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The World Bank in Russia

Russian Economic Report*

Reinvigorating the Economy

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Executive Summary

Early in the year, as the global economy was slowing and the euro area entered a recession, Russia's economy held steady. But now, as 2012 is entering its final quarter, growth is slowing. Just at a time when Russia's output levels have exceeded the pre-crisis peak, the economy is settling onto a lower trajectory, even though oil prices have stayed high.

But let us start with the strong points. The economy had a good first half of the year. While growth was stalling in Europe and slowing in other emerging economies, it remained steady in Russia. Key economic indicators were near or at record levels: the current account surplus stayed high and the Central Bank of Russia added to its reserves, helping to bolster market confidence. Capital outflows, long regarded as one of the soft spots of Russia's economy, declined in the second and third quarters of 2012 from the peaks in the previous two quarters. Whereas many countries in Europe are struggling with large public debt and high fiscal deficits, Russia's federal government public debt is close to single digit and the fiscal balance is in surplus. Inflation and unemployment rates declined to their lowest level in two decades. As people's purchasing power improved and more people had jobs, fewer people were in poverty than at any time since the beginning of the economic transition.

While these achievements of the twin-surplus economy are impressive, the recent economic news has been less encouraging. Whereas early in the year, growth was rising and inflation declining, now growth is declining and inflation rising. Domestic demand, the main driver of growth in Russia, is weakening, as consumers face higher inflation due to higher food prices, delayed administrative price increases and rising core inflation. In addition, companies are no longer restocking and not yet stepping up investment, while farmers struggle with a poor grain harvest. In spite of the recent efforts to strengthen the European financial firewall and the quantitative easing on both sides of the Atlantic, volatility in global financial markets remains elevated. With global trade and industrial production being sluggish, external demand is unlikely to provide relief from the ongoing economic slowdown. In the meantime, the share of non-energy exports declined further.

A challenging external environment and worsening sentiments among businesses and consumers translate into weak growth prospects. Excluding the crisis years of 1998 and 2009, growth in 2012 is set to decline to its lowest rate in a decade and a half (Table 1). And 2013 is unlikely to look much better. This is sobering, especially since oil prices are near record levels and higher than in 2011. Even such growth is at risk in case the euro area and the global economy fail to improve, or oil prices recede from their recent highs. With businesses struggling to fill vacancies, capacity utilization approaching pre-crisis peaks and oil prices projected to stay flat, new growth momentum will be difficult to come by. In addition, an aging and shrinking workforce and declining oil production could dampen growth over the next decades.

The weak outlook means that strong, three-pronged policy action is essential to reinvigorate the economy. First, economic policies have to ensure stability. The recent tightening in monetary policy was an important step in this direction. Second, Russia has to build buffers against the external volatility. This means replenishing the reserve fund, moving towards inflation targeting and strengthening banking supervision. Finally, the government has to lift the growth potential of the economy. This means raising productivity and competitiveness, diversifying the economy, and improving transport connectivity, as discussed in the last section of this report, in line with its longer-term economic policy goals. Making headway on this agenda will enable Russia to lift growth above 4 percent and more.

Table 1: Russia's Economic Outlook

	2011	2012 proj.	2013 proj.
GDP growth (%)	4.3	3.5	3.6
Consolidated government balance (% of GDP)	1.6	0	-0.1
Current account (% of GDP)	5.5	4.1	2.8
Capital account (% of GDP)	-4.1	-3.1	-1.7
Oil price assumption (WB Average, US$ per barrel)	104	105.7	105.8

Source: World Bank staff projections.

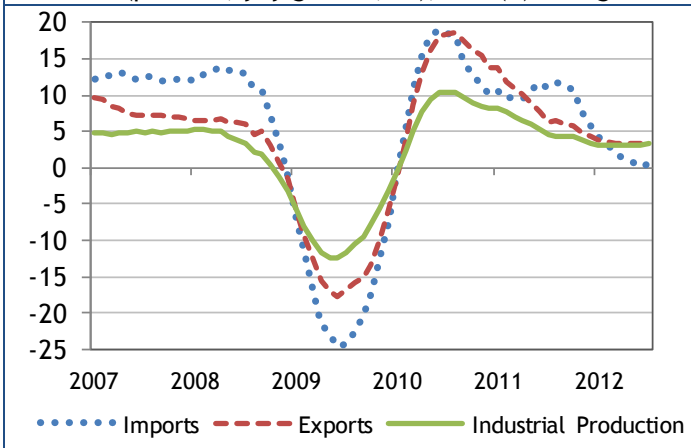
I. Recent Economic Developments

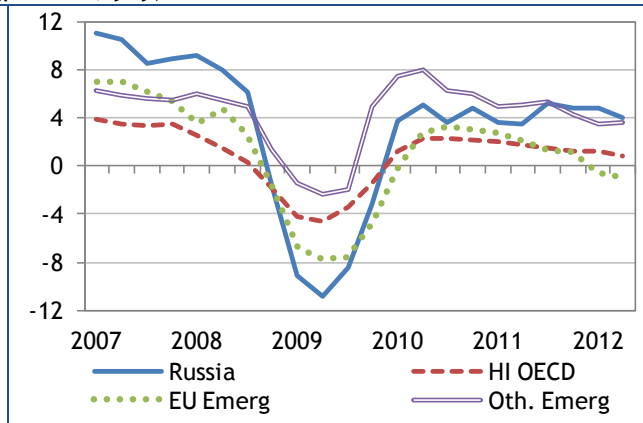
Growth — weakening after a strong first half of the year

In spite of external headwinds, Russia's economy performed well in the first half of 2012. However, the economy is slowing down in the second half of 2012 due to rising inflation, weakening domestic demand, negative base effects and sluggish external demand.

Against the backdrop of a difficult external environment, Russia's economy displays strengths. In the first half of 2012, faltering confidence in the global recovery and recurrent stress in the euro area translated into a slowdown of world trade and industrial production (Figure 1). Economic activity contracted in emerging EU countries and moderated in high-income OECD countries and other emerging economies.[†] In Russia, growth remained strong, lifting output above pre-crisis levels. As a result, in the last three quarters, year-on-year growth in Russia exceeded those of other emerging economies for the first time since the global financial crisis.

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



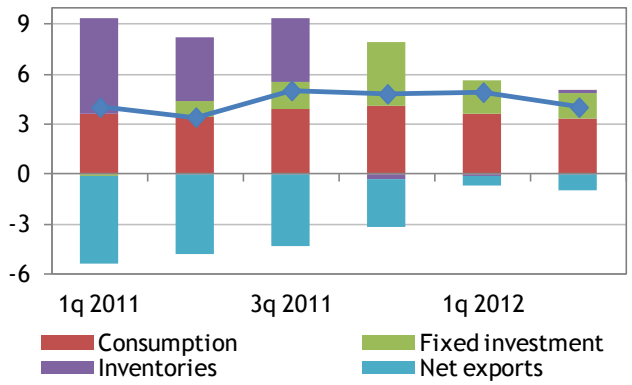


Source: OECD, IMF, World Bank staff calculations.

Strong domestic demand was the main driver of growth in the first half of 2012. Output expanded 4.9 percent in the first quarter supported by high oil prices and robust domestic demand. Growth moderated to 4.0 percent in the second quarter due to lower international oil prices and weaker export demand. Overall, the economy expanded 4.5 percent in the first half of 2012, only moderately less than the 4.8 percent in the second half of 2011. The resilience of growth reflects strong domestic demand, supported by falling unemployment, fast growth of wages and credit, and fiscal expansion. Consumption remained the most important growth driver in the first half of 2012. The decline in the positive contribution of investment and consumption since the fourth quarter of 2011 was balanced by a reduction in the negative contribution of net exports.

[†] 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 seven countries: Brazil, China, India, Indonesia, Mexico, South Africa and Turkey.

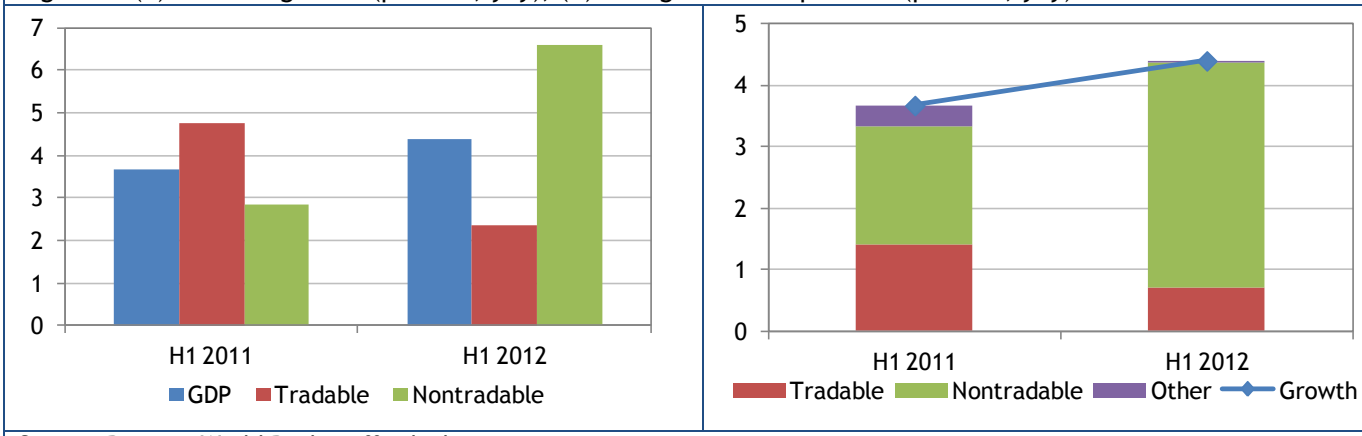
Figure 2: Year-on-year growth composition (percent)



Source: Rosstat, World Bank staff calculations

The non-tradable sector became the engine of growth, mirroring the pre-crisis pattern. In 2010 and 2011, the recovery from the global financial crisis was driven by tradable sectors, and in particular manufacturing. This reflected the sharp rebound in global industrial production and trade as well as the rise in oil prices. This pattern changed in the first half of 2012, as the slowdown in global demand dampened demand for Russian exports. In the first half of the year, growth in the tradable sectors declined to 2.4 percent compared to 4.8 percent in 2011, whereas growth in the non-tradable sectors increased over the same period to 6.6 percent from 2.8 percent (Figure 3.a). As a result, the contribution of the non-tradable sector to growth increased from 1.9 percentage points in first half of 2011 to 3.6 percentage points in the first half of 2012 (Figure 3.b). Over the same period, the contribution of the tradable sector halved from 1.4 percentage points to 0.7 percentage points. This implies that the non-tradable sector accounted for around 80 percent of GDP growth in the first half of 2012, similar to 2007.

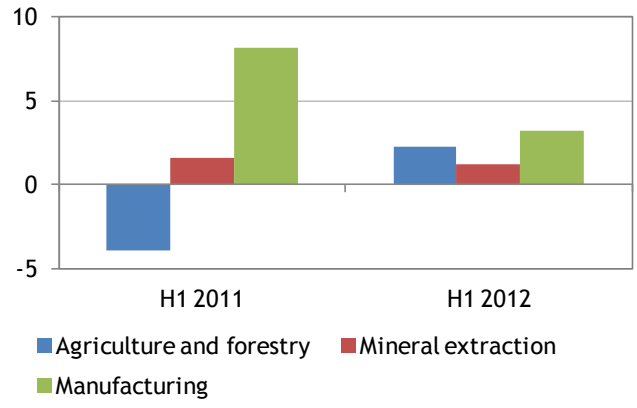
Figure 3: (a) Sectoral growth (percent, yoy); (b) GDP growth composition (percent, yoy)

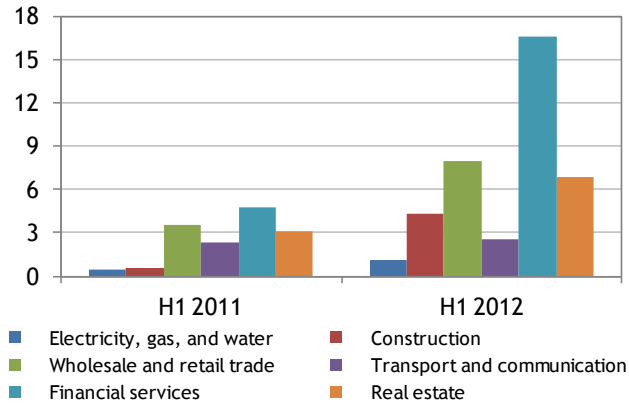


Source: Rosstat, World Bank staff calculations.

Growth moderated in manufacturing and mining, while it accelerated in most non-tradable subsectors. Agriculture output growth increased from -3.9 percent in the first half of 2011 to 2.2 percent in the first half of 2012 (Figure 4.a). Over the same period, growth decelerated in manufacturing from 8.2 percent to 3.2 percent, and in mineral extraction from 1.6 percent to 1.2 percent. The pick-up of the non-tradable subsectors was driven by financial services, as value added growth accelerated from 4.7 in the first half of 2011 to 16.7 percent in the first half of 2012 (Figure 4.b). Growth also increased noticeably in wholesale and retail trade, construction and real estate.

Figure 4: (a) Tradable sector growth (percent, yoy); and (b) Non-tradable sector growth (percent, yoy)

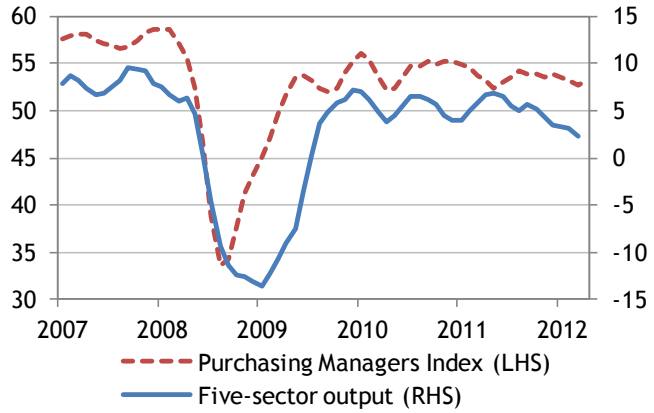


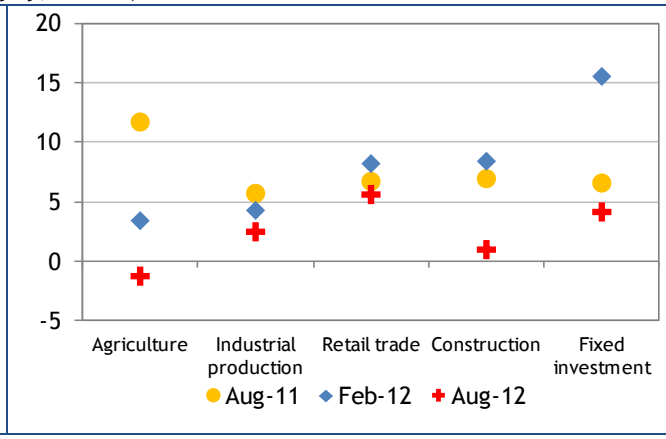


Source: Rosstat, World Bank staff calculations.

However, the momentum of the economy weakened in recent months, suggesting a growth moderation in the second half of 2012. The slowdown reflects five factors. First, the economy lost already momentum in the first half of 2012. Seasonally adjusted quarter-on-quarter growth rates show a decline from 1.6 percent in the last quarter of 2011 to 0.6 percent in the first quarter of 2012 and to 0.1 percent in the second quarter of 2012. Second, growth is declining due to the base effect, since growth increased from the first half to the second half of 2011. Third, weak global demand restrains the performance of the tradable sector (Box 1). Fourth, the rise in inflation lowers the purchasing power of consumers and dampens the expansion in the real sector. Finally, capacity utilization is approaching pre-crisis peak, so growth in future requires higher investment. In August 2012, the Purchasing Managers Index dipped to its lowest level in over a year, and the growth rate of the basic output indicators declined to its lowest level since the global financial crisis (Figure 5.a). The moderation in economic activity is visible across consumption, investment and production. In recent months, growth declined strongly in agriculture due to the drought and in construction, and moderately in industrial production, fixed capital investment and retail trade (Figure 5.b).

Figure 5: (a) Purchasing Manager Index (level, yoy, sa, 3mma) and Five-Sector Output Growth (percent, yoy, 3mma); and (b) Growth of selected indicators (percent, yoy, 3mma)





Source: Rosstat, World Bank staff calculations.

Box 1: Russia's economy outperformed other regions early in the year but is now slowing down

Russia's economy performed well relative to other regions this year. While growth of industrial production turned negative in recent months in other regions, it remained positive and even accelerated in Russia. Growth of retail sales in Russia exceeded the growth in other regions for the last year or so, and even with the recent slowdown, it remains far in excess of the growth in emerging EU and high-income OECD countries. But the Russian economy is in the process of slowing down. OECD leading indicators suggest that the expansion in economic activity is moderating. Business confidence dropped to the lowest levels in four years in recent months, although it remains above the long-term average of 100.

Figure 6: (a) Industrial Production (growth, percent, sa); (b) Retail sales (growth, percent, sa)

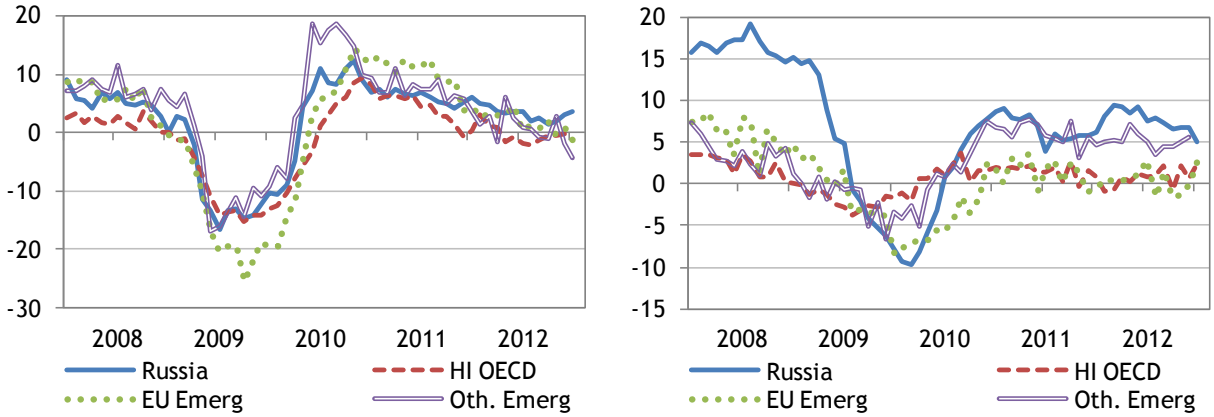
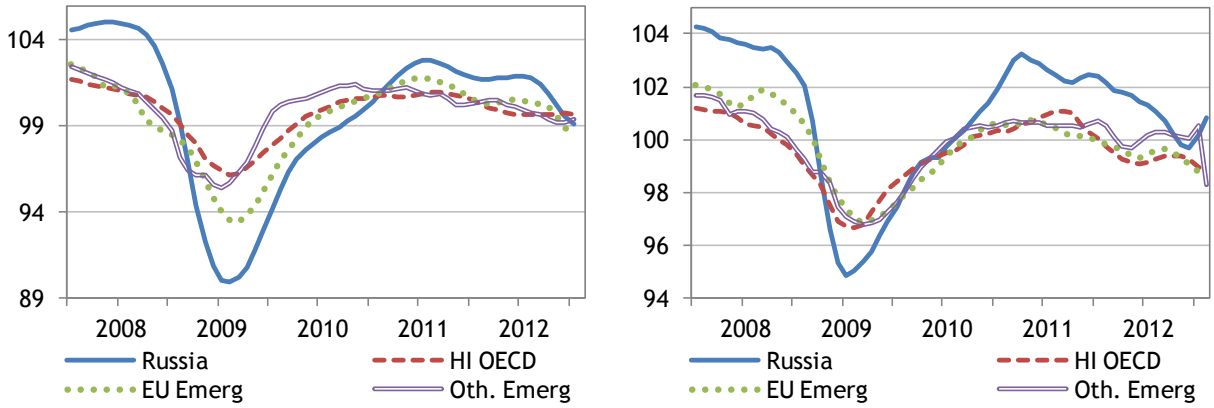


Figure 7: (a) Composite Leading Indicator (level); (b) Business Confidence Indicator (level)



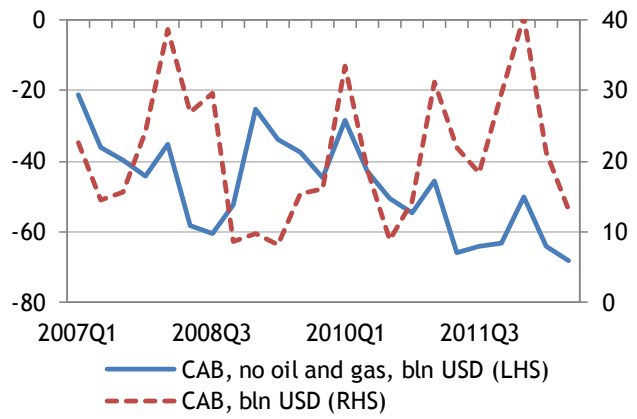
Source: OECD, World Bank staff calculations.

Trade and Capital Flows—rising trade surplus, declining net capital outflows

The balance of payment position strengthened thanks to a strong current account, although the non-oil current account deficit remained high. This, together with the moderation in capital outflows in the second and third quarters, allowed the Central Bank of Russia to add to its foreign reserves.

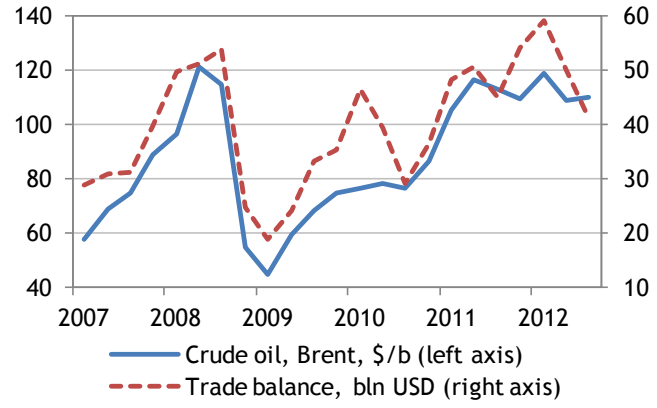
The external current account benefited from high oil prices. The current account surplus rose to US$74.6 billion in the first nine months of 2012 from US$70.5 billion in the first nine months of 2011 (Figure 8 and Table 2). The weakening of the current account from the first quarter to the second and third quarters of 2012 was partly seasonal, in addition to higher interest payments of the private sector in the income account. From the first to the second quarter of 2012, on a four quarter rolling basis, the current account surplus increased from 4.3 percent of GDP to 5.6 percent of GDP. The trade balance benefited from high oil prices (Figure 9), even though the growth in dollar export values declined in line with weak external demand since the beginning of the year. At the same time, the growth of import values dropped as weaker industrial production and fixed capital investment translated into lower import demand (Figure 10). The depreciation of the ruble in May and June also dampened food imports. As a result, the surplus in the trade balance for goods improved from 11 percent of GDP in the first half of 2011 to 12 percent of GDP in the first half of 2012 (Figure 11).

Figure 8: Current account balance



Sources: CBR; and World Bank staff estimates.

Figure 9: Trade balance and oil prices



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

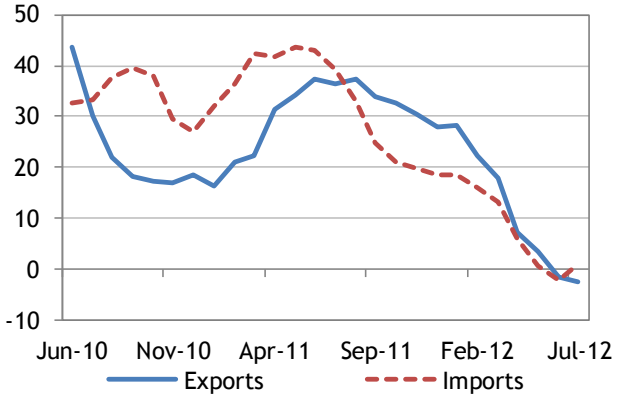
Table 2: Balance of Payments, 2007-2012, US$ billions

	2007	2008	2009	2010	2011	Q1-3 2011	Q1-3 2012*	Q1 2012	Q2 2012	Q3 2012*
Current account balance	77.8	103.5	48.6	71.1	98.8	70.5	74.6	40.4	21.2	13.0
Trade balance	130.9	179.7	111.6	152.0	198.2	144.0	150.4	59.2	50.1	41.2
Capital and financial account	84.5	-131.2	-43.5	-26.0	-76.2	-45.2	-40.8	-29.8	-2.0	-9.0
Errors and omissions	-13.3	-11.3	-1.7	-8.3	-10.0	-4.2	-12.9	-6.0	-4.3	-2.6
Change in reserves (- = increase)	-148.9	38.9	-3.4	-36.8	-12.6	-21.2	-21.1	-4.6	-15.0	-1.5
Memo: average oil price (Brent, US$/barrel)	72.5	96.9	61.5	79.7	111.1	111.6	112.4	118.7	108.8	109.9

Source: CBR. * Preliminary estimates.

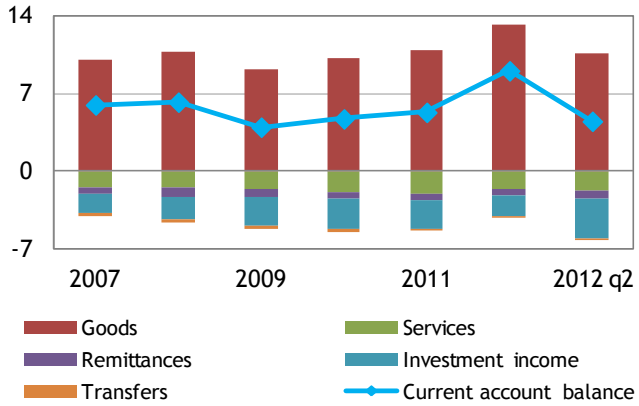
In spite of the large current account surplus, the large non-oil current account deficit indicates that the economy remains vulnerable to terms of trade shocks. According to preliminary estimates, the non-oil deficit of the current account reached US$115 billion, or 12.5 percent of GDP, in the first half of 2012, almost unchanged to the first half of 2011 (Figure 8). The share of non-energy exports in total goods export declined to 34 percent in the first nine months of 2012 from 35 percent in 2011 and 37 percent in 2009.

Figure 10: Export and imports (growth yoy, 3mma US$)



Source: Rosstat, World Bank staff calculations.

Figure 11: Current account balance (percent of GDP)



Source: CBR, World Bank staff calculations.

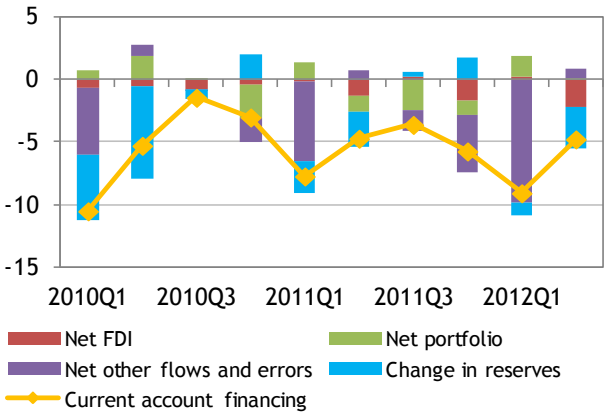
The capital account improved in the second quarter of 2012. According to preliminary estimates, the capital account deficit amounted to US$25.6 billion, or 2.8 percent of GDP, in the first half of 2012, compared to US$24.9 billion, or 2.9 percent of GDP, in the first half of 2011. Net capital outflows moderated somewhat in 2012 from the high levels in the fourth quarter of 2011, they declined in the second and third quarters of 2012 mainly thanks to inflows to the banking sector (Table 3 and Figure 12). While the improvement is to in part seasonal, additional factors affected the dynamics. First, capital flows to emerging markets improved only recently once concerns eased about the global economy and stress in the euro area. Second, banks imported capital in the second and third quarters of 2012. This helped to sustain high credit growth in an environment of tight liquidity. Third, the deterioration in the current account surplus in the second quarter of 2012 lowered capital outflows against the backdrop of a flexible exchange rate. Finally, the end of the political cycle might have favored the improvement in the capital inflows dynamics (Box 2).

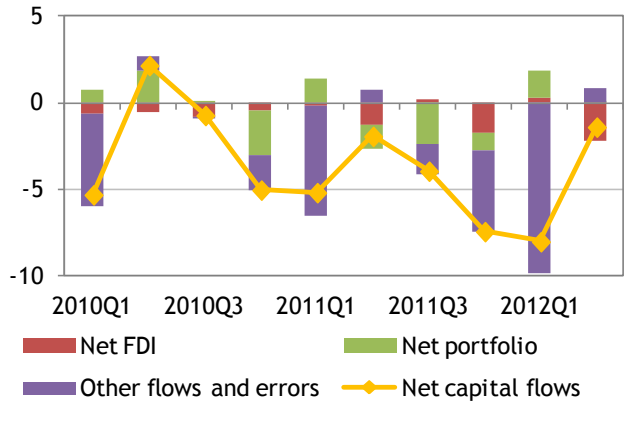
Table 3: Net Capital Flows, 2007–2012 (US$ billions)

	2007	2008	2009	2010	2011	Q1-3 2011	Q1-3 2012*	Q1 2012	Q2 2012	Q3 2012*
Total net capital inflows to the private	81.7	-133.7	-56.9	-34.4	-80.5	-45.5	-57.9	-34.6	-9.7	-13.6
to banking sector	45.8	-56.9	-30.4	15.9	-24.2	-17.4	5.3	-9.7	11.6	3.4
to non-banking sector	35.9	-76.8	-25.8	-50.3	-56.2	-28.1	-63.1	-24.8	-21.3	-16.9

Source: CBR. *Preliminary estimates.

Figure 12: (a) Current account financing (percent of GDP); and (b) Quarterly composition of net capital flows (percent of GDP)





Source: CBR, World Bank staff calculations.

The improvement in the current account surplus, along with a moderation in capital outflows, allowed the Central Bank of Russia to increase its foreign reserves. The CBR added about US$21 billion to its reserves, which increased to US$530 billion by end-September. The CBR refrained largely from active interventions on the foreign exchange market, with a few exceptions when the ruble came under strong pressure as concerns about the euro area escalated. Supported by high oil prices, the ruble appreciated about 3.1 percent against the US dollar and 3.5 percent against the euro from the end of 2011 to the end of September 2012.

Banks and non-financial corporations increased their external liabilities in spite of volatile global market conditions. According to the preliminary CBR debt statistics, the outstanding external debt of the corporate sector increased to US$532 billion by end-June 2012 from US$500 at end-January 2012 (Table 4). The disaggregated numbers show that the share of outstanding short-term debt remained stable in all subsectors. Long-term external liabilities increased for state-owned banks and corporations, and private corporations, while private banks kept their long-term debt stock unchanged (Table 5). The increase in debt exposure of banks and corporations came in spite of low risk appetite in global financial markets.

Table 4: External debt of the corporate sector, US$ billions

	1-Jan-10	1-Jul-10	1-Jan-11	1-Jul-11	1-Oct-11	1-Jan-12	1-Apr-12	1-Jul-12
Total debt	**421.3**	**410**	**442.4**	**490.9**	**481.9**	**499.5**	**517.6**	**532.2**
Banks	127.2	122.1	144.2	159	157.3	162.8	169.3	173.9
Short-term	*27.3*	*30.3*	*39.2*	*45*	*43.4*	*48.9*	*49.8*	*n.a.*
Non-financial corporations	294.1	287.9	298.2	331.9	324.6	336.6	348.3	358.3
Short-term	*19.2*	*20.3*	*17.3*	*24.1*	*20.2*	*17.6*	*18.8*	*n.a.*
State and quasi-state debt	181.3	181.9	199.8	213.4	212.1	221.8	231	n.a.

Source: CBR, World Bank staff calculations.

Table 5: External debt of the private sector, US$ billions

	1-Jan-10	1-Jan-11	1-Apr-11	1-Jul-11	1-Oct-11	1-Jan-12	1-Apr-12
Banks	**77**	**80.8**	**83.6**	**89.1**	**86.8**	**89.6**	**90.7**
Long-term	*50.1*	*53.8*	*56.3*	*56.9*	*55.8*	*54.8*	*54.9*
Short-term	*20.9*	*27*	*27.3*	*32.2*	*31*	*34.8*	*35.8*
Non-financial corporations	**208.9**	**208.3**	**222.0**	**236.7**	**228.2**	**233.9**	**243.8**
Long-term	*190.4*	*191.7*	*203.9*	*214.2*	*209.3*	*217.5*	*226.4*
Short-term	*18.5*	*16.7*	*18.1*	*22.2*	*18.9*	*16.4*	*17.3*

Source: CBR, World Bank staff calculations.

Box 2: Net capital flows to emerging markets are affected by external and internal factors

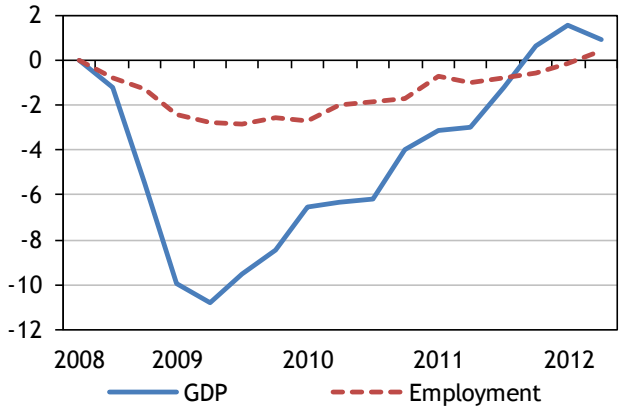
How does Russia compare with other emerging markets with regard to net capital inflows? The recent trends convey a mixed picture. The data up to the first quarter of 2012 suggest that concerns over the euro area and weak global growth affected emerging economies differently. Some economies continued to enjoy capital inflows: in Poland and Turkey, for example, net capital inflows increased noticeably in the first quarter of 2012. Other economies, including Russia and China, faced a sharp decline in gross inflows. But while China saw positive net inflows, Russia experienced large outflows. In Russia, in spite of strong macroeconomic fundamentals, the political cycle might have amplified low risk appetite in global financial market and the weak investment climate. This suggests that both global and domestic conditions matter for capital flows.

Jobs — businesses looking for workers

The labor market shows signs of overheating. The unemployment rate reached a record low, and the vacancy rate increased. The tight labor market led to rapid wage growth, also because public sector wages rose at a swift pace.

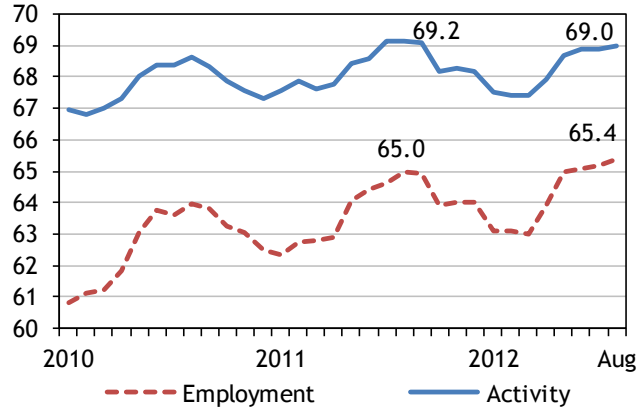
Russia's labor market is tight. Spring and summer tend to be good for labor markets. But the recent improvements in headline indicators suggest more than just seasonality. While the economic slowdown could lead to a cooling of the labor market in the coming year, the latest labor market indicator still suggest an overheating in key segments. First, employment totaled 72.3 million in July 2012, more than the previous peak of 72.1 million in August 2008. Seasonally adjusted employment also exceeded pre-crisis peaks. Second, in the second quarter of 2012, the employment rate and the labor market participation rate reached levels exceeding or nearly matching historic peaks. Third, in August 2012, the unemployment rate dropped to its lowest level over the last two decade. It declined to 5.2 percent, less than the previous trough of 5.4 percent in May 2008. Adjusting for seasonal effects, the unemployment rates fluctuated in recent months around 5.4 to 5.9 percent, similar to the previous historic low of 5.7 percent in May 2008. Registered unemployment rate was only 1.1 percent in August 2012, close to levels last seen more than a decade ago.

Figure 13: Recovery from crisis (%), 2Q 08=0, SA



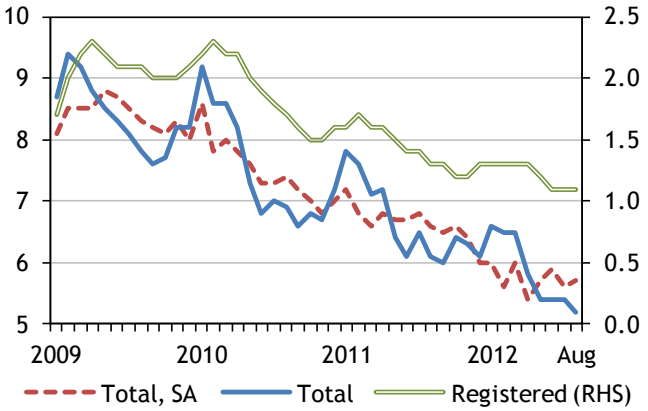
Source: Rosstat, World Bank staff calculations.

Figure 14: Employment and activity rates, %



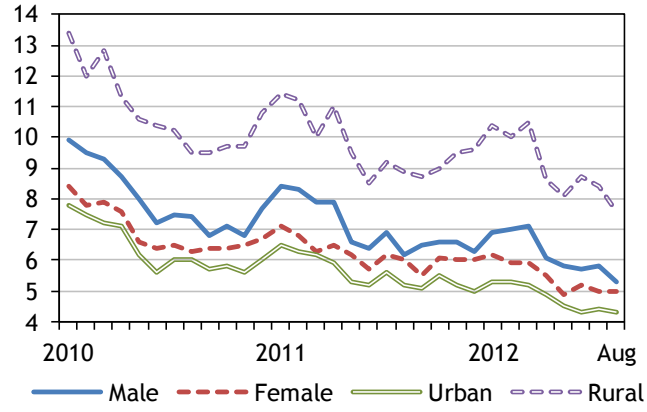
Source: Rosstat, World Bank staff calculations.

Figure 15: Unemployment rates, %



Source: Rosstat, World Bank staff calculations.

Figure 16: Unemployment rates by gender and locality, %



Source: Rosstat, World Bank staff calculations.

The recent declines in unemployment rates reflect mainly improvements in rural areas and for male workers. Unemployment in villages and male unemployment tends to be more seasonal, as it reflects sectors such as agriculture and construction that are sensitive to calendar effects. However, unemployment rates also declined in

cities and for women. Urban unemployment in August 2012 dropped to only 4.3 percent, which again is a historic low.

While regional unemployment varies across localities, most regions experienced a downward trend in the unemployment rate. All federal okrugs experienced a year-on-year decline of unemployment during March to May, even though the pattern was less even during June to August (Table 6). Similar to the previous year, the lowest unemployment rates were recorded in the city of Moscow (0.6 percent), the city of St. Petersburg (1 percent), Moscow oblast (2.7 percent), Yaroslavl oblast and Samara oblast (2.9 percent in each). Regions with the highest unemployment rate include Dagestan republic (11.3 percent), Altai republic (12.1 percent), Tuva republic (20.6 percent), Chechnya republic (33.5 percent) and Ingush republic (47.5 percent).

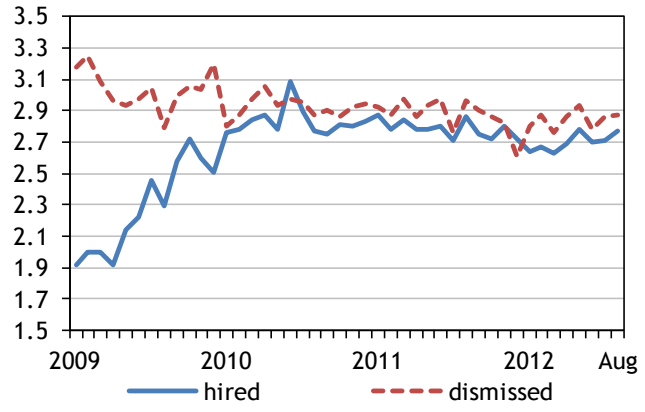
Table 6: Regional unemployment rates, percent

	March-May 2011	June-August 2011	March-May 2012	June-August 2012
Russian Federation	8.3	5.6	5.9	5.3
Central Federal Okrug	5.7	3.9	3.4	3.0
North-Western Federal Okrug	6.4	4.5	4.4	4.1
Southern Federal Okrug	8.5	6.1	6.6	5.7
North-Caucasus Federal Okrug	16.0	11.5	13.8	13.0
Volga Federal Okrug	9.0	5.8	5.8	5.2
Ural Federal Okrug	7.9	5.5	6.3	5.7
Siberia Federal Okrug	10.6	6.4	7.5	6.9
Far East Federal Okrug	8.0	7.0	6.9	6.5

Source: Rosstat and World Bank staff estimates.

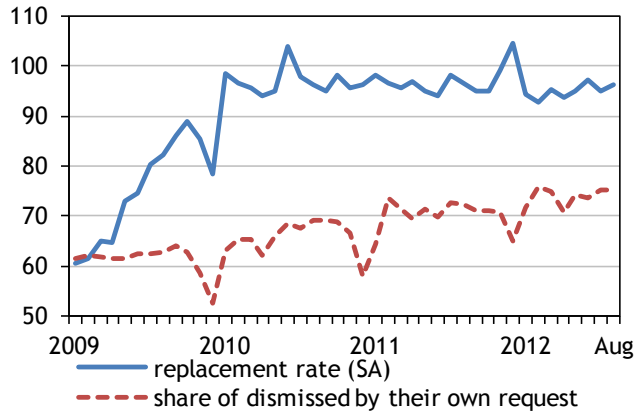
Other labor market indicators confirm signs of overheating. First, the number of hired people continues to almost equal the number of dismissed people, leaving the replacement rate at around 95 percent. Second, almost three in four dismissed people leave the enterprise on their own request — mostly to move to another job, although the indicator might overstate the true share of voluntary dismissals. Third, part-time work dropped below one percent, and employer initiated unpaid leave to below 0.5 percent.

Figure 17: Labor market movement rates, % SA



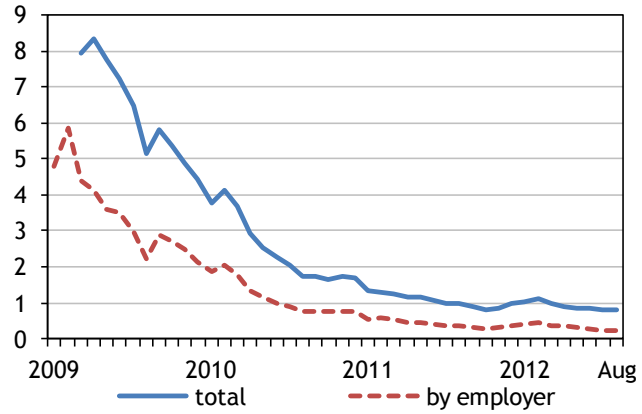
Source: Rosstat, World Bank staff calculations.

Figure 18: Labor market movement rates, %



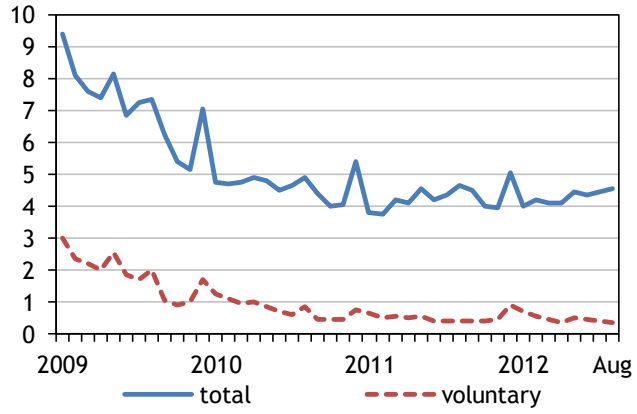
Source: Rosstat, World Bank staff calculations.

Figure 19: Part-time working rate, %



Source: Rosstat, World Bank staff calculations.

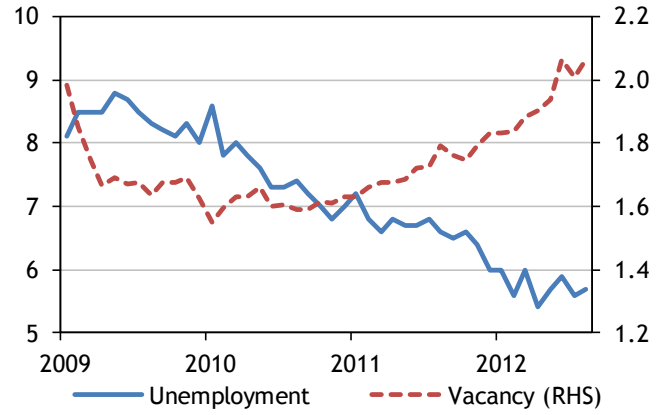
Figure 20: Unpaid leave rate, %



Source: Rosstat, World Bank staff calculations.

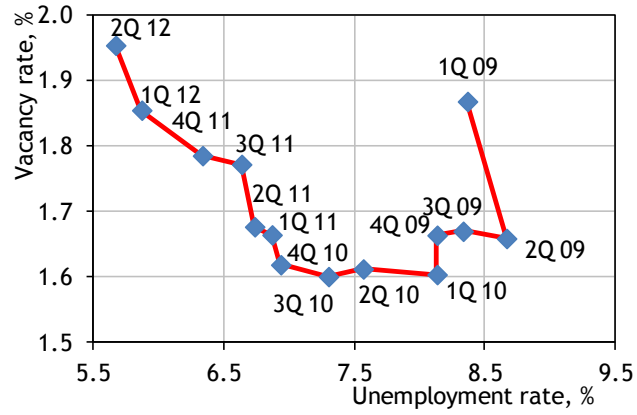
While fewer workers are looking for jobs, more employers are looking for workers. The vacancy rate, measuring the number of open vacancies divided by the total amount of jobs in the formal sector calculated for big and medium enterprises, increased to levels last seen prior to the global financial crisis. The Beveridge curve captures the joint dynamics of the unemployment and vacancy rates. Using seasonally adjusted figures, the Russian labor market moved since the third quarter of 2010 along the curve, in the direction of lower unemployment and high vacancy rates. While vacancy rates were about the same in the first quarter of 2012 and the first quarter of 2009, the unemployment rate declined more than 2 percentage points. This suggests that it takes workers less time now to find a job than three years ago.

Figure 21: Unemployment and vacancy rates, % SA



Source: Rosstat, World Bank staff calculations.

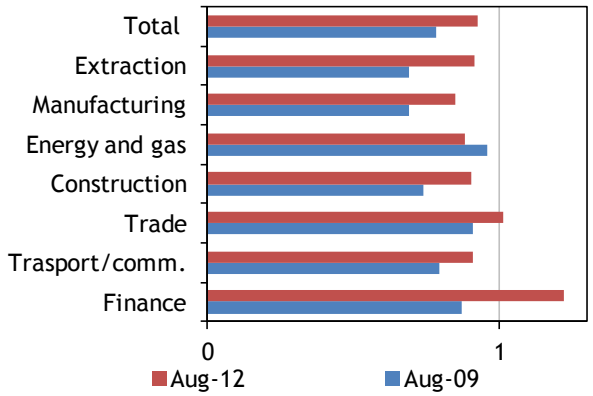
Figure 22: Beveridge curve, % SA rates



Source: Rosstat, World Bank staff calculations.

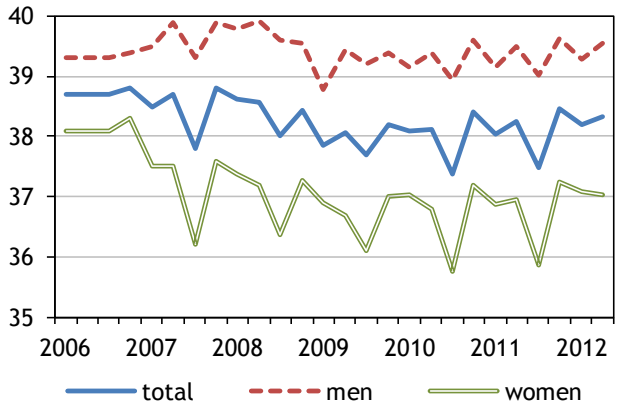
The tightening of the labor market is visible across most sectors. The replacement ratio increased in most sectors over the last 3 years (Figure 23). This ratio is highest in sectors that display clear signs of overheating – either in terms of high wages (finance, extraction) or in terms of highest wage growth (manufacturing, construction). The replacement rates already exceed unity in industries that are especially affected by overheating, such as finance. While the unemployment rate is already lower than pre-crisis, there is still some room for increases in the weekly working hours (Figure 24).

Figure 23: Replacement rate (hiring/dismissing), by sample of sectors, not seasonally-adjusted



Source: Rosstat, World Bank staff calculations.

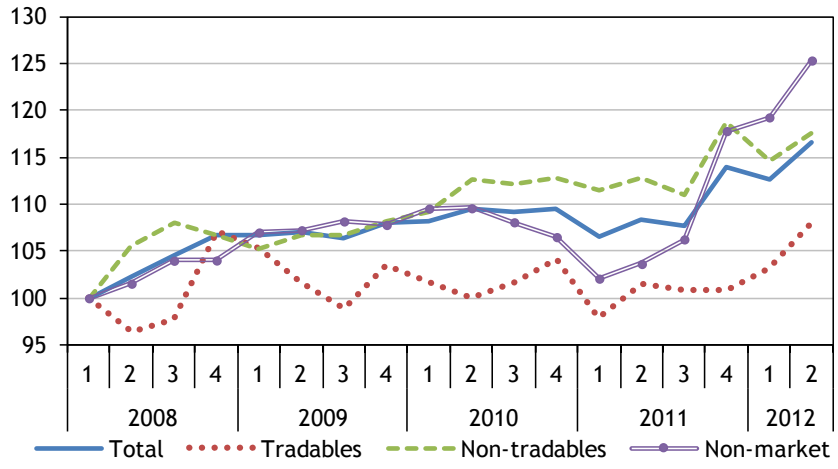
Figure 24: Average number of hours worked per week



Source: Rosstat, World Bank staff calculations.

The tight labor market translated into fast wage growth, outpacing productivity gains. In the first eight months of 2012, the year-on-year growth of wages reached 10 percent (Box 3), far in excess of the growth in disposable incomes (Figure 25, Figure 30 and Box 4). By contrast, output per worker increased only 3.3 percent in the first half of the year. The gap between growth in wages and productivity was far higher than in previous years. It was largest in the non-tradable sector, including public administration and defense, education and health and social services, where it reached 19 percent. Favored by the tight labor market, high wage increases in the non-market sectors might have fuelled wage growth also to the other sectors. This trend, if continued, could weaken the competitiveness of Russia's economy.

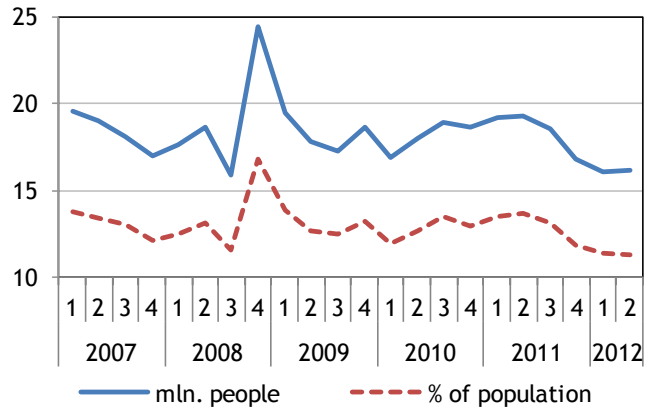
Figure 25: Difference in growth rates of real wages and output per worker, 1Q 08=100%, SA



Source: Rosstat, World Bank staff calculations

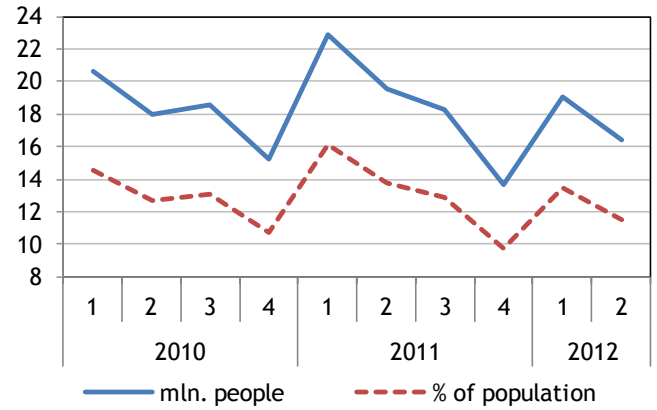
Income growth helped to reduce poverty. The gains in income were fairly evenly distributed among income groups of the population. As a result, the share of poor people in the population, as measured by the official poverty line, fell to 12.5 percent in the first half of 2012, its lowest rate in two decades (Figure 26 and Figure 27). Some 17.7 million people were poor, compared to 21.1 million people a year ago. Again, this is a record low. This decline in poverty was assisted by moderate increases in food items, which represent a high share in the poverty basket.

Figure 26: Number of poor people and poverty rate, SA



Source: Rosstat, World Bank staff calculations.

Figure 27: Number of poor people and poverty rate, NSA



Source: Rosstat, World Bank staff calculations.

Box 3: While wages in the market sectors have grown fast, wages in non-market sectors have grown even faster

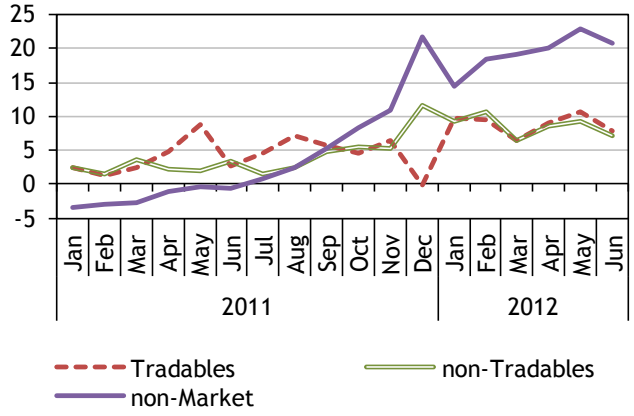
Until late 2011, overall wage growth was to a large extent driven by market sectors. This changed since late 2011, coinciding with the political cycle. While market sector wages grew at a swift pace, non-market sectors grew even faster. From December 2011 to June 2012, year-on-year real wage growth in non-market sectors was more than twice as high as the growth in the market sectors. For example, it reached 21.7 percent in public sector and defense, 20.5 percent in education and public health and 14.2 percent in social work service. These three sectors are part of the non-market services or non-market sector. Wages of employees of the non-market sector are largely paid by the government. The non-market sector makes up about one quarter of total employment. In previous years, wage growth in the market sectors exceeded those of the non-market sectors. Average wages in the non-tradable sector are around 15 to 18 percent higher than in the tradable sector.

Table 7: Wage growth composition, % y-o-y

	real growth, % y-o-y		contribution to growth, p.p.	
	Jan-2009-Jun-2012	Dec 2011-Jun 2012	Jan-2009-Jun-2012	Dec 2011-Jun 2012
tradables	4.0	7.6	1.0	1.8
non-tradables	2.6	9.0	1.5	5.0
non-market sector	3.6	19.6	0.7	4.2
total	3.2	11.0	3.2	11.0

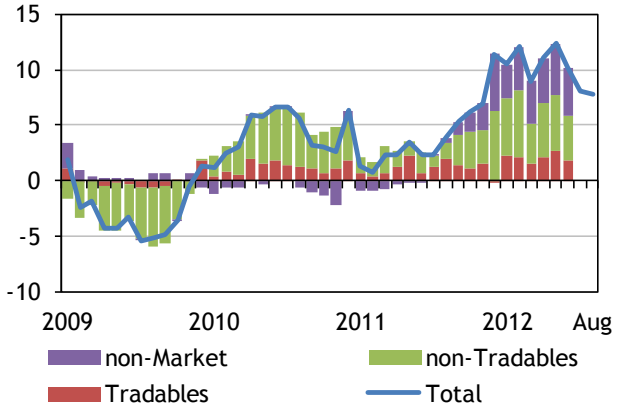
Source: Rosstat and World Bank staff estimates

Figure 28: Real wage growth, % y-o-y



Source: Rosstat and World Bank staff estimates.

Figure 29: Contribution to real wage growth, % y-o-y



Box 4: Exploring the wage-income growth puzzle

In the past, growth of real wages exceeded growth of disposable income but the gap was only around 2.5 percentage points. The picture changed recently. During the first eight months of 2012, year-on-year growth was 3.6 percent for real disposable income, yet 10 percent for real wages. What accounts for this difference?

One reason could be that, unlike wages, disposable income includes public benefits, most importantly pensions. But the growth of pensions was 5.5 percent in the first seven months of 2012, so lower growth of pensions goes only some way towards explaining the wage-income growth gap of 8.5 percentage points. Another reason could be statistical factors. This includes adjusting disposable income for currency sales, using different deflators or changing the share of compulsory payments. However, these factors turn out to be minor. Instead, the main reason appears to be the decline in the growth of other incomes. Such incomes could come from unregulated, unregistered or undeclared work, whether as dependent or own-account worker or as self-employed. In the first half of 2012, the rise in the contribution of formal sector wages to overall income growth was to a large extent compensated by a decline in the contribution of other incomes. This could be linked to the tightness of the labor market, since it allows workers to make the transition from unregulated to regulated employment. This shift then shows up as a decline in growth of other incomes and a rise in growth of wages.

Figure 30: Real income growth, % y-o-y

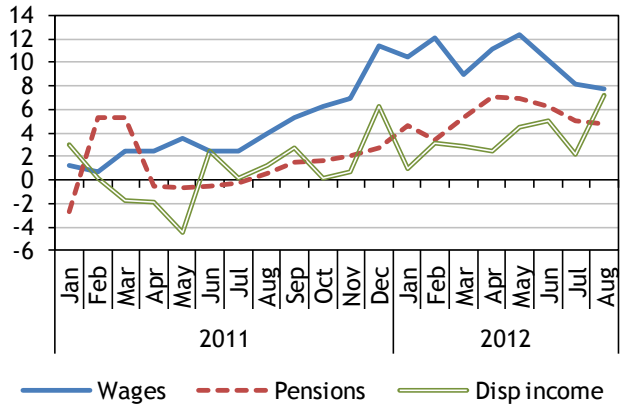
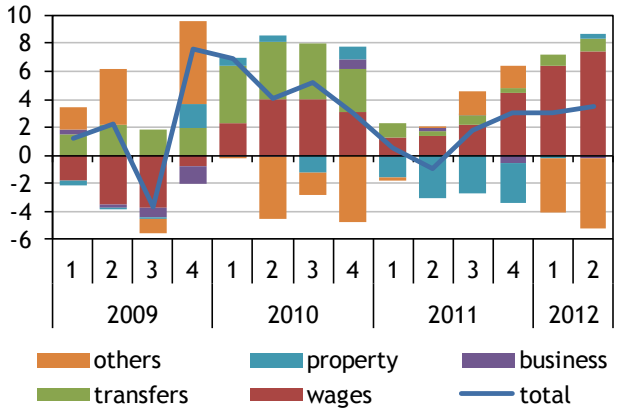


Figure 31: Contribution to income growth, % y-o-y



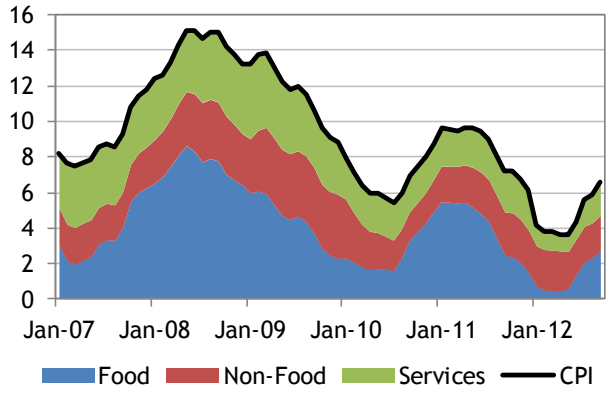
Source: Rosstat and World Bank staff estimates.

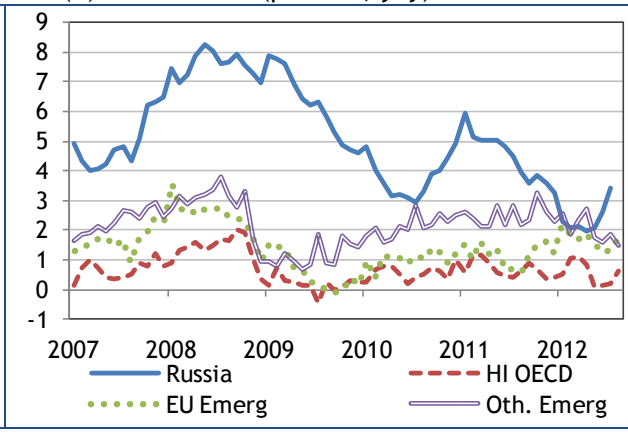
Money, Exchange Rate and Credit — CBR raises interest rates in response to rising inflation and rapid consumer credit expansion

Since reaching record lows in April 2012, inflation increased mainly due to higher food and administrative prices. With inflation exceeding its end-year target, the CBR increased interest rates to anchor inflation expectations in response to concerns about large credit and wage growth.

Inflation is on the rise since April 2012. On September 17, 2012 headline year-on-year inflation reached 6.4 percent, exceeding CBR's end-year target of 6 percent, compared to its low of 3.7 percent in April 2012 (Figure 32). The increase in inflation is related to three factors. First, it reflects the rise in food inflation triggered by the drought in Russia and key international grain producers. For example, year-on-year food inflation increased from naught in April 2012 to 5.6 percent in August 2012. The depreciation of the exchange rate in May and June further put upward pressure through higher prices of imported food, especially of meat, fruit and vegetables. Second, the rise in utility prices in July and September pushed up services inflation. Services inflation increased from 3.7 percent in April 2012 to 6.2 percent in August 2012. Third, there is some uptick in core inflation, which excludes food and gasoline. It increased from 5.1 percent in May 2012 to 5.5 percent in August 2012, which is the upper limit of CBR's core inflation target band.

Figure 32: (a) CPI inflation by component (percent, yoy); and (b) CPI inflation (percent, yoy)

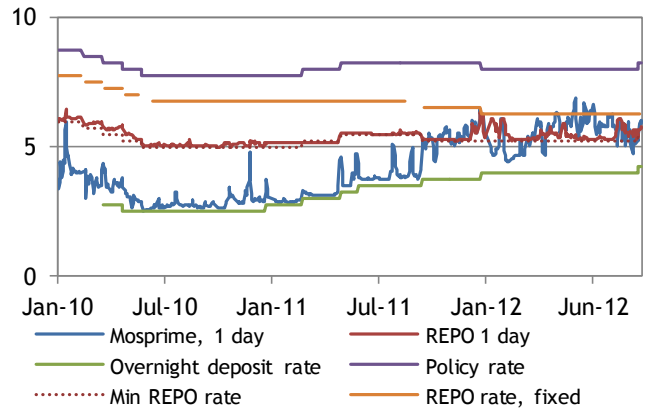


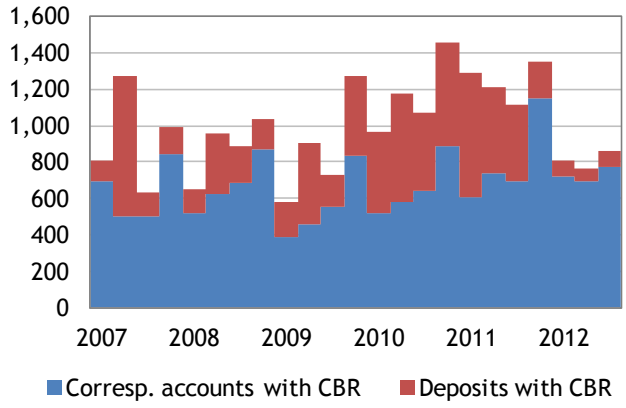


Source: Rosstat, OECD, and World Bank staff calculations.

In response to rising inflation, the CBR increased all its policy rates by 25 basis points. With inflation exceeding money market rates, the CBR increased in September 2012 the refinancing rate for the first time since May 2011. It also increased the one-week repo rate, which recently has become the main instrument for banks to access liquidity. With this measure, the CBR intends to anchor inflation expectations, as negative base effects, rising food prices, high credit growth and tight labor markets point to further increases in inflation in the coming months. In addition, the policy tightening sent a signal to market participants that the CBR remains fully committed to transitioning to inflation targeting. In view of persistent inflation pressures, CBR's draft monetary policy guidelines for 2013 to 2015 revised the 2013 inflation target upward from 4.5 to 5.5 percent to 5 to 6 percent, and postponed the full transition to inflation targeting from end-2014 to 2015.

Figure 33: (a) Interest rates (percent); and (b) Liquid assets of banks as share of overall assets, bln. RUB



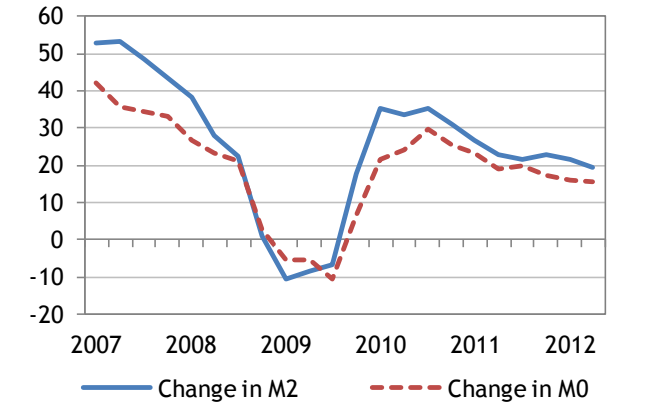


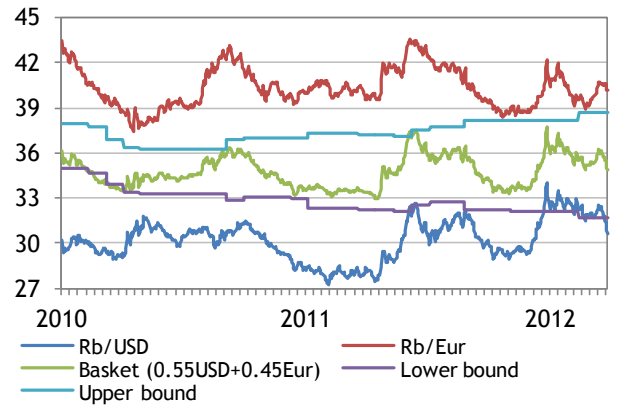
Source: CBR, World Bank staff calculations.

The CBR scaled up its refinancing operations to provide adequate liquidity. In spite of solid deposit growth and adequate profitability, rapid credit growth put pressure on banks' liquidity position. For example, the share of liquid assets held by banks declined to 21 percent by end-July from 24 percent in early 2012. Over the same period, year-on-year growth of M2 money supply declined from 23 percent to 18 percent. As a result, banks had to rely more on the CBR refinancing operations for liquidity. The CBR considerably scaled up its repo operations, along with providing liquidity through less secure instruments. Hence, the interbank interest rate remained within the interest rate band of the CBR's auction and fixed repo rates.

The exchange rate has become more flexible. In July 2012, the CBR widened further the bilateral currency corridor to 7 from 6 rubles as part of the gradual policy shift to inflation targeting (Figure 34.b). In addition, the CBR considerably reduced the amount of interventions at the foreign exchange markets. From January to August 2012, the CBR used only about US$1 billion in untargeted interventions to smooth market volatility compared to US$13 billion in 2011 and US$25 billion in 2010. As a result, the volatility of the exchange rate increased, as changes in oil prices and the risk appetite of investors translated into exchange rate movements. For example, heightened uncertainty over the euro area resulted in a depreciation of about 10 percent in May and June 2012, followed by a rapid rebound as these concerns eased. In September 2012, the ruble appreciated once again in response to a new round of quantitative easing of the European Central Bank and the Federal Reserve Bank.

Figure 34: (a) Money supply (percent, yoy growth); and (b) Exchange rate and its bilateral band



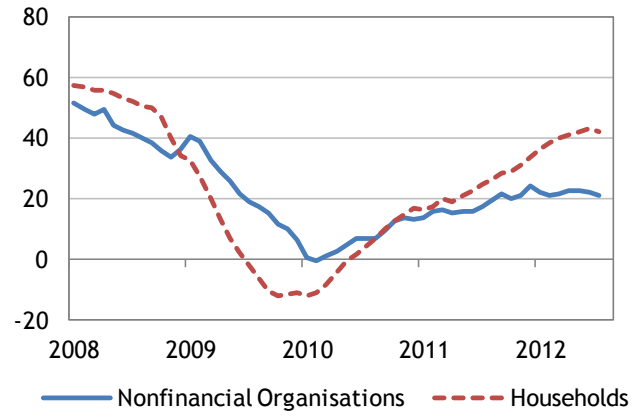


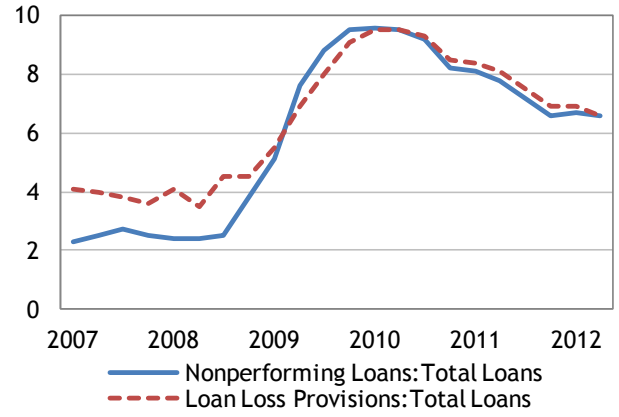
Source: CBR, World Bank staff calculations.

Credit growth accelerated due to consumer lending. The stock of private credit increased to 47.3 percent of GDP at the end of June 2012 compared to 45.9 percent at the end of December 2011. Credit growth to non-financial organizations reached 20 percent, in part because companies switched from foreign denominated credits to local currency credits to lower vulnerabilities to external shocks. In contrast, credit growth to households exceeded 40 percent in the second quarter of 2012 (Figure 35.a). The stock of mortgage debt of households rose from RUB1.5 trillions in December 2011 to RUB1.7 trillion in July 2012. Credit growth remained high even though

the spread between bank lending rates and the CBR policy rates remained wide. This mainly reflects the high levels of concentrated-party lending in the corporate sector and the lack of collateral of household borrowers. The fast credit expansion reduced the capital adequacy ratio of banks from 14.7 percent in December 2011 to 13.8 in June 2012, and increased loan-to-deposit ratios from 132 percent to 138 percent over the same period. While non-performing loans remained stable since the beginning of the year (Figure 35.b), maintaining credit quality might become more difficult in future as inflation is rising and economic activity easing.

Figure 35: Credit growth (percent, yoy); and (b) Nonperforming loans and loan loss provisions (percent of total loans)





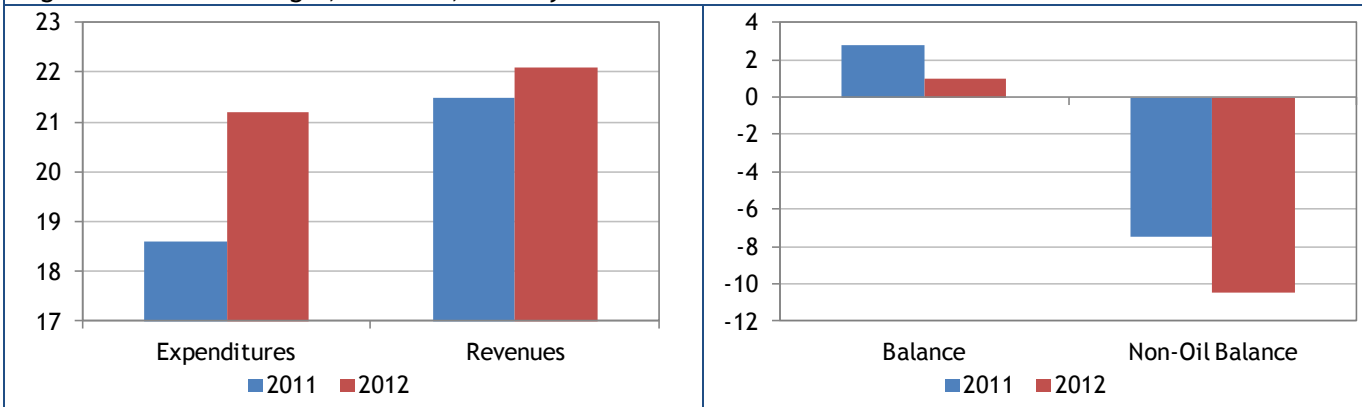
Source: CBR, World Bank staff calculations.

Government Budget — fiscal consolidation postponed

Supported by high oil revenues, the federal budget achieved a budget surplus in the first six months of 2012 in spite of higher expenditures and lower non-oil revenues. Still, fiscal policy was more expansionary in 2012 than in 2011. In the coming years, the government is set to consolidate public spending only at a modest pace, leaving the non-oil fiscal deficit elevated and fiscal buffers below pre-crisis levels.

The government loosened fiscal policy in the first six months of 2012. In 2011, the government reduced the non-oil fiscal deficit by 2.9 percent of GDP and used some of the savings to replenish the reserve fund in early 2012. In 2012, fiscal policy was loosened. First, partly due to implementing advance payments for some expenditure items for the first time, spending of the federal government increased 29 percent in nominal terms in the first six month of 2012. Over the same period, federal revenues grew only at 17 percent. As a result, fiscal expenditures up to June increased to 21.2 percent of GDP, compared to 18.6 percent of GDP last year (Figure 36). The federal budget surplus declined from 2.8 percent of GDP last year to 1.0 percent of GDP this year, in spite of an increase in federal revenues. Second, the rise in federal revenues was due to a modest increase in the average price for Urals crude oil, along with a weaker exchange rate, while federal non-oil revenues as percent to GDP declined somewhat. Higher spending and lower non-oil revenues brought about an increase in the non-oil fiscal deficit from 7.5 percent of GDP to 10.5 percent of GDP.

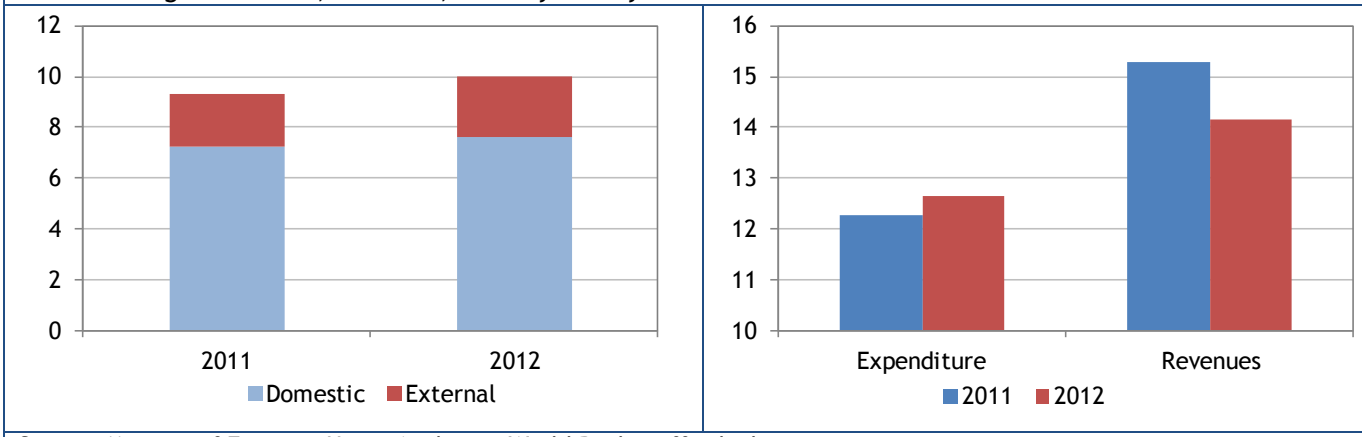
Figure 36: Federal Budget, % of GDP, January to June



Source: Economic Expert Group, World Bank staff calculations.

Federal debt increased and the subnational governments' budget balance declined. First, federal government debt increased as percent of GDP in the first half of the year, although it remained at low levels overall (Figure 37 and Box 5). Second, for the first sixth months of the year, the consolidated subnational governments increased spending moderately, while revenues declined noticeably.

Figure 37: (a) Federal government debt, % of GDP, 1st half of the year; and (b) Consolidated budget of subnational governments, % of GDP, January to July

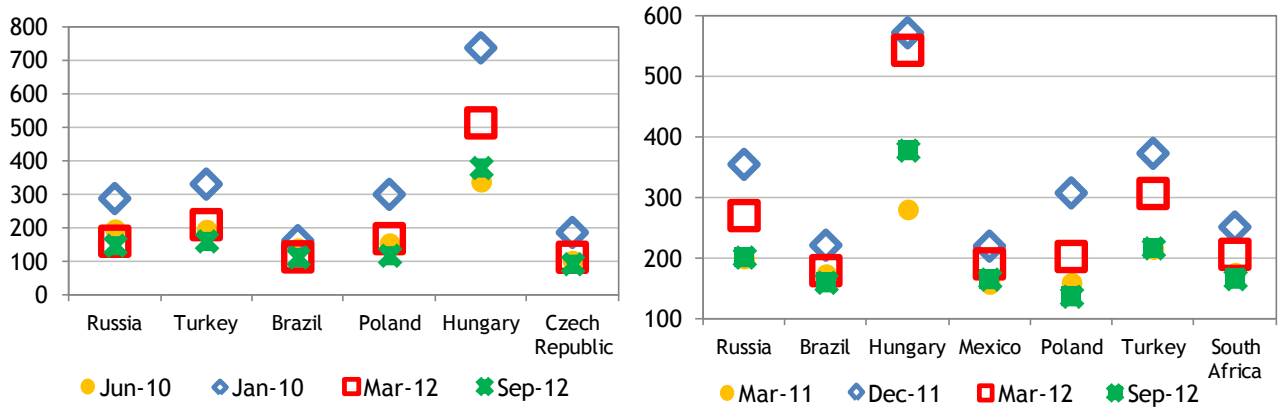


Source: Ministry of Finance, Haver Analytics, World Bank staff calculations.

Box 5: Markets see less risk in Russia, in line with better sentiment

Thanks to a strong oil price, large current account surplus and low public debt, along with an improvement in global market sentiment in September, market's risk perception of Russia has improved (Figure 38). The 5-year credit default swap spreads and spreads of sovereign bonds declined since mid-March 2012. Markets continue to rate Russia ahead of Turkey but behind Brazil.

Figure 38: (a) 5-year CDS spreads (basis points); and (b) Sovereign debt spreads (basis points)



Source: Bloomberg, World Bank staff calculations.

Fiscal balances are expected to deteriorate in 2012. While the federal budget achieved a surplus in the first six months of 2012, the amended budget law projects a nearly balanced budget for the whole year (Table 8). The budget deficit could end up being higher than planned for two reasons. First, the budget amendments in June 2012 assumed an Urals crude oil price of US$115 per barrel, somewhat higher than the average oil price during this year. Second, the government is identifying resources for Presidential initiatives that could increase spending at the end of 2012.

Table 8: Federal Budget, % of GDP

	2011	2012, Up to Aug.	2012	
	Execution	Execution	Budget Law	Amended Budget Law
Expenditures	20,1	20,5	21,6	21,0
Revenues	20,9	21,8	20,1	20,9
Oil Revenues	10,4	11,0	9,5	10,5
Balance	0,8	1,4	-1,5	-0,1
Non-Oil Balance	-9,6	-9,6	-11,0	-10,6
Urals crude oil price, US$/barrel	109,3	110,7	110,0	115,0

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

The government foresees a moderate fiscal consolidation until 2015. The revised draft medium-term budget, as issued by the Ministry of Finance in mid-September, takes into account recent commitments of the government in the areas of military and social spending, a reduction in import duties due to WTO accession, as well as the new fiscal rule (Box 6). The fiscal balance is projected to deteriorate in 2013, and then improve in 2014 and 2015, so that the federal budget balance would be almost unchanged compared to 2012 (Table 9). Oil revenues are assumed to decline from 2012 to 2013, and then remain fairly constant. Changes to overall revenues are driven by changes in oil-revenues, as non-oil revenues are projected to see little change. As a result, expenditures are assumed to decline by about 2 percent of GDP over the three years in order to accommodate the decline in oil revenues. This would bring down the non-oil fiscal deficit to 8.6 percent of GDP in 2015, compared to the suspended pre-crisis target of 4.7 percent of GDP (Figure 39). The Ministry of Labor has recently tabled a third reform of the pension system, which includes proposals to reduce incentive for early retirement and make contributions to the funded pillar voluntary (Box 7).

Box 6: Russia's new oil price rule

On July 6, 2012 the State approved in the first reading a new fiscal rule for the management of oil and gas revenues. The rule proposes a ceiling on federal expenditures equal to the sum of oil revenues at the base oil price, the nonoil revenues, and a net borrowing limit of 1 percent of GDP. Any oil revenues coming in due to the oil price exceeding the base price would be used to replenish the reserve fund until it reaches 7 percent of GDP. Beyond this threshold, the revenues would be split between the national wealth fund and priority development projects. In 2013, the base oil price would be derived as the average oil price over the last five years, using the first six months for 2012. The reference period would be extended progressively by one year until it reaches 10 years in 2018. In case the oil price drops below the base price, the resulting shortfall of revenues would be covered by the reserve fund. While the rule is supposed to become effective on January 1, 2013, it contains provisions to protect already incurred expenditure commitments as a result of last year's medium-term budget. The oil price rule would imply a base oil price of US$91 per barrel, while the draft 2013 budget is based on US$97 per barrel.

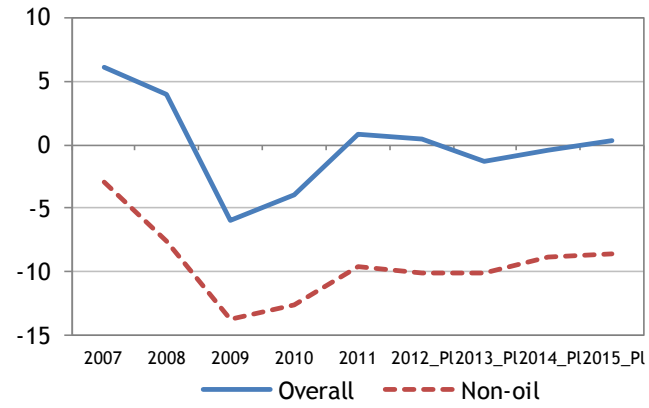
Table 9: Draft Medium-Term Government Budget, % of GDP

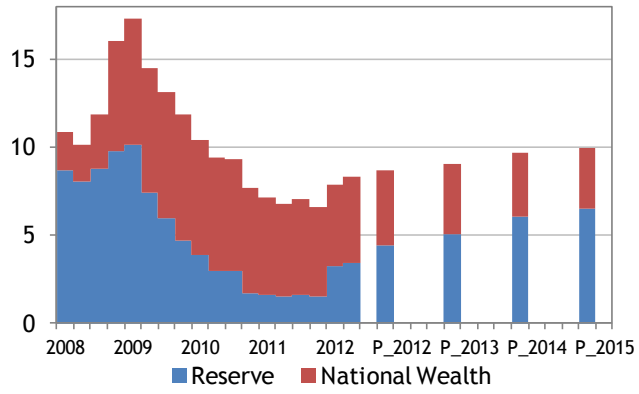
	2012	Preliminary Draft			Revised Draft		
	2012 Plan	2013	2014	2015	2013	2014	2015
Consolidated Budget							
Expenditures	37.6	37.9	36.6	35.9			
Revenues	38.0	36.6	36.2	36.2			
Balance	0.4	-1.3	-0.4	0.3			
Federal Budget							
Expenditures	21	20.3	19.2	18.8	20.1	19.2	18.9
Revenues	20.9	18.8	18.6	18.7	19.3	19	18.9
Balance	-0.1	-1.5	-0.6	-0.1	-0.8	-0.2	0
Non-Oil Balance	-10.6	-10.1	-8.9	-8.6			
Urals crude oil price, US$/barrel	115	97	101	104	97	101	104

Source: Ministry of Finance, World Bank staff calculations.

Replenishing Russia's fiscal buffers is likely to take time. According to the projections of the draft medium-term budget framework, the reserve fund, which provides resources to respond to an economic crisis, will remain below the government's target level of 7 percent of GDP by 2015. This target level is 3 percent of GDP below the level of the reserve fund prior to the global financial crisis. In the coming years, the government is also projected to tap the national wealth fund, which was set up to provide savings in preparation of the aging of the population, to fill the gap of the pension system. At the same time, federal government debt is projected to increase from 10 percent of GDP in the first half of 2012 to 14.4 percent of GDP in 2015.

Figure 39: (a) Federal overall and non-oil balance, % of GDP; (b) Reserve and National Wealth Fund, % of GDP





Source: Ministry of Finance, Haver Analytics, World Bank staff calculations.

Box 7: Reversals of private pension pillars in Eastern Europe

Many countries in Eastern Europe, including Russia, have overhauled their pension systems during the last 15 years. Fourteen countries introduced a second private pillar to complement the first (mandatory unfunded) pillar. The second pillar is typically mandatory (workers are required to participate), funded (pensions are paid from a fund accumulated from contributions), and with defined contributions (pension benefits are determined by the assets accumulated for a person's pension). Countries often combine the first and second pillars with a third, voluntary privately funded pillar.

In response to the crisis, however, several countries reduced funding for the second pillar. Recently, Russia's Ministry of Labor published its proposal for an overhaul of Russia's pension system. Along with proposals to limit early retirement and other measures, it proposes to reduce the mandatory contribution rate to the funded pillar and make this pillar voluntary.

Countries in Eastern Europe backtracked on reforms for three reasons. First, the crisis has underlined the importance of making sure that first-pillar benefits can be financed. Contributions to the first pillar have taken a hit with lower wages and higher unemployment. Second, the introduction of second pillar pensions makes it more difficult for EU member countries to comply with the EU Stability and Growth Pact. Third, while the reforms might take more time to bear fruits as the size of second pillars is in many countries still modest, the second pillar systems have not always performed as hoped. Private pillars typically generated decent rates of return before the crisis. Countries with second pillar pension systems also tend to look better in terms of long-term sustainability, though this mostly reflects that they were more active in lowering pension benefits under the first pillar. Yet, it is clear that expectations proved too optimistic. Governments have had to support the buildup of funds during the transition phase longer than expected.

Some lessons of recent reforms are as follows:
• Abrupt changes lead to instability and can undermine the credibility of pension systems and the trust in government.
• The fiscal effects of reversals are often negligible, as they trade off improvements in the short run with deteriorations in the long run in headline fiscal balances.
• In some countries, the main cost of the reversals will be borne by individuals in the form of lower benefits in retirement.
• Whatever the second pillar regimes, addressing structural problems, whether in the area of pensions or elsewhere, is critical. Many countries should raise the retirement age, rationalize special schemes and disability benefits, move from wage- to inflation-indexation of pension benefits, and improve the regulation of private pension funds.

Source: OECD Pension Outlook 2012; IMF 2011; and World Bank 2012.

II. Economic Outlook

Prospects — economic expansion weakening

Growth in Russia is slowing in view of weak global sentiment, the drought in agriculture, slowing domestic demand and rising inflation. Downside risks to growth include a drop in oil prices due to a correction of oil supply disturbances or weak global demand. Upside risks include that the recent improvement in global market sentiment translates into a rebound of demand both abroad and at home. Under the baseline scenario, poverty is likely to decline thanks to steady income growth in spite of the rise in food inflation.

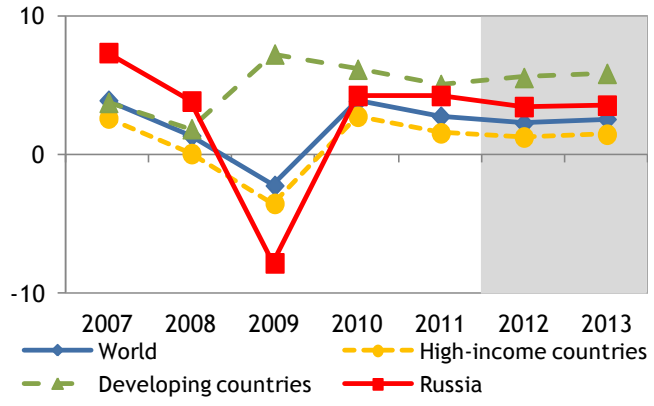
In spite of the recent easing for global market tensions, global growth remains weak. After a robust start to year, concerns about the euro area escalated in May and June, dampening global trade and industrial production. At the same time, major emerging markets are slowing. Recently, market sentiment improved thanks to progress of European policymakers in strengthening the European financial firewall and formation of a European banking union as well as further rounds of quantitative easing in Europe, the US and Japan. Even under the assumption that financial markets will continue to pick up, global growth is likely to improve only moderately in the fourth quarter of 2012, and remain sluggish in 2013. Global GDP growth is now forecasted to grow at 2.3 percent in 2012 and 2.5 percent in 2013, some 0.2 percentage points and 0.5 percentage points below the spring forecast (Table 10 and Figure 40). Moreover, there are a number of downside risks to this recovery, including difficulties in implementing euro area reforms, dealing with the 'fiscal cliff' in the US, an over-extended banking sector in China, and high international food prices.

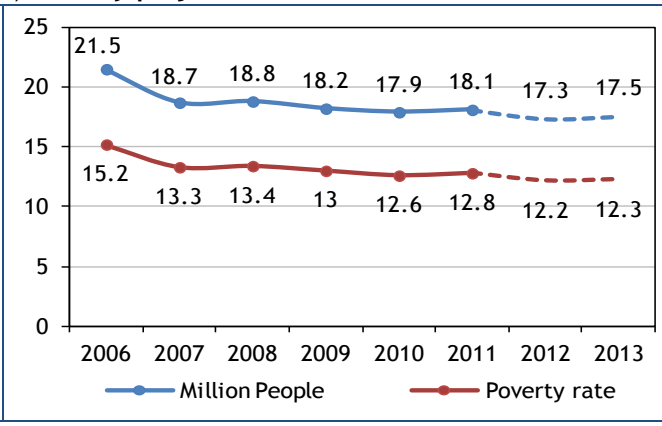
Table 10: GDP growth projections (percent)

	2007	2008	2009	2010	2011	2012 (proj.)	2013 (proj.)
World	4.0	1.4	-2.2	3.9	2.8	2.3	2.6
High-income countries	2.7	0.1	-3.5	2.8	1.6	1.3	1.5
Developing countries	3.8	1.9	7.3	6.2	5.1	5.6	5.9
Russia	7.4	3.9	-7.8	4.3	4.3	3.5	3.6

Source: World Bank staff projections

Figure 40: (a) GDP growth projections (percent); and (b) Poverty projections for Russia





Source: World Bank staff projections, Rosstat

Russia's economy is expected to slow over the next year. Due to unfavorable base effects, a drought in agriculture (Box 8), rising inflation, and weak global sentiment, growth is set to decline in the second half of 2012. In spite of a modest rise in the oil price (Box 9), we project growth in Russia to decline from 4.3 percent in 2011 to 3.5 percent in 2012 and 3.6 percent in 2013 (Table 11). Compared to our June forecast published in the Global Economic Prospects, this represents a downward revision of 0.4 percentage points in 2012 and 0.5 percentage points in 2013. The revision reflects the poor agricultural harvest and a weaker-than-expected global environment. A tight labor market, a weak grain harvest and recent increases in administrated utility prices will continue to exert upward pressure on prices in Russia in the near term. Inflation is set to reach around 6.5 to 7.0 percent by end-2012, and might stay above CBR's target range in 2013. In spite of rising inflation, private

consumption will remain the main growth driver supported by low unemployment. Even though capacity utilization is close to pre-crisis levels, private investors are likely to be cautious until global sentiment has improved and the economy regains dynamism. The government will find it difficult to step up public investment in view of the large non-oil budget deficit.

Table 11: Main economic indicators for the baseline projection

	2011	2012 proj.	2013 proj.
GDP growth (%)	4.3	3.5	3.6
Consolidated government balance (% of GDP)	1.6	0	-0.1
Current account (US$ billions)	101	80.1	59.1
Current account (% of GDP)	5.5	4.1	2.8
Capital account (US$ billions)	-75.3	-61	-36
Capital account (% of GDP)	-4.1	-3.1	-1.7
Oil price assumption (WB Average, US$ per barrel)	104	105.7	105.8

Source: World Bank staff projections.

The current account surplus and capital account deficit are set to decline in the second half of 2012 and in 2013. We project the current account surplus to reach 4.1 percent of GDP in 2012, and then to deteriorate to 2.8 percent of GDP in 2013. Imports are set to grow faster than exports, bolstered by private consumption and a stable ruble. The capital account deficit is projected to decline from 3.1 percent of GDP in 2011 to 1.7 percent of GDP in 2012, in line with the decline in the current account surplus. In 2013, we project further improvement of the capital account due to a return of non-debt capital inflows, lower debt repayments, and improved borrowing capacity of banks and nonfinancial corporations. Thanks to strong oil prices, the consolidated budget is likely to be balanced in 2012 and 2013, even though the non-oil deficit is estimated to remain over 10 percent of GDP in both years.

There are upside and downside risks to our scenario. The main upside is that businesses will respond faster than expected to high capacity utilization and undertake large investments. In addition, the recent improvements in global market sentiment could translate into a faster rebound of the European and global economy than anticipated. A persistent drop in the oil price remains the main downside risk. The trigger could be a decline of oil supply disturbances in the Middle East, or a renewed slowdown in the global economy and deepening of the recession in Europe. However, the flexible exchange rate management and the resilience of private consumption to oil price declines in the short-term are important stabilizing factors for the economy. Assuming the oil price will decline to US$80 per barrel in 2013, growth will moderate to 3.3 percent in 2012 and 1.5 percent in 2013 (Table 12). In addition, the fiscal balance is projected to deteriorate.

Table 12: Main economic indicators for the low-oil price projection

	2011	2012 proj.	2013 proj.
GDP growth (%)	4.3	3.3	1.5
Consolidated government balance (% of GDP)	1.6	-0.5	-2.8
Oil price assumption (WB Average, US$ per barrel)	104	101	80

Source: World Bank staff projections.

For the baseline scenario, we project modest reductions in poverty thanks to low unemployment and steady income growth. The share of the population with incomes below the national poverty line is estimated to drop from 12.8 percent in 2011 to 12.2 percent in 2012 and 12.3 percent in 2013 (Figure 40.b). This would translate into a decline in the number of poor people from 18.1 million in 2011 to 17.5 million in 2013. The decline in poverty in 2012 is supported by low food inflation in the first half of the year. Weaker growth and rising food inflation due to the drought and base effects is expected to stabilize poverty levels in the second half of 2012 and 2013.

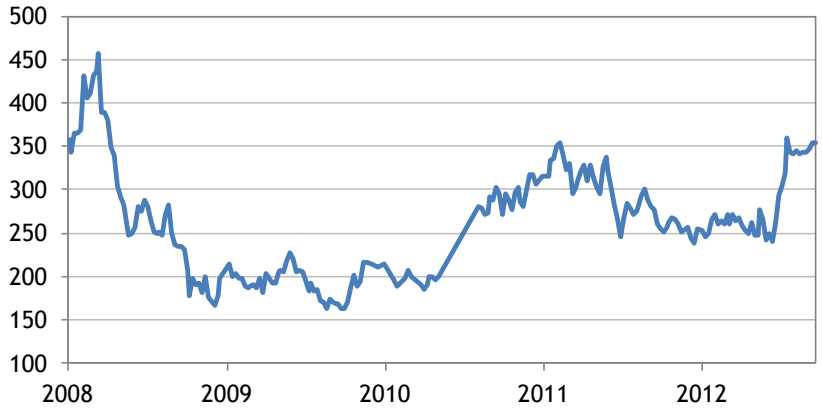
Box 8: Impact of the 2012 drought on output and prices in Russia

In 2012, Russia is experiencing a drought in several major agricultural regions. Harsh weather has dampened production of grains. As a result, according to latest government estimates, grain production is expected to decline to 70 million tons from 94.2 million tons in 2011. Given the share of agricultural production in GDP (about 4 percent) and the relative share of grain production in aggregate agricultural output (about 15 percent), this suggests that the drop in grain production could reduce output by 0.2 percent of GDP.

Drought is affecting not just Russia but also other major global grain producers including the USA and Ukraine. The world price of wheat reached about US$350 per ton at end-September, about the same level as during the previous drought in 2010 (Figure 41). Higher international prices and the domestic drought have translated into food price increases in Russia. The recent food price increases could add about 0.3 percentage points to CPI inflation in 2012.

While Russia's projected harvest is in line with domestic consumption needs, high international prices make it attractive for agricultural producers to export. Indeed, Russian exporters have already sold about 9.2 million tons. However, Russia still has some 17.8 million left-over stock of grain from last year suggesting that Russia has an exportable surplus. At the same time, the government has made preparations to intervene with grain reserves in October in order to stabilize domestic wheat prices in selected federal districts.

Figure 41: Russia's wheat export price (US$ per ton)



Source: Bloomberg.

Box 9: Global Oil Market Developments

After losing almost 25 percent from their March peak, crude oil prices (World Bank average) gained strength to reach 108/bbl in September. The weakness earlier in the year reflected, for the most part, poor prospects of the global economy, including a slowdown in China and fears of further deterioration of the debt problems in Europe. The recent surge reflects mostly supply-side issues, including drastic decline in Iranian production due to the EU embargo and most recently fears of rising tensions between Israel and Iran; violence in Libya and Syria have added further uncertainty. These concerns come on the top of limited OPEC spare production capacity, currently estimated at 2.5 million b/d. On the macro side, oil prices have found further support by policy measures, initially by the European Central Bank's bond buying program and more recently by the Fed's QE3 announcement as well lower policy rates by numerous countries.

Following a relatively sluggish growth from the second quarter of 2011 to the first quarter of 2012 (fluctuated between 0.2 and 0.5 million b/d), oil demand growth surged to reach 1.5 million bpd (year-on-year) during the second quarter of 2012. However, most of the growth was unrelated to prices; it reflected strong growth in Japan, which, after a post-Tohoku weak in the second quarter of 2011, increased considerably oil consumption for power generation. Furthermore, other growth drivers such as China, India, and several Middle East countries have high subsidies, making oil demand inelastic to price changes.

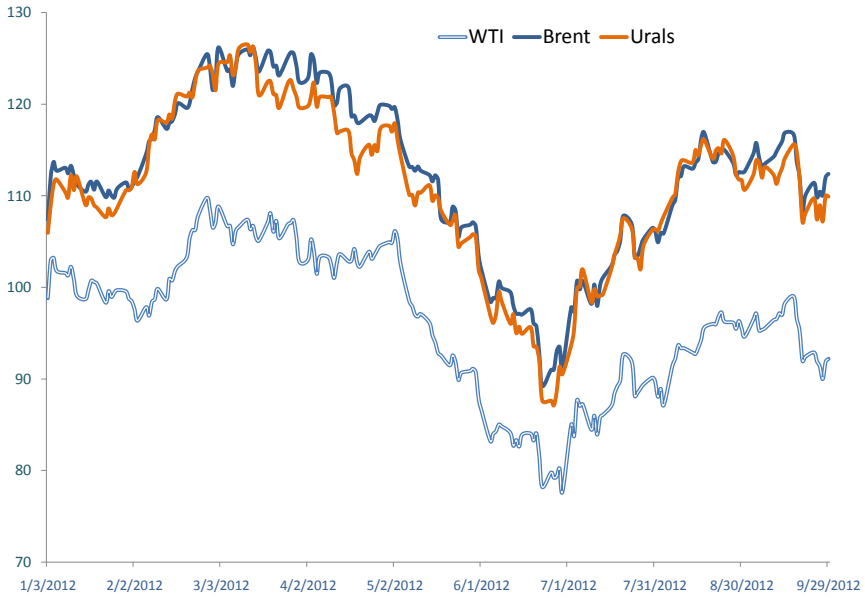
OPEC is continuing to produce oil at very high levels. Most of the increased supplies, however, come from Saudi Arabia, Kuwait, and UAE. As Iran's oil production has plunged in the wake of sanctions in the third quarter of 2012, Saudi Arabia's action has been instrumental in keeping global oil market relatively well supplied (it produces currently almost 10 million bpd). Increased OPEC production, however, implies lower spare OPEC capacity, currently estimated at 2.5 million b/d, making the global oil market sensitive to upside risks.

The World price forecast is set at US$ 105.7/bbl in 2012 (September 2012 update) and expected to remain almost unchanged in 2013. The forecast assumes an eventual resolution of the current supply disruptions, and no longer term impact from sanction on Iran. So far, OPEC capacity has been sufficient to make up for the reduction in Iranian oil exports. Global oil demand is expected to rise by 1.0 to 1.5 percent over the forecast period, with all the growth coming from non-OECD countries, as has been the case during the past few years. Non-OPEC supply is expected to increase by about 1.0 mb/d in 2012, and continue to record moderate gains. More positive developments on the supply side is that importantly, the surge of shale liquids production in the US (and increasingly elsewhere) is turning into a major source of supply growth.

The Brent/WTI differential is expected to begin closing in 2015 due to the expected construction of the pipelines and reversals that will take surplus Canadian and US crudes to Gulf refineries. The Brent premium against WTI, which averaged about 18 percent since February, exceeded 20 percent in early August reflecting not only the geopolitical concerns of the global markets but also the well–supplied position of the US. Oil from Urals is trading at small discount to Brent (the discount fluctuating around 1 percent in 2011 and 2012). Typically, when Urals is in surplus it will trade at a discount while when exports to the Mediterranean are tight then it will trade closer to parity with Brent. The discount of Urals against Brent is expected to widen, as light/sweet crude output returns, and incremental OPEC output is of heavier grades.

There are a number of risks to this forecast. Global supply risks remain from further deterioration in the Middle East as well technical problems. A major supply cutoff could limit supplies and result in prices spiking well above US$ 150/bbl depending on the severity, duration and response (from OPEC, emergency reserves and demand curtailment.) Downside risks, on the other hand, include weaker oil demand due to slower economic growth, especially by China and to a lesser extent other Middle income countries. A key element for price stability will be how well OPEC (and more importantly Saudi Arabia) can respond to changing demand conditions. Historically, OPEC has been able to respond very quickly to defend a price floor by cutting production sharply, but has been unwilling to respond as quickly to set a price ceiling. Yet, while the oil intensity of GDP in middle income countries has been rising, it has not reached levels that could derail economic growth.

Figure 42: WTI and Brent daily prices, US$/barrel



Notes: WTI and Brent and nearby futures closing; Urals is FOB, Baltic delivery
Source: Datastream and World Bank.

Policies – three-pronged agenda

Russia's economy did well early in the year in spite of a difficult external environment but now growth is slowing. In order to reinvigorate the economy, Russia faces three challenges. First, economic policies have to ensure stability. Second, Russia has to build buffers against the external volatility. Finally, the government has to lift the growth potential of the economy in line with its longer-term goals.

Russia's recent economic performance was solid. Aided by a high oil price, growth was steady, the current account balance was strong, fiscal balances remained in surplus, and unemployment receded to record lows. However, now growth is slowing and inflation rising. In order to reinvigorate the economy, Russia's economic policies have to address three issues.

Short-term balancing

Growth in the first half of 2012 is likely to have been above Russia's potential growth rate. Rising inflation, strong credit growth and tight labor markets indicated signs of overheating. However, while early in the year, growth was increasing and inflation declining, the dynamics has changed in recent months. The expansion of economic activity has moderated mainly in response to weaker domestic demand. And inflation has started to rise due to administrative price increases, higher food prices, and the delayed impacts from strong domestic demand and exchange rate depreciation. The recent tightening in monetary policy is assisting this adjustment to more sustainable growth. The priority for fiscal policy is to stick with prudent spending plans and to save oil revenues that come in over and above budget. Focusing monetary policy on low inflation will help to keep inflationary expectations in check and to ensure that inflation returns to the CBR's target range for 2013.

Preparing for the next crisis

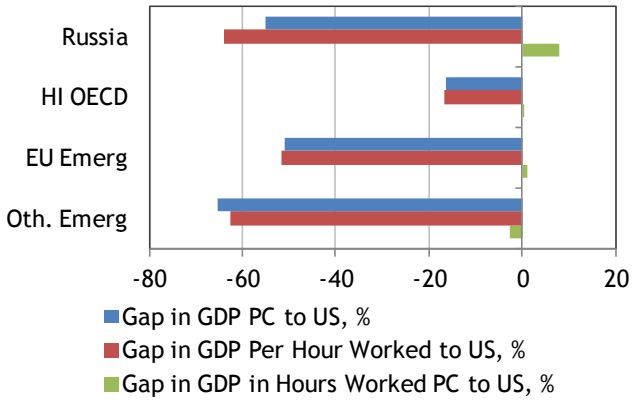
Strengthening macroeconomic policy frameworks is important in an uncertain external environment. In June 2012, the sudden drop in oil price triggered by concerns about the euro area was a reminder about how quickly Russia's economic outlook can change. It also illustrated the importance of exchange rate flexibility as shock absorber in case the external economic sentiment deteriorates. In addition, leaving room for fiscal automatic stabilizers to operate and providing sufficient liquidity to banks are key policy instruments to support the economy for this scenario. Bolstering the macroeconomic policy framework in three areas can help to moderate the vulnerability to spillovers from global uncertainty. First, fiscal policies should be guided by a clear medium-term target. Prior to the crisis, in line with good international practice, 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 increase above 10 percent of GDP this year. Now, Russia is likely to adopt a new oil-price rule that will reduce the non-oil deficit compared to the 2012-14 budget plans although it will remain far higher than the pre-crisis target. This rule should be consistent with rebuilding fiscal buffers in the coming years and sharing rents from exhaustible natural resources across generations. It also should be consistently implemented and complemented with a credible medium-term plan to phase out ineffective public spending, to improve vital public services and protect growth enhancing investment programs. Furthermore, the rule should not be undermined through excessive use of supplementary budgets. Second, greater exchange rate flexibility helps the transition towards full inflation targeting in the coming years. It also strengthens CBR's ability to withstand an oil price shock without significant losses of its foreign exchange reserves and to discourage speculative capital inflows. Third, strengthening banking supervision, also for intra-group lending, is important to make the economy more stable and to bolster Russia's financial markets.

Bolstering the growth potential

Before the crisis, the economy grew at more than 7 percent. Now, growth has slowed to less than 4 percent, as capital inflows turned into capital outflows. With unemployment at record low, capacity utilization approaching pre-crisis peaks and oil prices projected to stay unchanged, additional growth momentum will be difficult to come by. In addition, an aging and declining workforce and declining oil production dampen long-term growth prospects. Bolstering growth requires removing structural barriers and raising productivity. In 2011, the gap in output per hour worked relative to the USA was larger in Russia than among other emerging economies (Figure 43). Russia's executive order on long-term state economic policy sets out ambitious targets for the coming years (Box 10). Russia faces an agenda of enabling workers and entrepreneurs to contribute to and benefit from economic prosperity, and improving governance and the judicial system. This includes reducing the state's

footprint on the economy through privatization, such as through the successful US$5.1 billion sale of a 7.6 percent stake in Sberbank, Russia's leading financial institution, in September 2012. Russia's accession to the World Trade Organization on August 22, 2012 is an important milestone in strengthening the competitiveness of the economy. Russia's ambition to join OECD in the next couple of years is a further anchor for reforms. It is important to leverage the benefits of accession to international organizations with additional steps to improve the investment and business climate firms, both at the federal and the regional level (Box 11).

Figure 43: Gaps in income, productivity, and hours worked per capita in 2011



Source: OECD, World Bank staff calculations.

Box 10. Russia's long-term economic policy targets

On May 7, 2012, President Putin signed the Executive Order on long-term state economic policy. This order aims to step up the rate of sustainable economic growth, increase people's incomes and make Russia a technological leader.

Figure 44. (a) Fixed investment (% of GDP); (b) High-technology and science-intensive sectors (% of GDP)

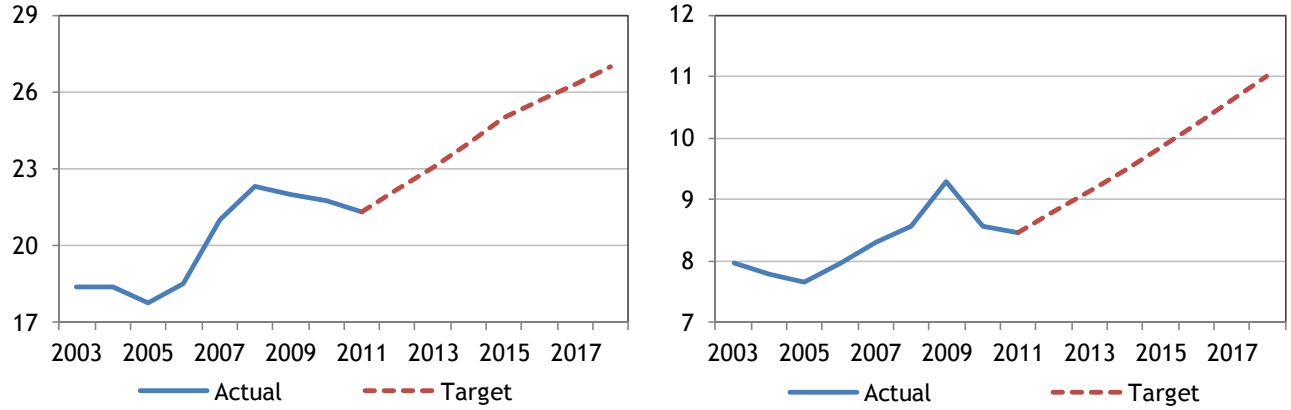
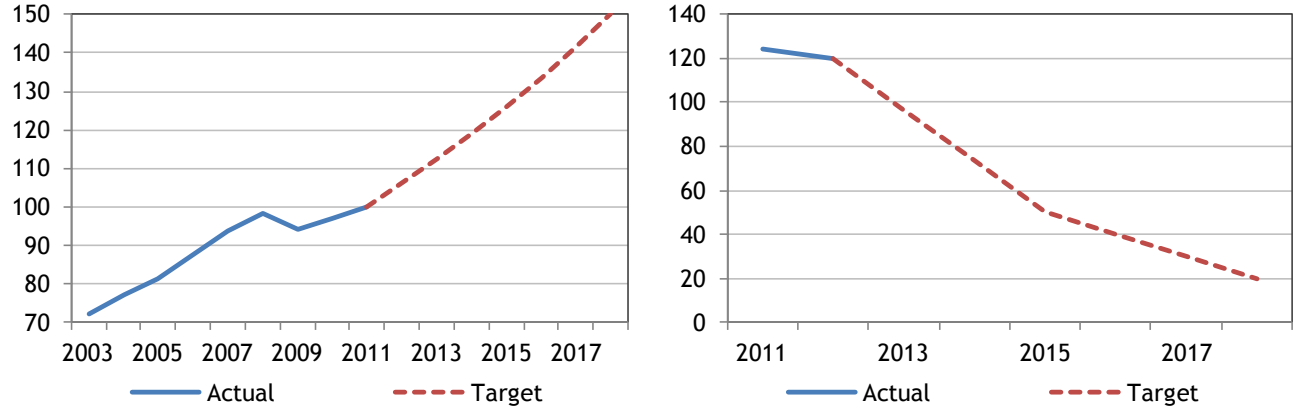


Figure 45. (a) Labor productivity (GDP per worker); (b) World Bank Doing Business rank



Source: Executive Order on long-term state economic policy, Rosstat, Doing Business Report, World Bank staff calculations.
Note: A fifth economic policy target is to create and modernize 25 million highly-productive jobs by 2020.

Box 11: The ease of doing business varies a lot across Russia's regions

Doing Business tracks business regulations that affect small and medium-size domestic limited liability companies. Moscow represents Russia in the annual Doing Business publication, which compares 183 economies worldwide. But entrepreneurs in Russia face different local practices depending on where they establish and operate their businesses. Doing Business in Russia 2009 was the first subnational project to go beyond Moscow and capture regional regulations and regulatory differences in 10 cities on 4 Doing Business topics: starting a business, dealing with construction permits, registering property, and trading across borders.

Doing Business 2012 updates the information from 2008 and tracks the progress in implementation of business reforms on 3 topics—starting a business, dealing with construction permits, and registering property. It also measures a new indicator—getting electricity—and expands the analysis to cover 20 additional cities.

Some observations should be made. First, this year's aggregate ranking should not be compared to the one in Doing Business in Russia 2009 for various reasons. The new aggregate ranking includes getting electricity, while the old ranking included trading across borders. Some changes can also be attributed to recent updates to the dealing with construction permits indicator methodology.

Second, consistent performers stay at the top—Kazan, for example, was already doing well on the areas of starting

a business and registering property in 2009 and continues to be among the top performers on these indicators. Irkutsk remained ranked in the top third of cities measured for starting a business and dealing with construction permits, thanks to continuous reforms.

Third, no city does equally well in all areas. For example, Rostov-on-Don ranks well on getting electricity and registering property, but lags behind on starting a business. Kaliningrad ranks third on the ease of dealing with construction permits, but in the bottom third on getting electricity and registering property. Saint Petersburg climbed to the top of the classification on starting a business due to reforms, but lags in other areas. These results can guide policy makers on areas where improvements are possible without major legislative changes. Cities can share experiences and learn from each other.

Fourth, the demand for business services is usually lower in smaller cities than in large business centers. That can lead to bottlenecks and higher costs for services in large cities, but these also benefit from economies of scale and might have more resources to invest in administrative modernization.

Finally, some regions implemented doing business reforms in recent months. For Moscow, the latest assessment will be presented as part of the global Doing Business report in late October.

Table 13: Doing Business Rankings of Russia's regions across four indicators

City	Region	Ease of starting a business	Ease of dealing with construction permits	Ease of getting electricity	Ease of registering property
Irkutsk	Irkutsk Oblast	8	6	10	18
Kaliningrad	Kaliningrad Oblast	11	3	22	22
Kaluga	Kaluga Oblast	17	9	15	1
Kazan	Republic of Tartastan	4	14	17	4
Kemerovo	Kemerovo Oblast	28	21	7	29
Khabarovsk	Khabarovsk Kray	24	29	8	17
Kirov	Kirov Oblast	13	5	4	20
Moscow	Moscow	25	30	30	26
Murmansk	Murmansk Oblast	12	19	27	23
Novosibirsk	Novosibirsk Oblast	23	18	29	24
Omsk	Omsk Oblast	19	20	13	4
Perm	Perm Kray	13	12	18	27
Petrozavodsk	Republic of Karelia	6	16	21	8
Rostov-on-Don	Rostov Oblast	26	15	3	4
Samara	Samara Oblast	22	24	28	8
Saransk	republic of Mordovia	20	8	1	8
St. Petersburg	St. Petersburg	1	9	24	27
Stavropol	Stavropol Kray	4	2	9	19
Surgut	Khanty-Mansiisk AO - Yugra	30	1	19	8
Tomsk	Tomsk Oblast	15	6	10	25
Tver	Tver Oblast	21	25	14	8
Ulyanovsk	Ulyanosk Oblast	3	4	5	8
Vladikavkaz	Republic of North Ossetia-Alania	27	11	2	2
Vladivostok	Primorsky Kray	18	22	23	3
Volgograd	Volgograd Oblast	2	27	26	4
Voronezh	Voronezh Oblast	15	28	16	8
Vyborg	Leningrad Oblast	10	23	12	8
Yakutsk	Republic of Sakha - Yakutia	8	26	25	30
Yaroslavl	Yaroslavl Oblast	7	17	6	16
Yekaterinburg	Sverdlovsk Oblast	29	13	19	20

Source: 2012 Doing Business in Russia.

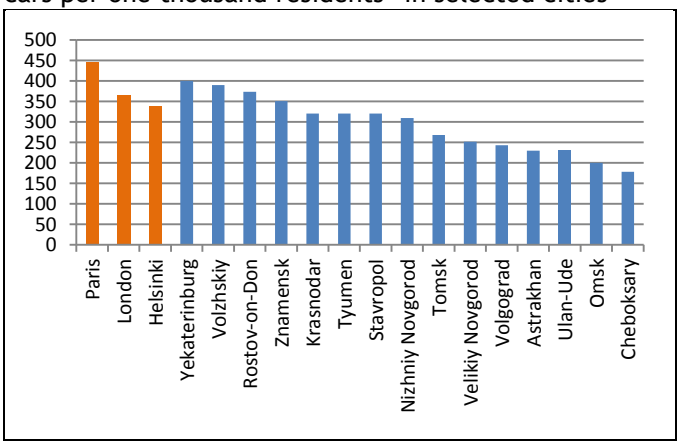
III. Towards Sustainable Urban Transport in Russian Cities

Urban transport is a matter of growing concern in Russian cities. Road congestion is increasing the costs of business in cities and damaging the viability of their economies, as well as wasting the time of its citizens. Congestion arises from a combination of a very high rate of increase of car ownership, combined with a road system which is often poorly maintained, and traffic which is not well managed or constrained. Social sustainability is threatened by the poor quality of public transport, by increasing difficulty in maintaining the concessional fares for disadvantaged categories, and by a road safety record that is among the very worst for industrialized nations. Environmental sustainability is compromised by air pollution from the increasing private vehicle fleet as well as by the age, condition, and outdated technology of many public transport vehicles. Underlying all this is a failure in financial sustainability caused by the inadequacy of resources that cities have to provide necessary services.

A. Russian Cities in Transition

Russian cities are undergoing critical economic and social changes that affect the performance and condition of their urban transportation systems. While the population of most large cities in Russia (over one million residents) remained relatively unchanged over the last decade, the average income of the urban dwellers has sharply increased. The number of private cars per capita and their use have increased rapidly, reaching the level of higher-income cities (Figure 1), and much faster than the supply of transport infrastructure.

Figure 46: Motorization rate—number of registered cars per one thousand residents—in selected cities



Source: European Commission (2006), Staff survey of Russian cities (2011)

At the same time, the transition to a market economy has introduced new private sector involvement in urban land development, an area which used to be entirely the responsibility of local governments. The traditional static command-and-control type master plan is thus no longer adequate. However, the lack of a comprehensive regulatory framework ensuring coordination between urban development and transportation planning—has created a vacuum in the public sector's planning capacity. In many cities, this has resulted in a mismatch between demand for and supply of transport infrastructure.

A similar transition has occurred in the provision of public transport services. Private bus operators have entered the market to fill the shortage of service supply left by publicly owned bus companies plagued with financial difficulties and operational inefficiency. But here again the lack of a comprehensive regulatory framework has undermined the potential of the private sector to play an integral role in a well managed urban public transport system, and created a *de facto* two-tier market that is less than efficient.

This review looks at the key challenges of urban transportation in Russian cities and examines their underlying causes. It is based on interviews or surveys of 24 Russian cities, as listed in Table 14.

Table 14: Basic Data of the Interviewed/Surveyed Cities

City	2010 Population (thousand)	Annual average population growth since 2002 (%)	Area (km^2)	Density (pop/ km^2)	2010 Average income (US$/year)
Novosibirsk	1,473	0.36%	507	2,812	
Yekaterinburg	1,387	0.78%	468	2,964	
Nizhniy Novgorod	1,262	-0.42%	411	3,071	
Omsk	1,154	0.19%	567	2,035	6,864
Rostov-on-Don	1,070	0.02%	349	3,070	

Volgograd	1,022	0.12%	859	1,190	6,924*
Krasnodar	786	2.20%	840	936	
Vladivostok	617	0.41%	562	1,099	
Tyumen	615	2.09%	235	2,617	
Tomsk	545	1.24%	294	1,854	6,540
Astrakhan	521	0.36%	209	2,495	8,268
Kemerovo	512	0.61%	295	1,737	8,208
Lipetsk	508	0.04%	330	1,540	8,167*
Cheboksary	463	0.55%	251	1,845	5,976
Ulan-Ude	406	1.36%	377	1,076	8,909*
Stavropol	399	1.31%	277	1,442	
Volzhskiy	314	0.03%	150	2,096	
Tambov	280	-0.51%	153	1,832	
Velikiy Novgorod	219	0.11%	90	2,433	
Ussuriysk	184	1.72%	134	1,377	
Kamyshin	119	-0.80%	38	3,132	4,464
Akhtubinsk	42		43	980	2,256
Znamensk	29		54	537	4,320
Kamyzyak	16		24	667	

Note: (*) indicates average wage (US$ per year)

The supply of transport infrastructure and services is highly variable across the cities surveyed (Table 15). The road network density, measured by the total length of the road network divided by the area of the city, ranges between 0.65 and 5.83 km/km^2; although the gap is smaller among larger cities (population 500,000 and above), ranging between 1.5 and 4.5 km/km^2. In most cities, autobuses and minibuses are the primary public transport modes, though most still have electric tram and trolleybus networks. Private sector supply already exceeds that of the public sector in many of the cities. Public transport route coverage, measured by the total length of operating routes divided by population, ranges widely between 1.10 and 9.69 km per thousand inhabitants in the surveyed cities.

Table 15: Supply of transport network and services

City	Road network (km)	Road density (km/km^2)	Public transport route length (km)						Route coverage (km/pop)
			Total	Bus	Suburban bus	Mini-bus	Trolley-bus	Tram	
Yekaterinburg	1327	2.84	2203	1601			213	389	1.59
Nizhniy Novgorod			2668	1010		1220	243	195	2.11
Omsk	1404	2.48	5621	1943	1243	2217	155	63	4.87
Rostov-on-Don	1193	3.42	3934	1644		2053	175	63	3.68
Volgograd			4249	773		3198	118	160	4.16
Krasnodar	1651	1.97	3838	1228	2307		179	124	4.88
Vladivostok			1127	1096			26	5	1.83
Tyumen	1112	4.73	3973						6.46
Tomsk			987	822			121	45	1.81
Astrakhan	819	3.92	2939						5.64
Kemerovo	1307	4.43	4960	1007	2731	1069	101	53	**9.69**
Lipetsk	508	1.54	1282	1113			115	54	2.52
Cheboksary	181	0.72	1430	1018			412		3.09
Ulan-Ude	245	**0.65**	1456	1400				56	3.59

Stavropol	455	1.64	2141	1955			186		5.37
Velikiy Novgorod	225	2.50	464	428			35		2.12
Ussuriysk	474	3.55	1474						8.01
Kamyshin	222	**5.83**	242						2.04
Akhtubinsk	135	3.14	247	247					5.86
Znamensk	45	0.83	32						**1.10**
Kamyzyak	67	2.79	18						1.13

B. Urban Transport Challenges Facing Russian Cities

Congestion. Road traffic congestion is regarded as serious in most cities with population 200,000 or more, and increasing rapidly in some (Table 16). For example, Nizhny Novgorod estimated that the length of its road system that is overloaded would increase from 10 kilometers to over 25 kilometers in the period 2009-2013. The congestion is regarded primarily as the consequence of a very high rate of growth of the private car fleet, unmatched by the limited road capacity, lack of efficient traffic management schemes, particularly at choke points and intersection, and lack of good alternatives to private transport—public transport modes.

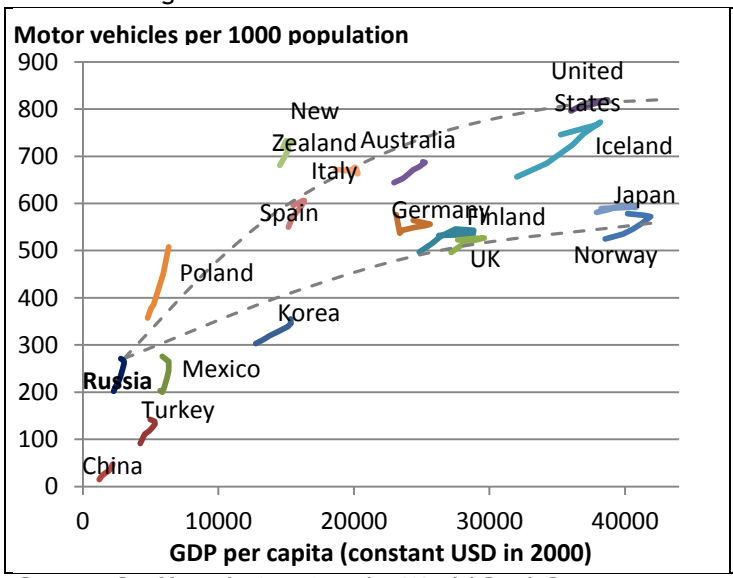
Table 16: Reported assessment of traffic congestion problems

City	Self-Assessment of Traffic Congestion in City
Yekaterinburg	Traffic congestion is a serious problem. During peak-hours, traffic speeds along main city streets are observed at 8-9 km/h.
Omsk	Road-based public transport operation is often delayed due to traffic congestion, up to 30-40 minutes later than the scheduled time.
Krasnodar	Traffic congestion is a serious problem. During peak-hours, traffic speeds along main city streets are observed at 10 km/h.
Tyumen	Traffic congestion during peak hours is a growing and severe problem. When the volume to capacity ratio exceeds 0.7, speeds noticeably decline and vehicles take more time to cross intersections, and the ratio often exceeds 0.9 on various road sections.
Tomsk	Traffic congestion during peak hours along main city streets causes time losses of 40 to 90 minutes per car.
Lipetsk	Traffic congestion is a serious problem. The speed at key choke points does not exceed 5 km/h during the peak hours.
Stavropol	The road infrastructure of Stavropol was not designed to support the substantially increased traffic flows; it corresponds to private car ownership of 60-100 cars per 1,000 residents, whereas the actual figure is already over 320 cars per 1,000 residents. This has resulted in the deterioration of traffic conditions, congestion and traffic jams, increased fuel consumption, worsening of the environmental situation and a growing number of traffic accidents.
Velikiy Novgorod	City suffers traffic jams at heavily populated crossroads. It is particularly felt during rush hours, affecting adversely the quality of passenger conveyances. Specifically, public transportation fails to follow its own timetables.
Ussuriysk	Traffic congestion during peak-hours and road repair works, and force majeure (e.g. natural disaster) is a key problem.
Kamyshin	Traffic congestion has recently become a problem, especially during peak-hours and at key junctions including entrance to the bridge.

Car ownership growth pattern. It is a worrying trend that citizens in larger Russian cities now own more number of cars than those in some Western European cities that have much higher income levels (Figure 47). These trends will continue in the next decade as the incomes continue to grow. Cross-sectional and time-series data of middle-

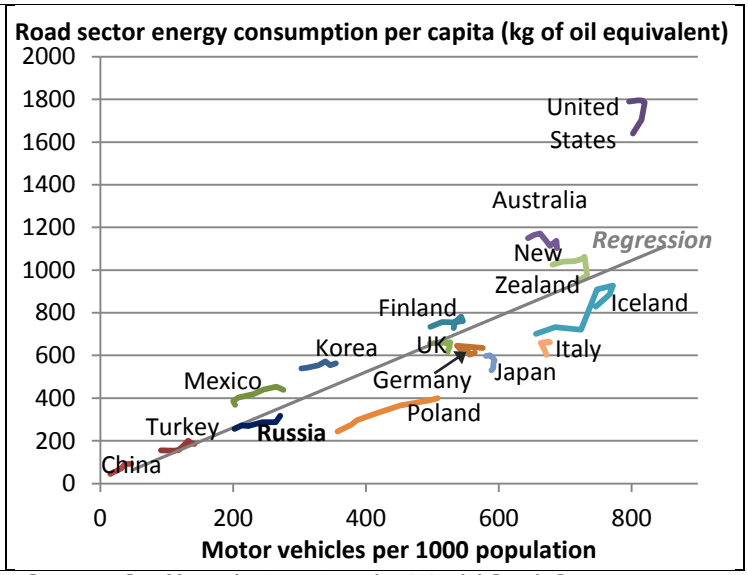
to-high income countries show strong positive correlation between income and car ownership (although with significant variance among countries at similar income level), and between car ownership and road sector energy consumptions (Figures 47 and 48).

Figure 47: GDP is positively correlated with car ownership, with significant variance among countries, trends during 2003-2009



Source: Staff analysis using the World Bank Data (data.worldbank.org)
Note: GDP per capita is in constant US dollars in 2000 price

Figure 48: Car ownership is positively correlated with road sector energy consumption, trends during 2003-2009



Source: Staff analysis using the World Bank Data
Note: The regression was done for cross-sectional data in 2009 and the R-square is 0.79.

Operating deficits and deteriorating fleet condition of municipal public transport services. All cities except three reported operating deficits of municipal bus operation; in case of Lipetsk, Volzhskiy and Znamensk, the deficits are as high as 183, 210 and 93 percent of the operating revenues respectively – i.e. fare revenues covering only between about 30 percent and 50 percent of operating costs (Table 17). While similarly low levels of cost coverage occur in several western European cities, even those with commercial private sector suppliers, this is usually the result of a conscious policy of funded subsidy of a well maintained fleet. In contrast in Russia, the financial situation of municipal operators requires budget-financing for fleet replacement and is usually associated with an aged and deteriorating fleet.

Table 17: Financial performance of bus operation and average age of bus fleet

City	Operating costs (US$)	Operating revenues (US$)	Operating deficits† (US$)	Operating deficits† (% of revenues)	Average age of autobus fleet
Yekaterinburg	55,642,297	40,424,543	15,217,753	38%	9
Omsk	92,542,057	82,766,450	9,775,607	12%	8.5
Krasnodar	69,753,250	72,877,020	-3,123,770	-4%	5
Tyumen	16,619,987	20,304,713	-3,684,727	-18%	5-27
Tomsk	19,717,867	14,563,800	5,154,067	35%	
Kemerovo	45,630,000	40,050,000	5,580,000	14%	8.4
Lipetsk	34,509,583	12,195,980	22,313,603	**183%**	8
Cheboksary	28,840,000	26,206,667	2,633,333	10%	6
Ulan-Ude	9,963,333	9,150,000	813,333	9%	Municipal operator: 12 Private operators: 7

Stavropol	9,646,667	7,093,333	2,553,333	36%	6
Volzhskiy	14,562,353	4,690,910	9,871,443	**210%**	12.4
Velikiy Novgorod	19,732,967	18,781,467	951,500	5%	16.9
Ussuriysk					10-15
Kamyshin					5.2
Akhtubinsk	1,142,670	1,191,473	-48,803	-4%	Municipal operator: 18.5 Private operators: 10
Znamensk	405,407	209,797	195,610	**93%**	10.4
Kamyzyak					5-6

† Note: Negative values of operating deficits mean that bus operators generated operating profits.

The concern of the cities with their public transport fleet is usually concentrated on the age and condition of the fleets of the municipal enterprises, though not all gave detailed information. Tyumen quoted the average age of its large bus fleet as 27 years, while Veliky Novgorod estimated the average age of its trolleybus fleet as 20 years. In contrast, however, the average age of the private large bus fleets was considerably lower, and that of the minibus and shuttle taxi fleets (which have a shorter physical life) was generally in the range from 3 to 5 years. Tender conditions are being used in some cases (e.g., Tyumen) to reduce the average age of the vehicle fleet owned by private operators. Decreasing quality and condition of public transport vehicles makes them unattractive to users, often perceived as "poor people's transport", which those who can afford owning private vehicles avoid using. This has resulted in the growing share of users that pay concessional fares.

Air quality. Air pollution in Russian cities is typically stated either in terms of aggregate weight of pollutants emitted or in terms of an air pollution index (API).‡ In most surveyed cities, road traffic is estimated to be the main source of air pollution accounting for over 50% of the total emissions. However, source apportionment is not usually undertaken scientifically and the transport contribution appears to be regarded as a general impression rather than a well demonstrated fact. While the overall air quality, appears to be improving moderately in some of the larger cities, and associated with improved vehicle fleet standards, parallel changes in industrial heating may also be playing a large part in the improvement. Table 18 summarizes the self-assessment of the cities in the sample.

Table 18: Reported assessment of air quality

City	Self-Assessment of Air Pollution in the City attributed to Transport
Yekaterinburg	The emission of pollutants into the atmosphere is 315,000 tons per year including 252,600 tons p.a. from moving sources.
Omsk	In 2010 the level of air pollution was 11, which is a high level. The main pollutants are formaldehyde and benzo (a)pyrene.
Krasnodar	Transport is the main source of pollution (90%). Exceeding of maximum permissible concentration by 0.3 % in peak-hours. Level of NO2 is close to maximum permissible concentration (MPC).
Tyumen	Atmospheric air quality somewhat improved in 2010: the API was 12, or 14% below the 2009 level and 40% below the maximum over the past five years. Motor transport is the main contributor to air pollution. In 2010 vehicle emissions amounted to 82,245 tons, with the principal pollutants being carbon monoxide, formaldehyde and suspended solids. Overall, over the years the number of atmospheric air samples exceeding the maximum permissible concentrations in Tyumen decreased from 3.6% in 2008 to 0.98% in 2010. The air pollution levels on highways were 7.4% in 2008 and 1.4% in 2010, and in industrial zones 1.6% and 0.45%,

‡ API is an index characterizing the input of separate pollutants (suspended matter, sulfur dioxide, carbon monoxide, nitrogen dioxide, nitrogen oxide, phenol, ammonium, formaldehyde, benz(a)pyrene) to overall atmospheric pollution over a given period for the given area or measurement point. The level of air pollution is considered to be: Extremely high if API ≥ 14, High if 13 > API > 7, Moderate if 6 > API > 5, and Low if API < 5

	respectively. The more efficient measures of reducing the impact on atmospheric air is the operation of motor transport conforming to the EURO-3 and EURO-4 emission standards and the installation of dust and gas trapping devices at industrial facilities.
Tomsk	The amount of air pollutants in 2010 was 123,000 tons, 6.9% up from 2009, including 86,800 tons (70%) emitted by transport (5% up from 2009)
Kemerovo	According to the Office of Natural Supervision of the Kemerovo City, the level of emissions amounted to 55.35 tons. The set maximum permissible level was 51.44 tons, thus the emissions exceeded the maximum permissible level on 7%. The emissions increased by 2.31 tons as compared to the previous year. The contribution of transport to total emissions amounted to 55.57%, including: carbon oxide - 87.7%; NO - 43.7%; volatile organic compounds - 89.4%.
Lipetsk	API is 7.5. Lipetsk is one of the five most polluted cities in Russia. In the past years the air pollution caused by growing number of vehicles become a pressing issue, the share of air pollution by vehicles is 28%.
Cheboksary	During 2006 - 2010, formaldehyde's level grew, while level of sulfur dioxide, carbon monoxide, nitrogen oxide, and phenol decreased. The level of suspended solids, soluble sulfates, and nitrogen dioxide remains stable. API was 11.0 in 2010. The basic contaminants include the following: formaldehyde API - 6.98, benzo(a)pyrene API - 2.41 suspended solids API - 0.98, nitrogen dioxide API - 0.64, carbon monoxide API - 0.42.
Ulan-Ude	Total emissions (from stationary sources and vehicles) in 2010 amounted to 54,315 kilotons, including: solids - 14,564 kilotons, sulfur dioxide - 7,736 kilotons, carbon monoxide - 23,438 kilotons, oxides of nitrogen - 5,415 kilotons, VOC - 2,834 kilotons. The contribution of transport to total emissions amounted to 40.88%, including: carbon monoxide - 32.36%, nitrogen oxide - 4.43%, VOC - 4.03%. Emissions from vehicles in 2010 decreased by 24,478 t as compared to 2009, but this was caused by changes in methodology for estimating emissions from mobile sources (road and rail transport). Level of air pollution (LAP) decreased over the past five years (LAP was 13.8 in 2006, 14.6 in 2007, 14.6 in 2008, and 13.6 in 2009) and remained at high level (12) in 2010.
Velikiy Novgorod	Gross atmospheric emissions 2010 total 44,632 kilotons, including: 11,471 kilotons from stationary sources, 33,161 kilotons from vehicular transport (74%). API is in decreasing trend, except an increase in 2009: 6.8 (2007), 5.0 (2008), 5.5 (2009), and 4.4 (2010).

C. Underlying Causes of Urban Transport Challenges

The negative externalities of urban transport—traffic congestion and air pollution—are the symptoms of several problems, such as insufficient infrastructure, subpar quality of public transport services that are inferior to private transport, and policies that encourage or fail to discourage behaviors that generates externalities. And these problems are attributed to various factors, including institutional, technical and financial ones.

Legal Framework, Allocation of Responsibilities and Powers, and Financial Resources

In the Russian legal framework, urban transportation is not specifically identified as a distinct, integrated and comprehensive strategy area. Instead, various laws define some modes and fragmented elements of urban transport in terms that are often technically inadequate. Government Decree 1090 of October 1993, "On the Rules of the Road," defines the basic rights and responsibilities of drivers, passengers and pedestrians. Federal Law No. 257-FZ, "On the Roads and Road Traffic in the Russian Federation and on Introducing Amendments to Certain Legislative Acts of the Russian Federation (November 8, 2007)," defines road transport and city ground electrical transport (trams and trolleybuses but not metro); Federal Law No. 196-FZ (December 10, 1995) loosely defines traffic management in relation with road safety but the definition does not adequately capture the modern sophistication of traffic management policies, instruments and technologies. Logically, responsibilities for things that are not legally and technically well defined cannot be granted to a legal entity.

There is also some confusion about the jurisdictional allocation of responsibilities and mismatch between the defined roles of a sub-national government and resources allowed for them to carry out their roles. Specific component technical functions are assigned separately by statutes, such as Federal Law 184-FZ, "On General Principles of Local Government in the Russian Federation (October, 2003)," and Federal Law No. 196-FZ, "On the Road Safety (December 10, 1995)". Some urban transport functions are at oblast and some at municipal level. For example, traffic management appears currently to be a function shared between federal and regional governments, road provision and maintenance is shared between regional and rayon administrations, while public transport provision is delegated to the lower level of the settlements. Furthermore, the federal responsibility for protection of the environment might be interpreted to give the Federation powers to intervene where urban transport could be deemed to have adverse environmental impacts. This current confusion in the assignment of responsibilities also makes it difficult for municipalities to develop a comprehensive strategy.

The current legal system makes it difficult to handle inter-jurisdictional issues, which transcend municipal boundaries and include catchment areas, in a strategic manner and metropolitan scale. Several cities claimed to have difficulties in organizing transportation beyond their municipal boundaries as a consequence of the absence of appropriate arrangements for metropolitan level institutions. As there is no provision in law for a metropolitan level organization, problems are met on an ad hoc basis. Novosibirsk has established interurban bus terminals near its boundaries to ensure that cross-boundary traffic transfers to the municipal services. Veliky Novgorod has a draft agreement with the adjacent rayon giving the municipality the right to plan services for the whole network. The delegation from Tomsk explained its plan to develop an interurban high speed train, which was conceived by an inter-municipal working group. Most cities believe that it would be more efficient if their municipal transport services could be extended through the whole of the catchment area and protected from being undermined by services given permits by the region to operate into the city.

Weak financial capability of municipalities undermines their ability to develop medium-term investment programs or to allocate adequate funds for maintenance of infrastructure assets and renewal of vehicles. This is attributed to the limited taxing power of municipalities and unpredictability of intergovernmental transfers. The only taxes that may be collected and administered by regional or municipal governments are those stipulated in the tax legislation (Tax Code) as regional or municipal taxes, at a rate that is equal to or lower than what is stipulated in the Tax Code. Most municipalities interviewed claimed that they are dependent on transfers from regions for approximately 70 percent of their revenues, with about 30 percent coming from their own sources (e.g., land tax, part of personal income tax, and municipal trading revenues). The Federal Government directly transfers funds to its subjects, i.e., regions, which then transfer funds to their subjects, i.e., municipalities and other rayons. Where some funds are earmarked for specific projects, as in some federal targeted programs, the regions pass them through automatically to the relevant subsidiary agency or jurisdiction. However, all other capital budget allocations to municipalities appear to be on an annual request-and-negotiation basis. This makes it difficult for municipalities to do meaningful long-term strategic planning, or to make sure that their allocation of resources is consistent with a long-term strategy.

The financial insecurity cascades down through the system: municipal transport companies rely on the city to finance vehicle replacement, while the city relies for money for this purpose either on its annual request to the region or on the even less regular and reliable source of federal targeted programs (i.e., sporadic grants allocation). As a result, the quality of municipal public transport suffers. The challenge facing Russia is thus to develop a more secure and predictable funding arrangements for the municipalities on the basis of which they can plan strategically and implement their plans consistently.

Urban Transport Planning and Institutional Capacity at Municipalities

In most cities, transport planning is weakly performed and limited in scope. In most cities planning effort is devoted to the traditional apparatus of land-use planning and development control (i.e., a general plan). This is performed mostly by a city architecture department, or its equivalent, which is often very powerful within a city authority. Typically a general plan determines the spatial allocation of activities, including spaces for road infrastructure, but often stops at identifying major infrastructure investment requirements without dealing with crucial issues of system management. There is no legal requirement for traffic impact assessment associated with new development permissions. In Stavropol and Tambov, the transport professionals found this arrangement unsatisfactory because of too narrow an interpretation of the urban development code, not recognizing the new realities of motorized transport demand. In Nizhny Novgorod and Novosibirsk, it was argued that parking standards should be determined essentially by transport policy, and that the standards currently applied were inappropriate.

Transport departments in municipal governments—often split between public transport and road traffic management functions—are generally poorly staffed to perform a strategic planning function. In Tomsk, Tambov, Novosibirsk and Veliky Novgorod the transportation units have a staff of only four-to-five people responsible for road safety and public transport. Nizhny Novgorod, a city of 1.25 million inhabitants, is richly endowed with a transport staff of 15. In Lipetsk, the Department of Town Planning and Architecture itself appears to play the role of lead urban transport planner. It is claimed that traffic management improvements and public transport routing are covered by the general plan. The Department of Town Planning and Architecture intend to commission a traffic management study, but indicated that they would engage the transport department to advise on that and to consult on traffic impacts of all new developments. Given those administrative arrangements, it is not surprising that none of these cities have a proper strategic plan for the urban transport sector. Tyumen is a rare exception in the interviewed cities, with a transport department staff of 45-50 persons including a strategic planning unit of 10 persons. It does have a transport strategy plan, produced in 2006 and most recently updated in 2011.

Public Transport Systems: Planning, Integration, and Quality

Most Russian cities lack a "backbone" of public transport system—high-speed and high-capacity mass transit that is supported by feeder systems—and instead often have a fragmented system in which various modes are not fully integrated. The former Soviet policy required provision of metro systems for all cities with a population exceeding one million; and according to this metro systems were constructed in eight cities, including several short ones—Novosibirsk (16 km), Nizhny Novgorod (15.5 km), Samara (11.4 km), Kazan (10.3 km), and Yekaterinburg (8.5 km). These systems were often built to connect primary residential areas to industrial zones during the Soviet era and are typically poorly integrated with the rest of the transport system. Failing to perform the high-speed trunk movement function, several of these systems now carry only small shares of total public transport trips: 16 percent of total public transport trips in Novosibirsk are by metro, 12 percent in Yekaterinburg, and only 2.5 percent in Nizhny Novgorod. Underutilization of and heavy subsidies for some metro systems are outcomes of the absence of coherent transport strategy and alternative analysis that explores various technology options not just metro rail.

The current status of conventional trams and suburban railways also reveals the need for comprehensive planning and system integration. Majority of medium-to-large Russian cities have conventional tram systems operated by municipal entities, which are in poor condition and offer low quality service. In some cases where the traditional municipally-run bus services have collapsed and are being replaced or supplemented by private bus operators, the trams continue as the main carrier of concessionary fare passengers, often at a high average cost per passenger. These existing tram systems, incurring operating deficits funded through the city budget, need to be revamped either through replacement with other modes or upgrading to modern rail systems. With regard to suburban railways, their potential role in many growing cities with sprawling catchment areas is not being adequately considered in most cities, though the situation is better in Moscow. This problem is accentuated by the lack of interest of the commercialized national railways in providing passenger services, as they focus their business on the more profitable freight services. It is necessary to explore the opportunity to transform the suburban rails into modern mass transit systems that can efficiently move suburban residents into the city center.

Facing rapid motorization, many Russian cities are in need of integrated, high-performance public transport systems, which can compete with, and divert passengers from, private transport. This can be achieved through good planning, organization and management of operations, and help of advanced technologies. Some key characteristics of good public transport systems include the following: (i) Trunk and feeder roles are appropriately allocated among modes; (ii) A significant portion of the trunk network of public transport, regardless of types of vehicles and propulsion technologies, is segregated from road traffic to ensure speed and service quality; and (iii) All modes are physically and operationally integrated within one system, making transfers easier and less costly.

Operation of existing road-based public transport modes and the way private bus services are procured is less than efficient. Many cities currently have a two-tier public transport system. Social services are provided by municipal unitary enterprises, of which assets (including vehicles) are owned by the municipal authority, under sole-source contracts and offer concessionary fare. Commercial services are competitively tendered and provided by private operators under term contracts. This arrangement undermines market efficiency, a status in which the most qualified cost-competitive operators provide services on particular routes under clearly defined contractual obligations. The current contracting system needs to be reformed to eliminate the two-tier system, to strengthen the competition for the market, and to improve monitoring of operators' performance in terms of service quality and vehicle standards.

For urban public transport to be economically sustainable it is necessary to reform not only the attitudes and procedures of service procurement, but also to reform the operators. The municipal operators must be truly commercialized: they must take ownership of their assets and be responsible for replacing them from revenues. They must operate under contracts to the municipality which, whether negotiated or won through competitive tendering, involve payment for the provision of unprofitable services as well as adequate compensation for the carriage of concessionary fare passengers. To achieve this they must be put at arm's length from the procuring authority. They must not receive any deficit finance for losses incurred beyond the money received under the service contracts, and they must be subject to bankruptcy if they fail. To achieve this will probably require a reform of the conditions under which services are procured from public sector companies. But legally it will also require a revision of the status of unitary municipal enterprises in public transport provision.

Road Network and Traffic: Capacity, Quality and Utilization of Existing Capacity

The urban street system is an extensive and costly fixed investment that requires substantial resources to maintain, and many cities are struggling to adequately meet the maintenance needs. The rapid increase in motor vehicle ownership in most cities is placing substantial additional challenges in terms of maintaining this system, upgrading the traffic carrying capacity of existing road links, and in providing extensions to road system.[§] This means cities need not only to maintain the existing road network, but also to selectively upgrade existing road links and to make investments in new streets in response to increased traffic and new land developments. In reality many municipalities have under-invested in road maintenance, which resulted in deterioration of these networks. In the long-run, failure to maintain the road network in a timely manner leads to even more costly road rehabilitation or complete reconstruction.

These poor road conditions have been acerbated by the current fiscal arrangements under which municipalities need to annually negotiate for road funds from oblast authorities. This has made it difficult to commit to longer-term road maintenance and investment plans. Many municipalities do not have in place adequate data on road conditions and traffic, and most have no computerized analysis of available data on which to directly take into account vehicle operating costs, unit costs of road works, and pavement strength and condition over the entire road network. Consequently, most municipalities are not able to develop an optimum road network maintenance strategy, i.e., the set of interventions (and related budget) that would minimize the total road maintenance and rehabilitation expenditures in the city.

Not just length and width of roads, but traffic management—how the road network is utilized—also determines the capacity of the road network. However, this function is narrowly defined and weakly performed in many Russian cities. In Russia, traffic management has historically been viewed primarily as a police function related to safety. While that has changed recently, only in the larger cities such as Moscow and St Petersburg has this resulted in the development of a more comprehensive traffic management function at the city level. Of the next level of cities only a few have established a sufficiently strong traffic management organization. Traffic signal systems in many cities are in poor condition and often primitive, with limited use of Intelligent Transportation Systems (ITS) applications that utilized advanced information and communication technologies in monitoring and traveler information services. Nevertheless, Russian experience shows that improved traffic management organization can yield great benefits. Since the creation of a Road Traffic Management Unit in Novosibirsk in 2006, the unit has been responsible for coordinating actions of various units and introducing new technologies, resulting in an increase of average travel speeds by 15-20 percent and a reduction of fatalities and serious injuries by 18-20 percent in a two year period.

Demand Management: Paradigm Shift, Policies and Incentives

Most Russian cities have not yet adopted the concept of demand management as part of their transport strategies. This is often a matter of philosophy—many cities are committed to accommodating increasing demand for car traffic that is rising rapidly as the income and motorization rate grow. But experience in other cities clearly show that it is neither physically nor financially feasible to accommodate unrestrained demand for car traffic without serious road congestion and its attendant environmental impacts. In Russia, St Petersburg is one of the first cities that adopted the notion of demand management in their 15-year urban transport strategy. The strategy, while including some important road investments, recognizes the need for a shift from private to public transport for journeys to the central area, particularly during the peak hours. And a policy to achieve such a shift needs to include both supply- and demand-side measures: the improvement of public transport and the management of private transport demand.

[§] Between 1993 and 2007 the Russian passenger car vehicle fleet increased from 11.5 million vehicles to 29.4 million, an increase of 155% or about 7% annually over this 14 year period. Most of this growth has occurred in urban areas.

Municipalities lack appropriate instruments—development control, regulatory framework, and pricing measures—to develop a comprehensive city-wide parking strategy. Parking policy, which is the main instrument for demand management in better performing cities, is severely hampered in Russia by the current legal provisions—the Urban Development Code, the Federal Law, or the Traffic Rules—in various ways. First, the minimum requirements for off-street parking spaces to be provided by developers are out of date and do not match the current levels of motorization. Second, none of the current legislation is concerned with limits on the total amount of available parking spaces in congested city center or the allowable duration of parking, which are crucial elements of a comprehensive city-wide parking strategy in most European cities. Third, while recent changes in Federal legislation do give more freedom to municipalities to manage the use of transport lands for parking, municipalities can develop a parking policy only for municipal roads and regional authorities do only for regional roads. Forth, restrictions remain on the application of penalties for infractions and on the use of civilian officers to enforce parking regulations, undermining efficient enforcement.

D. Roadmap to Improved Sustainability and Livability

Priority Legal Reform: Adopting a new comprehensive law on traffic management. The Concept of the Draft Law on Traffic Management prepared by the Ministry of Transport, dated February 2, 2012, lays out the ground for important reforms. The Draft Law recognizes that the gaps and contradictions in the existing legal system concerning road traffic management. It also adopts important principles such as viewing traffic management as a key strategic element of, and critical necessary condition for, sustainable urban transport systems. Nevertheless, there are remaining gaps in the new Draft Law. For instance, the Draft Law does not grant the power of traffic management solely to municipal authorities along with other functions of urban transportation. The Draft Law also needs to be clearer about its treatment of the relationship between land-use and transport planning. Municipalities should be given clear and extended power to limit, and charge for, on-street parking, to set charges and fines for infringement at local level, and to use civilian employees to implement and enforce parking policy.

Priority Legal Reform: Comprehensive legislation on public transport supply and operation. One of the important gaps of the Draft Law on Traffic Management is its omission of public transport issues. It is recommended that planning and regulation of public transport services, requirements for competitive tendering, recommendations for gross-cost contracting, and reforms of municipal unitary enterprises be handled in one comprehensive law on public transport supply and operation. Ideally, this law would allow for some intermediate forms of metropolitan coordination, which enable route planning and integrated operation of public transport services that cover multiple municipalities in urban areas.

Priority Advisory Assistance: Creating a national facility for knowledge sharing and capacity building. Given the economies of scale, there is a strong case for a national level institution performing a leading role in managing a national urban transport database and providing guidelines and good practice examples to all Russian cities. As these activities are the basis both for the development of training and capacity building and identification of research needs, it is considered that these two functions should also be in the same cluster. The institutional arrangement that is most appropriate in Russia needs to be identified. Possible options, some variants of which have been used in other countries, include (i) facilitator-model in which a compact organization subordinate to the Government is coordinating various activities through contracts with various research and education institutions, (ii) a budget-funded research and advisory institute model, in which a great proportion of substantial work is done by in-house staff; and (iii) a more direct arrangement in which the Ministry acts as the facilitator directly contracting packages of tasks.

Priority Financial Assistance: Supporting pilot projects for demonstration effects and potential scale-up. Federal government may choose to provide counterpart funding for carefully selected pilot projects—for instance, introduction of advanced traffic management systems, autobus procurement reforms, development of a city-wide parking policy, and development of modern mass transit corridors—that would have substantial demonstration effects. Not only would these pilot implementations demonstrate potential benefits of innovative urban transport measures, but also lessons learned during project preparation and implementation can be shared with other cities that are considering similar approaches. This could evolve into a more permanent arrangement of Federal financial assistance. Such an arrangement would improve sustainability of urban transport by encouraging a more strategic approach at the municipal level, improving project selection and results monitoring, and encouraging high impact reforms. An important caveat is that accountability should be ensured through clearly defined eligibility criteria and grant conditionality. Reliance of municipalities on sporadic and ad hoc injection of finance in solving chronic problems undermines long-term sustainability.

Russian Federation: Main Economic Indicators

	2007	2008	2009	2010	2011				2012								
Output Indicators	**Jan-Dec**	**Jan-Dec**	**Jan-Dec**	**Jan-Dec**	**Oct**	**Nov**	**Dec**	**2011**	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**
GDP, % change, y-o-y 1/	**8.5**	**5.2**	**-7.8**	**4.3**	-	-		**4.3**	-	-	4.9	-	-	4.5	-	-	
Industrial production, % change, y-o-y	**6.8**	**0.6**	**-9.3**	**8.2**	3.6	3.9	2.5	**4.7**	3.8	6.5	2.0	1.3	3.7	1.9	3.4	2.1	
Manufacturing, % change, y-o-y	**10.5**	**0.5**	**-15.2**	**11.8**	5.7	4.9	3.3	**6.5**	4.8	6.3	2.4	3.6	7.0	3.4	5.7	4.1	
Extraction of mineral resources, % change, y-o-y	**3.3**	**0.4**	**-0.6**	**3.6**	-0.3	1.3	1.8	**1.9**	1.4	3.7	0.8	1.2	-0.3	0.2	0.9	0.8	
Fixed capital investment, % change, y-o-y	**21.1**	**9.8**	**-16.2**	**6.0**	13.7	12.8	14.0	**8.3**	16.4	16.2	17.0	8.6	11.1	6.3	3.8	2.3	
Fiscal and Monetary Indicators																	
Federal government balance, % GDP 1/	**5.4**	**4.1**	**-5.9**	**-4.1**	3.2	2.8	0.8	**0.8**	-0.5	-3.0	-0.9	-0.3	0.5	0.9	0.9	1.4	
Consolidated budget balance, % GDP 1/ 2/	**6.1**	**4.8**	**-6.2**	**-3.6**		5.4	1.6	**1.6**									
M2, % change, p-o-p 3/	**51.3**	**27.2**	**-3.5**	**30.6**	-0.5	2.6	11.7	**23.3**	-3.5	0.7	0.8	0.8	0.8	1.3	-0.5	0.0	
Inflation (CPI), % change, p-o-p	**11.9**	**13.3**	**8.8**	**8.8**	0.5	0.4	0.4	**6.1**	0.5	0.4	0.6	0.3	0.5	0.9	1.2	0.1	
GDP deflator 1/	**13.8**	**18.0**	**1.9**	**11.4**	-	-	15.4	**15.4**	-	-	15.5	-	-	8.7	-	-	
Producer price index (PPI), % change, p-o-p	**25.1**	**-7.0**	**13.9**	**16.7**	0.9	1.0	0.2	**13.0**	-0.3	1.1	2.1	0.6	-2.4	-0.9	-1.2	5.1	
Nominal exchange rate, average, Rb/USD	**25.6**	**24.8**	**31.7**	**30.4**	31.4	30.9	31.5	**29.4**	31.5	29.9	29.4	29.5	30.7	32.9	32.5	32.0	31.5
Reserve Fund, bln USD e-o-p		**137.1**	**60.5**	**25.4**	26.4	25.6	25.2	**25.2**	61.4	62.4	62.3	62.2	60.2	60.5	59.9	60.5	61.5
National Wealth Fund, bln USD, e-o-p		**88.0**	**91.6**	**88.4**	91.2	88.3	86.8	**86.8**	88.3	89.8	89.5	89.2	85.5	85.6	85.2	85.9	87.6
Reserves (including gold) billion $, end-o-p	**478**	**427**	**439**	**479**	526	511	499	**499**	505	514	513	524	510	514	511	515	530
Balance of Payment Indicators																	
Trade Balance, billion $ (monthly)	**130.9**	**179.7**	**112.1**	**151.4**	16.6	16.9	20.6	**198.2**	20.5	20.4	18.3	18.3	17.7	14.1	11.1		
Share of energy resources in export of goods, %	**61.5**	**65.9**	**62.8**	**63.5**	-	-	65.2	**65.5**	-	-	68.8	-	-	64.8	-	-	63.6
Current Account, billion $	**76.6**	**102.4**	**48.9**	**70.3**	9.7	9.4	9.2	**98.8**	15.5	13.8	11.1	10.3	10.6	0.3	-	-	13 5/
Export of goods, billion $	**354.4**	**471.6**	**304.0**	**400.1**	46.0	47.3	51.3	**522.0**	39.7	45.2	46.9	45.1	45.8	41.0	40.6		
Import of goods, billion $	**223.5**	**291.9**	**191.9**	**248.7**	29.4	30.4	30.7	**323.8**	19.2	24.8	28.6	26.8	28.1	26.9	29.6		
Gross FDI, mln USD 1/	**27,797**	**27,027**	**15,906**	**13,810**	-	-	18,415	**18,415**	-	-	7,598	-	-	11,333			
Average export price of Russia's oil, $/bbl	**64.4**	**91.2**	**56.2**	**74.6**	105.2	105.0	104.2	**103.9**	102.5	108.1	112.7	111.7	106.6	94.5	93.6		
Financial Market Indicators																	
Average weighted lending rate for enterprises, % 4/	**10.8**	**15.5**	**13.7**	**9.1**	8.6	8.8	9.3	**9.3**	8.8	8.9	9.2	9.0	8.9	9.3	9.5	9.1	
CBR refinancing rate, %, end-o-p	**10.0**	**13.0**	**8.8**	**7.8**	8.3	8.3	8.3	**8.3**	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.25
Real average rate for Ruble loans, % (deflated by PPI)	**-3.4**	**-6.8**	**-0.1**	**-6.5**	-7.7	-4.5	-3.2	**-3.2**	-1.4	0.9	0.4	1.6	5.1	4.0	4.4	2.2	
Stock market index (RTS, ruble term, eop)	**2,291**	**632**	**1,445**	**1,770**	1,563	1,541	1,382	**1,382**	1,577	1,735	1,638	1,594	1,242	1,351	1,377	1,390	1,476
Enterprises Finances																	
Share of loss-making companies 1/	**23.4**	**25.2**	**30.1**	**27.8**	30.2	29.1	28.1	**28.1**	34.0	33.2	35.0	32.9	31.4	31.0	29.3		
Share of credits in capital investment 1/	**15.5**	**17.6**	**20.1**	**14.3**	-	-	12.8	**12.8**	-	-	13.4	-	-	13.7	-	-	
Income, Poverty and Labor Market																	
Real disposable income, (1999 = 100%)	**245.6**	**251.5**	**259.3**	**272.5**	269.3	272.0	394.2	**274.7**	210.5	255.9	255.4	275.9	257.4	291.1	279.7	280.3	
Average dollar wage, US $	**532**	**697**	**588**	**698**	789	776	1,019	**806**	782	830	869	879	813	838	829	810	
Unemployment (%, ILO definition)	**6.1**	**7.8**	**8.2**	**7.2**	6.4	6.3	6.1	**6.1**	6.6	6.5	6.5	5.8	5.4	5.4	5.4	5.2	

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.

5/ Data for the third quarter of 2012.