INTERNATIONAL MONETARY FUND

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RUSSIAN FEDERATION

2014 ARTICLE IV CONSULTATION—STAFF REPORT; INFORMATIONAL ANNEX; PRESS RELEASE

July 2014

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 2014 Article IV consultation with the Russian Federation, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 27, 2014, following discussions that ended on April 30, 2014, 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 June 11, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** summarizing the views of the Executive Board as expressed during its June 27, 2014 consideration of the staff report that concluded the Article IV consultation with the Russian Federation.

The following document has been or will be separately released.

Selected Issues Paper

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

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RUSSIAN FEDERATION

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

June 11, 2014

KEY ISSUES AND RECOMMENDATIONS

Context. The growth slowdown continued in 2013, reflecting pre-existing structural reasons, despite accommodative policies. The fallout from geopolitical tensions relating to Ukraine is bringing the economy to a standstill. Fiscal tightening is expected this year as the non-oil deficit remains near record high. In response to mounting pressures on the ruble, the Central Bank of Russia (CBR) raised interest rates to address risks to medium-term inflation and increased intervention to support the ruble. Some structural reforms were initiated, including a partial pension reform and a new procurement law.

Near-term macroeconomic policy mix. Faced with exceptional circumstances, policies should aim at preserving macroeconomic stability. A tighter monetary stance is required over the next year to attain the 2015 inflation target. The CBR should resume its policy towards greater exchange rate flexibility as soon as the current uncertainty subsidies. Modest fiscal tightening, despite the economic slowdown, appears justified as output remains close to potential. Adhering to the fiscal rule is essential to support its credibility and the needed medium-term fiscal consolidation.

Medium-term policy challenges. Structural reforms remain essential to enhance Russia's growth potential. Continued efforts at global integration are necessary to attract investment and boost potential growth. Reforms discussed in the context of the stalled OECD accession negotiations should continue, including improving labor markets and reducing tax burden, administrative barriers, and corruption. Pushing ahead with the privatization plans should enhance economic efficiency. Additional fiscal consolidation in outer years is recommended to rebuild buffers and to safeguard intergenerational equity.

Approved By
Aasim M. Husain and Kalpana Kochhar

Discussions for the 2014 Article IV consultation were held in Moscow during April 17–April 30. The mission comprised Mr. Spilimbergo (Head), Messrs. Belhocine, Painchaud, Roitman (all EUR), Mr. Ashin (LEG), Ms. Korolova (STA), Ms. Svirydzenka (SPR), and Mr. Joshi (Res. Rep.). Ms. Dynnikova (local senior economist), and Ms. Chebotareva (local economist) assisted the mission. Mr. Mozhin, Executive Director, participated in the discussions. The mission met with Minister of Finance Siluanov, Central Bank of Russia Governor Nabiullina, other senior officials, and representatives of financial institutions, corporations, academia, and think tanks. Mr. Jovanovic and Ms. Swirszcz contributed to the preparation of this report.

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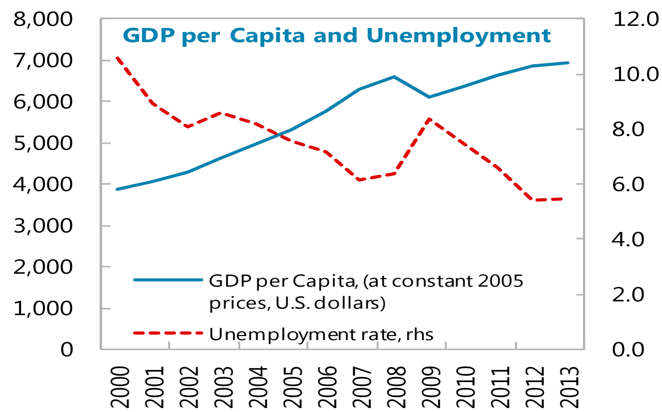
CONTEXT

1. **Russia's growth is slowing because of pre-existing structural reasons and the fallout from geopolitical tensions.** The growth slowdown that started in 2011 continued in 2013 despite accommodative policies as the economy hit capacity constraints. The fallout from recent geopolitical tensions relating to Ukraine and, to a lesser extent, the turmoil in emerging markets (EM) following the Fed's discussion of tapering unconventional monetary policy are bringing the economy to a standstill.

2. **This follows an almost doubling of Russia's real GDP per capita over 2000-2012.** During that period, growth also contributed to a significant decline in poverty rates and unemployment. However, after almost 15 years of growth based on rising oil prices, macroeconomic stabilization, and increasing use of spare resources, this growth framework has reached its limits.



Source: Haver Analytics.

3. **The authorities had begun taking some steps toward addressing the structural bottlenecks.** Since the 2008–09 crisis, the Russian authorities have strengthened their macroeconomic framework with the introduction of a fiscal rule, a transition toward inflation targeting and a more flexible exchange rate. Some structural reforms were initiated: the introduction of procurement and anti-corruption laws, measures to strengthen the judicial system, the creation of a Federal Business Ombudsman and a number of initiatives aimed at improving the business and regulatory environment. However, the privatization agenda has stalled and other structural bottlenecks continue to hamper growth, seriously constraining its long-term potential.

4. **Geopolitical uncertainties are taking a heavy toll on an already weak economy.** Following Russia's actions in Crimea, a number of countries imposed sanctions on Russian individuals and entities (Box 1). Concern about a possible escalation of sanctions has increased the uncertainty of doing business in Russia and is having a chilling effect on investment, while bond issuance has declined sharply. This comes at a crucial moment when the old growth model based on energy and use of spare capacity has been exhausted and moving to a new growth model based on diversification requires new investment, including foreign technology. Moreover, this risks derailing the reform agenda and a shift toward more emphasis on economic self-reliance rather than integration with the rest of the world.

RECENT DEVELOPMENTS

5. Growth in 2013 slowed despite accommodative policies and high oil prices (Figure 1). Growth slowed to 1.3 percent in 2013 due to a contraction in investment—mainly reflecting destocking of inventories and a reduction in state-owned enterprises' capital spending—while consumption remained robust owing to strong real wage growth and an unsecured consumer credit boom. Net exports also contributed to growth in 2013, but the share of non-oil exports in the economy continued to decline. Inflation remains above the CBR target. The slowdown appears principally structural and the output gap remained small (Selected Issues Paper).

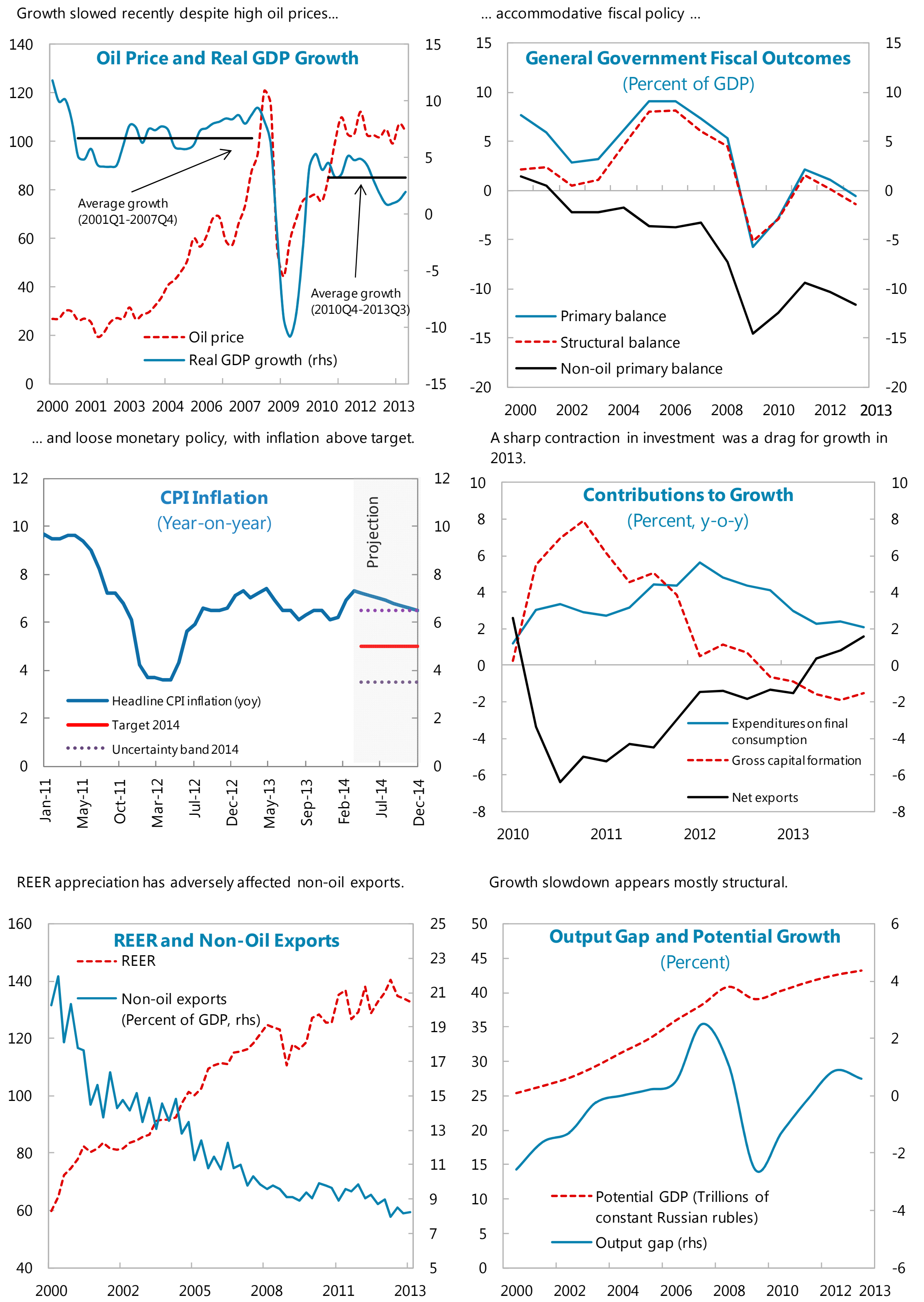
Box 1. Sanctions and Counter-Sanctions

The United States, the European Union (EU), Japan, Switzerland, and other countries, have adopted sanctions against Ukrainian and Russian individuals and entities in response to the unfolding situation in Ukraine, as well as the suspension of bilateral negotiations on a variety of topics. The EU has also suspended a number of bilateral discussions and imposed travel restrictions and financial sanctions. Canada, Switzerland, and Australia have announced their own programs of financial sanctions. A number of non-EU member European countries have aligned their national policies with EU decisions.

To date, the actual targets and measures taken differ across jurisdictions. For example, around 45 individuals and 20 companies have been designated for financial sanctions by the United States, while the EU named about 70 individuals and fewer than 5 companies. In addition, the U.S. Department of Commerce has announced that it will deny export licenses for any high-technology items that could contribute to Russian military capabilities and revoke any existing export licenses that meet these conditions.

On March 20 and March 24, Russia imposed retaliatory sanctions on U.S. and Canadian government officials. Russia also passed a bill to create a national payment system insulated from foreign companies' influence, and is considering the creation of a national rating agency.

Figure 1. Russian Federation: Summary Panel, 2000–14



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

6. Fiscal policy became more accommodative in 2013. The general government balance moved from an overall surplus of 0.4 percent of GDP in 2012 to a deficit of 1.3 percent of GDP in 2013, owing to weak revenues due to the economic slowdown and increased VAT refunds after the completion of large infrastructure projects. Russia continues to rely on oil revenues, as evidenced by a general government non-oil deficit of more than 12 percent of GDP. As a consequence, close to 80 percent of the oil revenues targeted for savings in the Reserve Fund (RF) were used to offset the decline in non-oil revenues and worse-than-expected privatization receipts. Hence, despite high oil prices, the RF remains well below the 7 percent targeted by the authorities. A timid and incomplete pension reform was introduced (Box 2).

Box 2. Pension Reform

The fiscal viability of the Russian public pension system is concerning.[1] The main problem is a low statutory retirement age (60 for men and 55 for women) given the expected demographic dynamics and the many exemptions making the effective retirement age even lower.

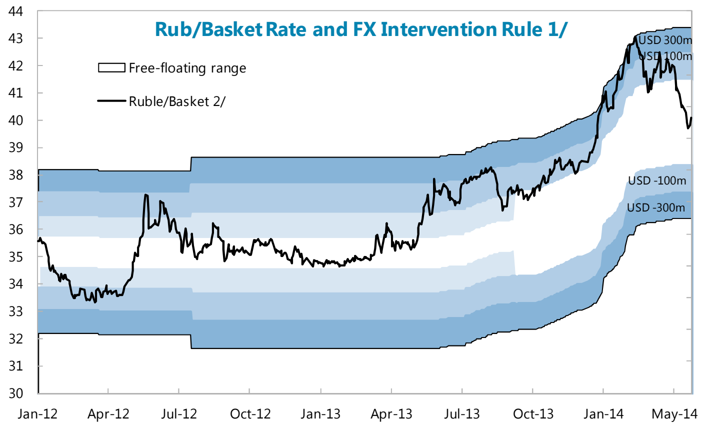
The reform introduced in December 2013 did not increase the statutory retirement age. Starting in 2015, contributors will earn notional pension points over their working life. The value of notional points will be assessed annually based on the system's revenue (including government transfers to be decided annually) divided by the sum of all notional points earned by pensioners. Other changes to the system include: (i) providing financial incentives to delay retirement; (ii) increasing the contribution rate for self-employed and hazardous jobs; (iii) increasing the minimum requirement of years worked from 6 to 15, before claiming a pension; and (iv) introducing a threshold of notional points before claiming benefits. These changes will increase the effective retirement age. A person earning minimum wage would require 40 years to accumulate the minimum notional points needed to claim benefits under the system.

According to the authorities, the generosity of the system – expressed as the ratio of the average benefit to the average wage – is expected to decline gradually by about 10 percentage points, from its current level of 37 percent. Under the new system, transfers from the federal government are expected to decline by about 1 percent of GDP by 2030.

[1] Eich, Gust, and Soto, 2012, "Reforming the Public Pension System in the Russian Federation", IMF WP 12/201.

7. Before March, monetary policy was accommodative and ruble flexibility increased. The CBR had kept policy rates constant since September 2012 amid a softening of economic activity and above-target inflation (Figure 1). It also eliminated its targeted foreign exchange (FX) interventions and widened its non-intervention band while reducing the cumulative level of FX interventions necessary to move the exchange rate corridor, increasing the flexibility of the ruble. During this time, capital outflows persisted, spurred by expectations of continuing ruble depreciation.

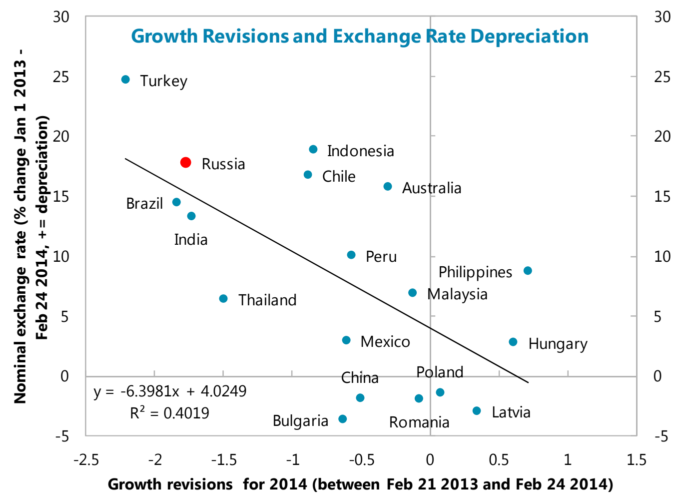
8. Pressures on the ruble have intensified in early 2014. The Fed tapering talk of May 2013 did not affect Russia as much as other EMs given that Russia had not experienced large capital inflows. Nonetheless, at end–2013 and early 2014, pressures re-emerged as inflation remained relatively high, policy rate tightening fell behind other EMs, and growth prospects and fundamentals outlook deteriorated. A move to increase ruble flexibility facilitated a needed orderly depreciation before March.



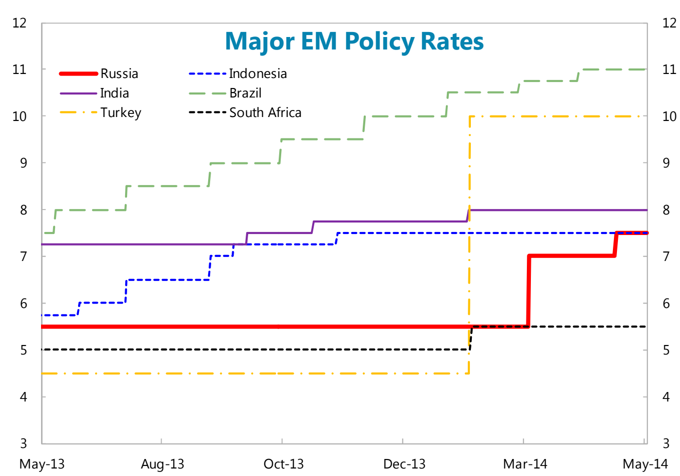
Sources: Central Bank of Russia; Bloomberg; and IMF staff calculations.

1/ Until end-February, the position of the band was shifted after USD350mn of cumulative untargeted interventions. In March, the CBR announced that the threshold was revised up to USD1.5bn. Bands show the size of untargeted daily interventions according to the rule.
2/ Russian ruble per basket (55% USD and 45% EUR).

9. In response to the exceptional circumstances, the CBR raised policy rates and reduced exchange rate flexibility from end February. The onset of geopolitical tensions raised the ruble pressure considerably and the CBR sharply increased net intervention, which reached US$26 billion for the month of March, almost matching the US$27 billion in net interventions for 2013. In a surprise move, the CBR raised its policy rates by 1½ percentage points in early March and a further ½ percentage point in April. Moreover, in response to significant currency pressures in early March, the CBR lowered the flexibility of its FX rule, increasing by more than fourfold, to US$1.5 billion, the cumulative interventions required to move the exchange rate corridor. While the CBR announced that it could determine its FX policy parameters on a daily basis, increasing discretion in its intervention policy, the shifts in the bands have so far occurred in accordance with the new rule. The discretionary policies followed by the authorities appeared to have contained the heightened currency and liquidity stress in early March. In late May, as the exchange rate traded firmly in the non-intervention zone, the CBR lowered the amount of interventions involved in each band by US$100 million to US$100 million in the inner intervention band and US$300 million in the outer intervention band.



Sources: Bloomberg; Consensus Forecasts; and IMF staff calculations.



Source: Haver Analytics; and IMF staff calculations.

10. The banking system remains broadly stable amid a gradual slowdown of unsecured retail credit growth and a stepping-up of bank oversight. Since the 2008 crisis, the banking system has moved from a negative to a positive net foreign asset position (Figure 5). Non-performing loans have remained relatively constant throughout 2013, reaching 6.4 percent in March, and were almost fully provisioned (Table 6). Capital adequacy ratios were relatively stable and remained above the statutory minimum of 10 percent (Figure 3) while overall liquidity has edged down (Table 6). The prudential measures taken in 2013 and early 2014, including tightening risk weights and raising provisioning, have significantly reduced the growth of unsecured consumer lending and were concomitant with a decline in the banking sector profitability (Table 6). The authorities have enacted legislation to tighten regulation over predatory lending practices which should come into effect in July, intended to further reduce risks from consumer lending. With increased supervisory powers (¶31), the CBR has stepped up its banking supervision since the second half of 2013. This resulted in a wave of bank closures, mostly very small banks, found in breach of banking operations or money laundering laws. Some depositors have reallocated their savings from smaller to bigger banks. The extensive coverage of personal deposits by the Deposit Insurance Agency (DIA), which covers 99 percent of retail deposits by number and 70 percent by value, has provided an important confidence backstop, and payouts to insured depositors have proceeded within a period of two weeks.

11. The current account surplus shrank but capital outflows continued in 2013. The current account surplus declined to 1½ percent of GDP in 2013 from 3.6 percent of GDP in 2012. This reflected weaker oil and merchandise exports, as well as continuing deterioration of service and income account balances. Net private capital outflows, which had mirrored the evolution of the current account surplus, remained elevated in 2013 at about 3 percent of GDP. Outflows were driven by the nonbank private sector via shadow capital flight and net portfolio outflows. The authorities are considering measures to promote "de-offshorization," i.e. to discourage Russian individuals and companies from using foreign corporate structures to conceal beneficial ownership or obtain undue tax advantages, which could reduce net capital outflows and increase government revenues. In May, Russia, Kazakhstan, and Belarus signed a treaty on the creation of the Eurasian Economic Union to become effective starting 2015.

12. Russia's external position in 2013 was weaker than its medium-term fundamentals (Annex II). While the REER gap identified for 2013 narrowed and perhaps closed following the recent depreciation, a lasting improvement in the current account would require sustained consolidation on the fiscal policy front and structural reforms to improve competitiveness. Foreign reserves are adequate, standing at the end of April 2014 at US$472 billion or 143 percent of the IMF's calculated reserve adequacy metric, near the upper bound of the recommended range of 100–150 percent.[1] External debt edged up due to a major acquisition in the oil sector but remains sustainable under the baseline scenario (Tables 8–11, Figure 5 and 9).

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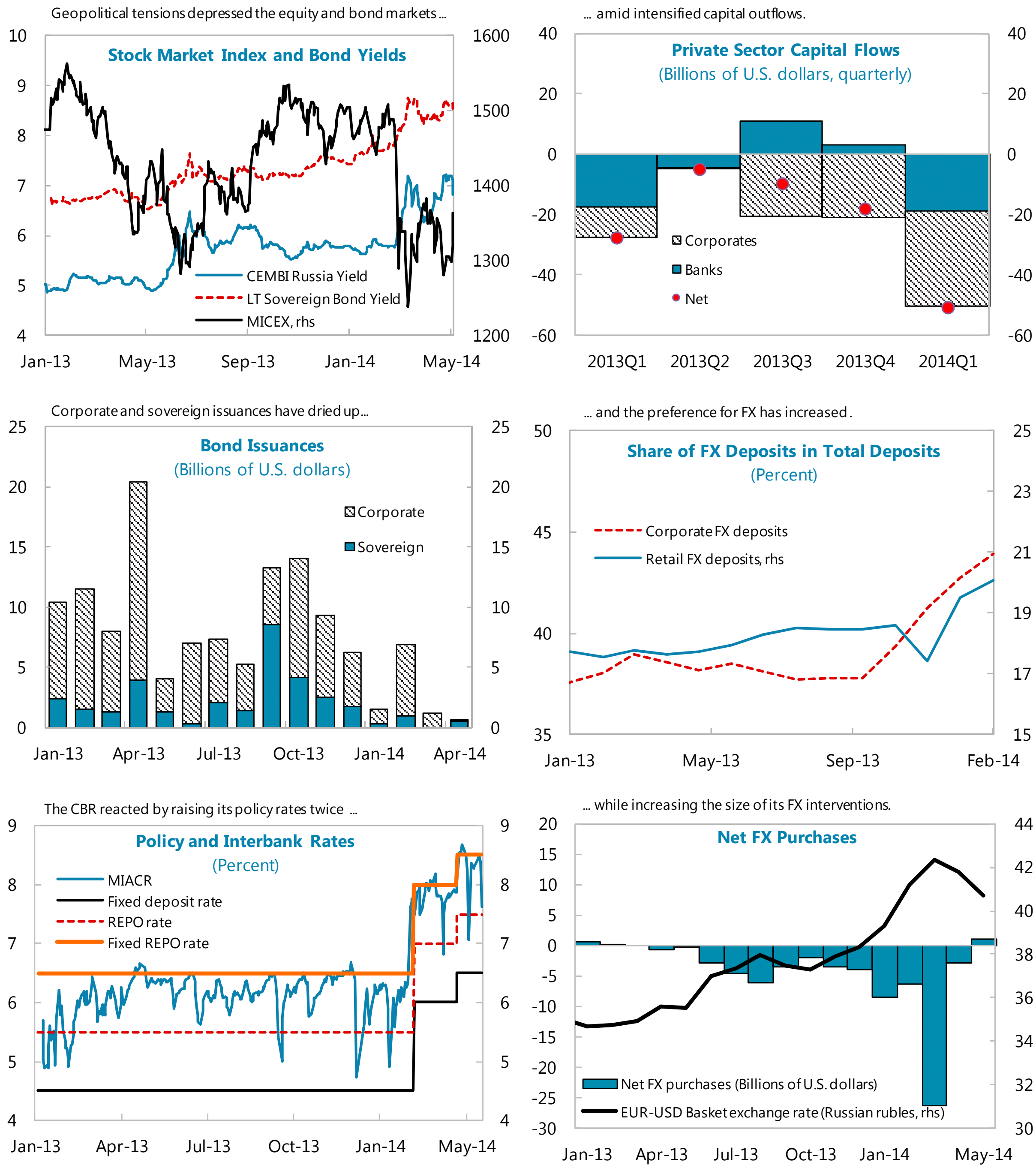
[1] See the IMF Policy Paper "Assessing Reserve Adequacy" (2011).

13. Net private capital outflows increased significantly in the first quarter of 2014 to US$51 billion (Figure 2 and Box 3). Reserves at the CBR experienced additional downward pressures following the sharp increase in FX intervention in early March. The increased level of FX swaps and correspondent accounts between the CBR and domestic banks has temporarily cushioned the level of reserves, which have not declined by the total amount of interventions. While FX swaps were used to access CBR liquidity, the increase in the level of correspondent accounts at the CBR has reflected increased foreign assets repatriation by domestic banks amidst increasing geopolitical uncertainties.

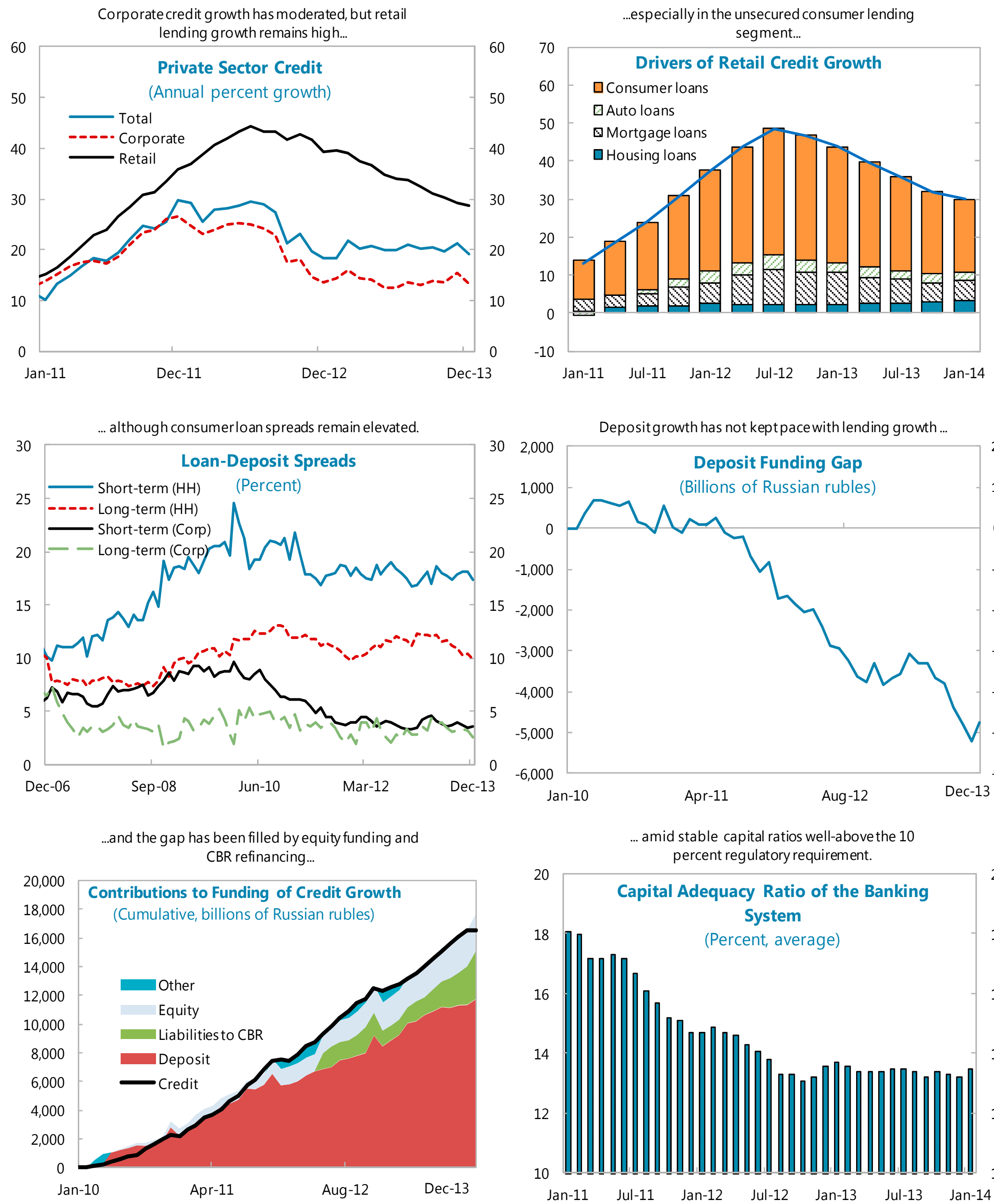
14. Geopolitical tensions are negatively weighing on the cost and access to financing. Since March, sovereign and private issuances have declined very sharply, with borrowing rates increasing by an average of 100–150 basis points (Figure 2). The government has also cancelled a number of domestic auctions. Moody's and Fitch revised the outlook on Russia's sovereign BBB rating from stable to negative while S&P downgraded the sovereign rating by one notch to BBB-, its lowest investment grade category. This downgrade forced similar ratings cut on major Russian corporations such as Gazprom, Rosneft, and VTB bank, as well as subsidiaries of international banks. The geopolitical uncertainty has also given rise to dollarization pressures.

Figure 2. Russian Federation: Impact of Geopolitical Tensions, 2013–14



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

Figure 3. Russian Federation: Monetary and Financial Development, 2006–14



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

OUTLOOK AND RISKS

15. Geopolitical tensions are bringing the Russian economy to a standstill (Figure 4, Table 2). Investment will further contract due to uncertainty and the recent monetary tightening. Capital outflows are expected to exceed US$100 billion in 2014, after reaching US$51 billion in the first quarter (Box 3). Consumption will remain the main growth driver; net exports are also expected to support growth as imports weaken (Table 3). Despite the economic slowdown, inflation is expected to remain well above the CBR's target due to the recent exchange rate depreciation. A slight recovery in growth to 1 percent is projected in 2015, on the back of stronger exports and stabilization of investment.

16. Over the medium term, growth will continue to be constrained by supply-side factors. The factors driving growth during 2000–2008, including oil price increases and utilization of spare capacity, are unlikely to support growth over the projection. In addition, the contribution of labor force is expected to be negative over the projection period due to adverse demographics and an already-low unemployment rate.

17. Risks are starkly on the downside (Annex III). The baseline projections assume a gradual resolution of geopolitical tensions. Even without escalation, prolonged uncertainty and the resulting deterioration of confidence could lead to lower consumption, weaker investment, and greater exchange rate pressure and capital outflows than assumed under the baseline. More fundamentally, sanctions could also derail further integration of Russia in the world economy, with the concomitant adverse impact on long-term growth as reforms are postponed.

18. Russia's direct exposure to a deterioration of the economic situation in Ukraine is moderate: (i) exposure of Russian banks to Ukraine is less than 2 percent of Russian banks' assets; (ii) exports to Ukraine are less than 5 percent of Russia's total exports; and (iii) Russian loans and arrears to Gazprom amounts to US$4.3bn (0.3 percent of GDP). However, about half of Russian gas exports to Europe go through Ukraine, with limited possibility of rerouting through other pipelines in the short run. In addition, some sectors (e.g., base metals, transport equipment, and chemicals) of the Russian economy are closely-integrated with the Ukrainian economy, and disruption of these supply chains could have important sectoral impacts. Uncertainty in Ukraine could undermine confidence in Russia, affecting further domestic consumption and investment.

Box 3. Capital Flows in 2014

Net private capital outflows reached US$51 billion in the first quarter of 2014. This is much higher than the outturn for the first quarter of 2013 at US$28 billion and somewhat lower than the total for 2013 at US$60 billion. However, seasonality is usually strong, with about half of annual outflows occurring in the first quarter. Capital outflows in the first quarter were also lower than the peak of US$132 billion in 2008 Q4 during the global financial crisis.

Larger net outflows were driven by higher-than-usual accumulation of financial assets abroad. In particular, 2014 Q1 saw: (i) US$19.6 billion accumulation of cash foreign currency by non-banks abroad; (ii) US$21 billion accumulation of foreign assets by banks; (iii) US$9.8 billion accumulation of other foreign assets by non-banks. In addition, borrowing from abroad reverted to below average levels at US$15 billion. During the period, domestic banks accumulated exceptional FX positions with the CBR—FX swaps of resident banks with the CBR increased by US$5 billion and FX correspondent accounts with the CBR increased by US$8 billion. Had domestic banks put this excess FX liquidity abroad, instead of parking it with the CBR, capital flows would have reached US$ 64 billion.

19. Other risks remain significant. Among them, external risks include the fallout from the EM turmoil during the transition to higher global interest rates and an acceleration of capital outflows. With 2/3 of exports of goods and ⅓ of general government revenues depending on the energy sector, the Russian economy remains very sensitive to oil and gas prices. Domestic risks include a sharper slowdown in investment, especially if business climate does not improve and financing becomes even more constrained. In the medium term, investment may be stronger than expected, also thanks to recent gas contract with China.

20. Russia has large buffers to face these risks but growth prospects could be damaged. Given the sizeable buffers from large international reserves, low public debt and the reduction of the corporate sector maturity and currency mismatches (Figure 5), the materialization of these risks may not endanger external sustainability but could imply a substantial setback to the growth outlook. At the end of April, gross international reserves covered 190 percent of the 2014 short-term debt outstanding at remaining maturity.

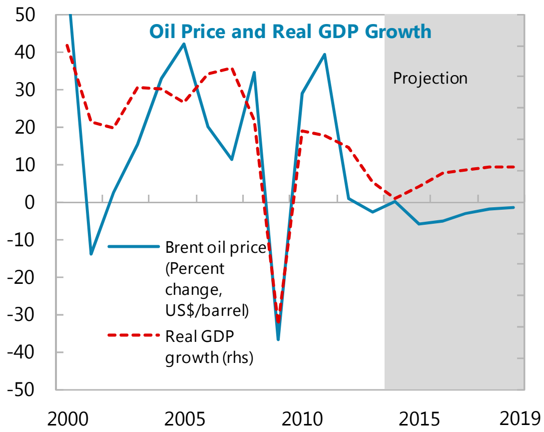
21. However, a significant escalation of tensions could lead to a much deeper recession and jeopardize external sustainability. An escalation of the conflict between Russia and Ukraine could lead to stronger and broader sanctions targeting the financial and/or the energy sectors. Sanctions on Russian banks would further disrupt commerce, investment, and consumption. Significant trade disruptions could emerge if sanctions are targeted at the energy sector. Either of these alternatives would severely impact confidence and intensify capital outflows. Both scenarios could lead to a much worse growth outcome than assumed under the baseline and, in the extreme, even jeopardize external sustainability.

22. While the impact so far has been limited, possible outward spillovers could be sizable. A further slowdown in Russia may affect Russia's neighbors in Eastern Europe, Caucasus, and Central Asia through trade, financial links, and remittances (Box 4). In addition to regional spillovers, Russia may have an effect on other countries outside the region. Russia typically accounts for 8 to 15 percent of major EM indices and its financial system is integrated with the international financial system through various financial instruments, including off-balance-sheet derivatives. A disruption of the Russian financial system or energy exports could have a considerable adverse impact on Europe

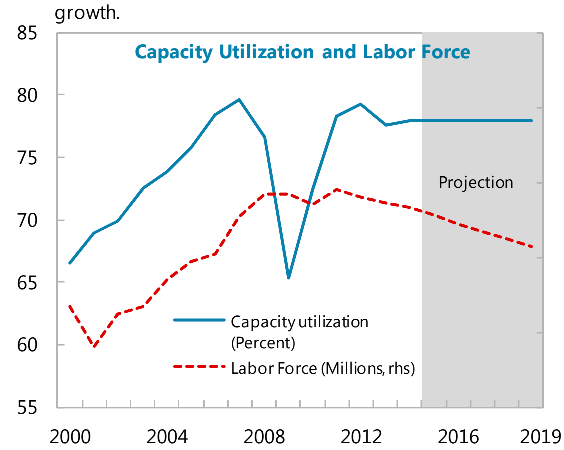
23. The authorities broadly agreed with the outlook and the risk assessment. They underscored geopolitical tensions as the main risk. The authorities also noted that pre-existing structural problems remain an important constraint for investment and growth. The Ministry of Economic Development is optimistic about the reform agenda and its implementation, projecting a medium-term growth rate of about 2½ percent and inflation of around 4 percent. The authorities shared their concerns that pass-through from the exchange rate depreciation to inflation may pose challenges to achieving the 2015 inflation target but the CBR reiterated its commitment to react promptly if inflation stays persistently above target. On the external side, the temporary suspension of the OECD accession talks may delay Russia's integration to the world economy, but the authorities remain committed to continue implementing the necessary reforms and underscored the risks of less integration. They noted that development of gas extraction and production in the Far East would help Russia diversify its exports markets and broaden trade links with Asia.

Figure 4. Russian Federation: Real Sector Developments, 2000–19

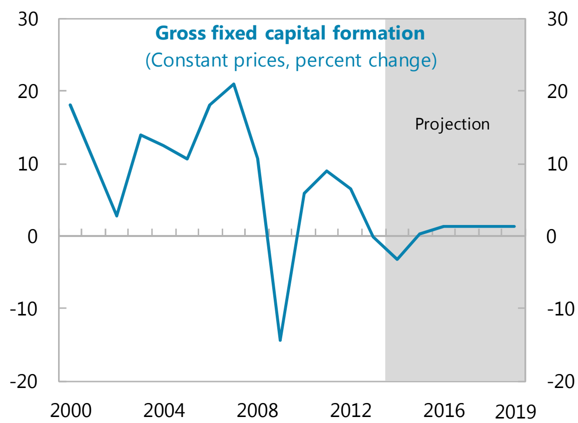
Growth is associated with oil price changes …



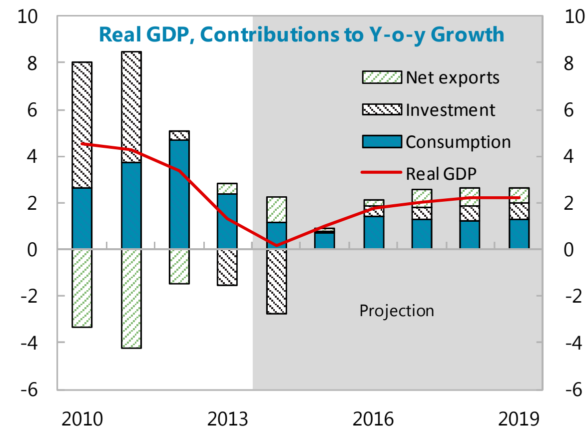
…while capacity utilization and the labor force supported pre-crisis growth, but are expected to constrain future growth.



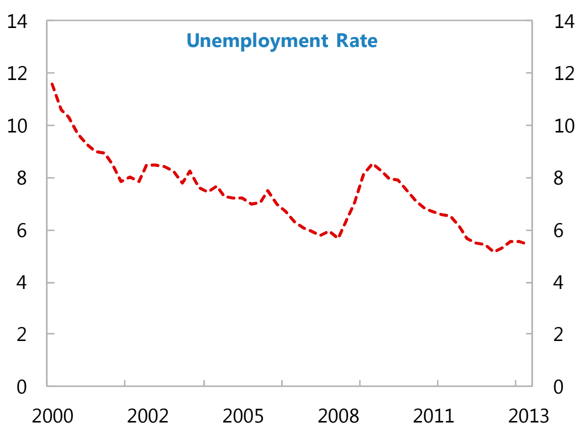
After a sharp contraction in investment in 2013, due to completion of large infrastructure projects …



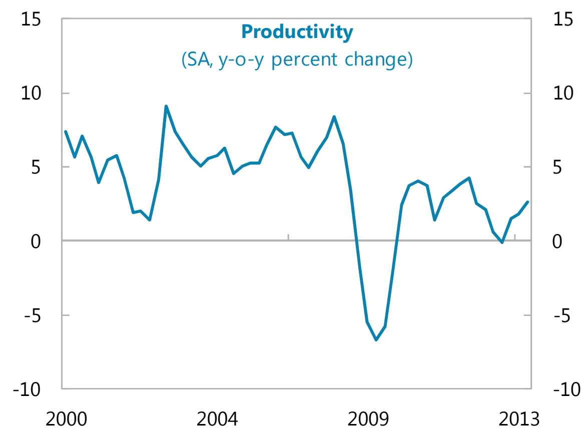
… a modest pick-up in investment and consumption are expected to drive aggregate demand growth over the medium term.



Unemployment rate at historical lows …

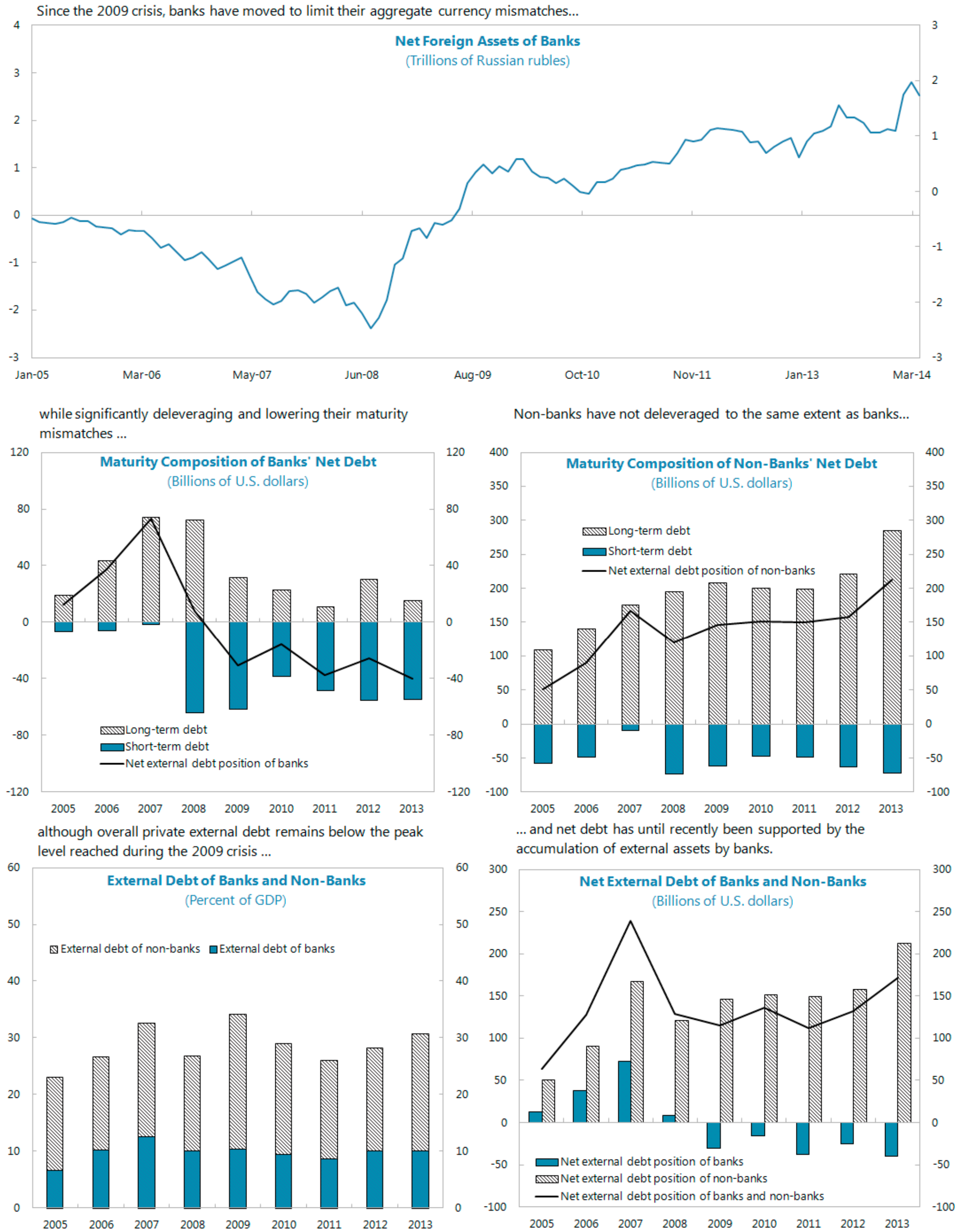


… and low productivity growth, underscore the need for structural reforms.



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

Figure 5. Russian Federation: External Position of the Corporate Sector, 2005–14



Source: Central Bank of the Russian Federation; and IMF staff calculations.
1/ Data for 2013 refers to the latest observation available (July 2013).

Box 4. Regional Spillovers

Regional spillovers from Russia could be sizable and could spread through trade flows, remittances, and the financial linkages.

Neighboring countries could be affected by the slowdown in Russian growth via trade and remittances flows. Exports of goods and services to Russia amount to over 20 percent of GDP in Belarus and are substantial for a number of countries in the Baltics, Eastern Europe, Caucasus, and Central Asia. While direct trade links with central Europe are smaller, they may understate the importance of Russia for their tradable sector where exports to Russia are channeled via Germany. Several Commonwealth of Independent States (CIS) countries receive large amounts of remittances from Russia.

Russia supplies about one-third of European oil and gas consumption. While oil is relatively easy to substitute, natural gas is less so. Finland, the Baltic countries, Belarus, and Czech Republic rely almost entirely on Russian gas for their domestic consumption. Dependence is also high at 40-60 percent in central Europe and southeastern Europe. About half of gas exports from Russia transits through Ukraine, 40 percent of which could be re-routed by using Belarus and Nord Stream pipelines at full capacity. However, it would be hard to re-route LNG gas from Western Europe coastline facilities to central Europe. From Russia's perspective, the possibility of re-routing its gas exports to Asia in the near term is limited by the absence of an appropriate pipeline system to China.

Most countries' direct banking sector linkages with Russia are limited but some international banks derive substantial profits from their Russian operations. Cyprus, Austria, and Hungary are most exposed to the Russian banking system, with total asset of their subsidiaries in Russia of about 4-10 percent of national GDP. Foreign claims by BIS-reporting countries point to further exposures of Austria, Sweden, and the Netherlands at about 2-4 percent of GDP in cross-border lending. Russian banks, on the other hand, are major lenders in Armenia, Belarus, Cyprus, and Ukraine.

Direct financial linkages between Russia and most other countries via FDI and equity and debt portfolio positions are limited. Russian FDI is important for immediate neighbors, financial centers, and the Montenegro real estate sector. While 70 percent of outward and 65 percent of inward FDI positions (stocks) for Russia in 2012 was with five countries, net FDI positions with these countries were close to zero. Low net FDI positions suggest round tripping of Russian money through these locations to take advantage of better property rights and favorable tax treatment. This limits the scale of spillovers for host countries should these flows stop. Similarly, Russian inward and outward portfolio investment has been channeled mostly via financial centers both for equity and debt flows. The largest FDI investors in Russia are the US, Germany, U.K., France, and Finland, mostly in consumer sectors, such as the automotive and food markets. Withdrawal of this "real" FDI from Russia would affect technology and knowledge transfer, with an impact on potential GDP growth.

Table 1. Russian Federation: Direct Exposures to Russia, 2012

(Percent of own GDP, unless otherwise indicated)

	Real exposures				Financial exposures										
					FDI			Equity			Debt			Banks 1/	
	Exports of goods and services	Gas (in percent of gas consumption) 2/	Gas (in percent of energy consumption)	Remittances	Assets	Liabilities	Net	Assets	Liabilities	Net	Assets	Liabilities	Net	Total Assets of Subsidiary Banks in Russia	Foreign Claims by BIS-Reporting Countries in Russia
EU member countries															
Austria	1.4	49.9	10.9	0.0	2.8	1.9	0.9	0.4	0.0	0.4	0.1	0.1	0.1	5.3	4.1
Belgium	1.0	0.0	0.0	0.0	0.6	0.2	0.4	0.1	0.0	0.1	0.0	0.0	0.0	...	0.1
Bosnia and Herzegovina	0.4	100.0	2.5	0.0	0.0	4.3	-4.3	...	...	...	...	...	...	...	...
Bulgaria	3.4	90.7	10.7	0.0	0.1	5.5	-5.4	0.0	...	...	0.0	0.0	0.0	...	...
Croatia	1.6	13.2	3.4	0.0	0.1	0.6	-0.5	...	...	...	...	0.0	...	...	...
Cyprus	13.5	0.0	0.0	0.0	654.1	660.2	-6.1	7.4	3.0	4.4	11.3	8.9	2.4	8.2	...
Czech Republic	2.6	89.7	17.6	0.0	0.2	0.8	-0.7	0.1	...	...	0.1	0.0	0.1	...	...
Denmark	1.1	0.0	0.0	0.0	0.3	0.2	0.1	0.4	...	...	0.4	0.0	0.4	...	0.0
Estonia	11.1	100.0	29.7	0.1	1.5	3.6	-2.1	0.5	0.1	0.4	0.1	0.0	0.1	...	...
Finland	4.0	102.3	11.1	0.0	2.2	0.5	1.7	0.9	0.0	0.9	0.0	...	...	...	...
France	0.5	17.1	2.8	0.0	0.7	0.1	0.5	0.4	0.0	0.4	0.0	0.1	0.0	1.3	2.0
Germany	1.5	39.9	9.6	0.0	0.7	0.3	0.5	0.1	0.0	0.1	0.1	0.1	0.0	...	0.6
Greece	1.0	62.0	8.1	0.0	0.0	0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	...	0.1
Hungary	2.2	35.0	14.1	0.0	0.9	0.1	0.8	0.0	0.0	0.0	0.0	0.1	-0.1	3.7	...
Ireland	0.0	0.0	0.0	0.0	8.9	1.2	7.7	1.5	0.1	1.5	0.6	5.2	-4.6	...	...
Italy	0.7	25.4	9.6	0.0	0.5	0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	1.6	1.5
Latvia	6.2	114.1	38.1	0.1	1.0	3.1	-2.1	0.1	...	...	0.2	0.0	0.2	...	...
Lithuania	15.6	98.8	41.3	0.1	0.6	3.1	-2.6	0.0	0.0	0.0	0.0	0.0	0.0	...	...
Luxembourg	1.2	23.9	5.9	0.0	119.5	16.5	103.0	34.3	0.4	33.9	16.3	19.5	-3.2	...	...
Macedonia, FYR	0.8	100.0	3.0	0.0	0.2	0.2	0.0	...	...	...	...	0.0	...	...	...
Malta	2.2	0.0	0.0	0.0	0.7	1.0	-0.3	...	...	...	...	...	...	...	...
Montenegro	10.1	0.0	0.0	0.1	0.7	27.4	-26.6	...	...	...	...	...	...	0.8	...
Netherlands	1.2	6.4	2.3	0.0	9.1	8.4	0.8	1.0	0.2	0.8	0.3	0.3	0.0	2.9	2.4
Poland	2.1	54.0	8.2	0.0	0.3	0.1	0.2	0.0	0.0	0.0	...	0.0	...	...	...
Portugal	0.3	0.0	0.0	0.0	0.0	0.0	0.0	...	0.0	...	...	...	...	...	0.0
Romania	0.7	18.3	5.4	0.0	0.0	0.1	-0.1	0.0	...	...	...	0.0	...	...	...
Serbia	4.0	54.2	5.4	0.0	0.1	4.7	-4.6	...	...	...	...	...	...	...	...
Slovak Republic	4.0	90.4	23.1	0.0	0.0	0.1	-0.1	0.0	...	...	0.0	0.0	0.0	...	...
Slovenia	2.6	45.1	4.7	0.0	0.9	0.3	0.7	0.1	...	...	0.0	0.0	0.0	...	...
Spain	0.6	0.0	0.0	0.0	0.1	0.4	-0.3	...	0.0	...	...	0.0	...	...	0.2
Sweden	0.7	0.0	0.0	0.0	3.0	0.2	2.9	0.8	0.0	0.8	0.0	...	...	1.8	2.8
Switzerland	1.0	0.0	0.0	0.0	1.8	1.9	-0.1	0.6	0.0	0.6	...	0.0	...	...	1.2
Turkey	1.3	58.5	19.3	0.0	0.1	0.9	-0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.5	0.1
United Kingdom	0.5	0.0	0.0	0.0	0.5	0.4	0.1	0.5	0.0	0.5	0.5	0.3	0.3	...	...
Former Soviet Union															
Armenia	5.9	80.0	24.3	14.6	3.5	25.0	-21.5	...	...	...	...	0.0	...	...	...
Azerbaijan	1.8	0.0	0.0	1.6	0.7	0.7	0.0	...	...	...	...	0.0	...	...	...
Belarus	28.3	99.3	70.1	0.3	0.6	14.2	-13.6	...	0.0	...	...	0.2	...	...	...
Georgia	1.8	0.0	0.0	4.6	0.1	2.3	-2.2	...	0.1	...	...	0.0	...	...	...
Kazakhstan	5.4	9.7	1.5	0.2	0.4	1.2	-0.8	0.0	0.0	0.0	0.1	0.1	0.0	2.3	...
Kyrgyz Republic	6.4	0.0	0.0	29.5	1.7	3.1	-1.4	...	0.1	...	...	...	...	...	...
Moldova	9.2	100.0	63.7	15.0	0.3	10.8	-10.4	...	0.0	...	...	...	...	...	...
Tajikistan	1.4	0.0	0.0	47.9	0.3	8.9	-8.7	...	...	...	...	...	...	...	...
Turkmenistan	11.3	0.0	0.0	0.1	0.0	0.0	0.0	...	...	...	...	...	...	...	...
Ukraine	12.6	60.2	23.7	1.5	0.2	3.1	-2.9	...	0.0	...	...	0.0	...	...	...
Uzbekistan	10.1	0.0	0.0	4.6	0.1	0.5	-0.5	...	...	...	...	...	...	...	...
Other financial centers															
Bahamas, The	...	0.0	0.0	0.0	359.7	72.9	286.8	...	0.0	...	...	...	...	...	...
Virgin Islands, British	...	0.0	0.0	0.0	...	...	...	...	...	...	...	...	...	...	...
Bermuda	...	0.0	0.0	0.0	...	...	...	...	...	...	...	...	...	...	...
St. Kitts and Nevis	...	0.0	0.0	0.0	953.6	675.2	278.3	...	0.0	...	...	10.8	...	...	...
Jersey	...	0.0	0.0	0.0	...	...	...	...	...	...	...	...	...	...	...
Seychelles	5.7	0.0	0.0	0.0	97.0	12.5	84.5	...	...	...	...	10.4	...	...	...
US and BRICS															
United States	0.1	0.0	0.0	0.0	0.1	0.1	0.0	0.3	0.0	0.3	0.1	0.0	0.1	...	0.2
China, P.R.: Mainland	0.7	0.2	0.0	0.0	0.0	0.0	0.0	...	0.0	...	...	0.0	...	...	...
Brazil	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...	0.0
South Africa	0.2	0.0	0.0	0.0	0.9	0.0	0.9	0.0	...	...	...	0.0	...	...	...
India	0.2	0.0	0.0	0.0	0.1	0.1	0.0	...	0.0	...	...	0.0	...	...	...

Highlight rules: Between 10 and 20 and -10 and -20; Greater than 20 and less than -20

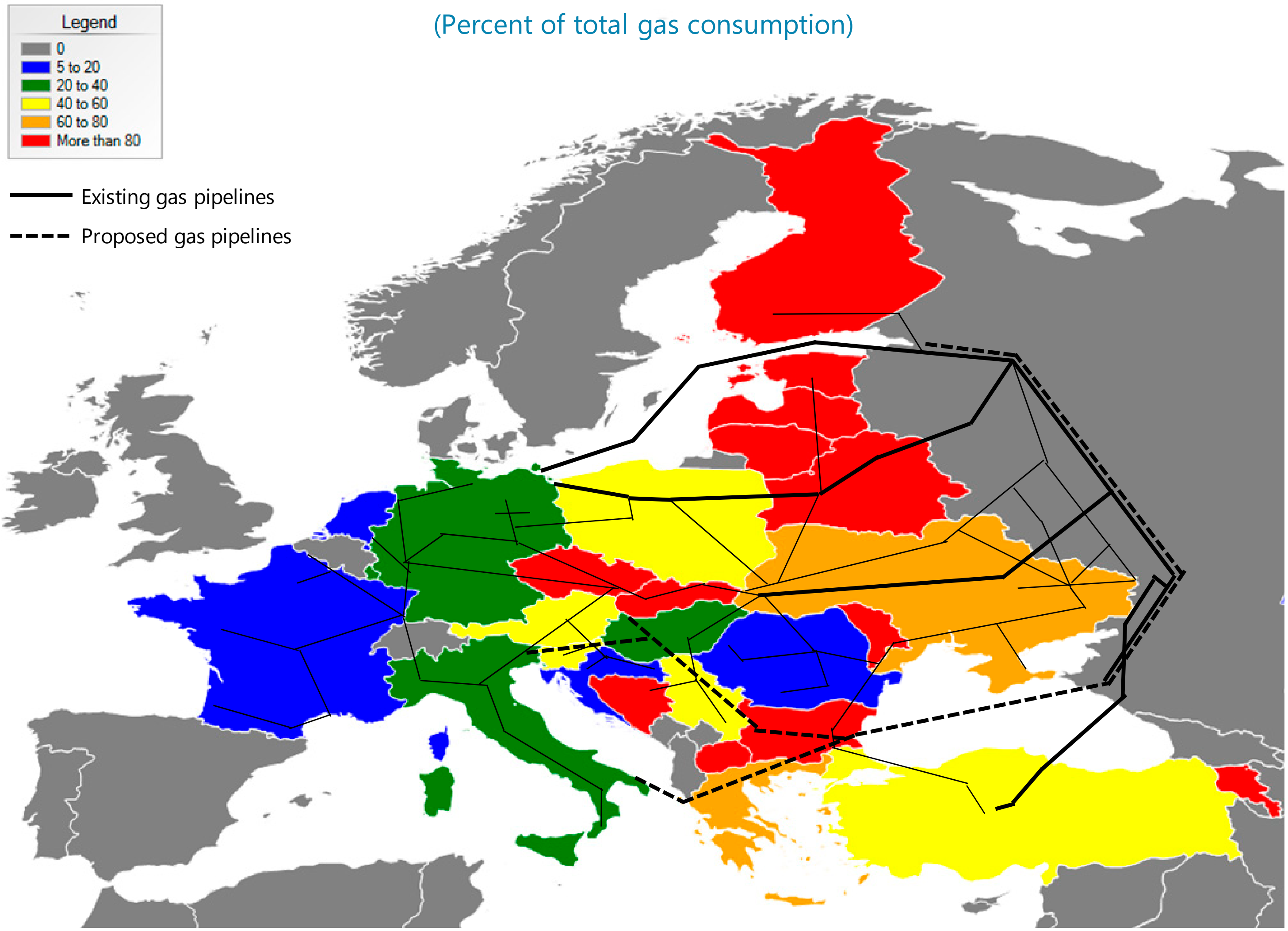
Sources: Eurostat; Direction of Trade; OECD; International Energy Agency; CPIS; CDIS; Bankscope; BIS; CBR; and IMF staff estimates and calculations.

1/ For Cyprus, data refer only to subsidiaries of banking institutions, and do not include subsidiaries whose parents are non-bank holding companies registered in Cyprus. The net asset position could be smaller, as Cypriot banks have sizable amount of Russian deposits.

2/ Imports can be higher than consumption due to replenishing of gas stocks and losses in distribution.

Figure 6. Russian Federation: Share of Russian Gas Exports in Domestic Gas Consumption, 2012 1/

(Percent of total gas consumption)



Sources: OECD; British Petroleum; Gas Infrastructure Europe; Gazprom; and IMF staff estimates and calculations.

1/ For CIS countries not shown on map the share of Russian gas in total gas consumption is 0 except Kazakhstan where it is 9.7 percent.

POLICY DISCUSSIONS

Discussions focused on (i) implementing policies to cope with the impact of geopolitical tensions and global financial volatility; (ii) enhancing the macroeconomic policy framework, including through the transition to inflation targeting and strengthening the fiscal rule (iii) raising long-term growth by introducing further structural reforms.

A. Monetary Policy: Delicate Transition to Inflation Targeting and to Further Exchange Rate Flexibility

24. A tighter monetary stance is required to attain the 2015 inflation target and anchor inflation expectations. Inflation has increased to 7.3 percent in April 2014 (yoy) but is expected to decline to 6.5 percent by year-end given the projected decline in food prices, the limits on utility tariffs' increases, and the emergence of a small negative output gap. Staff noted that the recent cumulative policy rates increase of 2 percentage points signaled CBR's commitment to contain inflationary pressures. Nonetheless, staff views this monetary tightening as insufficient to bring inflation to the CBR's target of 5 percent in 2014, given the size of the recent ruble depreciation and the lags in the transmission mechanism of monetary policy. Moreover, despite the cumulative hike, the real policy rate remains around zero, close to the estimated neutral rate and the slowdown is mainly structural in nature. Staff advocated that the CBR should raise further its policy rates over the next year to ensure that its 4.5 percent inflation target in 2015 is met, in order to anchor inflation expectations in the transition to a full-fledged inflation targeting framework. Higher rates would also help reduce capital outflows that have emerged amid geopolitical tensions, global liquidity tightening and rate hikes by major EMs' central banks.

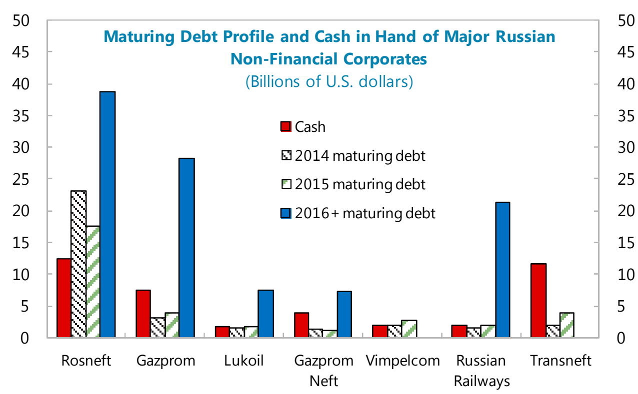
25. The CBR should resume its policy towards greater exchange rate flexibility as soon as the current uncertainties subside. Staff argued that enhancing exchange rate flexibility and using interest rates as the main policy instrument would increase the likelihood of a successful transition to inflation targeting. Exchange rate flexibility provides an important buffer against external shocks—in particular if the shocks and the associated currency stress are prolonged. Staff recommended that as soon as the situation permits, the CBR should gradually simplify and eliminate its intervention bands, lower the size of cumulative foreign exchange interventions required to move the exchange rate corridor, and increase the size of the corridor shifts. Staff noted that the pressures on the exchange rate have abated following the increase in the policy rates and the reduction in the pace of the currency depreciation.

26. The CBR should continue with steps to adopt inflation targeting by end–2014. The CBR has been rationalizing the structure of its instruments and announced in September that the one-week auction interest rate was to become its main policy rate with overnight standing facilities forming the upper and lower bounds of the interest rate corridor. Strengthening the transmission mechanism of monetary policy will require enhancing the signaling role of the policy rate and efforts to deepen the interbank market and reduce its volatility. A clear timeline for implementing steps towards formal adoption of inflation targeting remains also an important goal as well as enhancing communication. In the context of a lack of bank collateral to access liquidity, amid an increasing reliance on CBR funding by banks (Figure 3), the CBR created a three-year standing facility secured by investment projects with a state guarantee. Staff views this mechanism as unlikely to foster lending for investment projects as it does not address the structural weaknesses impeding investment (Section D) and risks benefiting only large banks.

27. The authorities reiterated their commitment to anchoring inflation while moving to inflation targeting and to a fully-flexible exchange rate by end–2014. The CBR expects inflation to come down to below 6 percent provided there are no additional external shocks and that the announced caps on tariff increases are actually implemented. Given the uncertain outlook, the CBR has adopted a wait-and-see mode with a tightening bias. The CBR concurs with staff that there are sizeable risks that inflation will be higher than projected, but reiterated its commitment to act promptly. In addition, the authorities reiterated their commitment to completing preparations for and adopting formal inflation targeting by end–2014, including greater exchange rate flexibility. Nonetheless, the CBR views the current FX intervention rule as appropriate as long as risks to financial stability remain, given the uncertain geopolitical environment and the potential confidence impact of further economic sanctions. The CBR viewed the use of capital flow management measures as potentially counterproductive, signaling policy regression. The CBR indicated that the new three-year facility was experimental and would involve only small amounts.

B. Financial Sector: Containing Risks

28. Recent financial turbulence requires heightened scrutiny of financial stability. Staff noted that even though many corporations benefit from foreign exchange receipts and appear to have enough buffers to deal with the current negative market sentiment, close monitoring of systemic risks remains warranted. In addition, the uncertain geopolitical environment combined with a slowdown in growth could have an adverse impact on banks' profitability and asset quality; on private banks via a deterioration in asset quality associated with the economic slowdown, and on (large) state-owned banks via lower profits and higher provisioning. Staff advised the CBR to continue to monitor any systemic risk build-up via its regular stress testing exercises and increased oversight.



Sources: Bloomberg; S&P; Company reports; and IMF staff calculations.

29. Risk from unsecured retail lending appears to be decreasing and the continued strengthening of bank supervision is welcome. Prudential measures taken by the authorities have reduced the growth of unsecured consumer lending, though it remains relatively high (Figure 3). However, continued oversight remains warranted to ensure the effectiveness of the most recently enacted legislation and prudential measures. The stepping up of banking supervision by the CBR has signaled a strong commitment to deal with banks in breach of banking operations or money laundering laws. Staff noted that this increased supervision will strengthen the stability of the banking system and support the necessary consolidation of the sector. Staff advised the CBR to continue to communicate widely and effectively its intended goals in order to maintain depositors' confidence.

30. The CBR has increased its supervisory and regulatory powers as progress is being made in implementing Basel III rules and the recommendations of the 2011 FSAP. The capacity to monitor systemic risks through regulating and supervising all bank and non-bank financial institutions was enhanced following the creation of a mega-supervisor through the merger of the CBR and the Federal Service for Financial Markets. In addition, the July amendments to the Banking Law was in line with the 2011 FSAP recommendations (Annex IV). However, reforms are still pending on introducing a unified administration regime for all banks, restricting open bank assistance by the DIA to systemic situations, and setting limits on concentration of collateral in the repo market. In preparation for the implementation of Basel III rules, legislation on capital requirements has been passed while regulation on liquidity standards is being finalized. Staff welcomed the CBR's publication of the criteria for the designation of systemic banks, which will be subject to stricter supervision and higher capital requirements.

31. The authorities consider the financial system to be sound and resilient. However, they broadly shared staff's concerns about: (1) potential risks to the banking system from high policy rates, low growth, and further economic sanctions; and (2) declining but still high unsecured consumer credit growth. The CBR noted that financial and non-financial corporations are much more resilient today than they were in 2008-09 given the extensive deleveraging that has taken place in the banking system and the decline of FX and maturity mismatches for corporations as a whole. The authorities' regular stress tests, including scenarios of large depreciation, complete shutdown from international financial markets and large negative growth, suggest that the banking sector as a whole would remain stable and resilient— although capitalization in banks representing one-third of banking system assets would drop below regulatory requirements. The CBR indicated that it stands ready to offer support to illiquid but solvent banks should financial stability be threatened. The CBR shared staff's view that unsecured credit growth remains high, although it is declining at a rapid pace. They were confident that recently adopted prudential measures would further lower risks from unsecured consumer lending, which they viewed as non-systemic. The CBR indicated that it will continue its campaign to revoke licenses for banks that are financially weak or that have dubious operations, which it viewed as important to make the banking system stronger. The CBR claimed that this stepping up of supervision is leading to a decline in money laundering activities.

C. Fiscal Policy: Gradual Consolidation

32. The fiscal stance is broadly appropriate for 2014 but flexibility could be considered in case of a more severe cyclical slowdown. The general government non-oil structural balance is expected to improve by 0.5 percent due to a reduction in VAT refunds and the implementation of the federal fiscal rule (Figure 7). This may, however, overstate the fiscal tightening as the government is expected to provide quasi-fiscal stimulus through the issuance of guarantees for multi-year projects and finance infrastructure projects through the National Wealth Fund. The modest direct fiscal tightening in 2014 appears justified despite the economic slowdown as the Russian economy remains close to its potential. In addition, adhering to the fiscal rule is essential to support its credibility given the current uncertain environment and the needed medium-term fiscal consolidation. In the event of a more severe and prolonged cyclical downturn, fiscal policy could be loosened, in view of the limited size of automatic stabilizers and the fact that monetary policy is constrained by its inflation objective. Additional fiscal measures, if needed, should be temporary and of high quality and be set in a medium-term framework that ensures sustainability.

33. Market financing could be limited given the current geopolitical situation. In recent weeks, the federal government has canceled some domestic bond auctions, stating that the implied interest rates were too high given the sovereign rating and economic standing. In the event of a lack of adequate financing, the federal government could revert to reducing transfers to the Reserve Fund (RF) as in 2013 when non-oil revenues and privatization receipts were lower than expected.

34. The baseline envisages an improvement in the non-oil balance over time. Non-oil revenues are expected to pick up as the economy slowly rebounds while expenditures are expected to be constrained by the implementation of the federal fiscal rule. Given the size of contingency reserves in the federal budget (about 0.3 percent of GDP in 2014) and the possibility of re-allocating spending within the budget, Crimea-related spending is not expected to affect the overall balance. Under the baseline scenario, general government debt is expected to remain sustainable and low, reaching 18 percent of GDP by the end of the forecasting period (Table 8).

35. But additional fiscal consolidation in outer years is needed to rebuild buffers. At 4.3 percent of GDP, the RF is below the authorities' target of 7 percent of GDP, which is designed to maintain government spending unchanged in the face of a reduction in oil prices to US$60 per barrel for 2 years. Under the baseline scenario the RF is not expected to reach its target level over the medium term. While appropriate in the short term, the diversion of resources intended for transfer to the

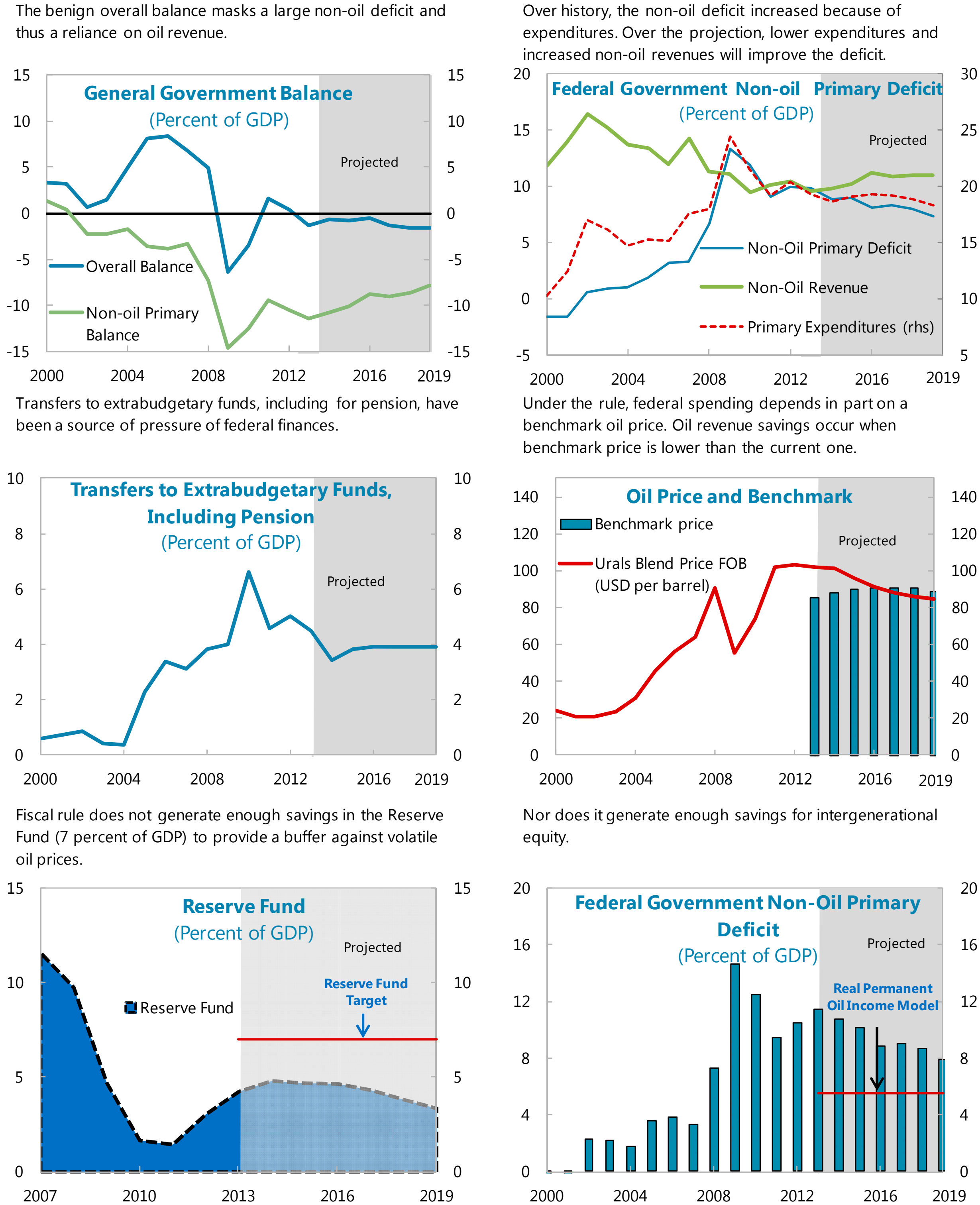
Possible General Government Fiscal Adjustment Measures
(Percent of GDP)

Measure	Budget Savings
Cut tax expenditures	1.0
Reduce wage bill	0.9
Better targeted social transfers and subsidies	1.5-2.0
Improve pension system	2.0
Improve capital budgeting	0.4
Improve tax structure	0.5
Increase excise taxes	0.5
Total	up to 7.3

Source: Ministry of Finance, WB, IMF staff estimates

RF to offset the impact of shortfalls in non-oil revenues, privatization receipts and available financing, would further distance the authorities from their objective. However, with the RF below its target, the authorities risk pro-cyclical fiscal adjustments in the event of large and lasting oil price decline. This risk is heightened given the already high level of oil prices. Staff argued for more prudent oil-price assumption during the budget process to generate more savings. For example, discounting the current benchmark oil price by approximately 15 percent would generate enough savings to rebuild the RF to 7 percent of GDP by 2019. The resulting additional cumulative tightening (compared to the baseline scenario) of about 1.5 percent of GDP could be achieved with various measures (see table). This fiscal consolidation should be introduced gradually in order to limit the adverse impact on the projected economic recovery.

Figure 7. Russian Federation: Fiscal Policy and Oil Savings, 2000–19



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

36. An even more ambitious long-term fiscal consolidation would be required to safeguard intergenerational equity. With a non-oil primary deficit near 11.5 percent of GDP, staff argued that the general government relies too heavily on oil revenues to bring its overall deficit closer to balance. Staff noted that these revenues are associated with exhaustible resources and should therefore be saved more to safeguard intergenerational equity. Staff estimated that under the real permanent-oil-income-model approach, which maintains constant in real terms the government's use of its net wealth, an appropriate target for the non-oil primary deficit would be roughly 5.5 percent of GDP. Currently, the baseline projection shows only a gradual improvement in the non-oil fiscal primary deficit slightly above 7.5 percent of GDP by 2019. Reducing the non-oil deficit would also offset possible Dutch disease effects and improve Russia's external sustainability.

37. Further pension reform would be pivotal for the consolidation effort. Despite the recent reform (Box 2), the generosity of the system is expected to decline over time and may become too low to be socially and politically acceptable, leading to fiscal pressure. Additional measures are needed to ensure the viability of the system while keeping its generosity at an acceptable level. These include: (i) increases in the retirement age (which is low in Russia by international standards); (ii) encourage the formalization of employment in the underground economy; and (iii) improving contribution compliance. Increasing the retirement age could also mitigate some of the expected decline in the labor force and consequently support growth.

38. Achieving fiscal consolidation depends crucially on resisting spending pressures. Recent discussions about relaxing the federal fiscal rule could jeopardize the consolidation. In addition, promises to further increase military spending and public sector wages, increased fiscal pressures from geopolitical tensions, and incomplete pension reform could weigh negatively on future budgets. Consolidation at the local level, which is not covered by the fiscal rule, is especially vulnerable given the 2012 electoral promises to increase wages and local governments' weak tax revenues. In this context, staff welcomes the recent proposal by the Ministry of Finance to limit the provision of tax expenditures. At the general government level, the authorities estimate that tax expenditure in 2012 amounted to Rub1.8 trillion or close to 3 percent of GDP. In addition, the Prime Minister has recently instructed the Ministry of Finance to propose a plan to reduce the public work force by 10 percent.

39. Given Russia's infrastrcture needs, public investment should be increased despite the fiscal consolidation. This implies resisting other spending pressures to preserve fiscal space and prioritizing and reallocating expenditures toward investment. Over time, this objective could be supported by the recently-introduced performance-based budgeting, which helps improve efficiency of public spending. Public spending efficiency could also be buttressed by the new procurement law (Box 6).

Box 5. Fiscal Transparency Evaluation (FTE) for Russia

A recent pilot of the IMF's new FTE assessed the Russian government's fiscal reporting, forecasting, and risk management practices against the IMF's revised Fiscal Transparency Code.[1] The FTE found a number of strengths including : (i) a comprehensive legal framework for fiscal management; (ii) frequent and timely accrual-based fiscal statistics which consolidate federal and sub-national governments and extra-budgetary units; (iii) a budget, submitted and approved in a timely manner, based on credible macroeconomic forecasts and with a strong medium-term orientation; and (iv) firm central controls over key sources of fiscal risk including annual limits on debt, credit, and guarantee issuance by federal and sub-national governments.

The FTE also highlighted some important gaps. First, Russia's most comprehensive reports cover only about 60 percent of the total public sector expenditure while a fuller accounting, taking into account the large and complex array of government-controlled enterprises, would reveal a much greater involvement of the state in the economy as well as slightly negative overall net worth (Figure 1). Second, while reported balance sheets include most conventional assets and liabilities, they exclude the government's estimated 200 percent of GDP in sub-soil oil and gas reserves and almost 300 percent of GDP in liabilities from public pensions and PPPs (Figure 2). Third, while the federal budget is relatively comprehensive, a large and growing proportion is classified as secret (rising from 14 to almost 25 percent of budget expenditure over the next three years as more agencies and activities, such as border protection, are classified as national security and spending on armaments increases), and there are plans for significant extra-budgetary activity via sovereign wealth funds.

Recommendations of the FTE include: (i) clarify the boundary between general government, public corporations, and private sectors—currently the general government accounts exclude government-controlled enterprises that perform non-market activities but these should be included in the general government according to international standards; (ii) expand the institutional coverage to encompass the entire public sector; (iii) publish a more comprehensive balance sheet including sub-soil assets and pension and PPP liabilities; (iv) improve the coverage and detail of the annual budget; and (v) enhance the disclosure and management of acute and long-term fiscal risks.

Figure 1: Coverage of Public Sector Expenditure

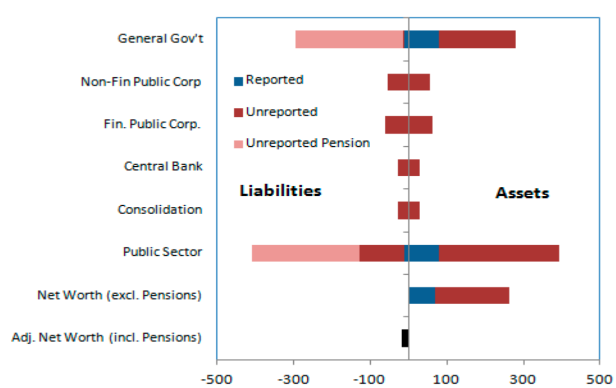
(Percent of GDP, 2012)

	Flows			Financial Balance Sheet		
	Revenue	Expenditure	Balance	Assets	Liabilities	Net Worth
General Government	44.4	41.4	3.0	34.2	16.1	18.1
Public Corporations	28.7	28.7	-0.1	90.8	126.9	-36.1
Non-Financial	23.1	23.9	-0.8	17.0	48.1	-31.2
Financial	5.6	4.8	0.8	73.8	78.7	-4.9
Public Sector[1]	71.3	68.4	3.0	99.7	117.7	-18.0

Source: GFSM 2001 statistics and IMF staff estimates based on a sample of 26 largest public corporations; accrual basis.
1/ Consolidated

Figure 2: Coverage of Public Sector Balance Sheet

(Percent of GDP, 2012)



[1] Russian Federation: Fiscal Transparency Evaluation, IMF, 2014

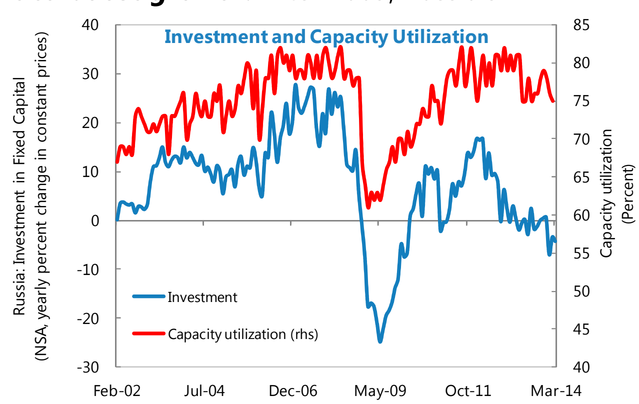
40. The coverage of fiscal reports should be extended. While Russia compiles a comprehensive set of the general government accounts that are broadly adequate for surveillance

(Informational Annex), these accounts understate the size of the general government, as they exclude government-controlled enterprises that are performing non-market activities. In addition, as noted in the recent Fiscal Transparency Evaluation (Box 5), Russia does not report statistics on the broader public sector, which would include all government-controlled enterprises. A broader definition of the public sector would reveal a much greater involvement of the state in the economy, larger public debt as well as a negative overall net worth. Finally, a large and growing share of budget expenditure is classified as "secret," reducing the specificity and transparency of the budget.

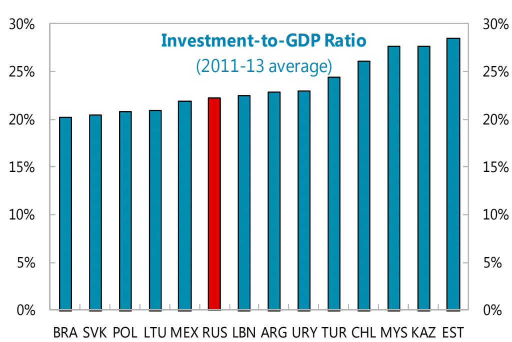
41. **The authorities reiterated their commitment to the fiscal rule.** They noted that structural reforms are needed to stimulate the economy, instead of fiscal stimulus, but noted that in the event of a significant slowdown, changes to the fiscal rule could be considered. The authorities agreed that further fiscal consolidation is required over the medium and long term as the current level of the non-oil balance is excessive. The authorities are cognizant of the spending pressures, and agreed that there is a need to increase public investment, which could come from re-allocating resources and the use of reserves. They noted that a sizeable portion of government spending goes to the public pension system and did not rule out the possibility of increasing the retirement age in the future, if needed.

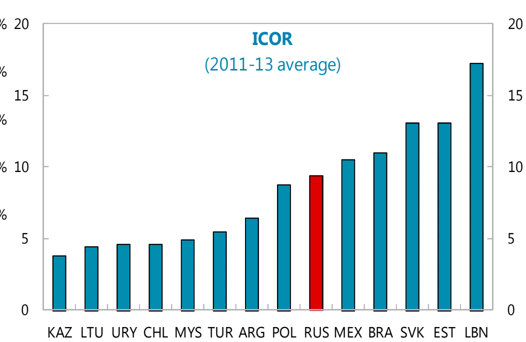
D. Structural Policies: Addressing Structural Bottlenecks

42. **Russia needs more and better investment to boost growth.** After 2009, Russia's investment rate remains low compared to other EMs with a similar level of economic development. At the same time, investment is weakening when it is most needed, as capacity utilization is close to historical highs. Russia's incremental capital-output ratio (ICOR) is also very low. The significant share of total investment in Russia undertaken by large state-controlled corporations may also limit the quantity and quality of investment.



Sources: Haver Analytics; and Russian Economic Barometer.





Source: *World Economic Outlook*.

43. Progress on structural reforms is pivotal to increase potential growth. This requires addressing problems of governance and corruption, administrative barriers and regulation, and the involvement of the state in the economy (Figure 8). In absolute terms, Russia is the third largest energy subsidizer in the word (US$116 billion). Moreover, increasing labor mobility of workers in "monocities," which is constrained by subsidies and social benefits, could free up resources for more productive use elsewhere. Finally, Russia could further exploit its comparative advantage by moving to a profit-based taxation of natural resources instead of revenues-based taxation, which inhibits the exploitation of higher-costs resources. Accelerating implementation of the government's revised privatization plan, if market conditions allow, may also enhance productivity.

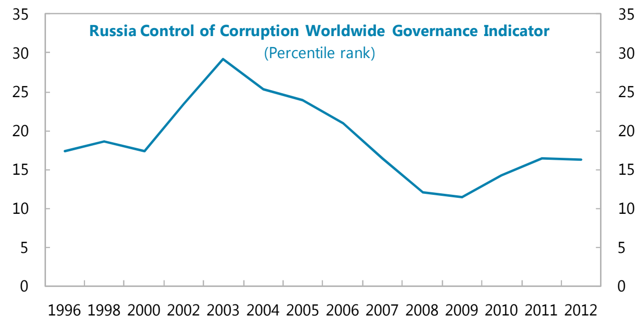
Changes in Privatization Plan

Company	State share in September 2013	Target state share under privatisation plan 2012-13 and until 2016	Target state share under privatisation plan 2014-16
Rosselkhozbank	100.00%	Full exit by 2016	No plans for privatisation
Sberbank	50% + 1	50% + 1 (reduction from 57.6%)	No plans for privatisation
VTB	60,9%	Full exit by 2016	50% + 1
Rostelecom	55.60%	Full exit by 2013	Full exit by 2016
Aeroflot	51.20%	Full exit by 2016	25% + 1
RZD Russian Railways	100%	75% + 1	75% + 1
Sovkomflot	100%	25% + 1	25% + 1
Sheremetyevo airport	83.00%	Full exit by 2016	Full exit by 2016
Vnukovo airport	74.70%	--	Full exit by 2016
Rusgidro	67%	Full exit by 2016	50% + 1
Rosneft	69.50%	Full exit by 2016	50% + 1
Transneft	78.30%	75% + 1	75% + 1
Zarubezhneft	100%	Full exit by 2016	50% + 1 share

Source: OECD 2014 and Russian Authorities

44. Banking and financial sector reforms are also key to boost investment and growth. The banking system is highly concentrated, lacks depth, and is inefficient at channeling savings to productive investment. The top three banks (state-owned) accounted for almost 60 percent of total sector assets at year-end 2013. Concentration indices point to a moderately concentrated system but large state-owned banks are found to exert more market power than others. With credit-to-GDP at 55 percent, the depth of the financial system is relatively low compared to other EMs. Finally, the banking system contributes only 6 percent of funding for business investment while peer comparison shows that Russian firms have much less access to bank and external financing (Figure 8). This may reflect, to some extent, privileged access to bank financing by large SOEs. The reform of the financial sector could also reduce capital outflows.

45. While some of Russia's rankings in international indicators of corruption have improved, the high absolute level and other measures underscore the persistence of the problem. Russia moved up 19 ranks on the World Bank's Doing Business Indicators[2] between 2012 and 2013 and its international ranking on the Transparency International Corruptions Perceptions Index also improved from 132nd to 127th across the same period. However, the Control of Corruption Worldwide Governance Indicator shows that Russia has hovered between the 15th and the 30th percentile in the 16 years.



Source: World Bank.

46. The Russian government has initiated a number of programs to combat corruption, reform procurement, and improve the business climate. The overall strategic guidance comes from bi-annual Anti-Corruption Plans, which have been issued since 2008. Public procurement rules were reformed (Box 6). Moreover, Russia created a Federal Business Ombudsman in 2012 to protect businesses. Finally, a set of 13 road maps have been elaborated and are being implemented with public-private monitoring for improving critical areas of the business climate.

47. Russia has improved its regime for Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT). In October 2013, Russia was removed from the FATF follow-up process given that major identified deficiencies had been addressed. Going forward, Russia will be preparing for its next assessment under the recently revised standards, which is more demanding including in the areas of tax crimes and enhanced scrutiny of domestic politically exposed persons.

48. Implementation remains crucial to having a tangible impact. Modernization of the declaration system of asset, income and expenditure declarations for public officials would be an important step, especially if it were to make the system more unified, transparent, and accessible. Such measure could allow the authorities to use the AML framework more effectively in the fight against corruption. It is also recommended that competitive, even-handed, and flexible procurement procedures should be increasingly enshrined in legislation and practice so that domestic and foreign firms and investors feel secure in their contractual, adjudication, and property rights.

49. Staff recommended reinvigorating implementation of the reform agenda. This would include continuing the fight against corruption, reinvigorating the privatization agenda, reducing price distortions, and improving competition. Staff welcomed the serious attention that the Russian authorities have focused on the area of public procurement and await with interest the results of current plans to amend the recently enacted 2013 procurement law. The PPP framework could

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[2] As pointed out in an independent evaluation of the Doing Business survey (www.worldbank.org/ieg/doingbusiness), care should be exercised when interpreting these indicators given subjective interpretation, limited coverage of business.

enhance transparency and accountability as long as the new PPP law is in line with best practices. Direct state involvement in operations of SOEs should be limited.

50. Staff noted that financial deepening is needed to support long-term growth. A deeper and more efficient financial system would improve the allocation of capital, thereby enhancing economic growth, and increase the saving rate in the private sector. Policies include reducing banking sector fragmentation through consolidation and reduced public bank ownership, enhance competition and encourage the development of medium-size banks, greater pricing transparency and consumer protection, and further strengthening the role of credit bureaus and collateral registries to reduce information asymmetries.

51. The authorities broadly agreed and noted that they remain committed to the reform agenda. They noted that adverse confidence effects are amplifying the deterioration in investment prospects due to pre-existing structural bottlenecks. The Ministry of Economic Development will continue implementing its reform agenda based on roadmaps, including in the following areas: strengthening the rule of law and ensuring effective implementation of laws, regulations, codes and policies; internet policy and information security; trade barriers and implementation of WTO commitments; investment climate, corporate governance, and environment policy. In addition, the authorities recognize the lack of access to financing by SMEs, and have recently taken initial steps to support them through the establishment of the Agency for Credit Guarantees. The authorities argued that excessive regulations and trade barriers have a negative effect on the business climate.

Figure 8. Russian Federation: Russia Faces Structural Problems, 2008–13

Sources: International Finance Corporation, 2012; OECD 2014; Transparency International; and IMF staff calculations.

Box 6. New Procurement Law

Increasing the efficiency of government expenditure is key to improve fiscal space, to ensure that public investment supports growth, and to fight against corruption.

A general reform of the procurement system in Russia started in 2005 when the following were introduced: (i) changes in the process of placing orders; (ii) e-procurement (unified website launched in 2011); (iii) use of a financial guarantee instead of qualification of bidders; (iv) third party payment system; and (v) administrative appeal procedure.

A new procurement law came into effect on January 1, 2014. The main changes introduced were: (i) compulsory planning procedure for all procurement types (Jan 1, 2015); (ii) procurement needs to be based on state and municipal roadmaps; (iii) mandatory disclosure of beneficial owner information by bidding companies; (iv) mechanisms for setting the initial contract price; (v) more options for bidders to provide securities and guarantees against non-performance; (vi) new contracting options—RFP (as opposed to a request for quote), two-stage tender, closed restricted tender; (vii) conduct of all auctions (one of the many contracting options) electronically; (viii) performance monitoring and auditing functions.

STAFF APPRAISAL

52. **Structural weaknesses and geopolitical uncertainties are taking a heavy toll on the economy.** Growth, already slowing because of pre-existing structural bottlenecks, is expected to weaken to 0.2 percent in 2014 with considerable downside risks. Continued conflict could lead to additional sanctions and worse outcomes. Critically, geopolitical tensions could slow, or even reverse, the process of integration of Russia into the world economy, damaging Russia's economic potential.

53. **Faced with exceptional circumstances, policies should aim in the near-term at preserving macroeconomic stability.** In recent years, Russia has considerably improved its macroeconomic framework with the adoption of a fiscal rule, the preparation for inflation targeting, and the implementation of increased exchange rate flexibility. Strengthening these critical policy anchors will support confidence and macroeconomic stability. Given the uncertainty about the duration of the geopolitical situation and the limited cyclical slack in the economy, authorities should refrain from short-term countercyclical policies.

54. **Further monetary tightening will likely be required over the next year to attain the 2015 inflation target**. The CBR should stand ready to raise further its policy rates to meet its 4½ percent inflation target in 2015 and anchor inflation expectations. Higher rates would also help reduce capital outflows. The CBR should resume its policy towards greater exchange rate flexibility as soon as the current uncertainties subside. Enhancing exchange rate flexibility and using interest rates as the main policy instrument would ensure a successful transition to inflation targeting.

55. **Continued strengthening of banking supervision is welcome.** Increased supervision will strengthen banks' stability and support the necessary consolidation of the sector. The CBR should

continue to communicate its intended goals widely and effectively in order to maintain depositors' confidence. Systemic risk from unsecured retail lending appears limited but continued oversight is still warranted. The authorities should continue to work towards implementing the remaining FSAP recommendations.

56. The fiscal stance remains appropriate for 2014. Modest fiscal tightening, despite the economic slowdown, appears justified as output remains close to potential. Adhering to the fiscal rule is essential to support its credibility given the current uncertain environment and the needed medium-term fiscal consolidation. Mounting spending pressures should be resisted in order to preserve fiscal space for investment. Additional fiscal consolidation in the outer years is needed to rebuild buffers. The current non-oil deficit remains very high and the overall deficit is low only due to high oil prices. Further pension reform is necessary. Increasing the retirement age is vital to ensure the viability of the system.

57. Structural reforms remain essential to enhance Russia's growth potential. Continued efforts at global integration are necessary to attract high-quality investment and boost potential growth. Reforms discussed in the context of the stalled OECD accession negotiations should continue, as skill mismatches in the labor market, large tax burdens, especially for SMEs, and administrative barriers and corruption remain key obstacles. Pushing ahead with the announced privatization plans should enhance economic efficiency.

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

Table 2. Russian Federation: Selected Macroeconomic Indicators, 2009–15

	2009	2010	2011	2012	2013	2014	2015
						Proj.	
			(Annual percent change)				
Production and prices							
Real GDP	-7.8	4.5	4.3	3.4	1.3	0.2	1.0
Real domestic demand	-14.2	8.5	9.1	5.5	1.0	-1.7	0.8
Consumption	-3.9	3.5	5.3	7.0	3.5	1.6	1.0
Investment	-41.0	28.5	21.0	1.5	-6.1	-12.1	0.2
Consumer prices							
Period average	11.7	6.9	8.4	5.1	6.8	6.6	6.0
End of period	8.8	8.8	6.1	6.6	6.5	6.5	5.5
GDP deflator	2.0	14.2	15.9	7.5	5.9	8.5	5.9
Unemployment rate	8.4	7.3	6.5	5.5	5.5	6.5	6.5
			(Percent of GDP)				
Public sector 1/							
General government							
Net lending/borrowing (overall balance)	-6.3	-3.4	1.5	0.4	-1.3	-0.7	-0.8
Revenue	35.0	34.6	37.3	37.7	36.1	36.4	36.1
Expenditures	41.4	38.0	35.7	37.2	37.3	37.1	36.9
Primary balance	-5.7	-2.9	2.1	1.0	-0.6	0.0	0.0
Nonoil balance	-15.2	-13.0	-10.0	-11.0	-12.2	-11.9	-11.0
Nonoil balance excl. one-off receipts 2/	-15.6	-13.0	-10.0	-11.3	-12.2	-11.9	-11.0
Federal government							
Net lending/borrowing (overall balance)	-6.0	-3.9	0.8	-0.1	-0.5	0.4	-0.2
Nonoil balance	-13.8	-12.4	-9.5	-10.4	-10.4	-9.7	-9.5
Nonoil balance excl. one-off receipts 2/	-14.2	-12.4	-9.5	-10.7	-10.4	-9.7	-9.5
			(Annual percent change)				
Money							
Base money	7.4	25.4	20.9	11.3	8.0	7.4	7.8
Ruble broad money	17.7	31.1	22.3	11.9	14.6	13.5	14.0
Credit to the economy	2.6	12.9	28.1	19.4	15.5	13.4	13.8
External sector							
Export volumes	-10.4	5.1	4.2	4.6	1.7	2.9	2.3
Oil	3.0	3.2	-1.9	0.4	2.6	1.8	-1.3
Gas	-13.8	5.6	6.7	4.6	9.7	-2.2	0.2
Non-energy	-23.2	11.2	6.1	5.9	5.0	6.9	8.6
Import volumes	-31.4	26.7	16.6	9.2	3.1	-3.0	2.0
			(Billions of U.S. dollars; unless otherwise indicated)				
External sector							
Total merchandise exports, f.o.b	297.2	392.7	515.4	527.4	523.3	530.7	523.1
Total merchandise imports, f.o.b	-183.9	-245.7	-318.6	-335.8	-343.0	-330.0	-333.6
External current account	50.4	67.5	97.3	71.3	32.8	59.1	49.4
External current account (percent of GDP)	4.1	4.4	5.1	3.5	1.6	2.9	2.4
Gross international reserves							
Billions of U.S. dollars	439.5	479.4	498.6	537.6	509.6	470.2	470.2
Months of imports 3/	21.3	17.9	14.6	14.5	13.0	12.5	12.4
Percent of short-term debt	303	339	331	327	286	252	237
Memorandum items:							
Nominal GDP (billions of rubles)	38,807	46,309	55,967	62,218	66,755	72,552	77,649
Nominal GDP (billions of U.S. dollars)	1,232	1,523	1,905	2,017	2,102	2,006	2,047
Exchange rate (rubles per U.S. dollar, period average)	31.7	30.4	29.4	30.8	31.8	...	...
Oil exports (billions of U.S. dollars)	148.7	206.3	277.5	284.6	283.0	285.8	269.0
World oil price (U.S. dollars per barrel) 4/	61.8	79.0	104.0	112.0	108.8	108.0	103.0
Urals crude oil spot price (U.S. dollars per barrel)	61.3	78.3	109.3	110.3	107.9	107.1	102.1
Oil Extraction (millions of tons) 5/	495.0	506.0	512.0	517.0	516.0	524.8	524.0
Real effective exchange rate (average percent change)	-6.9	9.3	4.9	3.7	-0.5	...	...

Sources: Russian authorities; and IMF staff estimates.

1/ Cash basis.
2/ Excludes one-off tax receipts from Nanotechnology and Housing Funds in 2009; and one-off nontax receipts from Sberbank privatization and Rosneftegaz dividends in 2012.
3/ In months of imports of goods and non-factor services.
4/ WEO through 2011; and Brent crude oil spot and futures prices for 2012-15.
5/ Previously reported as "Taxable oil volume (millions of tons)"

Table 3. Russian Federation: Balance of Payments, 2009–15

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

	2009	2010	2011	2012	2013	2014	2015
						Proj.	
Current Account	50.4	67.5	97.3	71.3	32.8	59.1	49.4
Trade Balance	113.2	147.0	196.9	191.7	180.3	200.7	189.6
Exports	297.2	392.7	515.4	527.4	523.3	530.7	523.1
Non-energy	106.4	138.7	173.6	180.6	173.1	180.8	193.0
Energy	190.7	254.0	341.8	346.8	350.2	349.9	330.1
Oil	148.7	206.3	277.5	284.6	283.0	285.8	269.0
Gas	42.0	47.7	64.3	62.3	67.2	64.0	61.1
Imports	-183.9	-245.7	-318.6	-335.8	-343.0	-330.0	-333.6
Services	-17.6	-26.1	-33.5	-46.6	-58.6	-49.0	-47.2
Income	-39.7	-47.1	-60.4	-67.7	-79.8	-85.4	-86.2
Public sector interest (net)	6.3	3.6	3.1	1.2	-0.9	-2.5	-1.8
Other sectors	-46.1	-50.7	-63.5	-68.9	-78.9	-82.9	-84.4
Current transfers	-5.5	-6.3	-5.7	-6.1	-9.2	-7.2	-6.8
Capital and financial account	-40.6	-21.6	-76.0	-30.9	-42.9	-98.4	-49.4
Capital transfers	-12.5	0.0	0.1	-5.2	-0.4	-11.0	0.0
Financial accounts							
Federal government	12.3	2.9	-0.3	16.4	5.3	16.5	13.2
Portfolio investment	3.8	4.9	3.3	17.1	10.1	6.8	14.9
Loans	7.3	-1.2	-2.0	-0.8	-1.0	-0.8	-1.3
Other investment	1.2	-0.9	-1.7	0.1	-3.7	10.6	-0.4
Local governments	0.4	0.5	-1.1	-0.2	-0.1	-0.1	-0.1
Private sector capital	-52.9	-22.5	-74.3	-45.4	-48.8	-103.9	-62.5
Direct investment	-6.7	-8.8	-11.7	1.8	-15.6	-8.0	-9.0
Portfolio investment	0.8	-4.8	-10.6	-9.9	-13.6	-13.9	-14.4
Other investment, commercial banks	-37.7	11.8	-28.1	17.0	-15.5	-23.8	-12.8
Assets	11.1	-0.7	-30.9	-8.5	-26.8	-28.0	-29.3
Liabilities (loans, deposits, etc.)	-48.8	12.4	2.8	25.5	11.3	4.2	16.6
Loans, corporations	2.6	-6.2	20.2	6.7	44.2	18.4	18.9
Disbursements	82.6	72.5	80.9	88.0	127.7	115.8	122.1
Amortizations	-80.0	-78.7	-60.7	-81.4	-83.5	-97.4	-103.2
Other private sector capital flows	-11.0	-14.3	-40.0	-60.9	-48.3	-76.5	-45.2
Errors and omissions, net	-6.4	-9.1	-8.7	-10.4	-11.9	0.0	0.0
Of which : valuation adjustment	-9.0	-3.2	-9.0	5.9	0.0	0.0	0.0
Overall balance	3.4	36.8	12.6	30.0	-22.1	-39.4	0.0
Financing	-4.0	-36.3	-12.2	-30.0	22.1	39.4	0.0
Net international reserves	-3.4	-36.8	-12.6	-30.0	22.1	39.4	0.0
Arrears and rescheduling	-0.6	0.4	0.4	0.0	0.0	0.0	0.0
Memorandum items:							
Current account (percent of GDP)	4.1	4.4	5.1	3.5	1.6	2.9	2.4
Non-energy current account (percent of GDP)	-11.4	-12.2	-12.8	-13.7	-15.1	-14.5	-13.7
Gross reserves 1/	439.5	479.4	498.6	537.6	509.6	470.2	470.2
(months of imports of GNFS)	21.3	17.9	14.6	14.5	13.0	12.5	12.4
(percent of short-term debt) 2/	303.2	339.1	331.1	327.2	285.9	252.3	236.7
Real growth in partner countries (percent change)	-2.9	4.2	3.4	1.3	1.6	2.3	3.0
Net private capital flows (percent of exports of GNFS)	-15.4	-5.1	-13.0	-7.7	-8.2	-17.2	-10.5
Net private capital flows, banks	-45.5	10.4	-29.7	15.9	-15.4	-21.9	-10.1
Public external debt service payments 3/	5.9	6.5	9.0	8.8	11.0	7.7	7.9
(percent of exports of goods and services)	1.7	1.5	1.6	1.5	1.9	1.3	1.3
Public external debt 4/	45.9	46.6	44.4	70.1	80.1	85.9	99.4
(percent of GDP)	3.8	3.1	2.3	3.5	3.8	4.3	4.9
Private external debt	421.3	442.4	500.7	566.4	634.1	660.1	699.2
(percent of GDP)	34.5	29.0	26.3	28.1	30.2	32.9	34.2
Total external debt	467.2	488.9	545.2	636.4	714.2	746.0	798.6
(percent of GDP)	38.2	32.1	28.6	31.5	34.0	37.2	39.0
World oil price (U.S. dollars per barrel) 5/	61.8	79.0	104.0	112.0	108.8	108.0	103.0
Urals oil price (U.S. dollars per barrel)	61.3	78.3	109.3	110.3	107.9	107.1	102.1
Terms of trade (percent)	-23.4	19.2	13.3	1.3	-1.6	-0.7	-2.8

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 2012-15.

Table 4a. Russian Federation: Fiscal Operations, 2009–15 1/

(Percent of GDP, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015
						Proj.	
General government							
Revenue	35.0	34.6	37.3	37.7	36.1	36.4	36.1
o/w Oil revenue	8.9	9.6	11.5	11.4	11.0	11.1	10.2
o/w Nonoil revenue	26.1	25.0	25.8	26.3	25.1	25.2	25.9
Taxes	25.9	26.5	28.7	28.7	27.4	28.0	27.7
Corporate profit tax	3.3	3.8	4.1	3.8	3.1	3.2	3.4
Personal income tax	4.3	3.9	3.6	3.6	3.7	3.7	3.7
VAT	5.3	5.4	5.8	5.7	5.3	5.6	5.8
Excises	0.9	1.0	1.2	1.3	1.5	1.6	1.6
Custom tariffs	6.9	7.0	8.3	8.0	7.5	7.3	6.8
Resource extraction tax	3.0	3.3	3.9	4.2	4.3	4.5	4.1
Other tax revenue	2.3	2.2	1.8	2.0	2.0	2.1	2.2
Social contributions	5.9	5.3	6.3	6.6	6.6	6.6	6.6
Other revenue	3.2	2.8	2.3	2.4	2.0	1.8	1.8
Expenditure	41.4	38.0	35.7	37.2	37.3	37.1	36.9
Expense	34.5	32.2	30.1	32.5	32.8	33.2	32.7
Compensation of employees	9.9	8.2	7.3	4.9	5.2	5.1	5.2
Use of goods and services	5.8	4.8	4.9	4.1	4.1	4.0	4.0
Interest	0.6	0.6	0.6	0.6	0.7	0.8	0.8
Subsidies	3.3	2.8	3.0	7.6	7.6	7.4	7.2
Grants	0.2	0.1	0.2	0.1	0.1	0.1	0.1
Social benefits	12.8	14.0	12.2	13.1	13.5	13.5	13.5
Other expense	1.8	1.7	2.0	2.0	1.7	2.3	1.9
Net acquisition of nonfinancial assets	6.9	5.9	5.6	4.8	4.5	4.0	4.1
Net lending (+)/borrowing (-) (overall balance)	-6.3	-3.4	1.5	0.4	-1.3	-0.7	-0.8
Federal government							
Revenue	18.9	17.9	20.3	20.7	19.5	19.6	19.0
o/w Oil revenue	7.8	8.4	10.3	10.3	10.0	10.1	9.3
o/w Nonoil revenue	11.1	9.5	10.0	10.4	9.5	9.5	9.7
Expenditure	24.9	21.8	19.5	20.7	20.0	19.2	19.3
Expense	21.4	18.7	16.5	18.0	17.3	16.9	16.8
Net acquisition of nonfinancial assets	3.5	3.2	3.1	2.8	2.7	2.3	2.4
Net lending (+)/borrowing (-) (overall balance)	-6.0	-3.9	0.8	-0.1	-0.5	0.4	-0.2
Memorandum items:							
General government nonoil primary balance	-14.6	-12.5	-9.4	-10.3	-11.6	-11.1	-10.2
General government nonoil overall balance	-15.2	-13.0	-10.0	-11.0	-12.2	-11.9	-11.0
Federal government nonoil primary balance	-13.4	-11.9	-9.0	-9.9	-9.9	-9.1	-8.9
Federal government nonoil overall balance	-13.8	-12.4	-9.5	-10.4	-10.4	-9.7	-9.5
World oil price (U.S.dollars per barrel) 2/	61.8	79.0	104.0	112.0	108.8	108.0	103.0
Urals prices (U.S. dollars per barrel)	61.3	78.3	109.3	110.3	107.9	107.1	102.1
Oil funds 3/	11.9	7.5	6.4	7.4	8.6	8.1	7.7
Reserve Fund	4.7	1.7	1.4	3.0	4.3	4.5	4.4
NWF	7.1	5.8	5.0	4.3	4.3	4.5	4.4
General government debt	10.6	11.3	11.6	12.7	13.9	15.5	16.2
GDP (billions of rubles)	38,807	46,309	55,967	62,218	66,755	72,552	77,649

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 4b. Russian Federation: General Government Stock Positions, 2007–12 1/

(Percent of GDP)

	2007	2008	2009	2010	2011	2012
Stock positions:						
Net worth	62.9	68.9	82.3	69.8	67.5	66.9
Nonfinancial assets	42.2	44.7	51.6	46.2	44.3	43.7
Net financial worth	20.7	24.2	30.7	23.6	23.2	23.2
Financial assets	29.5	32.3	41.6	34.7	34.2	34.4
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	18.6	22.2	19.7	14.8	16.1	16.0
Debt securities	0.6	0.9	1.0	0.8	0.4	0.3
Loans	6.1	5.8	5.6	4.6	4.0	3.7
Equity and investment fund shares	1.4	1.8	12.1	10.8	11.8	15.8
Insurance, pensions, and standardized guarantee schemes	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives and employee stock options	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	2.8	1.5	3.2	3.6	1.9	-1.4
Liabilities	8.8	8.1	11.0	11.0	10.9	11.2
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	0.0	0.0	0.0 ...	...	...	
Loans	8.2	7.6	9.4	9.5	9.7	1.4
Equity and investment fund shares	0.0	0.0	0.0	0.0	0.0	0.1
Insurance, pensions, and standardized guarantee schemes	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives and employee stock options	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable	0.6	0.5	1.5	1.5	1.2	0.9
Memorandum items:						
Publicly guaranteed debt	...	...	...	...	...	...
Debt (at market value)	...	...	...	...	...	...
Debt at face value	8.8	8.1	11.0	11.0	10.9	11.2
Maastricht debt	...	...	...	...	...	...
Debt (at nominal value)	...	...	...	...	...	...
Other economic flows:						
Change in net worth from other economic flows	-0.6	2.1	0.0	-0.6	0.7	-0.3
Nonfinancial assets	-0.8	0.5	0.0	0.0	0.3	0.3
Change in net financial worth from other economic flows	0.2	1.7	0.0	-0.6	0.4	-0.6
Financial assets	-0.3	1.8	1.1	-0.4	0.4	-0.6
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	-0.3	1.8	1.1	-0.4	0.4	-0.3
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.0	0.0	0.0	0.0	0.0	0.0
Equity and investment fund shares	0.0	0.0	0.0	0.0	0.0	0.0
Insurance, pensions, and standardized guarantee schemes	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives and employee stock options	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	0.0	0.0	0.0	0.0	0.0	-0.3
Liabilities	-0.4	0.1	1.1	0.2	0.0	0.0
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.0	0.0	0.0	0.2	0.0	0.0
Equity and investment fund shares	0.0	0.0	0.0	0.0	0.0	0.0
Insurance, pensions, and standardized guarantee schemes	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives and employee stock options	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable	-0.4	0.1	1.1	0.0	0.0	0.0

Sources: Government Finance Statistics; and IMF staff estimates.

1/ Accrual basis.

Table 5. Russian Federation: Monetary Accounts, 2009–15

(Billions of Russian rubles, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015
						Projections	
Monetary authorities							
Base money	4,716	5,913	7,150	7,960	8,598	9,233	9,954
Currency issued	4,623	5,785	6,896	7,668	8,307	8,901	9,570
Required reserves on ruble deposits	93	128	254	292	291	332	384
NIR 1/	12,755	14,304	15,701	15,767	16,112	17,082	17,843
Gross reserves	13,195	14,571	15,982	16,300	16,677	17,648	18,408
Gross liabilities	440	267	281	533	565	565	565
GIR (billions of U.S. dollars)	*436*	*478*	496	*537*	*549*	*475*	*475*
NDA	-8,039	-8,392	-8,551	-7,807	-7,514	-7,849	-7,888
Net credit to general government	-5,515	-3,963	-5,230	-6,312	-7,060	-7,245	-7,109
Net credit to federal government	-4,614	-2,907	-4,055	-4,588	-5,505	-5,690	-5,554
CBR net ruble credit to federal government 1/	-595	-293	-1,058	-630	-431	-1,223	-1,098
Foreign exchange credit	147	140	126	117	123	123	123
Ruble counterpart	-4,166	-2,754	-3,123	-4,075	-5,198	-4,591	-4,580
CBR net credit to local government and EBFs	-902	-1,056	-1,175	-1,724	-1,555	-1,555	-1,555
CBR net credit to local government	-385	-436	-529	-698	-659	-659	-659
CBR net credit to extrabudgetary funds	-517	-620	-647	-1,026	-896	-896	-896
Net credit to banks	-53	-1,640	101	1,498	2,567	2,278	2,067
Gross credit to banks	1,640	577	1,471	3,257	5,021	4,200	4,200
Gross liabilities to banks and deposits	-1,693	-2,217	-1,370	-1,760	-2,454	-1,922	-2,133
Of which: correspondent account balances	-900	-995	-982	-1,356	-1,270	-1,630	-1,700
Other items (net) 2/	-2,471	-2,789	-3,422	-2,993	-3,020	-2,882	-2,846
Monetary survey							
Broad money	19,096	23,791	28,754	32,227	36,849	42,787	49,160
Ruble broad money	15,268	20,012	24,483	27,405	31,405	35,647	40,629
Currency in circulation	4,038	5,063	5,939	6,430	6,986	7,787	8,343
Ruble deposits	11,230	14,949	18,545	20,975	24,419	27,860	32,287
Forex deposits 1/	3,828	3,779	4,271	4,821	5,445	7,140	8,531
Net foreign assets 1/	13,674	14,999	17,289	16,985	18,018	19,903	21,175
NIR of monetary authorities	12,755	14,304	15,701	15,767	16,112	17,082	17,843
NFA of commercial banks	919	694	1,588	1,218	1,906	2,821	3,333
NFA of commercial banks (billions of U.S. dollars)	30	23	49	40	54	76	86
NDA	5,422	8,793	11,465	15,242	18,831	22,884	27,985
Domestic credit	13,297	17,323	20,780	25,474	31,892	37,073	43,374
Net credit to general government	-5,119	-3,464	-5,840	-6,308	-4,815	-4,540	-3,985
Credit to the economy	18,416	20,787	26,620	31,782	36,708	41,613	47,359
Other items (net)	-7,875	-8,530	-9,315	-10,232	-13,061	-14,189	-15,389
Memorandum items:							
Accounting exchange rate (ruble per U.S. dollar, eop)	30.2	30.5	32.2	30.4	32.7	…	…
Nominal GDP (billions of rubles)	38,807	46,309	55,967	62,218	66,755	72,552	77,649
CPI inflation (12-month change, eop)	8.8	8.8	6.1	6.6	6.5	6.5	5.5
Ruble broad money velocity (eop)	2.5	2.3	2.3	2.3	2.1	2.0	1.9
Ruble broad money velocity (eop, s.a.)	2.7	2.4	2.4	2.4	2.2	2.1	2.0
Annual change in velocity	-21.1	-9.0	-1.2	-0.7	-6.4	-4.2	-6.1
Real ruble broad money (rel. to CPI, 12-month change)	8.1	20.5	15.3	5.0	7.6	6.6	8.0
Nominal ruble broad money (12-month change)	17.7	31.1	22.3	11.9	14.6	13.5	14.0
Base money (12-month change)	7.4	25.4	20.9	11.3	8.0	7.4	7.8
Real credit to the economy (12-month change)	-5.7	3.8	20.7	12.0	8.5	6.4	7.9
Ruble broad money multiplier	3.2	3.4	3.4	3.4	3.7	3.9	4.1

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, 2007–14

(Percent)

	2007	2008	2009	2010	2011	2012	2013	2014 Mar
Financial Soundness Indicators								
Capital adequacy								
Capital to risk-weighted assets	15.5	16.8	20.9	18.1	14.7	13.7	13.5	13.2
Core capital to risk-weighted assets	11.6	10.6	13.2	11.4	9.3	8.5	9.1	9.4
Capital to total assets	13.3	13.6	15.7	14.0	12.6	12.3	...	...
Risk-weighted assets to total assets	85.6	81.0	75.2	77.4	85.9	87.7	...	...
Credit risk								
NPLs to total loans	2.5	3.8	9.6	8.2	6.6	6.0	6.0	6.4
Loan loss provisions to total loans	3.6	4.5	9.1	8.5	6.9	6.1	5.9	6.2
Large credit risks to capital	211.9	191.7	147.1	184.6	228.4	209	204.3	209.5
Distribution of loans provided by credit institutions								
Agriculture, hunting and forestry	3.8	4.2	4.9	5.1	4.8	4.6	4.3	4.1
Mining	3.1	3.3	3.9	3.6	2.9	3.2	3.1	3.3
Manufacturing	13.5	14.4	15.7	16.0	15.2	14	13.6	14.1
Production and distribution of energy, gas and water	1.7	1.9	2.4	2.6	2.9	2.7	2.5	2.5
Construction	6.0	6.1	6.2	5.9	5.6	5.5	5.6	5.4
Wholesale and retail trade	18.0	17.4	18.4	17.1	15.6	14.9	13.7	14
Transport and communication	3.7	4.3	3.4	3.8	5.4	5.4	4.2	4.3
Other economic activities	23.3	23.3	21.9	22.2	22.3	20.5	21.1	20.7
Individuals	24.8	25.1	23.0	23.7	25.3	29.2	32.0	31.7
Of which: mortgage loans	5.1	6.6	6.5	6.6	6.7	7.5	8.5	8.7
Geographical distribution of interbank loans and deposits								
Russian Federation	40.0	27.1	29.5	41.1	41.6	47.1	39.7	36.8
United Kingdom	23.3	29.1	21.7	21.4	20.2	17.5	23.8	27.5
USA	4.1	7.1	4.1	2.5	3.0	3.6	6.8	3
Germany	6.8	7.5	4.7	6.0	4.2	1.6	0.6	2.3
Austria	6.1	5.7	8.2	3.7	6.6	5.9	7.3	8.8
France	3.5	4.0	5.7	4.0	2.7	1.6	1.9	2.1
Italy	1.7	1.5	1.8	0.1	2.7	2.7	0.1	0.1
Cyprus 1/	0.8	0.4	6.2	5.0	6.6	8.7	4.7	5
Netherlands	2.6	4.6	4.6	2.6	3.2	1.5	1.5	1.7
Other	11.0	13.1	13.4	13.6	9.0	9.8	13.6	12.7
Liquidity								
Highly liquid assets to total assets	...	28.0	26.8	13.5	11.8	11.1	9.9	11
Liquid assets to total assets	24.8	25.9	28.0	26.8	23.9	23.2	20.5	19.9
Liquid assets to short-term liabilities	72.9	92.1	102.4	94.3	81.6	82.9	78.7	75.2
Ratio of client's funds to total loans	94.8	84.6	99.9	109.5	105.3	101.2	98.7	97.8
Return on assets	3.0	1.8	0.7	1.9	2.4	2.3	1.9	1.8
Return on equity	22.7	13.3	4.9	12.5	17.6	18.2	15.2	14.5
Balance Sheet Structure, in percent of assets								
Total asset growth rate	44.1	39.2	5.0	14.9	23.1	18.9	16.0	19.1
Total customer loans growth rate	53.0	34.5	-2.5	12.6	28.2	...	...	...
Asset side								
Total customer loans	61.1	59.0	54.8	53.7	55.9	56.0	...	...
Accounts with CBR and other central banks	6.4	7.4	6.0	5.4	4.2	4.4	3.9	3.5
Interbank lending	7.0	8.9	9.3	8.6	9.5	8.5	8.9	8.7
Securities holdings	11.2	8.4	14.6	17.2	14.9	14.2	13.6	13.4
Liability side								
Funds from CBR	0.2	12.0	4.8	1.0	2.9	5.4	7.7	7.9
Interbank liabilities	13.9	13.0	10.6	11.1	11.0	9.6	8.4	8.1
Fund raised from organizations	35.0	31.3	32.5	32.9	33.6	31.6	...	...
Individual deposits	25.6	21.1	25.4	29.0	28.5	28.8	29.5	27.9
Bonds, PN and bank acceptance	5.5	4.0	3.9	4.0	3.7	4.4	...	...

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, 2010–19

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Projections					
					(Percent of GDP, unless otherwise indicated)					
Macroeconomic framework										
GDP growth at constant prices (percent)	4.5	4.3	3.4	1.3	0.2	1.0	1.8	2.0	2.2	2.2
Consumer prices (percent change, end of period)	8.8	6.1	6.6	6.5	6.5	5.5	5.0	4.0	4.0	4.0
Gross domestic investment	22.6	25.0	24.5	22.6	21.3	21.6	21.6	21.6	21.5	21.6
Private sector	18.4	21.2	20.4	18.4	17.4	17.9	18.0	18.2	18.1	18.2
Public sector	4.3	3.8	4.0	4.2	4.0	3.7	3.6	3.4	3.4	3.3
Gross national savings	27.0	30.1	28.0	24.1	24.3	24.0	23.3	23.2	23.1	23.0
Private sector	26.2	24.8	23.5	20.1	21.0	21.1	20.5	21.0	21.1	21.0
Public sector	0.8	5.3	4.5	4.1	3.2	2.9	2.8	2.2	2.0	2.0
External current account balance	4.4	5.1	3.5	1.6	2.9	2.4	1.7	1.6	1.6	1.4
Fiscal Operations 1/										
Federal government										
Net lending/borrowing (overall balance)	-3.9	0.8	-0.1	-0.5	0.4	-0.2	-0.8	-1.2	-1.3	-1.3
Nonoil balance	-12.4	-9.5	-10.4	-10.4	-9.7	-9.5	-9.2	-8.9	-8.6	-8.1
General government										
Net lending/borrowing (overall balance)	-3.4	1.5	0.4	-1.3	-0.7	-0.8	-0.8	-1.2	-1.4	-1.3
Revenue	34.6	37.3	37.7	36.1	36.4	36.1	35.9	35.3	34.9	34.6
Expenditure	38.0	35.7	37.2	37.3	37.1	36.9	36.7	36.5	36.3	35.9
Nonoil balance	-13.0	-10.0	-11.0	-12.2	-11.9	-11.0	-9.9	-9.6	-9.1	-8.5
Primary balance	-2.9	2.1	1.0	-0.6	0.0	0.0	0.0	-0.3	-0.4	-0.3
Gross debt	11.3	11.6	12.7	13.9	15.5	16.2	16.4	16.9	17.5	18.1
					(Billions of U.S dollars; unless otherwise indicated)					
Balance of payments										
Current account	67.5	97.3	71.3	32.8	59.1	49.4	36.8	35.6	35.9	33.9
Trade balance	147.0	196.9	191.7	180.3	200.7	189.6	178.3	179.0	184.9	190.1
Exports (f.o.b)	392.7	515.4	527.4	523.3	530.7	523.1	521.4	528.2	541.1	556.1
Of which: energy	254.0	341.8	346.8	350.2	349.9	330.1	312.0	300.3	292.8	287.0
Imports (f.o.b)	-245.7	-318.6	-335.8	-343.0	-330.0	-333.6	-343.1	-349.2	-356.2	-366.0
Services and transfers, net	-32.4	-39.2	-52.7	-67.8	-56.2	-54.0	-53.9	-50.8	-47.3	-44.7
Capital and financial account	-21.6	-76.0	-30.9	-42.9	-98.4	-49.4	-36.8	-35.6	-35.9	-33.9
Capital account	0.0	0.1	-5.2	-0.4	-11.0	0.0	0.0	0.0	0.0	0.0
Financial account	-21.5	-76.1	-25.7	-42.5	-87.5	-49.4	-36.8	-35.6	-35.9	-33.9
Private sector capital	-22.5	-74.3	-45.4	-48.8	-103.9	-62.5	-49.3	-48.8	-49.9	-51.2
Errors and omissions	-9.1	-8.7	-10.4	-11.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	36.8	12.6	30.0	-22.1	-39.4	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Gross reserves (end of period)										
Billions of U.S. dollars	479.4	498.6	537.6	509.6	470.2	470.2	470.2	470.2	470.2	470.2
Percent of short-term debt (residual maturity)	339.1	331.1	327.2	285.9	252.3	236.7	221.9	208.3	195.7	184.3
Months of prospective GNFS imports	17.9	14.6	14.5	13.0	12.5	12.4	12.1	11.9	11.7	11.5
Trade balance (percent of GDP)	9.6	10.3	9.5	8.6	10.0	9.3	8.3	8.1	8.1	7.9
Terms of trade (y-o-y change, percent)	19.2	13.3	1.3	-1.6	-0.7	-2.8	-2.9	-2.2	-1.5	-1.1
Excluding fuel	14.5	-1.8	-3.7	-0.9	-1.5	-0.8	0.4	0.2	0.2	0.1
Export volume, goods (y-o-y change, percent)	5.1	4.2	4.6	1.7	2.9	2.3	2.6	3.1	3.4	3.3
Import volume, goods (y-o-y change, percent)	26.7	16.6	9.2	3.1	-3.0	2.0	2.9	1.3	1.4	2.1
World oil price (U.S. dollars per barrel) 2/	79.0	104.0	112.0	108.8	108.0	103.0	98.2	94.9	92.8	91.3

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 2012-19.

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

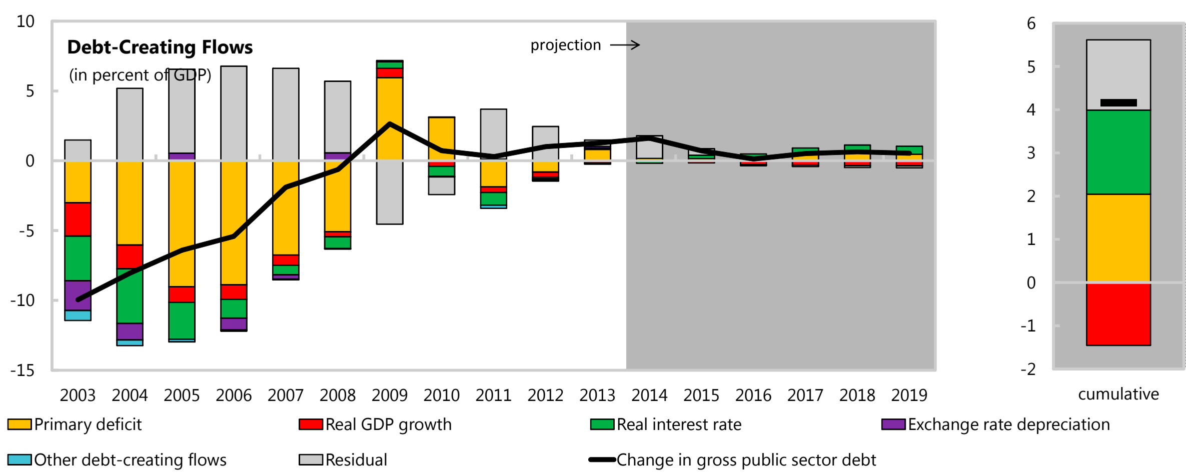
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections						As of May 09, 2014		
	2003-2011 [2]	2012	2013	2014	2015	2016	2017	2018	2019			
Nominal gross public debt	14.4	12.7	13.9	15.5	16.2	16.4	16.9	17.5	18.1	Sovereign Spreads		
Of which: guarantees	0.4	2.0	2.5	4.1	4.7	4.6	4.6	4.6	4.6	EMBIG (bp) 3/		247
Public gross financing needs	-0.4	0.7	2.4	2.0	2.3	2.0	2.4	2.4	2.0	5Y CDS (bp)		185
Real GDP growth (in percent)	4.9	3.4	1.3	0.2	1.0	1.8	2.0	2.2	2.2	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	14.7	7.5	5.9	8.5	5.9	5.6	5.2	4.7	4.7	Moody's	Baa1	Baa1
Nominal GDP growth (in percent)	20.5	11.2	7.3	8.7	7.0	7.5	7.3	7.0	7.0	S&Ps	BBB-	BBB
Effective interest rate (in percent) [4]	6.2	6.6	6.8	7.3	7.6	7.8	8.1	8.3	8.3	Fitch	BBB	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	-3.2	1.0	1.3	1.6	0.7	0.1	0.5	0.6	0.5	4.2	
Identified debt-creating flows	-6.4	-1.4	0.8	0.0	0.2	0.2	0.6	0.8	0.7	2.5	
Primary deficit	-3.5	-0.8	0.8	0.2	0.2	0.2	0.5	0.6	0.5	2.0	0.2
Primary (noninterest) revenue and grants	37.5	37.4	35.9	36.2	35.9	35.7	35.1	34.8	34.4	212.1	
Primary (noninterest) expenditure	34.0	36.6	36.7	36.4	36.0	35.9	35.6	35.4	34.9	214.2	
Automatic debt dynamics [5]	-2.7	-0.6	0.1	-0.2	0.1	0.0	0.1	0.2	0.2	0.5	
Interest rate/growth differential [6]	-2.4	-0.5	-0.1	-0.2	0.1	0.0	0.1	0.2	0.2	0.5	
Of which: real interest rate	-1.5	-0.1	0.1	-0.2	0.2	0.3	0.4	0.5	0.6	1.9	
Of which: real GDP growth	-0.8	-0.4	-0.2	0.0	-0.1	-0.3	-0.3	-0.3	-0.4	-1.5	
Exchange rate depreciation [7]	-0.3	-0.1	0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.2	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
General Government: Net privatization F	-0.2	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Lower transfers to Reserve Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8]	3.2	2.5	0.5	1.6	0.5	-0.1	-0.1	-0.1	-0.1	1.6	



Source: IMF staff.

1/ Public sector is defined as general government and includes public 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).

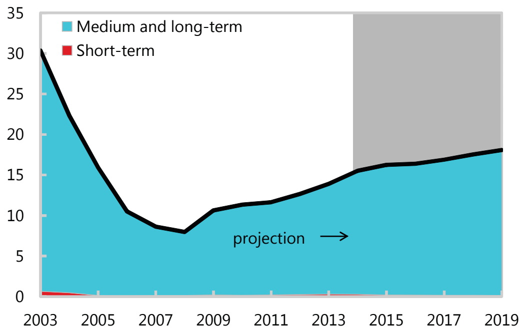
8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

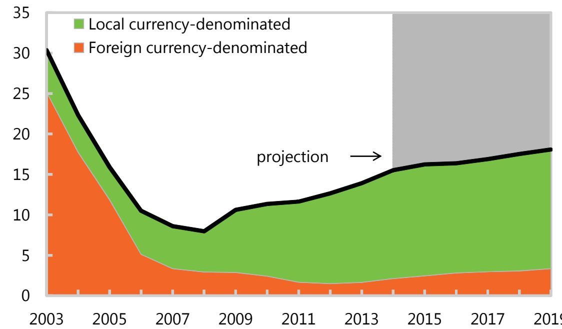
Table 9. Russian Federation: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



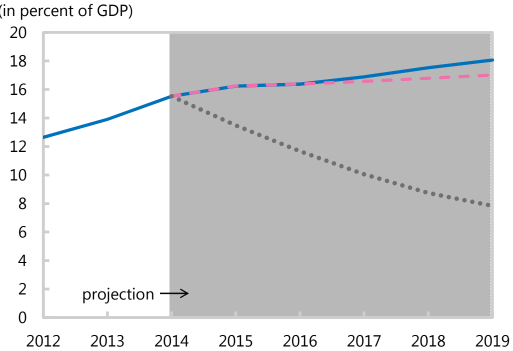
By Currency
(in percent of GDP)



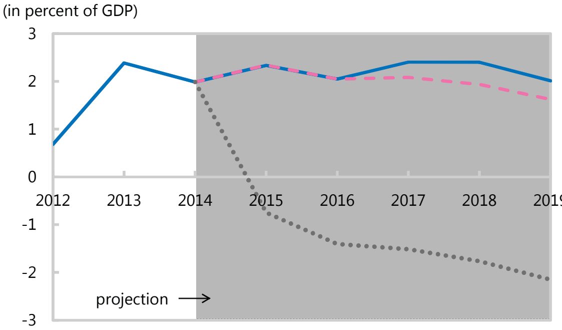
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

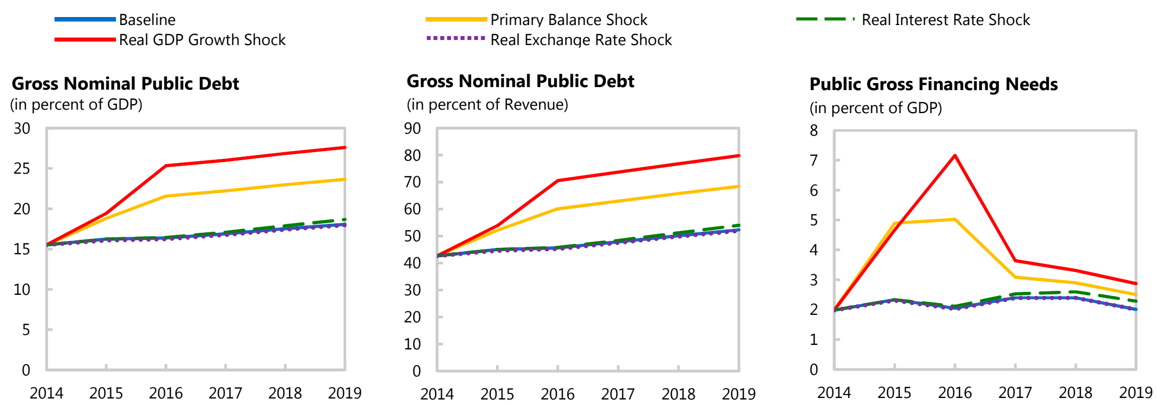
	2014	2015	2016	2017	2018	2019
Baseline Scenario						
Real GDP growth	0.2	1.0	1.8	2.0	2.2	2.2
Inflation	8.5	5.9	5.6	5.2	4.7	4.7
Primary Balance	-0.2	-0.2	-0.2	-0.5	-0.6	-0.5
Effective interest rate	7.3	7.6	7.8	8.1	8.3	8.3
Constant Primary Balance Scenario						
Real GDP growth	0.2	1.0	1.8	2.0	2.2	2.2
Inflation	8.5	5.9	5.6	5.2	4.7	4.7
Primary Balance	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Effective interest rate	7.3	7.6	7.8	8.1	8.3	8.3

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	0.2	4.1	4.1	4.1	4.1	4.1
Inflation	8.5	5.9	5.6	5.2	4.7	4.7
Primary Balance	-0.2	2.9	2.9	2.9	2.9	2.9
Effective interest rate	7.3	7.6	7.8	8.1	8.4	8.4

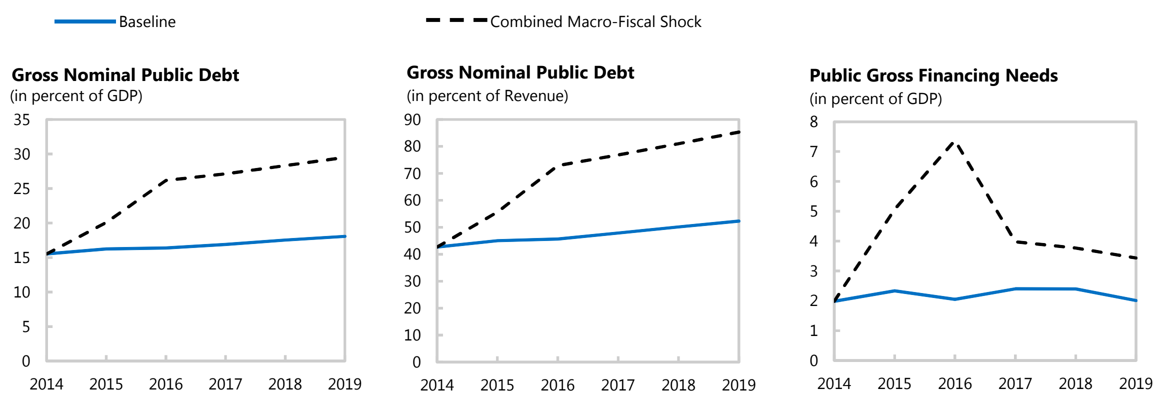
Source: IMF staff.

Table 10. Russian Federation: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2014	2015	2016	2017	2018	2019
Primary Balance Shock						
Real GDP growth	0.2	1.0	1.8	2.0	2.2	2.2
Inflation	8.5	5.9	5.6	5.2	4.7	4.7
Primary balance	-0.2	-2.7	-2.7	-0.5	-0.6	-0.5
Effective interest rate	7.3	7.6	8.0	8.4	8.6	8.5
Real Interest Rate Shock						
Real GDP growth	0.2	1.0	1.8	2.0	2.2	2.2
Inflation	8.5	5.9	5.6	5.2	4.7	4.7
Primary balance	-0.2	-0.2	-0.2	-0.5	-0.6	-0.5
Effective interest rate	7.3	7.6	8.4	9.1	9.8	10.2
Combined Shock						
Real GDP growth	0.2	-3.7	-2.9	2.0	2.2	2.2
Inflation	8.5	4.8	4.4	5.2	4.7	4.7
Primary balance	-0.2	-2.7	-4.7	-0.5	-0.6	-0.5
Effective interest rate	7.3	7.8	8.7	9.7	10.2	10.5

	2014	2015	2016	2017	2018	2019
Real GDP Growth Shock						
Real GDP growth	0.2	-3.7	-2.9	2.0	2.2	2.2
Inflation	8.5	4.8	4.4	5.2	4.7	4.7
Primary balance	-0.2	-2.4	-4.7	-0.5	-0.6	-0.5
Effective interest rate	7.3	7.6	7.9	8.5	8.7	8.7
Real Exchange Rate Shock						
Real GDP growth	0.2	1.0	1.8	2.0	2.2	2.2
Inflation	8.5	8.8	5.6	5.2	4.7	4.7
Primary balance	-0.2	-0.2	-0.2	-0.5	-0.6	-0.5
Effective interest rate	7.3	7.8	7.8	8.1	8.3	8.3

Source: IMF staff.

Table 11. Russian Federation: External Debt Sustainability Framework, 2009–19

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2009	2010	2011	2012	2013	10-Year Historical Average	10-Year Standard Deviation	2014	2015	2016	2017	2018	2019	Debt-stabilizing non-interest current account 6/
Baseline: External debt	38.2	32.1	28.6	31.5	34.0			**37.2**	**39.0**	**39.8**	**41.2**	**42.4**	**43.3**	**0.4**
Change in external debt	9.3	-6.2	-3.4	2.9	2.4			3.2	1.8	0.7	1.4	1.2	0.9	
Identified external debt-creating flows (4+8+9)	8.1	-8.0	-7.9	-3.4	-0.4			-0.7	-0.4	0.1	1.1	2.1	2.9	
Current account deficit, excluding interest payments	-2.4	-3.0	-3.8	-2.6	-0.7			-2.0	-1.4	-0.6	0.1	0.7	1.3	
Deficit in balance of goods and services	-7.8	-7.9	-8.6	-7.2	-5.8			-7.6	-7.0	-6.1	-6.1	-6.3	-6.3	
Exports	28.0	29.0	30.1	29.2	28.2			30.1	29.2	27.9	27.5	27.3	26.9	
Imports	20.2	21.0	21.5	22.0	22.4			22.5	22.2	21.7	21.4	21.0	20.6	
Net non-debt creating capital inflows (negative)	0.4	0.9	0.9	0.2	0.9			0.4	0.4	0.2	0.1	0.0	-0.2	
Automatic debt dynamics 1/	10.2	-5.9	-5.0	-0.9	-0.6			0.9	0.6	0.5	0.9	1.4	1.8	
Contribution from nominal interest rate	1.7	1.4	1.3	0.9	0.9			1.0	1.0	1.2	1.7	2.3	2.7	
Contribution from real GDP growth	3.1	-1.4	-1.1	-0.9	-0.4			-0.1	-0.4	-0.7	-0.8	-0.9	-0.9	
Contribution from price and exchange rate changes 2/	5.4	-5.9	-5.1	-0.9	-1.1			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	1.2	1.9	4.5	6.3	2.8			3.9	2.3	0.6	0.3	-0.9	-2.0	
External debt-to-exports ratio (in percent)	136.2	110.7	95.1	107.9	120.4			123.6	133.7	142.6	149.8	155.4	160.9	
Gross external financing need (in billions of US dollars) 4/	139.1	120.7	92.7	115.8	167.8			159.0	177.9	211.0	251.3	294.5	334.2	
in percent of GDP	11.4	7.9	4.9	5.7	8.0			7.9	8.7	9.8	11.4	12.9	14.0	
Scenario with key variables at their historical averages 5/								**37.2**	**30.5**	**23.6**	**16.8**	**10.0**	**3.7**	**-0.5**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	-7.8	4.5	4.3	3.4	1.3	4.1	4.7	0.2	1.0	1.8	2.0	2.2	2.2	
GDP deflator in US dollars (change in percent)	-20.2	19.4	19.8	2.4	2.9	13.6	14.5	-4.7	1.0	2.9	1.1	1.4	2.3	
Nominal external interest rate (in percent)	4.3	4.6	5.0	3.3	2.8	4.9	1.2	2.8	2.8	3.1	4.4	5.7	6.6	
Growth of exports (US dollar terms, in percent)	-34.5	28.8	29.8	2.8	0.6	16.9	21.8	1.7	-1.0	0.1	1.7	2.8	3.1	
Growth of imports (US dollar terms, in percent)	-32.5	29.8	27.8	8.4	6.0	18.4	20.2	-4.2	0.7	2.5	1.5	1.7	2.5	
Current account balance, excluding interest payments	2.4	3.0	3.8	2.6	0.7	4.7	2.9	2.0	1.4	0.6	-0.1	-0.7	-1.3	
Net non-debt creating capital inflows	-0.4	-0.9	-0.9	-0.2	-0.9	0.0	1.0	-0.4	-0.4	-0.2	-0.1	0.0	0.2	

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.

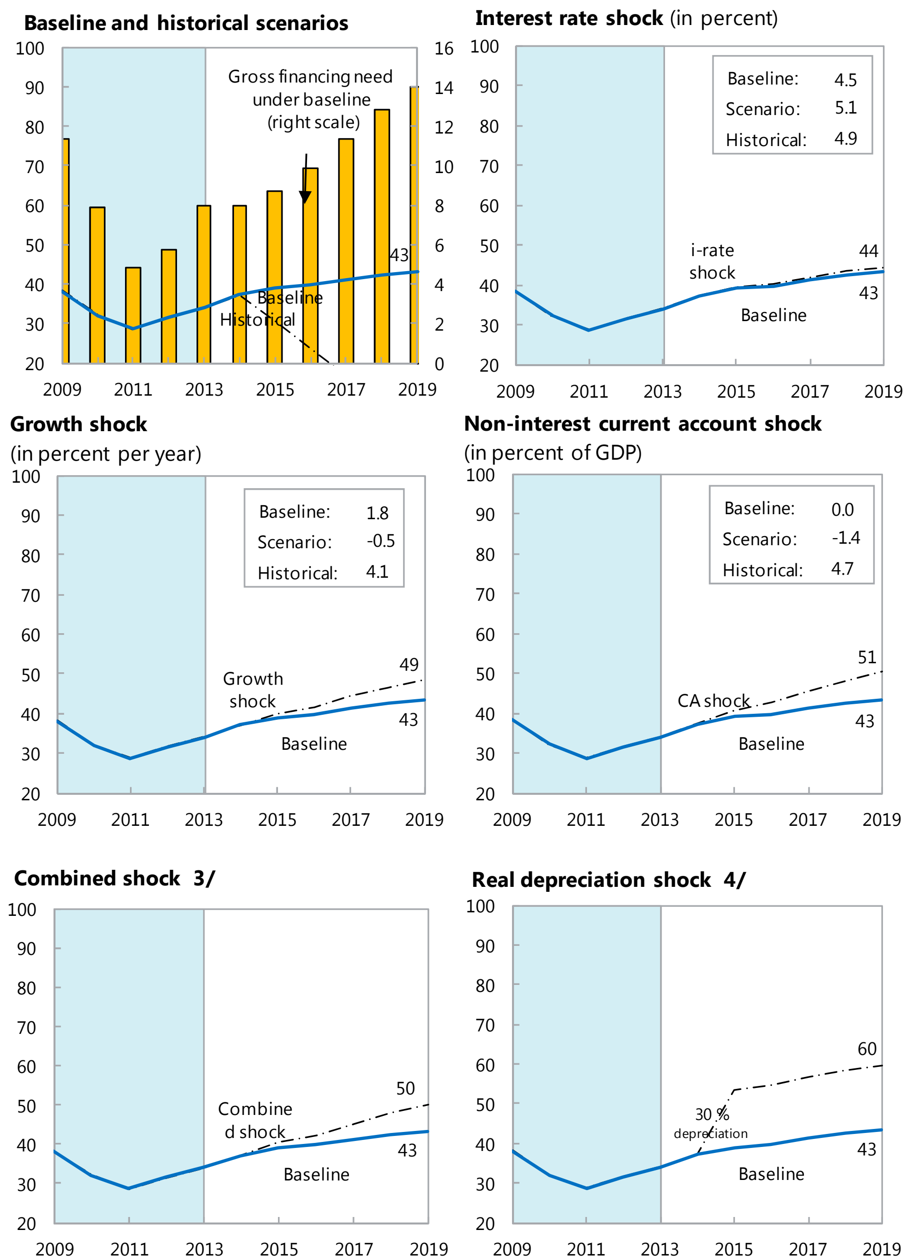
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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 9. 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.

Annex I. Implementation of Past IMF Recommendations

During the 2013 Article IV consultation, Directors noted that the macroeconomic policy frameworks had strengthened. With the economy at close to full capacity and growth slowing down, they saw the need to increase potential output growth by further strengthening policies and decisively implementing structural reforms, particularly supply-side reforms.

Key recommendations	**Implemented policies**
Fiscal Policy	
Resist pressure for higher spending.	The budget for 2014–16 is consistent with the adopted fiscal rule. However, quasi-fiscal spending via NWF and issuance of guarantees is increasing.
Medium-term fiscal consolidation to rebuild fiscal buffers.	Non-oil fiscal deficit remains high; while the Reserve Fund has increased, it remains below the government target. In 2013, transfers to the Reserve Fund were additionally limited by the need to compensate for the under-execution of privatization proceeds.
Rebalance expenditure to increase efficiency.	Discussion ongoing.
Advance pension reform.	Some changes adopted (see main text); increase in statutory retirement age not considered, while replacement rate is expected to decline in the medium term despite the reform.
Monetary Policy	
Keep monetary policy on hold with a tightening bias.	Policy rate held at 5 ½ percent (with tightening bias made explicit in February 2014) until Spring 2014 when it was cumulatively increased by 200 basis points.
Take further actions to strengthen the transmission mechanism.	Under discussion, including in the context of the President's mandate to the central bank to find ways to reduce lending rates. To improve monetary signaling, in September 2013, CBR reduced the number of policy rates, formally announcing the one-week repo rate to be the key policy rate and establishing a symmetric two percentage point-wide interest rate corridor around the key rate.
Complete transition to a flexible exchange rate and inflation targeting by end-2014.	Preparation ongoing, including with technical advice from the IMF. In response to market pressures, a temporary change to the intervention rule was introduced on March 3.

Financial Sector	
Monitor growth in unsecured consumer lending.	CBR increased risk coefficients for capital adequacy calculations and provisioning requirements for high-margin consumer credits, and limited deposit rates for banks with risky and aggressive policies. Federal law adopted in December 2013 set limits on deviations of individual bank credit rates to no more than one-third higher than the average market rate for similar credits.
Implement 2011 FSAP recommendations to address weaknesses in the supervisory framework.	Legislations approved to empower CBR to (i) use professional judgment in some situations; (ii) expand supervisory authority over bank holding companies and related parties; and (iii) sanction individual directors and managers, raise capital requirements on individual institutions, and impose restrictions on transactions between affiliates. Implementation guidelines pending.
Further strengthen corporate governance, creditor rights, and competition.	Legislation on credit bureaus approved, to ensure full information about borrowers of consumer credit.
Structural Policies	
Implement supply-side reforms to raise the growth potential, with policies to boost productivity, and improve the investment climate, governance, transparency, and property rights protection.	Action Plan to boost growth approved by the Prime Minister. OECD accession talks stalled. Bill to introduce public private partnership framework being discussed in Duma. Privatization has stalled.

Annex II. External Sector Assessment

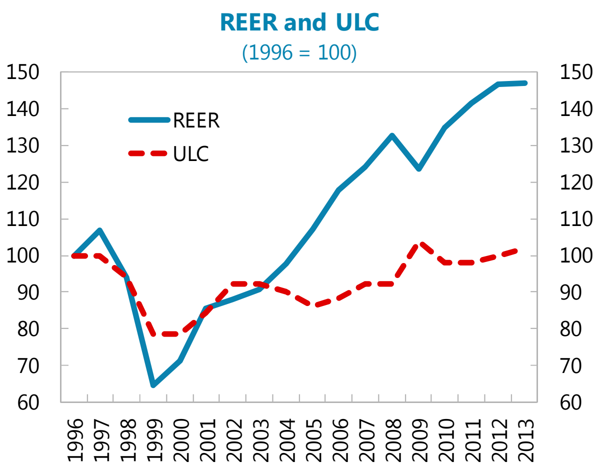
The external position in 2013 appeared weaker than the level consistent with medium-term fundamentals and desirable policy settings. While the REER gap identified for 2013 narrowed and perhaps closed following the recent depreciation, a lasting improvement in the current account would require sustained consolidation on the fiscal policy front and structural reforms.

The current account (CA) approach suggests an 11 percent REER overvaluation in 2013. This is slightly more than estimated in the 2013 Article IV report, reflecting: (i) decrease in the 2013 current account by more than what would be implied by fundamentals and current policies; and (ii) looser fiscal policy in 2013 relative to trade partners. The oil price boom of the past 13 years has been accompanied by a structural relaxation of the fiscal position, as the budget deficit followed the rise of oil prices. The non-oil fiscal balance worsened by 9 percentage points of GDP and current expenditures increased by 5 percentage points of GDP. More conservative fiscal policies over the medium-term with the non-oil fiscal balance reaching the estimated sustainable level of 5.5 percent of GDP would lead to a higher current account by 2 percent of GDP and a more depreciated REER.

The REER approach suggests an undervaluation but this approach may not be appropriate for Russia. According to the REER model, the average REER was 7 percent undervalued in 2013. Most of the appreciation of the equilibrium was driven by the following fundamentals: (i) trend appreciation typical for a transition economy; (ii) increase in the share of the domestic debt held by residents; and (iii) higher investment needs. However, the REER approach is less reliable in countries with large structural changes and short data spans, like Russia. Traditional indicators do not suggest a major deterioration of Russia's external competitiveness. Unit labor costs (ULC) remained relatively flat, and the share of Russia's goods exports in percent of the world's doubled. However, between 2000 and 2013, non-oil exports and current account surplus decreased by 12 and 16 percentage points of GDP respectively. This suggests that the REER appreciation may be a symptom of Dutch disease and focused policies may be needed to address its effects on the economy.

The net foreign asset (NFA) position is sustainable but should be higher for intergenerational reasons. NFA is projected to increase moderately over time, although historically there has been some disconnect between CA surpluses and NFA changes (Annex IV). Intergenerational equity considerations and signs of Dutch disease suggest that a higher portion of oil income should be saved. Foreign reserves are adequate, standing at the end of April 2014 at 143 percent of the IMF ARA metric, near the upper bound of the recommended range of 100–150 percent. However, the FX balances of the Reserve Fund and of the National Wealth Fund kept at the CBR are counted as part of foreign reserves because they are invested in liquid foreign assets. As a result, higher than "adequate" reserves are desirable, given that these balances are saved for precautionary and intergenerational purposes.

The REER gap identified for 2013 narrowed and perhaps closed following the recent depreciation in January–April 2014. In the first four months of 2014, the REER depreciated 7¼ percent compared to the 2013 average. As a result, the deviation of the REER from the 10-year average went from 14 percent on average in 2013 to 6 percent in April 2014. Furthermore, the current account in 2014 is projected to improve on the back of depreciation and projected contraction in domestic demand.



REER Misalignment

(in percent, + = overvaluation)

	EBA Rounds		
	2013 ESR	Fall 2013	2014 ESR
CA based	**2.6**	**5.5**	**10.5**
CA gap, without MC	-0.5	-1.1	-2.3
CA gap	-0.8	-2.0	-3.3
Elasticity	0.19	0.20	0.22
REER gap	**-8.2**	**-6.7**	**-6.5**
REER gap with MC	-7	-5.0	-5.0
ES based	**3.2**	**4.5**	**5.9**
CA gap	-0.6	-0.9	-1.3
Elasticity	0.19	0.20	0.22

Note: MC = multilateral consistency adjustment

Annex III. Risk Assessment Matrix (RAM) 1/

Risk	Overall Level of Concern		
	Relative Likelihood	**Expected Impact if Materialized**	**Recommended Policy Response**
1. A sharp increase in geopolitical tensions surrounding Ukraine	**Medium** Increasing geopolitical tensions surrounding Ukraine.	**High** Deepening of tension will lead to a drop in confidence, mounting pressure on FX Prolonged investment decline likely over the medium term.	Short-term depreciation pressure can be countered by intervening in the FX market and/or increasing interest rates. Tightening of fiscal policy should be postponed.
2. Sustained decline in commodity prices (medium-term)	**Medium** Deceleration of global demand and coming on-stream of excess capacity from the shale oil/gas revolution could lead to a sustained decline in the price of energy.	**High** Given Russia's dependence on energy exports, the economy would enter into recession. However, exchange rate flexibility and large international reserves provide some cushion.	Allow exchange rate to depreciate. Rebuild fiscal buffers and oil savings by tightening fiscal rule. Structural reforms to enhance economic efficiency and diversification.
3. Surges in global financial market volatility (related to UMP exit)	**High** Higher interest rates in advanced economies could trigger a sustained reversal of capital flows, a broad-based correction in risk premiums, and an intensification of liquidity strains on sovereigns and leveraged corporates.	**Medium** The macro framework is more robust than in 2008. Russia has experienced capital outflows for many years without major problems. Still, increased outflows would be a drag on investment and a sign of worsening business climate.	Enhance confidence and resilience by strengthening core institutions and policy frameworks and improve the investment climate. Tighten further monetary policy.
4. Renewed drop in domestic investment	**Medium** Private domestic investment does not recover	**Medium** Further downward pressure on growth, possibility of social discontent.	Create space for greater public capital expenditure by rationalizing current expenditure. Focus on structural and governance reforms to improve the investment climate.

[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 (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.** The regulatory framework is currently amended to allow the CBR to conduct consolidated supervision and to 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.** The regulatory framework is currently amended in order to apply restrictions on transaction between affiliates and to implement Pillar 2 requirements.
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)	
Pursue efforts to ensure an effective macro prudential oversight.	No decision.
Adopt a prompt remedial action framework for banks.	Draft regulation under preparation.
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.
Set limits on concentration of collateral in the repo market.	No decision.
Adopt a prompt remedial action framework for banks.	**Draft regulation under preparation.**
Introduce a unified administration regime for all banks (systemic or otherwise) with broad powers for the administrator.	No decision.[1]
Open-bank assistance such as loans, capital injections, nationalization by the Deposit Insurance Agency should be restricted to systemic situations.	No decision.[1]

[1] The authorities are preparing to upgrade the banking resolution framework in line with "Key Attributes for Effective Resolution" issued by the Financial Stability Board at the end of 2011.

Annex V. Why Does Russia Have a Low NFA Position Given Years of CA Surpluses?

NFA position has not kept apace with the CA surpluses due to unfavorable valuation changes and adjustment for "fictitious" capital outflows. The first factor is not expected to continue in the future as the Russian stock market boom is expected to slow down. The second factor implies that the true NFA position could be higher than the reported level. As a result, the NFA projected trajectory does not seem to be a concern from an external sustainability perspective.

Years of CA surpluses and capital outflows suggest a much higher rate of wealth accumulation than changes in the net IIP. Starting from 2000, cumulated CA surpluses suggest that the Russian net IIP should have been over US$700 billion or 38 percent of GDP by 2011. Instead, the 2011 NIIP stood at about US$140 billion or 7 percent of GDP. There was about 30 percent of GDP missing from the net IIP. This is not necessarily because NIIP is mismeasured. Isolating changes in the NIIP from valuation changes and other adjustments, e.g. focusing purely on transactions in financial assets, implies that the NIIP has increased in line with CA surpluses.

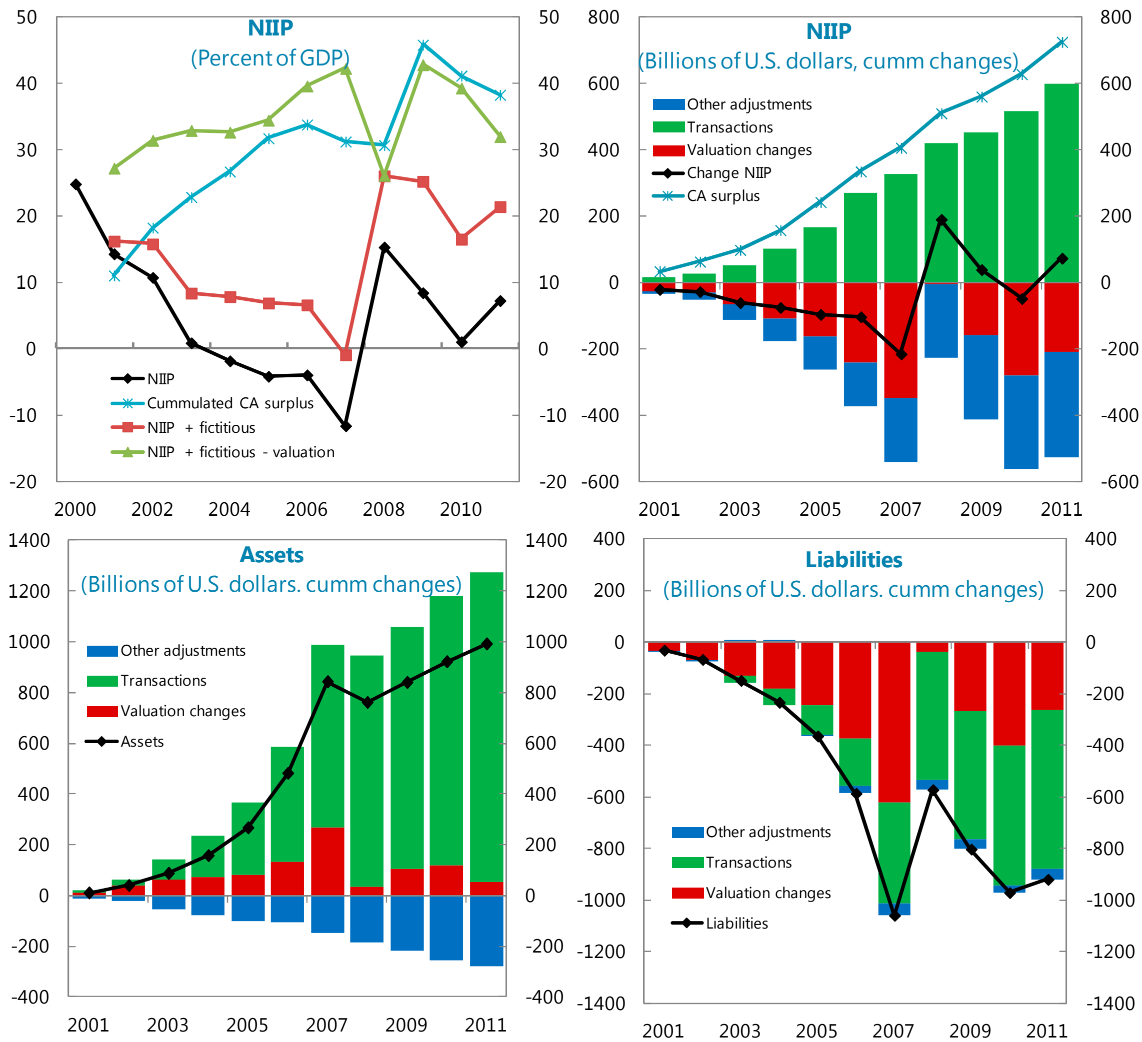
The NIIP was brought down by two factors: unfavorable valuation changes and other adjustments. The two factors combined to offset most of the transaction-based increase in the NIIP. Valuation changes were most important in increasing the value of liabilities, while other adjustments meant assets were lower than the accumulation of transactions and valuation changes.

Russia's stock market boom increased the value of liabilities. Valuation changes in the liabilities position were primarily in the portfolio and FDI equity positions. Those changes went hand in hand with Russia stock market movements. As oil prices more than quadrupled since 2000, stock market valuation rose by nine times. About half of the RTS index is composed of oil and gas companies. This factor is not expected to be a drag on the net IIP position in the future. As the oil price growth is expected to moderate, the Russian stock market boom will slow down.

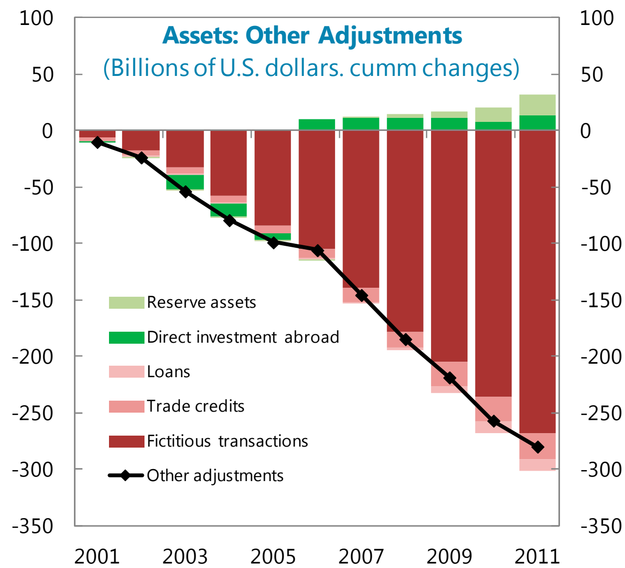
The CBR's BOP statistics department adjusts the asset position down by the size of so-called "fictitious" transactions. These transactions represent capital outflows that are not backed up by real economic activity, such as non-repatriation of exports proceeds, non-supply of goods and services against import contracts, securities trading, lending to nonresidents, and fictitious transactions with money transfers to residents' accounts abroad. For example, when a company reports to its bank that the transfer is done to prepay imports but then closes down before imports are received, CBR will allocate this transaction to "fictitious" outflows. Other examples include: (i) repeated large transfers abroad that deviate from standard remittances behavior; (ii) selling securities at a loss to your agent; and (iii) non-receipt of export earnings. CBR has a system to identify these flows based on detailed data on bank accounts, client information, and reputation of their clients abroad. The Department of Financial Monitoring and Control has approved these calculations.

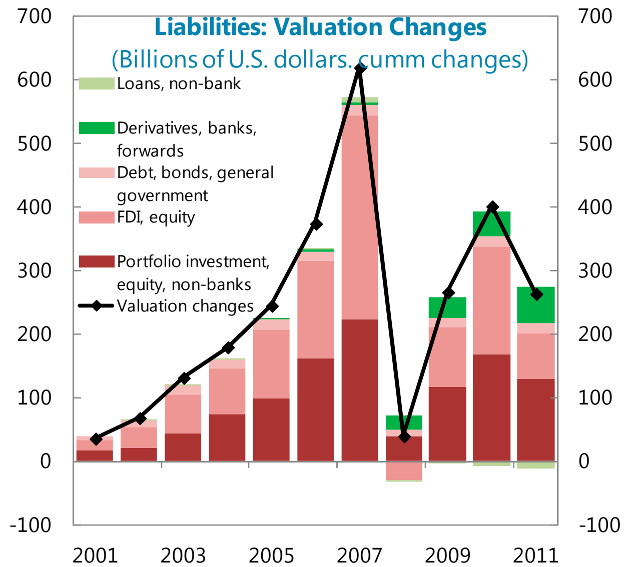
"Fictitious" transactions, which historically account for over 50 percent of net private sector capital outflows, receive a differential treatment in the BOP and IIP statistics. In the BOP statistics, they are reported by the CBR in the financial account as accumulation of foreign assets.

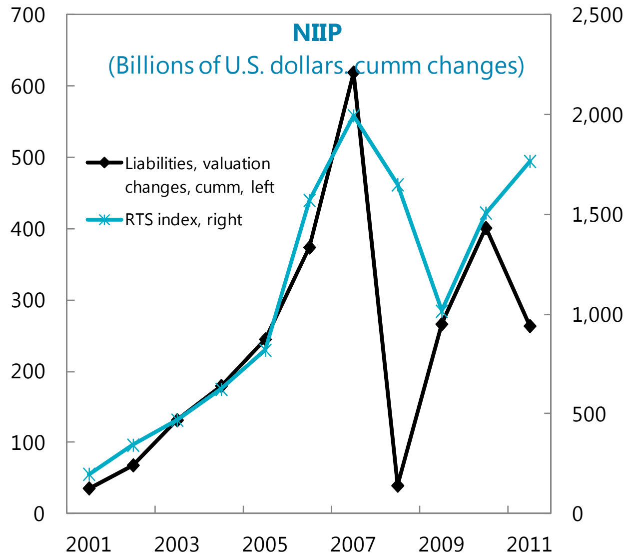
According to CBR, the CA itself is accurately measured, as it reflects actual economic transactions based on goods crossing the border. If these transactions were not separately identified in the financial account, the net errors and omissions category would be much higher. "Fictitious" flows are also recorded in the IIP statistics as purchases of financial assets abroad. However, the CBR then adjusts the foreign assets position downwards by the amount of these transactions in other adjustments. CBR chooses to adjust the IIP asset position down because they consider "fictitious" transactions as money that is leaving the country to never come back. However, to the extent that these are still foreign assets owned by residents, they could form part of the NIIP. If this adjustment were not made, the NIIP in 2011 would be 270 US dollar billions higher, standing at 21 instead of 7 percent of GDP.

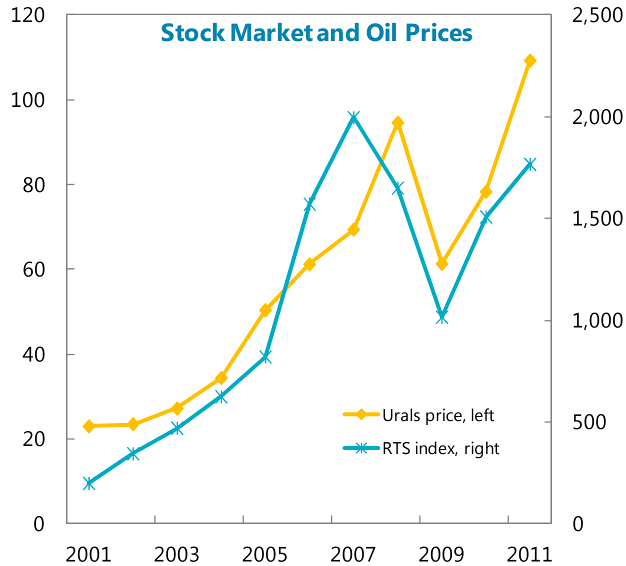


Sources: CBR; and IMF staff calculations.









Sources: CBR; Bloomberg; and IMF staff calculations.

INTERNATIONAL MONETARY FUND

RUSSIAN FEDERATION

June 11, 2014

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The European Department
(In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

(As of May 8, 2014)

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	4,038.00	71.12
Reserve Position	1,716.82	28.88
Lending to the Fund		
New Arrangements to Borrow	1,105.76	

SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	5,671.80	100.00
Holdings	5,689.62	100.31

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				
	2013	2014	2015	2016	2017
Principal					
Charges/Interest	---	0.03	0.03	0.03	0.03
Total	---	0.03	0.03	0.03	0.03

Implementation of HIPC Initiative: Not Applicable

Implementation of MDRI Assistance: Not Applicable

Exchange Arrangements: The *de jure* arrangement is other managed arrangement—namely, a controlled floating exchange rate arrangement. The ruble value of a bi-currency basket is used as the operating benchmark for transactions on the domestic foreign exchange market. The basket is currently composed of €0.45 and US$0.55. The value of the bi-currency basket is determined under the influence of both market factors and exchange interventions by the Central Bank of Russia (CBR). Interventions take place both in interbank currency exchanges and on the over-the-counter interbank market to limit daily fluctuations. The CBR does not set any quantitative limits on the exchange rate level of the national currency, but its exchange rate policy aims at keeping short-term fluctuations within an acceptable range, as determined by a floating operating band. Interventions take place both at the limits of the floating operating band and within it. They are triggered once the exchange rate crosses limits set by a nonintervention corridor, with intervention amounts and intervals established in advance. The limits of the operating bands itself shift 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. The range of permissible fluctuations may be revised further in response to changes in macroeconomic indicators. The CBR aims at further scaling down its direct interventions and creating conditions for the transition to a floating exchange rate regime by 2015. After the transition to a floating exchange rate regime, the CBR intends to abandon exchange rate-based operational indicators of its exchange rate policy. Owing to the continued control of the CBR over the exchange rate determination, the de facto exchange rate arrangement is classified as other managed arrangement. The Russian Federation accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement with effect from June 1, 1996, *and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions*.

Article IV Consultation: Russia is on the standard 12-month consultation cycle. The last consultation was concluded on September 18, 2013.

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.

IMF-WORLD BANK COLLABORATION

The IMF and World Bank teams agree that Russia's key challenges are to strengthen macroeconomic stability and to improve growth prospects. Stronger core institutions and a better regulatory, judicial, administrative and business environment are needed. This will support private-sector investment and the creation of more and better jobs.

The teams identified several reform areas as macro-critical:

- **Strengthening the fiscal framework:** Key elements of reform include: (i) strengthening the new fiscal rule to rebuild fiscal buffers and save more of the exhaustible oil income for intergenerational equity considerations; (ii) avoiding off-budget or other mechanisms for increasing spending outside the federal fiscal rule; (iii) strengthening fiscal risk assessment and transparency; and (iv) coordinating the National Wealth Fund domestic investment strategy with the Budget process.

- **Public expenditure reforms**: Key elements of reform include: (i) promoting aggregate fiscal discipline and strengthening public expenditure efficiency and management; (ii) strengthening capital budgeting in the road and rail sectors; and (iii) improving the efficiency of public employment.

- **Reforming the pension system**: The recent reform, while a step in the right direction, appears insufficient to safeguard the viability of the system without jeopardizing pension benefits. Key objectives of reform include managing long-run fiscal costs and providing reasonable pension benefits to all pensioners current and future. In particular, increasing the retirement age would cushion the projected impact on the labor force stemming from adverse demographic trends.

- **Strengthening the monetary policy framework:** Key elements of reform include (i) further increasing exchange rate flexibility, as the current geopolitical turmoil abates; and (ii) focusing monetary policy toward inflation targeting.

- **Financial sector stability assessment and financial sector development**: The banking sector is stable but a consolidation of the banking system would be beneficial. Some of the 2011 FSAP recommendations have yet to be implemented. Reforms would centered around: (i) introducing a unified administration regime for all banks, (ii) restricting open bank assistance by the Deposit Insurance Agency to systemic situations, (iii) setting limits on concentration of collateral in the repo market; and (iv) improving SMEs' access to finance.

- **Private sector development**: Key reforms would aim at (i) improving the business climate; (ii) increasing competition; (iii) diversifying the economy; and (iv) reducing the footprint of the state in the economy.

- **Improving the labor market**: Key elements of reform include: (i) reducing skills mismatch; and (ii) increasing labor market mobility. These reforms would also help to allow for continued economic mobility and off-setting the demographic challenge of aging.

The teams agreed the following division of labor:

- **Strengthening the fiscal framework**: The Fund will discuss further reform options with the authorities during the Article IV consultations. The Fund will continue its dialogue with the authorities on how to modernize the Federal Tax Service and improve transparency and disclosure of fiscal risks. The Bank will provide assistance on public finance reforms, including tax policy and administration, inter-budgetary relations, program budgeting and public expenditure efficiency.

- **Public expenditure reforms**: The Fund will discuss government plans for strengthening the fiscal rule in the context of the Article IV consultations. The Bank will further explore cooperation with the authorities in the areas of improving the business environment and public administration reform, including in the regions.

- **Reforming the pension system**: The Fund will discuss with the authorities the recent public pension system reform during the Article IV consultations. The World Bank is involved in activities of the intergovernmental working group on nonstate pension funds under the Ministry of Finance, which supports the preparation of several legislative initiatives to improve nonstate pension funds, supervision and operations.

- **Strengthening the monetary policy framework**: The Fund has elaborated reform options and discussed them with the authorities during the 2014 Article IV consultation. Envisaged follow-up work includes: (i) examining the optimal width of the policy rate corridor; (ii) coordination between monetary policy and government operations that affect liquidity conditions; (iii) foreign exchange intervention policy; and (iv) effective communications policies.

- **Financial sector stability assessment and financial sector development**: The Fund conducted a Financial Sector Assessment Program (FSAP) Update in March/April 2011 and discussed reform options with the authorities, along with participation of Bank staff. An IMF expert at the CBR (resident advisor) has helped the authorities adopt the IRB of Basel II (internal-ratings based approach for measuring credit risks) and Basel III frameworks and implement the recommendations of the FSAP Update. The Bank board approved a Microfinance development project which is currently pending signature. The Bank is also preparing a new lending project to (a) achieve an orderly financial market expansion and development of domestic capital markets to better serve the needs for corporate finance, (b) enhance financial market stability through a modernized state-of-the-art regulatory framework and the implementation of robust supervisory and enforcement mechanisms, and (c) reach global best practice standards in the market infrastructure and regulation, in order to achieve a broader international reach as a center of financing. However, with the recent changes in the supervisory architecture and recent decision to create a Mega-Regulator under the Central Bank of Russia, which will absorb the functions of the FSFM, the project is stalled and may need to be restructured or transformed depending on the needs of the CBR.

- **Private sector development**: The Fund will discuss further reform options with the authorities during the Article IV consultations. The World Bank program supports the government in several aspects to strengthen the private sector in Russia, this includes lending, technical assistance and analytical work in the areas of diversification, innovation, and the investment climate.

- **Improving the labor market**: The World Bank is actively supporting the authorities in improving the vocational education system and in identifying solution for existing labor market bottlenecks with the goal to increase Russia's competitiveness.

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

- The Fund team requests to be kept informed of progress in the macro-critical reform areas under the Bank's purview and the Bank will provide an assessment of the 2014–16 medium-term budget in its regular economic report.

- The Bank team requested that the Fund share on a regular basis with the Bank and invite, as needed, the Bank's comments on policy notes, draft staff reports, and other relevant materials; and that Bank staff be invited to attend policy meetings, as has already been the case in the context of Article Consultation Discussions.

The table below lists the teams' separate and joint work programs during July 2013 to September 2014.

Title	Products	Provisional Timing of Missions	Expected Delivery Date
1. Bank Work Program	Country Partnership Strategy (CPS)	Delivered	Board discussion Dec. 2011
	CPS Progress Report	July 2013 December 2013	Due in 2014
	Russian Economic Reports (RER)	Ongoing, latest editions: October 2013 and Mach 2014	Next editions: October 2014, March 2015
	Social Mobility, Poverty and Opportunity Study	Ongoing	Delivery in FY14
	Corporate Governance ROSC	Ongoing	Delivery in FY14
	Microfinance Development Project – cancelled, follow up RAS being prepared	Ongoing	Approved January 2013 - cancelled
	Public Financial Management Project	Ongoing	Approved September 2013
	Financial Market Development Project – dropped; follow up RAS being prepared	Ongoing	Dropped
	Other analytical work on diversification, the economic impact of aging, poverty and inequality, social mobility, gender assessment, post WTO developments, financial sector analysis (pensions, banking, capital markets and insurance) and technical assistance on diversification and innovation, investment climate, public procurement, customs, tax administration, statistical system building, judicial reform, health financing, social services modernization, smart cities, agriculture and growth, urban transport and open data, etc.	Ongoing	FY14–15
2. Fund Work Program	Modernization of the Federal Tax Service	September 2013	November 2013
	Fiscal Transparency Assessment	October 2013	May 2014
	2014 Article IV Mission	April 2014	June 2014
	2015 Article IV Mission	April 2015	By September 2015
3. Joint Products (in next 12 months)	No joint products planned at this time		

STATISTICAL ISSUES

A. Assessment of Data Adequacy for Surveillance

General: Data provision is broadly adequate for surveillance. However, in the context of emerging data demands for assessing external vulnerabilities, the scope for further data improvements exists.

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

National Accounts: Data are broadly adequate for surveillance, but there have been concerns about the reliability and consistency of quarterly GDP estimates among a wide range of users, including Fund staff. Rebasing GDP estimates to a recent year would close the gap between GDP estimate and its components. 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 are undervalued. Improvements in the coverage of source data are constrained by an inadequate response to business surveys. The unavailability of balance sheet data continues to be an obstacle for analyzing balance sheet vulnerabilities, and work is underway to disseminate the first quarterly sectoral accounts and balance sheets for 2012–14 by 2016.

Price statistics: Data are broadly adequate for surveillance. 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 PPI weight data are published on the Rosstat website for 2006–2013: and detailed data on total annual sales, which are used to develop weights for the PPI, are also published by economic activity on the website under the Entrepreneurship section, industrial subsection. However, the detailed weights are available only on the Russian version of the website, making it less accessible by users. Further efforts to improve the treatment of seasonal items in the core inflation index and a new household budget survey—which has been under consideration for some time—could significantly strengthen data quality.

Government finance statistics: Russia participates in the G-20 Data Gap Initiative. 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 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 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 (2005–11), 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.

Energy sector statistics: Data on the impact of oil production and exports on economic activity are inadequate for surveillance. In recent years, the levels of oil production and consumption, and oil price fluctuations have had a significant impact on economies of individual countries and for Russia, the relative impact of oil production and exports on GDP has grown over the past decade. As a result, there has been increased demand for information on oil and gas activities and products. It would therefore be useful to measure the share of oil and gas sector in GDP, preferably on an annual basis. The Russia team is currently working closely with the authorities, exploring options to overcome this deficiency during 2014.

B. Data Standards and Quality

Subscriber to the Special Data Dissemination Standard (SDDS) since January 31, 2005. SDDS flexibility option used for the timeliness of data on central government operations. A data ROSC prepared in October 2003 was published on the IMF website on May 14, 2004. A data ROSC reassessment in June-July 2010 was published on the IMF website on February 28, 2011 and concluded that Russia's macroeconomic statistics are generally of high quality. It found that compiling agencies have made significant progress in adopting international statistical methodologies and best practices.

C. Reporting to STA (Optional)

Data are being reported for publication in the *International Financial Statistics (IFS)*, *Government Finance Statistics Yearbook, the Direction of Trade Statistics*, and *the Balance of Payments Statistics Yearbook*. The CBR reports the summarized data, in the MFSM-recommended format for the surveys, on (i) the Central Bank Survey, (ii) the Other Depository Corporations Survey (covering credit institutions), (iii) the Depository Corporations Survey, (iv) the Other Financial Corporation Survey (covering insurance companies and private pension funds), and (v) the Financial Corporations Survey (data cover the banking system, insurance companies, and private pension funds). For the general government, the cash flow statement is published in the IFS, and operation statement (economic and functional classifications) and financial balance sheet are published in the annual *Government Finance Statistics Yearbook*. Headline data on reserves are reported to the Fund and the markets on a weekly basis with a four-business day lag. Comprehensive information is reported in the Reserves Template with a lag of 20 days, exceeding SDDS timeliness requirement of one month.

Russian Federation: Table of Common Indicators Required for Surveillance

(As of June 11, 2014)

	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 2014	5/28/14	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Apr. 2014	5/30/14	M	M	M		
Reserve/Base Money	Mar. 2014	5/20/14	D	W	W	O, O, LO, LO	O, O, O, O, O
Broad Money	Mar. 2014	5/20/14	D	M	M	O,O,LO,LO	O,O,O,O,O
Central Bank Balance Sheet	Mar. 2014	5/20/14	M	M	M	O,O,LO,LO	O,O,O,O,O
Consolidated Balance Sheet of the Banking System	Mar. 2014	5/20/14	M	M	M	O,O,LO,LO	O,O,O,O,O
Interest Rates[2]	Apr. 2014	5/19/14	M	M	M	O,O,LO,LO	O,O,O,O,O
Consumer Price Index	Apr. 2014	5/28/14	/M	/M	/M		
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Mar. 2014	5/30/14	M	M	M	O, LO, LNO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Mar. 2014	5/30/14	M	M	M	LO, LNO, LO, O	O, O, LO, O, NA
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Mar. 2014	4/18/14	M	M	M		
External Current Account Balance	2013Q4	4/10/14	M	M	M		
Exports and Imports of Goods and Services	2013:Q4	5/28/14	Q	Q	Q	O, O, O,L O	LO, O, O, O, O
GDP/GNP	2013: Q4	5/28/14	Q	Q	Q		
Gross External Debt	2013:Q3	1/14/14	Q	Q	Q	O, O, O, O	O, O,LO, O, LO
International Investment Position[6]	2012	6/29/13	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.

Press Release No. 14/322
FOR IMMEDIATE RELEASE
July 1, 2014

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

IMF Executive Board Concludes 2014 Article IV Consultation with the Russian Federation

On June 27, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Russian Federation.

The growth slowdown that began in 2011, reflecting structural constraints, continued in 2013 despite accommodative policies. Real GDP growth slowed to 1.3 percent due to a contraction in investment while consumption remained robust owing to strong real wage growth and an unsecured consumer credit boom. The general government balance moved from a modest surplus in 2012 to a deficit of slightly more than 1 percent of GDP in 2013. The Central Bank of the Russian Federation (CBR) kept its policy rates constant until March 2014 despite above-target inflation.

More recently, geopolitical tensions have brought the Russian economy to a standstill. Staff projects real GDP growth at 0.2 percent in 2014 with considerable downside risks. Concerns about sanctions so far, as well as the threat of additional sanctions in the future, following Russia's actions in Crimea, have increased the uncertainty of doing business in Russia and are having a chilling effect on investment. Capital outflows could reach US$100 billion in 2014. Consumption will remain the main growth driver in 2014 while net exports are also expected to support growth as imports weaken. A slight recovery in growth to 1 percent is projected in 2015, on the back of stronger exports and stabilization of investment. Despite the economic slowdown, inflation is expected to remain well above the CBR’s target due to the recent exchange rate depreciation.

Fiscal policy is being tightened. However, the non-oil deficit will remain high, highlighting Russia’s reliance on revenues from exhaustible resources. The Reserve Fund balance has increased but remains well short of the government’s 7 percent of GDP target.

[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.

The CBR raised policy rates by 1½ percentage points in early March and a further ½ percentage point in April and reduced exchange rate flexibility in response to the onset of geopolitical tensions. The CBR also increased to US$1.5 billion the cumulative interventions required to move the exchange rate corridor, lowering the flexibility of its FX rule. The discretionary policies followed by the authorities helped contain the heightened currency and liquidity stress. By the end of May, as the exchange rate traded firmly in the non-intervention zone, the CBR took steps to allow more exchange rate flexibility.

The banking system remains broadly stable amid a gradual slowdown of unsecured retail credit growth and a stepping-up of bank oversight. Non-performing loans ratio has remained relatively constant. Capital adequacy ratio has been stable and remains above the statutory minimum. The banking system has moved from a negative to a positive net foreign asset position, limiting aggregate currency mismatch.

Executive Board Assessment[2]

Executive Directors noted that despite accommodative policies, the Russian economy continues to experience a slowdown, reflecting mainly structural factors. Directors agreed that, with the economy operating close to its full potential, Russia's growth model based on energy exports with increasing oil prices and use of spare capacity is no longer reliable and that there is need to move to a new model.

Directors observed that the geopolitical tensions are having strong negative consequences for the Russian economy. The related sanctions and the possibility of their escalation have had an impact through capital outflows, exchange rate pressures, and limited access to external financing with higher borrowing costs, and are also raising the uncertainty of doing business in Russia. Directors agreed that, while the immediate policy priority is to preserve macroeconomic stability, enhancing the policy framework and undertaking further structural reforms will be essential to boost investment and raise growth potential in the long term.

Directors concurred that the fiscal stance in 2014 is broadly appropriate but noted that flexibility could be considered in the event of a more severe cyclical downturn. They emphasized that adhering to the fiscal rule should support its credibility and the needed medium-term fiscal consolidation to rebuild buffers and safeguard intergenerational equity. Directors welcomed the changes to the public pension system but stressed that additional measures, such as increasing the mandatory retirement age, would be necessary to ensure long-term viability of the system.

[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.

They highlighted that resisting spending pressures and increasing efficiency gains would help create space for infrastructure investment.

Directors agreed that a tighter monetary policy stance is required to achieve the 2015 inflation target and anchor expectations. They also welcomed the authorities' commitment to continue moving to an inflation targeting regime and to a fully-flexible exchange rate once the current uncertainty subsides. In this context, they took note of the recent measures taken to increase exchange rate flexibility.

Directors noted that the banking system remains generally stable and welcomed the regulatory steps taken to slow the growth of unsecured retail lending. They concurred that the Central Bank should continue to monitor the build-up of systemic risks through regular stress testing exercises and increased oversight. Directors underscored that a deeper and more efficient financial system would facilitate access to credit and support long-term growth. They also encouraged implementation of the remaining Financial Sector Assessment Program recommendations, and called for steps to reduce banking sector fragmentation through consolidation and enhancing competition among banks.

Directors considered that deeper structural reforms are critical to enhancing Russia's growth prospects. They welcomed the authorities' efforts to fight corruption and improve procurement and the business environment. They encouraged the authorities to curtail state involvement in the economy, reduce price distortions, especially utility prices, and take further measures to increase investment and productivity. Directors also urged the authorities to revive the nearly-stalled privatization program.

Russian Federation: Selected Macroeconomic Indicators, 2011–15

	2011	2012	2013	2014	2015
				Projections	
			(Annual percent change)		
Production and prices[3]					
Real GDP	4.3	3.4	1.3	0.2	1.0
Consumer prices					
Period average	8.4	5.1	6.8	6.6	6.0
End of period	6.1	6.6	6.5	6.5	5.5
GDP deflator	15.9	7.5	5.9	8.5	5.9
Public sector[4]			(Percent of GDP)		
General government					
Net lending/borrowing (overall balance)	1.5	0.4	-1.3	-0.7	-0.8
Revenue	37.3	37.7	36.1	36.4	36.1
Expenditures	35.7	37.2	37.3	37.1	36.9
Primary balance	2.1	1.0	-0.6	0.0	0.0
Nonoil balance	-10.0	-11.0	-12.2	-11.9	-11.0
Federal government					
Net lending/borrowing (overall balance)	0.8	-0.1	-0.5	0.4	-0.2
Nonoil balance	-9.5	-10.4	-10.4	-9.7	-9.5
			(Annual percent change)		
Money					
Base money	20.9	11.3	8.0	7.4	7.8
Ruble broad money	22.3	11.9	14.6	13.5	14.0
External sector					
Export volumes	4.2	4.6	1.7	2.9	2.3
Oil	-1.9	0.4	2.6	1.8	-1.3
Gas	6.7	4.6	9.7	-2.2	0.2
Non-energy	6.1	5.9	5.0	6.9	8.6
Import volumes	16.6	9.2	3.1	-3.0	2.0
			(Billions of U.S. dollars; unless otherwise indicated)		
External sector					
Total merchandise exports, fob	515.4	527.4	523.3	530.7	523.1
Total merchandise imports, fob	-318.6	-335.8	-343.0	-330.0	-333.6
External current account	97.3	71.3	32.8	59.1	49.4
External current account (in percent of GDP)	5.1	3.5	1.6	2.9	2.4
Gross international reserves					
Billions of U.S. dollars	498.6	537.6	509.6	470.2	470.2
Months of imports[5]	14.6	14.5	13.0	12.5	12.4
Percent of short-term debt	331	327	286	252	237
Memorandum items:					
Nominal GDP (billions of U.S.D)	1,905	2,017	2,102	2,006	2,047
Exchange rate (rubles per U.S.D., period average)	29.4	30.8	31.8	…	…
World oil price (U.S.D. per barrel)[6]	104.0	112.0	108.8	108.0	103.0
Real effective exchange rate (average percent change)	4.9	3.7	-0.5	…	…

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