ONLINE MONITORING OF RUSSIA'S ECONOMIC OUTLOOK

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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MAIN TRENDS AND CONCLUSIONS 3

1. MACROECONOMIC FORECAST FOR 2016–2018: THE ECONOMY IS PASSING THROUGH THE LOWEST POINT OF THE CURRENT CRISIS (V. Averkiev, S. Drobyshevsky, M. Turuntseva, M. Khromov) ..5

2. MONETARY POLICY OF THE RUSSIAN CENTRAL BANK: RISKS AND LIMITATIONS (A. Bozhechkova, A. Kiyutsevskaya, P. Trunin) 12

3. OIL SECTOR: POTENTIAL FOR TAX INCENTIVES (Yu. Bobylev, O. Rasenko) 15

4. RUSSIAN EXPORTS TO THE EU: A GENERAL DECLINE WITH MIXED TRENDS (A. Knobel, A. Firanchyuk) 19

5. "ANTI-TURKISH EMBARGO": WHO LOST THE MOST? (N. Shagaida) 22

AUTHORS 29

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MAIN TRENDS AND CONCLUSIONS

The disappearance, from all the recent forecasts, of the threatening figure 25 (meaning '$25 per barrel', which seems to have remained only in the Bank of Russia's stress scenario), coupled with a noticeable slowdown of inflation, had a most favorable effect on the general spirit and outlook of officials, businesspersons, and experts alike. Even the Bank of Russia has finally given in - in a positive sense of the word - although it is not promising to further reduce its key rate. Against this optimistic background, only the RF Ministry of Finance has been displaying a predominantly skeptical attitude, by its recurring sober reminders that Russia's reserve funds are not like Honore de Balzac's *la peau de chagrin,* and so cannot be stretched indefinitely.

However, the revival of a moderately optimistic outlook may serve, most likely, as a negative incentive that will preclude a serious discussion of the much-needed structural changes and the introduction of any relevant measures designed to bring about such changes. Anyway, any such attempts have been planned for 'the period after 2018'. Moreover, the recent talks at the President of the Russian Federation's Economic Council Presidium's meetings were evidently less than encouraging, as the authorities gained neither determination nor decisiveness. And given that 'the indicators are improving', one can hardly expect that this small 'situational' benefit may indeed urge them to set out on a quest for any 'fundamental' benefits.

The Gaidar Instutute's recently released macroeconomic forecast for 2016–2018 also offers some relatively positive estimates of the developments in Russia's economy, but it is by no means overoptimistic. It relies on only two scenarios (basic and optimistic), the first one implying that the price of oil will stay at $ 40 per barrel over the entire forecast period, and the second one hoping that it will rise from $ 45 to $ 60 per barrel.

The forecast's authors believe that the lowest point of the crisis will be reached somewhere around mid-year, and then, from H2 2016, we will observe stabilization, or even economic growth. Practically every possible scenario is oriented to GDP growth in 2017–2018, 'if no sharp plunge of oil prices is envisaged' – the latter course of events not even being considered as a possibility in the forecast. However, it is emphasized that a stably positive growth rate is unachievable before 2018. It cannot be achieved due to the low investment activity and the slow recovery of retail turnover, because over the next two years retail consumers will remain passive.

As far as inflation is concerned, the forecast says that it will decline at a stable rate to Russia's record low. Although its authors believe it to be unlikely that the RF Central Bank may indeed achieve its declared target of 4% per annum by late 2017 or in 2018, they still do not think that it should revise that target and by doing so, encourage higher inflationary expectations.

The downward movement of the domestic inflation index (ahead of its predicted movement trajectory) and the relatively stable external situation were among the factors that prompted the RF Central Bank, after nearly a year's wait, to reduce its key rate. The decline displayed by the CPI growth rate was so significant that there were months (February–March 2016) when

nominal wages were displaying real growth – for the first time since September 2014. Nevertheless, there exist several factors capable of triggering a new surge of prices. These are, among other things, an acceleration of the rate of growth of the money supply; the possible adjustment, by the US Federal Reserve System, of its monetary policy; China's ongoing economic slowdown; and the unpredictable movement pattern of oil prices.

The effects of the latter are visible in Russia's oil industry, which in its turn is being influenced by the current fiscal policy of the Russian government. Alongside the launch of the tax maneuver that targets Russia's oil production and oil-refining industry, the possibility of introducing a special excess-profits tax (EPT) designed to stimulate the development of new oil fields is being considered. Experts believe that it will be feasible to levy EPT in combination with the existing mineral extraction tax (MET), with the rate of the latter being considerably reduced. In that case, MET would guarantee a certain minimum level of budget revenue, while the progressive rate of EPT would make it possible to flexibly respond to the movement of world prices of oil and the domestic production costs. Rising oil prices would then translate in an increasing share of government revenue in the income generated by oil producers, and vice versa. The intended outcome would be the creation of more favorable economic conditions for the costly investments in the development of new oil fields. However, according to the experts, it would be difficult to administer EPT when applied to the existing mature oil fields. In order to intensify production at these oil fields in the latest phases of their exploitation, it would be easier to reduce the rate of MET levied on them.

The behavior of oil prices is one of the major factors responsible for Russia's declining balance of trade and the shrinking share of Russian products in, say, EU total imports. Over the period 2013–2015, the latter shrank 1.5 times – from 12.3% to 7.9%. Over the same period, the volume of Russian exports to that region in absolute terms declined from €207bn to €135bn. The plunge caused by the shrinking supplies of mineral fuel, rubber, inorganic chemicals, and ferrous metals could not be offset by the increasing share of Russian fertilizers, paper and aluminum in EU imports. Over the same period, Russia's share in EU exports also declined (from 6.9% to 4.1%). Russia's imports from the EU over 2013–2015 plunged even deeper (by 47.7%) than her imports from the other countries (by 37.9%), thus translating in a shrinkage of the EU's share in Russian imports by 5.6 pp.

The economic sanctions introduced against Russia and Russia's retaliatory sanctions, including the ban on food imports, all played their significant roles. After the ban on food imports from the EU was introduced (in August 2014), the share of Turkey in Russia's food imports significantly increased. Thus, for example, the share of Turkish vegetables soared to nearly 23%. However, in 2016, Russia introduced some new restrictions on food imports – this time on imports from Turkey. This measure strongly influenced, among other things, the behavior of prices on Russia's domestic food market. Nevertheless, should this ban be extended, or even expanded to include some other items, this can hardly produce any further visible effects on the Russian market due to the currently negligible volume of imports from Turkey. As for the possibility of retaliatory sanctions introduced by Turkey (including tougher phytosanitary requirements), these can be potentially harmful for Russia's exports of vegetable oils and oilseeds (in some years, half of it went to Turkey) and grains (14–19%).

1. MACROECONOMIC FORECAST FOR 2016–2018: THE ECONOMY IS PASSING THROUGH THE LOWEST POINT OF THE CURRENT CRISIS

V. Averkiev, S. Drobyshevsky, M. Turuntseva, M. Khromov

Our macroeconomic forecast of the most probable scenarios for 2016–2018 indicates that the Russian economy will pass through the lowest point of the current crisis in mid-2016, and that thereafter, from H2 2016 onwards, it will start displaying signs of stabilization and even recovery. In 2017–2018, a modicum of GDP growth seems to be likely under practically each of the possible scenarios (unless a new dramatic decline in oil prices takes place). The expected GDP growth cannot be characterized as stable because it will not be caused by the restoration of the internal business cycle, the use of idle industrial capacities and an increase in the number of weekly hours actually worked per worker employed by an enterprise. Investment activity will remain weak. The recovery of retail turnover will lag behind the recovery of real personal income, while net personal savings will be on the rise. The rate of inflation will significantly decline, but the 4% inflation target is unlikely to be achieved by the end of the period 2017–2018.

In Q1 2016, the movement pattern displayed by a number of RF socio-economic indicators showed an improvement on the same period of 2015. Thus, in Q1 2016, the rate of GDP decline reduced to 1.2% (relative to Q1 2015; for reference: in Q1 2015, this index had amounted to 2.8%). Investment dropped by 4.8%, retail turnover – by 5.2%, and real disposable personal income – by 4.7%. Over the course of Q1 2016, the consumer price index increased by 2.1% (vs. by 7.5% during Q1 2015). In Q1, the average interest rate on new ruble-denominated loans stood at 13.3% per annum in nominal terms, or 5.7% in real terms (a rather high rate indeed). As of the end of Q1 2016, the monetary base had shown practically no changes and remained at the level of Rb 11 trillion. At the same time, ruble money supply (M2) slightly contracted, to Rb 35.4 trillion.

The volume of foreign trade in US dollar terms continued to slide: in Q1 2016, exports and imports dropped by 33.2% and 15.2% respectively on Q1 2015.

In 2015, the average nominal ruble-to-USD exchange rate stood at Rb 74.6. The real effective exchange rate of the ruble dropped by 8.3%.

When assessing the development prospects for the Russian economy over the period 2016–2018, we considered two possible scenarios depending on the situation on the international oil market. We expect that under each of these scenarios, the year 2016 will see a further shrinkage of the Russian economy and a decline in the major macroeconomic indicators in real terms. In 2017–2018, the Russian economy will be able to begin a slow recovery, even if the external situation should follow the baseline pattern of development.

Under the basic scenario, it is expected that, in 2016–2018, the average annual price of Urals crude oil will amount to $40 per barrel. At that price level, it would be unrealistic to hope that the Russian economy may indeed face a significant improvement of its foreign trade conditions. As far as foreign

trade conditions are concerned, this scenario coincides with the baseline scenario of Russia's socio-economic development worked out by the RF Ministry of Economic Development in early May 2016 for a three-year period (until 2019)[1].

Under the optimistic scenario, it is expected that, in 2016, the average annual price of Urals crude oil will increase to $45 per barrel, and that the positive trend in the movement of oil prices on the international oil market will continue further ($50 per barrel in 2017, and $60 per barrel in 2018).

As has already been said, we expect that in 2016 real GDP will continue to decline under both scenarios: by 1.2% under the basic scenario and by 0.5% under the optimistic scenario. In 2017, its downward movement will come to an end, and then GDP will display growth by 0.3% under the basic scenario, and by 0.9% under the optimistic one. According to our forecast, in 2018 the economy will display growth by more than 1%: by 1.4% under the basic scenario, and by 1.9% under the optimistic scenario. The GDP deflator will decline following the slowdown in the inflationary processes in the Russian economy. Under the optimistic scenario, its value is expected to be slightly higher due to the rising prices of energy carriers and other mineral resources both in US dollar terms and in ruble terms.

Similar behavior patterns will also be displayed by the other economic activity indicators. Under the basic scenario, investment in fixed assets in 2016 will drop in real terms by 2%, retail turnover by 4.8%, and real disposable income by 2.3%. For 2017, it is forecasted that retail turnover will further decline by 0.4% alongside slight growth of investment (by 1.4%) and real disposable income (by 0.5%). In 2018, growth will be demonstrated by all these indicators: investment will increase by 1.7%, retail turnover by 0.8%, and real disposable money income by 1.5%.

The slower growth rate displayed by the household consumption index – the existence of a lag between retail turnover in real terms and the growth rate of real disposable income – can be explained by the slow recovery of the retail lending market and the persistently prevalent saving-oriented behavior model displayed by the population. In our opinion, banks will demonstrate a higher activity with regard to issuance of housing loans, which will translate into a positive effect on the share of debt in household disposable income. Longer loan terms and low interest rates on housing loans will push down the debt servicing volume[2].

Under the optimistic scenario, in 2016 all these economic indicators will likewise continue their downfall. The investment index will shrink by 1.6%, retail turnover by 4.5%, and real disposable income by 2.1%. However, over the period 2017–2018, their movement patterns will shift into growth zone: investment in fixed assets will increase by 2.9% in 2017 (vs. by 2.4% in 2018), retail turnover in real terms by 0.1% (vs. 1.3% in 2018), and real disposable income by 1.3% (vs. by 2.8% in 2018). Inflation (measured as CPI) in 2016 will amount to 7.3%, thereafter declining to 6.2–5.7% under the basic scenario and to 5.6–4.8% under the optimistic one.

If these conditions should become reality, the average nominal exchange rate of the ruble (in per annum terms) under the basic scenario will amount

1 http://economy.gov.ru/minec/about/structure/depMacro/20160506

2 This trend is noted in *Khromov M.* Banks: deterioration of assets quality and earnings reduction. Russian Economic Developments, 2015, No. 11.

to Rb 67.6 in 2016, to Rb 64.1 in 2017, and to Rb 63.4 in 2018 respectively. Under the optimistic scenario it is expected that, in 2016–2019, the ruble-to-USD nominal exchange rate will amount to Rb 66.3, Rb 60.1 and Rb 57.2 respectively. The real effective exchange rate of the ruble in 2016 will increase by 2.7% under the basic scenario and by 6.9% under the optimistic one. Thereafter it will continue to be on the rise under both scenarios, thus in 2017 amounting to 3.9% under the basic scenario (vs. to 3.3% under the optimistic one), and in 2018 to 2.8% under the basic scenario (vs. to 6.2% under the optimistic one).

If the average annual price of oil in 2016 plunge below its 2015 level, the volume of foreign trade will continue to shrink. Under the basic scenario, exports will amount to $314.9bn, and imports to $258.4bn; thereafter, in 2017 and 2018, these two indicators will display some growth – to $322.2bn and $328.4bn; and to $283.4 and $300.7bn respectively. Under the optimistic scenario, exports and imports will demonstrate a somewhat similar movement pattern: decline to $330bn and $262bn in 2016, and modest growth in 2017 and 2018 to $358.2bn and $397.2; and to $297bn and $319.8bn respectively.

Interest rates will stay at a rather high level. Under the basic scenario, the average nominal interest rate on ruble-denominated loans is expected to amount to 12.1% per annum (vs. real interest rate of 4.4%) in 2016; to 11.4% (vs. real interest rate of 3.5%) in 2017; and to 9.3% (vs. real interest rate of 3.4%) in 2018. Under the optimistic scenario for 2016, 2017 and 2018, the nominal interest rate will amount to 12.0%, 11.0% and 8.5% respectively (vs. the real interest rate of 4.4%, 3.7% and 3.5% respectively).

As seen from these projections, nominal interest rates on loans in 2018 will decline to the level that was typically observed over the period 2011–2012 (8.5–9.0% per annum), when the lending market was recovering after the 2008–2009 crisis.

We predict that money supply indices will increase at a moderate rate. Under the basic scenario, growth of money supply (M2) in 2016 will amount to 8.8%, and that of the monetary base – to 11.8%; the corresponding indexes under the optimistic scenario will amount to 9.9% and 11.8% respectively. Their growth will continue in 2017, so that under the basic scenario M2 will increase by 11.4% (vs. by 11.9% under the optimistic one), while the monetary base will increase by 7.3% and 8.9% respectively under the basic and optimistic scenarios. In 2018, M2 is expected to increase by 12.5% under the basic scenario and by 13.5% under the optimistic one. The monetary base under these two scenarios will increase by 6.8% and 7.5% respectively.

As in 2015, the main source of increasing money supply in 2016 will be the Reserve Fund[1]. And thereafter, over the course of the period 2017–2018, as it becomes depleted, we expect that the Bank of Russia will once again begin to refinance the banking sector, as budget deficit then will have to be covered by means of borrowing from domestic sources.

Thus, our estimates of the potential movement of Russia's main macroeconomic indicators under the most likely economic development scenarios for 2016–2018 demonstrate that the lowest point of the current cycle will be passed somewhere in mid-2016, and that from H2 2016 onwards one may expect a revival of growth at a slow pace (or stabilization, if the external situ-

1 *Sinelnikov-Murylev S.G., Trunin P.V.* Sovereign wealth funds and monetary policy in Russia. Financial journal (In Russian), 2015, No. 3 (25), pp. 26-34.

ation becomes unfavorable). Nevertheless, a stably positive growth rate of GDP can become achievable no earlier than in 2018.

We also expect that the 'situational' component of the growth rate will be slowly improving due to the recovery of the internal business cycle, the use of idle industrial capacities and an increase in the number of weekly hours actually worked per worker employed by an enterprise1. The existence of these factors can explain, among other things, the delayed recovery of investment in fixed assets and the persistently high real interest rates in the economy in face of moderate growth displayed by the lending market.

As far as the behavior of the inflation rate is concerned, we believe that it should be considered further in its own right. Under both scenarios, the Bank of Russia will not be able to achieve its stated aim of pushing the rate of inflation down to 4% per annum by the end of the period 2017–2018. However, the inflation rate has been steadily declining from year to year for a number of years, dwindling to its historic lows (below 6% in annual terms). In this connection we believe that the Russian Federation should not revise her inflation target, because an increase of that target can result in the strengthening of the inflationary expectations of economic agents, which will then further slow down the decline in the real inflation rate. Moreover, the obtained inflation projections for the end of the period 2017–2019 are, in fact, situated within the upper limit of the ±2 p.p. conventional range, and so, while not actually set as an element of Bank of Russia's policy, these values are quite common in the developing economies, where they are applied in the framework of inflation targeting policies, especially when those economies are suffering from negative external shocks produced by the situation on foreign markets[2].

A transition to higher sustainable growth rates of GDP, a recovery in investment activity and bank lending, and a rapid reduction in the inflation rate will be possible if the economy undergoes more fundamental and purposeful changes than those that it has been experiencing so far (a rise in total factor productivity, the lifting of the current economic sanctions, a significant improvement of the foreign market situation, which implies not only a robust growth of prices for Russian exports but also an expansion of foreign markets necessary for increasing the physical volume of exports). However, such scenarios are highly unlikely in a short-term perspective (up to 2 years), and therefore we do not consider them in our forecast.

1 See also *Drobyshevsky S.M., Kazakova M.V*. GDP Growth Rate In 2015-2016: What its decomposition speaks of. Russian Economic Developments, 2015, Issue 12 (22), pp. 4–9.

2 For more details, see *Bozhechkova A.V., Kiutsevskaya A.M., Trunin P.V.* Inflation targeting: world experience. Money and Credit (In Russian), 2015, No 4, pp. 61–67.

Basic scenario (Urals: 2015=51.1, 2016=35, 2017=40)	2015					2016					2017	2018
	Q1	Q2	Q3	Q4	Year-end	Q1	Q2	Q3	Q4	Year-end	Year-end	Year-end
	actual	*actual*	*actual*	*actual*	*actual*	*forecasted*	*forecasted*	*forecasted*	*forecasted*	*forecasted*	*forecasted*	*forecasted*
Urals, USD per barrel	52.0	61.4	49.3	41.8	51.1	32.6	41.9	42.8	42.8	40.0	40.0	40.0
GDP												
bn Rb	18 210	19 284	21 294	22 016	80 804	18 805	19 764	22 447	23 654	84 669	89 792	94 744
physical volume index, as % of corresponding period of previous year	97.2	95.5	96.3	96.2	96.3	98.8	98.5	98.9	99.1	98.8	100.3	101.4
deflator	109.3	107.0	108.4	106.4	107.7	104.5	104.1	106.6	108.4	106.0	105.7	104.0
Investment in fixed assets												
physical volume index, as % of corresponding period of previous year	95.2	91.2	87.0	93.6	91.6	95.2	97.6	98.6	98.7	98.0	101.4	101.7
Retail turnover												
as % of corresponding period of previous year	93.0	90.4	90.1	87.3	90.2	94.6	95.1	95.3	95.9	95.2	99.6	100.8
Real disposable money income												
as % of corresponding period of previous year	97.7	95.2	94.8	95.6	95.8	96.1	97.4	98.0	99.4	97.7	100.5	101.5
Exports												
bn USD	101.9	104.5	92.0	94.8	393.3	68.8	78.0	80.9	87.2	314.9	322.2	328.4
including:												
exports of goods	90.2	91.4	78.8	81.1	341.5	59.3	67.5	69.9	76.2	272.8	283.0	289.8
oil and gas exports	54.1	54.9	45.8	44.0	198.9	31.5	34.6	35.5	38.5	140.0	135.4	130.9
other exports	36.1	36.5	32.9	37.1	142.6	27.8	32.9	34.4	37.7	132.7	147.6	159.0
exports of services	11.7	13.1	13.2	13.7	51.8	9.5	10.6	11.1	11.0	42.1	39.2	38.5
Imports												
bn USD	64.7	70.2	75.1	71.3	281.4	52.1	63.2	71.0	72.0	258.4	283.4	300.7
including:												
imports of goods	44.7	47.7	49.8	50.8	193.0	37.8	44.0	49.6	52.5	183.9	208.9	223.4
imports of services	20.0	22.6	25.3	20.5	88.4	14.3	19.2	21.4	19.5	74.5	74.5	77.2
CPI												
as % of previous period	107.5	101.0	101.7	102.3	112.9	102.1	101.0	102.2	101.9	107.3	106.2	105.7
Average interest rate on ruble-denominated loans over given period, as % per annum												
real	1.5	0.8	-1.2	0.7	0.5	5.7	4.5	3.5	3.9	4.4	3.5	3.4
nominal	18.6	16.2	14.3	13.7	15.7	13.3	12.0	11.5	11.5	12.1	11.4	9.3

Basic scenario (Urals: 2015=51.1, 2016=35, 2017=40)	2015					2016					2017	2018
	Q1	Q2	Q3	Q4	Year-end	Q1	Q2	Q3	Q4	Year-end	Year-end	Year-end
	actual	*actual*	*actual*	*actual*	*actual*	*forecasted*	*forecasted*	*forecasted*	*forecasted*	*forecasted*	*forecasted*	*forecasted*
Ruble-to-USD exchange rate												
average nominal, for period	62.2	52.6	62.8	65.9	60.9	74.6	66.0	65.1	64.8	67.6	64.1	63.4
Ruble's real effective exchange rate												
period-end value, as % of previous period-end value	-10.8	20.3	-13.7	-0.3	-7.7	-8.3	6.7	3.6	1.3	2.7	3.9	2.8
Money base												
trillion Rb	9.7	9.7	9.8	11.0	11.0	11.0	10.9	11.0	12.3	12.3	13.2	14.1
Money supply (M2)												
period-end value, trillion Rb	31.6	32.5	33.0	35.8	35.8	35.4	36.6	36.8	39.0	39.0	43.4	48.8
growth, as % of previous period	-1.5	2.7	1.4	8.7	11.5	-1.0	3.2	0.6	5.8	8.8	11.4	12.5

Optimistic scenario (Urals: 2015=51, 2016=50, 2017=55)	2015					2016					2017	2018
	Q1	Q2	Q3	Q4	Year-end	Q1	Q2	Q3	Q4	Year-end	Year-end	Year-end
	actual	*actual*	*actual*	*actual*	*actual*	*forecasted*	*forecasted*	*forecasted*	*forecasted*	*forecasted*	*forecasted*	*forecasted*
Urals, USD per barrel	52.0	61.4	49.3	41.8	51.1	32.6	41.9	52.8	52.8	45.0	50.0	60.0
GDP												
bn Rb	18 210	19 284	21 294	22 016	80 804	18 805	19 764	22 829	24 053	85 451	91 311	97 430
physical volume index, as % of corresponding period of previous year	97.2	95.5	96.3	96.2	96.3	98.8	98.5	100.2	100.2	99.5	100.9	101.9
deflator	109.3	107.0	108.4	106.4	107.7	104.5	104.1	107.0	109.1	106.3	105.9	104.7
Investment in fixed assets												
physical volume index, as % of corresponding period of previous year	95.2	91.2	87.0	93.6	91.6	95.2	97.6	99.0	99.6	98.4	101.9	102.4
Retail turnover												
as % of corresponding period of previous year	93.0	90.4	90.1	87.3	90.2	94.6	95.1	95.8	96.4	95.5	100.1	101.3
Real disposable money income												
as % of corresponding period of previous year	97.7	95.2	94.8	95.6	95.8	96.1	97.4	98.1	99.9	97.9	101.3	102.8
Exports												
bn USD	101.9	104.5	92.0	94.8	393.3	68.8	78.0	87.2	96.0	330.0	358.2	397.2
including:												

Optimistic scenario (Urals: 2015=51, 2016=50, 2017=55)	**2015**					**2016**					**2017**	**2018**
	Q1	Q2	Q3	Q4	Year-end	Q1	Q2	Q3	Q4	Year-end	Year-end	Year-end
	actual	*actual*	*actual*	*actual*	*actual*	*forecasted*	*forecasted*	*forecasted*	*forecasted*	*forecasted*	*forecasted*	*forecasted*
exports of goods	90.2	91.4	78.8	81.1	341.5	59.3	67.5	75.7	84.3	286.8	315.9	352.5
oil and gas exports	54.1	54.9	45.8	44.0	198.9	31.5	34.6	41.4	46.7	154.1	168.4	193.8
other exports	36.1	36.5	32.9	37.1	142.6	27.8	32.9	34.4	37.6	132.7	147.5	158.7
exports of services	11.7	13.1	13.2	13.7	51.8	9.5	10.6	11.4	11.6	43.1	42.3	44.7
Imports												
bn долл.	64.7	70.2	75.1	71.3	281.4	52.1	63.2	72.3	74.3	262.0	297.0	319.8
including:												
imports of goods	44.7	47.7	49.8	50.8	193.0	37.8	44.0	50.7	54.4	186.9	220.1	238.6
imports of services	20.0	22.6	25.3	20.5	88.4	14.3	19.2	21.7	19.9	75.1	76.9	81.2
CPI												
as % of previous period	107.5	101.0	101.7	102.3	112.9	102.1	101.0	102.1	101.6	107.0	105.6	104.8
Average interest rate on new ruble-denominated loans for period, % per annum												
real	1.5	0.8	-1.2	0.7	0.5	5.7	4.5	3.4	4.0	4.4	3.7	3.5
nominal	18.6	16.2	14.3	13.7	15.7	13.3	12.0	11.3	11.2	12.0	11.0	8.5
Ruble-to-USD exchange rate												
average nominal, for period	62.2	52.6	62.8	65.9	60.9	74.6	66.0	63.8	60.8	66.3	60.1	57.2
Ruble's real effective exchange rate												
period-end, as % of previous period	-10.8	20.3	-13.7	-0.3	-7.7	-8.3	6.7	5.0	4.0	6.9	3.3	6.2
Money base												
trillion Rb	9.7	9.7	9.8	11.0	11.0	11.0	10.9	11.0	12.3	12.3	13.4	14.4
Money supply (M2)												
period-end, trillion Rb	31.6	32.5	33.0	35.8	35.8	35.4	36.6	37.3	39.4	39.4	44.0	50.0
growth, as % of previous period	-1.5	2.7	1.4	8.7	11.5	-1.0	3.2	1.9	5.6	9.9	11.9	13.5

2. MONETARY POLICY OF THE RUSSIAN CENTRAL BANK: RISKS AND LIMITATIONS

A. Bozhechkova, A. Kiyutsevskaya, P. Trunin

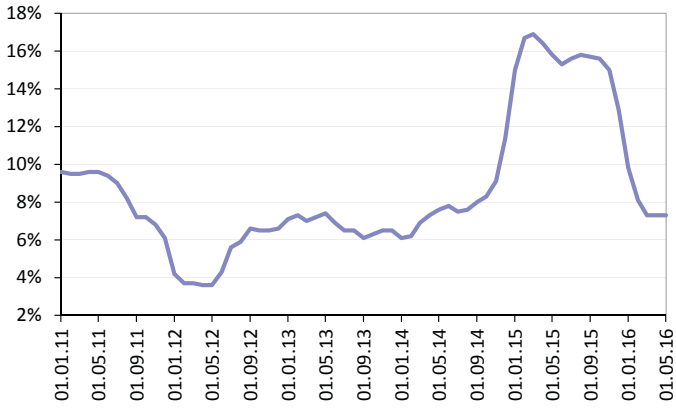
In June, the Russian Central Bank, for the first time since summer 2015, decided to reduce the key interest rate by 0.5 percentage points, to 10.5%. The decline in inflation expectations, further slowdown in inflation and stabilization of the external environment, together with the strengthening of the rouble, allowed the Bank of Russia to soften the monetary policy.

By reducing the key interest rate to 10.5%, the Bank of Russia reacted to the ongoing inflation slowdown. After gradual decrease in positive growth rate of prices in January–April 2016, the inflation stabilized and accounted for 0.4 % in May (0.4% in May 2015). Moreover, during the first week of June, the consumer price index (CPI) remained unchanged. At the same time, the cumulative 12-month inflation which had been declining since September 2015 has remained unchanged at 7.3% for the past 3 months (*Fig. 1*). Inflation slowdown in January–April 2016 was caused by the decline in aggregate demand, as well as rouble appreciation, which reduced the pressure on domestic prices due to the exchange-rate pass-through effect.

Nevertheless, the level of inflation expectations remains high, preventing the reduction of prices in the medium term. In April 2016, the median value of expected inflation rate for the year ahead fell only by 0.1 p.p. and amounted to 14.6%[1].

The possible recovery of consumer demand is a source of inflation risks, which ceteris paribus can lead to upward push on consumer goods prices. In Q1 2016, nominal wages of the population grew by 7.7% compared to the same period in 2015, and in April 2016, it grew by 5.4% compared to April 2015. For reference: in September–December 2015, this figure grew on average just by 3.4% in annual terms. It should also be noted that, due to the inflation slowdown, the positive growth of gross real wages was observed in February and March 2016 for the first time since September 2014. It accounted for 0.6 and 1.5%, respectively, compared to the same months in 2015.

Positive contribution to CPI growth in 2016 can be expected from the acceleration of money supply M2 growth rate due to an increase in the monetary base as the Reserve Fund money is being spent to finance the large budget deficit, as well as due to



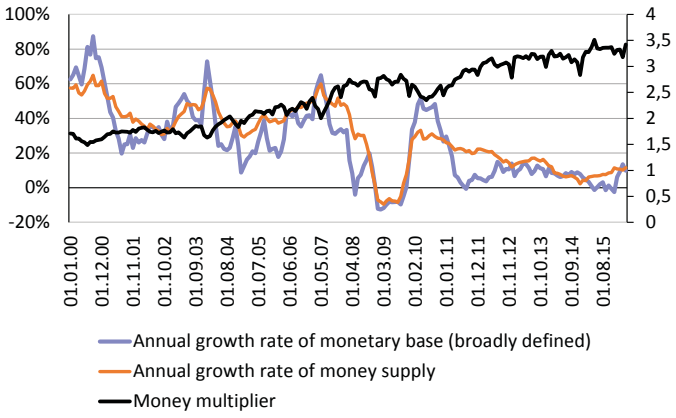
Source: Rosstat.

Fig. 1. CPI growth rate in 2011–2016 (% of the preceding 12 month)

1 This indicator is calculated by the Russian Central Bank, see: http://www.cbr.ru/DKP/standart_system/Infl_exp_16-04.pdf

the recovery of the credit activity[1]. The money supply M2 growth rate in January–April 2016 was, on average, 10.8%, while during the same period in 2015, it did not exceed 5.4% (*Fig. 2*).

It should be noted that the inflow of funds into the banks as money from the Reserve Fund is being spent is not fully compensated by the reduction of the banking system's debt to the Russian Central Bank. Because of this, in Q1 2016, despite the value of the key interest rate was constant, interest rates were declining. In particular, interest rates on individuals' deposits of up to 1 year decreased from 8.53% per annum in January to 7.71% in March 2016. According to the Bank of Russia estimates[2], in Q2 and Q3 of 2016, this trend will continue, regardless of whether the monetary policy will soften. Survey results of 56 financial institutions which own about 85% of the total loan portfolio showed that almost half of them are willing to reduce interest rates on loans.



Source: Rosstat.

Fig. 2. Dynamics of monetary aggregates and money multiplier in 2000–2016

Thus, in spite of the stabilization of the situation in the Russian economy, the Bank of Russia still faces significant internal risks impeding a more significant reduction of the key rate. To an even greater degree, however, the state of Russian financial markets depends on the dynamics of oil prices which are difficult to predict. One can remember the year 2015, when a recovery in the first half of the year was followed by a sharp decline in oil prices to new multi-year lows.

An important factor influencing the state of the global economy is the expectation of changes in the interest rate policy of the US Federal Reserve System (FRS). By postponing the raising of the key interest rate, FRS supports risk-taking behaviour of investors, causing a rise in the cost of developing countries' assets, including Russian ones. Changes in the FRS monetary policy may cause decline in the stock markets.

One can note the high sensitivity of the foreign exchange market participants to the news. For instance, the data on the US labour market released on 3 June came as a surprise as the number of those employed in the non-agriculture sector increased in May by 38 thousand people only. It is the lowest level since September 2010 when 52 thousand people were laid off. The following reaction was another weakening of the dollar on the global foreign exchange market, which supported the rise of the world prices on commodity products[3]. In such circumstances, they become not only reliable, but also the most profitable assets. By the end of May, the price for Brent rose to 50 dollars per barrel, a week later — to 51.5 dollars.

1 For details, see.: *Sinelnikov-Murylev S.G., Trunin P.V.* Government Wealth Funds and Monetary Policy in Russia // Financial Journal. 2015. No. 3 (25). P. 26–34.

2 Information and Analytical Bulletin of the Bank of Russia, "Changes in bank lending conditions", 2016. No. 1.

3 Since the contracts for many commodities are denominated in US dollars, the weaker dollar makes those products cheaper for buyers from outside the US, contributing to the growth of demand for them. The opposite is observed in the case of strengthening of the dollar.

The inevitable tightening of the FRS monetary policy together with actions of other developed countries' monetary authorities that adhere to super soft monetary policy is likely to provoke a change in the prices of financial assets and commodities worldwide. This, in turn, can lead to quicker capital outflow from Russia, the weakening of the rouble and the increase in inflation.

The situation in the Chinese economy which continues to slow down stays an important risk factor for the Russian economy in general and monetary policy in particular. The current easing of tension on the Chinese foreign exchange market is likely to be temporary. The index of business activity in the Chinese industry fell in May to 49.2 points compared to 49.4 points a month earlier. Further deterioration of the economic situation in China can lead to a new drop in energy prices.

3. OIL SECTOR: POTENTIAL FOR TAX INCENTIVES

Yu. Bobylev, O. Rasenko

The state of Russia's oil sector is marked by a general deterioration of the oil extraction conditions owing to depletion of existing deposits in developed regions and significantly higher extraction costs at the new oil fields and tight oil deposits. In order to improve the situation, investments in the development of new oil fields are required as well as in deepened development of existing deposits with an improved refining margin. Government fiscal policy should contribute to the resolution of these issues including implementation of structural reform in the tax system and introduction of special excess-profit tax.

At present, Russia's oil-producing industry is at the peak of its production capacity. Considerable part of the producing oil fields is at the declining production stage and the new oil deposits in the majority of cases are of inferior mining-and-geological and geographic parameters. Development of these deposits requires higher capital, operating, and transport costs. In order to maintain the achieved volumes of oil extraction, it is necessary to reactivate both non-producing reserves in the developed regions and to develop fields in the new production regions as well as improve additional extraction on producing deposits owing to their deeper exploitation. There is a high potential in the oil refining depth, which according to its technical level is no match to the level achieved by the developed countries.

Implementation of the structural reform in the tax system triggers the creation of tax incentives in upgrading of the downstream segment. That reform includes gradual reduction of export duty on crude oil and petroleum products (down to their total revocation) and increase of the role of mineral extraction tax (MET)[1]. Reduction of export duties results in cutting subsidies extended to the oil-refining sector and putting in place real incentives aimed at increasing the refining depth. Improved refining depths will lead to satisfaction of the domestic demand in motor oil amid relatively lower volumes of crude oil consumption.

As for 2016, reduction of the export duty was frozen (it was retained at the 2015 level) in order to increase state budget revenue and excises on petroleum products were raised by way of additional measure aimed at increasing revenue. We think that reduction of export duty could have been a more preferable solution. Both growing excises and reduction of export duty result in the growth of domestic prices on motor oil and increase of the budget revenue (both owing to MET growth rate and due to profits growth of oil producers thanks to domestic price growth). However, reduction of export duty

1 See: *Idrisov G., Sinelnikov-Murylev S.* Modernization or conservation: the role of export duty on oil and petroleum products. Ekonomicheskaya politika. 2012. No. 3, pp. 5–19; *Bobylev, Yu, Idrisov G., Sinelnikov-Murylev S.* Export duties on oil petroleum products: need to revoke and scenario analysis of consequences. Moscow, Gaidar Institute Publishers, 2012; *Bobylev Yu*. Tax maneuver in the oil sector. Russian economic Developments. 2015. No. 8, pp. 45–49; Idrisov G., Kaukin A. Tax maneuver: economic growth acceleration to the detriment of budget consolidation. OMREO, No. 9 (27) May 2016, pp. 11–15.

allows obtaining additional positive effects – stimulate modernization of the oil-refining sector and cut subsidization of the EAEU member states.

Introduction of a special excess-profits tax (EPT) at the new oil fields will be a driver of the development of the oil extraction sector. The EPT tax base is the difference between the cost of production and sale of hydrocarbons and costs of production and sale of products (minus depreciation), production capital investments, and irrecoverable costs of the previous fiscal period.

Application of the EPT progressive rate, which depends on the project's profitability represents an important factor. Profitability is measured by P-factor value, which is calculated as correlation of aggregate production profit and crude oil sale to aggregate capital and production costs. With P-factor's growth, the tax rate increases from 10 to 80% (*Table 1*).

This tax will ensure tracking of all rent-shaping factors and will automatically bring tax burden in line with actual economic efficiency of oil fields exploitation. In case of highly efficient projects, imposition of EPT will ensure progressive rent collection in favor of the state. At the same time, indispensable conditions will be put in place for the implementation of unproductive projects.

Table 1

EXCESS-PROFITS TAX RATE IN OIL EXTRACTION

P-factor (t – 1)	Excess-profits tax rate (t), %
To 1.00	0
From 1.00 to 1.10	10
From 1.10 to 1.20	15
From 1.20 to 1.30	20
From 1.30 to 1.40	30
From 1.40 to 1.50	40
From 1.50 to 2.00	50
From 2.00 to 2.50	60
From 2.50 to 3.00	70
Over 3.00	80

Sources: IEP, RANEPA.

It is feasible to levy EPT in conjunction with MET, which in such cases would be as a minimum guarantee tax ensuring a certain minimum level of proceeds from project's realization. Inasmuch as EPT is the main rent tax, MET amid EPT implementation should be levied at a rather low rate, for example, at ad valorem rate of 15%. Introduction of EPT will ensure a secured revenue to the state from the date of commencement of the crude oil production (through commencement of profit tax receipts) as well as in cases of low crude oil prices and high production costs. The crude oil export duty should be set at zero in the wake of levying EPT.

The EPT regime with a progressive tax rate ensures the tax system progressivity. On the back of growing world oil price, the government take in net income from crude oil production grows. At the same time, amid low oil prices as well as high production costs, the government take in net income falls, thus forming more favorable economic conditions for the development of high production costs oil fields.

According to our calculations computed with the help of a simulation model for the development of a typical oil field, implementation of EPT in conjunction with MET levied at ad valorem rate of 15% and zero export duty rate ensures increase of tax revenue from 70.2% from obtained net income

at oil price of $40 per barrel to 83.9% at the price of $120 per barrel (*Table 2*). Furthermore, at $40 per barrel and more the investor is guaranteed required return on investments (internal rate of return exceeds 16.3%).

Table 2

INDICES OF THE TAX BURDEN AND EFFICIENCY OF INVESTMENT IN OIL EXTRACTION IN THE CONTEXT OF EFFECTIVE FISCAL SYSTEM AND EPT REGIME

Tax regimes	World oil price, $/bbl.					
	40	50	60	80	100	120
1. Effective fiscal system (with privileges on MET):						
Government take in proceeds, %	53.8	57.8	60.8	64.5	66.7	68.2
Government take in net revenue, %	92.7	89.1	85.9	82.6	80.9	79.8
Internal rate of return, %	6.4	11.5	16.2	22.8	27.8	31.8
2. EPT regime (EPT = 10-80%, MET = 15%, ED = 0):						
Government take in proceeds, %	41.9	49.3	54.9	64.1	69.9	72.7
Government take in net revenue, %	70.2	72.8	75.1	80.2	82.3	83.9
Internal rate of return, %	16.4	19.3	21.8	25.3	27.7	30.3

Source: own calculations.

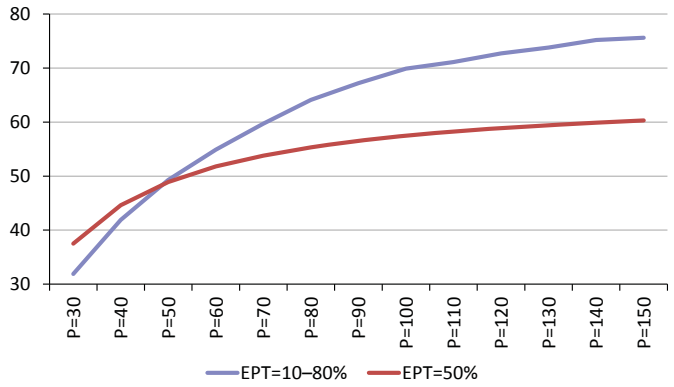
Progressive tax rate has some advantages compared to a single tax rate. In the context of a single tax rate, the multiplicity of mining-and-geological and geographic conditions of development of Russia's oil deposits and considerable differences in economic efficiency of projects are taken into consideration to a lesser degree. In case of highly efficient projects, this will result in shortfall by the state of certain part of resource rent. In case of unproductive projects, the single rate can become excessively high, which will hamper their realization.

According to our calculations, at a standard oil field EPT regime with a progressive tax rate in the range of 10 to 80% and a single tax rate of 50% creates approximately identical tax burden at price of oil of $50 per barrel. Meanwhile, compared to a single tax rate progressive tax rate guarantees higher share of the state in income obtained from crude oil extraction amid higher oil prices and ensures lower tax burden in the context of lower oil price (*Fig. 1*).

The progressive rate has similar advantages in the wake of higher and lower production costs. In the context of higher production costs, it ensures a lower tax burden compared to a single tax rate, i.e. more favorable conditions for investment in the development of high-cost deposits.

Introduction of the excessive-profit tax will allow to ensure a wider differentiation of the tax burden and create necessary conditions for investment in the development of the high-cost deposits. At the same time, such tax is a more complicated form of taxation, which implementation requires corresponding tax administration.

Levying of EPT is also feasible at the producing (brown fields) fields. However, it is more difficult from the point of view of tax administration. Stimulation



Source: own calculations.

Fig. 1. The share of state in income obtained from oil extraction in the context of progressive tax rate and single EPT rate, % to proceeds

of deeper exploitation of existing fields can be achieved with the use of a less complication tax mechanisms. A more significant reduction of MET rate against the currently effective one for the deposits with depleted resources can represent another solution. This will reduce the tax burden at mature oil fields and will provide incentives for their deeper exploitation and increase of oil recovery coefficient.

4. RUSSIAN EXPORTS TO THE EU: A GENERAL DECLINE WITH MIXED TRENDS

A. Knobel, A. Firanchyuk

Due to a drop in prices on energy commodities, the share of Russian goods in the EU's total imports in the 2013–2015 period fell 1.5 times over, that is, a decrease from 12.3% to 7.9%. The share of Russia in the EU's imports and the share of the EU market in the Russian exports rose in such commodity groups as fertilizers, paper and aluminum, while a decrease was observed in supplies of mineral fuel, natural rubber, inorganic chemical products, nickel and ferrous metals. Russia' share in the global exports of cereals and copper increased.

Aggregate Exports

Russian exports of goods to the EU countries (according to the Eurostat data[1] on the EU imports) have been falling in the past two years. So, if in 2013 the volume of supplies from Russia to the EU amounted to euro 207.0 bn ($274.8bn[2]), in 2014 it fell to euro 182.4bn ($242.2bn), while in 2015, to euro 135.6bn ($150.3bn).

With relatively stable total EU imports, the above situation has resulted in a 33.4% decrease in Russia's share in the EU's total imports (from 12.3% to 7.9%) (*Table 1*). The main factor behind such a dramatic decrease is a drop in global prices on energy commodities[3]. It is to be noted that in the 2013–2015 period, Russian exports to the EU were falling at a faster rate than exports to other countries[4] (in monetary terms exports to the EU fell by 41.6% against 27.1% to other countries). As regards supplies of goods from the EU to Russia, it can be stated that in the 2013–2015 period the share of Russia in the

Table 1

THE SHARES OF RUSSIA AND THE EUROPEAN UNION IN TRADE

Data source	Indicator	Imports			Exports			Trade turnover		
		2013	2014	2015	2013	2014	2015	2013	2014	2015
Eurostat	The share of Russia in the EU's imports /exports / trade turnover*, %	12.3	10.8	7.9	6.9	6.1	4.1	9.5	8.4	6.0
Federal Customs Service	The share of the EU in Russia's imports / exports / trade turnover, %	42.6	41.3	38.5	53.8	52.0	48.2	49.6	48.1	44.8

Note * – without taking into account trade between the EU-member states.

1 In research, the data on imports from Russia and the EU's total imports were taken from the Eurostat database http://ec.europa.eu/eurostat/web/international-trade/data/database

2 From this point onward, the average annual euro/USD exchange rate is used. https://www.imf.org/external/np/fin/ert/GUI/Pages/CountryDataBase.aspx

3 *A. Knobel.* The Pattern and Prices on Individual Commodities of Russian Exports and Imports // The Economic Development of Russia, 2016, No. 1 (23). pp. 22–25; A. Knobel. Foreign Trade: A Drop in Exports is Justified by a Decrease in Trade Balance // The Economic Development of Russia, 2016, No. 5 (27). pp. 16–18; *A. Firanchyuk*. The Analysis of Dynamics of Trade in Services. Exports and Imports: A Simultaneous Drop // On-Line Monitoring of Russia's Economic Outlook, 2016, No. 8 (26). pp. 5–13.

4 On the basis of the data of the Federal Customs Service. http://customs.ru/

EU's exports fell largely, too, from 6.9% to 4.1%. Such a reduction is largely related to depreciation of the ruble exchange rate against other main world currencies. It is to be noted that in the 2013–2015 period a drop in Russia's imports from the EU happened to be more dramatic (47.7%) than that from other countries (37.9%); as a result, the share of the EU in Russia's imports fell by 5.6 p.p.

Exports of Individual commodity groups

Dynamics of Russian exports to the EU by some important aggregated commodity groups is shown in *Table* 2. As seen in the table, the total share of Russian commodities in the EU's imports in the past three years was decreasing at a faster rate than that of the EU in Russia's exports of goods.

There was *growth in trade* (growth in the share of Russia in the EU's imports and the share of the EU in Russia's exports) in the following commodity positions: fertilizers, paper, and cardboard, aluminum, lead and other basic metals. Taking into account the fact that in the previous years the share of the EU's imports in the global aluminum imports did not change much (in the last column of *Table 2* maximum relative changes in the EU's share in global imports of goods in the past four years are shown), it can be concluded that the share of Russia in global exports of aluminum has probably increased, while the shares of fertilizers, paper, lead and other basic metals changed insignificantly[1].

On the contrary, *a reduction of trade* (simultaneous decrease in mutual shares of Russia and the EU) took place in such commodity groups as mineral fuel, inorganic chemical products, natural rubber, rubber, ferrous metals and nickel[2].

The share of Russia in the EU's imports of cereals is unstable, however, it can be concluded that the ratio of Russia's total exports of cereals to the EU's total imports of cereals rose nearly 1.5 times over. With lack of complete data on the global trade commodity pattern in 2015 and taking into account the fact that relative fluctuations of the EU's share in global trade in those products in the previous years were not high (maximum 17%), it can be concluded that the share of Russia in the global exports of cereals increased considerably. It is noteworthy that the extent of exports of cereals is largely determined by the level of yield in a specific year, so, this commodity group is rather volatile.

A similar situation can be observed in exports of copper where with *a stable share* of the EU in Russia's exports sudden growth in Russia's share in the EU's imports took place. The above fact is evidence of Russia's share in global exports of copper.

Reduction of the share of Russia in the EU's imports with simultaneous growth in the share of the EU in Russian exports points to the fact that Russia's share in global exports of such commodities as fur, timber and precious metals and stones is falling.

So, it can be stated that as regards the main non-fuel export positions (except for, probably, copper, aluminum and cereals) in 2015 Russia lost its posi-

1 See: *Yu.K. Zaitsev, A. Yu. Knobel.* The Trade Policy of the Russian Federation in Respect of Pharmaceutical Products in the Light of Accession to the WTO. // Bulletin of the Peoples' Friendship University of Russia, 2013. Series: Economy 4, 37–46.

2 On Dependence of Imports on Different Factors: *A. Yu. Knobel.* Assessment of the Function of Demand on Imports to Russia // Applied Econometrics, 2011. No. 4 (24). pp. 3–26.

Table 2

RUSSIAN EXPORTS TO THE EU BY INDIVIDUAL COMMODITY GROUPS

Commodity position code	Name of commodity position	Russia's export to the EU in 2015, billion USD	The share of Russia in the EU's imports, %			The share of the EU in Russia's exports, %			Estimate of relative growth in Russia's share in global markets*	Maximum relative fluctuations of the EU's share in global imports in the 2011–2014 period
			2013	2014	2015	2013	2014	2015		
10	Cereals	0.29	3.8	5.6	5.0	5.8	6.1	4.8	+60%	±17 p.p.
27	Mineral fuel	102.1	32.1	30.7	28.1	52.7	52.2	46.8	0%	±6 p.p.
28	Inorganic chemical products	2.31	21.7	21.8	15.3	50.0	48.3	43.7	-20%	±13 p.p.
31	Fertilizers	1.80	32.4	31.9	34.3	17.6	19.6	19.2	0%	±20 p.p.
40	Natural rubber, rubber	1.07	7.0	5.9	5.9	49.9	49.6	42.3	0%	±15 p.p.
43	Natural and artificial furs	0.05	14.3	8.3	8.5	59.0	72.3	73.4	-50%	±11 p.p.
44	Timber and woodwork	1.80	15.9	15.8	14.1	25.0	25.7	26.4	-15%	±11 p.p.
48	Paper and cardboard	0.44	4.6	5.2	5.1	17.6	18.8	20.4	0%	±11 p.p.
71	Precious metals and stones	3.34	5.7	6.4	5.2	26.7	35.6	37.5	-35%	±48 p.p.
72	Ferrous metals	4.62	17.5	16.0	16.1	37.0	27.1	30.5	10%	±20 p.p.
74	Copper	1.89	11.5	12.3	17.1	78.0	82.7	78.5	+50%	±13 p.p.
75	Nickel	0.75	19.6	19.2	16.0	96.9	97.5	90.5	-10%	± 9 p.p.
76	Aluminum	2.96	10.2	15.3	13.5	34.2	29.8	38.0	+20%	±12 p.p.
78	Lead	0.07	7.7	12.1	10.1	28.2	34.3	38.4	-5%	±19 p.p.
81	Other basic metals	0.36	9.4	8.6	9.6	50.7	51.9	55.8	-5%	± 9 p.p.
	Total	150.3	12.3	10.8	7.9	45.5	44.8	39.5	-25%	

Source: Authors' calculations on the basis of the data of Eurostat and COMTRADE.

Note* – the estimate is made on the assumption that the EU's share in the aggregate global imports of all the countries is permanent.

tions on global markets. Insignificant growth in physical volumes of non-fuel exports with substantial additional advantages created as a result of depreciation of the ruble exchange rate[1], can be explained not by a drop in global demand in respective commodities, but those difficulties which Russian enterprises experience in expanding output and export supplies[2].

1 See: *A Knobel.* The Pattern and Prices on Individual Goods of Russian Exports and Imports // The Economic Development of Russia, 2016, No. 1 (23). C. 22–25.

2 See.: *G Idrisov, Yu. Ponomarev, S. Sinelnikov-Murylev.* The Trade Conditions and Economic Development of Modern Russia // Economic policy, 2015, No. 3. pp. 7–37.

5. "ANTI-TURKISH EMBARGO": WHO LOST THE MOST?

N. Shagaida

The ongoing ban on Turkish vegetables is hardly noticeable for the Russian citizens due to insignificant volumes of supplies. During the summer months, demand for this type of product will be met by domestic production and shipments from the EAEU partners – Armenia, Kazakhstan, and Kirgizia.
The ban on shipments of tomatoes and cucumbers has produced different results for Turkey. Exports of tomatoes as long-lived commodity were redirected to other countries. The producers of cucumbers have suffered considerable losses: exports have fallen by 40% (Russia's share in Turkish export constituted 50%).

The Russian vegetable production comes to around 117 kg per capita per annum. Furthermore, Russia imports 20 kg per capita and exports 5 kg per capita (*Table 1*).

Table 1

IMPORTS AND CONSUMPTION OF VEGETABLES IN THE RUSSIAN FEDERATION, 2014

Indicator	2014
Share of imports in personal and productive consumption, %	16.1
Per capita production, kg	117.5
Per capita imports, kg	20.4
Exports, kg	5.2
Per capita consumption, kg	112.5
Per capita productive consumption, kg	14.0
Total per capita consumption (personal + productive), kg	126.5

Source: calculated on Rosstat data.

Following the imposition of embargo against the EU countries in August 2014, the share of vegetables from Turkey in Russian imports approached 23%. Since 2016, our country launches restrictions on imports of food products from Turkey. Initially, these restrictions were obviously of political nature. From 1 January 2016, the ban covered products whose share in 2014–2015 constituted around 60% of the overall Turkish food exports to Russia. Afterwards, based on phytosanitary grounds and declaring these measures and temporary the RF introduced restrictions on imports of red peppers, pomegranates, eggplants, two types of lettuce, and from 19 May 2016 – vegetable marrows and pumpkins.

Prior to the imposition of sanctions, the share of Turkish food products had not exceeded 5.6% of the Russian imports. Tomatoes, grapes, and tangerines from Turkey varied from 34 to 50% of Russian imports of these products. Shipments from Turkey provided 11% of the average annual consumption of tomatoes.

We analyzed in detail the consequences of banning imports of Turkish food products in a January issue of Online Monitoring of Russian Economic

Outlook[1]. Then we assumed that transition to other importers and stimulation of domestic producers of tomatoes should drive prices up because Turkey guaranteed low prices of supplies amid large volumes of shipments and Russian agro businesses lost to Turkish suppliers in price. By the end of Q1 2016, we can say that our assumption was confirmed. For example, redistribution in the structure of tomato imports resulted in Morocco becoming major exporter with a price 47% higher than the Turkish one (*Table 2*).

Table 2

STRUCTURE OF TOMATO IMPORTS INTO RUSSIA AND BORDER PRICES

	Import structure by price, %		Price, thousand dollars, doll/t	
	2015	2016	2015	2016
Iran, Islamic Republic	1.0	2.2	1.41	1.36
China	15.1	18.3	1.40	1.42
Belorussia	1.8	2.0	0.41	0.30
Armenia	0.0	5.0	0.35	0.58
Azerbaijan	1.0	7.4	1.24	1.12
Marocco	17.3	56.6	1.44	1.35
Israel	2.7	1.3	2.47	2.32
Republic of Macedonia	1.2	0.1	1.47	1.36
Egypt	0.6	3.2	1.78	1.50
Senegal	1.2	1.9	1.85	1.85
Tunis	0.2	0.5	3.11	2.02
Turkey	57.7	0.0	0.98	
Abkhazia	0.0	0.3		1.10
Bosnia-Herzegovina	0.0	0.2		1.47
Other countries	0.1	0.9		
Total	100	100		

Source: Federal Customs Service of RF.

Subsequent restrictions have affected certain products, which were not of any importance for the Russian consumer.

Eggplants[2]. There is no record of eggplants production volumes in Russia. Their production is registered among 'other' vegetables. Less than 7% of the total vegetable production in Russia is recorded as 'other vegetables' or 8 kg per capita. Ban on import of eggplants imposed from May 2016 does not harm any interested party: Turkish producers, intermediaries or agricultural producers and consumers from Russia. The reason is that eggplants are not grown in greenhouses and in summer Turkish eggplants are not competitive in price with Russian eggplants or those shipped from the near abroad.

Over recent four years, the share of Turkey is Russia's eggplant imports varied in the range from 14 to 26% (in terms of weight). In 2013–2014, their prices were below average. In 2014–2015, following the embargo the prices went up due to less competition with other suppliers, whose products were banned (*Table 3*).

Vegetable marrows and pumpkins. The share of Turkey in Russia's imports of vegetable marrows varied from 69 to 72% in different year. However, the volume of imports barely reaches 4% of the gross Russian production. Ban on imports of pumpkins and other cucurbits is even less important (see *Annex*).

1 *Uzun V.Ya.* Online Monitoring of Russia's Economic Outlook. Trends and new socio-economic challenges. 2016. No. 1(19). http://www.iep.ru/files/RePEc/gai/monreo/19-2016-jan.pdf

2 Eggplant is a berry and traditionally is registered as a vegetable.

Table 3

RUSSIA'S EGGPLANT IMPORTS

Year	From Turkey		Total		Share of Turkey, %		Price, doll./t	
	Thousand $	t	Thousand $	t	In volume	In price	Turkey	Total
2013	6803	4174	50774	29738	14.0	13.4	1630	1707
2014	7617	5509	40624	26160	21.1	18.7	1383	1553
2015	5982	5144	18236	19701	26.1	32.8	1163	926
2016*	775	528	2545	2780	19.0	30.5	1467	916

*For 3 months 2016.
Source: FCS of RF.

Red pepper. The share of Turkey in Russia's imports varies across year from 6 to 12%. In terms of per capita, merely 11 grams of Turkish red peppers are imported to Russia (see *Annex*).

Lettuce. Prior to ban imposed in August 2014, the share of imports of lettuce was extremely negligible. Only later, taking advantage of the fact that Turkey was not part of the countries whose food products were banned increased its share to nearly 15% (in terms of weight). However, general volumes of imports are insignificant.

Thus, *phytosanitary restrictions on imports of Turkish vegetables do not affect Russian consumer. On the whole they neither affect the agricultural sector of Turkey owing to the fact that at the second stage of restrictions phytosanitary measures referred to the products, which has an insignificant share in imports.*

Contraction of imports first of all was triggered by demand reduction on more expensive imported goods, which can be seen from the data given in Table 4. In 2015 prior to the imposition of sanctions by Russia, supplies of Turkish foodstuffs amounted to merely 50% of the sanction 2013. Imports of non-food products was not subject to sanctions but it also fell by more than 40%.

Table 4

CHANGES IN RUSSIA'S IMPORTS OF FOOD AND NON-FOOD PRODUCTS, 2015/2013, %

	Total	Including, from Turkey
All products	58	56
Foodstuffs (groups 1–24 across FIACN)	54	50
Non-food products	59	59

Source: FCS of RF.

Under these circumstances, it is highly unlikely that sanctions would make economies of the countries subject to restrictions feel their disciplinary effect. Most likely, this fact confirms a hypothesis that the ruble's devaluation put all countries, both under sanctions and fee of them, in the same conditions.

New exporters are taking the Turkish share on the Russian market. For example, Belorussia has become major exporter of eggplants, which is a country with similar to Russia environmental conditions and it managed to adapt them for growing heat-loving plants. Earlier we demonstrated that Belorussia since 2014 has become a supplier of not only apples but also of black cherries, kiwi, and strawberries[1]. Now Belorussia exports eggplants (*Table 5*).

1 *Uzun V.Ya.* Online Monitoring of Russia's Economic Outlook. Trends and challenges of socio-economic development. 2016. № 1(19). http://www.iep.ru/files/RePEc/gai/monreo/19-2016-jan.pdf

Table 5

SHARE OF EGGPLANTS IMPORTS INTO RUSSIA, %

Country	2013	2014	2015	2016*	Страна	2013	2014	2015	2016*
Belorussia	7.7	8.6	46.3	53.0	Israel	2.3	2.5	2.5	3.7
Turkey	14.0	21.1	26.1	19.0	Iran. Islamic Republic	0.5	1.1	1.3	5.0
China	12.8	15.4	16.7	18.7	Other importers	62.5	50.3	3.5	0.6
Morocco	0.2	1.0	3.6	0.0					

*For 3 months of 2016
Source: FCS of RF.

From 2013 to 2015, Belorussia has increased its exports of eggplants to Russia by more than four times. In 2013, Turkish exports exceeded Belorussian exports to Russia twofold. In 2015, Belorussian exports exceeded Turkish exports to Russia twofold. However, Belorussia is not birthplace of eggplants. According to Belstat data, Belorussia doubled their exports in 2015 compared to 2014[1]. Production of vegetables in Belorussia remains at around the same level as before and consumption went up insignificantly[2], which testifies about the hidden reexport of products.

Another example are the tomatoes. Turkey exported in Q1 2015 156.5 thousand tons of tomatoes including 70% of that amount to Russia. In 2016, exports to Russia was banned. Meanwhile, total exports of tomatoes from Turkey contracted merely by 8% (*Table 6*).

Table 6

EXPORT OF TOMATOES FROM TURKEY TO RF, THOUSAND TONS, JANUARY–MARCH

	Exports of tomatoes from Turkey			Imports of tomatoes to RF		
	2015	2016	2016/2015	2015	2016	2016/2015
RF	109.5	0	0	165.1	118.7	
Other countries	47	143.8	3.1			
Total	156.5	143.8	0.9			

Sources: UN Comtrade Database, FCS of RF.

During the same period in the context of sanctions against Turkey imports of tomatoes to Russia contracted merely by 46.4 thousand tons, i.e. secession of shipments from Turkey in the amount of over 100 thousand tons was replaced by other suppliers (in the volume of 64 thousand tons) and more expensive at that (*Table 7*).

Export of tomatoes from Turkey was redistributed. For example, shipments to Belorussia, Azerbaijan, Israel, and Syria went up nu more than tenfold, i.e. flows were redistributed to countries, which actively engage on special conditions with Russia (*Table 7*).

1 Comparison of exports-imports statistical data demonstrates a problem in statistical service. According to the Russian statistical data in 2015, Russia imported solely 9 thousand tons of eggplants but according to data released by Belstat – 14 thousand tons. According the Eurostat data, Belorussia imported 6.7 thousand tons in 2014 and 15.1 thousand tons in 2015, while Belstat registered solely 2.1 thousand tons. EU supply volume to Belorussia corresponds to the Belorussian supplies to Russia. Hence, there is a doubt about the authenticity of accompanying documents and proper products flows.

2 Belstat, 2016.

Table 7

EXPORTS OF TOMATOES FROM TURKEY

	Export of tomatoes(code FEACN 070200)			% of total exports	
	January–March 2015, t	January–March 2016, t	2016/2015	2015	2016
Belorussia	3690	39279	11	2	27
Georgia	3709	20682	6	2	14
Iraq	2791	16122	6	2	11
Rumania	8229	13619	2	5	9
Ukraine	5205	8403	2	3	6
Poland	2868	7692	3	2	5
Bulgaria	8000	5124	1	5	4
Serbia	2694	4241	2	2	3
Azerbaijan	77	3785	49	0	3
Syria	97	3628	37	0	3
Kazakhstan	378	3532	9	0	2
Israel	44	3348	76	0	2
Netherlands	1191	2475	2	1	2
Germany	1776	2325	1	1	2
Moldavia	2782	1747	1	2	1
RF	109489			70	
Other	3511	7779	2	2	5
Total	156531	143779	100	100	100

Source: UN Comtrade Database.

Banned in Russia, the Turkish cucumbers and gherkins were not redirected to other countries. For example in 2015, the share of (for January–March) Russia in the Turkish exports amounted to 50%. In 2016, the overall contraction of exports of these products constituted 40%.

Turkey is for Russia a large trade partner in export operations. In 2014–2015, export exceeded import (*Table 8*).

Table 8

CHARACTERISTICS OF IMPORT-EXPORT INTERACTION BETWEEN TURKEY AND RUSSIA

	2012	2013	2014	2015
Russia's imports from Turkey, mn dollars	2432.4	2783.5	2839.5	1394.0
Turkish share in Russia's imports, %	5.3	5.7	6.3	5.2
Share of exports to Russia, %	15.9	16.4	15.8	8.3
Russia's exports to Turkey, mn dollars	1937.74	1721.29	2369.20	1798.66
Share of Turkey in Russia's exports, %	11.56	10.58	12.48	11.10

Source: FCS of RF.

In 2014–2015, the share of Turkey in Russia's exports of vegetables was in the range of 43–48% (although the volumes are small so far). Regarding oil and oil-plants, the share of Turkey during various years exceeded half of Russian exports and regarding grains – 14–19%. In this regard, prospective Turkish sanctions imposed on the same phytosanitary grounds can be very painful to Russia[1]. Moreover, the gain and oil-plan markets are extensive (for instance, Ukraine).

1 So far, these possibilities are being discussed: http://agro2b.ru/ru/companiesnews/26812-Turciya-obsuzhdaet-zapret-importa-rossijskoj-pshenicy.html

May restrictions of supply of vegetables from Turkey will be insignificant for both Russian consumers and for the Turkish economy. First, the summer is coming when Russian production as well as production in the EAEU member states (Armenia, and Kirgizia) will easily replace imported products. Second, shipments from Turkey have fallen from the imposition of ban on tomatoes in January 2016. In the wake of tense political situation, the Turkish businesses preventively neutralizer trade risks with Russia. Third, flows of banned vegetables as it is seen by the shipments of eggplants and vegetable marrows reach Russian supermarkets via our partners of EAEU. The reliability of customs statistics remains a general issue. Comparison of data across countries testifies about possible documents manipulation on products, which does not allow to reliably assessing the scale of commerce between countries in the wake of sanctions.

Annex

VEGETABLE MARROWS, FRESH AND REFRIGERATED

Year	Imports from Turkey		Imports – total		Share of Turkey, %		Price, USD/t	
	Price thousand USD	Weight, t	Price thousand USD	Weight, t	In volume	In price	Turkey	Average
2013	23667	27271	34169	37690	72.4	69.3	868	907
2014	24184	31494	33698	42045	74.9	71.8	768	801
2015	19608	28259	22816	34737	81.4	85.9	694	657
2016*	10517	14389	12189	16573	86.8	86.3	731	735

*January–March.

OTHER PUMPKINS, VEGETABLE MARROWS AND OTHER CUCURBITS

Year	Imports from Turkey		Imports - total		Share of Turkey, %		Price, USD/t	
	Price thousand USD	Weight, t	Price thousand USD	Weight, t	In volume	In price	Turkey	Average
2013	2	2	2828	2566	0.1	0.1	1238	1102
2014	25	22	3282	3038	0.7	0.8	1152	1080
2015	51	47	764	912	5.2	6.6	1077	838
2016*	0	0	186	194	0.0	0.0		960

* January–March.

SWEET RED PEPPER

Year	Imports from Turkey		Imports - total		Share of Turkey, %		Price, USD/t	
	Price thousand USD	Weight, t	Price thousand USD	Weight, t	In volume	In price	Turkey	Average
2013	14025	10831	241865	165904	6.5	5.8	1295	1458
2014	14992	14382	209285	158108	9.1	7.2	1042	1324
2015	14246	15495	125094	126979	12.2	11.4	919	985
2016*	2728	2924	49064	35652	8.2	5.6	933	1376

* January–March.

HEAD LETTUCE, FRESH OR REFRIGERATED

Year	Imports from Turkey		Imports - total		Share of Turkey, %		Price, USD/t	
	Price thousand USD	Weight, t	Price thousand USD	Weight, t	In volume	In price	Turkey	Average
2013	97	58	38449	28426	0,2	0,3	1670	1353
2014	5004	3844	35033	26806	14,3	14,3	1302	1307
2015	3361	2627	12740	17983	14,6	26,4	1279	708
2016*	226	200	5819	6937	2,9	3,9	1130	839

LETTUCE FRESH OR REFRIGERATED

Year	Imports from Turkey		Imports - total		Share of Turkey, %		Price, USD/t	
	Price thousand USD	Weight, t	Price thousand USD	Weight, t	In volume	In price	Turkey	Average
2013	0	0	8192	5933	0,0	0,0		1381
2014	350	330	6327	5297	6,2	5,5	1061	1195
2015	159	170	2267	5421	3,1	7,0	934	418
2016*	0	0	1016	1887	0,0	0,0		539

* January–March.

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