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FOR AGENDA

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Supplement 1

CONFIDENTIAL

December 29, 1992

To: Members of the Executive Board

From: The Acting Secretary

Subject: Russian Federation - Recent Developments

The attached paper on recent developments in the Russian Federation provides supplementary information to the staff report on the review of developments under the stand-by arrangement with the Russian Federation, which was circulated as EBS/92/198 (12/1/92).

Mr. Wolf (ext. 37413), Mr. Berengaut (ext. 38773), or Ms. Christensen (ext. 38397) is available to answer technical or factual questions relating to this paper prior to the Board discussion, which is now tentatively scheduled for discussion on Monday, January 11, 1993.

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INTERNATIONAL MONETARY FUND

Russian Federation - Recent Developments

Prepared by the European II and the Policy Development and Review Departments

Approved by John Odling-Smee and Jack Boorman

December 28, 1992

1. Introduction

Following preparation of a staff report reviewing developments under the first credit tranche arrangement with Russia 1/, a staff team visited Moscow during December 1-10 with a view to updating information on recent economic developments. 2/ Monetary data beyond end-August are still not officially available to Fund staff, and information on external disbursements remains incomplete; as a result, the staff has not been able to evaluate Russia's performance relative to the end-September indicative targets under the arrangement, except as regards external arrears. Access to recent information on the fiscal accounts has also been limited. It is nevertheless clear that due to significantly looser fiscal and monetary policies than envisaged in the arrangement, the objective of reducing inflationary pressures has not been achieved. The goal of accelerating structural change in the second half of 1992 has been, however, broadly realized, particularly in the area of privatization.

After Mr. Chernomyrdin's appointment as Prime Minister at the close of the Congress of People's Deputies, a new cabinet was announced on December 23, 1992. Mr. Shumeiko remained as First Deputy Prime Minister, with responsibility for immediate management of the economy. In the economic sphere the following Deputy Prime Ministers were retained: Mr. Shokhin (international monetary institutions), Mr. Chubais (privatization) and Mr. Khizha (industrial policy). Mr. Fedorov, Russian Executive Director at the World Bank, was named Deputy Prime Minister in charge of monitoring economic and financial issues. Mr. Aven was replaced by his deputy, Mr. Glaziev, as Minister of Foreign Economic Relations. The

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1/ EBS/92/198, December 1, 1992.

2/ The mission consisted of Mr. Hernandez-Cata (EUR II), Ms. Christensen (PDR), Messrs. Berengaut, Koen, Ross and Aitken (EP) and Ms. Kaminska (all EUR II), Mr. Hagemann (FAD) and Ms. Strayer (EUR II) as administrative assistant. Mr. Lopez-Claros of the Moscow office participated in many of the discussions.

Ministry of Industry was abolished. Mr. Gaidar, former Acting Chairman of the Government, has been named as economic adviser to President Yeltsin.

2. Real sector developments

Net material product declined by 20 percent in the first 11 months of 1992 relative to the corresponding period in 1991. Crude oil production was 15 percent below comparable 1991 levels, while natural gas output remained broadly unchanged. Consumer price inflation rose from 9 percent in August to 15 percent in September and 31 percent in October, but slowed slightly in November to 26 percent. Official estimates show a tripling of the average domestic crude oil price from rub 2,000 per ton prior to the late September quasi-deregulation of oil prices to rub 6,000 per ton by end-October; there are indications that this price had been permitted to rise to some rub 8,000 per ton by end-November.

Real wages increased in September but declined in October to the level they had reached in June-August. The average nominal monthly wage was estimated at rub 8,853 in October, and the average industrial wage at rub 10,371. The stock of wage arrears (data are available for industry, construction and agriculture only) declined from rub 65 billion at mid-year to rub 21.5 billion by end September, but began to rise anew in October, reaching rub 30 billion by end-month. While the main underlying cause of the wage arrears through July was the cash shortage, the principal constraining factor since then would appear to have been the lack of financial resources of certain enterprises. By November 1, the number of registered job seekers had approached 1 million (or 1.4 percent of the labor force), while the number of registered unemployed had risen since the beginning of October by 75,000 to 442,400 (0.6 percent of the labor force), of which some 60 percent received unemployment benefits. The number of registered vacancies continued to decline in October, by 25,000, to 315,900.

3. Budgetary developments

Only partial information is available with respect to budgetary developments in the fourth quarter. The buoyancy of revenue recorded in September continued into the fourth quarter. In particular, another rub 557 billion in value-added taxes were collected during October and the first half of November, bringing the total for the first 10 1/2 months of the year to some rub 1.3 trillion or 13 percent of estimated GDP. Combined with a similar yield from profit taxes, rub 133 billion from excise taxes, and rub 292 billion from personal income taxes during this same 10 1/2 month period, slightly over rub 3 trillion in tax receipts had been collected from these four taxes by mid-November.

Part of the improvement in revenues can be traced to the loosening of bank credit to enterprises; this has been clearly the case with the CBR financing of interenterprise arrears, part of which were used to pay arrears to the budget (see section 4). Moreover, the Government changed the VAT accounting rules in midyear, retroactive to January 1, 1992, which resulted in a one-time jump in VAT revenues. 1/ Furthermore, the enterprise sector has been paying profit taxes at an average effective rate higher than the statutory rate of 32 percent, due to the limits on labor cost deductibility which are set as a multiple of the minimum wage. Because the minimum wage had not been changed since May, while actual wages had surged, profit tax payments on this account were estimated to have amounted to 2 1/2 to 3 percentage points of GDP in January-September 1992. It is likely, however, that the ability of the enterprise sector to meet these tax liabilities has been facilitated by the ready availability of bank credit.

While no recent data on expenditures of the federal budget are available, there have been indications of restraint, with spending being broadly limited to revenue collections. Since late summer the Government has reviewed all expenditures, cutting and/or postponing nonessential outlays (chiefly for investment, but also for operations and maintenance, and, to a lesser extent, for enterprise subsidies); it is unclear, however, whether budgetary arrears rose during the same period. The Supreme Soviet recently approved an additional rub 300 billion of CBR-financed credit (to be disbursed through the budget) to improve the working capital position of enterprises.

Explicit financial transfers to state enterprises are estimated to have amounted to some 35 percent of GDP during the first nine months of 1992. These include direct budgetary transfers (including import subsidies amounting to over 15 percent of GDP); budgetary credits for improving the working capital position of enterprises which are to be replaced by tax credits when repaid; and directed CBR lending largely on subsidized terms, amounting to around 10 percent of GDP. Much of the credit supported by the CBR is also unlikely to be repaid. More than half of directed credit has been to agriculture, with the remainder shared between the Northern Territories, the fuel and energy sector, and industry, the latter accounting for a low share of such diverted credit relative to its share in total output. Implicit subsidies (and taxes) associated with continued price distortions (particularly for energy, but also for foodstuffs and other basic consumer goods) also remain significant. 2/

A new version of the draft 1993 state budget has been submitted by the Government to the Supreme Soviet. This budget envisages a domestic financing requirement of around 5 percent of GDP. The Fund staff considers that with appropriate adjustments and in the absence of new revenue measures, that the domestic financing requirement of the state budget would more likely be in the neighborhood of 10 percent of GDP. The staff has not had ample opportunity to discuss the draft 1993 budget with the authorities.

1/ The change involved disallowing credits for VAT on inputs unless actually used in production (as opposed to all purchased inputs).

2/ These were among the findings of parallel Fund and Bank missions to Moscow during November 16-30. The Fund mission consisted of Messrs. Lorie, Marrese, Ross and Mendonca (all EUR II).

4. Money and credit

Partial information available to the staff points to rapid growth of credit and monetary aggregates in September and October 1992, albeit at a somewhat slower rate than in July and August. The slower growth of net domestic credit in recent months appears to have reflected a fall in net credit to government and a decline in the rate of growth of lending to enterprises. The fall in net credit to government reflects the prior using up by the federal government of its credit lines from the CBR (approved by the Supreme Soviet), together with a continuing build-up of deposits by local governments and extrabudgetary funds.

Total bank lending to enterprises continued to grow rapidly in September and October, 1992, largely in the form of mainly earmarked lending supported by the Central Bank of Russia (CBR) of about rub 390 billion, and credit extended in connection with the unblocking of balances arising from netting of interenterprise arrears. As a result of these developments, broad money continued to grow rapidly in September and October.

Regarding interenterprise arrears, on November 23, 1992 the CBR informed its branches that a cut-off date of November 25, 1992 had been established for the netting process and branches were instructed to report the final balances to the CBR as of that date. These reports were to be submitted to CBR headquarters by the second week of December; at that time the CBR was still collecting and verifying this information. When this process is completed, the final amount of net creditor and debtor positions, estimated at rub 450-500 billion, will be known more precisely. In addition to the rub 370 billion of creditor balances that were unblocked in October to pay arrears to the budget, to banks, and to enterprises in other states of the FSU, the remaining amount of already identified creditor balances in blocked accounts, some rub 80 billion, was unblocked in November.

The CBR finance rate and overdraft (penalty) interest rates have remained unchanged since late-May, at 80 percent and 160 percent per annum respectively. However, the CBR finance rate effectively applied to only 25-30 percent of the stock of CBR lending to banks as of November 1, 1992. Other CBR credits had been on-lent by commercial banks to enterprises at well below the CBR finance rate, so that the effective average lending rate of the CBR is well below 80 percent. Commercial bank interest rates on deposits and loans have generally followed a rising trend, though the entire structure of interest rates has remained sharply negative in real terms (Table 2). Average lending rates increased from about 65-90 percent in June to around 95-120 percent in November. Interbank loan rates followed a similar trend, rising during this period from around 80 to 110 percent. The average deposit rate offered by banks rose from 57 percent in June to 75 percent in November.

5. External sector 1/

The trade figures reported by the Goskomstat of the Russian Federation have been revised, partly to take into account oil exports on account of joint ventures and other private enterprises, which had hitherto been excluded from the statistics. On this basis, exports during the first three quarters of 1992 are now reported at US$26.9 billion and imports at US$25.7 billion, leaving a trade surplus of US$1.2 billion. 2/ Services are estimated to have recorded a deficit of US$5.3 billion, including interest payments of US$3.7 billion (assuming Russia is responsible for 100 percent of the external debt of the former U.S.S.R.). The current account deficit, including gold exports of US$0.9 billion, is estimated at US$3.2 billion (Table 3).

Disbursements of external credits through the Vneshekonombank amounted to US$9.3 billion during the first three quarters of 1992, while grants totalled an estimated US$1.2 billion. There was a sharp deceleration in disbursements of loans during the third quarter (to US$0.9 billion) compared to the first half of 1992 (US$8.4 billion), however, as credits committed to the former U.S.S.R. were used up and the depreciation of the exchange rate, combined with reduced rates of subsidization for imports, dampened the demand for such credits. Capital outflows through commercial banks amounted to about US$4 billion in the first three quarters, as Russian enterprises built up their foreign exchange deposits with domestic banks which, in turn, redeposited the funds abroad. An outflow of US$6.3 billion was recorded under errors and omissions during this period.

Scheduled debt service obligations on the entire debt of the ex-U.S.S.R., including on short-term maturities, amounted to US$11.7 billion (43 percent of merchandise exports) in the first nine months of 1992; debt service payments were US$1.2 billion (4 percent of exports). On the basis of a 100 percent share of debt service, Russia accumulated arrears in the first nine months of US$5.3 billion, reaching a level of US$10 billion by end- September. (On the basis of a 61 percent share, as assumed for purposes of the first credit tranche arrangement, the stock of arrears attributable to Russia on September 30, 1992 totalled US$6.1 billion, compared to an indicative target of US$2.675 billion.) Deferrals of

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1/ Balance of payments and debt data refer only to relations with countries other than FSU states. Data on transactions with the states of the former FSU remain sketchy. Indications are that so far in 1992 the volume of intra-FSU trade fell by some 20-30 percent compared with 1991. In the fourth quarter of 1992, Russia's exports of crude oil to the other states of the FSU were priced on average at rub 12,000-15,000 per ton, with individual contracts reaching rub 20,000 per ton.

2/ For the first ten months, the trade balance widened to US$1.5 billion, on exports of US$30.0 billion and imports of US$28.5 billion.

principal due on medium- and long-term debt contracted before the cut-off-date amounted to US$5.3 billion. 1/

Gross official foreign exchange reserves amounted to US$0.4 billion at the end of September 1992, of which US$0.3 billion belonged to the Central Bank of Russia and US$0.1 billion to the Government. Gold holdings were recorded at 240 tons, equivalent to US$2.3 billion (at $300 per ounce), or 50 tons less than at the beginning of the year. A second purchase under the first credit tranche arrangement in an amount equivalent to SDR 479 million was effected on December 18, 1992, bringing total purchases to the full amount agreed under the arrangement.

Following a steep depreciation of the ruble from rub 135 per U.S. dollar immediately following unification of the exchange system in early July, to rub 450 per U.S. dollar in late November, the ruble has tended to appreciate on the Moscow Interbank Foreign Currency Exchange, rising to rub 415 per U.S. dollar on December 22 (Table 4). 2/ On November 4, a regulation was issued--reversing the provisions of a regulation of August 6, 1992--which denied access of residents of other FSU states to the Moscow interbank foreign exchange market. A presidential decree of November 6 provided that effective January 1, 1993, exports to both the states of the FSU and all other countries would be subject to the same regulations regarding export licenses and export quotas. Export quotas would apply inter alia to energy products, non-ferrous metals, ores and concentrates of several metals, cellulose, timber, wood fiber, synthetic rubber and mineral fertilizers. As of early December, there still had not been established, as envisaged under the program, a mechanism for monitoring external commitments and disbursements. The draft 1993 budget (see section 3) continues to provide for a scheme of "centralized exports," under which some US$5 billion of exports in 1993 would be purchased by the Government from domestic producers for resale abroad. 3/

6. Systemic changes

The privatization program for medium and large enterprises is now underway. By December 1, 1992, about one half of the total number of privatization vouchers had been distributed to the population. Also in early December, shares in state enterprises began to be sold at public

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1/ This includes obligations on debt owed to official creditors and commercial banks, which have agreed to the deferral, as well as to suppliers, which have not granted deferral yet on comparable terms. It is believed that in fact most of the debt originally owed to suppliers has been taken over by commercial banks and therefore also has been deferred.

2/ On November 30, 1992, the CBR announced that it would continue to calculate on a monthly basis the official exchange rate of the Gosbank of the former U.S.S.R. for the purpose of valuation of external claims of the former U.S.S.R.

3/ See EBS/92/198, pp. 20 and 26-27.

auctions for vouchers. An active secondary market for these vouchers has developed, in which the price has fluctuated between around rub 4,000 per voucher in October-November to around rub 7,000-8,500 per voucher more recently. 1/ The Supreme Soviet recently decided that the Committee for Management of State Property (GKI) should prepare another issue of vouchers to be used to privatize agricultural land without, however, removing the current restrictions on the ownership of land. 2/ In late 1992 there were approximately 215,000 enterprises in Russia which had an independent status, of which some 200,000 were small- or medium-sized firms. 3/ As of end-November 1992, some 5,000 large state enterprises had been transformed into joint stock companies under the procedures for corporatization. As part of this process, enterprises were required to present their privatization plans for approval by the GKI; some 2,000 such plans have been approved. By November 1, some 29,000 small- and medium-sized business units had been privatized.

1/ The vouchers have a face value of rub 10,000 but their actual value depends on how they are used. See EBS/92/198, p. 22 for details.

2/ These restrictions include a ban on sales for five years and restrictions on the uses of this land.

3/ This includes state enterprises, joint ventures, and private companies, but excludes state and collective farms, industrial cooperatives, partnerships and sole proprietorships.

Table 1. Russian Federation: Basic Data
(Percentage change over same period one year earlier, unless otherwise specified)

	1990	1991	1992 January-October	1992 Year (Program) 2/
Real GDP	...	-9	...	-14
Real gross industrial output	-0.1	-8	-18	...
Production volumes of:				
Oil	-6.5	-10.7	-14	-14
Natural gas	4	0.4	-1	-2
Retail trade in comparable prices	7.4	-6	-39	...
Household money incomes	16.6	120 1/	...	...
Average wage (level, in rub per month)	311	580	8,853 3/	5,548
Minimum wage (level, in rub per month)	80	130	900 3/	...
Consumer prices (RPI/CPI)				
Year average	5.6	92.6	...	1,459
Within-period	...	143.9	1,422	2,445
Industrial wholesale prices				
Year average	3.9	138	...	...
Within-period	...	236	3,966	...
Registered unemployed (end-period level, in percent of the labor force)	...	0.1	0.6	...
General government deficit (on a commitments basis, level in percent of GDP)				
Notional (1991)	...	19.9	14.0 10/	7.5
Enlarged government sector 4/	...	...	30.3 10/	11.3
Credit to the economy (end-period) 6/				
Nominal	...	127	418 9/	595
Real 7/	...	-7	-49	-73
Broad money (end-period)				
Nominal	...	77	233 9/	465
Real 7/	...	-27	-67	-78
Exports in US$ 8/	...	-30	-27	-32
Oil exports (in volume) 8/	-16	-42	...	-18
Natural gas exports (in volume) 8/	...	-4	...	-3
Imports in US$ 8/	...	-46	-18	-18
Trade balance (level, in billions of US$) 8/	-2	6.5	1.5	-2.6
Current account balance (including gold sales, level, in billions of US$) 8/	-4.5	4.2	-3.2 10/	-7.6
Gross international reserves (end-period level, in billions of US$)	...	...	2.7 10/	3.8
of which: gold 11/	...	...	2.3 10/	2.4
Total scheduled debt service (in billions of US$)	14.0	10.4	11.7 10/ 13/	9.2 10/ 12/
Principal	11.1	7.8	8.1	5.6
Interest	2.9	2.6	3.6	3.6
Arrears (- decrease)	2.7	-0.5	5.3	-2.9

Sources: Goskomstat; Ministry of Finance; Central Bank of Russia; Vneshekonombank; and staff estimates and projections.

1/ Including deposit compensation for the April 1991 price increases.
2/ See EBS/92/119, Sup. 3.
3/ Level in October 1992.
4/ In 1991, refers to the notional budget deficit.
5/ General government, plus unbudgeted import subsidies associated with foreign disbursements.
6/ Excluding credit to government.
7/ Deflated by the within-period CPI/RPI.
8/ Excluding shipments to or from other states of the former U.S.S.R.
9/ Percentage change between January 1, 1992 - September 1, 1992.
10/ Through September, 1992.
11/ Including gold of the former U.S.S.R.
12/ Assuming Russia services 61 percent of the debt of the former U.S.S.R., and before any debt deferral or rescheduling.
13/ Assuming Russia services 100 percent of the debt of the former U.S.S.R., and before any debt deferral or rescheduling. Includes short term debt.

Table 2. Russian Federation: Interest Rates in the Moscow Region, 1992

(In percent, period average)

	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.
CBR finance rate 1/	20	20	20	50	80	80	80	80	80	80	80
CBR overdraft rate 1/	35	35	35	100	160	160	160	160	160	160	160
Bank rate on loans to state enterprises 2/	20	29	32	37	54	63	82	83	91	97	95
Bank rate on loans to other enterprises 2/	26	36	45	50	71	89	98	106	108	114	118
Interbank loan rate 2/	27	33	39	47	69	81	92	99	99	103	107
Interbank auction rate 2/3/	32	47	64	79	94	102	105	108	106	110	116
Deposit rate 2/	15	20	25	39	44	57	59	67	67	72	75

Sources: Central Bank of Russia; press reports.

1/ End-period interest rate.
2/ Averages from press reports.
3/ Three types of assets are traded in the interbank auction market: interbank loans, deposits of enterprises, and loans to enterprises. The rate given is only for interbank loans.

Table 4. Moscow Interbank Foreign Currency Exchange 1/

	Exchange Rate	Volume
	(rubles per U.S. dollar)	(In millions of U.S. dollars)
January	204.4	18.4
February	175.7	33.4
March	152.8	98.9
April	152.8	46.9
May	122.3	100.4
June	125.3	308.5
July	143.3	253.5
2	134.8	15.1
7,9	130.4	57.9
14,16	132.6	60.4
21,23	153.3	77.2
28,30	161.2	42.9
August	169.7	261.3
4,6	161.5	43.8
11,13	162.1	64.6
18,20	162.5	82.7
25,27	190.5	70.2
September	225.3	453.2
1,3	210.5	79.9
8,10	206.1	69.3
15,17	204.7	100.0
22,24	244.3	131.9
29	254.0	72.1
October	353.1	408.6
1	309.0	44.3
6,8	338.7	107.1
13,15	335.8	84.7
20,22	368.0	86.0
27,29	395.3	86.5
November	426.9	353.3
3,5	397.3	93.6
10,12	413.3	79.6
17,19	448.0	111.2
24,26	448.7	68.9
December		
1,3	407.5	108.7
8,10	419.0	112.9
15,17	417.0	112.6
22	415.0	71.0

Source: Moscow Interbank Foreign Currency Exchange.

1/ Beginning with July 7-9, the figures shown represent the weighted average weekly exchange rate and total weekly volume, respectively.