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RUSSIAN ECONOMIC DEVELOPMENTS

No.10 2013

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RUSSIA'S ECONOMY IN SEPTEMBER 2013: PRELIMINARY RESULTS AND MAJOR TRENDS

K.Rogov

Political Background: Neither Stability Nor Change

Russia's single voting day on 8 September 2013, when voters cast their ballots in the course of the election of regional bodies of authority in some RF subjects, became yet another illustration to the controversial political situation in this country. It is becoming increasingly difficult for the Kremlin to hold on to its formerly enjoyed electoral advantages in the politically active regions: independent and opposition candidates won in the elections in Yekaterinburg and Petrozavodsk, while one of the opposition's leaders, Aleksey Navalny, in spite of the unfavorable conditions of the Moscow mayoral election campaign, managed to seize 27.2% of the vote, while his rival Sergey Sobyenin, backed by the Kremlin, in spite of his enormous advantages in publicity and organization, showed results much worse than expected. In the politically inert and inactive regions the waning enthusiasm for the 'party of power' manifests itself in the increasing indifference of voters, visible by the significant drop in voter turnout.

While in Moscow the counting of votes was relatively honest, in some regions the scale of vote tampering was even more impressive than usually (thus, in Ivanovo Oblast, more than 20% of voters cast their votes 'from home'). Almost all the traditional systemic parties, especially the LDPR and Fair Russia, have been losing voter support. The alterations to legislation whereby the registration procedure for new parties has been simplified are going to speed up this process even more. Thus, the systemic parties will have either to resort to stronger criticism of the Kremlin and United Russia, or to become marginalized. In the Committee of Civil Initiatives' report on the election results, the current situation is described as 'a crisis of the former party and electoral system'. At the same time, one cannot but note the weakness and lack of consolidation amongst the opposition. So far, there have emerged no structures capable of harboring the rising public skepticism on a nation-wide scale, which was vividly reflected in the overall picture of the elections held on 8 September.

In September the RF Government approved the draft federal budget for 2014-2016, and it was immediately introduced into the State Duma. The final version of the draft reflected numerous compromises and adjustments caused by a sharp decline in current economic indicators and forecasts of Russia's economic development. At one

of its meetings in September, the RF Government announced that all expenditure items of the 2014 Budget, with the exception of a few 'sacred cows' ('protected items'), would be cut by 5%. Nevertheless, the draft budget was clearly focused on expenditure (first of all, on the RF Government's much advertized social liabilities). As a result, it can be said that the forecast of budget revenues as reflected in the draft looks hugely overoptimistic. Yet another sign of the rising nervousness in the RF Government's economic policy was its sudden decision to seize the contribution assets accumulated in private pension funds (unconvincingly explained by the necessity to convert those funds into joint-stock ventures and to establish an 'insurance fund'). As the actual aims of that initiative remain unclear, experts believe it to be an ominous signal pointing to Russia's unstable financial situation and to the unpredictability and non-transparency of her financial policy.

Macroeconomic Background:

External Support vs. Internal Weakness

Russia's macroeconomic background in September was determined, on the one hand, by favorable trends in international markets, however temporary those trends might be, and by a number of indications that her economic growth was beginning to falter on domestic factors, on the other.

In August and early September the global oil market saw a steady climb in oil prices. As a result, the average price of Brent crude oil during that period amounted to \$ 110.2 per barrel vs. \$ 103.1 per barrel in spring 2013. The main factors behind the rise in oil prices were expectations that the US Federal Reserve System would not halt the third round of quantitative easing (QE3), and the aggravation of the Syrian crisis. As a result of the rise in oil prices, in September the MICEX Index grew by 4.8% on August. Unfortunately, that episode cannot be seen as the beginning of an upward trend, indicating that Russia's stock market has finally ended its long spell of stagnation.

In September, the changing situation in world markets and the continuing weakening of the dollar against the euro resulted in a rather sharp trend reversal in the behavior of the ruble's exchange rate: having weakened in August against the bi-currency basket to the lowest level since 2009 (Rb 37.95), in September the ruble began to strengthen against the US dollar (climb-

ing from 33.43 rubles per USD as of the end of August to 31.58 Rb/USD as of 20 September, and then to 32.25 Rb/USD as of the end of September). In September, the Central Bank of Russia widened the floating corridor of its bi-currency basket by 5 kopecks. Thus, the new corridor extended from 32.25-39.25 to the basket.

In September, the monthly inflation rate amounted to 0.2% vs. 0.6% in September 2012. The main factors behind that drop in inflation were the seasonal fall in the prices of fruit and vegetable products and the stabilization of the housing and utilities tariffs and the prices of passenger transport services. As a result, the annual inflation rate dwindled to 6.1%. It is noteworthy that, in spite of the general deceleration of inflation, the past few months saw the prices of healthcare, education and household services rising faster than inflation. Later on, at the year's end, prices may experience upward pressure in response to the lower-than-normal crops yields; another contributing factor may become the weakening of the ruble. The factors suppressing the inflation rate's growth will be the declining domestic demand and the continuing slowdown in the growth rate of money supply (the per-annum growth rate of M2 dropped from 18.0% as of 1 August 2012 to 17.0% as of 1 August 2013). (For more details, see the 'Inflation and Monetary Policy' section).

In August, the surplus reserves held by commercial banks grew by 0.9%, to Rb 951.9bn, while the amount of banks' repo debt increased by 16.1%. As of 23 September, banks' repo debt amounted to over Rb 2.4 trillions. In conditions of the banking sector's continuing structural deficit of liquidity, the interest rate in the interbank market in July was on the average at the level of 6.11% (against 6.08% in July 2013). In September, the interest rate in the interbank market continued its upward trend: over the period from 1 through 23 September, the average interest rate was 6.18%.

In Q3 2013, net capital outflow from Russia increased to \$ 12.9bn. As a result, the outflow of capital from Russia over the course of the first three quarters of 2013 amounted to \$ 48.1bn, representing a significant increase on the same period of 2012. It should be said that the sole contributor to the outflow of capital from Russia was her non-bank sector, while the banking sector, on the contrary, was busily attracting capital inflows. According to the Bank of Russia, Russia's foreign debt as of the end of Q3 2013 amounted to \$ 719.6bn, which represented a 20% rise on 2012 (64% of that increase was accounted for by the non-bank sector). Thus, Russia, on the one hand, continues to be a net exporter of capital, while on the other hand, it steadily increases the share of external debt in total financing. Foreign direct investment in Russia's economy amounted to \$ 98.8bn, representing a 32.1 rise on

the first half year of 2012. At the same time, Russian investment abroad amounted to \$ 126bn (a 81.8% rise on the same period of 2012). Thus, Russia continued to experience a huge asymmetry between her inward and outward FDI (almost one-half of Russia's outward FDI – \$ 59bn – was received by the Virgin Islands). Russia's inward FDI continues to massively exceed her outward FDI. As we know, the trend towards investing abroad has emerged in Russia due to the drawbacks of her business climate and tax regime, while the remaining huge asymmetry between Russia's inward and outward FDI testifies that the Russian economy does not look very attractive to investors.

Over the period of January–August 2013, the volume of federal budget revenue dropped by 2.2% of GDP on the same period of 2012. The main factors behind that drop were the worsening of the external market situation (Russia's oil and gas revenues declined by 1.3% of GDP) and the slowdown of the Russian economy (domestic and external VAT revenues dwindled by 0.8% of GDP). At the same time, the volume of federal budget expenditure decreased by 1.7% of GDP because of the spending cuts applied to the following budget items: 'Social Policy' (-1.2 p.p.); 'National Economy' (-0.4 p.p.); and 'Healthcare' (-0.2 p.p.). The cuts in spending were motivated not only by the fall in budget revenues, but also by the RF Government's intention to redistribute the shrinking revenues in favor of such budget items as 'National Defense' (+0.1% of GDP), and 'Law-enforcement Activity' (+0.1% of GDP). Thus, the RF Government once again showed its proneness to non-productive expenditure and readiness to preserve and exacerbate the distortions on the expenditure side of the federal budget. However, it should be noted that the afore-mentioned changes in the revenue and expenditure sides of the federal budget reduced the non-oil and gas deficit from 9.7% of GDP in January–August 2012 to 8.9% in the same period of 2013. The consolidated budget of the Russian Federation's subjects dwindled by 1.9% of GDP. The main factors behind that drop were a considerable decline in profits tax revenues (-1.2% of GDP) and a reduction in government transfers (-0.8% of GDP). The asymmetrical reduction in regional budget expenditure was achieved at the expense of healthcare, social policy and the housing and utilities sector.

The Real Sector: Stabilization of Stagnation

The Russian economy is stagnating as before, although the situation in July-August was no longer worsening by comparison with the previous months. First of all, it should be noted that, over the three summer months, the financial situation faced by Russian companies became stabilized: as seen by the results of the period of January–July, the balance of the profit and loss account amounted to 79.8% of its level re-

corded in the same period of last year, while by the quarter-end results of Q1 2013 this index amounted to 70.9%. This means that profitability of production was no longer declining.

On the whole, industrial production in per annum terms demonstrated zero growth. The mineral extraction industry remains in the positive zone (in August – 102% on August 2012), while the growth rate in the processing industry remains negative, although practically approaching zero – which means that the threat of recession looms no longer (in August, the processing industry's result amounted to 99.8% per annum, while over the three previous months this index on the average had been at the level of 97.6%). At the same time, the depth of slump in the machine-building complex, while becoming less pronounced, is still impressive: over the period of January–August, the index of the production of machinery and equipment dropped by 7.0% on the same period of last year, that of production of freight vehicles – by 6.7%.

A positive growth rate of GDP in per annum terms as seen by the results of the first three quarters of 2013 may emerge due to the contribution of the services sector (103.7% on August 2012) and trade (104% on August 2012). At the same time, the consumer sector offers only very limited opportunities for promoting general growth. Although the growth rate of wages remains sufficiently high (105.9% on August 2012), growth of the population's real income in per annum terms was 2.1% against 9.3% a year earlier. The consumer behavior model is also undergoing a change: in conditions of restricted opportunities for further consumer lending, the population tends to accumulate saving and delay purchases. The growth rate of the population's payables continues to decline (to 31.7% in August in per annum terms), while the role of loans in sustaining household consumption is still increasing (it is estimated that the volume of newly issued loans in August amounted to 30% of aggregate retail turnover, public catering and commercial services). At the same time, the annual growth rate of the population's saving kept with banks amounts to approximately 20%, while the household saving norm increased to 5.6% from 4.8% a year earlier.

The ongoing decline in investment activity has a strong impact on the behavior of economic growth. In August, the situation once again worsened – investment over that month amounted to only 96.1% against August 2012. On the whole, while in the period from December 2012 through May 2013 the volume of investment was displaying zero growth, over the three summer months it once again declined, and so the results of January–August yield negative investment growth – 98.7% against the period of January–August 2012.

Another manifestation of low business activity is the behavior of companies' monies on bank accounts. Thus, August saw an outflow of cash from corporate clients' accounts (-1.2%); at the same time, while the volume of fixed date deposits was increasing (although at a lower rate than before: +1.1%). As a result, the share of fixed date deposits in the aggregate funds of the corporate sector increased to 55.3%, thus nearly hitting its record high of last May. The growth of corporate debt against bank loans issued over August amounted to 1.4%, and in per annum terms – to 13.2%, which is also near its record low of the last 2.5 years (for more details, see the 'The Russian Banking Sector' section).

The business opinion surveys also reflect a relative stabilization over the period of July–August, which was taking place alongside the persistently pessimistic outlooks concerning the Russian economy's future. Companies offered more optimistic estimates of the level of actual demand and the behavior of sales; positive trends are noted in the behavior of output; the July surge in the level of high surplus finished stocks had been adequately dealt with. However, the improved situation pushed up industrial product prices (a trend reflected in statistics since July; in the business opinion surveys, the balance of actual changes in prices became positive in August, after staying for four months at a zero level and in the negative zone). The stabilization of demand made is possible for enterprises to compensate for their increasing costs – a factor that represents a serious problem in an unfavorable economic situation: if in Q2 the growth rate of costs was estimated to be at the level of +5 points, by the end of summer it had risen to +15.

In the surveys, the demand level predicted for the period of September–October appears to be very pessimistic. The initial balance lost a total of 6 points over August, thus for the first time in 2013 failing to be positive (sales expectations became equal to sales' expected growth). Producer pessimism is also noticeable in the September entrepreneurial activity surveys conducted by Rosstat. Yet another acute problem is represented by labor shortage: as shown by the IEP's business opinion surveys, at present 22% of companies complain of insufficiency of human resources, while personnel shortage brings down the level of output for 37% of companies (for more details, see the 'Russian Industry in August 2013' section).

When estimating the slight improvement of the Russian economy's indicators displayed early this autumn, it should be borne in mind that in the autumn of 2012 the economy had already entered the phase of steep slowdown. ●

THE POLITICAL AND ECONOMIC RESULTS OF SEPTEMBER 2013

S.Zhavoronkov

In September 2013, voters cast their ballots on Russia's single voting day. The results of voting differed greatly from one region to another: in some regions, where the voting procedure had become a mere formality, United Russia managed to win from 40 to 80% of the votes cast, while in the regions where voting had been more or less competitive, this party bagged between 40 and 55% of the vote. The CPRF came in second, having gained more than 10% of the vote practically in every region, including Moscow. By contrast, the LDPR and, especially, Fair Russia suffered a decline in their electoral fortunes. Thus, Fair Russia failed to gain any seats in almost half of Russia's regional parliaments. In the Moscow mayoral election, Sergey Sobyenin narrowly won over his main contender, Aleksey Navalny, by bagging 51% of the vote. The Opposition's relative success was very relative indeed – on the one hand, 27% of the vote gained by Navalny is a good result that can be treated with measured optimism; while on the other hand, it nevertheless represents a defeat suffered by a large margin. The RF Government adopted a new three-year budget marked by a number of spending cuts. Some of these measures, designed to trim the state budget, were long overdue, including the Government's decision to freeze the salaries of public servants and the military (which have been growing at a breakneck pace in recent years), the belt-tightening with regard to the rearmament program, and a partial tariff freeze on natural monopolies (tariffs paid by enterprises will be completely frozen, while those paid by individuals will grow at a rate below the inflation rate). On the other hand, the Government's attitude to the pension system causes concern – by reducing the funded part of labor pension and simultaneously speculating on the possibilities of altogether abolishing the pension system introduced only ten years previously, the Government undermines public confidence in its policies and renders the payment of reported wages entirely senseless.

The main political event of September 2013 was the conclusion of the electoral campaigns for the election of governors, regional parliaments and city mayors and the results of the subsequent elections – which had been held, for the first time, under the recently adopted law. According to that Law, elections should be held on the second Sunday of September. The Law has also established that Russia should have a single voting day (instead of two days – in March and September). Apparently, the endless introduction of amendments to electoral legislation (several changes have been introduced this year alone) perfectly suits the ruling party, United Russia, because it has a greater ability than any of its rivals to pool its resources and participate in elections in all Russia's regions simultaneously. At the same time, all the other political parties have clearly begun to suffer from a lack of resources and personnel – and for that reason, two voting days were more preferable to them than a single voting day.

The most intriguing aspects of the recent elections are as follows. The Moscow mayoral election was the only mayoral or gubernatorial election where a prominent opposition politician was allowed to contest polls¹. This opposition hopeful was Aleksey Navalny.

The other Moscow mayoral candidates were nominees of the parliamentary parties, a candidate nominated by *Yabloko*, and a self-nominated candidate running as an independent, Sergei Sobyenin, one of the most influential people in Russia. All the participants of the mayoral race had raised and spent millions of dollars on their campaigns. For that reason alone, the stakes were very high. A number of issues, including the counting of votes, were vitally important for all parliamentary and non-parliamentary parties – first of all, for Mikhail Prokhorov's *Civic Platform*, a new political party which contested elections based on party lists for the first time. The mayoral elections in the big cities including Moscow were important for yet another reason – according to the unwritten rules of the game, the office of big-city mayor is the highest public office an opposition politician has a chance of being elected to. By contrast, the gubernatorial elections were not a very interesting event. No surprises could be expected because of the unprecedented and draconian 'municipal filter'. The essence of this 'filter' is as follows: anyone who wants to run for governor must collect signatures from between 5 and 10 percent of municipal legislators or mayors, who may sign for only one candidate for governor. Moreover, signatures must be collected in three quarters of a region's municipalities. Therefore, any strong candidates can be excluded

¹ Formally, the opposition politician Gennady Gudkov ran for Governor of Moscow Oblast, but his campaign was virtually non-existent, and so he won less than 5% of the vote.

from gubernatorial elections, thus ensuring the victory of a candidate handpicked by the authorities.

Although the Moscow election campaign was very eye-catching, we will begin with the regional campaigns because their results *en masse* are more indicative of the political situation in Russia as a whole. Both *United Russia* and the opposition scored successes in the mayoral elections held in Russia's large cities. Bearing in mind the great inequality of resources between the ruling party and the opposition, it can be said that *United Russia* won in Vladivostok, Khabarovsk, Novgorod the Great, Vologda and Voronezh. In the last three cities, elections for mayoralties were hard fought, but the single-round election system helped pro-Kremlin candidates to win. By contrast, *United Russia* lost single-round mayoral elections in Yekaterinburg and Petrozavodsk. In Yekaterinburg, the mayoral election was won by the prominent local opposition politician Yevgeny Roizman. It is noteworthy that, if the two-round election system had not been replaced by the single-round one on the eve of the election, the ratio of votes received by the candidates for Yekaterinburg mayor (33% – Yevgeny Roizman, 29% – Yakov Dilin, and 20% – State Duma member Alexander Burkov from *Fair Russia*) would have given the pro-Kremlin candidate a chance to win in the second round.

The results of the party-list elections to regional legislatures widely varied from one region to another. As before, *United Russia* scored extremely well in Chechnya (85%), Kemerovo Oblast (86%), Bashkiria (76%) and Rostov Oblast (62%). However, it should be added that voter attendance in the first two regions was unbelievably high – at the level of the recent presidential election. It is also noteworthy that in Rostov Oblast, voter attendance in Rostov-on-Don's two neighboring districts, Proletarskii and Pervomaiskii, was 47% and 75% respectively, while in different districts of Rostov Oblast it fluctuated between 22% and 79%. In fact, such inconsistencies show that the elections in those regions were a sham. Therefore, their results reflect not the power of one or other political party but that of the "administrative resource", which has failed, for some reasons, to manifest itself in a number of districts. Thus, it has become evident that electoral fraud remains a reality on a massive scale in Russia as a whole, except in Moscow, where the situation has significantly improved in this respect.

United Russia achieved mediocre results (45–57%) in Ivanovo and Ulyanovsk oblasts and in the republics of Sakha (Yakutia), Buriatia, Khakassia and Kalmykia. It bagged from 40% to 44% of the vote in the traditionally maverick Archangelsk (*UR*'s lowest score of 40.6%), Smolensk, Vladimir, Yaroslavl and Irkutsk oblasts, and Trans-Baikal Krai. The CPRF confirmed its position of

the second most influential political party by having managed to gain seats in all regional legislatures, with the exception of Chechnya and Kemerovo Oblast. It won more than 10% of the vote in all of Russia's regions except for Chechnya, Bashkiria and Kemerovo Oblast. Its highest results were in Buriatia (19.3%) and Irkutsk Oblast (18.8%). Having passed the electoral threshold, the CPRF were outdone by its leftist rival, *Fair Russia*, only in one region, Khakassia (12.7% and 15.9% respectively), and it was only in Khakassia that its results were lower than those of the LDPR (13.9% and 16.9% respectively). It is noteworthy that in Moscow, in spite of the extremely robust election campaign conducted by the opposition, the CPRF candidate for mayor, Ivan Melnikov, garnered 10.6% of the vote, thus demonstrating that the Communist Party had retained some electoral support even in the capital. At the same time, the mayoral candidates nominated by the LDPR and *Fair Russia* performed dismally, gaining just 2.8% and 2.7% of the vote respectively.

For these two parliamentary parties, the recent elections sent an alarming signal. In half of Russia's regions, the LDPR and *Fair Russia* failed to pass the electoral threshold. Without taking into account the four most dubious regions where the party of power garnered the highest percentage of the votes cast, out of the remaining 12 regions, the LDPR failed to pass the 5% electoral threshold only in Kalmykia, while *Fair Russia* failed to do so in Irkutsk, Ulyanovsk, and Ivanovo oblasts, Khakassia and Kalmykia. Thus, *Fair Russia* turned to be the most vulnerable player on the electoral field – lacking a charismatic leader, it had lost its former share of the opposition electorate hotly contested by the ever increasing number of small political parties. Moreover, the bizarre behavior of *Fair Russia*'s leadership (that party's election campaign on TV was limited to a rather strange episode when their second in command, Nikolai Levichev, assisted police in forcing entry into an apartment full of 'subversive' pro-Navalny agitation materials) – an act that had antagonized a lot of opposition voters and was counterproductive. At the same time, most of *Fair Russia*'s leaders in the provinces were lackluster characters incapable of attracting enough votes at the regional level and unwilling to finance their campaigns on their own. In this respect, the LDPR fared much better than *Fair Russia*, because it had a huge 'core' electorate oriented to its leader, the charismatic and eclectic Vladimir Zhirinovskiy. Nevertheless, the LDPR was rather painfully hurt by the fact of losing some of its share of non-partisan opposition voters.

The new political parties, including Mikhail Prokhorov's *Civic Platform*, had a very poor showing in the September elections. For example, *Civic Platform*

failed to breach the electoral threshold in the majority of regions (apart from Kalmykia and Irkutsk Oblast), and sometimes it performed dismally, capturing just one or two percent of the vote. Its successes in the party-list municipal elections in Yakutsk and Krasnoyarsk and the fact that Yevgeny Roizman, the winner of the mayoral race in Yekaterinburg, is a member of *Civic Platform*, slightly improves its lame-duck image. Nevertheless, its prospects remains grim because Mikhail Prokhorov is by no means eager to finance from Moscow any electoral campaigns of his party's regional branches, while the party itself has even fewer financially independent regional leaders than any of the parliamentary parties. Prokhorov's unconvincingly explained refusal to run for Moscow mayor has devalued his previous major success of garnering 20% of Moscow's votes in the presidential election – a result recently outdone by Navalny. The political parties that managed to breach the electoral threshold in one of Russia's regions were as follows: Boris Nemtsov's and Mikhail Kasianov's *RPR-Parnas* (Yaroslavl Oblast); *Rodina*, a party unofficially patronized by Deputy Prime Minister Dmitry Rogozin (Archangelsk Oblast); *Patriots of Russia*, a party led by the businessman Gennady Semigin (Kalmykia); and *Communists of Russia*, a party organized by a group of communist activists expelled from the CPRF. These results should be seen primarily as a sign that the afore-mentioned parties are still alive. It is noteworthy that the electoral performance of member-parties of Vladimir Putin's Popular Front, *Rodina* and *Patriots of Russia*, was as lackluster as that of the other small political parties. Their results indicate that the Popular Front continues to be an ephemeral political union, while United Russia has once again proved to be a real electoral process participant.

In Moscow, where the voter turnout was 32%, the pro-Kremlin candidate for mayor Sergei Sobyenin garnered 51% of the vote; Aleksey Navalny, nominated by the *RPR-Parnas* party – 27.2%; Ivan Melnikov, nominated by the CPRF – 10.6%; Sergey Mitrokhin, nominated by *Yabloko* – 3.5%; Mikhail Degtiarev, nominated by the LDPR – 2.8%; and Nikolai Levichev, nominated by *Fair Russia* – 2.7%. If Sergei Sobyenin had won about 30 thousand votes less than he did, there would have been a second round of voting. He was spared a run-off by the votes cast by soldiers garrisoned in Moscow – or, better say, by Russia's strange legislation provision stipulating that the right to vote in polls should be granted to *all* adult citizens (that is, including military servicemen) '*regardless of their place of residence*'. And it is an open secret that soldiers usually vote under supervision from their superiors. However, it should be admitted that except for that 'irregularity', there appears to have been little vote tampering in

anyone's favor. There was no multiple voting, and no voters were bussed around to various polling stations to repeatedly vote for one or other candidate – which is quite surprising actually, because this vote-rigging trick is hard to detect. Bearing in mind that Sobyenin was a pro-Kremlin candidate with enormous media and material resources, his election results were very weak. According to numerous sociological forecasts repeatedly published in the pro-government media and diligently spread on TV channels, the authorities had expected him to garner between 70 and 80% of the vote¹. Those expectations failed to materialize for a number of reasons, including the fact that many pro-Kremlin voters had been lulled into complacency by Sobyenin's widely publicized 70% personal approval rating in Moscow and decided to stay at home. By contrast, opposition voters had become strongly motivated and resolute, intrigued by the differences in the mayoral candidate's platforms and impressed by their robust and well funded election campaigns (although Sergey Mitrokhin and Mikhail Degtiarev campaigned on a more modest scale than the other candidates, their campaigns were visibly better funded than the average Russian election campaign). As a result, the opposition voters turned out en masse, thus breaking the downward trend in voter participation typical of all Russian elections except for presidential ones. In fact, Sobyenin had not campaigned at all – he had not participated in the 'televised debates', presenting himself as 'a man of deeds and not words' (a classical cliché in the parlance of today's officials), focused on such issues as the timely payment of pensions and wages, road building, improvement of social infrastructure, etc. However, his opponents had chosen a different election tactic. The concentrated attention on the various infrastructural and social problems plaguing the city of Moscow, that had become especially acute in the past three years, including traffic jams, illegal migrants and 'ethnic crime', exorbitantly priced housing and the skyrocketing prices of all products and services. The situation in Moscow had been aggravated by Sobyenin's pointless innovations such as obtrusive lawn care or the perpetual replacement of sidewalk tiles, or the new wave of the barbaric destruction of small-scale retail outlets in the summer of 2013. So-

1 The September election has yet another unexpected result – admittedly secondary but nevertheless important – a shameful debacle for Russia's major polling agencies already disgraced by their 2011 State Duma election forecasts. The polling agencies' credibility hit rock bottom after it had turned out that their forecasts for the September 2013 elections had been massively biased in favor of the government. The polling amateurishly conducted by Navalny's volunteers had been much more accurate than the work of those vaunted professionals, resulting in almost impeccable forecasts.

byanin had promised absolutely nothing to the electorate, and everyone had been aware of the fact that all the existing benefits (for example, the increased pensions or the building of new metro lines) had been initiated long ago, under Luzhkov. As a result, those positive factors had not been associated with Sobyannin. Aleksey Navalny's election result is rather ambiguous. On the one hand, he has come a very respectable second in a difficult mayoral race, and the hundreds of thousands of votes cast for him seem to be an excellent result for a 'non-systemic opposition' politician. This result clearly places him on the same level with mature politicians from the long-established political parties, and transforms him from a parvenu activist with a rather vague approval rating into a person generally acknowledged as a true politician. On the other hand, Navalny – unlike, for example, Roizman in Yekaterinburg – has nevertheless lost in spite of the honest vote count. Moreover, he has been defeated in Moscow, where he enjoys his highest approval rating. Moscow has about one hundred and fifty districts. Navalny has won in only one of them. Therefore it is hard to say whether or not he will soon become a candidate for president capable to defeat Vladimir Putin in a presidential race. Navalny's future electoral fortunes are also vague because of his lacking a political party of his own. Moreover, Navalny will lose his right to run in any election race if and when the guilty verdict in the *KirovLes* case comes into force, even if Navalny gets a suspended sentence. It is unlikely that any of his followers will be able to inherit his personal approval rating. Furthermore, Navalny has no hope of getting any large-scale organized support that could be provided to the leader of any parliamentary party. Nevertheless, the example of Navalny – as well as the previous example of Prokhorov – shows that Russian society has great demand for new political leaders.

Faced with a worsening economic situation, the RF Government was forced to consider cutting expenditures and to reasonably admit that a continuation of the policy of ever higher government spending would be counterproductive. The RF Government approved the draft three-year budget and the socio-economic development forecast for 2014 and the planning period of 2015-2016, to be submitted to the State Duma. The Government announced that some of military expenditures would be postponed to the period after 2016, and that the salaries of military personnel and civil servants would be frozen; that current spending by government departments would be cut by 5%; and that the funded component of labor pension would be slashed not to 2% but to zero for all people who had failed to transfer that part of their savings from Vneshekonombank to any other retirement fund, with

the money ending up in the insurance component of the labor pension (in order to prevent this, a special application should be submitted). Spurred by the rumors that Vneshekonombank, the manager of Russia's main retirement fund known to heavily invest in the numerous image-making projects launched by the Russian government (such as Olympic games and world championships)¹, was facing huge financial problems, the RF Government hinted at the possibility of introducing some strange measures resembling an initial step towards a wholesale confiscation of the funded part of labor pension. For example, it was said that the existing non-governmental pension funds should be 'audited' and 'auctioned', and that for the time being, until all of those measures are completed, their money should be seized and kept in Vneshekonombank. It should be noted that, on the one hand, the officialdom in the person of Minister of Finance Anton Siluanov have expressed doubts in the profitability of projects like the development of the Baikal-Amur mainline (currently operating at less than half its full capacity) or the construction of the high-speed highway Moscow-Kazan, and called for caution. On the other hand, a number of new venturesome projects continue to be developed – for example, a new investment program that would enable Vneshekonombank to extend targeted credits to small businesses, at an interest rate of 10% per annum. It should be said that projects, in order to be credited under this program, should be worth at least 1 billion rubles – an unimaginable amount of money in the small-business community. In fact, Vneshekonombank's lending policy and the state of Russia's pension system, where it functions as a major operator, can become an acute problem very soon – in the next few years, on the eve of the new cycle of presidential and parliamentary elections – when the effect of the government's half measures such as the seizure of insurance contributions will be exhausted.

Yet another important financial measure was the curbing of the growth rates of tariffs for services provided by natural monopolies. Initially, bearing in mind that in the past ten years their growth had outpaced inflation, thus boosting the rate of inflation, the RF Government even planned to freeze them (the RF Ministry of Economic Development's project). Finally, it was decided to freeze the tariffs set for enterprises, and to permit the tariffs for households grow at an annual rate of 4.2%, or at a pace 30% lower than inflation

¹ Some of these projects are reputed to be financed by private businesses. However, these private businesses do so by means of credits issued to them by Vneshekonombank. As a rule, such credits are never repaid.

(4.2% is the base figure to be used by regional energy commissions; in reality, it can be increased).

September saw the adoption of the scandalous Law on Reforming the Russian Academy of Sciences (RAS), its draft having been introduced into the State Duma on the eve of summer holidays without any prior discussion. Essentially, the draft law had been aimed at eliminating the autonomy of RAS institutes by means of transferring their property to some (unspecified) agency (because of the absence of any normative acts, the identity and purpose of this agency are still totally vague even now, after the adoption of the Law), and devaluing of the title of academician by merging the highly prestigious RAS with the much less prestigious Academy of Agricultural Sciences and Academy of Medical Sciences. The full members of the RAS, so hated by the officialdom, would have lost their academician titles as a result of the necessity to appeal for admittance to the newly established institution (more than 70 academicians, most of them world-renown specialists in sciences and not humanities, had immediately rejected that procedure). The draft law had caused an enormous scandal, in the course of which all the experts previously known to be close to the RF Ministry of Education and Science had repudiated the initiative. In the aftermath of the scandal, Putin promised the academic community a number of concessions (his most important concession being the promise that, during the transition period, the newly-established academy would be headed by the current head of the RAS, Academician Vladimir Fortov. However, none of those concessions has been included in the recently adopted Law. The Academy's future remains firmly in the hands of the anonymous developers of normative acts from the apparatus of the RF Government and the Presidential Executive Office. The only concession on the part of the State Duma was that the Law should not apply to

the Academy's Far Eastern, Siberian and Ural branches. The policy of clandestine talks with the authorities has so far been pointless, because the adoption of the current Law means that the authorities can now renege on any previously reached agreements, while their refusal to consolidate in the Law at least some of these agreements bodes ill for the future of the Academy. Although the voting power of the academic community is tiny, the authorities can seriously damage their image, including on the international arena, especially bearing in mind that over the past few years the Kremlin has repeatedly and loudly declared expansion of government support for science as one of its top priorities.

September saw two important high-level appointments. Assistant to President Putin and former Minister of Healthcare and Social Development Tatiana Golikova replaced Sergei Stepashin as head of the Audit Chamber, thus putting an end to a rather long intrigue and guesswork. The issue of her appointment had been hanging in abeyance for months for a number of reasons – first of all because Golikova herself perhaps would have preferred something else. After all, the Audit Chamber is a rather strange institution vested with the right to demand information from state agencies and companies, while at the same time having no right not only to punish them for the detected irregularities, but even to give them binding instructions. In fact, the Audit Chamber has been used in recent years mainly as a PR tool in various conflicts in government circles. Tatiana Golikova was replaced as Presidential Envoy to Abkhazia and South Ossetia by Vladislav Surkov, formerly the powerful first deputy head of the Presidential Executive Office and head of the government apparatus. Surkov's retirement from public service had lasted four months... In fact, he has become a member of the Kremlin's 'cadres reserve', which gives him some chances to climb back up again, God willing. ●

INFLATION AND MONETARY POLICY IN AUGUST 2013

A.Bozhechkova

In August 2013, the Consumer Price Index (CPI) amounted to 0.1% (same as its level in August 2012), which is by 0.7 pp. lower than its value recorded in July 2013. Thus, the inflation rate in per annum terms, as seen by the results of the first 8 months of 2013, increased above 6.5%. Over the period from 1 September through 23 September, the CPI amounted to 0.2%. In Q2 2013, according to the Bank of Russia's preliminary estimates, net capital outflow from Russia reached the level of \$ 10bn; on the whole over the first half year of 2013, it amounted to \$ 38.4bn, which is by \$ 1.7bn below its index for the first half year of 2012.

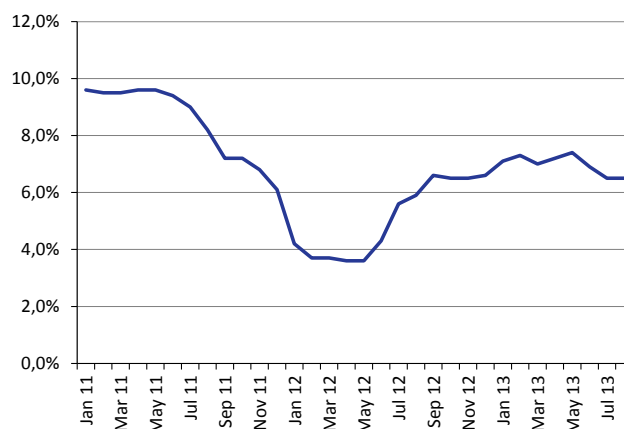
In August, the inflation rate in the Russian Federation became slower: the Consumer Price Index (CPI), as seen by the month-end results, amounted to 0.1% (against 0.8% in July 2013), thus reproducing the similar index for 2012. Thus, the inflation rate in per annum terms climbed to 6.5% (Fig. 1). The core inflation rate¹ in August 2013 was 0.5%, which is below its index for the same period of last year by 0.1 pp.

The prices of foodstuffs in August declined by 0.7% (Fig. 2), due in the main to the drop in the prices of fruit and vegetable products on July 2013 (from -0.3% in July to -11.3% in August). At the same time, the growth rate of prices for eggs increased (from -1.1% in July to 7.4% in August), as did prices for granulated sugar (from 0.1% in July to 4.4% in August), butter (from 1.1% in July to 2.6% in August), milk and dairy products (from 0.8% in July to 1.2% in August), fish and seafood (from 0.4% in July to 0.7% in August). As for the growth rate of prices for bread and bakery products, and those for alcoholic beverages, they remained unchanged since July – 0.3% and 0.5% respectively

The growth rate of the prices and tariffs established for commercial services rendered to the population in August amounted to 0.9%, thus plummeting below its July level 3.1%). Towards the start of the new school year, the prices for services in the education system displayed the highest growth rate (+2.0%). The growth rate of the housing and utilities tariffs in August was 1.3%. The prices of out-bound tourism services continued their upward movement, having increased by 2.6%. The prices of medical services (+0.4%), physical culture and sport (+0.4%), and personal consumer services (+0.3%) were also on the rise.

In August, the growth rates displayed by the prices of nonfood commodities increased on July 2013,

amounting, by the month-end results, to 0.5% (against +0.1% in July). In this commodity group, the steepest upward movement was demonstrated by the prices of motor gasoline (+3.1% against +0.1% in July 2013), tobacco products (+2.0% against +1.2% in July 2013), pharmaceuticals (+0.5% against +0.5% in July 2013), radio and television sets (+0.3% against -0.1% in July



Source: Rosstat.

Fig. 1. The CPI Growth Rate in 2011–2013 (% Year-on-Year)

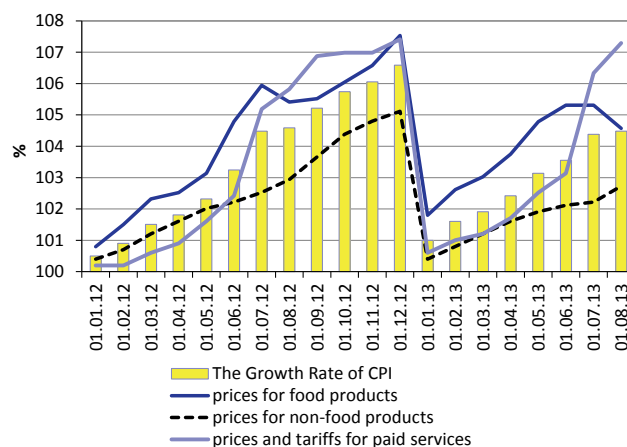


Fig. 2. The CPI Growth Rate in 2011–2013 (as % on December of Previous Year)

1 The core consumer price index reflects the level of inflation on the consumer market after adjustment for the seasonal (prices of vegetable and fruit products) and administrative (regulated tariffs for certain types of services, etc.) factors. This index is also calculated by the RF Statistics Service (Rosstat).

2013), clothes and underwear (+0.3% against +0.1% in July 2013), footwear (+0.3% against zero growth in July).

In September, the inflation rate continued its downward trend in response to both the cheapening fruit and vegetable products and the waning economic activity. The CPI, as determined by the results of the period of 1–23 September, amounted to 0.2% against 0.5% in the same period of 2012. Thus, the cumulative inflation rate since the year’s beginning rose to the level of 4.7% (against 5.1% over the same period of 2012). On the whole, the current inflation trends make it possible to believe that, in absence of any new price shocks, the year-end CPI can amount to approximately 6%.

In this connection, prices may come under upward pressure later this year in response to the expected lower crop yields resulting from the unfavorable weather conditions in some regions (drought in the south of Russia and heavy rains across the Middle Volga Region and Siberia); another contributing factor may become the weakening of the Russian ruble. The factors suppressing the inflation rate’s growth will be the declining domestic demand (a phenomenon that has already been observed for a year) and the continuing slowdown in the growth rate of money supply (the per annum growth rate of M2 dropped from 18.0% as of 1 August 2012 to 17.0% as of 1 August 2013).

In August 2013, the broad monetary base increased by 0.4% to Rb 8,896.2bn (Fig. 3). Among the increasing components of the broad monetary base one may point to banks’ deposits (growth by 4.9% to Rb 131.8bn), the monies kept on commercial banks’ correspondent accounts with the RF Central Bank (by 0.3% to Rb 820.1bn), and cash in circulation, including the cash balances of credit institutions (by 0.4% to Rb 7,442.8bn). The banking sector’s required reserves shrank by 1.2% to Rb 501.6bn.

The narrow monetary base (currency issued by the Bank of Russia plus required reserves) over August increased by 0.3%, amounting to Rb 7,944.4bn (Fig. 4).

In August 2013, the surplus reserves held by commercial banks¹ rose by 0.9% to Rb 951.9bn, while the amount of banks’ repo debt increased by 16.1% – to a level in excess of Rb 2.3 trillion. As of 23 September, banks’ repo debt was above Rb 2.4 trillion. In face of the continuing structural liquidity deficit experienced by the banking sector, the interest rate in the interbank market² in August was on the average at

1 The surplus reserves held by commercial banks at the RF CB are understood as the aggregate balance of their correspondent accounts, deposits with the RF CB, and the bonds issued by the RF CB and held by commercial banks.

2 The interbank interest rate is the average monthly interest rate on overnight ruble-denominated interbank loans (Moscow Interbank Actual Credit Rate – MIACR).

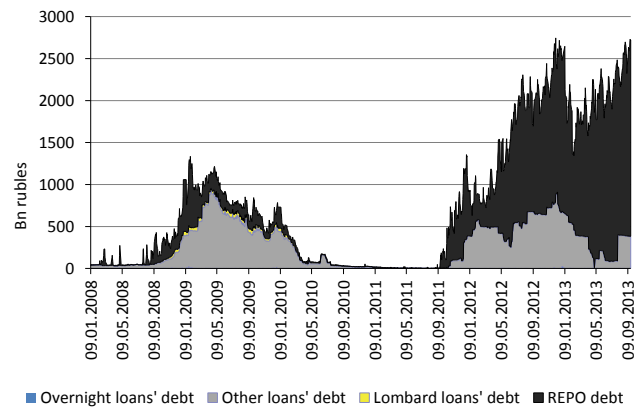


Fig. 3. The Movement of Commercial Banks’ Debt to the Bank of Russia in 2008–2013

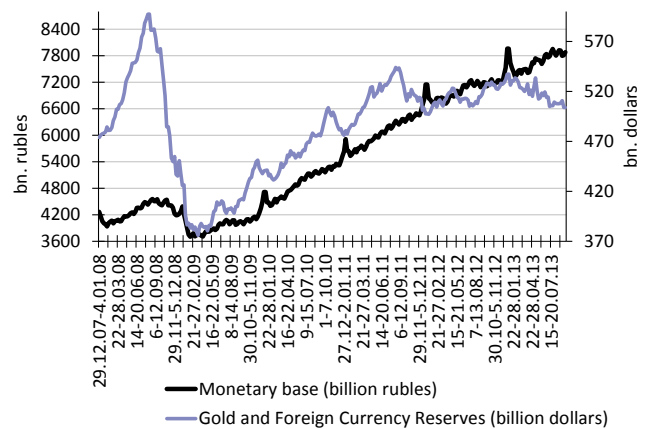


Fig. 4. Behavior of Russia’s Narrow Monetary Base and Gold and Foreign Currency (International) Reserves in 2007 – 2013

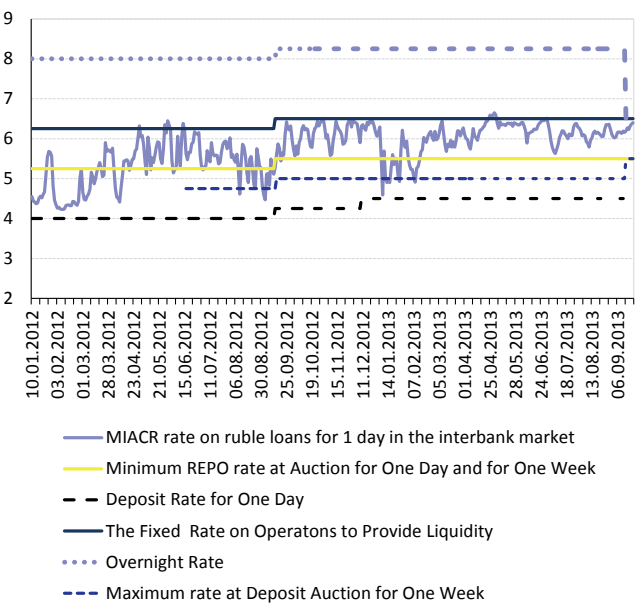
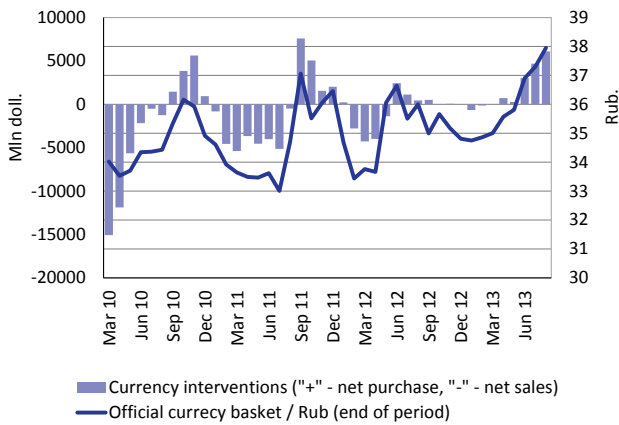
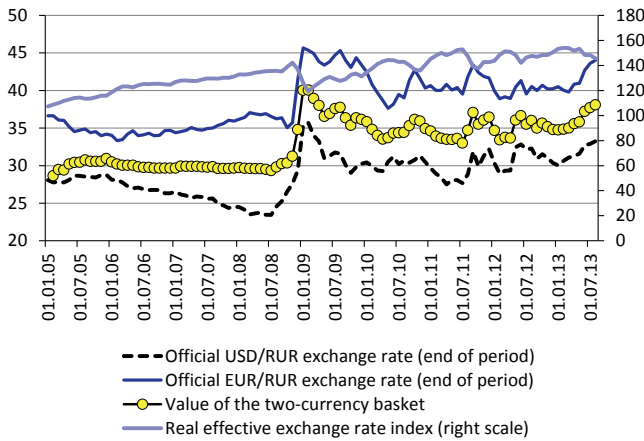


Fig. 5. The Bank of Russia’s Interest Rate Corridor and the Interbank Market’s Behavior in 2012–2013 (% per Annum)



Source: RF CB; the author's calculations.

Fig. 6. The Bank of Russia's Currency Interventions and the Ruble Exchange Rate against the Bi-currency Basket in March 2010 – August 2013



Source: RF CB; the author's calculations.

Fig. 7. Behavior of the Ruble's Exchange Rate Indicators in January 2005 – August 2013

the level of 6.11% (against 6.08% in July 2013), having risen above the similar index for January 2013 by 12.8% (5.4% in January 2013). Over the period from 1 through 23 September, the average interest rate was 6.18%, thus approaching the upper border of the interest rate corridor (Fig. 5).

As of 1 September 2013, the Bank of Russia's international reserves volume amounted to \$ 509.7bn, having shrunk since the year's beginning by 5.2% (Fig. 4). The downward movement of the volume of international reserves in August resulted from the Bank of Russia's sales of foreign currencies on the domestic market. At the same time, the reserves backed by monetary gold over the month of August increased by \$ 2,8bn due to an upward adjustment of asset value. Meanwhile, it should be noted that on the whole, the shrinkage of Russia's international reserves volume denominated in USD over the first half year of 2013

was caused in the main by the upward movement of the euro-to-USD exchange rate, and only in part – by the Bank of Russia's currency interventions.

As seen by the month-end results, the scale of currency interventions by the Bank of Russia in July was \$ 5,455.9m and € 475.6m, their purpose being to level down the volatility of the ruble's exchange rate during the periods of its rapid weakening (Fig. 6). The volume of currency sales in August hit its record high since September 2011. Over that month, the regulator repeatedly revised the boundaries of the bi-currency basket's floating corridor by 5 kopecks. As of 31 August, the boundaries of the bi-currency basket's floating corridor were set at Rb 32.15–39.15. In September, the bi-currency basket's corridor had been twice adjusted upwards by 5 kopecks, thus moving its boundaries further up, to the new level of Rb 32.15–39.15.

According to the Bank of Russia's preliminary estimates, net capital outflow from Russia in Q2 2013 increased to \$ 10bn, and on the whole for the first half year this index amounted to \$ 38.4bn, which is by \$ 1.7bn less than the same index for the first half year of 2012. From January through June 2013, net capital outflow from the banking sector was \$ 19.4bn, while that from the other sectors amounted to \$ 18.9bn.

In August, the ruble's real effective exchange rate against the two major foreign currencies lost 0.8% (having demonstrated no changes in July 2013) (Fig. 7). As seen by the quarter-end results of Q2 2013, the ruble's real effective exchange rate declined by 1.7%.

The exchange rate of the US dollar against the ruble over August rose by 0.64%, to Rb 33.2, which happened as a result of a decline of Russia's balance of trade following the downward movement of international prices for some metals and mineral fertilizers, as well as capital outflow from the developing markets in response to the continuing uncertainty as to whether the US Federal Reserve System's third round of quantitative easing (QE3) was going to be halted towards the year's end. The growth of the euro's exchange rate over August amounted to 0.54% (Rb 44.0). In August, the average exchange rate of the euro against the US dollar amounted to 1.33. The value of the bi-currency basket over August increased by 0.59%, to Rb 38.1. As seen by the results of the period of 1–21 September, over that month the USD/ruble exchange rate dropped by 4.6%, to Rb 31.7., the euro/ruble exchange rate – by 2.3%, to Rb 43.0. As a result, the bi-currency basket's value declined by 3.4%, to Rb 36.8. The ruble's strengthening in September had to do with the start of a new tax period, the responses of market participants to the declaration, by the RF Ministry of Finance, that it might refuse to buy currency on an open market for

the sovereign funds, and the diminishing investors' concerns that the US Federal Reserve System's third round of quantitative easing was indeed going to be halted soon. Thus, the average euro/USD exchange rate for September was 1.33.

On 13 September, at a planned meeting of the Bank of Russia's Board of Directors, it was announced that a set of measures designed to improve the existing system of monetary policy instruments should be implemented. The Bank of Russia decided to cut interest rate on overnight loans and on one-day loans secured by non-marketable assets and guarantees to 6.50% per annum, and to raise the maximum interest rate cap on one-week deposit auctions to 5.50% per annum, whilst the interest rates on the Bank of Russia's other operations and refinancing rates were to remain unchanged. At the same time, the system of monetary policy instruments was complemented by the auction for the provision of loans, secured by non-marketable assets, for 3-month term with floating interest rate.

The Bank of Russia's Board of Directors has declared the interest rate on Bank of Russia one-week liquidity provision and absorption open market operations (5.50 percentage per annum as at 13 September 2013) to be the Bank of Russia's key rate. The choice of a key rate appears to be well-substantiated, given that the main channel for obtaining liquidity by credit institutions from the Bank of Russia are one-week auctions (on the average over Q2 2013 – Rb 1.4 trillion), whereas the same indices for one-day auctions (on the average over Q2 2013 – Rb 317.2bn) and auctions for longer terms (3, 12 months) are significantly lower. The regulator intends to use the key rate as the main indicator of the monetary policy stance. It should be noted that, during the transition period, one-week repo rate will serve as a key one. By 1 January 2016, the Bank of Russia is going to make the refinancing rate equal to the key rate. Before that, the refinancing rate will play a minor role. The interest rates on Bank of Russia one-day liquidity provision and absorption standing facilities are to form the lower (4.50 percentage per annum as at 13 September 2013) and upper (6.50 percentage per annum as at 13 September 2013) borders of the interest rate corridor, respectively, which are symmetric relatively to the key rate (*Fig. 5*).

Among the innovations introduced by the Bank of Russia, an important one is that the inflation target is set as a point and not as a spread – a measure designed to facilitate a better understanding of monetary policy decisions by economic agents. The target consumer inflation growth rate continued is estimated to be at 4.5% in 2014 and 2015, and at 4% in 2016.

However, the inflation targets are set with a tolerance band of ± 1.5 pp., with a view towards possible effects of unpredictable factors. In our opinion, considering the current trends in Russia's national economy, the RF Government's decision to freeze the tariffs set by natural monopolies until the end of 2014, and the recent improvements to monetary policy, such inflation targets appear to be quite realistic; however, their actual achievement will strongly depend on the situation in the world economy.

In the draft *Guidelines for the Single State Monetary Policy in 2014 and for 2015 and 2016* published on 13 September, the Bank of Russia also proclaimed its intention to further increase the exchange rate flexibility. The regulator plans to complete the transition to a floating exchange rate regime by 2015, by reducing the volume of interventions it conducts which are aimed at cushioning fluctuations in the ruble exchange rate and by increasing the sensitivity of the operational band borders to Bank of Russia interventions, in order to facilitate market participants' ability to adapt to exchange rate fluctuations that are caused by external shock. Over the course of 2013, the Bank of Russia has been moving in that direction, progressively expanding the ruble's exchange rate corridor.

The draft establishes that, in the course of the transition to an inflation targeting regime, the Bank of Russia will continue increasing the effectiveness of the interest rate channel of the monetary policy transmission mechanism. Keeping overnight money market rates close to the Bank of Russia key rate will be an operational goal of the monetary policy. The regulator points out that interbank lending will play a major role in the redistribution of liquidity between market participants. At the same time, we must note the high segmentarization level of the interbank lending market in Russia, from which it follows that, in an event of financial instability, the Bank of Russia will have to be the main source of liquidity.

To alleviate the problem of liquidity deficit faced by some credit institutions, the Bank of Russia will continue conducting operations using various types of assets in addition to securities, including non-marketable assets. Besides, the Bank of Russia may use outright purchases or sales of assets as an additional instrument for regulating banking sector liquidity.

As one of the main monetary policy tools, the Bank of Russia will consider the possibility of unifying interest rates on same-term operations irrespective of the type of collateral, as well as combining refinancing operations with the same term and different types of collateral into a single auction.

The planned upward adjustment of the coefficient of averaging for the calculation of average size of re-

quired reserves is regarded by the regulator to be one of the measures designed to improve the efficiency of liquid asset management, thus creating better conditions for reducing the volatility of interest rates on the interbank market.

The regulator plans to pursue an aggressive information policy, including the explanation of the Bank of Russia's goals and the purpose of its measure to economic agents. This principle of Bank of Russia's accountability will increase the level of public confidence in its monetary policy and help shape the expectations of economic agents.

It should be noted that, on the whole, the intended modification of the system of monetary policy instruments will improve the functioning of the money market and the manageability of interest rates, while the inflation risks will become lower. However, to supply the economy with 'long money' is the task for the entire financial system, and not for the central bank alone. So, the issues of developing the institutional environment and deepening the financial sector's capacity are by no means losing their importance for the Russian economy. ●

FINANCIAL MARKETS IN SEPTEMBER 2013

N.Andrievsky, E.Khudko

Crude oil prices advanced late in August 2013 and pushed up the MICEX index by 5.52% during the first decade in September 2013. As of September 26, 2013, the MICEX index advanced by 8.6% since the beginning of the month and reached 1485 points. OJSC Sberbank stocks grew up by 14.39% during 26 days in September, showing maximum growth among blue chips. Stock market (MICEX) capitalization reached Rb 25.09 trillion (40.09% of GDP) by September 26, 2013. Domestic corporate bond market indicators such as market capacity, corporate bond market index, average weighted yield, activity of issuers and investors (especially in the financial segment) showed a positive trend. However, a few technical and real defaults were declared.

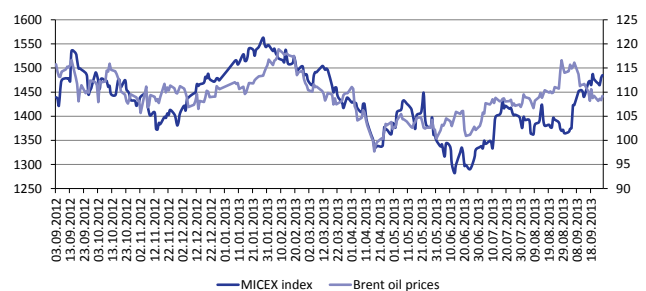
Dynamics of Russian stock market basic structural indices

Prices of Brent crude oil increased 5.31% (up to \$116.61 per barrel) on August 28, 2013 due to unstable situation in Syria and pushed up the MICEX index by 5.52% in the period of September 6 thru September 9, 2013. Easing of tensions in Syria pushed down oil prices to \$110 per barrel by September 16, 2013. Nevertheless, the MICEX index kept growing, and local maximum value was reached on September 19, 2013 (1487.19 points). The index reached 1485.14 points by September 26, 2013.

Gazprom, Sberbank, and Lukoil stocks were principal growth drivers for the MICEX index in September 2013. Gazprom and Rosneft stocks increased significantly at the beginning of the month. Growth rates of these stocks reached 6.5% and 6.36% respectively by September 5, 2013 since the beginning of the month. Sberbank stocks (as of September 20, 2013) showed a maximum growth of 14.39% since the beginning of the month.

Positive trends for blue chips resulted in 26.8% p.a. of annual yield of Rosneft stocks (in the period of September 27, 2012 thru September 26, 2013). Sberbank stocks demonstrated a yield of 12.88% and 16.5% on common and preferred stocks respectively. Growth in the value of Gazprom shares in September 2013 failed to change negative annual results (annual decline of 7.36%). The value of VTB Bank stocks fell by 2.1% as compared to the beginning of the year, and showed maximum fall in the value (19.57%).

The machine building sectoral index, which increased by 8.58% by September 12, 2013 since the beginning of the month, was leader in growth among sectoral indices. The machine building sectoral index's uptrend was driven basically by OJSC Solers's purchase of UAZ stocks, as well as KAMAZ stocks which raised in response to news of the release of a new make of towing truck and re-election of the Chairman of the Board



Source: RBK Quote.

Fig. 1. Dynamics of the MICEX index and futures Brent oil prices in the period of August 1, 2012 thru September 26, 2013

of Directors. Positive trends in the value of oil-and-gas companies observed by the end of the month resulted in a growth of 7.38% in the sectoral industry by September 26, 2013 since the beginning of the month.

According to the Emerging Portfolio Fund Research (EPFR), Russian-market-oriented funds saw a capital outflow of \$339m in the period of September 1 thru September 25, 2013. At the same time, in the last week of September, Russia-oriented funds saw capital inflow for the first time over the past eight weeks (since mid-July 2013). Russia's stock market (MICEX) capitalization amounted to Rb 25.09 trillion (40.09% of GDP) as of September 26, 2013, having shown an increase of Rb 1.65 trillion (7%) against the value observed on September 2, 2013. However, no significant changes took place in the capitalization structure. In particular, it was only the share of companies operating in the mineral extraction sector and financial sector that increased (by 0.4% and 0.15% respectively) as compared to the beginning of the month, whereas the share of companies specializing in energy production and distribution decreased by 0.38% in the same period.

Corporate bond market

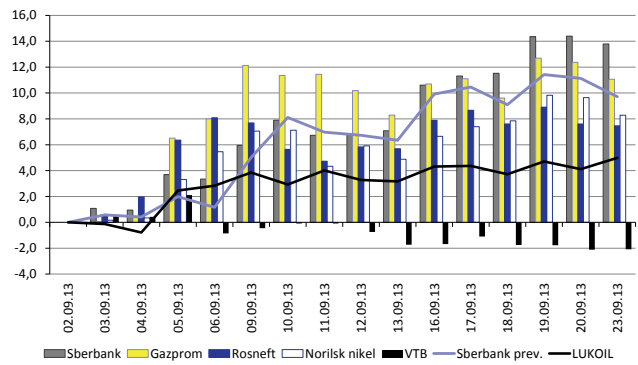
The domestic corporate bond market in Russia (measured by the par value of outstanding securi-

ties denominated in the national currency, including those issued by non-residents) kept growing in September 2013. By the end of September 2013 the value reached Rb 4 779.0bn, having shown an increase of 1.7% against the value observed by the end of August 2013¹. The increase in market capacity was related to an increase in the average volume of bond issues, because the number of bonds issues remained unchanged (1002 corporate bond issues registered in the national currency against 1000 issues at the previous month end), whereas the number of bond issuers even declined (346 issuers against 353 companies in August 2013). In addition, there are outstanding 12 USD-denominated bond issues of Russian issuers (a total of more than \$1.8bn), and a JPY-denominated bond issue. It is worth noting that the year 2013 saw a trend towards growth in the number of mortgage-backed bond issues which is most likely to continue in the coming months.

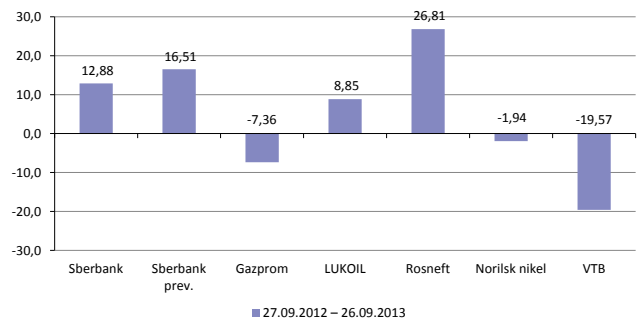
Investment activity in the corporate bond secondary market increased significantly in September 2013 after a long-lasting period of stabilization. For instance, in the period of August 22 thru September 23, total volume of market transactions in the Moscow Stock Market amounted to Rb 152.3bn (to compare, trading volume amounted to Rb 116.1bn in the period of July 22 thru August 21, 2013), and the number of transactions remained almost unchanged over the period under review and amounted to 27,400 (27,000 in the previous period)², being indicative of growth in the number of major transactions.

The Russia corporate bond market index (IFX-Cbonds) kept growing. Its value increased by 2.4 points (or 0.7%) by the end of September 2013 as compared to the value observed at the previous month end. The corporate bond average weighted yield also saw a positive trend, having dropped from 8.15% late in August 2013 to 8.07% by the end of September 2013 (Fig. 6)³.

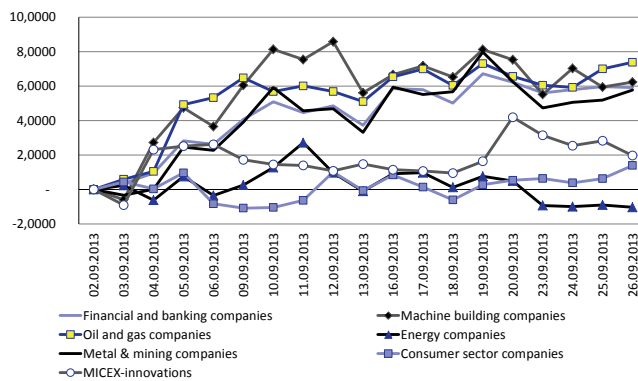
Dynamics of basic indicators are indicative of that the debt market hasn't yet been affected by the problems faced by the Russian economy. Adverse situation in the Eurozone has been exerting additional pressure upon the Russian economy. Therefore, should economic factors keep deteriorating, one may expect a change in the debt market trends. At the same time, it should be noted that no changes in the official inflation forecasts for 2013 (5-6%) and refinancing rate infused more certainty for investors and issuers. The market gained more "confidence" in response to stable forecasts by international rating agencies with regard to ranking of the largest Russian



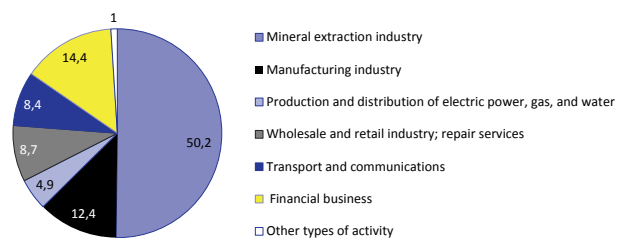
Source: RBK Quote, author's estimates.
Fig. 2. Blue chips growth rates in the Moscow Stock Exchange in August 2013 (month to date)



Source: RBK Quote, author's estimates.
Fig. 3. Blue chips growth rates in the Moscow Stock Exchange in the period of September 27, 2012 thru September 26, 2013 (% p.a.)



Source: RBK Quote, author's estimates.
Fig. 4. Growth rates in various sectoral stock different stock indices at the Moscow Stock Exchange (month to date)



Source: The Moscow Stock Exchange's official website, authors' estimates.
Fig. 5. Stock market capitalization structure by type of economic activity

1 According to Rusbonds information agency.
2 According to Finam Information Company.
3 According to Cbonds Information Agency.

issuers, namely Severstal, Rostelecom, RusHydro, Tatneft, NOVATEK, etc.¹

The corporate bond portfolio duration value remained unchanged. The duration was 717 days as of the end of September 2013, being six days beyond the value observed as of the previous month end. Relative stabilization of the duration value against insignificant decline of interest rates in the market is indicative of invariance of maturity of flow of payments on bonds and, therefore, maturity of outstanding bond issues in the corporate segment.

Like in the previous month, financial corporate issuers experienced most volatile movements. For instance, OJSC AK BARS BANK (series 04) and OJSC Petrocommerce Bank (series 05) saw highest fall in bond yield (more than 1 p.p.), whereas OJSC Bank Zenit bonds (series 08) showed a significant growth (more than 2 p.p.). Such yield movements were related to more intensive investment activity in the financial market: trading turnover on certain bond issues of large financial companies such as AK BARS, ALFA-BANK, ZENIT, Credit Europe Bank, NOMOS BANK) exceeded Rb 1bn over the period under review. Energy companies saw a significant fall in their bond yield, a insignificant downtrend was observed in the production and high-tech sectors (no more than 0.1 p.p. on average)².

Positive market trends persisting over the last few months were pushed up by activity of Russian issuers in terms of bond issue registration. For instance, 10 issuers registered 36 ruble bond issues at an aggregate par value of Rb 341.3bn in the period of August 22 thru September 23, 2013 (to compare, 69 ruble bond issues at a total of Rb 279.5bn were registered in the period of July 22 thru August 21, 2013). However, the major part of the registered issues (19 series of listed bonds at a total of Rb 235bn) was accounted for by a single issuer, OJSC Bank VTB. Listed bonds accounted for more than 2/3 of the registered issues.

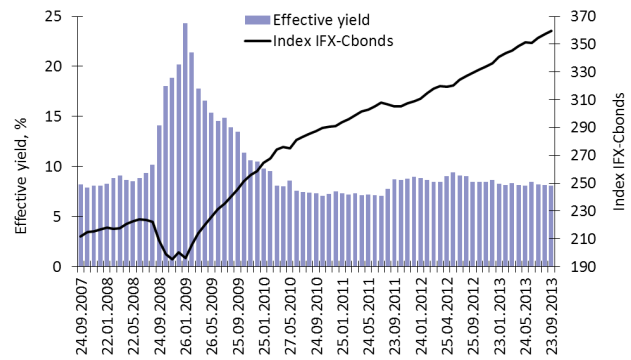
Unlike the secondary market, investment activity in the primary market slowed down a bit in September 2013 as compared to the previous period, but remained at a fairly high level. For instance, 19 issuers placed 23 bonds at an aggregate par value of Rb 113.8bn in the period of August 22 thru September 23, 2013, (to compare, 25 series of bonds at Rb 154.65bn were placed within a period of July 22 thru August 21, 2013) (Fig. 7). Two mortgage agents managed to obtain financing for a period close to 35 years.

Unlike the recent few months, the Bank of Russia Financial Markets Service declared void 15 issues of bonds in September 2013 for non-placement of a single bond³.

1 According to Cbonds Information Agency.

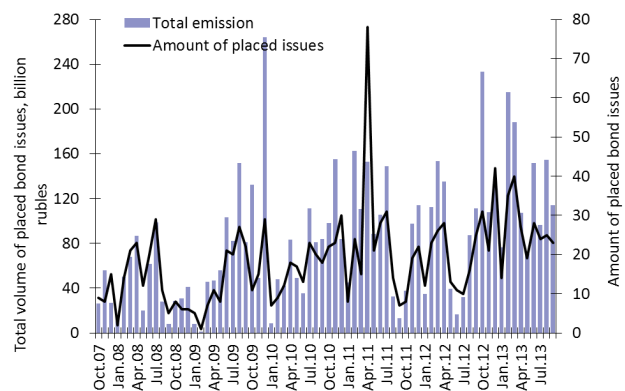
2 According to Finam Investment Company.

3 According to the Bank of Russia Financial Markets Service.



Source: according to Cbonds Information Agency.

Fig. 6. Dynamics of the Russian corporate bond market index and average weighted yield



Source: according to Rusbonds information agency.

Fig. 7. Dynamics of initial public offerings of corporate bonds denominated in the national currency

It is a negative signal for market players. Eighteen issuers were to redeem their debt at an aggregate par value of Rb 70.3bn in the period of August 22 thru September 23, 2013. However, two issuers failed to redeem their debt on the date of maturity (one issuer declared a technical default in the preceding period). Twenty issues of corporate bonds at a total of Rb 81.8bn are expected to be redeemed in October 2013⁴.

Two issuers declared real default⁵ on coupon yield payment in the period of August 22 thru September 23, 2013 (one issuer did the same in the corresponding period in the previous year). Like in the previous months, no real defaults took place in the redemption of par value of bond issues and early redemption of securities on put date⁶.

4 According to Rusbonds information agency.

5 It means that the issuer was unable to pay to bondholders even shortly after a regular scheduled due date, the so-called grace period.

6 According to Rusbonds company.

THE REAL SECTOR OF ECONOMY: FACTORS AND TRENDS IN H1 2013

O. Izryadnova

The trend towards slower economic dynamics by basic types of economic activity kept progressing in the period of May thru August 2013. With industrial production stagnating at the level of January–August 2012, manufacturing and electric power production contracted by 0.2% and 1.1% respectively. Freight turnover annual rates have declined since June 2013. Performance of works in the construction industry have become more irregular with declining capital investments. Consumers' demand which is determined by real wage increases remains the factor that promotes economic growth.

Macroeconomic situation this year has been characterized by gradual slowdown in growth rates. The GDP actual volume index accounted for 101.6% in Q1 2013, 101.2% in Q2 2013, and 101.4% at the end of H1 2013 of the level observed during the corresponding periods in 2012. Stagnation in the Russian economy in the period of January thru August 2013 was determined by simultaneous effect of external and internal factors. Global market trends which have been persisting since H2 2012, pushed down cost and physical export volumes and determined slow development dynamics of the extracting sector and related mineral resources refining industries. In H1 2013, mineral extraction's contribution in GDP was 0.9 p.p. less than the corresponding value observed in the previous year. Industrial production's weaker demand for mineral extraction which account for more than 1/10 of gross value added, almost 23% of capital investments and profits of enterprises and organizations in the Russian economy at large, had an adverse effect on the dynamics of manufacturing sector and transport services. Negative growth rates in the manufacturing industry have been observed on a year-on-year basis since May 2013. Outgrowth of rates in the extracting sector vs. the industry composite index in January–August 2013 couldn't compensate for the decline in the manufacturing sector and production of electric power, gas, and water. The manufacturing index in January–August 2013 accounted for 99.8% of the value observed during the corresponding period of the previous year, while production and distribution of electric power, gas, and water accounted for 99.1%.

The situation was aggravated by a long-lasting trend toward cost-price inflation related to the tariff policy of infrastructural monopolies, and outgrowth in wage increases. Worse financial performance results of enterprises and organizations restricted limited the capacity for adjusting the pricing policy in order to maintain competitiveness, as well as capital investment financing. The volume of capital investments contracted

by 1.3% during the period of January thru August 2013 and by 3.9% in August as compared to the corresponding periods of 2012. It is the functionality dynamics of machine building and metallurgical industries that was affected most by the decline in investment activity. In the period of January thru August 2013, production of machinery and equipment contracted (by 7.0%), cargo trucks output (by 6.7%), and production of assembled steel sections (by 2.5%) against the corresponding period of the previous year.

In August 2013, retail sales index accounted for 104.0% of the value observed in the previous year, including food products (103.7%) and non-food products (104.0%). It is worth noting that uptrends in retail sales turnover were to a greater extent related to the labor remuneration policy. Equalization of wages at budget-funded sectors with average amounts in the economy was the key growth element, but this factor's contribution has been weakening this year. In August 2013, real personal income increased 2.1% on a year-on-year basis, up from 9.3% last year, while real wages increased 5.9%, up from 6.0% last year.

The situation at hand determined the need to update basic parameters of the Russian economy development until the end of 2013 which outlined a forecast of social and economic development for 2014 and the planning period of 2014–2016. According to the estimates made by the Ministry of Economic Development of Russia, dynamics of basic macro indicators are expected to speed up in H2 2013, thereby allowing a 101.8% growth rate of GDP to be approached at year-end.

The Ministry of Economic Development of Russia has estimated quite optimistic social development parameters until the end of 2013. The situation in the labor market is expected to stabilize: unemployment rate is expected to remain at a level of 4.1 million persons, a minimum value over the past decade, or 5.7% of total gainfully employed population. Real personal income dynamics saw a slowdown in H2 2013, but growth rate

**FORECAST BASIC INDICATORS BY BASIC OPTION (1),
AS PERCENTAGE OF THE PREVIOUS YEAR**

	2012	2013		2014	2015	2016	2016 against 2012
	report	H1	assessed per year	forecast			
Consumer price index at year-end	106.6	103.5	106.0	104.5–105.5	104–105	104–105	
Gross domestic product	103.4	101.4	101.8	103.0	103.1	103.3	111.7
Industrial production index	102.6	100.1	100.7	102.2	102.3	102.0	107.4
Agricultural index	95.3	102.0	107.0	102.0	103.0	102.6	115.3
Capital investments	106.6	98.6	102.5	103.9	105.6	106.0	119.2
Retail sales turnover growth rate	106.3	103.7	104.2	104.0	104.4	104.7	118.5
Scope of paid services to the general public growth rate	103.5	102.2	102.2	102.5	103.1	103.4	111.7
Real household disposable income	104.4	104.4	103.4	103.4	103.3	103.3	114.1
Real wages	108.4	105.5	106.2	104.0	103.8	104.2	119.4
Foreign trade turnover	103.6	93.3	99.0	100.6	101.7	103.1	104.4
Export	102	96.2	96.9	99.0	100.1	102.1	98.1
Import	105	104.4	102.3	102.9	103.9	104.5	114.3
Employment volume in the economy	100.3	100.3	99.6	99.7	99.5	99.4	98.5
Labor productivity	103.0	–	102.2	103.3	103.7	103.9	113.7

Source: Ministry of Economic Development of Russia.

is estimated to reach 103.3% in 2013 and remain as such within the next three years. Should real wages growth rate increase in H2 2013, it is estimated to exceed by 0.7 p.p. the 2012 value and stand at 106.2%. The forecast retains the trend towards outgrowth in wage increases vs. labor productivity, and higher labor costs in GDP. Outgrowth in wage increases vs. labor productivity is estimated to lead to a 24.4% growth in the share of remuneration of salary-earning workers in GDP. Within the next three years (2014–2016) a 104% annual average growth rate of wages is expected to retain the share of labor remuneration in GDP at the 2013 level. Should wage increases keep outgrowing labor productivity in the next three years, the cost-price inflation trend would remain in place. It should be noted that in this case, all other factors being equal, economy cost-effectiveness would remain at the level reached in 2013.

The forecast that expects growth rates to accelerate in H2 2013 is based on the assumption that domestic consumer demand and investment demand would expand. However, the following should be taken into account: (1) regulated prices and tariffs of services provided to the general public increased in H2 2013, (2) growth in prices of manufacturers of industrial products has been accelerated since June 2013, and (3) prices of imported goods increased in response to a weaker ruble exchange rate. In H2 2012, these factors slowed down growth rates in sales turnover, irrespec-

tive of higher growth rates in real personal income as compared to the current situation.

Slower dynamics of capital investments and scope of works in the construction sector in the period between January and August 2013 can be explained by high base during the corresponding period in 2012. However, it should be accepted that the decline in capital investments in September–December 2012 was related to domestic problems occurred in response to cut back on investment programs at the backdrop of drastic slowdown in economic growth rates, influenced by production contraction, and for both external and internal markets. Inertial development of the situation remains the same this year. Investments in mineral extraction in H1 2013 contracted by 7.9%, including production of fossil fuels (by 11.5%), against the corresponding period of the previous year. Industrial production and retail sales turnover dynamics have been far behind import growth rates.

The assumption of faster growth in domestic demand against GDP dynamics is a key element of the forecast for 2014–2016. Therefore, structural changes to capital investments must be focused on gradually increasing investments in manufacturing industry and types of economic activity which provide services. Though capital investments are expected to account for an average of 20.8% of GDP in the period of 2014–2016, these resources may be found to be insufficient for a large-scale modernization of the economy. Though eco-

conomic growth rates are projected, investment demand in the period of 2014 thru 2016 will still be satisfied through outstripping growth rates in import of investment goods vs. domestic production. Furthermore, domestic production industry still depends on import of intermediate consumption products.

Faster rates in domestic demand for domestically provided goods and services implies quality changes to mechanisms of influence and motivation. Analysis of the capital investment financing structure shows that equity capital, public funds, and borrowings account for about 70%. Loans from foreign banks, as well as funds allocated by controlling holding and joint-stock companies and industrial-financial groups, which account for 12.4% of total capital investments, dropped drastically in nominal terms in H1 2013 as compared to the corresponding period of the previous year. One

may hardly expect any investment surge within the next four months in 2013 with the existing dynamics of financial performance results in H1 2013 and subsequent scrapping of investment programs at largest companies. This fact is especially alarming, because in such a case, one may hardly forecast more intensive investment activity to be seen in 2014.

The projection of investment dynamics for the period of 2014 thru 2016 is based on the conditions of changing the quality of institutions which support entrepreneurship and upgrading the public-private partnership mechanism, thereby allowing investment projects to be structured in a different manner, including projects which are to be implemented with National Wealth Fund's resources, ensuring protection against investment risks, and increasing total volume of investments. ●

THE RUSSIAN INDUSTRY IN AUGUST 2013

S.Tsukhlo

According to the data of business surveys of the Gaidar Institute¹, in August the Russian industry demonstrated positive changes in the dynamics of the demand and output, as well as growth in ex-factory prices. However, enterprises are not sure that the above trends will continue in the following months and do not still plan to increase investments.

Demand on the Industrial Produce

In August, the actual dynamics of the demand underwent insignificant positive changes as compared to July. The initial balance (growth rates) improved by 6 points, while that cleared of the seasonal factor, by 4 points (Fig. 1). Sales continue to fall (the balance remain a negative one), but not that fast as in the previous months.

As a result, two months of the 3rd quarter of 2013 as regards sales look better than the respective period of 2012. Both the above factor and absence of evident (crisis?) worsening of the situation with the demand permitted the industry to “take breath” – a traditionally distressing August happened to be quite calm for the industry this year. The latter factor ensured a six-point growth in satisfaction with current volumes of the demand and an increase in the balance of its estimates to the 15-month maximum.

However, forecasts of the demand for September and October are highly pessimistic. Within a month, the initial balance lost straight 6 points and for the first time in 2013 ceased to be a positive one (expectations of a decrease in sales became equal to expectations of their growth). With a seasonal factor cleared, the balance got worse by 4 points. It is to be noted that, a year ago August forecasts showed a modest upturn in expectations in industry.

Stocks of Finished Products

Evaluations of stocks of finished products keep demonstrating positive changes. The balance of that index decreased (that is, got better) by 6 points in August after a 10-point drop in July (Fig. 2). So, the June upswing of excessive stocks of finished products was successfully overcome within two months and, at present, the balance of their estimates came closer to values which are rather low for the 2011–2013 period.

¹ Surveys of managers of industrial enterprises are carried out by the Gaidar Institute in accordance with the European harmonized methods on a monthly basis from September 1992 and cover the entire territory of the Russian Federation. The size of the panel includes about 1,100 enterprises with workforce exceeding 15% of workers employed in industry. The panel is shifted towards large enterprises by each sub-industry. The return of queries amounts to 65–70%.

CHANGES IN SOLVENT DEMAND CLEARED OF A SEASONAL FACTOR (BALANCE=%GROWTH-%DECREASE)

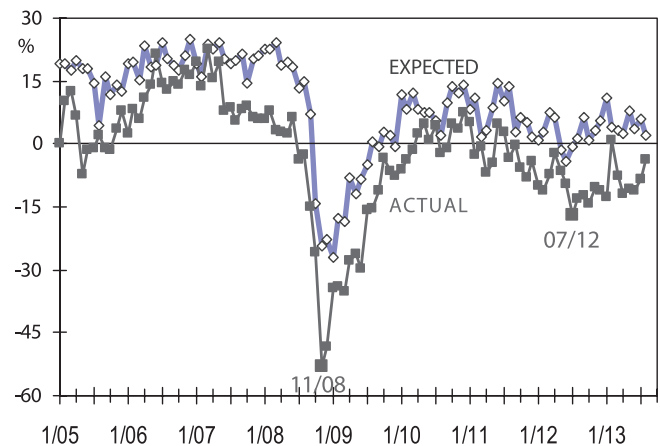


Fig. 1

BALANCE OF ESTIMATES OF STOCKS OF FINISHED PRODUCTS (BALANCE=%ABOVE-%BELOW THE NORM)

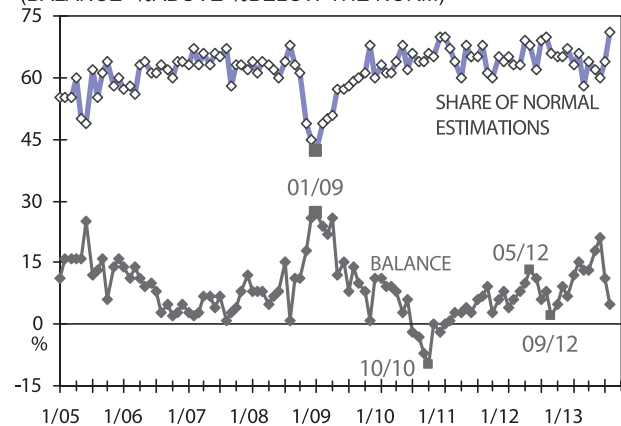


Fig. 2

The industry received an additional reason to boost the output which it is unable to use so far judging by its production plans.

The Output

In August, the industry’s production plans lost 6 points and 5 points as regards the initial data and that

cleared of a seasonal factor, respectively (Fig. 3). As result, the balance of forecasts fell to the levels which are worst for 2013, but remains a positive one – in industry there are still more hopes for output growth than expectations of a decrease in output.

In August, the actual dynamics of output showed positive changes. The initial balance (output growth rates) rose by 15 points, while that cleared of a seasonal factor, by 6 points and amounted to the 15-month maximum.

Enterprises’ Prices

Positive changes in the dynamics of the demand and output permitted enterprises to “work off” growth in tariff rates of the second half-year. In August, the balance of actual changes in prices became a positive one (the industry started to raise prices) after the balance had been in the zero and negative zones for four months running (the industry either kept the prices unchanged or reduced them) (Fig. 4). Another factor which prompted a change in the pricing policy was more intense growth in costs. If in the 2nd quarter their growth rates were estimated by enterprises at +5 points, at present they amount to +15, though forecasts did not predict such a change in the index in the current quarter. So, the industry managed to delay for a month a jump in prices of the second half-year. Last year, it took place in July, but later prices started to go down and there was an absolute drop in prices in November.

In the past three months, enterprises’ pricing forecasts did not actually change and remained positive ones (plans of prices-rises dominate over those of price-reductions), however, they are still at the very modest level in the past two years (the planned growth is expected to be the most moderate one from November 2011).

Actual Dynamics of Lay-Off Plans

The Russian industry keeps losing workers. According to business surveys of the Institute for Economic Policy, that process started a year ago and still remains dramatic and painful to enterprises. As a result, at present, 22% of enterprises lacks personnel. Labor shortages restrain output growth with 37% of enterprises. In more cases, only insolvent growth is mentioned as a constraining factor.

Forecasts of changes in the number of personnel do not promise anything good to the industry. In August, the balance of the index fell to the annual minimum (Fig. 5). In other words, the outflow of workers will continue, while the extent of provision of a possible (initial?) industrial growth with personnel decreases.

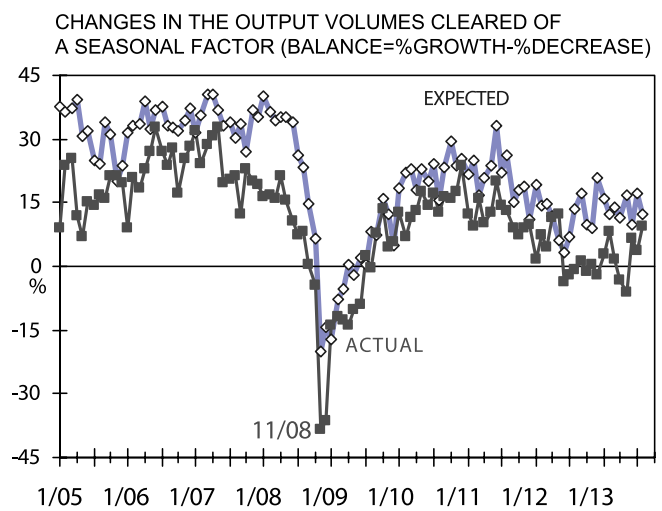


Fig. 3

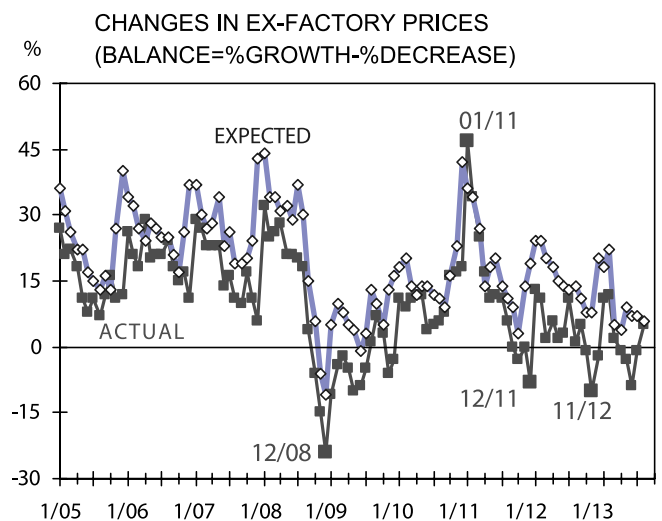


Fig. 4

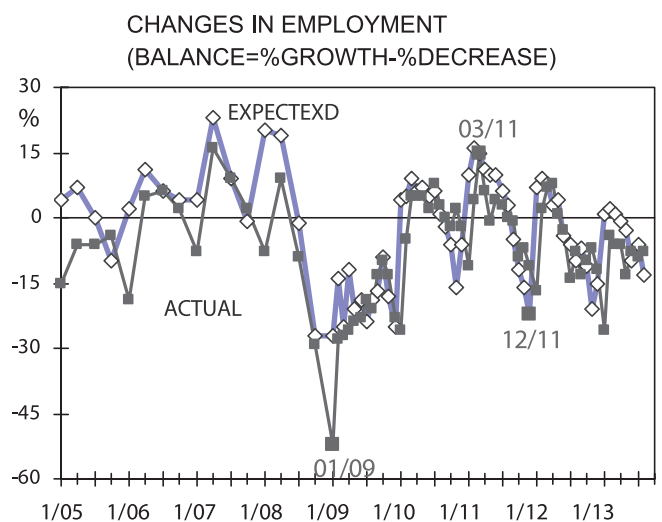


Fig. 5

FOREIGN INVESTMENTS IN THE RUSSIAN ECONOMY IN H1 2013

E.Ilyukhina

In the first six months, growth in foreign investments in the Russian economy was registered. The highest growth rates were observed with the direct investments segment whose unit weight in the aggregate indices rose to 12.3%. The volume of the withdrawn capital amounted to 63.2% of the volume of foreign investments received in the above period. In the first six months of 2013, investments from Russia abroad kept growing having exceeded by 27.9% the volume of foreign investments received within the above period.

In the first six months of 2013, foreign investments in the Russian economy amounted to \$98.8bn which is 32.1% higher than the index of the respective period of 2012. Tangible growth in foreign investments in the first six months of 2013 was ensured by their growth in the 1st quarter, while in the 2nd quarter the inflow of foreign investments corresponded to the indices of the respective period of 2012.

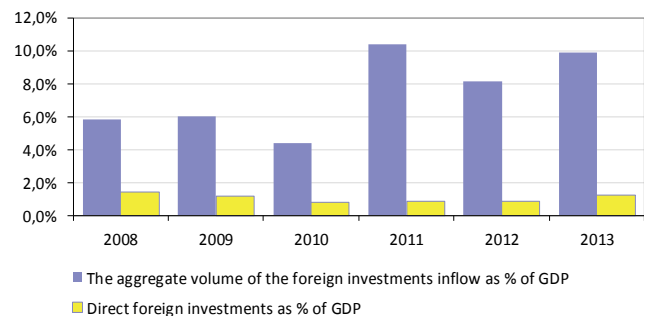
In the first six months of 2013, the level of inflow of foreign investments in shares of GDP grew as compared to the previous similar period.

As of July 1, 2013, the accumulated foreign investments in the Russian economy, including investments from CIS states amounted to \$370.6bn which is 10.7% and 2.3% higher than the indices as of July 1, 2012 and January 1, 2013, respectively.

In the first six months of 2013, \$62.5bn was withdrawn abroad as income of foreign investors and interest payments for utilization of loans and repayment of loans; the above value was 7.4% lower than the index in the first six months of 2012. In the first six months of 2013, the volume of the withdrawn capital amounted to 63.2% of the volume of the received foreign investments (in the first six months of 2012 90.2% of the volume of the received foreign investments was withdrawn). It is to be noted that in the 2nd quarter of 2013 the ratio amounted to 99.5% (in the 2nd quarter of 2012 that index amounted to 82.4%).

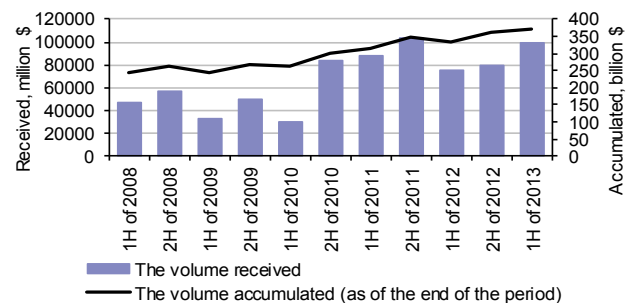
In the pattern of foreign investment in the Russian economy, other investments account for a major portion (Fig. 3).

On the basis of the results of the first six months of 2013, direct foreign investments amounted to \$12.1bn which is 59.8% higher than the level of January–June 2012. Higher growth rates of direct investments as compared to those of other investments and aggregate foreign investments resulted in growth in unit weight of direct investments in the aggregate pattern from 10.2% in the first six months of 2012 to 12.3% in the first six months of 2013. As in 2012, in the 2nd quarter of 2013 a 7.4% decrease in the inflow of



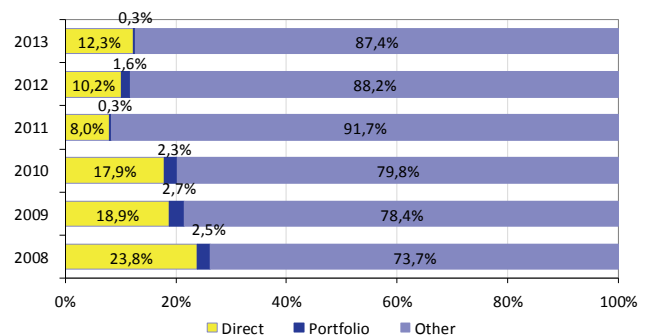
Source: Rosstat.

Fig. 1. The level of inflow of foreign investments in the Russian economy in the first six months of 2008–2013, % of GDP



Source: Rosstat.

Fig. 2. Dynamics of the volume of foreign investments in the Russian economy (without taking into account monetary control and the banking sector)



Source: Rosstat.

Fig. 3. The pattern of foreign investments in the Russian economy in the first six months of 2008–2013

Table 1

SECTORIAL PATTERN OF FOREIGN INVESTMENTS IN THE RUSSIAN ECONOMY IN THE FIRST SIX MONTHS OF 2010–2013

	Million US dollars				% of the result			
	2010	2011	2012	2013	2010	2011	2012	2013
Industry	18 047	28 149	29 959	65 658	59.4	32.1	40.1	66.5
Transport and communications	3 082	4 751	2 634	2 098	10.1	5.4	3.5	2.1
Commerce and public catering	4 620	6 788	8 723	15 146	15.2	7.7	11.6	15.3
Real estate operations, leasehold and rendering of services	2 553	2 956	3 705	3 849	8.4	3.4	5.0	3.9
Finances, lending, insurance and retirement insurance	1 321	44 432	29 004	11 318	4.4	50.7	38.8	11.5
Other sectors	761	622	764	726	2.5	0.7	1.0	0.7

Source: Rosstat.

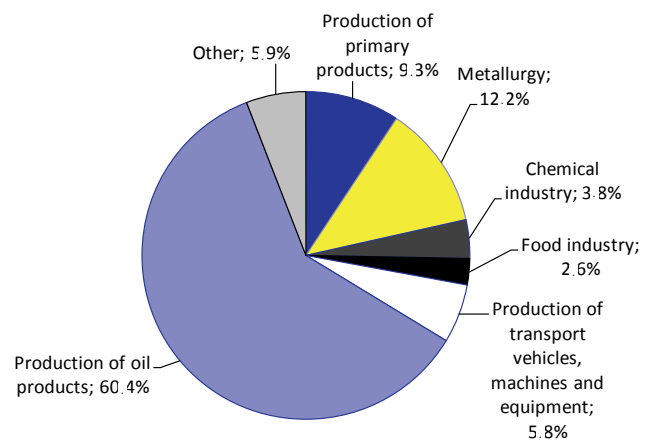
direct foreign investments as compared to the previous quarter was observed (in the 2nd quarter of 2012 a decrease amounted to 3.3%). At the same time, in the 2nd quarter a 56.2% growth was registered as compared to the respective period of the previous year.

In the first six months of 2013, sectorial pattern of investments in the Russian economy is characterized by a significant drop in investments in the financial sector (a 61.0% drop as compared to the first six months of 2012). So, the above sector of the economy moved in the sectorial pattern of foreign investments in the Russian economy from the first position in 2011 and the second position in 2012 to the third position after the industry and commerce (Table 1).

In the first six months of 2013, the volume of foreign investments in industry rose by 120% as compared to the respective period of 2012. Foreign investments in commerce and public catering increased by 73.6%, while those in operations with real estate, by 3.9%. Investments in transport and communications decreased by 20.3%.

In the first six months of 2013, manufacturing industries remained the most attractive ones in industry in general with \$58.6bn invested in them (a 220% growth) or 89.3% of aggregate investments in industry (in the first six months of 2012 – \$18.5bn or 61.8%). In the period under review, investments in production of primary products fell by 41.3% to \$6.1bn, while those in iron and steel industry, by 54.6% to \$8.0bn. Investments in production of charred coal and oil products increased by 430% to \$39.7bn, while those in food industry, by 52.7% to \$1.7bn. So, in 2013 the pattern of foreign investments in industry looks as follows (Fig. 4).

In the first six months of 2013, as compared to the first six months of 2012 the share of direct foreign investments in the pattern of investments in industry fell from 14.6% to 6.9%. In the period under review, the shares of other investments and portfolio invest-



Source: Rosstat.

Fig. 4. The pattern of foreign investments in industry in the first six months of 2013

ments in industry were estimated at 92.8% and 0.3%, respectively (in the first six months of 2012 – 81.8% and 3.6%).

In the first six months of 2013, industry accounted for 37.4%, 56.8% and 70.6% of the aggregate direct investments, portfolio investments and other foreign investments, respectively, in the Russian economy (in the first six months of 2012 – 57.6%, 90.5% and 70.6%) (Table 2).

In the first six months of 2013, 11.2% of foreign investments from direct investors were made in the primary sector (17.6% in the first six months of 2012). Manufacturing industry accounted for 25.8% of the aggregate direct foreign investments in the Russian economy (37.4% in the first six months of 2012), while commerce and real estate operations and rendering of services, for 30.6% (11.3% in the first six months of 2012) and 21.6% (17.9% in the first six months of 2012), respectively.

In the first six months of 2013, the priority areas for portfolio investments were production of power, gas

Table 2

THE PATTERN OF FOREIGN INVESTMENTS IN INDUSTRY IN THE FIRST SIX MONTHS OF 2013

	In million \$			% of the first six months of 2012		
	direct	portfolio	other	direct	portfolio	other
Industry	4 535	185.1	60 938	103.6	17.1	248.7
including:						
Production of primary products	1 354	0.1	4 766	101.2	2.0	52.4
Iron and steel industry	192	3	7 818	369.2	0.3	301.2
Chemical industry	278	1	2 237	190.4	100.0	155.0
Food industry	310	1	1404	61.4	100.0	227.6
Production of charred coal and oil products	12		34470	54.5		460.2
Other industry	2 389	180	10 243	103.2	151.3	313.4

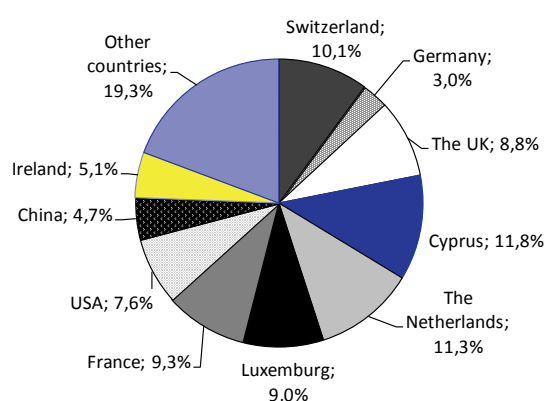
Source: Rosstat

and water in which sector 43.3% of the aggregate volume of portfolio investments in the Russian economy was made (8.7% in the first six months of 2012), while manufacturing industry accounted for 13.5% of portfolio foreign investments (81.4% in the first six months of 2012).

In the first six months of 2013, manufacturing industry accounted for the largest volume of other investments, that is, 64.2% of the aggregate volume of other investments in the Russian economy (22.3% in the first six months of 2012). Commerce and the financial sector accounted for 13.1% (11.9% in the first six months of 2012) and 12.5% (43,2%) of the aggregate volume of other investments, respectively, while production of primary products, for 5.5% (13.8%); transport and communications attracted 1.9% (3,6%) of other foreign investments.

In the geographic pattern of foreign investments attracted in the first six months of 2013, in the list of countries which were major capital exporters to the Russian economy the leader was Cyprus whose investments in the Russian economy rose by 87.9% as compared to the first six months of 2012 and amounted to \$11.6bn or 11.8% of the aggregate volume of foreign investments in the Russian economy; 41.0% of that volume was invested in commerce (*Fig. 5*).

In the first six months of 2013, the Netherlands, the UK and Luxemburg increased its investments by 20.3% to \$11.2bn, 15.4% to \$8.7bn and 370% to \$8.9bn, respectively. On the basis of the results of the first six months of 2013, Germany increased its investments in the Russian economy by 15.8% to \$3.0bn as compared to the respective period of 2012. In the above period, a drop in investments was registered with Switzerland, the leader as regards investments in the Russian Federation in the first six months of 2012 (a drop of 66.7%). On the basis of the results of the first six months of 2013, the first dozen countries – exporters of capital to the Russian



Source: Rosstat.

Fig. 5. The geographic structure of foreign investments in the Russian economy in the first six months of 2013

Federation – included the USA which made \$7.6bn worth of investments in Russia.

In the first six months of 2013, the ten largest investors in the Russian economy accounted for 84.2% of the aggregate volume of the accumulated foreign investments as of July 1 (84.7% in the first six months of 2012), including: 74.3% (78.1% in the first six months of 2012) of the direct accumulated investments and 77.6% (82.2%) and 89.2% (89.4%) of portfolio and other accumulated investments, respectively (*Table 3*).

In the first six months of 2013, investments from Russia abroad grew by 81.8% to \$126.4bn having accounted for 127.9% of the volume of foreign investments in the Russian economy in January–June 2013 (92.9% in the first six months of 2012). The Virgin Islands accounted for the main volume of investments from Russia – \$58.8bn – (46.1% of the aggregate investments from Russia abroad in the first six months of 2013), while Switzerland, Austria, Cyprus and the Netherlands, for 19.1% (\$24.1bn), 7.6% (\$9.6bn), 5.8% (\$7.4bn) and 4.3% (\$5.4bn), respectively.

Table 3

**CHANGES IN THE ACCUMULATED FOREIGN INVESTMENTS BY THE MAIN INVESTOR-COUNTRIES
AS OF JULY 1, 2013**

	% of those as of July 1, 2012				% of those as of July 1, 2013			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
Ireland	83.0	55.4	80.0	84.3	83.4	52.2	400.0	85.0
Germany	85.3	100.8	100.0	76.1	87.0	96.5	100.0	80.8
Japan	175.7	112.3	50.0	177.8	130.4	129.9	200.0	130.4
The UK	79.3	98.6	170.0	64.1	79.5	94.9	141.7	66.5
Cyprus	101.8	81.9	125.0	103.9	97.3	64.8	83.3	101.5
The Netherlands	96.6	70.8	100.0	100.3	93.2	69.1	96.3	96.6
Luxemburg	90.8	82.0	61.3	116.2	84.2	77.4	63.7	102.2
China	119.6	102.2	637.5	131.1	108.2	108.0	239.1	108.1
Other countries	130.7	109.0	172.4	131.3	112.2	92.9	83.9	113.0
Total	116.4	108.2	1500.0	116.7	115.4	94.7	375.0	116.5

Source: Rosstat.

FOREIGN TRADE IN SEPTEMBER 2013

N.Volovik

The WTO has revised downward the forecast of growth in the global trade volume. In January–July 2013, the foreign trade turnover of the Russian Federation decreased due to a drop in export supplies. From October 2, 2013, Rosselkhoznadzor introduced temporary restrictions on supplies to Russia of animal origin products from 10 Brazilian factories.

In September 2013, the World Trade Organization (WTO) revised downward the forecast¹ of growth in the volume of the global trade goods in 2013 and 2014 as compared to forecasts made in April: in 2013 a 2.5% growth is expected as compared to a 3.3% growth of the April forecast. In 2014, global trade growth will speed up to 4.5% (earlier a 5% growth was expected), but is still below the average index in the past 20 years, that is, 5.4%. The WTO changed its forecasts mainly due to the state of the European economy. In the 2nd quarter of 2013, its recovery was expected, however, the dynamics was rather weak. In accordance with the estimate published by Eurostat, in the 2nd quarter of 2013 as compared to the previous quarter GDP grew by 0.3% and 0.4% in the euro zone (EA17) and EC-27, respectively. In the 1st quarter of 2013, growth rates were -0.2% and -0.1%, respectively. In April, Pascal Lamy, the WTO Director-General warned that the risks stemming from the euro area may become a major factor behind a downward revision of global trade growth forecasts.

A certain role in a drop in growth rates of the global trade was played by protectionism which assumes ever new forms. Despite repeated statements of G20 states on importance of free trade, the number of trade re-

strictions increases with every day. Introduction of such restrictions is justified by the need to protect national industry, large enterprises, employment of the population and people's incomes and preserve competitive advantages. In the past six months, 109 protectionist measures (the ones which did not contradict the norms of the WTO) were initiated; the above measures concern 0.4% of the global trade import².

In July 2013, Russia's foreign trade turnover calculated on the basis of methods of the balance of payments increased by 3.4% as compared to July 2012 and amounted to \$73.6bn. Within that period, the volume of the Russian export amounted to \$43.5bn which value exceeded by 5.5% the similar index of the previous year. In July 2013, the volume of import to the Russian Federation amounted to \$30.1bn which is 1.5% more than in July 2012. As a result, in July 2013 the trade balance surplus increased by 15.6% to \$13.3bn as compared to July 2013.

In July 2013, on markets of energy carriers no violent fluctuations of prices were observed because they were under effect of alternate factors. Rumors that the US Federal Reserve would cut the stimulus program from \$85bn to \$65bn a month as early as September

1 http://www.wto.org/english/news_e/pres13_e/pr694_e.htm

2 REPORT ON G-20 TRADE MEASURES (MID-OCTOBER 2012 TO MID-MAY 2013), 17 June 2013.

Table 1

GROWTH RATES OF THE GLOBAL TRADE AND GDP, % OF THE PREVIOUS YEAR

	2009	2010	2011	2012	2013 (forecast)	2014 (forecast)
Total volume of global trade	-12.5	13.8	5.4	2.3	2.5	4.5
Export						
Developed countries	-15.2	13.3	5.1	1.1	1.5	2.8
Developing countries and the CIS	-7.8	15.0	5.9	3.8	3.6	6.3
Import						
Developed countries	-14.3	10.7	3.2	0.0	-0.1	3.2
Developing countries and the CIS	-10.6	18.2	8.1	4.9	5.8	6.2
GDP	-2.4	3.8	2.4	2.0	2.0	2.6
Developed countries	-3.8	2.7	1.5	1.2	1.2	1.9
Developing countries and the CIS	2.1	7.4	5.5	4.7	4.5	4.9

Source: on the basis of the data of the WTO Secretariat.

and bring it to an end completely in the 2nd quarter of 2014 prevented prices from going upward. However, escalation of the civil war in Syria and political crisis in Egypt prompted growth in prices.

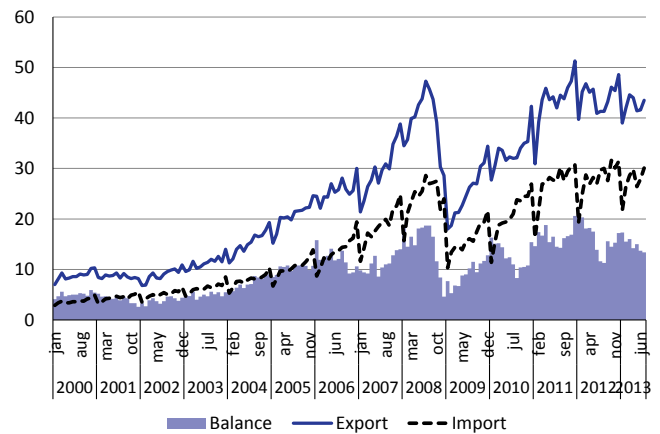
In July 2013, Brent oil prices appreciated by 4.5% and 4.4% as compared to the previous month and July 2012, respectively. The monthly average price amounted to \$107.7 a barrel.

On September 18, 2013, the US Federal Reserve made a decision not to reduce financing of the third program of quantitative easing. The above decision contributed to upward revision of forecasts for investments in primary goods. As a result, the official price of Brent oil on the electronic commodity exchange – the InterContinental Exchange Futures Europe – on the basis of the trade results on September 18, 2013 rose by \$2.41 as compared to the previous day and amounted to \$110.60 a barrel. However, after reports of growth in oil production in Libya the euphoria caused by the US Federal Reserve's decision ended up and on the basis of the trade results on September 19, 2013 oil depreciated by more than 1.6% to \$108.76 a barrel.

In July 2013, Urals oil prices rose by 5.2% as compared to the previous month and amounted to \$108.2 a barrel; as compared to July 2012 the price on oil rose by \$5.55 a barrel. In January–July 2013, the oil price amounted to \$106.8 a barrel, having dropped by 3.5% as compared to the respective period of the previous year.

According to the monitoring of the Ministry of Economic Development of the Russian Federation, from August 15, 2013 till September 14, 2013 the average Urals oil price amounted to \$827.9 a ton. As a result, from October 1, 2013 the export duty on crude oil rose to \$416.4 a ton from \$400.7 a ton in September 2013. From October 1, 2013, the single export duty rate on light and dark oil products, except for petrol, will grow to \$274.8 a ton against \$264.4 a ton a month earlier. It is to be noted that in October the duty on petrol preserved at the level of 90% of the oil duty will amount to \$374.7 a ton (\$360.6 a ton in September 2013).

Throughout the first six months of 2013, price levels of precious metals were rather adversely affected by



Source: The Central Bank of the Russian Federation
Fig. 1. The main indices of the Russian foreign trade, billion USD

repeated intentions voiced by the US Federal Reserve to start wrapping up of the quantitative easing program. As a result, in July 2013 the aluminum price fell to the minimum level from July 2009, while copper depreciated to the July 2010 minimum; nickel went down to the minimum value from May 2009.

According to the data of the London Metal Exchange, in July 2013 as compared to July 2012 prices on aluminum, copper and nickel fell by 5.7%, 9.2% and 15.2%, respectively. As compared to the previous month, the price on aluminum, nickel and copper fell by 2.7%, 4.0% and 1.6%, respectively. As compared to the respective period of the previous year, in January–July 2013 aluminum, copper and nickel were traded 7.4%, 7.1% and 12.7% lower, respectively.

In July 2013, the average value of the FAO food price index amounted to 205.9 points which value is 4 points and 7 points below the revised June index and the July 2012 index, respectively. A decline continues for three months running which situation is mainly justified by lower global prices on grain and soya and palm oil, as well as a drop in prices on sugar, meat and dairy products as compared to the previous month.

According to the data of the Bank of Russia, in January–July 2013 Russia's foreign trade turnover amounted to \$487.0bn which is 0.4% below the re-

Table 2

MONTHLY AVERAGE PRICES IN JULY OF THE RESPECTIVE MONTH

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
(Brent), USD a barrel	28.25	38.2	56.4	72.5	75.09	139.23	65.74	75.6	116.46	103.14	107.7
Natural gas*, USD/1m BTU	4.04	4.28	6.42	8,585	8.13	14.37	6.67	8.04	10.99	11.13	11.6
Copper, USD a ton	1730.3	2813.0	3614.0	7712	7962.7	8415.3	5215.5	6735.3	9650.5	7584.3	6906.6
Aluminum, USD a ton	1434.9	1710.0	1779.0	2513	2730.7	3071.2	1668	1988.3	2525.4	1876.3	1769.6
Nickel, USD a ton	8790.6	15038	14581	26585	33373	20160	15985	19518	23848	16128	13750

* Market of Europe, average contract price, franco-border.

Source: The World Bank.

spective index of the previous year, including export (\$296.0bn) (a 2.8% decrease) and import (\$191.1bn) (a 3.4% growth). The trade balance surplus remained positive – \$104.9bn – but fell by 12.3% as compared to January–July 2012 when it amounted to \$119.6bn.

In January–July 2013, export fell over all the positions of the expanded nomenclature of goods. Export of food products and agricultural primary products decreased dramatically. The export of the above goods was 14.4% lower than in January–July 2012. So, the physical volume of export of wheat and meslin, barley, rice and sunflower seeds fell by 58.9%, 53.4%, 57.7% and 93%, respectively.

The export of fuel and energy commodities fell by 0.9%. It happened due to a decrease in export of oil (5.8%) with growth in sales abroad of oil products (5.7%) and natural gas (2.1%).

Growth in export supplies was observed with the timber and pulp and paper articles group (2.2%) and the machines, equipment and means of transportation group (5.6%). It is to be noted that due to growth in supplies to CIS states the export of light vehicles rose by 42.9%.

In January–July 2013, growth in the volume of purchases from abroad was observed over all the positions of the expanded commodity nomenclature. So, as compared to the respective period of the previous year there was growth in import of textile, textile products and footwear by 9.3%, chemical products (6.9%), metals and metal articles (6%) and food products and agricultural primary products (5.8%). The import of machines, equipment and transportation means increased by the mere 0.3%. It is to be noted that the import of light vehicles and trucks decreased by 17% and 26.6%, respectively.

From October 2, 2013, Rosselkhoznadzor introduces temporary limitations on supplies to Russia of animal origin products from 10 Brazilian meat-processing factories. The decision was taken on the basis of the outputs of inspection which was carried out from June 30, 2013 till July 14, 2013. Russian experts checked 18 meat-processing factories, two of which did not supply products earlier to the territory of the Customs Union. In the course of the inspection, a number of system violations, as well as violations at individual factories were identified which is evidence of insufficient supervision by the Brazilian veterinary service over fulfillment of veterinary and sanitary requirements and norms of the legislation of the Customs Union and the Russian Federation.

Earlier, on July 15, 2012, Rosselkhoznadzor introduced temporary restrictions in respect of six Brazilian factories on supplies of animal products and it was decided to extend the period of those restrictions. Two factories which did not supply earlier products to Russia were denied approval to export produce to the countries of the Customs Union.

It was not the first time when Russia introduced a ban on supplies of meat from Brazil. In 2007, a temporary ban was applied in respect of 14 meat-processing factories due to identification of agents of dangerous diseases, particularly, salmonellosis. From April 30, 2011 a temporary ban on supplies of animal origin products was introduced.

Brazil is a major supplier of meat to Russia. In 2012, Brazil exported to Russia 246,400 tons of frozen cattle meat (41.6% of the total volume of import of that sort of meat to the Russian Federation), 124,400 tons of pork (16.9%) and 70,300 tons of poultry meat (13.3%). ●

NATIONAL BUDGET IN JANUARY–AUGUST 2013

T. Tischenko

Russia's Federal Treasury reports that in the period of January thru August 2013 federal budget revenues and expenditures contracted by 2.2 and 1.7 p.p. of GDP respectively, as compared to the corresponding period in 2012. At the end of eight months of 2013 the federal budget ran a surplus of Rb 391.1bn, or 0.9% of GDP, having declined by 0.5 p.p. of GDP against the value observed in January–August in the previous year. Federal budget oil-and-gas deficit in January–August 2013 contracted by 0.8 p.p. of GDP as compared to the corresponding period of the previous year, and accounted for 8.9% of GDP.

Analysis of federal budget implementation basic parameters in January–August 2013

According to the Ministry of Finance of Russia, federal budget revenues in January–August 2013 amounted to Rb 8417.1bn, having contracted by 2.2 p.p. of GDP against the corresponding period in 2012 (*Table 1*). Over the eight months in 2013 federal budget oil-and-gas revenues declined by 1.3 p.p. of GDP as compared to the corresponding period of the previous year, including mineral extraction tax (by 0.4 p.p. of GDP), export duties on crude oil (by 0.8 p.p. of GDP), import duties on natural gas (by 0.1 p.p. of GDP), export duties on refinery products (by 0.05 p.p. of GDP). In the period of January thru August 2013, the federal budget was implemented 65.4% of annual forecast values in terms of revenues, including oil & gas budget revenues (61.0%).

Budget expenditures during eight months of 2013 contracted by 1.7 p.p. of GDP against the corresponding period of the previous year, and amounted to Rb 8026.0bn (18.8% of GDP). As a result, the federal budget ran a surplus of 0.9% of GDP, having declined by 0.5 p.p. of GDP against the value reported during the corresponding period in 2012. Federal budget

non-oil-and-gas deficit contracted by 0.8 p.p. of GDP in January–August 2013 as compared to the corresponding period of the previous year, and accounted for 8.9% of GDP.

In the period of January thru August 2013, federal budget revenues contracted by 1.1 p.p. of GDP (to 7.4% of GDP) with regard to revenues generated from foreign economic activity, as compared to the corresponding period of the previous year (*Table 2*). At the end of eight months in 2013, federal budget revenues declined as percentage of GDP with regard to mineral extraction tax (by 0.4 p.p. of GDP), internal and external VAT (by 0.5 and 0.3 p.p. of GDP respectively), and profit tax (by 0.1 p.p. of GDP) as compared to the corresponding period of the previous year. In the period of January thru August 2013, budget revenues increased with regard to internal excises (by 0.1 p.p. of GDP) against the corresponding period of eight months in 2012. At the end of January–August 2013 federal budget revenues from import excises remained at the level of the corresponding period in 2012 and accounted for 0.09% of GDP.

Table 1

RUSSIA'S FEDERAL BUDGET BASIC PARAMETERS IN JANUARY–AUGUST 2012–2013

	January–August 2013		January–August 2012		Deviations, p.p. of GDP
	billions of rubles	% of GDP	billions of rubles	% of GDP	
Revenues, including:	8417.1	19.7	8353.8	21.9	-2.2
Oil and gas revenues	4180.6	9.8	4224.9	11.1	-1.3
Expenditures, including:	8026.0	18.8	7822.7	20.5	-1.7
interest expense	246.7	0.6	221.5	0.6	0.0
non-interest expense	7779.3	18.2	7601.2	19.9	-1.7
Federal budget surplus (deficit)	391.1	0.9	531.1	1.4	-0.5
Non-oil-and-gas deficit	-3789.5	-8.9	-3693.8	-9.7	0.8
GDP evaluation	42676		38057		

Source: Ministry of Finance of Russia, Federal Treasury of the Russian Federation, Gaidar Institute's estimates.

Table 2

FEDERAL BUDGET BASIC TAX REVENUES IN THE PERIOD OF JANUARY THRU AUGUST, 2012–2013

	January–August 2013		January–August 2012		Deviation as p.p. of GDP
	billions of rubles	% of GDP	billions of rubles	% of GDP	
1. Tax revenues, including:					
corporate profit tax	241.4	0.6	271.4	0.7	-0.1
VAT on goods sold on the territory of the Russian Federation	1170.9	2.7	1221.7	3.2	-0.5
VAT on goods imported to the Russian Federation	1065.9	2.5	1071.5	2.8	-0.3
excises on goods manufactured on the territory of the Russian Federation	290.6	0.7	218.7	0.6	0.1
excises on goods imported to the Russian Federation	37.0	0.09	33.6	0.09	0.0
Mineral extraction tax	1640.3	3.8	1599.0	4.2	-0.4
2. Revenues from foreign trade	3158.5	7.4	3248.3	8.5	-1.1

Source: Federal Treasury of the Russian Federation, Gaidar Institute's estimates.

The federal budget expenditure items saw multi-directional dynamics (Table 3). At the end of eight months budget expenditures (as percentage of GDP) increased for such items as 'National Defense', 'National Security and Law Enforcement' and 'Public Utilities Sector' (by 0.1 p.p. of GDP each), 'Physical Culture and Sports' (by 0.02 p.p. of GDP) as compared to the corresponding period in 2012, whereas some of the federal budget expenditure items as percentage of GDP contracted in January–August 2013, namely 'National Economy' (by 0.1 p.p. of GDP, 'Healthcare' (by 0.2 p.p. of GDP, 'Social Policy' (by 1.2 p.p. of GDP, 'Inter-budget Transfers' (by 0.1 p.p. of GDP against the corresponding period of the previous year. The rest of

federal budget expenditure items saw the same values (as percentage of GDP) in January–August 2013 as in the corresponding period in 2012.

As of the end of August 2013, a total amount of resources in the Federal Reserve Fund and the National Wealth Fund amounted to Rb 2838.6 and Rb 2884.8bn respectively in rubles equivalent.

Drafting of the draft federal budget for 2014–2016 acquired the status of most heavily discussed themes in the field of public finance in September 2013. At Russia's Government meeting held in the mid-September D. Medvedev stated that federal budget expenditures for 2014–2016 should be cut off by at least 5%, save for protected expenditure items¹. Most likely, it refers

Table 3

FEDERAL BUDGET EXPENDITURES IN JANUARY–AUGUST, 2012 AND 2013

	January–August 2013		January–August 2012		Deviation as p.p. of GDP
	billions of rubles	% of GDP	billions of rubles	% of GDP	
Total expenditures,	8026.0	18.8	7822.7	20.5	-1.7
including:	502.4	1.2	475.3	1.2	0.0
Nationwide Issues	1356.7	3.2	1186.2	3.1	0.1
National Defense	1171.8	2.7	995.2	2.6	0.1
National Security and Law Enforcement	928.2	2.2	975.0	2.6	-0.4
National Economy	72.8	0.2	53.5	0.1	0.1
Public Utilities Sector	16.5	0.04	14.1	0.04	0.0
Environmental Protection	463.5	1.1	410.5	1.1	0.0
Education	47.8	0.1	50.5	0.1	0.0
Culture and Cinematography	282.1	0.7	356.2	0.9	-0.2
Healthcare	2445.9	5.7	2620.5	6.9	-1.2
Social Policy	37.7	0.09	28.2	0.07	0.02
Physical Culture and Sports	50.4	0.1	47.4	0.1	0.0
Mass Media	246.7	0.6	221.5	0.6	0.0
Sovereign and Municipal Debt Servicing	402.9	0.9	388.4	1.0	-0.1

Source: Federal Treasury of the Russian Federation, Gaidar Institute's estimates
¹ <http://government.ru/meetings/date/2013-09-12/>

**BASIC PARAMETERS OF CONSOLIDATED BUDGET OF CONSTITUENT TERRITORIES OF THE RUSSIAN FEDERATION
IN JANUARY–JULY, 2012–2013**

	January–July 2013		January–July 2012		Deviation as p.p. of GDP
	billions of rubles	% of GDP	billions of rubles	% of GDP	
Total revenues, including:	4561.8	12.3	4678.0	14.2	-1.9
– corporate profit tax	1014.9	2.7	1275.1	3.9	-1.2
– personal income tax	1361.8	3.7	1231.5	3.7	0.0
– domestic excises	279.3	0.7	253.9	0.8	-0.1
– aggregate income tax	212.0	0.6	193.4	0.6	0.0
– property tax	559.6	1.5	482.3	1.5	0.0
– non-repayable revenues from other budgets of the budgetary system of Russia	778.8	2.1	895.5	2.7	-0.6
Expenditures	4403.1	11.9	4175.9	12.7	-0.8
Consolidated budget surplus (deficit) of constituent territories	158.7	0.4	502.1	1.5	-1.1
GDP evaluation	37079		32917		

Source: Federal Treasury of the Russian Federation, Gaidar Institute's estimates.

to the changes to the federal budget parameters which were submitted by the Ministry of Finance of Russia in July 2013 as part of the Guidelines of the Budgetary Policy for 2014–2016. Up to Rb 1.8 trillion will be re-allocated to senior expenses within a 3-year budget¹. A. Siluanov said that the draft budget for 2014–2016 covers financing of a series of structural reforms, including the transition to program-based budgeting, pension reform, reforms in healthcare, education, financial sector, as well as infrastructure development.

We will know soon, when Russia's Government submits a respective draft law to the State Duma for consideration, whether the parameters of the draft federal budget for 2014–2016 differ largely or not from the parameters budgeted in the Guidelines of the Budgetary Policy.

Consolidated budget implementation in the constituent territories of the Russian Federation in January–July 2013

According to the Federal Treasury, in January–July 2013 consolidated budget revenues in the constituent territories of the Russian Federation amounted to Rb 4561.8bn, or 12.3% of GDP, having contracted by 1.9 p.p. of GDP against the corresponding period in 2012 (Table 4).

Within seven months in 2013 consolidated budget expenditures of the constituent territories of the Russian Federation contracted by 0.8 p.p. of GDP and accounted for 11.9% of GDP, or Rb 4403.1bn, against the corresponding period of the previous year. At the end of January–July 2013, the constitu-

ent territories of the Russian Federation ran their budget with a surplus of a total of Rb 158.7bn, or 0.4% of GDP, having shown a decline of 1.1 p.p. of GDP against the values recorded during the corresponding period of the previous year.

Consolidated budget revenues of the constituent territories of the Russian Federation saw contraction during the seven months in 2013 as compared to the corresponding period in 2012, namely profit tax (by 1.2 p.p. of GDP), internal excises (by 0.1 p.p. of GDP) and non-repayable transfers from other budgets within the budget system of Russia (by 0.6 p.p. of GDP). The rest of the consolidated budget tax and non-tax revenues of the constituent territories of the Russian Federation as percentage of GDP in January–July 2013 remained at the level recorded during the corresponding period of the previous year.

At the end of the seventh month consolidated budget expenditures of the constituent territories of the Russian Federation (Table 5) contracted against the corresponding period in 2012 on the following expenditure items: 'National Economy' (by 0.1 p.p. of GDP), 'Public Utilities Sector' (by 0.2 p.p. of GDP), 'Healthcare' (by 0.3 p.p. of GDP), 'Social Policy' (by 0.2 p.p. of GDP), 'Inter-budget Transfers' (by 0.02 p.p. of GDP).

In the period of January thru July 2013, such expenditure items as 'Education' and 'Sovereign and Municipal Debt Servicing' saw an increase of 0.1 p.p. and 0.03 p.p. of GDP against the corresponding period of the previous year. The rest of the budget expenditure items of the constituent territories of the Russian Federation at the end of the seventh month of 2013

¹ <http://www1.minfin.ru/ru/press/speech/index.php?id4=20046>

**CONSOLIDATED BUDGET EXPENDITURES OF THE CONSTITUENT TERRITORIES OF THE RUSSIAN FEDERATION
IN JANUARY–JULY, 2012–2013**

	January–July 2013		January–July 2012		Deviation as p.p. of GDP
	billions of rubles	% of GDP	billions of rubles	% of GDP	
Total expenditures, including	4403.1	11.9	4175.9	12.7	-0.8
Nationwide Issues	285.3	0.8	265.8	0.8	0.0
National Defense	2.0	0.005	1.9	0.005	0.0
National Security and Law Enforcement	45.3	0.1	42.9	0.1	0.0
National Economy	727.7	2.0	681.2	2.1	-0.1
Public Utilities Sector	363.5	1.0	388.2	1.2	-0.2
Environmental Protection	11.1	0.03	9.2	0.03	0.0
Education	1290.9	3.5	1135.9	3.4	0.1
Culture and Cinematography	150.9	0.4	136.4	0.4	0.0
Healthcare	675.5	1.8	690.4	2.1	-0.3
Social Policy	703.2	1.9	689.3	2.1	-0.2
Physical Culture and Sports	79.4	0.2	69.6	0.2	0.0
Mass Media	21.7	0.06	19.2	0.06	0.0
Sovereign and Municipal Debt Servicing	42.9	0.1	36.1	0.1	0.0
Inter-budget Transfers	3.6	0.01	9.8	0.03	-0.02

Source: Federal Treasury of the Russian Federation, Gaidar Institute's estimates.

remained at the level (as percentage of GDP) recorded during the corresponding period in 2012.

In spite of that the consolidated budget of the constituent territories of the Russian Federation has a positive balance, regional budget will face issues in the next year. According to Ministry of Finance's estimates¹, the constituent territories of the Russian Federation will be able to draw up a regional consoli-

dated budget with a surplus of more than Rb 220bn in 2014. There is a plan to allocate more than Rb 120bn to provide extra financial support to the constituent territories of the Russian Federation in the next year. However, since such a support will be insufficient, the Ministry of Finance urges to consider replenishing the revenue side of regional budgets.

Certain adjustment towards budget consolidation is therefore inevitable, which suggests that first decisions on this issue will be taken in the near term. ●

1 <http://www1.minfin.ru/ru/press/speech/index.php?id4=20046>

THE RUSSIAN BANKING SECTOR IN AUGUST 2013

M.Khromov

In August 2013, Russia's banking sector witnessed a continuation of the trends observed over the several previous months. As in July, a considerable proportion of growth in total banking liabilities was accounted for by the Bank of Russia and the RF Ministry of Finance. The role of retail loans in financing current household consumption expenditure continued to grow. At the same time, the banking sector's capital adequacy and return on equity were declining.

In August, the growth rate of banks' assets became even lower than in July, amounting to only 0.8%¹. Over the past 12 months, the size of the banking sector's assets increased by 17.5%. In August, the monetary authorities carried on their lending activity, thus further boosting the growth of bank assets. When taken without the increased liabilities to the Bank of Russia and the RF Ministry of Finance, bank asset growth over that month amounts to only 0.3%; meanwhile, the 12-month growth of bank assets less the share of government support as seen by the month-end results amounts to 15.9%, which represents its record low since late 2010.

Over the course of August, the regulatory capital of the banking sector² increased by 1.3%, while the risk adjusted value of assets grew at a faster rate, and so increased by 2.5%. As a result, capital adequacy norm (N1) dwindled by another 0.2 p.p. to 13.2%.

In August 2013, the banking sector's profit amounted to Rb 82bn. This roughly corresponds to its mean value for the period since the year's beginning. The aggregate profit received by banks over the first 8 months of 2013 amounts to Rb 654bn, which is by Rb 24bn less than the same index for the first 8 months of 2012. Accordingly, return on bank assets in 2013 dropped on the previous year. Over the first 8 months of 2013, return on assets amounted to 1.9% per annum, which is by 0.5 pp. below the same index for 2012. Return on equity for banks over the same period of 2013 is by 3.6 pp. less than the same index for 2012 (16.9% against 20.5% per annum).

Attracted Funds

In August 2013, the bank accounts and deposits of the population increased by Rb 126bn (growth by

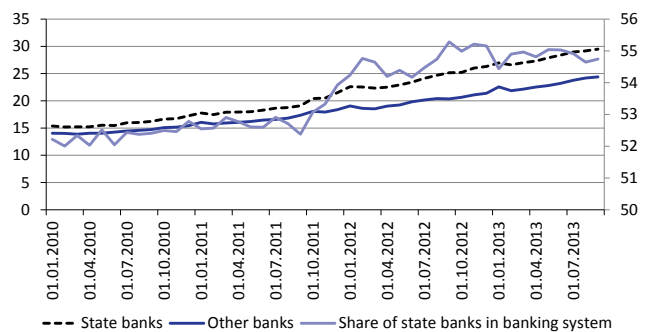


Fig. 1. The Movement of Bank Assets (State Banks vs Other Banks, Trillion Rb) and State Banks' Share in Aggregate Assets (% , Right-hand Scale)

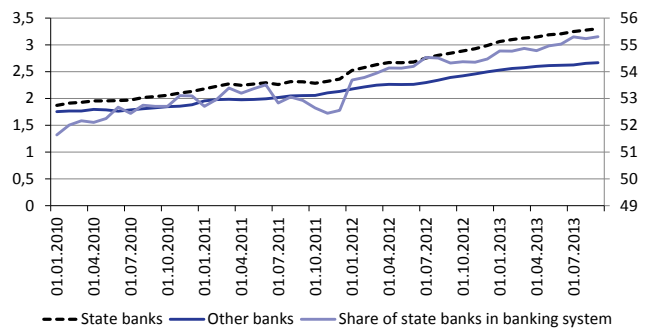


Fig. 2. The Movement of Equity³ of State and Other Banks (Trillion Rb), and State Banks' Share in Equity (% , Right-hand Scale)

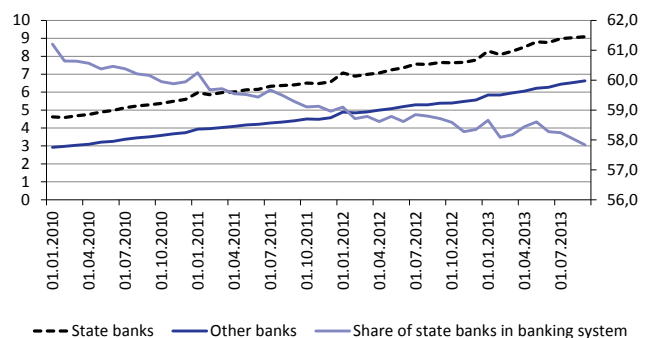


Fig. 3. The Movement of Individual Deposits with State and Other Banks (Trillion Rb), and State Banks' Share in the Market for Physical Persons' Deposits (% , Right-hand Scale)

1 Hereinafter, if not otherwise specified, the growth rates of balance-sheet indices are adjusted by changes in the value of their components denominated in foreign currencies.

2 Calculated in accordance with Credit Institutions Financial Reporting Form No 134.

3 Calculated on the basis of balance-sheet accounts (Form No 101).

0.8%). The per annum rate of growth of the population's monies on bank accounts increased stays at a level of approximately 20%.

The household saving norm for bank deposits over the first 8 months of 2013 amounts to 5.6% of disposable income (since the year's beginning, a total of Rb 1,346bn was placed in bank accounts). One year earlier, the saving norm amounted to 4.8% of disposable income, while the inflow of the population's monies into banks was 30% less than now (Rb 1,034bn over the same period of 2012).

The outflow of corporate clients' monies from their bank accounts continued as before. The monies kept in their current and settlement accounts kept on shrinking for a second month in a row, their volume declining in August by Rb 142bn (-1.2%). The same index for fixed date deposits, on the contrary, rose by Rb 128bn (+1.1%), but this was no compensation for the cash outflow from current accounts. The share of fixed date deposits in the aggregate funds of corporate clients increased to 55.3%, thus nearly hitting its record high achieved in May 2013 (55.5%).

Over August, the banking sector's debt to the Bank of Russia increased by Rb 237bn. This growth occurred in the main due to the increased volume of one-week direct repo operations. Over the course of that month, the liabilities against deposits with the RF Ministry of Finance also climbed – by Rb 45bn. The total amount of funds placed with banks by the Bank of Russia and the RF Ministry of Finance as of 1 September 2013 exceeded the level of Rb 3.5 trillion. Thus, the total amount of government support received by the banking sector nearly reached its crisis level of early 2009 (Rb 3.65 trillion). As a percentage of the banking sector's aggregate assets, it amounts to approximately one-half of the sum of government support received

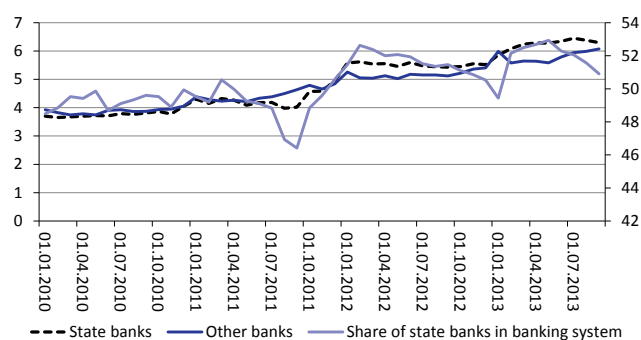


Fig. 4. The Movement of Corporate Clients' Deposits with State and Other Banks (Trillion Rb), and State Banks' Share in the Market for Corporate Clients' Accounts (% , Right-hand Scale)

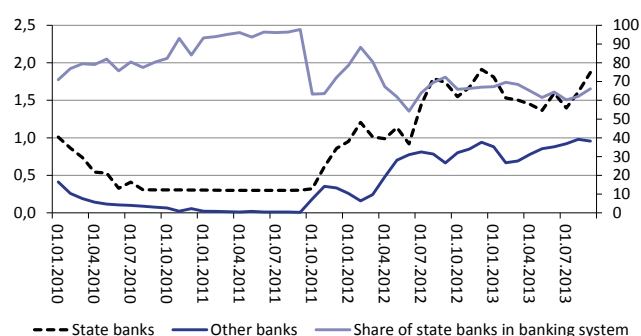


Fig. 5. The Movement of the Bank of Russia's Loans to State and Other Banks (Trillion Rb), and State Banks' Share in the Loans Issued by the Bank of Russia (% , Right-hand Scale)

at the time of crisis (6.5% against 12.3%), but its current level actually represents a record high since the year's beginning.

Invested Monies

Over the course of August 2013, the amount of outstanding debt of physical persons against bank loans

Table 1

THE STRUCTURE OF RUSSIA'S BANKING SYSTEM'S LIABILITIES (AS OF MONTH'S END), AS % OF TOTAL

	12.08	12.09	12.10	12.11	06.12	12.12	03.13	04.13	05.13	06.13	07.13	08.13
Liabilities, bn Rb	28,022	29,430	33,805	41,628	44,266	49,510	49,839	50,693	51,587	52,744	53,353	53,876
Equity	14.1	19.3	18.7	16.9	16.8	16.2	16.7	16.6	16.5	16.3	16.3	16.3
Credits allotted by Bank of Russia	12.0	4.8	1.0	2.9	5.1	5.4	4.5	4.4	4.8	4.4	4.9	5.3
Interbank operations	4.4	4.8	5.5	5.7	4.8	5.6	5.4	5.0	4.9	5.2	5.1	5.1
Foreign liabilities	16.4	12.1	11.8	11.1	11.3	10.8	10.4	10.8	10.7	10.8	10.6	10.4
Physical persons' monies	21.5	25.9	29.6	29.1	29.4	28.9	29.6	30.0	29.5	29.6	29.6	29.6
Enterprises and organizations' monies	23.6	25.9	25.7	26.0	24.0	24	23.9	23.4	23.5	23.5	23.2	23.0
Accounts and deposits of state administrative bodies and local governments	1.0	1.0	1.5	2.3	1.5	1.6	1.4	1.9	2.0	2.4	2.6	2.7
Securities issued	4.1	4.1	4.0	3.7	4.5	4.9	5.2	5.2	5.1	5.1	4.9	4.9

Source: RF Central Bank; the IEP's estimates.

issued to them increased by 2.4%, or by Rb 234bn. Its per annum growth rate, as shown by the month-end results, declined to 31.7%.

The quality of the retail credit portfolio in August changed only slightly. The growth rate of the number of credits with repayment in arrears over that month remained at the level of 4.4%¹, although it is higher than the lending volume growth rate on the whole (3.7%). The ratio of reserves against potential losses to payables increased in August by 0.1 pp. to 7.0%, while the amount of reserves itself increased over the same month by 4.1%.

In spite of the ongoing decline in the growth rate of the population's payables owed to banks, the share of bank loans in household final consumption expenditure is still on the rise. Thus, according to preliminary estimates, newly issued bank loans in August amounted to 30% of household expenditures on goods, public catering and commercial services. When applied to the entire period since the year's beginning, this index amounts to 28%. A year earlier, these two indices amounted to 27% and 25% respectively.

The interest rates on bank loans issued to physical persons remain high. Thus, in July 2013, the average weighted interest rates on ruble-denominated retail loans varied between 16% and 27% per annum. Besides, over the period of July-August 2013, banks issued loans at interest rates above 25% per annum in the total amount of at least Rb 320bn; of these, more than Rb 35bn was loaned at rates above 60% per annum.

The volume of corporate debt against bank loans issued over August amounts to 1.4% (Rb 278bn). The per annum growth rate of corporate payables as of 1 September 2013 was 13.2% – a figure close to that index's record low of the past 2.5 years (13.1% as of 1 July 2013).

The formal indicators of credit portfolio quality in the market's corporate segment continue to improve:

¹ Which resulted from the fact that the share of repayment in arrears was rounded off to the nearest 1/10th of a percent.

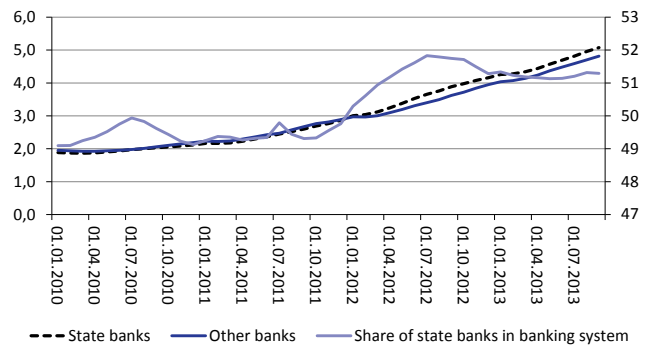


Fig. 6. The Movement of Retail Loans Issued by State and Other Banks (Trillion Rb), and State Banks' Share in Retail Lending (%), Right-hand Scale)

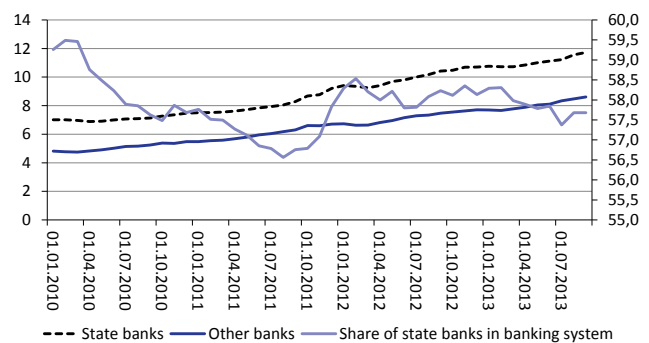


Fig. 7. The Movement of Loans Issued to Enterprises and Organizations by State and Other Banks (Trillion Rb), and State Banks' Share in the Market for Loans to Enterprises and Organizations (%), Right-hand Scale)

in August, reserves against potential losses were increasing at a slower rate than payables, while the amount of outstanding debt over that month even declined by Rb 10bn. As a result, the share of outstanding debt shrank by 0.1 pp. to 4.3%, while the ratio of reserves to the size of credit portfolio – also by 0.1 pp. to 7.1%.

Table 2

STRUCTURE OF RUSSIA'S BANKING SYSTEM'S ASSETS (AS OF MONTH'S END), AS % OF TOTAL

	12.08	12.09	12.10	12.11	06.12	12.12	03.13	04.13	05.13	06.13	07.13	08.13
Assets, bn Rb	28,022	29,430	33,805	41,628	44,266	49,510	49,839	50,693	51,587	52,744	53,353	53,876
Cash and precious metals	3.0	2.7	2.7	2.9	2.5	3.1	2.5	2.7	2.4	2.4	2.3	2.3
Monies placed with Bank of Russia	7.5	6.9	7.1	4.2	3.0	4.4	3.3	3.0	3.1	3.3	3.0	2.9
Interbank operations	5.2	5.4	6.5	6.4	5.8	6.8	6.4	6.1	6.0	6.0	5.9	5.8
Foreign assets	13.8	14.1	13.4	14.3	14.2	13.0	14.5	15.0	15.6	15.1	15.0	14.5
Population	15.5	13.1	13.0	14.4	16.0	16.8	17.4	17.7	17.8	17.9	18.1	18.4
Corporate sector	44.5	44.5	43.6	44.0	43.6	41.3	41.9	41.5	40.9	40.9	41.0	41.1
State	2.0	4.2	5.1	5.0	3.8	3.2	3.2	2.9	2.8	3.2	3.4	3.0
Property	1.9	2.7	2.6	2.3	2.3	2.2	2.2	2.2	2.2	2.2	2.1	2.1

Source: RF Central Bank; the IEP's estimates.

THE REAL ESTATE MARKET IN THE RUSSIAN FEDERATION IN H1 2013

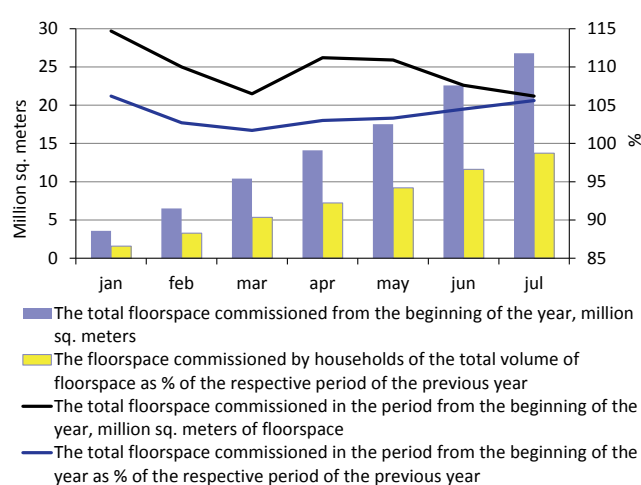
G.Zadonsky

In the first six months of 2013, 278,200 apartments with the total floorspace of 22.6m sq. meters were built. The average actual cost of building of 1 sq. meter rose by 11.8% in the first six months of 2013 as compared to the same period of 2012 and amounted to Rb 35,628, while the ratio between the price of 1 sq. meter of housing on the primary market and the cost of building of 1 sq. meter decreased within the same period by 7.0 p.p. and amounted to 138.5%. In the first six months of 2013, the volume of registration of individuals' titles to land plots increased by 5.9% as compared to the first six months of 2012. In January-July 2013, 410,880 mortgage housing loans (MHL) worth Rb 663.6bn were extended which figure exceeds by 28.1% the monetary volume of MHL extended in January-July 2012. In July 2013, the average weighted monthly rate on MHL in rubles fell to 12.5%.

According to the Rosstat's data, in the first six months of 2013, entities of all the forms of ownership built 278.200 apartments with total floorspace of 22.6m sq. meters which is equal to 107.6% on the respective period of the previous year. Individual developers built 11.6 m sq. meters of housing or 51.5% of the total volume of housing commissioned in the first six months of 2013. In July 2013, entities of all the forms of ownership built 52,200 new apartments with the total floorspace of 4.2m sq. meters which is 0.42% lower as regards the volume of floorspace than in July 2012, while in January–July they built 330,400 apartments with the total floorspace of 26.8m sq. meters which is 6.2% higher as regards the volume of floorspace than in the respective period of 2012 (Fig. 1). According to the data of Rosstat, in August 2013 65,700 new apartments with the total floorspace of 5.1m sq. meters were built, while from the beginning of the year – 396,100 apartments with the total floorspace of 31.9m sq. meters which figure is 8.1% higher as regards the volume of floorspace than in the respective period of 2012.

In the first six months of 2013, the largest volume of housing per 1,000 persons – over 300 sq meters – was commissioned in the Belgorod Region, the Moscow Region, the Krasnodar Territory, the Leningrad Region and the Republic of Tatarstan (Table 1). In the Belgorod Region – the leader of housing development – 80.9% of housing was commissioned by individual developers. As in the first six months of 2012, among federal districts the highest result (216.1 sq. meters per 1,000 persons) was registered with the Southern Federal District, while the lowest one – 74.8 sq. meters per 1,000 persons of the population – with the Far Eastern Federal District (Table 1). As regards that index, Moscow was rated the 61st.

In the first six months of 2013, all the housing – 100% – was commissioned by individual developers



Source: on the basis of the data of Rosstat.

Fig. 1. The dynamics of commissioning of housing in 2013

in the Jewish Autonomous Region, (the 45th place) – 125.1 sq. meters per 1,000 persons, in the Republic of Ingushetia (the 83rd place) – 56.7 sq. meters and in the Chechen Republic (the 89th place) – 30.2 sq. meters.

According to the data of Rosstat, in the 2nd quarter of 2013 the average actual cost of building of 1 sq. meter of floorspace of detached houses (apartment houses without additions, overstory and built-in premises and without dwelling houses built by individual developers) increased by 3.7% as compared to the 1st quarter of 2013 and amounted to Rb 36,216, while in the 1st half-year of 2013 it rose by 11.8% as compared to the 1st quarter of 2012 and amounted to Rb 35,628 (Fig. 2). According to the data of Rosstat, in the first six months of 2013 the highest cost of development which exceeded by 50% or more the average national level was observed in the Nenetsk Autonomous Region (Rb 52,333), the Sakhalin Region (Rb 54,070), the Yamalo-Nenets Autonomous Region (Rb 54,627), the Magadan Region (Rb 54,869), the Khabarov Ter-

Table 1

**DISTRIBUTION OF REGIONS OF THE RUSSIAN FEDERATION BY THE VOLUME OF HOUSING COMMISSIONED IN
JANUARY–JUNE 2013 PER 1,000 PERSONS OF THE POPULATION**

Region	The place of the region in the 1st half-year				Total floorspace com- missioned in H1 2013		Floorspace commissioned by individual developers	
	2013	2012	2011	2010	as % of H1 2012	Sq. Me- ters per 1,000 persons	% of the total floorspace commissioned	Place of the region
Belgorod Region	1	3	5	8	119.1	357.76	80.9	15
Moscow Region*	2	5	4	1	125.5	321.52	33.2	78
Krasnodar Territory	3	1	1	2	92.4	318.38	55.8	46
Leningrad Region	4	7	7	3	136.3	317.85	23.7	85
The Republic of Tatarstan	5	4	2	5	109.5	313.92	61.4	40
Tyumen Region	6	2	3	4	96.8	288.12	28.3	81
Lipetsk Region	7	8	8	15	107.1	249.35	66.8	29
The Republic of Bashkortostan	8	13	12	17	118.1	248.64	82.8	11
The Republic of Karachaevo-Cherkessia	9	64	75	78	266.1	245.42	93.9	5
The Republic of Altai	10	6	20	11	97.6	238.66	62.2	37
Kaliningrad Region	11	10	6	6	100.7	227.49	34.7	74
Southern Federal District	12	11	9	10	98	216.11	63.5	34
The Republic of Mariy-El	13	14	11	16	103.5	214.82	64.8	33
Ulyanovsk Region	14	15	25	39	101.3	205.65	66.7	31
Tambov region	15	16	17	19	102.9	204.23	91.0	6
Kursk Region	16	41	46	53	167.1	203.71	39.2	67
St. Petersburg	19	53	14	12	175	188.44	4.0	91
Privolzhsky Federal District	25	26	21	26	104.6	167.61	67.6	28
Central Federal District	28	37	34	22	118.5	164.17	43.0	63
The Russian Federation	29	33	30	25	107.6	157.60	51.5	51
Urals Federal District	30	22	27	28	92.9	156.80	39.0	68
North-Western Federal District	31	44	38	23	131.8	155.78	21.8	87
North-Caucasian Federal District	41	35	49	33	92,3	130,02	62,9	35
Siberian Federal District	48	48	41	44	107,6	123,17	54,6	48
Moscow*	61	85	68	70	143,4	99,09	8,7	90
Far Eastern Federal District	76	71	74	77	87,6	74,80	46,7	60

* The data on the city of federal importance Moscow and the Moscow Region is provided with taking into account changes in their borders from July 1, 2012.

Source: on the basis of the data of Rosstat.

ritory (Rb 57,396) and Chukot Autonomous Area (Rb 80,000). In 51 constituent entities of the Russian Federation, that cost was below the average national level with the lowest one registered in the Republic of Tyva (Rb 11,331), Dagestan (Rb 17,457) and the Kursk Region (Rb 21,851).

In the 2nd quarter of 2013, the average price of 1 sq. meter of housing (Rb 49,331) increased by 1.1% against the 1st quarter of 2013 (Fig. 2) having exceeded by 6.4% the average price of 1 sq. meter of housing in the 2nd quarter of 2012. In the 2nd quarter of 2013, the average price of 1 sq. meter of housing on the pri-

mary housing market amounted to 88.1% of the average price of 1 sq. meter of housing on the secondary market; the above value is 1.2 p.p. higher than in the 2nd quarter of 2012. In the 2nd quarter of 2013, the ratio between the price of 1 sq. meter of housing on the primary market and the cost of building of 1 sq. meter of housing amounted to 138.5% against 139.7% in the 1st quarter of 2013 (Fig. 2).

According to the data of Rosreestr provided to the OAO Agency for Housing Mortgage Lending (OAO AHML) (Fig. 3), in the 2nd quarter of 2013 the share of mortgaged real estate property in the total number of

the real estate units registered in housing transactions increased by 2.9 p.p. on the 2nd quarter of 2012 and amounted to 24.3%.

According to the data of Rosreestr, in the first six months of 2013 the volume of registration of individuals' titles to land plots (2,749,875 certificates) increased by 5.9% as compared to the first six months of 2012. On the contrary, the number of legal entities' registered titles to land plots fell by 7.1% and amounted to 126,281 certificates in the first six months of 2012. In the first six months of 2013, individuals' leasehold of land plots (38,457 certificates) decreased by 1.84% as compared to the first six months of 2012, while leasehold by legal entities increased by 130%.

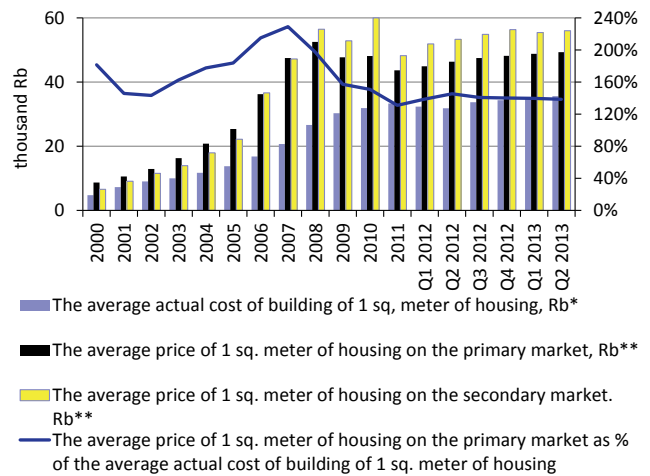
As compared to the first six months of 2012, in the first six months of 2013 the number of registered mortgaged land plots rose by 19.7% (227,784 certificates) and 11.9% (70,301 registered certificates) for individuals and legal entities, respectively.

According to the data of Rosreestr, the volume of registration in accordance with a simplified procedure (the summer cottage amnesty) of individuals' titles to land plots which were granted before the Land Code of the Russian Federation came into effect for personal husbandry, gardening, summer cottage building and individual garage or housing development keeps decreasing (Fig. 4) and amounted to 202,464 certificates in the first six months of 2013 which is 17.8% lower than in the first six months of 2012.

According to the data of the Central Bank of the Russian Federation, in January–July 2013 Rb 438.1bn worth of 438,099 housing loans were extended, including Rb 663.6bn worth of 410880 mortgage housing loans (MHL) which exceeds by 28.1% the monetary volume of MHL extended in January–July 2012. In July 2013, Rb 121.1bn worth of ruble MHL was extended which is 38.1% more than in July 2012 (Fig. 5) and Rb 8,496m worth of MHL in foreign currency which is 17.2% more than in July 2012.

In the period from April till July 2013, growth in the outstanding debt on MHL in rubles continued and as of August 1, 2013 the debt amounted to Rb 2,221.1bn which is 40.5% more than that as of August 1, 2012 (Fig. 5). As regards loans in foreign currency, as of August 1, 2012 the debt on MHL amounted to Rb 120.2bn which is 17.7% more than that as of August 1, 2012.

As of August 1, 2013, the overdue debt on MHL in rubles amounted to Rb 27.3bn (Fig. 5); it is to be noted that its share in the outstanding debt keeps falling and as of August 1, 2013 amounted to 1.2% which is 0.4 p.p. lower than that as of August 1, 2012. As of August 1, 2012, the overdue debt on MHL in foreign currency amounted to Rb 15.0bn or 12.5% of the out-

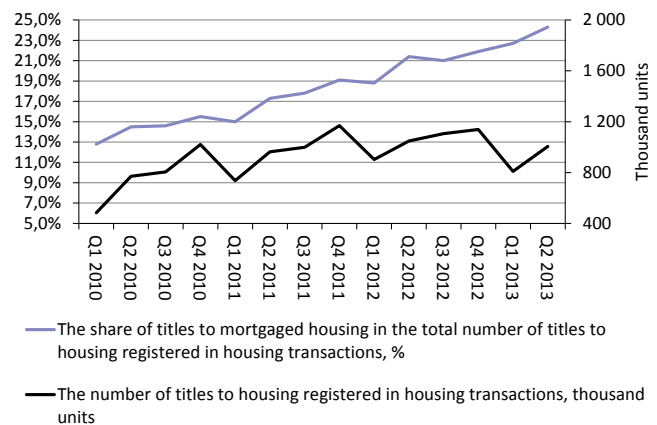


* The average actual cost of building of 1 sq. meter of floor-space in detached dwelling houses (all the apartments) without additions, overstorey and built-in premises in the Russian Federation (without those built by households at their own account and by means of borrowed funds);

** all the apartments.

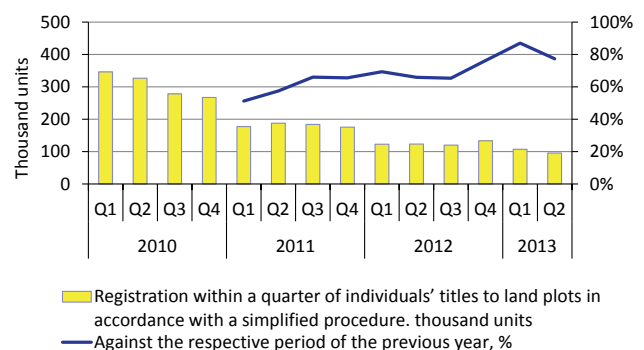
Source: on the basis of the data of Rosstat.

Fig. 2. The dynamics of building of 1 sq. meter of housing and prices of 1 sq. meter of housing on the primary and secondary markets in the Russian Federation



Source: OAO AHML on the basis of the data of Rosreestr.

Fig. 3. Dynamics of the number of real estate units registered in housing transactions and the shares of mortgaged real-estate units in the total number of real-estate units registered in housing transactions



Source: on the basis of the data of Rosreestr.

Fig. 4. Dynamics of registration of individuals' titles to land plots in accordance with a simplified procedure

standing debt which is 1.6 p.p. lower as compared to that as of August 1, 2012.

The average value of MHL in rubles in July 2013 increased by 6.9% as compared to July 2012 and amounted to Rb 1.6m (Fig. 6). The average value of MHL in foreign currency in July 2013 (Rb 8.3m) exceeded more than five times over the respective value of MHL in rubles.

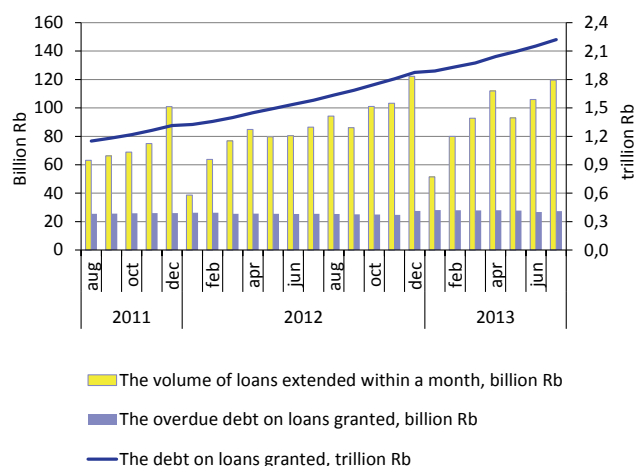
In 2013, the role of foreign currency in mortgage housing lending keeps going down. As of August 1, 2013 the share of MHL in foreign currency as regards the number of loans amounted to 0.3%, while that as regards the volume and the outstanding debt, to 1.4% against 1.5% as of August 1, 2012 and 5.1% against 8.3%, respectively. Though the share of the overdue debt on loans in foreign currency as a percentage of the total overdue debt has been decreasing, the value of the share remains quite a significant one and exceeds 35% as of August 1, 2013.

In 2012 and within the first six months of 2013, the volume of MHL extended from the beginning of the year in shares of GDP in current prices was growing steadily (Fig. 7). However, in the first six months of 2013 the volume of MHL in shares of GDP (1.7%) was still 0.03 p.p. lower than the maximum value in the first six months of 2008. At the same time, the debt in shares of GDP on MHL extended in 2012 (3.2%) exceeded by 0.6 p.p. the respective maximum value of the year 2009.

According to the data of the Central Bank of the Russian Federation, as of August 1, 2013 the debt on defaulted MHL (with a delay period of over 180 days) was 2.9% more than in the previous month (Rb 26.9bn), while as a percentage of the total sum of the debt amounted to 1.15% (Table 2) against 2.9% as of August 1, 2012. As of August 1, 2013, the share of the debt on MHL without overdue payments increased in money terms, but fell within a month by 0.24 p.p. as a percentage of the total sum of the debt (Table 2).

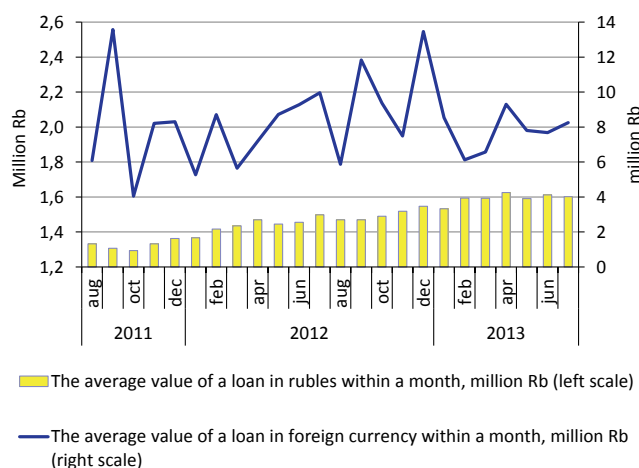
According to the data of the Central Bank of the Russian Federation, in July 2013 the average weighted rate on MHL in rubles extended within a month fell to 12.5% against the index of 2013 (Fig. 8). The respective rate on HL in rubles extended within a month decreased to the same value, as well. As of August 1, 2013, the average weighted rates on MHL and HL in foreign currency extended from the beginning of the year fell each by 0.3 p.p. against the index of May 2013 and were both equal to 9.8%.

The average weighted period of lending as regards MHL in rubles extended within a month preserved in July 2013 the same value of 14.7 years, while that as regards HL increased by 0.07 years and amounted to 14.5 years. As of August 1, 2013, the average weighted



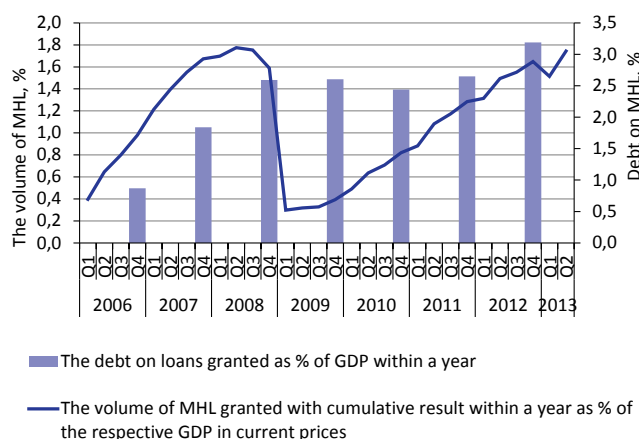
Source: on the basis of the data of the Central Bank of the Russian Federation.

Fig. 5. Dynamics of mortgage housing lending in rubles within a month



Source: on the basis of the data of the Central Bank of the Russian Federation.

Fig. 6. Dynamics of the monthly average value of MHL



Source: on the basis of the data of Rosstat.

Fig. 7. The volume and debt on MHL granted as % of GDP in current prices

Table 2

GROUPING OF THE DEBT ON MORTGAGE HOUSING LOANS BY PERIODS OF DELAY IN PAYMENTS IN 2013

	The total amount of the debt on MHL	Including							
		Without overdue payments		With overdue payments					
				From 1 day to 90 days		From 91 days to 180 days		over 180 days	
Million Rb	Million Rb	%*	Million Rb	%*	Million Rb	%*	Million Rb	%*	
Jan. 01	1 997 204	1 915 917	95.93	30 957	1.55	5 193	0.26	45 137	2.26
Feb. 01	2 010 610	1 928 376	95.91	47 048	2.34	5 228	0.26	29 958	1.49
Mar. 01	2 052 698	1 965 048	95.73	53 165	2.59	5 542	0.27	28 943	1.41
Apr. 01	2 094 424	2 014 626	96.19	43 983	2.10	5 655	0.27	30 160	1.44
May 01	2 160 918	2 073 616	95.96	55 104	2.55	6 051	0.28	26 147	1.21
Jun 01	2 213 610	2 124 401	95.97	55 340	2.50	7 748	0.35	26 121	1.18
Jul. 01	2 274 554	2 190 851	96.32	49 585	2.18	7 961	0.35	26 157	1.15
Aug. 01	2 341 306	2 249 527	96.08	57 128	2.44	7 726	0.33	26 925	1.15

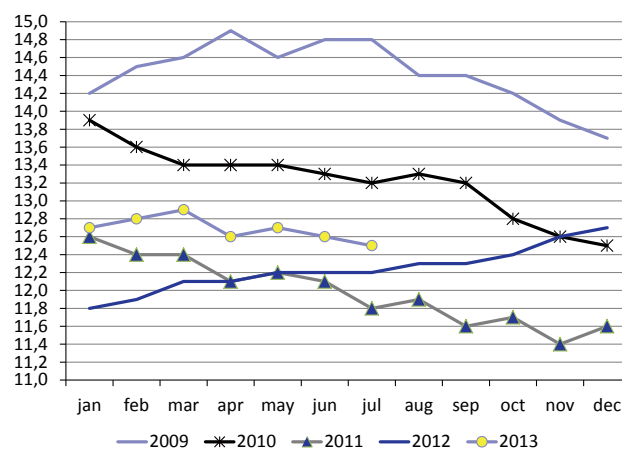
* as % of the total sum of the debt.

Source: on the basis of the data of the Central Bank of the Russian Federation.

period of lending as regards MHL in foreign currency extended from the beginning of the year amounted to 12.9 years, while that as regards HL in foreign currency, to 11.0 years.

According to operation outputs of leading mortgage banks, in the first six months of 2013 the St. Petersburg Bank showed the highest threefold growth in the volume of the extended MHL as compared to the respective period of 2012 (Table 3), while Sberbank – the leader as regards the volume of lending – growth of 21.8%. In the first six months of 2013, Sberbank and VTB 24 account for over a half of the mortgage market as regards the volume of the extended MHL (61.7%) which is 3.0 p.p. more than in the respective period of 2012.

In the first six months of 2013, the total volume of the early repaid MHL as compared to the respective period of 2012 rose by 9.0%, while early repay-



Source: on the basis of the data of the Central Bank of the Russian Federation.

Fig. 8. The average weighted interest rates on MHL in rubles extended within a month

THE OPERATION OUTPUTS OF THE LEADING MORTGAGE BANKS IN THE FIRST SIX MONTHS OF 2013

Table 3

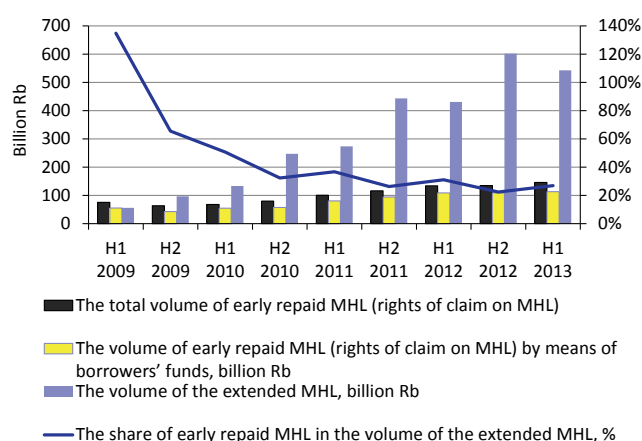
No	Bank	The volume of the extended MHL, million Rb	The number of the extended MHL	Growth in the volume of the extended loans as compared to six months of 2012, %
1	Sberbank	234 203	167 881	21.8
2	VTB 24	97 669	60 553	64
3	Gasprombank	36 032	16 742	34.8
4	DeltaCredit	11 650	4 208	14.6
5	Rosbank	8 434	3 981	16
6	Svyaz-Bank	8 338	4 242	49
7	Reiffeisenbank	7 540	2 765	130.1
8	Khanty-Mansiisky Bank	6 160	2 546	116.2
9	Absolut Bank	6 064	2 871	79
10	St. Petersburg Bank	5 875	2 862	200

Source: the data of Rosipoteka.

ment by means of the borrower's funds, by 4.1%. Along with, the share of early repaid MHL as a percentage in the volume of the extended MHL fell by 4.2 p.p. as compared to the first six months of 2012 and amounted to 26.8% (Fig. 9). The share of borrowers' own funds in the volume of early repaid MHL amounted to 77.7%.

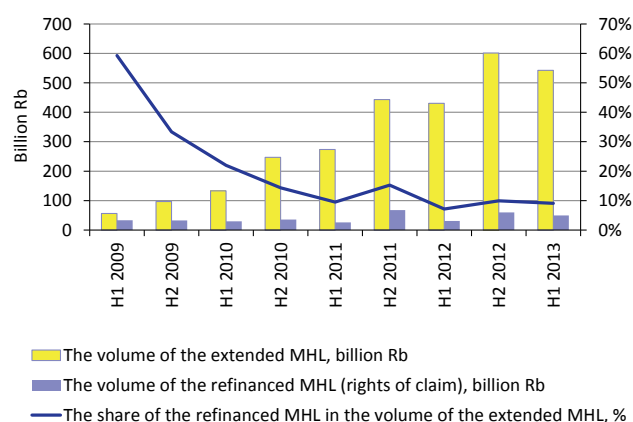
According to the data of the Central Bank of the Russian Federation, in the first six months of 2013 on the primary MHL market 505 credit institutions out of 665 ones extended MHL, while 160 credit institutions serviced the earlier extended loans. In the first six months of 2013, 129 credit institutions refinanced Rb 49.2bn worth of MHL (Fig. 10). Within the same period in 2012, 149 credit institutions refinanced Rb 30.7bn worth of MHL. As of July 1, 2013, the share of refinanced MHL amounted to 9.1% of the volume of the extended MHL (Fig. 10) against 7.1% in the first six months of 2012. As of August 1, 2013, OAO AHML bought back Rb 26.2bn worth of 18,276 mortgages which amounted to 3.9% of the primary MHL market. In the first six months of 2013, OAO AHML bought back Rb 22.3bn worth of mortgages which is equal to 45.3% of the total volume of the refinanced MHL.

According to the data of the Pension Fund of the Russian Federation, Russian families spent 94% out of Rb 645bn worth of the realized maternity capital on improvement of their housing conditions, including 66% of those funds on repayment of housing loans and credits and another 28% of funds on improvement of housing conditions without attracting loan funds. ●



Source: on the basis of the data of the Central Bank of the Russian Federation.

Fig. 9. Dynamics of early repaid MHL (rights of claim)



Source: on the basis of the data of the Central Bank of the Russian Federation.

Fig. 10. Dynamics of refinancing of MHL (rights of claim) through sale to other entities

THE REVIEW OF THE ECONOMIC LEGISLATION IN SEPTEMBER 2013¹

I.Tolmacheva, Yu.Grunina

In September, the following amendments were introduced into the legislation: the amounts of the initial contract price were determined so that a participant in the purchase was obliged to provide a customer with additional information in case those amounts were exceeded; a decision was made to establish a federal information system: the Federal Register of Apostils Affixed to Documents on Education and (or) Qualification; It was decided that development of proposals on determination of the need in foreign workers and approval of quotas would be carried out by the Ministry of Labor and Social (rotection of the Russian Federation).

Resolutions of the Government of the Russian Federation

1. Resolution No. 775 of September 4, 2013 ON SETTING OF THE AMOUNT OF THE INITIAL (MAXIMUM) CONTRACT PRICE IN CARRYING OUT OF PURCHASING OF GOODS, WORK AND SERVICES SO THAT IN CASE OF AN EXCESS OF THAT AMOUNT IT IS STIPULATED IN THE CONTRACT THAT THE SUPPLIER (CONTRACTOR, PERFORMER) IS OBLIGATED TO PROVIDE THE CUSTOMER WITH ADDITIONAL INFORMATION

From January 1, 2014, the amount of the initial (maximum) contract price is set so that in case of an excess of that amount an obligation of a participant in a purchase to provide the customer with additional information is to be specified in the contract. The additional information concerns provision by a participant in the purchase of a number of the data on its beneficiaries, one-man executive authority and members of the collegiate executive authority of the business entity, manager of the entity or unitary enterprise or other governing bodies of legal entities of participants in the purchase.

Also, the amount of the initial (maximum) contract price is set so that in case of an excess of that price an obligation is specified in the contract that the supplier (contractor, performer) is to provide the information on all the co-performers and sub-contractors which concluded a contract or contracts – whose price or the total price amount to over 10% of the contract price – with the supplier (contractor, performer):

- in carrying out of purchases for federal needs: Rb 1bn;
- in carrying out of purchases for needs of a constituent entity of the Russian Federation: Rb 100m.

2. Resolution No. 797 of September 10, 2013 ON FEDERAL INFORMATION SYSTEM: THE FEDERAL REGIS-

TER OF APOSTILS AFFIXED TO DOCUMENTS ON EDUCATION AND (OR) QUALIFICATION

The information system is established for the purpose of information and technological support of authorities delegated by the Russian Federation to constituent entities of the Russian Federation as regards confirmation of documents on education and (or) qualification.

The document includes a notion of the federal register of apostils – it is a federal information system which functions in accordance with unified institutional, methodological and program and technical principles which ensure its compatibility and networking with other public information systems and information and telecommunications networks, including information and technological and communications infrastructure, including the infrastructure which ensures information and technological networking of information systems utilized for provision of public and municipal services in an electronic format and includes information on apostils affixed to documents on education and (or) qualification.

Formation and maintenance of the federal register of apostils will be carried out by its operator – the Federal Service on Supervision in Education and Science (Rosobrnadzor).

It is envisaged that executive authorities of constituent entities of the Russian Federation which carry out authorities delegated by the Russian Federation as regards confirmation of documents on education or qualification provide the information on apostils affixed by them to documents on education or qualification within three days from the day of apostil being affixed by way of entering the information into the federal register of apostils.

The executive authorities of constituent entities of the Russian Federation ensure validity, relevance and promptness of entering of the data in the register and are in a position to utilize the data included in the federal register of apostils.

¹ The Review was prepared with assistance of the Konsultant-Plus legal system.

Rosobrnadzor takes measures to form and maintain the register of apostils:

- ensuring of technical functioning;
- ensuring of automated collection, storage, processing and generalization of the information;
- ensuring of safety of the information included in the register;
- ensuring of the regime of protection of the information;
- ensuring of an access of executive authorities of constituent entities of the Russian Federation to the information;
- carrying out of networking between executive authorities of constituent entities of the Russian Federation.

The information included in the federal data base is to be protected in accordance with the legislation of the Russian Federation. Access to the information included in the federal register of apostils is provided by Rosobrnadzor to authorized officials of executive authorities of constituent entities of the Russian Federation by means of the Internet with taking into account of requirements to safety of the personal data in processing of such data in information systems and limitation of use of the information and provided that software and technical means are applied to identify a person which was granted access to the information.

3. Resolution No. 800 of September 12, 2013 ON APPROVAL OF THE RULES OF DEVELOPMENT OF PROPOSALS ON DETERMINATION OF THE NEED IN ATTRACTION OF FOREIGN WORKERS, APPROVAL OF QUOTAS ON ISSUING OF INVITATIONS TO FOREIGN NATIONALS FOR ENTRY IN TO THE RUSSIAN FEDERATION FOR CAR-

RYING OUT LABOR ACTIVITIES, AS WELL AS QUOTAS ON ISSUING OF WORK PERMITS TO FOREIGN NATIONALS

The resolution in question was issued in accordance with the norm of the Federal Law on the Legal Status of Foreign Nationals in the Russian Federation.

According to the new rules, the draft document on determination of the need in attraction to the Russian Federation of foreign workers including that by priority vocational groups and approval of quotas for the next year will be developed by the Ministry of Labor and Social Protection of the Russian Federation on the basis of proposals of executive authorities of constituent entities of the Russian Federation which proposals are considered by an interagency commission made up of interested federal executive authorities.

The draft document is to be submitted to the Government of the Russian Federation not later than November 15 of the respective year. After the document has become effective the Ministry of Labor approves distribution of quotas by constituent entities of the Russian Federation and the list of vocations (occupations and job titles) for attraction of foreign workers and places it on its official site.

The information on depletion of quotas by constituent entities of the Russian Federation is submitted to the Federal Migration Service. With that information taken into account, adjustment of quotas for the current year is carried out at the expense of the reserve which is approved in the amount of no more than 30% of the approved proposals of executive authorities of constituent entities of the Russian Federation as regards the need in attraction of foreign workers.

The resolution becomes effective from January 1, 2014. ●

AN OVERVIEW OF NORMATIVE DOCUMENTS ON TAXATION ISSUES FOR AUGUST–SEPTEMBER 2013

L.Anisimova

In August and September 2013, work continued on the Draft Federal Budget for 2014. As the RF Ministry of Finance had managed to ensure the timely preparation of alterations to tax legislation whereby the rates of export customs duties on hydrocarbons are to be reduced, and the rates of Mineral Extraction Tax increased, the Draft Budget was composed with those alterations being taken into consideration¹. The RF Supreme Arbitration Court continued to methodologically clarify the application of tax legislation by Russia's judicial system, which would make it possible to improve the quality of judicial decisions and to reduce the number of errors in lawsuit consideration in courts of first instance.

The main problems that the Russian economy is faced with are stagnation in the production sphere, ongoing capital outflow, and accelerated growth of foreign debt. Unfortunately, the attempts to stabilize the Russian Federation's government debt at the level recommended by the International Monetary Fund (IMF) (10% of GDP) have failed²; the debt issues faced by the regions are even more serious³. As for the

1 V. Visloguzov. Gosduma smeshala neft' s gazom. Vlasti zaver-shili uglevodorodnye nalogovye manevery [The State Dume Mixes Oil with Gas. The Authorities Have Completed Their Hydrocarbon Tax Maneuvers'. *Kommersant*, No 172/P (5203), 23 September 2013.

The RF Government managed to elaborate a single formula for calculating tax on mineral resources extraction for gas, which is very important for creating competitive conditions on the domestic market in the gas extraction sector. 'From 1 July 2014 the currently applied fixed (ruble-denominated) tax rates will be replaced by payments calculated with due regard for gas composition, prices on gas supply markets, transportation costs, export duties on oil, the share of gas supply on the domestic market, the average USD-to-ruble exchange rate, and a number of other parameters. All these variables incorporated in special formulae will increase or decrease the basic rate of tax on mineral resources extraction, which is set at Rb 35 per thousand m³ of raw material'. The rate of tax on mineral resources extraction for oil will amount, in 2014, to 493 Rb/ton, in 2015 – to 530 Rb/ton., in 2016 – to 559 Rb/ton against the current rate of \$ 470. In the formula for calculating the duty on oil (29.2 USD/ton + 60% of the difference between the monitoring price and \$ 182.5), the percentage-based component will be decreased to 59% in 2014, to 57% in 2015, and to 55% in 2016.

2 Minfin: gosdolg RF uvelichitsia s 12% VVP v GDP 2013 g. do 14,3% VVP GDP v 2016 g. [The RF Ministry of Finance: RF Government Debt Will Increase from 12% of GDP in 2013 to 14.3% of GDP in 2016]. See www.ng.ru, 18 September 2013.

'The RF Ministry of Finance expects RF government debt to increase from 12% of GDP, or Rb 8.116 trillion, in 2013 to 14.3% of GDP, or Rb 12.416 trillion, in 2016 ... The volume of external debt... will increase from Rb 2.063 trillion in 2013 to Rb 3.081 trillion in 2016. Internal debt will be growing at a higher rate – from Rb 6.053 trillion in 2013 to Rb 9.336 trillion in 2016'.

3 "Izvestiia": k 2015 g. v Rossii poiaviatsia pervye regiony-bank-roty [Izvestiia [The News]: by 2015, the first bankrupt regions will appear in Russia]. See Gasera.ru, 19 September 2013.

foreign debt of the private sector, experts offer different interpretations of the existing situation. Thus, in particular, some experts believe that the loans attracted by Russian organizations are often fictitious in nature⁴. One may well agree with the view that fictitious debt growth serves as a cover for applying tax optimization schemes; however, at the same time the statements that such measures are not fraught with grave economic consequences for Russia's economy can hardly be regarded as believable. Let us explain our standpoint.

Shareholders are interested not so much in developing production as in maintaining and increasing equity (or their personal capital). So, in a situation of crisis, they do not think about production modernization – instead, their main concern is how to withdraw their personal equity into a 'safe harbor'. Development and modernization are usually the result of a successful resolution of a conflict concerning the valuation of a company's assets between its new and former owners – in favor of the new owner. Therefore an objective open market valuation of a company's equity is very important for the development of the entire economy. If proceeds begin to decline, all other conditions being equal, the company's owner evidently needs to sell it promptly, because afterwards its exchange value will dwindle. For a former owner, lower equity value means a capital loss, while for a new one a lower purchase price of a company means an opportunity to reduce the cost price of its products and to increase the efficiency of production, and even to stimulate capital growth. So, an objective valuation procedure

4 M. Papchenkova. Rossiia beriot vzaimy ochen' skhematicheski [Russia borrows very schematically]. 'The external debt of Russian companies is growing, although the economy is slowing down. The RF Ministry of Finance is worried – but it has no reason to be', believe experts from Interfax – Center of Economic Analysis (Interfax-CEA), 'this is not investment, this is tax economy'. See www.vedomosti.ru, 2 September 2013, 159 (3421).

for determining the open market value of an enterprise is important primarily for investors. In Russia, privatization gave rise to a very unfavorable situation where, in the majority of sectors, a limited group of big shareholders exercise control over production. Such 'personally owned' companies are not available for fair open market valuation. Unfortunately, the initial owners of privatized enterprises are not aiming at safeguarding their invested capital (in fact, they have invested nothing) – instead, they want to 'squeeze' capital out of the assets that they have managed to grab. An economy with a large number of big 'personally owned' production entities is archaic in nature. The World Bank and International Monetary Fund have noted many times that, in a modern economy, 'personally owned' production is represented in the main by small and medium-sized businesses. So, regretfully, we must admit that, in Russia's present situation, tax optimization schemes are aimed not at increasing production volumes – their purpose is only to increase the personal capital of company owners by means of draining the production capacities of the companies that they have been fortunate enough to appropriate.

Ineffective production is much more than just a headache for shareholders – it implies wasting all the resources (human and material) in the territory of a given country. Therefore, no government should tolerate ineffective production entities operating in the territory under its jurisdiction. In a modern market, as we have already noted elsewhere, the role of personnel have altered – priority is now given to the economic relations between employees and manufacturers (legal entities), the purpose of such relations being to generate maximum market income, and then to distribute it between the manufacturer and personnel. In this connection, the role of equity is increasingly becoming that of a tool for continual valuation of companies through the stock exchange mechanism by setting market prices for securities and searching for new income-generating products and projects. In terms of law, the role and status of a legal entity (manufacturer) in a country's economy must also undergo certain changes. Similarly to the way that the State, in civilized society, protects the rights of legally incapable persons (including children), it must also elaborate the rules for protecting legal entities (manufacturers) from their 'parents' (shareholders) or those who by chance may 'adopt' them on the exchange and then ruin them in order to increase the 'foster parent's' personal capital. If the service capacity of fixed assets is exhausted, resources spent, debts too heavy for restoring an effective production process, the personnel will leave, and the legal entity – be liquidated. Its capitalist owner will not effectuate the liquidation

because it will mean a loss of time and money, and so special structures are needed for undertaking that task. It is the government's function – to identify ineffective production entities and then to initiate the judicial proceedings necessary for liquidating them. The government must develop criteria for enforced restructuring or liquidation of ineffective production entities, with restrictions being imposed on their owners' rights – as it happened, for example, in the course of restructuring those Russian banks that were shattered by the 1998 crisis. It should be noted that Russia has already gained some positive experience of economic recovery of certain big banks, carried out by the Agency for Restructuring Credit Institutions (ARKO)¹ without damage to the smooth running of the entire banking system.

At the present stage of development, the government must pursue the goal of speeding up the transition of tangible assets and human resources from poorly performing producers to efficient ones. Banks must also bear responsibility for issuing loans to ineffective production entities – the sums of bad loans that are not redeemed for a very long time must be written off against their reserves, in an enforced procedure, from the balance sheets of the banks that have issued them to the balance sheet of the Deposit Insurance Agency (DIA) or another entity empowered to supervise this type of activities (thereby thus, naturally, reducing the capitalization of the bank that has allowed thus delay in loan repayment). These claims must then be presented to the relevant debtors for redemption against their property, the ultimate measure being the initiation of proceedings in bankruptcy or bankruptcy administration, with open market revaluation of their assets.

Capital is flowing out of Russia because the State, fearing an upsurge in unemployment, does not allow sale of assets on the market at their real market price, thus artificially maintaining the operation of ineffective production entities at the expense of raw material export revenues. However, such situations can be resolved by applying certain well-known mechanisms: for example, a foreign company may be allowed to operate on the domestic market in the framework of a joint venture (with Russian legal entities), with a legally established quota for hiring Russian citizens and a legally established level of their earnings. No doubt, this can be interpreted as a de facto tax on access of foreign organizations into Russia's territory. Nevertheless, such schemes are applied across the globe, and so we must explore the possibility of introducing

¹ The Agency for Restructuring Credit Institutions was liquidated in connection with the establishment of the Deposit Insurance Agency (DIA).

similar arrangements in Russia – among other things, in situations of market sale of ineffective production entities (at the same time, strategic entities, in accordance with the law, will remain property of the State, while natural resources are jointly owned by the Federation and its subjects). The longer the issue of artificial preservation of ineffective production entities remains unresolved, the more difficult it will become to provide adequate solutions to the unemployment issue 1 (in a non-market economy, unemployment is latent; but it may begin instantly to aggravate in a situation when the government is no longer capable of providing financial backing for ineffective production entities, while no incentives are created for the emergence of new efficiently performing companies).

With due regard for the aggravating problems in the sphere of government finance, in the period under consideration the government adopted several documents in order to provide more thorough methodological substantiation for the issue of regulating the revenue base of budgets and mandatory payments.

1. By RF Government Decree of 18 September 2013, No 819 alterations are introduced into the procedures for preparing financial and economic substantiation for measures envisaged in drafts of normative legal acts. In particular, the provision concerning the financial and economic calculations, on which those drafts are to be based, has been formulated more precisely.

From now on, the drafts of normative legal acts designed to influence the level of revenue or expenditure of a given budget within the RF budgetary system (with a corresponding financial and economic substantiation, the relevant amounts being expressed in thousand rubles) are to be submitted to the RF Ministry of Finance, which in its resolution must provide a well-founded estimation of the influence of such measures on the revenue or expenditure of a relevant budget.

In a similar manner, the wording of Item 12 of the Main Requirements to the Concept and Elaboration of Draft Federal Laws approved by RF Government Decree of 2 August 2001, No 576. The draft laws envisaged in Part 3 of Article 104 of the RF Constitution (meaning draft laws concerning the introduction or abolition of taxes, tax exemptions, issuance of government loans, changes to government financial liabilities, and other draft laws concerning the regulation of expenditures covered by the federal budget) from now on may be submitted to the RF State Duma only if the said finan-

cial and economic substantiation and the corresponding resolution are available (previously, the wording was more general – if the RF Government's resolution is available).

2. The RF Supreme Arbitration Court (RF SAC) is carrying on large-scale work aimed at technical adaptation of RF legislation and law enforcement practice to open market conditions. In this connection, it develops sufficiently adequate, logical and correct methodological approaches designed to protect the interests of the Russian Federation within the system of international economic relations in the private sector.

Thus, in order to improve the performance of judicial bodies and reduce the number of cases submitted to courts of second instance, the RF SAC is systematizing the requirements to legal suits, preparing methodological guidelines for dealing with typical situations arising whenever it becomes necessary to apply tax legislation, and developing normative legal substantiations for the issuance of relevant court rulings. These methodological guidelines are very important for increasing the independence of courts of justice when considering each specific case, and for shortening the period of court proceedings.

On 27 August 2013, Decree of the RF SAC plenary session of 30 July 2013, No 57 was posted to the RF SAC's website. In the preamble to the Decree it is stated that the latter is issued on the basis of Article 13 of the Federal Constitutional Law «On Arbitration Courts in the Russian Federation' in order to explain the issues arising in judicial practice and to ensure uniform approaches to the resolution of disputes arising in connection with the application of provisions stipulated in Part One of the RF Tax Code (RF TC).

The Decree focuses on the norms regulating the activities of tax agents, the procedural aspects of tax audits, law enforcement measures, suspension of taxpayers' bank accounts, application of tax exemptions and sanctions, execution of tax liabilities, tax control measures, execution of the decisions made by a tax agency, filing of appeals against the decisions made by tax agencies to a superior tax agency or a court of justice, etc.

For example, in accordance with the RF SAC plenary session's explanations with regard to Articles 24 and 46 of the RF Tax Code, a tax agent must transfer to the relevant budget the amount of tax that the said tax agent is liable to pay. This liability may be enforced by means of collecting from the tax agent the amount of tax due to be paid that has not been transferred to the budget, as well as the relating fines, in instances when a tax agent has collected the amount of tax in question from a taxpayer but failed to actually transfer

1 I. Naumov. Biznes rezhet shtaty po zhivomu. V obrabatyvaiushchikh otrasliakh predpriatia vynuzhdeny sokrashchat' sotrudnikov. [Businesses make ruthless personnel cuts. Companies in the manufacturing industry are forced to dismiss their employees]. See ng.ru 3 September 2013.

it to the budget. Considering the compensatory function of fines as the payments designed to compensate the treasury for losses incurred as a result of failure to pay taxes in due time, the tax agent that has failed to deduct tax from a taxpayer's monies, may be forced to pay fines for the period from the date on which tax was to be collected and transferred to the budget until the date on which tax was to be paid directly by the taxpayer in accordance with the results of a relevant tax period. At the same time, these rules are not applicable if money is paid to a foreign person, because such person is not registered with Russian tax agencies and so is not subject to tax administration. Consequently, in an event of failure to deduct tax from monies paid to a foreign person, the tax agent may be made liable to pay both the amount of tax and the amount of fines changed for the period until the date on which the execution of tax liability is due.

An important explanation is offered with regard to tax exemptions. A taxpayer may take advantage of the right to a tax exemption that has not been applied during previous tax periods by submitting an adjusted tax declaration, an application in the framework of an on-site tax audit (relative to exemptions pertaining to the object of a given tax audit and tax period), or an application to tax agency when paying tax on the basis of tax notification.

If the liability to pay tax arises for an organization or individual entrepreneur as a result of an audit conducted by the Federal Tax Service in connection with transactions concluded between mutually dependent persons, tax is to be collected in a judicial procedure (Items 4 and 2 of Article 45 of the RF Tax Code).

In an event when the funds of an organization being liquidated are insufficient, its founders (or participants) are obliged to pay the remaining sum of taxes, duties, penalties and fines within the limits and in accordance with the procedure established by RF legislation (Item 2 of Article 49 of the RF Tax Code). However, this obligation may be enforced only in cases when, in accordance with civil legislation, the founders (or participants) bear subsidiary responsibility with regard to the debts of the organization being liquidated.

One more area addressed by the RF SAC in the framework of preparing methodological explanation for applying tax legislation is the analysis of letters and instructions issued by the RF Ministry of Finance and the Federal Tax Service for an unspecified range of persons (at present, such letters and instructions are qualified to be normative documents).

Here are some examples.

Open-end Joint-stock Company *Avtoframos*, Closed Joint-stock Company *Volvo Vostok*, Limited Liability Company *Oriflame Cosmetics* filed an appeal to recog-

nize the order issued by the Federal Tax Service of 27 July 2012, No MMV-7-13/524@ 'On Approving the Notification Form Concerning Controlled Transactions, the Procedure for Filling in the Form, and the Format for the Submission, by a Taxpayer, of an Electronic Notification on Controlled Transactions' to be partly invalid for the reason of it being incompatible with the RF Tax Code. By its Ruling of 16 September 2013, No 10012/13 the RF SAC rejected the appeal. One impressive feature of that ruling is the legal analysis of the Notification Form with regard to compatibility of the information to be entered into the specific form fields with the requirements stipulated in the RF Tax Code. Such an analysis, conducted by a superior court, of a technical document format elaborated by a branch federal department, represents the first precedent of its kind. However, its importance cannot be overestimated, because from now on (after the RF SAC's ruling with regard to the format for submitting data on controlled transactions developed by the Federal Tax Service and coordinated with the RF Ministry of Finance) any failure to comply with that format, or incomplete data entered into that format, will be treated by the RF judicial system as a violation of prevailing tax legislation. In our previous overview, we have already noted the role of violations of RF domestic legislation in the rulings passed by Russian courts with regard to liquidation of Russian legal entities.

Meanwhile, it should also be noted that an appeal may be filed against the ruling to the effect that it may be revised in a supervisory procedure.

The same systemic approach to building a uniform methodological base in the taxation sphere was demonstrated by the RF SAC when considering the appeal, by Renault Samara (an affiliation of Renault France), on recognizing to be null and void certain paragraphs in the Federal Tax Service's Letter of 12 August 2009, No ShS-22-3/634@ 'On the Procedure for Drawing Up Invoices by Tax Agents'.

On 12 September 2013, the RF SAC issued Ruling No 10992/13 whereby the Federal Tax Service's Letter was deemed to be compatible with the RF Tax Code. Thus, the RF SAC effectively conducted a legal expert's estimation of a departmental document's compatibility not only with the provisions of the RF Tax Code, but also with legislation on competition. Such an outcome is even more important because the Federal Tax Service, in its comment on the appeal, had noted that the plaintiff was incorrectly applying the norms stipulated in the RF Tax Code, thus incurring additional costs, and simply asked that the appeal be rejected.

However, the RF SAC made a different decision. It treated the letter issued by the Federal Tax Service as a normative act. The expert's estimation by the RF SAC

resulted in the recognition of a departmental document to be a normative act compatible with the RF Tax Code, thus effectively incorporating it in the system of tax legislation. Later on, this ruling will prevent the filing of similar appeals by other tax agents of foreign organizations.

3. The qualitatively new level of dealing with explanatory documents issued by ministries and departments that has been demonstrated by the RF SAC implies stricter requirements to the legal backing for these documents, as well as for the answers to specific requests by taxpayers submitted to the RF Ministry of Finance and the Federal Tax Service. Their explanations must be based on the norms stipulated in the RF Tax Code; or, the various branch ministries and departments may, with a reference to the RF Tax Code, recommend specific solutions to taxpayers' problems. In actual practice, while a ministry may simply state its viewpoint with regard to a specific issue, this may be fraught with additional expenses for taxpayers. In the RF Ministry of Finance's Explanatory Letter of 23 August 2013, No 03-07-11/34617 on the procedure of levying VAT in an event of an enforced destruction of spoiled products in order to ensure production safety, the RF Ministry of Finance essentially only states its opinion. The Ministry believes that in a situation when it is necessary to destroy finished product in order to prevent, for example, an epidemic of a contagious animal disease, and such an act is ordered by decision of a RF subject, the amounts of incoming VAT accepted for deduction are not to be restored as part of tax liabilities.

Meanwhile, instead it could have been recommended to taxpayers that they should apply for a delayed payment of tax (or tax credit), which is fully compatible with the RF Tax Code, and then request that the RF Ministry of Finance inform them on the measures that it was intending to introduce in order to settle the situation in a procedure established by the RF Tax Code (if it plans to prepare the relevant alterations and then introduce them in tax legislation).

In a similar situation, the Federal Tax Service acted more consistently when, in its Letter of 3 September 2013, No BS-4-11/15963 it recommended that its territorial administrations should apply to the legislative (representative) bodies of RF subjects and the representative bodies of municipal formations and request a legal settlement of the issue of exempting the physical persons – victims of the recent floods – from the payment, in 2013, of personal income tax, land tax and transport tax. In this connection the Federal Tax Service explained that, in accordance with Item 4 of Article 5 of the RF Tax Code, the legislative acts on tax-

es and levies whereby taxes and/or levies can be abolished, or the rates of taxes and/or levies be reduced, or taxpayers, payers of levies, tax agents, or their representatives be relieved of their responsibilities, or the position of the said entities be improved in any other way, may become retroactive, if that possibility is explicitly stipulated therein. Normative acts must precisely establish the period from which exemptions are to be applied, the grounds for such exemptions (the titles of relevant documents and the bodies that have issued them), and the procedure for granting exemptions (with or without an application by a physical person).

4. The financial ministries and departments are also involved in elaborating methodology, meaning the issuance of letters and explanatory notes concerning specific instances of applying tax legislation. The task of offering explanations to taxpayers by federal ministries and departments is very important, because it boosts confidence in the government tax policy, helps prevent tax violations, and so brings down taxpayers' costs.

4.1. Letter of the Federal Tax Service of 9 September 2013, No ED-4-3/16239@, and Letter of the RF Ministry of Finance of 7 August 2013, No 03-03-10/31889 deal with the issue of applying the provisions stipulated in Items 7 and 8 of Article 262 of the RF Tax Code. These have to do with the 1.5 coefficient applicable to expenditures earmarked for research and development. This coefficient may be applied to actual expenditures on research and development established by the list approved by the RF Government Decree of 24 December 2008, No 988, and only with regard to the expenditure items specified in Subitems 1–5 of Item 2 of Article 262 of the RF Tax Code. In this connection, the profit tax declaration must be supplemented by a statement of a completed research and development project (or completed phases of a research and development project). If such a statement is not submitted, the amounts spent on research and development work (or specific phases of a research and development project) are to be considered as part of other expenditures, in their actual amount, without applying the coefficient.

4.2. Letter of the RF Ministry of Finance and the Federal Tax Service of 3 September 2013, No ED-4-3/15954@ explains the procedure for making the established regular payments for the use of mineral resources. These payments are regulated by the Federal Law 'On Mineral Resources'. The payments are transferred for the granting, on the basis of a State license, of exclusive rights for surveying and assessment of deposits of mineral resources, exploration and estimation of land plots for the construction and exploitation of

structures unrelated to mineral resources extraction, and construction and exploitation of underground structures unrelated to mineral resources extraction, with the exception of shallow underground engineering structures (up to 5 meters) for targeted use. The regular payments for the use of mineral resources are to be transferred on a quarterly basis, no later than the last day of the month following the relevant quarter, in equal installments in the amount of 1/4 of the estimated annual payment.

4.3. Letter of RF Ministry of Finance of 15 August 2013, No 03-03-06/1/33242 explains the procedure for determining the purchase price of securities received by an organization as dividends. This document deserves special attention because the correspondent compares the treatment of the dividend payment

transactions in the form of securities and property in several developed European countries and in Russian legislation. The analyzed approaches differ in that in European countries the payment of dividends in the form of property (including securities) is treated, on the one hand, as sale of property at a price determined by an independent valuator, while on the other hand, dividends are considered to be paid in an amount equal to the price of property being transferred, determined by the same independent valuator. In Russia, the property received in lieu of dividends is entered in the accounting records at its purchase price, i.e., in this case – this price is deemed to be equal to the amount of dividends declared by a shareholder meeting, and not to its market value. As a result, the budget incurs losses. ●

THE REVIEW OF THE MEETINGS OF THE GOVERNMENT OF THE RF IN SEPTEMBER 2013

M.Goldin

In September 2013, at the meetings of the Government of the Russian Federation, the following issues were discussed among other things: establishment of multifunctional cultural centers in Russian cities, as well as a draft law which delegates the issues related to organization of activities of multifunctional centers to authorities of regions.

On September 4, at the meeting of the Government of the Russian Federation the concept of establishment of cultural development centers in small Russian cities was discussed. The concept was presented by V.R. Medinsky, Minister of Culture of the Russian Federation.

The idea of establishment of multifunctional cultural centers (MCC) was formulated in Decree No. 597 of May 7, 2012 of the President of the Russian Federation On Measures on Implementation of the State Social Policy where the Government of the Russian Federation was instructed for the purpose of further preservation and development of the Russian Culture to establish at least five cultural development centers in small cities by 2015. In its turn, by Resolution No. 2606-r of December 28, 2012 the Government of the Russian Federation approved a plan of measures (“a road map”) – Changes in Sectors of the Social Sphere Aimed at Upgrading of Efficiency of the Sphere of Culture – in which the need of establishment of multifunctional cultural centers in small and mid-sized cities of Russia was confirmed.

In December, the Ministry of Culture of the Russian Federation had the terms of tender-based selection of cities for location of multifunctional cultural centers published. Taking into account requests of constituent entities of the Russian Federation and the need to establish MCC not only in small cities, the Ministry of Culture of the Russian Federation proposed not to limit the number of participants in tenders. It is to be noted that the main condition for participation in the tender is feasibility of co-financing, including that with utilization of the mechanism of the public-private partnership.

On the basis of the results of consideration of proposals and monitoring of the social and economic situation in cities where it was proposed to locate such centers, it was decided to select five pilot projects, however, it was later proposed to increase the quota of “winners” to 10.

At the same time, the layout of a standard multifunctional cultural center was developed.

On the basis of consideration of the issue, the Concept of Establishment of Cultural Development Centers in Small Russian Cities was approved. In addition to the above, V.R. Medinsky, Minister of Culture of the Russian Federation together with interested executive authorities of constituent entities of the Russian Federation were instructed to approve until November 15, 2013 the schedule of establishment of cultural development centers in small Russian cities.

Also, at the meetings of the Government of the Russian Federation the draft federal law on Amendment of Article 26³ of the Federal Law on the Guidelines for Organization of Legislative (Representative) and Executive State Authorities of Constituent Entities of the Russian Federation was discussed.

The draft law provides for functions related to organization of activities of multifunctional state and municipal centers being vested in public authorities of constituent entities of the Russian Federation in accordance with the Federal Law on Organization of Provision of Public and Municipal Services.

The draft law was approved and introduced into the State Duma of the Russian Federation by Resolution No.1618-r of September 10, 2013. ●

CHANGES IN THE REGULATORY BASE OF THE BUDGET PROCESS IN SEPTEMBER 2013 M.Goldin

The Government of the Russian Federation has issued documents which introduce from 2014 a simplified procedure for withdrawal of land plots from public (municipal) entities and state-owned enterprises in favor of the state treasury; amendments were introduced in to the procedure for provision of state guarantees on loans attracted by enterprises of the defense industry complex.

By Resolution No.821 of September 18, 2013 of the Government of the Russian Federation on Approval of the Rules of Taking of a Decision by an Executive Public Authority or Local Government Authority on Withdrawal of a Land Plot Granted to a Public or Municipal Entity or State-Owned Enterprise (Except for State Academies of Sciences Established by Such Academies of Sciences and (or) Entities Which are Under Their Jurisdiction) in Case of Improper Utilization Thereof (hereinafter – the Rules for Withdrawal of Land Plots) a simplified (extrajudicial) procedure has been approved for withdrawal of land plots which are not properly utilized by public and municipal entities, as well as state-owned enterprises.

Approval of the Rules of Withdrawal of Land Plots is provided for by Article 54(3) of the Land Code of the Russian Federation due to the fact that Article 54(2) of the Land Code of the Russian Federation grants the right to executive public authorities and local government authorities to take a decision without filing an action in the court on forced termination of the right to permanent (termless) utilization of a land plot granted to public or municipal entities or state-owned enterprises (except for state academies of sciences and entities which are under their jurisdiction).

A decision on withdrawal of a land plot which is in federal ownership from public entities, state-owned enterprises, as well as federal unitary enterprises which such land plots were granted to before the day the Land Code of the Russian Federation came into effect in case of improper utilization of such land plots is taken by:

The Ministry of Defense of the Russian Federation – in respect of land plots granted to public entities, state-owned enterprises and unitary enterprises which are under jurisdiction of the Ministry of Defense;

The Administration of the President of the Russian Federation – in respect of land plots granted to public entities and unitary enterprises which are under jurisdiction of the Administration of the President of the Russian Federation;

Rosimuschestvo – in respect of land plots granted to all other public entities and state-owned enterpris-

es, except for state academies of sciences established by such academies of sciences and (or) entities which are under their jurisdiction and state unitary enterprises.

Decision on withdrawal of a land plot by authorized executive authorities are taken provided that a package of the following documents has been received:

- Instructions on elimination of the identified violation of requirements of the land legislation;
- Certificate on checking of fulfillment by the land user of instructions on elimination of the identified violation;
- Other documents related to the outputs of checking the fulfillment of the instructions.

The Rules of Withdrawal of Land Plots will come into effect from January 1, 2014.

By Resolution No. 785 of September 6, 2013 of the Government of the Russian Federation on Introduction of Changes into the Rules of Provision in 2013 of State Guarantees of the Russian Federation on Loans Attracted by Enterprises of the Defense Industry Complex for Implementation of Projects Carried Out Within the Frameworks of the Federal Purpose Program: Development of the Defense Industry Complex of the Russian Federation in the 2011–2020 Period (hereinafter – The Rules of Provision of Guarantees), amendments were introduced into the procedure for provision in 2013 of state guarantees on loans attracted by enterprises of the defense industry complex (DIC) for implementation of projects carried out within the frameworks of the above federal program (hereinafter – guarantees).

According to amendments to the Rules of Provision of State Guarantees, guarantees are issued not only for securing obligations of enterprises of the defense industry complex as regards repayment of the amount of the loan (the principal), but also those as regards financing (making of contributions to charter capitals) of their subsidiaries participating in implementation of projects.

Also, the list of conditions for provision of guarantees has been expanded. At present, for securing a

guarantee enterprises of the military industry complex have to conclude an agreement with the Ministry of Industry and Trade of the Russian Federation and Rosimuschestvo on purchasing by the Russian Federation within the frameworks of the Program (in the volume, within deadlines and at the expense of budget allocations specified for those purposes in the Program) of

additional equities of enterprises of the defense industry complex which equities are to be issued in future (equities of an additional issue) and which equities they are obliged to sell (assign in ownership) to the Russian Federation in 2016 in the volume (the total par value) of no less than the amount of the loan attracted by the principal. ●