

**RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES**  
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## Budgetary and Tax Policy

According to the tentative performance of the budget in terms of revenues as of August 2006, the level of revenue of the RF federal budget made 24.29% of GDP; the expenditures accounted to 15.47% of GDP, budget surplus has come up to 8.82% of GDP. Within January - July of 2006 the RF consolidated budget revenues made 36.5% of GDP, consolidated budget expenditures made 25.4% of GDP, and consolidated budget surplus accounted to 11.2% of GDP. As of September 1, 2006 the volume of financial reserves of the RF Stabilization Fund made RUR 1 730.64 billion (13.3 % of GDP, whereas on August 1 of the current year it has reached RUR 2,207.33 64 billion (12.3 % of GDP).

### The State of the Federal Budget

According to the tentative estimates of the federal budget execution on cash basis, made by the RF Ministry of Finance, the federal budget was executed in terms of revenue in the amount of RUR 4 018.7 billion (24.29% of GDP), in terms of expenditures – in the amount of RUR 2 560.12 billion (15.47% of GDP). The budget surplus made RUR 1458.58 billion (8.82% of GDP). It should be noted that the amount of revenues of the federal budget within January-August of 2006 in absolute terms was significantly higher than the respective indicator of the relevant period of 2005 (RUR 3 236.64 billion); nevertheless, some decline was registered in the relevant period with regard to GDP (24.94% of GDP in 2005). The amount of federal budget expenditures throughout January-August 2006 has grown in nominal terms in comparison with the relevant period of the year 2005 (RUR 2 063.70 million); however, in relation to GDP it demonstrated a certain decline (RUR 15.9% of GDP in 2005). As to the federal budget surplus in January through August of the current year, in absolute terms it was also higher than the relevant indicator of 2005 (1,172.94 billion), whereas in relation to GDP it has declined (9.04% of GDP in 2005).

The amount of federal budget revenues in July through August 2006 made respectively the RUR 524.67 billion and RUR 562.28 billion, i.e. 22.45% and 23.26% of GDP for a month. Expenditures borne by the federal budget in July through August 2006 made respectively RUR 338.1 billion (14.46% of GDP) and RUR 351.62 billion (14.55% of GDP). The budget surplus made RUR 186.55 billion and 210.65 billion accordingly, i.e. 7.98% and 8.71% in relation to GDP. Therefore, basing on the results of August, an increase of revenue and expenditure of the federal budget in absolute terms can be registered with regard to preceding month as well as in relation to the monthly GDP. These circumstances determined an increase in the surplus of the federal budget, in the nominal terms and in terms of the share in GDP versus the respective indicators, registered in July of this year.

For the structure of revenues over the period under observation, see Table 1.

*Table 1.*

**Amounts of Revenues to the RF Federal Budget  
(per cent of GDP in terms of cash basis execution)**

	Execution on Cash basis		
	August 2005	July 2006	August 2006
Taxes and other payments administered by the Federal Tax Service	13.56%	13.20%	13.05%
Taxes and other payments administered by the Federal Customs Service	9.42%	9.41%	9.44%
Receipts administered by the Federal Agency for Management of Federal Property	0.21%	0.22%	0.27%
Revenues of the federal budget administered by other federal structures	1.76%	1.58%	1.48%
<b>Total revenues</b>	<b>24.94%</b>	<b>24.41%</b>	<b>24.24%</b>

As one can see in Table 1, in August of 2006 the structure of tax revenues as broken by individual sections did not practically change in comparison with the data registered in July and August of 2005. Thus, the bulk of the tax revenues was associated with the taxes and other payments administered by

the RF Federal Tax Service, their share in GDP made 13.05 %, as compared with 13.56 % of GDP registered in August of 2005 and 13.2 per cent of GDP in July of the current year. The revenues administered by the RF Federal Customs Service were somewhat higher than the respective indicators observed in August of the current year and has somewhat grown as to the respective period of the preceding year (by 0.21 per cent of GDP). Finally, the scope of expenses of the federal budget, administered by other federal authorities, has demonstrated some decrease in August of the current year versus the relevant indicators of the preceding year (1.76 per cent of GDP) and vs. July of the current year (0.22 per cent of GDP). As concerns the rest of the revenues of the RF federal budget administered by other federal structures, in August they have made 1.76 per cent of GDP, therefore, this amount has insignificantly decreased in comparison with the respective figures registered in the preceding year July of the current year (1.58 per cent of GDP).

For the preliminary data on the financing of the expenditures borne by the RF federal budget in January through August of 2005 and 2006 presented by the RF Ministry of Finance, see Table 2.

*Table 2.*

**Amounts of Financing of the RF Federal Budget Expenditures (in per cent of GDP)**

	Financing of Expenditures		
	January-August 2005	January-July 2006	January-August 2006
Federal issues	3.03%	2.87%	2.56%
Including expenditures associated with the servicing of the public and municipal debt	1.47%	1.05%	0.90%
National defense	3.16%	3.21%	2.89%
National security and law enforcement	2.42%	2.64%	2.31%
National Economy	1.17%	1.37%	1.26%
Housing and public utilities	0.03%	0.26%	0.23%
Environmental protection	0.03%	0.03%	0.03%
Education	0.85%	0.92%	0.83%
Culture, cinematography and mass media	0.24%	0.26%	0.23%
Health care and sports	0.49%	0.72%	0.64%
Social policy	0.98%	1.13%	0.97%
Interbudgetary transfers	6.74%	7.59%	6.58%
<b>Total expenditures</b>	<b>19.14%</b>	<b>20.99%</b>	<b>18.55%</b>

It should be noted that in January through August of this year the share of financed expenditures of the federal budget in GDP made 18.55 per cent, what was significantly lower than the respective indicator registered in January through August of 2005 (19.14 per cent) and in January through July of the current year (20.99 per cent). Comparison of the structure of expenditures shows that in 2006, similarly to the figures registered a year ago, the largest amount of financing was allocated in the sphere of interbudgetary transfers (6.58 per cent of GDP as compared to 6.74 per cent of GDP in 2005). As concerns other most significant flows of expenditures, there were also respective differences. Thus, in January through August of 2006 the expenditures for federal issues made 2.56 per cent of GDP (3.03 per cent of GDP in 2005), including 0.9 per cent of GDP for the servicing of public and municipal debt (1.47 per cent of GDP in 2005); for national defense (2.89 per cent of GDP as compared with 3.16 per cent of GDP registered in 2005); housing and public utilities (0.23 per cent of GDP as compared to 0.03 per cent of GDP in 2005). As concerns other largest expenditure items, the differences were less significant. Thus, the expenditures on national security and law enforcement in January through August of this year made 2.31 per cent of GDP as compared to 2.42 per cent of GDP a year ago; for national economy expenditures made 1.26 per cent as compared to 1.17 per cent in 2005. Other expenses throughout January-August 2006 totaled to 2.95 per cent of GDP as compared to 2.62 per cent of GDP in January through August 2005. As concerns the comparison of other expenditures made in January through July and throughout January-August 2006, one can see from the Table, that expenditures made in August were either decreased or remained at the level of the preceding month.

Table 3.

**Execution of the RF Consolidated Budget in January through May of 2006  
(in per cent of GDP)**

<b>2003</b>												
	<b>I</b>	<b>II</b>	<b>III</b>	<b>IV</b>	<b>V</b>	<b>VI</b>	<b>VII</b>	<b>VIII</b>	<b>IX</b>	<b>X</b>	<b>XI</b>	<b>XII</b>
Taxes*	25.6%	24.4%	25.6%	27.4%	27.1%	26.0%	26.1%	25.7%	5.0%	5.0%	5.1%	25.2%
Revenues	32.0%	30.3%	31.5%	33.4%	33.6%	32.2%	32.2%	31.6%	0.9%	0.8%	0.7%	31.1%
Expenditures	20.7%	25.3%	27.7%	28.8%	28.8%	28.6%	28.7%	28.5%	3.2%	7.8%	7.9%	29.7%
Deficit/ Surplus	11.3%	5.0%	3.8%	4.5%	4.7%	3.5%	3.6%	3.1%	.7%	.0%	.8%	1,4%
<b>2004</b>												
	<b>I</b>	<b>II</b>	<b>III</b>	<b>IV</b>	<b>V</b>	<b>VI</b>	<b>VII</b>	<b>VIII</b>	<b>IX</b>	<b>X</b>	<b>XI</b>	<b>XII</b>
Taxes*	6.1%		21.8%	27.4%	27.4%	26.6%	27.2%	27.1%	26.4%	26.5%	26.9%	26.8%
Revenues	30.6%	28.2%	29.8%	32.9%	32.9%	32.5%	33.1%	32.9%	31.9%	32.0%	32.3%	32.3%
Expenditures	18.5%	22.8%	25.4%	27.3%	26.9%	27.0%	27.0%	26.9%	26.0%	25.9%	26.1%	27.8%
Deficit/ Surplus	12,1%	5.4%	4.4%	5.6%	6.0%	5.5%	6.1%	6.0%	5.9%	6.1%	6.2%	4.5%
<b>2005</b>												
	<b>I</b>	<b>II</b>	<b>III</b>	<b>IV</b>	<b>V</b>	<b>VI</b>	<b>VII</b>	<b>VIII</b>	<b>IX</b>	<b>X</b>	<b>XI</b>	<b>XII</b>
Revenues	48.8%	40.3%	40.3%	40.8%	38.8%	38.2%	37.6%	37.0%	36.0%	35.9%	35.8%	36.1%
Expenditures	22.2%	23.3%	24.9%	27.1%	26.5%	26.6%	26.7%	26.6%	27.2%	26.1%	25.9%	28.1%
Deficit/ Surplus	26.5%	17.0%	15.4%	13.7%	12.3%	11.6%	11.0%	0.5%	8.8%	9.8%	10.0%	7.9%
<b>2006</b>												
	<b>I</b>	<b>II</b>	<b>III</b>	<b>IV</b>	<b>V</b>	<b>VI</b>	<b>VII</b>	<b>VIII</b>	<b>IX</b>	<b>X</b>	<b>XI</b>	<b>XII</b>
Revenues	36.2%	34.4%	37.9%	37.1%	37.2%	36.9%	36.5%					
Expenditures	17.6%	21.0%	24.2%	25.4%	24.7%	26.6%	25.4%					
Deficit/ Surplus	18.7%	13.4%	13.6%	11.7%	12.5%	10.3%	11.2%					

At the end of the first seven months of 2006, the revenues of the RF consolidated budget made 36.5 per cent of GDP as compared with 37.6 per cent of GDP, registered in the respective period of 2005. The expenditures of the consolidated budget have reduced as compared with the respective indicator of 2005 and made 25.4 per cent of GDP (against 26.7 per cent of GDP). The surplus of consolidated budget in 2006 made 11.2 per cent of GDP, what is somewhat higher of the 2005 figure (11.0 per cent of GDP).

Therefore, in January through July of 2006, there was observed some decrease in the revenues of the RF consolidated budget, while the expenditures were significantly decreased in terms of their share in GDP in comparison with the respective figures of 2005, what caused some growth of the surplus of the consolidated budget. Besides, in September the RF Ministry of Finance has published the data of the RF enlarged government on the budget execution in January through July of 2006. In accordance with the presented indicators, the amount of revenues of the enlarged government for the period under review made 40.5 per cent of GDP, the expenditures made 28.8 per cent, whereas the surplus made 11.7 per cent of GDP.

As of September 1, 2006 the financial reserves of the RF Stabilization Fund made RUR 1,730.64 billion (13.3 % of GDP) as opposed to RUR 2,207.33 billion (12.3 per cent of GDP) on August 1 of the current year.

### **Major developments in the budgetary sphere.**

In September the Ministry of Finance has announced that it is planned to finalize the work on amendments to the RF Tax Code provisions, related to transfer pricing issues. Sergey Shatalov, the Deputy Finance Minister, has informed that the draft legislation is being reviewed by the Government for nearly two years, but the issue is still acute, though the legislation still needs refinement. Thus, experience and tendencies of development of other countries, related to this problem, should be taken into consideration. He has also noted that by the end of the current year Ministry of Finance will complete the work on allocation of a separate field for VAT in payment orders. Besides, in 2007 the gov-

ernment can adopt a law, introducing the system of VAT taxpayers' registration, starting from the year 2008. The basic purpose of such registration, according to the Public Officer, is exemption of a lot of companies, especially small ones, from VAT payment and registration for VAT purposes. Besides, the registration will significantly reduce the number of businesses, enjoying the right for tax deductions. Currently there are 2 million of legal persons registered in the RF, a lot of them are supposed to be VAT payers, but they do not submit tax returns. S. Shatalov has also mentioned an issue of the unified social tax. According to his opinion, now Ministry of Finance is not ready to revise this tax rate. Nevertheless, he has admitted that in future payments made for obligatory pension insurance, and possibly also for obligatory medical insurance, will be made individually (rather than tax-related payments).

## Review of the RF Federal Budget Draft for 2007<sup>1</sup>

In August the RF government has presented a draft law "On the RF Federal Budget for 2007". Some comments on the revenues and expenditures of the budget and sources of financing of the federal budget deficit are presented below. The data on the amount of the RF federal budget revenues of 2006 and 2007 are shown in Table 4.

Table 4

**Key Indicators of the RF Budget Revenues for 2006 and 2007**

	2006 - approved		2006 forecast for execution		2007 - draft	
	RUR, mln	% of GDP	RUR, mln	% of GDP	RUR, mln	% of GDP
<b>Revenues including:</b>	<b>5 046 137.5</b>	<b>20.7</b>	<b>6 159 066.6</b>	<b>22.6</b>	<b>6 449 367.8</b>	<b>22.3</b>
Tax revenues	3 167 825.9	13.0	3 579 923.0	13.2	3 928 669.4	13.6
Non-tax revenues	1 878 311.6	7.7	2 579 143.6	9.5	2 520 698.3	8.7
<b>Deductions to Stabilization Fund</b>	<b>857 477.4</b>	<b>3.5</b>	<b>1 703 532.9</b>	<b>6.3</b>	<b>1 565 456.1</b>	<b>5.4</b>
<b>GDP</b>	<b>24 380 000</b>		<b>27 220 000</b>		<b>28 907 407</b>	

\* Prices of 2006.

Reviewing the basic factors which led to the RF macroeconomic indicators growth, an emphasis should be made on GDP growth, changes in import and export volumes, raise of profits of large enterprises, growth of output and sales of products subject to excise duties, enlarged extraction of mineral resources, growth of other volumetric indicators, raise of prices for Urals oil, change of prices for natural gas. Major tax innovations which decreased revenues as compared to 2006 budget execution were the transfer from administrative procedure of VAT refund to the exporters, paid by them on material resources, to the procedure of refund upon an application, reduction of the total profits tax base of enterprises by the amount of losses incurred in previous years, shorter time lines for writing-off the expenses on R&D with regard to enterprise profit tax and lower rate of tax on natural resources production, which is an incentive to continue exploration of mature oil fields and establishment of zero rate for mineral resources production tax on new oil fields. Reduction of revenues caused by amendments in tax legislation was partially recovered by the new excise rates introduced by the RF Tax Code. As to amendments to the budgetary legislation, there should be noted a transfer from the federal budget to the budgets of the RF Subjects of a part of the tax on mineral resources production, applied to diamonds, single payments for the usage of subsurface resources in certain cases, specified in the license for the usage of subsurface mineral resources on the RF territory, applied to the diamond deposits.

Reviewing the aggregate structure of revenues in the draft federal budget for 2007, one can notice a significant growth of the budget tax revenues in absolute terms in comparison with the budget law and its execution forecast for 2006. Alongside with that, some reduction of budget non-tax revenues in nominal terms is forecasted for 2007 as compared with the indicators of 2006. In terms of the shares in GDP the dynamics is somewhat different. Thus, if the share of tax revenues of the 2007 budget should make 13.6 per cent of GDP (as compared with 13.0 and 13.2 per cent of GDP specified in the budget

<sup>1</sup> Complete text of the Review of the federal budget draft for 2007 is available at the official IET site: [www.iet.ru](http://www.iet.ru)

law and its execution forecast for 2006 accordingly), the share of non-tax revenues in the budget of 2007 considerably exceeds the level specified in the budget law for 2006 (7.7 per cent of GDP); however, this level is somewhat lower than the forecasted indicators of the current year (9.5 per cent of GDP).

The structure of federal law revenues from basic taxes in 2007 is presented in Table 5.

Table 5

**Structure of Federal Budget Revenues from Basic Taxes in 2006 and 2007**

Tax	Budget law 2006 (RUR, mln)	Forecast for 2006 г. (RUR, mln)	Forecast for 2007 (RUR, mln) *
Enterprise profit tax	344 838.10	451 364.80	537 415.56
Unified social tax, transferred to the federal budget	302 090.20	310 412.10	341 457.31
VAT	1 634 342.60	1 534 485.30	1 918 326.20
Excise duties	110 187.50	107 507.50	117 299.44
Export-import taxes	1 607 843.30	2 261 555.00	2 216 836.76
Tax on mineral resources production	731 570.30	1 127 660.30	960 870.00

\* Prices for 2006.

Basing on the data presented in Table 5, a conclusion can be made, that increase of revenues is forecasted in 2007 for practically all basic taxes, excluding tax on mineral resources production and export-import taxes. The most significant gain is expected from value-added tax (growth by 25 per cent as compared with 2006 indicator) and enterprise profit tax (growth by 19.1 per cent), whereas revenues from excise duties and unified social tax might grow by 9.1 and 10.0 per cent accordingly. Therefore, regardless of a series of tax innovations, expected in 2007, total revenue from the basic taxes of the RF fiscal system will be increased. A comparison of expenses should be made between the RF budgets of 2006 and 2007, which is presented in Table 6.

Table 6

**Key Indicators of the RF Federal Budget Expenses for 2006 and 2007**

	2006 г. – утверждено		2006 г. – прогноз исполнения		2007 г. – проект	
	RUR, mln	% of GDP	RUR, mln	% of GDP	RUR, mln	% of GDP
<b>Expenses including:</b>	4 270 114,7	17,5	4 388 603,0	16,1	5 058 777,7	17,5
Interest expenditures	198 482,2	0,8	192 380,0	0,7	145 227,1	0,5
Non-interest expenditures	4 071 632,5	16,7	4 196 223,0	15,4	4 913 550,6	17,0

\* Prices of 2006.

Upon comparison of the presented indicators a conclusion can be made that according to the budget draft for 2007, a significant growth of expenses of the federal budget is expected in absolute terms in both, the budget law of 2006 and in the estimated budget execution for the current year. In regard to the share in GDP, the level of budget expenses for 2007 remained at the level approved by the budget law for 2006 (17.5 per cent of GDP) and happened to be much higher than relevant execution estimates (16.1 per cent of GDP). Alongside with the above, the Table shows that the total growth of budget expenses resulted from increase of non-interest revenues, where they have raised to 17.0 from 16.7 per cent of GDP specified in the budget law of 2006 and from 15.4 per cent of GDP according to execution forecast of the year results. One of the major reasons of such a noticeable growth of non-interest revenues of the federal budget for 2007 was the Letter of the RF President to the Federal Assembly, where a number of priority trends of the national policy for 2007 were outlined. In particular, a number of targets in social policy and welfare, national economy and interbudgetary relations were pointed out as priority trends. Provisions of the President Letter concerning the improvement of demographic situation in Russia are also taken into regard in the estimates of the budget expenditures for 2007.

Now the structure of the draft federal budget expenditures will be considered and compared with the structure of expenditures in the current year according to the budget law of 2006 and with regard to the introduced amendments (Table 7).

Table 7

**Structure of Federal Budget Expenses in 2006 and 2007**

	2006				2007	
	Budget law (RUR, mln)	% of GDP	Amended indicator (RUR, mln)	% of GDP	Draft (RUR, mln)	% of GDP
Federal issues	638 885.6	2.62	642 055.4	2.36	760 508.8	2.63
Including expenditures associated with the servicing of the public and municipal debt	198 482.2	0.81	197 786.3	0.73	145 227.1	0.50
National defense	666 026.6	2.73	659 258.1	2.42	760 344.4	2.63
National security and law enforcement	541 634.6	2.22	539 496.5	1.98	615 566.7	2.13
National Economy	339 334.0	1.39	346 839.0	1.27	459 145.6	1.59
Housing and public utilities	38 883.2	0.16	53 470.7	0.20	46 158.4	0.16
Environmental protection	6 334.3	0.03	6 435.0	0.02	7 265.3	0.03
Education	201 588.7	0.83	208 137.3	0.76	257 841.1	0.89
Culture, cinematography and mass media	51 248.1	0.21	51 242.7	0.19	60 286.8	0.21
Health care and sports	149 098.7	0.61	156 159.2	0.57	190 881.2	0.66
Social policy	205 253.3	0.84	217 288.9	0.80	195 320.0	0.68
Interbudgetary transfers	1 431 827. 8	5.87	1 443 703. 5	5.30	1 705 459. 4	5.90
<b>Total expenditures</b>	<b>4 270 114.7</b>	<b>17.51</b>	<b>4 324 086.3</b>	<b>15.89</b>	<b>5 058 777.7</b>	<b>17.50</b>

\* Prices of 2006.

An analysis of expenditures by sectors of functional classification shows that in general the structure of budget expenditures for 2007 is similar to the structure presented in the budget law for 2006, as well as to the estimated budget execution based on the current year results. The most noticeable changes are observed in such budget sectors and sub-sectors as “Servicing of national and municipal debt” (decrease from 0.81 to 0.50 per cent of GDP), “National economy” (growth from 1.39 to 1.59 of GDP), “Social policy” (decline from 0.84 to 0.68 per cent of GDP). In other sections and subsections the difference of indicators in terms of share in GDP are not so expressed. The major expenditure lines in the budget of 2007 remain, as before, “interbudgetary transfers”, “national security”, “federal issues”, “national security and law enforcement”, “national economy”. Total share of those expenses in GDP makes 14.88 per cent as compared with 14.83 per cent in the current year. Therefore, the share in GDP of total amount of expenditures broken down by major budget sections and subsections for 2007 practically remains at the level of the current year; changes mentioned above are explained by relocation of assets.

Some decrease of revenues of the federal budget for 2007 alongside with a significant growth of expenditures causes an explicit reduction of the federal budget surplus (see Table 8). The major sources of financing of government debt obligations in 2007 will be the assets received from government securities, emitted to the internal market.

An analysis of the structure of external financial sources shows that it is not planned in 2007 to issue government securities nominated in foreign currency. Among external financial sources for 2007 “untied” loans of foreign governments and international financial institutions are not mentioned. “Tied” loans were planned for the current and preceding years in line with the major trends of the RF debt policy and prospective financial plan for 2007 through 2009, where provisions are made for refusal from foreign loans. This policy will make it possible to abandon totally the usage of “tied” loans in 2007, two years earlier of the planned term.



Table 8

**Federal Budget Surplus and Sources of Federal  
Budget Deficit Recovery in 2006 and 2007**

	2006 - approved		2006 forecast for execution		2007 - draft	
	RUR, mln	% of GDP	RUR, mln	% of GDP	RUR, mln	% of GDP
Deficit (-)/Surplus (+) of federal budget	776 022.8	3.2	1 770 463.6	6.5	1 390 590.1	4.8
Sources of federal budget deficit recovery, including:	40 549.3	-	-501 611.4	-	174 866.0	-
internal	253 19.9	-	284 836.7	-	324 328.1	-
external	-212 641.6	-	-786 448.1	-	-149 462.0	-

\* Prices of 2006.

Therefore, basing on the above, the following conclusions can be made.

Firstly, the level of revenues in the draft budget for 2007 is explicitly higher in absolute terms than the level of revenues, approved by the budget law for 2006 and according to the budget execution forecast based on the results of the year. Alongside with that some decrease of revenues in terms of the share in GDP is expected in comparison with the execution forecast for 2006. Amendments to tax legislation are regarded as the major factors that led to revenue decrease in terms of the share in GDP. However, amendment of the forecast of the RF macroeconomic indicators allowed partial recovery of revenue reduction. Taking into consideration that a significant share of the budget revenues depends on market fluctuations and in view of the fact that the price for Urals oil will apparently remain close to the current level, the year 2007 should not bring any remarkable differences between approved by law and actually performed budget indicators. This is implicitly confirmed by some decrease of deductions to the RF Stabilization Fund, which are immediately dependant on the world oil prices.

Secondly, there are no major changes in the structure of the budget revenues. The greater share of revenues is derived from tax proceeds to the federal budget. In 2007 some growth of those proceeds is expected in terms of their share in GDP in comparison with the level of estimated revenues to be raised by the end of 2006. The structure of proceeds from basic taxes has also not been greatly changed. The growth is foreseen in the proceeds from basic taxes and the highest increase is expected in regard to value-added tax and tax on profit of enterprises. As to non-tax revenues, they may be lower as compared to the current year indicators both, in absolute terms and in terms of the share in GDP.

Thirdly, expenses of the federal budget for 2007 in absolute terms are much higher than the indicators of the current year budget law and the forecast of performance as well. However, in terms of the share in GDP the level of revenues indicated in the draft budget for 2007 is corresponding to the indicators of the current year budget law. Nevertheless, the level of expenses of the RF federal budget is expected to be noticeably higher versus the estimated performance of 2006. It should be also noted that in the draft federal budget for 2007 the indicators of non-interest expenses will be significantly higher than in this year. The growth is caused by addressing the budget funds for realization of a series of measures to be taken in priority areas of social policy, outlined by the RF President in his Letter to the RF Federal Assembly.

An analysis of expenditures for individual sections of functional classification shows that in general the structure of budget expenses in 2007 is comparable with both, the structure of the budget law for 2006, and with the forecasted results of budget execution of the current year. The most noticeable differences in the amount of expenses are related to such sections and subsections of the budget as "servicing of the public and municipal debt" (decrease from 0.81 to 0.50 per cent of GDP), "social policy" (decrease from 0.84 to 0.68 per cent of GDP). Alongside with that, the total share in GDP of the largest sections and subsections of budget structure of 2007 remains practically the same as compared with 2006 (14.88% versus 14.83% of GDP).

Therefore, regardless of the total growth of non-interest expenses in the budget for 2007, the share of assets from the largest sections and subsections of the budget structure, related to priority areas outlined by the President, shows only insignificant increase. Nevertheless, in our opinion, in the situation of welfare stabilization as compared with the level of 2006, there are certain risks in the growth of non-interest expenses section in view of the inflation, which apparently might overcome earlier esti-

mated value. Taking into regard that reduction of the inflation rate is one of priority measures for the government in 2006 and 2007, the government should pursue the policy of curbing the level of expenses in view of favorable situation in the world market of raw products, where additional revenues can be derived.

Fourthly, comparatively higher growth of expenses over the revenues has led to both, the reduction of the federal budget surplus in absolute terms in 2007, and its share in the GDP as compared to the forecasted results of performance in 2006. Making an analysis of financial sources for the budget deficit recovery, one should note that in 2007 the amount of assets, addressed to cover the external debt of the RF will be decreased due to extensive repayments made in 2005–2006. The government maintains the policy of extension of the internal and reduction of the external government debt.

Basing on the above arguments, the draft federal budget for 2007 can be defined in general as a rather conservative due to minor changes in the structure of its revenues and expenses. Nevertheless, one can observe stabilization of the income level in the situation, when the non-interest expenses are growing. Further implementation of policy of increase of non-interest expenses at a higher rate than the rate of GDP growth may result in excessive inflation pressure. This might hinder the measures taken by Central Bank to curb the growth of prices within the preset limits. On top of that, stabilization of the situation in the world market of raw products along with innovations in tax and budget area can increase the risks of a decline of the share of revenues, dependant on the market situation, and reduction of tax proceeds. It should be also noted that forecasted amount of federal budget revenues (either in terms of the share in GDP, or in nominal terms) is close to the indicators estimated on the basis of medium-term macroeconomic structural model, developed in IET

*D. Polevoy*

## **Monetary Policy in the Russian Federation in August 2006**

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The consumer price index parameter grew again in August 2006 against the previous year: prices of consumer goods grew up by an average of 0.2% in the country. Money supply also kept growing at faster rates: monetary base (narrow definition) grew by 3.9%. The volume of golden and foreign exchange reserves of the Russian Federation reduced by 2.3% in the same period due to payments made in repayment of the Russia's foreign debt due to the Paris Club of Creditors.

The value of consumer price index accounted for 0,2% in August 2006 (as opposed to –0.1% in August 2005 ( see Figure 1)). This means that no deflation took place as it was expected as a result of cheaper prices of fruits and vegetables, though the parameter of consumer price index in August was lower than that in July 2006. The reason behind it was substantial growth of price rates of non-food products (+ 0.8%) and fee – based services provided to the general public (+ 0.8%).

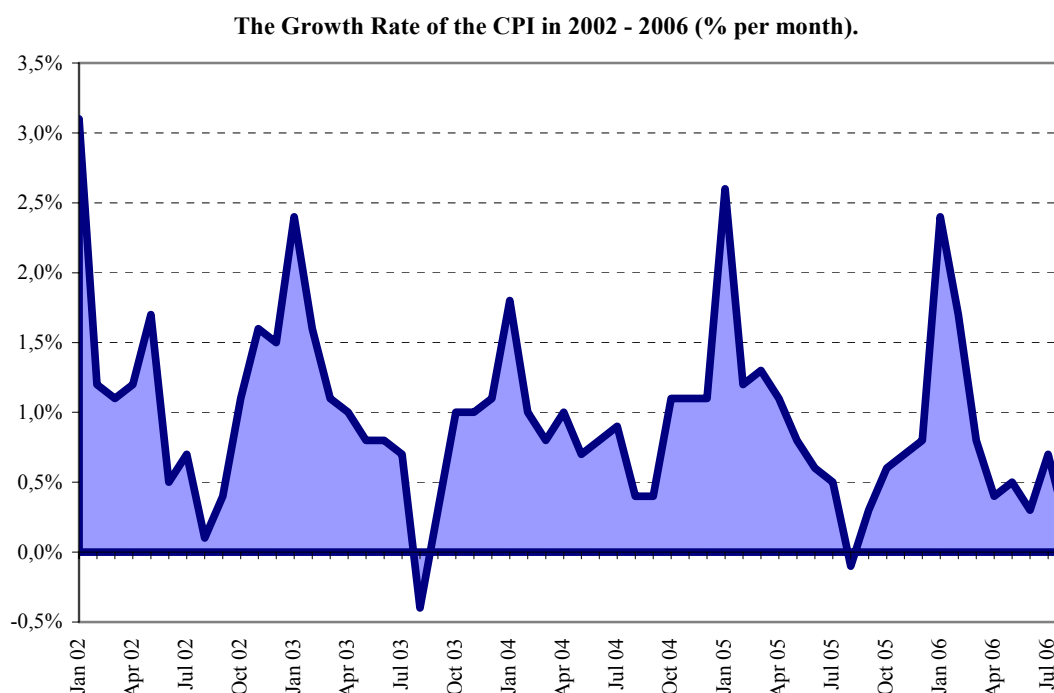
Considerable growth in prices of non-food products was caused by growing prices of motor gasoline (+ 5.4%) and building materials (+ 1.7%). In addition, prices of TV and radio goods (– 0.2%). Sharp increase in prices of gasoline resulted in that the Government of the Russian Federation again, as in the previous year, arranged for a meeting with representatives of Russian major oil companies, at which agreements were achieved to force gasoline price growth rates to reduce until the end of the year. However, there is a seasonal character in reduced demand for gasoline in the period between fall and winter. Therefore, prices of gasoline are likely to increase at slower rates in the nearest future.

Regarding fee-based services to the general population in August, prices of educational services and passenger transport grew most – by + 1.9% and + 1.1% respectively. It should be noted that such a significant growth in prices of educational services is of seasonal character featuring growing demand for such services, while growth in prices of passenger transport is due to the growth in prices of gasoline.

Prices of food products in August 2006 fell by an average of 0.5% in the country. Prices of fruits and vegetables fell most (– 10%), as was expected. In addition, prices of sunflower oil (– 0.1%) reduced slightly. Prices of alcoholic beverages kept growing due to reduced supply and increased suppliers' costs as a result of introduction of the Unified State Automated Information System of Accounting of Production and Trade of Ethanol and Alcoholic Beverages.

The value of the reference consumer price index <sup>2</sup> grew by 0.6% in August 2006 (as opposed to 0.5 % over the corresponding period of the previous year ). Therefore, underlying inflation continued to boost in August 2006 due to rapid growth in money supply in the current year. The upward trend in the underlying inflation cannot but alert given that over the first three month of the current year the monetary base (broad definition) almost tripled against that in the previous year. In our opinion, the underlying inflation is expected to keep growing in fall thus creating additional inflation risks.

The value of the consumer price index is estimated to account for 0.4 % in September and 0.5 % in October 2006, according to the IET's bulletin of model analysis of socio-economic performance forecasts in the Russian Federation .



Data source : the Federal State Statistics Service.

The monetary base ( broad definition )<sup>3</sup> grew by Rb 177,2 billion to reach Rb 3.48 trillions ( + 0.6 % ) in August 2006 . The volume of monetary base ( broad definition ) equaled Rb 3.31 trillion as of August 1, 2006. Let us consider the movement of the monetary base ( broad definition ) by component..

Active cash money including cash balances at credit organizations accounted for 2.51 trillion rubles as of September 1, 2006 ( as opposed to + 2.4 % on August 1 of the same year ), correspondent accounts of credit organizations with the Bank of Russia amounted to Rb 368.3 billion ( + 1.2 % ), mandatory reserves amounted to Rb 204.2 billion rubles ( + 5.3 % ), banks' deposits with the Bank of Russia accounted for 229.1 billion ( + 83.1 % ), the value of the bonds of the Bank of Russia held by credit organizations was Rb 168,1 billion ( + 0.5 % ), and currency transactions reserves deposited with the Bank of Russia amounted to Rb 0.3 billion ( - 40 % ). It should be noted that deposits with the Bank of Russia grew significantly in August 2006 due to increased deposit rates. It is to recall that rates of fund raising instruments were increased at credit organizations since August 7, 2006, namely

<sup>2</sup> The consumer price index is an indicator which reflects inflation level in the consumer market without consideration of a seasonal ( prices of food products ) and administrative ( tariffs of regulated types of services, etc. ) factors. The reference consumer price index is normally calculated by the Federal State Statistics Service of the Russian Federation .

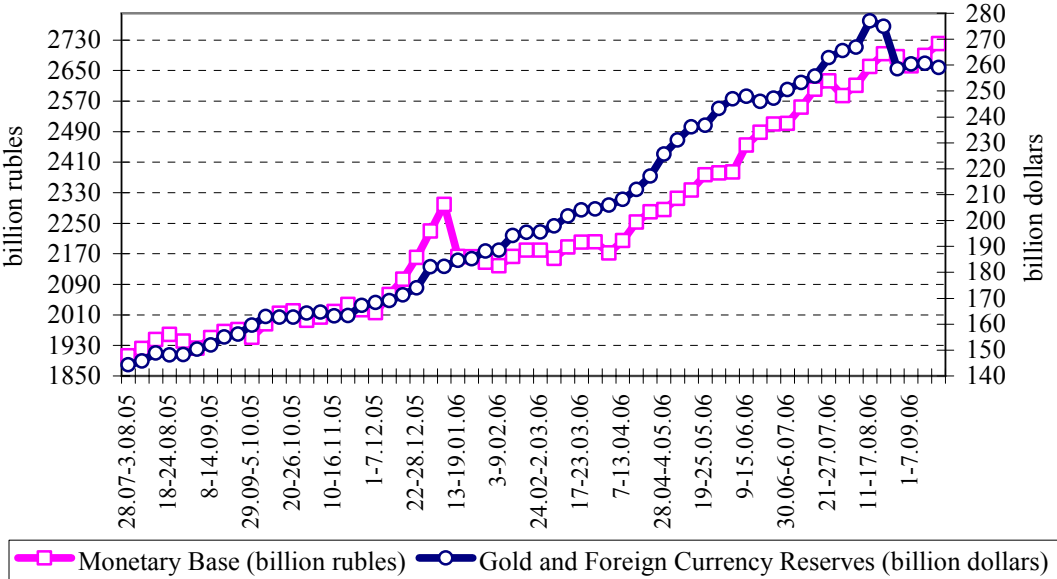
<sup>3</sup> The monetary base ( broad definition ) of the Russian Federation includes correspondent account balances deposited by credit organizations and banks with the Bank of Russia as well as active cash money issued by the Bank of Russia and account balances of compulsory reserves deposited with the Bank of Russia by credit organizations in borrowing funds in national currency .

deposits on standard terms and conditions – tom-next, spot/next and “on demand” ( from 1.5% to 2% per annum ), “first week” and “spot-week” ( from 2% to 2.5% per annum ). It was the third time since the beginning of 2006 that the said rates were increased in order to sterilize the excess liquidity in the country .

In August 2006, growth in the volume of active cash money ( + 2.4 % ) with simultaneous increase in mandatory reserves ( + 5.3 % ) resulted in that the monetary base (narrow definition ) ( cash money + compulsory reserves )<sup>4</sup> widened by 3.9 % ( see Figure 2). In addition , the RF gold and foreign exchange reserves of the Central Bank of the Russian Federation reduced in August 2006 ( - 2.3 % ) to \$265.7 billion US dollars as of September 1, 2006. The reserves reduced by another 2.5 % to total \$259 billion US dollars over the first three weeks in September 2006. Such a considerable reduction in the RF gold and foreign exchange reserves of the Central Bank of the Russian Federation is explained by two reasons. First, in August 2006 Russia repaid its foreign debt due to the Paris Club of Creditors to the amount of about \$23 billion US dollars. Second, prices of energy sources in the global market began to fall in September 2006, which aggravated foreign economic situation and resulted in reduction of currency inflow rate into the Russian Federation. At the same time the Bank of Russia continued to support gaining exchange rate of the national currency in order to reduce inflation rate. The repayment of the Russia’s foreign debt also resulted in reduction of the stabilization fund which totaled Rb 1730,6 billion in volume as of August 1, 2006 ( – Rb 475,4 billion as compared to August 1, 2006 ).

It should be noted that the amount of golden and foreign exchange reserves of the Russian Federation by the end of October 2006 is expected to exceed the amount of \$275 billion US dollars, according to the IET’s bulletin of model analysis of socio-economic performance forecasts in the Russian Federation.

**Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2005 - 2006.**



Data source : the Central Bank of the Russian Federation.

According to the information from the Federal Treasury, in July 2006, the Russian Federation’s expenditures on repayment of its foreign debt amounted to \$24 million US dollars, of which \$23.3 million US dollar were paid in repayment of the foreign debt, and \$0.7 million US dollars were paid for

<sup>4</sup> It will be recalled that monetary base ( broad definition ) represents national currency liabilities of the Bank of Russia rather than a monetary aggregate. The monetary base is a monetary aggregate ( one of the parameters representing money supply volume ) which is fully controlled by the RF Central Bank .

debt service. The biggest amounts were paid in repayment of Russia's debt due to the Paris Club of Creditors ( \$23.9 US dollars ), debts on loans extended by the IBRD and the EBRD ( \$38.7 million US dollars ), and loans raised upon bonds ( \$0.1 million US dollars ).

*Trunin P.*

## **Financial Markets<sup>5</sup>**

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On the whole, the situation in the Russian financial market in September slightly deteriorated as compared to the previous month. Russian eurobonds remained more or less stable: by the end of the month they either grew a little or remained at the August level. In the first half of September the rouble debt market also showed a stable growth, however in mid-September it went down against the backdrop of the rouble's drop against the dollar, a downturn in the rouble liquidity, high initial supply and a number of other external economic factors. The situation in the Russian equity market was the worst: following a drop in the world oil and metal prices, it was falling throughout the month.

### **Fixed income market**

The situation in Russia's foreign currency debt market in September remained favourable. The yield on traded issues either dropped further or remained at levels comparable to the August figures. In early September, despite a certain fall on the US debt market caused by a rise in the cost of labour, Russian bonds appeared quite stable, having suffered an insignificant drop. That was followed by an aggravation in external factors. Political instability in a number of developing countries as well as Ecuador's announcement of a revision of its external debt payments had a negative effect on western investors' demand for these countries' securities. At the same time the Russian market again demonstrated a relatively lower rate of fall. Moreover, several issues showed a minor growth by the end of the first week.

The beginning of the second half of the month did not bring any considerable changes. World factors continued to have a negative impact: investors were wary of a slowdown in the US economy; oil prices continued to fall and nearly reached \$60 dollars per barrel; western funds were withdrawing money from emerging markets. All of the above – given the lack of significant domestic news – contributed to a continued downward trend on the Russian share market. The third week in September was marked by a lower activity on the market as a result of which quotations on the whole stayed at the same level or slightly dropped. A falling oil price did bring about a certain drop in the prices of some issues. At the same time the risk of a rising yield on US government bonds, which are at present being traded below the basic interest rate, remains rather high. If this risk proves true, it will have a negative effect on the Russian foreign currency debt market.

As of 27 September, Russian eurobonds RUS 30 yield to maturity was 5.67% per annum; RUS-18, 5.81%. On the same date the yields on Russian eurobonds stood at: Minfin bonds (OVVZ, internal foreign currency bonds) tranche 8– 4.47%, tranche 7 – 5.43%; tranche 5 – 5.54%; and RUS-07 – 5.37%.

The situation on the rouble government bond market remained quite stable, too. Early in September quotations were on the rise despite a fall on the US market, a weaker rouble against the dollar and a certain rise in the initial supply. During the second week a moderate growth continued against the backdrop of a relatively stable dynamics of the Russian foreign currency debt and a certain strengthening of the rouble against the dollar. At the same time, a drop in the banking sector liquidity put pressure on the market. In mid-September quotations finally stopped to grow and began a moderate fall. That was brought about by a stabilisation of the external market, a stronger dollar against the rouble as well as the risk of higher interest rates on the US government bond market.

From 1 to 30 August the total volume of the GKO-OFZ secondary market amounted to approximately 70.9bln roubles at an average daily turnover of 3.22mln roubles (about 41.7bln roubles at an average daily turnover of 2.6bln roubles in July). Thus trading activity in rouble government bonds in August was much higher than in July.

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<sup>5</sup> This section is based on research published by the Zenit bank, the ATON investment company, MICEX (Moscow Interbank Currency Exchange), the Russian Central Bank, and on Russian issuers' official websites.

Fig 1.

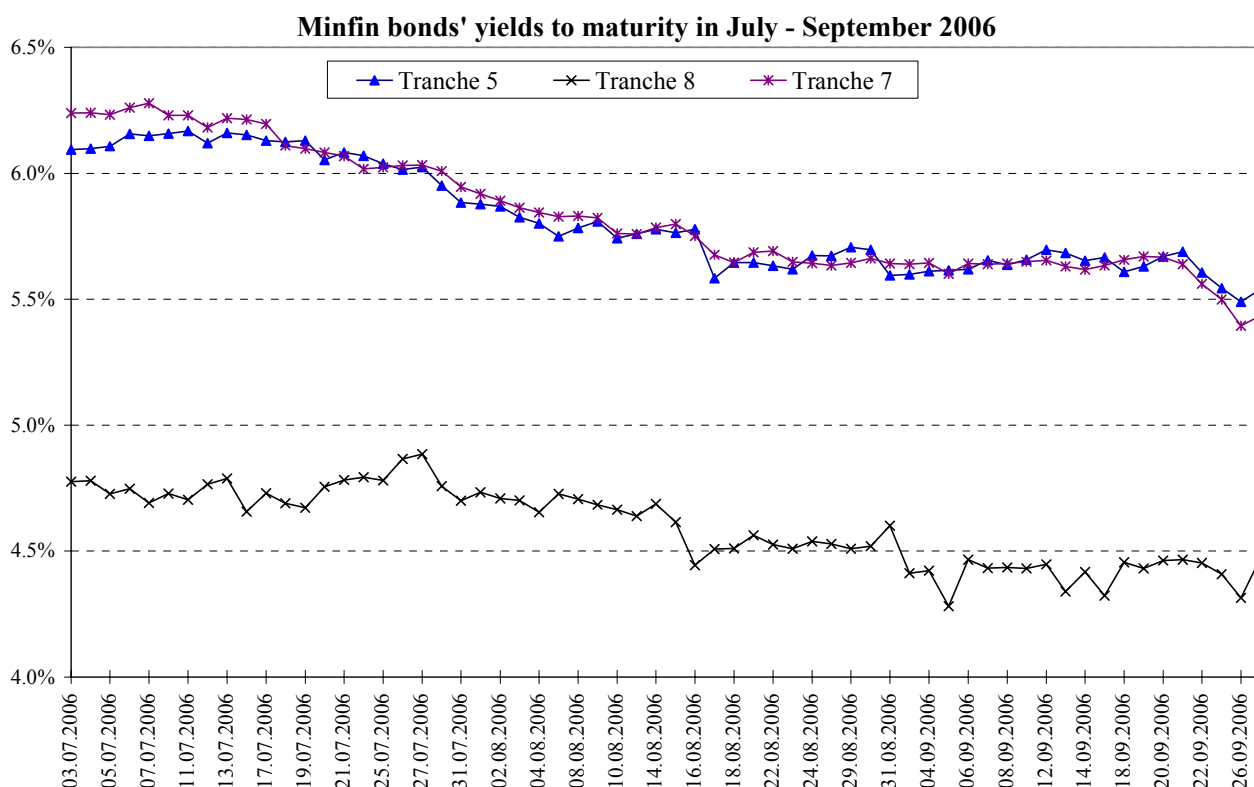
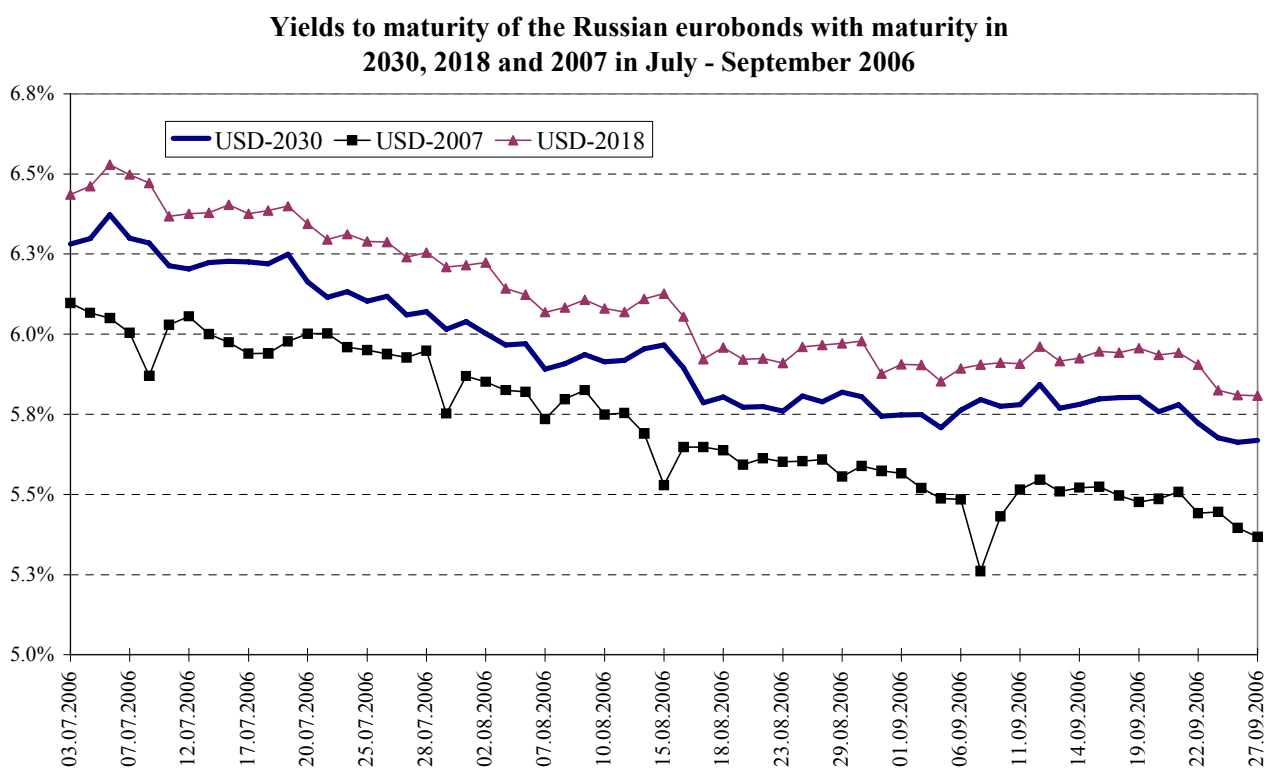


Fig 2.



On 13 August an auction for the placement of OFZ-AD series 46018 was held. The issue volume was 10bln roubles, demand for the bonds at a market value amounted to 27.33bln roubles. As a result,

a total of 8.89bln roubles' worth of bonds were placed, with an average weighted yield of 6.7% per annum.

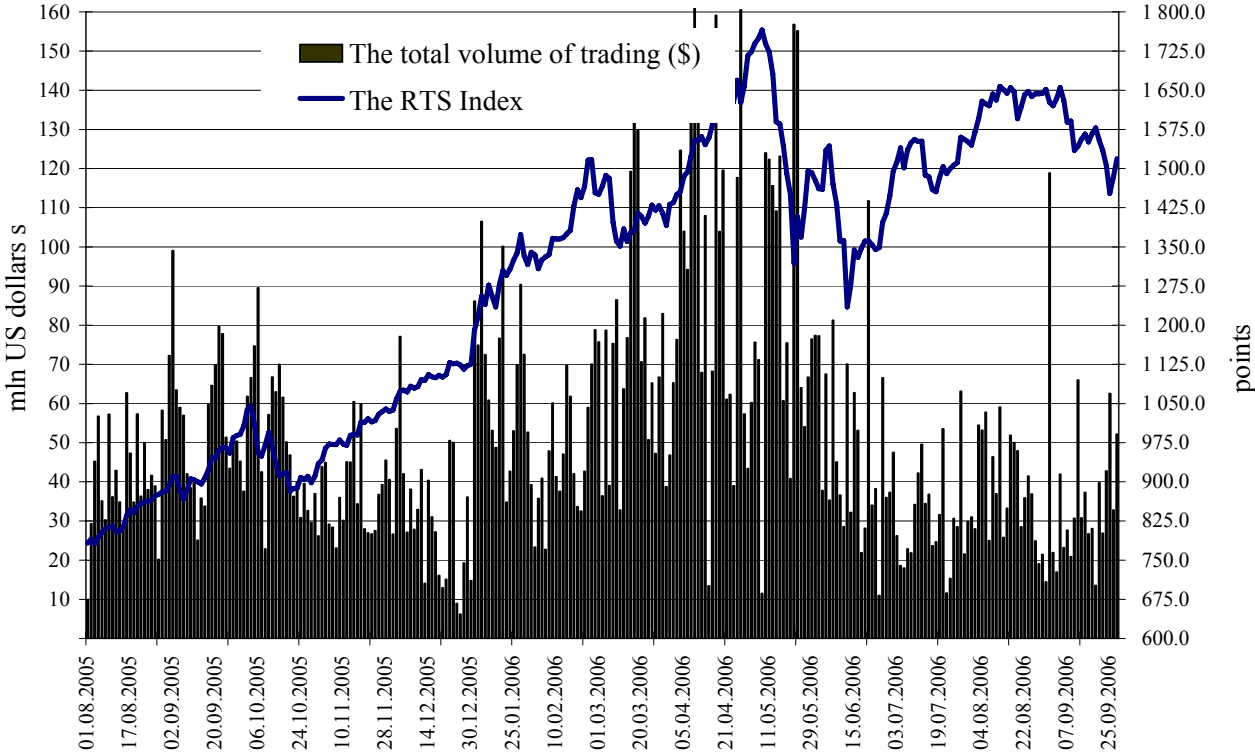
As of 27 September, the GKO-OFZ market amounted to 837.88bln roubles at face value and to 833.08bln roubles at market value. The duration of the GKO-OFZ market portfolio was 1979.82 days.

**Equity market**

**Share market overview**

Throughout September the Russian stock market was falling. In the absence of significant news domestically, the main factor behind the fall was a drop in prices on the world commodity markets. In August oil prices fell by about 15%, thus becoming a considerable negative factor for the Russian market, where the share of oil sector stocks is rather high. The second week in September also showed a fall in the market. By that time the falling oil prices were joined by other factors. In particular, US economic statistics revealed a certain slowdown in growth; the political situation in Brazil, Hungary, Poland and Thailand was unstable, which may have affected investors' interest in other emerging markets. In those circumstances western investors tried to withdraw funds from emerging markets, which further exacerbated the situation. A reduction in rouble liquidity – caused both by the end of the quarter and the need to make tax payments as well as a drop in export revenues against the continued fall in oil prices - put an additional pressure on the market.

*Fig 3.*

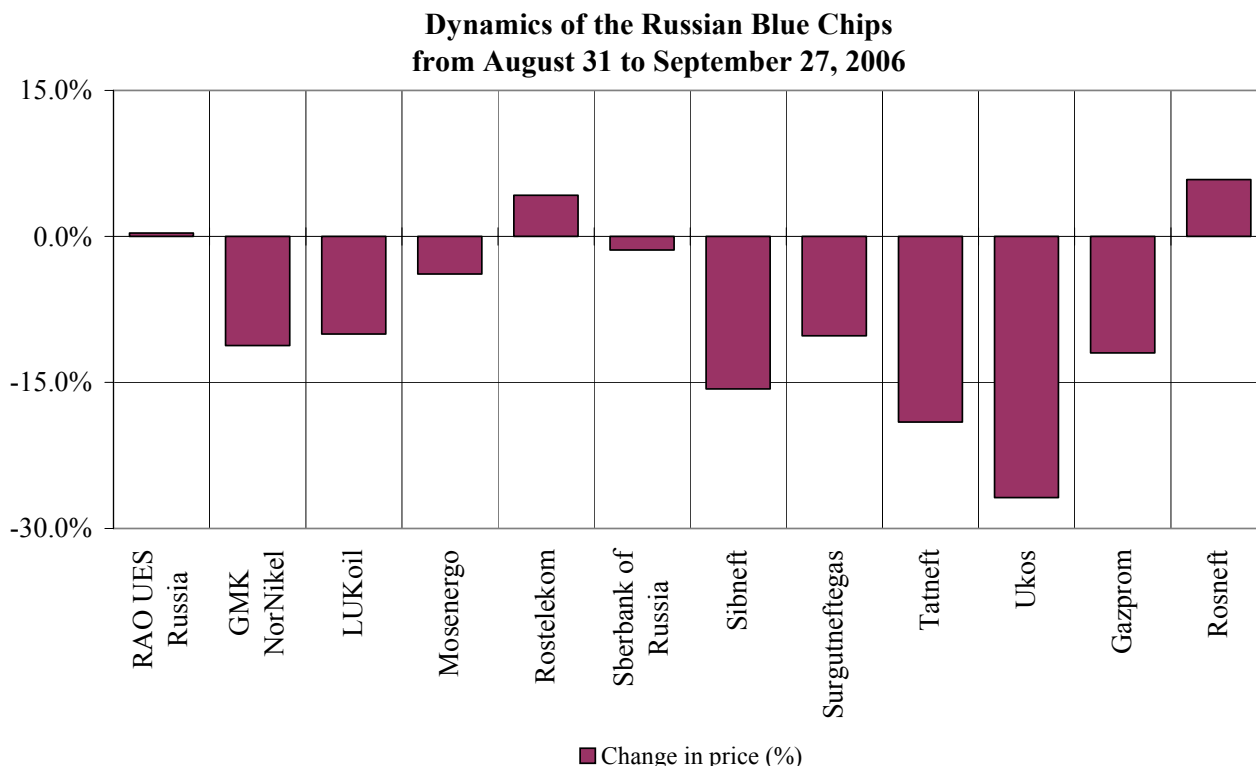


From 1 to 27 September 2006 the RTS index fell by 6.23% down to 1519.06 points (a fall of 100.94 points). In the same period the volume of trading in RTS shares amounted to about \$642.27mln at an average daily turnover of \$33.8mln (about \$941mln at an average daily turnover of \$40.95mln in August). Thus in September investor activity on the stock market was considerably lower than in August. The highest and lowest RTS turnover in September were \$65.98mln (on 12 September) and \$13.52mln (on 19 September), respectively.

In the period from 31 August to 27 September the majority of blue chips suffered a downward trend. The biggest losers were Yukos shares whose value by the end of the month dropped by 26.8%. They were followed by Tatneft and Sibneft shares which in the same period fell by 19.08 and 15.66%, respectively. A slightly slower fall was shown by Gazprom (-11.97%), NorNikel (-11.19%), Surgutneftegas (-10.2%) and LUKoil (-10.04%). Mosenergo shares lost about 3.87% in their value in Sep-

tember, Sberbank of Russia – a mere 1.41%. RAO UES of Russia, Rostelekom and Rosneft shares went up by 0.34, 4.21 and 5.83%, respectively.

Fig 4.



In September, RTS turnover<sup>6</sup> leaders were: RAO UES of Russia (12.9%), Gazprom (12.8%), and LUKoil (7.9%). On the basis of weekly trading, the list of turnover leaders also featured Rosneft, Surgutneftegas, NorNikel and Polyus Zoloto shares.

In terms of capitalization, as of 31 August the top five leaders of the domestic share market were<sup>7</sup>: Gazprom - \$279.63bln, LUKoil – \$72.34bln, Surgutneftegas – \$52.32bln, Sberbank of Russia – \$41.29bln, RAO UES of Russia – \$30.58bln, NorNikel – \$25.77bln.

#### **Futures and options market**

In September investor activity on the RTS futures and options market (FORTS) slightly went down as compared with August. From 1 to 27 September the total turnover on the RTS futures and options market amounted to approximately 218.7bln roubles (408,200 transactions; 7.3mln contracts) against 244.43bln roubles (485,360 transactions; 7.89mln contracts) in August.

The greatest demand, as before, was for futures: the volume of trading in futures in September was 190.85bln roubles (407,420 transactions; 6.53mln contracts). Options enjoyed a far lower demand, with the volume of trading at about 27.86bln roubles (12,670 transactions and 783,870 contracts). The highest amount of trading in the futures market was 15.52bln roubles (on 22 September), the lowest – 7.17bln roubles (on 19 September).

#### **Corporate bond market**

On the strength of September figures, the situation on the corporate and municipal debt market slightly deteriorated, which is clear from the dynamics of the bond market indices. At the same time, throughout September quotations behaved differently. At the beginning of the month the market showed immunity to a number of moderately negative factors, including a rise in the yield of US bonds, a stronger dollar as well as high activity on the primary market. Another negative factor for the market was a rise in the August inflation above the forecast. In a situation when the Central Bank has

<sup>6</sup> On the classical market.

<sup>7</sup> According to RTS data.

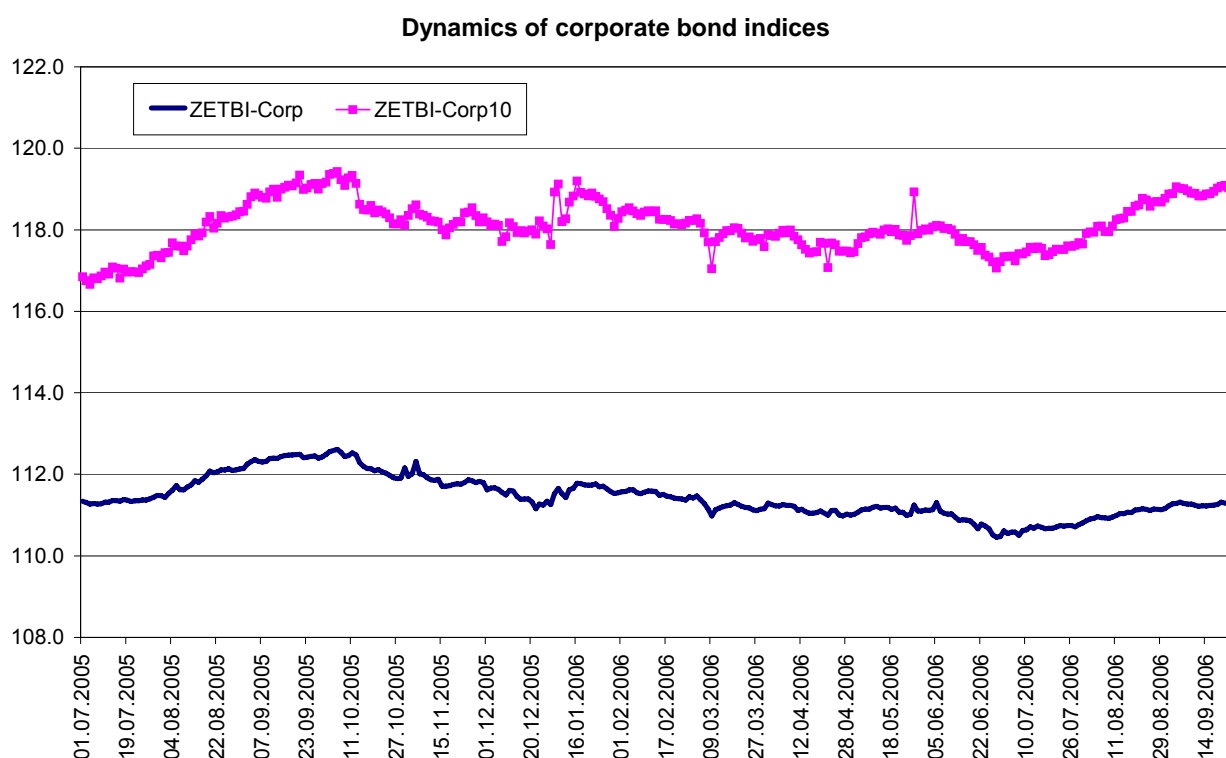


practically no opportunity to fight rising prices by strengthening the rouble, investors can also take into account a rise in inflation expectations, which should bring prices down.

Despite a moderately favourable situation on the foreign currency debt market, the domestic corporate debt market did not show any significant movement. Many blue chips either did not change in price or went slightly up. The situation on the primary market remained a positive factor: placements enjoyed a demand that considerably outstripped supply, thus ensuring investor interest in rouble instruments. A certain strengthening of the rouble at the end of the second week in September was also a positive factor. However later, given a low activity in the external market, corporate bonds began to fall. That was brought about by a return of the negative dynamics of the rouble against the dollar as well as a considerable growth in initial supply.

From 1 to 27 September, the price index of corporate bonds traded on MICEX<sup>8</sup> fell by 0.06 points (0.05%), while the index of the 10 most liquid corporate bonds dropped by 0.07 points (0.06%). In the same period the total turnover on the MICEX corporate bond section amounted to 21.9bln roubles at an average daily turnover of 1.5bln roubles (about 23.64bln roubles at an average daily turnover of 1.07bln roubles in August). Thus the average daily turnover in Russian companies' corporate bonds in September went considerably up against the previous month.

Fig 5



### External factors behind Russian stock market dynamics

In September the oil market dynamics became the top external economic factor. Negative trends that began in late August continued to dominate the market throughout September. Oil prices were falling, driven by Iran's statements on readiness to start talks on its nuclear programme and by an increase in US oil and oil reserves.

The situation on the world stock markets in September remained on the whole favourable (see Table 1). The main indicators on both developed and emerging markets were rising, with the exception of the RTS index and the securities indices of Japan and Brazil.

<sup>8</sup> The calculation was based on indices of corporate bonds traded on MICEX. The indices were produced by the Zenit bank.

Fig 6.

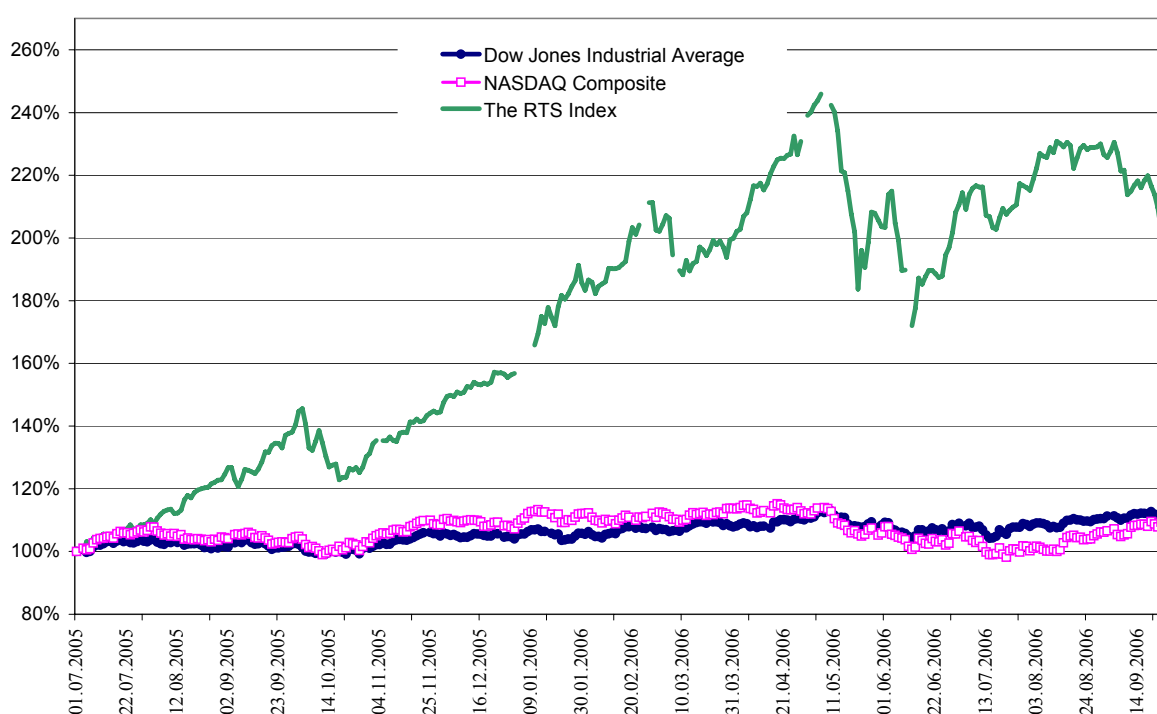


Table 1

## World stock market indices

As of 27 September	Value	Change since Aug 06 (%) <sup>9</sup>	Change since Jan 06 (%)
RTS (Russia)	1519.06	-6.62%	27.62%
Dow Jones Industrial Average (USA)	11689.24	2.71%	7.76%
NASDAQ Composite (USA)	2263.39	3.65%	0.88%
S&P 500 (USA)	1336.59	2.51%	5.34%
FTSE 100 (UK)	5930.1	0.41%	4.38%
DAX-30 (Germany)	5989.71	2.22%	9.90%
CAC-40 (France)	5243.1	1.51%	10.27%
Swiss Market (Switzerland)	8413.1	3.00%	10.28%
Nikkei-225 (Japan)	15947.87	-1.20%	-2.53%
Bovespa (Brazil)	36106	-0.35%	7.76%
IPC (Mexico)	21748.57	3.32%	21.33%
IPSA (Chile)	2266.12	2.71%	16.83%
Straits Times (Singapore)	2557.9	3.04%	7.96%
Seoul Composite (South Korea)	1360.03	0.54%	-2.10%
ISE National-100 (Turkey)	36818.73	-1.25%	-7.47%
Morgan Stanley Emerging Markets Free Index	776.02	0.37%	9.76%

## Corporate news

## OAO Mosenergo

On 19 September the placement of the company's rouble bond issue took place. The volume of the issue was 5bln roubles, the 1-6 coupon rate was 7.54%, maturity - five years. The bond issue is aimed to refinance the company's debt and to optimise its financial operations. The placement was held at the Moscow Interbank Currency Exchange (MICEX). On the following day, 20 September, Standard&Poor's raised Mosenergo's credit rating from B- to B, with the company's Russian rating rising from ruBBB+ to ruA-. It also issued a positive recommendation for buying the company's shares. The improvement in the rating had been caused by Mosenergo's better liquidity resulting from a successful

<sup>9</sup> Against the 31 August 2006 indices.

placement of a 5bln rouble bond issue. The money will be used to refinance the company's current debt. According to Standard&Poor's, Mosenergo's rating reflects the company's strong competitive advantages on the power and heat market in a rapidly developing Moscow region resulting from the combined power and heat generation as well as from technological restrictions for other power generators.

### Foreign currency market

From 1 to 27 September the dollar against the rouble rose by 0.0649 roubles (0.243%) and reached 26.794 roubles to a US dollar. The total volume of trading in US dollars on SELT in the same period amounted to about \$39.64bln at an average daily turnover of \$2.2bln (about \$55.79bln at an average daily turnover of \$2.54bln in August). Thus trading activity in foreign currency in September was much lower than in August. The largest amount of trading in US dollars in the given period was about \$4.1bln (on 25 September), and the smallest was \$920.9mln (on 4 September).

Fig 7.

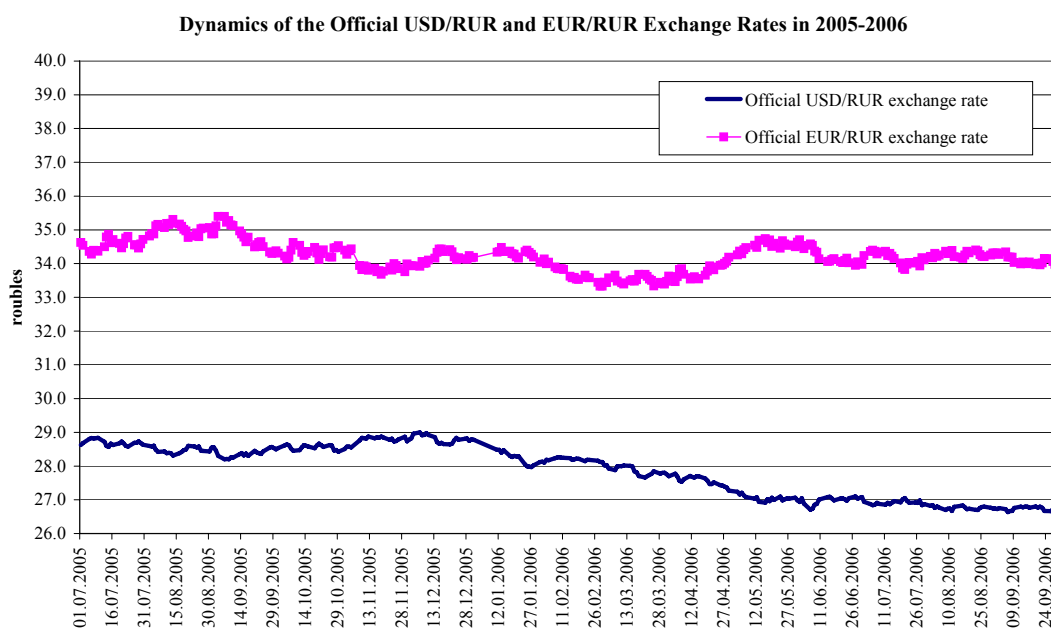
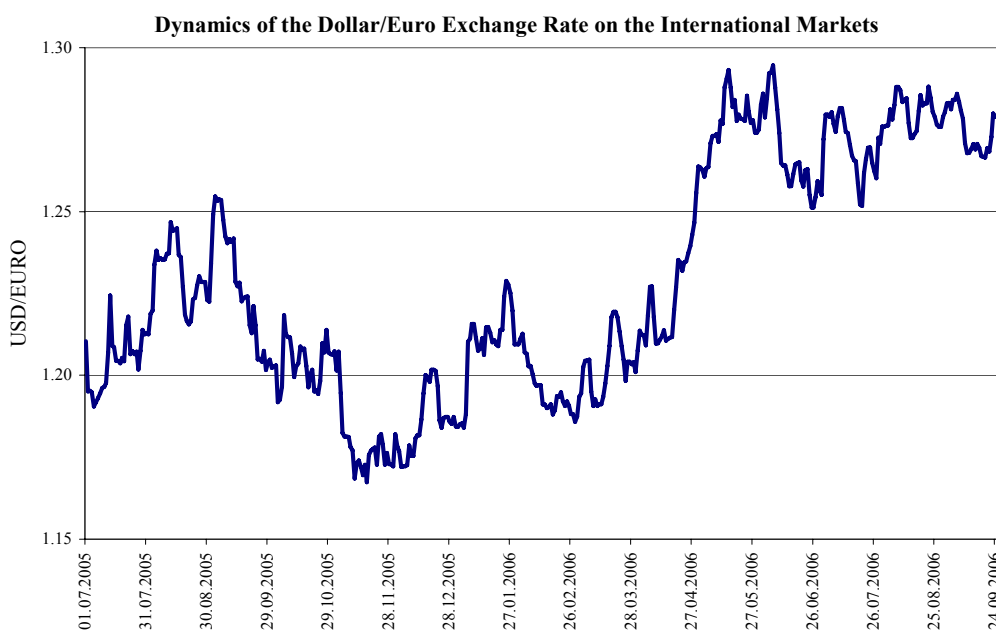


Fig 8.



The banking sector rouble liquidity in September suffered a considerable fall against August: the average balance on lending agencies' corresponding accounts in the Bank of Russia in September was about 354.98bln roubles against about 357.53bln roubles in August

From 1 to 27 September on the world market the euro fell by \$0.014 (-1.08%) down to \$1.2694 to a euro. This translated into a drop in the euro against the rouble in September. From 1 to 27 September the euro/rouble exchange rate fell by 0.3454 roubles. (-1.006%) from 34.318 to 33.973 roubles to a euro. The total volume of euro trading on SELT from 1 to 27 September reached about 661.66mln euros at an average daily turnover of 36.76mln euros (810.9mln euros at an average daily turnover of 36.86mln euros in August). Thus the euro trading on the Russian foreign currency market in September was much less active than in August. The largest amount of trading in that period was 55.49mln euros (on 24 September), and the lowest – 23.12mln euros (on 11 September).

Table 2.

### Financial market indicators/indices

Month	Oct	Nov	Dec	Jan	Feb*
monthly inflation	0.6%	0.7%	0.8%	2.4%	1.3%
estimated annual inflation given the current month trend	7.44%	8.73%	10.03%	32.92%	16.8%
Russian Central Bank refinancing rate	13%	13%	12%	12%	12%
average yield to maturity for all OFZ bond issues (% per annum)	6.55%	6.55%	6.53%	6.04%	6.5%
monthly turnover on the GKO-OFZ market (bln roubles)	33.04	24.58	34.80	32.33	10.0
Minfin bond yield to maturity at end of month (% per annum):					
tranche 5	5.37%	5.26%	5.27%	5.20%	5.3%
tranche 6	4.91%	4.77%	4.71%	4.50%	4.6%
tranche 7	5.73%	5.29%	5.37%	5.14%	5.3%
tranche 8	4.58%	4.58%	4.71%	4.38%	4.6%
Eurobond yield to maturity at end of month (% per annum):					
2007	4.97%	5.02%	5.00%	5.13%	5.3%
2010	5.15%	5.08%	5.07%	5.00%	5.2%
2018	5.90%	5.65%	5.67%	5.76%	5.7%
2028	6.18%	6.02%	6.08%	6.12%	6.1%
2030	5.67%	5.47%	5.50%	5.62%	5.6%
Interbank credit-MIACR rate (% per annum at end of month) on 1-day loans	12.13%	8.50%	4.25%	8.86%	6.31%
official rouble to US dollar exchange rate at end of month (RUR/USD)	28.4244	28.7312	28.7825	28.1207	28.1223
official rouble to euro exchange rate at end of month (RUR/EUR)	34.5300	33.9890	34.1850	34.0373	33.3305
change in the official rouble/US dollar exchange rate in one month (%)	-0.26%	1.08%	0.18%	-2.30%	0.01%
change in the official rouble/euro exchange rate in one month (%)	-0.43%	-1.57%	0.58%	-0.43%	-2.08%
RTS stock market turnover in one month (in mln US dollars, for shares on the RTS index list)	1045.18	778.05	683.99	1095.19	886.05
RTS-1 index at end of month	934.99	1037.26	1125.60	1315.96	1453.44
change in RTS-1 index in one month (%)	-7.22%	10.94%	8.52%	16.91%	10.45%

\* Estimate

D. Polevoy

## **Investment in Real Sector of Economy**

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In the current year there is observed a trend to overcome the tendency to reduction of the rates of growth of investments in the fixed assets. Under the influence of expanding production and the growth of national demand, which is getting ahead of it, whereas the financial resources of manufacturers are being expanded, the growth of investments in the first half-year 2006 made 10.8 per cent as opposed to 8.9 per cent in the relevant period of the preceding year.

A tendency of a slow-down of the growth rate of investments in the fixed assets is observed in the year 2006. Under the influence of expanding production and the growth of national demand, which is getting ahead of it, whereas the financial resources of manufacturers are being expanded, the growth of investments in the first half-year 2006 made 10.8 per cent as opposed to 8.9 per cent in the relevant period of the preceding year. Against the background of intensive growth of GDP the share of investments in the fixed assets made 13.1 percent, 06 percentage points less than the indicator of the preceding year.

In the current year the changes in the structure of investments in terms of financial sources were caused by an increased inflow of funds. In the situation of economic growth the Russian market is getting more attractive to national and foreign banks. One should note that in the first half-year 2006 the share of the Russian banks in the investment process has been increased by 7.1 per cent, 2.0 percentage points higher than the level of the preceding year.

In the environment of a steady growth of revenue from oil and gas export sales and due to the investment rating gained by Russia, it is reasonable for international banks to maintain high rates of investments in their diversification activities. According to the results of the first half-year 2006, foreign banks' credits made 2.2 per cent in the structure of financial sources of investments against 0.9 per cent made in the previous year. The share of foreign investments in the first half-year 2006 made 6.5 per cent of the total volume of investments in the fixed assets against 4.5 per cent made in the relevant period of the year 2005. As of the end of June of the year 2006 the volume of accumulated foreign capital was \$ 128.0 billion. The net inflow of foreign capital in the first half-year 2006 made \$11.4 billion as compared with \$ 3.9 billion in the first half-year 2005.

In the first half-year 2006 there were made 41.9 percent more of foreign investments in the Russian economy than in the relevant period of the preceding year, including direct investments, grown by 43.3 percent. The tendency of the direct investments growth reflects the reaction of foreign investors to enhancement of the investment climate components.

The share of budgetary assets in the structure of financial sources made 15.2 per cent, 1.9 percentage points lower than the relevant indicator of the preceding year, whereas a steady growth of federal budget share in investments is observed against the background of restrained participation of the Subjects of Federation.

In the federal budget of the year 2006 it is envisaged to provide financing to the Federal Targeted Investment Program in the amount of RUR 318,95 billion (including national defense order in the amount of RUR 64.3 billion). The effectiveness of the national expenditure for investments in many ways depends on the changes in the investment structure with the aim to ensure energy sector safety, modernization of energy sector infrastructure, development of manufacturing infrastructure and strengthening of competitive power of the Russian economy. With regard to the new targeted programs and development of public-private business cooperation, national expenditures for investments, including the Investment fund and investment share of national projects, will make in the year 2006 about 2 per cent of GDP, as estimated by the Ministry of Economic Development. According to Rosstat, the level of the scope of financing for construction sites and objects for national needs throughout January-July of 2006 made RUR 50.3 billion, i.e. 34.9 percent of the budget allocated for the year. Out of the total amount of funds envisaged by the Targeted Federal Investment Program for the construction sites and objects for federal national needs in 2006, the national clients have spent in January-June RUR 42.8 billion, or 29.6 per cent of the year budget limit, allocated for construction of those objects.

Table 1

**Structure of Investments in the Fixed Assets as per Financial Sources in  
First Half-Years of 2004 - 2006.  
(Excluding Small Businesses and Parameters of Informal Business)**

	2004	2005 <sub>r</sub>	2006
Investments in the fixed assets, including a break-down by sources of investment:	100	100	100
<b>Own capital</b>	48.6	47.2	47.0
among them:			
net profit of enterprises, left at their disposal	17.3	19.4	20.8
depreciation	24.9	22.4	23.2
<b>Inflow of funds</b>	51.4	52.8	53.0
among them:			
bank credits	7.3	6.0	9.3
foreign banks' loans	1.1	0.9	2.2
loans from other organizations	6.0	9.7	7.3
budget funds	16.2	17.1	15.2
including:			
funds from Federal Budget	4.2	5.0	4.9
funds from the Subjects of the Russian Federation	11.2	11.1	9.4
<b>Share of foreign investments in the total amount of investments in the fixed assets</b>	4.5	7.0	6.5

Source: Rosstat

Reviewing the investment activities, it is extremely important to make an analysis in terms of the types of economic activities. According to the results of the first half-year 2006, the dominant share of investments in the industries was made in the mineral extraction (19.5 per cent).

It should be noted that against the background of high prices for hydrocarbons, but a low level of investments inflow and diversification of growing revenue from export sales in upgrading, development and modernization of enterprises for natural resources extraction and refinement, a negative effect is provided on the indicators of economic growth. While in metallurgy simultaneous rise of the investments growth rates was observed in mining (110.6 per cent) and processing enterprises (108.8 per cent), one of the acute problems of the fuel and energy enterprises is the low investment activity in the oil industry (102 per cent by the half-year 2005).

In comparison with the preceding year, the share of investments in extraction of energy resources have been raised by 2 percentage points due to the growth of investments in the extraction of raw oil and natural gas (by 26.8 per cent).

After slow dynamics of the years 2004-2005 a break-through of investment activity has provided a recovery effect and was initiated by an acute necessity of immediate actions for solving such problems as depletion of resources of mature oil and gas deposits and infrastructure restrictions. Thus, OAO "GAZPROM" has reacted to this situation by the increase of the scope of their investment program for the year 2006 by RUR 63.04 billion; bringing its level to RUR 373.14 billion. Additional capital investments are supposed to be made in upgrading of En-Yakhinsk, Zapolyarny, Yuzhno-Russky, Bovanensky deposits and the system of pipelines between Bovanenkovo and Ukhta, as well as in a series of new construction developments for renovation of the Unified System of Gas Supply (USGS).

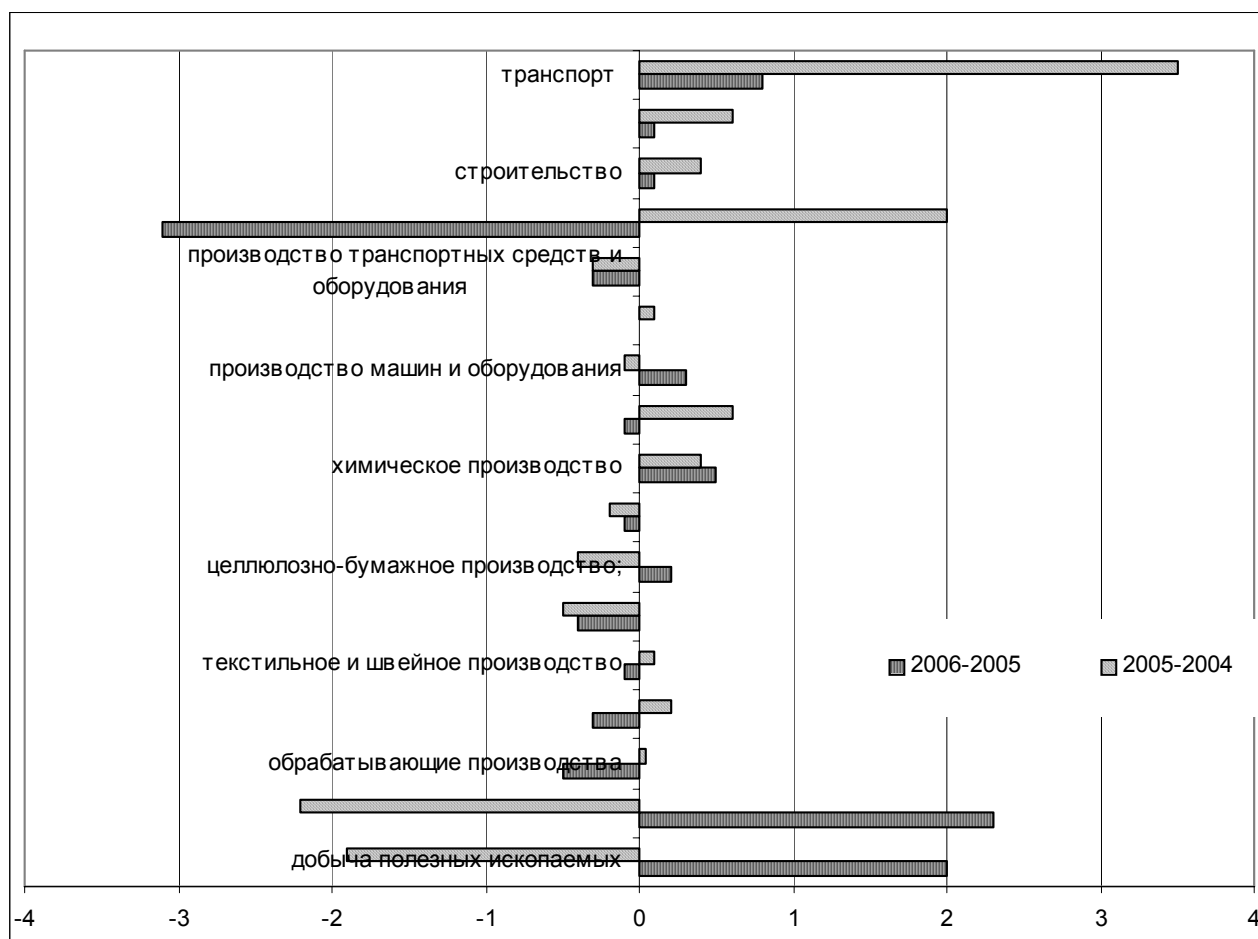
Diversification of investments inflow in transportation infrastructure is characterized by a special attention to the development of the system of transportation of oil, oil products and gas. The growth of investments in pipelines made in the first half-year 2006 came up to 38.9 per cent, their share in the total volume of investments in the fixed assets of the economy in general is 9.9 per cent, as opposed to 7.3 per cent in the same periods of the year 2005 and 6.7 per cent in 2004. The Federal Law "On Concession Agreements" is specially addressed to the issues of attracting of private investments in development of transportation infrastructure, acceleration of modernization of transportation system, energy sector and housing and utilities system.

It should be emphasized, that in the conditions of extremely favorable situation in the market of raw materials and dynamic growth of the exporter's revenues, one could expect much higher indices.

However, the disproportion in financial resources of investments in mineral extraction and processing, high cost of commercial credits, absence of effective and reliable ways of allocation of personal savings and protection thereof from inflation and dishonest companies accumulating the funds, underdeveloped stock market and institutions for joint investments – are the factors that restrain business activity in capital construction.

Fig. 1.

**Changes in the Structure of Investments in Capital Assets with a Break-down by Types of Economic Activities within the First Half-Years 2004- 2006, % versus the Relevant Period of Preceding Year**



Mineral resources extraction
Extraction of fuel and power resources
Processing industries
Textile and clothing manufacture
Food production
Wood processing and manufacture of wooden items
Pulp and paper manufacture
Coke and oil production
Chemical production
Manufacture of vehicles and equipment
Production and distribution of electric power, gas and water
Construction
Wholesale and retail trade, vehicles maintenance
Transport

In the first half-year 2006 the growth of investments in processing industries made 105.2 per cent against 112.4 per cent in the relevant period of the year 2005. The changes in the structure of investments in processing industries happened due to an increase of investment activity in production of intermediate demand commodities: in chemistry (investments index made 135.4 per cent), pulp and paper industry (156.3 per cent), coke production (135.4 per cent), in production of cast-iron and steel pipes (150.7 per cent), non-ferrous metals (132.9 per cent), in metallurgy (108.8 per cent).

The investment situation in the sector of the products of final demand in the first half-year 2006 is characterized by a decrease of investments in production of food products by 2.2 per cent.

Difficulties with the selection of strategy of development for industrial enterprises and insufficient pin-point support, provided to the selected enterprises, lead to unbalanced situation in the market of investment objects and strengthening of competitive capacity of foreign goods. In machinery and equipment manufacturing industry an increase of the investment rates is noted by 63.7 per cent in comparison with the first half-year 2005, and in the manufacture of vehicles and equipment a decrease is observed by 14.1 per cent against the background of reduced competitiveness in terms of prices.

In the current state of the structure of the national investment products the import remains one of the major sources of renovation of capital assets, upgrading and modernization of manufacturing industry. Investments in imported equipment in the first half-year 2006 made 20.9 per cent of the total volume of investments in machinery, equipment and vehicles.

To provide incentives for realization of the large infrastructure and innovation projects in the framework of private-public sectors cooperation mechanisms, the Government has initiated the formation of the Investment Fund for joint financing of investment projects, implemented jointly by national and private business. In conformity with the perspective financial plan for 2006-2008, the volume of the Investment Fund in 2006 will make RUR69.7 billion, in 2007 – RUR110.6 billion.

By now the Government Committee has approved seven investment projects. The purpose of the Project of integrated development of the lower Angara area is to improve the industrial capacity of the area: to finalize the construction and put in production Boguchansk hydraulic power station, a large aluminum plant, pulp and paper plant, gas refining plant. The purpose of building of refineries and gas-processing plants complex in Nizhnekamsk is to produce petrochemical products, which will replace the imported ones. The investment project of mineral and raw materials exploration is aimed at exploring of five complex ore deposits in the south-east of Chita area (deposits of copper, gold, silver, zinc, molybdenum, etc.); construction of four mining-and-processing integrated works, development of transportation infrastructure, extended employment opportunities.

The above-said integrated projects are implemented on the basis of joint financing: the Government provides the funds from the Investment fund for transportation and power infrastructure of the Projects (construction of highways and railways, electric power lines, bridges, which will stay in public property), the businesses will invest in the construction of industrial objects. The share of public finances, allocated for the seven selected objects, which is RUR 164.3 billion, makes only 25 per cent of the total amount of expenditures of RUR 667.7 billion.

In the nearest future special economic zones, which will be created on the territory of the Russian Federation, will serve as an advanced mechanism to encourage investments in the processing industries and innovation sectors of economy. The legislation provides tax and customs benefits, comfortable infrastructure and soft measures of administrative control, which will contribute to attraction of investments in the processing industries.

In the year 2007 it is planned to finalize the major developments in the special economic zones (SEZ): utility facilities, including information and telecommunication networks, as well as transportation lines. The registration of residents-investors is also foreseen in SEZ.

Adoption of the Federal Law on arrangement of special economic zones of tourist-recreation type in June 2006 became one more noticeable event to the potential investors. With regard to the high potential of national and external tourism this measure will provide an immediate and significant effect.

The works are being completed on the draft Law on creation of special economic zones in the seaside and riverside ports and in cargo terminals of international airports.

*O. Izryadnova*

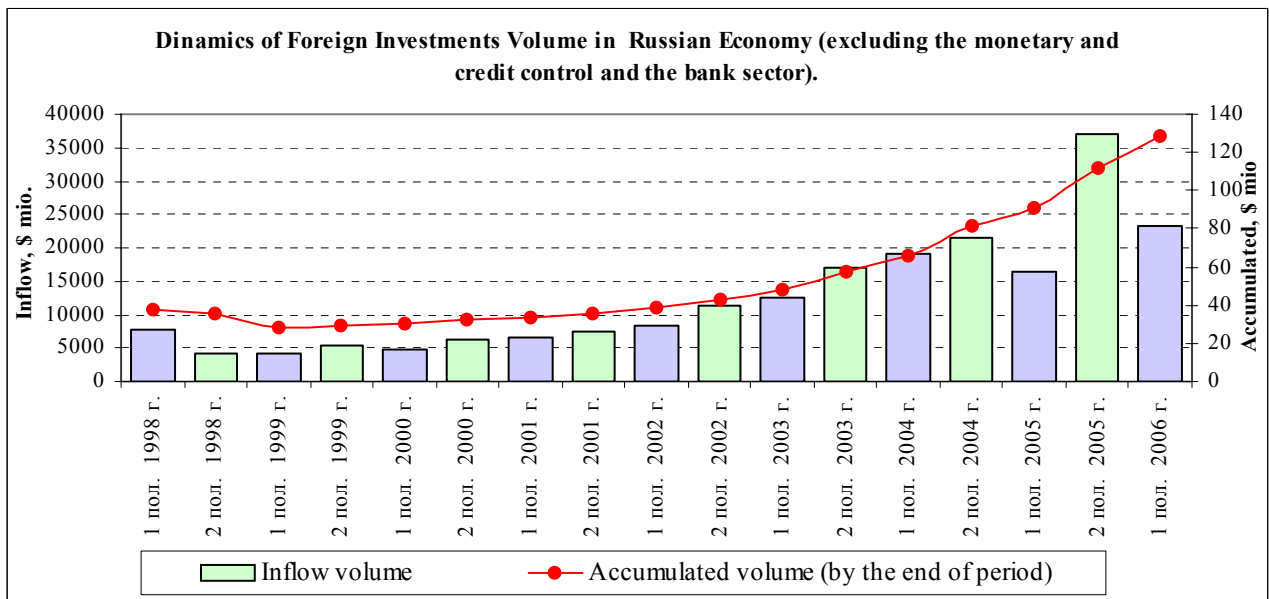


## Foreign Investments in Russian Economy

Russian economy is getting more and more attractive for foreign investors. Within the first six months of 2006 foreign investments in the Russian economy have grown by 41.9 per cent and came up to \$ 23.4 billion.

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Russian economy is getting more and more attractive for foreign investors. As of July 1, 2006 accumulated foreign investments in Russia, including those of state members of CIS have reached \$ 128,0 billion, which is by 42 per cent higher than the level of July 1, 2005 and exceeds the indicator of the beginning of the current year by 14,4 per cent. Foreign investments made in the Russian economy within the first six months of 2006 have grown as opposed to the relevant period of 2005 by 41.9 per cent and made \$ 23.4 billion (within the first six months of 2005 a reduction of foreign investments was observed in comparison with the first six months of 2004 by 13.1 per cent).



Source: Rosstat.

In the first six months of 2006 \$ 7.3 billion were withdrawn and transferred outside the country in the form of income of foreign investors and interest for credits services; this indicator is 5.5 per cent lower as compared to the relevant figure of preceding year. Alongside with that, in the first quarter of 2006, like in previous years (excluding the first quarter of 2005), a significant outflow of capital was observed, although in the second quarter only 3 per cent of foreign capital invested in the Russian economy were withdrawn. All in all, throughout the first six months of 2006 31.0 per cent of funds invested in the Russian economy were withdrawn (46.5 per cent within the first six months of 2005 and 52.2 per cent within the first six months of 2004).

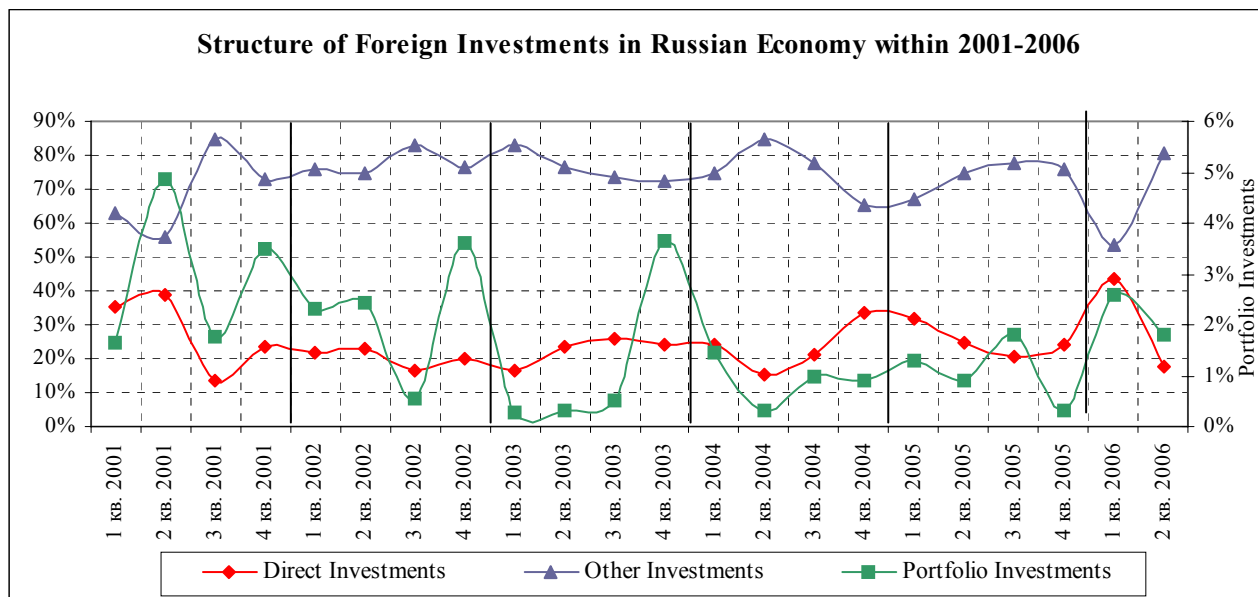
Throughout the past years “other investments” prevail in the structure of all foreign investments in the Russian economy. A negative factor of the current year is a decrease of the share of direct investments to 17.0 per cent in the structure of all foreign investments. However, due to considerable growth of direct investments during the first quarter of 2006, when that indicator overcame the level of the relevant period of 2005 twice, the results of the first six months of 2006 demonstrate growth of direct foreign investments to the level of 43,6%.

Table 1

## Foreign Investments in Russian Economy in 2002-2006

	Inflow of foreign investments	Withdrawal of foreign investments	Accumulated by the end of period	Withdrawal vs. inflow, per cent
1 Q. 2002	3789	4977	34436	131.4%
2 Q. 2002	4579	865	38150	18.9%
3 Q. 2002	4537	2885	39802	63.6%
4 Q. 2002	6875	3749	42928	54.5%
1 Q. 2003	6268	6165	43031	98.4%
2 Q. 2003	6394	1084	48341	17.0%
3 Q. 2003	8237	2983	53595	36.2%
4 Q. 2003	8800	5381	57014	61.1%
1 Q. 2004	6171	6121	57064	99.2%
2 Q. 2004	12812	3781	66095	29.5%
3 Q. 2004	10152	2818	73429	27.8%
4 Q. 2004	11374	2806	81997	24.7%
1 Q. 2005	6021	2924	85094	48.5%
2 Q. 2005	10482	4756	90820	45.4%
3 Q. 2005	10326	4672	96474	45.2%
4 Q. 2005	26822	11461	111835	42.7%
1 Q. 2006	8789	6819	113805	77.6%
2 Q. 2006	14621	438	127988	3.0%

Source: Rosstat.



Source: Rosstat.

Domination in growth rate of direct foreign investments over relevant indicators for other and portfolio foreign investments is observed for the second year in a row and is accompanied by a consistent decrease of the share of other investments, from 81.3 per cent in the first six months of 2004 to 71.7 per cent in the first six months of 2005 and 70.4 per cent in the first six months of 2006.

Table 2

**Structure of Foreign Investments in Russian Economy  
in the first six months of 2002-2006**

	\$, mln				% vs. previous year			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
2002	8368	1872	199	6297	25.2	-25.4	-16.4	59.9
2003	12662	2533	38	10091	51.3	35.3	-80.9	60.3
2004	18983	3427	129	15427	49.9	35.3	3.4	52.9
2005	16503	4489	175	11839	-13.1	31.0	35.2	-23.3
2006	23410	6445	499	16466	41.9	43.6	2.9 times more	39.1

Source: Rosstat.

In terms of sectors of economy, foreign investments, involved in the Russian economy within the first six months of 2006, were rapidly growing in such industries as transportation, communications and financial sector.

The rates of investments growth in those sectors have come up in the first six months of 2006 in comparison with the first six months of 2005 by 2,4 times and 2,6 accordingly.

Таблица 3

**Structure of Foreign Investments in Russian Economy in the first  
six months of 2003-2006 With a Brake-Down by Sectors**

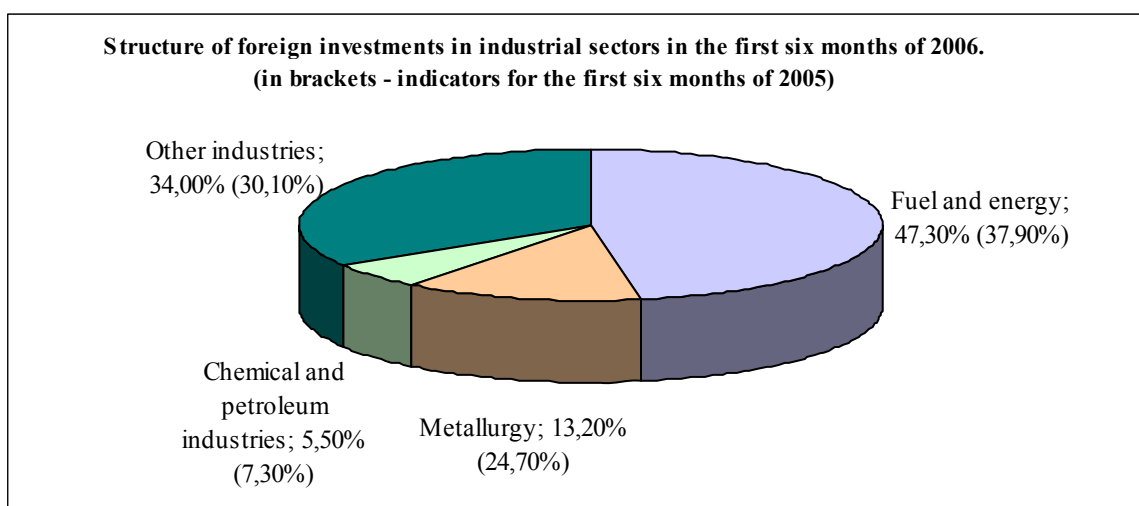
	\$, mln				% vs. previous year			
	2003	2004	2005	2006	2003	2004	2005	2006
Industries	4326	10250	8026	11362	34.2	54.0	48.6	48.5
Transportation and communications	741	337	1677	3946	5.9	1.8	10.2	16.9
Trade and catering	5686	6113	4917	5092	4.9	32.2	29.8	21.8
Market commercial services	1072	924	1153	1240	8.5	4.9	7.0	5.3
Finances, credit, insurance, pension services	112	468	526	1387	0.9	2.5	3.2	5.9
Other sectors	725	891	204	383	5.6	4.6	1.2	1.6

Source: Rosstat.

Volumes of investments in trade and catering in the current year remained at the level of \$5 billion, their growth in comparison with the first six months of 2005 is estimated at 3.6 per cent. This growth rate is quite low, though total volume of investments have grown by 41.9 per cent, but the share of trade and catering decreased to 21.8 per cent.

The results of the first six months of 2006 show that mineral resources extraction became most attractive for foreign investments made in industries in total; \$5.86 billion has been invested in this sector. This figure is more than twice higher than the relevant indicator of 2005.

\$5.3 billion is invested in the first six months of current year in processing industries (+6.7 per cent versus the first six months of 2005). In the first six months of 2006 investments in oil and gas extraction have grown by 2.4 times (to \$ 5.4 billion), investments in chemical production increased by 7.0 per cent (to \$ 628 billion); investments in metallurgy were decreased by 24.5 per cent (to \$1.5 billion). Therefore, the structure of foreign investments in industrial sector has been changed in the first six months of 2006.



Source: Rosstat.

The trend of previous years to increase the share of direct investments in the industrial sphere is maintained in the structure of investments in this sector. The percentage of direct investments in industrial sectors is higher than the cumulative level; basing on the results of the first six months of 2006, it makes 40.2 per cent (in the first six months of 2005 and 2006 it was 39.5 and 24.4 per cent accordingly). The share of other investments in industries in the period of current year under review is estimated at 57.3 (58.5 and 75.0 per cent in the first six months of 2005 and the first six months of 2004).

Like in preceding years, direct investments, made in industries in the first six months of 2006, make over 70 per cent of cumulative direct investments in Russian economy.

*Таблица 4*

**Structure of Foreign Investments in Industrial Sector in the first six months of 2006**

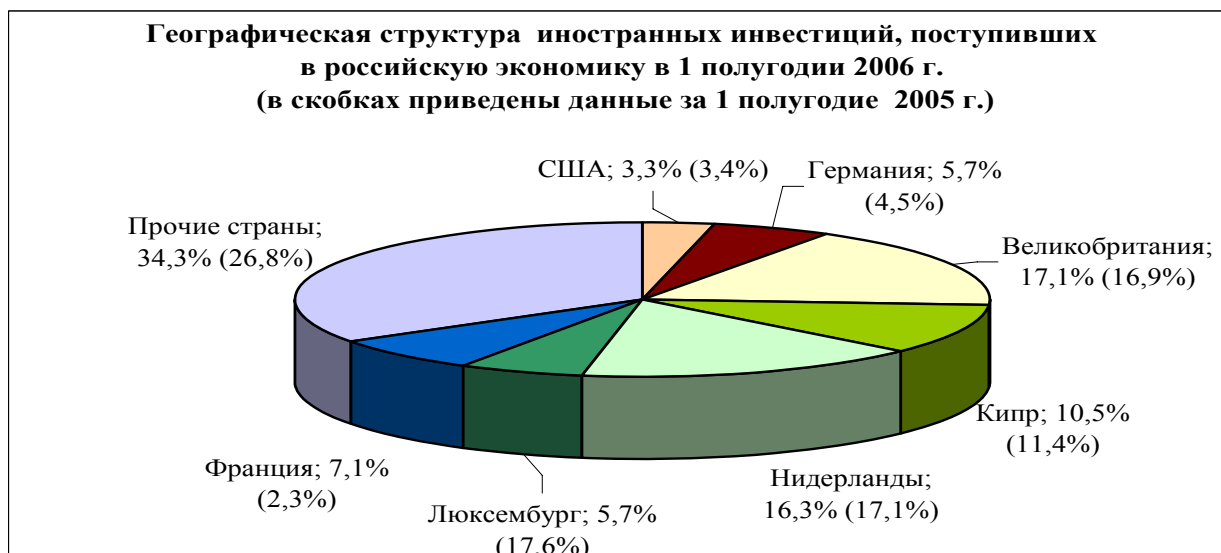
	\$, mln			Difference vs. first six months of 2005		
	Direct	Portfolio	Other	Direct	Portfolio	Other
<b>Industry</b>	4563	288	6502	44.3%	75.6%	38.7%
Including:						
• Mineral resources extraction	3410	0	2450	67.1%	-100%	3 times more
• Metallurgy	69	131	1299	-9.2%	16.4 times more	-31.7%
• Chemical and petrol industry	147	4	477	2.8%	8,5 times less.	16.3%
• Other industries	937	153	2276	3.8%	44.3%	45.7%

Source: Rosstat.

Over 70 per cent of funds from direct investors made in the first six months of 2006, were addressed to mineral resources extraction (51.2 per cent), in processing industries (17.5 per cent) and to trade and catering (4.4 per cent). In the first six months of 2005 direct investments in those economic spheres were estimated at 45.5, 22.7 and 9.4 per cent accordingly.

Other investments in industries for the relevant period are estimated at 28.5 per cent of cumulative volume of other investments in the Russian economy (39.6 and 49.8 per cent in first six months of 2005 and 2004).

There are some changes in the geographical structure of foreign investments made in the first six months of 2006.



Geographical Structure of Foreign Investments Made in Russian Economy in the First Six Months of 2006.

Other countries: 34.3% (26.8%)

USA: 3.3% (3.4%)

Germany: 5.7% (4.5%)

Great Britain: 17.1% (16.9)

Cyprus: 10.5% (11.4%)

Netherlands: 16.3%(17.1%)

Luxemburg: 5.7% (17.6

France: 7.1% (2.3%)

Source: Rosstat.

According to the results of the first six months of 2006, the leading position in the list of the largest countries-exporters of capital to the Russian economy is occupied by Great Britain, which has increased investments in the RF as compared with the first six months of 2005 by 43.2 per cent (to % 4.0 billion).

Netherlands, like for the first six months of 2005, take the second place; the country has invested in the Russian economy in the first six months of 2006 \$ 3.8 billion, by 35.9 per cent more than the level reached during the first six months of 2005.

Investments from Luxemburg, which had a leading position among the major countries-investors to the Russian economy as per results of the first six months of 2005, have decreased by 53.7 per cent countries. Therefore, according to results of the first six months of 2006, Luxemburg has moved to the sixth place. France and India have joined the list of the first five countries-exporters of capital in the Russian economy; their investments for the period in question are estimated at \$ 1.7 billion and \$ 1.6 billion. Total capital amount, invested by France in the first six months of 2006, has been increased by 4.4 times as opposed to the first six months of 2005. Investors from France and India have preferred mineral resources extraction, this industry has received 71.1 per cent of French and 95.2 per cent of Indian investments.

The structure of investments of three leading countries, which have invested in the Russian economy the largest volume of capital, with a break-down by sectors, can be presented as follows:

Table 5

**Structure of Investments of the Leading Countries-Exporters of Capital  
to the RF within the first six months of 2006**

	Great Britain		Netherlands		Cyprus	
	% vs. total	% vs. total investments in the sector	% vs. total	% vs. total investments in the sector	% vs. total	% vs. total investments in the sector
Processing industries	20.3	15.3	2.7	1.9	21.7	10.1
Trade and catering	56.0	44.0	н.д.	н.д.	16.9	8.2
Transportation and communications	19.8	20.1	39.6	38.4	н.д.	н.д.
Mineral resources extraction	н.д.	н.д.	43.5	28.4	н.д.	н.д.
Commercial activities	н.д.	н.д.	4.2	13.1	18.9	37.7
Financial activities	н.д.	н.д.	н.д.	н.д.	23.1	41.0

Source: Rosstat .

Alongside with that, like in the first six months of 2006, the share of ten largest investors in the current year makes over 85.8 per cent in the total volume of investments, accumulated as of July 1 (in the first six months of 2004 it was 87.3 per cent). The first ten countries-exporters of capital to Russia make 85.5 per cent of direct cumulative investments (86.1 per cent in the first six months of 2006). Portfolio and other investments make 68.4 per cent (89.7) and 87.1 per cent (88.3) accordingly.

One of the key incentives for the new investors to enter the Russian market and for those who are already working here, to extend the volumes of their investments, are the ratings of the world agencies Fitch, Moody's и S&P. At the end of July 2006 the Fitch was the first among the world agencies who has raised the sovereign rating of Russia to BBB+ level. At the beginning of September 2006 Standard&Poor's rating agency has also raised Russian rating to BBB+ level. Long-term Moody's rating is one point lower than those of Fitch and Standard&Poor's.

The significant incentives for the new investors to enter the Russian market and for those who are already working here to extend the volumes of investments, are not only the high credit ratings of the world agencies, but the efforts of the government to improve the investment climate in the country as well. At the end of August 2006 the government has approved the Program for technoparks in Russia. Before October 1, 2006 it is planned to select projects for tourist-recreational zones. Those measures are addressed at expansion of the spheres for foreign investors in the Russian economy.

*E. Ilyukhina*

### **Real Economy: Trends and Factors**

Russia's GDP for 1H'06 increased by 6.5% in current prices as compared to the similar period of the previous year. The economic growth has been supported by anticipated expansion of the internal demand. The internal market expansion has been determined by positive dynamics of both domestic production and imports. One of the factors contributing to the structural specifics of the economic growth is a sustainable outrunning growth of prices of industrial goods manufacturers vs the consumer price index.

According to the Regulations for Data Development and Submission by Federal Service of State Statistics, the preliminary assessment of the 1H'06 GDP was performed together with update of the 1Q'06 indicators. The 1H'06 GDP volume in current prices was RUR 12065,3 bio with a 6.5% increase vs the similar period of the previous year. Accelerated rates of industrial development and

works in the construction sector made a domineering impact on the structure of 2006 GDP with sustained development dynamics in trade and services turnover.

Table 1.

**GDP growth indices by sectors of economy during the first 6 months of 2004 – 2005, in % to the respective period of the previous year**

	2005				2006	
	By quarters				By quarters	
	I	II	III	IV	I	II
GDP	105	105,7	106,6	107,9	105,5	107,4
Industrial production	102	102,2	103,4	105	103,9	105,1
production of mineral resources	102,3	101,1	101,1	102,2	101,7	103,5
processing production	101,9	102,9	104,9	107,5	104,6	107,1
Electric power, gas and water production and distribution	101,5	100,8	101,4	100,4	106,2	105,2
Construction	104,6	105,8	111,2	114,6	101,6	112,3
Wholesale and retail trade	110,2	111,8	112,7	114,3	111	110,1
Transport and communications	106,7	106,2	104,9	106,9	104	107,9
Financial activities	106,4	106,4	106,5	106,5	109,1	109,5
Transactions with real estate, lease and provision of services	105,3	107,1	111	111,4	104,3	108,9
Government administration and military security; obligatory social security	102,5	103,0	102,8	102,8	106,2	107,6
Education	100,9	102,7	101,9	102,4	101,5	101,4
Health Service and social services	100,5	101	101,2	101,4	101,6	102
Provision of communal, social and personal services	105,7	106,8	107,2	110,6	104	108,7
Net taxes on products	107	108,1	108,6	107,1	110,3	110,5

Source: Rosstat

The acceleration of the economic growth rates in the current year has been supported by the outrunning expansion of the internal demand. In 1Q'06 the internal demand increased by 9.3%, and in 2Q – by 10.1%. Likewise in 2005 it was the enhanced investment activity that made a major impact on the structure of GDP distribution. The investment incremental growth in 2Q'06 was 11.7% vs 5.9% in 1Q'06.

With account of the income growth of the population and companies against a stable decrease in competitiveness of domestic goods and as a result of the strengthened ruble currency, a dynamic shift of the consumers' preferences towards imported goods has been observed. According to the Ministry for Economic Development and Trade, 70% of the internal demand in the 1<sup>st</sup> quarter and 44.8% in the 2<sup>nd</sup> quarter were met due to higher rates of imports growth. Thus in 1Q'06 the imports incremental growth was outrunning the internal demand growth by 2.8 times and in 2Q – by 1.6 times. The imports impact essentially differs by sectors of economy and commodity markets. Thus, e.g. on the intermediate goods market the import of some feedstock, completing parts for domestic appliances, and components for car assembly in car-assembly projects makes a positive impact on the restructuring processes and the level of business activity of the domestic producers. At the market of goods of investment machine building the increase of imports is a key factor in the investment projects implementation, upgrading of production facilities and implementation of new technologies. However, one should note more acute competition with the imported goods in such machine building sub-sectors as machine-tool manufacturing, agricultural engineering, manufacture of road building machinery and motor industry. These industries are characterized by low investment activity, high degree of depreciation of the fixed assets, outdated technologies that lead to lower competitiveness. Active implementation of industrial assembly business and transfer of foreign businesses to Russia remains one of the most promising trends in these industries. In January-July 2006 the share of machinery, equipment and transportation vehicles in the commodity structure of imports increased by 4.3 vs the similar period while their value

volume went up by 46.7%. The import of light-duty cars by legal entities increased by 30.9%, and by individuals – by 88.3% against 9.3% growth of domestic production.

The situation at the consumer market is defined by individual income growth, new segments of goods and services offers and more stringent requirements of the consumers towards product quality. The 1H'06 consumption rates of the households are retained at the level of 11.0% due to high dynamics of growth of the import volumes. As the ruble currency gets stronger and the consumers' preferences are shifted to average price segments determined by the price-quality ratio, the Russian manufacturers fail to compete with aggressive imports. The exception is the companies that after upgrading and rehabilitating their operation facilities, and building a radically new marketing and logistics system moved themselves into new niches after 1998 devaluation. The competitiveness of the domestic manufacturers of food goods has been based on active investment policy and the current quotas provided for certain food imports. As for production of non food staff, the Russian manufacturers, as a rule, have not compensated for the drop in their price competitiveness by upgrading their operation facilities, and this, in turn, have slowed down the production rates of consumer goods and led to a permanent crisis in textile, clothing and leather shoes manufacturing.

In spite of the exceptionally favorable situation at the world fuel and natural resources market the impact of the external demand continued to diminish this year. If in 1Q'06 the export (physical volume) increased by 7.8% vs the similar period last year, in the second quarter the slow down of the external demand growth to 5.8% was compensated by the acceleration of the domestic production up to 7.8%. In January – August 2006 the index of industrial production made 104.3% to the similar period of the previous year. The major input came from processing/manufacturing industries (index of production is 104.3%) and electric power, gas and water generation and distribution (105.4%). The incremental growth of natural resources production was 2.4%. The growth in construction works is 10.1% against January – August, and the commissioning of residential space exceeded the previous year indicator by 5.4. This year a trend of accelerating growth rates of paid services and retail goods turnover has continued.

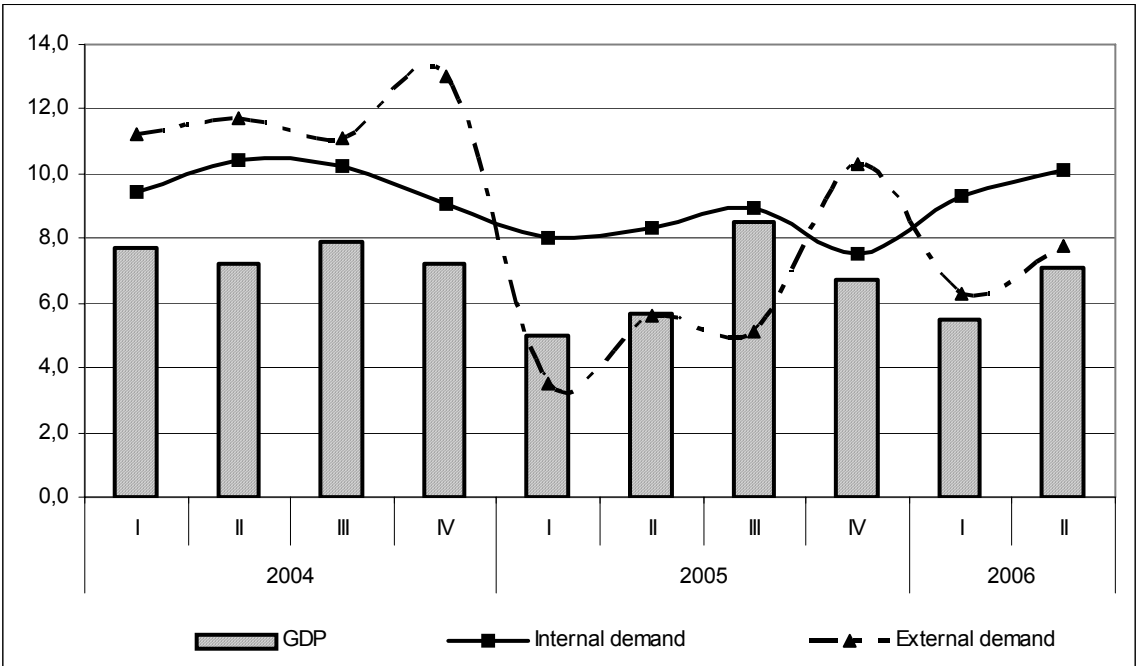


Fig. 1. Changes in the growth rates of internal and external demand in 2004 – 2006 in % vs the respective quarter of the previous year

Due to the increase of the purchasing power of the population retail trade turnover has raised considerably. With the retail turnover increase by 12.1% as compared to January – August 2005, the sales of food staffs went up by 9.4% and non-food staffs – by 14.5%. Such increase of the retail trade volumes is supported by a dynamically developing sector of consumer credits. Likewise in the last year, it was the advanced development of the nonfood market that pushed up the turnover. To a certain extent



this was promoted by structural shifts of the prices in the key commodity sectors. With a 7.1% increase of the consumer prices in January – August 2006, the food goods prices jumped up by 7.4% and non-food goods – by 3.5%. Such price rise on food goods exceeded the inflation rates due to the shrinkage of offers on a number of foods and a high level of monopoly in the sector of agricultural and food products sales at the regional markets.

As for the nonfood market, the factors curbing price growth were, on the contrary, a high dynamics of offers and a strong competition. However, in August 2006 the price incremental growth almost doubled vs the monthly rates of the price growth in the preceding months of the current year. The price dynamics in the nonfood goods category is considerably affected by the growing purchasing power of the population in relation to high-quality goods and by the expansion of consumer credits scale. Thus, e.g. in the last four months due to a sharp raise of demand the accelerated rates of the price growth on cars were recorded. Besides, the price dynamics on nonfood goods was negatively affected by the gasoline price increase: in August 2006 the gasoline price went up by 5.4% while in the 1H'06 the gasoline prices increased by 2.6%.

The price/tariff increase for the paid retail services in January – August this year was 11.5% vs 17.4% for the similar last year period, and therefore made a minor impact on inflation; such was the result of the late 2005 actions taken to restrict the tariffs on communal and housing services this year. In January – August 2006 the growth rates of tariffs on the market services slowed down to 9.1% against 10.5% in the similar period of the previous year. However, even with such restricted offer, tariffs on particular services remain pretty high: since the beginning of the year the price of the pre-school education services has gone up by 23.7%, the price of the spa and health rehabilitation services – by 18%, medical services by 9.3% and personal services by 8.7%.

One of the driving factors of the structural specifics of the 2004 – 2006 economic development is a sustainable outrunning growth of prices of industrial goods producers against the consumer price index. With account of inflation of 107.1% at the January- August consumer market, the price increase of the consumer goods producers was 13.7%, and the cargo traffic tariffs went up by 13.9%. The prices on consumer goods leaped due to structural factors like: electric power and gas tariff growth exceeding the inflation rates, weak competition at the domestic market of fuels and lubes, negative implications of the local monopolies, and restricted opportunities of the Russian producers to expand their offers in quality goods.

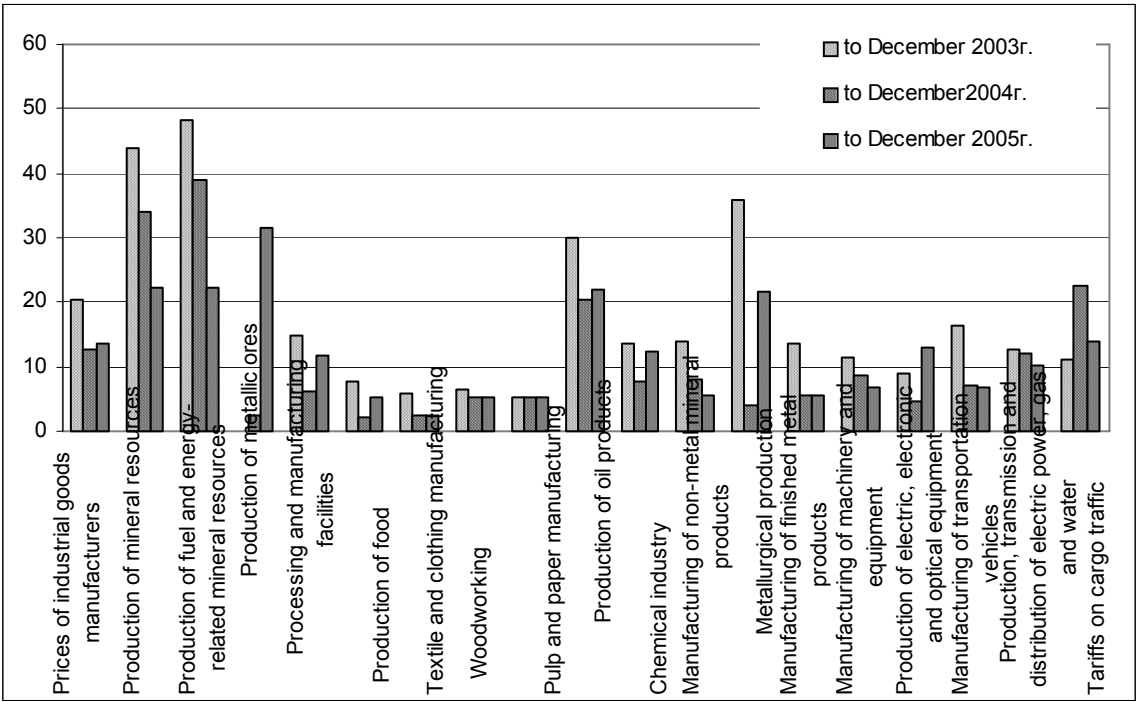


Fig. 2. Changes of price indexes of industrial goods manufacturers in August 2004 and in 2006.

The price dynamics varies essentially by producing and manufacturing/processing industries.

Given the 22.2% price increase on the products of producing companies and the 10.1% increase on the generation and distribution of water and gas vs early 2006, the consumer price index amounted to 111.6%. The reserved price policy of the domestic producers of the final demand goods has been formed mainly under the impact of changes in the competition environment and the enhanced import pressure backed up by the ruble strengthening.

It should be noted, however, that during the last two months the dynamic price growth on fuel and power resources and the products has become a driving factor pushing up prices on the final demand goods. The price growth of the industrial goods producers by 3.6% in the period January through August was caused by the price jump on the fuel and power natural resources by 7.5%, including that on crude by 21.1% and natural gas – by 22.6%.

In August, after a two-month suspension period, the prices on oil products jumped up considerably – by 7.7% while since the year start – by 26.1%. At the background of dropping prices on oil products at the world markets, the domestic prices on gasoline grew by 8.9%, diesel fuel by 3.9% and heating oil by 5.1%. Since the beginning of the year the prices on gasoline have increased by 30.6%, and on heating oil by 30.8% which exceeds the growth pace of the world prices.

This year the prices on metals have been growing at very high rates as much as the respective world prices also have been going up. In July – August the growth rates on the iron ore products were accelerated by 4.8%, non-ferrous ores by 4.1%, while the prices on the metallic ores production went up by 31.7% since early 2006. This in turn pushed up the prices in processing industries. Thus, since the beginning of this year in ferrous metals industry the prices have gone up by 43.2%, and in copper production by 60.6%. At the ferrous metal market the prices on cast iron and blast furnace ferrous alloys have increased by 26.4%, ferrous alloys (except blast furnace alloys) 8.3%, cast iron and steel pipes by 36.8%.

The price increase on engineering materials has led to accelerated growth of monthly producers' prices in the machine-building sector. In January – August 2006 the prices in the manufacturing sector of electric, electronic and optical equipment grew by 13.0% vs 4.5% in the similar period of the previous year. The strengthening of the real effective ruble exchange rate and higher rates of cost growth compared to the labor productivity almost fully set off those price benefits the Russian manufacturers enjoyed after 1988 devaluation in the machine and equipment building sector, and transportation vehicles manufacturing.

According to the estimates of IET, the forecasted growth of the producer price index in 2006 will make 14.4%, in natural minerals production – 30.4% and in processing/manufacturing industries – 15.8%.

*O. Izryadnova*

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## **Industrial Environment in Russia in September 2006**

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No significant changes were noticed in the trend of most of the parameters of Russian industrial environment in September 2006. Growth rates in demand and output, as well as their forecast, remained the same. Satisfaction with demand hit its record high level – two thirds of the domestic manufacturers are currently regarding their sales volumes as normal.

According to the data published by the Federal State Statistics Service, the upward trend in industrial production kept growing in August 2006. The average daily output increased by 0.6 % (seasonal factor was no longer present), according to the estimates of the Center for Macroeconomic Analysis and Short-Term Forecasting. In general, the average monthly growth rate in production reached 0.4 % during the latest two months of the 3Q 2006. At the close of 2006, the industrial production growth rate is estimated to vary within 104.6 – 104.9 % according to the method used in the Federal State Statistics Service, and 105.2 – 105.5 % according to the method used in the Center for Macroeconomic Analysis and Short-Term Forecasting ( January – July 2006 against January – July 2005: 104.3 % according to the estimates of the Federal State Statistics Service, and 104.7 % according to the estimates of the Center for Macroeconomic Analysis and Short-Term Forecasting ). In July and August 2006, the trend in consumer costs was found to be much higher than that in the previous year. In July 2006, inflation accounted for 100.7 % against 100.5 % in 2005, and 100.2 % in August 2006 ( against 99.9 % in 2005 ).

According to the reports of enterprises, growth intensity in product sales stopped to decline and started to grow by 3 % in all industries in September 2006 mainly in wood working and food industries. The same parameter remained unchanged for machine building industry.

However, such tiny changes in the demand were sufficient to lead to a significant review of the estimates at a higher/lower-than-normal scale. In August 2006, satisfaction with demand increased up to 67 % to reach the absolute record high for this parameter. Hence, two thirds of the Russian industrial enterprises are currently satisfied with sales volumes of their products. One hundred per cent of enterprises in fuel industry, 90 % in metallurgy, 70 % in chemistry and petrochemical industry, 63 % in light industry, and 61 % in machine building industry are currently regarding the demand as normal.

In September 2006, growth rates in output changed against those in August of the same year, as evident from questionnaires. Hence production keeps growing, but not as much intensive as in the 2Q 2006. Absolute reduction in production was recorded ( due to seasonal factor ) only in building materials industry, while the most intensive growth was reported in machine building industry .

Excess in stocks of end products ceased to reduce in September 2006. The balance of responses ( higher/lower than normal ) grew by 2 balance points ( due to a bigger number of 'higher-than-normal ' responses ), but still remains unexpectedly low for the level of 2001 – 2006. However, a share of lower-than-normal responses kept growing since the beginning of the year to reach the two-year maximum ( 17 % ). Hence enterprises are either losing their ability to instantly satisfy new ( unexpected ) orders due to production problems, or transiting to a new model of end product stocks management through improving planning of orders and delivery engineering.

It has been for the sixth month that profits in Russian industries have been growing, according to the responses of enterprises. No such a long-lasting and sustained growth of this parameter has been recorded since the commencement of its monitoring in 2002. With regard to industries, upward trends have been recorded in chemical and petrochemical industries, machine building industry, as well as wood working and building industries.

Borrowings have been becoming more available for Russian industrial enterprises. In 3Q of 2006, the normal availability level reached 77 % ( an absolute record high level ). Borrowings in chemical and petrochemical industry ( 97 % ), metallurgy ( 87 % ), electric power industry ( 81 % ) and food industry ( 79 % ) were found most available. Seventy four per cent of enterprises of machine building industry show normal availability .

Forecasts of changes in the demand for September 2006 remained the same as in August of the same year, when the highest figures were predicted through the entire period of monitoring. The demand is expected to keep growing in all industries, exclusive of ( due to seasonal factor ) building industry. Most optimistic results are expected in metallurgy, food industry, light and wood working industries. Production plans of 73 % of enterprises correspond to the demand forecasts. Output of 20 % of enterprises may grow at a more rapid rate than that of the demand. In general, however, both output plans and demand forecasts remained unchanged as compared to August 2006 thus showing ( after seasonal clearance ) 32 balance points against 40 balance points at the beginning of the year.

*Tsukhlo S. V.*

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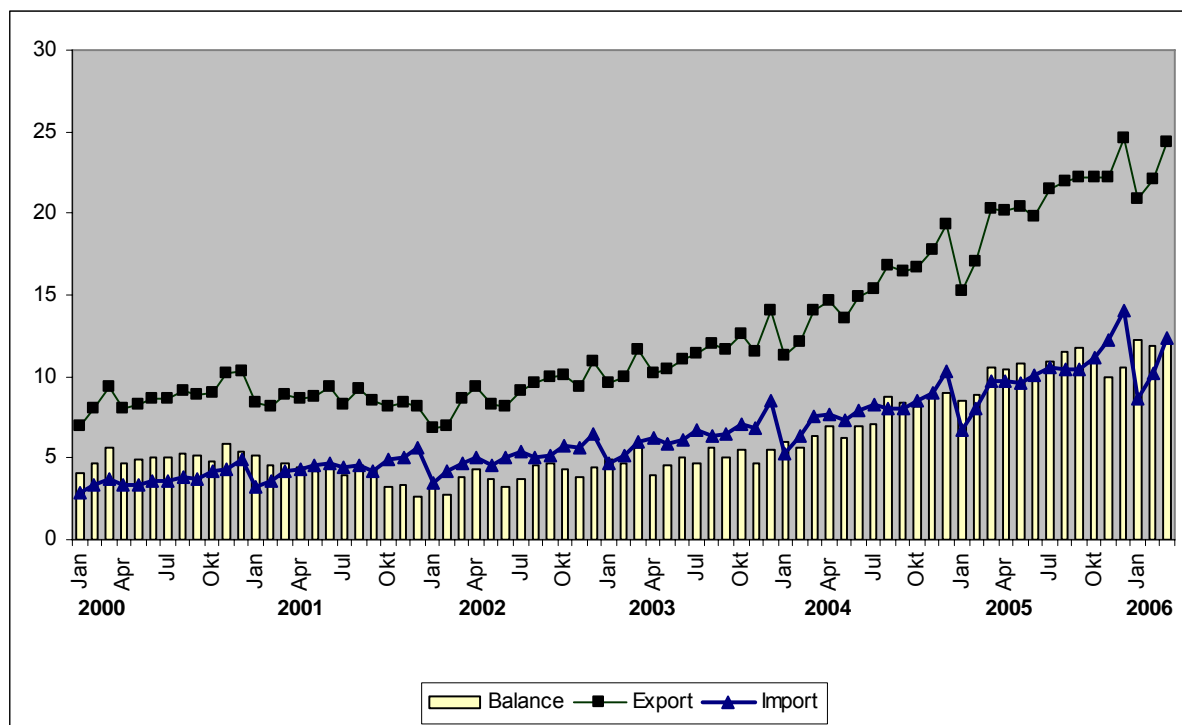
## **Foreign Trade**

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The further rise in value volumes of Russia's foreign trade has been fueled by a substantial growth in its export supplies. They in turn are stirred by a favorable state of affairs on the market for energy sources and a notable rise in imports generated by a soaring domestic demand. However, growth rates of the value volumes of the national foreign trade turnover have been in decline, because of a deceleration of growth rates of the price rise across main commodity items of Russia's export and import

In July 2006, the nation's foreign trade turnover, computed by the balance-of-payments methodology, grew up to USD 39. 5 bn., or at 23.1% vis-à-vis the respective period of 2005. The same month, the volume of the nation's export hit a record-high level of USD 25.8 bn., or at 20% more than in July 2005. Russian's exports to the Far-Abroad countries accounted for USD 22.0 bn., (+18.3% vs. July 2005), while those to the CIS countries totaled USD 3.8 bn. (+30.6%). In July 2006, the volume of import supplies to RF made up USD 13.7 bn. (+26.7% vs. July 2005), with their volume from the Far-Abroad countries accounting for USD 11.6 bn. (+28.4% vs. July 2005) vis-à-vis a USD 2.1 bn.- worth

volume of import supplies from the CIS countries (+ 18.3% vs. July 2005). Russia's positive foreign trade balance thus accounted for USD 12.1 bn. in July 2006, or at 11% up vs. its respective period in the prior year.



Source: CBR

The nation's balance of foreign trade, computed by the balance-of-payments methodology, grew by 28.3% between January and July 2006 vs. the last year's respective period and accounted for USD 253.065 bn. Exports rose at 29.4%, up to the level of USD 169.857 bn., while imports soared by 26.2% and reached the level of USD 83.208 bn. In the period in question, Russia's positive balance of foreign trade rose up to USD 86.649 bn. vs. 65.349 bn. reported a year ago.

The high growth rates of the value volume of export supplies are still explained by an extremely favorable state of affairs on international markets. According to the Bank of Russia's assessments, in July 2006 the world prices, with account of Russian exports across the totality of the commodities that account for 70%-plus of their total value demonstrated a 5.5% growth vs. the prior month, while between January and July 2006 vis-à-vis the respective period of 2005 they exhibited a 29% rise.

In July 2006, the international oil markets mostly witnessed oil prices soar. The price rise was driven upwards by the market participants' concern of a possible intensification of shortages of gas in the US, due to seasonal demand hikes, along with the rise in political challenges worldwide, which were generated by Iran, Nigeria and Iraq. The war on Hezbollah in mid-July and a dramatic exhaustion in the US crude oil reserves catapulted the world oil prices up to new record-high values. More specifically, on July 14, 2006, Urals was traded at USD 72.0/barrel, while Brent – 76.1.

The June-to-July 2006 price rise for oil was: 6.1% for Brent, Dubai and WTI and 7.7% for Urals (up to USD 68.9%/barrel). Overall, between January and July 2006 (here and henceforward vis-à-vis January- July 2005) the oil prices appeared on average at 33% higher. In July 2006 prices for petroleum derivatives soared by 5.3% on average, including: for diesel – by 1.9%, gas – 7.8%, black oil – 9.7%. Between January and July 2006 vs. the respective period of 2005 the oil prices were on average at 34% greater (with those for diesel fuel – at 26%, premium gas – 35% and black oil- 46% up).

Between January and July 2006 the European prices for natural gas climbed up at 3.5%, while those in the US -at 1.8%. During the period in question vs. the same period of 2005 the former prices rose by 41.3% vs. a 2.4% rise of the latter ones.

The world prices for the produces of Russia's fuel and energy complex rose in July 2006 at an average 6% vs. June 2006, while for the seven first months of the year they proved to be at 34% greater than over the respective period of 2005.

The main factor fueling the price rise for non-ferrous metals in July 2006 appeared to be some depreciation of the USD vs. Euro. In addition, London Metal Exchange reported a decline in the stock of copper and nickel, with the latter falling to the lowest level since January 2006. The conflict in the Middle East as also contributed to the price rise for nickel, hence maximum prices for this particular metal.

In July 2006 vs. the prior month aluminum prices rose by 1.4%, copper ones- by 7.1%, nickel – 28.1% (38%, 87% and 19% up between January and July 2006 vs. the respective period of 2005, respectively).

*Table 1*

**The average World Prices in July of the Respective Year**

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Oil (Brent), USD/barrel	18.25	12.96	18.8	28.4	24.62	25.7	28.25	38.2	56.4	72.5
Natural gas, USD/ 1mn BTE	2.121	1.983	2.363	4.01	3.15	2.94	5.021	6.034	7.554	9.305
Gas, USD/gallon	0.594	0.423	0.6	0.935	0.732	0.804	0.896	1.306	1.601	2.271
Copper, USD /t	2481.7	1754.3	1744.8	1864.2	1541.4	1589.0	1730.3	2813.0	3614.0	7712
Aluminum, USD/t	1563.7	1377.7	1403.5	1565.9	1412.2	1338.4	1434.9	1710.0	1779.0	2513
Nickel, USD/t.	6737.3	4620	5273	8202.0	5956.8	7143.1	8790.6	15038	14581	26585

Source: computed by the data of the London Metal Exchange (UK) and International Oil Exchange (London, UK)

The rise in exports was boosted solely by the mineral sector of the national economy. Because of the soaring prices, the value volume of export of rude oil grew by 36.5%, while that of natural gas likewise grow and displayed a 42.0% rise vs. the respective period of the prior year, and the value volume of export of oil products displayed a 48.6% growth.

However, despite a breathtaking surge in the world prices for main Russian exports, July 2006 saw the continuing trend to deceleration of their growth rates, which can be attributed to a decline in the dynamics of the physical volume of the nation's export.

More specifically, the exportation of crude oil plunged by 1.4% in natural terms over the first seven months of the year vs. the respective period of 2005 ( 146.6 mn. t. vs. ?????).

The exportation of natural gas in physical equivalent likewise slid by 5.8%, though different export directions manifested opposite trends: with gas supplies to the CIS countries falling by 38.1%, those to Far Abroad grew by 1%.

According to the Federal Customs Service, between January and July 2006 the specific weight of fuel and energy commodities in the goods structure of export to the Far-Abroad countries accounted for 70.9% of the total volume of exportation to those nations (vs. 65.5% reported over the respective period of the prior year). By contrast, the specific weight of all other groups of goods fell over the period in question compared with the noted respective period of 2005.

A considerable rise in the world prices for non-ferrous metals has failed to encourage a growth in the physical volume of their exportation. To cite a specific example, suffice it to note that the rise in aluminum export barely accounted for a meager 1.3%, while that of nickel – 5.7% vs. the respective seven months of the prior years, while the copper export plummeted down at 3.7%.

In the absence of positive price dynamics, export of ferrous metals and intermediate and finished goods in value equivalent slid by 6.9%. As a result, the proportion of the metals and goods in the total volume of the national export shrank to 13.3% during the seven months of 2006 vs. 16.2% reported over January-to July period of 2005.

A high rise in the value of export of machinery and equipment (19.5% over the seven months of 2006 vs. the respective period of the prior year) appeared particularly notable. This can be partly attributed to a drastic fall in export by this particular group in the beginning 2005. On the other hand, the governmental initiatives on financial and guarantee-based support of industrial export have resulted in a number of huge contracts, however, their proportion in the aggregate volume of the national export dropped by 0.3. percentage points.

High import growth rates are fueled by rising incomes in the economy (with the real GDP growth rate accounting for 6.5% and the population's real disposable incomes – for 11.4%) and appreciation of the Ruble, According to the Bank of Russia, between January to July 2006 vs. the respective period of 2005 Russia's national currency has appreciated at 7.9% vis-à-vis USD, at 13.7% - Euro and 9.9% - against the basket of the trade partners' currencies.

As concerns the goods structure of Russia's import, some changes in that particular area is associated with the ongoing accelerated growth in the "Machinery and Equipment" group. The specific weight of the group in the value of Russian import rose from 41.1% reported in January to July 2005 up to 47.7% over the first seven months of 2006, with the growth rate of its value volumes accounting for 48.6%.

According to FCS, the share of the noted group in imports from the Far-Abroad countries grew from 46.7% up to 50.2% between January to July 2006.

By contrast to Russia's export, the rise in the value volumes of which from the Far-Abroad countries appeared roughly equal to that from the CIS (+29.1% against 31.8%, respectively), the geographical structure of import in January to July 2006 has mirrored a more vigorous advancement in cooperation between Russia and the former group of countries vs. the CIS nations, with the respective growth rate in the noted period 2006 to that of 2005 accounting for 30.7% against 7.6%. A far greater appreciation of the Ruble against USD and Euro than that against the CIS countries' currencies contributed much to the respective ultimate effect.

According to the IET forecasts, the rise in export and import indicators over the period between October this year and March 2007 should make up an average 19%. During the period in question export to and import from the CIS countries, vs. the respective period 2005-06, should post a growth of 18% and 29%, respectively. The rise in the nation's balance of trade with all the countries and those outside the CIS should account for 19 and 8%, respectively, while the volume of balance of trade should make up USD 80 bn.

Thus the 2006 projections suggest a rise in the indicator of export to all the countries worldwide should account for 18%, while in that to the non-CIS countries – 13%. As concerns the respective import figures, they should account, accordingly, for 20 and 25%.

In July 2006 federal Law # 145-FZ 'On introducing amendments to Art. 3 of the Law of the Russian Federation "On customs tariff" was passed. The law reads that export customs duties on rude oil products shall be sent for the term of two months, but they shall become effective as of the first day of the second calendar month following the end of the period of monitoring; the RF Government's rulings on their economic force should be published no later than in ten days prior to their coming in force. This would enable one to synchronize timelines of the coming in force of decisions on adjustment of the noted export duty rates.

The earlier existing mechanism suffered a substantial deficiency, that is, a considerable gap (twenty days) between the period during which new duty rates applicable to oil products were computed and the period during which they came in force. That led to losses of the federal budget. For example, according to some estimates, between May and June 2005, when the customs duty rates rose by 2 USD for just 20 days, the government lost some USD 6 mn., because of the lag; however, when in January to February 2006 the customs duties sky-rocketed at 17 USD, the losses became ten-fold vs. the earlier noted period. Having come in force, the Law should help the government mobilize extra financial resources in to the federal budget.

According to the RF Government Resolution of September 16, 2006, "On approval of the rate of export customs duty on crude oil and crude oil derivatives produced from bituminous layers exported from the territory of RF to beyond the borders of the states that participates in agreements on the Customs Union", since October 1, 2006, the export duty on oil shall be raised from USD 216/t to a new, record-breaking value of USD 237.6/t.

*N. Volovik*

## **Reforming the Law on Local Self-Governance in the City of Moscow**

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Early summer 2006 saw modifications of the Moscow city law on local self-governance being brought in consistency with Federal Law # 131-FZ. The most substantial modifications were introduced to the provisions that regulate organizational fundamentals of local self-governance and division of powers between the Mayor's office and municipal authorities.

The Law "On introducing amendments to Moscow city Law of Nov. 6, 2002 "On organization of local self-governance in the city of Moscow" was passed on May 31, 2006. With its enactment, the city Law was brought in line with the Federal Law "On general fundamentals of organization of local

self-governance in RF<sup>27</sup>. The newly amended act has introduced substantial modifications into the regional legal provisions that regulate organizational fundamentals of local self-governance in the city and changes the list of matters of local concern the solution of which had been mandated to local self-governance bodies of the city districts.

As concerns regulation of organizational fundamentals of local self-governance, the amendments introduced to the Moscow city law have set principles of shaping a system of local self-governance bodies that fully comply with the Federal Law. More specifically, this concerns the obligation of the presence of the position of head of a municipality in the system of bodies and functionaries of local self-governance of intra-city municipal entities, or districts. Like the Federal Law, the newly adopted Moscow city act provides for two ways of electing a municipal entity head, that is, by means of municipal elections or by members of a representative body of local self-governance (municipal council) from their corps. Once elected by the former procedure, the municipal entity head may run an executive and administrative local self-governance body (municipality) or chair the municipal council. Should he (she) be elected out of the representative body, he (she) is nominated a chair of the municipal council, while the position of the municipality head is to be filled by contract. Given this, it is prohibited to occupy both positions.

It should be noted that yet prior to enactment of the noted city law, Moscow had seen a widely spreading model of organization of local self-governance under which the municipal entity head was elected from the municipal council and thus became its chairman, being appointed, at the same time, the municipal entity head. The modifications currently introduced in the charters of municipal entities in the part of the organizational fundamentals of local self-governance keep the model practically unchanged, except for the way the municipality head is appointed – in compliance with the federal and the newly adopted city acts, he (she) should be appointed using competition procedures.

Another avenue of modifying the city law, which should have substantial effects on the local self-governance system in Russian capital, is associated with changes in the list of matters of local concern. Interestingly the noted basic Federal Law, which has triggered a large-scale, nationwide municipal reform, left organization of local self-governance in the federal-level cities, namely Moscow and St. Petersburg, practically completely beyond the framework of its regulation. In compliance with its Art. 79, the setting of fundamentals of the territorial organization of local self-governance, the identifying the list of matters of local concern, regulation of revenues sources for local budgets, and the composition of municipal property of intra-city municipal entities form elements of the city authorities' mandate. By contrast, so far as other RF regions are concerned, these particular mandated facets are regulated on the federal level.

It should be noted that prior to the adoption of the new Moscow city law the local self-governance bodies' mandates were set by the city legislation and they had appeared far narrower than other municipal entities across the country would enjoy. At the time, the self-governance bodies of 125 intra-city municipal entities (aka rayons, or districts) had delivered practically no municipal services. Accordingly, the proportion of local budgets in the city's consolidated one was negligible. For instance, in 2005, the local budget expenditures accounted for 0.3% of the city consolidated budget, with the budget sufficiency per capita rate making a meager Rb. 148, or dozens time lower than in other municipal entities across the country. It should be particularly noted that a considerable share of the funds was spent on the local self-governance bodies themselves – such expenditures accounted for over 70% of municipal budgets.

Such an insignificant role of local self-governance in Moscow was traditionally justified by the “principle of integrity of the city's economy”. The predominant belief was that any decentralization is pregnant with much looser control over the city and collapse of its infrastructure. It was the noted principle to which Federal Law 131-FZ emphatically referred while delegating practically all the powers on regulation of organization of local self-governance in the two Russian capitals to the regional level.

Passed in May 2006, the aforementioned Moscow city Law not only has failed to improve the situation with emergence of local self-governance in Moscow and expansion of the local authorities' spheres of responsibility, but also to a significant extent diminished their possibility for exerting influence on local communities' life within the borders of local districts. More specifically, the list of matters of local concern now lacks such powers as assistance to mass media and provision of material and

technical support of their operations; accounting of local residents in need for improvement of their housing conditions; and support to development of small businesses in a given territory.

That said, the local authorities' rights were limited not only by the exclusion from the list of matters of local concern of any specific problems - as well, the newly amended Moscow city Law sets a closed list of matters of local concern. Accordingly, all the powers the local authorities may enjoy under other legal acts may not fall into the group of matters of local concern and local authorities may not attempt to exercise those. Consequently the local self-governance bodies have found themselves deprived of one of the critical instruments of influence on development of their territories, for their most significant powers were those associated with coordination of local development documentation. However, those powers were granted to them not by the law on local self-governance, but Moscow city Act of July 9, 2003, # 50 "On procedures of preparation for and obtaining permits for construction, reconstruction of buildings in the city of Moscow". In compliance with that statute, before seeking approval from the Mayor's office, city local development plans were subject to the compulsory endorsement by the district local self-governance bodies.

In compliance with the newly passed law on local self-governance, the respective bodies in Moscow have found their so-called "deliberative" powers extend. They include the power to submit proposals to various executive agencies of the city, among others. More specifically, now local self-governance bodies are allowed to submit to the Moscow city government suggestions to the plan of general development of territories of the city districts and administrative okrugs in the part of matters of development of the territory of a given municipal entity. In addition, local self-governance bodies hold a deliberative vote, so far as development of draft targeted programs, development of projects of housing territories, parks, as well as projects on organization and modification of operational routes and modes of public transport, among others, are concerned. However, today, the city legal acts have failed to identify procedures of interaction between its executive power and local self-governance bodies. This makes the involvement of the latter in the decision-making process on the above matters problematic. In addition, deliberative powers also comprise those associated with the necessity for local prefecturas to coordinate with local self-governance bodies their proposals on allocation of land for parking lots, placement of non-stationary retail sales objects, and matters of the targeted use of non-apartment facilities located in the housing fund.

In addition, the newly amended law granted the municipal authorities with a broader power to participate in the citywide events. More specifically, they were granted a possibility to take part in organization of activities with respect to the public ecological control, holding control over protection, maintenance and use of especially protected natural territories located on their respective territories, as well as in organization of operations of local public security offices, conscription office and a number of other activities that appear significant for their local residents.

It must be noted that the delegation of certain facets of the government mandate to the district level has somewhat expanded their sphere of activity – suffice it to note that today the Moscow city local self-governance bodies exercise powers on establishment and organization of operations of district commissions on minors and protection of their rights. As well it is planned to delegate them the powers on organization of the local work with children, teenagers and youngsters and those on development of physical-culture and sports work with the population, with the respective bill already submitted to the Moscow City Duma.

*M. Slavgorodskaya*

### **Issues Discussed at the RF Government Meetings on September 7, 14, 21 and 28, 2006 г.**

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The following issues were discussed at the RF Government meeting on September 7, 14, 21 and 28, 2006: performance of the Federal Targeted Programs and Federal Targeted Investment Program within the first half-year 2006, the RF Pension Fund budget execution in 2005, issues of enhancement of the system of Government purchases in Russia; there were also analyzed and adopted the drafts of the Federal Laws on reduction of the cost of the land areas, privatized by individuals and on diminishing of barriers for foreign citizens, entering the bank system of Russia.



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The RF Government meeting of September 7, 2006. At the meeting there were discussed the Report of the RF Ministry of Economic Development and Trade on performance of the Federal Targeted Programs and Federal Targeted Investment Program within the first half-year 2006. In the framework of monitoring of performance of the Federal Targeted and Federal Targeted Investment Program within the first half-year 2006, actual results of performance of Public clients, results of works on construction sites and objects, reasons of underperformance of some Program actions, as well as measures taken by Public clients for the purpose of elimination of identified deviations in implementation of programs and projects. Special attention was paid to the achievement of the established in a proper order targeted indicators and effectiveness factors of programs implementation, contracts of public clients performance of works, goods delivery, services provision for public needs, contracts performance, budget execution with federal budget funds, investment programs performance, as well as measures of R&D investment projects execution and "other needs". Besides, the possibilities of involvement of co-financing from the budgets of the Russian Federation, local budgets and non-budgetary funds were regarded.

The session of the Russian Federation Government of September 14, 2006. Among other issues, the execution of the budget of the Russian Federation Pension Fund in the year 2005 was considered. It is reported that the revenues of the Fund in the year 2005 have been approved in the amount of RUR 1330.8 billion, the expenditures in the amount of RUR 1295.6 billion. Out of those amounts revenue and expenditure of the budget, unrelated to the accumulated share of labor pensions (allocated from the budget), were adopted in the amounts of RUR 1241.9 billion and RUR 1290.8 accordingly. Therefore, the estimated deficit, which should be covered with carry-over balance of the Fund budget, makes RUR 48.9 billion. In general the Fund budget of 2005 is executed in the amount of RUR 1349.6 billion in terms of revenue and RUR 1299.1 billion in terms of expenditures. In the preset conditions the finance and budget policy in the year 2005 was addressed to performance of the adopted decisions on a decrease of the level pension insurance of the individuals and observance of financial stability of the pension system in the framework of financial limits, established by the Fund budget and the Federal budget.

The session of the RF Government as of September 21, 2006. The meeting was concerned with the draft of the Federal Law "On amendments to the legal Acts of the Russian Federation regarding the amendments to the legal provisions of the terms of acquisition of the property right for the land areas of the national and municipal property", hereinafter "the Draft Law". The purpose of the Draft Law is to diminish the barrier of purchase prices and rent payments for the land for the citizens, when the right for permanent (perpetual) property right for the land is transferred from legal persons.

Thus, in conformity with the draft law, the purchase prices shall be established by the laws of the Subjects of the Russian Federation in the limits, not exceeding 20 per cent of the Cadastral cost of the land areas, where the number of population is exceeding three million and 2.5 per cent in other areas. At the same time, in accordance with Article 2, Item 2 of the Federal Law "On Introduction of the Land Code of the Russian Federation" and Article 28, Item 7 of the Federal law "On privatization of National and Municipal Property", the Subject of the Russian Federation establishes the purchase price of the land areas, where the following number of population is:

Over three million – in the amount of five-fold to thirty-fold rate of the land tax rate for the square unit of the land;

From 500 thousand to three million people - in the amount of five- to seventeen-fold of the land tax rate for the square unit of the land;

Up to 500 thousand of people and beyond the populated area – in the amount from three- to ten-fold of the land tax rate for square unit of the land.

Therefore, in the opinion of the Draft Law authors, the adoption of the draft law will lead to reduction of the purchase price in comparison with the year 2006 in cities by 2.3 to 9 times on average and in rural areas by 7.3 times. The cumulative expenditures of industrial enterprises for the purchase of land areas will be reduced from RUR 736.5 billion to RUR 190.8 billion.

Based on the results of discussions of the Draft Law, the Government has approved and adopted the decision to present it to the State Duma.

The draft of the Federal Law "On amendments to the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)", hereinafter the Draft Law, has been also debated at the meeting.

The Draft Law introduces the following amendments to the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia)” and the Federal Law “On the banks and banking activities”:

1. It is proposed in the Draft Law to establish a threshold of acquisition of shares (equities) of a credit organization in the amount of 1 per cent, which can be increased upon notification of the Bank of Russia, and to establish a threshold of acquisition of 10 per cent, an increase of which requires preliminary approval on the part of the Bank of Russia. One should note, that currently, according to Article 61 of the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia)” and Article 11 of the Federal Law “On the banks and banking activities”, acquisition and (or) acceptance in trust management by legal or physical persons or a group of legal or physical persons of more than 5 per cent of shares (equities) of a credit organization is permitted upon notification of the Bank of Russia, and over 20 per cent – upon preliminary approval of the Bank of Russia.

2. Moreover, the Draft Law stipulates elimination of provisions of Article 28 of the Federal Law “On the banks and banking activities“, according to which a credit organization was bound to get a preliminary approval from the Bank of Russia for enlargement of its authorized capital with the funds of non-residents and for disposal (including the sale) of its shares (equities) to non-residents; and credit organization’s shareholders-residents – for disposal of their shares in favor of non-residents. Therefore, one more threshold for acquisition of shares (equities) of credit organizations by foreign legal and physical persons is, in fact, eliminated.

3. The Draft Law also stipulates elimination from Article 18 of the Federal Law “On the banks and banking activities“ of the provisions concerning the right of the Bank of Russia to establish additional requirements to credit organizations with foreign investments in regard to obligatory limits and minimal amount of capital for the newly registered branches of foreign banks.

Basing on the discussions, the RF Government has approved the Draft Law and adopted the decision to present it to the State Duma.

The session of the Government of the Russian Federation as of September 28, 2006. At this meeting the issue of implementation of the Federal Law “On placement of orders for the delivery of goods, performance of works, provision of services to the national and municipal needs” was considered. In relation to this topic the following issues were discussed at the meeting: performance of the system of national and municipal orders in the Russian Federation, based on the analysis of the Ministry of Economy of Russia in cooperation with Federal Antimonopoly Service of Russia and Russian National Defense Order Agency, of placement of orders on delivery of goods, performance of works, provision of services for the national and municipal needs by federal government authorities of the Russian Federation, bodies of the Subjects of the Russian Federation, local self-government authorities; dynamics of major indicators, reflecting the situation of orders placement for delivery of goods, presented in statistical reporting, provided by Rosstat for the first half-years 2005 and 2006; performance of works, provision of services for national and municipal needs, development of the legal basis for placement of orders, for control in the area of the orders placement; problems of information support of placements of orders, forecasting and planning of purchases.

*M.Goldin*

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## **A Review of the Russian economic laws issued in September 2006**

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The following amendments were made to the applicable legislation in September 2006: Rules to regulate the procedure of provision of state guarantees of the Russian Federation in 2006 were approved ; notifications forms on maximum retail prices of tobacco products made on the territory of the Russian Federation, and on tobacco products imported to the customs territory of the Russian Federation were approved ; information on registration of landholders was provided; the Bank of Russia determined the limit amount of cash settlements to be applied to transactions entered upon between legal entities (per single transaction) and self-employed entrepreneurs in the Russian Federation ; a procedure of payment of mineral tax taking into account of recently effective provisions of Federal Law “On General Principles of Local Self-Government in the Russian Federation” ; the data to be used for practical assessment of mineral tax with regard to oil production in August 2006 was provided .

## **I. REGULATIONS issued by the GOVERNMENT of the Russian Federation**

1. Regulation No. 571 “ ON THE PROCEDURE FOR PROVISION OF STATE GUARANTEES OF THE RUSSIAN FEDERATION IN 2006 FOR STATE SUPPORT OF EXPORT OF INDUSTRIAL PRODUCTS” was issued on September 16, 2006 .

Rules to regulate the procedure of provision of state guarantees of the Russian Federation in 2006, which in particular contain a list of types of products, works and services export of which is to be provided with the said guarantees, were adopted for the purposes of providing support to Russian exporters. It was established that the Ministry of Finance of the Russian Federation is entitled to provided guarantees of the Russian Federation in the amount not exceeding the amount equivalent to 50 million US dollars ( per each state guarantee ). A list of persons entitled to receive state guarantees, namely Russian exporters of industrial products, Russian banks-creditors or foreign banks-creditors which extend loans to Russian exporters, foreign importers, non-resident banks and foreign states in exporting Russian industrial products. State guarantees also may be provided on borrowings and bank guarantees provided by Roseksimbank. In providing state guarantees the Ministry of Finance of the Russian Federation shall enter into corresponding agreements on behalf of the Government of the Russian Federation.

Obligations for state guarantees shall be covered on account of the federal budget.

## **II. ORDERS AND LETTERS**

1. Order No. 108<sup>H</sup> “ON APPROVAL OF NOTIFICATION FORMS ON MAXIMUM RETAIL PRICES OF TOBACCO PRODUCTS ” was issued by the Ministry of Finance of the Russian Federation on August 25, 2006.

Registered with the Ministry of Justice of the Russian Federation on September 15, 2006. Registration number 8292.

Pursuant to the amendments made by Federal Law No. 134-FZ of 26.07.2006 to the Tax Code of the Russian Federation, notifications forms on maximum retail prices of tobacco products made on the territory of the Russian Federation, and on tobacco products imported to the customs territory of the Russian Federation were approved. It was established that the said notification forms shall be used from December 15, 2006 .

2. Letter No. MM-6-09/799@ “ ON REGISTRATION OF LANDHOLDERS” was issued by the Federal Tax Service on August 14, 2006.

It was stated that for the time being authorities keeping the state land register provide information on real estates recognized as land tax entities.

Given that this information can be outdated and/ or incomplete, as well as taking into account that authorities keeping the state land register, are not involved in state registration of estate in land and related transactions, information on real estate obtained from authorities keeping the state land register can not be deemed a ground for registering landholders – physical bodies – with tax authorities.

It was also specified that information on legal landholders, which municipal authorities convey to tax authorities in accordance with Clause 12, Article 396 of the Tax Code of the Russian Federation, may be used to control integrity of information of received from authorities keeping state registration of estate in land and related transactions.

3. Letter No. MM-6-21/819@ “ON THE PROCEDURE FOR PAYMENT OF MINERAL TAX” was issued by the Federal Tax Service on August 17, 2006.

A procedure of payment of Mineral Tax taking into account of recently effective provisions of Federal Law of 06.10.2003, No. 131-FZ “ On General Principles of Local Self-Government in the Russian Federation” was explained. In particular, it was specified that mineral tax in a separate constituent entity of the Russian Federation must be paid at the place where the taxpayer is registered as a taxpayer of Mineral Tax, irrespective of the fact that of Mineral Tax revenues are credited to local budgets in the given constituent entity of the Russian Federation. The OKATO code (National All Russian Classifier of Administrative Territorial Entities) at the place of registration of the taxpayer in the given constituent entity of the Russian Federation, as well as Taxpayer Identification Number and Tax Registration Code of the tax authority at the place where tax return is filed should be specified in executing payment documents for Mineral Tax, as well as in mineral tax return. The payment procedure for Mineral Tax set out in this letter shall be applicable since January 1, 2007. The letter of the Ministry

for Taxes and Charges of the Russian Federation issued on July 1, 2004 No. 21-2-05/74@ “ On the Procedure for Payment of Mineral Tax” shall cease to be in force since the same date .

4. Letter No. MM-6-06/869@ “ON LETTER No. 08-17/2540 ISSUED BY THE BANK OF RUS-SIA ON JULY 17, 2006 ” was issued by the Federal Tax Service on August 30, 2006.

Regulation of the Central Bank of Russia No. 08-17/2540 of 17.07.2006 with regard to application of Regulation No. 1050-Y of the Central Bank of Russia of 14.11.2001 “On Determination of the Limit Amount of Cash Settlements per Single Transaction Between Legal Entities in the Russian Federation” to self- employed entrepreneurs was issued. The provisions of Regulation of the Central Bank of Russia No. 1050-Y of 14.11.2001 shall be applicable to the case of cash settlements between legal entities and self-employed entrepreneurs and between self-employed entrepreneurs. It is a reminder that the this regulation determines Rb 60 000 as the limit amount of cash settlements per single transaction .

5. Newsletter No. MM-6-21/936@ “ ON CALCULATION OF MINERAL TAX RATE IN AUGUST 2006” was issued by the Federal Tax Service on September 18, 2006 .

The data to be used for practical assessment of mining tax for oil production in August 2006 was provided :

- The price of Urals oil averaged \$68.64 US dollars per barrel ;
- The USD/RUR exchange rate ( as quoted by the RF Central Bank ) averaged Rb 26,7653 per USD for the entire fiscal period ;
- Kc coefficient – 6, 1160;
- Tax rate subject to the Kc coefficient – Rb 2562,6040 per ton.

*Anisimova L., Tolmachiova I.*

## **A review of Budget Legislation: September of 2006**

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In September the following amendments were introduced in the effective legislation: by the Government Decree N 559 as of 11.09.2006 the amendments were introduced on the rules of provision of subsidies from the federal budget to the budgets of the Subjects of the Russian Federation for partially reimbursement of the interest on loans, received from the Russian credit organizations by a municipal infrastructure for the land areas, designated for residential construction. The amendments were introduced by the Government Decree N 576 as of 18.09.2006 on the rules of granting of subsidies from the federal budget to the budgets of the Subjects of the Russian Federation for partial reimbursement of the interest on investment credits, received by the producers of agricultural goods in the year 2006; there were also adopted: the Order of the RF Finance Ministry N 113n as of 29.08.2006 on additional issue of the Russian Federation external bonded loan with the final dates for reimbursement in the years 2010 and 2030. The Order of the RF Finance Ministry as of 23.08.2006 107n has introduced the Procedure of keeping of the National Debt Ledger in the RF Finance Ministry; a letter of the Finance Ministry N 02-14-10a/2293 as of 23.08.2006 is issued “On the procedure of presenting of budgetary reporting for the nine months of the year 2006 to the Federal Treasury”.

### **I. Decrees of the RF Government**

The Decree of the RF Government N 559 as of 11.09.2006 “On amendments to the rules of provision of subsidies from the federal budget to the budgets of the Subjects of the Russian Federation for partially reimbursement of the interest on loans, received from the Russian credit organizations by a municipal infrastructure for the land areas, designated for residential construction, introduced by the Decree of the Russian Federation Government N 221 as of April 17, 2006.

In conformity with the adopted amendments, the subsidies shall be granted for partial reimbursement of interest on the loans, received by the executive bodies of the Subjects of the Russian Federation or agencies of local self-government, excluding municipal bodies and construction developers. The amounts of reimbursement are established for the loans for the complete term of credit for construction of low-rise and high-rise dwelling houses; it is specified that dwelling houses up to three levels shall be regarded as low-rise dwelling houses, and those ones of four and more levels shall be regarded as high-rise buildings; some other amendments were introduced.

The Decree of the RF Government N 576 as of 18.09.2006 “On the amendments to Item 4 of the rules of granting of subsidies from the federal budget to the budgets of the Subjects of the Russian

Federation for partial reimbursement of the interest on investment credits, received in the year 2006 by the producers of agricultural goods, organizations of agro-industrial complex of any property form and farmers' households, in the Russian credit organizations for the term of up to eight years for the purposes of construction, reconstruction or renovation of livestock units (farms), introduced by the Decree of the Russian Federation Government N 69 as of February 4, 2006".

In accordance with the adopted amendments, the subsidies for partial reimbursement of the interest on investment credits, received in the year 2006 by the producers of agricultural goods, organizations of agro-industrial complex of any property form and farmers' households from the Russian credit organizations for the term of up to eight years for the purposes of construction, reconstruction or renovation of livestock units (farms), shall be granted from now on with due regard to the refund rate, established by the Central Bank of the Russian Federation on the date of the credit contract signature, as opposed to the date of the loan granting.

The RF Government Decree N 582 of 20.09.2006 "On amendments to the regulations on providing of funds from the Federal Budget for the support of small business, including farmers' households, introduced by the Decree of the Russian Federation N 249 as of April 22, 2005".

In particular, in accordance to the newly introduced amendments, a partial subsidy is foreseen for expenses of the small business subjects, producing and selling the goods (works, services) for export, for expenses on development, registration and/or legal protection outside the country of scientific discoveries or other intellectual activities, protected by law, as well as other means of individual identification of legal persons or products (works, services).

The regulations were supplemented with the new section on provision of subsidies for other measures of the Subjects of the Russian Federation, aimed at the support and development of the subjects of small business. It is specified that the subsidies are to be provided under condition of actual transfer of funds in the year 2006 by the Subject of the Russian Federation in conformity with the Program of Support and Development of the Small Business and in case of observance of provisions, introduced by the RF Ministry of Economy; other amendments were introduced.

## **II. Orders of RF the Finance Ministry**

The Order of the RF Finance Ministry N 113n as of 29.08.2006 "On additional issue of the Russian Federation external bonded loan securities with the final refund dates in the years 2010 and 2030, issued in the process of the former USSR commercial debt settlements with the external creditors, was registered in the Ministry of Justice under N 8229 as of 12.09.2006.

In accordance with the RF Government Decrees N 931 as of 29.12.2001 "On settlement of Commercial Debt of the former USSR with the external creditors" and of N 478 as of 29.12.2001 "On settlement of indebtedness of the former USSR to the external commercial banks and financial institutions-members of London Creditors Club", there were established the terms of additional emission and circulation of securities of the external Russian Federation bonded loan with the final refund dates in the years 2010 and 2030, issued in the process of the former USSR commercial debt settlements with the external creditors.

Additional securities of two types will be issued (securities with the final refund date as of March 31, 2010 and securities with the final refund date as of March 31, 2030) by tranches in the time limits, established by the issuer (the RF Finance Ministry)

The Order of the RF Finance Ministry N 107n as of 23.08.2006 "On administering of the procedure of keeping up the Debt Ledger of the Russian Federation in the RF Finance Ministry" is registered under N 8321 as of 15.09.2006.

The Order introduces the procedure of keeping up the Debt Ledger of the Russian Federation in the RF Finance Ministry, which is elaborated with the aim of determining the procedure of keeping up of the above ledger to ensure the control over reporting consistency, timely debt servicing and performance of debt liabilities and establishes requirements to the Debt Ledger structure, as well as rules of its on updating and storage.

It is stated that all debt liabilities, which have not been settled before September 1, 2006, shall be registered in the Debt Ledger.

The procedure of registration of any promissory note, with designation of the type of the state debt liability, the Tables are provided, where the codes of external Governments and international financial organizations are presented.

The Letter of the Finance Ministry N 02-14-10a/2293 as of 23.08.2006 “On provision of budgetary reporting for the nine months of the year 2006 to the Federal Treasury”.

The Letter specifies the scope of budgetary reporting for the nine months of the year 2006, which should be presented by the Chief Supervisors of the federal budget funds to the RF Federal Treasury in conformity with the Order of the RF Federal Treasury N 6n as of 29.06.2006 “On the time limits for providing of consolidated quarterly and yearly budget reporting of the Chief Supervisors of the federal budget funds and other recipients of federal budget funds in accordance with requirements of consolidated budget break-down for the year 2006”.

It is also outlined, that the financial bodies of the Subjects of the Russian Federation and municipal authorities, administrative bodies of the national non-budgetary funds and local non-budgetary funds have the right to adopt a decision on application of provisions of the Letter in regard to the budget institutions of the Subjects of the Russian federation and municipal bodies.

*M. Goldin*