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IMF Warns of Inflationary Pressures

By The Moscow Times

August 02, 2012

Russia needs to adopt both a tougher budget and tighter monetary policy to guard against the risk of overheating and to bear down on inflation, the International Monetary Fund said in a statement Thursday.

The statement follows a meeting of the IMF's executive board to discuss the results of annual consultations between the fund and the Russian government.

IMF directors "recommended an ambitious fiscal consolidation path to reduce overheating pressures and vulnerabilities and ensure intergenerational equity," the statement said.

The directors also "generally recommended a gradual further tightening of monetary policy to contain underlying pressures and anchor expectations."

The IMF has repeatedly expressed fears in recent months that Russia's economy is in danger of overheating, implying that demand is growing faster than potential output, leading to higher inflation.

In its latest statement, the IMF predicted that Russia's economy would grow about 4 percent in both 2012 and 2013, slightly above its assessment of the underlying growth potential.

The IMF said that although inflation has come down in recent months, the fund's measure of core inflation remains high, at about 6 percent.

It forecast that inflation would rebound to 6.5 percent by the end of the year, compared with 4.3 percent in June.

The forecast implies that the Central Bank will miss its inflation target of 5 to 6 percent for 2012, increasing pressure on the bank to raise interest rates.

The IMF's call for fiscal consolidation also reflects its long-standing concerns about Russia's high nonoil deficit, a measure of the underlying budget stance that excludes oil taxes.

The statement noted that although the nonoil deficit declined from 12.7 percent of GDP in 2010 to 9.8 percent in 2011, the deficit is set to rise by about 1 percent of gross domestic product this year.

The IMF commended Russia for adopting a new fiscal rule that will base government expenditures on the long-term average oil price. But it also said it "saw scope for further improvements to allow for the effective rebuilding of the reserve fund."

The reserve fund, which is designed to protect the federal budget against a decline in oil prices, is now worth roughly $60 billion (3.2 percent of GDP), down from $143 billion in 2008.

The IMF said effective fiscal consolidation would also need to be underpinned by structural reforms, including pension reform.

Structural reforms are also needed to improve the country's investment climate and long-term economic growth, the IMF said, recommending that Russia improve the rule of law, reduce corruption and privatize state-owned companies.

"The challenge in the short term is to manage domestic demand in order to avoid overheating and in the medium term to fully realize Russia's significant growth potential," the IMF said.

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