RUSSIAN ECONOMY IN 2016: SUSTAINABLE RECOVERY OR TEMPORARY PHENOMENON?

Draft version

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1. Introduction: the main questions we try to answer

This paper aims to analyze macroeconomic trends and results of monetary and fiscal policy in Russia in the last year. What has change in economic situation and how successful policy was implemented by the government and by the Bank of Russia? What has happened with Russian people' welfare? Why ruble exchange rate which fell rapidly in 2015 started to strengthen significantly during last 10 months? And what are the prospects for future for Russian economy? We try to answer all these questions.

In the paper we used statistical data and other information presented by Federal Service of State Statistics (Rosstat; http://www.gks.ru), by the Bank of Russia (http://www.cbr.ru), by Ministry of Finance (http://www.minfin.ru) by the World Bank (mainly Russian Economic Report N.36; further RER36) and by RIM Group (http://www.macroforecast.ru).

2. How did the key macroeconomic indicators behave?

In the year 2016 Russian economy demonstrated some features of stabilization. Real GDP shrank by 0.7 % year-on-year (y-o-y) in the first 9 months of 2016. Due to sustained contraction in real incomes household consumption decreased by 4.2 % during this period while government consumption only by 1.3 % (both figures in constant prices) as the government tried to prevent further slowdown of households' incomes and aggregate demand in general.[1]

Nevertheless the slowdown of consumer inflation from 16.1 % in 2015 to 6.7 % in 2016 (9 months y-o-y) mitigated the effect of households' incomes' reduction and served to slow the

[1] The budget expenditures on agriculture, ecology road maintenance and especially on social support even increased as a share of the GDP.

fall of consumer demand. In turn, investment demand shrank by 5.1 % in constant prices y-o-y, compared to 8.2 % in the same period last year strengthened by economic sanctions, by reduction of aggregate demand and corporate incomes and by still high inflation for investment goods, see Tables 2 and 5. The latter can be explained by Russia's strong dependence on imported equipment and materials.[2]

At the same time the index of exports was almost constant during 9 months of 2016 (y-o-y) after moderate growth in 2015 and imports continued to contract though by much slower rates than in 2015. That's why the overall contribution of net exports to GDP growth was *negative* in the first 9 months of 2016 in contrast to the same period of the previous year when this contribution was *positive* mostly due radical import reduction, see Table 2. Such dynamics can be explained by a) ruble strengthening which prevented non-oil export and supported import; b) as a consequence by radical slowdown of import prices nominated in rubles growth c) by dramatic decline of export prices for Russian goods;[3] d) probably by illegal import organized in order to avoid food embargo; e) by previous year' base effect for import; f) modest success in import substitution.[4]

It can be concluded that net export became an *impediment* to economic growth in 2016 instead of engine of as it had been in 2015. As a result the index of aggregate demand for domestic goods shrank by 5.3 % y-o-y in the first 9 months of 2016 y-o-y in comparison with 3.3 % increase in the same period of 2015 (see Table 1)[5] which may serve for future economic slowdown.

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[2] Russia was able to increase unexpectedly the import of equipment and vehicles in 2016 in spite of embargo.

[3] World prices reduced not only for oil but for metals, mineral fertilizer and wheat too, see further.

[4] Only agriculture demonstrates obvious signs of import substitution, the manufacturing likely not. The preliminary data show that production of agricultural machinery may serve one more example but mostly due to huge government subsidies (see Kommersant – DAILY, 2017, January 31).

[5] This index constructed as product of indexes of main GDP components weighted by their shares in the GDP.

Nevertheless Table 1 shows that all the GDP elements (but net export) have slowed their fall due to reasons we mentioned above. The increase of inventories was one more factor that mitigated an overall contraction in 2016.

Though the recession continued in the first 9 months of 2016, the pace of aggregate output contraction slowed substantially, supported mostly by such sectors as agriculture and mining, see Table 3. The agriculture demonstrates a sustainable growth during two years due to favorable prices (see Table 4), good harvests and new export opportunities partly due to weaker ruble[6] and to successful import substitution.[7] At the same time for 2017 agricultural' exports opportunities are expected to decline due to ruble strengthening and the glut of grain on both world and on internal markets.

Nevertheless the price factors in 2016 were unfavorable for tradable sectors: the average price growth for them reduced from 16.2 % in 9 months 2015 y-o-y to 2.9 % in 9 months 2016 y-o-y mostly due to price reduction in mining[8] (see Table 4). That's why their input in the GDP growth in *current prices* decreased to 16 % in 9 months of 2016 compared to 50 % in the 9 months of 2015 though the reduction of their constant prices' index was only -0.1 % (Table 3). The absence of notable success in import substitution (with the exception of agriculture and in spite of government support for this) added the problems to tradable sectors.

For non-tradable sectors the price growth reduction was not as severe as in tradable ones (Table 4) as in comparison with the latter the former are only indirectly affected by the world markets but stronger subjected to the influence of home inflation. The real wages stopped to reduce (Table 5) as inflation decelerated to single digits; economic activity increased and as

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[6] Agriculture was the single sector that increased export in 2016 (both in dollar value and in physical volumes); export of all other industries reduced

[7] Only milk products' import continued to increase in 2016.

[8] In large degree due to reduction of world prices for oil and gas and to ruble strengthening; the internal prices for products of mining increased since March 2016.

unemployment is on historical minimum. This supported recovery in major services sectors such as the financial sector and real estate, which demonstrate moderate growth.

But disposable income in general continued to decline in real terms. It contracted by 6.5 % in a year (Q3 2016 to Q3 2015), by 10.4 % in two years (to Q3 2014). Pensions were indexed by only 4 % in the beginning of the year, therefore declining in real terms by 3.7 % in January-August 2016. As a consequence such sectors as retail trade and construction continued to contract but much slower than a year ago. Mostly the dynamics of these two sectors led to a result that output reduction in non-tradable sectors was stronger than in tradable (Table 3).

Real profits reduced in 9 months 2016 y-o-y (Table 5) mostly due to the growth of wages[9] and partly due to the inflation decline. The cost inflation also cannot be excluded as industrial producer prices increased by 7.4 %[10] (December 2016 to December 2015), that is, almost twice against the GDP inflation. As about two-thirds of investment in fixed capital is financed by retained profits and accumulated depreciation this fact combine with international embargo can explain a long-term contraction of fixed capital formation and serve a serious obstacle to economic growth.

Table 5 shows a continued contraction of real value of net indirect taxes in 2016 though not so dramatic as a year earlier. As they constitute the major source of budget revenues this trend demonstrate the fiscal problems of Russian budget (see below).

3. What about the international factors?

Lower commodity prices reduced the trade balance, weakening the current account, see Table 6. The overall index of *ruble* export prices dropped by 8.9 % in the first 9 months of 2016

[9] *Nominal* gross wages increased by 6.7 % in 9 months 2016 y-o-y.

[10] The largest price increase was shown by petroleum products and metals.

y-o-y; in the same period of 2015 it *increased* by 13.5 % due to ruble weakening (Table 2). As during 9 months of 2016 the dollar exchange rate increased by 8.2 % y-o-y that means that *dollar* export prices' index dropped by 15.8 % during this period. As a result export of goods reduced by 23.5 % in dollar value (from 26.6 % of the GDP to 21.3 %) and trade balance (goods) by 46.8 % in dollar value (from 12.7 % of the GDP to 6.7 %).

The fall in *oil* prices, which started in July 2015, ended in February 2016,[11] and the average oil price has been gradually increasing in the first 9 months of 2016.[12] Yet, on an annual basis, in 10 months of 2016, and especially in the first half of 2016, average oil prices were lower than last year on 26.6 % (dollars per ton). As a result, the dollar value of *oil and gas export* proceeds dropped by 30.9 % y-o-y in the first nine months of 2016.[13] The dollar value of *non-oil exports* of goods decreased by 12.7 % y-o-y in the first nine months of 2016[14] as prices for other commodities exported by Russia were at low levels.[15] Nevertheless this process led to the increase of non-oil exports share from 33 % of total exports of goods in 2014 to 40 % in 2015 and 46 % in 2016 (first 9 months for all this years).

Due to high demand and gradual ruble strengthening in the 2nd half of 2016 the import of *goods* reduced only by 4.1 %[16] (9 months of 2016 y-o-y) in spite of continued ban of food

[11] The reduction of average export oil price was equal to 50.8 % dollars per ton.

[12] The average price for Russian oil in the world market increased by 55 % (from February to October 2016; Rosstat); the average world oil price increased by 77 % (December 2016 to January 2016; World Bank).

[13] It dropped to $107.0 billion from $154.9 billion in 9 months of 2015 and from $254.6 billion in 9 months of 2014.

[14] Russian export of metals had lost 13 % value, that of equipment and vehicles had lost 7 % and that of chemicals had lost 19 %. Only agricultural exports' value increased by 7 % due to factors we mentioned above. The preliminary data also show the increase of export of agricultural machinery on about 15 % due to huge government support.

[15] For wheat they were by 16 % lower, for fertilizer by 20 – 25 % lower, for aluminum by 4 %, for copper by 12 %, for nickel by 19 %, for platinum by 6 % (2016 monthly average to 2015 monthly average for 12 months; World Bank Commodity Price Data); the world prices increased only for iron ore, zinc and gold among Russian export goods.

[16] The import of tools and equipment (47 % of total import) even increased by 4.2 % in the first 11 months of 2016 y-o-y.

import. Such decline was much less severe than in the first 9 months of 2015 when the Real Effective Exchange Rate depreciated by 19.3 % and GDP contracted by 3.7 % y-o-y. As a result the share of import in the GDP remained approximately the same (14.5 %).

A substantial reduction in net external liabilities in 2015 reduced outbound interest and dividend payments in the first nine months of 2016, improving the investment income deficit (to $24.2 billion in 9 months of 2016 from $25.6 billion in 2015). Overall, improvement in services,[17] investment income, and labor income accounts deficits was equal to $24.5 billion (9 months 2016 to 9 months 2015). But it could not compensate for the worsening trade balance and the current account surplus decreased to $14.4 billion (1.5 % of GDP) from $54.4 billion (5.5 % of GDP) last year. The non-oil current account deficit increased in nominal terms to $92.6 billion (100.5 billion, 9 months of 2015) and improved in relative terms from 10.3 % of the GDP in 2015 to 9.9 % of the GDP in 2016, somewhat decreasing vulnerability of the economy to shocks on oil market.

The financial account (Table 7) strengthened from negative $59.5 billion (6.1 % of GDP) to negative $5.8 billion (0.6 % of GDP)[18] as net capital outflows moderated on the back of lower debt payments in the banking sector, hopes for improvement of Russia – US relations and increased oil prices and confidence in the ruble.

In the first nine months of 2016 private sector net capital outflows moderated to $11.1 billion from $51.1 billion in the same period last year. While net capital outflows in the non-banking sector remained almost unchanged in the banking sector it improved from *outflow* of $37.7 billion in 2015 to *inflow* of $2.7 billion in January – September 2016, on the back of lower

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[17] The negative balance of *services* improved only temporally in the 1st half of 2016 mainly on the back of subsiding tourist imports due to lower real incomes and restricted flights to Turkey and Egypt. When such restrictions were abolished it began to worsen again.

[18] We use here the following method of calculation: Δ Financial Account = Δ International reserves' assets - Δ Current Account – Net errors and omissions. The World Bank (see Russian Economic Report N.36) adjusts data on financial account for currency swaps and correspondent accounts of resident banks in the Bank of Russia. His figures for financial account are -$19.7 billion for 2016 and -$49.3 billion for 2015 (both for 9 months).

debt payments and slowdown of their foreign lending. As in 2015 FDI inflows stayed modest in the first half of 2016 and consisted largely of firms' profits, which were not channeled abroad.

While the Central Bank of Russia refrained from intervening in foreign-currency markets[19] and due to improvement of capital account, international reserves increased for the first time since 2012 from $368.4 billion (15.7 months of imports) at the end of 2015 to $377.7 billion (17.8 months of imports) at the end of 2016.

The sustained recovery in oil prices since March 2016 in connection with a slowdown of recession and improvement of financial account supported the ruble. This facilitated demand for ruble denominated financial assets, which offered attractive returns. The changes in the balance of payments described above and the flexible exchange rate enabled the Real Effective Exchange Rate to depreciate by 8.6 % in the first half of 2016. But in the second half of 2016 ruble demonstrated a gradual strengthening and to the beginning of 2017 is expected to restore its real value which it had at the end of 2015.

Russia's *external debt* (Table 8), adjusted for exchange rate movements, decreased by 19.4 % to the end of 2016 compared to the end of 2015, as the corporate sector continued deleveraging due to sanctions regime, higher borrowing costs, and limited growth prospects. As a consequence bank debt reduced by 26.5 %, non-bank corporate debt by 18.9 % and state debt by 0.5 %. But in relative terms the external debt burden became harder as it changed from 34.9 % of GDP (average ratio for 9 months of 2014) to 43.7 % of GDP (9 months of 2015) and 41.7 % of GDP (9 months of 2016), or 15.5, 17.5, and 18.9 months of exports, respectively.

The extension of the economic sanctions regime, coupled with low oil prices, and negative GDP growth has kept external borrowing costs elevated for Russian firms. Even though Russia's five-year credit-default swap (CDS) spread went down from 390 basis points (bps) in

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[19]Only in December 2016 it lost $11 billion due to offer liquidity to banks – residents and to some other operations. The Bank of Russia supported large banks' external debt payments under the imposed sanctions regime.

early 2016 to 220 bps in June 2016, this is still higher than the 170 bps in early 2014. Meanwhile, the external debt of the government increased as the federal budget deficit expanded. In May, the government issued $1.75 billion 10-year Eurobonds with an effective rate of 4.75 % for the first time since 2013. The ruble part of the government's external debt increased due to purchases of ruble government bonds by non-residents.[20]

4. How successful the monetary policy had been?

The Central Bank of Russia continued its careful management of monetary conditions, which led to a further slowdown of inflation. Consumer price inflation more than halved to 5.4 % in December 2016 compared to 12.9 % in December last year. For food it was equal to 4.6 % (14.0 % in 2015), for non-food 6.5 % (13.6 % in 2015) and 4.9 % for services (10.2 %).

The Central Bank continued its measured approach to monetary easing in 2016.[21] The regulator kept its key policy rate unchanged from August 2015 till June 2016 (11 %) as inflation expectations remained elevated. The key factor that affected inflation expectations was the new round of ruble depreciation during September 2015 - February 2016. In view of the sustained decline in inflation pressures due to ruble strengthening since March 2016, the Central Bank resumed its monetary easing in June 2016, cutting the key policy rate by 50 bps and by another 50 bps in September 2016 to 10 %. In the September statement, the regulator confirmed its cautious approach to monetary easing for the remainder of 2016, with the key interest rate likely remaining unchanged until the end of the year due to elevated inflation expectations.

[20] These data presented by the World Bank (Russian Economic Report N.36)

[21] We proposed the easing of monetary policy in our previous report in Rimini (May 2016).

One more reason for monetary easing was continued reduction of aggregate demand and gross fixed capital formation strengthened by real interest rates' growth. In such circumstances the Bank of Russia was forced to satisfy at least pertly the business demand for monetary easing.

The resumption of monetary easing, coupled with deficit financing from the Reserve Fund, led to a gradual relaxation of the monetary stance. The monetization of the economy increased with M2 to GDP ratio rising from 39.8 % in 2014 (9 months' basis) to 40.4 % 2015 to 43.9 % in 2016 (nine months). At the same time, average M2 growth accelerated to 12.3 % y-o-y in the first nine months of 2016 from 5.8 % at the same period of 2015. The growth rate of *monetary base* increased from 0.7 % for nine months of 2015 y-o-y to 14.1 % in the same period of 2016. The *money multiplier* which average value was 3.10 in 9 months of 2014 and 3.26 in the same period of 2015 reduced marginally to 3.21 reflecting a slowdown of monetary system development (Table 9).

Real cash balance increased by 7.9 % (9 months 2016 to 9 months 2015) while it *decreased* by 2.2 % in the same period a year earlier. We can propose that a easing of monetary policy, reduction of inflationary expectations and recession' slowdown in 2016 was the main reason of such change. The signs of partial economic recovery are obvious.

The observed relaxation in monetary stance led to a reduction in money market rates (Table 10) from 11.8 % y-o-y at the end of 2015 to 10.3 % y-o-y in December 2016. However, as inflation decelerated, real interest rates turned positive, keeping monetary conditions relatively tight preventing economic recovery and investment. Real average MIACR rates when deflated by the GDP deflator were 6.4 % y-o-y in 9 months of 2016 while 4.7 % in the same period of 2015 and 0.8 % in the same period of 2014.

Important factors such as strong base effect, weak domestic demand and real incomes' reduction helped ease inflation pressures. In January - December 2016, annual consumer inflation decelerated to 5.4 % compared to 12.9 % in the same period of 2015. The inflation slowdown was largely due to the sharp deceleration of food inflation from 14.0 % in 2015 to 4.6 % in 2016. The high base in 2015 (largely attributed to restrictions on food imports and the pass-through effect from the ruble depreciation) and success in agriculture in 2015 were the main reasons behind the deceleration in food inflation.[22] Inflationary pressures subsided, especially in the third quarter of 2016, partly supported by the stronger ruble. This was reflected in the dynamics of core inflation, which dropped to 6.0 % in December 2016 (annual to December 2015) compared to 13.7 % in December 2015.

In the banking sector (Table 11) *corporate loans* have grown in 6.0 % in real terms (9 months 2016 to 9 months 2015: a year earlier this figure was 3.9 %), driven mainly by refinancing of large companies and the obligation by banks recapitalized by the government to increase their exposure by 1 % a month for 3 years in certain strategic sectors. The *consumer loans'* growth continued to be *negative* (-7.2 % in real terms, 9 months 2016 to 9 months 2015: a year earlier this figure was -10.7 %). Such trend took place due to weak consumer and auto segments, with the exception of mortgage lending, which was boosted by the government's interest rate subsidies program. Given declining inflation and the falling Central Bank key rate (which was lowered twice in 2016), new lending rates decreased from 13.37 % in January 2016 to 11.72 % in November.[23] Such trend is expected to encourage demand for new loans.

As a result of reduced risks, credit quality improved up to the end of 2016: reported Non-Performing Loans (NPLs) reached 7.1 % of total loans to non-financial organizations in the first eight months of 2016 (up from 6.2 % at the end of 2015) but then dropped again to 6.3 % to the end of 2016. Nevertheless *in the average* loans' quality in 2016 was lower than in 2015. The

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[22] The illegal food import may make an input in deceleration of inflation also.

[23] These figures are weighted interest rates for loans to non-bank organizations offered for period less than 1 year. For loans given for more than 1 year they reduced from 13.67 % in January to 11.82 % in November. The spread reduction may witness about risk decrease also.

banking sector's capitalization remained stable this year with an aggregate capital adequacy ratio of 13 % (above the regulatory minimum of 8 %) as of November 1, 2016.

The ratio of total loans to total bank assets was 69.5 % on the beginning of 2017 (69.3 % a year earlier). The ratio of liquid bank assets[24] to their total assets was 8.0 % on this date (8.3 % a year earlier). That is, we can state an average worsening of bank liquidity in 2016.

The volume of total households' and corporate' deposits in real terms increased by 10.1 % during 2016 (though by 15.9 % a year earlier). The average share of ruble bank deposits in total volume of bank deposits was 61.7 % (Q1 2016 – Q3 2016) while 62.5 % in the same period of 2015 and 71.5 % in the same period of 2014.[25] The ratio of total households' bank deposits to total liabilities increased from 28.0 % in the beginning of 2016 to 30.2 % at the end of the year. In contrast, the ratio of banks' liabilities to the Bank of Russia reduced from 12.0 % in the beginning of 2015 to 6.5 % in the beginning of 2016 and to 3.4 % at the end of 2016.

Banks' financial performance has shown some improvements as the banking sector returned to profitability this year. The return on assets was 0.9 %, and return on equity was 7.8 % as of November 1, 2016. Sector profits increased 3.7 times since the beginning of the year and totaled 714 billion rubles in the first ten months of this year. All these facts witness about stabilization of Russian banking system.[26]

5. But the fiscal situation is alarming

[24] Including all bank' deposits in the Bank of Russia

[25] These figures don't include the balances on corporate' checking accounts; they are calculated in rubles using the current exchange rate.

[26] However, about 60 % of these profits came from Sberbank. Profits at other Russian banks were much weaker.

The government tightened its spending in the first nine months of 2016 (Table 12). In January – September 2016, general government revenues (including extra budgetary funds) dropped to 31.9 % of GDP from 33.2 % of GDP last year while expenditures reduced to 33.7 % from 34.4 % last year.

The ruble's depreciation only partly compensated for a drop in oil prices, and *oil and gas* revenues slumped from 7.8 % of GDP last year to 5.6 % of GDP in the first nine months of 2016. Overall revenues from mineral extraction and international trade dropped from 25.1 % of total government revenues in January – October 2015 to 20.3 % in the same period of 2016, or by 19 % in nominal terms or by 1.41 % of the GDP.

Despite the widening fiscal deficit, the general government's *non-oil and gas* primary deficit improved to 6.4 % of GDP from 8.7 % of GDP last year mostly due to increase of revenues from personal income tax, social insurance and indirect taxes (VAT and excises).

In the first ten months of 2016, government was able to decrease spending by 0.7 % of GDP and first of all on national defense (by 0.52 % of GDP) and on national security (by 0.20 % of GDP). Expenditures on housing and communal services, education, and intergovernmental transfers remained roughly at the same level as a share of GDP. The government indexed the majority of pensions but below inflation, at a rate of 4.5 %. Nevertheless overall government spending on *social policy* increased though marginally.

Decreases in expenditures could not compensate for a fall in revenues, and the consolidated budget' deficit widened from 1.3 % of GDP 9 months last year to 1.8 % of GDP 9 months this year and is expected to be about 4 % at the end of 2016.

Federal debt decreased in relative terms and stayed at a low level. In the first half of 2016, federal government debt decreased as % of GDP due to exchange rate movement, and it remains at an overall low level. The bulk of the federal budget deficit in the first nine months of

2016 was financed from the Reserve Fund. The net increase in domestic borrowing in the first ten months of 2016 totaled 492 billion rubles ($8.2 billion) in external one it was equal to 376 billion rubles ($6.3 billion). The government also issued 10-year Eurobonds for $1.75 billion in May and $1.25 billion in September, although this would only constitute about 6.3 % of the expected federal budget deficit.

As a result the state and municipal debt service increased by 22.2 % or by 0.15 % of GDP (10 months 2016 to 10 months of 2015). The further increase of borrowing will be problematic due to shortage of internal savings and unfavorable international conditions.

Privatization proceeds (from Alrosa and Bashneft) brought 382 billion rubles ($6.1 billion) for deficit financing.[27] The government expects also to gather EURO10.5 billion by privatization of Rosneft. Together with Bashneft it is expected to bring about 1 trillion rubles to budget[28] which is equal to about 4 % of its total revenues. The fiscal consolidation will also be supported by revenue mobilization efforts: the government projects to raise 1.1 % of GDP in 2017 – 2019 predominantly from transfer of dividends of the state controlled companies and increasing tax revenue from the energy sector.[29]

With the financing of the deficit mainly from the Reserve Fund, federal government debt is expected to increase to 14.2 % of GDP (upper limit 16.2 % of GDP) in 2016 from 13.6 % of GDP in 2015, partly due to increase of 500 billion rubles (upper limit 2.5 trillion rubles) in domestic guarantees.[30]

Currently, the government submitted the draft law on the federal budget 2017 – 2019 to the Duma. The draft law assumes a conservative oil price of $40/bbl for 2017 – 2019.

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[27] Data are presented by World Bank RER36.

[28] https://rg.ru/2016/12/09/dmitrij-medvedev-nazval-uspeshnoj-sdelku-po-privatizacii-rosnefti.html

[29] World Bank RER36

[30] Data are presented by World Bank RER36.

As in 2015 – 2016 the fiscal deficit was covered mostly by means of Reserve Fund the balance of the latter dropped from $87.91 billion on 01.01.2015 to $16.03 billion on 01.01.2017 or from 6.1 % to 1.1 % of the GDP. It is likely to be depleted in 2017 but money from another one fund – the National Welfare Fund - will be probably used for this purpose in 2018 – 2019. Its reserves reduced only slightly – from $78 billion on 01.01.2015 to $71.87 billion on 01.01.2017 or from 5.4 % to 5.0 % of the GDP.

6. Conclusion: stabilization but not a sustainable one!

The analysis shows that in spite of economic recession' softening and inflation reduction in 2016 Russian economy continues to demonstrate features of weakness. International factors changed from relatively favorable in the previous year to obviously unfavorable due to reduction of export prices and lack of success in import substitution. Russian economy is still very sensitive to the vagaries of the world raw materials' markets.

Low investment demand and reduction of corporate incomes hinder capital formation and long-term growth. There are no obvious signs in improvement of total factor productivity. All these factors make the opportunities of sustainable growth doubtful.

The sensitivity of Russian economy to the whims of world markets though reduced to some degree due to reduction of the share of oil and gas export but is still strong due to continuing dominant share of raw materials in her export. This vulnerability will worsen the cyclical volatility. A strong demand for import goods restored worsening significantly the current account.

Such positive trends as radical reduction of capital outflow and noticeable reduction of external debt (partly due to international embargo) led to ruble strengthening and mitigation of inflationary expectation. All that allowed easing monetary policy in order to reduce interest rates and encourage market conditions in general. In this direction monetary policy was obviously successful and inflation actually fell and recession slowed. Nevertheless the real interest rates continued to increase preventing investment and economic recovery.

The banking system continued to increase its resources in spite of all shocks of last two years. But the quality of loans didn't improve significantly and the liquidity reduced which may create problems for its stability in the case of new shocks.

Nevertheless the fiscal picture continued to worsen becoming the most serious challenge for Russian economy for the next three years. In spite of spending tightening the deficit of consolidated budget continued to grow and may approach 4 % of the GDP at the end of 2016. The government is looking for solving the problem by borrowing from sovereign funds and on internal and external markets and by privatization of large companies.

That means that in spite of successful monetary policy the fiscal problems threaten to future stability of financial system. If annual rates of economic growth will be limited by 1-2 % as is forecasted they threaten to become the main obstacle for general recovery. Only comprehensive reform of all economic system will allow Russian economy to get out of these circumstances.

7. Appendix

Table1

GDP and its components' dynamics, 9 months of 2016 and 2015, year-on-year

Indicator / Period	2016		2015	
	Index	Growth	Index	Growth
GDP	**0,993**	**-0,7%**	**0,963**	**-3,7%**
Households' consumption	0,958	-4,2%	0,915	-8,5%
Government purchases	0,987	-1,3%	0,982	-1,8%
Gross fixed capital formation	0,949	-5,1%	0,918	-8,2%
Export	1,002	0,2%	1,017	1,7%
Import	0,935	-6,5%	0,731	-26,9%
Aggregate demand for domestic goods index	**0,947**	**-5,3%**	**1,033**	**3,3%**

Table 2

GDP and its components' deflators, 9 months of 2016 and 2015, year-on-year

Indicator / Period	2016		2015	
	Index	Growth	Index	Growth
GDP	**1,039**	**3,9%**	**1,083**	**8,3%**
Households' consumption	1,067	6,7%	1,161	16,1%
Government purchases	1,060	6,0%	1,077	7,7%
Gross fixed capital formation	1,103	10,3%	1,154	15,4%
Export	0,911	-8,9%	1,135	13,5%
Import	1,126	12,6%	1,477	47,7%

Table 3

Gross value added dynamics by industry, 9 months of 2016 and 9 months of 2015, year-on-year

	2016_9M		2015_9M	
Item / Period	Index	Growth	Index	Growth
Gross value added	**0,993**	**-0,7%**	**0,968**	**-3,2%**
including				
Agriculture and forestry	1,021	2,1%	1,021	2,1%
Fishery	0,940	-6,0%	1,013	1,3%
Mining	1,015	1,5%	1,009	0,9%
Manufacturing	0,983	-1,7%	0,955	-4,5%

Production and distribution of electricity, gas and water	1,008	0,8%	0,994	-0,6%
Construction	0,952	-4,8%	0,917	-8,3%
Wholesale and retail trade	0,978	-2,2%	0,914	-8,6%
Hotel and restaurants	0,970	-3,0%	0,947	-5,3%
Transport and communications	0,996	-0,4%	0,978	-2,2%
Finance	1,006	0,6%	0,972	-2,8%
Real estate operations	1,010	1,0%	0,983	-1,7%
Public government	0,983	-1,7%	0,993	-0,7%
Education	0,978	-2,2%	0,959	-4,1%
Healthcare	0,989	-1,1%	1,003	0,3%
Other communal and personal services	0,998	-0,2%	0,984	-1,6%
Tradable sectors	**0,999**	**-0,1%**	**0,984**	**-1,6%**
Non-tradable sectors	**0,980**	**-2,0%**	**0,953**	**-4,7%**

Table 4

Industry deflators, 9 months of 2016 and 9 months of 2015, year-on-year

	2016_9M		2015_9M	
Item / Period	Index	Growth	Index	Growth
Gross value added	**1,047**	**4,7%**	**1,109**	**10,9%**
including				
Agriculture and forestry	1,043	4,3%	1,187	18,7%
Fishery	1,144	14,4%	1,419	41,9%
Mining	0,979	-2,1%	1,118	11,8%
Manufacturing	1,042	4,2%	1,182	18,2%
Production and distribution of electricity, gas and water	1,089	8,9%	1,036	3,6%
Construction	1,046	4,6%	1,054	5,4%
Wholesale and retail trade	1,056	5,6%	1,177	17,7%
Hotel and restaurants	1,062	6,2%	1,118	11,8%
Transport and communications	1,066	6,6%	1,078	7,8%
Finance	1,179	17,9%	0,951	-4,9%
Real estate operations	1,029	2,9%	1,115	11,5%
Public government	1,045	4,5%	1,025	2,5%
Education	1,059	5,9%	1,056	5,6%
Healthcare	1,059	5,9%	1,121	12,1%
Other communal and personal services	1,067	6,7%	1,093	9,3%
Tradable sectors	**1,029**	**2,9%**	**1,171**	**17,1%**

Non-tradable sectors	**1,067**	**6,7%**	**1,102**	**10,2%**

Table 5

Incomes growth in constant prices (GDP deflator), 9 months of 2016 and 9 months of 2015, year-on-year

	2016_9M		2015_9M	
Item / Period	Index	Growth	Index	Growth
Gross wages	1,025	2,5%	0,969	-3,1%
Gross wages: CPI deflator	1,000	0,0%	0,904	-9,6%
Gross profits	0,971	-2,9%	1,019	1,9%
Net taxes on production and import	0,941	-5,9%	0,787	-21,3%

Table 6

Current account of Russian Federation, 9 months of 2016 and 9 months of 2015, $million

	2016_9M		2015_9M	
Item / Period	Value	Growth y-o-y	Value	Growth y-o-y
Current Account	14403	-73,5%	54374	24,9%
Trade Balance (goods)	62845	-46,8%	118216	-19,6%
Export (goods)	199147	-23,5%	260363	-31,6%
Including:				
Oil	52206	-25,0%	69600	-42,7%
Petrol	33254	-38,5%	54033	-39,9%
Gas	21579	-31,0%	31262	-27,9%
Other	92108	-12,7%	105468	-16,3%
Import (goods)	136303	-4,1%	142147	-39,1%

Table 7

Financial account of Russian Federation, 9 months of 2016 and 9 months of 2015 and 9 months of 2014, $million

	2016_9M		2015_9M		2014_9M	
Item / Period	Value	% of GDP	Value	% of GDP	Value	% of GDP
Current Account	14403	1,5%	54374	5,5%	43528	2,8%
Financial Account	-5779	-0,6%	-59695	-6,1%	-93045	-6,0%
Reserves' Change	10092	1,1%	-2550	-0,3%	-43379	-2,8%
Errors and Omissions	1468	0,2%	2771	0,3%	6138	0,4%

Table 8

External debt of Russian Federation, average for 9 months of 2016 and 9 months of 2015 and 9 months of 2014, $million

	2016_9M		2015_9M		2014_9M	
Item / Period	Value	% of GDP	Value	% of GDP	Value	% of GDP
Total debt	**520983**	**41,7%**	**570588**	**43,7%**	**725845**	**34,9%**
Including:						
Banks	129756	10,4%	158183	12,1%	212432	10,2%
Non-banks	348047	27,9%	364718	27,9%	440022	21,2%
State	43180	3,5%	47687	3,6%	73391	3,5%

Table 9

Major indicators of monetary policy, average for 9 months of 2016 and 9 months of 2015, billion of rubles

	2016_9M		2015_9M	
Item / Period	Value	Growth y-o-y	Value	Growth y-o-y
The Money Mass (M2)	35574,1	12,3%	31689,3	5,8%
The Monetary Base (MB)	11100,4	14,1%	9726,5	0,7%
The Money Multiplier (mm)	3,21	-1,6%	3,26	4,9%
Monetization of economy	43,9%	8,7%	40,4%	1,5%
The Real Cash Balance (MP; Q4 1996 = 1)	6,006	7,9%	5,566	-2,2%

Table 10

Nominal and real average money market annual rates (one-day MIACR) for 9 months of 2016 and 9 months of 2015

	2016_9M	2015_9M
Nominal	10,7%	13,4%
Real (GFP deflator)	6,4%	4,7%

Table 11

The banking sector' indicators, average for 9 months of 2016 and 9 months of 2015

	2016_9M		2015_9M	
Item / Period	Value	Growth y-o-y	Value	Growth y-o-y
Corporate loans' index (constant prices; Q2 2000 = 1)	11,540	6,0%	10,888	3,9%
Consumer loans' index (constant prices; Q1 2001 = 1)	49,108	-7,2%	52,906	-10,7%
Corporate loans as a share of the GDP	42,3%	7,0%	39,6%	23,9%
Consumer loans as a share of the GDP	13,1%	-6,7%	14,0%	6,8%
Non-performing corporate loans as a share of total loans	6,7%	22,8%	5,5%	27,0%
All loans / all assets	69,5%	0,4%	69,2%	-3,1%
Liquid assets / all assets	7,7%	-12,0%	8,7%	5,2%
Total bank deposits' index (constant prices; Q2 2000 = 1)	12,694	10,1%	11,535	15,9%
Ruble deposits as a share of total deposits	61,7%	-1,3%	62,5%	-12,6%

Table 12

Consolidated budget of Russian Federation, including extra budgetary funds, January – September 2016 and 2015

Item / Period	2016	2015
Revenues, % of GDP	31,9%	33,2%
Expenditures	33,7%	34,4%
Deficit	-1,8%	-1,3%