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RUSSIAN ECONOMIC DEVELOPMENTS

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RUSSIA'S ECONOMY IN JUNE 2013: PRELIMINARY DATA AND PRINCIPAL TRENDS

K.Rogov

Socio-political environment. June 2013 was relatively quiet, but its major events were triggered by recently accumulated political conflicts and confrontations.

Having denied in May an option for economic amnesty proposed by the business community, President Putin offered his own version in June: not only does Putin's version rule out any possibility to include M. Khordorkovsky in the amnesty, it also specifies compensation for damages as compulsory condition for amnesty. This is a symbolically important update: according to the business community, the amnesty should have been an act of state's recognition of inadequate application of the criminal law against entrepreneurs, whereas in Putin's version it becomes an act of grace towards those who acknowledged the jail sentence legitimacy, i.e. the repressive rule of law established against businesses.

The 2013 Moscow mayoral election campaign and the conflict between President Putin and the Russian Academy of Sciences (RAS) were most high-lighted political events. Immediate electoral threats were minimized for S. Sobyenin (such hypothetical threats could have been created by communist union candidate Melnolkov, systemic opposition member M. Prokhorov, and non-systemic figure in opposition A. Navalny) after M. Prokhorov refused to run for mayor of Moscow, and Sobyenin's headquarters are basically focused on making his potential winning look legitimate as much as possible. The opposition has found itself under unfavorable conditions due to lack of time and monies to mount an effective election campaign against Sobyenin, as well as A. Navalny is being involved in a lawsuit against him in Kirov.

The proposed version of the reform of the Russian Academy of Sciences (RAS) is reduced to depriving RAS of the right to dispose of its property and assets. Externally, this version of the reform has been comprehended as Putin's response to the election of academician Fortov as RAS president and non-election of M. Kovalchuk, who is considered being close to President Putin, as director of the RAS-affiliated Institute of Crystallography.

Furthermore, President Putin's proposal to unite the Supreme Court and Supreme Arbitration Court of Russia looks like an echo of political confrontations. This significant reform, which requires amendments to the

Constitution of the Russian Federation, is unmotivated and according to experts and general public is only intended to create the position of chairperson in the united supreme court for incumbent Prime Minister Dmitry Medvedev after his alleged resignation soon.

An important event in June was the arrest of Makhachkala mayor Said Amirov which looked like a military operation. S. Amirov was a key figure who governed political balance in Dagestan and the North Caucasus in general. His arrest by special forces and transfer to Moscow must instate the Kremlin in its right to arrest selected regional leaders, on the one hand, and strengthen the position of Moscow's appointee Ramzan Abdulatipov as President of Dagestan, on the other hand. The situation in Dagestan has become essential due to upcoming Olympic games in Sochi.

Macroeconomic environment in June was governed by the events in external markets and Russia's economy sliding towards stagnation as evidenced by the May economic statistics. External adverse environment was governed by global markets' nervous response to the US economic authorities' statement about intentions to discontinue FRS's quantitative easing programs (the statements sounded more relaxed at the end of the month), as well as the problems in the Chinese banking system. Crude oil prices fluctuated within established corridor (Brent crude oil of \$100–106 p/b) as non-ferrous metals lost in price (a decline of about 10% on average). As a result, the MICEX index lost 11.5% from May 22 to June 13, 2013, but both global and Russian stock markets saw correction at the end of the month after a sedative FRS meeting and amid growth in crude oil prices. As a result, the MICEX index dropped about 2% at the end of June 2013.

Weakening of a ruble exchange rate became a more important macroeconomic factor, which analysts consider as soft devaluation. The weakening followed Minister of Finance's statements about potential weakening of a ruble exchange rate which triggered markets' nervous response. In general, the ruble began to weaken since April 2013: the USD gained 8.3% over RUB (from Rb 30,19 to Rb 32,71 as of June 29, 2013), a the dual currency basket lost 6.3%, in June RUB lost 3.5% again USD, and the dual currency basket lost 3.9%. The Russia's Government wants the ruble to weaken indeed: federal budget revenues accounted

for 20.0% of GDP in January–May (against 22.2% year on year) in response to deteriorated global prices and rapid slowdown in economic growth rates. In addition, US monetary authorities' intention to discontinue bond redemption programs is likely to force down crude oil prices in the upcoming fall. Preventive weakening of a ruble exchange rate amid such conditions would equalize the budget and mitigate potential shocks in the upcoming fall if prices go down fast.

In June, inflation dropped from 7.44% to 6.9% on a year-on-year basis in response to a very high inflation background in June 2012 (+0.9% of May 2012). Monthly prices grew up at a rate of 0.4% in June 2013, whereas core inflation stood at 0.3% against 0.4% in June 2012. Inflation slowed down basically in response to more moderate growth rates in prices of fruit and vegetable products and services in June 2013 against the previous year. Furthermore, it should be noted that money supply growth rates were moderate too: M2 growth slowed down on a year-on-year basis from 19.6% as of May 1, 2012 to 15.2% as of May 1, 2013. However, the June inflation slowdown shouldn't be confused with change in the trend: the upcoming indexation of communal services tariffs will maintain inflation.

The updated Central Bank's data on capital outflow show that the situation keeps very unfavorable. In H1 2013, net capital outflow totaled \$38,4bn as reported by the Central Bank of Russia, \$28,4bn in Q1 2013 (instead of previously reported \$25,8bn), and \$10bn in Q2 2013.

Situation in the real sector leaves no doubt that the situation in the Russian economy can be characterized as stagnation. Improved economic figures in March–April gave way to their deterioration in May. The industrial sector shows negative growth rates on a year-on-year basis – 98.6% against May 2013 (manufacturing sector – 95.6%), trade turnover dropped to 2.9%. In fact, annual figures improved in March–April in response to the weak data on March–April 2012, when the economy showed first signs of a serious slowdown, May 2012 was rather better. Not counting the base effect, it becomes apparent that Russia's industrial sector has been stagnating year-to-date, industrial growth rates in January–May 2013 stood at 0.2% year on year (mineral extraction industry – 0.6%, manufacturing sector – 0.2%). The situation in the mineral extraction sector was governed by slow growth in crude oil production (100.4% against January–May 2012) and reduction in the gas production sector (93% against January–May 2012). The situation in the manufacturing sector is quite different: food production, chemical industry and certain types of construction materials saw

positive growth rates, whereas negative rates were typical of light industry and machine building sector.

A negative uptrend in imports of consumer goods against downtrend in investment and intermediate goods developed early in 2013: consumer imports stood at 38% and investment goods at 25% Q1 2012 against 41% and 23% respectively in 2013. This means that considerably weakened consumer demand is mostly covered with growth in imports rather than growth in domestic industrial production. Therefore, one may say that sluggish demand is not the only reason for the industrial slowdown.

Stagnation in investments developed in response both to sluggish demand and corporate financial health deterioration. Loss-making enterprises accounted for 36.5% of the economy at large (against 35.0% in the preceding year), including 45.6% of the mineral extraction sector (against 41.0% in the preceding year), 36.3% of the manufacturing sector (against 33.6% in the preceding year) and 49.9% of the transport sector (against 48.5% in the preceding year). It should be noted that both unemployment (unemployment rate stood at 5.8% in Q1 2013 against 6.3% in the preceding year) and average real wages (in Q1 2013 – 104.5% against Q1 2012, a growth of 5.7% in May) keep growing against rapid economic slowdown and corporate financial health deterioration. Indeed, such a situation can't help the economy recover from stagnation and opts for current consumption in prejudice of investments.

In general, capital investments in January–May 2013 stood at 99.6% and 100.4% in May year on year. In Q1 2013, capital investments dropped by 5.0% in the segment of large and medium-sized enterprises, and grew up 7.1% in the segment of small-sized enterprises, though they halved year-on-year.

In Q1 2013, capital investments kept showing positive dynamics in the manufacturing sector (108.0% against Q1 2012) amid a substantial fall in investments in the mineral extraction sector (88.6%). Corporate profit-funded investments increased (53.0% against 50.6% in Q1 2012), although in Q1 2013 profitability stood at 8.4% in the economy at large and dropped 2.3 p.p. year-on-year. In Q1 2013, direct foreign capital investments dropped 2.8% in total investments against 3.3% in the preceding year. Such a situation with investments gives up hope of recovery from stagnation in a short-term period. ●

POLITICAL AND ECONOMIC RESULTS IN JUNE 2013

S.Zhavoronkov

In June 2013, the ruble was slightly devaluated with a view to increasing ruble budget revenues amid slow-down in economic growth. A.Ulyukayev was appointed a new Minister of Economic Development, replacing A. Belousov, which most probably means an attempt to observe moderation in government spending. President Putin admitted the need to limit growth in monopolized tariffs within inflation rate and carry over a part of military expenditures for better times. A new privatization program approved by the Russian Government was actual announcement to refuse to privatize large property (except for Rostelecom, Vnukovo and Sheremetyevo international airports, ROSNANO, Aeroflot) to the extent that privatization means gaining control over such property by a private owner. However, the previous program failed to be implemented, being just an attempt of political promotion, therefore no serious deterioration in a new reality can be observed. The arrest of Makhachkala mayor S. Amirov in Dagestan was an evidence of that the state is seriously determined to combat civil servants and ethnic tribes who have relations with terrorist underworld.

June 2013 saw lots of fundamental-nature but quite remarkable events. First of all, economy was in the spotlight: a Budget Message of the President of Russia was announced, the St. Petersburg International Economic Forum was held, a new Minister of Economic Development was appointed, ruble exchange rate dropped, a new version of the government program on privatization for 2014–2016 was adopted.

The new version of the government program on privatization for 2014–2016 specifies that no real privatization is planned, which is not a novelty, because top government officials' friends who manage state companies are not interested in such privatization, even though they could have, say, obtain loans and taken over the companies, they would have to assume business responsibility, risks, potential losses instead of enjoying comfortable circumstances, high- and rent-paid status. In addition, it is difficult to privatize many of the largest companies when money is held in Russia, and purchase of such companies by foreign buyers is more than unwanted. Things have been developing quite the opposite way, when expanding state companies taking over private businesses. In the years of 2008 thru 2012, Russia's government officials, namely Deputies prime minister I. Shuvalov and A. Dvorkovich repeatedly and persistently spoke about a fabulous privatization to be launched very soon to replace the apparent growth in the public sector. Though a government plan which promised that by 2016 the state would cease to have its interest in such companies as Rosneft, VTB, Russian Agricultural Bank, RusHydro, ALROSA, Zarubezhneft, Sovkomflot, etc. was adopted in the summer of 2011, it has failed to be implemented over the past two years, not counting the sale of a minority interest in state companies. The state retains

control interest or sells a state-held minority interest. Purchase and sale of a minor interest in Sberbank and VTB have become the largest transactions to date. In fact, sale of a control interest in a large company, like the Vanino Commercial Sea Port, was a most singular exception.

All illusions about privatization were shattered after Vladimir Putin took office as Russian President. Since stories about privatization no longer worked, government authorities decided to bring the actual situation in line with the real one. The new privatization plan rules out the possibility to sell control interest in all but a few largest companies, namely Rostelecom, Vnukovo and Sheremetyevo international airports, ROSNANO, and Aeroflot, in the next few years. However, a closer look can reveal some nuances: privatization of Rostelecom due its sophisticated structure with numerous subsidiaries with different interest was postponed on more than once occasion, and the government has postponed it from this year until 2014; privatization of Aeroflot was repeatedly postponed too. Furthermore, the latter is legally impeded by a story of charging royalty on foreign aircraft flights over Russia in favor of Aeroflot as state-run company; in May 2013 President Putin himself spoke against privatization of ROSNANO which, by the way, was scheduled for 2017. Perhaps, potential privatization of Vnukovo and Sheremetyevo international airports is the only case that should be considered realistic, because given the deficit of airport capacities in the Moscow Region, the airports will definitely attract private investors who would easily recover the investment. Therefore, the government authorities have nothing to do but select politically "loyal" buyers. It should be noted that Russia's Government began to revise the idea of selling minor inter-

est in largest companies to state-run Funds, namely the Pension Fund of the Russian Federation (PFR) and the National Wealth Fund (NWF). Therefore, the state will keep control over the management, and the Funds will have a permanent source of income as dividends. However, the level of state-run companies' dividends in Russia remains extremely low (to compare: in 2011, the last year before TNK-BP was acquired by Rosneft, the former paid 10 times as much per barrel of oil equivalent (BOE) produced), while some of them are as efficient as loss-makers such as InterRAO, a state-run monopolist in electric power exports. Therefore, a theoretically correct theory may turn out to make losses for the state-run Funds.

In June 2013, President Putin submitted a draft law on amnesty to the State Duma with a request to adopt it before summer vacations. In May, an ill-prepared attempt of Commissioner for Entrepreneurs' Rights B. Titov to propose amnesty for more than 100,000 persons was fraught with failure of amnesty as such. The amnesty was limited both in terms of articles of the Criminal Code of Russia and facts of amnesty application. It is only Articles 159.1 and 159.4 of the Criminal Code of Russia that remained in force (Swindling in business operations and lending remained the key business-related articles, whereas most sentences were awarded under most general Article 159 (Swindling) whose itemization was introduced not long ago in 2013). Amnesty lost other two articles of the Criminal Code, namely Article 160 (Misappropriation or Embezzlement) and Article 165 (Infliction of damage on property by deceit or breach of trust). In addition, amnesty is limited to those who was convicted for the first time, compensated or agreed to compensate for the damage, used no violence or threat of violence (it should be noted that this notion is quite reasonable, although being against early release of M. Khodorkovsky who was convicted twice). Therefore, approximately 5,000 persons will be subject to amnesty, which is better than none.

President Putin proposed to unite the Supreme Court and the Supreme Arbitration Court of the Russian Federation through amendments to the Constitution of the Russian Federation. He admitted that it would "require a thorough preparation". However, he didn't explain the reason for this measure. In Russia, the situation with the two supreme courts differs largely: the Supreme Arbitration Court of Russia, by the way, like inferior arbitration court instances, is distinguished by a quite competitive legal procedures under which government authorities may lose an action against economic agents. Though there are exceptions concerning a small number of cases initiated by the federal government, such as the YUKOS Case or the TV-6 Case, this system is not the

worst one. Moreover, the Supreme Arbitration Court itself is very meticulous about consideration of appeals, whereas the situation with courts of general jurisdiction in general and the Supreme Court in particular is quite opposite: 99% of judgments of conviction, while the Supreme Court hammers out ridiculous decisions even when it comes to low ranking civil servants¹ rather than top government officials. This is most likely to deteriorate the quality of justice, even though the arbitration court system retains independence.

President Putin took the leadership of a civil movement called the *National Front – For Russia* (the former *United National Front*) whose congress was prepared in great state and a few political analysts gave promising comments on that this entity would become a new ruling party. The congress, however, made an absolutely ridiculous impression. For example, President Putin was elected chairman without voting, tens of non-elite persons joined the management of the Front and none of those who belong to elite were enrolled. The program of the Front is simply a copy (a slightly tamed version) of the proposals made by Putin's opponents. For example, A. Navalny's initiative to set a limit of Rb 1,5m on government spending on the purchase of motor cars for government officials was modified "up to Rb 3m". The *Front* is likely to remain a political and PR decoration designed to launder *United Russia's* election results. With regard to the next parliamentary elections, *United Russia* is likely to be rebranded as *National Front*. However, it will make neither conceptual nor rating-boosting contribution to the party.

In June 2013, government officials admitted that the economic situation is not optimistic at all, as economic growth rapidly slowed down to approximate a level of statistical error (1.8% in the H1 against 4.5% in the preceding year), investment growth stopped, capital outflow increased and budget revenues decreased. In his Budget Message President Putin offered nothing new but two things, namely cutoff of military expenditures (to make it sound politically correct, he said that rearmament would be deferred until a later period) and growth in infrastructural expenditures, including at the expense of the NWF and PFR national funds. Drastic growth in the debt owed by constituent territories' budget was noted, which are designed, among other things, to finance President Putin's election pledges of wage raise for public-sector employees: one third of the regions had a debt being 1.5 times as much as their annual income at 2012 year-end. However, President Putin didn't offer any solution (later, Minister of

1 It should be recalled how the Supreme Court of Russia approved, for example, a decision to refuse registration of a parliamentary (State Duma) candidate on the ground of "104% invalid signatures".

Finance A. Siluanov spoke about reallocation of personal income tax, (at present, 60% of personal income tax is allocated to the constituent territories' budget, 40% to local budgets, and a proposal was made to allocate 70% to the regions, 30% to municipalities. Strategically, however, it fails to cope with the deficit issue in poor regions). The pension reform is still being in limbo, its parameters were promised to be defined in the upcoming 'fall'. Refusal to establish a standalone Russian Financial Agency for the management of state funds' assets was announced upon the formal legal pretext that such assets might become more vulnerable to malevolent legal actions abroad. According to certain data, the reason for that was a failed attempt to agree upon a person who would be able to chair such a powerful entity and maintain the balance of powers around the President.

Minister of Finance A. Siluanov admitted that budget revenues in 2014 may fall by Rb 650bn, and instantly proposed a solution by announcing that the ruble exchange rate could be slightly decreased, and promising to begin to buy foreign currency in the market "in the upcoming August". He also explained that the decrease would generate additional budget revenues of Rb 150bn: "...*The exchange rate only can be effected through market tools, when, for example, the Ministry of Finance participates in the purchase of foreign currency in the market, said the Minister in his interview to Bloomberg. The same operation may weaken the exchange rate by Rb 1–2 and take place as early as August*". The market responded instantly, the USD exchange rate jumped by Rb 2. First Deputy prime minister I. Shuvalov and then A. Siluanov himself had to deny "devaluation", whereas what we see is indeed an artificial devaluation of the national currency amid surplus of balance of payments. Such an operation is far from being painless: though core budget revenues are generated by exporters of raw materials, a very small number of employees are involved in this sector, whereas a majority of the Russia's population will suffer from the devaluation.

In June, Minister of Economic Development A. Belousov was removed from office and appointed an aid of the President of Russia. He was substituted by A. Ulyukayev, a Deputy Chairman of the Central Bank of Russia. This casting, which was indeed a downgrading for A. Belousov, seems to have resulted from a crisis of the policy he promoted – growth rates have been declining in spite of almost 2-fold growth in federal budget expenditures in the post-crisis period, to current parameters which are lower than in many EC countries whose crisis used to be referred to by Russia's government authorities. The newly appointed Minister will have to conduct audit of the national outlay and cut off expenses which are less obvious.

At the St. Petersburg International Economic Forum President Putin announced that monopolies' tariffs which previously outran the inflation rate, not to mention that they themselves generated inflation, would be limited: "*Inflation is still high, and we intend to further decline it. Current inflation has a big share of so-called non-monetary factors, simply said, the tariff component. Outstripping growth of tariffs has become a standalone and significant factor of unwinding inflation, actual factor of economic slowdown, growth in costs, and weakening competitive power of our manufactures. Indeed, tariffs should not grow at the same rates as before. Therefore, growth of regulated tariffs of infrastructural monopolies should be limited to the previous year's actual inflation rate. This procedure will stay in effect for a period of five years beginning with 2014*". Though this measure is quite reasonable, it is hard to be implemented, because the monopolies are managed by Putin's friends.

In a special-operation manner and without any preliminary discussion Russia's Government announced at the end of the month that it would submit a draft law on the Russian Academy of Sciences (RAS) reform to the State Duma. Minister of Education D. Livanov stated caddishly that there was nothing to discuss, since he had long been discussing this topic. All things considered, this can be regarded as government's response to the election of V. Fortov as head of RAS and non-election of President Putin's friend M. Kovalchuk as director of the RAS-affiliated crystallography institute. The idea of the draft law is to expropriate RAS's property, eliminate academic self-administration of RAS-affiliated institutes, and degrade the academician rank by merging two ranks, namely Fellow and Corresponding Member, as well as the RAS with the academies of medicine and agriculture. RAS's assets (i.e., in fact, decision-making on all employment and financial issues – recruitment and staffing, wages, etc.) are expected to be managed by a special agency whose director must be appointed by the Prime Minister of Russia: in fact, it is referred to the establishment of a new science-related entity similar to JSCo Oboronserve. Academicians, who will have to apply for admission to the new entity (such an application means *de facto* the acceptance of the reform and will be granted automatically) were promised to be paid higher wages, raising from Rb 25,000 up to Rb 50,000, but from now on they will become a club which has nothing to manage. Indeed, such a reform would be supported by non-competitive persons for whom wage raise is more valuable than being independent. The announced plans of the RAS reform show pure self-revelation of Russia's Government: the Government is interested in RAS's property rather than scientific results which

have reasonably been a target for RAS criticism. However, given President Putin's silence about the reform, it could be considered predetermined, unless the academic community stands against it, thereby unavoidably causing a severe damage to the reputation of the government authorities.

Makhachkala mayor S. Amirov, one of the most powerful leaders of ethnic clans in the North Caucasus, who held mayor's office over 15 years and had wide connections (e.g., two of his nephews became State Duma Deputies) with the federal government authorities, was arrested on June 1, 2013. He was accused of organizing murders. The evidence looks strong enough according to the first evaluation. Another fact is more important though: the day before, the federal security service presented audio records of conversations between a great number of Daghestan politicians and businessmen with I. Gajidayev¹, a

¹ Though nominally, Gajidayev, who assumed responsibility for the murder of Minister of the Interior of Daghestan A. Magomedtagirov, wasn't at the top of the underground hierarchy, being just a leader of the district, his influence on the most unstable district could be comparable, if not overpowering, with that of R. Aselderov, the leader of Daghestan insurgency hierarchy.

key leader of Islamic terrorist group, who was killed during a special operation in March 2013 in the house owned by the head of the Municipal Assembly of the Unsukulsky District, who, by the way, was killed fighting against police forces. The audio records leave no doubt about close relations between the foregoing persons, and the topic of discussion covers organization of mass riots which could have helped a locked group of terrorists break through set up barriers. The arrest of S. Amirov was followed by arrests of some of his relatives, heads of several districts in Daghestan, MPs, within a month. A few persons involved in "the Gajidayev audio records" case remain at large yet. The Daghestan incident resembles clearly the situation in the Ingush Republic three years ago, when it was revealed after the arrest of the leader of local Islamic underground groups that his immediate brother-in-arms was a brother of Deputy Minister of Construction of the Republic. One cannot but hope that liquidation of the political backing of terrorists and sending an explicit signal to local elites that they may not combine two – official and underground – businesses would help turn the tide in Daghestan which has long been facing a steadily severe terrorist environment. ●

INFLATION AND MONETARY POLICY IN MAY 2013

A.Bozhechkova

The consumer price index stood at 0.7% in May 2013 (0.5% in May 2012), showing an increase of 0.2 p.p. vs. April 2013. In June, prices were growing too: the consumer price index reached 0.3% within 20 days of the month, thereby boosting inflation by 7.4% on a year-on-year basis. A downtrend in the ruble exchange rate which was observed in May thru June didn't result in any substantial growth in Central Bank's currency interventions.

Consumer-price inflation accelerated in May: consumer price index increased from 0.5% in April 2013 to 0.7% at month-end, being 0.2% higher against 2012. As a result, inflation reached 7.4% on a year-on-year basis (see fig. 1). Core inflation¹ stood at 0.3% in May 2013, being 0.1 p.p. higher year on year.

The consumer price index increased basically in response to faster growth of prices of food products (from 0.7% in April to 1.0% in May) as a result of faster growth of prices of fruit and vegetable products (from 3.6% in April to 6.5%), sugar and granulated sugar (from 1.7% in April to 2.0%), fish and seafood products (from 0.2 in April to 0.6%). Prices of such food products as sun flower oil, as well as eggs were found to be 0.1% and 6.6% lower respectively against the previous month. Growth in prices of alcoholic beverages (from 1.4% in March to 1.0% in April and 0.8% in May), bread and flour products (from 0.8% in April to 0.4% in May) and macaroni products (from 0.6% in April to 0.4% in May) kept slowing down.

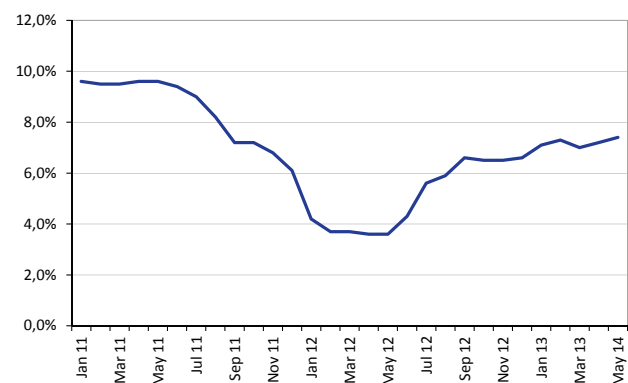
Prices and tariffs of retail paid services grew at a rate of 0.8% in May, being 0.5% higher than in April. It was the passenger transport services that increased most (by 4.8%) during the season of mass vacations, namely long-distance train charges, as well as costs of airline services. Furthermore, costs of health-improving services and international travel services grew up by 1.4% and 1.6% respectively. Costs of personal services (+0.5%), medical services (+0.7%) and insurance services (+0.7%) tended to grow.

In May 2013, growth in prices of non-food products slowed down vs. April to increase 0.3% (+0.4 in April) at the end of the month. It was prices of tobacco products (+3.2%) (+4.3 in April 2013) and medicaments (+0.9%) (+1.0 in April 2013) that increased most within this group of products. In June,

prices of audio visual goods (−0.3%) and motor benzene (−0.4%) kept dropping among non-food products.

The consumer price index stood at 0.3% as of June 20. As a result, accumulated year-to-date inflation reached 3.4%, being 1.3 times year on year. Inflation stood at 7.4% as of June 20 on a year-on-year basis.

The acceleration of inflation seems to basically have non-monetary nature and result from seasonal growth in prices of foods products, excises on excisable goods and tariffs of transport services at the beginning of the year. Indexation of pensions in February had a certain effect on the price growth too. Consumer-price inflation began to slow down in February and continued in March, but again prices tended to grow in April in response to an increase in prices of certain food products and tariffs and prices of certain groups and types of service. Further price growth will be encouraged by indexation of public utility rates scheduled for July 1 and a poor crop anticipated due to adverse weather conditions at certain regions. Inflation will be constrained by such factors as low domestic demand which has been observed over a year, and further slowdown in money supply growth rates (M2 growth rate slowed down



Source: Rosstat.

Fig. 1. CPI growth rate in 2011–2013 (% year over year)

¹ Reference consumer price index is an indicator which describes the level of inflation in the consumer market, net of seasonal (prices of fruit and vegetable products) and administrative (tariffs of regulated types of service, etc.) factors which is also calculated by the Federal State Statistic Service of Russia (Rosstat).

19.6% as of May 1, 2012 to 15.2% as of May 1, 2013 on a year-on-year basis).

In May 2013, M0 dropped 0.3% to Rb 8782,8bn (Fig. 2). M0 has the following growing components. Correspondent accounts, an increase of 9.6% to Rb 893,1bn, compulsory reserves, an increase of 2.8% to Rb 487bn, banks' deposits with the Central Bank of Russia, an increase of 10.9% to Rb 124,3bn. The volume of cash in circulation, including cash on hand at credit institutions, decreased by 1.8% to Rb 7278,5bn.

The fall in the volume of cash in circulation in May narrowed M1 (cash plus compulsory reserves) by 1.5% to Rb 7765,5bn (Fig. 3).

In May, the volume of excess reserves at commercial banks¹ grew up by 9.8% to Rb 1017,4bn, whereas banks' debt under repo transactions increased by 11.9% to reach Rb 2,07 trillion. According to the data as of June 26, banks' debt under repo transactions amounted to Rb 2,2 trillion (Fig. 2). Increased debt on repo transactions in May was accompanied by increase in interest rates in the interbank lending market² (from 6.2% in April to 6.37% in May). The interest rate stood at an average of 6.25% in June 1 thru 26.

On June 1, 2013, the volume of Central Bank's international reserves amounted to \$518,4bn, having dropped by 3.6% year-to-date (Fig. 3). Russia's dollar international reserves contracted in Q1 2013 basically because the US dollar gained against the Euro. In May, the international reserves kept contracting amid insignificant volumes of Bank of Russia's currency net sales in response to a growth in the EUR/USD exchange rate due to uncertainty about FRS's policy tightening and anticipated economic recovery in the EC.

Bank of Russia currency interventions didn't exceed \$237m and 19m Euro in May and were intended to level volatility of ruble exchange rate in the periods of its fast weakening (Fig. 4).

In May, ruble real effective exchange rate gained 1.1% (-1.4% in April 2013) against foreign currencies (Fig. 5). Ruble real effective exchange rate increased by 2.9% at the end of the 1st quarter.

US dollar exchange rate increased by 1.75% to Rb 31,59 in May in response to uncertainty about discontinuation of the FRS's QE (quantitative easing) program. In May, EUR exchange rate grew by 0.83% (Rb 40,97/euro) in expectation of good news about business climate in certain EC countries. EUR/USD

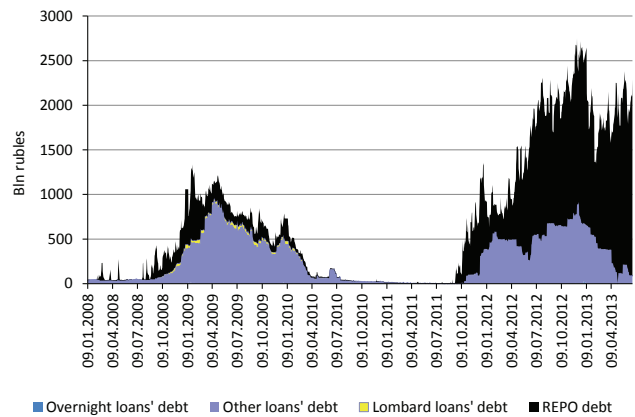
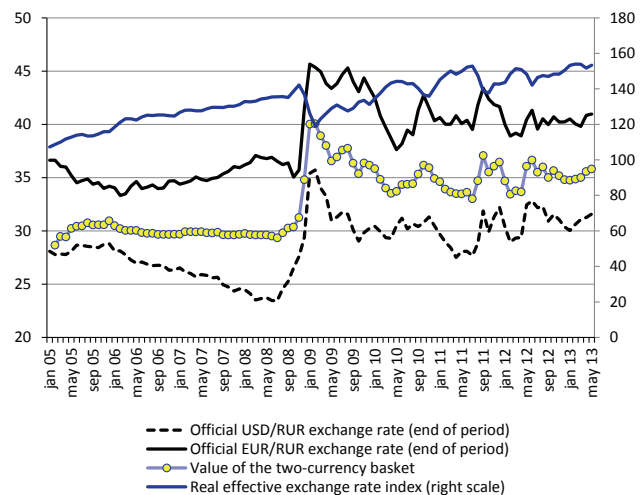


Fig. 2. Commercial banks' debt owed to the Bank of Russia in 2008–2013



Source: Central Bank of Russia, author's estimates.

Fig. 3. Dynamics of M1 and gold and foreign currency (international) reserves of the Russian Federation in 2007–2013

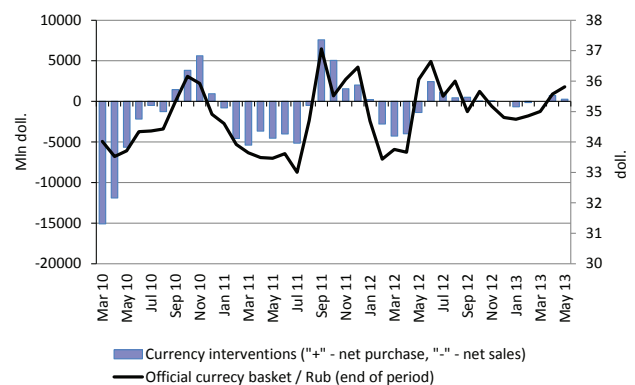
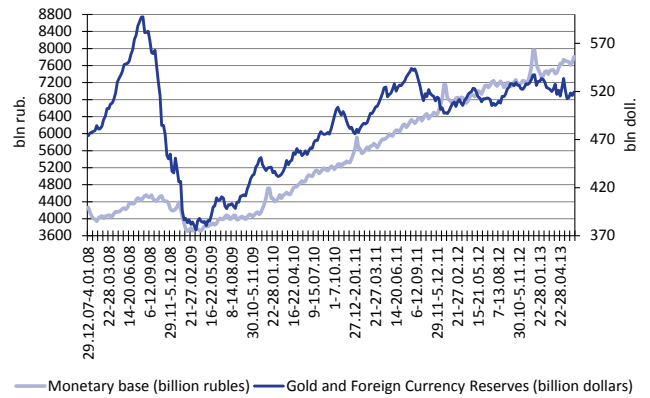


Fig. 4. Bank of Russia's currency interventions and ruble/currency basket exchange rate in March 2010 thru May 2013

1 Commercial banks' excess reserves with the Central Bank refer to the amount of commercial banks' correspondent accounts, their deposits with the Central Bank, as well as Central Bank bonds held by commercial banks.

2 Interbank interest rate is the monthly average MIACR, an interest rate on ruble overnight interbank loans.

exchange rate was 1.3 on average in May. The dual currency basket value increased by 1.28% to Rb 35,8 in May. Ruble devaluation in nominal terms was partially driven by lower oil prices in the global market. In June, a trend of ruble weakening in nominal terms continued. USD exchange rate increased by 2.9% to reach Rb 32,7, EUR exchange rate increased by 3.7% to reach Rb 42,97 as of June 26. As a result, the dual currency basket value increased by 3.3% to Rb 37,3. EUR/USD exchange rate was 1.3 on average within 26 days in June. ●



Source: Central Bank of Russia, author's estimates.

Fig. 5. Ruble exchange rate indicators in January 2005 thru May 2013

RUSSIAN FINANCIAL MARKETS IN JUNE 2013

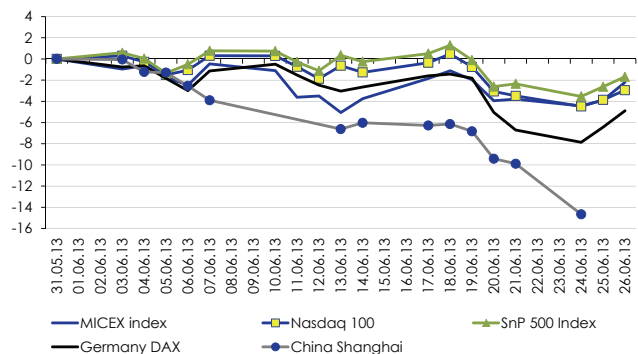
N.Andrievsky, E.Khudko

The Russian stock market in June was under the negative influence of the dynamics in international stock markets. Reduction in dividends on shares of “Gazprom” to Rb 8.97 per share for the 2011, to 5.99 rubles per share as of a result of 2012) led to a decrease in stock quotations of the company by 13.1% in June, which, in the aggregate, provided the loss of 28.5% of the value of the company for the year since June 2012. In addition, stocks of metallurgical and electric power companies continued to fall down in price and the capitalization of the stock market has reduced by Rb 575bn and as of June, 26 was Rb 22.3 trillion (35.8% of GDP). In the domestic corporate bond market in June the activity of issuers and investors has grown, but the index of corporate bonds decreased and the average yield (especially in the manufacturing and energy sectors) grew.

The dynamics of the Russian stock market basic structural indices

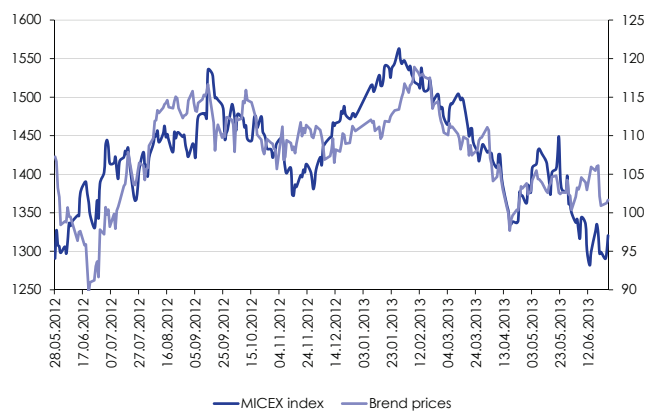
The main influence on the MICEX index in June was provided by the dynamics of the global stock indices. Thus, from May 31, 2013 to June 24, the Shanghai stock exchange index fell down by more than 14% due to liquidity problems in the banking sector. Herewith, the dynamics of the MICEX index was nearly the same as the dynamics of the indices of the American Stock Exchange NASDAQ and S & P 500. As a result, the MICEX index fell down by 2% from 1350 as of May 31 to 1320 points on June 26 (Fig. 1). Even the rise in oil prices to USD 106.12. / Bbl. by 19 June (5.7% of the price at the end of May) could not compensate for the negative impact of the dynamics of international stock exchanges (Fig. 2).

The positive dynamics of “blue chips”, which was observed in May, when the maximum in price value of the shares of Sberbank was recorded and the shares of Gazprom have grown by 8% within one week, was replaced in June by a reduction in prices. By June, 24 shares of Gazprom have lost 13.1% of the price as of the end of May, the same day the stock price of Sberbank share accounted only 80.8% from the maximum May indicator. Herewith, the optimistic forecasts for dividends and annual reporting caused an increase in growth of prices for shares of VTB by 7% within the period from May 31 to June 26 2013, and the shares of Rosneft have increased by 9.3% as compared with the beginning of the month (Fig. 3 and 4).



Source: Quote ПБК. Yahoo Finance

Fig. 1. Dynamic of international indices from May 31 to June 26, 2013



Source: Quote ПБК.

Fig. 2. The dynamics of the MICEX index and futures prices for Brent from May 28 2012 to June 26, 2013

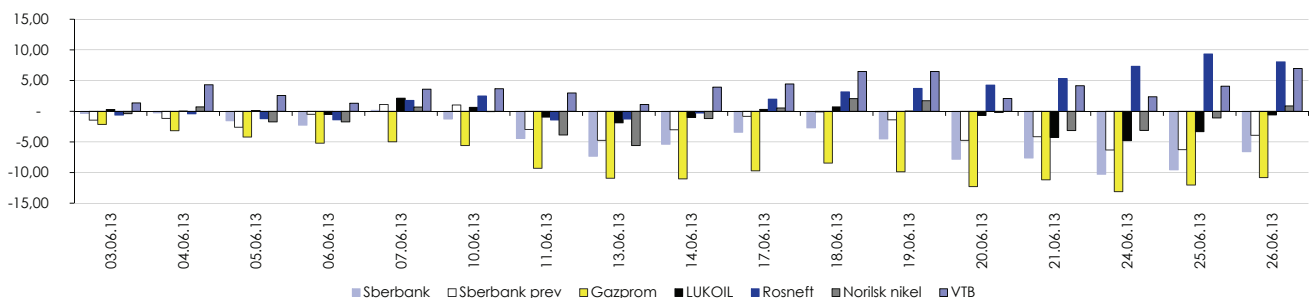


Fig. 3. Growth rates of quotations of highly liquid securities at the Moscow Stock in June

In June despite the decline in prices, the yield on common shares of Sberbank from June 27, 2012 to June 26, 2013 has reached 9.5%, while the preferred shares within the same period have been demonstrating the yield of 16.1%. The most significant loss was due to the shares of Gazprom, which have lost 28.5% of their value from the end of June 2012, the shares of Norilsk Nickel and VTB also turned out to be marginal (-13.3% and -12.1%, respectively).

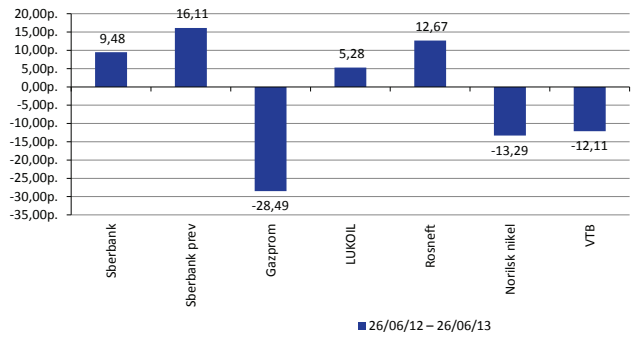
The rate of growth of quotations of shares highly liquid

Growth rates of Moscow highly liquid stock exchange quotations during the period from June 27, 2012 to June 26, 2013.

Dynamics of the sectoral index was influenced by the expectations of the results of the annual meetings of shareholders. So, while the MICEX-innovation grew 4.2% in the first ten days of June as a result of the positive outcome of the annual meeting of shareholders of companies "Armada", "Smelansky Electromechanical Plant", but then the negative results of "Utinet" led to the June 24th drop in the index by 5.8% as compared to the beginning of the month (Fig. 5). It should also be noted a significant decrease in the indices electricity, metallurgy and mining in June – the loss index reached 8.7% of the price at the beginning of the month. Among the positive trends can be noted correction "up" many indices at the end of the month. Thus, the above-mentioned innovation index rose from 24 to 26 June to 4% and the value of shares of the oil and gas industry to decline in the middle of the month to 94.2% from the level at the beginning of the month for the month rose by 1.8%.

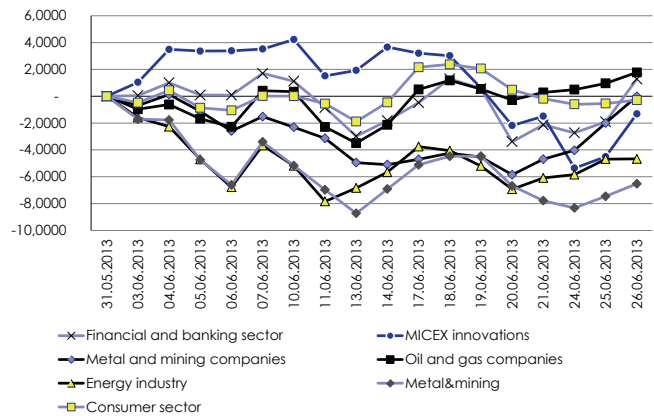
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The dynamics of stocks of sectoral indices was influenced by the expectations of the results of the annual



Source: Nickel Source Quote RBK, author 'estimates.

Fig. 4. Growth rates of the MICEX index and futures prices for Brent oil from May 28 2012 to June 26, 2013

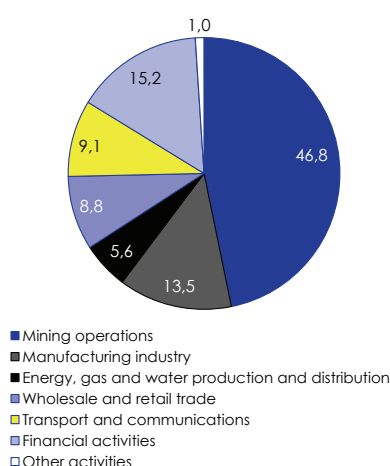


Source: Quote РБК, author's estimates.

Fig. 5. The growth rates of various stock indices of Moscow stock exchange

meetings of shareholders. Thus, while the MICEX-innovation has increased by 4.2% within the first ten days of June as a result of the positive outcome of the annual meeting of shareholders of companies: Armada and Smelansky Electromechanical Plant, but afterwards, the negative results of Utinet has resulted on June, 24 the drop in the index by 5.8% as compared to the beginning of the month (Fig. 5). It should be also noted a significant decrease in the indices of electricity, metallurgy and mining in June – the loss index reached 8.7% of the price at the beginning of the month. "Grow up" correction of a number of indices at the end of the month can be noted among the positive trends. Thus, the above-mentioned innovation index has increased from 24 to 26 June by 4%, and the value of shares of companies in the oil and gas sector which has been declining in the middle of the month to 94.2% from the level as of the beginning of the month, within the month has increased by 1.8%.

The total capitalization of the Russian stock market MICEX index on June 26, 2013 amounted to Rb 22.8 trillion or 35.8% of GDP, which is by 2.5% or Rb575bn lower, than the relevant indicator as of May, 24 (previous review). Herewith, there were some changes in the



Source: MICEX official web-site, authors' estimates.

Fig. 6. The structure of the stock market capitalization as broken down by industries

structure of the capitalization. In particular, the share of mining has declined from 47% in May to 46.6% in June. Moreover, in the proportion of wholesale and retail trade and financial activities continued to increase (increase in June was 0.6 percentage points and 0.2% points, respectively).

Corporate bonds market

The volume of domestic corporate bond market in Russia (at the nominal value of the securities in issue and those, denominated in national currencies, including non-residents of the Russian Federation) in June has slightly increased. By the end of the month it has reached the level of Rb 4 513. 8bn, which is only by 0.4% higher than its value as of the end of May (in the QI the growth was on average 1.5–2.0% per month). The stabilization of market capacity is mainly based on an increased number of bond issues (971 corporate bonds registered in national currency against 969 emissions at the end of the preceding month) and the number of emitters recorded in the debt segment (347 issuers against 348 companies in May). Eight issues of bonds issued by Russian emitters in U.S. dollars, and one issue of bonds in Japanese yen are still in circulation.

Investment activity in the secondary market for corporate bonds after the seasonal decline in the first half of May has increased again, though the trade figures were still well below the level of the QI of the current year. Therefore, from May 25 to June 24, the total volume of transactions on the Moscow Stock Exchange amounted to Rb 128.9bn (for comparison, from April 23 to May 24, the turnover was equal to Rb110.2bn), and the number of transactions within the period under review remained virtually

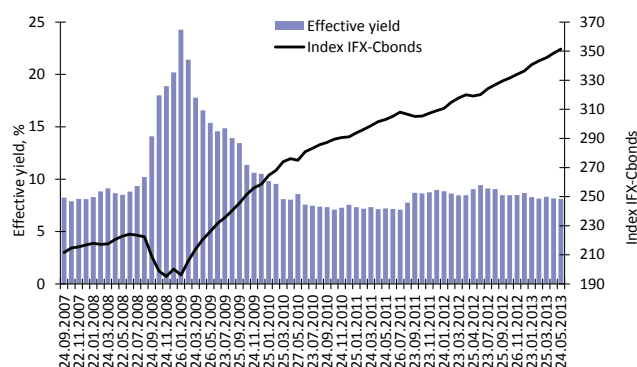
unchanged – 23.1 thousand (against 22.9 million in the preceding period).

The index of Russian corporate bond market IFX-Cbonds has declined for the first time during the recent year. As of the end of June, its value has decreased by 0.6 points (or 0.2%) as compared with the value at the end of the previous month. The weighted average yield of corporate bonds has increased from 8.11% at the end of May to 8.45% by the end of June (Fig. 7).

The negative dynamics of the indexes of the bond market (in the public sector, as well as in the corporate segment) was determined by a number of internal and external factors, although none of them can be called dominant. The relative stabilization of the financial sector, achieved by early May, proved to be unstable. The rate of growth of economic activity remains low, and the annual inflation rate by the end of May accelerated by 0.2 percentage points. The world economy in June is dominated by negative trends as well. Bank lending in the euro area is almost not growing, while inflation and unemployment is rising. The growth rate of China's economy slows down.

Index of corporate bonds portfolio duration corporate bonds has grown sharply in June. At the end of June the duration was 763 days, which is 86 days more than the indicator of the end of the preceding month. Due to the increase in market interest rates, such a growth of duration reflects treatment of bonds in the corporate segment. With an increase in the interest rates in the market the duration growth reflects an increase in the urgency of bond loans circulation in the corporate segment.

In the most liquid segment of the corporate market there was observed a remarkable increase in the yields of emissions. Maximizing yield (more than 1 percentage point) was cut out of the bonds of JSC "NLMK" (Series BO-07), JSC "RUSAL Bratsk Aluminum Plant" (series 07 and 08), JSC "Bank" Saint Petersburg (Series BO-02). "ALFA-BANK" (Series BO-07), JSC "Russian Rail-



Source: Cbonds information agency.

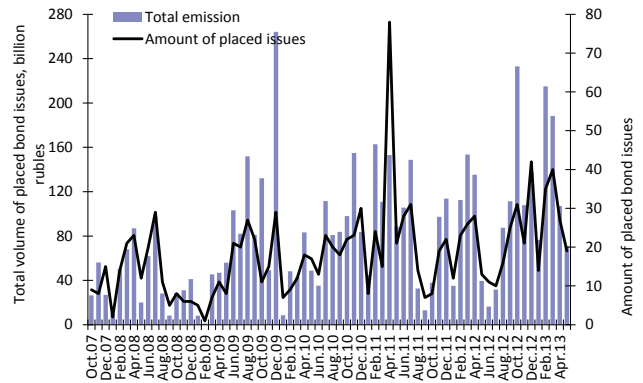
Fig. 7. Index dynamics of the Russian market of corporate bonds and the weighted average yield

ways” (series 17) and JSC “Russian Agricultural Bank” (Series 03) which yield of the securities mentioned above has declined by more than 1 p.p. were the exception from the general trend.

The most significant growth was demonstrated by the rates in the manufacturing and energy market segments (the rates increased on average by 0.3–0.4 p.p.), though the opposite trend was observed in May. Moreover, it should be noted, that the value of the most liquid issues of major issuers of financial sector still continued to decline.

Russian issuers have once again showed high activity in regard to registration of bonds, surpassing the record of the preceding month. Thus, over the period from May 25 to June 24, 18 issuers have registered 79 bond issues with total value of Rb 590.7bn. (For comparison, during the period from April 23 to May 24, there were 64 issues of the amount of Rb 531bn). Almost all of the registered bonds were stock bonds. Vnesheconombank has also registered two currency issues of bonds denominated with total value of more than \$ 1bn.

Despite the deterioration in market conditions, IPOs performance indicators were also rather high, moreover, not only the loans of large emitters, but also the debut issues have been successfully accommodated. Thus, since May 25 to June, 24, 23 issuers have accommodated 28 of bonds with total value of Rb 151.8bn (for comparison, from April 23 to May 24 19 bond issues in the amount of Rb 70.9bn were accommodated (See Fig. 8). The stock bonds accounted for a third part of all outstanding issues. The largest bond issues were placed by OAO or NK “Rosneft” (three series of bonds totaling Rb 40bn), JSC “Federal Grid Company UES” (two series of bonds with total value of Rb 30bn) and JSC “Russian Railways” (the series of exchange bonds



Source: Rusbonds data.

Fig. 8. Dynamics of primary placement of corporate bonds denominated in domestic currency

with total value of Rb25bn). Long-term loans for more than 10 years were over one-third part of the accommodated issues.

As of the end of June, there was no bond issue canceled because of non-deployment of any security, while in the period from April 23 to May 24, one debut issue and in the preceding month about 10–15 issues were canceled by the FFMS of Russia.

Since May 25 to June 24, 14 issuers had to pay off their loans of bonds totaling to Rb 51.1bn. However, a single issuer was not able to fulfill its obligations in due time (in the previous period, two of the issuers have announced of technical default), which is a negative event in the market. In July of 2013 the repayment of 17 corporate bond issues totaling Rb71.9bn is expected.

The situation with the fulfillment by issues their duties to the holders of the obligation bonds remains stable. From May 25 to June 24, as in the preceding period, there were no actual defaults. ●

REAL SECTOR OF THE ECONOMY: FACTORS AND TRENDS IN 2013

O.Izryadnova

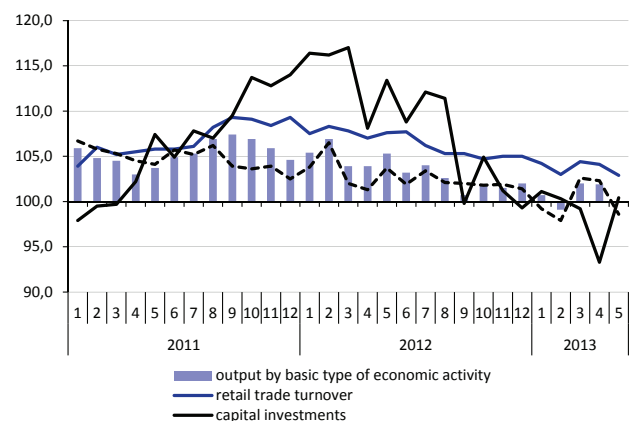
Russia's economy was characterized by lessening of internal and external demand within the first five months in 2013. A drop in industrial output which in May 2013 reached 1.4% against May 2012 had a substantial effect on the domestic market in the current year. Stagnation in the investment sector further lowered production of capital goods and construction materials. The manufacturing output index stood at 95.6% in May 2013 on a year-on-year basis amid severe recession in the machine building industry. Growth rates in retail sales turnover slowed down to 102.9% on a year-on-year basis in response to a fall of 1.3% against May 2012 in real household disposable income. The number of the unemployed in May 2013 remained less than in May 2012.

Macroeconomic situation in January thru May 2013 was governed since Q4 2012 by factors and trends towards slowdown in economic activity. At the same time, growth rates of investment and consumer demand were reported to slow down in the domestic market in May 2013. Capital investment index stood at 100.4% year on year in May 2013 against 113.7% in the preceding year. Retail trade turnover stood at 102.9% (on a year-on-year basis) in May 2013 against 107.6% in the preceding year. Inflation and real household income had an effect on consumer behavior. Consumer price index increased up to 107.4% year on year in May 2013 against 103.6% in the preceding year. Real disposable cash income accounted for 98.7% of the figure in May 2013.

Decline in industrial production had a substantial impact on the domestic market in 2013. Industrial production growth rates have been slowing down since May 2010 when highest values were hit year on year. In May and January–May 2013, industrial production index stood at 98.6% and 100.2% year on year respectively. Manufacturing industry declined in the industrial sector. In May 2013, manufacturing index stood at 95.6% on a year-on-year basis against 107.0% in the preceding year, 102.3% against 99.7% in the mineral production sector, and 101.2% against 100.5% in the production of electric power, gas and water.

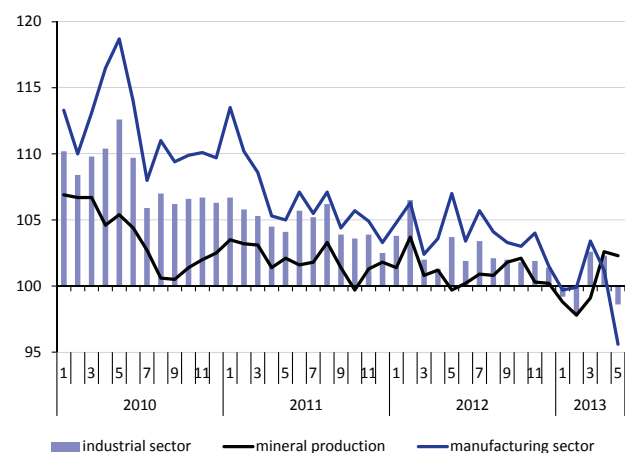
Low investment demand had a downtrend effect on capital goods production. The following dynamics developed in the machine building industry in May 2013 on year-on-year basis: the index of machine and equipment production stood at 97.3%, electrical, electronic and optical equipment production at 91.7%. Reportedly, production in these types of activity has been declining since December 2012 on a year-on-year basis.

Dynamics of production of transport means and equipment is extremely unstable. A decline in growth rates (by 0.7% year on year in Q4 2012 and 4.7% Q1 2013) stopped in April–May 2013. In general, how-



Source: Rosstat.

Fig. 1. Dynamics of output by basic type of economic activity in the years of 2011 thru 2013, on a year-on-year basis



Source: Rosstat.

Fig. 2. Industrial production growth rates by type of economic activity in 2010–2013, on a year-on-year basis

ever, production of transport means stood at 98.2% in January–May 2013 against 2012. Furthermore, transport means production rates are considerably differentiated by specific type of products. Production of

Table 1

A SHARE OF CONSUMER, INTERMEDIATE AND INVESTMENT GOODS IN TOTAL VOLUME OF IMPORTS

| | Goods | | |
|---------|----------|------------|--------------|
| | consumer | investment | intermediate |
| 2008 | 41.8 | 23.8 | 34.4 |
| 2009 | 44.3 | 19.7 | 36.0 |
| 2010 | 40.7 | 19.5 | 39.8 |
| 2011 | 36.6 | 21.4 | 42.0 |
| 2012 | 38.1 | 24.9 | 37.0 |
| Q1 2012 | 40.2 | 23.0 | 36.8 |
| Q2 2012 | 38.0 | 25.1 | 36.9 |
| Q3 2012 | 37.8 | 25.1 | 37.1 |
| Q4 2012 | 36.9 | 26.1 | 37.0 |
| 2013 | | | |
| Q1 2013 | 40.8 | 22.8 | 36.4 |

Source: Rosstat.

vessels, aircrafts and other transport means stood at 82.9% in May and 90.3% in January thru May against 2012. Positive dynamics in production of motor vehicles, trailers and semi-trailers are supported by an increase in production of motor components. Production of motor cars contracted by 18.1% and trucks by 13.7% in May 2013 against May 2012.

A cutback in production in the machine building and construction sectors had a downward impact the demand for construction materials. Metallurgical production and finished metal products stood at 94.2% and construction materials at 97.1% against May 2012.

Output of rubber and plastic products kept growing, by 4.5% in May and 8.3% in January–May 2013 year on year, in the intermediate goods segment.

In May 2013, the group of consumer goods saw a decline of 4.9% year on year in textile and garment industry, 17.8% in production of leather, items and footwear. In May, growth rates in food production stood at 99.3% on a year-on-year basis.

Rapid slowdown in the output of domestic products for the domestic market had an impact on changes in the structure of imports. It was registered in Q1 2013 that a share of imports of consumer goods increased as a share of investment and intermediate goods shrank.

Labor demand has been growing in 2013 as it did in 2012. Unemployment (according to ILO's methodolo-

gy) in May 2013 amounted to 3,9 million persons year on year. (5.2% economically active population); 1 million unemployed persons (1.2% of the economically active population against 1.8% in the preceding year) were registered with employment services. Growth in the working population, decline in general unemployment take place as economy growth rates slow down and wages rise substantially, thereby leading to lower effectiveness in labor force utilization, growth in productions costs, and inefficiency of the existing labor market. Loss-making enterprises accounted for 36.5% of the economy at large in Q1 2013 (35.0% in the preceding year), including 45.6% (41.0% in the preceding year) of the mineral production sector, 36.3% (33.6% in the preceding year) of the manufacturing sector, and 49.9% (48.5% in the preceding year) of the transport sector.

Lack of significant structural changes, sluggish development based on extensive utilization of labor force and fixed assets, a big share of imports in the domestic market resources remain the factors which govern the nature of Russia's economic development. An urgent need to enhance labor productivity as a key factor leading Russia's economy towards sustainable economic growth was highlighted in experts' reports at the St. Petersburg International Economic Forum. ●

RUSSIA'S INDUSTRY IN MAY 2013

S.Tsukhlo

First data of Gaidar Institute's business surveys on the situation in the Russian production sector in May 2013 show that the situation has been deteriorating in the sector. Enterprises had to further slow down their output, lower prices, reduce the number of employees and be very careful about their investment plans in response to further drop in sales and growth in finished product surplus stock.

Industrial output demand

In May, no serious changes were seen in the dynamics of product demand. Both source and deseasoned data showed further downtrend in product sales: source data showed a pace of -6 points, whereas deseasoned data showed a pace -10 points (Fig. 1). As a result, reports on growth in demand prevailed in the industrial sector in February thru March alone, which, however, ceased to be the case after formal deseasoning procedures were applied.

Demand forecasts in May were much more optimistic: source data improved by 8 points, whereas deseasoned data by 6 points. Such a drastic revision of sales forecasts in May took place only once in 2011.

Finished goods stock

Evaluations of finished goods stock in the industrial sector keep signaling about sales problems and uncertainty about any real possibility to revive the demand. 'Above normal' answers reached maximum over the last 45 months, 'below normal' answers lessened, and 'normal' answers kept the lead (Fig. 2). However, the later have steadily been prevailing in Russia's industrial sector over the last 13 years and more (since March 2000), thereby giving evidence of a successful stock management policy. They kept the lead over 'above normal' answers in the industrial sector even in January 2009 (at the height of the recent economic crisis).

Output

First data on output dynamics in May look very pessimistic. The initial balance of (growth-decline) answers which is interpreted as rate of change, dropped by 7 points at once. No such a drastic decline (in May) in this indicator have been registered to date. Deseasoning showed further decline, from -7 to -16 points, according to IET's surveys (Fig. 3). At first glance, the serious changes can be explained by the fact that some holidays were shifted from January to May. As a result, we saw another month being difficult for interpretation of statistic data and a reason for burst in

CHANGES IN ACTUAL DEMAND,
NET OF SEASONAL FACTOR (BALANCE=%GROWTH-%DECLINE)

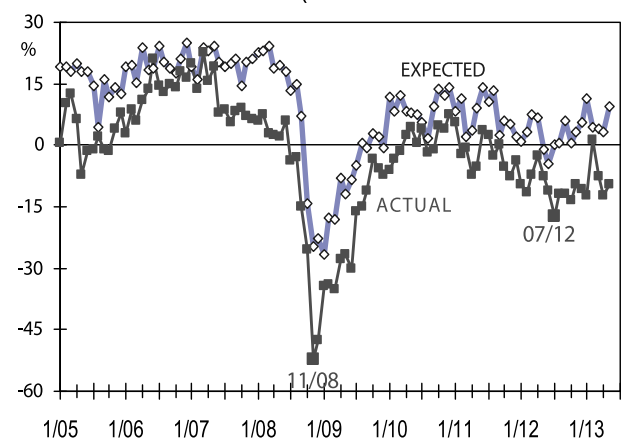


Fig. 1

BALANCE OF EVALUATION OF FINISHED GOODS STOCK
(BALANCE=%ABOVE NORMAL - %BELOW NORMAL)

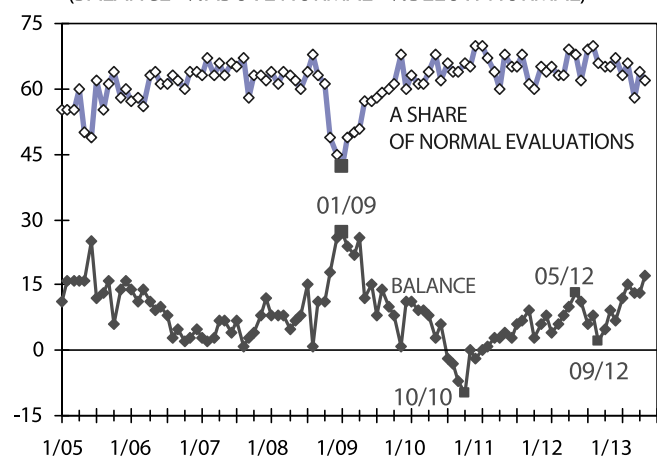


Fig. 2

discussions after official data on industrial production in May were published.

Output plans improved in May following demand forecasts, but in a lesser degree. As a result, a share of enterprises whose output plans fall behind sales forecasts increased up to 12% against the previous periods which showed just 6–7% of such enterprises. It turns out that the industrial sector is not sure about implementation of its own forecasts which were much more optimistic in May. After deseasoning, output plans of May have been remaining within a very narrow corridor of +12..+16 points since the beginning of 2013. It should be noted that last year this indicator decreased from +19 to +7 points for the first time over the previous five-year period.

Prices at enterprises

In May, price policy of enterprises showed new attempts in the industrial sector to revive a weak demand for their products. The balance of actual price changes (growth rate) lost another 5 points to become negative – the industrial sector shifted to absolute price lowering (Fig. 4). Such a price movement in May was very unusual, and a similar situation was registered only in 2009, when enterprises had to make adjustments to a faulty strategy of rapid recovery from the crisis of 2008–2009. In 2011 thru 2012, absolute decline in wholesale factory prices was registered at year-end. Furthermore, man-made (announced growth in the UST (uniform social tax) rate) and natural factors (drought) in 2010 resulted in abnormal price growth as early as year-end and upsurge in prices in January 2011. Prices have been continuing to go up only in food industry and construction materials industry over the last few months, whereas in other sectors price growth has been stopped or begun to fall.

Forecasts of price movements in March thru April remain record low as to any possible price growth for months to come. It is the fuel-producing industry, construction industry and nonferrous metallurgy that might see a substantial growth in prices, whereas other industries show very moderate price growth plans. Moreover, ferrous metallurgy even tends to lower prices.

Layoff actual dynamics and plans

Reductions in headcount continued in the Russia’s industrial sector in May, even more intensively. The layoff rate jumped to 13 points to reach -19 balance points during the month (Fig. 5). The industrial sector haven’t seen such intensity in layoffs since the crisis of 2008–2009. Moreover, even non-crisis layoffs in January seldom reached such values. Today, none of the industries performs staff recruitment, and most inten-

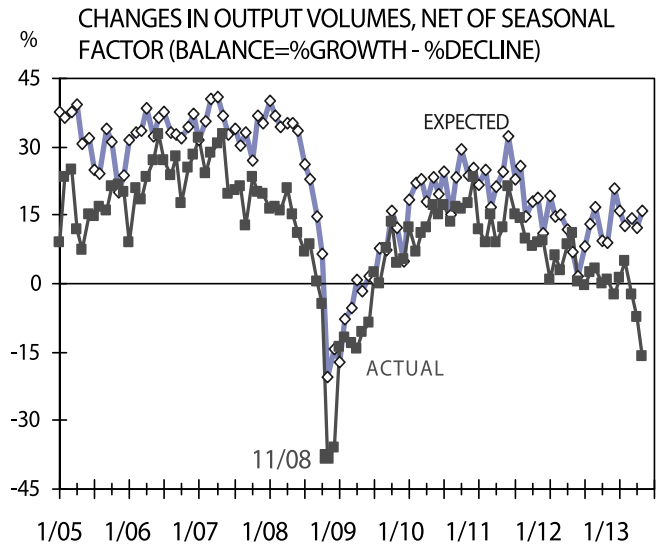


Fig. 3

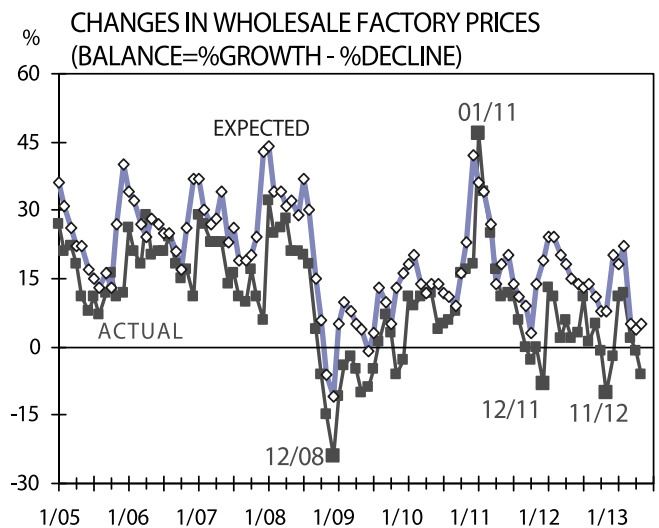


Fig. 4

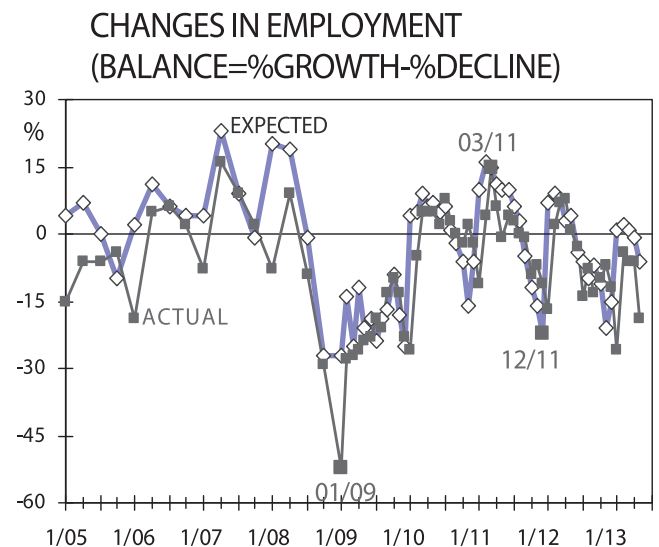


Fig. 5

sive layoffs have been reported in the machine building industry, consumer goods industry, chemical and petrochemical industries.

Lending to industrial sector

Today, 72% industrial enterprises are satisfied with general lending terms (*Fig. 6*), this value being near the ceiling of the corridor within which the indicator has been remaining for almost two years. Ferrous metallurgy (86% of enterprises, at a rate of 11%), chemical industry (83% of enterprises, at a rate of 11%) and food industry (74% of enterprises, at a rate of 13.2%) were most satisfied with availability of loans in April thru May. It was the consumer goods industry (as always) that is facing most problems concerning availability of loans, where 49% enterprises are satisfied with availability of loans. Banks offer an average minimal interest rate of 13.4% p.a. (in rubles) to enterprises in this industry. ●

A SHARE OF ENTERPRISES WITH "ABOVE NORMAL" + "NORMAL" AVAILABILITY OF LOANS

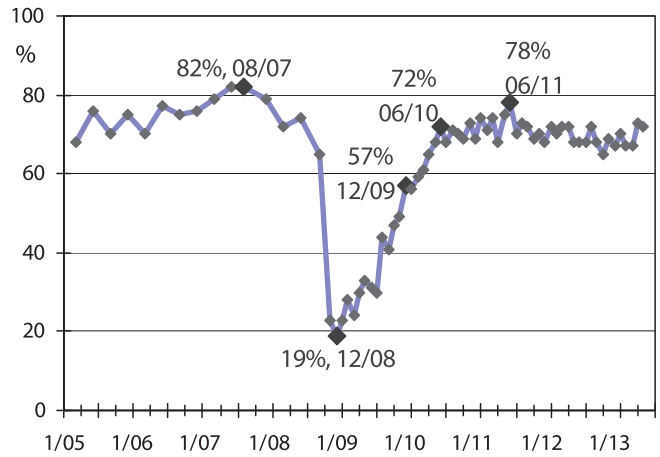


Fig. 6

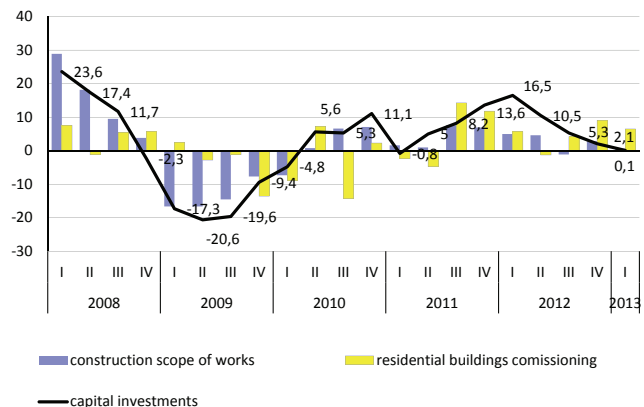
CAPITAL INVESTMENT IN RUSSIA IN Q1 2013

O. Izryadnova

In January thru May 2013 capital investments in real terms stood at 99.6% on a year-on-year basis. An uptrend in corporate own funds and federal budget funds was boosted in the structure of sources of investment financing. In Q1 2013, investments dropped in real terms on a year-on-year basis by 11.4% in the extractive industries, 13.9% in the production and distribution of electric power, gas and water, and 19.1% in transport sector. The preceding-year uptrend in investments remained unchanged in manufacturing industry, but output declined due to ineffective usage of investments.

The situation in the investment sector of the economy in 2013 has been governed by slowdown in business activity which began in H2 2012. Capital investments stood at 99.6% year on year in January–May 2013 and 100.4% in May. The scope of works performed in the construction sector within the first five months of the year stood at 99.0% (101.7% in May 2012), commissioning of residential buildings at 100.8% (110.9%) year on year.

In Q1 2013, capital investments in real terms stabilized at the level reported in the preceding year. Given that the 3-year downtrend for capital investments was reportedly overcome in Q1 2012, the result at the beginning of 2013, all other conditions being equal, shouldn't have produced alarming anticipations. However, it should be noted that capital investments saw an extremely unbalanced dynamics in 2012 and was characterized from H2 of the year by rapid slowdown in growth rates. In September and December 2012, capital investments declined against on a year-on-year basis. Low investment activity late in 2012, lack of required backlogs in construction had a downward im-



Source: Rosstat.

Fig. 1. Capital investments in 2008–2013, as percentage of a respective quarter in the preceding year

part on investments early in 2013. Capital investments stood at 12.6% of GDP in Q1 2013, being 0.2 p.p. less than in 2013.

Capital investments dynamics is differentiated by small and large enterprises. Capital investments con-

Table 1

**CAPITAL INVESTMENTS STRUCTURE BY TYPE OF FIXED ASSETS IN Q1 2009–2013
(EXCLUSIVE OF SMALL-SIZED ENTREPRENEURSHIPS AND INFORMAL ACTIVITY PARAMETERS),
AS PERCENTAGE OF TOTAL**

| | Billions of rubles | | | | | As percentage of total | | | | |
|--|--------------------|-------|-------|--------|--------|------------------------|------|------|------|------|
| | 2009 | 2010 | 2011 | 2012 | 2013 | 2009 | 2010 | 2011 | 2012 | 2013 |
| Capital investments | 933,3 | 802,1 | 956,8 | 1211,0 | 1310,2 | 100 | 100 | 100 | 100 | 100 |
| including: | | | | | | | | | | |
| housing | 56,4 | 44,3 | 47,6 | 48,4 | 63,9 | 6.0 | 5.5 | 5.0 | 4.0 | 4.9 |
| buildings (other than residential buildings) and facilities | 481,8 | 410,5 | 499,2 | 604,6 | 609,4 | 51.6 | 51.2 | 52.2 | 49.9 | 46.5 |
| machinery, equipment and transport means | 300,6 | 266,7 | 326,1 | 441,1 | 506,5 | 32.2 | 33.2 | 34.1 | 36.4 | 38.6 |
| of which: purchase of imported machinery, equipment, transport means | 76,6 | 54,4 | 63,6 | 71,4 | 89,9 | 8.2 | 6.8 | 6.6 | 5.9 | 6.9 |
| others | 94,5 | 80,6 | 83,9 | 116,9 | 10,4 | 10.2 | 10.1 | 8.7 | 9.7 | 10.0 |

Source: Rosstat.

**CAPITAL INVESTMENTS STRUCTURE BY SOURCE OF FINANCING IN Q1 2009–2013, AS PERCENTAGE OF TOTAL
(EXCLUSIVE OF SMALL-SIZED ENTREPRENEURSHIPS AND INFORMAL ACTIVITY PARAMETERS)**

| | Billions of rubles | | | | | As percentage of total | | | | |
|--|--------------------|-------|-------|--------|--------|------------------------|------|------|------|------|
| | 2009 | 2010 | 2011 | 2012 | 2013 | 2009 | 2010 | 2011 | 2012 | 2013 |
| Capital investments | 933,3 | 802,1 | 956,8 | 1211,0 | 1310,2 | 100 | 100 | 100 | 100 | 100 |
| including by source of financing: | | | | | | | | | | |
| equity | 381,3 | 362,1 | 464,8 | 613,3 | 693,9 | 40.9 | 45.1 | 48.6 | 50.6 | 53.0 |
| fundraising | 531,7 | 423,9 | 474,7 | 571,8 | 583,8 | 57.0 | 52.8 | 49.6 | 47.2 | 44.6 |
| including: | | | | | | | | | | |
| bank loans | 125,0 | 76,0 | 66,5 | 97,6 | 130,3 | 13.4 | 9.5 | 7.0 | 8.1 | 9.9 |
| of which | | | | | | | | | | |
| foreign bank loans | 40,0 | 25,3 | 17,4 | 23,2 | 15,9 | 4.3 | 3.2 | 1.8 | 1.9 | 1.2 |
| loans from Russian banks | 85,0 | 51,7 | 49,1 | 74,4 | 114,4 | 9.1 | 6.3 | 5.2 | 9.2 | 8.7 |
| other organizations' borrowings | 85,9 | 51,3 | 47,0 | 64,4 | 94 | 9.2 | 6.4 | 4.9 | 5.3 | 7.2 |
| budget funds | 121,5 | 103,3 | 127,6 | 133,4 | 148,4 | 13.0 | 12.9 | 13.3 | 11.0 | 11.3 |
| of which: | | | | | | | | | | |
| federal budget | 37,9 | 44,2 | 51,9 | 57,0 | 70,4 | 4.1 | 5.5 | 5.4 | 4.7 | 5.4 |
| budgets of constituent territories of the Russian Federation | 75,9 | 52,8 | 69,0 | 67,8 | 67,6 | 8.1 | 6.6 | 7.2 | 5.6 | 5.2 |
| money of extrabudgetary foundations | 2,1 | 1,6 | 3,4 | 2,9 | 6,1 | 0.2 | 0.2 | 0.3 | 9.2 | 0.5 |
| others | 197,2 | 191,7 | 230,2 | 273,5 | 204,9 | 21.1 | 23.9 | 24.1 | 22.6 | 15.6 |
| of which: | | | | | | | | | | |
| funds of senior organizations | 164,2 | 154,5 | 200,7 | 237,4 | 135,8 | 17.6 | 19.3 | 21.0 | 19.6 | 10.4 |
| money generated from corporate bonds issue | 0,1 | 0,02 | n/a | n/a | 0,4 | 0.01 | 0.0 | - | - | 0.0 |
| money generated from stock issue | 5,2 | 14,9 | 10 | 13,6 | 15,4 | 0.6 | 1.9 | 1.0 | 1.1 | 1.2 |
| money obtained for participatory construction projects (organizations and individuals) | 20,3 | 16,1 | 17,3 | 25,9 | 32,5 | 2.2 | 2.0 | 1.8 | 2.1 | 2.5 |
| including households' money | 8,4 | 7,8 | 10,6 | 16,6 | 25,4 | 0.9 | 1.0 | 1.1 | 1.4 | 1.9 |
| Of total capital investments – foreign investments | 62,9 | 46,2 | 36,4 | 40,3 | 36,6 | 6.7 | 5.8 | 3.8 | 3.3 | 2.8 |

Source: Rosstat.

tracted by 5.0% in the segment of large and medium-sized enterprises in Q1 2013. In Q1 2013, investments in the segment of small-sized enterprises increased by 7.1%, and, though the growth was one half as high year on year, but encouraged stabilization of the situation in the investment and construction sector at the level reported in Q1 2012. Transformation of capital investments structure in Q1 2013 took place through substantial increase in volumes and share of investments in housing construction and machinery, equipment and transport means and shrinkage of a share of investments in non-residential buildings and facilities. A share of investments in purchase of domestic machinery and equipment in total capital investments have gradually been increasing over the last five years. However, in Q1 2013 a share of imported machinery, equipment, transport means increased 17.7% in total investments in machinery, equipment, transport

means against 16.2% in Q1 2012. Outrunning growth in investment imports over capital investment dynamics has been following the recent trend and shows that domestic production of capital goods needs further development.

Post-crisis development of the construction & investment sector is distinguished by slow recovery of volumes of investments in housing construction. Investments in housing construction saw an outrunning growth over general dynamics of capital investments and construction of non-residential buildings in Q1 2013. Positive dynamics of commissioning of total housing floor space of residential buildings was noticed from H2 2011 and governed by the improvement in the situation with financing. Entities of all forms of ownership constructed 126,100 apartments, 10,4 million square meters of total floor space, in Q1 2013, showing an increase of 6.5% year on year. Individual

Table 3

CAPITAL INVESTMENTS BY TYPE OF ACTIVITY (EXCLUSIVE OF SMALL-SIZED ENTREPRENEURSHIPS AND VOLUME OF INVESTMENTS WHICH CAN'T BE SEEN THROUGH DIRECT STATISTIC METHODS) IN Q1 2009–2013

| | Growth rate, year on year | | | | | Structure as percentage of total | | | | |
|---|---------------------------|-------|-------|-------|-------|----------------------------------|------|------|------|------|
| | 2009 | 2010 | 2011 | 2012 | 2013 | 2009 | 2010 | 2011 | 2012 | 2013 |
| Total | 95 | 78.9 | 101.9 | 116.8 | 95.0 | 100 | 100 | 100 | 100 | 100 |
| agricultural sector, hunting and forestry | 74.8 | 100.8 | 107.8 | 116.7 | 102.5 | 2.9 | 3.4 | 3.0 | 3.2 | 3.3 |
| fishing, fish farming | 85.8 | 107.3 | 194.4 | 161.4 | 46.4 | 0.04 | 0.1 | 0.1 | 0.1 | 0.1 |
| industrial sector | 95.2 | 90.4 | 102.0 | 129.0 | 94.8 | 47.1 | 51.7 | 49.6 | 53.8 | 53.8 |
| mineral production | 90.7 | 89.9 | 107.5 | 132.2 | 88.6 | 20.7 | 22.4 | 22.1 | 25.0 | 24.1 |
| manufacturing | 97.8 | 78.6 | 104.7 | 128.9 | 108.0 | 19.1 | 17.7 | 17.9 | 18.5 | 20.2 |
| electric power production and distribution, | 100.6 | 122.6 | 87.2 | 121.9 | 86.1 | 7.3 | 11.6 | 9.6 | 10.3 | 9.5 |
| construction industry | 97.5 | 70.3 | 96.7 | 134.5 | 106.5 | 3.2 | 2.5 | 2.3 | 2.6 | 2.6 |
| retail and wholesale trade | 96.2 | 84.2 | 129.7 | 91.8 | 119.1 | 2.7 | 2.0 | 2.7 | 2.2 | 3.0 |
| hotels and restaurants | 89.9 | 141.2 | 94.7 | 40.3 | 135.4 | 0.3 | 0.5 | 0.5 | 0.2 | 0.7 |
| transports and communication | 105.4 | 76.5 | 113.0 | 106.2 | 80.9 | 25.6 | 24.2 | 26.3 | 24.0 | 19.5 |
| railway transport | 61.4 | 130.7 | 87.8 | 82.1 | 94.0 | 3 | 6.8 | 5.3 | 3.7 | 3.3 |
| pipeline transportation | 147.4 | 55.1 | 125.8 | 107.3 | 60.8 | 13.3 | 8.6 | 11.1 | 10.4 | 6.6 |
| communications | 75 | 82.8 | 107.9 | 129.0 | 104.1 | 3 | 3.1 | 3.0 | 3.2 | 3.2 |
| financial business | 135.3 | 61.4 | 129.6 | 140.6 | 99.8 | 1.5 | 1.1 | 1.3 | 1.4 | 1.6 |
| real estate transactions. | 76 | 66.7 | 87.5 | 97.9 | 115.4 | 10.2 | 8.8 | 7.4 | 6.3 | 9.2 |
| state administration | 106.7 | 81.5 | 85.7 | 121.3 | 80.0 | 1.1 | 1.2 | 0.8 | 0.8 | 0.7 |
| education | 80.9 | 97 | 124.3 | 88.7 | 116.1 | 1.1 | 1.3 | 1.5 | 1.2 | 1.2 |
| healthcare and provision of social services | 93.2 | 83.8 | 115.8 | 125.7 | 102.9 | 1.5 | 1.5 | 1.6 | 1.6 | 1.6 |

Source: Rosstat.

developers constructed 5,3 million square meters of total floor space of residential buildings, or 51.4% of total housing floor space commissioned in Q1 2013.

In 2010–2013, financing of housing construction underwent structural changes, thereby increasing the amount and a share of involvement of individuals in participatory housing construction projects as corporate costs were reduced. In Q1 2013 vs. Q1 2012, money for participatory construction increased by Rb 6,7bn, including an increase of Rb 8,8bn in household money. Growth in investment activity among individuals was supported by broadening the scope of lending. Mortgage loans amounted to Rb 224,1bn at the end of Q1 2013, having increased 1.25 times against the preceding year.

Post-crisis recovery of investment financing was increasingly focused on the use of equity capital of enterprises. In Q1 2013, a share of corporate proprietary investments stood at 53.0%, exceeding by 2.4 p.p. the value of Q1 2012. A share of investments through corporate profit increased regardless of the fact that profitability in the economy at large stood at 8.4% in Q1 2013, having declined by 2.3 p.p. year on year.

Amid general trend towards reviving involvement of the banking sector in investment financing, the

effect of the process on business activity in the construction sector can hardly be evaluated in a unique manner. In Q1 2013, bank loans accounted for 9.9% of the structure of sources of financing and exceeded absolute values by 5.1% year on year. Changes in the bank lending structure over the past three years have been distinguished by higher amounts and share of loans from Russian banks, thereby substituting foreign bank loans. Loans from Russian banks increased by Rb 40,0bn, whereas foreign banks' loans declined by Rb 7,3bn against Q1 2012.

A capital outflow trend had an adverse effect on the rate of involvement of banks in financing of investment programs in Q1 2013. According to Central Bank's preliminary evaluation, net capital outflow in the private sector in January–March 2013 amounted to \$25,8bn, including \$24,0bn through the banking sector. In addition, direct foreign capital investments declined in Q1 2013 while their share in total investments in Russia's economy dropped to 2.8% against 3.3% in the preceding year.

A share of budget funds at different budget levels underwent changes in the structure of funds raised for capital investment financing. In Q1 2012, Rb 148,4bn of capital investments (11.0% of total investments in the economy) were financed with budget funds.

Growth in volumes of investment financing with federal budget funds compensated moderate involvement of budgets of the constituent territories of the Russian Federation.

The Federal Targeted Investment Program (FTIP) for 2013 provides for Rb 869,5bn of federal budget funds, being Rb 41,9bn less than in 2012. In addition, the volume of funds to be allocated to finance special works performed within a state defense order as part of program and non-program components, amounts to 193,4bn Rb, exceeding by Rb 30,4bn the volume of 2012.

According to Rosstat (Federal State Statistics Service), items included into the FTIP (net of special works within state defense order) were financed with Rb 217,4bn of federal budget funds (35.7% of the allowed annual limit), Rb 61,2bn from all sources of financing was actually used. Items not included into federal targeted programs were financed with Rb 39,2bn or 18.9% of federal budget funds.

Capital investments by type of economic activity underwent significant changes in the period of 2009 thru 2013. The period of post-crisis development was distinguished by less deep decline rates of investment activity in the industrial sector against figures in the economy at large. In Q1 2013, a share of investments in the industrial sector remained at the level of Q1 2012 (53.8%).

Positive dynamics of capital investments in manufacturing sector (108.0% against Q1 2012) was maintained in Q1 2013, whereas investments in mineral production declined (88.6%). Investments in wood-working and production of wood items (170.2% against Q1 2012), chemical industry (127.9% against Q1 2012), production of coke and oil products (125.5% against Q1 2012), production of machinery and equipment (111.2% against Q1 2012) grew at outstripping rates over the average level in the manufacturing sector.

In Q1 2013, the mid- and high-tech sector saw accelerated growth rates in capital investments by type of activity. Capital investments in machine building industry and science increased 31.9% and 31.2% respectively against Q1 2012.

Types of activity such as production of electric power, gas and water (86.1% κ Q1 2012), transport (80.9%) had an adverse effect on the dynamics of investments.

Infrastructure development has been given a priority in the context of problems relating to the promotion of economic growth. A new fiscal period in 2014–2016 provides for allocation of National Wealth Fund resources and pension accruals to finance self-supporting infrastructural projects along with the development of new instruments attractive for private investments. ●

FOREIGN INVESTMENTS IN RUSSIA IN Q1 2013

E.Ilyukhina

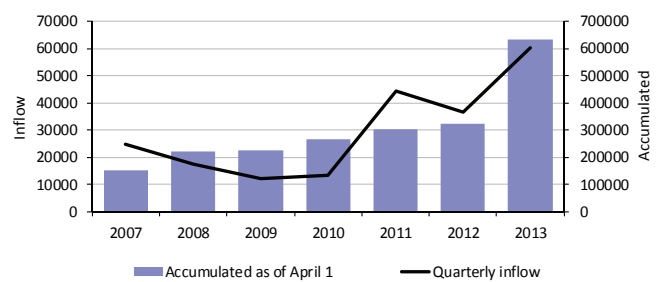
Foreign investment inflow increased 65.4% in Q1 2013. Accumulated foreign investments in Russia's economy increased 0.7% against the beginning of the year. Withdrawn capital saw a 3-fold contraction against January–March 2012, its volume accounting for 40.2% of foreign investment inflow over the period. However, Russian investments in other countries increased to account for 152.7% of the total foreign investments in Russia's economy. Unlike the previous periods, investments in the financial sector lost attractiveness for foreign investors in Q1 2013. The industrial sector was most attractive for foreign investors. Growth in investments in the production industry was supported basically by a substantial growth in investments in coke and oil product industries.

In Q1 2013, foreign investments in the non-financial sector of the Russian economy, net of monetary regulators, commercial and savings banks, including ruble investments converted into US dollars, amounted to \$60,4bn, being 65.4% higher vs. Q1 2012.

In Q1 2013, a capital of \$24,3bn, 32.4% less year on year, was withdrawn as foreign investors' revenues transferred from Russia, as well as payment of interest on and repayment of loans. Therefore, the amount equal to 40.2% of foreign investment inflow was withdrawn in Q1 2013 (98.4% in Q1 2012). In addition, in Q1 2013, Russian investments in other countries increased 91.1% to amount to \$92,3bn or 152.7% of total foreign investments in the Russian economy (the ratio of Russian investments in other countries to foreign investments in the Russian economy was 86.8% in Q1 2012).

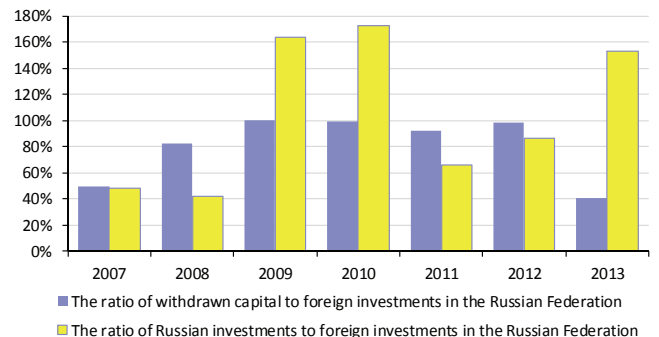
The current year is characterized by mixed trends in foreign investments. In Q1 2013, direct investments showed a growth of 63.2% to \$6,3bn against Q1 2012 (a decrease of 0.7% in Q1 2012). Portfolio investments in January–March 2013 contracted 8.5 times to \$119m (a 8.3-fold increase in Q1 2012). Other investments increased 70.6% up to \$54,0bn (other investments dropped 21.5% in Q1 2012).

The volume of contributions to capital in the direct investment segment declined 38% against Q1 2012 (it remained unchanged in Q1 2012). The share of contributions to capital in the structure of direct foreign investments decreased from 47.9% in Q1 2012 to 18.2% in Q1 2013. Loans from foreign co-owners of organizations increased by 2.8 times (a growth of 2.8% in Q1



Source: Rosstat (Federal State Statistics Service).

Fig. 1. Foreign investments in the Russian economy in Q1 2007 thru 2013, millions of US dollars



Source: Rosstat.

Fig. 2. Capital outflow from the Russian Federation in Q1 2007 thru 2013

2012). Their share in the structure of direct investments increased from 43.8% to 75.0%.

In January thru March 2013, trade credits increased by 19.6% against Q1 2012 (a growth of 18.6% in Q1

Table 1

STRUCTURE OF FOREIGN INVESTMENTS IN THE RUSSIAN FEDERATION IN Q1 2007 THRU 2013

| Investments | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|-----------------------|-------|-------|-------|-------|-------|-------|-------|
| Direct investments | 39.5% | 32.4% | 26.4% | 20.0% | 8.8% | 10.6% | 10.4% |
| Portfolio investments | 0.8% | 0.7% | 1.0% | 2.2% | 0.3% | 2.8% | 0.2% |
| Other investments | 59.6% | 66.9% | 72.6% | 77.8% | 90.9% | 86.6% | 89.4% |

Source: Rosstat.

Table 2

SECTORAL STRUCTURE OF FOREIGN INVESTMENTS IN THE RUSSIAN ECONOMY IN Q1 2011 THRU 2013

| | Millions of US dollars | | | As percentage of total | | | Year-on-year percentage change | | |
|---|------------------------|-------|-------|------------------------|------|------|--------------------------------|-------|-------|
| | 2011 | 2012 | 2013 | 2011 | 2012 | 2013 | 2011 | 2012 | 2013 |
| Industrial sector | 10,240 | 13050 | 44424 | 23.1 | 35.7 | 73.5 | 127.6 | 127.4 | 340.4 |
| Construction industry | 96 | 139 | 132 | 0.2 | 0.4 | 0.2 | 42.1 | 144.8 | 95.0 |
| Transport and communications | 3,632 | 394 | 624 | 8.2 | 1.1 | 1.0 | 240.1 | 10.8 | 158.4 |
| Wholesale and retail trade | 3,503 | 3267 | 8250 | 7.9 | 8.9 | 13.7 | 249.0 | 93.3 | 252.5 |
| Real estate transactions, leasehold and service provision | 1,585 | 2066 | 1239 | 3.6 | 5.7 | 2.1 | 171.9 | 130.3 | 60.0 |
| Financial sector | 25,072 | 17352 | 5607 | 56.5 | 47.5 | 9.3 | 2710.5 | 69.2 | 32.3 |
| Other industries | 221 | 266 | 160 | 0.5 | 0.7 | 0.3 | 175.4 | 120.4 | 60.2 |

Source: Rosstat.

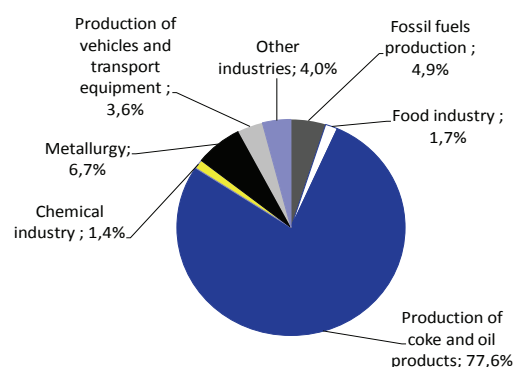
2012), whereas the share of such credits in overall structure of other investments shrank from 18.6% in Q1 2012 to 13.1% in Q1 2013. The volume of other loans, which accounted for 86.6% of total other foreign investments in the Russian economy (54.7% in Q1 2012), doubled (a decline of 33.1% in Q1 2012), of which short-term loans issued for a period of less than 180 days decreased by 3.3 times to \$5,3bn (a decline of 35% in Q1 2012). Long-term loans issued for a period of more than 180 days increased by 7.2 times to \$41,5bn (a decline of 26.7% in Q1 2012).

Portfolio investments contracted in response to a lesser interest in investments in stocks and units which contracted by 15.2 times against January–March 2012 (15.8-fold growth in Q1 2012).

Most of foreign investments were concentrated in the industrial sector. Trade sector was the second-priority target of foreign investors. Financial sector, which saw the lowest inflow of foreign investments, became the third-priority target of foreign investors.

In Q1 2013, foreign investments in the production of fossil fuels amounted to \$2,2bn, being 42.8% lower than in Q1 2012 (a decline of 15.9% in Q1 2012). In general, foreign investments in mining industry contracted by 54.3% to \$2,4bn against Q1 2012 (an increase of 11.5% in Q1 2012).

In January thru March 2013, the volume of foreign investments in the Russian manufacturing sector increased by 5.8 times to \$41,9bn against Q1 2012 (a growth of 30.9% in Q1 2012). Such a substantial growth in foreign investments in the manufacturing sector in Q1 2013 was supported basically through a 22.5-fold growth in investments in the production of coke and oil products up to \$34,5bn (a decline of 11.2% in Q1 2012). In January thru March 2013 investments in metallurgy increased by 49.4% year on year to \$3,0bn (a growth of 85.7% in Q1 2012), in food industry by 17.0% to \$772m (a growth of 57.9% in Q1 2012). In addition, foreign investments in chemical industry kept



Source: Rosstat.

Fig. 3. Sectoral structure of foreign investments in the industrial sector in Q1 2013

declining by 10.7% to \$610m against January–March 2012 (a decline of 4.7% in Q1 2012). Mixed dynamics of foreign investments by sector resulted in substantial changes in the structure of foreign investments in the industrial sector.

The structure of foreign investments in the industrial sector differs from a similar structure of total foreign investments in the Russian economy in a bigger share of other investments and small share of direct investments. In January–March 2013, direct investments in the industrial sector contracted by 3.2% against Q1 2012 (a decline of 24.6% in Q1 2012), whereas other investments in the industrial sector increased 3.4 times (a growth of 35.1% in Q1 2012), thereby reducing a share of direct investments in the structure of foreign investments in the industrial sector. Portfolio investments were almost discontinued.

Direct investments in the industrial sector in Q1 2012 accounted for 33.1% of total direct foreign investments in the Russian economy (55.8% in Q1 2012).

In Q1 2013, France (\$8,3bn), the United States (\$6,9bn), the Netherlands (\$6,8bn), Luxemburg (\$6,2bn), and Great Britain (\$6,0bn) accounted for a

FOREIGN INVESTMENTS IN THE INDUSTRIAL SECTOR IN Q1 2007–2013

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|-----------------------|-------|-------|-------|-------|-------|-------|--------|
| Direct investments | 70.3% | 46.0% | 30.4% | 19.1% | 27.9% | 16.5% | 4.7% |
| Portfolio investments | 1.0% | 1.2% | 0.1% | 1.6% | 0.5% | 7.6% | 0.03% |
| Other investments | 28.7% | 52.8% | 69.5% | 79.3% | 71.6% | 75.8% | 95.27% |

Source: Rosstat.

major part of foreign investments in the Russian economy. Investments from these countries accounted for 56.6% of total foreign investments in the Russian Federation (the top-5 investors in the Russian economy accounted for 76.5% of total investments in this country in Q1 2012).

France became a leader in the list of major investors in the Russian Federation (in Q1 2012, France was ranked among the top-10 investors in the Russian economy). A major part of French investments in Q1 2013 was concentrated in the production of coke and oil products (91.3% of total French investments in the Russian Federation). France accounted for 22.0% of total foreign investments in this sector in Q1 2013.

In January thru March 2013, U.S. investments in the Russian economy increased by 5.7 times against Q1 2012 (a 3.8-fold growth in Q1 2012). A major part of U.S. investments in 2013 was focused on the production of coke and oil products (\$6,5bn) (93.9% of US investments in the Russian Federation and 18.8% of total foreign investments in this sector). In Q1 2012, U.S. investments were focused on metallurgy, accounting for 74.0% of total US investments in the Russian Federation and 45.2% of total foreign investments in this sector.

Dutch investments in the Russian Federation in January thru March 2013 increased by 1.9 times year on year (a decline of 10.6% in Q1 2012). Dutch investments in the manufacturing industry totaled \$4,7bn (68.4% of total Dutch investments in the Russian economy and 11.1% of total investments foreign investments in this sector), and real estate transactions amounted to \$500m (7.3% and 40.4%). In Q1 2012, a major part of Dutch investments (\$2,6bn or 72.6% of total Dutch investments in the Russian Federation) was concentrated in the mining industry and accounted for 49.4% of total foreign investments in this sector.

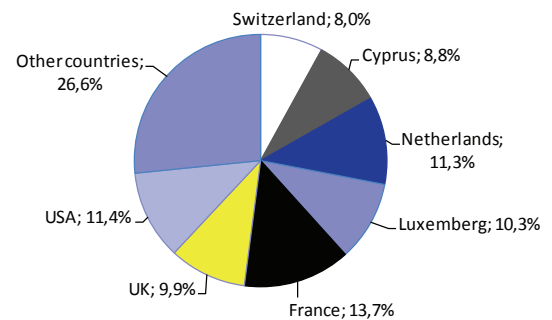


Fig. 4. Geographic structure of foreign investments in the Russian Federation in Q1 2013

UK investments in the Russian Federation tripled against January–March 2012 (a decline of 10.1% in Q1 2012), being focused on the production of coke and oil products (\$5,0bn) (82.8% of total UK investments in the Russian economy and 14.4% of total foreign investments in the sector).

Luxemburg investments in the Russian Federation in 2013 increased by 3.8 times against Q1 2012 (a decline of 28.2% in Q1 2012), being focused on trade: investments in this sector amounted to \$3,6bn (58.6% of total Luxemburg investments in the Russian Federation and 44.1% foreign investments in the sector).

Switzerland showed the lowest level of investments among top-investors in the Russian economy in January thru March 2013, 73.0%, year on year, about \$5,0bn, whereas China showed a biggest 17.5-fold growth up to \$2,2bn.

In general, as of the end of March 2013, accumulated foreign investments in the Russian economy reached \$364,9bn, being 12.9% higher year on year and 0.7% higher against the level registered as of January 1, 2013.

RUSSIAN FOREIGN TRADE IN APRIL 2013

N.Volovik, K.Kharina

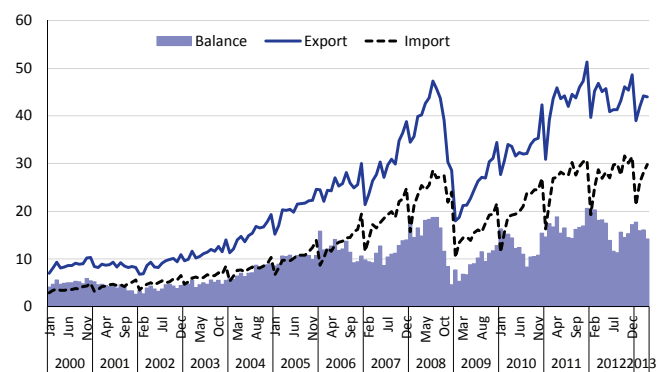
In April 2013, a decrease in the export with simultaneous growth in import was observed; due to the above the surplus of the trade balance of the Russian Federation dropped dramatically. In Russia's foreign trade turnover, the share of CIS states keeps decreasing. On June 25, at the meeting of the Collegium of the Eurasian Economic Commission a special protective duty on the import of combined harvesters and assembly units of combined harvesters to the territory of the Customs Union was introduced for the period of three years.

In April 2013, multidirectional dynamics of the main indices of the Russian foreign trade was observed. The foreign trade turnover calculated on the basis of the balance of payments amounted to \$73.8bn which is 2.4% higher than the index of last April. It is to be noted that growth took place at the expense of import supplies. In April 2013, \$29.8bn worth of goods was imported which figure exceeded by 10.3% the index of April 2012. As compared to the same index of the previous year, the export fell by 2.3% and amounted to \$44bn. As a result, the surplus of foreign trade turnover dropped: it amounted to \$14.2bn having decreased by 21.2% as compared to the same index of 2012.

In April 2013, a drop in the Russian export in monetary terms was justified by continued depreciation of prices on the global primary market. As compared to April 2012, prices virtually on all the commodities went down, except for gas which appreciated in price by 12.8% and 110% on the European market and the US market, respectively.

In April 2013, at the meeting of the Open Markets Committee of the Federal Reserve System the option of a possible scaling down of the program of qualitative easing was discussed. Ben Bernanke, Head of the US Federal Reserve said that scaling down of the program might begin as early as the end of 2013 provided that the US economy kept demonstrating the signs of recovery. The above information prompted growth in the USD dollar exchange rate which situation in its turn resulted in a drop in USD dollar denominated prices on primary products. The opposite effect on the dynamics of oil prices was caused by a volatile situation around Syria.

In April 2013, Brent oil prices depreciated by 14.6% as compared to April 2012. Having achieved within a month the maximum value of \$111.07 a barrel on April 1, 2013, the Brent oil price fell below \$100 a barrel to \$97.67 a barrel on April 17, but on April 22 regained the level above \$100 a barrel. In May-June 2013, the Brent oil prices fluctuated within the range of \$100 a barrel to \$106 a barrel.



Source: The Central Bank of the Russian Federation.

Fig. 1. The main indices of the Russian Foreign Trade, billion USD

In April 2013, the Urals oil price amounted to \$101.1 a barrel and fell by 13.7% and 5.2% as compared to April 2012 and March 2013, respectively. Within four months of 2013, the Urals oil price fell by 7.4% to \$108.5 a barrel as compared to the respective period of the previous year.

According to the data of the Ministry of Economic Development of the Russian Federation, in the period from May 15 till June 14, 2013 the average price on crude Urals oil amounted to \$749.3 a ton. As a result, from July 1, 2013 the export duty on oil in the Russian Federation will amount to \$369.2 a ton which is \$9.9 more than in June 2013. From July 1, 2013, reduced export duty for a number of oil deposits will amount to \$172.9 a ton against \$165.5 a ton in June.

The duty on oil products in July is set at \$243.6 a ton against \$237.1 a ton in June; the duty on petrol is set at \$332.2 a ton (\$323.3 a ton in June). The export duty on condensed gas was determined at \$45.2 a ton against \$72.2 a ton in June.

Slowdown of economic growth rates in all the large developing countries, particularly, China contributes to preservation of a negative price trend on the non-ferrous market. According to the data of the London Metal Exchange, in April 2013 as compared to April 2012 prices on aluminum, copper and nickel fell by

Table 1

MONTHLY AVERAGE GLOBAL PRICES IN APRIL OF A RESPECTIVE YEAR

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|--------------------------|--------|--------|-------|-------|-------|--------|--------|--------|--------|--------|---------|--------|
| Oil (Brent), USD/barrel | 25.81 | 24.79 | 33.5 | 50.6 | 68 | 68.32 | 108.26 | 50.85 | 84.98 | 123.07 | 120.46 | 102.9 |
| Natural gas*, USD/1m BTU | 2.81 | 4.03 | 3.92 | 5.86 | 8.24 | 8.00 | 12.19 | 8.51 | 7.52 | 10.36 | 11.42 | 12.88 |
| Petrol, USD/a gallon | 0,814 | 0,855 | 1,152 | 1,603 | 2,016 | 2.13 | 2,884 | 1,459 | 2,321 | 3.24 | 3.22 | 2.91 |
| Copper, USD/a ton | 1620.8 | 1598.5 | 2950 | 3395 | 6370 | 7766.5 | 8684.9 | 4406.6 | 7745.1 | 9483.3 | 8289.5 | 7234.3 |
| Aluminum, USD/a ton | 1370.3 | 1332.8 | 1734 | 1894 | 2620 | 2814.8 | 2959.3 | 1420.9 | 2316.7 | 2662.6 | 2049.7 | 1861.7 |
| Nickel, USD/a ton | 6940.6 | 7915.3 | 12872 | 16142 | 17935 | 50267 | 28763 | 11166 | 26031 | 26329 | 17939.8 | 15673 |

* Market of Europe, average contractual price, Franco-border.

Source: The World Bank.

9.2%, 12.7% and 12.6%, respectively. As compared to March 2013, prices on aluminum, copper and nickel fell by 3.0%, 6.0% and 6.5%, respectively. In January–April 2013, aluminum, copper and nickel were traded 8.4%, 6.6% and 12.1% lower as compared to the same period of 2012.

In April 2013, the average value of the FAO food price index amounted to 215.5 points which is 2 points (1%) more than the revised March index of 213.2 points and the index of April 2012. Both in March and April 2013, the main factor behind growth in the index was dramatic appreciation of dairy products. It is to be noted that prices on meat rose insignificantly, while prices on other types of food products decreased.

According to the data of the Bank of Russia, in January–April 2013, the Russian foreign trade turnover amounted to \$274.5bn (0.8% less than in January–April 2012), including \$169.2bn worth of export (a 4.2% reduction) and \$105.2bn worth of import (growth of 5.3%). Multidirectional dynamics of export and import resulted in a decrease in the trade balance surplus to \$64bn against \$76.8bn in January–April 2012.

Export deliveries of goods virtually decreased by all the commodity groups, except for timber and pulp and paper products (growth of 1.6%) and cars, equipment and means of transportation (a 0.1% growth). Export of the produce of the fuel and energy complex and the chemical industry fell by 3.8% and 3.1%, respectively. A sharp drop took place in the export of food products (18.9%) and metals and products made of metals (14.1%).

According to the data of the Federal Customs Service of Russia, in January–April 2013 78.4m tons of oil were exported which is 0.6% more than in the same period of 2012. It is to be noted that the export of oil to far abroad countries amounted to 68.8m tons (101.1% on the respective period of 2012), while that to CIS states declined by 2.6% and amounted to 9.7m tons due to suspension of oil deliveries to Ukraine.

In January–April 2013, export of gas amounted to 66.1bn cubic meters, which is 2.7% lower than in the same period of 2012. It is to be noted that 45.3 cubic meters of gas were supplied (102.3% on the level of 2012) to far abroad countries against the mere 20.8 cubic meters supplied to CIS countries which is 11.9% lower than in the same period of 2012. So, a drop in that index took place due to a reduction in supplies to CIS countries, primarily, as a result of a 27.4% drop in gas supplies to Ukraine.

As regards import, the highest growth was demonstrated by the produce of chemical industry (growth of 11.1% to \$15.7bn), textile and footwear (growth of 10.9% to \$6.3bn), food products and agricultural primary products (growth of 8.4% to \$13.4bn) and metals and metal products (growth of 6.1% to \$6.9bn). The import of machines and equipment which accounts for at least half of the import volume in monetary terms increased by 3.3% to \$47.9bn.

However, in January–April 2013 the import of cars to Russia fell by 8.3% to 297,200 cars. According to the data of the Federal Customs Service of Russia, within four months from the beginning of the year \$5.93bn worth of cars was imported to Russia, including 277,100 cars from far abroad (5.7% less than in January–April 2012) and 20,100 cars from CIS states (a decrease of 33.9%).

So, reduction in the Russian trade with CIS states has continued. In the first four months of 2013, Russian export and import to and from those countries fell by 12.5% and 9.3%, respectively. The share of the CIS states in the foreign trade turnover of the Russian Federation fell from 14.6% in January–April 2012 to 13% in January–April 2013.

Russia's trade with the member-states of the Customs Union (CU) fell, as well: in the first four months of 2013 it amounted to \$17.9bn which is 12.1% lower than in the same period of the previous year, while the share of CU member states in the foreign trade

turnover of the Russian Federation decreased from 7.5% to 6.7%.

At the same time, volumes of illegal financial operations with the CU member-states are growing rapidly. In Letter No.110-T of June 19, 2013 on Attaching by Credit Institutions of Higher Attention to Individual Transactions by Customers, the data was published for the first time on the volumes of illegal outflow of capital from Russia through false import schemes with CU member-states. According to the data of the Central Bank of the Russian Federation, in 2012 the volume of funds taken out of the country under the cover of fictitious import from the CU member-states amounted to \$25bn of which \$10bn was withdrawn through Kazakhstan and another \$15bn, through Belarus.

In using the above scheme, Russian residents transfer funds under foreign trade contracts under which the "import" of goods is carried out from Belarus and Kazakhstan to "sellers'" accounts opened with foreign banks situated beyond the territory of those countries. Conditions of the CU create a favorable situation for that: on border of the three member-states a simplified procedure for transportation of goods is used; the above procedure suggests that in respect of goods only consignment notes, rather than customs cargo declarations are executed and due to that it is highly complicated to check authenticity of such consignment notes and, consequently, the existence of goods supplies.

In the member-states of the Customs Union the work is being carried out on protection of domestic producers of goods. On June 25, 2013, at the meeting of the Collegium of the Eurasian Economic Commission (EEC) a decision was taken to introduce a final special protective duty on combined harvesters and assembly units of combined harvesters till March 7, 2016.

By Decision of December 25, 2012 of the EEC, a preliminary special protective duty on combined harvest-

ers and assembly units of combined harvesters was imposed in the amount of 27.5% of the customs value. As a result of the analysis of the information received in the course of investigation, a conclusion was made as regards the existence of grounds for application of a special protective measure.

So, in the 2009–2011 period the volume of import of combined harvesters to the CU member-states rose by 19.9 %, while in the first six months of 2012 it increased by 92.3% as compared to the respective period of 2011. The above resulted in a drop in the volume of production and sales volumes of combined harvesters by 14.4% and 43.4%, respectively, and growth of 67.4% in merchandise inventory. As a result, the share of manufacturers of combined harvesters on the CU market fell by 14.6 p.p., while their profit decreased by 72.2%. In 2012, the above trend intensified.

Special protective duty will be a diversified one: 26.7% in 2013, 26.2% in 2014, 25.7% in 2015 and 25.2% in 2016. The rates are added to the 5% duty. The protective measure is applied to assembly models of combined harvesters (partially dismantled equipment without wheels, cabin and other units) which at present are imported duty-free to the member-states of the Customs Union.

As the rate of the preliminary protective duty which was in effect from February 2013 was higher than the final duty, customs services of the CU will have to return the difference to importers who in that period imported that equipment and paid the duty at a higher rate.

Imposition of duties will hit most the John Deere Company, the US manufacturer as the decision of the EEC makes unprofitable both the import of combined harvesters to the territory of the CU and SKD assembly in the Moscow Region. ●

RUSSIA'S STATE BUDGET IN MAY 2013

T.Tishchenko

In January–May 2013 the federal budget revenues decreased by 2.2 p.p. of GDP over the same period of the last year due to a reduction of oil and gas revenues by 1.5 p.p. of GDP and non-oil revenues by 0.7 p.p. of GDP. The consolidated revenues of the Subjects of the Russian Federation within the period under review also fell down by 2.0 p.p. of GDP relative to the first four months of 2012, the expenditures of the federal budget and the consolidated budget of the Russian Federation in January–April 2013 have decreased by 2.0 and 0.6 p.p. of GDP against the relevant period of the last year, accordingly. The federal budget surplus amounted to 0.5% of GDP and surplus of the consolidated budget of the Subjects of the Russian Federation – to 1.6% of GDP.

Analysis of key indicators of the federal budget execution in January–May 2013

According to the Federal Treasury, in January–May 2013 the federal budget revenues amounted to Rb 5.1146 trillion or 20.0% of GDP, which is by 2.2 p.p. of GDP lower than in the corresponding period of the previous year (*Table 1*). The reduction in revenues was due to lower oil and gas revenues by 1.5 p.p. of GDP and non-oil revenues by 0.7 p.p. of GDP. The structure of the federal budget also changed: while in January–May of the last year oil and gas revenues accounted for 52.7% of the federal budget, as the result of the first five months of the current year, they made only 49.2%. Herewith, within the first five months of this year, in the federal budget the oil and gas revenues made 44.1% of planned annual volume, and the non-oil revenues amounted only to 36.1%.

Budget expenditures for January–May 2013 amounted to Rb 4.9862 trillion. (19.5% of GDP), which is by 2.0 p.p. of GDP lower than the indicators of the relevant period of the previous year. Herewith, the cash execution of the federal budget for the first five months of the current year amounted to only 37.1% of the annual volume of approved expenses, while as of January–May 2012 results the cash execution of expenditures was slightly higher – 38.8%.

As of five months of 2013, the federal budget was executed with surplus of Rb 128.4bn (0.5% of GDP). Non-oil deficit in absolute terms declined by 1.4 p.p. of GDP (9.7% of GDP) against the corresponding period of the previous year.

Within the five months of the current year revenues to the federal budget have reduced under the most of tax and non-tax incomes against the relevant period of the preceding year including those from income tax – by 0.1 p.p. of GDP, from domestic VAT – by 0.5 p.p. of GDP, from import VAT – by 0.2 p.p. of GDP, from the mining tax – by 0.5 p.p. of GDP and from external economic activity – by 1.0 p.p. of GDP (*Table 2*). Herewith, income from domestic excise taxes in January–May 2013 increased by 0.2 p.p. of GDP against the relevant period of the last year. At the same time, import excise tax revenues to the federal budget within the first five months of the year remained unchanged from January to May 2012 at a rate of 0.09 p.p. of GDP.

As of five months of the current year there was observed a reduction of expenditures (in percentage of GDP) as compared to January–May 2012 in the following budget sectors (*Table 3*): “National Economy” by 0.1 p.p. of GDP, “Education” – by 0.1 p.p. of GDP, “Health Care” – by 0.4 p.p. of GDP, “Social Policy” –

Table 1

THE KEY INDICATORS OF THE FEDERAL BUDGET IN JANUARY–MAY, 2012–2013

| | January–May 2013 | | January–May 2012 | | Change, p.p. of GDP |
|--|------------------|-------|------------------|-------|------------------------|
| | Rb bn | GDP % | Rb bn | GDP % | |
| Revenues | 5114.6 | 20.0 | 5 083.3 | 22.2 | -2.2 |
| -including oil and gas | 2611.3 | 10.2 | 2 688.0 | 11.7 | -1.5 |
| Expenditures | 4986.2 | 19.5 | 4 951.2 | 21.5 | -2.0 |
| -including percentage expenditures | 142.8 | 0.5 | 128.6 | 0.5 | 0.0 |
| non-percentage expenditures | 4843.4 | 18.9 | 4822.6 | 21.0 | 1.1 |
| Deficit (-) /Surplus (+) | 128.4 | 0.5 | 132.1 | 0.7 | -0.2 |
| Non-oil and gas deficit (-) /Surplus (+) | -2482.9 | -9.7 | -2555.9 | -11.1 | 1.4 |

Source: Ministry of Finance of Russia. RF Federal Treasury. Gaidar Institute assessments.

Table 2

REVENUS FROM BASIC TAXES TO THE FEDERAL TO THE FEDERAL BUDGET IN JANUARY–MAY 2012–2013

| | January–May 2013. | | January– May 2012. | | Change, p.p. of GDP |
|---|-------------------|-------|--------------------|-------|------------------------|
| | Rb bn | GDP % | Rb bn | GDP % | |
| 1. Revenue, including: | | | | | |
| corporate profit tax | 134.9 | 0.5 | 150.5 | 0.6 | -0.1 |
| VAT on goods sold in the RF territory | 730.8 | 2.8 | 761.2 | 3.3 | -0.5 |
| VAT on goods imported to the RF territory | 635.4 | 2.5 | 613.9 | 2.7 | -0.2 |
| Excise duties on goods manufactured in the RF territory | 171.5 | 0.7 | 122.1 | 0.5 | 0.2 |
| Excise duties on goods imported to the RF territory | 22.4 | 0.09 | 20.1 | 0.09 | 0.0 |
| MET | 1025.3 | 4.0 | 1032.4 | 4.5 | -0.5 |
| 2. Revenue from external economic activities | 1962.6 | 7.7 | 1989.8 | 8.7 | -1.0 |

Source: Ministry of Finance of Russia. RF Federal Treasury. Gaidar Institute assessments.

Table 3

FEDERAL BUDGET EXECUTION IN TERMS OF EXPENDITURES IN JANUARY–MAY 2012–2013

| | January–April 2013 | | January–April 2012 | | Change, p.p. of GDP |
|--------------------------------------|--------------------|------|--------------------|------|------------------------|
| | Rb bn | GDP% | Rb bn | GDP% | |
| Expenditures. total | 4986.2 | 19.5 | 4 951.2 | 21.5 | -2.0 |
| including | | | | | |
| Federal issues | 306.2 | 1.2 | 281.2 | 1.2 | 0.0 |
| National defense | 1006.5 | 3.9 | 884.6 | 3.8 | 0.1 |
| National defense and law enforcement | 693.7 | 2.7 | 593.4 | 2.6 | 0.1 |
| National Economy | 527.7 | 2.1 | 517.4 | 2.2 | -0.1 |
| Housing and public utilities | 24.6 | 0.1 | 24.7 | 0.1 | 0.0 |
| Environmental protection | 10.1 | 0.04 | 8.5 | 0.04 | 0.0 |
| Education | 285.8 | 1.1 | 282.3 | 1.2 | -0.1 |
| Culture and cinematography | 27.7 | 0.1 | 34.8 | 0.1 | 0.0 |
| Healthcare | 207.9 | 0.8 | 267.0 | 1.2 | -0.4 |
| Social policy | 1443.9 | 5.6 | 1631.8 | 7.1 | -1.5 |
| Physical training and sports | 17.4 | 0.07 | 15.5 | 0.07 | 0.0 |
| Mass media | 30.9 | 0.1 | 29.7 | 0.1 | 0.0 |
| Public and municipal debt servicing | 142.8 | 0.5 | 128.6 | 0.5 | 0.0 |
| Intergovernmental transfer | 260.8 | 1.0 | 251.4 | 1.1 | -0.1 |

Source: Ministry of Finance of Russia. RF Federal Treasury. Gaidar Institute assessments.

by 1.5 p.p. of GDP and the “Intergovernmental transfers” – by 0.1 p.p. of GDP.

The growth of federal budget expenditures over five months of the current year as compared to January–May 2012 in terms of GDP occurred under the following budget lines: “National Defense” – by 0.1 p.p. of GDP and the “National Security and Law Enforcement” – by 0.1 p.p. of GDP. The expenditures in the other sectors of the federal budget over five months in 2013 in regard to GDP remained at the level of January–May 2012.

According to the Federal Treasury, in May 2013 the operations with the accounts of the Reserve Fund and of the National Welfare Fund were not executed. However, due to the difference in exchange rates, the Reserve Fund volume as of 01.06.2013 has grown by Rb

13.0bn and amounted to Rb 2 665,9bn. the volume of the National Welfare Fund increased to Rb 2 739.3bn (+Rb 11.5bn in May 2013).

Execution of the RF Subjects consolidated budget in January–April 2013

According to the Federal Treasury, the consolidated budget revenues of the Subjects of the Russian Federation in January–April 2013 amounted to Rb 2.663.2 trillion or 13.2% of GDP, which is by 0.6 p.p. of GDP lower than indicators of the relevant period of 2012 (Table 4).

Within four months of the current year the expenditures of the consolidated budget have decreased against the relevant period of the preceding year by 0.6 p.p. of GDP and made 11.6% of GDP, or

Table 4

KEY INDICATORS OF CONSOLIDATED BUDGET EXECUTION OF THE RF SUBJECTS IN JANUARY–APRIL 2012–2013

| | January–April 2013 | | January–April 2012 | | Change, p.p. of GDP |
|---|--------------------|-------|--------------------|-------|------------------------|
| | Rb bn | GDP % | Rb bn | GDP % | |
| Revenue including | 2 663.2 | 13.2 | 2 434.4 | 13.8 | -0.6 |
| - corporate profit tax | 678.0 | 3.3 | 606.7 | 3.4 | -0.1 |
| - individual income tax | 725.9 | 3.6 | 637.0 | 3.6 | 0.0 |
| - domestic excise duties | 152.5 | 0.7 | 132.2 | 0.7 | 0.0 |
| - aggregate income tax | 135.5 | 0.7 | 119.5 | 0.7 | 0.0 |
| - property tax | 301.3 | 1.5 | 254.8 | 1.4 | 0.1 |
| - non-repayable proceeds from other budgets of the RF fiscal system as broken down by the RF Subjects | 510.2 | 2.5 | 532.1 | 3.0 | -0.5 |
| Expenditures including | 2 346.0 | 11.6 | 2 148.3 | 12.2 | -0.6 |
| Deficit (–) /Surplus (+) | 317.2 | 1.6 | 286.1 | 1.6 | 0.0 |
| GDP estimates for reference. Rb bn | 20 220 | | 17 577 | | |

Source: Ministry of Finance of Russia. RF Federal Treasury. Gaidar Institute assessments.

Rb 2.346.0bn. As a result of the period of January–April 2013 the budgets of the RF Subjects were executed with a surplus of Rb 317.2bn or 1.6% of GDP, which matches the relevant period of the preceding year.

Despite the fact, that for the first four months of the year the volume of revenues in the consolidated budgets of the RF Subjects were reduced in terms of GDP as compared to the relevant period of 2012, the situation with the refund of the regional budgets at the expense of their own tax and non-tax revenues somehow improved against the preceding two months. In particular, if by the results of January–February and January–March of the current year the consolidated budgets of the RF Subjects for income tax decreased by 0.4 and 0.7 p.p. of GDP as compared to the relevant period of the last year as of four months of 2013 the indicator was only 0.1 p.p. of GDP.

A similar situation with the gradual covering of the gap in the budget execution in the current and in the preceding years is observed in incomes of individuals: in January–April 2013 revenues in the consolidated budgets of the Subjects of the Russian Federation for personal income remained unchanged as compared with the four months of the last year at 3.6% of GDP, while the results of the two and three months of this year. revenues from personal income tax decreased by 0.2 and 0.1 p.p. of GDP against the relevant period of the preceding year.

In terms of the other tax and non-tax revenues of budgets of the RF Subjects for the four months of 2013 in percentage of GDP, as compared to the relevant period of the last year. there is noted an increase in revenues from property tax by 0.1 p.p. of GDP and reduction of uncompensated revenues from other issues of

budget system of the Russian Federation by 0.5 p.p. of GDP. The incomes from domestic excise taxes and from total income tax remained at the level of four months of the last year in the volume of 0.7% of GDP for each tax.

Thus, the main reason for the reduction of incomes of consolidated budgets of the Subjects of the Russian Federation) are reduced inter-budgetary transfers .

Expenditures of the consolidated budget of the RF Subjects (*Table 5*) in the first four months of the current year have decreased as compared to the relevant period of 2012 under the following budget lines: “General Questions” by 0.1 p.p. of GDP, “National Economy” – by 0.2 p.p. of GDP, “Housing and communal services” by 0.1 p.p. of GDP, “Health Care” – by 0.2 p.p. of GDP, “Social Policy” by 0.1 p.p. of GDP, “Intergovernmental Transfers” by 0.01 p.p. of GDP. In January–April 2013 expenses in the GDP share against the four months of the previous year have increased in the following sectors: “Education” by 0.2 p.p. of GDP and “State and municipal debt service” by 0.01 p.p. of GDP. In the other sectors of the budget expenditures of the RF Subjects in January–April in the current year remained at the level of the relevant period of 2012 in terms of GDP.

Major developments in the field of fiscal policy

Key challenges and priorities of fiscal policy in the medium term have been formulated in June 2013 in the Budget Message of the President of Russia. There was noted a reduction of the potential growth of the federal budget revenue base at the expense of external sources, as well as a reduction of the opportunities for accelerated compensation of declining oil and gas

**EXECUTION OF THE RF SUBJECTS CONSOLIDATED BUDGET IN TERMS OF EXPENDITURES
IN JANUARY–APRIL 2012–2013**

| | January–April 2013 | | January–April 2012 | | Change p.p. of GDP |
|--------------------------------------|--------------------|-------|--------------------|-------|-----------------------|
| | Rb bn | GDP % | Rb bn | GDP % | |
| Expenditures including | 2 346.0 | 11.6 | 2 148.3 | 12.2 | -0.6 |
| Federal issues | 153.1 | 0.7 | 136.3 | 0.8 | -0.1 |
| National defense | 1.0 | 0.005 | 0.9 | 0.005 | 0.0 |
| National defense and law enforcement | 23.3 | 0.1 | 21.8 | 0.1 | 0.0 |
| National Economy | 351.7 | 1.7 | 337.5 | 1.9 | -0.2 |
| Housing and public utilities | 176.8 | 0.9 | 182.3 | 1.0 | -0.1 |
| Environmental protection | 5.4 | 0.03 | 4.7 | 0.03 | 0.0 |
| Education | 705.8 | 3.5 | 582.2 | 3.3 | 0.2 |
| Culture and cinematography | 81.6 | 0.4 | 73.0 | 0.4 | 0.0 |
| Healthcare | 362.1 | 1.8 | 360.2 | 2.0 | -0.2 |
| Social policy | 405.7 | 2.0 | 379.1 | 2.1 | -0.1 |
| Physical training and sports | 42.0 | 0.2 | 37.1 | 0.2 | 0.0 |
| Mass media | 12.0 | 0.06 | 10.3 | 0.06 | 0.0 |
| Public and municipal debt servicing | 22.1 | 0.1 | 16.8 | 0.09 | 0.01 |
| Intergovernmental transfers | 3.4 | 0.02 | 5.8 | 0.03 | -0.01 |

Source: Ministry of Finance of Russia. RF Federal Treasury. Gaidar Institute assessments.

revenues at the expense of non-oil and gas sources, which requires the detection of reserves and their redistribution in favor of the priority areas and projects, primarily those, providing the solutions of targets identified in the decrees of the President of the Russian Federation on May 7, 2012 and creating the conditions for economic growth.

It should be noted, that already in April, the Russian Ministry of Economic Development has warned that the recession in Russia is expected in autumn of the current year, if necessary measures for the support of the economy are not taken. In June the IMF has sharply lowered the forecast for the growth of Russian GDP in 2013 from 3.4 to 2.5%, and from 3.8 to 3.25%

in 2014 and again advised the Russian government to conduct large-scale reform of economic policy.

The slowdown in economic growth and the reduction of budget revenues are forcing the country leaders to use the National Welfare Fund to implement the infrastructure projects. Without any attempt to analyze all the implications of this decision in the framework of the monthly revue, it should be noted. that the infrastructure projects are supposed to be financed from the NWF on the basis of PPP on a refundable basis are long-term, while at the present time the problem of improvement of efficiency of budget expenses looks more reasonable. ●

RUSSIA'S BANKING SECTOR IN MAY 2013

M.Khromov

Banks' assets grew at a rate of 20.1% in May 2013, being a slightly lower than in 2011 and 2012. In May, financial result of the banking business was found to be minimal since the fall of 2011. Household savings on bank accounts and deposits slowed down rapidly after three months of growth. A mid-term downtrend for retail lending was still there. The corporate segment of the lending market also saw slow growth rates. Banks became a beneficiary of the decline in the ruble exchange rate in June. In June 2013, growth in USD/RUB exchange rate may generate a net profit of more than Rb 30bn for banks from revaluation of accounts.

Banking sector's assets increased 1.2%¹ in May 2013. Assets of small- and medium-sized banks, other than the top-30 largest banks, were growing much faster (by 1.6%). Assets of state banks increased (by 1.2%) in the banking sector in general, accounting for 55% of total bank assets. However, this result was achieved through more intensive growth (by 1.4%) of Sberbank. Subsidiary foreign banks among the largest Russian banks saw a decline of 0.6% in their total assets in May.

Annual growth rates in bank assets stood at 20.1% in May 2013, being slightly less but corresponding to the results achieved in 2011 (21.4%) and 2012 (20.4%), which means that bank assets saw stable growth rates in the post-crisis period.

Banks' equity capital grew at a much slower rate vs. assets. Book value of capital increased by 0.4%, regulatory capital by 0.7% during the month, which means that bank assets growth was basically achieved through banks' borrowings rather than equity.

A share of state banks in total bank capital remained almost unchanged during the month, having remained at a level of 55.0%.

The financial result of banking business amounted to Rb 68bn in May, a minimal value since the fall of 2011. Profit in the banking sector remained at a level of Rb 82bn on average over the last 12 months. An increase in contributions payable to the provisions for losses, which reached Rb 57bn in May, was basically responsible for profit shrinkage. It was a minimal value since January 2010, whereas the provisions increased by Rb 22bn per month on average over the last 12 months. The increase in contributions showed higher overall risk level bank assets were exposed to.

Return on assets in the banking sector fell to 1.6% and equity to 14.0% in May in response to the profit shrinkage. Annual financial efficiency values for the

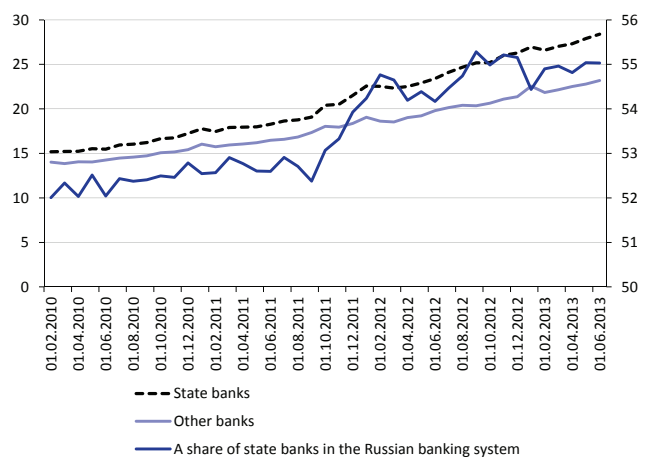


Fig. 1. Dynamics of state and other banks' assets (trillions of rubles), and a share of state banks in the assets (% , right-hand scale)



Fig. 2. Dynamics of state and other banks' equity capital (trillions of rubles), and a share of state banks in capital (% , right-hand scale)

¹ Hereinafter, unless otherwise indicated, growth rates in balance sheet figures are presented with allowance for revaluation of the foreign currency component.

banking sector dropped to 2.1 and 18.1% respectively.

Fundraising

Growth in balances of retail bank accounts and deposits, which increased rapidly during the three preceding months (by 2.3% per month on average), slowed down abruptly in May, having contracted by 0.3%. Curiously enough, such a situation was typical of this month during the past few years (in May 2012 retail accounts and deposits shrank by 0.2%, in May 2011 by 0.3%), which might be caused by a seasonal fall in the household income nominal value. In May, annual growth rate in retail bank accounts and deposits remained even higher (20.4%) than at the beginning of the year (19.4%).

The shrinkage of bank deposits in May had an effect on almost all groups of large banks in terms of certain groups of banks. Retail bank accounts and deposits in state banks shrank by 0.8%, including 1.0% in Sberbank, 1.8% in foreign banks, 0.8% in large private banks, except for small- and medium-sized banks, where bank deposits saw an increase of 1.2% during the month.

Balances of corporate accounts increased by 1.7% in May. This type of bank liabilities saw a positive dynamics in less than just two months since the beginning of the year, the previous growth was reported in February. As a result, corporate customers' bank accounts increased just 1.5% within five months since the beginning of the year. Annual growth rate in May increased up to 13.3%, being much higher than the minimal level (9.6%) in January, but kept being far behind the total dynamics of bank assets.

Regardless of the fact that overall growth in May was governed by increased balance of settlement and current accounts, term deposits (54.6% as of the beginning of June 2013) kept prevailing in total corporate customers' funds.

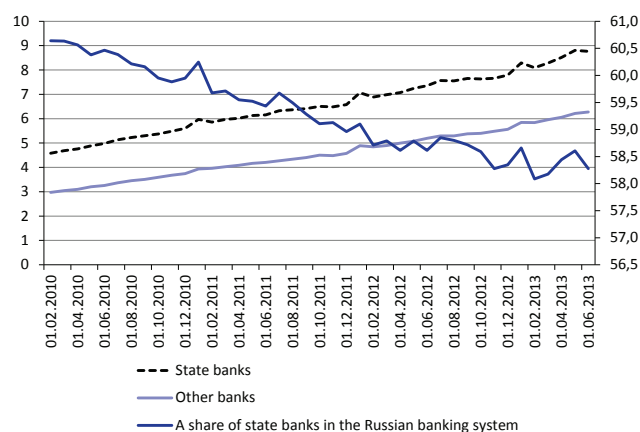


Fig. 3. Dynamics of state and other banks' retail deposits (trillions of rubles), and a share of state banks in the retail deposit market (% , right-hand scale)

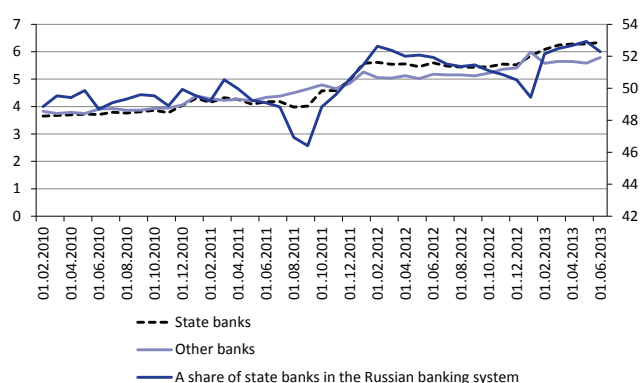


Fig. 4. Dynamics of corporate accounts with state and other banks (trillions of rubles), and a share of state banks in the corporate account market (% , right-hand scale)

Table 1

RUSSIAN BANKING SYSTEM'S STRUCTURE OF LIABILITIES (AT MONTH END), AS PERCENTAGE OF TOTAL

| | 12.08 | 12.09 | 12.10 | 12.11 | 03.12 | 06.12 | 09.12 | 12.12 | 01.13 | 02.13 | 03.13 | 04.13 | 05.13 |
|---|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Liabilities, billions of rubles | 28022 | 29430 | 33805 | 41628 | 41533 | 44266 | 45861 | 49510 | 48429 | 49165 | 49839 | 50693 | 51587 |
| Equity | 14.1 | 19.3 | 18.7 | 16.9 | 17.5 | 16.8 | 16.9 | 16.2 | 16.8 | 16.7 | 16.7 | 16.6 | 16.5 |
| Loans from the Bank of Russia | 12.0 | 4.8 | 1.0 | 2.9 | 3.5 | 5.1 | 5.1 | 5.4 | 4.5 | 4.5 | 4.5 | 4.4 | 4.8 |
| Interbank operations | 4.4 | 4.8 | 5.5 | 5.7 | 5.1 | 4.8 | 5.1 | 5.6 | 5.4 | 5.4 | 5.4 | 5.0 | 4.9 |
| Foreign liabilities | 16.4 | 12.1 | 11.8 | 11.1 | 10.2 | 11.3 | 11.0 | 10.8 | 10.5 | 10.6 | 10.4 | 10.8 | 10.7 |
| Retail accounts and deposits | 21.5 | 25.9 | 29.6 | 29.1 | 29.4 | 29.4 | 28.7 | 28.9 | 29.1 | 29.3 | 29.6 | 30.0 | 29.5 |
| Corporate accounts and deposits | 23.6 | 25.9 | 25.7 | 26.0 | 25.7 | 24.0 | 23.3 | 24 | 24.1 | 24.2 | 23.9 | 23.4 | 23.5 |
| Accounts and deposits of government agencies and local government authorities | 1.0 | 1.0 | 1.5 | 2.3 | 1.4 | 1.5 | 2.5 | 1.6 | 1.1 | 1.0 | 1.4 | 1.9 | 2.0 |
| Outstanding securities | 4.1 | 4.1 | 4.0 | 3.7 | 4.8 | 4.5 | 4.8 | 4.9 | 5.2 | 5.3 | 5.2 | 5.2 | 5.1 |

Source: Central Bank of Russia, IET's estimates.

Loans issued

Household debt to banks increased 2.5% in May. Banks' retail credit portfolio grew up by 34.4% over 12 months. A monthly average downtrend for growth in retail lending was still there.

Different groups of banks showed similar growth rates in retail loans. Subsidiary foreign banks (2.2%) showed minimal growth rates, whereas state banks showed maximum growth rates (2.6%).

The quality of retail loans kept deteriorating. In May, overdue debt increased up to 4.4% of total loans, while accumulated provisions for losses grew up to 6.8%. Post-crisis minimal values of both indicators were reached at 2012 year-end and stood at 4.1% and 6.1% respectively.

The corporate segment of the lending market kept growing at slow rates. Corporate credit portfolio grew up by 0.4% in May, and 14.0% over the last 12 months. Low growth rates in corporate lending resulted in a weird situation when retail lending was growing faster in nominal terms than corporate lending over more than a month. For example, household debt to banks increased by Rb 867bn, whereas corporate debt increased just Rb 610bn since the beginning of the year.

Growth in corporate lending at largest banks almost stopped (+0.1%) in May. Credit portfolio shrank by 2.8% at foreign banks, whereas state banks saw insignificant shrinkage of their credit portfolio (0.5 and 0.3% respectively). It was small- and medium-sized banks that were responsible for the overall growth, where debt on corporate loans increased by 1.6%.

The quality of corporate loans remained unchanged year-to-date. A share of overdue debt in May was just 0.1 p.p. higher than as of the beginning of the year (4.6 and 4.7% of total loans respectively), and the ratio of provisions for losses to total debt on loans remained unchanged over the last five months (7.5%).

In May, banks invested basically in foreign assets. For example, retail loans increased by Rb 225bn, whereas foreign assets increased more than \$12bn. In May, foreign liabilities contracted by \$2bn, whereas net foreign assets in the banking sector increased by \$14,4bn. Foreign currency position of banks saw a much bigger growth, i.e. an excess of foreign currency assets over foreign currency liabilities: from \$27,2bn as of May 1 to \$43,3bn as of June 1. Therefore, one may conclude that banks became a beneficiary of the decline in the ruble exchange rate in June. In June 2013, growth in USD/RUB exchange rate may generate more than Rb 30bn of net profit for banks from revaluation of accounts.

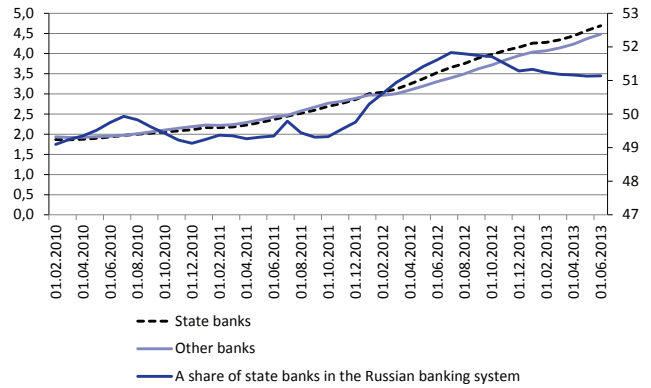


Fig. 5. Dynamics of state and other banks' retail loans (trillions of rubles), and a share of state banks in the retail loan market (% , right-hand scale)

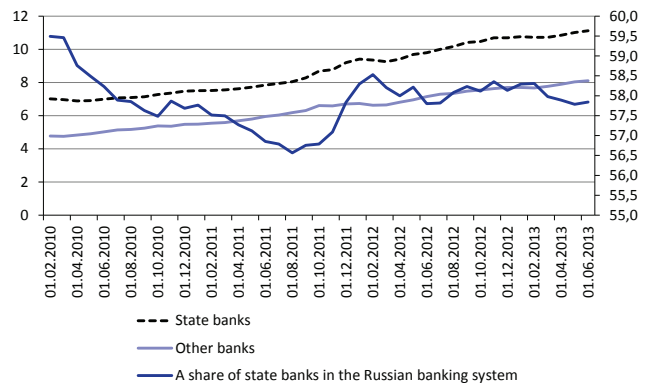


Fig. 6. Dynamics of state and other banks' corporate loans (trillions of rubles), and a share of state banks in the corporate loan market (% , right-hand scale)

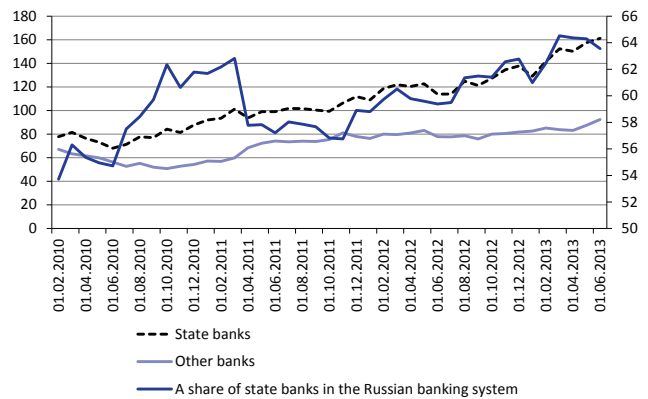


Fig. 7. Dynamics of state and other banks' foreign assets (billions of US dollars), and a share of state banks in total foreign assets (% , right-hand scale)

Table 2

Russian banking system's structure of assets (at month end), as percentage of total

| | 12.08 | 12.09 | 12.10 | 12.11 | 03.12 | 06.12 | 09.12 | 10.12 | 01.13 | 02.13 | 03.13 | 04.13 | 05.13 |
|--------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|-------|
| Assets, billions of rubles | 28022 | 29430 | 33805 | 41628 | 41533 | 44266 | 45861 | 47096 | 48429 | 49165 | 49839 | 50 693 | 51587 |
| Cash and precious metals | 3.0 | 2.7 | 2.7 | 2.9 | 2.4 | 2.5 | 2.6 | 2.6 | 2.6 | 2.5 | 2.5 | 2.7 | 2.4 |
| Deposits in the Bank of Russia | 7.5 | 6.9 | 7.1 | 4.2 | 3.2 | 3.0 | 2.8 | 2.7 | 2.9 | 3.1 | 3.3 | 3.0 | 3.1 |
| Interbank operations | 5.2 | 5.4 | 6.5 | 6.4 | 6.2 | 5.8 | 5.8 | 6.1 | 6.7 | 6.6 | 6.4 | 6.1 | 6.0 |
| Foreign assets | 13.8 | 14.1 | 13.4 | 14.3 | 14.2 | 14.2 | 13.9 | 14.3 | 14.0 | 14.6 | 14.5 | 15.0 | 15.6 |
| Retail sector | 15.5 | 13.1 | 13.0 | 14.4 | 15.3 | 16.0 | 16.8 | 16.8 | 17.3 | 17.3 | 17.4 | 17.7 | 17.8 |
| Corporate sector | 44.5 | 44.5 | 43.6 | 44.0 | 44.4 | 43.6 | 43.4 | 42.9 | 42.3 | 42.1 | 41.9 | 41.5 | 40.9 |
| State | 2.0 | 4.2 | 5.1 | 5.0 | 4.9 | 3.8 | 3.3 | 3.2 | 3.7 | 3.3 | 3.2 | 2.9 | 2.8 |
| Property | 1.9 | 2.7 | 2.6 | 2.3 | 2.4 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.2 | 2.2 | 2.2 |

Source: Central Bank of Russia, IET's estimates.

REAL ESTATE MARKET IN THE RUSSIAN FEDERATION IN Q1 2013

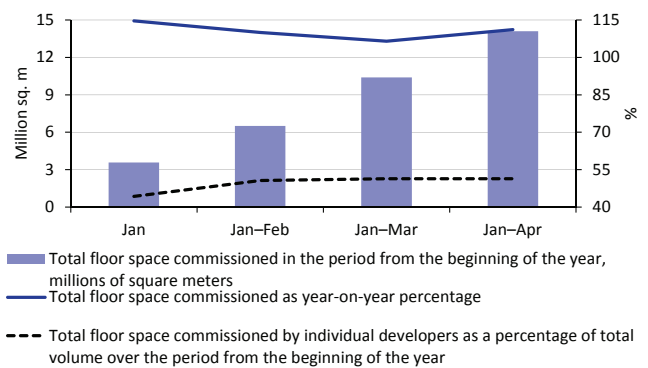
G.Zadonsky

126,100 apartments covering a total of 10.4 million square meters floor space were constructed in Q1 2013, accounting for 106.5% against Q1 2012. Average actual cost of construction of 1 square meter in the housing total floor space increased 7.89% in Q1 2013 vs. Q1 2012 and amounted to Rb 34,920. The ratio of the price of 1 square meter of residential floor space in the total floor space in the primary housing market to the cost of construction of 1 square meter of the residential floor space increased by 0.85 p.p. over the same period and stood at 139.75%. State registration of land title for individuals (1,243m title deeds) increased 6.24% in volumes in Q1 2013 vs. Q1 2012. 211480 housing mortgage loans (HMLs), Rb 341,0bn, were issued from January to April 2013, showing an increase of 27.52% vs. April 2012. In April 2013, monthly growth in the weighted average interest rate on ruble HMLs gave way to a decline for the first time since November 2011. The interest rate decreased 0.3 p.p., falling to 12.6%.

According to the Federal State Statistics Service of Russia (Rosstat), organizations of all types of incorporation constructed 126,100 apartments covering a total of 10.4 million sq. m floor space, accounting for 106.5% year on year, of which individual developers constructed residential buildings covering 5.34 million square meters of floor space in Q1 2013, accounting for 101.7% vs. Q1 2012 and 51.4% of the total volume of buildings commissioned in Q1 2013 (Fig. 1). 46,500 new apartments covering a total of 3.71 million sq. m floor space were constructed in April 2013, or 126.9% vs. April 2012.

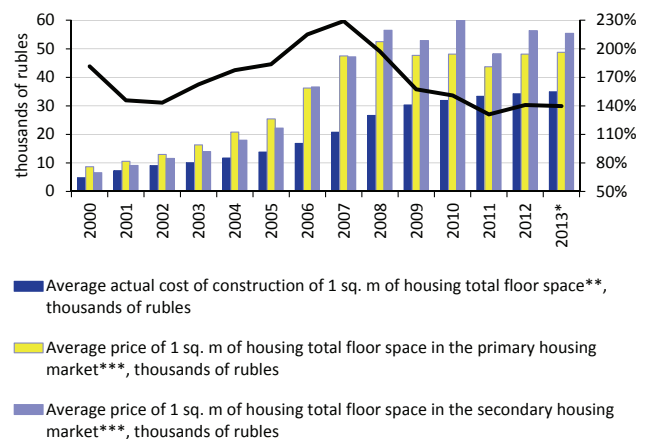
Average actual cost of construction of 1 square meter of housing total floor space amounted to Rb 34,920 in Q1 2013 (Fig. 2), showing an increase of 7.89% vs. Q1 2012 (Rb 32,366 in Q1 2012). Average price of 1 square meter of housing total floor space in the primary housing market increased 8.44% in Q1 2013 (Rb 48,800) vs. Q1 2012, remaining lower than average price (Rb 55,400) of 1 square meter of housing total floor space in the secondary housing market which also increased vs. Q1 2012. In addition, the ratio of the price of 1 square meter of housing total floor space in the primary housing market as a percentage of the cost of construction of 1 square meter of housing floor space increased 0.85 p.p. in Q1 2013 and grew up to 139.75% vs. Q1 2012 (Fig. 2).

According to Rosstat, the Nenets Autonomous District (Rb 55617) and Yamalo-Nenets Autonomous District (Rb 51470) had the highest cost of construction, being 1.5x and more the Russian average, in Q1 2013; 51 constituent territories of the Russian Federation showed below the Russian average cost, of which the Republic of Dagestan (Rb 17210), Penza Region (Rb 22019) and Zabaikalye Territory (Rb 22309) had lowest costs.



Source: based on the data provided by Rosstat.

Fig. 1. Dynamics of housing commissioning as progressive total from the beginning of 2013



* Q1 2013;

** average actual price of construction of 1 square meter of housing total floor space of detached residential buildings (all apartments) without extensions, integral and attached premises;

*** all apartments.

Source: based on the data provided by Rosstat.

Fig. 2. Dynamics of the cost of construction of 1 square meter of housing total floor space and the price of 1 square meter of housing total floor space in the primary and secondary housing markets in the Russian Federation

According to the Russian State Register, в Q1 2013 the number of registered individuals' titles to living quarters (2159456 title deeds) increased 16.28% vs. Q1 2012 (Fig. 3), whereas the number of registered legal entities' titles to living quarters (42147 title deeds) decreased 8.63% vs. Q1 2012.

According to the Russian State Register, the volume of state registrations of land title for individuals (1243811 title deeds) increased 6.24% in Q1 2013 vs. Q1 2012 (Fig. 4). The number of state registrations of land title for legal entities contracted 3.44% to amount to 60145 title deeds in Q1 2013. Leasehold of land plots by individuals (16322 leasehold deeds) contracted 1.16% in Q1 2013 vs. Q1 2012, whereas leasehold of land plots by legal entities increased by 3.9 times (41996 leasehold deeds) over the same period.

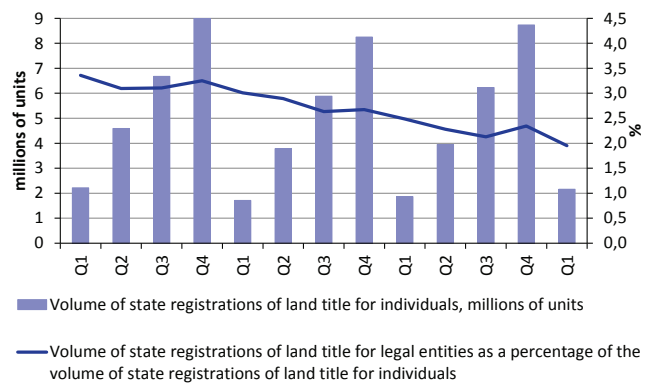
According to the Russian State Register, the volume of simplified state registrations of title to certain types of immovable property ("country house amnesty") most of which are land plots which were registered prior to the introduction of the Land Code of the Russian Federation for private subsidiary farming, country-house, home gardening, private garage or housing construction, tends to decline (Fig. 4). In Q1 2013, the volume of simplified state registrations of title to certain types of immovable property amounted to 210281 title deeds, being 13.42% less than in Q1 2012, including 106928 title deeds of simplified state registration of land, being 12.95% less than in Q1 2012.

The number of mortgaged land plots registered in Q1 2013 increased 15.40% for physical bodies (95699 mortgage deeds) and 14.45% for legal entities (33035 mortgage deeds) against Q1 2012.

The number of housing mortgages contracted 4.93% in Q1 2013 (235284 mortgage deeds) against Q1 2012. In addition, the number of mortgages on living quarters owned by individuals that were purchased (constructed) through borrowed funds or a special-purpose loan in Q1 2013 (168993 mortgage loans) increased 14.58% against Q1 2012 (Fig. 5).

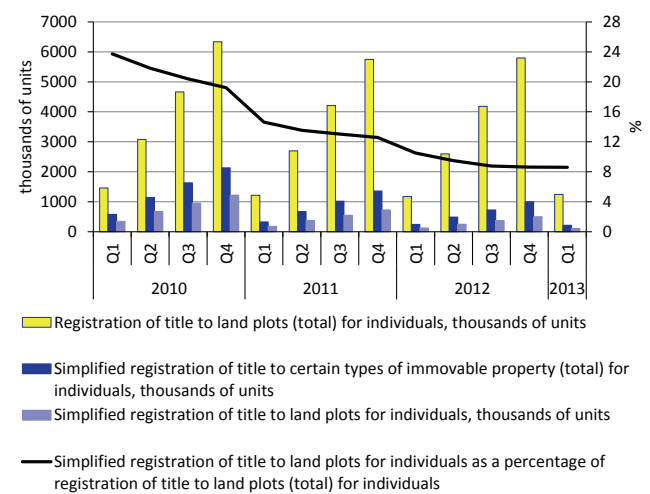
According to the Central Bank of Russia, 224217 housing loans (HLs) at Rb 351,524bn were issued from January to April 2013, including 211480 housing mortgage loans (HMLs) at Rb 341,0bn, exceeding by 27.52% the amount of HMLs issued from January to April 2012.

A total of Rb 111,91bn of ruble HMLs were issued in April 2013, being 27.28% more than in April 2012 (Fig. 6), Rb 2,101bn of foreign currency HMLs, being 71.93% more than in April 2012 (Fig. 7). In April 2013, outstanding debt on ruble HMLs increased 3.37% to reach Rb 2,042 trillion, whereas outstanding debt on foreign currency loans contracted 0.24% to Rb 118,9bn.



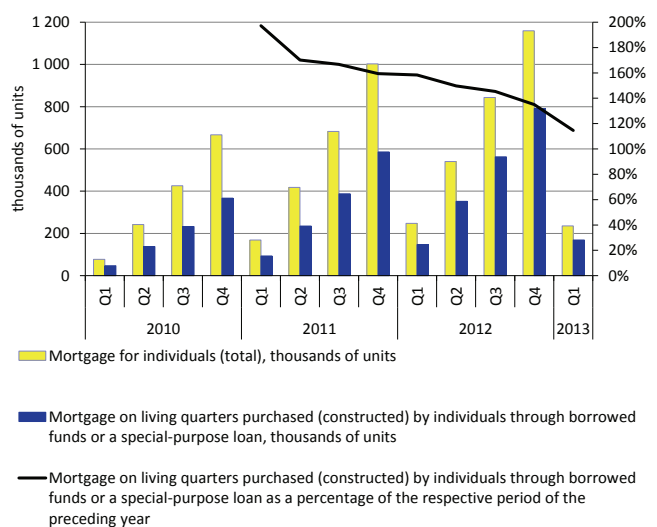
Source: based on the data provided by the Russian State Register.

Fig. 3. Dynamics of state registration of title to living quarters



Source: based on the data provided by the Russian State Register.

Fig. 4. Dynamics of state registration of title to land plots for individuals



Source: based on the data provided by the Russian State Register.

Fig. 5. Dynamics of state registration of housing mortgage

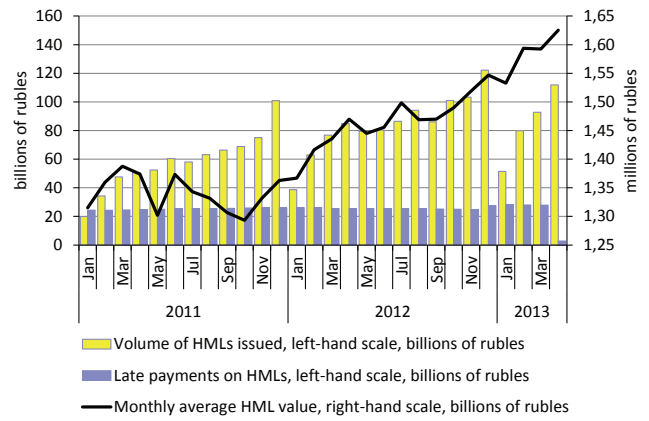
Beginning with October 2011, average monthly value of ruble HMLs increased 25.69% and amounted to Rb 1,625m as of May 1, 2013 (Fig. 6). Monthly average amount of foreign currency HMLs followed no steady trend at the same period, amounting to Rb 9,296m in April 2013, being 41.39% higher than in March 2013 (Fig. 7). Late payments on HMLs as of May 1, 2013 (Rb 42,159bn, of which ruble loans amounted to Rb 27,94bn (Fig. 6) and foreign currency loans to Rb 14,219bn (Fig. 7)) decreased 5.42% vs. as of May 1, 2012. Late payments as a percentage of outstanding debt declined steadily at the same period and stood at 1.95% as of May 1, 2013, being 0.86 p.p. less than as of May 1, 2012.

Late payments as a percentage of outstanding debt due on ruble HMLs declined steadily and stood at 1.37% as of May 1, 2013, being 0.39 p.p. less than as of May 1, 2012. Late payments on foreign currency HMLs as a percentage of outstanding debt increased again after a fall to 11.42% in December 2012, and stood at 11.96% as of May 1, 2013.

According to the Central Bank of Russia, as of May 1, 2013, the debt on defaulted HMLs (with a delay period longer than 180 days) amounted to Rb 26,143bn and accounted for 1.21% of total debt owed, being 0.23 p.p. less than in the previous month (Table 1). A share of debt on HMLs without late payments decreased by 0.23 p.p. and accounted for 95.96% of the total amount of debt on HMLs as of May 1, 2013 vs. April 1, 2013 (Table 1).

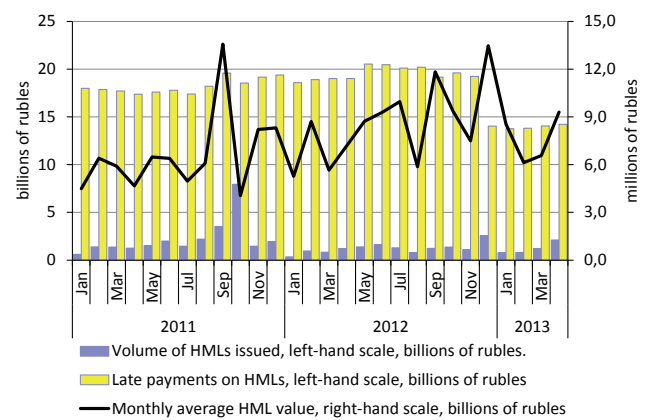
Weighted average interest rates on ruble HMLs and HMs issued during that month stopped growing at 12.9% in March 2013 (Fig. 8). In April 2013, weighted average interest rate on HMLs declined to 12.6%, and on HMs to 12.7%. Weighted average interest rates on HMLs and foreign currency HMs issued during the year became equal at 10.0% as of May 1, 2013.

Weighted average periods for ruble loans issued during the month decreased in April 2013 vs. March 2013: to 14.9 years for HMLs and 14.7 years for HMs



Source: based on the data provided by the Central Bank of Russia.

Fig. 6. Dynamics of ruble housing mortgage loans



Source: based on the data provided by the Central Bank of Russia.

Fig. 7. Dynamics of foreign currency housing mortgage loans

(Fig. 8). Weighted average period of lending for foreign currency HMLs issued year-to-date was 12.48 years in April 2013, and 10.66 years for foreign currency HMs.

In 2013, a share of foreign currency HMLs in the outstanding debt kept declining like it did in 2012, and stood at 5.5% as of May 1, 2013, being 3.14 p.p. less

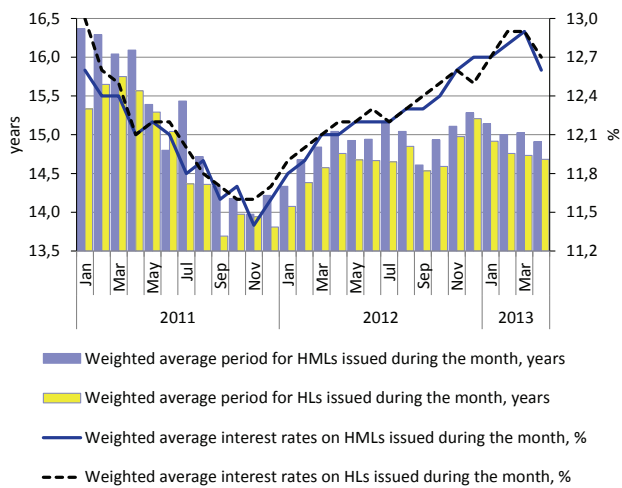
Table 1

BREAK-DOWN OF DEBT ON HOUSING MORTGAGE LOANS BY PERIOD OF DELAYED PAYMENT IN 2013

| 2013 | Total amounts owed on HMLs millions of rubles | Including | | | | | | | |
|--------|--|-----------------------|-------|--------------------|------|--------------------|------|--------------------|------|
| | | without late payments | | with late payments | | | | | |
| | | millions of rubles | %* | 1 to 90 days | | 91 to 180 days | | more than 180 days | |
| | | | | millions of rubles | %* | millions of rubles | %* | millions of rubles | %* |
| 01 Jan | 1,997,204 | 1,915,917 | 95.93 | 30,957 | 1.55 | 5,193 | 0.26 | 45,137 | 2.26 |
| 01 Feb | 2,010,608 | 1,928,374 | 95.91 | 47,048 | 2.34 | 5,228 | 0.26 | 29,958 | 1.49 |
| 01 Mar | 2,052,696 | 1,965,046 | 95.73 | 53,165 | 2.59 | 5,542 | 0.27 | 28,943 | 1.41 |
| 01 Apl | 2,094,420 | 2,014,622 | 96.19 | 43,983 | 2.10 | 5,655 | 0.27 | 30,160 | 1.44 |
| 01 May | 2,160,601 | 2,073,313 | 95.96 | 55,095 | 2.55 | 6,050 | 0.28 | 26,143 | 1.21 |

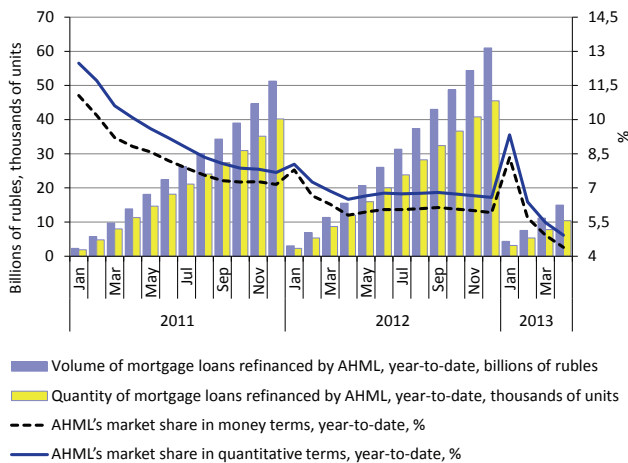
* of total amounts owed.

Source: data provided by the Central Bank of Russia.



Source: based on the data provided by the Central Bank of Russia.

Fig. 8. Weighted average periods for and weighted average interest rates on ruble loans issued during the month



Source: OJSC AHML.

Fig. 9. Dynamics of ruble mortgage loans refinancing by OJSC AHML

than as of May 1, 2012. As of May 1, 2013, foreign currency HMLs accounted for 1.44% of the volume of HMLs issued year-to-date, exceeding by 0.20 p.p. the value observed in April 1, 2013.

According to the Agency for Housing Mortgage Lending (AHML), as of May 1, 2013, the Agency refinanced 10404 ruble HMLs at Rb 14,977bn, accounting for 4.92% in quantitative terms and 4.39% in money terms of the total mortgage loans issued during that period (Fig. 9). Year-on-year comparison shows that the volume of refinancing is 3.36% less in quantitative terms and 13.42% in money terms. Weighted average interest rate on refinanced in April 2013 AHML loans stood at 11.37% against 12.6% of weighted average interest rate in the same period according to the Central Bank of Russia.

Since March 2013, Sberbank, whose mortgage market share is almost 50%, lowered interest rates by 1 p.p. to 12–14% p.a., whereas its minimal interest rate for special offers remained 10.5% during the summer period. The AHML and VTB 24 Bank lowered mortgage rates by 1–1.2 p.p. in May 2013. Today, interest rates stand at 7.65 to 10.75% under AHML's Maternity Capital Program, and 7.9 to 11% p.a. under Low-Rise Housing Construction and New Construction programs.

In June 2013, the Supervisory Board of OJSC AHML approved a new version of the development strategy through to 2018, under which the AHML is to focus on the development of securities market. A newly established or purchased bank is to be in charge of retirement of securities, the Agency for Restructuring of Housing Mortgage Loans (ARHML) is to be restructured into Housing and Home Finance Agency (HHFA). The foregoing strategy also provides for the development of Stimul-Ekonom sub-program designed to finance banks which finance construction of economic-class residential buildings pursuant to a priority Economy Class Housing project. The project provides for construction and sale of at least 50% of living quarters to individuals at a fixed price which is 20% lower than current market prices, but not higher than Rb 30,000 per square meter. The HHFA is expected to issue direct guarantees to purchase unsold living quarters and provide banks with a 100% funding for housing construction.

NEW 'USE' PASSION

T.Klyachko

Late May and June is the period when high school graduates take their Unified State Exam (USE). Naturally, the USE draws more attention in this period: numerous stories about corruption relating to the USE are published in mass media, and this type of exam receives an increasing criticism.

Neither did May and June 2013 become an exception: the very first day of the Russian-language exam (one of the two compulsory exams) was notoriously marked by a big scandal. Exam monitoring and test materials were found to have been posted on the Internet before the USE began. It did happen before, but not in such unprecedentedly large scale as it was in 2013. The Federal Education and Science Supervision Agency made initial attempts to lead general public to believe that the materials was just a fake until it had to admit that the disclosed examination assignments were authentic. The Federal Education and Science Supervision Agency managed to “promptly” detect a few violators (in Tomsk, for instance, first examination results of a girl were cancelled, but since the discontent tidal wave kept growing, the list of violators was growing accordingly¹). The USE situation was heavily covered in both electronic mass media and newspapers: detected were a few regions (Dagestan in particular) in which eleven grade schoolers were moved on a massive scale from urban to rural high schools, because the latter were less meticulous about USE monitoring and accepted far less expensive bribes. The USE received most negative response in Moscow where it was kept under tight monitoring, thereby considerably decreasing chances for Moscow high schoolers to enter prestige Moscow higher schools, at least this is what their parents said. In general, the USE has become a pet aversion for Moscow and St. Petersburg, because it was basically Moscow residents who used to enter higher schools in Moscow before the USE was introduced. The same was true for St. Petersburg and its residents. Now, both cities have been facing a strong inflow of high-grade high school graduates from other regions, whereas Moscow and St. Petersburg residents are reluctant to move to smaller cities, thereby having objectively less chances to enter good higher schools. Furthermore, a tougher monitoring over

the USE in Moscow makes the situation even worse for Moscow high school graduates. According to witnesses, the USE monitoring was more relaxed in St. Petersburg, thereby having become another cause for USE criticism: non-cheating schoolers (and their parents) failed to win, whereas those who had not high integrity standards stood to gain by receiving high grades to be well on the way to prestige higher schools. And it's not just entering that is the case, because a firm belief developed that cheaters would be entitled to study on a state-funded basis (i.e. free of charge), whereas non-cheaters would have to pay for their education.

As a result, the Unified State Exam has rapidly been losing people's confidence. Even more illustrative was a USE survey conducted by Fond “Obschestvennoye Mneniye” (Public Opinion Foundation) (POF)².

Just 20% of the respondents supported the introduction of USE, whereas 51% of those being aware of it were in opposition. Furthermore, these figures are typical of all types of communities – 50% of the population in large cities, and villages disliked the USE, whereas just one fifth of the population said that the introduction was a positive measure.

The same POF conducted in 2001 a public opinion survey concerning the USE, when the USE-introduction experiment was recently launched. The survey results were precisely the opposite: 56% of the respondents had a positive view of the Unified State Exam, whereas 25% didn't like it. Positive attitude towards the USE was based on parents' hope that it would offer more chances to schoolers from rural and remote areas to enter prestige higher schools.

Incredible as it may seem, on the one hand, it did help more rural and upcountry high school graduates enter higher schools in Moscow and St. Petersburg. On the other hand, it made different social groups to harden to the view that most of these graduates are cheaters or bribe givers. It has long been forgotten to date that in 2001 most of high school graduates believed that Moscow higher schools were difficult to enter because they “had all the aces”. Nonetheless, the

¹ However, on the conference call held on June 27, 2013 on the occasion of the completion of the Unified State Exam, Deputy Prime Minister Golodets O. Y. pointed out that not more than 140 exam papers leaked to the Internet before the USE started, and the source was detected and respective measures taken, as strong as cancelling the examination results, with regard to 138 papers.

² Survey's results were published on June 19, 2013, see <http://fom.ru/obshchestvo/10961>

**ANSWERS TO THE QUESTION WHY DO YOU THINK THE INTRODUCTION OF THE UNIFIED STATE EXAM
IN HIGH SCHOOL IS WRONG?**

| Data as percentage of the total interviewed | Answers |
|---|--|
| 14 | USE results provide no full picture of a level of knowledge, they are largely of random nature |
| 10 | USE is focused on getting an inch-deep knowledge, the level of knowledge has declined |
| 10 | Too heavy burden is placed on schoolers, they are under stress |
| 6 | Traditional exams are better than tests |
| 3 | The USE system needs refining, tests contain many flawed, tests contain many flawed, ill-conceived questions |
| 3 | Too much forgery, corruption |
| 2 | USE can't be used for all high schoolers |
| 2 | I dislike the USE, there are many negative comments |
| 1 | USE fails to consider the difference between high schools in the level of teaching |
| 1 | Not all topics can be sat as tests |
| 1 | I adhere to the Soviet educational system |
| 2 | Other |
| 2 | To be undecided |

belief has been growing that top higher schools can't be entered just like that. Today, in fear that their children can't enter a higher school, parents pay to tutors and those who can "help with exams". One may assume, however, that payment to tutors and USE-related bribes have resulted from a negative environment created around the Unified State Exam through annual hysteria around the same.

It should be noted that in 2012 the *Institut Gumanitarnogo Razvitiya Megapolisa (Institute of Metropolitan Humanitarian Development)* (IMHD) conducted a survey of Moscow high schools and obtained a very interesting result: shortly after the SFC (State Final Certification, a USE equivalent for middle school graduates) was introduced for nine-grade schoolers, 68% of families hired tutors to make sure that their children get high grades at this (virtually intermediate) exam. As a result, it turned out to be difficult to tell who gives knowledge to enable schoolers to pass the SFC with high grades, a good school or the family which cares about their children and hires tutors.

Those who believed that the USE introduction was wrong (51% of the respondents who are aware of the Unified State Exam) were asked the question "Why do you think the introduction of the unified state exam in high school is wrong?". Summarized answers of the respondents are presented in *Table 1*¹.

Table 1 is a good illustration of that respondents' vision of the USE has largely been shaped through the picture going the rounds year after year (especially when they sit the Unified exam) in mass media rather than first-hand experience. A random character of USE results, as well focus on teaching to the exam, and inch-

deep level of knowledge were highlighted. The answer "too heavy burden is placed on schoolers, they are under stress" given by 10% of those who dislike the USE sounds odd in particular. It should be recalled that the USE was introduced in particular to relieve stress from high school graduates, because they had to sit high school final exams and higher school entrance exams.

However, this answer may be interpreted the following way: exams at high school were given by "friendly" teachers who wanted their schoolers to pass all exams to their best (it did relieve stress from 17-year old "kids"), while tutors were hired from the higher school to be entered (and these tutors would often provide support during entrance exams).

Another big scandal broke out at the very end of USE-2013, when the Federal Education and Science Supervision Agency announced that grave violations were committed in 3/4 of the high-grade exam papers.

Perhaps, all these scandals resulted from the statement made by Minister of Education and Science Livanov D.V. that the approach to the USE should be changed. He also said that a high schooler portfolio (his/her involvement in social activity, etc.), sports achievements, and the Overall Grade Point Average would be taken into account in order to be admitted to a higher school, which should enhance the high school prestige and on top of that encourage eleven grade high schoolers to study not only the USE subjects, but also other high school disciplines. The Minister and many other speakers referred to the US practice, where not only national test results, but also other characteristics of a candidate are considered for university admission. Referring, however, to the US practice, they ignored the fact that the US high school graduate portfolio contains no test results on

¹ See <http://fom.ru/obshchestvo/10961>.

many subjects since the second grade class, and the said test is to be conducted by independent organizations.

All of the proposed changes give rise to a great concern¹, because the concept of the USE is its independence from high and higher schools – gradually degrading. In this context, it is the Overall Grade Point Average that might become the most controversial element of the new system. Anyway, it remains to be seen what weight it would carry in the total result of a high school graduate.

In the meantime, summing up the USE results on June 27, vice prime minister Golodets O.Y. , pointed out that she was satisfied with the results, notwithstanding that more than 4,000, or about 0.5%² of to-

1 Although the portfolio is definitely useful, its contents should be extensively discussed.

2 It should be noted that those who failed their Russian-language and math exams accounted for more than 2% and 3% respectively of total high school graduates annually since 2009,

tal, high school graduates failed the Russian-language and math exams in 2013. In particular, she noted that many regions had switched to “a more unbiased method of conducting the USE”. Therefore, the vice prime minister made it clear that the Unified State Exam – a symbol of educational reforms – would not be abolished but keep developing. ●

when the USE switched to its regular operation mode. In 2008 – the last year of the USE experiment – more than 11% and 23% of those who sat the Russian-language and math exams received a fair (2) mark (on a traditional 1-5 scale).

DOMESTIC LABOUR MIGRATION IN RUSSIA: INCIDENCE AND GEOGRAPHY OF MIGRATION

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The possibility of active and effective usage of domestic labor reserves used to be offered for discussion following a reduction in and slower growth of working-age population in Russia¹ and growth in external labor migration from CIS member countries to Russia throughout the entire 2000x. The need to accelerate domestic “permanent” migration from labor-force-redundant to labor-force-deficit regions, as well as more actively encourage domestic temporal labor migrants to move to certain areas/zones of economic growth were listed among such measures.

These discussions acquired a new context during the crisis of 2008–2009, and it wouldn't be superfluous to recall them in anticipation of economic hardships. Targeted support to individuals ready to move for job substitution from highly unemployed areas to other regions was announced among the four measures to combat unemployment during the crisis of 2009. Originally, 100,000 persons² were expected to receive migration support, but the figure was reduced to 15,900 persons at the stage of concluding contracts with regions. Eventually, actual support was rendered to 11,000 persons through spending 70% of the funds allocated to finance these measures³. Those Russia's nationals to whom such a support was offered, were reluctant to take it. Domestic mobility of unemployed persons and job seekers which was studied by the request of the Federal Labor and Employment Service⁴ in all Russia's regions in two 'waves', namely prior to (October 2008) and during the crisis (December 2009), showed that readiness to work in other region had almost nothing to do with unemployment and fear of job loss, and stood at 4.2% prior to the crisis and 4.4% during 'crisis survey'⁵.

A survey of working and unemployed people's migration intentions which was conducted in 2006 by

the Center for Migration Studies in 10 largest cities in Russia, revealed that the effect of job satisfaction on migration mobility was much weaker than it was expected⁶. The data of the survey showed that 4.4% of respondents had session work (save for pendulum migration and rotation based work) within the past two years or members of their families used to move to other places to find a job, including representatives of 1.7% of households who did that on a regular basis. Session work was the key and/or sole employment for at least 2/3 of the respondents.

Permanent migration in the post-Soviet period was more intensively substituted with different forms of temporal labor migration, reaching the scale comparable with seasonal work at the turn of 19th-20th centuries. However, no sufficient information is available on temporal labor migration.

In 2010, Rosstat (Federal State Statistics Service) for the first time began to compile data on workplace as part of its regular Population Surveys in order to study employment issues, and included a small set of migration-related questions into them in 2012. The workplace question was also included into the 2010 census questionnaire. These data were published in 2013⁷.

According to the PSEI data on 2012, 2,3 million persons, accounting for 2.1% of the population at the age of 15–72, or 3.2% of those who specified their workplace, worked outside their place of residence. The difference can be explained basically by the fact that 35.1% of the PSEI respondents were primarily very young and pension-aged people.

The presented data may be interpreted as a measure of the scale of temporal labor migration, but sub-

1 We remind that the working-age population decreased in 2006 for the first time in the Soviet and Russian history, and has been decreasing in Russia since 2006. The working-age population decreased by 927,300 persons in 2011 and the first two months of 2010 alone (based on the data of the National Population Census 2010) // Demografichesky ezhegodnik Rossii – 2012. Rosstat, 2013.

2 Reaching the workplace // SmartMoney, May 18, 2009

3 Progress monitoring of regional programs which provide for extra measures aimed at easing tensions in the labor market (January thru December 2009) M.: Rostrud, 2010, p. 11). The state guaranteed as part of the program to cover transport costs, rentals (Rb 550 daily for 3 months on average), and pay a travelling allowance.

4 State contract “Developing a model of organization of employment in other places for job seekers by state service bodies” headed by M. B. Denisenko).

5 Denisenko M., Karachurina L., Mkrtchan N. Whether or not Russia's unemployed ready to move for work? // Demoscope Weekly, No. 445-446) <http://demoscope.ru/weekly/2010/0445/index.php>

6 Karachurina L., Mkrtchan N. Migration activity of working and unemployed people (based on the data of a social survey conducted in 10 large Russia's cities // Demoscope Weekly. 2009. No. 401–402) <http://demoscope.ru/weekly/2009/0401/analit05.php>

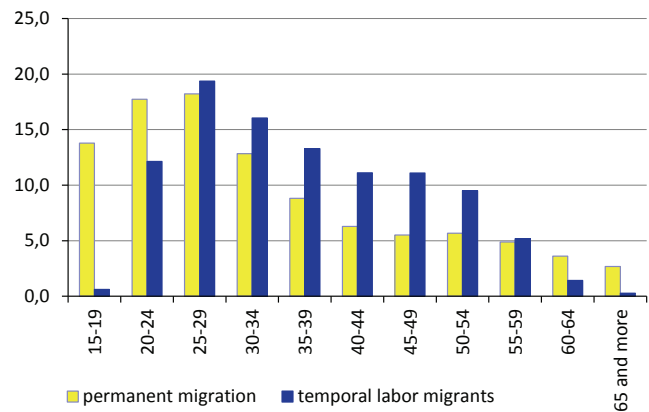
7 See the Official Results of the National Population Census 2010, Vol. 8 http://www.gks.ru/free_doc/new_site/perepis2010/croc/perepis_itogi1612.htm

ject to certain reservations: temporal labor migration may take place within regions. Remote towns and areas are often located 100–150 km as far as regional capitals in Russia, thus making impossible daily pendulum-like traveling to the workplace. Therefore, one should take into account that, according to the PSEI data, another 4,1 million Russia's nationals worked in other city (district¹), and some of them were temporal labor migrants too.

However, having a job in other region doesn't always imply involvement in temporal labor migration, because it may be pendulum migration in certain cases. It is pendulum migration that employment in other region should be referred to for most of those living in the Moscow² and Leningrad Regions and traveling daily to their workplace in metropolitan centers, as well as those living in Moscow and St. Petersburg and working in the respective regions. The headcount of such workers totaled 715,000 in 2012, thereby reducing substantially total number of temporal labor migrants according to the PSEI data. It is even more reasonable that 760,000 persons working in other region travelled on a daily basis. According to the trip frequency criterion, net of pendulum migration cases, the headcount of temporal labor migrants, according to PSEI data, totaled 1,6 million, or accounted for 2.2% of the total employed persons in 2012.

Unlike the census data³, PSEI materials are illustrative of the structural components of temporal labor migration. Males and females account for 75.7% and 24.3% of temporal labor migrants respectively, with males largely outnumbering females. Age-related distribution of temporal labor migrants is shifted towards older ages vs. 'permanent' migrants including many college-aged young people (Fig. 1). Distribution of migrants by marital status corresponds approximately to the national average – 51.7% labor migrants were married (55.5% of total population, according to the 2010 census data).

Education level of temporal labor migrants corresponds in general to the distribution for the population in total, but they contain less persons with higher and secondary vocational education, and more ones with secondary vocational and general secondary education. Perhaps, such a distribution of domestic labor migrants by level of education can be explained by employment in the construction industry and indus-



Source: Rosstat: running records; PSEI data.

Fig. 1. Distribution of domestic (permanent migration) and temporal labor migrants in Russia by age in 2012, as % of total headcount of migrants at the age of 15–72

trial sector⁴. The following occupations are prevailing: motor vehicle drivers, security personnel, retail sales personnel, loaders and common labor personnel, construction workers and construction & installation personnel, welding and oxygen-cutting operators, construction unskilled labor force, well-drill operators, bricklayers, and accouters. These are most widespread occupations which account for 40% of all domestic labor migrants in Russia.

Not counting citizens of Russia's largest (Moscow and St. Petersburg) agglomerations, the Central Federal District (Ivanovo, Tula, Tambov, Smolensk, Kursk, Bryansk Regions) and the Volga Region (the Chuvash Republic, the Republics of Mari El, Mordovia, Bashkortostan, and Penza Region) would be distinguished by a share of temporal labor migrants (working in other regions) in the total employed population, where persons working in other regions accounted for 5–10% in 2012. The Kurgan Region accounts for the biggest share of temporal migrants in the Urals, the Republic of Kalmykia in the Southern Federal District, the Omsk Region in Siberia. Almost all of the above listed regions are economically depressed or falling far behind the neighboring regions.

According to PSEI data, Moscow Region (Moscow and Moscow Region) is most attracting for temporal labor migrants. Not counting mutual pendulum-like trips between these regions, the headcount of temporal labor migrants from other regions would be 851,000 persons, or 7.4% of the total employed. The Moscow Region is ranked #1 in the number of labor migrants terms, followed far behinds by the Khanty-Mansi Autonomous Area with 97,000 labor migrants,

1 Exclusive of urban districts.

2 Shitova Y.Y. Pendulum labor migration in the Moscow Region: methodological and applied analysis // Ekonomichesky Zhurnal HSE. 2006. No. 1, pp. 63-79)

3 See the Official Results of the National Population Census 2010, Vol. 8 http://www.gks.ru/free_doc/new_site/perepis2010/croc/perepis_itogi1612.htm)

4 Labor market trends. Analytical materials). Rosstat's official website. http://www.gks.ru/bgd/regl/B11_04/IssWWW.exe/Stg/d03/2-rin-trud.htm

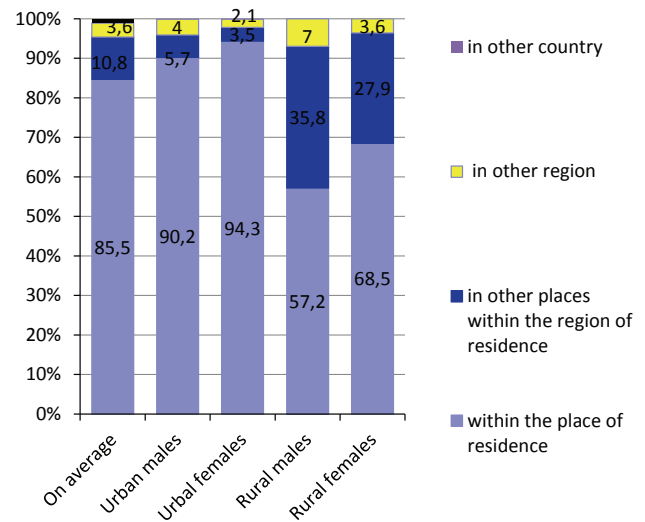
accounting for mere 10% of the total employed in this Federal District. The Yamalo-Nenets Autonomous District has 46,000 labor migrants (Russia's nationals), but this is 13% of the total employed. St. Petersburg and the Leningrad Region have 63,000 labor migrants, not counting trips between these regions, but they account for mere 1.6% of the employed. The Krasnodar Territory, the Sverdlovsk Region, the Republic of Tatarstan, Samara and Rostov Regions are significant centers of attraction for labor migrants which account for no more than 2% of the total employed persons.

PSEI data shows principal routs of labor migration within Russia. The Moscow Region attracts labor migrants primarily from the nearest regions such as Tula, Vladimir, Tver, Kaluga, Smolensk, Ivanovo Regions, as well as remote regions, namely Penza, Bryansk, Tambov, Rostov Regions, the Chuvash Republic, and the Republic of Mordovia. Workforce flow to the Moscow Region from the eastern areas of the country was insignificant.

The Republic of Bashkortostan which accounts for 40% of total labor migration to the Federal District is the key migration 'donor' for the Khanty-Mansi Autonomous Area. Omsk, Kurgan, Sverdlovsk Regions, the Republic of Tatarstan, the Chelyabinsk Region can be distinguished too. The Yamalo-Nenets Autonomous District looks attractive for labor migrants from the Republic of Bashkortostan (34%), as well as Omsk, Kurgan, Kirov Regions, and the Republics of Tatarstan and Udmurtia. St. Petersburg and the Leningrad Region are more attractive basically for the population of the Northwestern Federal District: Pskov, Novgorod and Tver Regions.

PSEI data are supported by the development of materials of the National Population Census 2010 which show that the same 2,3 million Russia's nationals worked in other regions. The data of the National Population Census 2010¹ show that 96.3% of the employed Russia's nationals at the age of 15–72 who specified their workplace location worked in their region of residence; 85.5% worked in their place of residence. Therefore, not only is spatial labor mobility low in general, but also a share of those who didn't move even within their own region is big.

For example, the data of annual population surveys in France in 2007² show that places of residence and work differed for almost 65% of the employed; 17% persons moved to other departments for work³. Even trans-regional labor movements are insignificant and



Source: based on the data of the National Population Census 2010.

Fig. 2. Workplace location of employed private household population at the age of 15–72 by category of population, %, 2010 (excluding those who didn't specify their workplace location)

challenging in modern Russia, when only regional centers have more or less diverse labor market in relatively developed, developing, and depressed regions, and spatial linkage is weak.

Rural male population are most mobile in Russia: just a bit more than 50% of them work at the place of their residence, of which a share of workers employed in other regions is bigger too. Urban female population show the lowest labor mobility (Fig. 2).

Near-to-capital territories (the Moscow and Leningrad Regions account for one fourth of such territories⁴) and such regions as the Republic of Adygeya or the Jewish Autonomous Region which have historical links with the 'parent' Krasnodar and Khabarovsk Territories show high parameters of employment outside the area of residence. More compact (thus spatially traversable) and adjacent-to-Moscow areas in the Central Federal District are distinguished by lower – according to Russian standards – level of employment. 98–100% of the population are employed within their area or residence in 20 Russia's regions. However, the 'nature' of high level of employment outside the area of residence in the Moscow and Leningrad Regions differs from the Chuvash Republic. The former refers to the classic pendulum migration, whereas the latter to temporal labor migration from home to the workplace for several weeks or months.

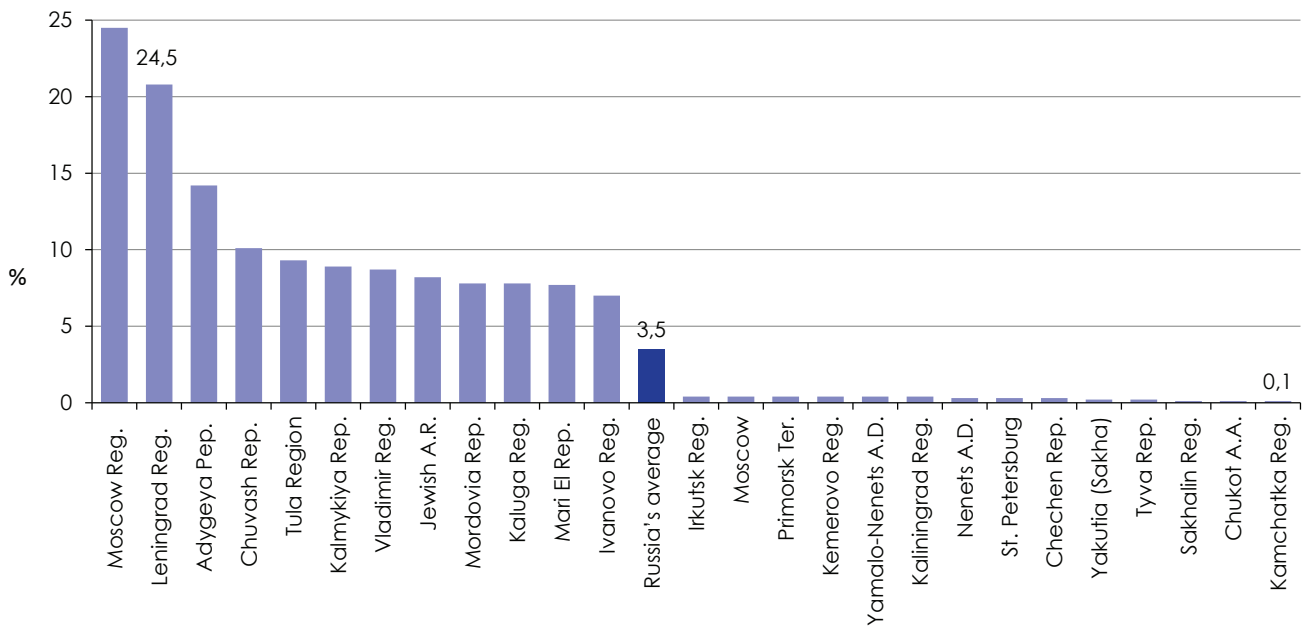
Trans-regional labor mobility is minimal in the eastern regions of the country, where neither trans-

1 See the Official Results of the National Population Census 2010, Vol. 8 http://www.gks.ru/free_doc/new_site/perepis2010/croc/perepis_itogi1612.htm

2 Have been conducted since 2004 instead of one-state censuses common for Russians.

3 Denisenko M., Karachurina L., Mkrтчan N. Whether or not Russia's unemployed ready to move for work? // Demoscope Weekly, No. 445-446) <http://demoscope.ru/weekly/2010/0445/tema01.php>

4 However, it is just over half of the Moscow Region population that work in their place of residence, whereas 'home' employment accounts for more than 90% in certain Siberian areas and Moscow.



Source: based on the data of the National Population Census 2010.

Fig. 3. A share of persons employed in other constituent entity of Russia in total employed private household population at the age of 15–72 by region, %, 2010

port capacity nor significantly attractive places are available. In 14 Russia's regions (other than Siberian regions, Moscow, St. Petersburg, Kaliningrad Region) less than 0.5% of the working population at the age of 15–72 work in other constituent territories of Russia. This figure exceeds 7% in almost the same number of

regions (Fig. 3). Not counting the first three 'pendulum regions', there would be just less than 10 Russia's regions for whom trans-regional labor mobility is really significant and plays an important role for the labor market in these regions and ... Moscow as recipient of these migrants. ●

REVIEW OF RUSSIA'S ECONOMIC LEGISLATION IN JUNE 2013¹

I.Tolmacheva, Yu.Grunina

In June, the following amendments were introduced into the legislation: a state and municipal contract on supply of goods, fulfillment of jobs and rendering of services may be canceled due to a unilateral refusal of a party to fulfill it; high-skilled foreign experts may reside and work in Russia without a patent which is issued to a foreign national who arrived in Russia in accordance with the procedure which does not require a visa; exclusive rights of the Russian Federation to intellectual outputs will be assigned more actively to nationals of the Russian Federation and legal entities; the procedure for execution and issuing by the Federal Migration Service of Russia of invitations to foreign nationals and stateless persons for entry into the Russian Federation has been updated.

I. Federal Laws of the Russian Federation

1. Federal law No. 114-FZ of June 7, 2013 on AMENDMENT OF THE FEDERAL LAW ON PLACEMENT OF ORDERS FOR SUPPLY OF GOODS, FULFILLMENT OF JOBS AND RENDERING OF SERVICES FOR STATE AND MUNICIPAL PURPOSES

In the federal law, new article 19.2 is introduced. The above article sets the procedure for termination of a contract due to a unilateral refusal by a party to the contract to fulfill it. The need of such a norm to be included is justified by the fact that the effective wording of the law provides for termination of the contract only by agreement between the parties or a court decision though the civil legislation provides for the possibility of termination of contracts unilaterally in case important terms of the contract have been violated.

So, the customer is in a position to take a decision on a unilateral refusal to fulfill the contract in accordance with the civil legislation provided that it was envisaged by the contract in case of examination of goods delivered, jobs fulfilled and service rendered with engagement of experts and expert organizations prior to taking of a decision on a unilateral refusal to fulfill the contract. It is to be noted that the selection of experts and expert organizations is carried out in accordance with the Federal Law in question. If the customer has carried out examination of goods delivered, jobs fulfilled and services rendered with engagement of experts and expert organizations, a decision on unilateral refusal to fulfill the contract can be taken by the customer only on condition that on the basis of the results of the examination of goods delivered, job fulfilled and service rendered such violations of the terms of the contract as constituted grounds for a unilateral refusal by the customer to fulfill the contract have been confirmed in the conclusion of the expert and expert organization. The information on the provider (performer or contractor) with

whom the contract was terminated due to a unilateral refusal of the customer to fulfill the contract is entered in accordance with the procedure adopted by the Law in question in the register of unscrupulous providers. The customer is in a position to take a decision on unilateral refusal to fulfill the contract in accordance with the civil legislation if the right of the customer to take a decision on unilateral refusal to fulfill the contract was envisaged in the contract. Decision of the provider (performer or contractor) on unilateral refusal to fulfill the contract becomes effective and the contract is deemed terminated 10 days after the day of proper notification by the provider (performer or contractor) of the customer of unilateral refusal to fulfill the contract. The decision of the provider (performer or contractor) on unilateral refusal to fulfill the contract becomes effective and the contract is deemed terminated 10 days after the day of proper notification by the provider (performer or contractor) of the customer of a unilateral refusal to fulfill the contract.

In termination of the contract due to unilateral refusal by a party to the contract to fulfill the contract, the other party to the contract is in a position to demand indemnification of only actually incurred damage directly justified by circumstances which constitute grounds for taking of a decision on unilateral refusal to fulfill the contract.

II. Resolutions of the Government of the Russian Federation

1. Resolution No. 481 of June 6, 2013 on AMENDMENT OF RESOLUTION NO.487 OF JUNE 30, 2010

By the Resolution, a new form of request of the employer or customer of jobs (services) as regards employment of a high-skilled foreign expert (HSFE) has been approved and any mention of a patent issued to a foreign national arriving in the Russian Federation in accordance with a procedure which does not require a visa has been excluded in order to avoid inconsistency of the norms as the patent issued to a foreign national

¹ The Review has been prepared with assistance of the KonsultantPlus Legal System.

arriving in the Russian Federation in accordance with the procedure which does not require a visa is not mentioned in Article 13.2 of the Federal Law on The Legal Status of Foreign Nationals in the Russian Federation which regulates in detail the procedure for engagement and stay in the Russian Federation of such a category of foreign nationals as HSFE; the need to secure a patent is determined by the Federal Law only in respect of foreign nationals who work for individuals.

2. Resolution No.458 of May 30, 2013 on AMENDMENT OF THE RULES OF CARRYING OUT BY STATE CUSTOMERS OF MANAGEMENT OF THE RUSSIAN FEDERATION'S RIGHTS TO INTELLECTUAL OUTPUTS OF CIVIL, MILITARY AND DUAL PURPOSE

It is envisaged that state customers on which order intellectual outputs (IO) were created are obligated at least once a year to consider expedience of preservation of the exclusive rights of the Russian Federation and take in respect of those rights the following decisions: on loss of importance to preserve the rights of the Russian Federation; on a possibility to enter into agreement on a free of charge assignment of the right; on a possibility to enter into agreement on granting of an open (non-exclusive) license to utilize IO by third persons; or on expedience of preservation of the exclusive right of the Russian Federation. The list of IO in respect of which one of the first three decisions has been taken is to be placed by state customers at their official Web-sites provided that the information does not constitute a state secret. The above license agreement (in case of refusal by the contractor of the state contract – which contractor created IO – to enter into agreement on a free of charge assignment of the exclusive right) is to be concluded by the state customer within six months from the day of placement of the information on the Web-site with those Russian nationals and legal entities registered in the territory of the Russian Federation which applied to it. If within three years nobody applied with a request to conclude a license agreement, the state customer is to take a decision on early termination of the patent on IO.

In addition to the above, the grounds behind a decision on loss of importance to preserve the right of the Russian Federation to IO have been specified, that is, non-use of that output for state needs within three, not four years as it was determined earlier.

III. Instructions, Letters and Orders

1. Order No.390 of November 30, 2012 of the Federal Migration Service of Russia on APPROVAL OF ADMINISTRATIVE REGULATIONS AS REGARDS RENDERING BY THE FEDERAL MIGRATION SERVICE OF A PUBLIC SERVICE RELATED TO EXECUTION AND ISSUING OF INVITATIONS FOR ENTRY IN THE RUSSIAN FEDERATION OF FOREIGN NATIONALS AND STATELESS PERSONS

The above Order was registered by the Ministry of Justice of Russia under No.28578 on May 30, 2013.

The procedure for executing and issuing by the Federal Migration Service of Russia of invitations for entry by foreign nationals and stateless persons in Russia has been updated. In the regulations, the content, deadlines and sequence of administrative actions by officials of the Federal Migration Service of Russia in fulfillment of that function were specified.

It is determined that the invitation is to be executed within a period not exceeding 20 days (not 30 days as it was before) from the day of application and submission of all the required and properly executed documents.

The number of applicants for receipt of invitations now includes branches of foreign legal entities which in accordance with notification procedure became registered with the Federal Migration Service of Russia or its territorial office in case of invitation by those branches of foreign nationals for work in the Russian Federation. Also, the content and forms of documents used in the process of receipt of invitations have been specified. In addition to the above, in the annex to the Order the contact information on territorial offices of the Federal Migration Service of Russia by the constituent entities of the Russian Federation is provided.

Order No.142 of June 6, 2008 of the Federal Migration Service of Russia which set the former procedure for issuing of invitations for entry in the Russian Federation of foreign nationals and stateless persons became null and void.

2. Order No.211 of April 19, 2013 of the Federal Migration Service of Russia on APPROVAL OF THE FORMS OF APPLICATION FOR PATENT

The above Order was registered by the Ministry of Justice under No. 28650 on June 4, 2013.

The new form of a patent issued to a foreign national arriving in the Russian Federation in accordance with a procedure which does not require a visa has been updated. Foreign nationals who stay legally in the territory of the Russian Federation may be engaged by individuals for fulfillment of jobs (rendering of services) which are not related to business activities provided that they have got a patent. Earlier, the form of such a patent (recognized as void) was approved by the Government of the Russian Federation (Resolution No.487 of June 30, 2010; amendments were considered above). At present, the Federal Migration Service of Russia is entrusted with those authorities.

The new form of the patent provides for more detailed information on a foreign national (including the personal data, place of permanent stay, migration card number and address of migration registration, the place of work and other).

REVIEW OF THE MEETING OF THE GOVERNMENT OF THE RUSSIAN FEDERATION IN JUNE 2013

M.Goldin

In June 2013, at the meetings of the Government of the Russian Federation the following issues among other things were discussed: a draft law which considerably reduces the period of depreciation of intangible assets in the form of an exclusive title to audiovisual products; a draft law which makes accounting simpler at some non-profit organizations and draft law which expands grounds for unscheduled checks of non-profit organizations.

On **June 6**, at the meeting of the Government of the Russian Federation draft federal law on Amendment of Article 257, Article 258 and Article 264 of Part Two of the Tax Code of the Russian Federation was discussed.

At present, according to Article 258 (2) of the Tax Code of the Russian Federation as regards intangible assets in respect of which the period of useful utilization of the product cannot be determined the norms of depreciation are set on the basis of the period which is equal to 10 years (but no more than the taxpayer's period of activities). Such intangible assets include assets in the form of the exclusive title to audiovisual products, including motion pictures. However, for example, in the existing practice of film distribution the larger portion of revenues from a film distribution is received within a few months, if not weeks from the first show. So, application of such a lengthy period of useful utilization (10 years) in respect of intangible assets in the form of the exclusive title to audiovisual products is hardly justified. For that reason, the draft law provides for reduction of the period of depreciation of the specified intangible assets to 2 years.

The draft law was approved and submitted to the State Duma of the Russian Federation.

On **June 17**, at the meeting of the Government of the Russian Federation the draft federal law on Amendment of Article 7 of the Federal Law on Accounting as

Regards Organization of Accounting at Non-Profit Organizations.

The draft law provides for the possibility of carrying out accounting all alone without an accountant being hired by the manager of a socially-oriented non-profit organization, except for an entity of the public sector. It is to be noted that the existing wording of Article 7 of the Federal Law on Accounting permits only managers of small and mid-sized business to carry out accounting on their own.

The draft law was approved and submitted to the State Duma of the Russian Federation.

On **June 17**, at the meeting of the Government of the Russian Federation draft federal law on Amendment of Article 32 of the Federal Law on Amendment of Article 32 of the Federal Law on Non-Profit Organizations and Recognition as Null and Void of Paragraphs 3-7 of Article 2 (5) (zh) of the Federal Law on Amendment of Individual Statutory Acts of the Russian Federation as Regards Regulation of Activities of Non-Profit Organizations which Carry Out Functions of a Foreign Agent was discussed.

The draft law provides for expansion of grounds for unscheduled checks of non-profit organizations. The draft law was approved and submitted to the State Duma of the Russian Federation. ●

A REVIEW OF TAXATION REGULATORY DOCUMENTS ISSUED IN MAY 2013 L. Anisimova

In the period of 2013 under review, President Putin presented a Budget Message in which he outlined the guidelines for the state monetary policy in years to come, and the Taxation Policy Guidelines for 2014–2016 adopted by the Russian Government were published. Both documents showed higher quality of the economic decision-making procedure at the top levels of power and a visible refusal to present a standard set of populist measures as economic policy and apply the recent practice of promoting economic development though nothing by tax allowances and exemptions for certain categories of manufacturers amid further acceleration of state socio-economic obligations without providing any reference to sources of financing thereof.

An international economic forum was held in St. Petersburg on June 20 thru 22, 2013. The forum was dedicated to challenges faced in the development of global economy and the role of the middle class. The forum was attended by approximately 5,000 domestic and foreign participants, namely entrepreneurs and businessmen, top-level civil servants of Russia, international experts.

President Putin's Budget Message outlined a new trend in the economic policy – financial functionalism. More specific rules for balancing government revenues and expenditures focused on providing support to businesses and creating comfortable business conditions were proposed:

1) stop increasing tax burden on manufacturers, while it was explicitly stated that social expenditures may rise with economic growth only;

2) fix a premium rate of 30%¹ or less to state extrabudgetary funds for a few years to come, recover premium exemption for individual entrepreneurs;

3) complete the pension reform until the end of 2013², covering the deficit of the Pension Fund of Russia (PFR) partially at the expense of National Wealth Fund (NWF)³;

4) a provision was made to use the NWF to finance self-supporting infrastructural projects⁴ apart from covering PFR deficit;

5) a proposal was made to defer national defense expenditures until a later time and incur them subject to specific programs⁵;

6) combating tax evasion was proclaimed as a priority task (optimization of the tax burden on private businesses by transferring capital to offshore)⁶;

7) a proposal was made to simplify fiscal accounting, narrow the gap between fiscal accounting and accounting;

8) governors and mayors were given an order to publish their budget so that citizen can see how efficiently they spend public resources⁷. Financial federalism is planned to be strengthened: "Expenditures of the constituent territories of the Russian Federation must be secured as far as possible by their own sources of income. For this purpose, all decisions made must be worked out in advance and financially secured. Supplementary financial aid to the constituent territories of the Russian Federation must be combined with the development of their economy at their own account"⁸. The foregoing measures are economically viable and deserve support.

It should be noted that Russia has not avoided many blunders which are normally faced by other countries amid a financial crisis⁹. Apart from low level of public debt Russia has managed to create a relatively sustainable system of internal protection of the banking sector from financial shocks. The following is intended.

Under the applicable legislation banks must have provisions with the Bank of Russia, which are calculated according to established standards, funded through the accounts of the Bank of Russia Cash Settlement Center (BR CSC) and then used for commercial banks'

7 "The President will set key economic objectives in his annual message to the Federal Assembly", *izvestia.ru* dated 13.06.2013.

8 C. 8 of the Presidential Budget Message dated 13.06.2013.

9 O. Plotonova, "G20 leaders are about to refuse to provide banks with systemic state support. G20 countries will no longer save their banks, even the largest ones, – this is what they are going warn about after the September meeting in St. Petersburg", *vedomosti.ru* dated 11.06.2013.

According to Deputy Minister of Finance S. Storchak, G20 leaders will make a special statement in St. Petersburg: "Nobody is going to use national budgets to save private financial institutions who issue subsidiary loans to insecure borrowers and accumulate bad assets and afterwards, through their influence in national economies, apply to the government for incredible amounts of financial support".

1 N. Raibman. "Putin orders to retain a premium rate of 30%", *vedomosti.ru* dated 13.06.2013.

2 C. 4 of the Presidential Budget Message dated 13.06.2013.

3 It is not clear, however, how the deficit is planned to be covered amid low oil prices, in which case the NWF might rapidly run out of money due to the current deficit.

4 C. 5 of the Presidential Budget Message dated 13.06.2013.

5 C. 2 of the Presidential Budget Message dated 13.06.2013.

6 C. 7 of the Presidential Budget Message dated 13.06.2013.

current operations¹. For this purpose, Russia's taxation system allows banks not only to book provisions for impairment of loan receivables and their equivalent to tax base reduction, but also compensate for losses from outstanding interest on such loans by easing tax obligations. If a bank finds itself in a severe financial hardship, in addition to payments for insured retail deposits through the compulsory deposit insurance fund in case of bankruptcy or financial rehabilitation of the bank, the Bank of Russia would compensate the trustee or temporary manager (represented by the State Corporation Deposit Insurance Agency (DIA) in both cases) for the previously built up reserves in order to repay bank's obligations to other creditors, as well as impose (in case of financial rehabilitation) a special monitoring regime which provides for preferences in observation of compulsory bank standards during financial rehabilitation so that the bank can gather momentum. Therefore, the banking system itself provides for a recovery mechanism designed for banks facing temporary hardships or bankruptcy of non-viable banks with the use of protective schemes for making reserves on accounts with the Central Bank and insurance of retail deposits in order to minimize the effect of bank insolvency on sustainability of the banking system and reduce losses for bank's customers. DIA's effectiveness is monitored by the Accounts Chamber of the Russian Federation. We believe that these measures are sufficient, provided that efficient banking supervision is in place.

Therefore, it is the recently initiated State Duma's proposals to exempt bank capitalized profit from taxation² that are alarming. The fact is that profit is not an absolute indicator of the effectiveness of an organization, especially when it comes to finances. Market value of financial assets depends on current market conditions, foreign currency exchange rates, inflation factors. Tax-exempted capitalization of profits generated from fluctuations of currency exchange or inflation rates would lead to economically unreasonable imbalance between budget revenues (a decrease) and expenditures (which would be paid at market prices, i.e. subject to inflation rate and current exchange rate). Like in the 1990s (when the difference in exchange rate was not subject to profit tax), banks will earn basically from the difference in exchange rate. One should expect more active application of "under-the-table"

payroll schemes to minimize officially reported salaries (cost reduction) and make payments as different types of bonus from after-tax profit, revival of note-based payroll schemes, non-deliverable swaps, etc. Any profit tax relief means that such profit is automatically granted the "after-tax profit" status, i.e. becomes a part of its equity capital. In a free market, any organization is entitled to dispose of their equity capital at it thinks fit, because it totally owns this capital which may not be subject to any restrictions when it comes to transfers to a tax haven. In addition, tax exemption for capitalized profit will create unreasonable advantages for banks over other manufacturers, thereby breaching the fair market competition principle.

Russia's Government approved the *Guidelines of Fiscal Policy in the Russian Federation for 2014 and the Planning Period of 2015 and 2016* on May 30, 2013. The Government highlighted the need to retain competitive power of the Russian fiscal system vs. fiscal systems in other countries involved in the battle for investments in the global market and provide taxpayers in good faith with as comfortable as possible tax administration procedures. No significant changes are planned in the existing fiscal system in years to come, except for revision of real estate excises and taxes.

In our opinion, however, some of the measures proposed in the Guidelines need further refining which is likely to take place at State Duma commissions and committees as part of the consideration of the draft federal budget for 2014–2016.

1. Personal income tax. Personal income tax allows for measures of support concerning socially important personal income tax relieves. No progressive personal income tax is planned to be introduced. A proposal was made to allow tax exemptions to parents who adopt a parentless child, including a disabled child; streamline the list of incomes and payments to be exempted from personal income tax, in particular grants, compensation payments; a proposal was made to exempt from taxation cash aid and gifts to veterans and disabled persons, as well as widows of servicemen participated in the WWII, the Soviet-Japanese War, former prisoners of Nazi concentration camps, prisons and ghettos, as well as former under-age prisoners of concentration camps, ghettos and other detention facilities established by Nazis and their allies during the WWII.

The principle of a marginal fixed property-related tax relief of Rb 2m per person is envisaged for personal income tax in case of purchase of personal residence irrespective of the number of property items (units in purchased property items). In other words, a citizen may use his/her unrealized deduction entitlement when he/she buys property items in the future.

1 See the Provision on the procedure for building up provisions for losses approved by the Central Bank of Russia dated 20.03.2006, No. 283-P (concerning loan receivables and their equivalent for taxation purposes) and the Provision on the procedure for building up provisions for losses at credit institutions (concerning devaluation of other assets).

2 A. Aleksandrovskikh, T. Shirmanova, "Banks will receive Rb 177bn as presentation", *izvestia.ru* dated 30.05.2013.

The Russia's Government believes that personal investments in real estate (in the context of property exemption) should not allow for more benefits than financial investments and investments in listed securities, because real estate sale exemptions can unreasonably discount cash from stock market. Regrettably, Government's explanations on the reasons for the proposed exemption from personal income tax on income generated from securities, placement of funds on bank accounts, and other financial operations are quite controversial.

It should be recalled that income subject to personal income tax comprises two radically different groups, namely personal income from business activities and other personal income. The introduction of articles concerning taxation of income from securities operations and interest into the personal income tax chapter was intended to equal the terms of taxation of certain types of business transactions irrespective of organizational form of such business activity carried by an individual – he/she (individual) may open and close stock market deals on his/her own account without having to register as entrepreneur, or separate a part of his/her property – make a contribution to legal entity's capital in order to play as professional in the market and restrict to the amount of such contribution his/her property liability under transactions.

When the Government speaks about inadequate tax burden upon trade in immovable property and stock market instruments, it confuses business income and other personal income. Trade in real property is to be regarded as type of business activity: in this case, an individual must register as self-employed entrepreneur or set up a company (legal entity), because investments are intended to generate income. Such investments in real estate for the purpose of further reselling have nothing to do with property exemption relating to sale of personal residence, country house, etc. Any person needs personal property as much as food products, water, some need books, others pay for gas, etc, but such expenses are not personal expenses and can't reduce the personal income tax base. Various types of such expenses include personal residence, personal property which are not to be confused with investments. Therefore, an allowance as property-related personal income tax deduction is granted for these large property items which are required for normal human life.

By placing his/her idle funds in the stock market or bank, an individual conducts business activity aimed at profit generation, and such an activity is to be taxable under the rules which apply to self-employed entrepreneur or legal entity. Stock market instruments have nothing to do with individual's personal property. It is,

therefore, economically wrong to link tax burden level on stock exchange operations with property-related tax deduction on sale of personal property (residence).

2. *Profit tax.* The Guidelines retain the proposal to introduce a preferential tax regime for interest on corporate Eurobonds (qualified as "crucial decision in the field of taxation", see the text of the Guidelines) against which we spoke in our previous review. Russia's Government brought forward the following argument as rationale: "Account should be taken on the need to create incentives for the development of Russian financial center, an element of which is an opportunity for direct purchase of Russian corporate bonds by foreign organizations subject to mandatory holding on nominal holder's accounts opened by largest international depository and clearing systems with the Russian central depository". It should be noted that this fails to comply with the decisions made by G20 leaders at their meeting in Lough Erne (Northern Ireland) in June 2013: "The OECD suggested that financial regulators and automatic data exchange should cover not only personal dividends and interest income (e.g., as they do in the European Union), but also chains of fly-by-night companies, trusts and other entities which can "conceal" both assets and related revenues. 'Income concealing' bearer shares as well as nominal shareholders and nominal directors must cease to exist in financing in the long-term perspective¹." President Putin attended the meeting.

Moreover, a great deal of questions can be addressed to the following principle set forth in the Guidelines: "Indeed, the taxation regime for the interest income that foreign organizations generate from Russian corporate bonds subject to mandatory centralized holding, shouldn't result, all other conditions being equal, in withholding by a Russian fiscal agent, who pays such income, of taxes in a volume higher than in payment of Eurobonds interest income". It should imply the following: since we plan to apply tax exemption to the interest on corporate Eurobonds (i.e. Russian corporate bonds issued by foreign mediators), the tax rate on interest on other corporate bonds should be reduced too. It should be recalled that Russia's fiscal agent will not withdraw "too much" on the interest paid, providing that the beneficiary provides in advance a certificate of registration with the tax authority at the tax residence, which is common practice in execution of international agreements on avoidance of double taxation. Therefore, the proposed tax exemption on the interest on Eurobonds in favor of "nominal" shareholders fails to comply with the G20 decisions and should therefore be adjusted.

1 T. Edovina, "G8 files a tax return", *Gazeta Kommersant*, 104 (5135) dated 19.06.2013.

We consider untimely the proposal to recognize revenues and costs from listed securities and forward/futures deal financial instruments in the aggregate with operating income and costs. Since it is sale of raw materials that generates principal revenues for Russia, the decision to book losses from securities operations to the results of sale of raw materials is aimed at tax-exempted reallocation of revenues from sale of raw materials in favor of stock market players rather than the development of a competitive market.

Other proposals to relieve excessive technical tax regulation for securities transactions are acceptable. By retaining separate taxation of operating income and financial market transactions, the acknowledgement of actual price of securities transaction and futures deal financial instruments (save for monitored transactions, i.e. between two interdependent parties) as market price, as provided for by the Guidelines, will have no adverse effect on the budget, in which case (as now) losses from stock-exchange transactions will not reduce taxable profit from real asset transactions.

Also acceptable in general are the proposals to requalify repo operations into securities realization transactions in case of non-execution of reverse transaction (failure to repurchase), and technical simplification of the currently applicable rule for assessing the maximum size of interest recognizable in costs for the purpose of reducing the profit tax base.

Lifting restrictions on booking to costs certain specific expenses such as advertizing costs, representation expenses for the purpose of reducing the tax base seems to be untimely. Capital under the guise of such expenses can be transferred from Russia to other tax jurisdictions. For example, booking a place for a shareholder meeting in other country at the prestige hotel controlled by shareholder's relative is an exact form of capital withdrawal – tax on rent revenues will be paid in other country, whereas representation expenses will be recognized in the Russian Federation. Indeed, tax accounting rules should be brought in line with the accounting rules, but Russian Federation has no court practice qualifying such expenses as necessary and sufficient for business activity, therefore, it would hardly be reasonable to abolish all restrictions on booking them to tax base reduction.

In addition, there is much truth in Ministry of Finance's remark that direct dependence of taxation parameters on accounting rules may create preconditions for the occurrence of tax consequences, including easing the tax burden on certain categories of taxpayers through changes in accounting rules, bypassing the legislation on taxes and levies.

The Guidelines contain a system of measures aimed at supporting participants in the investment projects

being in progress in certain regions of the Russian Federation.

With regard to investment project participants, a proposal was made to set a tax rate of 0% to the extent payable to the federal budget as tax incentive measure for profit of organizations for a 10-year term of investment project implementation. Furthermore, the respective term is to start from the period when the first proceeds are generated from sale of goods manufactured as part of the investment project, but not later than 5 (3) years from the date when a respective project is registered in a respective register. A proposal was made to allow by the decision of the government authorities of a constituent territory of Russia for a possibility to reduce profit tax rates down to zeroing for organizations during the first five years of investment project implementation and set at least 10% profit tax rates for organizations within subsequent 5 years of investment project implementation.

However, the following limits are to be imposed on participants in such projects: 1) an investment project may not be focused on the production of crude oil, natural gas production, and provision of services relating to oil and gas production; manufacturing ethyl alcohol, alcoholic products, manufacturing tobacco products and other excisable goods (save for motor cars and motorbikes); 2) non-profit organizations, banks, insurance companies, and other financial institutions may not be investment project participants; 3) capital investments under the project must total at least Rb 150m within a 3-year period, or at least Rb 500m within a 5-year period.

The Guidelines attempt to resolve the issue of booking to costs goods lost in the course of commercial activity. A proposal was made to set standards for losses (shortfalls) booked to profit tax base reduction in the commerce sector at 0.75% or less of sales proceeds.

3. *Mineral tax.* The Guidelines has a big section dedicated to setting mineral tax rates on raw hydrocarbon extraction. Since there is no way to conduct a strict feasibility study of tax rate differentiation by deposit, the focus is placed on the development of a certain formula linking mineral tax rates to the value of total basket of raw hydrocarbon extracted (including natural gas and natural gas liquid). According to the developers, it should level the yield of gas supply to domestic and external markets.

Particularly worth noting is an attempt to introduce a sort of tax on extra income (taxation of revenues on the investment project at large) generated from the development of new subsea raw hydrocarbon deposits located within the boundaries of the internal sea waters, territorial sea, in the continental shelf of Russia and the Caspian Sea. A proposal was made to

set mineral tax ad valorem rates (5 to 30%) subject to the difficulty category of a new subsea raw hydrocarbon development project and keep the tax rates unchanged over a specific period of time (5 to 15 years), as well as lift limits on periods of deferral of tax losses and application of the accelerated amortization mechanism in evaluating the profit tax base for organizations for each of such investment projects. A proposal was made to allow exemptions on corporate property tax, VAT and import customs duties on property being used during implementation of new subsea raw hydrocarbon development projects.

Gradual decrease in the crude oil export customs duty rate along with compensation for income shortfalls through an increase in the crude oil mineral tax rate was formulated as a strategic objective in crude oil production. At current stage, however, each deposit will be subject to customized correction factors to the mineral tax.

The mineral tax which applies to extraction of solid commercial minerals is to be refined in terms of the tax assessment procedure for the production of precious metals and multi-component complex ores. Delegation to regional governments the authorities to set mineral tax rates on common commercial minerals is being under consideration.

The water tax collection procedure for the use of subterranean water bodies is planned to be rectified.

4. *Personal property tax.* Taxable item's cadastral value as of January 1 of a year as fiscal period is to be used as the tax base for immovable property tax assessment.

Draft amendment provides for a tax deduction equal to the cadastral value of 20 square meters in a residential building or any other respective taxable item in evaluating the tax base. Marginal tax rates were set for different types of property items. Tax rates of 0.1 to 0.5% are applied to taxable items whose cadastral value is up to and including Rb 300m.

Substandard tax rates within a maximum range of 0.5 to 1% are to be set for taxable items whose total cadastral value is more than Rb 300m.

A marginal tax rate of 1.5% is set for land plots.

Draft amendment provides for a transition period until January 1, 2018 during which an immovable property tax is to be gradually introduced when municipalities are ready for the introduction.

5. *Enhancing taxation of immovable property owned by organizations.* For the purpose of ensuring a unified approach towards taxation of the property owned by organizations and individuals, appraisal of the cadastral value of non-residential property items is proposed as the tax base for immovable property tax organizations. Therefore, the federal executive autho-

rities will have to develop a method for appraising the cadastral value of such property items (including industrial buildings, offices, facilities, linear facilities, etc.), as well as update the Unified State Immovable Property Cadastre with information about property items owned by legal entities.

6. *Excising.* Excise tax rates will be indexed subject to actual developments in the economy with regard to excising during the planning period. The current rates are expected to be retained, with some exceptions though, for the years of 2014 thru 2015. Later on, a proposal was made to index excise rates on alcohol-containing products as 10% of the 2015 value (on alcohol-containing products, on other types of alcoholic products – on the forecast inflation rate for 2016 (5.4% by 2015). Excise rates of the Customs Union member countries are expected to gradually become similar in size by 2020. Excise rates on diesel fuel oil, straight-run gasoline, lube products are subject to changes too.

Russia's Government doesn't rule out that the growth rates in excise rates on tobacco products provided for by the Concept might slowdown until 2020, in spite of the of National Policy Concept for Tobacco Consumption Control (the executive order dated 23.09.2010, No. 1563-r) adopted by Russia's Government, which set a goal to bring excise rates on tobacco products from the current value of excise tax burden in the Russian Federation (about 30% of the price) in line with European countries (WHO) (about 47.5% of the price), subject to conclusion of respective accords with the Customs Union member countries.

7. *For the purpose of counteracting tax evasion* by using low-tax jurisdictions, proposals to introduce provisions on controllable foreign companies and income final recipients (beneficiaries) into the Russian legislation are planned to be submitted, as well as introduce a concept of fiscal residence of organizations, thereby counteracting violations in calculating income of foreign organizations which are subject to taxation in the Russian Federation. The procedure for taxation in the Russian Federation of the proceeds from sale of shares (interest in) of organizations whose immovable property in Russia account for more than 50% of their assets is expected to be refined.

8. *Tax administration.* The fiscal policy guidelines provide for a set of measures aimed at enhancing effectiveness of tax administration: exercising control over banks' compliance with the applicable tax legislation of Russia; taking measures to enforce taxpayer obligations against persons evading their obligations as taxpayers, e.g. through schemes involving fly-by-night companies or third parties; imposing taxpayer obligations on organizations and self-employed entrepreneurs to provide tax authorities with information

on the conclusion of simple partnership agreements and the parties thereto, or termination of simple partnership agreements, etc.

9. *Regrettably, the Guidelines don't address the e-commerce questions* brought up by the Customs Service (in particular goods delivered as postal items are not subject to VAT, and payments to suppliers are not subject to income tax, especially when the Russia's territory constitutes the source of such income¹). Therefore, according to the Customs Service administration, foreign supply agencies acting on the territory of Russia unreasonably enjoy competitive advantages. One has to agree with this point of view. It is to be recalled that a priority objective of ensuring state budget revenues – income source was agreed upon by G20 leaders at the meeting in the Northern Ireland.

The following documents should be focused on among those adopted in the period of May thru June 2013:

The following amendments were made to Chapters 21 (VAT) and 25 (Profit Tax) of the Federal Law of June 7, 2013 No. 131-FZ. Application of VAT and preferences for the profit tax established for banks, insurance companies, non-governmental pension funds on organization constituting insurance of export loans and investments against business and/or political risks under the Federal Law of May 17, 2007, No. 82-FZ "On the Development Bank".

¹ A Kreknina, "Russians will pay for low price. The Federal Customs Service ready to regulate e-commerce. Russia's retail chain stores praise the initiative", *vedomosti.ru* dated 17.06.2013.

In its letter to the Ministry of Finance of Russia dated June 6, 2013, No. 07-02-05/20990, the Department for Regulation of State Financial Control, Auditing Activities, Accounting and Reporting prepared detailed recommendations for auditors on how to detect transactions covered by the requirements set forth in the Federal Law dated August 7, 2001, No. 115-FZ "On Combating the Legalization of Proceeds of Crime (Money Laundering) and Terrorist Financing", subject to the provisions set forth in the Manual for the application of the risk assessment approach for accountants adopted by the Financial Action Task Force on Money Laundering (FATF). A reason for regarding a transaction as controllable is counterparty's tax residence in a country (zone) offering a special taxation regime, i.e. offshore jurisdiction.

It should be recalled that the Law also applies to cash transactions of Rb 600,000; immovable property transactions, provided that the amount of transaction is Rb 3m or more; cash and/or other property transfer into the name of a non-profit organization from foreign countries, international and foreign organizations, foreign nationals and stateless persons, provided that the amount of such transfer is Rb 200,000 or more. Furthermore, the letter specifies other factors which may classify transactions as controllable under the Law.

The letter contains a list of FATF documents, a list and e-mails of other key sources of information concerning combating the legalization of proceeds of crime (money laundering).

CHANGES IN RUSSIA'S REGULATORY BASE OF THE BUDGETARY PROCESS IN JUNE 2013

M.Goldin

In June 2013, in the regulatory base of the budgetary process the following developments took place: the administrative procedure for withdrawal of land plots allocated to state or municipal entities and state-run enterprises; the grounds have been expanded for provision of budget allocations out of the reserve fund of the Government of the Russian Federation to federal executive authorities and executive authorities of constituent entities of the Russian Federation for partial reimbursement of expenditures related to financial support of measures aimed at liquidation of emergency situations.

By **Federal Law No. 123-FZ of June 07, 2013** on Amendment of the Land Code of the Russian Federation and Article 3 of the Federal Law on Introduction into Effect of the Land Code of the Russian Federation, an administrative procedure was approved for withdrawal of land plots allocated to state or municipal entities and state-run enterprises.

According to the general rule, withdrawal of land plots allocated to state or municipal entities and state-run enterprises for undue utilization is carried out by judicial means (Article 54 (5) of the Land Code of the Russian Federation).

According to the revised version of the Land Code of the Russian Federation, for undue utilization of such land plots or in case of the need to withdraw them for public or municipal purposes, as well as in other cases provided for by the legislation land plots will be withdrawn in accordance with the administrative procedure, rather than by judicial means.

In case of undue utilization, forced termination of the right to permanent (termless) utilization of a land plot allocated to state or municipal entities and state-run enterprises (except for state academies of sciences and entities which were established by such academies of sciences and (or) subject to their jurisdiction) will be carried out by decision of an executive state authority or local government on withdrawal of the land plot (provided that undue utilization of the land plot was not eliminated).

The procedure for taking by a state executive authority or local government of a decision on withdrawal of a land plot is to be determined by the Government of the Russian Federation.

At the same time, in the transition period prior to approval by the Government of the Russian Federation of a procedure for withdrawal of such land plots land plots will be withdrawn by judicial means.

Federal Law No. 123-FZ of June 7, 2013 becomes effective 90 days after the day of its official publication.

By Resolution No. 517 of June 20, 2013 of the Government of the Russian Federation on Amendment of the Rules of Provision of Budget Allocations Out of the Reserve Fund of the Government of the Russian Federation for Prevention and Liquidation of Emergency Situations and Consequences of Natural Disasters, grounds have been expanded for provision of budget allocations out of the reserve fund to federal executive authorities and executive authorities of constituent entities of the Russian Federation for partial reimbursement of expenditures on financial support of the following measures related to liquidation of emergency situations.

So, allocations can be provided for payment of a lump-sum aid:

- To family members (wife (husband), children, parents and dependent persons) of persons who were killed (died) as a result of an emergency situation in the amount of Rb 1m for each person killed (died) in equal shares to each family member;
- To families of persons who were killed (died) as a result of emergency situations in the amount equal to the cost of services provided in accordance with the guaranteed list of burial services set by the legislation of the Russian Federation;
- To persons whose health was damaged as a result of occurrence of an emergency situation with taking into account the injury severity level on the basis of severity (severe injury or injury of medium severity – Rb 400,000 per person, while in case of a minor injury – Rb 200,000 per person).

Earlier, budget allocations were granted for payment of lump-sum allowances to members of families (wife (husband), children, parents and dependent persons) of persons killed (died) as a result of an emergency situation.

In addition to the above, budget allocations out of the reserve fund may be provided for rendering of financial support in connection with loss of property:

- To persons (for partial loss of property – up to Rb 50,000 to a family; for complete loss of property – up to Rb 100,000 to a family);
- To legal entities (for partial loss of property – up to Rb 100,000 to a legal entity; for complete loss of property – up to Rb 200,000 to a legal entity).