INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/229

RUSSIAN FEDERATION

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

July 2016

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 2016 Article IV consultation with the Russian Federation, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 29, 2016 consideration of the staff report that concluded the Article IV consultation with the Russian Federation.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 29, 2016, following discussions that ended on May 21, 2016, 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 14, 2016.
- An **Informational Annex** prepared by the IMF staff.

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

Selected Issues
Financial Stability System Assessment

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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July, dd, 2016

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IMF Executive Board Concludes 2016 Article IV Consultation with the Russian Federation

On June 29, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Russian Federation.

The Russian economy contracted by 3.7 percent in 2015 due to falling oil prices and the quasi closure of international financial markets to Russian entities. The economic contraction is nonetheless shallower than previous recessions as a stronger external position and the authorities' economic package—a flexible exchange rate regime, banking sector capital and liquidity injections, limited fiscal stimulus, and regulatory forbearance—cushioned the shocks, helped restore confidence and stabilized the financial system.

Lower oil prices and needed fiscal adjustment will keep the economy in recession in 2016 with an expected decline in real GDP of 1.2 percent. The negative output gap and the lack of aggregate demand pressures are expected to lower CPI inflation to 6.6 percent at end–2016. Growth is expected to resume in 2017 and reach 1 percent, as domestic demand slowly recovers on the back of easing financial conditions and pent up demand. With adverse demographics, and barring significant structural reforms that increase productivity growth, potential growth is likely to be at around 1½ percent over the medium term. A fall in oil prices is the main risk to the outlook.

Executive Board Assessment[2]

[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.

[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

Directors observed that the authorities' flexible and effective policy response has cushioned the economy from the dual shocks of lower oil prices and sanctions. At the same time, the Russian economy will need to adjust to the challenge of persistently lower oil prices by reducing its dependence on oil and energy exports over the medium term. They stressed that structural reforms will be essential to leverage the current competitive exchange rate to boost long-term potential growth.

Directors encouraged the authorities to undertake the necessary fiscal adjustment anchored on a credible medium-term plan. In this context, they noted the authorities' large fiscal adjustment effort planned for 2016, and considered that an adjustment based on quality and permanent measures that safeguard growth-enhancing expenditure would have been preferable. They agreed that reintroducing the three-year budgeting framework in the 2017 budget would be critical to reduce policy uncertainty and provide greater clarity over future fiscal measures. Directors also emphasized that a credible fiscal rule would support medium-term sustainability. They also noted that a parametric pension reform has become urgent to reap the fiscal benefits in a timely manner.

Directors commended the authorities for implementing policies that were helpful in bringing down inflation. Given the negative output gap and little evidence of demand-side pressures, they considered that monetary policy normalization would be appropriate. However, they cautioned that the pace of easing should be gradual, given past strong links between volatile oil prices, the exchange rate, and inflation.

Directors welcomed the authorities' success in stabilizing the financial system. They also welcomed the completion of the government's capital support program and the lifting of most regulatory forbearance measures. Directors encouraged the authorities to implement the main findings of the Financial Sector Assessment Program by improving the resolution framework to minimize the use of public funds, conducting a review of banks' asset quality and using its findings to strengthen banks' capital, and further improving supervision and regulation. They stressed the need to deepen and diversify the financial sector by continuing the privatization program, pursuing the closure of weak banks, and encouraging the involvement of the private sector in bank resolution.

Directors noted that Russia has the opportunity to diversify its economy as a result of a more competitive exchange rate. They emphasized the importance of reforms to facilitate the reallocation of resources to the non-energy tradable sector. In this regard, trade integration initiatives to widen the scope of market access for non-energy exporters would be important. Directors also saw scope for accelerating institutional reforms and further enhancing the business climate. They highlighted the need to strengthen contract enforcement and the protection of property rights, improve labor market policies, and invest in innovation and infrastructure.

Russian Federation: Selected Macroeconomic Indicators, 2013–17

	2013	2014	2015	2016	2017
				Projections	
	(Annual percent change)				
Production and prices					
Real GDP	1.3	0.7	-3.7	-1.2	1.0
Consumer prices					
Period average	6.8	7.8	15.5	7.5	5.7
End of period	6.5	11.4	12.9	6.6	5.2
GDP deflator	4.8	9.0	7.7	7.4	5.5
Public sector[1]	(Percent of GDP)				
General government					
Net lending/borrowing (overall balance)	-1.2	-1.1	-3.5	-3.7	-1.6
Revenue	34.4	34.3	32.8	31.2	32.2
Expenditures	35.6	35.4	36.3	34.9	33.8
Primary balance	-0.6	-0.4	-2.7	-2.7	-0.4
Nonoil balance	-11.1	-11.5	-11.7	-10.0	-8.3
Federal government					
Net lending/borrowing (overall balance)	-0.5	-0.4	-2.4	-3.2	-1.5
Nonoil balance	-9.8	-10.1	-9.8	-9.0	-7.5
	(Annual percent change)				
Money					
Base money	8.0	6.3	-4.3	4.6	5.4
Ruble broad money	14.6	2.2	11.5	6.8	7.7
External sector					
Export volumes	1.9	0.1	2.6	1.1	2.3
Oil	2.7	0.1	10.9	-1.3	-1.6
Gas	9.9	-11.3	13.8	6.0	2.7
Non-energy	5.8	7.9	-5.5	2.2	6.4
Import volumes	3.2	-6.9	-28.4	-3.6	2.7
	(Billions of U.S. dollars; unless otherwise indicated)				
External sector					
Total merchandise exports, fob	523.3	497.8	339.6	299.0	332.2
Total merchandise imports, fob	-341.3	-308.0	-194.0	-180.1	-185.9
External current account	34.1	59.5	65.8	51.3	69.3
External current account (in percent of GDP)	1.5	2.9	5.0	4.0	4.9
Gross international reserves					
Billions of U.S. dollars	509.6	385.5	368.4	373.1	387.8
Months of imports[2]	13.0	10.8	15.7	17.2	17.3
Percent of short-term debt	251	302	478	257	274
Memorandum items:					
Nominal GDP (billions of U.S.D)	2,231	2,031	1,326	1,270	1,410
Exchange rate (rubles per U.S.D., period average)	31.8	38.4	60.9	…	…
World oil price (U.S.D. per barrel)	104.1	96.2	50.8	42.2	48.8
Real effective exchange rate (average percent change)	1.8	-8.5	-17.4	…	…

Sources: Russian authorities; and IMF staff estimates.

1/ Cash basis.
2/ In months of imports of goods and non-factor services.

RUSSIAN FEDERATION

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

June 14, 2016

KEY ISSUES AND RECOMMENDATIONS

Context. Despite a flexible and effective policy response that helped restore confidence and stabilize the financial system, the decline in oil prices and sanctions led to a sharp contraction of economic activity in 2015. The recession is extending into 2016 due to lower oil prices, fiscal consolidation and still tight financial conditions. The banks' capital support program came to completion while most regulatory forbearance measures were lifted. Medium-term prospects remain subdued due to long-standing structural bottlenecks in addition to adverse population dynamics and the impact of sanctions on productivity and investment.

Near-term macroeconomic policy mix. The fiscal policy adjustment in 2016 is procyclical and a smoother adjustment would have been preferable. Monetary policy normalization could resume at a prudent pace given the decline in inflation and inflation expectations. Financial sector policies should focus on implementing the main findings of the Financial Sector Assessment Program (FSAP) by improving the resolution framework, conducting a review of banks' asset quality, and further strengthening supervision and regulation.

Medium-term policy challenges. Policies need to address the challenge of persistently lower oil prices. Fiscal policy should be guided by a multi-year adjustment program based on quality and durable measures. The financial policy framework needs further strengthening, per the FSAP recommendations, to limit potential sources of macro-financial risks and foster the financial sector's contribution to medium-term growth. Finally, structural reforms remain essential to leverage the more competitive exchange rate and raise productivity and investment, while diversifying the sources of economic growth.

Approved By
James Gordon and Vikram Haksar

Discussions for the 2016 Article IV consultation were held in Moscow during May 10–19. The mission comprised Mr. Ramirez Rigo (Head), Messrs. Belhocine, Painchaud (all EUR), Ms. Karlsdóttir (MCM), Ms. Kyobe (SPR), and Mr. Di Bella (Res. Rep.). Ms. Dynnikova (local senior economist), and Ms. Chebotareva (local economist) assisted the mission. Mr. Mozhin, Executive Director, Mr. Karl Habermeier (MCM), and Mr. Gordon (EUR) participated in the discussions. The mission met with Minister of Finance Siluanov, Central Bank Governor Nabiullina, other senior officials and representatives of financial institutions. Mr. Jovanovic and Ms. Madaraszova contributed to the preparation of this report.

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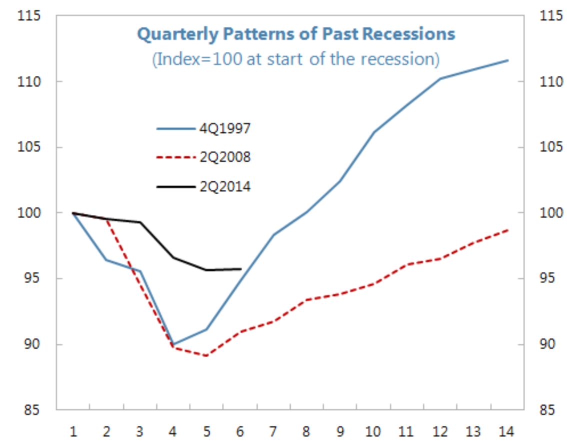
CONTEXT: NAVIGATING THE CHALLENGE OF PERSISTENTLY LOWER OIL PRICES



1. **An effective policy response has cushioned the economy from the dual shocks of lower oil prices and sanctions.** The 45 percent decline in oil prices between 2014 and 2015 and the continued quasi closure of international financial markets to Russian entities depressed economic conditions. The economic contraction is nonetheless shallower than previous recessions as a stronger external position and the authorities' economic package—a flexible exchange rate regime, banking sector capital and liquidity injections, limited fiscal stimulus, and regulatory forbearance—cushioned the shocks, helped restore confidence and stabilized the financial system.

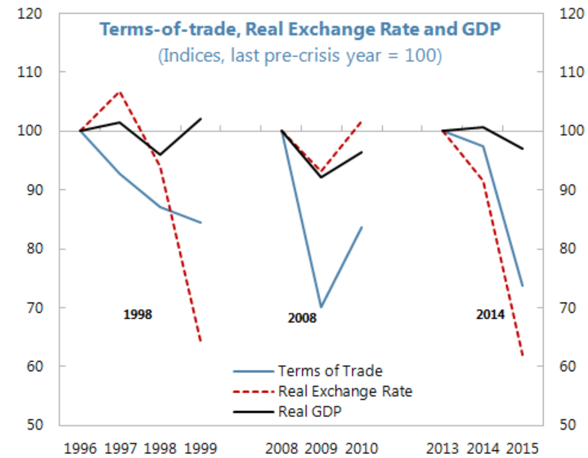
2. **The anti-crisis measures introduced in December 2014 have been phased out or not renewed.** The government's capital support program was completed and most regulatory forbearance measures were lifted. The temporary and limited fiscal stimulus in 2015 supported growth. Normalization of monetary policy proceeded for most of 2015, following the emergency 650bp rate hike in December 2014, as confidence improved and inflation came down. Finally, the CBR has progressively raised the cost of its FX facilities while banks proceeded to repay about half of their FX borrowing.

3. **The external adjustment has been progressing rapidly.** In spite of falling oil prices, the current account improved in 2015 due to import contraction, improvement in the services' balance deficit, and a narrowing of the income account deficit. Despite the ruble's significant adjustment towards a lower equilibrium, the response of non-energy exports has so far been limited to a few specific sectors (Annex II and Box 1). Meanwhile, external deleveraging, triggered by sanctions, has reduced external private debt by USD 176bn over the past two years. Finally, capital outflows declined in 2015 to half their 2014 level, reflecting the return of confidence and a reduction in exchange rate pressures.

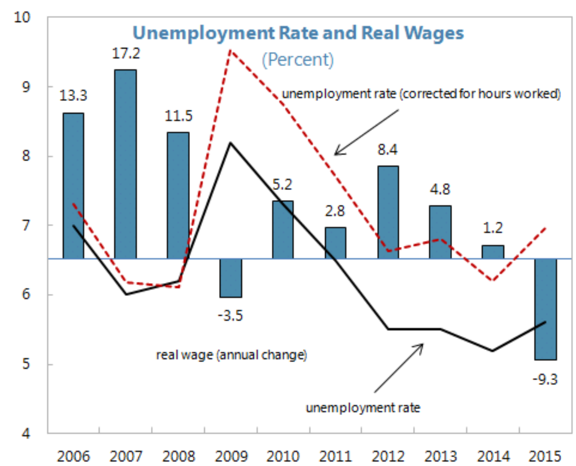
4. **Increased headwinds have delayed the recovery (Figure 1).** After some signs of improvements in mid–2015, the renewed slump in oil prices throughout the second half of 2015 dampened economic prospects. As a result, the federal government introduced new spending cuts to the 2016 budget while the ruble depreciation led the CBR to pause its monetary easing in August 2015. Given the fragile economic situation, the banking sector has remained weak although financial stability concerns have subsided.

Box 1. The Economy's Adjustment to the Current Recession

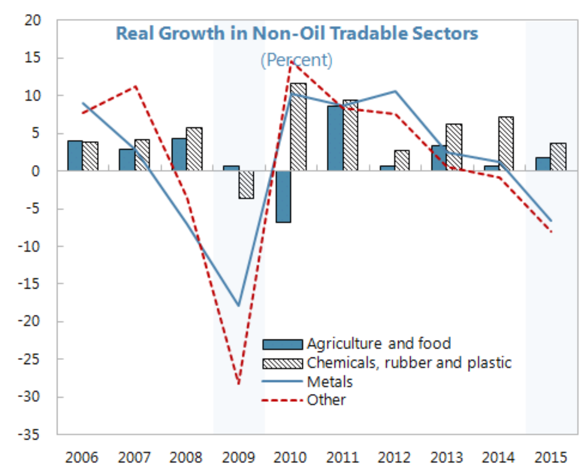
Russia's economic adjustment to the oil price shock has been smoother than past recession episodes. The 30 percent cumulative deterioration in the terms-of-trade has been larger than the 2009–10 episodes. Yet, real GDP contraction in 2015 has been milder than in 2009 amid a much more pronounced real exchange rate adjustment (REER).



Stronger real wage flexibility, lower increases in unemployment, and higher profits in the tradable sector have helped cushion the impact of the oil price shock. The flexible exchange rate and the tight income policies of the government facilitated the downward adjustment of real wages, which fell by 9 percent in 2015, compared to a 3 percent decline in 2009. As a result, unemployment remained broadly stable at around 6 percent, in contrast to 2009, when unemployment increased to more than 8 percent. The fall in real wage led to a rebalancing of national income in favor of corporate profits, more noticeably in the non-oil basic commodities' sectors.



A more competitive REER supported import competing industries and to a lesser extent some exports. In contrast with 2009–10, volumes of some non-oil exports, such as chemicals and agriculture products, increased during 2014–15, outperforming domestic market sales. In addition, domestic sales of goods and services (in real terms) fell less than domestic demand, suggesting some import substitution as a result of expenditure switching. Agriculture and food as well as chemicals, rubber and plastics showed the best performance among tradable goods.



Sustaining these trends will be key to support diversification. Domestic sales of goods and services outperformed domestic demand in each of the episodes of REER decline since the late 1990s, increasing the share of domestic goods in total demand by 5–6 percentage points. However, these gains were reversed as the REER rebounded.

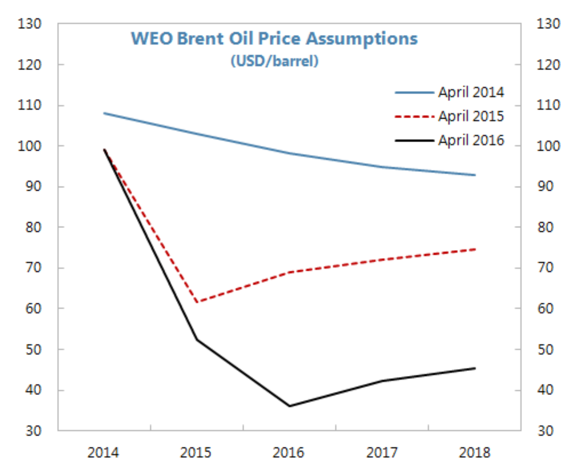
RECENT DEVELOPMENTS

5. The rebound in oil prices in the first half of 2016 has improved the short-term economic outlook. Brent prices reached a low of USD 26 per barrel in January 2016 before staging a recovery that is extending into Q2 2016, with oil prices averaging USD 47 per barrel in May. There have been some tentative signs of economic improvements in specific sectors but broad signs are not yet widespread. Industrial production has stopped declining sequentially although PMI suggests continued weaknesses in the manufacturing sector while the services sector activity seems to be gathering strength. A negative output gap, lower-than-expected exchange rate pass through, declining international food prices, and tight income polices have contributed to lowering inflation, which reached 7½ percent in April, down from 16½ percent a year before.

6. The banking system remains weak but stable. The overall capital adequacy ratio resumed its declining trend on the back of low profitability and anemic credit growth.[1] Credit quality continues to worsen, with reported NPLs reaching 9.2 percent of total loans in Q1 2016. Despite the challenging environment, the flow of deposits is increasing, liquidity in both rubles and foreign exchange (FX) has improved, and there are no signs of increased dollarization. CBR has continued closing banks, most of them small, in many cases because they are weak or not in compliance with regulations (including under AML/CFT legislation).

OUTLOOK AND RISKS

7. Lower oil prices and tighter policies will keep the economy in recession in 2016 while the recovery and medium-term prospects remain modest (Figure 2). Real GDP is expected to decline by 1.2 percent in 2016, as consumption adjusts to lower real wages and tighter credit conditions while investment remains weak. The negative output gap and the lack of aggregate demand pressures are expected to lower CPI inflation to 6.6 percent at end–2016 and 5.2 percent at end–2017. Growth is expected to resume in 2017 and reach 1 percent, as domestic demand slowly recovers on the back of easing financial conditions and pent-up demand. Nonetheless, private consumption and investment are likely to remain subdued over the medium-term against a background of lower-than-trend credit



[1] The move to Basel III has narrowed the eligible capital to calculate the CAR with an estimated impact of 0.6 percentage point. See paragraph 23 and Figure 5 for further discussion.

growth from a weak banking system and deleveraging, dampened oil prices, and tight fiscal policy. Finally, with adverse demographics, and barring significant structural reforms that increase productivity growth, potential growth is likely to be at around 1½ percent over the medium term.

8. Risks remain significant but existing buffers will help limit adverse effects. The main risks to the Russian economy are a further decline in oil prices, an intensification of geopolitical tensions, and a weaker banking system for longer (RAM, Annex III). The materialization of these risks would deepen the recession and, if residents' confidence is destabilized, increase balance of payments pressures. Although most corporates have enough foreign exchange to cover their short-term external debt obligations and have natural hedges against exchange rate risks, further deleveraging could reduce investment and thus potential output.[2] Moreover, the absence of credible measures to consolidate public finances in the medium-term could foster uncertainty and further limit investment and growth. Weak growth would also weigh on the recovery of the financial sector. However, the banking sector is relatively small as a share of GDP. Also, Russia has a floating exchange rate, large official foreign exchange reserves, a positive net international investment position of about 20 percent of GDP, and a current account surplus.[3] In addition, balance sheet currency mismatches seem low and do not impose a significant constraint on exchange rate flexibility. More importantly, public sector debt is low, financing needs moderate, and should it be needed in a tail event, the National Wealth Fund (NWF)—with liquid assets worth 5 percent of GDP—could be used as an alternative to finance the deficit.

Authorities' Views

9. The authorities broadly agreed with staff's risk assessment but had a more optimistic view on the growth prospects. For 2016, the Ministry of Finance expects a much milder contraction than staff, of 0.2 percent, due in large part to lower fiscal multipliers assumptions and the expectations of stronger domestic demand. The Ministry of Finance and the CBR considered that the Russian economy has largely adjusted to the dual shocks of lower oil prices and sanctions while financial conditions were improving. They pointed out that specific sectors are performing well such as agriculture and chemicals, benefiting from the ruble depreciation and other government policies. However, they underscored the risks to the outlook coming from volatile oil prices, a weaker banking system, and lack of progress in fiscal adjustment. They agreed with staff that in the absence of structural reforms, growth prospects would remain dim.

[2] Staff projections assume that Russian entities will be able to roll-over their external debt at higher roll-over rates from 2017 (Table 3).

[3] International reserves stood at USD368 billion at end-2015, equivalent to 266 percent of the Fund's basic reserve adequacy metric, exceeding the adequacy minimum of 150 percent. Taking into account Russia's vulnerability to commodity shocks, the adjusted adequacy metric falls to 199 percent of the metric, remaining above the minimum adequacy threshold (see "Assessing Reserve Adequacy – Specific Proposals" IMF, April 2015). Nonetheless, additional reserves could be justified given that Russia's access to international capital markets is impaired.

POLICY DISCUSSIONS

The discussions focused on managing the ongoing adjustment to lower oil prices and the policies required to ensure a recovery by: (i) anchoring the fiscal adjustment in a credible medium-term plan and thus avoiding an excessively tight fiscal policy in the short run; (ii) resuming monetary policy loosening as inflation risks subside to mitigate the fiscal drag and support the recovery; (iii) strengthening financial sector institutions to better support growth; and (iv) advancing structural reforms to leverage the more competitive exchange rate and rebalance growth towards non-energy tradable goods.

A. Fiscal Policy: Designing and Sequencing Fiscal Consolidation

10. The budget for 2016 targeted a deficit of 3 percent of GDP. The approved budget was based on oil prices averaging USD 50 per barrel and included a freeze of public sector wages—for a second year in a row—and a partial indexation of pension benefits to inflation. The subsequent decline in oil prices in early 2016 led the authorities to implement additional measures to limit the impact of oil prices on the deficit, including a 10 percent across-the-board cut in non-defense/non-social spending. The government also reallocated spending to priority areas under a new "anti-crisis package". The deficit is to be financed primarily through a drawdown from the Reserve Fund (RF) and via privatization receipts from a number of large state-owned companies. Net financing from the domestic market would amount to only 0.4 percent of GDP while net external financing would be negligible, after accounting for the USD 1.75bn in Eurobonds that has already been issued.

11. The authorities announced the goal of balancing the budget by 2020 and then reintroducing the fiscal rule. The authorities aim to reintroduce the multi-year fiscal framework, suspended last year, in the 2017 budget. To adjust to the new reality of lower oil prices, they are considering a broad range of fiscal consolidation measures including pension reform, means-testing social benefits, postponing investment and improving capital budgeting, cutting subsidies, and improving tax collection. The 2017 budget and the measures envisaged in the multi-year framework will be submitted to Parliament in October. Finally, the government is considering reintroducing a fiscal rule once the fiscal adjustment is completed, based on a fixed oil price of USD40 or USD50 per barrel depending on the authorities' assessment of long-term average oil prices, to smooth the impact of oil price cycles on public finances, domestic demand, and the real exchange rate.

12. Staff estimates that the fiscal deficit will be slightly larger than budgeted for 2016. Based on an average Urals oil price of USD 42.2 per barrel, the federal deficit is expected by staff to reach 3.2 percent of GDP.[4] In parallel, the general government deficit is expected to deteriorate from

[4] Privatization proceeds from the possible sale of 19.5 percent of the Rosneft's capital are accounted for in the 2017 budget as a dividend transfer from the holding company Rosneftegaz. Privatization proceeds from the sale of the government's stake in other companies are treated as financing. Privatization receipts are excluded from the calculation of the structural deficit and hence do not affect the assessment of the fiscal stance.

3.5 percent of GDP in 2015 to 3.7 percent of GDP in 2016, as the fall in oil revenues is only partly offset by a decline in expenditures as a share of GDP. This corresponds to an improvement of the structural non-oil primary deficit of 1.6 percent of potential GDP, implying a significant fiscal drag on the economy in 2016.

13. Given the sizeable deterioration in the oil price outlook compared to last year's Article IV, staff agreed that fiscal consolidation was more pressing. However, the economic outlook has deteriorated since the last Article IV and there remains slack in the economy. Thus, given the available fiscal space, the flexible exchange rate, and the constraints on monetary policy to offset the fiscal drag, staff argued that a smaller underlying fiscal adjustment of about 0.7 percent of GDP in 2016 would have been appropriate.[5] Furthermore, an adjustment based on better quality measures would have been preferable to an across-the-board spending cut that could reduce some productive and needed outlays. Staff also recommended preserving more of the RF as liquidity risks could materialize (e.g. drop in oil prices, low privatization receipts, and/or a tightening of sanctions), and instead relying more on debt issuance since public debt is relatively low and there is demand for domestically-issued government bonds.

14. Staff recommended that the necessary fiscal consolidation be anchored in a credible medium-term framework. The absence of credible measures to balance the budget in the medium-term could foster uncertainty and limit growth. Staff's baseline is consistent with the authorities' stated objective of balancing the budget by 2020. This will necessitate taking fiscal measures of 4 percent of GDP over 2017–2020. Staff considers such an ambitious adjustment to be reasonable as it would enable Russia to adjust to the new enviornment of lower oil prices and reach a fiscal position more consistent with integenerational equity by 2020 (Box 2). Staff proposed a menu of measures to be considered by the authorities (text table). Staff advocated that the consolidation be based on quality measures, with the lowest multipliers in the short-term to limit the impact on growth (excises and VAT), and look at a broad range of unproductive spending, leveraging on the initial result of the authorities' ongoing expenditure review. To support the fiscal consolidation effort, staff also noted the benefits of strengthening the financial oversight of government-controlled enterprises, in line with the recommendations of the 2014 Fiscal Transparency Evaluation for Russia. In addition, reestablishing the three-year fiscal framework would help reduce policy uncertainty and provide a path to anchor

Possible Fiscal Adjustment Measures
(Percent of GDP)

Measure	Budget Savings
Revenue measures	up to 4.2
Cut tax expenditures	2.0
Increase excise taxes	0.7
Improve productivity of VAT, duties, excise and social contributions	1.2
Increase PIT base	0.3
Expenditure measures	up to 7.6
Reduce subsidies	1.5
Better targeted social transfers	2.0
Increase retirement age	2.0 - 3.0
Reduce early pensions	0.7
Improve capital budgeting	0.4
Total	up to 11.8

Source: Ministry of Finance, WB, IMF staff estimates

[5] As measured by the non-oil primary structural balance.

the adjustment, in light of the risks stemming from the election cycles (Duma in September 2016, presidential in March 2018) and possible contingent liabilities from the banking system.

15. Staff noted that parametric pension reform is essential to balance the budget by 2020. Staff reiterated the pension reform proposals made at the 2015 workshop delivered by IMF experts which consisted of: (1) increasing and equalizing statutory retirement ages; (2) reducing early retirement benefits; (3) improving coverage and compliance; (4) curtailing (continuing) pension benefits for pensioners below (above) the mandatory retirement age; and (5) striving to develop and preserve private pensions in order to support long-term financing to the economy. Pension reform that increases retirement age and provides more incentives to stay in the labor force would have the additonal benefit of easing demographic pressures on labor supply.

16. Staff argued that a credible fiscal rule would help support medium-term fiscal sustainability. While the authorities are still considering options for the specific design of their fiscal rule, staff reiterated its views expressed in the last Article IV Consultation and the accompanying Selected Issues Paper. In particular, staff noted that a more flexible oil-price rule, which sets an oil benchmark that incorporates future oil prices in its calculation, as done in Mexico for instance, could be preferable. This would help avoid suspending the rule when faced with pressures to increase spending, during an oil price boom, or when market pressures constrain financing, during an oil price downturn. Staff also noted that to be fully consistent with intergenerational equity, an additional fiscal adjustment of at least one percent of GDP would be required by 2021.

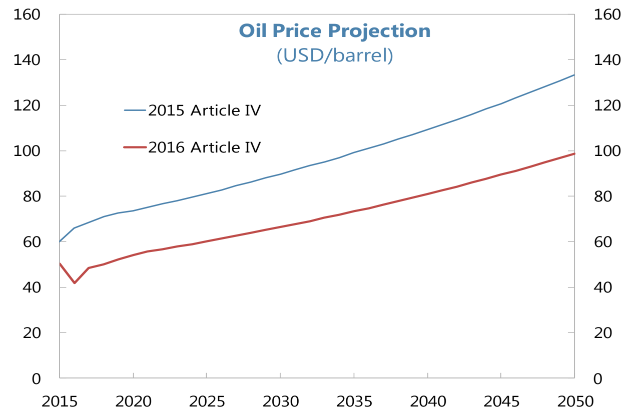
Authorities' Views

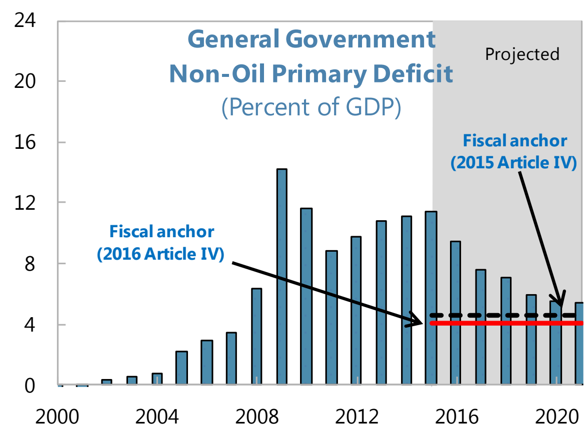
17. The authorities agreed with the need for medium-term fiscal consolidation under a credible fiscal rule. In their view, the decline in oil prices is mainly permanent and thus requires permanent fiscal adjustment. In contrast to staff, however, they believed that fiscal consolidation is unlikely to have an adverse impact on short-term economic activity, as fiscal multipliers are assumed to be low, possibly reflecting a lower estimate of the output gap and tight monetary conditions. They noted their ongoing efforts to find appropriate consolidation measures in the context of their comprehensive expenditure review, including means testing of social benefits, and steamlining inefficient health care spending. They agreed that pension reform is indispensable to reach their objective of a balance budget by 2020. Moreover they noted that encouraging private pensions would support the availability of long-term capital, which would be beneficial to the economy. The authorities agreed that reintroducing a fiscal rule could support fiscal sustainability and emphasized that a rule based on a fixed oil price would be simpler, more transparent and easier to communicate. They argued that the reliance on the RF to finance the deficit reflected the still-high cost of domestic borrowing. In addition, they pointed out to the current complex situation for issuing externally, where they believe that moral suasion by the US and EU authorities could increase uncertainty and risk primia. However, they are considering legislative budgetary changes to allow for greater flexibility in debt issuance to be able to take advantage of better market conditions.

Box 2. Revisions to the Fiscal Anchor Estimate

Given the lower oil price outlook since the last Article IV consultation, staff has updated its analysis of long-term fiscal benchmarks for Russia, consistent with the methodology presented in "Russia's Fiscal Framework and the Oil Price Shock". For simplicity, this presents the results for the "real annuity", which is a constant real transfer of resources over a fixed period of time (50 years) after which all resource wealth is exhausted.

While the impact of projected lower oil prices is partially offset by a more depreciated exchange rate, the updated analysis indicates that Russia would need to reduce its projected non-oil primary deficits to be consistent with the real annuity. For example, in the 2015 Article IV, a real annuity starting in 2021 and amounting to 4.6 percent of GDP was consistent with Russia's estimated oil wealth. Lower projected oil prices have reduced this real annuity to 4.1 percent of GDP, implying a need for an overall stronger fiscal effort of about 0.5 percent of GDP by 2021 relative to the original baseline envisaged in the 2015 Article IV consultation.





B. Monetary Policy: Returning to Normalization

18. Policy rates have remained constant since August 2015 due to inflation risks (Figure 4). After lowering rates by 600bps during January-August to a new level of 11 percent, the CBR paused its easing cycle in August to assess the impact of the ruble depreciation on inflation. The renewed pressures on the exchange rate from lower oil prices at year-end extended the pause, despite the weak economy and the additional fiscal tightening, with the CBR assessing the balance of risks skewed towards higher inflation risks. Since the beginning of 2016, the CBR has emphasized uncertainty over the fiscal policy outlook, reflecting the lack of clarity over government income policies for 2017. The CBR remains committed to reaching its 4 percent inflation target by end–2017.

19. Staff recommended resuming normalization of monetary policy at a prudent pace to support the economy. Inflation has been coming down on a sequential basis and is expected to continue to decline as a result of the negative output gap and slow nominal wage growth—in the context of freeze of public sector salaries for a second year in a row and partial pension benefit indexation. In addition, inflation expectations have continued to come down. Moreover, the exchange rate is broadly in line with fundamentals (Annex II), limiting further depreciation pressures that may fuel inflation. And, with headline inflation falling to 7.3 percent in May and unchanged nominal policy rates, real policy rates have increased. In addition, the monetary stance is tight as the policy rate is well above estimates of the neutral rate, which on balance suggest the CBR could resume its easing cycle. However, the pace of easing should be gradual given past strong links between volatile oil prices, the exchange rate and this inflation, factors that should condition the size and timing of interest rate cuts. Indeed, an aggressive monetary policy easing could lead to capital outflows, deposit withdrawals, and possibly destabilizing dollarization. In addition, uncertainty over the fiscal stance next year calls for a cautious approach to easing. Finally, unexpected policy tightening in the US and/or capital flow volatility related to concerns over the outlook for China would further limit CBR's room to ease (see RAM Annex III).

Authorities' Views

20. The authorities agreed that monetary policy normalization should proceed at a cautious pace. The CBR viewed the weak inflation readings in early 2016 as potentially transitory, due among other things to falling world food prices. It indicated that its moderately tight monetary stance was necessary to build credibility as a new inflation targeter and help bring down inflation to about 5 percent by end–2016 and to target by end–2017. Finally, the CBR argued that lowering policy rates should be cautious and given the uncertainty over future fiscal policies and still above-target inflation expectations, should be undertaken only once more clarity over the drivers of inflation is ascertained.

C. Macro-Financial: Improving the Institutional Framework to Secure a Higher Contribution to Growth

21. The banking system is likely to require additional capital. After adjusting for the lower quality of restructured loans, misclassifications, and transfer of distressed assets to affiliated off-balance sheet entities, the FSAP assessed that NPLs might be higher than reported by some 3.5 percentage points resulting in a capital shortfall of about 0.5-1 percent of GDP. Under stress scenarios, the shortfall could reach up to about 4½ percent of GDP.

22. Macro-financial risks remain as the economy adjusts to lower oil prices (Box 3). Ruble depreciation has cushioned the revenues of energy exporters from lower oil prices (Figure 6). In addition, energy companies have remained profitable given that their cost structure is primarily in rubles and that they are among the lowest-cost producers globally. However, the corporate sector as a whole shows signs of weaknesses. Debt servicing capacity has been falling, while smaller companies show weaker returns on assets and higher leverage. At the aggregate level, about half of corporate debt is denominated in FX. However, FX risks appears contained as corporate net foreign currency denominated debt to the banking system amounts to 4 percent of GDP while the private sector's short-term external assets exceed its short-term liabilities by about USD 65 bn. Most corporations that borrow externally have natural hedges. Moreover, external borrowing other than intercompany lending, the part most affected by sanctions and that would not be easily rolled-over externally, is more than covered by the external assets of corporations. Support to the loss-making Russian Development Bank (VEB), a non-deposit taking institution, has yet to be fully formalized but could reach up to 2 percent of GDP over the next few years.

23. The authorities' policies continue to support banking system stability. Nearly all the funds allocated under the 2015 government's capital support program have been assigned, amounting to 25 percent of eligible banks' capital. Participating private banks are raising an additional 12.5 percent in capital through retained earnings and/or share issuance, as required under the capital support program. Most regulatory forbearance measures introduced in December 2014 have been lifted, with the exception of continued flexibility in provisioning against loans restructured during December 2014–15 (Box 4). To offset the impact of the tighter capital definition and new capital buffers under Basel III, CBR lowered the minimum regulatory CAR from 10 percent to 8 percent, which is in line with minimum Basel III. [6] The introduction of the Basel capital buffers would allow banks to temporarily run down these new buffers which would be helpful in the current economic environment, but elevates the importance of strong supervision, including in asset valuations and risk management. The necessary move to Basel III, by narrowing the eligible capital to calculate the CAR, has improved the loss absorption capacity of banks' reported capital. Banks are less reliant on CBR liquidity but their funding remains short term and segmented by size and ownership structure.

[6] The tighter capital definition is estimated to lower banking system CAR by 0.6 percent of risk weighted assets (RWA). The new capital buffers are 0.625 percent of RWA for capital conservation and 0.15 percent of RWA for the systemic surcharge in 2016. These will gradually increase to 2.5 percent and 1 percent, respectively, when fully implemented in 2019. Thus, the effective minimum CAR is reduced temporarily by 0.775 percent of RWA for all banks but will recover and be higher by 2019.

Box 3. Macro-Financial Linkages from Lower Oil Prices (Continued)

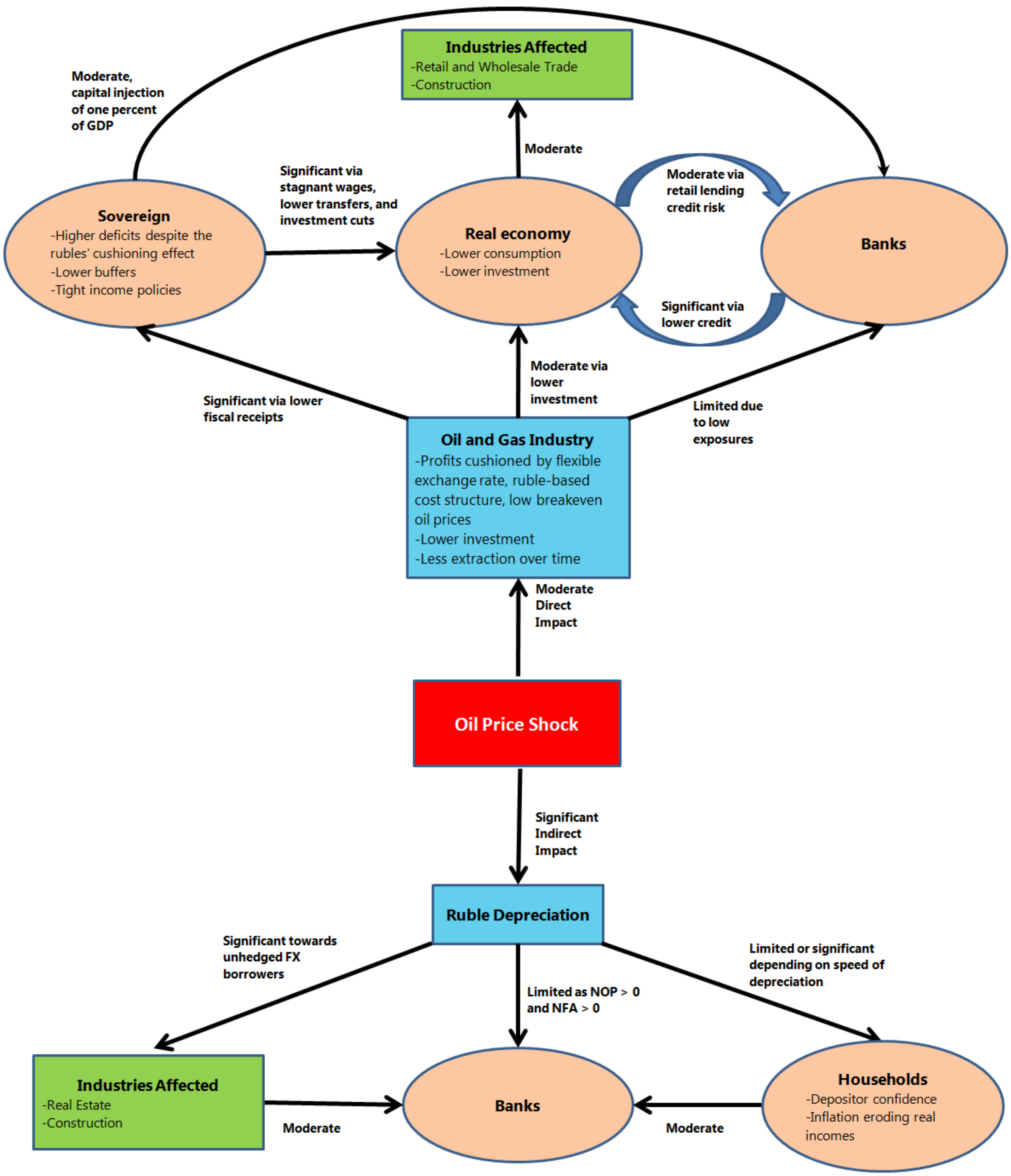
Russia is experiencing the aftershocks of the fall in oil prices through a web of macro-financial spillovers affecting primarily the following sectors:

Corporate sector. The direct impact on the oil and gas (O&G) industry has been relatively benign (paragraph 22, Figure 6). Nonetheless, oil prices are positively correlated to leverage and investment (Figure 7). As a result, oil extraction is expected to decline and gradually affect growth over the very long-term. Upstream and downstream sectors such as drilling and transportation (dominated by state-owned companies Transneft and Russian Railways) will also be affected. The indirect impact of lower oil prices through the large ruble depreciation has been more significant for unhedged sectors such as real estate and construction where contracts were labeled in FX and not rolled over when the exchange rate depreciated (Figure 8). Other sectors experiencing some difficulties include wholesale and retail trade due to low domestic demand and a slowdown in government spending.

Banking system. Bank lending is rather diversified across sectors without a significant concentration in the O&G industry—this sector typically borrows externally to take advantage of lower cost of funding and deeper capital markets (Figure 8). Nonetheless, indirect exposures and spillovers can be large. The FSAP stress test envisaged two scenarios: (1) a V-shape scenario where oil prices rebound from a low of USD 19 per barrel, and (2) an L-shape scenario where oil prices stay lower for longer after falling to USD 25 per barrel. The results show that the banking system would have capital needs that could at worst top about 4½ percent of GDP in both scenarios. The weak banking system will contribute to lower investment and growth, while offering little support to economic diversification. Sensitivity tests for the default of a bank's five largest corporate borrowers resulted in capital deficits in 338 banks equivalent to 2 percent of GDP. This rather severe outcome reflects the high concentration of lending into few borrowers.

Sovereign performance. A fall in oil prices reduces revenues from the O&G sector, although cushioned by the currency depreciation, leads to a general decline in fiscal receipts from a growth slowdown, and lowers dividend payments from state-owned enterprises and banks linked to the O&G industry. Fiscal adjustment via restrictive income policies—wage freezes and low pension indexation—have impacted consumption while the across-the-board cuts will affect capital spending. Buffers are being slowly eroded to finance the deficit, with the RF expected to fall to about 0.2 percent of GDP in 2017, which could necessitate the use of the NWF (5 percent of GDP) for any subsequent deficit financing, should the authorities decide to continue tapping into their reserves. The potential future support to banks and VEB could further dent buffers, although the authorities' public debt, which stood at 18 percent of GDP in 2015, remains relatively low, is overwhelmingly denominated in local currency, and has long maturities.

Box 3. Macro-Financial Linkages from Lower Oil Prices (Concluded)



Box 4. Banking Sector Regulatory Forbearance

The authorities introduced temporary forbearance as part of a comprehensive policy package in December 2014, to help banks avoid regulatory triggers due to the acute ruble depreciation and volatile securities market prices. The strategy was appropriately combined with intensified supervision, but transparency in regards to asset quality has suffered.

Forbearance Measures	Status
Valuation of securities Temporary moratorium on recognizing negative valuation changes for securities to limit the sensitivity to market risk.	Introduced in December 2014 at October 1st, 2014 prices with a deadline for the measure's expiration of July 2, 2015. **Lifted on July 2, 2015.**
Valuation of FX items I Allowing the use of a fixed exchange rate on the conversion of FX-denominated assets and liabilities that existed before January 2nd, 2015, to limit the impact of FX depreciation on all prudential ratios.	Introduced in December 2014 at October 1st, 2014 rates, (39 RUB/USD and 50 RUB/EUR corresponding to a 25-30 percent below market rates during the period), with a deadline for the measure's expiration of July 1st, 2015. The measure was extended in May 2015 for the period of July 1st to October 1st 2015 using new rates (45 RUB/USD and 52 RUB/EUR corresponding to a 30 percent below market rates at end-period). The measure was re-extended in September 2015 for the period of October 2nd to January 1st, 2016, using new rates (55 RUB/USD and 64 RUB/EUR corresponding to a 20-25 percent below market rates at end period). **Lifted on January 2, 2016.**
Valuation of FX items II Allowing the use of a fixed exchange rate on the conversion of FX-denominated assets and liabilities that existed before January 2nd, 2016, for calculation of large exposure norms N6 and N21.	Introduced in January 2016 at January 1st 2016 rates (73 RUB/USD and 80 RUB/EUR but by April 1st, the RUB had appreciated below these levels and the measure was therefore not applied by banks at the end of Q1 2016) with a deadline for the measure's expiration of April 1st, 2016. **Lifted on April 2, 2016.**
Loan loss provisioning I An existing forbearance measure in the law allows flexibility in loan classification and loan-loss provisioning in extraordinary situations, such as calamities, wars, etc. Loans affected by the conflict in Ukraine were eligible for this measure and its application extended from 1 year to 3 years.	Introduced in November 2014 with a deadline for expiration of 3 years from the start of the extraordinary event.
Loan loss provisioning II Banks were allowed flexibility in loan classification and loan-loss provisioning of (i) loans that deteriorated because of economic sanctions and the related economic conditions; and (ii) loans restructured as of December 1st, 2014.	Introduced in December 2014 with an expiry date of July 1st, 2015. The measure was extended in May 2015 until October 1st 2015 and re-extended until January 1st, 2016. On January 2nd, 2016, the measure (i) was lifted and (ii) was grandfathered for performing loans restructured during December 2014-15 that had not been further restructured.

Box 5. Financial Sector Strategy (Continued)

Enhanced Stress testing: It would be advisable to conduct stress tests, including on liquidity by currency, on a consolidated basis. The current tests are performed on a solo basis and may miss downstreaming of problematic assets by D-SIBs (which are subject to stricter regulatory requirements) to unconsolidated subsidiaries. Similarly, liquidity stress tests based on aggregate asset and liability categories may overlook liquidity shortages in particular currencies.

Asset Quality Reviews (AQR). The design and implementation of an AQR must be credible and perceived as such by market participants. This is usually achieved through rigorous design, transparent public disclosure of procedures and results, and engagement of independent third-party experts (domestic and international) to conduct and/or oversee the AQR. The experts' tasks may include advising on setting scope and methodologies, drafting Terms of Reference (TOR), and overseeing the conduct of the AQR.

Ahead of the AQR, the authorities should formulate a strategy to address any weaknesses that the AQR may uncover. The strategy should include a method for assessing banks' viability on a forward-looking basis, based on the AQR's results, and eligibility criteria for banks to receive public solvency support (from federal funds as outlined below). Undercapitalized but viable banks should be required to submit time-bound recapitalization plans. For banks that are deemed unviable, CBR and DIA should make advance preparations for orderly resolution.

The AQR can be conducted in one go or in phases, using a risk-based approach. Two approaches could be considered or a combination of the two:

- *Independent external auditors*. Banks are asked to hire independent external auditors (different from their normal auditors) from a pre-approved CBR list of reputable firms—international firms for large and complex banks, and local auditors for smaller banks.
- *CBR:* CBR supervisory staff conducts the AQR and the role of independent external advisors is elevated to discussing and challenging the results during its conduct. The experts could be domestic and/or international.

Improving supervision. The FSAP identified five key areas for improvements, including legal changes:

- *The CBR's relations and interactions with the external auditing profession*. Material deficiencies include lack of power to reject the appointment of an external auditor who has inadequate independence; inadequate experience or weak professional standards; ability to ensure rotation of external auditors; and meeting with audit firms to discuss matters pertaining to supervised institutions.
- *Flow of information*. There are no requirements for professional service providers, such as auditors, to notify CBR in advance, or at all, of material information that is relevant to the soundness and stability of the supervised bank. The onus is therefore on CBR to raise the relevant question at the right moment to uncover the information it needs. Legal protection of service providers should be put in place as necessary.

Box 5. Financial Sector Strategy (Concluded)

- *The legal regime for related parties.* In assessing connectedness, the concept of economic linkages was introduced in law already in 2014, but implementation was twice postponed, lately to January 2017. The regulatory framework does not require that lending to affiliates be on same terms and conditions as those generally offered to the public. CBR lacks authority to impose penalties on directors who benefited from favorable conditions.
- *Management of country and transfer risks*. There are no enforceable requirements for risk policies, processes and limits. CBR's approval is not required for major acquisition of domestic nonbank institutions.
- *Oversight of operational risk.* A large part of norms that govern operational risk is in the form of non-binding recommendations.

Improving the bank resolution framework. The FSAP identified several areas for improvement. These include: (1) expanding the scope of resolution to cover bank-holding companies; (2) enhancing CBR powers to facilitate mergers and recapitalization and business transfers, while ensuring the continuity of critical functions; and (3) introducing shareholder and creditor safeguards to reduce legal risks. With regards to enhancing CBR's resolution powers ((2) above), it is critical to implement legal and operational changes to enhance the effectiveness of Purchase and Assumption (P&A) transactions, including by removing financing constraints, increasing flexibility in determining the scope of liabilities to be transferred, and using fair valuation of assets. In addition, introducing the bail-in tool could reduce the reliance on public funds to recapitalize banks, but the framework needs to be carefully designed to take into account its implication on financial stability and authorities' legal risks stemming from the application of such powers.

For resolution funding, public funds should be restricted to systemic banks and provided with federal funds or, if temporarily with CBR funds, with an indemnity. The authorities should consider replacing below-market rate loans with direct capital injection to facilitate a swift return of healthy resolved banks to the market.

24. To strengthen the banking system's ability to support growth, the mission conveyed the key FSAP recommendations (Box 5):

- *Enhanced Stress tests and an Asset Quality Review (AQR) would be important steps towards putting the banking system on a sounder footing.* Stress tests, including on liquidity by currency, should be performed on a consolidated basis. These need to be supplemented by a granular and comprehensive review of banks' asset portfolios to gauge capitalization needs, reduce uncertainty on valuations, and bolster confidence following the long period of forbearance. In particular, the AQR will be helpful to ascertain the identified capital shortfall in the baseline scenario of 0.5-1 percent of GDP. If this is indeed confirmed, the authorities should devise the necessary plans outlined in Box 5 to keep the banking system on a sound footing.

- *The authorities should prepare an action plan to address deficiencies in supervision*. In addition, vigilant implementation and monitoring is needed for the many important changes that were recently introduced to support CBR's Risk Based Approach in supervision.[7]

- *Improvements in the bank resolution framework will be critical to minimize the use of public funds*. To improve the resolution effectiveness, and rely less on open bank resolution and the use of public funds, CBR should take steps to strengthen and broaden resolution powers and safeguards, in line with the Financial Stability Board (FSB) Key Attributes.

- *There is room to improve the liquidity framework*. Steps are needed to reduce the fragmentation of the money market and CBR's collateral framework could play a key role by eliminating early pre-payment and extendibility options to repo pledged instruments, setting additional controls for non-marketable collaterals, and making the legal basis for realizing them more robust. CBR should also formalize an appropriate safety net to meet the emergency liquidity needs of individual institutions.

25. Staff argued that deepening the financial sector is necessary to support strong and sustainable economic growth. Comprehensive measures need to be taken to raise the efficiency of the highly concentrated and mostly state-owned banking system to support the recovery. The authorities should continue implementing their privatization plans, as economic conditions permit, close weak banks, and refrain from using state-owned financial institutions to bail out struggling commercial banks.

26. VEB requires an improved business model and stronger oversight. The mission recommended bringing VEB into a prudential supervisory framework to support, among other things, VEB's standards for risk, capital and liquidity management, and corporate governance.

Authorities' Views

27. The authorities were in broad agreement with the FSAP findings and have already taken steps to address some key recommendations. The CBR has approved a work program to improve supervision and asset valuation. A new department will be established to assess risk in all banks, making use of new reports and IT platform, with loan-by-loan data for legal entities. The CBR does not plan to conduct comprehensive AQRs, as recommended by the FSAP, but instead they plan off-site asset quality analysis and stress tests by loan products, which are expected to provide analytical support for macroprudential policies and a comprehensive view of banks' capital needs by end-2017. In addition, there have been several bills drafted in Parliament, addressing deficiencies identified by the BCP Assessment. These include improved CBR interaction with external auditors, requirements for CBR approval for major acquisition of financial companies, and increased powers for CBR to assess collateral values. The authorities are committed to avoid further delays in extending

[7] This includes new powers and regulations on the quality of risk management and governance within firms, and introducing scrutiny of risk appetite in firms. In this context, systemic banks are to submit the results from their Internal Capital Adequacy Assessment Process (ICAAP) in 2017, and all other banks in 2018.

the definition of related parties to cover economic relations (now planned for January 2017) while legal amendments are under preparations to require lending to related parties on market terms. Improvements to the bank resolution framework are under consideration and the authorities announced their intention to introduce statutory bail-in of large corporate depositors in 2017. The authorities argued that the current extraordinary economic circumstances, combined with the urgent need to remove weak banks from the system, justified the extensive use of CBR funds in resolution. Finally, the authorities agreed that VEB should have better underwriting and supervisory standards and pointed to the recent change in management as a first step to improve the financial standing of the bank.

D. Structural Policies: Leveraging the More Competitive Exchange Rate

28. Structural impediments are slowing economic diversification and growth, and affecting income convergence (Figure 9). Investment is constrained by weak protection of property rights, burdensome administrative procedures and inspections, and a continued large footprint of the state in the economy.[8] As a result, productivity growth is lagging advanced countries. These structural rigidities are weighing on the export response to the recent exchange rate depreciation and slowing factor reallocation from the non-tradable to the tradable sector. Finally, Russia is facing adverse demographics with declining population and lower labor force participation.

29. Supporting the tradable sector is now the focus of the authorities' policies and structural agenda. The anti-crisis package of 2016 includes measures to support local production in sectors with export potential, such as agriculture, machinery, and civilian aviation. It also aims to foster economic diversification and efficiency by improving the investment climate, streamlining SOEs' costs and supporting SMEs. Counter-sanctions, consisting of bans and limits on imports of agricultural and food products have supported import-substitution in agriculture and food-processing industries. Export diversification has decreased over time although among other EM commodity exporters, Russia is the third most diversified fuel exporter after Bahrain and Colombia.[9]

30. The authorities have been considering structural reform priorities for a long time. A review of the authorities' policy actions during the past 15 years suggests a recognition of the structural impediments. However, progress has been slow due to lack of persistent implementation and proper sequencing of actions. [10] Existing reforms in the pipeline include **:**

- *Institutional development.* Efforts are underway to reduce the scope of state intervention in the economy including through an acceleration of SOEs' privatization. However, little progress has been made since mid–2000 on basic institutional pillars, such as property rights protection,

[8] See references provided in Selected Issues Paper "Structural Policies in Russia 2000-2015: A Medium-term Perspective", in Box 6, and in Figure 9.

[9] For further discussion, see Selected Issues Paper "Raising Productivity Growth in Russia".

[10] See Selected Issues Paper "Structural Policies in Russia 2000-2015: A Medium-term Perspective".

governance and transparency, and judicial independence.[11] Insufficient reporting of SOEs results clouds the true footprint of the state in the economy and discourages competition. Recently enacted amendments to broaden the categories of public officials forbidden to have foreign bank accounts, as part of the anti-corruption law signals a commitment to improve institutions.

- *Goods market efficiency.* Administrative requirements have been eased overtime for business start-ups and red tape reduction efforts continue. In addition, legislative work is underway to ease regulations for construction permits and a new corporate insolvency regime is being prepared to incentivize restructuring rather than liquidation. However, remaining burdensome regulations and a long list of strategic sectors prevent higher FDI flows by holding back entry in some markets and thus competition.

- *Labor market policies.* The authorities noted that the labor market would benefit from: (1) improving professional education to make it more consistent with labor market demands; (2) strengthening access to quality education for low-income groups; and (3) increasing labor market mobility. The authorities have recently launched a website to showcase vacancies across Russia in order to encourage labor mobility by lowering search costs.

- *Investing in infrastructure and innovation.* A scientific fund was created to support innovation and the adoption of new technologies. However, R&D spending remains low compared to peers and tends to be inefficient, hampering its effectiveness. In addition, infrastructure spending has been cut given lower oil prices and some projects financed from the NWF have been frozen.

31. Staff stressed that structural reforms are indispensable to boost potential growth and leverage the more competitive exchange rate. Cross-country research suggests that reaping the benefits of structural reforms requires, as a pre-requisite, improvements in the institutional and business environment.[12] Specific priority areas are (see Box 6):

- *Institutional improvements.* Accelerating reforms to reduce unwarranted administrative pressures on businesses while improving the framework to settle disputes between the private and the public sector would increase the efficiency of the goods market. To pave the way for government divesture of stakes in SOEs, the recommendations of the 2014 fiscal transparency report should be implemented, including by strengthening the financial oversight of SOEs. Strengthening contract enforcement and the protection of property rights would increase productivity and investment. Given the need for fiscal consolidation, tax policy changes should minimize the negative impact on investment incentives. Finally, the list of strategic sectors that require prior approval for foreign investment should be shortened to encourage FDI.

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[11] For further discussion, see Selected Issues Paper “Structural Policies in Russia 200-2015: A Medium-term Perspective”.

[12] See Selected Issues Papers “Raising Productivity Growth in Russia”.

- *Labor market policies*. Increasing mobility and reducing skills mismatches by improving education quality and vocational training, increasing the coordination between employers and training institutes, and strengthening active labor market policies should increase labor productivity. Parametric pension reform, such as increasing the statutory retirement age, could help to offset the negative demographic trend on labor markets.

- *Investing in innovation and infrastructure*. Supporting innovation and protecting infrastructure spending while directing it to bottlenecks in electricity and transport would support export diversification and higher value added sectors.

Authorities' Views

32. The authorities acknowledged the need for reforms and broadly agreed with the priorities. They emphasized that their reform strategy aims to complement the more competitive exchange rate to diversify its economy. In that context, they are implementing various support programs for SMEs to foster competition in the domestic market, improve the quality of production and facilitate the increase of localization of manufacturing. They also highlighted ongoing efforts to reduce the state's footprint in the economy, including through the privatization program of SOEs. However, they are also aware that trade integration initiatives will be needed to widen the scope of market access to exporters. They noted their labor market policies pay particular attention to increase labor productivity and the supply of labor by reducing skill mismatches through improving education quality and vocational training, and increasing the coordination between employers and training institutes. The authorities also agree that the pension reform should improve the incentives for people to remain for longer in the labor market, thus temporarily helping maintain labor supply.

STAFF APPRAISAL

33. The Russian economy continues to adjust to the dual shocks of lower oil prices and sanctions. The economic contraction is nonetheless shallower than previous recessions as the authorities' economic package—a flexible exchange rate regime, banking sector capital and liquidity injection, limited fiscal stimulus, and regulatory forbearance—cushioned the shocks, helped restore confidence and stabilized the banking system.

34. The recession is extending to a second year. Despite an effective and flexible policy response, the economy will remain in recession in 2016 due to lower oil prices, sanctions, weak household income growth and fiscal consolidation. With oil prices expected to stabilize and domestic financial conditions to ease, the economy is projected to start growing again in 2017. However, medium-term prospects remain subdued due to adverse population dynamics coupled with long-standing structural bottlenecks, and the impact of sanctions on productivity and investment.

35. Initial steps to lower the deficit should lead the way to a credible medium-term fiscal adjustment plan. Strong steps were taken in 2016 to limit the impact on the fiscal deficit of lower oil prices. However, a smoother fiscal adjustment plan based on quality and permanent measures, anchored within a credible multi-year framework would have been preferable. In this regard, reintroducing in the 2017 budget the three-year budgeting framework is critical to help reduce policy uncertainty by providing greater clarity over future fiscal measures, while a credible fiscal rule would support medium-term sustainability. In addition, any fiscal adjustment should safeguard growth-enhancing expenditures such as efficient public investment, education and health care spending. Finally, a parametric pension reform has become urgent to help support the fiscal adjustment in a timely manner. Such a reform should strive to develop and preserve much-needed sources of long-term financing to the economy.

36. Monetary policy normalization could resume at a cautious pace. Monetary policy has been appropriately on hold since August 2015. However, monetary policy normalization could resume cautiously as inflation is on a declining path and inflation expectations continue to fall. In addition, the improvement in the external position is limiting potential depreciation pressures that could fuel inflation. This said the pace of easing should be gradual given volatile oil prices, uncertainty about future government's income policies and the behavior of wages. In addition, policy tightening in the U.S. or emerging market jitters could limit the central bank's room to ease its policy stance.

37. Banking sector policies have been appropriate and early steps in implementing the main recommendations of the FSAP are welcomed. The banking system remains weak but the authorities' willingness and ability to support it provides an important anchor to confidence. Staff welcomes the authorities' plans to perform a capital risk assessment of all banks. The asset quality assessments could however be improved by adding: (1) a strong on-site component, with file reviews and evaluation of collateral valuation and enforceability; (2) establishing a panel of external experts to advise on setting scope and methodologies, drafting terms of reference, and overseeing conduct. The authorities are encouraged to complement the bail-in plans with a plan to remove legal and operational impediment in P&A transactions. This would allow shifting the focus from rescuing the entire failed banks to rescuing the essential functions of the failed banks – protecting taxpayers' money, while preserving financial stability. The diversification and deepening of the financial sector are priorities to support strong and sustainable economic growth. In addition, policies should emphasize pursuing the closure of weak banks, encouraging the involvement of the private sector in bank resolution, and proceeding with privatization of state-owned banks as economic conditions permit.

38. A strong structural reform agenda should be put in place to leverage the more competitive exchange rate. Russia has the opportunity to diversify its economy as a result of a more competitive exchange rate. The authorities should act more decisively on the reform priorities that they have identified to facilitate the reallocation of resources to the non-energy tradable sector. Finally, to deliver on the needed increase in investment, specific structural reform priorities lie in the following areas: (1) Accelerating reforms to reduce unwarranted administrative pressures on businesses while strengthening contract enforcement and the protection of property rights; (2) Increasing mobility and reducing skills mismatches by improving vocational training, increasing the coordination between employers and training institutes, and increasing the statutory retirement age to increase labor supply; and (3) Supporting innovation for higher value added sectors and protecting infrastructure spending while directing it to bottlenecks in electricity and transport.

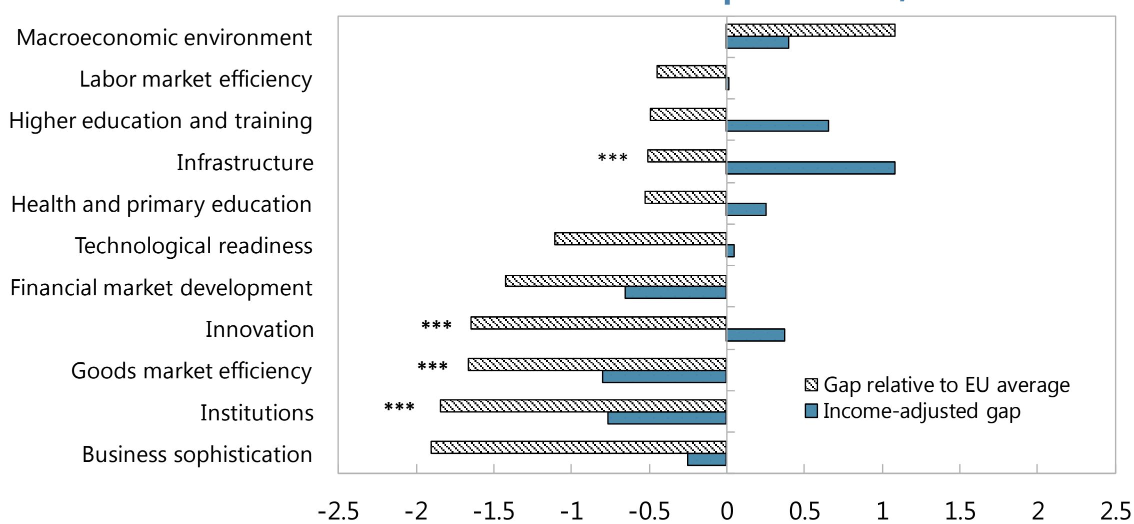
39. It is proposed that the next Article IV consultation be held on the standard 12-month cycle.

Box 6. Reform Priorities

Reform priorities are set by benchmarking to the EU. First, competitiveness gaps are identified by benchmarking Russia to the average EU country, and on an income-adjusted basis, along a wide set of indicators.[1] Then, these gaps are ranked according to their importance for growth using cross-country growth regressions. Finally, reform priorities are identified by interacting the size of the reform gaps with the growth regression coefficients.

Russia is found to significantly lag the EU on most competitiveness indicators. The largest gaps are in the areas of institutions (property rights and corruption indicators); goods market efficiency (tax and tariff rates); financial market development (legal rights); business sophistication (local supply quality and production process sophistication) and innovation (availability of scientists and engineers).

Structural Reform Gaps in Russia, 2015



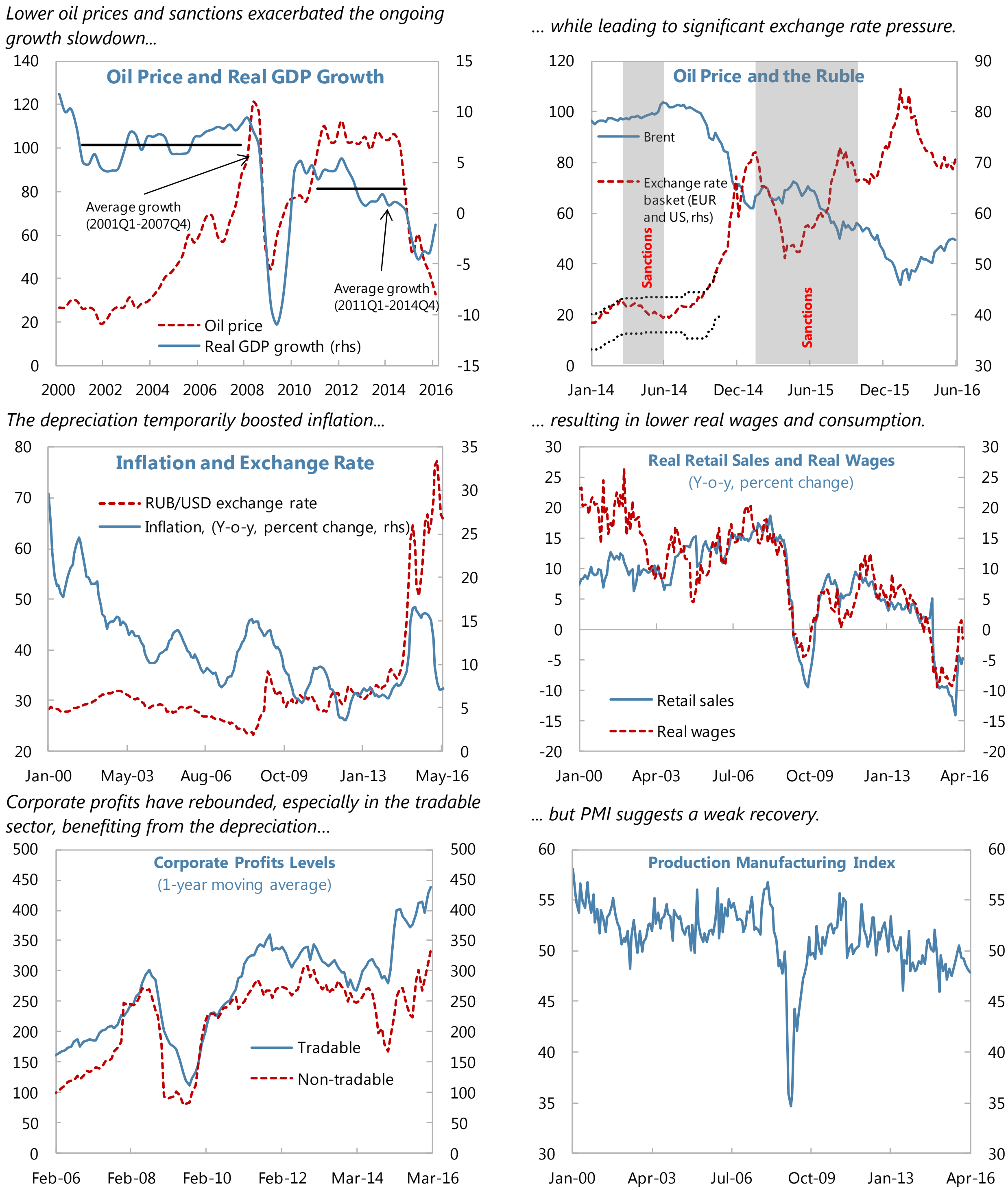
*** denote reform priorities identified by combining gaps with their estimated growth impact.

Some gaps are large even compared to countries with a similar income level. Relative to peers, Russia ranks high on innovation, infrastructure, health and education. However, gaps are large in institutions and goods and market efficiency—the pre-requisites for innovation and education to deliver substantial growth dividends.

Russia's reform gaps are particularly large in areas found to be most critical for long-term growth. The priority areas that need further improvements are institutions, infrastructure, goods market efficiency, business sophistication and innovation.

[1] The methodology is based on the Regional Economic Issues, Special Report, March 2015. Competitiveness is defined as the set of institutions, policies, and factors that determine the level of productivity of a country. Data is sourced from the World Economic Forum's Global Competitiveness Report.

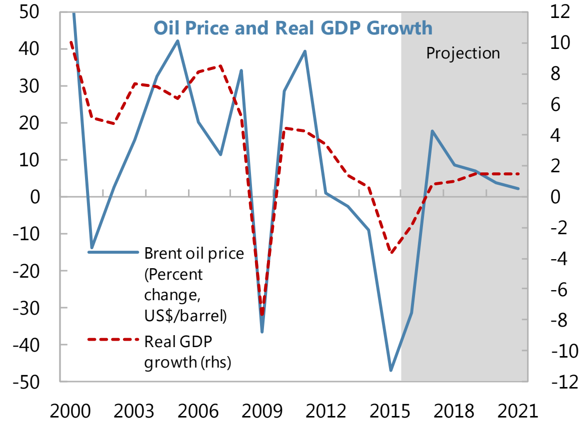
Figure 1. Russian Federation: Recent Economic Developments, 2000–2016



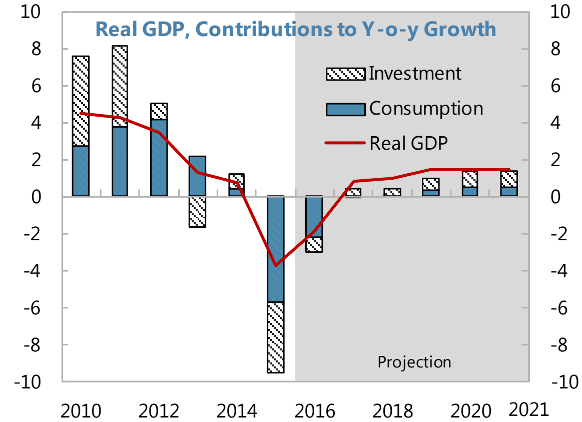
Sources: Russian authorities and IMF Staff calculations.

Figure 2. Russian Federation: Selected Macroeconomic Indicators, 2000–2021

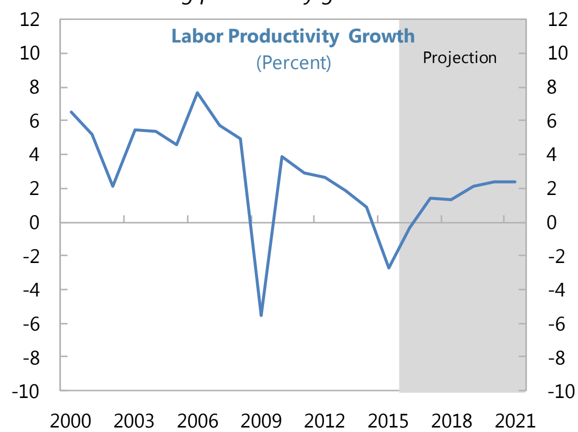
The economy is expected to contract again in 2016 due to lower oil prices and fiscal consolidation ...



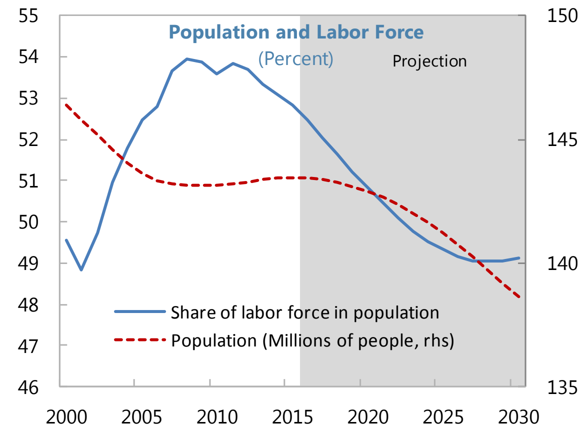
... with domestic demand remaining weak.



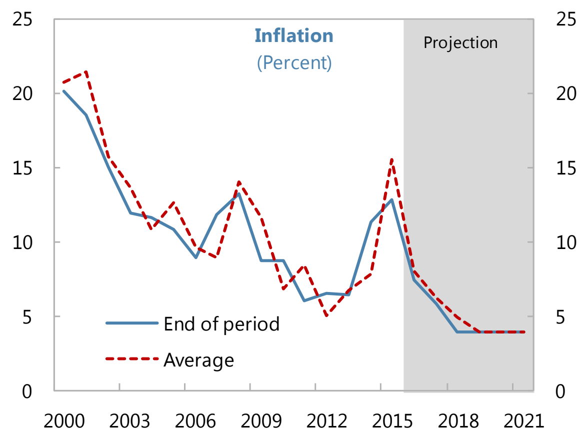
Long-term growth will remain low due to structural bottlenecks limiting productivity growth ...



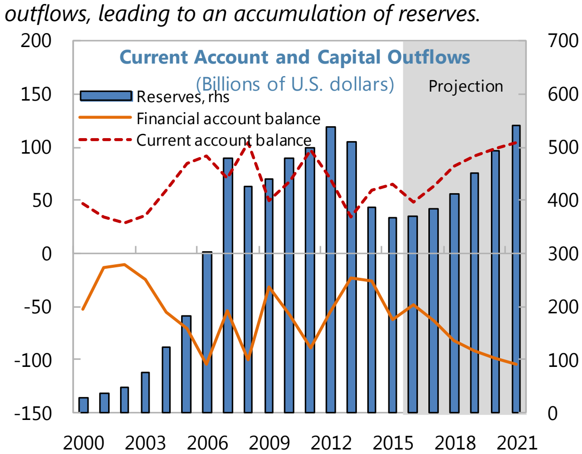
... and negative demographic trends adversely affecting the labor force.



Inflation is expected to come down to the CBR's target.



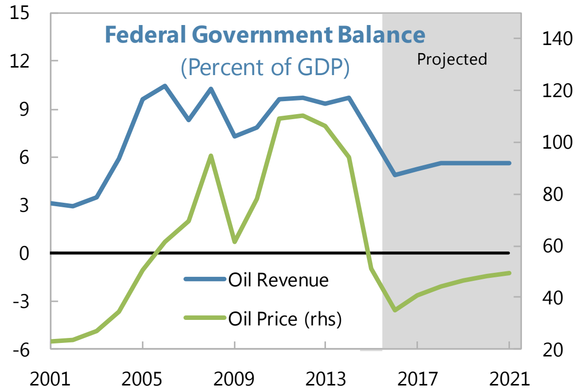
The current account improvement should more than cover outflows, leading to an accumulation of reserves.



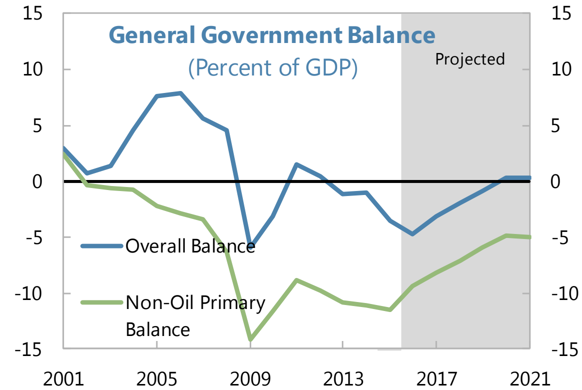
Sources: Russian authorities and IMF Staff calculations.

Figure 3. Russian Federation: Fiscal Policy, 2000–2021

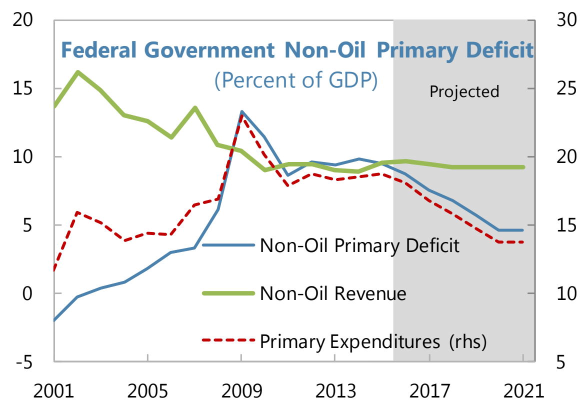
The decline in oil prices has led to a large drop in oil revenues ...



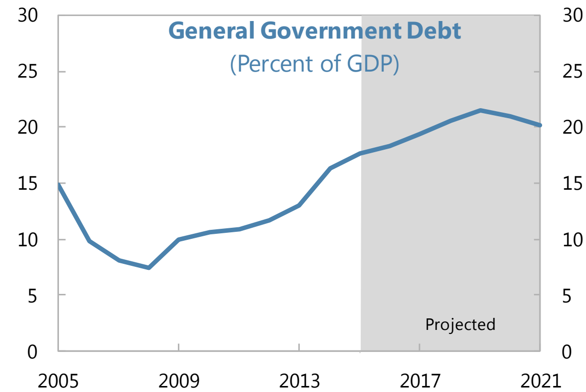
... which led to a deterioration of the deficit while the non-oil deficit has remained elevated.



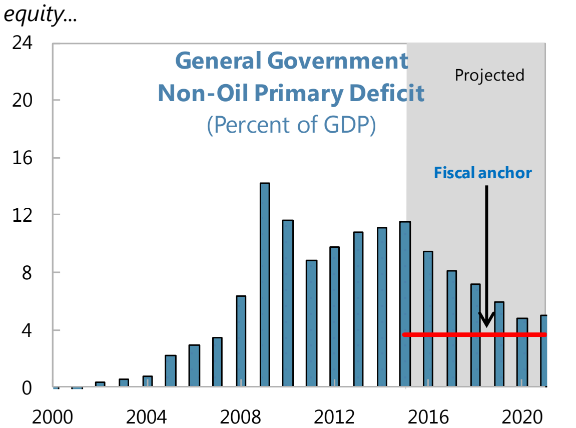
Fiscal consolidation is expected to be achieved via lower expenditures.



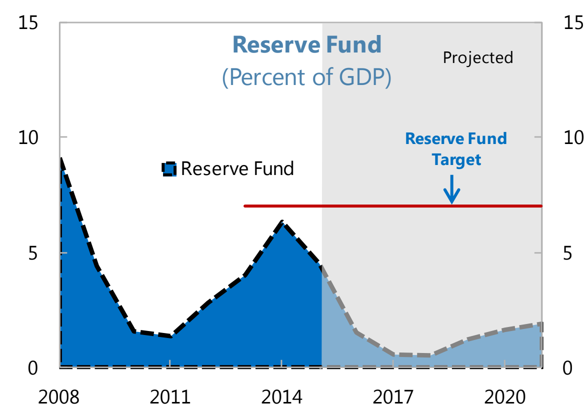
Gross government debt, including guarantees, is expected to remain low, due to the use of the Reserve Fund to partially finance deficits in 2015-17.



Ambitious fiscal consolidation could bring the non-oil deficit close to a level consistent with intergenerational equity...



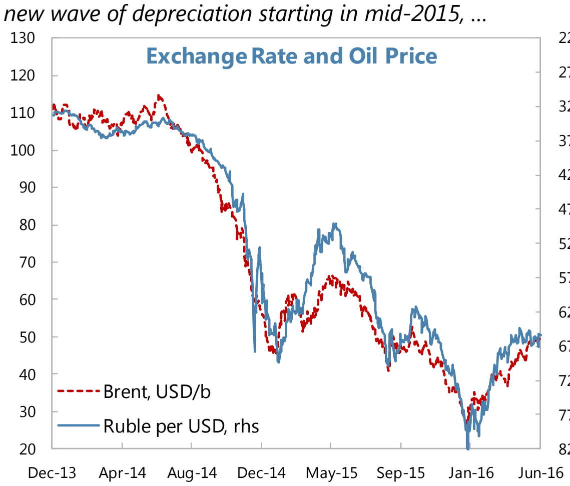
But the Reserve Fund would only gradually increase providing a limited buffer against volatile oil prices.



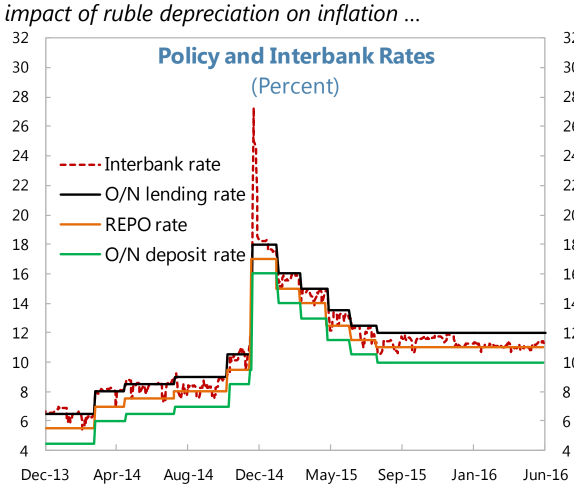
Sources: Russian authorities and IMF Staff calculations.

Figure 4. Russian Federation: Monetary Policy and Inflation, 2013–2016

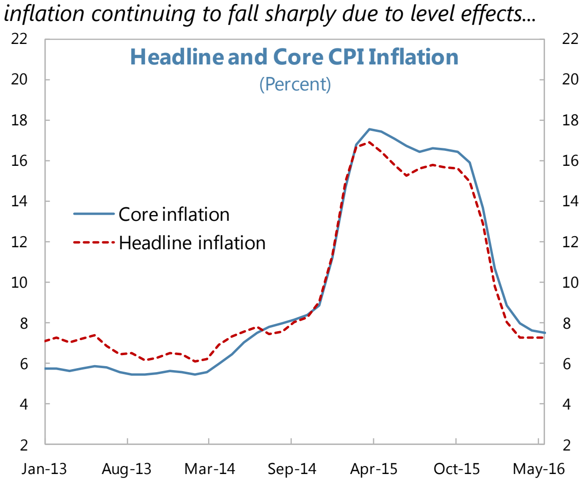
Following the decline in oil prices, the ruble experienced a new wave of depreciation starting in mid-2015, …



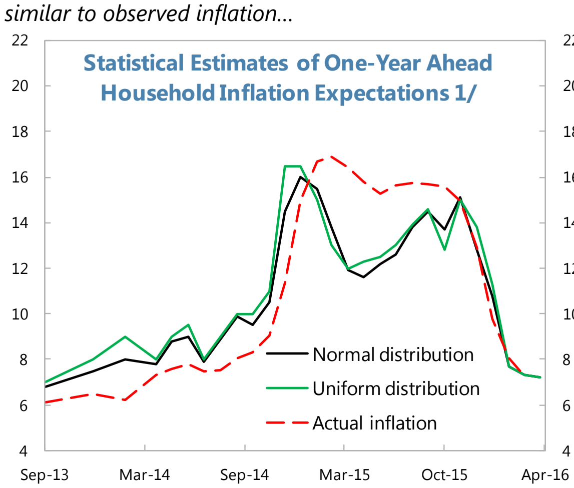
… leading the CBR to pause its easing cycle to assess the impact of ruble depreciation on inflation …



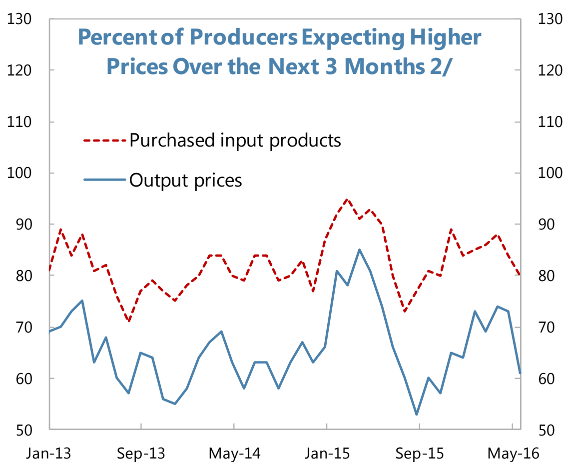
… but pass-through to inflation has been muted with inflation continuing to fall sharply due to level effects…



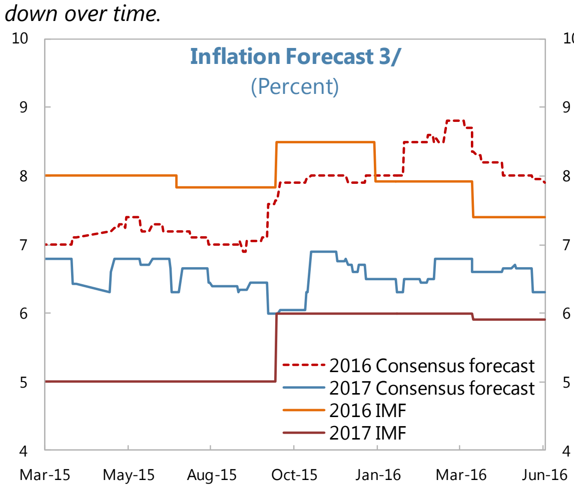
… while household inflation expectations declined to levels similar to observed inflation…



…and producers' inflation expectations are leveling off…



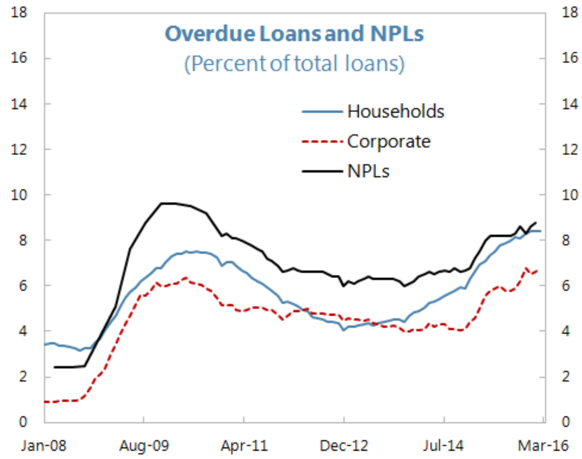
… with consensus forecasts expecting inflation to come down over time.



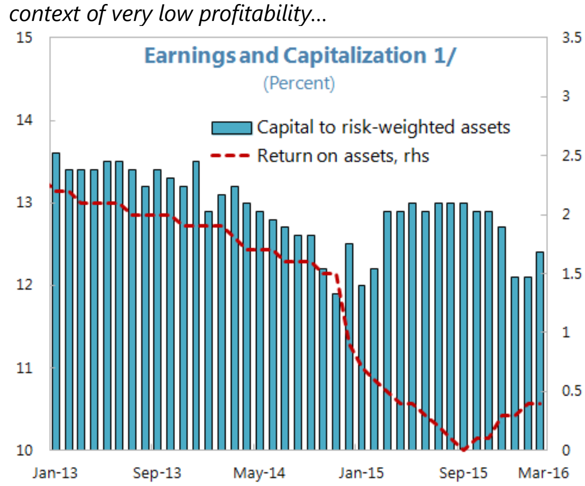
Sources: 1/ Central Bank of Russia and Public Opinion Foundation Survey; 2/ Russia Economic Barometer; 3/Bloomberg Consensus Forecast, and IMF staff calculations.

Figure 5. Russian Federation: Banking Sector Developments, 2013–2016

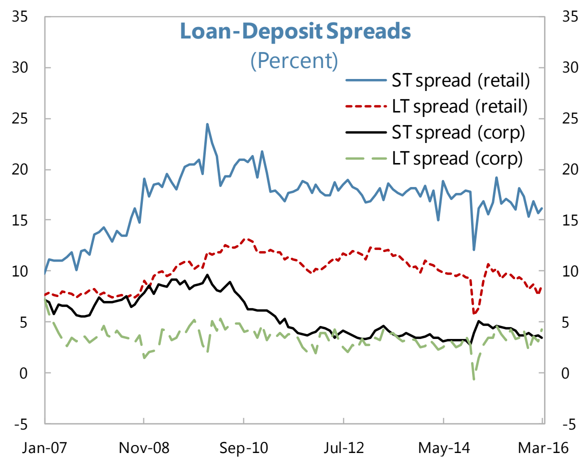
NPLs are expected to continue increasing, especially after the lifting of forbearance…



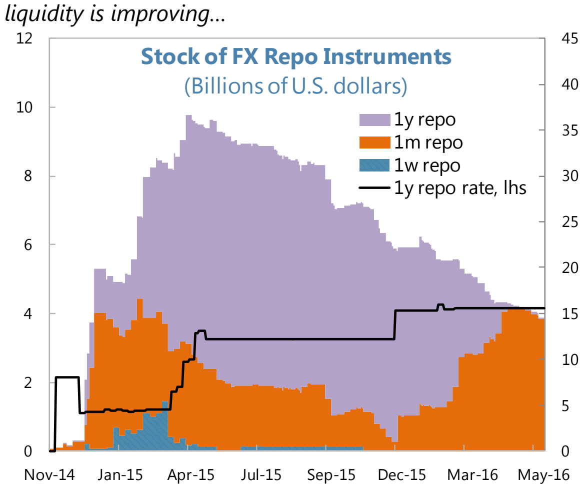
… which is starting to show up on lower CAR, in the context of very low profitability…



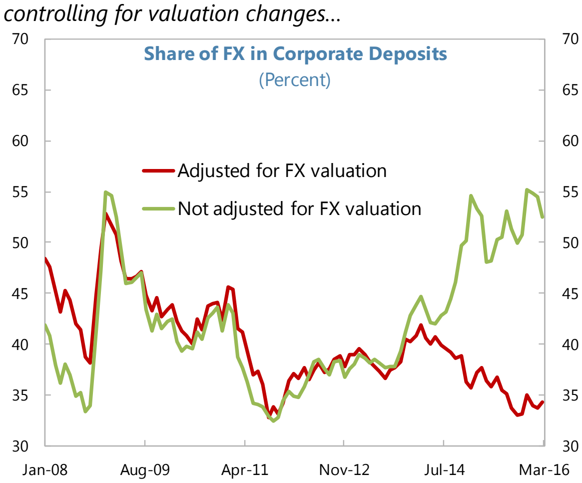
… although net interest margins of banks are now broadly stable.



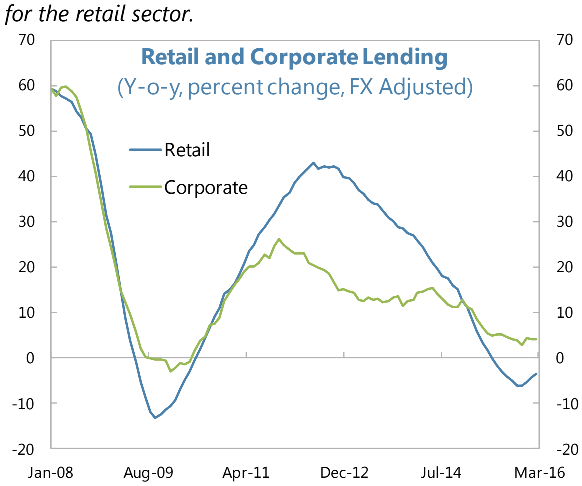
Banks are lowering their FX borrowing from the CBR as FX liquidity is improving…



… and dollarization continues to slow down after controlling for valuation changes…



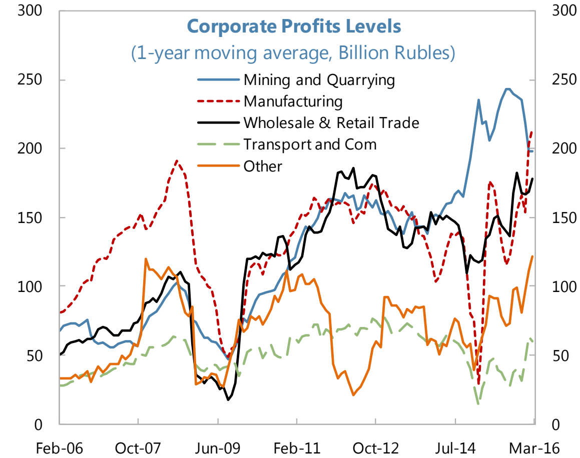
… although credit growth remains depressed, in particular for the retail sector.



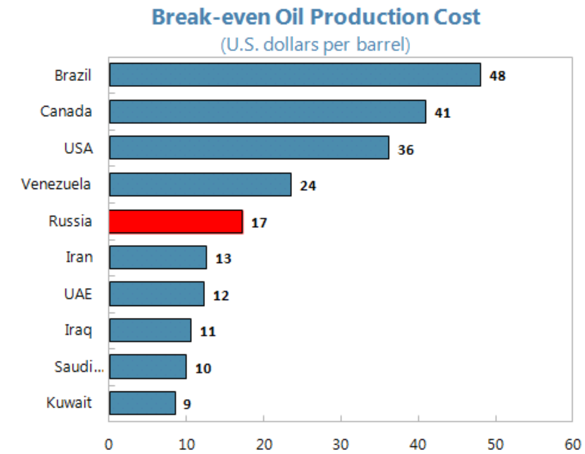
Sources: Central Bank of Russia and IMF staff calculations. 1/ On January 1st, 2016, CBR implemented the stricter Basel III definition of capital.

Figure 6. Russian Federation: Corporate Sector Developments, 2006–2016

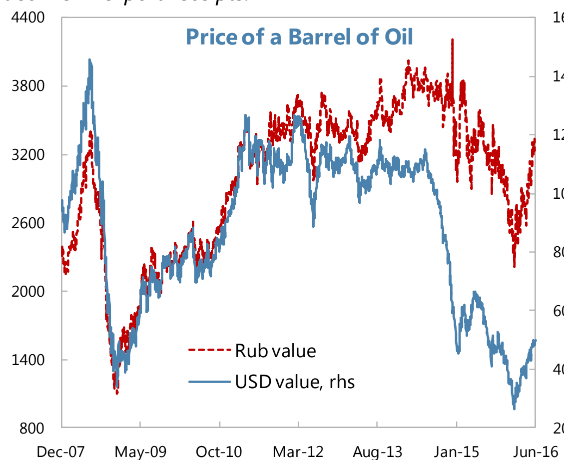
Corporate profitability, in particular in the oil and gas sector, has increased...



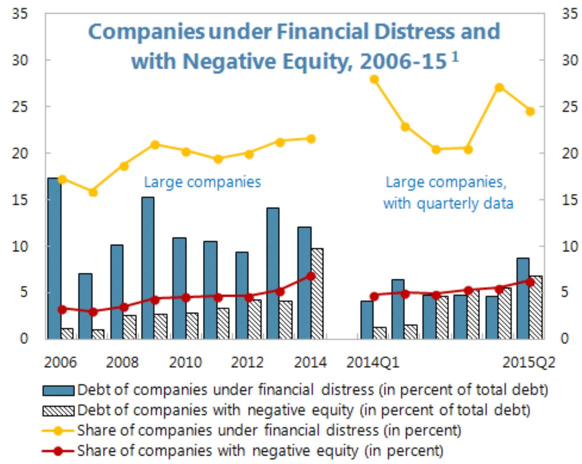
...supported by a cost structure primarily in rubles and a low breakeven oil price ...



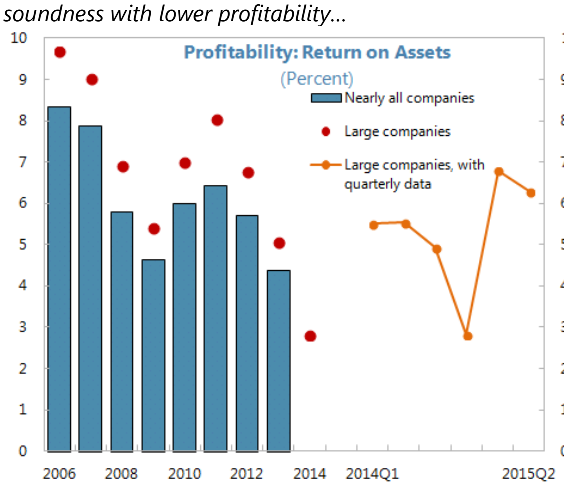
...and by a decline in the ruble value which cushioned the decline in export receipts.



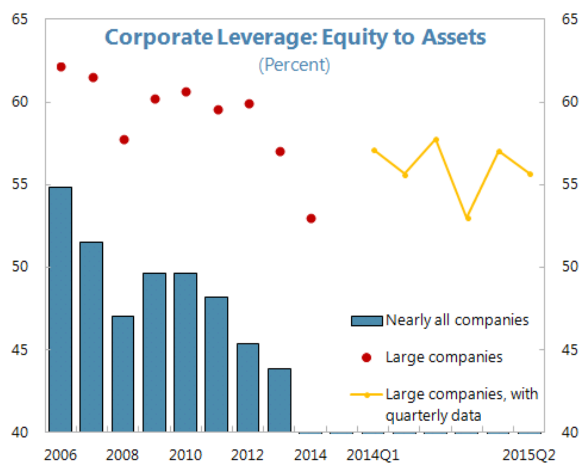
However, the share of companies facing difficulty servicing their debt has increased...



... while smaller companies show weaker financial soundness with lower profitability...



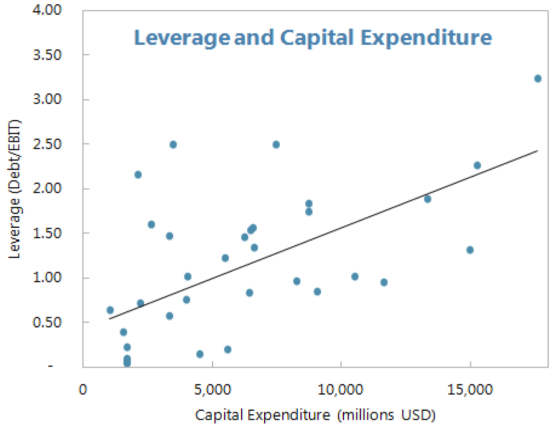
... and higher leverage.



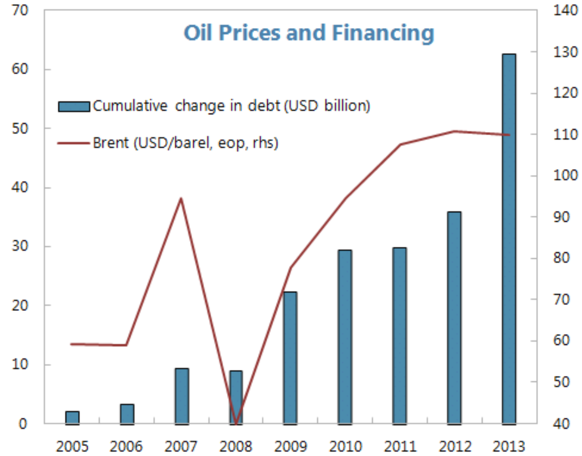
Sources: Rosstat, Rystad Energy, Bloomberg, Orbis, and IMF staff calculations. 1/ Large companies sample includes companies with total assets and turnover > 1 million rubles (3,000 entities). The “large companies, with quareterly data” sample is a subset of “large companies” with quarterly data (about 750 entities). “Nearly all companies” includes entities with total assets and utrnover of more than 0.2 million rubles (about 350,000 entities).

Figure 7. Russian Federation: Oil and Corporate Sector Developments, 2005–2015

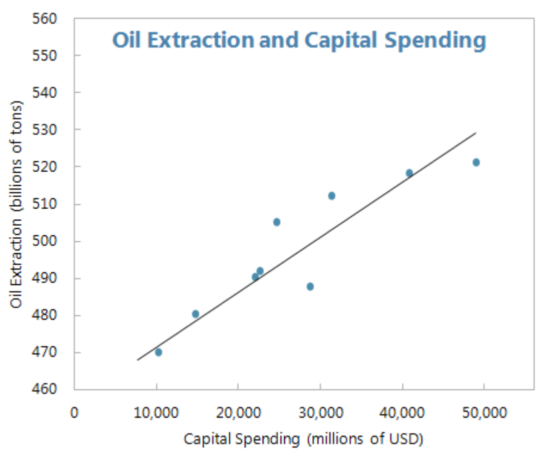
Oil companies in Russia are dependent on leverage to expand investment …



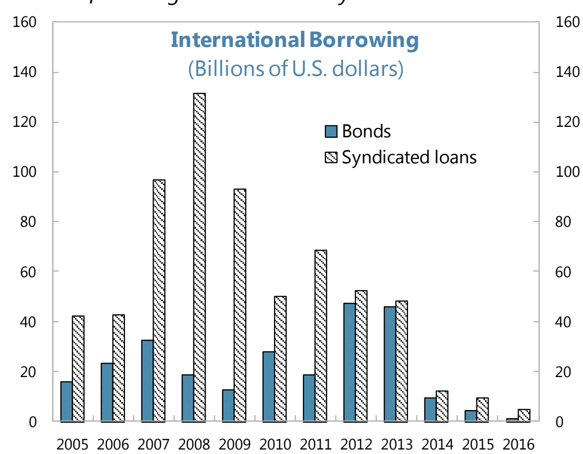
…but lower oil prices have in the past constrained financing…



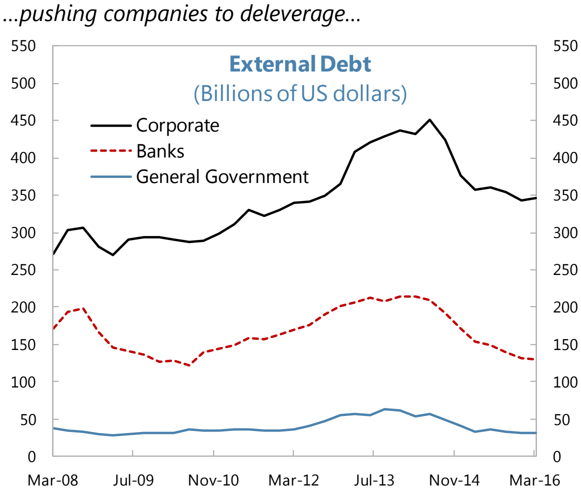
…which will ultimately negatively impact extraction.



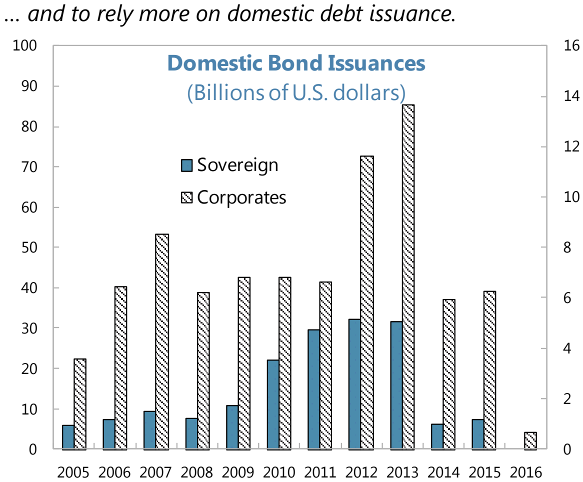
External financing is constrained by sanctions…



…pushing companies to deleverage…



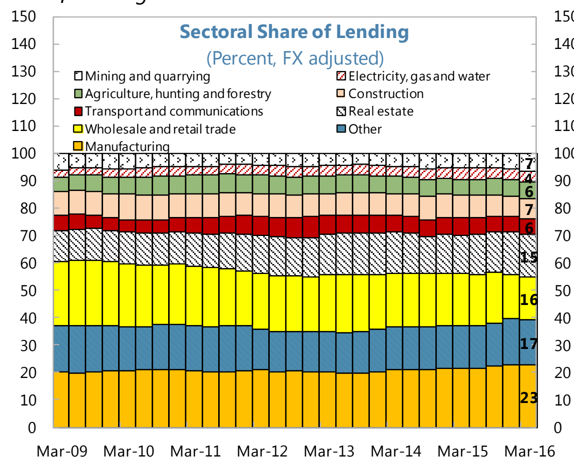
… and to rely more on domestic debt issuance.



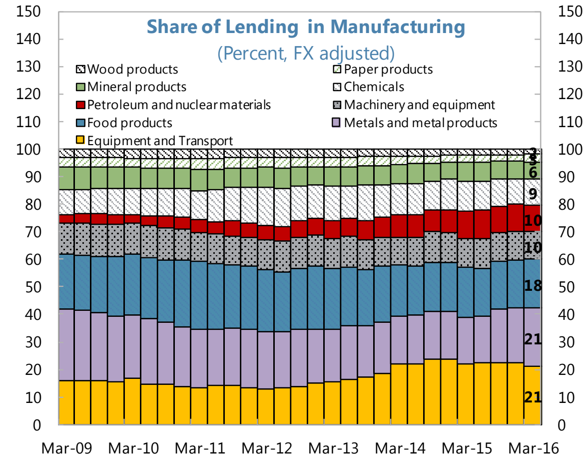
Sources: Rosstat, Orbis, and IMF staff calculations.

Figure 8. Russian Federation: Banking System Exposures, 2005–2015

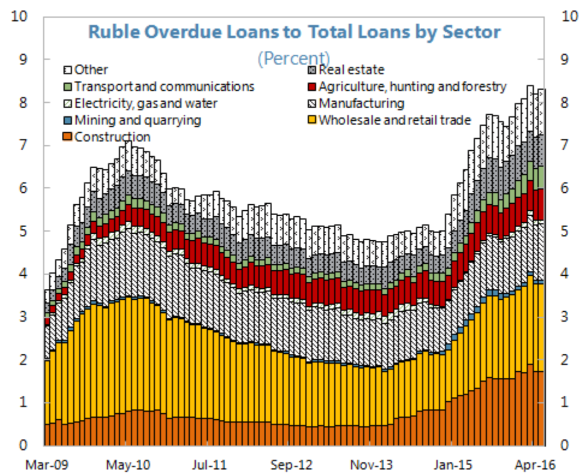
The banking system lends to a variety of sectors but manufacturing dominates...



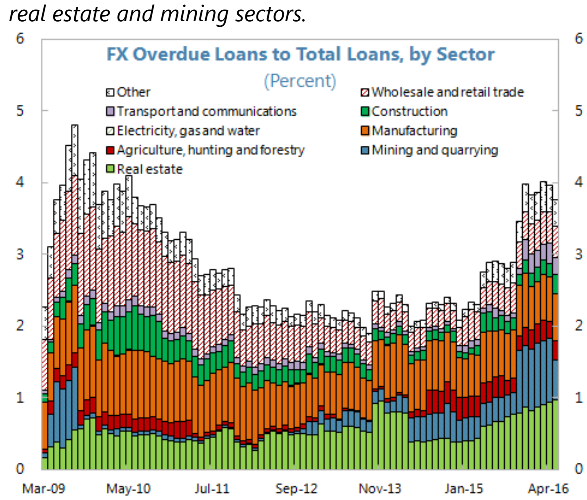
...while the oil and gas sectors are not significant..



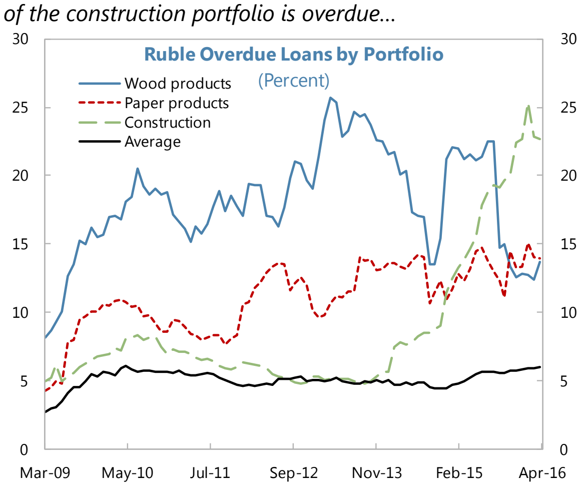
Overdue loans in rubles have increased primarily in the construction and retail trade sectors...



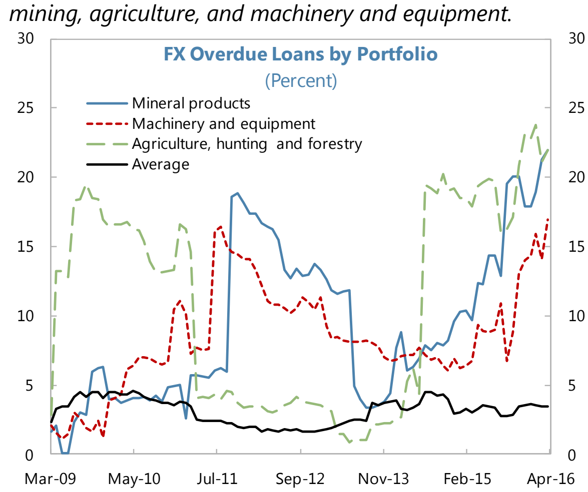
... while overdue loans in FX have risen primarily in the real estate and mining sectors.



Using sectoral loans in rubles show that nearly 25 percent of the construction portfolio is overdue...



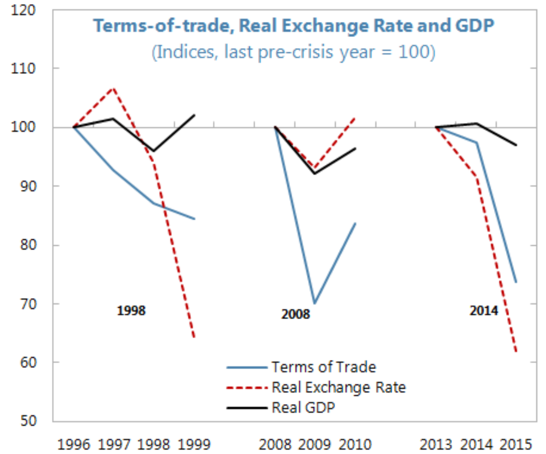
... while sectoral loans in FX uncover weak performance in mining, agriculture, and machinery and equipment.



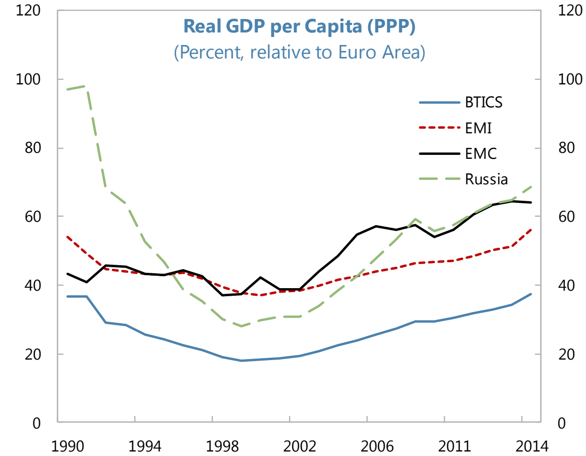
Sources: Central Bank of Russia, and IMF staff calculations.

Figure 9. Russian Federation: Structural Policies, 1970–2015

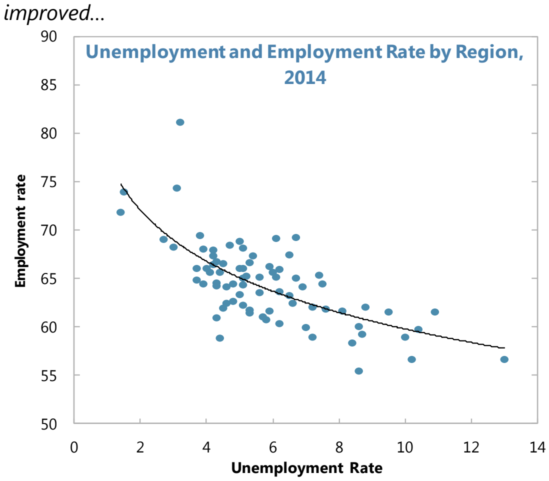
Russia's policy response cushioned the impact of oil price and sanctions shocks compared to previous recession episodes.



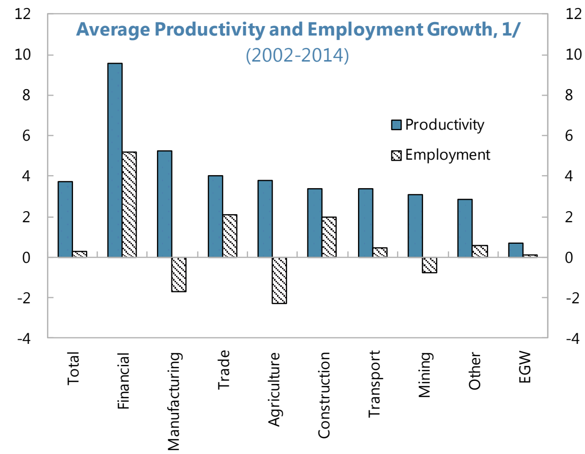
Going forward, the more competitive exchange rate should support closing the relative per capita income gaps.



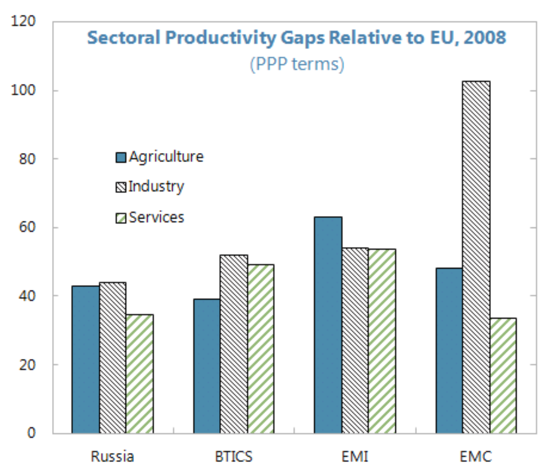
To help increase productivity, labor mobility could be improved...



... and skill mismatches reduced.



Most sectors have room to increase productivity...



... and large reform gaps with the EU suggests few areas of structural priorities.

*** Denote reform priorities identified by combining gaps with their estimated growth impact.

Sources: Global Competitiveness Report, and IMF Staff calculations.
1/ EGW stands for electricity, gas, and water.

Table 1. Russian Federation: Selected Macroeconomic Indicators, 2013–21

	2013	2014	2015	2016	2017	2018	2019	2020	2021
			Est.			Projection			
					(Annual percent change)				
Production and prices									
Real GDP	1.3	0.7	-3.7	-1.2	1.0	1.2	1.5	1.5	1.5
Real domestic demand	0.9	-0.9	-10.0	-2.7	0.5	0.6	0.9	1.2	1.3
Consumption	3.6	1.1	-7.5	-2.6	0.0	0.1	0.5	0.9	1.1
Investment	-7.3	-8.0	-18.7	-2.8	2.0	2.0	2.0	2.0	2.0
Consumer prices									
Period average	6.8	7.8	15.5	7.5	5.7	4.6	4.0	4.0	4.0
End of period	6.5	11.4	12.9	6.6	5.2	4.0	4.0	4.0	4.0
GDP deflator	4.8	9.0	7.7	7.4	5.5	4.0	4.0	4.0	4.0
Unemployment rate	5.5	5.2	5.6	6.5	6.3	5.6	5.5	5.5	5.5
					(Percent of GDP)				
Public sector 1/									
General government									
Net lending/borrowing (overall balance)	-1.2	-1.1	-3.5	-3.7	-1.6	-1.1	0.0	0.4	0.4
Revenue	34.4	34.3	32.8	31.2	32.2	31.7	31.9	31.9	31.9
Expenditures	35.6	35.4	36.3	34.9	33.8	32.8	31.9	31.6	31.4
Primary balance	-0.6	-0.4	-2.7	-2.7	-0.4	0.2	1.3	1.7	1.7
Nonoil balance	-11.1	-11.5	-11.7	-10.0	-8.3	-8.0	-6.9	-6.5	-6.3
Nonoil primary structural balance	-11.3	-10.3	-10.8	-9.2	-8.2	-7.5	-6.3	-5.9	-5.8
Federal government									
Net lending/borrowing (overall balance)	-0.5	-0.4	-2.4	-3.2	-1.5	-1.2	-0.3	0.0	0.0
Nonoil balance	-9.8	-10.1	-9.8	-9.0	-7.5	-7.4	-6.5	-6.2	-6.1
					(Annual percent change)				
Money									
Base money	8.0	6.3	-4.3	4.6	5.4	5.9	6.3	6.4	6.4
Ruble broad money	14.6	2.2	11.5	6.8	7.7	8.3	8.6	8.7	8.7
Credit to the economy	17.2	22.8	8.9	7.4	8.5	8.9	9.1	9.2	9.2
External sector									
Export volumes	1.9	0.1	2.6	1.1	2.3	1.3	3.2	3.4	3.5
Oil	2.7	0.1	10.9	-1.3	-1.6	-1.9	0.5	0.5	0.5
Gas	9.9	-11.3	13.8	6.0	2.7	-4.9	0.0	0.0	0.0
Non-energy	5.8	7.9	-5.5	2.2	6.4	6.6	6.9	7.0	7.0
Import volumes	3.2	-6.9	-28.4	-3.6	2.7	3.5	4.1	4.5	5.8
					(Billions of U.S. dollars; unless otherwise indicated)				
External sector									
Total merchandise exports, f.o.b	523.3	497.8	339.6	299.0	332.2	344.5	366.8	388.1	409.4
Total merchandise imports, f.o.b	-341.3	-308.0	-194.0	-180.1	-185.9	-193.5	-202.9	-213.3	-227.2
External current account	34.1	59.5	65.8	51.3	69.3	81.0	89.1	98.7	104.9
External current account (percent of GDP)	1.5	2.9	5.0	4.0	4.9	5.5	5.7	6.0	6.0
Gross international reserves									
Billions of U.S. dollars	509.6	385.5	368.4	373.1	387.8	415.2	450.0	491.9	535.1
Months of imports 2/	13.0	10.8	15.7	17.2	17.3	17.8	18.4	19.1	19.5
Percent of short-term debt	251	302	478	257	274	300	319	352	410
Memorandum items:									
Nominal GDP (billions of rubles)	71,017	77,945	80,804	85,722	91,376	96,186	101,582	107,213	113,186
Nominal GDP (billions of U.S. dollars)	2,231	2,031	1,326	1,270	1,410	1,477	1,569	1,656	1,738
Exchange rate (rubles per U.S. dollar, period average)	31.8	38.4	60.9	...	...	...	...	...	...
Oil exports (billions of U.S. dollars)	283.0	269.8	156.2	127.8	145.6	148.1	155.7	161.4	166.3
World oil price (U.S. dollars per barrel)	104.1	96.2	50.8	42.2	48.8	50.5	52.8	54.6	56.0
Urals crude oil spot price (U.S. dollars per barrel)	106.3	94.5	51.0	42.2	48.9	50.7	53.1	55.0	56.4
Oil Extraction (millions of tons)	521.7	525.1	525.0	525.0	525.0	525.0	525.0	525.0	525.0
Real effective exchange rate (average percent change)	1.8	-8.5	-17.4	...	...	...	...	...	...

Sources: Russian authorities; and IMF staff estimates.

1/ Cash basis.
2/ In months of imports of goods and non-factor services.

Table 2. Russian Federation: Balance of Payments, 2013–21

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

	2013	2014	2015	2016	2017	2018	2019	2020	2021
				Projection					
Current Account	34.1	59.5	65.8	51.3	69.3	81.0	89.1	98.7	104.9
Trade Balance	181.9	189.7	145.6	118.9	146.3	151.0	163.8	174.7	182.1
Exports	523.3	497.8	339.6	299.0	332.2	344.5	366.8	388.1	409.4
Non-energy	173.0	172.8	141.5	134.4	142.9	153.3	166.0	180.0	195.2
Energy	350.2	325.0	198.1	164.6	189.3	191.2	200.8	208.1	214.2
Oil	283.0	269.8	156.2	127.8	145.6	148.1	155.7	161.4	166.3
Gas	67.2	55.2	41.9	36.7	43.7	43.1	45.1	46.7	47.9
Imports	-341.3	-308.0	-194.0	-180.1	-185.9	-193.5	-202.9	-213.3	-227.2
Services	-58.3	-55.2	-37.1	-35.5	-33.8	-35.3	-36.5	-38.2	-41.4
Income	-80.2	-67.2	-36.3	-27.1	-37.9	-29.3	-32.6	-32.0	-29.8
Public sector interest (net)	-0.9	-0.6	0.2	1.1	2.0	2.9	3.5	3.6	3.8
Other sectors	-79.4	-66.6	-36.5	-28.3	-39.9	-32.2	-36.1	-35.6	-33.6
Current transfers	-9.3	-7.9	-6.4	-5.0	-5.2	-5.4	-5.6	-5.8	-6.1
Capital and financial account	-45.4	-175.8	-90.1	-46.6	-54.6	-53.7	-54.3	-56.8	-61.6
Capital transfers	-0.4	-42.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Financial accounts									
Federal government	5.3	30.1	-8.9	4.9	11.4	13.9	11.7	9.6	4.1
Portfolio investment	10.1	-8.7	-6.7	7.5	12.4	14.9	12.7	10.6	5.1
Loans	-1.0	33.9	-1.2	-1.7	0.0	0.0	0.0	0.0	0.0
Other investment	-3.8	4.9	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Local governments	-0.1	-0.1	0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Private sector capital	-51.2	-161.6	-82.7	-53.0	-67.5	-69.2	-67.6	-68.0	-67.3
Direct investment	-16.0	-35.4	-13.8	-1.3	-15.3	-27.7	-28.6	-29.5	-30.3
Portfolio investment	-13.2	-17.8	-5.5	-8.0	-8.2	-11.9	-17.7	-18.4	-17.7
Other investment, commercial banks	-15.3	-49.4	-35.9	-27.3	-25.5	-12.7	-9.7	-10.9	-12.2
Assets	-26.6	-7.7	30.1	-3.2	-4.3	-5.5	-6.8	-8.1	-9.4
Liabilities (loans, deposits, etc.)	11.3	-41.7	-66.0	-24.1	-21.2	-7.2	-3.0	-2.8	-2.7
Loans, corporations	44.7	-5.7	-2.3	-1.4	-2.9	-1.0	5.1	8.2	10.4
Disbursements	159.6	121.7	78.0	49.1	99.2	100.4	106.2	110.6	114.8
Amortizations	-115.0	-127.4	-80.3	-50.5	-102.1	-101.4	-101.2	-102.4	-104.3
Other private sector capital flows	-51.2	-53.2	-25.2	-14.9	-15.5	-15.8	-16.6	-17.4	-17.6
Errors and omissions, net	-10.8	8.8	-3.2	0.0	0.0	0.0	0.0	0.0	0.0
Of which : valuation adjustment	16.6	-10.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-22.1	-107.6	-27.5	4.7	14.8	27.3	34.8	41.9	43.2
Financing	22.1	107.6	27.5	-4.7	-14.8	-27.3	-34.8	-41.9	-43.2
Net international reserves	22.1	107.6	27.5	-4.7	-14.8	-27.3	-34.8	-41.9	-43.2
Arrears and rescheduling	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Current account (percent of GDP)	1.5	2.9	5.0	4.0	4.9	5.5	5.7	6.0	6.0
Non-energy current account (percent of GDP)	-14.2	-13.1	-10.0	-8.9	-8.5	-7.5	-7.1	-6.6	-6.3
Gross reserves 1/	509.6	385.5	368.4	373.1	387.8	415.2	450.0	491.9	535.1
(months of imports of GNFS)	13.0	10.8	15.7	17.2	17.3	17.8	18.4	19.1	19.5
(percent of short-term debt) 2/	251.5	301.6	477.9	257.4	274.5	299.9	319.3	351.8	410.1
Real growth in partner countries (percent change)	1.8	1.9	1.6	2.2	2.5	2.6	2.7	2.8	2.8
Net private capital flows (percent of exports of GNFS)	-8.6	-28.7	-21.2	-15.4	-17.7	-17.5	-16.1	-15.3	-14.3
Net private capital flows, banks	-15.3	-47.5	-33.2	-23.5	-21.6	-8.7	-5.7	-6.8	-8.1
Public external debt service payments 3/	11.0	8.1	5.4	5.0	4.3	5.8	5.6	8.2	6.3
(percent of exports of goods and services)	1.9	1.4	1.4	1.4	1.1	1.5	1.3	1.8	1.3
Public external debt 4/	77.7	52.2	44.8	50.6	62.9	77.7	90.4	101.0	106.1
(percent of GDP)	3.5	2.6	3.4	4.0	4.5	5.3	5.8	6.1	6.1
Private external debt	651.2	545.0	460.5	446.6	429.6	427.4	436.3	448.1	462.0
(percent of GDP)	29.2	26.8	34.7	35.1	30.5	28.9	27.8	27.0	26.6
Total external debt	728.9	597.3	505.3	497.2	492.5	505.2	526.7	549.1	568.1
(percent of GDP)	32.7	29.4	38.1	39.1	34.9	34.2	33.6	33.1	32.7
World oil price (U.S. dollars per barrel)	104.1	96.2	50.8	42.2	48.8	50.5	52.8	54.6	56.0
Urals oil price (U.S. dollars per barrel)	106.3	94.5	51.0	42.2	48.9	50.7	53.1	55.0	56.4
Terms of trade (percent)	-1.2	-1.9	-24.4	-9.5	8.1	1.8	2.4	1.7	1.3

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

1/ Excluding repos with non-residents to avoid double counting of reserves. Including valuation effects.
2/ Excludes arrears.
3/ Net of rescheduling.
4/ Includes indebtedness of repos by the monetary authorities.

Table 3. Russian Federation: External Financing Requirements and Sources, 2013–2021

(Billions of U.S. dollars)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
				Projection					
Gross financing requirements	-161	-138	-57	-20	-70	-54	-43	-36	-29
Current account balance	34	59	66	51	69	81	89	99	105
Debt amortization	-195	-197	-122	-72	-139	-135	-132	-135	-134
Public sector	-7	-5	-4	-4	-3	-4	-3	-5	-2
Central Bank									
General government	-7	-5	-4	-4	-3	-4	-3	-5	-2
Banks	-73	-65	-39	-17	-34	-30	-29	-28	-27
Corporates	-115	-127	-80	-51	-102	-101	-101	-102	-104
Sources of financing	148	33	18	26	77	85	81	72	110
Capital account balance (net)	0	-42	0	0	0	0	0	0	0
Foreign direct investment (net)	-16	-35	-14	-1	-15	-28	-29	-29	-30
RUS investment abroad	-87	-56	-21	-9	-23	-36	-38	-40	-41
Foreign investment in RUS	71	21	7	7	8	8	9	10	11
New borrowing and debt rollover	259	145	41	46	113	140	144	139	140
Borrowing	259	145	41	46	113	140	144	139	140
Public sector	7	0	0	2	8	11	8	8	0
Central Bank									
General government	7	0	0	2	8	11	8	8	0
Banks	84	23	8	6	19	24	26	25	24
Corporates	160	122	78	49	99	100	106	111	115
Other	-95	-35	-9	-19	-22	-27	-35	-37	0
of which: Net errors and omissions	-11	9	-3	0	0	0	0	0	0
GIR change	-22	-108	-27	5	15	27	35	42	43
Financing gap	0	0	0	0	0	0	0	0	1

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

Table 4. Russian Federation: Fiscal Operations, 2013–21 1/

(Percent of GDP, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
			Est.			Projection			
General government									
Revenue	34.4	34.3	32.8	31.2	32.2	31.7	31.9	31.9	31.9
o/w Oil revenue	9.9	10.5	8.2	6.2	6.7	6.9	6.9	6.8	6.7
o/w Nonoil revenue	24.5	23.9	24.6	25.0	25.5	24.8	25.0	25.1	25.2
Taxes	25.8	25.8	23.5	22.2	22.8	22.9	23.1	23.1	22.9
Corporate profit tax	2.9	3.0	3.2	3.1	3.3	3.2	3.4	3.4	3.3
Personal income tax	3.5	3.5	3.5	3.5	3.6	3.7	3.7	3.7	3.7
VAT	5.0	5.1	5.2	5.2	5.3	5.3	5.3	5.3	5.2
Excises	1.4	1.4	1.3	1.4	1.5	1.5	1.5	1.5	1.5
Custom tariffs	7.1	7.0	4.1	3.4	3.0	3.0	3.0	3.0	2.9
Resource extraction tax	4.1	4.1	4.3	3.7	4.2	4.4	4.4	4.4	4.3
Other tax revenue	1.8	1.8	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Social contributions	6.6	6.5	6.6	6.8	6.9	6.9	6.9	7.0	7.1
Other revenue	2.0	2.0	2.6	2.2	2.5	1.9	1.9	1.9	1.9
Expenditure	35.6	35.4	36.3	34.9	33.8	32.8	31.9	31.6	31.4
Expense	31.4	31.3	31.6	30.5	29.5	28.8	28.1	27.9	27.9
Compensation of employees	4.9	4.7	4.4	4.1	3.9	3.8	3.8	3.7	3.6
Use of goods and services	3.8	3.5	3.4	3.3	3.2	3.1	3.0	2.9	2.9
Interest	0.6	0.7	0.8	1.0	1.2	1.3	1.3	1.3	1.3
Subsidies	7.1	8.4	7.1	7.0	6.8	6.6	6.4	6.3	6.1
Grants	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social benefits	13.2	12.8	13.6	13.7	13.3	13.1	12.9	12.9	12.9
Other expense	0.8	0.3	1.0	0.2	0.0	-0.1	-0.3	-0.1	0.2
Net acquisition of nonfinancial assets	4.2	4.1	4.7	4.5	4.3	4.1	3.8	3.6	3.5
Net lending (+)/borrowing (-) (overall balance)	-1.2	-1.1	-3.5	-3.7	-1.6	-1.1	0.0	0.4	0.4
Non-oil primary structural balance	-11.3	-10.3	-10.8	-9.2	-8.2	-7.5	-6.3	-5.9	-5.8
Gross financing requirements	3.1	3.8	7.6	5.9	3.1	2.6	1.4	0.5	0.2
Federal government									
Revenue	18.3	18.6	16.9	15.3	15.9	15.4	15.4	15.4	15.3
o/w Oil revenue	9.3	9.7	7.4	5.7	6.1	6.2	6.2	6.2	6.1
o/w Nonoil revenue	9.0	8.9	9.5	9.5	9.9	9.2	9.2	9.2	9.2
Expenditure	18.8	19.0	19.3	18.5	17.4	16.6	15.7	15.4	15.3
Expense	16.3	16.4	16.0	15.3	14.3	13.7	13.1	12.9	27.9
Net acquisition of nonfinancial assets	2.5	2.6	3.3	3.2	3.0	2.8	2.6	2.5	2.4
Net lending (+)/borrowing (-) (overall balance)	-0.5	-0.4	-2.4	-3.2	-1.5	-1.2	-0.3	0.0	0.0
Non-oil primary structural balance	-9.7	-8.8	-9.4	-8.3	-7.3	-6.6	-5.7	-5.3	-5.3
Gross financing requirements	1.2	0.9	3.7	4.6	2.3	2.0	1.1	0.7	0.5
Memorandum items:									
General government nonoil primary balance	-10.5	-10.9	-10.9	-9.0	-7.2	-6.7	-5.6	-5.1	-5.0
General government nonoil overall balance	-11.1	-11.5	-11.7	-10.0	-8.3	-8.0	-6.9	-6.5	-6.3
Federal government nonoil primary balance	-9.4	-9.8	-9.5	-8.4	-6.7	-6.5	-5.6	-5.3	-5.2
Federal government nonoil overall balance	-9.8	-10.1	-9.8	-9.0	-7.5	-7.4	-6.5	-6.2	-6.1
World oil price (U.S.dollars per barrel)	104.1	96.2	50.8	42.2	48.8	50.5	52.8	54.6	56.0
Urals prices (U.S. dollars per barrel)	106.3	94.5	51.0	42.2	48.9	50.7	53.1	55.0	56.4
Oil funds 2/	8.1	12.0	11.0	6.6	6.1	5.8	6.1	6.2	6.2
Reserve Fund	4.0	6.3	4.5	1.1	1.0	0.9	1.5	1.8	2.1
NWF	4.1	5.6	6.5	5.5	5.1	4.8	4.6	4.3	4.1
General government debt	13.1	15.9	16.4	17.1	18.2	19.2	19.8	19.5	19.1
GDP (billions of rubles)	71,017	77,945	80,804	85,722	91,376	96,186	101,582	107,213	113,186

Sources: Russian authorities; and IMF staff estimates.

1/ Cash basis.

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

Table 5. Russian Federation: Monetary Accounts, 2013–21

(Billions of Russian rubles, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
				Projection					
Monetary authorities									
Base money	8,598	9,140	8,746	9,152	9,642	10,215	10,856	11,546	12,280
Currency issued	8,307	8,841	8,522	8,670	9,119	9,646	10,234	10,866	11,536
Required reserves on ruble deposits	291	299	224	482	522	569	622	680	744
NIR 1/	16,112	20,706	26,255	24,826	25,333	27,089	29,261	32,072	35,064
Gross reserves	16,677	21,665	26,850	25,421	25,927	27,683	29,855	32,667	35,658
Gross liabilities	565	960	595	595	595	595	595	595	595
GIR (billions of U.S. dollars)	*510*	*385*	*368*	*384*	*399*	*426*	*461*	*503*	*546*
NDA	-7,514	-11,566	-17,509	-15,675	-15,691	-16,874	-18,405	-20,526	-22,784
Net credit to general government	-7,060	-10,342	-9,182	-6,578	-6,554	-6,748	-7,719	-8,601	-9,525
Net credit to federal government	-5,505	-8,926	-8,019	-5,622	-5,622	-5,622	-6,247	-6,691	-7,074
CBR net ruble credit to federal government 1/	-431	-682	-798	-1,616	-1,717	-1,721	-1,737	-1,719	-1,685
Foreign exchange credit	123	207	276	276	276	276	276	276	276
Ruble counterpart	-5,198	-8,452	-7,497	-4,282	-4,181	-4,177	-4,786	-5,249	-5,665
CBR net credit to local government and EBFs	-1,555	-1,415	-1,163	-956	-932	-1,126	-1,471	-1,910	-2,452
CBR net credit to local government	-659	-701	-759	-552	-528	-722	-1,067	-1,506	-2,048
CBR net credit to extrabudgetary funds	-896	-714	-404	-404	-404	-404	-404	-404	-404
Net credit to banks	3,233	6,512	2,289	-453	-633	-1,097	-1,112	-1,481	-1,576
Gross credit to banks	5,021	8,617	4,441	500	600	800	900	950	950
Gross liabilities to banks and deposits	-1,788	-2,106	-2,152	-953	-1,233	-1,897	-2,012	-2,431	-2,526
Of which: correspondent account balances	-1,270	-1,216	-1,628	-1,506	-1,632	-1,778	-1,944	-2,126	-2,325
Other items (net) 2/	-3,687	-7,736	-10,617	-8,644	-8,503	-9,030	-9,574	-10,445	-11,682
Monetary survey									
Broad money	37,272	43,032	51,524	59,316	66,735	74,424	81,789	89,948	98,313
Ruble broad money	31,405	32,111	35,809	38,260	41,198	44,615	48,474	52,707	57,316
Currency in circulation	6,986	7,172	7,239	8,148	8,565	9,053	9,600	10,185	10,806
Ruble deposits	24,419	24,939	28,570	30,113	32,634	35,562	38,874	42,522	46,510
Forex deposits 1/	5,867	10,922	15,714	21,056	25,537	29,809	33,316	37,241	40,997
Net foreign assets 1/	17,881	24,720	33,001	32,505	34,278	36,595	39,105	42,387	45,958
NIR of monetary authorities	16,112	20,706	26,255	24,826	25,333	27,089	29,261	32,072	35,064
NFA of commercial banks	1,769	4,014	6,746	7,678	8,945	9,506	9,845	10,314	10,895
NFA of commercial banks (billions of U.S. dollars)	54	71	93	116	138	146	152	159	167
NDA	19,391	18,312	18,522	26,812	32,457	37,829	42,684	47,562	52,354
Domestic credit	32,425	37,539	43,995	50,802	56,443	62,471	67,977	73,844	79,988
Net credit to general government	-4,815	-8,201	-5,818	-2,682	-1,610	-759	-1,024	-1,515	-2,302
Credit to the economy	37,241	45,740	49,813	53,485	58,053	63,231	69,001	75,358	82,290
Other items (net)	-13,034	-19,227	-25,472	-23,991	-23,986	-24,642	-25,293	-26,282	-27,634
Memorandum items:									
Accounting exchange rate (ruble per U.S. dollar, eop)	32.7	56.3	72.9	…	…	…	…	…	…
Nominal GDP (billions of rubles)	71,017	77,945	80,804	85,727	91,387	96,195	101,588	107,257	113,207
CPI inflation (12-month change, eop)	6.5	11.4	12.9	6.6	5.2	4.0	4.0	4.0	4.0
Ruble broad money velocity (eop)	2.3	2.4	2.3	2.2	2.2	2.2	2.1	2.0	2.0
Ruble broad money velocity (eop, s.a.)	2.4	2.5	2.4	2.3	2.3	2.2	2.2	2.1	2.1
Annual change in velocity	-7.4	7.3	-7.0	-0.8	-1.0	-2.8	-2.8	-2.9	-2.9
Real ruble broad money (rel. to CPI, 12-month change)	7.6	-8.2	-1.2	0.2	2.4	4.1	4.5	4.6	4.6
Nominal ruble broad money (12-month change)	14.6	2.2	11.5	6.8	7.7	8.3	8.6	8.7	8.7
Base money (12-month change)	8.0	6.3	-4.3	4.6	5.4	5.9	6.3	6.4	6.4
Real credit to the economy (12-month change)	10.1	10.3	-3.5	0.7	3.2	4.7	4.9	5.0	5.0
Ruble broad money multiplier	3.7	3.5	4.1	4.2	4.3	4.4	4.5	4.6	4.7

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: Medium-Term Framework and Balance of Payments, 2013–21

	2013	2014	2015	2016	2017	2018	2019	2020	2021
			Est.			Projection			
			(Percent of GDP, unless otherwise indicated)						
Macroeconomic framework									
GDP growth at constant prices (percent)	1.3	0.7	-3.7	-1.2	1.0	1.2	1.5	1.5	1.5
Consumer prices (percent change, end of period)	6.5	11.4	12.9	6.6	5.2	4.0	4.0	4.0	4.0
Gross domestic investment	21.1	21.1	20.7	21.6	21.6	22.0	22.1	22.2	22.3
Private sector	17.2	17.3	16.7	17.7	17.8	18.3	18.7	19.0	19.2
Public sector	3.9	3.8	4.0	4.0	3.8	3.6	3.4	3.3	3.1
Gross national savings	22.7	24.0	25.7	25.7	26.5	27.4	27.8	28.2	28.4
Private sector	18.8	21.3	25.2	25.5	24.3	24.9	24.4	24.6	24.8
Public sector	3.8	2.7	0.5	0.2	2.2	2.5	3.4	3.6	3.5
External current account balance	1.5	2.9	5.0	4.0	4.9	5.5	5.7	6.0	6.0
Fiscal Operations 1/									
Federal government									
Net lending/borrowing (overall balance)	-0.5	-0.4	-2.4	-3.2	-1.5	-1.2	-0.3	0.0	0.0
Nonoil balance	-9.8	-10.1	-9.8	-9.0	-7.5	-7.4	-6.5	-6.2	-6.1
General government									
Net lending/borrowing (overall balance)	-1.2	-1.1	-3.5	-3.7	-1.6	-1.1	0.0	0.4	0.4
Revenue	34.4	34.3	32.8	31.2	32.2	31.7	31.9	31.9	31.9
Expenditure	35.6	35.4	36.3	34.9	33.8	32.8	31.9	31.6	31.4
Nonoil balance	-11.1	-11.5	-11.7	-10.0	-8.3	-8.0	-6.9	-6.5	-6.3
Primary balance	-0.6	-0.4	-2.7	-2.7	-0.4	0.2	1.3	1.7	1.7
Gross debt	13.1	15.9	16.4	17.1	18.2	19.2	19.8	19.5	19.1
			(Billions of U.S dollars; unless otherwise indicated)						
Balance of payments									
Current account	34.1	59.5	65.8	51.3	69.3	81.0	89.1	98.7	104.9
Trade balance	181.9	189.7	145.6	118.9	146.3	151.0	163.8	174.7	182.1
Exports (f.o.b)	523.3	497.8	339.6	299.0	332.2	344.5	366.8	388.1	409.4
Of which: energy	350.2	325.0	198.1	164.6	189.3	191.2	200.8	208.1	214.2
Imports (f.o.b)	-341.3	-308.0	-194.0	-180.1	-185.9	-193.5	-202.9	-213.3	-227.2
Services and transfers, net	-67.6	-63.1	-43.5	-40.5	-39.0	-40.7	-42.1	-44.0	-47.5
Capital and financial account	-45.4	-175.8	-90.1	-46.6	-54.6	-53.7	-54.3	-56.8	-61.6
Capital account	-0.4	-42.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-45.0	-133.8	-89.9	-46.6	-54.6	-53.7	-54.3	-56.8	-61.6
Private sector capital	-51.2	-161.6	-82.7	-53.0	-67.5	-69.2	-67.6	-68.0	-67.3
Errors and omissions	-10.8	8.8	-3.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-22.1	-107.6	-27.5	4.7	14.8	27.3	34.8	41.9	43.2
Memorandum items:									
Gross reserves (end of period)									
Billions of U.S. dollars	509.6	385.5	368.4	373.1	387.8	415.2	450.0	491.9	535.1
Percent of short-term debt (residual maturity)	251.5	301.6	477.9	257.4	274.5	299.9	319.3	351.8	410.1
Months of prospective GNFS imports	13.0	10.8	15.7	17.2	17.3	17.8	18.4	19.1	19.5
Trade balance (percent of GDP)	8.2	9.3	11.0	9.4	10.4	10.2	10.4	10.6	10.5
Terms of trade (y-o-y change, percent)	-1.2	-1.9	-24.4	-9.5	8.1	1.8	2.4	1.7	1.3
Excluding fuel	-0.8	-1.2	1.0	-3.4	-0.6	0.0	0.6	0.6	0.6
Export volume, goods (y-o-y change, percent)	1.9	0.1	2.6	1.1	2.3	1.3	3.2	3.4	3.5
Import volume, goods (y-o-y change, percent)	3.2	-6.9	-28.4	-3.6	2.7	3.5	4.1	4.5	5.8
World oil price (U.S. dollars per barrel)	104.1	96.2	50.8	42.2	48.8	50.5	52.8	54.6	56.0
Output gap	0.7	0.6	-1.8	-2.0	-1.0	-0.1	0.0	0.0	0.0

Sources: Russian authorities; and IMF staff estimates.

1/ Cash basis. Expenditures based on 2014-16 budget and the fiscal rule.

Table 7. Russian Federation: Financial Soundness Indicators, 2013–16

(Percent)

	2013	2014	2015	2016 March
Financial Soundness Indicators				
Capital adequacy				
Capital to risk-weighted assets	13.5	12.5	12.7	12.4
Core capital to risk-weighted assets	9.1	9.0	8.5	8.4
Credit risk				
NPLs to total loans	6.0	6.7	8.3	9.2
Loan loss provisions to total loans	5.9	6.5	7.8	8.4
Large credit risks to capital	204.3	245.5	254.4	248.1
Distribution of loans provided by credit institutions				
Agriculture, hunting and forestry	4.3	3.5	3.5	3.6
Mining	3.1	4.2	4.9	5.5
Manufacturing	13.6	15.5	17.1	16.9
Production and distribution of energy, gas and water	2.5	2.5	2.5	2.5
Construction	5.6	5.3	4.8	4.8
Wholesale and retail trade	13.7	13.3	11.3	11.0
Transport and communication	4.2	4.4	4.2	4.3
Other economic activities	21.1	21.2	24.1	23.9
Individuals	32.0	30.1	27.5	27.6
Of which: mortgage loans	8.5	9.4	10.1	12.5
Geographical distribution of interbank loans and deposits				
Russian Federation	39.7	53.6	54.0	58.9
United Kingdom	23.8	13.9	12.3	11.1
USA	6.8	4.9	4.5	4.7
Germany	0.6	0.4	0.8	1.0
Austria	7.3	7.3	4.9	4.1
France	1.9	1.8	1.8	2.4
Italy	0.1	0.0	0.0	0.1
Cyprus	4.7	4.9	9.2	6.2
Netherlands	1.5	1.3	0.8	0.4
Other	13.6	11.8	11.8	11.0
Liquidity				
Highly liquid assets to total assets	9.9	10.4	10.6	11.6
Liquid assets to total assets	20.5	22.0	24.6	22.8
Liquid assets to short-term liabilities	78.7	80.4	139.3	121.8
Ratio of client's funds to total loans	98.7	92.8	59.0	59.4
Return on assets	1.9	0.9	0.3	0.4
Return on equity	15.2	7.9	2.3	3.4
Balance Sheet Structure, in percent of assets				
Total asset growth rate	16.0	35.2	6.9	9.0
Asset side				
Accounts with CBR and other central banks	3.9	4.2	3.0	3.6
Interbank lending	8.9	8.9	10.4	10.7
Securities holdings	13.6	12.5	14.2	14.6
Liability side				
Funds from CBR	7.7	12.0	6.5	5.0
Interbank liabilities	8.4	8.5	8.5	9.5
Individual deposits	29.5	23.9	28.0	27.8

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

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

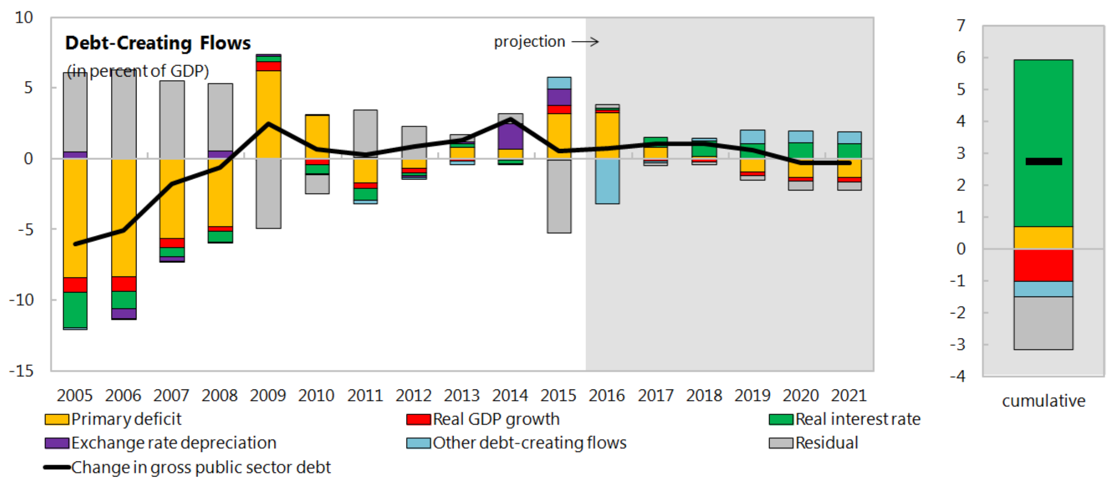
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections							As of June 01, 2016		
	2005-2013 [2]	2014	2015	2016	2017	2018	2019	2020	2021				
Nominal gross public debt	10.7	15.9	16.4	17.1	18.2	19.2	19.8	19.5	19.2		Sovereign Spreads		
Of which: guarantees	0.9	3.1	3.2	4.6	5.0	5.5	5.8	5.8	5.8		EMBIG (bp) 3/		347
Public gross financing needs	-0.1	3.8	7.6	5.9	3.1	2.6	1.4	0.5	0.2		5Y CDS (bp)		364
Real GDP growth (in percent)	3.8	0.7	-3.7	-1.2	1.0	1.2	1.5	1.5	1.5		Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	12.4	9.0	7.7	7.4	5.5	4.0	4.0	4.0	4.0		Moody's	Ba1	Ba1
Nominal GDP growth (in percent)	16.8	9.8	3.7	6.1	6.6	5.3	5.6	5.5	5.6		S&Ps	BB+	BBB-
Effective interest rate (in percent) [4]	6.6	6.9	6.6	8.1	9.9	10.2	10.2	10.1	10.0		Fitch	BBB-	BBB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	-0.9	2.8	0.5	0.7	1.0	1.0	0.6	-0.3	-0.3	2.8	
Identified debt-creating flows	-3.3	2.1	5.6	0.4	1.2	1.2	0.9	0.4	0.3	4.4	
Primary deficit	-2.1	0.7	3.2	3.2	0.8	0.2	-0.9	-1.3	-1.3	0.7	1.6
Primary (noninterest) revenue and gra	35.0	34.1	32.2	30.7	31.8	31.3	31.5	31.5	31.5	188.3	
Primary (noninterest) expenditure	32.9	34.8	35.5	33.9	32.6	31.5	30.6	30.2	30.1	189.0	
Automatic debt dynamics [5]	-1.1	1.5	1.6	0.3	0.5	0.8	0.8	0.9	0.8	4.2	
Interest rate/growth differential [6]	-1.1	-0.3	0.5	0.3	0.5	0.8	0.8	0.9	0.8	4.2	
Of which: real interest rate	-0.7	-0.3	-0.1	0.1	0.7	1.1	1.1	1.1	1.1	5.2	
Of which: real GDP growth	-0.4	-0.1	0.6	0.2	-0.2	-0.2	-0.3	-0.3	-0.3	-1.0	
Exchange rate depreciation [7]	0.0	1.8	1.1	...	...	...	...	...	...	...	
Other identified debt-creating flows	-0.1	0.0	0.8	-3.2	-0.1	0.2	1.0	0.8	0.8	-0.5	
General Government: Net privatizatic	-0.1	-0.1	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	-0.2	
Change is cash balance of EBF	0.0	0.0	0.8	-0.2	0.0	0.2	0.3	0.4	0.5	1.2	
Transfers to RF and NWF	0.0	0.0	0.0	-2.8	0.0	0.0	0.6	0.4	0.3	-1.4	
Residual, including asset changes [8]	2.5	0.7	-5.1	0.3	-0.2	-0.2	-0.3	-0.6	-0.6	-1.7	

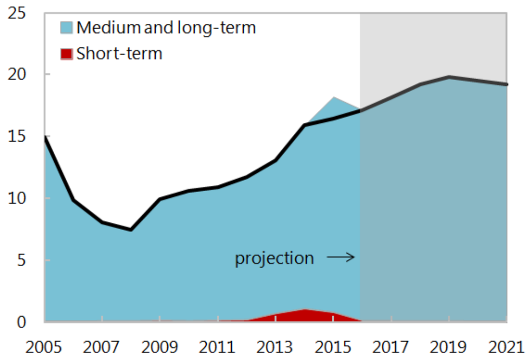


Source: IMF staff.
1/ Public sector is defined as general government and includes federal guarantees.
2/ Based on available data.
3/ EMBIG.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).
8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

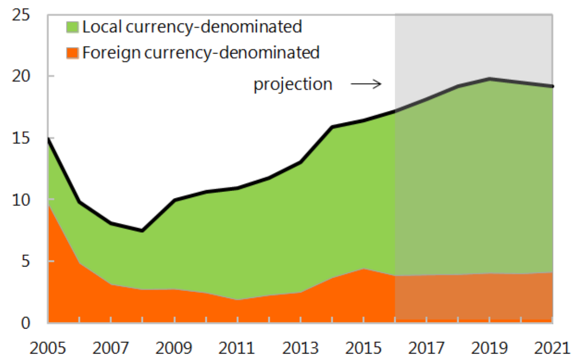
Table 9. Russian Federation: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



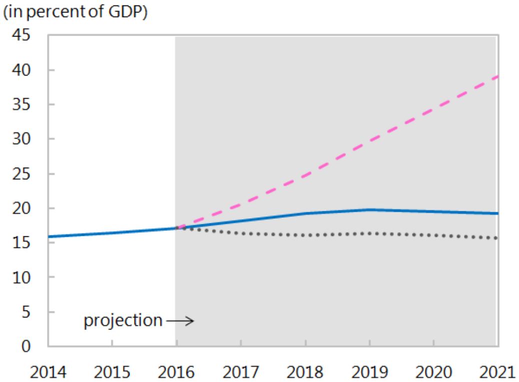
By Currency
(in percent of GDP)



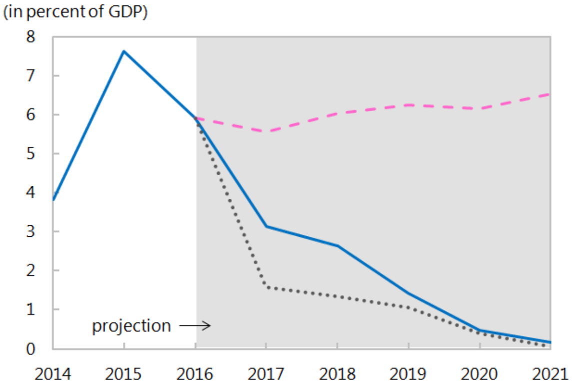
Alternative Scenarios

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)

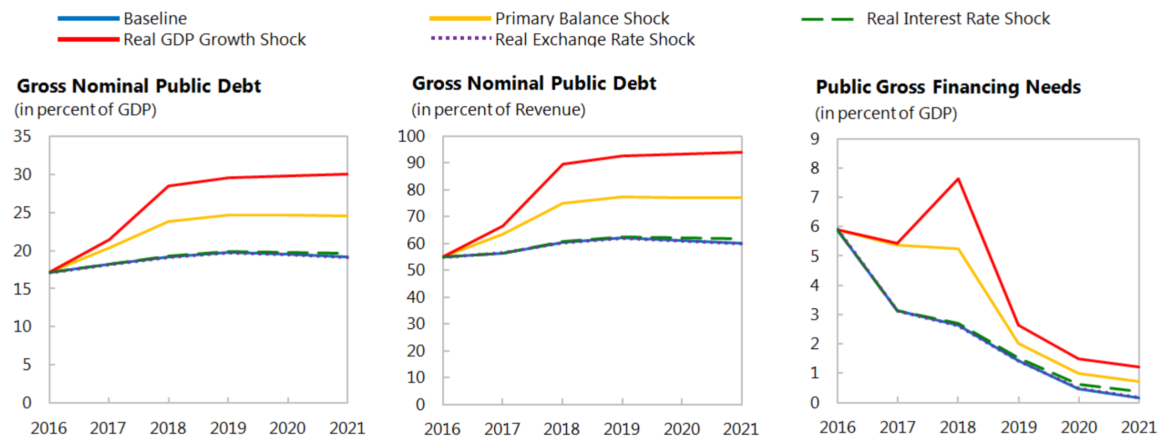
Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	-1.2	1.0	1.2	1.5	1.5	1.5
Inflation	7.4	5.5	4.0	4.0	4.0	4.0
Primary Balance	-3.2	-0.8	-0.2	0.9	1.3	1.3
Effective interest rate	8.1	9.9	10.2	10.2	10.1	10.0
Constant Primary Balance Scenario						
Real GDP growth	-1.2	1.0	1.2	1.5	1.5	1.5
Inflation	7.4	5.5	4.0	4.0	4.0	4.0
Primary Balance	-3.2	-3.2	-3.2	-3.2	-3.2	-3.2
Effective interest rate	8.1	9.9	10.2	10.0	9.7	9.4

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	-1.2	2.5	2.5	2.5	2.5	2.5
Inflation	7.4	5.5	4.0	4.0	4.0	4.0
Primary Balance	-3.2	0.7	0.7	0.7	0.7	0.7
Effective interest rate	8.1	9.9	9.2	8.2	6.8	5.9

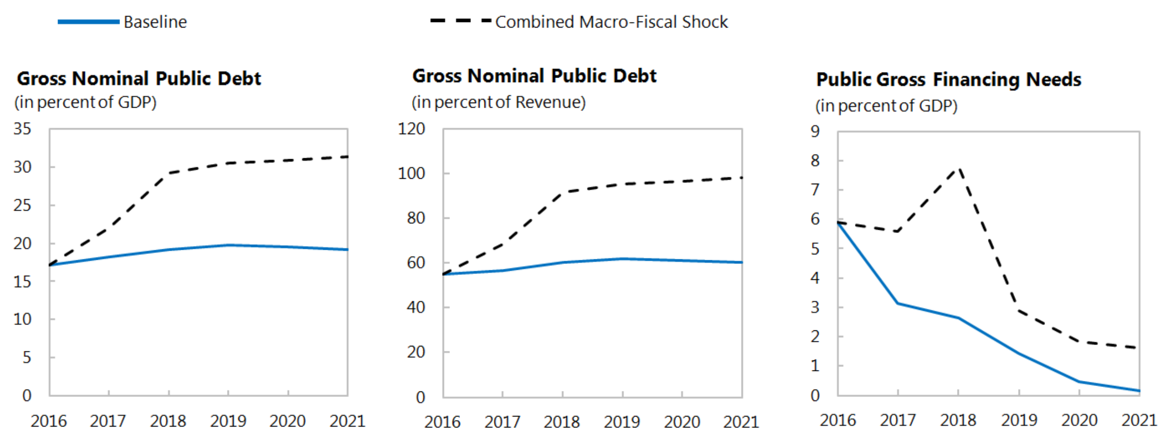
Source: IMF staff.

Table 10. Russian Federation: Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2016	2017	2018	2019	2020	2021
Primary Balance Shock						
Real GDP growth	-1.2	1.0	1.2	1.5	1.5	1.5
Inflation	7.4	5.5	4.0	4.0	4.0	4.0
Primary balance	-3.2	-3.1	-2.4	0.9	1.3	1.3
Effective interest rate	8.1	9.9	10.4	10.3	10.2	10.1
Real Interest Rate Shock						
Real GDP growth	-1.2	1.0	1.2	1.5	1.5	1.5
Inflation	7.4	5.5	4.0	4.0	4.0	4.0
Primary balance	-3.2	-0.8	-0.2	0.9	1.3	1.3
Effective interest rate	8.1	9.9	10.6	11.0	11.2	11.2
Combined Shock						
Real GDP growth	-1.2	-4.1	-3.9	1.5	1.5	1.5
Inflation	7.4	4.2	2.7	4.0	4.0	4.0
Primary balance	-3.2	-3.1	-4.5	0.9	1.3	1.3
Effective interest rate	8.1	10.1	10.7	11.0	11.1	11.1

	2016	2017	2018	2019	2020	2021
Real GDP Growth Shock						
Real GDP growth	-1.2	-4.1	-3.9	1.5	1.5	1.5
Inflation	7.4	4.2	2.7	4.0	4.0	4.0
Primary balance	-3.2	-3.0	-4.5	0.9	1.3	1.3
Effective interest rate	8.1	9.9	10.4	10.4	10.3	10.1
Real Exchange Rate Shock						
Real GDP growth	-1.2	1.0	1.2	1.5	1.5	1.5
Inflation	7.4	8.3	4.0	4.0	4.0	4.0
Primary balance	-3.2	-0.8	-0.2	0.9	1.3	1.3
Effective interest rate	8.1	10.0	10.1	10.1	10.0	9.9

Source: IMF staff.

Table 11. Russian Federation: External Debt Sustainability Framework, 2011–2021

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2011	2012	2013	2014	2015			2016	2017	2018	2019	2020	2021	Debt-stabilizing non-interest current account 6/
Baseline: External debt	26.8	29.3	32.7	29.4	38.1			**39.7**	**35.5**	**34.3**	**33.6**	**33.2**	**32.7**	**-1.3**
Change in external debt	-3.0	2.5	3.3	-3.3	8.7			1.6	-4.1	-1.3	-0.7	-0.4	-0.5	
Identified external debt-creating flows (4+8+9)	-8.5	-3.3	-1.2	-1.3	7.6			-1.1	-3.7	-5.0	-4.9	-4.9	-4.9	
Current account deficit, excluding interest payments	-3.6	-2.4	-0.7	-2.3	-4.2			-3.1	-3.9	-4.5	-4.6	-4.7	-4.7	
Deficit in balance of goods and services	-48.4	-47.7	-47.7	-48.9	-50.5			-46.8	-45.4	-44.9	-44.5	-44.6	-45.1	
Exports	28.2	27.2	26.6	27.7	29.4			26.6	26.6	26.3	26.4	26.5	26.6	
Imports	-20.2	-20.5	-21.1	-21.1	-21.2			-20.2	-18.8	-18.5	-18.1	-18.1	-18.5	
Net non-debt creating capital inflows (negative)	-0.2	0.3	-0.2	-1.2	-0.2			0.8	-0.3	-1.1	-1.1	-1.0	-1.0	
Automatic debt dynamics 1/	-4.7	-1.2	-0.2	2.2	12.1			1.3	0.4	0.6	0.8	0.9	0.9	
Contribution from nominal interest rate	1.1	0.8	0.8	0.6	0.7			0.7	0.8	1.0	1.2	1.3	1.3	
Contribution from real GDP growth	-1.0	-0.9	-0.4	-0.3	1.7			0.6	-0.4	-0.4	-0.5	-0.5	-0.5	
Contribution from price and exchange rate changes 2/	-4.8	-1.1	-0.7	1.9	9.7			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	5.5	5.8	4.5	-2.0	1.1			2.6	-0.4	3.7	4.2	4.5	4.4	
External debt-to-exports ratio (in percent)	95.1	107.9	122.8	106.0	129.8			149.1	133.7	130.0	127.2	125.3	122.9	
Gross external financing need (in billions of US dollars) 4/	83.4	109.7	202.5	166.9	81.1			46.9	102.6	90.1	85.7	85.2	81.2	
in percent of GDP	4.1	5.1	9.1	8.2	6.1	10-Year	10-Year	3.7	7.4	6.1	5.5	5.1	4.7	
Scenario with key variables at their historical averages 5/								**39.7**	**38.4**	**39.6**	**41.1**	**42.4**	**43.3**	**-1.2**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	4.3	3.5	1.3	0.7	-3.7	2.5	5.1	-1.5	1.0	1.2	1.5	1.5	1.5	
GDP deflator in US dollars (change in percent)	19.8	3.2	1.5	-9.6	-32.2	4.4	19.5	-4.1	9.4	5.2	4.8	4.0	3.4	
Nominal external interest rate (in percent)	4.8	3.3	2.8	1.6	1.6	4.2	1.8	1.8	2.3	3.0	3.8	4.2	4.2	
Growth of exports (US dollar terms, in percent)	29.8	2.8	0.6	-5.0	-30.9	6.7	24.7	-14.3	10.4	5.5	6.6	5.8	5.5	
Growth of imports (US dollar terms, in percent)	27.8	8.4	5.6	-8.7	-34.6	8.8	26.2	-9.8	3.0	4.7	4.1	5.7	7.0	
Current account balance, excluding interest payments	3.6	2.4	0.7	2.3	4.2	3.4	1.7	3.1	3.9	4.5	4.6	4.7	4.7	
Net non-debt creating capital inflows	0.2	-0.3	0.2	1.2	0.2	0.0	0.8	-0.8	0.3	1.1	1.1	1.0	1.0	

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.

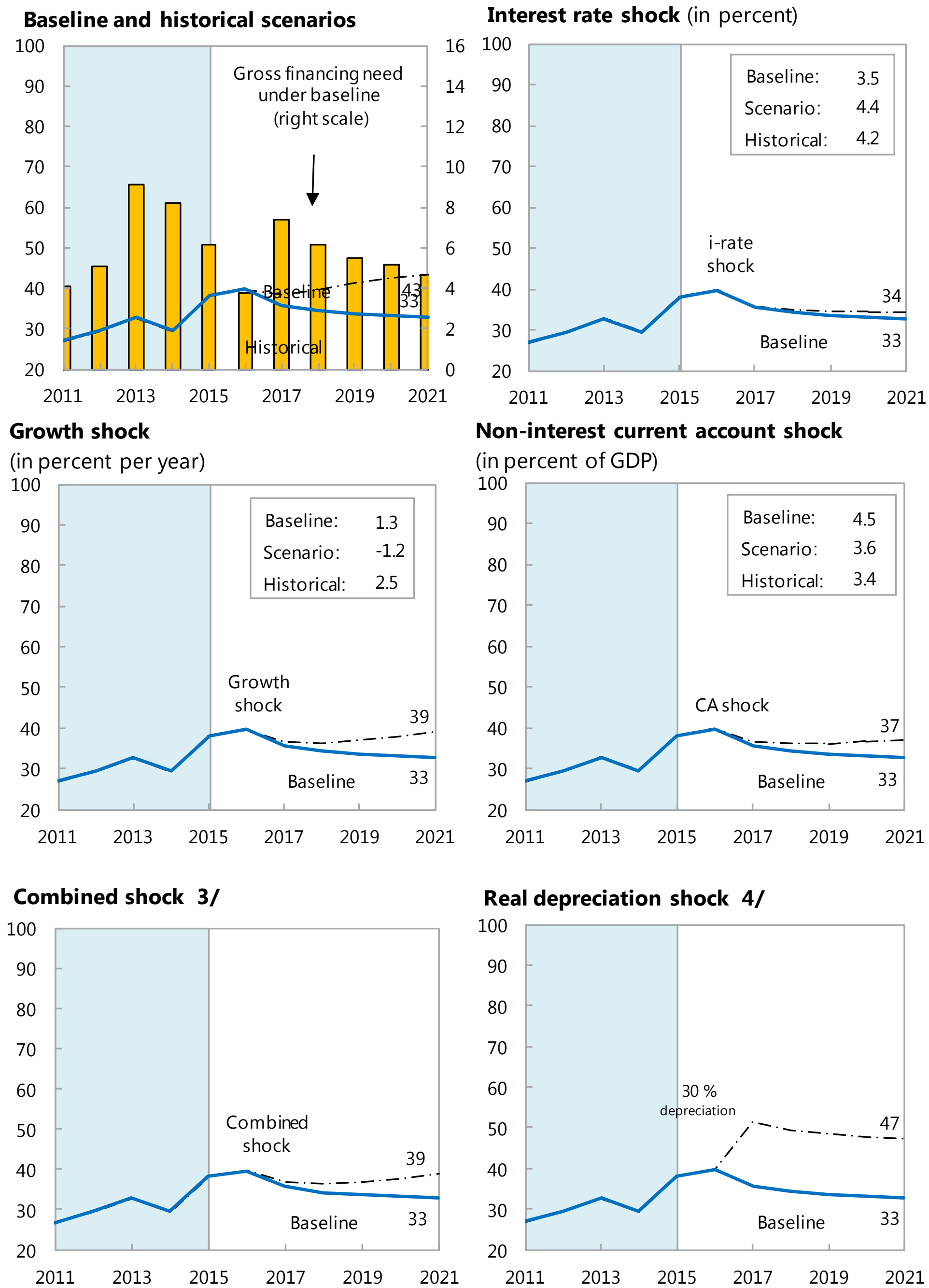
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

(External debt in percent of GDP)



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

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

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

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

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

Annex I. Implementation of Past IMF Recommendations

During the 2015 Article IV consultation, Directors commended the policy actions taken by the authorities to stabilize the economy in light of the significant stress created by lower oil prices and sanctions. Pre-existing structural weaknesses also contributed to this difficult situation. Directors concurred that continued prudent policies and reforms would be necessary to ensure macroeconomic stability and boost potential growth.

Key recommendations	**Implemented policies**
Fiscal Policy	
Medium-term fiscal consolidation is required to adjust to lower oil prices and rebuild buffers while detailed fiscal measures will help credibility.	The authorities suspended the three-year fiscal framework and are devising measures to be announced in the 2017 budget to adjust to lower oil prices.
The application of the fiscal rule will lead to a slow consolidation while pension indexation would make it difficult to achieve the necessary fiscal adjustment.	The authorities suspended the fiscal rule, as it was providing too little fiscal adjustment, and are planning on reinstating it when the balanced budget is achieved. Pension indexation to inflation was partial.
A limited fiscal adjustment could begin in 2016 with the pace of fiscal consolidation adjusted to provide support to the economy.	The authorities have adopted a tight fiscal stance, frontloading the fiscal adjustment despite the cyclical downturn.
The use of quasi-fiscal operations should be limited and coordinated to avoid an overly stimulative fiscal stance.	The structural non-oil deficit deteriorated by less than expected (0.2 percent of GDP versus 0.4 percent of GDP) as the fiscal stimulus was limited.
Monetary Policy	
Continue the normalization of policy rates at a gradual pace commensurate with the decline in underlying inflation and inflation expectations.	Policy rates were decreased throughout 2015 by a cumulative 600bps, to 11 percent. The CBR paused its easing cycle in August to assess the impact of lower oil prices and ruble depreciation on underlying inflation and inflation expectations.
Repricing and rationalizing the FX facilities while indicating a time-frame for conducting FX purchases.	The CBR curtailed FX allotments, increased the costs of its FX facilities and eliminated the one-year FX facility in an effort to rationalize the FX facilities. It also put a halt to the FX purchase program as the ruble volatility increased in second half of 2015 following the decline in oil prices.

Financial Sector Policy	
Eliminate regulatory forbearance promptly along with the implementation of the bank capital support program.	Almost all regulatory forbearance measures were lifted and the government's capital support program was completed.
Tailor the capital support program to the specific needs of individual banks and introduce tighter eligibility criteria, higher cost of capital, while eliminating credit growth targets.	The capital support program has been implemented as originally designed.
Introduce legislation to provide for a number of resolution tools including the powers to use a bridge bank and to bail-in all unsecured uninsured liabilities.	The authorities' supervisory agenda was dominated by the implementation of the Basel III requirements and discussions over bail-in legislation are ongoing.
Structural Policies	
Improving governance and the protection of property rights, increasing competition in domestic markets, increasing output in the non-energy tradable sector, and attracting investment.	Import-substitution policies have been the focus of the authorities' structural policy agenda by supporting local production in sectors with export potential. Part of the government anti-crisis package is aimed at supporting SMEs by reducing their financial and administrative costs. The privatization agenda remained stalled, given adverse market conditions.

	Russia	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) at end-September 2015 was at about 23 percent GDP (up from 6 percent in 2013), with gross assets of 89 percent of GDP and liabilities of 66 percent of GDP. Total external debt is at 37.8 percent of GDP. There are no obvious maturity mismatches between the gross asset and liability position. Historically, the NIIP position has not kept pace with the CA surpluses due to unfavorable valuation changes and the treatment of "disguised" capital outflows.1/ **Assessment**. The projected current account surpluses suggest that Russia will continue to maintain a positive IIP, which minimizes risks to external stability. Moreover, assets should increase further, as accumulation of fiscal savings in the oil funds resumes in the medium-term. The external deleveraging since 2014 reduces risks further.	**Overall Assessment**: *The external position in 2015 was broadly consistent with medium-term fundamentals and desirable policy settings.* Relative to 2015, the REER has recently depreciated further. This in part reflects the adjustment to a new norm due to substantially lower oil prices. The structural implications of sanctions create exceptional uncertainty when assessing the external position. Nevertheless, staff's view is that the depreciation has kept the REER not far from medium-term fundamentals. **Potential policy responses**: The nonoil fiscal deficit remains significantly higher than its long-term desirable level and needs to adjust to facilitate a rebalancing from public to private activity, and a re-allocation of government expenditure from current to capital spending. The consolidation should be gradual to avoid undermining domestic demand. This rebalancing—coupled with a renewed emphasis on structural reforms to invigorate the private sector—would help increase public saving that would be matched by both higher private and public sector investment over the medium-term.
Current account	**Background**. From 2000 to 2013, the current account (CA) surplus fell from 18 to 2 percent of GDP, despite rising oil prices, as consumption increased rapidly. A correction, however, is underway with the CA improving to 2.9 percent in 2014 and 5 percent in 2015. This improvement took place despite the negative terms of trade shock, as reduced oil export revenues (approximately 7 percent of GDP) was offset by falling absorption (due to the real depreciation of the ruble) and lower income payments. In the medium-term, the increase in oil prices will support gradual improvement in the CA. **Assessment**. There are particular uncertainties with the external assessment when oil plays such a dominant role in the economy, and oil price movements have been very large, compounded now by the uncertain long-term impact of sanctions on saving-investment decisions and therefore the normative external position. 2/ Staff assesses that the 2015 CA gap was between -2 to 2 percent of GDP. In the medium term, fiscal policy should be tightened to rebuild buffers and save more of the oil wealth for future generations.	
Real exchange rate	**Background**. The sustained oil price boom and related expansion of domestic demand led to a strong real effective exchange rate (REER) appreciation between 2000 and 2013. The REER has since depreciated 18 percent between 2014 and 2015. This reflects the impact of lower terms of trade, sanctions, and the move to a floating exchange rate regime in November 2014. The REER at end-January 2016 reached new lows as oil prices fell to their lowest level in a decade. The REER has weakened 3 percent through April 2016 compared to its 2015 average. **Assessment**. Based on the CA gap, staff assesses that the REER was not far from medium-term fundamentals in 2015 with a REER gap of about -7 to +7. 3/ The REER is now below the historical average and at the level it was before the increases in oil prices. Nevertheless, in staff's view, the REER equilibrium could be lower should the oil price shock become permanent.	
Capital and financial accounts: flows and policy measures	**Background**. Net private capital outflows continued in 2015 though the pace has significantly slowed relative to 2014, as domestic confidence has resumed. External deleveraging has continued in the face of limited access to international capital markets. Nonetheless, volatile and lower oil prices will continue to weigh on the outlook. Over the medium term, structural outflows are expected to decline if Russia improves its investment climate. **Assessment**. While Russia is exposed to risks of accelerated capital outflows because of the uncertain geopolitical context, large international reserves provide substantial buffers and the new floating exchange rate regime will help absorb these shocks.	

	Russia (continued)		
FX intervention and reserves level	**Background**. Since adopting a free floating exchange rate regime, FX interventions have been limited. In May 2015, the CBR started rebuilding reserves for few months as uncertainty remained elevated. **Assessment**. International reserves stood at USD368 billion at end-2015, equivalent to 266 percent of the Fund's basic reserve adequacy metric, exceeding the adequacy minimum of 150 percent. Taking into account Russia's vulnerability to commodity shocks, the adjusted adequacy metric falls to 199 percent of the metric remaining above the minimum adequacy threshold. A policy of small regular reserve purchases to replenish reserves could be justified by the heightened level of uncertainty related to sanctions and as a buffer given Russia's vulnerability to oil shocks. Large FX interventions should be limited to episodes of market distress.		
Technical Background Notes	1/ Unfavorable valuation changes arise because the Russian stock market has performed very well in the last 15 years as the oil price soared, boosting the valuation of foreign-owned assets. "Disguised" capital outflows include transactions such as pre-payments on import contracts where the goods are not delivered, repeated large transfers abroad that deviate from standard remittances behavior, or securities transactions at inflated prices. The CBR includes estimates of "disguised" capital outflows in the financial account but not in the foreign asset position of the reported NIIP. Hence, the actual NIIP position could be higher than the reported level and this treatment of "disguised" outflows may explain part of the discrepancy between accumulated CA surpluses and the reported NIIP position. 2/ The EBA-estimated 2015 CA norm was 6.2 percent of GDP and the cyclically adjusted CA was 7.3 percent of GDP. The difference in the model-based gap relative to 2014 reflects both an improvement in the 2015 CA (from 2.9 percent in 2014) and an increase in the estimated current account norm (from 5 percent in 2014). The EBA estimated CA norm of 6.2 percent of GDP rests mostly on the need to save out of income from non-renewable oil exports. Staff's assessment shares this basic logic in also calling for a CA surplus for Russia but acknowledges that such saving (i.e., refraining from consumption) would not necessarily have to take a financial form and could in part take the form of productive investment spending, which could justify a somewhat lower CA surplus than the EBA-estimated norm. Sanctions and geopolitical tensions have introduced an additional level of complexity in the external assessment as they introduce exceptional uncertainty that model based estimates do not adequately account for. 3/ The EBA Level REER model suggests an undervaluation of 21 percent, and the EBA Index REER regression model an undervaluation of 22 percent. The estimated impact of commodity terms of trade may, however, be less reliable in these models as they are derived from the historical relationships, which quite significantly understate the impact of the recent large oil price shock on the REER gap.		

Annex III. Risk Assessment Matrix (RAM) 1/

Risks	Overall Level of Concern		Recommended Policy Response
	Relative Likelihood	Expected Impact if Materialized	
Persistently lower energy prices, triggered by supply factors reversing only gradually.	**High**	**High**	The floating exchange rate remains key to cushion the shock. Fiscal policy could temporarily use existing buffers within a medium-term framework that ensures consolidation. Structural reforms should be advanced to improve economic efficiency and enhance diversification.
Increase in geopolitical tensions. Regional tension flare-ups or intensification could depress business confidence and heighten risk aversion.	**Medium**	**Medium**	The floating exchange rate remains key to cushion the shock. Disorderly market conditions can be countered with foreign exchange intervention. An interest rate increase could be considered. Fiscal policy tightening could be postponed.
Weaker banking system for longer. If undercapitalized banks are unable to improve their capital position, credit growth will be lower with negative implications on growth.	**Medium**	**Medium**	Weak banks should be required to submit time bound plans for recapitalization while bringing their capitalization closer to regulatory minima under an adverse stress scenario. In the case of weak viable government related banks, the government may want to consider precautionary capital injections.
Sharper-than-expected global growth slowdown: • **Significant China slowdown**, triggered by corporate distress that propagates through shadow banks, precipitating deleveraging, uncertainty and capital outflows. Weak domestic demand further suppresses commodity prices, roils global financial markets, and reduces global growth.	**Low/Medium**	**Medium**	The exchange rate should be allowed to adjust. Disorderly market conditions can be countered with foreign exchange intervention. Rebuild fiscal buffers and oil savings by tightening fiscal rule if prices are lower, and structural reforms should be advanced to enhance economic efficiency and diversification.
Continued drop in domestic investment. Authorities pursue inward-looking policies. Lack of structural reform could lead to a decline in investment and TFP.	**Low**	**Medium**	Focus on structural and governance reforms to improve the investment climate. Avoid distortive measures and leverage the real exchange rate depreciation while increasing trade openness.

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

Annex IV. Key FSAP Recommendations[1]

Recommendations	Timing
Banking Stability	
Conduct an asset quality review (AQR) to ensure adequate bank capitalization (CBR).	ST/MT
Enhance stress testing practices (CBR).	MT
Liquidity Management	
Enhance framework to encourage banks to self insure and manage their risks in the market (CBR).	ST
Review FX repo framework, and formalize lender of last resort (CBR).	ST
Re-establish t-bill program and coordinate sterilization of excess liquidity (MoF, CBR).	ST
Ensure adequate realized capital through legal amendments as needed (CBR).	MT
Financial Sector Oversight and Regulation	
Require prior approval for banks' domestic investments in nonbank institutions (CBR).	ST
Issue specific requirements for management of banks' country and transfer risks (CBR).	ST
Upgrade framework for relations with and use of banks' external auditors (CBR).	ST
Strengthen further the legal framework applicable to related parties (CBR).	ST
Upgrade framework for prudential oversight of banks' operational risk (CBR).	ST
Bring securities and insurance regulation and supervision into line with international standards (CBR).	MT
Ensure the effective implementation of the AML/CFT framework (CBR, MoF).	ST
Macroprudential Policy	
Adopt legal changes to provide a comprehensive policy toolkit (CBR, MoF).	ST/MT
Crisis Management and Resolution	
Review the framework for the use of public funds to finance the DIA for resolution purposes, to be provided by the federal government. If it is necessary to use CBR funds, the federal government should provide an indemnity (CBR, MoF).	MT
Establish a funding mechanism for recovery of the costs of providing temporary public financing through levies on the financial industry (CBR, MoF).	MT
Introduce the full range of resolution powers and safeguards recommended by the FSB Key Attributes, including by implementing legal and operational changes needed to make purchase and assumption (P&A) an effective resolution tool (CBR, MoF).	ST
Banking Sector Development	
Promote legal reforms to increase state-owned commercial banks (SOB's) Board effectiveness (MoF, CBR).	MT
Continue gradual privatization of SOBs (MoF, CBR).	MT

[1]A list of all of the recommendations included in the Aide-Mémoire is in Annex 1. "ST–short term" is within one year; "MT-medium term" is one–three years.

INTERNATIONAL MONETARY FUND

RUSSIAN FEDERATION

June 14, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

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

CONTENTS

FUND RELATIONS

(As of June 2, 2016)

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

General Resources Account	**SDR Million**	**Percent Quota**
Quota	12,903.70	100.00
Fund holdings of currency	11,424.30	88.54
Reserve Position	1,479.41	11.46
Lending to the Fund	800.06	
New Arrangements to Borrow		

SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	5,671.80	100.00
Holdings	4,822.27	85.02

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	13,206.57	5,779.71
Of which SRF	07/20/98	03/26/99	3,992.47	675.02
Stand-by	04/11/95	03/26/96	4,313.10	4,313.10

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

	Forthcoming				
	2016	2017	2018	2019	2020
Principal					
Charges/Interest	0.3	0.62	0.62	0.62	0.62
Total	0.3	0.62	0.62	0.62	0.62

Implementation of HIPC Initiative: Not Applicable

Implementation of MDRI Assistance: Not Applicable

Exchange Arrangements: Effective November 10, 2014, the CBR eliminated its exchange rate corridor and canceled regular FX interventions, adopting a *de jure* and *de facto* floating exchange rate regime, with FX interventions conducted only to safeguard financial stability. The Russian Federation accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement with effect from June 1, 1996, *and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions*.

Article IV Consultation: Russia is on the standard 12-month consultation cycle. The last consultation was concluded on June 29, 2015.

FSAP Participation, FTE and ROSCs: Russia participated in the Financial Sector Assessment Program during 2016, and the FSSA report will be discussed by the Board at the time as the 2016 Article IV discussion. 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. Gabriel Di Bella, Resident Representative since July 15, 2015.

WORLD BANK GROUP RELATIONS[1]

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

[1] Prepared by the World Bank.

A. International Bank for Reconstruction and Development

The Russian Federation joined the World Bank (IBRD and IDA) in 1992. The Bank has provided financing for 70 projects in different sectors totaling slightly over US$10.5 billion in IBRD loans. About 95 percent of the total portfolio has already been disbursed. **IBRD's current portfolio of projects** amounts to US$636 million in the areas of public sector management, municipal infrastructure, cultural heritage preservation, financial literacy, hydro-meteorology, and forestry. The undisbursed balance is US$267 million as of May 2016. All of the Bank's financing in the portfolio is in the form of investment project financing.

Advisory Services and Analytics (ASA) are an important part of IBRD's engagement in Russia. ASA products are helping to modernize public finance and administration and improve social service delivery and the investment climate. The Bank also provides technical assistance in areas such as early childhood development, indigenous people, social development, and social accountability. In FY16, along with two traditional flagship Russia Economic Reports, the World Bank is planning to release a study on Connectivity and Inclusive Growth in Russia.

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

B. International Finance Corporation

Russia became an IFC member in 1993. Since then, IFC's long-term investments in Russia totaled US$10 billion, of which US$3.5 billion were mobilized from partners, across 263 projects.[2] As of May 2016, IFC's committed investment portfolio in Russia stood at US$1.0 billion in 65 projects with about 50 clients. Since the beginning of the current CPS period, IFC provided about US$2.0 billion of long-term financing to the clients in Russia, of which about US$800 million was mobilized from partners. In addition to the investment services, since early years of its operations in Russia, IFC has provided a wide range of advisory services to the Russian companies, financial institutions, and municipalities.

C. Multilateral Guarantee Agency

MIGA's gross exposure in Russia was US$437 million as of April 2016. MIGA is involved in five projects in the finance, infrastructure, and manufacturing sectors. In dollar terms, MIGA's exposure is concentrated in Russia's financial sector (some 75 percent of MIGA's gross exposure), supporting the investment of a French financial institution in its Russian subsidiary. In terms of the number of

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

projects, MIGA's exposure is concentrated in the manufacturing sector, geographically located in the greater Moscow area as well as Rostov Oblast.

STATISTICAL ISSUES

(As of June 2, 2015)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance. However, in the context of emerging data demands for assessing external vulnerabilities, the scope for further data improvements exists.
National Accounts: Data are broadly adequate for surveillance, but there have been concerns about the reliability and consistency of quarterly GDP estimates among a wide range of users, including Fund staff. The Federal State Statistics Service (Rosstat) started a national account development plan for 2011–17, which will expedite compilation of quarterly GDP estimates consistent with the annual GDP estimates. In April 2016, Rosstat released GDP estimates compiled according to the 2008 SNA; however, the data are only available from 2014. In addition, the data for 2011 to 2013 have been revised, but are compiled according to the 1993 SNA. The main changes introduced in the latter revised series include improvements in the estimation of the imputed rental services of owner-occupied dwellings and the use of the market value of assets to estimate consumption of fixed capital. The unavailability of balance sheet data continues to be an obstacle to analyzing balance sheet vulnerabilities; however, work is underway to disseminate the first quarterly sectoral accounts and balance sheets for 2012–14 by 2016.
Price Statistics: Monthly CPI and PPI, both compiled using the Two-Stage (Modified) Laspeyres (2000=100), cover all regions of the Russian Federation. The weights reflect expenditures in the 12 months ended the previous September. Aggregate price indices are compiled for each good and service item for the 89 regions, seven federal regions, and the Russian Federation as a whole. However, population weights, as opposed to expenditure shares are applied to the individual regional indices possibly biasing the CPI downwards if price increases are higher in regions with higher per capita expenditures. Detailed data on total annual sales, which are used to develop weights for the PPI, are published by economic activity on the Rosstat website. The detailed weights are available only on the Russian version of the website, making it less accessible to some users. Further efforts to improve the treatment of seasonal items in the core inflation index and a new household budget survey—which has been under consideration for some time—could significantly strengthen data quality.
Government Finance Statistics: The authorities compile comprehensive set of the general government accounts based on the *Government Finance Statistics Manual 2001 (GFSM 2001)* on annual basis. These data comprise the statement of sources and uses of cash as well as the accrual based government operations (revenue, expenditure and transactions in assets and liabilities), complete balance sheet (including non-financial assets), holding gains and losses and other changes in volume of assets and liabilities, and outlays by functions of government (COFOG). Monthly *GFSM 2001* based statement of sources of uses of cash is also compiled for the whole general government sector. In addition, the authorities have recently started reporting quarterly accrual based general government operation statement as well as financial balance sheet. Some gaps remain, for example the lack of historical quarterly data, unexplained data breaks (for instance the reclassification of some

wage expenses from the budgetary central government accounts to the regional government accounts (following 2011 reforms), unavailability of monthly data on ruble guarantees prior to 2011, no integrated debt monitoring and reporting system, and the lack of reconciliation between different datasets of fiscal reporting (budget execution, cash flow statement, economic versus functional classification, fiscal statistics data).
Monetary and Financial Statistics: In the context of the recent global turmoil, analysis of balance sheet effects has been hindered by a lack of comparable data on the currency and maturity breakdown of banking-sector assets and liabilities. Adoption of data reporting in the full detail of the framework for Standardized Report Forms (SRFs), as recommended by an STA mission in 2007 (and re-affirmed by the ROSC mission in 2010), would provide comprehensive information on the currency and instrument breakdowns of the assets and liabilities of the central bank, credit institutions, and other financial corporations. Since March 2011, the Banking System Survey (which is equivalent to the Depository Corporations/Broad Money Survey) published by the Central Bank of Russia (CBR) has included a breakdown of positions by national and foreign currency. Publication of a similar breakdown of positions by national and foreign currency in the central bank and the credit institutions surveys would be useful for analysis.
External sector statistics: Balance of payments data are broadly adequate for surveillance, and significant improvements have been made to enhance data quality. The CBR has recently published the gross capital flow data for the private sector, which would facilitate the analysis of relatively complex flows. Starting from 2012, the balance of payments is compiled according to the framework of the *Fund's Balance of Payments and International Investment Position Manual*, sixth edition (BPM6) and the CBR has revised historical data (going back to 2000Q1 for BOP, and to 2004Q1 for IIP), consistent with BPM6. Partial data from a variety of sources are supplemented by the use of estimates and adjustments to improve data coverage. In particular, the CBR makes adjustments to merchandise import data published by the Federal Customs Service to account for "shuttle trade," smuggling, and undervaluation. Statistical techniques are also used to estimate transactions and positions of foreign-owned enterprises with production sharing agreements, and these techniques are continuously being improved. At the same time, Russian compilers are seeking to reconcile their data with those of partner countries. Improvements have been made in the coverage and quality of surveys on direct investment, and the CBR is participating in the Fund's Coordinated Direct Investment Survey (CDIS) and Coordinated Portfolio Investment Survey (CPIS).
Financial sector surveillance: Russian reports all 12 core financial soundness indicators (FSIs) and 9 of the 13 encouraged FSIs for deposit takers on a quarterly basis with the exception of FSIs for earnings and profitability that are reported on an annual basis. In addition, 2 FSIs for households and 3 FSIs for real estate markets are reported on a quarterly basis. Data are reported for posting on the IMF's FSI website with more than one quarter lag.

II. Data Standards and Quality	
Russia is an SDDS subscriber since 2005. Russia participates in the G-20 Data Gap Initiative. Russia reports data for the Fund's statistical publications.	Data ROSC was published in 2011.

Russian Federation: Table of Common Indicators Required for Surveillance

(As of June 2, 2016)

	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	April 2016	5/13/2016	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	April 2016	5/13/2016	M	M	M		
Reserve/Base Money	March 2016	5/18/2016	D	W	W	O, O, LO, LO	O, O, O, O, O
Broad Money	March 2016	5/16/2016	D	M	M	O,O,LO,LO	O,O,O,O,O
Central Bank Balance Sheet	March 2016	5/18/2016	M	M	M	O,O,LO,LO	O,O,O,O,O
Consolidated Balance Sheet of the Banking System	March 2016	5/18/2016	M	M	M	O,O,LO,LO	O,O,O,O,O
Interest Rates[2]	April 2016	n.a.	M	M	M	O,O,LO,LO	O,O,O,O,O
Consumer Price Index	March 2016	5/10/2016	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	January 2016	6/01/2016	M	M	M	O, LO, LNO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	January 2016	6/01/2016	M	M	M	LO, LNO, LO, O	O, O, LO, O, NA
Stocks of Central Government and Central Government-Guaranteed Debt[5]	March 2015	5/18/2015	M	M	M		
External Current Account Balance	2015Q4	4/05/2016	M	M	M		
Exports and Imports of Goods and Services	2015Q4	4/05/2016	Q	Q	Q	O, O, O,LO	LO, O, O, O, O
GDP/GNP	2015Q4	5/13/2016	Q	Q	Q		
Gross External Debt	2015Q4	5/14/2016	Q	Q	Q	O, O, O, O	O, O,LO, O, LO
International Investment Position[6]	2015Q4	5/10/2016	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.