September 2008
IMF Country Report No. 08/309

Russian Federation: 2008 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion

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 2008 Article IV consultation with the Russian Federation, the following documents have been released and are included in this package:

- The staff report for the 2008 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 3, 2008, with the officials of the Russian Federation on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 10, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff statement of August 1, 2008, updating information on recent developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its August 1, 2008 discussion of the staff report that concluded the Article IV consultation.

The document listed below has been or will be separately released.

Selected Issues Paper

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

RUSSIAN FEDERATION

Staff Report for the 2008 Article IV Consultation

Prepared by Staff Representatives for the 2008 Consultation with the Russian Federation

Approved by Alessandro Leipold and G. Russell Kincaid

July 10, 2008

EXECUTIVE SUMMARY

Russia's economic recovery is gaining strength. Soaring oil prices, large capital inflows, and rapid financial deepening underlie a virtuous circle of strong growth in investment, productivity, real incomes and consumption. Catch-up gains in productivity are reinforcing the momentum.

But despite a strong supply response, inflation is rising sharply—well beyond increases in food and energy prices—as real domestic demand growth has reached 15 percent annually. Moreover, while the ruble is still undervalued, it is moving close to its equilibrium and competitiveness margins are narrowing.

The demand pressures reflect in part that fiscal policy is procyclical, and that the ruble peg continues to fuel rapid growth in money and credit. With private demand growth set to remain strong, and possibly accelerate, the rise in the non-oil fiscal deficit in 2008 implies further procyclical stimulus. At the same time, the peg against the dollar-euro basket will likely entail further monetary easing, as Russia's relative cyclical position vis-à-vis the US and the Euro area continues to strengthen.

In staff's view, the CBR would be best advised to refocus monetary policy on inflation reduction, allowing more exchange rate flexibility. Fiscal policy should preferably withdraw stimulus; at a minimum, a further increase in the non-oil fiscal deficit should be avoided, implying that the supplement to the 2008 budget should be reconsidered.

Absent policy corrections, domestically generated inflationary pressures risk increasing further. Over the medium-term, a continued pro-cyclical fiscal stance could cause the ruble to continue to appreciate apace in real terms, even as the current account swings into a deficit. With the ruble already close to its equilibrium, this points to the risk of the exchange rate overshooting its equilibrium path. It is, therefore, important to reduce the non-oil fiscal deficit from 2010, as planned in the medium-term budget, strictly adhering to the envisaged spending limits.

The financial sector is weathering the global turmoil well. But after years of fast credit growth and negative real interest rates, staff is concerned about vulnerabilities if a sharp monetary tightening becomes necessary. It should be a priority to improve the regulatory and prudential system as recommended by the FSAP update.

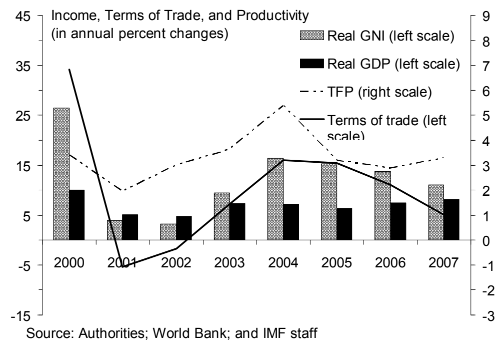
The government is determined to reinvigorate stalled structural reforms, focusing in particular on improving the investment climate. Plans are well-advanced and implementation should proceed expeditiously.

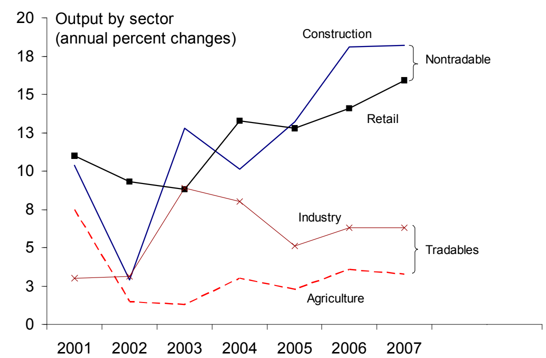
Contents Page

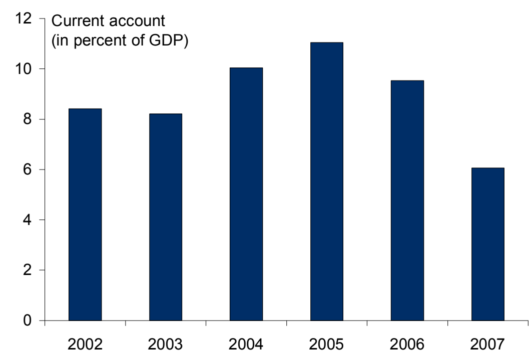
I. Summary

1. **Rising investments are increasingly propelling GDP growth and are helping Russia to realize its catch-up potential.** Returns on investment are high—reflecting the scarcity of capital—and surging oil prices, large capital inflows, and a steady deepening of financial markets are providing investors with the financing and retained earnings needed to take advantage of this. The resulting rise in investment, and the associated reallocation of labor to more productive sectors, are unlocking catch-up gains in productivity. This is providing a further boost to growth in real incomes and consumption, which have already been buoyant for some time, owing to large terms-of-trade gains. Financial deepening is also reinforcing this process, by allowing households to take advantage of low indebtedness to borrow against expected future income gains.

2. **However, despite a strong supply response, surging domestic demand has been associated with signs of overheating.** Inflation has doubled during the last year and competitiveness margins have steadily been reduced, although staff estimates suggest that the ruble is still likely undervalued. The rising demand pressures reflect in part a fiscal policy that is becoming increasingly procyclical, and a fixed exchange rate policy that, in the face of rising oil prices and large capital inflows, has hampered monetary policy and resulted in very high money and credit growth.





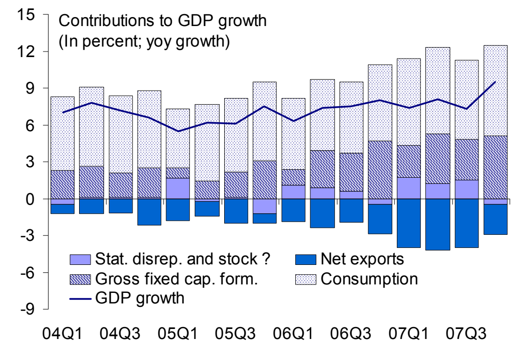


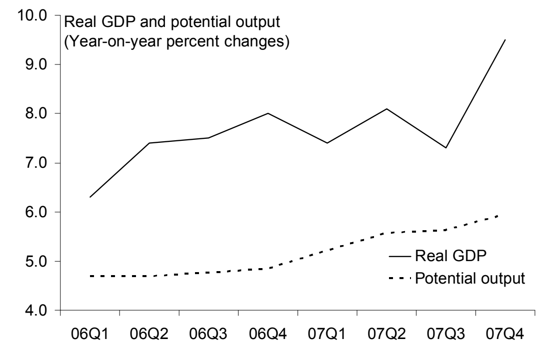
3. **Against this background, the key challenges are containing inflation pressures, preventing the exchange rate from overshooting it's equilibrium level, and further bolstering long-term GDP growth.** The related issues covered in this report include the appropriate stance of macroeconomic policies, the spillovers from the global financial turmoil, the need for reinvigorating the structural reform agenda, and potential vulnerabilities in the financial sector.

II. An Overheating Economy

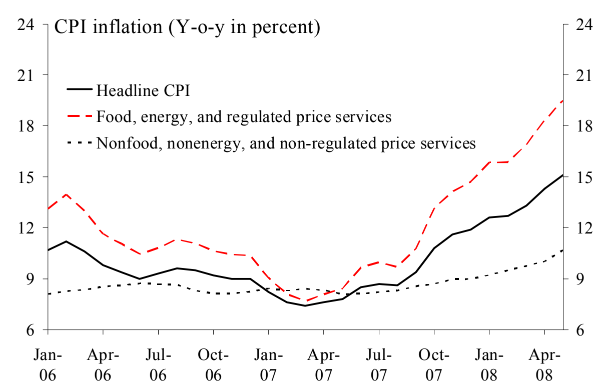
A. Recent Economic Developments

4. **Economic growth, while increasingly better balanced, is continuing to gain momentum, to well beyond potential** (Table 1). GDP growth accelerated sharply in the final quarter of 2007, to an annual rate of about 8 percent, and has maintained this momentum in the first half of 2008. Domestic demand growth has risen to an annual rate of 15 percent in real terms, reflecting higher oil prices and a notable fiscal relaxation, but also continued strong credit growth and capital inflows. Particularly noteworthy is the rising strength of investment, although consumption remains the main engine of growth—due to continued rapid growth in real wages and consumer lending. While the supply-side response is robust, GDP growth is running notably higher than both staff's and the authorities' estimates of potential of 5 ½ to 6 percent.[1] Tightening domestic resource constraints are reflected in higher prices, rising wages, and rapidly increasing imports relative to GDP.





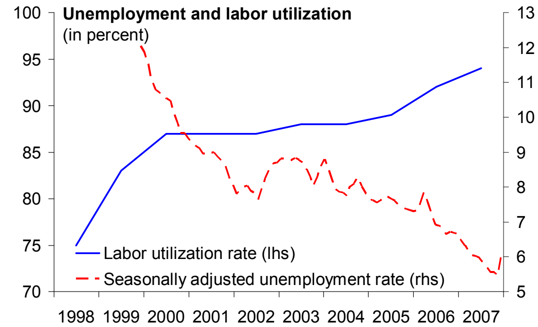
5. **Inflationary pressures are rising fast.** Headline inflation rose from 7.4 percent (year-on-year) in March 2007 to 15.1 percent in May 2008, significantly overshooting the end-2007 target of 8.5 percent. While the increase was initially spurred by rising food and energy prices, it is now beginning to extend to a broader range of goods and services. Estimated inflation of consumer prices excluding food, energy, and public services, which in recent years was broadly stable at about 8–8½ percent, has picked up since August 2007 and is currently running at 10.7 percent (year-on-year).



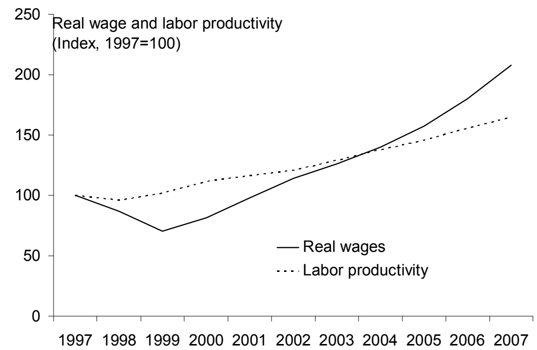
---

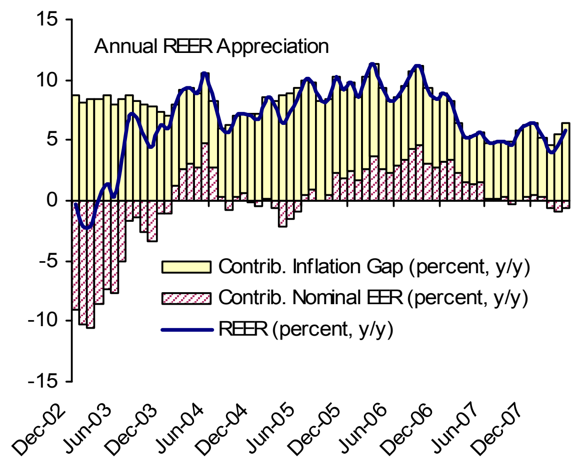
[1] Although current output growth is substantially above both staff's and the Russian authorities' estimates of potential growth, conceptual and statistical problems limit the usefulness of standard output-gap analysis in a structurally changing economy like Russia's.

6. **Labor markets continue to tighten, and accelerating real wage growth is pushing up unit labor costs.** Labor utilization rates have reached record highs and the unemployment rate continues to decline, with acute labor shortages in high-growth areas such as Moscow and St. Petersburg. For the economy as a whole, real wage growth has accelerated to an annual rate of 15 percent, well above productivity growth: unit-labor costs were up 5 percent in 2007, compared to an increase of 1.8 percent in 2006.



Source: Authorities; and REB.





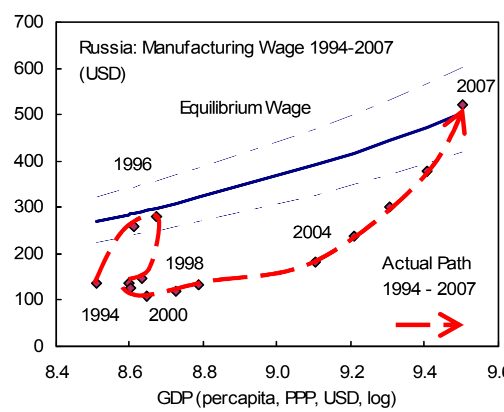
7. **The pace of real exchange rate appreciation has picked up again and the ruble is approaching its estimated equilibrium range.** After the switch to a less flexible exchange rate policy in 2006, the pace of real appreciation slowed initially, but accelerated anew as the attendant relaxation of monetary policy began to spill over into higher inflation. It has now reached 7 percent per year, reflecting the widening inflation differential between Russia and its trading partners; the nominal effective exchange rate has remained virtually unchanged since the third quarter of 2006. But despite the potential loss of competitiveness implied by the steady real appreciation, the manufacturing sector continues to perform well, growing by 10 percent year-on-year during the first five months of 2008. Staff estimates suggest, however, that competitiveness margins are narrowing and that the real effective exchange rate is now closer to its equilibrium range (Box 1).

8. **Despite surging imports and stagnant oil export volumes, the balance-of-payments surplus remains large, owing to rising oil prices and strong capital inflows**. While the volatility of inflows has increased as a result of the global turmoil, interventions in the foreign exchange market have remained high, and foreign reserves rose by US$145 billion in the year through end-May 2008, reaching US$549 billion. The main features of the balance of payments are as follows:

Box 1. Russia's External Competitiveness

Despite the rapid pace of real appreciation in recent years, Russia remains competitive. However, equilibrium-based indictors suggest that the undervaluation of the ruble—a salient feature over the post-1998 period—has narrowed significantly, and that the real exchange rate is now getting close to its equilibrium level, although a small margin still remains. Looking forward, transition-related productivity gains will result in a steady and sizable real appreciation over the medium term, without necessarily implying a deterioration in competitiveness. But, given the limited margin left, if the authorities maintain their current procyclical fiscal stance, there is a significant risk of the real exchange rate overshooting this equilibrium path, even if the current account swings into a deficit.

- Staff research suggests that Russia's **competitive edge in wages** has weakened over the past five years, and that the manufacturing wage is now consistent with Russia's underlying productivity. The finding is based on empirical estimates of the equilibrium manufacturing wage, which is modeled as a function of different measures of productivity and income (e.g., per capita GDP, human capital, share of agriculture, institutional indicators) in a cross-country panel-data framework.[2] Using the USD wage as a cost-based indicator of the real exchange rate, estimates suggest that an undervaluation of as large as 50 percent in 2002 had been mostly closed by 2007, reflecting rapid real appreciation over this period. These results are encouraging, in that there are no signs yet of above-equilibrium wages, which would suggest a "Dutch-disease" deterioration in competitiveness. However, over the near term, they point to the need to keep the pace of real appreciation under close review.



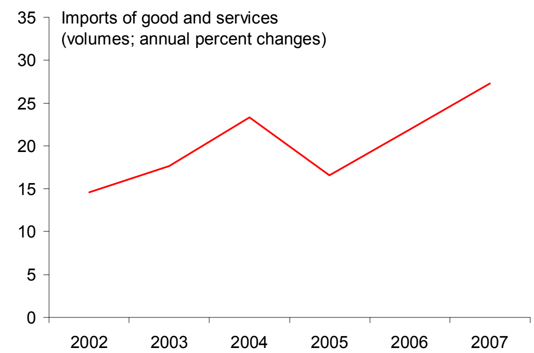
- The Funds' standardized **CGER exercise** also suggests that the undervaluation of the Ruble is narrowing, and that the currency is approaching its equilibrium value. Current estimates indicate that the extent of undervaluation ranges from 0-20 percent.[3] More specifically, the **equilibrium exchange-rate approach** agrees with staff's own finding that the ruble is now broadly line with Russia fundamentals, finding that the currency is overvalued by only about 2 percent. Alternatively, CGER's **external-sustainability approach** finds that the currency is *under*valued by 21 percent, implying that, presently, Russia could absorb further appreciation and run a reduced current-account surplus without necessarily leading to a worsening of its underlying net international investment position (NIIP). Currently, staff estimates suggest that Russia is an overall creditor, and that net assets are expanding rapidly. The **macroeconomic balance approach**, suggests that the currency is undervalued by 2 percent. This estimate is based on a medium-term current-account norm for Russia of 2.6 percent of GDP, which is in line with an estimated underlying current account balance of 3.1 percent of GDP in 2007. The latter is derived from the projected medium-term current account deficit after stripping away cyclical and temporary factors, and taking into account a real appreciation of about one-third. This real appreciation would lower the estimated underlying current account balance in 2013. Russia is still transitioning to a new, more market-based economy, and therefore the estimated current-account norm is expected to change; as Russia's business environment improves, investment opportunities will increase, reducing the current account norm. In addition, projected real appreciation in the base line is considered to be an equilibrium response to increased productivity, and owing to Balassa-Samuelson effects should not adversely impact competitiveness

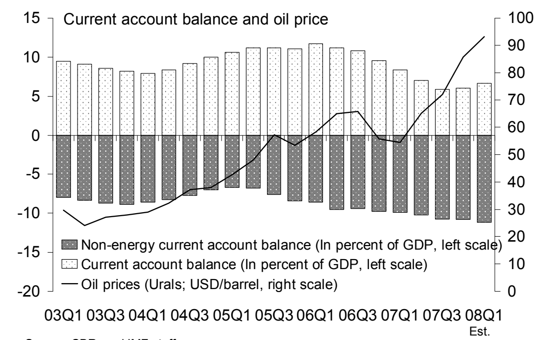
---

[2] Staff estimates are based on an update of the model presented in Krajnyák and Zettlemeyer (*IMF Staff Papers*, Vol.45), and subsequently applied in Ukraine (Country Report 05/20) and Romania (Country Report 06/169).

[3] These figures are from the most recent CGER exercise in February 2008. Updated figures are not yet available, but a 5-percent real appreciation over the past few months suggest that this range may now be around +5 to -15 percent.

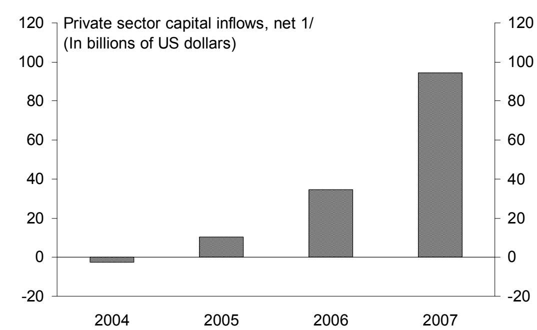
- **Import growth is driving a rapid increase in the non-oil current account deficit.** Reflecting the acceleration in domestic demand growth in the face of tightening resource constraints, import volume growth continues to rise rapidly and is now running at an annual rate of almost 30 percent. This, and the stagnation in oil export volumes since 2005, had until recently resulted in a notable decline in the headline current-account surplus, but this decline has been reversed, for now, by a renewed surge in oil prices. The current account balance in the year through March 2008 was 6.6 percent of GDP, up from a surplus of 6.1 percent of GDP in 2007.



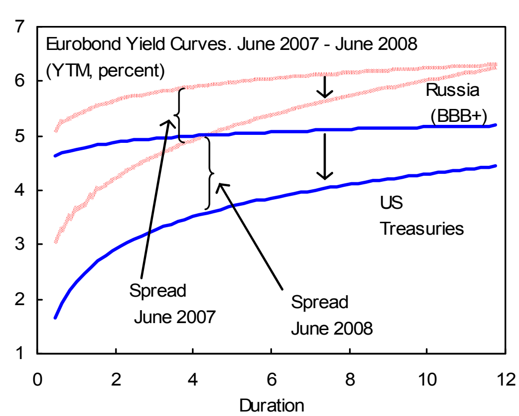


Source: CBR; and IMF staff

- **Capital inflows declined initially following the onset of the global financial turmoil, but are now recovering.** The increase in spreads following the turmoil led to a general delay of planned corporate Euro bond placements. However, the decline in overall capital inflows was mitigated by continued Euro bond issuances by a few state-dominated energy companies and banks; by increased recourse to the syndicated loan market, which saw less of an increase in spreads; by the continued strength of FDI; and, not least, by carry-trade inflows, reflecting the widening differential between Russian and foreign interest rates and, in particular, rising expectations of future ruble appreciation. The initial turnaround was exacerbated by exceptionally large inflows prior to the turmoil, owing to large share issuances by two state banks and substantial

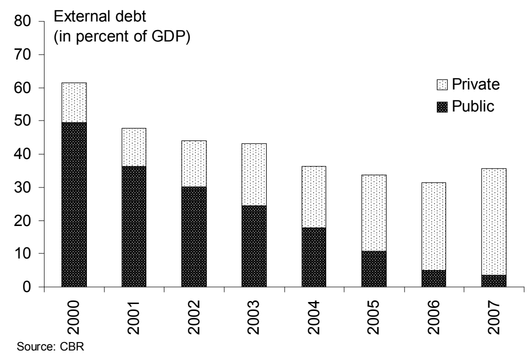


1/ Excluding errors and omissions, 2003-07



borrowing by a state oil company to finance purchase of Yukos assets. In recent months, Russian borrowers have returned to the Euro bond market in force, and capital inflows have largely recovered to pre-turmoil levels. In this regard, the rise in spreads has only had a limited impact on interest rates on U.S. dollar denominated bonds, especially for higher-rated state-owned entities, owing to the decline in dollar benchmark rates.

- **Private capital inflows have benefited from a significant reduction in external vulnerability and low sovereign spreads** (Tables 4 and 5). The trend decline in public-sector indebtedness in recent years has gone hand-in-hand with a sharp increase in private-sector debt, consistent with the private sector's falling savings-investment surplus. However, despite the increase in private-sector borrowing, total external debt has declined to a modest 35.2 percent of GDP, and is now exceeded by official foreign exchange reserves. While the private sector's overall access to foreign borrowing has benefited indirectly from Russia's reduced external vulnerability, low sovereign spreads are likely to have particularly helped large state-controlled enterprises, not least in the energy and banking sector, as they are perceived to enjoy implicit sovereign guarantees (borrowing by such enterprises is classified as private sector borrowing). The net international position, which was slightly negative in 2006 (-6 percent of GDP), is estimated to have turned to balance in 2007.



B. Economic Policies

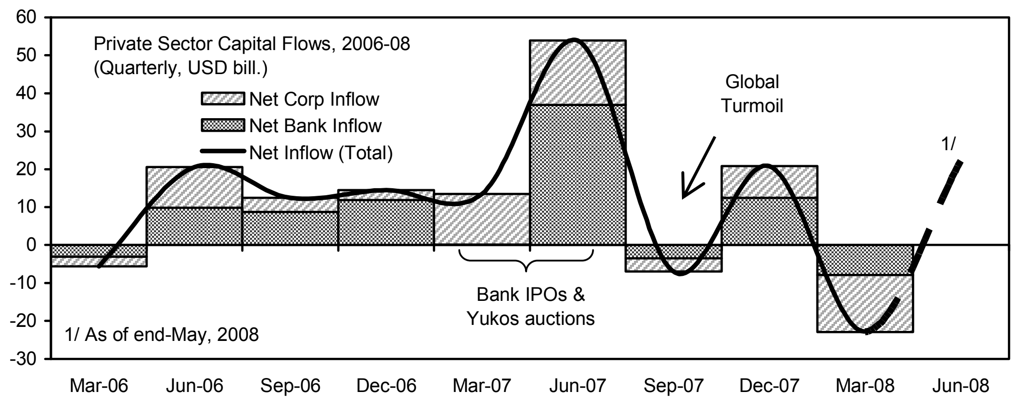
9. **Fiscal policy is adding to demand pressures**. Primary expenditures by the federal government rose by 15 percent in real terms, and the non-oil deficit—excluding a one-off collection of tax arrears from Yukos—rose by 0.8 percent of GDP in 2007, to 4.7 percent of GDP.[4] As spending was heavily back-loaded, fiscal policy provided a particularly strong stimulus towards the end of the year. The 2008 budget, including the recently proposed supplement, entails a further notable impulse, as the non-oil deficit of the federal government is set to increase for the fourth consecutive year, by 0.9 percent of GDP, to 5.6 percent of GDP.

[4] The non-oil balance is adjusted for a one-time receipt of tax arrears from Yukos. These payments were financed by borrowing from abroad.

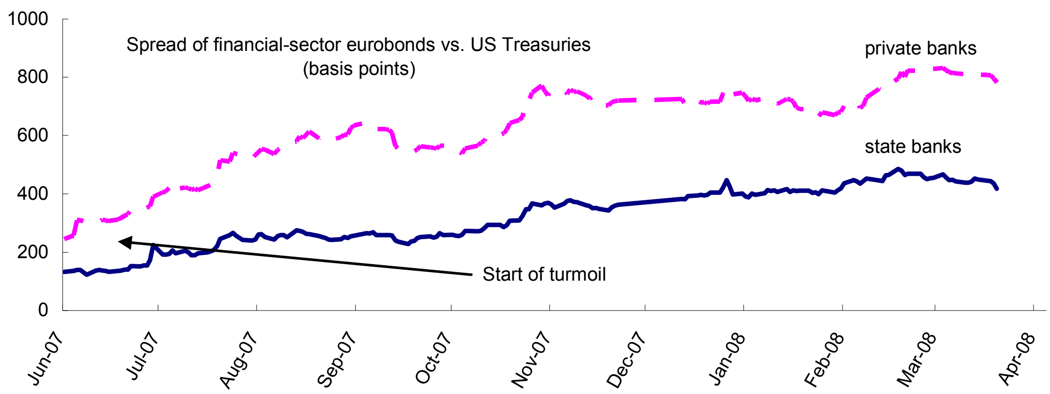
Figure 1. Russian Federation: Capital Inflows and Borrowing Costs, 2006-08

Despite the turmoil in global capital markets...

...inflows into Russia remain strong...

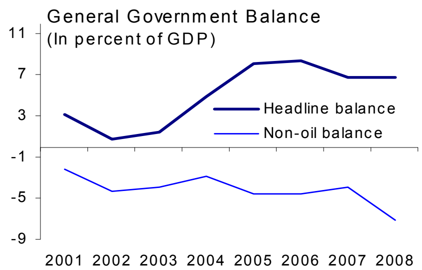


...but the public-private interest rate gap has widened.

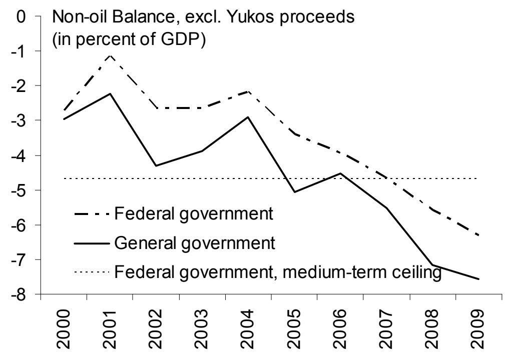


Source: CBR, Datastream, staff estimates.

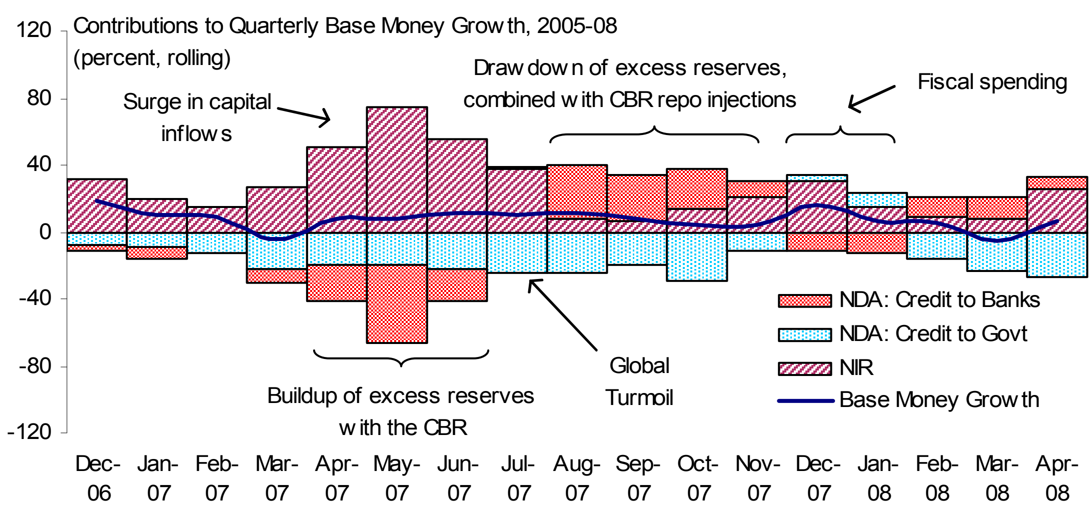
***One-off Yukos proceeds are masking the deterioration in the underlying non-oil balance*.**



Source: Authorities; and IMF staff calculations. 1/
1/ Projection based on 2008 federal budget, including supplementary budget.



10. **The fixed exchange rate policy continues to cause a lax monetary stance.** In defense of the de facto peg, strong capital inflows have required equally-large unsterilized interventions in the foreign-exchange market, which have in turn translated into excess liquidity in the banking system. Indeed, the interbank market was extremely liquid on the eve of the global financial turmoil. This reflected the bank IPOs and Yukos-related auctions in the first half of 2007, which resulted in substantial inflows and a dramatic surge in banks' excess reserves with the CBR. Following the onset of the turmoil in the second half of the year, therefore, this existing pool of reserves provided a significant cushion for the banking system as a whole, offsetting the impact of lower inflows on domestic liquidity. In addition, given Russia's fragmented interbank market and concerns that some smaller banks might run into liquidity difficulties, the CBR quickly stepped up its repo operations and broadened its list of eligible collateral for liquidity support when money market rates began to rise (Box 2). At present, Russia's banking system remains comfortably liquid, overnight interbank rates are at the lower end of the usual trading range, and CBR repo operations have been scaled back sharply. Recent CBR efforts to tighten monetary conditions, by raising interest rates and reserve requirements, will have only marginal impact on liquidity conditions.

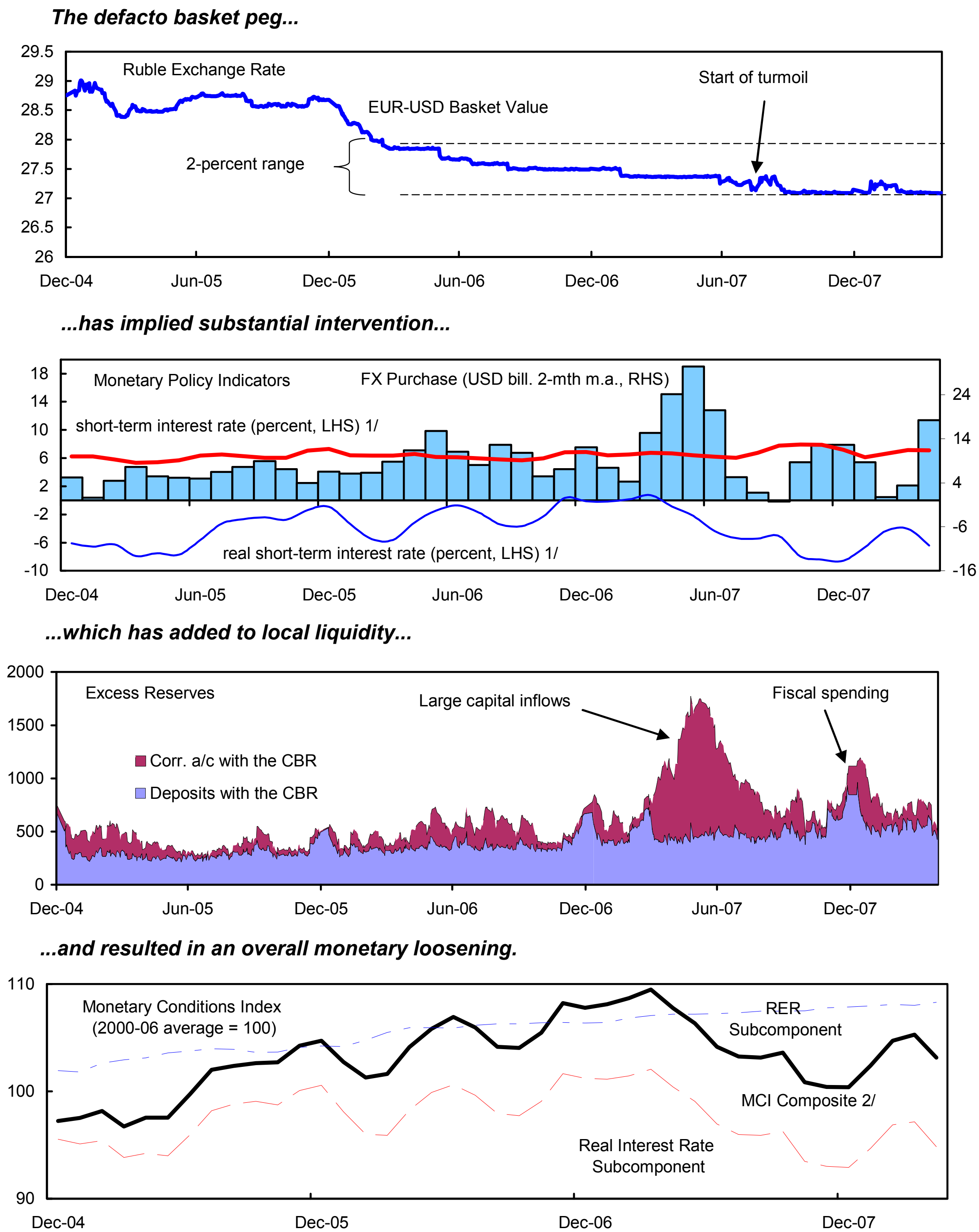


Box 2. Liquidity Support Measures, 2007–08

Over the past 9 months, the CBR has taken various steps to address liquidity pressures arising in large part from fluctuations in capital inflows following the onset of the global financial turmoil.

- The "Lombard list" of eligible collateral (the list of securities used for repo operations) was expanded by reducing the minimum acceptable rating to B+/B1. This is estimated to have provided access to an additional 160 billion rubles (US$6 billion) in support.
- Average haircuts on collateral were lowered from 19 percent to 10 percent.
- All required reserve ratios were reduced temporarily by 100 bps, for a term of three months (October 11, 2007–January 14, 2008). This is estimated to have provided an additional 100 billion rubles (US$4 billion) in support.
- The currency swap rate reduced from 10 percent to 8 percent, aligning it with the overnight direct repo and Lombard rates.
- A six-month term-lending facility, collateralized with bank loans, was tapped for the first time by a few banks (it had been available since 2005, but never exercised).
- The list of eligible collateral was further extended in February 2008 to include Eurobonds of Russian corporates, not traded publicly in Russia.
- An end-year surge in government spending also helped ease liquidity, including the capitalization of Russia's new development institutions.
- Starting in April, 2008, the government has offered to recycle a limited portion of its cash surplus, via a weekly series of one-month deposit auctions.

Figure 2. Russia: Monetary Policy, 2005-08



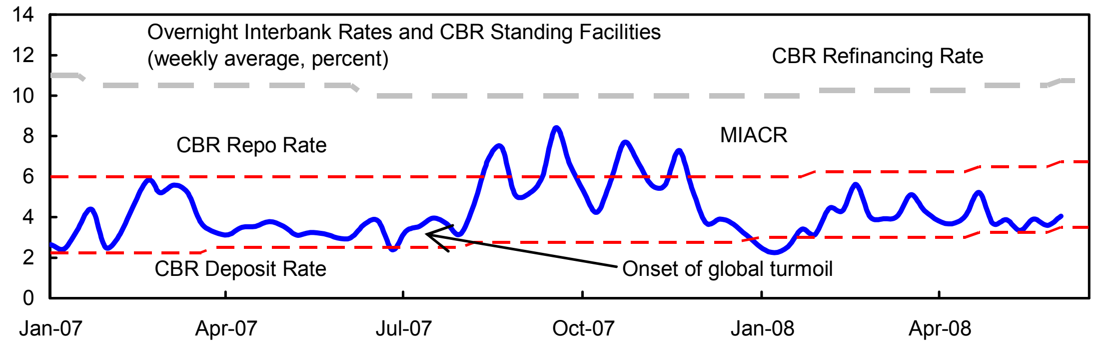
1/ 3-month MIBOR; real rate deflated by most-recent 3-month CPI inflation (annualized, s.a.)

2/ $MCI_t = MCI_{t-1} \times [1+(r_t - r_{t-1}) + a_t \times \log(REER_t / REER_{t-1})]$, where r_t is the real 3-month interest rate, and a_t is the time-varying average of the export and import-to-GDP ratios.

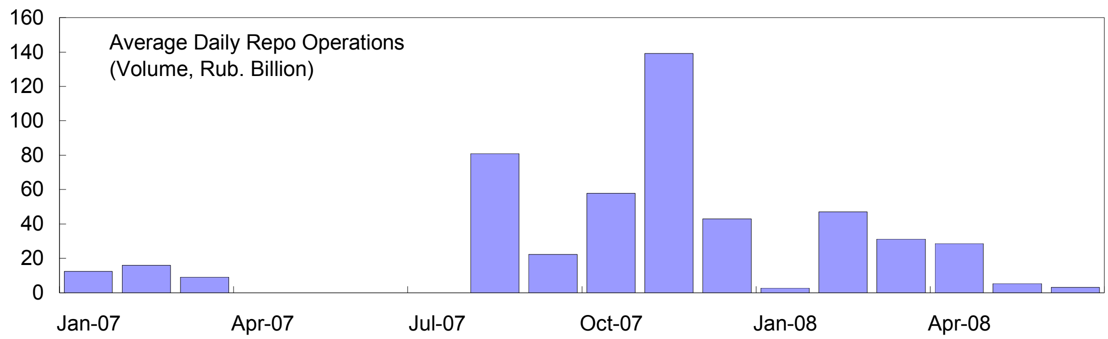
Sources: CBR, Haver analytics, and staff calculations.

Figure 3. Russia: Liquidity Operations, 2007-08

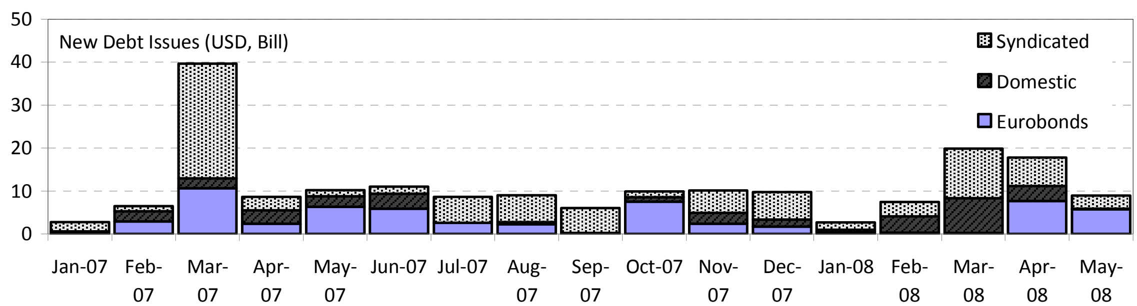
A tightening of liquidity following the global turmoil...



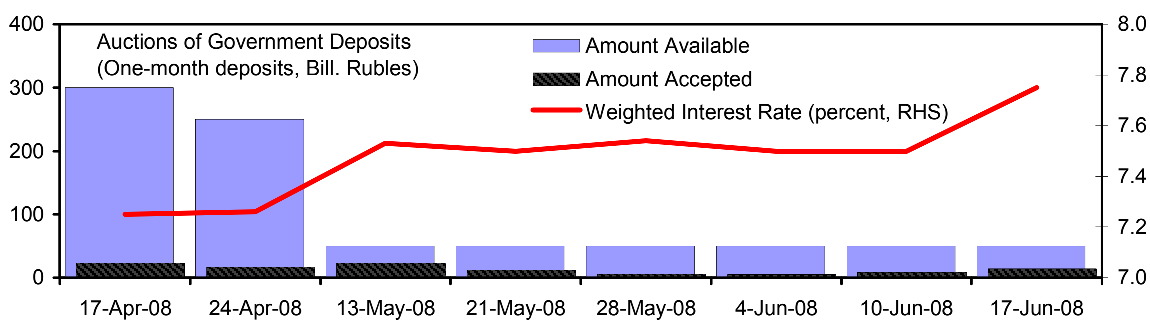
...resulted in large CBR liquidity injections in the second half of 2007...



...but a return of inflows in early 2008...



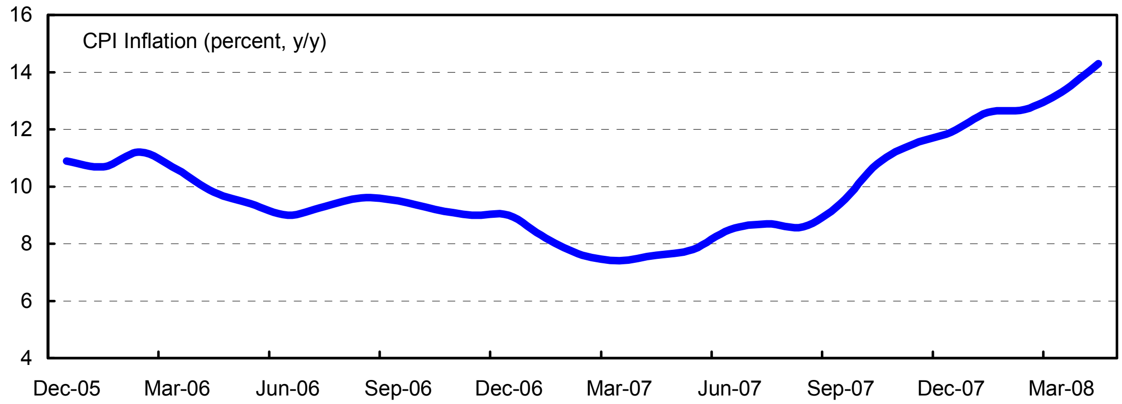
...has substantially eased local liquidity conditions.



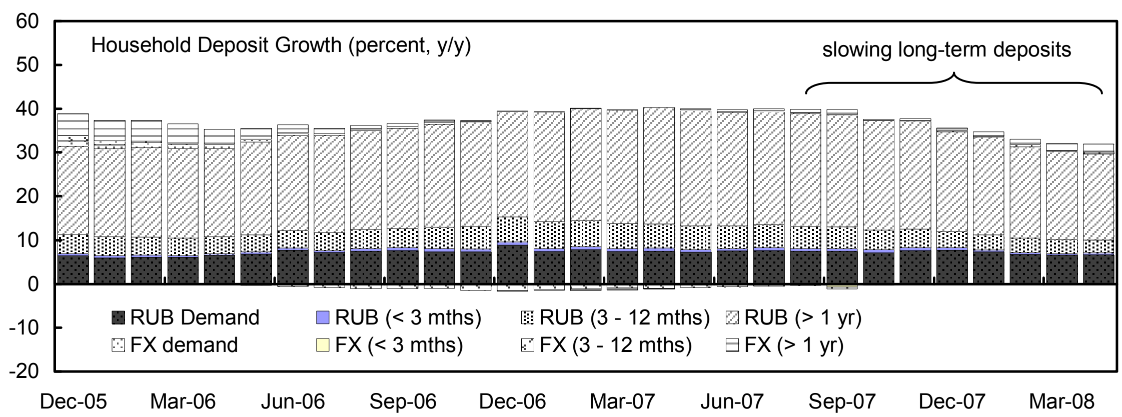
Source: CBR, Cbonds, staff calculations

Figure 4. Russia: Money Demand, 2006-08

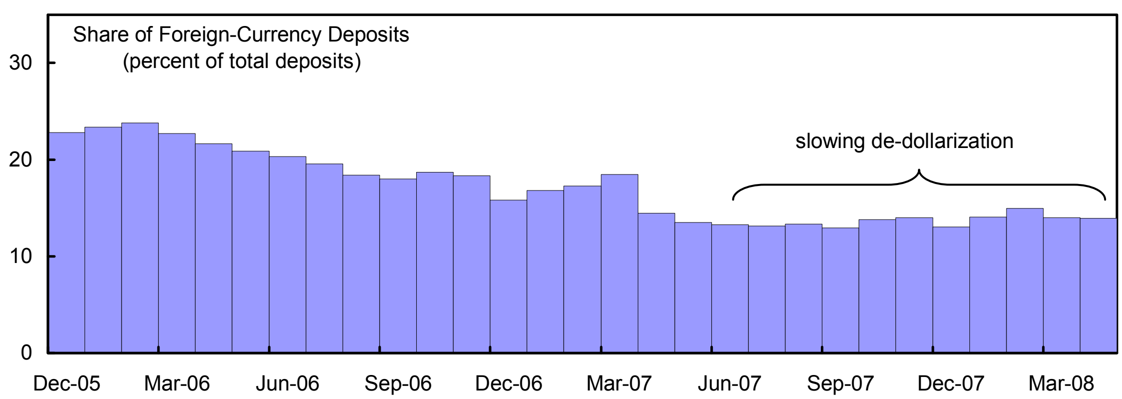
Rising inflation....



...is impacting money demand growth...

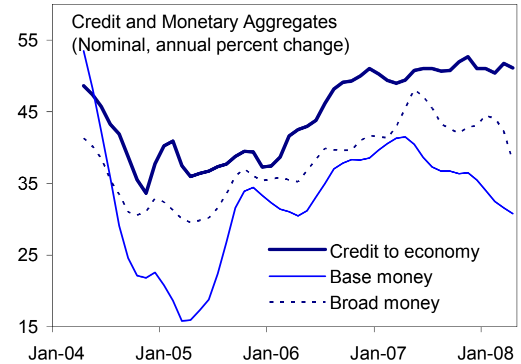


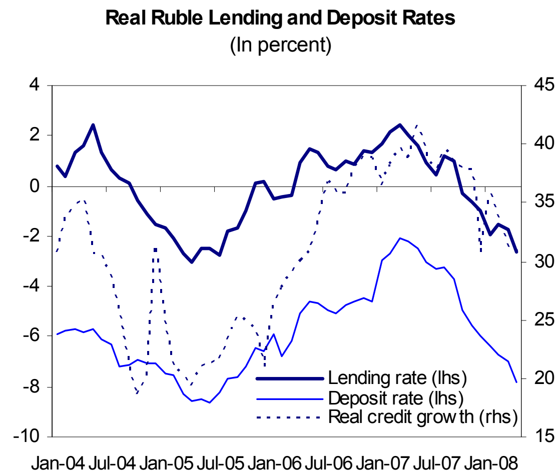
...and slowing the pace of remonetization.

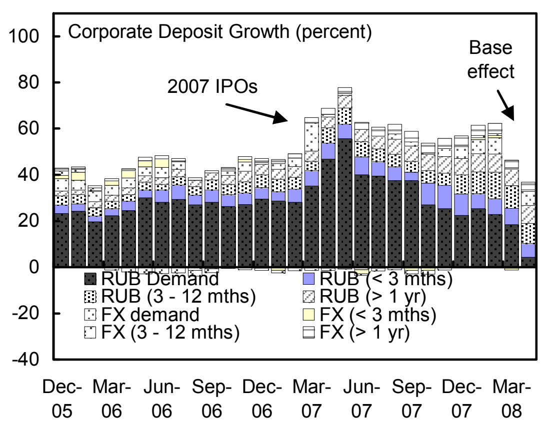


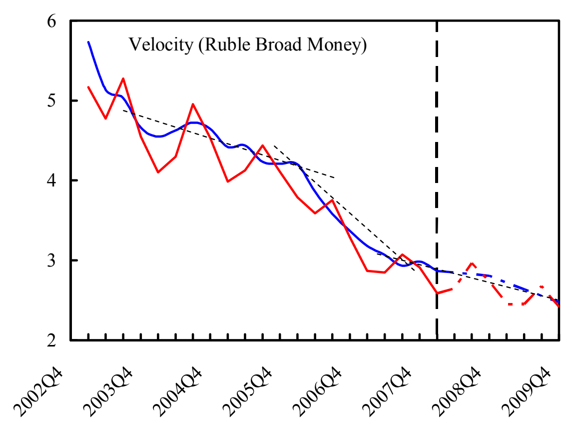
Source: CBR, staff calculations.

11. **Real interest rates have become increasingly negative, credit growth has remained very strong, and remonetization has begun to slow.** Real interest deposit rates have declined to minus 8 percent and average real lending rates to minus 4 percent. In line with this, credit has continued to expand at more than 50 percent year-on-year, and there is evidence that the decline in velocity is starting to slow. With still very limited demand for long-term ruble denominated assets, and with the global financial turmoil giving rise to concern about the availability of long-term foreign financing, private-sector calls for the government to place part of the stabilization fund's assets with the domestic banking system have been increasing.









III. OUTLOOK

12. **GDP growth is set to remain strong**. For 2008, the further fiscal relaxation, the terms-of-trade improvement estimated at almost 30 percent, and the limited impact of the global financial turmoil to date suggest that domestic demand growth will remain strong, and might possibly accelerate further. However, with growth already running well above estimated potential, and with a further significant real exchange rate appreciation in the offing, leakage through the balance of payments is expected to increase. In view of this, and taking into account base-effects, real GDP growth is expected to ease slightly in 2008, to 7¾ percent. Reflecting a considerable moderation in the terms-of-trade gains and a slightly lower fiscal impulse, growth is projected to slow further in 2009, to about 7¼ percent. This is still above estimated potential growth of about 6 percent. The unwinding of the headline surplus in the current account will revert temporarily in 2008 as a result of the very sharp recent increase in the terms-of-trade, before resuming in 2009. The non-energy current account deficit is projected to deteriorate further, albeit modestly, from 10.8 percent in 2007 to 11.9 percent in 2009.

Russian Federation: Key Economic Indicators

	2007	2008	2009
		projection	
	(in percent changes)		
Real GDP	8.1	7.8	7.3
Terms of trade	3.7	28.9	1.5
Inflation (e.o.p.)	11.9	14.1	13.5
World food price	15.2	18.2	-0.9
	(in percent of GDP)		
Current account	6.1	8.1	4.6
Energy exports	16.9	19.4	16.6
Non-energy current account	-10.8	-11.3	-11.9

Source: WEO; and staff calculations.

13. **The risks to growth are broadly balanced in the near term.** The outlook for oil prices is favorable and any impact from a decline will be largely absorbed by the automatic stabilizers built into the oil stabilization fund—which absorbs almost 85 percent of the change in revenues associated with changes in oil prices. The risk of a rapid unwinding of the large capital account surplus appears to have largely subsided with Russia continuing to weather the global financial turmoil relatively well. Indeed, it is possible that capital inflows will be stronger than in staff's baseline scenario. Looking beyond the next 6–12 months, the main downside risk to GDP growth stems—in staff's view—from the consequences of leaving inflation unchecked and the attendant possibility that monetary policy would have to be tightened significantly to bring inflation back under control.

14. **Inflationary pressures are likely to remain strong.** With strong growth and little remaining spare capacity, inflation is set to exceed the revised official end-year target of 10.5 percent by a wide margin in 2008.[5] Pressures on headline CPI inflation will likely ease somewhat in the second half of the year, as food price inflation moderates owing to a base effect from the second half of 2007. However, under the current mix of procyclical fiscal and accommodative monetary policies, there is a risk that domestically generated pressures could

[5] The original end-year inflation target was 9.5 percent.

increase, especially if the economy is buffeted by additional external price and demand shocks. All in all, staff projects inflation to be 14.1 percent by the end of 2008.

15. **The key medium-term challenge is to avoid a policy-induced overshooting of the real exchange rate and the current account.** With strong domestic demand causing imports to outpace exports by a wide margin, there is a risk of overshooting, especially in light of the procyclical fiscal stance. Under the staff's base-line medium-term scenario, which is based on announced fiscal policies and assumes a continuation of the fixed exchange rate policy, overshooting of the real effective exchange rate and the current account is avoided, but this depends critically on the government avoiding a procyclical fiscal stance, by adhering to the ceilings in the medium-term fiscal framework—which entails a gradual decline in the non-oil deficit starting in 2010 (Table 9). It also depends on the assumption that a reinvigoration of structural reforms will enable Russia to continue to realize considerable catch-up gains in productivity in the coming years. However, considering the recent experience, there is a risk that a prolonged period of above-trend oil prices might further weaken spending discipline in coming years and cause a continuation of procyclical fiscal policy. Staff's alternative medium-term scenario shows that, in the absence of medium-term fiscal consolidation, the real effective exchange rate and the current account balance are likely to overshoot their equilibrium paths (Table 10). This also points to a heightened risk of being forced to implement a procyclical fiscal tightening in the event of a sharp drop in oil prices in the future.

IV. THE POLICY RESPONSE

16. Against this background, the key economic policy issues confronting the Russian economy are how to (a) respond to the sharp rise in inflation, (b) avert the medium-term risk of the exchange rate overshooting its equilibrium path, and (c) address the vulnerabilities in the financial sector.

A. Fiscal Policy

17. **Further fiscal relaxation is in store for 2008.** The government has proposed a supplementary budget of 0.3 percent of GDP. This will add to the fiscal stimulus that is already implied by the 0.6 percent increase in the non-oil deficit contained in the original 2008 budget. Officials of the Ministry of Finance acknowledged that such a procyclical relaxation at a time when demand pressures are already strong would increase pressures on prices and the ruble. In this regard, they were concerned that calls for higher spending were mounting, not least because of the swelling of the oil stabilization fund. Overall, however, they felt that the incremental inflationary pressures

Russian Federation: Federal Government Budget, including preliminary supplementary 2008 budget

	2007	2008
	Actual	Staff proj.
	(in percent of GDP)	
Overall balance	6.2	6.7
Non-oil balance 1/	-4.7	-5.6
Memo item		
Oil price (Urals, USD bbl, period average)	64.3	109.7

1/ Excluding one-off revenues from the sale of Yukos assets.
Source: Authorities; and staff projections

would be manageable. Officials of the Ministry of Economy, who considered the economy not to be at risk of overheating at this juncture, did not feel that the ongoing fiscal relaxation would add to inflationary pressures.

18. **Looking to 2009 and beyond, Ministry of Finance officials expect the demand on public sector resources to increase as a result of important reforms.** In particular, the need to overcome serious infrastructure bottlenecks, improve the quality of public health service, and support pension reform will require substantial additional resources. However, while mobilizing the needed funds for such spending, Ministry of Finance officials felt that it would be important to adhere to the ceilings in the medium-term framework. The non-oil deficit was set to decline from 6.8 percent of GDP in 2008 to 4.5 percent of GDP in 2011. Taking into account the government's revenue and GDP projections, this implies a reduction in total spending by the federal government from 17.9 percent of GDP in 2008 to 16.6 percent of GDP in 2011 (Table 7). Other officials questioned these ceilings as they were generally less concerned about the inflationary effect of higher public spending, arguing that higher expenditure on infrastructure and structural reforms was necessary to boost Russia's long-run growth potential.

19. **Staff warned against further pro-cyclical fiscal stimulus.** It noted that, while the 2008 supplementary budget was relatively small, it entailed an additional fiscal impulse at a time when policy should ideally be withdrawing stimulus. Staff urged the authorities to reconsider the proposed supplementary budget, save any revenues above budgeted amounts, and underexecute the 2008 budget to the extent possible, as in previous years. For 2009, staff stressed that fiscal policy should aim to provide a counter-cyclical stimulus, but that, as a second best, the authorities should avoid a further 0.7 percent increase in the non-oil deficit, as implied by the approved medium-term budget.[6]

20. **Further fiscal relaxation over the medium term would heighten the risk of exchange-rate overshooting.** Staff stressed that absent a slowdown in domestic demand growth, upward pressures on the real effective exchange rate will persist and import growth will remain high. Staff, therefore, agreed with the Ministry of Finance that the ceilings in the medium-term budget should not be relaxed and that room should be created within the ceilings to accommodate higher spending on reforms and infrastructure. Staff noted that, in judging the impact of these projects, it is important to take into account that their impact on GDP growth will be slow in coming and that they, therefore, should not be expected to provide an immediate respite from resource constraints.

21. **Calls for a reduction in the general VAT rate or its outright elimination have intensified.** Officials at the Ministry of Economy felt that the VAT led to distortions,

[6] These estimates are based on lower growth in non-oil revenue in 2009 than projected by the authorities, and on the IMF staff classification of non-oil revenue.

hampering in particular exports and investments, and that it was too susceptible to fraud. While details remained to be worked out, they suggested a unification of the general and special rates at 12 percent, close to the estimated effective VAT rate of 11.4 percent.[7] They were confident that such a proposal would not entail a major revenue loss as it would increase the tax base by reducing incentives for tax evasion. This proposal was not supported by officials of the Ministry of Finance. While VAT administration should be improved—in particular the long delays in the payment of refunds—they saw no case for significant changes in the VAT, which was the least distortionary tax. Stressing that tax reform should be revenue neutral at this juncture, they argued that the focus should be on the corporate income tax. Staff supported the Ministry of Finance in its opposition to the proposed changes in the VAT and agreed with its priorities for tax reform. It urged the Ministry of Finance to take immediate steps to overcome the long delays in VAT refunds and noted that its calculations suggested that unification of VAT rates at 16 percent, combined with the elimination of exemptions, would be broadly revenue neutral.

22. **Staff welcomed the authorities' commitment to a good governance and transparency as far as the management of Russia's sovereign wealth funds (SWFs) is concerned.** Russia currently has two SWFs after the former oil stabilization fund was split into the Reserve Fund (RF) and the National Welfare Fund (NWF) in early 2008. The RF is capped at the equivalent of 10 percent of GDP and is invested (like the former stabilization fund) in liquid, triple A, sovereign or quasi-sovereign securities. The resources in the NWF will eventually be invested in somewhat more risky and longer-term assets than the RF; the NWF's investment strategy and risk management framework is still under consideration, and, its resources will remain invested in more liquid assets in the meantime. The authorities stressed they intend to follow the generally accepted principles and practices for sovereign wealth funds that are now being developed by the International Working Group of Sovereign Wealth Funds (IWG) with Russia's participation. Staff underscored the importance of Russia's active participation in the IWG.

B. Monetary Policy

23. **CBR officials were confident that the rise in inflation could be reversed without a more flexible exchange-rate policy.** Although they believed that the revised official end-2008 target of 10½ percent would be difficult to attain, they nonetheless considered that headline inflation would peak within the next few months and would decline significantly, reaching a low double-digit level by the end of the year. In this regard, they pointed out that: (i) the rate of broad-money growth had slowed over the first quarter of 2008, which would help curb inflationary pressures by the third quarter; (ii) recent measures to raise interest rates

[7] Currently, the general VAT rate is 18 percent and the special rate is 10 percent. Staff estimates of the effective VAT rate indicate that it increased from 11.4 percent in 2006 to 11.7 percent in 2007 (excluding one-off revenues from Yukos).

and reserve requirements would start to have an impact at around the same time; and (iii) global food-price inflation was expected to ease substantially over the second half of 2008. As for 2009, on the assumption of lower oil prices and continued strong import growth, an expected drop in currency inflows would ease upward pressure on the exchange rate, removing the need for continued large-scale liquidity injections through the foreign-exchange window. Also, CBR officials reaffirmed that they stood ready to raise reserve requirements more aggressively, in the event that banks were more liquid than deemed desirable.

24. **Nonetheless, as part of their transition to inflation targeting, exchange rate flexibility would gradually increase over time.** For the time being, the CBR would maintain tight control over the level of the currency basket. However, rather than intervening only at the edges of the bid-ask band, the CBR was also buying predetermined amounts of foreign exchange within the band. The immediate impact would be to add an element of day-to-day uncertainty, and so help discourage excessive speculation. Over the longer-run, as the pace of inflows slowed, a progressive widening of the band would allow a gradual step-by-step transition to a more freely-floating exchange-rate, and ultimately to an inflation-targeting framework. In this regard, the authorities confirmed their intention to move to inflation targeting within three years.

25. **Staff advocated substantially more exchange-rate flexibility.** It stressed that: (i) the current slowdown in money growth largely reflected a base effect from early 2007; (ii) recent efforts to tighten interest rates and reserve requirements had been marginal, and by themselves would have little material impact on inflation or inflationary expectations; and (iii) the prospects for a decline in inflation over 2008 depended largely on a hoped-for, but still uncertain, slowdown in external food-price inflation. Looking further ahead, with a procyclical fiscal relaxation in the pipeline, and with an apparent revival of capital inflows, staff cautioned that it would be a mistake to delay monetary tightening on the assumption that an unwinding of the current account surplus would ease appreciation pressures, thereby reducing the need for intervention. On the contrary, upward pressures on the currency would remain high, as long as buoyant private demand and an expansionary fiscal policy maintained GDP growth above potential. In this context, given the strength of Russia's economy relative to those of the United States and European Union, the de facto basket peg would become increasingly unsustainable, and it was thus a matter of urgency that the authorities should relax the peg and be able to set monetary policy independently, with a view to inflationary conditions in Russia. More generally, staff was concerned that, under current policies, Russia's inflationary path would continue to be largely determined by external events over which the CBR had no control.

26. **Staff agreed that an immediate move to formal inflation targeting may be somewhat premature at this stage.** But this did not preclude a more aggressive, less-formal focus on inflation. Moreover, it was noted that, from the experience of other central banks, it was not necessary to meet a stringent set of sophisticated preconditions before adopting the new framework. Instead, the key to success is an independent central bank—one that can

credibly commit to placing inflation ahead of other objectives. In this regard, to help anchor expectations, the CBR was encouraged to strengthen its communications strategy: providing a realistic assessment of current trends, clearly outlining its thinking and intentions, and demonstrating how its policy measures will bring prices back into line. At this stage, that would entail explaining that the end-year inflation target for 2008 would likely be missed, and would also entail outlining measures to bring inflation back on target by end-2009.

C. Financial Sector Issues

27. **There was agreement that the Russian banking system was weathering turmoil in global capital markets well**. The authorities confirmed that no bank has required direct support from the CBR—a few banks that relied heavily on foreign funding had faced increased strain, but these institutions have been able to restructure their balance sheets without much difficulty. Overall the banking system has proved reassuringly resilient, and depositor confidence remained high. Looking forward, the central bank has engaged in a close dialogue with Russian banks since September, focusing in particular on their contingency plans against a prolonged period of uncertainty. Refinancing requirements over the near term are not seen to present a problem, and banks appear to be well prepared for the next peak in repayments in the third quarter of 2008. Even in the event of protracted global turmoil, any individual difficulties would likely be dealt with easily by further capital injections, or possible consolidation. The authorities stressed that banking was still an attractive and expanding business in Russia, and that local owners could provide substantial additional funding if needed.

28. **Nonetheless, many financial vulnerabilities remain.** In view of extremely rapid credit growth, negative real funding costs, and a competitive focus on market share, discussions focused on the concern that Russian banks' may face limited incentives to prudently assess and manage risk. In the context of rising inflationary pressures, staff highlighted in particular concerns as to the potential impact of a sharp monetary tightening. The views of market participants and the authorities on this issue were mixed. Some considered that Russian banks, given their strong cash flows and high margins, would adapt to a new higher-cost environment without much difficulty. Others stressed that a significant increase in interest rates to positive real levels, for both deposit and lending rates, might take a more serious toll.

29. **In this context, staff stressed the importance of following up on the recommendations of the recent update of Russia's Financial System Stability Assessment (FSSA)**. The FSSA had found that, although the financial system and regulatory framework has strengthened, the system still faces notable risks (Box 3). The main near-term challenge is credit risk. Moreover, the update indicated that banks' resilience may be less than suggested by reported data and that, given the fragmented interbank market, liquidity risk might continue to present a problem in the event that private confidence weakens or foreign appetite for Russian exposure declines. In this regard, the update recommended that the authorities: strengthen loan classification and provisioning practices; enhance the CBR's

tools for managing interbank liquidity; and strengthen the framework for resolving problem banks at an early stage.

30. **The authorities concurred with most of the findings of the FSAP update (Box 3).** They disagreed, however, with the suggestion that loan classification and provisioning practices in Russia were problematic. They argued that CBR methodology and supervisory practice in this area is now more advanced, and more conservative, than it had been 4–5 years ago. The existing system worked adequately, and it was not clear that the FSAP recommendations would improve the situation in practice. The authorities agreed, however, on the importance of consolidated supervision, and noted that this would be a future priority.

D. Structural Reform and Long-Term Growth

31. **There was agreement that Russia's long-run growth prospects hinge on higher investment.** The authorities shared the staff's analysis that increases in capacity utilization and productivity have been the main sources of potential GDP growth in recent years, but that, with the economy virtually at full capacity, room for further increases in capital and labor utilization rates is very limited. Officials at the Ministry of Economy acknowledged that, while productivity growth may remain high for several more years, it will eventually slow as the scope for easy catch-up gains begins to wane. Against this background and because the contribution from labor force growth will remain limited, owing to Russia's ageing population, they felt that the key to sustaining strong potential growth was higher investment.

32. **To boost investment the new government is focusing on improving infrastructure and the investment climate.** The government is proposing increases in infrastructure spending, including through public-private partnerships, to address severe bottlenecks that are hampering long-run growth prospects. Moreover, President Medvedev has made a stronger investment climate a key priority and this will be reflected in the government's long-term development strategy. The broad objectives under consideration include strengthening the judiciary and tackling corruption, as well as a reinvigoration of reform of the civil service and public administration. Action plans in these areas will be decided in the coming months.

33. **Social sector reforms have also become a policy priority.** The authorities noted that the key reforms in this area are improving the quality of education and the health system, and strengthening the public pension system. They stressed that the latter reform was particularly pressing as the current replacement rate of 24 percent—which is already far below the lowest rate among OECD countries—is projected to decline to 17 percent by 2027 under current policies. Plans in these areas would also be finalized in the coming months.

Box 3. Key Conclusions of the 2007 FSAP Update

The FSAP update found that Russia's financial system has strengthened since the original assessment in 2003. This is a reflection of favorable economic conditions, growing confidence in the financial system, and a stronger legal and regulatory framework.

Nonetheless, the banking system still faces important risks.

- **The chief issue is credit risk**, which reflects Russia's rapid lending growth, especially to households. This is a high-risk segment owing to a combination of limited information on household borrowers, on the one hand, and banks' untested risk-management systems, on the other. In such an environment there is a danger that rapid credit expansion may conceal an unrecognized deterioration in asset quality. Also important is **liquidity risk**. Despite an expanding range of funding options, this is a concern for banks with limited or no access to the interbank market—these are typically smaller banks with a limited deposit base that could face problems if confidence weakens or foreign appetite for Russian exposure declines.
- **Market risk is less of a concern.** Although exposure has risen in some banks, with increased holding of securities, these remain small relative to risk-weighted capital. **Currency risk** is also limited. Banks maintain long open positions in foreign exchange, but unhedged positions are relatively small, so exposure is modest. **Interest rate risk** is potentially significant for some banks, but data limitations have prevented a detailed analysis in this area.

The update found that banks' resilience may be less than suggested by reported financial data. Capital ratios have fallen since 2003 as a result of strong asset growth, and reported capital appears to be overstated because of weaknesses in loan classification and provisioning—the adoption of more prudent provisioning would decrease capital by as much as 50 percent.

There is still scope for further strengthening of the financial system.

- The CBR's monitoring of systemic risk has improved, but internal coordination should be strengthened.
- The bank-resolution framework has been effective so far, but may face difficulties resolving medium-sized banks. The CBR lacks the authority to intervene at an early stage so as to minimize the cost of resolution and the disruption to creditors, including depositors.
- The regulatory and legal framework for capital markets has been fortified, but significant challenges remain in the rapidly expanding insurance sector.
- Implementation of Russian and international accounting and auditing standards is improving. However, additional measures are needed, including approval of new laws on consolidation, accounting, and auditing.
- Despite a dramatic expansion in recent years, the equity market remains highly concentrated in the ten largest companies.
- The FSAP update also concluded that the turmoil in global financial markets did not pose an immediate systemic threat to the banking system, but problems could arise if current conditions persist. With shallow domestic capital markets and retail deposits concentrated in the largest state bank, a prolonged period of limited access to foreign borrowing would further increase funding costs, exposing some banks to refinancing difficulties, and compressing profitability across the banking sector. Thus far, the banking system has shown considerable resilience, helped in part by strong cash flows and large liquidity injections by the central bank.

34. **Staff supported the government's reform priorities and welcomed the focus on raising investment.** It agreed that the key to higher investment is improvements in infrastructure and reforms to strengthen the business climate. It noted, however, that implementation of reform plans had stalled in may areas in recent years. While acknowledging the challenge to secure broad political support at a time when strong growth and high oil prices may cause complacency about the urgency of reforms, staff urged the authorities to take advantage of the new government's coming into office to advance implementation of reforms. It stressed that with reform plans well-advanced in many areas, early implementation should be feasible. Staff also called for measures to ensure greater investment in the oil and gas sector and, in this regard, welcomed the planned reduction in the mineral extraction tax and the step-wise liberalization of domestic gas prices. On social sector reforms, staff agreed with the urgency of pension reform and noted that its estimates showed that maintaining the replacement rate at its current level would require additional annual transfers to the pension fund averaging 1½ percent of GDP over 2008 to 2050.

35. **The authorities expected Russia to be able to join the WTO by early 2009.** They noted that progress is being made in addressing the remaining outstanding issues, which include export duties on timber, the treatment of state-trading companies, and budget support for agriculture. Staff stressed the importance of early accession to the WTO as it would as it would serve as a catalyst to strengthen change. It welcomed the expiration of the prohibitive export taxes on wheat and other grains as of July 1, 2008 and urged the authorities to refrain from new measures that would limit international trade in food staples.

V. Staff Appraisal

36. **Russia's economic expansion is gaining strength.** Soaring oil prices, large capital inflows, and rapid financial deepening are providing the impetus for a virtuous circle of strong growth in investment, productivity, real incomes and consumption. Momentum is being boosted further by high returns on investment owing to the scarcity of capital; by continued scope for catch-up gains in productivity, not least by reallocating existing factors of production to more productive sectors; and by the still low financial leverage. Thus, while the commodity price boom remains an important propellant of economic growth, the strength of investment is increasingly underpinned by other, endogenous factors, suggesting that the economic expansion is becoming more resilient.

37. **The recovery owes much to prudent management of oil revenues.** The ruble has appreciated steadily in real terms, but this is unavoidable, indeed desirable, in view of Russia's large terms-of-trade and productivity gains. As to be expected, growth is led by nontradable sectors, but there are no strong signs so far that the tradable sector has become uncompetitive, although margins have been reduced. Crucial in this regard has been the policy of saving most of Russia's oil revenue windfall in the stabilization fund, which has prevented excessive real appreciation. With the budget balanced at an oil price of less than half the current world market prices, and with close to 85 percent of marginal earnings absorbed by the stabilization fund, Russia is indeed well protected against even a sharp drop

in oil prices. This is another aspect of the recovery's resilience often overlooked by the contention that Russia's success is merely an oil story.

38. **But the risk of overheating is rising owing to an expansionary macroeconomic policy mix.** Despite the economy's strong supply response, inflation now extends well beyond what can be explained by global increases in food and energy prices, which is not surprising considering that domestic demand has been booming at unsustainable annual rate of 15 percent in real terms. However, rather than reducing demand pressures, procyclical fiscal policy and an exchange rate policy geared towards resisting appreciation through unsterilized interventions are exacerbating such pressures. For a number of years, this policy mix has made it difficult for the authorities to bring down inflation decisively, despite the benefits of rapid remonetization and large productivity gains. Now, it is undermining their ability to arrest and reverse rapidly increasing inflation as the economy is being jolted by imported food price shocks, sharply accelerating domestic demand, and monetary easing abroad.

39. **The policy mix leaves Russia exposed to the risk of inflation being buffeted by future external developments beyond the authorities' control.** The targeted reduction in headline inflation by end-2008 hinges mostly on a possible, but uncertain, deceleration in the growth of global food prices. Similarly, the assumed reduction in inflation next year depends to a large extent on the assumption that an unwinding of the current account surplus—because of lower oil prices and continued rapid import volume growth—will begin to reduce pressures on the ruble and, therefore, the need for unsterilized interventions. But such pressures will remain high, even as the current account swings into a deficit over the medium term, as long as buoyant private demand and procyclical fiscal policy maintain GDP growth above potential. There is thus a need for a stronger monetary tightening and a more prudent fiscal stance aimed at containing domestically generated inflationary pressures.

40. **Monetary tightening will require greater exchange rate flexibility**. The policy of pegging the ruble to a dollar-euro basket is becoming increasingly inflationary, as Russia's cyclical position continues to strengthen relative to that of the U.S. and the euro area. With the liberalization of capital controls, exchange rate flexibility is likely to be unavoidable in order to ensure an independent monetary policy, calibrated with a view to inflationary pressures in Russia. In this regard, raising reserve requirements is not a sustainable substitute for exchange rate flexibility, in part because this instrument will encourage financial disintermediation if used too aggressively. Meanwhile, the increasing tensions between the authorities' inflation and exchange rate targets is exacerbating capital inflows, as the market expects that the latter will eventually give way to the former. Scaling back interventions and permitting ruble appreciation is necessary not only in order to set inflation on a sustained downward path, but also to guard against the risk that further exogenous shocks feed into additional price increases. And doing so soon would reduce the risk of higher inflation expectations getting entrenched.

41. **Additional fiscal stimulus should be avoided**. While the bulk of oil and gas taxes are still being saved, the steady increase in the non-oil deficit has entailed adding stimulus just as private demand has become more buoyant. This procyclical fiscal stance shifts more of the burden of demand management onto a monetary policy already somewhat hamstrung by political and social resistance to appreciation. And with little evidence of broad support for substantially greater exchange-rate flexibility, this further unbalancing of the macroeconomic policy mix will most likely increase inflationary pressures in the near term. In view of this, the authorities are best advised to prevent a further increase in the non-oil deficit in 2008–09, suggesting that the decision to supplement the 2008 budget should be reconsidered.

42. **Continued procyclical policy is a threat to competitiveness**. While staff estimates suggest that the ruble is approaching its equilibrium level, margins have been reduced in as much as the ruble has steadily become less undervalued. This points to the risk that a continuation of the increase in the non-oil fiscal deficit, in face of very buoyant domestic demand, could cause the real exchange rate and the external current account deficit to overshoot their equilibrium levels. Under the assumption that the authorities will adhere to their plans for a reduction in the non-oil deficit from 2010, staff believes that the ruble will remain within its equilibrium range over the medium term, despite the still relatively fast real appreciation expected over 2008–09. Failure to adhere to these plans would, however, most likely prompt the ruble to overshoot its equilibrium path, as would the slowdown in productivity growth that would likely result over the medium term if reforms were not reinvigorated as planned.

43. **Vulnerabilities in the financial sector remain a concern.** The sector has weathered the recent global financial turmoil well and it is encouraging that both CBR officials and leaders of key financial institutions are confident about its ability to withstand further turmoil. This is in line with the finding of the FSAP update that the financial system, including the regulatory and supervisory system, has strengthened significantly since the original FSAP. But this progress notwithstanding, concerns remain that, after years of negative real interest rates and extremely fast lending growth, a significant increase in real interest rates, in the event that the CBR is forced to undertake a sharp monetary tightening would take a significant toll on the banking system. It should accordingly be a priority to further improve the regulatory and prudential framework as recommended by the FSAP update. Most importantly, loan classification and provisioning standards should be strengthened and legal amendments should be finalized to allow effective consolidated supervision.

44. **The government's focus on improving the investment climate is most welcome.** Raising investment is key to sustaining strong potential GDP growth in Russia, and will need to be supported by the elimination of infrastructure bottlenecks and the promotion of a favorable investment climate. The broad outline of the government's long-term development strategy and policy priorities are encouraging, and are appropriately focused on strengthening

the judiciary and tackling corruption. Plans to reinvigorate reform of the civil service and public administration are also important for the investment climate. In several of these areas, plans have been well-advanced for some time, which should make early implementation feasible.

45. **It is recommended that the next Article IV consultation take place on the standard 12-month cycle**.

Table 1. Russian Federation: Selected Macroeconomic Indicators, 2004–09

	2004	2005	2006	2007	2008	2009
	Actual				Proj.	
	(Annual percent change)					
Production and prices						
Real GDP	7.2	6.4	7.4	8.1	7.8	7.3
Consumer prices						
Period average	10.9	12.7	9.7	9.0	14.6	13.8
End of period	11.7	10.9	9.0	11.9	14.1	13.5
GDP deflator	20.1	19.2	15.7	13.5	24.5	14.8
	(In percent of GDP)					
Public sector						
General government						
Overall balance	4.9	8.2	8.3	6.8	6.8	4.4
Revenue	36.6	40.9	39.5	40.2	40.7	39.2
Expenditures	31.7	32.8	31.2	33.4	33.8	34.8
Primary balance	6.1	9.1	9.1	7.4	7.3	4.9
Nonoil balance	-2.9	-4.6	-4.5	-3.9	-7.2	-7.6
Nonoil balance excl. Yukos 1/	-2.9	-5.1	-4.5	-5.5	-7.2	-7.6
Federal government						
Overall balance	4.3	7.5	7.4	6.2	6.7	4.3
Nonoil balance	-2.2	-2.9	-3.9	-3.1	-5.6	-6.3
Nonoil balance excl. Yukos 1/	-2.2	-3.4	-3.9	-4.7	-5.6	-6.3
	(Annual percent change)					
Money						
Base money	24.9	31.7	39.6	33.1	31.4	28.3
Ruble broad money	35.8	38.6	48.8	47.5	42.6	38.5
	(Annual percent change)					
External sector						
Export volumes	10.5	4.7	5.8	4.6	5.2	5.4
Oil	11.3	3.2	0.3	5.4	2.2	2.2
Gas	5.5	3.7	-2.5	-5.4	1.0	-1.5
Non-energy	11.2	6.9	18.2	7.3	13.4	14.7
Import volumes	21.3	18.3	24.0	26.0	29.3	24.0
	(In billions of U.S. dollars; unless otherwise indicated)					
External sector						
Total merchandise exports, fob	183.2	243.8	303.6	355.5	522.4	561.6
Total merchandise imports, fob	-97.4	-125.4	-164.3	-223.4	-312.9	-389.6
External current account	59.5	84.4	94.4	78.3	150.1	106.4
External current account (in percent of GDP)	10.1	11.0	9.5	6.1	8.1	4.6
Gross international reserves						
In billions of U.S. dollars	124.5	182.2	303.7	476.4	660.7	828.8
In months of imports 2/	11.4	13.3	17.4	20.2	20.5	20.9
In percent of short-term debt	198	161	175	281	377	442
Memorandum items:						
Nominal GDP (in billions of rubles)	17,048	21,625	26,880	32,987	44,270	54,546
Nominal GDP (in billions of U.S. dollars)	592	764	989	1,290	1,855	2,306
Exchange rate (rubles per U.S. dollar, period average)	28.8	28.3	27.2	25.6	23.9	23.7
World oil price (U.S. dollars per barrel, WEO)	37.8	53.4	64.3	71.1	116.5	125.0
Real effective exchange rate (average percent change)	7.8	8.7	9.5	5.7	6.1	7.0

Sources: Russian authorities; and Fund staff estimates.

1/ Excludes on-off tax receipts from Yukos in 2007.
2/ In months of imports of goods and non-factor services.

Table 2. Russian Federation: Balance of Payments, 2004-09
(In billions of U.S. dollars, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009
					Proj.	
Current Account	59.5	84.4	94.4	78.3	150.1	106.4
Trade Balance	85.8	118.4	139.3	132.0	209.6	172.0
Exports	183.2	243.8	303.6	355.5	522.4	561.6
Non-energy	83.0	94.9	112.8	136.9	162.6	179.8
Energy	100.2	148.9	190.8	218.6	359.8	381.8
Oil	78.3	117.2	147.0	173.7	293.4	322.6
Gas	21.9	31.7	43.8	44.8	66.5	59.2
Imports	-97.4	-125.4	-164.3	-223.4	-312.9	-389.6
Services	-12.7	-13.9	-13.7	-19.8	-17.1	-24.2
Income	-12.8	-19.0	-29.6	-30.4	-34.5	-30.6
Public sector interest (net)	-2.2	0.5	7.8	16.0	15.7	28.3
Other	-10.6	-19.4	-37.5	-46.4	-50.2	-58.9
Current transfers	-0.9	-1.0	-1.5	-3.5	-7.8	-10.8
Capital and financial account	-6.4	-11.7	6.9	84.2	34.2	61.7
Capital transfers	-1.6	-12.8	0.2	-10.2	-5.0	-5.0
Federal Government	-2.4	-9.0	-28.0	0.2	-8.9	-4.0
Portfolio investment	2.8	-1.6	-1.0	-3.9	-7.0	-2.8
Loans	-3.4	-18.3	-29.8	-5.2	-1.9	-1.2
Of which:						
Disbursements	0.7	0.5	0.7	0.4	0.0	0.0
Amortization	-4.9	-19.8	-26.5	-4.0	-1.9	-1.2
Other investment	-1.8	11.0	2.9	9.3	0.0	0.0
Local Governments	0.2	-0.3	0.2	-0.1	-0.4	-0.2
Private sector capital	-2.6	10.3	34.5	94.4	48.5	70.9
Direct investment	1.7	-0.7	9.2	6.8	9.3	12.1
Portfolio investment	-0.9	-3.3	8.8	9.7	6.0	9.5
Commercial banks	4.6	7.9	24.1	29.5	40.2	52.1
Corporations	16.2	40.9	16.8	88.2	44.7	50.8
Other private capital	-24.1	-34.6	-24.5	-39.9	-51.7	-53.7
Errors and omissions, net	-6.4	-8.3	7.5	-13.6	0.0	0.0
Of which : valuation adjustment	-2.4	3.8	-14.0	-23.7	0.0	0.0
Overall balance	46.7	64.4	108.7	148.9	184.3	168.1
Financing	-46.7	-64.4	-108.7	-148.9	-184.3	-168.1
Net international reserves	-46.9	-64.9	-107.5	-148.9	-184.3	-168.1
Gross reserves (- increase)	-45.2	-61.5	-107.5	-148.9	-184.3	-168.1
Net Fund liabilities	-1.7	-3.4	0.0	0.0	0.0	0.0
Purchases	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases	1.7	3.4	0.0	0.0	0.0	0.0
Arrears and rescheduling	0.2	0.6	-1.3	0.0	0.0	0.0
Memorandum items:						
Current account (in percent of GDP)	10.1	11.0	9.5	6.1	8.1	4.6
Gross reserves 1/	124.5	182.2	303.7	476.4	660.7	828.8
(in months of imports of GNFS)	11.4	13.3	17.4	20.2	20.5	20.9
(as a percent of short-term debt) 2/	198	161	175	281	377	442
(as a percent of public debt service)	371	550	2,882	4,249	11,072	14,704
Net private capital outflows (in percent of trade)	3.2	-0.5	-9.0	-13.9	-5.8	-7.5
World oil price ($barrel) (WEO)	37.8	53.4	64.3	71.1	116.5	125.0
Terms of trade (percent)	15.6	16.7	11.4	3.7	28.9	1.5
Public external debt service payments 3/	13.0	33.5	33.1	10.5	11.2	6.0
(percent of exports of goods and services)	6.4	12.5	9.9	2.7	1.9	1.0
Public external debt	105.6	82.1	48.6	46.4	37.1	32.9
(percent of GDP)	17.8	10.7	4.9	3.6	2.0	1.4
Private external debt (incl local gov't)	108.9	175.1	262.0	413.2	521.7	652.2
Total external debt	214.5	257.2	310.6	459.6	558.8	685.1
(percent of GDP)	36.2	33.7	31.4	35.6	30.1	29.7

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

1/ Excluding repos with non-residents to avoid double counting of reserves.
2/ Excludes arrears.
3/ Net of rescheduling.

Table 3. Russian Federation: Financial Soundness Indicators, 2002-08 1/
(In percent)

	2002	2003	2004	2005	2006	2007	2008 2/
Capital							
Regulatory capital to risk-weighted assets	19.1	19.1	17.0	16.0	14.9	15.5	15.3
Regulatory capital to risk-weighted assets (Top 30)	19.7	16.8	15.9	15.1	...	...	...
Asset quality							
Nonperforming loans to total gross loans	5.6	5.0	3.3	2.6	2.4	2.5	2.4
Sectoral exposures							
Sectoral distribution of loans to total loans							
Industry	36.7	33.3	28.0	22.1	20.5	18.3	18.2
Manufacturing	...	...	...	16.3	14.6	13.5	13.8
Extraction	...	...	...	3.5	3.9	3.1	2.7
Utilities	...	...	...	2.3	2.0	1.7	1.7
Agriculture	2.2	2.4	2.7	3.0	3.6	3.8	3.8
Construction	4.4	4.4	4.5	4.6	4.9	6.0	6.1
Trade and restaurants	21.6	20.6	18.8	23.9	19.6	18.0	18.3
Transport and communication	4.6	5.1	4.8	4.0	3.7	3.7	3.7
Others	22.4	22.7	24.9	22.8	21.3	23.3	23.0
Individuals	8.0	11.5	16.2	19.6	23.9	24.8	24.7
including House mortgages	…	…	0.5	1.0	3.0	5.1	5.5
Regions							
Russia	41.1	54.2	54.0	47.4	35.9	40.0	39.9
U.K.	23.4	9.0	6.6	13.0	21.5	23.3	19.5
U.S.	6.2	8.2	6.7	9.0	7.7	4.1	3.0
Germany	5.9	2.4	7.2	9.5	7.9	6.8	5.2
Austria	5.7	6.8	6.1	5.2	7.0	6.1	8.2
France	1.5	1.6	3.1	3.0	3.8	3.5	5.1
Italy	1.6	1.0	1.8	1.2	1.2	1.7	2.4
Others	14.5	16.8	14.5	11.7	15.0	14.4	16.7
Profitability							
Return on assets	2.6	2.6	2.9	3.2	3.3	3.0	0.7
Return on equity	18.0	17.8	20.3	24.2	26.3	22.7	4.8
Liquidity							
Liquid assets to total assets	39.1	36.1	30.4	27.4	26.8	24.8	23.9
Liquid assets to short-term liabilities	90.6	90.4	78.0	73.7	76.8	72.9	68.7
Market risk							
Net open position in foreign exchange to capital	18.5	8.4	5.8	5.8	5.3	3.6	3.5
Other FSIs							
Loan loss reserves to total gross loans	6.3	5.9	4.9	4.6	4.1	3.6	3.5
Large exposures to capital	228.6	241.0	242.8	239.9	240.6	211.9	211.2
Interest rate risk to capital	6.9	9.9	13.3	13.3	19.3	24.3	26.8
Net open position in equities to capital	11.7	12.4	12.6	14.4	20.4	10.8	10.4
Customer deposits to total (noninterbank) loans	24.8	27.2	27.9	28.5	27.3	25.6	…
Assets to GDP	38.3	42.1	41.7	44.8	51.9	61.0	…
Regulatory Capital to Assets	14.0	14.6	13.3	12.8	12.1	13.3	…

Source: Central Bank of Russia

1/ Credit and depository institutions
2/ Data for 2008 is as of April 1, 2008.

Table 4. Russian Federation: Indicators of External Vulnerability, 2003−07
(In percent of GDP, unless otherwise indicated)

	2003	2004	2005	2006	2007
Financial indicators					
Public sector debt 1/	31.6	23.1	14.2	9.1	7.3
Broad money (percent change, 12-month basis)	51.6	35.8	38.6	48.8	47.5
Private sector credit (percent change, 12-month basis)	46.6	46.7	34.2	48.5	48.5
Moscow InterBank Actual Credit Rate (MIACR, from 8-30 days, percent p.a. for rouble credits)	5.5	4.9	3.9	4.1	5.4
Moscow InterBank Actual Credit Rate (MIACR, from 8-30 days, percent p.a. for rouble credits, real)	-8.1	-6.0	-8.8	-5.6	-3.6
External Indicators					
Exports (percent change in US$)	26.7	34.8	33.1	24.5	17.1
Imports (percent change in US$)	24.8	28.0	28.8	31.0	36.0
Terms of Trade (percent change, 12 month basis)	12.4	15.6	16.7	11.4	3.7
Current account balance (in billions of US$)	35.4	59.5	84.4	94.4	78.3
Capital and financial account balance (in billions of US$)	2.1	-6.4	-11.7	6.9	84.2
o/w: Inward portfolio investment (debt securities etc.)	-2.3	4.4	-0.8	9.1	12.7
Other investment (loans, trade credits etc.)	5.4	-9.1	1.9	-2.4	81.7
Gross official reserves (in billions of US$)	76.9	124.5	182.2	303.7	476.4
Liabilities to the Fund (in billions of US$)	5.0	3.5	0.0	0.0	0.0
Short-term foreign assets of the financial sector (in billions US$)	13.4	14.8	20.9	33.4	42.7
Short-term foreign liabilities of the financial sector (in billions US$)	9.1	9.1	9.8	20.7	30.5
Foreign currency exposure of the financial sector (in billions US$)	0.0	0.0	1.9	-12.1	-18.9
Official reserves in months of imports GS	8.9	11.4	13.3	17.4	20.2
Ruble broad money to gross reserves	1.4	1.2	1.2	1.1	0.0
Total short-term external debt to reserves	81.8	91.1	95.1	55.8	36.8
Total external debt (in billions of US$)	186.0	214.5	257.2	310.6	459.6
o/w: Public sector debt (in billions of US$)	106.0	105.6	82.1	48.6	46.4
Total external debt to exports GS (in percent)	122.2	105.2	95.7	92.8	116.4
External interest payments to exports GS	5.8	5.5	4.6	4.8	5.5
External amortization payments to exports GS	20.2	19.6	21.7	23.2	30.3
Exchange rate (per US$, period average)	30.7	28.8	28.3	27.2	25.6
REER depreciation (-) (12-month basis)	3.0	7.8	8.7	9.5	5.7
Financial Market Indicators					
Stock market index 2/	567.3	614.1	1125.6	1921.9	2290.5
Foreign currency debt rating 3/	BB	BB+	BBB	BBB+	BBB+
Spread of benchmark bonds (basis points, end of period) 4/	257.0	213.0	118.0	99.0	157.0

Sources: Russian authorities; and Fund staff estimates.

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

Table 5. Russian Federation: External Debt Sustainability Framework, 2003-2013
(In percent of GDP, unless otherwise indicated)

		Actual					Projections						
		2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Debt-stabilizing non-interest current account 6/
1	**Baseline: External debt**	43.1	36.2	33.7	31.4	35.6	**30.1**	**29.7**	**29.9**	**30.7**	**32.0**	**33.7**	**-3.5**
2	Change in external debt	-1.0	-6.9	-2.6	-2.2	4.2	-5.5	-0.4	0.2	0.8	1.3	1.7	
3	Identified external debt-creating flows (4+8+9)	-16.7	-22.1	-19.1	-18.7	-15.1	-10.5	-6.9	-3.6	-1.5	0.0	1.2	
4	Current account deficit, excluding interest payments	-10.3	-11.9	-12.7	-11.2	-7.8	-9.2	-5.9	-3.2	-1.3	0.1	1.3	
5	Deficit in balance of goods and services	-11.3	-12.4	-13.7	-12.7	-8.7	-10.4	-6.4	-2.9	-0.9	0.4	1.5	
6	Exports	35.3	34.4	35.2	33.9	30.6	31.2	27.0	23.0	20.3	18.1	16.3	
7	Imports	23.9	22.1	21.5	21.2	21.9	20.8	20.6	20.1	19.3	18.5	17.8	
8	Net non-debt creating capital inflows (negative)	0.3	-0.3	0.1	-1.6	-1.7	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	
9	Automatic debt dynamics 1/	-6.7	-9.8	-6.6	-6.0	-5.7	-0.8	-0.4	0.1	0.2	0.4	0.4	
10	Contribution from nominal interest rate	2.0	1.9	1.6	1.6	1.7	1.1	1.3	1.7	1.8	1.8	1.9	
11	Contribution from real GDP growth	-2.6	-2.3	-1.8	-1.9	-2.0	-1.9	-1.8	-1.6	-1.5	-1.5	-1.5	
12	Contribution from price and exchange rate changes 2/	-6.2	-9.4	-6.4	-5.7	-5.4	...	...	...	...	...	...	
13	Residual, incl. change in gross foreign assets (2-3) 3/	15.7	15.2	16.5	16.5	19.3	5.0	6.5	3.9	2.3	1.3	0.5	
	External debt-to-exports ratio (in percent)	122.2	105.2	95.7	92.8	116.4	96.5	109.9	130.1	151.4	176.5	206.6	
	Gross external financing need (in billions of US dollars) 4/	10.3	6.7	3.8	21.0	95.9	19.2	69.0	146.2	221.4	299.1	393.9	
	in percent of GDP	2.4	1.1	0.5	2.1	7.4	1.0	3.0	5.2	6.7	7.6	8.5	
	Scenario with key variables at their historical averages 5/						**30.1**	**26.4**	**19.8**	**11.9**	**3.5**	**-5.1**	**-0.2**
	Key Macroeconomic Assumptions Underlying Baseline												
	Real GDP growth (in percent)	7.3	7.2	6.4	7.4	8.1	7.7	7.3	6.7	6.1	5.7	5.5	
	GDP deflator in US dollars (change in percent)	16.4	28.0	21.4	20.4	20.7	33.5	15.8	13.3	12.3	11.7	11.5	
	Nominal external interest rate (in percent)	5.8	6.0	5.8	6.3	7.0	4.6	5.5	7.0	7.1	7.1	7.1	
	Growth of exports (US dollar terms, in percent)	25.8	33.9	31.9	24.5	18.0	46.7	7.7	2.8	5.0	5.7	5.7	
	Growth of imports (US dollar terms, in percent)	22.2	26.6	25.7	27.3	35.1	36.8	23.1	17.8	14.6	13.3	12.7	
	Current account balance, excluding interest payments	10.3	11.9	12.7	11.2	7.8	9.2	5.9	3.2	1.3	-0.1	-1.3	
	Net non-debt creating capital inflows	-0.3	0.3	-0.1	1.6	1.7	0.5	0.5	0.5	0.5	0.5	0.5	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growt
ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (t

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.

Table 6. Russian Federation: Fiscal Operations, 2004-09
(In percent of GDP)

	2004	2005	2006	2007	2008	2009
				Prel. Est.	Proj.	Proj.
General government						
Total revenue	36.6	40.9	39.5	40.2	40.7	39.2
Of which : Oil revenue	7.8	12.7	12.9	10.7	14.0	12.0
Corporate profit tax	5.1	6.2	6.2	6.6	6.2	6.2
Personal income tax	3.4	3.3	3.5	3.8	3.8	3.8
VAT	6.3	6.8	5.6	6.9	5.5	5.6
Excises	1.4	1.2	1.0	1.0	1.0	1.0
Custom tariffs	5.0	7.5	8.3	7.0	9.0	8.0
Resource extraction tax	3.4	4.5	4.7	3.7	4.2	3.6
Social security taxes	7.3	6.7	5.4	5.6	5.6	5.6
Other revenue	2.1	2.7	4.9	5.6	5.4	5.4
Total expenditure	31.7	32.8	31.2	33.4	33.8	34.8
Interest	1.2	1.0	0.7	0.6	0.5	0.5
Non-interest	30.5	31.8	30.4	32.8	33.4	34.3
Primary balance	6.1	9.1	9.1	7.4	7.3	4.9
Overall balance	4.9	8.2	8.3	6.8	6.8	4.4
Non-oil primary balance	-1.7	-3.6	-3.8	-3.3	-6.7	-7.1
Non-oil overall balance	-2.9	-4.6	-4.5	-3.9	-7.2	-7.6
Non-oil balance excl. Yukos 1/	-2.9	-5.1	-4.5	-5.5	-7.2	-7.6
Federal government						
Total revenue	20.1	23.7	23.3	23.6	24.3	22.9
Of which : Oil revenue	6.5	10.4	11.3	9.2	12.3	10.6
VAT	6.3	6.8	5.6	6.9	5.5	5.6
Excises	0.7	0.5	0.4	0.4	0.4	0.4
Corporate profit tax	1.2	1.7	1.9	1.9	1.7	1.7
Custom tariffs	5.0	7.5	8.3	7.0	9.0	8.0
Other revenue	6.9	7.1	7.1	7.3	7.8	7.1
Total expenditure	15.8	16.2	15.9	17.4	17.6	18.6
Interest	1.1	0.9	0.6	0.4	0.3	0.3
Non-interest	14.7	15.3	15.3	17.0	17.3	18.3
Primary balance	5.4	8.4	8.0	6.6	7.0	4.6
Overall balance	4.3	7.5	7.4	6.2	6.7	4.3
Non-oil primary balance	-1.1	-2.0	-3.3	-2.6	-5.2	-6.0
Non-oil overall balance	-2.2	-2.9	-3.9	-3.1	-5.6	-6.3
Non-oil balance excl. Yukos 1/	-2.2	-3.4	-3.9	-4.7	-5.6	-6.3
Memorandum items:						
World oil price	37.8	53.4	64.3	71.1	116.5	125.0
Russian oil price	31.0	45.2	56.3	64.3	109.7	118.2
Russian oil price balancing the budget:						
General government	20.0	26.0	29.0	26.0	53.5	73.0
Federal government	17.5	21.5	26.0	23.0	50.5	70.0
Oil fund(s)	...	...	8.7	12.0	16.4	19.1
General government debt	23.1	14.2	9.1	7.3	7.8	8.4
Current account balance	10.1	11.0	9.5	6.1	8.1	4.6
Real GDP (percent growth)	7.2	6.4	7.4	8.1	7.8	7.3
CPI (percent growth; average)	11.7	10.9	9.7	9.0	14.6	13.8
GDP (billions of rubles)	17,048	21,625	26,880	32,987	44,270	54,546

Sources: Russian authorities; and Fund staff estimates.

1/ Excludes on-off tax receipts from Yukos in 2007.

Table 7. Russian Federation: Federal Government Budget, 2007-11
(In percent of GDP)

	2007		2008		2009		2010		2011	
	AuthEst	Est.	AuthProj	Proj.	AuthProj	Proj.	AuthProj	Proj.	AuthProj	Proj.
Revenue	23.6	22.0	21.2	24.3	19.6	22.9	18.7	21.3	17.9	20.2
o/w Oil revenue	8.8	9.2	10.1	12.3	7.5	10.6	6.5	8.7	5.8	7.4
Non-oil revenue	14.8	12.8	11.1	12.0	12.1	12.3	12.2	12.6	12.1	12.8
Expenditures	18.1	17.4	17.9	17.6	18.0	18.6	17.4	18.1	16.6	17.5
Differences to budgets due to:										
Underlying GDP	…	…	-0.8		0.0		0.0		0.0	
Match spending with budget NOB in %GDP	…	…	…		0.6		0.7		0.9	
New development funds spending profile	…	-0.7	0.5		0.0		0.0		0.0	
Overall balance	5.5	4.6	3.3	6.7	1.6	4.3	1.3	3.2	1.3	2.7
Non-oil overall balance (excl. one-off Yukos receipts)	-3.3	-4.7	-6.8	-5.6	-5.9	-6.3	-5.2	-5.5	-4.5	-4.7
Memorandum items:										
Oil Stabilization/Reserve Fund	…	12.0	8.3	7.9	10.0	10.0	10.0	10.0	10.0	10.0
National Welfare Fund	…	…	5.9	8.5	5.2	9.1	5.0	11.1	...	12.7
World oil price	…	71.1	…	116.5	…	125.0	…	123.5	…	123.5
Russian oil price	69.3	64.3	92.0	109.7	78.0	118.2	74.0	116.7	...	116.7
GDP (billions of rubles)	32,987	32,987	42,240	44,270	48,620	54,546	55,690	65,402	...	77,326

Sources: Russian authorities; and Fund staff estimates.

Table 8. Russian Federation: Monetary Accounts, 2005–09

(In billions of rubles, unless otherwise indicated)

	2005	2006	2007				2008			2009
	Dec.	Dec.	Mar.	June	Sept	Dec.	Mar.	Apr	Dec	Dec
									Proj.	Proj.
Monetary authorities										
Base money	2,299	3,208	3,082	3,424	3,687	4,269	4,020	4,165	5,608	7,196
Currency issued	2,195	3,062	2,943	3,255	3,470	4,119	3,794	3,931	5,385	6,878
Required reserves on ruble deposits	103	146	139	169	217	151	226	234	223	318
NIR 1/	5,245	7,998	8,867	10,577	10,799	11,694	12,024	12,771	15,624	19,750
Gross reserves	5,245	7,998	8,867	10,577	10,799	11,694	12,024	12,771	15,624	19,750
Gross liabilities	0	0	0	0	0	0	0	0	0	0
GIR (in billions of U.S. dollars)	*182.2*	*303.7*	*336.8*	*401.7*	*410.1*	*476.4*	*489.8*	*520.3*	*636.5*	*804.6*
NDA	-2,946	-4,789	-5,785	-7,153	-7,112	-7,425	-8,003	-8,606	-10,016	-12,554
Net credit to enlarged government	-2,221	-3,696	-4,419	-5,093	-5,770	-5,613	-6,600	-7,170	-8,455	-10,788
Net credit to federal government 2/	-2,000	-3,350	-3,853	-4,450	-5,038	-5,085	-5,712	-6,224	-7,867	-10,102
CBR net ruble credit to the federal government 1/	-1,643	-752	-865	-1,063	-1,344	-1,027	-1,626	-2,138	-741	217
Foreign exchange credit	92	81	81	74	74	118	118	118	125	125
Ruble counterpart 2/	-449	-2,679	-3,069	-3,461	-3,768	-4,176	-4,204	-4,204	-7,251	-10,444
CBR net credit to local government and EBFs	-221	-346	-566	-643	-732	-528	-888	-946	-588	-686
CBR net credit to local government	-115	-212	-363	-413	-491	-324	-644	-690	-376	-513
CBR net credit to extrabudgetary funds	-106	-134	-202	-230	-241	-204	-244	-256	-212	-173
Net credit to banks	-552	-810	-1,055	-1,637	-696	-1,124	-579	-595	-553	-609
Gross credit to banks	5	28	2	0	101	49	158	100	149	149
Gross liabilities to banks and deposits	-557	-838	-1,057	-1,638	-796	-1,173	-738	-695	-702	-758
Of which: correspondent account balances	-509	-638	-518	-529	-576	-802	-596	-607	-549	-612
Other items (net) 3/	-174	-283	-311	-422	-646	-688	-824	-841	-1,008	-1,157
Monetary survey										
Broad money	7,224	10,151	10,921	12,082	12,773	14,638	14,998	14,919	20,342	27,622
Ruble broad money	6,046	8,996	9,413	10,874	11,494	13,272	13,383	13,348	18,926	26,206
Currency in circulation	2,009	2,785	2,741	3,028	3,221	3,702	3,475	3,601	4,769	5,999
Ruble deposits	4,036	6,211	6,671	7,846	8,273	9,570	9,907	9,746	14,157	20,208
Forex deposits 1/	1,178	1,155	1,508	1,208	1,279	1,366	1,615	1,572	1,415	1,415
Net foreign assets 1/	4,900	6,896	8,009	8,835	9,167	9,919	10,482	10,837	12,863	15,709
NIR of monetary authorities	5,245	7,998	8,867	10,577	10,799	11,694	12,024	12,771	15,624	19,750
NFA of commercial banks	-345	-1,102	-858	-1,741	-1,632	-1,774	-1,542	-1,933	-2,761	-4,041
In billions of U.S. dollars	*-12.0*	*-41.8*	*-32.6*	*-66.1*	*-62.0*	*-72.3*	*-62.8*	*-78.8*	*-112.5*	*-164.6*
NDA	2,324	3,255	2,912	3,247	3,606	4,719	4,516	4,082	7,479	11,913
Domestic credit	4,107	5,470	5,447	5,996	6,518	7,917	8,130	7,783	11,159	15,742
Net credit to general government	-1,743	-3,221	-4,028	-4,663	-5,418	-5,055	-6,119	-6,935	-7,897	-10,230
Net credit to federal government	-1,489	-2,777	-3,262	-3,823	-4,430	-4,473	-5,144	-5,720	-7,255	-9,490
Net credit to local government and EBFs	-254	-444	-766	-840	-987	-582	-975	-1,215	-642	-740
Credit to the economy	5,851	8,691	9,475	10,658	11,936	12,973	14,249	14,718	19,056	25,972
Other items (net)	-1,784	-2,215	-2,534	-2,749	-2,912	-3,199	-3,614	-3,701	-3,680	-3,829
Memorandum items:										
Accounting exchange rate (eop, ruble per U.S. dollar)	28.8	26.3	26.3	26.3	26.3	24.5	24.5	24.5	24.5	24.5
Nominal GDP (in billions of rubles)	21,625	26,880	...	...	...	32,987	...	...	44,270	54,546
CPI inflation (eop, 12-month change)	10.9	9.0	7.4	8.5	9.4	11.9	13.3	14.3	14.1	13.5
Ruble broad money velocity	4.1	3.3	2.9	2.9	3.1	3.2	2.7	3.1	2.7	2.4
Annual change in velocity	-9.4	-20.0	-24.3	-21.7	-20.0	-3.3	-6.8	0.3	-13.8	-11.0
Real ruble broad money (rel. to CPI, 12-month change)	24.9	36.5	42.1	41.3	35.4	31.8	25.5	16.7	25.0	22.0
Nominal ruble broad money (12-month change)	38.6	48.8	52.6	53.3	48.2	47.5	42.2	33.4	42.6	38.5
Base money (12-month change) 4/	31.7	39.6	41.9	36.3	36.3	33.1	30.4	29.3	31.4	28.3
Real credit to the economy (12-month change)	21.0	36.3	39.9	39.2	38.3	33.4	32.7	32.3	26.9	20.1
Ruble broad money multiplier	2.6	2.8	3.1	3.2	3.1	3.1	3.3	3.2	3.4	3.6
Real exchange rate (12-month change) 5/	9.9	8.9	5.2	4.7	4.6	6.5	6.3	6.3	6.8	7.0
Real exchange rate (average annual change) 5/	8.7	9.5	...	...	...	7.2	...	...	6.1	7.0

Sources: Russian authorities; and Fund staff estimates.

1/ Data calculated at accounting exchange rates.

2/ Represents the government's use of NIR resources and calculated in flow ruble terms.

3/ Inclusive of valuation gains and losses on holdings of government securities.

4/ The drop in the multiplier in 2007 includes an increase in reserve requirements from 2.5 to 4 percent in July 2007.

5/ Historical data from IFS. A positive number implies real effective appreciation.

Table 9. Russian Federation: Macroeconomic Framework under Baseline Scenario, 2005-13 1/
(In percent of GDP, unless otherwise indicated)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
				Projections					
I. Savings-Investment balances									
General Government									
Revenues minus Transfers, *of which*	30.7	31.2	30.9	30.4	29.0	28.1	27.5	26.5	25.6
Transfers	10.2	8.3	9.2	10.2	10.2	9.4	8.9	9.0	9.1
Consumption	16.6	17.0	17.6	17.2	17.9	18.3	18.3	18.3	18.3
National savings	11.2	12.4	11.4	11.5	9.3	8.0	7.4	6.3	5.5
Gross investment	3.1	4.1	4.6	4.6	4.8	4.7	4.6	4.7	4.7
National savings - investment	8.2	8.3	6.8	6.8	4.4	3.3	2.8	1.7	0.8
Private Sector									
Consumption	49.0	47.9	47.9	46.2	47.6	49.2	50.5	51.4	52.5
Net income from abroad	-2.7	-3.9	-3.9	-3.1	-3.0	-3.1	-3.2	-3.2	-3.2
National savings	19.9	18.5	19.2	21.8	22.5	22.2	21.6	21.6	21.2
Gross investment	17.0	17.3	20.0	20.6	22.3	24.0	24.9	25.3	25.3
National savings - investment	2.9	1.2	-0.7	1.3	0.2	-1.8	-3.3	-3.7	-4.0
Overall Economy									
Consumption	66.2	65.5	66.1	63.9	65.9	67.9	69.1	70.1	71.1
Net income from abroad	-2.6	-3.2	-2.6	-2.3	-1.8	-1.4	-1.5	-1.6	-1.7
National savings	31.1	30.9	30.6	33.3	31.8	30.2	29.0	27.9	26.8
Gross investment	20.1	21.3	24.6	25.2	27.2	28.7	29.5	29.9	30.0
National savings - investment (current account)	11.0	9.5	6.1	8.1	4.6	1.5	-0.5	-2.0	-3.2
II. General government accounts									
Revenues	40.9	39.5	40.2	40.7	39.2	37.6	36.4	35.5	34.8
Expenditure	32.8	31.2	33.4	33.8	34.8	34.3	33.7	33.8	33.9
Noninterest expenditure	31.8	30.4	32.8	33.4	34.3	33.9	33.2	33.4	33.5
Overall balance	8.2	8.3	6.8	6.8	4.4	3.3	2.8	1.7	0.8
Primary balance	9.1	9.1	7.4	7.3	4.9	3.7	3.2	2.1	1.2
III. Balance of payments and external debt									
External current account	84.4	94.4	78.3	150.1	106.4	41.2	-17.5	-77.8	-147.7
In percent of GDP	11.0	9.5	6.1	8.1	4.6	1.5	-0.5	-2.0	-3.2
Change in external terms of trade (in percent)	16.7	11.4	3.7	28.9	1.5	-3.0	-1.6	-1.3	-1.1
Change in Russian crude oil price (in percent)	47.1	20.8	13.4	64.5	7.5	-1.2	0.0	0.0	0.2
Official reserves	182.2	303.7	476.4	660.7	828.8	956.5	1,062.4	1,159.7	1,250.1
In months of imports	13.3	17.4	20.2	20.5	20.9	20.5	19.9	19.1	18.3
Public external debt service / exports of goods and services (in percent)	12.5	9.9	2.7	1.9	1.0	0.9	1.0	0.7	0.6
IV. Growth and prices									
Real GDP growth	6.4	7.4	8.1	7.8	7.3	6.7	6.1	5.7	5.5
CPI inflation, end of period	10.9	9.0	11.9	14.1	13.5	11.5	10.5	10.0	9.5
CPI inflation, average	12.7	9.7	9.0	14.6	13.8	12.4	11.0	10.2	9.7
Change in GDP deflator, average	19.2	15.7	13.5	24.5	14.8	12.4	11.4	10.8	10.5
Nominal GDP (billions of rubles)	21,625	26,880	32,987	44,270	54,546	65,402	77,326	90,590	105,623
Nominal GDP (billions of U.S. dollars)	764	989	1,290	1,855	2,306	2,787	3,320	3,921	4,611
Nominal exchange rate, rubles per U.S. dollar, end of period	28.8	26.3	24.5	23.8	23.5	23.4	23.2	23.0	22.8
Nominal exchange rate, rubles per U.S. dollar, average	28.3	27.2	25.6	23.9	23.7	23.5	23.3	23.1	22.9
Real effective exchange rate, average change	8.7	9.5	5.7	6.1	7.0	6.2	5.4	4.8	4.0
World oil price (U.S. dollars per barrel, WEO)	53.4	64.3	71.1	116.5	125.0	123.5	123.5	123.5	123.8
Net international investment position (in percent of GDP)	-6.4	-6.4	1.2	8.9	11.8	11.2	8.9	5.5	1.5

Sources: Russian authorities; and Fund staff estimates.

1/ Net Fund financing is included in domestic financing, as a component of MA credit; foreign financing therefore excludes the Fund.

Table 10. Russian Federation: Macroeconomic Framework under Alternative Scenario, 2005-13 1/
(In percent of GDP, unless otherwise indicated)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
				Projections					
I. Savings-Investment balances									
General Government									
Revenues minus Transfers, *of which*	30.7	31.2	30.9	30.4	29.0	27.8	26.9	25.9	25.2
Transfers	10.2	8.3	9.2	10.2	10.2	9.8	9.5	9.5	9.4
Consumption	16.6	17.0	17.6	17.2	17.9	18.9	19.5	19.7	20.0
National savings	11.2	12.4	11.4	11.5	9.3	7.1	5.5	4.3	3.2
Gross investment	3.1	4.1	4.6	4.6	4.8	4.9	5.0	5.1	5.1
National savings - investment	8.2	8.3	6.8	6.8	4.4	2.1	0.5	-0.8	-1.9
Private Sector									
Consumption	49.0	47.9	47.9	46.2	47.6	49.7	51.4	52.7	53.5
Net income from abroad	-2.7	-3.9	-3.9	-3.1	-3.0	-3.1	-3.1	-3.1	-3.1
National savings	19.9	18.5	19.2	21.8	22.5	22.1	21.4	20.9	20.7
Gross investment	17.0	17.3	20.0	20.6	22.3	23.2	23.7	24.2	24.7
National savings - investment	2.9	1.2	-0.7	1.3	0.2	-1.1	-2.3	-3.3	-4.0
Overall Economy									
Consumption	66.2	65.5	66.1	63.9	65.9	69.0	71.2	72.7	73.9
Net income from abroad	-2.6	-3.2	-2.6	-2.3	-1.8	-1.4	-1.5	-1.6	-1.8
National savings	31.1	30.9	30.6	33.3	31.8	29.2	27.0	25.2	23.9
Gross investment	20.1	21.3	24.6	25.2	27.2	28.1	28.7	29.3	29.8
National savings - investment (current account)	11.0	9.5	6.1	8.1	4.6	1.0	-1.8	-4.1	-5.9
II. General government accounts									
Revenues	40.9	39.5	40.2	40.7	39.2	37.6	36.4	35.4	34.6
Expenditure	32.8	31.2	33.4	33.8	34.8	35.5	35.9	36.2	36.5
Noninterest expenditure	31.8	30.4	32.8	33.4	34.3	35.0	35.5	35.8	36.1
Overall balance	8.2	8.3	6.8	6.8	4.4	2.1	0.5	-0.8	-1.9
Primary balance	9.1	9.1	7.4	7.3	4.9	2.6	0.9	-0.4	-1.5
III. Balance of payments and external debt									
External current account	84.4	94.4	78.3	150.1	106.4	28.5	-61.0	-168.4	-294.2
In percent of GDP	11.0	9.5	6.1	8.1	4.6	1.0	-1.8	-4.1	-5.9
Change in external terms of trade (in percent)	16.7	11.4	3.7	28.9	1.5	-3.0	-1.6	-1.3	-1.1
Change in Russian crude oil price (in percent)	47.1	20.8	13.4	64.5	7.5	-1.2	0.0	0.0	0.2
Official reserves	182.2	303.7	476.4	660.7	828.8	943.3	1,004.2	1,008.0	946.8
In months of imports	13.3	17.4	20.2	20.5	20.9	19.8	17.8	15.1	12.1
Public external debt service / exports of goods and services (in percent)	12.5	9.9	2.7	1.9	1.0	0.9	1.0	0.7	0.6
IV. Growth and prices									
Real GDP growth	6.4	7.4	8.1	7.8	7.3	6.3	5.6	5.1	4.7
CPI inflation, end of period	10.9	9.0	11.9	14.1	13.5	13.5	13.0	13.0	12.5
CPI inflation, average	12.7	9.7	9.0	14.6	13.8	13.5	13.2	13.0	12.7
Change in GDP deflator, average	19.2	15.7	13.5	24.5	14.8	13.5	13.9	14.0	14.0
Nominal GDP (billions of rubles)	21,625	26,880	32,987	44,270	54,546	65,836	79,206	94,893	113,296
Nominal GDP (billions of U.S. dollars)	764	989	1,290	1,855	2,306	2,806	3,401	4,108	4,946
Nominal exchange rate, rubles per U.S. dollar, end of period	28.8	26.3	24.5	23.8	23.5	23.4	23.2	23.0	22.8
Nominal exchange rate, rubles per U.S. dollar, average	28.3	27.2	25.6	23.9	23.7	23.5	23.3	23.1	22.9
Real effective exchange rate, average change	8.7	9.5	5.7	6.1	7.0	8.2	7.9	7.8	7.0
World oil price (U.S. dollars per barrel, WEO)	53.4	64.3	71.1	116.5	125.0	123.5	123.5	123.5	123.8
Net international investment position (in percent of GDP)	-6.4	-6.4	1.2	8.9	11.8	10.7	7.0	1.7	-4.5

Sources: Russian authorities; and Fund staff estimates.

1/ Net Fund financing is included in domestic financing, as a component of MA credit; foreign financing therefore excludes the Fund.

Table 11. Russian Federation: Public Sector Debt Sustainability Framework, 2003-13
(In percent of GDP, unless otherwise indicated)

		Actual					Projection					
		2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
1	**Baseline: Public sector debt 1/**	31.6	23.1	14.2	9.1	7.3	**7.8**	**8.4**	**9.0**	**9.5**	**9.8**	**9.9**
	o/w foreign-currency denominated	24.6	17.8	10.7	4.9	3.6	2.0	1.4	1.1	0.7	0.5	0.4
2	Change in public sector debt	-10.5	-8.5	-8.9	-5.2	-1.8	0.5	0.6	0.6	0.4	0.3	0.1
3	Identified debt-creating flows	-11.0	-10.1	-6.1	-6.5	-2.9	0.4	0.6	0.6	0.4	0.3	0.1
4	Primary deficit (excluding deposits in oil funds from revenue)	-3.1	-3.0	-2.7	-3.7	-1.6	1.9	1.6	1.6	1.4	1.3	1.1
5	Revenue (excluding deposits in oil funds)	36.3	33.5	34.5	34.2	34.4	31.5	32.7	32.3	31.8	32.1	32.4
6	Primary (noninterest) expenditure	33.1	30.5	31.8	30.4	32.8	33.4	34.3	33.9	33.2	33.4	33.5
7	Automatic debt dynamics 2/	-7.9	-7.0	-3.4	-2.8	-1.4	-1.5	-1.0	-0.9	-1.0	-1.0	-1.0
8	Contribution from interest rate/growth differential 3/	-6.0	-5.9	-3.9	-2.0	-1.1	-1.4	-1.0	-0.9	-1.0	-1.0	-1.0
9	*Of which* contribution from real interest rate	-3.5	-4.1	-2.8	-1.2	-0.5	-1.0	-0.6	-0.5	-0.5	-0.5	-0.5
10	*Of which* contribution from real GDP growth	-2.5	-1.8	-1.2	-0.8	-0.6	-0.4	-0.5	-0.5	-0.5	-0.5	-0.5
11	Contribution from exchange rate depreciation 4/	-1.9	-1.2	0.5	-0.8	-0.3	-0.1	0.0	0.0	0.0	0.0	0.0
12	Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
16	Residual, including asset changes 5/	0.5	1.6	-2.8	1.3	1.2	0.1	0.0	0.0	0.0	0.0	0.0
	Public sector debt-to-revenue ratio 1/	87.2	69.0	41.3	26.5	21.2	24.7	25.6	27.9	29.7	30.4	30.6
	Gross financing need 6/	1.4	-3.7	-6.9	-7.5	-6.1	-6.1	-4.2	-3.1	-2.6	-1.5	-0.6
	In billions of U.S. dollars	6.0	-22.1	-53.0	-74.3	-78.3	-113.4	-95.9	-85.1	-84.9	-57.3	-26.8
	Stress tests for public sector debt											
	Scenario with key variables at their historical averages 7/					**5.3**	**1.4**	**-1.8**	**-4.4**	**-6.4**	**-8.0**	**-9.3**
	Scenario with no policy change (constant primary balance) in 2007-12					**7.3**	**4.2**	**2.1**	**0.3**	**-1.3**	**-2.7**	**-4.0**
	Key Macroeconomic and Fiscal Assumptions Underlying Baseline											
	Real GDP growth (in percent)	7.3	7.2	6.4	7.4	8.1	7.7	7.3	6.7	6.1	5.7	5.5
	Average nominal interest rate on public debt (in percent) 8/	4.9	4.9	5.3	6.5	7.8	8.8	7.2	6.5	5.7	5.2	4.9
	Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	7.9	6.1	-3.6	9.3	7.3	…	…	…	…	…	…
	Inflation rate (GDP deflator, in percent)	14.0	20.1	19.2	15.7	13.5	24.5	14.8	12.4	11.4	10.8	10.5
	Growth of real primary spending (deflated by GDP deflator, in percent)	4.2	-1.3	11.0	2.8	16.4	9.6	10.3	5.3	4.2	6.2	5.8
	Primary deficit	-3.1	-3.0	-2.7	-3.7	-1.6	1.9	1.6	1.6	1.4	1.3	1.1

1/ General government gross debt.
2/ Derived as $[(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp))$ times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $ae(1+r)$.
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.

INTERNATIONAL MONETARY FUND

RUSSIAN FEDERATION

Staff Report for the 2008 Article IV Consultation
Informational Annex

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

July 10, 2008

Contents Page

ANNEX I. RUSSIAN FEDERATION: FUND RELATIONS
(As of May 31, 2008)

I. **Membership Status**: Joined 06/01/1992; Article VIII.

II. **General Resources Account**:

	SDR Million	Percent of Quota
Quota	5,945.40	100.00
Fund holdings of currency	5,708.69	96.02
Reserve position	236.79	3.98

III. **SDR Department**:

	SDR Million	Percent of Allocation
Holdings	0.50	n.a.

IV. **Outstanding Purchases and Loans:** None

V. **Latest Financial Arrangements**:

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

VI. **Projected Obligations to Fund**: None

VII. **Implementation of HIPC Initiative:** Not Applicable

VIII. **Implementation of MDRI Assistance:** Not Applicable

IX. **Exchange Arrangements**: The de jure arrangement is a managed float with no pre-determined path for the exchange rate. The Central Bank of the Russian Federation (CBR) sets and announces the official exchange rates of foreign currencies against the ruble on a daily basis. These rates are based on ruble quotes against the dollar on the internal foreign exchange market and on quotes of other foreign currencies against the dollar on the global exchange market. The CBR intervenes in both interbank currency exchanges and the over-the-counter interbank market to limit fluctuations in the exchange rate of the ruble against a basket of the euro and dollar in the short run. The dollar is the main intervention currency. As a result of the stability of the ruble against the euro-dollar basket, the de facto exchange rate arrangement of Russia will be changed, with a starting date of February 1, 2006, from managed floating with no predetermined path for the exchange rate to a conventional fixed peg to a composite.

The Russian Federation accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement with effect from June 1, 1996, *and maintains an exchange system free of restrictions on the making of payments and transfers for currents international transactions*.

X. **Article IV Consultation**: Russia is on the standard 12-month consultation cycle. The last consultation was concluded on September 12, 2007.

XI. **FSAP Participation and ROSCs**

Russia participated in the Financial Sector Assessment Program during 2002, and the FSSA report was discussed by the Board in May 2003, at the time of the 2003 Article IV discussion (IMF Country Report No. 03/147). An FSAP update took place in the fall of 2007. The FSSA report is scheduled for discussion by the Board in August 2008, at the time of the 2008 Article IV discussion.

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

XII. **Resident Representatives**:

Mr. Neven Mates, Senior Resident Representative, since October 1, 2004.

ANNEX II. RUSSIAN FEDERATION: RELATIONS WITH THE WORLD BANK GROUP

1. World Bank Group activities in Russia are guided by the recent three-year Country Partnership Strategy (FY07–09) which was endorsed by the Bank's Board in December 2006. The CPS reflects a strong commitment by both the World Bank Group and the Russian government to continue a close and productive relationship that is suitable to Russia's new conditions. While the federal government no longer needs the financial support of the World Bank, it still values highly World Bank knowledge, experience, and project management skills. New borrowing by the federal government will be limited over the period of this CPS, whereas the use of guarantees, sub-national borrowing and new fee-for-service arrangements for investment and policy advice are likely to grow. Given substantial developmental challenges in a large number of Russian regions, the federal government has encouraged the Bank Group to deepen its direct involvement in the regions. Correspondingly, a central theme of the CPS is the focus of Bank Group activities in select regions, including economic analysis (growth and business environment diagnostics), regional development strategies, and related investment projects. IFC and MIGA operations will remain substantial (Russia is IFC's and MIGA's largest exposure). The successful full transition to new modalities of cooperation with the Russian government will involve increased coordination among IBRD, IFC and MIGA.

2. The CPS envisions a partnership with the Russian government for the realization of four primary objectives: (a) sustaining rapid growth, (b) improving public sector management and performance, (c) improving the delivery of social services, and (d) enhancing Russia's global role. The first three pillars correspond closely to the pillars of the previous Country Assistance Strategy (CAS), and channel support directly toward the development challenges and policies elaborated in the government's Medium-Term Economic Program, with a particular focus on the regions. The fourth pillar forms the basis for a new area of assistance, and concerns Russia's integration in the world economy and donor community**.**

Major areas of Bank Group activities by CPS strategic pillars

(a) Sustaining rapid growth

3. The World Bank Group will assist Russia in various ways in meeting the challenges of sustaining rapid growth, including participation in macro-policy debates, monitoring the investment climate, supporting public investment and PPPs for growth and diversification, working with regions to identify and overcome barriers to growth, supporting investments in priority areas at the regional level, and providing direct assistance to the private sector:

- *Macroeconomic policy, long-term fiscal sustainability, and the effective management of Russia's large external inflows:* The Bank will contribute to the macro-policy debate in Russia through the periodic Russian Economic Reports, on-demand policy notes and knowledge sharing. Advisory services can include training and impact monitoring activities related to WTO accession. In addition, there is strong interest in the Bank's technical assistance in advising on alternative uses for the windfall oil revenues, including the development of an institutional framework for the effective management of a growing diversified portfolio of foreign assets. The Bank is also preparing a larger study on long-term fiscal risks and fiscal sustainability. In April 2008, the Bank of Russia and World Bank Treasury formally signed a fee-based services agreement whereby Treasury will provide technical support in internal investment management capacity for a period of 3 to 4 years.

- *Investment climate monitoring and policy advice*: The Bank will continue periodic business environment and enterprise performance (BEEPS) surveys, regional investment climate assessments, and administrative barriers studies undertaken by FIAS for interested regions. The Bank and MIGA can work at the regional level on capacity building and the development of investment promotion programs for attracting FDI, similar to the initiative currently underway in Rostov Region. WBI will continue capacity-building activities related to investment climate assessments.

- *Supporting energy efficiency.* The World Bank jointly with the IFC is currently preparing a study on energy efficiency, which is designed to provide senior Russian policymakers with a comprehensive and practical analysis of energy efficiency issues in Russia, its potential, benefits, and policy recommendations.

- *Supporting Government investment and public-private partnerships (PPPs) for growth and diversification:* On-going investment projects support land registration and the development of a national cadastre for securing property rights and the development of land markets. Possible partial risk guarantees of the Bank to the power sector could help attract investment to the electricity sector for modernization and substantial increases in capacity. In addition, regular and reimbursable TAs are now being provided to support development of PPPs across sectors. In particular, the largest Bank's fee-for-service portfolio belongs to the City of St. Petersburg and includes such prominent PPP infrastructure projects as Western High Speed Diameter, Orlovsky tunnel, NADEX and Pulkovo airport. The Bank would also work with Russia's Development Bank (VneshEconomBank - VEB) to develop its capacity to support large-scale PPPs and also possibly to carry out joint PPP projects. Another area where the Bank is helping the Government to prepare an investment program is microfinance sector, with focus on financial cooperatives and their integration into the financial system of the country.

- *Working with regions to identify engines of growth, develop growth strategies, and remove barriers to growth*: The Bank held two major knowledge events on regional development strategies in early 2008: an early discussion of World Development Report on regional disparities and its implications for Russia, and Regional Development Strategies workshop for Russia's regional governments and other stakeholders of regional development. In addition, the Bank is finalizing a Country Economic Memorandum focused on barriers to growth at the sub-national level and on issues of regional agglomerations. The development of fee-for-service arrangements with the regions would provide another avenue for supporting preparation of regional investment strategies and growth analyses, and provision of other analytical services.

- *Supporting investments in priority areas at the regional level*: The IFC/Bank Sub-National Development Program will support priority regional public investments. The government is interested in developing this financing mechanism further, as it involves direct lending to well-performing regions and municipalities without sovereign guarantees. Three such sub-national operations have been completed to date, including two in the Chuvash Republic and one in Petropavlosk municipality (Kamchatka). Infrastructure is also an important area of IFC investments. This concerns primarily transport and logistics, but also includes municipal infrastructure. MIGA can play a role in supporting foreign direct investment in infrastructure at the sub-sovereign level, including in the water and solid waste sectors. Regional infrastructure projects supported by the Subnational Program is another area where the Bank and IFC could partner with VEB for joint project preparation and support.

- *Providing direct support to the private sector:* IFC will continue to support Russia's private sector growth agenda through a combination of financial and advisory services to promote the growth of the private sector and the diversification of the Russian economy. IFC will finance projects (1) with important spill-over effects to other companies, such as infrastructure and financial markets, (2) in sectors where Russia may have a comparative advantage, for example the processing of natural resources and those that promote the knowledge economy, and (3) those increasing the range and quality of products and services available in the Russian market, particularly outside of Moscow. Much of IFC's activities will remain concentrated in the financial sector, where priorities will be: (i) building long-term relationships with medium-sized independent private regional banks, so as to increase competition and the range of services available to the population. IFC financing, provided in the form of long-term senior loans and, in selected cases, subordinated loans, will help to strengthen the banks' balance sheets, reach new clients (including SMEs), attract more depositors, and consolidate their position as leading regional banks; (ii) supporting the introduction of specialized banking products, including mortgage financing, consumer finance and leasing; (iii) supporting the process of privatization of state-owned banks, as and when requested by the Russian Government; and (iv) supporting development and use of new financial instruments, such as partial guarantees of local currency bonds and securitization.

- *Continuing IFC advisory work through the Private Enterprise Partnership and FIAS:* This technical assistance will address the following objectives: (a) increasing the development impact of investments through strengthening local suppliers and engaging in community development work around large investments; (b) building the capacity of private banks to deliver new product lines, such as mortgage finance and financing for energy efficiency; and (c) improving corporate governance and environmental sustainability through work with banks and real sector clients, including IFC investees. FIAS will continue to work with select regions to improve the business climate by assisting in implementation of policies/instruments to kick-start functioning markets of land and commercial real estate.

- *MIGA will continue to support foreign investors through the provision of political risk guarantees:* Supporting foreign investment in infrastructure, in close coordination with the Bank, will remain an important area of MIGA's activity in Russia. In the financial sector, the Agency will continue to explore opportunities to support capital markets transactions, including asset-backed securitizations. MIGA may also continue to promote the role and assist in the expansion of foreign banks in the Russian banking sector. Areas for potential further involvement in Russia include manufacturing, agribusiness and services sectors.

(b) Improving public sector management and performance

4. Public sector management has been a particular area of strength of World Bank work in Russia, which will be further deepened in coming years. The Bank will remain engaged in supporting programs for modernizing selected public sector institutions, improving government administration, the judiciary, local self-government, and budgetary management at federal and sub-national levels. The Bank will expand its engagement in regions in these areas, in accordance with the federal priority for improving public sector performance at the sub-national level.

- *Modernizing selected public sector institutions:* The completion of on-going projects will contribute to the modernization of public institutions and improved public services. These include tax modernization, customs development, cadastre and registration, fiscal federalism, performance-based budgeting, treasury development, and a statistical development project.

- *Supporting the government program in administrative reform:* The Bank will continue its close engagement with the government in the area of administrative reform at the federal and sub-national levels, including the coordination and implementation of substantial donor funds. The primary goal will continue to be bringing Bank and international expertise to bear on the implementation of the government's program for administrative reform, which currently places a strong emphasis on encouraging initiatives at the sub-national level. So far, the Bank has concentrated sub-national work in the Southern Federal Okrug and regions in the North-West. A fee-based advisory service supports Khanti-Mansiysk Okrug-Yugra on administrative streamlining and establishment of an e-services portal. Similar fee-based advisory services may also be developed with other regions. Support for public administration and governance for selected regions which cannot afford fee-based services is being provided through a DFID Trust Fund which runs from 2007–10.

- *Stepping up engagement on judicial reform:* Assistance on judicial reform also involves the coordination of donor funds and special cooperation at the regional level. A recently approved project, which complements the 2007–11 Federal Targeted Program for judicial modernization, supports judicial reform (FY07) with a focus on improving the efficiency of dispute resolution and the transparency of judicial functioning. A complementary grant from the Government of Japan will provide support to Perm Krai and Leningradskaya Oblast on demand-side justice sector issues such as legal aid to the poor and juvenile justice. In addition, at the request of the Chairman of the Supreme Commercial Court the Bank plans to partner with it and the Ministry of Economic Development to support the drafting of framework legislation to strengthen administrative resolution of disputes and complaints handling, as well as individual bankruptcy law.

- *Support for budgetary reforms:* The Bank will continue to respond to the demands of the federal and some regional governments for assistance in budgetary reform and the development of performance-based budgeting. In addition, the Bank will remain a partner to the government in the continued scaling up of the Fiscal Federalism Project (now financed by the Russian government) and its expansion to the municipal level.

- *Supporting the reform of local self-government:* The Bank will continue its dialogue with the government in this area, and in brining international experience to bear on this vital area of reform in Russia. A study has been launched for monitoring and assisting the development of local-self government in rural areas in the Perm, Penza, and Adygeya regions. The Bank will seek to engage directly with regions and municipalities in this area on the basis of new modalities, including a discussion of replicating the positive experience of the Fiscal Federalism Project model for building capacity at the municipal level.

- *Investments in municipal development:* On-going and possible future regional projects have significance for overall municipal development and the quality of municipal services. This includes the completed Kazan Municipal Development Project and on-going Saint Petersburg Economic Development Project, a Housing and Communal Services project awaiting for signature (FY09, also see below), possible regional projects on water and heating system upgrades, and a proposed Cultural Heritage II project (FY09) aimed to use the cultural heritage and the cultural heritage tourism as a resource for economical and social development in the participating regions. The Stavropol pilot Local Initiatives Support project improves the quality of settlement level social infrastructure and the Bank is working with Ministry of Regional Development on scaling up the program nationally.

- *Supporting anti-corruption initiatives:* As a coherent national-level anti-corruption program may begin to take shape, the Bank will explore avenues of possible constructive contributions to such anti-corruption initiatives.

(c) Improving the delivery of social and communal services

5. In addition to continued general cooperation with the federal government, the Bank will concentrate much of its support for improving social service delivery at the sub-national level. The Government has prioritized the social sector and social services in its medium-term program. Given that the primary responsibilities and initiatives for reform in these services will be at the sub-national level, the Bank will concentrate its focus on the regions. Main activities include the continuation of work in the areas of poverty, education, and health in cooperation with the regions. Additional activities include the monitoring of social trends and service delivery quality (joint with USAID) and special employment-related activities in the Southern Federal Okrug (the development of decentralized employment services, and labor integration of youth). Another critical area for improving living standards is provision of housing and communal services. The government places high importance on improving the performance of the housing and communal services (HCS) sector and on the delivery of high quality services by communal enterprises, and closely links service provision with improving the quality of life.

- *Continuation of the poverty work:* In addition to continued cooperation with Rosstat and federal ministries, the emphasis of the Bank poverty work (in cooperation with DFID) has moved to the regional level. The Bank is working, and will continue to work, directly with regions on monitoring poverty and improving social assistance programs aimed at better targeting. Regional social protection strategies for Tver and some other regions will be developed with Bank assistance. Successful models of cooperation can be scaled up to similar regions.

- *Improving the health of the population:* The Bank will continue its engagement with the government on adult health, and the development of a national strategy to improve the health of the population, with the goal of reversing the strongly negative trends in premature mortality and morbidity. As a follow up to earlier child welfare efforts and jointly with international donors the Bank will assist in design and implementation of practical mechanism for family support, preventive social welfare and child care at federal and regional level. Additional advocacy, public awareness and information sharing efforts jointly with government leaders, public figures, private sector and NGOs will be undertaken in support of critically needed government policies in this area. Another priority is to advise federal and regional authorities on appropriate risk pooling, insurance, and sustainable health financing. IFC will continue working with private companies on programs for occupational health, including HIV-AIDS issues. The Bank will implement on-going projects in the health sector and offer to scale up or modify existing models at the sub-national level as a service to regions. The development of public-private partnerships in the health sector could be supported jointly by TA from the Bank and direct financing by IFC to PPPs and/or purely private providers. Lessons from the TB/AIDS project could be applied through more focused interventions in interested regions through sub-national projects and TA. A few regional projects could be supported for removing environmental hotspots and addressing other environmental concerns posing major health risks to population.

- *Modernization and improvement of the education system and vocational training:* The Bank will complete current projects in education designed to modernize the system and improve vocational training. As is the case of health, the Bank will seek to meet demands of regions for special support at the sub-national level for education reform. Regional TA and possible projects could focus on improving systems for professional and vocational education, accompanied by parallel assessments of local labor markets with an eye to improving the quality of local professional labor supply. Another focus could be pre-school education and early childhood education. The recently completed Youth Strategy by the Bank provides recommendations for improvements in youth policies, with possible applications to Russia for forwarding the dialogue on youth policies in the area of education and training.

- *Improvement in the provision of housing and communal services:* The Bank's support in the infrastructure sector will largely focus on improving quality of utility services and housing. The Bank has a large portfolio focused on improving heating, water, electricity, and other municipal services in selected regions. This includes the recently completed Kazan Municipal Development Project and electricity sector reform support project and on-going Saint Petersburg Economic Development, Municipal Heating, Municipal Water and Wastewater projects. As part of the larger effort by the Government to invest into improvements of the HCS sector, the Bank is working on preparation of a program that would support reforms and investments in HCS on grant basis allocated to regions competitively. Also, a large share of sub-national lending is expected to focus on improving these services.

- *Housing finance and energy efficiency through IFC's PEP program:* IFC's PEP program is currently focusing its work on two new product platforms in Russia: housing finance and energy efficiency, both of which are complemented by IFC investments in this area**.** The Primary Mortgage Development Project is working to streamline the mortgage lending process in Russia. IFC's Sustainable Energy Efficiency Program in Russia combines IFC's advisory and investment capacity. The project makes credit lines available to banks for on-lending for energy efficiency projects, and provides technical assistance to banks and private companies in order to raise the lending volumes available for energy-saving projects. The program has already disbursed its first credit line to Center Invest Bank in Rostov, and currently has a US$60 million pipeline of potential deals across all regions of Russia. IFC also runs a number of additional programs in Russia, including support for corporate governance in the banking sector, for improvement of forestry management practices in the Northwest, and for development of local suppliers to the mining sector in the remote region of Magadan.

(d) Enhancing Russia's global role

6. The Bank has a strong commitment to support Russia's increasing global role, and assist the country in fulfilling its global commitments. The Bank will continue cooperation with the Russian government in support of its emergence as an international donor and active member of multilateral organizations. In addition, the Bank will assist in establishment of mechanisms and implementation of specific actions arising from Russia's global engagements, such as the Climate Change and Biodiversity Conventions, and pandemic diseases initiatives. During the CPS period, the Bank will also seek to share with Russian experts its analysis (and advocacy) that is currently directed towards the traditional DAC donors. Specific areas for Bank's engagement in Russia are:

- *Assistance in the formulation of an ODA strategy for Russia as emerging donor:* The Bank will continue to assist Russia as an emerging donor, and will cooperate on the design of Russia's development aid strategy and the establishment of a national ODA system. Specific Bank support includes training/capacity events, information sharing, and advisory services. The Bank will remain engaged with Russia on international policy initiatives developed under Russia's G-8 presidency, including on Russia's priority themes for international assistance—quality of education, energy poverty, and controlling the spread of infectious diseases. The Government counterparts will be involved in policy dialogue on global food crisis and climate change.

- *Providing access to the Bank's instruments for channeling Russian developmental assistance:* The Bank will help in preparation of Africa debt-for-development swap, facilitate Russia contributions in multilateral TFs such as Avian Flu Trust Fund, the Education-For-All/Fast Track Initiatives, and support design of Russia supported programs like Malaria control in Africa, Global Village Energy Partnership, Quality of Basic Education. Following increased Russia's contributions to IDA15 the Bank will further work on developing ownership of IDA among Russian policy makers. Beginning with a high-level Emerging Donor Meeting in April 2006, the Bank is assisting Russia in organizing development aid seminars and international events. The Bank will also seek opportunities for increased engagement of Russian experts in development policy debates, their participation in the Bank's work in other countries, and "staff secondments" for building capacity within the Russian Government for aid allocation and management.

- *Fulfilling international obligations related to global goods:* The Bank will assist Russia in developing procedures and mechanisms for implementing specific activities in the framework of the Climate Change and Biodiversity Conventions**.** TA is currently being provided on the introduction of low-carbon technologies and climate change mitigation. If the government moves ahead with the introduction of financial instruments for low-carbon technologies in Russia, the Bank would be ready to support the preparation and implementation of a number of carbon-finance projects. There are three GEF projects in the Bank's pipeline awaiting the establishment of a legal and institutional framework for their introduction at the regional level with federal oversight. Additional projects on biodiversity and climate change could also be prepared. The Bank will continue participation in the Ministerial Conference on Forest Law Enforcement and Governance in Europe and North Asia.

- *Linking Russian companies to global markets:* IFC and MIGA activities are also relevant to the expansion of Russia's global role. In keeping with its global strategic objective to encourage investment across emerging markets (South-South investment), IFC will continue to actively support strong, reputable Russian clients in investments elsewhere in emerging markets. Consistent with its strategic objective to support South-South investments through the provision of guarantees, MIGA will continue to proactively engage Russian companies planning to invest in emerging markets.

Focus on Russian regions

7. The Bank is working with the federal government in identifying a small sub-set of 6–10 regions that may become the target of concentrated work programs with the Bank. Regions are being chosen from wealthier, middle income, and poorer areas. Important criteria for the selection of regions for Bank engagement are (i) the willingness and commitment of the regional administration to work with the Bank; (ii) a past history of successful cooperation; (iii) the reform-orientation and competence of the regional administration; (iv) strategic importance of the region for Russian development and the existence of other similar regions for possible scaling up of successful cooperation; and (v) the region's creditworthiness and potential interest in Bank operations (for wealthier or middle income regions). Following initial engagement of selected regions, the strategic directions and modalities of cooperation with the Bank will be included in a joint Memoranda of Understanding, to be signed with the leaders of the focus regions. As noted, Bank involvement at the regional level would involve a combination of targeted AAA on diagnostics of the local economy and investment climate, and development of regional strategies, coupled with selected lending operations to address key challenges.

8. *The World Bank Group will concentrate some work in poorer Russian regions, which are often in most need of development assistance*. The list of priority regions will include some such poorer regions. IBRD engagement in poorer regions that lack creditworthiness will depend significantly on opportunities for participation in federal programs or the coordination of donor funds. IFC will make special efforts to support private sector activities in poorer areas. For some poorer Russian regions which have achieved creditworthiness, potential opportunities exist for fee-for-service activities or sub-national lending without sovereign guarantees. Discussions on the development of new instruments will give particular attention to facilitating Bank work in poorer areas.

ANNEX III. RUSSIAN FEDERATION: STATISTICAL ISSUES

1. Economic and financial data provided to the Fund are broadly adequate for surveillance purposes. The Russian Federation has a reasonably comprehensive and timely statistical database, with a wide range of regular, timely publications on financial and economic statistics. However, difficulties remain in terms of data accuracy and frequent data revisions. State and private enterprise activities are measured through forms sent to firms included in enterprise registers, with sample surveys increasingly replacing full-count collections. The authorities are generally cooperative in reporting data to the Fund, mainly through the resident representative office, and during missions. The Russian Federation subscribed to the Special Data Dissemination Standard on January 31, 2005. The authorities report data for the Fund's *International Financial Statistics (IFS), Government Finance Statistics Yearbook (GFSY), the Direction of Trade Statistics,* and *the Balance of Payments Statistics Yearbook.*

2. While a draft data ROSC prepared in 1999–2000 was not published, a new data ROSC prepared in October 2003 was published on the IMF website in April 2004. Federal legislation regulating the statistical system became effective on December 17, 2007.

National accounts

3. The Federal State Statistics Service (Rosstat) compiles and publishes quarterly and annual national accounts data on a timely basis, using the *1993 System of National Accounts*. Rosstat introduced chain-linking into their quarterly and annual national accounts in 2006, and chain-linked data have been published for 2003 onwards. Source data are obtained from surveys of businesses and households, including financial surveys of businesses and employment surveys of households, and are supplemented by administrative data. Efforts are underway to improve coverage, but further progress is needed to cover small and medium enterprises. Estimates of GDP are compiled by type of economic activity and expenditure category, with the former considered more accurate. The statistical discrepancy between the production and expenditure approaches is generally no more than two percent, broadly acceptable by international standards. The data are also presented by income category, and institutional sector accounts are also compiled, although the financial account by institutional sector is not compiled.

4. Inadequate reporting by firms has constrained improvement of the national accounts. In addition, revisions are often not flagged when they are disseminated, making it difficult for users (including the Fund) to maintain consistent time series.

Prices

5. Rosstat compiles a national consumer price index (CPI) of good quality, which was developed with Fund technical assistance. Following a moderation of inflation, Rosstat stopped the weekly publication of headline inflation in January 2003, retaining only monthly reports. In addition, Rosstat has begun publication of monthly core inflation data. Further

improvements could be made on the basis of a new household budget survey—which has been under consideration for some time—and by the current efforts to improve the treatment of seasonal items in the index. Assistance from the World Bank and the European Commission's Technical Aid to the Commonwealth of Independent States is available in these areas. Rosstat also publishes a producer price index, and the State Customs Committee has initiated the development of foreign trade price indexes.

6. Monthly CPI and PPI, both Laspeyres indices (2000=100), cover all regions of the Russian Federation. In addition to the general CPI index, Rosstat publishes indices for the foodstuffs, non-food products, and services. However, the weights of the CPI components have been made available since 2006 while PPI components are not disclosed, rendering time series analysis difficult.

Government finance statistics

7. The staff is provided with monthly information on revenues, expenditures, and financing of the federal government and annual information on revenues, expenditures, and financing of local governments and extrabudgetary funds. The published functional classification of expenditure differs slightly from international standards. Expenditure data, classified by economic type, need improvement. Presently, annual data are compiled with a long delay. Data on domestic and external federal debt are compiled monthly, but are made public only in summary form on a quarterly basis. In addition, there is no unified debt monitoring and reporting system. In the context of a work program for statistical improvement agreed with STA, there have been ongoing improvements in the coverage and quality of government finance statistics; there remains, however, scope for improvement of expenditure data. The reform of budgetary accounting is well advanced and includes the introduction of accrual accounting for the whole of government. In the 2007 *GFSY*, data for the central, local and general government were reported through 2006 on both an accrual and a cash basis, in accordance with the methodology recommended in the *Government Finance Statistics Manual 2001*. Beginning in 2007, the Treasury began reporting detailed government finance statistics for publication in *IFS* on a cash basis.

Monetary and financial statistics

8. Monetary and financial statistics are reasonably comprehensive and generally in accordance with international standards. Classification and sectorization are in line with the methodological guidelines, except that financial derivatives data, currently under development, are not included in the instrument classification. The basis of recording broadly follows methodological recommendations. Since 2006, monetary gold is valued at current quotations set by the Central Bank of Russia (CBR). Following the 2003 data ROSC recommendations, the authorities included all non-operational credit institutions in the coverage of the monetary statistics and reclassified their deposits as restricted deposits. The CBR intends to revise further its compilation procedures to conform fully to the guidelines of the *Monetary and Financial Statistics Manual 2000*.

9. Analytical accounts for the monetary authorities and commercial banks are reported for publication in *IFS* with a lag of one month. Timely interest rate data are available. The CBR has yet to conclude compilation of monetary data using new Standardized Report Forms (SRFs). At the request of the authorities, a TA mission visited Moscow in April 2007 to assist in expanding the coverage to include other (nondepository) financial corporations and to facilitate the completion of the SRFs.

External sector statistics

10. Balance of payments statistics are compiled on the basis of the fifth edition of the *Balance of Payments Manual (BPM5).* Though significant improvements have been made to enhance data quality, there remains scope to improve the coverage of certain components of the current and the capital and financial accounts. In particular, improving the detail of data on the financial account would facilitate the analysis of relatively complex flows.

11. Merchandise import data published by the State Customs Service tends to under-record transactions due to "shuttle trade," smuggling, and undervaluation, as evidenced by large differences with partner country export data. While the statistical agencies are seeking to reconcile their data with those of partner countries, the CBR has developed a methodology for calculating export and import transactions that are unrecorded by the customs authorities for use in balance of payments statistics. There is a need to improve the coverage and quality of surveys on direct investment and trade in services. On the latter, the authorities are planning to harmonize statistical methodologies with those prescribed in the *Manual on Statistics of International Trade in Services*.

12. As noted, Russia disseminates the data template on international reserves and foreign currency liquidity. However, published historic series on reserves have not been corrected for changes in definitions. Headline data on reserves are reported to the Fund and the markets on a weekly basis with a four-business day lag. The Fund receives additional detail on reserves and reserve liabilities through the central bank balance sheet, but this information is not as comprehensive as the reserve template, which is disseminated with a lag of twenty days. Quarterly external debt data are now published by sector, maturity, instrument, and currency, with a lag of one quarter as prescribed by the SDDS. Furthermore, the CBR has started publishing quarterly debt service projections by sector and instruments. Reserves template series are available on http://www.imf.org/external/np/sta/ir/colist.htm, and external debt series are available on http://www.worldbank.org/data/working/QEDS/sdds_countrydata.html.

13. The CBR publishes an annual international investment position for all sectors with data starting in 2000. The international investment position for the banking sector has been available on a quarterly basis since 2001Q1 and published with a three-month lag.

RUSSIAN FEDERATION: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of June 19, 2008)

	Date of latest observation	Date received	Frequency of data[6]	Frequency of reporting[6]	Frequency of publication[6]	Memo Items: Data Quality – Methodological soundness[7]	Memo Items: Data Quality Accuracy and reliability[8]
Exchange Rates	6/19/08	6/19/08	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	6/12/08	6/19/08	W	W	W		
Reserve/Base Money	6/2/08	6/11/08	W	W	W	O, LO, LO, LO	O, O, O, O, O
Broad Money	4/30/08	5/30/08	M	M	M		
Central Bank Balance Sheet	5/31/08	6/11/08	M	M	M		
Consolidated Balance Sheet of the Banking System	4/30/08	5/30/08	M	M	M		
Interest Rates[2]	6/19/08	6/19/08	D/W/M	D/W/M	D/W/M		
Consumer Price Index	May. 2008	6/5/08	M	M	M	LO, LO, LO, LO	O, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2007	Mar. 2008	A	A	A	LNO, LO, LO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	2007	Mar. 2008	M	A	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2007	Apr. 2008	A	A	A		
External Current Account Balance	Q1 2008	4/4/08	Q	Q	Q	O, O, LO, O	O, O, O, O, O
Exports and Imports of Goods and Services	Q1 2008	4/4/08	Q	Q	Q		
GDP/GNP	Q1 2008	6/16/08	Q	Q	Q	O, O, LNO, O	LO, LO, O, O, O
Gross External Debt	Q4 2007	3/31/08	Q	Q	NA		
International Investment Position	2006	7/4/07	A	A	A		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[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] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC published on May 2004 and based on the findings of the mission that took place during October 8–23, 2003 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[8] Same as footnote 7, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, assessment and valid.

Statement by the IMF Staff Representative on the Russian Federation

August 1, 2008

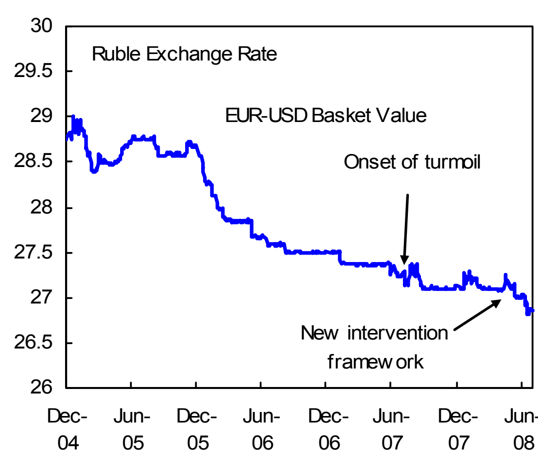
1. This statement summarizes information that has become available since the staff report was issued. The thrust of the staff appraisal remains unchanged.

2. **As expected, GDP growth has slowed somewhat, but is set to remain well above potential.** Both private consumption and fixed investment have softened in recent months. Construction activity also appears to be slowing. This is not only due to the high base effect in 2007, but also reflects some easing in the momentum of month-on-month growth rates. The moderation in GDP growth was already assumed in staff's original projections and does not alter the near-term outlook. The risks to growth remain tilted to the upside as the recent volatility in oil prices will, to a large extent, be absorbed by the stabilization fund, while stronger-than-expected capital inflows (see below) may provide an additional boost to growth.

3. **Inflationary pressures remains strong.** Headline CPI inflation was 15.1 percent (year-on-year) in June, the same level as in May. Core inflation has continued to increase, however, rising from 14.5 percent in May to 15 percent in June. These developments are consistent with staff's end-year inflation projection of 14.1 percent.

4. **Capital inflows have continued to recover.** In mid July, Moody's upgraded Russia's foreign-currency debt by one notch to Baa1, citing the recent smooth transition of presidential power as well as Russia's low level of sovereign debt. A number of Russian banks, especially state-owned banks, were also upgraded. Net capital inflows in the second quarter were stronger than expected—about US$37 billion—and together with higher oil prices have helped boost Russia's international reserves by over US$56 billion over the same period.

5. **The CBR has continued to tighten monetary policy.** In mid July it increased interest rates again by 25 bps—the fourth such hike since the beginning of 2008. However, compared to an estimated inflation rate of about 15 percent, the one-day repo rate is still only 7 percent, and the official refinancing rate is only 11 percent. The CBR has also continued to allow somewhat greater day-to-day flexibility in the exchange rate, but the pace of appreciation is still very limited—the currency basket has appreciated by only 0.9 percent since mid May. These measures have as yet had little impact on liquidity, which remains high, reflecting fiscal



relaxation and—above all—continued large unsterilized intervention in the face of buoyant capital inflows.

6. **The authorities are still planning a further fiscal relaxation in the context of the supplementary 2008 budget.** The supplementary budget is expected to be sent to the Duma in late August. Its parameters remain as described in paragraph 17 of the staff report.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 08/112
FOR IMMEDIATE RELEASE
August 28, 2008

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

IMF Executive Board Concludes 2008 Article IV Consultation with the Russian Federation

On August 1, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Russian Federation.[1]

Background

Russia's economic recovery is gaining strength as investment rises. Returns on investment are high—reflecting the scarcity of capital—and surging oil prices, large capital inflows, and a steady deepening of financial markets are providing investors with the financing and retained earnings needed to take advantage of this. The resulting rise in investment, and the associated reallocation of labor to more productive sectors, are unlocking catch-up gains in productivity. This is providing a further boost to growth in real incomes and consumption, which have already been buoyant for some time, owing to large terms-of-trade gains. Financial deepening is also reinforcing this process, by allowing households to take advantage of low indebtedness to borrow against expected future income gains. Against this background, GDP growth has accelerated to an annual rate of more than 8 percent.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

But despite a strong supply response, signs of overheating are emerging. Domestic demand growth has risen to an annual rate of 15 percent in real terms, significantly above estimates of potential growth. Inflation has more than doubled since early 2007, running at 15.1 percent (year-on-year) in June 2008. While the increase was initially spurred by rising food and energy prices, it is now beginning to extend to a broader range of goods and services. Tightening domestic resource constraints are particularly evident in labor markets, where shortages have caused real wage growth to accelerate to about 16 percent annually, well above growth in labor productivity. While the ruble is still undervalued, competitiveness margins are narrowing and the real effective exchange rate is moving close to staff's estimate of its equilibrium.

Procyclical fiscal policy is adding to demand pressures. Primary expenditures by the federal government rose by 15 percent in real terms, and the non-oil deficit—excluding a one-off collection of tax arrears from the Yukos oil company—rose by 0.8 percent of GDP in 2007. The 2008 budget entails a further notable impulse, as the non-oil deficit of the federal government is set to increase for the fourth consecutive year, by 0.9 percent of GDP.

The Russian banking system has proven to be relatively resilient in the face of worldwide turmoil. A number of banks that had relied heavily on external borrowing have had to sharply curtail credit growth and restructure their balance sheets. Overall, banks in Russia remain profitable, non-performing loan ratios are still relatively low, and depositor confidence is robust. Taking note of the high rates of lending growth, a recent Financial System Stability Assessment update by IMF and World Bank experts expressed concern about credit risk, recommending a further strengthening of provisioning standards and implementation of consolidated supervision.

The fixed exchange rate is also fueling demand pressures. In defense of the de facto peg, the very strong balance of payments position has required large unsterilized interventions in the foreign-exchange market, which have in turn translated into excess liquidity in the banking system. While the turmoil in global financial markets resulted in a significant drop in foreign inflows in the second half of 2007, this had little net impact on credit growth as large external borrowing prior to the onset of the turmoil had left the banking system highly liquid. In addition, the CBR quickly stepped up its repo operations and broadened its list of eligible collateral for liquidity support when money market rates began to rise. More recently, capital inflows have recovered strongly, and the CBR's repo operations have been scaled back sharply. In fact, the CBR has raised interest rates four times in 2008, for a combined increase of 100 bps, and has increased reserve requirements twice. Additionally, the bank has allowed greater exchange rate volatility against the euro-dollar basket since June—the basket has appreciated by 0.9 percent over June-July, 2008. Nonetheless, the central bank is still intervening heavily in the foreign exchange market and Russia's banking system is still comfortably liquid with overnight interbank rates at the lower end of the usual trading range.

The near-term economic outlook is favorable, although inflationary pressures are likely to remain high. GDP growth will continue to be underpinned by strong domestic demand growth, reflecting further fiscal relaxation, additional large terms-of-trade gains, and the renewed recovery in capital inflows. However, with growth already running well above estimated potential, and with a further significant real exchange rate appreciation in the offing, leakage through the balance of payments is likely to increase. In view of this, IMF staff project GDP growth to ease slightly in 2008 to 7¾ percent. With continued robust growth and little remaining spare capacity, inflation is set to exceed the revised end-year target of 10.5 percent by a notable margin. The unwinding of the surplus in the current account is expected to resume in 2009 in the absence of further large terms of trade gains.

Executive Board Assessment

Directors welcomed the continued strong performance of the Russian economy, manifested in higher and more broad-based economic growth and supported by robust investment and productivity increases. Directors considered that sound economic management and high oil prices have both contributed to this performance. They commended the authorities on the prudent management of oil revenues so far—in particular, the policy of saving most of the oil-price windfall in the stabilization fund.

Directors expressed concern about the threat to Russia's growth prospects from rising inflationary pressures. Price rises now extend well beyond what can be explained by worldwide increases in food and energy prices, and are likely to exceed the authorities' objective by a substantial margin. Directors considered that the current macroeconomic policy mix is contributing to the overheating of the economy. In particular, a procyclical fiscal stance in the 2008 and 2009 budgets and the policy of resisting exchange rate appreciation through unsterilized interventions are exacerbating demand pressures.

Directors accordingly suggested a careful reconsideration of the authorities' policy stance, so that price developments are not shaped primarily by uncertain external developments that remain beyond the authorities' control—in particular, an eventual deceleration of food prices and a further unwinding of the current account. Directors generally cautioned that upward pressures on the ruble will likely remain high as long as buoyant private demand and a procyclical fiscal policy maintain GDP growth above potential.

Against this background, Directors encouraged the authorities to tighten monetary policy, while noting that the peg of the ruble to a dollar-euro basket could become increasingly inflationary as Russia's cyclical position strengthens relative to that of the U.S. and euro area economies. They also observed that the growing tension between inflation and exchange rate objectives is fuelling capital inflows, and further complicating monetary management. While welcoming the authorities' commitment to fight inflation and the recent increases in interest rates and the steps to introduce more flexibility in the exchange rate, most Directors called for a further refocusing of monetary policy towards inflation reduction accompanied by greater exchange rate flexibility—an approach that would also pave the way for an eventual move to inflation targeting. They suggested that at this juncture competitiveness concerns should not stand in the way of further exchange rate appreciation given the productivity gains that have accompanied recent real exchange rate appreciation. While generally seeing merit in greater exchange rate flexibility, some Directors were not convinced of the need for early adjustment of the nominal exchange rate, pointing, in particular, to the risk that faster appreciation might exacerbate speculative capital inflows.

Directors expressed concern about the increasing procyclicality of fiscal policy. In the near term, this will further burden monetary policy and increase inflationary pressures. In the medium-term, a continued procyclical policy might cause the real exchange rate to overshoot its equilibrium level. Directors accordingly called upon the authorities to adhere to their medium-term fiscal strategy—which calls for a reduction in the non-oil deficit—and to reinvigorate the pace of structural reform. A number of Directors also encouraged the authorities to reconsider the pending supplementary budget in 2008, and to avoid any further fiscal stimulus until demand pressures ease.

Directors noted that Russia's financial sector has weathered the recent global financial turmoil well, and is generally well positioned to withstand further turmoil. They noted that this assessment is in line with the findings of the recent FSAP update, which concluded that the financial system has strengthened significantly since 2003. At the same time, Directors pointed to the risk that, after years of negative real interest rates and rapid lending growth, a significant policy-induced increase in real interest rates might have an adverse impact on the banking system. Directors encouraged the authorities to further improve the regulatory and prudential framework, in line with the recommendations of the FSAP update. Directors also welcomed the authorities' commitment to follow generally accepted principles and best practices as guidelines for Russia's sovereign wealth funds.

Directors welcomed the government's focus on improving Russia's investment climate. This will require the elimination of infrastructure bottlenecks and the promotion of a more favorable business environment. Directors were encouraged by the new government's development strategy and priorities, in particular its focus on strengthening the judiciary and tackling corruption. Plans to reinvigorate the reform of the civil service and the public administration will also be important. Directors saw the economy's strong growth and gains from high oil prices as providing a valuable opportunity for the authorities to press ahead with their earlier plans for reform. The authorities' plans to join the World Trade Organization should also serve as a catalyst to strengthen the reform momentum.

Russian Federation: Selected Macroeconomic Indicators

	2004 Actual	2005	2006	2007	2008 Proj.	2009
	(Annual percent change)					
Production and prices						
Real GDP	7.2	6.4	7.4	8.1	7.8	7.3
Consumer prices						
Period average	10.9	12.7	9.7	9.0	14.6	13.8
End of period	11.7	10.9	9.0	11.9	14.1	13.5
GDP deflator	20.1	19.2	15.7	13.5	24.5	14.8
	(In percent of GDP)					
Public sector						
General government						
Overall balance	4.9	8.2	8.3	6.8	6.8	4.4
Revenue	36.6	40.9	39.5	40.2	40.7	39.2
Expenditures	31.7	32.8	31.2	33.4	33.8	34.8
Primary balance	6.1	9.1	9.1	7.4	7.3	4.9
Nonoil balance	-2.9	-4.6	-4.5	-3.9	-7.2	-7.6
Nonoil balance excl. Yukos 1/	-2.9	-5.1	-4.5	-5.5	-7.2	-7.6
Federal government						
Overall balance	4.3	7.5	7.4	6.2	6.7	4.3
Nonoil balance	-2.2	-2.9	-3.9	-3.1	-5.6	-6.3
Nonoil balance excl. Yukos 1/	-2.2	-3.4	-3.9	-4.7	-5.6	-6.3
	(Annual percent change)					
Money						
Base money	24.9	31.7	39.6	33.1	31.4	28.3
Ruble broad money	35.8	38.6	48.8	47.5	42.6	38.5
External sector						
Export volumes	10.5	4.7	5.8	4.6	5.2	5.4
Oil	11.3	3.2	0.3	5.4	2.2	2.2
Gas	5.5	3.7	-2.5	-5.4	1.0	-1.5
Non-energy	11.2	6.9	18.2	7.3	13.4	14.7
Import volumes	21.3	18.3	24.0	26.0	29.3	24.0
	(In billions of U.S. dollars; unless otherwise indicated)					
External sector						
Total merchandise exports, fob	183.2	243.8	303.6	355.5	522.4	561.6
Total merchandise imports, fob	-97.4	-125.4	-164.3	-223.4	-312.9	-389.6
External current account	59.5	84.4	94.4	78.3	150.1	106.4
External current account (in percent of GDP)	10.1	11.0	9.5	6.1	8.1	4.6
Gross international reserves						
In billions of U.S. dollars	124.5	182.2	303.7	476.4	660.7	828.8
In months of imports 2/	11.4	13.3	17.4	20.2	20.5	20.9
In percent of short-term debt	198	161	175	281	377	442
Memorandum items:						
Nominal GDP (in billions of U.S. dollars)	592	764	989	1,290	1,855	2,306
Exchange rate (rubles per U.S. dollar, period average)	28.8	28.3	27.2	25.6	23.9	23.7
World oil price (U.S. dollars per barrel, WEO)	37.8	53.4	64.3	71.1	116.5	125.0
Real effective exchange rate (average percent change)	7.8	8.7	9.5	5.7	6.1	7.0

Sources: Russian authorities; and Fund staff estimates.

1/ Excludes one-off tax receipts from Yukos in 2007.

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