

The World Bank in Russia

Russian Economic Report*

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Moderating Risks, Bolstering Growth



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Executive Summary

Half a year ago, Russia's economic prospects looked uncertain. The global economy was losing momentum, the expansion in the euro area was grinding to a halt and commodity prices were beginning to fall. Yet, while output growth is slowing this year in line with weaker growth in Europe and elsewhere, Russia's latest economy performance has been solid, though aided by favorable oil prices.

The economy returned to the pre-crisis peak towards the end of last year, supported by strong consumption, as growth held steady at the same rate as in 2010. In 2011, measured in current dollars, Russia's economy was the ninth biggest in the world, compared to the eleventh biggest in 2007. This year, Russia's output might exceed US\$2 trillion. Equalizing for prices difference with purchasing power parity, Russia's economy is already the sixth biggest today. The current account looks strong thanks to a large surplus in the trade balance, and the Central Bank of Russia added again in 2011 to its stock of foreign reserves. Employment returned to pre-crisis levels even earlier than output, and wages grew at a solid pace. Inflation reached its lowest level in two decades. Inequality declined and consumption levels of low-income households improved. The fiscal balance returned to a surplus. And while average public debt levels in advanced economies exceeded 100 percent of GDP in 2011, Russia's public debt was no more than 10 percent of GDP.

However, a fair share of the recent accomplishments is tied to high oil prices. Boosted by supply constraints rather than strong global demand, the price of Urals crossed US\$125/barrel in early March 2012, the first time since July 2008. High oil prices have translated into strong export receipts, buoyant fiscal revenues, and a bullish stock market. Nevertheless, in spite of high oil prices, Russia's economic expansion remains subdued. Indeed, Russia's recovery from the 2008 crisis was slow compared to its recovery from the 1998 crisis, as well as compared to the recovery of many other economies in the last few years.

A closer look at the economic situation reveals a number of weaknesses. The growth of the manufacturing industries slowed in the second half of 2011. Fixed investment has started picking up only recently, foreign direct investment stays sluggish, and capital outflows are elevated. The non-oil current account deficit reached a record 13 percent of GDP in 2011, underlying the oil dependence of Russia's export sector. The non-oil fiscal deficit remained close to 10 percent of GDP, and is projected to increase further this year. Inflation is set to pick up later in the year, as delayed increases in utility and gasoline prices kick in and prices pressures increase as enterprises find it more difficult to fill job vacancies.

Economic policies can help to shore up Russia's resilience in a volatile economic environment, diversify its economy, and strengthen its growth potential. First, fiscal policy should be used to rebuild fiscal buffers while oil prices are high. This would not only help to prepare for the next crisis, but also make sure that fiscal policy does not become procyclical as the output gap closes. Furthermore, monetary policy should continue to focus on low inflation, and financial policies on strengthening oversight. Finally, removing structural barriers to growth can help to bolster investment and productivity. Improving the business environment would go a long way to make the most of the economic benefits of Russia's World Trade Organization accession in summer 2012.

	2011	2012	2013	2012	2013
	Actual	Baseline		High oil price	
GDP growth (%)	4.3	3.5	3.9	4.0	4.2
Consolidated government balance (% of GDP)	1.6	-1.3	-0.9	1.4	2.0
Current account (% of GDP)	5.5	2.7	1.1	4.1	1.8
Oil price (WB Average, US\$ per barrel)	105	98.2	97.1	125.0	125.0

Source: World Bank staff projections

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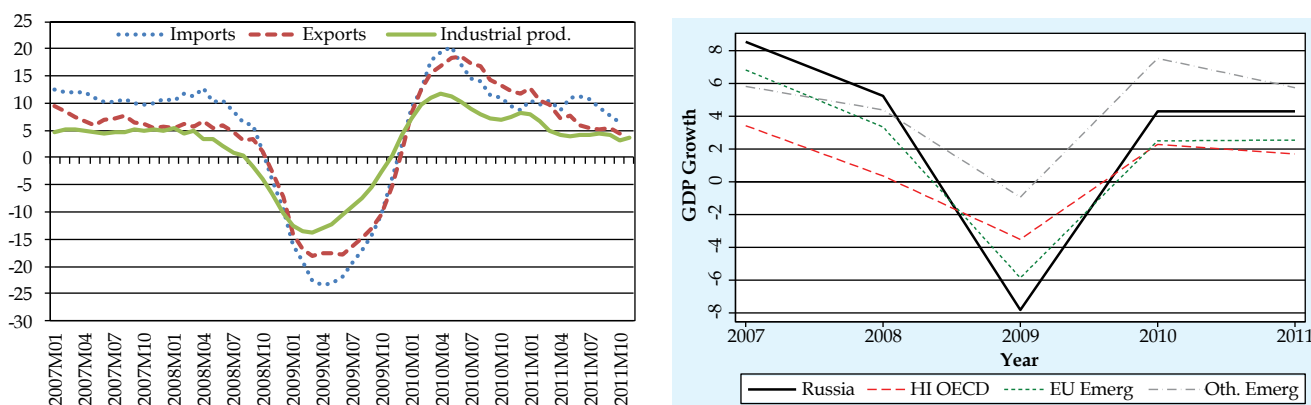
Recent Economic Developments

Growth—steady even though global recovery stalls

While the global economy weakened, Russia's economic performance strengthened in the second half of 2011. Helped by broad-based growth, including a strong rebound in agriculture, Russia's output returned to pre-crisis levels at the end of 2011, even though fixed investment lagged behind. The growth momentum carried over to 2012, supported by a rebound in non-tradable sectors.

While the global recovery weakened, Russia's growth remained resilient and its output returned to pre-crisis levels. Strains in financial and sovereign debt markets of the euro area, the slowing recovery in the US, the recession in Japan, high commodity prices, and the end of the inventory cycle and fiscal consolidation dampened global economic activity in 2011. This led to a slow-down in the expansion of world trade and industrial production (Figure 1). Yet, Russia's recovery remained on track. While growth moderated from 2010 to 2011 in high-income OECD countries and emerging economies outside the EU, growth in 2011 reached 4.3 percent in Russia, unchanged from 2010.¹ As a result, Russia's output returned to pre-crisis levels towards the end of 2011. However, the recovery was slow relative to the recovery from the 1998 crisis, and compared to other economies (Box 1 and Box 2).

Figure 1. (a) World import and export volumes (percent, yoy growth, sa, US\$) and world industrial production volumes (percent, yoy growth, sa); (b) GDP growth (percent)



Source: OECD, IMF, World Bank staff calculations.

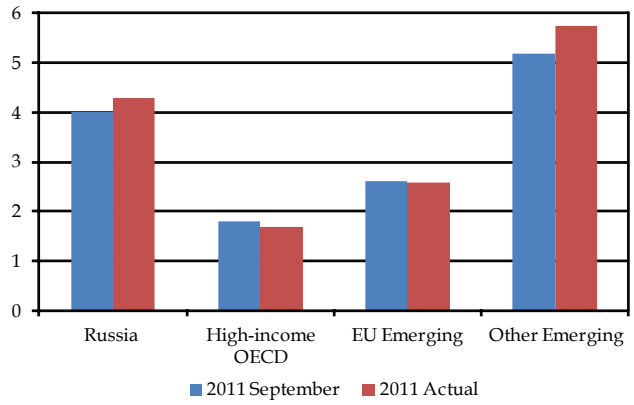
The robust expansion in Russia reflects a solid performance in the second half of 2011. Growth in Russia accelerated from 3.8 percent year-on-year in the first half to 4.8 percent in the second half of 2011.² The upturn benefited from the base effect, as growth weakened from the first to the second half of 2010. But it also was due to the dynamism of the economy as quarter-on-quarter growth picked up from the first half of 2011 to the second half of 2011. As a result, growth in 2011 was 0.3 percent of GDP better than expected in September, at the time when the previous Russian Economic Report was released (Figure 2). This reflects in part a larger-than-expected carry-over effect of growth, as growth in 2010 was revised upwards from 4.0 to 4.3 percent. And, as we discuss below, domestic demand was more robust than expected.

¹ Emerging EU economies include the six central European countries that are member both of the EU and the OECD: Czech Republic, Estonia, Hungary, Poland, Slovak Republic, and Slovenia). Other emerging economies includes also six countries: Brazil, China, India, South Africa, Turkey, and Mexico.

² However, revisions to the 2011 quarterly GDP numbers for 2011 released in April 2012 could moderate the uptick in the second half.

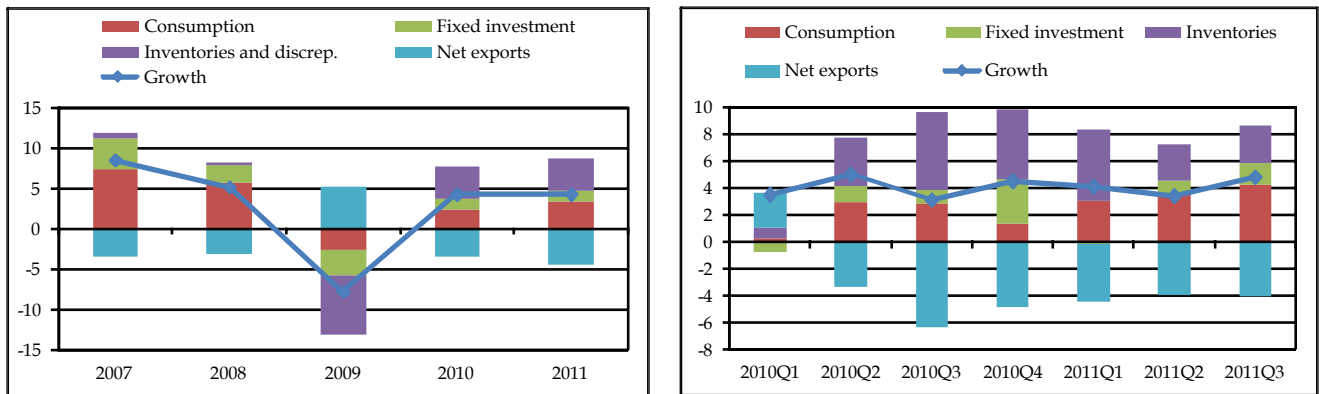
Growth was fairly broad-based in 2011. Consumption, fixed capital investment and inventories all contributed to growth. Restocking remained the most important growth driver, as companies continued to rebuild their inventories following the sharp decline in 2009 (Figure 1). Consumption was the second most important factor, as household consumption picked up and the contribution of public consumption turned positive for the first time since 2009. Private consumption was supported by falling unemployment, solid wage growth, falling inflation, and a strong ruble in the first half of the year. Fixed capital investment remained sluggish, as in 2010. The larger contributions from inventories and consumption were offset by a decline in net exports, mainly due to weaker exports. In 2011, looking at growth trends over the quarters shows that consumption instead of inventories became the largest growth contributor in the second and third quarters.

Figure 2. 2011 growth — forecast and actual (percent)



Source: IMF, World Bank staff calculations.

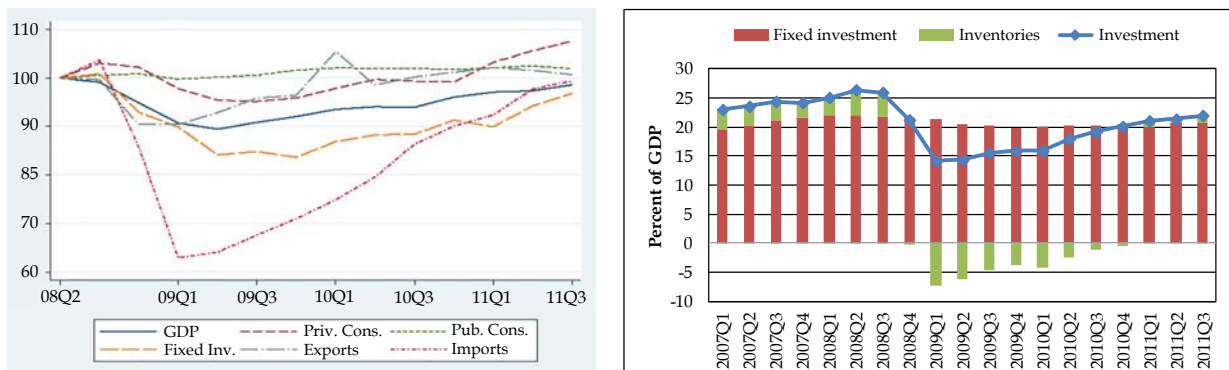
Figure 3. (a) Annual growth composition (percent of GDP); (b) Quarterly growth composition (percent of GDP)



Source: Rosstat, World Bank staff calculations. Discrepancies accounted for -0.3 percent of GDP in 2010 and 0.2 percent of GDP in 2011.

Fixed capital investment is still recovering from the crisis. Relative to the pre-crisis peak of the second quarter of 2008, private consumption recovered the fastest, followed by public consumption and exports. While imports contracted the sharpest during the crisis, they recovered strongly and were in the third quarter of 2011 close to the pre-crisis level. Fixed capital investment rebounded the slowest, and remained 3 percentage points below the pre-crisis level in the third quarter of 2011 (Figure 4). Overall investment reached 22 percent of GDP in the third quarter of 2011, some 4.4 percent of GDP below the level in the second quarter of 2008. However, the latest numbers suggest that fixed capital investment is picking up.

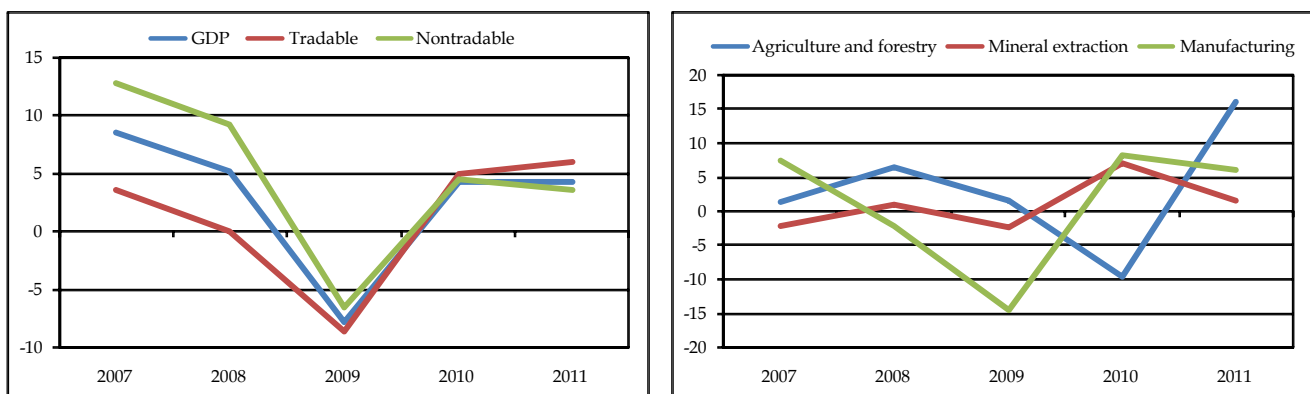
Figure 4. (a) GDP growth by components (Q2 2008 =100); (b) Investment (percent of GDP)



Source: Rosstat, World Bank staff calculations.

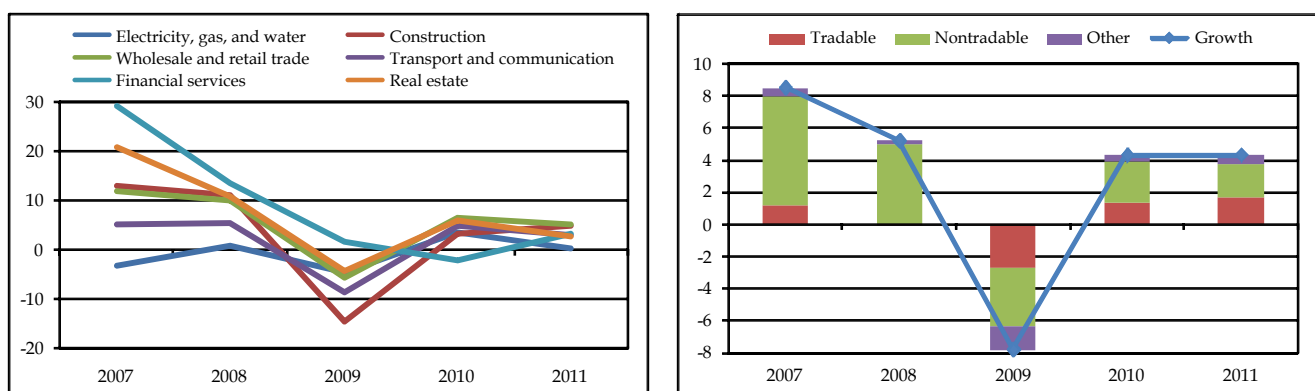
Growth in the tradable sector picked up, lifted by a strong rebound in agriculture. A sectoral breakdown shows that, in contrast to previous years, the tradable sector grew faster than the non-tradable sector. Prior to the crisis, growth relied heavily on construction, real estate, wholesale and retail trade and financial services. These non-tradable sectors underwent sizable adjustments during the crisis, and, with the exception of financial services, rebounded in 2010 (Figure 5). In 2011, all non-tradable sectors posted positive growth, although growth moderated in some subsectors compared to 2010, including wholesale and retail trade and transport and communication. In the tradable sector, mineral extraction and manufacturing also took a hit during the 2008/09 crisis as global demand for energy and industrial production plummeted. While these two sectors rebounded in 2010, agriculture contracted sharply due to a drought, moderating growth in the tradable sector to below 5 percent. In 2011, growth in manufacturing and especially mineral extraction moderated, but growth in agriculture bounced back strongly due to a bumper crop. As a result, growth in tradable sectors increased to 5.9 percent, compared to only 3.6 percent in the non-tradable sectors. The growth contribution of mineral extraction and manufacturing declined from 1.8 percent of GDP in 2010 to 1.1 percent of GDP in 2011, while agriculture improved from -0.4 percent of GDP in 2010 to 0.6 percent of GDP in 2011 (Figure 6).

Figure 5. (a) Sectoral growth (percent); (b) Tradable sector growth (percent)



Source: Rosstat, World Bank staff calculations.

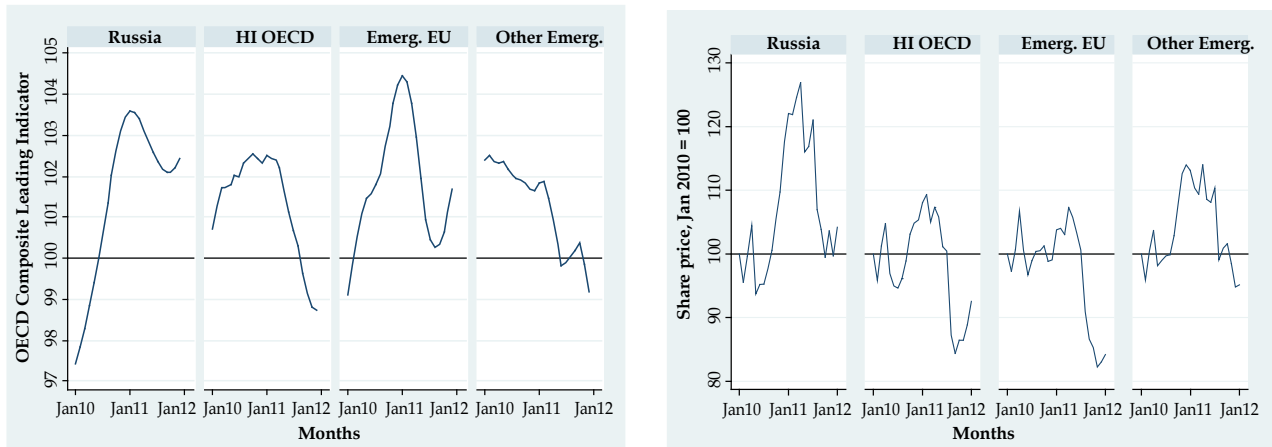
Figure 6. (a) Non-tradable sector growth rates (percent); (b) GDP growth composition (percent)



Source: Rosstat, World Bank staff calculations.

High-frequency indicators suggest that the growth momentum carried over into early 2012. Rosstat's business confidence index improved from -6 percent in December 2011 to -2 percent in February 2012. The OECD composite leading indicator for Russia also rose in January, and was above its long-term average of 100. This indicator also improved for emerging EU countries, but declined both in high-income OECD countries and emerging economies outside the EU (Figure 7). Rising oil prices and improving global market risk appetite also lifted Russia's stock market.

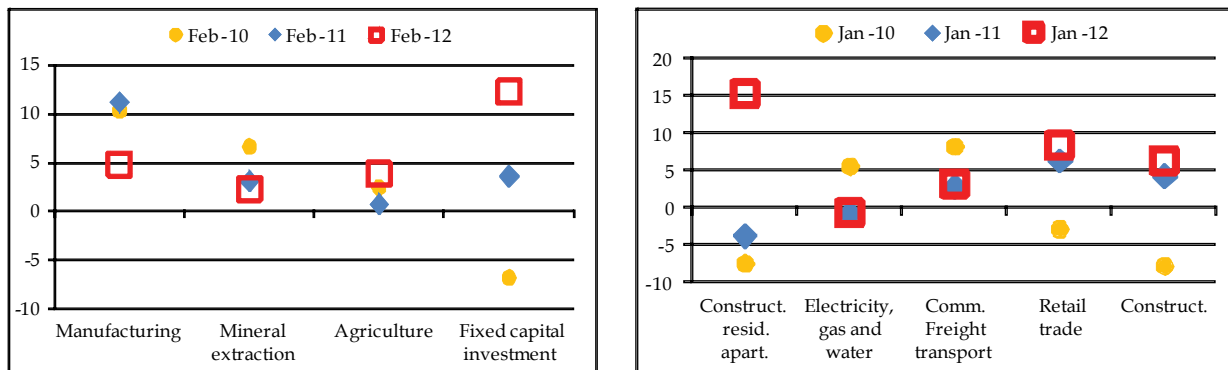
Figure 7. (a) OECD composite leading indicator (long-term average = 100); (b) Share prices (Jan 2010 = 100)



Source: OECD, World Bank staff calculations.

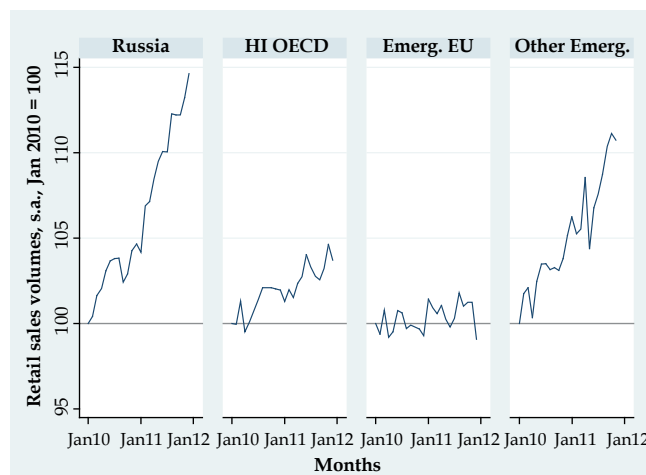
The dynamics of the non-tradable sector improved recently relative to the tradable sector. In the tradable sector, only agriculture performed strongly, while growth of mineral extraction, and especially manufacturing, was noticeably weaker than a year ago (Figure 8). In the non-tradable sector, retail trade and construction improved from a year ago. Electricity, gas and water remained unchanged, partly due to a mild winter, and commercial freight transport picked up moderately. Registrations for the construction of residential apartments turned positive in July 2011 for the first time since December 2010 and reached in January 2012 their highest growth rate since December 2007. The performance of Russia's retail sector stands out in international comparisons. Since January 2010, retail trade volumes increased 15 percent in Russia, compared to only 11 percent in non-EU emerging economies (Figure 9).

Figure 8. (a) Tradable sector growth (percent, yoy, 3mma); (b) Non-tradable sector growth (percent, yoy, 3mma)



Source: Rosstat, World Bank staff calculations.

Figure 9. Retail sales volumes (sa, Jan 2010 = 100)

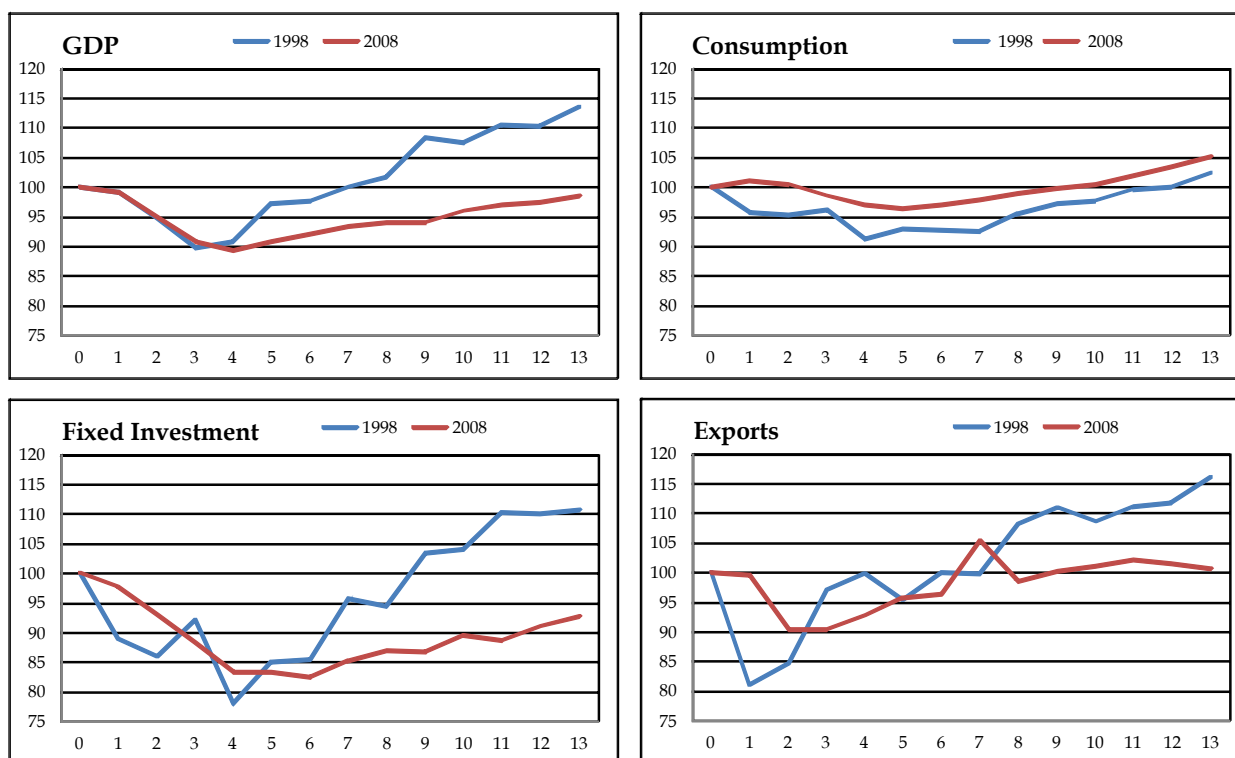


Source: OECD, World Bank staff calculations.

Box 1. Russia's recovery from the 2008 crisis

While Russia's output exceeded the pre-crisis peak in the late 2011, the recovery from the crisis is slow. This is borne out by comparisons with the recovery from the 1998 crisis. For both the 1998 and 2008 crisis, GDP dropped about 10 percentage points from peak to trough. However, GDP took seven quarters to recover to pre-crisis level after the 1998 crisis, yet twice as long after the 2008 crisis. What accounts for the weaker recovery? Looking at GDP components, we find that investment is a key culprit (Figure 10). After 13 quarters, investment was still 20 percent off its pre-crisis peak in the 2008 crisis, while it had recovered to pre-crisis levels in the 1998 crisis. Similarly, after 13 quarters, fixed investment was already 10 percent above pre-crisis levels in the 1998 crisis, yet it remained 8 percentage points below the pre-crisis level in the 2008 crisis. By contrast, consumption held up better in the 2008 crisis than in the 1998 crisis, in part because Russia's stronger fiscal position allowed it to respond during the 2008 crisis with counter-cyclical fiscal policy. However, imports also plummeted less and recovered faster in the 2008 crisis. After 13 quarters, imports reached their pre-crisis level in the 2008 crisis, while they were still 10 percentage points off the pre-crisis level in the 1998 crisis. In addition to investment and imports, exports also contributed to the weaker recovery. After 13 quarters, exports remained at pre-crisis level in the 2008 crisis, but were about 18 percent above pre-crisis level in the 1998 crisis. The slower rebound from the 2008 crisis compared to the 1998 crisis is perhaps unsurprising. While the 1998 crisis was regional in nature, the 2008 crisis was global, and the world economy experienced a longer and deeper contraction. World growth moderated to only 2.5 percent and rebounded already after one year in the late 1990s, but dropped over 6 percent and rebounded only after two years in the late 2000s. In addition, Russia's economy had vast spare capacity in the late 1990s, and benefited from a sharper depreciation than during the 2008 crisis.

Figure 10. Trends of GDP components by quarter in the 1998 and 2008 crises (Last pre-crisis quarter = 0)



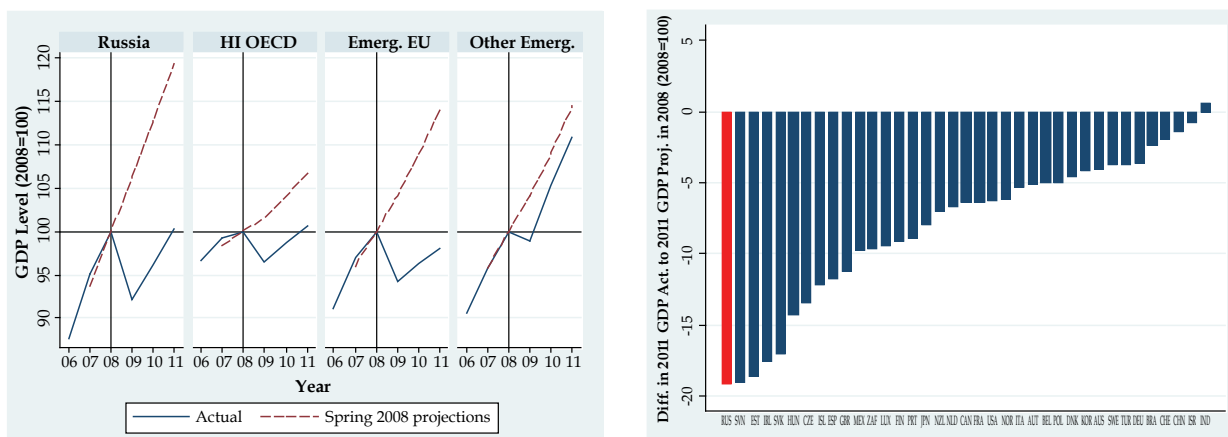
Source: Rosstat, World Bank staff calculations.

However, Russia's recovery from the 2008 crisis is also weak compared to other economies. Comparing IMF growth projections from the eve of the 2008 crisis to actual developments suggests that the crisis led to both a downward shift and a flattening of the growth trajectory. Two points are noteworthy. First, the crisis changed growth trajectories for all country groupings shown below (Figure 11). All four groups experienced a downward shift in output due to the economic adjustment in 2009. However, the slope of the growth trajectory post-crisis looks roughly unchanged for high-income OECD countries and other emerging economies. By contrast, growth slowed post-crisis in Russia and emerging EU countries, and the gap with the pre-crisis trajectory widened. Nevertheless, the growth trajectory in Russia remains steeper than in high-income OECD countries and emerging EU countries, as Russia still has vast potential to close the productivity gap with the high-income economies through capital accumulation, skill development, and technology absorption. Second, growth moderation was starker for Russia than for other

Box 1. Russia's recovery from the 2008 crisis (continued)

countries. In fact, among the 37 countries investigated here, Russia was the furthest off the pre-crisis trajectory in 2011. This is related to three factors. Russia's economy was overheating in the run-up to the crisis, making the pre-crisis growth trajectory unsustainable. In addition, Russia's downturn during the crisis was especially severe, as the economy faced three shocks. Like, for example, the emerging EU countries, Russia faced a sharp decline in credit and trade flows. But Russia also was hit by a plunge in oil prices. Finally, in the post-crisis period, notwithstanding high oil prices, investment remained weak due to capital outflows, high global risk aversion, and renewed attention to the quality of the investment climate.

Figure 11. (a) GDP trends: actual versus projections (2008=100);
(b) Difference in actual 2011 GDP compared to 2011 GDP projection (percent)

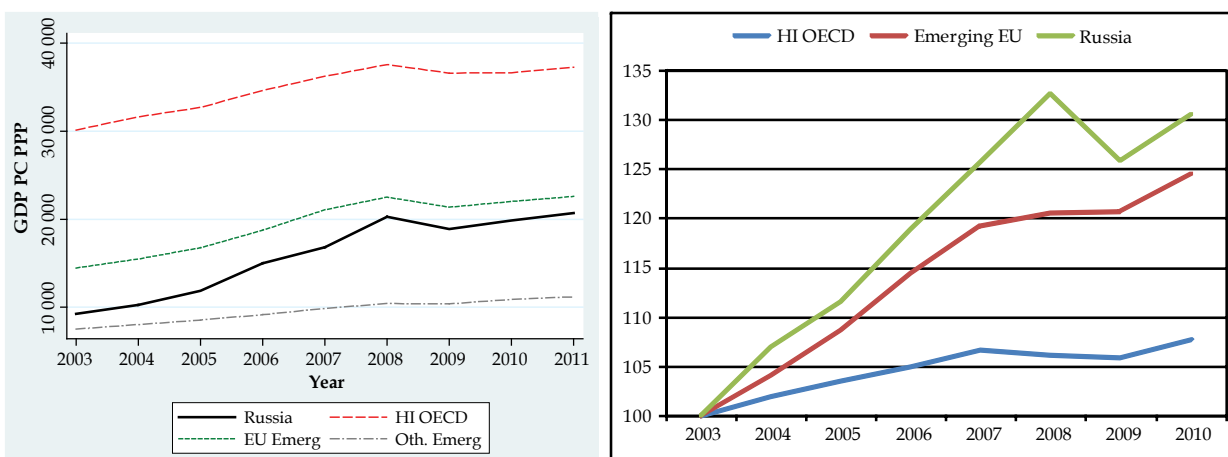


Source: OECD, World Bank staff calculations.

Box 2. Russia's income convergence and labor productivity

Russia's convergence to income levels of the high-income countries has slowed since the crisis. Russia's income level rose rapidly from 30 percent in 2003 to 54 percent of the high-income OECD level in 2008 (Figure 12). Yet, at 55 percent, it was only moderately improved in 2011 compared to 2008. The slowdown in convergence is linked to the drop in labor productivity. From 2003 to 2008, Russia's GDP per hour worked rose rapidly, fuelling a catch-up in living standards with advanced economies. From 2008 to 2010, labor productivity fell, while it continued to rise in the emerging EU countries and high-income OECD countries. In 2010, Russia's labor productivity was still only 43 percent of the level of high-income OECD countries, and 74 percent of the level of emerging EU countries.

Figure 12. (a) Trends of GDP per capita; (b) Trends in labor productivity (GDP per hour worked, 2003=100)



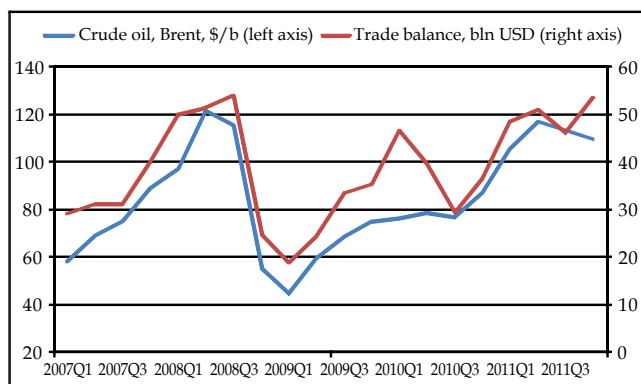
Source: OECD, IMF, World Bank staff calculations.

Balance of payments – large current account surplus, large capital outflows

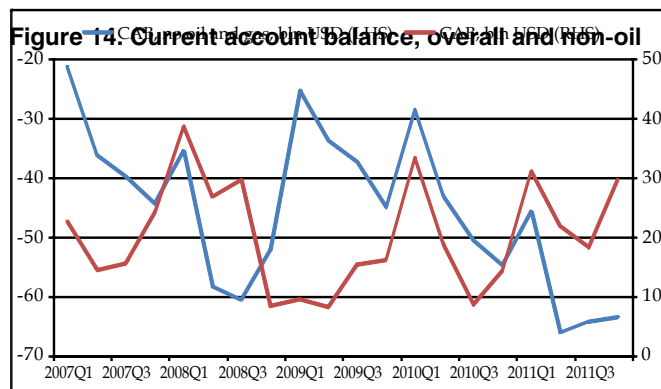
The current account performed well in 2011, supported by high oil prices. This allowed the Central Bank of Russia to add to its foreign reserves, even though net capital outflows increased towards the end of the year. The real depreciation of the exchange rate in the second half of 2011 reversed in early 2012 with the improvement in global market sentiment.

The external current account benefited from high oil prices in 2011 but remains vulnerable to oil price shocks. Russia's trade balance remains largely a function of oil prices (Figure 13). The strong rise in oil prices in 2011 more than offset the modest decrease in oil export volumes and helped to improve the trade balance, which in turn strengthened Russia's current account. In addition, monthly year-on-year import growth slowed from over 40 percent in nominal dollar value in mid-2011 to around 20 percent by end-2011, contributing to the strength of the current account (Figure 15). The current account surplus rose to US\$101 billion in 2011 from US\$70 billion in 2010 (Table 1). The current account surplus is just over half the size of the trade surplus, as Russia ran large deficits in services and investment income, where payments abroad are about twice the amount of payments received. At the same time, the non-oil current account deficit further increased to US\$240 billion in 2011 (13 percent of GDP) from US\$184 billion in 2010 (12.4 percent of GDP), underlying the vulnerability of the current account to oil price shocks (Figure 14). In 2011, non-energy exports declined to less than 35 percent of total goods exports, down from over 37 percent in 2009 (Figure 16).

Figure 13. Oil Prices and the Trade Balance



Sources: CBR; and World Bank staff estimates.



Source: World Bank staff calculations based on Rosstat and CBR data.

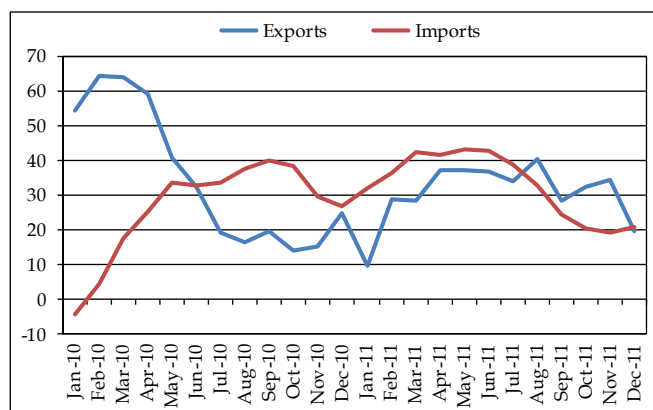
Table 1. Balance of Payments, 2007 – 2011 (US\$ billions)

	2007	2008	2009	2010	2011*	I-IIIq 2010	I-IIIq 2011	IVq 2010	IVq 2011*
Current account balance	77.8	103.5	48.6	70.3	101.1	57.6	71.5	12.7	29.6
Trade balance	130.9	179.7	111.6	151.7	198.1	115.3	144.8	36.4	53.3
Capital and financial account	84.5	-131.2	-43.5	-25.5	-75.3	-9.0	-44.8	-16.5	-30.5
Errors and omissions	-13.3	-11.3	-1.7	-8.0	-13.1	-3.2	-5.4	-4.8	-7.7
Change in reserves (- = increase)	-148.9	38.9	-3.4	-36.8	-12.6	-45.4	-21.2	8.6	8.6
Memo: average oil price (Brent, US\$/barrel)	72.5	96.9	61.5	79.7	111.1	77.3	111.7	86.9	109.3

Source: CBR.

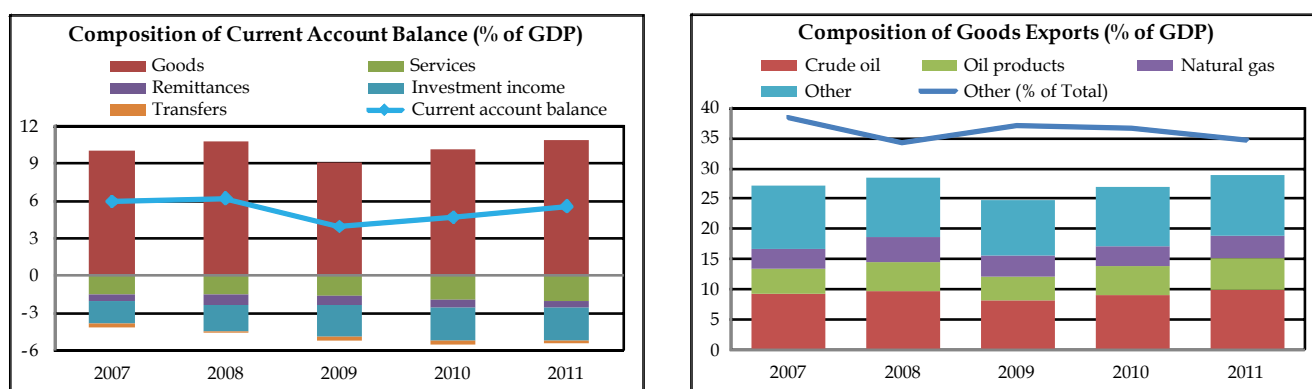
* Preliminary estimates.

**Figure 15. Export and import values
(yoy growth, 3mma, nominal US\$)**



Source: Rosstat, World Bank staff calculations.

**Figure 16. (a) Current account balance composition (percent of GDP);
(b) Composition of goods exports (percent of GDP)**



Source: CBR, World Bank staff calculations.

The capital account deteriorated considerably in 2011, as uncertainty about the global recovery and concerns over the euro area led to a flight to safety. According to preliminary estimates, the capital account deficit amounted to US\$75 billion in 2011 compared to US\$26 billion in 2010. Net foreign direct investment flows reached -0.6 percent of GDP in the first nine months of 2011, the same level as for the full year in 2010 and 2009, and far below the level of 1.7 percent of GDP in 2007. Almost half of the capital account deficit was registered in the last quarter of 2011. In spite of high oil prices and robust growth, net capital outflows intensified towards the end of the year. The bulk of the capital flows came from the private sector. According to preliminary CBR estimates, net capital outflows from the private sector amounted to US\$84.2 billion in 2011, compared to US\$ 33.6 billion in 2010 (Table 2). Both banks and non-financial corporations increased their net foreign asset position in 2011. In the last quarter, net capital outflows amounted to US\$7.5 billion for banks and US\$30.0 billion for non-financial corporations, which was almost half of the total outflows for the year (Figure 17).

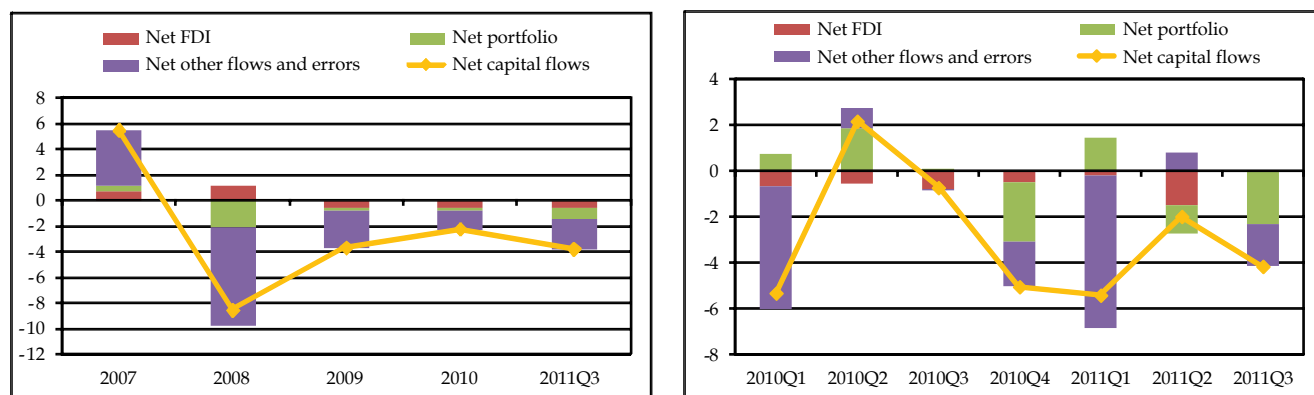
What accounts for the increase in net capital outflows? Investors' concerns about the quality of the investment climate and domestic political uncertainty during the election cycle are likely to have affected capital flows. However, the rise in net capital outflows in the second half of 2011 was mainly a response to worries about an escalation of the euro area debt crisis and a slowdown in the global recovery. A flight to safety was visible across the main emerging markets in the second half of 2011. Due to the size and liquidity of its market, changes in global market sentiment tend to affect Russia more than smaller emerging markets. At the same time, it is worth noting that net capital outflows remained far below the peak in 2008, when capital outflows reached US\$134 billion, especially when measured in percent of GDP. In addition, as Russia moves towards a flexible exchange rate strategy, net capital outflows are a typical counterpart of current account surpluses. Russia's sales of goods and services abroad translate into the acquisition of foreign assets.

Table 2. Net Capital Flows, 2007 – 2011 (US\$ billions)

	2007	2008	2009	2010	2011	IVq 2010	IVq 2011*
Total net capital inflows to the private sector	81.7	-133.7	-56.9	-33.6	-84.2	-19.3	-37.8
Net capital inflows to the banking sector	45.8	-56.9	-30.4	15.9	-26.2	-1.8	-7.5
Net capital inflows to the nonbanking sector	35.9	-76.8	-25.8	-49.5	-57.9	-17.5	-30.3

Source: CBR. * Preliminary estimates.

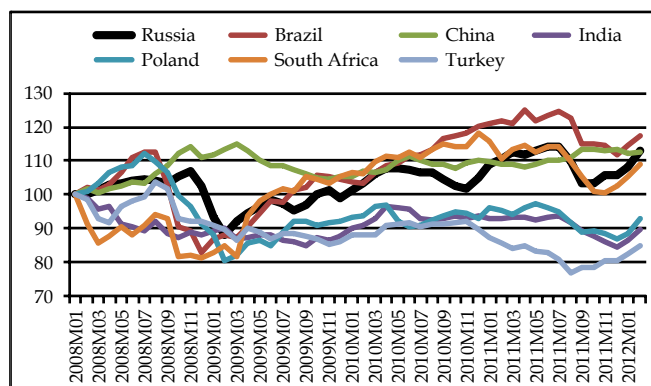
Figure 17. (a) Annual composition of net capital flows (percent of GDP);
(b) Quarterly composition of net capital flows percent of GDP



Source: CBR, World Bank staff calculations.

The ruble depreciated in late 2011 in view of a rise in net capital outflows but appreciated again as global market sentiment improved in early 2012. Higher oil prices led to a real appreciation of the ruble up to July 2011. The real effective exchange rate weakened with the shift in global market sentiment in the third quarter of 2011, but had recouped its losses by end-February 2012. Relative to January 2008, the ruble gained 12 percent, similar to the Chinese renminbi and the South African rand. This compares to losses of about 10 percent of the Polish zloty and the Indian rupee and 15 percent of the Turkish lira.

Figure 18. Real exchange rate of selected countries
(January 2008=100)



Source: World Bank, World Bank staff calculations.

In spite of the large net capital outflows, the CBR accumulated additional reserves thanks to the high current account surplus. The CBR added some US\$12 billion to its reserves, about one third of the amount in 2010. At the end of 2011, the CBR's foreign exchange reserves were just under US\$500 billion, or about 28 percent of GDP. While this was some US\$25 billion below the level in the second quarter of 2011, it represented an increase of about US\$115 billion from the trough during the crisis in the first quarter of 2009.

Despite some deleveraging in the third quarter of 2011, official debt statistics show an increase in the overall debt exposure of the corporate sector in end-2011. Difficult market conditions limited the rollover capacity of banks and nonfinancial corporations, and they deleveraged their balance sheets during the third quarter of 2011. However, according to the CBR preliminary debt statistics, the outstanding external debt of the corporate sector increased above the level of end-June 2011 to US\$494 billion by end-December 2011 (Table 3). In the second half of 2011, external liabilities increased for banks, but decreased for nonfinancial corporations. Furthermore, in spite of volatile global market conditions, both banks and non-financial corporations increased their long-term external financing by end-September 2011 (Table 4), while the share of outstanding short-term debt remained stable.

Table 3. *External debt of the corporate sector, 2010 – 2011 (US\$ billions)*

	1-Jan-2010	1-Jul-2010	1-Jan-2011	1-Jul-2011	1-Oct-2011	1-Jan-2012
Total debt	421.3	410	442.4	490.9	481.9	493.7
Banks	127.2	122.1	144.2	159	157.3	164
Short-term	27.3	30.3	39.2	45	43.4	<i>n.a.</i>
Nonfinancial corporations	294.1	287.9	298.2	331.9	324.6	329.7
Short-term	19.2	20.3	17.3	24.1	20.2	<i>n.a.</i>
State and quasi-state debt	181.3	181.9	199.8	213.4	212.1	<i>n.a.</i>

Source: CBR, World Bank staff calculations.

Table 4. *External debt of the private sector, 2010 – 2011 (US\$ billions)*

	1-Jan-2010	1-Jan-2011	1-Apr-2011	1-Oct-2011
Banks	77	80.8	83.6	86.8
Long-term	50.1	53.8	56.3	55.8
Short-term	20.9	27	27.3	31
Nonfinancial corporations	208.9	208.3	222	228.2
Long-term	190.4	191.7	203.9	209.3
Short-term	18.5	16.7	18.1	18.9

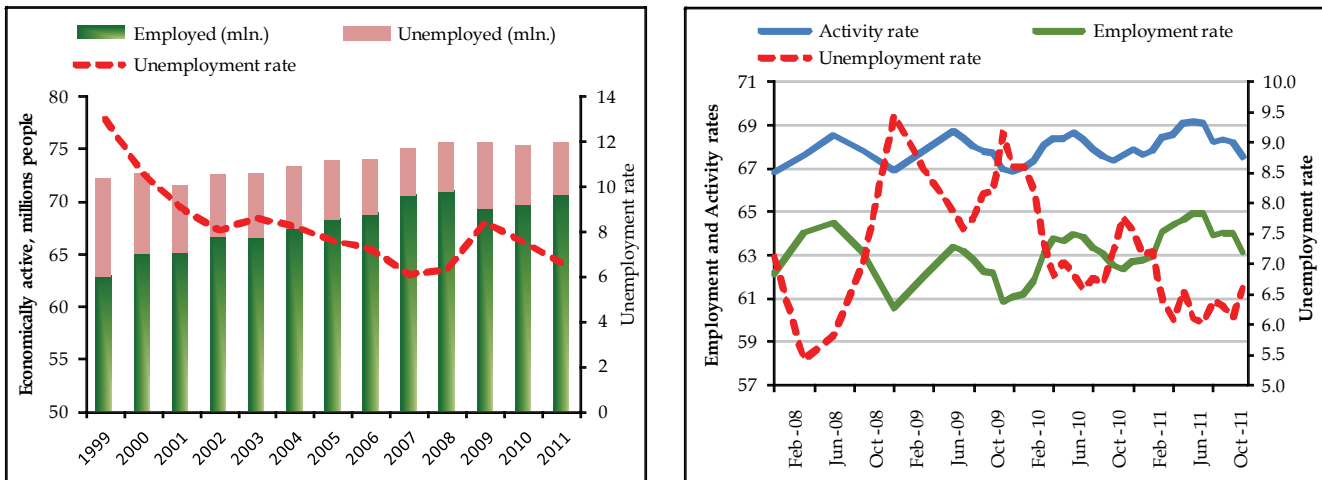
Source: CBR, World Bank staff calculations.

Labor Markets and Poverty – falling unemployment, rising wages, and falling inequality and stable poverty in spite of high food inflation

The labor market tightened, although seasonal effects slowed some improvements in the second half of 2011. Employment rose above pre-crisis level, and unemployment dropped to pre-crisis levels in about half of the regions. Real wages increased, and real consumption rose, especially for poorer households. This lowered inequality, even though the gains in income of poor people were offset through price increases of food and other necessities, leaving poverty rates broadly unchanged.

Russia's labor market improved in 2011, as the main outcomes gradually reached the pre-crisis levels. Employment and labor force participation rates were steadily growing prior to the economic crisis (Figure 19). The unemployment rate fell from 10.6 percent in 2000 to 6.1 percent in 2007 and 6.3 percent in 2008. The crisis abruptly hit the economy in the fall of 2008, leading to a surge in the unemployment rates to 8.4 percent in 2009. In 2010 and 2011, the unemployment rates fell gradually, almost returning to the pre-crisis level.

**Figure 19. (a) Yearly trends in economically active population;
(b) Monthly employment, unemployment and activity rates**

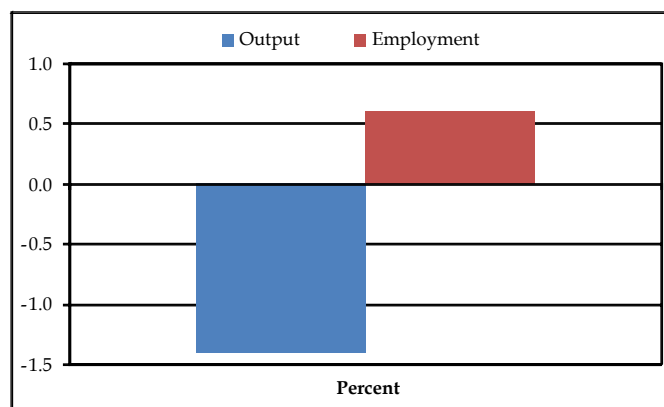


Source: Rosstat, World Bank staff calculations.

After rapid improvements in the first half of 2011, the labor market stabilized in the second half of the year. Up until July 2011, the main labor market outcomes had gradually improved with the activity, employment, and unemployment rates reaching pre-crisis levels. The unemployment rate reached 6.1 percent in June, rose slightly to 6.5 percent in July, and fluctuated around this level through the end of the year. Similarly, economic activity and employment rates increased in the first half of the year, but gradually fell in the last quarter of 2011 in line with seasonal trends.

Overall, Russia’s employment levels recovered fairly quickly from the crisis. In the third quarter of 2011, output remained close to 1.5 percent below the pre-crisis level of the second quarter of 2008. By contrast, employment already exceeded this level by over 0.5 percent (Figure 20).

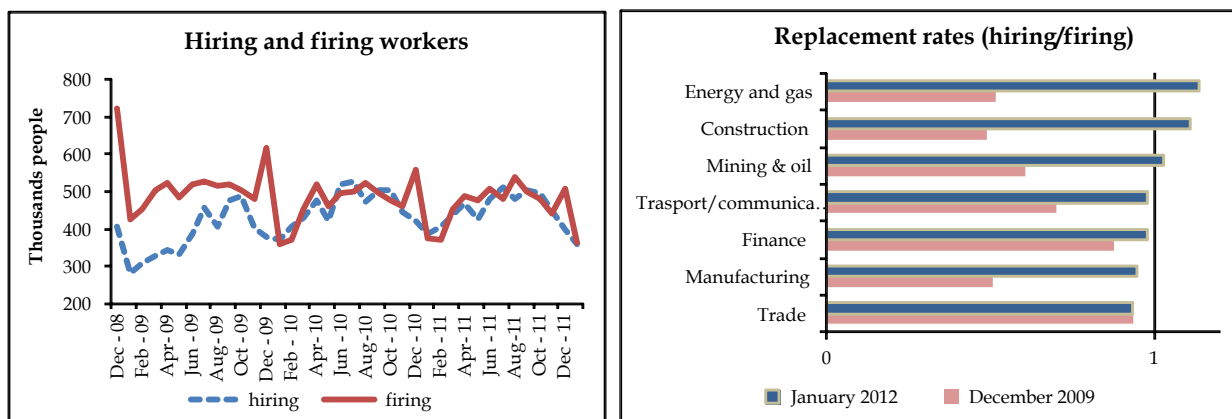
**Figure 20. Output and employment in Q3 2011
(percentage change compared to Q2 2008)**



Source: Rosstat, World Bank staff calculations.

Hiring and firing balanced out labor supply and demand in 2011. After the crisis hit in the fall of 2008, firing exceeded hiring by almost one quarter. Since January 2010 the balance between hiring and firing has been gradually restored, with the replacement rates, expressed as a ratio of hiring to firing almost equal to one through 2011 (Figure 21). Replacement rates improved as of January 2012 in comparison to the same period in 2009 in almost all sectors. Replacement rates exceeded unity in energy, construction, and mining sectors, as they were hiring more workers than firing. The number of vacancies fell sharply during the crisis, but increased gradually since February 2010. In August 2011 it reached its highest point and then fell slightly through the end of the year in view of seasonal factors.

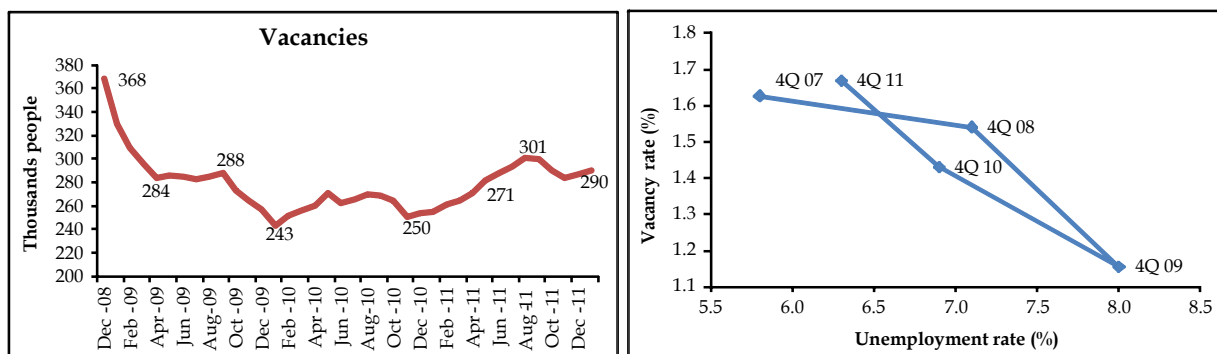
Figure 21. (a) Firing and hiring workers; (b) Industry replacements rates



Source: Rosstat, World Bank staff calculations.

The reduction in unemployment was so far supported by a fairly smooth job search process. This is demonstrated by the Beveridge curve, which shows the relationship between the vacancy rate (the number of unfilled jobs expressed as a proportion of the labor force) and the unemployment rate (Figure 22). We look at the trends for the fourth quarter in order to eliminate the effect of seasonality. From 2007 to 2009, the rise in unemployment coincided with a drop in job openings. From 2009 to 2011, lower unemployment came together with more job openings. However, the reduction in the unemployment rate from 2010 to 2011 translated into a noticeable increase in the vacancy rate. This could be a sign that larger increases in vacancy rates are needed to bring about further reductions in unemployment in the next years.

Figure 22. (a) Vacancy rates; (b) Beveridge curve



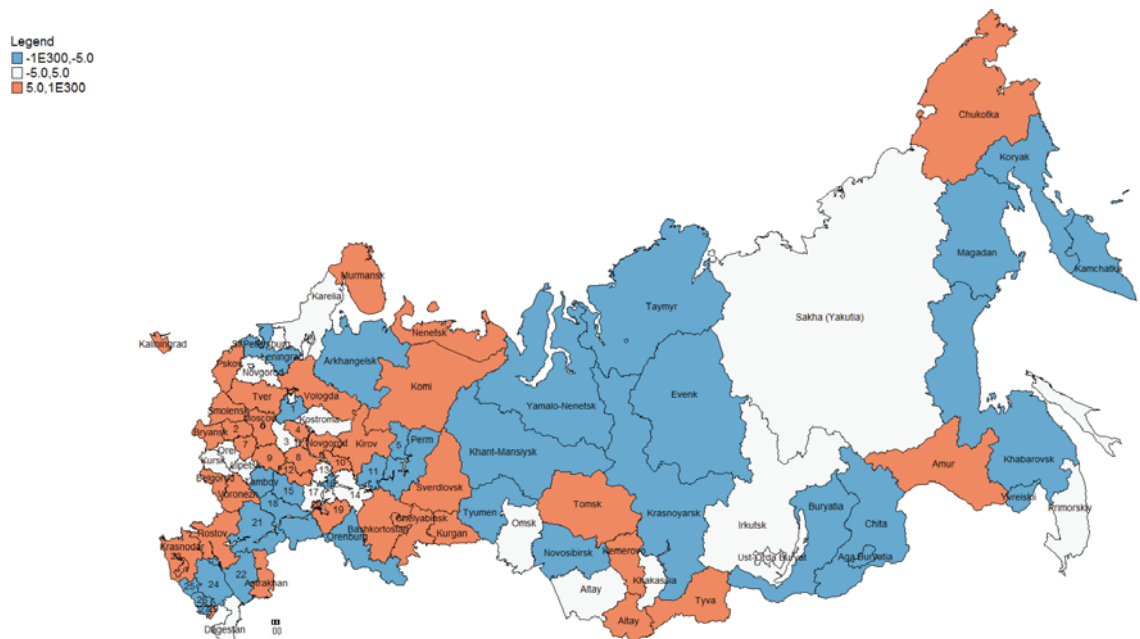
Source: Rosstat, World Bank staff calculations

The positive developments in the labor market characterize all federal districts; however, regional diversity persists. The unemployment rate was reduced in all districts beginning in 2010 and continued to fall during 2011. As of July 2011, the lowest level of unemployment was observed in the Central federal district (4.2 percent), and the highest in the North-Caucasian federal district (15.1 percent). The unemployment rate in 2011 was more than 10 percent higher than in 2008 in the Ural Federal District, North-Western District, and Central Federal Districts.

The diversity in the unemployment recovery on the regional level is striking. In 44 out of 83 regions, unemployment levels in 2011 were still significantly higher than in 2008. As illustrated on the map below, the unemployment rates in 2011 remained above the 2008 levels in many regions (Figure 23).³ This trend was especially prominent in the following regions: Ryazan, Pskov, Moscow city, Sverdlovsk, Bashkortostan, Moscow, Tula, and Chelyabinsk, where the unemployment rate in 2011 was higher by 30 percent or more than in 2008.

³ The regions with large increases in unemployment between 2008 and 2011 are shown in red; regions with small changes in unemployment are shown in white; and regions with reductions in unemployment between 2008 and 2011 are shown in blue.

Figure 23. Percentage change in unemployment rates — 2011 versus 2008



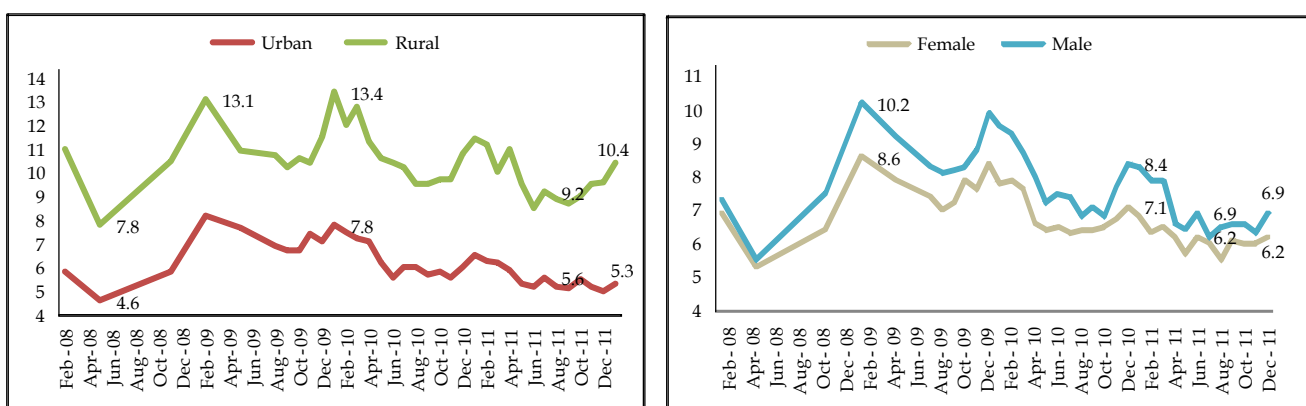
List of regions

1 Yaroslavl	7 Tula	13 Chuvashia	21 Volgograd	27 North Ossetia - Alania
2 Kaluga	8 Nizhniy Novgorod	14, 16 Tatarstan	22 Kalmykia - Khalmg	28 Chechnya
3 Vladimir	9 Ryazan	15 Penza	23 Adygea	29 Ingushethia
4 Ivanovo	10 Mari El	17 Ulyanovsk	24 Stavropol	
5 Komi-Permyak	11 Udmurtia	18 Saratov	25 Karachay-Cherkess	
6 Moscow	12 Mordovia	19, 20 Samara	26 Kabardino-Balkari	

Source: World Bank staff computation based on Rosstat's data.

The gap in unemployment rates between rural and urban areas increased since autumn, while gender gaps returned to the pre-crisis level. The unemployment rate has significantly increased in rural areas since August 2011, consistent with seasonal patterns (Figure 24). At the same time, the unemployment rate in urban areas continued to steadily fall throughout the year. In January 2012, the unemployment rate in rural areas reached 10.4 percent - almost twice as high as in urban areas. During the crisis, the gap in unemployment rates between males and females became noticeably higher due to a significant hit to construction and manufacturing jobs. However the gap has since diminished with the market recovery.

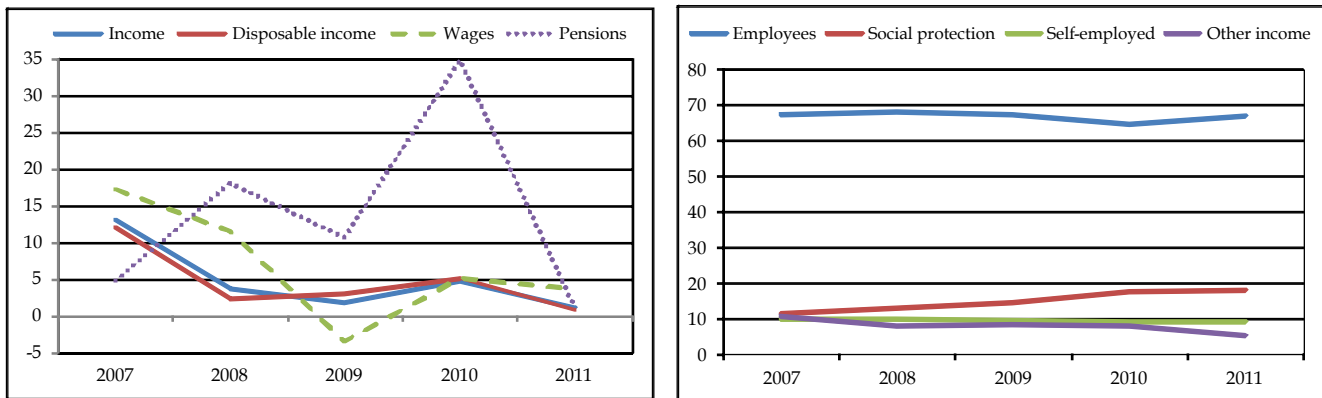
Figure 24. (a) Unemployment rates by location; (b) unemployment rates by gender



Source: World Bank staff calculations based on Rosstat's data.

Real incomes increased in each of the last four years, but the composition of income sources changed. During the crisis, despite a sharp reduction in GDP, real incomes increased 1.8 percent (Figure 25). Real wages fell in 2009 3.5 percent, but the expansion in pensions and social assistance benefits contributed to the increase in incomes, and the vast expansion of social protection benefits continued in 2010. Pensions increased in real terms by 18.1 percent in 2008, 10.7 percent in 2009, and 34.8 percent in 2010. As a result of the expansion of social protection benefits, the share of these benefits in total incomes of the population increased from 11.6 percent in 2007 to 18.1 percent in 2011, the highest rate over the last 20 years. In 2011, real income growth was 1.1 percent, the lowest rate in many years. In contrast, real wages increased 4.2 percent, although only 2 percent for the public sector.

Figure 25. (a) Growth in household income, wages and pensions; (b) and composition of household income sources

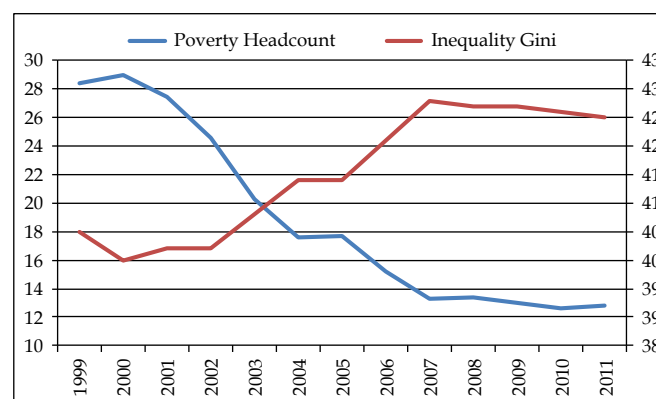


Source: Rosstat, World Bank staff calculations.

The improvement in the economic situation of people led with a reduction in inequality. In 2009, consumption growth turned negative for middle and high income people, while it remained fairly stable for poorer households. Since 2009, consumption growth increased for all groups but remain higher for lower deciles. This translated into a reduction in inequality (Figure 26).

However, the official poverty rates remained broadly stable, mainly because of the real increase in the subsistence minimum. Despite real consumption growth and inequality reduction, poverty rates stayed flat through 2007–2011. This is because poor people consume a higher share of food and necessities than non-poor people, and prices of such basic goods increased especially fast in recent years. Changes of the subsistence minimum correspond closely to changes in the food price index. Thus, while the cumulative rate of inflation from 2007 to 2011 was 48 percent, the subsistence minimum grew 68 percent.

Figure 26. Poverty headcount and Gini inequality index



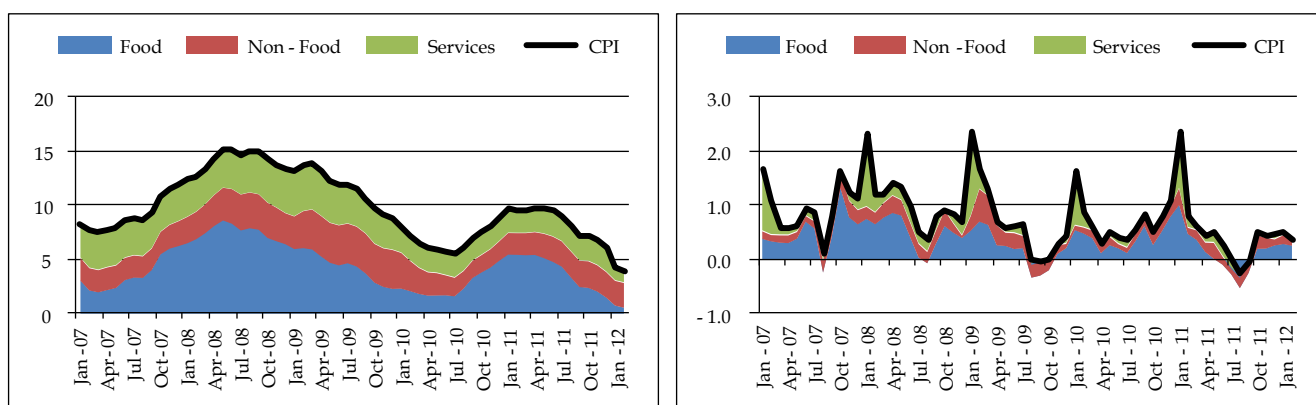
Source: World Bank staff calculations based on 2011 Rosstat data.

Monetary and Exchange Rate Policy and Credit – low inflation, tight liquidity, strong credit growth

Inflation declined sharply as local governments delayed increases in administrative prices, food inflation declined, monetary policy tightened, and the exchange rate appreciated. Credit to household and nonfinancial corporations picked up, even though real interest rates increased.

Russia's headline inflation dropped to its lowest level of the last two decades. Price pressures moderated thanks to low food and services inflation and a favorable base effect, as well as an appreciating exchange rate and tighter monetary policy (Figure 27). CPI inflation declined for the tenth months in a row from 9.7 percent in April 2011 to 3.8 percent in February 2012, the lowest reading since the early 1990s. Low food inflation helped to reduce headline inflation, as Russia's agriculture went from a bad to a good harvest. In addition, services inflation declined, as utility prices are set to increase only in July this year rather than January as last year, and petrol stations delayed increases in gasoline prices in response to higher international oil prices. As a result, from December to January, prices increased only 0.4 percent this year compared to 2.4 percent last year. However, not only headline inflation declined, but also core inflation, which excludes fruits and vegetables, fuel and administrated service prices. Core inflation reached 5.7 percent in February 2012, down from 8.4 percent in July 2011. This indicates that monetary and exchange rate factors also played a role in bringing down inflation.

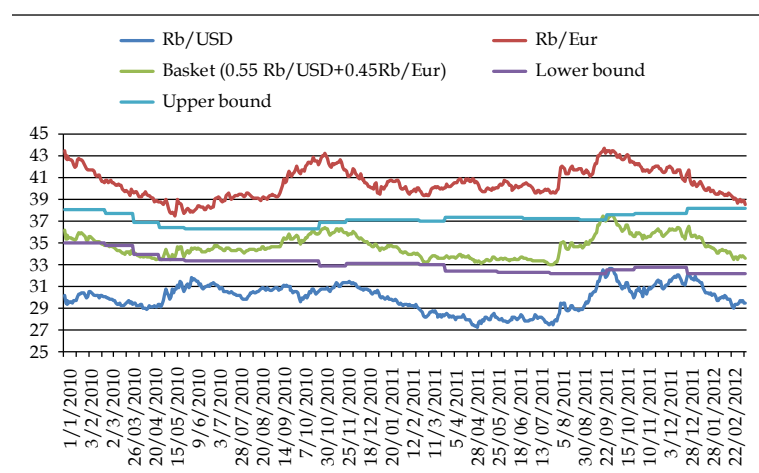
Figure 27. (a) CPI inflation by component (percent, yoY); (b) CPI inflation by component (percent, mom)



Source: CBR, World Bank staff calculations

The appreciation of the exchange rate moderated price pressures. In the third quarter of 2011, market sentiment deteriorated due to concerns about the euro area, putting pressure on the ruble (Figure 28). Subsequently, the ruble appreciated as oil prices increased and, more recently, market

Figure 28. Exchange rate and its bilateral band

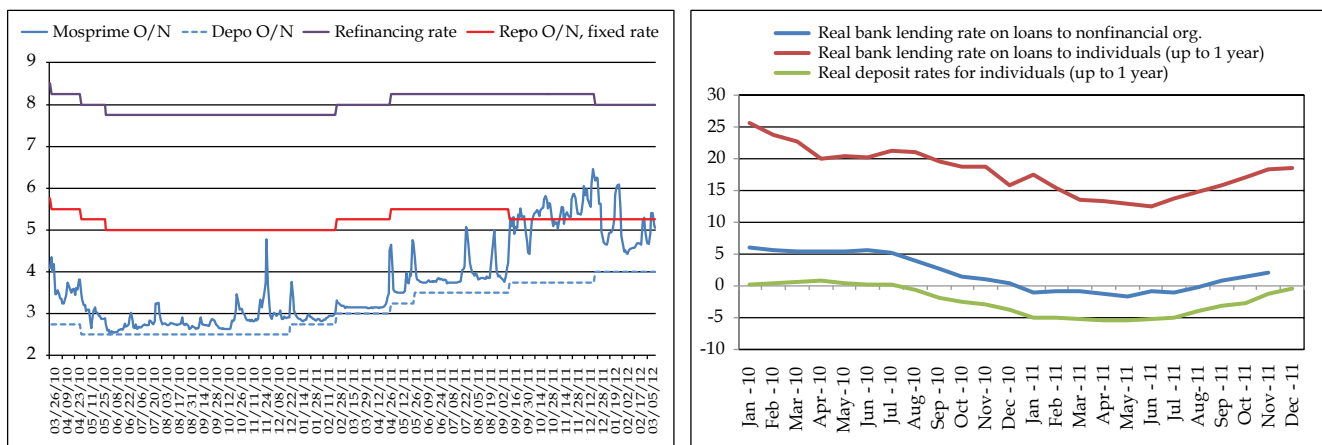


Source: CBR, World Bank staff calculations

sentiment picked up. This dampened price pressures from imports. The CBR allowed greater flexibility of the exchange rate as part of the gradual policy shift to inflation targeting. It widened the currency corridor to 6 rubles by end-December 2011 from 4 rubles at end-December 2010. In addition, the CBR scaled back exchange rate interventions. In 2011, the CBR used about US\$13 billion to smoothen market volatility, compared to US\$25 billion in 2010. While in January 2012 the CBR's net purchases of foreign currency was small, it reached US\$2.6 billion in February 2012 as the ruble appreciation continued.

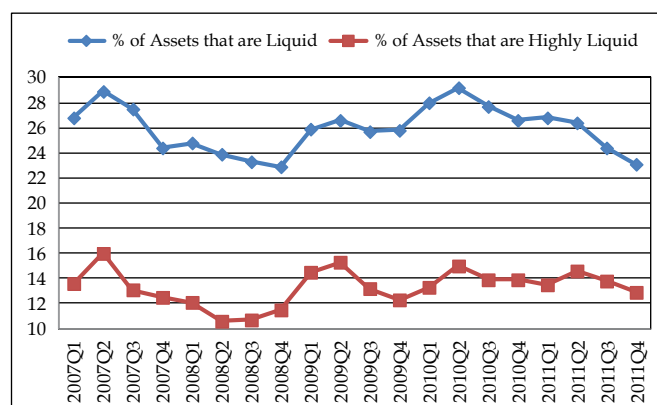
Tighter monetary policy also contributed to lowering inflation. While headline CPI inflation fell almost 520 basis points from June 2011 to February 2012, the CBR lowered its refinancing rate only once during this time, lowering it by only 25 basis points to 8 percent in January 2012 (Figure 29). As a result, real interest rates turned positive in September 2011. This curtailed domestic demand, although, as inflation is expected to pick up later in the year, the economically relevant real interest rate (nominal interest rate minus expected inflation) is not as high as the current inflation rate indicates. At the same time, the CBR increased its overnight deposit rate in September 2011 and January 2012 by 25 basis points each to a level of 4 percent. Hence, the policy interest rate corridor narrowed 75 basis points over this period, although it remains relatively wide by international standards. Minimum capital requirements for banks doubled to 180 million rubles in January 2012, and are set to increase to 300 million rubles in 2015. During this time though, the CBR also reduced the stock of bank liquidity. For example, the percentage of liquid assets held by banks declined to just under 24 percent in early 2012, down from over 29 percent in the second quarter of 2009. Liquidity fell as the CBR switched from net purchases of foreign exchange in the first half to net sales of foreign exchange in the second half of 2011, while demand for cash rubles continued to grow with nominal wage growth of 12 percent (Figure 30 and Figure 31). As a result, banks had to rely more on the CBR's refinancing operations as a source for liquidity, along with short-term Ministry of Finance deposits. For example, banks borrowed over 0.8 trillion rubles from the CBR in November and December 2011, the highest volume borrowed since 2002. Hence, the interbank interest rate moved away from the deposit rate towards the center of the interest corridor. The absorption of bank liquidity, along with large capital outflows, translated into a slower expansion of the money supply. Growth of M2 money supply declined to 21.4 percent in 2011 from 30.7 percent in 2010.

Figure 29. (a) Interest rates (percent); (b) Real lending and deposit rates (percent)



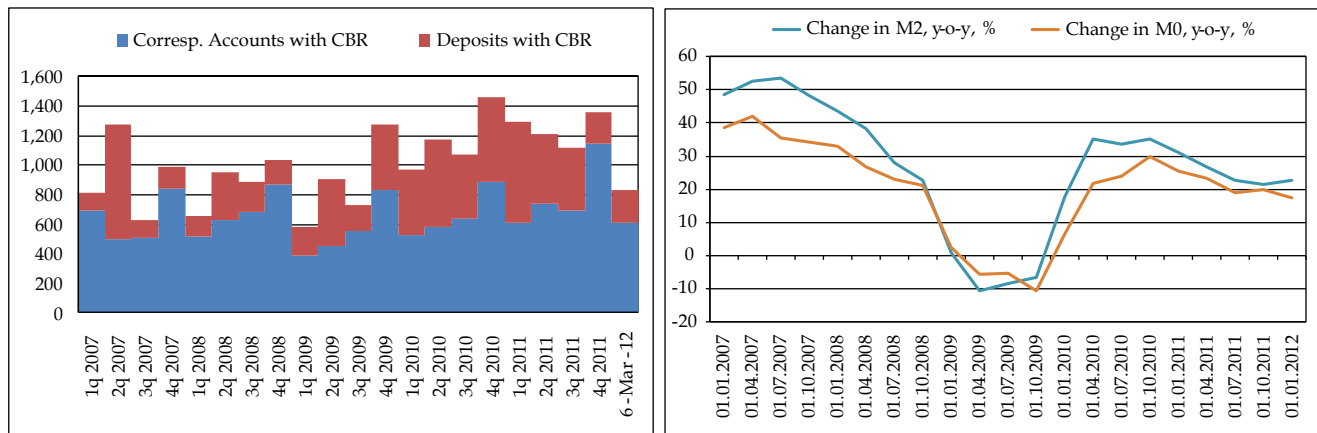
Source: CBR, World Bank staff calculations

Figure 30. Liquid assets of banks (percent of overall assets)



Source: CBR, World Bank staff calculations

Figure 31. (a) Stock of bank liquidity (billions ruble); (b) Money supply (percent, yoy growth)

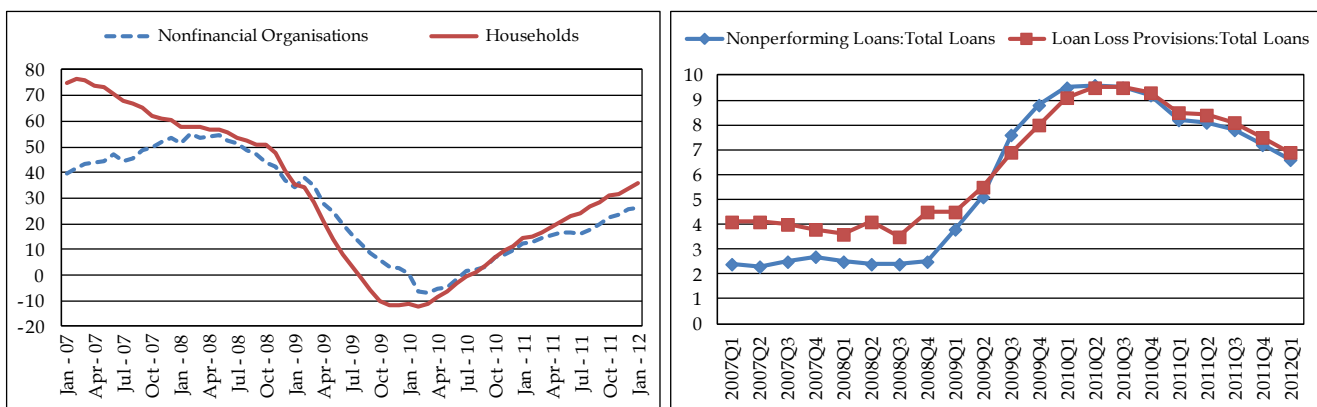


Source: CBR, World Bank staff calculations

Monetary policy tightening translated into higher lending rates to households. After declining from around 34 percent in January 2010 to 22 percent in June 2011, lending rates to households increased in the second half of 2011, reaching 25.2 percent in November 2011, even though inflation fell. Whereas the spread between lending rates to households and the CBR refinancing rate remained high at 1695 basis points in November 2011, lending rates to enterprises converged almost to the level of the refinancing rate. Lending rates for corporations are much lower than for households. This is in part due to large intra-group lending and a high concentration of loans to single corporate borrowers, as well as the higher risk perception of household lending, especially in the absence of collateral.

In spite of higher interest rates, credit to the private sector continued to recover. The total stock of credit to the private sector increased 26 percent in nominal terms in 2011. This lifted private credit to 46.1 percent of GDP in the fourth quarter of 2011 from 43.9 percent of GDP a year ago (Figure 32). Credit to households, including for example mortgages, consumer lines of credit and car loans, rose 34 percent, and credit to non-financial corporations increased 24 percent. Mortgage lending, which was supported by a government refinancing program, decreased down-payment requirements, and an average lending rate of just 11.9 percent (the lowest rate in the history of mortgage lending in Russia), saw particularly strong growth, reaching 713 billion rubles last year, up from 380 billion rubles in 2010. Furthermore, the share of non-performing loans decreased to 6.6 percent of all loans in January 2012, down from 8.2 percent in January 2011 and 9.5 percent in January 2010. However, the share of loans that are non-performing as well as the share of loans with loan loss provision placements remain above pre-crisis levels (Figure 32).

Figure 32. (a) Credit growth (percent, yoy); (b) Nonperforming loans and loan loss provisions (percent of total loans)



Source: CBR, World Bank staff calculations

Fiscal Policy – improving headline figures, worsening non-oil imbalances

The 2011 fiscal outcomes were strong, bolstered by high oil prices and a cautious expenditure execution. However, Russia's public finances face a number of strains in the coming years. They include worsening fiscal balances, a high dependency on oil and gas revenues, the need to replenish the fiscal reserve funds, and the emergence of new expenditure pressures.

In 2011, Russia's consolidated budget balance turned to surplus thanks to favorable oil prices and prudent expenditure execution. The consolidated budget surplus amounted to 1.6 percent of GDP in 2011, compared to a deficit of 3.5 percent of GDP in 2010 (Table 5). Revenues contributed about 70 percent of the improvement. This reflected strong tax receipts from natural resources and customs duties due to high oil prices, strong social security contributions due to a hike in payroll tax rates from 26 percent to 34 percent as well as robust wage growth, increased profit taxes due to improved enterprise profit margins, and an increase in VAT due to strong consumption. Expenditures fell 1.5 percent of GDP, as the gradual phase-out of anti-crisis measures continued and expenditures were executed below plan.

Table 5. Execution of Russian Federation budgets (percent of GDP)

	2010	2011
Consolidated budget		
Revenues	34.8	38.4
Expenditures	38.3	36.8
Balance	-3.5	1.6
Federal budget		
Revenues	18.4	20.9
Expenditures	22.4	20.1
Balance	-4.0	0.8
Subnational budget		
Revenues	14.5	14.1
Expenditures	14.7	14.1
Balance	-0.2	-0.1
State Extra-budgetary funds		
Revenues	12.0	12.4
Expenditures	11.3	11.5
Balance	0.7	0.8

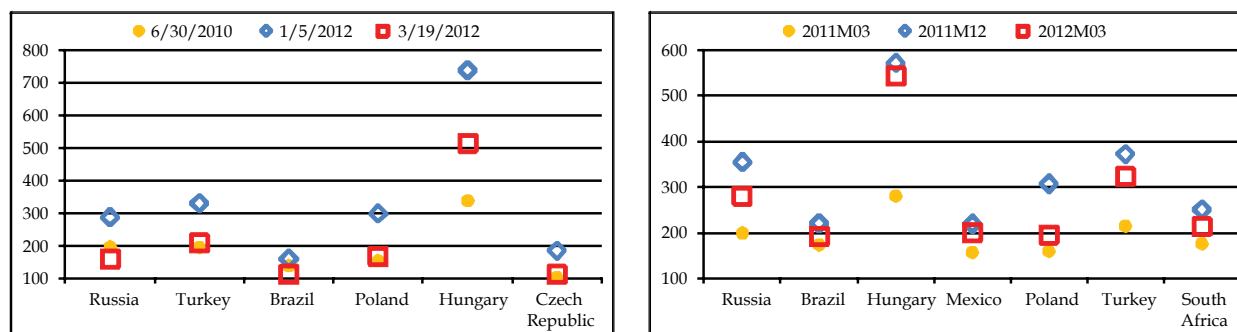
Source: Ministry of Finance, Economic Expert Group, World Bank staff calculations

The improvement of the consolidated budget balance was almost entirely due to the federal budget. Federal expenditures remained over one percent of GDP above the original budget target, and federal revenues over three percent of GDP. Consolidated sub-national budget expenditures and revenues both decreased around 0.5 percent of GDP, and extra-budgetary funds' revenues increased somewhat more than expenditures. Federal public debt remained low at around 10 percent of GDP in 2011, one fifth of which was external (Box 3).

Box 3. Financial markets and Russia's fixed income securities

Russia's strong fiscal headline numbers, the improvement in global market sentiment, and the end of the election cycle helped to boost government bonds (Figure 33). 5-year credit default swaps spreads declined to their lowest levels since early August 2011. Spreads on sovereign debt also declined. For example, the spread over US Treasuries in mid-March was 248 for Russia, some 73 below the average for emerging markets. Rising demand for Russia sovereign paper boosted returns for its holders.

Figure 33. (a) 5-year CDS spreads (basis points); (b) Sovereign debt spreads (basis points)



Source: Bloomberg, World Bank staff calculations

The rally on Russian fixed income securities was also supported by regulatory changes. As part of the efforts to develop Moscow as an international financial center, regulators have, for the first time, made Russian domestic debt (OFZs) tradable over the counter since the beginning of this year. In addition, the government and the CBR are working to establish a centralized depository by June 2012. This would allow non-resident investors to open nominal holder accounts with Russian depositories. This is expected to prompt Euroclear Bank, the world's largest provider of bond settlement, to make OFZs euroclearable in the second half of 2012. These steps will make it easier for investors to trade Russian debt.

In spite of the improvement in headline fiscal outcomes, Russia's public finances face a number of strains in the coming years. They include worsening fiscal balances, a high dependency on oil and gas revenues, the need to replenish the fiscal reserve funds, and the emergence of new expenditure pressures.

Table 6. Medium-term budget projections (percent of GDP)

	2011 (actual)	2012	2013	2014
Federal budget				
Revenues	20.9	20.1	19.6	19.4
Expenditures	20.1	21.6	21.2	20.1
Balance	0.8	-1.5	-1.6	-0.7
Non-oil balance	-9.6	-11	-10.3	-9.1
Consolidated budget				
Revenues	38.4	37.3	36.9	37.1
Expenditures	36.8	38.4	38	37.2
Balance	1.6	-1.1	-1.1	-0.2
Assumptions				
Urals oil price, US\$/barrel	109.3	100	97	101
Exchange rate, Rub/US\$	29.4	28.7	29.4	30.5

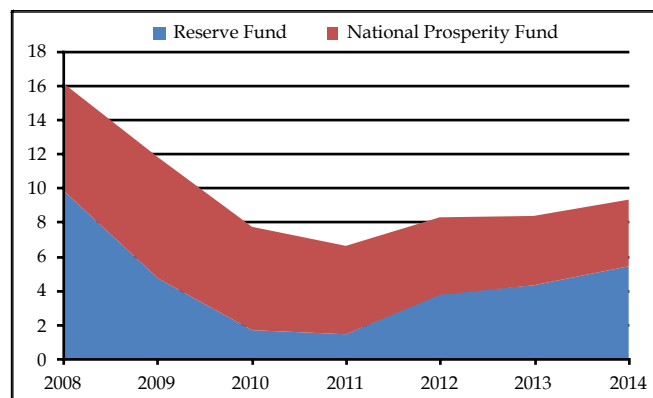
Source: Ministry of Finance, Economic Expert Group, World Bank staff calculations

The consolidated and fiscal budgets are expected to turn to a deficit in 2012. Even though the output gap is closing and economic growth is broadly in line with its potential, the consolidated budget could deteriorate 2.7 percent of GDP from 2011 to 2012 (Table 6). Of course, higher-than-anticipated oil prices could once again result in better-than-planned outcomes. However, during the first two months of 2012, the federal government deficit was around 3 percent of GDP in part due large expenditure disbursements for the first quarter of the fiscal year. In particular, allocations of inter-governmental transfers to the regions, advance payments for military modernization, and quarterly subsidies to organizations in health and education contributed to a budget deficit.

The federal budget relies increasingly on high oil prices. This is borne out by three indicators. First, in 2011, oil and gas revenues were 10.4 percent of GDP, equal to half of federal revenues. In 2009, they were only 7.6 percent of GDP, equal to two-fifths of federal revenues. Second, the federal budget is based on a higher oil price assumption than in the past. The Urals oil price assumption of the federal budget increased from US\$75/barrels in 2011 to 100 in 2012. Third, the oil price needed for the federal budget to break even increased from less than US\$30 up to 2007 to around US\$100 or more since 2009. For 2012, the break even oil price is estimated to be over US\$110. Hence, even a moderate correction in the oil prices could reverse improvements on the revenue side achieved in 2011.

The national reserve and national prosperity funds still need to be replenished. They declined from 16.0 percent of GDP in 2008 to only 6.6 percent of GDP in 2011 as the government used the resources to stabilize the economy during the crisis. While the reserve fund increased again in the first two months of 2012, mainly thanks to the transfer of the 2011 fiscal surplus, it is projected to stay below 10 percent of GDP by 2014 (Figure 34). In addition, in the absence of a fiscal rule, such as a limit on the non-oil fiscal deficit, the effectiveness of these funds to shelter the economy from oil price volatility and ensure intergenerational equity, is diminished.

Figure 34. Reserve and National Prosperity Fund (percent of GDP)



Source: Ministry of Finance, Rosstat, World Bank staff calculations

Additional expenditure pressures weigh on the federal budget law for 2012–2014. They relate to a military modernization program and commitments to increase wages and pension of military and security personnel. In addition, fiscal plans envision an increase in outlays for road maintenance in 2013 (Table 7). Spending on federal transfers to extra-budgetary funds and social policy is projected to increase from 5.8 percent of GDP in 2011 to 7.5 percent of GDP in 2013. According to the government’s medium term plans for 2012 to 2014, these additional expenditures amount to more than 4 percent of GDP. Moreover, the decline in oil production is expected to continue in the medium term, resulting in a decrease in oil revenues by almost 2 percent of GDP over the next three years. In addition, the medium-term federal budget for 2012–2014 does not include pre-election commitments made by the President-elect Putin. This could result in additional spending of about 0.5 to 1.5 percent of GDP per year over the next 6 years. Russia’s aging infrastructure also requires resources in excess of those allocated in the budget plans.

Table 7. *Funding needs and funding sources for the 2012–2014 federal budget*
(change to previous year, percent of GDP)

	2012	2013	2014	Cumulative
A: Additional funding needs	<u>3.1</u>	<u>2.3</u>	<u>1</u>	<u>6.3</u>
1. Expenditure pressures	2.2	1.5	0.7	4.4
Modernization of military, including wage increases	1.2	0.4	0.2	1.7
Social protection (The indexation of pensions)	0.9			0.9
Road infrastructure		0.3		
Debt service	0.2	0.8	0.5	1.5
2. A decrease in oil revenues	0.9	0.8	0.3	1.9
B: Additional sources of financing	<u>0.8</u>	<u>2.2</u>	<u>1.9</u>	<u>4.9</u>
1. Revenue measures				
Changes in normative acts (non-oil revenues)	0.3	0.1	0.2	0.6
..of which alcohol tax changes	0.1	0.0	0.0	0.2
..of which changes in the administration of vehicle registration tax	0.1			0.1
..of which excise on tobacco products	0.0	0.1	0.1	0.2
2. Expenditure reprioritization	0.5	1.2	1.6	3.3
Reducing expenditures on economic affairs	0.2	0.4	0.4	1.0
Reducing expenditures on general public services		0.1	0.2	0.3
A transfer of select responsibilities for public service delivery	0.3	0.4	0.4	1.1
A reduction in the pension fund deficit		0.2	0.7	0.9
3. Other changes	0.0	0.9	0.1	1.0
Net changes in the fiscal balance (B-A)	-2.3	-0.1	0.9	-1.5

Source: Ministry of Finance, World Bank staff calculations

To deal with new expenditure pressures, the government's federal budget for 2012 to 2014 aims to gradually broaden the non-oil revenue base and reduce non-priority expenditures. Efforts to broaden the non-oil revenue base include increasing taxes on alcohol and tobacco products as well as transferring the collection of the vehicle registration tax to the federal budget. Reprioritization of other expenditures is expected to result in additional fiscal savings of about 3.3 percent of GDP. While part of these savings reflects cuts in general public services and economic affairs, a sizable part is a shift of responsibilities for service provision in health, education and housing services to agencies outside the federal budget.

II

Economic Outlook

Prospects – moderate slowdown as global growth eases

With the slowdown of growth in Europe and elsewhere, growth in Russia is likely to moderate somewhat in 2012, before picking up again in 2013. Downside risks to growth include a drop in oil prices either due to weak global demand or a correction of oil supply disturbances. In addition, growth could disappoint in case consumption and investment weaken in view of tight liquidity and sluggish external demand. Upside risks include that oil prices remain high as supply disturbances continue or global demand rebounds faster-than-expected from the current slowdown.

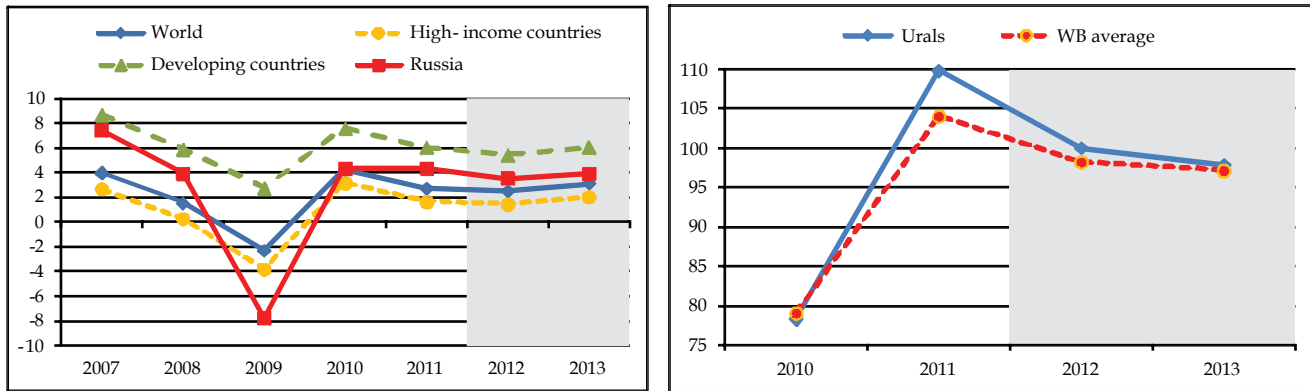
Economic news during the first two months of 2012 has been positive, but the global recovery remains fragile. After several months of heightened uncertainty, conditions in financial markets have improved significantly during the first three months of 2012, with spreads paid on sovereign debt of both high-spread European and developing economies coming off their late 2011 highs in response to ECB policy steps, the successful restructuring of Greek debt and progress toward fiscal consolidation. In spite of these positive developments, the uncertainty of the second half of 2011 has taken its toll, with Europe having re-entered recession toward the end of 2011 and falling European imports cutting into global trade. In 2012, growth in the euro area is expected to drop more than 1.5 percentage points, leading to a mild recession in the euro area and stagnation in the EU. Despite these headwinds, economic activity and business expectations outside of Europe are improving. The recovery in the US is strengthening and other emerging economies such as Brazil, China, India, South Africa and Turkey, where industrial production had been previously decelerating, are now all seeing an up-tick in activity. Reflecting these improving prospects, metal and oil prices have firmed in recent months. Nevertheless, continued fiscal contraction in Europe, ongoing banking-sector de-leveraging, and still elevated risk aversion are all expected to weigh on activity in 2012. After expanding 4.2 percent in 2010, global GDP slowed to 2.7 percent in 2011, and is expected to come in at a relatively weak 2.5 percent in 2012 before firming to 3.1 percent in 2013 (Table 8 and Figure 35). Developing country growth is projected to come in at 5.4 percent, the second worst result in 10 years—only the crisis year of 2009 was worse. GDP among high-income countries is expected to expand only 1.4 percent. Outturns remain vulnerable to a deterioration of conditions in Europe. While the likelihood of such a significant deterioration has eased, the risk remains real and could have large implications for the global economy including developing countries.

Table 8. GDP growth projections (percent)

	2007	2008	2009	2010	2011	2012 proj.	2013 proj.
World	4.0	1.5	-2.3	4.2	2.7	2.5	3.1
High-income countries	2.7	0.2	-3.9	3.1	1.6	1.4	2.0
Developing countries	8.7	5.9	2.7	7.6	6.0	5.4	6.0
Russia	7.4	3.9	-7.8	4.3	4.3	3.5	3.9

Source: World Bank staff projections

Figure 35. (a) GDP growth projections (percent); (b) Oil price assumptions (US\$ per barrel)



Source: World Bank staff projections

Russia's economy is expected to slow somewhat in 2012, and to pick up in 2013. Our baseline scenario assumes that the actions of European policy makers succeed in gradually reducing risks associated with the euro crisis. Nevertheless, growth in Russia faces headwinds as growth declines in the EU (Box 4), eases in developing countries, and global capital flows moderate. We also assume that oil prices will moderate from today's high levels (Box 5). As a result, investors could remain cautious and adopt a wait-and-see attitude before undertaking large commitments. Hence, we project growth in Russia to decline from 4.3 percent in 2011 to 3.5 percent in 2012 (Table 9). Domestic demand will support the expansion of economic activity, aided by a carry-over of the growth momentum from end-2011, improving confidence of businesses and financial markets, and a higher fiscal deficit. In spite of positive real interest rates, consumption growth is set to remain robust in view of low inflation and low unemployment. Fixed investment is expected to improve as companies respond to capacity constraints and a more stable economic outlook. However, the contribution to growth of agriculture, which was bolstered through a bumper crop and a low base in 2011, is projected to be minor. Likewise, as the inventory cycle comes to an end, the contribution of restocking, which played an important role in supporting growth in 2010 and 2011, will decline. In 2013, an acceleration of growth in Europe and elsewhere, along with improving industrial production, will lift growth in Russia. However, the closing of the output gap, the tightening of labor markets, and the modest decline in oil prices are set to limit growth to 3.9 percent.

Box 4. Russia and the European Union

Russia's territory is four times as large as the EU's, with a population only two-seventh as large. In purchasing power parity, its 2010 GDP per capita was equal to 55 percent of the level of the EU. However, in current dollar, its overall GDP was only 9 percent of the size of the EU economy. Russia's main trading partner is the EU. It accounted for 47 percent of trade turnover in 2010. In 2010, Russia's imports of goods and services from the EU amounted EUR108 billion, and its exports to the EU reached EUR173 billion. Russia's exports are mainly energy and mineral fuel products, while Russia's imports range from machinery and transport equipment, to manufactured goods and food. Some three quarters of FDI stocks in Russia come from the EU.

We project modest reductions in poverty in the coming years. In view of the low elasticity of growth in the recent years and lower growth rates than prior to the crisis, projected poverty rates in 2012 will be 12.7 percent and 12.5 percent in 2013.

Table 9. Main economic indicators for the baseline projections

	2011	2012 proj.	2013 proj.
GDP growth (%)	4.3	3.5	3.9
Consolidated government balance (% of GDP)	1.6	-1.3	-0.9
Current account (US\$ billions)	101	53.8	25
Current account (% of GDP)	5.5	2.7	1.1
Capital account (US\$ billions)	-75.3	-48.9	-21.6
Capital account (% of GDP)	-4.1	-2.4	-1.0
Oil price assumption (WB Average, US\$ per barrel)	104.0	98.2	97.1

Source: World Bank staff projections

In our baseline scenario, the current account surplus and capital account deficit are set to decline and the fiscal balance is set to turn into a deficit. The balance of payments position is expected to remain strong, even though capital flows are likely to remain volatile. Under our conservative oil price forecast, we expect the surplus of the external current account to reach 2.7 percent of GDP in 2012 and 1.1 percent of GDP in 2013. This reflects a combination of stagnant oil production volumes, somewhat moderating oil prices, and increasing import demand. In 2012, the capital account deficit is projected to moderate as global conditions gradually improve, the risk appetite of investors improves, the OFZ market liberalization proceeds, and debt repayments decline. The capital account deficit is set to continue to decline in 2013 as the global market sentiment picks up further. Under the new oil price assumptions and budget parameters for 2012–14, we project that the consolidated budget will run a deficit of 1.3 percent of GDP in 2012 and of 0.9 percent of GDP in 2013. However, the non-oil deficit is projected to rise from 9.6 percent of GDP in 2011 to more than 10 percent in 2012 and 2013. Inflation is expected to stay low in the coming months in view of tight monetary policy and recent exchange rate appreciation. However, it is set to increase later in the year as the delayed increases in utility prices take effect in July. In addition, demand pressures are likely to strengthen as the output gap closes and labor shortages emerge. By year-end, inflation could be close to the upper limit of the CBR's target band of 5.0 to 6.0 percent.

There are domestic and external downside risks to our baseline scenario. The main domestic risk factor is that positive real interest rates, tight liquidity and weak manufacturing could translate into weaker-than-expected credit expansion, consumption and investment. But more important is the external risk factor. The ongoing slowdown of growth in Europe and in developing countries could persist through the year, if adverse feedback loops between sovereign and bank funding pressures resurface in the euro area, and bank deleveraging is more protracted. This could trigger a drop in global oil prices, leading to a flight to safety of capital flows from emerging markets. In Russia, lower oil prices would translate into larger fiscal deficit, larger capital outflows, weaker current account position in spite of a weaker exchange rate, and lower growth (Table 10).

Table 10. Main economic indicators for the high-oil price projections

	2011	2012 proj.	2013 proj.
GDP growth (%)	4.3	4.0	4.2
Consolidated government balance (% of GDP)	1.6	1.4	2.0
Current account (US\$ billions)	101	89.4	47.5
Current account (% of GDP)	5.5	4.1	1.8
Capital account (US\$ billions)	-75.3	-39.5	-2.6
Capital account (% of GDP)	-4.1	-1.8	-0.1
Oil price assumption (WB Average, US\$ per barrel)	104	125	125

Source: World Bank staff projections

The main upside risk to our baseline scenario is a higher oil price. The price for Urals crude rose in early March above US\$125 per barrel for the first time since July 2008, mainly due to supply disturbances in the Middle East. This has helped spur the stock market, lift the ruble, and improve

business confidence in Russia. If the oil price were to remain high, this would boost growth, improve current and capital account balances and help to maintain the surplus of the fiscal accounts. At the same time, it would lead to price pressures and increase the risk of overheating in the economy.

Box 5. Global Oil Market Developments

In 2012, oil prices jumped on fears of production losses, notably from Iran, but from other oil producers as well, such as Iraq, Nigeria, South Sudan, Syria, Yemen and the North Sea. Prices have also been supported by improving macroeconomic data, low stocks and a bout of cold weather in Europe and Asia. The price of Brent crude has surged above US\$126 per barrel, with Urals trading near parity as European refiners search for crudes to replace Iranian grades, and as more Urals crude is shipped to eastern export markets and to domestic refineries. Meanwhile, WTI prices continue to trade at a large discount to Brent due to transportation bottlenecks in the US at Cushing OK, rising crude inflows from Canada, and liquids-rich shale projects in North Dakota, which have limited outlet to Gulf coast refiners.

An EU embargo of Iranian crude, and US sanctions that penalize companies that do business with Iranian banks, are both set to come into full force in July. The EU embargo could affect up to 0.6 mb/d of Iranian exports, although broader U.S. and EU economic sanctions on Iran's Central Bank could curtail exports further. European customers have already curtailed Iranian imports, and Asian buyers are lining up alternative sources of supply. European customers are likely to look to Russia, Iraq and Saudi Arabia for replacement barrels. Up to 1 mb/d of Iran's 2.6 mb/d of exports may be replaced by alternative supplies once sanctions go into effect.

World oil demand growth slowed sharply in 2011 to just 0.7 mb/d or 0.8 percent, from a large 2.7 mb/d or 3.2 percent gain in 2010. In the first quarter, world oil rose marginally, weighed down by weak economic activity, mild weather, and high prices. Oil demand in the OECD has fallen for 5 out of the past 6 years, for a combined loss of 4.3 mb/d or 7.5%, and is due in part to high oil prices. Non-OECD countries are less immune to high prices, in part because many countries are growing rapidly and need energy to expand output and raise incomes. In addition, many countries maintain large subsidies to energy consumers, particularly in oil producing countries.

On the supply side, non-OPEC oil production grew little in 2011 due to a number of production outages, notably in the North Sea, Yemen, Sudan, and Syria, but also shortfalls from a number of other producing countries such as Australia, Azerbaijan, and China. Despite meager growth in production overall, there were significant gains in a number of countries—the five largest contributors (U.S., Colombia, Russia, Canada, and Brazil) grew a combined 0.7 mb/d. Russia's oil production rose 0.13 mb/d in 2011, and is projected to grow 0.14 mb/d in 2012, due to ramp-up of major projects.

The slowdown in non-OPEC production last year allowed total OPEC output to rise by nearly 1.0 mb/d. The Organization agreed to a new crude oil production target of 30 mb/d for 2012, which now includes Iraq, but individual country quotas were not assigned. Saudi Arabia's oil minister said they would produce according to market demand, and now states that they prefer oil prices at \$100/bbl. The rise in OPEC production has lowered its spare capacity to under 4 mb/d, with more than half in Saudi Arabia. Libya's oil production began to steadily recover in the fall of 2011, and has reportedly climbed above 1.3 mb/d, with exports at 1.2 mb/d.

Tensions between Iran and the West are expected to dominate market sentiment until there is satisfactory resolution to Iran's suspected nuclear weapons program. Iran has also threatened to blockade the Strait of Hormuz where some 17 mb/d of crude oil and refined products transit, even though such a cutoff is seen as unlikely. Still, it is not hard to envisage oil prices grinding higher under such tensions and uncertainty. However, in the absence of a major outage, it is unlikely that oil prices would stay above US\$120/bbl for an extended period, as demand has proved resistant in recent years when prices were much above this level. It is expected that OPEC will keep the market well supplied—as Saudi Arabia and the group have stated they will do—and will not want to unduly threaten the fragile global economic recovery. Seasonal demand is falling, and the IEA and the U.S. have said they would draw down emergency reserves if needed.

The World Bank oil price forecast is set at US\$98.2/bbl in 2012 and falls to US\$94.7/bbl in 2015. The forecast assumes a gradual resolution to current oil supply disruptions, and no large-scale impact from sanctions on Iran. OPEC spare capacity is more than sufficient to make up for a large reduction in Iranian oil exports, however it could take OPEC spare capacity to lower levels. Global oil demand is expected to rise by 1.0-1.5% over the forecast period, with all of the growth in non-OECD countries. Non-OPEC oil supply is expected to increase by 1.0 mb/d in 2012, and continue to record moderate gains. The surge in shale liquids production in the U.S. is turning that country into major supply growth region, and shale production could expand to other countries around the world.

OPEC crude oil production is not expected to increase in 2012, and may contract. OPEC countries will have to juggle production depending on losses of Iranian crude, the rise in Libya's production, and growth in new capacity in Iraq. Over the medium-term, OPEC producers are expected to absorb a portion of the moderate growth in global oil demand. This will erode surplus capacity only modestly, as most countries are investing in new capacity.

Box 5. Global Oil Market Developments *(continued)*

The differential between Brent and WTI is expected to narrow by 2015 due to the expected construction of new pipelines and reversals to take surplus Canadian and domestic crudes to Gulf refineries. However, rising output is expected to keep WTI from returning to premium status before 2015. The price of Urals is expected to decline relative to Brent, as light/sweet crude output returns, and incremental OPEC output is of heavier grade. The price of Urals is projected to decline from US\$100.0/bbl in 2011 to US\$93.9/bbl in 2015.

There are a number of risks to the forecast. Global supply risks remain from further geopolitical turmoil and outages, and unexpected technical problems. A major supply cutoff could, of course, result in prices spiking well above US\$150/bbl depending on the severity, duration, and response (from OPEC, emergency reserves, and demand curtailment). On the other hand, there are also downside risks to prices from weaker oil demand and slower economic growth, and to the ongoing impact of high oil prices—a key issue that OPEC should pay heed. A key element for price stability will be how OPEC responds to higher or lower demand for its crude. Historically OPEC has been very quick to defend a price floor with sharp cuts (e.g., end-2008), but has been very unwilling or unable to set a price ceiling (e.g., 1H-2008). The oil burden of GDP is steadily rising, and approaching near 2008 levels for some economies. While not enough to derail economic growth by itself, it does raise inflationary concerns and hence puts pressure on the ongoing loose monetary policy, which in turn can have a detrimental impact on nascent global growth, particularly in the OECD.

Policies – moderating risks, bolstering growth

Economic policy should aim to reinvigorate growth in two ways. Economic policies should ensure macroeconomic stability as the output gap is closing; and lift structural barriers to productivity growth and economic diversification. WTO accession offers a unique opportunity to advance this agenda.

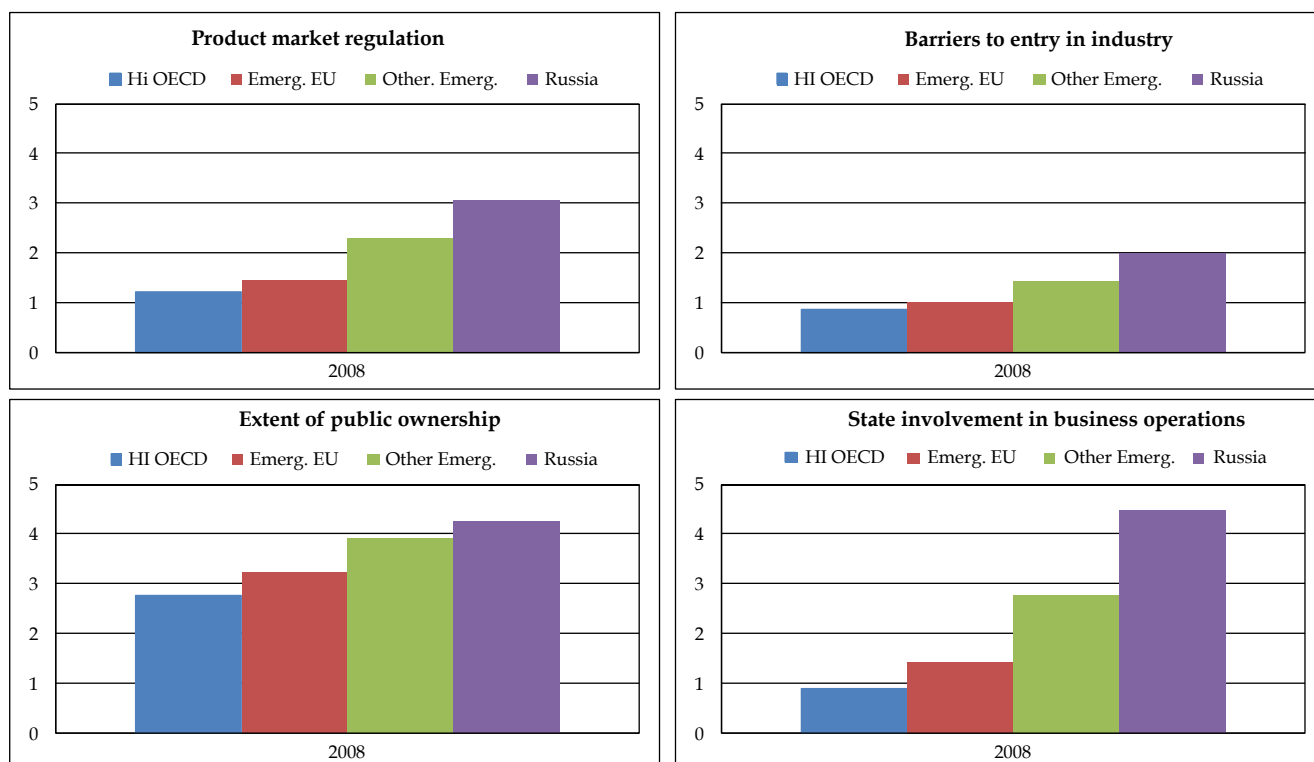
Russia has progressed significantly since the crisis a few years ago but could do much better. Before the crisis, the economy grew at more than 7 percent. Now, growth has slowed to around 4 percent, even though oil prices are high. Strengthening Russia's economic outlook involves responding to two challenges. While Russia did well during the crisis, it still has to readjust policies to ensure macroeconomic stability as the output gap is closing and the external environment remains uncertain. In addition, Russia faces the longer-term challenge of improving productivity and diversifying the economy against the backdrop of a shrinking labor force.

Fiscal policy should be used to rebuild fiscal buffers while oil prices are still high. This would make sure that fiscal policy does not become procyclical, as the output gap closes. And it would reduce the vulnerability of public finances to the volatility in oil prices as the Reserve Fund remains far below the pre-crisis level. This means sticking to prudent spending plans and saving oil revenues that come in over and above budget. It also means establishing a clear medium-term anchor for fiscal policy. A key policy decision would be to move the focus of fiscal policy from the overall fiscal balance to the non-oil fiscal balance. Prior to the crisis, Russia's long-term fiscal target was a 4.7 percent of GDP non-oil fiscal deficit target. The target was suspended during the crisis, and the non-oil fiscal deficit is set to remain above 10 percent of GDP this year. Alternatively, in order to delink the budget from oil price volatility and ensure intergenerational equity, Russia could adopt an oil-price rule, along with an aggregate borrowing ceiling. Strengthening public sector governance and raising the quality of public spending would be crucial for bringing about fiscal savings while maintaining public services. This would also create the room to invest in growth-enhancing infrastructure.

Focusing monetary policy on low inflation and strengthening financial sector oversight would also limit Russia's vulnerability to adverse external developments. Continuing to move to inflation targeting and allowing greater exchange rate flexibility are also important to limit the vulnerability of Russia's balance of payments to oil prices shocks. It would strengthen the CBR's ability to withstand an oil price shock without significant losses of its foreign exchange reserves. Greater exchange rate flexibility also discourages speculative capital inflows. Together with improving banking supervision, these policies will make the economy more stable and help to bolster Russia's financial markets.

Structural reforms are needed to strengthen Russia’s economic outlook. Removing structural barriers to growth can help to bolster and diversify the economy in a sustainable way. Russia’s 2020 Strategy Update, prepared by a group of independent advisors to the government and presented on March 16, 2012, lays out an ambitious reform program for the coming years. Russia faces an agenda of reducing the state’s footprint on the economy through privatization (for example, the federal budget for 2012–2014 foresees a privatization program of 0.5 to 0.7 percent of GDP annually), improving governance, and enabling workers and entrepreneurs to contribute to and benefits from economic prosperity (Figure 36). Easing the cost of doing business remains central to these efforts (Box 6). The accession to the World Trade Organization expected this summer is an important milestone for Russia’s economic development, as we discuss in the last section of this report.

Figure 36. Selected structural policy indicators



Source: OECD 2012, Going for Growth, World Bank staff calculations. The indicators are scaled from 0 (least restrictive) to 6 (most restrictive).

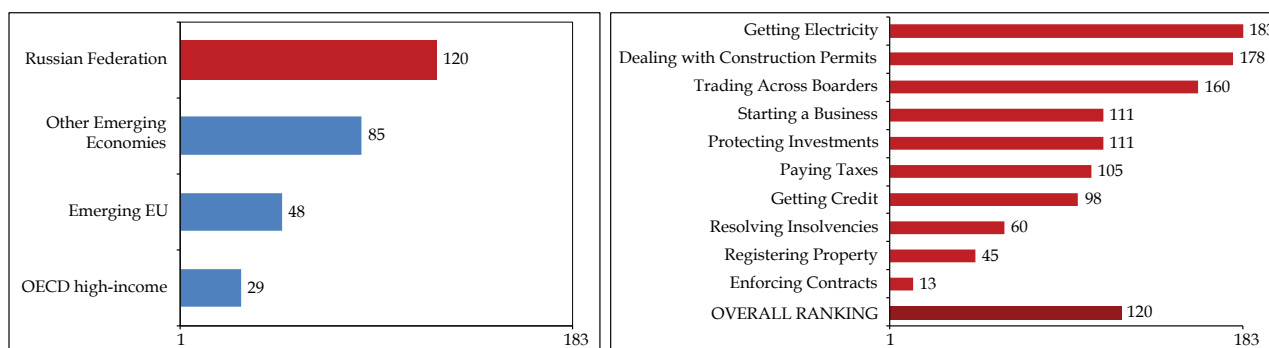
Box 6. Russia’s 2012 Doing Business ranking

The success of an economy depends in large measure on ensuring that small and medium sized enterprises (SMEs) are able to do business easily. In leading economies, SMEs are key drivers of job creation, innovation, competition, and economic growth. However, thriving SMEs rely on a regulatory environment that encourages their creation and growth. As policy makers look into ways to improve their economy’s regulatory environment, a good place to start is to find out how it compares with the regulatory environment of other economies. *Doing Business 2012*, a joint report of the IFC and World Bank, analyzes business regulation across 183 economies, focusing on ten areas that affect the life-cycle of domestic SMEs. The report ranks these economies on a scale of 1 to 183, with 1 being the most business-friendly. While *Doing Business* does not capture all aspects of the business environment that matter to firms — aspects such as security, macroeconomic stability and corruption — the rankings provide a rough guide to which countries are business-friendly, and which are not. The scores on specific areas of business regulation are also helpful in revealing regulatory bottlenecks, such as large numbers of procedures, long delays or high cost. Thus, *Doing Business* identifies areas where practical changes can be made to directly improve the business environment.

Box 6. Russia's 2012 Doing Business ranking (continued)

Russia ranked 120 out of the 183 economies assessed in the *Doing Business 2012* report. This ranking suggests that the regulatory environment in Russia is, on average, less business-friendly than other countries (Figure 37). Russia does better in some areas than in others. In areas such as enforcing contracts, registering property, and resolving insolvencies, Russia has implemented business-friendly regulation, and as a result scores well on the global index. However, in other areas, such as getting electricity, dealing with construction permits and trading across borders, regulation continues to be an extremely complicated and costly affair. As an example, it takes 423 days and costs 184 percent of income per capita to complete the 51 procedures needed to open a warehouse. Similarly, obtaining a new electricity connection (Russia's lowest score) requires 10 procedures, takes 281 days and costs 1,852 percent of per capita income to complete. These are clearly areas where regulation meant to protect the public is being administered inefficiently, placing excessive time and cost constraints on business.

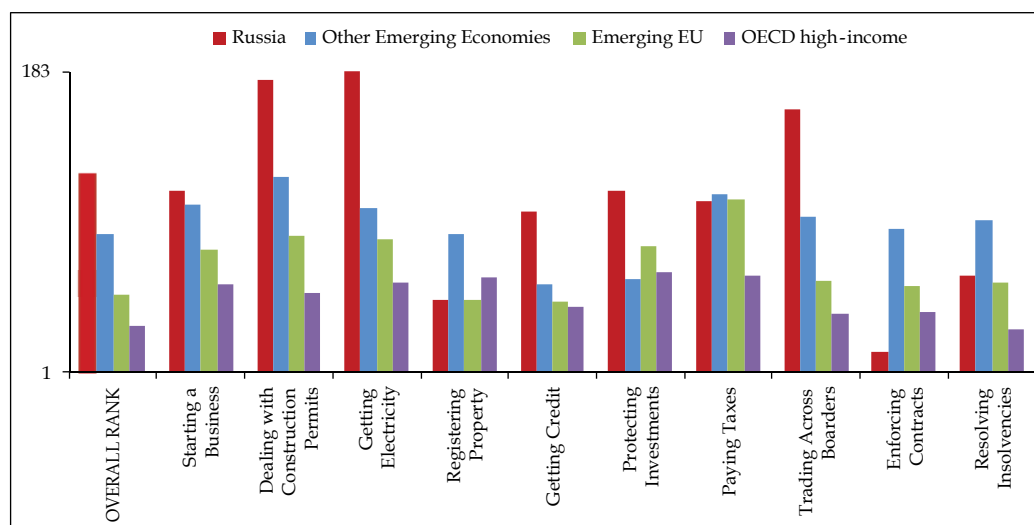
Figure 37. (a) 2012 Doing Business ranking; (b) Russia's 2012 Doing Business ranking by area



Source: World Bank and IFC, World Bank staff calculations

SMEs have a more difficult time doing business in Russia than in peer economies. Compared to high-income OECD countries and EU emerging economies, Russia is competitive in enforcing contracts. When compared to other emerging economies though, Russia fares better, ranking higher in areas of registering property, paying taxes, and resolving insolvencies. In other areas of business regulation, however, Russia lacks a competitive advantage (Figure 38). For example, it still takes nearly a year longer to deal with a construction permit and several hundred U.S. dollars more to export a container in Russia than in other countries in the region. And each procedure needed to obtain a new electricity connection — and there are many — takes an average of 28 days to complete in Russia, compared with just 10 days in India and six days in Brazil.

Figure 38. 2012 Doing Business ranking by country grouping



Source: World Bank and IFC, World Bank staff calculations

Box 6. Russia's 2012 Doing Business ranking (continued)

The *Doing Business 2012* report finds that Russia improved in nine of the ten indicators measured by *Doing Business* since 2004, although its overall ranking remains low. Biggest improvements have been made in the areas of dealing with construction permits, getting credit, and paying taxes. In keeping with this trend, Russia made it easier for domestic entrepreneurs in 2010–2011, rising in the global rankings from 124 to 120. This rise was largely due to the fact that Russia implemented four business regulation reforms last year, the highest ever recorded in a single year. This year Russia made it easier to:

- **Enforce contracts**, by introducing a new electronic court case filing system;
- **Transfer property**, by eliminating the requirement to obtain cadastral passports on land plots;
- **Import**, by reducing the number of documents needed for import transactions;
- **Afford electricity**, but cutting the cost of getting a new electrical connection in half.

It is important to look at regional differences in business regulation as well. *Doing Business* looks exclusively at regulation affecting SMEs that operate in Moscow, Russia's main business centre. However, regulations vary across countries. In order to capture regional differences within Russia, a sub-national *Doing Business* report, the second of its kind, will be published this June. This report will rank 30 Russian regions on ease of doing business, and provide recommendations to improve performance at the local level.

III

WTO Accession: A Unique and Important Opportunity for Economic Development

After 18 years of negotiations, Russia successfully negotiated the terms of its accession to the World Trade Organization. We estimate large and broad based gains to Russia from the accession. In the medium term, the gains should be about 3 percent of GDP per year with wages rising 4 – 5 percent and more than 99 percent of the households gaining income. In the long run, the gains should be about 11 percent of Russian GDP per year with wages rising about 13-17 percent. Russia has committed to maximum tariffs such that the un-weighted average Most Favored Nation (MFN) “bound” (or maximum) tariff will equal 8.2 percent after all commitments are implemented. But the un-weighted average applied MFN tariff will equal only 7.6 percent, because there will be many tariff lines where the Russian tariffs will be applied at less than the maximum limit required by its WTO commitments. This compares to an average un-weighted applied MFN tariff of Russia of 11 percent in 2011. Despite the tariff reductions, the majority of sectors will increase profitability and competitiveness due to lowered input costs (especially services inputs) and increased prices for exports. For sectors where workers may be displaced, appropriate government policy is to focus on assisting with the adjustment of displaced workers by providing resources for retraining and relocation of displaced workers to higher wage jobs – as opposed to subsidizing declining sectors and delaying the adjustment to a more productive economy. In order to achieve strong growth, it would be important to leverage the benefits that will be achieved from reforms as part of the WTO accession package with further steps to improve the investment, business and regulatory climate. Diversification, modernization and growth will be all the stronger if WTO accession is complemented with improvements in the business climate for all firms doing business in Russia, Russian and foreign.

Introduction

On December 16, 2011, during its Ministerial meetings in Geneva, the World Trade Organization (WTO) formally accepted the offer of Russia and invited Russia to join the WTO. Russia will have until mid July 2012⁴ to ratify the accession agreement and will become a member 30 days after it notifies the WTO of its ratification. If their legislatures adopt the accession agreement, the Russian Federation, Montenegro and Samoa will become the 155th , 156th and 157th members of the WTO. Spanning more than 18 years, the Russian accession negotiations were the longest in the history of the WTO; and the Working Party on accession of Russia to the WTO was the largest such Working Party in the history of the WTO. Trade among the WTO members represented 97 percent of the world’s trade turnover, including over 94 percent of the foodstuffs in recent years. Russia has been, by far, the largest economy in the world that is not a member of the WTO.

WTO accession is a comprehensive process that involves much more than commitments on tariffs on goods. WTO accession will impact on a wide range of policies and institutions, including tariff policy, customs administration, rules for using safety standards on goods in a non-protective manner, rights of market access and national treatment for foreign providers of services, rules for the treatment of foreign investors in goods, constraints on trade distorting agricultural subsidies, intellectual property, rules requiring transparency in the foreign trade regime and even government procurement.⁵ The process brings government decision-makers from the highest levels into the decision-making and represents a time for evaluation of a very wide range of regulations. It represents an opportunity to implement important trade, foreign direct investment and institutional changes, and therefore accession is a crucial tool for economic development.

⁴ More precisely, the deadline for notification of the ratification is 220 days from the invitation date of December 16, 2011.

⁵ The Report of the Working Party on Accession of Russia is a 758 page document, plus two addendums for the schedules of specific commitments on services (73 pages) and goods (a large Excel file that covers commitments on thousands of tariff lines in the customs code of the Russian Federation).

This note summarizes the key results of a series of studies supported by the World Bank to estimate the impact of Russian WTO accession on real GDP, wages, household incomes and poverty, regional incomes, industrial sector impacts and other key economic indicators. These studies employed computable general equilibrium models of the Russian economy.⁶ The World Bank has also assessed the impact of changes in Russia's tariff regime in recent years and has recently calculated the impact of commitments to the WTO on the applied tariffs.⁷

Estimates of the World Bank team of the gains in real GDP, wages, household income, and regional impacts

We estimate that in the medium term, Russia should gain about 3.3 percent per year of the value of Russian GDP (or about \$49 billion per year based on 2010 GDP at market exchange rates). In the long term, when the positive impact on the investment climate is incorporated, the gains should increase to about 11 percent per year of the value of Russian GDP (or about \$162 billion per year at 2010 market exchange rates). These are estimated gains that will repeat each year, i.e., they are not a one-time gain (Jensen, Rutherford and Tarr, 2007). Based on the econometric estimates of the gains from an open economy trade regime, these estimated gains are very plausible.⁸

The average Russian household would experience a gain of 7.2 percent of its income each year, with more than 99 percent of Russian households experiencing gains within the range of 2 to 25 percent of their incomes each year. Skilled and unskilled workers wages are estimated to increase by about five and four percent, respectively in the medium run and by about 17 and 13 percent in the long run. Skilled labor and urban households should gain relatively more than average due to the increase in foreign direct investment in the skill intensive business services sectors. Rich households should gain less than the average household, since increased competition from foreign direct investment results in capital gaining less than labor. The poorest households are estimated to gain at about the level of the average household, thereby reducing poverty, (Rutherford and Tarr, 2008).

⁶ Jesper Jensen, Thomas Rutherford and David Tarr (2007), "The Impact of Liberalizing Barriers to Foreign Direct Investment in Services: The Case of Russian Accession to the World Trade Organization," *Review of Development Economics*, Vol. 11 (3), August, 482-506; Thomas Rutherford and David Tarr (2008), "Poverty Effects of Russia's WTO Accession: modeling real households and endogenous productivity effects," *Journal of International Economics*, Vol. 75 (1), 131-150; Thomas Rutherford and David Tarr (2010), "Regional Impacts of Russia's Accession to the WTO," *Review of International Economics*, Vol. 18 (1), 30-46; and Jesper Jensen, Thomas Rutherford and David Tarr (2006), "Telecommunications Reform within Russia's Accession to the WTO," *Eastern European Economics*, Vol 44 (1), January-February, 25-58.

⁷ Oleksandr Shepotylo and David Tarr (2008), "Specific tariffs, tariff simplification and the structure of import tariffs in Russia: 2001-2005," *Eastern European Economics*, Vol. 46 (5), September –October 2008, 49-58; and Oleksandr Shepotylo and David Tarr (2012), "Impact of WTO Accession on Bound and Applied Tariff Rates of Russia," mimeo.

⁸ A welfare increase of 3.3 percent of GDP is quite plausible in the context of the estimated gains from trade liberalization from econometric studies. First, Rutherford and Tarr (2002) have shown that a permanent increase of between 0.4 percent and one percent in the growth rate of an economy corresponds to a welfare increase of between 10 and 35 percent. Sachs and Warner (1995) estimate that open economies have grown about 2.45 percent faster than closed economies, with even greater differences for open versus closed economies among developing countries. They note that trade liberalization is often accompanied by macro stabilization and other market reforms, and their open economy variable can be picking up these other effects as well. But they argue that trade liberalization is the *sine qua non* of the overall reform process, because other interventions such as state subsidies often are unsustainable in an open economy. While similar results were found in studies by Edwards (1993) and Dollar (1992), Rodriguez and Rodrik (2001) criticized all these studies, in part because of their failure to account for simultaneity bias. However, Frankel and Romer (1999) have shown that adjusting for the simultaneity bias in cross country regression studies such as Sachs and Warner does not reduce the estimated impact of openness on growth. More recently, using time series data on individual countries, rather than cross-country growth regressions, Wacziarg and Welch (2009) find compelling evidence that countries grow about 1.5 percentage points faster after they liberalized trade.

Rodrik, Subramanian and Trebbi (2004) and Bolaky and Freund (2008) have highlighted the importance of good institutions to economic growth. Bolaky and Freund have shown that in 25% of the countries with the worst business and labor regulations, open trade can harm growth. On the other hand, for the 75% of the countries with the best business and labor regulations, open trade has an even stronger beneficial impact on growth than previous authors have found. But Dollar and Kraay (2003) find evidence that trade is more important than institutions in the medium terms; and Rodrik, Subramanian and Trebbi have shown that trade liberalization can improve institutions while Ades and di Tella (1999) find evidence that increased trade leads to reduced corruption. For full citations of the references in this footnote as well as additional considerations regarding Russia's trade and foreign investment regimes, see David Tarr and Natalya Volchkova (forthcoming), "Russia Trade and Foreign Investment Policy at the Crossroads," in *Handbook of the Russian Economy*, Michael Alekseev and Shlomo Weber (editors), Oxford: Oxford University Press.

All regions should gain substantially, but the regions that will gain the most are those that are most successful at attracting foreign direct investment, which depends on both location advantages and creating a good investment climate. The regions likely to gain the most are the Northwest, Saint Petersburg and Far East regions, (Rutherford and Tarr, 2010).

In a focused study of the telecommunications sector, the authors estimated that skilled workers wages in the telecom sector will increase substantially from foreign direct investment (FDI). Multinational firms that locate in Russia employ mostly Russians and will increase the demand and wages for Russians with the skills needed in their companies. Russian firms that become part of joint ventures with foreign investors will likely preserve or increase the value of their investments; but Russian capital owners in the telecom sector who remain wholly independent of multinational firms will likely see the value of their investments decline. Households dependent on income from these types of firms may lose from WTO accession (Jensen, Rutherford and Tarr, 2006).

What are the sources of these estimated gains?

About 72 percent of the estimated gains come from improved quality and lower prices of services that lead to productivity increases and increased competitiveness of Russian firms using these better services. Crucially, firms and consumers will have access to more and better services from increased FDI in business services. Increased productivity means that real wages should increase and prices should decline – benefiting consumers and lowering cost of production for firms.

Tariff reductions will allow purchase of intermediate inputs and final goods of consumers at lower prices, accounting for 18 percent of the estimated gains. Although many sectors in Russia are characterized by imperfect competition, international evidence is strong that prices decline in response to trade liberalization. Even imperfectly competitive firms reduce prices in response to increased competition.⁹ Tariff reduction will make it easier to import products that contain modern and diverse technologies.

Improved market access for Russian exporters accounts for the remaining 10 percent of the estimated gains. Russian firms that have been subject to antidumping actions in export markets, such as Russian steel producers, non-ferrous metal producers and chemical exporters, will have increased legal rights to protect their commercial interests in antidumping cases.

Sector impacts and Adjustment Assistance

Many sectors will expand despite tariff reductions due to input price declines, improved quality of services inputs and export price increases. Which sectors expand or contract depends on the interaction of several impacts. On the negative side, the reduction of import tariffs will lead to a reduction of prices for sales in Russia, which will negatively impact profits and output. But the increased demand for imports will depreciate the real exchange rate, so import prices and prices in Russia will decline by less than the tariff reduction, putting less negative pressure on Russian industry. On the positive side, the cost of intermediate inputs to Russian industry will decline for two reasons. First, prices of intermediate inputs will decline due to the tariff decreases. Second, better quality and diverse services and goods will be available that will increase productivity and further lower the quality adjusted cost of intermediate goods and services. Exporting firms will receive higher price for exports in rubles due to real exchange rate depreciation. And for firms subject to antidumping actions, WTO membership means that they will have better rights in export markets to defend themselves in antidumping cases.

Export intensive sectors such as non-ferrous metals, ferrous metals and chemicals will benefit from higher export prices in rubles and are the industrial sectors that are most likely to expand. The export intensive sectors benefit from higher prices of exports in rubles from real exchange rate depreciation and from better protection of their rights in antidumping cases. These sectors are also among those whose costs of production decline the most due to more intensive use of inputs whose prices decline.

Many services sectors that will be more open to foreign direct investment (FDI) will also expand production, such as telecommunications, banking and insurance. Foreign firms that invest

⁹ See Tybout, James (2003), "Plant and Firm Level Evidence on New Trade Theories," in *Handbook of International Trade, Volume 1*, James C. Harrigan (editor), Basil-Blackwell, 388-415..

and produce in Russia will employ predominantly Russian workers. The experience of the Chinese insurance sector is instructive in this regard. Despite great fears of a contraction in the Chinese insurance industry, there was a large expansion. Salaries of skilled workers in the Chinese insurance sector, such as statisticians and actuaries, increased substantially after WTO accession. Even domestic insurance firms in the Chinese insurance sector doubled as foreign firms sought Chinese companies as joint venture partners. Sectors that have relatively high tariffs and export little, such as the food industry, light industry, machinery and equipment and construction materials are the sectors that are likely to experience the greatest competitive pressure and may reduce output.

For workers facing displacement from increased import competition, it is better for the government to provide assistance to workers to retrain or relocate, while avoiding support to industries. It is important to focus on the displaced workers, not the sectors. In the absence of a general effective social safety net to assist displaced workers (the first best policy tool), a well designed program of trade adjustment assistance could be effective. For example, the United States has had a trade adjustment assistance program for more than 35 years. The European Union introduced the “European Global Adjustment Fund” in 2006 and South Korea recently introduced a similar program in anticipation of possible free trade agreements with the United States and the European Union.¹⁰ These programs assist workers to obtain training and with relocation expenses to move to the expanding sectors where the wages are rising. Subsidizing the declining sectors to avoid any output contraction defeats the liberalization and denies the potentially expanding sectors the needed additional workers.

By 2020, applied Most-Favored Nation¹¹ tariffs of the Russian Federation will fall by at least 30 percent

Table 1 shows the applied average “most favored nation” (MFN) tariff rates of Russia on an annual basis from 2001 until 2011 and the projected impact of the commitments to the WTO on the tariff rates between 2012 and 2020. The tariff commitments of Russia to the WTO are staged, with transition periods for implementation of the tariff cuts for the more sensitive sectors. The final tariff cuts will not be implemented until eight years after accession to the WTO.¹² The average applied MFN tariff is calculated both on a simple average (un-weighted average) basis and on a trade weighted average basis.¹³

¹⁰ Trade adjustment assistance must be well designed, however, or it is likely to be ineffective. Monetary compensation and retraining in the early years of the US program were found to be ineffective since the assistance was not well targeted at truly displaced workers. The effectiveness of retraining assistance tends to be more effective if it is driven by demand from the private sector, such as with subsidized apprentice programs as opposed to government sponsored training. In Hungary, O’Leary (1997) found that unemployed workers that participated in retraining programs had a slightly better chance of becoming employed, received slightly better wages on re-employment, and had a longer duration of employment after finding a job. Decker and Corson report that participation in a training program in the US for trade displaced workers increased the earning of trainees. For a review of the program of the United States see Paul Decker and Walter Corson (1995), “International Trade and Worker Displacement: Evaluation of the Trade Adjustment Assistance Program,” *Industrial and Labor Relations Review*, 48 (4), 758-774. The European Global Adjustment Fund is discussed in Joseph Francois, Marion Jansen, and Ralf Peters (2011), “Trade, Adjustment Costs and Assistance: The labour market dynamics,” in *Trade and Employment: From Myths to Facts*, Marion Jansen (editor), International Labor Organization and the European Commission. The South Korean program is discussed in Inkyo Cheong and Jungran Cho (2011), “Reforms of Korea’s Trade Adjustment Assistance Program for Its Bilateral Free Trade Agreements with the European Union and the United States,” *Asian Economic Papers*, Vol. 10(1), 32-55. For a review of the evidence on the effectiveness of trade adjustment assistance and a discussion of some other similar programs see Steven Matusz and David Tarr (2000) “Adjusting to Trade Liberalization,” in Anne O. Krueger (ed.), *Economic Policy Reform: The Second Stage*, Chicago: The University of Chicago Press.

¹¹ The “Most Favored Nation” tariff principle means that any WTO member will be treated as well as the most favored nation. For example, if Japan offers a tariff of 5 percent on some kind of machine to the United States, then Russian exporters and exporters of all other WTO member countries, will also face a tariff no higher than five percent on their exports of the machine to Japan. Customs unions and free trade agreements, as well as tariff preferences for developing countries, are major exceptions to the MFN principle.

¹² Calculation of the Russian tariff structure is complicated by the fact out of the more than 11,000 tariff lines in the Russian tariff code, there were about 2,000 that used the so called “combined” tariff system in 2011. For the combined system tariff lines, the actual tariff applied by Russian customs is the maximum of the ad valorem or specific tariff. (For footwear it is the sum of the ad valorem and specific tariff.) To assess the changes in the tariff structure, it is necessary to first calculate the ad valorem equivalents of the specific tariff component of the 2000 tariff lines with specific tariffs.

¹³ For the years 2011 through 2020, we have used the latest data available for the calculations of trade weights—namely the trade data of 2010.

At least in terms of the overall averages, the Customs Union tariff had very little impact on tariffs of the Russian Federation. As of July 1, 2010, the customs code of the Russia-Belarus-Kazakhstan Customs Union became the customs code of the three member countries, with some exceptions, mostly in Kazakhstan.¹⁴ The impact of imposing the Customs Union tariff code is measured by the differences in the tariffs between the years 2010 and 2011.

By the year 2020, tariffs will fall from an 11 percent average in 2011 to 7.6 percent on a simple average basis. The trade weighted average tariff, however, falls more substantially from 11.6 percent in 2011 to 5.4 percent in 2020. The WTO commitments are progressively implemented beginning in the year 2012, with almost all commitments implemented by 2017 or 2018. The greater drop in the trade weighted average is due significantly to substantial cuts in the tariffs in the automotive sector (from 19.2 to 7.7 percent) and in electrical equipment and machinery sector (from 8.1 to 4.9 percent). Together imports of these two sectors constitute more than 25 percent of the value of total imports of the Russian Federation. It is possible, however, that as a result of the Russian automobile program, designed to increase Russian production of automobiles and automobile parts, that imports in the automobile sector will decline in the future. If so, the trade weighted average tariff will not fall as sharply when based on the actual trade weights of the future. For further details see Shepotylo and Tarr (2008; 2012).

The “bound” or maximum average un-weighted MFN tariff of Russia will be 8.2 percent after all commitments are implemented – higher than the projected average applied tariffs

On over 1500 tariff lines, the current applied tariff of Russia is less than the final “bound” rate under the commitments of Russia to the WTO. Countries may apply tariffs at rates less than their “bound” maximum rates.¹⁵ Assuming the applied tariffs are not increased, the average “bound” MFN tariff of Russian 2020 will be higher than the average applied MFN tariff of 7.6 percent (Table 11). Consequently, unless applied tariff rates are increased, Russia’s tariffs will be 0.6 percentage points lower (on an un-weighted basis) than required by the WTO commitments.

Table 11. *Applied MFN tariffs of Russian 2001 – 2020 and Bound Rates for 2012 – 2020*

Year	Number of product lines	Number of product lines with non-zero specific tariffs	Applied MFN rate				Bound MFN tariff rate	Number of product lines with bound MFN rate above applied MFN rate
			Simple average		Weighted average			
			Mean	Standard deviation	Mean	Standard deviation		
2001	11,076	1,609	11.7	10.8	11.4	9.5		
2002	11,148	1,624	12.2	13.7	13.3	14.9		
2003	11,161	1,774	12.8	18.7	14.3	18.0		
2004	11,218	1,783	12.4	13.3	14.1	17.0		
2005	11,365	1,792	12.1	12.7	14.0	15.2		
2006	10,875	1,920	11.7	11.3	13.7	12.2		
2007	11,001	1,856	11.4	11.3	11.7	11.2		
2008	11,057	1,924	11.3	10.8	13.4	22.7		
2009	11,067	1,891	11.9	13.2	11.6	16.6		

¹⁴ During the first year of the Customs Union, Kazakhstan was permitted to set tariffs different from the Customs Union for 409 tariff lines. See World Bank (2012), Assessment of Costs and Benefits of the Customs Union for Kazakhstan, Report No. 65977-KZ, Poverty Reduction and Economic Management Unit, Europe and Central Asia Region.

¹⁵ The WTO Secretariat estimated that the bound tariffs of Russia will be 7.8 percent in 2020. While our estimates are close, they are slightly higher for two reasons. Due to data limitations, the WTO statistical office had to calculate tariff averages based on aggregated categories, rather than at the “ten digit” tariff line level of the tariff schedule of the Russian Federation. We had the more detailed ten digit data available, which allows more accurate calculations. Further, also due to data limitations, the WTO calculations ignored specific tariffs on more than 200 tariff lines where the specific tariffs and the import data were in different units. We obtained a concordance in such cases and estimated the tariff equivalents of the specific tariffs for all ten digit tariff lines.

Table 11. *Applied MFN tariffs of Russian 2001 – 2020 and Bound Rates for 2012 – 2020 (continued)*

Year	Number of product lines	Number of product lines with non-zero specific tariffs	Applied MFN rate				Bound MFN tariff rate	Number of product lines with bound MFN rate above applied MFN rate
			Simple average		Weighted average			
			Mean	Standard deviation	Mean	Standard deviation		
2010	11,051	1,948	11.1	13.5	11.0	17.6		
2011	11,125	2,020	11.0	13.4	11.6	18.9		
2012	11,557	1,422	10.5	10.1	8.9	8.0	2,630	
2013	11,557	1,421	9.7	9.7	7.9	7.8	2,520	
2014	11,557	1,420	8.8	9.4	7.2	7.5	2,231	
2015	11,557	1,407	8.1	9.2	6.4	7.3	1,705	
2016	11,557	1,401	7.8	9.1	6.0	6.6	1,574	
2017	11,557	1,390	7.7	9.1	5.7	6.2	1,522	
2018	11,557	1,372	7.7	9.1	5.4	5.7	1,522	
2019	11,557	1,371	7.6	9.1	5.4	5.7	1,522	
2020	11,557	1,371	7.6	8.7	5.4	5.2	1,522	

Source: Shepotylo and Tarr (2012)

760 of the total tariff lines with applied MFN tariffs less than WTO bound tariff levels are in the machinery and mechanical appliances and electrical machinery and equipment categories (2-digit categories 84 and 85). Notable examples at the ten digit tariff line level are the following. Over \$ 2 billion in three ten digit categories of auto parts entered with a zero import tariff in 2010 in the Customs Union, while the bound rate at the WTO for these categories was either five or fifteen percent.¹⁶ Over \$1 billion in electricity turbo-generators (ten digit code 8502292000) entered in 2010 with a Customs Union tariff of zero, while the WTO bound rate is five percent.

Russia has made a comprehensive offer that is typical of the commitments to the WTO by acceding countries¹⁷

The agreement between Russia and the WTO is a comprehensive offer from Russia for membership that has satisfied the members of the Working Party, but is not unusual. The offer is typical of the agreements of the countries that have acceded to the WTO that are not “Least Developed Countries (LDC).” Among the Transition countries, only Latvia (9.4 percent) and China (9.1 percent) acceded with a higher average bound tariff than the 8.2 percent tariff commitment of the Russian Federation. All other Transition countries acceded with average tariffs bound at levels between 4.8 percent and 7.5 percent, with most in the range of 5.5 percent to 6.6 percent.

Russia has made substantial commitments to market access and national treatment of foreign providers of services, which are typical of non-LDC countries acceding to the WTO. Russia has made commitments in 116 services sub-sectors. Examples include: the quota on the maximum share of foreign banks or insurance companies has been increased from 15 percent to 50 percent of the market. Branches of foreign insurance companies will be allowed nine years after accession. In telecoms, the 49 percent maximum foreign equity restriction will be removed four years after accession. The monopoly restriction on fixed-line long distance telephone services within Russia has already been removed. National treatment and market access will be provided for a wide variety of professions (such as lawyers and accountants), and for wholesale and retail trade and courier services.

¹⁶ These categories are 8707101000 (auto bodies), 8708291000 (parts and accessories) and 8708402001 (gear boxes).

¹⁷ For details of the commitments of other acceding countries compared to Russia, see David Tarr and Natalya Volchkova (forthcoming), “Russia Trade and Foreign Investment Policy at the Crossroads,” in *Handbook of the Russian Economy*, Michael Alekseev and Shlomo Weber (editors), Oxford: Oxford University Press.

Russian negotiators succeeded in preserving protection of some sensitive sectors and obtaining substantial adjustment periods

Russia succeeded in its negotiating objective of protecting some sensitive sectors. For example, a major objective of the Russian negotiators was to avoid a commitment to accept branches of foreign banks. Despite the fact that all non-LDC countries that have acceded to the WTO have made a commitment to accept branches of foreign banks on their territory,¹⁸ the Russian negotiators succeeded in their objectives of allowing only subsidiaries. The Russian automobile program requires the use of minimum shares of Russian local content and imposes minimum production requirements on foreign investors in order to obtain preferential tariff treatment on imported inputs. These constraints on foreign investors in goods are considered violations of the Trade Related Investment Measures (TRIMs) agreement of the WTO. Russia succeeded obtaining a transition period of six years before it is obligated to terminate these rules on foreign investors in autos. By that time, a substantial increase in Russian auto assembly and parts production should be in place – so the negotiated transition period for Russia was very important. There are also substantial transition periods built into implementation of the tariff commitments on goods, with bound tariff levels for some products becoming effective only seven or eight years after accession.

Conclusion: A Unique and Important Opportunity for Economic Development

WTO accession is a unique and important opportunity to move the country forward toward an outward-looking model of economic development. As Russia seeks to diversify and modernize its economy, how will it achieve its objectives? The studies cited above indicate that Russia will reap substantial gains from WTO accession and that the benefits are widespread and will reduce poverty. The examples of fast growth or “development miracles” in the past half century, such as South Korea, Singapore, Hong Kong, Taiwan (China), Chile, China and Mauritius, were all countries whose rapid growth was led by export growth. Import tariffs, however, act as a tax on exports and impede the movement toward an open economy or export led model of economic development. In a business as usual scenario, concentrated forces who want protection in their sectors will lobby to defeat liberalization, while there are many who gain from liberalization, the gains are not concentrated and typically they do not lobby for liberalization. The uneven lobbying often leads to excessive protection compared to what is beneficial for the country. WTO accession involves foreign business interests and foreign governments in the negotiations on the level of home protection. Then policy-makers at the highest levels of government must engage in the process, and the result is usually a broader and deeper set of reforms than could be achieved without the accession process. Ratification by Russia for the Protocol on its Accession to the WTO would thus be an important step in reform of the Russian economy. It would be important to leverage the benefits that will be achieved from reforms as part of the WTO accession package with further steps to improve the investment and business climate. Diversification, modernization and growth will be all the stronger if WTO accession is complemented with improvements in the business climate for all firms doing business in Russia, Russian and foreign.

¹⁸ Except possibly the officially designated “least developed countries.”

Main indicators

Output Indicators	2007		2008		2009		2010		2011															
	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	2011	Jan	Feb	
GDP, % change, y-o-y	8.5	5.2	-7.8	4.3	-	4.1	-	4.1	-	4.1	-	4.1	-	3.4	-	4.8	-	4.8	-	4.8	4.3	-	4.3	-
Industrial production, % change, y-o-y	6.8	0.6	-9.3	8.2	6.7	5.8	5.3	4.5	4.1	5.7	5.2	6.2	6.2	5.7	5.2	3.9	3.6	3.9	2.5	4.7	4.7	3.8	6.5	6.5
Manufacturing, % change, y-o-y	10.5	0.5	-15.2	11.8	13.5	10.2	8.6	5.3	5.0	7.1	5.5	7.1	4.4	5.7	4.9	5.7	4.4	4.9	3.3	6.5	6.5	4.8	6.3	6.3
Extraction of mineral resources, % change, y-o-y	3.3	0.4	-0.6	3.6	3.5	3.2	3.1	1.4	2.1	1.6	1.8	3.3	1.4	-0.3	1.3	1.8	1.8	1.3	1.8	1.9	1.9	1.4	3.7	3.7
Fixed capital investment, % change, y-o-y	21.1	9.8	-16.2	6.0	-2.1	-0.5	-0.3	2.2	7.4	4.9	7.8	7.0	9.5	13.7	12.8	14.0	8.3	15.6	15.1	8.3	8.3	15.6	15.1	15.1
Fiscal and Monetary Indicators																								
Federal government balance, % GDP 1/	5.4	4.1	-5.9	-4.1	3.6	0.7	1.1	0.9	2.0	2.9	2.5	2.3	2.9	2.9	2.5	2.3	2.9	3.2	2.8	0.8	0.8	-0.5	-0.5	-3.0
Consolidated budget balance, % GDP 1/2/	6.1	4.8	-6.2	-3.6	13.9	6.2	7.1	5.6	7.3	7.2	7.3	7.1	6.3	7.2	7.3	7.1	6.3	5.4	5.4	1.6	1.6	1.6	1.6	1.6
M2, % change, p-o-p 3/	51.3	27.2	-3.5	30.6	-3.5	1.2	1.4	1.2	0.7	2.7	0.5	1.1	2.0	0.5	1.1	2.0	-0.5	2.7	11.8	23.3	23.3	-3.5	0.7	0.7
Inflation (CPI), % change, p-o-p	11.9	13.3	8.8	8.8	2.4	0.8	0.6	0.4	0.5	0.2	0.0	-0.2	0.0	0.5	0.4	0.4	0.5	0.4	0.4	6.1	6.1	0.5	0.4	0.4
GDP deflator 1/	13.8	18.0	1.9	11.4	-	-	14.5	-	15.4	-	15.4	-	14.9	-	15.4	-	14.9	-	15.4	15.4	15.4	-	-	-
Producer price index (PPI), % change, p-o-p	25.1	-7.0	13.9	16.7	2.1	3.3	1.3	2.0	1.1	-2.3	-1.0	3.3	0.5	0.9	1.0	0.2	13.0	-0.3	1.1	13.0	13.0	-0.3	1.1	1.1
Nominal exchange rate, average, Rb/USD	25.6	24.8	31.7	30.4	30.1	29.3	28.4	28.1	27.9	28.0	27.9	28.8	30.5	31.4	30.9	31.5	29.4	30.4	29.0	29.4	29.4	30.4	30.4	29.0
Reserve Fund, bln USD e-o-p	137.1	60.5	25.4	88.4	90.2	90.9	91.8	94.3	92.5	92.6	92.7	92.6	88.7	91.2	88.3	86.8	86.8	88.3	89.8	86.8	86.8	88.3	88.3	89.8
National Wealth Fund, bln USD, e-o-p	88.0	427.1	439.0	479.4	484.2	493.8	502.5	524.0	521.1	524.6	533.9	545.0	516.8	525.6	510.9	498.6	498.6	505.4	514.0	498.6	498.6	505.4	514.0	514.0
Reserves (including gold) billion \$, end-o-p	477.9	427.1	439.0	479.4	484.2	493.8	502.5	524.0	521.1	524.6	533.9	545.0	516.8	525.6	510.9	498.6	498.6	505.4	514.0	498.6	498.6	505.4	514.0	514.0
Balance of Payment Indicators																								
Trade Balance, billion \$ (monthly)	130.9	179.7	112.1	151.4	14.0	17.4	16.7	18.8	15.5	16.4	14.5	14.4	16.3	16.6	16.9	20.6	198.2	20.5	20.5	198.2	198.2	20.5	20.5	20.5
Share of energy resources in export of goods, %	61.5	65.9	62.8	63.5	-	-	67.9	-	65.8	-	65.8	-	63.3	-	65.2	65.5	65.5	-	-	65.5	65.5	-	-	-
Current Account, billion \$	76.6	102.4	48.9	70.3	8.9	12.2	10.0	12.4	8.9	0.6	6.1	4.6	7.7	-	28.3	98.8	98.8	-	-	98.8	98.8	-	-	-
Export of goods, billion \$	354.4	471.6	304.0	400.1	30.3	39.2	43.6	45.9	43.6	44.2	42.0	44.5	43.8	46.0	47.3	51.3	522.0	40.1	40.1	522.0	522.0	40.1	40.1	40.1
Import of goods, billion \$	223.5	291.9	191.9	248.7	16.3	21.8	26.9	27.1	28.2	27.7	27.5	30.2	27.6	29.4	30.4	30.7	323.8	19.6	19.6	323.8	323.8	19.6	19.6	19.6
Gross FDI, mln USD 1/	27 797	27 027	15 906	13 810	-	-	3 890	-	7 039	-	11 736	-	18 415	-	18 415	18 415	18 415	-	-	18 415	18 415	-	-	-
Average export price of Russia's oil, \$/bbl	64.4	91.2	56.2	74.6	89.8	91.5	100.2	108.7	109.7	112.0	107.6	107.0	105.7	105.2	105.0	104.2	103.9	102.5	102.5	103.9	103.9	102.5	102.5	102.5
Financial Market Indicators																								
Average weighted lending rate for enterprises, % 4/	10.8	15.5	13.7	9.1	8.6	8.7	8.7	8.3	8.0	8.6	7.9	7.9	8.0	8.6	8.8	9.3	9.3	8.8	8.8	9.3	9.3	8.8	8.8	8.8
CBR refinancing rate, % end-o-p	10.0	13.0	8.8	7.8	7.8	8.0	8.0	8.0	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.0	8.0
Real average rate for Ruble loans, % (deflated by PPI)	-3.4	-6.8	-0.1	-6.5	-9.9	-10.9	-10.5	-9.7	-8.6	-8.8	-7.8	-7.8	-9.4	-7.7	-4.5	-3.2	-3.2	-1.4	-1.4	-3.2	-3.2	-1.4	-1.4	-1.4
Stock market index (RTS, ruble term, eop)	2 291	632	1 445	1 770	1 910	1 970	2 044	2 027	1 889	1 907	1 965	1 702	1 341	1 563	1 541	1 382	1 382	1 577	1 735	1 382	1 382	1 577	1 735	1 735
Enterprises Finances																								
Share of loss-making companies 1/	23.4	25.2	30.1	27.8	37.1	36.9	38.6	36.6	35.0	34.7	33.1	31.7	31.9	30.2	29.1	28.1	28.1	34.0	34.0	28.1	28.1	34.0	34.0	34.0
Share of credits in capital investment 1/	15.5	17.6	20.1	14.3	-	-	11.9	-	-	13.4	-	-	14.1	-	-	12.8	12.8	-	-	12.8	12.8	-	-	-
Income, Poverty and Labor Market																								
Real disposable income, (1999 = 100%)	245.6	251.5	259.3	272.5	205.4	246.9	247.1	268.9	245.2	276.4	271.7	260.0	264.1	267.8	271.1	333.0	274.7	209.5	254.7	274.7	274.7	209.5	254.7	254.7
Average dollar wage, US \$	532.0	696.9	588.3	697.8	696.6	714.6	797.5	818.9	811.5	859.6	852.5	798.7	738.0	789.4	775.7	1018.9	806.4	753.6	810.6	806.4	806.4	753.6	810.6	810.6
Share of people living below subsistence, % 1/	13.3	13.4	13.0	12.6	16.1	16.1	16.1	14.9	14.9	14.9	14.9	14.9	14.3	14.3	14.3	14.3	14.3	14.3	14.3	14.3	14.3	14.3	14.3	14.3
Unemployment (% , ILO definition)	6.1	7.8	8.2	7.2	7.8	7.6	7.1	7.2	6.4	6.1	6.5	6.1	6.0	6.4	6.3	6.1	6.1	6.6	6.5	6.1	6.1	6.6	6.5	6.5

Source: Goskomstat, CBR, EEG, IMF, staff estimates.

1/ Cumulative from the year beginning.

2/ Starting 2006 incl. extrabudgetary funds.

3/ Annual change is calculated for average annual M2.

4/ All terms up to 1 year.