, or securities transactions at inflated prices. The CBR includes estimates of "disguised" capital outflows in the financial account but not in the foreign asset position of the reported NIIP. Hence, the actual NIIP position could be higher than the reported level and this treatment of "disguised" outflows may explain part of the discrepancy between accumulated CA surpluses and the reported NIIP position. 3/ The change in the EBA CA gap vis-à-vis the 2017 Article IV is due primarily to revisions in the EBA methodology. The 2017 CA norm for Russia is 2½ percentage points of GDP lower than under the previous methodology. 4/ The commodity buffer is computed in line with Annex III of the Guidance Note on Reserve Adequacy.

Annex III. Risk Assessment Matrix (RAM)[1]

Sources of Risks	Overall Level of Concern		Recommended Policy Response
	Relative Likelihood	Expected Impact if Materialized	
External Risks			
Retreat from Cross-Border Integration	**Medium**	**Medium**	If the country is affected by the imposition of tariffs, macroeconomic policies (fiscal and monetary, including FX intervention) should be supportive to weather the initial impact through the trade channel on the domestic economy. Structural reforms should be accelerated to enhance diversification and increase trade links beyond neighboring countries.
Escalation of Geopolitical Tensions could depress business confidence, heighten risk aversion, lower demand for credit, limit access to international financial markets, and reduce FDI.	**High**	**Medium/High**	The floating exchange rate remains key to cushioning the shock. Disorderly market conditions can be countered with foreign exchange intervention. In addition, an increase in policy interest rates could be considered. Fiscal policy tightening could be temporarily postponed.
Lower Energy Prices	**Low**	**High**	The floating exchange rate should be the main shock absorber. Fiscal policy could use existing buffers within the framework of the new fiscal rule. Structural reforms should be advanced to improve economic efficiency and promote diversification.
Significant China Slowdown and its Spillovers or **Structurally Weak Growth in Key Advanced Economies**	**Low/Medium** **High**	**High** **Medium**	A decline in oil prices would be the main spillover channel. In that context, the exchange rate should be allowed to adjust. Disorderly market conditions could be countered with foreign exchange intervention. Fiscal policy tightening could be temporarily postponed and structural reforms should be accelerated to enhance economic efficiency and diversification.
Tighter Global Financial Conditions. Higher debt service and refinancing risks could stress leveraged firms, households, and vulnerable sovereigns, including through capital account pressures in some cases.	**High**	**Medium/Low**	Enhance resilience and confidence in the financial system by strengthening core institutions and policy frameworks. Improve the investment climate. Tighten monetary policy if balance of payment pressures emerge, while allowing the exchange rate to adjust, and intervening only to counter disorderly market conditions.
Domestic Risks			
Weaker Banking System for Longer. Imprudent lending could lead to a systemic build-up of impaired assets. Credit growth will be even lower, with negative implications for growth.	**Medium**	**Medium**	The authorities should swiftly complete AQRs aligned with best international practices. Weak banks should be required to submit time-bound plans for recapitalization to bring their capital to regulatory minima under an adverse stress scenario. In the case of weak but viable government-related banks, the government may want to consider precautionary capital injections.
Inflation Continues to Fall Short of the Target.	**Low**	**Medium**	Accelerate the pace of reducing the policy rate, which could involve moving below a neutral policy stance.
Lack of Structural Reforms could lead to a decline in investment and TFP.	**Medium**	**Medium**	Focus on structural and governance reforms to improve the investment climate. Avoid distortive measures and increase trade openness.

[1] The RAM shows events that could materially alter the baseline path discussed in this report (which is the scenario most likely to materialize in the view of the staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding this baseline. The RAM reflects staff's views on the source of risks and overall level of concerns as of the time of discussions with the authorities.

Annex IV. Implementation of FSAP Recommendations

Recommendation	Timing	Progress
Banking Stability		
Conduct an asset quality review (AQR) to ensure adequate bank capitalization (CBR).	ST/MT*	**Not done.** The CBR initiated some elements of an AQR for the banking system with the recently established Risk Analysis Service unit, but more efforts are needed to swiftly complete the evaluations and to also ensure their alignment with best international practices on AQRs.
Enhance stress-testing practices, including on a consolidated basis and by currency (CBR).	ST/MT	**In progress.** CBR continues upgrading its methodologies to develop bank-specific and bank-group-specific behavioral models on a consolidated basis. In 2017, the CBR undertook its first macroprudential stress testing of the financial sector.
Liquidity Management		
Review the FX repo framework, and formalize the lender-of-last-resort function (CBR).	ST	**Done.** The FX repo framework takes into account banks' access to FX funding from the interbank market. The CBR implemented an ELA facility in 2017.
Re-establish a T-bill program.	ST	**Not done.** T-bill operations are a part of budget policy.
Financial Sector Oversight and Regulation		
Require prior approval for banks' domestic investments in nonbank institutions (CBR).	ST	**In progress.** A draft law requires banks to coordinate with the CBR on the acquisition of large stakes in non-bank institutions. The draft law has passed public discussion and is at the stage of inter-agency examination. Provisions regulating CBR's prior approval for individuals and legal entities to acquire over 10 percent of shares in non-bank institutions are codified in Federal No. 281-FZ of July 29, 2017, which became effective on January 1, 2018.
Issue specific requirements for management of banks' country and transfer risks (CBR).	ST	**In progress.** Under review.
Upgrade framework for relations with and use of banks' external auditors (CBR).	ST	**In progress.** A draft federal law that would allow the CBR to regulate and supervise audit activities passed a first reading in the State Duma last December and a second reading in June 2018.
Strengthen further the legal framework applicable to related parties (CBR).	ST	**In progress.** A new regulatory limit that caps bank's loans to related-parties at 20 percent of their total regulatory capital became effective on January 1, 2017. A new draft law that requires credit institutions to deal with related parties on an arm's length basis has passed public discussion and is at the stage of inter-agency examination.
Upgrade the framework for prudential oversight of banks' operational risk (CBR).	ST	**In progress.**

Bring regulation and supervision for securities and insurance markets in line with international standards (CBR).	MT	**In progress.** CBR has approved a roadmap to harmonize the Russian legislation with both the IOSCO Objectives and Principles of Securities Regulation and the IAIS Insurance Core Principles.
Ensure the effective implementation of the AML/CFT framework (CBR, MoF monitoring).	ST	**In progress.**
Macroprudential Policy		
Adopt legal changes to provide a comprehensive policy toolkit (CBR, MoF).	ST/MT	**In progress.** A federal law that became effective in March authorizes the CBR's governing board to increase risk weights for certain types of assets. The calculation of the PTI ratio will be mandatory from January 1, 2019.
Crisis Management and Resolution		
Review the framework for the use of public funds to allow the federal government to finance the DIA's resolution activities. If CBR funds are used, the federal government should provide an indemnity (CBR, MoF).	MT	**Not done.** The authorities do not intend at this point to implement this recommendation and budget funds are not used to finance bank resolution.
Establish a mechanism for the recovery of the costs of providing temporary public financing through levies on the financial industry (CBR, MoF).	MT	**Not done.** The resolution mechanism does not envisage levies on banks other than the premia already collected by the DIA.
Introduce the full range of resolution powers and safeguards recommended by the FSB Key Attributes, including by implementing legal and operational changes needed to make purchase and assumption (P&A) transactions an effective resolution tool (CBR, MoF).	ST	**In progress.** The authorities have introduced a new resolution mechanism. However, there is no provision yet for asset transfers at market prices to an acquiring institution as part of a P&A transaction.
Banking Sector Development		
Promote legal reforms to increase the effectiveness of the boards of state-owned commercial banks (SOBs) (MoF, CBR).	MT	**In progress.** The CBR is engaged in drafting a bill that provides for audit committees as well as an enhanced role of the boards of directors at public joint stock companies. The bill has passed a second reading in parliament.
Continue the gradual privatization of SOBs as conditions permit (MoF, CBR).	MT	**Not done.** Market conditions do not seem favorable at this time.
* "ST" means within one year; "MT" means within one to three years.		

INTERNATIONAL MONETARY FUND

RUSSIAN FEDERATION

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 17, 2018

Prepared By | The European Department (In Consultation with Other Departments and the World Bank).

CONTENTS

FUND RELATIONS[1]

(As of May 31, 2018)

Membership Status: Joined June 1, 1992; Article VIII.

General Resources Account	**SDR Million**	**Percent Quota**
Quota	12,903.70	100.00
Fund holdings of currency	11,497.24	89.10
Reserve Position	1406.49	10.90
Lending to the Fund	470.55	
New Arrangements to Borrow		

SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	5,671.80	100.00
Holdings	4,830.55	85.14

Outstanding Purchases and Loans: None

Latest Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-by	07/28/99	12/27/00	3,300.00	471.43
EFF	03/26/96	03/26/99	13,206.57	5,779.71
Of which SRF	07/20/98	03/26/99	3,992.47	675.02
Stand-by	04/11/95	03/26/96	4,313.10	4,313.10

Projected Obligations to Fund
(SDR Million; based on existing use of resources and present holdings of SDRs)**:**

	Forthcoming				
	2018	2019	2020	2021	2022
Principal					
Charges/Interest	3.97	8.00	8.01	8.00	8.00
Total	3.97	8.00	8.01	8.00	8.00

[1] http://www.imf.org/external/np/fin/tad/exfin2.aspx?memberkey1=819&date1Key=2999–12

Implementation of HIPC Initiative: Not Applicable

Implementation of MDRI Assistance: Not Applicable

Exchange Arrangements: The *de jure* and *de facto* exchange rate arrangement is free floating. Under this arrangement, the exchange rate of the ruble is determined by market factors. The CBR may intervene in the domestic foreign exchange market in the event of threats to financial stability. Effective February 1, 2017, the MOF implemented a new mechanism for foreign exchange purchases and sales to enhance the stability and predictability of local economic conditions and to reduce the impact of price volatility in the global energy market on Russia's economy and public finances. Trade volumes will depend on the amount of oil and gas revenues in the federal budget. As long as the actual Urals price exceeds US$40 per barrel, MOF will be purchasing foreign exchange in the amount of additional oil and gas revenues. If the actual prices drop below this level, MOF will be selling foreign exchange in the amount of the resulting shortfall in oil and gas revenues. The size of these operations will be announced at the start of every month and purchases will be evenly distributed within the month. The foreign exchange purchase program is preannounced, predictable, involves small daily amounts, and is not triggered by an exchange rate level. The Russian Federation accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement with effect from June 1, 1996, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation: Russia is on the standard 12-month consultation cycle. The last consultation was concluded on June 29, 2017.

FSAP Participation, FTE and ROSCs: Russia participated in the Financial Sector Assessment Program during 2016, and the FSSA report was discussed by the Board in July 2016 at the time of the 2016 Article IV discussion. An FSAP financial stability assessment took place during April 2011, and the FSSA report was discussed by the Board in September 2011, at the time of 2011 Article IV Consultation. An FSAP update took place in the fall of 2007, and the FSSA report was discussed by the Board in August 2008, at the time of the 2008 Article IV discussion.

IMF's Fiscal Transparency Evaluation (FTE) was undertaken in October 2013 and published in May 2014. It assessed the Russian government's fiscal reporting, forecasting, and risk management practices against the IMF's revised Fiscal Transparency Code

Resident Representative: Mr. Gabriel Di Bella, Resident Representative since July 15, 2015.

WORLD BANK GROUP RELATIONS[2]

A. International Bank for Reconstruction and Development

The Russian Federation joined the World Bank (IBRD and IDA) in 1992. The Bank has provided financing for 70 projects in different sectors totaling slightly over US$10.5 billion in IBRD loans. IBRD's current portfolio of projects amounts to US$536 million in the areas of financial literacy, statistics, municipal infrastructure, cultural heritage preservation, hydro-meteorology and forestry. The undisbursed balance is US$113 million as of May 2018. All Bank financing in the portfolio is in the form of investment project financing.

The Bank also has a program of Advisory Services and Analytics (ASA), including reimbursable advisory services (RASs). The ASA program is organized around the priorities identified in the Systematic Country Diagnostic (SCD) for the Russian Federation, along the following two broad areas: 1. Growth and Competitiveness (e.g., labor markets and informality, investment climate, export promotion and digital economy) and 2. Human Capital, Poverty and Shared Prosperity (e.g., education quality and equity, skills, integrative health, social protection, and spatial equity). In FY18, along with two regular Russia Economic Reports, the World Bank is planning to finalize work on the Russian labor market and informality, digital economy, and green finance.

B. International Finance Corporation

Russia became an IFC member in 1993. Since then, IFC's long-term investments in Russia totaled US$10 billion, of which US$3.5 billion were mobilized from partners, across 263 projects.[3] As of April 2018, IFC's committed investment portfolio in Russia stood at US$446.6 million of which US$417.4 million was disbursed.

C. Multilateral Guarantee Agency

MIGA's gross exposure in Russia was US$329 million as of April 2018. MIGA is involved in two projects in the finance and manufacturing sectors. In dollar terms, MIGA's exposure is concentrated in Russia's financial sector (some 85 percent of MIGA's gross exposure), supporting the investment of a French financial institution in its Russian subsidiary. MIGA's exposure in the manufacturing sector supports the investment on a company located in the greater Moscow area.

[2] Prepared by the World Bank.

[3] Previously IFC reported the total volume of investments, including short-term and long-term. Due to changes in accounting of short-term instruments, they are no longer included in the total investment volume.

STATISTICAL ISSUES

(As of June 20, 2018)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance. However, in the context of emerging data demands for assessing external vulnerabilities, the scope for further data improvements exists.
National Accounts: Data are broadly adequate for surveillance, but there have been concerns about the reliability and consistency of quarterly GDP estimates and seasonally adjusted headline GDP among a wide range of users, including Fund staff. In April 2016, Rosstat released GDP estimates compiled according to the 2008 SNA. In addition, the data for 2011 to 2013 have been revised, but are compiled according to the 1993 SNA. The main changes introduced in the revised series include improvements in the estimation of the imputed rental services of owner-occupied dwellings and the use of the market value of assets to estimate consumption of fixed capital. Real GDP data are rebased to 2016 prices, and published from 1995Q1. The Central Bank of Russia compiles quarterly sectoral financial accounts and financial balance sheets; however, data are only available on the agency's website up to the fourth quarter of 2017.
Price Statistics: Monthly CPI and PPI, both compiled using the Two-Stage (Modified) Laspeyres (2000=100), cover all regions of the Russian Federation. The weights reflect expenditures in the 12 months ending in the most recent September. Aggregate price indices are compiled for each good and service item for all the regions and the Russian Federation as a whole. However, population weights, as opposed to expenditure shares are applied to the individual regional indices possibly biasing the CPI downwards if price increases are higher in regions with higher per capita expenditures. Detailed data on total annual sales by economic activity, which are used to develop weights for the PPI, are published on the Rosstat website. The detailed weights are available only on the Russian-language version of the website, making it less accessible to some users. Further efforts to improve the treatment of seasonal items in the core inflation index and a new household budget survey—which has been under consideration for some time—could significantly strengthen data quality.
Government Finance Statistics: The authorities compile a comprehensive set of the general government accounts based on the *Government Finance Statistics Manual 2014 (GFSM 2014)* on an annual basis. These data comprise the statement of sources and uses of cash as well as the accrual-based government operations (revenue, expenditure and transactions in assets and liabilities), complete balance sheet (including non-financial assets), holding gains and losses and other changes in the volume of assets and liabilities, and outlays by functions of government (COFOG). A monthly statement of sources and uses of cash based on *GFSM 2014* is also compiled for the whole general government sector. In addition, the authorities have recently started reporting quarterly accrual-based general government operation statement as well as a financial balance sheet.

Monetary and Financial Statistics: Analysis of balance sheet effects has been hindered by the lack of comparable data on the currency and maturity breakdown of banking-sector assets and liabilities. Adoption of detailed data reporting using Standardized Report Forms (SRFs), as recommended by an STA mission in 2007 and re-affirmed by the ROSC mission in 2010, would provide comprehensive information on the currency and instrument breakdowns of the assets and liabilities of the central bank, other depository corporations, and other financial corporations. Since March 2011, the Banking System Survey (which is equivalent to the Depository Corporations/Broad Money Survey) published by the Central Bank of Russia (CBR) has included a breakdown of positions by national and foreign currency. Publication of a similar breakdown of positions by national and foreign currency in the central bank and other depository corporations surveys in the SRF format would be useful for analysis. STA has made recommendations to the authorities to improve their submitted monetary data to conform to the SRF format. The authorities are yet to follow up on these recommendations.	
External sector statistics: Balance of payments data are broadly adequate for surveillance, and significant improvements have been made to enhance data quality. The CBR has recently published the gross capital flow data for the private sector, which would facilitate the analysis of relatively complex flows. Starting from 2012, the balance of payments is compiled according to the framework of the *Fund's Balance of Payments and International Investment Position Manual*, sixth edition (BPM6) and the CBR has revised historical data (going back to 1994Q1 for BOP, and to 2001Q1 for IIP), consistent with BPM6. Partial data from a variety of sources are supplemented by the use of estimates and adjustments to improve data coverage. In particular, the CBR makes adjustments to merchandise import data published by the Federal Customs Service to account for "shuttle trade," smuggling, and undervaluation. Statistical techniques are also used to estimate transactions and positions of foreign-owned enterprises with production sharing agreements, and these techniques are continuously being improved. At the same time, Russian compilers are seeking to reconcile their data with those of partner countries. Improvements have been made in the coverage and quality of surveys on direct investment, and the CBR is participating in the Fund's Coordinated Direct Investment Survey (CDIS) and Coordinated Portfolio Investment Survey (CPIS).	
Financial sector surveillance: Russia reports all 12 core financial soundness indicators (FSIs) and 9 of the 13 encouraged FSIs for deposit takers on a quarterly basis. After 2016, FSIs on earnings and profitability are reported on a quarterly basis instead of on an annual basis. Also, 2 FSIs for households and 3 FSIs for real estate markets are reported on a quarterly basis. Data are reported for posting on the IMF's FSI website with a lag of more than one quarter.	
II. Data Standards and Quality	
Russia is an SDDS subscriber since 2005. Russia plans to revamp the SDDS National Summary Data Page to disseminate data also in machine-readable format (SDMX).	Data ROSC was published in 2011.

Russian Federation: Table of Common Indicators Required for Surveillance
(As of June 20, 2018)

	Date of latest observation (For all dates in table, please use format dd/mm/yy)	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:[8]	
						Data Quality – Methodological soundness[9]	Data Quality – Accuracy and reliability[10]
Exchange Rates	May 2018	06/15/2018	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	May 2018	06/15/2018	M	M	M		
Reserve/Base Money	April 2018	5/31/2018	D	W	W	O, O, LO, LO	O, O, O, O, O
Broad Money	April 2018	5/31/2018	D	M	M	O,O,LO,LO	O,O,O,O,O
Central Bank Balance Sheet	May 2018	6/14/2018	M	M	M	O,O,LO,LO	O,O,O,O,O
Consolidated Balance Sheet of the Banking System	April 2018	5/31/2018	M	M	M	O,O,LO,LO	O,O,O,O,O
Interest Rates[2]	May 2018	5/31/2018	M	M	M	O,O,LO,LO	O,O,O,O,O
Consumer Price Index	April 2018	5/04/2018	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	March 2018	5/09/2018	M	M	M	O, LO, LNO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	March 2018	5/09/2018	M	M	M	LO, LNO, LO, O	O, O, LO, O, NA
Stocks of Central Government and Central Government-Guaranteed Debt[5]	April 2018	5/22/2018	M	M	M		
External Current Account Balance	2018:Q1	4/10/2018	Q	Q	Q		
Exports and Imports of Goods and Services	2018:Q1	4/10/2018	Q	Q	Q	O, O, O,LO	LO, O, O, O, O
GDP/GNP	2017:Q4	4/02/2018	Q	Q	Q		
Gross External Debt	2018:Q1	4/26/2018	Q	Q	Q	O, O, O, O	O, O,LO, O, LO
International Investment Position[6]	2017:Q4	04/03/2018	Q	Q	Q		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[8] These columns should only be included for countries for which Data ROSC (or a Substantive Update) has been published.
[9] This reflects the assessment provided in the data ROSC or the Substantive Update (published in February 2011, and based on the findings of the mission that took place during June-July 2010) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[10] Same as footnote 7, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

RUSSIAN FEDERATION

August 31, 2018

2018 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

Prepared By	European Department

This supplement provides information that has become available since the Staff Report (SM/18/199) was circulated to the Executive Board on July 17, 2018. The information does not alter the thrust of the staff appraisal.

Turbulence in emerging markets and heightened geopolitical tensions have increased downside risks, at least in the short term. The likelihood of a further escalation in sanctions, together with tighter financial conditions in emerging markets, poses risks to the outlook. The ruble, in line with many other emerging market currencies, has depreciated over the summer by 5-10 percent, and long-term interest rates on domestic public debt have increased by 100-150 bps. On the upside, most recent high-frequency indicators suggest that the recovery has regained momentum, after a weak second half of 2017. GDP growth accelerated to 1.8 percent (yoy) in Q2 of 2018 from 1.3 percent in Q1, according to Rosstat's flash estimate. First quarter GDP is likely to be revised upward.

On the policy front, the authorities have adopted legislation for several of the policy initiatives discussed with staff and reported in the staff report. Over the summer, the State Duma approved an increase in the main VAT rate from 18 to 20 percent, effective in 2019. It also passed legislation to complete the shift in oil sector taxation from export duties to mineral extraction taxes over 2019-24. Both of these measures will generate additional revenues to finance the authorities' policy priorities, including increased spending on education and health. The legislature also amended the Budget Code to establish a temporary infrastructure fund which will be financed by relaxing the fiscal rule by 0.5 percent of GDP on average over a period of six years (2019-24). A bill proposing a parametric pension reform, which would raise the statutory retirement age from 55/60 to 63/65 years for women/men by an average of 6 months every year, also passed its first reading in the Duma. Its second and third reading are expected in the fall. In sum, while many of the legislative pieces are now in place, the authorities' fiscal package will be finalized in the fall, in time for discussions over the 2019-21 budget.

Given recent inflation developments, the Central Bank of Russia (CBR) decided to keep its key policy rate unchanged at its July 27 policy meeting. Headline CPI inflation accelerated to 2.5 percent in July (yoy), up from record lows earlier this year, and due to a smaller decline in fruit and vegetable prices than in the summer of 2017 as well as emerging pressures in prices of other foods. The CBR considers that the shift to a neutral monetary policy stance is now highly likely to be completed in 2019 instead of 2018. Given the impact of planned fiscal policy changes on inflation and inflation expectations, the CBR believes that monetary conditions should remain somewhat tight to limit the secondary effects of the VAT rate hike and stabilize annual inflation close to the 4 percent target. Effective July 1, the CBR increased risk ratios for FX loans, including real estate loans. Effective August 1, it also raised mandatory reserve requirements on FX liabilities by 1 percentage point. In addition, due to the rapid growth in unsecured consumer lending (17.0 percent in June, yoy), higher risk weights will be applied to such loans issued after September 1.