

Institute for the Economy in Transition

RUSSIAN ECONOMY IN 2009

TRENDS AND OUTLOOKS

(ISSUE 31)

Volume 1

www.iep.ru

**Moscow
2010**

UDC 33(470+571)(066)"2009"

BBC 65.9(2Рос)я54

Agency CIP RSL

Institute for the Economy in Transition

www.iep.ru

Editorial Board:

S. Sinelnikov-Murylev (editor-in-chief),

A. Radygin,

N. Glavatskaya,

K. Rogov

R95 Russian economy in 2009 (issue 31): Trends and outlooks / Inst. for the Economy in Transition; [S. Sinelnikov-Murylev and others]. In 2 Volumes. Volume 1. – M.: IET, 2010. – 340 p.: il. – ISBN 978-5-93255-288-9.

The review provides a detailed analysis of main trends in Russia's economy in 2009. The paper contains five big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit and financial spheres; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

The publication of the present paper was sponsored with the grant from the United States Agency for International Development (USAID)

UDC 33(470+571)(066)"2009"

BBC 65.9(2Рос)я54

ISBN 978-5-93255-288-9

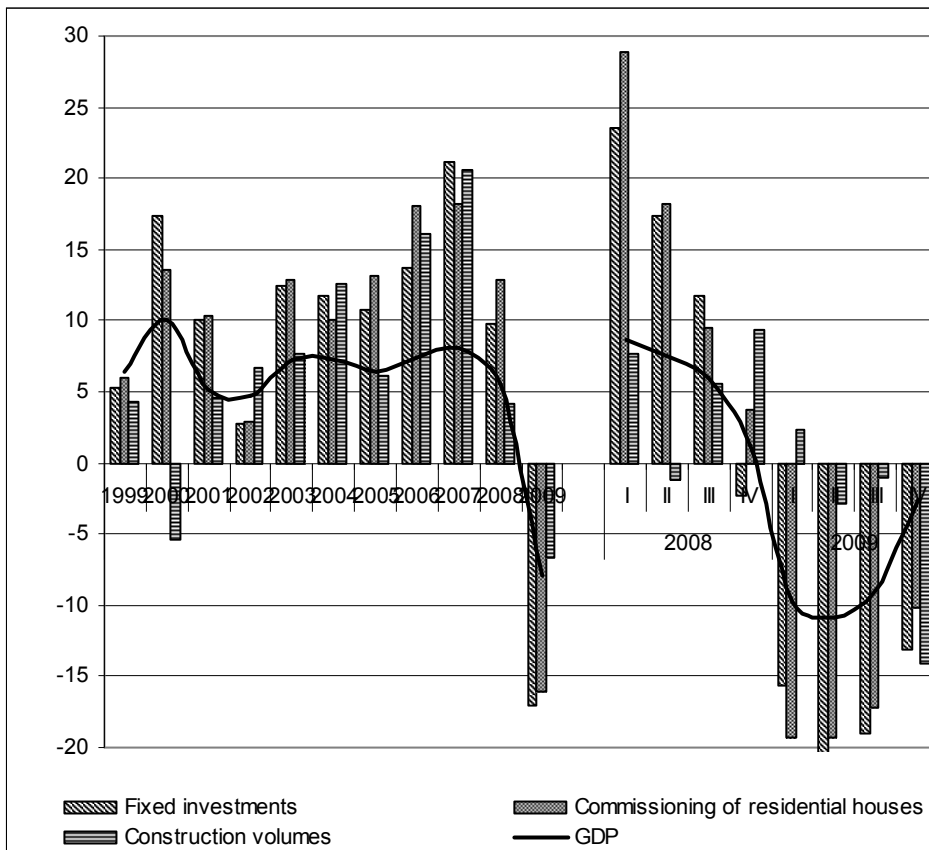
© Institute for the Economy in Transition, 2010

Russia’s Domestic and Foreign Investments in 2009

Domestic Fixed Investments

Fixed Investments Movement: General Trend

Slowdown in the economic activity has resulted in a new situation in the investment sector. Through 2008 a gradual downward trend in the investment growth was observed which coupled with the global financial crisis and from November 2008 was followed by a drastic turning point in behavior: for the first time since 2000 the investment upturn trend got to the negative territory. In the 4Q 2008 fixed investments constituted 97.7% of the same period of the preceding year. In 2009 downward trend in fixed investments took a more acute form: fixed investments shrank by 17.0%, where GDP contraction stood at 7.9%. The fall in the fixed investment volume in the small business sector over the year exceeded 25%. Downward trend in the investment sector predetermined the features of technological and reprocessing activity in the economy as a whole and across the types of economic activity, as well as the process of financing investment expenditures.



Source: Federal service of state statistics

Fig. 1. Rates of Growth of GDP, Fixed Investments, Construction Volumes and Commissioning of New Residential Houses in 2000–2009, and quarter-on-quarter 2008–2009, in % to corresponding period of the preceding year

Positive trend in construction of industrial and infrastructure facilities coupled with the downward trend in commissioning of residential housing was characteristic of 2009. In 2009 commissioning of agricultural facilities went up by 46.8%, in the industrial sector – 11.8% in comparison with a year ago. It is worth noting that in spite of rather rigid financial constraints, commissioning of industrial facilities in public health sector went up by about 1.7fold (*Table 1*).

Table 1

Commissioning of Buildings across Types in 2007–2009

	Total floor space, mln square m			In % to a year ago	
	2007	2008	2009	2008	2009
Buildings commissioned	91.0	93.8	89.8	103.1	95.7
Of which:					
Residential	73.5	77.1	72.8	104.9	94.4
Non-residential	17.6	16.7	17.0	94.9	101.8
Of which:					
Industrial	2.2	2.2	2.5	100.0	111.8
Agricultural	1.5	2.0	2.9	133.3	146.8
Commercial	7.9	6.3	6.2	79.7	97.0
Educational	1.9	1.8	1.0	94.7	56.4
Public health	1.1	0.9	1.5	81.8	169.9
Other	3.0	3.5	0.9	116.7	27.4

Source: Federal service of state statistics

Downward trend in commissioning of residential housing was observed from the 2Q and by the end of 2009 constituted 6.7%. Attention should be paid, first, to the reduction in net investment volumes in residential housing construction in comparison with January-September 2008 by 74.8 bn Rb and, second, to the decline of the investment in residential housing construction in fixed investments structure in January-September to 6.7% against 7.6% for the same period a year ago.

One more peculiarity of the investments structure was increased share of expenditures on construction of buildings and facilities in fixed investments structure in 2009 to 55.8% (by 4.1 percentage points more than for the same period of the preceding year) under the reduction in the share of expenditure on machines and equipment to 31.2% against 33.4% in 2008. Let us point out that against the background of sharp downturn in domestic production of capital goods, investments in imports and in purchasing of machines, equipment and means of transport (without small business and informal economy) in 2009 came to 371.8 bn Rb or 20.7% of the overall volume of investments in machines, equipment and means of transport against 20.0% in previous year. In other words, in the first half we observed positive trend in purchases of imported equipment and machinery coupled with sharp scaling back of their domestic production. In the 3Q production curtailment of production of domestic capital goods

was accompanied by a downturn in the investments in imported equipment and machinery, and in the 4Q against the background of change in the ration of domestic and import prices and slowdown of the recession, an increase in the share of domestic machinery and equipment in the types structure of fixed investments was observed.

Table 2

**Structure of Fixed Investment across Types of Major Assets in 2008–2009
(without small business and informal economy), in % to total**

	2008	Of which			2009	Of which		
		I quarter	I half year	January-September		I quarter	I half year	January-September
Fixed investments – total	100	100	100	100	100	100	100	100
Of which across types of major assets:								
Residential housing	7.5	8.1	7.8	7.6	6.0	6.0	6.0	6.1
Buildings and facilities	52.4	48.5	49.9	51.3	55.8	51.6	54.4	54.8
Machines, equipment, means of transport	33.0	34.5	34.1	33.6	31.2	32.2	30.7	31.1
Other	7.1	8.9	8.2	7.5	7.0	10.2	8.9	8.0

Source: Federal service of state statistics.

Changes in the Investment Structure across Sources of Funding

Investment structure against sources of financing was also subjected to notable changes. Rather sharply contracted the share of proprietary funds of organizations in the investments' volume (by 2.8 percentage points in 2009 against a year ago). Correspondingly the share of raised funds in the investment structure went up. The share of investments from revenues shrank most dramatically (from 18.5% in 2008 to 14.8% in 2009). In its turn, the role of budget funds is growing in the structure of borrowed funds directed to fixed investments: in 2009 1240.8 bn Rb of fixed investments were funded from the budget (21.5% of the overall volume of investments in the economy), of which the federal budget funded 622.9 bn Rb (10.8%) and budgets of the subjects of federation – 546.6 bn Rb (9.5%). The federal budget funding directed at investments increased by 1121.1 bn Rb. This fact has to a certain extent offset contraction of the investment from the budgets of the constituent entities of the Russian Federation by 166.6bn Rb and budgets of other levels of government authority – by 14.4 bn Rb (Table 3).

Table 3

**Structure of Fixed Investments across the Sources of Financing,
in % to total (without small business and informal economy)**

	2008	2009
Fixed investment – total	100	
Of which across sources of financing:		
<i>Net worth</i>	39.5	36.3
Of which:		
Income	18.5	14.8
<i>Borrowed funds</i>	60.5	63.7
Of which:		
Bank loans	11.8	9.4
Including foreign banks	3.0	2.8
Borrowed funds of other organizations	6.2	10.7
Budgetary funds:	20.9	21.5
Federal budget	8.0	10.8
Budgets of the subjects of the Russian Federation and local budgets	11.3	9.5
Other	21.2	21.9
Including funds obtained for share participation in construction	3.5	2.3

Including funds of the population	1.9	1.0
Foreign investment in the overall volume of fixed investment	4.3	4.6

Source: Federal service of state statistics.

State demand for domestically produced goods and services was maintained by means of the implementation of planned investment projects in the field of transport, telecommunications, etc. realized within Federal Targeted Program (FTP) and Federal Targeted Investment Program (FTIP), as well as by way of large infrastructure projects of the Investment Fund. In the wake of the crisis the government stimulated investments in the economy by means of the implementation of technological federal targeted programs whose investments were either maintained at the planned level or reduced insignificantly.

In compliance with the List of construction sites and projects for the federal government needs approved by the RF Government edict of 31 December 2008 № 2058-p and included in the federal targeted investment program for 2009, the state envisaged allocation of public funds for 2444 construction sites, construction projects and various events with planned commissioning of 1186 projects.

In October 2009 the List of construction sites and projects of the federal targeted investment program was amended in accordance with applications submitted by principal administrators of the federal budget funds and caused by revisions in the budget allocations, as well as bringing names of government customers, developers, construction sites and projects and other parameters of construction sites and projects in line with registration documentation. According to data as of 1 October 2009 in compliance with the amended List government investments were envisaged for 2666 construction sites, projects and events and commissioning of 1412 projects.

In 2009 projects construction and realization of events included in the federal targeted investment program (FTIP) with account of optimization of the volume and structure of expenditure of the federal budget were to receive 708.0 bn Rb from the federal budget, of which for financing the projects included in the state defense order – 158.4 bn Rb. For financing the projects included in the federal targeted programs the government planned to allocate 503.2 bn Rb, of which 99.9 bn Rb were planned to direct to the state defense order.

With account of introduced amendments, in 2009 the total volume of budget allocations on construction projects and implementation of measures included in the federal targeted investment program (FTIP) amounted to 601.2 bn Rb, of which directed to financing projects in the federal targeted program – 298.9 bn Rb, on construction projects and implementation of measures outside of the FTIP in 2009 – 197.8 bn Rb. The volume of funds directed to the financing of special assignments included in the state defense order constituted 104.5 bn Rb or 17.4% of the overall volume of the FTIP (of which within the planned part of the FTIP – 62.7 bn Rb, outside the planned part – 41.8 bn Rb).

According to the preliminary data of the Federal service of state statistics, construction sites and projects of the FTIP (excluding special assignments included in the state defense order) which are being monitored by the Federal service of state statistics the level of budget allocations in January-December 2009 constituted 317.1 bn Rb or 63.2% of the annual limit.

In 2009 construction sites and projects of FTIP which were monitored by the Federal service of state statistics received budget allocations in the amount of 317.1 bn Rb. As of 1 January 2010 1715 projects were financed in full, and 597 projects were in the state of technical readiness in the range between 51.0% and 99.9%.

Considerably higher than on the whole across construction sites and projects reserved for the state needs the annual limit of state capital investments was financed in agro industrial complex (80.3%) and transport complex (79.4%). In case of the special complex budget allocations were financed up to 62.3% and in case of the social complex to the extent of 51.6%. On average across Russia for January-December 2009 nearly 90.2% of the overall volume of funds was allocated using all sources of funding. Special complex was financed in full (100%) and the social complex was financed at the level of 87.0%, and the industrial production complex – at the level of 91.7%.

Table 4

Projects Envisaged by the Targeted Investment Program and the Volume of State Capital Investments in 2009 г. (exclusive of construction sites and projects included in the state defense order)

	Number of projects in 2009		Commissioned in January-October 2009		Limit of state capital investments for 2009		Financed from the federal budget in 2009	Total investments out of all sources of funding 2009
	Total	In-service dated in 2009	Full capacity	In part	Total	Of which from the federal budget		
	Units				Bn Rb			
Total	2643	1413	212	67	527.1	501.7	317.1	303.9
Of which:	289	127	13	7	203.1	197.2	156.6	148.9
Transport complex								
Agricultural complex	425	261	50	22	12.2	11.7	9.4	9.3
Special complex	351	189	32	6	19.9	19.1	11.9	12.6
Social complex	1427	730	102	32	265.7	249.7	128.8	123.2
Other projects	151	106	15	–	26.2	24.0	10.4	9.8

Source: Federal service of state statistics

North-Western, Urals, Siberian and Privolzhsky Federal Okrugs have received more than average amount of funds allocated for construction sites and projects of the FTIP. In the Central, Sothern, and Far-Eastern Federal Okrugs disbursement of budget capital investments has been significantly lower than the average mark (Table 5).

Table 5

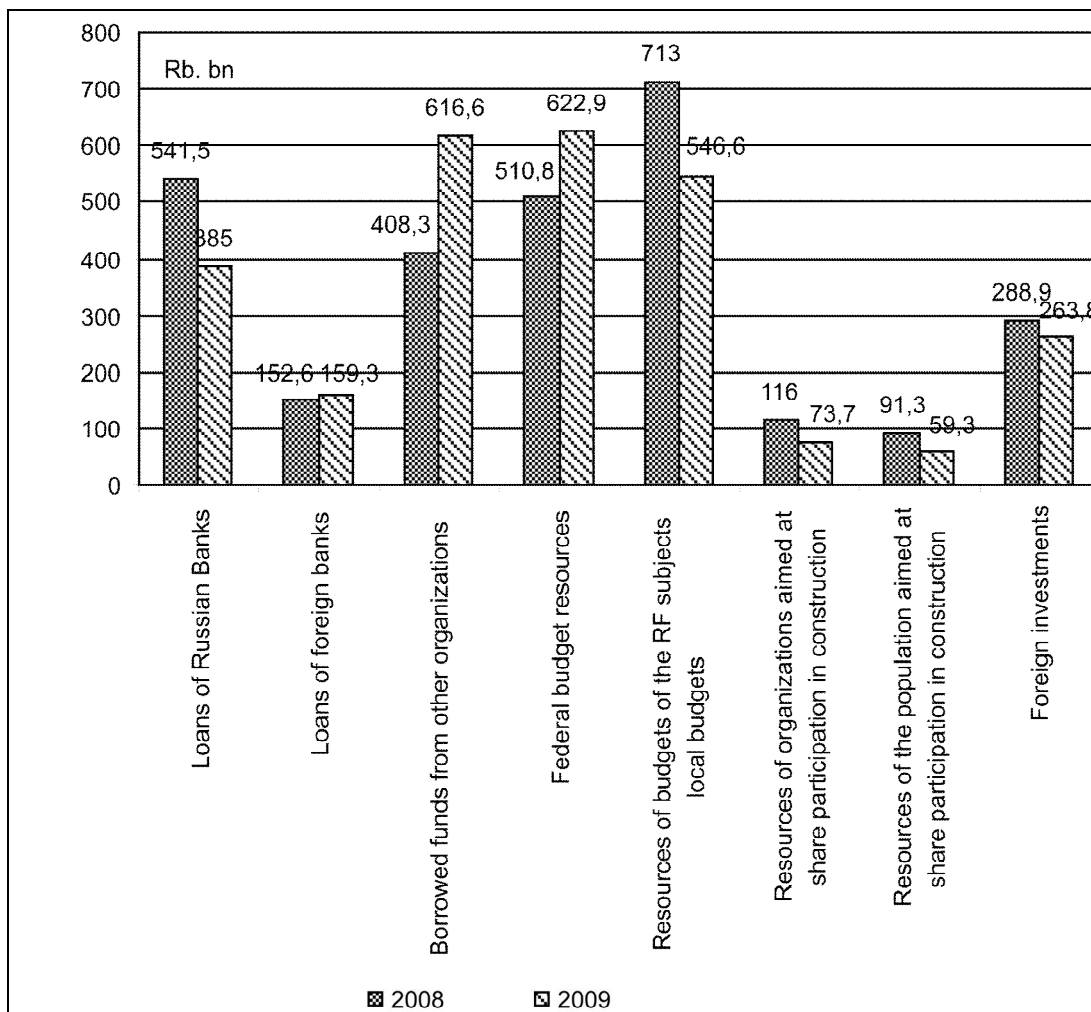
Disbursement of Funds on Construction Sites and Projects for the Federal Needs

	Limit of appropriations from all sources, bn Rb	Limit of state investments per year, bn Rb	Actually disbursed from all sources of funding	
			Bn Rb	in % to limit per year
Russian Federation	527.1	501.7	303.9	57.7
Central Federal Okrug (FO)	218.3	217.7	90.8	41.6
North-Western FO	90.6	76.6	67.6	74.7
Sothern FO	69.8	69.0	45.3	64.9
Privolzhsky FO	22.8	21.7	16.0	70.3
Urals FO	6.6	5.9	6.5	98.0
Siberian FO	31.6	30.3	24.4	77.1
Far-Eastern FO	87.4	80.5	53.3	61.0

Source: Federal service of state statistics.

Contraction of domestic market and downturn in the revenues of the economy predetermined, as was mentioned earlier, drastic reduction in the volumes and share of the proprietary funds of enterprises and organizations in the structure of the sources of financing fixed investments. In 2009 net worth of large and medium-size enterprises directed to the investments

amounted to 2092.0 bn Rb against 2506.6 bn Rb a year before. Acute shortage of net worth was offset by the bank loans and borrowed funds. In 2009 out of 3765.5 bn Rb of borrowed funds 694.1 bn Rb or 18.4% were bank loans (*Fig. 2*).



Source: Federal service of state statistics.

Fig. 2. The Structure of Borrowed Funds directed to Financing Fixed Investments in 2008 and 2009, in bn Rb

The structure of bank loans in the sources of financing fixed investments were subject to significant changes. If in 2008 the share of foreign banks loans amounted to 22.0% of the overall amount of bank loans, then in 2009 this mark went up to 29.3%. Foreign banks loans in 2009 in comparison with a year ago went up by 4.3% at net fall of domestic banks loans directed to fixed investments by 156.5 bn Rb (decrease by 29.3% against the level a year before). As a result, the share of foreign investments in the overall volume of fixed investments increased to 4.6% and constituted 263.8 bn Rb.

This trend was formed against the background of upward trend in capital outflow and contraction of foreign investments. According to preliminary data provided by the Central Bank of Russia, in 2009 net outflow of private capital amounted to USD 52.4 bn against USD 132.8 bn a year ago. Foreign investments in the Russian economy in 2009 stood at USD 81.9 bn (79.0%

to 2008), of which direct investments – USD 15.9 bn (58.9% to the level a year ago) (*Table 6*).

Table 6

Net Inflow/Outflow of Private Sector Capital, according to balance of payments data, in bn USD

	Net inflow/outflow of private sector capital, total	Of which:	
		Net inflow/outflow of capital by banks	Net inflow/outflow of capital by non finance enterprises and households
2007	82.4	45.8	36.6
2008	-132.8	-56.9	-75.8
I quarter	-23.7	-9.9	-13.7
II quarter	40.7	22.1	18.6
III quarter	-19.3	-13.5	-5.8
IV quarter	-130.5	-55.6	-74.9
2009 (estimate)	-52.4	-32.5	-19.9
I quarter	-35.1	-6.8	-28.3
II quarter	4.5	-5.8	10.3
III quarter	-33.4	-27.6	-5.8
IV quarter (estimate)	11.6	7.7	3.8

Source: Central Bank of Russia

Shortage of proprietary resources and negligible role of the domestic banking sector in fixed investments preconditioned wider circle of borrowing companies. In 2009 the volume of borrowed funds directed into fixed investments (insurance and investment companies, trade enterprises, etc.) constituted 616.6 bn Rb and by 231.6 bn Rb exceeded the volume of the domestic banks' loans in the structure of financing of fixed investments.

The global financial crisis defined the behavior of the investors in the market of residential housing construction. In 2009 net decline in the resources directed both by the organizations and the population to the share participation in construction. In 2009 the share of funds directed to the share participation in construction amounted to 2.3%, of which the funds of the population – 1.0% against correspondingly 3.5% and 1.9% in 2008.

Investment Restructuring across Types of Economic Activity

By the end of 2009 fixed investments structure in the economy as a whole was affected by drastic exacerbation of contraction in the investments in agricultural sector (75.2% 2008), in commerce (75.7%), in the communication sector (66.6%), and transactions with real estate (70.8%) (*Table 7*).

Investment activity in the infrastructure sector serves as an indicator of the potential for the future growth due to its orientation for the solution of subsequent issues. Dip in the investments in the development of railway transport by 21.0% against a year ago sent a warning signal. Net reduction in the investments has very negatively impacted associated productions of capital goods. Upward trend in the movement of the investments in the transportation was backed by an increase in the volumes of finding of priority projects in the development of the pipeline transport. Investments in the pipeline transport in comparison with 2008 went up by 1.54fold, and their share in the fixed investments structure in the economy as a whole went up by 5.2 percentage points to 11.8%.

Due to the contraction of the domestic market, investments in the retail sector against 2008 went down at 28.8%, in the wholesale sector – at 13.2%, and in car dealerships – at 34.7%.

Restructuring of the fixed investments across types of economic activity in industry in 2009 was dictated by contraction in the investment activity in the extraction sector at 11.7%, manufacturing industries – at 21.8%, and in the production and distribution of electricity, gas and water – at 0.2% against the 2008 level. The share of investments in industry in the overall volume of fixed investments constituted 42.2% and went up by 1.3 percentage points in reference to 2008.

Table 7

Fixed Investments Structure across Types of Economic Activity (excluding small business and informal economy)

	2008	2009
Total	<i>100</i>	100
Of which across types of economic activity:		
Agriculture, hunting and forestry	3.8	3.3
Industry	40.9	42.2
Extraction of natural resources	16.1	16.8
Of which, extraction of fuel and energy natural resources	14.7	15.5
Manufacturing industries	16.1	15.3
Production and distribution of electricity, gas and water	8.7	10.1
Construction	2.6	2.8
Wholesale and retail sector; automotive maintenance, motorcycles, household goods and personal items	3.1	2.4
Transport	19.6	23.0
Communication	5.2	5.2
Financial activity	1.3	1.3
Transactions with real estate, lease and provision of services	12.9	9.6
Education	2.2	2.0
State governance and state defense, compulsory social security	2.2	2.3
Public health and provision of social services	2.6	2.5
Delivery of other utility, social and personal services	3.1	2.9

Source: Federal service of state statistics.

In the extraction of fuel and energy resources contraction of investments against 2008 constituted 22.2%. Although it is worth noting that with the increase of the world prices commercial production of fuel and energy resources in 2009 went up to 29.2% against 24.7% a year ago.

The share of manufacturing industries in the fixed investment structure on the whole of the economy in 2009 amounted to 15.3%, and in the fixed investments in industry – 36.2% which is 3.2 percentage points below the 2008 mark. Investment activity in the manufacturing industries was ensured by the increase in the investments in the production of petroleum products (135.8% against 2008 mark). Among industries with the deepest investment slump are chemical production (74.2% against 2008), food processing (75.6%), manufacture of leather and footwear (65.7%), textile manufacture (82.4%), and cellulose and paper (63.2%).

Small investment demand for capital goods and construction materials coupled with underutilization of production capacities have led to a contraction in the investments in metallurgical production by 29.1% and production of metal goods - by 32.6% against 2008.

Analysis of behavior and structure of investments demonstrate reduction of as it is small share of investments in machine building. Change in the investments in machine building was mainly dictated by a contraction of investments in manufacture of means of transport by 26.9% against 2008 and in manufacture of machines and equipment – by 30.6%. Considering age, technological and reproduction structure of fixed capital slow investment rates in machine

building industry remain a factor which slows rates of development of industries which manufacture final and intermediary products.

In 2009 major factors which hampered the investment activity in industry were insufficient demand for goods and products, high interest rates, as well as ambiguity of economic situation and prospects for economic development (*Tale 8*). The share of enterprises which pointed out to the shortage of proprietary funds as a constraint of economic activity remained high. However, at the same time, it remained at the average levels recorded for recent five-six years.

Table 8

**Ranging of Organizations across Factors Limiting Investment Activity,
in % to overall number of organizations**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Small demand for goods and products	10	21	14	10	15	21	17	11	18	29
Shortage of proprietary funds	41	53	68	66	60	65	63	59	63	66
Expensive commercial borrowing	47	35	31	31	30	31	28	27	26	36
Complicated mechanism for obtaining loans for the implementation of investment projects	39	31	24	23	17	17	12	14	15	19
Investment risks	35	33	27	26	24	25	28	29	27	23
Unsatisfactory state of the technical base	18	19	14	14	12	9	8	8	7	7
Low return on fixed investments	8	14	10	18	11	14	13	12	8	10
Ambiguity of economic situation in the country	49	35	29	19	20	18	14	11	33	48
Inadequate normative-legal base regulating the investment processes	36	30	22	17	21	17	13	18	10	10

Source: Federal service of state statistics

Under the 2009 level of utilization of production capacities and investments, fixed investments as in the previous years were directed to the replacement of worn-out equipment and machinery. According to findings of business surveys of the investment activity of organizations 64% of the overall number of organizations specified that reason. Under the contraction of demand a natural reaction of producers was to reduce the nomenclature of output which was followed by stagnation in job creation. Loss of interest on the part of enterprises to pursue the policy of production costs and energy saving looked very threatening in the wake of the crisis. Finally, this fact provoked growth of production costs and earnings delusion of services and products. The situation was aggravated by the lack of motivation to improve technical and technological production characteristics. In this connection, replacement of work-out equipment was due to solution of current or short-term issues of enterprise functioning and was not oriented to long-term perspective.

In spite of the fact that the lion's share of fixed investments in 2009 was directed at procurement of machines and equipment, the high level of long-life performance and worn-out state of the equipment and machinery remain one of the principal factors determining low efficiency of production, capital and utilization of labor. For instance, the share of buildings and facilities which are over 20 year constitute 28%, the share of machinery and equipment of the same age amounts to 14% and means of transport – 6% in the companies engaged in the extraction of mineral resources, manufacturing industries companies, those engaged in production and distribution of electricity, gas and water in 2008. Average age of machines and equipment in metallurgy, manufacture of means of transportation and equipment, production of cellulose, wood pulp, paper, carton and their products does not exceed the average age across the companies under survey.

Table 9

**Ranging of Organizations across Fixed Investments Objectives (findings
of the investment activity surveys, in % to the overall number of organizations)**

Fixed investments objectives	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Expansion of production capacities with permanent nomenclature of products	42	35	35	36	33	28	31	27	29	29
Expansion of production capacities with expansion of nomenclature of products	34	26	28	27	33	38	36	39	39	27
Automatization and mechanization of current production process	51	51	46	51	53	51	51	53	51	45
Introduction of new manufacturing technologies	41	43	42	39	40	46	47	44	42	33
Reduction of primecost of the output	42	41	39	39	47	49	46	48	46	39
Energy saving	39	39	37	38	44	49	44	48	43	35
Replacement of worn-out equipment and machinery	56	73	68	71	70	73	72	73	70	64
Job creation	30	17	17	16	21	25	21	21	22	16
Environment protection	48	51	40	46	46	50	50	49	46	36

Source: Federal service of state statistics.

At the same time, note positive trends in the structure of fixed investments.

Table 10

**Ranging of Organization across Types of Purchased Fixed Assets,
in % to the overall number of organizations**

	2009	2010 projection
Machines and equipment		
Complexes and manufacturing lines	58	56
Individual plants	54	50
Means of transport	49	46
Computer technologies and mechanical and automatization equipment	62	57
Telecommunications equipment	38	36
Other	32	27

Source: Federal service of state statistics.

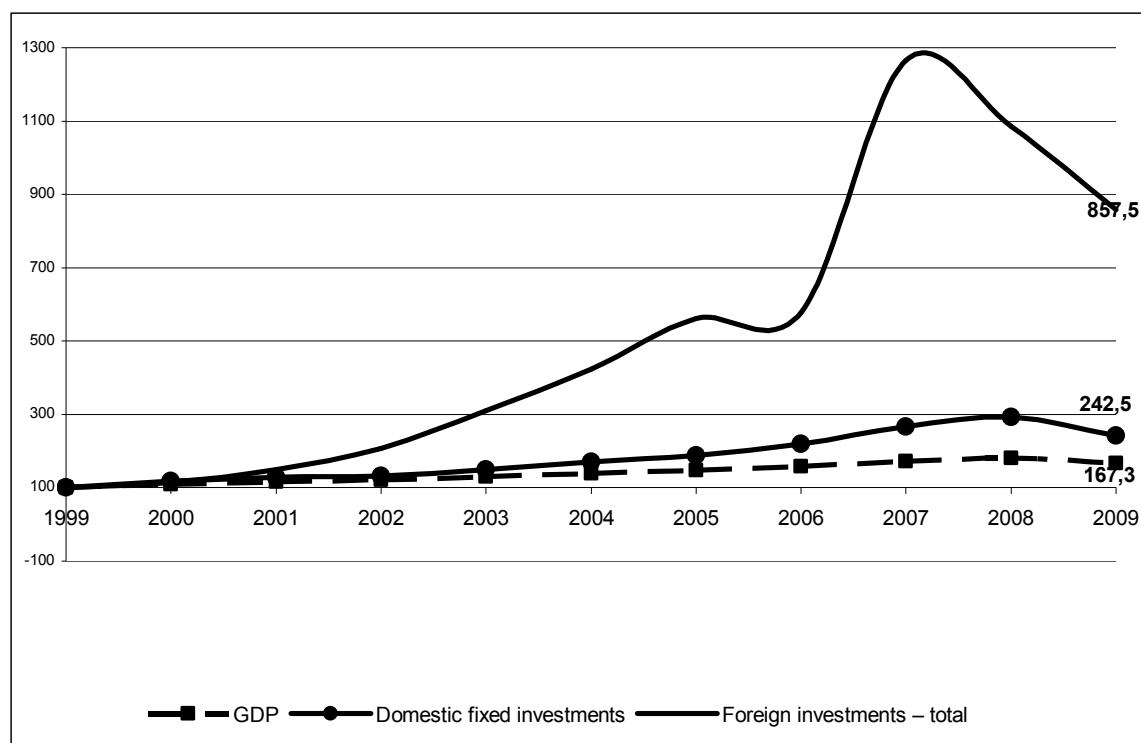
Investment in the new technological lines and complexes has been growing on the back of the decline in the replacement of machines and equipment which fully corresponds long term purposes of modernization and reconstruction of industrial production and fosters manufacture of competitive high-tech products. This trend is paramount due to the fact that the majority of companies in 2009 – 87% of all companies subject to survey - purchased new machines and equipment of domestic origin and only 37% - imported. Such shift in priorities will undoubtedly influence positively the domestic market of investment-intensive goods.

3.3.2. Foreign investment

Over the last ten years in the Russian economy dominated the trend according to which foreign investments grew faster than domestic investments. Significant outrunning rates of growth of the overall volume of foreign investments in comparison with domestic investments movement were due to structural features. Major share of foreign investments in the Russian economy constitute “other type of investment” which are ranged by type of financial tool as: loans and credits; commercial credits; credits obtained from indirect investors, in particular, from in-

ternational financial organizations (World Bank, International Monetary Fund, International bank for reconstruction and development, European bank for reconstruction and development); credits from foreign governments under guarantees of the RF Government, etc. On average, for the period 2000-2008 the share of direct investments stood at about 26% of the overall volume of foreign investments, the portfolio investments – 2%, and other – 72%.

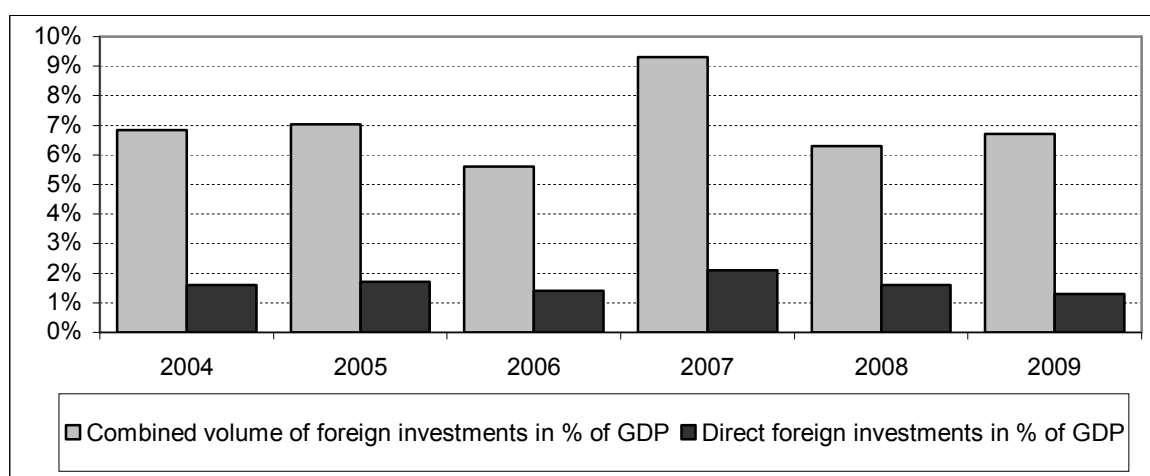
The rates of growth and the volume of foreign investments in the Russian economy peaked in 2007. That year the volume of foreign investments doubled against the level of a year ago. In 2007 the volume of direct investments reached USD 27.9 bn which exceed the volume of investments received for two preceding years. Sustainable growth of direct investments came on the back of a surge in tied commercial credits and loans from direct investors. For the year 2007 increment in other investments exceeded USD 50 bn which, undoubtedly, affected the national financial indicators. At the same time, the stock market remains a zone of high risks which conditioned instability of behavior of the portfolio investments. Contraction in the volume of portfolio investments, the lion's share of which constitute investments in shares, during 2000-2004 was interrupted by a somewhat revival recorded in 2005 and surge in growth by 7fold in 2006 with slowdown of the movement to 131.8% in 2007. Dramatic upsurge in activity of foreign investors turned to a sluggish behavior in 2008. At the end of 2008 the volume of foreign investments in Russian economy in comparison with 2007 declined by 14.8%. Downward trend in foreign fixed investments continued over entire 2008 and remained in 2009.



Source: Federal service of state statistics.

Fig. 3. Indices of the Physical Volume of GDP, Domestic Fixed Investments and Foreign Investments in 1999–2009, in % to 1999

Although insignificant decline in the volume of foreign investments was recorded in the 4Q 2008, crisis developments in the investment sector were clearly revealed in the 1Q 2009 when the volume of foreign investments in the Russian economy dipped by 30.3% against the same period of 2008 and by 2.3fold in comparison with the preceding quarter. Global unfavorable situation on the hydrocarbons market and on other raw material resources markets along with instability reported on the global stock markets provoked by the onset of 2009 the outflow of foreign investments from the Russian market. In the 1Q 2009 the amount of transferred profit obtained by foreign investors coupled with repayment of loans and interest payment on those loans was comparable with the amount of foreign investments received over this period. Furthermore, for the first time in the last decade Russia's investments abroad exceeded the volume of foreign investments in the Russian economy. This trend continued in the 2Q and in the 3Q 2009. In the 4Q 2009 Russian investments abroad constituted only 46.5% of the amount of foreign investment in Russian economy for this period. Increase of interest rates on credits, high investment risks, contraction of domestic demand, unfavorable global market environment conditioned low level of the investment activity.



Source: Federal service of state statistics.

Fig. 4. Level of Inflow of Foreign Investments in Russian Economy in 2004-2009 (in % of GDP)

Initial decrease of sovereign credit ratings of Russia due to the global financial crisis took place in December 2008 when international credit ratings agency S&P lowered sovereign rating of Russia from BBB+ to BBB, with negative projection for the credit rating. According to S&P “decrease of sovereign credit rating reflects the risks connected with the sharp contraction of currency reserves and other investment flows, which have resulted in increasing costs and difficulties with access to external financing.” For the same reason Fitch lowered the credit rating of Russia from BBB+ to BBB in February 2009 with negative projection of the rating. In August 2009 Fitch confirmed the credit rating fixed in February 2009. In its press-release S&P in September 2009 noted that decided not to change sovereign ratings of Russia. Given reason were continued risks for the Russian economy.

Moody's did not lower credit rating of Russia following S&P and Fitch and confirmed in the end of 2008 its positive projection for the RF promissory notes and deposits, limiting to

reviewing projection from positive to stable (in July 2008 Moody's increased Russia's credit rating from Baa2 to Baa1 with positive projection for the rating). In the end of October 2009 Moody's announced that the sovereign credit rating of Russia will remain in the near future within A3-Baa2 and considers as insignificant chances for its decrease.

In 2009 as a whole foreign investments are estimated to stand at USD81.9 bn or 79.5% against 2008.

The highest dip in net indices (at USD11.1 bn) and relative (at 41.1%) in 2009 was recorded in the direct investment segment. Other investments carried out on repayable basis shrank at USD10.2 bn. At the same time, contributions to the authorized capital at the end of 2009 fell at 49.7% to USD8.0 bn. Loans from foreign joint owners went down at 34.2% to USD 6.4 bn. Thus, the share of loans obtained from foreign joint owners in the structure of direct foreign investments in Russia went up from 36.2% in 2008 to 40.5% in 2009 and the share of contributions in the authorized capital decreased from 58.8% to 50.3%.

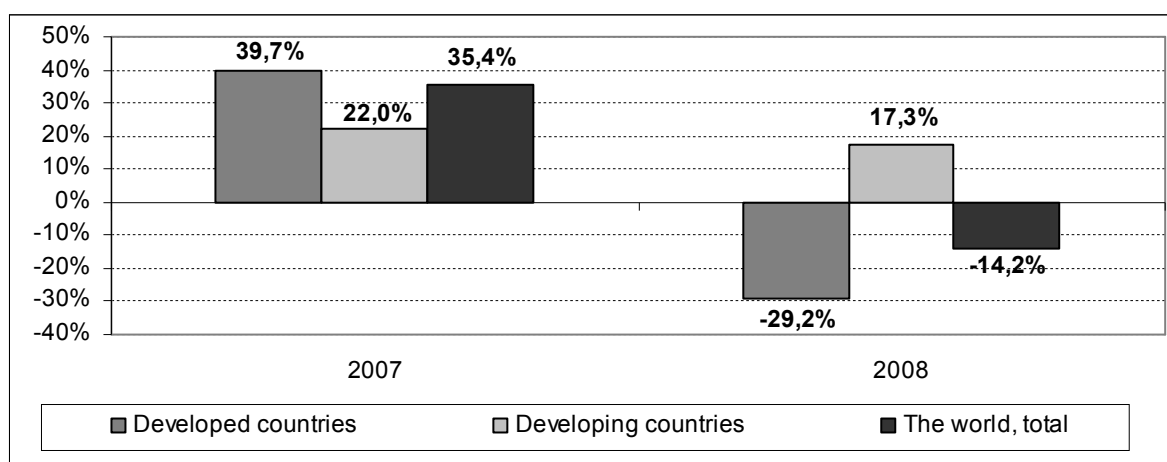
Table 11

Volume and Behavior of Investments Received from Foreign Investors in the Russian Economy, across types of investments

	Mln USD				In % to preceding year			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
2005	53 651	13 072	453	40 126	132.4	138.8	136.3	130.5
2006	55 109	13 678	3 182	38 249	102.7	104.6	700.0	95.3
2007	120 941	27 797	4 194	88 950	219.5	203.2	131.8	232.6
2008	103 769	27 027	1 415	75 327	85.8	97.2	33.7	84.7
2009	81 927	15 906	882	65 139	79.0	58.9	62.3	86.5

Source: Federal service of state statistics.

According to UNCTAD "World Investment Report 2008", the volume of attracted direct foreign investments in 2008 Russia took 5th place in the world (2007 – 9th, 2006 – 10th, 2005 – 15th) and among developing countries Russia took 2nd place behind China (2005 – 3rd). According to the data represented in the report, in 2008 Russia attracted 4.1% of direct global foreign investments (2007 – 2.8%) due to significant reduction in the inflow of direct foreign investments in developing countries.



Source: UNCTAD, "World Investment Report 2008".

Fig. 5. Adjustment in the Influx of Direct Foreign Investments in 2007–2008

According to the UNCTAD report contraction of the combined volume of direct foreign investments in the world was recorded gradually starting with the 1Q 2008. In January-March 2009 decrease in the combined direct foreign investments in the world according to estimate constituted 44% against the 1Q 2008. At the same time, it was noted that for the same period the fall of direct foreign investments was recorded in 70 out of 96 countries. In the developed countries influx of direct foreign investments in the 1Q 2009 fell in relation to peak marks recorded in the 4Q 2007 by more than 3fold. In the developing countries peak volumes of direct foreign investments were recorded in 1Q 2008. At the end of the 1Q 2009 their reduction constituted about 40%. Later than anywhere else (starting with the 3Q 2008) the fall of direct foreign investments was recorded in the East European and CIS countries. Decrease of net indices in the East European and CIS countries was much deeper in comparison with combined index and with the data for the developed and developing countries. However, in relative terms at the end of January-March 2009 direct foreign investments in relation to maximum indices of the 2Q 2008 dipped by about half. In the segment of portfolio investments in the Russian economy in 2009 a decrease was noted by 37.7% in comparison with 2008. At the same time, decrease in the investments in shares and stock which constituted the lion's share of the portfolio investments (2007 – 95.5% of the volume of portfolio investments, 2008 – 79.6%, 2009 – 42.9%).

The volume of other investments in 2009 went down in relation to the corresponding period of 2008 by 13.5%. The share of commercial credits in the structure of other investments at the end of 2009 remained at the level of 2008 and constituted 21.4% (2008 – 21.5%). According to terms of attracted loans, the share of loans exceeding six months remained at the level of 67.9% (2008 – 68.1%).

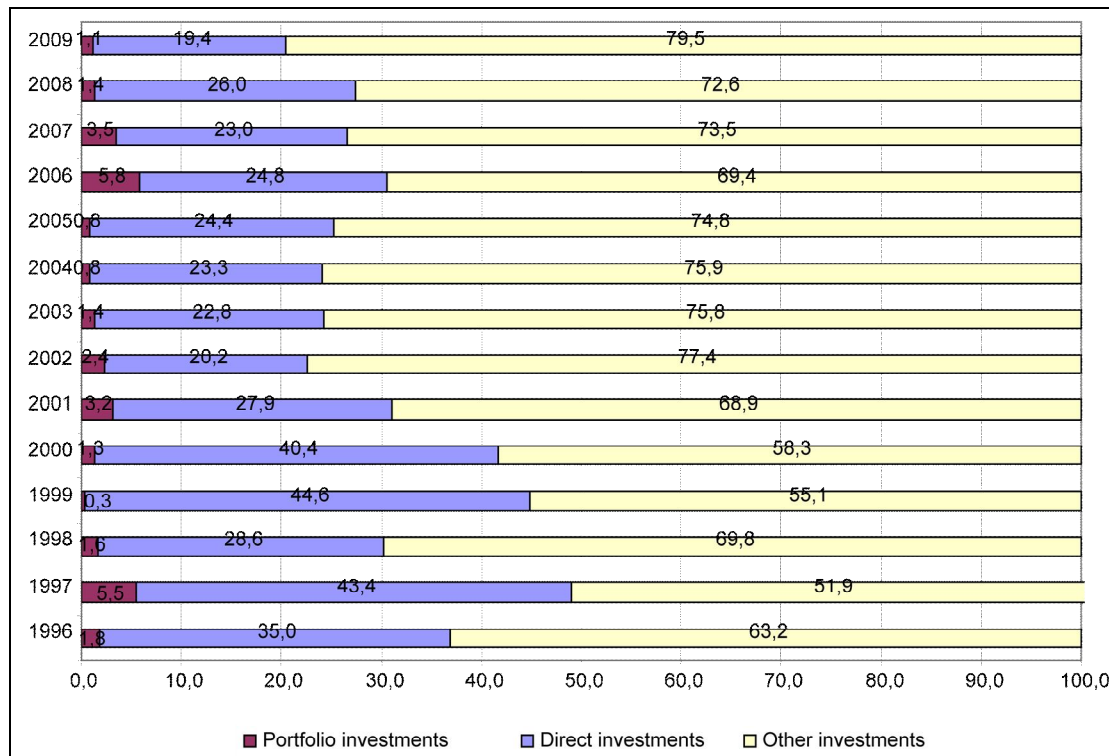
Thus, in comparison with the preceding year, in 2009 the structure of foreign investments in the Russian economy was subject to certain amendments.

In 2009 foreign investments in industry went down by about one third and constituted 40.3% of the overall volume of foreign investments in the Russian economy. After twofold reduction of investments in commerce in 2008, in 2009 foreign investment in commerce dropped by 4.7%, at the same time their share in the overall volume of foreign investments went up to 27.5%. 2009 has brought back a positive trend in foreign investment in transportation and communication sectors following their downturn by 27.5% a year ago. Foreign investment in the pipeline transportation in 2009 amounted to USD 9.0 bn and exceeded the level of the successful 2007 by 3.2fold. Dynamic growth of foreign investment in the communication sector in 2009 by 5.1fold in comparison with preceding year not only totally offset a fall recorded in 2008 but also ensured expansion of the investment potential by 20% against 2007. As a result, the share of transportation in the structure of foreign investment in 2009 went up to 12.1% against 3.4% in 2008 and 2.8% in 2007, and communication, correspondingly, to 4.5% against 1.3% and 2.7%

The global crisis which was triggered by the housing bubble in the United States has sizably affected the real estate sector. Many countries recorded two-digit rates of price slump annualized in the real estate. All that has led to a downturn of the investors' interest to Russian real estate sector. In 2009 foreign investment in real estate contracted by about half.

Foreign investment in industry at the end of 2009 compared with 2008 recorded a fall by 16.7% in the extraction of minerals (in 2008 decline amounted to 28.7%). Foreign investment

in manufacturing industries went down by 34.5% (2008 posted investments growth in manufacturing industry by 6.2%) Investment in the food processing industry declined by 40.0%, in chemical industry – 37.6% and constituted USD 2.4bn and USD 1.6 bn correspondingly. Under unfavorable world market price trends on metals foreign investment in metallurgy in 2009 contracted 3.2fold constituting USD 4.5 bn compared with the same period a year ago.



Source: Federal service of state statistics.

Fig. 6. Structure of Foreign Investments in the Russian Economy in 1996–2009, in % to total

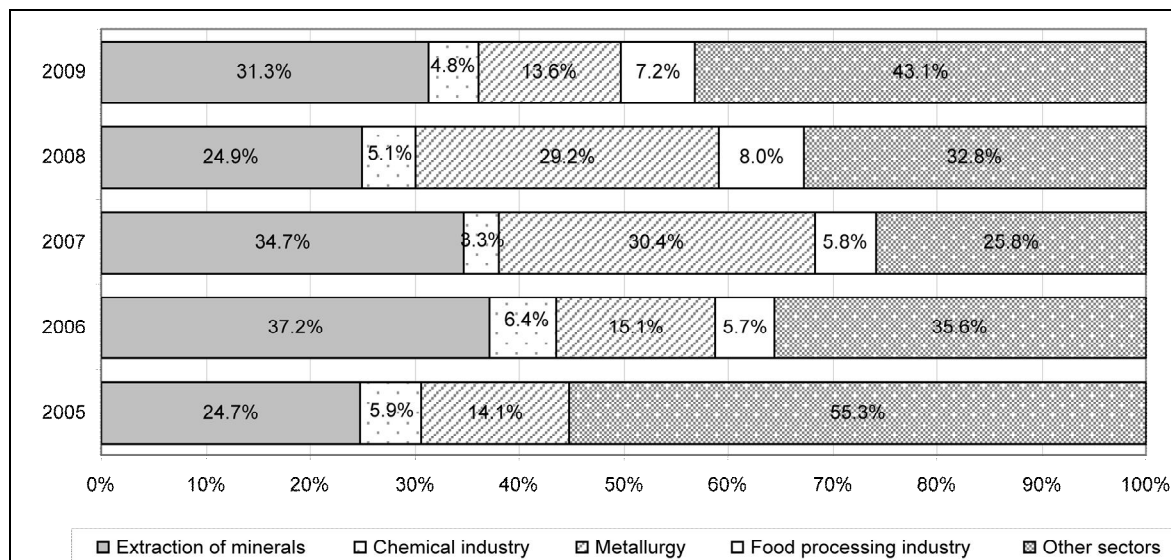
Table 12

Volume, Behavior and Structure of Foreign Investment in the Russian Economy across types of economic activity in 2007–2009

	In mln USD			In % to preceding year			In % to total		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
Total	120941	103769	81927	219.5	85.8	79.0	100	100	100
Industry	50 163	49 704	32 980	203.9	99.1	66.4	41.5	47.9	40.3
Transportation and communication	6 703	4 861	13 749	126.5	72.5	282.8	5.5	4.7	16.8
Wholesale and retail sector; maintenance of motor transport, motorcycles, household appliances and personal items	47 310	23 905	22 792	361.4	50.5	95.3	39.1	23	27.8
Transactions with real estate, lease and services provision	8 414	15 378	7 937	140.3	182.8	51.6	7	14.8	9.7

	In mln USD			In % to preceding year			In % to total		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
Financial activity	4 450	4 977	2 658	94.7	111.8	53.4	3.7	4.8	3.2
Other sectors	3 901	4 944	1 811	274.7	126.7	36.6	3.2	4.8	2.2

Source: Federal service of state statistics



Source: Federal service of state statistics. Data on foreign investment in food processing industry for 2005 are missing.

Fig. 7. Structure of Foreign Investments in Industry in 2005–2009

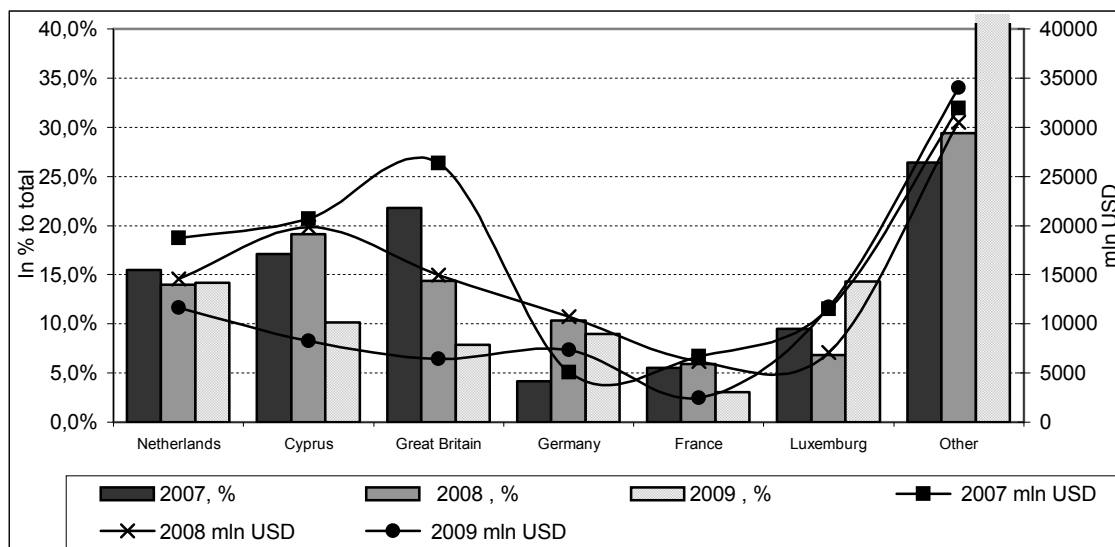
Direct and portfolio investments in industry decreased in 2009 compared with 2008 by 44.1% and 41.2%. Other investments in industry also went down by 29.5% against a year ago. Thus, the share of other investments in industry went up from 71.1% in 2008 to 75.6% in 2009, the share of direct and portfolio investment for the same period declined from 26.6% and 2.3% to 22.4% and 2.0% correspondingly.

The structure of foreign investments across types of economic activity in industry was subject to adjustments. In the extraction of minerals sector direct investments went down by 36.2% to USD3.2 bn which resulted in contraction of their share in cumulative investments in this sector at the end of 2009 at 30.7% (2008 – 40.2%). The share of other investments in the extraction sector which posted reduction at the end of 2009 by 7.2% (to USD6.8 bn) went up to 65.8% (2008 – 59.0%).

In manufacturing industry in 2009 major part of investments also fell to the share of other investments which compared with 2008 went down by 35.5% constituting in the cumulative indices of the investments in manufacturing industry 80.6% (2008 – 81.9%). Foreign direct investments in manufacturing industries for the period under consideration went down by 30.7%. The share of direct investments in manufacturing industries went up at the end of 2009 to 18.5% (2008 – 17.5%).

The Netherlands and Luxemburg have preserved their positions as large exporters of capital in the geographical structure of foreign investment in the Russian economy in 2009. In 2009 Luxemburg invested the largest amount USD 11.7 bn (14.3% of the overall amount of foreign investment in the Russian economy for the given period), the Netherlands invested USD 11.6 bn (14.2%). China became the third largest investor whose investments at the end of 2009

amounted to USD 9.8 bn. At the same time, the US did not get into the first ten largest exporters of capital to Russia at the end of 2009.



Source: Federal service of state statistics.

Fig. 8. Geographic Structure of Foreign investments in Russian Economy in 007–2009

In 2009 the largest growth of investment was posted from Japan – by 3.5fold against 2008 (to USD3.0 bn), investments from Luxemburg went up by 65.7%. At the same time, investments from Cyprus went down by 2.4fold, Great Britain – 2.3fold, France – 2.5fold, Ireland – 3.9fold. Investments from the Netherlands went down by 20.0%, Germany – by 31.3%. Changes in the investment movement have resulted in the changes in the geographical structure of foreign investments in the Russian economy.

As of the end of 2009 cumulative foreign capital exclusive of monetary and credit regulatory agencies, commercial and savings banks, inclusive of ruble investments evaluated in USD constituted USD 268.2 bn which exceed by 1.4% corresponding parameter as of beginning of the year. The negative fact is that direct cumulative investments for the year fell by USD 13.4 bn. However, contraction of cumulative direct investments was posted in the 1Q 2009 (at USD27.2 bn, or by 22.2% for quarter). In the 2Q of preceding year cumulative foreign direct investments on the contrary went up and increased for half year by USD14.0 bn (at 14.7%).

At the end of 2009 Cyprus, the Netherlands, Luxemburg, Great Britain and Germany are among leader in the overall volume of cumulative foreign investments at the end of 2009. Their share constituted 59.1% (2008 – 70.3%). At the same time, the share of the first five investor-countries in the segment of portfolio investments went up to 85.0% (2008 – 75.3%), in the structure of direct and other investments it went down to 61.8% and 55.3% (2008 – 73.4% and 57.6%).

Table 13

Cumulative Foreign Investments across Major Investors

Cumulative as of 01.01.2010 mln USD				Adjustment to 01.01.2009, %			
Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other

	Cumulative as of 01.01.2010 mln USD				Adjustment to 01.01.2009, %			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
Ireland	9 212	415	5	8 792	95.3	86.5	1250.0	95.8
Germany	19 226	7 834	14	11 378	110.3	107.7	53.8	112.4
France	8 622	2 182	29	6 411	90.4	113.2	2900.0	84.2
Great Britain	23 585	3 625	2 327	17 633	76.5	78.0	99.5	74.0
Cyprus	49 128	33 547	1 835	13 746	86.3	82.4	106.2	953.3
Netherlands	48 619	29 065	4 280	15 274	104.9	80.9	10439.0	147.2
Luxemburg	37 157	1 185	273	35 699	108.0	97.4	100.0	108.5
Other coun-tries	72 677	31 169	1 495	40 013	120.3	113.5	268.4	88.2
Total	268 226	109 022	10 258	148 946	101.4	89.1	182.3	109.1

Source: Federal service of state statistics.

In the structure of foreign investment accumulated at the end of 2009 other investments prevail. They constitute 55.5%. The same parameter for foreign direct investment constituted 40.6%.

In 2010 according to projections of the RF Ministry of Economic Development the upward trend in foreign investments in the Russian economy will continue. For instance, at the end of December 2009 S&P revised its projection of the credit rating of Russia from negative to stable, thus confirming the currency rating at the level BBB. At the end of January 2010 Fitch has also preserved Russia's rating at the level of BBB revising projection on rating from negative to stable.