

MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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MAIN TRENDS AND CONCLUSIONS (V.Gurevich).....	3
1. FEDERAL BUDGET FOR 2017–2019: AN INSIGHT INTO KEY PARAMETERS (I.Sokolov).....	6
2. INCOME AND POVERTY IN 2016 (E.Grishina, A.Burdyak)	13
3. BALANCE, ROUBLE, CAPITAL: RUSSIA'S BALANCE OF PAYMENTS IN JANUARY-SEPTEMBER 2016 (A.Bozhechkova, P.Trunin, M.Khromov).....	16
4. THE SPECIFICS OF RUSSIAN EXPORTS AND IMPORTS IN JANUARY-AUGUST 2016 (A.Knobel, A.Firanchuk).....	21
AUTHORS	27

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РАНХиГС
РОССИЙСКАЯ АКАДЕМИЯ НАРОДНОГО ХОЗЯЙСТВА
И ГОСУДАРСТВЕННОЙ СЛУЖБЫ
ПРИ ПРЕЗИДЕНТЕ РОССИЙСКОЙ ФЕДЕРАЦИИ



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MAIN TRENDS AND CONCLUSIONS

V.Gurevich

While the recent sale of *Bashneft* necessitated a certain adjustment and clarification of the very notion of privatization, the frequent changes repeatedly introduced in the macroeconomic parameters applied in the official forecasts will probably lead to an adjustment of the notion of economic forecast.

The differences in and the corrections to the socioeconomic development forecasts for 2017–2019 (inflation, forex rates, growth rates, etc.) are being commented upon with such vigor that now hardly anyone could have been surprised by the inevitable conclusion that, until all the financial and economic departments of the government achieve a complete and final agreement, none of them should come forth with its own view of our economic future - let alone publish that view officially. But in that case, much of the federal budget and most of the forecasts released at the federal level would have become classified items. Perhaps this would then become a necessary feature of ‘the new normality’.

So far, however, it is the unexplained weakening of the ruble, expected to happen in 2017–2019 against the backdrop of abating inflation, dwindling capital outflow, and stable oil prices, that is being perceived as not quite normal (among all the other ‘forecasted news’). Since the oil price level is to remain stable, while the output and exports of hydrocarbons will not decline - instead, their indices will be on the rise (as predicted in all the available corporate and sectoral forecasts), it can hardly be expected that revenue from their exports may indeed fall below its today’s level. Meanwhile, this is indeed the only factor capable of influencing the national currency’s foreign exchange rate. That is why the forecast adventurous movement of the ruble in Russia appears to be an extraordinary phenomenon.

Rather far from normal is another unexpected development, which is to occur in 2016. This is the suddenly increased federal budget revenue (contrary to its previously declared continual shrinkage) due to the additional allocations to the military, to the value of several hundreds of millions of rubles. An investigation on that matter, which was far from easy to accomplish because the relevant information is classified, revealed that these were not additional resources urgently requested by the RF Ministry of Defense for its own needs, but the money needed by the government to cover its loan guarantees issued several years ago to certain enterprises belonging to the military-industrial complex. It would hardly be worthwhile to ask what (and how well) those enterprises had done with the money they managed to lay their hands on thanks to those loans, let alone ask why they had chosen not to repay them (it would be strange indeed for them to want to repay the debts that the government had been prepared to repay from the start).

However, it is well worth asking why the government had been unable to come to an agreement with its own banks (all the loans had actually been issued by state banks) concerning, say, prolongation or restructuring of these debts, or - more importantly - how the budget expenditure in excess of Rb 0.5 trillion could literally just pop out of the blue. Considering that in the future, the amount of government guarantees issued to secure the debts

obligations assumed by economic subjects is expected to soar, and that their style of doing business leaves much to be desired, one better be prepared for the worst scenario: in the end, it is the budget that will pay for everything.

In their analysis of the law on federal budget for 2017–2019 recently submitted to the government, our experts note, among other things, the planned sustainable growth of non-oil and gas budget revenues. Still, they believe that one of the factors to be relied on in order to secure such growth has been overestimated - namely the creation of a single budget revenue administration system. The desired effect of merging the Federal Tax Service and the Federal Customs Service into one system may turn out to be on a much more modest scale than expected, while that produced by the Federal Tax Service's information system set up in 2015 has already been felt.

The experts have also paid attention to the mechanism of budgetary rules that is being reestablished in order to play down the budget's sensitivity to the volatility of oil prices (in this connection, the period 2017–2019 is declared to be a transition period). However, 'the architecture of the rules itself does not appear to be sufficiently sustainable in the long run': to keep budget expenditure pegged to oil prices can be worthwhile only 'if the budgetary rules rely on a more or less veritable hypothesis describing the regularities of the movement of prices of oil'.

Besides, from 2020 onwards, the budgetary rule is expected to set a ceiling for the basic amount of borrowing to cover the costs of debt servicing (0.8–1.0% of GDP per annum). Such an approach is correct in principle, because 'it is not the actual amount of debt that is critically relevant, but the amount of borrowing needed for its servicing'. Meanwhile, as early as 2018, the cost of debt servicing may approach the established ceiling; it is planned to annually borrow more than Rb 1 trillion in the domestic market; the problems caused by the regions' rising debts and the lack of proper balance in the RF Pension Fund will persist. Taken together, all these facts point to that ceiling 'hardly being realistic'. Meanwhile, the task of switching over to the budgetary rules from 2020 onwards implies the necessity of budget consolidation in 2017–2019.

Special note is made of the continually worsening structure of federal budget expenditure over the course of recent years. Budget expenditure has been increasing only with regard to three items, none of them having anything to do with production: defense; social policy; debt servicing. Meanwhile, 'among the countries not being in a state of armed conflict, Russia can boast of a record high amount of expenditure allocated to defense'; the expenditure allocated to pensions is steadily on the rise, and without pension reform that trend is unlikely to reverse in the next few years; recent years have seen 'an unregulated growth of government debt owed by the Federation's subjects'.

There exist at least three reasons for a fundamental revision of Russia's budgetary policy. First, the budget that for many years have relied on revenues generated by mineral resources is now by itself a serious obstacle to structural reform in the economy. However, at present the amount of redistributed oil rent is plunging at a stable rate. Second, the very fact of availability of reserves in the sovereign funds was making it possible to ignore the obvious challenges; however, the Reserve Fund will be fully spent up in 2017, while the liquid assets in the National Welfare Fund that have not been invested in projects will need to be stretched to produce a balanced budget over the planning period. (At the same time, while 70% of budget deficit is to be covered by the sovereign

funds in 2016, 90% of it will be covered predominantly by government securities by 2019). Third, regions' consolidated budget debt is being increasingly transferred to the federal level. All these circumstances will conduce to inevitable changes in the current budgetary policy.

In order to keep budget deficit by 2019–2020 at a level no higher than 1.0–1.5% of GDP, and the ceiling for the general government budget expenditure at 33–34% of GDP, the so-called 'inflationary economic growth' may be attempted, when non-production costs are kept at a current nominal level, while production costs are adjusted by the inflation rate (or even higher). However, according to our experts, later on it will be necessary to switch over to a 'debt-brake' policy: a zero budget balance in real terms. In other words, the amount of deficit will be minimized by bringing down the amount of interest payments.

The complicated situation with the budget is inevitably reflected by the level of wealth, especially in an economic system where small and medium-sized businesses are underdeveloped, while a major share of the population earn their living in the budget-funded sectors.

The specific feature of the current crisis is the long-term plunge of real personal income, which has been constantly declining for two years, as noted by experts. On the whole, between September 2014 and September 2016, this index shrank by 8.7%. The depth of its fall is also significant: in Q3 2016, it stood 6.1% below its value recorded in Q3 2015; no similar plunge had been observed (within such a short period of time) since 1999.

True, the situation observed specifically in September 2016 appears to be somewhat better: real personal income amounted to 97.2% of its September 2015 level, while real wages even gained 2.8% on the same period. This year, the poverty index somewhat declined: in Q2, the share of population with incomes below subsistence level amounted to 13.5% vs. 14.0% a year ago (approximately the same decline rate is demonstrated by the corresponding indices for H1 2016 and H1 2015). The decisive factor in that decline was the significant slowdown demonstrated by the inflation rate: over January-September, prices gained 4.1%, which is the record low of the entire period since 1991.

In theory, both these indices (real income and poverty) may be influenced by the seasonal (year-end) increase of prices of fruits and vegetables in the consumer basket. However, inflation is more strongly influenced by other factors, including the strengthening ruble.

The ruble became stronger, among other things, due to the fivefold shrinkage, over January-September, of net capital outflow (on the same period of 2015). This happened in the main due to the much slower rate at which Russian banks were reducing their external debt by comparison with the same period of last year. If capital outflow had been more rapid, the balance of payments would have been far worse. However, even so, as follows from data released by the Bank of Russia, the positive current account balance for January-September 2016 amounted to only \$15.6bn, having radically shrunk (by 71.3%) on the same period of last year. The main reason for this state of affairs was the worsening balance of trade.

The data for June-August indicate that Russian exports continued their plunge (amounting to 85.2% of their level recorded over the same period of 2015), while imports, in fact, were no longer on the decline, and even increased over the summer 2016 (to 103.2% of their value observed over the same period of last year). ●

1. FEDERAL BUDGET FOR 2017–2019: AN INSIGHT INTO KEY PARAMETERS

I.Sokolov

A draft law On Federal Budget for 2017 and the Planning Period 2018 and 2019 describes 2016 as a period of adjusting to external economic challenges. The period is planned to be followed by a period of reaching balanced economic development parameters. However, this will, among other things, require certain updates in the volume and structure of budget expenditure in order to consolidate the budget and achieve deficit size goals.

The draft law *On the Federal Budget for 2017 and the Planning Period 2018 and 2019* (hereinafter – the draft law) was considered at a meeting of the Russian government on 13 October 2016. The draft law includes preliminary assessments of the 2016 federal budget execution¹, as well as parameters of the budget system and conceptual updates therein that are scheduled for the ensuing three years.

Russia's Ministry of Finance and government are reintroducing three-year budget planning: the draft law includes parameters for 2017 and for the 2018–2019 planning period. However, the important question is whether the target parameters could be met within a three-year period and whether this could be real rather than nominal signal to individuals and businesses that the public fiscal policy is sustainable?

This year the Russian government have gotten out of the routine of considering the Guidelines of the Budget, Tax and Customs Tariff Policy in May or June, as they did before 2016. Instead, the Guidelines were considered for the first time at a government meeting that was held a week ahead of the date on which the draft federal budget and the explanatory note thereto were considered, which actually devalues their importance as documents underlining the federal budget draft law.

The draft law relies on a baseline socio-economic development forecast for the Russian Federation for 2017 and 2018 and 2019, whose key parameters are presented in *Table 1*.

Table 1

KEY PARAMETERS OF BASELINE SOCIO-ECONOMIC DEVELOPMENT FORECAST FOR THE RUSSIAN FEDERATION FOR 2017–2019

	2015	2016	2017	2018	2019
GDP, Rb billion	80804,0	82815,0	86806,0	92296,0	98860,0
GDP growth rate, year-on-year, %	-3.7	-0.6	0.6	1.7	2.1
Urals crude average price, US dollars a barrel	51,2	41,0	40,0	40,0	40,0
Rouble to US dollar average exchange rate, roubles per US dollar.	60,7	67,5	67,5	68,7	71,1
Consumer Price Index, year-on-year, %	12.9	5.8	4.0	4.0	4.0

Sources: 2015 actual values. The 2016–2019 explanatory note to the draft law *On the Federal Budget for 2017 and the Planning Period 2018 and 2019*.

¹ The assessment of the 2016 budget execution considers amendments to the applicable law that were made in October 2016.

External and internal factors and conditions

In terms of external conditions for the Russian economic development, global economic growth rates are projected to slow down further, as a result of which no improvement in prices and demand for Russia's exports goods is expected. In addition, sanctions against Russia are expected to stay in force throughout the entire period under review. Urals crude price is expected to average \$41 a barrel in 2016 and to stay stable at \$40 a barrel in 2017–2019, according to preliminary estimates.

As to internal factors, the Russian economy is expected to resume its growth following a two-year downturn: GDP growth rate is anticipated to reach 0.6% in 2017, 1.7% in 2018 and 2.1% in 2019. With a moderate nominal growth in domestic demand and relatively stable exchange rate dynamics, inflation slowdown to 4% a year should have a positive effect on economic growth. The rouble to US dollar exchange rate is expected to vary within 67,5–71,1 roubles per US dollar.

Overall, the federal budget draft law describes 2016 as a period of adjusting to the external economic challenges that emerged in 2014–2015. The period is planned to be followed by a period of reaching balanced economic development parameters.

The federal budget key characteristics rely on the baseline socio-economic development forecast (*Table 2*).

Table 2

FEDERAL BUDGET KEY CHARACTERISTICS

	Rb billion					% of GDP				
	2015 (actual)	2016* (estimated)	2017 (projected)	2018 (projected)	2019 (projected)	2015 (actual)	2016 (estimated)	2017 (projected)	2018 (projected)	2019 (projected)
Revenue	13,659	13,369	13,437	13,989	14,825	16.9	16.1	15.5	15.2	15.0
Including:										
oil and gas revenues	5863	4,778	5,029	5,133	5,370	7.3	5.8	5.8	5.5	5.4
non-oil and gas revenues	7797	8,591	8,408	8,856	9,455	9.6	10.4	9.6	9.6	9.6
Expenditure	15,620	16,403	16,181	15,978	15,964	19.3	19.8	18.6	17.3	16.1
Deficit (-) / surplus (+)	-1.961	-3,034	-2,744	-1.989	-1,139	-2.4	-3.7	-3.0	-2.2	-1.2
Non-oil and gas deficit	-7,823	-7,812	-7,773	-7,122	-6,509	-9.7	-9.4	-9.0	-7.7	-6.5

* The presented parameters of preliminary assessment of the 2016 federal budget execution consider revenues from selling a 19.5% interest in Rosneft. The relevant transaction is expected to be closed until the end of 2016.

Sources: 2015 actual values. The 2016–2019 explanatory note to the draft law *On the Federal Budget for 2017 and the Planning Period 2018 and 2019*.

Revenue

Federal budget revenue are anticipated to contract in 2017–2019, from 16.1% of GDP in 2016 to 15.0% by 2019, which will first of all be driven by the dynamics of oil and gas revenues that are expected to reduce from 5.8% of GDP in 2016–2017 to 5.4% by 2019. In terms of volume, non-oil and gas revenues are anticipated to be stable and they, according to budget projections, will not slide below 9.6% of GDP, which is similar to the level recorded in 2015. The marked growth in non-oil and gas revenues in 2016 (up to 10.4% of GDP) is the result of extra revenues that are expected from partial privatization of Rosneft.

Table 3

FEDERAL BUDGET REVENUES IN 2017–2019

	Rb billion					% of GDP				
	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019
Total revenues	13659	13369	13437	13989	14825	16.9	16.1	15.5	15.2	15.0
Oil and gas revenues	5,863	4,778	5,029	5,133	5,370	7.3	5.8	5.8	5.6	5.4
<i>of which:</i>										
mineral extraction tax	3,160	2,819	3,278	3,386	3,527	3.9	3.4	3.8	3.7	3.6
export duties	2,703	1,959	1,750	1,746	1,843	3.3	2.4	2.0	1.9	1.9
Non-oil and gas revenues	7797	8,591	8,408	8,856	9,455	9.6	10.4	9.7	9.6	9.6
<i>of which:</i>										
corporate profit tax	491	465	599	635	686	0.6	0.6	0.7	0.7	0.7
VAT on goods sold on the territory of the Russian Federation	2,448	2,637	2,888	3,205	3,559	3.0	3.2	3.3	3.5	3.6
VAT on goods imported in the territory of the Russian Federation	1,785	1,910	2,001	2,119	2,265	2.2	2.3	2.3	2.3	2.3
excise duties on goods manufactured on the territory of the Russian Federation	528	623	791	854	894	0.7	0.8	0.9	0.9	0.9
excise duties on goods imported in the territory of the Russian Federation	54	57	51	50	52	0.1	0.1	0.1	0.1	0.1
import duties	560	542	529	538	558	0.7	0.7	0.6	0.6	0.6

Sources: 2015 actual values. The 2016–2019 explanatory note to the draft law On the Federal Budget for 2017 and the Planning Period 2018 and 2019.

The volume of all the non-oil and gas revenues (except import duties that are expected to decrease by 0.1 percentage points of GDP) in 2017–2019 is forecast to be equal or above what is estimated for 2016 (approximately 0.1 percentage points of GDP). The most visible growth, +0.4 percentage points of GDP by 2019, is expected in VAT revenues (VAT on goods sold on the territory of the Russian Federation) (Table 3).

Stable non-oil and gas tax revenues, as well as partial compensation for falling oil and gas revenues in the mid-term, will be supported by measures aimed to mobilizing extra budget revenue, of which the following are the most important:

A “tax manoeuvre” that is scheduled for completion in 2018–2020. This will lift mineral extraction tax rates and abolish exports duties on oil and petroleum products and bring about updates in the system of collecting excise duties on petroleum products. In addition, a tax on added income is supposed to be introduced in a pilot mode. Overall, the tax burden on oil and gas industries is planned to be balanced with regard to taxation on oil and gas production in the mid-term;

An increase of 25 to 50% in the lower standard for dividends on public shares and public companies;

Developing a single budget revenue administration system by introducing a unified methodological framework. This initiative is expected to improve the revenue performance rate and contribute to relaxing the administrative burden.

In our view, however, the expected effects of the third of the above listed measures are well overestimated. First, the expected improvement of imports administration through integration of the FCS (Federal Customs Service) and

FTS (Federal Tax Service) information systems may increase the VAT tax base for imports, however, the overall effect of revenues from this tax may turn out to be much moderate given that most of the tax withheld in the process of customs declaration is subsequently subject to “internal” VAT credit.

Second, all other conditions being equal, an increase in the customs value will entail higher customs duties, which will eventually boost supplier costs and result in either higher prices (inflation) or lower profits (shortfall in profit tax revenues).

Third, as to ASK VAT-2 (FTS information system) that was introduced in 2015, it identifies companies that report no sales while they carry out procurement operations, which narrows the scope of FTS’s control and audit activities. The fiscal effect in 2015 was estimated Rb 150bn, but considering a more complicated “cash in” procedure in general and the fact that the ASK VAT-2 has been in service since 2015, the fiscal effect was evident predominantly in the year when this system was put into service, and the same effect can hardly be seen again in the form of substantial additional annual revenues.

Expenditure and budget rules

Federal budget expenditure for 2017–2019 were developed within the budget rule framework. The budget rule mechanism is set to be reintroduced in the mid-term in order to make the budget system less sensitive to volatile global crude prices. According to preliminary projections, a new version of budget rules will take full force beginning with 2020, and 2017–2019 are announced as transition period because of the need to prevent expenditure from contracting too fast to the level provided for by the concept of new budget rules.

Russia’s Finance Ministry suggests that from 2020 the maximum volume of federal budget expenditure should be defined as the sum of the following three components: 1) reference volume of oil and gas revenues that is calculated given a steady Urals crude price of \$40 a barrel and reference rouble exchange rate; 2) the volume of non-oil and gas revenues that is calculated given the baseline mid-term forecast made by Russia’s Ministry of Economic Development; 3) debt servicing expenses. Furthermore, if the forecast volume of the Reserve Fund falls below 5% of GDP as of January 1 during the initial year of the planning period, the maximum volume of spending the Reserve Fund may not exceed 1% of GDP in the ensuing fiscal year, and the maximum volume of spending is adjusted accordingly.

This framework of rules is intended to smoothing the effect of crude price fluctuations on internal prices and exchange rate, while the budget policy is mated with monetary regulation objectives. Obviously, there is no room whatsoever for active budget policy if the first and the third components of the formula exhibit acyclic behaviour while the second one exhibits procyclic behaviour, and if no deficit is allowed for. In addition to the points of large-scale privatization and stable tax burden, this is indicative of a course that have been set for reducing the share of government-led direct intervention in the economy.

The framework of rules by itself doesn’t seem to be sustainable enough in the long term, because there is no point in pegging expenditure to crude price unless budget rules rely on a more or less plausible hypothesis that describes the crude price behaviour.¹ Otherwise, the rules may be discredited,

¹ Budget rules: Redundant constraint or integral tool of budget sustainability? Gurvich E.T., Sokolov I.A. Moscow, Voprosy Ekonomiki, No. 4, 2016.

which would make their revision inevitable, as was the case with the 2014 version thereof.

In addition, the budget rule provides for limiting the basic amount of fundraising to the volume of debt servicing expenses (0.8–1.0% of GDP annually) beginning with 2020. This indeed is correct because debt servicing expenses are deemed to be considered more critical than the size of a debt. However, the following should be taken into consideration: debt servicing expenses would approach the upper limit (0.93% of GDP) as early as 2018 under the hypothesis of deficit reduction; more than Rb 1 trillion are planned to be raised domestically on an annual basis; issues of growing regional debts and disequilibrium of the Pension Fund of the Russian Federation still remain to be tackled. Collectively, all the above-mentioned aspects indicate that this limit could hardly be realistic.

The objective of shifting to new budget rules in 2020 predetermines the need for budget consolidation that is scheduled for implementation during the transition period of 2017–2019. The upcoming budget consolidation provides for further cutting on federal government spending commitments while enhancing their efficiency.

Indeed, federal budget expenditure are expected to be cut in the period under review both in nominal terms, almost Rb 0.5 trillion to the level seen in 2016, and as a percentage of GDP, almost four percentage points (from 19.8% of GDP in 2016 to 16.1% in 2019).

It is important to consider not only the total volume but also the structure of federal budget expenditure that have been deteriorating over the past few years. As a result, expenditure only have increased for three expenditure items, namely national defence, social policy, debt servicing, all of which are productive. Russia is a champion in terms of defence spending among non-belligerent states. Pension expenses have been growing steadily, and it is unlikely that this trend will reverse in the near future, until a pension reform is implemented.

A public debt issue has deteriorated at the regional level. Subjects of the Russian Federation have recently been facing a non-controllable growth in their public debt. While raising wages of public workers, regions not only have abandoned budget investment, but they also have amassed debts due to growing consolidated budget deficit. Indeed, many subjects of the Russian Federation had insignificant public debt prior to 2012. In contrast, 14 regions had a public debt accounting for more than 100% of the regional budget tax and non-tax revenues as early as 2016.

Furthermore, facing the recent economic downturn, the federal budget and regional budgets have responded to “new reality” largely by cutting on the expenditure that determine the future of the country and its regions, namely investment spending.

While the budget projections for 2017–2019 cannot reverse the previously established trends, they provide for certain positive updates in the expenditure structure (Table 4). In particular, military/defence spending have been cut, social spending are planned to be cut, although this is more of a sluggish motion within total budget consolidation than a conscious update in the nature of budget policy. The latter point can be illustrated by a certain decline in healthcare and education expenditure in terms of a percentage of GDP.

Table 4

FEDERAL BUDGET EXPENDITURE (FUNCTIONAL CLASSIFICATION OF EXPENDITURE) FOR 2017–2019

	Rb billion					% of GDP				
	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019
Total expenditure including:	15620	16403	16181	15978	15964	19.3	19.8	18.6	17.3	16.1
General National Issues	1118	1098	1170	1126	1115	1.4	1.3	1.3	1.2	1.1
National Defence	3181	3889	2840	2728	2856	3.9	4.7	3.3	3.0	2.9
National Security and Law Enforcement	1966	1943	1968	1945	2007	2.4	2.3	2.3	2.1	2.0
National Economy	2324	2166	2292	2247	2054	2.9	2.6	2.6	2.4	2.1
Housing and Utilities	144	57	60	30	27	0.2	0.1	0.1	0.0	0.0
Environmental Protection	50	65	76	78	80	0.1	0.1	0.1	0.1	0.1
Education	611	558	568	589	586	0.8	0.7	0.7	0.6	0.6
Culture and Cinematography	90	92	94	88	80	0.1	0.1	0.1	0.1	0.1
Healthcare	516	466	377	394	360	0.6	0.6	0.4	0.4	0.4
Social Policy	4265	4631	5080	4962	5054	5.3	5.6	5.9	5.4	5.1
Physical Culture and Sports	73	66	86	55	34	0.1	0.1	0.1	0.1	0.0
Mass Media	82	76	74	68	67	0.1	0.1	0.1	0.1	0.1
Public Debt Servicing	519	640	729	848	870	0.6	0.8	0.8	0.9	0.9
Inter-Budget Transfers	682	656,4	768	770	776	0.8	0.8	0.9	0.8	0.8

Source: 2015 actual values. The 2016–2019 explanatory note to the draft law On the Federal Budget for 2017 and the Planning Period 2018 and 2019.

The reasons why budget policy may be revised

There are three prerequisites for drastic revision of the budget policy nature:

1. A budget that has long been relying on resource-based revenues has become a serious constraint, even a setback, for structural shift in the economy: guaranteed unearned income and a lack of materials sector's demand for direct budget support discourage taking measures aimed at updating the structure of economy. The volume of oil royalty reallocated via the budget has steadily been declining since 2015, thus creating conditions for shifting budget expenditure priorities.

2. Although deficit reduction was proclaimed as one of the budget policy objectives, reserves that were available in sovereign funds encouraged not seeking out responses to challenges that confront long-term budget equilibrium (population aging; sluggish and rigid expenditure structure biased towards social security and military/national security; updates in the structure of budget revenues; informal sector and low stability of the banking system). It is now apparent that the Reserve Fund will be depleted completely in 2017, and the National Wealth Fund has not enough liquid assets (that are not allocated in infrastructure projects) to run the federal budget in equilibrium during the planning period. This situation also prompts revision of budget policy approaches.

3. With "specified" figures being meticulously executed, the "self-reproducing" amount of debt owed by consolidated budgets of subjects of the Russian Federation will ultimately bring the regional budget equilibrium issue to the federal level that has no sufficient reserves to maintain the budget system as a whole and the federal budget itself at a sustainable level. The budget policy in force leads to wider fiscal gap and deterioration of long-term budget sustainability, that is to say that it will not take long before crisis developments crop up in public finance.

Deficit and budget strategy

It is expected that budget consolidation measures reduce considerably the volume of federal budget deficit at a rate of about 1% of GDP annually (see *Table 2*). For instance, by the end of 2019, total deficit is to stay at about 1% of GDP against the expected 3.7% of GDP in 2016 (4.5% of GDP, excluding revenues from partial privatization of Rosneft). Non-oil and gas deficit will also be reduced markedly during the period, down to 6.5% of GDP in 2019 (almost by 3 percentage points of GDP from the level seen in 2016).

Table 5

SOURCES OF FEDERAL BUDGET DEFICIT FINANCING IN 2017–2019 (RB BN)

	2016	2017	2018	2019
Sources of deficit financing	3034	2744	1989	1139
Reserve Fund and National Wealth Fund	2144	1812	1140	137
Other than Reserve Fund and National Wealth Fund	890	932	849	1002
Domestic sources of deficit financing	897	1136	1078	1130
government securities	449	1050	1050	1050
privatization	382*	138	14	14
budget loans and credits within the country	-183	29	133	155
Other sources	249	-81	-119	-89
External sources of deficit financing	-7	-203	-229	-127

* The amount includes revenues from selling an interest in Bashneft.

Sources: 2016 – the Guidelines of the Budget Policy for 2017–2019, 2017–2019 – explanatory note to the draft law *On the Federal Budget for 2017 and the Planning Period 2018 and 2019*.

The ratio of sources of deficit financing will be changed considerably amid overall reduction of deficit during the planning period (see *Table 5*). While about 70% of the deficit is financed with sovereign funds in 2016, up to 90% of the total deficit will be financed from domestic sources of deficit financing, mainly with government securities, by 2019. This structure of sources of deficit financing provides that the Reserve Fund will be depleted as early as 2017 and the National Wealth Fund will account for 3.1% of GDP by the end of 2019.

However, it must be acknowledged that the existing structure of budget expenditure and prevailing trends towards its changes fail to meet the requirements of budget sustainability and sustainable economic growth in the long term.

A budget manoeuvre towards productive expenditure is facing serious constraints amid falling government revenue: the manoeuvre has to be performed amid falling total budget expenditure of the general government. “Inflationary expansion” of the economy can be employed for some time to run a budget deficit of not more than 1–1.5% of GDP by 2019–2020 and to keep the maximum volume of general government budget expenditure at not more than 33–34% of GDP: productive expenditure are adjusted for inflation rate, or even higher, while non-productive expenditure are kept at the current nominal level. However, this should be followed by a “debt brake” policy (zero budget balance in real terms, over the period under review) through introducing relevant updates in the budget rules and adopting mid-term budget consolidation programmes. ●

2. INCOME AND POVERTY IN 2016

E.Grishina, A.Burdyak

In September 2016, real disposable income and real wage were 97.2% and 102.8%, respectively, compared to the same period last year. The real size of pension benefits in August 2016 reached 96.2% compared to the same period last year. In two years, real disposable income decreased by 8.7% while retail sales of food and non-food products fell even more – by 13.9%.

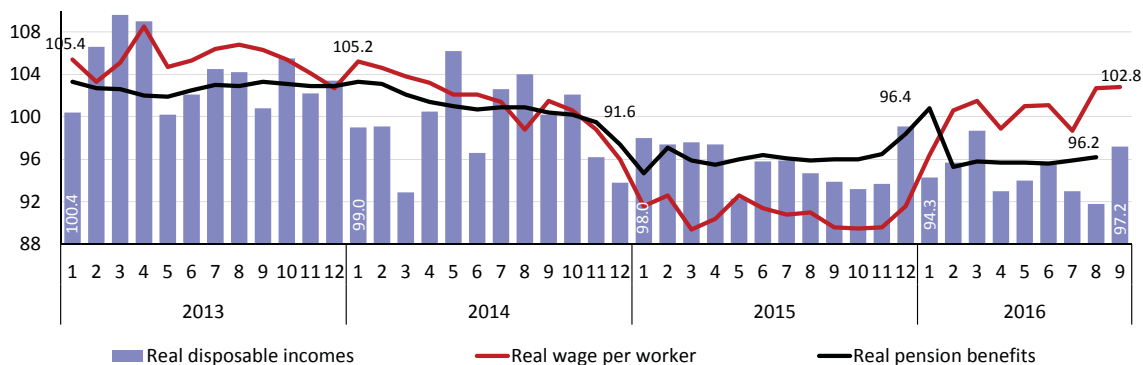
Poverty rate in Q2 2016 was 13.5%, which is slightly below the level of the Q2 2015 – 14.0%. Growth in consumer prices in January – September 2016 (4.1%) was the lowest for the entire period since 1991.

In September 2016, real disposable income went down by 2.8% compared to the same period of 2015, while real wage increased by 2.8%. Real pension benefits dropped in August 2016 by 3.8% compared to the same period of 2015 (Fig. 1).

There has been no such significant drop in real income in Q3 as in Q3 2016 (6.1% compared to the same period last year) since 1999. Even in times of crisis in 2009, the drop in real disposable income was slightly less significant than in the current year: then, real income in Q3 decreased by 3.3% compared to the same period of the preceding year.

The current situation is characterized by prolonged recession: revenues have been going down for two years in a row. Overall, from September 2014 to September 2016, real disposable income decreased by 8.7%

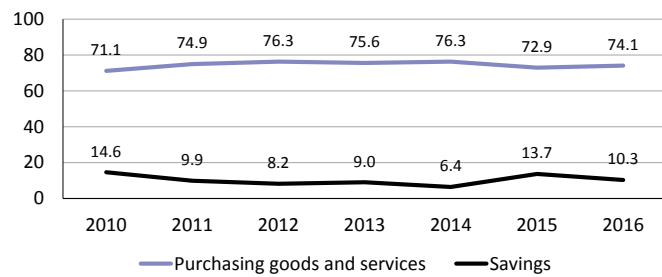
The volume of retail sales is an alternative indicator of population's welfare and purchasing power of income. From September 2014 on September 2016, the volume of retail sales of food products at constant prices decreased by 13.6%, the volume of retail sales of non-food products decreased by 14.2%. The total volume of food and non-food products sold to the population during one month (September) decreased by 13.9% over the past two years. As we can see, the decline in retail trade is more significant than that in the incomes of the population.



Sources: Rosstat, Information on Social and Economic Situation in Russia, January – September 2016; Rosstat, Short-Term Economic Indicators of the Russian Federation in August 2016.

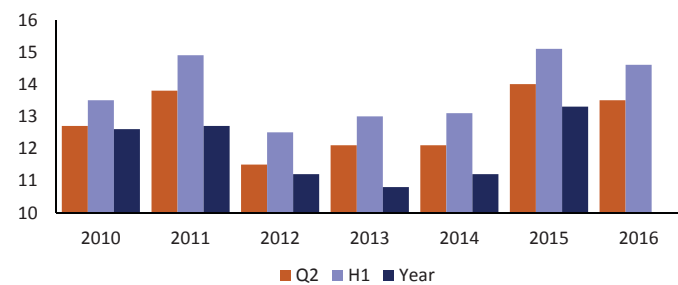
Fig. 1. Dynamics of real disposable income, real wage and real pension benefits in 2013–2016, % of the level of the same period of the previous year

Traditionally, people spend the main part of their income on purchasing goods and services. A year ago, in January – August 2015, the share of money spent on goods and services dropped, while the share of income going to savings increased. Now, a partial shift in the opposite direction is observed in income use structure. Comparing the first eight months of 2016 with the same period of the previous year, we see that the share of money spent on goods and services increased from 72.9 to 74.5% of the income, while the share of savings decreased from 13.7 to 10.3% (Fig. 2). At the same time, the proportion of income spent on goods and services remains below the level observed in the same period of 2011–2014, while the share of savings remains above that level.



Source: Rosstat, Social and Economic Situation in Russia, January – August 2016.

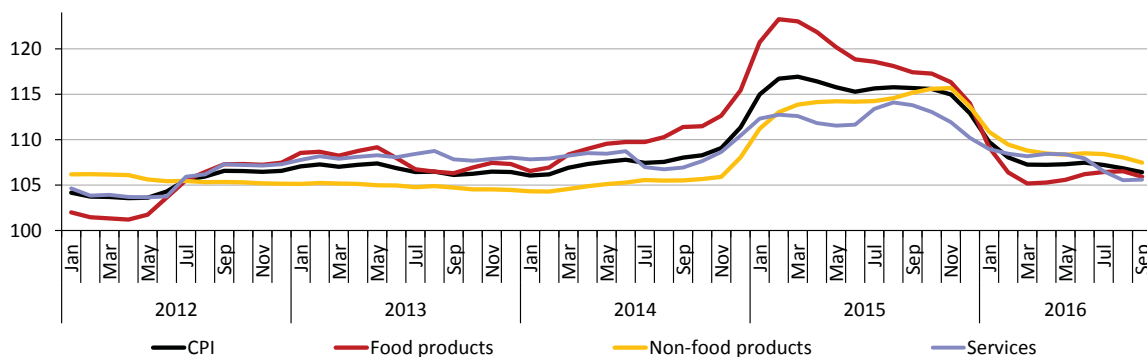
Fig. 2. The share of income used for purchasing goods and services and going to savings in January – August 2010–2016, % of income



Source: Rosstat. On the relation among money incomes of the population, the subsistence level, and the number of the poor in the Russian Federation in Q2 2016.

Fig. 3. Poverty rate, 2010–2016, %

Poverty rate, i.e. the proportion of population with income below the subsistence level, was 13.5% in Q2 2016 and 14.6% in H1 2016. As compared to Q2 2015 and H1 2015, the share of poor population went down, but at the same time, poverty rate remained above the level of the corresponding periods of 2012–2014 (Fig. 3). The reduction of poverty was caused by the lowering of subsistence level in Q2 2016 compared to the same period of 2015, which in turn was associated with a significant decrease in prices of potatoes (by 30.1% compared to the average price in Q2 2015), cabbage (by 28.5%), onions (by 26.4%), beets (by 18.1%) and carrots (by 22.2%) which are considered when calculating the subsistence minimum.



Source: Rosstat. Consumer price indices in the Russian Federation in 1991–2016. URL: http://www.gks.ru/free_doc/new_site/prices/potr/tab-potr1.htm (accessed 11.10.2016).

Fig. 4. Consumer price index (CPI), food price index, price indices for non-food products and services, % of the level of the same month of the previous year

According to Rosstat, in September 2016, consumer prices rose by 6.4% compared to September 2015. Prices of non-food products rose most – by 7.5%, prices of food products increased by 5.9% in annual terms, prices of services rose by 5.6% (*Fig. 4*).

Growth in consumer prices in January – September 2016 (4.1%) was the lowest not only in the 2000s, but also in the corresponding months during the entire period since 1991. Food inflation in the first 9 months of the current year (2.4%) was close to the lowest one in the 2000s, which was in January – September 2011 (2.1%). In the current year, the growth of prices for services was record low for the entire period of observations (4.9%). In the group of non-food products, the inflation rate in Q3 of the current year was 5.2%, being slightly higher than similar indicators of 2010–2013, but much lower than the ones of last year: the prices of non-food products in January – September 2015 increased by 11.2%.

According to the forecast of the Russian Central Bank, only moderate food inflation is expected in the second half of 2016, but at the end of the year, potato prices may rise.¹ This will create the prerequisites for the growth of the subsistence level, which in the conditions of falling real incomes will increase the risks of poverty rate growth. ●

1 The Central Bank of the Russian Federation. What Trends Say, July 2016.

3. BALANCE, ROUBLE, CAPITAL: RUSSIA'S BALANCE OF PAYMENTS IN JANUARY-SEPTEMBER 2016

A.Bozhechkova, P.Trunin, M.Khromov

Russia's BoP current account surplus was affected considerably by falling exports, whereas imports declined at a slower rate, as compared with the same period previous year. In January-September 2016, net capital outflow in the private sector is reported to be five times less than what it was during the same period previous year, as the rate of repayment of bank debts and liabilities slowed down, as a result of which the rouble appreciated in real terms in January-September 2016 to the level seen early in 2006.

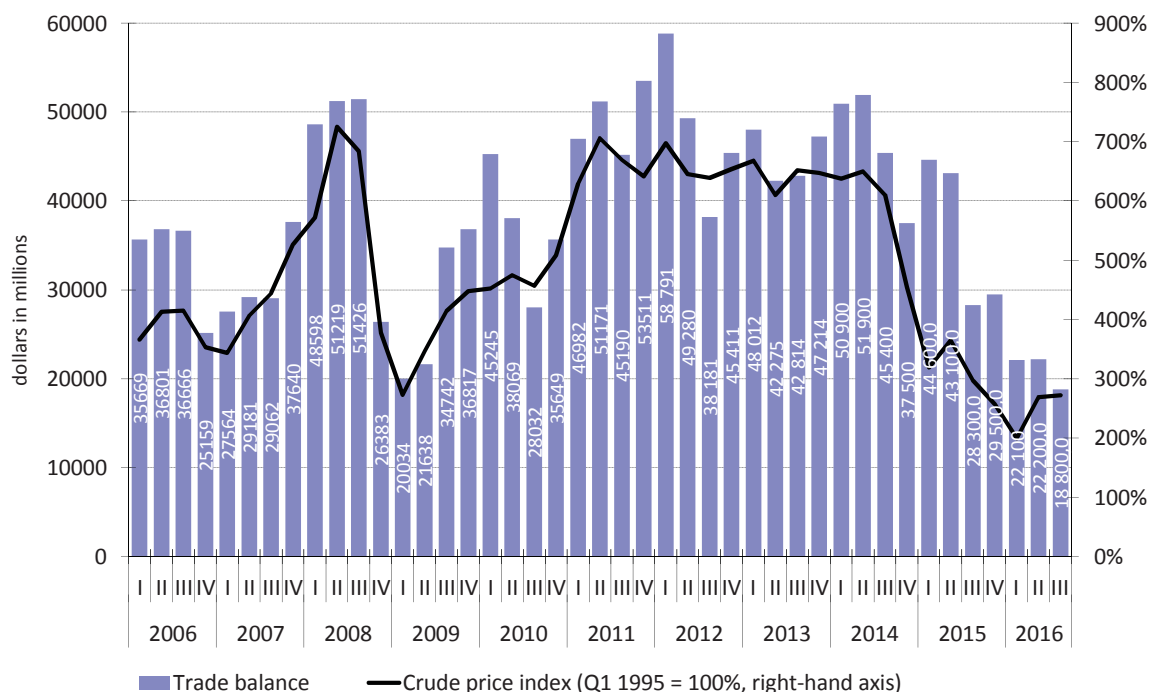
According to the Bank of Russia's preliminary assessment of the balance of payments (BoP) for January-September 2016, the current account balance stood positive at \$15.6bn, 71.3% (\$54.4bn) below the value seen January-September 2015. Such a considerable contraction resulted from a decline in the trade balance, as the decline in exports was faster than the contraction of imports of goods and services.

Balances

In January-September 2016, exports of goods contracted by 23.6% from what it was in the same period previous year (from \$260.4bn to \$199.0bn), including exports of crude oil (down 24.3% to \$52.7bn) and natural gas (down 31.6% to \$21.4bn), due to low global prices of energy-carrying resources. Indeed, in January-September 2016, the Brent crude was traded by an average of 24.5% below the price set in the same period previous year, while imports of goods dropped as little as 4.4% (from \$142.1bn to \$135.9bn) below the figure recorded in January-September 2015, which was driven by a stronger rouble (up 9.7% in real terms by December 2015) and slower decline in aggregate demand (in January-August 2016, decline rates of real wages slowed down to 0.4% against the fall of 8.7% in the same period of 2015), as a result of which a positive trade balance contracted by 46.6% (from \$118.2bn to \$63.1bn) (Fig. 1).

The decline (in absolute terms) in a negative service balance, compensation of employees balance and investment income balance prevented the current account balance from contracting further in January-September 2016. Indeed, a service balance deficit stood at \$18.2bn in January-September 2016, which is 39.3% (in absolute terms) below the value recorded in January-September 2015: imports of services dropped 19.4% to \$57.8bn largely because individuals continued to cut back on their international travel expenses, while exports of services fell 3.7% to \$36.6bn.

The compensation of employees balance increased (in absolute terms) 65.9% to \$4.1bn (\$1.4bn in January-September 2015). An investment income balance deficit was down 9.3% (from \$25.7bn to \$23.3bn) from the value recorded in the same period previous year due to lower costs of servicing foreign debts and liabilities that were reduced. Investment income receivable dropped 8.0% (from \$25.1bn to \$23.1bn) due to contraction of foreign asset holdings in the private sector. The income payable at non-



Sources: Bank of Russia, Gaidar Institute's own research.

Fig. 1. Russia Trade Balance and global oil price index in 2006–2016

financial enterprises decreased by 10.9% (\$38.4bn). The income receivable in the banking sector increased from \$7.1bn in January-September 2015 to \$8.1bn in January-September 2016, which resulted in an overall positive investment income balance of \$1.7bn (it was negative (\$0.9bn) in January-September 2015).

Capital outflow dynamics

The decline in a current account surplus was attended by a comparable contraction of the financial account deficit of \$6.6bn in January-September 2016 (against \$59.5bn in January-September 2015). The non-public sector saw net capital outflow amount to \$9.6bn in Q1-Q3 2016, including \$2.5bn in Q3. In absolute terms, the outflow in M9 2016 was found to be five times less than the outflow (\$48.1bn) seen in the same period of 2015, although net capital inflow amounted to \$3.4bn in Q3 2015, in contrast to 2016, when the balance of non-public sector capital operations with the rest of the world was found to be positive (\$0.9bn) in Q2 (Fig. 2).

The observed capital outflow dynamics can almost fully be explained by banking sector operations. The balance of Russian bank capital operations with the rest of the world increased \$41.3bn in Q1-Q3 2016 over the same period previous year, as a result of which the 2015 net outflow of \$37.7bn gave way to the inflow of \$3.6bn in 2016.

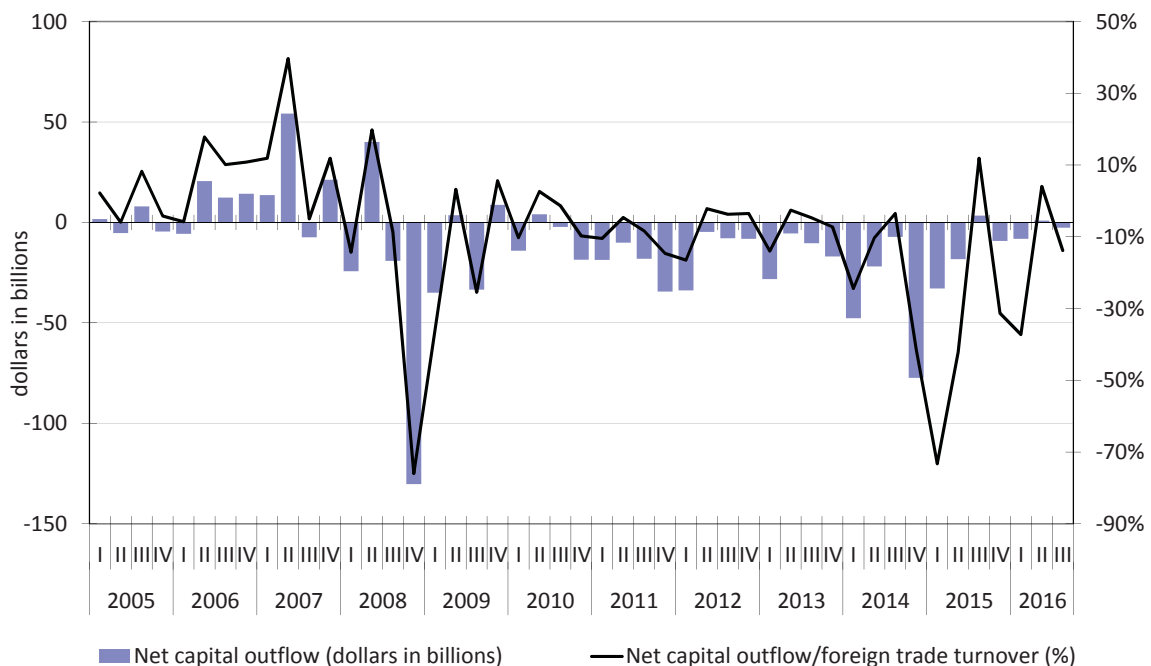
It is the slower rate of repayment of bank debts and liabilities that had the biggest effect on the dynamics of the balance of bank operations with the rest of the world. Bank debts and liabilities to non-residents were reduced by \$19.7bn in Q1-Q3 2016, whereas they decreased by \$50.6bn in the previous year. Bank payments due under the foreign debt repayment schedule were reduced insignificantly (from \$29.7bn in Q1-Q3 2015 to \$23.1bn in the same period of 2016). At the same time, no reduction whatsoever was seen in bank

debts and liabilities to non-residents (in Q1-Q3 2015, earlier (than scheduled) repayments contracted by \$20.9bn). Furthermore, reduction of bank foreign debts and liabilities in Q1-Q3 2016 was found to be less (by \$3.4bn) than scheduled, which is an indication of partial refinancing or new fundraising.

Besides slower reduction of foreign debts and liabilities, banks hastened to reduce their foreign asset holdings in Q1-Q3 2016. While they were reduced by \$12.9bn in Q1-Q3 2015, the reduction in the same period of 2016 was \$23.3bn. This dynamics can in part be explained by bank repayment of repos with the Bank of Russia. Bank foreign currency debts and liabilities to the central bank were reduced by \$12.3bn in M9 2016.

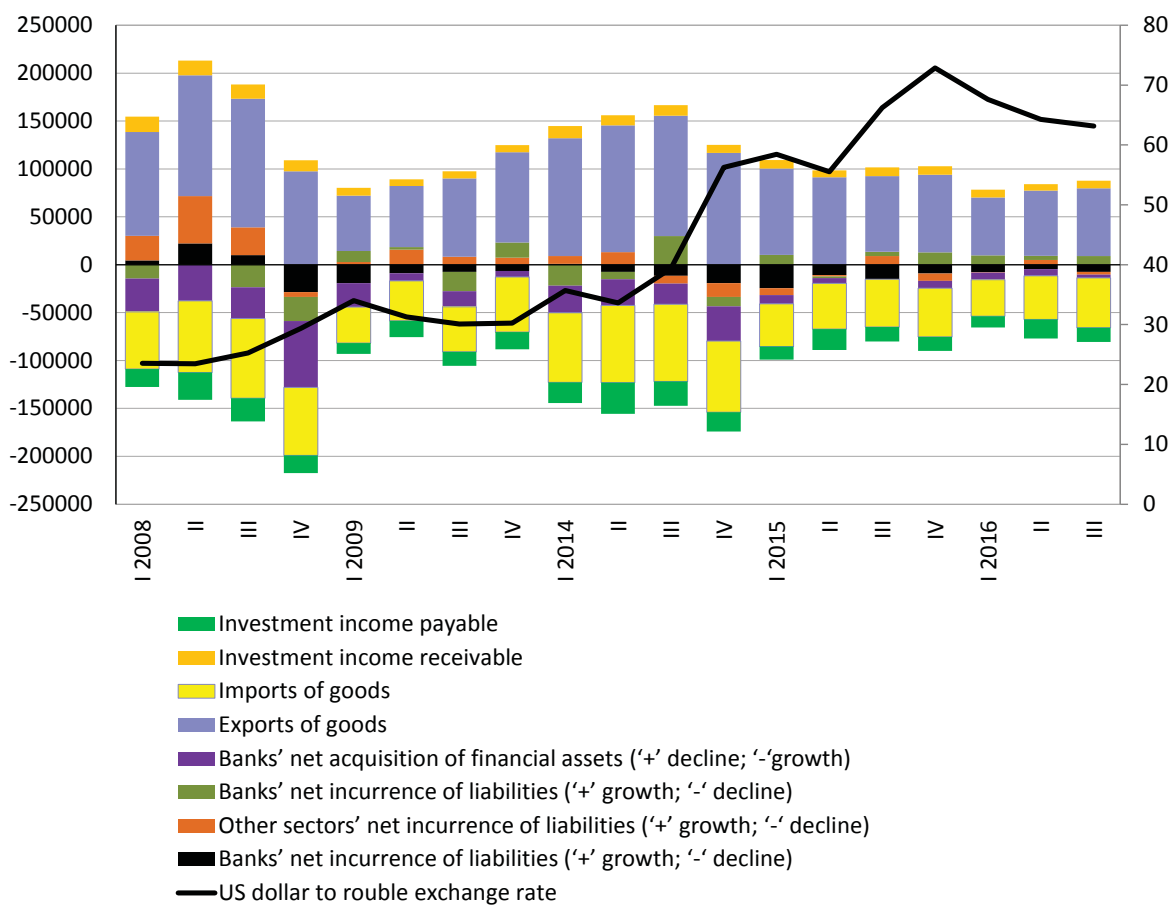
Net capital outflow from other sectors increased \$2.7bn in Q1-Q3 2016, as compared to the same period previous year. The increase (by \$6.6bn) in non-bank sector foreign debts and liabilities almost equals the level (\$6.0bn) recorded in the same period of 2015. At the same time, the inflow pattern of non-bank sector foreign debts and liabilities underwent some changes: direct investment inflow increased \$6bn (from \$2.3bn in Q1-Q3 2015 to \$8.3bn in Q1-Q3 2016) while other fundraising decreased by \$5.4bn: the inflow of \$3.7bn in Q1-Q3 2015 gave way to the outflow of \$1.7bn in the same period of 2016. The reduction in the inflow of other debts and liabilities was attended by the reduction of payments (from \$64.3bn in Q1-Q3 2015 to \$52.7bn in Q1-Q3 2016) due under the foreign debt repayment schedule. However, non-bank borrowers managed to obtain as little as \$51.1bn of new foreign loans in 2016, whereas they raised \$68.0bn a year earlier.

Note that the process of individuals investing in foreign currency cash stopped in foreign asset operations in other sectors. Our estimates show that in Q1-Q3 2016 the balance of foreign currency in cash held outside the Russian banking sector increased \$1.2bn, whereas it decreased by \$10.6bn in the same period of 2015.



Sources: Bank of Russia, Gaidar Institute's own research.

Figure 2. Net capital outflow in private sector



Source: Russia's central bank.

Figure 3. Key sources of foreign currency supply and demand

The BoP data show that international reserve assets increased \$10.1bn in January-September 2016 because the banking sector met outstanding foreign currency obligations to the central bank.

Thus, a positive trade balance in January-September 2016 contributed to a considerably smaller foreign currency inflow to the country, as compared to the same period previous year, because exports of goods were declining at a higher rate than imports. However, the downward pressure upon the rouble due to the decline in a positive trade balance in H1 2016 was offset by across-the-board cutbacks in capital outflow, especially in the banking sector (Fig. 3).

Rouble exchange rate

In January-September 2016, the US dollar to rouble nominal exchange rate decreased by 13.3% from 72.9 to 63.2 roubles per US dollar due to the above-noted trends in the dynamics of various components of the balance of payments and because prices of energy-carrying resources increased in Q2-Q3 from Q1 and capital outflow slowed down. As a reminder, the US dollar was traded at more than 80 roubles in the foreign exchange market in the second half of January 2016. In January-September 2016, with a stable inflation rate and a strengthening (in nominal terms) rouble, the rouble real effective exchange rate increased 9.6% from what it was in December 2015, reaching the level recorded earlier in 2006.

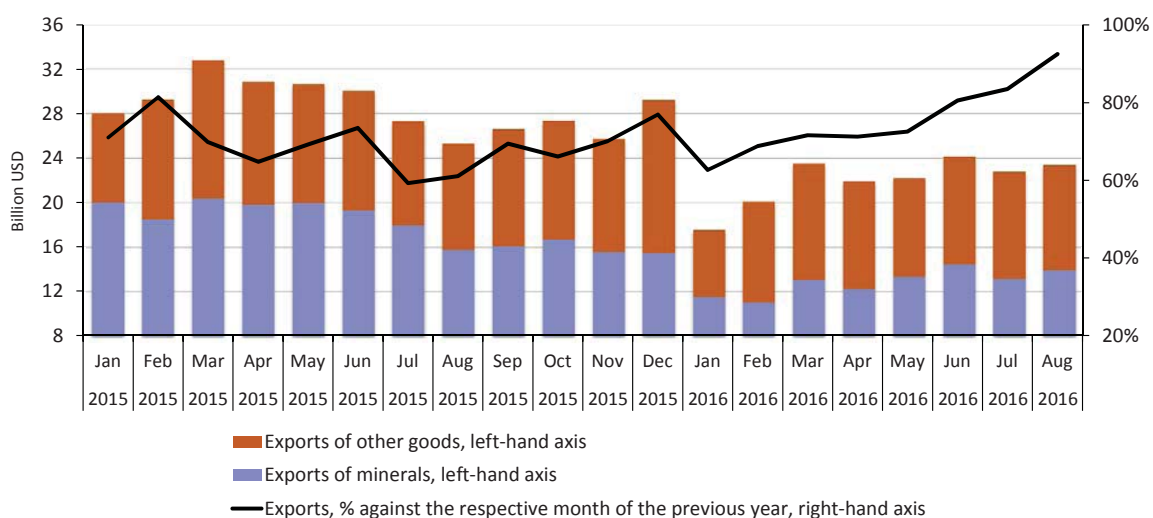
Despite the rouble appreciation in January-September 2016, there is high risk that the rouble will depreciate in the mid-term because crude prices may fall due to a disproportionality between supply and demand in the global market. This may be worsened by a slowdown in the China economic growth, as well as by a tighter Fed's monetary policy, thus making US assets relatively more attractive, which results in capital outflows from other developed and emerging markets, including Russia. ●

4. THE SPECIFICS OF RUSSIAN EXPORTS AND IMPORTS IN JANUARY-AUGUST 2016

A.Knobel, A.Firanchuk

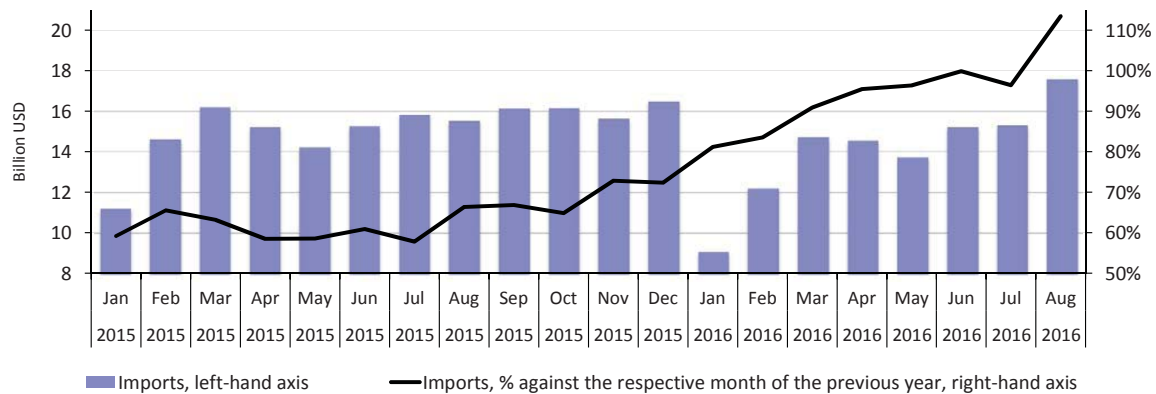
Unlike imports whose dynamics showed signs of stability (103.2% in June-August against the respective indicators of 2015), exports kept on falling (85.2% in June-August against the respective indicators of 2015). The dynamics of exports in summer 2016 could be explained by a number of factors: as regards primary products, it was depreciation of global prices (against summer 2015) with fairly stable output volumes and export supplies; as regards medium-processed goods, it is depreciation of global prices against 2015 which depreciation was partially made up by growth in physical volumes of exports; as regards machinery and equipment, it was closure of some sales markets (in particular, further shrinking of the Ukrainian market for Russian suppliers) and dramatic reduction of demand on the part of CIS countries (Kazakhstan, Azerbaijan and Belarus).

In January-August 2016, exports kept on falling as compared to the respective period of 2015 (Fig. 1). In the first 8 months of 2016, exports in monetary terms fell to \$176,0bn (75.0% and 51.3% against the levels of January-August 2015 and January-August 2014, respectively). The main contribution to the negative dynamics of exports was made by fuel which accounted for about 80% of the total reduction of exports in monetary terms (\$48.8bn out of \$58.5bn). However, reduction of monetary volumes took place not only under the influence of exports of energy commodities, but also those of medium and highly-processed non-primary goods: exports of goods which are not attributed to mineral fuel (code: 27 under FTNG (foreign trade nomenclature of goods)) fell to \$72.7bn (88.2% and 74.2% against the levels of January-August 2015 and January-August 2014, respectively).



Source: own calculations on the basis of the data of the Federal Customs Service of the Russian Federation

Fig. 1. Dynamics of Russian exports in 2015–2016



Source: the authors' calculations on the basis of the data of the Federal Customs Service of the RF.

Fig. 2. Dynamics of Russian imports in 2015–2016

Imports Demonstrate Signs of Stability

In the first 8 months of 2016, imports in monetary terms amounted to \$112.5bn which is somewhat lower than in 2015 (95.2% and 58.2% of the levels of January-August 2015 and January-August 2014, respectively). In summer months (May-August 2016) imports stabilized, having amounted to 103.2% on the 2015 index (Fig. 2).

Export Potential Failed to Be Realized

According to the data of the Central Bank of Russia, in January-August 2016, the exchange rate of the RUR against the USD (and euro) in nominal terms fell by 15.4% as compared to January-August 2015; in the same period of 2016 the index of nominal effective exchange rate of the ruble against foreign currencies decreased by 10.5% as compared to the same period of 2015 and the index of real effective exchange rate of the ruble went down by 5.8%¹. Despite export growth capabilities at the expense of higher competitiveness achieved due to depreciation of the national currency, in January-August exports decreased which can largely be explained by a drop in global prices not only on minerals, but also the main medium-processed commodities of the Russian exports (*Table Changes in prices and volumes of main export goods supplies*).

Generally, in January-August 2015 Russian export indicators were virtually the same as those of January-May 2016² except for some differences in summer months.

In June-August 2016, fuel export volumes kept on falling (FTNG code: 27) to \$41.7bn (78.5% and 46.5% of the levels of June-August 2015 and June-August 2014, respectively). However, in June-August non-fuel export stabilized, having amounted to \$28.8bn (97.2% and 74.2% of the levels of June-August 2015 and June-August 2014, respectively), which factor is mainly related to the beginning of T-90 tanks supplies to Algeria.

In commodity terms, exports (in USD) fell in six out of ten enlarged analytical commodity groups singled out by the Federal Customs Service of the RF (Table 2) with a drop being substantial in the “mineral products” and “chemical industry products” commodity groups (21% and 22%, respectively).

¹ The Central Bank of Russia: The main derived indices of the ruble exchange rate dynamics in 2016.

² For more details, refer to A. Knobel and A. Firanchuk. Factors Behind a Drop in Russian Exports in January-May 2016. Russian Economic Developments. 2016, No.8. pp. 15–21.

Table 1

CHANGES IN PRICES AND VOLUMES OF MAIN EXPORT GOODS SUPPLIES

FTNG Code	Position name	Price		Change in price %	Change in physical volumes, %	Change in monetary volumes, %	Share in exports as of 01.07.2016, %
		January-August 2015	January-August 2016				
Food products:							
1001	Wheat and meslin, USD per ton	201	169	-16	44	21	1.34
Fuel:							
2701	Fossil coal USD per ton	66	51	-23	11	-14	3.1
2709	Crude oil, USD per ton	394	271	-31	6	-27	26.0
2710	Petrochemicals, USD per ton	420	275	-35	-11	-42	16.2
2711110000	Condensed natural gas, USD per cubic m	258	141	-45	22	-34	1.2
2711210000	Natural gas, USD per thousand cubic m	240	156	-35	5	-32	10.9
Chemical products:							
3102	Mineral and azotic fertilizers, USD per ton	241	178	-26	21	-10	0.85
3104	Mineral potassium fertilizers, USD per ton	268	212	-21	-29	-44	0.71
3105	Mixed mineral fertilizers, USD per ton	368	298	-19	4	-16	1.05
2814100000	Anhydrous ammonia, USD per ton	394	255	-35	-1	-36	0.33
4002	Synthetic rubber, USD per ton	1493	1265	-15	2	-14	0.47
Timber and timber articles:							
4403	Rough timber, USD/cubic meter	72	68	-6	10	3	0.51
4407	Sawn timber, USD per ton	222	194	-13	15	0	1.19
4412	Glued wood, USD per cubic m	467	376	-20	13	-9	0.36
4702-4704	Wood pulp, USD per ton	530	467	-12	3	-9	0.37
4801	Newsprint paper, USD per ton	409	396	-3	-5	-7	0.16
Metals and metal articles:							
72	Ferrous metals, USD per ton	385	311	-19	3	-17	5.0
72 (кроме 7201-7204)	Ferrous metals (except for cast iron, ferro-alloys, waste products and scrap), USD per ton	411	332	-19	4	-16	3.6
7201	Cast iron, USD per ton	291	214	-26	4	-24	0.41
7202	Ferro-alloys, USD per ton	1740	1573	-10	4	-6	0.44
7207	Carbon steel semi-products, USD per ton	344	279	-19	4	-16	1.5
7208-7212	Carbon steel flat rolled products, USD per ton	439	348	-21	6	-16	1.2
7403	Refined copper, USD per ton	5820	4629	-20	-1	-22	0.89
7502	Rough nickel, USD per ton	13135	8792	-33	9	-27	0.66
7601	Rough aluminum, USD per ton	1923	1415	-26	1	-25	1.9
Machinery, equipment and transport means:							
840130	Unexposed heat-producing elements (fuel elements), thousand USD per unit	601	511	-15	-9	-23	0.35
8411123009	Gas-driven turbines with thrust of over 44 kN and maximum 132 kN, USD per unit	4373	3522	-19	7	-14	0.36
8450111100	Household washing machines, USD per unit	181	163	-10	109	89	0.06
85287240	LC TV sets, USD per unit	334	282	-16	-8	-23	0.04
860692	Open railway cars, USD per unit	7571	7243	-4	-46	-49	0.11
8703231910	Cars with engine cylinder work volume of over 1500 cm ³ , but maximum 1800 cm ³ , USD per unit.	30200	32127	6	-18	-13	0.05
8704229108	Other trucks with full weight of 5-20 tons, USD per unit.	601	511	-15	-9	-23	0.35

Source: The authors' calculations on the basis of the data of the Federal Customs Service of the RF.

Table 2

RUSSIAN EXPORTS IN JUNE-AUGUST 2016 BY A COMMODITY GROUP

FTNG code	Name	06-08 2015	06-08 2016	Growth	Growth rates, %
		Million USD			
01-24	Food products and agricultural primary products (except for textile)	3648	3680	31	+0.9
25-27	Mineral products	53952	42548	-11404	-21.1
27	Fuel and energy products	53071	41770	-11301	-21.3
28-40	Chemical industry products, rubber	6272	4917	-1356	-21.6
41-43	Rawstock, furs and articles made thereof	55	53	-2	-3.9
44-49	Timber and pulp and paper products	2477	2443	-34	-1.4
50-67	Textile and textile articles and footwear	231	239	8	+3.6
71	Precious stones, precious metals and articles made thereof	1788	1706	-82	-4.6
72-83	Metals and metal articles	7897	7801	-96	-1.2
84-90	Machinery, equipment and transport means, including:	5274	5909	635	+12.0
84	Reactors, equipment and mechanical appliances	2 023	1 823	-200	-9.9
85	Electrical machines and equipment	765	855	90	+11.8
86	Railway transport	151	118	-33	-21.9
87	Land transport means	668	1156	488	+73.1
89	Vessels, boats and self-floating structures	472	401	-71	-15.0
90	Optical instruments and device	329	381	53	+16.0
68-70, 91-97	Other goods	1047	1115	69	+6.6
	Total exports	82641	70412	-12230	-14.8

Source: calculations on the basis of the data of the Federal Customs Service of the RF

Factors Which Can Explain Export Dynamics for Various Commodity Groups

Fuel Material. A drop in exports of *fuel* commodities (21%) is caused by a 18%-40% depreciation of prices as compared to June-August 2015. According to the data of the Federal Customs Service of the RF, physical volumes did not change much: crude oil supplies rose by 9%, petrochemicals supplies fell by 7%, while coal and natural (piped) gas supplies increased by 24% and 0.5%, respectively.

Food Products and Agricultural Primary Products. Substantial growth in physical volumes of grain (wheat and meslin) supplies which was registered in January-May 2016 came to a halt. In June-August, exports physical volumes exceeded by the mere 5% the respective indices of 2015 which factor failed to compensate a 11% depreciation of prices on those products in summer 2016 as compared to summer 2015. Generally, as regards this commodity group exports in monetary terms were stable (growth of 0.9%).

The main factors behind negative dynamics of exports of *chemical produce* (a 22% drop) were depreciation of export prices on mineral fertilizers (24%-30%) and petrochemicals and gas-derived chemicals (hydrogen nitride (32%) and synthetic rubber (10%)).

Despite continued depreciation of prices on *timber and paper products* (except for newsprint paper pieces which rose by 4%), growth in physical volumes of exports by a number of positions permitted to increase monetary volumes. Generally, exports of the industry in question fell insignificantly (1.4%).

The main factor behind a substantial drop in monetary volumes of exported *metals* (4.6%) was depreciation of export prices. Physical volumes of ex-

ports rose virtually by all the positions, except for cast iron (a drop of 2%). Depreciation of export prices on metals (as compared to June-August 2015) was as follows: ferrous metals (5%), aluminum (13%), copper (17%) and nickel (22%). As before, expansion of exports is hindered by a broad supply – underpinned by the state – of various inexpensive and quality steel products from China. In addition to the above, demand on some markets (for example Kazakhstan and Belarus) which are vital to Russia is at the lower level than in 2015.

Generally, depreciation of monetary volumes of exports as regards energy commodities and medium-processed goods (chemical industry produce, timber, rawstock, base metals and articles made thereof) can be explained by worsening of pricing for Russian exporters. It is to be noted that for all the above categories of goods, except for fuel and chemical industry produce a drop in export monetary volumes in June-August 2016 (as compared to June-August 2015) was fairly moderate (up to 5%).

Considerable growth of 12% in export monetary volumes of enlarged commodity positions was registered only as regards machinery, equipment and transport means (FTNG codes: 84-90) mainly due to a 73% increase in exports of land transport means, including the above-mentioned tanks. It is to be noted that exports of the above category of goods to far abroad countries rose by 27% with a drop of 16% in exports to CIS countries.

In the **Reactors, Equipment and Mechanical Device** commodity group (FTNG code: 84), the highest absolute drop was registered in the Turbojet and Turboprop Engines and Gas-Driven Turbines subgroup (8411) (a decrease of \$124m), while the highest absolute growth, in the Household Washing Machines commodity group (8450) (growth of \$31m) and the Nuclear Reactors and Fuel Elements commodity group (8401) (growth of \$30m).

The largest growth (in absolute terms) was observed in supplies to the Czech Republic and Bulgaria (\$44m and \$35m, respectively), while there was a drop in supplies to China (a decrease of \$102m or 34%), Kazakhstan (\$89m or 27%) and Belarus (\$65m or 36%).

In the **Electrical Machines and Equipment and Their Parts** commodity group (FTNG code: 85), the largest absolute drop of \$23m was observed with the Insulated Wires group (code: 8544), while growth, with the Radio-Locating and Radio-Navigation Equipment group (an increase of \$100m) and Telephone Sets group (code: 8517) (\$25m). The largest growth was registered in supplies to Iran (an increase of \$63m) and Algeria (\$23m), while there was drop in supplies to Kazakhstan (a decrease of \$22m or 13%).

In the **Railway Transport** commodity group (FTNG code: 86), almost the entire drop was related to a decrease in exports of commodities of the Railway and Tram Cars and Non-Self-Propelled Cargo Cars group (code: 8606) (a drop of \$40m or 48%). The largest drop (in absolute terms) was registered in supplies to CIS countries: Azerbaijan (a decrease of \$38m or 93%), Kazakhstan (\$31m or 62%) and Belarus (\$10m or 58%), while supplies to Cuba and Serbia rose a great deal (\$23m and \$22m, respectively).

In the **Land Transport Means** group (with military equipment not taken into account) (FTNG code: 87), the largest absolute drop was observed with the Motor Transport Vehicles for Cargo Transportation group (code: 8704) (a decrease of \$38m or 36%), the Industrial Purpose Transport Means group (code: 8709) (\$27m or 99%), the Tractors group (code: 8701) (\$27m or 70%) and the Cars group (code: 8703) (\$16m or 6%), while the highest growth,

with the Special Purpose Motor Transport Means (code: 8705) (\$55m or 2.3 times).

Aggregate growth in exports of commodities of the **Land Transport Means** group (code: 87) (with military equipment taken into account) was feasible due to the start of supplies of Russian military equipment, primarily, T-90 tanks¹ to Algeria. For three months, the aggregate exports of group 87 to that country amounted to \$533m (against \$5m in June-July 2015) or 46% of the entire exports of group 87. It is to be noted that there was a dramatic drop in export supplies of group 87 to Kazakhstan (\$152m or 60%) and Azerbaijan (\$62m or 85%).

In the **Vessels, Boats and Self-Floating Structures** group (code: 89), individual contracts on export supplies of vessels play an important role, particularly, supplies to Japan (\$119m), China (\$77m), the US (\$57m) and Sweden (\$38m).

Trade Partners from Near Abroad Countries

In January-July 2016, Ukraine's imports of Russian goods amounted to the mere 59.8% of the level of January-July 2015, while Ukraine's total imports amounted to 96.0% of the respective index a year before which factor was behind a drop in Russia's share in Ukraine's total imports to 12.6%².

In January-July 2016, the share of Russia in Kazakhstan's imports did not virtually change, having amounted to 34.8% against 34.3% a year before with the total drop of 28.8% in Kazakh imports, including a 28.0% drop in imports from Russia.³ In January-July 2016, imports of Russian goods to Belarus fell insignificantly to 85.5% as compared to the level of January-July 2015 and that is in line with a general decrease in Belarus imports (to 85.6% against the level of January-July 2015). The share of Russia remained at the level of 57.0%⁴.

1 <http://www.interfax.ru/world/519117> The mass media reported shipment of 67 out of 200 T-90CA tanks to Algeria.

2 On the basis of the data of Ukraine's State Statistical Service ukrstat.gov.ua

3 On the basis of the data of Kazakhstan's Committee on Statistics stat.gov.kz

4 On the basis of the data of the National Statistical Board of Belarus belstat.gov.by

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