INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/260

RUSSIAN FEDERATION

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT

August 2019

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 2019 Article IV consultation with Russian Federation, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 12, 2019 consideration of the staff report that concluded the Article IV consultation with Russian Federation.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 12, 2019, following discussions that ended on May 24, 2019, with the officials of Russian Federation on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 25, 2019.
- An **Informational Annex** prepared by the IMF staff.

The documents listed below will be separately released.

Selected Issues

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

Press Release No. 19/282
FOR IMMEDIATE RELEASE
July 16, 2019

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

IMF Executive Board Concludes 2019 Article IV Consultation with the Russian Federation

On July 12, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Russian Federation.

Russia's economy continues to show moderate growth, under sound macroeconomic policies but with structural constraints and the effects of sanctions. Output grew by 2.3 percent in 2018, driven by exports and consumption, which was supported by growth in real wages and higher labor demand. Investment registered a moderate increase compared to the previous year. After reaching historical lows earlier in 2018, inflation picked up in the second half of the year. One-off factors (such as ruble depreciation as well as food and fuel price increases) rather than demand pressures were the major drivers of the increase.

Growth is projected at 1.2 percent in 2019, reflecting a weak first quarter estimate, lower oil prices and the impact of the higher VAT rate on private consumption. At the same time, GDP growth should be supported by an increase in public sector spending in the context of the national projects announced in 2018. Inflation has begun to fall and is expected to return to the 4 percent target by early 2020. The medium-term growth outlook remains modest. Public infrastructure spending under the national projects together with increase labor supply due to pension reform could have a positive effect on the growth rate of potential output. However, absent deeper structural reforms, long-run growth is projected to settle around 1.8 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.

(continued…)

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. Executive Directors commended the authorities for their sound macroeconomic policy framework, which helped reduce policy uncertainty, and mitigate the effects of external shocks. Directors noted that, despite the ongoing recovery, the medium-term outlook remains modest. They called for continued strong policy efforts and comprehensive structural reforms to accelerate potential growth, address institutional weaknesses and governance issues, strengthen the financial sector, and lift productivity and investment.

Directors agreed that a neutral fiscal policy stance is currently appropriate. However, they noted that additional fiscal consolidation would be needed in the long-term to ensure inter-generational equity. Directors agreed that the fiscal rule anchors fiscal policy and helps shield the economy from fluctuations in oil prices, thus facilitating economic diversification. They emphasized that further changes to the rule, especially after the slight relaxation last year, should be avoided to firmly establish its credibility. Directors encouraged the authorities to refrain from quasi-fiscal activities through the National Welfare Fund (NWF) and that they should continue to invest NWF funds into high-quality foreign assets.

Directors welcomed the authorities' implementation of the pension reform and their plans to boost spending on health, education, and infrastructure. However, they emphasized that the spending plans should be well-targeted toward strengthening growth, and efficiently implemented. Directors noted that Russia's fiscal revenue framework could benefit from tax base broadening and further growth-friendly shifts in taxation to incentivize labor supply, reduce labor informality, and attract new investment. They recommended that oil sector taxation should be simplified, and subsidies on domestic fuel consumption phased out. Directors noted that expenditure on social assistance needs to be better targeted to have a stronger impact on reducing poverty.

Directors supported continued easing of monetary policy, given the recent inflation outturns. They welcomed the Central Bank of Russia's plans to maintain its careful and data-driven approach in setting monetary policy, as inflation expectations are not yet firmly anchored. Directors encouraged the CBR to further refine its monetary policy communications strategy.

Directors encouraged the authorities to continue to enhance bank supervision and regulation. This should include strengthening asset quality reviews and reducing related-party loans. They also recommended continued efforts to complete the consolidation of the banking sector. Directors welcomed the authorities' recent macroprudential measure to curb unsecured consumer lending. However, they noted that additional measures may be needed if lending growth does not

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

moderate. Directors underscored the importance of having a credible strategy for returning rehabilitated banks to the private sector in a way that is consistent with increasing competition among banks.

Directors underscored that ambitious structural reforms will be important to raise growth. They noted that priority should be given to creating a more vibrant private sector, and reducing the footprint of the state. However, Directors emphasized the importance of first enhancing competition by facilitating the entry and exit for firms and strengthening the institutional architecture in which firms compete. They welcomed the government’s advances in the fiscal transparency agenda and underscored that further progress is needed, including to report the government’s obligations under Public Private Partnerships, reduce the share of classified expenditure in the budget, and strengthen State Owned Enterprise governance.

Table 1. Russian Federation: Selected Macroeconomic Indicators, 2016–20

	2016	2017	2018	2019	2020
				Projection	
Production and prices			(Annual percent change)		
Real GDP	0.3	1.6	2.3	1.2	1.9
Real domestic demand	-1.1	3.8	1.5	1.1	1.9
Consumption	-1.0	3.1	1.8	1.1	1.7
Investment	-1.2	6.0	0.8	1.0	2.2
Consumer prices					
Period average	7.1	3.7	2.9	4.9	3.9
End of period	5.4	2.5	4.3	4.3	3.9
Core CPI					
Period average	7.5	3.5	2.5	4.3	3.8
End of period	6.0	2.1	3.7	4.1	3.8
GDP deflator	3.2	5.4	10.3	4.3	3.9
Unemployment rate	5.5	5.2	4.8	4.8	4.8
Public sector 1/			(Percent of GDP)		
General government					
Net lending/borrowing (overall balance)	-3.7	-1.5	2.9	1.5	1.3
Revenue	32.8	33.3	35.5	34.7	34.3
Expenditures	36.4	34.7	32.6	33.3	33.0
Primary balance	-3.2	-1.0	3.4	1.9	1.8
Nonoil balance	-9.8	-8.7	-7.0	-6.9	-6.7
Nonoil primary structural balance	-8.9	-7.7	-6.6	-6.4	-6.1
Federal government					
Net lending/borrowing (overall balance)	-3.4	-1.4	2.6	1.5	1.4
Nonoil balance	-9.0	-8.0	-6.2	-6.2	-6.0
Money			(Annual percent change)		
Base money	3.8	8.6	8.0	8.6	7.2
Ruble broad money	9.2	10.5	11.0	8.8	7.4
Credit to the economy	-1.6	7.5	10.6	9.8	8.6
External sector					
Export volumes	2.6	3.1	4.2	2.8	3.0
Oil	-1.2	-2.5	2.3	-1.0	1.9
Gas	7.1	7.1	3.6	0.0	0.0
Non-energy	-3.3	15.5	9.8	7.4	4.7
Import volumes	1.5	16.7	2.1	2.2	3.3
External sector			(Billions of U.S. dollars; unless otherwise indicated)		
Total merchandise exports, f.o.b	281.7	353.5	443.1	447.7	451.0
Total merchandise imports, f.o.b	-191.5	-238.1	-248.6	-255.7	-264.5
External current account	24.5	33.2	113.8	106.5	97.5
External current account (percent of GDP)	1.9	2.1	6.9	6.3	5.6
Gross international reserves					
Billions of U.S. dollars	377.7	432.7	468.5	517.5	551.5
Months of imports 2/	17.0	15.9	16.4	17.6	18.1
Percent of short-term debt	422.7	376.0	480.0	519.1	571.9
Memorandum items:					
Nominal GDP (billions of rubles)	86,014	92,101	103,876	109,663	116,072
Nominal GDP (billions of U.S. dollars)	1,283	1,579	1,658	1,678	1,733
Real per capita GDP (2014=100)	97.7	99.2	101.5	102.8	104.8
Output gap (percent of potential GDP)	-1.5	-0.8	0.2	-0.1	-0.1
Exchange rate (rubles per U.S. dollar, period average)	67.1	58.3	62.7	…	…
Oil exports (billions of U.S. dollars)	119.9	151.6	207.2	197.2	196.2
Brent oil price (U.S. dollars per barrel)	44.0	54.4	71.1	68.4	66.9
Urals crude oil spot price (U.S. dollars per barrel)	41.9	53.0	69.6	66.9	65.4
Real effective exchange rate (average percent change)	-1.2	14.6	-9.6	…	…

Sources: Russian authorities; and IMF staff estimates.

1/ Cash basis.

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

INTERNATIONAL MONETARY FUND

RUSSIAN FEDERATION

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

June 25, 2019

KEY ISSUES

Context: In recent years, the authorities have put in place a sound macroeconomic policy framework that has reduced uncertainty and helped weather external shocks. The current macroeconomic policy mix combines moderately tight monetary policy with a broadly neutral fiscal stance. The medium-term growth outlook remains modest due to structural constraints and sanctions. The authorities have implemented some politically difficult measures in the past year (pension reform and a VAT increase) and have announced plans aimed at raising productivity growth, including higher public spending on infrastructure, health, and education. To significantly increase Russia's long-term growth prospects and reduce stagnation risks, deeper efforts are needed to address the large footprint of the state, overbearing regulation, and governance and institutional weaknesses.

Policy Recommendations:

Fiscal Policy: Seek further growth-friendly shifts in taxes and spending, while maintaining overall discipline under the fiscal rule. Refrain from quasi-fiscal activities through the National Welfare Fund (NWF) and continue investing NWF funds into high-quality foreign assets even after the liquid part of the fund reaches 7 percent of GDP.

Monetary Policy: Continue monetary easing and building credibility of the inflation targeting framework—including through better communications of factors guiding policy decisions.

Financial Sector Policies: Continue the consolidation process of the banking sector while reducing state presence. Strengthen supervision and regulation. Address risks from fast-growing credit to households.

Structural Reforms: Enhance competition by facilitating entry/exit and reforming public procurement. Reduce barriers to trade and FDI. To increase government effectiveness and reduce vulnerability to corruption, further improve fiscal transparency as well as accountability and governance in the SOE sector.

Approved By
Jörg Decressin (EUR) and Zuzana Murgasova (SPR)

Discussions for the 2019 Article IV consultation were held in Moscow during May 13–24. The mission comprised Mr. Arena, Ms. Kyobe, Mr. Roaf (Head), Ms. Shi, and Mr. Slavov (all EUR), Mr. Hughes (FAD external expert), Mr. Berkhout (LEG), Mr. Yu (SPR), and Mr. Di Bella (Res. Rep). Ms. Dynnikova (local senior economist) and Ms. Chebotareva (local economist) assisted the mission. Ms. Stankova (COM) briefly joined the mission. Mr. Mozhin, Executive Director, participated in the discussions. The mission met with Minister of Economy Oreshkin, Deputy Minister of Finance Kolychev, Central Bank Governor Nabiullina, other senior officials and representatives of financial and business institutions. Support was provided by Ms. Tenali and Ms. Maneely (both EUR), and Ms. Rubina and Ms. Chernisheva (Moscow office).

CONTENTS

TABLES

ANNEXES

CONTEXT: SOUND MACROECONOMIC FRAMEWORK BUT DEEPER REFORMS NEEDED

1. Russia's relative growth performance and prospects have weakened in recent years. After outpacing emerging economy peers during the 2000s boom, Russia's growth has fallen short in recent years. Income convergence with advanced countries has stalled at close to 60 percent of their average level. A number of factors have been at play (Box 1 and Annex VI):

Sources: IMF *WEO* and IMF staff calculations.

- **The 2014 sanctions and fall in oil prices,** and subsequent additional sanctions and geopolitical tensions, raised uncertainty and dampened domestic and foreign private investment. The threat of further sanctions continues to hang over the economy.

- **The required macroeconomic policy adjustment in response to those shocks.** This involved tight monetary policy to maintain confidence and bring inflation down under the new inflation targeting regime with a free floating exchange rate; and fiscal consolidation to correct the very large non-oil structural deficit and adjust to lower oil revenues, later cemented in a new fiscal rule.[1]

- **Structural constraints are long standing and** include a large footprint of the state, excessive regulation, widespread governance and institutional weaknesses, inadequate infrastructure, and demographic headwinds. Reform momentum has slowed in recent years after the significant structural transformation observed in the 1990s and early 2000s.

2. Currently, macroeconomic policies are transitioning from tight to more neutral stances. Following the success in rebuilding fiscal buffers, which remain essential for reducing Russia's vulnerability to external shocks, the fiscal stance in 2019 is estimated to be broadly neutral. Monetary policy remains moderately tight but is expected to shift towards neutral over the coming year.

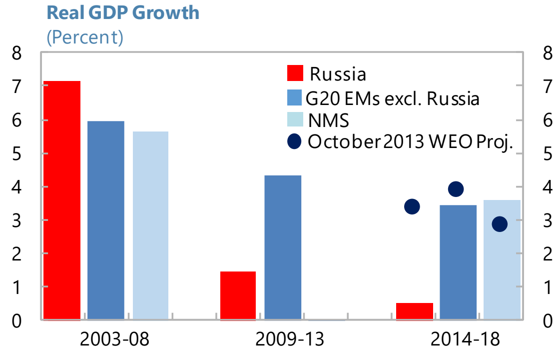
3. The government has articulated a set of ambitious policy objectives. These include raising GDP growth above the global average and cutting poverty in half by 2025. Investment should increase to 25 percent of GDP in the medium-term. These objectives have now been operationalized in the authorities' 13 national projects, which envision a ramp-up of public spending on infrastructure, health, and education (see Box 3). The national projects have potential to stimulate activity, but only if they are implemented effectively and complemented with far-

[1] See paragraph 14 for details of the fiscal rule.

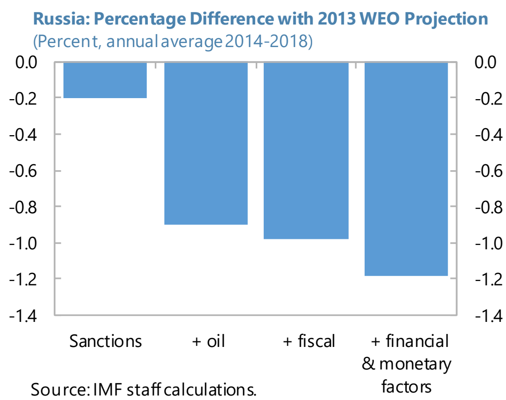
reaching efforts to strengthen competition, roll back state intervention, and improve state-owned enterprise efficiency.

Box 1. Factors Behind Russia's Growth Slowdown[1/]

Output growth averaged 0.5 percent in 2014–18, over 2 percentage points a year slower than originally projected. Sanctions, the unexpected decline in oil prices, together with financial market and policy responses to the dual shocks, contributed to the lower-than-expected growth since 2014. Falling consumption and investment were the main drivers of the unexpected slowdown of growth in terms of demand. The needed monetary and fiscal policy response to lower oil prices and capital outflows amplified the demand effects. On the supply side, growth accounting suggests a slowdown in total factor productivity that started with the global financial crisis, while capital and labor inputs also grew more slowly.



Sources: IMF *WEO* and IMF staff calculations.
Note: Calculated as a cross-sectional median and average for the period.



Source: IMF staff calculations.

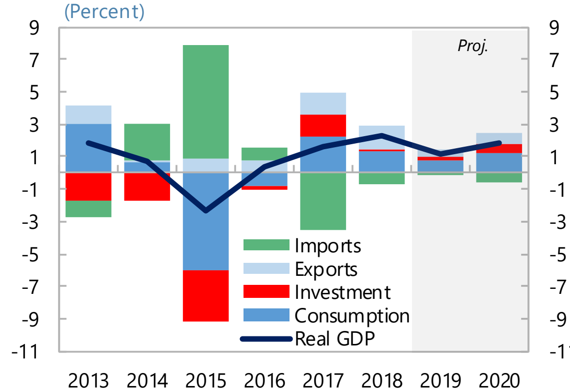
Counterfactual analysis suggests growth could have been about 1 percent higher annually without the shocks. Analysis based on two models from the IMF Research Department (GIMF and G20 Model), suggests that unfavorable external conditions, including sanctions and the decline in the global oil price, led growth to fall short of expectations by around 0.8 percentage point per year since 2014. The responses from the financial sector and macroeconomic policies contributed to a further 0.3 percentage point decline in growth rates compared to the projection in 2013.

[1/] Annex VI examines Russia's growth experience over the past 20 years in more detail.

RECENT ECONOMIC DEVELOPMENTS AND NEAR-TERM OUTLOOK

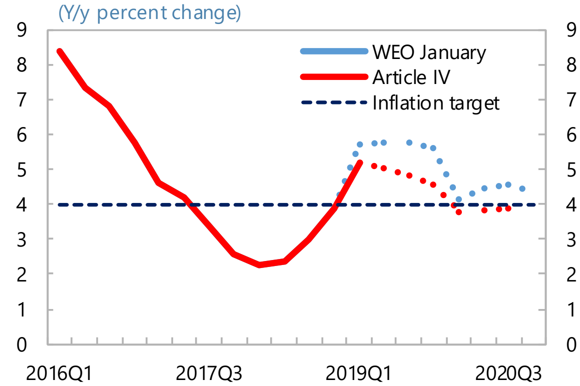
4. **Growth picked up in 2018 despite the restrictive fiscal and monetary policies (Figure 1).** The economy continued its recovery from the 2015–2016 recession. Output grew by 2.3 percent, outpacing both staff's projection of 1.7 percent and the Central Bank of Russia (CBR)'s forecast (1.5–2.0 percent). According to the CBR, this outcome exceeded the projection due to temporary factors, primarily additional growth in the volume of construction works. Recovering oil prices boosted energy exports, while import growth slowed significantly amid ruble depreciation (reflecting an episode of capital outflows across emerging markets and growing uncertainty over sanctions against Russia). Private sector consumption was supported by growth in real wages and higher labor demand, and investment registered a moderate increase compared to the previous year.

5. Lower growth is forecast for 2019. GDP is projected at 1.2 percent, reflecting a weak first quarter estimate, lower oil prices and the impact of the higher VAT rate on private consumption. At the same time, GDP growth should be supported by an increase in public sector spending in the context of the 13 national projects, especially during the second half of the year. Assuming the planned implementation of the national projects, growth is expected to accelerate in 2020 to 1.9 percent, mainly driven by domestic demand.



Sources: Rosstat and IMF staff calculations.

6. Inflation is expected to return to target by early 2020 (Figure 2). After reaching historical lows earlier in 2018, inflation picked up in the second half. One-off factors (such as ruble depreciation as well as food and fuel price increases), rather than demand pressures, have been the major drivers behind the increase. The VAT rate increase in January 2019 had a lower-than-expected impact on inflation, which peaked in March at 5.3 percent and declined to 5.1 in May. Assuming both the pass-through from VAT to prices is complete and stable domestic fuel prices, inflation is projected to continue decelerating through 2019, falling to 4.3 percent by December, reaching the target in early 2020 and subsequently temporarily falling below the target.



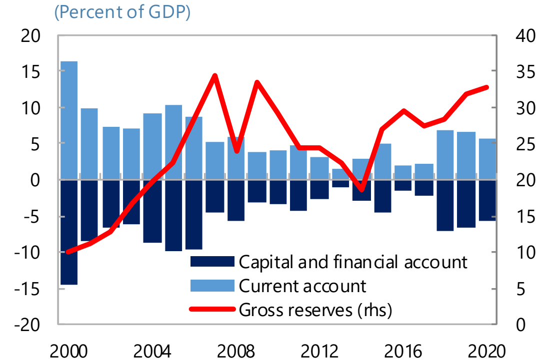
Source: IMF staff calculations.

7. The overall general government budget balance remains in surplus, under higher oil prices (Figure 4). The overall balance moved from a deficit to a surplus of 2.9 percent of GDP in 2018. This was mostly due to higher oil and gas prices, but the non-oil primary structural deficit also improved by 1.1 percent of GDP, driven by strong revenue collections in an improving economy with expenditures contained by the fiscal rule. The fiscal surplus is projected to fall to around 1.5 percent of GDP in 2019–20, as oil prices ease, while the non-oil deficit remains broadly stable.

8. The delinking of oil prices and the exchange rate has contributed to a strong external sector and further increases in external buffers (Figure 3). The REER depreciated by around 7½ percent in 2018 despite high oil prices, reflecting both depreciation due to new sanctions (and the threat of new measures) and the influence of FX purchases under the fiscal rule. This helped the current account register a record surplus of 7 percent of GDP in 2018, with robust export growth and moderate imports. External debt fell by 5½ percent of GDP, as the private sector continued its external deleveraging. Non-residents cut their holdings of ruble-denominated government debt to about 24 percent of the total stock in December 2018 from a peak of almost 35 percent in March 2018, due to heightened geopolitical tensions, but have since recovered to 28 percent in April 2019. International reserves increased to 284 percent of the ARA metric at end-2018. Staff assesses the external position to be moderately stronger than suggested by fundamentals and desirable policy settings (Annex V).

9. The current account surplus is expected to narrow gradually in line with falling in oil prices, and reserves to increase further under the application of the fiscal rule. The strong momentum in the current account continued into 2019:Q1. While sanctions are expected to weigh on capital flows, the large FX reserves and the free floating exchange rate regime provide substantial buffers to help absorb external shocks. The recent external deleveraging by the private sector further reduced risks. In addition, both the shift of fiscal expenditure to health, education, and infrastructure, and an increase in private sector investment are expected to bring the external position closer to fundamentals over the medium-term. (See Annex 5).

Balance of Payments and Gross Reserves
(Percent of GDP)



Source: IMF staff calculations.

MEDIUM-TERM OUTLOOK AND RISKS

10. Russia's growth potential is limited by structural constraints including supply-side bottlenecks, adverse demographic trends and the impact of sanctions. Public infrastructure spending under the national projects together with increased labor supply due to pension reform could have a positive effect on the growth rate of potential output, estimated at 0.1–0.5 percent a year over the next five years (Box 2). However, absent deeper structural reforms, long-run growth is projected to settle around 1.8 percent.

11. Risks to the outlook remain generally tilted to the downside (Annex I). In particular, geopolitical risks related to the prospect of additional US sanctions have increased uncertainty and may weaken investment. However, compared to the initial imposition of sanctions in 2014–15, today the authorities have stronger policy and crisis management frameworks in place, and larger buffers. Beyond sanctions risks, a potential intensification of global trade tensions could affect the benign global environment that Russia, as a commodity exporter, is currently benefiting from. On the domestic side, accelerating retail credit growth could lead to a build-up of impaired assets.

Authorities' Views

12. The authorities broadly shared staff's views on the growth outlook, and risks. While recognizing a degree of tightness in their policy mix in recent years, the authorities emphasized that the sound macroframework that they have put in place not only reduces risks to the economy but also contributes to increase long-term growth by encouraging investment. They consider that the national projects will increase potential output growth but, at the same time, recognized that the quantification of their impact is still ongoing. Also, the authorities agreed with staff on the sources of external risks that could affect the economy. In addition, both the CBR and the Ministry of Finance consider as a domestic source of uncertainty for growth and inflation projections the potential use of resources from the NWF to stimulate domestic demand,

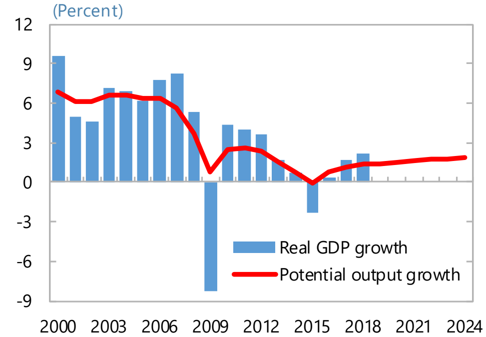
Box 2. Assessing the Impact of the Pension Reform and National Projects on Potential Output Growth

The pension reform combined with a reallocation of resources from consumption to investment could boost the supply side of the economy. Over 2019–2024, federal spending is planned to be increased by 1.1 percent of GDP annually, nearly half of it for infrastructure, while VAT revenues would increase by about 0.5–0.6 percent of GDP annually to cover the increases in current spending. The net increase in public investment spending should both raise demand, and, over time, help mitigate some structural bottlenecks. In addition, in 2018 the government adopted a parametric pension reform which gradually raises retirement ages to 65 for men and 60 for women by 2028. According to the Ministry of Economic Development, this reform will increase the labor force by around 2 million people (or about 3 percent) by 2024.

A production function approach is used to assess the impact on potential output of the pension reform and increased investment spending related to the national projects. The PF method is based on a standard neoclassical growth model, where output is obtained from a production function combining three inputs: labor, physical capital, and total factor productivity (TFP). We assume that employment increases from 72.5 million workers in 2018 to 74.0 million by 2024 (2 percent). Following IMF (2014), we consider three specifications of the PF specification: (i) potential levels of labor and capital are computed using the HP filter. With respect to TFP, in one case it is assumed that most fluctuations in TFP are cyclical, and in another it is assumed almost no cyclical fluctuations; (ii) using capacity utilization shares as in Oomes and Dynnikova (2006), where both labor and physical capital inputs are adjusted by their corresponding trends of capacity utilization shares, which were calculated using the HP filter; and (iii) supplementing (ii) with forecasts of the potential level of employment based on econometric estimates of the natural rate of unemployment.

The results point to an acceleration of the growth rate of potential output, from 1.5 percent to between 1.6 and 2.0 percent by 2024. The growth rate of potential GDP was previously estimated at around 1.5 percent. Under the first specification of the PF, the range of estimates is between 1.6 and 2.1 percent. Under the second specification, we estimate two cases: one where we have a small cyclical adjustment in TFP and another with no cyclical fluctuations in TFP. Based on these adjustments, the range of estimates is between 1.6 and 1.7 percent. Under the third specification, we consider different variants: adjusted and unadjusted factors of production by capacity utilization, with or without a cyclical component in TFP. The range of estimates is between 1.7 and 2.2 percent. Using the PF results to inform medium-term steady states, we estimate the likely trajectory of potential output between 2001 and 2024 using the multivariate filter approach to account for additional information in the estimation (unemployment and inflation) (Berger et al. 2015 and Blagrave et al. 2015).

GDP Growth and Potential Output Growth Rate
(Percent)



Source: IMF staff calculations.

once the portion invested in liquid foreign assets exceeds 7 percent of GDP. Furthermore, they agree that the ruble is somewhat undervalued, but emphasized the degree of uncertainty around this result due to the effects of sanctions imposed on the country.

POLICY DISCUSSIONS: SLOW GROWTH UNDERSCORES THE IMPORTANCE OF CONTINUING THE REFORM EFFORT

Assuming broadly neutral fiscal policy and monetary policy shifting from moderately tight to neutral, the output gap is projected to stay close to zero in the next few years, with growth in the 1.5–2.0 percent range. This outlook is subject to substantial market and geopolitical risks. The neutral fiscal stance is appropriate, and the focus in coming years should be on engineering a further growth-friendly shift in the composition of taxes and spending while boosting the credibility of the fiscal rule. Additional fiscal consolidation would be needed eventually, for intergenerational equity reasons. Notwithstanding the recent cut in the key policy rate in June, monetary policy remains moderately tight. Given the revised inflation outlook, easing toward a neutral stance should continue. In the financial sector, the authorities should continue strengthening supervision and regulation, and address risks from fast-growing credit to households. Finally, with macroeconomic policies geared to provide economic stability, an acceleration of potential output growth requires efforts to tackle structural challenges.

A. Extending Growth-Friendly Shifts in Taxes and Spending While Following the Fiscal Rule

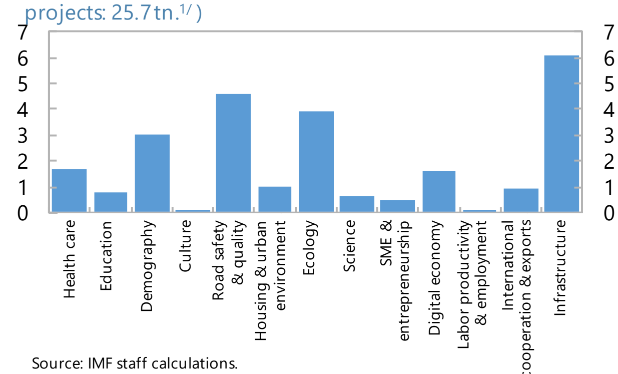
13. The authorities have implemented significant changes to their fiscal framework in the context of the 2019–21 budget. On the expenditure side, the government unveiled the 13 national projects, intended to accelerate growth and reduce poverty (see Box 3). To partially pay for these, they raised the main VAT rate from 18 to 20 percent starting in January 2019. However, the 10 percent reduced VAT rate for socially important goods was preserved, together with all other tax expenditures. The authorities also approved an oil sector tax reform, which will gradually eliminate export duties on oil and gas by 2024 and replace them with mineral extraction taxes. This was intended to reduce implicit subsidies for domestic refining and consumption of fuel.

14. The fiscal rule was temporarily relaxed slightly to accommodate higher infrastructure spending under the national projects. The revised fiscal rule now targets a primary deficit of 0.5 percent of GDP (previously zero) over 2019–2024 at the benchmark oil price of $40 (in real 2017 terms, adjusted for US inflation). As before, if actual oil prices exceed the benchmark, the fiscal authorities are required to purchase foreign exchange equal to the excess fiscal revenues and save it in the NWF. Flows into the NWF are held at the CBR as part of Russia's international reserves, at least until the target for NWF liquid assets, of 7 percent of GDP, is met (expected in 2020). Further changes to the rule should be avoided, in order to firmly establish its credibility. Russia has some fiscal space, due to the low level of public debt and limited financing needs. However, long-run scenario analysis suggests that further fiscal consolidation of 1–2 percent of GDP would eventually be needed to reach a nonoil primary balance consistent with sharing equitably Russia's finite resource wealth with future generations.[2] The authorities should refrain from quasi-fiscal activities through the NWF and should continue to invest NWF funds into high-quality foreign assets even after the liquid part of the fund reaches the 7 percent of GDP target, in order to safeguard resources for future generations and avoid procyclicality and insulate the domestic economy from oil price volatility, supporting diversification and growth of the nonoil economy.

Box 3. Russia's National Projects

In a May 2018 presidential decree following his re-election, President Putin spelled out a set of ambitious policy objectives for the next six years. These include raising GDP growth above the global average, cutting poverty in half, and extending life expectancy. These objectives have now been operationalized in the authorities' 13 national projects, which envision a ramp-up of public spending on infrastructure, health, and education. New federal spending on infrastructure is planned to account for a total of about RUB 3.5 trillion over the next six years (3 percent of annual GDP), while about RUB 4.5 trillion (4 percent of GDP) goes to health, education, and other current spending. Infrastructure spending will be financed by a temporary relaxation of the authorities' fiscal rule by 0.5 percent of GDP for the next six years, while the additional current spending is mostly financed by an increase in the main VAT rate from 18 to 20 percent.

Russia's National Projects
(Percent of 2018 GDP; based on total spending for the national projects: 25.7 tn.1/)



Source: IMF staff calculations.
1/Decomposition of the 25.7 tn for National Projects: 13.2 trillion from the federal budget (but only 8 trillion is new spending), 5.0 trillion from regional budget and extra-budgetary funds, and 7.5 trillion from extra-budgetary sources.

There are 13 national projects, further broken into more than 70 federal projects. For example, the 13th project, an integrated plan to modernize and expand transport and energy infrastructure, is broken into 11 federal projects: connecting Europe to Western China, seaports, northern waterways, railway transport, logistical centers, communications among centers of economic growth, development of regional airports and air routes, high speed rail, domestic waterways, energy infrastructure, and oil and gas transit infrastructure.

The authorities have set up a comprehensive monitoring framework. Each national project has been assigned a curator, a manager, and an administrator (typically, a deputy prime minister, a minister, and a deputy minister). The authorities have published detailed key performance indicators for each national project and have set up an online reporting system. However, more specifics are needed on the structure of additional spending under the national projects, to fully assess its impact.

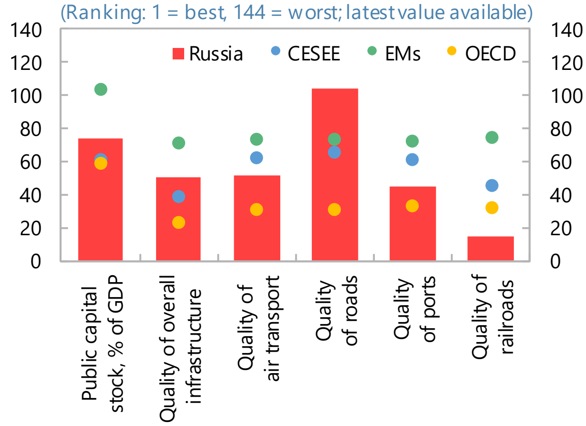
15. Russia's fiscal revenue framework could benefit from tax base broadening and a further growth-friendly shift in taxation. The authorities' annual budget document estimates

[2] For details, see IMF (2015).

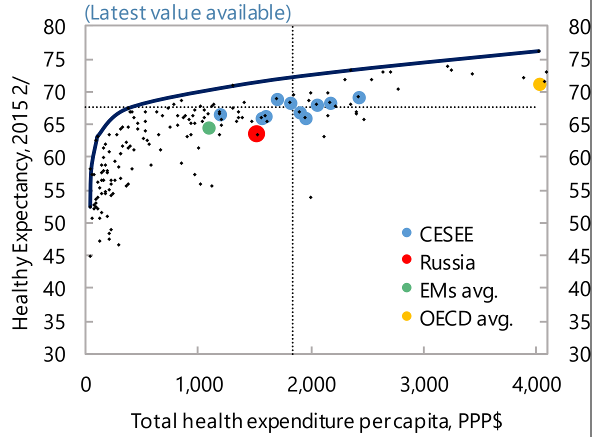
tax expenditures at around 2.5 percent of GDP. However, the survey omits tax expenditures under the personal income tax, notably various deductions and exemptions. Direct taxes remain quite high, including social contributions of 30 percent for most workers. A shift from direct to indirect taxes (for example, lower social contributions financed by VAT base broadening) could help incentivize labor supply and reduce informality.[3] While VAT base broadening might lower the purchasing power of vulnerable groups, such as retirees, the government has already committed to increasing pensions by 40 percent over the next six years, significantly above projected cumulative inflation.

16. Oil sector taxation should be simplified, and subsidies to domestic fuel consumption phased out. Repeated revisions to the oil sector tax reform over the past 12 months have complicated oil sector taxation. The original reform to replace oil export duties with a mineral extraction tax would have created a level playing field between domestic and export markets. However, this was undermined by restoring subsidies to domestic refining and consumption in the form of a "reverse excise," which is conditional on how remote each oil company or refinery is, whether it has an approved modernization plan, and whether it is targeted by sanctions. The reverse excise also contains a "damping component" which compensates oil companies for a portion of the difference between domestic and international fuel prices, in order to incentivize them to maintain stable prices for domestic consumers. The reverse excise has been revised several times over the past year, and the end result is a complex mechanism for subsidizing domestic refining and consumption. Any further revisions to oil sector taxation should be revenue-neutral. A schedule should be set for phasing out the reverse excise (including the damping component), in order to simplify the oil taxation regime and eliminate domestic fuel subsidies, while heeding the impact of rising fuel prices on vulnerable groups.

Capital Stock and Infrastructure Quality
(Ranking: 1 = best, 144 = worst; latest value available)



Health Efficiency Frontier 1/
(Latest value available)

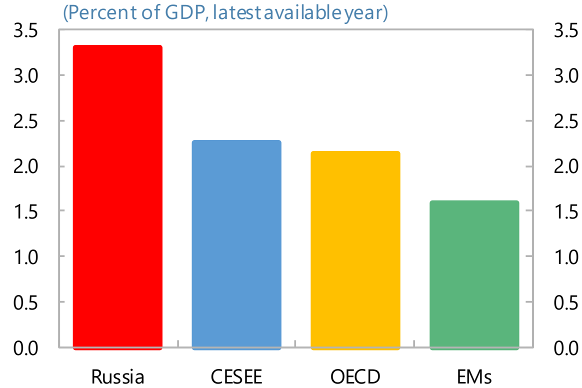


Source: IMF Expenditure Assessment Database.
1/ Dashed lines are the average of CESEE.
2/ Healthy life expectancy (HALE) is a measure of health expectancy that applies disability weights to health states to compute the equivalent number of years of life expected to be lived in full health.

[3] This should be accompanied by other measures to reduce informality, including improving tax compliance and regulatory quality, strengthening institutions, implementing labor market reforms, developing human capital, and boosting investment.

17. Additional spending on health, education, and particularly infrastructure is welcome, but the authorities could build further on their social spending reform. New infrastructure spending should target the most binding constraints: Russia faces substantial infrastructure gaps, especially for roads but also for air transport. Increases in health spending should go hand-in-hand with increasing its efficiency. The pension reform is welcome and should be fully implemented, as it is projected to reduce the pension fund's deficit by 0.5–1.0 percent of GDP by 2024. However, early retirement provisions remain overly generous and in need of reform.[4] Finally, expenditure on social assistance is relatively high (text chart) and appears to be too broadly and thinly spread.[5] Given the constrained fiscal space, social assistance could be better targeted toward reducing poverty, for example, by shifting from universal to means-tested benefits. The recent reform to unemployment benefits, which made them more generous but curtailed their duration for most workers, is welcome.

Social Assistance Spending
(Percent of GDP, latest available year)



Source: IMF Expenditure Assessment Database.

Authorities' Views

18. The authorities re-affirmed their strong support for the fiscal rule in its current form. While discussions are ongoing about investment rules for the NWF once its liquid portion exceeds 7 percent of GDP, the authorities agree that these rules should avoid strengthening the link between the price of oil and the exchange rate, in line with the logic of the fiscal rule and the associated mechanism for FX purchases. They are currently strengthening their framework for assessing tax expenditures, by making it more comprehensive and by also beginning to analyze the efficiency of tax expenditures. Regarding the changes in oil sector taxation, the authorities acknowledged that the reverse excise has added complexity to the system, but also claimed that subsidies for domestic consumption and refining have been significantly reduced, compared to the previous regime. They noted that they are already implementing a comprehensive strategy to reduce informality and felt that the current social contribution rate offers a reasonable compromise among competing priorities. Concerns about the employability of older workers

[4] Under the current system, people in certain occupations which in many cases are not particularly hazardous, can retire at an early age and receive full pensions without paying additional social contributions. By some estimates, up to 30 percent of workers in the formal sector are eligible for early retirement. For further details, see Eich, Soto, and Gust (2012).

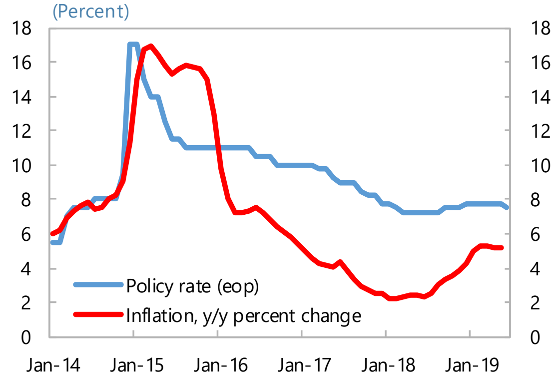
[5] According to recent estimates, 65 percent of the Russian population currently get some form of social assistance. While 10 percent of social assistance is targeted, only a quarter of this goes to the around 15 percent of the population living in poverty. While total spending on social assistance is more than enough to eradicate poverty, in practice it reduces the incidence of poverty only by a third. For further details, see a 2017 joint report by the World Bank and the Financial Research Institute of the Ministry of Finance.

make the authorities reluctant to revisit eligibility requirements for early retirement. Finally, the authorities remain committed to means-testing any new social benefits.

B. Monetary Policy: Easing Should Continue

19. The CBR cut its key policy rate by 25 bps to 7.50 percent in June after raising it in the second half of 2018. The CBR raised its key policy rate twice by 25 bps in 2018 H2 (September and December). In December, the CBR justified its decision as a pre-emptive move to contain second-round effects of the VAT rate increase. The inflation outcome in 2019:Q1 reflected a smaller-than-expected impact on headline inflation from the VAT increase (around 0.5 percent, compared to an expected increase over 1 percent). In this context, due to the inflation slowdown and decline of short-term pro-inflationary risks, the CBR cut its key policy rate and lowered its end-of-year annual inflation forecast for 2019 from 4.7–5.2 percent to 4.2–4.7 percent, allowing the possibility of further key policy rate reductions and a transition to neutral monetary policy during 2020. Also, based on the observed inflation outcomes, expected stability in domestic fuel and food prices, staff has also revised down its inflation forecast.

Policy Rate and Inflation
(Percent)



Sources: Central Bank of Russia and Rosstat.

20. Staff's estimates of the natural real interest rate (NRIR) overlap with those of the CBR (Box 4 and Annex VII). Most of staff's NRIR estimates are in the 1–3 range with the median of these estimates falling in the lower bound of the 2–3 percent range of the CBR. However, there is uncertainty around these estimates. Based on these, the stance of monetary policy appears to have remained somewhat tight during the entire economic cycle that began in late 2014, as inflation expectations have been brought towards the target against a challenging external environment.

21. As inflation outturns continue to be broadly in line with or below staff's forecast, the CBR should continue to ease monetary policy. Staff's inflation forecast incorporates recent developments in demand-side indicators and external sector conditions and it is consistent with a gradual decline of the policy rate. Some undershooting of inflation below the 4 percent target is expected in 2020.

22. The CBR needs to continue refining its policy framework and communications strategy. According to its most recent guidelines, the CBR's main objective is to keep inflation "close" to the target level of 4 percent. However, in practice, the CBR has less tolerance for inflation deviations above the target than below the target. Given Russia's inflationary history, such an approach may be warranted while seeking to establish credibility of the IT regime, to gradually eliminate expectations of high inflation. Currently, inflation expectations of households and corporates are more responsive to price growth acceleration than to a slowdown. But this has not stood in the way of record low inflation and limited pass-through of VAT hikes. Staff cautioned the authorities that looking forward a more symmetrical approach should be adopted to avoid episodes of persistent undershooting of the target–which could also result in unnecessarily high long-term real interest rates. Staff argued that the credibility of the inflation-targeting regime is built not through rigid adherence to numerical targets, but rather by a transparent strategy to gradually correct any deviations from the target. The CBR has strengthened its communication strategy in recent years but there is still room for improvement. Staff emphasized that the communication of the policy rate decisions should mainly reflect the CBR's view of the economic and inflation outlook.

23. The CBR could consider the possibility of developing an explicit FX intervention policy to address disorderly market conditions. Past episodes of volatility, such as in September of 2018, suggest that an FX intervention policy could have mitigated abrupt movements in the exchange rate, potentially reducing the need for shifts in the policy interest rate. However, any such policy would need to demonstrate credibly that it will not attempt to influence the exchange rate away from fundamentals.

Authorities' Views

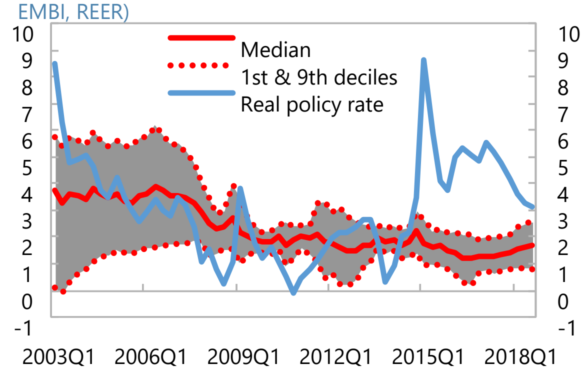
24. The CBR pointed to various factors arguing for caution in reducing interest rates. They consider that inflation expectations are elevated, and, based on cross-country experiences,

Box 4. Natural Real Interest Rate (NRIR) in Russia[1]

NRIR estimates for late 2018 fall into the 1– 3 percent range, with most estimates falling at about 2 percent, which is at the lower bound of the range estimated by the CBR (2–3 percent).

The NRIR is estimated to have decreased over the past 15 years. The main factors driving this decline are lower potential growth rates, but also lower international rates and country risk premia. Regarding the latter, increases in country risk push the natural rate upwards in EMs (like Russia) as capital mobility ensures that risk-adjusted real returns are arbitraged. Comparing actual real policy rates during this period to the NRIR estimates suggest that monetary policy was relatively accommodative during the 2005–08 period, while in more recent years policy has been moderately tight.

Natural Real Interest Rate: Range of Estimates
(Percent; Variables explaining r*: trend growth, US interest rate, EMBI, REER)



Source: IMF staff calculations.

Uncertainty around the NRIR estimate creates challenges for policy implementation. The central bank's ability to smooth the impact of short-term shocks depends on central bank's policy space. However, noisy estimates of the NRIR complicate this assessment. In this context, due to the great uncertainty and sensitivity around NRIR estimates, they should be considered jointly with other indicators such as deviations of inflation from target and a careful analysis of medium-term inflation prospects when setting monetary policy.

1/ See Annex VII.

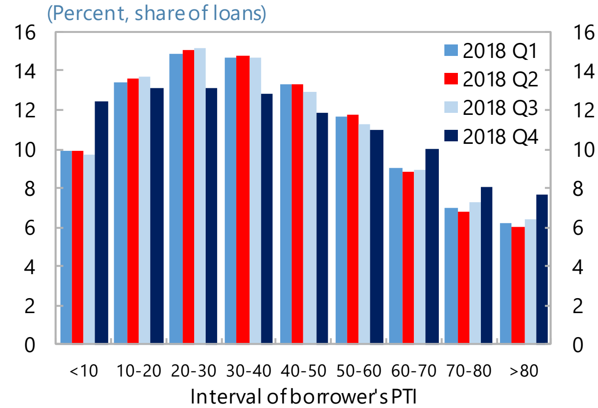
that relatively high real interest rates are needed to anchor expectations. Also, the authorities characterized their approach as not a preference to undershoot the target, but rather to place more weight on pro-inflationary risks than disinflationary ones. The authorities agreed that there is still room for further improvement in their communications. With respect to the possibility of implementing a FX intervention policy, the authorities consider that such policy could both provide the wrong signals to the market (e.g. the CBR is trying to defend a certain exchange rate level) and create risks to the communication of the CBR's objectives. Moreover, the authorities emphasized that the CBR will introduce the necessary measures to address specific market uncertainties (e.g. liquidity measures) in the context of episodes of exchange rate volatility.

C. Financial Policies: Fostering Resilience and Addressing Emerging Risks

25. The banking sector has been performing well, putting it in a position to support growth (Figure 5 and Table 7). The aggregate returns on assets and equity both increased in 2018, mainly driven by the largest banks. The system-wide capital adequacy ratio stayed close to 12 percent. NPLs remain high at (10.3 percent in March) but are adequately provisioned, according to CBR data. The CBR has continued its cleanup of the banking sector, bringing the total number of credit institutions to 469, as of May 1, from over 900 in 2013. A bank for core and non-core assets ("bad bank") has been set up to deal with the impaired assets of banks in open resolution, with a size (in book value) of around 2 percent of GDP. The authorities hope for a recovery rate of about 40 percent through actions, including asset sales to the market. Staff emphasized the importance of having a strategy for returning rehabilitated banks to the private sector in a way consistent with increasing competition among banks. Regarding NPLs, staff recommended that the CBR assesses the viability of NPLs and ensures banks have incentives to write them off.

26. Rapid retail lending growth has spurred a regulatory response, but more may be needed. Reflecting recovering demand and lower interest rates, the growth rates of unsecured consumer and mortgage lending each stood at about 24 percent in March. Although household debt remains relatively low in aggregate at 15.5 percent of GDP, the lending has been increasing in a subgroup of borrowers: the share of unsecured consumer lending to households with a payment-to-income (PTI) ratio above 50 percent increased to 37 percent at end-2018. To mitigate financial stability risks from the sector, the CBR raised risk weights several times in 2018, and again in April 2019. Staff emphasized that the CBR should consider increasing risk weights for unsecured consumer loans based on debt-to-income or payment-to-income ratios. Indeed, on June 11, in order to limit the risks associated with the debt burden in unsecured consumer lending, the CBR announced that it will establish surcharges to risk coefficients depending on both the effective interest rate (APR) and the PTI ratio since October 2019. The

Distribution of Unsecured Consumer Loans by PTI
(Percent, share of loans)



Sources: CBR; and IMF staff calculations.

new requirements introduce a matrix of risk weights where the higher the PTI and the APR, the higher the risk weight. If fast growth in lending to households continues, additional measures may be needed like broadening the macroprudential toolkit by introducing borrower-based tools (based on loan-to-value (LTV) and debt-to-income (DTI)/PTI ratios), which are often more effective in constraining credit growth than sectoral capital requirements. Regarding non-financial companies, credit to the corporate and the SME sectors show modest growth rates (below 6 percent, year-on-year, as of end-2018 and below 4 percent, year-on-year, in the last quarter of 2018, respectively). Also, increased profitability in the tradable and non-tradable sectors as well as lower FX risks for corporates have contributed to reduce macro-financial risks (Figure 6).

27. The CBR made further changes to its supervisory and regulatory framework in 2018, which it should continue to develop. Capital adequacy requirements can now be augmented with risk-based buffers; the CBR sets the Basel III net stable funding ratio for systemically-important banks (SIBs); a set of formal criteria were adopted to guide bank resolution decisions; and 149 banks with capital less than RUB 1 billion were switched to a restricted basic license, under which they are subject to simplified regulation but prohibited from most overseas operations. Looking forward, the legal framework for related party exposures and the draft law upgrading the framework for banks' external auditors could be strengthened further.[6] In the ongoing process of asset quality review (AQR), there is scope to further improve the identification of risks in consumer lending, and to take into account the situation of corporate borrowers' business environments. The final increase of the capital conservation buffer and capital surcharge for SIBs should be implemented as scheduled so banks achieve fully-loaded levels by January 2020. Supervision could be enhanced by enabling the CBR to exercise professional judgement as part of an explicit early intervention mechanism.

28. The CBR launched a new instant payment system (IPS) in January 2019. The system was built using best international experience (BIS CPMI, Australia's NPP and ECB's TIPS) and it is set to enable instant customer-to-customer interbank transfers 24/7/365. Tariffs for banks will be between 0.5 and 3 rubles per payment depending upon the volume with a grace period in 2019. The CBR communicated that its intention is to foster competition in this market segment. Staff recommended a clearer delineation of oversight versus operational responsibilities for payment systems in CBR's organizational structure. Oversight standards should be applied consistently to comparable payment and settlement systems, including systems operated by the CBR.

Anti-money Laundering and Combating the Financing of Terrorism (AML/CFT)

29. The authorities have made progress in addressing some of the shortcomings identified in the 2016 FSAP (AML/CFT Technical Note), also in preparation for the currently

[6] With respect to related-party exposures, regulation could include a legal prohibition on performing related party transaction on more favorable terms than corresponding transactions with non-related counterparties. With respect to external auditors, regulations should provide that an external auditor is sufficiently independent and meets eligibility criteria, including professional standards.

ongoing FATF/MONEYVAL/EAG comprehensive mutual evaluation**.** This includes the finalization of the National Risk Assessment (NRA). A public summary[7] highlights i) fraud and misappropriation of budgets and taxes; ii) corruption and bribery; iii) financial sector fraud; and iv) drug trafficking as the main money laundering threats. Going forward, authorities will need to continue to take appropriate mitigating measures to address identified risks. The FATF/MONEYVAL/EAG mutual evaluation report is scheduled for adoption by FATF in October 2019 and will provide the authorities with a useful roadmap for future improvements.

30. The authorities have also taken measures to improve the availability of beneficial ownership information, by requiring all Russian legal entities to have such information available. Nevertheless, as the abuse of domestic and foreign legal entities remains one of the main vulnerabilities for money laundering and corruption, consideration should be given to also requiring legal entities to feed this information into a domestic beneficial ownership registry.

31. The possible negative impact of sanctions on the risk appetite of foreign financial institutions to do business with Russian counterparts is a concern, which authorities should continue to monitor and mitigate. Bilateral foreign sanctions against Russian individuals and entities, and the extraterritorial impact of bilateral foreign sanctions against third countries (even if not legally applicable in Russia), potentially increase the risk exposure of foreign financial institutions when doing business with Russian counterparts. This in turn may lead to pressures on correspondent banking relationships. Likewise, ongoing investigations in third countries related to money laundering schemes that involved Russia, even if the laundering took place some time ago, may have similar impacts on risk appetite and consequences for correspondent banking relationships.

Authorities' Views

32. In the authorities' assessment, the health of the financial system has improved over the past year. Based on their AQRs, the general quality of the asset portfolio has stabilized, especially in the corporate sector. However, they agreed that further work is needed to expand the review coverage of the consumer lending portfolio given its recent growth. They emphasized that they intend to disinvest the rescued banks, but question whether the market is ready and if there is enough private sector capital to enter into the financial sector. They would like to avoid that only one private sector shareholder has a dominant position in the banks to be sold. Finally, the authorities agreed that to enhance supervision, the CBR needs to be able to exercise professional judgement. This in turn, requires legal protection for supervisors which the State Duma is currently reluctant to grant.

33. The authorities agreed that they could deploy additional macroprudential measures to curb the growth rate of unsecured consumer lending, if needed. They consider the already-implemented measures as pre-emptive in order to mitigate potential financial stability risks. An additional measure that they would explore is to implement risk weights based on DTI.

[7] http://www.fedsfm.ru/en/preparation-fatf-fourth-round.

Finally, the authorities mentioned that, currently, they do not have the legal scope to implement borrower-based macroprudential measures (LTV and PTI).

34. The authorities agreed that significant progress has been made on AML/CFT since the 2016 FSAP. They also pointed to additional advances in other areas related to the AML/CFT standards to mitigate money laundering and related corruption risks. They noted that the requirement for companies to hold accurate and up-to-date beneficial ownership information is recent and seems to be working well. However, they will continue to monitor the issue in light of the high risk that lack of transparency of beneficial ownership poses according to the NRA. Regarding investigations of past money laundering schemes, authorities noted that cases can date back some years ago before the introduction of recent improvements in the Russian AML/CFT framework. They also pointed out that some investigations in other countries benefit from law enforcement and supervisory information shared by Russian competent authorities.

D. Persisting with Structural Reforms to Lift Potential Growth

35. The decline of Russia's per capita income relative to EU new member states (NMS) in recent years continues to underscore the importance of structural reforms. Most of the drivers behind Russia's extraordinary growth performance during 2003–08 cannot be replicated. The large initial efficiency gains from Russia's transformation into a market economy, the benefits from achieving macroeconomic stability, and favorable external conditions including the commodity-price boom of the early 2000s are factors that are either one-off or exogenous to Russia.[8] After exiting the recent recession, it is time to accelerate necessary reforms to improve productivity and foster new sources of growth. Long-standing weaknesses include inadequate infrastructure, a large footprint of the state, lack of competition, excessive regulations, weak protection of property rights, corruption vulnerabilities, and adverse demographic trends.

36. The authorities have taken some steps to tackle structural bottlenecks (Annex II). The gradual extension of pension ages adopted in 2018 should help offset negative demographic trends. The government plans to boost public spending on human and physical capital, supporting labor productivity and entrepreneurship, and enhancing international cooperation in the context of the 13 national projects. To reduce informality, the authorities launched pilots for lower and simpler taxation of the self-employed in four regions in 2019. Also, the authorities are making efforts to improve competitiveness and diversify exports. One of the national projects focuses on increasing non-energy exports and trade integration within the Eurasian Economic Union. The authorities' plan to improve the business climate (adopted in January 2019) also aims to facilitate trade by promoting exports, selectively reducing import duties, and expediting customs procedures (through digitalization and expanded use of a risk-based approach).

[8] See Annex VI.

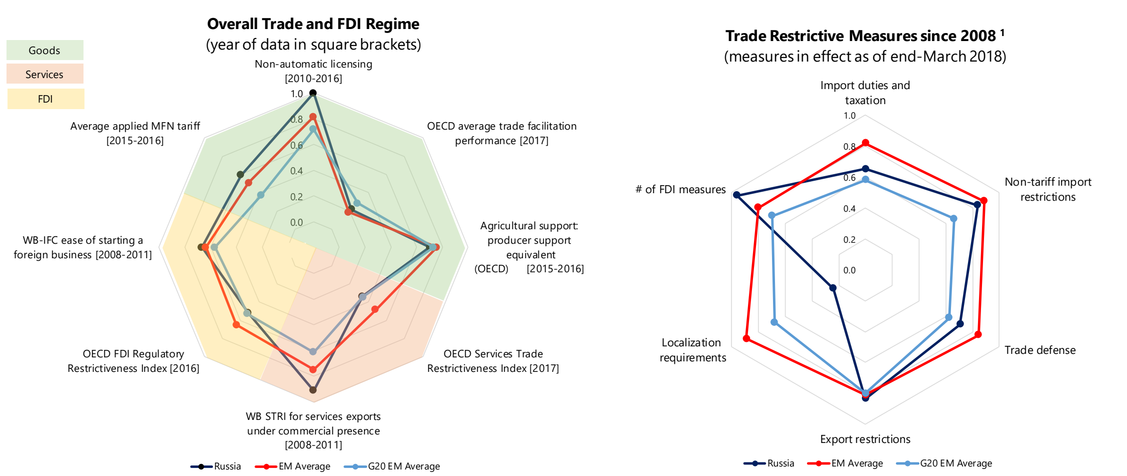
37. Comprehensive and ambitious structural reforms are needed to lift productivity and investment. Reducing the footprint of the state, in particular, could accelerate potential growth, especially in light of findings that SOEs are systematically less efficient than peer firms in the private sector.[9] However, sale of state assets will be more difficult in the current geopolitical environment which makes Russia less attractive to foreign investors and curtails domestic investors' appetite for expansion.

38. In the near term, reform priorities should focus on measures that are feasible and have a high productivity impact. The authorities should enhance competition by facilitating entry/exit of firms (for example, by reforming the bankruptcy framework), strengthening the competition authority's enforcement powers, and reforming public procurement rules to ensure open and competitive tendering. A well-designed reduction in taxes on labor, financed by targeted expenditure savings or the elimination of inefficient tax breaks, could incentivize labor supply and (as part of a broader package of measures) help reduce informality.

39. The authorities should persist with their efforts to strengthen competitiveness and promote trade integration, including by reducing barriers to trade and FDI. They should address the structural rigidities identified in the 2017 Article IV Selected Issues Papers (e.g. business regulation and undiversified export basket) which continue to dampen the response of the economy to changes in relative prices. Steadfast implementation of the revised fiscal rule should help, as it has weakened the impact of oil prices on the exchange rate (Figure 2), thus supporting the non-oil economy and facilitating export diversification. In addition, high localization requirements (the third highest among G20 countries) may have the unintended consequence of keeping Russia outside of global supply chains and should be reduced.

Selected Trade Policy Indicators

(0=least open country in G20:1=most open country in G20)



Sources: Tariff data are from the WTO, *World Tariff Profiles;* the import licensing measure is based on UNCTAD TRAINS and COMTRADE data; the average trade facilitation performance, agricultural support measure, Services Trade Restrictiveness Index (STRI), and FDI Restrictiveness Index are from the OECD; WB STRI is from the World Bank; the post-GFC indicators are from Global Trade Alert.

Notes: The indicators reflect no judgment as to WTO compliance of underlying measures, nor whether certain measures (such as trade defense) are an appropriate response to the actions of other countries. The "ease of starting a business" indicator is based on perceptions as part of an established IFC survey process.

[1] Import (export) coverage ratio, except for the case of FDI (number of measures).

[9] See Di Bella, Dynnikova, and Slavov (2018).

40. There is a range of possible measures to address long-standing weaknesses in governance, reduce vulnerability to corruption, and improve government efficiency. Several studies like Kaufmann, Kraay, and Zoido-Lobaton (1999), Kaufmann and Kraay (2002), Knack and Keefer (1995), and Barro (1996) show that variables reflecting the quality of governance[10] are closely correlated with GDP growth rate per capita, investment, or human capital development. Discussions with the authorities focused on the identified governance weakness in a few state functions, particularly AML/CFT measures (paragraphs 29–31) fiscal governance and SOE oversight.

41. Further improvements in fiscal transparency could raise government efficiency and reduce corruption vulnerabilities (Box 5). Cross-country evidence confirms that fiscal transparency is broadly and robustly correlated with better outcomes, including better efficiency of public investment and revenue collection, lower borrowing costs, and improved corruption perceptions. Russia has made significant progress since being one of the first countries to volunteer for an IMF Fiscal Transparency Evaluation (FTE) in 2014, but there remains room for improvement, particularly in areas such as reporting the government's obligations under PPPs, reducing the share of classified expenditure in the budget, and strengthening SOE governance.

Authorities' Views

42. The authorities emphasized that the national projects are not the only set of reforms in the government's agenda. In particular, the authorities noted the reform related to the reduction of the regulatory burden to enterprises (the "*Regulatory Guillotine*") in order to improve the business climate. Also, they mentioned the proposed procurement reform, which would allow more SME participation. In addition, the authorities mentioned that they have finalized a methodology, drawing on international practice, that would assess both the social impact (return) of proposed projects and their impact on GDP, which would be a key tool in the selection of projects. Regarding the idea to reduce taxes on labor (in particular, the 30 percent social contribution rate), the authorities argued that following last year's substantial changes to the tax code, their top priority going forward is stability in the tax system, which they see as beneficial for investors.

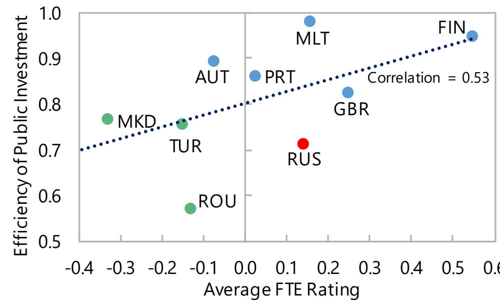
43. The authorities welcomed the update to the 2014 FTE. They agreed that significant progress had been made over the past 5 years, and plan to make further progress on fiscal transparency. The MoF has initiated a program to review the value for money of the government's tax expenditures to inform the 2020 Budget. Work to strengthen financial oversight of SOEs is underway with statistics on the consolidated public corporations sector expected in the early 2020s. The government also plans to extend the time horizon for its longer-term economic and fiscal forecast beyond the current 17-year horizon and include within it a more detailed analysis of fiscal risks.

[10] Among these variables: government effectiveness, rule of law, control of corruption, repudiation of contracts by the government, risk of expropriation, and quality of bureaucracy.

Box 5. Further Improving Fiscal Transparency In Russia[1]

Fiscal transparency has acquired a central role in IMF surveillance since the wave of crises that struck emerging markets in the late 1990s. In a seminal paper, Kopits and Craig (1998) defined fiscal transparency as "openness toward the public at large about government structure and functions, fiscal policy intentions, public sector accounts, and projections."

Correlation Between Average FTE Rating and Efficiency of Public Investment for 9 EUR Countries



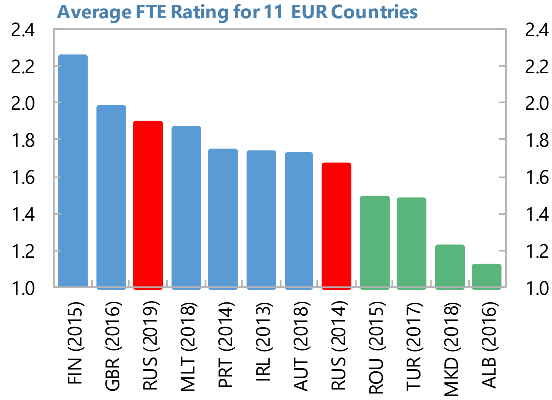
Sources: IMF Fiscal Transparency Evaluations Database and Investment and Capital Stock Dataset.
Note: Both measures are controlled for GDP per capita (PPP-adjusted).

Fiscal transparency is important because it facilitates the efficient allocation of resources by the public sector and reduces vulnerability to corruption ("sunlight is the best disinfectant"). It enables the market to evaluate and impose discipline on government policies. It raises the political costs of unsustainable policies. It reduces fiscal illusion, that is, the overstatement of benefits and the understatement of the costs and risks of government programs. It decreases informational asymmetry between politicians (especially incumbents) and voters, and, therefore, it also reduces the political business cycle and increases political competition. Finally, it strengthens the enforcement of fiscal rules, by making their circumvention more difficult.

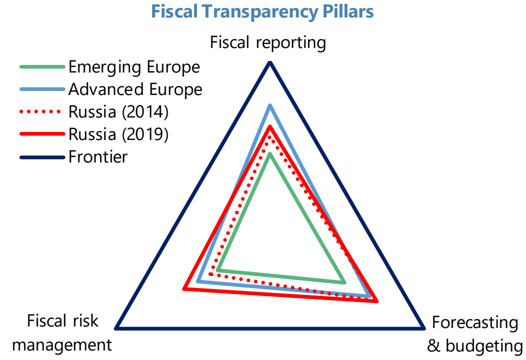
Cross-country evidence from European countries confirms that fiscal transparency is broadly and robustly correlated with better public sector performance. Improved outcomes include better efficiency of public investment and revenue collection, lower borrowing costs, and improved corruption perceptions.

Russia has made significant progress since being one of the first countries to volunteer for an IMF Fiscal Transparency Evaluation in 2014, but there remains room for further improvement. Among the eleven European countries that have undergone a fiscal transparency evaluation by the IMF, Russia's overall score in 2014 was better than that of any other CESEE country, and close to those of advanced economies. Over the last five years, the government has built on its relatively good record in this area by providing estimates of the value of its natural resources, reporting in detail on the cost of tax expenditures, publishing longer-term fiscal projections and a comprehensive report on fiscal risks, and adopting a program-based budget classification. However, further progress is needed, including to report the government's obligations under PPPs, reduce the share of classified expenditure in the budget, as well as strengthen the governance and enhance the financial reporting of the over 30,000 state-owned enterprises. In particular, the authorities should start producing a summary document on the financial performance of the SOE sector and require all SOEs to publish audited financial statements.

Average FTE Rating for 11 EUR Countries



Fiscal Transparency Pillars



Source: IMF Fiscal Transparency Evaluation Database.

[1]See Selected Issues Paper, "Further Improving Fiscal Transparency in Russia To Raise Government Efficiency and Reduce Vulnerabilities to Corruption."

STAFF APPRAISAL

44. Improving Russia's moderate growth prospects will depend on domestic policies and reforms. External impetus to growth is expected to be limited, as sanctions, global political and trade uncertainty and lower oil prices have replaced the favorable external conditions that contributed to rapid growth in the 2000s boom. Thus, Russia needs to focus on domestic reforms. A key building block is the credible macroeconomic framework the authorities have established since 2014, in difficult circumstances, in the form of inflation targeting, exchange rate flexibility and the fiscal rule. Beyond this, stronger medium-term growth will require an acceleration of structural reforms to improve the working of the economy.

45. The neutral stance of fiscal policy in 2019 implied by the fiscal rule is appropriate. Further changes to the rule, especially after the slight relaxation last year, should be avoided in coming years, in order to firmly establish its credibility. However, additional consolidation of 1– 2 percent of GDP is estimated to be needed in the long term to share equitably Russia's natural resource wealth with future generations. The authorities should refrain from quasi-fiscal activities through the NWF and should continue to invest NWF funds into high-quality foreign assets, to safeguard resources, avoid procyclicality, and shield the economy from oil price fluctuations.

46. The authorities' plans for a growth-friendly shift in taxes and spending are welcome but could be extended, within the confines of the fiscal rule. The planned spending increases in public infrastructure, health and education under the national projects are welcome if they can be well-targeted toward strengthening growth and efficiently implemented. Oil sector taxation should be simplified, including phasing out subsidies for domestic consumption while ensuring protection for vulnerable groups that could be affected. Improved revenue collection and removal of inefficient tax breaks could finance a reduction in social contributions, helping address informality. Notwithstanding the recent pension reform, early retirement provisions remain overly generous. Within the current social assistance budget, greater emphasis on means-tested rather than universal benefits would help to reduce poverty.

47. Further bolstering financial sector soundness will help support economic growth. The cleanup of the banking sector needs to be completed. At the same time, the authorities need to continue strengthening bank supervision and regulation. This should include reducing lending concentration and related-party loans; strengthening asset quality review; and fully implementing Basel III regulatory standards as scheduled. Additional measures to curb unsecured consumer lending may be needed to contain financial stability risks if current measures prove insufficient. The authorities also need to develop a strategy for returning rehabilitated banks to private hands in a way consistent with increasing competition among banks.

48. The monetary policy stance is estimated to be moderately tight, and with reduced inflationary pressures, continued easing appears appropriate. The VAT increase has had a lower-than-expected impact on headline inflation, and the recent appreciation of the ruble and stability of domestic fuel prices reduce inflationary pressures. A forecast that incorporates these developments is consistent with inflation reaching the 4 percent target in early 2020, under a declining path for the central bank's policy rate.

49. The potential to raise growth will depend on the ambition of reforms to strengthen competition and reduce the role of the state. Combined with the labor supply impact of pension reform, the public infrastructure spending quantified under the National Projects is projected to lift potential growth by 0.1–0.5 percentage points, depending on the effectiveness of implementation. Other welcome initiatives under the projects include targeting demographics, labor productivity and employment support, SMEs and entrepreneurship support, enhancing international cooperation, and increasing non-commodity exports. To achieve significant growth dividends, reforms will need to address the long-standing problems of lack of competition in the economy, and relatedly, the large footprint of the state—both in terms of its high share in the economy and its intrusiveness into business activity. This should involve facilitating the entry and exit of firms; strengthening SOE governance; fully implementing plans for improving the business climate; and encouraging competition within and across regions, including in public procurement.

50. Russia can build further on its good record on fiscal transparency. Since the 2014 Fiscal Transparency Evaluation, the government has advanced its agenda by providing estimates of the value of its natural resources, reporting in detail on the cost of tax expenditures, publishing longer-term fiscal projections and a comprehensive report on fiscal risks, and adopting a program-based budget classification. However, further progress is needed, including to report the government's obligations under PPPs, reduce the share of classified expenditure in the budget, as well as strengthen the governance and enhance the financial reporting of SOEs.

51. Public and external debt are assessed to be sustainable. The external position in 2018 was moderately stronger than fundamentals and desirable policy settings. The next Article IV consultation should be held on the standard 12-month cycle.

Table 1. Russian Federation: Selected Macroeconomic Indicators, 2016–24

	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Projection					
Production and prices	(Annual percent change)								
Real GDP	0.3	1.6	2.3	1.2	1.9	2.0	2.0	1.9	1.8
Real domestic demand	-1.1	3.8	1.5	1.1	1.9	2.4	2.5	2.3	2.1
Consumption	-1.0	3.1	1.8	1.1	1.7	2.0	2.1	1.9	1.8
Investment	-1.2	6.0	0.8	1.0	2.2	3.3	3.6	3.2	2.9
Consumer prices									
Period average	7.1	3.7	2.9	4.9	3.9	4.0	4.0	4.0	4.0
End of period	5.4	2.5	4.3	4.3	3.9	4.0	4.0	4.0	4.0
Core CPI									
Period average	7.5	3.5	2.5	4.3	3.8	3.9	4.0	4.0	4.0
End of period	6.0	2.1	3.7	4.1	3.8	4.0	4.0	4.0	4.0
GDP deflator	3.2	5.4	10.3	4.3	3.9	4.0	4.0	4.0	4.0
Unemployment rate	5.5	5.2	4.8	4.8	4.8	4.7	4.7	4.7	4.8
Public sector 1/	(Percent of GDP)								
General government									
Net lending/borrowing (overall balance)	-3.7	-1.5	2.9	1.5	1.3	0.6	0.0	-0.3	-0.6
Revenue	32.8	33.3	35.5	34.7	34.3	33.6	33.2	33.0	32.9
Expenditures	36.4	34.7	32.6	33.3	33.0	33.0	33.2	33.3	33.5
Primary balance	-3.2	-1.0	3.4	1.9	1.8	1.5	1.0	0.7	0.5
Nonoil balance	-9.8	-8.7	-7.0	-6.9	-6.7	-6.8	-7.1	-7.3	-7.4
Nonoil primary structural balance	-8.9	-7.7	-6.6	-6.4	-6.1	-6.0	-6.2	-6.3	-6.3
Federal government									
Net lending/borrowing (overall balance)	-3.4	-1.4	2.6	1.5	1.4	0.7	0.1	-0.2	-0.4
Nonoil balance	-9.0	-8.0	-6.2	-6.2	-6.0	-6.1	-6.5	-6.6	-6.8
Money	(Annual percent change)								
Base money	3.8	8.6	8.0	8.6	7.2	6.9	6.7	6.6	6.3
Ruble broad money	9.2	10.5	11.0	8.8	7.4	7.1	6.9	6.8	6.5
Credit to the economy	-1.6	7.5	10.6	9.8	8.6	8.2	7.7	6.7	6.6
External sector									
Export volumes	2.6	3.1	4.2	2.8	3.0	2.7	2.5	2.6	2.5
Oil	-1.2	-2.5	2.3	-1.0	1.9	1.6	1.0	1.2	1.4
Gas	7.1	7.1	3.6	0.0	0.0	0.0	2.0	2.0	1.5
Non-energy	-3.3	15.5	9.8	7.4	4.7	4.3	3.9	3.7	3.6
Import volumes	1.5	16.7	2.1	2.2	3.3	3.3	3.8	3.9	3.6
External sector	(Billions of U.S. dollars; unless otherwise indicated)								
Total merchandise exports, f.o.b	281.7	353.5	443.1	447.7	451.0	452.3	456.7	466.1	478.7
Total merchandise imports, f.o.b	-191.5	-238.1	-248.6	-255.7	-264.5	-275.1	-287.5	-300.8	-315.6
External current account	24.5	33.2	113.8	106.5	97.5	90.6	75.1	69.2	64.2
External current account (percent of GDP)	1.9	2.1	6.9	6.3	5.6	5.1	4.1	3.7	3.3
Gross international reserves									
Billions of U.S. dollars	377.7	432.7	468.5	517.5	551.5	582.5	608.5	629.5	645.5
Months of imports 2/	17.0	15.9	16.4	17.6	18.1	18.4	18.4	18.2	17.8
Percent of short-term debt	422.7	376.0	480.0	519.1	571.9	594.8	600.4	638.4	653.3
Memorandum items:									
Nominal GDP (billions of rubles)	86,014	92,101	103,876	109,663	116,072	123,139	130,646	138,492	146,624
Nominal GDP (billions of U.S. dollars)	1,283	1,579	1,658	1,678	1,733	1,776	1,828	1,892	1,963
Real per capita GDP (2014=100)	97.7	99.2	101.5	102.8	104.8	107.0	109.4	111.7	114.0
Output gap (percent of potential GDP)	-1.5	-0.8	0.2	-0.1	-0.1	0.1	0.2	0.2	0.1
Exchange rate (rubles per U.S. dollar, period average)	67.1	58.3	62.7	…	…	…	…	…	…
Oil exports (billions of U.S. dollars)	119.9	151.6	207.2	197.2	196.2	189.1	184.0	183.1	184.8
Brent oil price (U.S. dollars per barrel)	44.0	54.4	71.1	68.4	66.9	63.4	61.2	60.1	59.9
Urals crude oil spot price (U.S. dollars per barrel)	41.9	53.0	69.6	66.9	65.4	61.9	59.7	58.7	58.4
Real effective exchange rate (average percent change)	-1.2	14.6	-9.6	…	…	…	…	…	…

Sources: Russian authorities; and IMF staff estimates.

1/ Cash basis.

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

Table 2. Russian Federation: Balance of Payments, 2016–24
(Billions of U.S. dollars, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Projection					
Current Account	24.5	33.2	113.8	106.5	97.5	90.6	75.1	69.2	64.2
Trade Balance	90.2	115.4	194.5	192.0	186.5	177.2	169.3	165.3	163.1
Exports	281.7	353.5	443.1	447.7	451.0	452.3	456.7	466.1	478.7
Non-energy	130.6	163.2	186.8	203.2	208.6	219.5	229.7	239.9	250.3
Energy	151.1	190.3	256.3	244.4	242.4	232.8	227.0	226.2	228.3
Oil	119.9	151.6	207.2	197.2	196.2	189.1	184.0	183.1	184.8
Gas	31.2	38.7	49.1	47.3	46.2	43.7	43.0	43.1	43.5
Imports	-191.5	-238.1	-248.6	-255.7	-264.5	-275.1	-287.5	-300.8	-315.6
Services	-24.0	-31.2	-29.9	-31.7	-34.3	-37.7	-41.3	-44.8	-48.4
Income	-35.5	-42.1	-41.4	-39.2	-42.6	-38.3	-44.2	-44.3	-45.1
Public sector interest (net)	-0.3	-0.4	0.9	1.6	1.0	1.6	1.5	1.4	1.4
Other sectors	-35.2	-41.6	-42.3	-40.7	-43.6	-39.8	-45.7	-45.7	-46.5
Current transfers	-6.3	-9.0	-9.3	-14.6	-12.1	-10.5	-8.7	-7.0	-5.3
Capital and financial account	-10.8	-13.1	-78.2	-57.5	-63.5	-59.6	-49.1	-48.2	-48.2
Capital transfers	-0.8	-0.2	-1.1	0.0	0.0	0.0	0.0	0.0	0.0
Financial accounts									
Federal government	3.9	12.1	-7.0	-10.6	-2.3	2.2	3.1	0.2	3.4
Portfolio investment	5.2	15.5	-5.3	-7.6	0.6	5.1	6.0	3.1	6.4
Loans	-0.3	-2.6	-1.3	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Other investment	-0.9	-0.9	-0.3	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0
Private sector capital	-14.1	-26.2	-68.1	-45.0	-59.2	-59.9	-50.2	-46.4	-50.7
Direct investment	10.2	-8.2	-23.1	-23.9	-27.8	-32.3	-34.2	-36.2	-38.4
Portfolio investment	-3.5	-9.7	-2.1	-3.5	-3.6	-2.3	-2.4	-2.5	-2.6
Other investment, commercial banks	1.7	-23.9	-33.7	-7.4	-8.5	-9.7	-10.5	-10.1	-8.5
Assets	30.5	5.2	-5.9	-5.1	-7.3	-10.7	-13.8	-13.4	-11.9
Liabilities (loans, deposits, etc.)	-28.8	-29.1	-27.8	-2.2	-1.1	1.0	3.3	3.3	3.4
Loans, corporations	-4.3	-3.6	-0.8	3.4	5.4	5.5	6.8	6.6	6.6
Disbursements	46.2	55.8	76.0	70.5	72.9	73.4	74.6	72.3	72.1
Amortizations	-50.5	-59.4	-76.8	-67.1	-67.5	-68.0	-67.8	-65.7	-65.5
Other private sector capital flows	-18.2	12.0	-13.0	-13.6	-24.7	-21.0	-9.9	-4.2	-7.8
Errors and omissions, net	-5.4	2.6	2.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	8.2	22.6	38.2	49.0	34.0	31.0	26.0	21.0	16.0
Financing	-8.2	-22.6	-38.2	-49.0	-34.0	-31.0	-26.0	-21.0	-16.0
Net international reserves	-8.2	-22.6	-38.2	-49.0	-34.0	-31.0	-26.0	-21.0	-16.0
Arrears and rescheduling	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Current account (percent of GDP)	1.9	2.1	6.9	6.3	5.6	5.1	4.1	3.7	3.3
Non-energy current account (percent of GDP)	-9.9	-10.0	-8.6	-8.2	-8.4	-8.0	-8.3	-8.3	-8.4
Gross reserves 1/	377.7	432.7	468.5	517.5	551.5	582.5	608.5	629.5	645.5
(months of imports of GNFS)	17.0	15.9	16.4	17.6	18.1	18.4	18.4	18.2	17.8
(percent of short-term debt) 2/	422.7	376.0	480.0	519.1	571.9	594.8	600.4	638.4	653.3
Real growth in partner countries (percent change)	2.6	3.6	3.1	2.4	2.8	2.7	2.7	2.7	2.7
Net private capital flows (percent of exports of GNFS)	-4.2	-6.4	-13.4	-8.8	-11.4	-11.5	-9.6	-8.7	-9.2
Net private capital flows, banks	5.5	-20.0	-29.7	-3.3	-4.4	-5.6	-6.4	-6.0	-4.4
Public external debt service payments 3/	6.6	7.7	8.4	5.4	9.1	5.7	7.6	8.6	6.5
(percent of exports of goods and services)	2.0	1.9	1.7	1.1	1.7	1.1	1.4	1.6	1.2
Public external debt 4/	51.2	70.1	63.5	54.9	54.5	58.7	63.8	66.0	72.4
(percent of GDP)	4.0	4.4	3.8	3.3	3.1	3.3	3.5	3.5	3.7
Private external debt	460.5	448.0	390.6	401.4	410.4	421.5	436.4	451.4	466.5
(percent of GDP)	35.9	28.4	23.6	23.9	23.7	23.7	23.9	23.9	23.8
Total external debt	511.8	518.1	454.0	456.3	465.0	480.2	500.2	517.3	538.9
(percent of GDP)	39.9	32.8	27.4	27.2	26.8	27.0	27.4	27.3	27.5
Brent oil price (U.S. dollars per barrel)	44.0	54.4	71.1	68.4	66.9	63.4	61.2	60.1	59.9
Urals oil price (U.S. dollars per barrel)	41.9	53.0	69.6	66.9	65.4	61.9	59.7	58.7	58.4
Terms of trade (percent)	-14.5	10.9	16.2	-2.3	-2.3	-3.0	-2.1	-1.2	-1.1

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

1/ Excluding repos with non-residents to avoid double counting of reserves. Including valuation effects.

2/ Excludes arrears.

3/ Net of rescheduling.

4/ Includes repo indebtedness by the monetary authorities.

Table 3. Russian Federation: External Financing Requirements and Sources, 2018–24

(Billions of U.S. dollars)

	2018	2019	2020	2021	2022	2023	2024
		Projection					
Gross financing requirements	5	15	4	0	-17	-21	-24
Current account balance	114	107	98	91	75	69	64
Debt amortization	-109	-92	-94	-90	-92	-90	-89
Public sector	-5	-2	-4	-1	-2	-3	0
Central Bank							
General government	-5	-2	-4	-1	-2	-3	0
Banks	-28	-23	-22	-22	-22	-22	-23
Corporates	-77	-67	-67	-68	-68	-66	-66
Sources of financing	34	34	30	31	43	42	40
Capital account balance (net)	-1	0	0	0	0	0	0
Foreign direct investment (net)	-23	-24	-28	-32	-34	-36	-38
RUS investment abroad	-32	-33	-38	-44	-47	-50	-53
Foreign investment in RUS	9	10	10	11	12	13	15
New borrowing and debt rollover	100	83	95	97	103	101	102
Borrowing	100	83	95	97	103	101	102
Public sector	2	-8	1	1	3	3	4
Central Bank							
General government	2	-8	1	1	3	3	4
Banks	22	20	21	23	25	25	26
Corporates	76	71	73	73	75	72	72
Other	-42	-25	-37	-34	-26	-22	-24
of which: Net errors and omissions	3	0	0	0	0	0	0
GIR change	38	49	34	31	26	21	16
Financing gap	0	0	0	0	0	0	0

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

Table 4. Russian Federation: Fiscal Operations, 2016–24[1]

(Percent of GDP, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Projection					
General government									
Revenue	32.8	33.3	35.5	34.7	34.3	33.6	33.2	33.0	32.9
o/w Oil revenue	6.1	7.2	9.9	8.3	8.0	7.4	7.1	7.0	6.9
o/w Nonoil revenue	26.6	26.0	25.6	26.4	26.3	26.2	26.1	26.1	26.0
Taxes	22.0	24.2	26.7	25.7	25.3	24.8	24.5	24.3	24.2
Corporate profit tax	3.2	3.6	3.9	3.5	3.5	3.4	3.4	3.4	3.5
Personal income tax	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
VAT	5.3	5.6	5.8	6.3	6.3	6.3	6.3	6.3	6.2
Excises	1.6	1.7	1.5	1.6	1.6	1.6	1.6	1.6	1.6
Custom tariffs	3.0	2.8	3.6	3.2	2.8	2.4	2.1	1.9	1.7
Resource extraction tax	3.7	4.9	6.3	5.6	5.7	5.6	5.6	5.6	5.7
Other tax revenue	1.6	2.0	2.0	1.9	1.9	1.9	1.9	1.9	1.9
Social contributions	7.0	7.1	6.9	7.0	7.0	7.0	7.0	6.9	6.9
Other revenue	3.8	2.0	2.0	2.1	2.0	1.8	1.8	1.8	1.8
Expenditure	36.4	34.7	32.6	33.3	33.0	33.0	33.2	33.3	33.5
Expense	31.7	31.0	29.1	29.4	29.2	29.1	29.3	29.5	29.6
Compensation of employees	4.3	4.1	3.8	4.0	3.9	3.9	3.9	4.0	4.0
Use of goods and services	3.4	3.0	2.8	2.9	2.9	2.9	2.9	2.9	2.9
Interest	0.9	0.9	0.8	0.9	1.0	1.1	1.1	1.2	1.3
Subsidies	7.2	7.5	7.0	7.2	7.2	7.2	7.2	7.2	7.3
Grants	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social benefits	13.8	13.7	12.9	12.8	12.7	12.5	12.3	12.1	11.9
Other expense	1.8	1.6	1.6	1.5	1.3	1.4	1.7	1.9	2.0
Net acquisition of nonfinancial assets	4.7	3.8	3.5	3.9	3.9	3.9	3.9	3.9	3.9
Net lending (+)/borrowing (-) (overall balance)	-3.7	-1.5	2.9	1.5	1.3	0.6	0.0	-0.3	-0.6
Non-oil primary structural balance	-8.9	-7.7	-6.6	-6.4	-6.1	-6.0	-6.2	-6.3	-6.3
Gross financing requirements	10.6	9.1	1.6	-0.3	0.0	0.6	1.0	1.2	1.2
Federal government 3/									
Revenue	15.6	16.4	18.7	18.2	17.7	17.0	16.6	16.5	16.4
o/w Oil revenue	5.6	6.6	8.9	7.7	7.4	6.9	6.6	6.4	6.3
o/w Nonoil revenue	10.0	9.8	9.9	10.5	10.3	10.1	10.1	10.1	10.1
Expenditure	19.1	17.8	16.1	16.7	16.4	16.3	16.5	16.7	16.8
Expense	15.6	15.3	13.8	14.0	13.7	13.6	13.9	14.0	14.1
Net acquisition of nonfinancial assets	3.5	2.6	2.3	2.7	2.7	2.7	2.7	2.7	2.7
Net lending (+)/borrowing (-) (overall balance)	-3.4	-1.4	2.6	1.5	1.4	0.7	0.1	-0.2	-0.4
Non-oil primary structural balance	-8.3	-7.1	-5.8	-5.7	-5.4	-5.2	-5.4	-5.5	-5.5
Gross financing requirements	4.2	2.6	-1.8	-0.7	-0.5	0.1	0.7	0.9	0.9
Memorandum items:									
General government nonoil primary balance	-9.3	-8.2	-6.5	-6.5	-6.2	-5.9	-6.1	-6.2	-6.3
General government nonoil overall balance	-9.8	-8.7	-7.0	-6.9	-6.7	-6.8	-7.1	-7.3	-7.4
Federal government nonoil primary balance	-8.6	-7.4	-5.7	-5.7	-5.4	-5.2	-5.4	-5.5	-5.5
Federal government nonoil overall balance	-9.0	-8.0	-6.2	-6.2	-6.0	-6.1	-6.5	-6.6	-6.8
Federal government primary balance at benchmark oil price	...	-1.6	-0.8	-0.6	-0.4	-0.4	-0.5	-0.5	-0.5
Urals oil price (U.S. dollars per barrel)	41.9	53.0	69.6	66.9	65.4	61.9	59.7	58.7	58.4
Oil funds 2/	6.2	4.1	3.6	7.1	9.7	11.9	13.5	14.7	15.5
General government debt	16.1	15.5	14.6	15.8	16.3	17.1	18.1	19.2	20.5
GDP (billions of rubles)	86,014	92,101	103,876	109,663	116,072	123,139	130,646	138,492	146,624

Sources: Russian authorities; and IMF staff estimates.

1/ Cash basis.

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

3/ Expenditures reflect the authorities budget; oil revenues are staff's estimates.

Table 5. Russian Federation: Monetary Accounts, 2016–24

(Billions of Russian Rubles, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Projection					
Monetary authorities									
Base money	9,076	9,854	10,647	11,565	12,403	13,261	14,149	15,081	16,030
Currency issued	8,790	9,539	10,312	11,201	12,012	12,843	13,701	14,603	15,521
Required reserves on ruble deposits	286	315	334	364	391	419	448	478	509
NIR 1/	22,418	24,520	31,935	33,634	36,979	40,396	43,399	45,940	48,077
Gross reserves	22,918	24,986	32,488	34,187	37,532	40,949	43,952	46,493	48,630
Gross liabilities	501	466	553	553	553	553	553	553	553
GIR (billions of U.S. dollars)	*378*	*434*	*468*	*517*	*551*	*582*	*608*	*629*	*645*
NDA	-13,341	-14,666	-21,288	-22,069	-24,576	-27,134	-29,250	-30,859	-32,047
Net credit to general government	-6,254	-5,609	-9,132	-12,859	-15,741	-18,368	-20,732	-23,000	-25,328
Net credit to federal government	-5,031	-4,725	-7,940	-12,144	-15,403	-18,479	-21,061	-23,304	-25,350
CBR net ruble credit to federal government 1/	-1,373	-1,711	-888	-1,065	-832	-462	-59	338	745
Foreign exchange credit	222	202	173	173	173	173	173	173	173
Ruble counterpart	-3,881	-3,216	-7,225	-11,252	-14,745	-18,190	-21,175	-23,816	-26,268
CBR net credit to local government and EBFs	-1,222	-884	-1,193	-715	-338	111	329	304	23
CBR net credit to local government	-864	-640	-989	-511	-134	315	533	508	227
CBR net credit to extrabudgetary funds	-359	-244	-204	-204	-204	-204	-204	-204	-204
Net credit to banks	54	-2,283	-1,917	1,695	5,284	9,172	13,340	17,463	22,083
Gross credit to banks	2,723	2,632	3,258	900	950	950	952	954	954
Gross liabilities to banks and deposits	-2,669	-4,915	-5,176	795	4,334	8,222	12,388	16,509	21,129
Of *which:* correspondent account balances	-1,823	-1,931	-1,898	-2,055	-2,208	-2,365	-2,528	-2,699	-2,873
Other items (net) 2/	-7,142	-6,774	-10,238	-10,905	-14,118	-17,938	-21,859	-25,322	-28,803
Monetary survey									
Broad money	50,903	54,667	62,627	67,678	72,226	76,853	81,615	86,601	91,652
Ruble broad money	38,418	42,442	47,109	51,265	55,080	58,995	63,051	67,318	71,674
Currency in circulation	7,715	8,446	9,339	10,163	10,919	11,695	12,499	13,345	14,209
Ruble deposits	30,703	33,996	37,770	41,102	44,161	47,300	50,552	53,973	57,466
Forex deposits 1/	12,485	12,225	15,518	16,414	17,146	17,858	18,564	19,283	19,977
Net foreign assets 1/	27,449	29,745	39,797	40,907	44,173	47,432	50,167	52,419	54,353
NIR of monetary authorities	22,418	24,520	31,935	33,634	36,979	40,396	43,399	45,940	48,077
NFA of commercial banks	5,031	5,224	7,862	7,273	7,194	7,036	6,768	6,479	6,276
NFA of commercial banks (billions of U.S. dollars)	83	91	113	110	106	100	94	88	83
NDA	23,454	24,922	22,830	26,772	28,053	29,421	31,449	34,181	37,299
Domestic credit	48,454	51,515	52,646	57,257	61,763	66,961	72,920	79,127	85,735
Net credit to general government	-2,491	-3,270	-7,965	-9,278	-10,467	-11,224	-11,253	-10,701	-9,977
Credit to the economy	50,944	54,786	60,610	66,535	72,230	78,185	84,174	89,828	95,712
Other items (net)	-25,000	-26,593	-29,816	-30,485	-33,710	-37,540	-41,472	-44,945	-48,436
Memorandum items:									
Accounting exchange rate (ruble per U.S. dollar, eop)	60.7	57.6	69.5	...	...	...	...	...	...
Nominal GDP (billions of rubles)	86,014	92,101	103,876	109,663	116,072	123,139	130,646	138,492	146,624
CPI inflation (12-month change, eop)	5.4	2.5	4.3	4.3	3.9	4.0	4.0	4.0	4.0
Ruble broad money velocity (eop)	2.3	2.2	2.1	2.1	2.1	2.1	2.1	2.1	2.0
Ruble broad money velocity (eop, s.a.)	2.4	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.1
Annual change in velocity	-1.2	-4.5	-4.4	1.9	-1.5	-1.0	-0.7	-0.7	-0.6
Real ruble broad money (rel. to CPI, 12-month change)	3.6	7.8	6.5	4.4	3.4	3.0	2.8	2.7	2.4
Nominal ruble broad money (12-month change)	9.2	10.5	11.0	8.8	7.4	7.1	6.9	6.8	6.5
Base money (12-month change)	3.8	8.6	8.0	8.6	7.2	6.9	6.7	6.6	6.3
Real credit to the economy (12-month change)	-6.6	4.9	6.1	5.3	4.5	4.1	3.5	2.7	2.5
Ruble broad money multiplier	4.2	4.3	4.4	4.4	4.4	4.4	4.5	4.5	4.5

Sources: Russian authorities; and IMF staff estimates.

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

Table 6. Russian Federation: Medium-Term Framework and Balance of Payments, 2016–24

	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Projection					
	(Percent of GDP, unless otherwise indicated)								
Macroeconomic framework									
GDP growth at constant prices (percent)	0.3	1.6	2.3	1.2	1.9	2.0	2.0	1.9	1.8
Consumer prices (percent change, end of period)	5.4	2.5	4.3	4.3	3.9	4.0	4.0	4.0	4.0
Gross domestic investment	23.5	24.1	22.7	23.0	23.3	23.6	24.0	24.3	24.6
Private sector	18.8	20.3	19.2	19.1	19.5	19.8	20.1	20.4	20.7
Public sector	4.7	3.8	3.5	3.9	3.9	3.9	3.9	3.9	3.9
Gross national savings	25.4	26.2	29.6	29.4	29.0	28.7	28.1	28.0	27.8
Private sector	24.3	23.9	23.2	24.0	23.8	24.3	24.2	24.4	24.5
Public sector	1.1	2.3	6.4	5.3	5.1	4.5	3.9	3.6	3.3
External current account balance	1.9	2.1	6.9	6.3	5.6	5.1	4.1	3.7	3.3
Fiscal Operations									
Federal government									
Net lending/borrowing (overall balance)	-3.4	-1.4	2.6	1.5	1.4	0.7	0.1	-0.2	-0.4
Nonoil balance	-9.0	-8.0	-6.2	-6.2	-6.0	-6.1	-6.5	-6.6	-6.8
General government									
Net lending/borrowing (overall balance)	-3.7	-1.5	2.9	1.5	1.3	0.6	0.0	-0.3	-0.6
Revenue	32.8	33.3	35.5	34.7	34.3	33.6	33.2	33.0	32.9
Expenditure	36.4	34.7	32.6	33.3	33.0	33.0	33.2	33.3	33.5
Nonoil balance	-9.8	-8.7	-7.0	-6.9	-6.7	-6.8	-7.1	-7.3	-7.4
Primary balance	-3.2	-1.0	3.4	1.9	1.8	1.5	1.0	0.7	0.5
Gross debt	16.1	15.5	14.6	15.8	16.3	17.1	18.1	19.2	20.5
	(Billions of U.S dollars; unless otherwise indicated)								
Balance of payments									
Current account	24.5	33.2	113.8	106.5	97.5	90.6	75.1	69.2	64.2
Trade balance	90.2	115.4	194.5	192.0	186.5	177.2	169.3	165.3	163.1
Exports (f.o.b)	281.7	353.5	443.1	447.7	451.0	452.3	456.7	466.1	478.7
Of which: energy	151.1	190.3	256.3	244.4	242.4	232.8	227.0	226.2	228.3
Imports (f.o.b)	-191.5	-238.1	-248.6	-255.7	-264.5	-275.1	-287.5	-300.8	-315.6
Services and transfers, net	-30.2	-40.2	-39.2	-46.3	-46.4	-48.2	-50.0	-51.8	-53.7
Capital and financial account	-10.8	-13.1	-78.2	-57.5	-63.5	-59.6	-49.1	-48.2	-48.2
Capital account	-0.8	-0.2	-1.1	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-10.1	-12.9	-77.1	-57.5	-63.5	-59.6	-49.1	-48.2	-48.2
Private sector capital	-14.1	-26.2	-68.1	-45.0	-59.2	-59.9	-50.2	-46.4	-50.7
Errors and omissions	-5.4	2.6	2.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	8.2	22.6	38.2	49.0	34.0	31.0	26.0	21.0	16.0
Memorandum items:									
Gross reserves (end of period)									
Billions of U.S. dollars	377.7	432.7	468.5	517.5	551.5	582.5	608.5	629.5	645.5
Percent of short-term debt (residual maturity)	422.7	376.0	480.0	519.1	571.9	594.8	600.4	638.4	653.3
Months of prospective GNFS imports	17.0	15.9	16.4	17.6	18.1	18.4	18.4	18.2	17.8
Trade balance (percent of GDP)	7.0	7.3	11.7	11.4	10.8	10.0	9.3	8.7	8.3
Terms of trade (y-o-y change, percent)	-14.5	10.9	16.2	-2.3	-2.3	-3.0	-2.1	-1.2	-1.1
Excluding fuel	-3.1	1.6	1.9	0.7	-2.1	0.2	0.1	0.0	-0.5
Export volume, goods (y-o-y change, percent)	2.6	3.1	4.2	2.8	3.0	2.7	2.5	2.6	2.5
Import volume, goods (y-o-y change, percent)	1.5	16.7	2.1	2.2	3.3	3.3	3.8	3.9	3.6
Brent oil price (U.S. dollars per barrel)	44.0	54.4	71.1	68.4	66.9	63.4	61.2	60.1	59.9
Output gap	-1.5	-0.8	0.2	-0.1	-0.1	0.1	0.2	0.2	0.1

Sources: Russian authorities; and IMF staff estimates.

Table 7. Russian Federation: Financial Soundness Indicators, 2013–18
(Percent)

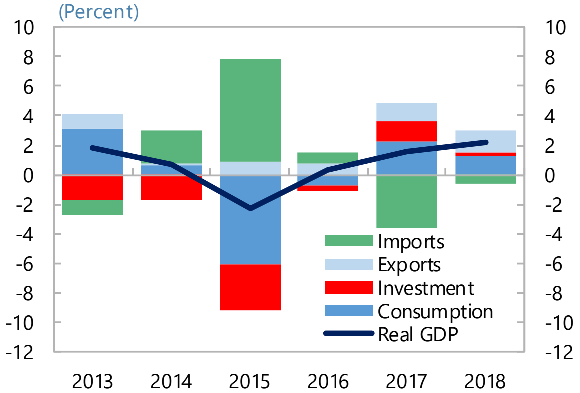
	2013	2014	2015	2016	2017	2018	2019Q1
Financial Soundness Indicators							
Capital adequacy							
Capital to risk-weighted assets	13.5	12.5	12.7	13.1	12.1	12.2	12.2
Tier 1 capital to risk-weighted assets	9.1	9.0	8.5	9.2	8.5	8.9	9.6
Credit risk							
NPLs to total loans	6.0	6.7	8.3	9.4	10.0	10.1	10.4
Loan loss provisions to total loans	5.9	6.5	7.8	8.5	9.3	9.1	9.2
Large credit risks to capital	204.3	245.5	254.4	219.6	226.1	204.7	196.9
Distribution of loans provided by credit institutions							
Agriculture, hunting and forestry	4.3	3.5	3.5	4.0	4.1	4.1	...
Mining	3.1	4.2	4.9	5.6	6.2	6.4	...
Manufacturing	13.6	15.5	17.1	15.4	15.3	14.2	...
Production and distribution of energy, gas and water	2.5	2.5	2.5	3.1	3.2	2.9	...
Construction	5.6	5.3	4.8	4.5	3.9	3.4	...
Wholesale and retail trade	13.7	13.3	11.3	10.9	9.5	9.5	...
Transport and communication	4.2	4.4	4.2	4.2	4.2	5.0	...
Other economic activities	21.1	21.2	24.1	23.1	22.6	21.4	...
Individuals	32.0	30.1	27.5	29.1	30.9	33.0	...
Of which: mortgage loans	8.5	9.4	10.1	12.1	13.2	14.3	...
Liquidity							
Highly liquid assets to total assets	9.9	10.4	10.6	10.5	11.0	10.6	11.4
Liquid assets to total assets	20.5	22.0	24.6	21.8	23.2	21.1	21.8
Liquid assets to short-term liabilities	78.7	80.4	139.3	144.9	167.4	166.4	168.6
Ratio of client's funds to total loans	98.7	92.8	59.0	107.5	111.1	108.8	111.4
Return on assets	1.9	0.9	0.3	1.2	1.0	1.5	1.8
Return on equity	15.2	7.9	2.3	10.3	8.3	13.8	15.9
Balance Sheet Structure, in percent of assets							
Total asset growth rate	16.0	35.2	6.9	-3.5	6.4	10.4	10.5
Asset side							
Accounts with CBR and other central banks	3.9	4.2	3.0	3.8	5.6	4.6	4.9
Interbank lending	8.9	8.9	10.4	11.4	11.5	9.9	10.2
Securities holdings	13.6	12.5	14.2	14.3	14.5	13.9	13.5
Liability side							
Funds from CBR	7.7	12.0	6.5	3.4	2.4	2.8	2.8
Interbank liabilities	8.4	8.5	8.5	10.7	10.9	9.8	9.2
Individual deposits	29.5	23.9	28.0	30.2	30.5	30.2	30.6

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

Figure 1. Russian Federation: Real Sector Developments 2008–19

The cyclical recovery was driven by consumption and exports in 2018.

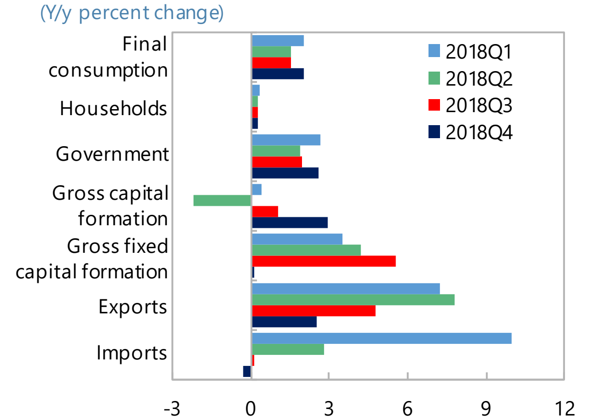
Contributions to Real GDP Growth
(Percent)



Sources: Rosstat and IMF staff calculations.

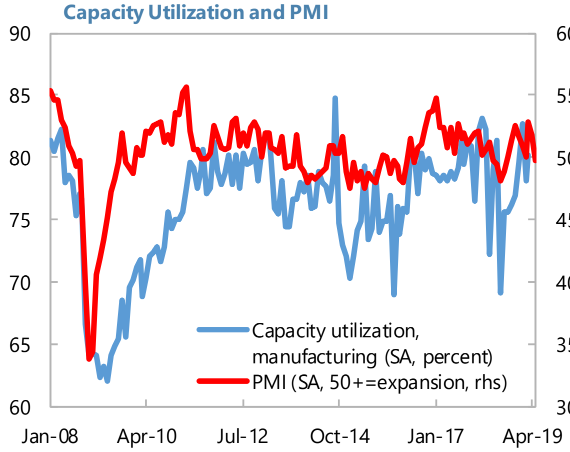
Gross fixed capital formation decelerated in the last quarter of 2018.

Real GDP by Expenditure
(Y/y percent change)



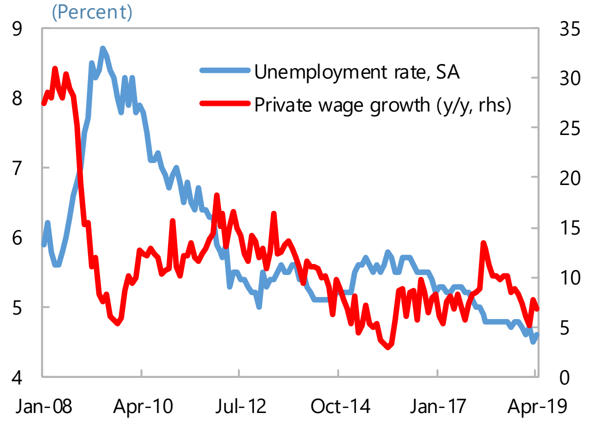
High-frequency indicators point to the fragility of the recovery's momentum.

Capacity Utilization and PMI



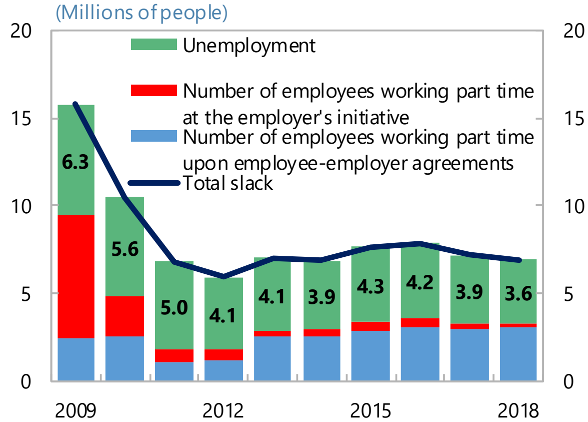
The headline unemployment rate has fallen while wage growth has moderated recently.

Wages and Unemployment
(Percent)



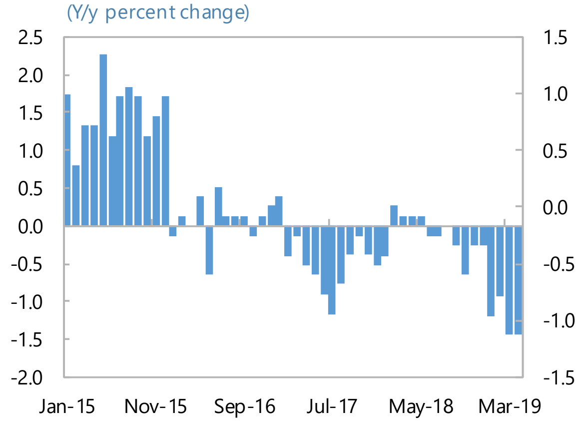
Broader measures also point to a tight labor market.

Broader Labor Market Slack
(Millions of people)



The full implementation of the pension reform would help to mitigate the decline in the labor force.

Labor Force
(Y/y percent change)

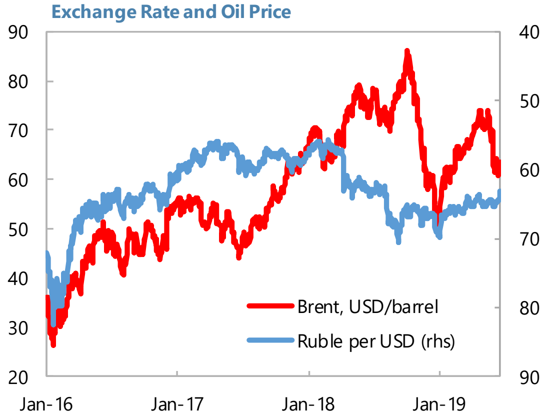


Sources: Rossstat and IMF staff calculations.

Figure 2. Russian Federation: Inflation and Monetary Policy, 2016–19

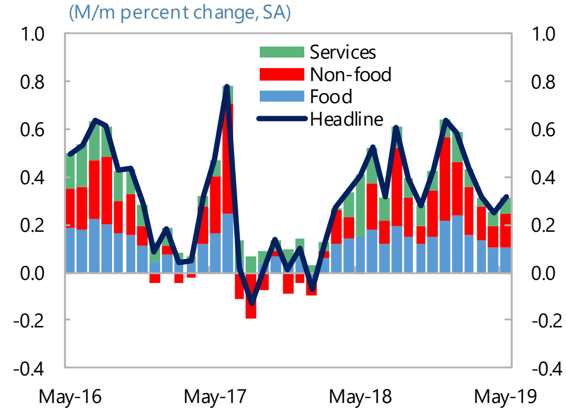
The ruble depreciated between April and September 2018, due to geopolitical tensions and volatility in EMs…

Exchange Rate and Oil Price



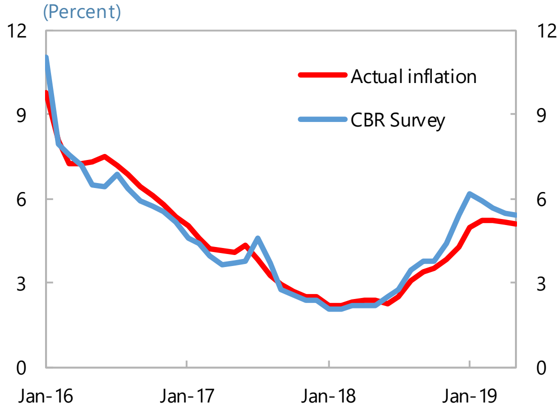
…which pushed inflation up, together with higher food and fuel prices and the VAT increase in January 2019. However, inflation has been showing a gradual decline since April.

Contributions to Headline Inflation
(M/m percent change, SA)



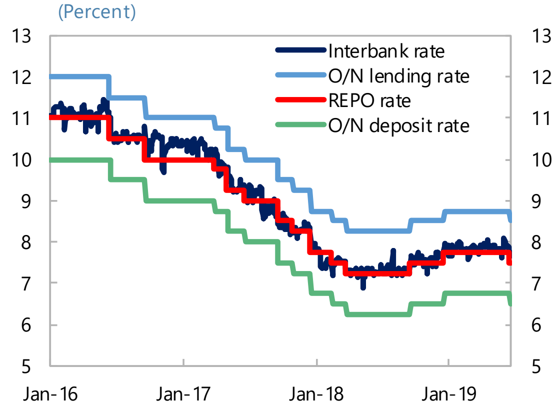
Inflation expectations increased throughout 2018, but appear to have peaked.

CBR Survey of One-Year Ahead Inflation Expectations
(Percent)



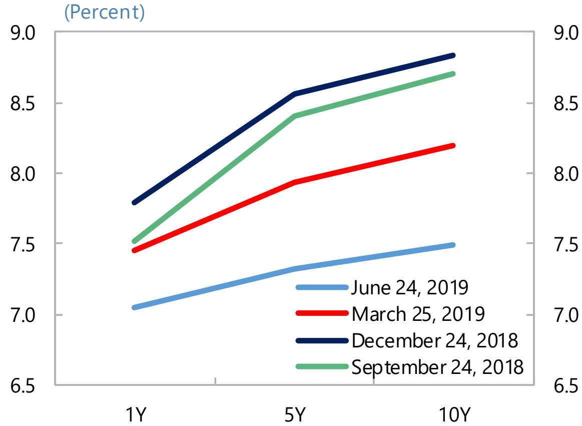
Due to the inflation slowdown and decline of short-term pro-inflationary risks, the CBR cut its key policy rate by 25 bps in June after an increase of 50 bps in 2018 H2.

Policy and Interbank Rates
(Percent)



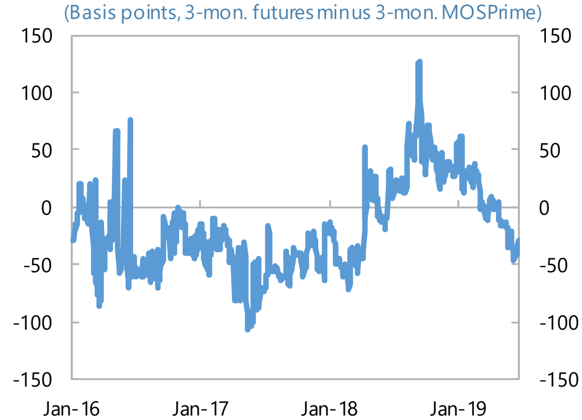
Yields on governments securities jumped after geopolitical shocks in 2018, but have declined in recent months.

Yield Curves
(Percent)



Market expectations for further policy rate increases have declined since the beginning of 2019.

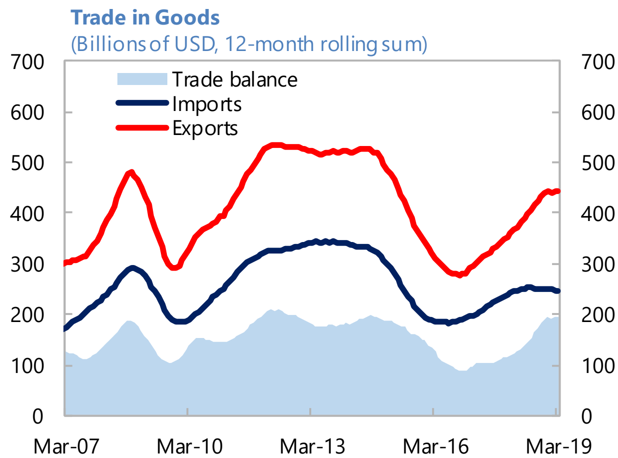
Expectations of Future Policy Rates
(Basis points, 3-mon. futures minus 3-mon. MOSPrime)



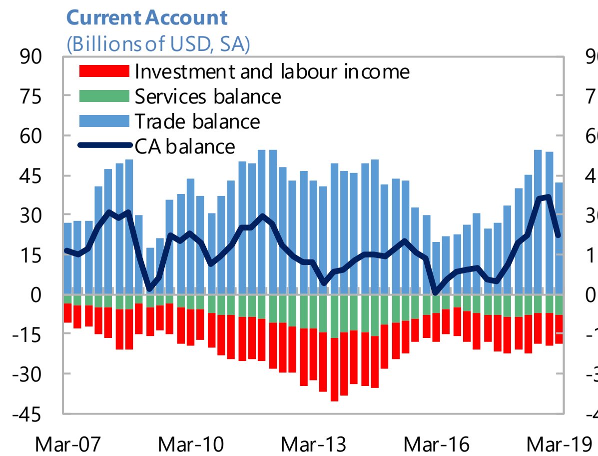
Sources: Central Bank of Russia and Public Opinion Foundation Survey; Russia Economic Barometer; Bloomberg Financial Market L.P.; and IMF staff calculations.

Figure 3. Russian Federation: External Sector Developments, 2007–19

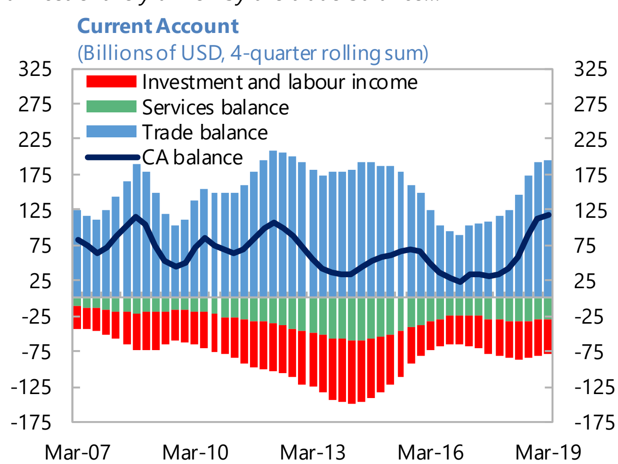
Exports have been robust thanks to a recovery in oil prices…



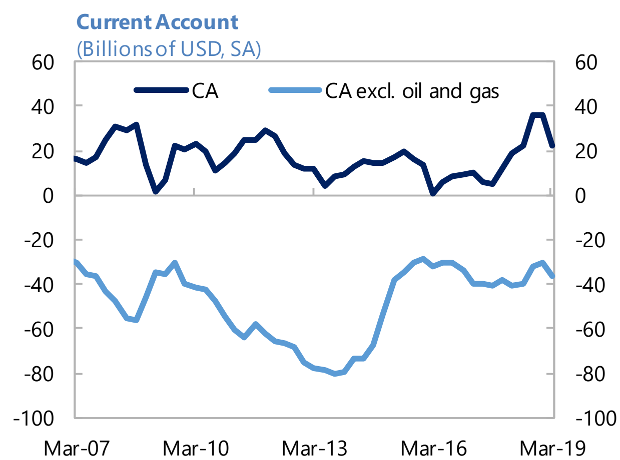
…and the current account surplus reached a record high in 2018.



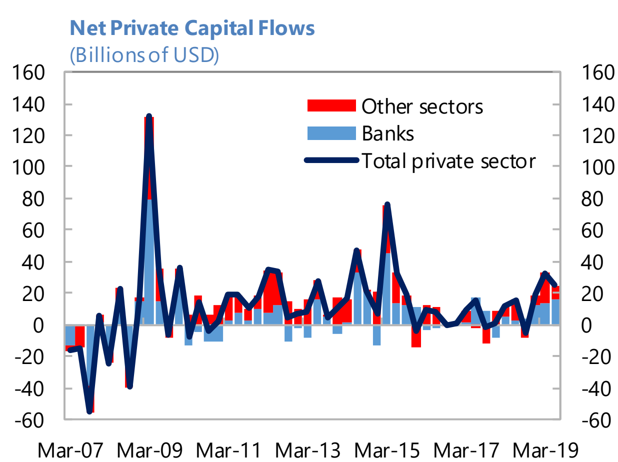
The sharp increase in the headline current account surplus is almost entirely driven by the trade balance…



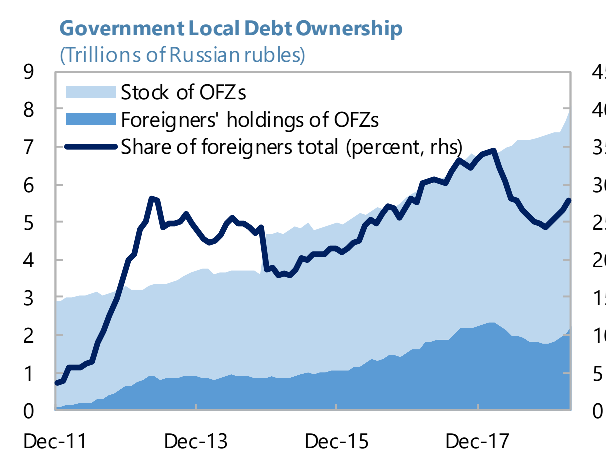
…but the non-energy current account balance has stagnated.



Net private capital outflows continued…



…while foreign holding of sovereign debt declined, but appear to have bottomed out.

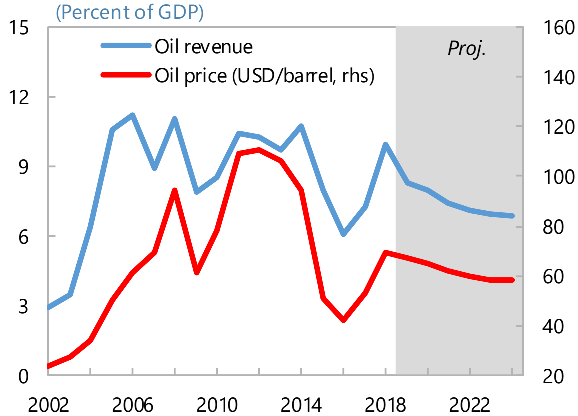


Sources: Rosstat; and IMF staff calculations.

Figure 4. Russian Federation: Fiscal Policy, 2002–24

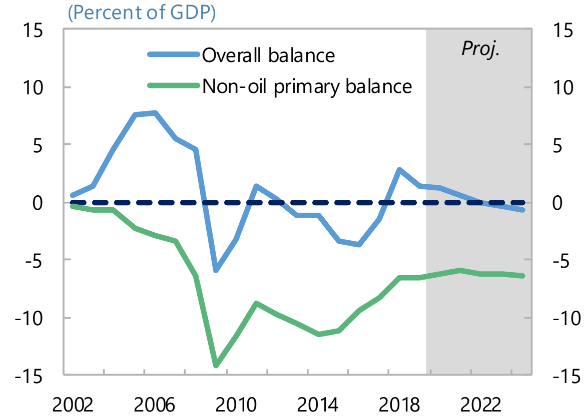
Oil prices and related fiscal revenues are projected to stabilize at somewhat lower levels than in 2018.

General Government Oil Revenues
(Percent of GDP)



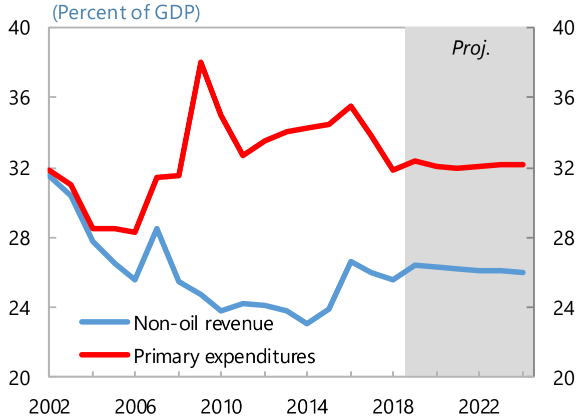
The authorities have completed an ambitious fiscal consolidation…

General Government Balance
(Percent of GDP)



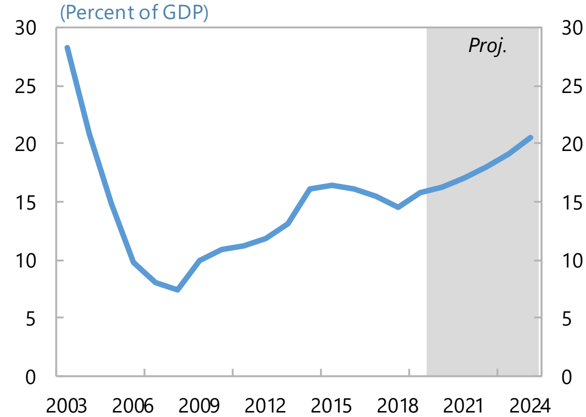
…which relied both on the expenditure and revenue sides of the budget.

General Government Non-Oil Primary Deficit
(Percent of GDP)



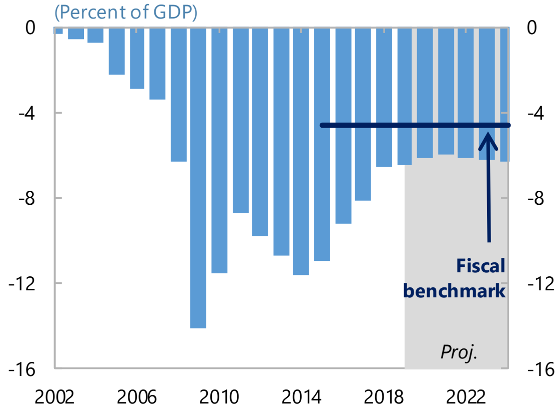
Gross government debt remains low, due to the use of the Reserve Fund to partially finance deficits in 2015–17.

General Government Debt
(Percent of GDP)



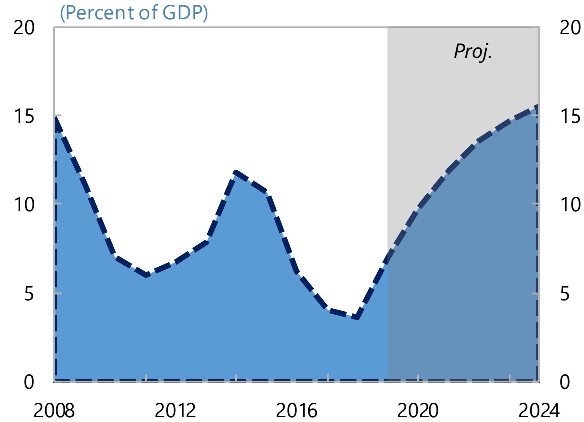
Further fiscal consolidation is needed to bring the non-oil deficit to a level consistent with intergenerational equity.

General Government Non-Oil Primary Balance
(Percent of GDP)



A gradual rebuilding of fiscal buffers is projected.

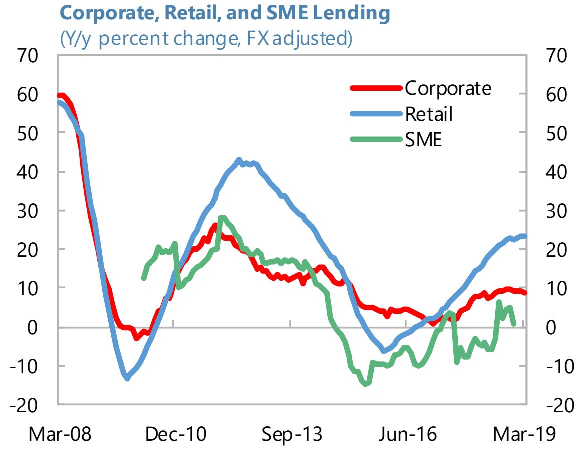
National Welfare Fund
(Percent of GDP)



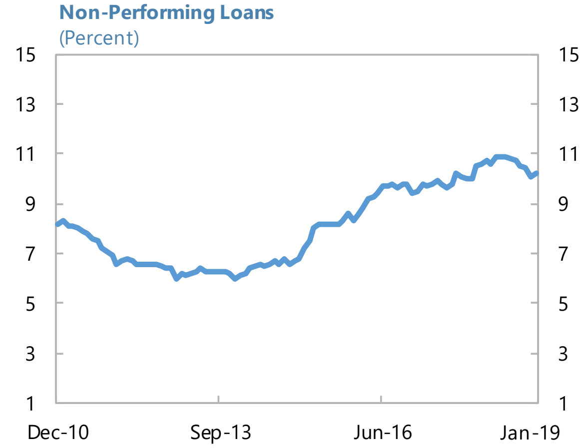
Sources: Russian authorities; and IMF staff calculations.

Figure 5. Russian Federation: Banking Sector Developments, 2008–19

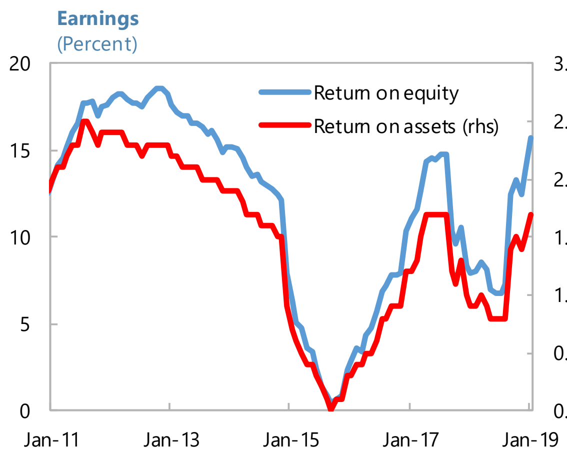
Retail credit growth has accelerated and corporate credit has been increasing slowly.



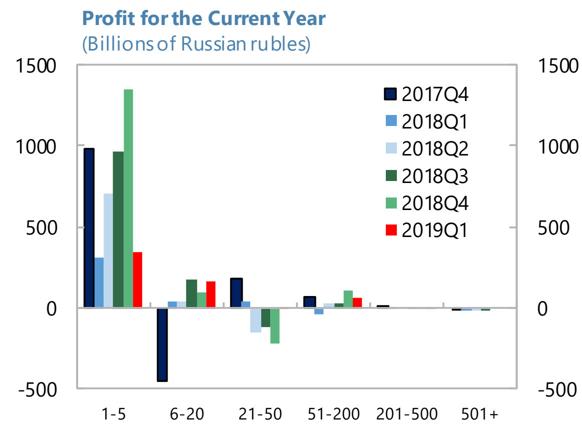
NPLs have remained around the same level over the last year.



Following the failures of three large private banks in 2017, bank profitability is recovering...

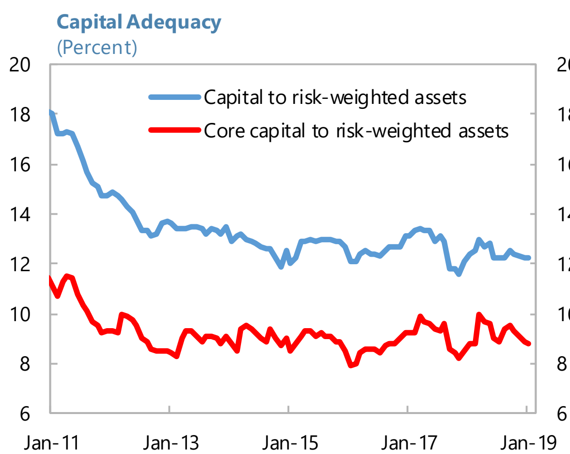


...especially for large banks.

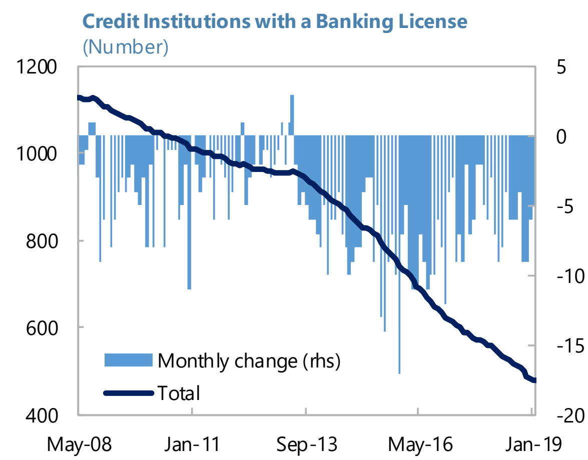


Note: No data for 501+ from 2018Q4 due to banks consolidation.

Aggregate capital ratios have remained stable.



The CBR continues the cleanup of the banking system.

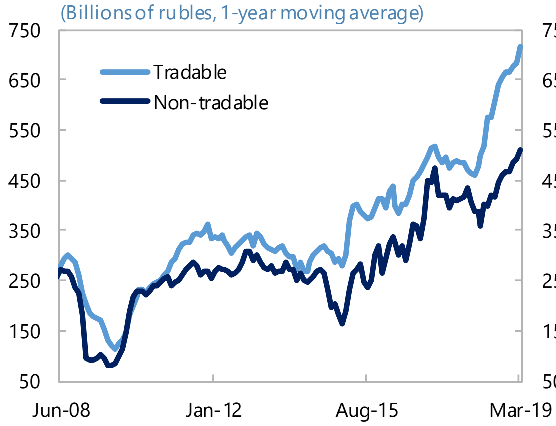


Sources: Central Bank of Russia; and IMF staff calculations.

Figure 6. Russian Federation: Macro-Financial Developments, 2008–18

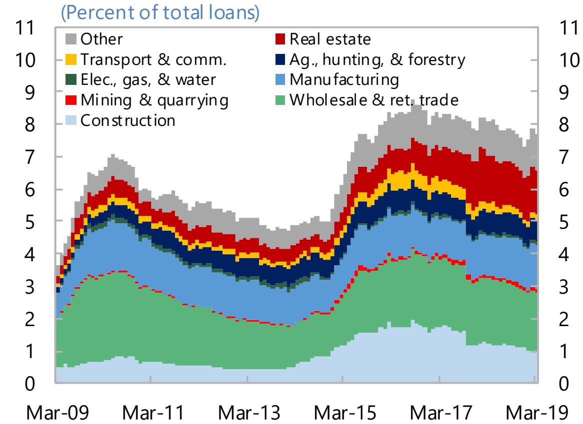
Profitability of the tradable and non-tradable sectors recovered in 2018.

Corporate Profit Levels
(Billions of rubles, 1-year moving average)



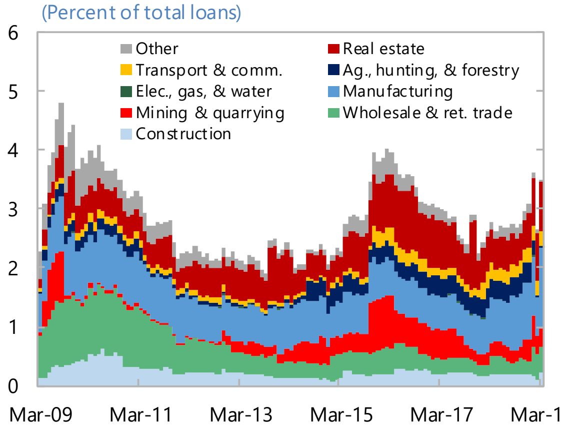
The stock of overdue loans in rubles declined slightly in 2018, with many banks working through legacy issues.

Ruble Overdue Loans by Sector
(Percent of total loans)



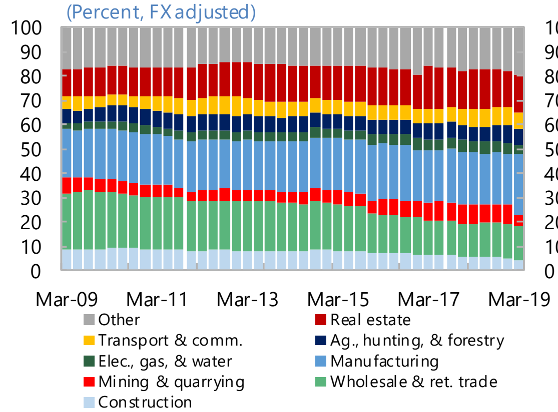
Overdue loans in FX increased in 2018, particularly in manufacturing.

FX Overdue Loans by Sector
(Percent of total loans)



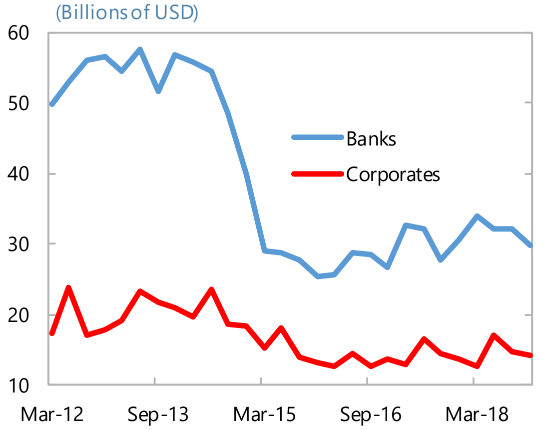
The share of real estate in total lending has increased since end-2016.

Sectoral Share of Lending
(Percent, FX adjusted)



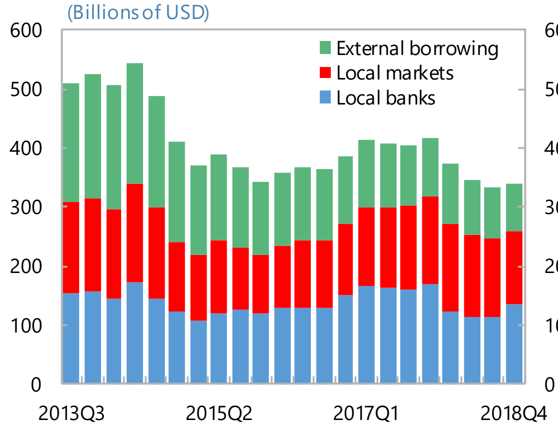
The corporate sector had reduced its external debt in recent years…

Gross Short-Term External Debt by Sector
(Billions of USD)



… while banks' external borrowing declined in 2018.

Residency Breakdown of Banks' Debt
(Billions of USD)



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

Annex I. Risk Assessment Matrix (RAM)[1]

Sources of Risks	Overall Level of Concern		Recommended Policy Response
	Relative Likelihood	Expected Impact if Materialized	
External Risks			
Escalation of geopolitical tensions could depress business confidence, heighten risk aversion, lower demand for credit, limit access to international financial markets, and reduce FDI.	**High**	**Medium**	The floating exchange rate should play a key role in cushioning the shock. Disorderly market conditions could be countered with foreign exchange intervention. An increase in policy interest rates could also be considered. Fiscal policy could use existing buffers within the framework of the fiscal rule.
Rising protectionism and retreat from multilateralism. In the near term, escalating and sustained trade actions threaten the global trade system, regional integration, as well as global and regional collaboration. Additional barriers and the threat of new actions reduce growth both directly and through adverse confidence effects (increasing financial market volatility). In the medium term, geopolitical competition and fraying consensus about the benefits of globalization lead to economic fragmentation and undermine the global rules-based order, with adverse effects on growth and stability.	**High**	**Medium**	If the country is affected by the imposition of tariffs, macroeconomic policies should be supportive in order to weather the initial impact through the trade channel. Structural reforms should be accelerated to enhance diversification and increase trade links. They should be accompanied by support for multilateral efforts to promote global trade and strengthen the multilateral trading system.
Weaker-than-expected global growth. The global growth slowdown could be synchronized as weakening outlooks in the U.S., Europe and China feed off each other and impact on earnings, asset prices, and credit performance.	**Medium/High**	**Medium**	A decline in oil prices would be the main spillover channel. In that context, the exchange rate should be allowed to adjust. Disorderly market conditions could be countered with foreign exchange intervention. Fiscal policy could use existing buffers within the framework of the fiscal rule.

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

Sources of Risks	Overall Level of Concern		Recommended Policy Response
	Relative Likelihood	**Expected Impact if Materialized**	
External Risks			
Large swings in energy prices. Risks to prices are broadly balanced, reflecting offsetting—but large and uncertain—supply and demand shocks. In the near term, uncertainty surrounding the shocks translates to elevated price volatility, complicating economic management and adversely affecting investment in the energy sector. As shocks materialize, they may cause large and persistent price swings. While, on aggregate, higher oil prices would harm global growth, they would benefit oil exporters.	**Medium**	**Medium**	The floating exchange rate should be the main shock absorber. Fiscal policy could use existing buffers within the framework of the fiscal rule. Structural reforms should be advanced to promote diversification.
Sharp tightening of global financial conditions. This causes higher debt service and refinancing risks; stress on leveraged firms, households, and vulnerable sovereigns; capital account pressures; and a broad-based downturn.	**Low/Medium**	**Low**	Enhance resilience and confidence in the financial system by strengthening core institutions and policy frameworks. Improve the investment climate. Tighten monetary policy if balance of payment pressures emerge, while allowing the exchange rate to adjust, providing liquidity, and intervening only to counter disorderly market conditions.
Domestic Risks			
Lack of structural reforms could lead to a decline in investment and TFP. The resulting stagnant growth could increase the appeal of populist policies.	**Medium/High**	**Medium**	Focus on structural and governance reforms to improve the investment climate. Avoid distortive measures and increase trade openness. Monitor closely (through KPIs and other metrics) the implementation of the 13 national projects and other planned structural reforms.
Faster growth in consumer lending could lead to a build-up of impaired assets.	**Medium**	**Medium**	Deploy additional macroprudential measures related to payment-to-income and/or debt-to-income ratios to mitigate financial stability risks. Continue the consolidation process in the banking sector, including through resolution of banks that are not compliant with regulatory and supervisory norms.

Annex II. Implementation of Past IMF Recommendations

Key Recommendations	Implementation Status
Fiscal Policy	
Refrain from revising the fiscal rule, as this would be procyclical at this juncture and also weaken the hard-won credibility of the authorities' macroeconomic framework. Over the medium term, implement further fiscal consolidation to reach a nonoil primary balance consistent with intergenerational equity in sharing Russia's resource wealth.	**Not implemented.** The fiscal rule was temporarily relaxed by 0.5 percent of GDP over 2019–2024, in order to accommodate higher infrastructure spending.
Reform oil sector taxation in order to reduce distortions and implicit fuel subsidies. Implement a shift from direct to indirect taxation to incentivize labor supply, reduce informality, and attract new investment. Eliminate inefficient tax expenditures.	**Some progress.** The authorities approved an oil sector tax reform, which will gradually eliminate export duties by 2024 and replace them with mineral extraction taxes. However, the reform was diluted by restoring subsidies to domestic refining and consumption in the form of a "reverse excise" which has made oil sector taxation more complex. The main VAT rate was raised from 18 to 20 percent in January 2019. Tax expenditures have been preserved.
Implement parametric pension reform, including raising the statutory retirement age and limiting early retirement.	**Substantial progress.** A parametric pension reform was approved in 2018. It will raise the retirement age by 5 years over the next decade, but did not reform early retirement.
Improve the quality of the spending mix by increasing spending on physical and human capital and reprioritizing other spending. Improve the targeting of social assistance.	**Some progress.** The authorities intend to spend an additional 7 percent of GDP over 2019–2024 on investment in physical and human capital under the national projects. They have formulated a plan to improve the efficiency of public spending over the next six years. The authorities have also reformed unemployment insurance, by increasing benefits and reducing their duration for most workers.
Monetary and Financial Sector Policy	
Refine further the CBR's communication strategy.	**Some progress.** CBR's communications are reinforcing the message that policy decisions are targeting inflation forecasts rather than current inflation.
Strengthen bank supervision and regulation. Complete independent asset quality evaluations and ensure their alignment with best international practices. Bolster further the legal framework for banks' related party exposures and external auditors. Enable the CBR to exercise professional judgment. Strengthen the CBR's *ex post* communication of the rationale behind its bank resolution decisions. Improve internal cooperation and data sharing within the CBR.	**Some progress.** The CBR continues its efforts to improve bank supervision and regulation. All banks have been subjected to enhanced on-site inspections. The authorities report that related party lending has declined. Lack of legal protection for the exercise of professional judgement continues to limit the enforcement of regulations on related party lending.

Key Recommendations	Implementation Status
Monetary and Financial Sector Policy	
Nudge the banking system toward more competition and better governance. Reduce concentration in the sector and level the playing field between private and state-owned banks (SOBs). Develop a credible strategy for returning SOBs to private hands in a way that is consistent with increasing competition and efficiency.	**Some progress.** The CBR has made progress with banks under open resolution and aims to eventually return them to the private sector. A "bad bank" has been set up that will deal with the non-performing and non-core assets of these banks. Its assets have been classified by type of industry, and industry-specific strategies to deal with these have been developed. However, the CBR still needs to spell out a strategy for returning banks under open resolution to the private sector and reduce the footprint of the state. No major advances have been made to level the playing field between private and state-owned banks.
Structural Policies	
Reduce the state's footprint over the medium term, while in the short-term efforts should focus on enhancing competition, leveling the playing field in public procurement, and improving efficiency.	**Some progress.** In line with the National Plan for Promoting Competition for 2018–20, a draft law banning the creation of state and municipal unitary enterprises in competitive markets is currently under consideration in the State Duma. The authorities have also drafted and published a bill prohibiting state-owned banks from buying their private competitors.
Tackle long-standing institutional and governance issues, including excessive regulation.	**Some progress.** In January 2019, the government introduced a comprehensive plan to improve the business climate. It aims to ease access to utility networks, expedite construction approvals, digitalize the registration of real estate, simplify SME access to government procurement and funding, ease business registration, improve corporate governance, and reduce administrative pressures on business. This includes the so-called "regulatory guillotine" initiative—a comprehensive review of all existing rules and regulations for businesses, and automatic cancelation of those that do not meet a cost-benefit test. The State Duma is also considering a draft law to reform and expand the so-called "special investment contract" framework, which guarantees a stable regulatory environment to investors for a fixed period of time.
Persist with efforts to strengthen competitiveness, promote trade integration, and diversify exports, including by reducing barriers to trade and FDI.	**Some progress.** One of the authorities' announced 13 national projects focuses on increasing non-energy exports, particularly of machinery, agriculture, and services. It also targets further trade integration within the Eurasian Economic Union. The authorities' plan to improve the business climate (outlined above) aims to promote exports and expedite customs procedures through digitalization.
Strengthen transparency, accountability, and governance standards in the SOE sector.	**Some progress.** The government is exploring the possibility of introducing real-time remote access by tax authorities to the tax and financial statements of SOEs, in exchange for exemptions from on-site tax inspections. In May 2019, the State Duma passed a bill which enables the Audit Chamber to audit the subsidiaries of of government companies and government corporations.
Reduce informality.	**Some progress.** In 2019, the authorities launched pilots for lower and simpler taxation of the self-employed in 4 regions. By mid-2019, real-time online registration will be required for all retail sales.

Annex III. Debt Sustainability Analysis

Figure 1. Russia Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

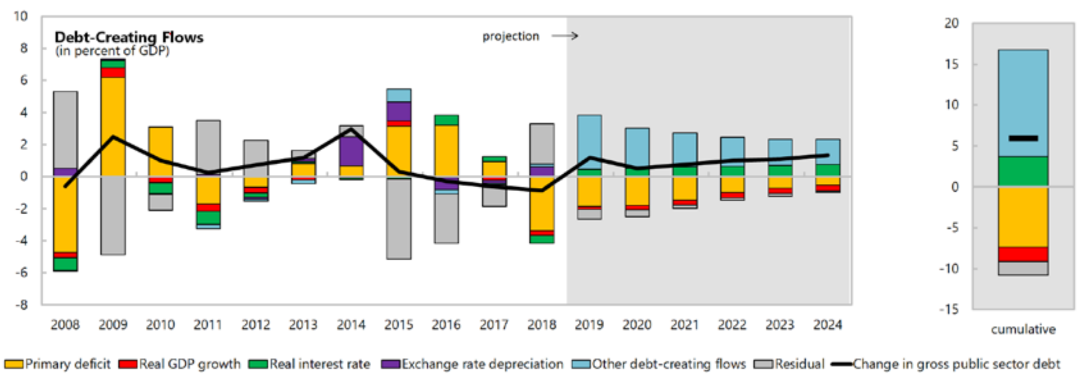
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators 1/

	Actual			Projections						As of May 31, 2019		
	2008-2016 2/	2017	2018	2019	2020	2021	2022	2023	2024			
Nominal gross public debt	12.6	15.5	14.6	15.8	16.3	17.1	18.1	19.2	20.5	Sovereign Spreads		
Of which: guarantees	2.0	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2	EMBIG (bp) 3/		217
Public gross financing needs	3.8	9.1	1.6	-0.4	0.0	0.6	1.0	1.2	1.2	5Y CDS (bp)		129
Real GDP growth (in percent)	1.2	1.6	2.3	1.2	1.9	2.0	2.0	1.9	1.8	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	9.1	5.4	10.3	4.3	3.9	4.0	4.0	4.0	4.0	Moody's	Baa3	Baa3
Nominal GDP growth (in percent)	10.7	7.1	12.8	5.5	5.8	6.1	6.1	6.0	5.9	S&Ps	BBB-	BBB-
Effective interest rate (in percent) 4/	6.8	7.3	6.9	7.6	7.6	7.9	8.1	8.1	8.2	Fitch	BBB-	BBB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance 9/
Change in gross public sector debt	0.9	-0.6	-0.9	1.2	0.5	0.8	1.0	1.1	1.3	5.9	
Identified debt-creating flows	1.1	0.7	-3.4	1.8	0.9	1.0	1.2	1.3	1.5	7.6	
Primary deficit	1.1	1.0	-3.4	-1.9	-1.8	-1.5	-1.0	-0.7	-0.5	-7.4	2.0
Primary (noninterest) revenue and grants	33.2	32.9	35.2	34.3	33.9	33.4	33.0	32.8	32.7	200.1	
Primary (noninterest) expenditure	34.3	33.9	31.8	32.4	32.1	31.9	32.1	32.1	32.1	192.7	
Automatic debt dynamics 5/	0.1	-0.1	-0.2	0.3	0.3	0.3	0.3	0.4	0.4	1.9	
Interest rate/growth differential 6/	-0.3	0.0	-0.8	0.3	0.3	0.3	0.3	0.4	0.4	1.9	
Of which: real interest rate	-0.2	0.3	-0.5	0.5	0.5	0.6	0.7	0.7	0.8	3.7	
Of which: real GDP growth	-0.1	-0.2	-0.3	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-1.8	
Exchange rate depreciation 7/	0.3	-0.2	0.6	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	-0.1	0.2	3.4	2.5	2.1	1.8	1.6	1.6	13.0	
General Government: Net privatization Proceeds (negative)	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Change in cash balance of EBF	0.1	0.0	0.2	-0.4	-0.3	-0.4	-0.2	0.0	0.2	-1.1	
Transfers to RF and NWF	0.0	0.0	0.0	3.8	2.8	2.5	2.0	1.6	1.4	14.1	
Residual, including asset changes 8/	-0.3	-1.4	2.5	-0.6	-0.4	-0.2	-0.2	-0.2	-0.1	-1.7	



Source: IMF staff.

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

2/ Based on available data.

3/ EMBIG.

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

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

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

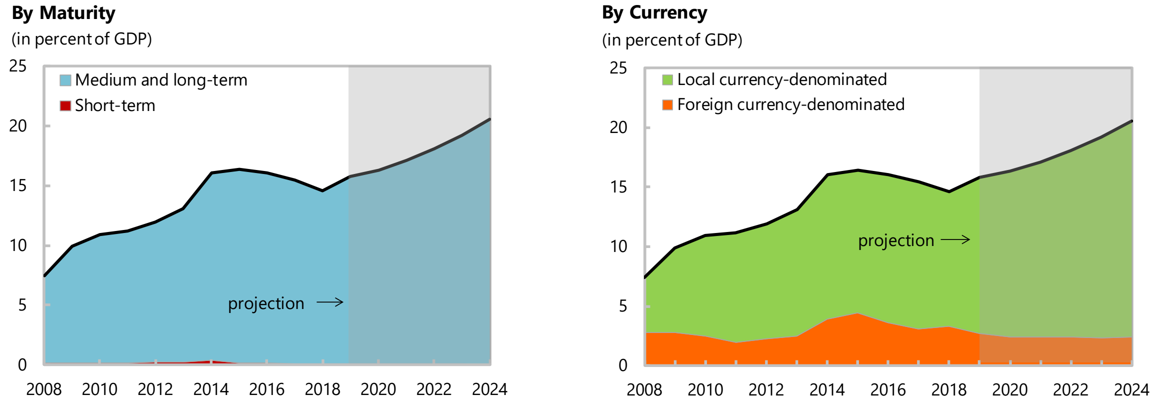
7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

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

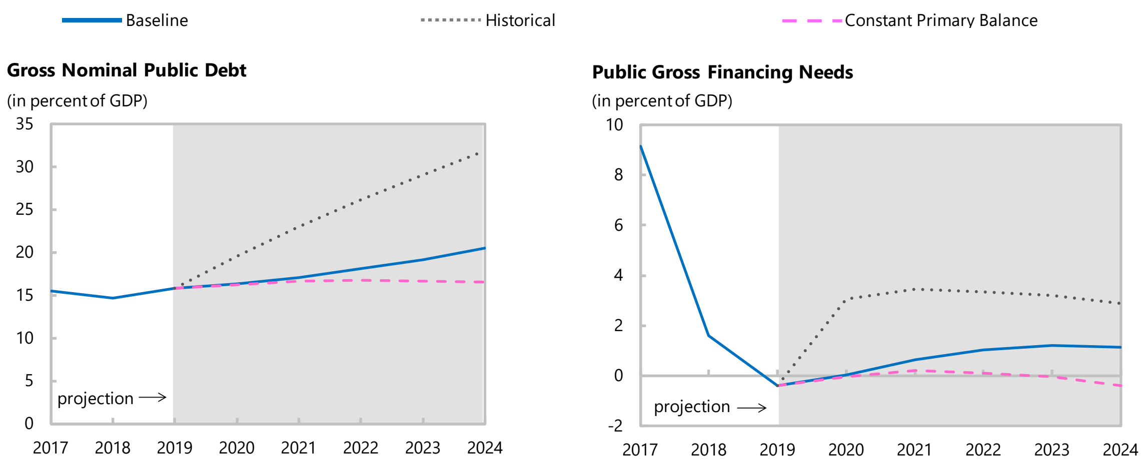
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 2. Russia Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions
(in percent)

Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	1.2	1.9	2.0	2.0	1.9	1.8
Inflation	4.3	3.9	4.0	4.0	4.0	4.0
Primary Balance	1.9	1.8	1.5	1.0	0.7	0.5
Effective interest rate	7.6	7.6	7.9	8.1	8.1	8.2
Constant Primary Balance Scenario						
Real GDP growth	1.2	1.9	2.0	2.0	1.9	1.8
Inflation	4.3	3.9	4.0	4.0	4.0	4.0
Primary Balance	1.9	1.9	1.9	1.9	1.9	1.9
Effective interest rate	7.6	7.6	7.9	8.1	8.2	8.3

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	1.2	1.0	1.0	1.0	1.0	1.0
Inflation	4.3	3.9	4.0	4.0	4.0	4.0
Primary Balance	1.9	-1.2	-1.2	-1.2	-1.2	-1.2
Effective interest rate	7.6	7.6	6.5	5.7	5.1	4.8

Source: IMF staff.

Table 1. Russian Federation: External Debt Sustainability Framework, 2014–2024

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2014	2015	2016	2017	2018			2019	2020	2021	2022	2023	2024	Debt-stabilizing non-interest current account 6/
Baseline: External debt	29.1	38.0	39.9	32.8	27.4			**28.0**	**27.6**	**27.5**	**27.5**	**27.3**	**27.3**	**2.2**
Change in external debt	-2.7	8.9	1.9	-7.1	-5.4			0.6	-0.3	-0.1	0.0	-0.2	0.0	
Identified external debt-creating flows (4+8+9)	3.1	11.4	-0.2	-9.1	-7.1			-4.5	-3.8	-2.9	-2.4	-1.8	-1.3	
Current account deficit, excluding interest payments	-4.2	-6.7	-3.5	-3.0	-7.9			-6.7	-6.2	-5.7	-5.2	-4.6	-4.1	
Deficit in balance of goods and services	-6.5	-8.1	-5.2	-5.3	-9.9			-8.0	-7.6	-7.0	-6.6	-6.0	-5.7	
Exports	27.3	28.8	25.9	26.1	30.7			30.1	30.5	30.7	30.9	30.9	31.3	
Imports	20.8	20.7	20.7	20.7	20.8			22.1	22.9	23.7	24.3	24.9	25.5	
Net non-debt creating capital inflows (negative)	2.3	1.5	-0.7	0.5	1.4			1.5	1.7	2.0	2.0	2.0	2.0	
Automatic debt dynamics 1/	5.0	16.6	4.0	-6.6	-0.5			0.7	0.7	0.7	0.7	0.8	0.8	
Contribution from nominal interest rate	1.4	1.7	1.6	0.9	1.0			1.1	1.2	1.3	1.3	1.3	1.3	
Contribution from real GDP growth	-0.2	1.0	-0.1	-0.5	-0.7			-0.3	-0.5	-0.5	-0.5	-0.5	-0.5	
Contribution from price and exchange rate changes 2/	3.8	13.9	2.5	-6.9	-0.9			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-5.8	-2.5	2.0	2.0	1.6			5.1	3.5	2.8	2.5	1.5	1.3	
External debt-to-exports ratio (in percent)	106.6	131.9	154.0	126.0	89.3			93.0	90.6	89.6	89.0	88.4	87.2	
Gross external financing need (in billions of US dollars) 4/	145.7	60.1	59.0	56.1	0.2			5.5	15.3	19.7	26.6	33.7	37.7	
in percent of GDP	7.1	4.4	4.6	3.6	0.0	10-Year	10-Year	0.3	0.9	1.1	1.5	1.8	1.9	
Scenario with key variables at their historical averages 5/								**28.0**	**28.7**	**28.9**	**29.0**	**28.2**	**27.3**	**1.7**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	0.7	-2.3	0.3	1.6	2.3	1.0	3.8	1.2	1.9	2.0	2.0	1.9	1.8	
GDP deflator in US dollars (change in percent)	-10.8	-32.2	-6.2	21.1	2.7	-0.1	17.7	-2.8	1.3	1.7	2.0	2.3	2.4	
Nominal external interest rate (in percent)	4.0	3.8	4.0	2.7	3.3	4.1	0.7	3.9	4.5	4.7	4.8	4.9	4.8	
Growth of exports (US dollar terms, in percent)	-5.0	-30.1	-15.4	23.7	23.7	2.4	23.9	-3.5	4.5	4.5	4.8	4.1	5.7	
Growth of imports (US dollar terms, in percent)	-8.7	-34.3	-5.6	22.9	5.3	1.9	22.6	4.6	6.9	7.4	6.7	6.9	7.0	
Current account balance, excluding interest payments	4.2	6.7	3.5	3.0	7.9	4.9	1.7	6.7	6.2	5.7	5.2	4.6	4.1	
Net non-debt creating capital inflows	-2.3	-1.5	0.7	-0.5	-1.4	-0.8	0.9	-1.5	-1.7	-2.0	-2.0	-2.0	-2.0	

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

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

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

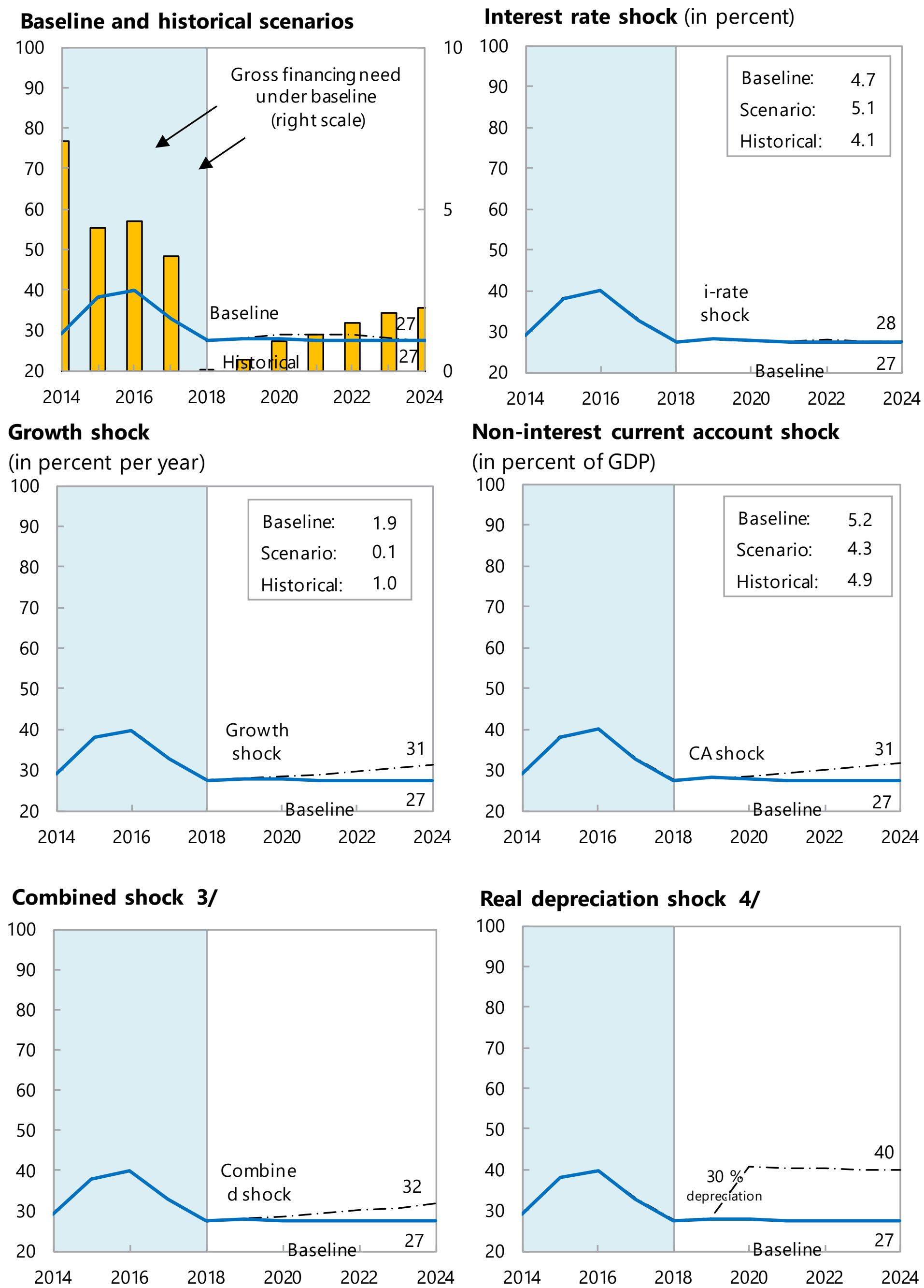
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Figure 3. Russian Federation: External Debt Sustainability: Bound Tests 1/2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2010.

Annex IV. FSAP Key Recommendations[1]

Recommendations	Timing	Progress
Banking Stability		
Conduct an asset quality review (AQR) to ensure adequate bank capitalization (CBR).	ST/MT*	**In progress.** Collateral registry is being prepared to ensure the timeliness and completeness of the valuation of assets and collateral. The CBR considers that the quality of the portfolio of the corporate sector has stabilized. However, regarding consumer lending, further work is needed to complete the identification of risk from this segment. The CBR is publishing stress-test results but not AQRs.
Enhance stress testing practices, including on a consolidated basis and by currency (CBR).	ST/MT	**In progress.** CBR continues upgrading its stress-testing methodology: extended supervisory boundaries of entities, updated the methodology for assessing credit, market and interest rate risks. Also, a draft regulation, which lays out the stress-testing requirements for the internal procedures of assessing capital adequacy (ICAAP) is being finalized. In 2017, the CBR undertook its first macroprudential stress testing of the financial sector.
Liquidity Management		
Review FX repo framework and formalize lender of last resort (CBR).	ST	**Done.** The FX repo framework takes account of banks' access to FX funding from the interbank market. The CBR implemented an ELA facility in 2017. Procedures and criteria for liquidity provision under this facility set by the CBR are different from monetary policy instruments.
Re-establish T-bill program.	ST	**Not done.** T-bill operations are a part of the budget policy.
Financial Sector Oversight and Regulation		
Require prior approval for banks' domestic investments in nonbank institutions (CBR).	ST	**In progress.** A draft law requires banks to coordinate with the CBR on acquisition of large stakes in non-bank institutions. The draft law has been communicated to the Ministry of Finance. Provisions regulating CBR's prior approval for individuals and legal entities to acquire over 10 percent of shares in non-bank institutions is codified in Federal No. 281-FZ of July 29, 2017, which became effective January 1, 2018.
Issue specific requirements for management of banks' country and transfer risks (CBR).	ST	**In progress.** A single regulatory act is being developed with requirements for managing country and transfer risks.
Upgrade framework for relations with and use of banks' external auditors (CBR).	ST	**In progress.** A draft law allows the CBR to regulate and supervise audit activities has been prepared. However, no new developments have been observed.

[1] These are most of the high-level summary FSAP recommendations. A complete list of the recommendations is available in the FSAP itself.

Recommendations	Timing	Progress
Strengthen further the legal framework applicable to related parties (CBR).	ST	**In progress.** Effective from January 2017, the definition of related parties has been broadened and a limit set on such exposure at 20 percent of a bank's equity capital. A new draft Law that requires credit institutions to deal with related parties on an arm's length basis has been communicated to the Ministry of Finance.
Upgrade framework for prudential oversight of banks' operational risk (CBR).	ST	**In progress**. A pilot project to conduct a comprehensive analysis of the quality of the operational risk management systems of credit institutions under the existing regulatory framework has been completed. A separate methodology has been developed to assess the efficiency of the system of ensuring business continuity and/or restoration in credit institutions. A draft regulation on the requirements for the operational risk management system in a credit institution and a banking group has been prepared.
Bring securities and insurance regulation and supervision into line with international standards (CBR).	MT	**In progress**. With respect to IOSCO principles, a total of 112 recommendations were received, of which as of April 1, 2019: 22 were fully implemented; 58 are in progress, of which 19 were implemented substantially (34 regulatory legal acts were adopted, 5 regulatory legal acts were submitted to the State Duma for discussion, 5 reports were published for public consultations, 55 inspections of securities market participants were conducted). Based on a self-evaluation, the Principles of IAAS No. 4 and No. 5 has been completed: 4 out of 6 recommendations of the 2015–16 FSAP have been partially implemented, 1 has been fully implemented, 1 has not been implemented.
Ensure the effective implementation of the AML/CFT framework (CBR, MoF monitoring).	ST	**In progress.** The CBR participated in the AML/CFT National Risk Assessment (NRA) and conducted a comprehensive sectoral AML/CFT risk assessment in the supervised sectors taking into account regional specificities. On December 2018, the CBR issued guidelines for handling certain category of clients. The NRA is used also for the FATF/MONEYVAL/EAG comprehensive AML/CFT mutual evaluation. A public summary highlights: (i) fraud and misappropriation of budgets and taxes, (ii) corruption and bribery, (iii) financial sector fraud, and (iv) drug trafficking as the main money laundering threats.
Macroprudential Policy		
Adopt legal changes to provide a comprehensive policy toolkit (CBR, MoF).	ST/MT	**In progress.** A Federal Law authorizes the CBR to increase risk weights by its Board decisions for certain types of assets. A CBR ordinance from August 2018 determines the method of applying risk premiums for capital adequacy purposes. Also, since October, a single methodology for the calculation of the payment-to-income ratio will be used.

Recommendations	Timing	Progress
Crisis Management and Resolution		
Review the framework for the use of public funds to finance the DIA for resolution purposes to be provided by the federal government. If necessary to use CBR funds, the federal government should provide an indemnity (CBR, MoF).	MT	**Not done.** At present, budget funds cannot be used to finance bank resolution.
Establish a funding mechanism for recovery of the costs of providing temporary public financing through levies on the financial industry (CBR, MoF).	MT	**Not done.** The resolution mechanism does not envisage levies on banks other than the premia already collected by the DIA.
Introduce the full range of resolution powers and safeguards recommended by the FSB Key Attributes, including by implementing legal and operational changes needed to make purchase and assumption (P&A) an effective resolution tool (CBR, MoF).	ST	**In progress.** The authorities have introduced a new resolution mechanism (Banking Sector Consolidation Fund). However, there is no provision as yet for asset transfer at market prices to an acquiring institution as part of a P&A transaction.
Banking Sector Development		
Promote legal reforms to increase state-owned commercial banks (SOB's) Board effectiveness (MoF, CBR).	MT	**In progress.** A Federal Law was adopted in July 2018 (On Amendments to the federal Law on Joint-Stock Companies), which aims at strengthening the role of the board of directors and ensuring the creation of an effective risk management and internal control system, and internal audit in public companies.
Continue gradual privatization of SOBs (MoF, CBR) as conditions permit.	MT	**Not done.** Market conditions do not seem favorable at this time. There was an attempt to sell one bank, which was rescued using the new resolution framework, in March 2019.
* "ST–short term" is within one year; "MT–medium term" is one to three years.		

Annex V. External Sector Assessment

	Russian Federation	Overall Assessment
Foreign asset and liability position and trajectory	**Background:** The net international investment position (NIIP) rose to US$370.9 billion at end-2018, which at 22 percent of GDP is marginally higher than in 2017 and well above the near balance net stock position in 2010. Gross assets stood at 81 percent of GDP, while liabilities (53 percent equity and 47 percent debt) declined from 68 percent of GDP in 2017 to 59 percent of GDP on private sector deleveraging. Debt liabilities to nonresidents, ¾ of which are in foreign currencies, declined from 32 percent of GDP in 2017 to 28 percent of GDP by end-2018. Non-residents have also cut their holdings of ruble-denominated government debt to about 25 percent of the total stock from a peak of 34.5 percent in Q1:2018, due to heightened geopolitical tensions. 1/ There are no obvious maturity mismatches between the gross asset and liability positions. Historically, the NIIP position has not kept pace with CA surpluses due to unfavorable valuation changes and the treatment of "disguised" capital outflows. 2/ **Assessment:** The projected current account (CA) surpluses suggest that Russia will see a gradual rise of its positive NIIP, lowering risks to external stability. Moreover, official external assets have been increasing rapidly since the introduction of the new fiscal rule, despite the temporary suspension of the associated FX purchases between August 2018 and January 2019. The recent external deleveraging by the private sector further reduced risks.	**Overall Assessment:** The external position in 2018 was moderately stronger than fundamentals and desirable policy settings. Favorable commodity prices have boosted exports, while worsening geopolitical tensions weakened the exchange rate and contained imports. As a result, the current account surplus reached a historical high. In the meantime, uncertainty about sanctions has weighed on capital flows and complicates the external sector assessment. **Potential Policy Responses:** Fiscal policy should continue operating within the parameters of the new fiscal rule to reduce the impact of oil price volatility on the non-oil sector, while rebalancing government expenditure toward health, education, and infrastructure in the medium term. Greater focus should be given to structural reforms aimed at improving the business climate and boosting private sector investment, especially in the nonoil sector. Both the reorientation of fiscal expenditure to key areas and an increase in private sector investment will raise Russia's growth potential while bringing the external position into balance.
2018 IIP (% GDP)	NIIP 22.4 | Gross Assets 80.9 | Res. Assets 28.3 | Gross Liab. 58.5 | Debt Liab. 27.4	
Current account	**Background:** On the back of strong energy exports, and moderate import growth, the CA balance reached 6.9 percent of GDP in 2018, the highest level in more than a decade. However, the non-energy CA remains in deficit (8.6 percent of GDP in 2018), reflecting relatively weak competitiveness in the non-energy sector. In the medium term, the CA surplus is expected to taper off to around 3 percent of GDP on moderating oil prices and a pick-up in imports. **Assessment:** The EBA CA model yields a norm for 2018 of 3.2 percent of GDP, compared to a cyclically adjusted CA surplus of 6.6 percent of GDP. This implies an EBA CA gap of 3.4 percent of GDP, for which identified policies contributed 2.5 percent of GDP, mainly reflecting the lower-than-desirable health spending and the large fiscal surplus in 2018. However, given that the EBA model may be underestimating the cyclical effects related to the oil price increase in 2018, staff assesses the CA gap to be lower and around 1.6 percent of GDP in 2018, with a confidence interval between 0.6 and 2.6 percent of GDP. The large uncertainty also reflects difficulties in estimating the impact and duration of sanctions (protracted sanctions could lead to higher precautionary savings, lower investment and a higher CA norm).	
CA Assessment 2018	Actual CA 6.9 | Cycl. Adj. CA 6.6 | EBA CA Norm 3.2 | EBA CA Gap 3.4 | Staff Adj. 1.8 | Staff CA Gap 1.6	
Real exchange rate	**Background:** The REER depreciated by 7.5 percent in 2018, despite higher oil prices, mainly reflecting sanctions, both those imposed in 2018 and the threat of new measures. As of February 2019, the ruble has depreciated by 2.1 percent in real terms relative to the 2018 average. **Assessment:** EBA Level and Index REER models indicate an undervaluation of 19 percent and 14 percent, respectively. However, both approaches generate large residuals (around -10 percent). Among the model determinants, the most important contributor to undervaluation is health expenditure. Using an elasticity parameter of 0.27, staff assess that the 2018 REER was between 2 and 10 percent *below* the level consistent with fundamentals and desired policies.	
Capital and financial accounts: flows and policy measures	**Background:** Net private capital outflows continued in 2018 (lower net liabilities generated an outflow of $38 billion and the net acquisition of financial assets resulted in an outflow of $39 billion). In the banking sector, outflows mainly took the form of a reduction in foreign liabilities, while the non-banking private sector built up foreign assets during this period. Sanctions and the projected moderation of oil prices are expected to weigh on flows over the medium term. **Assessment:** While Russia is exposed to risks of continued outflows due to geopolitical uncertainties, the large FX reserves and the floating exchange rate regime provide substantial buffers to help absorb external shocks.	

Russian Federation (concluded)		
FX intervention and reserves level	**Background:** Since the floating of the ruble in November 2014, FX interventions have been limited. International reserves rose to US$468 billion (more than 16 months of imports) by end-2018. **Assessment:** International reserves at end-2018 were equivalent to 284 percent of the Fund's reserve adequacy metric, considerably above the adequacy range of 100–150 percent. Taking into account Russia's vulnerability to oil price shocks and sanctions, an additional commodity buffer of $65 billion is appropriate, translating into a ratio of reserves to the buffer-augmented metric to 204 percent. The ratio remains above the adequacy level but is justifiable given the high degree of geopolitical uncertainty. 4/ Large FX interventions should be limited to episodes of market distress.	
Technical Background Notes	1/ Nominal GDP denominated in US dollars grew by only 3.3 percent in 2018, largely reflecting moderate growth and a weak ruble. 2/ Unfavorable valuation changes arise because the Russian stock market has performed very well in the last 15 years as the oil price soared, boosting the valuation of foreign-owned assets. "Disguised" capital outflows include transactions such as pre-payments on import contracts where the goods are not delivered, repeated large transfers abroad that deviate from standard remittances behavior, or securities transactions at inflated prices. The CBR includes estimates of "disguised" capital outflows in the financial account but not in the foreign asset position of the reported NIIP. Hence, the actual NIIP position could be higher than the reported level and this treatment of "disguised" outflows may explain part of the discrepancy between accumulated CA surpluses and the reported NIIP position.	

Annex VI. Long-Term Growth: Experiences and Challenges

Russia's Growth Swings

1. **Growth accelerated strongly in early and mid-2000s, decelerated sharply in the aftermath of the Global Financial Crisis (GFC), and virtually stopped when sanctions and lower oil prices hit from 2014.** The reasons behind the varying performance are multiple, but differing domestic and international contexts and policies, both at the macro and structural levels, played a major role in explaining the differences.

Table 1. Russian Federation: Growth Decomposition

(Average annual contribution to GDP growth, percentage points, unless noted)

	1996-2002	2003-2008	2009-2013	2014-2018
GDP growth	2.5	7.1	1.2	0.5
Demand Side:				
Domestic Demand 1/	**1.8**	**9.0**	**2.0**	**-1.1**
Consumption	1.4	6.0	2.2	-0.5
Fixed Capital Investment	-0.4	2.7	0.3	-0.2
Exports	2.1	2.6	0.4	1.0
Imports	-1.4	-4.5	-1.2	0.6
Production Side:				
Potential Output	**0.5**	**6.0**	**1.9**	**0.8**
Labor	-0.2	0.6	0.3	0.2
Capital	-0.2	1.6	1.7	1.1
Total Factor Productivity	0.5	3.8	-0.1	-0.5
Cyclical Output	2.0	1.1	-0.7	-0.3
Memorandum items:				
Oil production contribution	0.9	1.3	0.3	0.2
Oil exports contribution	0.6	0.7	0.2	0.2
Fiscal Impulse 2/	-	1.0	0.8	-0.8

Source: Rosstat and IMF staff calculations.

1/Totals do not add due to inventory accumulation and statistical discrepancy.

2/Fiscal impulse is defined as the average change in the non-oil primary structural balance relative to GDP.

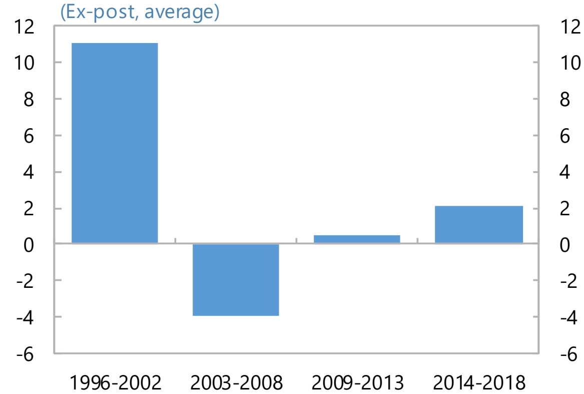
2. **The 1990s were marked by structural transformation.** The transition from communism was characterized by mass privatization, reallocation of labor and relative price dislocation, and high inflation rates as the economy sought to achieve macroeconomic stability. Moreover, the international context was not supportive, with unfavorable terms of trade and low external inflows. Growth

averaged 2.5 percent per year in 1996–2002, as the economy emerged from the transformational recession, and unemployment gradually declined from its peak in the mid-1990s (Table 1).

3. Supportive external and domestic environments paved the way for a sharp growth acceleration in the mid-2000s, which averaged around 7 percent per year in 2003–08. A confluence of factors contributed to this extraordinary performance:

- ***Total demand expanded at double-digit rates.*** Externally, the China-led commodity boom contributed to the tripling of the oil price and terms-of-trade growth of over 10 percent a year. Rising exports account for about a third of the output growth in the period. Domestically, pent-up demand was reflected in booming consumption and growing investment, fueled by bank lending and inflows from abroad reflecting the macroeconomic improvement and reduced interest rates and country risk premia. The boom was also supported by accommodative monetary policy and highly expansionary fiscal policy, as the bonanza in oil revenues was allowed to feed through to a rapidly growing non-oil deficit. Government noninterest expenditure growth averaged nearly 12 percent a year in real terms.

Real Interest Rate on Federal Debt
(Ex-post, average)



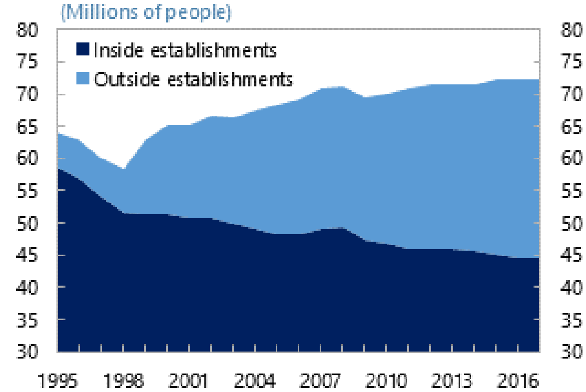
Sources: Rosstat; and IMF staff calculations.

- ***Production responded strongly.*** The economy was able to expand production strongly, as it emerged out of the transformational recession with most of the privatization program complete, and macroeconomic stability broadly achieved. Rising labor and capital stocks supported growth, but the largest contribution, at nearly 4 percent of GDP a year, came from higher productivity growth.

4. Growth decelerated sharply following the global financial crisis, averaging around 1 percent per year in 2009–13. The external and domestic factors that supported economic performance in 2003–08 subsided:

- ***Demand fell sharply.*** The export contribution slowed to only 0.4 percent of GDP a year, as oil and commodity prices stabilized (albeit at a high level) amid weakened external demand. Capital inflows ticked down, and real interest rates edged up due to higher country risk premia. As a result, both consumption and investment growth decelerated sharply, with demand being sustained in large part through continued rapid expansion of fiscal policy.

- ***Productivity growth virtually stalled.*** Capital and labor expanded mildly. The decline in productivity growth reflected lower employment in goods-producing establishments, and an increasing share of labor in trade and other (relatively) lower-productivity service sectors. Progress in the implementation of reforms slowed, contrasting with the large gains derived from macroeconomic stabilization in 2003–08. Oil output started to plateau, and therefore moved from being a driver of overall GDP growth to a drag on growth.

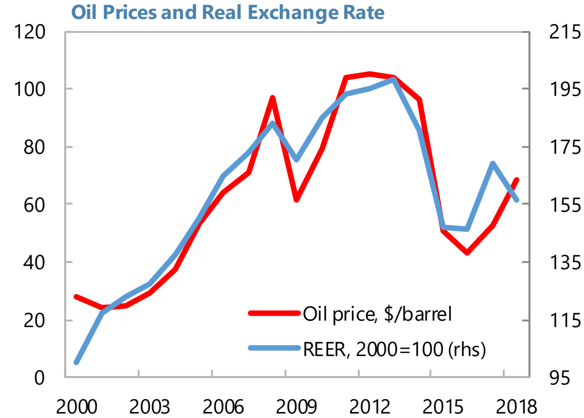


Sources: Rosstat; and IMF staff calculations.

- ***Most of the decline in growth was structural,*** although a part was the result of a negative cyclical contribution on average, made up of the collapse in output when the GFC hit in 2009 with some cyclical recovery in the following three years.

5. **GDP stagnated after the dual shock of sanctions and lower oil prices in 2014, with growth averaging only 0.5 percent over 2014–18.** Further sanctions hit in 2017–18. The sanctions constrained the access of Russian corporates and banks to international financial markets, forcing them to deleverage. Gross external outflows averaged 2 percent of GDP per year in 2014–18 (a reversal from nearly 6 percentage points of GDP of inflows in 2003–08), and country risk premia increased.

- ***Domestic demand growth fell into negative territory.*** Both consumption and investment fell in real terms during the period, reflecting the turnaround in capital flows, higher spreads, loss of confidence and the necessarily restrictive macro policies. Monetary policy is estimated to have been moderately tight throughout the period (see Annex VII), as the CBR sought to establish confidence in the inflation targeting framework under difficult external circumstances, including the exchange rate depreciation. With the fall in oil prices, fiscal policy too needed to tighten from the large non-oil deficits that had developed up to 2014, which was reflected in a negative fiscal impulse.[1] The large depreciation of the real exchange rate helped growth: although oil exports were lackluster, the contribution of nonoil exports picked up encouragingly, and imports fell markedly, reflecting also the weak domestic demand.



Sources: IFS and IMF *WEO*.

- ***Weak productivity growth continued.*** Labor and capital accumulation continued to make positive contributions to output, but at slower rates than in earlier periods. However, overall productivity declined, as the trends observed in 2009–13 in employment composition and lack

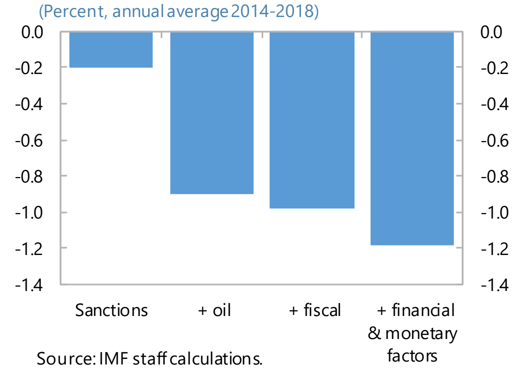
[1] The tight policy stance is expected to ease from 2019 on, with monetary policy moving to a neutral stance and little further change in the non-oil structural primary fiscal balance, following the fiscal rule.

of dynamism in goods-producing sectors deepened. Oil volumes continued to grow only slowly, making very little contribution to overall growth.

- ***Most of the slowdown in output growth was again structural.*** There was a small negative cyclical component on average, possibly related to the policy tightening during the period**.**

6. Analytical work based on economic models finds that sanctions, lower oil prices, and financial market and policy responses, explain about half the slowdown compared to expectations. Russia has been growing about 2 percent a year slower than expected at the time of the October 2013 WEO. The counterfactual analysis based on both the GIMF and G20 models[2] suggest unfavorable external conditions, including sanctions and the decline in global oil price, explain around 0.8 percentage points of the shortfall, with a further 0.3 percentage points coming from the responses to these shocks from the financial sector and macroeconomic policies. The remaining differences between the October 2013 WEO projection and the actual growth of Russia could result from other factors, such as the structural problems in the domestic economy or forecasting errors.

Russia: Percentage Difference with 2013 WEO Projection
(Percent, annual average 2014-2018)



Source: IMF staff calculations.

Comparing Russia's Growth Performance with Peers

7. Russia has important commonalities and differences both with the EU new member states (NMS) and with other G20 emerging market economies (G20 EMs). It shares a common legacy of socialism with the NMS, and, to a lesser extent, their links with Western European markets and financial sectors. Size and openness in Russia are more comparable to the G20 EMs. Russia's external trade is also linked to the dollar, while the NMS are focused on the euro (some of them being euro members), and is an oil exporter, while the NMS and most G20 EMs are oil importers. It is therefore illuminating to compare how Russia's recent growth patterns have compared with these two groups.[3]

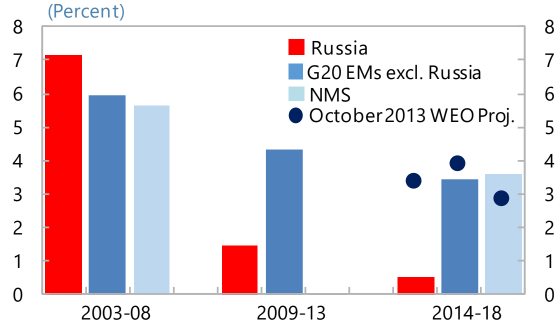
8. Growth in Russia outpaced both NMS and other G20 EMs in the boom and remained above the NMS in the aftermath of the GFC. The high growth rates in both Russia and NMS economies until the GFC has some common causes (namely, reaping the benefits of the reforms implemented in the transformational recessions of the 1990s), but also idiosyncratic causes. While Russia benefitted from riding the China-fueled commodity exports boom, NMS economies profited

[2] This analysis was prepared by Zoltan Jakab and Benjamin Hunt (both from RES).

[3] The NMS comprise Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia. Other G20 EMs comprise the following countries: Argentina, Brazil, China, India, Indonesia, Mexico, South Africa, and Turkey.

from increasing integration with advanced Europe, both in trade and financial markets. Other G20 EMs also benefitted strongly during the commodity boom. While Russia and the NMS suffered similar output losses in the GFC itself, Russia grew more strongly during 2010–13, helped by high oil prices and a continued fiscal expansion, while the NMS embarked on fiscal consolidation. The other G20 EMs generally suffered smaller output losses during the GFC than the European economies, as they were able to sustain growth through strong domestic demand. Hence, they fared markedly better than either Russia or the NMS overall in 2009–13.

Real GDP Growth
(Percent)



Sources: IMF *WEO* and IMF staff calculations.
Note: Calculated as a cross-sectional median and average for the period.

9. Macroeconomic trends diverged significantly across the groups from 2014. Interestingly, medium-term growth projections made in 2013 for all three groups were relatively similar, whereas the outturns differed strongly.[4] In Russia, growth virtually stagnated under the impact of sanctions and lower oil prices, as discussed above.[5] The other G20 EMs grew much faster, roughly followed expectations. By contrast in the NMS, growth has surprised somewhat on the upside. A number of factors appear to have been at play:

- ***Oil prices averaged 33 percent lower than expected over 2014–18[6].*** This will have given a modest boost to the NMS countries, and most of the G20 EMs, but a much more significant drag on GDP in Russia.

- ***Linkages with Western Europe.*** While sanctions had the effect of diminishing financial and trade ties between Russia and the advanced European economies, the NMS continued to strengthen their integration in value chains, deleveraging of Western European banks reversed, and the NMS continued to benefit from very large transfers under the EU structural and cohesion funds. Relatedly, the NMS countries have increased their already high overall openness to trade over the past two decades, while Russia's has remained at a low level.

- ***Structural and institutional reform.*** Russia made important strides in putting in place robust macroeconomic frameworks over 2014–18 but made less progress in structural reform. The footprint of the state rose somewhat in this period, notably in the financial sector. Meanwhile the NMS have generally continued to benefit from institutional convergence with EU standards and practices.

[4] In the case of Russia, Consensus Forecast projected 3.4 percent GDP growth in 2013 for the period 2014–2018.

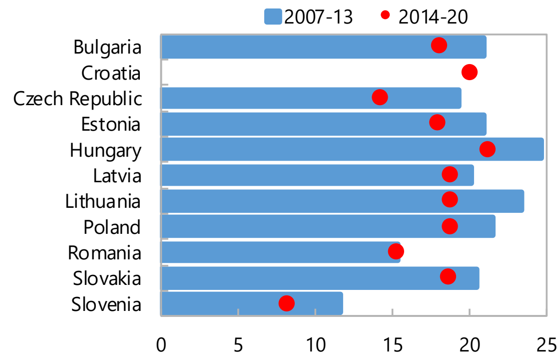
[5] See also IMF (2014), "Regional Economic Issues. Central, Eastern and Southeastern Europe: Geopolitical Tensions Taking a Toll", October.

[6] Based on October 2013 WEO projections.

- ***Fiscal policy has diverged.*** The NMS countries embarked on fiscal consolidation immediately after the GFC. By 2014 the process was more or less complete, and there has been no further structural fiscal adjustment on average since. Russia, in contrast, continued an expansionary fiscal policy through 2013 and then needed to reverse course after the sanctions and oil prices hit from 2014, with significant fiscal tightening. G20 EMs on average did not make large changes to the fiscal stance in the period.

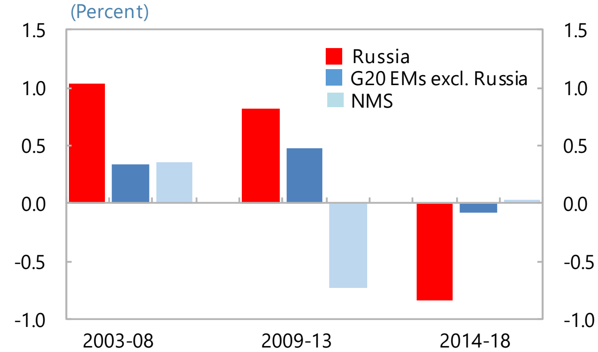
- ***Spreads and capital flows have delinked.*** Up to 2013 Russian bond spreads comoved with the NMS. But Russia's significantly higher and more volatile spreads since 2014 have contrasted with declining spreads in the NMS. These trends are reflected in capital flows, which have moved in opposite directions (especially relative to expectations in 2013), falling in Russia and rising in the NMS. Russia's spreads have moved somewhat closer to the G20 EM average recently.

NMS: EU SCF Allocations
(Percent of GDP in first year of program)



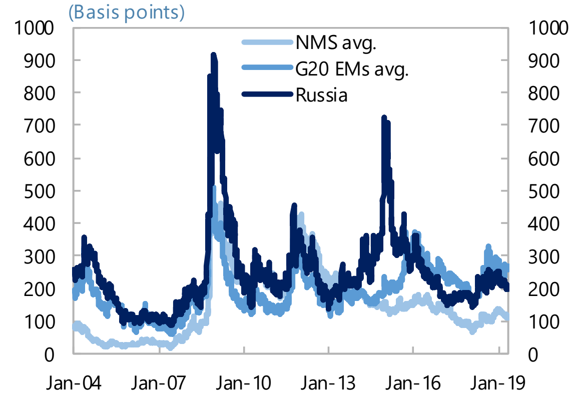
Sources: EU Cohesion Data; and IMF staff calculations.

Fiscal Impulse[1]
(Percent)



Source: IMF *WEO* and IMF staff calculations.
1/ Defined as the change in structural primary balance relative to potential GDP; non-oil primary structural balance used for Russia.

Sovereign Eurobonds Spreads
(Basis points)

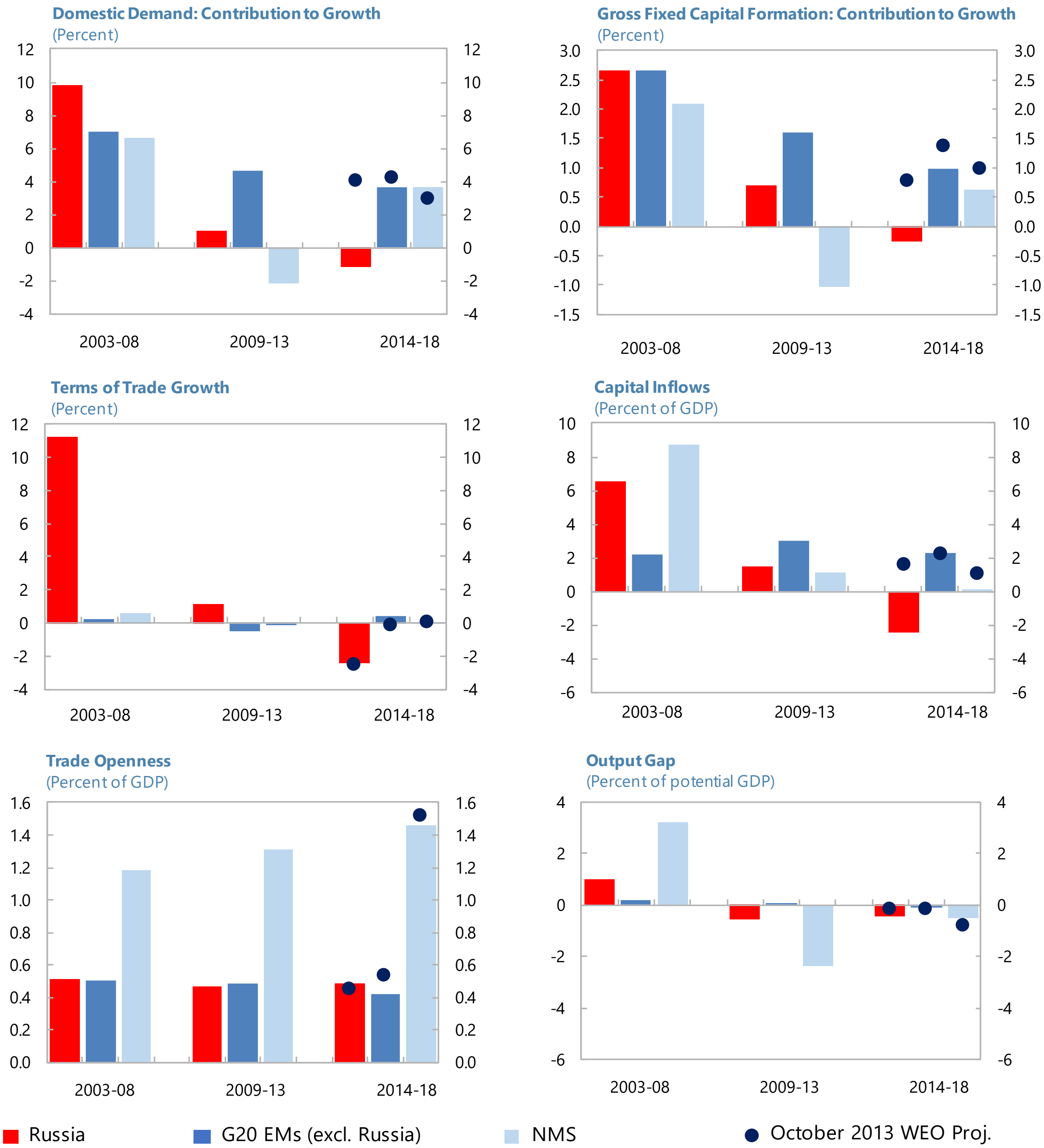


Sources: Bloomberg Financial L.P.

Conclusions

10. While Russia can grow faster, it is unlikely to recapture the growth momentum it enjoyed in the mid-2000s. Almost all the factors driving the heady growth of the boom years have since gone into reverse—and the last few years have seen a "perfect storm" of external and domestic factors holding growth back. It may be that some of these factors will ease in coming years, including the tightness of macro policies. And the strong macroeconomic frameworks Russia now has in place should help restore confidence, reduce real interest rates and limit the reaction of the real exchange rate to oil prices – all subject to the risk of further external shocks. With the addition of strong structural and institutional reforms, Russia's medium-term growth could increase, but the kind of growth rates that arose from the combination of economic transformation, ramping up of oil production and prices, and loose macro policies, and massive global liquidity and risk appetite, are unlikely to be repeated.

Figure 1. Russian Federation Versus G20 Emerging Markets and New Member States



Sources: Haver; IMF *WEO*; Rosstat; and IMF staff calculations.
Note: All variables for NMS and G20 EMs are calculated as a cross-sectional median and average for the period.

Annex VII. The Natural Interest Rate in the Russian Federation: A Preliminary Assessment

Introduction

1. There has been a revival in interest at both the academic and policy levels to understand the determinants and the level of natural real interest rates (NRIR). This revival is mainly explained by the need to assess and better understand the effectiveness of monetary policy in an environment of very low interest rates post-GFC.

2. The NRIR (like potential output or the NAIRU) is an unobserved variable. There are alternative definitions of the NRIR (beginning with Wicksell's in the late XIX century) but more recently, it has been defined as the rate prevailing in the economy after all shocks have run their course; when the real interest rate is at its natural level, inflation is at the central bank's target and output at potential. In an open economy, the NRIR should ensure that the arbitrage condition between real returns of domestic and foreign assets is met (real uncovered interest parity).

Estimation Framework

3. This Annex uses a version of the Laubach and Williams (2003), LW, model as proposed by Pescatori and Turunen (2015). There are multiple advantages of using this methodology, including its versatility, intuitive structure, and its widespread use, which facilitates cross-country comparisons with the estimates in other papers (e.g., IMF (2017), IMF (2018)). It proposes a small-scale model, that includes a backward-looking IS curve that relates output gap to the deviation of the real interest rate from the NRIR; a Phillips curve that links inflation to output gap and imported inflation; and an additional equation that links the NRIR to potential output growth and other possible determinants of the equilibrium interest rate. This semi-structural model allows the simultaneous estimation of the NRIR, trend output and potential growth (all of them unobserved variables), from observable data via the Kalman filter. The determinants of the NRIR (r_t^*) are trend growth (g_t) and an exogenous process (z_t) capturing variables other than trend growth[1],

$$r_t^* = cg_t + z_t \qquad (1)$$

Trend growth and the NRIR are linked by a constant, $c > 0$. Alternative definitions of the exogenous process (z_t) will result in two proposed specifications. The first specification (*Specification 1*) makes the exogenous process dependent on a news index of economic policy uncertainty (p_t), country risk (c_t), the US 10-year real sovereign yield (e_t), and autoregressive terms,

$$z_t = \delta_1 z_{t-1} + \delta_2 z_{t-2} + \delta_c \Delta c_t + \delta_p \Delta p_t + \delta_e \Delta e_t + \varepsilon_t^z \qquad (2)$$

[1] This section benefits from Osorio Buitrón (2016, unpublished manuscript).

A second specification (*Specification 2*) replaces the economic policy uncertainty index by the real effective exchange rate (REER) (as, in principle, short-term REER fluctuations should be associated with both changes in economic policy uncertainty, which affect international financial flows, and with changes in the terms of trade, which affect the current account). Specifications 1 and 2 will be estimated allowing the model to determine trend growth, and thus the output gap, endogenously.

Data and Results

4. **The semi-structural model described in the previous section is estimated using quarterly data, for the period 2003:Q1–2018:Q3.** The observed real interest rate (in percent) is obtained by subtracting the quarterly average of the central bank's nominal policy rate minus the quarterly average of 1-year ahead headline inflation expectations from Consensus Economics. The policy rate time series takes into consideration the changes in its definition, as stated by the Central Bank of Russia (CBR). Core and import price inflation calculated from Haver, seasonally-adjusted series, are the annualized quarter on quarter changes expressed in percent. In particular, import price inflation is calculated from underlying prices expressed in domestic currency and proxied by the GDP deflator on imports. Two alternative specifications are considered. In Specification 1, economic policy uncertainty is measured by the Bloom et al news-based index of economic policy uncertainty for Russia; country risk is measured by the Emerging Market Bond Index (EMBI) for Russia; and the international risk-free international interest rate is proxied by the U.S. 10-year real sovereign yield.

5. **NRIR estimates fall into the 1–3 percent range** (i.e, not far from Kreptsev et al. (2016)), with most estimates falling at about 2 percent, which is at the lower bound of the CBR range (2–3 percent). The NRIR estimated levels are explained by the estimated long-term growth rates at end sample broadly falling in a range of 1–1.5 percent, and the other possible determinants of the NRIR. The better performance of Specification 1 seems to be associated with the use of the Economic Policy Uncertainty Index, which explains a large part of the exogenous process (see Figure 1).

6. **The general trends in all cases are similar, with NRIR showing a broadly declining trend, on the back of declining long-term growth (Figure 1).** In Specification 1, the NRIR decreases through 2010, and then moves sideways in a context of increasing volatility, which is also reflected by sharp moves in the NRIR distribution (the 10th and 90th percentiles are shown), in particular since the impact of the dual shock of sanctions and lower oil prices at end-2014. As discussed above, the model allows for a decomposition of the NRIR estimate into its main driving forces. In this regard, the decrease observed in the NRIR during the first decade of the 2000s was the counterpart of a decrease in long-term (trend/potential) growth. A decomposition of the exogenous variables affecting the NRIR shows that effects from the decline in the US long-term interest rate have been partially offset by increases in country risk premium (as measured by the EMBI). In recent years, the negative impact in the NRIR of decreases in global interest rates and reductions in country risk has been more than offset by increases in the perception of economic policy uncertainty. In Specification 2, the contribution of the REER to NRIR is small, which could be reflecting a correlation with the other possible determinants (US rate and EMBI).

7. The direction in which some factors affect the NRIR in emerging markets (like Russia) can be different in reserve currency countries. For instance, the country risk premium is found to push the natural rate upwards in Russia, as capital mobility ensures that risk-adjusted real returns are arbitraged. However, risk increases in reserve currency countries may temporarily decrease the NRIR as the central bank loosens the monetary policy stance to offset the negative impact of higher uncertainty on economic activity.

8. Uncertainty around the NRIR estimate creates challenges for policy implementation. The central bank's ability to smooth the impact of short-term shocks depends on central bank's policy space. However, noisy estimates of the NRIR complicate this assessment. In this context, uncertainty about NRIR estimates suggest they should be considered jointly with other indicators such as deviations of inflation from target.

References

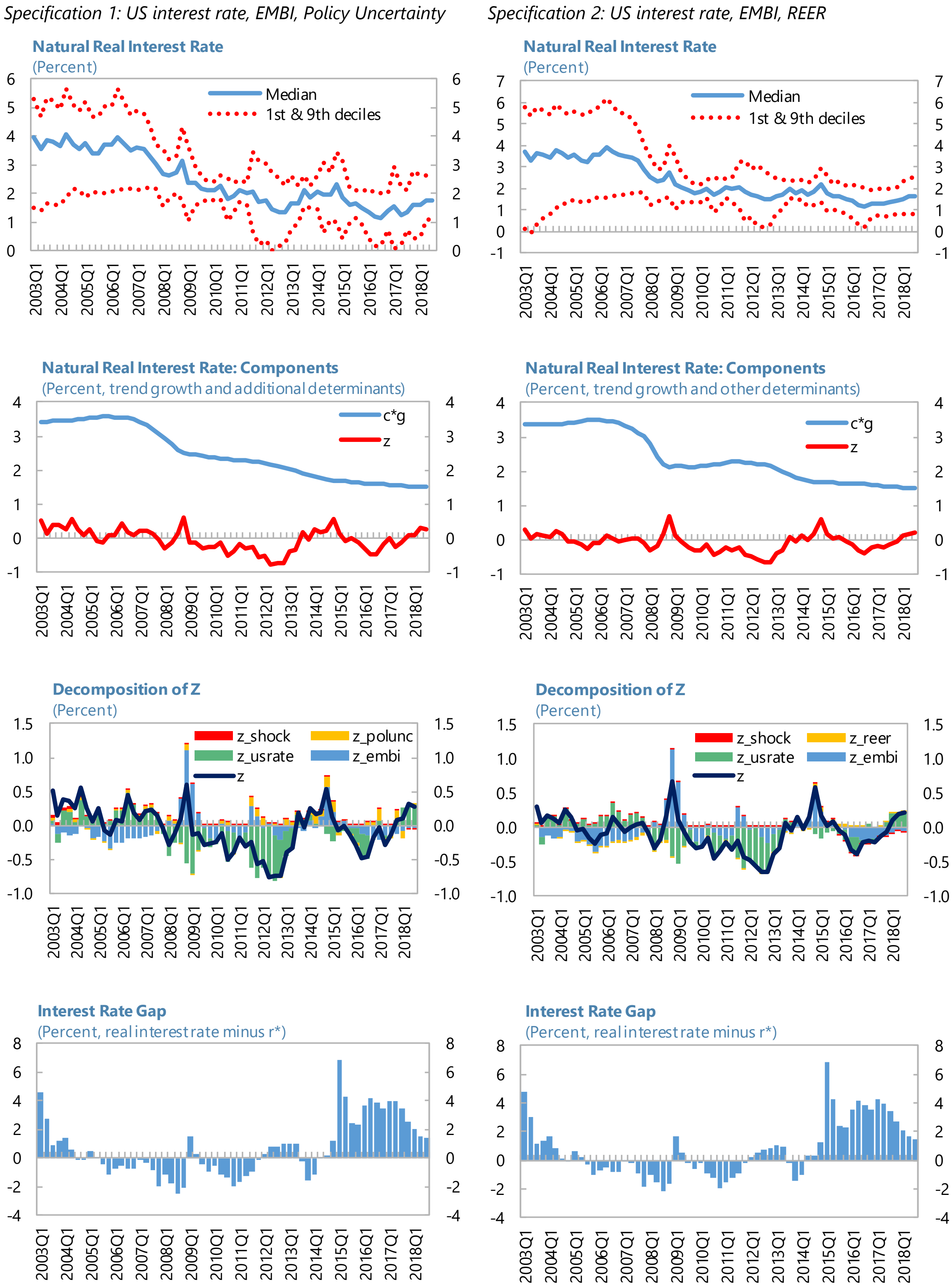
Dmitry Kreptsev, Alexey Porshakov, Sergey Seleznev, Andrey Sinyakov (2016) The equilibrium interest rate: a measurement for Russia. Bank of Russia, Economic Research Working Papers No. 13, July 2016.

IMF (2017), "G-20 Report on Strong Growth, Sustainable, and Balanced growth," October.

Laubach, Thomas, and John C. Williams, 2003. "Measuring the Natural Rate of Interest," The Review of Economics and Statistics, MIT Press, vol. 85(4), pages 1063–1070, November.

Pescatori, Andrea and Jarkko Turunen, 2015. "Lower for Longer; Neutral Rates in the United States," IMF Working Papers 15/135, International Monetary Fund.

Figure 1. Russian Federation: Natural Real Interest Rate Estimations



Source: IMF staff calculations.

INTERNATIONAL MONETARY FUND

RUSSIAN FEDERATION

June 25, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By	The European Department (In Consultation with Other Departments).

CONTENTS

FUND RELATIONS[1]

(As of May 31, 2019)

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

General Resources Account	**SDR Million**	**Percent Quota**
Quota	12,903.70	100.00
Fund holdings of currency	10,521.01	81.53
Reserve Position	2,382.72	18.47
Lending to the Fund		
New Arrangements to Borrow	336.92	

SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	5,671.80	100.00
Holdings	4,842.61	85.38

Outstanding Purchases and Loans: None

Latest Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-by	07/28/99	12/27/00	3,300.00	471.43
EFF	03/26/96	03/26/99	13,206.57	5,779.71
of which SRF	07/20/98	03/26/99	3,992.47	675.02
Stand-by	04/11/95	03/26/96	4,313.10	4,313.10

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

Forthcoming

	2019	2020	2021	2022	2023
Principal					
Charges/Interest	4.66	9.30	9.29	9.29	9.29
Total	4.66	9.30	9.29	9.29	9.29

[1] http://www.imf.org/external/np/fin/tad/exfin2.aspx?memberkey1=819&date1Key=2999–12

Implementation of HIPC Initiative: Not Applicable

Implementation of MDRI Assistance: Not Applicable

Exchange Arrangements: The *de jure* and *de facto* exchange rate arrangement is free floating. Under this arrangement, the exchange rate of the ruble is determined by market factors. The CBR may intervene in the domestic foreign exchange market in the event of threats to financial stability. Effective February 1, 2017, the MOF implemented a new mechanism for foreign exchange purchases and sales to enhance the stability and predictability of local economic conditions and to reduce the impact of price volatility in the global energy market on Russia's economy and public finances. Trade volumes will depend on the amount of oil and gas revenues in the federal budget. As long as the actual Urals price exceeds US$40 per barrel, in real terms, the MOF will be purchasing foreign exchange in the amount of additional oil and gas revenues. If the actual prices drop below this level, MOF will be selling foreign exchange in the amount of the resulting shortfall in oil and gas revenues. The size of these operations will be announced at the start of every month and purchases will be evenly distributed within the month. The foreign exchange purchase program is preannounced, predictable, involves small daily amounts, and is not triggered by an exchange rate level. The Russian Federation accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement with effect from June 1, 1996, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation: Russia is on the standard 12-month consultation cycle. The last consultation was concluded on September 7 , 2018.

FSAP Participation, FTE and ROSCs: Russia participated in the Financial Sector Assessment Program during 2016, and the FSSA report was discussed by the Board in July 2016 at the time of the 2016 Article IV discussion. An FSAP financial stability assessment took place during April 2011, and the FSSA report was discussed by the Board in September 2011, at the time of 2011 Article IV Consultation. An FSAP update took place in the fall of 2007, and the FSSA report was discussed by the Board in August 2008, at the time of the 2008 Article IV discussion.

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

Resident Representative: Mr. Gabriel Di Bella, Resident Representative since July 15, 2015.

RELATIONS WITH OTHER FINANCIAL INSTITUTIONS

World Bank

http://www.worldbank.org/en/country/russia

STATISTICAL ISSUES

(As of May 31, 2019)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance. However, in the context of emerging data demands for assessing external vulnerabilities, the scope for further data improvements exists.
National Accounts: Data are broadly adequate for surveillance, but there have been concerns about the reliability and consistency of quarterly GDP estimates and seasonally adjusted headline GDP among a wide range of users, including Fund staff. In April 2016, Rosstat released GDP estimates compiled according to the 2008 SNA. In addition, the data for 2011 to 2013 have been revised, but are compiled according to the 1993 SNA. The main changes introduced in the revised series include improvements in the estimation of the imputed rental services of owner-occupied dwellings and the use of the market value of assets to estimate consumption of fixed capital. Real GDP data are rebased to 2016 prices, and published from 1995:Q1. The Central Bank of Russia compiles quarterly sectoral financial accounts and financial balance sheets; however, data are only available on the agency's website up to the fourth quarter of 2017.
Price Statistics: Monthly CPI and PPI, both compiled using the Two-Stage (Modified) Laspeyres (2000=100), cover all regions of the Russian Federation. The weights reflect expenditures in the 12 months ending in the most recent September. Aggregate price indices are compiled for each good and service item for all the regions and the Russian Federation as a whole. However, population weights, as opposed to expenditure shares are applied to the individual regional indices possibly biasing the CPI downwards if price increases are higher in regions with higher per capita expenditures. Detailed data on total annual sales by economic activity, which are used to develop weights for the PPI, are published on the Rosstat website. The detailed weights are available only on the Russian-language version of the website, making it less accessible to some users. Further efforts to improve the treatment of seasonal items in the core inflation index and a new household budget survey—which has been under consideration for some time—could significantly strengthen data quality.
Government Finance Statistics: The authorities compile a comprehensive set of the general government accounts based on the *Government Finance Statistics Manual 2014 (GFSM 2014)* on an annual basis. These data comprise the statement of sources and uses of cash as well as the accrual-based government operations (revenue, expenditure and transactions in assets and liabilities), complete balance sheet (including non-financial assets), holding gains and losses and other changes in the volume of assets and liabilities, and outlays by functions of government (COFOG). A monthly statement of sources and uses of cash based on *GFSM 2014* is also compiled for the whole general government sector. In addition, the authorities have recently started reporting quarterly accrual-based general government operation statement as well as a financial balance sheet.

Monetary and Financial Statistics: Following remote technical assistance from STA, in January 2019 Russia started reporting monetary data using the standardized report form (SRFs). Data are reported on a monthly basis for the central bank and other depository corporations, and on a quarterly basis for other financial corporations. Reported data are broadly consistent with the methodology of the *Monetary and Financial Statistics Manual and Compilation Guide* (*MFSMCG*).
External sector statistics: Balance of payments data are broadly adequate for surveillance, and significant improvements have been made to enhance data quality. The CBR has recently published the gross capital flow data for the private sector, which would facilitate the analysis of relatively complex flows. Starting from 2012, the balance of payments is compiled according to the framework of the *Fund's Balance of Payments and International Investment Position Manual*, sixth edition (BPM6) and the CBR has revised historical data (going back to 1994:Q1 for BOP, and to 2004:Q1 for IIP), consistent with BPM6. It has also been reported supplementary data (currency breakdown and derivatives) covering the period 2015:Q4 to 2018:Q3. Partial data from a variety of sources are supplemented by the use of estimates and adjustments to improve data coverage. In particular, the CBR makes adjustments to merchandise import data published by the Federal Customs Service to account for "shuttle trade," smuggling, and undervaluation. Statistical techniques are also used to estimate transactions and positions of foreign-owned enterprises with production sharing agreements, and these techniques are continuously being improved. At the same time, Russian compilers are seeking to reconcile their data with those of partner countries. Improvements have been made in the coverage and quality of surveys on direct investment, and the CBR is participating in the Fund's Coordinated Direct Investment Survey (CDIS) and Coordinated Portfolio Investment Survey (CPIS).
Financial sector surveillance: Russia reports all 12 core financial soundness indicators (FSIs) and 9 of the 13 encouraged FSIs for deposit takers on a quarterly basis. After 2016, FSIs on earnings and profitability are reported on a quarterly basis instead of on an annual basis. Also, 2 FSIs for households and 3 FSIs for real estate markets are reported on a quarterly basis. Data are reported for posting on the IMF's FSI website with a lag of more than one quarter.

II. Data Standards and Quality	
Russia is an SDDS subscriber since 2005. Russia plans to revamp the SDDS National Summary Data Page to disseminate data also in machine-readable format (SDMX).	Data ROSC was published in 2011.

Russian Federation: Table of Common Indicators Required for Surveillance
(As of May 31, 2019)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:[8] Data Quality – Methodological soundness[9]	Memo Items:[8] Data Quality – Accuracy and reliability[10]
Exchange Rates	May 2019	5/31/2019	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	April 2019	5/20/2019	M	M	M		
Reserve/Base Money	May 2019	5/31/2019	W	W	W	O, O, LO, LO	O, O, O, O, O
Broad Money	April 2019	5/31/2019	M	M	M	O,O,LO,LO	O,O,O,O,O
Central Bank Balance Sheet	March 2019	5/06/2019	M	M	M	O,O,LO,LO	O,O,O,O,O
Consolidated Balance Sheet of the Banking System	April 2019	5/31/2019	M	M	M	O,O,LO,LO	O,O,O,O,O
Interest Rates[2]	May 2019	5/31/2019	W	W	W	O,O,LO,LO	O,O,O,O,O
Consumer Price Index	April 2019	5/15/2019	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	April 2019	5/22/2019	M	M	M	O, LO, LNO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	April 2019	5/22/2019	M	M	M	LO, LNO, LO, O	O, O, LO, O, NA
Stocks of Central Government and Central Government-Guaranteed Debt[5]	April 2019	5/22/2019	M	M	M		
External Current Account Balance	2019:Q1	4/09/2019	Q	Q	Q		
Exports and Imports of Goods and Services	2019:Q1	4/09/2019	Q	Q	Q	O, O, O,LO	LO, O, O, O, O
GDP/GNP	2018:Q4	4/02/2019	Q	Q	Q		
Gross External Debt	2019:Q1	4/26/2019	Q	Q	Q	O, O, O, O	O, O,LO, O, LO
International Investment Position[6]	2018:Q4	4/02/2019	Q	Q	Q		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[8] These columns should only be included for countries for which Data ROSC (or a Substantive Update) has been published.
[9] This reflects the assessment provided in the data ROSC or the Substantive Update (published in February 2011, and based on the findings of the mission that took place during June-July 2010) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[10] Same as footnote 7, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.