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RUSSIAN FEDERATION

Country briefing notes

Growth slowed on weak commodity exports

- Economic growth decelerated further from 3.5% in 2012 to a four-year low of 1.3% in 2013. A sluggish global economic recovery held back the country's hydrocarbon exports. Related sectors, such as trade, industry and finance, also faced a slowdown. Lower oil revenues led to a slightly larger fiscal deficit of 0.5% of GDP in 2013.
- Although capacity utilization was close to its pre-crisis level, fixed investment remained weak as several public investment projects were completed. The economy was supported mainly by household consumption, which benefited from easy access to consumer loans and higher real wages.
- GDP growth for 2014 is expected to soften further to 0.3% due to geopolitical tensions with Ukraine that have resulted in capital outflows. Domestic investment is also projected to be weak.

Wage increases and currency depreciation pushed up inflation

- Despite slowing economic growth, the policy interest rate was kept unchanged between September 2012 and February 2014, as inflation stayed above the central bank's official target. Inflation rose to 6.8% in 2013 from 5.1% in 2012, partly due to rising wage levels.
- The policy rate was recently raised to curb inflationary pressures emerging from currency depreciation as capital outflows accelerated. Inflation stood at 6.4% in the first quarter of 2014. To contain inflation, the central bank also intervened actively in currency markets to limit the currency depreciation.
- In response to a higher household debt-to-income ratio, from 15% in 2010 to 24% in 2013, the central bank introduced higher requirements for uncollateralized loans and increased the risk weights for consumer loans. The supervisory role of the central bank is strengthened through key amendments to the Banking Law.

Current account surplus shrank

- The current account surplus decreased to 2.9% of GDP in 2013, compared with 3.7% of the GDP in 2012. Exports contracted by 1.3% amid lower export prices of energy, while imports rose amid strong household demand, which was fuelled by credit growth.

Economic diversification through regional cooperation

- The medium-term growth could dip below the pre-crisis pace mainly due to the country's high dependence on oil production, which is likely to remain sluggish.
- North and Central Asian economies should align their foreign investment strategies more closely with regional cooperation and integration initiatives in order to attract large-scale foreign investment in non-resource sectors, which thus far had been limited.
- Reducing trade costs would help foster intraregional trade. Cross-border and transit transport remains hindered by complex and non-harmonized procedures, as well as by limited cross-border transport infrastructure.
- Governments may consider public-private partnerships with an appropriate risk-sharing and regulatory framework as an option for cost-effective public service delivery. This especially matters for transport networks. Fair competition and better access to finance could promote innovation and entrepreneurship.

Enhancing tax revenues

- Between 2000 and 2011, the country's tax revenue fell by 2% while non-tax revenue, which is typically volatile, increased by 56%.
- Since 2001, the Russian Federation has applied a flat income tax rate of 13%. Given that flat rates are regressive and there has been an increase of income inequality in the country, a more appropriate move may be a dual income tax system that imposes increasing marginal rates on income on labour and capital separately.
- Like many other Asia-Pacific countries, the Russian Federation is engaged in corporate tax competition. However, several studies show that lower corporate tax rates do not necessarily help to attract more foreign direct investment.

Urbanization challenges in North and Central Asia

- Urbanization policies aimed at establishing and maintaining productive, sustainable and inclusive cities are often lacking. By developing growth poles that focus on strategic urban centres and economic corridors, both national and regional economic prospects can be enhanced, including through cross-border trade routes to distant markets.
- North and Central Asia has implemented different approaches for urban development with the aim to improve the capacities of municipal governance systems, such as municipal budgeting and support for social development in urban areas. However, greater opportunities still lie in streamlining policies and creating broader stakeholder engagement.

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