RUSSIAN FEDERATION

Following a soft patch in the second half of 2012, growth is projected to pick up again to around 4% in 2013 and 2014, underpinned by increasing oil prices and easing headwinds from the euro area crisis. Gradual disinflation will continue after a temporary rebound of inflation due to the delayed increase of administrative prices and food price increases. The budget will be in surplus, but the non-oil deficit will remain substantial. The large current account surplus will diminish slowly.

Post-election budgetary spending pressures need to be contained. While the new fiscal rule will provide more stabilisation against fluctuations in oil revenues, a non-oil deficit rule would be a better anchor for a sound medium-term fiscal position. Monetary policy should target disinflation, while allowing the exchange rate to fluctuate and absorb shocks. Improvements in corporate governance and the business environment are essential for boosting output and increasing potential growth.

The economy has slowed down

Growth slowed in 2012 due to the global economic weakening, political uncertainty surrounding the elections, a bad harvest and the continuation of the euro area crisis. On the other hand, moderation in capital outflows suggests solid investor confidence in the domestic growth outlook and policy framework.

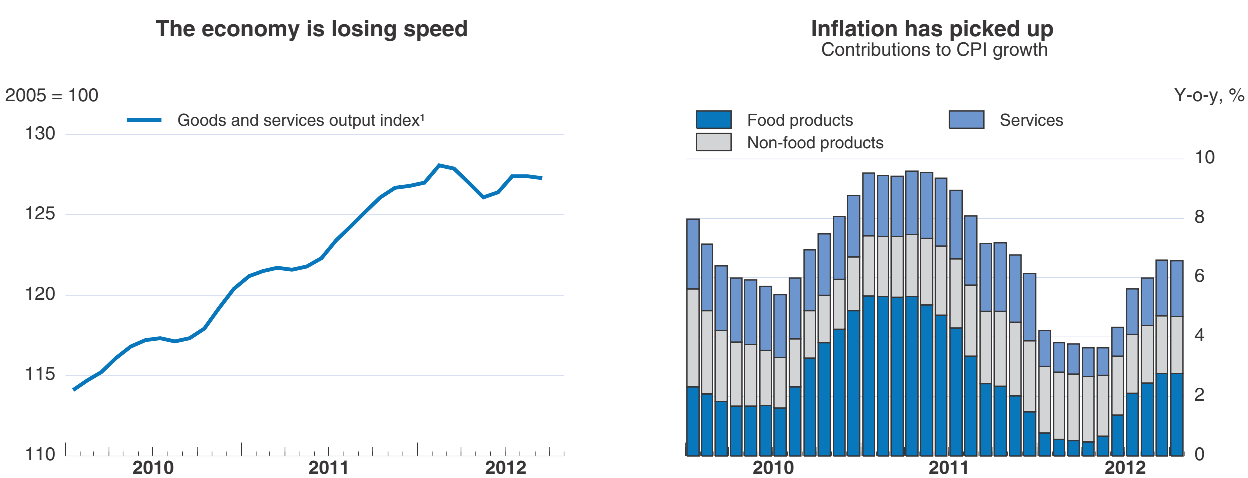
Consumption has been sustained by job gains and credit growth

Domestic demand has weakened but continues to provide the basis for growth. Consumption is supported by a strengthening labour market, as the unemployment rate has reached a pre-crisis low and employment exceeds its pre-crisis peak. Further gains will be more modest, but real wages are likely to grow fast. Rapid consumer credit growth led to fears of overheating, but seems to have eased more recently.

Inflation has picked up

After falling to a post-Soviet era low, inflation picked up sharply in the middle of the year, driven by a delayed increase of administrative

Russian Federation



1. Seasonally adjusted, 3-month moving average.
Source: OECD calculations and estimates based on Rosstat.

StatLink http://dx.doi.org/10.1787/888932744033

Russian Federation: **Macroeconomic indicators**

	2010	2011	2012	2013	2014
Real GDP growth	4.3	4.3	3.4	3.8	4.1
Inflation (CPI), period average	6.9	8.4	5.0	6.4	4.3
Fiscal balance (per cent of GDP)[1]	-3.5	1.6	0.5	0.1	0.0
Current account balance (per cent of GDP)	4.8	5.3	4.6	2.7	1.8

1. Consolidated budget.
Source: OECD Economic Outlook 92 database.

StatLink http://dx.doi.org/10.1787/888932745382

prices and food price increases connected with the poor harvest. While these supply factors will make the largest contribution to overshooting the central bank inflation target in 2012, core inflation has also risen, suggesting significant second-round effects.

Monetary policy needs to react to price pressures

In response to inflation pressures and rapid credit growth, the central bank increased its policy rates by 25 basis points in September, and more tightening will probably be required in 2013 to gain credibility in the run-up to the introduction of a more formal inflation targeting framework. Prudential policy tools, such as ceilings on the loan-to-value ratio might also be considered for containing the growth of credit to households. Increasing exchange rate flexibility further would provide better external shock absorption, and narrowing the corridor between the central bank lending and borrowing rates would help to better regulate liquidity in the banking system.

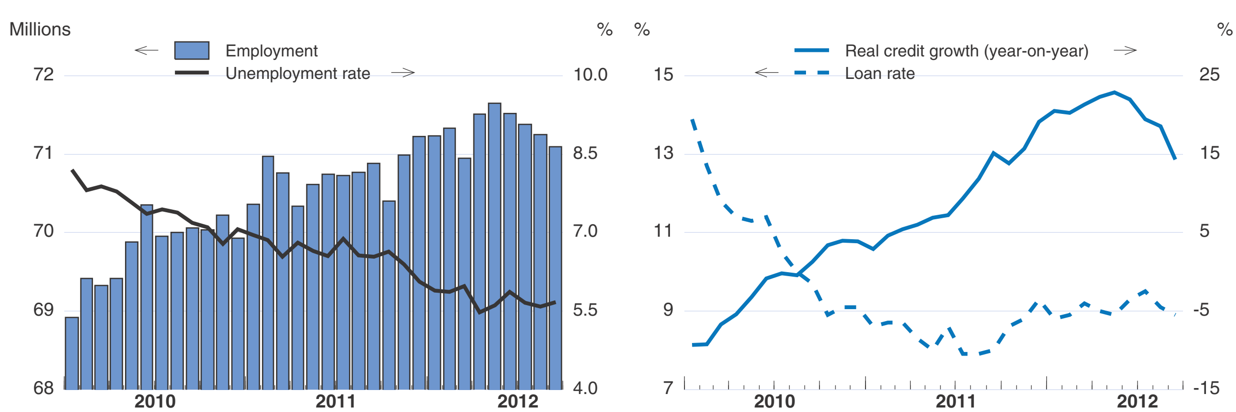
Uncertainties about fiscal policy should be clarified

High oil and gas prices yielded a budget surplus in 2011, but increasing non-oil deficits imply fiscal loosening in 2012. The 2013 draft

Russian Federation

The labour market has stabilised
Seasonally adjusted

Credit growth is easing



Source: OECD calculations and estimates based on Rosstat.

StatLink http://dx.doi.org/10.1787/888932744052

Russian Federation: **External indicators**

	2010	2011	2012	2013	2014
	$ billion				
Goods and services exports	445.3	576.3	602.0	607	640
Goods and services imports	322.0	414.0	442.7	486	536
Foreign balance	123.3	162.4	159.4	121	104
Invisibles, net	- 52.2	- 63.5	- 68.6	- 64	- 62
Current account balance	71.1	98.8	90.7	57	42
	Percentage changes				
Goods and services export volumes	7.0	0.4	- 0.7	2.0	3.4
Goods and services import volumes	25.8	20.3	6.7	11.1	9.4
Terms of trade	19.2	20.8	4.8	0.1	1.1

Source: OECD Economic Outlook 92 database.

StatLink http://dx.doi.org/10.1787/888932745401

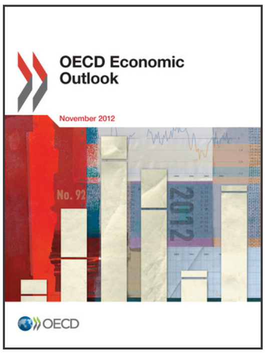
Budget incorporates a new fiscal rule that limits the use of oil revenues to that calculated at the reference price of $91 per barrel. While the rule will provide some stabilisation against the fluctuation in oil revenues and reduce the risk that spending will fuel overheating, a non-oil deficit rule would be a better anchor for a sound medium-term fiscal position and intergenerational equity. In line with the draft Budget, it is projected that partial implementation of electoral promises will not lead to an additional pro-cyclical fiscal stimulus. Increasing the retirement age and phasing out early retirement options would help to secure long-term sustainability of public finances, and a decision about such reform is long awaited.

Growth will accelerate

Growth is projected to accelerate in 2013 and 2014 as the headwinds from the euro area crisis ease. As domestic demand outpaces output, the current account surplus will diminish slowly. Inflation will fall gradually towards the central bank's policy objective of 4-5% in 2014. Improvements in corporate governance and the business environment are essential to increase potential growth both within and outside the extraction sectors.

The oil price is the main risk factor

The further intensification of the euro area crisis, substantial weakening of the world economy and rising petroleum supply (from US shale, for example) could lead to downward pressure on oil and gas prices. This would hurt exports and budget revenues, as well as investment in new extraction projects. The impact would spill over into other sectors of the economy through reduced incomes. A sudden deterioration in financial market sentiment and global flight to quality could lead to much larger capital outflows, tightening financial conditions in Russia. On the other hand, it is uncertain how electoral spending promises that amounted to a cumulative 6% of GDP by 2018 will be actually implemented, but they might contribute to overheating.



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