INTERNATIONAL MONETARY FUND

IMF Country Report No.11/294

# RUSSIAN FEDERATION

## 2011 ARTICLE IV CONSULTATION

September 2011

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 2011 Article IV consultation with Russian Federation, the following documents have been released and are included in this package:

- **Staff Statement** of September 9, 2011, updating information on recent developments.
- **Staff Report** for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 14, 2011, with the officials of Russian Federation on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 4, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Public Information Notice** (PIN)summarizing the views of the Executive Board as expressed during its September 9, 2011 discussion of the staff report that concluded the Article IV consultation.

The document(s) listed below have been or will be separately released.

Selected Issues Paper
Financial Sector Stability Assessment

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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**International Monetary Fund**
**Washington, D.C.**

Statement by the IMF Staff Representative on the Russian Federation
September 9, 2011

1. **This statement reports on information that has become available since the staff report was issued. This information does not alter the thrust of the staff appraisal.**

2. **Incoming data since the completion of the Article IV consultation in mid-June have been mixed.** The preliminary 2011Q2 outturn for GDP growth was weaker than expected, suggesting that seasonally-adjusted quarter-on-quarter growth was only 0.1 percent compared to 0.9 percent in 2011Q1. The extent of the slowdown was surprising given that short-term indicators suggested robust performances in retail trade and fixed investment in April-June. Inflation slowed in July on the back of lower food prices, but remained elevated at 9 percent year-on-year vs. 9.4 percent in June. As in many other countries, financial conditions have worsened in Russia since the staff report was finalized at end-July as the MICEX index has dropped by more than 10 percent and the EMBI+ spread has increased by about 35 basis points. Since end-July, the ruble has depreciated by about 5 percent vis-à-vis the currency basket. Last, both the end-July federal government nonoil deficit and the end-May general government nonoil deficit outturns were better than projected at 5.1 percent of GDP and 1.4 percent of GDP, respectively, due to higher nonoil revenues and lower spending.

3. **Overall, these data and the worsened outlook for global growth have caused staff to revise its near-term growth forecast downward, though the substance of staff's policy advice is unchanged.** On the basis of the recent slowdown observed in Russia, a stronger-than-anticipated slowdown in global growth, and lower oil prices, staff has revised down its GDP growth forecast by half a percent in 2011 and 0.4 percent in 2012, to 4.3 percent and 4.1 percent, respectively. However, the balance of risks to the outlook is tilted to the downside as both global growth and oil prices could yet be weaker than expected. Staff has also marked down its forecast for 2011 year-end inflation by half a percent to 7.5 percent, given recent inflation data and expectations that continued food price deflation will more than offset the recent ruble depreciation. This level will still exceed the central bank's own target range of 6–7 percent for end-2011 and in the staff's view, further monetary tightening remains necessary to bring inflation firmly on a path toward an appropriate medium-term level of 3–5 percent. Staff is now forecasting a slightly more favorable federal government nonoil deficit of 11 percent in 2011, compared with 11.2 percent in the staff report, to reflect the latest budget outturn and the expectation of another supplemental budget later this year. Unless oil prices decrease substantially from current levels and the growth outlook becomes much weaker, staff's advice remains for a more ambitious medium-term fiscal consolidation than planned to return the nonoil deficit to a sustainable level, through growth-friendly, credible measures.

4. **An initial draft of Strategy 2020 was released in August.** The interim report on this social and economic strategy to guide Russia's development through the year 2020 was developed by a number of expert working groups, commissioned by the government. The report proposes a set of recommendations as a basis for government discussion and stresses the importance of policy changes to achieve high-quality economic growth by ensuring macroeconomic and social stability, improving the business and investment climate, and diversifying exports. Discussion of Strategy 2020 is now ongoing, and the authorities also plan to seek input from foreign experts, including the Fund, on their assessment of the report. This process is expected to lead to changes in the policy recommendations and should be completed by December 1. Staff's preliminary assessment is that the recommendations dovetail well with the reforms discussed in the staff report and, accordingly, would help lay the basis for sustained growth.

5. **The date for parliamentary elections has been set for December 4.** Presidential elections will follow in the first part of 2012.

# RUSSIAN FEDERATION

## STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

August 4, 2011

## KEY ISSUES

**Background:** While the authorities' crisis response was broadly effective, post-crisis economic performance has been unimpressive, high oil prices notwithstanding. The exit from crisis-related fiscal stimulus has been slow, while the central bank has been hesitant to respond to rising inflation. Financial stability has been maintained, but banks remain burdened with a high stock of nonperforming assets. Meanwhile, the poor business climate continues to hamper investment.

**Challenges:** The key challenge is to leverage the commodity boom to put growth on a sustained higher trajectory and reduce Russia's economic vulnerabilities. This would require breaking with the procyclical policies of the past, strengthening economic policy frameworks, and reinvigorating long-stalled reforms. The authorities broadly agreed with this assessment, but noted that most difficult reforms would need to be postponed until after the 2011 parliamentary and 2012 presidential elections.

**Policy recommendations:** Growth can be lifted through a set of mutually reinforcing policies, underpinned by stronger economic frameworks: a more decisive fiscal consolidation; monetary policy focused on inflation; stronger financial sector supervision; and a more welcoming investment climate. The authorities and staff agreed that a more credible, ambitious, and growth-friendly deficit reduction, supported by a sound fiscal framework, would promote economic stability and balanced growth. However, the authorities noted the difficulty in implementing fiscal adjustment in a pre-election year. The authorities did not see a clear need to tighten monetary policy—advocated by Fund staff to lower inflation—expecting that a slowdown in money growth, a moderation of food inflation, and further ruble appreciation would reduce inflationary pressures going forward. The authorities welcomed the recommendations of the recent FSAP stability module mission to strengthen the financial sector supervision to reduce risks and support sustainable credit growth and saw a speedy adoption of the legislation on connected lending and consolidated supervision as a key priority. Finally, like staff, the authorities attached great importance to improving the investment climate, confirming their intention to implement the President's plan to strengthen the business environment.

Approved By
**Antonio Borges and David Marston**

Discussions for the 2011 Article IV consultation were held in Moscow during June 2–14. The mission comprised Mr. Kähkönen (head), Ms. Zakharova, Ms. Gust, Messrs. Hofman and Kim (all EUR), Mr. Demekas and Ms. Melo (MCM), Mr. Brekk (senior resident representative) and Ms. Dynnikova (Moscow-based economist). Mr. Mozhin, Executive Director, also participated in the discussions. The mission met with Deputy Prime Minister and Minister of Finance Kudrin, Central Bank of Russia (CBR) Governor Ignatiev, other senior officials, and representatives of financial institutions, corporations, academia, and think tanks.

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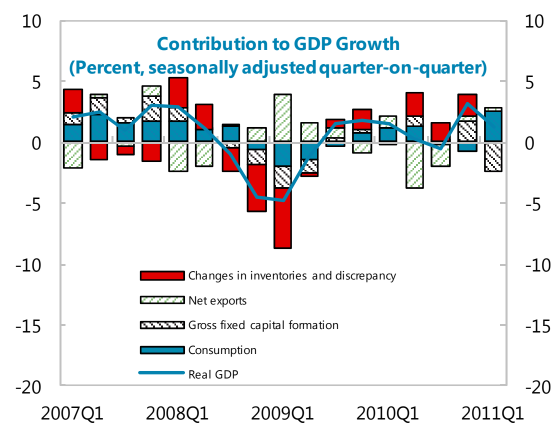
# EXITING THE CRISIS

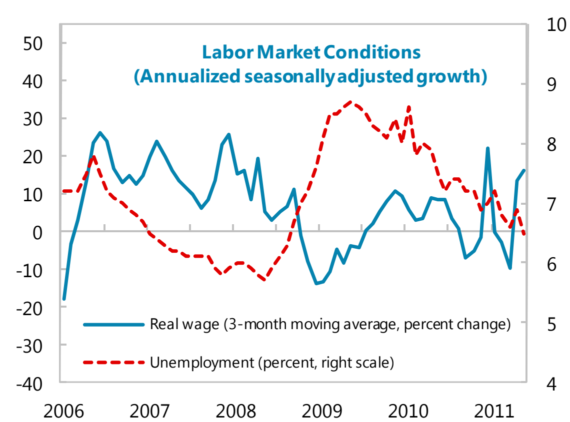
*Russia's economic recovery is proceeding in fits and starts amid high inflation. The current account has strengthened, aided by high oil prices, but capital outflows persist. Financial conditions are improving and credit has resumed growing, but the banking system is still vulnerable. The CBR has withdrawn the crisis-related support for the financial system, while the exit from fiscal policy support has been slow.*

## A. An Uneven Recovery

**1. The Russian economy has improved, but the recovery has been uneven, despite high commodity prices.** Russia's output contracted by 7.8 percent in 2009—the worst decline among its peers—as the sharp decline in domestic demand was only partially offset by a massive fiscal stimulus and a contraction in imports. Growth picked up to 4 percent in 2010, intermittently carried by consumption—supported by large pension hikes—and investment, while the contribution of net exports turned sharply negative as imports surged. But the recovery has been patchy. In summer 2010, it was interrupted by a heatwave and drought, compounded by a weakening in consumer demand as the impact of fiscal stimulus faded. And while growth resumed in Q4, fueled largely by a temporary rebuilding of inventories, short-term economic indicators point to a notable slowdown in the first half of 2011 (Figure 1). Unemployment has declined, while real wages remain volatile.




Sources: Russian Federal State Statistics Service (Rosstat); and IMF staff calculations.

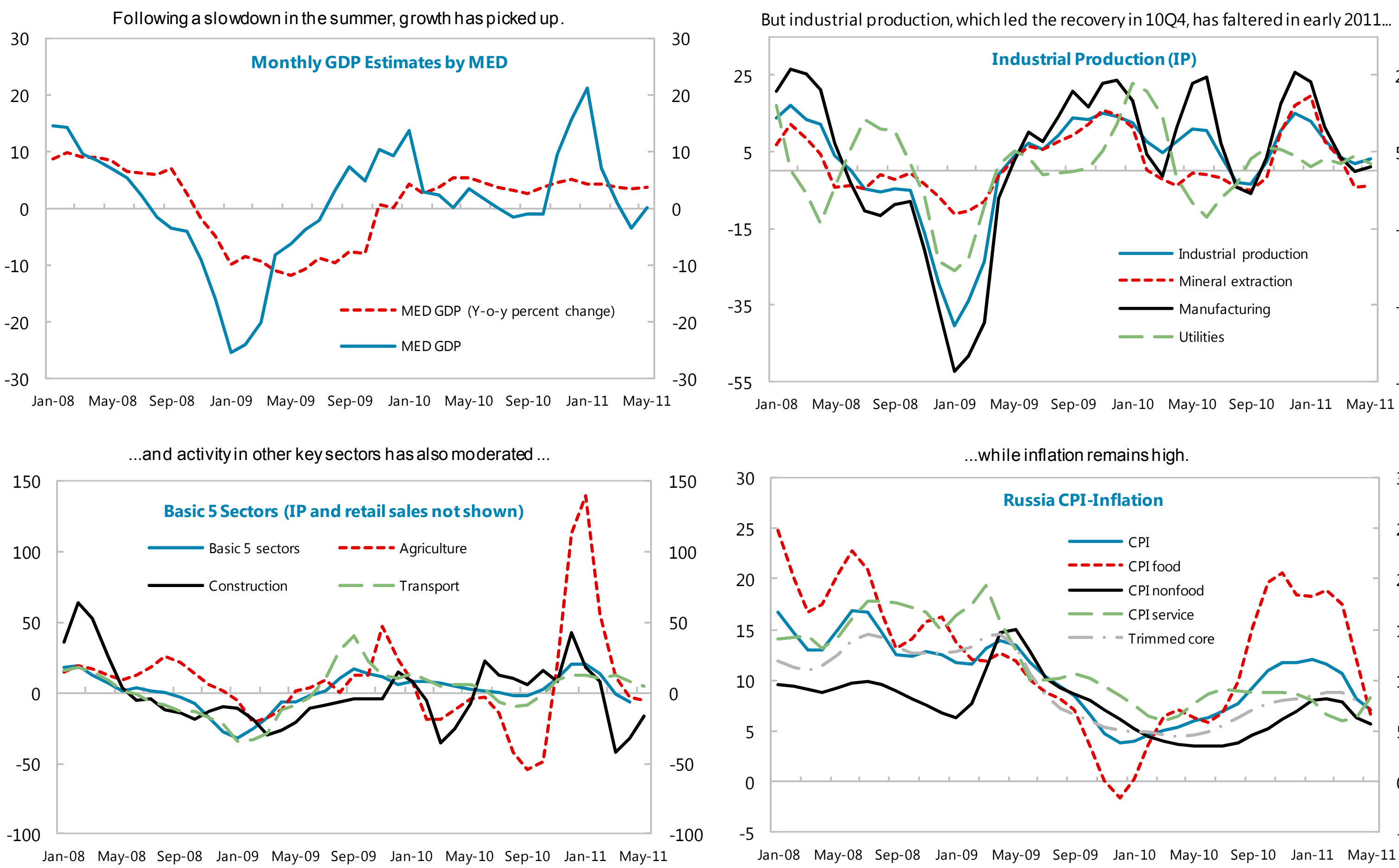



Sources: Rosstat; and IMF staff calculations.

**2. Inflation remains stubbornly high, signaling second-round effects of last year's spike in food prices.** While monthly inflation has edged down amid easing food prices, an appreciating ruble, and regulatory pressures to limit gas price increases, yearly inflation remained high at 9.4 percent in June—well above the authorities' end-year target range of 6-7 percent.

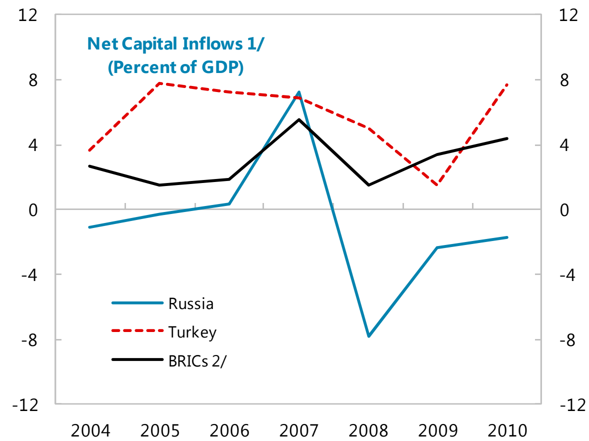
## Figure 1. Russian Federation: Production Indicators and Inflation Developments, 2008–11

(Annualized quarter-on-quarter growth rate of seasonally adjusted 3-month moving average, unless otherwise indicated)

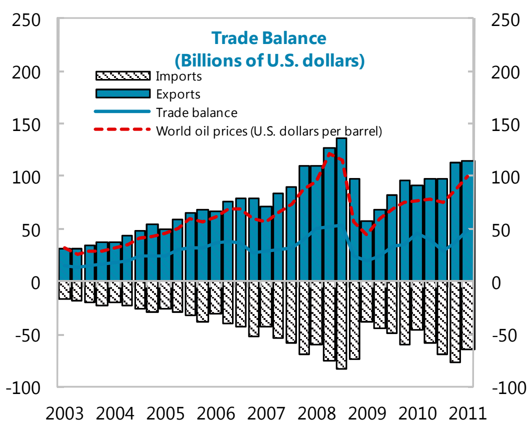



Sources: Rosstat; Ministry of Economic Development (MED); and IMF staff estimates.

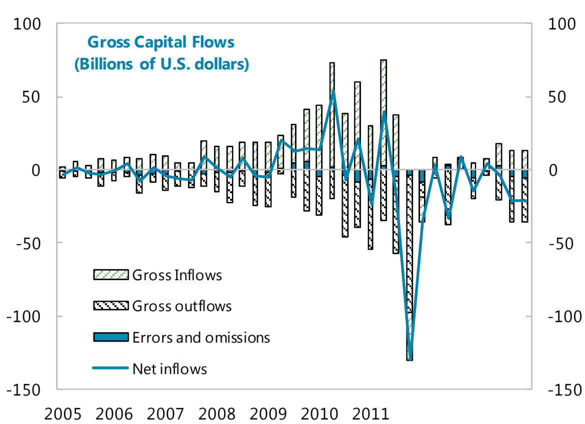
**3. The current account has been strengthening, but net capital outflows persist.** Following a brief deterioration in the third quarter of 2010 amid a temporary surge in imports, the current account has been improving, aided by high oil prices. Unlike many emerging markets, Russia experienced net capital outflows in 2010, which continued into the first half of 2011. The outflows likely reflected political uncertainty in the run up to the 2012 presidential election and a renewed focus by investors on Russia's poor business climate and vulnerable economic structure.




Sources: Haver Analytics; and IMF staff calculations.
1/ Sum of FDI, portfolio investment, and other flows
2/ Averages of Brazil, China, and India.




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




Source: Central Bank of Russia

**4. Russia's exchange rate remains competitive and international reserves are adequate.** The ruble has appreciated by 12 percent in real effective terms against the Euro-dollar basket over the past 12 months, surpassing its pre-crisis level, while gross international reserves increased by some $63 billion during the same period to $524 billion at end-June. The CGER estimates and staff's analysis suggest that the ruble is slightly undervalued (Box 1).[1] Staff views foreign reserves as broadly adequate (Annex I).

**5. Financial conditions improved in 2010 but have weakened recently** (Figure 2). The MICEX stock market index rose 23 percent during 2010 and continued to rise briskly through mid-April 2011. However, volatility in recent months has erased most of the gains for the year. In the same vein, sovereign spreads improved from a short-lived peak

[1] Russia's exchange rate is classified as "other managed arrangement" effective November 1, 2008. Russia accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement with effect from June 1, 1996. The exchange system is free of restrictions on payments and transfers for current international transactions.

## Box 1. 2011 Exchange Rate Assessment*

The most recent CGER estimates suggest that the ruble is slightly undervalued, but not clearly out of line with fundamentals. The 2011 Spring CGER results point, on balance, to a slightly increasing undervaluation of the ruble relative to the assessment in the fall of 2010.[1] Given the uncertainty associated with this exercise, however, the current average deviation from equilibrium of -5 percent indicated by the three CGER methods is not clearly out of line with fundamentals.

The results suggest that fundamentals have improved faster than the ruble has appreciated. The real effective exchange rate (REER) appreciated by about 9½ percent in 2010, broadly reversing the depreciation incurred in 2009, and this trend continued in the first half of 2011. But at the same time the medium-term outlook for oil prices improved sharply, which allows for a stronger ruble (or, a lower equilibrium external current account) under the macro-balance and external sustainability approaches. On balance, therefore, the gap between the actual REER and the equilibrium widened on both approaches, to -10 percent (indicating undervaluation). The results of the equilibrium real exchange rate (ERER) approach, however, changed only marginally and continued to indicate modest overvaluation.

CGER Results 2010–11
(Percentage deviation from estimated equilibrium)

| | Fall 2010 | Spring 2011 |
|---|---|---|
| Macro-balance approach | -6 | -10 |
| External stability approach | -6 | -10 |
| ERER approach | 7 | 7 |
| Average | -2 | -5 |

An alternative dollar-wage comparison broadly supports the CGER findings. As introduced in the 2009 Russia staff report, and as a supplement to the standard CGER methods, an additional regression was estimated that uses dollar wages as a dependent variable—these are directly comparable across countries and therefore serve as a useful proxy of the real exchange rate. This approach is conceptually similar to the standard ERER approach but differs in that it draws from a wider sample of countries, and explicitly allows for the fact that most transition countries may not have been in a long-run equilibrium for most of the sample period. For 2010, this equilibrium wage approach suggests that the ruble is some 2 percent undervalued, broadly in line with the findings of the CGER exercise.

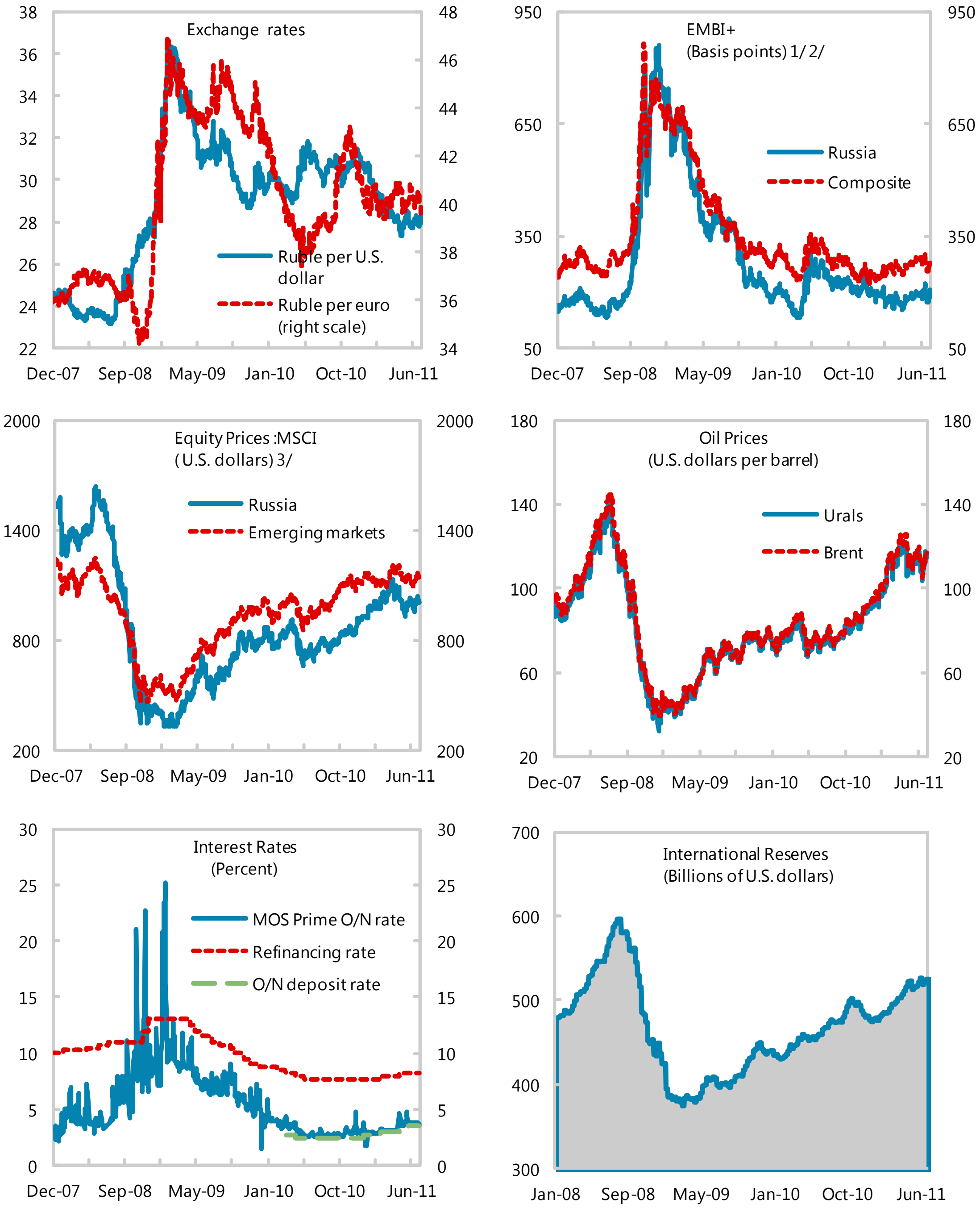
Equilibrium Dollar Wage, 1994–2010

| | 1994 | 1996 | 1998 | ... | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|
| Actual Wage (U.S. dollars) | 137 | 280 | 135 | ... | 375 | 503 | 646 | 523 | 627 |
| Equilibrium Wage (U.S. dollars) | 271 | 298 | 297 | ... | 572 | 611 | 636 | 611 | 640 |
| Equilibrium Ratio (Percent) | 51 | 94 | 46 | ... | 66 | 82 | 102 | 86 | 98 |

[1] The CGER methodology is described in IMF Occasional Paper No. 261 and WP/09/281.

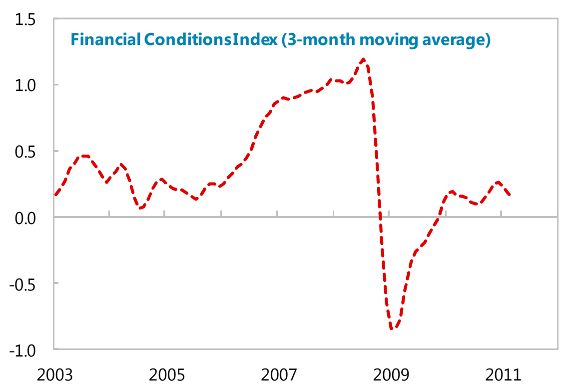
* Prepared by David Hofman and Daehaeng Kim.

## Figure 2. Russian Federation: Financial Market Indicators, 2007–11



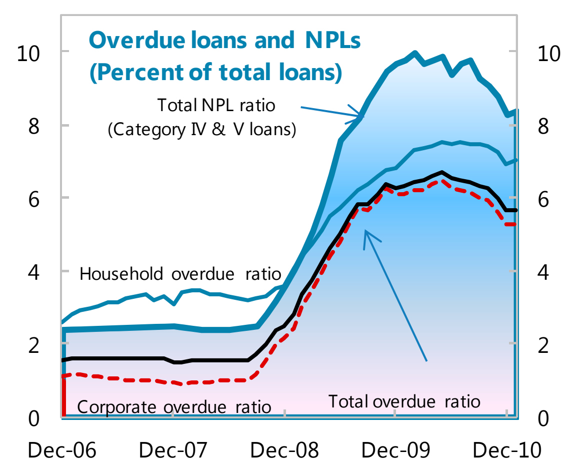

**Source: Bloomberg.**
1/ Data lags one day.
2/ Tracks total returns of external debt instruments of emerging markets with an outstanding face value of at least $500 million.
3/ The MSCI Emerging Markets Index is a commonly used free float-adjusted market capitalization index designed to measure equity market performance in global emerging markets. Consists of the following: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, Turkey and Venezuela. Based in U.S. Dollars, 1997=100.

above 300bp in May 2010 to around 160bp in early April, but they have risen again to around 200bp since, likely owing to renewed uncertainties surrounding peripheral Europe. Meanwhile, the staff's aggregate indicator of financial conditions—which in addition to equity prices and interest rates also includes house prices, the exchange rate, and credit conditions (see Selected Issues Chapter III)—showed a deterioration in 2011 so far, reflecting in particular renewed weakness in the Russian housing market.




Source: IMF staff calculations.

**6. Credit growth has resumed, although banks' balance sheets still carry significant weak assets.** The banking system is liquid and official data suggest nonperforming loans (NPLs) have come down from a peak of 10 percent during the crisis to 8.1 percent of loans in April, while profitability has bounced back from crisis lows. However, banks remain burdened by a high stock of nonperforming assets. Against this background, real credit growth reached only about 4 percent in 2010, although it has picked up further in recent months, reflecting stronger demand and improving funding conditions.




Source: Central Bank of Russia.

## B. A Gradual Exit from Crisis-Related Policies

**7. The Russian authorities are gradually exiting from crisis policy support, but the exit has been slow and, in some areas, not sufficiently ambitious.** In particular, while good progress has been made in unwinding the crisis support to banks, the exit from the fiscal stimulus is being drawn out and monetary policy has been hesitant in addressing inflation.

- **The large and poorly-targeted fiscal stimulus, much of it in the form of permanent measures, is being only partially withdrawn.** Following a massive fiscal expansion of some 9 percent of GDP during the crisis, the general government nonoil deficit—which is a relevant measure of the fiscal stance in oil producing countries, given the volatility of oil price and nonrenewable nature of oil reserves—fell by 1¾ percent of GDP in 2010, mainly on account of the recovering economy and expenditure under-execution, rather than a deliberate tightening of fiscal policy (Figure 3). The medium-term budget plans only a modest further reduction in the federal nonoil deficit of some 2¼ percent of GDP by 2013, with over half of the adjustment stemming from the increase in the rate of the payroll tax in 2011 from 26 to 34 percent, and the remainder from a reduction in civil service employment—policy plans for which are still being elaborated—and lower investment and transfers.

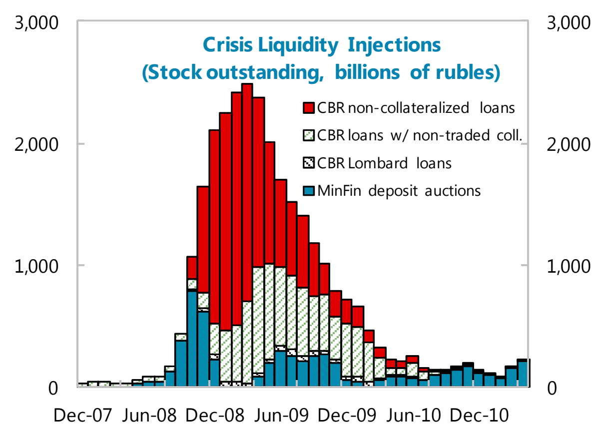
- **The CBR has been slow to respond to rising inflation.** Even though inflation had been steadily increasing since the summer of 2010, a policy tightening was not initiated until the end of the year. Following an initial increase in the CBR's overnight deposit rate in December 2010, policy rates were tightened more comprehensively in February, April, and May (but rates were left unchanged in June). In addition, the CBR raised reserve requirements and differentiated them by residency. The floating band for the ruble has been widened and intervention amounts scaled back (Figure 4).

Consolidation measures in 2011-13 Budget
(Percent of GDP)

| Measure | Effect on budget |
|---|---|
| Revenue | 1.6 |
| Increase in payroll tax | 1.6 |
| Expenditure | 0.7 |
| Cuts to wage bill | 0.9 |
| Social security (transfers) | 0.2 |
| Investment | 0.4 |
| Other | -0.8 |
| Total | 2.3 |

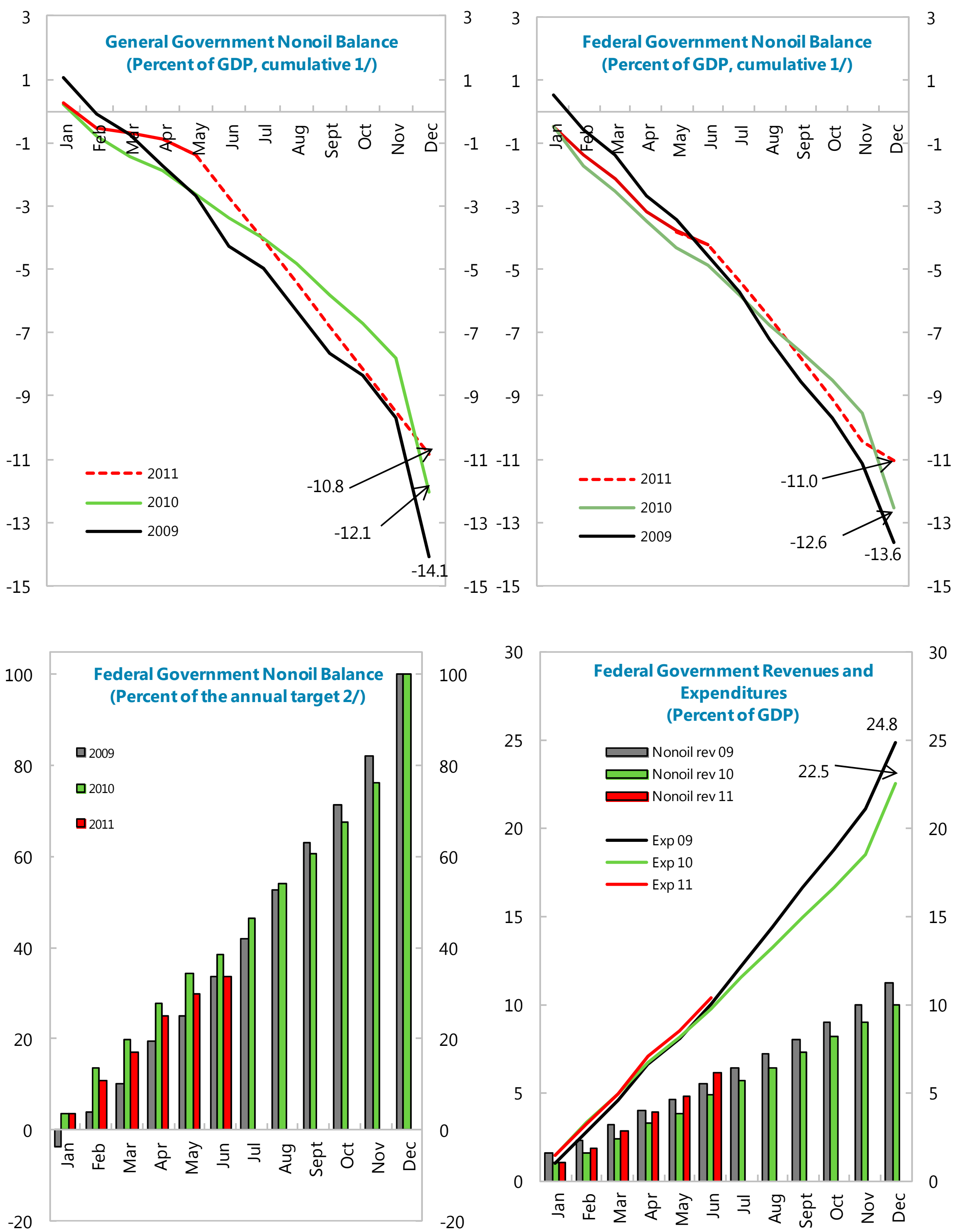
Sources: Ministry of Finance and IMF staff estimates.

- **The crisis-related support to banks has been unwound.** By mid-2010, the CBR had exited from the extraordinary liquidity support and terminated the relaxed loan classification rules introduced during the crisis. The CBR's uncollateralized lending to banks was terminated at end-2010, and interbank market guarantees were unwound.




Source: Central Bank of Russia.

## Figure 3. Russian Federation: Selected Fiscal Indicators, 2009–11

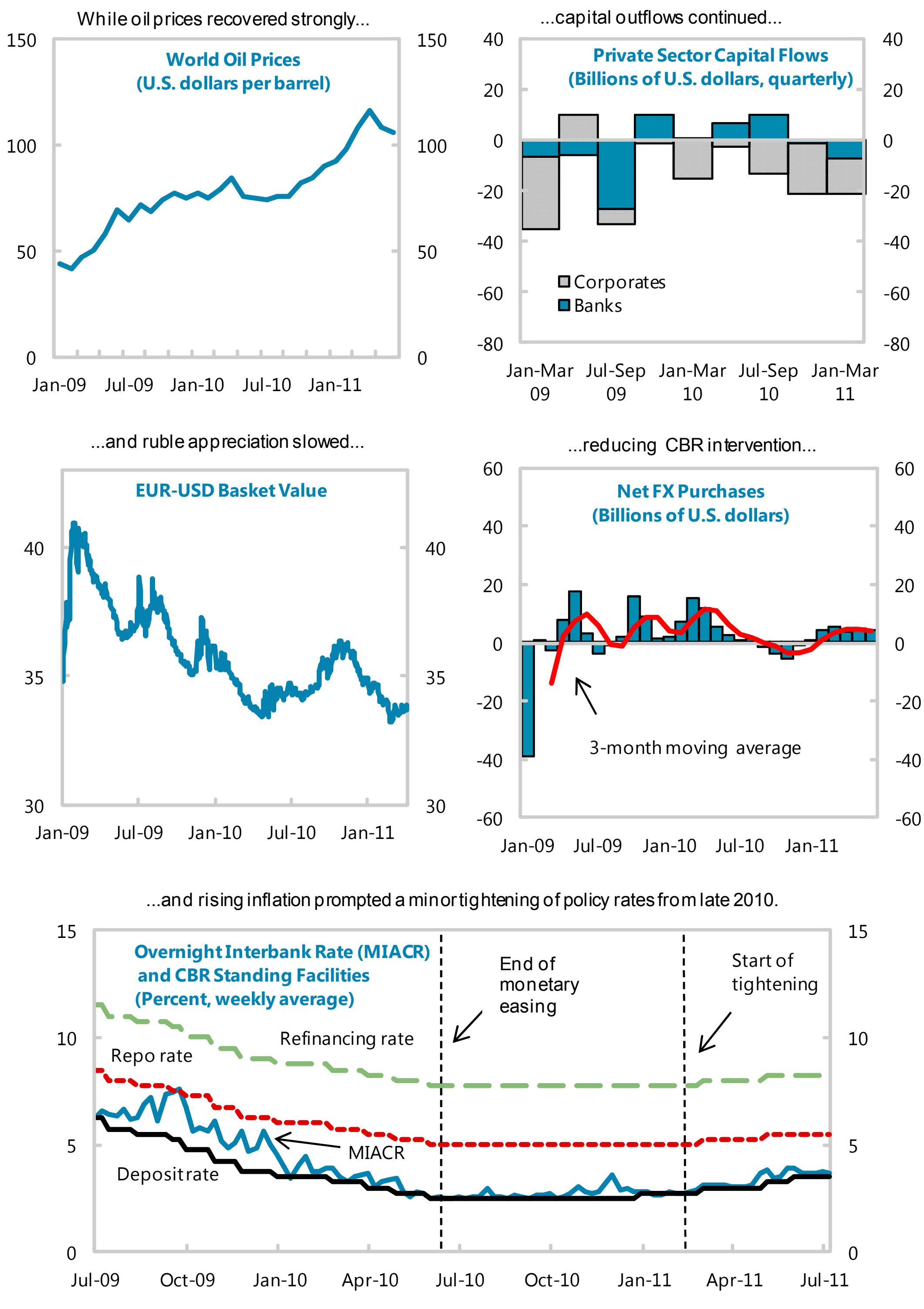



**Sources: Russian authorities; and IMF staff estimates.**

1/ Authorities' definition. Includes corporate income tax on oil companies in the nonoil revenue. Dotted line is projection.

2/ Cumulative monthly nonoil balance as a share of the actual and projected annual nonoil balance.

## Figure 4. Russian Federation: Monetary Policy, 2009–11




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

# OUTLOOK

## A. Near-Term Outlook and Risks

*Against the backdrop of a still-fragile banking system, increased risk aversion by investors, and continued political uncertainty, the outlook is for only modest growth, despite high oil prices. Risks relate to oil prices and capital flows.*

**8. Despite high oil prices, under unchanged policies, the outlook is for only moderate growth, accompanied by high inflation.** Staff projects real growth at 4.8 percent in 2011, compared to over 7 percent during 2000–07, even as the output gap is still negative and oil prices are high. The muted outlook reflects expectations that the combination of high oil prices and large capital inflows—which, together with procyclical economic policies, propelled credit and powered the boom in the run-up to the crisis—is unlikely to return amid political uncertainty, a still fragile banking system, and increased risk aversion by investors. Inflation is projected to fall to 8 percent by end-2011, assuming food prices continue to moderate.

**9. Near-term risks are broadly balanced.** On the upside, higher oil prices and the return of large capital inflows, in the event political uncertainty lifts, could push growth up. On the downside, unfavorable external developments—particularly lower oil prices, increased global risk aversion, or lower external demand—or domestic complacency and a lower appetite for reform could drag growth down. As indicated in the recent IMF report on potential spillovers from the Euro Area (EA), an intensification of the EA debt crisis, especially if it were to spread to the core EA, could have a significant negative impact on the Russian economy through trade and financial linkages.[2] A worse-than-expected growth outcome in Russia would have negative spillovers throughout the region, mainly through remittances and trade (Box 2).

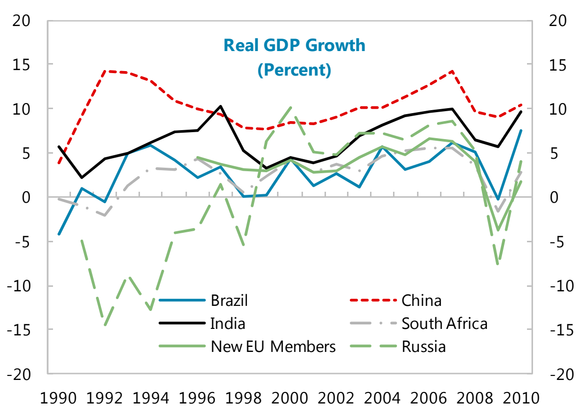
## B. Medium-Term Outlook

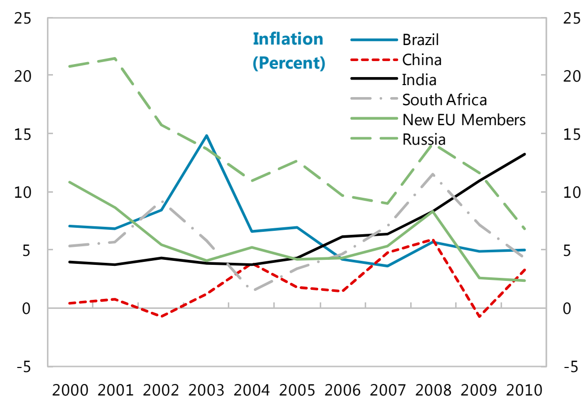
*Under unchanged policies, medium-term growth will be held back by weak policy frameworks and the lack of economic diversification. By the same token, the Russian economy will remain vulnerable to external shocks. But Russia can do much better if it successfully leverages the commodity boom to strengthen policies.*

**10. The medium-term economic outlook is constrained by Russia's weak policy frameworks and continued dependence on oil.** Over the past decade, Russia's economy has experienced a greater degree of volatility than its peers, reflecting its dependence on oil, exacerbated by procyclical economic policies and lack of reforms. The crisis laid bare these structural weaknesses of the economy, which have amplified vulnerabilities and undermined

[2] Euro Area Policies: Spillover Report for the 2011 Article IV Consultation with Member Countries.

Russia's medium-term growth prospects. The current policy plans do not go sufficiently far in reversing the crisis-related stimulus and ensuring economic stability and growth. Unless these weaknesses are forcefully addressed, growth prospects will remain subdued, with real growth projected to fall to 3¾ percent by 2016 in the baseline scenario (Figure 5). Long-term potential growth will be modest—below 4 percent—and Russia will remain vulnerable to shocks. Inflation will come down somewhat on the back of a moderate withdrawal of government demand and an appreciating ruble, but will remain elevated. The current account surplus will gradually decline as oil prices stabilize and imports pick up. Most official and private interlocutors agreed that in the absence of reforms the economic outlook is unremarkable.




Source: World Economic Outlook.

**11. A continuation of weak policies would amplify Russia's vulnerability to external shocks.** In an adverse scenario, a sharp and permanent decline in commodity prices—following, for example, a significant drop in global demand—would put considerable pressure on Russia's external and fiscal accounts, triggering another recession. Over the medium term and in the face of multiple economic crises in the space of just over a decade, investor confidence would be slow to return and capital outflows would continue putting a drag on long-run growth.

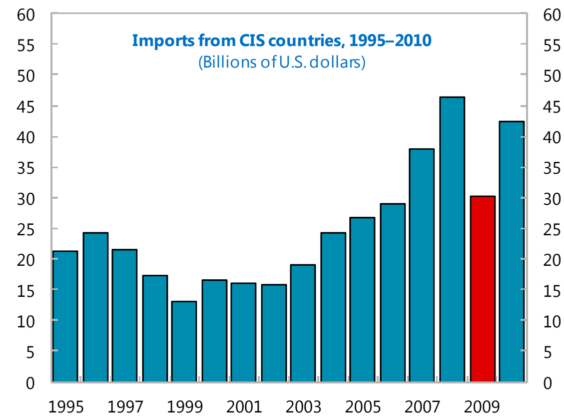
**12. Elevating the medium-term growth path would require a major strengthening of economic policies.** The reform scenario envisages higher medium-term growth—around 6 percent—supported by a stronger and more credible fiscal retrenchment, monetary policy taking control of inflation, a stronger and more competitive financial system, and effective implementation of structural reforms. In this scenario, the short-term drag on growth from fiscal retrenchment would be offset by a more stable and business-friendly economic environment and greater credibility of government policies. This would boost investor confidence and support an early return of productive capital inflows.

**Box 2. Regional Spillovers from Russia's Economic Recovery***

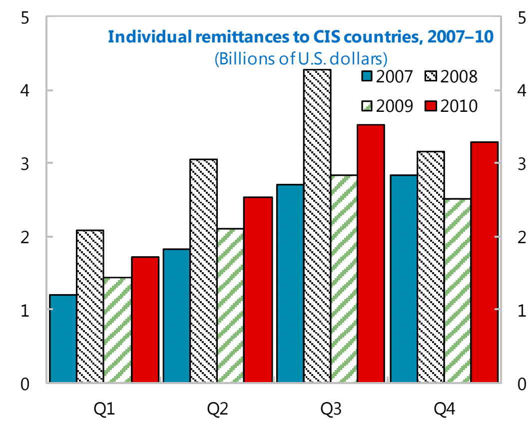
During the crisis, a sharp contraction of the Russian economy hit hard its regional partners. At the peak of the crisis, exports to Russia from neighboring countries plummeted, amid a sharp contraction in Russia's demand. Remittances from Russia to CIS countries fell by over 30 percent in 2009, reflecting the deep recession in Russia, particularly in the construction sector—a key employer of migrant labor. A significant depreciation of the Russian ruble during 2008-09 triggered sharp currency devaluations in most CIS countries, weakening banks' balance sheets and credit.

Russia's improving economy is benefiting the region through trade, remittances, and investment. The value of the CIS exports to Russia rose by almost 40 percent in 2010. Individual remittances from Russia to the CIS are recovering gradually, amid Russia's still volatile construction activity, with remittances to Belarus, Kazakhstan, Ukraine, and Uzbekistan already exceeding the pre-crisis levels. Private capital flows from Russia to the CIS have also recently picked up.

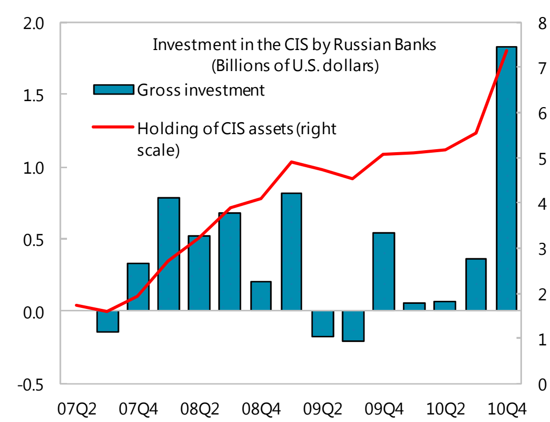
But Russia's export ban on cereals, during August 2010-June 2011, and the significant increase in the gasoline export duty in May 2011 added to inflationary pressures in the region. While the poor harvest in Russia and the subsequent export ban pushed up global grain prices, the adverse impact on inflation has been particularly acute in Caucasus and Central Asian countries, given the high weight of food in their consumption baskets and significant dependence on imported food. Inflationary pressures in the region were further exacerbated by the increase in the gasoline export duty to a prohibitive level—implemented in May to mitigate the gasoline shortages in Russia. Policy measures to ease price pressures in the region—such as higher subsidies, the release of grain reserves, and wage and pension hikes—have entailed significant fiscal costs.




Source: Central Bank of Russia.



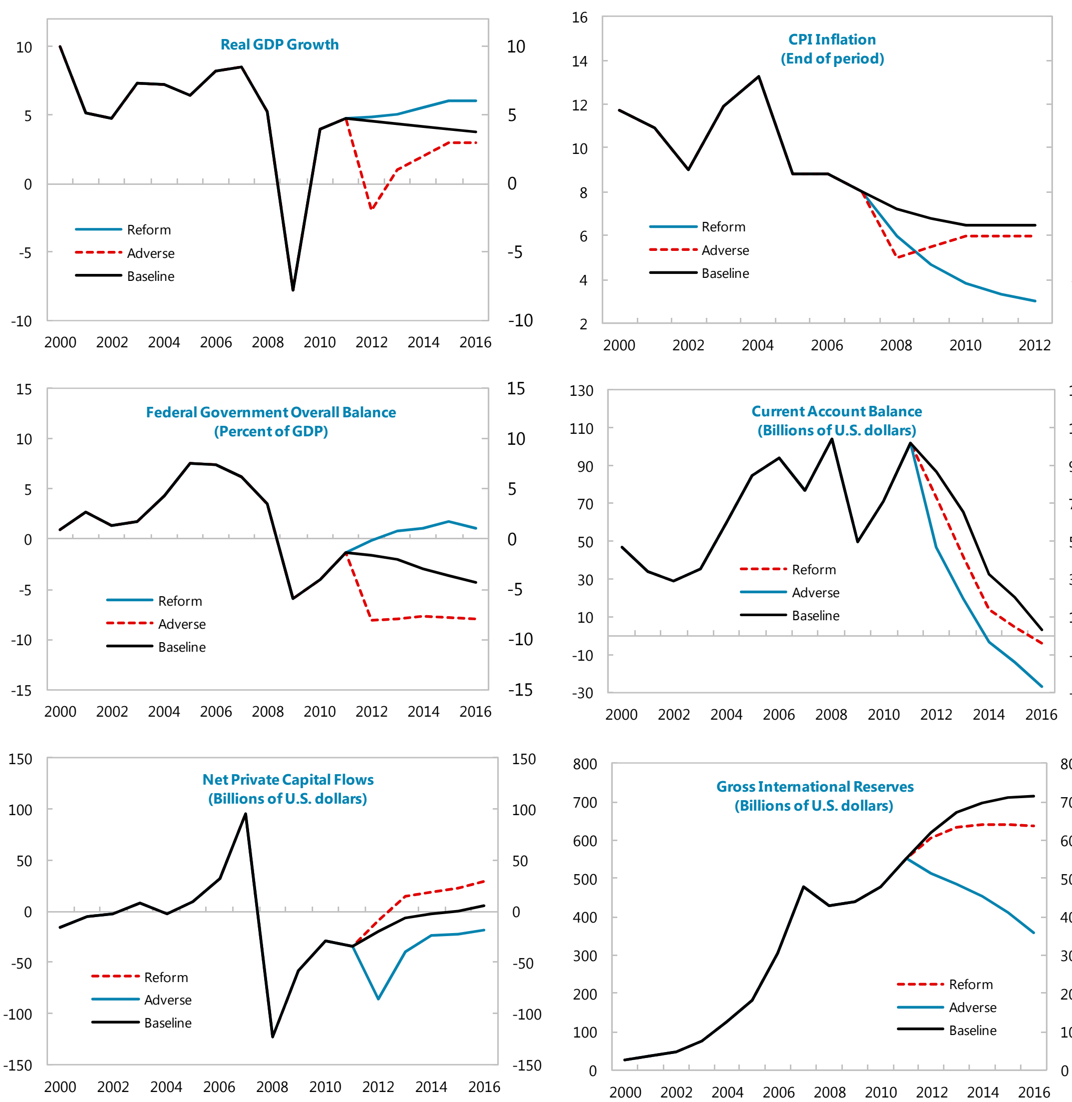

Source: Central Bank of Russia.




Source: Central Bank of Russia.

* Prepared by Daehaeng Kim based on the May 2011 REO for Middle East and Central Asia.

**Figure 5. Russian Federation: Selected Economic Indicators Under Three Scenarios, 2004–16 1/**




**Sources: Russian authorities; and IMF staff estimates.**

1/ Assumptions for the three scenarios are as follows:

▪ **Baseline scenario** assumes a continuation of current policies. Monetary policy will continue to focus on multiple objectives, while allowing some greater exchange-rate flexibility, with inflation remaining elevated. Fiscal policy will implement the 2011-13 medium-term budget, with no additional consolidation after 2013. There will be no major changes in banking sector policies. Policy frameworks will remain unreformed.

▪ **Adverse scenario** assumes a permanent external shock, with oil prices declining sharply to $50 per barrel in 2012 and staying there in real terms for the remainder of the forecast. In 2012, fiscal policy responds by maintaining expenditures unchanged in nominal terms at their 2011 level, while monetary policy becomes accommodative. During 2013-14, the nonoil deficit of the federal government is reduced at the same pace as envisaged in the current medium-term budget for 2012-13, with no further consolidation after 2014, while monetary policy remains neutral. As in the baseline, no progress is made regarding structural reforms and the strengthening of policy frameworks.

▪ **Reform scenario** assumes full implementation of reforms recommended by the staff. Monetary policy will focus on bringing inflation down to 3 percent over the medium term, amid a flexible exchange rate. Fiscal policy will implement a more ambitious, credible, and growth-friendly consolidation with the nonoil deficit of the federal government declining to the government's long-term target of 4.7 percent of GDP by 2015. The supervisory framework will be strengthened along the lines recommended by the recent FSAP. Fundamental structural reforms are put in place to improve the business climate and competitiveness, and policy frameworks will be strengthened in line with IMF staff recommendations.

# LEVERAGING THE OIL BOOM TO STRENGTHEN POLICIES AND LIFT GROWTH

13. **The policy discussions focused on how Russia could leverage high commodity prices and the relatively benign external environment to put in place strong economic policies and boost growth.** Growth can be lifted through a comprehensive set of mutually reinforcing measures. A credible, ambitious, and growth-friendly fiscal consolidation, anchored in a sound fiscal framework would reduce fiscal vulnerabilities. A more decisive and better communicated monetary tightening—underpinned by a flexible exchange rate and an improved monetary framework—would help to bring down inflation. Stronger oversight of the financial sector would promote stability and thereby underpin faster growth. And better governance and a more welcoming business environment would help to attract productive investment and facilitate economic diversification. Staff encouraged the authorities to incorporate these reforms into the 2020 social and economic strategy now being formulated.

## A. Credible Fiscal Consolidation for Stability and Growth

*A stronger, more credible and growth-friendly budget deficit reduction is needed to put public finances on a sustainable path and to promote balanced growth. Durable fiscal consolidation will require a credible and sustainable fiscal anchor and effective implementation of fundamental structural reforms, including in pensions, healthcare, and social protection.*

14. **Staff cautioned that continued high nonoil deficits would amplify fiscal vulnerabilities and undermine economic stability—a concern shared by many private and some official interlocutors.** At 12¾ percent of GDP in 2010, the federal government nonoil deficit was more than 8 percent of GDP above its pre-crisis level. Debt sustainability is currently not an issue, given the still-low public and external debt levels (below 12 percent of GDP, and just over 30 percent of GDP respectively, in 2010). However, if the output gap closes sooner than expected and fiscal adjustment is delayed, fiscal policy risks becoming procyclical, fueling inflation and real appreciation. This would undermine competitiveness and contribute to another boom-bust cycle. At the same time, the oil Reserve Fund—used to finance Russia's massive fiscal stimulus during the crisis—has been largely run down, leaving public finances vulnerable to a sudden drop in oil prices.

15. **In this regard, staff views the medium-term budget as falling short of what is needed to reduce fiscal risks.** The 2011–13 budget envisages that by 2013 the nonoil deficit will still be some 5¾ percent of GDP above the government's long-term deficit target of 4.7 percent of GDP—suspended during the crisis—which remains consistent with fiscal sustainability and equitable intergenerational use of the oil wealth (Box 3). Against this backdrop, staff regretted the recently-approved supplemental budget for 2011, since it further delayed consolidation.

Moreover, preliminary plans for the 2012–14 budget, made public after the mission, are a step backward, since they propose a less ambitious fiscal retrenchment in 2012 and 2013 than the current three-year budget, with the nonoil deficit remaining in double digits through 2014 (text table). The planned upward revision to the 2012 and 2013 nonoil deficit targets puts in question the government's commitment to fiscal sustainability and weakens the credibility of fiscal policy.

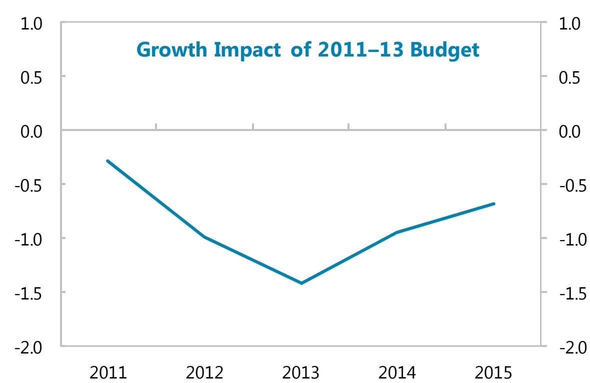
2011-13 Budget vs. Draft 2012–14 Budget

(Percent of GDP)

| | 2011 | 2012 | | 2013 | | 2014 |
|---|---|---|---|---|---|---|
| | | 2011–13 budget | 2012–14 budget | 2011–13 budget | 2012–14 budget | |
| Total revenues | 19.3 | 17.0 | 18.5 | 16.8 | 18.4 | 18.0 |
| Nonoil and gas revenues | 9.5 | 9.1 | 9.9 | 9.2 | 10.2 | 10.3 |
| Total expenditures | 20.7 | 20.1 | 21.2 | 19.7 | 21.2 | 20.3 |
| Overall deficit | -1.3 | -3.1 | -2.7 | -2.9 | -2.7 | -2.3 |
| Nonoil deficit | -11.2 | -10.9 | -11.3 | -10.4 | -11.0 | -10.1 |

Source: Ministry of Finance.

**16. There was broad agreement that the composition of the planned adjustment in the 2011–13 budget is not supportive of growth.** Staff estimates that the adjustment could shave off as much as 1½ percentage points of annual real growth by 2013, as the government withdraws demand and employment contracts in response to the distortionary increase in the payroll tax. Moreover, the negative growth impact of the higher payroll tax would persist in the medium term. The authorities acknowledged that the increase in the payroll tax could harm the economy and have since announced plans to reduce it in 2012. The government is presently discussing offsetting measures to compensate for lost revenue.




Source: IMF staff estimates.

**17. Discussions highlighted how Russia's weak fiscal framework undermines fiscal sustainability and could amplify the negative growth effect of fiscal tightening.** In particular, the lack of a credible and sustainable anchor for fiscal policy, the policy focus on the overall rather than the nonoil balance, and the use of supplementary budgets to spend excess oil revenue add to

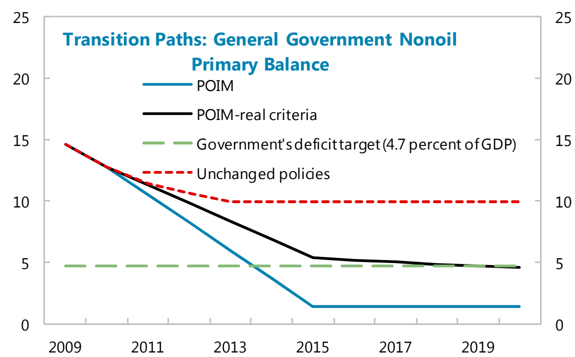
## Box 3. Applying the Permanent Oil Income Model to Russia*

A Permanent Oil Income Model (POIM) is one approach used by oil-producing countries to manage oil wealth. The POIM applies the permanent income hypothesis developed by Friedman to help decide on how to allocate government wealth (including oil in the ground) across generations. The basic POIM yields a constant per capita level of the primary nonoil deficit financed by perpetual income from oil wealth.[1] This approach could be attractive to countries that would like to keep the size of government constant in relation to the size of their economies.

An alternative is a POIM-real criterion approach. The objective of this approach is to maintain the purchasing power of the wealth distributed each year, with government spending remaining constant in real terms (adjusted by a deflator). This rule is less restrictive in the early years than the standard POIM approach, but becomes more conservative in the outer years. The POIM-real criterion rule would be well-suited to countries that prefer to spend some oil wealth upfront to invest in public services and infrastructure that could boost future output.

Staff views the POIM or the POIM-real criterion rules as appropriate for Russia since: (i) they are sufficiently conservative to address the considerable fiscal risks facing Russia in the long run—including the potentially large fiscal costs of pension reform and the long-term spending pressures from rising healthcare costs—; and (ii) a similar rule—albeit temporarily suspended during the crisis—has already been incorporated into Russia's budget code, signaling ownership and political buy-in.

Staff calculations suggest a POIM-real criterion approach would be broadly consistent with the government's nonoil deficit target of 4.7 percent of GDP.[2] Based on oil price assumptions from the July 2011 WEO, the POIM-real criteria rule would be consistent with fiscal consolidation in the medium-term to about 5½ percent of GDP by 2015. In contrast, the POIM approach would imply a large consolidation in the medium term to about 1½ percent of GDP, but would allow a higher level of consumption of oil wealth in the outer years than under the POIM-real criterion rule.




Source: IMF staff estimates.

[1] See Medas and Zakharova (2009), "A Primer on Fiscal Analysis in Oil-Producing Countries", IMF Working Paper 09/56 for further discussion of POIM and fiscal policy in oil-exporting countries.

[2] See Selected Issues Chapter IV for more details on staff's calculations.

* Prepared by Charleen Gust.

the procyclicality of fiscal policy and undermine the credibility of budget targets—an important channel through which fiscal retrenchment affects growth. And according to the recent World Bank Public Expenditure Review, weak budgeting practices continue to restrain the quality of public service delivery, particularly in capital projects.

**18. Staff and the authorities agreed on the need for a more growth-friendly, credible, and ambitious fiscal consolidation to reduce vulnerabilities and oil dependence** (Box 4). But the authorities noted the difficulties of securing the consensus to do so in a pre-election year.

- *Growth-friendly*. Staff estimates that the adverse effect of fiscal retrenchment on growth can be mitigated by directing the composition of the adjustment toward growth-friendly instruments—especially a reversal in temporary subsidies extended to strategic enterprises during the crisis, and a reduction in transfers and tax exemptions. The impact on growth would be further mitigated by a relatively favorable external environment, including high oil prices, and focusing on items with low fiscal multipliers.

- *Credible*. A credible fiscal plan could help to realize some growth benefits of the adjustment as early as in 2013. The credibility of the adjustment can be enhanced by front-loading the consolidation—for example, by carrying out two-thirds of the adjustment in the first three years—strengthening the fiscal framework, and spelling out clearly the planned policies. Durable consolidation will need to be underpinned by fundamental structural reforms, including in pensions and healthcare—where potential costs of future public liabilities are estimated to be particularly high—and social protection.[3] The authorities convened an expert Working Group on pensions in January 2011 as part of the government's work on its 2020 strategy and will outline possible pension reform options later this year. However, they conceded that implementation of difficult reforms, including in pensions, would likely be postponed until after the elections.

**Possible consolidation measures**

(Percent of GDP)

| Measure | Budget savings |
|---|---|
| **Short-term** | **< 7.0** |
| Increase excise taxes | 0.7 |
| VAT reform | 1.0 |
| Cut subsidies to enterprises 1/ | 1.3 |
| Cut tax expenditures 2/ | < 4.0 |
| **Medium-to-long-term** | **6.1–7.1** |
| Reduce wage bill | 0.9 |
| Better target social transfers | 1.0 |
| Increase retirement age | 2.0–3.0 |
| Reduce early pensions | 0.7 |
| Improve capital budgeting | 0.4 |
| Improve regional expenditure efficiency | 1.1 |
| **Total** | **< 13.1–14.1** |

Source: Ministry of Finance, expert, WB and IMF staff estimates.

1/ Originally part of crisis-related stimulus.

2/ As noted by Finance Minister Kudrin in 2010. Excludes potential savings from unifying VAT rates and reducing VAT exemptions, reported separately in the table based on WB estimates.

- *Ambitious*. To put public finances on a sustainable path, staff advocated reinstating the government's long-term fiscal anchor for the nonoil deficit of 4.7 percent of GDP and gearing policies towards reaching this target by 2015.

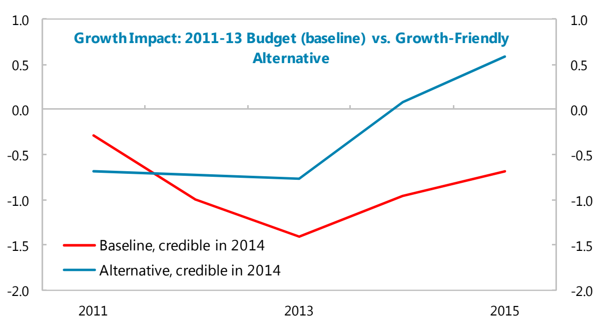
[3] For further elaboration on long-term fiscal risks of pensions and healthcare see Russian Federation: 2011 Selected Issues.

## Box 4. Growth-Friendly, Credible, and Ambitious Fiscal Consolidation in Russia*

Staff's analysis, based on the IMF's Global Integrated Monetary and Fiscal model, suggests that the composition of the 2011–13 medium-term budget is unfriendly to growth.[1] The budget relies mainly on an increase in the payroll tax (which distorts labor decisions) and cuts to government investment (which reduce the productive capacity of the economy). If market participants were to see the consolidation as credible only in 2014, there would be an immediate negative impact on growth (red line), which would reach about 1–1½ percent annually in the medium term.

***Growth-friendly***

If the same size, phasing, and credibility of consolidation were instead to be delivered via growth-friendly instruments, the near-term negative impact on growth would be more muted and there would be a positive effect in the medium term (light blue line). In this alternative scenario, three-quarters of the consolidation is delivered through cuts to transfers (e.g., by better targeting social transfers), with the remainder from cuts to government consumption (e.g. cutting the size of the civil service). These instruments are considered growth-friendly since they are less distortionary to investment and labor decisions.



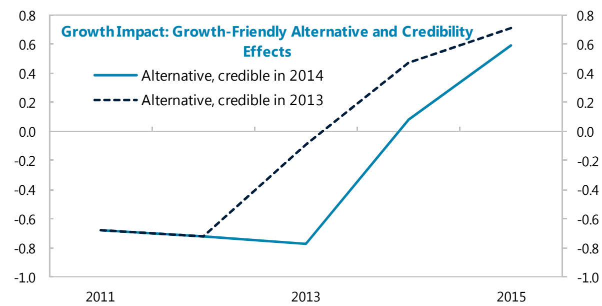

Source: IMF staff estimates.

[1] See Selected Issues Chapter V for more details on the model results.

* Prepared by Charleen Gust.

***Credible***

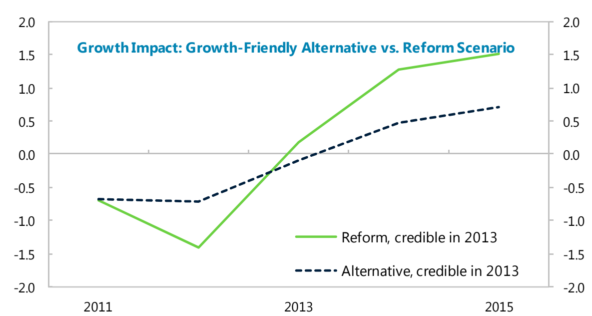
Credibility affects growth-promoting benefits of fiscal consolidation. If consolidation is credible, market participants expect that lower future real interest rates (from smaller deficits) will create room for higher government spending or lower taxes, prompting them to smooth consumption and raise investment. Thus, if the consolidation package were to be perceived as credible starting in 2013 (dark blue dashed line), this would move the positive effect of the growth-friendly package forward by one year. The medium-term effect would be broadly the same.




Source: IMF staff estimates.

***Ambitious***

Using the same instruments and credibility as in the growth-friendly scenario above, if a more ambitious consolidation were undertaken to return the nonoil deficit to the government's long-term target of 4.7 percent of GDP, the positive impact on growth would be even higher (green line), largely owing to a stronger investment response to lower interest rates and higher net exports as a result of the consolidation.

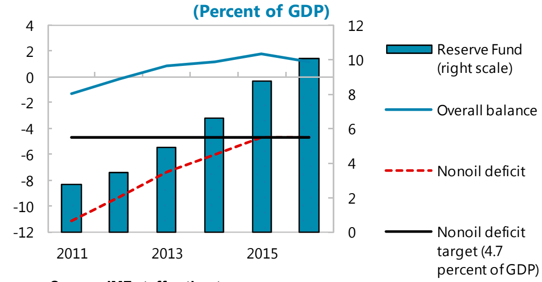



Source: IMF staff estimates.

The authorities are currently considering whether to reinstate the nonoil deficit target or to replace it with an oil-price rule, where revenue above a certain oil price is saved in the oil funds. They noted that the main appeal of the oil-price rule is that it is easy to communicate. In staff's view, a nonoil deficit target is the best anchor for fiscal policy in Russia, since unlike the oil price rule, it explicitly addresses intergenerational equity concerns. An oil-price rule could be a second-best alternative if supplemented by a ceiling on expenditure or borrowing to avoid procyclical fiscal policy, but still would not necessarily preserve the wealth from oil for future generations. The authorities argued that the oil-price rule could be based on an oil price that would ensure intergenerational equity, but staff cautioned that it could then be difficult to explain to the public how the oil price was set.

**19. A stronger fiscal policy framework will enhance credibility and support balanced growth.** Staff outlined key elements to achieve this, which would include eschewing excessive use of supplementary budgets to avoid procyclical increases in spending, and replenishing the oil Reserve Fund—taking advantage of high oil prices—through more ambitious consolidation to create a cushion against external shocks. The authorities acknowledged the important role the Reserve Fund and the National Wealth Fund had played in responding to the global financial crisis. They reaffirmed their commitment to replenish the funds and noted that the assets held in the Reserve Fund would double this year, to 1.4 trillion rubles (2.7 percent of GDP).

**Reform Scenario: Federal Government Fiscal Balances and Reserve Fund (Percent of GDP)**



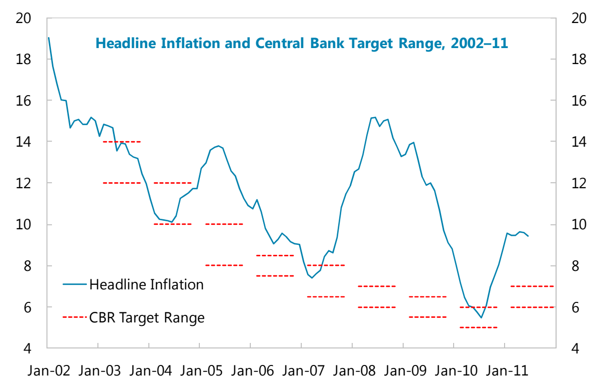

Source: IMF staff estimates.

**20. Complementary institutional reforms would further strengthen the fiscal framework.** In particular, staff suggested the establishment of an independent fiscal agency tasked with conducting impartial and transparent fiscal analysis and assessment of fiscal policy implementation could further enhance the credibility of fiscal policy and improve its effectiveness. To broaden support for fiscal policy reforms, the Ministry of Finance recently established an external advisory group representating academia, think tanks, and the private sector. Furthermore, the authorities' planned accounting of tax expenditures was welcomed by staff as it would help to better prioritize the use of budget resources and increase transparency. Staff recommended a speedy streamlining of these expenditures to improve allocation of resources across economic sectors, reduce the incentives for rent-seeking, and support the much-needed fiscal retrenchment. Staff noted that fiscal vulnerabilities could be further reduced through better assessment, disclosure, and management of fiscal risks—including those stemming from contingent liabilities, such as deposit insurance scheme and state-controlled enterprises. Finally, to improve the effectiveness of government spending, staff and the authorities agreed that public financial management and procurement should be strengthened.

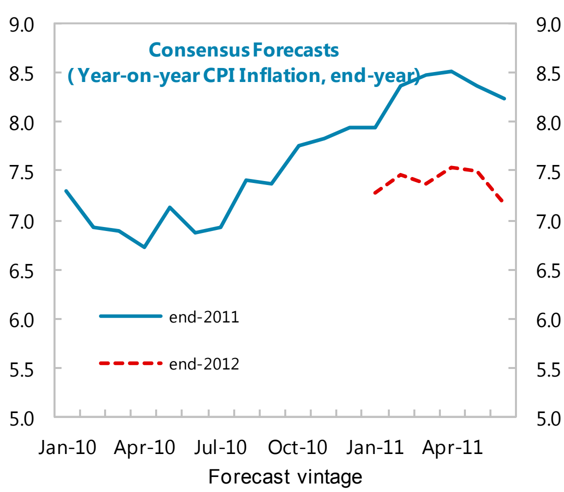
## B. Strengthening Monetary Policy to Bring Down Inflation

*Monetary policy has been slow to respond to rising inflation but has recently been tightened. Bringing inflation down from its current high level will likely require a further tightening, while improvements to the operational framework are key to enhance the effectiveness of monetary policy and to ultimately anchor inflation at a low level. A more flexible exchange rate and fiscal tightening should be the first lines of defense if large capital inflows resume.*

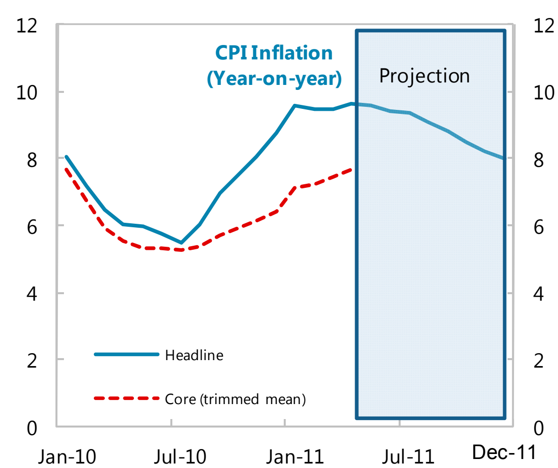
**21. Monetary policy has belatedly been tightened, but inflation looks likely to remain high in 2011.** Inflationary pressures have been building since the summer of 2010, but the CBR did not embark on a tightening cycle until late December 2010. Despite the still-negative output gap, headline inflation, at 9½ percent in June, as well as core inflation and inflation expectations, remain high. Staff's leading indicators model suggests that inflation at end-2011 will reach 8 percent ,remaining well outside the CBR's target range of 6–7 percent—a target, which has been revised upward along with actual inflation and, in staff's view, is unambitious.




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




Source: Consensus Forecasts.

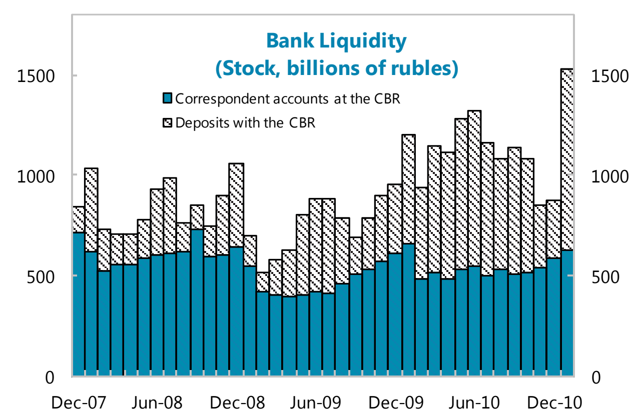



Sources: Rosstat; and IMF staff estimates.

**22. The authorities were not convinced of the need to tighten monetary policy—advocated by staff to lower inflation.** The authorities expected that recent positive trends in food prices and money growth, and some further appreciation of the ruble, would reduce inflationary pressures, potentially bringing inflation down to 7 percent by the end of the year—close to the CBR target, thus weakening the case for a further policy tightening. While noting that it was already too late for monetary policy to influence end-2011 inflation significantly, staff advocated to be more ambitious and recommended a continued policy tightening this year to put inflation on a firm declining trend toward a more appropriate medium-term level of 3–5 percent. Staff also underscored the importance of a consistent communication policy, which in the past has not always been clear about the direction of policy. In this regard, the transparency of communications could be increased by publishing information on inflation expectations and the CBR's medium-term inflation forecast. Looking further ahead, the need for monetary tightening could be lessened by a more decisive fiscal retrenchment.

**23. Policy discussions highlighted the need to strengthen the operational framework to enhance the effectiveness of monetary policy.** Staff recommended to streamline the set of policy instruments to improve the transmission of monetary policy signals; drain remaining excess reserves holdings of banks via open market operations to make the refinance rate—the CBR's headline policy rate—binding; and gradually narrow the interest rate policy corridor to reduce interest rate volatility. The ultimate goal would be to move away from the nonbinding refinance rate toward a binding open market operations rate, in the center of the policy-rate corridor, as the main policy target. Effective implementation of these measures would be facilitated by communicating to market participants a time-bound path for these changes. The authorities broadly agreed with the staff on the need to strengthen the operational framework and were preparing improvements. In the context of the recent interest rate increases, they had already effected some narrowing of the policy rate corridor.

**24. The staff welcomed recent steps by the CBR toward greater exchange-rate flexibility.** The recent widening of the operational band for the ruble and smaller, less frequent interventions are helping to create room for monetary policy to focus more squarely on inflation. The authorities and staff agreed it was important that this trend toward a more flexible ruble is continued going forward. Some further appreciation that might result in the context of high oil prices and a more flexible exchange rate would not be an immediate concern for competitiveness since the ruble appears slightly undervalued at present.



Source: Central Bank of Russia.

**25. A flexible exchange rate and fiscal tightening should be the first lines of defense against excessive capital inflows.** Staff argued that at present, the differentiation of reserve requirements by residency appeared unwarranted, given that Russia was not seeing net capital inflows. The authorities conceded that it was largely a preventative measure. Given that the ruble is somewhat undervalued, staff advocated allowing more rapid exchange-rate appreciation if the inflows were to return in force. In addition, the recommended fiscal retrenchment would further reduce any overheating pressures. Staff emphasized that capital flow management measures (especially capital controls) should not be used in place of these (necessary) macroeconomic policy adjustments.

## C. Promoting Sound Financial Intermediation by Strengthening Oversight

*Russia's banking system has weathered the crisis relatively well, but the use of off-balance sheet vehicles for distressed assets and possible overvaluation of on-balance sheet foreclosed assets and restructured loans, combined with regulatory forbearance extended during the crisis has likely masked underlying vulnerabilities. The recent FSAP financial stability assessment identified several areas for improving financial sector policies and bringing them in line with international standards.*[4] *Such improvements would be essential if the authorities' goal of turning Moscow into international financial center is to be advanced.*

**26. The Russian authorities maintained financial stability in the face of a major global shock.** Although the recent global financial crisis hit the Russian economy hard, the authorities succeeded in shielding, to a large extent, the financial sector from its impact, including through liquidity support to banks and a carefully managed exchange-rate adjustment. The financial system is now recovering and the performance of financial institutions improved in 2010. Financial soundness indicators are rebounding and compare broadly favorably with peers, even though they generally remain below pre-crisis levels and may understate problems owing to weaknesses in reporting (Figure 6).

**27. Stress tests conducted under the recent FSAP suggest that the Russian banking system is resilient to a variety of shocks.** Under a "severe" double-dip scenario that assumes a 4 percent contraction of GDP in 2011 (a 1.7 standard deviation shock relative to the 2000–10 average), net losses would amount to about 22 percent of system capital. This would leave the system-wide capital adequacy ratio (CAR) at 14.1 percent, while banks representing about 8 percent of the system by assets would see their CAR fall below 10 percent. While substantial, such an impact would appear manageable. Single factor tests suggest that credit risk (including concentration risk) is the most important source of vulnerability, while liquidity risk is also significant.

**28. However, the FSAP concluded that the financial system may be more vulnerable than the stress tests suggest.** In particular, the FSAP found that banks' loan quality may be overestimated, while the level of provisions remains lower than it should be,

[4] The main FSAP recommendations are summarized in Box 5.

**Box 5. Key FSAP Recommendations**

***Short term (implementation within 12 months)***

- Empower the CBR to use professional judgment in interpreting laws and regulations, issuing enforceable risk management guidance, and applying it to individual banks.

- Approve pending amendments to expand CBR supervisory authority over bank holding companies and related parties, and eliminate restrictions on information-sharing with other domestic and foreign supervisors.

- Allow the CBR to sanction individual directors and managers, raise capital requirements on individual institutions, and impose restrictions on transactions between affiliates.

- Ensure the unified securities and insurance supervisor (FSFM) has the power to issue secondary regulation to interpret the law, as well as industry-wide binding norms.

- Empower the FSFM to require insurers to have in place internal controls and risk management systems commensurate with the complexity of their business.

- Apply fit and proper requirements to directors and key management of insurers on an ongoing basis.

- Make home-host notifications and cross-border cooperation in insurance mandatory for the FSFM.

- Adopt pending legislation that empowers the FSFM to appoint a provisional administrator, freeze assets, and wind down distressed securities firms.

***Medium term (implementation in 1–3 years)***

- Adopt a prompt remedial action framework for banks.

- Give the chairman and key members of FSFM fixed-term appointments.

- Require government guarantee for all CBR loans that are unsecured or not backed by marketable collateral or guarantees.

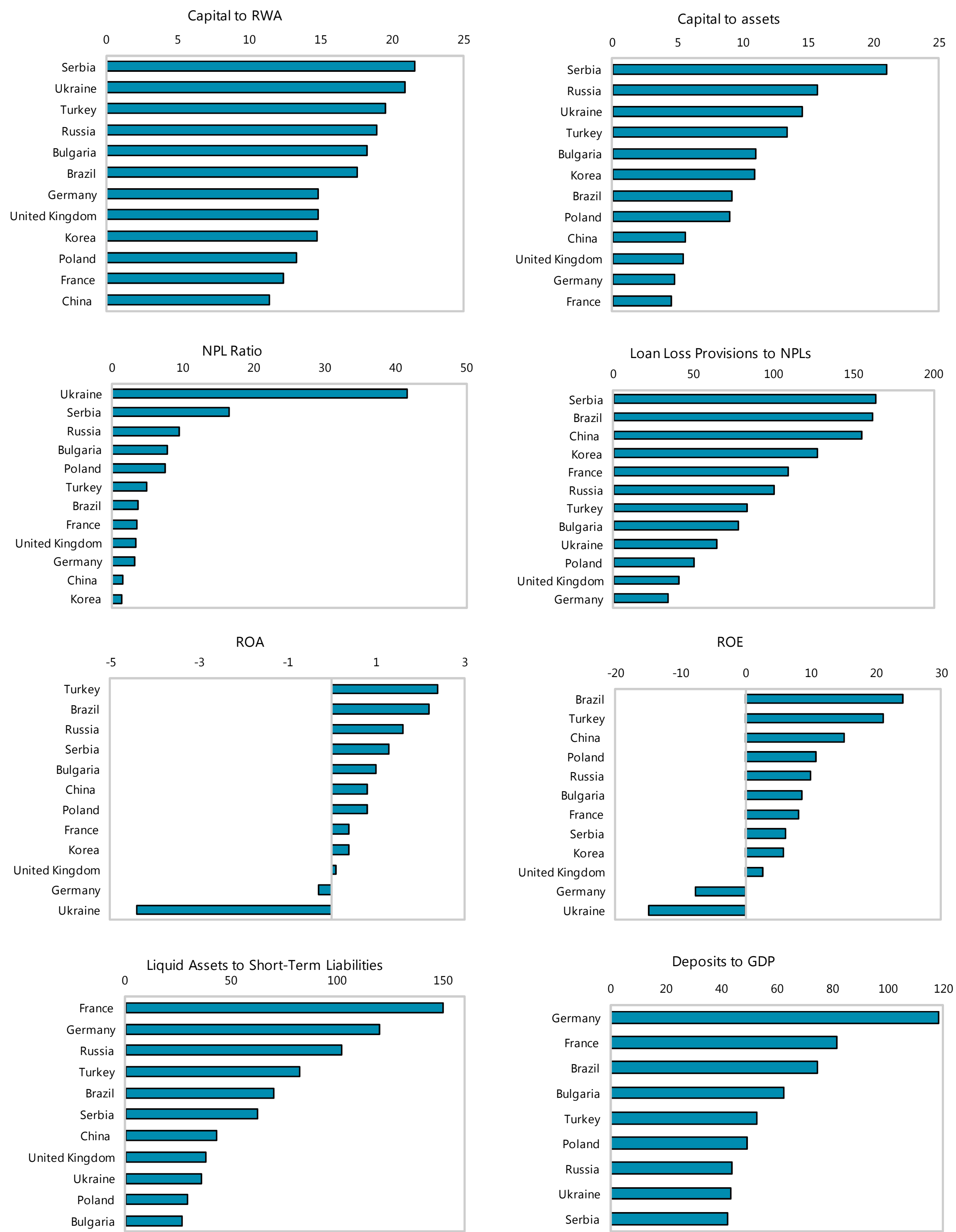
- Require repo transactions to take place using central counterparty clearing.

- Set limits on concentration of collateral in the repo market.

- Introduce a unified administration regime for all banks (systemic or otherwise) with broad powers for the administrator.

- Open-bank assistance such as loans, capital injections, nationalization by the Deposit Insurance Agency (DIA) should be restricted to systemic situations.

## Figure 6. Comparative Soundness of the Banking System

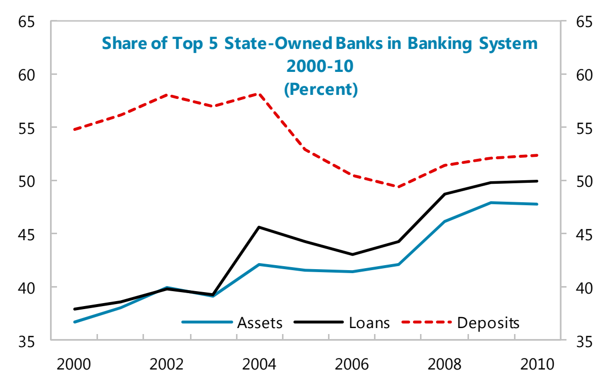



**Sources: FSR Statistical Appendix (Fall 2010) and International Financial Statistics.**

making the banking sector vulnerable to shocks. In this regard, it is telling that the impact of illustrative adjustments of banks' balance sheets for these factors—though necessarily based on subjective assumptions—could well exceed that of the stress tests. This is a key concern, particularly because the system remains exposed to significant risks from fluctuations in oil prices and capital flows. Thus, while the risks to financial stability are ultimately mitigated by Russia's sizable international reserves, increased vigilance is warranted in the period ahead. The authorities broadly agreed with this assessment, but qualified the finding that current provisions were too low by pointing to the positive trend in NPLs.

**29. Recent consolidation in the banking sector has favored a few large state-owned banks, reducing competition and potentially increasing moral hazard.** While the share of state-owned banks in total deposits had been falling until 2007, the crisis turned this trend around as depositors fled for safety and at end-2010 the state banks held 52 percent of total deposits. The share of the state banks in lending and total system capital also rose, reflecting their easier access to funding and capital during the crisis which allowed them to increase market share. As a result of the increasingly strong position of the state banks in core banking segments, some private banks are trending towards niche markets and, possibly, greater risk-taking. Separately, there is a risk that the strong government support to the systemic state-owned banks during the crisis has increased moral hazard.

**30. Despite recent progress in strengthening the regulatory and supervisory frameworks, the FSAP mission found important gaps.** In particular, the lack of authority for the CBR to supervise bank holding companies and related parties, issue binding guidance on risk management by banks, and use supervisory discretion in applying laws and regulations to individual banks greatly limits its ability to conduct effective supervision, a case in point being the recent Bank of Moscow episode.[5] In the nonbank financial sector, the recent merger of the securities and insurance supervisors could be beneficial, but the merger process remains surrounded by uncertainties, including with respect to the powers of the new agency.



Source: Central Bank of Russia.

[5] The recent discovery, shortly after the mission, of a large capital shortfall in the Bank of Moscow—apparently derived from massive related lending, which appeared to have gone unaddressed for a considerable time—underscores the importance of strengthening banking supervision, the regulatory framework, and early corrective action structures. The episode also illustrated the issues of non-transparent ownership structures, and deficiencies in financial reporting which were highlighted in the recent FSAP as well as previous FSAPs.

**31. The authorities agreed with staff that a stronger regulatory and supervisory framework would safeguard financial system soundness and promote sustainable credit growth.** Key improvements would include greater supervisory authority for the CBR—including adoption of the pending legislation regarding connected lending and consolidated supervision—and greater discretion to use "professional judgment" in applying laws and regulations to individual banks, which would facilitate the reduction of the reporting and regulatory burden. Staff urged the authorities to adopt a transparent framework for prompt remedial action, with a clearly delineated set of mandatory measures that escalate as a bank's financial situation deteriorates and ensure the adequacy of provisions in the system. The authorities shared staff's views on the needed improvements. They noted that the legislation on consolidated supervision had been submitted to the Duma, but expressed concern that the final legislation could be significantly weakened in the legislative process. Meanwhile, the CBR indicated that it was exploring options for a transparent remedial action framework.

**32. Improved supervision of nonbank financial institutions should foster public confidence and a deepening of the sector.** The nonbank financial sector is small and not considered systemically important, but the insurance sector is performing poorly and many companies will not be able to meet the increased minimum capital requirements in 2012—underscoring the need for regulatory vigilance. The authorities noted that the recent merger of the securities and insurance supervisors offers the prospect of giving supervisors a comprehensive view of the market, expanding the perimeter of oversight, harmonizing supervisory approaches and requirements, and realizing economies of scale. Staff agreed but emphasized that for these benefits to materialize, the framework that was under preparation for the new Federal Service for Financial Markets (FSFM) should provide it with the power to issue secondary regulation and industry-wide binding norms and ensure its independence and adequate resources. In this regard, the authorities' plans appeared broadly appropriate, but needed to be followed by full and effective implementation.

**33. Strengthening systemic risk monitoring is key to containing moral hazard and associated vulnerabilities.** Given the outsize importance of a few large banks in Russia, systemic risk monitoring and the closer supervision of systemically important banks are imperative. The authorities are aware of the challenges involved, and the recent establishment of an inter-agency working group under the Presidential Council and the creation of a special department at the CBR in charge of macroprudential analysis are welcome. The FSAP recommended that to ensure close cooperation and information-exchange between all supervisory agencies, the Deposit Insurance Agency also be included in the working group, and the authorities have noted this was being arranged. In addition, the FSAP recommended the CBR maintain the possibility of permanent supervisory presence on-site in systemically important banks.

## D. Improving the Investment Climate

*Improving Russia's ailing investment climate is key to attracting productive capital inflows and promoting sustainable growth. The authorities announced plans to strengthen the business environment, but broader structural and governance reforms are needed to boost investment and support economic diversification.*

**34. Staff and the authorities agreed that Russia's poor business environment and weak governance are key obstacles to economic diversification and vibrant growth.** Adverse demographic trends suggest that investment and productivity gains will have to become the primary sources of long-term growth in Russia. This underscores the need for a stronger business climate and better governance—dimensions on which Russia compares poorly to other BRICS and emerging economies in Europe (Figure 7). The authorities noted that addressing these issues is a key reform priority, as reflected in the ten-point plan to improve the investment climate recently put forward by President Medvedev (Box 6).

**35. Staff welcomed the ten-point plan and called for its expeditious implementation, but underscored that some aspects of the plan would need to be carefully managed.** In particular, the lost revenue from the proposed reversal of the payroll tax increase should be fully replaced, for example by reducing subsidies to connected enterprises, and eventually, by increasing the retirement age, rationalizing early retirement schemes, and means-testing basic pensions. Similarly, the creation of a private equity fund with government partnership could encourage foreign investment by reducing operational uncertainties. However, its political independence should be ensured to protect the fund from being used as a means to implement marginal, but politically attractive projects, while the risks to the sovereign balance sheet from contingent liabilities would need to be contained.

**36. More generally, staff emphasized the need for broader governance reforms.** These reforms include the strengthening of property rights and the rule of law, and the reform of the judiciary system and civil service. Accession to the WTO would also improve the business climate through increased predictability of the government's trade policy. Furthermore, decisive implementation of the planned extensive privatization—including in the banking sector—should help to curtail state dominance, improve competition, and reduce moral hazard. The authorities confirmed their intention to implement an ambitious privatization program in the next three years.

# STAFF APPRAISAL

**37. Russia's post-crisis rebound is underway, but bold and decisive reforms are needed to strengthen the medium-term outlook.** Despite a strong pick up in commodity prices, growth has been relatively modest and inflation is high. The economy has been on an upward trajectory since the second half of 2009, but the recovery has been uneven. Meanwhile, weak economic policy frameworks, an unfavorable investment climate, and lack of economic diversification continue to weigh on the economic outlook, raising the specter of below-par growth and continued instability.

**38. The authorities have a window of opportunity, created by high commodity prices to reduce vulnerabilities and lay the foundation for stronger growth.** The Russian economy has experienced a greater degree of instability over the past decade and a much larger output loss during the recent crisis than its peers, owing to its continued dependence on commodities, poor governance, and procyclical economic policies rooted in weak policy frameworks. To put growth on a sustained higher trajectory, the focus should be on reducing fiscal vulnerabilities, reining in inflation, promoting a stronger and more competitive banking system, and creating a welcoming environment for investment. Improvements to economic policy frameworks and a reinvigoration of long-stalled structural reforms would be integral elements of this strategy and would send a positive signal to investors and boost Russia's growth potential.

**Box 6. President's Action Plan to Improve Russia's Investment Climate***

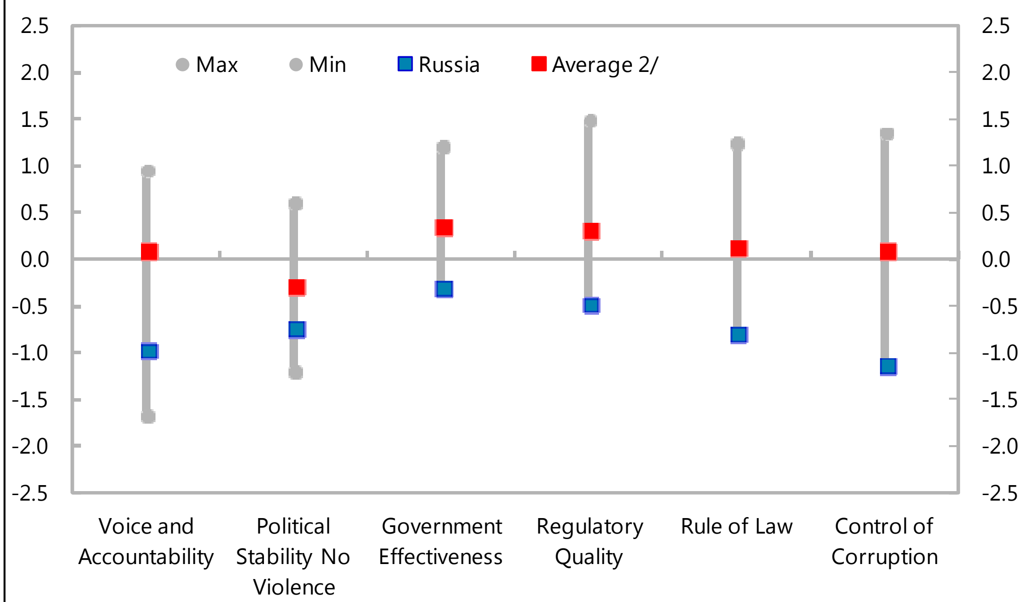
In April 2011, President Medvedev proposed a plan to improve Russia's investment climate. The plan specifies ten priority measures to enhance the business environment and public sector governance, while reducing corruption and the interference of the state in the economy. The plan called for the following actions:

1. Unwind the recent increase in the payroll tax rate, and cut healthcare procurement costs by 15 percent.
2. Develop a system to follow up on corruption complaints.
3. Review business regulations to identify those obstructing business and investment activity.
4. Appoint an investment ombudsman in each federal district to facilitate business development.
5. Reduce interference of the state in private business through:
    - Further privatization efforts;
    - Replacement of government regulators on boards of SOEs with independent directors;
    - More transparent public communication regarding government procurement plans.
6. Improve access of minority shareholders to corporate information.
7. Establish a state-backed private equity fund to facilitate foreign direct investment in non-natural resource sectors.
8. Reduce the authority of the state commission on foreign investments in strategic sectors.
9. Improve public services for businesses.
10. Involve the President's Office in monitoring the quality of public services.

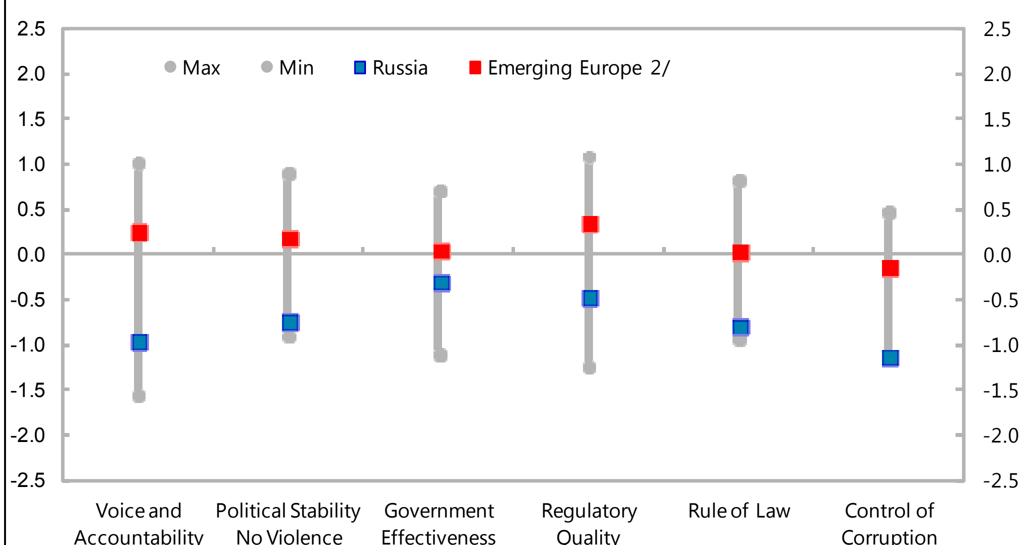
* Prepared by Daehaeng Kim.

**Figure 7. Governance Indicators for Selected Countries 1/**

**BRICS, Chile, and Turkey**




**Emerging Europe 3/**




**Sources: The 2009 World Governance Indicators; and IMF staff calculations.**
1/ Higher values mean better governance. Indicators range from +2.5 to -2.5.
2/ Excluding Russia.
3/ For 14 Emerging European Economies.

This would also generate positive economic spillovers for the region. The 2020 strategy currently under preparation provides an opportunity to put in place the reforms to support stronger growth.

**39. Fiscal policy needs to be firmly anchored on a sustainable nonoil deficit target.** Putting public finances on a sustainable path and preserving oil wealth for future generations would require reinstating the government's long-term nonoil deficit target of 4.7 percent of GDP. Concrete plans—grounded in growth-friendly measures, including a reversal of the payroll tax increase, reductions in subsidies and tax exemptions, and better targeting of social transfers—should be laid out to reach this target by 2015. These actions would also help to rebuild fiscal buffers in the oil funds, in line with the authorities' stated goal, thereby reducing fiscal vulnerabilities. Durable adjustment would require fundamental reforms, including to pensions, social protection, and healthcare. Front-loading the consolidation, while strengthening fiscal institutions, would enhance its credibility and help to realize sooner the growth benefits. In this regard, the 2012–14 preliminary budget should be reconsidered, since it further delays fiscal consolidation and thereby exacerbates fiscal risks and undermines the credibility of fiscal policy with potentially negative knock-on effects on growth.

**40. A continued tightening of monetary policy is needed to rein in inflation.** Despite a still-negative output gap, core inflation and inflation expectations are uncomfortably high. While the CBR has appropriately, if belatedly, embarked on a tightening cycle, continued policy tightening will be needed this year to bring inflation down towards a medium-term rate of 3-5 percent. The effectiveness of this endeavor would be bolstered by improvements to the operational framework for monetary policy and a consistent communications policy, the transparency of which could be increased by publishing information on inflation expectations and medium-term inflation forecasts. Ongoing steps to enhance exchange rate flexibility are a positive development. They allow monetary policy to focus on inflation, and could help dampen current inflationary pressures. Thus, the flexible exchange rate and fiscal adjustment would serve as the first lines of defense against volatile capital flows.

**41. Addressing remaining gaps in the regulatory and supervisory frameworks would help safeguard a sound financial system and underpin growth.** The authorities successfully maintained financial stability in the recent global crisis, but the banking system remains vulnerable to shocks, including potential spillovers from the Euro area, underscoring the need for continued vigilance. Against this background, the recent FSAP financial stability assessment recommended strengthening financial sector policies, including by granting the CBR greater supervisory powers and adopting the legislation on consolidated supervision and connected lending. Effective implementation of the FSAP recommendations would reduce banking sector risks and bring supervision in line with international standards.

**42. Enhancing the attractiveness of the investment climate remains a high priority.** Given the nonrenewable nature of oil and gas reserves, the non-energy share of the economy will need to increase over time and become the engine of growth. Key to the goal of achieving economic diversification and higher growth is attracting durable and productive investment, including through macroeconomic stability and an enhanced business environment. Provided that it is effectively implemented, the President's action plan could help achieve this goal, but sustained reform efforts will be needed to fully reap growth benefits. Thus, moving ahead on broader reforms, including WTO accession, reducing the role of the state in the economy, and improving governance, is a necessary complement to the action plan.

**43.** It is proposed that the next Article IV consultation be held on the standard 12-month cycle.

Table 1. Russian Federation: Selected Macroeconomic Indicators, 2008–12

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|
| | | | Estimate | Projections | |
| | | | (Annual percent change) | | |
| Production and prices | | | | | |
| Real GDP | 5.2 | -7.8 | 4.0 | 4.8 | 4.5 |
| Consumer prices | | | | | |
| Period average | 14.1 | 11.7 | 6.9 | 9.1 | 7.6 |
| End of period | 13.3 | 8.8 | 8.8 | 8.0 | 7.2 |
| GDP deflator | 18.0 | 1.9 | 11.4 | 14.6 | 8.4 |
| Unemployment rate | 6.4 | 8.4 | 7.5 | 7.3 | 7.1 |
| | | | (Percent of GDP) | | |
| Public sector 1/ | | | | | |
| General government | | | | | |
| Net lending/borrowing (overall balance) | 4.9 | -6.3 | -3.5 | -1.1 | -1.5 |
| Revenue | 39.2 | 35.1 | 35.0 | 37.1 | 36.0 |
| Expenditures | 34.3 | 41.4 | 38.5 | 38.2 | 37.5 |
| Primary balance | 5.3 | -5.7 | -2.9 | -0.3 | -0.4 |
| Nonoil balance | -7.7 | -15.2 | -13.4 | -12.2 | -11.7 |
| Nonoil balance excl. one-off receipts 2/ | -7.7 | -15.6 | -13.4 | -12.2 | -11.7 |
| Federal government | | | | | |
| Net lending/borrowing (overall balance) | 3.6 | -5.9 | -4.0 | -1.3 | -1.7 |
| Nonoil balance | -7.6 | -13.8 | -12.7 | -11.2 | -10.9 |
| Nonoil balance excl. one-off receipts 2/ | -7.6 | -14.2 | -12.7 | -11.2 | -10.9 |
| | | | (Annual percent change) | | |
| Money | | | | | |
| Base money | 2.9 | 7.4 | 25.4 | 27.4 | 23.5 |
| Ruble broad money | 0.8 | 17.7 | 31.1 | 27.3 | 25.0 |
| Credit to the economy | 37.2 | 2.6 | 12.9 | 21.7 | 20.4 |
| External sector | | | | | |
| Export volumes | -2.6 | -9.8 | 8.4 | 3.4 | 3.5 |
| Oil | -2.6 | 3.0 | 5.7 | 1.5 | 1.5 |
| Gas | 1.8 | -13.8 | 23.5 | -0.9 | -0.9 |
| Non-energy | -4.4 | -18.2 | 10.7 | 8.0 | 8.2 |
| Import volumes | 11.1 | -31.0 | 25.7 | 18.8 | 10.8 |
| | | | (Billions of U.S. dollars; unless otherwise indicated) | | |
| External sector | | | | | |
| Total merchandise exports, f.o.b | 471.6 | 303.4 | 400.1 | 515.1 | 543.1 |
| Total merchandise imports, f.o.b | -291.9 | -191.8 | -248.7 | -321.1 | -357.7 |
| External current account | 103.7 | 49.5 | 71.1 | 101.9 | 86.8 |
| External current account (percent of GDP) | 6.2 | 4.1 | 4.8 | 5.3 | 4.0 |
| Gross international reserves | | | | | |
| Billions of U.S. dollars | 427.1 | 439.5 | 479.4 | 550.8 | 617.6 |
| Months of imports 3/ | 14.0 | 20.8 | 17.9 | 15.9 | 16.1 |
| Percent of short-term debt | 288 | 303 | 349 | 375 | 422 |
| Memorandum items: | | | | | |
| Nominal GDP (billions of rubles) | 41,277 | 38,786 | 44,939 | 53,980 | 61,152 |
| Nominal GDP (billions of U.S. dollars) | 1,665 | 1,231 | 1,488 | 1,909 | 2,188 |
| Exchange rate (rubles per U.S. dollar, period average) | 24.9 | 31.7 | 30.4 | … | … |
| World oil price (U.S. dollars per barrel, WEO) | 97.0 | 61.8 | 79.0 | 106.3 | 109.3 |
| Urals crude oil spot price (U.S. dollars per barrel) | 94.4 | 61.2 | 76.8 | 104.1 | 107.1 |
| Real effective exchange rate (average percent change) | 6.8 | -7.0 | 9.4 | … | … |

Sources: Russian authorities; and IMF staff estimates.

1/ Based on the 2011–13 budget.
2/ Excludes one-off tax receipts from Nanotechnology and Housing Funds in 2009.
3/ In months of imports of goods and non-factor services.

Table 2. Russian Federation: Balance of Payments, 2008–12
(Billions of U.S. dollars, unless otherwise indicated)

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|
| | | | Estimate | Projections | |
| Current Account | 103.7 | 49.5 | 71.1 | 101.9 | 86.8 |
| Trade Balance | 179.7 | 111.6 | 151.4 | 193.9 | 185.4 |
| Exports | 471.6 | 303.4 | 400.1 | 515.1 | 543.1 |
| Non-energy | 161.5 | 112.7 | 146.1 | 176.8 | 191.9 |
| Energy | 310.1 | 190.7 | 254.0 | 338.2 | 351.2 |
| Oil | 241.0 | 148.7 | 206.3 | 286.3 | 298.9 |
| Gas | 69.1 | 42.0 | 47.7 | 51.9 | 52.3 |
| Imports | -291.9 | -191.8 | -248.7 | -321.1 | -357.7 |
| Services | -24.3 | -20.1 | -27.8 | -36.9 | -41.6 |
| Income | -48.9 | -39.6 | -48.4 | -48.8 | -50.2 |
| Public sector interest (net) | 17.4 | 6.3 | 3.6 | 3.8 | 4.9 |
| Other sectors | -66.3 | -45.9 | -52.0 | -52.6 | -55.1 |
| Current transfers | -3.5 | -2.8 | -4.1 | -6.4 | -6.9 |
| Capital and financial account | -131.0 | -44.3 | -28.5 | -30.4 | -19.9 |
| Capital transfers | 0.7 | -11.4 | 0.2 | 0.0 | -5.0 |
| Financial accounts | | | | | |
| Federal government | -9.1 | 24.7 | -0.2 | 3.7 | 5.3 |
| Portfolio investment | -6.5 | 3.8 | 4.9 | 4.8 | 6.3 |
| Loans | -2.3 | -3.4 | -1.2 | -1.1 | -1.0 |
| Other investment | -0.3 | 24.2 | -4.0 | 0.0 | 0.0 |
| Local governments | -0.1 | 0.4 | 0.5 | -0.2 | -0.2 |
| Private sector capital | -122.6 | -58.1 | -29.0 | -34.0 | -20.0 |
| Direct investment | 19.4 | -8.1 | -10.5 | 5.9 | 8.3 |
| Portfolio investment | -28.6 | -7.3 | -7.6 | 5.1 | 7.4 |
| Other investment, commercial banks | -55.3 | -29.0 | 13.6 | -7.1 | -2.5 |
| Assets | -57.7 | 21.8 | 2.8 | 2.9 | 3.0 |
| Liabilities (loans, deposits, etc.) | 2.4 | -50.8 | 10.8 | -10.0 | -5.5 |
| Loans, corporations | 48.8 | 2.6 | -6.7 | 0.0 | 4.4 |
| Disbursements | 170.8 | 82.6 | 71.9 | 71.9 | 85.8 |
| Amortizations | -122.0 | -80.0 | -78.6 | -71.9 | -81.4 |
| Other private sector capital flows | -106.9 | -16.3 | -17.8 | -37.8 | -37.6 |
| Errors and omissions, net | -11.6 | -1.2 | -6.3 | 0.0 | 0.0 |
| Overall balance | -38.9 | 4.0 | 36.3 | 71.4 | 66.8 |
| Financing | 38.9 | -4.0 | -36.3 | -71.4 | -66.8 |
| Net international reserves | 38.9 | -3.4 | -36.8 | -71.4 | -66.8 |
| Arrears and rescheduling | -0.1 | -0.6 | 0.4 | 0.0 | 0.0 |
| Memorandum items: | | | | | |
| Current account (percent of GDP) | 6.2 | 4.1 | 4.8 | 5.3 | 4.0 |
| Non-energy current account (percent of GDP) | -12.4 | -11.5 | -12.3 | -12.4 | -12.1 |
| Gross reserves 1/ | 427.1 | 439.5 | 479.4 | 550.8 | 617.6 |
| (months of imports of GNFS) | 14.0 | 20.8 | 17.9 | 15.9 | 16.1 |
| (percent of short-term debt) 2/ | 288.3 | 303.3 | 349.1 | 374.5 | 421.9 |
| Real growth in partner countries (percent change) | 2.4 | -3.3 | 3.8 | 3.6 | 3.3 |
| Net private capital flows (percent of exports of GNFS) | -23.4 | -16.8 | -6.5 | -5.9 | -3.3 |
| Net private capital flows, banks | -56.9 | -36.7 | 12.5 | -5.1 | 0.5 |
| Public external debt service payments 3/ | 8.4 | 5.9 | 6.5 | 7.7 | 6.0 |
| (percent of exports of goods and services) | 1.6 | 1.7 | 1.5 | 1.3 | 1.0 |
| Public external debt 4/ | 32.8 | 45.9 | 46.6 | 50.1 | 55.2 |
| (percent of GDP) | 2.0 | 3.8 | 3.1 | 2.6 | 2.5 |
| Private external debt | 447.7 | 421.3 | 442.1 | 432.1 | 432.5 |
| (percent of GDP) | 27.0 | 34.5 | 29.9 | 22.6 | 19.8 |
| Total external debt | 480.5 | 467.2 | 488.7 | 482.2 | 487.7 |
| (percent of GDP) | 28.9 | 38.2 | 33.0 | 25.3 | 22.3 |
| World oil price (U.S. dollars per barrel, WEO) | 97.0 | 61.8 | 79.0 | 106.3 | 109.3 |
| Urals oil price (U.S. dollars per barrel) | 94.4 | 61.2 | 76.8 | 104.1 | 107.1 |

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 indebtedness of repos by the monetary authorities.

Table 3. Russian Federation: Fiscal Operations, 2009–12 1/

(Percent of GDP, unless otherwise indicated)

| | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|
| | | Estimate | Projections 2/ | |
| General government | | | | |
| Total revenue; *of which:* | 35.1 | 35.0 | 37.1 | 36.0 |
| Oil revenue | 8.9 | 9.9 | 11.1 | 10.2 |
| Nonoil revenue | 26.2 | 25.1 | 26.0 | 25.8 |
| Corporate profit tax | 3.3 | 3.9 | 4.0 | 3.8 |
| Personal income tax | 4.3 | 4.0 | 4.0 | 4.0 |
| VAT | 5.3 | 5.6 | 5.5 | 5.5 |
| Excises | 0.9 | 1.0 | 1.2 | 1.2 |
| Custom tariffs | 6.9 | 7.2 | 8.2 | 7.6 |
| Resource extraction tax | 3.0 | 3.4 | 3.6 | 3.5 |
| Social security taxes | 5.9 | 5.1 | 6.2 | 6.2 |
| Other revenue | 5.5 | 4.8 | 4.4 | 4.3 |
| Expenditure | 41.4 | 38.5 | 38.2 | 37.5 |
| Expense | 34.5 | 32.1 | 31.9 | 31.3 |
| Gross operating balance | 0.6 | 2.9 | 5.2 | 4.7 |
| Net acquisition of nonfinancial assets | 6.9 | 6.4 | 6.3 | 6.2 |
| Net lending/borrowing (overall balance) | -6.3 | -3.5 | -1.1 | -1.5 |
| Nonoil primary balance | -14.6 | -12.8 | -11.4 | -10.6 |
| Nonoil overall balance | -15.2 | -13.4 | -12.2 | -11.7 |
| Net acquisition of financial assets | -5.6 | -2.8 | 1.4 | 0.2 |
| Net incurrence of liabilities | 0.8 | 0.8 | 2.6 | 1.7 |
| Federal government | | | | |
| Total revenue; *of which:* | 18.9 | 18.5 | 19.5 | 18.7 |
| Oil revenue | 7.8 | 8.7 | 9.9 | 9.2 |
| Nonoil revenue | 11.1 | 9.8 | 9.6 | 9.5 |
| Expenditure | 24.8 | 22.5 | 20.8 | 20.4 |
| Expense | 21.4 | 19.2 | 17.6 | 17.4 |
| Compensation of employees | 4.4 | 3.9 | 3.6 | 3.5 |
| Use of goods and services | 2.8 | 2.4 | 2.5 | 2.4 |
| Interest | 0.5 | 0.4 | 0.7 | 0.9 |
| Subsidies | 1.5 | 1.2 | 1.0 | 1.0 |
| Grants | 9.4 | 9.3 | 7.7 | 6.7 |
| Social benefits | 2.2 | 0.9 | 0.7 | 0.7 |
| Other expenses | 0.6 | 1.1 | 1.4 | 2.2 |
| Gross operating balance | -2.4 | -0.7 | 1.9 | 1.3 |
| Net acquisition of nonfinancial assets | 3.5 | 3.3 | 3.2 | 2.9 |
| Net lending/borrowing (overall balance) | -5.9 | -4.0 | -1.3 | -1.7 |
| Nonoil primary balance | -13.3 | -12.3 | -10.5 | -10.0 |
| Nonoil overall balance | -13.8 | -12.7 | -11.2 | -10.9 |
| Net acquisition of financial assets | -5.2 | -3.3 | 1.3 | 0.0 |
| Domestic | -5.2 | -3.3 | 1.3 | 0.0 |
| Foreign | 0.0 | 0.0 | 0.0 | 0.0 |
| Net incurrence of liabilities | 0.8 | 0.8 | 2.6 | 1.7 |
| Domestic | 1.1 | 0.5 | 2.5 | 1.5 |
| Foreign | -0.3 | 0.2 | 0.1 | 0.1 |
| Memorandum items: | | | | |
| World oil price (U.S.dollars per barrel) | 61.8 | 79.0 | 106.3 | 109.3 |
| Urals prices (U.S. dollars per barrel) | 61.2 | 76.8 | 104.1 | 107.1 |
| Oil fund(s) | 11.9 | 7.7 | 7.7 | 6.8 |
| Reserve Fund | 4.7 | 1.7 | 2.7 | 2.4 |
| NWF | 7.1 | 6.0 | 5.0 | 4.4 |
| General government debt | 11.0 | 11.7 | 11.6 | 11.3 |
| GDP (billions of rubles) | 38,786 | 44,939 | 53,980 | 61,152 |

Sources: Russian authorities; and IMF staff estimates.
1/ Cash basis.
2/ Based on the 2011–13 budget; does not incorporate the planned reduction in the payroll tax in 2012.

Table 4. Russian Federation: Monetary Accounts, 2008–12
(Billions of rubles, unless otherwise indicated)

| | 2008 | 2009 | 2010 | | | | 2011 | | 2012 |
|---|---|---|---|---|---|---|---|---|---|
| | Dec | Dec | Mar | June | Sept | Dec | Mar | Dec | Dec |
| | | | | | | | | Proj. | Proj. |
| **Monetary authorities** | | | | | | | | | |
| Base money | 4,392 | 4,716 | 4,517 | 4,945 | 5,147 | 5,913 | 5,647 | 7,533 | 9,302 |
| Currency issued | 4,372 | 4,623 | 4,411 | 4,828 | 5,024 | 5,785 | 5,483 | 7,254 | 8,951 |
| Required reserves on ruble deposits | 20 | 93 | 105 | 117 | 123 | 128 | 164 | 279 | 350 |
| NIR 1/ | 11,199 | 12,755 | 13,529 | 14,460 | 14,595 | 14,304 | 14,643 | 16,481 | 18,518 |
| Gross reserves | 12,225 | 13,195 | 13,829 | 14,730 | 14,864 | 14,571 | 14,910 | 16,748 | 18,785 |
| Gross liabilities | 95 | 440 | 301 | 270 | 269 | 267 | 267 | 267 | 267 |
| *GIR (billions of U.S. dollars)* | *416* | *436* | *457* | *487* | *491* | *478* | 489 | 550 | *616* |
| NDA | -6,808 | -8,039 | -9,012 | -9,516 | -9,448 | -8,392 | -8,996 | -8,948 | -9,216 |
| Net credit to general government | -7,152 | -5,515 | -5,492 | -5,619 | -5,645 | -3,963 | -5,113 | -4,640 | -4,632 |
| Net credit to federal government 2/ | -6,343 | -4,614 | -4,297 | -4,362 | -4,241 | -2,907 | -3,593 | -3,584 | -3,576 |
| CBR net ruble credit to federal government 1/ | -615 | -595 | -458 | -893 | -768 | -293 | -835 | -32 | 17 |
| Foreign exchange credit | 168 | 147 | 142 | 120 | 119 | 140 | 140 | 140 | 140 |
| Ruble counterpart 2/ | -5,897 | -4,166 | -3,981 | -3,589 | -3,592 | -2,754 | -2,898 | -3,692 | -3,734 |
| CBR net credit to local government and EBFs | -809 | -902 | -1,194 | -1,257 | -1,403 | -1,056 | -1,520 | -1,056 | -1,056 |
| CBR net credit to local government | -397 | -385 | -614 | -639 | -753 | -436 | -679 | -436 | -436 |
| CBR net credit to extrabudgetary funds | -412 | -517 | -580 | -618 | -650 | -620 | -841 | -620 | -620 |
| Net credit to banks | 2,515 | -53 | -877 | -1,444 | -1,299 | -1,640 | -1,219 | -1,328 | -1,442 |
| Gross credit to banks | 3,692 | 1,640 | 902 | 726 | 589 | 577 | 563 | 400 | 250 |
| Gross liabilities to banks and deposits | -1,177 | -1,693 | -1,779 | -2,170 | -1,888 | -2,217 | -1,783 | -1,728 | -1,692 |
| *Of which:* correspondent account balances | -1,028 | -900 | -579 | -604 | -590 | -995 | -597 | -944 | -1,186 |
| Other items (net) 3/ | -2,170 | -2,471 | -2,644 | -2,452 | -2,505 | -2,789 | -2,664 | -2,980 | -3,143 |
| **Monetary survey** | | | | | | | | | |
| Broad money | 16,277 | 19,096 | 19,420 | 20,445 | 21,300 | 23,791 | 23,914 | 30,194 | 37,597 |
| Ruble broad money | 12,976 | 15,268 | 15,639 | 16,901 | 17,690 | 20,012 | 19,817 | 25,474 | 31,849 |
| Currency in circulation | 3,795 | 4,038 | 3,986 | 4,368 | 4,525 | 5,063 | 4,916 | 6,593 | 8,120 |
| Ruble deposits | 9,181 | 11,230 | 11,653 | 12,533 | 13,166 | 14,949 | 14,901 | 18,881 | 23,729 |
| Forex deposits 1/ | 3,301 | 3,828 | 3,781 | 3,544 | 3,610 | 3,779 | 4,097 | 4,720 | 5,748 |
| Net foreign assets 1/ | 10,869 | 13,674 | 14,427 | 15,164 | 15,082 | 14,999 | 15,575 | 17,330 | 19,352 |
| NIR of monetary authorities | 11,199 | 12,755 | 13,529 | 14,460 | 14,595 | 14,304 | 14,643 | 16,481 | 18,518 |
| NFA of commercial banks | -330 | 919 | 899 | 704 | 487 | 694 | 932 | 850 | 834 |
| NFA of commercial banks (billions of U.S. dollars) | -11 | 30 | 32 | 22 | 16 | 23 | 35 | 28 | 27 |
| NDA | 5,407 | 5,422 | 4,993 | 5,281 | 6,218 | 8,793 | 8,339 | 12,863 | 18,244 |
| Domestic credit | 11,266 | 13,297 | 13,445 | 13,752 | 14,877 | 17,265 | 17,267 | 22,043 | 27,743 |
| Net credit to general government | -6,680 | -5,119 | -5,080 | -5,245 | -5,055 | -3,522 | -4,399 | -3,258 | -2,716 |
| Credit to the economy | 17,945 | 18,416 | 18,525 | 18,997 | 19,932 | 20,787 | 21,666 | 25,301 | 30,459 |
| Other items (net) | -5,858 | -7,875 | -8,452 | -8,471 | -8,659 | -8,473 | -8,928 | -9,179 | -9,498 |
| Memorandum items: | | | | | | | | | |
| Accounting exchange rate (ruble per U.S. dollar, eop) | 29.4 | 30.2 | 30.2 | 30.2 | 30.2 | 30.5 | 30.5 | 30.5 | 30.5 |
| Nominal GDP (billions of rubles) | 41,789 | 38,786 | ... | ... | ... | 44,939 | ... | 53,980 | 61,152 |
| CPI inflation (12-month change, eop) | 13.3 | 8.8 | 6.5 | 5.8 | 7.0 | 8.8 | 9.5 | 8.0 | 7.2 |
| Ruble broad money velocity | 3.4 | 2.8 | 2.4 | 2.5 | 2.7 | 2.5 | 2.3 | 2.4 | 2.1 |
| Ruble broad money velocity (s.a.) | 3.3 | 2.8 | 2.7 | 2.6 | 2.5 | 2.6 | 2.6 | 2.3 | 2.1 |
| Annual change in velocity | 14.2 | -17.4 | -14.7 | -13.8 | -16.5 | -11.6 | -5.9 | -5.6 | -9.4 |
| Real ruble broad money (rel. to CPI, 12-month change) | -11.0 | 8.1 | 26.8 | 26.3 | 26.2 | 20.5 | 15.8 | 17.9 | 16.6 |
| Nominal ruble broad money (12-month change) | 0.8 | 17.7 | 35.0 | 33.6 | 35.0 | 31.1 | 26.7 | 27.3 | 25.0 |
| Base money (12-month change) | 2.9 | 7.4 | 22.9 | 25.5 | 30.2 | 25.4 | 25.0 | 27.4 | 23.5 |
| Real credit to the economy (12-month change) | 21.1 | -5.7 | -2.5 | 0.0 | 1.6 | 3.7 | 6.8 | 12.7 | 12.3 |
| Ruble broad money multiplier | 3.0 | 3.2 | 3.5 | 3.4 | 3.4 | 3.4 | 3.5 | 3.4 | 3.4 |

Sources: Russian authorities; and IMF staff estimates.

1/ Data calculated at accounting exchange rates.
2/ Represents the government's use of NIR resources and calculated in flow ruble terms.
3/ Inclusive of valuation gains and losses on holdings of government securities.

Table 5. Russian Federation: Medium-Term Framework and Balance of Payments, 2008–16

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|---|---|---|
| | | | Estimate | Projections | | | | | |
| | (Percent of GDP, unless otherwise indicated) | | | | | | | | |
| **Macroeconomic framework** | | | | | | | | | |
| GDP growth at constant prices (percent) | 5.2 | -7.8 | 4.0 | 4.8 | 4.5 | 4.3 | 4.1 | 3.9 | 3.8 |
| Consumer prices (percent change, end of period) | 13.3 | 8.8 | 8.8 | 8 | 7.2 | 6.8 | 6.5 | 6.5 | 6.5 |
| Gross domestic investment | 25.5 | 18.9 | 22.8 | 23.8 | 24.8 | 25.6 | 26.2 | 26.7 | 27.0 |
| Private sector | 20.8 | 14.3 | 18.4 | 20.3 | 21.6 | 22.8 | 23.7 | 24.4 | 24.6 |
| Public sector | 4.7 | 4.6 | 4.4 | 3.5 | 3.2 | 2.8 | 2.5 | 2.3 | 2.4 |
| Gross national savings | 31.7 | 22.9 | 27.6 | 29.2 | 28.8 | 28.3 | 27.5 | 27.4 | 27.1 |
| Private sector | 22.7 | 24.6 | 28.8 | 28.4 | 27.5 | 26.4 | 24.9 | 24.2 | 23.3 |
| Public sector | 9.0 | -1.7 | -1.2 | 0.8 | 1.3 | 2.0 | 2.6 | 3.2 | 3.8 |
| External current account balance | 6.2 | 4.1 | 4.8 | 5.3 | 4.0 | 2.7 | 1.2 | 0.7 | 0.1 |
| **Fiscal Operations** | | | | | | | | | |
| Federal government | | | | | | | | | |
| Net lending/borrowing (overall balance) | 3.6 | -5.9 | -4.0 | -1.3 | -1.7 | -2.0 | -3.0 | -3.6 | -4.3 |
| Nonoil balance | -7.6 | -13.8 | -12.7 | -11.2 | -10.9 | -10.4 | -10.4 | -10.4 | -10.4 |
| General government | | | | | | | | | |
| Net lending/borrowing (overall balance) | 4.9 | -6.3 | -3.5 | -1.1 | -1.5 | -1.7 | -2.8 | -3.4 | -4.1 |
| Revenues | 39.2 | 35.1 | 35.0 | 37.1 | 36.0 | 35.0 | 33.9 | 33.3 | 32.6 |
| Expenditures | 34.3 | 41.4 | 38.5 | 38.2 | 37.5 | 36.7 | 36.8 | 36.8 | 36.7 |
| Nonoil balance | -7.7 | -15.2 | -13.4 | -12.2 | -11.7 | -11.1 | -11.0 | -10.8 | -10.7 |
| Primary balance | 5.3 | -5.7 | -2.9 | -0.3 | -0.4 | -0.6 | -1.9 | -2.5 | -3.2 |
| Gross debt | 7.9 | 11.0 | 11.7 | 11.6 | 11.3 | 11.4 | 13.1 | 15.3 | 17.8 |
| | (Billions of U.S dollars; unless otherwise indicated) | | | | | | | | |
| **Balance of payments** | | | | | | | | | |
| Current account | 103.7 | 49.5 | 71.1 | 101.9 | 86.8 | 65.7 | 32.4 | 20.3 | 3.2 |
| Trade balance | 179.7 | 111.6 | 151.4 | 193.9 | 185.4 | 164.6 | 135.9 | 112.1 | 92.4 |
| Exports (f.o.b) | 471.6 | 303.4 | 400.1 | 515.1 | 543.1 | 560.4 | 567.3 | 583.8 | 603.3 |
| *Of which:* energy | 310.1 | 190.7 | 254.0 | 338.2 | 351.2 | 353.8 | 345.5 | 345.2 | 345.8 |
| Imports (f.o.b) | -291.9 | -191.8 | -248.7 | -321.1 | -357.7 | -395.8 | -431.4 | -471.7 | -510.9 |
| Services and transfers, net | -27.1 | -22.5 | -31.9 | -43.3 | -48.5 | -54.1 | -59.2 | -64.1 | -68.1 |
| Capital and financial account | -131.0 | -44.3 | -28.5 | -30.4 | -19.9 | -11.9 | -8.3 | -5.9 | -0.1 |
| Capital account | 0.7 | -11.4 | 0.2 | 0.0 | -5.0 | -5.0 | -5.0 | -5.0 | -5.0 |
| Financial account | -131.7 | -32.9 | -28.7 | -30.4 | -14.9 | -6.9 | -3.3 | -0.9 | 4.9 |
| Private sector capital | -122.6 | -58.1 | -29.0 | -34.0 | -20.0 | -6.1 | -2.5 | -0.1 | 5.7 |
| Errors and omissions | -11.6 | -1.2 | -6.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Overall balance | -38.9 | 4.0 | 36.3 | 71.4 | 66.8 | 53.8 | 24.1 | 14.4 | 3.1 |
| *Memorandum items:* | | | | | | | | | |
| Gross reserves (end of period) | | | | | | | | | |
| Billions of U.S. dollars | 427.1 | 439.5 | 479.4 | 550.8 | 617.6 | 671.4 | 695.5 | 709.9 | 713.0 |
| Percent of short-term debt (residual maturity) | 288.3 | 303.3 | 349.1 | 374.5 | 421.9 | 447.5 | 452.2 | 449.3 | 461.1 |
| Months of prospective GNFS imports | 14.0 | 20.8 | 17.9 | 15.9 | 16.1 | 15.9 | 15.2 | 14.2 | 13.2 |
| Trade balance (percent of GDP) | 10.8 | 9.1 | 10.2 | 10.2 | 8.5 | 6.8 | 5.1 | 3.9 | 2.9 |
| Terms of trade (y-o-y change, percent) | 16.2 | -25.1 | 17.9 | 14.6 | 1.3 | -0.6 | -2.4 | -0.9 | -1.0 |
| Excluding fuel | 5.7 | -6.9 | 16.3 | 3.1 | -0.2 | -1.2 | -1.1 | -0.3 | -0.3 |
| Export volume, goods (y-o-y change, percent) | -2.6 | -9.8 | 8.4 | 3.4 | 3.5 | 3.9 | 4.0 | 3.8 | 3.9 |
| Import volume, goods (y-o-y change, percent) | 11.1 | -31.0 | 25.7 | 18.8 | 10.8 | 10.8 | 9.2 | 9.3 | 7.8 |

Sources: Russian authorities; and IMF staff estimates.

Table 6. Russian Federation: Medium-Term Framework and Balance of Payments Under Reform Scenario, 2008-16

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|---|---|---|
| | | | Estimate | | | Projections | | | |
| | | | (Percent of GDP, unless otherwise indicated) | | | | | | |
| **Macroeconomic framework** | | | | | | | | | |
| GDP growth at constant prices (percent) | 5.2 | -7.8 | 4.0 | 4.8 | 4.8 | 5.0 | 5.5 | 6.0 | 6.0 |
| Consumer prices (percent change, end of period) | 13.3 | 8.8 | 8.8 | 8 | 6.0 | 4.7 | 3.8 | 3.3 | 3.0 |
| Gross domestic investment | 25.5 | 18.9 | 22.8 | 23.8 | 24.9 | 25.9 | 26.9 | 27.8 | 28.4 |
| Private sector | 20.8 | 14.3 | 18.4 | 20.3 | 21.7 | 23.1 | 24.4 | 25.5 | 26.1 |
| Public sector | 4.7 | 4.6 | 4.4 | 3.5 | 3.2 | 2.8 | 2.5 | 2.3 | 2.4 |
| Gross national savings | 31.7 | 22.9 | 27.6 | 29.2 | 28.2 | 27.6 | 27.4 | 27.9 | 28.3 |
| Private sector | 22.7 | 24.6 | 28.8 | 28.4 | 26.9 | 25.6 | 24.9 | 24.7 | 24.5 |
| Public sector | 9.0 | -1.7 | -1.2 | 0.8 | 1.3 | 2.0 | 2.6 | 3.2 | 3.8 |
| External current account balance | 6.2 | 4.1 | 4.8 | 5.3 | 3.3 | 1.7 | 0.5 | 0.1 | -0.1 |
| **Fiscal Operations** | | | | | | | | | |
| Federal government | | | | | | | | | |
| Net lending/borrowing (overall balance) | 3.6 | -5.9 | -4.0 | -1.3 | -0.2 | 0.8 | 1.1 | 1.8 | 1.1 |
| Nonoil balance | -7.6 | -13.8 | -12.7 | -11.2 | -9.3 | -7.3 | -6.0 | -4.7 | -4.7 |
| General government | | | | | | | | | |
| Net lending/borrowing (overall balance) | 4.9 | -6.3 | -3.5 | -1.1 | 0.0 | 1.1 | 1.3 | 2.0 | 1.3 |
| Revenues | 39.2 | 35.1 | 35.0 | 37.1 | 35.9 | 34.7 | 33.6 | 32.9 | 32.2 |
| Expenditures | 34.3 | 41.4 | 38.5 | 38.2 | 35.9 | 33.7 | 32.3 | 31.0 | 30.8 |
| Nonoil balance | -7.7 | -15.2 | -13.4 | -12.2 | -10.0 | -7.9 | -6.5 | -5.2 | -5.1 |
| Primary balance | 5.3 | -5.7 | -2.9 | -0.3 | 1.1 | 2.2 | 2.2 | 2.9 | 2.3 |
| Gross debt | 7.9 | 11.0 | 11.7 | 11.6 | 9.7 | 7.2 | 5.2 | 2.8 | 1.2 |
| | | | (Billions of U.S dollars; unless otherwise indicated) | | | | | | |
| **Balance of payments** | | | | | | | | | |
| Current account | 103.7 | 49.5 | 71.1 | 101.9 | 73.0 | 41.8 | 14.0 | 4.4 | -4.4 |
| Trade balance | 179.7 | 111.6 | 151.4 | 193.9 | 174.9 | 146.7 | 123.5 | 103.2 | 91.8 |
| Exports (f.o.b) | 471.6 | 303.4 | 400.1 | 515.1 | 543.1 | 560.4 | 570.6 | 589.8 | 612.5 |
| *Of which:* energy | 310.1 | 190.7 | 254.0 | 338.2 | 351.2 | 353.8 | 345.5 | 345.2 | 345.8 |
| Imports (f.o.b) | -291.9 | -191.8 | -248.7 | -321.1 | -368.1 | -413.7 | -447.1 | -486.6 | -520.7 |
| Services and transfers, net | -27.1 | -22.5 | -31.9 | -43.3 | -51.7 | -59.8 | -63.9 | -68.4 | -70.6 |
| Capital and financial account | -131.0 | -44.3 | -28.5 | -30.4 | -20.3 | -13.4 | -7.4 | -3.7 | 3.2 |
| Capital account | 0.7 | -11.4 | 0.2 | 0.0 | -10.0 | -10.0 | -10.0 | -10.0 | -10.0 |
| Financial account | -131.7 | -32.9 | -28.7 | -30.4 | -10.3 | -3.4 | 2.6 | 6.3 | 13.2 |
| Private sector capital | -122.6 | -58.1 | -29.0 | -34.0 | -9.4 | 14.4 | 18.4 | 22.1 | 29.0 |
| Errors and omissions | -11.6 | -1.2 | -6.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Overall balance | -38.9 | 4.0 | 36.3 | 71.4 | 52.7 | 28.4 | 6.6 | 0.7 | -1.2 |
| *Memorandum items:* | | | | | | | | | |
| Gross reserves (end of period) | | | | | | | | | |
| Billions of U.S. dollars | 427.1 | 439.5 | 479.4 | 550.8 | 613.5 | 641.8 | 648.4 | 649.2 | 648.1 |
| Percent of short-term debt (residual maturity) | 288.3 | 303.3 | 349.1 | 374.5 | 407.2 | 411.3 | 401.1 | 386.5 | 388.4 |
| Months of prospective GNFS imports | 14.0 | 20.8 | 17.9 | 15.9 | 15.6 | 14.5 | 13.6 | 12.6 | 11.8 |
| Trade balance (percent of GDP) | 10.8 | 9.1 | 10.2 | 10.2 | 7.9 | 5.8 | 4.5 | 3.4 | 2.7 |
| Terms of trade (y-o-y change, percent) | 16.2 | -25.1 | 17.9 | 14.6 | 1.3 | -0.6 | -2.4 | -0.9 | -1.0 |
| Excluding fuel | 5.7 | -6.9 | 16.3 | 3.1 | -0.2 | -1.2 | -1.1 | -0.3 | -0.3 |
| Export volume, goods (y-o-y change, percent) | -2.6 | -9.8 | 8.4 | 3.4 | 3.5 | 3.9 | 4.6 | 4.3 | 4.4 |
| Import volume, goods (y-o-y change, percent) | 11.1 | -31.0 | 25.7 | 18.8 | 14.1 | 12.5 | 8.3 | 8.8 | 6.5 |

Sources: Russian authorities; and IMF staff estimates.

Table 7. Russian Federation: Financial Soundness Indicators, 2008–10
(Percent)

| | 2008 | 2009 | 2010 |
|---|---|---|---|
| ***Financial Soundness Indicators*** | | | |
| **Capital adequacy** | | | |
| Capital to risk-weighted assets | 16.8 | 20.9 | 18.1 |
| Core capital to risk-weighted assets | 10.6 | 13.2 | 11.1 |
| Risk-weighted assets to total assets | 64.9 | 60.6 | 59.6 |
| **Credit risk** | | | |
| NPLs to total loans | 3.8 | 9.6 | 8.2 |
| Loan loss provisions to total loans | 4.5 | 9.1 | 8.5 |
| Large credit risks to capital | 191.7 | 147.1 | 184.6 |
| **Distribution of loans provided by credit institutions** | | | |
| Agriculture, hunting and forestry | 4.2 | 4.9 | 5.1 |
| Mining | 3.3 | 3.9 | 3.6 |
| Manufacturing | 14.4 | 15.7 | 16.0 |
| Production and distribution of energy, gas and water | 1.9 | 2.4 | 2.6 |
| Construction | 6.1 | 6.2 | 5.9 |
| Wholesale and retail trade | 17.4 | 18.4 | 17.1 |
| Transport and communication | 4.3 | 3.4 | 3.8 |
| Other economic activities | 23.3 | 21.9 | 23.7 |
| Individuals | 25.1 | 23.0 | 23.7 |
| of which mortgage loans | 6.6 | 6.5 | 6.6 |
| **Geographical distribution of interbank loans and deposits** | | | |
| Russian Federation | 27.1 | 29.5 | … |
| United Kingdom | 29.1 | 21.7 | … |
| USA | 7.1 | 4.1 | … |
| Germany | 7.5 | 4.7 | … |
| Austria | 5.7 | 8.2 | … |
| France | 4.0 | 5.7 | … |
| Italy | 1.5 | 1.8 | … |
| Cyprus | 0.4 | 6.2 | … |
| Netherlands | 4.6 | 4.6 | … |
| Other | 13.1 | 13.4 | … |
| **Liquidity** | | | |
| Highly liquid assets to total assets | 14.5 | 13.3 | 13.5 |
| Liquid assets to total assets | 25.9 | 28.0 | 26.8 |
| Liquid assets to short-term liabilities | 92.1 | 102.4 | 94.3 |
| Ratio of client's funds to total loans | 84.6 | 99.9 | 109.5 |
| **Return on assets** | 1.8 | 0.7 | 1.9 |
| Net interest income/assets | 1.5 | 0.7 | 1.7 |
| Net securities income | 0.0 | 1.3 | 1.1 |
| Net FX related income | 0.9 | 0.5 | 0.1 |
| Net commissions income | 1.6 | 1.4 | 1.3 |
| Net income, excl. provisions | 3.1 | 4.3 | 2.4 |
| Net provisions | -1.6 | -3.6 | -0.7 |
| Net interest margin for customer loans | 5.6 | 12.2 | 6.7 |
| **Return on equity** | 13.3 | 4.9 | 12.5 |
| ***Balance Sheet Structure, in percent of assets*** | | | |
| Total asset growth rate | 39.2 | 5.0 | 14.9 |
| Total customer loans growth rate | 34.5 | -2.5 | 12.6 |
| **Asset side** | | | |
| Total customer loans | 59.0 | 54.8 | 53.7 |
| Accounts with CBR and other central banks | 7.4 | 6.0 | 5.4 |
| Interbank lending | 8.9 | 9.3 | 8.6 |
| Securities holdings | 8.4 | 14.6 | 17.2 |
| *of which* | | | |
| At fair value through profit or loss statement | 2.2 | 5.0 | 4.9 |
| Available for sale | 4.1 | 7.3 | 8.9 |
| Held-to-maturity | 0.6 | 0.5 | 1.4 |
| **Liability side** | | | |
| Funds from CBR | 12.0 | 4.8 | 1.0 |
| Interbank liabilities | 13.0 | 10.6 | 11.1 |
| Fund raised from organizations | 31.3 | 32.5 | 32.9 |
| Individual deposits | 21.1 | 25.4 | 29.0 |
| Bonds, PN and bank acceptance | 4.0 | 3.9 | 3.9 |
| Capital | 13.6 | 15.7 | 14.0 |
| Core capital | 8.6 | 9.9 | 8.8 |
| **Maturity Structure, share of claims due within one year (contractural)** | | | |
| Deposits from individuals | 34.8 | 36.3 | 35.3 |
| Funds raised from non-financial organizations | 48.6 | 53.8 | 50.0 |
| Bonds | 0.2 | 0.9 | 0.0 |

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

Table 8. Russian Federation: Indicators of External Vulnerability, 2006–10

(Percent of GDP, unless otherwise indicated)

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| **Financial indicators** | | | | | |
| Public sector debt 1/ | 9.0 | 8.5 | 7.9 | 11.0 | 11.7 |
| Broad money (12-month basis, percent change) | 48.8 | 47.5 | 1.7 | 16.3 | 27.5 |
| Private sector credit (12-month basis, percent change) | 48.5 | 48.5 | 37.4 | 2.3 | 13.3 |
| InterBank Prime Rate (3-month average, percent) | 5.1 | 5.9 | 9.7 | 14.1 | 4.4 |
| InterBank Prime Rate (3-month average, percent, real) | -4.6 | -3.2 | -4.4 | 2.4 | -2.5 |
| **External Indicators** | | | | | |
| Exports (percent change, U.S. dollars) | 24.5 | 16.8 | 33.1 | -35.7 | 31.9 |
| Imports (percent change, U.S. dollars) | 31.0 | 36.0 | 30.6 | -34.3 | 29.7 |
| Terms of trade (percent change, 12 month basis) | 11.4 | 2.8 | 16.2 | -25.2 | 17.6 |
| Current account balance (billions of U.S. dollars) | 94.3 | 77.0 | 103.7 | 49.5 | 71.1 |
| Capital and financial account balance (billions of U.S. dollars) | 4.6 | 85.7 | -131.0 | -44.3 | -28.5 |
| Inward portfolio investment (debt securities etc.) | 9.5 | 16.9 | -27.4 | 7.4 | 0.0 |
| Other investment (loans, trade credits etc.) | -5.0 | 79.1 | -104.3 | -40.3 | -28.7 |
| Gross official reserves (billions of U.S. dollars) | 303.7 | 478.8 | 427.1 | 439.5 | 479.4 |
| Short-term foreign assets of the financial sector (billions of U.S. dollars) 2/ | 33.4 | 42.7 | n.a. | n.a. | n.a. |
| Short-term foreign liabilities of the financial sector (billions of U.S. dollars) 2 | 20.7 | 30.5 | n.a. | n.a. | n.a. |
| Foreign currency exposure of the financial sector (billions of U.S. dollars) 2/ | -12.1 | -18.9 | n.a. | n.a. | n.a. |
| Official reserves (months of imports goods and services) | 17.4 | 20.3 | 14.0 | 20.8 | 17.9 |
| Ruble broad money to gross reserves | 1.1 | 1.1 | 1.3 | 1.1 | 1.4 |
| Total short-term external debt to reserves | 71.2 | 30.9 | 33.9 | 31.3 | 30.7 |
| Total external debt (billions of U.S. dollars) | 313.2 | 471.0 | 480.5 | 467.2 | 488.7 |
| *Of which:* public sector debt (billions of U.S. dollars) | 48.6 | 46.4 | 32.8 | 45.9 | 46.6 |
| Total external debt to exports of goods and services (percent) | 93.6 | 119.6 | 91.9 | 135.4 | 109.9 |
| External interest payments to exports of goods and services | 4.8 | 5.5 | 5.0 | 6.4 | 5.3 |
| External amortization payments to exports of goods and services | 23.2 | 22.8 | 24.5 | 24.3 | 18.7 |
| Exchange rate (per U. S. dollar, period average) | 27.2 | 25.6 | 24.9 | 31.7 | 30.4 |
| REER depreciation (-) (12-month basis) | 9.9 | 5.5 | 6.8 | -6.8 | 13.8 |
| **Financial Market Indicators** | | | | | |
| Stock market index 3/ | 1921.92 | 2290.51 | 631.9 | 1444.61 | 1767.8 |
| Foreign currency debt rating 4/ | BBB+ | BBB+ | BBB | BBB | BBB |
| Spread of benchmark bonds (basis points, end of period) 5/ | 99 | 157 | 805 | 203 | 224 |

Sources: Russian authorities; and IMF staff estimates.

1/ Gross debt of general government.
2/ Series discontinued in 2008.
3/ RTS index, end of period.
4/ S&P long-term foreign currency debt rating, end of period.
5/ JPMorgan EMBIG Russia Sovereign Spread.

## Table 9. Russian Federation: Public Sector Debt Sustainability Framework, 2008–16

(Percent of GDP, unless otherwise indicated)

| | Actual | | Est. | | | Projection | | | | | | Debt-stabilizing |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | | | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | primary balance |
| Baseline: public sector debt 1/ | 7.9 | 11.0 | 11.7 | | | 11.6 | 11.3 | 11.4 | 13.1 | 15.3 | 17.8 | -0.4 |
| *Of which*: foreign-currency denominated | 2.4 | 3.7 | 3.2 | | | 2.7 | 2.6 | 2.3 | 2.1 | 1.9 | 1.7 | |
| Change in public sector debt | -0.6 | 3.1 | 0.8 | | | -0.1 | -0.4 | 0.1 | 1.7 | 2.2 | 2.6 | |
| Identified debt-creating flows | -1.6 | 0.1 | -1.1 | | | 1.5 | -0.3 | 0.1 | 1.8 | 2.2 | 2.6 | |
| Primary deficit (excluding deposits in oil funds from revenue) | -1.0 | -1.1 | -0.2 | | | 1.6 | 0.4 | 0.6 | 1.9 | 2.5 | 3.2 | |
| Revenue (excluding deposits in oil funds) | 34.8 | 41.9 | 38.1 | | | 35.8 | 36.0 | 35.0 | 33.9 | 33.3 | 32.6 | |
| Primary (noninterest) expenditure | 33.8 | 40.8 | 37.9 | | | 37.4 | 36.4 | 35.6 | 35.8 | 35.8 | 35.7 | |
| Automatic debt dynamics 2/ | -0.6 | 1.2 | -0.9 | | | -1.4 | -0.3 | 0.0 | -0.1 | -0.3 | -0.6 | |
| Contribution from interest rate/growth differential 3/ | -1.2 | 1.1 | -0.9 | | | -1.2 | -0.3 | -0.1 | -0.2 | -0.3 | -0.6 | |
| *Of which:* contribution from real interest rate | -0.8 | 0.5 | -0.5 | | | -0.7 | 0.2 | 0.4 | 0.2 | 0.1 | -0.1 | |
| *Of which:* contribution from real GDP growth | -0.4 | 0.7 | -0.4 | | | -0.5 | -0.5 | -0.4 | -0.4 | -0.5 | -0.5 | |
| Contribution from exchange rate depreciation 4/ | 0.6 | 0.1 | 0.0 | | | -0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Other identified debt-creating flows | 0.0 | 0.0 | 0.0 | | | 0.7 | -0.5 | -0.5 | 0.0 | 0.0 | 0.0 | |
| Residual, including asset changes 5/ | 0.9 | 3.0 | 1.9 | | | -1.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Public sector debt-to-revenue ratio 1/ | 22.6 | 26.2 | 30.8 | | | 32.4 | 31.2 | 32.4 | 38.6 | 45.8 | 54.8 | |
| Gross financing need 6/ | -4.3 | 7.1 | 3.9 | | | 1.4 | 1.7 | 2.0 | 3.1 | 3.8 | 4.5 | |
| Billions of U.S. dollars | -71.2 | 87.3 | 57.2 | 10-Year | 10-Year | 26.9 | 38.3 | 49.2 | 83.7 | 111.1 | 145.3 | |
| Stress tests for public sector debt | | | | | | | | | | | | |
| Scenario with key variables at their historical averages 7/ | | | | | | 9.6 | 7.8 | 6.1 | 5.2 | 4.3 | 3.5 | -1.2 |
| Scenario with no policy change (constant primary balance) in 2009–15 | | | | | | 10.8 | 9.8 | 9.1 | 8.7 | 8.3 | 7.2 | -0.5 |
| Key macroeconomic and fiscal assumptions underlying baseline | | | | Average | Deviation | | | | | | | |
| Real GDP growth (percent) | 5.2 | -7.8 | 4.0 | 4.9 | 4.7 | 4.8 | 4.5 | 4.3 | 4.1 | 3.9 | 3.8 | |
| Average nominal interest rate on public debt (percent) 8/ | 6.7 | 7.3 | 6.1 | 6.1 | 0.9 | 8.2 | 10.4 | 11.1 | 8.9 | 7.9 | 6.8 | |
| Nominal appreciation (increase in U.S. dollar value of local currency, percent) | -16.5 | -2.9 | ... | -0.5 | 8.2 | ... | ... | ... | ... | ... | ... | |
| Inflation rate (GDP deflator, percent) | 18.0 | 1.9 | 11.4 | 14.6 | 5.2 | 14.6 | 8.4 | 7.1 | 6.3 | 6.5 | 7.1 | |
| Growth of real primary spending (deflated by GDP deflator, percent) | 9.4 | 11.1 | -3.3 | 8.2 | 7.2 | 3.3 | 1.8 | 2.0 | 4.7 | 3.9 | 3.5 | |
| Primary deficit | -1.0 | -1.1 | -0.2 | -2.7 | 2.0 | 1.6 | 0.4 | 0.6 | 1.9 | 2.5 | 3.2 | |

1/ General government and government-guaranteed gross debt.

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = 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).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

Table 10. Russian Federation: External Debt Sustainability Framework, 2008–16
(In percent of GDP, unless otherwise indicated)

| | Actual | | | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | | | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | Debt-stabilizing non-interest current account 6/ |
| **Baseline: External debt** | 28.9 | 38.2 | 33.0 | | | **25.3** | **22.8** | **21.0** | **19.7** | **18.6** | **17.4** | **-0.8** |
| Change in external debt | -7.3 | 9.3 | -5.2 | | | -7.8 | -2.5 | -1.8 | -1.3 | -1.1 | -1.2 | |
| Identified external debt-creating flows | -13.8 | 6.3 | -9.1 | | | -6.1 | -4.7 | -3.4 | -1.9 | -1.3 | -0.7 | |
| Current account deficit, excluding interest payments | -7.8 | -5.9 | -6.4 | | | -6.2 | -4.6 | -3.3 | -1.7 | -1.3 | -0.8 | |
| Deficit in balance of goods and services | -9.4 | -7.5 | -8.4 | | | -8.2 | -6.6 | -4.8 | -3.1 | -1.9 | -0.9 | |
| Exports | 31.5 | 28.2 | 30.0 | | | 29.9 | 27.6 | 25.7 | 23.8 | 22.5 | 21.2 | |
| Imports | 22.1 | 20.7 | 21.7 | | | 21.7 | 21.0 | 20.9 | 20.7 | 20.7 | 20.3 | |
| Net non-debt creating capital inflows (negative) | 0.2 | 1.5 | 2.1 | | | 0.5 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | |
| Automatic debt dynamics 1/ | -6.1 | 10.6 | -4.8 | | | -0.4 | -0.4 | -0.2 | -0.3 | -0.1 | 0.1 | |
| Contribution from nominal interest rate | 1.6 | 1.8 | 1.6 | | | 0.8 | 0.6 | 0.6 | 0.5 | 0.6 | 0.7 | |
| Contribution from real GDP growth | -1.5 | 3.1 | -1.3 | | | -1.2 | -1.0 | -0.9 | -0.8 | -0.7 | -0.6 | |
| Contribution from price and exchange rate changes 2/ | -6.2 | 5.8 | -5.1 | | | ... | ... | ... | ... | ... | ... | |
| Residual, incl. change in gross foreign assets 3/ | 6.5 | 3.0 | 3.9 | | | -1.7 | 2.2 | 1.7 | 0.6 | 0.1 | -0.5 | |
| External debt-to-exports ratio (in percent) | 91.9 | 135.4 | 109.9 | | | 84.4 | 82.5 | 81.8 | 82.7 | 82.4 | 82.0 | |
| **Gross external financing need (in billions of US dollars) 4/** | 112.4 | 98.6 | 74.2 | | | 35.5 | 60.3 | 85.1 | 121.9 | 137.7 | 159.1 | |
| in percent of GDP | 6.8 | 8.1 | 5.0 | | | 1.9 | 2.8 | 3.5 | 4.6 | 4.7 | 5.0 | |
| **Scenario with key variables at their historical averages 5/** | | | | | | **25.3** | **16.9** | **7.9** | **-1.4** | **-10.0** | **-18.1** | **2.4** |
| **Key Macroeconomic Assumptions Underlying Baseline** | | | | 10-Year Historical Average | 10-Year Standard Deviation | | | | | | | |
| Real GDP growth (in percent) | 5.2 | -7.8 | 4.0 | 4.9 | 4.7 | 4.8 | 4.5 | 4.3 | 4.1 | 3.9 | 3.8 | |
| GDP deflator in US dollars (change in percent) | 21.4 | -20.2 | 16.4 | 14.4 | 13.4 | 23.1 | 9.7 | 6.5 | 5.1 | 5.1 | 6.0 | |
| Nominal external interest rate (in percent) | 5.5 | 4.6 | 5.1 | 5.8 | 0.6 | 3.3 | 2.9 | 3.1 | 2.4 | 3.4 | 4.4 | |
| Growth of exports (US dollar terms, in percent) | 32.7 | -34.0 | 28.9 | 16.7 | 21.3 | 28.5 | 5.7 | 3.4 | 1.5 | 3.2 | 3.6 | |
| Growth of imports (US dollar terms, in percent) | 30.0 | -31.0 | 26.6 | 19.8 | 18.7 | 29.1 | 11.0 | 10.3 | 8.6 | 9.0 | 8.0 | |
| Current account balance, excluding interest payments | 7.8 | 5.9 | 6.4 | 9.9 | 2.8 | 6.2 | 4.6 | 3.3 | 1.7 | 1.3 | 0.8 | |
| Net non-debt creating capital inflows | -0.2 | -1.5 | -2.1 | -0.2 | 1.1 | -0.5 | -0.2 | -0.1 | -0.1 | -0.1 | -0.1 | |

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

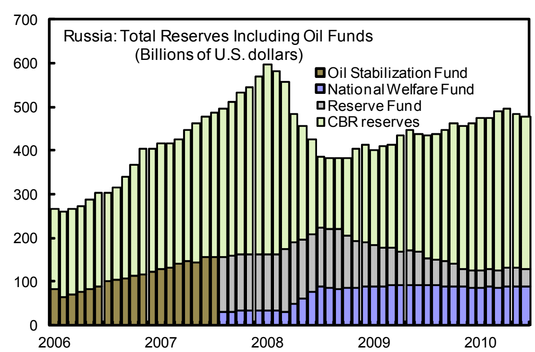
5/ The key variables include real GDP grow th; nominal interest rate; dollar deflator grow th; and both non-interest current account and non-debt inflow s in percent of GDP.

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

## ANNEX I. Russia's Foreign Currency Reserves—Too Little, Too Much, or Just Right?[6]

*Russia faces unusually large external vulnerabilities, which makes adequate reserves holdings important as a buffer against external shocks. Separately, as a nonrenewable-resource exporter, Russia saves some of its oil wealth for fiscal and intergenerational equity purposes and, for the time being, these savings are held in the form of reserves. Accounting for these country-specific factors, Russia's current reserves appear to be broadly adequate.*

Benefiting from high oil prices in recent years, Russia has built a considerable stock of foreign currency reserves, amounting to $444bn at the end of 2010. Part of this reserves build-up reflects conventional central bank interventions for exchange rate and precautionary purposes, while another part reflects fiscal savings. The latter savings are accumulated in two sovereign wealth funds, which are effectively managed by the Central Bank of Russia (CBR). These funds are (i) the Reserve Fund (RF), intended as a medium-term fiscal stabilization fund, and (ii) the National Wealth Fund (NWF), an investment fund with a longer-term objective, aimed at preserving part of the oil wealth to backstop the pension system. The twin funds are the successors of the earlier Oil Stabilization Fund, which was split in early 2008. At the end of 2010, the oil funds held at the CBR together amounted to some $93bn.




Sources: Ministry of Finance; and Central Bank of Russia.

### *Large vulnerabilities*

Russia's reserves accumulation should be assessed against considerable external vulnerabilities. In particular:

- First, with oil and gas accounting for some two-thirds of exports, Russia is heavily dependent on volatile energy prices and exposed to frequent disruptive terms of trade shocks. The recent crisis provided a stark reminder of this as, following the sharp decline in oil prices during the global crisis, Russia's exports receipts dropped by 34 percent in 2009—a decline topped by only a small number of other countries (almost exclusively other oil exporters).

- Second, weak policy frameworks and a poor investment climate exacerbate external vulnerabilities in downturns in Russia. The limited credibility of the fiscal and monetary policy frameworks, as well as Russia's unattractive business environment (it ranks 123rd on the summary measure of the World Bank's "Doing Business" indicators) make interest in Russia highly sensitive to global risk appetite.

- Third, and partly reflecting the aforementioned vulnerabilities, Russia is particularly prone to capital flight, including on the part of domestic residents. This, too, was illustrated during

[6] Prepared by David Hofman.

the recent crisis as capital outflows reached over $130 billion (or 8 percent of annual GDP) in the fourth quarter of 2008 on account of large portfolio withdrawals, a flight into foreign currency cash holdings, rising bank net foreign asset positions, and net loan repayments by the corporate sector. These massive capital outflows put severe pressure on the ruble, which depreciated by about 30 percent against the euro-dollar currency basket (and 15 percent in real effective terms) during December 2008-January 2009.

In the face of these significant vulnerabilities, adequate reserves levels are an important buffer for Russia against external shocks. Indeed, during the recent crisis, with large pressures stemming from both the external current and capital accounts, the authorities lost more than a third (some $210bn) of their reserves in a matter of just a few months. And although the impact of the global downturn on the economy was still very substantial, the presence and use of the reserve buffer arguably helped prevent a much deeper crisis, such as the one Russia had experienced earlier in 1998 (see chapter on Russia in forthcoming IMF book on the crisis in Emerging Europe).

***Measures of reserve adequacy***

While reserves are useful during times of external pressures, there are significant costs to holding reserves.[7] So how much is enough and what level of reserves should Russia aim for?

Standard Measures of Reserve Adequacy

| Variable | Reserve Cover (2010) |
|---|---|
| Imports (months) | 16.6 |
| Short-term debt (percent) | 370.9 |
| Broad money (percent) | 56.4 |

Source: IMF staff estimates.

Several measures have been used over the years to assess reserve adequacy. On one traditional rule of thumb for reserve adequacy, full coverage of short-term external debt, Russia currently has more than 3½ times the amount of reserves suggested by the rule. However, in Russia's experience, short-term debt has been only one among several sources of large outflows. Given Russia's historic susceptibility to capital flight among domestic residents, another traditional measure that is relevant for Russia is coverage of M2, as a proxy for the total liquid assets held by residents (Blanchard et al., 2010 and Obstfeld, 2008). And here current reserves cover only just over half of the potential drain.

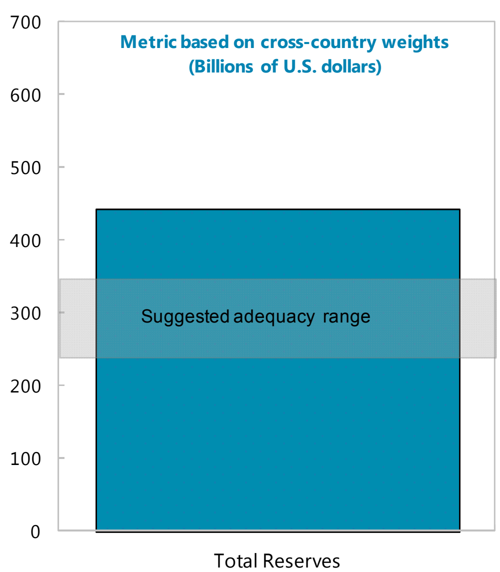
The problem, however, with the above rules of thumb and with similar traditional yardsticks such as import cover and GDP is that they each highlight only one dimension of vulnerability, while in reality there are many. To mitigate this problem, we base our assessment of reserve adequacy on the newly developed IMF metric, which is a composite indicator

[7] Holding reserves entails an opportunity cost because they could alternatively be used to e.g., finance public investment or pay down external debt and reduce the interest bill. Also, the accumulation of reserves often also entails a sterilization cost. While such costs may be mitigated by a downward effect on external debt spreads (see Hauner, 2006), the importance of this effect is proportional to the size of the sovereign external debt stock (which is relatively small in the case of Russia) while the marginal benefit from it declines as reserve levels rise.

(continued)

comprising four channels of potential external drains—short-term debt, portfolio flows, domestic liquidity, and export volatility. Each of these variables is assigned a risk weight based on the foreign exchange loss observed at the tenth percentile of a cross-country distribution for the variable during past periods of market pressure (the methodology is described in IMF, 2011).

In the IMF methodology two different sets of weights are calibrated; one based on countries with fixed/managed exchange rate regimes, which tend to be more vulnerable to reserve losses, and one for countries with floating exchange rates, which are less vulnerable. Given that Russia is classified as having a managed exchange rate arrangement, the former set of weights applies. When total reserves at end-2010 are evaluated against this measure Russia appears to hold somewhat more reserves, at 197 percent of the metric, than would be recommended on the basis of a 100-150 percent adequacy range (text chart).




Source: IMF staff calculations.

As pointed out in IMF (2011), however, careful judgment is needed in the application of the metric in individual country cases to account for country-specific characteristics. In this context, two important qualifiers are in order for Russia.

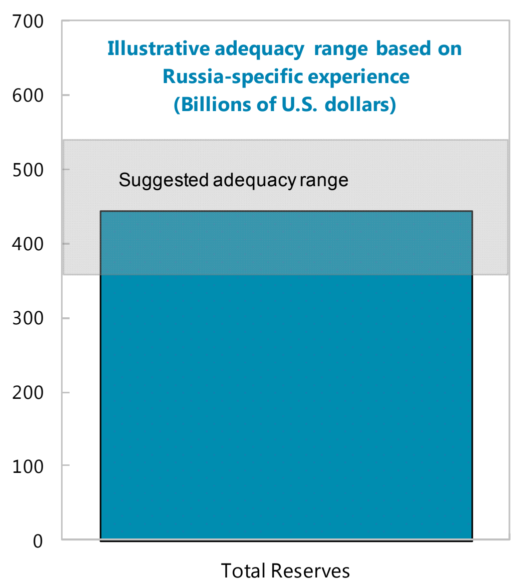
First, as the new IMF metric focuses on the precautionary role of reserves, the role of Russia's reserve holdings that reflect fiscal and intergenerational savings objectives warrants special attention. While these holdings are currently invested mainly in liquid assets and therefore are part of usable reserves, their accumulation over time is governed by a different set of considerations than those for regular reserves and their adequacy cannot be assessed solely with reference to potential balance of payments drains. The further accumulation of oil fund savings is highly advisable to smooth fiscal revenue volatility, and to support the pension system and foster intergenerational equity—and this desirability is largely independent of the above precautionary considerations.

In this context, it could be noted that—given their longer-term objective—there is no clear need to hold the NWF savings in liquid assets. Holding an increasing share of these savings in higher yielding, less liquid assets would offer the prospect of better investment returns. Accordingly, the authorities are looking into options for diversifying the investment mix, implying that over time part of the NWF holdings would likely cease to qualify as reserves.

Second, as described above, Russia is encumbered by weak policy frameworks and faces unusually large external vulnerabilities. In this respect it is telling that on 3 out of the 4 variables in the metric, the actual drains during the recent crisis exceeded the tenth percentile of the distribution of the cross-country sample that is used for the calibration of the metric weights (text table). As a result, the weights based on cross-country experience may underplay the potential drain in Russia. To illustrate this, the text chart shows how the reserve adequacy range would shift if the metric were calculated using weights based on the actual drains experienced in Russia during the most recent crisis.

Metric Weights: Cross-country and Russia-specific

| | IMF weights (IMF, 2010) | Russia weights (2008/09 crisis) |
|---|---|---|
| Short-term debt | 0.30 | 0.31 |
| Other portfolio liabilities | 0.15 | 0.29 |
| Broad money | 0.10 | 0.04 |
| Exports | 0.10 | 0.34 |



Source: IMF staff calculations.

***Too little or too much reserves?***

In all, combining the above elements, reserves levels in Russia appear broadly adequate, with no clear indication of under- or overaccumulation.

Further accumulation of foreign assets is, however, desirable for non-precautionary reasons. While it would be advisable to invest non-precautionary reserves in higher yielding (but less liquid) assets, such a shift should take account of institutional constraints (including capacity) and not be done in a way that reduces usable reserves to a level that is inadequate from a precautionary perspective.

Finally, reserves can only provide a temporary and partial solution to the vulnerabilities that stem from Russia's lack of economic diversification and weak policy frameworks. To durably reduce risks it will be imperative to implement economic reforms that address these issues directly. Accordingly, in the longer run, if the authorities strengthen policy frameworks, increase exchange rate flexibility, and succeed in making Russia's economy less dependent on oil, reserve needs would be expected to decline in line with ensuing reductions in external vulnerability.

## References

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INTERNATIONAL MONETARY FUND

# RUSSIAN FEDERATION

August 4, 2011

## STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The European Department (In consultation with other departments and the World Bank)

## CONTENTS

# ANNEX I. RUSSIAN FEDERATION: FUND RELATIONS

(As of July 28, 2011

### Membership Status

Joined 06/01/1992; Article VIII.

### General Resources Account

| | SDR Million | Percent Quota |
|---|---|---|
| Quota | 5,945.40 | 100.00 |
| Fund holdings of currency | 4,390.24 | 73.84 |
| Reserve position in Fund | 1,559.19 | 26.16 |

### SDR Department

| | SDR Million | Percent Allocation |
|---|---|---|
| Net cumulative allocation | 5,671.80 | 100.00 |
| Holdings | 5,679.83 | 100.14 |

### Outstanding Purchases and Loans

None

### Latest Financial Arrangements

**In millions of SDR, (mm/dd/yyyy)**

| Type | Approval Date | Expiration Date | Amount Approved | Amount Drawn |
|---|---|---|---|---|
| Stand-by | 07/28/99 | 12/27/00 | 3,300.00 | 471.43 |
| EFF | 03/26/96 | 03/26/99 | 6,305.57 | 1,443.45 |
| Of which | | | | |
| SRF | 07/20/98 | 03/26/99 | 3,992.47 | 675.02 |
| EFF | 03/26/96 | 03/26/99 | 6,901.00 | 4,336.26 |

### Projected Payments to Fund

**(SDR million; based on existing use of resources and present holdings of SDRs):**

| | Forthcoming | | | | |
|---|---|---|---|---|---|
| | 2011 | 2012 | 2013 | 2014 | 2015 |
| Principal | | | | | |
| Charges/interest | 0.08 | 0.08 | 0.08 | 0.08 | 0.08 |
| **Total** | 0.08 | 0.08 | 0.08 | 0.08 | 0.08 |

### Implementation of HIPC Initiative:

Not Applicable

### Implementation of MDRI Assistance:

Not Applicable

### Exchange Arrangements:

The de jure arrangement is other managed arrangement—namely, a controlled floating exchange rate arrangement. The ruble value of a bi-currency basket is used as the operating benchmark for transactions on the internal currency market. The basket is currently composed of €0.45 and $0.55. The target boundaries of its permissible fluctuations were revised based on changes in fundamental factors governing formation of the country's balance of payments in accordance with the Uniform State Monetary Policy Guidelines for 2008, in response to a gradual transition to a more flexible exchange-rate-setting policy. The value of the bi-currency basket is determined under the influence of both market factors and exchange interventions by the Central Bank of Russia (CBR). The interventions take place both in interbank currency exchanges and on the over-the-counter interbank market to limit daily fluctuations. Effective October 13, 2010, the CBR has eliminated the fixed trading band of Rub 26–41 against the bi-currency basket, in force since January 2009. The CBR has also widened the moving intervention band from 3 to 5 rubles in two installments, with the size of the maximum intervention amount within the band reduced from $700 million to $600 million. The permissible fluctuations may be revised in response to changes in macroeconomic indicators. Owing to the continued control of the CBR over the exchange rate determination, the de facto exchange rate arrangement is other managed arrangement. 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 currents international transactions.

**Article IV Consultation:**

Russia is on the standard 12-month consultation cycle. The last consultation was concluded on July 23, 2010.

**FSAP Participation and ROSCs**

Russia participated in the Financial Sector Assessment Program during 2002, and the FSSA report was discussed by the Board in May 2003, at the time of the 2003 Article IV discussion (IMF Country Report No. 03/147). 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. An FSAP financial stability assessment took place during April 2011.

A Fiscal Transparency ROSC mission, headed by Peter Heller (FAD), visited Moscow in July 2003, and a Data ROSC module was undertaken by a mission in October 2003, led by Armida San Jose (STA). A mission led by Ms. San Jose undertook a reassessment of Data ROSC module in July 2010.

**Resident Representatives:**

Mr. Odd Per Brekk, Senior Resident Representative, since March 1, 2009.

# ANNEX II. RUSSIAN FEDERATION: WORLD BANK-IMF COLLABORATION

**1. The Fund Russia team led by Ms. Zakharova (deputy mission chief) met with the World Bank Russia economic policy team led by Mr. Bogetic (lead economist and country sector coordinator for poverty reduction and economic management)** on May 4, 2011 to discuss and reconfirm macrocritical structural reforms and coordination of the two teams' work for the period September 2010-March 2012. The teams had previously met on September 7, 2010 to discuss/set the team's work program for the period September 2010-August 2011.

**2. The teams agreed that Russia's main macroeconomic challenges are to raise growth prospects and strengthen the banking system.** A timely exit from the crisis-related stimulus and reinvigoration of structural reforms will be needed to meet these challenges.

**3. Based on this shared assessment, the teams identified five reform areas as macrocritical:**

- **Strengthening the fiscal framework:** Key elements of reform include: (i) focusing on the nonoil balance as the anchor for fiscal policy, (ii) using a Permanent Oil Income Model (POIM) rule to ensure long-term fiscal sustainability; (iii) avoiding excessive use of supplemental budgets; and (iv) replenishing the Reserve Fund (designed as a "rainy day" fund). These reforms are macrocritical as they will help to reduce fiscal (and economic) vulnerabilities, and increase the credibility of fiscal policy, which would support stronger growth.

- **Public expenditure reforms:** Key elements of reform include: (i) promoting aggregate fiscal discipline and strengthening public expenditure efficiency and management; (ii) strengthening capital budgeting in the road and rail sectors; and (iii) improving the efficiency of public employment. These reforms are macrocritical as they will help to identify savings to support fiscal consolidation and reduce fiscal vulnerabilities.

- **Reforming the pension system:** Key objectives of reform include bringing down long-run fiscal costs and providing reasonable pension benefits to all pensioners current and future. These reforms are macrocritical as they will help to reduce fiscal vulnerabilities.

- **Strengthening the monetary policy framework:** Key elements of reform include (i) streamlining the set of policy instruments; (ii) draining excess liquidity; and (iii) a gradual narrowing of the policy corridor. These reforms are macrocritical as they will help to improve the effectiveness of the monetary policy efforts to control inflation, which is key for macroeconomic stability and growth.

- **Financial sector stability module assessment and financial sector development:** The banking sector is stable but regulatory and supervisory deficiencies need to be addressed, specifically: (i) prompt adoption of pending legislation on consolidated supervision and connected lending; (ii) granting an appropriate degree of supervisory discretion to the CBR; (iii) closer supervision of systemically important banks to contain moral hazard and improve systemic risk monitoring. These reforms are macrocritical as financial sector stability is key for effective intermediation of savings to promote investment and growth.

**4. The teams agreed the following division of labor:**

- **Strengthening the fiscal framework:** The Fund has elaborated reform options and discussed them with the authorities during the 2011 Article IV consultation. The Bank is preparing a new lending project for FY13 to strengthen the fiscal regime to encourage business investment, streamline the intergovernmental fiscal system, and increase oversight of financial risks through policy advice and capacity building in the Ministry of Finance and the Federal Tax Service. The Bank is also monitoring fiscal developments, reforms and policies as part of its regular Russian Economic Reports covering macroeconomic and structural issues. In addition, the Bank is providing technical assistance on program budgeting and public expenditure efficiency.

- **Public expenditure reforms:** The Bank has elaborated reform options in its Public Expenditure Review, which were discussed with the authorities and published in June 2011. The Bank will further explore cooperation with the authorities in the areas of improving the business environment and public administration reform, including in the regions.

- **Reforming the pension system:** The Fund plans to elaborate reform options, present them at a high-level conference in Moscow in January 2012 which will include representatives from the government, academia, private sector, and civil society, and discuss these options in the context of the 2012 Article IV consultation. The Fund will also assess the reform proposals of the Working Group on Pensions that the authorities have instituted as part of their Strategy 2020 and which will present its report by end-2011. The Bank has completed several recent studies that relate to the pension system, including a study of long-term fiscal risks and a recent paper on the second, private pillar. The Bank team has shared these studies and is ready to coordinate with the Fund team, as needed.

- **Strengthening the monetary policy framework:** The Fund has elaborated reform options and discussed them with the authorities during the 2011 Article IV consultation.

- **Financial sector stability module assessment and financial sector development:** The Fund conducted the assessment in March/April 2011 and discussed reform options with the authorities, along with participation of Bank staff. The Bank has appointed a new private sector/financial sector coordinator for Russia, who is stationed in Moscow to coordinate the work on longer-term developmental issues in the private/financial sector. The Bank is also preparing a new lending project to (a) achieve an orderly financial market expansion and development of domestic capital markets to better serve the needs for corporate finance, (b) enhance financial market stability through a modernized state-of-the-art regulatory framework and the implementation of robust supervisory and enforcement mechanisms, and (c) reach global best practice standards in the market infrastructure and regulation, in order to achieve a broader international reach as a centre of finance.

**5. The teams have the following requests for information from their counterparts:**

- The Fund team requests to be kept informed of progress in the macrocritical reform areas under the Bank's purview.
- The Bank team requested that the Fund share on a regular basis with WB and invite, as needed, Bank's comments on policy notes, draft staff reports, and other relevant materials; and that Bank staff be invited to attend policy meetings, as has already been the case with the 2011 Article Consultation. Timing: in the context of the Article IV and other missions (and at least semi-annually).

**6. The table below lists the teams' separate and joint work programs during September 2010-March 2012.**

| Title | Products | Provisional timing of missions | Expected delivery date |
|---|---|---|---|
| **A. Mutual information on relevant work programs** | | | |
| 1. Bank work program | Country Partnership Strategy | Preparatory work is ongoing | Board discussion expected Nov. 2011 |
| | Russian Economic Reports (RER) | Ongoing | September 2011, March 2012 |
| | Public Expenditure Review | Ongoing | June 2011 |
| | Russia: Reshaping Economic Geography | Ongoing | July 2011 |
| | Other analytical work on export diversification, growth and jobs, and inequality and economic opportunities, financial sector analysis (pensions, | Ongoing | n.a. |

| | | | |
|---|---|---|---|
| | banking, capital markets, and insurance) and technical assistance on diversification and innovation, customs, tax administration and judicial reform. | | |
| | Russia energy efficiency project | Ongoing | Board discussion expected March 2012 |
| | Financial Intermediary Loan (FIL) | Ongoing | Board discussion expected March 2012 |
| | Financial Sector Development Project | Ongoing | Board discussion expected Feb. 2012 |
| | Fiscal and Financial Development | Ongoing | Board discussion expected Dec. 2012 |
| 2. Fund work program | 2010 staff visit | December | n.a. |
| | FSAP stability module update | March/April | September 2011 |
| | 2011 Article IV mission | June 2011 | September 2011 |
| | Presentation of pension fund paper at Gaidar Forum conference | January 2012 | |
| 3. Joint products in next 12 months | No joint products planned at this time | | |

# ANNEX III. RUSSIAN FEDERATION: STATISTICAL ISSUES

## A. 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.

Russia is an SDDS subscriber, has a range of statistical dissemination formats, and reports data for the Fund's statistical publications. These sources inform surveillance.

**National Accounts:** Data are broadly adequate for surveillance, but there have been concerns about the reliability and consistency of quarterly GDP estimates among a wide range of users, including Fund staff. This may point inter alia to lags in the revision schedule of the various data formats. The Federal State Statistics Service (Rosstat) started a national accounts development plan for 2011–17, which will expedite compilation of quarterly GDP estimates consistent with annual GDP estimate. The introduction of methodological changes in the compilation of important indicators without releasing backward revisions of the series on a timely basis also impaired economic analysis. However, a historical revision of the industrial production index was released in July 2010. Consistent with the new series, a historical revision of the annual and quarterly GDP series, incorporating the results of the 2006 agriculture census as well as methodological improvements, was made in the third quarter of 2010.

The Rosstat in general follows the 1993 SNA, although scope exists for methodological improvements in the calculations of volume measures of the production-based GDP estimates, including estimates of the output of financial intermediation services indirectly measured (FISIM). The imputed rental services of owner-occupied dwellings are undervalued. Improvements in the coverage of source data are constrained by an inadequate response to business surveys. The unavailability of balance sheet data continues to be an obstacle for analyzing balance sheet vulnerabilities.

**Price statistics:** Data are broadly adequate for surveillance, but time series analyses involving detailed CPI components are a challenge to perform because of limited time series data on CPI weights. Monthly CPI and PPI, both compiled using the Two-State (Modified) Laspeyres (2000=100), cover all regions of the Russian Federation. In addition to the general CPI index, Rosstat also publishes indices for foodstuffs, non-food products, and services. Since September 2010, the Rosstat has also published price indices broken down according to the Classification of Individual Consumption According to Purpose (COICOP) on a monthly basis. Detailed CPI weight data have been made available in the publication Prices in Russia beginning in 1995 and on the Rosstat website beginning in 2006. Since 2009, detailed consumer expenditure data, used as the basis to develop the CPI weights, are posted on Rosstat's website annually. Earlier data on detailed household expenditures have been published in the following publications: Prices in Russia 2004 and Prices in Russia 2006. Detailed PPI weight data are published on the

Rosstat website for 2006–2011; and detailed data on total annual sales, which are used to develop weights for the PPI, are also published by economic activity on the website under the Entrepreneurship section, industrial subsection. However, the detailed weights are available only on the Russian version of the website, making it less accessible by 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:** For surveillance purposes, the timeliness and level of detail of the data disseminated can be improved. Since July 2010, data on the economic classification of expenditures are published on a monthly basis with a lag of about 1½ months, but problems with consistent historical data still remain. The data on functional classification of expenditure and financing differ from international standards. Historical data on the maturity structure of domestic and external federal debt are not published, except the most recent observation available through SDDS. Monthly data on the size and composition of ruble guarantees are not available prior to 2011. Historical monthly data on foreign currency debt are not available prior to 2009, though quarterly data are available since 2006. In addition, there is no integrated debt monitoring and reporting system. Reconciliation of different datasets of fiscal statistics (budget execution, cash flow statement, GFSM 2001 format, SDDS) is difficult. The website where fiscal statistics are disseminated can be made more user friendly by consolidating all statistical links in a dedicated data dissemination page, available both in Russian and in English, and supplementing the data with relevant definitions, description of compilation methodology, and relevant analytical materials. The authorities are working to address the recommendations of the 2010 ROSC Data Module Update.

**Monetary statistics:** Since July 2008, the Central Bank of Russia (CBR) provides to the IMF, in the MFSM-recommended format for the surveys, summarized data on (i) the Central Bank Survey, (ii) the Other Depository Corporations Survey, (iii) the Depository Corporations Survey, (iv) the Other Financial Corporation Survey (data cover insurance companies and private pension funds), and (v) the Financial Corporations Survey (data cover the banking system, insurance companies, and private pension funds). In the context of the recent financial crisis, analysis of balance sheet effects has been hindered by a lack of comparable data on the currency and maturity breakdown of banking-sector assets and liabilities. Adoption of data reporting in full detail of the framework for Standardized Report Forms (SRFs), as recommended by an STA mission in 2007, would provide information on the currency and instrument breakdowns of the banking sector assets and liabilities. Starting in July 2010, the CBR includes in the Surveys the breakdown of positions by currency.

**External sector statistics:** While balance of payments data are broadly adequate for surveillance, and significant improvements have been made to enhance data quality, there remains scope for improving the coverage of certain components of the current, capital, and financial accounts. Improving the detail of supplemental data on the financial account would facilitate the analysis of relatively complex flows. The balance of payments is compiled according to the framework of the

Fund's Balance of Payments Manual, fifth edition (BPM5) and the CBR is actively implementing the recommendations of the 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.

Headline data on reserves are reported to the Fund and the markets on a weekly basis with a four-business-day lag. Comprehensive information is reported in the Reserves Template with a lag of 20 days, exceeding SDDS timeliness requirement of one month.

## B. Data Standards and Quality

Subscriber to the Special Data Dissemination Standard (SDDS) since January 31, 2005. SDDS flexibility option used for the timeliness of data on central government operations.

A data ROSC prepared in October 2003 was published on the IMF website on May 14, 2004. A data ROSC reassessment in June-July 2010 was published on the IMF website on February 28, 2011 and concluded that Russia's macroeconomic statistics are generally of high quality. It found that compiling agencies have made significant progress in adopting international statistical methodologies and best practices.

## C. Reporting to STA (Optional)

Data are being reported for publication in the International Financial Statistics (IFS), Government Finance Statistics Yearbook, the Direction of Trade Statistics, and the Balance of Payments Statistics Yearbook. Monetary data reported as the basis for publication in IFS are in the format of summarized surveys rather than in the full detail of the SRFs that present positions by financial instrument disaggregated by currency (national and foreign) and the economic sector of counterparty.

## RUSSIAN FEDERATION: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE (As of June 30, 2011)

| | Date of latest observation | Date received | Frequency of data[8] | Frequency of reporting[8] | Frequency of publication[8] | Memo Items: | |
|---|---|---|---|---|---|---|---|
| | | | | | | Data Quality – Methodological soundness[9] | Data Quality Accuracy and reliability[10] |
| **Exchange Rates** | 6/30/11 | 6/30/11 | D | D | D | | |
| **International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]** | 6/1/2011 | 6/6/11 | M | M | M | | |
| **Reserve/Base Money (narrow definition)** | 6/20/11 | 6/24/11 | D | W | W | O, O, LO, LO | O, O, O, O, O |
| **Reserve/Base Money (broad definition)** | 6/1/2011 | 6/14/11 | D | M | M | O,O,LO,LO | O,O,O,O,O |
| **Broad Money** | 6/1/2011 | 6/27/11 | M | M | M | O,O,LO,LO | O,O,O,O,O |
| **Central Bank Balance Sheet[2]** | 6/1/2011 | 6/14/11 | M | M | M | O,O,LO,LO | O,O,O,O,O |
| **Consolidated Balance Sheet of the Banking System** | 6/1/2011 | 6/30/11 | M | M | M | O,O,LO,LO | O,O,O,O,O |
| **Interest Rates[3]** | 6/30/11 | 6/30/11 | D/W/M | D/W/M | D/W/M | | |
| **Consumer Price Index** | May 2011 | 6/6/11 | M | M | M | O, LO, LNO, O | O, O, O, O, O |
| **Revenue, Expenditure, Balance and Composition of Financing[4] – General Government[5]** | April, 2011 | 6/7/11 | M | M | M | LO, LNO, LO, O | O, O, LO, O, O |
| **Revenue, Expenditure, Balance and Composition of Financing[4]– Central Government** | May, 2011 | 6/10/11 | M | M | M | | |
| **Stocks of Central Government and Central Government-Guaranteed Debt[6]** | 6/1/2011 | 6/27/11 | M | M | M | | |
| **External Current Account Balance[7]** | Q1 2011 | 4/5/11 | Q | Q | Q | O, O, O,L O | LO, O, O, O, O |
| **Exports and Imports of Goods and Services** | Q1 2011 | 4/5/11 | Q | Q | Q | | |
| **GDP/GNP** | Q1 2011 | 5/16/11 | Q | Q | Q | O, LO, O, O | O, O,LO, O, LO |
| **Gross External Debt** | Q1 2011 | 6/30/11 | Q | Q | Q | | |
| **International Investment Position** | 2010 | 6/30/11 | A | A | A | | |

[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] Ratings refer to Central Bank Survey.

[3] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[4] Foreign, domestic bank, and domestic nonbank financing.

[5] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[6] Including currency and maturity composition.

[7] Ratings refer to Balance of Payments.

[8] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

[9] Reflects the assessment provided in the data ROSC (reassessment) published on February 28, 2011, and based on the findings of the mission that took place during June 23-July 7, 2010 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

[10] Same as footnote 9, 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

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# IMF Executive Board Concludes 2011 Article IV Consultation with the Russian Federation

On September, 9, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Russian Federation.[1]

## Background

The Russian economy has improved, but the recovery has been uneven, high commodity prices notwithstanding. Growth picked up to 4 percent in 2010, intermittently carried by consumption—supported by large pension hikes—and investment, while the contribution of net exports turned sharply negative as imports surged. Following strong growth in the fourth quarter of 2010, fueled by a temporary rebuilding of inventories following a severe drought in the summer, short-term economic indicators suggest a notable slowdown in the first half of 2011. Meanwhile, inflation remains stubbornly high, pointing to second-round effects of last year's spike in food prices. Unemployment has declined, while real wages remain volatile. The current account has strengthened aided by high oil prices, but net capital outflows persist likely owing to political uncertainty in the run-up to the 2012 Presidential elections and the poor business climate.

The financial system is still in a process of balance sheet repair. Banks are liquid and official data suggest nonperforming loans have come down from a peak of 10 percent during the crisis to just over 8 percent of loans in April, while profitability has bounced back from crisis lows. However, banks remain burdened by a high stock of nonperforming assets

[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. 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.

and this continues to weigh on the outlook for credit growth. Also, remaining weaknesses in reporting and banking supervision pose risks, as was pertinently illustrated by the discovery in June 2011 of a large capital deficiency in the Bank of Moscow, which prompted a $14.2 billion rescue operation.

The large crisis-related fiscal stimulus, much of it in the form of permanent measures, is being only partially withdrawn. Following a massive fiscal expansion of some 9 percent of GDP during the crisis, the general government nonoil deficit—the relevant measure of the fiscal stance in oil exporters, given oil price volatility and the nonrenewable nature of oil reserves—fell by 1¾ percent of GDP in 2010. This reduction was achieved mainly on account of the recovering economy and expenditure under-execution. The 2011–13 budget plans only a modest further reduction in the federal nonoil deficit of some 2¼ percent of GDP by 2013. Over half of this adjustment stems from an increase in the payroll tax rate in 2011—which is likely to be partially reversed in 2012—and the remainder from lower investment and transfers and a reduction in civil service employment, policy plans for which are still being elaborated. The recently published preliminary 2012–14 budget further scales down the planned fiscal retrenchment. The budget leaves the nonoil deficit in double-digits by 2014 and some 5½ percent of GDP above the government's own long-term target of 4.7 percent of GDP (suspended during the crisis).

With inflation increasing since the summer of 2010, the Central Bank of Russia (CBR) initiated a policy tightening at the end of the year. Following an initial hike in the CBR's overnight deposit rate in December 2010, policy rates were increased more comprehensively during February-May 2011. In addition, reserve requirements were raised and differentiated by residency. Meanwhile, the CBR has continued to increase exchange rate flexibility as the floating band for the ruble was widened and intervention amounts scaled back.

The short-term outlook is for only moderate growth. Real growth is projected at 4.8 percent in 2011—compared to over 7 percent during 2000-07—even as the output gap is still negative and oil prices are high. The muted outlook reflects expectations that the combination of soaring oil prices and large capital inflows—which, together with procyclical economic policies, propelled credit and powered the boom in the run-up to the crisis—is unlikely to return amid political uncertainty, a still fragile banking system, and increased risk aversion by investors. Inflation is projected to edge down to 8 percent by end-2011, assuming food prices continue to moderate.

**Executive Board Assessment**

Executive Directors observed that while Russia's post-crisis rebound is underway, growth has been moderate and inflation high. Downside risks have increased against the backdrop of a worsened external environment. Directors underscored that high commodity prices create a window of opportunity to embark on bold and decisive reforms to strengthen growth prospects over the medium term. The focus should be on reducing fiscal vulnerabilities, lowering inflation, promoting a stronger and more competitive banking system, and creating a favorable environment for investment and economic diversification. Directors observed that the 2020 strategy, currently under preparation, provides an occasion to introduce the reforms to support stronger growth.

Directors encouraged the authorities to undertake a growth-friendly, credible, and ambitious fiscal consolidation. They recommended re-anchoring fiscal policy on the long-term nonoil deficit target of 4.7 percent of GDP. This would also help rebuild fiscal buffers in the oil funds, thereby reducing fiscal vulnerabilities. Directors underscored that durable adjustment would require fundamental fiscal reforms, including to pensions, social protection, and healthcare. Most Directors noted that front-loading the consolidation while strengthening fiscal institutions, would enhance its credibility and help realize growth benefits sooner, and, in this regard, recommended reconsideration of the 2012–14 preliminary budget.

Most Directors saw a need for a continued tightening of monetary policy this year to bring inflation down towards a medium-term rate of 3–5 percent. A few Directors, however, saw merit in a more cautious approach to further tightening given the still negative output gap and easing food prices. Directors noted that the effectiveness of monetary policy would be bolstered by improvements to the monetary operations framework and a consistent communications policy. They welcomed the ongoing steps to enhance exchange rate flexibility, which will allow monetary policy to focus on inflation and could help dampen current inflationary pressures.

Directors encouraged the authorities to address remaining gaps in the framework for financial regulation and supervision to help safeguard the financial system. They supported the FSAP recommendations to strengthen financial sector policies, including by granting the CBR greater supervisory powers and adopting the pending legislation on consolidated supervision and connected lending. Directors noted that effective implementation of these recommendations would reduce banking sector risks and bring supervision in line with international best practice.

Directors underscored the importance of improving the business climate to bolster private investor activity and diversify the economy. They noted that the President's action plan, if effectively implemented, would make progress in this direction. At the same time, they called for broader reforms, including WTO accession, reducing the role of the state in the economy, and improving governance, to reap the plan's growth benefits fully.

***Public Information Notices (PINs)*** form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Russian Federation: Selected Macroeconomic Indicators, 2008–12

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|
| | | | Estimate | Projections | |
| | | | (Annual percent change) | | |
| Production and prices | | | | | |
| Real GDP | 5.2 | -7.8 | 4.0 | 4.8 | 4.5 |
| Consumer prices | | | | | |
| Period average | 14.1 | 11.7 | 6.9 | 9.1 | 7.6 |
| End of period | 13.3 | 8.8 | 8.8 | 8.0 | 7.2 |
| GDP deflator | 18.0 | 1.9 | 11.4 | 14.6 | 8.4 |
| | | | (Percent of GDP) | | |
| Public sector 1/ | | | | | |
| General government | | | | | |
| Net lending/borrowing (overall balance) | 4.9 | -6.3 | -3.5 | -1.1 | -1.5 |
| Revenue | 39.2 | 35.1 | 35.0 | 37.1 | 36.0 |
| Expenditures | 34.3 | 41.4 | 38.5 | 38.2 | 37.5 |
| Primary balance | 5.3 | -5.7 | -2.9 | -0.3 | -0.4 |
| Nonoil balance | -7.7 | -15.2 | -13.4 | -12.2 | -11.7 |
| Nonoil balance excl. one-off receipts 2/ | -7.7 | -15.6 | -13.4 | -12.2 | -11.7 |
| Federal government | | | | | |
| Net lending/borrowing (overall balance) | 3.6 | -5.9 | -4.0 | -1.3 | -1.7 |
| Nonoil balance | -7.6 | -13.8 | -12.7 | -11.2 | -10.9 |
| Nonoil balance excl. one-off receipts 2/ | -7.6 | -14.2 | -12.7 | -11.2 | -10.9 |
| | | | (Annual percent change) | | |
| Money | | | | | |
| Base money | 2.9 | 7.4 | 25.4 | 27.4 | 23.5 |
| Ruble broad money | 0.8 | 17.7 | 31.1 | 27.3 | 25.0 |
| External sector | | | | | |
| Export volumes | -2.6 | -9.8 | 8.4 | 3.4 | 3.5 |
| Oil | -2.6 | 3.0 | 5.7 | 1.5 | 1.5 |
| Gas | 1.8 | -13.8 | 23.5 | -0.9 | -0.9 |
| Non-energy | -4.4 | -18.2 | 10.7 | 8.0 | 8.2 |
| Import volumes | 11.1 | -31.0 | 25.7 | 18.8 | 10.8 |
| | | | (Billions of U.S. dollars; unless otherwise indicated) | | |
| External sector | | | | | |
| Total merchandise exports, fob | 471.6 | 303.4 | 400.1 | 515.1 | 543.1 |
| Total merchandise imports, fob | -291.9 | -191.8 | -248.7 | -321.1 | -357.7 |
| External current account | 103.7 | 49.5 | 71.1 | 101.9 | 86.8 |
| External current account (in percent of GDP) | 6.2 | 4.1 | 4.8 | 5.3 | 4.0 |
| Gross international reserves | | | | | |
| Billions of U.S. dollars | 427.1 | 439.5 | 479.4 | 550.8 | 617.6 |
| Months of imports 3/ | 14.0 | 20.8 | 17.9 | 15.9 | 16.1 |
| Percent of short-term debt | 288 | 303 | 349 | 375 | 422 |
| *Memorandum items:* | | | | | |
| Nominal GDP (billions of U.S. dollars) | 1,665 | 1,231 | 1,488 | 1,909 | 2,188 |
| Exchange rate (rubles per U.S. dollar, period average) | 24.9 | 31.7 | 30.4 | … | … |
| World oil price (U.S. dollars per barrel, WEO) | 97.0 | 61.8 | 79.0 | 106.3 | 109.3 |
| Real effective exchange rate (average percent change) | 6.8 | -7.0 | 9.4 | … | … |

Sources: Russian authorities; and IMF staff estimates.
1/ Based on the 2011–13 budget.
2/ Excludes one-off tax receipts from Nanotechnology and Housing Funds in 2009.
3/ In months of imports of goods and non-factor services.