WORLD BANK GROUP

RUSSIA'S ECONOMIC RECOVERY GATHERS PACE

SPECIAL FOCUS ON COST-EFFECTIVE SAFETY NETS

45 RUSSIA ECONOMIC REPORT
MAY 2021

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ABBREVIATIONS AND ACRONYMS

AI	Artificial intelligence
APC	Air pollution control
APEC	Asia-Pacific Economic Cooperation
CA	current account
CAPB	Cyclically adjusted primary balance
CBR	Central Bank of Russia
CCTV cameras	Closed Circuit Television
CIS	Commonwealth of Independent States
CIT	Corporate Income Tax
COVID-19	Corona Virus Disease 2019
CPB	Netherlands Bureau for Economic Policy Analysis
CPI	Consumer price index
CRE	Cleaner or more resource efficient technologies and products
DC	District of Columbia
ECA	Europe and Central Asia
EGISSO	Unified National Registry
EMDEs	Emerging Markets and Developing Economies
EPP	Environmentally preferable products
EU	European Union
FX	Foreign Exchange
GCI	Green Complexity Index
GDP	Gross Domestic Product
GMI	Guaranteed minimum income
GNFS	General Number Field Sieve
GRP	Gross Regional Product
HEM	Heat and energy management
HS	Harmonized System
ICT	Information and communications technology
IEA	International Energy Agency
IHS Markit	American-British information provider
ILO	International Labour Organization
IP	Industrial production
IRENA	International Renewable Energy Agency
IRF	Impulse responses
JODI	Joint Organization's Data Initiative
LNG	Liquefied natural gas
LPM	Local projection method

MON	Environmental monitoring, analysis and assessment equipment
NIFI	Federal State Budgetary Institution «Financial Research Institute»
NVA	Noise and vibration abatement
NWF	National Welfare Fund
OECD	Organization for Economic Co-operation and Development
OECD	Organization for Economic Co-operation and Development
OFZ	Russian government bonds
OPEC	Organization of the Petroleum Exporting Countries
PMI	Purchasing Managers' Index
PMI	Purchasing Managers' Index
RCA	Revealed comparative advantage
REER	Real Effective Exchange Rate
REMAP 2030	Renewable Energy Prospects for the Russian Federation (Working Paper)
REP	Renewable energy plant
RLMS	Russia Longitudinal Monitoring Survey
ROA	Return on assets
ROE	Return on equity
ROSSTAT	Russian Federal State Statistics Service
RUSMOD	Tax-Benefit Micro Simulation Model for Russia
SA	Social Assistance
SCP	Social Contract Program
SME	Small and medium-sized enterprises
SMS	Short message service
SSN	Social Safety Nets
SWM	Management of solid and hazardous waste and recycling systems
UNSTATS	International Data exchange database on National Account Statistics
UNWTO	United Nations World Tourism Organization
VAR	Vector Autoregressions
WAT	Wastewater management and potable water treatment
WTO	World Trade Organization

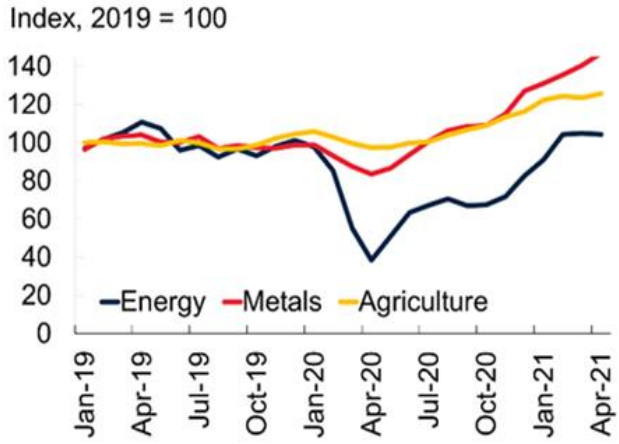
OVERVIEW

A. Renewed COVID-19 outbreaks continue to disrupt the global recovery

The COVID-19 pandemic continues to disrupt activity across the world, casting wide uncertainty around GDP projections. Despite the protracted and uncertain nature of the pandemic, global GDP growth is forecast to recover to 4 percent in 2021 and to moderate to 3.8 percent in 2022 under baseline assumptions established in January 2021. The baseline recovery, however, is not sufficient to return global output to pre-pandemic projections by 2022, with levels expected to be 4.4 percent below pre-pandemic projections next year. COVID-19 has reversed hard-won gains in poverty reduction, with the pandemic expected to push over 100 million people into extreme poverty by the end of 2021. Accompanying the rise in extreme poverty is that of food insecurity, especially in light of the steep falls in household incomes due to widespread job losses – many of which are not anticipated to be regained this year. The pandemic is expected to have longer-term scarring effects on productivity growth and potential output, as the erosion of business confidence further weakens investment and as human capital accumulation slows due to a deterioration in health outcomes, extended school closures, and prolonged unemployment. Global trade continues to recover, but with wide variations across countries and sectors. Global financing conditions remain accommodative amid ongoing vaccination drives in major economies.

Activity in Russia's two largest trading partners – the Euro area and China – shows divergent paths. Euro area activity remains vulnerable to COVID-19 resurgences, whereas China, Russia's second-largest trading partner, continues to experience a cyclical recovery. China was among the few economies that averted a recession in 2020, growing at 2.3 percent, with activity partly buoyed by public investment.

Figure OV-1: Nearly all commodity prices rose in Q1 2021



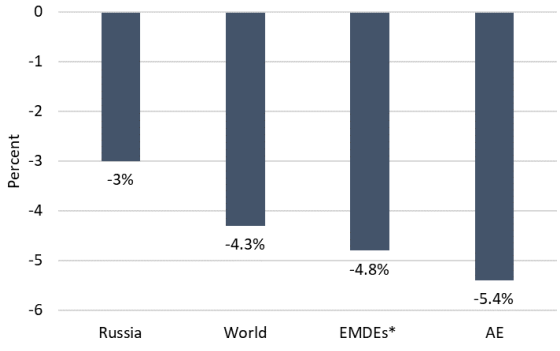
Source: International Energy Agency; World Bank.

Nearly all commodity prices rose in Q1 2021, continuing the marked rebound since mid-2020. (Figure OV-1). The largest increase was for energy commodities, which rose by around one-third (q/q). Energy exports are particularly important for Russia, accounting for around 60 percent of total goods exports in 2019. Most commodity prices now exceed their pre-pandemic levels, with several reaching multi-year highs. The recovery has been driven by the global recovery from last year's recession and improved growth prospects, supported by significant policy stimulus in advanced economies. Commodity-specific supply factors have also played a role, especially for crude oil, natural gas, copper, and several food commodities.

B. Russia's 2020 GDP growth: a lower decline compared to the global average and to EMDE commodity exporters

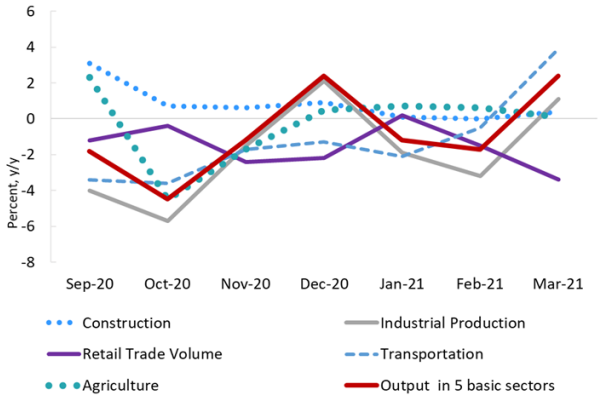
Russia's GDP fell by 3.0 percent in 2020 compared to contractions of 3.8 percent in the world economy, 5.4 percent in advanced economies and 4.8 percent in commodity-exporting EMDEs (Figure OV-2). Several factors helped Russia perform relatively better: in recent years, Russia undertook significant macro-fiscal stabilization efforts, resulting in an improved fiscal position. The federal budget non-oil primary deficit reached 4.7 percent of GDP, compared to 9.7 percent of GDP in 2013 — including a sizeable accumulation of fiscal and reserve buffers (as of May 1, 2021, the NWF reached US$185.8 billion (11.6 percent of GDP), while its liquid part reached about US$116.4 billion (7.3 percent of GDP). International reserves as of April 1 stood at a comfortable US$574.8 billion (22.6 months of imports), reducing exposure to oil price volatility and lowering the public debt burden (19.7 percent at the end of 2020). A massive banking sector clean-up, together with enhanced regulation and supervision, fortified capital and liquidity buffers. These efforts strengthened Russia's ability to respond to the pandemic's most adverse economic shocks. They allowed the government to provide a substantial countercyclical fiscal stimulus (about 4.5 percent of GDP, on par with other EMDEs) and an accommodative monetary policy (the key rate was lowered by 200 basis points between February and July 2020). Other contributing factors were relatively soft restrictions for industrial and construction sectors, closer ties to a relatively fast-growing China, a relatively small services sector and a large public sector that buffered against unemployment. Digital technologies also played a critical role during the pandemic, enabling the society and economy to operate during lockdowns and providing the government with effective tools to reach out to socially vulnerable populations. The development of a comprehensive national data strategy that enables rapid innovation while ensuring essential economic and social protections can further advance the role of digital technologies in the economy (see Box 1 in the main report). As the pandemic's second wave swept across Russia and the globe in the autumn of 2020, the earlier growth rebound in Q3 2000 stopped in 4Q 2020. However, in the first quarter of 2021, growth picked up again with some stabilization of new COVID-19 cases, the lifting of related restrictions, and the loosening of OPEC+ production cuts (Figure OV-3).

Figure OV-2: In 2020, Russia's GDP contracted less than the global average and that of EMDE commodity exporters'



Source: Rosstat, World Bank.
Note: * EMDEs = Emerging Market and Developing Economies (commodity-exporting); AE = Advanced Economies.

Figure OV-3: High-frequency statistics reveal a recovery gaining pace in Q1 2021



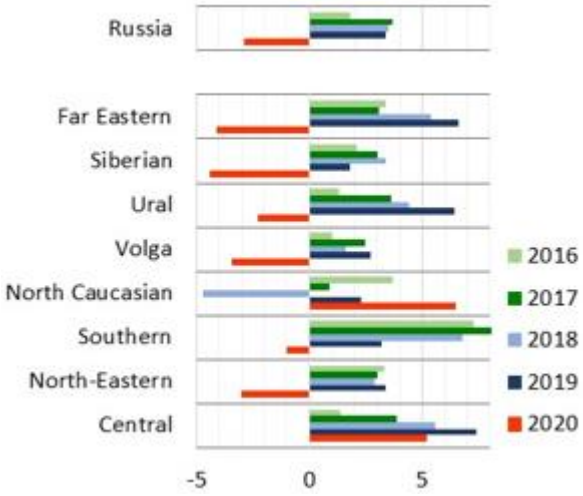
Source: Rosstat.

The COVID-19 crisis continues to affect Russian regions' economic indicators to varying extents, based on their exposure to the pandemic, on pre-existing conditions, and on the type of activity. The COVID-19-induced shock led to negative growth in industrial production and retail trade in 2020 in most regions (Figure OV-4). Regions dependent on mineral extraction demonstrated negative industrial production growth in annual terms (Figure OV-5).

Figure OV-4: The COVID-19-induced shock led to negative growth in retail trade in 2020 in the majority of regions

Source: Rosstat.

Figure OV-5: Industrial production declined in all districts except North Caucasian and Central districts (percent, y/y)

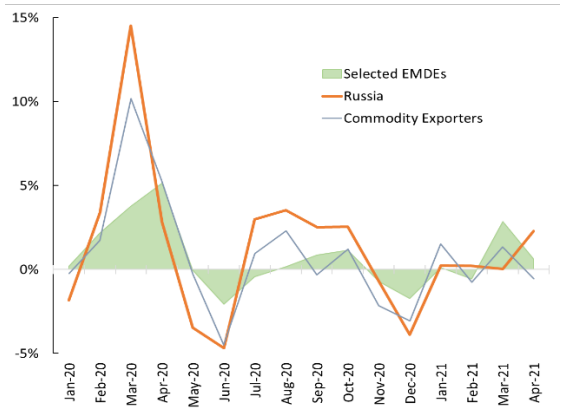


Source: Rosstat.

Lower energy-export receipts, financial-market volatility and increased geopolitical risks resulted in capital outflows and ruble depreciation in 2020, with some pressures alleviated in early 2021. Capital outflows in 2020 increased to US$47.8 billion, up from US$22.1 billion in 2019, driving a real effective exchange-rate (REER) depreciation: the REER depreciated by 7.5 percent, y/y. However, firming oil prices, a stabilizing number of new COVID-19 cases and a stimulus package in the U.S. providing hopes for a faster global recovery supported the ruble in the first quarter of 2021. The ruble appreciated with respect to the U.S. dollar, gaining 2.5 percent, q/q (Figure OV-6). In April 2021, on the back of elevated geopolitical tensions, the ruble lost 2.2 percent with respect to the US dollar. The current account could be further supported by expanding exports of green products. As a major energy exporter in a greening global economy, environmentally sustainable exports could play a stronger role for Russian export diversification. "Green" or environmental goods include those that are either environmentally beneficial in use or consumption; substitutes which are produced causing comparatively less environmental harm; or which actively contribute to cleaning or reducing damage made to the environment. Under this definition, Russia's exports of environmental goods have risen modestly, making up 1.6 percent of exports (3.4 percent of non-energy exports) in 2019 as compared to 0.9 percent (2.6 percent) in 2010, but imports still far exceed exports (Figure OV-7). Russia's exports of environmental goods are led by products with low technological sophistication and which can primarily serve as inputs or substitutes (such as articles or structures

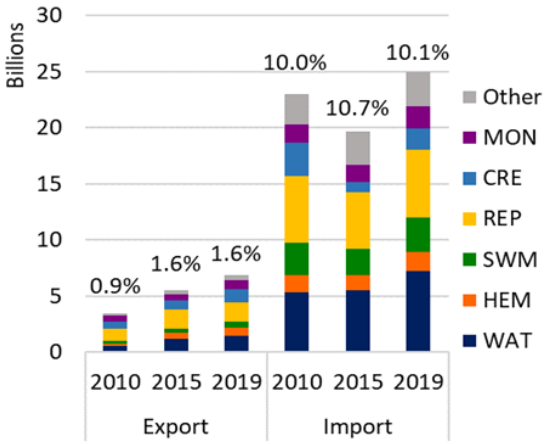
of steel).A first-time analysis in the main report (Box 4) identifies specific green products that Russia is well positioned to export competitively.

Figure OV-6: The ruble appreciated with respect to the U.S. dollar in the Q1 2021, q/q



Source: CBR.

Figure OV-7: Imports of environmental goods exceed exports



Source: Comtrade, OECD2014.

Notes: CRE = Cleaner or more resource efficient technologies and products; HEM = Heat and energy management; MON = Environmental monitoring, analysis and assessment equipment; REP = Renewable energy plant; SWM = Management of solid and hazardous waste and recycling systems; WAT = Waste water management and potable water treatment.

The CBR's monetary policy remained consistent with the inflation-targeting framework, with inflationary factors, in particular food price inflation, on the rise. Demand-side and supply-side inflationary factors pushed up the annual rate of consumer price index (CPI) inflation to 5.5 percent in April. Household and corporate inflation expectations increased, compared to pre-pandemic times, and they remain elevated. Food prices in Russia have been rising faster than overall prices since March 2020 (Figure OV-8), putting pressure on poor households as the average real disposable income decreased by 3.5 percent in 2020. Contributing factors for food price inflation include ruble depreciation, higher global food prices, and lower harvests of some agricultural items. Moreover, since the 2014 food embargo against imports from certain mostly Western countries, food price indices have been on average 10 percent higher than in Europe and 3 percent higher than in the rest of the world. Prices increased most substantially for sugar, eggs, groats and legumes and fruits and vegetables. Per capita consumption of cereals, oils and sugars constitutes a relatively small share in the food consumption basket of the average Russian citizen (16 percent) but account for a greater share of consumption among the poor. The poorest Russians (by income decile) spend 45 percent of their income on food – almost 2.5 times as much as the Russians in the highest decile. Food price inflation tends to be higher than overall inflation in those Russian regions that are less connected, have a higher share of poor population and are prone to significant weather and climate risks (Figure OV-9), while in Moscow, food price inflation has been almost at the level of the overall consumer price inflation.

Figure OV-8: Food prices in Russia have been rising faster than overall prices since March 2020 (y/y)

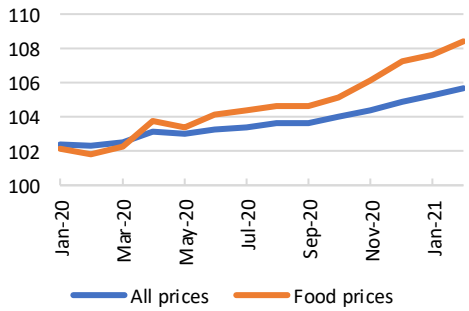
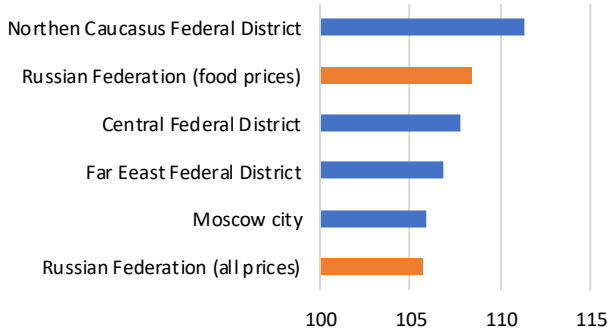


Figure OV-9: Food price inflation has been uneven across Russia (February 2021, y/y)



Source: Rosstat.

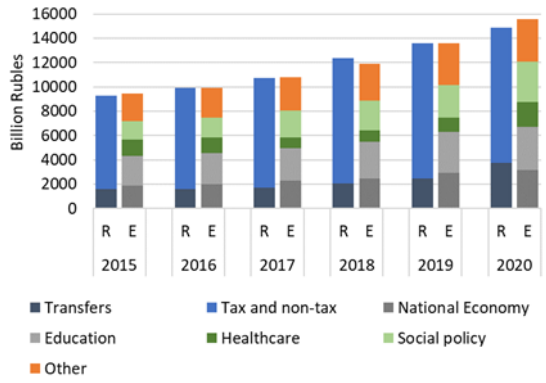
In response to rising food price inflation, Russia introduced several measures. These included establishing price caps on socially important food items, restricting exports of staple commodities, and/or providing subsidies to producers of key food items. Such measures are politically attractive because they seem to provide immediate relief and put Russian consumers first. Despite their domestic political salience, however, these regulatory actions are economically distortive and fiscally expensive. A better approach would be to implement targeted social assistance programs, taking into account country-specific circumstance and social norms, that deliver relief to the most vulnerable segments of the population (part 3 of the main report is on cost-effective safety nets).

Russia's fiscal outcomes worsened in 2020, but still compared favorably with other countries and improved slightly in the first quarter of 2021. In 2020, hit by the shocks induced by the pandemic, the federal budget registered a deficit of Rub4.1 trillion (3.8 percent of GDP), compared to a surplus of Rub1.9 billion (1.8 percent of GDP) in 2019. In 2020, the federal debt increased by 5.4 percent of GDP to 17.7 percent of GDP. The debt burden, however, remains substantially lower than in other EMDEs (19.7 percent of GDP vs. about 63 percent of GDP for EMDEs), as does the debt service (1 percent of GDP for Russia, vs 2 percent of GDP for the EMDEs). In Q1 2021, the federal budget outcomes improved amidst an economic rebound. Federal budget revenues increased y/y, due to higher non-energy revenues (mostly higher VAT receipts). Meanwhile, Corporate Income Tax (CIT) revenues fell by almost 18 percent, y/y, as accrued CIT receipts for 2020 were lower. Despite lower expenditures on health, in the first quarter of 2021, primary federal budget expenditures grew by 13 percent, y/y, driven by higher spending on state management, social policy, education, and communal and housing services. Economic sanctions, introduced in April, are expected to have a marginal effect on the Russian economy and the government's access to finance. On April 20th 2021, Russia raised 1.5 billion euros (US$1.83 billion) in two Eurobond issues maturing in 2027 and 2036 with foreign investors showing sufficient interest in investing in Russian debt instruments, stemming from relatively high yields (2.65 percent for 15 year bonds compared to 0.15 percent for 15 year bonds issued by Germany) and low debt levels in Russia. In 2021, about 1.1 percent of GDP will be spent under the framework of the plan of actions aimed at restoring economic growth and growth of disposable incomes from the federal budget, mainly on social benefits and infrastructure. Given its relatively low public debt, sizeable macro-fiscal buffers, and expected persisting negative output gap, Russia has the fiscal space for a more gradual consolidation, allowing further increases in social spending and support to regions if the pandemic situation

worsens. Output losses from fiscal consolidation are estimated to be pronounced in Russia: a 1 percent of GDP decrease in government spending could lead to a decrease in output of 0.4 to 2 percent.

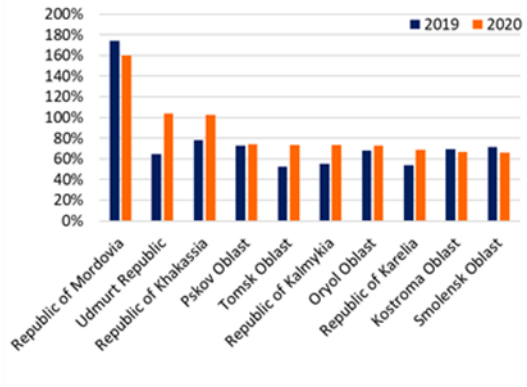
The debt situation in the regions has worsened but remains manageable. The crisis has resulted in a budget deficit in 57 regions (compared to 34 in 2019), contributing to an 18.1 percent rise in the debt of regions (Figure OV-10). The top 10 regions in terms of deficit accounted for 72.6 percent of the total deficit in 2020. Among the regions with the highest deficits, Tyumen Oblast, Yamal-Nenets Autonomous Area and Perm Krai stood out, having slid into deficit in 2020 from a surplus in 2019. The total debt burden (debt/tax and non-tax revenue) rose from 19.2 percent in 2019 to 23.1 percent in 2020, rising most sharply in Udmurt Republic, Republic of Khakassia, Kemerovo Oblast, and Tomsk Oblast (Figure OV-11).

Figure OV-10: Regional budgets slid into deficit in 2020 amidst higher expenditure, as revenues rose supported by transfers



Source: MoF.

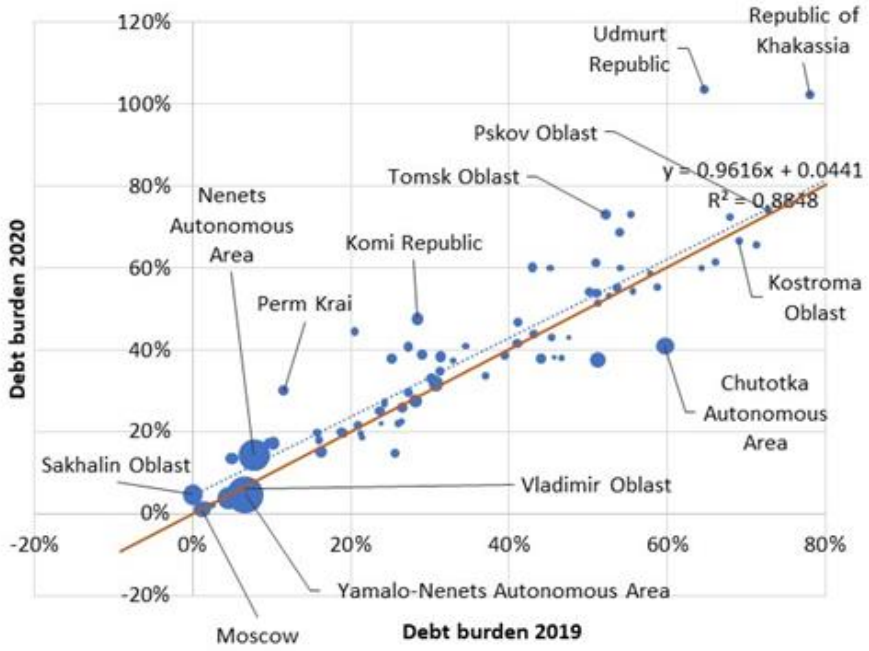
Figure OV-11: Several of the top regions in terms of highest debt burden experienced sharp rise in 2020 (debt/ tax and non-tax revenue)



Source: MoF.

Overall, the debt burden increased slightly more for regions where it was lower before the pandemic (Figure OV-12), as these regions (with more intensive economic activities) were hit harder by the pandemic and had more room to increase debt. An increase of the debt burden at the regional level led the government to convert regional commercial debt exceeding 25 percent of the regions' own revenues into budget credits (at a rate of 0.1 percent) to be paid by 2029. While justified on the basis that the pandemic is not over yet, at the same time, this decision could send mixed signals to regions with more conservative debt policies. Another option could have been a disbursement of general-purpose transfers for regions less prepared to face persistent pandemic challenges in 2021. The overall regional debt situation, however, remains manageable, with the consolidated regional debt at 23.1 percent of revenues, and deficit at 0.6 percent of GDP in 2020, compared to 30.4 percent and 0.2 percent, respectively, in 2015.

Figure OV-12: On average, the debt burden increased slightly more for regions less indebted before the pandemic

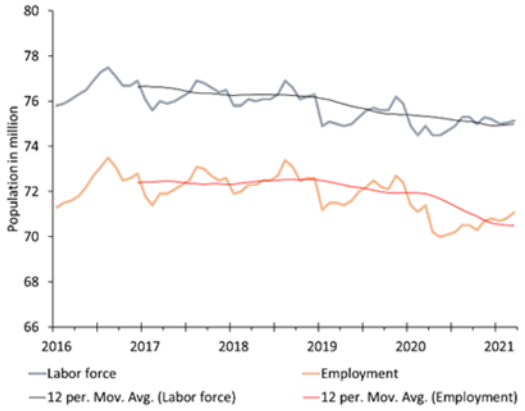


Source: MoF.
Notes: Size of bubbles represents GRP per capita in 2019; excludes Mordovia as outlier.

The Russian banking sector has been resilient so far, but medium-term impacts remain to be seen. Credit growth has been supported by a slow economic recovery and public credit support programs. In March, corporate sector loans grew by 9 percent, y/y, while retail lending increased by 14.4 percent, y/y. Reinforced by regulatory forbearance measures, the system-wide capital adequacy remained largely stable at 12.6 percent, and non-performing loans remained largely unchanged at about 9 percent of total loans. Banks' asset quality, profitability and capitalization may come under pressure when forbearance measures are lifted. However, this is expected to be moderate, given the CBR's moderate credit loss projections and strong credit growth. Recent sanctions on Russian sovereign debt do not threaten Russia's financial stability due to strong macro-fiscal buffers and relatively moderate share of foreign investor holdings (23.3 percent) of Russian government debt, which could be compensated through domestic investors.

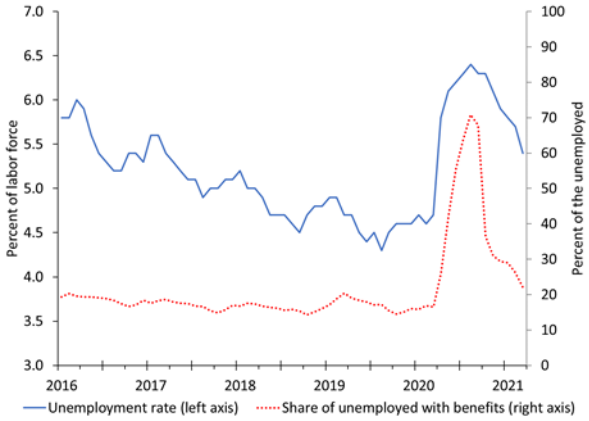
Although employment is still below pre-pandemic levels, the labor market began showing some signs of improvement by the end of year 2020 (Figure OV-13)**.** The national unemployment rate has been declining since last August, when it peaked at 6.4 percent, to 5.4 percent in March 2021. This rate is still 0.7 percentage points higher than in the same month of the previous year, which means that, despite the improvement, labor markets are not where they were before the pandemic. Moreover, the situation of the unemployed has worsened: coverage of unemployment insurance tapered off notably in the fourth quarter of 2020. Even though the unemployment rate has declined, the share of the unemployed who are protected by unemployment insurance has declined even faster, leaving a larger number of unemployed without coverage than before the pandemic (Figure OV-14).

Figure OV-13: Although employment is still below pre-pandemic levels, the labor market began showing some signs of improvement by the end of year 2020



Source: Rosstat and Haver Analytics.

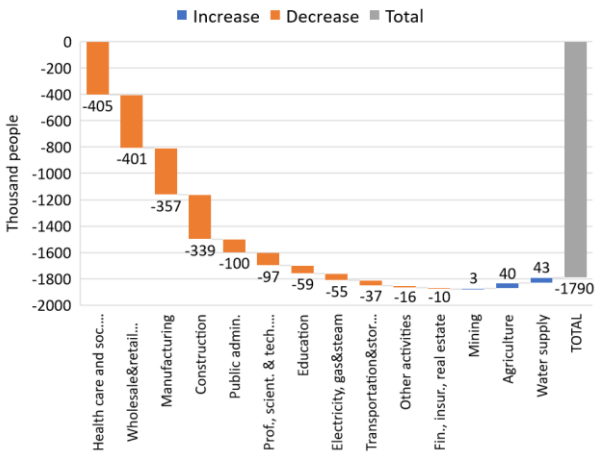
Figure OV-14: Unemployment rate has declined, but coverage of unemployment insurance has declined even faster



Source: Rosstat and Haver Analytics.

Job losses are not the same across economic activities. When comparing the average employment by sector between Q4 2020 and the same period the year before, the total loss of 1.78 million jobs was concentrated in four sectors: manufacturing, construction, retail and hospitality, and health/social services (Figure OV-15). These four had similar losses of around 350,000 jobs each. Losses in manufacturing, construction and retail and hospitality are associated with lock-down measures and the difficulty of tele-working in these activities. The fall of employment in health/social services, during a pandemic, however, is more difficult to explain. Possible explanations are increased mental and physical fatigue of health workers; increased infections in this segment of the workforce; or the fall in employment in social care facilities (including private) which were hit by the pandemic. The rest of the sectors have had much smaller losses, or none, which indicates that for the rest of the economy, the worst of the crisis seems to have passed as of now.

Figure OV-15: Job losses are concentrated in four economic sectors (changes in employment by economic activity, Q4 2020 vs Q4 2019)



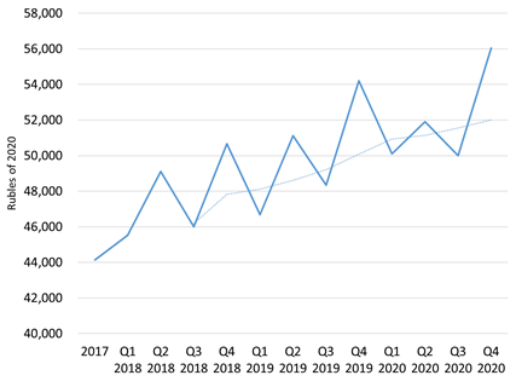
Source: World Bank staff using data from ROSSTAT.

While unemployment rates declined, informal employment has increased its share within total employment. The proportion of workers who worked only in the informal sector rose from 17.9 percent in Q2 2020 to 18.9 in Q4 2020. At the beginning of the crisis, most of the job losses occurred in the informal sector. But in the second

half of the year, most jobs were also created in the informal sector: the number of people working only in the informal sector grew by 828,000 in 2H 2020, whereas those working in the formal sector — or with jobs in both sectors — declined by 337,000. This indicates that the labor market, although regaining traction, is still feeble and labor demand has not regained full strength.

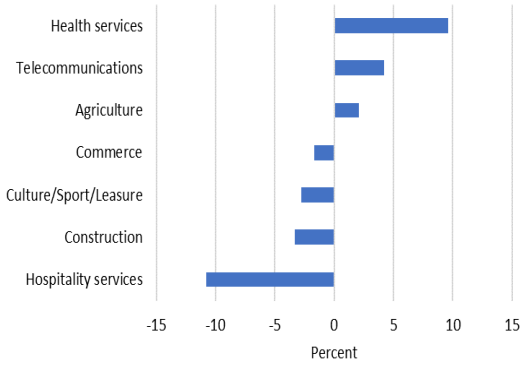
Average real wages increased by 1.7 percent between 2019 and 2020 but masked important differences across economic activities. Real wages increased in agriculture (2.1 percent), telecommunications (4.2 percent), and health services (9.6 percent), but fell in many other sectors, with large declines in hospitality services (-10.8 percent), construction (-3.3 percent), culture/sports/leisure activities (-2.8 percent) and commerce (-1.7 percent) (Figure OV-17). These data indicate that sectors that suffered the largest employment losses also had the largest real wage losses, which is consistent with a severe demand contraction in these sectors that are most affected by lockdown and are less prone to telework. The exception is the health/social services sector, which experienced a decline in employment but an increase in wages (perhaps due to the special premium given to medical staff working on COVID), which would be compatible with sustained or even increased demand for these services and at the same time a decline in the supply of workers in this area for reasons mentioned in the previous paragraph.

Figure OV-16: Real wages of employees have continued growing …



Source: World Bank staff using data from Rosstat.

Figure OV-17: …but the upward trend in real wages masks important differences across economic activities, 2020



Source: Rosstat.

Increase in real wages, however, does not compensate the decline in per capita disposable income in 2020. Per capita disposable income in the last three quarters of 2020 was lower by 7.9, 5.3 and 1.7 percent, respectively, than in the same periods of the previous year. The decline in per capita income, however, seems to not have disproportionately affected the poorest households (Figures 18 and 19). The share of cash incomes (the largest component of disposable income) among the poorest 20 percent of the population increased, while it remained the same for the second and third quintiles. This implies a slight decline in the Gini coefficient of cash incomes (from 41.1 to 40.6), as well as a decline in the 90/10 income share ratio, which fell from 15.4 to 14.4.

Figure OV-18: Per capita disposable income declined during the last three quarters of 2020

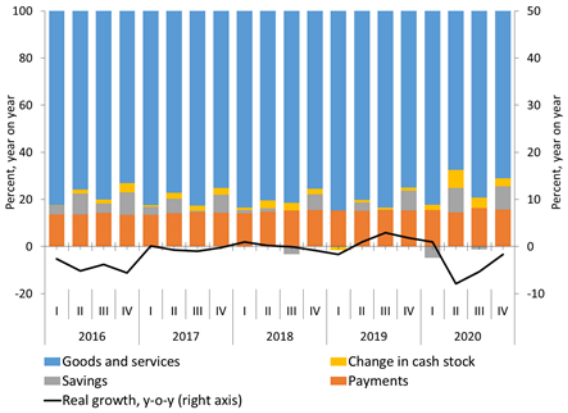
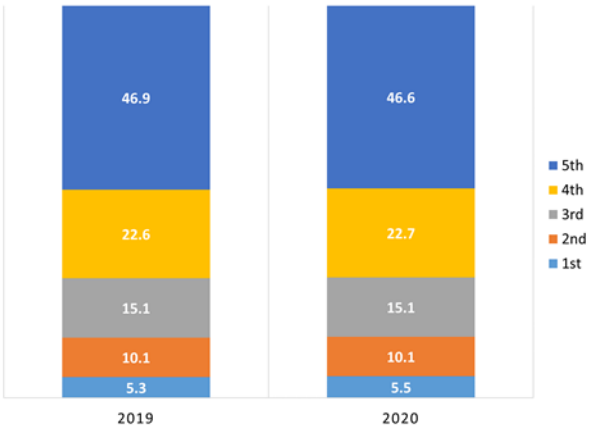


Figure OV-19: The share of income for the poorest quintile did not fall

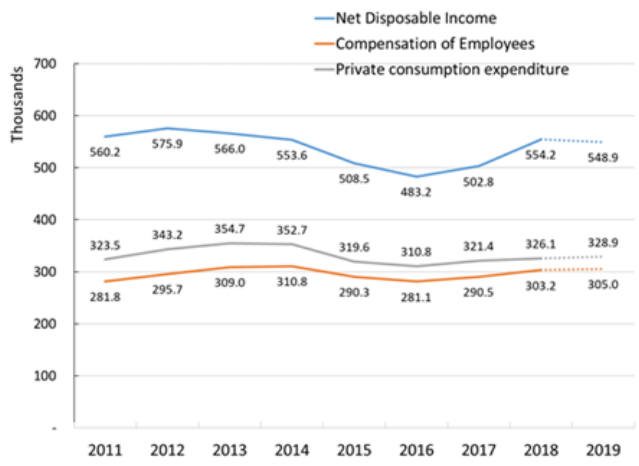


Source: World Bank staff using data from Rosstat.

Disposable incomes have been declining since 2013, but the magnitude of the decline is uncertain. Rosstat measures a decline of 10.6 percent in real disposable incomes since 2013. However, the level, deflators, components and full methodology behind this decline are not publicly available, so the reasons behind this decline are open to debate. Using UN sources, real disposable income per capita in 2019 is measured to be 3 percent lower than in 2013 (Figure OV-20). However, private consumption per capita declined 7.3 percent for the 2013-2019 period: a figure closer to ROSSTAT estimates. This indicates that ROSSTAT's numbers refer more closely to households' standard of living, rather than to the nation's disposable income. In contrast, employees' compensation per capita declined only 1.3 percent, for the period 2013-2019. Regardless of the magnitude of the decline in real incomes (which may not be known with much precision), a breakdown of the decline in disposable incomes suggests (i) a clear decline in households' standard of living; (ii) income losses among informal workers and small business owners; and (iii) an increase in precautionary savings, leading to higher poverty levels than in 2013 (see Box 9 in main report).

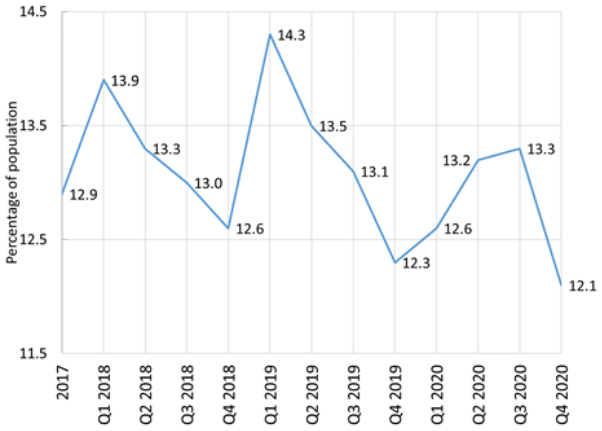
Additional spikes in the poverty rate have been contained in 2020. The increase in real wages, the decline in unemployment, and creation of new jobs — although mostly informal — during Q4 2020, together with compensatory social policies adopted during the second and third quarter of 2020, have led to a contained increase in poverty rates during the second and third quarter of the year and an important decline by the fourth quarter to 12.1 percent (Figure OV-21).

Figure OV-20: Real disposable income per capita in 2019 is 3.0 percent lower than in 2013



Source: World Bank Staff using data from UNSTATS.
Note: vertical axis in Annual Rubles of 2016, data for 2019 is preliminary.

Figure OV-21: After moderate increases mid-year, the poverty rate ended slightly below the previous year

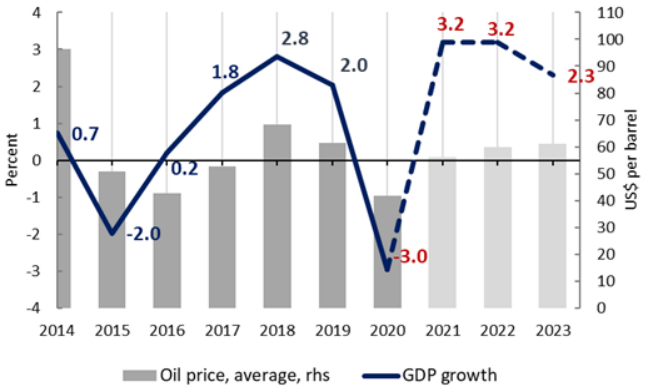


Source: World Bank staff using data from Rosstat.

C. Outlook: economic recovery to continue amid pandemic risks

Baseline Russian GDP growth is forecasted at 3.2, 3.2, and 2.3 percent in 2021, 2022 and 2023, respectively (Figure OV-22). This is the baseline scenario of gradual decline in new COVID-19 infections. Global economic recovery, higher oil prices, and soft domestic monetary conditions in 2021 are expected to support a recovery to be led by household consumption and investment. Subdued international tourism is expected support consumption as well. Growth momentum in gross fixed-capital investment is expected to be supported by improved business confidence and public investment projects. Migration flows are expected to be restored by end-2021, beginning of 2022, which would also support investment projects currently lacking a sufficient labor force in some locations. The combined effect of economic growth and changes in compensation policies (and assuming new ones are fully implemented and targeted) may lead to an end-year poverty rate of 11.4 percent (compared to 12.1 percent in 2020).

Figure OV-22: The baseline growth forecast for Russia suggests full recovery to pre-pandemic output level in 2021 (real GDP growth, percent)



Source: Rosstat, World Bank.

In an upside scenario, faster-than-expected vaccination rates could result in mobility restrictions being lifted sooner than planned. Global growth could recover more rapidly, and prove more longer-lasting, than expected, as a result of widespread vaccinations, faster reopening of economies and large stimulus packages. Oil demand growth could be significantly stronger than expected. In such an upside scenario, GDP growth in Russia is expected to accelerate to 3.8, 4.8, and 3.3 percent in 2021, 2022 and 2023, respectively with domestic demand expanding faster than in the baseline scenario.

In a downside scenario, renewed outbreaks of the pandemic and the spread of variants could result in lockdowns being needed for longer, and in more countries. This would result in substantially weaker oil demand. Weaker demand and lower prices could put increasing pressure on the OPEC+ agreement. A possible collapse of the agreement and a subsequent rise in production could result in oil prices being materially lower for longer. In the downside scenario, GDP growth is expected to stand at 2.6, -0.7, and 0.6 percent in 2021, 2022 and 2023, respectively with substantially lower consumer demand than in the baseline scenario, and investment contracting in 2022 – 2023.

Downside risks outweigh upside risks. The main risk to the forecast is the evolution of the pandemic. The continued spread of COVID-19 in parts of the world, particularly the spread of different variants, suggests that renewed outbreaks at a global level are still possible. New infections leading to renewed lockdowns could result in a further deterioration in oil demand and in oil prices being materially lower than currently expected. A sharp increase in new infections in Russia could lead to a reintroduction of strict lockdowns, negatively affecting domestic demand. Slow vaccinations or a lower-than-expected effectiveness of the vaccine (against new strains, for instance) could also delay the economic recovery. New sanctions could worsen Russia's outlook. Banks could face deteriorating asset quality, profitability, and capitalization following the full exit from the regulatory forbearance measures (expected by mid-2021). However, this is expected to be moderate, given the CBR's moderate credit loss projections and strong credit growth. The pandemic has also amplified contingent liabilities risk. An abrupt tightening of global financing conditions, perhaps triggered by a sudden removal of accommodative monetary policy in large, advanced economies, could represent a medium-term risk for Russia. Upside risks emerge from global growth recovering more rapidly amidst faster-than expected vaccination rates, which could result in oil demand significantly stronger than expected.

Russia's longer-term economic prospects will depend on boosting potential growth. Russia's potential growth has been trending downward since the global financial crisis. While near-term recovery will be contingent on the stemming of the pandemic, longer-term economic prospects will depend on boosting potential growth through promoting economic diversification, leveling the playing field for the private sector, improving governance – particularly of state-owned enterprises, and taking advantage of shifting global value chains. A green transition could pose significant challenges for the Russian economy unless the government undertakes preemptive steps toward decarbonization.

D. Special section: Halving poverty through cost-effective social safety nets

Recognizing the need of sharing prosperity, Russia declared a national goal to halve poverty to 6.6 percent by 2030. Growth will play an important role in achieving it; however, even under the most generous growth scenarios, it will be difficult to achieve this goal in the absence of a well-targeted national program lifting those in poverty. While Russia's social safety-nets system plays an important role in reducing poverty, it does so at a high cost. Russia spends over 3 percent of GDP or US$30 billion on social-assistance programs. This level of spending is

more than 3 times greater than the combined income deficit of all poor families in the country before transfers. It is also double the global spending on social assistance of 1.5 percent of GDP, and higher than the spending in ECA of 2.2 percent of GDP (World Bank 2018b). Introducing a national, targeted program providing financial assistance to people falling below a poverty threshold could be key to cost-effective poverty reduction. Such a program would cost around 0.33 percent of the GDP, or four times less than if Russia's existing social safety nets system were expanded. However, this estimate depends crucially on assumptions made, such as no leakage; no behavioral response; and reasonable administrative costs of 10 percent (as a share of total transfer amounts). A change in any of these assumptions would increase the cost of reducing the poverty gap. Moreover, many steps will be required to operationalize such a program, including a need to unify standards and develop key systems at the national level, as well as to strengthen various program features.

PART 1. Recent Economic Developments

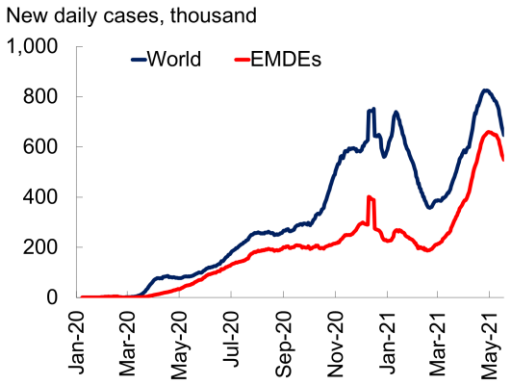
1.1. Global activity: COVID-19 resurgences continue to disrupt the recovery.

The COVID-19 pandemic continues to disrupt activity across the world, casting wide uncertainty around GDP projections.[1] Despite the protracted and uncertain nature of the pandemic, global GDP is forecast to recover to 4 percent in 2021 and to moderate to 3.8 percent in 2022 under baseline assumptions established in January 2021.[2] The baseline recovery, however, is not sufficient to return global output to pre-pandemic projections by 2022, with levels expected to be 4.4 percent below pre-pandemic projections next year. COVID-19 has reversed hard-won gains in poverty reduction, with the pandemic expected to push over 100 million people into extreme poverty by the end of 2021.[3] Accompanying the rise in extreme poverty is that of food insecurity, especially in light of the steep falls in household income last year due to widespread job losses — many of which are not anticipated to be regained this year.[4] The pandemic is expected to have longer-term scarring effects on productivity growth and potential output, as the erosion of business confidence further weakens investment and as human capital accumulation slows due to a deterioration in health outcomes, extended school closures, and prolonged unemployment.[5] [6] Nearly all commodity prices rose in 2021Q1, continuing the marked rebound since mid-2020. It was driven by the global recovery from last year's recession and improved growth prospects.

The global recovery is underway, but activity continues to be disrupted by sharp COVID-19 resurgences. Incoming quarterly data estimate that global GDP fell by 3.8 percent in 2020, as the pandemic brought economic activity to a grinding halt. The drag on output, however, was partly offset by solid improvements in manufacturing activity and commodity prices later in the year, as well as exceptional macroeconomic policy support. Rising mobility trends and the emergence of new variants have contributed to a sharp resurgence of new COVID-19 cases in 2021, particularly in EMDEs, prompting several countries to reimpose COVID-19 restrictions and lockdowns (Figure 1). Although the epidemiological curve appears to be bending, progress at containing COVID-19 has been hampered by uneven vaccination progress, amid formidable logistical challenges and general vaccine reluctance (Figure 2 and 3).[7] As a result of the recent COVID-19 resurgence, various PMI indicators have remained subdued in some countries, but the impact has been far smaller than during the first wave observed about a year ago, and manufacturing activity has remained markedly resilient (Figure 4).

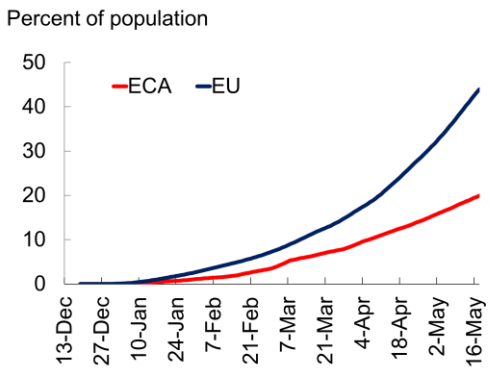
[1] Guenette, Justin-Damien; Yamazaki, Takefumi. 2021. "Projecting the Economic Consequences of the COVID-19 Pandemic". Policy Research Working Paper; No. 9589. World Bank, Washington, DC.; World Bank. 2021. *Europe and Central Asia Economic Update: Data, Digitalization, and Governance*. March. Washington, DC: World Bank.
[2] World Bank. 2021. *Global Economic Prospects*, January 2021. Washington, DC: World Bank.
[3] World Bank. 2020. *Poverty and Shared Prosperity: Reversals of Fortune,* October 2020. Washington, DC: World Bank.
[4] International Labour Organization. 2021. *ILO Monitor: COVID-19 and the world of work.* Seventh edition. Geneva: ILO.
[5] Dieppe. 2020. *Global Productivity: Trends, Drivers, and Policies*. Washington, DC: World Bank.
[6] World Bank. 2020. *Human Capital Project: Year 2 Progress Report,* October 2020. Washington, DC: World Bank.
[7] World Bank. 2021. *Europe and Central Asia Economic Update: Data, Digitalization, and Governance*. March. Washington, DC: World Bank.

Figure 1: New daily COVID-19 cases have accelerated sharply in 2021



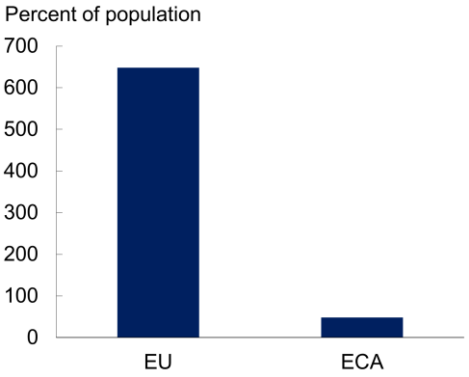
Source: Our World in Data; World Bank.
Note: ECA = Europe and Central Asia; EMDEs = Emerging market and developing economies. Figure shows 7-day moving average of new daily COVID-19 cases. Last observation is May 8, 2021.

Figure 2: The pace of COVID-19 vaccination has been somewhat uneven amid logistical challenges and vaccine reluctance



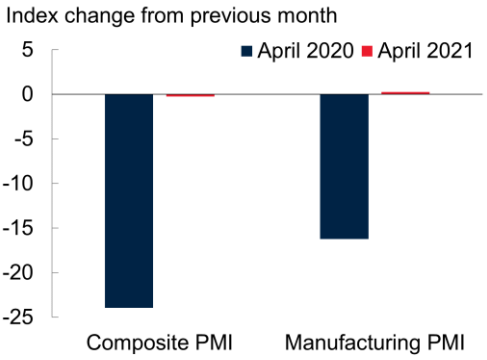
Source: Our World in Data; World Bank.
Note: ECA = Europe and Central Asia; EU = European Union. Figure shows 7-day moving average of total vaccinations per hundred people. Last observation is May 18, 2021.

Figure 3: The procured number of COVID-19 vaccine doses point to bottlenecks to equitable distribution



Source: Duke Global Health Innovation Center (2021); World Bank.
Note: ECA = Europe and Central Asia; EU – European Union. Figure shows confirmed doses purchases per hundred people. Last observation is April 30, 2021.

Figure 4: The monthly change in composite and manufacturing PMIs suggest recent COVID-19 disruptions are smaller in size



Source: Haver Analytics.
Note: Figure shows change in composite and manufacturing Purchasing Managers' Index (PMI) for EMDEs excluding China. Sample includes 16 EMDEs for composite PMI and 14 EMDEs for manufacturing PMI. Last observation is April 2021.

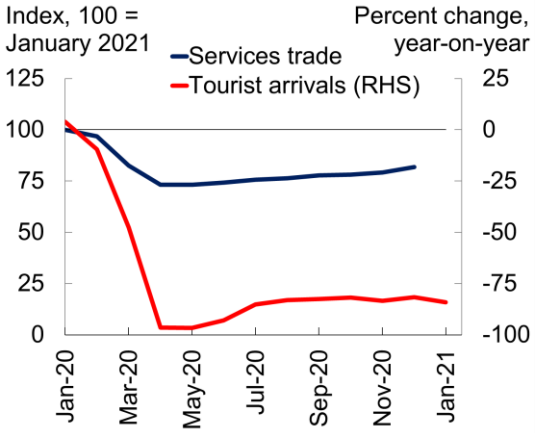
Global trade continues to recover, but with wide variation across countries and sectors. Global goods trade volumes recovered in tandem with industrial production last year — with both indicators returning to pre-pandemic levels by November 2020 — but the strength of the earlier rebound was driven in large part by China and, to a smaller extent, the rest of Asia (Figure 5). Global manufacturing new export orders point to further

expansion in the second quarter of 2021, but delivery times have lengthened considerably due to various supply bottlenecks such as shipping-container shortages, which may constrain the near-term recovery in goods trade. Meanwhile, COVID-19 disruptions continue to weigh heavily on services trade, with tourist arrivals remaining depressed after collapsing last year due to ongoing international travel restrictions (Figure 6).[8,9]

Figure 5: Global industrial production and goods trade volumes have stabilized above pre-pandemic levels, partly reflecting strength in China

Source: CPB Netherlands Bureau for Economic Policy Analysis; World Bank.
Note: Goods trade measured as the average of export and import volumes. Last observation is February 2021 for goods trade and March 2021 for industrial production.

Figure 6: Global services trade and international tourist arrivals remain weak amid ongoing COVID-19 restrictions



Source: United Nations World Tourism Organization; World Bank; World Trade Organization.
Note: Services trade measured as the average of export and import values. Last observation is December 2020 for services trade and January 2021 for tourist arrivals.

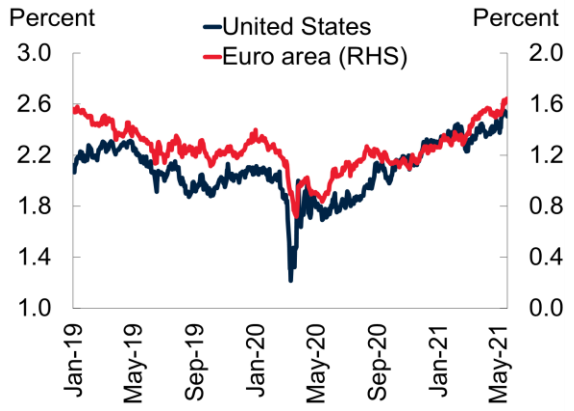
Global financing conditions remain accommodative amid ongoing vaccinations in major economies. An improving pandemic outlook in major advanced economies has bolstered confidence and activity, with equity prices surging to multi-year highs well into the second quarter of 2021. Growing prospects of the release of pent-up demand — particularly in the United States following robust GDP growth in the first quarter of 2021 and the announcement of continued large fiscal support packages — have sparked a rise in market-based inflation expectations (Figure 7). As a result, long-term government bond yields have risen in 2021 but have stabilized somewhat in the second quarter as major central banks continue to reaffirm their commitment to accommodative monetary policy. This has helped provide liquidity, contributing to supportive near-term global financing conditions despite bond-yield increases.

EMDE financing conditions are experiencing renewed volatility. A rise in market-based inflation expectations in advanced economies triggered widespread global risk aversion in early 2021, interrupting the steady rebound in EMDE portfolio inflows observed towards the end of 2020. Equity inflows were particularly affected, with the

[8] WTO (World Trade Organization). 2020. *Exports Restrictions and Prohibitions*. Information note, Geneva: WTO.
[9] UNWTO (United Nations World Tourism Organization). 2021. "2020: Worst Year Tourism History With 1 Billion Fewer International Arrivals." *UNWTO News Release*. Madrid: UNWTO.

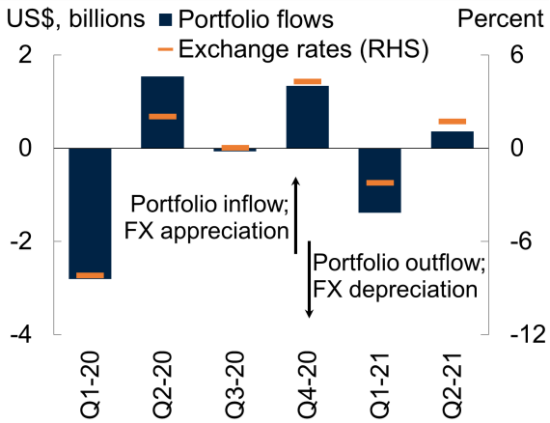
turbulence translating into widespread depreciation in EMDE currencies, accelerated portfolio outflows, and widening local-currency bond spreads (Figure 8**Figure 8**). In the second quarter of 2021, however, earlier losses in currency valuations and equity flows retreated in some EMDEs, as strong commitment to accommodative policy in major advanced economies assuaged market participants and helped stabilize external financing conditions. Despite bond market volatility, international bond issuances by EMDEs have been robust in early 2021, as governments have sought to finance widening budget deficits. The first quarter of 2021 witnessed the largest recorded volume of international bonds issued by EMDE sovereigns and corporations, with half of EMDE corporate bonds issued for refinancing as companies sought to lock in current low rates amid favorable external financing conditions.

Figure 7: Inflation expectations in the United States and euro area are rising as fiscal stimulus measures paired with improved vaccination progression lift economic activity



Sources: Bloomberg; World Bank.
Note: Figure shows seven-year inflation swap rates for the euro area and the United States. The last observation is May 19, 2021.

Figure 8: EMDE portfolio flows and exchange rates have improved at the turn of the second quarter of 2021 as market concerns dissipated

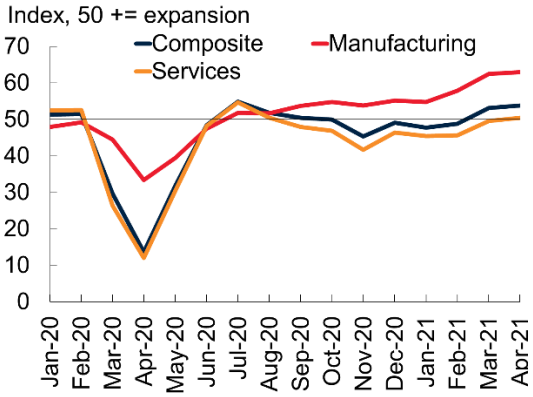


Sources: Haver Analytics; Institute of International Finance; World Bank.
Note: Exchange rates aggregated using simple average. Sample includes 10 EMDEs for portfolio flows and 23 EMDEs for exchange rates. Second quarter includes data through last observation, which is May 17, 2021.

Figure Euro area activity remains vulnerable to COVID-19 resurgences. Following a weakness in retail sales and goods trade in early 2021, incoming survey data point to firming activity in the second quarter of this year. After rising above the threshold for expansion in March, the composite PMI gathered further momentum in April. The manufacturing sector has continued to be a key source of strength in the euro area, while domestic services output has staged an incipient recovery this year (Figure 9). Activity and sentiment in the euro area, however, remain vulnerable to renewed surges in COVID-19 cases. New restrictions in some economies — including in France, where a national lockdown was introduced — have likely weighed on activity at the turn of the second quarter of 2021. Nevertheless, mobility trends in retail and recreation remain resilient so far. Vaccination has accelerated rapidly at the start of the second quarter of 2021, with the share of the population receiving at least one vaccine dose quadrupling in a matter of weeks. As of May 18, roughly 45 percent of the population has received at least one dose.

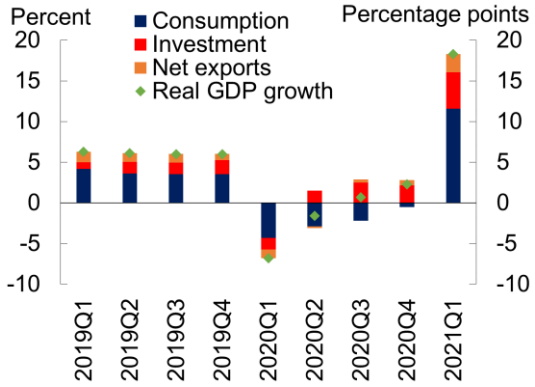
China, Russia's second-largest trading partner, continues to experience a cyclical recovery. China was among the few economies that averted a recession in 2020, growing at 2.3 percent, with activity partly buoyed by public investment. Recent high-frequency indicators point to a services-led improvement in activity this year, owing to the removal of mobility restrictions, with retail sales growth rebounding 33.9 percent in the first quarter of 2021. Industrial production and trade growth also continued to expand at a robust pace, with notable strength in import growth as domestic demand firmed (Figure 10).

Figure 9: PMIs in the euro area continue to show resilience in manufacturing activity, while services remain sensitive to disruptions from COVID-19 but are gradually stabilizing



Source: Oxford University; World Bank.
Note: PMI readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction. Last observation is April 2021.

Figure 10: China's investment-led recovery has now broadened, with private consumption rebounding in the first quarter of 2021



Sources: Haver Analytics; National Bureau of Statistics of China.
Note: Real GDP. Seasonal adjustment provided by the National Bureau of Statistics of China.

Nearly all commodity prices rose in Q1 2021, continuing the marked rebound since mid-2020 (Figure 11). The largest increase was for energy commodities, which rose by around one-third (q/q). Energy exports are particularly important for Russia, accounting for around 60 percent of total goods exports in 2019. Most commodity prices now exceed their pre-pandemic levels, with several reaching multi-year highs. The recovery has been driven by the global recovery from last year's recession and by improved growth prospects supported by significant policy stimulus in advanced economies. Commodity-specific supply factors have also played a role, especially for crude oil, natural gas, copper, and several food commodities.

Crude oil prices rose 36 percent in 2021Q1, supported by ongoing production restraint by OPEC and its partners (OPEC+), as well as a gradual recovery in demand. The recovery in prices has been the fastest on record following a price collapse. Brent crude oil prices have ranged between US$62/bbl and US$70/bbl in April and May, as positive news regarding the recovery in oil demand in some countries, such as the United States, is being weighed against worries about rising COVID-19 infection rates elsewhere, notably India, and the impact it could have on oil demand. While oil consumption has seen a sizeable recovery, it is still 10 percent below pre-pandemic levels in OECD countries, and 3 percent below in non-OECD countries.

Since the start of 2021, OPEC+ have increased production at a much slower rate than they had originally announced, either by prolonging production cuts or raising production by less than expected. In contrast to most members of the group, Russia and Kazakhstan were granted small increases in their production quota in February and March. Russian oil production rose by 0.15 million barrels per day (mb/d) in 2021Q1 (Figure 12). In contrast, Saudi Arabia announced it would voluntarily reduce production by an additional 1mb/d (more than 10 percent of Saudi Arabia's current production), which collectively brought the total production cuts by OPEC+ below the level during 2020H2. Outside of OPEC+, crude oil production in the U.S. has seen a partial recovery to around 11mb/d, but remains well below its pre-pandemic highs of close to 13mb/d.

Natural gas prices have experienced sharp fluctuations over the past 12 months, with European prices reaching their lowest level on record and U.S. prices hitting a multi-decade low in 2020Q2, before staging a rapid recovery. Natural gas prices in the U.S. rose by nearly 40 percent in 2021 Q1 (q/q), while those in Europe increased by 25 percent. Prices have been boosted by the recovery in global economic activity, very cold weather in the U.S. and Japan, as well as by some supply disruptions. Russia's natural gas exports fell in 2020 as demand softened, and several European countries purchased cheaper liquefied natural gas (LNG) from the U.S., rather than via pipeline from Russia.

Non-energy commodity prices rose 12 percent in the first quarter of 2021 (q/q), following a 10 percent increase during the previous two quarters. Base metals and ore prices rose 16 percent, driven by a broad-based strengthening in global demand, especially from China. China accounts for more than half of global consumption of metals and is Russia's largest trading partner. Metal prices have also been supported by the proposed infrastructure spending bill in the United States, while supply disruptions boosted copper and iron ore prices to record highs in May. Most agricultural commodity prices, particularly food commodities, also rose sharply in 2021Q1. The price of wheat, Russia's largest agricultural export, rose to its highest level since 2014 in April. Similar to metals, the increase in agricultural prices was driven by a surge in demand from China, as well as some supply shortfalls, particularly for soybeans and maize.

Figure 11: Nearly all commodity prices rose in Q1 2021

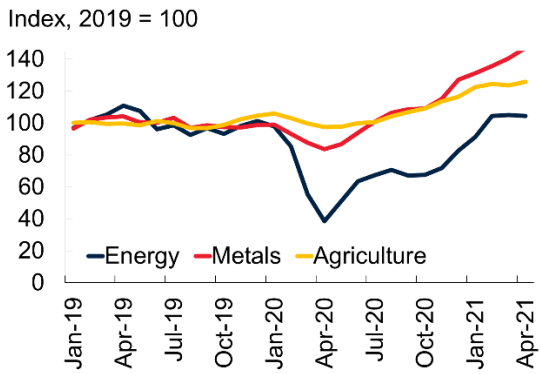
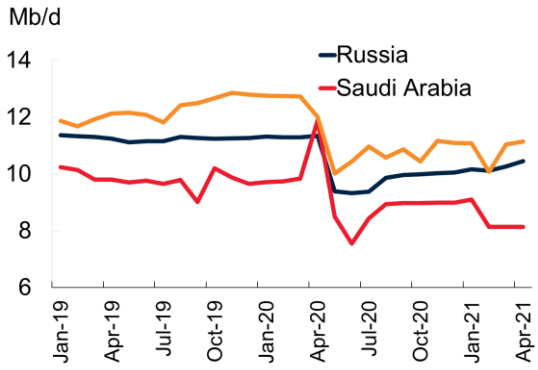


Figure 12: Crude oil production in the top 3 largest producers



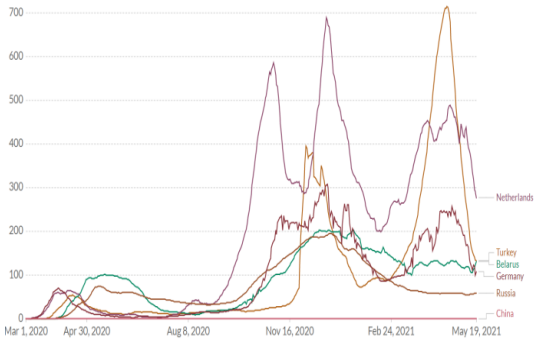
Source: International Energy Agency; World Bank.

1.2. Russia: economy picks up in early 2021

Russia's overall GDP growth in 2020 was relatively strong in 2020, compared to the global average and to other commodity exporters. As the pandemic's second wave swept across Russia and the globe in autumn 2020, the earlier growth rebound in Q3 2020 stopped in 4Q 2020. However, in the first quarter of 2021, growth picked up again with some stabilization of new covid-19 cases, lifting of related restrictions, and loosening of OPEC+ production cuts.

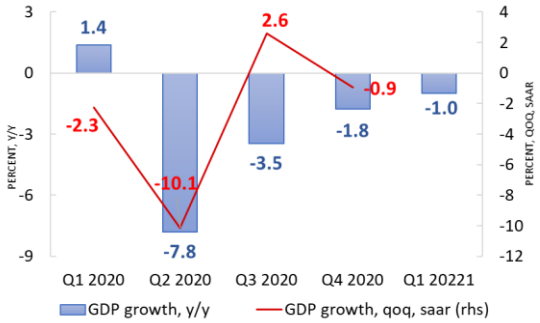
As the pandemic's second wave swept across Russia and the globe in autumn 2020 (Figure 13), the earlier rebound in economic growth in Q3 2020 stopped in 4Q 2020. In Q4 2020, GDP growth registered negative growth of 0.9 percent, q/q, saar, interrupting the rebound that started in the third quarter (Figure 14). Weak momentum in households' consumer demand on the back of renewed restrictions related to the pandemic (restricted mobility of the older population, distance-learning regime for students and schoolchildren, restrictions on the functioning of restaurants and cafeteria, sport centers, cultural spots, etc.) resulted in household consumption shrinking by 6 percent, q/q, saar. In Q4, investment demand continued rebounding, partly supported by higher public expenditures (Figure 15). From the supply side, growth momentum worsened in mineral-resource extraction and related transportation sectors as well as in hotels and catering. Export dynamics stabilized in Q4 after downward trends in Q2 and Q3, supported by export of food items, metals, and machines (Figure 16).

Figure 13: The pandemic's second wave came upon Russia in autumn



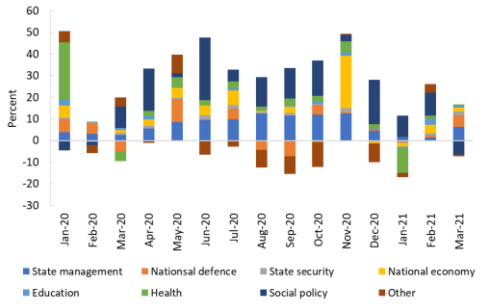
Source: Our World in Data.

Figure 14: Economic growth rebound stalled in Q4 2020



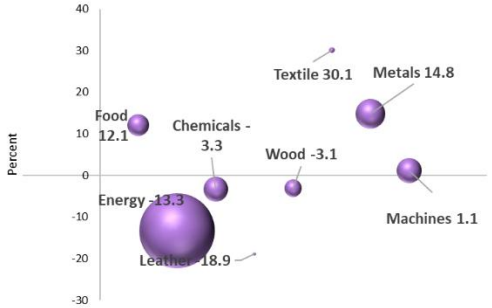
Source: Rosstat.

Figure 15: Higher public expenditures supported growth in Q4 2020



Source: Roskazna.

Figure 16: Export of metals, machines and food items supported export in Q4 2020



Global energy markets were heavily affected by the COVID-19 pandemic and this had a significant impact on the Russian oil and gas industry. Global demand for crude oil fell by around 9 percent compared to 2019, more than twice as much as any previous one-year decline, while demand for natural gas fell 2 percent. Oil demand was significantly more affected because around two-thirds of oil is used for transport, which was heavily curtailed by lockdown measures. These developments had a significant impact on the Russian oil and gas industry, leading to a steep decline in both the production and export of oil and natural gas. Total oil production (including condensates and NGLs) fell by 8.7 percent in 2020, from an average of 11.4 million barrels per day (mb/d) to 10.4 mb/d (Figure 17). Exports saw a larger decline, dropping by 12.4 percent. The fall in Russia's oil production began in May, when the group agreed to participate in the production cuts between OPEC and a group of non-OPEC countries (OPEC+; Figure 18). Under the agreement, Russia was to cut crude oil production from a baseline level of 11mb/d to 8.5mb/d in May to July, and to gradually increase production thereafter. The International Energy Agency estimates that Russia's compliance with the cuts averaged 95 percent in 2020 (IEA 2021a[10]). Russia was granted small increases in its production quota for February and March 2021 (in addition to Kazakhstan), while all other countries production quotas remained unchanged.

Natural gas production declined 5.7 percent in 2020, with a particularly steep fall in the first half of the year, and production recovering in the second half (Figure B4-2, Figure 19). Exports fell by 23.8 percent, however, the decline in exports masks a divergence between pipeline and liquefied natural gas (LNG) exports. Pipeline exports fell by 29 percent, while LNG exports actually rose 4.5 percent. LNG has become an increasingly important method of exporting natural gas for Russia (Figure 20). However, it has also been a source of risk. The sharp drop in pipeline exports in 2020 was partly due to weaker demand in Europe. However, it was also the result of a substantial increase in U.S. exports of LNG, which had been intended for Asia but were rerouted to Europe amid low demand and low prices in Asia. This caused European natural gas prices to reach an all-time low in August 2020, and also resulted in a sharp decrease in pipeline imports from major European consumers, including imports from Russia (IEA 2021b[11]).

Figure 17: Total oil production and exports

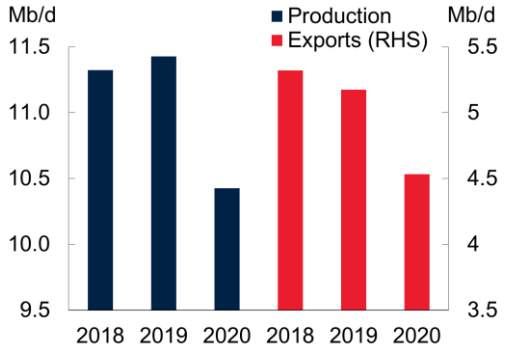
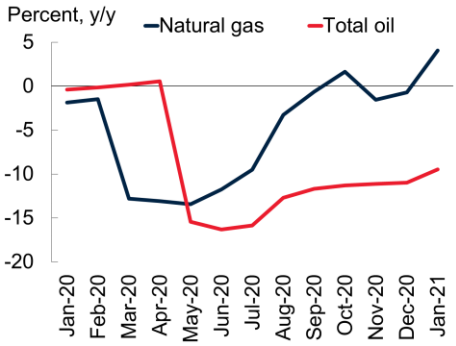


Figure 18: Oil and natural gas production growth



[10] IEA (International Energy Agency). 2021a. "Oil Market Report, January 2021." International Energy Agency, Paris.
[11] IEA (International Energy Agency). 2021b. "Gas Market Report, Q1-2021." International Energy Agency, Paris.

Figure 19: Natural gas production and exports

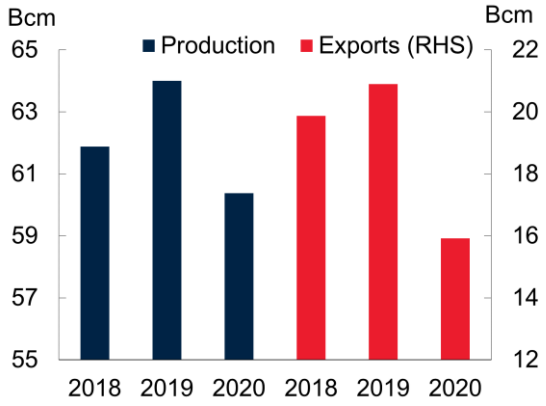
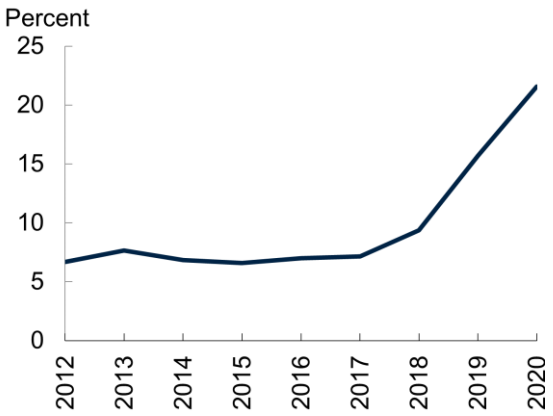


Figure 20: Share of LNG in total natural gas exports



Source: JODI, World Bank.
Notes: Charts for Russia's production only. "Oil" refers to crude oil, condensates, and natural gas liquids (NGLs). LNG stands for liquefied natural gas.

Relatively, the performance of the Russian economy was nonetheless strong in 2020, compared to other countries. The Russian GDP contracted by -3.0 percent in 2020. This is compared to contractions of -3.8 percent in the World Economy, -5.4 percent in advanced economies and a contraction of -4.8 percent in commodity-exporting EMDEs.[12] Meanwhile, in China, GDP expanded by 2.3 percent in 2020, supported by public investment-led stimulus. Several factors helped Russia to perform relatively better: in recent years, Russia undertook significant macro-fiscal stabilization efforts, resulting in an improved fiscal position — including a sizeable accumulation of fiscal and reserve buffers (as of May 1, 2021, the NWF reached US$185.8 billion (11.6 percent of GDP), while its liquid part reached about US$116.4 billion (7.3 percent of GDP). International reserves as of April 1 stood at a comfortable US$574.8 billion (22.6 months of imports), reducing exposure to oil price volatility and a lower public debt burden. A massive banking sector clean-up, together with enhanced regulation and supervision, fortified capital and liquidity buffers. These efforts strengthened Russia's ability to respond to the pandemic's most adverse economic shocks. They allowed the government to provide a substantial countercyclical fiscal stimulus (about 4.5 percent of GDP, on par with other EMDEs) and an accommodative monetary policy (the key rate was lowered by 200 basis points between February-July 2020). Other contributing factors were relatively soft restrictions for industrial and construction sectors, closer ties to a relatively fast-growing China, a relatively small services sector and a large public sector that buffered against unemployment. Digital technologies also played a critical role during the pandemic, enabling the society and economy to operate during lockdowns and providing the government with effective tools to reach out to socially vulnerable populations (Box 1).

Box 1: Leveraging Digital Technologies to Combat the COVID-19 pandemic

Digital technologies played a critical role during the pandemic, enabling the society and the economy to operate during lockdowns and providing the government with effective tools to reach out to socially vulnerable populations. The pandemic highlighted the importance of data and digital technologies, not only to

[12] 2020 GDP growth in some of the commodity-exporting EMDEs: Argentina -10%, Brazil -4.1%, Chile – 6%, Uruguay – 5.8%, South Africa -7%, Kazakhstan -2.6%.

combat the spread of the disease, but to empower the rapid change in social behavior and business practices. There was a spike in the use of national platforms. E-commerce saw unprecedented growth, accounting for about 10 percent of all retail sales since mid-2020, as the market capitalization of large online marketplaces such as Ozon and Wildberries exceeded US$10 and 14 billion respectively (that's a 10-to-14-fold increase compared to 2016). Many platforms attracted a large influx of users due to the provision of affordable or free services. Food delivery platforms also enjoyed significant growth. Estimates indicate that Delivery Club by Mail.Ru Group and Yandex.Food doubled their revenue during 2020,[13] with Yandex. Food's customer base growing by 120 percent. ICT exports were also on the rise, expanding by 8.1 percent in value in 2020.

As elsewhere around the world, the COVID-19 crisis has mobilized the Russian government to accelerate the provision of data-driven government services and launch new pilot projects to address the social and economic costs of the pandemic at the federal, regional and municipal levels. During the lockdown in April 2020, Moscow introduced a system of digital passes that could be obtained via the official Moscow city platform by phone or by sending an SMS. The state registration number of the car and details of public transport cards were entered in a database for automatic processing and authorities used CCTV cameras and facial-recognition data to enforce compliance. Since then, a federal platform for issuing digital passes has been implemented in a number of Russian regions.

Mobilized by the urgency of the crisis, regional governments have also demonstrated leadership and innovation in building partnerships with banks, telcos and others to share, analyze and leverage data in order to provide effective and innovative social services at the local level, targeting those worst affected by the pandemic. For example, in 2020, the Governors' Command Center Information System was launched in the Russian regions to monitor the spread of the disease.

As new digital services were launched to address the pandemic crisis, the number of users of the online government and municipal services portal has passed 100 million (vs 40 million in 2016).[14] In just six days in May 2020, users submitted over 7 million applications for a one-time government COVID-related pay-out.[15] The service has become the single most popular one on the portal since its launch in 2009. At peak hours, over 3,000 applications per minute were processed, with an average speed of 1,500 per minute.

Digital transformation remained a priority at the highest level of government, its importance underscored by the COVID-19 pandemic. The Russia Digital Economy Program adopted in July 2017 and a number of digital initiatives at the regional/oblast level came together as elements of the digital transformation strategy at the national level. 2019 saw the adoption of a Presidential decree for the creation of a National Strategy for the Development of Artificial Intelligence 2020-2030.[16] 2020 further mobilized the government's commitment to digital transformation and witnessed the adoption of the Law on Experimental Regal Regimes in the Field of

[13] https://secretmag.ru/news/eksperty-rasskazali-chto-zhdyot-rossiiskii-rynok-dostavki-edy-posle-pandemii.htm
[14] https://www.gosuslugi.ru
[15] See https://digital.gov.ru/ru/events/39906/
[16] Decree of the President of the Russian Federation No. 490 dated 10 October 2019 'On Development of Artificial Intelligence in the Russian Federation'.

Digital Innovations,[17] the approval of the Concept for the Development of Regulation of Relations in the Field of AI and Robotics18, and further amendments to the Personal Data Law19.

Going forward, as Russia fine-tunes its national digital transformation strategy and continues to develop cutting-edge digital solutions to address critical social and economic issues, it is important that it apply a systematic approach that focuses not only on the successful implementation of technical projects, but also on the development of a comprehensive national data strategy that enables rapid innovation while ensuring essential economic and social protections. The path towards a national data strategy in Russia is the subject of a new World Bank Report, "Leveraging Data to Fuel Development," to be launched in June 2021.

Yet there are significant variations in the regional performance based on their pandemic exposure and predominant economic activities (Box 2).

Box 2: Different Russian regions were affected differently by the crisis

After the initial shock hit Russian regions most severely in April-May 2020, in line with strict containment measures, industrial production growth remained depressed in regions dependent on mineral extraction.
Retail trade has declined y/y across all federal districts, with the largest declines in catering. However, growth resumed as the containment effects subsided. Retail trade turnover declined least in the North-Western federal district, supported by a 6 percent increase in turnover in the Leningrad region (at least in part on the back of a relatively early mid-May easing of restrictions and increased consumer demand from St. Petersburg residents).
Investment declined by 1.4 percent, y/y, in Russia in 2020, growing most in the North Caucasian district, where budget investment accounts for over half of all investments. The decline in investment in the Far Eastern federal district (with a relatively high share of mining in GRP, see Table B2-1) was driven by the completion of large projects, notably the construction of the Power of Siberia gas pipeline in Yakutia.

[17] Federal law No. 258-Fz dated 31 July 2020 "On Experimental Legal Regimes in the Field of Digital Innovation in the Russian Federation."

[18] Order of the Government of the Russian Federation No. 2129-r dated 19 August 2020 "On the approval of the Concept for the Development of Regulation of Relations in the Field of Artificial Intelligence and Robotics for the Period up to 2024."

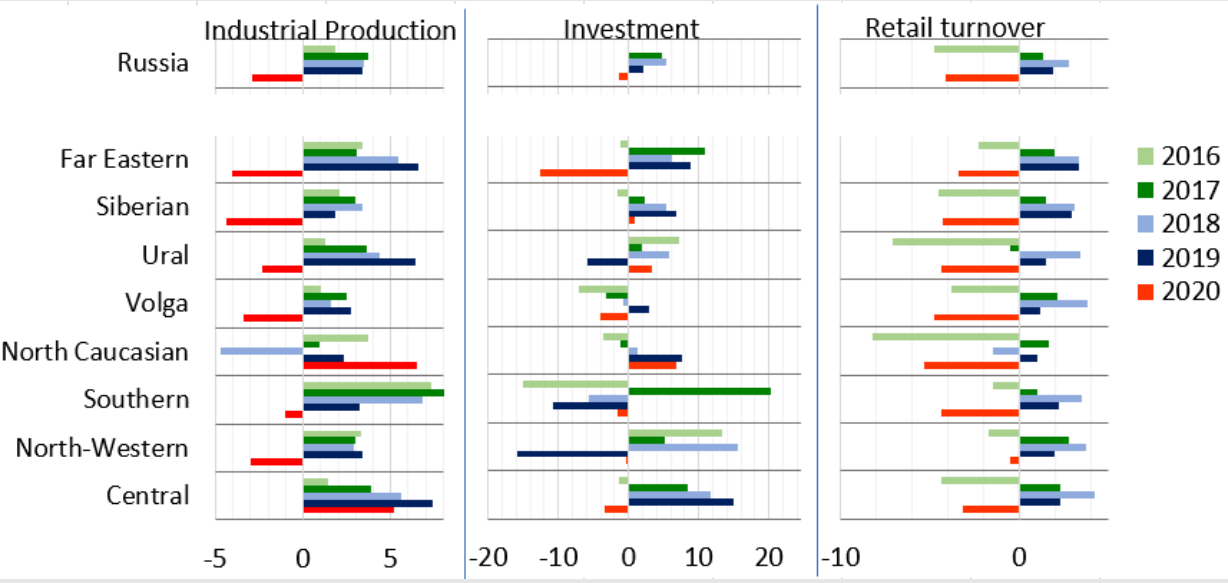
[19] Federal law No.519-Fz dated 30 December 2020 "On Amendments to the Federal Law "On Personal Data""

Figure B2-1:

A. Industrial production declined in all districts except North Caucasian and Central districts

B. Investment declined most in the Far Eastern district

C. Retail turnover fell in all regions, but least in the North-Western Federal District



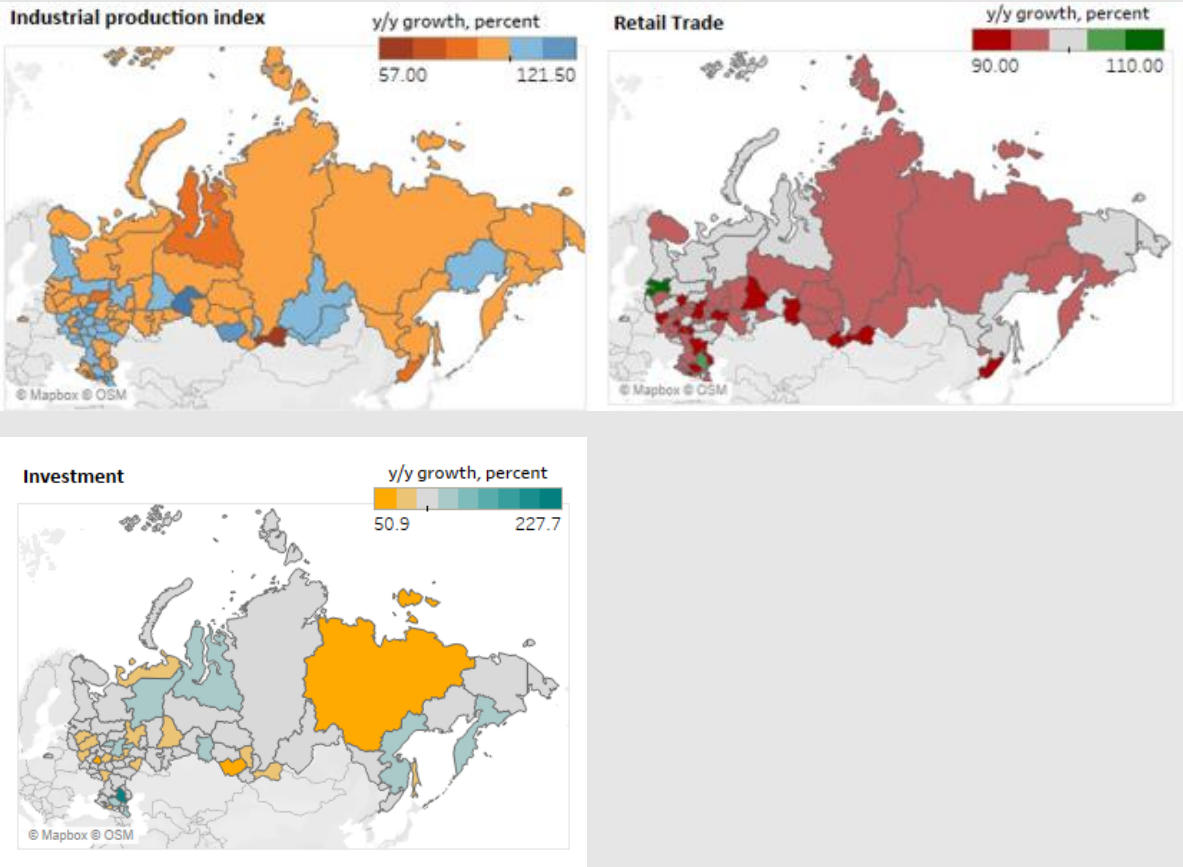
Source: Rosstat.

Table B2-1. Geographical differences in economic structure by federal district

Federal District	GRP per capita, thous. Rub	Share of sectors in GRP %, 2019					
		Agriculture	Mining	Manufacturing	Construction	Wholesale and retail trade	Public administration and military security
Russia	**646.1**	**4.1**	**13.5**	**16.8**	**5.4**	**14.2**	**5.6**
Central	835.9	3.0	0.8	18.0	4.7	22.0	5.8
North-Western	752.8	2.8	7.3	18.3	4.7	11.8	5.9
Southern	400.9	9.3	5.9	13.8	6.2	13.6	6.7
North Caucasian	232.0	14.1	0.6	7.3	10.7	15.8	11.0
Volga	480.5	5.7	15.7	21.9	5.7	10.9	4.7
Ural	1070.6	1.6	44.1	13.3	6.0	6.0	3.1
Siberian	535.3	4.2	17.7	21.1	4.6	9.3	5.6
Far Eastern	730.1	5.4	28.7	4.8	6.8	9.2	8.3

Source: Rosstat.

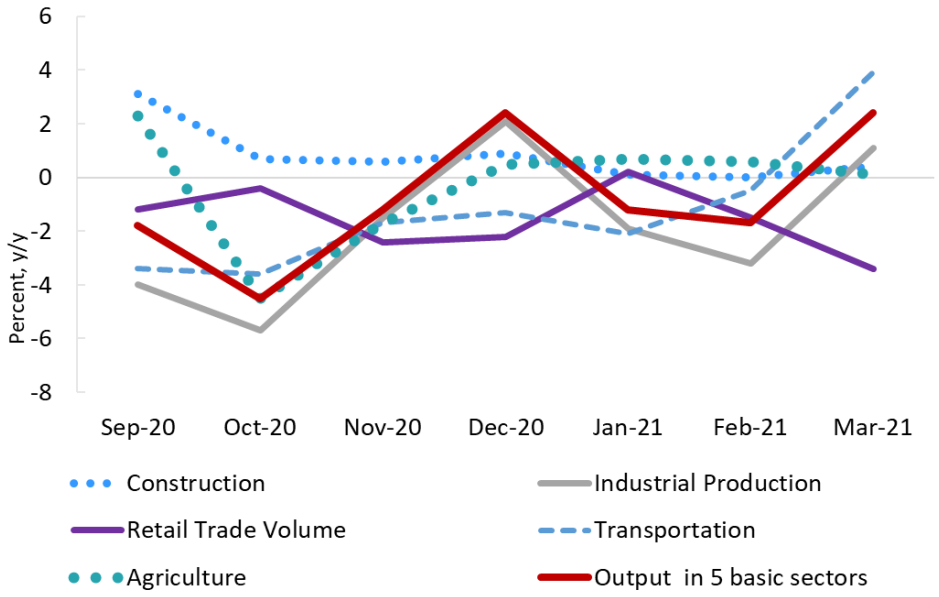
Figure B2-2: The Covid-19 induced shock led to negative growth in industrial production and retail trade in 2020 in the majority of regions; investment growth was limited to few regions



Source: Rosstat.

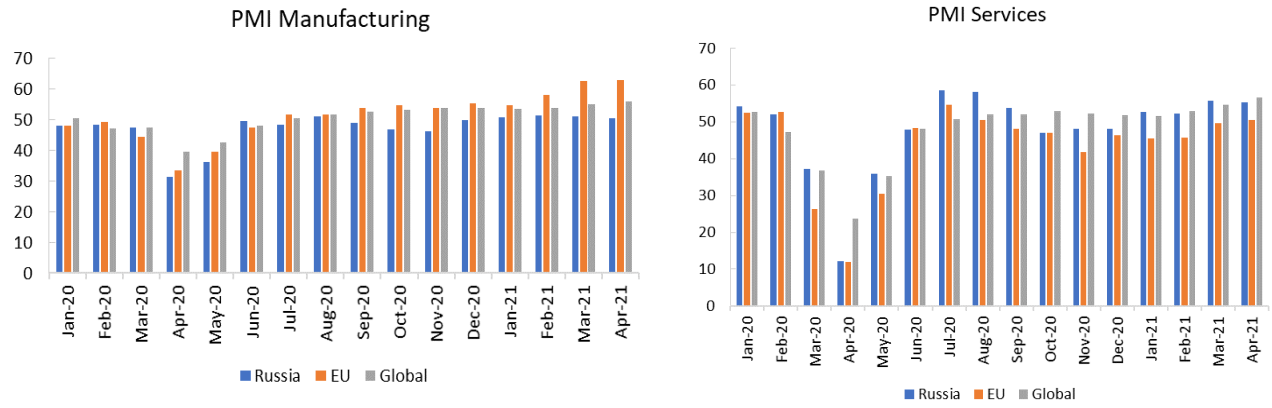
In Q1 2021, growth picked up with some stabilization of new covid-19 cases, the lifting of related restrictions, and the loosening of OPEC+ production cuts. In Q1 2021, a Rosstat GDP growth flash estimate registered -1 percent, y/y. Industrial production grew by 0.8 percent, in January-March, compared to December, sa. Some relaxation of the OPEC+ restrictions and a cold winter supported mineral resource extraction. The transportation sector also gained from that. Manufacturing output accelerated in the beginning of 2021, and in March, it exceeded the pre-pandemic level. High-frequency indicators point to recovery in services as well (Figure 21 and 22). Growth in equipment imports and positive readings in construction indicate a continued rebound in investment demand from the fourth quarter of 2020. Consumer-related indicators (retail trade turnover), which showed some positive dynamics m/m in January-February, softened in March, possibly reacting to higher food inflation. Again, significant variations are hidden in regional performances (Box 3).

Figure 21: High-frequency statistics reveal recovery gaining pace in Q1 2021



Source: Rosstat.

Figure 22: PMI point to faster recovery in services than in manufacturing.



Source: IHS Markit.

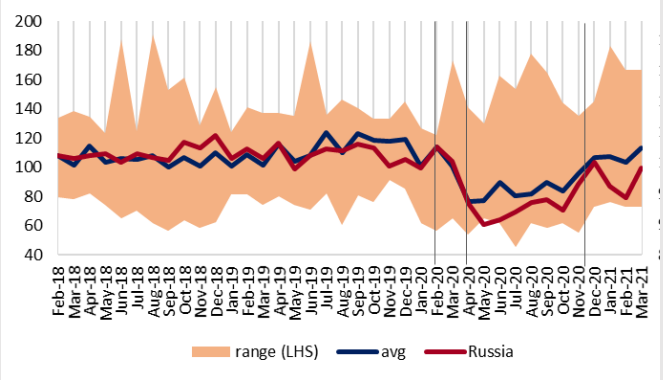
Box 3: A recovery emerges, with regional caveats

In 2020, retail sales turnover overall declined by 4 percent, y/y, although growth largely stabilized from July 2020 on as the containment effects subsided. In January-March 2021, retail trade declined by 1.6 percent in Russia y/y. The strongest growth in retail sales, picking up after declines through much of April-December 2020, was recorded in Kamchatka (+5 percent), Yaroslavl Oblast (+4.8 percent), and the Chechen Republic (+3.4 percent). At the start of the year, retail sales remained depressed in Sverdlovsk Oblast (-13.2 percent), Omsk Oblast (-9.9 percent), Nizhny Novgorod Oblast and Samara Oblast (both -8.5 percent). All these regions have seen y/y declines in retail sales since April 2020. Notably, the gap between the region with the highest and

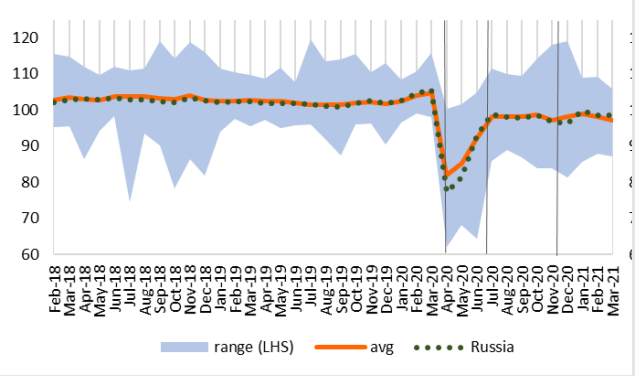
lowest growth (per month, y/y) was largest in June 2020, April 2020, and again in December 2020 (see Figure B3-1).

Figure B3-1: After a steep decline in April-May 2020, signs of recovery emerge with regional caveats

A. After signs of recovery, industrial production fell at the beginning of the year



B. Retail trade has been relatively stable since July 2020

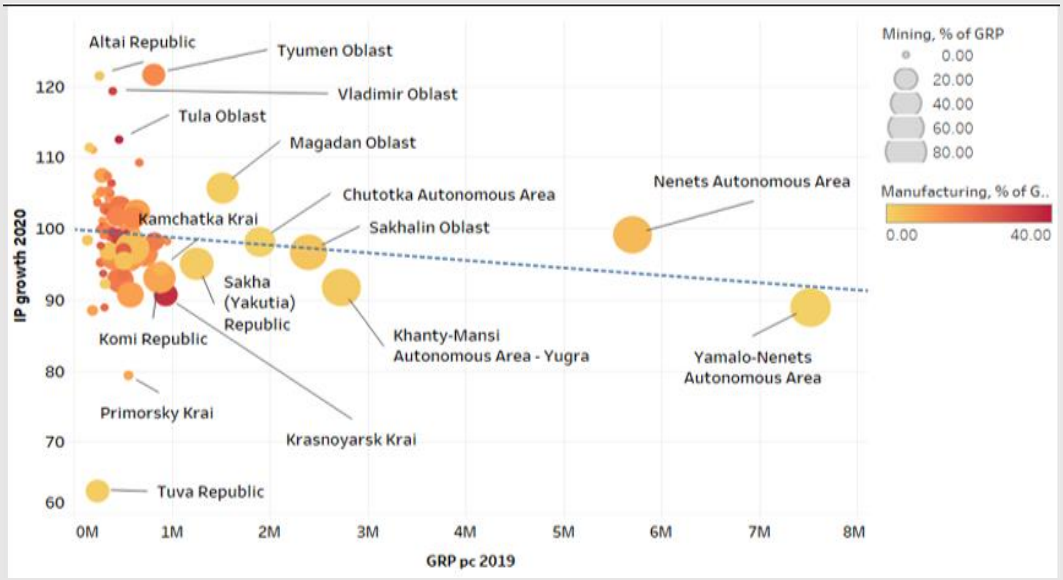


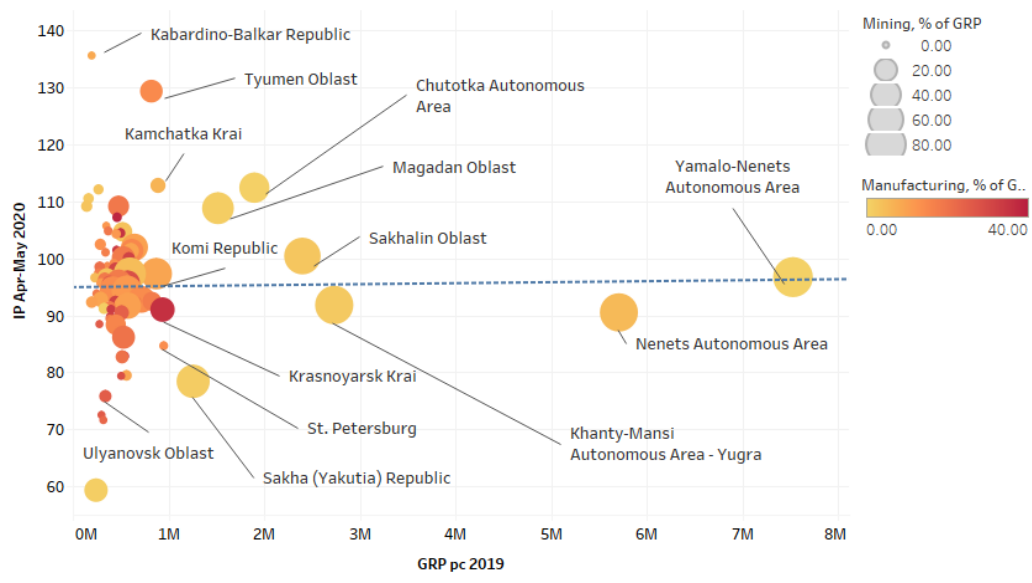
Source: Rosstat.

Industrial production showed signs of recovering, after having bottomed out in May 2020. Although lockdowns had subsided, global demand dynamics continued to impact regions relying on exports, especially of natural resources. While in April-May 2020, the Covid-19-induced shock affected especially two groups of regions – those dependent on manufacturing and those dependent on resource-extraction revenues – the former group saw recovering production levels in the second half of 2020. The latter group shows persistent declines in industrial production in annual terms, led by Yamalo-Nenets Autonomous Area and Khanty-Mansi Autonomous Area (see Figure B3-2) (yet for 2021, this is attributed to a high base pre-pandemic).

In 1Q 2021, industrial production declined by 1.3 percent in Russia, y/y, falling in 31 regions (compared to 19 in the same period of the previous year). The steepest declines were recorded in Nenets Autonomous Area (-14 percent, due to a decrease in the oil and gas sector), Karachay-Cherkess Republic (-13.9 percent, led by manufacturing industries), and Sakhalin Oblast (-13.5 percent, notably in extraction of minerals).

Figure B3-2: Regions dependent on mineral extraction still demonstrate negative IP growth in annual terms partly due to a high pre-pandemic base.





Source: Rosstat.
Notes: Size of bubbles represents share of mining in GRP, coloring represents share of manufacturing in GRP (yellow=low; red=high).

1.3. Balance of payments: a weak current account in the first quarter on the back of stronger merchandise imports.

In 2020, with the pressure from lower oil prices and a weaker global demand for other major goods exported by Russia, the current account registered a surplus of about half of the surplus in 2019. Strong goods imports on the back of the economic rebound weighed on the current account in 1Q2021. In the first three months of 2021, despite higher net foreign-assets acquisition, net capital outflows came in slightly lower than in the same period last year. Russia needs to tap its potential for 'green' products exports.

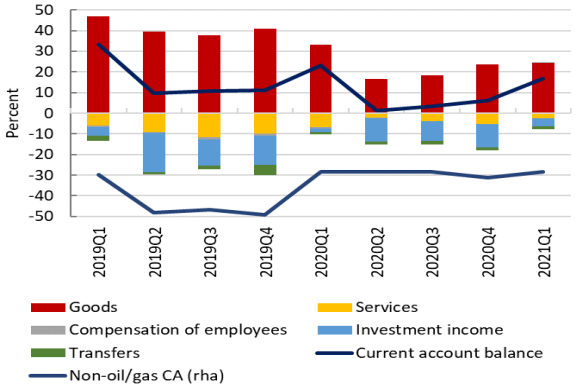
In 2020, the current account (CA) registered a surplus of US$33.9 billion, about half of the surplus in 2019 (US$64.8 billion, Figure 23 and 24). The contraction was largely due to a weaker trade balance. In 2020, Russia faced a sizable negative terms-of-trade shock due to oil prices dropping by about 32 percent, lower global demand for most exported products and services, elevated uncertainty, and significant financial markets volatility. While imports of goods and services dropped (by US$14.5 and 35.9 US$ billion, respectively) on the back of the REER depreciation, GDP contraction and restrictions on travel, this could not compensate for the drop in the value of energy exports (-US$90 billion) and services export (-US$17.4 billion).

Exports of non-energy products have grown by 11.9 percent, y/y, led by exports of gold, metals and agriculture products. Exports of gold grew as the CBR halted its purchases of gold for international reserves in April 2020, and thus released higher volumes of gold for exports. While agricultural products exports have posted growth throughout the pandemic (+19.6 percent, y/y, in 2020), metals exports have begun to grow again only in 4Q2020, but declined by 7 percent, y/y, in 2020 overall. Agricultural products exports notably included wheat, vegetable oil, and meat; while exports rose, imports of agricultural and food products remained stable.

The pandemic-induced changes in the goals of the National Project on International Cooperation and Exports. In 2020, non-energy export values that do not include commodities (gold, wheat, etc.) dropped to about US$145 billion from US$154.5 billion in 2019 as opposed to the targeted increase to US$167 billion. The decline was due to lower industrial exports, which reached US$119.5 billion compared to US$136 billion in 2019 and US$142 billion targeted before the pandemic. A substantial part of this decline was attributed to lower prices. Agricultural non-commodity export value appeared to be resilient to the pandemic shocks and increased from US$24 billion in 2019 to US$25 billion in 2020.

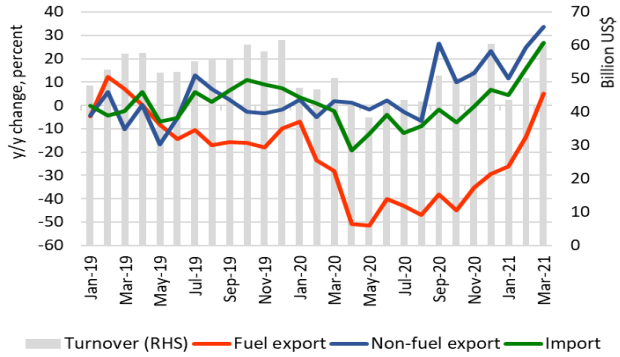
To account for the pandemic effects and possible price volatility, the National Project on International Cooperation and Export was renewed. Now it aims to increase non-energy, non-commodity exports by 70 percent in real terms from the base of 2020 by 2030 (as opposed to targets in nominal values set before). The target implies an average growth of non-energy non-commodity export volume of 5.4 percent in the period 2021-2030.

Figure 23: The current account strengthened in Q1 2021 (Percent of GDP)



Source: CBR.

Figure 24: Merchandise import and export levels have recovered to pre-pandemic levels



Source: Russian Customs.

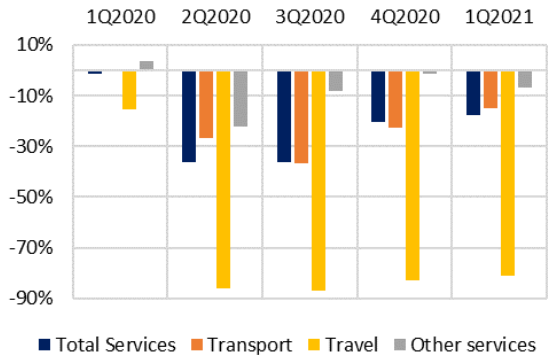
In 2020, export and import of travel services dropped the most in percentage terms. A decrease in outbound tourism was an important factor supporting domestic household consumption in 2020.

Lower energy export receipts, financial market volatility, and increased geopolitical risks fuelled a sharp increase in capital outflows in 2020 ($47.8 billion, up from $22.1 billion in 2019), driving a real effective exchange-rate depreciation. A fall in the external liabilities of the banking and non-banking sectors drove net capital outflows. Elevated uncertainty and lower reinvestment of profits wiped out incoming FDI, which fell to US$6.3 billion, down from US$22.6 billion last year.

With regards to BOP operations, international reserves dropped by US$14.9 billion in 2020, largely due to FX sales in the fiscal rule framework and public debt payments. With the downward pressure on export receipts, financial markets volatility, elevated uncertainty, and elevated geopolitical risks (especially in Q3 2020), the REER depreciated by 7.5 percent, y/y; however, the REER adjustment to lower oil prices in 2020 could have been much more severe without the fiscal rule.

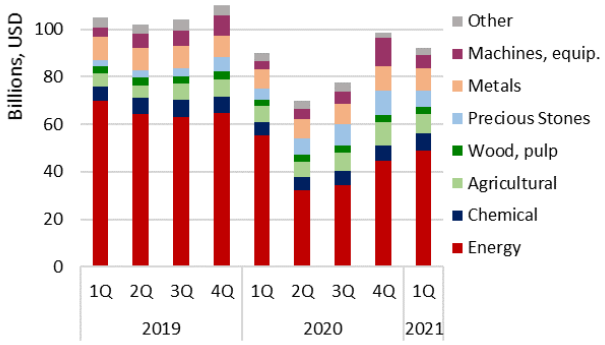
In 1Q2021, the current account surplus amounted to US$ 16.8 billion, almost a third lower than levels in the previous year (US$23 billion), on the back of strong goods imports recovery and weak fuel exports. The trade balance stood at US$24.4 billion, down from US$33.1 billion in 1Q2020, amidst strong merchandise import recovery. While energy exports remain below levels of the same period in the previous year, exports of non-energy products have grown (Figure 25 and 26).

Figure 25: Services exports remained depressed in Q1 2021



Source: CBR.

Figure 26: Energy exports remained low, while other commodity groups showed growth

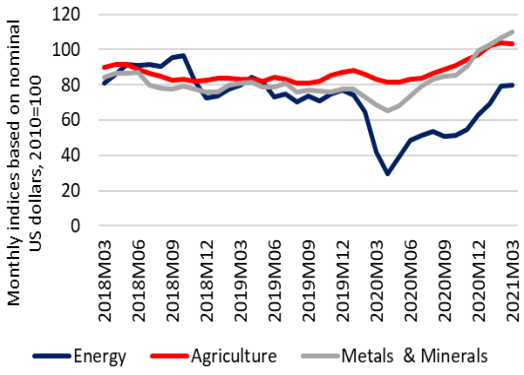


Source: Russian Customs.

In 2020, the value of energy exports declined by 36.4 percent, y/y, and by 11.5 percent in 3M2021. As Urals prices reached US$70/bbl in mid-March, the lower performance of crude oil exports in 1Q2021 was connected to lower export volumes, amidst production restricting OPEC+ agreement and possibly higher domestic demand (Figure 27). In the first quarter of 2021, crude oil exports value declined by 22.6 percent, y/y (-26.3 percent to the EU and -17.3 percent to China). Crude oil exports declined by 40.6 percent, y/y, in value terms in 2020, and by 11.1 percent in volume terms, largely driven by a decline of exports to the EU (Figure 28).

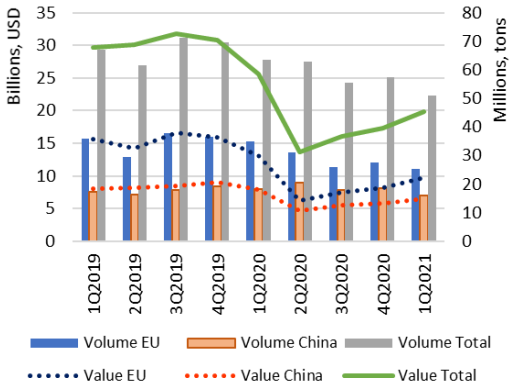
Merchandise imports grew by 12.3 percent, y/y, in the first quarter of 2021, while exports overall declined by 2 percent, y/y. Almost half of merchandise imports are accounted for by machinery and equipment products, which rose by 16.2 percent, y/y, in 2M2021, reflecting a rebound in investment demand. Another important import category is chemical products, largely pharmaceuticals, for which imports from non-CIS countries rose by 23 percent, y/y, in 2M2021.

Figure 27: Commodity prices recovered …



Source: WB 'Pink Sheets'.

Figure 28: 1Q2021 oil export value rose less than expected

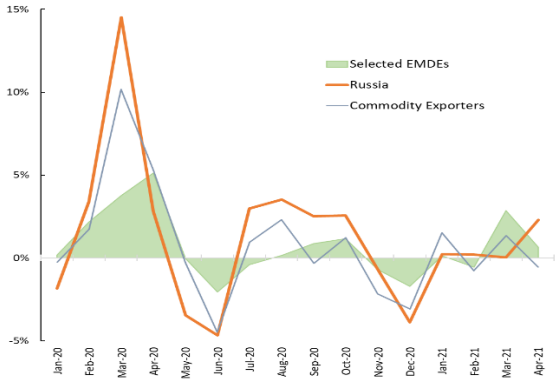


Source: Russian Customs.
Notes: shows exports of crude oil (Goods Nomenclature 2709).

In the first three months of 2021, despite an acquisition of higher net foreign assets, net capital outflows amounted to US$12.0 billion, slightly down from US$14.7 billion in the same period last year. Elevated geopolitical pressure resulted in a decrease of net foreign liabilities for the public sector. The share of foreign investors among government bonds (OFZ) holders dropped to about 20 percent, from 23.3 percent in the beginning of 2021. International reserves increased by US$5.0 billion, mainly due to the purchases of foreign currency under the fiscal rule framework, as oil prices has been exceeding the one specified in the fiscal rule.

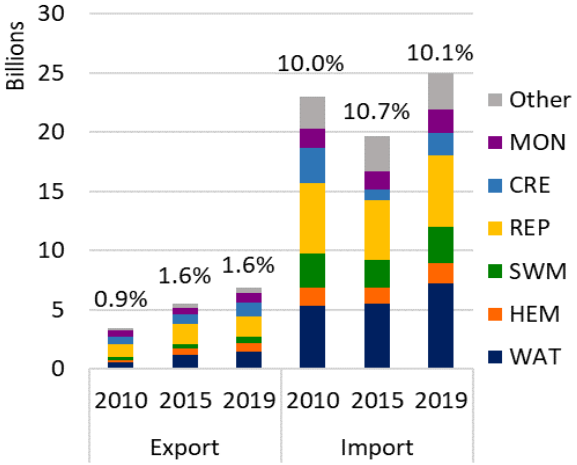
Higher oil prices, a stabilizing number of new COVID-19 cases and a stimulus package in the U.S. providing hopes for a faster global recovery supported the ruble in the first quarter of 2021. As a reflection of higher oil revenues, on January 15, 2021, the CBR resumed purchases of foreign currency after its suspension in March 2020.[20] The suspension followed a heightened global risk aversion in financial markets, increased exchange-rate volatility, and a collapse in oil prices. In January-March 2021, the average price for Urals oil was US$59.8 per barrel, compared to the cut-off price in the budget rule of US$43.3. Overall, under the fiscal rule framework, the CBR purchased Rub485.7 billion (US$6.4 billion) from January to the beginning of May. Starting in April, the shares of the dollar and the euro in the NWF was reduced in favor of the Japanese yen and the Chinese yuan. The ruble appreciated with respect to the U.S. dollar, gaining 2.5 percent, q/q, despite elevated geopolitical tensions, increased global risk aversion to all EMDEs since mid-February (please see section for Global activity for details), and resumed FX currency purchases under the fiscal rule framework (Figure 29). The REER strengthened by 1.9 percent, q/q. In April, on the back of elevated geopolitical tensions, the ruble lost 2.2 percent with respect to the US dollar.

Figure 29: The ruble strengthened in the Q1 2021, q/q



Source: CBR.

Figure 30: Imports of environmental goods exceed exports



Source: Comtrade, OECD2014.

Notes: CRE = Cleaner or more resource efficient technologies and products; HEM = Heat and energy management; MON = Environmental monitoring, analysis and assessment equipment; REP = Renewable energy plant; SWM = Management of solid and hazardous waste and recycling systems; WAT = Waste-water management and potable water treatment.

[20] Starting March 10th, the CBR discontinued its FX purchases and started pre-emptive sales of the FX reserves from the National Welfare Fund (NWF) under the fiscal rule framework. In addition to that, on March 19, the CBR established a mechanism for additional FX sales on the domestic market. In case the price of the Russian oil price benchmark (Urals) falls below US$25/ bbl, the CBR will conduct FX sales to compensate for oil, gas, and oil products exporters' revenue fallout.

Russia can better tap its potential for 'green' products exports. As a major energy exporter in a greening global economy, environmentally sustainable exports could play a stronger role for Russian export diversification. As the world moves toward decarbonization, Russia faces the challenge of formulating a forward-looking strategy for the energy sector and exports, encouraging technological adaptation and investment. Russia has a significant forest area, offering a clear advantage in terms of bioenergy resources. Previous studies have suggested it can become a competitive exporter of renewable energy equipment.[21]

'Green' or environmental goods include those that are either environmentally beneficial in use or consumption; substitutes that are produced causing comparatively less environmental harm; or which actively contribute to cleaning or reducing damage made to the environment. While there is still no international consensus on a list of such goods, the OECD classification (164 products) offers a comprehensive starting point, defined as "activities which produce goods and services to measure, prevent, limit, minimize or correct environmental damage to water, air and soil, as well as problems related to waste, noise and eco-systems."[22] The 2012 APEC Vladivostok Declaration made comparatively early progress by establishing commitments for member states to reduce tariffs on 54 environmental goods to a maximum of 5 percent. Trade liberalization in environmental goods is important, easing access to crucial environmental technologies for both businesses and consumers.

The largest exporters of environmental goods are China, Germany, the U.S., and Japan, together accounting for almost half of global exports. Between 2010 and 2019, global trade in environmental goods rose by 29.2 percent, with the share in global trade rising from 7.8 percent to 8.2 percent of global trade. Renewable energy products make up the largest share of exported environmental goods, also experiencing the highest growth rate, driven by solar photovoltaic systems.[23]

Russia's exports of environmental goods have risen moderately, making up a modest 1.6 percent of exports (US$6.9 billion or 3.4 percent of non-energy exports) in 2019 as compared to 0.9 percent (2.6 percent) in 2010, but imports still far exceed exports (Figure 30). Russia's exports of environmental goods are led by products that are relatively uncomplex and serve primarily as inputs or substitutes (such as articles or structures of steel). Table 1 shows Russia's exports with the highest technology contents; export volumes remain very small for these products and there is room to diversify into more technologically sophisticated exports (Box 4).

Table 1: Russia's current exports of complex (following PCI) environmental goods (EGs)

HS Code	EG Category	Product label	Environmental Use	Share in Russia's EG exports	Export value growth 2015-2019	PCI

[21] IRENA. 2017. REMAP 2030: Renewable Energy Prospects for the Russian Federation. Working Paper, April 2017, p. 27.
[22] Environmental goods are defined following OECD 2014 and considered at the 6-digit HS level. Limitations persist in defining environmental goods in absence of an internationally agreed upon definition and classification of the sector and due to the use of the Harmonized System (HS) classification, which does not account for end-use.
[23] For more details see Garsous, G. 2019. "Trends in policy indicators on trade and environment", OECD Trade and Environment Working Paper 2019/02.

847989	SWM	Machines & mechanical appliances nes	Machines and appliances designed for range of areas of environmental management including waste, wastewater, drinking water production and soil remediation.	2.0%	19.5%	3.9
903180	MON	Measuring equipment, nes	Equipment used in the measurement, recording, analysis and assessment of environmental samples or environmental impact.	4.0%	15.3%	2.9
901390	REP	Parts and accessories of optical appliances nes	Heliostats orient mirrors in concentrated solar power systems to reflect sunlight on to a CSP receiver.	1.3%	4.9%	2.8
841480	APC	Air compressor, hoods	Air handling equipment. Transport or extraction of polluted air, corrosive gases or dust.	1.1%	9.0%	2.7
850440	REP	Static converters, nes	Converts solar energy into electricity.	1.4%	3.8%	2.6

Source: UN Comtrade; APEC and OECD EG descriptions.

Box 4: Russia can better tap its potential for increasing exports of green products.

This box offers a snapshot view of Russia's potential strengths in producing and exporting "green" products. Following the product space methodology, generating measures of economic complexity and proximity (distance),[24] it is possible to identify which green products Russia are well positioned to export competitively. In terms of the Green Complexity Index (GCI) – which aims to capture the extent to which countries are able to competitively (RCA>1) export green, technologically sophisticated goods – Russia scores relatively low in relation to its income, but higher than other major oil exporters (Figure 4-1).

Figure B4-1: Russia's GCI score is low compared to income level, but higher than other major hydrocarbon exporters

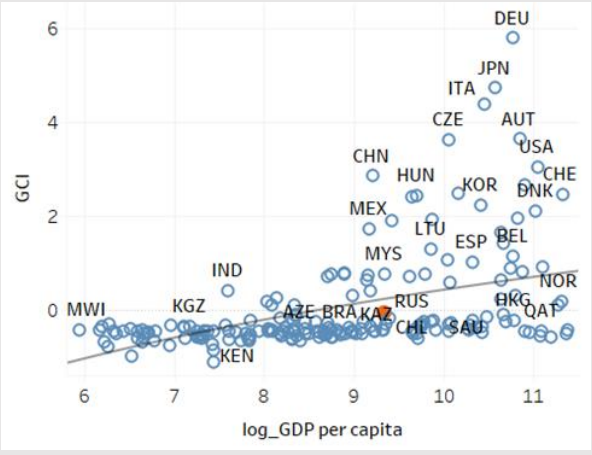
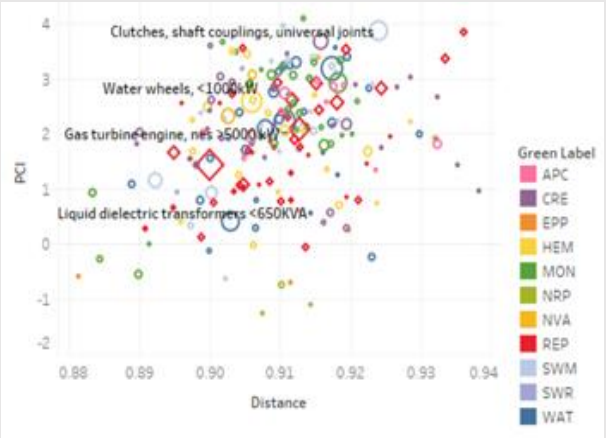


Figure B4-2: There are complex environmental goods close to Russia's current export basket 'knowledge'



[24]Following Mealy and Teytelboym 2020; Hildago and Hausmann 2009; Hausmann et al. 2014.

Source: Comtrade, OECD 2014. *Source*: Calculations based on Harvard Economic Atlas.

Notes: APC = Air pollution control; CRE = Cleaner or more resource efficient technologies and products; EPP = Environmentally preferable products based on end use or disposal characteristics; HEM = Heat and energy management; MON = Environmental monitoring, analysis and assessment equipment; NRP = Natural resources protection; NVA = Noise and vibration abatement; REP = Renewable energy plant; SWM = Management of solid and hazardous waste and recycling systems; SWR = Clean up or remediation of soil and water; WAT = Waste water management and potable water treatment.

The goods highlighted in Figure B4-2 are close in proximity to the "existing knowledge."[25] proxied through export capabilities and can thus potentially facilitate a profitable (complex) participation in the green economy. However, the nascent green industry faces considerable challenges, for instance through a requirement for the "localization" of components used in renewable energy sources. In addition, the government has decided to cut volumes of the national program to support green generation by 22 percent to Rub 313 billion, further limiting production development of equipment for green energy.

1.4. Monetary Policy: The CBR tightens and moves to neutral monetary policy.

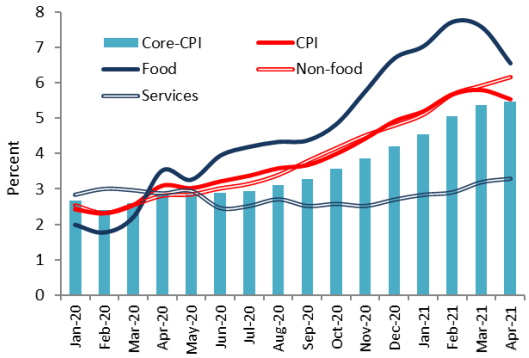
The CBR's monetary policy remained consistent with the inflation-targeting framework. On the back of prevailing pro-inflationary factors, the CBR started to move towards a neutral monetary policy, increasing the key rate by a cumulative 75 bps to 5 percent in March and April. Monetary policy maintained short-term interest rates close to the key rate. Monetary conditions remained soft. Demand-side and supply-side pro-inflationary factors pushed up the annual rate of consumer price index (CPI) inflation to 5.5 percent in April. Household inflation expectations and corporate price expectations increased, compared to pre-pandemic times, and they remain elevated.

The Inflation dynamics continued to develop under the influence of a large number of factors, among which pro-inflationary factors prevail. Since the end of 2020, the annual headline consumer price index (CPI) inflation has exceeded the CBR's target of 4 percent. In April, it decelerated to 5.5 percent compared to 5.8 percent in March mainly due to a strong base of last year (Figure 31). Annual CPI inflation accelerated in most Russian regions and ranged from 2 to 8 percent. The rise in inflation is determined by a group of factors, both on the demand side and on the supply side. Recovering domestic demand has become a pro-inflationary factor exacerbated by supply bottle necks. The main pro-inflationary factor on the supply side is the increase in the costs of producers of goods and service providers caused by global and local problems with supply chains, requirements for sanitary and epidemic protection, ruble depreciation, and continuing restrictive measures.

[25]The x-axis shows 'distance' which measures how close a good is to the current export capabilities; Using the measure introduced in Hidalgo et al. (2007), it is possible to estimate how related a given product is to a country's current set of production capabilities, calculating the average proximity between a given product j and all the products country c can currently export competitively

The acceleration of food inflation continued to contribute the largest share of the growth of headline CPI, although it dropped to 6.6 percent, y/y from 7.6 percent, y/y, in March**.** The growth of food inflation resulted from the ruble's depreciation, higher global food prices, and lower harvests for some agricultural items. Government measures, such as the introduction of price caps, export quotas, subsidies to producers, and incentives for food production development programs limited the rise in prices for certain goods (see Box 5). Meanwhile, non-food inflation and inflation in services continued to accelerate. Non-food consumer goods inflation increased to 6.2 percent, y/y, in April. Prices of construction materials, tobacco, and tv/radio goods accelerated the most, compared to the previous month. Inflation in services accelerated to 3.3 percent, y/y, reflecting an easing of COVID-19 restrictions and a higher demand for services, including in the sectors most affected by the restrictive measures, such as tourism. In April, core CPI (which excludes food and gasoline) stood at 5.5 percent, y/y.

Figure 31: The annual headline CPI inflation continues to exceed the CBR's target



Source: Rosstat.

Box 5: Food price inflation puts pressure on domestic consumption

Food prices in Russia have been rising faster than overall inflation since March 2020 (Figure B6-1), putting pressure on poor households as real disposable income decreased by 3.5 percent in 2020. Prices increased most substantially for sugar, eggs, groats and legumes and fruits and vegetables. Per capita consumption of cereals, oils and sugars constitutes a relatively small share in the food consumption basket of the average Russian citizen (16 percent) but account for a greater share of consumption among the poor. The poorest Russians (by income decile) spend 45 percent of their income on food items – almost 2.5 times as much – as Russians in the highest decile.[26] Food price inflation tends to be higher than overall inflation in those Russian regions that are less connected, have a higher share of poor population and are prone to significant weather and climate risks (Figure B6-2), while in Moscow, food price inflation has been almost at the level of the overall consumer price inflation.

[26] Based on ROSSTAT data.

Figure B5-1: Food prices in Russia have been rising faster than overall prices since March 2020 (y/y)

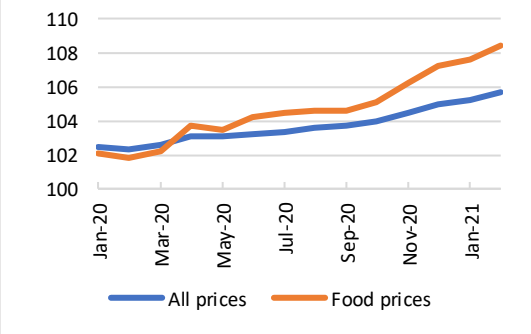
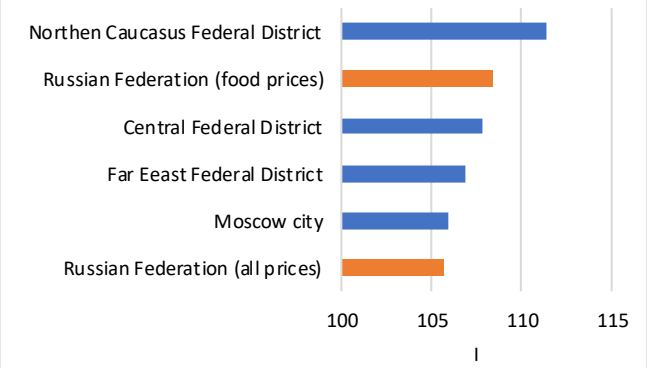


Figure B5-2: Food price inflation has been uneven across Russia (February 2021, y/y)



Source: Rosstat.

Despite strong state support measures and improved policy prioritization, domestic production growth for key agri-food products has been slow in boosting supply to pre-embargo levels. Since the 2014 food embargo against imports from certain mostly Western countries, food price indices have been on average 10 percent higher than in Europe and 3 percent higher than in the rest of the world. At the same time, there have been differences in producer price inflation, where Russian producer prices growth seems to be markedly lower than that of comparator countries since 2015, which risks undermining producer profitability. The differences in consumer and producer price growth in Russia from world prices growth can be linked to two key factors – domestic supply patterns and agri-food policy. A greater policy emphasis on agri-food sector competitiveness, promoting productivity and profitability of producers, could lead to better outcomes for domestic producers and consumers.

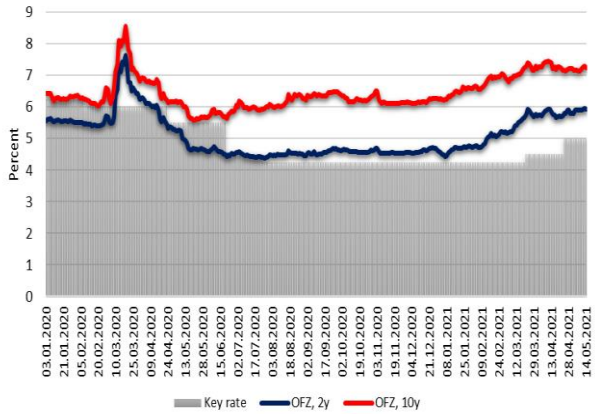
Global food security is a function of the supply of safe and affordable food to people around the world. At the same time, it is dependent on the stability of global food markets and on economic access to food at the household level, particularly in the less developed countries. Over the last decade, Russia has increased global grain supplies by boosting its exports. For Russian agricultural policies to be supportive of global food security, they would need to contribute to stability and predictability in global grain markets. Export restrictions (bans, quotas, tariffs) during periods of rising world prices contribute to instability in global grain markets and are not the most effective means of addressing domestic price increases.

In response to rising food price inflation, Russia introduced several measures. These included establishing price caps on socially important food items, restricting exports of staple commodities, and/or providing subsidies to producers of key food items. Such measures are politically attractive because they seem to provide immediate relief and put Russian consumers first. Despite their domestic political salience, however, these regulatory actions are economically distortive and fiscally expensive. A better approach would be to implement targeted social assistance programs, taking into account country-specific circumstance and social norms, that deliver relief to the most vulnerable segments of the population (part 3 of the main report is on cost-effective safety nets).

Both household inflation expectations for the twelve months ahead and corporate-sector price expectations for the next three months[27] remained elevated. In April, household inflation expectations significantly increased, reaching 11.9 percent, compared to pre-pandemic level of 7.9 percent, mainly due to the price growth of certain goods as well as ruble depreciation at the end of March – beginning of April. Corporate-sector price expectations increased to 25 percent from 18.1 percent due to the recovery in demand, while maintaining high estimates of the increase in cost prices.

The CBR tightens and accelerates its movement towards neutral[28] monetary policy. The pace of economic recovery is becoming increasingly steady. The rapid recovery in demand is generating sustained inflationary pressures, exacerbated by supply-side constraints. On the back of these factors, in March-April, the CBR increased its key rate by a cumulative 75 basis points (bps) to 5 percent, the lower bound of the neutral monetary policy range (Figure 32). The increase in the key rate should raise the attractiveness of bank deposits and protect the purchasing power of savings. In the end of April, the maximum interest rate on deposits in Russian rubles was 4.7 percent,[29] which is below the inflation rate. The monetary policy maintains the short-term interest rates (like the overnight deposit rate) close to the key rate.

Figure 32: The CBR started to move towards a neutral monetary policy



Source: CBR.

Monetary conditions remain soft, given the lags[30] in monetary policy. Soft monetary conditions contribute to the lending growth. The continuing lending expansion significantly supports the increase in consumer demand, which creates an inflationary pressure. Apart from the key rate, lending dynamics are substantially influenced by the subsidized lending and partial credit guaranty programs for SMEs and affected industries implemented by the Government and the CBR, as well as by regulatory relaxations. On the back of the CBR's decision of an earlier return to a neutral monetary policy (on April 23) the short and medium-term federal loan bond (OFZ) yields rose, while longer-term slightly declined due to a decrease of the sanctions risks and lower yields of the US government bonds.

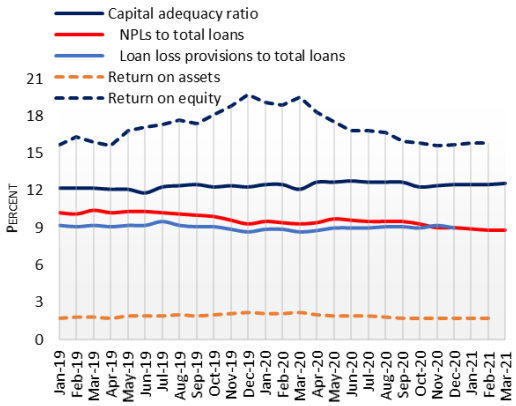
[27] This is the balance of corporates' answers on the question "whether the company is going to increase prices in forthcoming three months," which reflects prevalence of expectations of changes in prices.
[28] The CBR's neutral rate range is 5 to 6 percent. A neutral key rate would not either decelerate or accelerate inflation, relative to the target level of 4 percent.
[29] Results of the CBR's monitoring of the maximum interest rates on deposits in Russian rubles of ten credit institutions attracting the largest volume of deposits from individuals.
[30] "Lag" is defined as the timing relation between the resulting monetary series and resulting series of effects of monetary actions. The *"lag"* amounts to an average of *three* to *six months*.

1.5. Financial sector: the Russian banking sector remained largely resilient during the first year of the pandemic, though Covid-19's medium-term impacts remain to be seen.

The Russian banking sector has been withstanding the pressure from the COVID-19 pandemic and its associated economic slowdown due to relevant policy response measures introduced by the Russian Government and the central bank. Credit growth has been supported by a slow economic recovery and public credit support programs. The system-wide capital adequacy remained largely stable, supported by the regulatory forbearance measures. Although the gradual economic recovery may help improve banks' asset quality and operating environment, banks' asset quality, profitability and capitalization may come under pressure when forbearance measures are lifted. However, this is expected to be moderate, given the CBR's moderate credit loss projections and strong credit growth. The banking sector managed to remain largely resilient during the first year of the COVID-19 pandemic and could retain stability in 2021 if the economic situation does not worsen or geopolitical pressure does not increase further. The recent sanctions on Russian sovereign debt do not threaten Russia's financial stability due to strong macro-fiscal buffers and a relatively moderate share of foreign-investor holdings of Russian government debt, which could be compensated through domestic investors.

Russian banks' key credit risk and performance indicators remained largely stable, supported by the policy response measures and regulatory forbearance measures (Figure 33). The forbearance on loan provisioning granted by CBR at the outset of the pandemic allows banks to delay the reclassifying of restructured loans and postpone provisioning for potential loan losses until April 1, 2021 for corporate loans and July 1, 2021 for retail loans and loans to SMEs. As of April 2021, the aggregate capital adequacy ratio stood at 12.6 percent (against a regulatory minimum of 8 percent). Non-performing loans remained largely unchanged at about 9 percent as banks benefited from the regulatory forbearance measures. Banking-sector profitability has been showing signs of recovery, supported by strong credit growth fueled by the government credit support programs and improving economic conditions. In 1Q 2021, the banking sector net profit amounted to Rub 578 billion (US$7.7 billion) – which is higher compared with the same period in 2020 (Rub 528 billion (US$7 billion), even considering the end of regulatory forbearance measures when restructured corporate loans had to be fully provisioned by April 1, 2021. Consequently, the return on assets (ROA) and return on equity (ROE) were 1.7 percent[31] and 15.8 percent,[32] respectively. Banking-sector liquidity has been stable, with highly liquid assets (defined as cash and equivalents,

Figure 33: Banks' key credit risk and performance indicators remained largely stable



Source: CBR.

[31] As of March 1, 2021, the latest available date.
[32] As of March 1, 2021, the latest available date.

short-term placements with banks and unpledged government bonds) representing about 20 percent of sector assets at end-2M21 and covering customer accounts by 28 percent.

Credit trends remained positive across all segments, supported by a nascent economic recovery, low interest rates and public support programs. In March, corporate sector loans grew by 9 percent, y/y, backed by the government programs for the affected industries and systemically important enterprises, while retail lending continued benefiting from the subsidized mortgage loan program launched by the government in April 2020. SME loans grew by 22.3 percent, y/y, in March, also largely supported by the government programs.

Based on loan restructuring trends, so far, bank losses appear to be contained. Eleven percent of banks' loans had been restructured since the beginning of the pandemic (exceeding a notional value of RUB 7.4 trillion), according to the CBR, including 14 percent of total loans to large corporates, 15 percent of loans to SMEs and 4 percent of loans to individuals. Sixty-four percent of the restructured corporate loans accounted for three sectors – oil and gas, construction and real estate, and metallurgy. Nearly half of the restructured SME loans accounted for real estate and construction enterprises, 15 percent for trade and 7 percent for hotels and catering – sectors that have been affected the most by the pandemic. Earlier this year, the CBR said that it expected only 20-30 percent of bank loans that were restructured as a result of the pandemic to become problematic, requiring incremental credit loss charges of around 2 percent of banks' loan book this year. This appears to be manageable for most of the banks, although some smaller banks could potentially face difficulties.

Continuing double-digit mortgage growth expansion on the back of government support program[33] has not led to an increase in mortgage NPLs thus far, but risks may be on the rise. Since the start of the government program last year, the banks issued 450,000 loans worth RUB1.3 trillion (US$17.4 billion). While the quality of mortgage loans has not been showing any signs of deterioration (they're currently at 3.4 percent), increased demand has led to an overheating of the real estate market in some regions. Moreover, housing affordability may be worsened by the widening gap between declining household income and growing property prices. If real estate prices grow further as households' real income stagnates, borrowers' debt burden for newly originated mortgages will increase. This may amplify credit risks in the system if lenders loosen underwriting standards to maintain or boost loan growth.

The impact of a new round of US sanctions on the financial sector has been muted thus far; yet their further escalation may put additional pressure. On April 15, 2021, the US launched a new set of sanctions on Russia, which prohibit US financial institutions from participation in the primary market for Russian RUB or non-RUB-denominated bonds issued after June 14, 2021 by the Central Bank of Russia, the National Welfare Fund (NWF) or the Ministry of Finance (MoF). Lending RUB or non-RUB-denominated funds to the CBR, the NWF or the MoF is also prohibited. These sanctions follow on from the US sanctioning the primary markets of the Eurobonds in August 2019. The short-term implications have been limited as the new sanctions do not threaten Russia's financial stability due to strong macro-fiscal buffers, strong CBR capacity to provide extra liquidity support to the market if

[33] The program was introduced in April 2020 with the aim to support the construction industry and homebuyers in response to the COVID-19 pandemic and then has been extended through July 1, 2021. Under the program mortgages on the purchase of new homes (up to a maximum of 12 million rubles (US$158,000) in Moscow and St. Petersburg, and half that level in the regions) are capped at 6.5 percent and a down payment is reduced to 15 percent. While the government decision regarding another extension of the subsidized mortgage program is currently pending, it is likely to be largely terminated, continuing in only a few Russian regions with low demand.

needed, and relatively moderate share of foreign investor holdings of Russian government debt. Russia is unlikely to face any funding issues as the domestic demand for bonds – from both institutional and retail investors – can compensate for the exit of international investors.

Box 6: CBR's regulation of ecosystems

In April 2021, Russia's central bank released its consultation paper on the regulation of ecosystems.[34] Innovation and fintech financial services have grown rapidly in Russia, leading to creation of large marketplace ecosystems led by banks that include e-commerce, travel, entertainment, insurance and a wide range of other financial and non-financial services. Global ecosystems have emerged on the basis of major technological companies possessing considerable amounts of data and an extensive client base. Large technology companies are also expanding the range of their platforms and systems, beginning to offer financial services to customers, among other things. Bank ecosystems present unique challenges for regulators as they do not fit into the existing mold of financial market regulation because they combine financial and non-financial services. The regulatory measures the CBR proposed are aimed at preserving financial stability, leveling the playing field for large and small players, promoting competition and ensuring adequate consumer protection. According to the CBR vision, the envisioned structure of the Russian market would include at least several major national ecosystems competing with each other and foreign actors, as well as niche providers and smaller platforms meeting clients' needs beyond ecosystems, while challenging the leaders.

1.6. Fiscal policy: Russia's fiscal stance improved in the first quarter amidst an economic rebound

In 2020, hit by the shocks induced by the pandemic, the federal budget registered a deficit of Rub4.1 trillion (3.8 percent of GDP), compared to a surplus of Rub1.9 billion (1.8 percent of GDP) in 2019. In 2020, the federal debt increased by 5.4 percent of GDP, yet the debt burden and the debt services remained relatively small, compared to peer countries. The debt situation in the regions has worsened but remains manageable. An increase of the debt burden at the regional level led the government to convert regional commercial debt exceeding 25 percent of the regions' own revenues into budget credits. In the first quarter of 2021, the federal budget fiscal stance improved amidst an economic rebound. The fiscal stance in Russia is expected to be procyclical over the near term as planned fiscal adjustments progress alongside negative output gaps. Output losses from fiscal consolidation are estimated to be pronounced in Russia: a 1 percent of GDP decrease in government spending could lead to a decrease in output of 0.4 to 2 percent.

In 2020, hit by the shocks induced by the pandemic, the federal budget registered a deficit of Rub4.1 trillion (3.8 percent of GDP), compared to a surplus of Rub1.9 billion (1.8 percent of GDP) in 2019. This was on the back of

[34] 'Ecosystems: Regulatory Approaches'.
https://www.cbr.ru/Content/Document/File/119962/Consultation_Paper_eng_02042021.pdf

higher spending driven by the response to the spread of the pandemic and the need to support the economy amidst lower oil/gas revenues. In 2020, oil/gas revenues dropped by 33.9 percent, y/y, as energy prices plummeted, and energy production decreased (Figure 34). Non-oil tax receipts, alleviated by the ruble's depreciation, stayed at about the same level as in 2019, dropping in real terms by 2 percent. Government measures aimed at fighting the COVID-19 pandemic and mitigating its economic impact led to an increase of primary expenditures by 26 percent, y/y, (+4.6 trillion Rub), driven mainly by growth in spending on social policy (+2.4 trillion Rub, y/y), national economy (+1 trillion RUB, y/y), and health (+0.8 trillion Rub, y/y). Compared to the pre-pandemic plans, primary expenditures grew by about Rub 3.4 trillion (3.3 percent of GDP).

Figure 34: In 2020, oil/gas revenues dropped by 33.9 percent, y/y

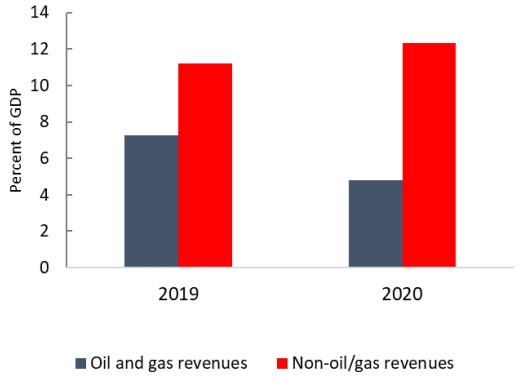
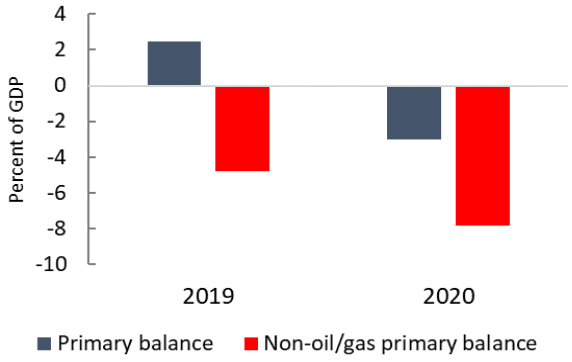


Figure 35: In 2020, the federal budget registered a primary deficit of 3.0 percent of GDP

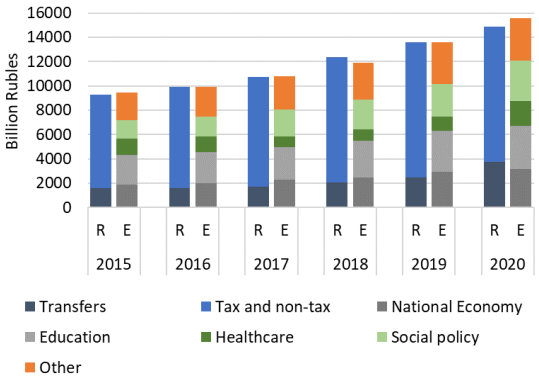


Source: Roskazna.

In 2020, the federal debt increased by 5.4 percent of GDP, yet the debt burden and the debt service remained relatively small, compared to peer countries. The federal budget deficit was largely financed by borrowing in the domestic market. In 2020, the federal government's ruble-denominated debt grew by Rub4.6 trillion, amounting to Rub14.8 trillion (14.3 percent of GDP). This debt was purchased largely by domestic investors. Meanwhile, the debt burden remains substantially lower than in other EMDEs (about 63 percent of GDP), as does the debt service (1 percent of GDP, vs 2 percent of GDP for the EMDEs).

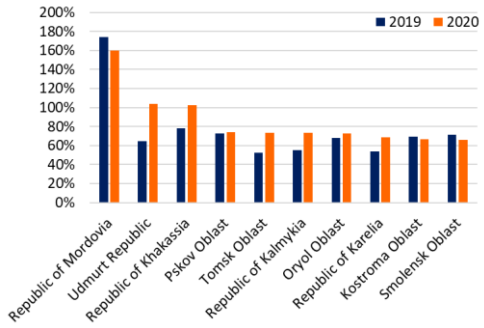
In 2020, regional consolidated budget expenditures reached Rub15.6 trillion, growing faster than revenues, which reached Rub14.9 trillion despite record-high intergovernmental fiscal transfers. Expenditure grew by 14.8 percent, y/y, led by a 71.5 percent increase in expenditure on health and a 23.6 percent rise in spending on social policy. Meanwhile, revenues of the consolidated budgets of the regions rose by a mere 9.8 percent, supported largely by transfers that increased by 53.9 percent. Tax and non-tax revenues declined by 2 percent, with corporate income tax (CIT) dropping by 13 percent. In April-May 2020, total revenues had fallen by 11.6 percent, with a 25.8 percent decline in tax and non-tax revenues and a 32.7 percent drop CIT revenue.

Figure 36: Regional budgets slid into deficit in 2020 amidst higher expenditure, revenues rose supported by transfers



Source: MinFin.

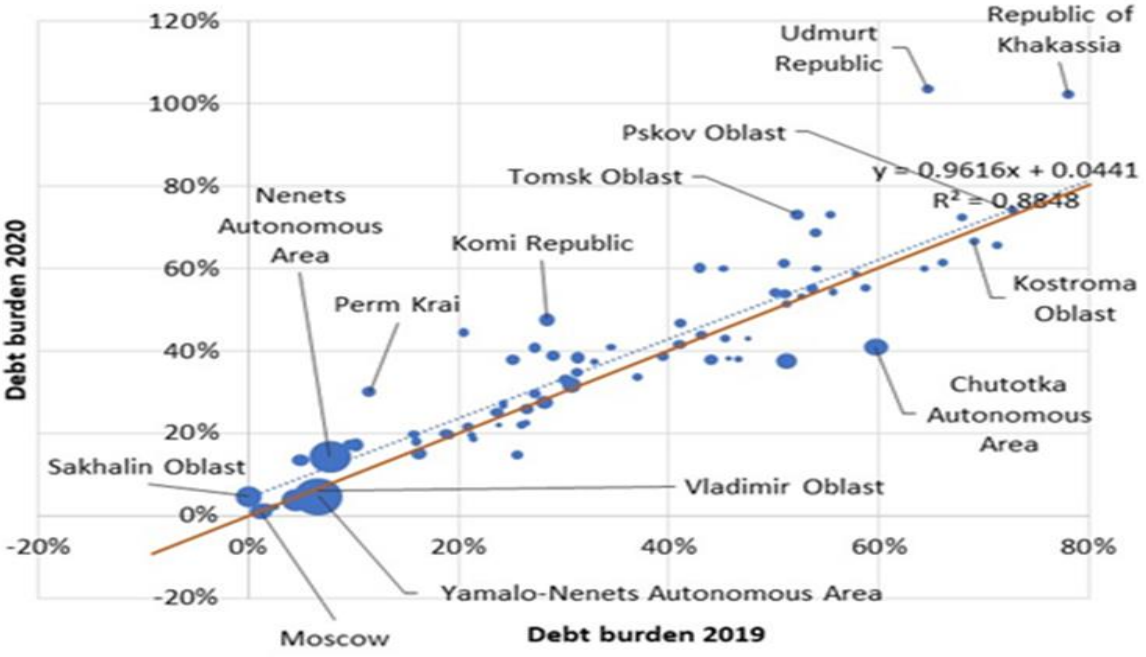
Figure 37: Several of the top regions in terms of highest debt burden experienced sharp rise in 2020 (debt/ tax and non-tax revenue)



Source: MinFin.

The crisis has resulted in a budget deficit in 57 regions (compared to 34 in 2019), contributing to an 18.1 percent rise in the debt of regions (Figure 36). The overall regional debt situation, however, remains manageable, with the consolidated regional debt at 23.1 percent of revenues, and deficit at 0.6 percent of GDP in 2020, compared to 30.4 percent and 0.2 percent, respectively, in 2015. At the end of 2020, the deficit of the consolidated budgets of the Russian regions stood at Rub676.5 billion, compared with a surplus of Rub4.7 billion at the end of 2019. The top 10 regions in terms of deficit accounted for 72.6 percent of the total deficit in 2020. Among the regions with the highest deficits, Tyumen Oblast, Yamal-Nenets Autonomous Area and Perm Krai stood out, having slid into deficit in 2020 from a surplus in 2019. The debt of regions rose from Rub2.1 trillion as of January 1, 2020 to Rub2.5 trillion as of January 1, 2021. The total debt burden (debt/tax and non-tax revenue) rose from 19.2 percent in 2019 to 23.1 percent in 2020, rising most sharply in Udmurt Republic, Republic of Khakassia, Kemerovo Oblast, and Tomsk Oblast (Figure 37. Overall, the debt burden increased slightly more for regions where it was lower before the pandemic (Figure 38), as these regions (with more intensive economic activities) were hit harder by the pandemic and had more room to increase debt. In April 2021, the decision was made to convert regional commercial debt (mark-to-market interest rate) exceeding 25 percent of the regions' own revenues into budget credits (at a rate of 0.1 percent) to be paid by 2029. While justified on the basis that the pandemic is not over yet, at the same time, this decision could send mixed signals to regions with more conservative debt policies. To avoid this, the government introduced another instrument: budget credits to regions (at a higher 3 percent interest rate) which would be disbursed to regions with lower debt burdens. While justified on the basis that the pandemic is not over yet, at the same time, this decision could send mixed signals to regions with more conservative debt policies. Another option could have been a disbursement of general-purpose transfers for regions less prepared to face persistent pandemic challenges in 2021.

Figure 38: On average, the debt burden increased slightly more for regions less indebted before the pandemic

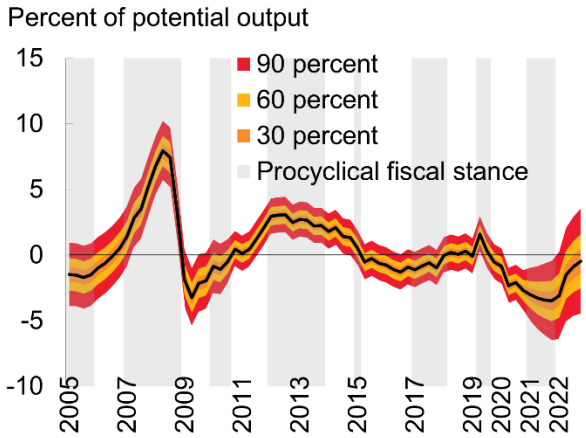


Source: MinFin.

Notes: Size of bubbles represents GRP per capita in 2019; excludes Mordovia as outlier.

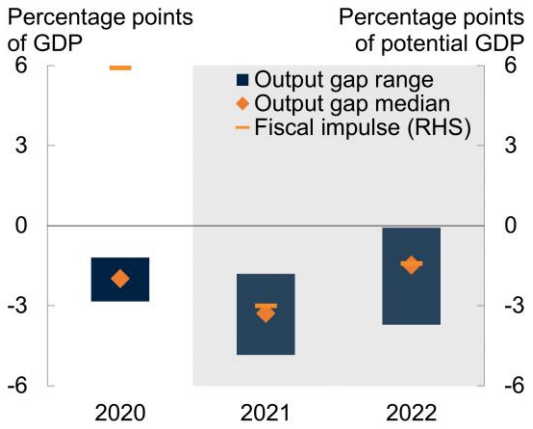
In the first quarter of 2021, the federal budget fiscal stance improved amidst an economic rebound. In the first quarter of 2021, federal budget revenues increased y/y, due to higher non-energy revenues (mostly higher VAT receipts). Meanwhile, CIT revenues fell by almost 18 percent, y/y, as accrued CIT receipts for 2020 were lower. Despite much lower expenditures on health, in the first quarter of 2021, primary federal budget expenditures grew by 13 percent, y/y, driven by higher spending on state management, social policy, education, and communal and housing services. The federal budget surplus increased to Rub205 billion, compared to Rub113 billion in the same period last year. In the first quarter of 2021, the federal government borrowed about Rub739 billion. Economic sanctions, introduced in April, are expected to have a marginal effect on the Russian economy and Russia's budget access to finance (See Financial Sector section for details). On April 20th 2021, Russia raised 1.5 billion euros (US$1.83 billion) in two Eurobond issues maturing in 2027 and 2036 with foreign investors showing sufficient interest in investing in Russian debt instruments, stemming from relatively high yields (2.65 percent for 15 year bonds compared to 0.15 percent for 15 year bonds issued by Germany) and low debt levels in Russia.

Figure 39: Output gap and procyclicality of fiscal stance in Russia



Source: World Bank.
Note: Figure shows output gap estimate and confidence intervals. Fiscal stance is procyclical when fiscal impulse is higher (lower) than 0.5 (-0.5) percent of GDP and output gap estimate is positive (negative). Fiscal impulse is defined as the negative change in the cyclically adjusted primary balance (CAPB) from the previous year.

Figure 40: Estimated output gaps in Russia



Source: World Bank.
Note: Shaded areas indicate forecasts. Fiscal impulse defined as change in the cyclically adjusted primary balance (CAPB) from previous year. Decline in the CAPB indicates fiscal consolidation; increase in the CAPB indicates fiscal expansion.

The fiscal stance in Russia is expected to be procyclical over the near term as planned fiscal adjustment s progress alongside negative output gaps. In order to assess the cyclicality of fiscal policy, an estimate of the output gap is needed to gauge the business-cycle phase.[35] Measuring output gaps at the national level is complex since it is an unobserved variable. The assessment of fiscal cyclicality is also sensitive to the measurement of output gaps. Nevertheless, output gaps can be estimated using a range of methods. Univariate filters — which typically decompose quarterly output series into trend and cycle component — are often expanded into multivariate filters that include inflation, unemployment, various financial indicators, and commodity prices. Filtering techniques distinguish short-run deviations of output from trends, which is most relevant for the assessment of fiscal policy cyclicality. A multivariate filter, which incorporates more economic information than univariate filters, is the technique used in this box.[36]

Output gap estimates for Russia are subject to uncertainty, especially amid the pan demic, but are projected to remain negative over the near term. Prior to the pandemic, confidence bands around Russia's output gap estimate suggested that the cyclicality of fiscal policy could not be easily assessed (Figure 39). Since the onset of COVID-19, however, estimates for the output gap have been persistently negative — even when accounting for elevated uncertainty — and are expected to remain negative in the near term due to the pandemic's lingering effects (Figure

[35] Output gaps capture the difference between the level of actual output and its "potential," scaled by potential output. A positive output gap indicates excess demand, where economies are operating above the level that is sustainable at full employment. Conversely, a negative output gap indicates weak demand and the presence of global spare capacity.
[36] Estimates of long-term potential output rest on structural models of the production function or long-term growth expectations. Refer to World Bank 2018 for additional details.

40). As a result, the fiscal stance in Russia is expected to pivot from countercyclical accommodation to procyclical fiscal tightening.

Fiscal adjustment poses output costs in EMDEs based on estimates of fiscal multipliers, but the size of output losses varies with the business cycle. Fiscal adjustment is often needed in EMDEs to ensure access to market financing and to restore medium-term debt sustainability, but there is broad consensus that fiscal consolidation is contractionary in the short term.[37] Moreover, the business cycle can amplify the output losses from fiscal adjustment, as fiscal multipliers tend to be larger during recessions (Riera-Crichton, Vegh, Vuletin 2016; Jordà and Taylor 2015).

Fiscal multipliers are developed to assess the impact of fiscal policy in Russia. Fiscal multipliers are estimated using the local projection method, or LPM (Auerbach and Gorodnichenko 2012, 2013; Jordà 2005) (Box 7).

Fiscal multiplier estimates for Russia suggest fiscal policy has a significant impact on output but are sensitive to oil prices. Using the local projections model, as specified, over a three-year horizon, output losses from fiscal consolidation are estimated to be pronounced in Russia, with the cumulative impact reaching nearly 0.7 after around two years (Figure 41; Table 2). Although these results suggest that a US$1 increase in government spending increases output by less than US$1, they are broadly in line with the literature on EMDEs.[38] Estimates for government spending multipliers, however, are much larger when accounting for oil prices, when oil prices are below trend — as calculated using a Hodrick-Prescott filter — government spending multipliers for Russia range from 0.4 in the short term to 2 in the medium term (Figure 42). This implies that a 1 percent of GDP decrease (increase) in government spending leads to a decrease (increase) in output of 0.4 to 2 percent (Table 3).

The impact of oil prices on spending multipliers in Russia appears to be asymmetric; that is, estimates for spending multipliers are larger when oil prices are below trend than above trend (Table 2). Below-trend oil prices could reflect state-dependent effects as lower oil prices typically correspond with periods of economic downturn in energy exporters — particularly for those with less diversified economies.[39] Moreover, energy exporters are often forced into sizable fiscal consolidation when oil prices decline due to the heavy reliance on extractives as a source of government revenue; conversely, the impact of higher oil prices does not necessarily yield large growth dividends.[40] [41] Absent progress on economic diversification, the adverse impact of oil price declines on fiscal revenues in energy exporters could be further exacerbated by the ongoing energy transition (Carbon Tracker 2021; Wheeler et al. 2020).

[37] A key challenge, however, is that estimation requires the identification of exogenous fiscal adjustment episodes—namely, fiscal responses that are orthogonal to cyclical fluctuations in real activity. Fiscal consolidation episodes in this box is identified using the cyclically-adjusted primary balance (CAPB) as a share of potential GDP—a common identification approach. An alternative approach, pioneered by Romer and Romer (2010), uses narrative history to identify fiscal adjustment episodes driven by policy actions related to long-term fiscal sustainability considerations. Refer to Escolano et al. (2014) for a survey of the relevant literature.

[38] See Loayza and Pennings (2020) for a rich literature review of fiscal multipliers in EMDEs.

[39] As documented in the literature more generally, fiscal multipliers tend to be larger during recessions (Riera-Crichton, Vegh, Vuletin 2016; Jordà and Taylor 2015).

[40] The asymmetric effects of oil price shocks in energy exporters is discussed in Moshiri (2015), Stocker et al. (2018),

[41] Russia, for instance, implemented its fiscal rule to help mitigate the cyclical impact of oil prices on government revenues.

There are important considerations other than oil prices and possible state-dependent effects for spending multipliers.[42] In EMDEs, the importance of strengthening governance to bolster inclusive development has long been recognized; in ECA, this is magnified by the large footprint of the state, whose role has increased amid the pandemic due to the need for intervention.[43] [44] Higher institutional quality is associated with higher fiscal multipliers — including in energy exporters, particularly when oil prices are elevated as oil revenue windfalls are more likely to be saved for rainy days or to be spent more effectively, such as on measures that help lift longer-term growth prospects (Moshiri 2015).[45] Fiscal multipliers also tend to be larger in EMDEs with wider fiscal space and lower government debt, such as in Russia (Huidrom et al. 2019).

Figure 41: Government spending multipliers in Russia

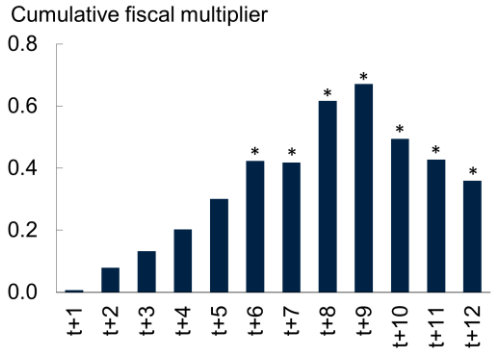


Figure 42: Government spending multipliers in Russia for above and below trend oil prices

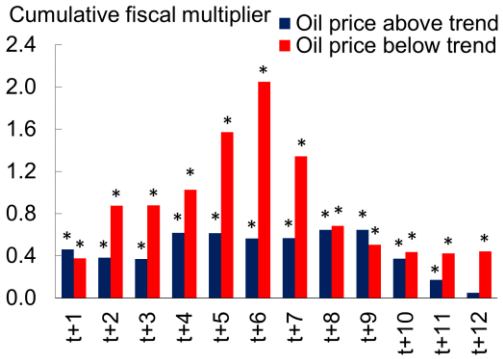


Table 2: Estimated cumulative spending multipliers in Russia (for the impact horizons from 1 to 12 quarters):

h1	h2	h3	h4	h5	h6	h7	h8	h9	h10	h11	h12
0.007	**0.079**	**0.132**	**0.203**	**0.301**	**0.423***	**0.418***	**0.617***	**0.671***	**0.494***	**0.427***	**0.359***

* significant at 10 percent level.

Table 3: Estimated cumulative spending multipliers in Russia (for the impact horizons from 1 to 12 quarters):

	h1	h2	h3	h4	h5	h6	h7	h8	h9	h10	h11	h12
oil price above trend	0.462*	0.383*	0.370*	0.617*	0.614*	0.564*	0.567*	0.647*	0.646*	0.372*	0.172*	0.0493

[42] Mechanically, data availability constricts the sample to 2004Q1 to 2019Q4 —implying there is no oil price decline observed following Russia's implementation of the fiscal rule in this sample. Thus, the size of spending multipliers in Russia may become less dependent on oil price fluctuations in the future.

[43] https://www.ebrd.com/news/publications/transition-report/transition-report-202021.html

[44] https://www.worldbank.org/en/region/eca/publication/europe-and-central-asia-economic-update

[45] Closing government spending efficiency gaps could also help yield sizable growth dividends in EMDEs (Schwartz et al. 2020).

oil price below trend	**0.377***	**0.877***	**0.878***	**1.025***	**1.571***	**2.049***	**1.342***	**0.685***	**0.506***	**0.435***	**0.425***	**0.441***

* significant at 10 percent level.

Box 7: Fiscal multipliers are developed to assess the impact of fiscal policy in Russia.

Fiscal multipliers are estimated using the local projection method, or LPM (Auerbach and Gorodnichenko 2012, 2013; Jordà 2005). This estimates the same impulse responses (IRF) as Vector Autoregressions (VAR), but also allows for more flexibility to incorporate nonlinear specifications, such as state-contingent estimation of fiscal multipliers (Plagborg-Møller and Wolf 2021).[46] The baseline linear LPM specification looks as follows:

$$y_{t+h} = \alpha_h + \psi_h(L)x_{t-1} + \beta_h shock_t + \varepsilon_{t+h} \text{ for } h = 0,1,2 \dots$$

where *y* is real per capita GDP, *x* are control variables (which include lagged real GDP per capita and government spending), $\psi_h(L)$ is a polynomial in the lag operator of order 4, and *shock* is the identified government spending shock. The coefficient β_h is an estimate of the fiscal multiplier – or the response of real GDP at time *t+h* to the shock at time *t*. Under the Blanchard and Perotti (2002) structural VAR (SVAR) recursive identification, the shock is simply the current government spending. The impulse response function is a sequence of estimated coefficients β_h from a series of single regressions for each horizon *h*. This approach can be extended to the estimation of state-contingent multipliers (fiscal multipliers in bad and good times) by estimating the following model:

$$y_{t+h} = I_{t-1}\left(\alpha_{B,h} + \psi_{B,h}(L)x_{t-1} + \beta_{B,h}shock_t\right) + (1 - I_{t-1})\left(\alpha_{G,h} + \psi_{G,h}(L)x_{t-1} + \beta_{G,h}shock_t\right) + \varepsilon_{t+h}$$

where I_{t-1} indicates whether the economy is in a recession (1) or expansion (0). Fiscal multipliers during recessions are given by the estimates of $\beta_{B,h}$; and in expansions – by $\beta_{G,h}$. Similar to IRFs, these specifications estimate fiscal multipliers at the horizon *h* – the impact of spending shock on GDP at *t+h*. The cumulative fiscal multipliers, or the cumulative response of GDP over *h* quarters to the spending shock at *t* can be estimated from a single regression using the following instrumental variable (IV) specification:

$$\sum_{j=0}^{h} y_{t+h} = \alpha_h + \psi_h(L)x_{t-1} + m_h \sum_{j=0}^{h} g_{t+h} + \varepsilon_{t+h} \text{ for } h = 0,1,2 \dots$$

where $\sum_{j=0}^{h} y_{t+h}$ and $\sum_{j=0}^{h} g_{t+h}$ are the sums of real GDP per capita and real government spending from *t* to *t+h*. Government spending at time t is used as an instrument to the sum of government spending over the estimation horizon. The coefficient m_h estimates cumulative fiscal multiplier over *h* quarters following the shock at time *t*.

[46] Estimates are based on quarterly data from 1999 to 2019, which includes real GDP and real government expenditure, excluding interest payments. Real government spending is calculated by dividing nominal government expenditure by the GDP deflator. All variables are seasonally adjusted and expressed in per-capita terms. As in Ramey and Zubairy (2018) GDP and spending variables are scaled by trend GDP estimated as a sixth-degree polynomial of the real per-capita GDP. This rescaling transforms all variables in the same units and allows direct estimation of fiscal multipliers. Regressions that use logarithms of the variable produce estimates of elasticities that must be converted to multiplier equivalents using ex post conversion factor of the sample average of the ratio of GDP to government spending.

1.7. Labor markets and households' welfare

The fourth quarter of 2020 and the first quarter of 2021 have shown improvement in the conditions of the labor market, as measured by a reduction in unemployment and an increase in real wages. These trends are similar across regions, but with differences between economic activities. The favorable evolution of the labor market in the 4th quarter, and the compensatory measures of adopted during the 2nd and 3rd quarter have led to slightly lower poverty[47] rates by the end of 2020 than in 2019.

The size of the labor force remained close to its pre-pandemic levels. In March 2021, the total labor force reached 75.1 million people, higher than the 74.9 million observed in March 2020. The participation rate, or the proportion of people working or looking for jobs as a share of population aged 15 or more, went from 62.7 to 62.2 percent between the fourth quarter of 2019 and 2020, with the rates by gender declining from 71.0 to 70.5 percent for men, and from 55.8 to 55.4 for women, in the same period.

Although the labor force remained stable, employment is still below pre-pandemic levels (Figure 43). However, the labor market began showing some signs of improvement by the end of year 2020. The national unemployment rate has been declining since last August, when it peaked at 6.4 percent, to 5.4 percent in March 2021. This rate is still 0.7 percentage points higher than in the same month of the previous year, which means that, despite the improvement, labor markets are not where they were before the pandemic. Moreover, the situation of the unemployed has worsened. The facilitation and extension of unemployment insurance that was part of the measures adopted during the second quarter of year 2020 and were extended until 2021, but coverage tapered off notably in the fourth quarter of 2020. Beneficiaries of unemployment insurance grew from 17 percent to 70 percent of the unemployed between March and August, but then declined to 29 percent in December and 22 percent in March 2021. The unemployment rate has declined, but the share of the unemployed who are protected by unemployment insurance has declined even faster, leaving a larger number of unemployed without coverage than before the pandemic (Figure 44).

All regions have experienced a reduction in the unemployment rate in Q4 2020 from its peak in the 3rd quarter, with the largest reduction in the North Caucasian region (1.1 percentage points) and the smallest in the Southern (0.3 percentage points) and the Far-Eastern region, which experienced no change in the unemployment rate. Nonetheless, all regions still experience higher unemployment rates that at the beginning of the crisis (Figure 45). The differences are mostly due to the relative size of unemployment in each region. If considered in relative terms, the decline of unemployment rates is similar across regions (although faster in Central and North Western).

Job losses, however, are not the same across economic activities. When comparing the average employment by sector between Q4 2020 and the same period the year before, the total loss of 1.78 million jobs is concentrated in four sectors: manufacturing, construction, retail &hospitality, and health/social services. These four have similar losses of around 350,000 jobs each. The losses in manufacturing, construction and retail & hospitality are associated with lock-down measures and the difficulty of tele-working in these activities. The fall of employment in health/social services, during a pandemic, however, is more difficult to explain. Possible explanations are

[47] Poverty is based on the official regional poverty lines as of 4Q 2020 (most of which are close to the national line of Rubles 11,329 per month per person for IVQ'2020)

increased mental and physical fatigue of health workers; increased infections in this segment of the workforce; or the fall in employment in social care facilities (including private) which were hit by the pandemic. The rest of the sectors have had much smaller losses, or none, which indicates that for the rest of the economy, the worst of the crisis seems to have passed (Figure 46).

Figure 43: Although employment is still below pre-pandemic levels, the labor market began showing some signs of improvement by the end of year 2020

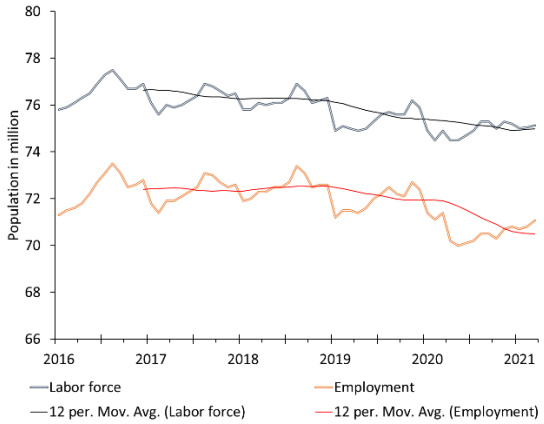


Figure 44: Unemployment rates have receded, but coverage of unemployment insurance has declined even faster

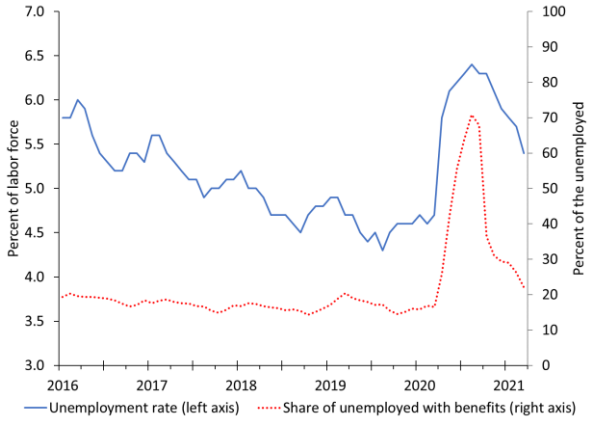


Figure 45: Unemployment rates have fallen in all regions

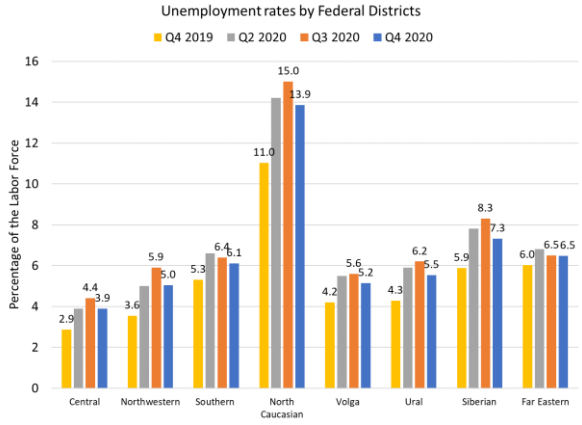
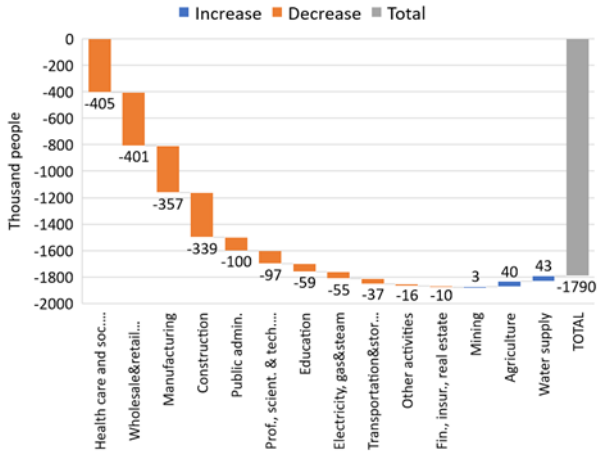


Figure 46: Job losses are concentrated in four economic sectors (changes in employment by economic activity, Q4 2020 vs Q4 2019)



Source: World Bank staff using data from ROSSTAT.

While unemployment rates declined, informal employment has increased its share within total employment. The proportion of workers who worked only in the informal sector (as a proportion of total employment) was 19.3 percent in the Q4 2019, declining to 17.9 percent in the Q2 2020, and then climbed up to 18.9 in Q4 2020. At the beginning of the crisis, most of the job losses occurred in the informal sector. But in the second half of the year, most jobs were also created in the informal sector: the number of people working only in the informal sector grew by 828,000 in 2H2020, whereas those working in the formal sector – or with jobs in both sectors – declined by

337,000. This indicates that the labor market, although regaining traction, is still feeble and labor demand has not regained full strength.

Job postings from employers in employment agencies are still weaker than before the pandemic. In December 2020, the ratio of unemployed to job posts was 2.5 compared to 2.3 the same month the year before. Again, as we reported in the previous issue, the number of job postings was not very different from a year ago (still about 1.7 million jobs). It is the number of unemployed that remains high which, together with job creation in the informal sector, suggest that employment agencies are not being the channel of new job creation in the formal sector.

Average real wages increased by 1.7 percent between 2019 and 2020. The growth of real wages among employees continued its regular pattern with each quarter being higher than in past year, except for the second quarter of 2020 (Figure 47). This upward trend masks important differences across economic activities. Real wages increased in agriculture (2.1 percent), telecommunications (4.2 percent), and health services (9.6 percent), but fell in many other sectors, with large declines in hospitality services (-10.8 percent), construction (-3.3 percent), culture/sports/leisure activities (-2.8 percent) and commerce (-1.7 percent).[48] These data indicate that sectors that suffered the largest employment losses also had the largest real wage losses, which is consistent with a severe demand contraction in these sectors that are most affected by lockdown and are less prone to telework. The exception is the health/social service sector which had experienced a decline in employment but an increase in wages (perhaps due to the special premium given to medical staff working on COVID), which would be compatible with sustained or even increased demand for medical and social services and at the same time a decline in the supply of workers in this area.

Figure 47: Real wages of employees have continued growing …

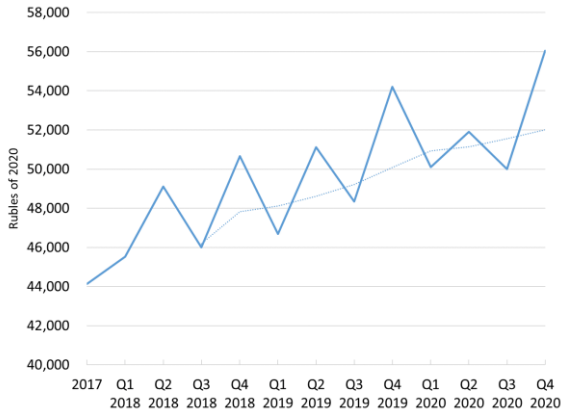
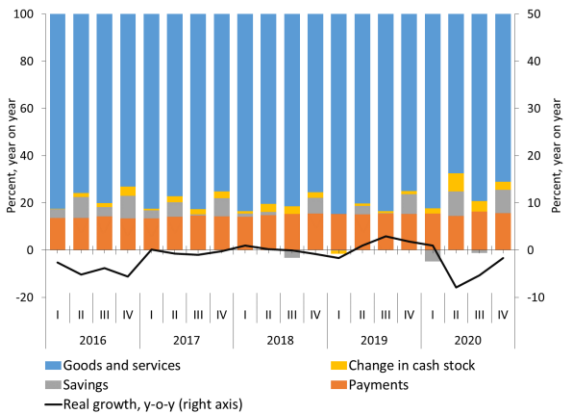


Figure 48: …but per capita disposable income declined during the last three quarters of 2020



[48] Change in real wages is defined as the difference between the change in nominal wages in each economic activity and the change in the national consumer price index.

Figure 49: The share of income for the poorest quintile increased slightly

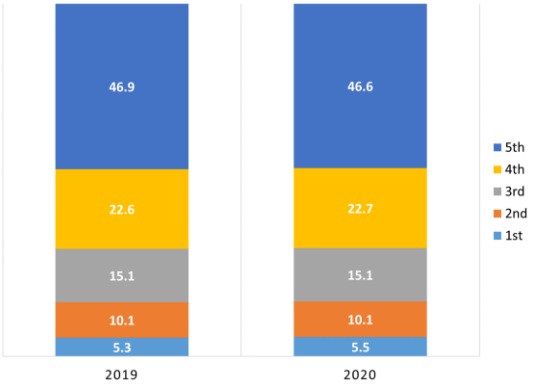
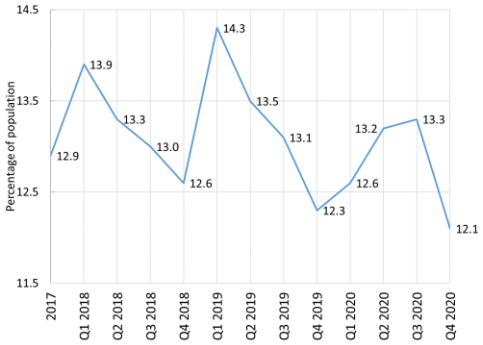


Figure 50: After moderate increases mid-year, the poverty rate ended slightly below the previous year



Source: World Bank staff using data from Rosstat.

This increase in real wages, however, does not compensate the decline in per-capita disposable income observed in year 2020. The three last quarters of 2020 had lower per capita disposable income in 7.9, 5.3 and 1.7 percent, respectively than in the same periods of the previous year (Figure 48 and Box 8). The decline in per capita income, however, seems to not have disproportionately affected the poorest households. The share of cash incomes (the largest component of disposable income) among the poorest 20 percent of the population increased, while it remained the same for the second and third quintiles (see Figure 49). This implies a slight decline in the Gini coefficient of cash incomes (from 41.1 to 40.6), as well as a decline in the 90/10 income share ratio which fell from 15.4 to 14.4.

The increase in real wages, the decline in unemployment, and creation of new jobs – although mostly informal – during Q4 2020, together with the compensatory social policies adopted during the second and third quarter of 2020, have led to a contained increase in poverty rates during the second and third quarter of the year and an important decline by the fourth quarter (Figure 50).

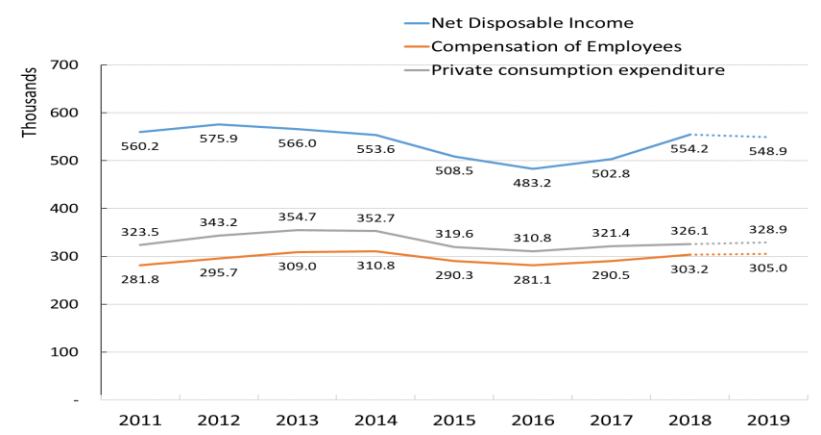
Box 8: The evolution of disposable income in Russia suggests: a decline in households' standard of living; income losses among informal workers and small business owners and an increase in precautionary savings, leading to higher poverty levels than in 2013.

ROSSTAT produces monthly regular estimates of changes in real disposable money income per capita at the national level. According to these estimates, the average real disposable income per capita has declined most years since 2013, being 10.5 percent lower in 2020 than in 2013.[49] The level, deflators, components and full methodology of these estimates are not publicly available, and the reasons behind this decline are open to debate.

[49] Data from Federal State Statistics Service Socio-economic situation in Russia – 2021), https://gks.ru/bgd/regl/b21_01/Main.htm visited on May 3, 2021.

Other sources of data show a similar pattern. Data from the System of National Accounts included in the United Nations Statistics Division – as collected by the OECD – shows a similar, albeit less pronounced, decline. Figure B8-11 shows that real disposable income per capita in 2019 is 3.0 percent lower than in 2013.[50] The main reason for this is the double impact of the sanctions and oil price decline in 2015, which caused disposable income to fall severely in 2015 and 2016 and has not fully recuperated since. Average private consumption per capita and average compensation to employees show a similar pattern of decline in years 2015 and 2016, followed by yearly increases since. Private consumption declined 7.3 percent for the 2013-2019 period; a figure closer to ROSSTAT estimates which indicates that the agency's numbers refer more closely to households' standard of living, rather than whole nation's disposable income. In contrast, employee's compensation per capita declined only 1.3 percent, for the period 2013-2019.

Figure B8-1: Real disposable income per capita in 2019 was 3.0 percent lower than in 2013



Source: World Bank Staff using data from UNSTATS.
Note: vertical axis in Annual Rubles of 2016, data for 2019 is preliminary.

The difference between the decline in disposable incomes and the fall in employees' compensation is the change in the ratio of these two components.[51] This ratio represents the share of non-wage incomes within disposable income, such as income from one's own business, self-employment, rents and dividends. The decline of this ratio (1.7 percent for the period of analysis) indicates that these sources of income have also declined, even faster than wages, hinting at income losses among informal workers and small business owners.

A different decomposition of disposable income provides additional insight. The difference between changes in disposable income and private consumption is the change in their ratio.[52] This ratio has increased approximately

[50] Data from UNSTATS, International Data exchange database on National Account Statistics, https://unstats.un.org/unsd/nationalaccount/sdmxdata/ visited on May 3,2021

[51] Formally, given the identity, $\frac{Y_d}{P} = \frac{Y_d}{L}\frac{L}{P}$, where Yd stands for disposable income, L for employees' compensation and P for population, it can be shown that percentage change in the term to the left of the equal sign approximates the sum of the percentage changes of the terms to the right of the equal sign.

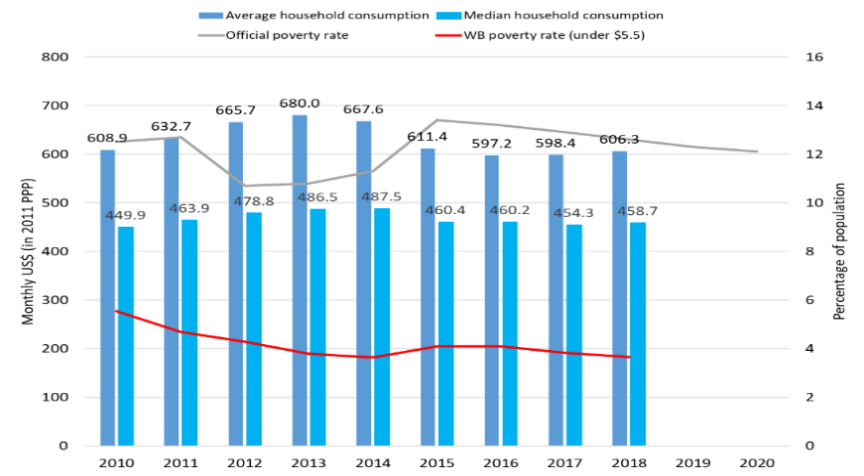
[52] Similarly, given the identity, $\frac{Y_d}{P} = \frac{Y_d}{C}\frac{C}{P}$, where Yd stands for disposable income, C for private consumption and P for population, it can be shown that percentage change in the term to the left of the equal sign approximates the sum of the percentage changes of the terms to the right of the equal sign.

4.3 percent for the period, which indicates that consumption represents a smaller share of disposable income, hence household savings have grown as a share of disposable income. This may hint to a sense of economic insecurity on the part of the population and a need for precautionary savings. This larger share of savings within disposable money income is also documented in ROSSTAT data.

The data used in previous paragraphs come from aggregates of the system of national accounts, and only population averages can be derived from it. Additional insights about the distribution of household standards of living can be derived from survey data. Using the Russian Household Budget Surveys archived in PovcalNet,[53] the evolution of the average household consumption shows a similar trend to the average household consumption from national accounts (Figure 10). Interestingly, the median household consumption and poverty rates shows a similar evolution over time, with a trough in 2015 and levels in 2018 still below the 2013 peak. The decline of the median, however, is smaller than in the average for the period 2013-2018 (5.7 and 10.8 percent respectively), indicating a less pronounced decline of standards of living in the bottom of the distribution, which coincides with the stability or slight decline of poverty rates since 2015 (both under official and World Bank estimates) but still higher than in 2013. Estimates of the Gini and Palma indexes from PovcalNet (not shown in the figure) also render a time trend with an increase in household consumption inequality between 2010 and 2015, followed by a decline in following years.

Estimates based on macro aggregates or household surveys like the ones discussed above may be different from sources and methodology adopted by ROSSTAT. Only after further disclosure of components and methods used for computing disposable income by ROSSTAT will a more complete understanding of its evolution be possible.

Figure B8-2: Median household consumption declined less than the average



Source: World Bank staff estimates using PovcalNet.

[53] PovcalNet is an interactive computational tool developed by staff of the World Bank's Development Research Group to allow users to estimate poverty and other welfare indexes from the World Bank household surveys archive. Estimates included here come from http://iresearch.worldbank.org/PovcalNet/povOnDemand.aspx, visited on May 6, 2021.

PART 2. Russia's economic recovery gathers pace

Crude oil prices are forecast to average US$56/bbl in 2021 and US$60/bbl in 2022, close to their average level over 2016-19. Oil demand is expected to continue to gradually rise, aided by increasing rates of vaccination. In the baseline scenario, an economic recovery is expected to bring Russia's GDP back to pre-pandemic levels in 2021. In 2023, with the output gap closing, the economy would return to trend growth, albeit from a lower base (about 1.6 percent lower). Baseline GDP growth is projected to be 3.2, 3.2 and 2.3 percent in 2021, 2022 and 2023 respectively. The growth projection was revised upwards for 2021, given slightly better-than-expected dynamics in the first quarter of 2021. Poverty is projected to decline from 12.1 percent in 2020 to 11.4 percent in 2021. The main risk to the forecast is the evolution of the pandemic. In the downside scenario, global renewed outbreaks of the pandemic and spread of variants could result in lockdowns being needed for longer, and in more countries. In that case, Russia could slide back to recession in 2022.

Global

Crude oil prices are forecast to average US$56/bbl in 2021 and US$60/bbl in 2022, close to their average level over 2016-19. Oil demand is expected to continue to gradually rise, aided by increasing rates of vaccination (Figure 51). However, it will be broadly met by increased production by OPEC+. The group currently intends to increase production by 0.35mb/d in May and June, and by a further 0.45mb/d in July, with Saudi Arabia also gradually reducing its additional voluntary cut of 1mb/d over that period. Even with those increases, however, the group will still have a large amount of spare production capacity, which is expected to limit any further increase in prices. In addition, an unexpectedly high price rise would likely trigger an increase in U.S. shale production. Indeed, the rig count has already doubled from its August 2020 lows, following the recovery in oil prices so far (Figure 52).

Figure 51: Change in oil demand since Q4 2019

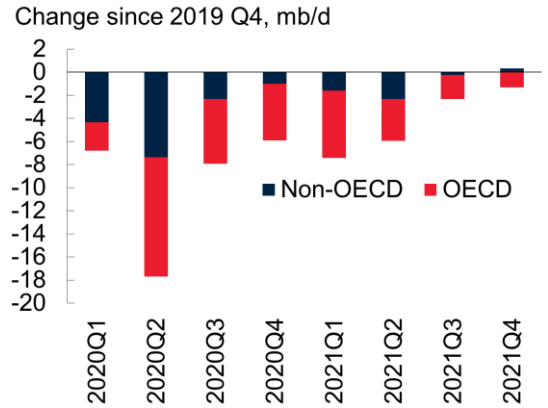
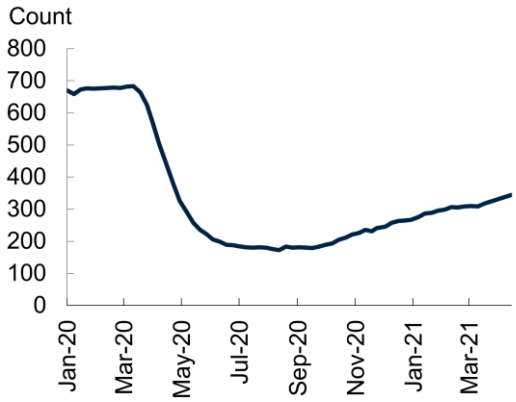


Figure 52: U.S. oil rig count



Source: Baker Hughes; International Energy Agency; World Bank.
Note: 2021Q2-Q4 show the International Energy Agency's forecast.

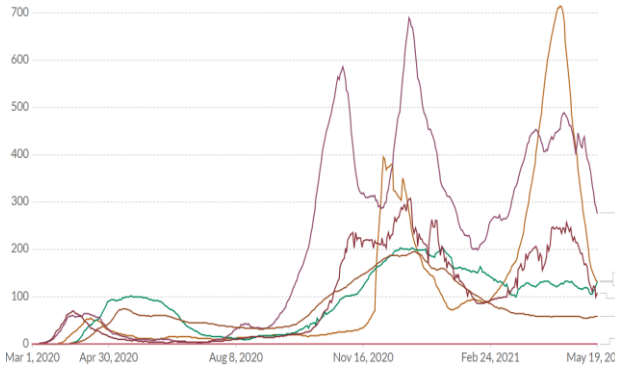
Following their sharp recovery, **non-energy prices** are expected to remain close to their current high levels in 2021, supported by the global economic recovery, which would represent a sharp increase in prices relative to their 2020 average. *Base metal prices* are projected to increase nearly 27 percent in 2021 before dropping back in 2022 as supply constraints ease, while support from policy stimulus may soften. *Agricultural prices* are projected to rise nearly 14 percent in 2021 before stabilizing in 2022. Production shortfalls in some food commodities, such as maize, palm oil, and soybeans have resulted in steep price increases; however, most global food commodity markets remain adequately supplied by historical measures.

The number of new confirmed cases in Russia decreased compared to its peak in end-December but remains higher than in July-September 2020 (Figure 53). The mass vaccination campaign that began in January continues.

As of May 18, more than 14.6 million Russian citizens have been vaccinated with the first dose of the Sputnik V vaccine (about 21.3 percent of total number of people planned by the Ministry of Health to be vaccinated, or 60 percent of population), and more than 10 million Russian citizens to date have been vaccinated with the two doses of the vaccine (about 14.6 percent of total number of people planned).

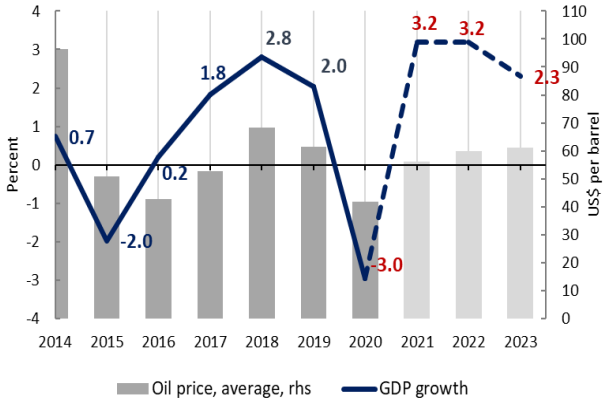
The uptake of the vaccine in Russia is slow compared to other countries based on the share of the total population that received at least one COVID-19 vaccine dose: Russia (9.84%), Israel (62.77%), USA (47.19%), EU (31.98%), Turkey (17.77%), Brazil (17.1%) [54].

Figure 53: New confirmed cases in Russia are lower than in December 2020 (number of confirmed new cases per million people)



Source: Our World in Data.

Figure 54: The baseline growth forecast for Russia suggests full recovery to pre-pandemic output level in 2021 (real GDP growth, percent)



Source: Rosstat, World Bank.

54 [1] https://ourworldindata.org/covid-vaccinations (as of May 17).

In the baseline scenario, if no substantial increase of corona-virus infections occurs in Russia, an economic recovery is expected to bring its GDP back to pre-pandemic levels by 2021. With the output gap closing in 2023, the economy would return to trend growth, albeit from a lower base (about 1.6 percent lower).[55] Growth momentum is expected to accelerate in the second half of 2021, as consumer and business confidence are expected to improve further. Global economic recovery and higher oil prices are expected to support growth in Russia in the medium term. GDP growth is forecast at 3.2 percent in 2021, 3.2 percent in 2022 and 2.3 percent in 2023 (Figure 54 and table 4). The recovery is expected to be led by household consumption, which plummeted by 8.6 percent in 2020, and which will be supported by soft monetary conditions in 2021. Subdued international tourism would support consumption as well. Growth momentum in gross fixed capital investment is expected to be supported by improved business confidence and by public investment projects. Migration flows are expected to be restored by end 2021-beginning of 2022, which would also support investment projects currently lacking a sufficient labor force in some locations. The fiscal stance in Russia is expected to be procyclical over the near term as planned fiscal adjustment progresses alongside negative output gaps. The general government deficit is expected to improve, narrowing to 2.1 percent of GDP in 2021 and turning into 0.4 percent of GDP surplus in 2023. Deficit financing, mainly through domestic debt issuance, is expected to increase general government debt to a still-manageable 20.5 percent of GDP in 2023 (from 14.4 percent in 2019). Given its relatively low public debt, sizeable macro-fiscal buffers, and expected persisting negative output gap, Russia has the fiscal space for a more gradual consolidation, allowing further increases in social spending and support to regions. Recent social support measures introduced for families with children prove that the government stands ready to provide assistance for vulnerable population groups if the pandemic situation worsens. Output losses from fiscal consolidation are estimated to be pronounced in Russia: a 1 percent of GDP decrease (increase) in government spending could lead to a decrease (increase) in output of 0.4 to 2 percent. In line with the OPEC+ agreement, oil production restrictions will fall away in 2021-22, supporting the growth of oil output and of export volumes. Twelve-month consumer price inflation is projected to average 5.5 percent in 2021 before stabilizing around the central bank's target of 4 percent in 2022-23.

Gradually increasing oil prices are expected to push up the current account balance in 2021-2022. Yet rebounding imports of goods and outbound tourism will weigh on the current account in 2022-2023. Net capital outflow is expected to stay moderate, helped by relatively strong macro-fundamentals and accumulated macro-fiscal buffers.

Table 4: The baseline growth forecast for Russia suggests full recovery to pre-pandemic output level in 2021 (Major macroeconomic Indicators)

	2018	2019	2020	2021f	2022f	2023f
GDP growth, percent	2.8	2.0	-3.0	3.2	3.2	2.3
HH consumption growth, percent	4.3	3.2	-8.6	6.7	5.3	2.5

[55] This is one of the longer-term effects on the Russian economy. Other potential effects include influence on labor force through learning loss: he pandemic is estimated to result in school learning losses of more than one-third of a Russian school year, reducing marginal future earnings by about 2.5 percent per year over a student's working life. Please see Russian Economic Report #43 for details.

Gross fixed capital formation growth, percent	0.6	1.5	-4.3	2.9	3.4	3.2
Export growth, percent	5.6	0.7	-4.3	1.5	5.3	3.5
Import growth, percent	2.7	3.4	-12.0	5.3	6.7	4.1
General government balance, percent of GDP	2.9	1.9	-4.0	-2.1	0.1	0.4
General government debt, percent of GDP	13.9	14.4	19.7	20.0	20.3	20.5
Current account (US$ billions)	115.7	64.8	33.9	69.3	73.0	67.0
Current account, percent of GDP	7.0	3.8	2.3	4.3	4.3	3.7
Exports (GNFS), bln US$	508.6	481.8	379.1	440.2	473.0	489.3
Imports (GNFS), bln US$	343.6	353.3	304.7	314.6	338.0	352.6
Capital and financial account (US$ billions)	-78.5	3.9	-49.9	-44.3	-46.0	-39.0
Capital and financial account, percent of GDP	-4.7	0.2	-3.4	-2.8	-2.7	-2.2
CPI inflation (average)	2.9	4.5	3.4	5.5	4.0	4.0
Unemployment rate, percent	4.8	4.6	5.8	-	-	-

Source: Rosstat, CBR, WB staff calculations.

In an upside scenario, faster-than-expected vaccination rates could result in lockdowns being lifted sooner than planned. Global growth could recover more rapidly and prove more longer-lasting than expected as a result of widespread vaccinations and reopening of economies, and large stimulus packages. Oil demand growth could be significantly stronger than expected. In the short-term, supply may be slow to respond to the increase in demand despite the significant amount of spare capacity held by OPEC+, causing a surge in prices. Over time, however, higher prices would likely lead to rising U.S. shale oil production (and increases elsewhere) and could dampen oil demand growth, causing the surge in prices to unwind over a couple of years. In the upside scenario, GDP growth is expected to accelerate to 3.8, 4.8, and 3.3 percent in 2021, 2022 and 2023 respectively, with domestic demand expanding faster.

In a downside scenario, renewed outbreaks of the pandemic and the spread of variants could result in lockdowns being needed for longer, and in more countries. This would result in substantially weaker oil demand. Weaker demand and lower prices could put increasing pressure on the OPEC+ agreement. A possible collapse of the agreement and a subsequent rise in production could result in oil prices being materially lower for longer. In the downside scenario GDP growth is expected to stand at 2.6, -0.7, and 0.6 percent in 2021, 2022 and 2023 respectively with substantially lower consumer demand and investment contracting in 2022 - 2023.

Poverty projections for year 2021

The trend of the poverty rate in 2021 will depend, as in previous years, on the evolution of economic growth and the efficacy of social protection policies, both in terms of coverage (percentage of intended beneficiaries that actually get benefits) and of sufficiency (size of the transfer with respect to poverty line). In 2020, the impact of a severe economic growth decline due to the COVID-19 pandemic on poverty was cushioned by compensatory social policies, leading to an almost stagnant poverty rate: it moved from 12.3 to 12.1 percent between the fourth quarters of 2019 and 2020.

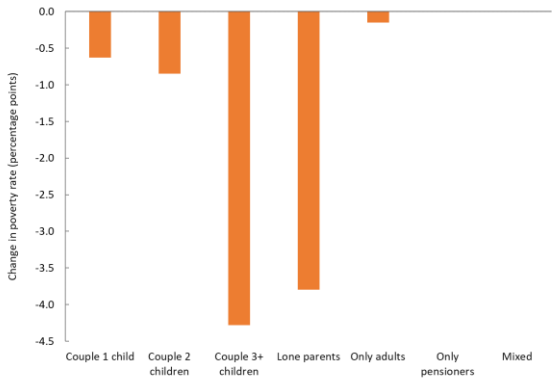
For 2021, the baseline GDP growth projection of 3.2 should bring some employment and wage gains.

However, some one-off compensatory policies introduced in 2020 (including the most effective child benefits for Rub 25,000) were cancelled in 2021. On the other hand, new policies have been recently announced:

a) Monthly payments to pregnant women registered in healthcare institutions in the early stages of pregnancy and in difficult financial situation. Average amount is estimated at Rub 6,350 per month. However, it is not clear what is meant by "difficult financial situation." It is assumed that the payment is means-tested at the household level (i.e., a household is below the subsistence minimum level), and that it starts in July.
b) Lump-sum payments of Rub 10,000 to each child of school age (to help prepare for the new school year), to be paid in August.
c) Monthly payment to children aged 8-16 years inclusive, from single-parent families. Average amount is estimated at Rubles 5,650 per month and is to start in July.

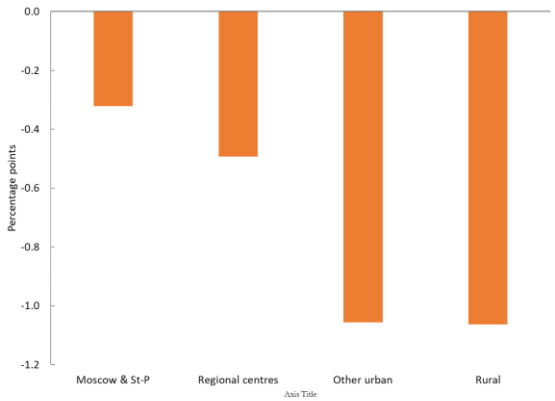
The combined effect of economic growth and changes in compensation policies (and assuming the new ones are fully implemented and targeted) may lead to an end-year poverty rate of 11.4 (compared to 12.1 percent in 2020). These policies will have a particularly strong impact on poverty rates among families with three or more children and with single parents (Figure 55), and on households in rural and small urban areas (Figure 56). Although well-targeted to the poorest members of society, these policies have a small impact upon national poverty reduction because they leave many other families with little protection.

Figure 55: New social protection measures may specially benefit families with children…



Source: World Bank staff calculations.

Figure 56: …and families in rural and small urban areas



Source: World Bank staff calculations.

Downside risks outweigh upside risks.

The main risk to the forecast is the evolution of the pandemic. The continued spread of COVID-19 in parts of the world, particularly the spread of different variants, suggests that renewed outbreaks at a global

level are still possible. New infections leading to renewed lockdowns could result in a further deterioration in oil demand and in oil prices being materially lower than currently expected. A sharp increase in new infections in Russia could lead to a reintroduction of strict lockdowns, negatively affecting domestic demand. Slow vaccination or lower-than-expected effectiveness of the vaccine (against new strains, for instance) could also delay the economic recovery. New sanctions could worsen Russia's outlook. Banks could face deteriorating asset quality, profitability, and capitalization following the full exit from the regulatory forbearance measures (expected by mid-2021). However, this is expected to be moderate, given the CBR's moderate credit loss projections and strong credit growth. The pandemic has also amplified contingent liabilities risk. An abrupt tightening of global financing conditions, perhaps triggered by a sudden removal of accommodative monetary policy in large, advanced economies, could represent a medium-term risk for Russia. Upside risks emerge from global growth recovering more rapidly amidst faster-than-expected vaccination rates, which could result in oil demand significantly stronger than expected.

Russia's longer-term economic prospects will depend on boosting potential growth.

Russia's potential growth has been trending downward since the global financial crisis. While near-term recovery will be contingent on the stemming of the pandemic, longer-term economic prospects will depend on boosting potential growth. National projects remain the main tool for accelerating long-term potential growth through infrastructure development, promoting economic diversification, raising total factor productivity through digitalization, and enhancing human capital. Yet more efforts should be devoted to reducing the state's economic footprint, leveling the playing field for the private sector, improving governance – particularly of state-owned enterprises – and taking advantage of shifting global value chains. A green transition could pose significant challenges for the Russian economy unless the government undertakes preemptive steps toward decarbonization.

Part 3. Halving poverty through cost-effective social safety nets

Recognizing the need of sharing prosperity, Russia declared a national goal to halve poverty to 6.6 percent by 2030. Growth will play an important role in achieving it; however, even under the most generous growth scenarios, it will be difficult to achieve this goal in the absence of a well-targeted national program lifting those in poverty. While Russia's social safety-nets system plays an important role in reducing poverty, it does so at a high cost. Introducing a national, targeted program providing financial assistance to people falling below a poverty threshold could be key to cost-effective poverty reduction. Implementing such a program could reduce poverty faster and at a lower fiscal cost. To develop such a program, Russia could build up from its existing Social Contract Program, which is designed to graduate beneficiaries out of poverty. For this to happen, there are different steps that are required, such as a need to unify standards and develop key systems at the national level, as well as to strengthen various program features.

1. Russia's social safety nets reduce poverty, but at a high cost

Russia has a goal to halve poverty by 2030, but even under the most optimistic growth projections, this goal would be difficult to achieve in the absence of policy changes. In 2018, Russia declared the goal of reducing poverty by half, from 13.2, to 6.6 percent by 2024. This means that 4 million people would need to be lifted out of poverty. However, estimates suggest that an average annual growth of 1.5 percent would bring down the poverty rate to only 10.7 percent by the target date (World Bank 2018a). And even under the best growth scenario of 3.2 percent annually, the poverty rate would only fall to 8.1 percent – still short of the stated goal. Even when the aspiration later was postponed to 2030, it remains outside reach under current conditions. The COVID-19 pandemic has only deepened the challenges to halve poverty.

Russia's Social Safety Nets play an important role in reducing poverty, though at a high cost. Social Safety Nets (SSN) are non-contributory programs providing income support and social care services.[56] In addition to essential anti-poverty drivers such as income growth and improvements in human capital, targeted social assistance is the policy instrument most central to pulling people out of poverty. Around the world, strong safety nets help prevent poverty, support households in managing difficult life circumstances, and ultimately provide a foundation for more efficient and equitable economic outcomes. In Russia, the poverty headcount would be 20 percent higher than the current poverty rate without social assistance. Nonetheless, this is achieved with very high spending – over 3 percent of GDP or US$30 billion on social assistance programs.[57] This level of spending is more than 3 times greater than the combined gap between the national poverty line and the average income of poor families in the country before transfers. It is also higher than the spending in

[56] SSN are usually deployed through cash transfers (conditional and unconditional), in-kind transfers, public works (of low job qualification) and non-contributory social pensions.

[57] This figure includes non-contributory programs providing income support and social care services. This figure is not easy to recover from official publications which use a broad definition of social protection and blur contributory and non-contributory spending. It was estimated by NIFI with the technical assistance from the World Bank using a variety of sources, Rosstat, Treasure data and MoF data. Details are provided in Nazarov V. Posarac A. (eds), 2017.

Europe and Central Asia of 2.2 percent of GDP (World Bank 2018b). Many countries achieve the same result in poverty reduction by spending half or a third less (World Bank 2019).

The COVID-19 pandemic underscored the importance of Social Safety Nets in mitigating the impacts of shocks. To overcome the adverse impact of the crisis, globally there was an unprecedented expansion of SSN: over 1.28 billion people, or 16 percent of the world's population, is benefiting from additional support (Gentilini et al. 2020). Cash transfer programs are the most effective form of support for people's incomes and, as the world experience shows, it has been the most common form of support to the crisis, with about 1.1 billion people benefiting from additional support globally. For many countries, the crisis triggered permanent expansions of SSN. Spain, for example, expedited the introduction of its first nationwide guaranteed minimum income (GMI) program, after the pandemic exacerbated the poverty situation. The new program, which combines cash benefits with measures promoting employment and inclusion, is there to stay beyond COVID-19. The push by the Spanish Government echoes an open letter, signed by 25 members of the European Parliament in April 2020, calling on the EU to respond to the "catastrophic" impact of the virus by proposing a minimum income. Like most other countries, Russia introduced additional social assistance measures in response to the COVID-19 crisis. While these measures have played an important role in mitigating the impacts of the pandemic, they have also put in evidence that Russia does not have a system ready to be scaled up in case of need to quickly provide benefits to households affected by economic shocks.

Social Safety Nets Concepts

Guaranteed Minimum Income provides financial assistance to people falling below a poverty threshold. Benefits are often determined by the difference between family income and threshold. Beneficiaries usually carry responsibilities such as being available to work, participate in training, or bring their children to regular health check-ups.

Universal Basic Income provides a flat support to everyone regardless of income and wealth, and it is not subject to any conditions.

Negative income tax provides financial assistance to low wage earners via the tax system and is usually provided as a lump sum every year. This is a benefit that is only available for those formally employed and therefore would exclude the poor who are not employed in the formal sector.

A national Guaranteed Minimum Income program is a cost-effective tool to address the poverty reduction challenge in Russia. A national GMI program would provide regular cash transfers to poor families, focusing resources on those who need it. The benefit amount is usually determined by the difference between the family income and an income threshold such as the poverty line. As in many countries around the world, a national GMI in Russia could combine cash assistance with measures to graduate a family out of poverty. As part of these measures, employment and social services can be provided to ensure that the family has the essential means to graduate out of poverty. "Co-responsibilities" to receive the benefits should also be considered. For example, those who can work must be available to work and agree to take a job when offered. Graduation measures can be selected for each family after considering its needs. This process would be supported by electronic case management and profiling systems.

A GMI program can *adapt* to the changing economic environment. At times of economic growth and social prosperity, program spending goes down. And during crises, it helps the economy recover faster. By giving cash to low-income families with a high propensity to consume, domestic consumption grows, generating large *multiplier effects* (Blinder & Zandi 2015). Cash assistance during crises can also prevent households engaging in negative coping strategies, which can have long-lasting negative effects (for example selling productive assets, or having children stay at home instead of going to school). Cash assistance, especially when combined with other measures, can also contribute to human capital accumulation, thereby reducing the intergenerational transmission of poverty (Fiszbein & Schady, 2009, Millan et al. 2020).

Countries around the world, including most of OECD countries, are relying on programs combining cash with active measures designed to achieve self-sufficiency. For example, Italy's GMI program focuses on economic support to alleviate short-term poverty, and graduation measures to tackle long-term causes of poverty. In Portugal, GMI beneficiaries must comply with an "integration contract" tailored to individuals' circumstances. In Germany, unemployment and social assistance were combined into one benefit, and individuals who are capable of working have to take part in work-oriented inclusion measures. Russia can draw from their experience to develop its own model reflecting its cultural and economic context.

Most studies do not support concerns that cash transfers reduce motivation to work or create dependency. While the basic economic model of labor supply predicts that cash benefits would lead to people working less, practice has proven otherwise (Baird et al. 2018). In fact, the expansion of targeted cash transfers over the last two decades in countries worldwide was accompanied by many impact evaluations examining work and labor supply effects. On the whole, most of these studies – covering widely varying contexts – do not support significant concerns that safety nets may reduce the motivation to work or create dependency (Gentilini et al., 2019, Banerjee et al. 2017, Jones & Marinescu, 2018, Salehi & Mostafavi, 2018, Murphy et al. 2018). In fact, by alleviating liquidity and risk constraints, some cash transfers programs can even have a positive impact on labor supply (Baird et al. 2018 and Bastagli et al. 2018). In general, the benefits provided by GMI programs are low enough not to push people to refuse work, but high enough to make a difference in the lives of the poorest.

2. The absence of a national anti-poverty program reduces the effectiveness of Russia's social safety nets to reduce poverty

There are various reasons why Russia's social safety nets system has a high cost, relative to the poverty-reduction outcomes. Most important is the absence of a national anti-poverty program. It shows the system does not generally prioritize the poor. When it does, below-par means-testing methodologies, the low adequacy of benefits, and large regional variations in performance hinder the ability of the system to make a greater poverty reduction impact. Also, Russia's system does not easily adapt to shocks to support households in need.

In contrast with many other countries, the Safety Net system does not prioritize the poor. The poor – representing 13 percent of the population in 2018 – received only 10 percent of social assistance transfers. This is a result of the primary objectives of each program and related approaches used to allocate benefits. Not all SSN programs have the primary objective of poverty reduction. In Russia, most programs rely on categorical methods: beneficiaries are selected if they belong to specific socio-demographic categories, and

everyone within a category is entitled to the same benefit regardless of actual need. Among thousands of programs, only a fraction of the social assistance budget (0.4 percent of GDP) is spent on programs that specifically target the poor through means-testing methods (World Bank 2019). Not surprising, when programs specifically target the poor, poverty reduction in Russia is achieved at a much lower cost: the benefit-cost ratio for the overall social assistance system is only 17 percent while for means-tested programs it is 51 percent.[58]

Benefit levels are not sufficient to help the poor move out of poverty. The level of benefits received by the poor are small. Means-tested benefits do not exceed 15 percent of the poverty line. After social assistance transfers, the average income deficit of the poor is still almost 20 percent of the poverty threshold. In general, there is a lack of connection between needs and the level of assistance provided to different households.

In many cases, the means-testing methodologies are not effective at identifying the poor. The means-tested programs supposed to reach the poor cover 13 percent of the population, almost exactly as many as there are poor in Russia; however only 44 percent of all poor are included in these programs. Despite significant improvements over time, means-testing methodologies remain fragmented with large variations in performance. The information needed to determine eligibility to the program largely relies on the submission of paper documents that are rarely verified or compared to other sources of information, such as administrative databases. Furthermore, the benefits are often awarded for long periods, without requirements to verify income periodically.

The large number of programs with different rules makes it difficult for the poor to understand what support is available to them. Russia runs over 800 social assistance interventions[59] at the national level, and almost 13,000 at the subnational level. The system is regulated by hundreds of laws and thousands of by-laws, decrees, ministerial orders and other official acts. The social assistance system in Russia has evolved for almost a century, reflecting changing needs over time and different approaches to the social assistance system. Over time, new programs have been introduced, without a single program being discontinued, creating a maze of mostly small interventions. Given the system's complexity, vulnerable and socially excluded people often do not know what types of programs they are entitled to.

Russia's social safety nets system is not very adaptive to shocks. In an efficient SSN system, funds flow quickly and automatically to those who need it, avoiding rushed and costly emergency responses. Like other countries around the globe, Russia harnessed its social assistance programs to protect people from the COVID-19 pandemic. However, while social assistance emergency measures[60] have helped prevent poverty from increasing, the crisis has highlighted the need to have a system ready in place to quickly provide benefits to those affected by economic shocks. A fifth of those living below the poverty line did not benefit from any

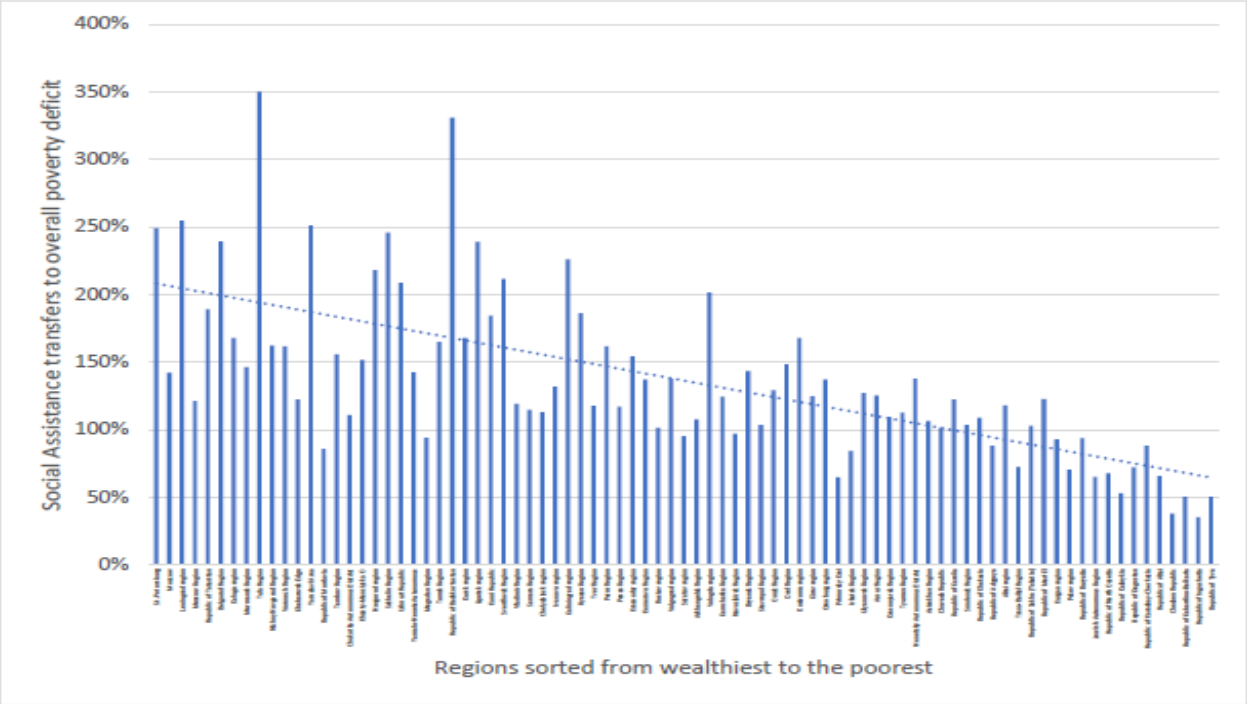
[58] The benefit-cost ratio of a program is measured as the reduction in the income deficit of the poor for each 1 unit spent on the program. For example, for 1 RUB spent by the overall social assistance system in Russia, the income deficit of the poor is reduced by only 0.17 RUB.

[59] Social assistance interventions in Russia are called "measures of social support" and each is regarded as a separate unit, governed by a separate law, even though most entail meager cash payments with only minimum variation in rules.

[60] Social assistance emergency measures included: Automatic extension of social benefits without submitting any additional information and going to the authorities; Additional cash transfers for families with children; Suspension on penalties for utility services related debts and late payments; Increase in generosity of the child allowances/benefits.

of the support measures (Accounts Chamber of the Russian Federation, 2020). Moreover, as surveys show, many measures to alleviate the effect of the crisis were criticized for unclear procedures, inconsistency in determining eligible family members, and insufficient support.[61]

Figure 57: Despite a large national budget, many of the poorest regions do not have enough resources



Note: Figure from World Bank, 2019. Estimates based on the Rosstat Survey of Incomes and Social Programs Participation. 2017.

In the absence of a national anti-poverty program, large regional variations reduce the effectiveness of SSN in reducing poverty. Regional variations in budgets and the uneven capacity of delivery systems creates inequitable implementation and reduces the effectiveness of the national social assistance policy. Despite high spending on SSN at the national level, many of the poorest regions do not have enough resources to support the poor. Some regions have as much as 3.5 times the resources needed to cover their poverty deficits, while others barely have 0.4 times the resources needed to cover their poverty deficits (Figure 57).[62] Substantial variation across regions also exist in the benefit-cost ratio to reduce poverty, ranging from 8 percent, all the way to 93 percent (Figure 58).

[61] Surveys were conducted in 2020 by the Institute of Social Policy and were presented at the seminar "Social protection as a part of anti-crisis packages in the world and in Russia on the backdrop of COVID pandemic" in Moscow on December 17, 2020.

[62] It is important to note that since most programs are not means tested, spending would need to be greater than the resources needed to cover poverty deficits to fully eliminate the poverty gap.

Figure 58: There is large regional variation in the performance of means-tested programs

Note: Estimates based on micro data from ROSTAT: Survey of population incomes and social programs participation, 2017. Benefit-cost ratio is harmonized with the global ASPIRE indicator. It represents the share of benefits going to close the income deficit of beneficiaries to the poverty line, where the poverty line is uniformly set across countries at 40 percent of the population.

3. A national guaranteed minimum-income program could effectively halve poverty by 2030

A national guaranteed minimum income program could help achieve poverty reduction goals in a cost-effective way. Such a program would cost around 0.33 percent of the GDP, or four times less than if Russia's existing social safety nets system were expanded. Russia's existing Social Contract program provides a good foundation to build such program. Doing so would require unifying standards and developing key program delivery systems at the national level to reap the benefits of economies of scale and promote quality. It would also require improving the adequacy of benefits and reducing exclusion errors while maintaining low inclusion errors.

A guaranteed minimum-income program could help achieve poverty reduction goals in a cost-effective way. Because of the different features of Russia's SSN system mentioned in the previous section, achieving the goal of reducing poverty to 6.6 percent by expanding existing SSN programs would not be cost-effective, and would imply spending an additional 1.35 percent of GDP (World Bank, 2018a). Instead, introducing a national GMI program would allow to achieve poverty reduction objectives at a much lower cost. Such a program would focus resources on those in need, guaranteeing their minimum living standards, while promoting sustainable income paths through graduation measures.

Estimates show that by topping-up the incomes of the poor so that they can satisfy their basic needs and thus eliminate poverty, such program would cost 0.33 percent of GDP under the assumption of no leakage, no behavioral responses, and administrative costs of 10 percent (as a share of total transfer amounts).[63] Although

[63] Bank's estimates based on simulations relying RUSMOD, a microsimulation tool, using the 2019 Russia Longitudinal Monitoring Survey (RLMS), a nationally representative survey run jointly by the National Research University Higher School of Economics and ZAO Demoscope, together with the Carolina Population Center at the University of North

administrative costs depend on a range of factors, including the type and scale of a program, internationally cash transfer programs often range from 7 to 10 percent of program's budgets (Grosh et al. 2008 and Tesliuc et al.2014). It is important to note that estimates provided crucially depend on assumptions made, and as such results should be taken with caution.[64] Nonetheless, they provide an idea on what could be expected from a GMI program.

An important advantage of GMI programs is that they are dynamic: when some regions would grow fast while others would stagnate or even decline, the number of beneficiaries in each region will increase or decrease following changes in incomes. GMI's uniform eligibility rules and frequent and systematic recertification of beneficiaries distinguishes it from categorical programs which are not triggered to expand when the economic situation deteriorates. However, compared to categorical programs, the administrative costs of GMIs are higher due to cost of income and wealth verification and frequent (often yearly) recertification. Higher administrative costs, however, are expected to be largely offset by gains emerging from better targeting and lower exclusion error. Evidence from Europe and Central Asia shows that the benefit-cost ratio of GMIs is high (Tesliuc et al. 2014).

A Guaranteed Minimum Income program would be in line with the hopes of many Russians. Opinion surveys[65] show that in 2020, most Russians (89 percent) thought that the state should provide some type of SSN benefits. Among those supporting SSN benefits, the most popular type of SSN benefit is a program founded on the same principles as a GMI, providing decent living standards for families in a difficult life situation: 40 percent of Russians supported such program.[66] Popularity for such program follows an increasing trend, from 27 percent in 2018.

Russia could build on the strengths of its existing *Social Contract Program*. To move towards a GMI program, Russia does not have to start from scratch. It could build on the strengths of its existing Social Contract Program (SCP), which aims to graduate families from poverty through a combination of cash, conditions, and services. The SCP is targeted to the poor and involve a "contract" between beneficiaries and government: in exchange for benefits, beneficiaries must follow pre-determined actions, such as looking for a job and accepting it if offered. Employment and social services are also provided depending on individual needs. Given the program's transformative potential, in 2019, the President of Russia called for a substantial increase in its scale of the program from about 65,000 to 9 million participants. To become a cost-effective national GMI program, however, a number of elements need to be introduced or strengthened.

Carolina, Chapel Hill. The provision of transfers to poor households is simulated for an amount equal to the income deficit of each beneficiary family (i.e., the difference between their household income and the poverty line). The average income deficit of the poor in Russia is estimated in this database as 2,795 rubles per month. Since every poor family is given a transfer that equals its income deficit, the average benefit per household equals the average income deficit. Benefits were assumed to be provided to all poor Russians (which in the micro-simulation database represent 10.9 percent of the population or approximately 16 million people). The official poverty line of 11,329 rubles per month per person, as of IVQ'2020, was used. The simulation renders an approximate fiscal expenditure of 530 billion rubles a year.

[64] For instance, behavioral responses such as people choosing to work less may occur and could increase the cost of reducing the poverty gap if conditions related to availability to work for able bodied individuals are not in place. However, the behavioral response could be addressed using active labor market conditions and measures.

[65] Survey results presented by the Institute of Social Policy at the seminar "Social protection as a part of anti-crisis packages in the world and in Russia on the backdrop of COVID pandemic" in Moscow on December 17, 2020.

[66] The survey included the other following types of SSN benefits (with corresponding support): universal assistance (18 percent), assistance for non-able-bodied (24 percent), assistance based on merits (7 percent).

There is a need for federal rules to unify the standards of the SCP. Currently, there is weak consistency of rules setting program standards across regions. Putting in place federal rules that unify different standards based on best practices would promote the quality and equity of benefits. It would allow that identical families living in different places would be treated the same. Standards could include a range of aspects, such as methods to define the minimum level of income, determination of eligibility criteria, definition of conditions, and identification of needs for employment and social services.

Similarly, there is a need to ensure a high quality and uniformity of key systems for the delivery of SCP across regions. Any SSN program requires a delivery system that can effectively implement key activities such as registration and enrollment of beneficiaries, verification of incomes, payment, and monitoring of compliance with co-responsibilities. Such systems usually benefit from economies of scale, use of technology, and inter-agency agreements for data exchange protocols. However, in Russia, regions usually rely on their own systems to deliver the program, leading to fragmented implementation. To bear the benefits of economies of scale and to promote better service delivery quality, several key systems of the program should be built at the federal level. Systems for income verification, enrollment, payments, and case-management (which connects beneficiaries to employment and social services), could be based on a common federal-level platform, with options for providing the flexibility to innovate or introduce specific system features according to regional needs.

The Guaranteed Minimum Income program could be a key instrument for a successful implementation of the National Social Initiative. Russia's newly announced National Social Initiative aims to achieve better population wellbeing by centering social services around the household or individual. This people-centered

Leysan, a Social Contract Program beneficiary, hopes that her family won't go hungry again and that her kids will never be poor.

Leysan* is 18 years old and lives with her family in a suburb of Kazan. She is the eldest of five children, two of whom have learning disabilities and are home-schooled. Leysan's mother works part-time on a dairy farm, and her stepdad is a tractor driver.

"I graduated from secondary school last year but did not go to university because my mother needs my help at home," says Leysan. "If I had three wishes, I would ask to have enough food for my family every day; I would register my twin sisters in music classes, which they dream about; and I would try to get admitted to medical school. I dream of becoming a nurse, or perhaps a doctor one day!"

In terms of income, Leysan's family is poor. Indeed, about twelve percent of Russia's population lives in poverty today. Leysan's family applied for the Social Contract Program, went through the income assessment process, and received a social assistance package (addressing the family's financial, educational, and health-related needs), along with access to training and employment benefits.

"Since we signed up for this social support program, several months ago, we now have enough money to buy food for the entire family," says Leysan. "My twin sisters have had an opportunity to attend music classes, and I hope this education will help them develop further. My mother is currently completing a free accounting training course, and the social service department is assisting her with getting a job in accounts. As for me, I received an education grant and have started my studies at a medical school. I hope I'll be able to earn enough money, so my family won't go hungry again, and my kids will never be poor."

* *Leysan is not her real name, which was changed for privacy reasons.*

approach aims to improve client experience, quality, and accessibility of social services. The GMI has a common goal, which focuses on improving the quality of life by addressing in a timely and flexible manner the changing needs and circumstances of the individual. For example, Russia offers many types of assistance, however, many families and individuals may struggle to avail this assistance and services due to barriers such as onerous administrative processes, lack of outreach, or lack of capacity to navigate the rules and conditions. As a safety net of last resort, the national GMI program is an ideal instrument to address difficult social and economic circumstances of potential beneficiaries. The GMI program would assess household and individual needs, develop, and provide an assistance program that may include cash and social services tailored to improve its well-being and earnings potential. As part of the National Social Initiative, and as a "one window" program using a modern case-management-system, the GMI program would enable matching of services to a wide range of households in need of support, easily and in a timely fashion. Its case management system can be nested within the broader information system being developed to support the National Social Initiative.

Importantly, cash benefit levels need to match needs. For poverty to be reduced, cash benefits need to cover the difference between people's income and a threshold. Benefit levels of the social contract are often not enough. More than one half of regions provide rather small grants for only a period of 3-6 months. Assessing applicants' means is mostly used only to establish their *eligibility* for a benefit as opposed to the *benefit level*. As such, most benefits are flat and do not vary according to the individuals' needs. While providing flat benefits can have some advantages, they can also break the connection between the need and the support received, reducing the potential impact on poverty.

The provision of services that support beneficiaries to graduate out of poverty remain a challenge. A potential key strength of the Social Contract Program are the conditionalities and services to promote income self-sufficiency. There is already a range of existing measures designed to achieve this through employment and health services, as well as through support for agricultural self-employment. However, two important challenges remain. The first challenge is to adequately assess the needs of each family and link it to available services. The second challenge is to develop further capacity and a range of potential services needed, especially in more remote regions. Establishing a federal case management system to identify and properly manage the root causes of poverty could promote a human-centric approach that tailors services according to the specific needs of each vulnerable family. This would also reduce the amount of subjectivity from the officer managing the case by establishing more effective processes and accountability. It would help ensure that individuals are treated equitably, regardless of the place of residence.

Targeting approaches should be strengthened to minimize errors of exclusion and continue to keep leakage down. The SCP is often effective at avoiding *leakage* (e.g. including those that do not need assistance), but not effective at avoiding *exclusion errors* (e.g. leaving people in need out of the program). In increasing its scale, the program should strengthen its targeting approaches to minimize errors of exclusion and continue to keep leakage low. To do so, there should be a unified means-test methodology with clear and effective methods for calculating and verifying household welfare. For this to happen, it is essential to have access to relevant, timely, and accurate information on the welfare of households. This would require modernizing the management of information using Russia's EGISSO, a Unified National Registry which brings data together from all SA programs on their beneficiaries. Greater reliance on administrative data already containing information on income, taxes, employment status and property could play an important role in obtaining, cross-checking, and updating information. Simplifying the application process while requesting beneficiaries

to renew their applications and update their information annually or bi-annually could also help. This could be done within the framework of the National Social Initiative. Finally, conditions in place should further contribute to minimizing any leakages.

A viable and sustainable financing mechanism should be found. Currently the program operates at a small scale with funding coming from a combination of regional and federal budgets. To expand the program nation-wide, a viable and sustainable financing mechanism needs to be in place. This would require assessing the scope for financing through different measures, such as energy subsidy reform, tax expenditure savings or expenditures reprioritization. In the medium-term, there is a window of opportunity for strengthening taxes that benefit health (hiking taxes on tobacco, alcohol, and sugary drinks and food).

This is a difficult time for many countries, including Russia. At the same time, the present crisis presents an opportunity to allow Russia to strengthen its ability to protect and improve the standards of living for its citizens in the long term. The Bank is well placed to support the government in pursuing this objective given its broad experience developing social protection systems in many countries. Russia could leapfrog and learn from these experiences. A pilot GMI program could represent a first step in the process. This would allow developing, testing and refining standards and tools to deliver the program at a small scale, before scaling it up at the national level.

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