



WORLD BANK

Russian Economic Report No. 24

Sustaining Reforms Under the Oil Windfall

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OUTLINE

- I. Recent Economic Developments and Policies
- II. Russia's Outlook for 2011-2012
- III. Policy Challenges



Global Environment

Global risks increased

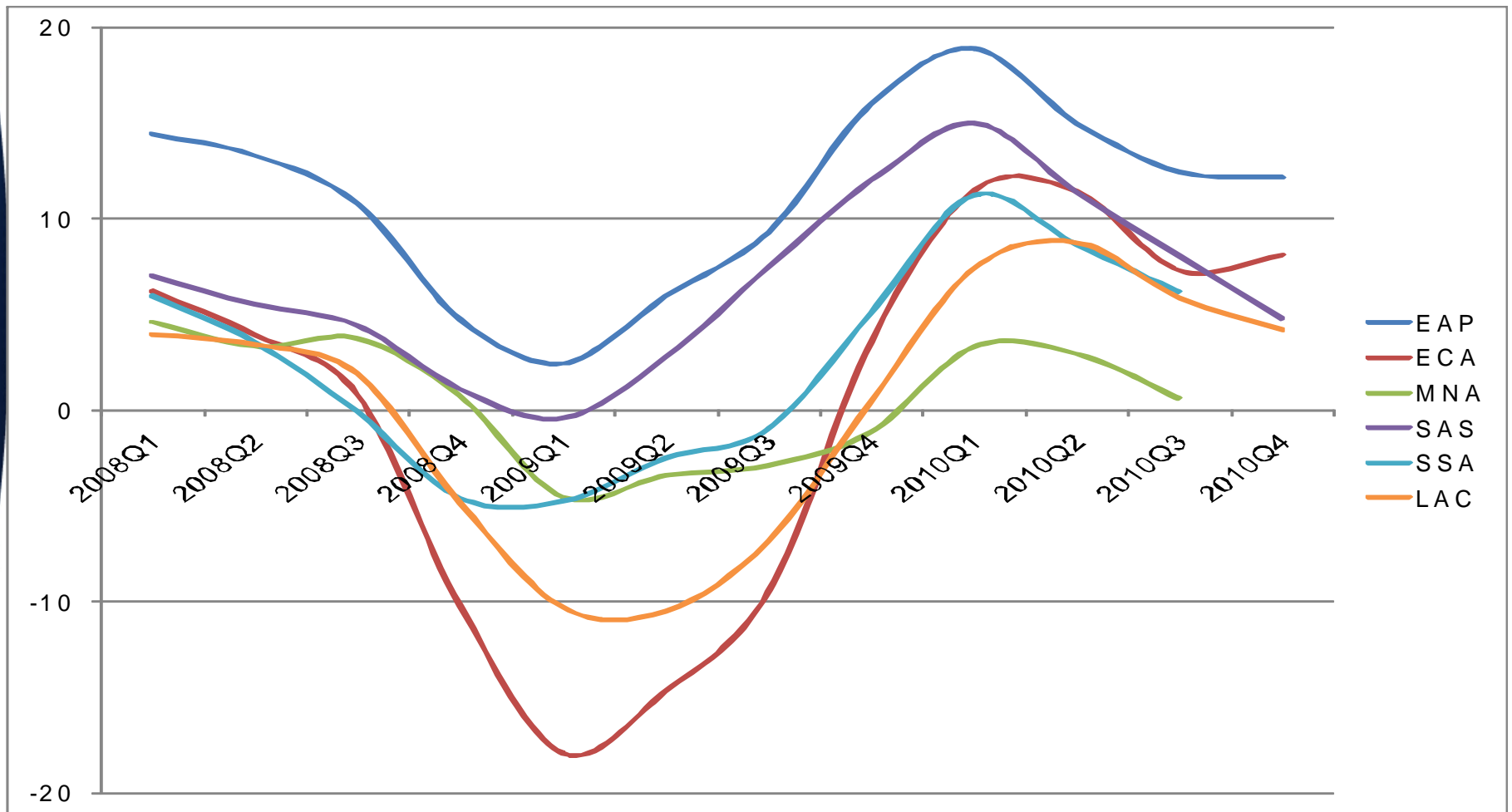
- Slowdown after the 2010 bounceback*
- The new oil shock—oil above \$100 pb*
- Aftereffects of the earthquake in Japan*



But the underlying growth of the global economy remains solid.

Despite some deceleration, growth in developing countries remains robust

Global Industrial production



Source: Global prospects, World Bank.

Instability in the Middle East may be affecting capital flows and risk perceptions

Capital flows to developing countries

\$ billion

	2009				2010					2011
	Jan	H1	H2	Total	Jan	H1	H2	Dec	Total	Jan
Total	24	110	243	353	38	197	316	42	512	41
Bonds	9	36	80	115	22	86	98	4	184	29
Banks	9	43	86	129	9	54	87	15	141	2
Equity	6	32	77	109	7	57	131	23	188	10
Lat. America	10	37	100	137	9	66	98	10	164	17
Bonds	5	15	47	62	8	37	45	3	82	14
E. Europe*	4	22	50	72	13	53	70	4	123	10
Bonds	2	13	20	33	7	31	33	1	64	9
Asia	9	44	78	122	13	64	133	27	197	11
Bonds	2	6	10	16	7	13	15	1	28	4
Others	1	7	15	22	2	14	15	1	28	3

* Including Poland & Croatia

Source: DECPG

source: Global prospects, world Bank.



RUSSIA'S RECENT ECONOMIC DEVELOPMENTS AND MACRO POLICIES IN 2010

- *Economic growth (4%)--driven by inventory restocking and exports*
- *Labor markets and poverty—gradually improving*
- *Balance of payments—stronger because of high oil prices*
- *Monetary policy— inflation concerns*
- *Fiscal policy—return of the “oil curse?”*



Russia's economy grew 4.0 percent in 2010, driven largely by a sharp rebound in investment demand and growth in tradable industries

GDP growth by main sectors (value added): 2006–2010

	2007	2008	2009	2010
GDP growth	8.5	5.2	-7.8	4.0
Tradable sector	3.5	-0.1	-8.6	6.5
Agriculture, forestry	1.3	6.4	1.4	-12.1
Extraction industries	-2.2	1.0	-0.3	4.8
Manufacturing	7.5	-2.1	-15.6	13.4
Nontradable sector	12.8	9.1	-7.0	2.9
Electricity, gas, and water production and distribution	-3.4	0.7	-3.0	5.9
Construction	13.0	11.1	-14.6	-0.9
Wholesale and retail trade	11.7	9.9	-6.5	4.5
Transport and communication	4.8	5.2	-8.4	7.0
Financial services	29.1	13.5	2.2	-3.0

Source: World Bank staff calculations based on Rosstat data.



Labor markets – gradually improving with limited effect of seasonal unemployment

Labor productivity, disposable income, wages, and unemployment

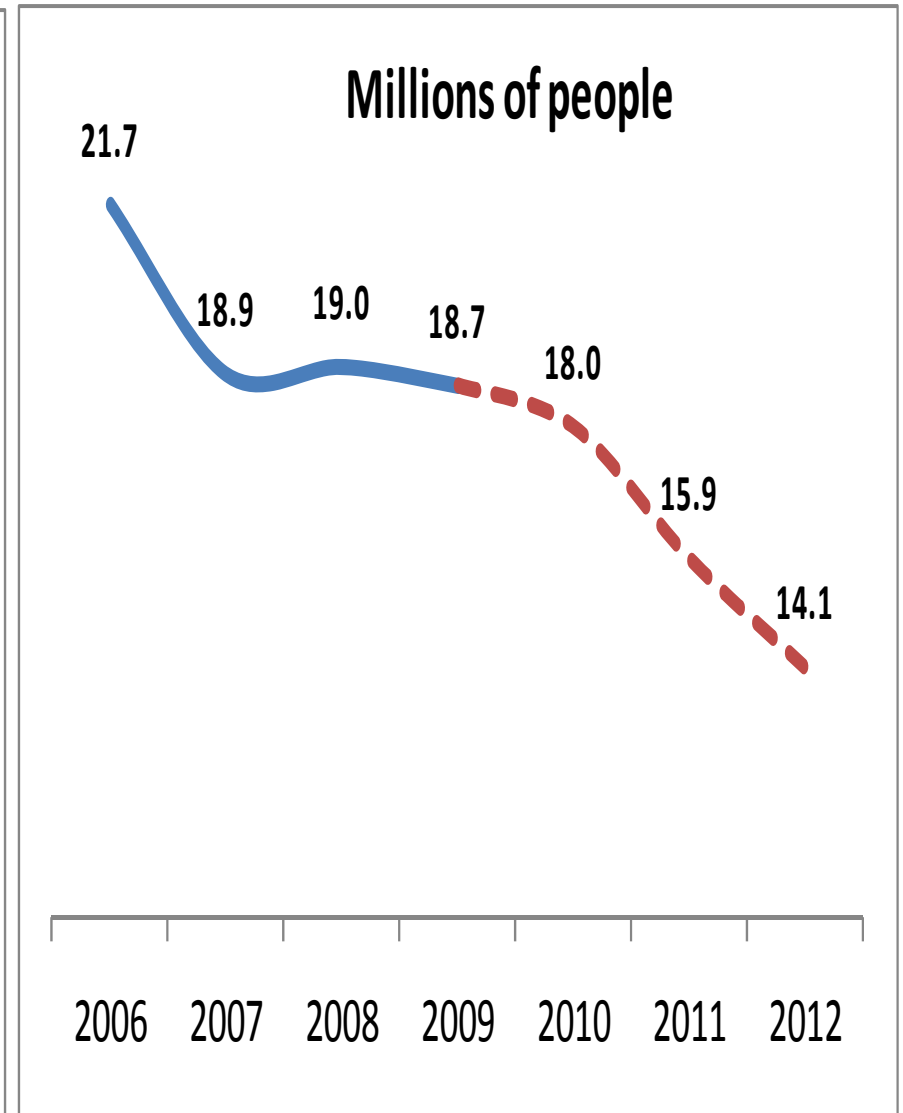
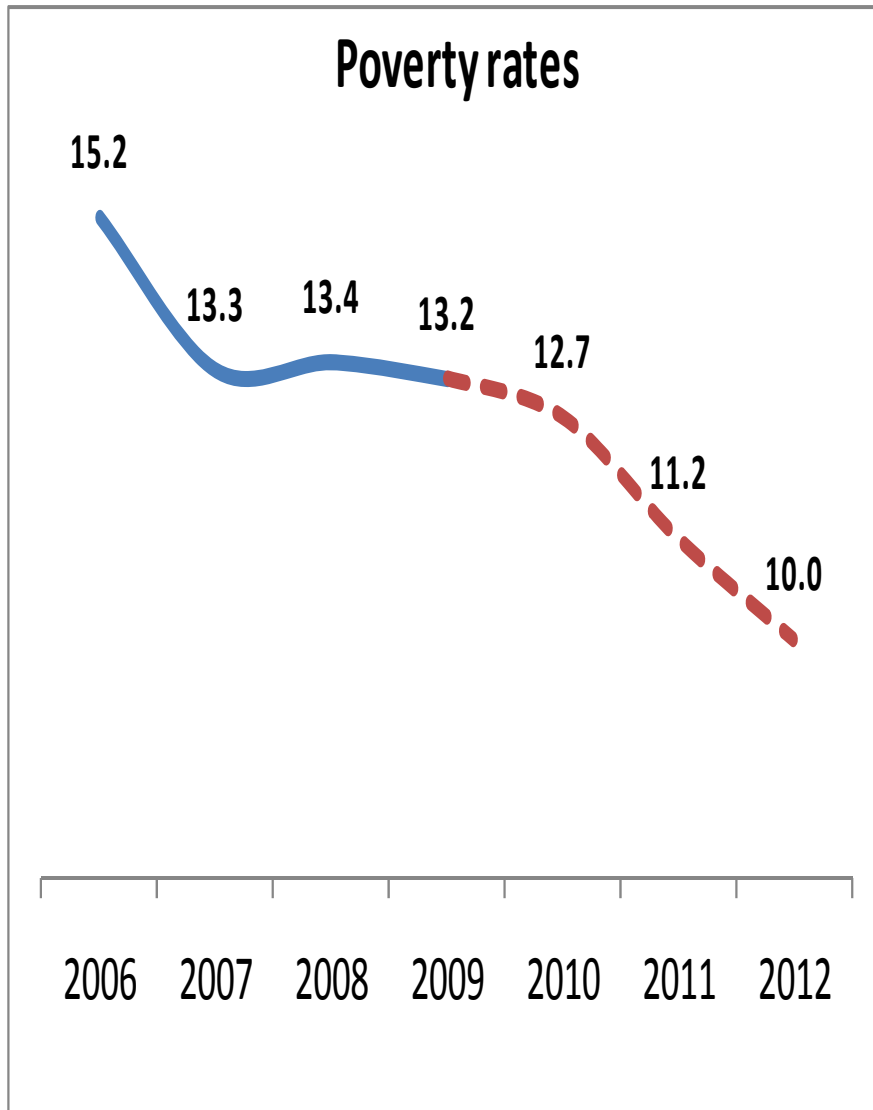
	2007	2008	2009	2010
	Jan– Dec	Jan– Dec	Jan– Dec	Jan–Dec
GDP growth (% , y-o-y)	8.5	5.2	–7.8	4.0
Total employment (million people)	70.5	70.9	69.4	69.6
Employment growth (% , y-o-y)	2.4	0.5	–2.1	0.3
Labor productivity growth (% , y-o-y)	6.0	4.7	–5.9	3.7
Real disposable income growth (% , y-o-y)	12.1	1.9	1.9	4.1
Real wage growth (% , y-o-y)	17.2	11.5	–2.8	4.2
Average monthly wage (US\$)	533.2	692.1	593.0	697.8
Unemployment ^b (% , end of period)	6.1	7.8	8.2	7.2

Source: Rosstat.

^a Data for the first half of 2010.



Russia's poverty rates have been broadly flat in 2009 and continued to fall in 2010



Balance of payments—stronger because of high oil prices

Balance of payments (USD billions), 2007–2010

	2007	2008	2009	2010 ^a	Q3- 2010 ^a	Q4- 2010 ^a
Current account balance	77.0	103.7	49.4	72.6	6.1	14.3
<i>Trade balance</i>	130.9	155.4	111.6	149.2	29.1	34.3
Capital and financial account	84.8	-131.3	-44.3	-30.5	-6.0	-21.4
<i>Errors and omissions</i>	-12.9	-11.3	-1.7	-5.4	2.7	-1.5
Change in reserves (+ = increase)	148.9	-38.9	3.4	36.8	2.8	-8.6

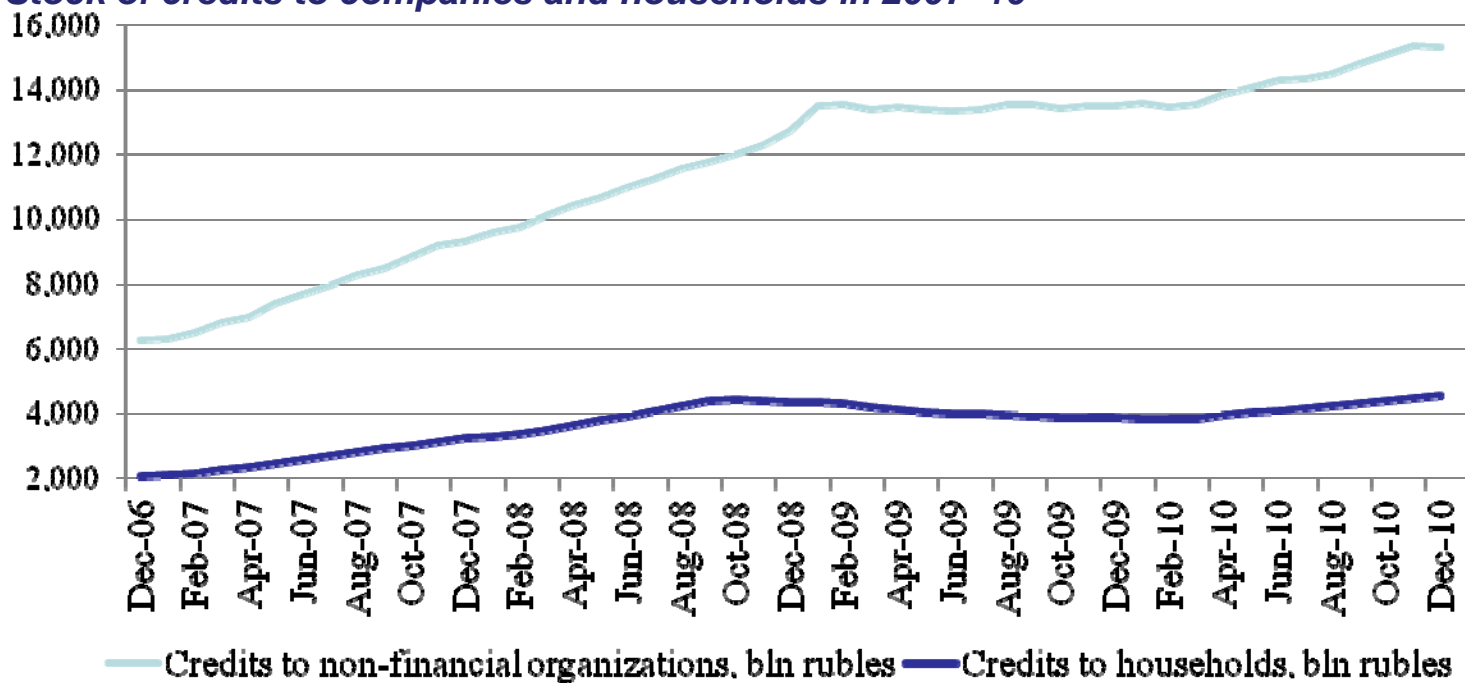
Source: CBR. ^a Preliminary estimates.



Monetary and exchange rate policy

- Inflation concerns result in CBR tightening monetary conditions
- The exchange rate management complicated by a possible return of speculative capital inflows with high oil prices
- gradual credit recovery under way
- CBR has further widened the exchange rate corridor

Stock of credits to companies and households in 2007–10

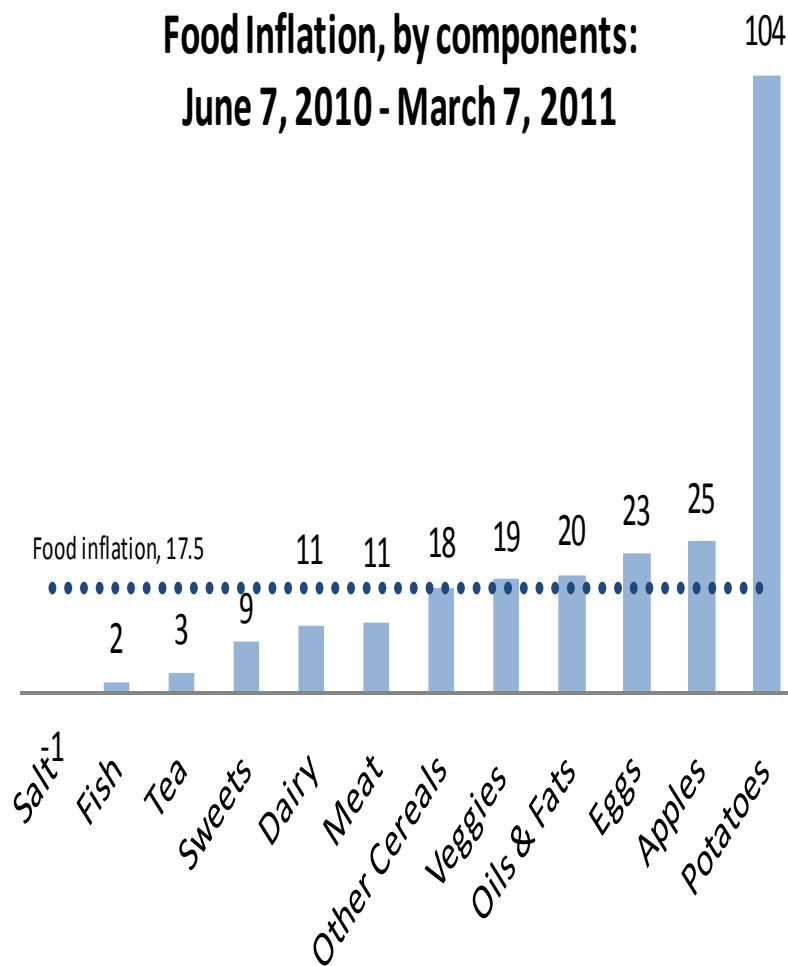


Source: CBR; World Bank staff estimates.

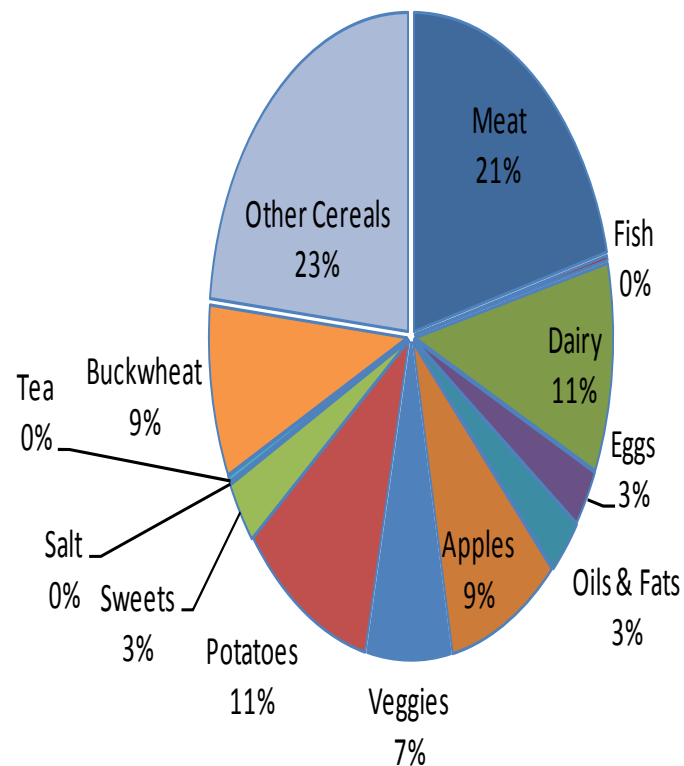
Increases in food prices contributed to inflation in June 2010-Feb 2011 period



**Food Inflation, by components:
June 7, 2010 - March 7, 2011**



Contribution of each food component to 2.3 percentage points hypothetical increase in poverty



Fiscal policy—return of the “oil curse?”

Medium term fiscal framework (in percent of GDP)


	2011*	2012*	2013*
Revenues (Consolidated)	34,8	34,0	33,2
<i>Of which Federal budget</i>	17,6	17,0	16,8
Expenditures (Consolidated)	38,9	37,6	36,3
<i>Of which Federal budget</i>	21,1	20,1	19,7
Federal budget Non-oil deficit	-11,6	-10,5	-9,8
Federal budget balance	-3,5	-3,1	-2,9
Consolidated budget balance	-4,2	-3,6	-3,1

*Draft Budget 2011 – 2013.

Source: World Bank staff estimates based on draft budget documents, the Ministry of Finance.



Strengthening Aggregate fiscal discipline

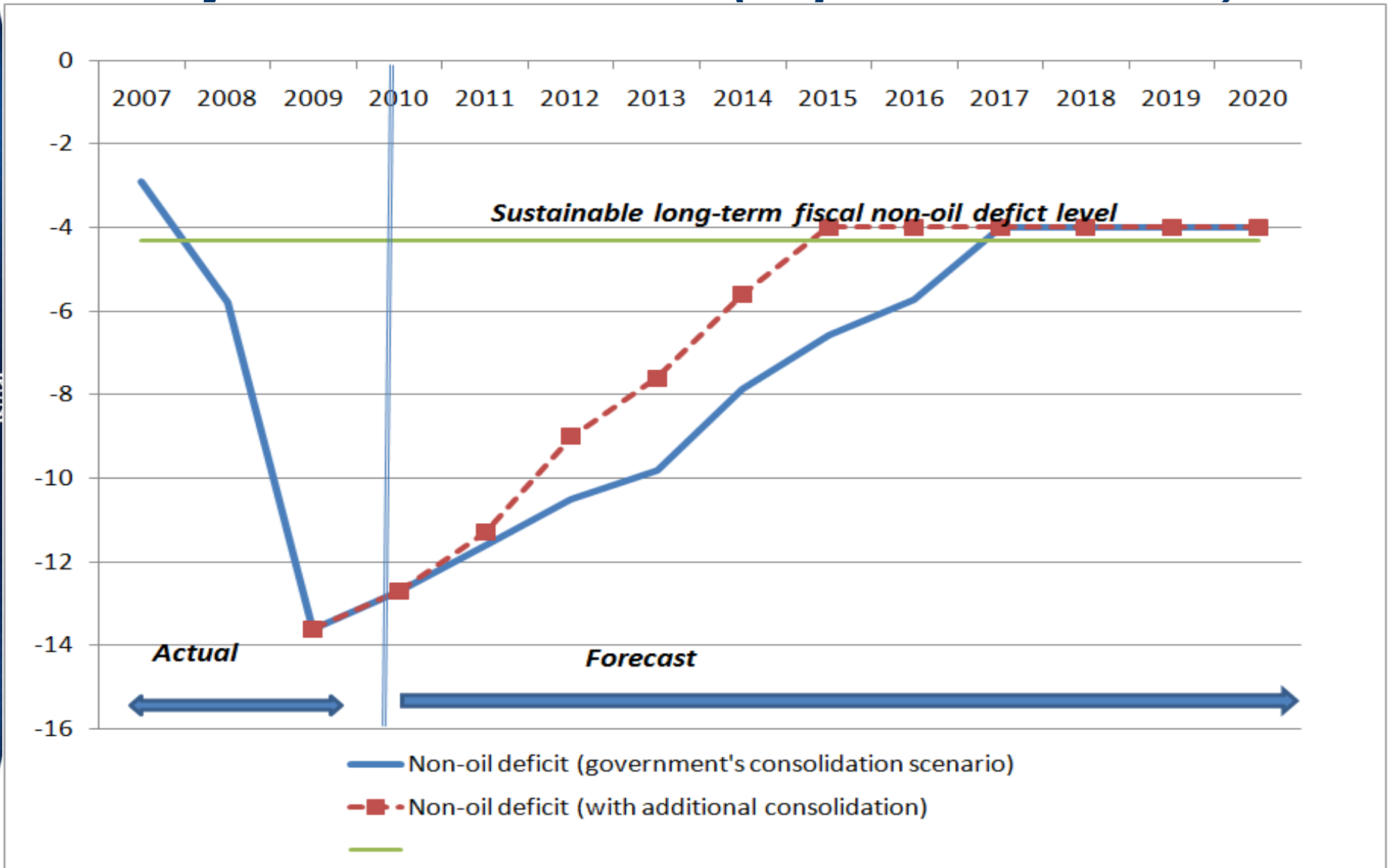
- *The government expects in the medium term to gradually reduce the fiscal deficit from budgeted 4.1 percent of GDP in 2010 to 2.9 percent in 2013*
- *This is a reasonable plan, but the budget remains vulnerable to new expenditure pressures. And non-oil fiscal deficit will decline only gradually*
-  *A more ambitious fiscal adjustment might be needed to strengthen Russia's budget's capacity to deal with new shocks--reduce non-oil fiscal deficit faster to the long-term sustainable level*
- *Both revenue and expenditure measures will be needed*

Measures to implement a more ambitious fiscal adjustment


- **Further broadening the non-oil tax base** (e.g., increasing excises on tobacco, alcohol, vehicle licenses; revisiting VAT exemptions and some mineral extraction tax preferences).
- **Strengthening results monitoring systems to monitor target indicators of public programs.**
- **Continue strengthening public expenditure management and controls**
- **Reducing non-priority and unproductive expenditures e.g., crisis-related subsidies supporting select sectors of the economy.**
- **Increasing the targeting of social assistance programs.**
- **Taking steps to ensure the long-term sustainability of the pension system**
- **Supporting structural reforms in the education and health sectors.**
- **Implementing systematic annual public expenditure reviews to improve effectiveness of public expenditures**



Russia's non-oil fiscal deficit under alternative adjustment scenarios (in percent of GDP)



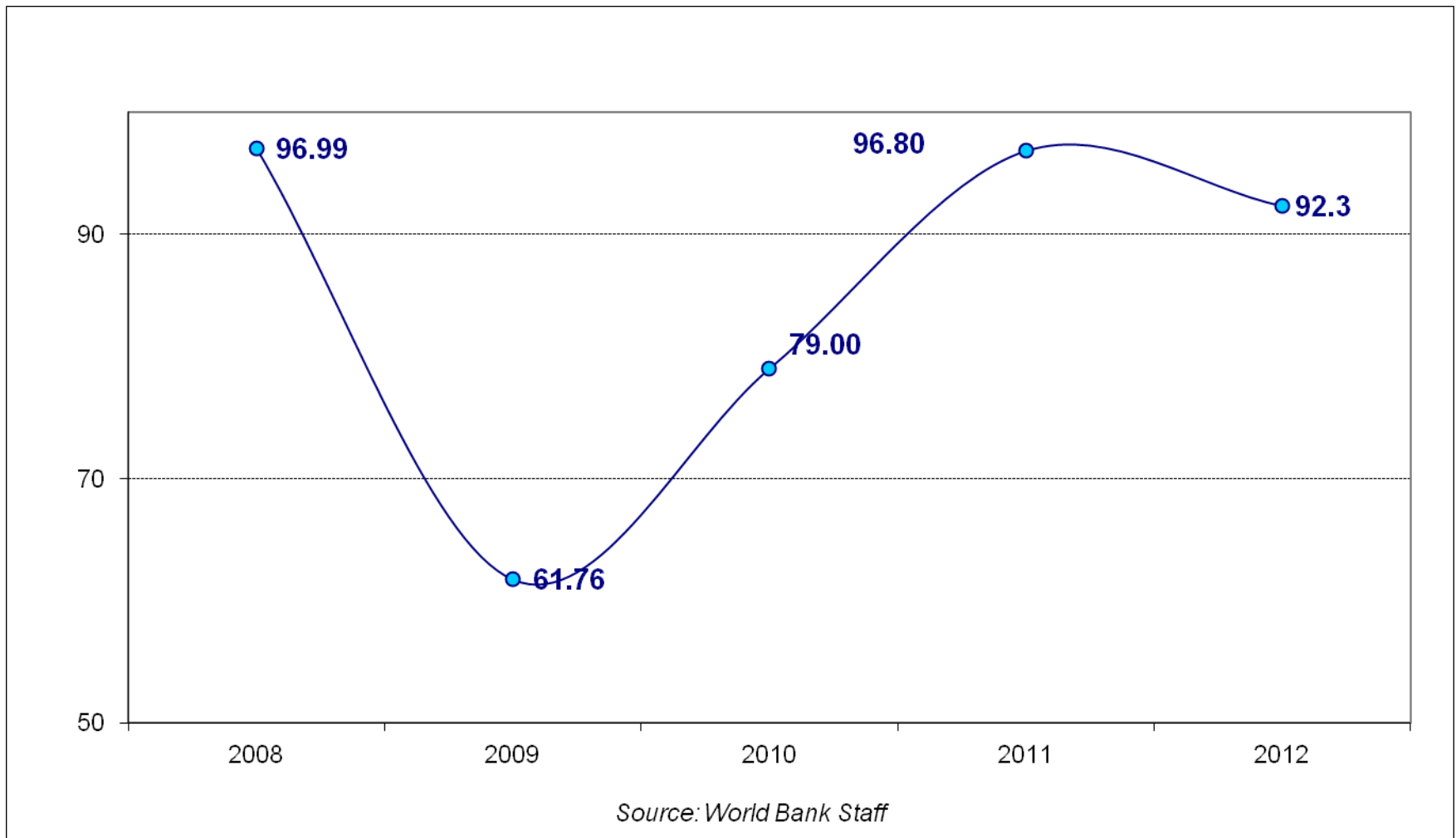
Global Environment for Russia, 2011-2012 (real GDP growth, %)

	2009 <i>(actual)</i>	2010 <i>(actual)</i>	2011	2012
World	-2.2	3.9	3.1	3.4
 High-income countries	-3.4	2.8	2.4	2.7
Developing countries	2.0	7.0	6.0	6.1
Russian Federation	-7.9	4.0	4.4	4.0

Source: Global Prospects for world growth; Russian Economic Report for Russia, The World Bank.

The beginning of 2011 brought about a new global oil supply shock

World Bank oil price forecast. Average crude (Brent, Dubai and WTI), simple average, \$/bbl



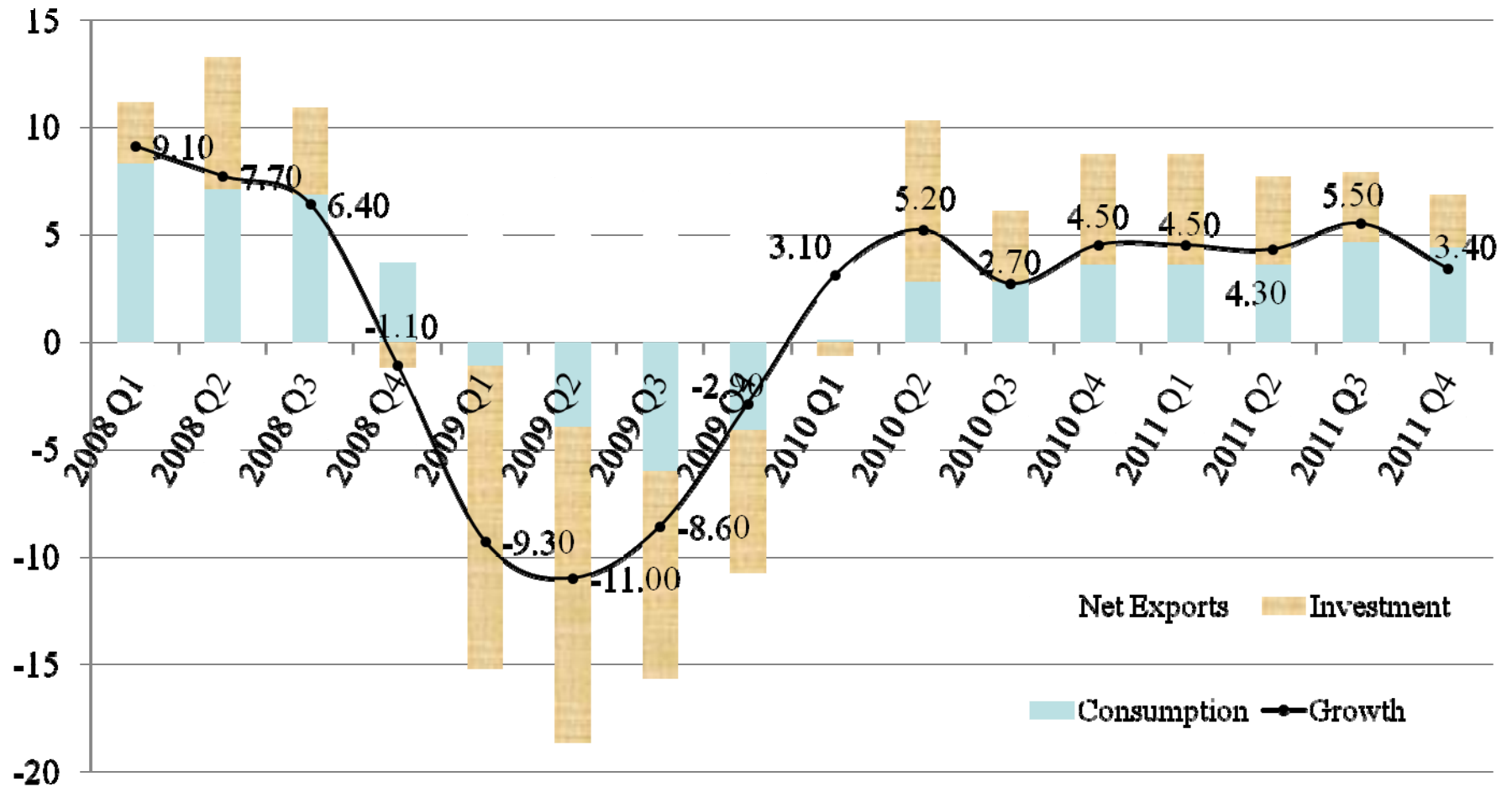
Outlook for Russia: 2010 - 2012

	2011	2012
GDP growth (%)	4.4	4.0
Consolidated government balance (% of GDP)	-0.9	-0.8
Current account (US\$ billions)	67	28
Capital account (US\$ billions)	13	19

Source: *Russian Economic Report, The World Bank.*

Demand Sources of Russia's Growth

Demand sources of Russia's real growth, by quarter, 2008–10
(percent change year to year)



Source: Rosstat; World Bank staff estimates.

In Sum ...

Solid growth, the new oil windfall:

- Solid growth (4% in 2010), accelerating to 4.4% in 2011
- Lower than expected unemployment (7.6%) and poverty (12.7%)
- Higher export and fiscal revenues

Policy initiatives:



- Progress on WTO
- Privatization
- Effectiveness of public expenditures

Concerns:

- Fiscal policy risk rising—potentially escalating expenditures during political cycle
- Delays in structural reforms

Policy challenges

Reducing inflation

Implementing medium-term fiscal adjustment towards sustainable non-oil fiscal deficit (4.3% of GDP).



Improving the efficiency of public expenditure to create fiscal space for productive infrastructure

Strengthening the investment climate for the private sector remain among key long-term challenges.

Strengthening skills and institutions

Thank you!

