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**RUSSIAN ECONOMY IN 2014
TRENDS AND OUTLOOKS
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The review provides a detailed analysis of main trends in Russia's economy in 2014. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit spheres; financial sphere; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

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2.1. Russia's Monetary policy in 2014

The key developments in Russia's monetary policy in 2014 were determined by adverse processes in the Russian economy, which related to the tense geopolitical situation, massive capital outflow and the decline in the price of energy resources.

In 2014, the Bank of Russia encountered a series of global challenges while pursuing its monetary policy. The economic situation in 2014 was distinguished by bilateral sanctions and the drastic depreciation of the national currency in January-December 2014, which resulted in an inflation of 11.4%, above the target level of 5% set forth for 2014 in the central bank's Guidelines for the Single State Monetary Policy for 2014–2016. In an effort to stabilize the ruble's exchange rate and inflations expectations, the Bank of Russia more than once lifted the CBR key rate, from 5.5% in January to 17% in December 2014.

On 10 November 2014, the Bank of Russia abolished the previously applicable exchange rate policy mechanism, revoking the acceptable range of the ruble value of dual-currency basket and regular interventions within/outside the specified operational band. In fact, the Bank of Russia migrated to a floating exchange rate for the first time in Russia's contemporary history, reserving the right to undertake operations in the domestic FX market only when financial sustainability is at threat.

2.1.1. Money market

In the period between January 2014 and December 2014, the monetary base (broad definition) increased 7.9%, running at Rb 11,3 trillion as of 1 January 2015. The Bank of Russia's operations aimed at providing commercial banks with money remained the key factor responsible for the growth in the monetary base in 2014, whereas the factor responsible for the shrinking of monetary base in 2014 was the Bank of Russia's transactions aimed at selling foreign currency in the domestic market. As a reminder, the monetary base increased 6.6%, up to Rb 10,5 trillion in 2013.

It is worthwhile noting that, despite the central bank's statements about migrating by 2015 to an inflation targeting regime and implementing measures aimed at increasing the flexibility of the exchange rate regime, the central bank in 2014 increased largely its presence in the FX market, selling considerable amounts of foreign currency through respective transactions. To compare, net purchases of foreign currency saw a decline in annual volume beginning with 2010 (\$34,1bn in 2010, \$12,4bn in 2011, \$7,6bn in 2012). On the other hand, net sales of foreign currency reached \$27bn in 2013 and more than \$83,4bn in 2014. Those measures were caused by the Bank of Russia seeking to set back the depreciation of the national currency exchange rate, considering the adverse foreign economic and geopolitical conditions.

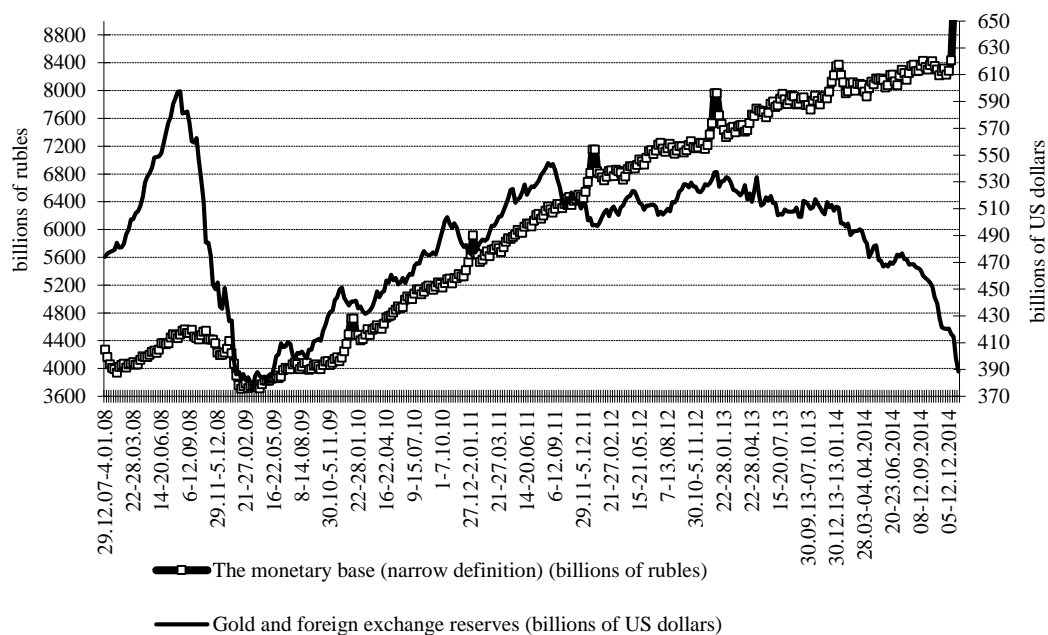
Such an intervention policy of the central bank meets in general the objective of migrating to inflation targeting, because due to the effect of exchange-rate pass-through to prices, the ruble's depreciation appeared to be a key factor of the accelerated inflation in 2014. However, the spending of international reserves to support the national currency exchange rate eventually appeared to be inefficient, considering the actual scope of ruble's depreciation. Apparently, the

central bank should have either undertaken stronger interventions to be able to reduce the possibilities for market players to benefit from short-term exchange rate volatility and prevent devaluation expectations from growing, or a one-time, sharp depreciation of the ruble's exchange rate, instead of making it a longer-lasting process. Additionally, a well-timed imposing of limits on the provision of ruble liquidity, thus making it less possible for commercial banks to play against the ruble, would have allowed the regulator's policy to be more efficient. As a reminder, it was not until November 2014 that the \$2bn limit on the provision of ruble liquidity through FX swap transactions was introduced.

However, the key short-term measure of the monetary policy should have been a timely lifting of the CBR key rate to a level making it economically inefficient to use short-term ruble-denominated loans to purchase foreign currencies, expecting the ruble to depreciate. It is worthwhile noting that it was not until December 2014 that the central bank decided to considerably increase the CBR key rate (to 17% p.a.) (see Section 2.3.1. "The main decisions concerning the monetary and exchange rate policies").

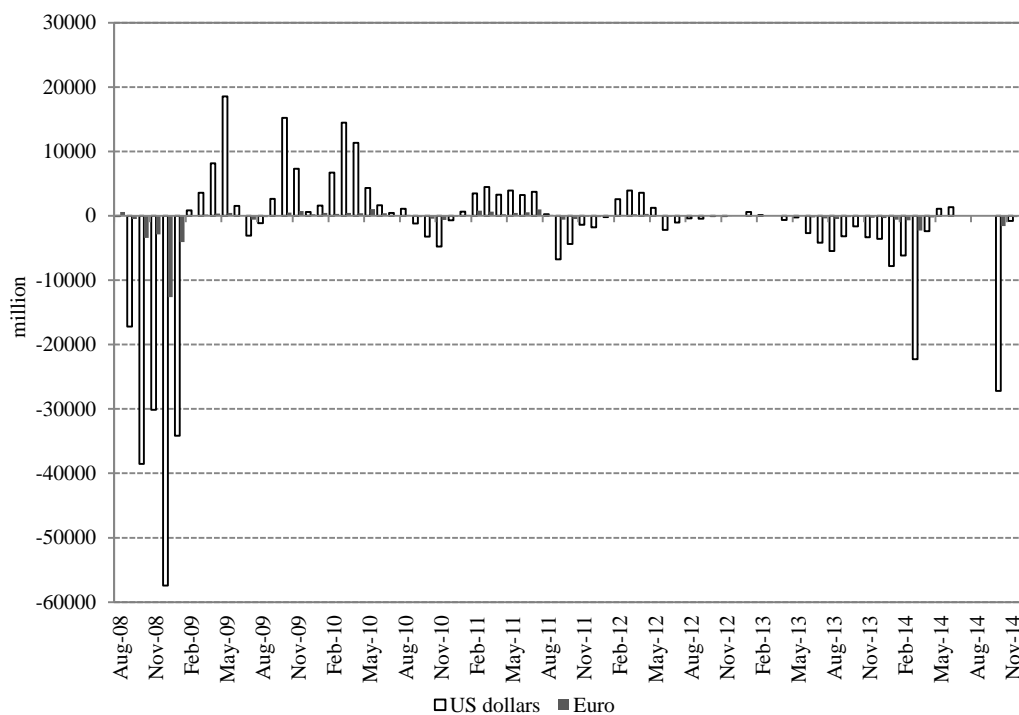
In the 12 months of 2014, Russia's international reserves shrank by \$124,1bn (24.4%) and were running at \$385,5bn as of the beginning of January 2015 (see *Fig. 1* and *2*). In 2014, Russia's foreign exchange reserves declined by \$130,2bn (-27.7%). In 2013, the same reserves lost \$17bn (-3.5%). The monetary gold stock increased \$6,1bn (+15.3%) compared to that seen early in the year, the increase was basically determined by an upward revaluation of the stock. As a result, as of 1 January 2015, the foreign exchange reserves accounted for 88.0% (92.2% in 2013) of the total amount of reserve assets, while gold did for 12.0% (7.9% in 2013). At present, the reserves are sufficient to maintain a stable balance of payments, because they cover both 10 months of imports of goods and services in the Russian Federation (13 months in 2013) and external debt repayments due in 2014–2015. However, should the reserves see further shrinking, they may be found to be below the level allowing Russia to be rewarded a credit rating and maintain its macroeconomic sustainability.

The general government's funds accumulated on accounts with the central bank in the first 11 months of 2014 saw a Rb 2,7 trillion (46%) increase in volume, which basically can be explained by an upward revaluation of the foreign currency assets accumulated in the Reserve Fund and the National Wealth Fund (see *Table 1*).



Source: The Bank of Russia.

Fig. 1. The dynamics of monetary base (narrow definition) and the gold and foreign exchange (international) reserves of the Russian Federation in 2008–2014.



Source: The Bank of Russia.

Fig. 2. The Bank of Russia currency interventions (foreign currency net purchases) in 2008–2014

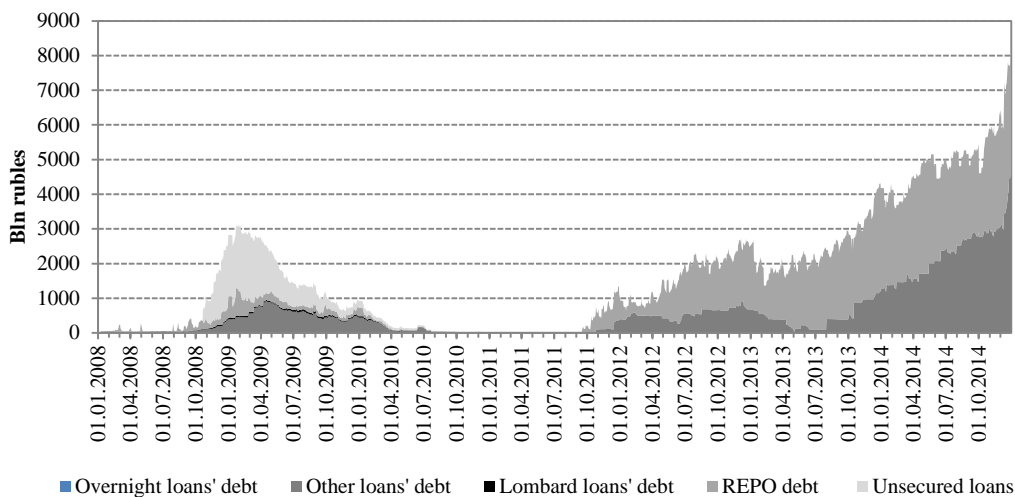
Table 1

**The Bank of Russia Balance Sheet
in 2013–2014**

	01.01.2013		01.01.2014		12.01.2014	
	billions of ru- bles	as a percent- age of assets/ liabilities	billions of ru- bles	as a percent- age of assets/ liabilities	billions of ru- bles	as a percent- age of assets/ liabilities
Funds placed with nonresidents and securities issued by nonresidents	14,525,436	70.4	15,091,147	66.9	17,366,198	60.8
Credits and deposits	3,158,355	15.3	4,881,376	21.6	7,263,702	25.4
Precious metals	1,646,187	8.0	1,394,150	6.2	2,299,460	8.1
Securities	456,314	2.2	450,306	2.0	630,958	2.2
Other assets	251,549	1.2	99,468	0.4	128,815	0.5
Total assets	20,630,744	100	22,562,411	100	28,580,786	100
Cash in circulation	7,667,950	37.2	8,307,755	36.8	7,922,408	27.7
Funds in accounts with the Bank of Russia	9,404,984	45.6	10,358,984	45.9	12,577,139	44.0
<i>of which:</i> Russian government funds	4,913,764	23.8	5,848,761	25.9	8,536,119	29.9
funds of resident credit institutions	2,185,349	10.6	2,196,821	9.7	2,174,339	7.6
Float	158	0.0	5,680	0.03	17,415	0.06
Bank of Russia bonds	–	–	–	–	–	–
Liabilities to the IMF	447,686	2.2	500,028	2.2	695,697	2.4
Other liabilities	138,183	0.7	108,785	0.5	4,199,069	14.7
Capital	2,724,457	13.2	3,151,918	14	3,169,058	11.1
Profit of a fiscal year	247,326	1.2	–	–	–	–
Total liabilities	20,630,744	100	22,562,411	100	28,580,786	100

Source: The Bank of Russia.

The dynamics of commercial banks' debt owed to the central bank is shown in *Fig. 3*. The uptrend in volumes of the Bank of Russia liquidity provision to credit institution has been observed since 2011. In the 12 months of 2014, the debt doubled (2.1 times) the peak levels seen in the crisis-hit 2009 and was running at Rb 9,3 trillion as of 1 January 2015. As of 1 January 2014, five banks accounted for 70% of the total debt of Rb 6,7 trillion owed by credit institutions to the regulator. Credit institutions raised liquidity from the regulator basically from the single source as repo auctions, on which the debt averaged Rb 2,69 trillion in the 12 months of 2014 (Rb 2,63 trillion in 2013, Rb 1,9 trillion in 2012, Rb 1,1 trillion in 2011), as well as loans secured by non-marketable assets and guarantees, on which the debt averaged Rb 2,3 trillion in the 12 months of 2014 (Rb 0,46 trillion in 2013, Rb 0,55 trillion in 2012). The maximum amount of funds can be raised at 1-week repo auctions (an average of Rb 2,6 trillion in 2014, Rb 1,6 trillion in 2013).



Source: The Bank of Russia.

Fig. 3. Commercial bank's debt owed to the Bank of Russia in 2008–2014

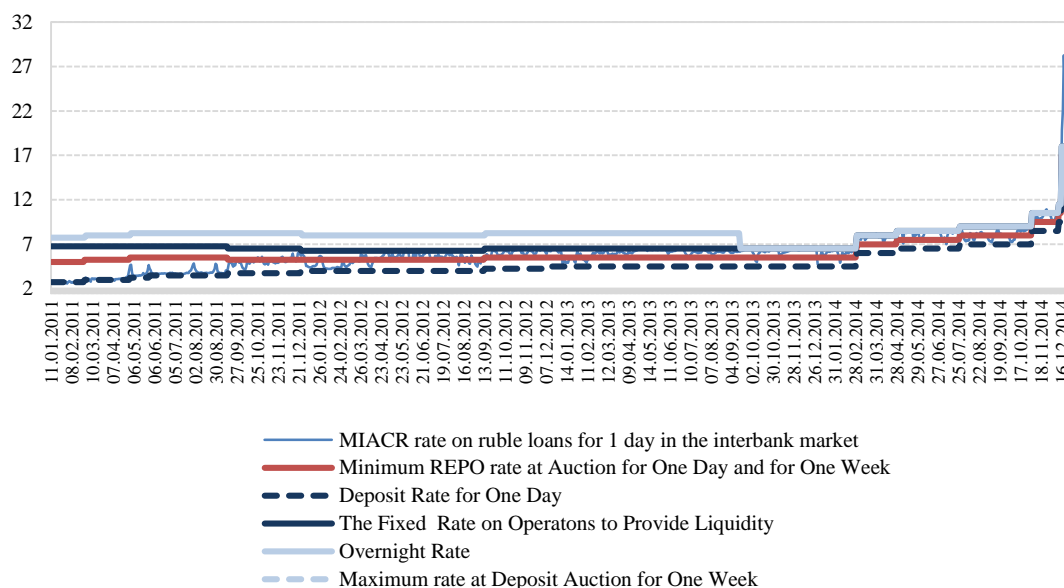
Weighted average interest rates on short-term repo operations were 8.3% in the period between January 2014 and December 2014. The debt of the banking sector on central bank loans secured by non-marketable assets and guarantees saw a rapid increase in 2014, because of the dried up collateral base for repo transactions. However, the increase in the debt secured by non-marketable assets and guarantees in Q2 and Q3 2014 had a positive effect on the volume of unencumbered market collateral. In particular, in Q3 2014, the utilization of marketable assets declined to 51% from 53%. According to the Bank of Russia's estimates, risks of the market collateral facing a deficit in the short run can be regarded as low given the slowdown in lending rates and the monetary base.

In 2013, the Bank of Russia introduced a 3-month repo auction to provide loans secured by non-marketable assets (promissory notes, credit claims) at variable interest rate. In 2014, the regulator allotted through this tool an average of Rb 490bn at an weighted average rate of 7.8%. As a reminder, the minimum value of a loan is linked to the 1-week repo key rate, plus 0.25 p.p. A 18-month repo auction secured by non-marketable assets was held on 10 November 2014, banks raised Rb 150bn at a rate of 9.75%, corresponding to the maximum amount of allotted funds. The advantage of 3-month auctions over similar longer-term auctions is that the former provides readily available collateral with a required term for credit institutions and a higher value of the collateral available at banks through a reduced term of the provision of funds. Despite the easy terms of lending at a variable interest rate, such an auction is available only for large banks whose collateral base is visibly bigger.

The interest rate in the interbank lending market¹ increased by 2.5 times in the 12 months of 2014 (to 15.5% on average in December 2014 from 6.3% on average in January 2014). The interbank loan interest rate was at the upper level of the central bank interest band, nearing closer to its cap from time to time (see Fig. 4). The most critical crossing of the MIACR on overnight interbank ruble-denominated loans was seen in 10 thru 24 December 2014 due to panic sentiments in the interbank lending market caused by the lifted CBR key rate and the

¹ Interbank interest rate is (Moscow InterBank Actual Credit Rate) MIACR on overnight interbank ruble-denominated loans

limits imposed on the ruble liquidity provision. Overall, the annual average MIACR on overnight interbank ruble-denominated loans increased by 2.6 times to 16.1% in 2014 from 6.1% in 2013. It is worthwhile noting that in the situation when central bank operations is the main channel to increase the monetary base, it is Bank of Russia's decisions that determine the dynamics of interest rates. The fact that the United States and the European Union restricted the access of certain Russian state-controlled banks to external financing, and the central bank lifted the CBR key rate, turned out to be a supplementary growth factor for the interest rate in the interbank lending market, beginning with Q2 2014.



Source: The Bank of Russia, calculated at the Gaidar Institute.

Fig. 4. The Bank of Russia interest rate band and the dynamics of interbank lending market in 2012–2014

It is worthwhile noting that further expansion of Bank of Russia tools designed to provide liquidity for long terms (3-months, 1-year repo auctions secured by non-marketable assets) will allow banks to release the market collateral and create conditions for further growth of interbank lending volumes and making the same more available.

Let's take a closer look at the structure of the monetary base (broad definition) (see Table 2).

Table 2

**The dynamics of monetary base (broad definition) in 2014
(billions of rubles)**

	01.01.2014	01.04.2014	01.07.2014	01.10.2014	01.01.2015
Monetary base (broad definition)	10,504	9,344.7	9,672.4	9,947.9	11,332
- cash in circulation, including cash on hand at credit institutions	8,308	7,620.7	7,779.9	7,943.8	8,840.5
- correspondent accounts of credit institutions with the Bank of Russia	1,270	1,162.6	1,371.5	1,358.6	1,215.5
- mandatory reserves	442.7	450	432.1	429.4	471.3
- credit institutions' with the Bank of Russia	118.7	220	89	216.1	804.6
- Bank of Russia's bonds held by credit institutions	0	0	0	0	0
For reference: excess reserves	1,788	1,281	1,461	1,575	2,020

Source: The Bank of Russia.

The following monetary base (broad definition) components saw an increase in volume mandatory reserves of banks (up 15.3% to Rb 471bn), deposits of credit institutions with the Bank of Russia (up 55% to Rb 804,6bn), cash in circulation (up 6.4% to Rb 8840,5bn in 2014). Correspondent accounts of credit institutions declined (down 4.3% to Rb 1215,5bn).

In the period between January and November 2014, the money supply M2 increased at an average rate of 8.7% on an annualized basis (compared to the same period previous year). The monetary base M2 saw a slowdown in annual growth rates over much of 2014, to 6% in November from 14.6% in January. The monetary base saw average growth rates of 32.5% in 2010, 24.3% in 2011, 19.4% in 2012, 15.3% in 2013.

Therefore, the monetary aggregate M2 saw quite moderate growth rates in the first 11 months of 2014 compared to previous periods and by itself creates no preconditions for monetary factors to be able to affect the price stability.

Given that in the first 11 months of 2014 the monetary base and money supply shrank by 8.2% and 3.6%, respectively, the money multiplier (M2/monetary base ratio) increased 5%. In the period between January to November 2014, the money multiplier averaged 3.2. This value of money multiplier is average for developing economies (Ukraine, Belarus, Kazakhstan), whereas in developed countries it tends to vary within a range of 5 and 8. It is worthwhile noting that over the last two decades the money multiplier has been growing with the development of the banking system in the East European countries. For example, in Poland, the money multiplier increased to 6.1 from 3.1 in the period between 1993 and 2013.

In the period between 1999 and 2013, the level of monetization of the Russian economy (M2/GDP ratio) increased 2.7 times to 55.8% in 2013. To compare, in Belarus, the M2/GDP ratio increased by 1.8 times to 30.4% during the same period, in Kazakhstan by 2.5 times to 34.0% in 2013, in Ukraine by 3.7 times to 62.5%. Relatively slower growth rates of GDP monetization in the period of 1999–2013 were typical of most of the Central and East European countries, for example, the M2/GDP ratio in Poland increased by 1.5 times to 59.9% in 2013, in Germany it remained relatively stable and reached 163% in 2013. It is worthwhile noting that a relatively low level of monetization of the Russian economy is determined by a lower level of the development of Russia's financial system.

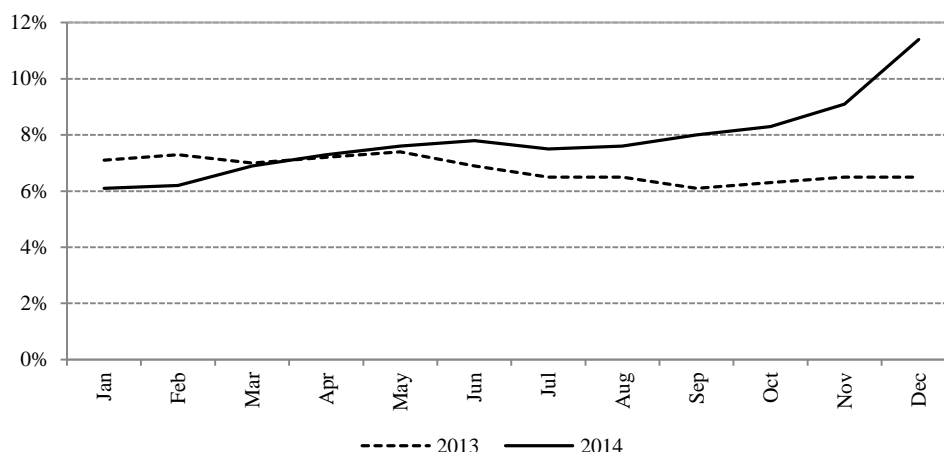
Analyzing the monetary base components, one can notice that in January–November 2014 retail deposits saw an average growth of 8.6% on an annualized basis (18.3% in 2013), deposits of nonfinancial organizations and financial organizations increased by an average of 8.3% (12% in 2013). The monetary aggregate M0 saw an average growth of 7.2% in 2014 on an annualized basis (8.2% in 2013), while its share in M2 averaged 22.4% (22.6% in 2013). It is worthwhile noting that the M0/M2 ratio in Poland was 17.1% in 2013 (18.5% in 2012), in Ukraine it was 26.2% (26.4% in 2012). The downtrend in the ratio of cash in circulation to M2 in developing countries is also related to the financial system development.

2.1.2. Inflation processes

In 2014, inflation turned out to be far above the target level of 5% for 2014 set forth in the central bank's Guidelines for the Single State Monetary Policy for 2014–2016. The year-end inflation was 11.4% (6.5% in 2013) (see *Fig. 5*).

The increase of inflation above the upper level of target range was basically caused by other than monetary factors. It is the ruble's depreciation induced by the geopolitical tensions, massive capital outflow and the decline in crude oil prices, as well as the ban on imports of food products of certain categories to Russia from the countries which imposed sanctions against Russia that were responsible for most of the acceleration of inflation given a substantial share

of imported goods in the consumption of Russian economic agents. It is worthwhile noting that our estimates show that the 2014 year-end double depreciation of the ruble against the U.S. dollar and the Euro will boost inflation at least by 10–15 p.p. in 2015.



Source: Rosstat (Russia’s Federal State Statistics Service); calculated at the Gaidar Institute.

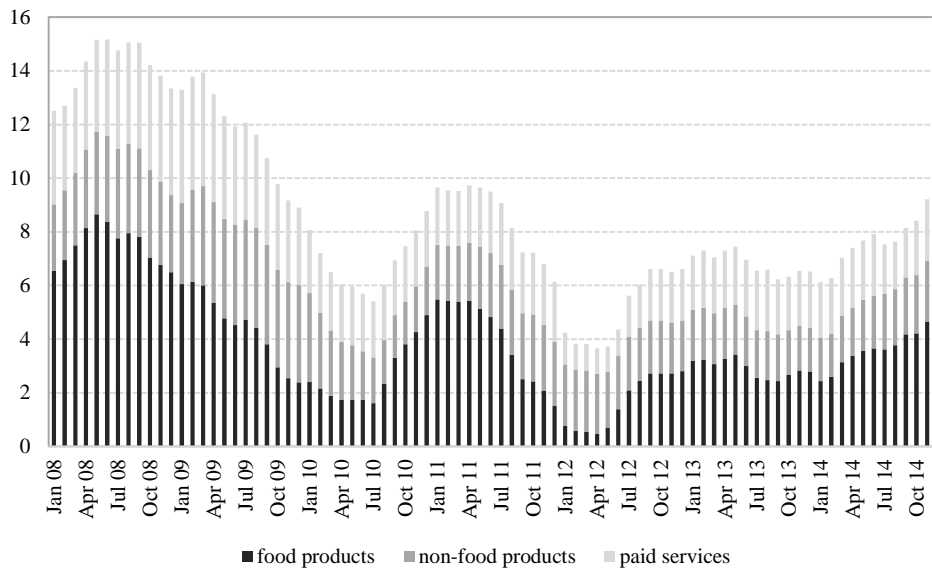
Fig. 5. The growth rate in consumer price index in 2013–2014 (% y-o-y)

Overall, despite the fact that the failure to maintain the target inflation level has little in common with the plans to migrate to inflation targeting. The central bank is not the one to be blamed for the failure, because such an adverse development of geopolitical processes can hardly be foreseen.

Let’s take a closer look at the inflation processes in 2014. It is shown in *Table 3* that in the period between January 2014 and December 2014 the prices of consumer products were growing much faster than those in 2013. The price of the following food products contributed most to the price growth of food products: cereals and beans (+34.6%), fruits and vegetables (+22.0%), meat and poultry (+20.1%), fish and seafood products (+19.1%), butter (14.5%), milk and dairy products (+14.4%), alcoholic beverages (+13.7). The price growth of the foregoing food products was determined basically by the ban on imports of food products from the United States, Canada, Australia, Norway and the European Union.

The growth rate of prices of non-food products increased as well (+8.1%) in 2014. The prices of the following products of this commodity group saw faster growth rates due to the increase in excise duties as well as the ruble’s exchange rate depreciation: tobacco products (+27.1). The price growth of electric products and other household appliances (+17.9%), audio visual goods (+15.8%), medicaments (+13.1%) and motor gasoline (+8.9%) is worth noting. Overall, the price growth of non-food products was associated with the ruble’s depreciation amid the Russian market large dependence on foreign supplies.

In 2014, the prices of paid services to individuals increased 10.5% compared with those in 2013. The price growth of outbound tourism services (41.1%), insurance services (21.7%), utility services (19%), early childhood education services (15.6%), education services (13.8%) made a noticeable contribution to the price growth of paid services. The considerable price growth of outbound tourism services and insurance services was associated with the depreciated exchange rate of the national currency.



Source: Rosstat; calculated at the Gaidar Institute.

Fig. 6. The structure of inflation in 2008–2014 (in percent compared to same month previous year)

Table 3

The annual growth rate of prices of consumer goods and services of certain types in 2012–2014 (in percent compared to December previous year)

	2012	2013	2014	2012–2014
Consumer Price Index	6.6	6.5	11.4	26.5
Food products	7.5	7.3	15.4	33.1
Cereals and beans	-7.0	3.2	34.6	29.2
Butter	3.0	18.6	14.5	39.9
Sunflower oil	3.4	-3	5.0	5.3
Macaroni products	7.6	4.7	8.4	22.1
Milk and dairy products	4.4	13.1	14.4	35.1
Eggs	5.1	28.8	4.6	41.6
Bread and flour products	12.0	8.0	7.5	30.0
Meat and poultry	8.3	-3	20.1	26.2
Fish and seafood products	1.9	7.6	19.1	30.6
Fruits and vegetables	11.0	9.3	22.0	48.0
Alcoholic beverages	12.1	14.6	13.7	46.1
Non-food products	5.2	4.5	8.1	18.8
Medicaments	5.1	2.5	13.1	21.8
Motor gasoline	6.8	5.7	8.9	22.9
Tobacco products	22.6	29.3	27.1	101.5
Services	7.3	8.0	10.5	28.1
Utility services	9.4	9.8	9.4	31.4
Early childhood education services	6.4	9.9	15.6	35.2
Convalescence services	5.9	5.7	7.6	20.4
Passenger transportation services	6.9	8.9	7.3	24.9
Cultural organizations' services	8.8	10.5	9.9	32.1

Source: Rosstat.

Finally, the consumer price growth rates in Russia are compared with those in other countries in Table 4.

Table 4

**The dynamics of consumer price indices in various countries
in 2012–2014, % annual**

	2012	2013	2014*	2012–2014*
Azerbaijan	–0.3	3.5	–0.8	2.4
Armenia	3.2	5.6	0.2	9.2
Belarus	21.8	16.5	14.8	62.9
Kazakhstan	6.0	4.8	6.3	18.1
Kyrgyzstan	7.5	4.0	6.8	19.4
Moldova	4.1	5.2	3.1	12.9
Russia	6.6	6.5	7.1	21.6
Tajikistan	6.4	3.7	6.1	17.1
Ukraine	–0.2	0.5	19	19.4
Germany	2.0	1.5	0.4	3.9
France	2.0	0.9	0.8	3.7
The United States	2.1	1.5	2.1	5.8
The Netherlands	2.5	2.5	1.5	6.6

* the data on January–October.

Sources: the CIS Interstate Statistical Committee (CISSTAT) (<http://www.cisstat.com/>), the OECD data base (<http://stats.oecd.org/>).

In the period between January 2014 and October 2014, Russia was ranked 3rd after Ukraine and Belarus on consumer price growth rates among the CIS member countries. In the first 10 months of 2014, the rate of inflation in Ukraine and in Belarus was 19% and 14.8%, respectively. Inflation in Russia in January–October 2014 was 4.5 times that in developed countries (see *Table 4*). Hence Russia is facing a high level of inflation compared to both the developed countries and emerging economies.

In 2015, the economic decline and a moderate growth in money supply will be the factors that will constrain inflation. However, the effect of ruble's exchange rate pass-through to prices will definitely boost inflation which is most likely to be above 10–12% at 2015 year-end.

At the same time, the target-level inflation of 4% can be reached by 2017 given the fact that the effect of the ruble's depreciation on prices will cease to exist in the mid run, while there is almost no monetary prerequisites for the acceleration of inflation.

2.1.3. The main decisions concerning the monetary and exchange rate policies

In 2014, while gradually migrating to an inflation targeting regime, the Bank of Russia made a series of important decisions aimed at enhancing its interest-bearing toolkit, as well as making the exchange rate formation a more flexible process.

The decision to gradually increase the CBR key rate to 17% in January from 5.5% on 16 December 2014 was the most significant one the Bank of Russia made in 2014. On 3 March, the CBR key rate was lifted to 7% p.a. from 5.5% p.a., on 28 April to 7.5% p.a. from 0.5 p.p., to 8% p.a. on 25 July, to 9.5% on 5 November, and to 10.5% p.a. on 12 December. These decisions were intended to lower inflation expectations and maintain a financial stability.

It is worthwhile noting that the regulator was expected in 2014 to adopt a floating exchange rate regime and inflation targeting, increase gradually the CBR key rate in response to the rapid decline of the international reserves. It is our opinion that the Bank of Russia's decision to lift the interest rates was correct given the circumstances. With inflation getting higher, a lower real interest rate would have resulted in further depreciation of the ruble, having no effect on economic growth rates, because with the FX market being unsettled, economic agents tend to curtail their fixed investment. At the same time, with lower inflation, the central bank may need to lower the CBR key rate in order to support economic activity.

In 2014, the central bank gradually upgraded the monetary policy mechanism based on interest rate management. In particular, fine-tuning operations to provide liquidity were introduced on 3 February in response to abolished daily overnight repo auctions. The regulator allotted an average of Rb 212bn as part of each “fine tuning” repo during the year. No such operations were conducted in February, June, August 2014. It is worthwhile noting that the demand for such operations in certain periods was governed by the substantial oversupply of liquidity in the banking sector. On 17 February 2014, the Bank of Russia complemented its monetary policy toolkit with fine-tuning operations to absorb liquidity. Such operations were undertaken as 1–6 day fine-tuning deposit auction at maximum interest rate equal to the CBR key rate. In the period between January 2014 and December 2014, only five such operations were undertaken – in July, August, and November – with the liquidity absorption varying between Rb 64,6bn to Rb 360bn per auction. From 12 to 44 business entities participated in such auctions, being indicative of weak demand for this tool.

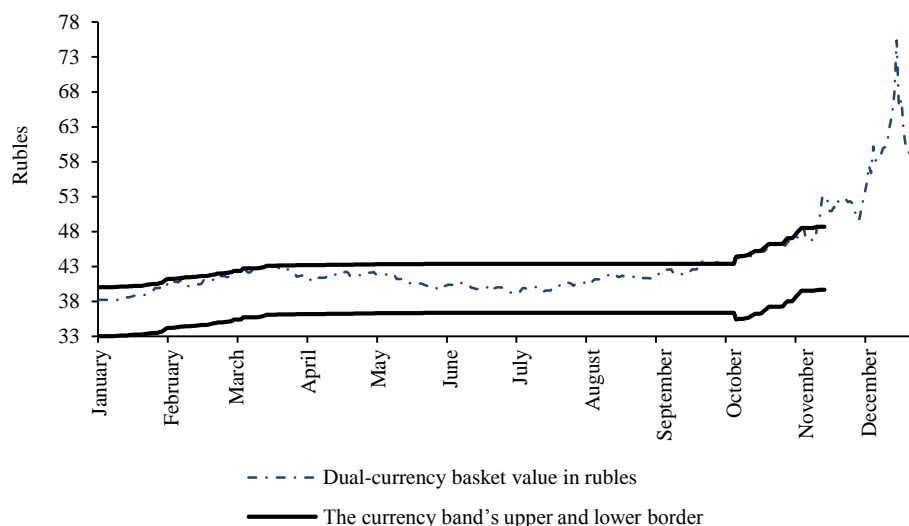
Credit institutions’ stronger demand for Bank of Russia refinancing operations amid limited volumes of the collateral base for repo operations resulted in bigger volumes of bidding and the frequency of 3-month auctions for loans secured by non-marketable assets. Additionally, in June 2014, the maximum term of money provision were extended to 549 from 365 days for standing facilities, namely loans secured by non-marketable assets, guarantees or gold. This measure had an insignificant effect on the liquidity of the banking sector. It is 1-3-month loans that show the strongest demand among secured loans, which accounted for an average of 63% of the banks’ total debt on secured loans in 2014, whereas 181-365-day secured loans accounted for as little as 7% on average. This liquidity provision tool shows a weak demand because of its high fixed interest rate, most banks have no collateral available for the required term (12 months), as well as high alternative costs from the decline of collateral available to credit institutions (lost opportunities to obtain short-term loans because of running short of the collateral available).

The Bank of Russia decided on 25 April to introduce an new tool designed to refinance credit institutions. The regulator employs this tool to provide loans to banks for a term less or equal to 3 years at a rate of 6.5% p.a.. The foregoing mechanism of refinancing is secured by claims on credits provided to finance investment projects guaranteed by the state. At the initial stage, the new mechanism is available only for large banks with an equity more than Rb 50bn. The tool is intended to stimulate investment, however, in our opinion, it is the financial system as a whole, not the central bank, that is to be involved in the formation of long money in economy. It is therefore the issues of enhancing the financial sector depth and the investment potential of Russian assets, not the growth in money supply, that are still quite relevant for the Russian economy.

The situation in the FX market in 2014 became, perhaps, the key challenge for the Bank of Russia, as the drastic ruble’s depreciation made it impossible to reach the target level of inflation and put financial sustainability at threat. Let’s take a closer look at the central bank exchange policy in 2014.

Early in 2014, the Bank of Russia implemented a series of policies aimed at increasing the flexibility of exchange rate formation mechanisms. As part of the planned migration to a floating exchange rate, the Bank of Russia decided on 13 January to discontinue target interventions. Having revoked the flattening of exchange rate volatility caused by fundamental factors regarding the change in the foreign trade balance, the Bank of Russia participation in the process of exchange rate formation has been restricted since January 2014 to flattening a sharp short-term volatility of the exchange rate. The revocation of CBR target currency interventions increased

the sensitivity of operational band borders of the currency-band exchange rate policy to the volume of regulator's currency interventions. As a result, the currency band borders were gradually going up 2–3 times a week since early in the second half of January, reaching Rb 35,40 and Rb 42,40 late in February, whereas earlier in the year they were at Rb 33,05 and Rb 40,05 (see Fig. 7).



Sources: The Bank of Russia, www.cbr.ru, the authors' calculations.

Fig. 7. The value of the dual-currency basket in rubles and the operational band border in 2014

Since 19 February, the Bank of Russia began to adjust currency interventions to the operations, taking into account the transfer of funds in foreign currencies by the Ministry of Finance of the Russian Federation and the Federal Treasury to the Reserve Fund.

In the period between January and February 2014, the monthly average volume of Bank of Russia sales of the European currency increased to 0,6bn Euro, US dollar to \$7,0bn. Therefore, the value of net sales of U.S. dollars in January-February 2014 outperformed that in September 2011 (\$6,8bn), only being less than the value seen in January 2009.¹

Further acceleration of the Russian currency depreciation against the world's primary currencies was sparked by the escalated conflict in Ukraine and raised geopolitical tensions. CBR currency interventions hit a record volume early in March, thus being the cause of the sharp reversal in of the exchange rate policy. The Bank of Russia decided on 3 March 2014 to increase the amount of accumulated interventions resulting in the 5-kopek shift of the operational band borders of the exchange rate policy, to \$1,5bn from \$350m. Operations related to foreign currency purchases by the Federal Treasury were suspended too.

The decisive measures of the Bank of Russia allowed foreign currency sales to be substantially reduced in volume and resumed operations in order to purchase the same as early as May–June. Furthermore, a decision was made to resume FX operations, effective 14 April, of Russia's Finance Ministry and the Federal Treasury, and gradually relax by the end of May the participation of the Bank of Russia in the exchange rate formation. On 22 May, the Bank firstly

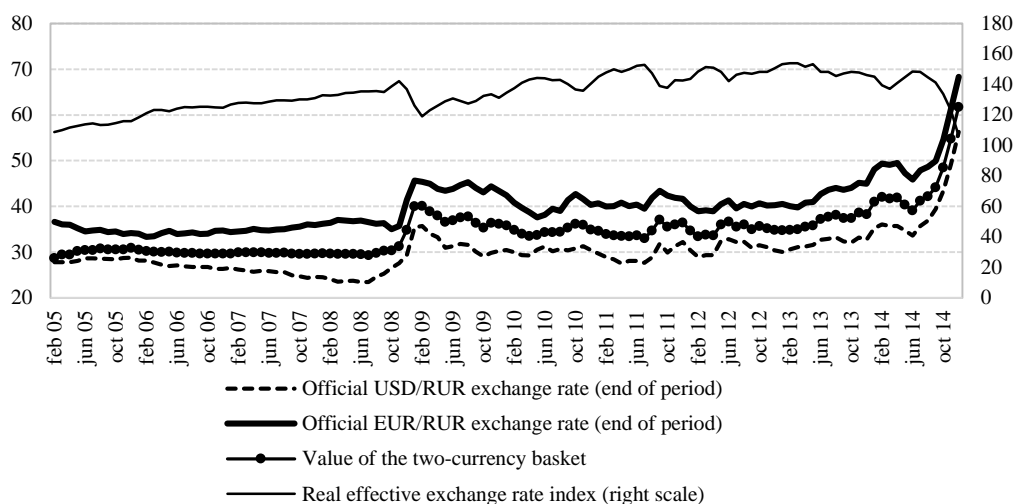
¹ As a reminder, at the height of the crisis 2008–2009, the Bank of Russia monthly average sales of US dollars amounted to more than \$35,4bn in the period between September 2008 and January 2009.

reduced by \$100m the volume of CBR currency interventions within the range of the floating operational band and aimed at flattening the volatility of the exchange rate, while other parameters of the exchange rate policy remained unchanged. On 17 June, the Bank of Russia, first, further reduced by \$100m CBR currency interventions within the range of operational band. Second, the Bank of Russia widened the range within which the Bank is not supposed to interfere with the exchange rate formation, to Rb 5,1 compared with Rb 3,1 in effect since 7 October 2013. And, finally, the Bank reduced to \$1000m from \$1500m the amount of accumulated interventions resulting in automatic shifting by 5 kopeks of the operational band boundaries. As a consequence, the Bank of Russia fully discontinued as early as July its operations in the domestic FX market.

Furthermore, despite the ongoing aggravation of the geopolitical situation and further sanctions, not only did the Bank of Russia decided on 18 August to reduce to \$350m the volume of CBR currency interventions and revoke CBR currency interventions within the range of floating operational band, but it also decided to symmetrically widen the same to Rb 9 from Rb 7. As a result, the Bank of Russia conducted no CBR currency interventions in the period between August and September. Therefore, the of exchange rate formation of the Russian currency was driven exclusively by market factors within the three months (July–September) of 2014.

The situation worsened in the market in mid-September, when the decline in global prices of energy resources accelerated. At the same time, the Bank of Russia made a few statements that it will keep implementing its plan to completely migrate to a floating exchange rate in 2014. In September, the ruble weakened against the US dollar and the Euro by 13.1% and 7.9%, respectively, compared to previous period. As a result, the Bank of Russia resumed early in October sales of both U.S. dollars and Euros, and the volume of interventions exceeded \$27bn and 1,6bn Euro, respectively, in the same month.

In an effort to ease the feverish demand for foreign currencies, the Bank of Russia employed additional tools designed to provide foreign currencies. First, the Bank of Russia began on 17 September to hold overnight FX swap operations in order to sell U.S. dollars for rubles to be subsequently purchased. Second, a new tool designed to provide foreign-currency liquidity – repo transactions denominated in foreign currencies – was introduced on 27 October. Initially, the term of repo US\$/Euro transactions in the form of auctions was restricted to 1 week and 28 days. Minimum rates were equal to the LIBOR in terms of respective foreign currencies and with comparable terms, increased by 2 and 2,25 p.p. for operations for a term of 1 week and 28 days, respectively. At the same time, only four of the 33 currency FX swap auctions in the period between 17 September and 5 November can be recognized as held, with the volume of raised funds totaling \$1476,5m. The demand for foreign currencies allotted by the Bank of Russia through repo operations was found to be weak. During the initial auctions in November, the volume of raised U.S. dollars for 1-week term was running at \$12,5m against the maximum limit of \$2bn, whereas the volume of funds raised for 28-day term was running at \$199,9m against the limit of \$1,5bn. The currency band range was shifted upwards 17 times in October, and in certain months, e.g., on 23, 28 and 29 October, by 40 kopeks within a day. As a result, the operational band floor was Rb 38,55 while the cap was Rb 48,55 by the end of October (see *Fig. 8*). In October 2014 kypc Russian currency depreciation weakened against the US dollar and the Euro by 7.1% and 5.4%, respectively.



Source: The Bank of Russia, calculated at the Gaidar Institute.

Fig. 8. Ruble exchange rate in January 2005 to December 2014

The weak demand for new tools from credit institutions resulted in softer terms of foreign-currency liquidity provision. Therefore, the central bank decided on 5 November to lower minimum interest rates on FX repo transactions for 1-week and 28-day term, equaling the same to the LIBOR expressed in corresponding foreign currencies and comparable terms, increased by 1.5 p.p. Additionally, the Bank of Russia decided to introduce another tool designed to provide long-term FX liquidity as FX repo transactions for 12-month term. The minimum interest rate on this tool was also equal to LIBOR expressed in corresponding foreign currencies, increased by 1.5 p.p. However, the total amount of funds allotted during the auctions in November was small, running at \$403,8m. The auction for foreign-currency liquidity provision for 28-day term was most in-demand, during which \$312,4m were allotted. A total of \$87,7m were allotted, with the limit of \$10bn during the initial annual auction. The 1-week repo results testified that there was no demand for a short-term liquidity: with the limit of \$2bn, the volume of closed transactions was running at as little as \$3,7m despite the growing demand for foreign currencies in the domestic FX market. According to the Bank of Russia estimates, in Q3 2014, the private sector's net capital export was running at \$13,0bn. At the same time, the banks' net capital export was running at \$20,8bn, and other sectors' net capital export was running at \$33,8bn (nonfinancial and other financial corporations, as well as individuals) in the period between July and September. It is worthwhile noting that it is only Q4 2008 that saw no big volumes of exported financial resources (\$78,1bn).

Under the circumstances, the Bank of Russia limited to \$350m the volume of overnight operations on 5 November 2014. Additionally, the regulator reserved the right to conduct currency interventions only when during the entire trading session the value of dual-currency basket is within or outside the borders of the operational band. As a result, as recently as the following day the official ruble value of the dual-currency basket was above the cap of the operational band, whose role became nominal against the preset parameters of the exchange rate policy. And, finally, the Bank of Russia revoked on 10 November 2014 the previously applicable exchange rate policy mechanism, revoking the acceptable range of the ruble value of dual-currency basket and regular interventions within/outside the specified operational band. In fact, the Bank of Russia migrated to a floating exchange rate for the first time in Russia's contemporary history, reserving the right to undertake operations in the domestic FX market only when

financial sustainability is at threat. At the same time, having reached on 10 November the peak of Rb 53,02, the ruble value of dual-currency basket stopped to increase for a certain period of time, which supports the significant role of the speculative factors that boosted the depreciation of the Russian currency. However, the Russian currency resumed its depreciation by the end of the month amid the drastic fall of crude oil prices. As a result, the Russian ruble lost 16.2% year-on-year in 2014 against the U.S. dollar and the Euro. In the end, the USD/RUB and EUR/RUB exchange rate increased by the end of December to Rb 56,26 per US\$ and Rb 68,34 per Euro, respectively, compared to Rb 32,73 and Rb 44,97 as of the end of December 2013. The depreciation of the ruble's real effective exchange rate in the period between January and December 2014 is estimated 8.3% compared to its 1.2% strengthening during the same period of 2013.

In December 2014, the Bank of Russia resumed currency interventions aimed at selling foreign currencies. As a result, while flattening the short-term volatility of the ruble's exchange rate, the Bank of Russia sold more than \$10,3bn in December.

It is worthwhile noting that there was no demand for the central bank's new tools designed to provide foreign currencies, because economic agents expected the ruble to depreciate and would rather purchase than borrow foreign currencies given that borrowed currencies had to be repaid at a much lower ruble's exchange rate against the US dollar and the Euro. Furthermore, the Bank of Russia provides commercial banks with ruble-denominated funds in big volumes and at an interest rate which can be easily covered with the plummeting ruble's exchange rate. The Bank of Russia conducted interventions in the FX market whereby reducing the monetary base in other words, in order to prevent the exchange rate sharp volatility. However, to be able to maintain the money market interest rate within the band, the central bank provided on a regular basis credit institutions with new ruble liquidity which the latter instantly transferred back to the FX market. Under such circumstances, the situation in the FX market (with the same macroeconomic and political factors) can be stabilized by contracting the surplus reserves at commercial banks. Therefore, the Bank of Russia announced on 11 November the introduction of a limit on the provision of ruble liquidity through FX swaps. The daily limit was set in rubles equivalent to \$2bn in the period of 12 thru 30 November, as well as 15 thru 21 December 2014. Additionally, the regulator limited volumes of funds allotted through 1-week repo operations of more than Rb 100bn, compared to the formerly set parameters. It is noteworthy that the ruble liquidity limit may create problems for some banks, including large banks, and increase risks of worsening the banking crisis. Target support of ailing banks may be required to address the issue.

On 25 November 2014, the regulator announced that the maximum volume of funds for fine-tuning operations to provide ruble liquidity was set at Rb 200bn. It is worthwhile noting that the regulator's measures failed to contract the reserves at commercial banks. In particular, according to the data on the beginning of December 2014, the value saw a positive growth, 29.5% by the beginning of November and 50% compared to the same period previous year. Early in January 2015, the surplus reserves at commercial banks gained another 28.6%. Despite the limits on the provision of ruble liquidity, the regulator held repo auctions intended to replace Rb 1 trillion on the deposits withdrawn by Russia's Finance Ministry from the accounts with commercial banks, in order to prevent the money market rates from a substantial increase. Therefore, the Bank of Russia increased Rb 400bn the limits on repo auctions early in December. There is no way to prevent the ruble's exchange rate from falling with such volumes of liquidity provision, while panic sentiments are developing in the market.

Overall, the objective to maintain both the ruble's exchange rate and the interbank market rate within the interest rate band cannot be met amid a feverish demand for foreign currencies. An upsurge of interest rates or massive interventions in the FX market should be required to stabilize the exchange rate amid the worsening fundamental factors (the decline in crude oil prices and capital outflow). However, it is worthwhile noting that such measures only should help prevent panic and stabilize the exchange rate in the short run, whereas in the long run the dynamics of ruble's exchange rate should be determined by the dynamics of prices of energy resources, market evaluations of foreign policy risks, as well as Russia's investment potential.

2.1.4. Balance of payments and ruble's exchange rate

The adverse foreign policy conditions, as well as the trend in the global markets of raw materials had a strong impact on Russia's balance of payments in the period between January and December 2014. As noted above, the central bank increased its presence in the FX market in 2014 despite the migration to an inflation targeting regime. In the 12 months of 2014, net capital outflow from the country appeared to be more than that in 2013, which was caused by closing down Russian economic agents, who have to repay their external debt, from foreign capital markets.

According to the Bank of Russia preliminary assessment of Russia's balance of payments in January–December 2014, current account surplus was running at \$56,7bn, up 66% compared to that in 2013. Additionally, trade surplus increased 2.0% (to \$185,6bn from \$181,9bn). Export of goods dropped by 5.7% (to \$494bn from \$523bn), except that exports were running at \$34,2bn in December 2014 compared to \$45,9bn in December 2013. Import of goods contracted by 9.8% (to \$308bn from \$341,3bn) due to the ruble's depreciation and sanctions on food products, except that in imports were running at \$44,6bn in December 2014 compared to \$56,1bn in December 2013. It seems that if the current exchange rate remains the same, the decline of imports in 2015 would see a harder decline than that in December 2014, because supplies in December were made mostly under the previously concluded contracts, factoring in a different ruble's exchange rate.

The trade balance whose balance in turn depends largely on the dynamics of prices of hydrocarbons was the key factor which determined the value of balance of the current account in the Russian economy throughout the 2000s. The same trend was observed in 2014 too (see *Fig. 9*).

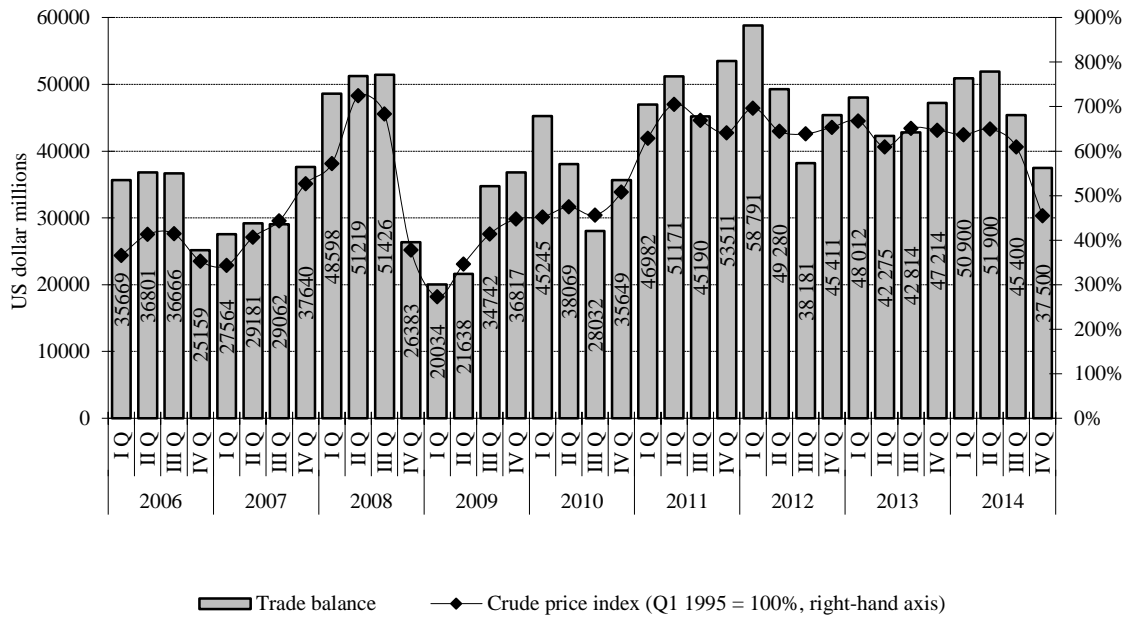
Exports of crude oil, oil products and natural gas accounted for 65.3% of the total exports, down 1.6 p.p. compared to the corresponding period of 2013, given the 43% decline of crude oil prices in 2014, reaching \$63 per barrel on average in December 2014, as well as the contraction of physical volumes of supplies (see *Fig. 10*).

Supplies of the key exported commodities were contracting while the terms of trade were worsening on all commodity items, except nickel and fertilizers of certain types.

In 2014, imports contracted basically on all commodity items, especially for engineering products from countries other than CIS member states, i.e., for explicitly investment products. Furthermore, supplies saw most of the contraction in December (–24% in December 2014 against December 2013 on engineering products).

In 2014, the deficit balance on services reached \$54,6bn and declined by 6.3% (in absolute terms) compared to the corresponding period of 2013. Export of services were running at \$66,6bn, a decline of \$4bn (–5%) compared to previous year. Import of services in the 12 months of 2013 lost 5.6% to \$121bn compared to the value seen 2013, which is for the most part determined by the decline in individuals' outbound travelling costs. The balance on the compensation of employees contracted by 32% to –\$9,0bn in the period between January and

December 2014 ((-13,2)bn US\$ in 2013). The deficit balance on the investment income declined by 10% year-on-year in 2014 and reached \$56,9bn. Investment income receivable increased 6% to \$43,5bn from \$37,9bn. The income payable declined by 2% to \$81,1bn on non-financial organizations and 12.4% to \$16,2bn on banks, which governed a 4.6% decline of the total revenue receivable to \$100,3bn. The balance on the rent¹ was running at +\$0,1bn in 2014 (+\$0,1bn in 2013). The balance on the secondary income² in the 12 months of 2014 was running at (-8,7)bn US\$ ((-9,3)bn US\$ in 2013), and the balance on capital transfers was running at (-42,0)bn US\$, ((-0,4)bn US\$) in 2013) due to the write-off of the debts owed by Cuba, Uzbekistan and North Korea.

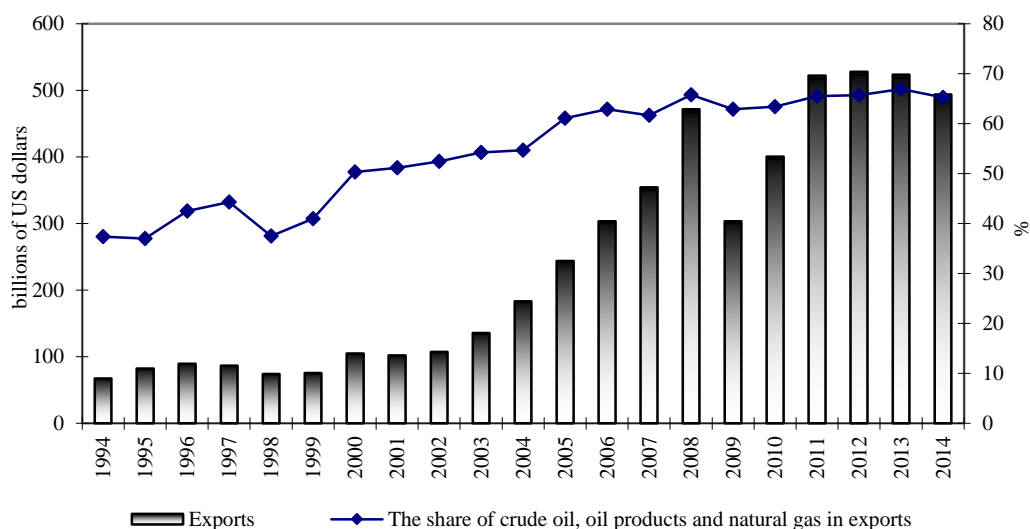


Source: the Bank of Russia; EIA; calculated at the Gaidar Institute.

Fig. 9. Russia's trade balance and the crude oil price index in 2006–2014

¹ The rent means an income receivable for making natural (mineral) resources available for other institutional entity. Examples of the rent include sums payable for land utilization, extraction of mineral resources and other extractable resources, as well as the right of fishing, forest and pasture utilization.

² The former balance on current transfers. According to the Central Bank of Russia, current transfers tend to increase the level of disposable income and consumption of goods and services of the recipient and reduce the disposable income and consumption potential of the donor, for example, a humanitarian aid provided in the form of consumer goods and services. Current transfers are recognized in the current account. Non-current transfers are inherently recognized as capital transfers. Capital transfers result in changes in the volume of assets or liabilities of the donor and the recipient and recognized in the capital account. If the donor and the recipient are residents of various countries, then capital transfer results in changes in the level of national wealth of the economies they represent. An example of capital transfers is free transfer of the title to fixed assets, waiver of debts.



Source: The Bank of Russia.

Fig. 10. The dynamics of exports of goods and the share of energy sector in 1994–2014

In 2014, the balance on the financial account was running at $-\$125,6\text{bn}$ ($-\$45\text{bn}$ in 2013) (see Table 5). The growth in the liabilities of Russian economic agents to foreign economic agents reached $\$48,7\text{bn}$ in the 12 months of 2014, 2.6 times less than the previous year growth ($\$125,8\text{bn}$). The external liabilities of federal administration agencies declined by $\$9,4\text{bn}$ in 2014. The external liabilities of constituent territories of the Russian Federation were running at $\$0,1\text{bn}$. A negative growth of the liabilities of monetary authorities in 2014 was less or equal to $\$3\text{bn}$. The banking sector ceased to raise funds through external loans in 2014 due to sanctions and kept repaying on previously accumulated external liabilities. For instance, Russian banks' external debt increased $\$20\text{bn}$ in 2013, whereas in 2014 it decreased $\$37\text{bn}$. The non-bank sector reduced drastically fundraising from non-residents in 2014, increasing its external liabilities as little as $\$1\text{bn}$ compared to $\$49\text{bn}$ raised in 2013. The inflow of foreign direct investment declined by $\$27\text{bn}$ (19 against $\$46\text{bn}$). Other external liabilities (portfolio investment, credits and loans and other liabilities) declined by $\$18\text{bn}$ and by $\$3\text{bn}$ after the growth in 2013.

The foreign assets of residents (foreign economic agents' liabilities to Russian economic agents) increased by $\$76,9\text{bn}$ in the 12 months of 2014 ($\$170,8\text{bn}$ in 2013), whereas the foreign assets of monetary authorities contracted by $\$0,5\text{bn}$ (down $\$0,6\text{bn}$ in 2013). The foreign assets of the banking sector increased $\$12,7\text{bn}$ in 2014 ($\$27,9\text{bn}$ in 2013). Capital export from other sectors decreased 25% year-on-year in 2014 and reached $\$104,4\text{bn}$, of which direct and portfolio investment in foreign assets was running at $\$47,1\text{bn}$ and $\$4,2\text{bn}$ respectively ($-\$85,4\text{bn}$ and $-\$2,2\text{bn}$ in 2013, respectively). The growth in investment in the foreign assets of the non-bank sector was basically determined by a growth in investment in foreign currencies in cash. According to the Bank of Russia estimates, the volume of foreign currencies in cash held by Russian residents increased $\$34\text{bn}$ in 2014, whereas it remained basically unchanged in 2013. Other assets of the non-bank sector increased in 2014 nearly 30% less than those of the previous year (67bn against 95bn), thus offsetting the growth in demand for foreign currencies in cash.

Table 5

**The key accounts of the balance of payments and the dynamics
of external debt in 2012–2014 (billions of US dollars)**

Indicator	2012					2013					2014				
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4*	Year
Balance from current and capital accounts	34.7	16.1	5.6	10.3	66.8	25	1.8	-0.7	8	34.1	26.8	12.9	6.4	10.5	26.8
Financial account (excluding reserve assets)**	-24.8	0.8	-4.0	1.6	-26.5	-13.3	-7.8	-4.5	-19.3	-45	-50.7	-30	-5.1	-39.8	-125.6
Change in the foreign exchange reserves ('+' corresponds to an increase, '-' corresponds to a decrease in the reserves)	-4.6	-15.0	-1.5	-8.9	-30.0	-4.9	4.4	7.4	15.2	22.1	27.4	10.3	5.7	64.2	107.5
Net errors and omissions	-5.3	-2.0	-0.1	-2.9	-10.3	-6.8	1.6	-1.9	-3.8	-10.8	-3.3	6.8	3	-3.1	3.4
Change in Russia's external debt ('+' corresponds to an increase, '-' corresponds to a decrease of the debt)	18.6	13.1	28.3	37.5	97.6	55.3	16.1	8.5	12.6	92.4	-13.2	16.8	-53.0	-79.9	-92.5
Change in Russia's sovereign external debt	1.7	5.1	5.0	7.9	19.7	3.1	-1.5	6.7	-0.9	7.3	-8.1	3.5	-7.7	-7.9	-20.2
Change in Russian private sector's external debt	16.5	8.0	21.7	27.6	73.8	48.3	18.2	3.2	15.1	84.8	-4.5	12.8	-45.0	-66.9	-103.6

* – preliminary estimate; ** – net of foreign exchange reserves.

Source: The Bank of Russia.

Russia's external debt declined by 17.7% in 2014, being \$599bn as of 1 January 2015. It is worthwhile noting that in 2014 the external debt of Russia's private sector dropped by \$103,6bn (+\$84,8bn in 2013) due to the imposed sanctions limiting the access to global capital markets (see *Table 5*). The sovereign external debt contracted by \$20,2bn in 2014, whereas it saw a positive increase of \$7,3bn in 2013.

The decline in the prices of Russia's key export commodities and high inflation in Russia for all of 2014 year-end pushed down the ruble's real effective exchange rate by 27.2% (a 2.8% decline in 2013), reaching the value seen in April 2014 (see *Fig. 9*). In the period between January and December 2014, the USD/RUB official exchange rate increased 69.6% to Rb 55,8 on average in December 2014 from Rb 32,9 on average in January 2014. At the same time, the EUR/RUB exchange rate in December averaged Rb 68,8, an annual growth of 49.2%. Eventually, the ruble depreciated against the dual-currency basket: the value of the dual-currency basket increased 56.8% during the same period to Rb 61,6 from Rb 39,3.

According to the Bank of Russia preliminary estimation, a trend setter in the dynamics of the balance of payments in 2014 was the dynamics of net capital outflow from the nonfinancial

sector, running at \$151,5bn, up \$96bn above the value seen in the 12 months of 2013¹. Given the adjustment for the amount of FX swaps between the Bank of Russia and resident banks, the amount of funds the Bank of Russia allotted in foreign currencies on a reverse basis (FX repos) to resident banks, as well as the funds held on the correspondent accounts of resident banks with the Bank of Russia – \$130,5bn. At the same time, capital outflow was seen basically throughout the entire year, except June and September, when the net exports of capital through the private sector was running at \$12,5bn and \$0,1bn, respectively. In the period between January 2014 and December 2014, net capital outflow through banks and the private non-financial sector reached \$49,8bn and \$101,7bn, respectively.

In 2014, the migration to repayment of external loans and investment from fundraising was the key cause that triggered the growth in net capital outflow. Additionally, there was an upsurge in investment in foreign currencies in cash. Nonetheless, the capital outflow in 2014 was outperformed by that caused by the crisis of 2008–2009. The biggest capital outflow over a comparable period was seen during the four quarters between Q3 2008 and Q2 2009, when net capital outflow from the private sector was running at \$183bn, nearly \$31bn above that in 2014.

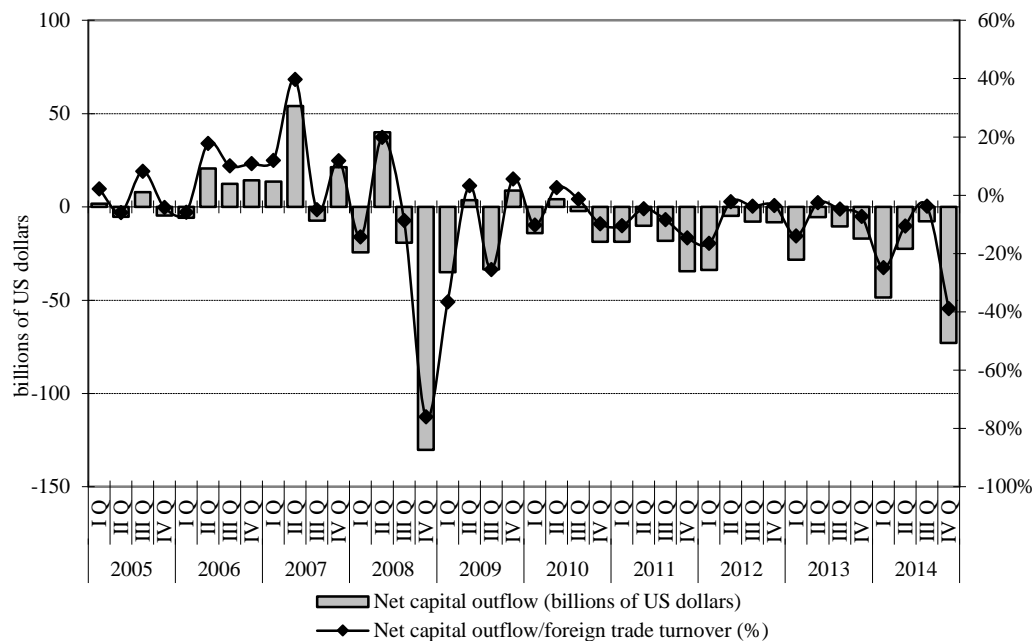
Even during the latest crisis, Russia's banking sector managed to increase its external liabilities, including direct investment, reaching a bigger volume than that in 2014 (\$41bn during the crisis of 2008–09 against \$18bn in 2014). Furthermore, at present, the stronger demand for foreign currencies in cash has been found to be more positive. During the crisis of 2008–2009, the growth in foreign currencies in cash was positive only within two quarters (Q4 2008 and Q1 2009), whereupon Russian residents began to gradually sell foreign currencies. This trend, however, is by no means surprising given the much more serious depreciation of the ruble in 2014.

Regarding the rest of net capital outflow components, the situation in 2014 remained visibly better than that amid the crisis of 2008–2009. The capital outflow from the banking sector in 2008–2009 was running at \$32bn above the value seen in 2014. At that time banks were accumulating more intensively their foreign assets while making substantial repayments on their external debt. In 2008–2009, the foreign assets of the non-bank sector (save for foreign currencies in cash) increased more, running at \$48bn above the value seen in 2014 (\$115bn against \$67bn)

The 2014 year-end capital flight (see *Fig. 12*) was running at \$10,9bn, based on our estimates (in 2013 – \$47,6bn)².

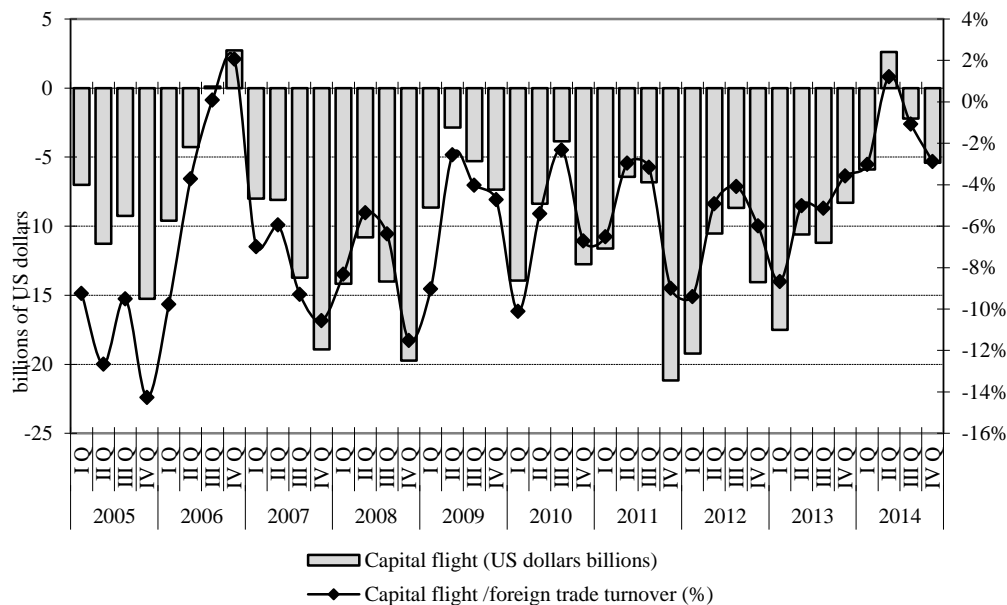
¹ While comparing the volumes of capital flows, the data on 2013 was purged from the effect of the Rosneft TNK-BP-purchase deal, Rosneft external fundraising for the purpose and the related increase in BP investment in the Rosneft's capital.

² The IMF capital flight measurement was used: the sum of “trade credits and advances”, “timely not received export revenue and goods and services prepaid according to import contracts” and “net errors and omissions”.



Source: The Bank of Russia; measured at the Gaidar Institute.

Fig. 11. The dynamics of net capital outflow in 2005–2014



Source: The Bank of Russia; measured at the Gaidar Institute.

Fig. 12. The dynamics of capital flight in 2005–2014

It is worthwhile noting that future trends concerning the state of Russia’s balance of payments are mixed. On the one hand, the 2014 uptrend of the balance on the current account is likely to prevail in the mid run due to the ruble’s depreciation and the respective fall in imports. On the other hand, the massive decline of crude oil prices, the geopolitical tensions, the downgrade of the credit rating for Russia are the factors that worsen the state of the balance of payments.