

RUSSIAN ECONOMIC REPORT

April 2006

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I. RECENT ECONOMIC DEVELOPMENTS

A strong expansion in internal demand continues to drive economic growth in Russia, although a slowdown in most manufacturing and tradable sectors is becoming increasingly visible. Preliminary estimates place growth in GDP and industrial production for 2005 at 6.4 and 4.0 percent, respectively, relative to 7.2 and 8.3 percent in 2004. Preliminary data for the first two months of 2006 suggest that the industrial slowdown may be continuing. GDP growth is deriving increasingly from non-tradable sectors, and investment remains concentrated in oil and gas. Recent productivity growth has still been strong in some parts of manufacturing, although this appears in large part due to labor shedding.

The continued widening of Russia's balance of payments strengthens the country's financial position, but also creates new challenges. In addition to record current account surpluses, Russia is beginning to attract substantial capital inflows, including foreign direct investment. While this should give a needed boost to investment and modernization, additional inflows are also increasing pressure on inflation and the real exchange rate. An associated monetary expansion in Q4 2005 contributed to higher base inflation in early 2006.

Economic policy has become increasingly focused on the implementation of four priority National Projects in health, education, housing, and agriculture. The government has an opportunity to combine higher spending in these areas with structural reforms that could ensure sustainable improvements. Higher-than-expected inflation in early 2006 has motivated discussions of a new package of anti-inflationary measures by the government and Central Bank.

Table 1: Main Macroeconomic Indicators

	2001	2002	2003	2004	2005	2006 (Jan - Feb)
GDP growth, %	5.1	4.7	7.3	7.2	6.4	-
Industrial production growth, y-o-y, %	4.9	3.7	7.0	8.3	4.0	2.7
Fixed capital investment growth, %, y-o-y	8.7	2.6	12.5	10.9	10.5	1.6
Federal government balance, % GDP	3.0	2.3	1.7	4.2	7.5	11.4
Inflation (CPI), % change, y-o-y	18.6	15.1	12.0	11.7	10.9	4.1
Current Account, billion \$	35.1	32.8	35.9	60.1	86.6	28 (Jan.- Mar.)
Reserves (including gold) billion \$, end-o-p	36.6	47.8	76.9	124.5	182.2	195.9

Source: Rosstat, Minfin, CBR

GDP and Industrial Production

Russian GDP growth remained strong in 2005, registering at an estimated 6.4 percent, as opposed to 7.2 percent in 2004. But the structural composition of growth has undergone some significant changes. If the growth in 2003 and the first half of 2004 was lead by oil and some other industrial sectors, subsequent growth has shifted to the production of (largely) non-tradable services and goods for the domestic market (Table 2). Almost forty percent of the GDP expansion in 2005 came from trade. Construction also witnessed relatively rapid growth. Industrial growth contracted to 4 percent in 2005, down from 8.3 percent in 2004. The most notable decline in industrial growth came from the mineral resource extraction sector (1.3 percent in 2005 versus 6.8 percent in 2004), but growth in manufacturing also declined from 10.5 percent to 5.7 percent. A further slowdown in industrial growth in early

2006 (2.7 percent for the first two months of the year) has raised some concerns, although at least part of this decline is most likely due to the exceptionally cold winter.

Table 2: Russian Economic Growth: 2003-2005 (by value added)

	2003	2004	2005
GDP	7.3	7.2	6.4
Agriculture, hunting, forestry	5.5	3	1.1
Extraction of mineral resources	10.8	7.9	1.7
Manufacturing	9.5	7.8	4.4
Electricity, gas, water production and distribution	1.6	2.1	1
Construction	13	10.2	9.7
Retail and wholesale trade, repair and maintenance of vehicles, white goods and personal effects	13.2	9.8	12.4
Transport and communication	7.2	10.5	6.2
Finance	9.6	4.5	6.4
Immovable property operations, leasing and services provision	3	4.5	9

Source: Rosstat

Annual data confirm trends in manufacturing that were identified in the previous RER. The vast majority of manufacturing sectors showed marked slowdowns in economic growth in 2005 relative to 2004. This particularly concerns sectors producing tradable goods in competition with foreign producers. Of these sectors, the food industry continues to show resilience, expanding at the same pace as in 2004 (4.4 percent). The consumer electronics industry grew significantly, but almost certainly due to lower import tariffs on parts than final products. The strongest decline was registered in machine-building, where growth slowed from over 20 percent in 2004 to -0.1 percent in 2005. (Figures 1 - 4).

Figure 1: Growth Rates in Machine Building (%)



Figure 2: Growth Rates in Chemicals and Metallurgy (%)

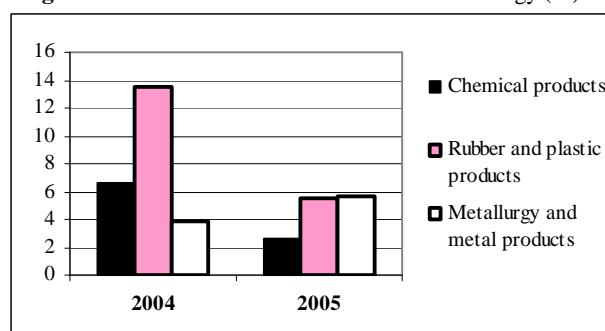


Figure 3: Growth rates in food and light industry (%)

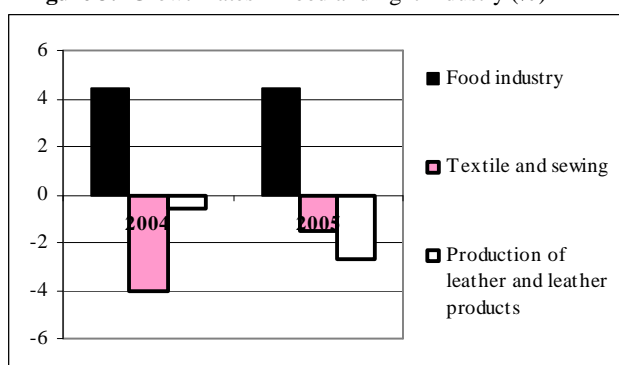
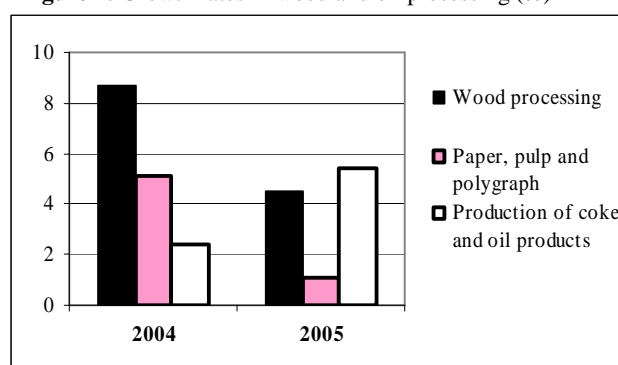


Figure 4: Growth rates in wood and oil processing (%)



Sources: Rosstat

Capacity constraints have become increasingly important in industry, particularly in resource extraction. Although the oil industry also suffered in 2005 from the disruptive effects of the Yukos affair, most experts expect slow growth from this sector over the medium term due to capacity constraints that can be alleviated only through high fixed investment. The slowdown in manufacturing appears to be related to increasing competitive pressures from the rapid appreciation of the ruble (Figure 9). Although the interpretation of official Russian financial data for enterprises is difficult, these figures nevertheless give an indication of possible huge swings in relative profitability across different sectors of the economy (Table 3). According to these data, aggregate growth in (nominal) net profits in manufacturing during 2005 was only slightly higher than inflation (16 percent), while profit growth in trade, finance, transportation and communication, construction, and (especially) resource extraction were considerably higher. This can be contrasted to 2004, when growth in profits in manufacturing was estimated at 57.5 percent.

Table 3: Index of Net Profits (current prices), y-o-y, %

	2004	2005
Total	152.4	136.6
Agriculture, hunting, forestry	230	75.3
Extraction of mineral resources	220	175.6
Manufacturing	157.5	116.2
Electricity, gas and water production and distribution	140.6	134.4
Construction	87.3	121.1
Retail and wholesale trade, repair and maintenance of vehicles, white goods and personal effects	133.0	142.5
Transport and communication	127.36	130.3
w/o communication	113.2	161.5
Finance	160.3	151.5*

Source: Rosstat; *data for Jan-Nov

Under these conditions, it would be natural to expect a flow of labor and other resources from manufacturing to other sectors. Data on labor flows suggest exactly this (Table 4).

Table 4: Growth in employment in selected sectors: 2005

Total	-1.0
Agriculture, hunting, forestry	-11.9
Extraction of mineral resources	-2.3
Manufacturing	-4.0
Construction	-1.4
Trade and other msc. services	9.7
Hotels and restaurants	2.6
Transport and communication	-2.1
Finance	7.4
Real estate and leasing	-0.5
Government administration and social security	7.2

Source: Rosstat

Labor shedding has been a primary source of productivity growth in much of industry, and has been a key to keeping productivity growth in pace with nominal wage growth in manufacturing. Figures 5 and 6 present nominal growth in output per worker and nominal wages for both 1999-2004 and 2005 (A change in statistical classification requires treating

these time periods separately). While fuels and metals have shown particularly high growth in receipts per worker relative to wages due to relative price increases, Figures 5 and 6 indicate that manufacturing sectors have also roughly succeeded in increasing productivity in step with wages. Even so, there are indications that increases in the costs of other inputs have been even more rapid, implying a deterioration of competitiveness in some sectors.

Figure 5: Growth in output per worker and wages in industry during 1999-2004 (current rubles)

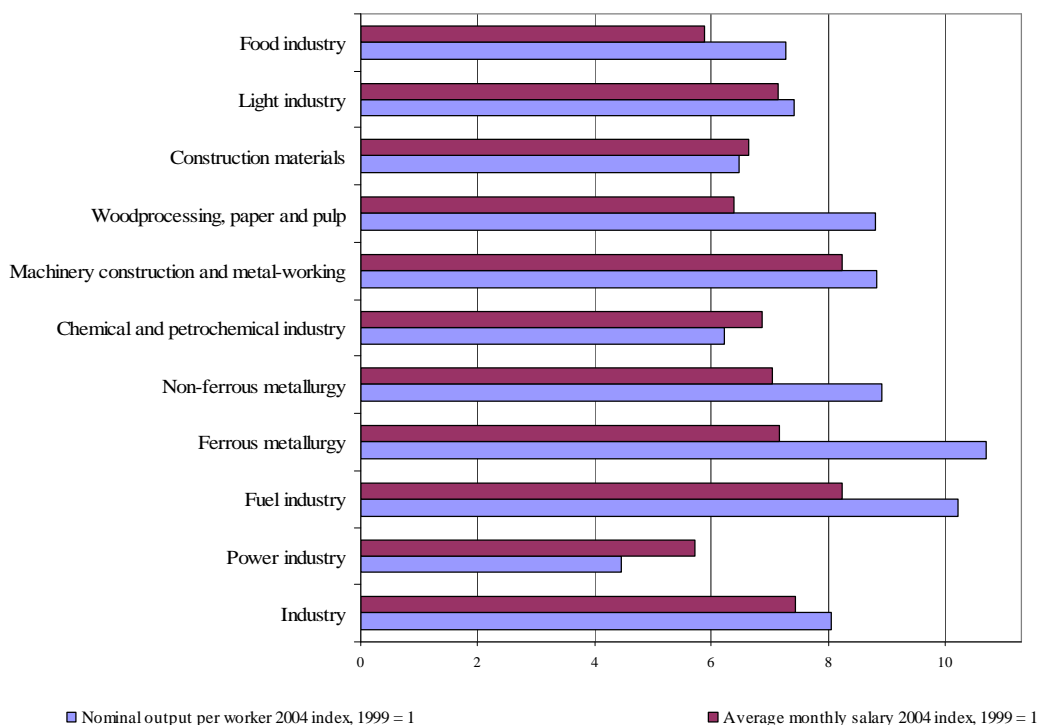
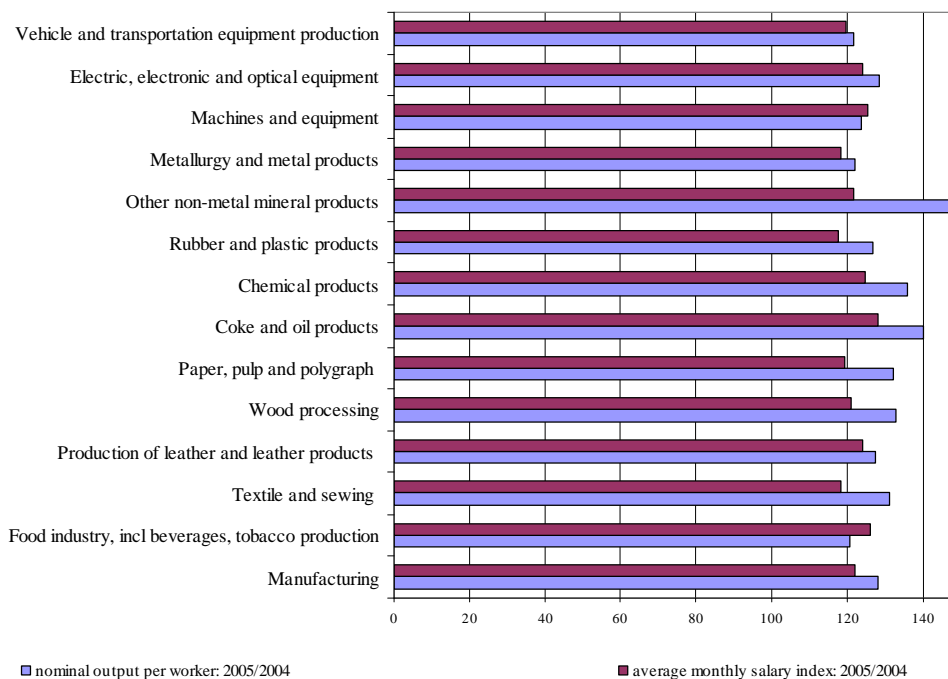


Figure 6: Growth in output per worker and wages in industry during 2005 (current rubles)



Source: Rosstat

Investment

Aggregate fixed capital investment continued its strong double digit growth (10.5 percent) in 2005. As is the case with output growth, a very sharp registered decline in fixed capital investment growth in the first two months of 2006 (1.6 percent) should be at least partly related to the very cold winter. 2005 also witnessed a substantial increase in foreign direct investment, which reflects improvements in the business climate and Russia's economic outlook. FDI inflows grew by 39 percent relative to 2004, reaching an estimated USD 13.1 billion.

Although Russia has experienced double-digit fixed capital investment growth for the third consecutive year, absolute investment levels remain low in Russia relative to emerging market economies that have sustained growth over a number of years. In 2005, fixed capital investment constituted only an estimated 18 of GDP, whereas countries that have sustained rapid growth usually have associated investment rates of 25 percent or higher. Investment also remains quite concentrated in oil and gas ("transportation" includes pipeline investment). As illustrated in Tables 5 and 6, most manufacturing sectors of the economy receive rather low shares of investment and FDI. Although manufacturing on aggregate received a relatively large share of FDI in 2005, this was due entirely to exceptional investment in oil processing associated with the Sibneft deal.

Table 5: Total fixed capital investment by sector (% of total)

	2004	2005
Agriculture, hunting, forestry	3.2	3.2
Extraction of mineral resources	17.4	15.2
Manufacturing	17.3	17.6
<i>Food industry, incl beverages, tobacco production</i>	3.2	3.1
<i>Coke and oil products</i>	2.0	1.8
<i>Chemical products</i>	1.4	1.7
<i>Other non-metal mineral products</i>	1.2	1.5
<i>Metallurgy and metal products</i>	4.5	4.7
Electricity, gas and water production and distribution	8.3	7.8
Construction	3.4	2.9
Retail and wholesale trade, repair and maintenance of vehicles, white goods and personal effects	2.3	2.8
Transport and communication	19.1	22.1
Communication	6.4	6.7
Immovable property operations, leasing and services provision	12.2	11.5
Health care and social services	2.2	2.3
Provision of other public utilities, social and personal services	2.5	2.6

Source: Rosstat

Table 6: Shares of Foreign Direct Investment by sector of the economy

	2004	2005
	% total	% total
Agriculture, hunting, forestry	0.9	0.9
Fishing, fish-breeding	0.0	0.0
Extraction of mineral resources	43.3	30.7
<i>energy resource extraction</i>	42.3	29.9
Manufacturing	30.9	46.1
<i>Food industry, incl beverages, tobacco production</i>	3.6	4.2
<i>Textile and sewing</i>	0.4	0.1
<i>Production of leather and leather products</i>	0.1	0.1
<i>Wood processing</i>	3.5	2.5
<i>Paper, pulp and polygraph</i>	0.5	0.7
<i>Coke and oil products</i>	0.1	27.2
<i>Chemical products</i>	2.5	1.8
<i>Rubber and plastic products</i>	0.8	1.2
<i>Other non-metal mineral products</i>	4.8	3.0
<i>Metallurgy and metal products</i>	12.1	1.3
<i>Machines and equipment</i>	0.6	-
<i>Electric, electronic and optical equipment</i>	0.3	0.5
<i>Vehicle and transportation equipment production</i>	1.2	1.7
Electricity, gas and water production and distribution	0.001	1.1
Construction	0.9	0.9
Retail and wholesale trade, repair and maintenance of vehicles, white goods and personal effects	10.2	5.9
Hotels and restaurants	0.2	0.2
Transport and communication	2.1	1.9
<i>o/w communication</i>	0.4	0.4
Finance	3.8	4.5
Immovable property operations, leasing and services provision	6.9	7.1
Provision of other public utilities, social and personal services	0.7	0.6

Source: Rosstat

The Balance of Payments, Capital Flows, and FDI

Despite an acceleration in the dollar value of imports (25% in 2005), Russia's balance of payments continues to move from strength to strength. Record foreign inflows from the current account, together with a significant strengthening of the capital account, dominate the Russian macroeconomic picture, fueling domestic demand and exerting ever greater pressure on inflation and the real exchange rate of the ruble.

Russian export growth in quantity terms slowed markedly to 5.6 percent in 2005 (compared to 11.9 percent in 2004). Thus, the record trade and current account surpluses owe almost entirely to price increases on Russian exports, most particularly for oil and gas. According to preliminary estimates, the current account totaled USD 84.2 billion in 2005, compared to USD 58.6 in 2004. Russia's trade surplus reached USD 118.3 billion in 2005, as compared to USD 85.8 billion in 2004 (Table 7). Total merchandise exports rose to USD 243.6 billion (or by 33 percent compared to 2004), with oil, oil products and gas exports accounting for 61 percent of the total (USD 148.9 billion). Gross foreign reserves continued to set records, reaching USD 182.2 billion at the end of 2005 and increasing further 205.9 billion by the end March 2006. By preliminary data, still higher average oil prices fueled another record current account surplus in the first quarter of 2006.

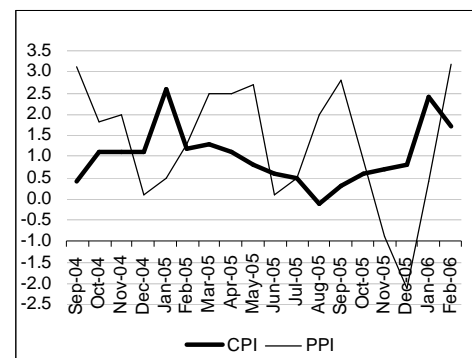
Table 7: Balance of Payments (USD billions)

	2003	2004	2005	2006* (Q1)
Current Account Balance	35.4	58.6	84.2	28
Trade Balance	59.9	85.8	118.3	32.6
Capital and Financial Account	-0.8	-6.3	-10.9	-4.5
Errors and Omissions	-8.2	-7.1	-11.9	-2.1
Change in Reserves	26.4	45.2	61.5	-21.4

Source: CBR * preliminary estimates

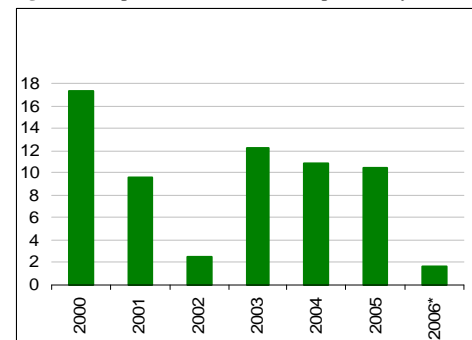
The statistical weakening of capital account in 2005 can be attributed to the pre-payment of USD 17 billion in foreign debt and the sale of Sibneft, which led to a classification of approximately USD 10 billion as a foreign outflow (Sibneft was technically held by an offshore company before the sale). If not for these two factors, Russia would have experienced its first capital account surplus of the transition period. According to Central Bank estimates, net private capital flows in 2005 were non-negative, as opposed to an outflow of 8.0 billion in 2004 (Table 8). The biggest reduction in capital outflows was reported in the non-banking sector (from USD 11.5 billion in 2004 to USD 4.9 billion in 2005).

Figure 7: CPI and PPI monthly inflation, %



Source Rosstat

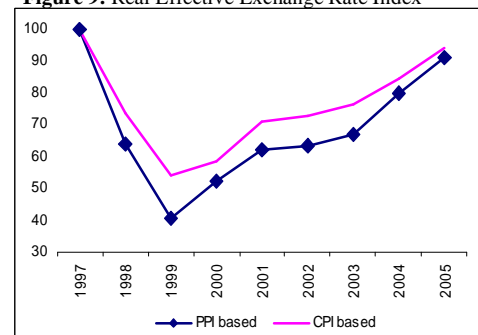
Figure 8: Capital investments, % to previous year



Source Rosstat

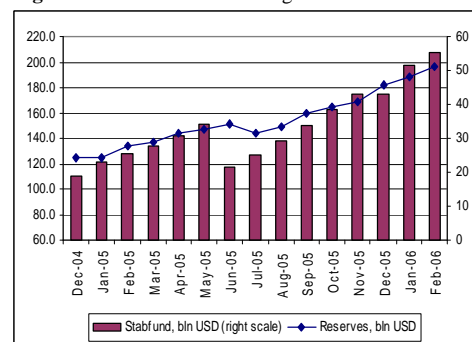
* data for January – February 2006

Figure 9: Real Effective Exchange Rate Index



Source: Staff estimates

Figure 10: Stabfund and Foreign Reserves



Source: Rosstat

Table 8: Net Capital Outflows (USD billion)

	2004	2005
Total net capital outflows from the private sector	8.0	0.0
<i>Net capital outflows from the banking sector</i>	-3.5	-5.9
<i>Net capital outflows from non-banking sector</i>	11.5	5.9

Source: CBR, staff estimates

External Debt

High oil prices and prudent macroeconomic management, on one hand, and relatively low international interest rates, on the other, have had a noticeable impact on the dynamics of Russia's external debt. According to CBR estimates, the stock of Russia's total debt to non-residents increased from USD 214.5 billion at the end of 2004 to over USD 258.5 billion at the end of 2005. The Russia's debt dynamics in recent years have been driven by two opposing trends: a substantial reduction in sovereign debt, on the one hand, and a rapid increase of debt accumulated in the corporate and private sector on the other. Official Russian debt was reduced from USD 106 billion to 82 billion during 2005. If the government succeeds in its intention of pre-paying another USD 12 billion to the Paris Club, sovereign debt will also decline substantially in 2006. By contrast, the corporate and private sector accumulated an additional USD 67 billion during the year, bringing its stock of debt to an estimated USD 176.2 billion. Most of this increase concerns non-financial enterprises (by USD 50 billion), while banks increased their debt by USD 18 billion. Due to considerable hikes in the debt levels accumulated by the private sector the overall foreign debt exposure in this sector, measured as a share of debt in GDP, increased from 19 percent at the end of 2004 to 23 percent in 2005.

Monetary Policy, Inflation and Exchange Rates

The inflation statistics for the fourth quarter of 2005 came as a surprise to most market observers. In spite of initial expectations that CPI inflation might accelerate towards the end of the year, actual inflation in the fourth quarter amounted to only 2.1 percent, bringing annual inflation to 10.9 percent for the year. The extent of the deceleration is difficult to explain, although two important factors are (informal) controls introduced on gasoline prices and an acceleration in economic growth in the fourth quarter. Core CPI inflation (excluding administrative price increases) fell to 8.3 percent in 2005, as compared to 10.5 percent in 2004. As in 2004, producer prices in 2005 increased faster than CPI inflation, registering at 13.4.

The decline in inflation in the fourth quarter of 2005 came, ironically, at a time of record foreign inflows, purchases of foreign reserves by the Central Bank, and quite rapid ruble money supply growth. Consequently, gross reserves of the Central Bank increased by USD 21 billion in the fourth quarter alone. The inflationary pressures from this expansion began to be felt in early 2006, however. For January and February alone, consumer prices increased by an estimated 4.1 percent. As in 2005, part of this acceleration in inflation concerns administrative increases in housing and utilities prices. Nevertheless, core inflation for January and February (2 percent) was measurably higher than in the previous year (1.6 percent).

Concerns over inflation have brought an important change in monetary policy. While the Central Bank defended a relatively stable exchange rate of the ruble versus the dollar during most of 2005, it has allowed for a 3.5 percent nominal appreciation in the first quarter of

2006. While nominal appreciation may hold promise as a means of relieving pressure on inflation, the Russian context is complicated due to the presence of potentially large and unstable capital flows (including internal flows due to the large amount of hard currency held by the population). The degree to which nominal appreciation can bring down inflation rates in the short run is debatable, although the experience in 2006 should help reveal more information to that effect.

Concern over higher-than-expected inflation has dominated economic policy discussions in the government in early 2006. The government has been preparing a package on anti-inflationary measures in the context of proposals that include price controls, restricting wage growth in state-owned companies, restricting borrowing by state-owned companies, and reducing state expenditures. Monopoly pricing has been targeted in some discussions, although there is little economic justification for linking inflation to monopoly power.

Practice in other countries confirms that the use of price controls as a means of reducing moderate inflation is a poor policy choice. The costs of the associated market distortions and shortages substantially outweigh the benefits. Anti-inflationary economic policy should target only core inflation. The Ministry for Economic Development and Trade should not be made responsible for inflation, as it does not control any appropriate instruments for affecting core inflation. Russia currently has only limited instruments for reducing core inflation. Primary among these instruments are levels of government spending (as opposed to accumulation in the Stabilization Fund), exchange rate policy, and other limited means of the Central Bank for regulating liquidity. When a larger internal bond market finally develops, the hand of the Central Bank will be strengthened considerably for the conduct of anti-inflationary monetary policy.

Fiscal policy and the Federal Budget

According to preliminary estimates the Federal Budget in 2005 was executed with a surplus of 1617 billion rubles, or 7.5 percent of GDP on a cash basis. This is somewhat higher than the surplus stipulated in the revised Budget Law for 2005 (6.9 percent). Federal budgetary revenues amounted to 5,121 billion rubles, or 23.6 percent of GDP, which exceeded revenues in 2004 by 3.1 percent of GDP. Although the main factor for increased revenues has been higher oil prices, higher taxes on the oil sector have also made an important contribution. By contrast, federal government spending in 2005 remained at 16.2 percent of GDP, practically the same level as in 2004.

The Federal Budget for 2006 was passed into law at the end of December 2005. Planned federal expenditures for 2006 amount to 17.5 percent of GDP, which is 1.3 percent of GDP higher than actual expenditures in 2005 (table 9). The additional money will be spent primarily on government investment and social programs. The additional spending may be associated with some additional inflationary pressures, although the magnitude of the fiscal expansion is still rather limited. Due to a conservative assumption on oil prices (USD 40 dollars a barrel), revenues are officially projected at 20.7 percent of GDP, about 3 percent lower than actual revenues in 2005. If oil prices remain at current levels, however, revenues in 2006 should exceed those in 2005. Surplus revenues that are not immediately transferred to the Stabilization Fund could become a subject of political bargaining during the year, although concerns over inflation have at least temporarily strengthened the hand of fiscal conservatives in the government. The Stabilization Fund has already reached over 1.5 trillion rubles (USD 53 billion) by the end of 2005, and could accumulate to over USD 3 trillion by the end of the year.

Table 9: The Federal Budget (% of GDP)

	2003	2004	2005	2006 Budget Law (approved)
Revenues	19.6	20.4	23.6	20.7
Expenditures	17.9	16.1	16.2	17.5
Of which:				
General state management (without debt service)				2.62
National defense				2.73
National security, law enforcement				2.22
National economy				1.39
Housing and utility				0.16
Environment				0.03
Education				0.83
Culture, mass media				0.21
Health and sport				0.61
Social policy				0.84
Interbudgetary transfers				5.87

Sources: Minfin, EEG, World Bank staff calculations

Income, Employment and Poverty

News on the standard of living front in Russia are still encouraging. Average real wages and incomes continued to exhibit strong growth in 2005, registering at 9.7 and 8.8 percent, respectively. Although official data on poverty are not yet available for 2005, it is probable that growth in Russia remained strongly pro-poor in 2005. The Ministry of the Economy projects that the share of the population below the official poverty line declined from 17.8 percent in 2004 to 15.8 percent in 2005. Given the strong appreciation of the ruble, dollar wages grew much more rapidly than real wages in 2005, and averaged USD 302 a month, a 27.4 percent increase over 2004. Unemployment rates also fell, averaging 7.6 percent in 2005, as compared to 8.6 and 8.2 percent in 2003 and 2004, respectively. Demographic statistics for 2004 indicate that the disturbing rise in mortality rates may have finally bottomed out. Life expectancy finally increased from 64.3 to 65.8 years.

National Projects

Four priority National Projects in health, education, housing, and agriculture have become a primary focus of economic policy in Russia. These projects directly target the standard of living of the population. Under the plan, 382 billion rubles (14 billion dollars) will be spent from federal and subnational budgets, while 60 billion rubles (2.2 billion dollars) will be granted in guarantees, according to the breakdown given in Table 10. 76 percent of the associated expenditures will come from the federal budget (290 billion rubles).

Table 10: Financing of the National Projects from Federal and Regional Budgets

	2006	2007	Total (06-07)
Health	88.4	120.5	208.9
Education	25.3	31.2	56.5
Housing	35.4	46.2	81.6
<i>government guarantees</i>	26.5	33.5	60.0
Agriculture	16.2	18.7	34.9
Total (excluding guaranties)	165.3	216.6	382

The program in health accounts for more than half of national project spending, most of which is devoted to salary increases, the modernization of equipment, and the creation of new health facilities. The majority of spending in the education project is devoted to pay increases, including incentive pay for innovative teachers and outstanding students (grants). Much of the housing project offers assistance to families for purchasing housing, either through redeemable certificates, subsidized mortgages, or guarantees. The agriculture program consists primarily of various subsidies, most particularly subsidized credits.

The national projects should have a positive impact on the welfare of the Russian population and the Russian poor, particularly the health project (See section 3 of this RER). In addition to the value of the services to the population, many health and education workers are among the lowest paid Russian professionals, and their families are commonly numbered among the Russian poor. At the same time, Russia should not miss the opportunity to combine increased social spending in these areas with much needed structural measures to reform these sectors in order to ensure their higher efficiency and sustainability in years to come. The government is discussing the launching of some regional pilots to this effect, which would be a very welcome addition to the social agenda.

II. THE MANAGEMENT OF SURPLUS OIL REVENUES: MAJOR OPPORTUNITIES FOR RUSSIA

Given the limited capacity of the Russian economy to absorb the enormous oil inflows, accumulation in the Stabilization Fund has become a primary instrument for supporting macroeconomic stability. By investing these surplus resources in a managed international portfolio, Russia can make the budget less dependent on oil and expand significantly its opportunities for diversified economic development and social policy. This note discusses the nature and magnitude of these opportunities, and includes a simulation exercise under a particular set of not improbable assumptions.

Despite the strong economic growth and other positive trends in recent years, Russia continues to face a challenging development agenda. This includes spatial imbalances, deteriorating infrastructure, still low investment rates, social distress in many regions, a demographic crisis, and problems in supporting the competitiveness of manufacturing industries. In stark contrast to the 1990s, the Russian government has also been accumulating large surplus revenues and reserves in the context of high oil and gas prices. Much attention in political debates has therefore naturally focused on how Russia might manage or use its growing fiscal reserve to solve its remaining development problems.

Numerous proposals suggest one or another fiscal expansion, either through lower tax rates or more substantial programs for state investment. Although Russia has been moving gradually in these directions, it faces serious constraints in the demands of macroeconomic stabilization, potential budgetary volatility, and weak institutions for supporting efficient state investment. The sterilization of huge foreign inflows through the accumulation of fiscal surpluses in the Stabilization Fund has been critical to maintaining macroeconomic stability and preventing an even more rapid appreciation of the real exchange rate. Weaknesses in financial markets and the banking sector prevent the effective sterilization of inflows of this magnitude through monetary policy. Reducing the tax burden on the non-oil sector would increase even further the high vulnerability of Russia's budgetary position to changes in oil prices. The context of the 1990s favored the development of only short-term budgetary institutions. Only now is Russia beginning to move toward medium-term budgeting, although the creation of effective institutions for longer-term finance of priority investment projects is proving to be a difficult task. High levels of corruption and distorted incentives of officials at all levels of government further complicate this objective.

Russia's fiscal reserve is becoming large, and will become much larger still in the event that oil prices remain high. Given the magnitude of the issues at stake for Russia's development, it is important to assess as correctly as possible the opportunity costs of one or another policy decision. This assessment is not easy. Yet at least one important opportunity cost is not sufficiently accounted for in most Russian debates over the Stabilization Fund, namely the opportunity costs of foregoing national savings in a diversified portfolio of foreign assets. The presumption is sometimes that either the surplus is spent today, or it is simply removed from the economy, only to reappear in the event that oil prices fall to very low levels. In fact, by foregoing a fiscal expansion at the present time, these surplus funds can still be employed today in a manner that brings Russia a very high return, and has the potential to expand significantly economic security, living standards, and the opportunity set for policy in the medium and longer term. Russia can learn much from the experience of other countries that have managed commodity funds, most particularly Norway. Yet there are even opportunities on financial markets of potential interest to Russia that most of these countries have not yet exploited.

The Stabilization Fund is no longer just insurance for the federal budget against oil price fluctuations. It is becoming an increasingly important part of the wealth of the country. The Fund has accumulated to 1.5 trillion rubles in early 2006, and could mushroom to 3 trillion by the end of the year, depending on oil prices. This is already sufficient to insure the government budget for a number of years into the future in the event that the world price of oil falls to 20 dollars a barrel. If the price of oil does not fall dramatically in the near future or medium term, as most experts now project, the size of the fund will expand quite rapidly. Thus, it makes increasing sense for Russia to designate part of the surplus to a longer-term fund as exists in a number of other oil-exporting countries.

The Stabilization Fund is currently held as a ruble account at the Central Bank. Fears that some Russian assets abroad could be frozen in legal disputes have delayed the investment of the Stabilization Fund in foreign assets. The current law permits only investment in safe and highly liquid foreign government bonds. Yet the government is currently considering changing this law in a manner that would allow the investment of part of the Fund in equities. This is advantageous for two important reasons: First, for a longer-term investment strategy, a portfolio that includes equities gives a significantly higher return. Second, the returns on many corporate stocks are negatively correlated with oil prices. Thus, if appropriately selected, corporate securities can actually help hedge against the risk of an oil price shock.

If oil prices remain at rather high levels over the medium term, Russia would be able to accumulate a diversified investment fund in foreign securities that would offer partial solutions to a number of Russia's current development challenges listed above. Over the medium term, Russia's fiscal reserve fund would become sufficiently large, and the return sufficiently high, that Russia could consume only the return on the fund (without even eating into the capital) in a manner that would create substantial opportunities:

- Given the diversified nature of the Fund and its negative correlation with oil prices, the current problem of high vulnerability of the state budget to changes in oil prices could be significantly alleviated. In addition to the important security that this would provide the Russian government against oil shocks, it would alter the entire framework for fiscal policy. In particular, it would substantially decrease the risks of promoting diversified growth through a lower tax burden for the non-oil sector. Less reliance on oil revenues will also allow for a lower tax burden on the oil and gas sectors themselves, thereby creating incentives and funds for the high investment that these sectors need for their successful development. In addition, the Fund will support the development of effective counter-cyclical fiscal policy, i.e. drawings from the Fund can be increased in order to pull the Russian economy out of an oil-price related recession.
- Russia currently faces a demographic crisis in the form of an ageing and declining population. The Pension Fund is already in deficit, and this deficit is projected to grow. The ageing of the population also places a huge burden on health care. While many countries in the world are struggling with similar problems, Russia has a huge possible advantage for capitalizing the pension fund and accumulating a reserve to meet the future social needs of the country.
- Russia has recently launched important budgetary reforms that promise to rationalize and increase the effectiveness of public expenditures, including investment spending. These reforms are still in their early stages, however. A higher efficiency of government spending in future years implies a possible gain from postponing expenditures on some projects to a later date, and instead reaping returns on this money in a managed international portfolio.

We conducted a simulation exercise to give a general feel for the extent of the opportunities for Russia from accumulation in a managed Fund. This scenario assumes that oil prices will gradually decline, but still remain generally high over the medium term, thus allowing for the accumulation to take place. The question of protecting the budget from a sharp fall in oil prices is taken up subsequently below. More specifically, we assume that oil prices in real terms decline gradually to US\$ 40 a barrel by the year 2030. Federal government expenditures are fixed at 17 percent of GDP, and all additional fiscal revenues are assumed to accrue to the Fund. The assumption on GDP growth in the simulation is rather conservative: GDP growth slows gradually from 5.5 percent to 3 percent. Overall tax collection is presumed to increase in pace with GDP, so that fluctuations in oil receipts are the only cause of changes in budgetary revenue. We assume that the ruble will continue to appreciate in real terms against the dollar in the near future, beginning from 10.6 percent in 2006, but that this appreciation will gradually slow as the balance of payments moves toward equilibrium. The elasticity of federal budgetary revenues in the price of oil is taken as a constant at 0.7. This estimate, while on the conservative side, is in the ballpark of other estimates in the literature. Finally, annual US dollar inflation is assumed to be 3 percent. Table A2.1 presents the specific assumptions in detail.

Until the fund reaches a large enough size, and until Russia creates the requisite oversight institutions and laws for a longer-term portfolio, Russia will most likely need to protect the budget by holding a large share of its fiscal reserve in highly liquid and relatively safe assets. If oil prices remain strong, as the reserve Fund becomes larger and requisite institutions emerge, the government should naturally move a larger share of these reserves into a longer term asset portfolio. This longer-term portfolio will exhibit more volatility over the short term, but offer a substantially higher return over the longer term. For the simulation exercise, we postulate that the government invests first in a portfolio of 50 percent 3-month treasury bills and 50 percent longer term government bonds, then switches to a portfolio of 1/3 treasury bills, 1/3 bonds, and 1/3 equities from 2008 to 2010, and finally holds a portfolio of 10 percent bills, 30 percent bonds and 60 percent equities thereafter. From historical data, the postulated average annual returns of these three portfolios are 119.5, 225, and 328.3 basis points, respectively.

Figure 2.1 gives the estimated real dollar size of the Fund under all of these assumptions, whereas Figure 2.2 shows the share of the Fund in GDP. As the ruble is appreciating and GDP is growing, the latter dynamic is slower:

Figure 2.1: Real (2006) dollar value of the Fund

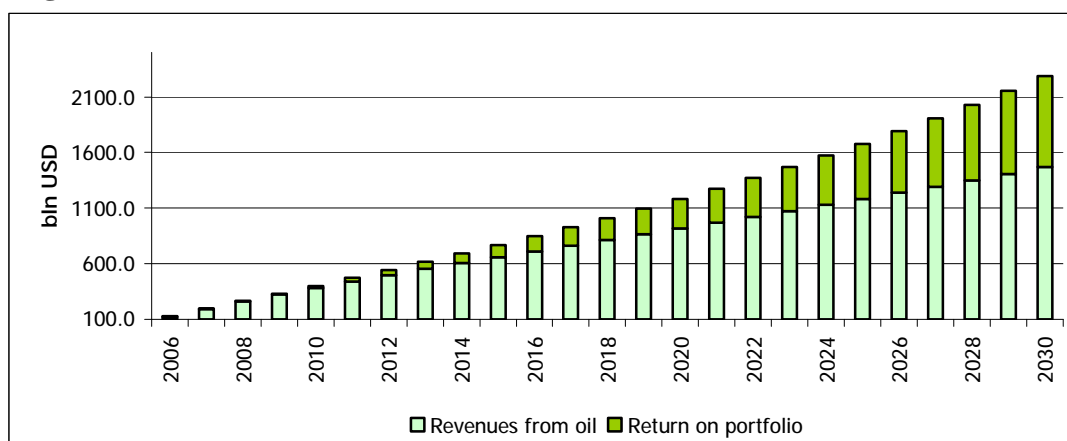
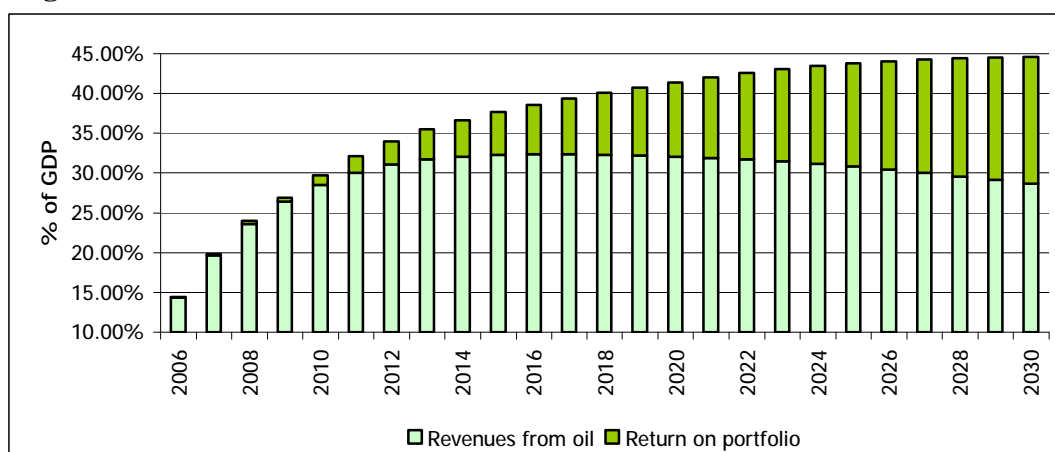


Figure 2.2: Fund value as a share of GDP

Source: WB staff estimates

The implied accumulation of the Fund is quite impressive. Even if it were not invested, the Fund would accumulate by 2030 to an estimated 1.47 trillion (2006) dollars, roughly double the current value of Russian GDP, and 29 percent of the projected 2030 value of GDP. If the government were to invest the Fund according to the assumed scenario, and spend nothing until 2030, Russia's wealth would expand by an additional estimated USD 818 billion (2006) dollars, bringing the entire size of the Fund to USD 2.29 trillion dollars, or 43 percent of estimated 2030 GDP.

What about future income possibilities for the government? Table 2.1 shows cases in which the government takes a decision either in 2015, 2020, or 2025 to stop rolling over the returns and maintain a constant value of the Fund in real dollar terms indefinitely. In the case of 2015, this would free up annual funds that could be used (beginning) in 2016 of US\$ 77 billion, a sum roughly equivalent to current federal revenues from the oil extraction and export taxes. Of this amount, US\$ 25 billion would be income from the Fund itself (as opposed to new surplus oil revenues). If the government waits until 2020, the numbers would be 91 and 39 billion, respectively. Waiting to 2025 would yield 110 and 55 billion, respectively. In any case, the relative dependence of the federal budget on oil could be significantly reduced. Given negative correlation of the Fund's returns with oil prices, a lower oil price would decrease oil revenues but may increase an annual return on the portfolio.

Table 2.1: Income scenarios for the government if the size of the Fund is held constant in real dollar terms (US\$ billion)

	Scenario 1: 2015			Scenario 2: 2020			Scenario 3: 2025		
	Fund balance	Available for spending	Of which income from the Fund	Fund balance	Available for spending	Of which income from the Fund	Fund balance	Available for spending	Of which income from the Fund
2015	769	0	0	768.7	0.0	0.0	769	0.0	0
2016	769	77.3	25.24	846.7	0.0	0.0	847	0.0	0
2017	769	76.9	25.24	926.9	0.0	0.0	927	0.0	0
2018	769	76.7	25.24	1009.6	0.0	0.0	1010	0.0	0
2019	769	76.6	25.24	1095.1	0.0	0.0	1095	0.0	0
2020	769	76.8	25.24	1183.5	0.0	0.0	1183	0.0	0
2021	769	77.0	25.24	1183.5	90.6	38.9	1275	0.0	0
2022	769	77.4	25.24	1183.5	91.0	38.9	1370	0.0	0
2023	769	78.0	25.24	1183.5	91.6	38.9	1469	0.0	0
2024	769	78.6	25.24	1183.5	92.3	38.9	1572	0.0	0

2025	769	79.4	25.24	1183.5	93.1	38.9	1679	0.0	0
2026	769	80.4	25.24	1183.5	94.0	38.9	1679	110.3	55.1
2027	769	81.4	25.24	1183.5	95.0	38.9	1679	111.3	55.1
2028	769	82.5	25.24	1183.5	96.2	38.9	1679	112.4	55.1
2029	769	83.8	25.24	1183.5	97.4	38.9	1679	113.7	55.1
2030	769	85.1	25.24	1183.5	98.7	38.9	1679	115.0	55.1

Source: WB staff estimates

Of course, if the price of oil were to fall significantly in the short or medium term, then Russia would no longer have the option of accumulating such a large Fund. Following a sharp fall in the price of oil, the Stabilization Fund would be depleted over the short term in financing deficits of the federal budget. If oil prices remained this low, the medium term would require a serious fiscal adjustment that could be particularly painful for an economy reeling from an oil-related recession. Thus, the question of protecting the country in this contingency is understandably a primary political priority.

In the scenario above, the government protects the budget by maintaining a relatively large portfolio of highly liquid assets in the short term, and only gradually expands the longer-term invested portion of the portfolio. International financial markets also provide other opportunities for Russia to hedge against the risks from a sharp fall in oil prices. Given today's expectations that a drastic fall in oil prices in the short or medium term is unlikely, it has become relatively inexpensive to purchase guarantees of minimum future prices for sales of oil. For example, Bank experts estimate that Russia could purchase a five-year guarantee (put) for the annual sale of one billion barrels of oil at today's price for roughly US\$ 9.5 billion. Given the existing accumulation in the Stabilization Fund, another option would be to make a more limited purchase to insure against future years for which more uncertainty exists. For example, purchasing guarantees for 2009 and 2010 would give Russia a five-year cushion against oil price fluctuations, during which time a good portion of the Reserve Fund could accumulate and put Russia in a very strong position for future years. Purchases of guarantees on the market could potentially free up a larger share of the Fund at an earlier date for the longer-term high-return portfolio.

The opportunities are many for Russia in the management of its surplus oil revenues. The opportunity costs are also extremely high. Reality will most likely deviate significantly from the scenario presented above. In particular, oil prices could end up being significantly higher or lower than those projected here. The government has understandably made the management of the Stabilization Fund a primary priority in its current policy discussions. Future textbooks on Russian history will likely evaluate the economic policies of the current government to a large extent on how effectively it manages the country's growing oil wealth.

Table 2.1: Assumptions for the simulations

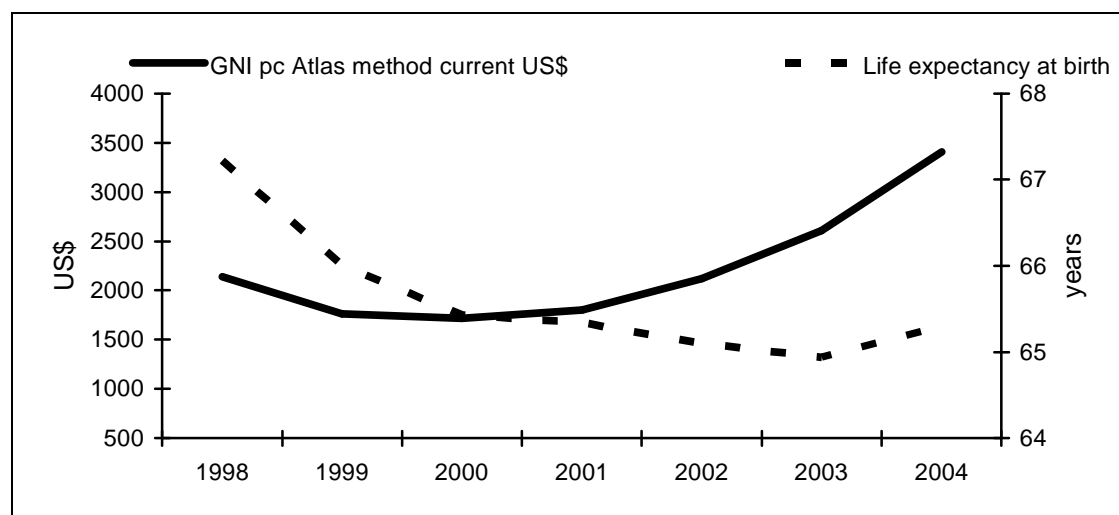
Year	Real GDP Growth	Oil Price bbl USD, real terms	Real appreciation of the ruble relative to the US dollar (1=no appreciation)	Federal Budgetary Expenditures (% of GDP)	Average Real Rate of return on portfolio	USD Annual Inflation (%)
2006	5,50%	57	1.106	17	1.195%	3
2007	5,00%	55	1.049	17	1.195%	3
2008	4,50%	53	1.044	17	2.225%	3
2009	4,00%	51	1.040	17	2.225%	3
2010	4,00%	50	1.029	17	3.283%	3
2011	4,00%	48	1.019	17	3.283%	3
2012	4,00%	47	1.018	17	3.283%	3
2013	4,00%	46	1.017	17	3.283%	3
2014	4,00%	45	1.015	17	3.283%	3
2015	3,60%	44	1.013	17	3.283%	3
2016	3,50%	44	1.011	17	3.283%	3
2017	3,40%	43	1.009	17	3.283%	3
2018	3,30%	43	1.007	17	3.283%	3
2019	3,20%	42	1.005	17	3.283%	3
2020	3,10%	42	1.003	17	3.283%	3
2021	3,00%	42	1.001	17	3.283%	3
2022	3,00%	41	1.000	17	3.283%	3
2023	3,00%	41	1.000	17	3.283%	3
2024	3,00%	41	1.000	17	3.283%	3
2025	3,00%	41	1.000	17	3.283%	3
2026	3,00%	41	1.000	17	3.283%	3
2027	3,00%	41	1.000	17	3.283%	3
2028	3,00%	41	1.000	17	3.283%	3
2029	3,00%	41	1.000	17	3.283%	3
2030	3,00%	40	1.000	17	3.283%	3

III: MORTALITY AND THE HEALTH OF THE RUSSIAN POPULATION

Poor health detracts from the quality of life of a large portion of the Russian population, restrains economic development, and is an important component of the growing demographic crisis in the country. A recent World Bank report, “Dying Too Young”¹, investigated the exceptional problems of mortality and morbidity among the Russian working age population, and outlined some distressing implications for future economic development. Recently, the government has made improving health care a major political priority, and new data available for 2004 indicate that recent sharp increases in household incomes and declines in poverty may be having at least some affect on mortality rates. Still, Russia continues to face tremendous challenges in confronting its demographic and health crisis, reforming the health system, and changing the unhealthy life styles of much of the population. The rapid spread of Tuberculosis and HIV-AIDS presents a particular future health threat, compounding the already high toll imposed by non-communicable diseases such as cardiovascular conditions, cancer and injuries. This note summarizes some results from “Dying Too Young”, other recent information, and outlines the nature of the implied future challenge to the country.

The countries of the former Soviet Union share, with sub-Saharan Africa, the dubious distinction of comprising the two major regions of the world in which life expectancy has been declining. In the Russian Federation, female life expectancy (72 years) is close to the level of 1955; male life expectancy (59 years) is three years less than in that year, and is now at the same level as in Eritrea and Papua New Guinea. Until 2004, declines in life expectancy in Russia contrasted sharply with strong growth in incomes and poverty reduction since 1998 (Figure 3.1). Even with the positive dynamic exhibited in 2004, average life expectancy in Russia only rebounded to the low level of 2000 (65.3 years). This can be compared with a 78 year average in the European Union.

Figure 3.1: Gross National Income per Capita and Life Expectancy



Source:

World Bank World Development Indicators 2005/WHO/EURO HFA Database 2005.

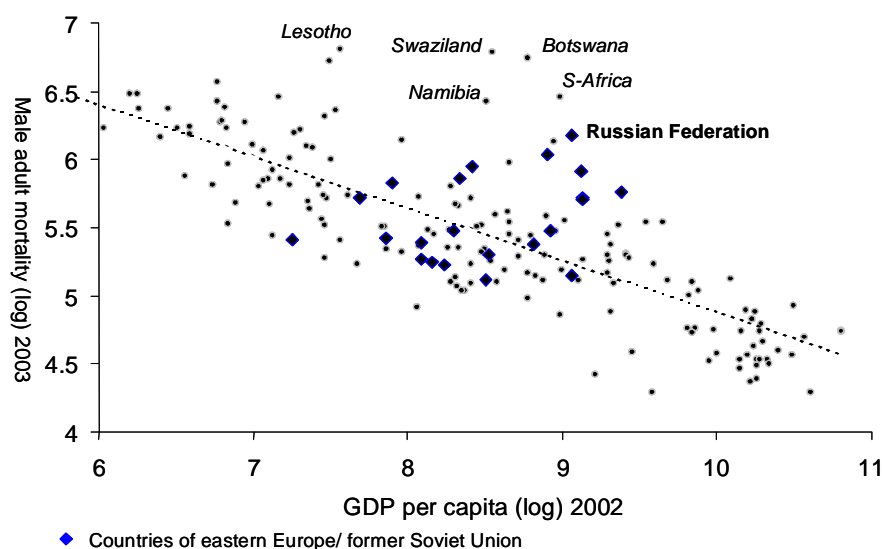
Note: When calculating GNI in U.S. dollars from GNI reported in national currencies, the World Bank follows the Atlas conversion method, using a three-year average of exchange rates to smooth the effects of transitory exchange rate fluctuations.

Mortality rates for males are extraordinarily high in Russia relative to other countries at similar income and development levels. Figure 3.2 plots Russia against other countries with respect to male adult mortality (vertical axis) and GDP per capita (horizontal axis). The only

¹ World Bank. 2005. *Dying Too Young. Addressing Premature Mortality and Ill Health Due to Non-Communicable Diseases and Injuries in the Russian Federation*. Washington, D.C.: The World Bank.

other countries that show comparable or worse mortality rates for their wealth category are African countries that have been recently devastated by the AIDS epidemic:

Figure 3.2: GDP Per Capita and Male Adult Mortality in Russia and Other Countries



At present levels of mortality, less than six out of every ten 15 year old Russian boys can expect to survive to the age of 60, while almost eight out of every ten Brazilian or Turkish boys and nine out of ten British boys can expect to live until 60. The survival prospects for Russian girls, while still inferior to many other countries, do look markedly better than for Russian boys.

Table 3.1: Life expectancy and adult mortality in selected countries

Country	Probability of dying between ages 15 and 60 (% males) (2000 to 2001)	Probability of dying between ages 15 and 60 (% females) (2000 to 2001)
Russian Federation	42.4	15.3
Japan	9.8	4.4
France	13.7	5.7
USA	14.1	8.2
Germany	12.6	6.0
United Kingdom	10.9	6.6
Denmark	12.9	8.1
Mexico	18.0	10.1
Poland	22.8	8.8
Turkey	21.8	12.0
Brazil	25.9	13.6
Kyrgyz Republic	33.5	29.9

Source: World Bank (2003): World Development Indicators.

The gap between Russia and Western Europe is even more pronounced when morbidity is accounted for in a composite variable of “healthy life expectancy.” Table 3.2 illustrates a less well-recognized problem of ill health among women. Indeed, the healthy life expectancy of Russian women is not much higher than for men.

Table 3.2: Life expectancy (LE) and healthy life expectancy (HLE) in Russia

	Country/Region	At age 20		At age 40		At age 65	
		LE	HLE	LE	HLE	LE	HLE
Males	Russia	41.9	36.7	22.4	17.3	11.4	6.7
	Western Europe	54.5	50.4	31.2	27.6	15.0	12.5
Females	Russia	54.2	40.6	31.1	18.5	15.2	5.8
	Western Europe	60.2	53.7	36.0	30.3	18.1	14.0
Female-male gap (years)	Russia	12.3	3.9	8.7	1.2	3.9	-0.9
	Western Europe	5.7	3.3	4.8	2.7	3.1	1.5

Source: Andreev, McKee, and Shkolnikov (2003). ADD

In addition to direct welfare implications, high mortality and morbidity among the Russian working age population represent threats to economic development and national security. Labor supply is bound to become an ever greater constraint on economic growth, as Russia faces a general demographic crisis of even more serious magnitude than in Western Europe. Most expert opinions project a decline in the population in the order of 17 percent by the year 2050. The expected decline in working age population is even more severe, and experts estimate that an annual inflow of roughly one million working age migrants would be needed to fill the gap after 2007.² In addition, low health rates among the working population have economic costs in the form of low productivity, early retirement, and high medical expenditures. A rapidly growing dependence on migrant labor raises national security questions for Russia, as does poor health in the military.

What are the causes of extremely high mortality and morbidity rates in Russia? This question has puzzled specialists over the years. The problem itself extends back into the Soviet period. In 1970, life expectancy in the Soviet Union had reached 69 years, relative to an average of 72 in Western Europe. During the 1970s, however, life expectancy began a steady decline, which was interrupted only briefly in the mid-1980s. The primary component of the increase in mortality is men between the ages of 25 to 64. Heart disease, cancer, and injuries account for 78 percent of deaths among the male working age population. Possible important contributing factors include high alcohol and tobacco consumption, a diet high in animal fat and salt, and low in fruits and vegetables, low safety standards, problematic access to quality health care for a large part of the population, and pollution. The recent rapid spread of HIV-AIDS in Russia owes primarily to intravenous drug use, which in turn exacerbates the Tuberculosis epidemic among the civilian and prison populations.

Alcohol occupies a prominent place in many explanations of Russia's health crisis. It can potentially explain part of the huge difference in male and female life expectancy. Lower alcohol consumption in the early years of Mikhail Gorbachev's anti-alcohol campaign coincided with a temporary reversal of the negative trend. Evidence continues to mount to the effect that alcohol may indeed be a primary culprit. A recent study of 1700 cases of male deaths between the ages of 25 and 54 in Izhevsk presents what may be the most convincing case. The study was able to link clearly an astonishing 38% of these deaths to problems of alcohol abuse.³ A large portion of these deaths concern individuals who drank surrogate alcoholic beverages or had frequent prolonged drinking episodes (*zapo*). Studies in other countries, including Finland and Canada, have also found persuasive evidence that the pattern of drinking large amounts of ethanol on single occasions is strongly related to mortality, including cardiovascular disease.

² Mkrtychian, N.V., Zubarevitch, N.V. (2005) "Typology of Russian regions by migration and socio-economic development" ["Tipologiiia regionov Rossii po pokazateliam migratsii i sotsialno-economiticheskogo razvitiia"], Tsentr strategicheskikh razrabotok, Moscow, Mimeo, April

³ Leon, D, Andreev, E., Kiryanov, N., McKee, M., Suburova, V., Shkolnikov, V. and Tomkins, S. (2005), "Izhevsk Family Study," Interim Report. London School of Hygiene and Tropical Medicine

The Russian Federation also has the highest road death rate (per 100 thousand population) of all European Conference of Ministers of Transport (ECMT) member countries. In 2004, 208,558 reported road crashes resulted in 34,506 deaths, roughly half of which were the most economically active part of the population (15-44 years old). Along with a 260 percent increase in the car fleet since the early 1990s, Russia was witness to a dramatic deterioration in road safety. Problems in the mix of road user traffic, high vehicle speeds, poor roads, and low vehicle crash protection have been contributing to a growing road safety crisis in Russia. The continued rapid growth in the number of motor vehicles on the road implies that the challenges will become even greater in coming years.

The Russian health care system has been the focus of attention in many studies. Given the increasing costs, including informal costs, of quality medical care and pharmaceuticals, experts have raised concerns that access to quality care may have declined substantially for poorer segments of the population. Indeed, increases in mortality and morbidity rates are particularly concentrated among the poor. Through 1995, government spending on health care (3 – 4.5% of GDP) was low compared to many other countries, including typical levels of over 6 percent in the European Union. Yet survey evidence indicates that private contributions, including informal payments, have been at roughly the same level as government contributions, bringing overall Russian expenditure on health well in line with international standards for middle income countries. The implication of the growing importance of informal expenditures, however, is that the effective allocation of health services has become more unequal. The Russian health care system also suffers from a number of well-known major structural weaknesses that include an overemphasis on hospitals relative to primary care and disease prevention, poor monitoring of health risks and the quality of services, an inefficient distribution of health workers across geographic areas, low pay for a large number of medical professionals, a shortage of modern equipment, little budgetary flexibility at the municipal level, and an under-funded national insurance system. Russia exceeds most other countries, including those of the EU, in per capita numbers of doctors, nurses, other hospital personnel, hospital beds, and average lengths of hospital stays. Yet it lags behind in most other areas, most particularly in health promotion and disease prevention.

What is the proper policy response to the Russian health and demographic crisis? Given that the root causes of this crisis appear linked to the unhealthy lifestyles of Russian citizens, particularly men, programs aimed at affecting these lifestyles, together with preventive care, are of particular interest. Global trends in health care are favoring much more investments in keeping people healthy relative to treating the sick. Russia can learn from the experience of a number of other countries in this regard, including programs in Sweden and Finland that have succeeded in reducing alcohol consumption. The North Karelia Project in Finland represents a particularly interesting example of an integrated strategy to reduce the probability of disease, including both population-based and high-risk prevention strategies.⁴ The latter includes a significant investment in identifying individuals at high risk of developing selected diseases, and shows that risk factors can be decreased relatively quickly in many cases, i.e. while exposure may take many years to give rise to disease, its removal can achieve rapid reductions in risk.

Involvement of the private sector is also of particular importance. Since private firms bear much of the costs from the poor health of employees, they also have a direct incentive to invest in their health. Private and public/private initiatives can reduce the cost and increase the effectiveness of programs aimed at protecting the health of the population. Companies

⁴ Puska, P., Tuomilehto, J., Nissinen, A., Vartiainen (eds.), *The North Karelia Project: 20 Year Results and Experiences*. The National Public Health Institute. Helsinki, Finland.

can also have a strong influence on the behavior of their staff and can make them aware of health risks in ways not open to the government.

Reforms in the health care system should also have a measurable impact on the situation. Under the priority “National Project for Health Care,” the Russian government is devoting a total of 145.6 billion rubles in 2006 and 2007 to the health system. The majority of this money is channeled in three directions: the creation of new high-tech medical centers (22%) salary increases for basic medical personnel (21%), the provision of modern medical equipment (20%), and increases in the quantity of provided services (11%). There are also significant provisions for immunization programs (7%) and the targeting of HIV-AIDS and Tuberculosis (7.4 %).

The National Project should certainly have a positive impact on health care in Russia, In the absence of other measures, however, it will not correct a number of the structural weaknesses in the health system itself. The Russian health system, which is dominated by hospitals, poor incentives, outdated guidelines, and vertical systems for service delivery, should be restructured toward a primary care system that places emphasis on health promotion, disease prevention, performance incentives, and more flexible budgetary processes. In this regard, possible regional pilots in health care reform, currently under discussion in the Russian government, are of particular interest. These pilots would concentrate attention on the rationalization of budgetary allocations in the medical sphere, placing emphasis on monitoring results, creating stronger incentives for medical staff to deliver quality care, and reallocating resources to areas of the highest return for the health of the population. Such pilots could potentially provide successful models for subsequent implementation in other regions.

The marginal improvements in recent indicators of mortality are certainly no reason for complacency by the Russian government. The health crisis in Russia continues, and newer challenges coming from HIV-AIDS and tuberculosis could potentially worsen the situation. Of course, problems in unhealthy lifestyles have complicated psychological, cultural, and traditional roots. Yet the experience of other countries suggests that effective national programs can indeed affect lifestyles in a positive direction.

Table 10: Main Macroeconomic Indicators

Output Indicators	2001	2002	2003	2004	2005	2005					2006		
	Yr	Yr	Yr	Yr	Yr	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb
GDP, % change, y-o-y 1/	5.1	4.7	7.3	7.2	6.4	-	-	5.8	-	-	6.4	-	-
Industrial production, % change, y-o-y	4.9	3.7	7.0	8.3	4.0	4.9	3.4	5.2	3.5	5.5	4.6	4.4	1.1
Manufacturing, % change, y-o-y	-	1.1	10.3	10.5	5.7	5.4	4.5	8.1	6.2	9.1	6.7	4.1	-0.1
Extraction of mineral resources, % change, y-o-y	-	6.8	8.7	6.8	1.3	1.1	0.3	0.1	1.4	2.1	2.1	0.9	1.1
Fixed capital investment, % change, y-o-y	8.7	2.6	12.5	10.9	10.5	11.2	9.7	10.5	10.3	12.4	12.0	1.5	1.7
Fiscal and Monetary Indicators													
Federal government balance, % GDP 1/	3.0	2.3	1.7	4.2	7.5	9.4	8.9	7.7	8.2	8.4	7.5	13.9	11.4
Consolidated budget balance, % GDP 2/	-	-	1.3	4.5	7.7	-	-	-	-	-	-	-	-
M2, % change, p-o-p 3/	44.6	34.1	44.8	42.5	35.6	1.2	3.0	3.1	0.4	2.3	11.2	-3.4	1.3
Inflation (CPI), % change, p-o-p	18.6	15.1	12.0	11.7	10.9	0.5	-0.1	0.3	0.6	0.7	0.8	2.4	1.7
GDP deflator	16.5	15.7	14.0	19.5	19.6	-	-	-	-	-	-	-	-
Producer price index (PPI), % change, p-o-p	8.3	17.7	12.5	28.8	13.4	0.5	2.0	2.8	0.9	-0.9	-2.1	0.4	3.2
Nominal exchange rate, average	29.2	31.4	30.7	28.8	28.3	28.7	28.5	28.4	28.6	28.8	28.8	28.2	28.2
Real effective exchange rate, July 1998=100 (IMF)	79.4	82.0	90.5	103.7	112.6	100.1	98.6	99.1	100.8	101.2	100.8	101.2	-
Real effective exchange rate, % change, p-o-p (IMF)	18.7	3.3	10.3	14.5	8.7	0.1	-1.6	0.6	1.7	0.4	-0.4	0.4	-
Stabilization Fund bln USD, end-o-p	-	-	-	18.7	42.9	25.1	29.2	33.9	38.3	43.0	42.9	51.6	55.4
Reserves (including gold) billion \$, end-o-p	36.6	47.8	76.9	124.5	182.2	144.6	149.7	159.6	165.0	168.4	182.2	188.5	195.9
Balance of Payment Indicators													
Trade Balance, billion \$	48.1	46.3	59.9	145.8	118.3	10.7	10.8	10.9	10.7	9.9	10.6	12.2	12.0
Share of energy resources in export of goods, %	51.2	52.4	54.2	54.7	61.1	-	-	64.4	-	-	61.3	-	-
Current Account, billion \$	33.9	29.1	35.4	58.6	84.2	-	-	19.7	-	-	21.8	-	-
Export of goods, billion \$	101.9	107.3	135.9	183.2	243.6	21.5	21.6	21.7	22.2	22.3	24.5	20.9	22.1
Import of goods, billion \$	53.8	61.0	76.1	96.3	125.3	10.8	10.8	10.8	11.5	12.4	13.9	8.7	10.2
Gross FDI, mln USD 1/	3980	4002	6781	9420	13072	-	-	6602	-	-	13072	-	-
Average export price of Russia's oil, \$/bbl	20.9	21.0	23.9	34.1	45.2	48.9	52.9	54.8	52.5	49.9	48.4	51.5	-
Financial Market Indicators													
Average weighted lending rate for enterprises, %	17.9	15.8	13.1	11.5	10.9	10.3	10.7	10.7	10.8	11.5	11.2	10.4	-
CBR refinancing rate, %, end-o-p	25.0	21.0	16.0	13.0	12.0	13.0	13.0	13.0	13.0	13.0	12.0	12.0	-
Real average rate for Ruble loans, % (deflated by PPI)	-1.1	3.9	-2.2	-10.1	-8.2	-8.5	-8.4	-8.1	-7.2	-3.9	-2.0	-2.6	-
Net credits to real sector, R billion	486.0	479.0	897.8	1210.2	1603.6	130.3	127.7	145.1	194.1	170.0	223.4	20.4	-
Net credits to real sector/ GDP, %	5.4	4.4	6.8	7.1	7.4	-	-	6.9	-	-	9.3	-	-
Stock market index (RTS, ruble term)	260.1	359.1	567.3	614.1	1125.6	778.9	882.0	1007.1	935.0	1037.3	1125.6	1316.0	1453.4
Enterprises Finances													
Share of loss-making companies 1/	38.4	43.4	41.3	35.8	33.5	37.8	36.5	35.7	35.6	34.5	33.5	-	-
Share of credits in capital investment 1/	-	10.8	14.5	15.2	13.8	-	-	14.4	-	-	13.8	-	-
Profitability (net profit/paid sales), % 1/	25.6	17.4	20.7	25.5	-	25.2	25.4	26.3	28.4	-	-	-	-
Income, Poverty and Labor Market													
Real disposable income, 99 = 100	121.7	135.3	155.4	170.8	185.8	191.1	185.6	198.2	198.4	200.0	279.2	151.3	185.5
Average dollar wage, US \$	112.4	138.6	179.4	237.2	301.6	303.2	300.0	308.4	315.3	308.9	384.7	330.1	323.8
Share of people living below subsistence, % 1/	27.3	24.2	20.6	17.8	15.8	-	-	-	-	-	-	-	-
Unemployment (% , ILO definition)	9.0	8.1	8.6	8.2	7.6	7.2	7.1	7.3	7.6	7.8	7.7	7.7	7.7

1/ Cumulative from the year beginning

2/ Federal and consolidated regional budgets (no extrabudgetary funds)

3/ Annual change is calculated for average annual M2

Source: Goskomstat, CBR, EEG, IMF, staff estimates.