

Russian Federation

In Search of a New Growth Model

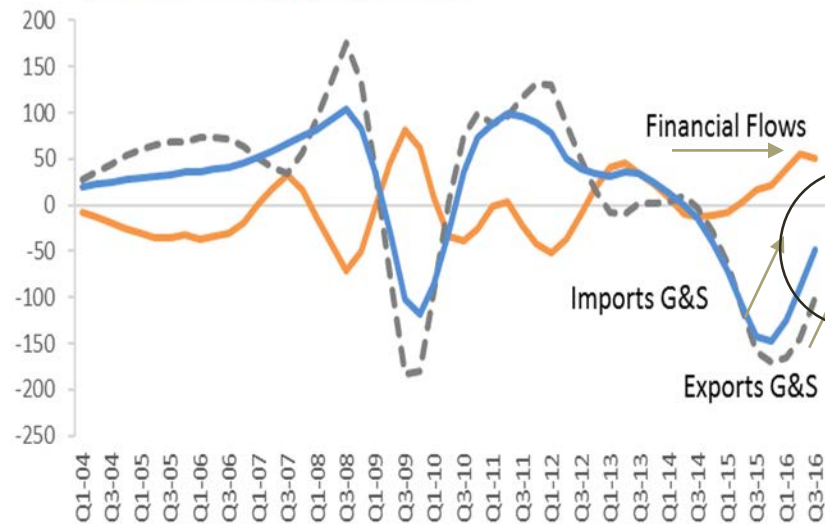
IMF OFFICE IN THE RUSSIAN FEDERATION

February 2018

Russia stabilized after External Shocks...

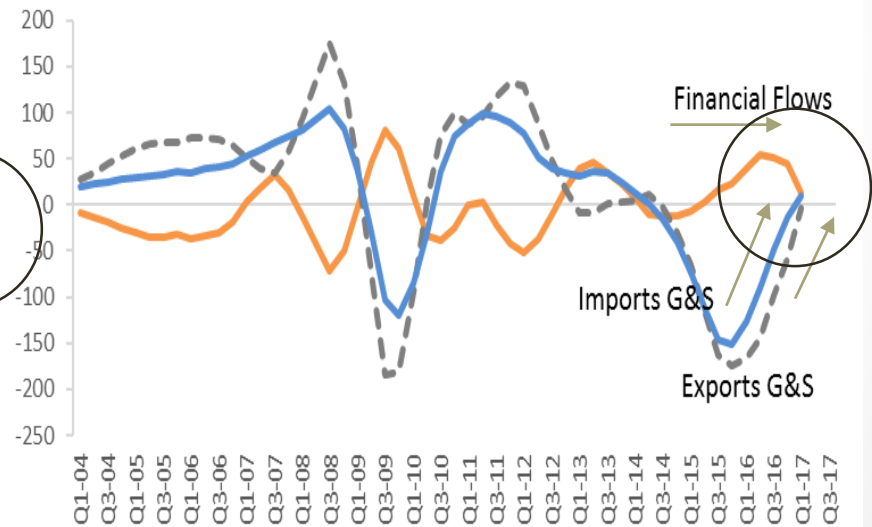
Lower net financial outflows together with higher oil prices have allowed economic activity to stabilize

Russia. Exports, Imports and Financial Flows
(12-month changes, US\$ billion)



December 2016

Russia. Exports, Imports and Financial Flows
(12-month changes, US\$ billion)

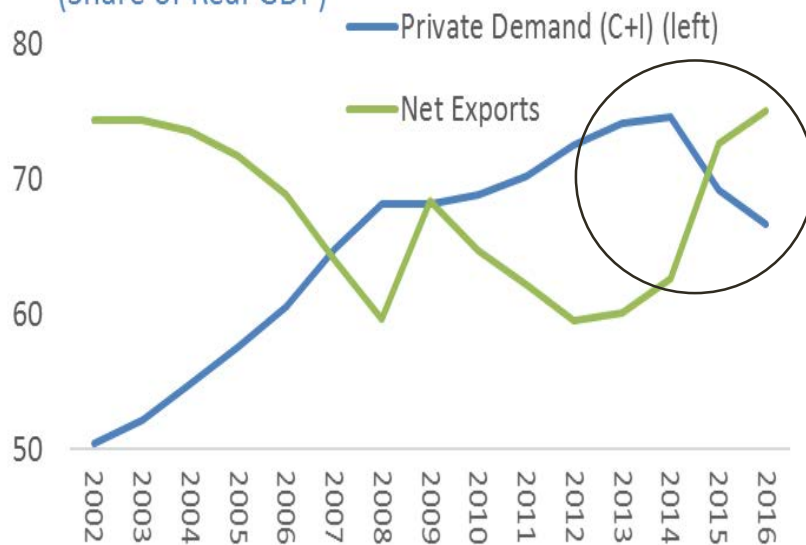


December 2017

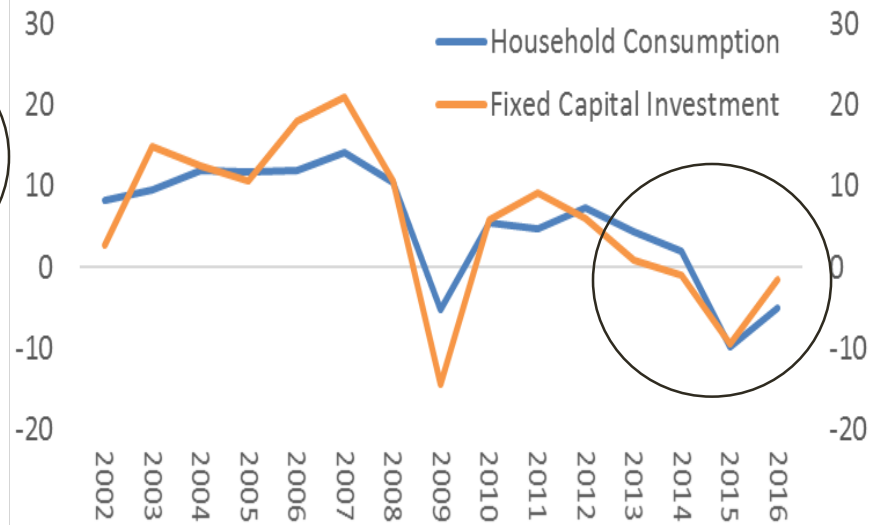
Russia stabilized after External Shocks...

Consumption of Households adjusted while Fixed Capital Investment stabilized

Russia: Aggregate Demand
(Share of Real GDP)



Russia: Aggregate Demand
(annual real change, percent)

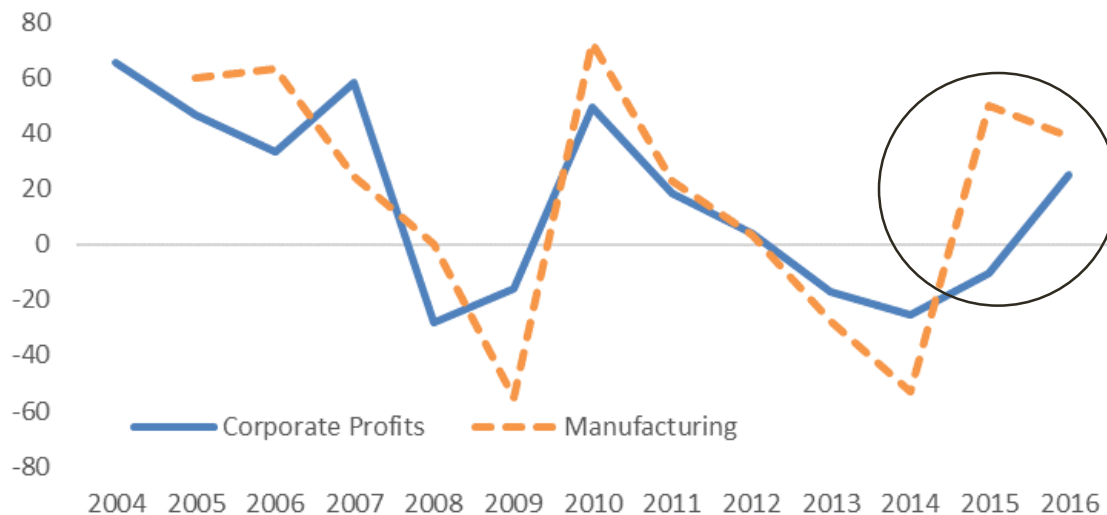


Conditions for a mild cyclical rebound in 2017-18 are in place...

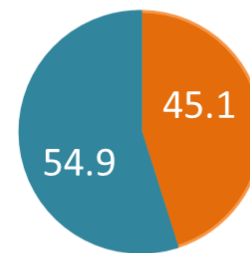
Corporate profits increased, and own cash-flows replaced other sources as main factor in financing investment...

Russia: Corporate Profits

(annual percentage change, over US\$ values)

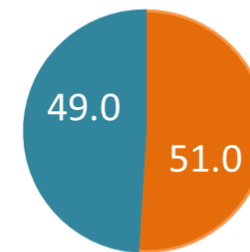


2012-14



Own Funds Other Sources

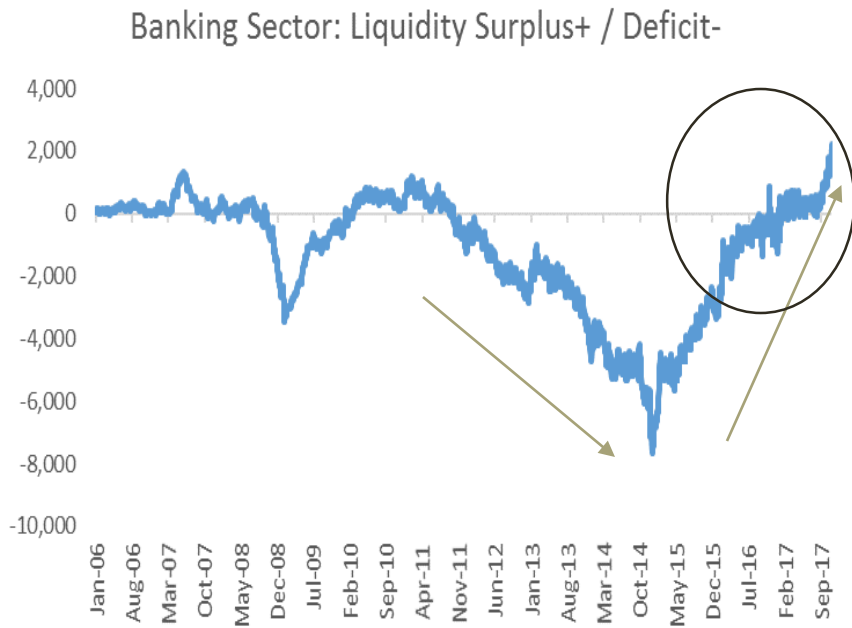
2015-16



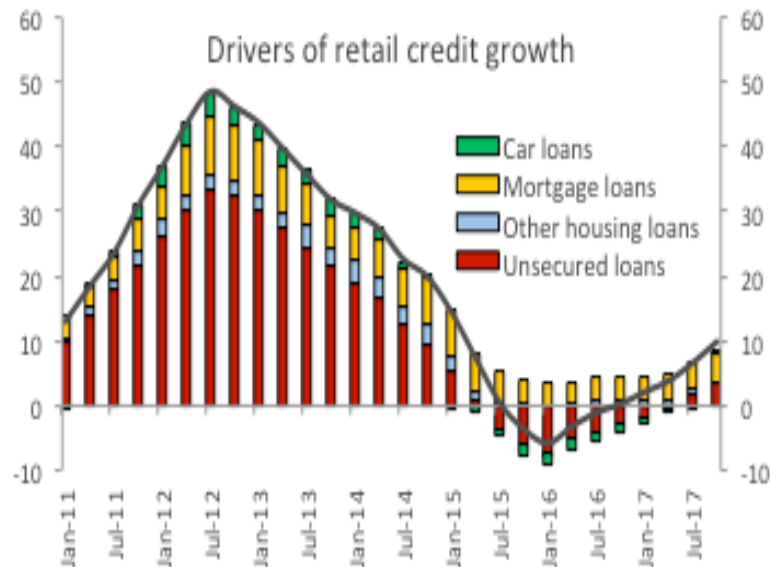
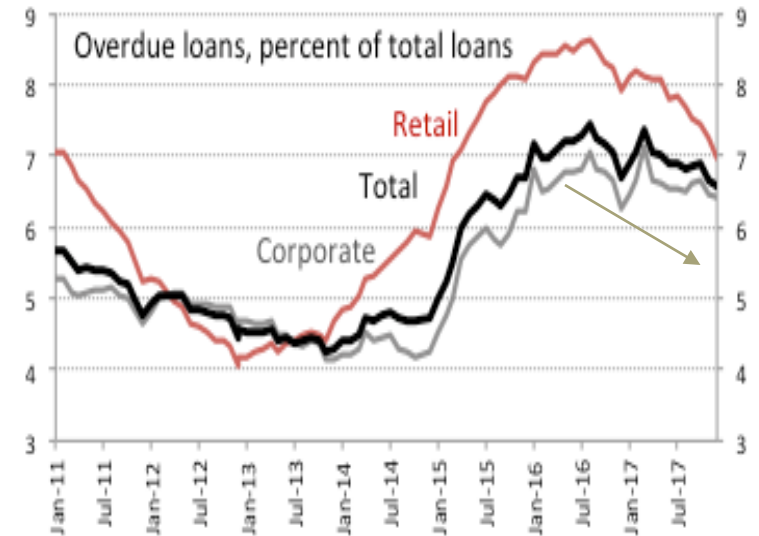
Own Funds Other Sources

Conditions for a mild cyclical rebound in 2017-18 are in place...

The banking system is moving to structural liquidity surplus...

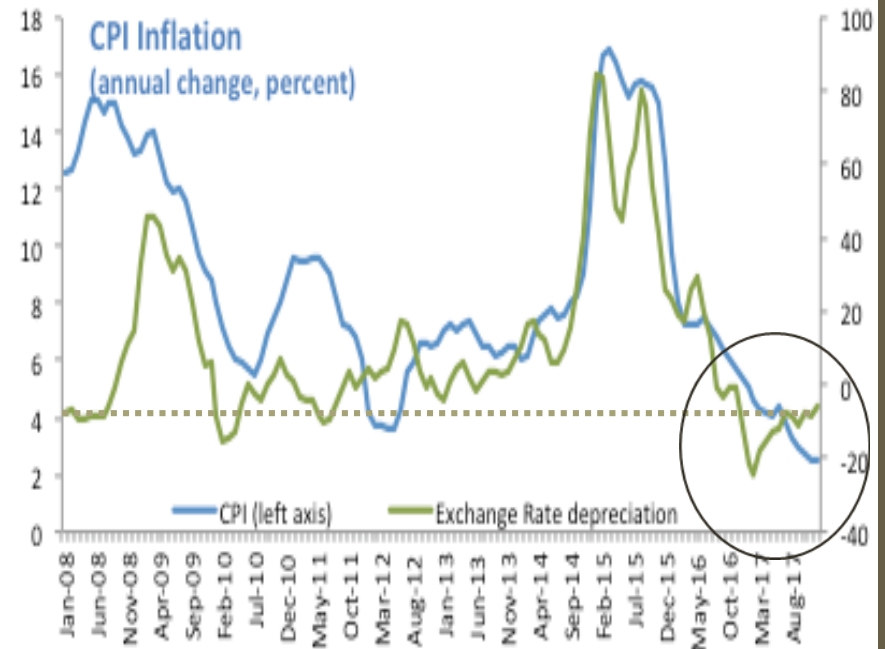
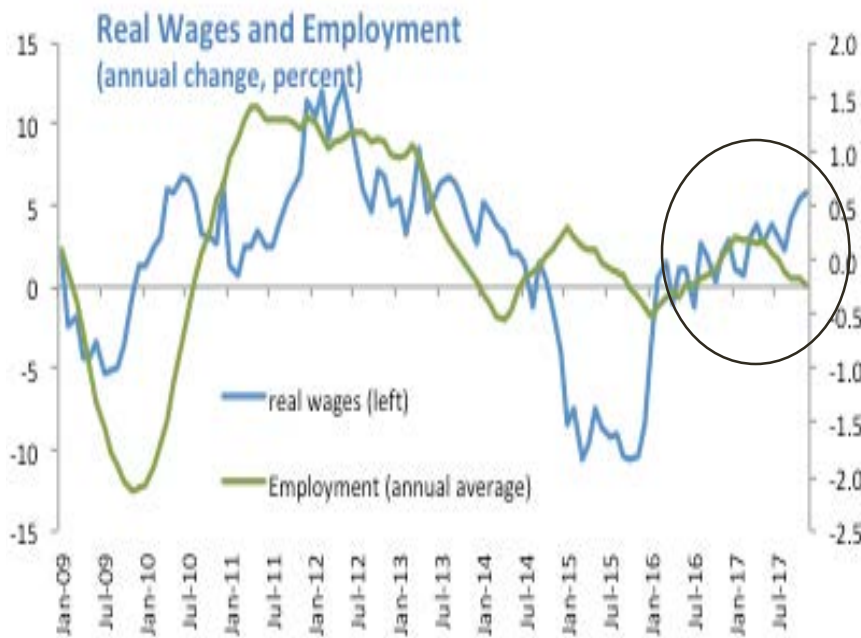


...and NPLs appeared to have peaked, allowing increases in real credit growth



Conditions for a mild cyclical rebound in 2017-18 are in place...

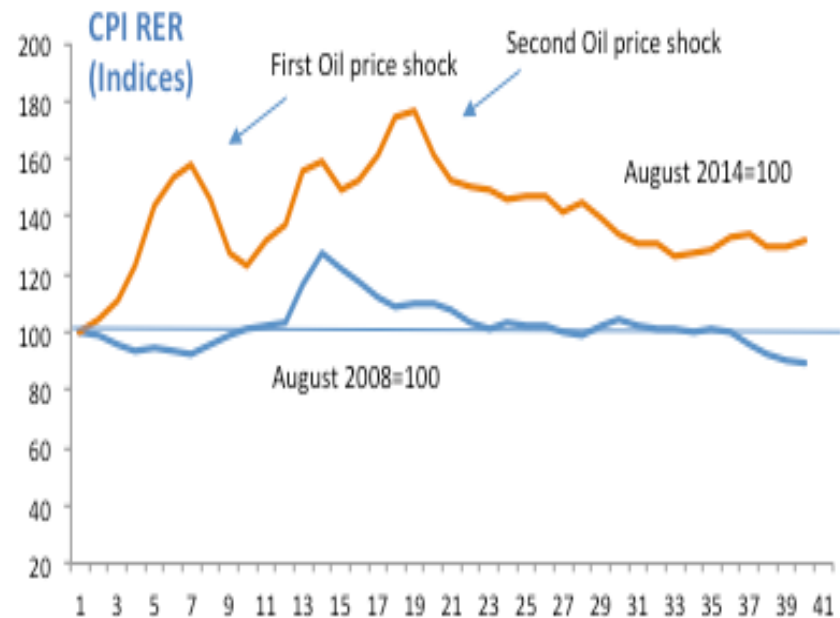
...real wages are growing, and employment and real disposable income are stabilizing, amid decreases in inflation



Conditions for a mild cyclical rebound in 2017-18 are in place...

Despite some weakness at end-2017, high frequency indicators show moderate signs of expansion, amid strengthening of the ruble

Russia: PMI Composite Output Total Economy
(>50 = Expansion)





Macroeconomic Policies in 2018-20: A Continuous Balancing Act

Policies in 2018-20 should balance the need to support the recovery while laying the ground for more diversified growth in the future

1. Fiscal Policy:

- 3-year budget consistent with primary balance in 2019
- Anchors federal budget to realistic oil prices and delinks expenditure from oil price fluctuations: New Fiscal Rule
- Measures to restore balance should be growth-friendly

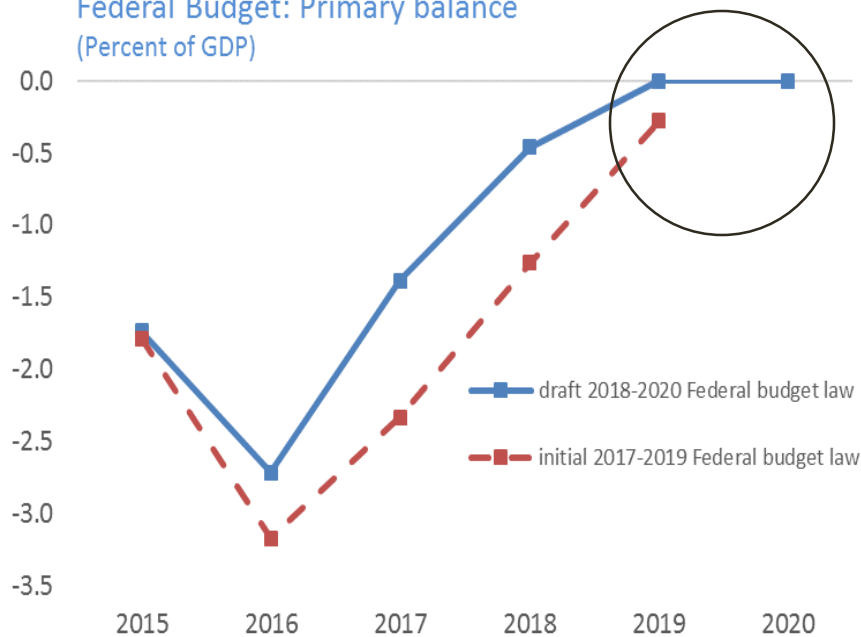
2. Monetary and Financial Policies:

- Further decreases in the key rate provided inflation continues in its current declining trend
- Continued attention to quality of bank assets to ensure a healthy sector

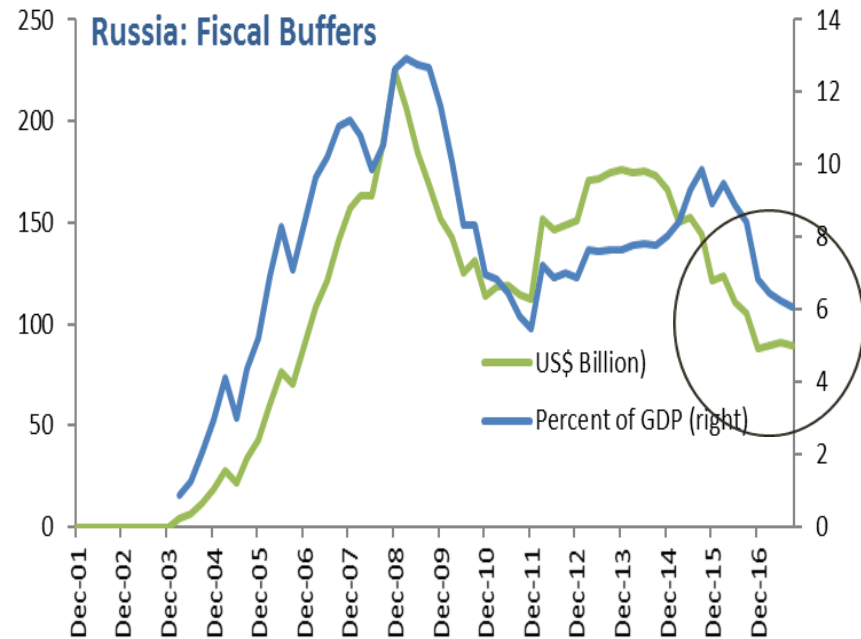
Macroeconomic Policies in 2018-20: A Continuous Balancing Act

...the fiscal deficit is contracting after increasing following the twin shocks and buffers are stabilizing

Federal Budget: Primary balance
(Percent of GDP)



Russia: Fiscal Buffers





The Bottom line: Moderate pick-up in Activity Given Small Economic Slack

Barring shocks, activity will pick up moderately in 2017-18. Relatively small output gap to be closed in 2018.

1. 2017:

- Growth to increase sequentially in 2017 to about 1.5 %
- Negative fiscal impulse to be offset by gradual normalization of CBR rates
- Inflation to undershoot CB target

2. 2018:

- Average growth to increase sequentially and stabilize around long-term trend
- Negative fiscal impulse to be offset by stronger credit growth and policy rate normalization
- Inflation to stay around the CB target (4 %)



Sources of Growth after Output Gap Closes?

Given demographics, market size will expand if investment and productivity support per capita growth. In absence of reforms, growth will be low.

1. Reforms needs to be adequately prioritized

- Fiscal Rule delinks expenditure from oil prices: RER stability
- Education, health and infrastructure expenditure are needed to sustain competitiveness. Pension Reform.
- Economy needs less administrative pressures, opening to trade, reducing footprint of state

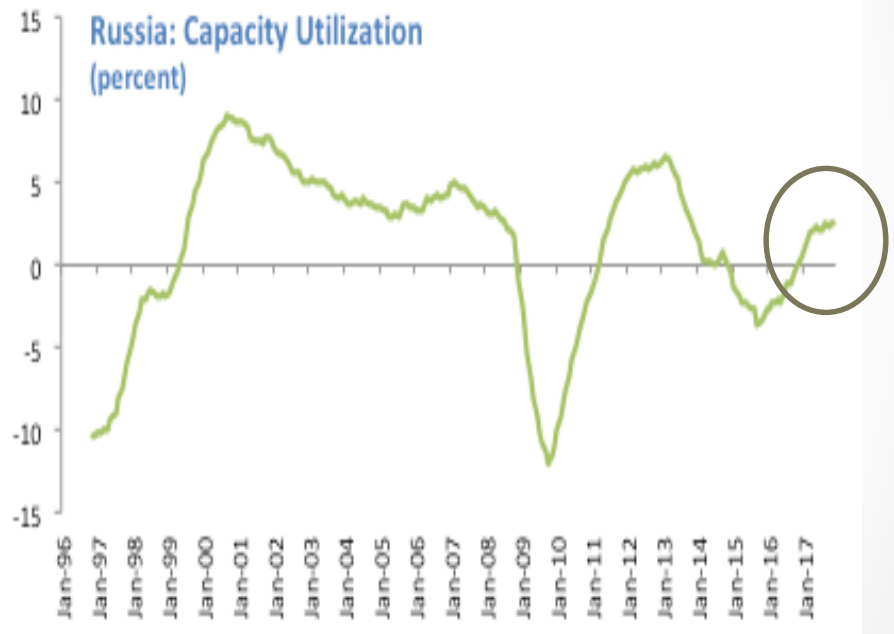
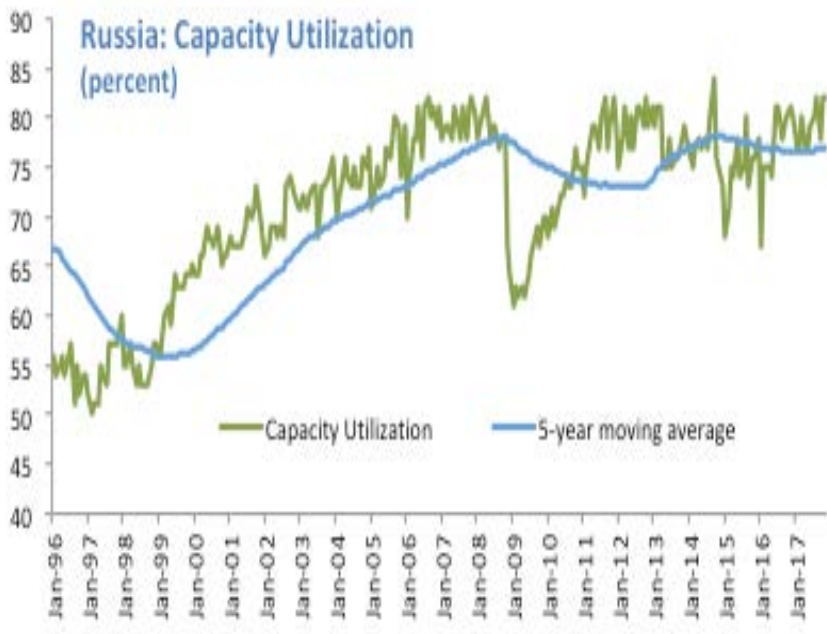
2. End to reform cyclicity to support Competitiveness

- Some convergence to OECD competitiveness but progress slow
- Need to break reform 'cyclicity' and need targeted reforms to leverage better relative prices

Capacity utilization increases will not provide a lasting boost

Unlike in the early 2000s capacity utilization is high...

...and thus, its increases will not provide a lasting boost to growth



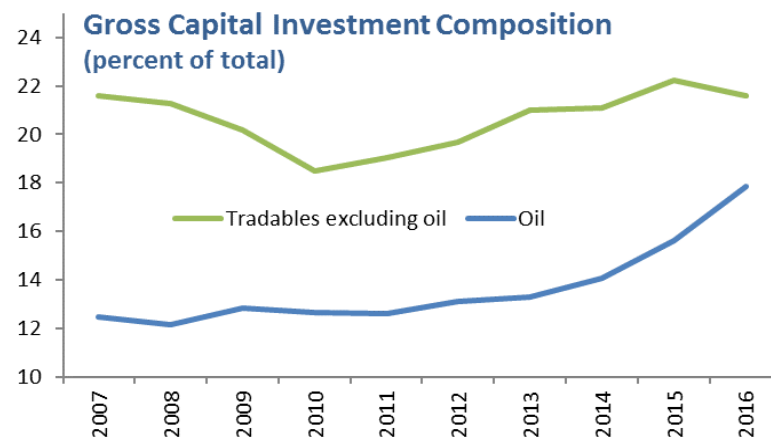
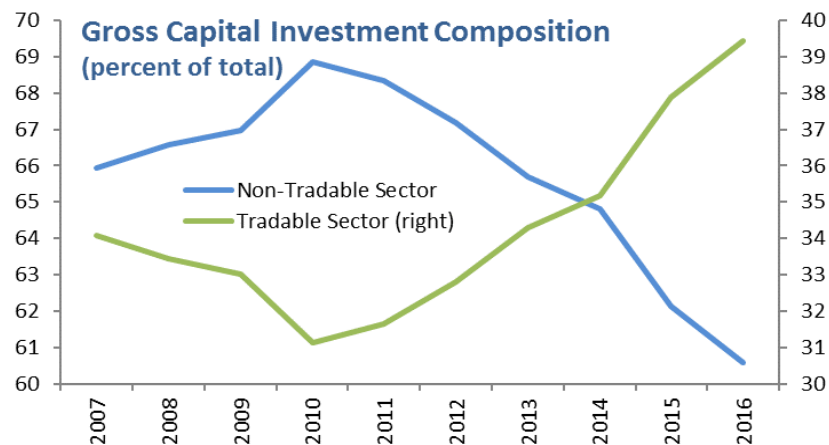
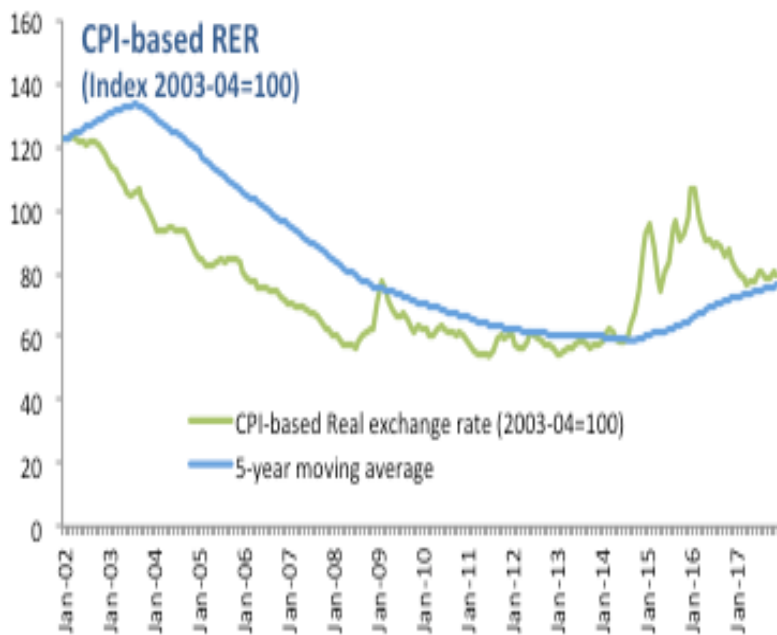


Fiscal Rule: Looking better

1. **MINFIN proposal an improvement vis-a-vis previous rules:** Oil Price benchmark (US\$40/b) similar to 50-year average, prudent, more credible than 5/10 backward-looking MAs.
2. **Challenges – Issues for further thought**
 - ***Need mechanism to adjust benchmark downwards:*** Changes in oil Prices are persistent; 80s/90s prices were persistently lower than 50-year average. Need mechanism to adjust benchmark (and non-oil deficit) downwards.
 - ***Target:*** Primary balance may be an appropriate operational target for 2018-19, but low for inter-generational equity, and given demographics, pension liabilities and other inflexible spending.

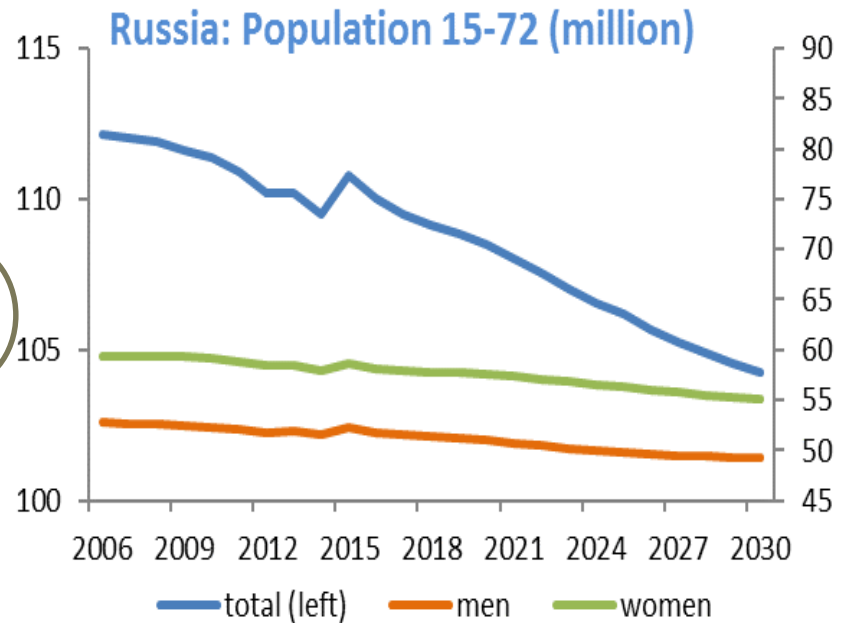
Fiscal Rule and Relative Price Stability

The budget has worked as a propagating mechanism to oil price volatility. A fiscal rule will stop that.



Market Size: Productivity and Demographics

Growth in output per worker has steadily decreased, and working age population to decrease too in the next few years



Market Size: Income Distribution

An unequal income distribution may limit the room for demand growth, constraining existing pent-up demand of durables

Population by per-capita money income ¹⁾
(percent of total)

| | 2010 | 2012 | 2013 | 2014 | 2015 | 2016 |
|-------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Total population | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| of which | | | | | | |
| with average per capita | | | | | | |
| monthly money income, | | | | | | |
| under 7000 | 18.8 | 12.6 | 9.8 | 8.1 | 6.2 | 6.1 |
| 7000,1 – 10000 | 14.6 | 11.9 | 10.4 | 9.4 | 8.0 | 7.9 |
| 10000,1 – 14000 | 16.6 | 15.3 | 14.2 | 13.4 | 12.2 | 12.0 |
| 14000,1 – 19000 | 15.2 | 15.5 | 15.2 | 15.0 | 14.4 | 14.3 |
| 19000,1 – 27000 | 14.7 | 16.7 | 17.5 | 17.8 | 18.1 | 18.1 |
| 27000,1 – 45000 | 13.3 | 17.2 | 19.3 | 20.7 | 22.5 | 22.6 |
| 45000,1 – 60000 | 6.8 | 5.4 | 6.5 | 7.3 | 8.4 | 8.5 |
| over 60000,0 | ... | 5.4 | 7.1 | 8.3 | 10.2 | 10.5 |

81.0

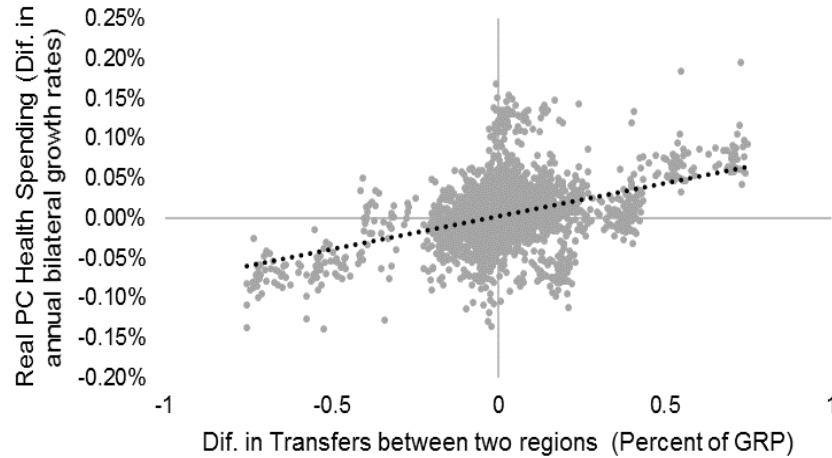
Source: Rosstat

¹⁾ Estimation is based on sample household budget survey and macroeconomic indicator of per capita money income of population.

Market Size: Regions

Fiscal Federalism supported better regional education, health and infrastructure, but has not contributed to close income disparities

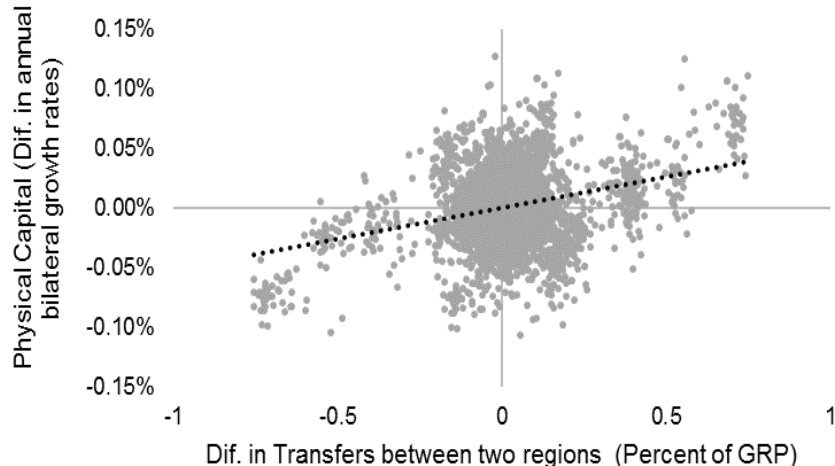
Transfers and Per Capita Spending in Health



Federal Transfers and Regional Public Sector Size



Transfers and Physical Capital Accumulation



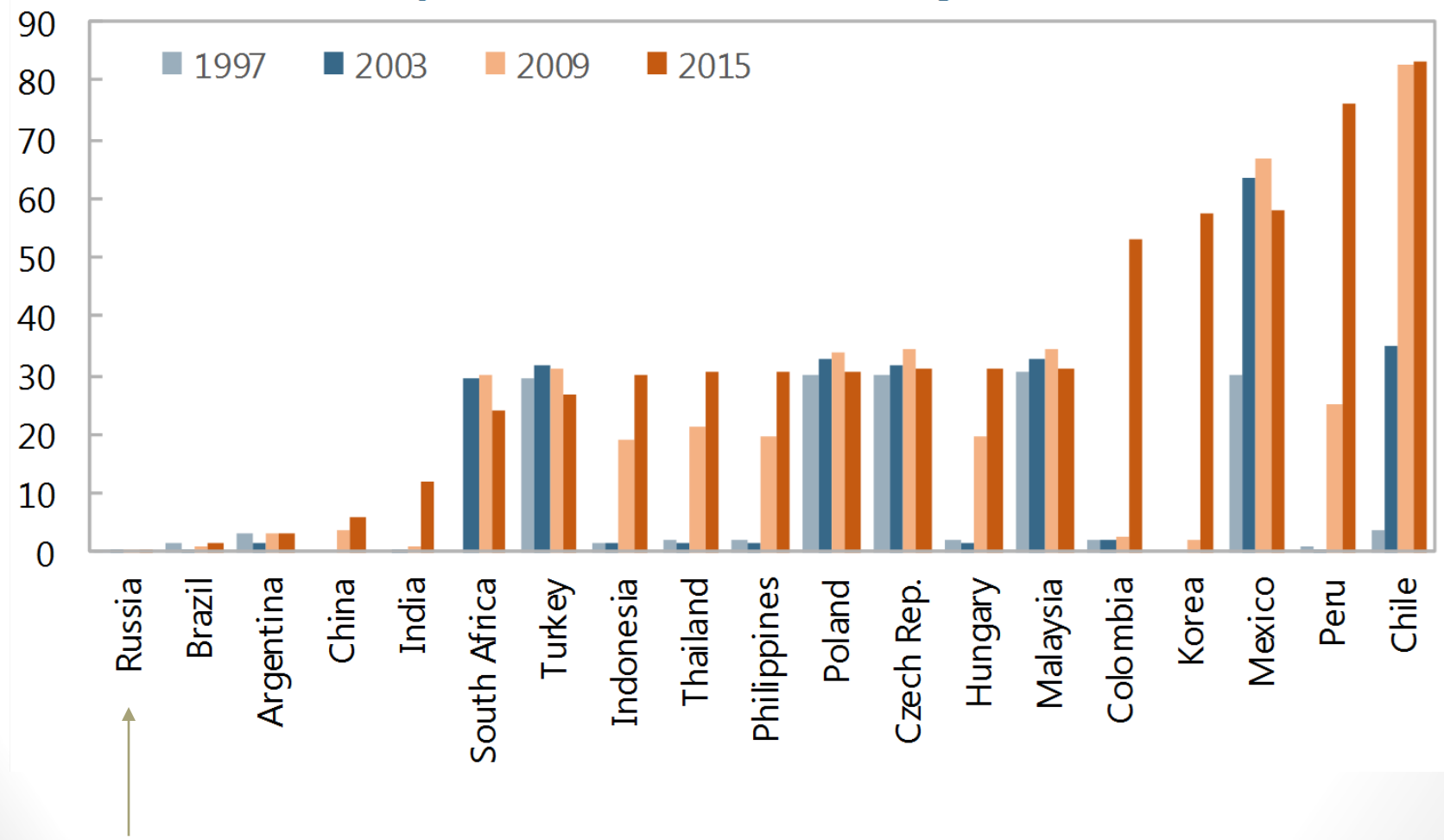
Federal Transfers and Regional TFP Growth





Market Access: Still much to do

RTA partner countries share in global GDP





Footprint of the State: *What we do know*

1. **Share of the State is large:** About 64,000 budgetary, extra-budgetary, unitary and joint stock companies most of which operating at the regional level in 2016.
2. **The state operates in all sectors of economic activity:** Agriculture, mining and extraction, manufacturing and all services.
3. **In Regions it is associated with lower productivity:** Higher transfers resulted in higher public sectors, higher factor accumulation but lower productivity.



Footprint of the State: *What we (still) don't know*

1. **Share of the “State” in the Economy unknown:** Need a better understanding of the share of government (at different levels), EBFs, SOEs (financial and non-financial) in GDP.
2. **State’s Footprint should be the focus of analysis and structural reforms in Russia:** Data needed including for public employment. Affects perceptions. Assess importance on:
 - Competition
 - Adoption of technology
 - Contingent fiscal liabilities

Risk Factors: WEO – January 2018

Risks on global growth forecast balanced in the near term, but skewed to the downside in medium term.

- **Upside:** Stronger/more sustained rebound in Europe, where political risk has diminished.
- **Downside:**
- High Policy Uncertainty coupled with rich market valuations and very low volatility
- China's strong credit growth
- Monetary policy normalization in advanced economies
- A turn toward inward-looking policies and geopolitical risks – (and sanctions)



Russia: Mitigating Factors

1. Mitigating Factors (Stocks):

- Low public debt ratios
- Positive External Investment Position
- High levels of External Reserve Buffers
- Relative Prices broadly aligned with fundamentals

2. Mitigating Factors (Flows):

- Current Account surplus
- Manageable Fiscal Deficits
- Floating Exchange Rates



Большое Спасибо