

Russian Federation

Short-term Outlook and Long-term Challenges

IMF MOSCOW OFFICE

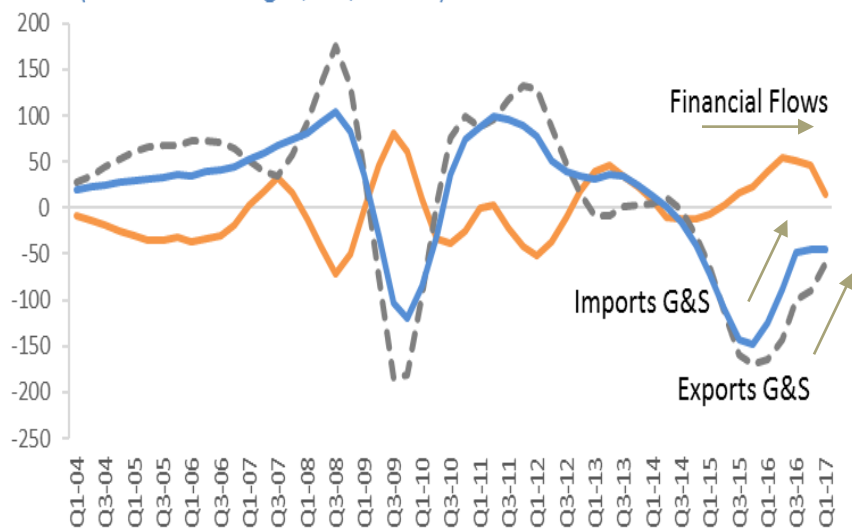
June 2017

Russia stabilized in 2016 after External Shocks...

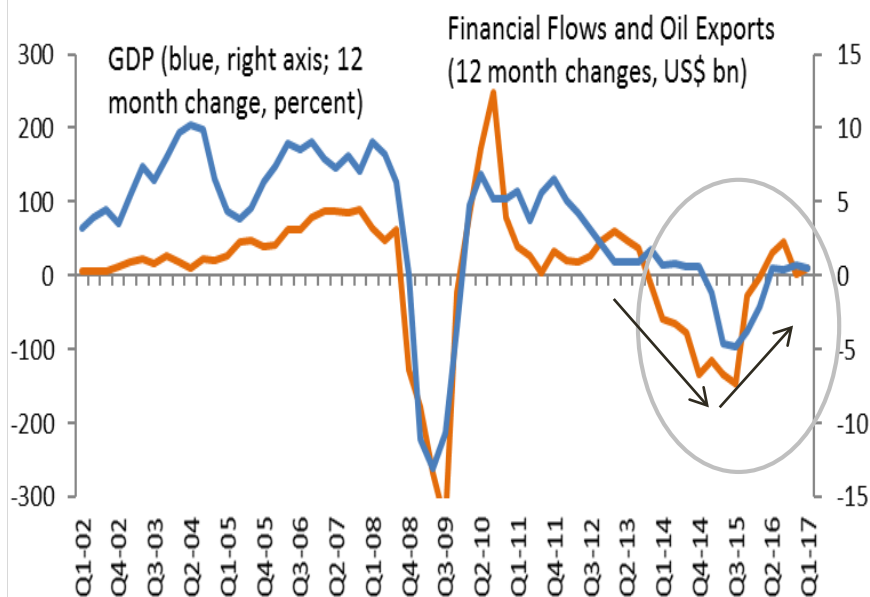
Lower net financial outflows together with higher oil prices have allowed economic activity to stabilize

Russia. Exports, Imports and Financial Flows

(12-month changes, US\$ billion)



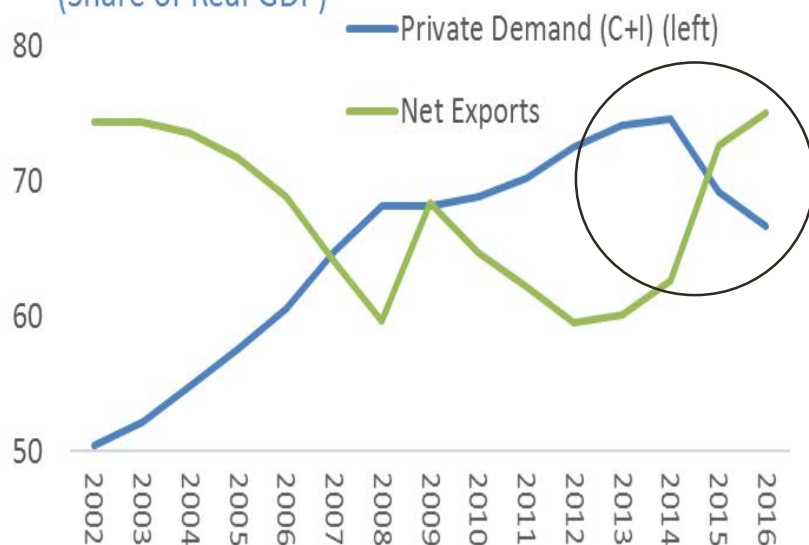
Russia. External Conditions and Activity



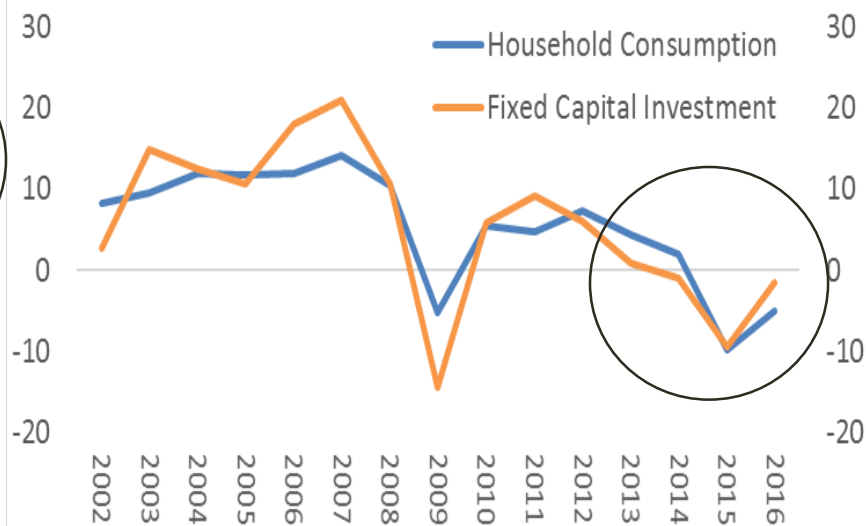
Russia stabilized in 2016 after External Shocks...

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)

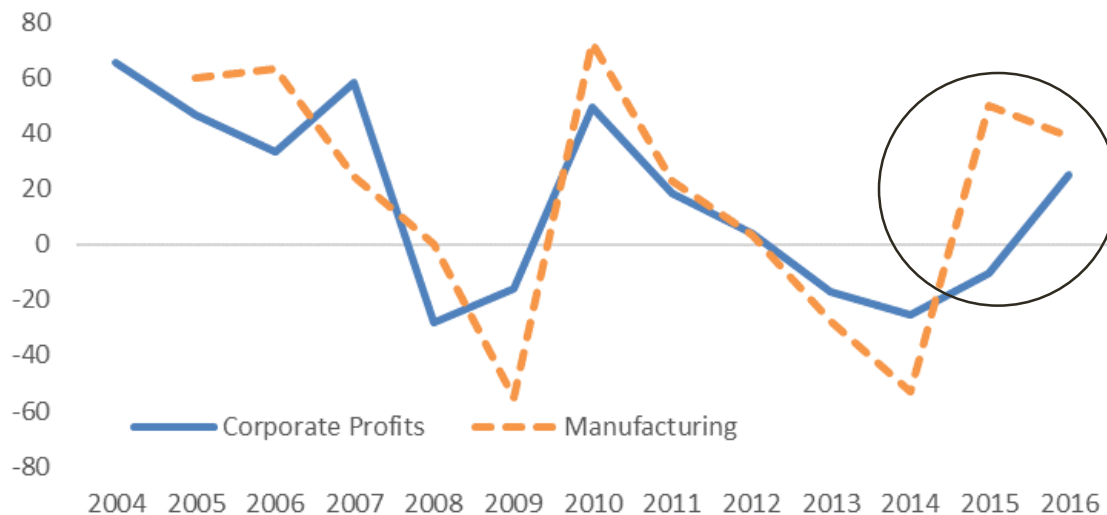


Conditions for a mild cyclical rebound in 2017-18 are in place...

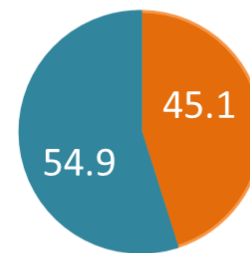
Corporate profits increased, and own cash-flows replaced other sources as main factor in financing investment...

Russia: Corporate Profits

(annual percentage change, over US\$ values)

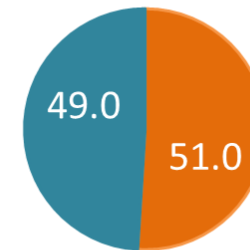


2012-14



Own Funds Other Sources

2015-16



Own Funds Other Sources

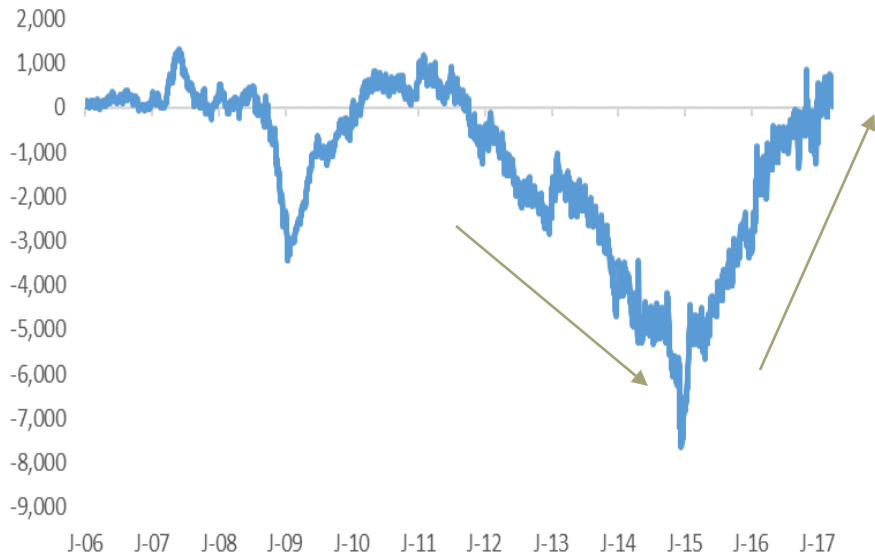


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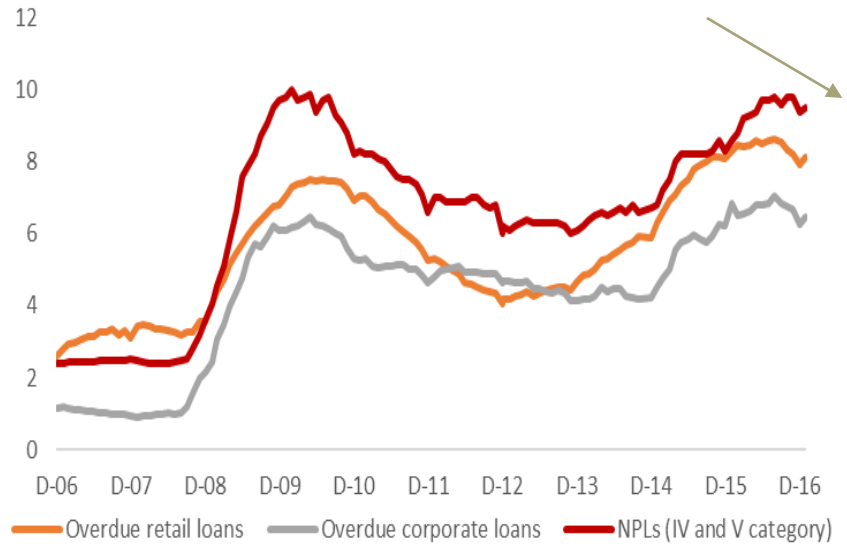
The banking system is moving to structural liquidity...

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

Liquidity Surplus+ / Deficit-

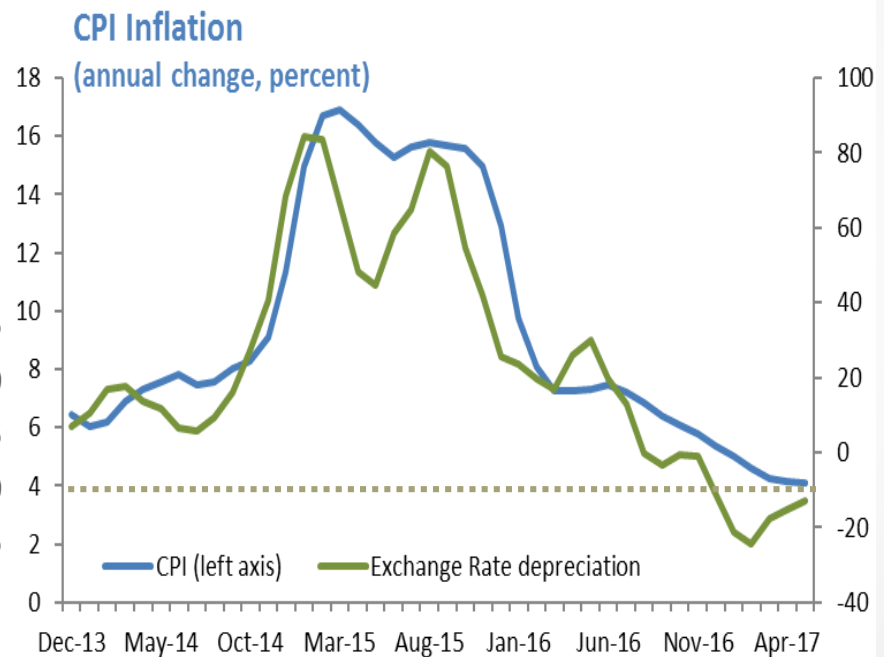
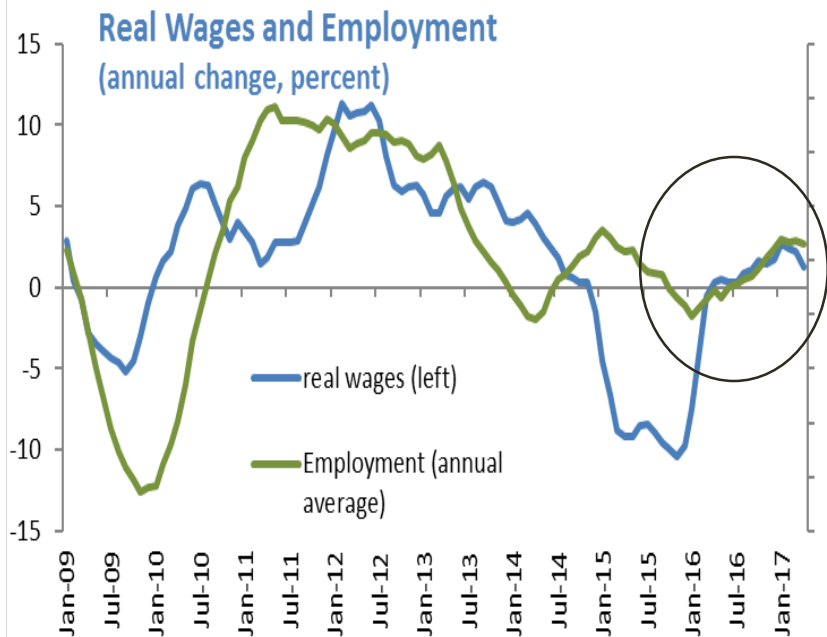


Russia: Share of overdue loans and NPLs



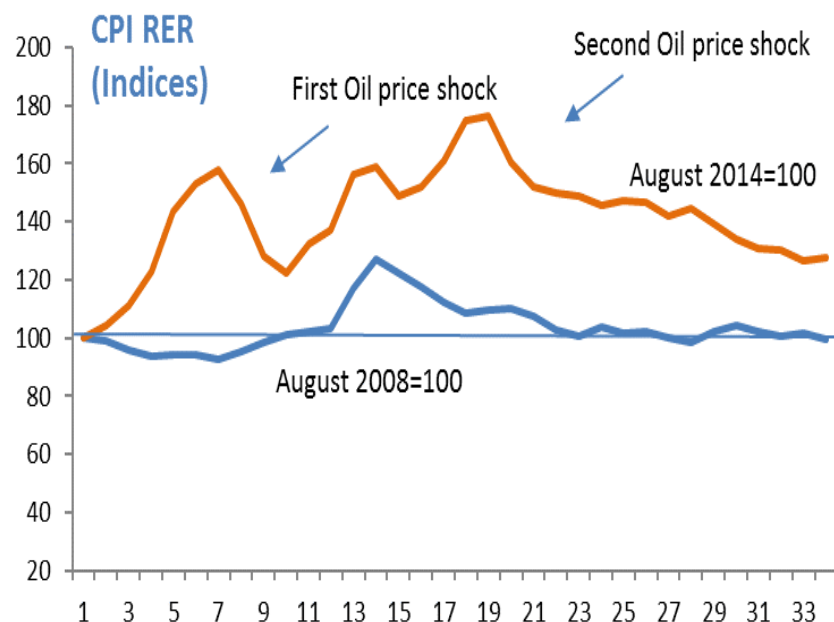
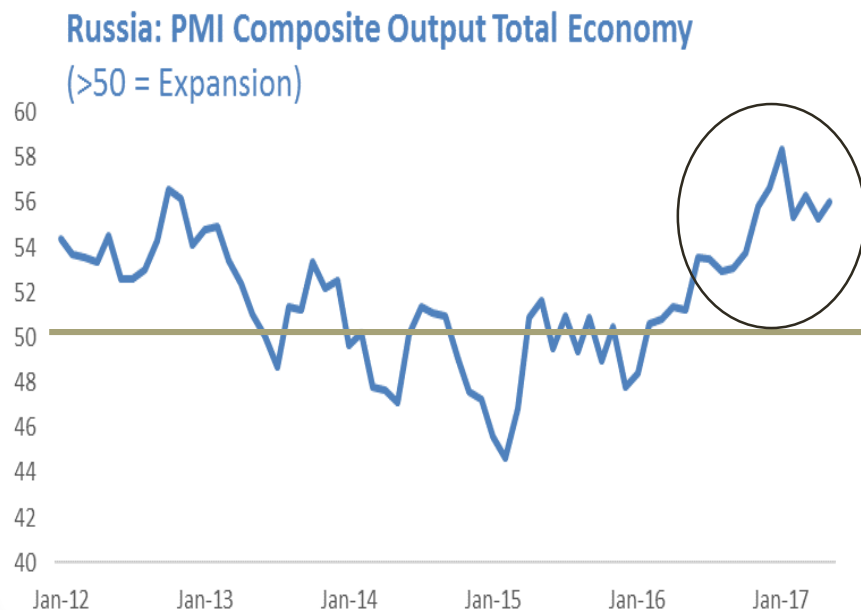
Conditions for a mild cyclical rebound in 2017-18 are in place...

...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





Macroeconomic Policies in 2017-18: A Balancing Act

Policies in 2017-18 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 targets deficit reduction of 1 pp of GDP/year
- Anchors federal budget to realistic oil prices and delinks expenditure from oil price fluctuations: 1st step to new 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



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 1.4 %
- 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 (1.5 %)
- 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

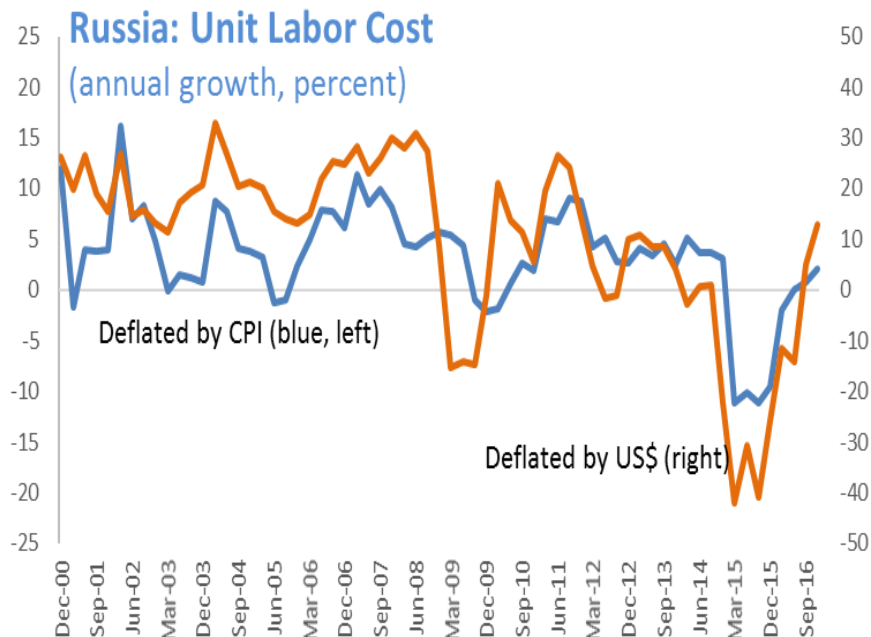
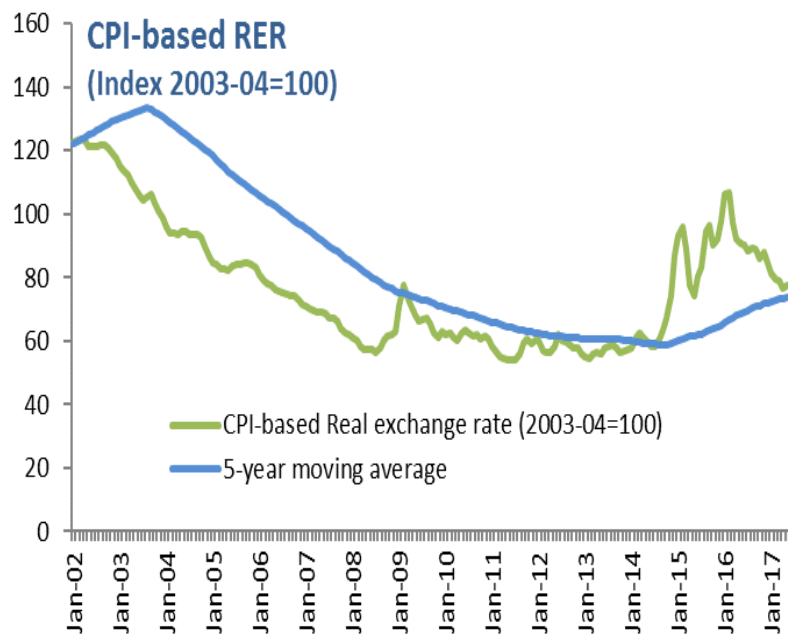
- Fiscal Rule delinks expenditure from oil prices: RER stability
- Education, health and infrastructure expenditure are needed to sustain competitiveness. Pension Reform.
- Economy needs less administrative pressures, opening to trade, reducing footprint of state

2. End to reform cyclicality to support Competitiveness

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

Fiscal Rule and Relative Price Stability

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



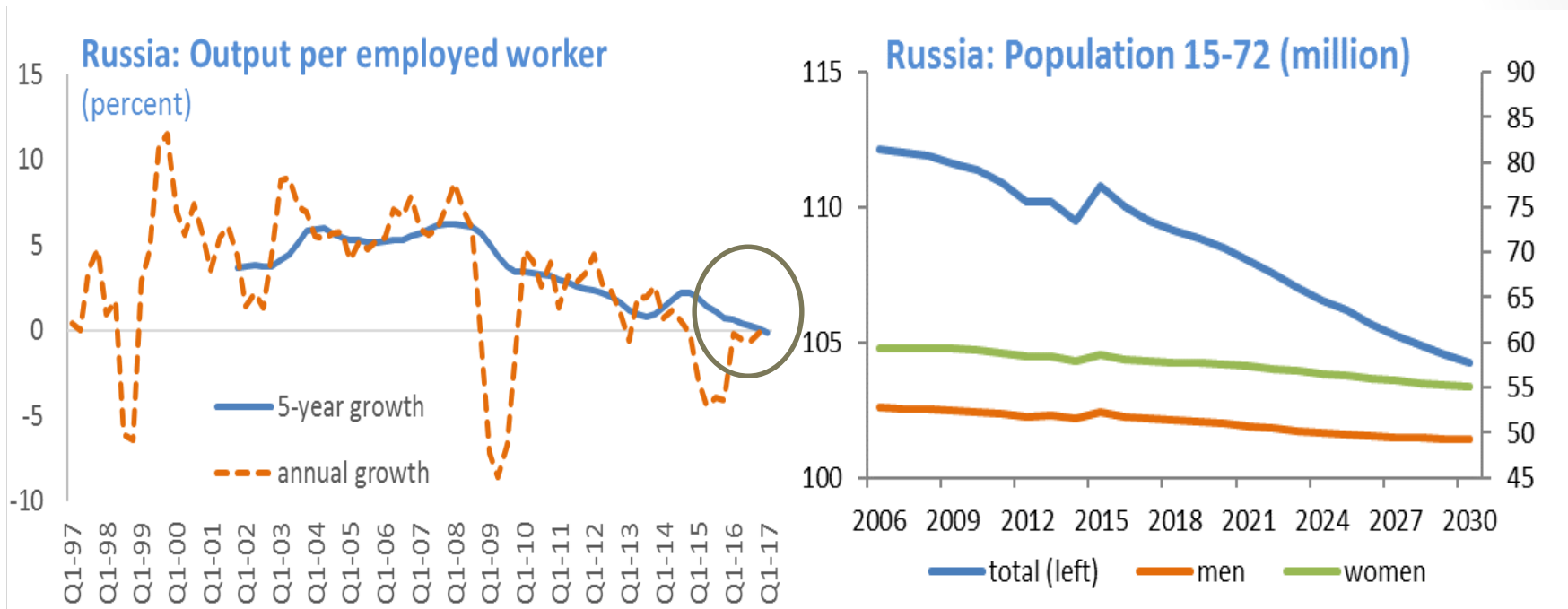


Fiscal Rule: Looking better

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.

Productivity and Demographics

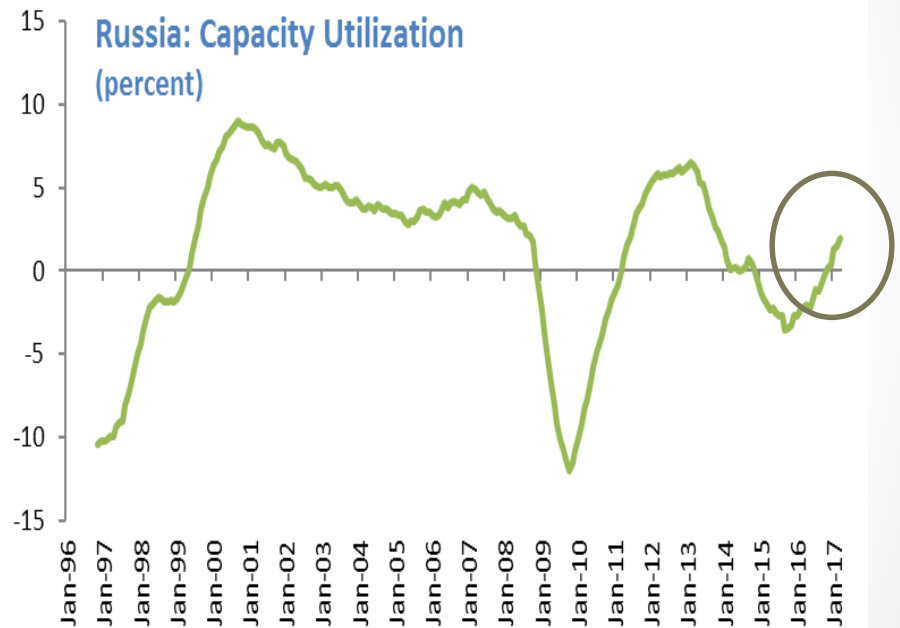
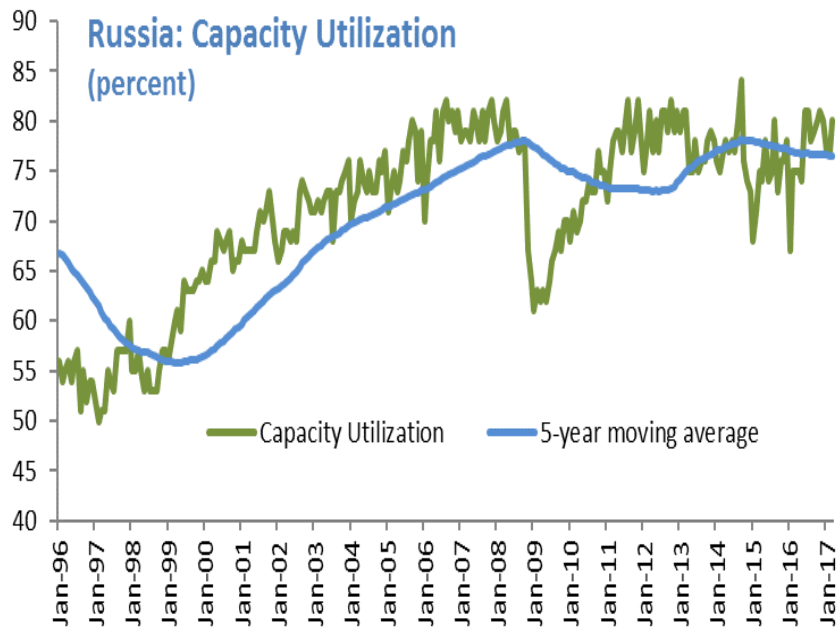
Growth in output per worker has steadily decreased, and working age population to decrease too in the next few years



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





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.



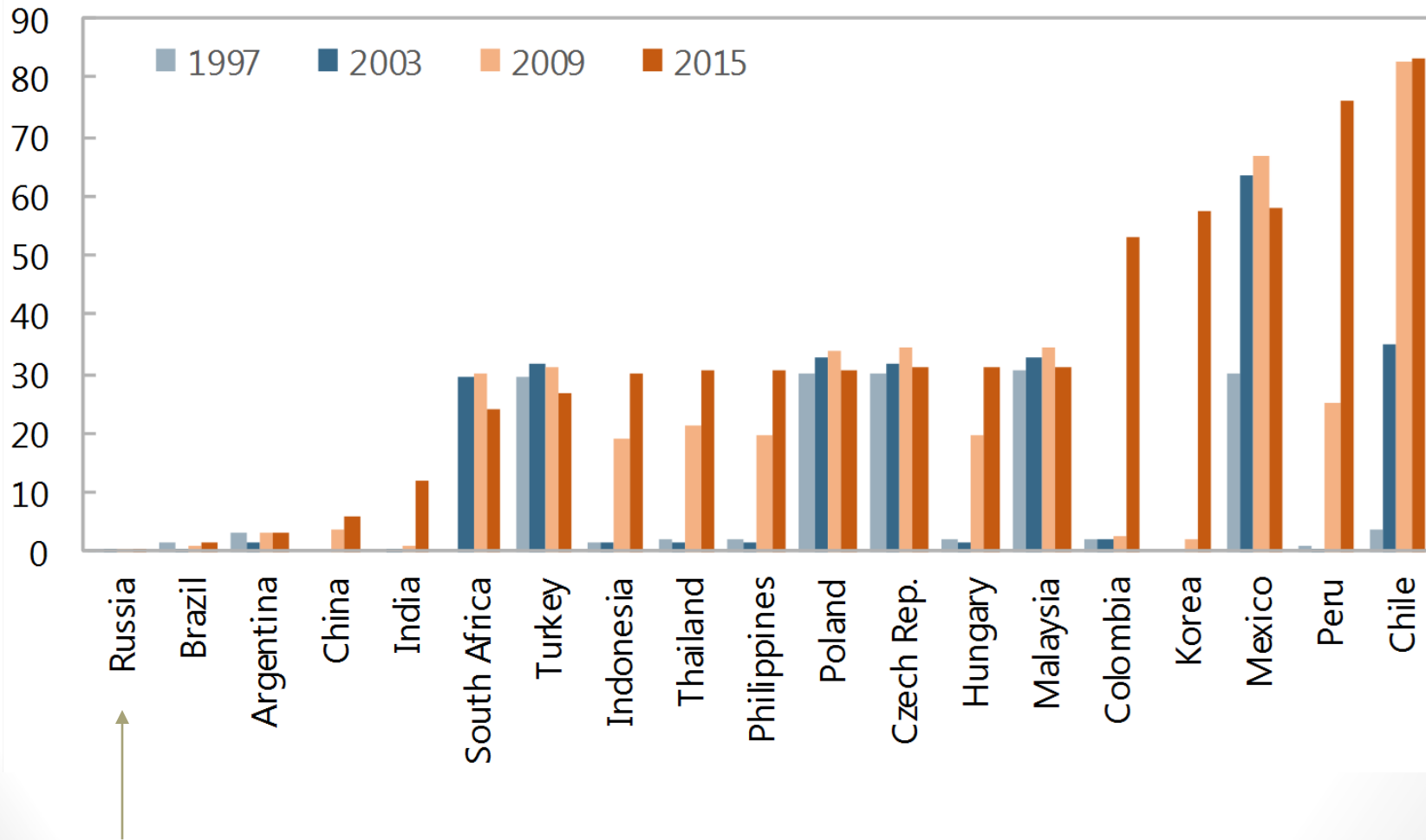
Footprint of the State: *What we don't know*

1. **Share of the “State” in the Economy unknown:** No official data (past or present) to reconstruct 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. Assess importance on:
 - Competition
 - Adoption of technology
 - Contingent fiscal liabilities



Market Access: Still much to do

RTA partner countries share in global GDP



Russia: Risks and Mitigating Factors

External risks: Oil price and financial market volatility and geopolitical tensions.

Domestic risks: Mainly linked to fiscal policy implementation

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



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