RUSSIAN FEDERATION

Aided by the large rise in oil prices since early 2009, the economic recovery is gaining momentum. Although some components of domestic demand have yet to rebound, they are projected to do so in the course of 2010 and into 2011. Inflation has declined strongly in the last year, but is likely to move back up slightly before stabilising. The current account surplus will widen in 2010 on account of strong export prices, but will narrow again in 2011 as the recovery in private domestic demand gathers strength and as the real appreciation of the rouble over the past year boosts import growth.

The unexpectedly strong recovery should be used to eliminate the fiscal deficit more quickly than previously planned. Windfall revenues should be saved and fiscal measures to support demand phased out more quickly. As the effects of the crisis fade, longer-term policy priorities should be brought to the fore.

Growth is accelerating

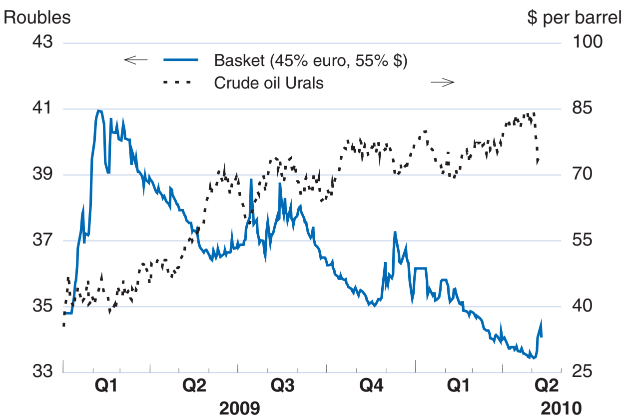
Most indicators point to growing strength through 2009, from a decline of about 6½ per cent in the first quarter to growth of about 2% in the fourth quarter. About a third of the 11% peak-to-trough decline in output was recovered in the second half of 2009, and most indicators point to continued robust growth in the first half of 2010. The initial impetus for the recovery was the rebound in global trade. Public consumption also made increasing contributions to output growth during 2009, and the fall in inventories slowed. The recovery has yet to spread to private consumption and gross fixed capital formation, however. Employment was surprisingly stable during the recession, but in February 2010 was still down slightly compared to a year earlier.

Inflation is bottoming out at near record lows

Inflation has moved down steadily on a year-on-year basis from early 2009, and at around 6% is near its lowest level of the 19-year transition period. One factor aiding disinflation has been the exchange rate; the rouble has appreciated in nominal terms by about 16% against

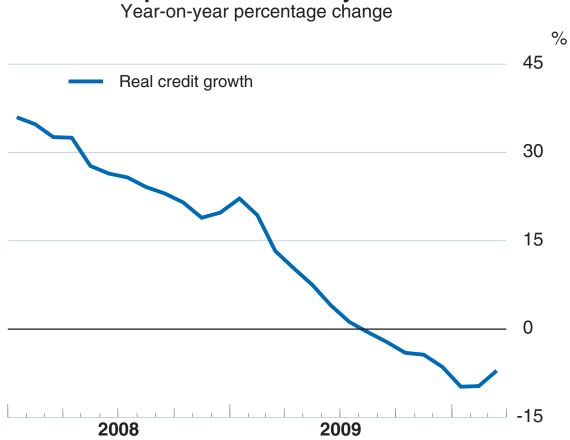
Russian Federation

Oil prices have underpinned rouble strength



Credit to the private sector has yet to rebound

Year-on-year percentage change



Source: Central Bank of Russia, Russian Federal Service for State Statistics and Datastream.

StatLink http://dx.doi.org/10.1787/888932305000

Russian Federation: **Macroeconomic indicators**

	2007	2008	2009	2010	2011
Real GDP growth	8.1	5.6	-7.9	5.5	5.1
Inflation (CPI), period average	9.0	14.1	11.7	6.5	7.1
Fiscal balance (per cent of GDP)[1]	6.0	4.8	-6.2	-5.1	-2.2
Current account balance (per cent of GDP)	5.9	6.0	3.8	7.0	5.3

1. Consolidated budget.
Source: OECD Economic Outlook 87 database.

StatLink http://dx.doi.org/10.1787/888932307147

the US dollar/euro basket since February 2009, with the rise in commodity prices underpinning sentiment. This appreciation has also largely offset the direct inflationary effect of rising oil prices. Interest rates have come down broadly in line with the moderation of inflation, with bank lending rates tracking changes in the central bank's repo rate since April 2009.

Several factors point to further strengthening of domestic demand

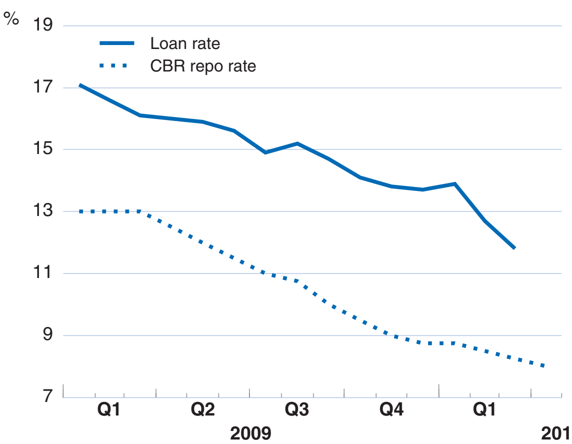
Growth momentum is building up, especially via the domestic demand effects of higher oil prices and rising private capital inflows. Real wages are also now increasing, and restocking is likely. Output growth in the first half of 2010 should therefore be strong. Year-on-year credit growth has continued to slow from the very high rates seen before the crisis, becoming sharply negative. However, interest rates have been falling for a year, confidence is returning and banks have been strengthening their balance sheets, setting the stage for a recovery in lending in the near term.

Policies should be geared to the cyclical upswing and the longer term

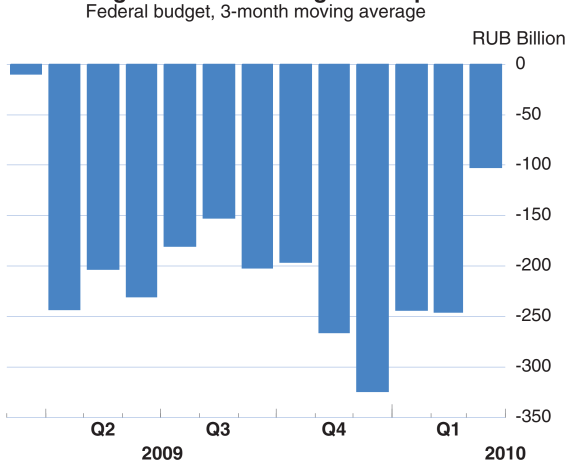
The fiscal deficit is shrinking sharply on account of stronger commodity prices and corporate profits, and some structural consolidation is budgeted in 2010 and 2011. This withdrawal of stimulus

Russian Federation

Loan rates have declined with the CBR's policy rates



The budget balance has begun to improve
Federal budget, 3-month moving average



Source: Central Bank of Russia, Federal Service for State Statistics and Economic Expert Group.

StatLink http://dx.doi.org/10.1787/888932305019

Russian Federation: **External indicators**

	2007	2008	2009	2010	2011
			$ billion		
Goods and services exports	393.4	523.0	344.1	464	488
Goods and services imports	281.5	368.6	251.9	315	360
Foreign balance	111.8	154.3	92.1	149	129
Invisibles, net	- 34.8	- 51.9	- 43.2	- 43	- 37
Current account balance	77.0	102.4	49.0	106	92
			Percentage changes		
Goods and services export volumes	6.3	0.5	- 4.7	13.2	4.3
Goods and services import volumes	26.5	15.0	- 30.4	25.3	13.8
Terms of trade	3.5	16.0	- 29.8	19.7	0.7

Source: OECD Economic Outlook 87 database.

StatLink http://dx.doi.org/10.1787/888932307166

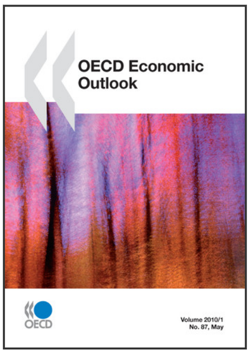
looks well-timed given that private demand seems likely to recover more strongly than previously expected. If oil prices and/or private capital inflows continue to strengthen, windfall revenues should be saved and extra consolidation efforts may be warranted to mitigate the risks of a new boom-and-bust cycle. In particular, demand-boosting measures designed in the context of the crisis, such as the incentives for new car purchases, could be withdrawn sooner than otherwise. Strong fiscal consolidation in the upswing would also help take the pressure off monetary policy, which is likely to be faced with a sharper tradeoff between managing capital inflows and bringing down inflation as a number of favourable factors for inflation fade. The government should also take advantage of strong sentiment to reinvigorate privatisation, including some divestment of public stakes in the largest banks, which have seen their dominance enhanced during the crisis. With the effects of the crisis fading, increasing attention should be paid to long-term policy challenges, such as strengthening competition and innovation.

Inflation will stabilise as the output gap narrows

Growth in the first half of 2010 is expected to have continued to benefit from rebound effects, but growth is thereafter projected to slow gradually as output converges on potential. The output gap should close towards the end of 2011. Annual average inflation will be lower in 2010 than 2009, although the year-on-year rate is projected to rise through the year to exceed 7% by December. Inflation is expected to be little changed in 2011. The pick-up in domestic demand, coming at the same time as the recovery in global trade volumes and combined with the strong real appreciation of the rouble over the past year, will push import volumes up strongly. Export volume growth will be more restrained, in part because oil exports, which account for about half of the total, cannot be greatly increased in the short run. The current account surplus will increase in 2010, boosted by the stronger terms of trade, and then fall back in 2011.

The emergence of a new boom-and-bust cycle is a risk

The main risk has shifted from a relapse into recession to a renewed boom driven by improving terms of trade and strong private capital inflows, along the lines of the immediate pre-crisis years. If oil prices and capital inflows continue to increase, avoiding excesses will be the main policy challenge. On the downside, a sharp fall of oil prices, such as might arise from renewed weakness among OECD economics, would, as ever, have large negative effects on growth and fiscal outcomes. Also, some risks remain in the banking sector, which is still absorbing the surge of non-performing loans engendered by the crisis. The likelihood is, however, that any emerging problems will be relatively isolated and will not hold back the recovery significantly.



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