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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.

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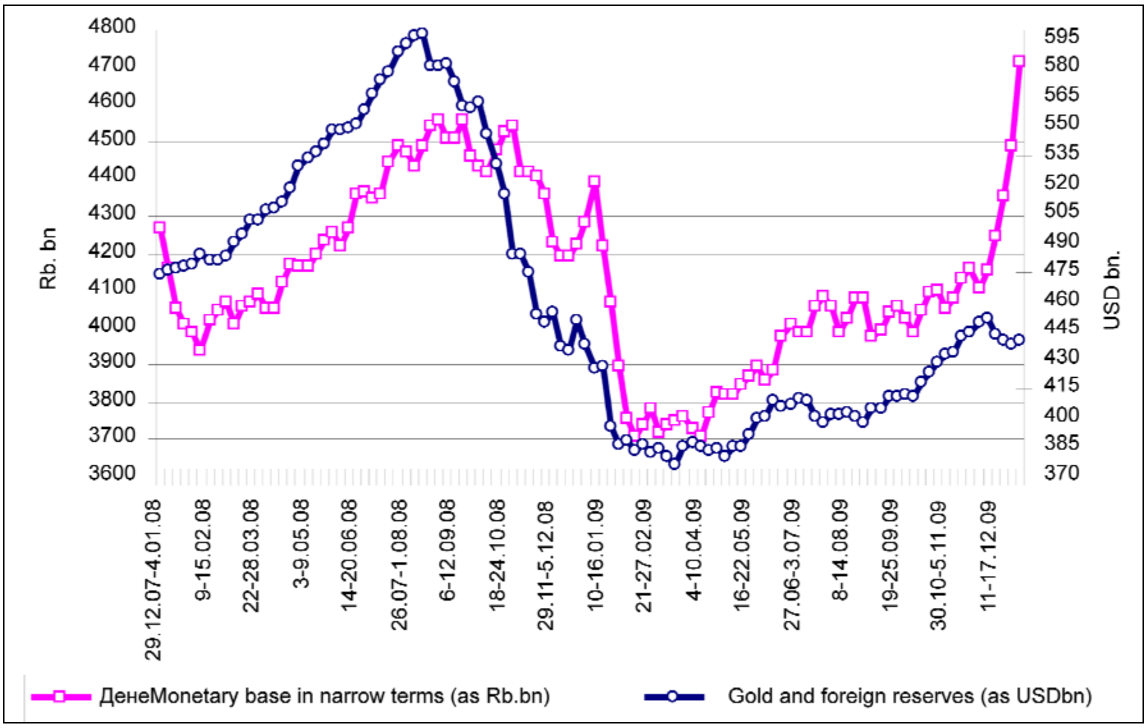
Monetary Policy in the Crisis Period

2.1.1. Monetary Market

The global financial and economic crisis that burst out in Russia in late 2008 battered primarily the financial sector of the economy. In August, crisis developments on the global financial markets were further aggravated by Russia's military action in the Southern Ossetia and triggered a sizeable capital outflow from the country. Plus, a slowdown in the largest economies' growth resulted in a dramatic deterioration of foreign trade conditions for Russia and a subsequent drastic contraction of the nation's foreign exchange revenues. As a result, Russia's international reserves began to dwindle rapidly, as the Bank of Russia had to throw them on pegging the Rb. exchange rate. In addition, the appreciation of the USD against the Euro on the global forex market has sent the value of the USD-denominated fraction of the reserves nosedive.

A rapid depletion of the volume of international reserves had been continuing through January 2009 and was the result of the Bank of Russia's pursuance of the policy of a gradual devaluation of the Rb. It was just the stabilization of prices for energy sources and the end of a sharp phase of the global economic crisis that allowed one to stop the rapid fall of the reserves. Between February and March 2009 the dynamic of international reserves demonstrated its fluctuating nature, with their minimum value reported in mid-March, when they stood at USD 376.1bn vis-à-vis a peak of USD 597.5bn back in the early August 2008. So, the gradual devaluation cost the bank of Russia roughly as much as one-third of the nation's international reserves (with account of the fact that the fall in the reserves was partly fueled by the noted appreciation of the USD vs. the Euro). The policy *de facto* enabled economic agents (primarily, commercial banks) to cut it fine with betting on a predictable exchange rate dynamic. It can be suggested that had the authorities opted for a one-time devaluation of the Rb. exchange rate to a level of circa Rb. 35/USD, the equilibrium on the forex market would have been secured anyway, but the price for the monetary authorities would have been less. That said, the gradual nature of depreciation of the Rb. allowed one to somewhat smooth down negative social effects from the process.

With global financial market stabilizing and prices for major Russian exports slightly bouncing back to normality, as early as in May 2009 the volume of the nation's international reserves was back on track of growth and by November-December accounted already for USD 440bn-plus. So, despite a sizeable contraction of the reserves, their volume remained fairly considerable by international standards (as of December 2009, Russia had the world's third greatest volume of the reserves after China and Japan). In all likelihood, should oil prices in the medium term remain within the corridor of USD 60-70/bbl or above that, the nation's international reserves would stabilize or slightly grow.



Source: the CBR

Fig. 1. The Dynamic of the Monetary Base and International Reserves in 2008−2009

The dynamic of money supply over the crisis period also allows singling out several sub-periods. As already noted above, in the second half 2008 Russia's gold and foreign reserves were in decline, as the CBR had to sell forex to keep the Rb. exchange rate buoyant. But a considerable increase in the CBR's volume of lending to commercial banks (between July and December 2008 the increase in loans credit organizations had received from the CBR accounted for over Rb. 3.3trln), nonetheless, resulted in a slight growth (+2.9%) of the monetary base over the 2nd half 2008. In January 2009, in the conditions of a full-scale capital outflow form the private sector, there took place the most significant contraction of the monetary base over the crisis period (-22.4%). It was fueled by the fall in the volume of cash (-14.5%) in the first place and that of balances of the credit organizations' corresponding accounts with the CBR (more than twice) due to a USD 40.2bn-worth contraction of Russia's gold and foreign reserves (*Table 2*). The CBR partly damped the liquidity outflow from the banking sector in January by boosting up the volume lending to Russian banks. More specifically, in January 2009 alone, the aggregate volume of loans disbursed to the national banking sector surged by Rb. 325.3bn (up 8.8%).

Between February and March 2009, the amount of the monetary base in broad terms has not undergone any substantial changes due to some stabilization on the exchange market and remained at the level of a. Rb. 4.3trln. Between April and December 2009, with the global economy recovering, prices for main Russian exports soaring, and the Rb. rate appreciating, the volume of the monetary base rose at 50.4% against the background of growing budget expenditures. It was the spending of the Reserve Fund's resources and the CBR's purchases of foreign exchange that formed main factors contributing to the growth in the monetary base. Specifically, the use of the resources from the Reserve Fund on financing the budget deficit has increased money supply by more than Rb. 2 trln. Meanwhile, the CBR's cutting back on the volume of lending to commercial banks helped slightly inhibit the increase of the monetary base.

So, spending the Reserve Fund's resources in 2009 began to contribute substantially to the growth in money supply. Given that as of January 1, 2009, the aggregate volume of the National Welfare Fund and the Reserve Fund combined accounted for Rb. 6,612.1bn (USD 225.1bn, or 15.9% of GDP) (+ Rb. 2,763bn when compared with January 1, 2008), as of January 1, 2010, the respective value was Rb. 4,599.5bn (USD 152.4bn, or 13.6% of GDP). A rapid increase of budget expenditures may once again fuel an impetuous surge of money supply – by results of December 2009, the monetary base increase rate has already hit 24% and proved to be the most substantial one since December 2003. Meanwhile, the CBR's capability to sterilize an excessive money supply by virtue of recovery of the earlier extended to commercial banks credits will be smaller than between March and August 2009.

Table1

Dynamics of Monetary Base in Broad Terms between 2008–2009 (as Rb bn)

	1.07.2008	1.10.2008	1.01.2009	1.04.2009	1.07.2009	1.10.2009	1.01.2010
Monetary base (in broad terms) including:	5 422.9	5 317.8	5578.7	4298.8	4967.6	4803.7	6467.3
Cash in circulation, with account of credit organizations' cash balances	4 077.2	4 285.3	4372.1	3658	3908.1	3869.2	4622.9
Commercial organizations' corresponding accounts with the CBR	592.4	702.9	1027.6	431.7	471.4	545.4	900.3
Emergency funds	360.3	152.1	29.9	33.3	61.8	153.9	151.4
Commercial organizations' deposits with the CBR	369.3	154	136.6	163.4	508.8	216.9	509
The CBR's obligations in hands of commercial organizations	23.7	23.5	12.5	12.4	17.5	18.4	283.7

Source: the CBR

An analysis of the change in the structure of assets in the CBR's balance (see *Table 2*) allows one to note that in the critical phase of the crisis (between the autumn 2008 and the winter 2009) it was credits and deposits disbursed to Russian credit organizations that demonstrated the highest increase rate. By contrast, capital placed with non-residents was shrinking[1]. Once between the spring and summer 2009 the global financial market began recovering, the CBR has been gradually shutting off its lending pipe. In parallel with that, the RF Government had found by then its resources drying up, as were the CBR's accounts. In other words, because of the crisis phenomena, it was the CBR's operations on refinancing credit institutions that formed the principal source of formation of money supply. This is consistent with the most developed nations' practice. In the circumstances it is interest rates of the CBR's credits that gain a far greater role than before, as employing them, the Bank of Russia can exert a substantial influence on the situation in the monetary sphere. Meanwhile, as long as resources were being spent from the Reserve Fund, the money supply in the country was on the rise, and the Bank of Russia precludes it from a further excessive growth by cutting back on the net lending to commercial banks. But its capability to do so is limited,

[1] This paper highlights on changes in the Bank of Russia's international reserve assets.

while further appropriations from the accounts of the RF Government with the CBR might result in an acceleration of growth rates of money supply, which, in the event of a sharp aggravation of the situation on financial markets in the form of a growing financial instability, could create a downward pressure on the Rb. exchange rate and trigger inflation escalation.

Let us note that the lending fragmentation to credit institutions in the autumn 2008 (in anticipation of a looming devaluation) did not allow one both to solve the problem with liquidity in the banking sector and the problem of lending to the real sector, as at the expense of the *de-facto* predetermined gradual devaluation the CBR has generated very lucrative assets, that is, foreign exchange, that has proved to be more rewarding and less risky than alternative avenues for investment. As a result, once bankers received the CBR's transfers, the latter were immediately channeled onto the forex market and ultimately back to the reserves-bleeding CBR. So, the gradual devaluation allowed the financial sector to generate extra profits, which mitigated the liquidity crisis in the banking system, albeit, as already noted, it cost the CBR one-third of its international reserve assets and triggered a boom on the forex market.

Table 2

The Balance Sheet of the Bank of Russia in 2008–2009

	1.08.2008		**1.01.2009**		**1.12.2009**	
	USDbn.	**% assets / liabilities**	**USDbn.**	**% assets / liabilities**	**USDbn.**	**% assets / liabilities**
Funds placed with non-residents and foreign issuers' securities	13653.9	93.2	12091.1	71.3	12448.2	80,4
Loans and deposits	69.2	0.5	3871.3	22.8	1707.7	11.0
Precious metals	382.2	2.6	450.3	2.7	746.4	4.8
Securities	442	3.0	441	2.6	459.7	3.0
Other assets	103.1	0.7	110	0.6	120.8	0.8
Total, by assets	**14650.3**	**100**	**16963.7**	**100**	**15482.6**	**100**
Cash in circulation	4153.9	28.4	4378.2	25.8	4024.9	26.0
Funds deposited in accounts with the CBR	9729.8	66.4	10237.6	60.4	8520.7	55.0
including the RF Government's	7145.9	48.8	7093.9	41.8	5441.6	35.1
resident credit institutions'	1097.6	7.5	2010.1	11.8	1214	7.8
Receivables	50.3	0.3	16.1	0.1	52.2	0.3
Issued securities	40.7	0.3	12.5	0.1	111	0.7
Other liabilities	201.6	1.4	319.2	1.9	823.7	5.3
Capital	474.1	3.2	1902.4	11.2	1950.1	12.6
Profit in the banking year	0	0.0	97.8	0.6	0	0.0
Total by liabilities	**14650.3**	**100**	**16963.7**	**100**	**15482.6**	**100**

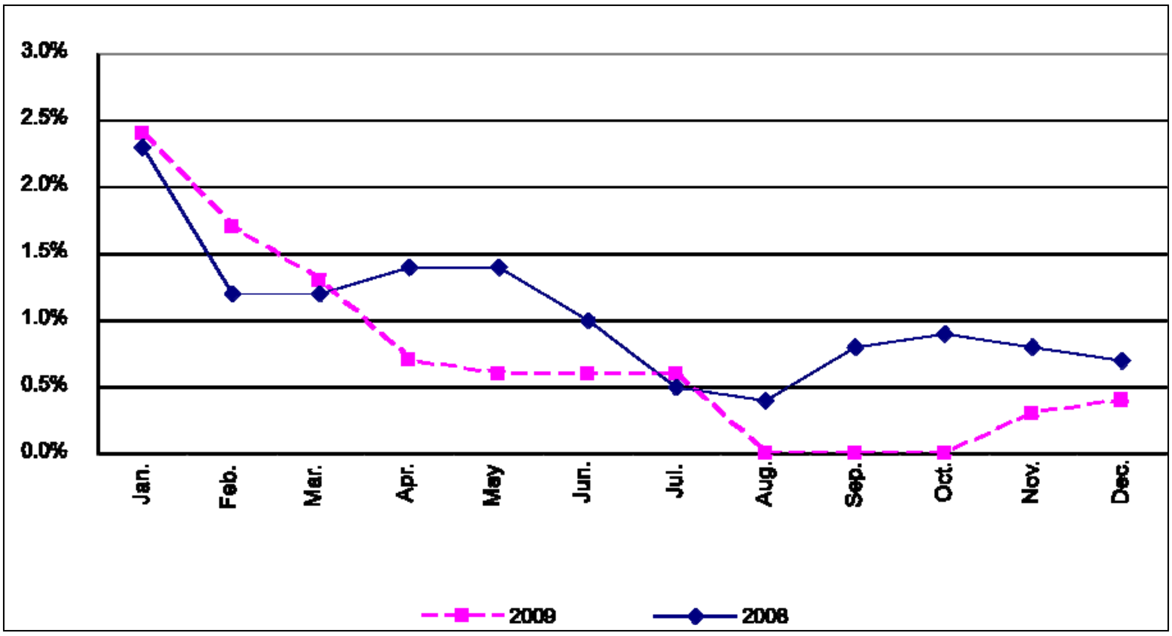
Source: the CBR

Money supply M_2 in national terms increased in 2008 just at 1.7% and as of January 1, 2009, accounted for Rb. 13, 493.2bn, or 32.5% of GDP (as of January 1, 2008, M_2 equaled Rb.1,3272.1bn, or 40.2% of GDP). Main reasons behind such a slow rise of money supply were the CBR's sales of international reserve assets for the sake of protecting the Rb. exchange rate and a fall of the lending activity in the banking system due to the crisis. In 2009, money supply tumbled by 1.4% and by September 1 had hit the level of Rb. 13,305bn (32.5% of GDP). So, in 2009, the monetization rate of Russia's GDP remained at its 2008 level. Compression of money supply in 2009 was noted only in January – at the time, by results of the month it plunged by 11.1% resulting from the CBR's large-scale forex interventions. In the conditions of a high uncertainty about further trends of Russia's economic development, an increase in money supply in the medium term will be determined largely by the situation in the foreign trade sector, velocity of the economy's recovery, and the lending activity in the banking sector.

2.1.2. Inflationary processes

In the first half 2008 inflation remained high compared with the same period of the previous year (*Fig. 2*), with a rapid increase of money supply in late 2007 accelerating the price rise. But in the second half 2008, due to the contraction in international reserve assets the CBR was selling to buoy the Rb. exchange rate, money supply began to contract and the price rise rate started slowing down. In all, by results of the year the CPI hit 13.3% vs. 11.9% reported in 2007, with consumer prices nationwide rising at an average 3.2% between September and December (vs. 4.8% over the same period of the prior year).

But the depreciation of the Rb. in early 2009 triggered an acceleration of the price rise, when the contracting domestic and external demand continued inhibiting it. With the Rb. exchange rate stabilizing, the decline in economic activity has formed a critical factor fanning up inflationary processes and the CPI in Russia accounted for 8.8% by results of the year. Let us examine the 2009 dynamic of the CPI in a greater detail.



Source: the Rosstat

Fig. 2. The Dynamic of Russia’s CPI (Monthly Values) in 2008–2009

Costs of paid services to the population gained 11.6% in 2009 (15.9% в 2008 г.). Between January and December it was prices for housing and utilities (+19.6%), preschool education services (+16.2%), medical services (+13.9%) that posted the highest growth rates. So, the paid services to the population became the greatest contributor to the 2009 increase in the CPI. Prices of non-food goods soared at 9.7% (+ 8% - in 2008). Between January and December it was prices for tobacco goods (+ 18.7%), medicines (+17.6%), washing and cleaning goods (+12.6%), and clothing and linen (+11%) that demonstrated the highest growth rates. Between January and December 2009 food prices surged by 6.1% (16.5% over the same period of the prior year) (*Table 3*). In 2009, it was prices for white sugar (+42.7%), fish and seafood (+10.6%), and liquors (+8.9%) whose contribution to the price rise for foods was the greatest one. The 2009 growth in the basic consumer price index made up 8.3% (13.6% - over the same period in 2008). So, the main factors behind the 2009 inflation slowdown were the declining domestic demand as a result of the crisis, a slow rise of money supply over the first three quarters, and the price downfall for an array of import goods (foods, primarily) on the global market.

As evidenced by data of *Table 3*, it was the rise in the housing and utilities tariffs that has formed the principal inflation component between 2006 and 2009. The respective payments account for a substantial fraction of the households' expenses, particularly because prices of the said services nearly doubled between 2006 and 2009. As concerns the group of non-food goods, it is worth noting the price rise for gas on the backdrop of bouncing upwards prices for energy sources and a very moderate price rise for construction materials, because of an intense slump in the construction sector. Finally, it is important to note a sharp deceleration of price rise rates for foods in 2009.

Table 3

The Annual Price Increate Rates for Individual Kinds of Goods and in 2006–2009 (%)

	2006	2007	2008	2009	2006–2009
CPI	**9.0**	**11.9**	**13.3**	**8.8**	**50.4**
Foods	8.7	15.6	16.5	6.1	55.3
Cream butter	6.8	40.3	10.5	7.9	78.7
Pasta	4.7	23.6	33.8	1.6	75.9
Bread and bakery	11.1	22.4	25.9	2.4	75.3
Gruels and legumes	12.1	24.7	25.8	-2.5	71.5
Milk and dairy products	8.7	30.4	12.2	2.3	62.7
Fish and seafood	7.8	9.0	15.1	10.6	49.6
Sunflower seed oil	-1.2	52.3	22.1	-19.8	47.3
Meat and poultry	5.9	8.4	22.2	5.0	47.3
Non-food goods	6.0	6.5	8.0	9.7	33.7
Construction materials	11.5	16.2	11.3	2.1	47.2
Gasoline	10.9	8.5	1.2	8.0	31.5
Paid services for the population	13.9	13.3	15.9	11.6	66.9
Pre-schooling services	28.5	11.8	20.7	16.2	101.5
Housing and utilities	17.9	14.0	16.4	19.6	87.1
Sanatorium and rehabilitation services	15.2	15.6	21.2	9.5	76.7
Services by organizations of culture	15.6	14.5	15.5	11.3	70.2
Passenger transportation services	14.2	13.6	22.5	6.5	69.3

Source: Rosstat

In conclusion let us compare the price rise rates in Russia with those across the CIS (*Table 4*).

Table 4

Consumer Price Indexes in the CIS in 2000–2009 гг., as % to the Same Period of the Prior Year

	2000	2001	2002	2003	2004	2005	2006	2007	2008	Jan.-Sep. 2009
Azerbaijan	2	2	3	2	7	10	8	17	21	2.1
Armenia	−1	3	1	5	7	1	3	4	9	2.9
Belarus	169	61	43	28	18	10	7	8	15	13.9
Kazakhstan	13	8	6	6	7	8	9	11	17	7.8
Kyrgystan	19	7	2	3	4	4	6	10	25	9.1
Moldova	31	10	5	12	12	12	13	12	13	0.2
Russia	20	19	15	12	12	11	9	12	14	12.5
Tajikistan	24	37	10	17	7	8	12	22	20	7.2
Ukraine	28	12	1	5	9	14	9	13	25	16.8

Souurce: The CIS Intergovernmental Statistics Committee (http://www.cisstat.com/).

It can be noted that the 2009 inflation slowed down in all the CIS countries, while the impact of the global financial crisis on the inflationary processes in Russia and other CIS countries was two-fold.

For one part, the depreciation of the national currency drove up the price rise for imports and the rise in inflationary expectations. The latter were also stirred by the growing financial instability. Finally, the slowdown of the economic activity resulted in a lesser demand for cash, as economic agents lost confidence in the national banking system and were transferring their Rb.-denominated savings into the forex ones.

On the other hand, a sharp slowdown of money supply growth rates sent the monetary inflation down. Let us note that the compression of money supply during the critical phase of the crisis was taking place regardless of sizeable anticrisis public expenditures, as a consequence of economic agents' transferring their savings in forex and the money multiplier being in decline. Finally, a sharp compression of the aggregate demand also exerted a substantial downward pressure on prices.

So, in Russia's conditions, contraction in money supply and in the aggregate demand has led to inflation deceleration. Meanwhile, the stabilization of the state of affairs on the global markets that kicked off in April and the price rise for energy sources have resulted in a significant decline in expectations of a further depreciation of the Rb. exchange rate as early as in the spring 2009. The prices for main Russian exports bounced back, the private capital inflow in Russia was noted in the 4th quarter of the year, while the budget deficit was financed out of the Reserve Fund – all this caused a spike of money supply at the end of the year. Should these inflationary trends be further unfolding in 2010, inflation may not demonstrate its further decline and its rate may account for 8-9%.

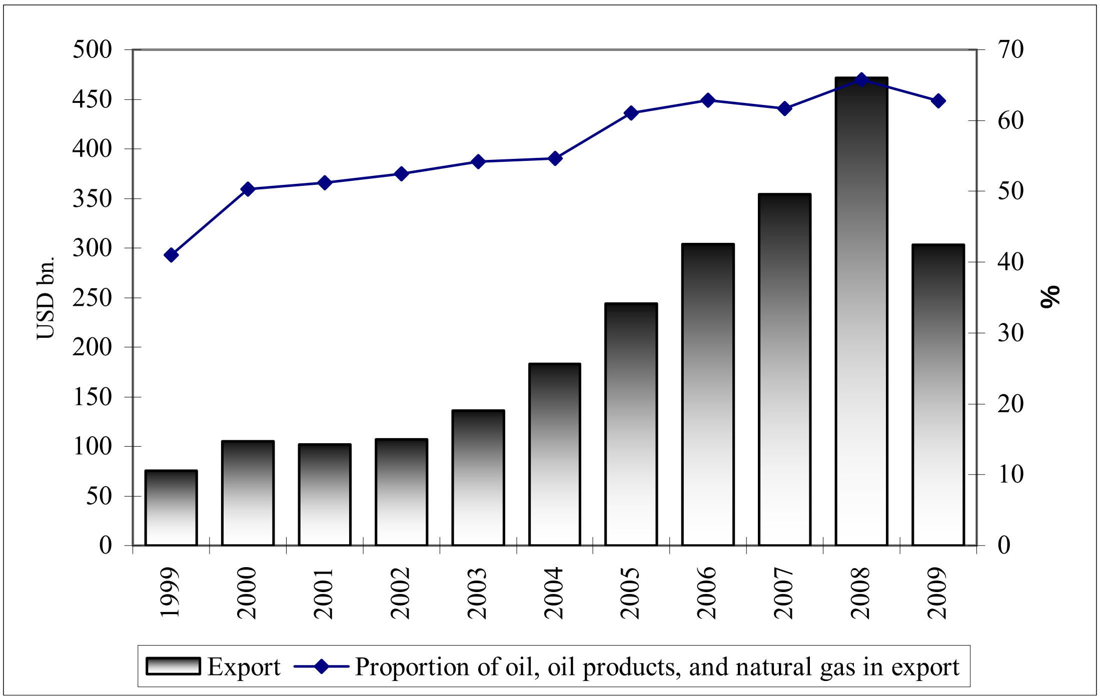
2.1.3. The State of the Balance of Payments[1] and the Forex Market

The sustainability of Russia's balance of payments in 2009 was traditionally secured by its exports, primarily the fuel and energy goods. Meanwhile, the global financial crisis has led to a price downfall for main Russian exports, which is why their ultimate 2009 export volume from RF plunged by 35.7% vs. the prior year. But the restoration of the prices and improve-

[1] Evaluation of the balance of payments was conducted on the basis of preliminary data of the CBR. http://cbr.ru/statistics/credit_statistics/print.asp?file=bal_of_payments_est.htm

ment of the global economy's health since the spring 2009 have resulted in a stabilization of the nation's balance of payments. Ultimately, by the 2009 results, Russia's balance of payments appears fairly sustainable; however in the medium-term the sustainability of the balance of payments will remain exposed to an intensification of the global crisis and an advanced growth in imports in RF vis-à-vis the nation's exports.

According to the published by the CBR's preliminary estimation of the nation's 2009 balance of payments, the positive balance of the current account was USD 47.5bn., i.e. 53.6% down compared with 2008 (*Table 5*). More specifically, down at 38.5% was the positive balance of trade (from USD 139.7bn to 110.6bn), with exports down by 35.7% (from USD 371.6bn to 303.3bn) and imports shrinking at 34% (from USD 291.9bn to 192.7bn). The proportion of oil, petroleum derivatives and natural gas in the aggregate volume of Russia's export was 62.8% (in 2006- 62.8%, 2007 – 61.7%, 2008- 65.8%) (*Fig. 3*). So, like in the recent years, it was the balance of trade that formed a main factor behind the value of the balance of current account. Meanwhile, the balance of the balance in trade in turn is strongly dependent on the dynamic of world prices for energy sources and other main Russian exports. The data presented in *Fig. 4* evidence that the correlation between the world oil prices for oil and the balance of Russia's balance of trade, which was noted between 2002-2008, was still there in 2009.



Source: The CBR.

Fig. 3. Dynamic of Export and Proportion of Products of the Fuel and Energy Complex in 1999–2009

The deficit of the balance of services accounted for USD 19.8bn and tumbled (by its absolute value) by 20.8% vs. its respective value of 2008. Export of services made up USD

42.4bn, thus being USD8.9bn (17.4%) down compared with the prior year. The 2009 value of import of services plunged by 18.6% and accounted for USD 62.1bn.

The 2009 labor compensation balance fell by the absolute value and made up USD -8.7bn (vs. -14.2bn in 2008). The deficit of the balance of investment revenues in 2009 tumbled by 10.4% vis-à-vis 2008 and was USD 31.4bn. Investment incomes due slid from USD 52.2bn to 30bn, which was determined by a substantial drop of the indicator by non-financial enterprises (from USD 28.2bn to 14.2bn) and monetary regulators (from USD 18.3bn to 6.9bn). The fall in incomes due can be ascribed to the global financial crisis and the plunge in the volume of overseas investment. The drop of incomes due across non-financial corporations from USD 73.7bn to 46.4bn was determined by the fall in the aggregate income due from USD 90.2bn to 61.4bn.

The 2009 balance of current transfers[1] accounted for USD -3.2bn (up 4.2% compared with 2008).

So, the main factors underlying the retaining of a considerable positive balance of the current account of Russia's balance of payments in 2009 were prices for main Russian exports that bounced back to their high values in the 2nd-4th quarters of the year. It is worth noting that, despite concerns of potential difficulties the crisis engendered with respect to servicing the private sector's external debt, the national banks and the non-financial sector's indebtedness to overseas economic agents contracted (see *Table 5*) as a consequence of a partial debt restructuring against the background of a notable reduction in the volume of attraction of new debts. One can expect a renewal of the growth rate of the foreign debt in the medium term, and the process should encompass both the private sector and the public one, as the country lacks domestic financial resources which are very costly.

In 2009, determined by stabilization of the state of affairs in the global economy, the absolute value of the balance of the capital account plunged considerably and accounted for USD – 45.2bn. The 2009 balance of capital transfers was -11.7 bn USD. So, without regard to the capital transfers, the 2009 financial account deficit was -33.5 bn USD.

The 2009 ultimate increase in the domestic economic agents' liabilities before overseas economic agents was just USD 6.3bn, or 14.6 times less than in 2008 (USD 92.4bn).

In 2009, the federal public administration agencies became net borrowers before non-residents, with their external liabilities standing at USD 0.8bn resulting from sales of T-bonds to the non-residents. Meanwhile, the balance of external liabilities of the RF Subjects remained practically unchanged. The 2009 rise in the monetary regulatory agencies' liabilities hit USD 11.6bn chiefly due to the Bank of Russia's conducting REPO with foreign counterparts.

[1] According to the CBR, current transfers, e.g. humanitarian relief in the form of consumer goods and services, bolster the level of the disposable income and consumption of goods and services by the recipient and diminish the donor's disposable income and consumption capacity. Current transfers are reflected in the current account. Transfers that are not current by default form capital transfers. Capital transfers result in a change of both the donor and recipient's volume of assets or liabilities and are reflected in the capital account. In the event the donor and the recipient are non-residents towards each other, the capital transfer entails a change in the level of the national wealth of the economies they represent. An example of capital transfers is a non-repayable reassignment of property rights for capital assets, debt forgiveness.

Table 5

Main Items of the Balance of Payments and the Dynamic of the Foreign Debt in 2007–2009 (as USDbn)

Items of the balance	2007					2008					2009				
	I Q	II Q	III Q	IV Q	*Год*	I Q	II Q	III Q	IV Q	*Year*	I Q	II Q	III Q	IV Q*	*year**
Current account	22.6	14.5	15.7	24.2	*77*	38.0	26.2	29.7	8.5	*102.4*	9.3	7.6	15.0	15.6	*47.5*
Capital account**	14.5	48.4	–3.7	26.5	*85.7*	–25.6	35.7	–9.6	–135.5	*–135.2*	–32.0	3.2	–25.4	9.0	*–45.2*
Change in forex reserves («+» means reserves are down, «–» – рост reserves are up)	–32.9	–65.5	–7.9	–42.6	*–148.9*	–6.4	–64.2	–15.0	131.1	*45.3*	30.5	–14.2	9.1	–28.8	*–3.5*
Net errors and omissions	–4.1	2.6	–4.1	–8.2	*–13.8*	–6.0	2.4	–5.0	–4.0	*–12.6*	–7.7	3.5	1.3	4.1	*1.1*
Change in Russia's foreign debt («+» means the debt is up, «–» the debt is down)	41.8	44.2	38.6	33.2	*157.8*	13.6	51.1	12.5	–67.7	*9.5*	–32.8	21.3	9.8	–8.5	*–10.2*
Change in Russia's foreign public debt	3.6	–3.2	3.5	–6.1	*–2.2*	–5.4	–2.1	3.9	–10	*–13.6*	–2.4	4	9.5	0.9	*12*
Change in Russia's foreign debt of the private sector	38.3	47.3	35.2	39.3	*160.1*	18.9	53.3	8.6	–57.8	*23*	–30.5	17.3	0.4	–9.5	*–22.3*

* Preliminary estimate
** With regard to forex reserves.
Source: the CBR.

The continuance of the global financial crisis that has seriously derailed the Russian economic agents' possibilities to attract borrowings for overseas and a vehement restructuring of already attracted loans have led to a USD 43.7bn-worth contraction in the banking sector's liabilities towards non-residents. The overseas economic agents' investment in the Russian non-financial sector made up USD 37.4bn (vs. 97.1bn in 2008). So, the 2009 volume of non-resident investments plunged drastically vs. the respective indicator of 2008, albeit it proved to be far in excess of that to the banking sector. That said, the volume of direct investment in the non-financial sector over the year accounted for USD 38.2bn vs. 63bn. in 2008, while the increase in portfolio investment was in the prior year. In 2009, the volume of the non-financial sector's debt by loans and credits towards non-residents dropped by USD 5.2bn.

Residents' foreign assets (liabilities of foreign economic agents before Russian ones) grew by USD 39.8bn in 2009 (in 2008 – by USD 228bn).

Meanwhile, foreign assets of the federal public administration agencies plunged by USD 10.2bn, while those of banks – by 11.2bn. In contrast, foreign assets of monetary regulatory institutions remained practically unchanged.

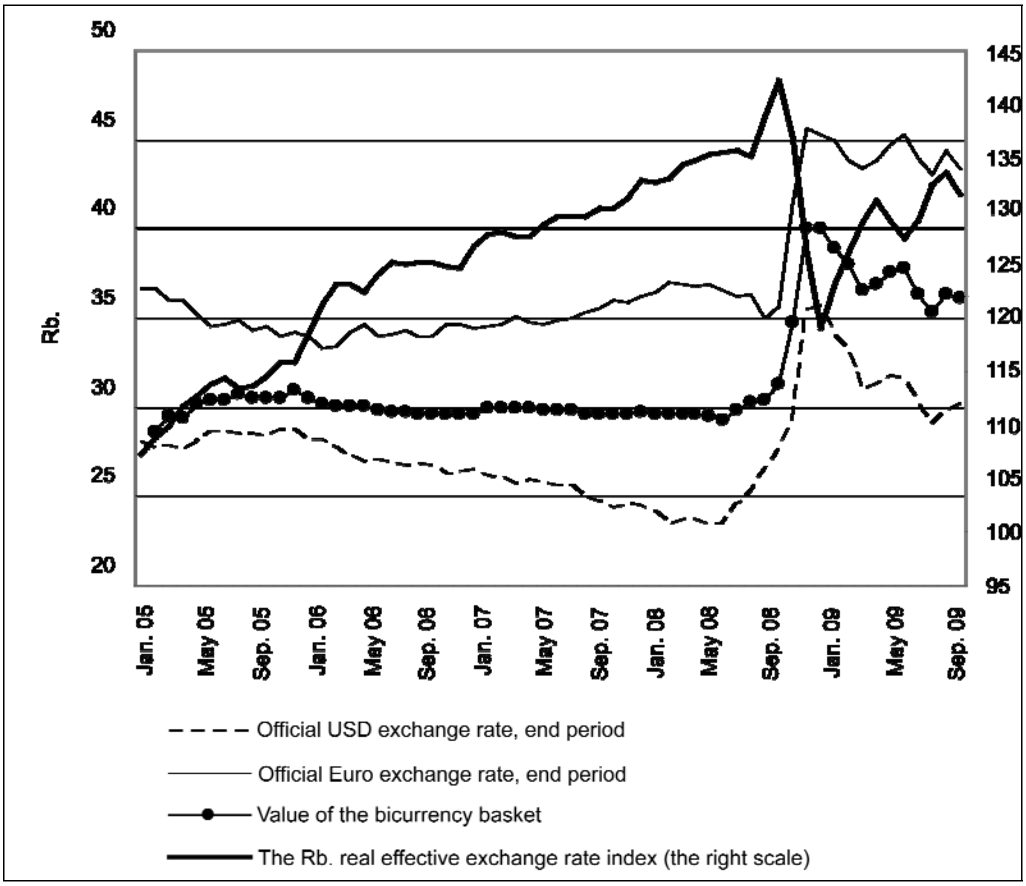
Capital export from the sector of non-financial corporations and households fell by 61.8% vs. 2008 and accounted for USD 61.2bn. The volume of the "not collected on time export proceeds, goods and services not received against monetary transfers by import contracts, transfers by fictitious transactions with securities" also tumbled compared with 2008 and accounted for USD 26.5bn. At this point, it is worth noting that the dynamic of the item "cash foreign exchange" underwent considerable changes – in 2009, Russia saw a USD 3.9bn-worth export of foreign exchange in the cash form, while in 2008 as much as USD 25bn was imported into the country. In other words, once in the autumn of 2008 the Rb. showed the first signs of depreciation towards the bicurrency basket (both in the nominal and real terms), the population and the non-financial sector once again, for the first time since 1997, began vehemently buying foreign exchange. But in 2009, with the situation on the financial markets gradually stabilizing and the Rb. renewing its appreciation trend, the boom on the forex market subsided.

Let us note that during the acute phase of the crisis, that is between November 2008 and February 2009, which was characterized by a large-scale capital outflow and a non-stop price downfall for energy sources, the Bank of Russia allowed a gradual decline of the Rb. rate against the bicurrency basket. In the situation of a considerable fall of Russia's forex revenues, the earlier exchange rate could have been sustained only over a limited period of time by wasting the international reserve assets. That said, as the Bank of Russia was depreciating the Rb. gradually, economic agents found buying forex a relatively low-risk and highly lucrative investment instrument, which led to an increasing demand for forex and the need to spend an increasing amount of the international reserve assets.

We believe in the circumstances a one-time depreciation of the Rb. with a subsequent pegging of the new declared level was the best *modus operandi*, as it would have enabled the CBR to avoid a further waste of reserves and to lower inflationary expectations. We question just the moment picked for a sharp devaluation of the Rb – it can be suggested that in order to save the gold and forex reserves one could have opted for this move far earlier than in early 2009.

As a result, in all between December 2008 and February 2009 the real effective rate of the Rb. slid by 16.3% (see *Fig. 5*). But, driven by the stabilization on the Russian and global financial markets in the spring 2009 and the subsequent price rise for energy sources, the real effective rate of the Rb. renewed its rise and by October had won back over 40% of its value lost due to the earlier drop. Once investors' appetite for risk increased, the USD/Euro rate began to descend, and as a consequence, between March and December the official USD/Rb rate tumbled by Rb. 5.48 – by late December 2009 the USD/Rb exchange rate was 30.24 vs. 35.72 as of February 28, 2009. Meanwhile, the Rb. has grown relative to the bicurrency basket[1] – the value of the bicurrency basket slid by 3.90Rb between March and December – from 40.05Rb. to 36.16 Rb. As a result, the Euro/Rb. rate in the late December was 43.39.

[1] The bicurrency basket constitutes a CBR's forex policy operational benchmark, with the proportion of the Euro in the basket currently accounting for 45% and, accordingly, 55% that of the USD.

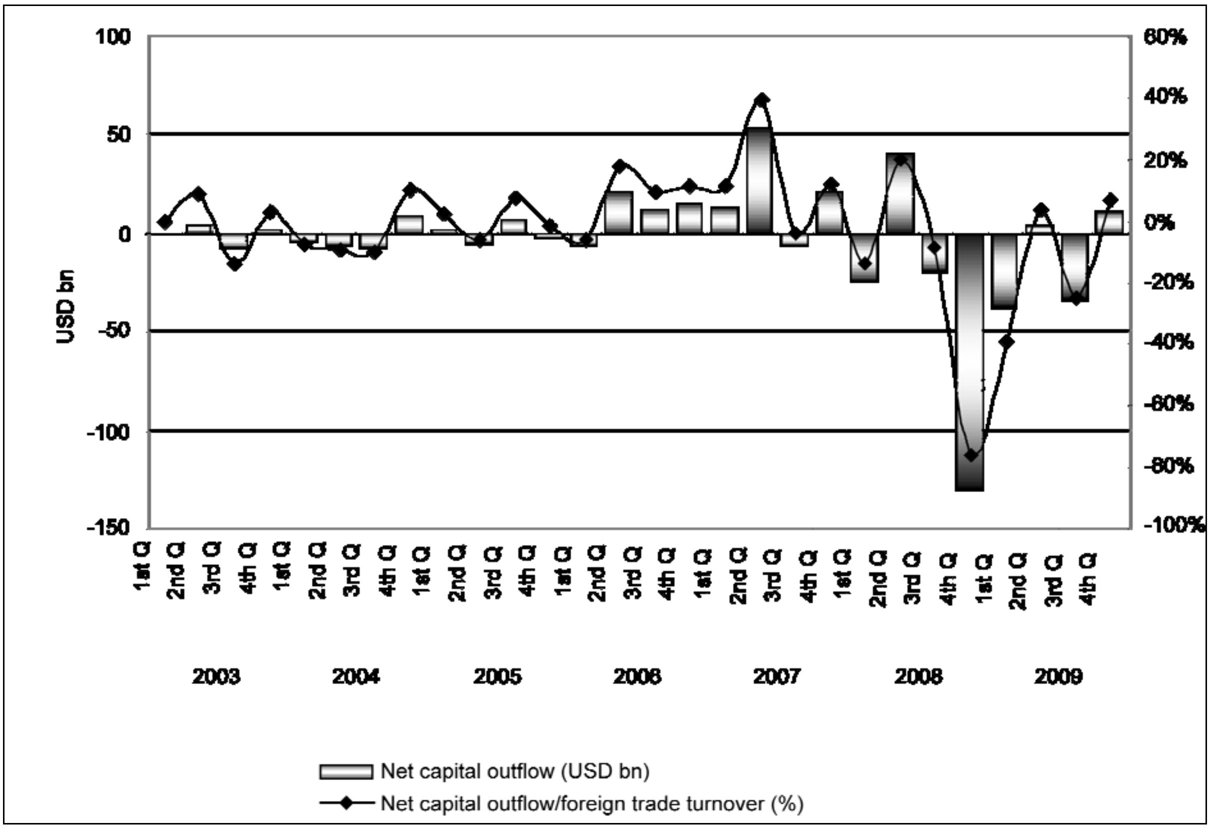


Note: While calculating the Rb. real effective exchange rate, 100= the level as of January 2002
Source: the CBR, the author's calculations.

Fig. 5. Indexes of the Rb. Exchange Rate Between January 2005 – December 2009

So, the CBR's forex policy in the crisis period has basically been smoothing down exchange rate fluctuations without creating obstacles to fundamental changes of exchange rate. More specifically, in the second half 2009, the amplitude of the exchange rate fluctuations was over 15%. By increasing the exchange rate volatility, the CBR creates disincentives for economic agents to play on the forex market. The CBR is going to stick to this tactic in the medium term, too. However, it should be noted that in the event of a further price rise for energy sources and renewal of a large-scale capital inflow, the Rb. will find itself under a considerable upward pressure and the CBR may once again start buying forex in order not to let the Rb. nominal rate surge. In such circumstances, the monetary policy will de-facto replicate the pre-crisis one, which once again will give rise to bubbles on the financial markets, unless the government succeeds in creating additional mechanisms of sterilization of an excessive money supply.

In addition to the contraction of the balance of current account, one of the pivotal trends in the dynamic of indicators of the nation's 2009 balance of payments was the dynamic of net capital outflow from the non-financial sector, which by results of the year hit USD 52.2bn. (in 2008, stirred by the crisis, the respective figure was 132.8bn) (see *Fig. 6*). Meanwhile, the dynamic of the private capital flow was uneven during the crisis. Between the 3rd quarter 2008 and the 1st quarter 2009 the net private capital outflow accounted for USD 186.6bn. In the 2nd quarter 2009, there was noted its insignificant inflow worth a total of USD 4.2bn, which once again was replaced by a -32.2bn outflow in the 3rd quarter of the year. In the 4th quarter 2009, against the investors' growing confidence in stability of Russia's economy (at least, in the short run) and their desire to make money on the appreciation of the Rb, the private capital inflow accounted for USD 11.1bn.

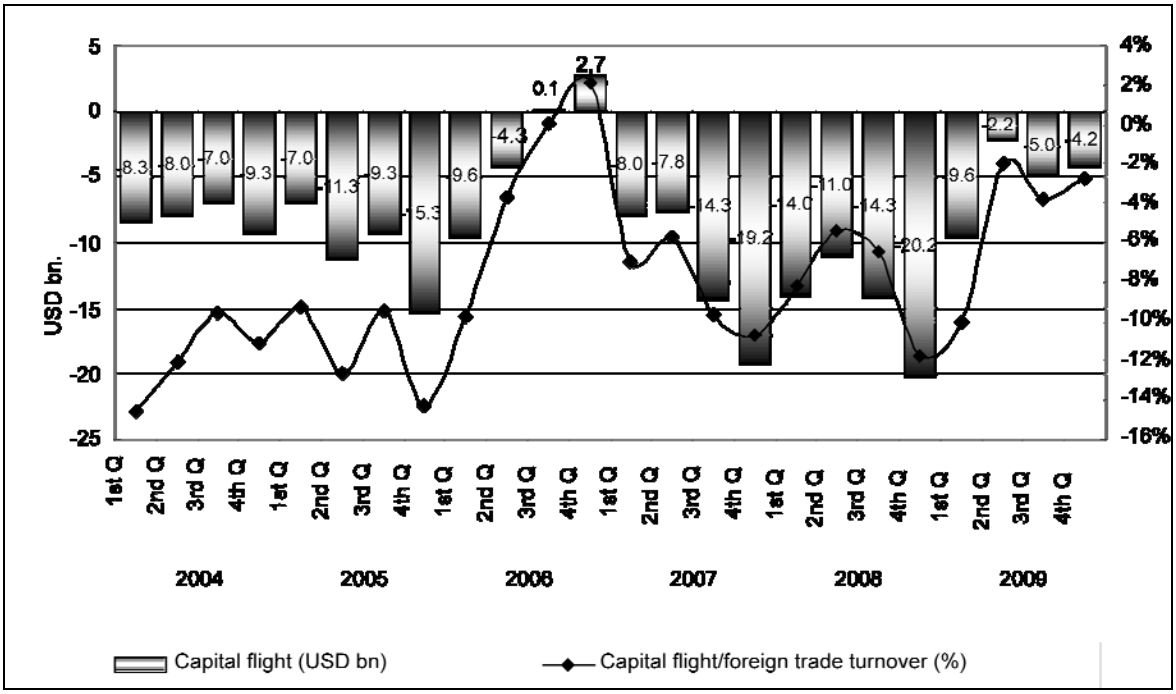


Source: the CBR; the IET calculations.

Fig. 6. Dynamic of the Net Capital Outflow in 2003–2009

The 2009 unofficial capital outflow (capital flight) (*Fig. 7*) also dropped significantly vs. 2008 and accounts, by our estimates[1], for some USD 21bn, or at 38.5bn. less than in 2008. Accordingly, the proportion of capital flight in the nation's foreign trade turnover slid from 7.8% in 2008 to 4.2%.

[1] We calculate capital flight with the use of the IMF methodology, according to which it constitutes the sum of "trade loans and down payments", "not received on time export proceeds and goods and services not supplied against money transfers by import contracts" and "net errors and omissions".



Source: the CBR; the IET calculations.

Fig. 7. Dynamics of the Capital Flight in 2004–2009

As for other peculiarities of the 2009 balance of payments, it is worth noting a remaining high proportion of revenues from energy sources in export of goods. The price downfall for energy sources in the late 2009 exposed the vulnerability of the nation's balance of payments. The oil prices recovery in 2009 and the Rb. depreciation allowed Russia to stabilize its balance of payments, but, with the situation in the economy gradually improving, import began to recover, too. That said, given that between the 2nd and 3rd quarters 2009 the pace of its recovery has been falling behind the one of export, in the 4th quarter of the year the import increase rate practically accounted for 24%, while that of export - just for 15%. Should the tendency persist further on, the positive balance of current account may renew its plunge, which, other conditions being equal, would create a downward pressure on the Rb. exchange rate. However, it should be noted that traditionally, the 4th quarter is the period of seasonal import hikes, and given the current economic stagnation, a further rapid growth in import appears unlikely.

As to the balance of capital account, in the medium term, the dynamic of capital flows to a significant degree will be driven by the situation on the global financial markets. Should the trend of a gradual recovery of the world economy persist, one may expect a net private capital inflow in Russia by results of 2010.

2.1.4. Main Steps in the Monetary Policy

Whatever moves the CBR was undertaking to ensure the financial system's stability, they can be provisionally split into two groups- namely, *the interest rate policy and other measures*.

Speaking of the CBR's interest rate policy in 2008-2009, it can be further broken into two stages. At the first stage, the CBR has been raising the refinancing rate four times (Nov 12, Dec 1, 2008; Feb 2 and 9, 2009). That said, prior to the first raising of the refinancing rate in the crisis period the CBR had lowered rates on a series of liquidity lending instruments without changing the refinancing rate. The move was made in pursuance of facilitation of the access to liquidity for commercial banks. As a result of the four consequent moves, the refinancing rate rose from 11 to 13% annualized and the CBR's lending rates to commercial banks were raised by a comparable value.

Underlying the increase in the interest rates largely was the CBR's desire to increase costs of the resources credit institutions attracted from the Bank of Russia and subsequently invested in forex assets. As a reminder, since January 23, 2009, the CBR set the upper margin of the technical band of the bicurrency basket at the level of Rb 41/USD and declared its readiness to maintain the rate by the margin for a minimum of several months. Meanwhile, already on January 30, after the tax payment period was over and banks had free Rb-denominated liquidity at hand, the value of the bicurrency basket was over Rb. 40. Given that yet back in November 2008 the value of the bicurrency basket was below Rb. 30, buying forex became a very lucrative direction of investment for the domestic economic agents. Expectations of devaluation were fueled by low oil prices that engendered fewer forex revenues in the country and the capital outflow from emerging markets. At that juncture the CBR decided to constrain the banks' capacity for buying forex by increasing for them costs of attraction of Rb.-denominated resources. This move was simultaneously aimed at demonstration of the CBR's commitment to keep the Rb. exchange rate at the selected level, which contributed to a fall of forex buys by economic agents and the subsidence of speculative activities on the forex market. Given that the CBR's resources have increasingly been playing a greater role in the domestic credit organizations' liabilities (see sub-section 2.1.1), the policy indeed helped lower the attractiveness of forex purchases against the background of statements made by the CBR leadership that a dramatic contraction of import between late 2008 and early 2009 enabled it to balance the current account of the nation's balance of payments.

Once the state of affairs on the financial markets began stabilizing, the CBR started to gradually soften its monetary policy. Specifically, between April and December 2009, the CBR lowered interest rates seven times, with the refinancing rate ultimately being brought down from 13% to 8.75% annualized, while rates on the CBR's operations were down at 3.5-4.5 p.p. Underpinning these moves was a drastic deceleration of the pace of lending to the real sector against the background of a lowering inflation. The inflation deceleration enabled the Bank of Russia to lower the costs of resources disbursed to commercial banks without a serious change of the value of the rates in real terms, as the nominal rates were maintained at a level roughly equaling that of inflation.

The decline in interest rates was also fueled by the renewal of influx of forex revenues in the country due to the price rise for Russia's main exports and stabilization of the economic situation worldwide. In the event of a further slowdown of inflation, the CBR may once again lower its interest rates. But we believe an overly drastic softening of the monetary policy in the current circumstances appears unjustified, as it may once again trigger escalation of inflation against the backdrop of the growing budget deficit. Plus, it should be borne in mind that high credit rates banks set for the real sector mirror not only costs of attraction of financial resources, but high credit risks associated with the uncertainty of the future economic dynamic. Hence, renewal of lending to the real sector will become consequent to stabilization of Russia's economy and the recovery of the external demand.

Let us also note that in the crisis period, the CBR's interest rates for the first time ever have grown into an effective monetary policy instrument. That was the result of the growth of the share of the CBR's credits in commercial banks' liabilities, as for them the CBR's resources in the crisis conditions formed practically a sole source of relatively inexpensive funds. Meanwhile, it proved impossible to boost the domestic money supply by purchasing forex by the CBR, either, due to a large-scale capital outflow out of the country and the price downfall for major Russian exports. In other words, the CBR's monetary policy has increasingly become similar to that of the developed nations' central banks that manage the situation on the monetary market by means of interest rates. The CBR's ability to pursue this policy in the future will be determined by the situation on the domestic forex market (the absence of considerable fluctuations in forex flows in and out of the country) and the Bank of Russia's readiness to allow fluctuations of the Rb. exchange rate and to transit to the inflation targeting regime.

As for the CBR's non-interest policy, the shortage of liquidity in the banking system in the autumn 2008 compelled the CBR to undertake a series of extraordinary moves aimed at preclusion of the rise of instability in the national banking sector.

Thus, on October 10, 2008, the State Duma promulgated an act that granted the CBR with the powers to disburse unsecured loans to Russian commercial banks. Such loans can be extended for the term of 6 months to credit organizations whose credit rating is not below a set level. The measure was aimed at supporting the national banking sector that had found itself in a dire situation because of a large-scale capital outflow from the country, a sizeable external debt (under growing expectations of devaluation) accumulated over the previous years, and the crisis in the real sector. Until the adoption of the new act the CBR had been able to disburse loans to Russian commercial banks against securities, forex, receivables under loan agreements or credit institutions' guarantees. But as the banks were in a great need in credit resources, they lacked assets against which they could receive a loan from the Bank of Russia. At that juncture the granting of the possibility to the CBR for disbursement of unsecured loans enabled it to support Russian banks, albeit the move increased risks of an inequitable conduct by the banks that were recipients of such loans. With the financial markets stabilizing, the credit institutions' debt to the CBR was gradually declining. As of January 1, 2010, their aggregate debt before the CBR was Rb. 190 bn, or down by Rb. 1.6trln over the whole 2009. Let us note that in order to maintain the banking system's stability it proved possible to support just a handful of large banks. Most Russian credit institutions *de facto* are not engaged in the classical banking. Rather, they are engaged in schemes related to optimization of taxation, which allows one to tolerate their bankruptcy without serious ramifications for the whole domestic financial system.

To buoy the banking sector in the conditions of the unfolding financial crisis, the CBR began enter into agreements with large Russian banks on compensating a part of their prospective losses due to interbank lending. The Bank of Russia has also assumed an obligation to compensate to the banks a part of their losses with regard to their transactions with other banks whose licenses were subsequently revoked. As of October 1, 2009, the CBR had concluded 18 such agreements. As well, the CBR has also undertaken such measures as provision of the REPO financing against the collateral in the form of an extended list of assets, extension of the term of the REPO lending, provision of subordinated loans to strategic banks, and adoption of the legislation on guarantees by corporate loans. In addition, in order to conduct a bailout of the banking system, the Deposit Insurance Agency has been recapitalized.

Let us note that in order to tame speculation on the forex market, on December 25, 2008, the CBR offered recommendations to credit institutions not to boost up their foreign assets and net balance positions by foreign exchange, whose exercise the Bank of Russia accounted while imposing limits on the credit institutions' participation in forex auctions. The recommendations have failed to preclude mass purchases of forex during the acute phase of the crisis, but they contributed to subdue the boom on the forex market in the course of the stabilization of the financial markets. On July 2, 2009, the CBR announced that due to stabilization of the situation on the domestic forex market, it ruled not to extend the effect of the recommendations. Thus the Bank of Russia demonstrated it was confident that a large-scale capital outflow and depreciation of the Rb. exchange rate in the second half 2009 were unlikely developments.

Finally, on December 30 2009, the CBR modified procedures of the credit institutions' building provisions for losses on loans and advances. In compliance with the effective procedures, credit institutions are bound to provide reserves for possible losses on loans depending on the degree of credit risk. That said, the exercise diminishes the volume of resources available for commercial banks to carry out their current operations.

According to the decisions, credit institutions were granted the right not to increase their reserves on loans through December 31, 2009, in the event:

- the delinquency by the principal debt or interest on the debt has extended for no more than 30 calendar days relative to the effective term;
- the loan is restructured (e.g. in the event of a change of the currency in which the loan has been denominated, modified (the principal debt and/or interest repayment timelines) in the period since October 1, 2008;
- the loan received since October 1, 2008, is used for repayment of an earlier extended loan.

The move was devised to help the banks cope with yet another challenge they had faced when the unfolding crisis battered the national real sector, that is, growth in arrears by earlier disbursed loans. While the arrears growth rates fell in the fall of 2009, the problem of "bad" assets still appears a fairly persisting one and may aggravate once again, should the state of affairs in the national economy deteriorate.

In 2009, the mechanism of extension of subordinated loans to banks has proved to be fairly efficient one, as far as the recapitalization function is concerned, at least, for the largest banks. Provision of the first-level capital to banks with government participation in the current volume is most likely to satisfy their need in capital even in the event the situation develop according to the negative scenario. As to the backbone private banks, should they face capital shortages, there exists a mechanism of implanting the temporary administration therein represented by the Deposit Insurance Agency, which was commissioned to conduct their rehabilitation.

Let us note that without cleaning the banks' balances from problematic assets, regalvanizing the lending to the real sector may take long. Anyway, while tacking this challenge, the government's participation will allow a substantial simplification of the process. To maintain the budget stability, it seems appropriate to replace a fraction of problematic assets with long-term securities backed by the government agencies' guarantees. This can form a plausible mechanism to solve the problem.

Other key monetary policy measures aimed at bolstering the financial stability the Bank of Russia implemented during the financial crisis were:

1. The Board of the Bank of Russia twice (on January 19 and April 23, 2009) ruled to extend the timelines for a stage-by-stage increase of the effective standards of contributions to the Compulsory Reservation Fund (CRF). As a reminder, since October 15, 2008, the Bank of Russia lowered the respective contribution rates – they were set at 0.5% across all kinds of reserved liabilities. On the same date it was ruled to lower the rates for a certain period of time – they should be raised up to 1.5% since February 1, 2009 and to a further 2.5% - since March 1, 2009. On January 19, the Bank of Russia decided to shift the timelines for increase of the standards from the said dates to May 1 and June 1, 2009, respectively. According to decisions made in April, the standards were set for a stage-by-stage 0.5% increase- that is, on May 1, June 1 and August 1. So, the level of all the standards had hit 2.5% by August 1.
   The CBR took the decision because of a complex situation in the domestic financial sector, which was spurred by the global financial crisis. Russian credit institutions may soon face a rise of arrears on extended loans, which would derail their financial standing. Withdrawing liquidity from banks in the form of deductions to the CRF would add to their financial instability. We think that in the event there are no signs of improvement of the state of affairs in the banking sector in the summer 2010, the timelines of the increase of compulsory reservation rates may once again be modified.
   In addition, the Bank of Russia offered credit organizations, regardless of classification groups they are awarded with resulting from their economic standing, the possibility to use the averaging of emergency funds[1]. Lastly, in August 2009 the CBR ruled to shift, since November 2009, timelines of conduct of regulation of emergency funds in such a fashion so that the end of a regulation period would not coincide in time with the period when bank's need in liquidity on the dates of tax payments to the budget is the greatest one.
2. On January 19, 2009, the CBR's Board took a decision to extend the term of asset-backed lending available to banks up to 365 calendar days, while the earlier set maximum timeline for such loans had been 181 days. Besides, on June 15, 2009, there was held the first ever direct REPO auction for the term of 1 year.
   Let us note that in the spring 2009 the CBR has been gradually cutting back on volumes of unsecured lending, and with the economy stabilizing, the Bank of Russia is in transition towards "long" loans backed by papers. We find this move to be a right one – it will contribute to solidification of the financial stability and increase in the CBR's influence on interest rates.
3. On February 9, the CBR's Board decided to extend the Bank's Lombard list, ie the list of securities against which commercial banks may attract the Bank of Russia's resources. Added to the list were stock and bonds issued by companies enumerated in the list of strategic backbone corporations approved by the government commission on increase of stability of the Russian economy's development. That said, such papers should be included in the quotation list of at least one exchange operating in the territory of the Russian Federation. The CBR started to accept such corporations' promissory notes and credit contracts as a security against disbursed loans.

[1] The averaging of emergency funds enables credit institutions to hold on their corresponding accounts and use in settlements a fraction of emergency funds equaling the averaging coefficient.

The move pursues the goal of boosting the banking system's demand for these issuers' papers and, accordingly of bolstering the opportunity for them to attract financing. Meanwhile, it should be remembered that while providing liquidity to banks against such papers, the CBR assumes the risks associated with a possible aggravation of the strategic corporations' standing. Plus, the extension of the Lombard list should improve the standing of those credit institutions on whose balance sheet there are securities issued by backbone corporations whose papers were not previously been included in the Lombard list, as such banks can now get financing against such papers.

4. On March 27, the Bank of Russia announced changes in the methodology of calculation of the Russian commercial banks' statutory requirements. In compliance with the ruling, first, participation of public corporations in legal entities' authorized capital is not regarded as the grounds for classification of these legal entities as a group of associated borrowers for the sake of calculation of a rate of the maximum size of the risk per borrower or a group of associated borrowers (N6). The rate is calculated as the bank's calls to the group of associated borrowers to the bank's capital ratio. In all likelihood a number of banks have found it hard to comply with N6 due to the financial crisis and the public companies' participation in numerous corporations' capital. So, the decision can be regarded as a softening of regulation for such banks.
Second, the Bank of Russia decided to set a 50% risk coefficient with regard to credit calls to open-end joint-stock companies that meet the natural monopoly criteria, providing they are included in section 2 of the List of Strategic Corporations and Strategic Joint-Stock Companies as well as providing the companies' securities have been included in the Bank of Russia's Lombard list. The measure, too, is to soften for banks restrictions on lending to such corporations from the perspective of the credit risk rate.
5. On April 10, the CBR ruled to raise credit limits by unsecured loans extended to credit organizations that, at the same time, meet the following criteria:

- their long-term international credit rating is not below B (by the S&P and Fitch's classification) or below B3 (by the Moody's classification);
- they have decided to convene the general shareholder meeting of the credit organization, with the issue of its reorganization in the form of merger or acquisition on its agenda, and submitted the respective information to the Bank of Russia;
- they have got agreements by which creditors lodged a claim to the said credit organizations on an early execution of their obligations in connection with the rise of developments determined by the reorganization, and submitted the respective information to the Bank of Russia.

So, the CBR has extended its possibilities to provide financial aid to credit organizations engaged in M&A processes. This move can be regarded as a positive one, as Russia's banking system appears overly fragmented, with most banks not actually exercising the classical banking functions. In the circumstances, encouraging consolidation in the sector proves to be a fairly justifiable move on the part of the monetary regulator.

On May 26, the CBR approved modifications of the methodology of calculation of credit institutions' capital. In compliance with the novelties, banks can increase their Core Tier 1 capital at the expense of a string of subordinated loans that must satisfy the conditions of longevity (for the term of not less than 30 years), non-cumulativity (the unpaid interest on them is not refunded, nor accumulated), as well as the possibility to cover the credit organization's losses. Meanwhile, the overall volume of included in the capital subordinated loans with additional conditions is capped at the level of 15% of the value of the Tier 1 capital.

Thus, the CBR has de facto softened its requirements to sufficiency of the credit organizations' capital. The move was dictated by the growth of arrears and, accordingly, the need for securing reserves against potential losses. In so doing, it is important to bear in mind that such moves do not resolve the problem of growth in arrears debts *per se* nor they give banks additional resources to overcome that. Rather, they were devised to preclude the rise of an inconsistency between the large banks' reporting and the regulator's requirements, which may trigger negative systemic effects on the financial market.

7. On June 19, the Board of the Bank of Russia introduced a number of amendments to the Instruction "On compulsory standards for banks" which is one of the pivotal ones for the domestic credit organizations, as it sets compulsory standards failure to comply with which can result in the license revoking. The main amendments are:

- a considerable increase in the minimum amount of the credit institution's own capital (from euro 500,000 up to Rb. 180m);
- setting a 70% risk coefficient by mortgage loans that meet the following conditions combined – the bank's own capital sufficiency rate (N1) and the maximum amount of risk per one borrower or a group of associated borrowers (N6);
- setting a 10% decreasing coefficient on calls by mortgage loans extended to the military who partake in the savings-and-mortgage system;
- exclusion of an increased (1.3) risk coefficient with regard to calculation of N1 standard by calls to credit institutions that are members of the same group as the lending bank;
-Vnesheconombank, which, in compliance with the federal act "On the development bank", is a public corporation that performs banking operations while exercising its function, has become subject to the same approaches to risk (credit, liquidity) assessment as the ones applied to resident banks of RF;
- calls towards resident banks of RF that have arisen with respect to transactions completed between October 14, 2008 and December 31, 2009, in the part subject to the CBR's compensation have been now classified as risk-free assets;
- calculation of the acid test ratio (N2) encompasses liquidity placed with resident banks of RF for the term of 1 day or on demand that are on the balance sheet for no longer than 10 calendar days discharge of obligations by which as per an agreement is provided for not later than on the date following the day of their demand and on condition the said assets are recognized as the 1st –class quality loans;
- the international development banks' committed loans have been classified as liquid assets for the sake of calculation of the current liquidity (N3);
- classification as highly liquid and liquid of cast interest claims with respect to the 2nd-class quality assets as per CBR's Statute of March 26, 2004, №254-П and on the 1st- and 2nd –class quality assets as per CBR's Statute of March 20, 2006, №283-П for the sake of calculation of standards N2, N3.

Overall, the amendments were of a qualifying nature and have brought the law on compulsory standards in consistency with the realities of the crisis. We regard their introduction as an attempt to spur concentration in Russia's banking system for one part, and to soften to some degree standards in the crisis conditions, on the other hand.

8. In compliance with federal act of October 13, 2008, № 173-FZ "On additional measures on support of the financial system of the Russian Federation", the CBR extended Rb. 500bn

in subordinated loans to Sberbank of Russia under 8% annualized with the term of credit until December 31, 2009. Besides, in compliance with the federal act, Rb. 410bn (resources of the National Welfare Fund) may be deposited with the VEB in order to disburse loans to Russian credit institutions. As of October 1, 2009, as many as 14 banks were granted subordinated loans worth a total of Rb. 267.4bn, including 225bn. extended in loans to two banks in 2008 and another 42.4bn. – to twelve banks in 2009.

The moves have boosted recapitalization of a number of large banks that had found themselves under pressure of a rapidly mounting delinquency. It should be noted though that with the economic situation stabilizing, demand for such loans plunged considerably.