



# Russian Federation

## In Search of a New Growth Model

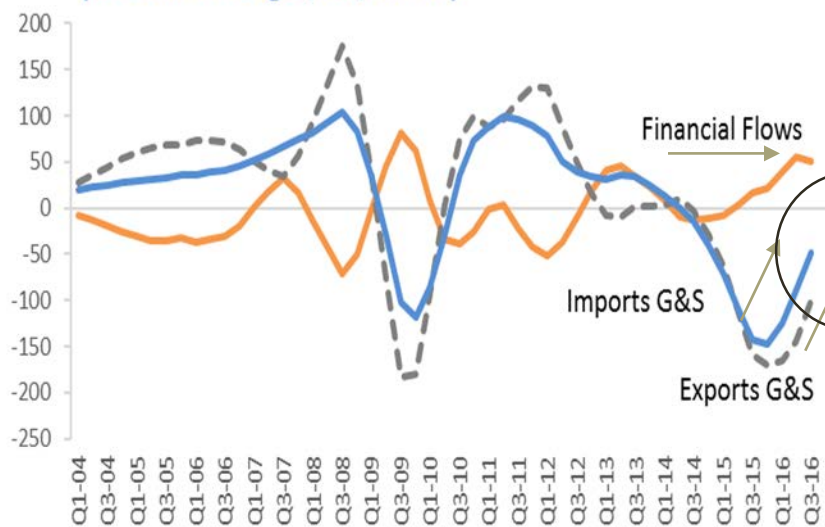
IMF MOSCOW OFFICE

November 2017

# Russia stabilized in 2016 after External Shocks...

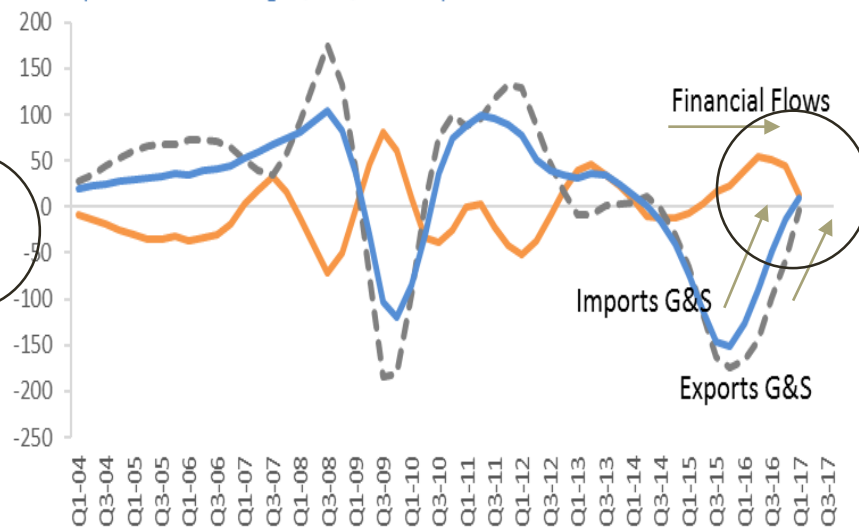
*Lower net financial outflows together with higher oil prices have allowed economic activity to stabilize*

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



November 2016

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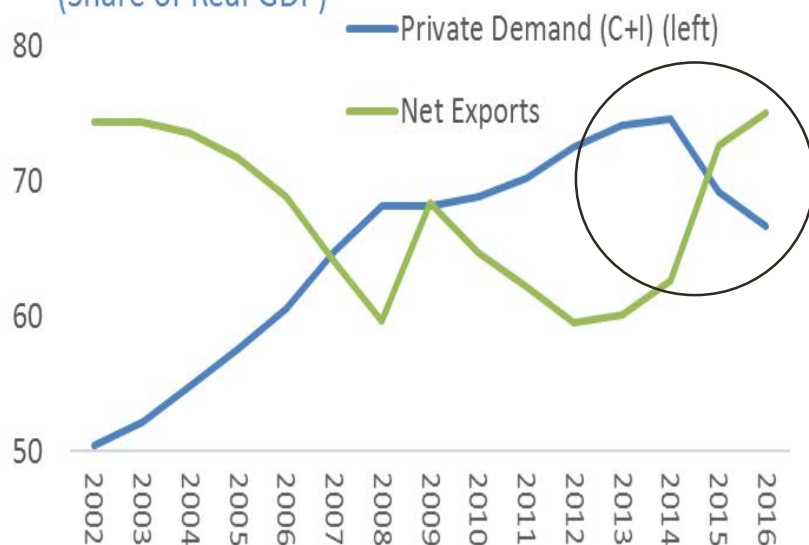


November 2017

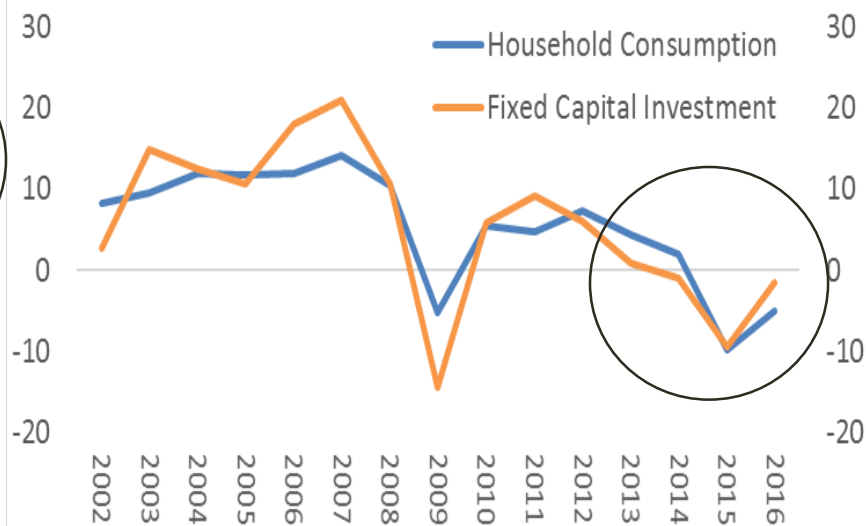
# Russia stabilized in 2016 after External Shocks...

*Consumption of Households continued adjusting in 2016 while Fixed Capital Investment stabilized*

Russia: Aggregate Demand  
(Share of Real GDP)



Russia: Aggregate Demand  
(annual real change, percent)

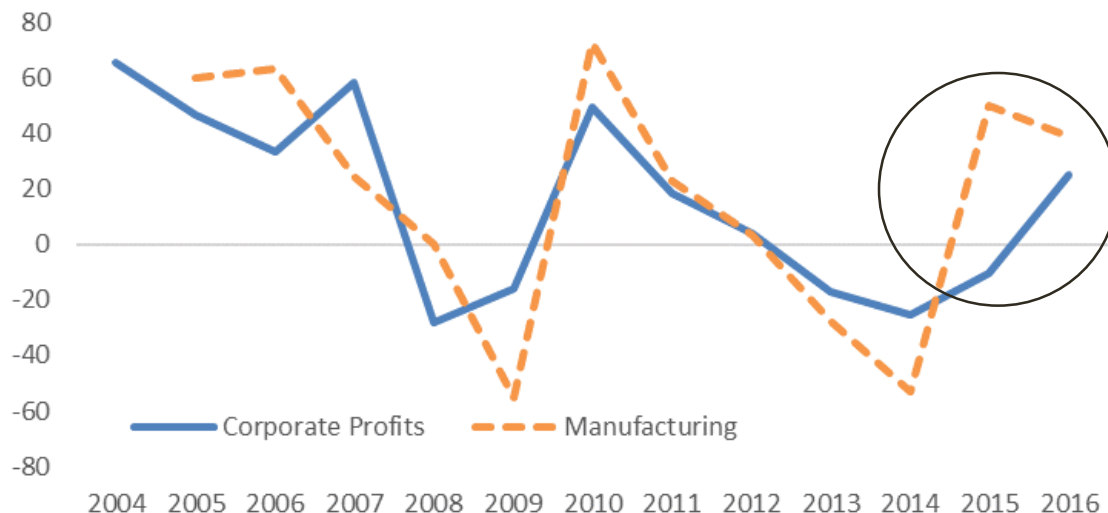


# Conditions for a mild cyclical rebound in 2017-18 are in place...

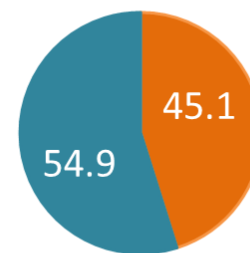
*Corporate profits increased, and own cash-flows replaced other sources as main factor in financing investment...*

## Russia: Corporate Profits

(annual percentage change, over US\$ values)

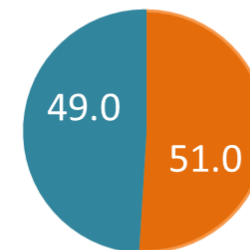


2012-14



Own Funds Other Sources

2015-16



Own Funds Other Sources

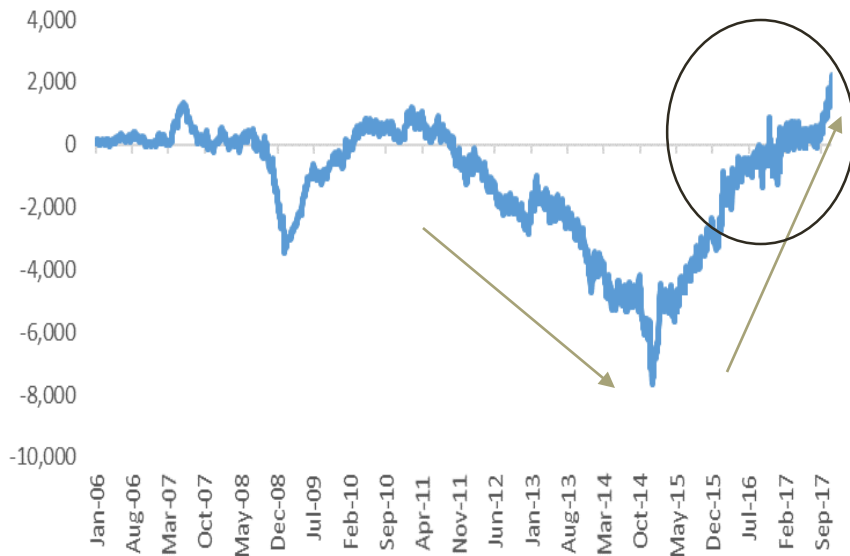


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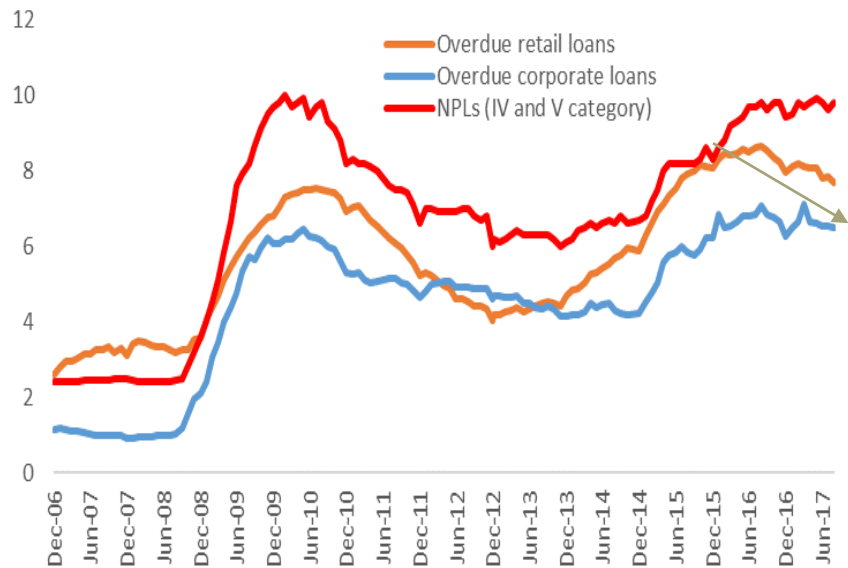
*The banking system is moving to structural liquidity...*

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

Banking Sector: Liquidity Surplus+ / Deficit-

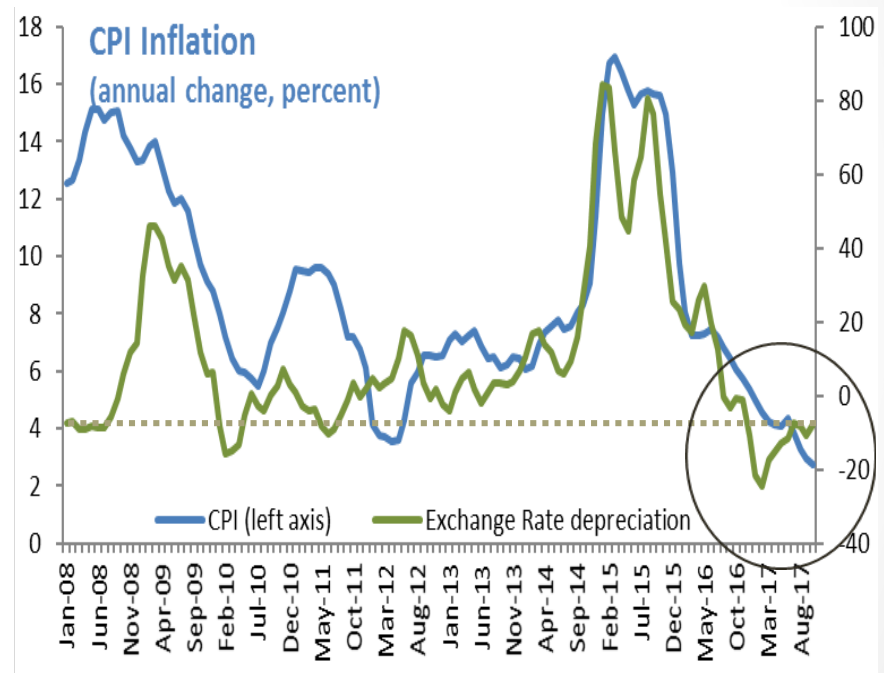
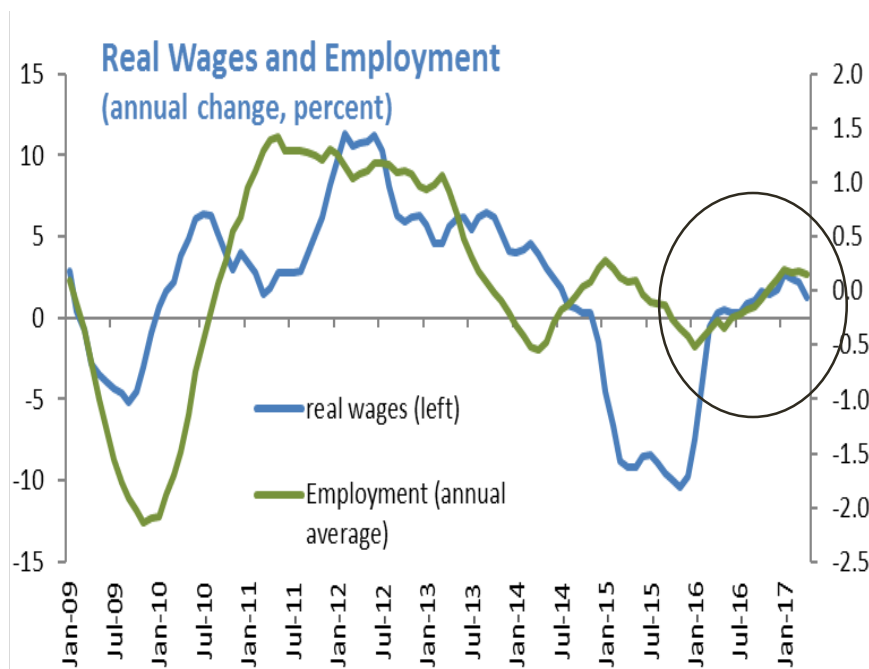


Banking Sector: Share of overdue loans and NPLs



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

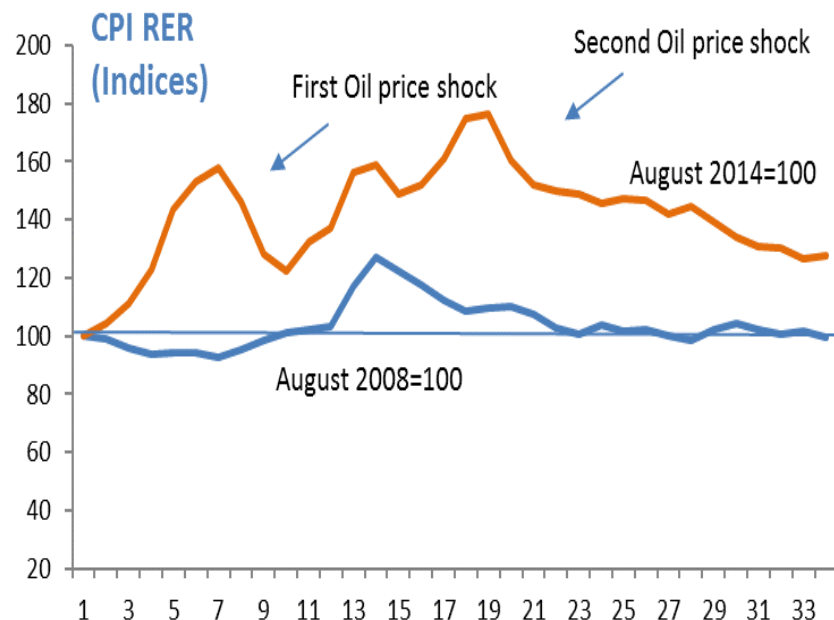
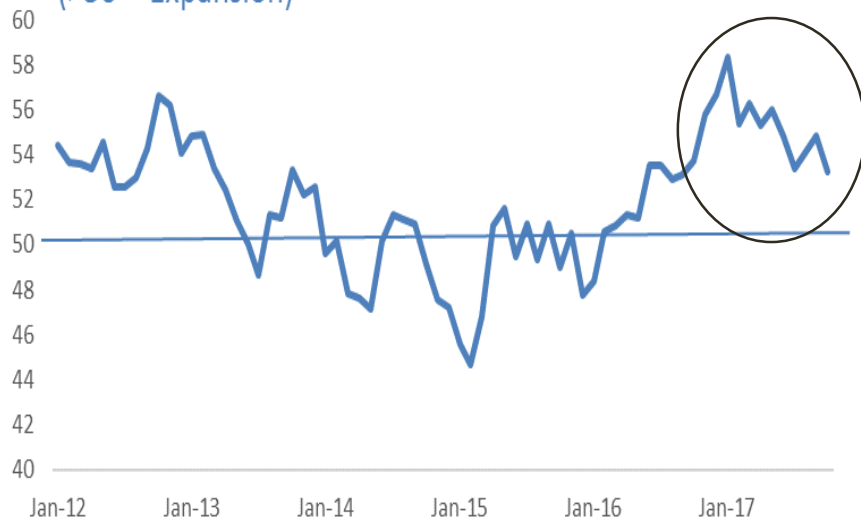
*...real wages and employment began growing, and real disposable income is stabilizing, amid decreases in inflation*



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

*High Frequency indicators show some moderate signs of expansion, amid some strengthening of the real value 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:

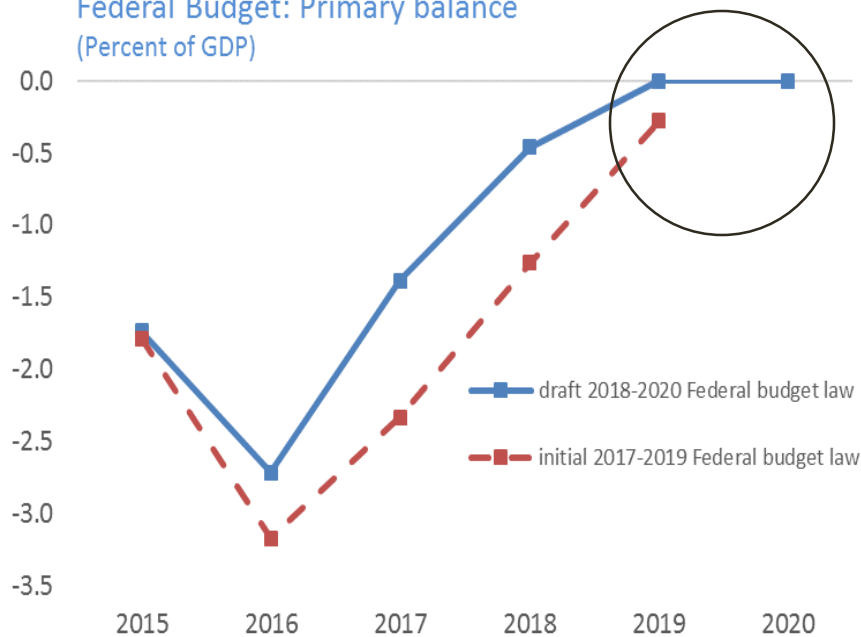
- Further decreases in the key rate provided inflation continues in its current declining trend
- Continued attention to quality of bank assets to ensure a healthy sector



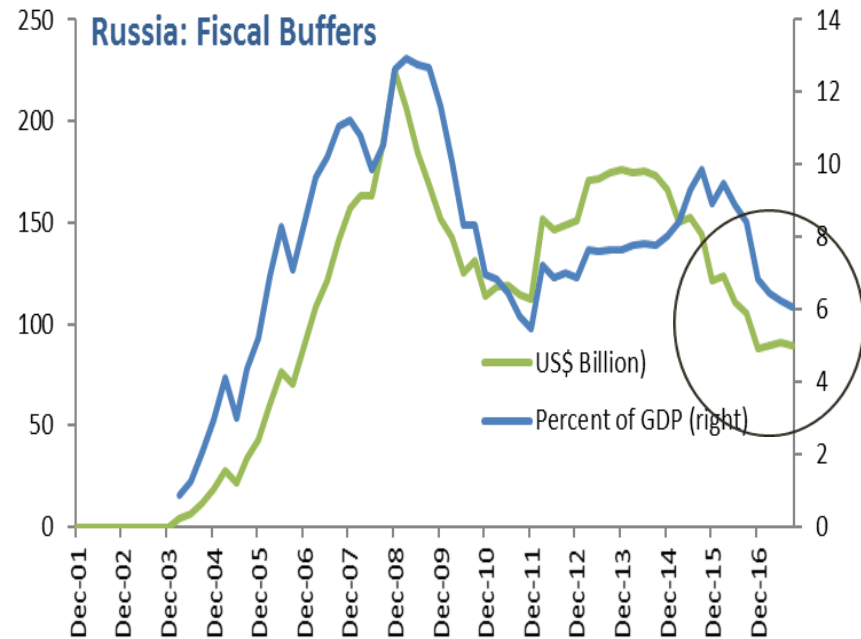
# Macroeconomic Policies in 2018-20: A Continuous Balancing Act

*...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 1.8 %
- Negative fiscal impulse to be offset by gradual normalization of CBR rates
- Inflation to converge to CB target

## 2. 2018:

- Average growth to increase sequentially and stabilize around long-term trend (1.6 %)
- 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 cyclicalities to support Competitiveness

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



# Market Size: How Fast will Expand?

*Stronger integration with external markets essential to support higher growth rates. Domestic markets to expand moderately.*

## 1. Domestic

- **Demographics:** Population Composition and Growth
- **Income per capita:** Productivity and Capacity Expansion
- **Income distribution:** Pent-up demand, credit, tax policy
- **Geography:** Infrastructure, Human Capital, Concentration
- **Access:** Administrative pressure, market competition

## 2. External

- **International context:** Strategic choosing
- **Integration:** Long-term Endeavor
- **Ease of Doing Business:** Customs
- **Appropriate Relative Prices:** Macro policies

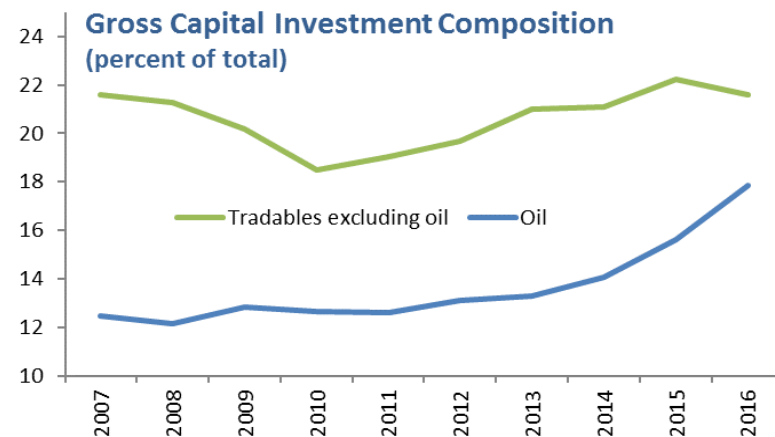
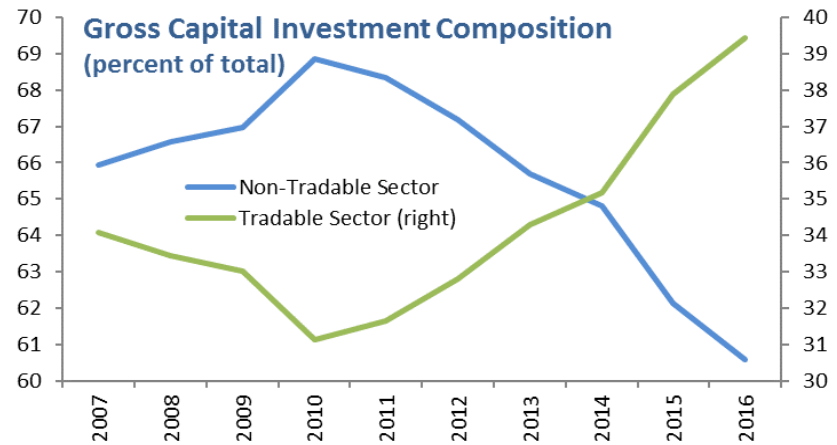
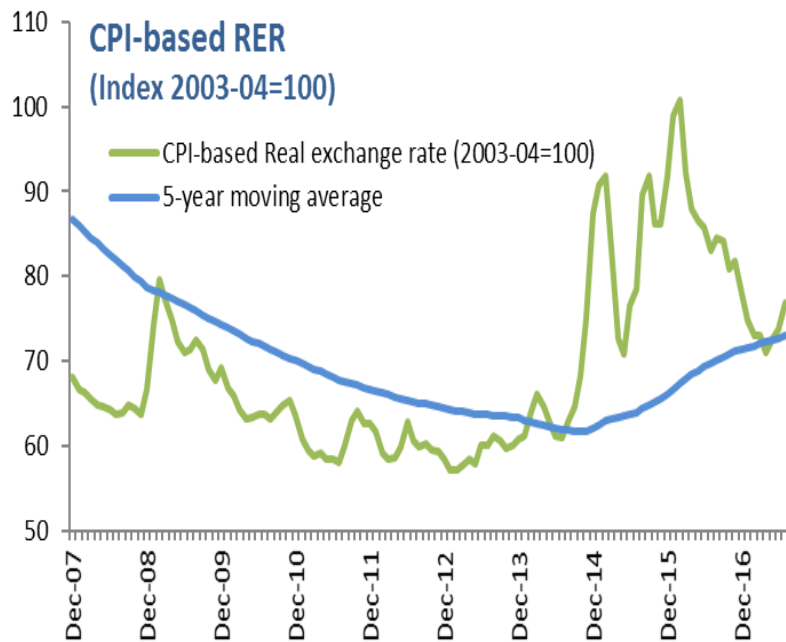


# Fiscal Rule: Looking better

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.

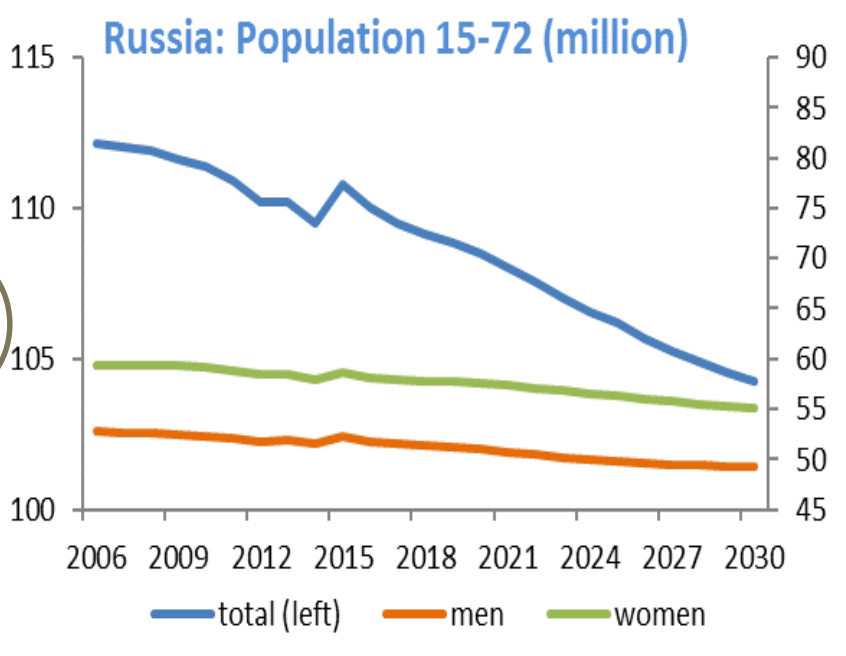
# Fiscal Rule and Relative Price Stability

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



# Market Size: Productivity and Demographics

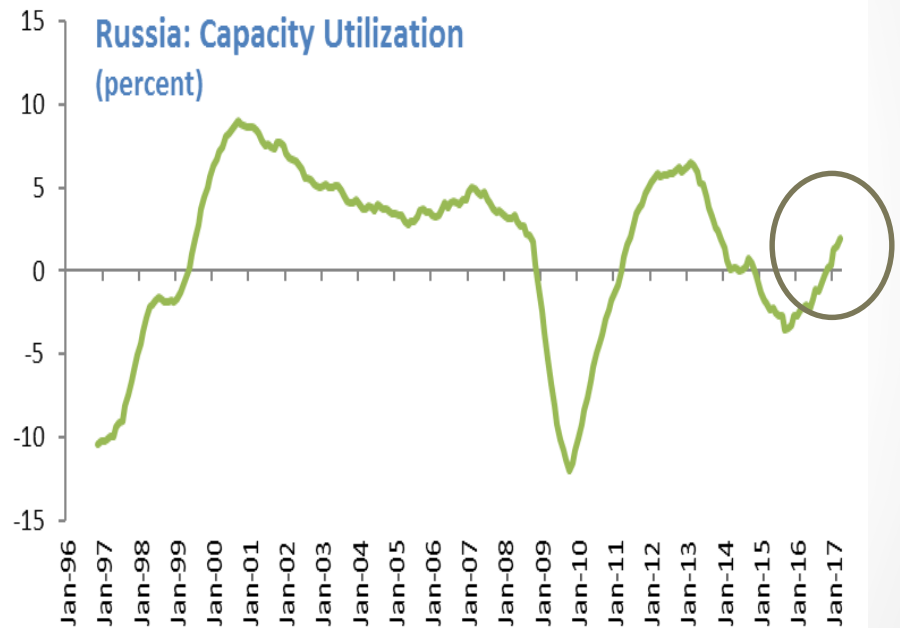
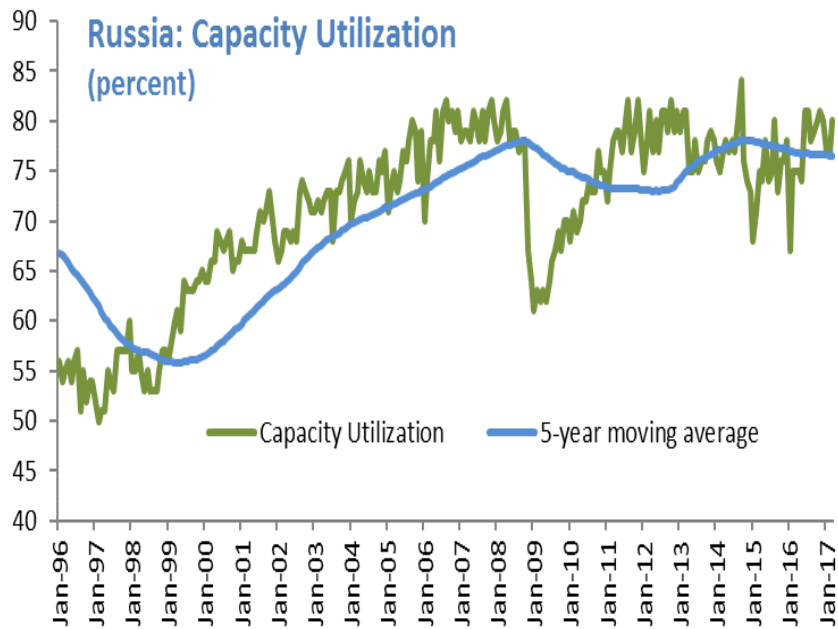
*Growth in output per worker has steadily decreased, and working age population to decrease too in the next few years*



# 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*





# 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 <sup>1)</sup>**  
(percent of total)

	2010	2012	2013	2014	2015	2016
<b>Total population</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
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

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



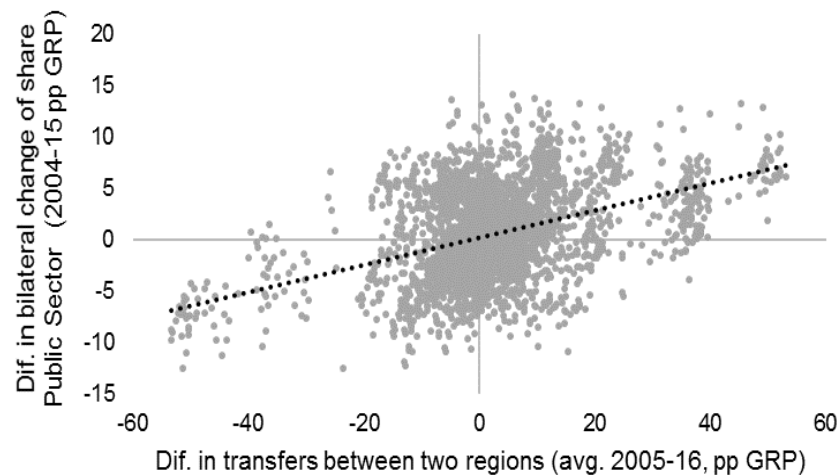
# Market Size: Regions

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

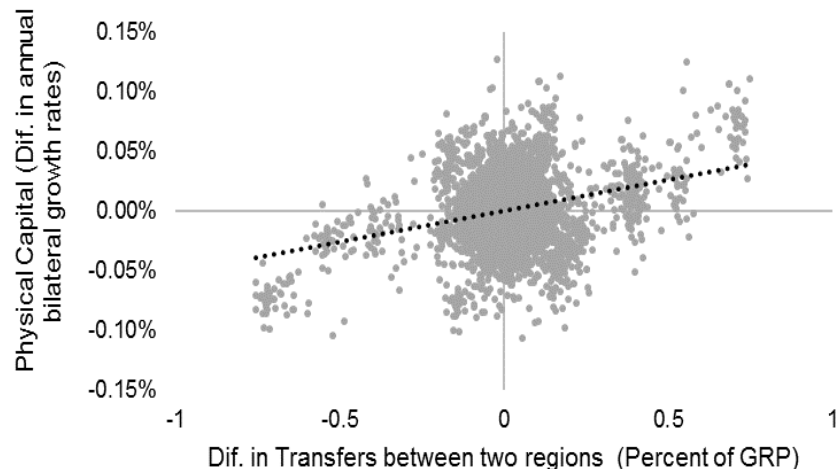
Transfers and Per Capita Spending in Health



Federal Transfers and Regional Public Sector Size



Transfers and Physical Capital Accumulation



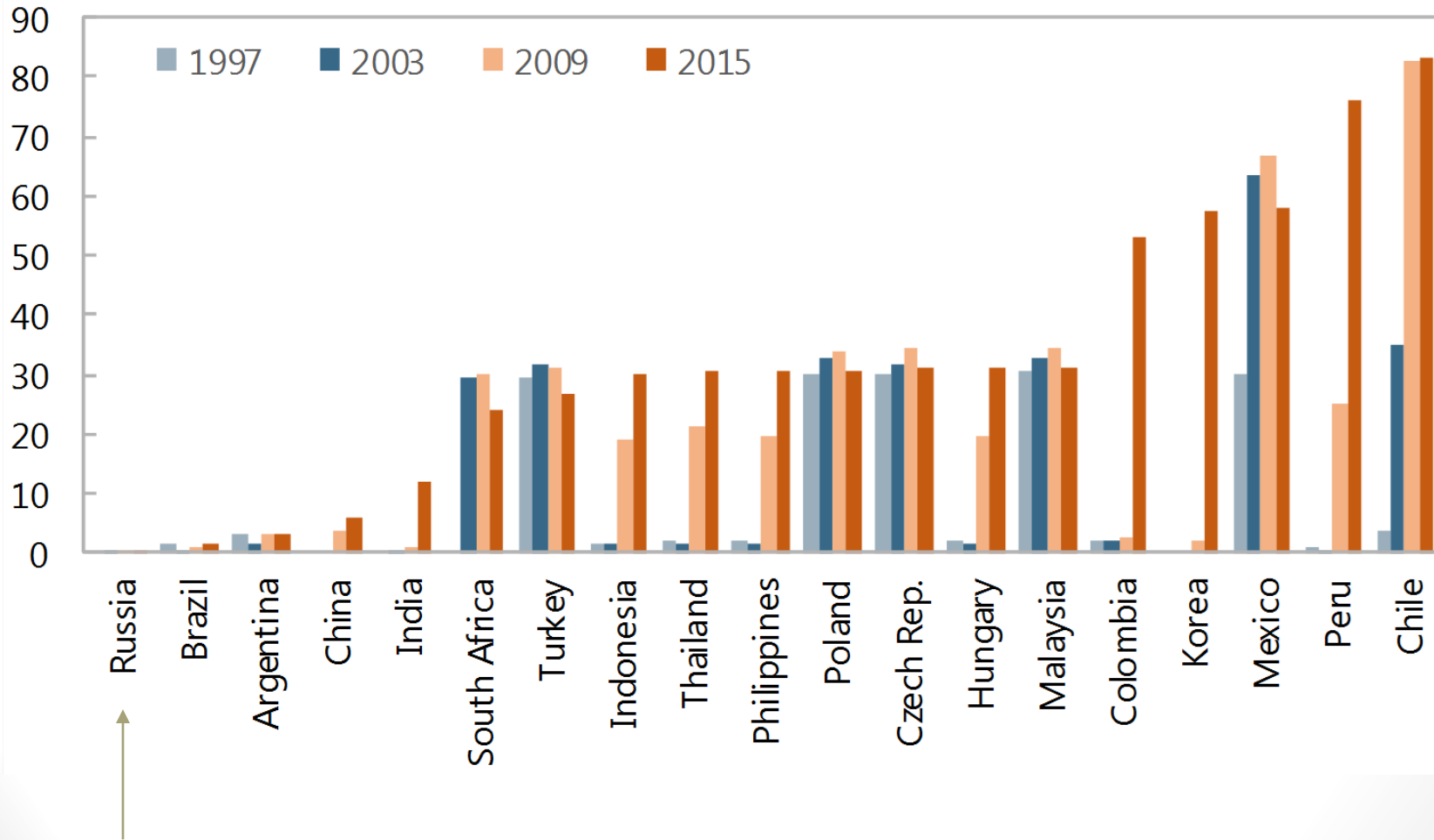
Federal Transfers and Regional TFP Growth





# 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 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 – October 2017

*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



# 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**