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Statement by Mr. Mozhin on Russian Federation
Executive Board Meeting
February 3, 2021

My Russian authorities continue to highly appreciate the professional and constructive dialogue with the Fund's staff. This round of Article IV consultations took place virtually in November 2020.

I need to immediately clarify that I am writing this statement before I have seen the anticipated supplement to the staff report. What is behind this situation is that it took somewhat longer for my authorities to provide their written comments to the staff report due to the rapidly evolving developments in the Russian economy.

Outlook. It has now become clear that output performance in Q4 2020 turned out to be somewhat stronger than was previously anticipated. This stronger recovery of demand was one of the factors behind the spike in inflation in the end of 2020. I am expecting staff to address these changes in the forthcoming supplement to the staff report.

Overall, the Russian economy has demonstrated quite a remarkable resilience in the face of the COVID-19 shock, which was aggravated by the fall in oil prices. The output contraction in 2020 turned out to be much less severe than in many other countries and regions, even despite a much more moderate fiscal support. Strong frameworks and fundamentals in Russia are well described in the staff report.

Fiscal Policy. Responsible fiscal policy over quite a long period has played a critical role in allowing the authorities to appropriately respond to challenges associated with the COVID-19 shock. Low public debt and significant fiscal buffers created ample fiscal space, which remains quite large even after the fall in revenue and spending increase in 2020. Public debt-to-GDP ratio is now at about 20 percent of GDP.

The authorities intend to begin the gradual withdrawal of fiscal stimulus already in 2021 with the objective to fully resume the implementation of the currently suspended fiscal rule in

2022. However, should circumstances require, the authorities will be prepared to adjust their fiscal policy accordingly.

The authorities (Ministry of Finance) disagree with the prominence given in the staff report to the level of unemployment benefits. By the way, spending on unemployment benefits is only a small fraction in overall spending: less than 0.5 percent of total spending at the federal level and about 0.2 percent of total spending at the general government level.

The level of unemployment benefits is a sensitive political and social topic everywhere. The authorities' concern is that the explicit recommendation by staff to maintain unemployment benefits at the current elevated level is likely to increase social pressures on the government.

Also, the system can be easily abused, as those Russians, who are employed in the informal sector, simply pocket these benefits as a supplement to their informal sector incomes. And, by the way, the meaningful recovery in employment has already taken place, as the unemployment rate declined from its peak of 6.6 percent in August 2020 to 5.9 percent in December 2020 (seasonally adjusted), thus shaving off more than a third of the post-COVID-19 spike.

Monetary Policy. In November, at the time of the consultations, the authorities (Bank of Russia) were much less confident than staff that disinflationary factors in 2021 will prevail, as they could already see signs of mounting inflationary pressures. For that reason, they were concerned about the explicit recommendation by staff to reduce their key rate by another 50 basis points.

The latest developments on the inflation front made it clear that the authorities' concerns were entirely reasonable. In the last three months the monthly seasonally adjusted annualized inflation rate printed at 5.8-7.3 percent, pushing the headline annual rate of inflation to 4.9 percent for 2020 as a whole (against the target of 4 percent). In January, the annual rate of inflation is expected to exceed 5 percent.

This spike in inflation is largely driven by the pass-through from the exchange rate depreciation, as well as some non-monetary factors, such as supply-side factors in a handful of food categories and the effects of government restrictive measures. The rapid growth of credit and accelerating buoyancy of the recovery also have an impact on prices.

In December, the Central Bank Board made the decision to keep the key rate unchanged at 4.25 percent. In other words, the signal from the Bank of Russia has already become less dovish. At the same time, the Bank of Russia will continue to closely monitor the developments on the inflation front and to assess the potential for further key rate reduction.

Financial Sector. As it is described in the staff report, the Russian banking sector entered the COVID-19 shock in a position of strength. This was the outcome of many years of efforts by the Bank of Russia to strengthen the banking system and clean it up from non-viable and fraudulent banks.

Nonetheless, the Bank of Russia was quick to introduce regulatory forbearance measures in response to the COVOD-19 shock. These measures proved to be helpful to allow the banking sector to get through the most acute phase of the shock and to remain almost intact.

The staff position is that now is the time to begin curtailing regulatory forbearance measures, especially those on loan loss classification and provisioning. The authorities agreed and indicated that they are now considering not extending these forbearance measures.

The big event last year was the sale of the Bank of Russia’s majority stake in Sber-bank, by far the largest Russian bank, to the government. This was the end of a long-lasting saga. The Bank of Russia also intends to divest its stakes in several commercial banks, which are now under the open resolution procedure, as soon as market conditions allow.

Structural Reforms. Even under the most difficult circumstances of the last couple of years the authorities have continued the implementation of their structural reform agenda. Apart from the parametric pension system reform and other undertakings, among the more recent initiatives well-described in the staff report are “the tax maneuver”, “the regulatory guillotine”, and 13 far-reaching national projects.

Among other structural reform initiatives not mentioned in the staff report I would single out the decision to consolidate the long list of development institutions, which have mushroomed over the last decade or so. It is expected that 12 such institutions and agencies will be merged with Vnesheconombank, the main government development institution, already by mid-2021.

Finally, on footprint of the state. There must be significant room in the Russian economy for divesting assets of the state. However, such a divestment will have to wait until more appropriate market conditions are in place. It is also important that the approach to such a divestment is pragmatic rather than ideological.