INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/211

RUSSIAN FEDERATION

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

August 2015

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 2015 Article IV consultation with the Russian Federation, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 29, 2015 consideration of the staff report that concluded the Article IV consultation with the Russian Federation.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 29, 2015, following discussions that ended on May 21, 2015, with the officials of the Russian Federation on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 2, 2015.
- An **Informational Annex** prepared by the IMF staff.

The documents listed below have been or will be separately released.

Selected Issues

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August 3, 2015

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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2015 Article IV Consultation with the Russian Federation

On July 29, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Russian Federation.

Russia entered 2014 with declining potential growth owing to the stabilization of oil prices, stalled structural reforms, weak investment, declining total factor productivity and adverse population dynamics. In addition, the ongoing slowdown was exacerbated by the dual external shocks from the sharp decline in oil prices and sanctions.

The authorities took measures to stabilize the economy and the financial system. The sharp decline in oil prices and sanctions led to severe pressure on the ruble, a surge in inflation, market turbulence, and concerns over financial stability. In response, the authorities (i) accelerated the move to a floating exchange rate, raised policy rates and increased FX liquidity; (ii) introduced temporary regulatory forbearance and a capital support program; and (iii) provided some fiscal stimulus and limited wage indexation to support the disinflationary process.

Russia is expected to be in recession in 2015 due to the sharp drop in oil prices and sanctions. GDP is expected to decline by 3.4 percent driven by a contraction in domestic demand weighed down by falling real wages, higher cost of capital, and weakened confidence. The external position will remain challenging due to deleveraging in the face of limited market access. Inflation is expected to come down due to the dissipating impact of the ruble depreciation, the limited wage indexation in the budget and the recession. Growth should resume in 2016 while inflation continues to decline. However, the recovery is unlikely to be strong as the limiting factors behind decelerating potential growth will take time to be addressed, leading to medium-term growth of 1.5 percent per year. An increase in geopolitical tensions is the main risk to the outlook.

[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.

Executive Board Assessment[2]

Executive Directors commended the policy actions taken by the authorities to stabilize the economy in light of the significant stress created by lower oil prices and sanctions. Pre-existing structural weaknesses also contributed to this difficult situation. Directors concurred that continued prudent policies and reforms will be necessary to ensure macroeconomic stability and boost potential growth.

Directors agreed that a supportive fiscal stance is appropriate at present, given cyclical considerations and available fiscal space. However, they highlighted that quasi-fiscal operations should be limited and coordinated to avoid an overly stimulative impulse. For the medium term, Directors called for a gradual fiscal tightening to adjust to lower oil prices and rebuild buffers. In this context, they welcomed the authorities' intention to revisit the fiscal rule so that the oil price benchmark better reflects market developments. Directors also underscored the need for permanent and credible fiscal measures, including pension reform, reduction of energy subsidies, and better targeting of social transfers.

Directors concurred that monetary easing should continue at a pace commensurate with the decline in underlying inflation and inflation expectations as external and financial stability risks abate. Noting the foreign exchange purchase program to rebuild precautionary buffers, they encouraged the authorities to ensure that it is consistent with inflation targeting.

Directors noted that policies have been successful in stabilizing the banking system. They highlighted the need to support individual banks according to their specific capital needs while adjusting the parameters of the capital support program to strengthen incentives and minimize cost to the public sector. Directors encouraged the authorities to phase-out regulatory forbearance along with the implementation of the capital support program and better align Russia's resolution framework to best international practices. They also saw a need for reducing banking sector fragmentation and encouraging competition among banks, by stepping up supervision and moving toward the adoption of Basel III capital standards.

Directors emphasized that accelerating the pace of structural reforms is key to raising Russia's potential growth. In this context, they noted that priority should be given to further measures aimed at strengthening governance and property rights and streamlining regulation. Directors also emphasized the need to reduce trade barriers, improve the transparency and efficiency of public investment, and increase competition in domestic markets. They noted that reinvigorating the privatization agenda, as soon as market conditions permit, would enhance economic efficiency. In addition, Directors highlighted that a deeper and more efficient financial system would improve the allocation of capital and boost potential growth.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm

Russian Federation: Selected Macroeconomic Indicators, 2012–16

	2012	2013	2014	2015	2016
					Projections
	(Annual percent change)				
Production and prices[3]					
Real GDP	3.4	1.3	0.6	-3.4	0.2
Consumer prices					
Period average	5.1	6.8	7.8	15.6	7.5
End of period	6.6	6.5	11.4	12.5	7.8
GDP deflator	7.4	5.1	7.2	7.4	8.8
Public sector[4]	(Percent of GDP)				
General government					
Net lending/borrowing (overall balance)	0.4	-1.3	-1.2	-4.8	-4.2
Revenue	37.7	36.9	37.5	35.0	35.3
Expenditures	37.3	38.2	38.7	39.8	39.5
Primary balance	1.0	-0.6	-0.4	-3.8	-3.0
Nonoil balance	-10.8	-12.0	-12.6	-13.3	-13.0
Federal government					
Net lending/borrowing (overall balance)	-0.1	-0.5	-0.5	-3.3	-3.9
Nonoil balance	-10.6	-10.5	-11.0	-11.3	-12.0
	(Annual percent change)				
Money					
Base money	11.3	8.0	6.3	2.3	6.4
Ruble broad money	11.9	14.6	2.2	3.3	8.6
External sector					
Export volumes	2.9	2.0	0.1	4.6	2.7
Oil	0.4	2.7	0.1	2.4	-1.0
Gas	-5.8	9.9	-11.3	0.8	1.6
Non-energy	5.6	5.7	7.6	7.8	7.0
Import volumes	8.3	3.5	-7.2	-21.8	0.0
	(Billions of U.S. dollars; unless otherwise indicated)				
External sector					
Total merchandise exports, fob	527.4	523.3	497.8	374.6	404.9
Total merchandise imports, fob	-335.8	-341.3	-308.0	-230.0	-230.5
External current account	71.3	34.1	59.5	60.8	78.5
External current account (in percent of GDP)	3.5	1.6	3.2	4.5	5.5
Gross international reserves					
Billions of U.S. dollars	537.6	509.6	405.2	362.4	374.8
Months of imports[5]	14.5	13.0	11.3	13.6	13.6
Percent of short-term debt	257	251	320	496	281
Memorandum items:					
Nominal GDP (billions of U.S.D)	2,016	2,079	1,861	1,337	1,433
Exchange rate (rubles per U.S.D., period average)	30.8	31.8	38.4	…	…
World oil price (U.S.D. per barrel)[6]	112.0	108.8	98.9	61.5	67.2
Real effective exchange rate (average percent change)	1.5	1.8	-8.5	…	…

Sources: Russian authorities; and IMF staff estimates.

[3] Real GDP growth and prices for 2013-14 reflect updated staff projections.
[4] Cash basis. Expenditures based on 2013-15 budget and the fiscal rule.
[5] In months of imports of goods and non-factor services.
[6] WEO through 2013, and Brent crude oil spot and futures prices for 2014-15.

INTERNATIONAL MONETARY FUND

RUSSIAN FEDERATION

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

July 2, 2015

KEY ISSUES AND RECOMMENDATIONS

Context. Growth was anemic in 2014, reflecting preexisting structural bottlenecks exacerbated by geopolitical uncertainty and sanctions. The ruble depreciated for the most part of 2014 and came under severe pressures at the end of the year due to the sharp decline in oil prices and the intensification of sanctions. As a result, inflation accelerated sharply. In response, the shift to a flexible exchange rate was accelerated and monetary policy was tightened significantly. Measures to stabilize the banking system were introduced, including a bank capital support plan. The authorities' policy response stabilized the economy. However, structural reforms have remained stalled.

Near-term macroeconomic policy mix. The fiscal policy stance for 2015 appropriately allows for limited stimulus. Monetary policy normalization should continue at a prudent pace, commensurate with the decline in underlying inflation and inflation expectations. The size of the bank capital support program appears to be sufficiently large, but the parameters of the program should be adjusted to strengthen incentives for banks to seek private capital and reduce cost to the public sector.

Medium-term policy challenges. An ambitious and credible medium-term fiscal consolidation program is necessary to adjust to lower oil prices. Changes to the fiscal rule should be considered to support medium-term fiscal sustainability. Boosting potential growth will require implementation of structural reforms. This would include (i) strengthening governance and protection of property rights; (ii) lowering administrative barriers and regulation; (iii) increasing competition in domestic markets; (iv) enhancing customs administration and reducing trade barriers; and (v) improving the transparency and efficiency of public investment procedures. Reinvigorating the privatization agenda, as soon as market conditions permit, would enhance economic efficiency. A deeper and more efficient financial system would improve the allocation of capital thereby enhancing economic growth.

Approved By
James Gordon and Vikram Haksar

Discussions for the 2015 Article IV consultation were held in Moscow during May 12–May 21. The mission comprised Mr. Ramirez Rigo (Head), Messrs. Belhocine, Painchaud, Roitman (all EUR), Ms. Karlsdóttir (MCM), Mr. Steinberg (SPR), and Mr. Joshi (Res. Rep.). Ms. Dynnikova (local senior economist), and Ms. Chebotareva (local economist) assisted the mission. Mr. Mozhin, Executive Director, and Mr. Gordon (EUR) participated in the discussions. The mission met with Minister of Finance Siluanov, senior management at the Central Bank of Russia, other senior officials and representatives of financial institutions. Mr. Jovanovic and Ms. Swirszcz contributed to the preparation of this report.

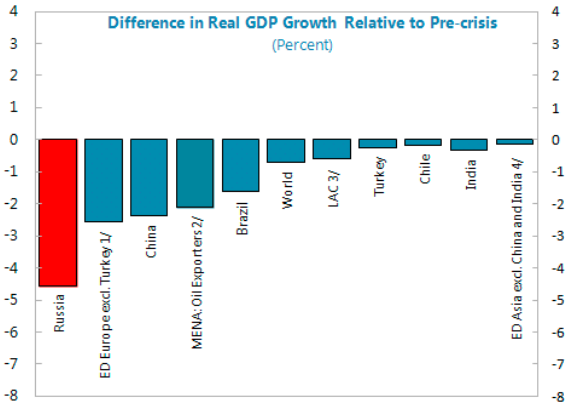
CONTENTS

TABLES

ANNEXES

CONTEXT

1. Russia entered 2014 with declining potential growth. Over 2011–14, Russia's growth decelerated more (relative to pre-crisis performance) than in most other countries and comparator groups. While some of Russia's growth deceleration is attributable to the stabilization of oil prices, it also reflects stalled structural reforms, weak investment, declining total factor productivity (TFP), and adverse population dynamics.[1] In particular, excessive regulation, weak governance, and a large government footprint in the economy have discouraged efficiency-enhancing investment.



Source: *World Economic Outlook*.
1/ Emerging and Developing Europe excluding Turkey
2/ Middle East and North Africa: Oil Exporters
3/ Latin America and the Caribbean
4/ Emerging and Developing Asia excl. China and India
Note: Each bar represents the difference between the average growth for 2011-2014, and the average growth for 2000-2008.

2. In the second half of 2014, the dual external shock from oil prices and sanctions exacerbated the slowdown. Sanctions triggered a sudden stop as Russian firms' access to international markets was impaired while geopolitical tensions increased uncertainty and weakened confidence (Box 1). In late 2014, the economy was also affected by the sharp decline in terms of trade due to falling oil prices[2]. These shocks combined to make growth anemic in 2014 (Figure 1). The growth slowdown in 2014 occurred amidst record-low unemployment, above-target inflation, and an economy operating slightly above full capacity.

3. The ruble came under severe pressure at end-2014, reflecting the balance of payments shocks from lower oil prices, limited access to international capital markets, and concerns about the large external debt redemptions in December. These led to large net capital outflows (USD154 billion or about 8 percent of GDP, the highest level since 1999–2000) and a significant decline in FX reserves (Figure 2). Also, inflation accelerated sharply following the exchange rate depreciation and Russia's countersanctions (ban on imports of food products).

4. Sanctions and market turbulence raised concerns over financial stability (Figure 3 and 4). Prior to the sharp ruble depreciation, banks' capital and income positions were already deteriorating due to the economic slowdown. The situation worsened in mid-December 2014 as retail deposit outflows created liquidity pressures, asset prices declined and the Central Bank of Russia (CBR) raised policy interest rates, worsening banks' net interest margins. Finally, the ruble depreciation put pressure on banks' risk-weighted capital.

[1] See "Potential Output and the Output Gap in Russia", Selected Issues, IMF, 2014.

[2] The annualized terms-of-trade shock is equivalent to about 8 percent of GDP.

5. The authorities took steps to stabilize the financial system and the economy (Box 2). The CBR allowed the exchange rate to float, tightened monetary policy significantly and expanded its FX liquidity facilities. The government introduced an anti-crisis plan, including a 2 percent of GDP bank capital support program, and revised its 2015 budget to reallocate spending to priority sectors.

Box 1. Impact of Sanctions

The United States (US), the European Union (EU), Japan, Switzerland, and other countries, imposed sanctions against Ukrainian and Russian individuals and entities in response to Russia's actions in Crimea and developments in Eastern Ukraine.[1] In particular, the US and EU sanctions prohibit US and EU persons and transactions conducted in the US and EU that involve providing financing for, or otherwise dealing in new debt with maturity of more than 30 days, by major state-owned Russian banks and energy companies. Sanctions also include a ban on exports of high-technology goods for use in the energy sector. On August 7th, Russia introduced a one year ban and limits on imports of agricultural and food products from countries that imposed sanctions on Russia. Russia and the EU have subsequently extended the duration of sanctions.

Sanctions will impact growth negatively in the short-run via weaker investment and consumption. Model-based estimates suggest that sanctions and counter-sanctions could initially reduce real GDP by 1 to 1½ percent. Prolonged sanctions, could lead to a cumulative output loss over the medium term of up to 9 percent of GDP, as lower capital accumulation and technological transfers weakens already declining productivity growth.

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[1] Switzerland has taken measures to prevent the circumvention of international sanctions through its territory.

Box 2. Authorities' Policy Response

The authorities put together a comprehensive policy package around three main pillars: (i) accelerating the move to a floating exchange rate regime and provision of FX liquidity; (ii) stabilizing the banking system; and (iii) providing some fiscal stimulus while limiting wage indexation in order to contain second-round effects of the depreciation on inflation.

The CBR floated the ruble when market pressures intensified in November 2014 to facilitate a more rapid adjustment to external shocks and curb reserve losses. Subsequently, the CBR raised the policy rate to 17 percent, including by 650 bps on December 16th to limit financial stability risks and respond to a worsening inflation outlook. In addition, the CBR expanded its FX liquidity facilities, as new maturities were added to CBR's FX auctions and the definition of eligible collateral was broadened. Finally, the government issued a directive requesting five large SOEs to ensure that by March 1st 2015, the size of their net foreign asset holdings is no greater than the level as of October 1st, 2014.[1]

The authorities introduced temporary regulatory forbearance, a capital support program, and doubled the level of insured deposits to support the banking system, to secure financial stability and avoid a credit crunch. Under forbearance, banks were (i) granted a moratorium on recognizing negative valuation changes for securities portfolios; (ii) allowed to price FX-denominated assets and liabilities at October 1st 2014 exchange rates; and (iii) allowed flexibility in loan classification and provisioning. CBR estimates that regulatory forbearance sheltered bank's capital position by up to 2 percentage points. The plan is to start lifting the temporary regulatory forbearance in July 2015. Funds initially worth about 2 percent of GDP—Rub 1 trillion from the 2014 Federal Budget and Rub 400 billion from the National Wealth Fund (NWF)—were allocated for the recapitalization of 27 large banks (43 percent of system assets), smaller banks affected by the sanctions and selected regional banks.[2] In addition, the CBR undertook to recapitalize the largest bank (Sberbank which accounts for 30 percent of system assets) if needed.

Finally, the government revised the 2015 budget by reallocating expenditures to increase spending on pension and support specific sectors and employment. Additional measures included budget credit to regions, federal credit guarantees, and use of the National Wealth Fund to support systemically important enterprises and banks.

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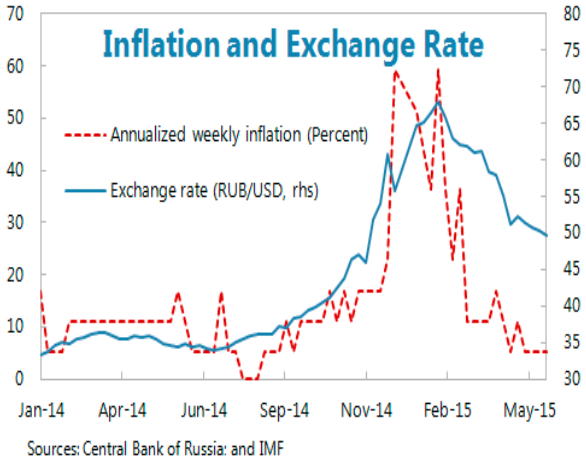
[1] This measure would be a Capital Flow Management measure in the institutional view (see The Liberalization and Management of Capital Flows: An Institutional View, IMF, November 2012). Staff assesses that it had limited implications for domestic and BOP stability with no implications on the effective operations of the International Monetary System.

[2] The capital support program was subsequently reduced to Rub 830 billion, as estimates of capital needs were decreased. Up to 10 percent of NWF' assets (Rub 400 billion) could be used to capitalize banks for the purpose of implementing infrastructure projects. In addition, up to Rub 300 billion from the NWF could be used to finance real sector projects through Vnesheconombank (VEB), Russia's Bank for Development and Foreign Economic Affairs.

RECENT DEVELOPMENTS



Sources: Central Bank of Russia; and IMF

6. In early 2015, the economy contracted, the ruble strengthened, and inflation peaked. GDP contracted by 2.2 percent y-o-y (-2.5 percent q/q) in 2015Q1, owing to declining private consumption and investment, and despite rising government spending. The ruble strengthened significantly, supported by higher oil prices, tentative easing of geopolitical tensions, improvements in confidence due to the authorities' policy response and lower external debt redemptions by Russian corporates. Weekly inflation (annualized) decelerated sharply, suggesting that the impact of the depreciation and countersanctions largely dissipated by May 2015.

7. The external sector adjustment is underway. In the first quarter of 2015, imports declined sharply reflecting both weak domestic demand and expenditure switching due to the ruble depreciation. Export fell with global oil prices but volumes remained broadly constant. External deleveraging continued in the face of limited market access, with external debt falling to USD560 billion at end-2015Q1 from USD730 billion at end-2013. The exchange rate depreciation has moved the real exchange rate towards a level closer to medium-term fundamentals (Annex 2). However, the possible structural implications of sanctions create exceptional uncertainty about assessing the external position.

8. A banking crisis was avoided but weaknesses persist. Higher deposit interest rates and ruble stabilization resulted in an increase in retail deposits from February 2015 and reduced the liquidity pressures the system faced. The 650 bps policy rate hike was accompanied by a temporary drying up of liquidity in the interbank market (Figure 2), which abated after the authorities announced measures to stabilize the financial system. The strengthening of the ruble, improvements in asset prices and declining spreads have reduced pressure on bank capital, which has been further supported by the authorities' bank capital support program and regulatory forbearance. However, the banks' profitability has continued to deteriorate as credit growth has declined sharply, interest margins have fallen, and credit quality has deteriorated. The CBR has continued closing banks, most of them very small in size, involved in dubious transactions or excessive credit risk. Since January 2014, the number of banks has declined by about 115 to around 815, with 27 licenses revoked between January–June 2015.

9. Sanctions have forced banks and corporations to deleverage their external debt (Figure 5). Companies have turned to the local market and banks for FX funding given impaired access to international markets. As a result, external debt has been declining. Moreover, the net FX position of banks has remained positive and all sectors have continued to exhibit higher short-term external

assets than liabilities (Figure 7). Some corporates have been successful in rolling over part of their external intra-company liabilities.

OUTLOOK AND RISKS

10. A recession is projected for 2015 due to sanctions and the sharp drop in oil prices (Table 1, Figure 6). Real GDP is expected to contract by 3.4 percent in 2015, as real wages and credit growth fall, and private consumption declines. Investment is expected to continue falling due to low confidence and tight financial conditions. Net exports will support growth as imports decline on the back of falling domestic demand and ruble depreciation. The current account balance (in USD) is expected to remain broadly unchanged as a sharp fall in imports and an improvement in the services balance will mostly offset the negative impact of oil prices on exports. In 2015, net capital outflows are likely to remain elevated due to Russia's limited access to international capital markets. As a result, FX reserves are expected to decline to about USD360 billion (13.6 months of imports). In the baseline, external and public debts remain low and manageable.

11. The recovery in 2016 will be muted and medium-term prospects are weak. The more competitive exchange rate, increasing external demand and normalization of financial conditions will support the recovery in 2016. However, private consumption and investment are likely to remain subdued as real income growth remains slow, households continue to deleverage, and external financing is constrained.[3] Moreover, unlike in 2008–09, when oil prices rebounded sharply and Russia's recovery was rapid, staff's medium-term projection is based on persistently low oil prices, suggesting a muted recovery. Coupled with the lingering effects of sanctions, negative population dynamics and slowing productivity due to the lack of structural reforms, this is expected to result in weak potential growth in the medium term (around 1.5 percent).

12. Inflation should decline rapidly over the next two years. The recession in 2015 is expected to open an output gap of about 1 percent of potential GDP.[4] This, together with the dissipating one-off effect of the exchange rate depreciation in late 2014–early 2015, the recent ruble appreciation, and the partial public wage indexation, will set the stage for inflation to fall to about 12 percent at end-2015 and close to 8 percent at end-2016.

13. An increase in geopolitical tensions is the main risk to the outlook. The baseline scenario is predicated on the absence of additional external shocks. However, an escalation of geopolitical

[3] The terms-of-trade shock should be mitigated by the ruble depreciation and sharp reduction in real imports and expenditure switching. In addition, oil prices are expected to gradually increase over the medium term, but to remain well below their 2014 level. As a result, the net effect from the fall in oil prices over the medium term results in a decline in consumption and investment, but less than the initial shock.

[4] Potential output is expected to decline during the next two years due to the transition costs related to re-allocating resources across the economy following the terms-of-trade shock. The decline also reflects the impact of sanctions on domestic investment through the limited availability of financing and increased uncertainty. However, there is significant uncertainty about the evolution of potential output and hence the output gap.

tensions could create additional balance-of-payment pressures and a significant deterioration in confidence. The ruble could depreciate as capital outflows surge and inflation would increase further. Elevated uncertainty would cause investment to contract and precautionary savings to increase further, putting additional downward pressure on domestic demand. The ensuing contraction in economic activity would have a negative effect on the fiscal position and could create additional capital needs for banks.

14. But other risks also cloud the outlook (Annex 3). Lower and/or more volatile oil prices could further dampen the economic outlook. In addition, the positive effect from a more competitive exchange rate is likely to be limited should the authorities pursue inward-looking policies. Although most corporations have enough cash on hand to finance their external debt coming due over the next 1-2 years, and have natural hedges due to energy exports, rapid deleveraging could entail reducing investment, which if sustained would further affect potential output. Possible spillovers from Ukraine could also adversely affect Russian banks, although they have already reported large provisioning against their Ukrainian exposure. A faster-than-expected end to sanctions, while positive, would pose some macroeconomic challenges, as Russia could face large and volatile capital inflows.

15. Against these risks and uncertainties, Russia has large buffers (Figure 7). Russia has a positive and large net IIP (18 percent of GDP), a sizable current account surplus of 4.5 percent of GDP in 2015, low public debt and no need to access international markets for government financing in the short term due to the Reserve Fund (RF) buffer. In addition, while access to international capital markets has been impaired, Russian companies are expected to gradually regain access, as sanctions are lifted. Moreover, the CBR's reserves remain adequate but could be increased somewhat to reflect Russia's vulnerability to tail risks stemming from commodity-price shocks and the heightened level of uncertainty related to sanctions.[5] Finally, balance-sheet currency mismatches are low and do not limit exchange rate flexibility. Thus, existing buffers reduce the likelihood of a systemic event.

16. Sizeable outward regional spillovers from Russia are unfolding (Figure 8, Box 3). However, the Russian authorities' policy response, which stabilized its economy, helped to mitigate outward spillovers. Despite this, Commonwealth of Independent States, Ukraine and Baltic countries, closely linked to Russia mostly through trade, remittances and FDI channels, are facing significant spillovers. Eastern Europe's links to Russia are generally weaker though for some countries' trade and FDI exposures are still significant (Bulgaria, Serbia, Hungary, Czech and Slovak republics). Some Western European countries, such as Austria and Cyprus, have direct financial exposures to Russia but trade links, beyond energy, are limited.

[5] On May 20th 2015, CBR's reserves stood at USD 360 billion. Under the Fund's basic reserve adequacy metric, reserves within a range of USD 190–280 billion would be deemed appropriate. However, taking into account Russia's vulnerability to commodity shocks would increase the range of appropriate reserves to USD 240–350 billion. Finally, additional reserves could be justified given that Russia's access to international capital markets is impaired. See "Assessing Reserve Adequacy – Further Considerations", IMF, November 2013 and "Assessing Reserve Adequacy – Specific Proposals" IMF, April 2015.

Authorities' Views

17. The authorities are more optimistic about Russia's growth prospects but broadly agreed with staff's risk assessment. The Ministries of Finance (MoF) and Economic Development (MED) expect the contraction in economic activity to be milder in 2015 and forecast positive growth of about 2.5 percent in 2016.[6] In their assessment, the more competitive real exchange rate and the bank capital support program will have a larger impact on growth than staff estimates. Moreover, they believe that with the stabilization of confidence and rapid decline in inflation, real income growth will be higher and lead to an earlier and faster recovery in private consumption. Their medium-term outlook envisages higher potential output growth (at around 2.5 percent) than staff's (at around 1.5 percent), as they expect import substitution to deliver higher investment growth. However, they recognized that this will require implementing structural reforms. They underscored the risks of long-lasting sanctions and lower oil prices, and emphasized the importance of preserving and rebuilding buffers. The authorities remain committed to deepen Russia's links to CIS countries and Asia, and recognized that a long period of sanctions against Russia may disrupt further integration to the world economy.

Box 3. Regional Spillovers

In the face of sharply lower oil prices and geopolitical tensions, Russia has entered into a recession. This has resulted in significant spillovers to many Commonwealth of Independent States (CIS), Ukraine and Baltic countries. The spillovers to Eastern Europe have been more limited. The degree of impact is commensurate with the level of countries' trade, remittances, and FDI links to Russia.

Trade, remittances, and FDI are the main channels of economic spillovers from Russia to neighboring countries, particularly the CIS (Figure 8). Belarus, Lithuania, Ukraine and Turkmenistan have the largest share of exports to Russia (over 9 percent of GDP). The remittances channel is particularly prominent for CIS oil importers, which are among the most remittance-dependent economies in the world. In 2014, remittances constituted close to 20 percent of GDP in Armenia, 24 percent of GDP in Moldova, 30 percent of GDP in the Kyrgyz Republic and 45 percent of GDP in Tajikistan, mainly sourced out of Russia. The FDI channel is also important for a number of CIS countries (Armenia, Belarus, Moldova, and Tajikistan), Bulgaria and Montenegro. The financial sector channel is more limited, given the relatively small presence of Russian banks, although exchange rate depreciations have impacted local banks, especially in highly dollarized economies.

The negative spillovers have contributed to sizable downward revisions to growth forecasts across the CIS. In particular, for Belarus, Moldova, and Caucasus and Central Asia (CCA) oil importers, adverse spillovers from Russia's recession in 2015 account for more than 2.5 percentage points of the downward growth revision relative to April 2014 forecast. For CCA oil exporters, negative spillovers from Russia contributed to about 1.4 percentage point of the downward revision in the growth forecast. The slower medium-term growth in Russia is expected to negatively impact the medium-term outlook of both CIS and Baltic countries.

Currencies of most CIS countries depreciated (or were devalued) sharply relative to the US dollar following the ruble's depreciation (in some cases accompanied by large interventions), reflecting confidence effects and expected decline in foreign currency inflows from Russia. Countries with significant trade and remittance links to Russia experienced larger currency depreciation. Rising dollarization in the region, particularly in the CCA countries, where the share of dollar deposits rose to around 60 percent in most countries, points to weak confidence and expectation of devaluations. At the same time, the sharp depreciation of the ruble and the appreciation of the US dollar (to which some CIS currencies are pegged) have put upward pressure on nominal effective exchange rates.

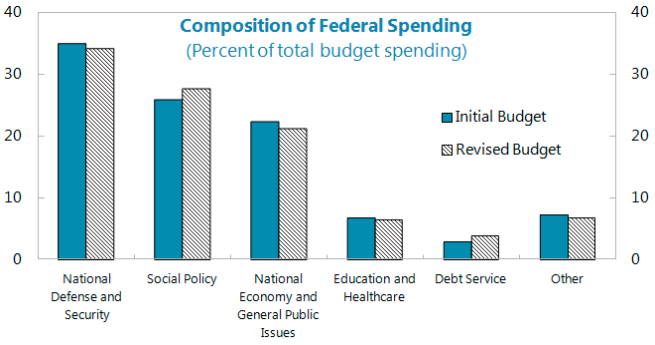
[6] The CBR is less optimistic, forecasting a decline of 3.2 percent in 2015, and growth of between -1.2 and 0.7 in 2016.

POLICY DISCUSSIONS

The difficult economic conditions require a prudent macroeconomic policy response, especially in view of the elevated external risks. Thus, the discussions focused on (i) providing a limited fiscal stimulus in the context of needed medium-term fiscal consolidation; (ii) bringing inflation down to target over the medium term while avoiding overly tight conditions in the short term; (iii) ensuring financial stability; and (iv) advancing structural reforms that can leverage the more competitive exchange rate to rebalance growth.

A. Fiscal Policy: Short-term Stimulus, Medium-term Consolidation

18. Parliament approved a new 2015 federal budget based on more realistic oil prices and macroeconomic assumptions. Under the new budget, the non-oil deficit is expected to deteriorate by 2 percentage points of GDP compared to 2014, (excluding the one-off bank capital support program). Compared to the initial budget, nominal spending was cut slightly, despite higher inflation in 2015, in an effort to recognize the new economic reality of lower oil prices and economic slowdown. Spending was re-allocated to priority areas such as support to the manufacturing sector (in line with the anti-crisis plan) and social payments, while some programs were cut by 10 percent, and public wages were only partially indexed to inflation. The budget also included limited tax cuts (about 0.2 percent of GDP). It assumes gross financing from the RF of about Rub 3 trillion (4 percent of GDP) in 2015, reducing considerably fiscal buffers for the future.



Sources: Ministry of Finance and staff estimates.

Federal budget

	2014	2015	
		Initial budget	Revised Budget
	Ruble (billion)		
Revenues	14,497	15,082	12,540
Oil Revenues	7,418	7,717	5,636
Non-Oil Revenues	7,079	7,365	6,904
Expenditures	14,831	15,513	15,215
Overall balance	-334	-431	-2,675
Overall balance (excluding one-off)[1/]	666	-431	-2,675
Non-oil balance (excluding one-off)[1/]	-6,752	-8,148	-8,311
	Percent of GDP		
Revenues	20.4%	19.5	17.1
Oil Revenues	10.5%	10.0	7.7
Non-Oil Revenues	10.0%	9.5	9.4
Expenditures	20.9%	20.1	20.8
Overall balance	-0.5%	-0.6	-3.7
Overall balance (excluding one-off)[1/]	0.9%	-0.6	-3.7
Non-oil balance (excluding one-off)[1/]	-9.5%	-10.5	-11.4

1/ The 2014 budget included Rub 1000 billion for the bank recapitalization program.

19. Staff supported a slightly expansionary fiscal stance for 2015. The structural non-oil deficit of the general government (federal and regional governments, and extra budgetary funds) is expected to deteriorate by 0.4 percent of GDP, as the federal stimulus is expected to be offset by ongoing consolidation at other levels of government (Table 4). Fiscal policy would thus appropriately provide some stimulus given cyclical considerations, available fiscal space and a measured normalization of monetary policy, while partial wage indexation would support the disinflationary process. However, this may understate the ultimate level of fiscal stimulus as quasi-fiscal stimulus will be provided through the National Wealth Fund and the

issuance of guarantees. Staff recommended that the use of quasi-fiscal operations should be limited and coordinated to avoid an overly stimulative fiscal stance.

20. However, staff noted that medium-term fiscal consolidation is required to adjust to lower oil prices and rebuild buffers. Assuming the maximum spending allowed under the federal fiscal rule, staff expects some stimulus in 2016 followed by fiscal consolidation, as the impact of lower oil prices is only gradually captured by the fiscal rule and therefore expenditures.[7] This consolidation path would result in a relatively large non-oil primary deficit (almost 7 percent of GDP) and a low Reserve Fund buffer (only 1.0 percent of GDP) by 2020 (Figure 9, Table 4). Indeed, these deficits are above medium-term benchmarks estimated by staff which take into consideration intergenerational equity (Box 4). Reaching these benchmarks would entail additional adjustment, relative to the baseline, of 2–3 percent of GDP over the medium term. Accordingly, a limited fiscal adjusment could begin in 2016. Ultimately, the pace of fiscal consolidation may need to be adjusted to protect the nascent recovery or in the event of a more prolonged or protracted recession.

21. Staff cautioned that current rigidities create a challenge to achieving fiscal adjustment. In particular, the application of the fiscal rule and pension indexation could make it difficult to achieve the necessary fiscal adjustment. Under the fiscal rule, the oil price benchmark is a backward-looking average, thus requiring only a gradual consolidation despite the expected persistence of the oil price shock. This could be exacerbated by the conversion of benchmark revenues into rubles using a much depreciated exchange rate.[8] Furthermore, full indexation of pension benefits (to 2015 inflation) could permanently increase spending by about 1.1 percent of GDP in 2016, which would need to be offset by reducing other spending to comply with the fiscal rule.

22. Staff recommended changes to the fiscal rule to help support medium-term fiscal sustainability. In particular, staff discussed a menu of options to improve two operational aspects of the rule: (i) increasing the pace of adjustment of the oil price benchmark to allow for a more timely fiscal adjustment; and (ii) gradually raising the amount of savings generated by the fiscal rule to a surplus of 1–2 percent of GDP, as the projected non-oil primary deficits are above the medium-term benchmarks estimated by staff which take into consideration intergenerational equity (Box 4). Improvements along these two dimensions could be made without a significant reform of the principles governing the fiscal rule. Other changes to the fiscal rule could also be considered such as (i) expressing the rule in terms of minimum savings instead of maximum spending to focus the policy debate on savings; (ii) including a limit on spending growth, to avoid pro-cyclical fiscal policy when there is a revenue windfall; and (iii) adjusting non-oil revenues to the economic cycle, and using potential GDP to calculate net financing. However, adjusting for the economic cycle is complicated

[7] Under the fiscal rule, federal expenditures are capped, ex ante, as the sum of (i) projected non-oil revenues; (ii) oil revenues at a benchmark price (in USD) converted to rubles; and (iii) net financing of one percent of GDP.
[8] However, in contrast to previous years, the authorities are considering converting oil revenues using a historical average of the exchange rate, instead of the projected exchange rate, which could result in lower spending than assumed by staff.

and subject to great uncertainty, as cyclically adjusted balances are often revised ex post due to revisions to potential GDP.

23. Detailed fiscal measures will also be critical for the credibility of the consolidation program. In particular, a reform of the pension system could deliver substantial fiscal savings over time. Other possible areas for fiscal consolidation include (i) better targeting of social transfers; (ii) reducing energy subsidies; and (iii) cutting tax expenditures. Fiscal consolidation should safeguard public investment, education and health care spending while improving the efficiency of capital budgeting to increase returns on public investment.

Possible Fiscal Adjustment Measures
(Percent of GDP)

Measure	Budget Savings
Short-term	up to 2.7
Cut tax expenditures	2.0
Increase excise taxes	0.7
Medium-to-long-term	up to 7.1
Reduce energy subsidies	1.0
Better targeted social transfers	2.0
Increase retirement age	2.0 - 3.0
Reduce early pensions	0.7
Improve capital budgeting	0.4
Total	up to 9.8

Source: Ministry of Finance, WB, IMF staff estimates

Authorities' Views

24. The authorities agreed with the need for medium-term fiscal consolidation. In their view, the recent oil price decline should be treated as permanent, requiring fiscal adjustment based on permanent measures. They believed that a balanced budget by 2018 would be consistent with medium-term fiscal sustainability and are considering tightening fiscal policy by limiting spending starting in 2016. They also recognized the challenges created by the current fiscal rule and pension benefit indexation. In that context, the authorities agreed that there is a need to revisit the fiscal rule and welcomed the set of possible modifications suggested by staff.[9] Following the workshop on pension reform delivered by IMF experts in March, the authorities are seeking politically feasible reforms to ensure the system's viability. They argued that a combination of fewer early retirement benefits, and an increase and equalization of statutory retirement ages would bring about a significant improvement in the pension system's balance.

[9] At the request of the authorities, IMF staff delivered a workshop on fiscal rules on June 22–23, 2015.

Box 4. Russia's Fiscal Rule[1]

Resource-rich countries face two important fiscal challenges: (i) conducting a prudent fiscal policy consistent with the long-term value of their resource wealth; and (ii) managing the impact of short-term resource-revenue volatility. The recent sharp oil price decline has exacerbated these challenges. Having an appropriate fiscal framework helps to manage these challenges, reduces "Dutch disease" effects, and limits the risks of large and disruptive adjustments in the future i.e. fiscal sustainability risks.

Russia introduced an oil-price based fiscal rule in December 2012, but it could be further improved. Under the rule, the oil-price benchmark is set as the minimum of (i) a backward-looking moving average of up to ten years of Urals oil prices (USD/barrel); and (ii) a three-year backward looking average. The fiscal rule could be modified to: (i) allow for a faster adjustment in fiscal policy in response to oil-price developments; and (ii) generate more savings as Russia's current and projected non-oil primary deficits are larger than suggested by typical long-term fiscal benchmarks. Improvements along these two dimensions could be made without a significant reform of the principles governing the fiscal rule.

In particular, the oil price benchmark could adjust more rapidly to developments in the oil market. To adjust more rapidly to perceived changes in the long-term price of oil, the calculation of the oil-price benchmark could usefully include future oil prices, as is done in other countries such as Mexico and Mongolia. An alternative to including future oil prices could be to convert revenues to rubles using an exchange rate that is more consistent with the oil price benchmark, instead of the projected exchange rate (as was done in the past) i.e. the projected exchange rate assumes lower oil prices than the oil price benchmark. However, determining the appropriate exchange rate for conversion is complicated by the fact that (i) the ruble has not been floating until recently; (ii) the level of the exchange rate reflects a number of non-oil factors, including inflation differentials and, recently, the impact of sanctions against Russia. Furthermore, converting revenues using such an exchange rate could complicate communications with the public and markets, as the exchange rate used to convert revenues would be different than the projected one.

The fiscal rule could generate more savings to safeguard intergenerational equity. Estimates of long-term fiscal benchmarks consistent with intergenerational equity points to a federal non-oil primary deficit (NOPD) in the range of 3-4.5 percent of GDP. Generating such NOPDs could be achieved by changing the "net financing" of 1 percent of GDP allowed under the fiscal rule, which increases the maximum level of spending and the deficit, to "net savings" of 1–2 percent of GDP.

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[1]For more details, see the Selected Issues Paper "Russia's Fiscal Framework and the Oil Price Shock."

B. Monetary Policy: Measured Normalization

25. The CBR initiated an easing cycle, introduced changes to its FX facilities and set up an FX purchase program (Figure 2). Since the end of January, the CBR started unwinding the December 16th emergency rate hike, reducing its policy rate by 550 bps. Banks have relied primarily on the FX repos to ease dollar funding pressures in the interbank market and support a smooth external deleveraging. In March 2015, the CBR started to increase the cost of these facilities as the FX market normalized. In May, the CBR suspended the 1-year FX repo facility and announced a program of daily FX purchases of between USD 100–200 million.

26. In staff's view, the ongoing monetary policy normalization is appropriate and should continue at a prudent pace. The acceleration in inflation (y-o-y) over December 2014–April 2015 reflected, to a large extent, the one-off impact of the ruble depreciation and countersanctions. Thereafter, disinflation should be driven by the recession underway, the stabilization of the ruble, and partial wage indexation in the budget. Therefore, a gradual reduction in the policy rate, commensurate with the decline in underlying inflation and inflation expectations, would be appropriate. In addition, if the authorities implement a tighter budget in 2016 than assumed by staff,

this could support a faster normalization of monetary policy. Nevertheless, there are a number of factors arguing for a prudent pace of monetary easing including the uncertainty over the external outlook, the potential for second-round effects given the magnitude of the exchange rate depreciation (Box 5), and the CBR's need to build credibility under the recently introduced inflation targeting regime. As inflation expectations appear to be mainly adaptive, surveys of inflation expectations should be used cautiously in assessing underlying inflation (Figure 10). Finally, the easing of policy rates should be conditional on a reduction in external and financial stability risks.

Box 5. Exchange Rate Pass-through[1]

Exchange rate fluctuations can have a significant impact on the evolution of inflation and inflation expectations. As such, central banks should carefully estimate the exchange rate pass through to inflation. This is difficult in the case of Russia because nominal exchange rate fluctuations have been relatively limited in the recent past. Therefore, exchange rate pass through to consumer prices has been estimated using data for emerging markets. The analysis suggests that:

i. The size of the exchange rate fluctuation matters. In particular, a larger exchange rate depreciation tends to lead to a greater impact on inflation (a larger exchange rate pass through). For example, the typical exchange rate pass through in emerging markets is estimated at 20 percent after 12 months. However, the pass though increases up to 45 percent after 6 months when the depreciation is greater than 20 percent.
ii. Episodes of depreciation are associated with greater exchange rate pass through than episodes of appreciation. In particular, the estimated pass through during periods of depreciation is five times greater than during episodes of appreciation.
iii. Inflation-targeting countries typically have lower pass through. However, this result holds only in countries where the central bank has built sufficient credibility to anchor inflation expectations.

Given these results, the CBR should be careful when normalizing monetary policy. First, the ruble depreciated significantly in late 2014-early 2015, suggesting that the inflation pass through was large and relatively fast. Second, the recent appreciation of the ruble, while helpful in bringing inflation down, may not produce a large disinflationary effect. Third, introducing flexibility in the exchange rate regime is often accompanied by higher-than-normal volatility, hence it is important for the CBR to establish credibility by anchoring inflation and inflation expectations under the new regime.

[1] For more details, see the Selected Issues Paper "Exchange Rate Pass-through to Inflation. Is Russia Different?"

27. Staff agreed that the changes to the FX liquidity facilities and the introduction of an FX purchase program were broadly adequate. The normalization in the FX interbank market and the end of large FX debt redemptions called for a repricing and rationalization of these facilities. The central bank could consider limiting further the FX allotments to ensure that the facilities remain sufficient for emergency purposes. The pre-announced daily FX purchase program to build precautionary buffers would help guard against tail risks presented by the exceptional external conditions, given Russia's limited access to international capital markets and vulnerability to commodity shocks. However the strategy should be strengthened by indicating the time-frame the central bank expects to be conducting these operations, thereby avoiding an open-ended policy that may be misconstrued as targeting an exchange rate level.

Authorities' Views

28. The authorities agreed that monetary policy normalization should proceed at a cautious pace. The CBR noted that the exchange rate pass-through was greater and faster than expected but that disinflationary pressures are now firmly in place given the latest inflation readings, the ruble appreciation and partial wage indexation. As a result, the CBR expects inflation to come down to about 12–14 percent by the end-2015 and between 5.5–7.5 percent by end-2016, provided there are no additional shocks. This should allow further easing to avoid an overly tight monetary stance. The CBR concurred with staff that the pace of interest rate normalization should be cautious and viewed its inflation target of 4 percent as realistically achievable by 2017.

29. The CBR believes there is a need to rebuild reserve buffers. They argued that given the exceptional circumstances and uncertainty regarding the external outlook, there is scope to increase reserves, especially given the evolution of the ruble in the first half of the year. The CBR indicated that the goal of the new FX purchasing program is to rebuild precautionary buffers. They agreed with staff that it was critical to ensure that the program is not seen as targeting a specific exchange rate and noted that they remain committed to the floating exchange rate regime. The authorities also indicated that the parameters of the FX facilities would be adjusted according to market conditions.

C. Financial Sector: A Tailored Policy Response

30. The banking system is facing challenging times (Figure 3). The sector reported after-tax losses in December 2014 and during the first five months of 2015. At end-April, the sector's reported capital was comparable to a year ago, at 12.9 percent, owing to capital support from the NWF and the government (Rub 236 billion) and regulatory forbearance. Non-performing loans (NPLs) have increased by only 1.5 percentage points to 8.0 percent compared to April 2014 (Figure 4), again helped by regulatory forbearance.

31. Staff acknowledged that anti-crisis measures helped stabilize the banking system. The acute ruble depreciation in December caused regulatory compliance challenges due to the impact on risk-weighted assets from the revaluation of FX-denominated assets. The forbearance measures insulated prudential reports from the depreciation and helped avoid regulatory triggers. The strategy was appropriately combined with intensified supervision, although staff noted that it should be strengthened by increasing transparency with regards to asset quality to improve market confidence. Moreover, staff argued for the prompt elimination of forbearance, along with the implementation of the capital support program, to avoid the emergence of additional financial stability risks in the medium term.

32. The size of the capital support program appears to be sufficiently large (Box 6). Although profitability and capital will continue to be under pressure, recent CBR's stress tests suggest that the government support for all the large eligible banks—before owners' mandatory contribution—is sufficient to cover loan-loss provisioning and market losses under an adverse scenario (including an increase in NPLs to 18 percent). However, staff noted that the capital support

should be better tailored to the specific needs of individual banks and based on stress tests that are sufficiently conservative, instead of being arbitrarily set at 25 percent of a bank's total capital.

Box 6. Features of the Government's Bank Capital Support Program

In December 2014, the government launched a Rub 1 trillion[1] (1.2 percent of GDP) bank capital support program. The main features of the program as of mid-June 2015 are:

Eligibility: The program targets three categories of commercial banks: (i) Banks with at least Rub 25 billion in capital – 27 banks meet this requirement (excluding Sberbank).[2,] (ii) Banks that are directly or indirectly affected by economic sanctions; and (iii) top regional lenders (up to 13 banks).

Type of capital support: Under the program, the DIA offers government bonds (OFZ) in exchange for banks' subordinated Tier 2 debt and, for (partly) state-owned and sanctioned banks, in exchange for Tier 1 debt and preferred shares. The subordinated debt should be remunerated above the OFZ rate, but below market rates. Support is set at 25 percent of a bank's total capital, irrespective of current or prospective capital needs, if any.

Conditions: Banks receiving support must be in full compliance with CBR's prudential requirements at the time of the capital injection. With the exception of (partly) state-owned banks, banks must raise their own funds equal to at least 50 percent of the government's support. Owners' contributions can be in the form of retained earnings over the duration of the subordinated debt. Other conditions include increased monitoring, a commitment to increase credit to selected sectors by 1 percent monthly for three years, and a three-year ban on increasing management salaries and the overall wage bill of the bank. Failure to comply with these conditions would result in penalties that worth up to 2 percent per year of the capital support.

Procedures: Eligible banks, other than regional banks, had until June 1, 2015 to accept DIA's offer and the process should be finalized by November 1, 2015. Thereafter, the CBR performs a due diligence to verify that banks are in compliance with the program conditions. Onsite asset quality reviews are performed at banks that have not had an onsite supervisory inspection in the preceding 12 months. In the event that a bank does not meet all the program conditions, remedial actions need to be implemented. Finally, requests for support are subject DIA board approval.

In addition to the government's capital support program, up to 10 percent of the assets of the NWF (0.5 percent of GDP) could be used to support bank's financing of large infrastructure projects. NWF financing would be provided through subordinated deposits or purchases of subordinated debt with a maturity of up to 30 years. Resources from the NWF would be on-lent by banks (with the lending rate equal to the financing costs from the NWF). Finally, the CBR has been authorized to support Sberbank with subordinated credits (deposits, loans, bonds) amounting to up to 100 percent of its capital, if needed.

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[1] The program has subsequently been reduced to Rub 830 billion as estimates for capital needs have been reduced.

[2] Sberbank also meet this requirement but is excluded from the program as it is majority-owned by the CBR. Eight of the 27 banks are partly state-owned, with total capital amounting to 64 percent of the group.

33. However, staff recommended adjustments to the program to minimize the cost to the public sector:

- *Tighter eligibility criteria.* Only banks identified *ex ante* as systemically important should be eligible, while allowing weak non-systemic banks to be resolved in an orderly fashion.
- *Higher cost of capital,* to ensure stronger efforts by banks to seek private capital before resorting to public funds. Given that markets are not currently functioning properly, the cost could be benchmarked against historical and/or international experience for similar capital instruments.

This would create incentives to repay the government support, as soon as banks regain access to capital markets. Finally, when requiring the private sector to co-finance the capital injection, the authorities should aim at achieving a level playing field between private and partly state-owned banks.

- *Eliminate credit growth targets* as forced lending could increase credit risks and potential inefficient credit allocation. While the capital support may facilitate credit growth, credit underwriting should best be based on banks' commercial assessment of risk and remuneration.

34. Staff noted that the bank resolution framework has been upgraded, but further work is needed to fully address past FSAP recommendations (Annex 4). Legislation adopted in late December 2014 revokes, replaces and consolidates into one law the General Bank Insolvency Law and the 2008 Temporary Law for resolution of banks posing a threat to financial stability. The new law makes notable improvements, such as (i) more timely exchange of information between the DIA and the CBR on failing institutions; (ii) mandatory imposition of losses on shareholders prior to the use of public funds provisions; (iii) greater powers to sanction managers of failing institutions; and (iv) provisions for the bidding procedures of the assets and liabilities of a failed bank. However, staff noted that the new legislation does not provide for a number of tools contemplated in the Key Attributes for Effective Resolution Regimes, including the powers to use a bridge bank and to bail-in all unsecured uninsured liabilities. Finally, staff recommended that supervision of banks heavily dependent on CBR liquidity should be stepped up, including by requesting funding and liquidity plans that makes their business model independent of CBR support.

Authorities' Views

35. The authorities believe the package was key to stabilizing confidence in the banking system and avoiding a credit crunch. The authorities acknowledged the need for a timely lifting of forbearance and plan to start eliminating these measures in July 2015. They emphasized that capital support provided to banks was aimed at supporting credit growth rather than to cover losses. In their view, this justifies the large number of eligible banks, the relatively low cost of capital, and the requirement that banks increase lending. The authorities also noted that the list of systemically important banks is still under discussion and is expected to include a number of regional banks in addition to the 19 banks already supervised by CBR's SIB unit. The risk to public funds is seen as minimal as capital support is only granted to banks after CBR's inspection. Furthermore, the wage bill restrictions are considered to be a sufficient incentive for banks to seek private sector capital. The authorities agreed that private capital would have been preferable, but argued that even if greater incentives were in place, it would be difficult to attract capital given the sanctions. The authorities agreed that over time they should reconcile the current bank resolution framework with the Key Attributes.

D. Structural Policies: Re-invigorate the Reform Agenda

36. Structural challenges have slowed potential growth. Adverse population dynamics have contributed to the decline in the labor force, while low statutory retirement ages have reduced

workers' incentives to extend their working life. Administrative barriers, high regulation, weak governance (including perceptions of corruption and weak property rights protection), and poor infrastructure have limited investment and growth (Figure 11).[10] The significant presence of state-owned enterprises (SOEs) in key sectors of the economy has also made it difficult to increase competition and efficiency. Several new anti-crisis initiatives aimed at supporting different sectors through subsidies, guarantees, restrictions on the participation of foreign producers in public procurement, and import substitution-like polices, have introduced additional distortions which will put a drag on growth. Finally, the banking system is highly concentrated, lacks depth, and is inefficient at channeling savings to investment.

37. Effective implementation of a structural reform agenda is needed to boost growth. There is an excess of savings over investment in Russia, as evidenced by its large current account surplus. How to retain these savings and channel them into efficient investment is paramount. Improving governance and the protection of property rights, and increasing competition in domestic markets would contribute to improving investors' confidence, increasing output in the non-energy tradable sector, and attracting investment. Specific reforms that could be introduced in the short term include: (i) strengthening mechanisms to protect property rights; (ii) enhancing customs administration, reducing trade barriers and promote trade; (iii) empowering the Federal Antimonopoly Service (FAS) to eliminate entry barriers to several sectors/markets; and (iv) ensuring mandatory public technology and price audits of all major investment projects with government participation. A deeper and more efficient financial system would improve the allocation of capital thereby enhancing economic growth (Box 7). The privatization program should be revamped as soon as market conditions permit, and SOEs should be managed on a commercial basis. Reforms related to OECD accession should be rekindled despite the suspension of accession talks. Finally, pension reform, especially increasing the statutory retirement age, could increase future labor supply and potential growth.

Authorities' Views

38. The authorities broadly agreed with the diagnosis and noted their commitment to implement structural reforms. They noted that sanctions and adverse terms of trade are affecting potential growth, on top of pre-existing structural bottlenecks, hence the need to accelerate structural reforms. They see pension reforms as important to increase labor force. The authorities noted that improving property rights, revamping transport infrastructure and enhancing competition in goods and services markets is needed to improve the business climate and boost investment. Moreover, the authorities remain committed to support the manufacturing sector through various programs, ensuring effective support for SMEs. In addition, the MED will continue implementing its reform agenda based on roadmaps, including in the following areas: reducing trade barriers, facilitating the acquisition of construction permits, and improving access to electricity. The Ministry

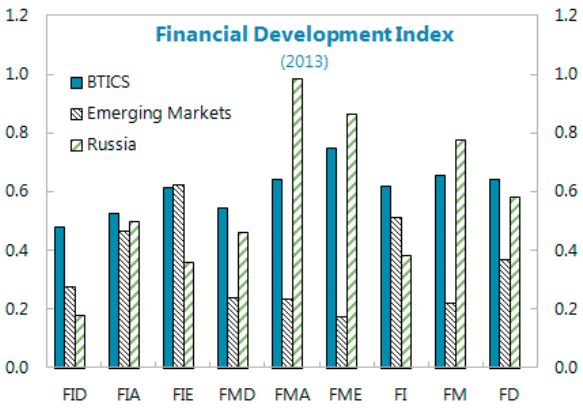
[10] As pointed out in an independent evaluation of the Doing Business Survey, care should be exercised when interpreting these indicators.

of Agriculture will implement several programs where they see significant scope for efficiency gains and import-substitution.

Box 7. Russian Banking System and Growth

Russia's financial sector is analyzed through the lenses of a broad-based measure of financial development (FD).[1] Financial development is defined as a combination of depth (size and liquidity of markets), access (ability of individuals to access financial services), and efficiency (ability of institutions to provide financial services at low cost and with sustainable revenues, and the level of activity of capital markets).[2]

Russia's financial markets (FM) are found to be relatively developed but financial institutions (FI) lag behind in terms of efficiency and depth. Russia's FD index (0.58) is higher than the average EM (0.37) and slightly lower than the average BTICS (0.64), a group of countries composed of Brazil, Turkey, India, China, and South Africa. Nonetheless, the components of the index show large disparities between levels of development of FM versus FI. Russia scores much higher than the comparator groups for FM developments as it features higher degrees of access and efficiency in the operations of its financial markets. Although the depth of financial markets is slightly lower than BTICS countries, it remains much higher than the average EM. Nonetheless, along the dimension of FI, Russia lags behind both comparator groups in terms of efficiency and depth while access to financial institutions is about the same.



FID: FI Depth. FIA: FI Access. FIE: FI Efficiency. FMD: FM Depth. FMA: FM Access. FME: FM Efficiency. Source: IMF staff calculations.

Intermediation and efficiency are hampered by the structure of the banking system. With some 850 banks operating, the Russian banking system is highly concentrated at the top, and fragmented at the bottom. The top three banks (state-owned) accounted for more than 50 percent of total sector assets at year-end 2014 while the top 20 banks accounted for 75 percent of total sector assets. Lending is highly concentrated among the top 10 bank groups making about 850 banks contribute only 15 percent of total lending. Some indicators of efficiency, including lending-deposit spreads, are close to the average observed in comparator groups. However, most other indicators of efficiency, in particular non-interest income to total income and overhead costs to total assets, show that the banking system is much less efficient in its operations than comparator countries. In addition, concentration indices point to a moderate concentration on the deposit side.

Financial development dividend could be large. Estimates suggest that annual growth could increase by an average of 1 percentage point should Russia move to the maximum level of the FI index. Policies towards this outcome include reducing banking sector fragmentation through consolidation via the continuation of the policies of increased supervision, and tightening capital standards via the adoption of Basel III standards. In addition, strengthening the role of credit bureaus and collateral registries to reduce information asymmetries could foster and improve credit allocation. Finally, the authorities should consider removing interest rate rigidities, in particular by allowing deposit rates to adjust freely while designing in parallel an incentive mechanism that prevents predatory bank lending.

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[1] For more details, see the Selected Issues Paper "Fostering Financial Contribution to Growth." The analysis focuses on supply factors that could foster financial contribution to growth. Demand factors are beyond the scope of this study.

[2] Sahay et al. (2015). "Rethinking Financial Deepening: Stability and Growth in Emerging Markets." Staff Discussion Note No. 15/8 (Washington: IMF).

STAFF APPRAISAL

39. The Russian economy is in a recession in 2015 due to lower oil prices and sanctions. The external position will remain challenging due to deleveraging in the face of limited market access. Growth should resume in 2016 due in part to the authorities' policy response and higher oil prices. However, the recovery is likely to be hampered by unaddressed structural bottlenecks and adverse population dynamics, leading to weak medium-term growth prospects.

40. Staff welcomes the authorities' policy response to stabilize the economy. However there remain significant uncertainties regarding oil prices and geopolitical risks. Given these risks, the macroeconomic policy stance must remain prudent.

41. The short-term fiscal stimulus in the 2015 budget is appropriate but medium-term consolidation is required. A slightly expansionary fiscal stance is adequate for 2015 given cyclical considerations and available fiscal space. However, the use of off-budget measures—investment by the NWF and issuance of guarantees—should be coordinated to avoid an overly stimulative fiscal stance. Fiscal consolidation is required over the medium term to adjust to lower oil prices, rebuild buffers and safeguard intergenerational equity. The needed fiscal adjustment should protect public investment, education and health care spending, and could be anchored by revisiting the fiscal rule. In addition, it should be accompanied by permanent and credible fiscal measures which could include (i) pension reform, (ii) reducing energy subsidies, and (iii) better targeting social transfers.

42. Monetary policy normalization should continue at a cautious pace. The dissipating one-off effect of the exchange rate depreciation in late 2014–early 2015, the economic contraction, the partial wage indexation in the 2015 budget, and the recent ruble appreciation will support disinflation. However, the pace of easing should be commensurate with the decline in underlying inflation and inflation expectations. External risks, the potential for second-round effects, and the central bank's need to build credibility call for cautious monetary easing. The normalization in the FX interbank market and the end of large FX debt redemptions appropriately led to an adjustment of the parameters of FX liquidity facilities, but limiting allotments could be considered. The FX purchase program to rebuild precautionary buffers is understandable but an open-ended policy should be avoided to prevent the perception that the CBR is targeting a specific exchange rate level.

43. The anti-crisis package comprising temporary forbearance and public support has been successful in stabilizing the banking system. The forbearance strategy was appropriately combined with intensified supervision, but should be strengthened by increasing asset-quality transparency to further improve market confidence. The size of the capital support program appears to be sufficiently large, but support to individual banks should be tailored to their specific capital needs. Furthermore, the parameters of the program should be adjusted to strengthen incentives and reduce cost to the public sector. Forbearance should be lifted promptly by end-2015 along with the implementation of the capital support program.

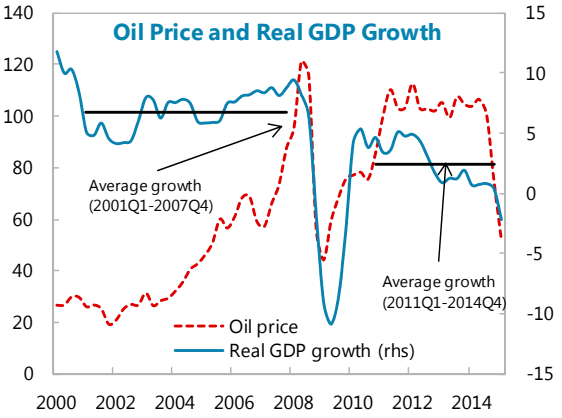
44. Despite progress in improving the bank resolution framework, additional steps should be considered to better align the new legislation, over time, with the Key Attributes for Effective Resolution Regimes, including the powers to use a bridge bank and to bail-in unsecured uninsured liabilities.

45. Boosting medium term growth requires re-invigorating the reform agenda. Avoiding global de-integration, improving governance and property rights protection, increasing competition in domestic markets, reducing the government's footprint in the economy and limiting regulations remain crucial to foster efficiency, confidence and investment. Initiatives in these areas would also be critical to support the non-energy tradable sector and diversify the economy. In addition, pension reform would help improve labor force dynamics in the face of negative demographic trends. Finally, financial deepening and a more efficient banking system are needed to support long-term growth.

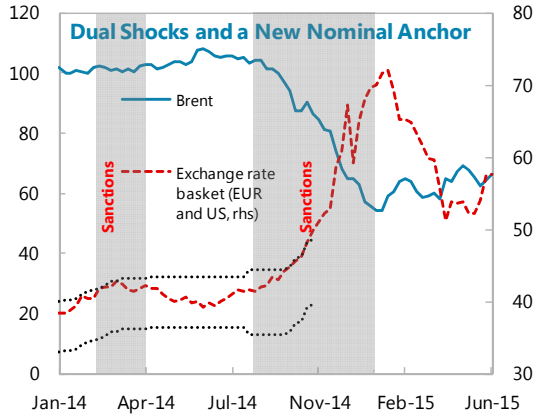
46. It is proposed that the next Article IV consultation be held on the standard 12-month cycle.

Figure 1. Russian Federation: Recent Developments

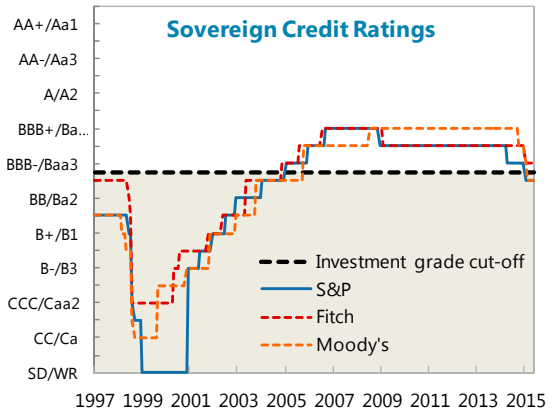
Growth was decelerating as oil prices stabilized, albeit at a high level.



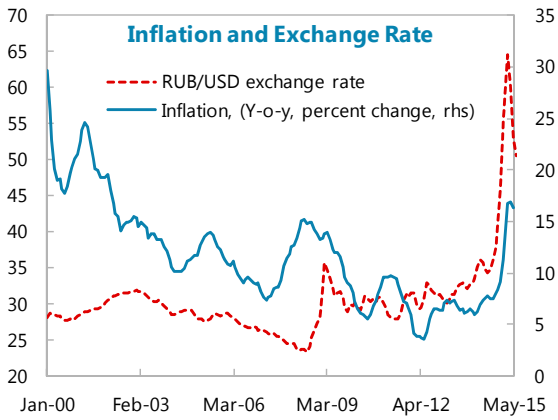
Sanctions and a terms-of-trade shock resulted in exchange rate depreciation...



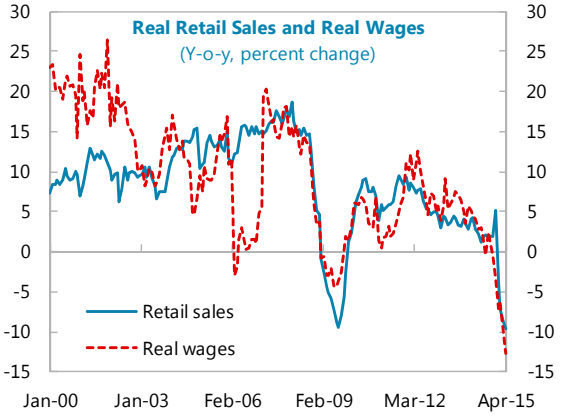
... and a reassessment of the credit rating, leading to a sovereign downgrade.



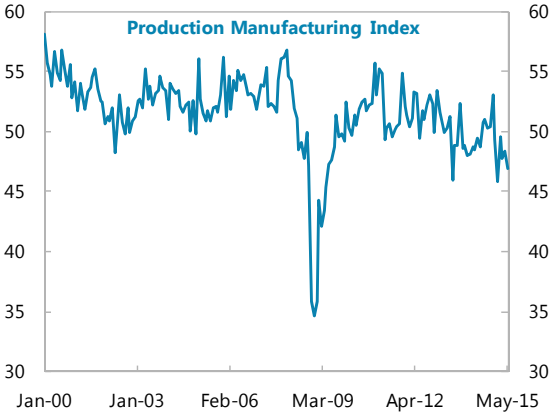
The exchange rate depreciation put upward pressure on inflation.



Falling real wages and confidence are leading to a fall in consumption...



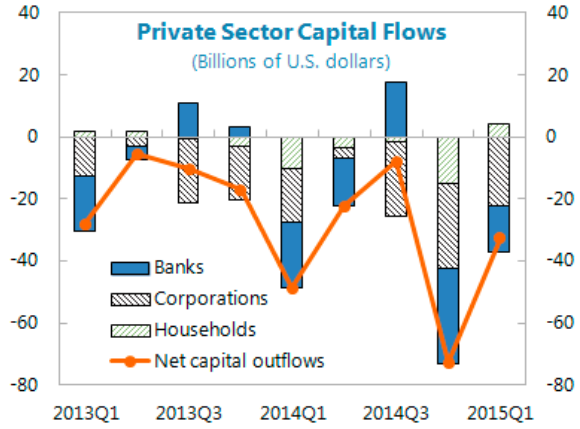
... and PMI points to a recession.



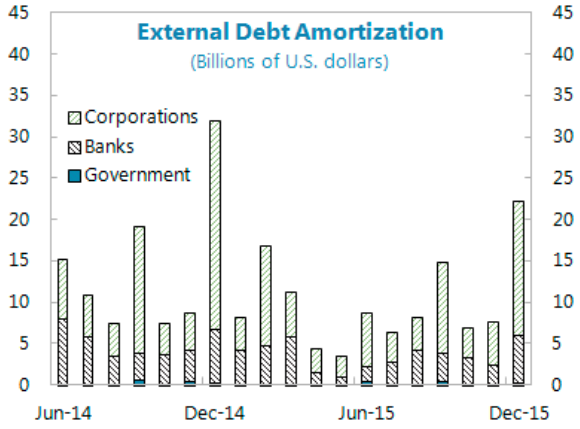
Sources: *World Economic Outlook*; Russian authorities; and IMF staff estimates and calculations.

Figure 2. Russian Federation: Monetary and Financial Developments, 2013–15

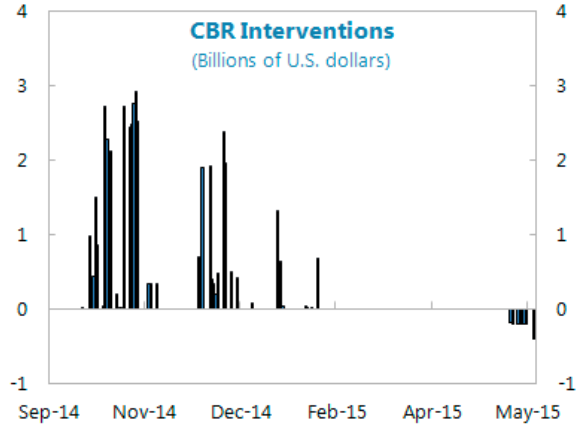
The ruble depreciation intensified in Q4 2014 due to the decline in oil prices, sanctions and weakening confidence…



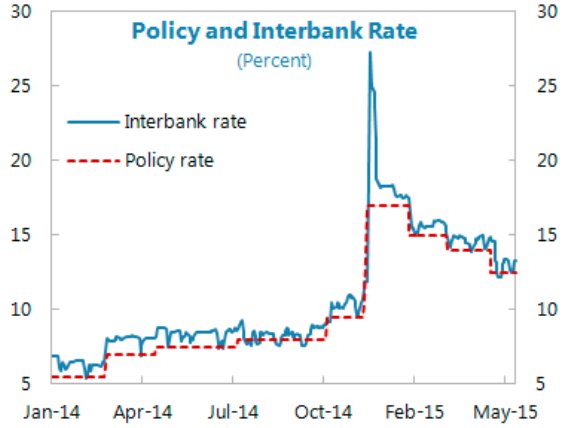
… in the context of large external debt redemptions in December 2014.



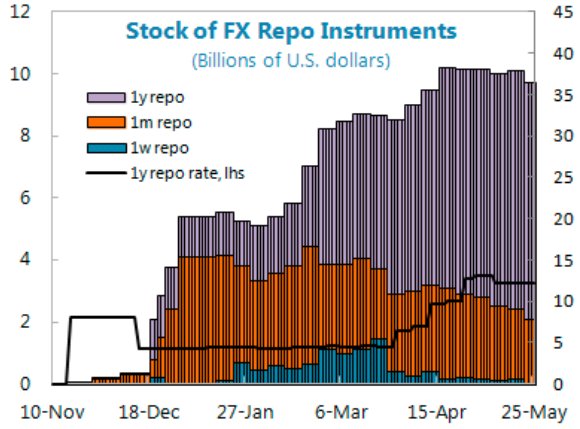
Large FX interventions by the CBR in October were followed by a move to a flexible exchange rate…



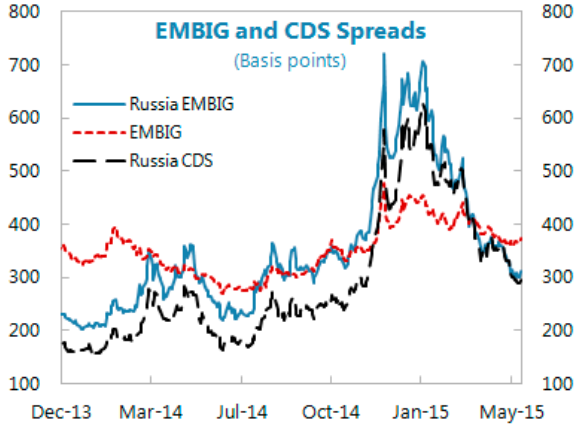
… and an emergency policy rate hike in December of 650bps to stem ruble pressures …



… and increased provision of FX via FX liquidity facilities.



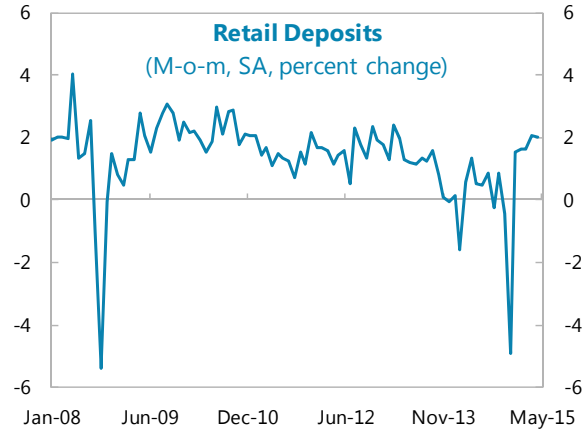
These steps supported a stabilization of markets and risk sentiments.



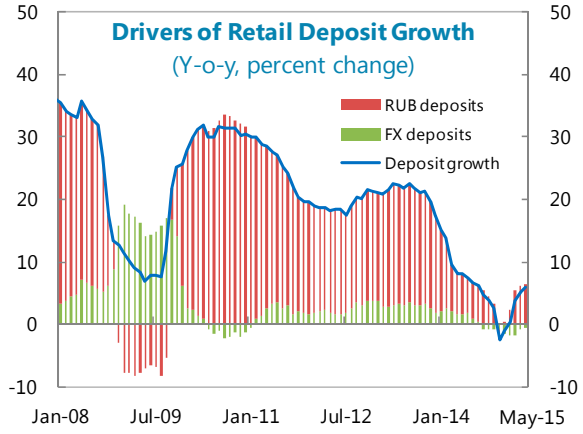
Sources: Central Bank of the Russian Federation; Bloomberg; and IMF staff estimates and calculations.

Figure 3. Russian Federation: Banking Sector Developments, 2008–15

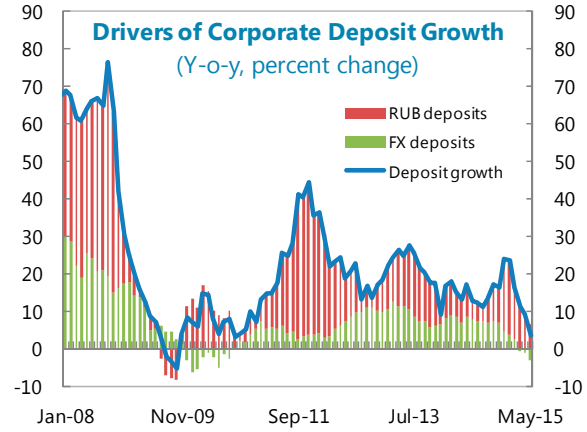
Weakening depositor confidence led to a short-lived deposit outflows...



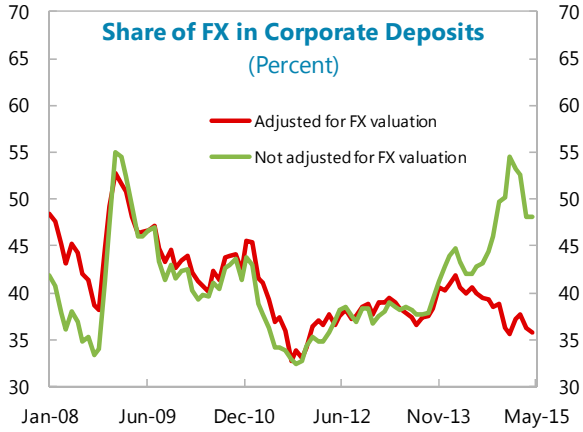
...in both FX and rubles...



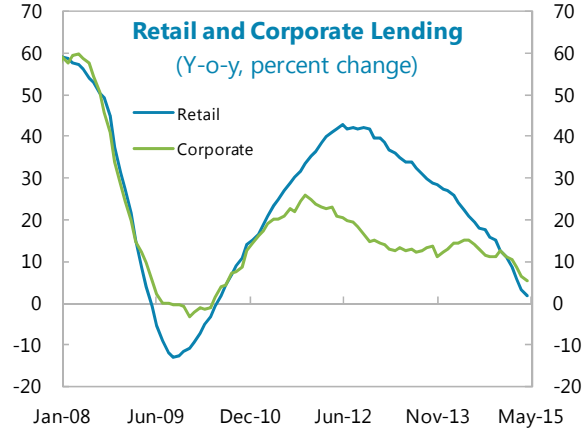
...while corporations increased ruble savings given the weak economic outlook...



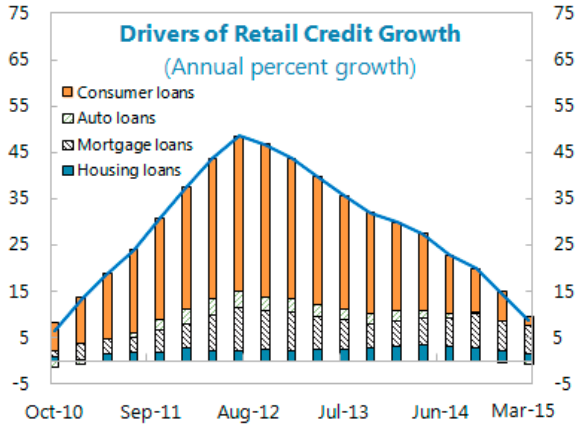
...but dollarization has not grown after controlling for valuation changes.



Financial tightening is slowing credit growth ...



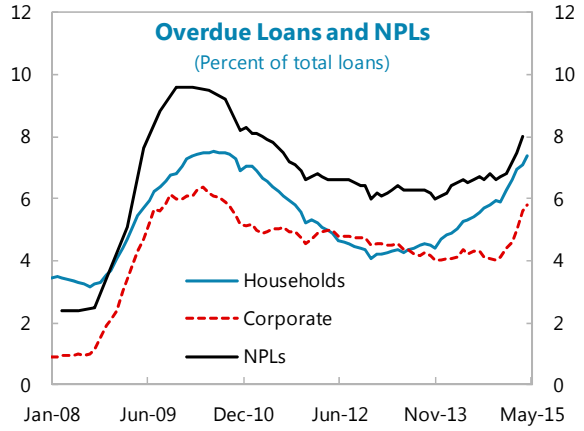
... driven by the retail segment, especially unsecured consumer lending.



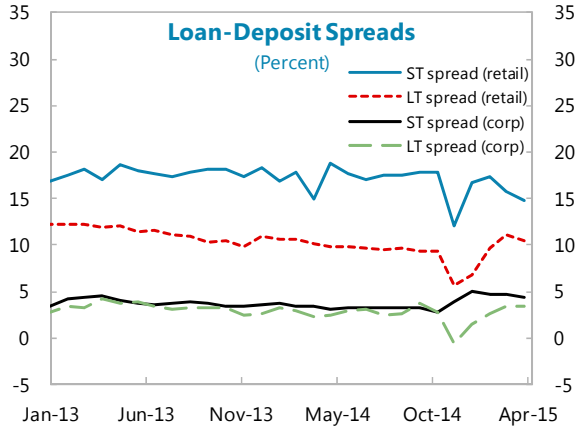
Sources: Central Bank of the Russian Federation; IMF staff estimates and calculations.

Figure 4. Russian Federation: Banking Sector Soundness, 2011–15

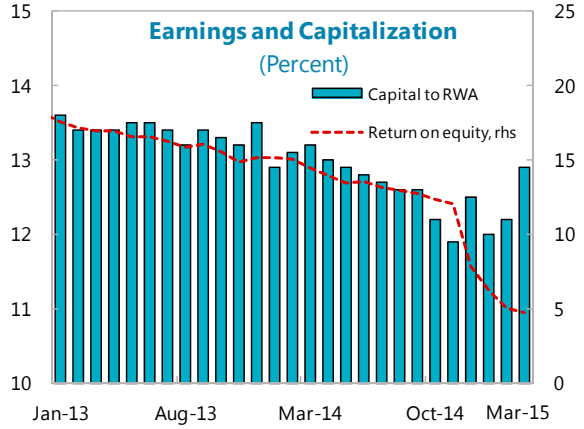
Decelerating economic activity is taking a toll on credit quality...



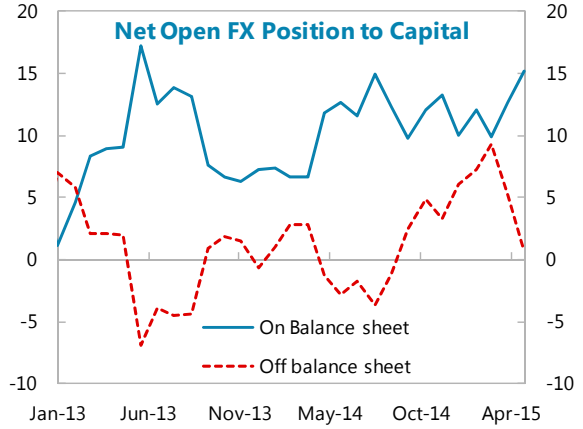
...while high policy rates have weakened banks' funding costs...



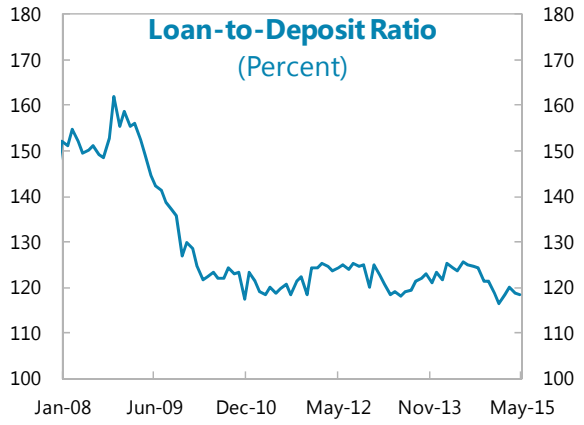
... which in turn are pressuring earnings and capitalization...



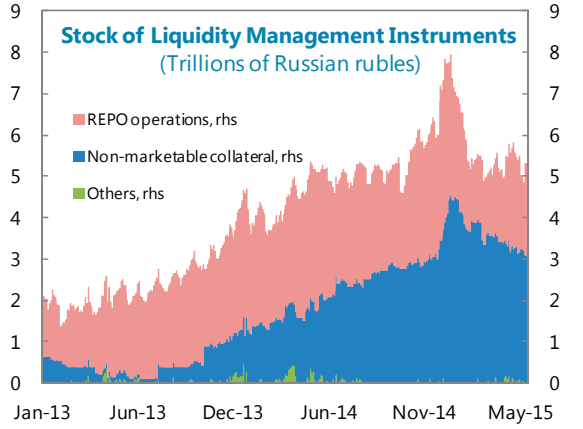
...but banks' net open FX position remained positive.



Banks' loan-to-deposit ratio is improving...



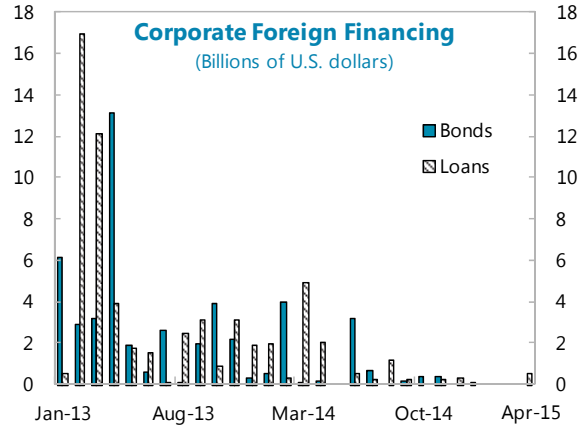
... and reliance on CBR liquidity is easing.



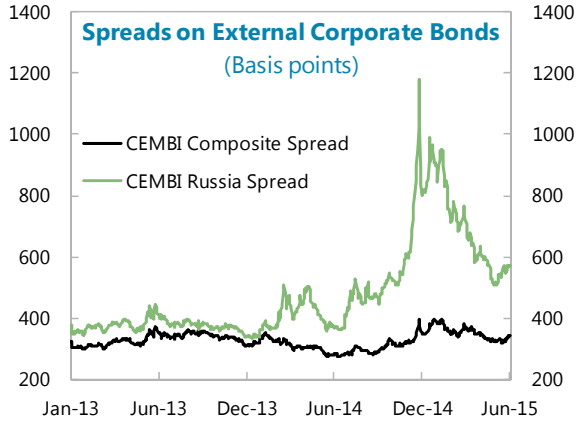
Source: Central Bank of Russia; Haver Analytics, and IMF staff calculations.

Figure 5. Russian Federation: Corporate Sector Developments, 2008–15

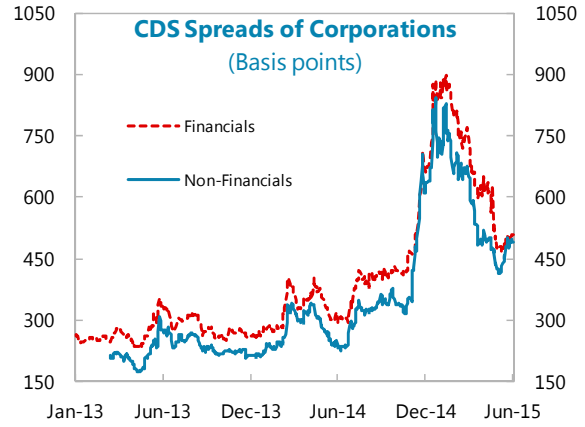
Sanctions have cut off external financing to most Russian companies...



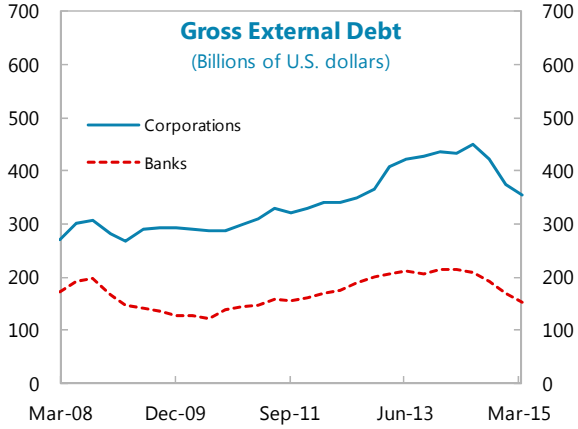
... which have been facing higher external borrowing costs...



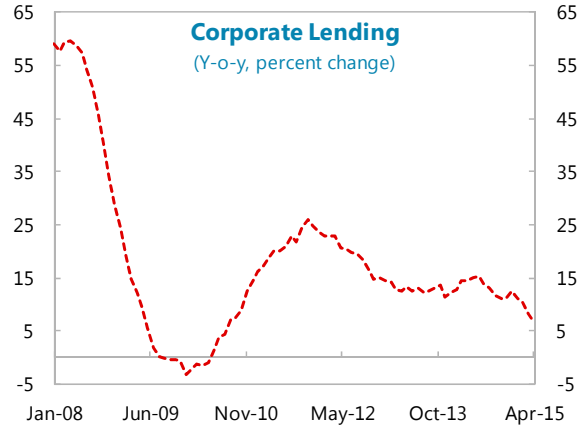
... and markets priced higher default risk ...



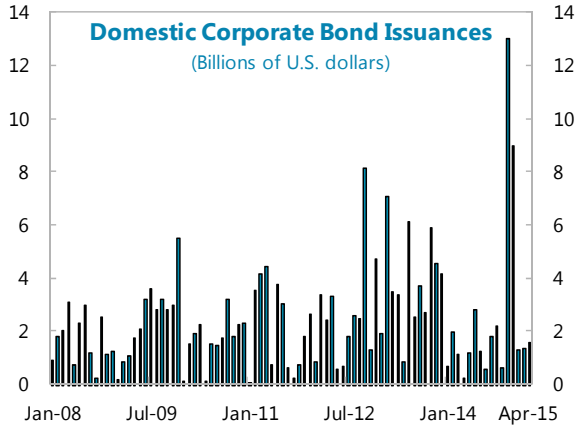
... leading to external deleveraging.



Corporations are turning to local banks, allowing corporate credit growth to proceed at a healthy pace, ...



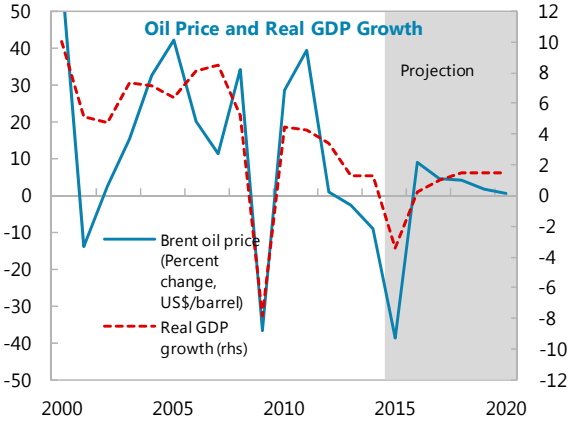
... while tapping more strongly domestic bond markets than before.



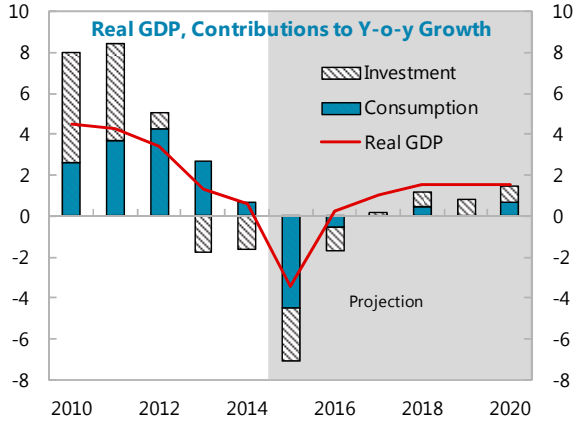
Sources: Central Bank of the Russian Federation; Dealogic; Bloomberg; and IMF staff estimates and calculations.

Figure 6. Russian Federation: Selected Macroeconomic Indicators: 2000–20

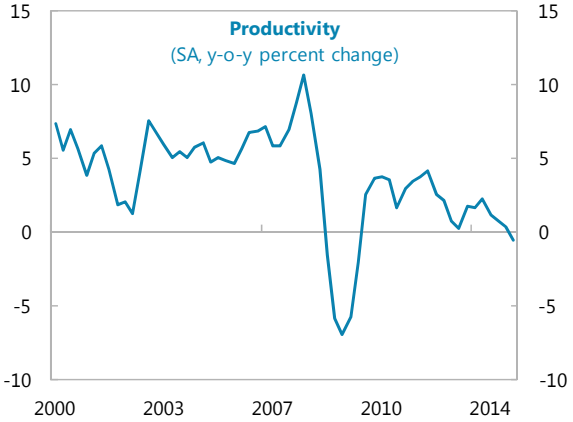
Growth is expected to contract with the drop in oil prices and sanctions...



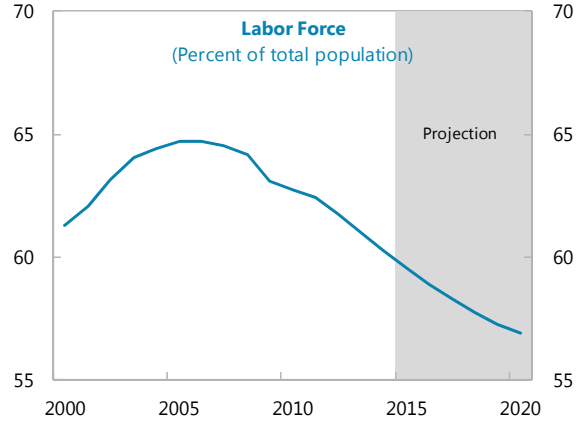
... weakening domestic demand in 2015 and 2016.



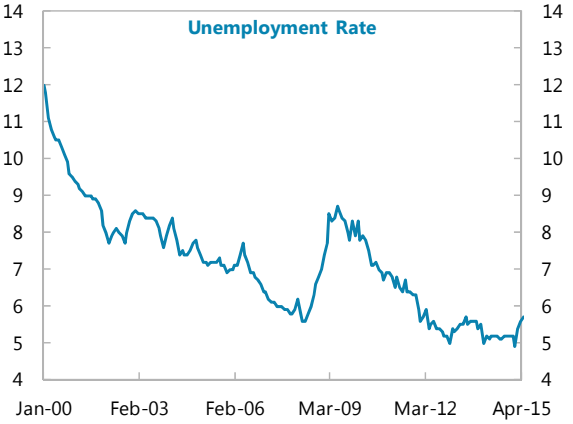
A pre-existing downward trend in productivity is likely to deepen further...



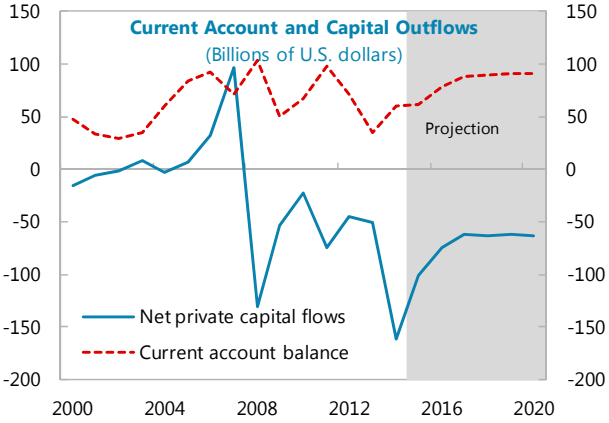
... while the labor force is expected to continue declining.



Unemployment remains at record lows...



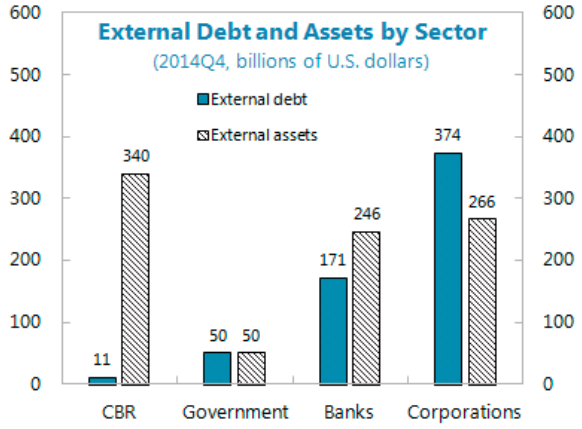
...and capital outflows at record highs.



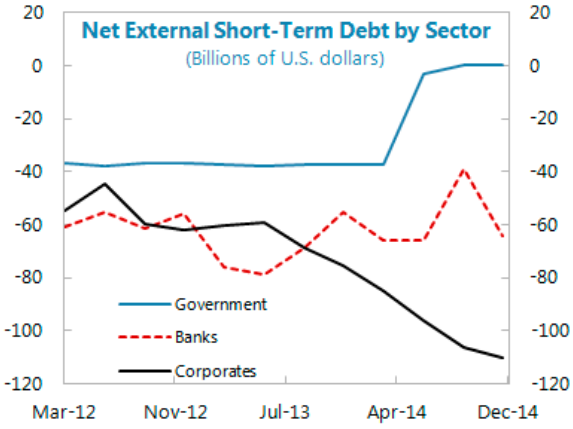
Sources: Russian authorities; International Labour Organization; Haver Analytics; and IMF staff calculations.

Figure 7. Russian Federation: External Position, 2008–15

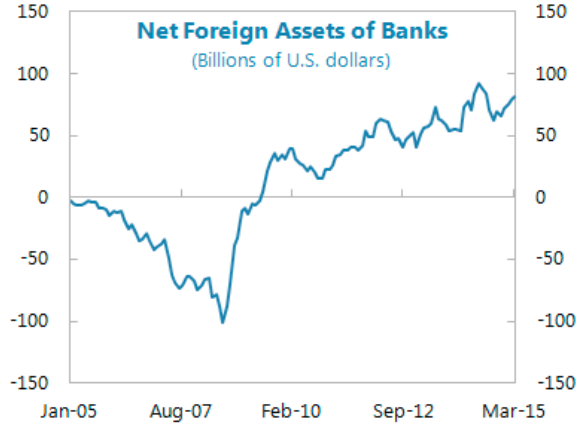
The corporate sector is the only sector with more external liabilities than assets...



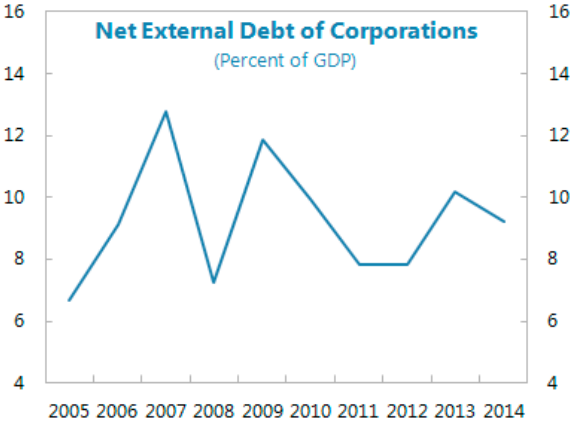
... while no sector shows maturity risk with short-term assets exceeding short-term debt in aggregate.



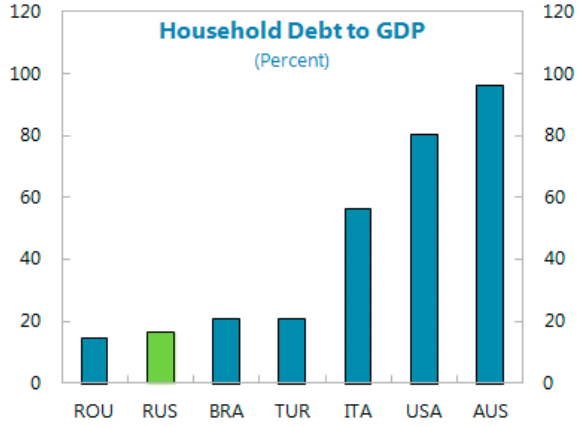
Compared to 2007, banks have a positive net foreign asset position...



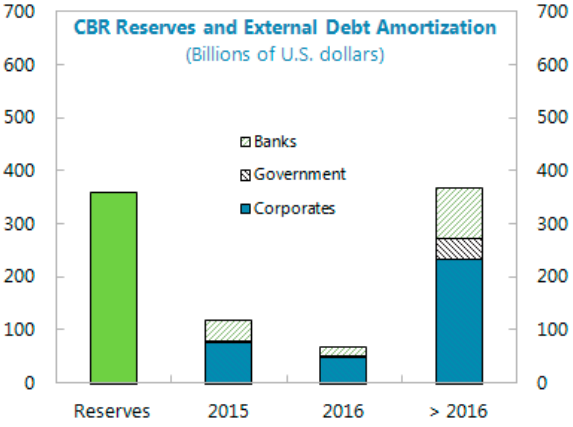
...and corporations have a lower net external debt position...



... while household debt is domestic and low.

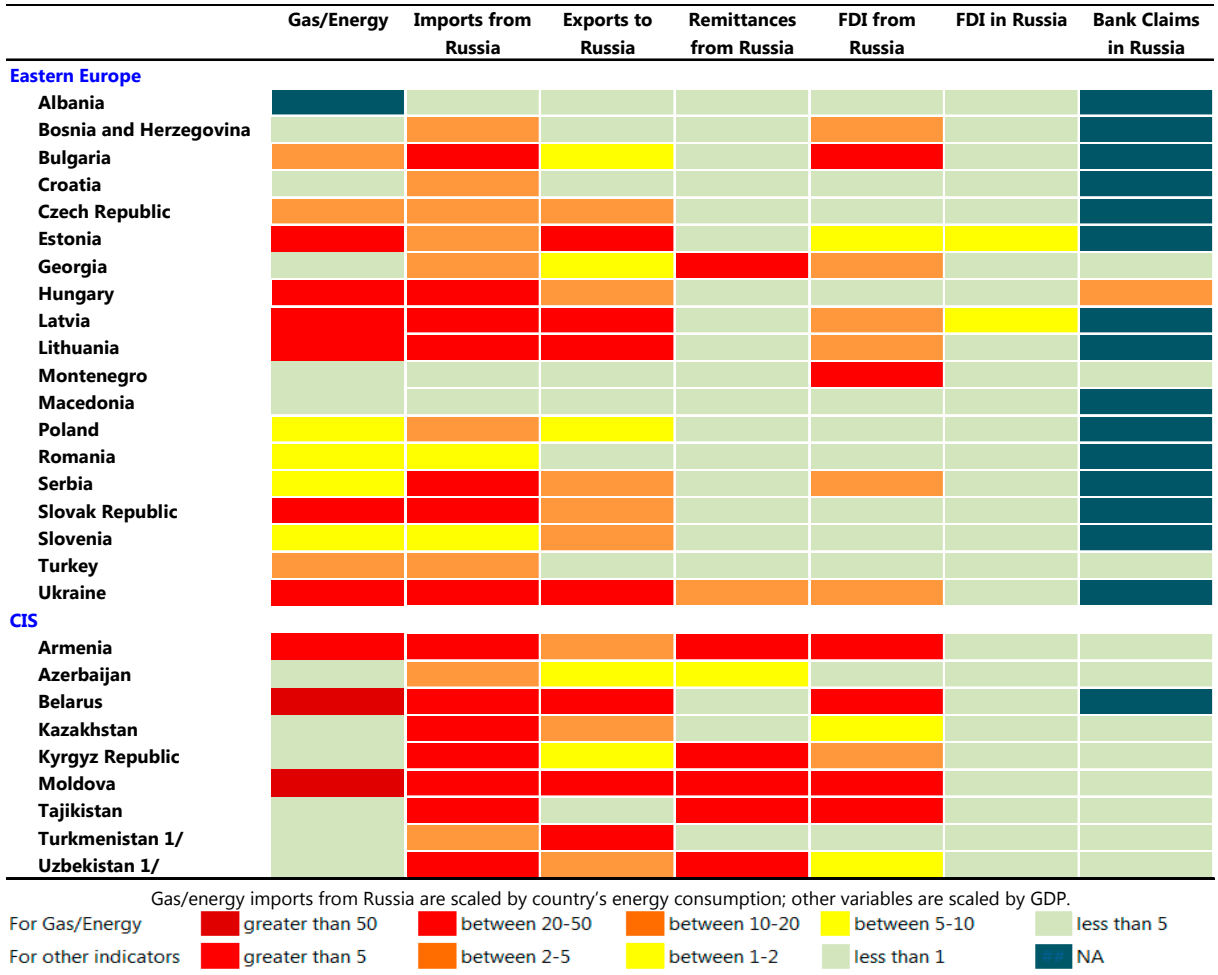


Exchange rate and liquidity risks are mitigated by the CBR's large reserve level.



Source: Central Bank of the Russian Federation; IMF staff estimates and calculations.

Figure 8. Exposures to Russia, 2014 (or the latest available)

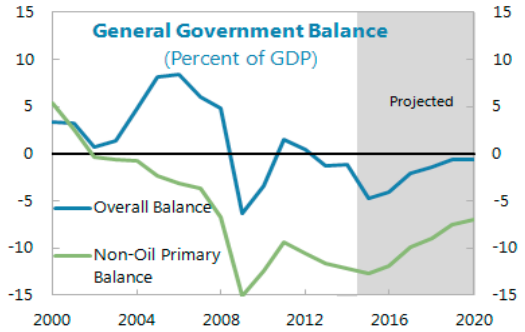


1/ Gas exporters to Russia

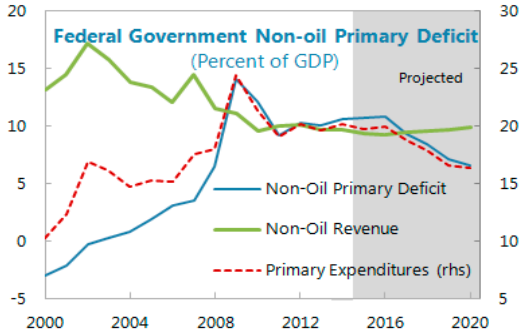
Source: IMF staff estimates and calculations.

Figure 9. Russian Federation: Fiscal Policy, 2000–20

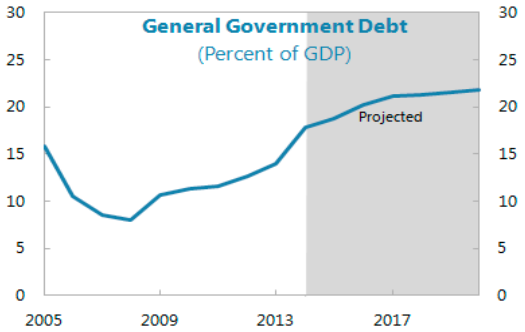
The benign overall balance masks a large non-oil deficit



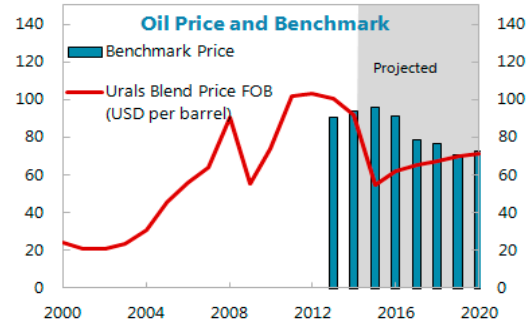
In the past, the non-oil deficit increased because of expenditures. Over the projection, lower expenditures will improve the deficit.



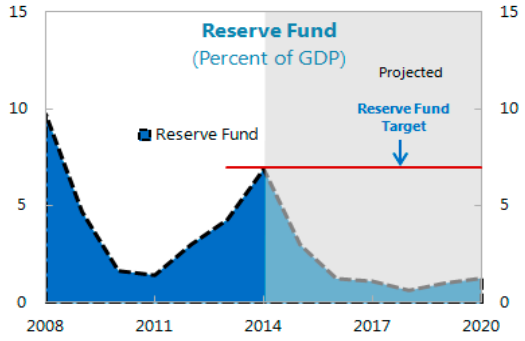
General government debt (including guarantees) is expected to remain low, reflecting the use of the Reserve Fund to partially finance federal deficits in 2015-16



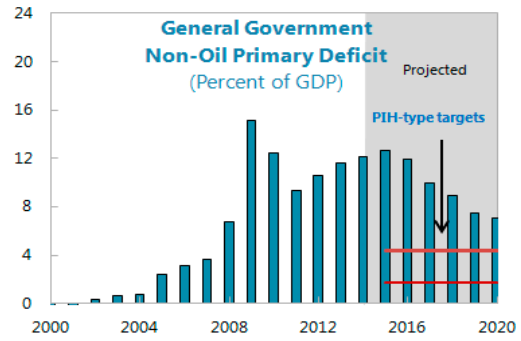
Under the fiscal rule, federal spending depends in part on a benchmark oil price. Oil revenue savings occur when benchmark price is lower than the current one.



Fiscal rule does not generate enough savings in the Reserve Fund (7 percent of GDP) to provide a buffer against volatile oil prices.



Nor does it generate enough savings for intergenerational equity.

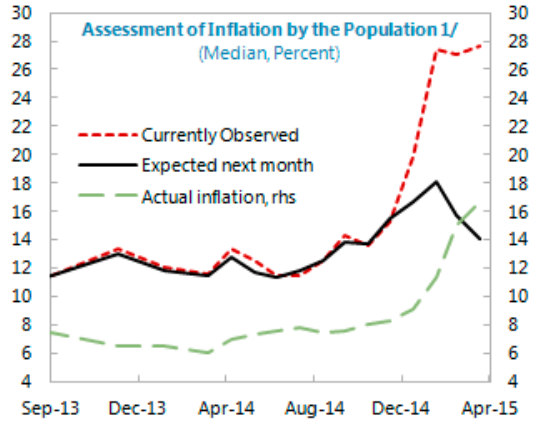


Lower target: nominal perpetuity starting in 2021
Upper target: 50-year real annuity starting in 2021

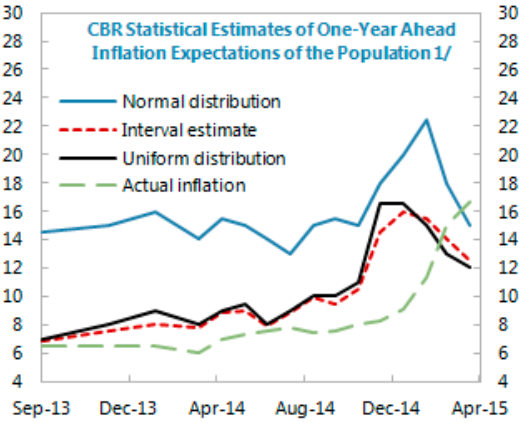
Sources: Russian authorities; and IMF staff estimates and calculations.

Figure 10. Russian Federation: Inflation Expectations, 2009–15

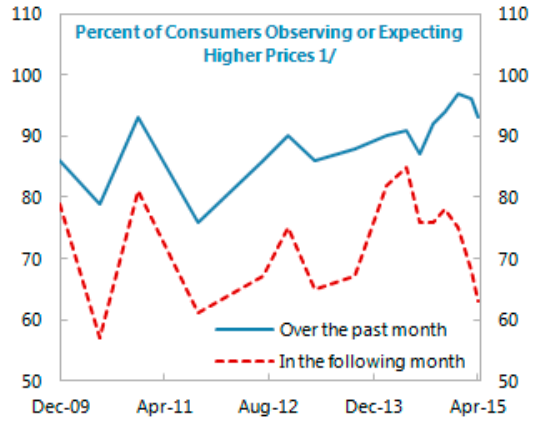
Inflation expectations of the population have been typically adaptive and above observed inflation.



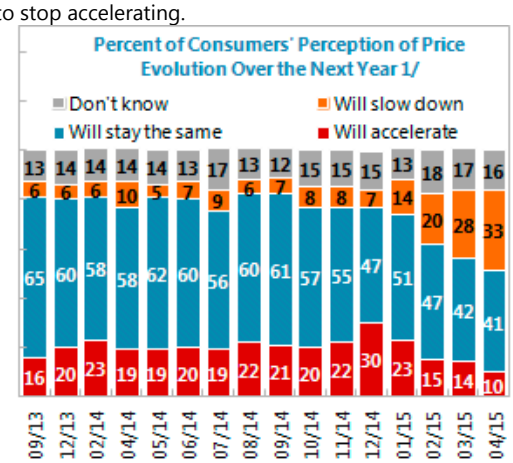
Over the past few months, one-year ahead inflation expectations have come down, although they remain high.



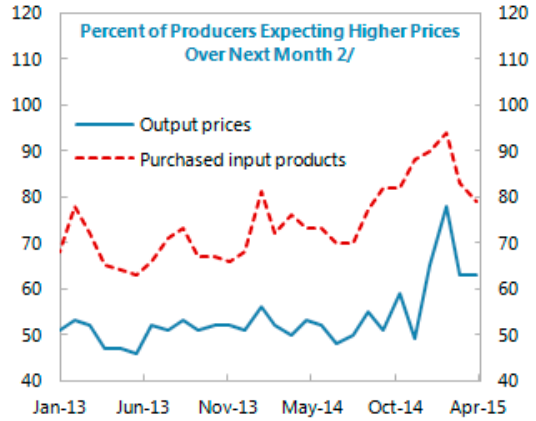
In the very short term, a lower proportion of consumers expect prices to increase...



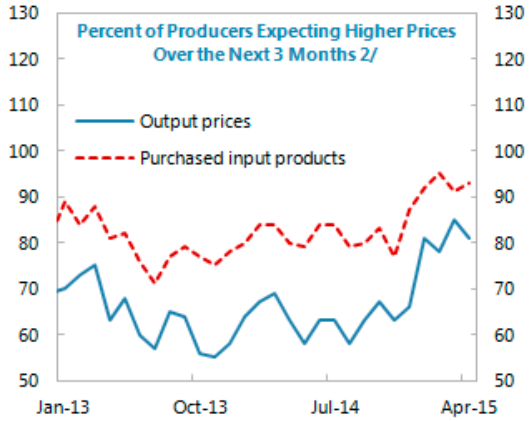
... with an increasing proportion of respondents expect prices to stop accelerating.



Price expectations of producers are starting to level off for the very short term...



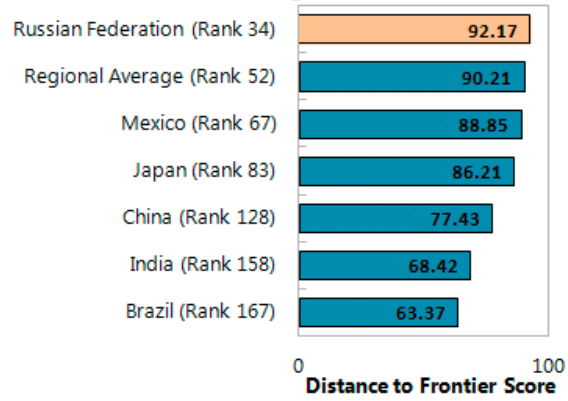
...and fewer producers are now expecting higher prices over the next three months than before.



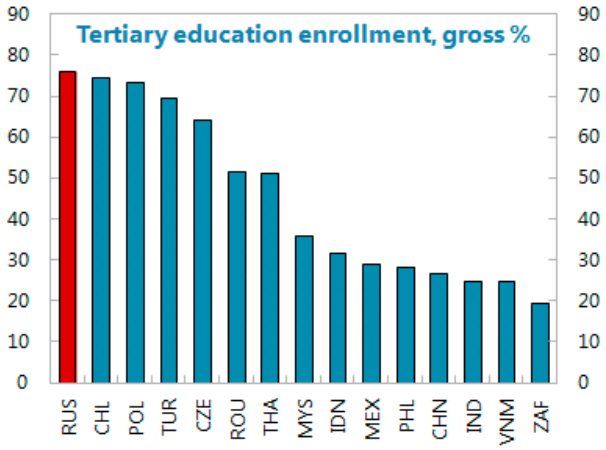
Sources: 1/ Central Bank of Russia and Public Opinion Foundation Survey; 2/ Russia Economic Barometer.

Figure 11. Russian Federation: Russia Faces Structural Problems, 2014

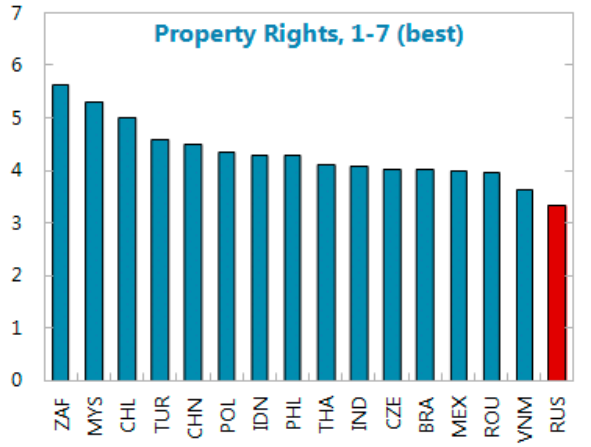
Starting a business in Russia is now easier than in the past...



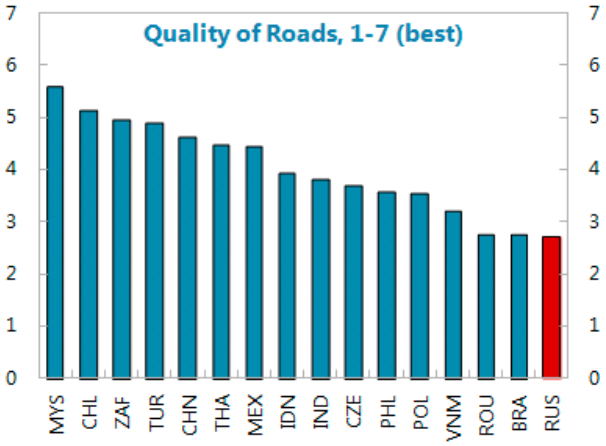
... and human capital levels are high.



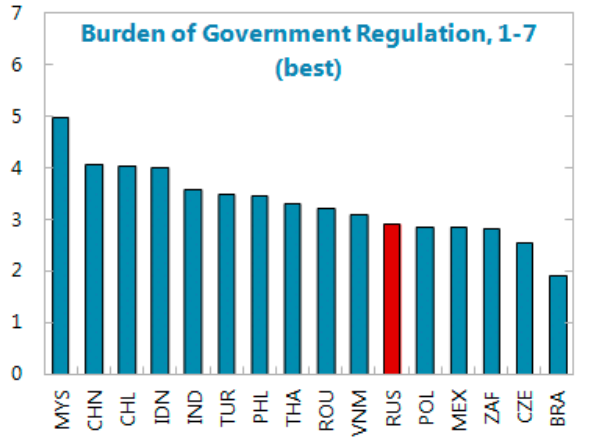
Property rights remain relatively weak...



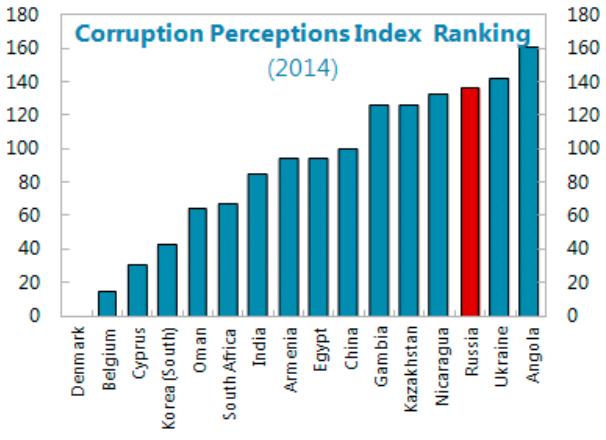
... while infrastructure is not in good shape.



Government regulation remains relatively high....



...and governance can be improved.



Sources: Global Competitiveness Report; Transparency International; and Ease of Doing Business Report.

Table 1. Russian Federation: Selected Macroeconomic Indicators, 2008–16

	2008	2009	2010	2011	2012	2013	2014	2015	2016
								Proj.	
				(Annual percent change)					
Production and prices									
Real GDP	5.2	-7.8	4.5	4.3	3.4	1.3	0.6	-3.4	0.2
Real domestic demand	9.1	-14.2	8.5	9.1	5.5	1.0	-1.1	-7.6	-1.8
Consumption	8.6	-3.9	3.5	5.3	6.4	3.9	0.9	-6.2	-0.8
Investment	10.5	-41.0	28.5	21.0	3.1	-7.1	-7.3	-12.6	-5.9
Consumer prices									
Period average	14.1	11.7	6.9	8.4	5.1	6.8	7.8	15.6	7.5
End of period	13.3	8.8	8.8	6.1	6.6	6.5	11.4	12.5	7.8
GDP deflator	18.0	2.0	14.2	15.9	7.4	5.1	7.2	7.4	8.8
Unemployment rate	6.2	8.2	7.3	6.5	5.5	5.5	5.2	6.5	6.5
				(Percent of GDP)					
Public sector 1/									
General government									
Net lending/borrowing (overall balance)	4.9	-6.3	-3.4	1.5	0.4	-1.3	-1.2	-4.8	-4.2
Revenue	39.2	35.0	34.6	37.3	37.7	36.9	37.5	35.0	35.3
Expenditures	34.3	41.4	38.0	35.7	37.3	38.2	38.7	39.8	39.5
Primary balance	5.3	-5.7	-2.9	2.1	1.0	-0.6	-0.4	-3.8	-3.0
Nonoil balance	-7.0	-14.8	-12.5	-9.7	-10.8	-12.0	-12.6	-13.3	-13.0
Federal government									
Net lending/borrowing (overall balance)	4.1	-6.0	-3.9	0.8	-0.1	-0.5	-0.5	-3.3	-3.9
Nonoil balance	-6.8	-13.8	-12.3	-9.5	-10.6	-10.5	-11.0	-11.3	-12.0
				(Annual percent change)					
Money									
Base money	2.9	7.4	25.4	20.9	11.3	8.0	6.3	2.3	6.4
Ruble broad money	0.8	17.7	31.1	22.3	11.9	14.6	2.2	3.3	8.6
Credit to the economy	37.2	2.6	12.9	27.9	19.5	17.2	22.8	4.2	6.8
External sector									
Export volumes	-2.6	-10.4	5.4	4.3	2.9	2.0	0.1	4.6	2.7
Oil	-2.6	3.0	3.2	-1.9	0.4	2.7	0.1	2.4	-1.0
Gas	1.8	-13.8	5.6	6.7	-5.8	9.9	-11.3	0.8	1.6
Non-energy	-4.4	-23.2	11.0	6.7	5.6	5.7	7.6	7.8	7.0
Import volumes	11.1	-31.4	27.4	16.8	8.3	3.5	-7.2	-21.8	0.0
				(Billions of U.S. dollars; unless otherwise indicated)					
External sector									
Total merchandise exports, f.o.b	466.3	297.2	392.7	515.4	527.4	523.3	497.8	374.6	404.9
Total merchandise imports, f.o.b	-288.7	-183.9	-245.7	-318.6	-335.8	-341.3	-308.0	-230.0	-230.5
External current account	103.9	50.4	67.5	97.3	71.3	34.1	59.5	60.8	78.5
External current account (percent of GDP)	6.3	4.1	4.4	5.1	3.5	1.6	3.2	4.5	5.5
Gross international reserves									
Billions of U.S. dollars	427.1	439.5	479.4	498.6	537.6	509.6	405.2	362.4	374.8
Months of imports 2/	14.0	21.3	17.9	14.6	14.5	13.0	11.3	13.6	13.6
Percent of short-term debt	288	303	339	331	257	251	320	496	281
Memorandum items:									
Nominal GDP (billions of rubles)	41,277	38,807	46,309	55,967	62,176	66,190	71,406	74,045	80,715
Nominal GDP (billions of U.S. dollars)	1,665	1,230	1,524	1,905	2,016	2,079	1,861	1,337	1,433
Exchange rate (rubles per U.S. dollar, period average)	24.9	31.7	30.4	29.4	30.8	31.8	38.4	...	...
Oil exports (billions of U.S. dollars)	241.0	148.7	206.3	277.5	284.6	283.0	269.8	160.6	173.8
World oil price (U.S. dollars per barrel) 3/	97.0	61.8	79.0	104.0	112.0	108.8	98.9	61.5	67.2
Urals crude oil spot price (U.S. dollars per barrel)	94.6	61.3	78.3	109.3	110.3	107.6	109.0	60.1	65.8
Oil Extraction (millions of tons) 4/	488.0	492.3	505.3	512.4	518.7	521.7	525.1	525.0	517.1
Real effective exchange rate (average percent change)	6.8	-6.9	9.3	4.9	1.5	1.8	-8.5	...	...

Sources: Russian authorities; and IMF staff estimates.

1/ Cash basis.
2/ In months of imports of goods and non-factor services.
3/ WEO through 2011; and Brent crude oil spot and futures prices for 2012-16.
4/ Previously reported as "Taxable oil volume (millions of tons)"

Table 2. Russian Federation: Balance of Payments, 2012–20

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

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
Current Account	71.3	34.1	59.5	60.8	78.5	88.4	89.4	91.5	91.1
Trade Balance	191.7	181.9	189.7	144.6	174.4	187.6	191.7	197.8	201.4
Exports	527.4	523.3	497.8	374.6	404.9	426.5	449.1	468.4	488.9
Non-energy	180.6	173.0	172.8	171.2	183.4	198.4	214.6	232.1	252.0
Energy	346.8	350.2	325.0	203.5	221.5	228.1	234.5	236.3	236.9
Oil	284.6	283.0	269.8	160.6	173.8	178.0	182.2	182.9	182.8
Gas	62.3	67.2	55.2	42.9	47.7	50.1	52.3	53.4	54.1
Imports	-335.8	-341.3	-308.0	-230.0	-230.5	-238.9	-257.3	-270.6	-287.4
Services	-46.6	-58.3	-55.2	-36.4	-41.4	-50.6	-54.6	-56.4	-59.5
Income	-67.7	-80.2	-67.2	-47.6	-54.3	-48.0	-46.8	-48.0	-47.7
Public sector interest (net)	1.2	-0.9	-0.6	-0.5	0.8	2.1	2.9	3.0	3.0
Other sectors	-68.9	-79.4	-66.6	-47.2	-55.1	-50.1	-49.7	-51.0	-50.7
Current transfers	-6.1	-9.3	-7.9	0.2	-0.2	-0.5	-0.9	-1.9	-3.1
Capital and financial account	-30.9	-45.4	-172.6	-103.6	-66.1	-48.8	-49.3	-46.7	-55.0
Capital transfers	-5.2	-0.4	-42.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial accounts									
Federal government	16.4	5.3	31.1	-2.2	8.1	13.7	13.5	15.8	8.6
Portfolio investment	17.1	10.1	-7.7	-1.8	8.5	14.1	13.9	16.2	9.0
Loans	-0.8	-1.0	33.9	0.0	0.0	0.0	0.0	0.0	0.0
Other investment	0.1	-3.8	4.9	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Local governments	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0
Private sector capital	-45.4	-51.2	-161.6	-101.3	-74.1	-62.4	-62.7	-62.6	-63.6
Direct investment	1.8	-16.0	-35.4	-18.0	-19.9	-30.1	-30.6	-30.7	-30.7
Portfolio investment	-9.9	-13.2	-17.8	-17.8	-12.7	-13.2	-13.7	-14.3	-14.9
Other investment, commercial banks	17.0	-15.3	-49.4	-5.4	-6.6	-6.6	-3.3	-4.5	-5.8
Assets	-8.5	-26.6	-7.7	20.9	0.0	0.0	-15.0	-16.6	-18.3
Liabilities (loans, deposits, etc.)	25.5	11.3	-41.7	-26.3	-6.6	-6.6	11.7	12.1	12.6
Loans, corporations	6.7	44.7	-5.7	-50.2	-14.0	-12.9	0.9	0.9	0.9
Disbursements	88.0	159.6	121.7	27.0	34.1	73.4	84.2	84.4	84.7
Amortizations	-81.4	-115.0	-127.4	-77.2	-48.1	-86.3	-83.3	-83.5	-83.7
Other private sector capital flows	-60.9	-51.2	-53.2	-10.0	-21.0	0.4	-16.0	-14.0	-13.2
Errors and omissions, net	-10.4	-10.8	8.8	0.0	0.0	0.0	0.0	0.0	0.0
Of which : valuation adjustment	5.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	30.0	-22.1	-104.4	-42.8	12.3	39.7	40.1	44.7	36.1
Financing	-30.0	22.1	104.4	42.8	-12.3	-39.7	-40.1	-44.7	-36.1
Net international reserves	-30.0	22.1	104.4	42.8	-12.3	-39.7	-40.1	-44.7	-36.1
Arrears and rescheduling	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Current account (percent of GDP)	3.5	1.6	3.2	4.5	5.5	5.8	5.5	5.2	4.7
Non-energy current account (percent of GDP)	-13.7	-15.2	-14.3	-10.7	-10.0	-9.1	-8.9	-8.2	-7.6
Gross reserves 1/	537.6	509.6	405.2	362.4	374.8	414.4	454.6	499.3	535.4
(months of imports of GNFS)	14.5	13.0	11.3	13.6	13.6	14.1	14.3	15.0	15.1
(percent of short-term debt) 2/	257.2	251.5	320.0	496.4	281.4	323.1	348.9	378.6	413.5
Real growth in partner countries (percent change)	1.3	1.7	1.8	1.9	2.6	2.7	2.8	2.8	2.8
Net private capital flows (percent of exports of GNFS)	-7.7	-8.6	-28.7	-23.6	-16.0	-12.7	-12.1	-11.6	-11.2
Net private capital flows, banks	15.9	-15.3	-47.5	-2.7	-2.8	-2.7	0.7	-0.4	-1.7
Public external debt service payments 3/	8.8	11.0	8.1	6.5	5.4	7.1	7.7	6.9	5.9
(percent of exports of goods and services)	1.5	1.9	1.4	1.5	1.2	1.5	1.5	1.3	1.0
Public external debt 4/	70.1	77.7	69.3	67.4	75.8	89.8	103.6	119.9	128.8
(percent of GDP)	3.5	3.7	3.7	5.0	5.3	5.9	6.4	6.8	6.7
Private external debt	566.4	651.2	607.1	534.3	517.9	504.2	522.7	542.3	562.4
(percent of GDP)	28.1	31.3	32.6	39.9	36.1	32.9	32.1	30.7	29.2
Total external debt	636.4	728.9	676.4	601.7	593.6	593.9	626.3	662.2	691.3
(percent of GDP)	31.6	35.1	36.4	44.9	41.4	38.8	38.4	37.5	35.9
World oil price (U.S. dollars per barrel) 5/	112.0	108.8	98.9	61.5	67.2	70.0	72.5	74.1	75.0
Urals oil price (U.S. dollars per barrel)	110.3	107.6	109.0	60.1	65.8	68.6	71.1	72.7	73.6
Terms of trade (percent)	2.3	-1.0	-2.2	-24.6	5.0	2.0	1.7	0.9	1.0

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.
5/ WEO through 2011; Brent crude oil spot and futures prices for 2012-16.

Table 3. Russian Federation: External Financing, 2012–20

(Billions of U.S. dollars)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
Gross financing requirements	-74	-170	-138	-60	11	-39	-33	-33	-35
Current account balance	71	34	59	61	78	88	89	91	91
Debt amortization	-146	-204	-197	-121	-67	-127	-122	-124	-126
Public sector	-6	-7	-5	-4	-3	-4	-3	-2	0
Central Bank									
General government	-6	-7	-5	-4	-3	-4	-3	-2	0
Banks	-58	-82	-65	-40	-17	-38	-36	-39	-42
Corporates	-81	-115	-127	-77	-48	-86	-83	-84	-84
Sources of financing	105	148	34	18	2	79	73	77	71
Capital account balance (net)	-5	0	-42	0	0	0	0	0	0
Foreign direct investment (net)	2	-16	-35	-18	-20	-30	-31	-31	-31
RUS investment abroad	-49	-87	-56	-39	-41	-53	-55	-58	-60
Foreign investment in RUS	51	71	21	21	21	23	25	27	30
New borrowing and debt rollover	178	259	145	41	46	113	140	144	139
Borrowing	178	259	145	41	46	113	140	144	139
Public sector	7	7	0	0	2	9	8	9	0
Central Bank									
General government	7	7	0	0	2	9	8	9	0
Banks	84	93	23	14	10	31	47	51	55
Corporates	88	160	122	27	34	73	84	84	85
Other	-70	-95	-34	-5	-25	-4	-36	-36	-38
of which: Net errors and omissions	-10	-11	9	0	0	0	0	0	0
GIR change	30	-22	-104	-43	12	40	40	45	36
Financing gap	0	0	0	0	0	0	0	0	0

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

Table 4. Russian Federation: Fiscal Operations, 2012–20 1/

(Percent of GDP, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
General government									
Revenue	37.7	36.9	37.5	35.0	35.3	36.1	36.1	35.7	35.4
o/w Oil revenue	11.3	10.7	11.4	8.5	8.8	9.1	8.7	8.2	7.6
o/w Nonoil revenue	26.4	26.3	26.1	26.4	26.5	27.0	27.4	27.5	27.8
Taxes	28.5	27.7	28.2	25.1	25.5	26.2	26.2	25.8	25.5
Corporate profit tax	3.8	3.1	3.3	3.4	3.5	3.5	3.6	3.7	3.8
Personal income tax	3.6	3.8	3.8	3.7	3.8	4.0	4.1	4.1	4.1
VAT	5.7	5.3	5.5	5.4	5.5	5.7	5.8	5.9	6.1
Excises	1.3	1.5	1.5	1.4	1.4	1.5	1.5	1.5	1.5
Custom tariffs	8.0	7.6	7.7	4.7	4.1	3.7	3.5	3.3	3.1
Resource extraction tax	4.2	4.3	4.5	4.5	5.2	5.8	5.7	5.4	5.0
Other tax revenue	1.9	2.0	1.9	2.0	2.0	2.0	2.0	2.0	2.0
Social contributions	6.6	7.1	7.1	7.3	7.4	7.6	7.6	7.7	7.6
Other revenue	2.5	2.2	2.2	2.6	2.3	2.3	2.3	2.2	2.2
Expenditure	37.3	38.2	38.7	39.8	39.5	38.2	37.5	36.3	36.1
Expense	32.5	33.7	34.2	35.5	35.4	34.3	33.9	32.8	32.7
Compensation of employees	4.9	5.2	5.1	5.3	5.1	4.8	4.6	4.4	4.4
Use of goods and services	4.1	4.1	3.9	4.1	4.0	3.8	3.6	3.4	3.4
Interest	0.6	0.7	0.7	1.0	1.2	1.4	1.5	1.5	1.6
Subsidies	7.6	7.6	9.2	8.0	7.9	7.6	7.4	7.1	7.1
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social benefits	13.1	14.2	13.9	14.6	15.7	15.6	15.5	15.5	15.4
Other expense	0.8	0.9	0.3	1.6	0.8	0.4	0.4	0.0	0.2
Net acquisition of nonfinancial assets	4.8	4.6	4.5	4.3	4.1	3.9	3.7	3.5	3.3
Net lending (+)/borrowing (-) (overall balance)	0.4	-1.3	-1.2	-4.8	-4.2	-2.2	-1.4	-0.6	-0.6
Non-oil primary structural balance	-10.8	-11.8	-11.0	-11.4	-11.8	-9.9	-8.9	-7.5	-7.0
Federal government									
Revenue	20.7	19.7	20.3	17.6	17.4	17.9	17.7	17.2	16.9
o/w Oil revenue	10.5	10.0	10.6	7.9	8.0	8.3	8.1	7.5	7.0
o/w Nonoil revenue	10.2	9.7	9.7	9.6	9.4	9.5	9.6	9.7	9.9
Expenditure	20.7	20.2	20.8	20.9	21.4	20.0	19.2	17.8	17.6
Expense	18.0	17.4	17.9	18.0	35.4	34.3	33.9	32.8	32.7
Net acquisition of nonfinancial assets	2.8	2.7	2.8	2.8	2.7	2.5	2.3	2.1	2.0
Net lending (+)/borrowing (-) (overall balance)	-0.1	-0.5	-0.5	-3.3	-3.9	-2.1	-1.5	-0.6	-0.8
Non-oil primary structural balance	-10.4	-10.2	-9.4	-10.5	-11.1	-9.4	-8.5	-7.1	-6.7
Memorandum items:									
General government nonoil primary balance	-10.2	-11.3	-11.9	-12.3	-11.8	-9.8	-8.7	-7.2	-6.7
General government nonoil overall balance	-10.8	-12.0	-12.6	-13.3	-13.0	-11.2	-10.2	-8.8	-8.3
Federal government nonoil primary balance	-10.3	-10.1	-10.7	-10.7	-11.3	-9.5	-8.6	-7.1	-6.7
Federal government nonoil overall balance	-10.6	-10.5	-11.0	-11.3	-12.0	-10.4	-9.6	-8.2	-7.7
World oil price (U.S.dollars per barrel) 2/	112.0	108.8	98.9	61.5	67.2	70.0	72.5	74.1	75.0
Urals prices (U.S. dollars per barrel)	110.3	107.6	109.0	60.1	65.8	68.6	71.1	72.7	73.6
Oil funds 3/	7.4	8.7	13.1	8.9	6.8	6.1	5.1	5.1	5.0
Reserve Fund	3.0	4.3	6.9	3.1	1.2	1.1	0.5	0.9	1.0
NWF	4.3	4.4	6.1	5.8	5.6	5.0	4.6	4.2	4.0
General government debt	12.7	14.0	17.8	18.8	20.2	21.4	21.6	22.0	22.2
GDP (billions of rubles)	62,176	66,190	71,406	74,045	80,715	86,480	91,961	96,758	102,292

Sources: Russian authorities; and IMF staff estimates.

1/ Cash basis.

2/ WEO through 2011; and Brent crude oil spot and futures prices for 2012-14.

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

Table 5. Russian Federation: Monetary Accounts, 2012–20

(Billions of Russian rubles, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
Monetary authorities									
Base money	7,960	8,598	9,140	9,349	9,943	10,565	11,137	11,614	12,095
Currency issued	7,668	8,307	8,841	8,934	9,489	10,070	10,600	11,039	11,480
Required reserves on ruble deposits	292	291	299	415	453	495	536	575	615
NIR 1/	15,767	16,112	20,706	19,215	21,279	22,679	24,119	26,032	27,630
Gross reserves	16,300	16,677	21,665	20,175	22,239	23,638	25,079	26,992	28,590
Gross liabilities	533	565	960	960	960	960	960	960	960
GIR (billions of U.S. dollars)	*537*	*510*	*385*	*367*	*380*	*419*	*460*	*504*	*540*
NDA	-7,807	-7,514	-11,566	-9,866	-11,336	-12,113	-12,982	-14,418	-15,535
Net credit to general government	-6,312	-7,060	-10,342	-7,334	-5,921	-6,148	-5,999	-6,724	-7,318
Net credit to federal government	-4,588	-5,505	-8,926	-6,407	-4,885	-4,860	-4,401	-4,782	-5,029
CBR net ruble credit to federal government 1/	-630	-431	-682	-4,504	-4,504	-4,504	-4,504	-4,504	-4,504
Foreign exchange credit	117	123	207	207	207	207	207	207	207
Ruble counterpart	-4,075	-5,198	-8,452	-2,110	-588	-563	-104	-485	-732
CBR net credit to local government and EBFs	-1,724	-1,555	-1,415	-928	-1,037	-1,288	-1,598	-1,942	-2,289
CBR net credit to local government	-698	-659	-701	-214	-323	-574	-884	-1,228	-1,575
CBR net credit to extrabudgetary funds	-1,026	-896	-714	-714	-714	-714	-714	-714	-714
Net credit to banks	1,498	3,233	6,512	4,903	1,343	744	-391	-1,197	-1,769
Gross credit to banks	3,257	5,021	8,617	5,600	3,400	2,400	1,800	800	200
Gross liabilities to banks and deposits	-1,760	-1,788	-2,106	-697	-2,057	-1,656	-2,191	-1,997	-1,969
Of which: correspondent account balances	-1,356	-1,270	-1,216	-1,201	-1,247	-1,293	-1,330	-1,354	-1,377
Other items (net) 2/	-2,993	-3,687	-7,736	-7,435	-6,759	-6,709	-6,592	-6,498	-6,448
Monetary survey									
Broad money	32,227	37,272	43,032	46,523	54,901	59,692	64,387	68,714	73,234
Ruble broad money	27,405	31,405	32,111	33,164	36,008	39,064	42,045	44,775	47,621
Currency in circulation	6,430	6,986	7,172	7,233	7,668	8,121	8,532	8,867	9,202
Ruble deposits	20,975	24,419	24,939	25,931	28,340	30,943	33,513	35,908	38,419
Forex deposits 1/	4,821	5,867	10,922	13,358	18,893	20,629	22,342	23,939	25,613
Net foreign assets 1/	16,985	17,881	24,720	23,280	25,777	27,159	28,420	30,273	31,910
NIR of monetary authorities	15,767	16,112	20,706	19,215	21,279	22,679	24,119	26,032	27,630
NFA of commercial banks	1,218	1,769	4,014	4,065	4,498	4,480	4,301	4,241	4,280
NFA of commercial banks (billions of U.S. dollars)	40	54	71	74	77	79	79	79	81
NDA	15,242	19,391	18,312	23,243	29,124	32,534	35,967	38,441	41,323
Domestic credit	29,776	32,425	37,539	43,303	50,034	55,034	59,590	63,006	66,778
Net credit to general government	-2,006	-4,815	-8,201	-4,379	-883	741	1,796	1,977	2,423
Credit to the economy	31,782	37,241	45,740	47,682	50,917	54,293	57,793	61,029	64,354
Other items (net)	-14,534	-13,034	-19,227	-20,060	-20,910	-22,500	-23,623	-24,565	-25,454
Memorandum items:									
Accounting exchange rate (ruble per U.S. dollar, eop)	30.4	32.7	56.3	...	...	...	...	...	...
Nominal GDP (billions of rubles)	62,176	66,190	71,406	74,045	80,715	86,480	91,961	96,758	102,292
CPI inflation (12-month change, eop)	6.6	6.5	11.4	12.5	7.8	5.0	4.0	4.0	4.0
Ruble broad money velocity (eop)	2.3	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.1
Ruble broad money velocity (eop, s.a.)	2.4	2.2	2.3	2.3	2.3	2.3	2.3	2.3	2.2
Annual change in velocity	-0.8	-7.1	5.5	0.4	0.4	-1.2	-1.2	-1.2	-0.6
Real ruble broad money (rel. to CPI, 12-month change)	5.0	7.6	-8.2	-8.2	0.7	3.3	3.5	2.4	2.3
Nominal ruble broad money (12-month change)	11.9	14.6	2.2	3.3	8.6	8.5	7.6	6.5	6.4
Base money (12-month change)	11.3	8.0	6.3	2.3	6.4	6.3	5.4	4.3	4.1
Real credit to the economy (12-month change)	12.2	10.1	10.3	-7.3	-1.0	1.6	2.4	1.5	1.4
Ruble broad money multiplier	3.4	3.7	3.5	3.5	3.6	3.7	3.8	3.9	3.9

Sources: Russian authorities; and IMF staff estimates.

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

Table 6. Russian Federation: Financial Soundness Indicators, 2012–15

(Percent)

	2012	2013	2014	2015 April
Financial Soundness Indicators				
Capital adequacy				
Capital to risk-weighted assets	13.7	13.5	12.5	12.9
Core capital to risk-weighted assets	8.5	9.1	9	9.1
Credit risk				
NPLs to total loans	6.0	6.0	6.7	7.5
Loan loss provisions to total loans	6.1	5.9	6.5	7.1
Large credit risks to capital	209	204.3	245.5	235.6
Distribution of loans provided by credit institutions				
Agriculture, hunting and forestry	4.6	4.3	3.5	3.6
Mining	3.2	3.1	4.2	4.4
Manufacturing	14	13.6	15.5	15.6
Production and distribution of energy, gas and water	2.7	2.5	2.5	2.6
Construction	5.5	5.6	5.3	5.2
Wholesale and retail trade	14.9	13.7	13.3	13.2
Transport and communication	5.4	4.2	4.4	4.6
Other economic activities	20.5	21.1	21.2	21.4
Individuals	29.2	32.0	30.1	29.6
Of which: mortgage loans	7.5	8.5	9.4	9.7
Geographical distribution of interbank loans and deposits				
Russian Federation	47.1	39.7	53.6	43.8
United Kingdom	17.5	23.8	13.9	13.3
USA	3.6	6.8	4.9	4.5
Germany	1.6	0.6	0.4	0.8
Austria	5.9	7.3	7.3	9.4
France	1.6	1.9	1.8	3.1
Italy	2.7	0.1	0	0.2
Cyprus 1/	8.7	4.7	4.9	8.6
Netherlands	1.5	1.5	1.3	1.8
Other	9.8	13.6	11.8	14.4
Liquidity				
Highly liquid assets to total assets	11.1	9.9	10.4	11.2
Liquid assets to total assets	23.2	20.5	22	22.7
Liquid assets to short-term liabilities	82.9	78.7	80.4	127.1
Ratio of client's funds to total loans	101.2	98.7	92.8	62.8
Return on assets	2.3	1.9	0.9	0.5
Return on equity	18.2	15.2	7.9	4.8
Balance Sheet Structure, in percent of assets				
Total asset growth rate	18.9	16.0	35.2	25.4
Asset side				
Accounts with CBR and other central banks	4.4	3.9	4.2	3.2
Interbank lending	8.5	8.9	8.9	8.3
Securities holdings	14.2	13.6	12.5	12.8
Liability side				
Funds from CBR	5.4	7.7	12	10.2
Interbank liabilities	9.6	8.4	8.5	6.8
Individual deposits	28.8	29.5	23.9	25.6

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

1/ Exposure to Cyprus mostly reflects a state-owned bank's exposure to its subsidiary in the country.

Table 7. Russian Federation: Medium-Term Framework and Balance of Payments, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
				(Percent of GDP, unless otherwise indicated)					
Macroeconomic framework									
GDP growth at constant prices (percent)	3.4	1.3	0.6	-3.4	0.2	1.0	1.5	1.5	1.5
Consumer prices (percent change, end of period)	6.6	6.5	11.4	12.5	7.8	5.0	4.0	4.0	4.0
Gross domestic investment	24.9	22.8	20.3	19.5	18.5	18.6	19.0	19.5	20.0
Private sector	20.8	18.6	16.2	15.2	14.8	14.8	15.3	16.0	16.7
Public sector	4.0	4.2	4.2	4.3	3.7	3.7	3.7	3.5	3.3
Gross national savings	28.4	24.5	23.5	24.1	24.0	24.3	24.5	24.7	24.7
Private sector	23.9	20.4	20.5	24.6	24.4	22.8	22.2	21.7	22.1
Public sector	4.5	4.1	3.0	-0.5	-0.5	1.6	2.2	2.9	2.7
External current account balance	3.5	1.6	3.2	4.5	5.5	5.8	5.5	5.2	4.7
Fiscal Operations 1/									
Federal government									
Net lending/borrowing (overall balance)	-0.1	-0.5	-0.5	-3.3	-3.9	-2.1	-1.5	-0.6	-0.8
Nonoil balance	-10.6	-10.5	-11.0	-11.3	-12.0	-10.4	-9.6	-8.2	-7.7
General government									
Net lending/borrowing (overall balance)	0.4	-1.3	-1.2	-4.8	-4.2	-2.2	-1.4	-0.6	-0.6
Revenue	37.7	36.9	37.5	35.0	35.3	36.1	36.1	35.7	35.4
Expenditure	37.3	38.2	38.7	39.8	39.5	38.2	37.5	36.3	36.1
Nonoil balance	-10.8	-12.0	-12.6	-13.3	-13.0	-11.2	-10.2	-8.8	-8.3
Primary balance	1.0	-0.6	-0.4	-3.8	-3.0	-0.8	0.1	1.0	0.9
Gross debt	12.7	14.0	17.8	18.8	20.2	21.4	21.6	22.0	22.2
				(Billions of U.S dollars; unless otherwise indicated)					
Balance of payments									
Current account	71.3	34.1	59.5	60.8	78.5	88.4	89.4	91.5	91.1
Trade balance	191.7	181.9	189.7	144.6	174.4	187.6	191.7	197.8	201.4
Exports (f.o.b)	527.4	523.3	497.8	374.6	404.9	426.5	449.1	468.4	488.9
Of which: energy	346.8	350.2	325.0	203.5	221.5	228.1	234.5	236.3	236.9
Imports (f.o.b)	-335.8	-341.3	-308.0	-230.0	-230.5	-238.9	-257.3	-270.6	-287.4
Services and transfers, net	-52.7	-67.6	-63.1	-36.2	-41.7	-51.1	-55.6	-58.3	-62.6
Capital and financial account	-30.9	-45.4	-172.6	-103.6	-66.1	-48.8	-49.3	-46.7	-55.0
Capital account	-5.2	-0.4	-42.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-25.7	-45.0	-130.6	-103.6	-66.1	-48.8	-49.3	-46.7	-55.0
Private sector capital	-45.4	-51.2	-161.6	-101.3	-74.1	-62.4	-62.7	-62.6	-63.6
Errors and omissions	-10.4	-10.8	8.8	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	30.0	-22.1	-104.4	-42.8	12.3	39.7	40.1	44.7	36.1
Memorandum items:									
Gross reserves (end of period)									
Billions of U.S. dollars	537.6	509.6	405.2	362.4	374.8	414.4	454.6	499.3	535.4
Percent of short-term debt (residual maturity)	257.2	251.5	320.0	496.4	281.4	323.1	348.9	378.6	413.5
Months of prospective GNFS imports	14.5	13.0	11.3	13.6	13.6	14.1	14.3	15.0	15.1
Trade balance (percent of GDP)	9.5	8.8	10.2	10.8	12.2	12.3	11.8	11.2	10.5
Terms of trade (y-o-y change, percent)	2.3	-1.0	-2.2	-24.6	5.0	2.0	1.7	0.9	1.0
Excluding fuel	-3.4	-0.7	-1.5	-3.7	-0.1	0.1	0.1	0.1	0.8
Export volume, goods (y-o-y change, percent)	2.9	2.0	0.1	4.6	2.7	2.6	3.0	2.9	3.0
Import volume, goods (y-o-y change, percent)	8.3	3.5	-7.2	-21.8	0.0	3.0	7.1	4.7	5.8
World oil price (U.S. dollars per barrel) 2/	112.0	108.8	98.9	61.5	67.2	70.0	72.5	74.1	75.0
Output gap	0.6	0.5	0.7	-1.0	-0.9	-0.5	-0.1	0.0	0.0

Sources: Russian authorities; and IMF staff estimates.

1/ Cash basis. Expenditures based on 2014-16 budget and the fiscal rule.
2/ WEO through 2011; and Brent crude oil spot and futures prices for 2012-20.

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

(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

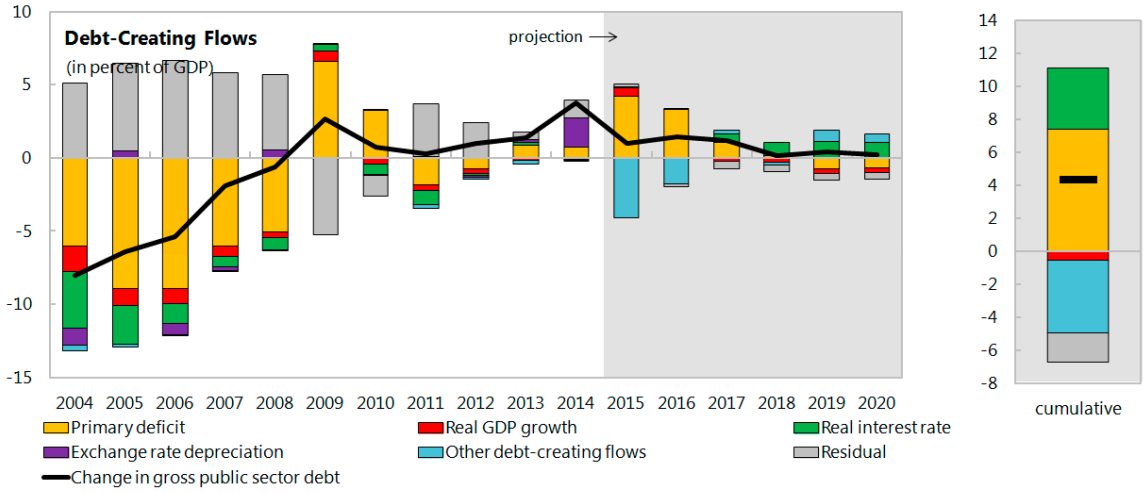
	Actual			Projections					
	2004-2012 [2/]	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross public debt	12.4	14.0	17.8	18.8	20.2	21.4	21.6	22.0	22.2
Of which: guarantees	0.6	2.5	3.4	4.3	4.2	4.2	4.2	4.2	4.2
Public gross financing needs	-0.6	3.3	4.2	6.9	5.9	3.6	2.7	1.6	1.2
Real GDP growth (in percent)	4.4	1.3	0.6	-3.4	0.2	1.0	1.5	1.5	1.5
Inflation (GDP deflator, in percent)	14.0	5.1	7.2	7.4	8.8	6.1	4.8	3.7	4.2
Nominal GDP growth (in percent)	19.3	6.5	7.9	3.7	9.0	7.1	6.3	5.2	5.7
Effective interest rate (in percent) [4/]	6.4	6.7	6.9	7.3	8.9	9.3	9.2	9.3	9.3

As of June 15, 2015

Sovereign Spreads		
EMBIG (bp) 3/		347
5Y CDS (bp)		364
Ratings	Foreign	Local
Moody's	Ba1	Ba1
S&Ps	BB+	BBB-
Fitch	BBB-	BBB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.0	1.4	3.8	1.0	1.4	1.2	0.1	0.4	0.2	4.4	
Identified debt-creating flows	-5.1	0.9	2.6	0.8	1.6	1.7	0.6	0.9	0.6	6.2	
Primary deficit	-3.1	0.9	0.7	4.2	3.3	1.0	0.2	-0.7	-0.7	7.4	1.3
Primary (noninterest) revenue and gra	37.4	36.6	37.2	34.5	35.0	35.8	35.9	35.5	35.2	211.9	
Primary (noninterest) expenditure	34.3	37.5	37.9	38.8	38.3	36.8	36.1	34.8	34.5	219.3	
Automatic debt dynamics [5/]	-1.9	0.2	1.9	0.6	0.0	0.4	0.6	0.8	0.7	3.2	
Interest rate/growth differential [6/]	-1.8	0.0	-0.1	0.6	0.0	0.4	0.6	0.8	0.7	3.2	
Of which: real interest rate	-1.2	0.2	-0.1	0.0	0.0	0.6	0.9	1.1	1.0	3.7	
Of which: real GDP growth	-0.6	-0.2	-0.1	0.6	0.0	-0.2	-0.3	-0.3	-0.3	-0.6	
Exchange rate depreciation [7/]	-0.1	0.2	2.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	-0.1	-0.3	0.0	-4.1	-1.8	0.3	-0.2	0.7	0.6	-4.4	
General Government: Net privatizatic	-0.1	-0.3	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Change is cash balance of EBF	0.0	0.0	0.0	-0.7	0.1	0.3	0.3	0.4	0.3	0.8	
Transfers to RF and NWF	0.0	0.0	0.0	-3.4	-1.9	0.0	-0.5	0.4	0.2	-5.2	
Residual, including asset changes [8/]	3.1	0.5	1.2	0.2	-0.2	-0.5	-0.5	-0.5	-0.4	-1.8	



Source: IMF staff.

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

2/ Based on available data.

3/ EMBIG.

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

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

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

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

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

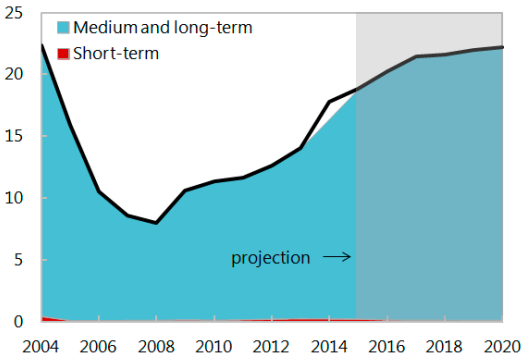
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

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

Composition of Public Debt

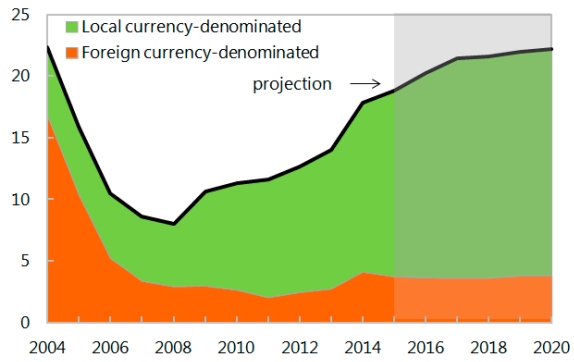
By Maturity

(in percent of GDP)

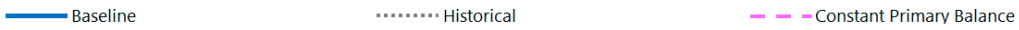


By Currency

(in percent of GDP)

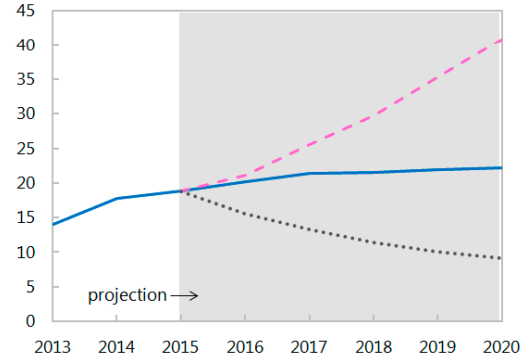


Alternative Scenarios



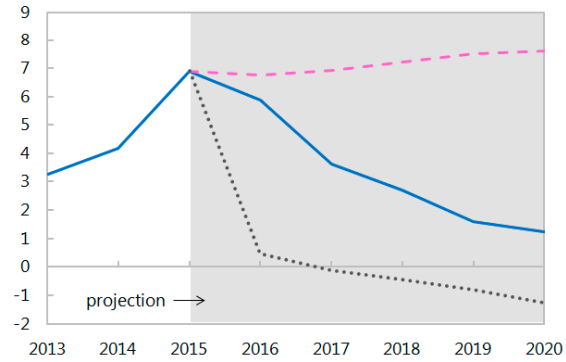
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

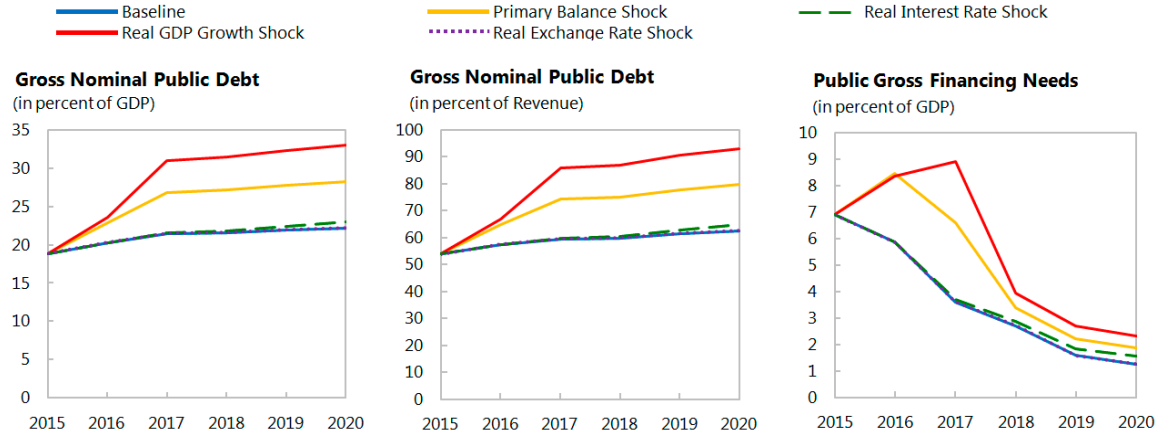
Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	-3.4	0.2	1.0	1.5	1.5	1.5
Inflation	7.4	8.8	6.1	4.8	3.7	4.2
Primary Balance	-4.2	-3.3	-1.0	-0.2	0.7	0.7
Effective interest rate	7.3	8.9	9.3	9.2	9.3	9.3
Constant Primary Balance Scenario						
Real GDP growth	-3.4	0.2	1.0	1.5	1.5	1.5
Inflation	7.4	8.8	6.1	4.8	3.7	4.2
Primary Balance	-4.2	-4.2	-4.2	-4.2	-4.2	-4.2
Effective interest rate	7.3	8.9	9.3	9.2	9.1	9.0

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	-3.4	3.5	3.5	3.5	3.5	3.5
Inflation	7.4	8.8	6.1	4.8	3.7	4.2
Primary Balance	-4.2	2.0	2.0	2.0	2.0	2.0
Effective interest rate	7.3	8.9	8.8	8.6	8.8	9.0

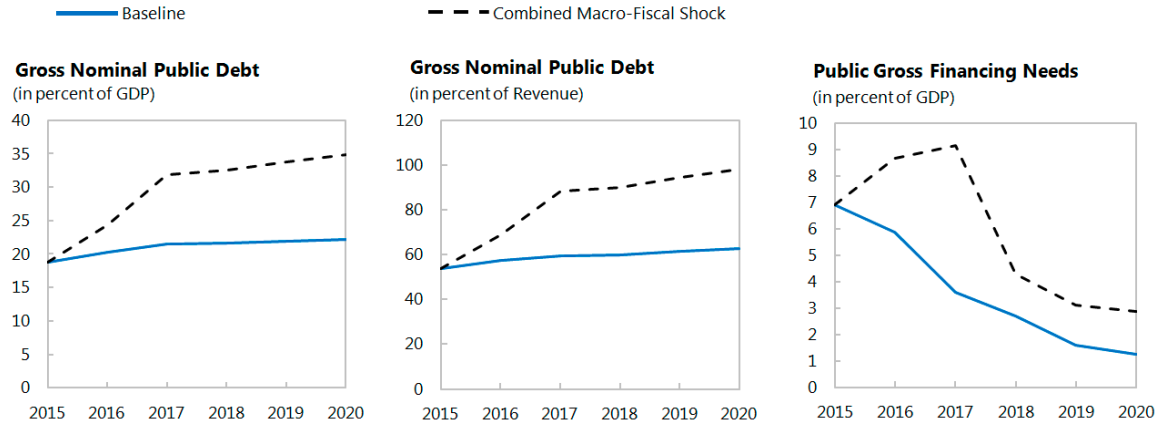
Source: IMF staff.

Table 10. Russian Federation: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2015	2016	2017	2018	2019	2020
Primary Balance Shock						
Real GDP growth	-3.4	0.2	1.0	1.5	1.5	1.5
Inflation	7.4	8.8	6.1	4.8	3.7	4.2
Primary balance	-4.2	-5.9	-3.6	-0.2	0.7	0.7
Effective interest rate	7.3	8.9	9.7	9.7	9.7	9.6
Real Interest Rate Shock						
Real GDP growth	-3.4	0.2	1.0	1.5	1.5	1.5
Inflation	7.4	8.8	6.1	4.8	3.7	4.2
Primary balance	-4.2	-3.3	-1.0	-0.2	0.7	0.7
Effective interest rate	7.3	8.9	9.9	10.2	10.5	10.7
Combined Shock						
Real GDP growth	-3.4	-4.5	-3.7	1.5	1.5	1.5
Inflation	7.4	7.6	4.9	4.8	3.7	4.2
Primary balance	-4.2	-5.9	-5.7	-0.2	0.7	0.7
Effective interest rate	7.3	9.0	10.2	10.6	10.8	11.0

	2015	2016	2017	2018	2019	2020
Real GDP Growth Shock						
Real GDP growth	-3.4	-4.5	-3.7	1.5	1.5	1.5
Inflation	7.4	7.6	4.9	4.8	3.7	4.2
Primary balance	-4.2	-5.7	-5.7	-0.2	0.7	0.7
Effective interest rate	7.3	8.9	9.6	9.8	9.8	9.7
Real Exchange Rate Shock						
Real GDP growth	-3.4	0.2	1.0	1.5	1.5	1.5
Inflation	7.4	11.6	6.1	4.8	3.7	4.2
Primary balance	-4.2	-3.3	-1.0	-0.2	0.7	0.7
Effective interest rate	7.3	9.0	9.3	9.2	9.3	9.3

Source: IMF staff.

Table 11. Russian Federation: External Debt Sustainability Framework, 2010–20

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2010	2011	2012	2013	2014			2015	2016	2017	2018	2019	2020	Debt-stabilizing non-interest current account 6/
Baseline: External debt	32.1	28.6	31.6	34.4	36.9			**52.7**	**44.7**	**40.4**	**38.0**	**36.3**	**34.3**	**-1.7**
Change in external debt	-6.2	-3.4	3.0	2.8	2.6			15.7	-8.0	-4.3	-2.4	-1.7	-2.0	
Identified external debt-creating flows (4+8+9)	-9.1	-9.1	-3.2	-1.3	3.0			0.1	-3.4	-3.8	-2.7	-1.8	-1.3	
Current account deficit, excluding interest payments	-3.0	-3.9	-2.6	-0.8	-1.8			-3.5	-4.7	-4.1	-3.2	-2.5	-2.1	
Deficit in balance of goods and services	-50.0	-51.6	-51.3	-51.1	-53.3			-60.7	-56.0	-54.0	-51.1	-48.7	-46.5	
Exports	29.0	30.1	29.3	28.5	30.2			35.8	33.3	31.9	30.0	28.5	27.0	
Imports	-21.0	-21.5	-22.1	-22.6	-23.1			-24.9	-22.7	-22.1	-21.1	-20.3	-19.5	
Net non-debt creating capital inflows (negative)	-0.2	-0.2	0.4	-0.3	1.1			-0.6	-0.7	-1.2	-1.1	-0.9	-0.8	
Automatic debt dynamics 1/	-5.9	-5.0	-0.9	-0.3	3.7			4.1	2.0	1.5	1.6	1.7	1.7	
Contribution from nominal interest rate	1.4	1.2	0.9	0.9	1.3			1.9	1.5	1.9	2.2	2.2	2.2	
Contribution from real GDP growth	-1.4	-1.1	-0.9	-0.4	-0.2			2.2	0.5	-0.4	-0.5	-0.5	-0.5	
Contribution from price and exchange rate changes 2/	-5.9	-5.1	-0.9	-0.8	2.7			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	2.9	5.7	6.1	4.1	-0.4			15.7	-4.6	-0.5	0.3	0.1	-0.8	
External debt-to-exports ratio (in percent)	110.7	95.1	107.9	120.4	122.5			147.3	134.1	126.8	126.6	127.5	126.8	
Gross external financing need (in billions of US dollars) 4/	121.0	90.8	115.8	211.2	177.5			96.8	30.7	93.4	105.8	118.7	127.5	
in percent of GDP	7.9	4.8	5.7	10.2	9.6	10-Year	10-Year	8.2	2.2	6.1	6.2	6.3	6.1	
Scenario with key variables at their historical averages 5/								**52.7**	**48.5**	**44.3**	**41.1**	**37.3**	**32.8**	**-2.0**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	4.5	4.3	3.4	1.3	0.6	3.5	4.7	-3.8	-1.1	1.0	1.5	1.5	1.5	
GDP deflator in US dollars (change in percent)	19.4	19.8	2.3	1.9	-11.2	9.6	15.4	-34.2	18.3	9.4	10.1	9.1	9.0	
Nominal external interest rate (in percent)	4.6	4.8	3.3	2.8	3.3	4.7	1.3	3.3	3.4	4.8	6.0	6.4	6.6	
Growth of exports (US dollar terms, in percent)	28.8	29.8	2.8	0.6	-5.6	12.9	21.9	-24.9	9.0	5.6	5.3	5.0	5.1	
Growth of imports (US dollar terms, in percent)	29.8	27.8	8.4	5.6	-8.6	14.8	21.6	-31.7	6.6	7.6	6.7	6.3	6.3	
Current account balance, excluding interest payments	3.0	3.9	2.6	0.8	1.8	4.0	2.7	3.5	4.7	4.1	3.2	2.5	2.1	
Net non-debt creating capital inflows	0.2	0.2	-0.4	0.3	-1.1	-0.2	0.8	0.6	0.7	1.2	1.1	0.9	0.8	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

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

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

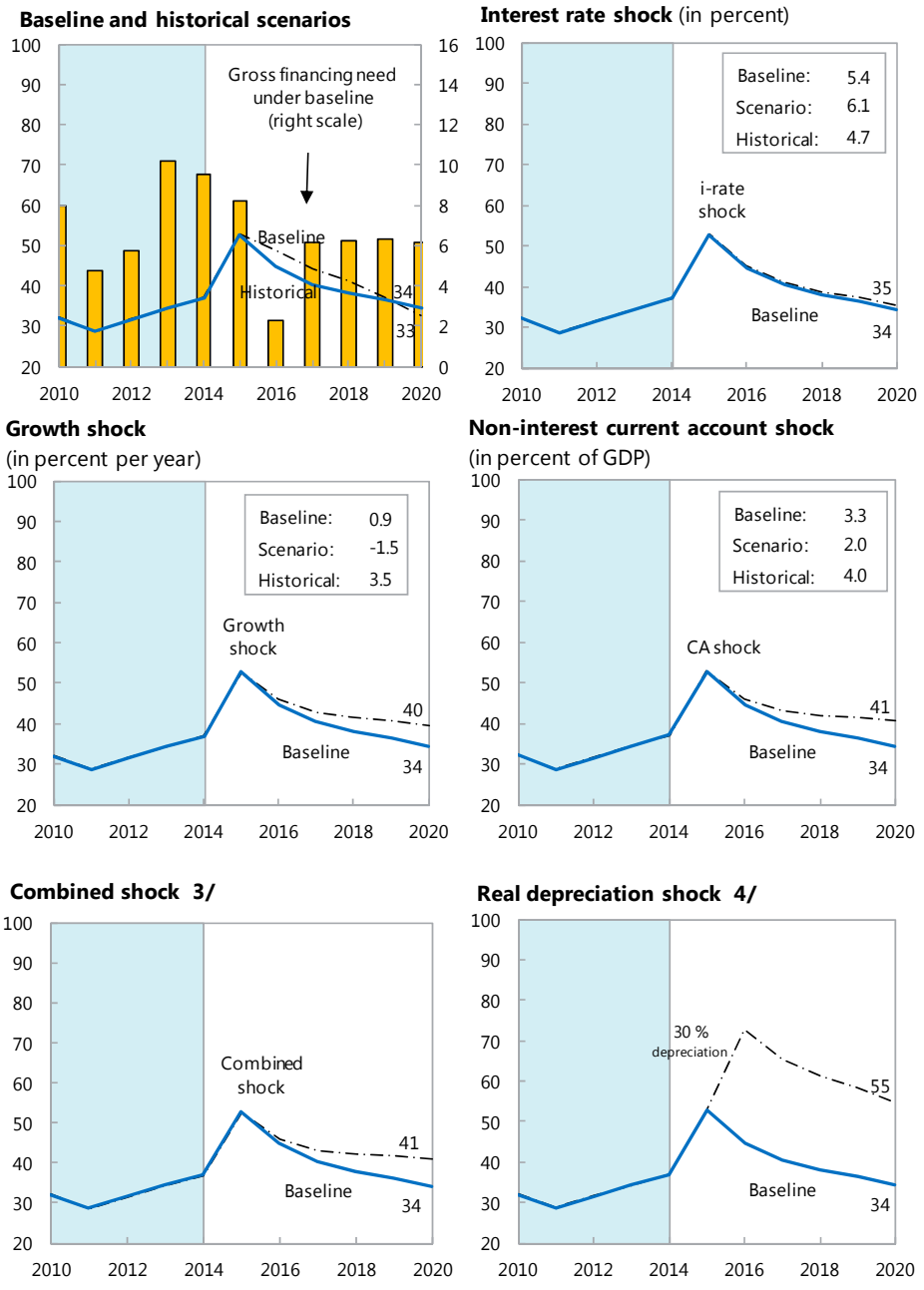
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Figure 12. Russian Federation: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



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

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

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

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

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

Annex I. Implementation of Past IMF Recommendations

During the 2014 Article IV consultation, Directors noted that while the immediate priority—in the context of ongoing geopolitical tensions—was to preserve macroeconomic stability, it was essential to boost investment and thus increase potential output growth by enhancing the policy framework and undertaking further structural reforms.

Key recommendations	Implemented policies
Fiscal Policy	
Consider flexibility in the event of a more severe cyclical downturn.	The budget for 2015 is consistent with cyclical considerations and available fiscal space. Quasi-fiscal spending via NWF and issuance of guarantees may provide further stimulus.
Adhere to the fiscal rule to support its credibility and the medium-term fiscal consolidation.	Adopted fiscal rule is followed in the budget for 2015–17. Possible enhancements to the fiscal rule, to better account for oil-price changes and to anchor needed medium-term fiscal consolidation, are currently being discussed.
Take additional measures to ensure long-term viability of the public pension system.	A renewed public debate is ongoing on further changes to the pension system, including gradually increasing the statutory retirement age.
Reduce spending pressures and increase efficiency gains to create space for infrastructure development.	NWF investments—via recapping commercial banks and VEB—and state loan guarantees are to be used to support infrastructure investments and lending to the real sector. However, anti-crisis measures have crowded out budgeted investment expenditures.
Monetary Policy	
Tighten monetary policy stance to achieve the 2015 inflation target and anchor inflation expectations.	Policy rates were increased. The CBR has maintained its medium-term inflation target of 4 percent.
Continue moving to an inflation-targeting regime and a fully flexible exchange rate once the current uncertainty subsides.	The inflation targeting regime was formally adopted on schedule, at end 2014. The move to further exchange rate flexibility was accelerated amidst market turbulence in late 2014, with the CBR removing its intervention bands to facilitate a more rapid adjustment to external shocks.

Financial Sector Policy

Monitor build-up of systemic risks through regular stress testing exercises and increased oversight.	Supervision of banks was intensified through additional CBR representatives at banks (165, as of April 1, 2015, compared to 57 on July 1, 2014). Amidst market stress, in December 2014, the CBR introduced temporary regulatory forbearance on loan classification, provisioning, and valuation accounting. A bank recapitalization program is being implemented; the government has also approved the use of up to 10 percent (400 billion rubles) of the NWF resources to support banks.
Implement the remaining Financial Sector Assessment Program recommendations.	The recently passed legal reforms on bank resolution do not fully incorporate the recommendations of the 2011 FSAP and Financial Stability Board Peer Review. In particular, it does not provide for a number of tools contemplated in the Key Attributes for Effective Resolution Regimes such as bridge banks and bail-in of all unsecured uninsured liabilities.
Take steps to reduce banking sector fragmentation through consolidation and enhancing competition among banks.	To support financial stability, the CBR has revoked over 114 banking licenses since January 1, 2014, mostly from small banks, following established resolution procedures.

Structural Policies

Curtail state involvement in the economy, reduce price distortions, take further measures to increase investment and productivity, and revive the nearly-stalled privatization program.	State involvement in economic activity has increased, with a shift to locally produced goods and services in procurement for local and municipal needs, and state support to import substitution in the real sector. Countersanctions increased price distortions by banning food imports from many countries. A part of the government anti-crisis package is aimed at supporting small and medium enterprises by reducing their financial and administrative costs. The privatization agenda remains stalled, given current market conditions.

Annex II. External Sector Assessment

		Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) was positive at end-December 2014 at about 18 percent GDP (up from 6 percent in 2013); with gross assets of 70 percent of GDP and liabilities of 52 percent of GDP. Total external debt was 36 percent of GDP. Historically, the NIIP position has not kept pace with the CA surpluses due to unfavorable valuation changes and the treatment of "disguised" capital outflows. 1/ **Assessment**. The projected current account surpluses mean that Russia will continue to maintain a positive international investment position, which minimizes risks to external stability. Recent deleveraging reduces risks further.	**Overall Assessment**: *The external position in 2014 was moderately weaker than the level consistent with medium-term fundamentals and desirable policy settings.* *Relative to the 2014 assessment period, the REER has depreciated. This in part reflects the adjustment to a new norm with substantially lower oil prices and sanctions that are affecting medium term growth. The structural implications of the sanctions create exceptional uncertainty when assessing the external position. Nevertheless, staff's initial view is that the depreciation has moved the REER toward a level closer to medium-term fundamentals that have changed materially since the last ESR.* **Potential policy responses**: The nonoil fiscal deficit remains significantly higher than its long-term desirable level and needs to adjust to facilitate a rebalancing from public to private activity, and a re-allocation of government expenditure from current to capital spending. This rebalancing—coupled with a renewed emphasis on structural reforms to invigorate the private sector—would help increase public saving that would be matched by both higher private and public sector investment over the medium-term.
Current account	**Background**. From 2000 to 2013, the current account (CA) surplus fell from 18 to 2 percent of GDP despite increasing oil prices, as consumption increased rapidly. A correction, however, is underway with the CA improving to 3.21 percent in 2014 and 4.5 percent in 2015. This improvement took place despite the negative terms of trade shock, as reduced oil export revenue (approximately 5 percent of GDP) was offset by falling absorption due to the real depreciation of the ruble, and tightening of financial conditions. **Assessment**. There are particular uncertainties with the external assessment when oil plays such a dominant role in the economy, compounded now by the uncertain long-term impact of sanctions in saving-investment decisions and therefore the normative external position. 2/Staff believes higher uncertainty warrants higher savings, hence a stronger current account norm than implied by the model. Against this background, staff assesses that the 2014 CA gap was between -3 to 0 percent of GDP. In the medium term, fiscal policy should be tightened to rebuild buffers, save more of the oil wealth for future generations, and counter Dutch disease.	
Real exchange rate	**Background**. The sustained oil price boom and related expansion of domestic demand led to a strong real effective exchange rate (REER) appreciation between 2000 and 2013. The REER has since depreciated 8 percent between 2013 and 2014, and through May 2015, by a further 2 percent on average relative to the average for 2014, despite significant inflation differentials with trading partners. This reflects lower oil prices, sanctions, and the move to a floating exchange rate regime in November 2014. **Assessment**. EBA estimates that the average REER in 2014 was 7 percent overvalued based on the CA regression approach and 10 percent undervalued based on the REER level regression approach (and 13 percent based on the index approach). The latter approach, however, is less reliable in commodity-exporting countries over a period in which commodity prices have been exceptionally high and is discarded from the staff assessment. Based on the current account gap, and taking into account the uncertainties discussed in the current account assessment, staff assesses that the REER was overvalued by 0-10 percent on average during 2014. Staff assess that the recent depreciation has moved the REER toward a level closer to medium-term fundamentals.	
Capital and financial accounts: flows and policy measures	**Background**. Net private capital outflows have picked-up, as the non-bank sector has increasingly found it difficult to rollover existing debt and confidence has deteriorated. Geopolitical tensions and lower oil prices will continue to weigh on the outlook. Over the medium term, structural outflows are expected to decline if Russia improves its investment climate. **Assessment**. While Russia is exposed to risks of accelerated capital outflows and sudden stop of external funding because of the exceptional current geopolitical tensions, large international reserves provide substantial buffers and the new floating exchange rate regime help absorb these shocks.	
FX intervention and reserves level	**Background**. The CBR intervened according to its FX intervention rule in large volumes in 2014 dampening the pace of depreciation before abandoning its managed float policy. The CBR has since moved to a floating exchange rate regime and limited intervention, and in May 2015, started rebuilding reserves as uncertainty remains elevated. **Assessment**. The current level of foreign reserves is adequate according to a range of reserve coverage indicators and is above 150 percent of the IMF's composite reserve adequacy metric. Accumulation of fiscal savings in the oil funds should continue and the current policy of small regular reserve purchases to replenish reserves could be justified by the heightened level of uncertainty related to sanctions and as a buffer given Russia's vulnerability to oil shocks. Large FX interventions should be limited to episodes of market distress.	

Technical Background Notes	1/ Unfavorable valuation changes arise because the Russian stock market has performed very well in the last 15 years as the oil price soared, boosting the valuation of foreign-owned assets. "Disguised" capital outflows include transactions such as pre-payments on import contracts where the goods are not delivered, repeated large transfers abroad that deviate from standard remittances behavior, or securities transactions at inflated prices. The Central Bank of Russia includes estimates of "disguised" capital outflows in the financial account but not in the foreign asset position of the reported NIIP. Hence, the actual NIIP position could be higher than the reported level and this treatment of "disguised" outflows may explain part of the discrepancy between accumulated CA surpluses and the reported NIIP position. 2/ EBA-estimated 2014 CA norm was 5 percent of GDP; and the cyclically adjusted CA was 2.9 percent. The lower model-based gap relative to 2013 reflects both an improvement in the 2014 CA (from 1.6 percent in 2013) and a small reduction in the estimated current account norm (from 5.2 percent in 2013). This change in the norm broadly reflects two offsetting factors, with lower oil prices reducing the norm by 1 percent and lower medium-term growth increasing the norm by 0.5 percent. The EBA estimated CA norm of 4.8 percent of GDP, rests mostly on the need to save out of income from non-renewable oil exports. Staff's assessment shares this basic logic in also calling for a CA surplus for Russia, but acknowledges that such saving (i.e., refraining from consumption) would not necessarily have to take a financial form, and could in part take the form of productive investment spending, which could justify a somewhat lower CA surplus than the EBA-estimated norm. Sanctions and geopolitical tensions have introduced an additional level of complexity in the external assessment, as they introduce exceptional uncertainty in model based estimates.

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Annex III. Risk Assessment Matrix (RAM) 1/

Risk Overall Level of Concern	Overall Level of Concern		
	Relative Likelihood	Expected Impact if Materialized	Recommended Policy Response
Political fragmentation erodes the globalization process and fosters inefficiency: **Russia/Ukraine**: the mounting conflict depresses business confidence and heightens risk aversion, amid disturbances in global financial, trade and commodity markets.	**Medium**	**High**	The exchange rate should be allowed to adjust. Disorderly market conditions can be countered with foreign exchange intervention. An interest rate increase should be considered. Tightening of fiscal policy could be postponed.
Risks to energy prices: **Increased volatility** due to uncertainty about the persistence of the oil supply shock and the underlying drivers of the price decline. **Persistently low prices** triggered by supply factors reversing only gradually, and weaker demand.	**High** **Medium**	**High** **High**	The exchange rate should be allowed to adjust. Disorderly market conditions can be countered with foreign exchange intervention. Rebuild fiscal buffers and oil savings by tightening fiscal rule if prices are lower, and structural reforms should be advanced to enhance economic efficiency and diversification.
Side-effects from global financial conditions: **A surge in financial volatility:** as investors reassess underlying risk and move to safe-haven assets given slow and uneven growth as well as asymmetric monetary exit, with poor market liquidity amplifying the effect on volatility.	**High**	**Medium**	Enhance confidence and resilience by strengthening core institutions and policy frameworks and improve the investment climate. Tighten monetary policy if balance of payment pressures emerges, while allowing the exchange rate to adjust, and intervening only to counter disorderly market conditions.
Renewed drop in domestic investment. Authorities pursue inward-looking policies. Lack of structural reform could lead to a decline in investment and TFP.	**Low**	**High**	Focus on structural and governance reforms to improve the investment climate. Avoid distortive measures and real exchange rate overvaluation while increasing trade openness.

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

Annex IV. Key FSAP Recommendations and Implementation

Recommendation	Status in May 2015 (changes from last year in bold)
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.	Legislation adopted.
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.	Legislation adopted. CBR authorized to conduct consolidated supervision and supervise related parties.
Allow the CBR to sanction individual directors and managers, raise capital requirements on individual institutions, and impose restrictions on transactions between affiliates.	Legislation adopted. Restrictions applied on transaction between affiliates. New requirement on implementation of Pillar 2.
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.	Pending. With the merger of the CBR and FSFM, implementation guidelines are being developed.
Empower the FSFM to require insurers to have in place internal controls and risk management systems commensurate with the complexity of their business.	Legislation pending
Apply fit and proper requirements to directors and key management of insurers on an ongoing basis.	No decision
Make home-host notifications and cross-border cooperation in insurance mandatory for the FSFM.	No decision
Adopt pending legislation that empowers the FSFM to appoint a provisional administrator, freeze assets, and wind down distressed securities firms.	Legislation pending
Medium term (implementation in 1–3 years)	
Adopt a prompt remedial action framework for banks.	Draft regulation under preparation.
Pursue efforts to ensure an effective macro prudential oversight	No decision.
Require government guarantee for all CBR loans that are unsecured or not backed by marketable collateral or guarantees.	No decision. CBR has suspended providing unsecured loans.
Require repo transactions to take place using central counterparty clearing.	No decision. However, **economic incentives** have been implemented.
Set limits on concentration of collateral in the repo market.	No decision
Introduce a unified administration regime for all banks (systemic or otherwise) with broad powers for the administrator.	**Unified legislation adopted.** Provisions include timely exchange of information, mandatory dilution of shareholders prior to use of public funds, purchase and assumption transactions, conversion of certain subordinated debt into equity and greater powers to sanction former insiders. CBR's authorization to provide capital support is restricted to systemically important institutions.
Open-bank assistance such as loans, capital injections, nationalization by the Deposit Insurance Agency (DIA) should be restricted to systemic situations.	

INTERNATIONAL MONETARY FUND

RUSSIAN FEDERATION

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 2, 2015

Prepared By

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

CONTENTS

FUND RELATIONS

(As of March 31, 2015)

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

General Resources Account	**SDR Million**	**Percent Quota**
Quota	5,945.40	100.00
Fund holdings of currency	4,969.76	83.59
Reserve Position	975.65	16.41
Lending to the Fund		
New Arrangements to Borrow	891.56	

SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	5,671.80	100.00
Holdings	5,691.55	100.35

Outstanding Purchases and Loans: None

Latest Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-by	07/28/99	12/27/00	3,300.00	471.43
EFF	03/26/96	03/26/99	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 Obligations to Fund

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

	Forthcoming				
	2015	2016	2017	2018	2019
Principal					
Charges/Interest	0.04	0.04	0.04	0.04	0.04
Total	0.04	0.04	0.04	0.04	0.04

Implementation of HIPC Initiative: Not Applicable

Implementation of MDRI Assistance: Not Applicable

Exchange Arrangements: Effective November 10, 2014, the CBR eliminated its exchange rate corridor and canceled regular FX interventions, adopting a *de jure* and *de facto* floating exchange rate regime, with FX interventions to be conducted only to safeguard financial stability. The *de jure* and *de facto* exchange rate arrangement used to be categorized as other managed arrangement until November 10, 2014—namely, a controlled floating exchange rate arrangement. The ruble value of a bi-currency basket was used as the operating benchmark for transactions on the domestic foreign exchange market. The basket was composed of €0.45 and US$0.55. The value of the bi-currency basket was determined under the influence of both market factors and exchange interventions by the Central Bank of Russia (CBR). The CBR did not set any quantitative limits on the exchange rate level of the national currency, but its exchange rate policy aimed at keeping short-term fluctuations within an acceptable range, as determined by the floating operating band. Interventions took place both at the limits of the floating operating band and within it. They were triggered once the exchange rate crossed the limits set by a nonintervention corridor, with intervention amounts and intervals established in advance. The limits of the operating bands itself shifted by 5 kopecks once a predetermined cumulative volume of interventions has been reached. Effective October 13, 2010, the CBR eliminated the fixed trading band of Rub 26-41 against the bi-currency basket, in force since January 2009. Since 2010 the CBR has widened the moving intervention band from 3 to 7 rubles in four installments. Up until March 3, 2014, the CBR had successively reduced the volume of cumulative interventions triggering a 5 kopeck shift in the operational band from originally $700 million to $350 million and widened the non-intervention band from 1 to 3.1 rubles. Following the heightened financial turmoil from the crisis in Ukraine, the CBR decreased the sensitivity of the band to interventions, increasing the cumulative FX sales required to shift the operational band to US$1.5bn. Effective May 22, 2014, the amount of interventions in all sub-bands was reduced by US$100 million, from US$400 million to US$300 million and from US$200 million to US$100 million, with the aim of reverting to greater flexibility. Further, effective June 17, 2014, the cumulative volume of interventions leading to a shift in the floating operational band was reduced from US$1.5 billion to US$1 billion; the US$100 million intervention sub-band was eliminated leading to an increase in the non-intervention zone by 2 rubles; and the amount of interventions in the remaining sub-band was reduced from US$300 million to US$200 million. Effective August 18, 2014, the exchange rate corridor was widened to RUB 9 from RUB 7 and interventions were eliminated within the corridor. The cumulative interventions to move the corridor by 5 kopeck were reduced to USD 350mn from USD 1bn. Effective November 5, 2014, daily interventions were capped at US$350 million when the ruble touches the exchange rate corridor or is outside of it. Effective November 10, 2014, the CBR adopted a floating exchange rate regime by abandoning the exchange rate-based operational indicators of its exchange rate policy. The Russian Federation accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement with effect from June 1, 1996, *and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions*.

Article IV Consultation: Russia is on the standard 12-month consultation cycle. The last consultation was concluded on June 27, 2014.

FSAP Participation, FTE 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, and the FSSA report was discussed by the Board in September 2011, at the time of 2011 Article IV Consultation.

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

Resident Representative: Mr. Bikas Joshi, Resident Representative since July 1, 2013, will be succeeded by Mr. Gabriel Di Bella in mid-July, 2015.

WORLD BANK GROUP RELATIONS[1]

The World Bank Group's engagement with the Russian Federation is three-dimensional: global, regional, and national. At the **global level,** Russia has increased its contributions to IDA and supports the provision of global public goods through contributions to global funds. In addition, the Bank offers its expertise to help prepare Russia for the presidency of international fora such as APEC, G20, and BRICS. At the **regional level**, the World Bank Group supports Russia as an emerging donor for less-developed countries in ECA. Russia is already a significant provider of development assistance through a growing portfolio of IDA/IBRD-administered trust funds. At the **national level**, the World Bank Group aims to maximize its development impact by reaching out to the regions in Russia with the most development needs.

The current World Bank Group 2012–2016 Country Partnership Strategy (CPS) for the Russian Federation was discussed by the Board of Executive Directors in December 2011. It is aligned with government priorities and is organized around **four strategic themes: (i) increasing growth and diversification** through better management of public finances, improved investment climate and innovation, stronger financial sector, better infrastructure, and more effective protection of the environment, **(ii) expanding human potential** by strengthening skills and social services through improvements in education, health, and social protection, **(iii) improving governance and transparency** through more accountability and better service standards in public administration, procurement, and financial management, and **(iv) deepening Russia's role in global and regional development** related to the provision of global public goods and Russia's growing role as a donor. The CPS is being implemented largely as anticipated, with some delays in project preparation and emerging modifications in the lending program. The strategy endorsed an envelope of up to US$5 billion in IBRD lending to support the program over the CPS period. IFC committed to invest between US$3.8 and US$4.8 billion for its own account, plus the significant mobilization of counterpart funds. The Multilateral Investment Guarantee Agency (MIGA) continues to support foreign investors through the provision of political risk guarantees.

A. International Bank for Reconstruction and Development

The Russian Federation joined the World Bank (IBRD and IDA) in 1992. The Bank has provided financing for 70 projects in different sectors totaling slightly over US$10.5 billion in IBRD loans. About 95 percent of the total portfolio has already been disbursed. The **IBRD active lending portfolio** amounts to US$668 million (as of April 2015) across ten projects in the areas of public sector management, municipal infrastructure, land registration, cultural heritage preservation, financial literacy, hydro-meteorology, and forestry. The undisbursed balance is US$353 million as of April 2015. All of the Bank's financing to Russia is provided in the form of investment project financing.

[1] Prepared by the World Bank.

Advisory Services and Analytics (ASA) are an important part of IBRD's engagement in Russia. ASA products are helping to modernize public finance and administration and improve social service delivery and the investment climate. The Bank also provides technical assistance in areas such as early childhood development, indigenous people, social development, and social accountability. In FY15, along with two traditional flagship Russia Economic Reports, the World Bank is finalizing a report on Social Mobility and Opportunity and another on Aging.

Demand for Reimbursable Advisory Services (RAS) in Russia is steady, with continued interest from the regions and growing demand from the federal government. Since 2007, the World Bank has entered into more than 80 RAS agreements, which cover a wide range of activities that are well aligned with Russia's development challenges. RAS are also of increasing importance for Russia's regions, as more than 30 of Russia's subnational governments have signed at least one RAS with the World Bank (15 currently active in nine different regions).

B. International Finance Corporation

Russia became an IFC member in 1993. Since then, IFC's long-term investments in Russia have totaled US$10 billion,[2] including US$3.5 billion in syndicated loans across 263 projects. IFC's current committed investment portfolio in Russia is US$1.5 billion in about 100 projects with roughly 70 clients. In FY14, IFC committed US$655 million for its own account and mobilized US$104 million from partners. Since the beginning of FY15, IFC has committed about US$60 million for its own account.

In line with the World Bank Group CPS, IFC continues to support economic diversification and growth in Russia by helping its private sector clients realize long-term development potential, with a particular focus on maximizing impact in less-developed regions. These efforts include the creation of new high-skilled jobs; the expansion of high value-added manufacturing; and the improvement of transport and social infrastructure to provide people and companies with better access to goods and services. In addition, IFC provides Russian companies and banks with strategic advice on achieving long-term sustainable growth, increasing energy and resource efficiency, and improving corporate governance, and also advises Russian regions on structuring municipal infrastructure projects.

C. Multilateral Guarantee Agency

MIGA's gross exposure in Russia was US$804 million as of February 2015 (MIGA's third-largest gross and net exposure). MIGA is involved in eight projects in finance, infrastructure, manufacturing, agribusiness, and services. In dollar terms, MIGA's exposure is concentrated in Russia's financial sector (some 80 percent of MIGA's gross exposure), supporting the investments of global financial institutions in their banking, mortgage, and leasing subsidiaries in Russia. Five out of

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

MIGA's eight projects are in non-financial sectors, some of them in Russia's regions, such as agribusiness in Russia's "black earth" regions of Penza and Tambov and manufacturing in Novocherkassk.

STATISTICAL ISSUES

(As of May 18, 2015)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance. However, in the context of emerging data demands for assessing external vulnerabilities, the scope for further data improvements exists.
National Accounts: Data are broadly adequate for surveillance, but there have been concerns about the reliability and consistency of quarterly GDP estimates among a wide range of users, including Fund staff. The Federal State Statistics Service (Rosstat) started a national account development plan for 2011–17, which will expedite compilation of quarterly GDP estimates consistent with the annual GDP estimates. The Rosstat follows the 1993 SNA in general, 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 may be underestimated. 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 to analyzing balance sheet vulnerabilities; however, work is underway to disseminate the first quarterly sectoral accounts and balance sheets for 2012–14 by 2016.
Price Statistics: Monthly CPI and PPI, both compiled using the Two-Stage (Modified) Laspeyres (2000=100), cover all regions of the Russian Federation. The weights reflect expenditures in the 12 months ended the previous September. Aggregate price indices are compiled for each good and service item for the 89 regions, seven federal regions, and the Russian Federation as a whole. However, population weights, as opposed to expenditure shares are applied to the individual regional indices possibly biasing the CPI downwards if price increases are higher in regions with higher per capita expenditures. Detailed data on total annual sales, which are used to develop weights for the PPI, are published by economic activity on the Rosstat website. The detailed weights are available only on the Russian version of the website, making it less accessible to some users. Further efforts to improve the treatment of seasonal items in the core inflation index and a new household budget survey—which has been under consideration for some time—could significantly strengthen data quality.
Government Finance Statistics: The authorities compile comprehensive set of the general government accounts based on the *Government Finance Statistics Manual 2001 (GFSM 2001)* on annual basis. These data comprise the statement of sources and uses of cash as well as the accrual based government operations (revenue, expenditure and transactions in assets and liabilities), complete balance sheet (including non-financial assets), holding gains and losses and other changes in volume of assets and liabilities, and outlays by functions of government (COFOG). Monthly *GFSM 2001* based statement of sources of uses of cash is also compiled for the whole general government sector. The main data gaps are due to the unavailability of quarterly primary data to compile the accrual based general government operation statement, financial balance sheet, and gross debt (by

instrument, maturity, residency, and currency). The actual split of annual debt into foreign and domestic refers to the domestic/foreign currency rather than residency. Additional gaps remain that affect the data quality for surveillance, for example the lack of historical quarterly data, unexplained data breaks (for instance the reclassification of some wage expenses from the budgetary central government accounts to the regional government accounts (following 2011 reforms), unavailability of monthly data on ruble guarantees prior to 2011, no integrated debt monitoring and reporting system, and the lack of reconciliation between different datasets of fiscal reporting (budget execution, cash flow statement, economic versus functional classification, fiscal statistics data).

Monetary and Financial Statistics: In the context of the recent global turmoil, 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 the full detail of the framework for Standardized Report Forms (SRFs), as recommended by an STA mission in 2007 (and re-affirmed by the ROSC mission in 2010), would provide comprehensive information on the currency and instrument breakdowns of the assets and liabilities of the central bank, credit institutions, and other financial corporations. Since March 2011, the Banking System Survey (which is equivalent to the Depository Corporations/Broad Money Survey) published by the Central Bank of Russia (CBR) has included a breakdown of positions by national and foreign currency. Publication of a similar breakdown of positions by national and foreign currency in the central bank and the credit institutions surveys would be useful for analysis.

External sector statistics: Balance of payments data are broadly adequate for surveillance, and significant improvements have been made to enhance data quality. The CBR has recently published the gross capital flow data for the private sector, which would facilitate the analysis of relatively complex flows. Starting from 2012, the balance of payments is compiled according to the framework of the *Fund's Balance of Payments and International Investment Position Manual*, sixth edition (BPM6) and the CBR has revised historical data (going back to 2005Q1 for BOP, and to 2011Q1 for IIP), consistent with BPM6.

Partial data from a variety of sources are supplemented by the use of estimates and adjustments to improve data coverage. In particular, the CBR makes adjustments to merchandise import data published by the Federal Customs Service to account for "shuttle trade," smuggling, and undervaluation. Statistical techniques are also used to estimate transactions and positions of foreign-owned enterprises with production sharing agreements, and these techniques are continuously being improved. At the same time, Russian compilers are seeking to reconcile their data with those of partner countries. Improvements have been made in the coverage and quality of surveys on direct investment, and the CBR is participating in the Fund's Coordinated Direct Investment Survey (CDIS) and Coordinated Portfolio Investment Survey (CPIS).

II. Data Standards and Quality	
Russia is an SDDS subscriber. Russia participates in the G-20 Data Gap Initiative. Russia reports data for the Fund's statistical publications.	Data ROSC was published in 2011.

Russian Federation: Table of Common Indicators Required for Surveillance

(As of June 18, 2015)

	Date of latest observation (For all dates in table, please use format dd/mm/yy)	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:[8]	
						Data Quality – Methodological soundness[9]	Data Quality – Accuracy and reliability[10]
Exchange Rates	May 2015	5/28/15	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	April 2015	5/29/15	M	M	M		
Reserve/Base Money	April 2015	5/20/15	D	W	W	O, O, LO, LO	O, O, O, O, O
Broad Money	April 2015	5/20/15	D	M	M	O,O,LO,LO	O,O,O,O,O
Central Bank Balance Sheet	April 2015	n.a.	M	M	M	O,O,LO,LO	O,O,O,O,O
Consolidated Balance Sheet of the Banking System	April 2015	n.a.	M	M	M	O,O,LO,LO	O,O,O,O,O
Interest Rates[2]	April 2015	n.a.	M	M	M	O,O,LO,LO	O,O,O,O,O
Consumer Price Index	April 2015	n.a.	/M	/M	/M		
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Mar. 2015	5/30/15	M	M	M	O, LO, LNO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Mar. 2015	5/30/15	M	M	M	LO, LNO, LO, O	O, O, LO, O, NA
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Mar. 2015	5/18/15	M	M	M		
External Current Account Balance	2015:Q1	5/18/15	M	M	M		
Exports and Imports of Goods and Services	2015:Q1	4/15/15	Q	Q	Q	O, O, O,L O	LO, O, O, O, O
GDP/GNP	2015:Q1	4/15/15	Q	Q	Q		
Gross External Debt	2015:Q1	5/14/15	Q	Q	Q	O, O, O, O	O, O,LO, O, LO
International Investment Position[6]	2014	5/18/15	Q	Q	Q		

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