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RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES 03'2010

MONTHLY BULLETIN:

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RUSSIAN ECONOMY IN MARCH 2010: TENTATIVE INDICATORS AND MAJOR TRENDS

The most important events of the **political background** in March were the explosions in the Moscow subway on March 29, that killed 40 people. Thundered after a six-year break since the recent terrorist attacks in Moscow and concurred with the decade since the date when Vladimir Putin became the President of Russia (March 26, 2000), the explosions demonstrated ineffective efforts made to combat terrorism. Elections to the regional authorities, which took place in several regions in March, happened to be a setback for the "United Russia". Although the predominance of the "UR" has been predetermined, the "result" of the "Party of Power" was almost everywhere considerably worse than in previous elections. This result demonstrated the resistance of regional elites to the attempts to turn "UR" into an absolutely leader party and ensure its dominance in the political life of the regions. Among other news of the month, one can highlight the first concrete solutions related to the construction project of Science City - one of the key events of the innovation strategy of the government. However, only technical details were clarified (project supervision and its location), while the key elements of business scheme are still vague: the sources of funding, time frames and mechanisms of return on investment.

In March **macroeconomic trends** were highly dependent on the situation in external markets. Prices for crude oil and nonferrous metals, after a roll-back in February, in March, returned to the post-crisis peak indicators reached in early January 2010 (average price for Russian Urals in the period of March 1-26 amounted to 76.8 dollars per barrel, what significantly exceeds the average prices in 2007 and 1.75 times higher than the average price in the first quarter of 2009). Similar dynamics was observed in stock indices, which returned after the "roll-back" in February to the post-crisis maximum of January (for the period from March 1 to 31, the MICEX index rose by 7.3% and the RTS - to 10% with some reduction in the volume of trades).

Significant export earnings and inflow of speculative capital have provoked the change of trend in the dynamics of foreign currency and gold reserves. The reserves have decreased since the beginning of December 2009 until mid-February 2010 (from the level of USD 449.7 billion to USD 431.5 billion), but over the next month they started to grow again rapidly, having reaching on March 19 the peak on the November maximum (USD 448.2 billion). The sharp upsurge in foreign currency and gold reserves was largely based on the efforts of the Bank of Russia to restrain further ruble strengthening. In February 2010 the real effective ruble exchange rate has been strengthened by 2.4%, and since the beginning of the year it grew by 5%; in March 2010 ruble continued to grow against dollar and Euro.

The need to counter speculative capital inflow and a further slowdown in inflation allowed the Bank of Russia once again to downgrade interest rates by 0.25 p.p. to 8.25% per annum. Recently, inflation was reducing faster than the interest rates, which opened the way to the speculative actions. The reduced refinancing rate is intended to restrain the inflow of speculative capital and to improve crediting in the economy. However, meanwhile the policy of reducing rates did not fully achieve neither the first nor the second objectives. Banks have no problems with money, their excess reserves in February increased again, having reached RUR 1,430.2 trillion as of the month result (increased by 7.9%); interest rates in the interbanking market in February fell down to 3.8%, nearly coming back to the level of mid-2008. Herewith, the volume of crediting in industry is not growing and even shows a weaker trend to a further reduction: credits to companies in the overall banking system declined in February by 0.04%, to individuals - by 0.7%

Inflation continues to slow down. CPI in February was 0.9%, nearly twice lower than in 2009 (1.7%), and from March 1 to 29 prices have grown only by 0.7% (against 1.3% over the same period of the last year). Thus, the growth of consumer prices since the beginning of the year to March 29 had reached 3.3% (5.3% last year). As a result, in annual terms, inflation rate fell below the level

of 7% (6.9% as of March 29). The main factor in inflation curbing, as always, remains stagnant domestic demand. One can expect an increase in inflation rate only in the second half of 2010.

The situation in the **real sector** remains stable, but there are no signs of improvement so far. Thus, market surveys of businesses show that their assessment of the level of demand, although they are the best for the total crisis term, demonstrate no further growth of optimism. 2/3 of enterprises remain dissatisfied with the sales of its products and only 1/3 consider them normal. The attitude of enterprises to the issue of increasing the stock remains conservative: despite of improved estimates of demand that occurred in previous months, enterprises are not rushing to increase reserves. Surplus stocks are noted in the first quarter in the steel industry and light industry (by +22 bp), construction industry (+17 bp), and in the food industry the stocks are insufficient (-9 bp). Estimates of output growth demonstrate that production increased in March in all sectors except non-ferrous metallurgy. The growth of output, on the assumptions of enterprises will prevail at the beginning of the second quarter; the most optimistic expectations, as in the case of demand, is observed in construction materials industry. Against the background of fairly moderate optimism of expectations, the companies maintain the strategy of raising prices for its products. In March (judging by the polls) prices have been increased by all sectors, except for construction industry, the most rapid growth in March occurred in chemicals and petrochemicals (+35 bp), non-ferrous metals (+29) and food industry (+27). Machinery-producing industry begins to restrain the growth of prices for their products: in March it was still sustained, but not so expressed as in January and February. However, the companies believe that in the future they will be forced to move to a more restrained pricing policy.

Key indicators of the Russian economy in January-February compared with the relevant period of preceding year are demonstrating some successes of the post-crisis stabilization. Industrial production in January-February 2009 was at the level of crisis minimum, while the indicators of January-February 2008 were near pre-crisis maximum. The growth of industrial production in January-February 2010 amounted, according to the Federal State Statistics Service, to 5.8% against the level of January-February 2009, whereas in January-February 2009 (the crisis minimum) there was noted a downfall by 14.6% versus the level of January-February 2008. Index of output of goods and services in the basic industries has made 102.4% against the level of January-February 2009, when the decline against the relevant period of 2008 amounted to 12.2%. Freight turnover has grown by 10.8% against the same period of 2009, when the 17.7% downfall was recorded.

As one can see, the freight turnover is recovering in a faster pace, while the indicators of output of goods and services, by contrast, look very modest. This is due to the fact that, unlike industry, the crisis minimums (the greatest downfall versus the levels of the preceding year) in the public service sector have been achieved only in September-October of 2009. Here, it is too early to speak of the recovery: thus, the volume of commercial services in February 2010 amounted to 99.4% as compared with February 2009, when it also declined against February 2008 (98.5%). Retail sales turnover in February 2010 reached the level of pre-crisis indicators of February 2008, but is still far from pre-crisis peaks in August-September 2008 (growth against February 2009 indicator amounted to 101.3%, but in February 2009 there was noted a reduction in trade as compared with the same period in 2008 by 1.4%). Finally, as estimated by the Federal State Statistics Service, investments in fixed assets amounted in January-February to 92% from the last year level, when they fell down by 17.6 % as compared with January-February of 2008.

Thus, if the industrial sector is demonstrating the signs of post-crisis recovery, the situation in the public service sector looks more like stagnation, and the dynamics of investment does not allow to speak about overcoming the crisis so far. ●

THE POLITICAL AND ECONOMIC RESULTS OF MARCH 2010

S.Zhavoronkov

March 2010 was marked with two major events: (1) the deadliest terrorist attack on Moscow since 2004 that revealed the growing scope of activities of the Islamist underground in the North Caucasus and the inadequacy of the means being used to combat these terrorists; and (2) the spring 2010 regional elections that demonstrated an almost universal (except for Voronezh Oblast), sometimes very considerable, decline in the electoral fortunes of United Russia.

In the morning of 29 March, the Moscow Metro was shaken by two explosions – the first one at Lubyanka Station at 7:52 am local time, and the second one at Park of Culture Station at 8:36 am. According to the official version of events, the explosions were perpetrated by female suicide bombers. In these two attacks, 39 persons were killed and hundreds more were injured. Two days later there was another major terrorist attack, this time in the town of Kizliar (Dagestan) where 12 persons were killed, including the local police chief. The responsibility for the terrorist incident was later claimed by the leader of North Caucasus Islamists, ‘the Emir of the Caucasus Emirate’ – Dokka Umarov. He said that the purpose of the attack was to mete out revenge for the Muslims killed in the North Caucasus (in March, the special services had managed to eliminate Anzor Astemirov, the leader of the Islamists of Kabardino-Balkaria, and Aleksandr Tikhomirov (aka Said Buriatsky) - ‘Deputy Emir of the Caucasus Emirate’ and another well-known Islamist ideologue-cum-trainer of shahids (suicide attackers).

The Moscow bombing was the first major terrorist strike outside the North Caucasus since 2004. In 2004 – 2010, the Islamists concentrated on attacking personnel of the North Caucasus power structures and those elements of the local population who were not loyal to the terrorists. It should be noted that the personnel of the local power structures were targeted by the terrorists more frequently than the assigned and attached security personnel from the rest of Russia.

Over the past six years, the war in the Caucasus has been waged with a varying degree of success: although the situation has been relatively stable in Karachaevo-Cherkessia (in 2005, the power structures totally wiped out a large Islamist band that was trying to seize the town of Nalchik, and inflicted a considerable loss on the terrorist infrastructure – which has never been able to fully recuperate since then), the situation in Dagestan and especially in Ingushetia has considerably deteriorated, and their power structures have become virtually besieged by the rebels. Contradictory information is coming from Chechnya where the local authorities have achieved just one undisputable success – they have completely purged the republic of any independent-minded journalists. At present, the terrorists have become confident enough to resume war outside Caucasus.

Financial investments in the North Caucasus republics are partly intercepted by the militants, while military operations against them are frequently ill-conceived to the point of merely swelling their ranks. An important part of the picture shunned by the official media is significant support given to the Islamists by the population of the Muslim republics of the North Caucasus, especially by the young, and the religious roots of the current wave of terror in general.

The leadership of the federal bodies of authority have assured the country that the war on terror will continue. The legislative and normative measures that the government is going to take have not been specified as yet. In order to reduce the terrorist menace in Russia, *two highly important measures should be implemented* in addition to the ongoing punitive actions against the terrorists and their accomplices, and the current efforts to upgrade the personnel policy in the Caucasus so as to take into account the interests of a considerable part of the local elite and ethnic clans (it should be admitted that the effects of the latter innovations are difficult to formally assess). These measures are as follows. Firstly, the government should ensure that the local population is indeed given the opportunity to participate in the formal institutions designed to legally protect their interests (participation in local elections; a special procedure for criminal and economic appeals

adjusted to North Caucasus conditions – given the weakness of the local judicial system; and the development of independent mass media). Secondly, the authorities should carry out a thorough inspection of the system of Islamic education and preaching, so as to exclude the possibility of its being used for the justification of terrorism (it is a well-known fact that a considerable part of terrorists were graduates from a handful of the now disbanded religious establishments in Naberezhnye Chelny, Buguruslan, etc.).

The March 2010 regional elections have indicated a significant drop in voter support for *United Russia*. That party's poorest showing was in Sverdlovsk Oblast, where it managed to collect only 39.8 % of the vote (a 22 p.p.-drop in comparison to 2007; *United Russia* also lost all mayoral elections in the municipal formations of Sverdlovsk Oblast which took place on the same day as the regional elections). *United Russia* gained 64 % of the vote in Yamalo-Nenetsk Autonomous Okrug (a 15 p.p.-drop), 44.3 % in the Republic of Altai (a 25 p.p.-drop), 41.2 % in Kurgan Oblast (23 p.p.-drop), 47.9 % in Khabarovsk Krai (a 13 p.p.-drop), 53.6 % in Kaluga Oblast (a 7 p.p.-drop), and 52 % in Riazan Oblast (a 5 p.p.-drop).

The only region where *United Russia* managed to preserve its electoral dominance undiminished was Voronezh Oblast, where the authorities had barred from standing all independent candidates and forced the so-called systemic parties to completely refrain from criticism of United Russia and the governor.

As far as the mayoral elections in the majority of big cities were concerned, the *United Russia* candidates had no serious competitors - they had simply been barred from standing. Nevertheless, one sensation did happen. In Irkutsk, where a local popular politician, Anton Romanov, had been barred from standing, the electorate resorted to protest voting for an obscure CPRF candidate – Victor Kondrashov, who thus captured 62 % of the vote in the first round.

The Communists improved their electoral results in the majority of the regions by 7 – 10 p.p., but in Altai and Sverdlovsk Oblast their gains were much more substantial – from 10 % in both cases to 25 % and 21.7 % respectively. The LDPR considerably improved its performance in Riazan Oblast (from 9.9 % to 17.8 %) by using the slogan 'Let us return the free 90s', and slightly improved it in the rest of the regions (except for Voronezh Oblast). The same trend was shown by *Fair Russia* (a sharp increase in captured votes in Kurgan Oblast и Khabarovsk Krai, and a slight increase in the rest of the regions except for Voronezh where its electoral fortunes declined).

Of course, it should be borne in mind that, as far as the systemic parties were concerned, the results of the regional elections primarily depended on the efforts of local businessmen who had bought 'franchises' on their lists and not on the ratings of their federal leaderships. However, one can detect a clearly growing effect of voting 'for anybody, but against *United Russia*'. Preference is given to the parliamentary parties simply for their being the strongest ones; so, this time, none of the non-parliamentary parties has won seats in local legislatures, while the electoral lists of the *Yabloko* party had not even been registered in Kaluga and Sverdlovsk Oblasts. By the way, it is noteworthy that in Kaluga Oblast, where *Yabloko* had previously had a faction in the local legislature, *United Russia* has ignored the RF President's message recommending that such parties should be exempted from collecting voter signatures. ●

INFLATION AND CREDIT AND MONETARY POLICY

N.Luksha

As a result of February, inflation has slowed down: CPI was 0.9 per cent, which nearly twice lower than a similar indicator in 2009 (1.7 per cent). Inflation decline was continued in March: "Over three weeks of the month prices have grown only by 0.5 per cent. Thus, the increase in consumer prices since the beginning of the year to March 22 reached 3.1 per cent, what is by 1.8 percentage points lower than the relevant indicator of 2009. The real effective ruble rate continued to be strengthened: in February it has grown by 2.4 per cent. In the first decade of February, Russia's foreign currency reserves were reducing, but then started to grow again until the end of the third week of March and reached USD 448.2 billion on March 19. The RF Central Bank decided to reduce from May 1, 2010 credit risk limits for credit institutions to provide unsecured credits. From March 29 the Bank of Russia has reduced the refinancing rate by 0.25 percentage points to 8.25 per cent per annum.

In February consumer price index made 0.9 per cent (see Fig. 1). The largest contribution to the growth in prices has made appreciation of food products (+1.3 per cent). As in the previous two months, the utmost growth rates were noted in fruit and vegetables (+5.6 per cent). Prices were growing up for granulated sugar (+3.4 per cent), eggs and butter (by 1.9 per cent both). Cereals and beans ceased to grow in price, which has grown by 1.8 per cent as of the month results. Falling prices in this group of products affected only pasta (-0.3 per cent).

After the January upsurge in prices for commercial services, caused by the traditional for this month's increase in tariffs for housing and municipal services, in February, the pace of growth has slowed down (1 per cent versus 3.9 per cent a month earlier). In February, the main contribution to the observed growth in prices for services was made by more expensive services for housing maintenance (+2.7 per cent), as well as for garbage disposal and hot water supply (by +2 per cent both). In February, the cost of communication services has significantly increased (+2.4 per cent). Overseas tours have become cheaper by 1 per cent.

In February, non-food prices have grown by 0.3 per cent. As in the previous month, the utmost growth was observed in prices for tobacco products (1.7 per cent). Further growth was noted in knitwear, clothing and underwear (by 0.5 per cent). Motor gasoline prices have ceased to decline, its price growth made 0.3 per cent as per the month result. As opposed to that, prices for medicines, however, continued to decline (-0.7 per cent).

Thus, in February, consumer price growth in Russia was almost twice lower than last year, having somewhat approached the European level, and was even lower than in the Benelux countries and Norway, where the average inflation indicator was 1.5 per cent¹. Nevertheless, in general for the EU the growth in consumer prices was still lower than in our country - by 0.6 p.p.

In March, inflation growth rate has continued to reduce. During the first three weeks of March prices rose by 0.5 per cent, and over a week from March 16 to 22, the growth of the consumer price index slowed down to 0.1 per cent. Under the forecast of the Ministry of Economic Development, inflation in March will amount to 0.6-0.8 per cent². Restraining factors of inflation will act, as in the past months, the dynamics of monetary supply and low consumer demand.

One can expect inflation growth only in the second half of 2010. It will be pushed by the dynamics of monetary supply M2. Despite the fact that the absolute value of the monetary supply in January and February has decreased, the rate of reduction in these months was the lowest since 2004. Besides, in February, the rate of growth of monetary supply was positive against the previous month, amounting to 1.5 per cent. An important role will play the factors associated with the real ruble strengthening. The Bank of Russia is actively trying to curb ruble strengthening: only in February it has bought USD 6.7 billion in the market, almost 3 times more than planned.

1 RBC News (<http://rian.ru/economy/20100218/209838747.html>), 18.02.2010.

2 Interfax (<http://www.interfax.ru/business/news.asp?id=128973>), 22.03.2010.

The basic CPI of consumer price index¹ in February 2010 has made 0.5 per cent (versus 1.6 per cent in the relevant period of 2009).

As of February results, the monetary base (in broad definition) has increased by 3.2 per cent and amounted to RUR 5968.7 bn. Cash in circulation growth in the structure of monetary base made 1.8 per cent. Cashless component of the monetary base was growing with higher rates: thus, banks' deposits with the Bank of Russia have grown by 11.3 per cent to RUR 386.8 bn,

the value of shares of the Bank of Russia with credit organizations increased by 8.4 per cent to RUR 487.9 billion, correspondent accounts of credit organizations in the Bank of Russia - by 5.6 per cent to RUR 555.5 billion, mandatory reserves – by 1.7 per cent to RUR 159.1 billion.

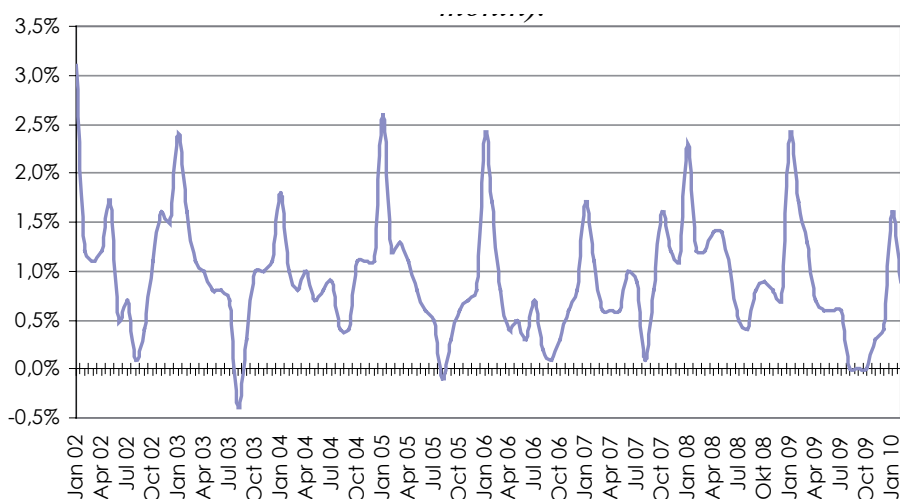
In February, the excessive reserves of commercial banks² have increased, amounting as a result of the month to RUR 1430.2 billion. Therefore, the growth made RUR 105 billion, or 7.9 per cent. Due to the accumulated excessive liquidity in the banking system, the rates in the interbanking market in February, have decreased by 3.8 per cent, having actually returned to the level of mid-2008.

In February, no significant positive changes were observed in the credit market. Despite the fact that the growth of arrears has slowed down, it nevertheless continued. According to G. Melikyan, the First Deputy Chairman of the Central Bank, arrears on corporate credits increased over the month by 0.1 percentage points, having reached 6.18 per cent of credit portfolio, on retail credits - by 0.26 p.p. to 7.31 per cent³. Moreover, in the past month the volume of credits continued to decline: credits to companies in the banking system in general decreased by 0.04 per cent, credits to individuals - by 0.7 per cent⁴.

In February the growth of the volume of cash in circulation by 1.8 per cent and grown mandatory reserves by 1.7 per cent urged the extension of monetary base in narrow definition (cash plus mandatory reserves)⁵ by 1.7 per cent (see Fig. 2).

In February the volume of foreign currency reserves of the RF Central Bank has increased by 0.1 per cent and by the end of the month amounted to USD 436.3 bn. In March foreign currency reserves continued to grow, having made on March 19 USD 448.2 bn. In just one week from March 13 to 19, the reserves have grown by leaps to USD 6.9 billion, i.e., by 1.6 per cent. The main contribution to the growth of reserves were made by the Bank of Russia currency interventions to curb the ruble strengthening.

In February, the real effective ruble rate continued to strengthen (+2.4 per cent). Real effective exchange rate as of the month result has grown to 138.22⁶ (see Fig. 3). The reason for the RUR



Source: RF Statistical Service.

Fig. 1. The Growth Rate of the CPI in 2002–2010 (% per month)

1 Basic index of consumer prices is an indicator of the inflation level without regard to seasonal price reduction (fruit and vegetable products) and to administrative measures (tariffs for government-regulated services, etc.). It is estimated by the RF Statistics Service

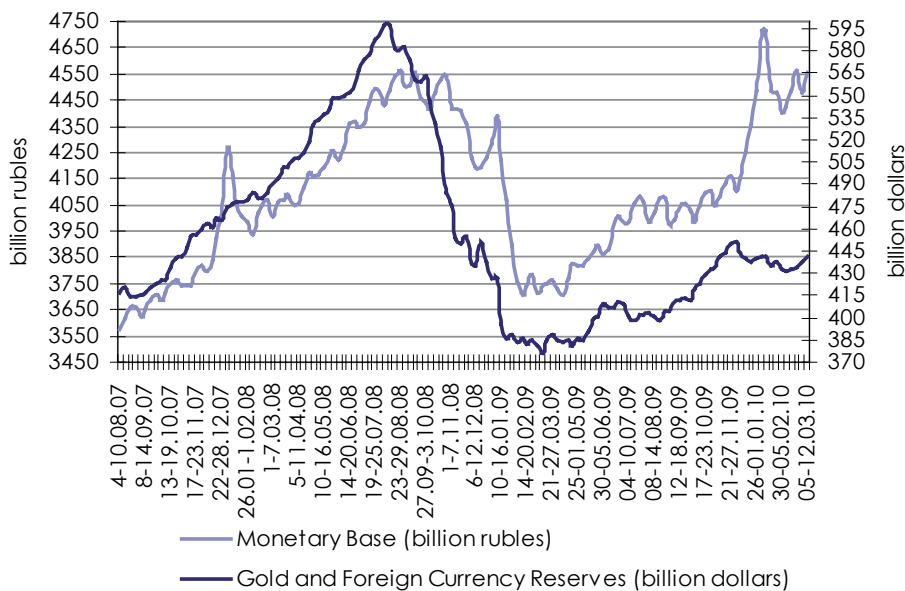
2 Under the excessive reserves of commercial banks in the CBR is understood the sum of correspondent accounts of commercial banks, their deposits with the CBR and CBR bonds in commercial banks.

3 RBCdaily (<http://www.rbcdaily.ru/2010/03/18/finance/465264>), 18.03.2010.

4 Kommersant newspaper (<http://www.kommersant.ru/doc-y.aspx?DocsID=1341929>), 24.03.2010.

5 We would like to remind, that the monetary base in the broad definition is not a monetary instrument, it reflects the obligations of the Bank of Russia in national currency. The monetary base in narrow definition is a monetary instrument (one of indicators of the volume of monetary offer), which is under total control of the RF Central Bank.

6 The level of January 2002 is accepted as 100 per cent.



Source: RF Central Bank.

Fig. 2. Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2007–2010

per cent to RUR 39.38. As a result, the cost of the two-currency basket¹ has updated the minimum of the end of 2008, amounting to RUR 33.95 by March 27 (-2.5 per cent). The main reason for the ruble strengthening against the two-currency basket was sustained high oil prices.

In mid-March an open discussion was launched between the Deputy Minister of Economic Development A. Klepach and Minister of Finance A. Kudrin on the impact of the ruble strengthening on the economy of our country. The position advocated by A. Klepach, is that the excessive strengthening of the ruble negatively affects the competitiveness of the domestic economy. In his view, currently the efforts made by the Central Bank to curb the RUR revaluation are insufficient, and at the same time, implementation of additional interventions will not provide a significant impact on inflation. According to the Ministry of Economic Development estimates, with the sustained current policy of the Central Bank in the next 2-3 years, the ruble could be strengthened by 20 per cent².

A. Kudrin supports an opposite opinion, his views are also shared by A. Ulyukayev, the First Deputy Chairman of the Central Bank. Their position is that the current strengthening of the ruble caused by fundamental reasons, namely the growing surplus of current account. A. Ulyukayev noted that the strong ruble, of course, has both, positive and negative consequences. In positive terms, the strong ruble contributes to the modernization (imported equipment and technologies get relatively cheaper).

Finally, the issue is, what is less “damaging” to the country: absorption of currency inflow through the strengthening of the national currency, or through inflation. However, in both cases there is no way to avoid real ruble appreciation.

On March 19 the Central Bank decided from 1 May 2010 to reduce the limit on credit risk, established for credit institutions to provide credits without security. The objective of this step is to mitigate the anti-crisis measures of support to credit institutions and their readdressing to implementation of traditional instruments of monetary policy. The central bank is trying to hinder obtaining the new unsecured credits. They are becoming increasingly more expensive. The Bank of Russia stopped to cut down the rates on them since August 2009, while the interest rates on other financial

growth in recent months remains the same - the inflow of export revenues to the country, caused by stable high prices for hydrocarbons.

In February and March, Euro has continued to fall in price. Since the beginning of the year to March 27, its rate decreased by 9.4 per cent to RUR 38.39 per euro. From the second week of February and almost until the end of the second decade of March dollar was also downgrading, but by the end of the fourth week its dynamics changed to modest growth.

During the first four weeks of March the nominal value of dollar against ruble has fallen down by 1.5 per cent to RUR 29.51 and Euro - by 3.5

1 Two-currency basket is the RF Central Bank operational indicator in its foreign currency policy. Currently the share of EURO in the currency basket makes 45 per cent, USD – 55 per cent

2 RBK daily (<http://rbcdaily.ru/2010/03/17/focus/464907>), 17.03.2010.

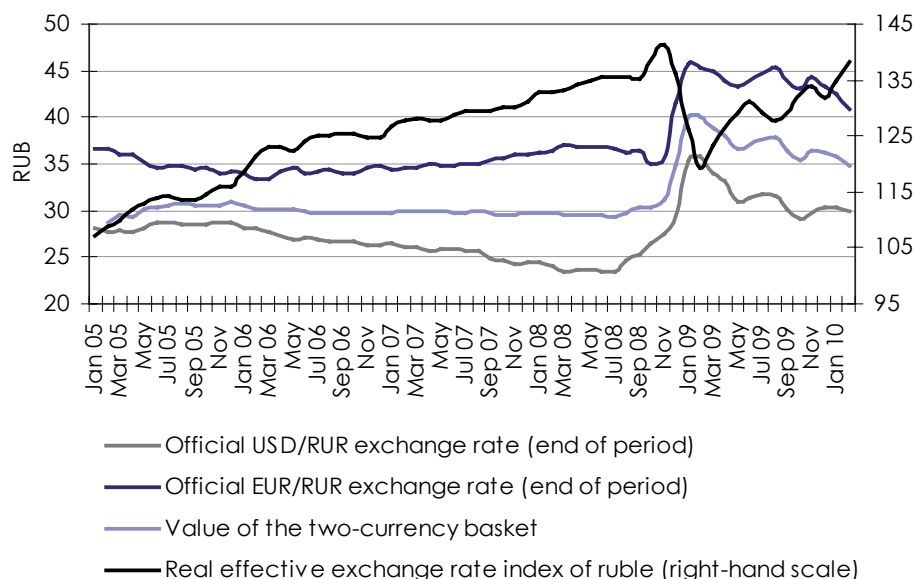
3 The level of January 2002 is accepted as 100 per cent.

instruments were declined together with the inflation. From February 1, 2010 the Bank of Russia has lowered the permissible limit of credit risk and raised the minimum credit capacity ratings for potential borrowers.

With the stabilization of the economic situation, credit institutions themselves refuse from the expensive unsecured loans. Thus, according to the RF Central Bank, in less than 3 months of 2010 the banks' debt for unsecured credits has decreased by nearly threefold as compared with the beginning of the year: from RUR 190.4 billion to RUR 69.2 billion as of March 26.

On March 29, 2010 the Bank of Russia for the second time over this year decided to reduce the refinancing rate and other key interest rates on operations of the RF Central Bank. The refinancing rate was set at 8.25 per cent per annum (see Table. 1).

Moreover, the Central Bank decided to resume the overnight deposit transactions, which were suspended in March 2003 because of their unpopularity, -the rates for them were set up at 2.75 per cent. This risk-free instrument with a positive return will allow the banks to more efficiently use the free ruble monetary supply, which is accumulated by the end of the day. The need to return to a one-day deposits with the Central Bank due to the low demand for free ruble liquidity in the interbanking market.



Source: RF Central Bank, author's estimates.

Fig. 3. Indicators of RUR exchange rate within January 2005 – January 2010¹

Table 1

INTEREST RATE UNDER RF CENTRAL BANK CREDIT OPERATIONS

	Term	From 24.02.10	From 29.03.10
Lombard credits (lowest interest rates)	14 days	5.75	5.5
	3 months	7.25	7
	6 months	7.75	7.5
	12 months	8.25	8
Direct Repo through an auction (Stock Exchange and OTC) (minimum interest rate)	1 day	5.75	5.5
	7 days	5.75	5.5
	90 days	7.25	7
	6 months	7.75	7.5
	12 months	8.25	8
Overnight credits	Overnight	8.5	8.25
	1 day	8.5	8.25
«Foreign currency swop» (RUR share) Lombard credits (under fixed interest rate)	1 day	7.5	7.25
	7 days	7.5	7.25
	30 days	7.5	7.25
Direct Repo (under fixed interest rate)	1 day	7.5	7.25
	7 days	7.5	7.25
	12 months	8.25	8

Table 1, cont'd

	Term	From 24.02.10	From 29.03.10
Credits, secured by assets or warranty (Credit, secured by assets or warranty)	Up to 90 days	7.5	7.25
	From 91 to 180 days	8	7.75
	From 181 to 365 days	8.5	8.25
Deposit operations (Credit, secured by assets or warranty)	«tom-next», «tom-next», «on demand»	3.25	3
	«Week 1», «Spot-week»	3.75	3.5

Source: RF Central Bank.

It is worth reminding that the Bank of Russia has cut down the interest rates for the twelfth consecutive time since April of the last year. The reasons for lowering the rates were the same as before. In particular, the persistent trend to the inflation reduction (on March 22, the annual inflation made 6.9 per cent as compared to 7.2 per cent in February), as well as the need to encourage credit activity of commercial banks to ensure the recovery of economic growth. Moreover, the reduction of the difference in rates between Russian and foreign markets is aimed at limiting the inflow of speculative capital.

Despite the consistent policy of interest rates reduction, the Bank of Russia has not yet managed to achieve the planned objectives. Recently, the inflation has slowed faster than the declining rates of the Central Bank, so the rates in real terms have grown, and as a result, speculators had an opportunity to earn on the difference in interest rates. In addition, while over the last year an average weighted rate for ruble credits to non-financial institutions for up to 1 year decreased from 17.1 per cent in January to 13.7 per cent in December (in January 2010, they again grew slightly to 13.9 per cent), nevertheless, no clear signs of credit growth are observed.

The decision on further mitigation of monetary and credit policy will depend on the dynamics of inflation, as well as indicators of manufacturing and credit activity, and will be taken by the Board of Directors of the Central Bank in April. ●

FINANCIAL MARKETS¹

N.Burkova, E.Khudko

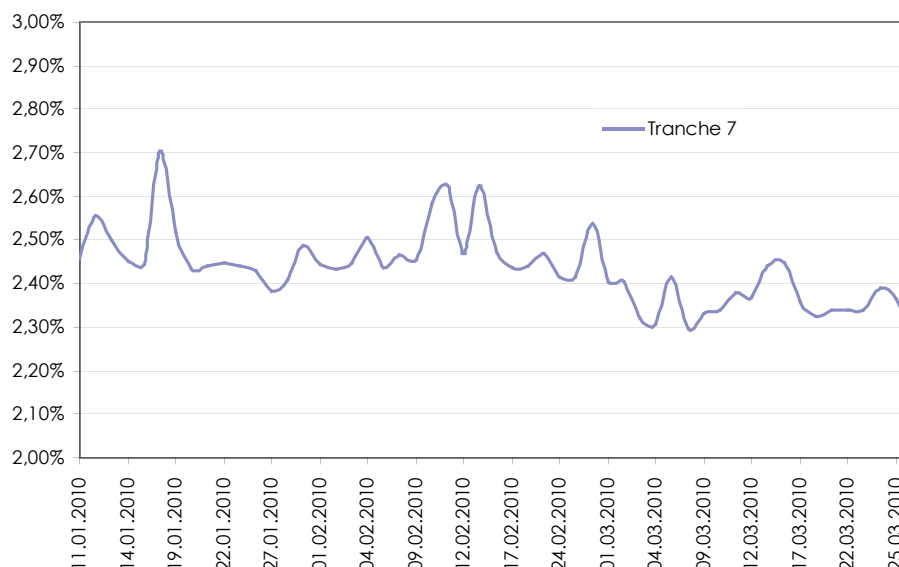
In March there was volatile dynamics in the Russian financial market under the impact of both, external and internal factors. Thus, some stabilization of the global economy, Greece's development of plan to reduce the budget deficit, strengthening of the national Russian currency, the growth GDP of the Russian GDP in January-February 2010, increased foreign currency reserves of Russia, a positive situation with ruble liquidity levels have contributed to the support of the government securities market and increase of the daily average turnover by 4 times. Similar trends were seen in the dynamics of quotations of the most liquid companies of Russia, rising by 5-13 per cent on average at the end of the month. However, the volatility of the global oil prices, reducing the financial performance of a number of major international and Russian companies on the basis of 2009 led to a reduction of trading volume in the market of corporate shares by 8 per cent.

In domestic corporate bond market growth was demonstrated in nearly all key indicators: market volume, index of corporate bonds, corporate bonds portfolio duration, the activity of investors in the secondary market, although the volume of IPOs has somewhat decreased. The major problem in the bond market is still the failure of issuers to perform their obligations to the bondholders.

Government securities market

During March, the relative stabilization of the global economy, a positive situation with ruble liquidity level, the strengthening of the ruble against the two-currency basket, reduced rates of the RF Central Bank supported the government securities, inspired positive dynamics of the quotations in the ruble and foreign currency government bonds and a significant increase in trading activity in the secondary market. The lack of proposals in the primary market during the month has also contributed to the grown turnover in the market.

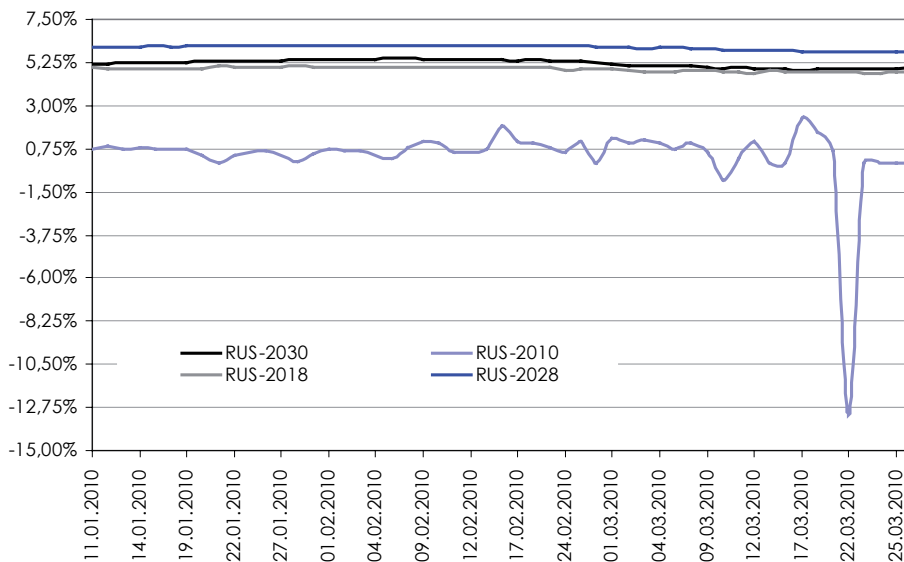
As of March 28, the Russian Eurobonds RUS-28 yield to maturity has decreased as compared with the level of February 23 from 6.12 to 5.81 per cent per annum (by 5.08 per cent), RUS-18 – from c 4.99 to 4.76 per cent per annum (by 4.73 per cent), RUS-30 – from 5.35 to 4.99 per cent per annum (by 6.89 per cent), and RUS-10 – from 0.83 to 0 per cent per annum. At the same time, the yield to maturity of RUS-30 has increased from 5.32 per cent to 5.35 per cent per annum (by 0.56 per cent), and RUS-10 – from 0.38 to 0.83 per cent per annum (times 2.2). As of the same date, a similar downgrading trend was observed in the yields of external currency debt bonds. Thus, the yield to redemption of the



Source: "Finmarket" Information Agency data

Fig. 1. Minfin bonds' yields to maturity in January – March 2010

¹ In the course of preparation of the survey, there were used analytical materials and surveys published by the "Interval", MICEX, RTS, RF Central Bank and the materials presented at web sites of Russian issuing companies.



Source: “Finmarket” Information Agency data

Fig. 2. Yields to maturity of the Russian Eurobonds with maturity in 2010, 2018, 2028 and 2030 in January – March 2010

on government bonds placement at the primary government bonds market (there was one auction a month before). However, in the period under review there were 4 auctions for government bonds additional placement in the secondary market (one auction a month before). Thus, on February 24, on March 3, 17 and 24 there were auctions were arranged for government bonds additional placement series 25073 for the amount of RUR 20, 10, 6 and 12.19 bn. Actual placement volume was RUR 10.23, 9.96, 4.09 and 1.06 bn with an average weighted yield of 6.88, 6.58, 6.1 and 6.1 per cent per annum accordingly. Therefore, the actual volume of placement for the period under review was RUR 52.6 per cent versus the estimated level (34 per cent a month earlier), which demonstrates a grown interest of the investors to placements in the primary government bonds market in March. This trend reflects an upgrading dynamics in the government bonds market.

As of March 28, the volume of government bonds made RUR 1,487.18 bn at face value and RUR 1,494.73 bn at the market value (as compared with RUR 1,467.43 bn and RUR 1,454.73 bn accordingly as of February 24). The duration of the OFZ market portfolio was 1,614.82 days, having increased by 1.72 days as compared with the preceding month (as of February 23).

Stock market

Stock market situation

In March, in contrast to the previous month, trading volumes in the stock market showed some decline at the background of the continuing volatility of the global financial markets, strengthening of the national Russian currency, reductions of the RF Central Bank refinancing rate since February 19 (from 9 to 8.75 per cent), Russian GDP growth in February 2010 versus February 2009 by 3.9 per cent (by estimates), the growth of industrial production in Russia within January-February 2010 by 5.8 per cent, growth of the foreign currency reserves of Russia, reduction of external Russian debt as of February by 0.97 per cent to RUR 1.82 trillion on the one hand, and the decline of the net profit of a number of Russian companies as of 2009 year results, the decrease of direct foreign investments in the Russian economy by 21 per cent to USD 81.9 bn, as well as the growing number of unemployed in Russia in January (to 6.84 million people) and revocation of licenses from a number of banks on the other hand.

All those factors contributed to the volatile dynamics of the Russian financial market with a predominance of an upward trend of quotations within the month. MICEX index has reached minimum value for the period on March 1 – 1,356.27 points (against 1,304.86 points in the preceding month). The maximum value the MICEX index has reached on March 17, having reached

seventh tranche of external currency debt bonds has increased from 2.47 to 2.30 per cent per annum (by 7.01 per cent) (see *Figs 1-2*).

Within the period from February 24 to March 28 the total turnover of the secondary market of government bonds amounted to approximately RUR 433 billion with an average daily turnover of RUR 18.83 billion (about RUR 93.62 billion with an average daily turnover of RUR 4.68 billion in February), which means the growth of an average monthly turnover by 4 times.

In the period from February 24 through March 28, there were no auctions

1,435.31 points (1,436.63 per cent points in the preceding month) (Fig. 3).

In general, within the period from February 24 to March 28, the MICEX index has increased by 4.56 per cent, what makes about 61.79 points in absolute terms (within the year, from March 29, 2009 to February 28, 2010, the MICEX index has been upgraded times 1.7). Over the same period, the turnover of trades in securities included in the MICEX index, made about RUR 1,210.8 bn at an average daily turnover of RUR 52.64 bn (against RUR 1,145.84 bn with an average daily turnover of RUR 57.29 in the preceding period). Therefore, the investors' average daily activity in the stock market in March has declined as compared with the preceding period by 8 per cent. The indicators of maximum and minimum daily turnover in the market trades made, accordingly, RUR 63.12 bn (as of March 5), and RUR 40.64 bn (on March 15).

As of the month results (from February 22 through March 28), all the "blue chips" securities have shown an upgrading trend, with the exception of Gazprom. The leaders in growth were GMK Nornickel, whose shares have increased by 13.62 per cent, Surgutneftegas (13.42 per cent), Gazprom Neft (12.73 per cent), Mosenergo (12.16 per cent) and Sberbank of Russia (11.33 per cent). Some less upgrading rates were noted in securities of by VTB Bank (6.06 per cent) and LUKOIL (5.05 per cent). They were followed by Tatneft, Rosneft and Rostelecom, which have grown by 1.54, 1.37 and 1.33 per cent accordingly. At the same time, a decline by 5.79 per cent was demonstrated by Gazprom (Fig. 4). In March the MICEX turnover leaders were: "Sberbank of Russia" (34.91 per cent of the total turnover), Gazprom (18.77 per cent), LUKOIL (7.75 per cent), GMK "Nornickel" (6.79 per cent), and Rosneft (5.9 per cent). Herewith, the significant growth of transactions with the shares of LUKOIL has brought the company back to the third place among the five «blue chips» leaders. The total volume of transactions with the shares of those five «blue chips» was about 74 per cent (all «blue chips» - 82 per cent) of the total trades in shares at the MICEX stock market during the period from February 24 to March 28.

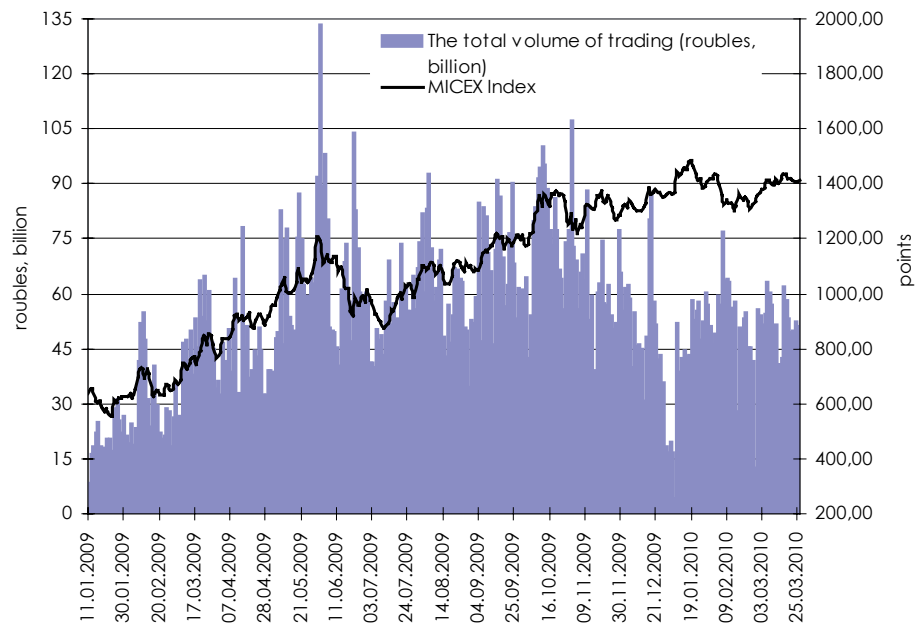


Fig. 3. Dynamics of MICEX Index and trading volume

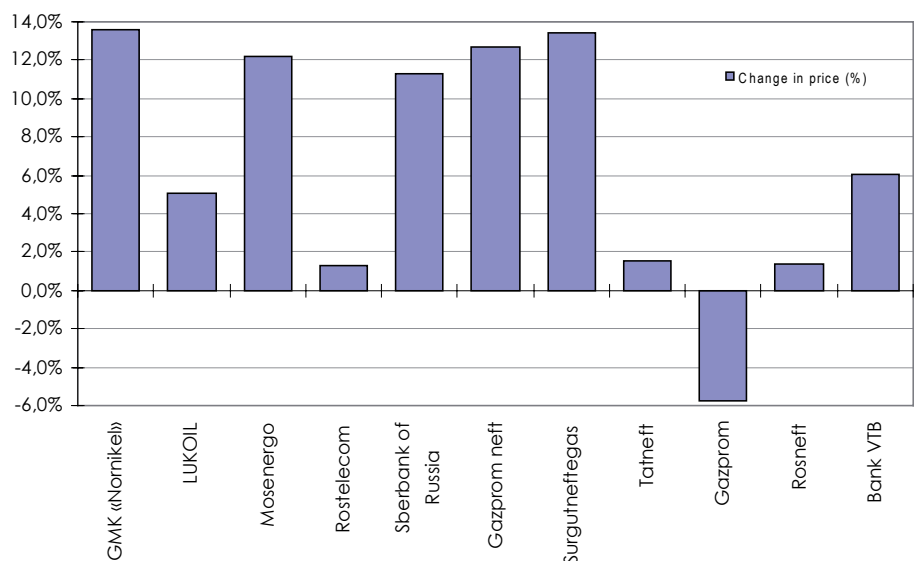


Fig. 4. Dynamics of the Russian Blue Chips from February 24 to March 28

According to MICEX information, as of March 28, the top five leaders of the domestic stock market in terms of capitalization were: “Gazprom” – RUR 3,815.70 bn (RUR 3,989.22 bn a month earlier), “Rosneft” – RUR 2,427.19 bn (against RUR 2,447.65 bn), “Sberbank of Russia” - RUR 1,843.09 bn (against RUR 1,685.29 bn), “LUKOIL” - RUR 1,395.37 bn (RUR 1,332.64 bn in preceding month) and “Surgutneftegas” – RUR 1,002.08 bn (RUR 882.93 bn).

Futures and Options Market

In March the total turnover in the MICEX futures market has grown by 27 per cent as compared with the preceding month. Thus, in the period from February 24 through March 28 the total turnover in the MICEX (futures) market made approximately RUR 103.15 bn (466.23 thousand of transactions, 1.95 mln of contracts), against approximately RUR 80.98 bn (304.79 thousand of transactions, 1.41 mln of contracts) in February. The largest volume of trading in March, like a month before, was observed in contracts for futures and equity instruments, amounting to RUR 69.7 billion (464.04 thousand of transactions, 0.95 mln of contracts). Herewith, futures for the MICEX index in the short-term MICEX market in terms of the volume of trade were followed by contracts for «Sberbank of Russia», Gazprom, Nornickel and LUKOIL shares. It should be noted, that the value of the MICEX index (the price of transactions) for June 2010 was in the range of 1,360–1,430 points, for September – 1,400–1430 points.

The second place in terms of trading volume within the month was taken by foreign currency futures (RUR 29.85 bn). Herewith, contracts for the US dollar were in the first place in terms of trading in the MICEX futures market, followed by futures contracts for Euro and for Euro/USD rate. It is worth noting that prices of futures contracts, concluded in March for RUR/USD futures in the MICEX market were within RUR/USD 29.7–29.9 for June, RUR/USD 29.7–29.9 for September, RUR/USD 30.4–30.8, for December. Trading volume in futures for commodity assets within the period has increased by 15 per cent (from RUR 3.15 billion to RUR 3.62 billion). There were no contracts for interest rate in February. In addition, from March 15, the MICEX Group started to make supplies for the futures contracts in shares under a new technology - from the accounts of the stock market.

Opposite trends were observed in the RTS FORTS futures market, where the investors' activity in March has somewhat decreased as compared with the previous month (by 2.2 per cent). Thus, in the period from February 24 to March 28 the total market turnover of futures and options in RTS was about RUR 2,097.3 billion (9.11 million of transactions, 45.11 million of contracts) as compared with about RUR 2 144,96 billion (9.88 million of transactions, 44.42 million of contracts) in February. The greatest demand among the participants, as before, was demonstrated in futures: trading volume in them during the period under review amounted to RUR 2,032.57 billion (9 million of transactions and 43.46 million of contracts). The first place in terms of futures trading were the futures contracts on the RTS index, which was followed with a significant margin by the futures contracts for dollar-ruble rate and for the shares of Sberbank of Russia and Gazprom. It should be noted that in the futures market of RTS FORTS prices of the recent transactions, concluded on futures contracts for the date of execution on June 15, were within RUR 29.6–30.4/ USD, on September 15, 2010 - RUR 29.8–30.7/ USD, and on December 15, 2010 – RUR 30.2–31/ USD.

The value of futures of the RTS index (based on the prices of recent contracts) for June 15, 2010 was estimated on average at 1 390–1 530 points, for September 15, 2010 - 1 400–1 520 points. Options enjoyed far less demand, the turnover made about RUR 64.73 bln (110.33 thousand transactions and 1.65 mln of contracts). The maximum daily turnover in the short-term RTS futures market in the period under review made RUR 124.76 billion (as of March 12), and minimum was RUR 76.38 bln. (on March 16).

External factors behind the Russian stock market dynamics

In March the Russian financial market dynamics, as a month earlier, was largely dependant on the situation in the global financial markets. Among the basic factors of positive global market indicators, affecting the Russian market in January, one should mention:

- preservation of the key interest rate by the U.S. Federal Reserve in the range of 0-0.25 per cent per annum, the Bank of Japan - at the level of 0,1 per cent;

- information about reducing the net losses as of 2009 results: British bank Royal Bank of Scotland – by 77 per cent to 1.66 billion pounds sterling, U.S. mortgage agencies Freddie Mac - by 57 per cent to 21.6 billion dollars, AIG insurance company – by more than 8 times to 12.2 billion dollars;
- information about the net profits of Allianz SE insurance company as of 2009 results in the amount of Euro 1.09 billion (against Euro 3.08 billion net loss a year earlier);
- information on the British bank Lloyds Banking Group growth of the net profit in 2009 by 3,7 times to GBP 2.95 billion;
- preservation of the European Commission forecast for the growth in gross domestic product of the European Union in 2010 at 0,7per cent;
- GDP growth of U.S. and UK as of the the IV quarter of 2009 results, according to the latest information, by 5.6 per cent and 0.3 per cent respectively;
- production growth in Japan by 2.5 per cent in January, in the U.S. by 1,7 per cent in February;
- global oil prices growth to USD 82 per barrel.;
- Development of the Greek government the plan to reduce the budget deficit.

Along with the above, the following events were restraining the global markets growth within the month:

- decline in world trade volume in 2009 by 12 per cent;
- same level of GDP of Germany as of the IV quarter of 2009 against the previous quarter;
- information on a possible lowering of Greece credit rating by the international rating agencies Standard & Poor's and Moody's in view of its economic problems;
- long-term ratings of Portugal downgrading from AA to AA- with a negative outlook by the international rating agency Fitch Ratings ;
- decrease in the net profit as of 2009 results of the German chemicals BASF Group by more than twice to Euro 1.41 billion, Bayer Group - by 20.9 per cent to Euro 1.36 billion, the auto producer Volkswagen - by 80 per cent to Euro 960 million, BMW Group - by 36,4 per cent to Euro 210 million, the Italian banking group UniCredit - by 57.6 per cent to Euro 1.7 billion;
- decline in sales of housing in the secondary market in the U.S. in January 2010 by 7.2 per cent.

All those factors have generally resulted in the upgraded dynamics of the global stock indices in March, as of the month results. Herewith, the markets of both, developed and developing countries were demonstrating a general increase in the indices by 3-9 per cent, with the exception of Chile IPSA indices, which decreased by 1.8 per cent. Herewith, there was observed a decline in the basic stock market indices in the global markets as compared with early January 2010 results (See *Table 1* and *Fig. 5*).

Table 1

DYNAMICS OF THE GLOBAL STOCK INDICES (AS OF MARCH 28, 2010)

Index	Ticker	Value	Dynamics within the month(%)	Dynamics since the year beginning(%)
MICEX (Russia)	MICEXINDEXCF	1 415.54	4.56	3.32
RTS (Russia)	RTSI	1 519.87	6.80	5.21
Dow Jones Industrial (USA) Average (USA)	DJI	10 850.36	5.52	4.05
NASDAQ Composite (USA)	NASD	2 395.13	8.21	5.55
S&P 500 (USA)	SPX	1 166.59	6.58	4.62
FTSE 100 (UK)	FTSE	5 703.02	7.30	5.36
DAX-30 (Germany)	DAX	6 120.05	9.21	2.73
CAC-40 (France)	CAC	3 988.93	7.60	1.34
Swiss Market (Switzerland)	SSMI	6 838.95	2.86	4.48
Nikkei-225 (Japan)	NIKKEI	10 996.37	6.22	4.27
Bovespa (Brasil)	BUSP	68 682.69	3.89	0.14
IPC (Mexico)	IPC	33 147.81	4.07	3.20
IPSA (Chile)	IPSA	3 748.92	-1.80	4.68
Straits Times (Singapore)	STI	2 906.28	4.45	0.30

Index	Ticker	Value	Dynamics within the month(%)	Dynamics since the year beginning(%)
Seoul Composite (South Korea)	KS11	1 697.72	4.22	0.89
ISE National-100 (Turkey)	XU100	56 610.66	10.10	7.17
BSE 30 (India)	BSE	17 644.76	8.34	1.03
Shanghai Composite (China)	SSEC	3 059.72	2.59	-6.63
Morgan Stanley Emerging Markets Free Index	EFM	788.32	5.65	0.70

* – Versus index indicator valid on February 23, 2010.

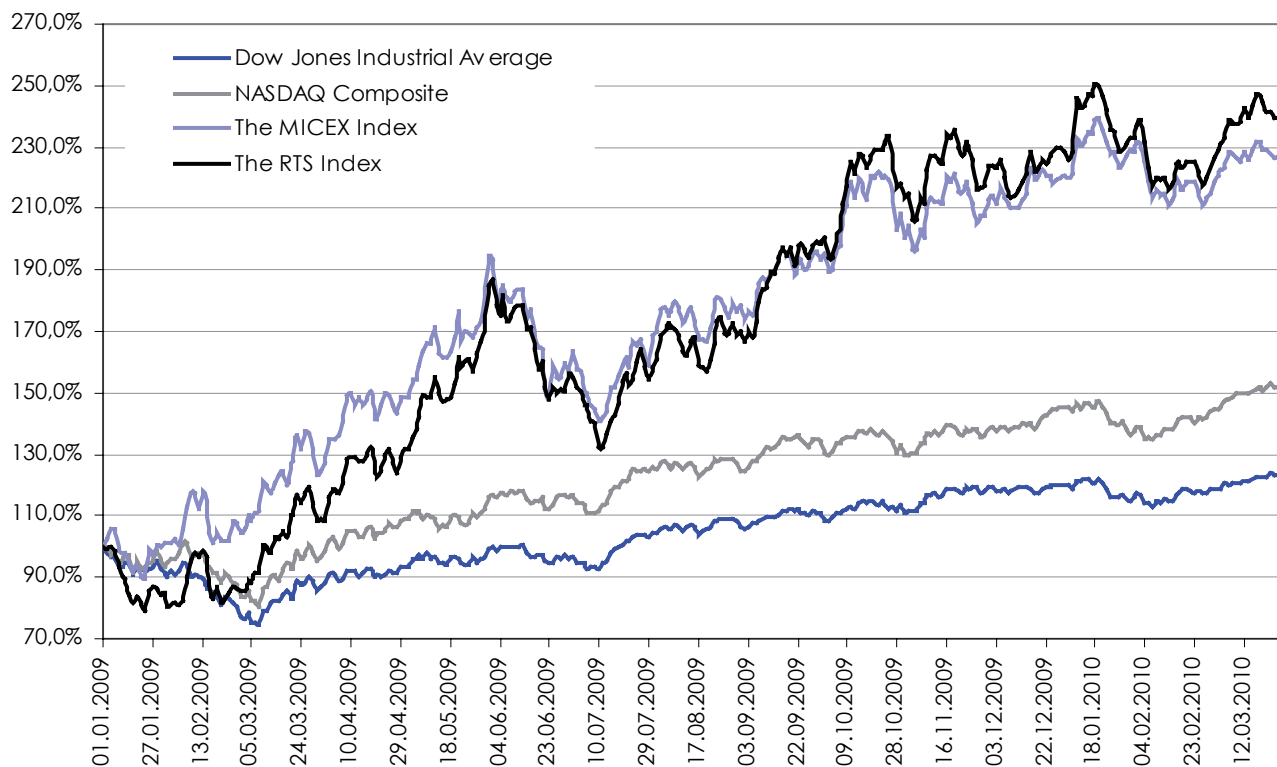


Fig. 5. Dynamics of the main USA and Russian stock indices (in per cent to the date 01.01.2009)

Corporate News

OAO "VTB Bank"

On February 25, VTB Bank and Netherlands ING Bank have signed a credit agreement, whereby VTB Bank shall provide a long-term credit line for Euro 250 million for the purpose of attraction medium- and long-term financing for the Russian importers of commodities and services from a number of European countries under the coverage of export insurance agencies of those countries. On February 26, VTB Bank has signed with the Eurasian Development Bank a memorandum on cooperation, in particular providing for the participation of Parties in the financing of joint projects, including those in the framework of intergovernmental programs (from \$ 50 million). On March 4, VTB Bank and Export Development Canada, have signed a credit agreement that provides funding for Canadian exports of equipment and services in Russia amounting to USD 100 million. On March 23 a supplementary agreement was signed between VTB Bank and the Export-Import Bank of China, providing for extended cooperation in the framework of the credit agreement dated March 26, 2007.

On February 25, OAO "VTB Bank" has successfully completed the placement of Eurobonds issue in the amount of USD 1.25 billion in the framework of program of VTB foreign currency issuance

of medium-term notes, and on March 19 – placement of exchange bonds (Issues Series EB-01, EB-02 and EB-05), totaling to 20 billion rubles for the period of 3 years with a fixed coupon rate of 7.6 per cent per annum. In addition, on March 4, OAO “VTB Bank” has disclosed unconsolidated results under RAS for February 2010: assets as of March 1, 2010 amounted to RUR 2 444 billion, as compared to 2 RUR 590 billion as of February 1, the net profit exceeded RUR 7.04 billion.

OAO «Gazprom Neft»

On March 10 OAO “Gazprom Neft” has disclosed its consolidated financial results under the US GAAP for 2009: net profit amounted to USD 2,766 million, which is by 41 per cent lower than the level of 2008 (USD 4,658 million), the indicator EBITDA is USD 5,977 million, i.e., 31 per cent as compared with 2008 (USD 8,610 million).

OAO «Mosenergo»

On March 16, OAO “Mosenergo” has disclosed financial reporting developed under RAS for 2009: net profit amounted to RUR 4 509 mln., having exceeded by 3.2 times the indicator of 2008, the value of assets as of December 31, 2009 – RUR 207,098 million (growth by 2.2 per cent as compared with the beginning of the reporting period).

OAO «Rostelecom»

On March 19, OAO “Rostelecom” has announced of the start of trading in American Depositary Receipts (ADRs) for the ordinary shares on the OTC U.S. OTCQX. OAO “Rostelecom” was the second Russian company (after OAO “Gazprom Neft”), having registered at this site.

Sberbank of Russia

On February 27, Sberbank and Visa have signed an agreement on cooperation as partners in sponsoring the Olympic Games in Sochi. On March 3, Sberbank of Russia acted as an organizer and an agent for the syndicated credit to “GAZ Group” in the amount of RUR 39.3 billion for the term of 5 years for the purpose of refinancing of the credit portfolio. The share of Sberbank of Russia in the syndicate is 16 per cent.

On March 16, Sberbank of Russia has disclosed financial performance results, developed under RAS for the January-February of 2010: net profit increased by 4.8 times and amounted to RUR 24.4 billion against RUR 5.1 billion within January-February of 2009; assets have grown by 1.7 per cent to RUR 7 229 billion rubles. Russian enterprises were granted loans amounting to RUR 450 billion; capital adequacy ratio was about 21 per cent. On March 18 the Sberbank of Russia has disclosed its consolidated financial statements under IFRS for 2009: net profit amounted to RUR 24.4 billion (against RUR 97.7 billion a year earlier); capital adequacy ratio under the Basel Capital Accord (Basel 1) - 18.1 per cent as on December 31, 2009.

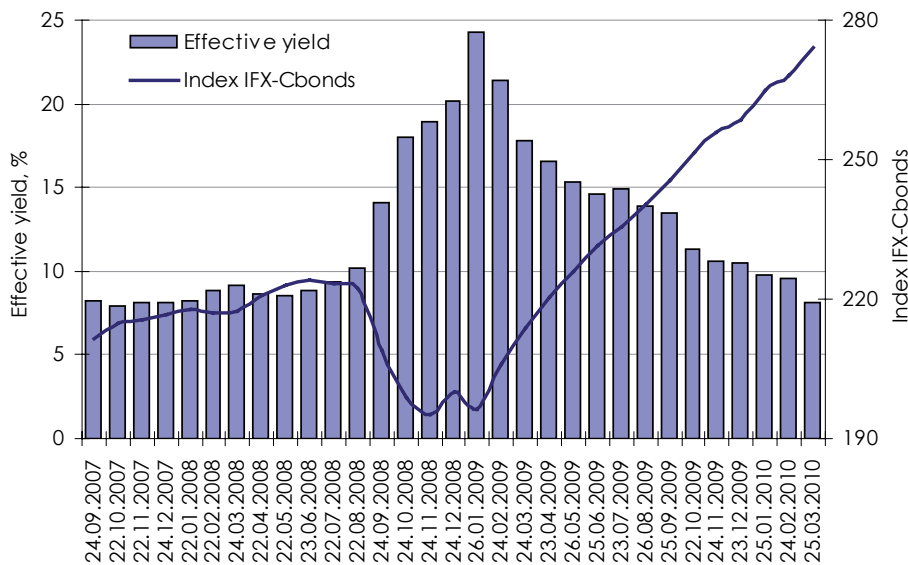
Corporate bonds market

The volume of the Russian domestic stock market (as per nominal value of shares in circulation, denominated in national currency) in March of the current year, after a short term of stabilization has somewhat grown again at the end of the month reached RUR 2,425.7 bn, which is more than the relevant indicator of preceding month by 0.9 per cent¹. The total number of emitters and emissions has decreased again from 666 to 663 emissions and from 386 to 378 emitters. There are still one emission of bonds in circulation, denominated in Japanese yens and two emissions denominated in US dollars.

In March of the current year the volume of trading in the secondary market of corporate bonds reached a new record level. The trading volume in the period from February 24 to March 26 of the current year reached its maximum over the last eighteen months and amounted to RUR 133.7 billion, which is by 17.2 per cent higher than in the preceding relevant period (from January 25 to February 19, the trading volume was equal to RUR 114.0 billion)². In the period under review on the MICEX Stock Exchange there were committed 31.3 thousand of transactions in bonds, which

1 As per Rusbonds information

2 As per “Finmarket” Information agency.



Source: Cbonds data.

Fig. 6. Russian corporate securities index and average weighted yield dynamics

demonstrated an unexpected growth, like in December of the last year and by March 25 made 756 days, which is by 184 days less against the level of the end of preceding month.

Such dynamics was the result of intensive lowering of interest rates and reflected the trend of increasing maturity term of corporate bonds.

In March of the current year, large companies still were active in borrowing assets through the bonds emissions, registering 3-8 emissions at a time. The total number of registered emissions has increased in comparison with the previous month nearly twice, though the number of emissions remained practically unchanged. Thus, in the period from February 25 through March 25, eight emitters have registered 25 bond issues for the total amount of RUR 145.0 billion (for comparison, from January 26 to February 24, ten emitters have registered 23 emissions amounting to RUR 78.7 billion). Again, large companies are paying special interest to the bonds issue under the simplified procedure without a state registration in the Federal Financial Markets Service of Russia – out of 25 totally issued, 12 were exchange bonds (against 14 issues out of 23 totally issued). The largest share of the reported emissions were seven series of bonds of “Transneft” Shareholding oil transporter for the total amount of RUR 50 billion and two series of bonds of in the amount of RUR 119 billion¹.

The dynamics of primary bond market is extremely unstable since the fourth quarter of preceding year after the expressed growth of primary bond emissions market in March, this indicator has declined again, though the number of emissions was larger. Thus, in the period from February 25 to March 25 there were placed 12 corporate bonds emissions, including 8 stock bonds issues totaling to RUR 42.5 billion (for comparison, from January 26 through February 24 there were placed 9 emissions for the total amount of RUR 48.1 billion (See Fig. 7). During the period under review the largest bond issues were placed by OAO “VTB Bank” (three series of bonds worth RUR 20 billion) and OAO «» (two series of stock bonds worth RUR 15 billion) and OAO “Novolipetsk Steel Works” (one series of stock bonds worth RUR 10 billion).

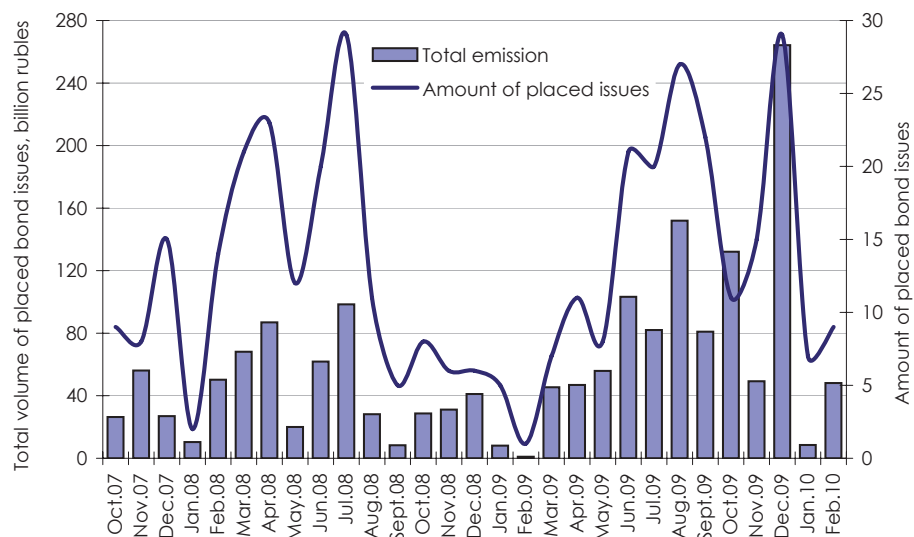
In the period from February 25 through March 25 there were three emissions offered for open placement, recognized invalid by the Federal Statistical Service for Financial Markets due to non-placement of any security (versus only one emission from January 26 through February 24)².

1 As per Rusbonds data

2 As per FSS of Russia.

Within February 25, eighteen emitters were supposed to redeem their bond issues totaling to RUR 21.7 billion. However, four emitters have announced a technical default on repayment of their bond loan, totaling to RUR 4.0 bn (against five emitters announced a technical default on repayment of their bond loans, totaling to RUR 6.6 bn in preceding period). In April 2010, 22 issues of corporate bonds redemption for the total amount of RUR 23.2 bn are expected¹.

Thus, February 25 through March 25, the real default on bonds coupon yield redemption was announced by ten emitters for nine emissions (since January 26 through February 24 a real default on bonds coupon yield redemption was announced by 7 emitters). Among them, three emitters managed to reach agreement with bondholders to restructure the debts. A real default on offer (bonds redemption) and redemption of the nominal value of their bonds was announced by five emitters (in the previous period only one emitter has announced a real default on offer)². ●



Source: Rusbonds data

Fig. 7. Corporate securities primary placement dynamics, denominated in national currency

1 As per Rusbonds data.

2 Cbonds data

REAL SECTOR: TRENDS AND FACTORS

O.Izryadnova

Starting with 2010 the domestic market was considerably affected by the recovery of the positive dynamics of the industrial production and retail trade turnover. In January-February industrial production index made 104.8% (106.7% in minerals extraction and 105.2% in the processing industries) and retail trade index – 0.8%. Continuing drop of investments by 8.0% versus January-February 2009 and high level of unemployment (8.6% of the economically active population) had a negative effect.

According to the revised forecast of the RF Ministry of Economic Development the expected growth of the GDP in 2010 is projected to be in the range from 1.3% to 3.1% (conservative and moderately optimistic scenario). The increase of GDP growth rates is based on higher growth rates of the industry (101.7–102.8%), construction (101.1–102.8%) and trade (101.9–103.3%).

In January-February of the current year the macroeconomic situation was defined by the influence of factors and trends towards the slow-down of business activity decrease rates, which were formed in the 4th quarter 2009. The domestic market was considerably affected by the recovery of the industrial production positive dynamics. In January-February 2010 the industrial production growth made 101.9% and 105.8%, correspondingly, versus the drop of 13.2% and 14.6% the same period of the previous year. The business activity upsurge was accompanied by the growth of demand for transportation services by 10.8%, including that for the railway transportation – by 15.5% versus January-February 2009.

The increase of the retail trade turnover by 0.8% versus January-February 2009 was a positive moment at the beginning of 2010, although the maintenance of negative monthly dynamics over the same period of the previous year testifies the unsteadiness of the situation on the consumer market. It should be noted that it was the increase of the foodstuffs retail trade turnover (by 3.9% versus January-February 2009) that had the biggest influence on the dynamics of retail trade. At the same time the slackened movement of the consumer demand in January-February of the current year was determined by the sustention of the trend for the decrease of the non-food goods market turnover by 2.0% and the volume of the paid services rendered to the population – by 1.3% versus the corresponding period of 2009.

In February 2010 inflation on the consumer market made 2.5% and was 1.6 per cent below the figure of the previous year. Starting with the beginning of the year the growth of prices for foodstuffs slowing down to 2.7% (3.3% in January-February 2009), for foodstuffs – by 0.5% (2.3%) and for paid services rendered to the population – by 5.0% (7.8%), the real disposable monetary incomes of the population increasing versus the corresponding period of the previous year by 8.1% (-2.9%) and the real wages – by 2.0% (-0.4%), consumer behavior of the population remains quite restrained.

On the labor market the situation is still quite tense. According to the preliminary data, in February 2010 6.4 million of people or 8.6% of the economically active population was classified as unemployed (according to methodology of the International Labor Organization). There are 2.3 million registered at the state unemployment agencies, of which 2.0 million got unemployment benefit. The number of officially registered unemployed went up by 19% versus January-February 2009, and the total number of the unemployed – by 20.9% versus the corresponding period of the previous year.

The decrease in the volumes of gross saving in 2009 defined the sustention of unfavorable background in the investment sphere. The decrease of investments in the fixed assets in January-February 2010 made 8.0%, and in the workload in construction – 10.3% as compared with January-February of the previous year.

Throughout 2009 the financial situation of the real economy sector was observed to improve gradually, following a dramatic drop of financial indices in October 2008. While on the whole throughout the economy balances financial result in 2009 made RUR 4 300.5 billion or 114.2% versus the figure of 2008, the proportion of the gross profit of the economy and gross mixed incomes in the structure of the GDP as a result 2009 was at the level of 31.4% versus 32.8% in 2008 the proportion of labor remuneration increasing up to 51.9% versus 47.3%.

Table 1

 BALANCED FINANCIAL RESULT OF ORGANIZATIONS BY TYPES OF ECONOMIC ACTIVITY
 IN 2008, AS RUR BILLION

	2008	Quarters				2009	Quarters			
		1	2	3	4		1	2	3	4
Total	3998.6	1260	1979.9	1200.9	-442.2	4300.5	366.5	1267.9	1171.3	1494.8
Minerals extraction	872.5	250.9	381.6	304.2	-64.2	892.5	130.6	252.9	267.7	241.3
Fossil fuels extraction	84.6	43.8	55.8	54.6	-69.6	806.8	149.1	227.1	228.2	202.4
Processing industries	1693.7	451.3	775.2	583	-115.8	970.8	-67.3	347.8	381.7	308.6
Electricity, gas and water production and distribution	98.6	75.7	-3.4	-41.9	68.2	242.3	126.5	23.7	5.9	86.2
Construction	130.4	14.1	37.9	37.4	41	105.3	0.9	28.3	27.8	48.3
Wholesale and retail trade	567.8	296.2	401.3	245.1	-374.8	1184.9	83.2	310.8	126.7	664.2
Transportation	286.8	100.9	97.3	97.3	-8	267.6	10.3	122.9	176.4	-41.9
Communication	286.7	66.3	99.9	90.4	30.1	235.7	41.2	88.8	52.1	53.6
Operations with real estate, rent and services rendering	292.8	97.1	131.1	19.9	44.7	302.0	16.3	77.8	81.3	126.6

Source: Federal Service of State Statistics

The situation was considerably differentiated by types of economic activities. It was the enterprises that were primarily oriented to the domestic market that suffered most due to the crisis. The financial results of manufacturing industries were primarily affected by the drop of industrial production index in 2009 by 16.0%, the producers' prices growing by 5.9% on the whole over the year. As to the dynamics of minerals extraction profit, it, on the contrary, was positively influenced by the prices growth of 49.2% on the whole over 2009, the production decreasing versus the figure of 2008 by 1.2%. The fact that the financial activity results nearly doubled in 2009 was the consequence of the upsurge in consumption of the population in the 2nd and 4th quarters 2009.

On the whole over the economy the profitability of sold goods made 11.5% in 2009, the profitability in fossil fuels extraction, electricity, gas and water production and distribution and in communication was above the figures of 2008. The drop of organizations' assets profitability was accounted for by the crisis at the stock market and sharp decrease of company's value. It was in the manufacturing industry and at the real estate market where the profitability of both the goods and assets were observed to decrease to the most considerable extent.

Table 2

 PROFITABILITY OF SOLD GOODS, PRODUCTION, SERVICES, AND ASSETS BY TYPES OF
 ECONOMIC ACTIVITY, AS PERCENTAGE

	Profitability					
	of sold goods, production, services			of assets		
	2007	2008	2009	2007	2008	2009
Total	14.3	14.0	11.5	10.5	6.0	5.7
Minerals extraction	31.5	27.6	29.7	16.3	12.9	10.6

Table 2, cont'd

	Profitability					
	of sold goods, production, services			of assets		
	2007	2008	2009	2007	2008	2009
Fossil fuels extraction	31.1	24.7	29.2	16.5	12.9	11.3
Processing industries	18.4	17.7	12.5	14.3	11.1	5.6
Electricity, gas and water production and distribution	5.3	4.7	7.4	3.3	2.1	4.0
Construction	6.3	6.9	6.7	4.4	3.8	2.9
Wholesale and retail trade	9.5	11.7	8.3	8.6	4.1	7.8
Transportation and communication	16.3	13.7	14.1	6.8	5.2	4.0
Operations with real estate, rent and services rendering	11.5	12.3	10.4	12.8	3.7	3.9

Source: Federal Service of State Statistics

It should be noted that within the 4th quarter 2008 – 1st quarter 2009 the limitation of enterprises' own liquid funds, high extent of enterprises' dependence on bank loans and the crisis of confidence between enterprises and banks resulted in the enterprises being unable to make payments for mutual settlements with counteragents, for wages, loans and credits. Starting with the 2nd quarter 2009 the gradual increase of the export prices and demand for raw materials, consecutive decrease of credit rates and increase of credits availability contributed to some improvement of the enterprises' financial situation. However the increase in the number of unprofitable enterprises to 30.1% in 2009 versus 25.2% in 2008 in the total number of enterprises was one of the factors of restrained decisions in the investment sphere in the current year. According to the preliminary data in January 2010 the organizations' balanced financial result made RUR 462.0 billion, the proportion of unprofitable enterprises decreasing on the whole, which, other conditions being equal, can result in reconsideration of the investment programs.

At the beginning of the current year the trend for growth in minerals production which had been observed since October 2009 remained unchanged. In January-February 2010 minerals extraction went up by 6.7% versus the corresponding period of the previous year, fossil fuels extraction growing by 6.3% the growth of other kinds of minerals production making 12.8%.

In January-February 2009 electricity production went up by 6.6%, which corresponds with the growth behavior of main sectors of the economy and the increase in the demand for electricity from the housing and utilities services and population.

Manufacturing industry production in January-February 2010 versus the corresponding period of the previous year went up by 5.2% versus the output decrease of 21% over the corresponding period of the previous year.

Table 3

PRODUCTION OUTPUT INDICES AS BROKEN BY TYPES OF MANUFACTURING INDUSTRIES
IN JANUARY-FEBRUARY 2009-2010

	February 2009 as percentage versus		January-February 2009 as percentage versus January- February 2008	February 2010 as percentage versus		January-February 2010 as percentage versus January- February 2009
	February 2008	January 2009		February 2009	January 2010	
Manufacturing industries	81.7	119.7	79.0	100.8	108.3	105.2
Foodstuffs, including tobacco and beverages production	96.2	111.1	96.3	104.0	112.0	103.0
Textile and sewing industries	84.1	135.7	77.6	105.3	119.6	107.7

Table 3, cont'd

	February 2009 as percentage versus		January-February 2009 as percentage versus January-February 2008	February 2010 as percentage versus		January-February 2010 as percentage versus January-February 2009
	February 2008	January 2009		February 2009	January 2010	
Leather, leather goods and footwear	84.7	135.8	79.3	123.2	118.1	128.3
Timber industry and wooden goods production	71.5	119.7	68.6	106.9	116.1	109.8
Pulp-and-paper industry, printing and publishing	81.5	112.2	80.2	106.7	107.9	108.2
Coke and oil products	94.9	95.3	95.3	102.7	91.8	105.5
Chemicals	78.7	117.0	72.9	117.3	98.5	127.7
Rubber and plastic goods	86.5	116.2	79.9	112.9	118.4	117.9
Other non-metal mineral products	66.7	113.5	66.2	104.6	111.8	105.8
Metallurgy, production of metal goods	71.7	109.1	70.8	112.9	96.7	110.2
Machinery and equipment	94.0	189.3	78.8	82.9	129.5	98.8
Electric, electronic and optic equipment	53.4	120.9	53.1	121.8	120.7	119.8
Transport vehicles and equipment	69.0	146.4	66.5	114.7	160.7	102.0
Other	74.9	105.0	79.1	120.2	95.4	117.7

Source: Federal Service of State Statistics

Low base of January-February 2009 defined the growth of production in all types of manufacturing industries besides machinery and equipment production, the decrease of which versus January-February 2009 made 1.2%. The dynamics of machinery and equipment production continued to be negatively influenced by the contraction of volumes and fulfillment rates of construction projects and investments programs at industrial enterprises. In January-February 2010 as compared with the corresponding period of 2009 the production of bulldozers went down by 51.9%, caterpillar tractors – by 47.1%, metal-cutting machines – by 27.6%, forging presses – by 15.6%. At the same time in January-February 2010 as compared with the corresponding period of 2009 the growth of mechanical equipment production (by 30.7%) was observed, which was caused by the specific character of production cycle of this group of commodities and uneven distribution of the concluded contracts. Production of machinery and equipment for agriculture and forestry went up by 32.4%, which was mainly due to an increase in the demand for equipment from producers of agriculture goods and low base of 2009.

The biggest increase in processing goods versus January-February 2009 was observed in leather, leather goods and footwear production (128.3%), chemicals (127.7%), production of electric, electronic and optic equipment (119.8%), other branches of industry (117.7%).

Transport vehicles and equipment production index in January-February 2010 made 102% versus the level of the corresponding period of the previous year. The decrease in the volume of the passenger traffic at railways contributed into the reduction of OJSC Russian railways investment programs, in connection with which the decrease in railway equipment production used to transport passengers, was observed. Production of passenger carriages dropped by 34.9% versus January-February 2009, main electric locomotives – by 7.4%. at the same time an increase in the volumes of railway freight transportation was contributed by an increase of procurements, and, correspondingly, production of railway equipment for freight transportation: production of freight carriages went up by 2.5fold, diesel locomotives – by 33%.

Production of passenger cars in January-February 2010 went up by 68.1%, trucks – by 29.4%, which is due to low base of January-February 2009 as a result of decrease in demand and closure of a number of enterprises. Demand on the domestic market for ferrous products is ensured by

the development rates in metal-intensive sectors of economy and the external market. Metallurgy production and finished metal goods production index made 110.2% in January-February 2010 versus January-February 2009, metallurgy production index being 121.8%, finished metal goods production index – 78%. The capacity of the domestic market of the rolled metal according to the calculations made 142.4% versus the corresponding period of the previous year, and the rolled metal production volume made 140.0%. The physical volume of rolled metal export made 2.3 million tons in January 2010 versus corresponding period of the previous year. The domestic consumption of steel pipes went up by 79.2% versus the level of the corresponding period of the previous year the production increasing by 65.4%, import – by 66.5% and export going down by 29.2%.

The upsurge at the global markets contributed to the growth of demand and world prices for principal non-ferrous metals, which was the basis for growth of internal process and the improvement of financial and economic indices of the companies, as well as of the increase in production efficiency. Non-ferrous metals production index made 108.2% in January-February 2010 versus corresponding period of the previous year. At the same time a low level of investment project in the branch is sustained. The level of investments in 2009 went down to 42.5% in 2009 versus 2008.

According to the corrected moderately optimistic forecast of the RF Ministry for Economic Development the industrial production index in 2010 will make 102.8% mainly due to the growth of processing industries up to 103.5%. The growth of the world economy as well as that of prices for raw materials to improve the forecast for export-oriented branches of industry, for instance in metallurgy the output index will make 102% in 2010, in timber processing – 101.8%, in pulp-and-paper industry – 100.9%. The increase of the investment demand will result in the growth of the investments branches by 7.9% versus 2009. ●

RUSSIAN INDUSTRY IN MARCH 2010

S.Tsukhlo

The first quarter of 2010 was the best among the periods of the current crisis but with regard to dynamics it is obviously behind the previous months. It seems that the way out of the crisis has slowed down.

February Official Statistics

According to the data of the Federal State Statistics Service in February 2010 the output in the industry went up by 1.9% versus February 2009 and by 4.8% versus January 2010. However the change in the structure of the proportions in the industrial production index makes the analysts to estimate the official data cautiously or refuse from their application, “Industrial index of the Federal State Statistics Service cannot be compared or interpreted and I will not comment on it”, “What is published now one cannot analyze” – these are the comments of Center for Macroeconomic Analysis and Short-term Forecasting experts on the published index, having to work on 1700 trading positions independently bringing the new trading nomenclature in concordance with the old. As a result, according to estimations, in February the growth of industry made 10.1% (versus February 2009), 1.6% versus January upon exclusion of seasonality following the decrease by 0.3% in January versus December.

Demand for Industrial Goods

In March the dynamics of the demand (according to initial data, i.e. before the exclusion of seasonality) continued to improve: the balance went up by another 8 points as compared with February data and reached +10. However the exclusion of seasonality has only demonstrated the stabilization around zero: the demand has stopped falling but the growth has not started yet. As a result 2/3 of enterprises remain unsatisfied with the volumes of their goods sales and only 1/3 regard them as normal. The forecasts for the demand in the 2st quarter 2010 have changed but little remain the best for the current crisis and are quite comparable with the level of the first post-default years. In April-May no industry expects a dramatic worsening of the sales conditions of their goods. It is the construction industry that is characterized by the most optimistic forecasts.

Stocks of Finished Goods

Despite the insufficient sales the enterprises do not allow the increase of the stocks of finished goods at their storehouses. The balances of the estimations of the stocks do not change over two months on the whole and remain at the level of crisis minimum (if one excludes the burst of November 2009) and at the level of the reasonable excess characteristic for pre-crisis years. But this is not true for all the branches. The great excesses of stocks in the 1st

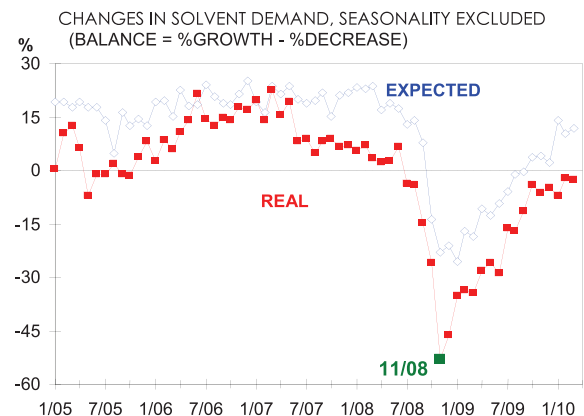


Fig. 1.

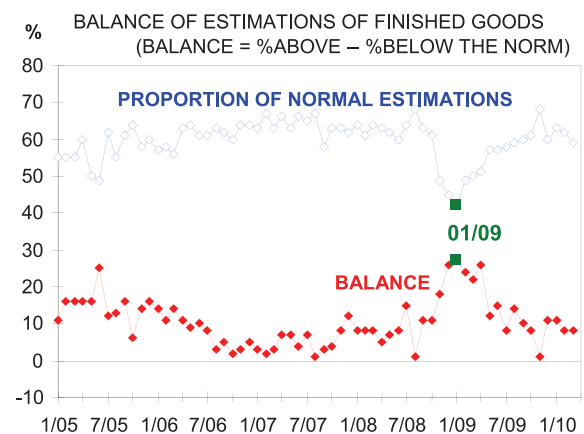


Fig. 2.

quarter 2010 were registered in the 1st quarter 2010 and light industry (+22 balance points), construction industry (+17 balance points). The excesses are much less in the timber industry and machine building (+8 balance points each), and the foodstuffs production has insufficient stocks (-9 balance points).

Production Output

The intensity of production in March went up by further 19 points, reaching the growth rates of +34 balance points which was normal for pre-crisis years. Thus, in March the trend for the previous pre-crisis growth of the output (based on the initial data) has sustained.

The exclusion of seasonality lowered the growth rates to +11 balance points which was the best value of this index for the crisis and quite comparable with pre-crisis value of the index. The production went up in March in all the branches of industry besides non-ferrous metallurgy.

The plans of production as well as the forecasts of the demand demonstrated (before and after exclusion of seasonality) in the 1st quarter 2010 the record-breaking stability. The growth of output at the beginning of the 2nd quarter as it is expected will prevail in all the branches of industry. The most optimistic hopes, the same as in case of demand, is demonstrated by the industry of construction materials production.

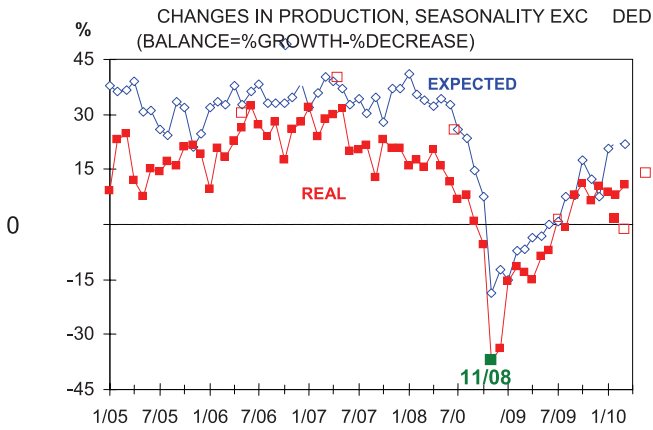


Fig. 3. 8 1

Prices of Enterprises

Growth of sales prices in the Russian industry retains the intensity that is the highest for the current crisis. In March the prices were increased in all the branches of industry except for the industry of construction materials, which has only went to the policy of stable prices after the policy of prices decrease.

It was in chemistry and petrochemistry (+35 balance points), non-ferrous metallurgy (+29) and foodstuffs production (+27) that were characterized by the most intensive growth. The machine-building industry starts to restrict the prices growth for their goods: it will continue in March but not as intensive as in January-February.

However in the forthcoming months the industry is planning to slow down the growth of its prices. The balance of the proposed changes of prices has lost 6 points in March and returned to the level of November 2009. Further increase of process growth can retain only in ferrous metallurgy, industry of construction materials and light industry. Other branches of industry plan to retrieve to a more moderate growth of prices.

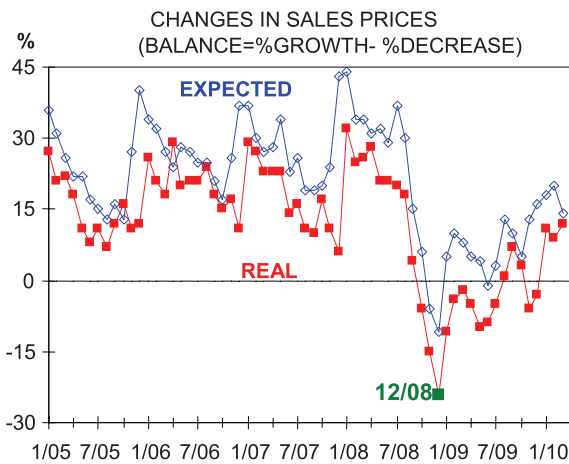


Fig. 4.

FOREIGN TRADE

N.Volovik, K.Rezenkova

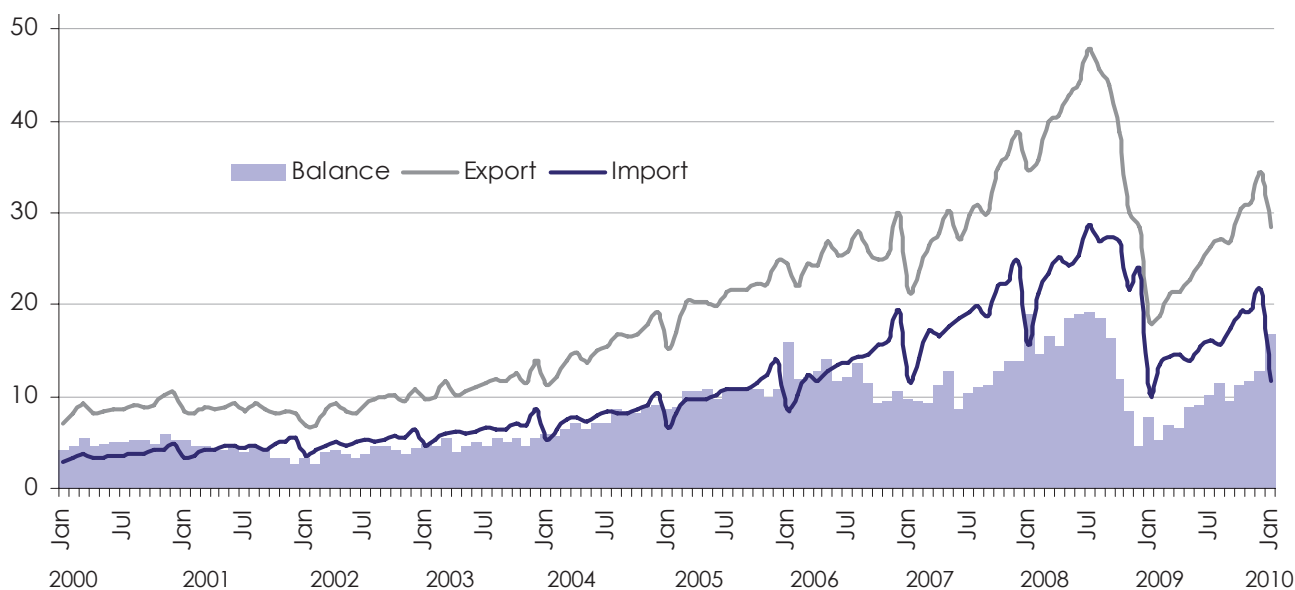
In January 2010 the volumes of the Russian foreign trade continued to recover gradually, which was accounted for by the recession overcoming by the majority of the developed countries. Russia, Belorussia and Kazakhstan at the working meeting of the Customs Union committee agreed upon the mechanism for payment and distribution of the customs duties to the budget of three countries.

The dynamics of the Russian foreign trade in January 2010 was formed against the background of the improvements for the world economy development prospects. The International Monetary Fund corrected towards the increase its forecast for the growth of the global GDP up to 3.9% in 2010 and 4.3% in 2011.

Russia's foreign trade turnover calculated basing on the balance-of-payments methodology went up in January 2010 versus January 2009 (which is the point of the extreme drop) by 40.6% up to USD 40 billion.

In January 2010 Russian export increased by 58.3% versus January 2009 and made USD 28.4 billion. The increase in export value is connected with the growth of prices for the main goods of Russian export, among which prices energy carriers and non-ferrous metals went up most notably.

At the beginning of 2010 the oil prices went up to USD 80 per barrel, but by the end of January they lowered by nearly USD 2 per barrel. It should be mentioned that whereas earlier it was dollar exchange rate and the volume of oil and oil products reserves in the USA, which is the largest oil consumer, that were the main factors influencing pricing, at the beginning of 2010 they were supplemented by the China's economic policy. In the 4th quarter 2009 the growth of the Chinese economy exceeded the expectations and made 10.7%, and the resulting growth of 2009 reached the record level for the crisis of 8.7%. The government of the People's Republic of China declared the intention for further stimulation of the expenses but expressed anxiety concerning the increase of the inflation in January 2010 and made the leading banks limit credit issuing in the middle of



Source: Central Bank of the Russian Federation

Fig. 1 Main Indices of Russian Foreign Trade (as USD billion)

the month. These and other measures of the Chinese government are partially accounted for by the anti-crisis liquidity infusions, which can lead to cumulative effect: the decrease of prices for raw materials caused by the lift of the monetary overhang will be assisted by the decrease of the demand from the second largest oil consumer.

The price for oil grade Urals in January 2010 reached the level of USD 75.92 per barrel, which is by 1.7 times above the average level of January 2009 and makes 3% increase versus December 2009. Over the period of monitoring from February 15 to March, 14 the average price of oil grade Urals mode USD 75.52 per barrel. Thus, basing on the statements of the Law on customs tariff, the maximum level of customs duty rate for Russian oil starting with April 1, 2010 will make USD 268.9 per ton, increasing by 6% versus the previous month. The duty rate for light oil products will make USD 193.5 per ton, and for dark – USD 104.2 per ton.

For the oil fields of the Eastern Siberia zero export duty rate, which was introduced from December 1, 2009 for 13 oil fields of the region, will be maintained up to April 2010. Starting with January 19, 2010 the duty rate has been applied to 22 oil fields. Export duty rate for such oil is nullified every month, simultaneously with the monthly establishment of duty rates for oil and oil products.

According to the data of London Metal Exchange average world prices in January 2010 were considerable higher than the figures of January 2009: copper was 2.3 times more expensive, aluminum and nickel – 1.6 times; as compared with the previous month prices for copper increased by 5.8%, for aluminum – by 2.5%, for nickel – by 8%.

Table 1

AVERAGE MONTHLY WORLD PRICES IN JANUARY OF CORRESPONDING YEAR

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Oil (Brent), USD/barrel	11.3	25.5	26.0	19.4	28.1	31.3	42.9	62.5	54.8	92.4	45.7	76.2
Natural gas, USD/1 million BTU	1.426	2.431	5.214	2.146	5.048	6.156	6.907	9.725	6.917	7.86	5.22	5.79
Petrol, USD/gallon	0.494	0.739	0.865	0.573	0.852	0.992	1.291	1.849	1.59	2.38	1.115	2.04
Copper, USD/ton	1528.2	1887.9	1849.6	1557.8	1571.3	2441.9	3170	4734	5668.7	7061.6	3220.7	7385
Aluminum, USD/ton	1301.4	1695.5	1641.5	1377.9	1291.1	1608.2	1832	2378	2808.3	2445.5	1413.1	2234.5
Nickel, USD/ton	4550.8	8338.1	7091.3	6094.6	7643.9	14855	14505	14555	36795	27689	11307	18430

Source: calculated on the basis of data of London Metal Exchange, International Oil Exchange (London)

According to the data of the International Monetary Fund, prices at the world markets of foodstuffs and agriculture goods rose by the average of 60% in January 2010 versus the previous month. At the same time prices for foodstuffs excluding raw materials for beverages production went up by 1%.

Because of good crops and record-breaking levels of stocks prices for grains remain stable. At the same time the prices for beef and sugar are continuing to grow. Thus, prices for beef, maintaining the trend for the growth of February 2009 went up from cent 236 per kilo to cent 295 per kilo over the last 12 months. Prices for sugar reaching by the end of the last year the record-breaking level of the last decade went on growing at the beginning of the current year. In January 2010 as compared with December 2009 brown sugar imported in the USA and brown sugar sold in Caribbean ports became by 18.2% and 12.5% more expensive, correspondingly.

The main contribution to the increase in the Russian export value (about 74%) was made by the supplies of fuel and energy commodities, whose value in January 2010 went up by one and a half times as compared with January 2009. The value of oil and oil export went up due to the price growth although the physical volumes reduced.

In January 2010 export of natural gas from Russia went up by 64.3% as compared with the figure of January 2009. The volume of export to non-CIS countries made 9.2 billion cu m, and to CIS countries – 5.4 billion cu m. The increase in export versus January 2009 was caused by the base effect - a year ago the volumes of gas export went down dramatically because of the conflict with Ukraine concerning the price of fuel for the country. Besides, the volumes of export were negatively influenced by the global economic crisis and comparatively warm winter in Europe.

The world prices for oil growing, the proportion of goods not belonging to the fuel and energy complex in the total volume of export which went up in the environment of the crisis started to diminish. Thus, a share of metals and goods thereof reduced from 11.7% in January 2009 to 10.2% in January 2010, that of machine-building production – from 4.5% to 2.34%, of mineral fertilizers – from 1.2% to 0.5%, timber industry and pulp-and-paper industry products – from 2.6 to 2.3%.

In January import in value terms made USD 11.6 billion, i.e. in January 2010 the import of goods for the first time after continuing reduction last year exceeded the corresponding figure of 2009 by 10.4%. It was the foodstuffs (by 17.4%) and the chemistry industry goods (by 28.5%) that were the main sources for its growth. The supplies of machine-building goods also went up in January (by 1.1%) – due to the supplies of electric equipment, planes and locomotives. The growth of import is accounted to by the effect of low base together with the increase in the monetary incomes of the population.

As a result of the anticipating growth of the export value volumes the balance of foreign trade in January 2010 exceeded the figure of January 2009 by nearly twofold. The coefficient of foreign trade misbalance (ratio of the balance to the turnover) went up by 0.262 in January 2009 to 0.421 in January 2010.

In connection with a considerable growth of export prices as compared with import prices the trading conditions were favorable for Russia in January 2010. The index of trading conditions made 117.4 (100 being the corresponding period of the previous year).

A considerable gap between the dynamics of export and import physical volumes is observed. In January 2010 export physical volumes went up by 15.9% as compared with January 2009, whereas the import in physical terms reduced by 1.2% over the period under consideration.

On March 25, 2010 the work meeting of Customs Union Committee took place in Moscow, which resulted in the agreement on the mechanism for imports customs duty rates payment and distribution (as well as other equivalent duties, taxes and fees). According to the adopted decision the sums of import customs duties for each party should be distributed as the following: 4.0% to the Republic of Belorussia, 7.33% - to the Republic of Kazakhstan, 87.97% - to the Russian Federation.

In January the parties did not succeed in coming to agreement concerning the issue, even when the Russian Federation agreed to allocate some bigger share to the partners. At the time the structure of customs duties distribution was suggested to be the following: 86.5% - to Russia, 8.5% - to Kazakhstan, 5% - to Belorussia. The consensus could not be reached because of the Belorussian party, which insisted on the increase in its share of Union customs duties by 0.3%.

The agreements concerning the distribution of the import customs duty rates between the budgets of Customs Union countries which were concluded in March do not result from political decisions, but from the economic calculations. The regulations were defined on the basis of UN Comtrade statistics data. The amendments concerning 409 positions resulting from the Kazakhstan's official statistics on its foreign trade and goods import in the Russian Federation in 2009 were taken into account. The mechanism of customs duties distribution should be legally approved by July 1, 2010.

The conclusion of such an agreement is a big step forward, but the decision on two other disputable issues – on oil export customs rates within the Customs Union and import of high-tech equipment – is postponed once again. Kazakhstan and Belorussia which have similar problems with oil export customs rates agreed to the Russia's initiative: discussion of all the disputable oil issues, including duties for oil supplies, is not subject to the agreements of the Customs Union, but is to be included in the agenda of negotiations concerning the agreement of the Unified Economic Space.

The nullification of high-tech equipment and components is another burning issue. The RF Ministry for Economic Development has prepared the main directions for customs and tariff policy for

three forthcoming years. Their priority lies in the contribution to the innovative breakthrough and modernization, for which purpose import customs rates for high-tech equipment and its components should be reduced or nullified.

Belorussia and Kazakhstan, however, are not ready yet to accept Russia's position and the decision of the corresponding issue is also postponed till the conclusion of the agreement on the Unified Economic Space. In the current year it is planned to adopt only a part of agreement concerning the UES, the main documents are to be signed in the second half of 2011. The single economic space which suggests deeper unification of economic and trading policy than the Customs Union should come into the effect starting with 2012. ●

INVESTMENTS IN REAL ECONOMY SECTOR

O.Iryadnova

In 2009 investments in fixed assets decreased by nearly 17.0% whereas the GDP dropped by 7.9%. The reduction of investments in fixed assets in the segment of small-scale enterprises over the year was deeper than 25%. The contraction of the workload in construction made 16% versus 2008. The decrease in the groundwork, lack of investment resources defined the negative background of the beginning of 2010. Investments in fixed assets in January-February 2010 made 92.0% and the volume of workload in construction – 89.7% versus the figure of the corresponding period of 2009. According to the forecast of the RF Ministry of Economic Development the expected growth of investments in 2010 will make 102.9% versus the level of 2009.

The positive dynamics of production and infrastructure objects construction against the background of residential areas implementation rates decrease was characteristic for 2009. In 2009 the implementation of buildings in agriculture went up by 46.8%, in industry – by 11.8% as compared with the previous year. The contraction of the residential area implementation has been observed since the 2nd quarter 2009 and made 6.7% as a result of the year. It should be noted that, first, the absolute volumes of investments in construction of housing decreased by RYR 123.7 billion versus 2008 and, second, the proportion of investments in housing construction in the structure of investments in fixed assets reduced to 6.0% versus 7.5% over the corresponding period of the previous year.

The increase of the proportion of expenditures for construction of buildings and installations in the structure of investments in fixed assets to 55.8% (by 4.1 per cent exceeding the corresponding figure of the previous year) while the expenditures for machinery and equipment reduced to 31.2% versus 33.4% in 2008 was another peculiar feature. It should be noted that against the background of the sharp decrease of the domestic production of capital goods, investments in purchase of import machinery, equipment, transport vehicles (not taking into account the subjects of small-scale entrepreneurship and parameters of informal activity) made 371.8 billion in 2009 or 20.7% of the total volume of investments in machinery, equipment and transport vehicles, as compared with 20.0% in the previous year.

Table 1

STRUCTURE OF INVESTMENTS IN FIXED ASSETS AS BROKEN BY KINDS OF FIXED ASSETS IN 2008-2009 (NOT TAKING INTO ACCOUNT THE SUBJECTS OF SMALL-SCALE ENTREPRENEURSHIP AND PARAMETERS OF INFORMAL ACTIVITY), AS PERCENTAGE TO THE TOTAL

	2008	Including			2009	Including		
		1 st quarter	1 st half of the year	January-September		1 st quarter	1 st half of the year	January-September
Investments in fixed assets - total	100	100	100	100	100	100	100	100
As broken by main kinds of fixed assets:								
Housing	7.5	8.1	7.8	7.6	6.0	6.0	6.0	6.1
Buildings and constructions	51.7	48.5	49.9	51.3	55.8	51.6	54.4	54.8
Machinery, equipment and transport vehicles	33.4	34.5	34.1	33.6	31.2	32.2	30.7	31.1
Other	7.0	8.9	8.2	7.5	7.0	10.2	8.9	8.0

Source: Federal State Statistics Service

As broken by the sources of financing the structure of investments was subject to considerable changes. The proportion of investments made at the expense of organizations' own funds decreased quite dramatically (by 3.2 percentage points in 2009 as compared with the previous year) de-

creased dramatically, and the proportion of borrowed funds went up correspondingly. The proportion of investments made from organization's profit reduced to the highest extent (from 18.5% in 2008 to 14.8% in 2009). The role of budget funds in the structure of borrowed funds for financing of investments in fixed assets has also been observed to change: in 2009 RUR 1240.8 billion of investments in fixed assets was financed at the expense of budget funds (21.5% of the total volume of investments in the economy), of which RUR 622.9 billion at the expense of the federal budget (10.8%) and RUR 546.6 billion (9.5%) – at the expense of subjects of the Federation. The expansion of the volumes of investment financing from the federal budget funds by RUR 112.1 billion is to some extent compensated by the decrease in the expenses for investment goals from the budgets of subjects of the Russian Federation by RUR 166.6 billion and from budgets of other levels – by RUR 14.4 billion.

Table 2

STRUCTURE OF INVESTMENTS IN FIXED ASSETS AS BROKEN BY SOURCES OF FINANCING, AS PERCENTAGE TO THE TOTAL (EXCLUDING THE SUBJECTS OF SMALL-SCALE ENTREPRENEURSHIP AND PARAMETERS OF INFORMAL ACTIVITY)

	2008	2009
Investments in fixed assets - total	100	100
Including by sources of financing:		
own funds	39.5	36.3
of which:		
profit	18.5	14.8
borrowed funds	60.5	63.7
of which:		
banks' credits	11.8	9.4
including those of foreign banks	3.0	2.8
borrowed funds of other organizations	6.2	10.7
budget funds:	20.9	21.5
of federal budget	8.0	10.8
of budgets of subjects of the Russian Federation and local budgets	11.3	9.5
other	21.2	21.9
out of which the funds received for share participation in construction	3.5	2.3
including the means of the population	1.9	1.0
Foreign investments in the total volume of investments in fixed assets	4.3	4.6

Source: Federal State Statistics Service

In 2009 own funds of large- and medium-scale enterprises used for investment purposes made RUR 2092.0 billion versus RUR 2506.6 billion in the previous year. An acute shortage of own funds was compensated by attraction of banking credits and loans. In 2009 RUR 544.3 billion or 14.8% out of attracted funds of RUR 3677.8 billion was accounted for by the banking credits.

The structure of banking credits in the sources of investment in fixed assets financing was subject to considerable changes. Whereas in 2008 the proportion of foreign banks' credits accounted for 22.0% of the total sum of bank credits, in 2009 this index went up to 29.3%. credits of foreign banks in 2009 as compared with the preceding year went up by 4.3%, the credits of domestic banks financing investments in fixed assets decreasing in absolute terms by RUR 156.5 billion (reduction of 295 of the level of the previous year). As a result the proportion of investments incoming from abroad in the total volume of investments in fixed assets went up to 4.6% and made RUR 263.8 billion.

The lack of own funds and weak participation of the domestic banking sector in the investments in fixed assets financing accounted for the expansion of the number of borrowing companies. In 2009 the volume of borrowed funds of other organizations (insurance and investments companies, trading companies etc.) for investments in fixed assets financing made RUR 616.6 billion, exceeding by RUR 231.6 billion the amount of Russian banks' credits for these purposes.

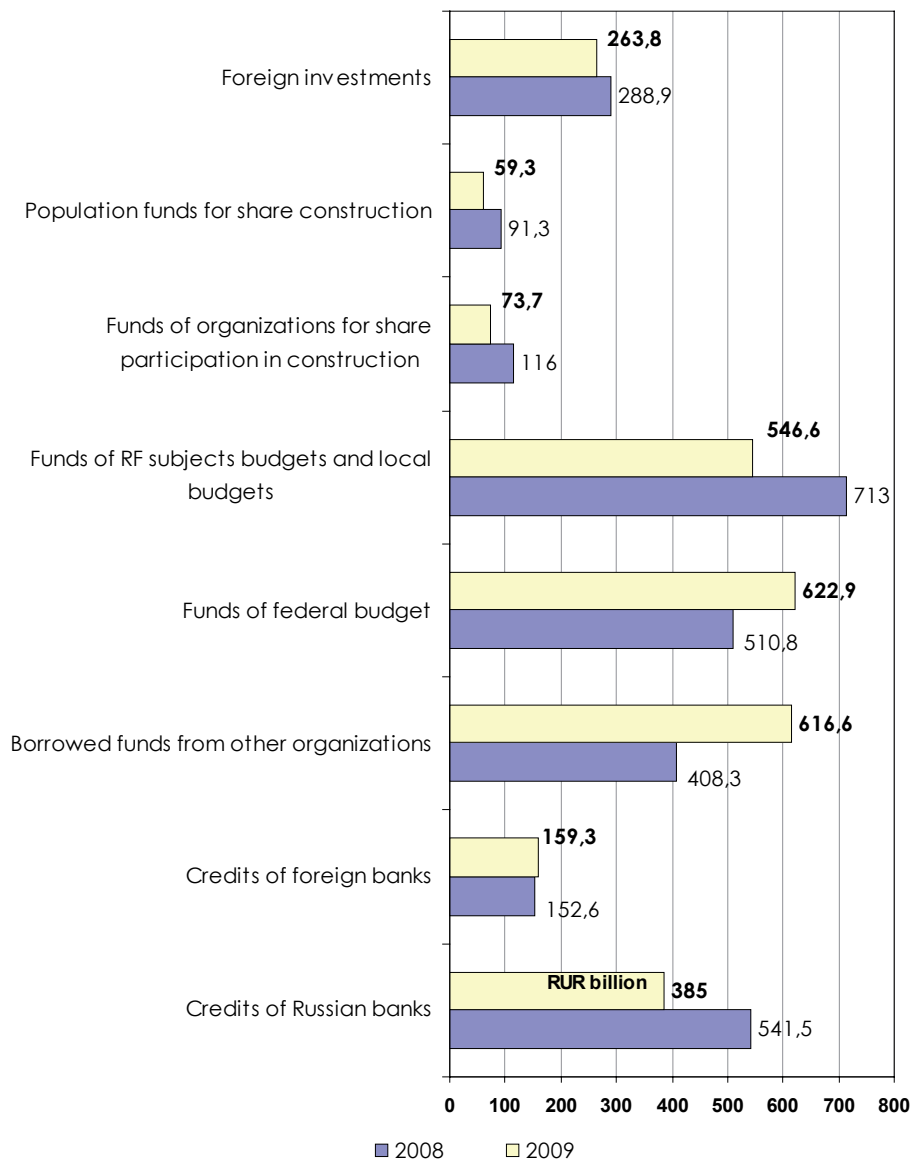
Financial crisis defined the change in the investors' behavior at the market of housing construction. In 2009 the absolute decrease in funds directed to share participation in construction

from both the population and the organizations was observed. In 2009 the proportion of funds received for share participation in construction in the total volume of investments made 2.3%, including the funds of population of 1.0% versus, correspondingly, 3.5% and 1.9% in 2008. As a result of 2009 the structure of investments in fixed assets on the whole throughout the economy was considerably influenced by a dramatic drop of investments in agriculture (75.2% versus the level of 2008), in trade (75.7%), in the sphere of communication (66.6%) and operations with real estate (70.8%).

Investment activity in the branches of infrastructure is one of the indicators of future growth potential, since it is oriented to the solution of the prospective problems. It was the decrease in the investments in the development of railway transportation by 21.0% versus the previous year that was a worrying moment of investments in transportation dynamics in 2009. The decrease in investments

scale in absolute terms had an especially negative influence on the adjacent production of capital goods. The positive dynamics of investments in transportation was supported by the increase in financing volumes of priority projects concerning pipeline transportation. Investments in pipeline transportation as compared with 2008 went up by 1.54 times, their share in investments in fixed assets structure on the whole over the economy increased by 5.2 percentage points up to 11.8%.

As a result of the contraction of the internal market investments in retail trade reduced as compared with 2008 by 28.8%, in wholesale trade – by 13.2% and in motor transport vehicles – by 34.7%.



Source: Federal State Statistics Service

Fig. 1 Borrowed Funds for Investments in Fixed Assets Financing in 2008 and 2009, as RUR billion

Table 3

STRUCTURE OF INVESTMENTS IN FIXED ASSETS AS BROKEN BY KINDS OF ECONOMIC ACTIVITY (EXCLUDING THE SUBJECTS OF SMALL-SCALE ENTREPRENEURSHIP AND PARAMETERS OF INFORMAL ACTIVITY), AS PERCENTAGE TO THE TOTAL

	2008	2009
Total	100	100
Including by kinds of economic activities:		
Agriculture, hunting and forestry	3.8	3.3

Table 3, cont'd

	2008	2009
Industry	40.9	42.2
Minerals extraction	16.1	16.8
Including fossil fuels extraction	14.7	15.5
Processing industry	16.1	15.3
Electricity, gas and water production and distribution	8.7	10.1
Construction	2.6	2.8
Wholesale and retail trade, motor vehicles and motorcycles servicing, household appliances servicing, repair of items of private use	3.1	2.4
Transportation	19.6	23.0
Communication	5.2	5.2
Financial activity	1.3	1.3
Operations with real estate, rent and services rendering	12.9	9.6
Образование	2.2	2.0
State management, securing military safety; compulsory social security	2.2	2.3
Health care and social services rendering	2.6	2.5
Rendering of other social, communal and private services	3.1	2.9

Source: Federal State Statistics Service

Changes in the structure of investments in fixed assets as broken by kinds of economic activities in industry in 2009 were determined by the decrease of the investment activity in extractive industry by 11.7%, in processing industry – by 21.8%, in electricity, gas and water production and distribution – by 0.2% of the level of 2008. The proportion of investments in industry in the total volume of investments in fixed assets made 42.2% and went up by 1.3 percentage points versus 2008.

The investments in fossil fuels extraction decreased by 22.2% versus 2008. It is, however, necessary to notice that the prices at the world market increasing, the profitability of fossil fuels extraction in 2009 went up to 29.2% versus 24.7% in the previous year.

The proportion of processing industries in the structure of investments in fixed assets on the whole throughout the economy in 2009 made 15.3%, in the structure of investments in industry – 36.2%, which is 3.2 percentage points below the level of 2008. The contribution of investment activity maintenance was secured by the increase in investments in oil products production (135.8% versus the level of 2008). It is the chemistry production (74.2% versus 2008), foodstuffs production (75.6%), leather and footwear production (65.7%), pulp-and-paper production (63.2%) that were characterized by the deepest recession of investment activity.

Low investment demands for capital goods and construction materials the facilities load being low resulted in the reduction of investments in metallurgy production by 29.1% and in metal goods production – by 32.6% versus 2008.

The analysis of the dynamics and the structure of investments demonstrated the decrease of low share of investments in machine-building. The change in the proportion of investments in machine-building was mainly defined by the contraction of investments in transport vehicles production by 26.9% versus 2008, in machinery and equipment production – by 30.6%. Under existing age, technological and reproduction structure of fixed assets low investment rates in machine-building remain the factor limiting the growth rates of production of final and intermediate goods.

In 2009 it was insufficient demand for goods, high interest rates as well as uncertainty of economic situation that were the main factors limiting investment activity of organizations in industry.

Under existing facilities load and investment expenses in 2009 the main purpose of investments in fixed assets was, the same as in the previous year, the replacement of the exhausted technology and equipment. According to materials of selective research of organizations' investment activity this was cited by 64% of the total number of enterprises. In the environment of contracting demand it was only natural for producers to decrease the importance of the tasks on the expansion of the output goods nomenclature, which was accompanied by the decrease of interest in creation of new workplaces. A sharp decrease in the enterprises' interest to the decrease of cost price and economy

of energy resources which can potentially lead to the growth of production and decrease of production and services profitability seemed worrying in the environment of the crisis. The situation was aggravated by the reduction of motivation for the improvement of productions' technological characteristics.

Table 4

DISTRIBUTION OF ORGANIZATIONS REGARDING ESTIMATION OF INVESTMENTS IN FIXED ASSETS PURPOSES (BASING ON SELECTIVE RESEARCH OF ORGANIZATIONS' INVESTMENT ACTIVITY, AS PERCENTAGE TO THE NUMBER OF ORGANIZATIONS)

	2000	2005	2006	2007	2008	2009
Purposes of investments in fixed assets:						
Increase of production facilities, the production nomenclature remaining unchanged	42	28	31	27	29	29
Increase of production facilities, the production nomenclature expanding	34	38	36	39	39	27
Automation and mechanization of the existing production process	51	51	51	53	51	45
Implementation of new production technologies	41	46	47	44	42	33
Decrease of production prime cost	42	49	46	48	46	39
Saving energy resources	39	49	44	48	43	35
Replacements of exhausted devices and equipment	56	73	72	73	70	64
Creation of new workplaces	30	25	21	21	22	16
Environmental protection	48	50	50	49	46	36

Source: Federal State Statistics Service

It should be noted that there are also positive changes in the structure of purchased fixed assets. Investments in purchase of technological lines and complexes for output of new production are becoming more attractive while the interest for replacing separate devices, machines and pieces of equipment which corresponds to the long-term aims of modernization and production reconstruction and contributes into production of competitive high-tech goods.

Table 5

DISTRIBUTION OF ORGANIZATIONS BY KINDS OF FIXED ASSETS PURCHASED, AS PERCENTAGE TO THE TOTAL NUMBER OF ENTERPRISES

	2009	Forecast 2010
Machinery and equipment		
Complexes and technological lines	58	56
Separate installations	54	50
Transport vehicles	49	46
Computer equipment, mechanization and automation means for engineers and managers	62	57
Communication means	38	36
Other	32	27

Source: Federal State Statistics Service

Formation of this trend is of vital importance since the biggest part of enterprises in 2009 – 87% of the researched enterprises – purchased new cars and equipment of domestic production and only 37% of enterprises – import ones. Such a shift in priorities will undoubtedly have a positive impact on the internal market of investment goods.

According to the forecast of the Ministry for Economic Development, the expected growth of investments in 2010 will make 102.9% versus the level of 2009. ●

FOREIGN INVESTMENTS

E.Ilukhina

The decrease in the activity of foreign investors in the Russian Federation was characteristic for 2009 against the background of the increase in the withdrawn capital. Foreign investments are still concentrated in the industry and sphere of trade. It is the processing industries that were the most attractive for the investors in the industry. As to geographic structure the biggest volume of investments was directed to the Russian Federation from Luxemburg and the Netherlands. As a result of 2009 the third place among the leading investors in the Russian Federation is occupied by China.

In 2009 the total of USD 81.9 billion was directed to the Russian economy, which is by 21.0% below the corresponding figure for 2008.

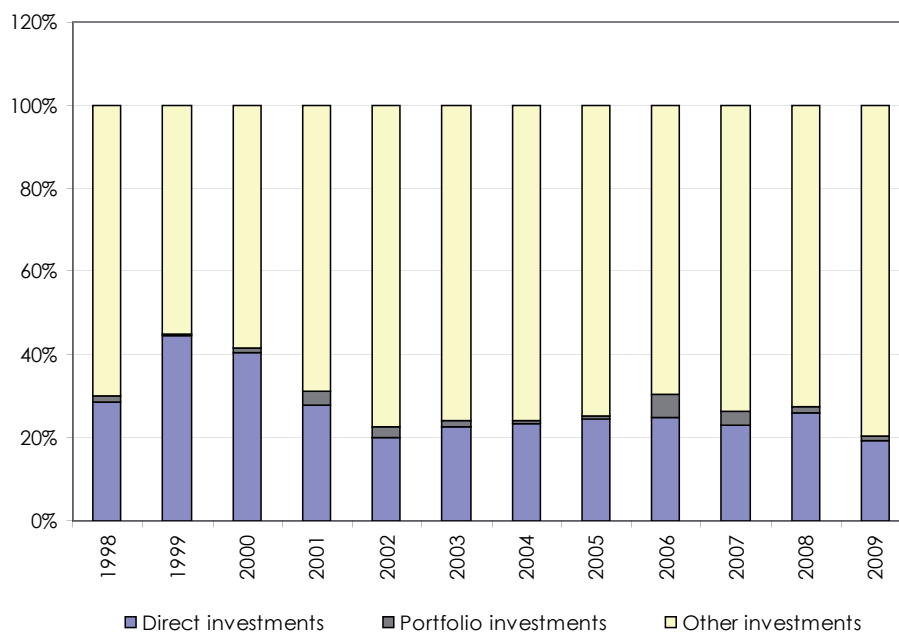
Table 1

STRUCTURE OF FOREIGN INVESTMENTS IN RUSSIAN ECONOMY IN 2005–2009

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

Source: Federal State Statistics Service

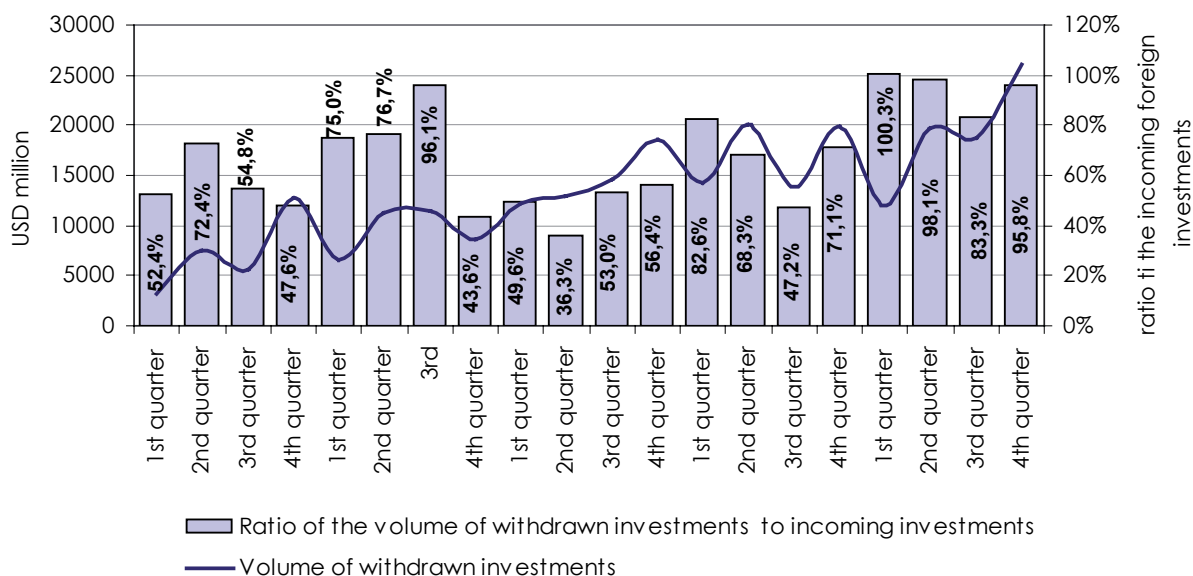
The total volume of foreign investments incoming into the Russian economy in 2009 lowered primarily due to the reduction of direct investments by USD 11.1 billion, which as a result of the previous year made USD 15.9 billion. The decrease occurred due to the contributions to authorized capital stocks, which, as a result of 2009 went down by 49.7% to USD 8.0 billion. Thus, in the



Source: Federal State Statistics Service

Fig. 1 Structure of Foreign Investments in Russian Economy in 1998–2009

structure of direct foreign investments into the Russian Federation the proportion of credits received from foreign co-owners of enterprises went up from 36.2% in 2008 to 40.5% in 2009, and the proportion of contributions to the authorized capital stock decreased from 58.8% to 50.3%. As to the segment of portfolio investments incoming into the Russian economy in 2009, there a decrease of 37.7% compared to 2008 was observed. At the same time in their structure the proportion of investments in stocks and shares, which up to recently made up the biggest part of portfolio foreign investments, have been ob-



Source: Federal State Statistics Service

Fig. 2. Withdrawal of Foreign Capital from Russian Economy in 2005–2009

served to decrease (95.5% of the total volume of portfolio investments in 2007, 7.6% in 2008 and 42.9% in 2009).

Versus 2008, in 2009 other investments dropped by 13.5%. The proportion of trade credits in the structure of other investments as a result of 2009 remained at the level of 2008 and made 21.4% (21.5% in 2008). As a result of attraction of funds the proportion of credits for the period of over 6 months remained at the level of 67.9% (68.1% in 2008).

As compared with the previous year in 2009 the structure of foreign investments in the Russian economy was subject to some changes (fig. 1).

The decrease of foreign investments incoming in the Russian economy in 2009 was accompanied by the considerable increase in the volumes of withdrawn capital. Throughout 2009 the volume of withdrawn funds in the form of foreign investors' incomes transferred abroad as well as payment of interest rates for the credits and credits repayment was comparable with the volume of foreign investments incoming this year.

As a result of 2009 USD 76.7 billion was withdrawn, which exceeds the figure of 2008 by 12.8%. On the whole over 2009 93.6% of the volume of incoming investments was withdrawn (65.5% in 2008, 28.3% in 2007).

The same as in the previous year, in 2009 the concentration of foreign investments in industry and trade was maintained. At the same time as a result of 2009 the foreign investments in industry reduced by 33.6% versus 2008, in trade – by 4.7%. In connection with the global crisis which concerned primarily the real estate sector, the interest of investors in the Russian real estate sector has lowered – the operations with immovable have reduced nearly by half. Investment in transportation and communication last year, on the contrary, nearly tripled. A considerable reduction in investments in industry and real estate against the background of the increase of investments in transportation and communication resulted in the change of the foreign investment structure by branches of industry. The distribution of foreign investments among the main branches of the Russian economy is presented in table 2.

Table 2

FOREIGN INVESTMENTS IN RUSSIAN ECONOMY: STRUCTURE BY BRANCHES OF INDUSTRY IN 2007–2009

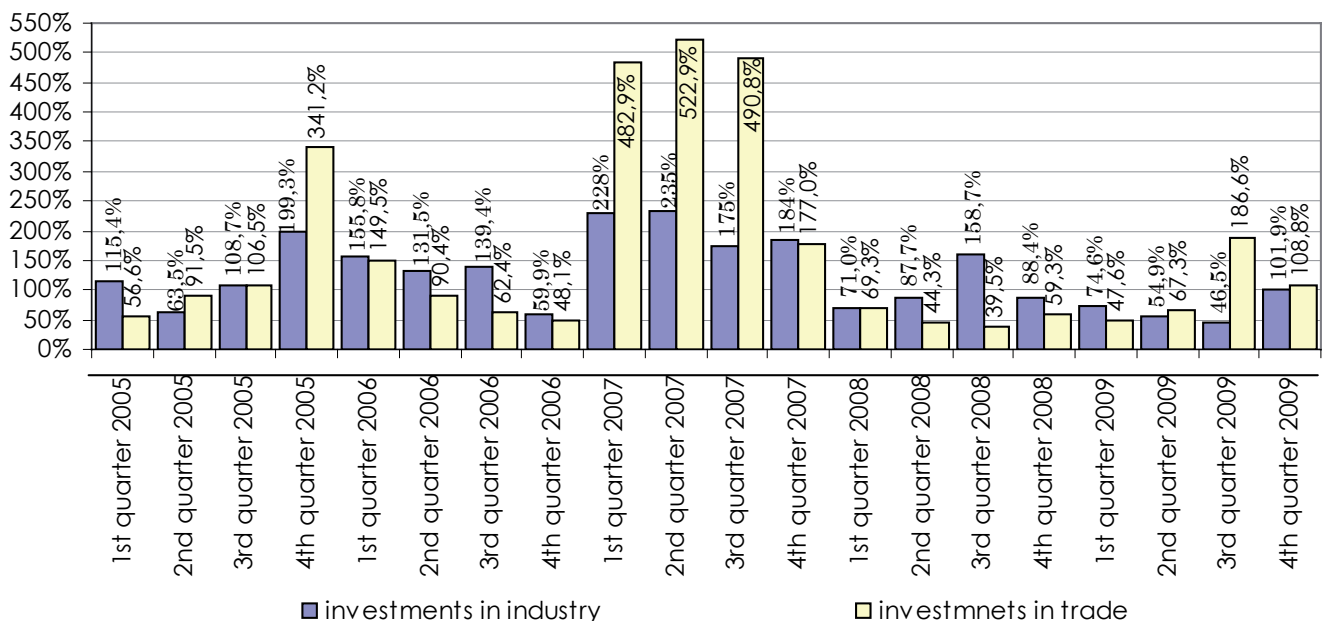
	As USD million			Change as percentage to the previous year			As percentage to the total		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
Industry	50 163	49 704	32 980	203.9	99.1	66.4	41.5	47.9	40.3

	As USD million			Change as percentage to the previous year			As percentage to the total		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
Transportation and communication	6 703	4 861	13 749	126.5	72.5	282.8	5.5	4.7	16.8
Wholesale and retail trade; motorvehicles and motorcycles servicing; repair of household appliances and items of private use	47 310	23 905	22 792	361.4	50.5	95.3	39.1	23.0	27.8
Operations with real estate, rent and services rendering	8 414	15 378	7 937	140.3	182.8	51.6	7.0	14.8	9.7
Financial activity	4 450	4 977	2 658	94.7	111.8	53.4	3.7	4.8	3.2
Other branches of industry	3 901	4 944	1 811	274.7	126.7	36.6	3.2	4.8	2.2

Source: Federal State Statistics Service

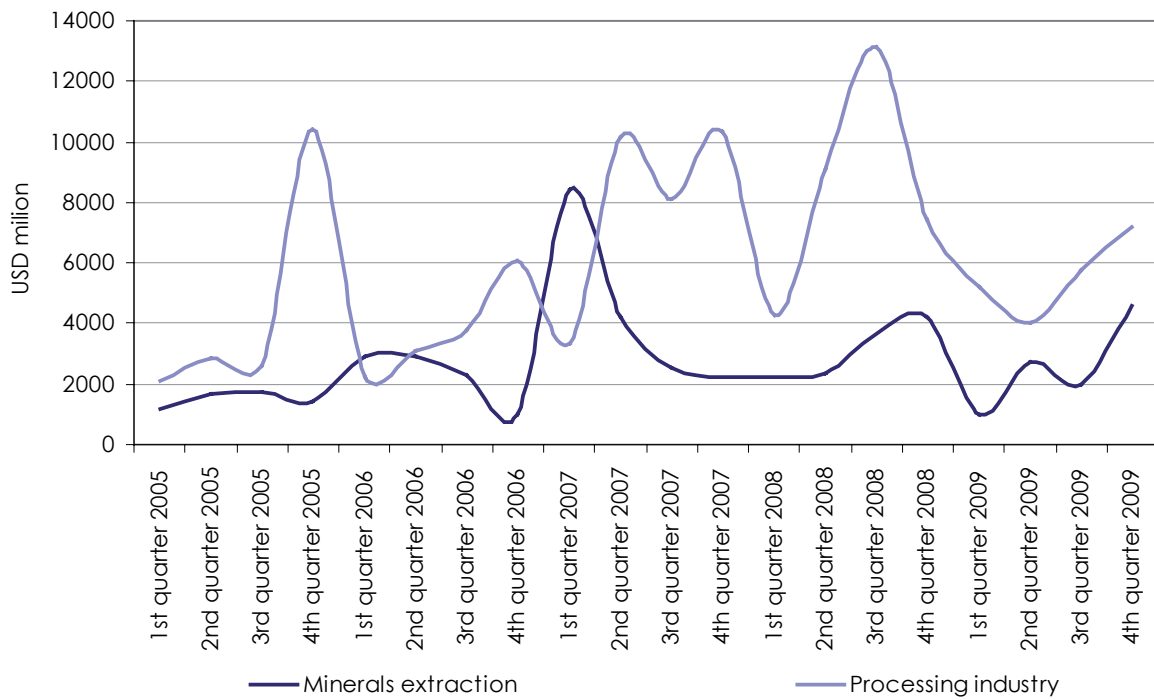
The analysis of quarter-by-quarter dynamics of foreign investments in the industry in 2009 as compared with the corresponding periods of 2008 testifies that the incoming of foreign investments has been gradually decreasing throughout the whole year excluding the 4th quarter, when a growth of 1.9% was observed. Quarterly volumes of foreign investments in trade in the 1st half of 2009 turned out to be below the corresponding indices of 2008. In the 3rd and 2th quarters 2009 the growth of 86.6% and 8.8%, correspondingly, was observed, which allowed the annual figures to reach 95.2% of the level of 2008 (see fig. 3).

As a result of 2009 the structure of foreign investments in industry was characterized by 16.0% drop of investments in minerals production (the decrease of 28.7% was observed in 2008). Foreign investments in processing industries went down by 34.5% (-6.2% in 2008). As to processing industries, investments in foodstuffs production decreased by 40.1%, in chemistry industry – by 37.6%, making USD 2.4 billion and USD 1.6 billion, correspondingly. Foreign investments in metallurgy reduced by 3.2 times versus 2009 and made USD 4.5 billion.



Source: Federal State Statistics Service

Fig. 3 Foreign Investments in Industry and Trade in 2005-2009, as percentage to the corresponding period of the previous year

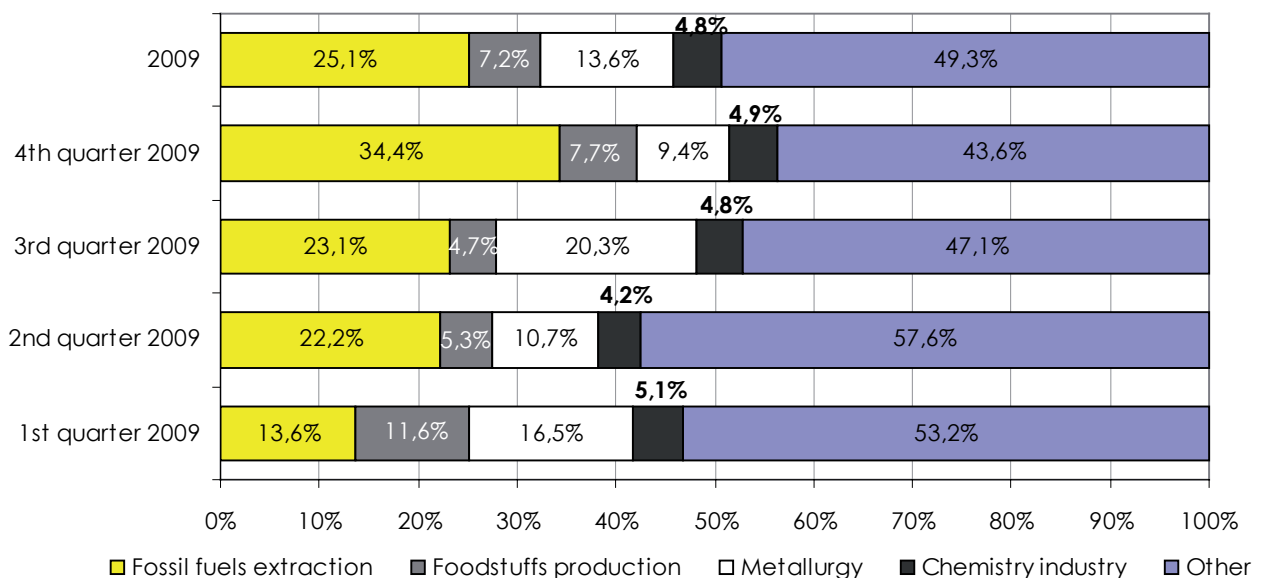


Source: Federal State Statistics Service

Fig. 4. Inflow of Foreign Investments in Extractive and Mining Industries in 2005–2009

Quarter-by-quarter statistics of foreign investments in minerals extraction and processing industries demonstrated the recovery of the upward trends in the 2nd half of 2009 (fig. 4).

It should be noted that whereas in the 1st-3rd quarters of 2009 the quarter-by-quarter dynamics of foreign investments in different branches of industry versus the corresponding periods of 2008 was negative and differed only in the rates of investments decrease rates by sectors, in the 4th quarter it was diversified. Thus, investments in metallurgy and foodstuffs production continued to decrease, reducing by 56.4% and 18.7%, correspondingly, whereas investments in fossil fuels production and chemistry industry went up by 15.1% and 52.4%. Such discrepancies were reflected in the changes of quarter-by-quarter dynamics of structure of foreign investments in industry during 2009 (fig. 5).



Source: Federal State Statistics Service

Fig. 5. Structure of Foreign Investments in Industry by Branches in 2009

The proportion of direct investments in industry went down from 26.6% in 2008 to 22.4% in 2009, the proportion of other investments over the period under consideration growing from 71.1 to 75.6%.

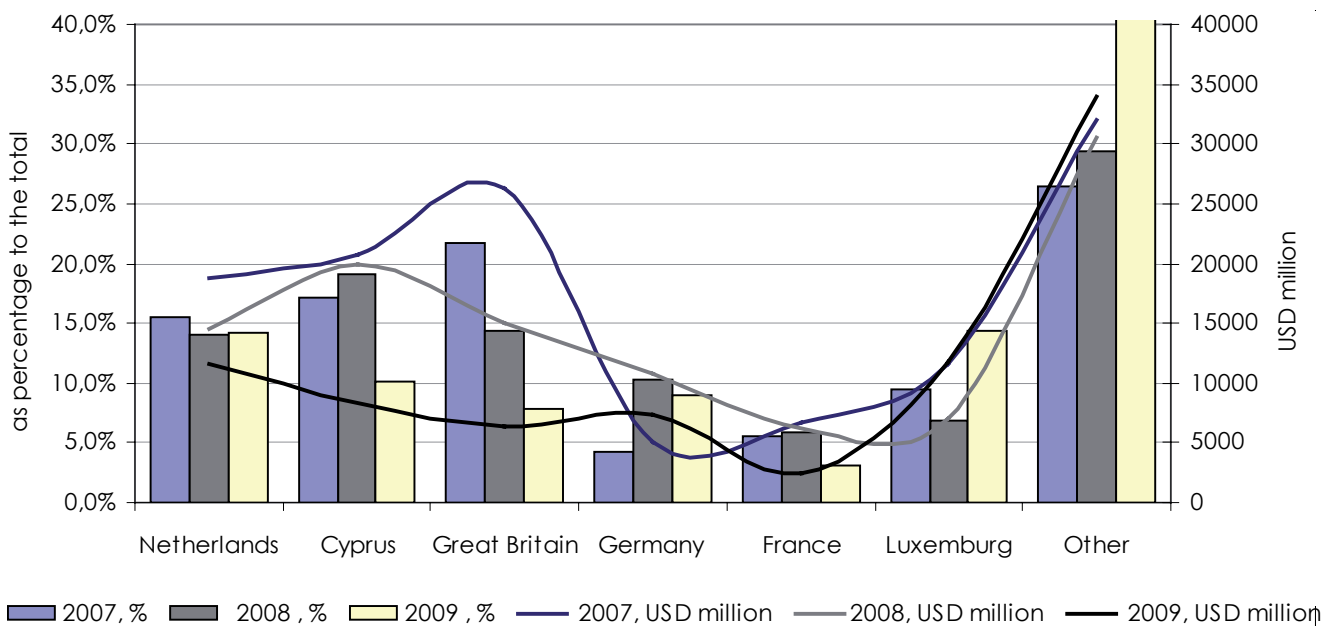
Changes were also observed in the structure of foreign investments by kinds of economic activities. In the sphere of minerals production in 2009 the direct investments decreased as compared with 2008 by 36.2% to USD 3.2 billion, which resulted in the decrease of their share in the total investments in this branch of industry from 40.2% to 30.7% (80.1% in 2007). Other investments in the extraction reduced by 7.2% over the period under consideration and made USD 6.8 billion. Thus, their proportion in the total investments in the branch rose from 59.0% to 65.8%.

The biggest part of investments in the processing industry in 2009 was also accounted for by other investments, which decreased by 35.5% to USD 17.9 billion versus 2008, making 80.6% of the total investments in processing industry (81.9% in 2008). Direct foreign investments in processing industries went down by 30.17% to USD 4.1 billion, their proportion increasing from 17.5% to 18.5%.

As to the geographical structure, as a result of 2009 the biggest amount of USD 11.6 billion (14.3% of the total volume of foreign investments incoming in the Russian economy in 2009) was directed from Luxemburg, the Netherlands investing USD 11.7 billion into the Russian Federation (14.2%) (fig. 6).

In 2009 it was the investments from Japan that were observed to grow at fastest – by 3.5 times versus 2008 (up to USD 3.0 billion), while the investments from Luxemburg went up by only 65.7%. at the same time investments from the Cyprus reduced by 2.4 times, from the Great Britain – by 2.3 times, from France – by 20% and from Germany – by 31.3%. The differences in the investment dynamics resulted in the changes of foreign investments geographic structure. One of the most notable changes was in the geographic structure of foreign investments in the Russian Federation the fact that the third place regarding the volume of invested capital was occupied by China (USD 9.8 billion or 11.9% of the total volume of foreign investments incoming in the Russian economy in 2009), and the USA are even not among the ten largest capital exporters.

Geographic structure of foreign investments by branches, which accounted for 94.0% of the total incoming of foreign investments in the Russian economy, is represented in table 3.

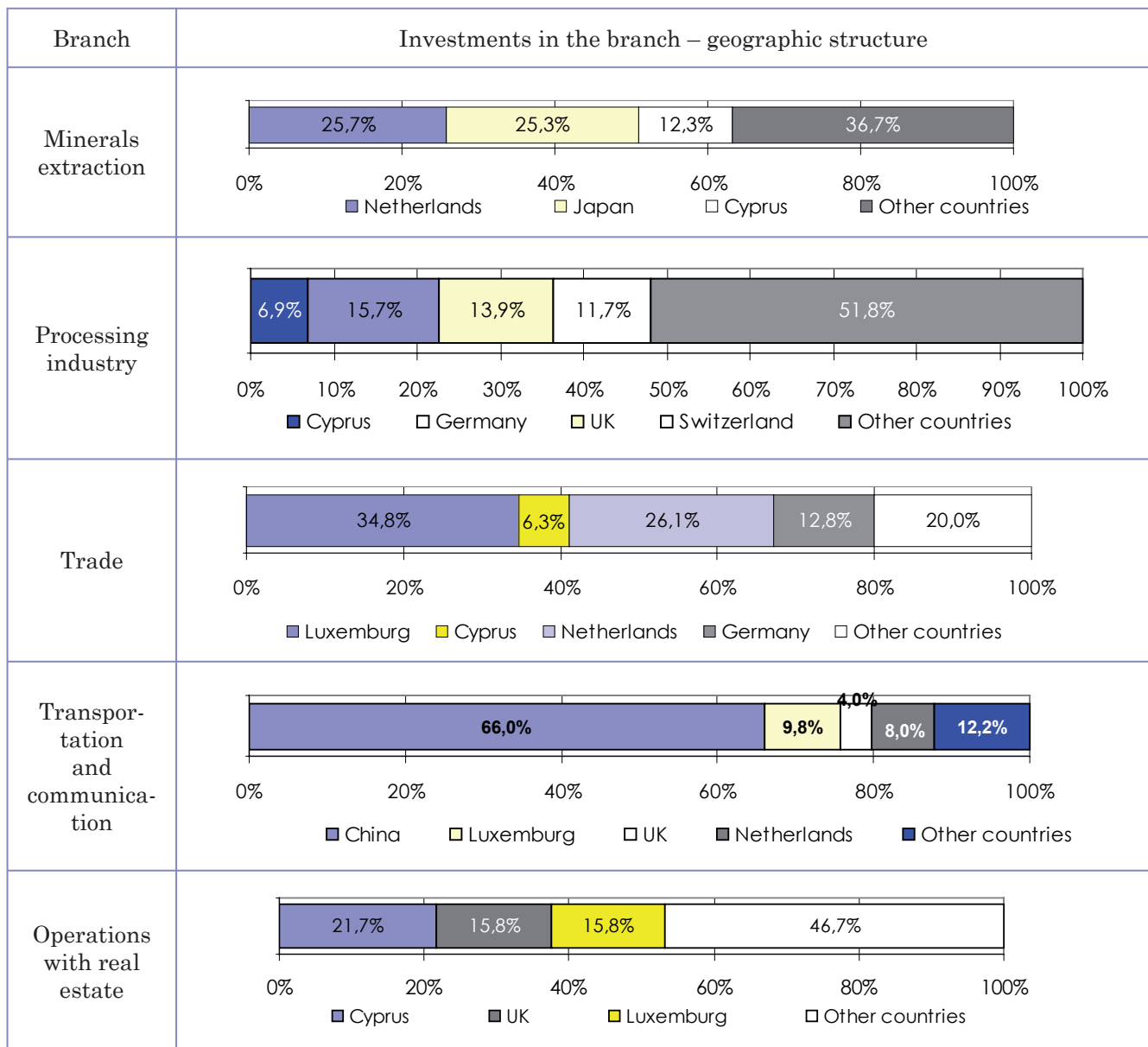


Source: Federal State Statistics Service

Fig. 6. Geographic Structure of Foreign Investments in Russian Economy in 2007–2009

Table 3

GEOGRAPHIC STRUCTURE OF FOREIGN INVESTMENTS AS BROKEN BY BRANCHES OF RUSSIAN ECONOMY 2009



Source: Federal State Statistics Service

At the end of 2009 the aggregated foreign capital not taking into account the bodies of monetary and credit regulation, commercial and saving bank, including ruble investments, recalculated in US dollars, made USD 268.2 billion, which is by 1.4% above the corresponding index of the beginning of the year. However the reduction of the aggregated direct investments was observed in the 1st quarter 2009 (by USD 27.2 billion or by 22.2% over the quarter) and in the 2nd quarter 2009 (by USD 180 million or by 0.2%) was observed. In the second half of the previous year the accumulated direct foreign investments, on the contrary, went up, increasing by USD 14 billion over a half of the year (by 14.7%).

As a result of 2009 it is the Cyprus, the Netherlands, Luxemburg, the UK and Germany that are leading as to the volume of aggregated investments, their share being 59.1% (70.3% in 2008). At the same time the share of first five leading countries in the segment of portfolio investments went up to 85.0% (75.3%), decreasing in the structure of direct and other investments down to 61.8% and 55.3%, correspondingly (73.4% and 57.6% in 2008).

Table 4

AGGREGATED FOREIGN INVESTMENTS AS BROKEN BY INVESTING COUNTRIES

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

Source: Federal State Statistics Service

As to the structure of foreign investments aggregated by the end of 2009, it is other investments that prevail, their share accounting for 55.5%. The corresponding figure for direct foreign investments made 40.6% (table 4).

According to the report on investments of the UN conference on trade and development published in September 2009, regarding the volume of the direct foreign investments in 2008 Russia occupies the 5th place in the world (9th place in 2007, 10th place in 2006, 15th place in 2005). The same as in the previous year among the developing countries Russia is the second, following China (3rd place in 2005). In concordance with the report, in 2008 the Russia's share accounted for 4.1% of the global direct foreign investments (2.8% in 2007), which is due to a considerable decrease of the inflow of direct foreign investments in the developed countries.

Despite a number of negative moments in the field of attraction of the foreign investments in the Russian economy in 2009 the prospects in the investment sphere of the Russian Federation can be characterized as optimistic. At the end of December 2009 S&P agency reconsidered the forecast for Russia's credit rating from "negative" to "stable", confirming the currency rating at the level of "BBB". At the end of January 2010 international rating agency Fitch also maintained Russia's rating at the level of "BBB", reconsidering the forecast for the rating from "negative" to "stable". ●

THE STATE BUDGET

E.Fomina

On the basis of a preliminary estimation of the results of the first few months of the year 2010, it can be said that certain positive shifts in Russia's macroeconomic situation have been becoming increasingly visible. Thus, in January – February 2010, economic growth amounted to 4.5 % against the rate observed in same period of last year. At the same time, the situation remains poorly predictable because the recent economic revival has been rather unstable and fraught with the risk of this country's financial system becoming more unbalanced. In particular, the size of the non-oil-and-gas federal budget deficit in the first two months of 2010 amounted to 13 % of GDP.

An analysis of the main parameters of the execution of the general government budget in January 2010.

According to the preliminary estimates of the general government budget's execution in January 2010, the revenue volume dropped by 7.6 p. p. of GDP on the corresponding period of 2009, while the expenditure volume, on the contrary, increased by 1.5 p. p. of GDP. As of 1 February 2009, the general government budget is executed with a surplus of 14 % of GDP, while in the corresponding period of 2009 the general government balance amounted to 23 % of GDP (see *Table 1*).

Table 1

THE EXECUTION OF BUDGET REVENUE AND EXPENDITURE AT ALL LEVELS OF AUTHORITY IN JANUARY 2009 AND 2010.

	January 2010		January 2009		Deviation, p. p. GDP
	in bn Rb	as % of GDP	in bn Rb	as % of GDP	
Federal budget					
Revenue	737.6	26.2	772.0	30.8	– 4.6
Expenditure	650.5	23.1	395.5	15.8	+ 7.3
Deficit (–) /Surplus (+)	+ 87.1	+3.1	376.5	+15.0	– 11.9
Consolidated budgets of RF subjects					
Revenue	355.5	12.6	292.9	11.7	+ 0.9
Expenditure	192.7	6.9	159.3	6.4	+ 0.5
Deficit (–) /Surplus (+)	+ 162.8	+ 5.8	133.6	+ 5.3	+ 0.5
General government budget					
Revenue	972.7	34.6	1,059.9	42.2	– 7.6
Expenditure	576.7	20.5	477.0	19.0	+ 1.5
Deficit (–) /Surplus (+)	+ 396.0	+ 14.1*	+ 582.9	+ 23.2	– 9.1
For reference: GDP, bn Rb	2,812.0		2,509.0		

*The markedly high general government budget surplus, as compared to the indices demonstrated by the federal budget and the budgets of RF subjects, can be explained by the altered procedure for the transfer of money to off-budget funds, which now bypass the federal budget.

Source: RF Ministry of Finance, IET estimates.

Throughout the first few months of 2010, just as it used to be before, the resources of the general government budget have remained highly depended on the external market situation. The parameters of the revenue inflow related to oil and gas were fluctuating depending on world prices and demand for the products of Russia's fuel and energy complex. According to the World Bank's experts, Russia must become less dependent on its oil-related revenues, which necessitates the introduction of a 'fixed surplus rule' for oil – that is, to introduce special norms for the use of oil and gas revenues and to curb the non-oil-and-gas deficit. In this connection, the

fixed share of oil and gas revenues that Russia can afford to use on an annual basis as part of her budget revenue without any detriment to her financial stability, as estimated by the World Bank, amounts to 79.3 bn 2009 USD, or 4.3 % of GDP¹, while in the 'crisis year' (2009) the size of RF non-oil-and-gas budget deficit was approximately 13.5 %.

While looking at the structure of general government budget revenue as it had emerged by 1 February 2010 (*Table 2*), it can be noted that the most dramatic drop was demonstrated by the revenues from items unrelated to oil and gas exports, e.g. the profits tax and the personal income tax. At the same time, due to the relatively favorable external situation, the revenues from foreign trade, as well as from the tax on mineral resources extraction, have been demonstrating a rise on the trends existing in early 2009.

The volumes of revenues from the tax on mineral resources extraction and foreign trade in January 2010 amounted to 4.0 % of GDP (against 2.4 % of GDP in January 2009) and 7.1 % of GDP (against 6.1 % of GDP in January 2009) respectively. The price of oil in January 2010 amounted to 75.92 USD/barrel, as compared to 42.8 USD/barrel in January 2009.² The level of budget revenues was higher than that in the same period of 2009, while still being much lower than the pre-crisis level. Thus, volumes of revenues from tax on mineral resources extraction and foreign trade in January 2008 amounted to 8.9 % of GDP and 5.3 % of GDP respectively.

Besides the relative deterioration of external factors (the declining prices and demand for Russian export commodities relative to their pre-crisis levels), the volume of 'situational' revenues was also influenced by some domestic factors. One of these, for example, was the preferential regime introduced for the export of oil from some oil fields in East Siberia. In December 2009, export duty for oil was reduced to zero for 13 East Siberian oil fields, which in January 2010 were joined by another nine oil fields. This exemption has been introduced for an indefinite period, and it is prolonged at the end of each month by a special government decree whereby this zero rate of export duty is consolidated further. However, as of this April, the RF Ministry of Finance may introduce some restrictions on this preferential regime³.

The volume of revenues from the tax on profits of organizations in the general government budget in January 2010 declined dramatically both in absolute and relative terms, amounting to 1.5 % of GDP against 3.1 % p. p. of GDP in the corresponding period of 2009. Most probably, this dynamics was largely the result of the alterations introduced in the procedure for calculating the tax and the transfer of the tax payments to the budget, rather than a rapid deterioration of the parameters of companies' operation.

Previously, economic agents had applied the scheme of advance quarter payments, while from the year 2009 onwards they were granted the opportunity to pay tax every month on the basis of the size of their actual profit, without gauging this amount to the volumes of profit obtained in more successful periods. At the same time, the volume of revenues from the tax on profits of organizations in January 2009 truly reflects organizations' operations in late 2008. In view of these facts, it should be acknowledged that these periods cannot be regarded as comparable when analyzing the dynamics of revenues from profit tax.

Following the decline of the revenues from the tax on profits of organizations, the volume of revenues from PIT in the general government budget dropped to 3.0 % of GDP, which is by 0.4 p. p. of GDP lower than the index recorded in the corresponding period of last year. However, this index somewhat increased in absolute terms. The currently observed dynamics of revenues from PIT in absolute terms can be explained by growth of real wages, which in January 2010 rose on December 2009 by 0.7 % (when cleared of the seasonal effect), whereas the rise on January 2009 amounts to 3.3 %.

According to preliminary estimates, the rise of the population's real disposable incomes (incomes less mandatory payments, adjusted by consumer price index (CPI)) in January 2010 on the corresponding period of last year amounted to almost 16 %. The population's real disposable incomes thus increased largely due to the higher levels of pensions resulting from their valorization in January 2010.

1 <http://www.finmarket.ru/z/nws/hotnews.asp?id=1448554>

2 <http://www.minfin.ru/ru/press/speech/index.php?id4=9338>

3 <http://bujet.ru/article/71107.php>

Table 2

DYNAMICS OF THE TAX BURDEN LEVEL AND THE REVENUES FROM THE MAIN TAXES IN RF
GENERAL GOVERNMENT BUDGET IN JANUARY 2009 AND 2010 (AS % OF GDP)

	January 2010	January 2009
Tax burden level (1 + 2 + 3)	29.6	29.2
Tax revenues (1), including:	20.6	20.8
Tax on profits of organizations	1.5	3.1
PIT	3.0	3.4
SST*	0**	1.4
VAT	8.0	7.8
Excise	1.6	1.1
Tax on mineral resources extraction	4.0	2.4
Insurance contributions to mandatory pension insurance (2)	1.9	2.3
Revenues from foreign trade (3)	7.1	6.1

* less insurance contributions to mandatory pension insurance.

** from 2010 onwards, SST is transformed into insurance contributions to be transferred to off-budget funds.

Source: RF Ministry of Finance; Rosstat; IET estimates.

Against the backdrop of the declining volume of revenues from the tax on profits and PIT, the volume of VAT receipts in January 2010 demonstrated slight growth in relative terms: the volume of revenues from this tax in the general government budget amounted to 0.2 p. p. of GDP, while in nominal terms these revenues noticeably increased even by comparison with their pre-crisis indices. The cause of this growth displayed by VAT receipts was the general revival of the business activity of economic agents. Besides, January 2010 was the period during which the VAT payments for Q IV 2009 were to be transferred.

In January 2010, there occurred a noticeable growth of revenues from excises in the general government budget. The volume of these revenues amounted to 1.6 % of GDP against 1.1 % of GDP in January 2009. The cause of such growth of revenues was the raised excise rates applied to a number of excisable commodities. Thus, from January 2010, the rates of excises on alcohol products with per cent volume of ethyl alcohol of up to 9 % inclusive and on alcohol-containing products and wines were indexed on the average by 30 %, and the rates of excises on beer – by 50 %. With regard to cigarettes (or cigarettes with cardboard mouthpieces), the ad valorem part of the excise rate was increased relative to the upper margin of their retail prices; in particular, the specific component of the excise rate for filter-tipped cigarettes was raised on the average by 30 %, while that for cigarettes without filter – by 50 %. Growth of revenues may also be linked in part to the technical changes introduced in the excise records; due to the switchover to a new mechanism of tax payment, in January 2010 the Federal Tax Service simultaneously registered the payments of excises for two months¹.

Against the backdrop of the dwindling general government's budget revenue, in January 2010 budget expenditure increased in the main due to the dynamics of federal budget expenditure (Table 3). General government budget expenditure in January 2010 amounted to 20.5 % of GDP against 19.0 % of GDP in 2009 (Table 3).

Table 3

THE EXECUTION OF THE GENERAL GOVERNMENT EXPENDITURE BUDGET IN JANUARY 2009
AND 2010, AS % OF GDP

	January 2010		January 2009		Deviation, p. p. of GDP
	bn Rb	as % of GDP	bn Rb	as % of GDP	
Expenditure, total	576.7	20.5	477.0	19.0	+1.5
	including				
Nationwide issues	59.4	2.1	53.9	2.2	-0.1

1 <http://bujet.ru/article/72905.php>

Table 3, cont'd

	January 2010		January 2009		Deviation, p. p. of GDP
	bn Rb	as % of GDP	bn Rb	as % of GDP	
Of these, servicing of state and municipal debts	20.5	0.7	18.4	0.7	0
National defense	27.1	1.0	27.3	1.1	-0.1
National security and law-enforcement activity	75.5	2.7	61.9	2.5	+0.2
National economy	37.9	1.4	33.9	1.4	0
Housing and utilities system	14.3	0.5	13.1	0.5	0
Environment protection	0.5	0.02	0.2	0.01	+0.01
Education	50.7	1.8	42.3	1.7	+0.1
Culture, cinematography and mass media	10.2	0.4	9.0	0.4	0
Public health care and sports	58.4	2.1	48.8	1.9	+0.2
Social policy	241.6	8.6	186.2	7.4	+1.2

Source: RF Treasury, IET estimates.

Over the period under consideration, substantial additional financing was allocated to the item 'Social Policy': 8.6 % of GDP in January 2010 against 7.4 % of GDP in January 2009. There was also a certain increase in the volume of financing (although somewhat less noticeable – of about 0.1 – 0.2 p.p. of GDP) allocated to the items 'Education' 'Public health care and sports', and 'National Security and Law-Enforcement Activity'. The growth of budget expenditure in January 2010 occurred due to the accelerated rate (by comparison with that in the previous year) of allocation of budget resources, which is quite in line with the established goal of improving the rhythm and efficiency of the usage of state funds, both for the purpose of minimizing the consequences of growing inflation and increasing the yield on budget expenditure.

The execution of the RF federal budget in January – February 2009 and 2010

According to the preliminary estimates published by the RF Ministry of Finance, the execution of federal budget revenue in January – February 2010 amounted to 21.5 % of GDP, which is by 10.4 p.p. of GDP lower than the same index for the period of January – February 2009 (Table 4). The drop in the volume of federal budget revenue in 2009 on the previous year's level occurred largely due the declining volume of receipts unrelated to the oil and gas sector, which resulted from the unstable situation in certain sectors of the domestic economy.

Table 4

THE MAIN PARAMETERS OF THE RF FEDERAL BUDGET IN JANUARY – FEBRUARY 2009 AND 2010

	January – February 2009		January – February 2010		As % of budget revenue and expenditure	Deviation	
	bn Rb	as % of GDP	bn Rb	p. p. of GDP		bn Rb	p.p. of GDP
Revenue, including:	1,679.3	31.9	1,307.7	21.5	18,8	- 371,6	- 10,4
Revenues from oil and gas	343.8	6.5	595.3	9.8	18,6	+ 251,5	+ 3,3
Deductions to Reserve Fund and National Welfare Fund (Stabilization Fund)	268.5	5.1	26.5	0.4	-	- 242,0	- 4,7
Expenditure, including:	1,442.3	27.4	1,502.4	24.7	15,2	+ 60,1	- 2,7
interest	35.4	0.7	35.9	0.6	11,8	+ 0,5	- 0,1
non-interest	1,406.9	26.7	1,466.4	24.1	15,3	+ 59,5	- 2,6
Federal budget surplus (deficit)	236.9	4.5	- 1,94.6	- 3.2	6,6	- 431,5	- 7,7

Table 4, cont'd

	January – February 2009		January – February 2010		As % of budget revenue and expenditure	Deviation	
	bn Rb	as % of GDP	bn Rb	p. p. of GDP		bn Rb	p.p. of GDP
Non-oil-and-gas deficit	– 106.8	– 2.0	– 790.0	– 13.0	12,9	– 683,2	– 11,0
GDP estimates	5,268.0		6,083.0				

Source: RF Ministry of Finance (preliminary estimates), IET estimates.

Federal budget expenditure in January – February 2010 rose by almost 3 % of GDP on the corresponding period of last year, and thus amounted to 24.7 % of GDP.

In 2010, it is intended to discontinue, in part, the co-financing from the federal budget earmarked to covering the powers of subjects of the Russian Federation pertaining to social support of the population. The increase of the corresponding expenditures of regional budgets is to be compensated by certain alterations introduced to tax and budget legislation (in the part of indexation of the rates of excises on products with low alcohol content, wines and beers; the rates of excises on petroleum products; transport tax; and state duty). The RF Government has forecasted that the consolidated budget revenues received by RF subjects under these items can amount (as estimated by the RF Audit Chamber) to 45.1 bn Rb

Besides, in 2010 the volumes of financing allocated to Federal Target Programs (FTPs) were reduced. While in 2009 RF ministries and departments received a total of 990.1 bn Rb towards the implementation of federal programs (with regard to the non-classified part of federal budget), this year only 740 bn has been allocated to the implementation of 53 FTP¹. Against the backdrop of cuts in the funding redistributed through government programs, other mechanisms will be applied more extensively to the provision of financial support. Chairman of the RF Government V. Putin has called for a more active use, alongside departmental programs, of some other development instruments, namely the RF Investment Fund, Vneshekonombank, Rosselkhozbank, Rosagrolizing, special economic zones, concession agreements, support of exports and subsidizing of interest on bank loans.

As a result of the multi-vector trends displayed by federal budget revenue and expenditure, RF federal budget deficit, as seen by the results of January – February 2010, amounted to 3.2 % of GDP (against budget surplus of approximately 4.5 % of GDP observed in the same period of 2009. In this connection, as early as March 2010, the forecast of annual federal budget deficit was already revised by the RF Ministry of Economic Development towards its lowering. By this year's results, thus index may amount to 6.2 – 6.4 % of GDP (against the previously expected and stated in the law on federal budget value of 6.8 % of GDP²).

The main source for ensuring an adequate balance of the federal budget will be the RF Reserve Fund. It is expected that by late 2010 the resources of the RF Reserve Fund (its volume as of 1 March 2010 being almost 1 trillion 764 bn Rb) will be fully spent in order to cover budget expenditure. However, it is possible that, in case oil prices once again become high, the Fund will once again be replenished from oil and gas revenues. This can probably happen no earlier than 2013. Therefore, the RF Government is already planning to attract some foreign borrowings this year.

Table 5 demonstrates the behavior of the federal budget revenues generated by the oil and gas sector set against their spending and distribution between 'oil and gas' funds. As of 1 March, the volume of 'oil and gas' resources in the federal budget amounted to almost 600 bn Rb; the volume of the National Welfare Fund is estimated to be 2,684.2 bn Rb.

Table 6 shows the dynamics of spending the resources of the federal budget in accordance with the functional classification of budget expenditures relative to the adjusted budget revenue and expenditure for the year 2010. On the whole, the execution of the federal budget in January 2010 displayed an accelerated rate, and so amounted to 6.6 % against 4.3 % in the same period of 2009. The most marked improvement in the allocation of budget resources can be noted with regard to

1 <http://www.gazeta.ru/financial/2010/03/10/3336018.shtml>

2 <http://www.vedomosti.ru/finance/news/2010/03/15/968131>

the sections 'Interbudgetary transfers' (an increase in the rate of financing by 4.7 p. p.); 'Environment protection' (by 1.6 p. p.); 'Public Health Care and Sports' (by 1.1 p. p.); 'National security and law-enforcement activity' (by 1.1 p. p. of the adjusted budget revenue and expenditure).

Table 5

THE DYNAMICS OF THE FORMATION AND USE OF THE OIL AND GAS REVENUES IN THE FEDERAL BUDGET IN JANUARY – FEBRUARY 2010, BN RB

Indices	Fund residuals, end of 2009	Approved for 2010 budget	Received in January – February 2010	Allocated in January – February 2010		Fund residuals, end of February 2010
				on maintaining well-balanced federal budget	on oil and gas transfer	
Oil and gas revenues in federal budget	x	2,057.2	595.3			x
Areas for allocating oil and gas revenues:	x	x				x
Oil and gas transfer	x	2,531.1	595.3			
Reserve Fund	1,830.5	5,147.5	0	0	0	1,763.9
National Welfare Fund	2,769.0	x	26.5	–	–	2,684.2
Total	4,599.5	x	621.8	0	0	4,448.1

* residuals as recalculated at the exchange rate as of March 2010

Source: Federal Treasury.

Table 6

FEDERAL BUDGET EXECUTION IN CASH TERMS IN JANUARY 2009 AND 2010
(AS A PERCENTAGE OF ANNUAL BUDGET REVENUE AND EXPENDITURE)

	2010	2009
Budget expenditure, total	6.6	4.3
including		
Nationwide issues	3.3	3.1
Servicing of state and municipal debts	5.6	7.3
National defense	2.2	2.0
National security and law-enforcement activity	5.9	4.9
National economy	1.4	1.9
Housing and utilities system	0.6	0.5
Environment protection	2.0	0.4
Education	2.5	1.9
Culture, cinematography and mass media	3.8	3.2
Public health care and sports	1.9	0.8
Social policy	2.7	1.9
Interbudgetary transfers	12.7	8.0

Source: RF Ministry of Finance; IET estimates.

Against the backdrop of the generally accelerated spending of federal budget resources as compared to the behavior of that parameter observed in January 2009, the execution of a number of items, on the contrary, became slower. In particular, the decline under the section 'National Economy' amounted to 0.5 p. p; and that under the section 'Servicing of State and Municipal Debts' - by 1.7 p.p.

An overview of the main developments in the sphere of tax and budgetary policy in March 2010

On 10 March 2010, a meeting was held where the issues pertaining to the implementation of the tax policy in the framework of forming the draft federal budget for 2011 – 2013 were discussed.¹ Among the key government-proposed tax policy measures to be implemented from the year 2011 onwards, the following major ones can be pointed out.

Firstly, it was considered feasible to alleviate the tax load on the wages fund (contrary to the previously planned increase, from 2011, of the size of insurance contributions to mandatory social insurance. Following the proposal concerning the preservation, in 2010, of the existing rate of insurance contributions (26 %), it was then suggested that in 2011 the rate was to be increased to 32 % instead of 34 % (to compensate for the refusal to raise the medical insurance contributions from 3.1 % to 5.1 %). This measure will make it possible to ensure a more gradual increase of the fiscal load, which will be easier for businesses.

At the same time, it was suggested that the rate of insurance contributions for innovative enterprises be kept, as before, at the level of 14 %. Besides, there exist some opportunities for expanding the list of sectors where companies may take advantage of this privilege. In this connection, the RF Ministry of Finance proposed to extend the period of applying this privilege ‘until 2015 certainly, and probably even until 2020’, as well as to envisage the possibility to carry back these privileges to 2010.

Secondly, the necessity of continuing the development of ‘new depreciation mechanisms compatible with the modern economic realities’ was discussed. In particular, this means envisaging some further steps aimed at switching over to function-linked depreciation groups and at shortening the depreciation periods for certain types of fixed assets.

Thirdly, from the year 2011 onwards, not-for-profit organizations operating in the spheres of public education, science, culture, and medicine may be made exempt from tax on profit, which will have a positive effect on the availability and quality of services in these spheres. Besides, it was suggested that some tax exemptions can also be granted to innovative businesses, thus making these businesses more attractive in terms of investments and promoting the demand for their products. In this connection, it must be well understood that what is meant here is not tax exemptions proper, but rather an adjustment of the existing structure of taxes in order to make it compatible with the needs of innovative businesses, e.g. the introduction of more precise depreciation records, a special regime for levying taxes on transactions with intellectual property and some other specific types of property, simplification of the procedures for tax administering, including those pertaining to exports, etc.

According to the estimates published by the RF Ministry of Finance, the volume of revenue losses in the RF budget resulting from granting exemptions to innovative businesses, as well as from exempting commercial organizations operating in the spheres of public education and health care from tax on profit, will amount to approximately 100 bn Rb in 2011, and to a further 100 – 150 bn Rb in 2012. In other words, the resulting loss of tax receipts will amount to approximately 0.2 – 0.3 % of GDP per annum, which in principle cannot be fraught with any significant consequences from the point of view of disrupting the balance of the country’s budgetary system, given the fact that, in recent years, the volume of receipts from major taxes (less insurance contributions and customs duties) in the general government budget of the Russian Federation has never dropped below the level of 20 % of GDP, and that the most acute phase of the crisis is already over.

In March 2010 it was stated that the next scheduled indexation of pensions and some other social benefits would begin on 1 April 2010.² Thus, it is planned that the size of pensions is to be indexed by 6.3 % (with due regard for growth of prices for commodities and services in 2009). Social pensions are to be increased by 8.8 %, as a result of which the average size of a social pension will amount to 4,611 Rb. In addition to increasing labor and social pensions, from 1 April an index of 10 % is to be applied to the monthly payments allocated to various categories of pensioners. Besides, it should be noted that, from the year 2010 onwards, all the indexations

1 <http://bujet.ru/article/72405.php>

2 <http://www.rbc.ru/rbcfreenews/20100316131626.shtml>

will be applied to the total size of pensions received in January 2010 as part of their valorization. In this connection, over 2010 pensions may increase in general by 46.1 % (with due regard for the completed valorization).

However, it should be acknowledged that any such increase of social benefits requires a very measures approach, because it inevitably involves an additional burden on the federal budget. Thus, according to preliminary estimates, the previous increase in pension payments carried out at the beginning of the current year is year, according to preliminary estimates, will cost the budget 502 bn Rb (or approximately 1.2 % of GDP) per annum. ●

THE REAL ESTATE MARKET IN THE RF

G.Zadonsky

Housing affordability was on the rise throughout the year 2009, which is demonstrated by the drop of the housing affordability coefficient's value by 20 %. The cost of housing construction in 2009 increased by 13.18 % as compared to 2008. The stable decline of the interest rate on housing credits in the second half-year 2009 gave way in January 2010 to slight growth. There still exists a trend towards increasing the volume of outstanding debt against ruble-denominated housing mortgage credits, while the volume of outstanding debt against housing mortgage credits denominated in foreign currencies is fluctuating.

In February 2010, a total of 31.0 thousand new apartments were built by organizations of all types of ownership; and the figure for January - February 2010 is 66,0 thousand apartments with total area of 6.0 mln sq m, which amounts to 101.3 % of the corresponding index for the same period of last year.

The construction cost of residential buildings per sq m of total area in 2009 increased by 13.18 % by comparison with 2008 – from 26,622 Rb in 2008 to 30,130 Rb in 2009 (Table 1). In cities and urban-type settlements, this index rose by 12.92 %, and in rural areas – by 17.86 %.

Table 1

CONSTRUCTION COST OF RESIDENTIAL BUILDINGS PER SQ M OF TOTAL AREA (RB)

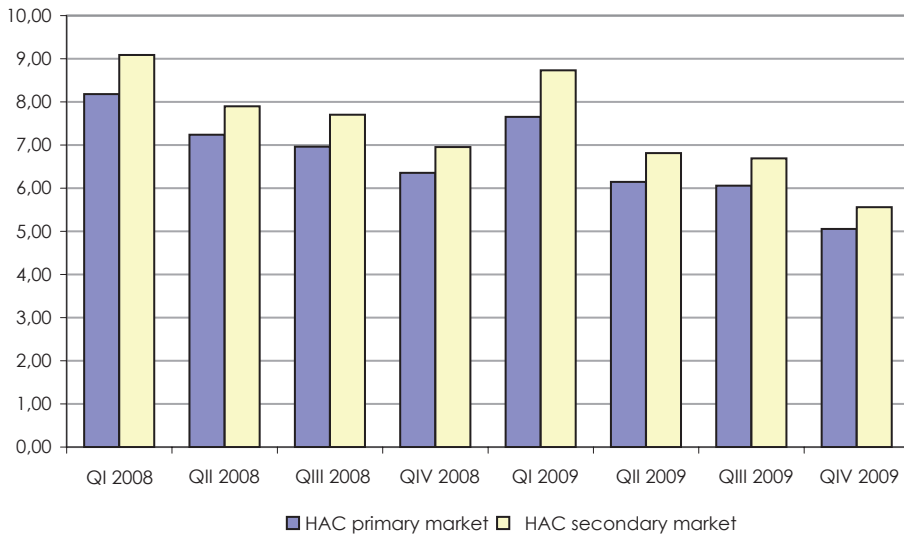
	Residential buildings (apartments) without annexes, superstructures and inbuilt premises, and without residential buildings constructed by individual constructors		
	total	in rural areas	in cities and urban-type settlements
2009			
Q I	28,814	28,597	28,826
Q II	28,763	29,994	28,673
1 st half-year	28,790	29,358	28,754
Q III	29,294	28,393	29,338
January - September	29,002	29,011	29,002
Q IV	31,298	32,038	31,256
Year	30,130	30,509	30,108

Source: Rosstat.

The mean actual construction cost of residential buildings per sq m of total area in 2009 in Moscow (59,761 Rb), Kamchatka Krai (58,365 Rb), Chukotka Autonomous Okrug (92,756 Rb), Yamalo - Nenets Autonomous Okrug (58,621 Rb), and Nenets Autonomous Okrug (47,487 Rb) was by 1.5 times (and more) higher than Russia's average.

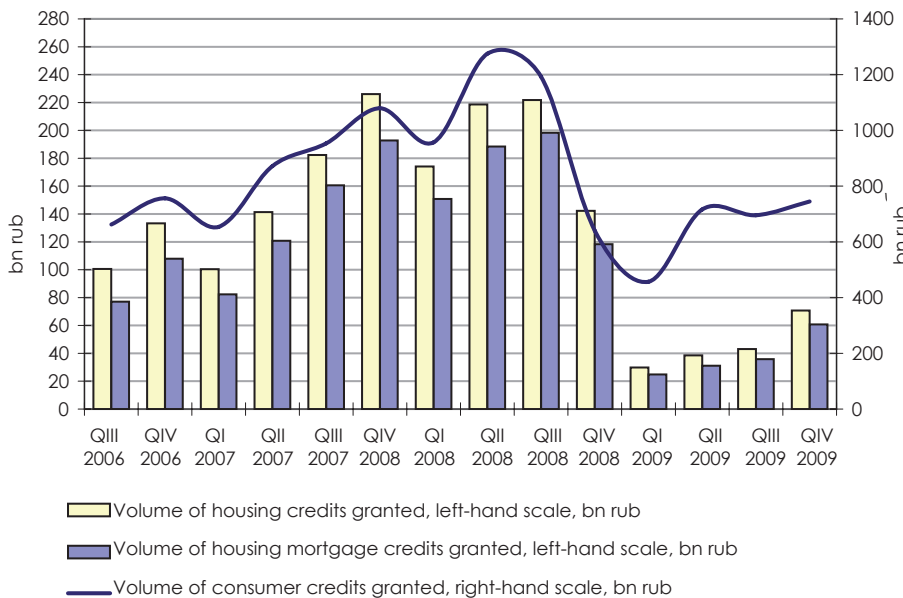
The housing affordability coefficient (HAC) (estimated as ratio of value of a standard apartment of 54 sq m for a family of three persons to an annual family income) in 2009 was declining. The greatest drop was observed in Q IV 2009 when HAC fell on Q IV 2008 by 20.5 % on the primary market and by 20.0 % on the secondary market.

In 2009, within the framework of the subprogram 'Fulfillment of the state obligations regarding the allocation of housing to the categories of citizens established by federal legislation under the 'Federal Target Program "Dwelling" for 2002 – 2010', through the realization of government housing certificates, a total of 1.9 thousand apartments (total area 103.3 thousand sq m) were purchased for citizens discharged from military service in the Ministry of Internal Affairs' bodies and for the



Source: Rosstat.

Fig. 1. Housing affordability coefficient, years



Source: RF Central Bank.

Fig 2. Credits granted to physical persons, by quarter

Cadastre of Immovable Property’ and ‘On State Registration of Titles to Immovable Property and Transactions Therewith’ have made it possible, from 1 March 2009, to simultaneously submit applications and documents for the entry in the State Cadastre records and for State registration of a title to a house or a plot of land. The Federal Service for State Registration, Cadastre and Cartography (*Rosreestr*) also intends to abolish the requirement concerning a mandatory submission for State Registration of titles of a cadastre certificate for a plot of land, and from 1 January 2013 – also of a cadastre certificate for a building, structure, premises, or an uncompleted construction project. It is planned to make it possible to complete the formalization of a title to an apartment or a 0.6-hectare plot of land via postal service or the Internet.

In 2009, according to the RF Central Bank, a total of 130,085 housing mortgage credits were granted in the amount of 152,501 mln Rb. Relative to the corresponding 2008 indices, the number of credits amounted to 37.22 %, and the volume of money granted in the form of credits – to 23.25

persons equated thereto, to the sum of 3,240.3 mln Rb, including those covered by subsidies – to the sum of 3,077.9 mln Rb.

According to the data published by the Federal Service for State Registration, Cadastre and Cartography (*Rosreestr*), a total of 47 mln plots of land are currently in private ownership by various types of property right holders. In the two years since the introduction of a simplified procedure for housing property registration (‘the dacha amnesty’), it has been applied by more than 4 mln Russians out of the 20 mln owners of dachas and orchard and vegetable garden plots. In 2009, *Rosreestr* registered 7,056,665 physical persons’ titles to plots of land; of these, there were 3,191,812 titles to agricultural plots, 3,854,767 titles to settlements’ land, and only 8,133 titles to industrial and ‘special purpose’ lands.

In 2009, according to *Rosreestr*, a total of 86,555 encumbrances of physical persons’ titles (mortgages) to plots of land, and 75,512 encumbrances of juridical persons’ titles thereto were registered.

The amendments made to the Laws ‘On the State

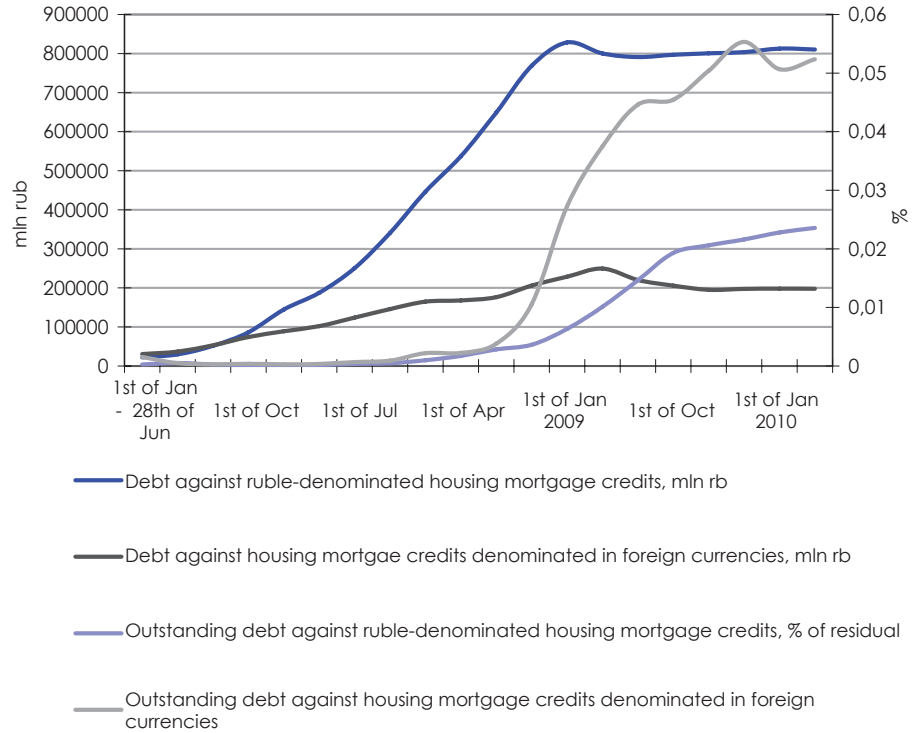
% . The residual debt against housing mortgage credits as of 1 January 2010 was 1,010,889 mln Rb, or 94,45 % of the amount of residual debt as of 1 January 2009. According to *Rosreestr*, in 2009 as total of 256.9 thousand housing objects encumbered by mortgage were registered.

According to the RF Central Bank, in 2009, a total of 178 371 housing credits in the amount of 182,192 mln Rb were granted. The number of housing credits granted in 2009 amounted to 35.16 % relative to 2008, and their volume – to 24.07 % of the volume of housing credits granted in 2008.

The residual debt against housing mortgage credits in late 2009 and early 2010 remained almost unchanged. Outstanding debt still displays a trend towards growth, both in absolute and relative terms. As of 1 February 2010, outstanding debt against ruble-denominated housing mortgage credits amounted to 19,101 mln Rb, or 2.36 % of the corresponding residual debt, while outstanding debt against housing mortgage credits denominated in foreign currencies amounted to 12,766 mln Rb, or 5.24 % of residual debt (*Fig 2*).

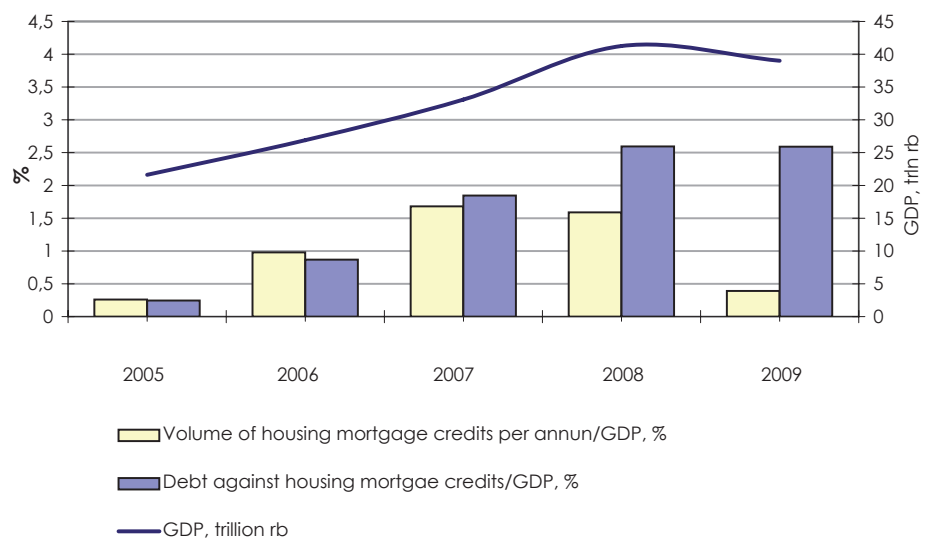
The ratio of the quarterly volume of granted housing mortgage to quarterly GDP was highest in Q IV 2007 (1.99 %), and dropped to 0.29 % in Q I 2009. This ratio on the whole in 2009 amounted to 0.39 %, (in 2008 – 1.59 %; in 2007 – 1.68 % (*Fig 3*).

According to the data published by the RF Central Bank, the monthly average weighted interest rate on housing and housing mortgage credits decreased from 14.0 % in mid-2009 to 13.7 % in December (a historic low) (*Fig 4*). At the same time, the average weighted interest rate on housing mortgage credits refinanced on a monthly basis by Open-end Joint-Stock Company *Agentstvo*



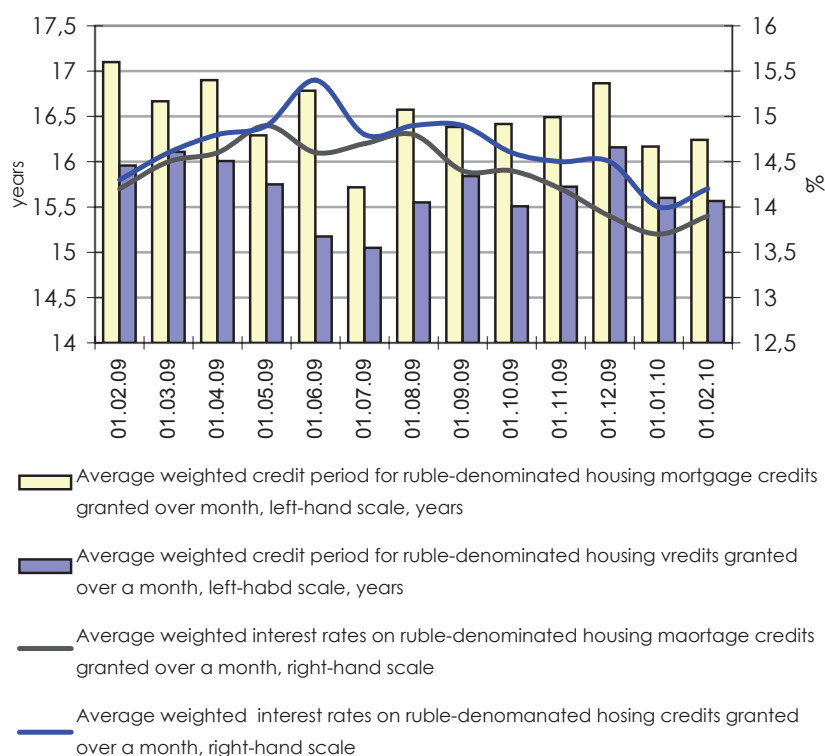
Source: RF Central Bank.

Fig. 3. Changes in residual and outstanding debt against housing mortgage credits



Sources: RF Central Bank and Rosstat.

Fig 4. Relationship between GDP, volume of housing mortgage credits per annum, and residual debt



Source: RF Central Bank.

Fig. 5. Average weighted periods and interest rates on ruble-denominated credits

po ipotechnomu zhilishchnomu kreditovaniyu (AIZhK) [Agency for Housing Mortgage Crediting], in December decreased to 11.7 %.

The share of credits denominated in foreign currencies in the total volume of housing mortgage credits granted in 2009 decreased, by comparison with 2008, from 14.51 % to 6.25 %; while the share of housing mortgage credits denominated in foreign currencies in the total volume of residual debt decreased, by comparison with 2008, from 21.62 % to 19.60 %. As of 1 January 2010, Sberbank topped the list of banks by the volume of housing mortgage credits granted and by its current credit portfolio. Sberbank's housing mortgage credit portfolio amounted to nearly half of total residual debt against all housing mortgage credit granted in the RF. Sberbank and VTB Group are far ahead all the other banks by the volumes of housing mortgage operations (Table 2).

Table 2

THE RESULTS DISPLAYED BY LEADING HOUSING MORTGAGE BANKS OVER THE PAST DECADE

Bank	Current housing mortgage credit portfolio (mln Rb)	Volumes of credits granted (mln Rb)	Volumes of credits granted (mln Rb)	Share of housing mortgage credits in total volume of credits granted to physical persons, %	As of
1. Sberbank	514,177	793,263	1,109,168	44	01.01.2010
2. VTB Group	172,630	174,256	70,856	37	01.01.2010
3. Deltacredit	47,628	71,508	32,723	100	01.01.2010
4. Uralsib	42,808	68,024	53,108	52	01.01.2010
5. Raiffeisenbank	27,739	42,707	17,052	36	01.01.2010
6. TransCreditBank	30,091	37,422	25,764	55	01.01.2010
7. Rosbank	18,795	29,097	18,426	16	01.01.2010
8. BSGV	21,388	28,811	7,771	45	01.01.2010

Source: Data published by Rusipoteka, based on primary sources.

In 2009, the volume of early redemption of housing mortgage credits through sale of mortgaged property amounted to 2,674.2 mln Rb, or 0.27 % of residual debt as of 1 January 2010, or 8.6 % of outstanding debt against housing mortgage credits as of 1 January 2010.

In 2009, AIZhK refinanced housing mortgage credits in the amount of 28,770 mln Rb, or 20.12 % of the total volume of ruble-denominated housing mortgage credits granted over that year. In the sphere of refinancing, AIZhK enjoys a stable monopoly (Table 3),

Table 3
Statistics on the operation of refinancing organizations

Company	Buyout volume, mln Rb								
	2001	2002	2003	2004	2005	2006	2007	2008	2009
AIZhK	7	36	678	3,952	7,829	27,053	39,298	26,430	28,770
GBP-Ipoteka	-	-	-	-	4,071	13,203	13,930	9,952	335
ATTA Ipoteka	-	-	-	-	778	6,643	3,781	-	-
KIT Finans	-	-	-	-	-	3,241	6,740	28	-
VTB	-	-	-	-	-	-	11,675	14,548	-
Russkii Ipotechnyi Bank [Russian Mortgage Bank]	-	-	-	-	-	-	1,658	2,589	-

Source: Data published by *Rusipoteka*, based on primary sources.

In December 2009, *AIZhK* decided to create *Strakhovaia kompania AIZhK* [*AIZhK* Insurance Company] with a charter capital of 1.5 bn Rb; the necessary money has already been transferred to the affiliated company's charter capital, and they are preparing to apply for an insurer license. In March 2009, the RF State Duma sent a parliamentary inquiry to the RF Minister of Finance concerning the purposes of creating *Strakhovaia kompania AIZhK* and the operations of the Agency for Housing Mortgage Crediting itself in connection with the issue of targeted usage of financial resources received by it both in the form of credits (or loans) from *Vneshekonombank* and budget allocations from the federal budget.

On 27 February, *AIZhK*, Open-end Joint-Stock Company *Novyi Investitsionno-Kommercheskii Orenburgskii Bank Razvitiia Promyshlennosti 'NIKO-Bank'* [New Orenburg Commercial Investment Bank for Industrial Development 'NIKO-Bank'], and Limited Liability Company *Ekodol'e – Orenburg* signed an agreement concerning their participation in the implementation of a pilot project aimed at developing and implementing credit instruments in the sphere of low-storey housing construction, whereby additional deductions from interest rates on credits are envisaged for the buyers of 'economy class' housing and for participants in federal housing programs. ●

THE OIL AND GAS SECTOR

Yu.Bobylev

The rebound of the world economy and the limited supply of oil by OPEC countries were factors that contributed to international oil prices climbing in Q I 2010 to a relatively high level. In its turn, this resulted in a significant growth in oil and natural gas extraction in Russia. The hike in oil prices and the adopted measures designed to reduce the tax load improved the financial situation of oil companies and pushed up stimulated oil extraction.

The recuperation of economic growth in the leading developed countries, which occurred while OPEC member states have been limiting the supply of oil and some oil-producer countries (Norway, the UK, Mexico) had cut its extraction, contributed to international oil prices climbing to a relatively high level. According to preliminary estimates, in Q I 2010 the price of Urals on the world (European) market amounted to 75.3 USD per barrel, which was by 23.4 % higher than its average level of the previous year (Table 1). Data on the month-on-month movement of international oil prices in Q IV 2009 – Q I 2010 are presented in Table 2. In view of the existing market situation, the March 2010 Conference of OPEC took a decision not to change the quotas for oil extraction set for its member countries.

Table 1

INTERNATIONAL OIL PRICES IN 2007 – 2010, USD / BARREL

	2007	2008	2009 Q I	2009 Q II	2009 Q III	2009 Q IV	2009	2010 Q I (preliminary estimate)
Price of Brent, UK	72.5	97.7	45.0	59.1	68.4	75.0	61.9	76.2
Price of Urals, Russia	69.4	94.5	43.7	58.1	68.0	74.3	61.0	75.3

Source: IMF, OECD/IEA.

Table 2

INTERNATIONAL OIL PRICES IN 2009 – 2010, USD / BARREL

	2009 October	2009 November	2009 December	2010 January	2010 February	2010 1 – 26 March
Price of Brent, UK	72.8	76.7	74.3	76.2	73.6	78.7
Price of Urals, Russia	72.7	76.3	73.9	76.1	72.9	76.8

Source: OECD/IEA, OPEC.

Due to all these factors, oil extraction in Russia have been continuing on its upward trend. In January – February 2010 it increased by 3.2 % on the corresponding period of the previous year (Table 3). It could be noted that in 2005 – 2007 oil extraction was increasing at 2.1 – 2.2 % annually, while in 2008, for the first time in recent years, it declined, which clearly demonstrated that the country's potential for increasing oil output by intensifying the development of existing oil fields had been all but exhausted. In 2009, oil extraction resumed growth, although at a relatively low rate (1.2 %). The upward trend in oil extraction was contributed to by the launch of several new deposits (in the north of European Russia and in Eastern Siberia) and by the entry into force of a number of amendments to the RF Tax Code, which were introduced in order to reduce the tax load on the oil sector and to stimulate oil extraction.

Likewise to previous years excepting 2009, early 2010 witnessed a more rapid growth in oil processing than in oil extraction, which was mainly determined by a higher growth rate of oil product exports. In its turn, their high growth rate was clearly stimulated by the level of export duties on oil products that had been set lower than export duties on crude oil. In 2005 – 2008, the growth rate of primary oil refining amounted to 3.2 – 6.3 % per annum, while in January – February 2010 it was 4.7 %. At the same time, increase in the depth of refining was extremely slow: in 2009, it amounted to

only 72 % against 90 – 95 % in the leading industrially developed countries. In January – February 2010, the depth of oil refining in Russia was 70.1 % (vs. 70.6 % in January – February 2009).

Table 3

PRODUCTION OF OIL, PETROLEUM PRODUCTS AND NATURAL GAS IN 2005 – 2010, AS A PERCENTAGE OF A PREVIOUS YEAR

	2005	2006	2007	2008	2009	2010 January - February
Oil, including natural gas condensate	102.2	102.1	102.1	99.3	101.2	103.2
Primary oil refining	106.2	105.7	103.8	103.2	99.6	104.7
Motor gasoline	104.8	107.4	102.1	101.8	100.5	96.0
Diesel fuel	108.5	107.0	103.4	104.1	97.7	102.0
Furnace fuel oil	105.8	104.5	105.2	101.9	100.8	106.5
Natural gas	100.5	102.4	99.2	101.7	87.9	116.5

Source: Federal State Statistics Service.

In 2009, the largest volumes of oil were produced by the oil companies Rosneft, LUKOIL, TNK-BP, and Surgutneftegaz and Gazprom. These five companies accounted for 77 % of Russia's total oil production. Medium-sized companies (Tatneft, Slavneft, RussNeft and Bashneft) accounted for 14.2 % of this country's oil production. In 2009, the operators of production sharing agreements accounted for 3.0 % of all oil extracted in Russia. The share of all the other oil producers that comprised more than 100 small oil-extracting establishments amounted to only 5.3 % (Table 4). State companies (federally owned) accounted for 32 % of Russia's crude oil output.

Table 4

STRUCTURE OF OIL PRODUCTION IN 2004 - 2009

	Oil extraction in 2007, mln tons	Share in total output of crude oil, %	Oil extraction in 2008, mln tons	Share in total output of crude oil, %	Oil extraction in 2009, mln tons	Share in total output of crude oil, %
Russia, total	491.3	100.0	488.5	100.0	494.2	100.0
Rosneft	110.7	22.5	113.8	23.3	116.3	23.5
LUKOIL	91.4	18.6	90.2	18.5	92.2	18.7
TNK – BP	69.4	14.1	68.8	14.1	70.2	14.2
Surgutneftegaz	64.5	13.1	61.7	12.6	59.6	12.1
Gazprom (including Gazprom Neft)	45.8	9.3	43.4	8.9	41.9	8.5
Tatneft	25.7	5.2	26.1	5.3	26.1	5.3
Slavneft	20.9	4.3	19.6	4.0	18.9	3.8
RussNeft	14.2	2.9	14.2	2.9	12.7	2.6
Bashneft	11.6	2.4	11.7	2.4	12.2	2.5
Novatek	2.6	0.5	2.7	0.6	3.3	0.7
Operators of P-SA	13.8	2.8	12.0	2.5	14.8	3.0
Other producers	20.7	4.2	24.1	4.9	26.0	5.3

Source: RF Ministry of Energy, the author's estimates.

Natural gas production was traditionally dominated by Gazprom. At the same time, owing to the fact that the 2009 decline in Russia's natural gas extraction was mainly accounted for by Gazprom, its share in this country's output of natural gas dropped to 78.2 % (Table 5). On the contrary, the oil companies, Novatek and the operators of production sharing agreements increased their share in natural gas extraction. The sharp drop in natural gas extraction that was observed in 2009 (down by 12.1 % from the previous year) had been caused by a decline in domestic and external demand (resulting from the economic recession and relatively warm weather) and the early-2009 reduction of natural gas deliveries to Europe brought about by Russia's conflict with Ukraine.

Table 5

STRUCTURE OF NATURAL GAS PRODUCTION IN 2007 - 2009

	Gas extraction in 2007, bn. cubic meters	Share in total output, %	Gas extraction in 2008, bn. cubic meters	Share in total output, %	Gas extraction in 2009, bn. cubic meters	Share in total output, %
Russia, total	654.1	100.0	664.9	100.0	596.4	100.0
Gazprom (including Gazprom Neft)	551.9	84.4	553.1	83.2	466.6	78.2
Oil companies	56.9	8.7	54.8	8.2	63.5	10.6
Novatek	28.5	4.4	30.8	4.6	32.8	5.5
Operators of P-SA	6.7	1.0	8.5	1.3	18.3	3.1
Other producers	10.1	1.5	17.6	2.6	15.2	2.5

Source: RF Ministry of Energy, the author's estimates.

In 2009, despite a fall in demand for oil in Europe caused by the economic recession, Russia managed to increase the level of its oil exports in physical terms (Tables 6 & 7). This can be explained by the fact that all the other oil producers – Norway, the UK, and OPEC countries – had cut their oil deliveries. As far as Norway and the UK were concerned, this cut resulted from a drop in oil extraction for objective reasons (due to the exhaustion of their developed oil fields), while OPEC countries resorted to this measure as a result of the cartel's decisions that OPEC member countries should reduce their volumes of oil extraction.

Table 6

EXPORTS OF OIL, PETROLEUM PRODUCTS AND NATURAL GAS FROM RUSSIA IN 2005 – 2009, AS A PERCENTAGE OF THE PREVIOUS YEAR

	2005	2006	2007	2008	2009
Oil, total	98.4	98.0	104.0	94.0	101.8
including to non-CIS countries	99.1	98.0	104.8	92.6	102.9
to CIS countries	94.9	98.0	99.4	102.6	95.4
Petroleum products, total	117.9	106.3	108.0	105.0	105.3
including to non-CIS countries	119.1	104.5	107.6	102.0	107.1
To CIS countries	94.6	148.8	115.3	152.2	86.8
Natural gas, total	103.7	97.6	94.6	101.8	86.2

Source: Federal Statistics Service.

In 2009, overall net exports of oil and petroleum products amounted to 368.9 mln tons (a 3-percent rise on the previous year). The share of net exports of oil and petroleum products in oil production increased to 74.6 % (Table 7). In 2009, net exports of oil amounted to 49.7 % of its production. In 2009, the share of exports in fuel oil and motor gasoline production amounted to 81.4 % and 12.6 %, respectively (for reference: in 2005, the share of exports in motor gasoline production was 18.5 %; in 2008, it amounted to 12.5 %). In 2009, the share of imports in the coverage of domestic demand for petroleum products remains low: only 0.6 % for motor gasoline, and 0.4 % for diesel fuel and fuel oil. At the same time, the year 2009 witnessed a drop in exports of natural gas caused by a sharp reduction in its deliveries to Europe (a 13.8 – percent drop from the previous year). As a result, the share of net exports in gas production dwindled to 26.8 %.

Table 7

RELATIONSHIP BETWEEN THE PRODUCTION, CONSUMPTION AND EXPORTS OF OIL AND NATURAL GAS IN 2005 - 2009

	2005	2006	2007	2008	2009
Oil, bn tons					
Production	470.0	480.5	491.3	488.5	494.2
Exports, total	252.5	248.4	258.4	243.1	247.4

Table 7, cont'd

	2005	2006	2007	2008	2009
Exports to non-CIS countries	214.4	211..2	221..3	204..9	210..9
Exports to CIS countries	38..0	37..3	37..1	38..2	36..5
Net exports	250..1	246..1	255..7	240..6	245..6
Domestic consumption	123..1	131..2	124..1	130..4	125..3
Net exports as percentage of production	53..2	51..2	52..0	49..3	49..7
Petroleum products, mln tons					
Exports, total	97..0	103..5	111..8	117..9	124..4
Exports to non-CIS countries	93..1	97..7	105..1	107..6	115..4
Exports to CIA countries	3..9	5..8	6..7	10..3	9..0
Net exports	96..8	103..2	111..5	117..5	123..3
Oil & petroleum products, mln tons					
Net exports of oil & petroleum products	346..9	349..3	367..2	358..1	368..9
Net exports of oil & petroleum products as percentage of oil production	73..8	72..7	74..7	73..3	74..6
Natural gas, bn cubic meters					
Production	636..0	656..2	654..1	664..9	596..4
Exports, total	207..3	202..8	191..9	195..4	168..4
Exports to non-CIS countries	159..8	161..8	154..4	158..4	120..5
Exports to CIS countries	47..5	41..0	37..5	37..0	47..9
Net exports	199..6	195..3	184..5	187..5	160..1
Domestic consumption	436..4	460..9	469..6	477..4	436..3
Net exports as percentage of production	31..4	29..8	28..2	28..2	26..8

Source: Federal State Statistics Service, RF Ministry of Energy, RF Federal Customs Service, the author's estimates.

Despite some increase in the share of petroleum products, the structure of oil exports was still dominated by crude oil exports which accounted, in 2009, for 66.6 % of total exports of oil and petroleum products. Most of petroleum product exports consisted of furnace fuel oil which is used in Europe as a raw material for further processing, and of diesel fuel. Most of energy resources (85 % of oil, 93 % of petroleum products, and 72 % of natural gas) were exported to non-CIS countries.

An analysis of the behavior of Russian oil exports over a long period of time is indicative of an upward trend displayed by petroleum products, whose proportion went up from 18.2 % in 1990 to 33.4 % in 2009. Under conditions of a sharp decline in the domestic consumption of oil (according to our estimates, it had dropped from 269.9 mln tons in 1990 to 125.3 mln tons in 2009, or by more than two times) the share of net exports of oil and petroleum products in oil production had increased, over that period of time, from 47.7 to 74.6 %.

Although the above data indicate that the export orientation of the oil sector has significantly increased by comparison with the Soviet period, it should be borne in mind that this increase has been caused not only by the increase in the absolute volumes of exports but also by the considerable contraction of the domestic consumption of oil resulting from the market transformation of the Russian economy. During the years of rapid economic growth that preceded the 2008 – 2009 financial and economic crisis the volumes of Russia's domestic consumption of oil were sufficiently stable, which is indicative of a reduction in the oil intensity of Russian GDP.

In 2009, world oil prices' drop from the previous year entailed a considerable contraction of revenues from oil exports. Aggregate revenues from exports of oil and major types of petroleum products (motor gasoline, diesel fuel and fuel oil) amounted to 141.2 bn USD, or 61.7 % of the figure for the previous year, when export revenues hit their historic highs due to record high world oil prices. (Tables 8 & 9). For comparison, it could be noted that the minimum level of revenues from oil exports was observed alongside a steep plunge in world oil prices in 1998, when Russia's oil export revenues amounted to

only 14 bn USD. In 2009, the share of fuel and energy products in Russian exports was 66.7 %, with crude oil accounting for 33.3 %, and natural gas – for 13.9 % thereof respectively.

Table 8

REVENUES FROM THE EXPORT OF CRUDE OIL AND PETROLEUM PRODUCTS
IN 2005 – 2009, BN USD

	2005	2006	2007	2008	2009
Revenues from export of crude oil and major types of petroleum products	112.4	140.0	164.9	228.9	141.2

Source: the estimates are based on data from the RF Federal State Statistics Service.

Table 9

REVENUES FROM THE EXPORT OF CRUDE OIL AND PETROLEUM PRODUCTS
IN 2008 – 2009, BN USD

	2008 Q I	2008 Q II	2008 Q III	2008 Q IV	2009 Q I	2009 Q II	2009 Q III	2009 Q IV
Revenues from export of crude oil and major types of petroleum products	53.2	64.4	68.9	42.4	25.6	30.6	39.2	45.8

Source: the estimates are based on data from the RF Federal State Statistics Service.

Domestic prices for oil and petroleum products (producers' prices) expressed in US dollars, which had substantially decreased in late 2008 – early 2009, later on recuperated in accordance with the movement of world prices: in 2009, as a result of an upsurge in world oil prices they considerably grew up. In the first months of 2010, prices for gasoline and diesel fuel exceeded the level of late 2009 (Table 10). At the same time, Russia's domestic oil prices have remained much below the level of world oil prices. The gap between the levels of world and domestic prices has been caused by the existence, in Russia, of an export duty on oil and by the additional transportation costs of exports. In recent years, the price of oil on the free domestic market (a segment of the market where oil is not sold at transfer prices) has actually been formed on the basis of the world price of oil less the export duty and export costs.

Unlike domestic oil prices, domestic natural gas prices still remain in the sphere of government regulation. It is planned that, in the coming years, domestic natural gas prices will be gradually increased to a level that will ensure an equal profitability of the sale of natural gas on the domestic and external markets. Although in this case the gap between world and domestic prices will become narrower, domestic natural gas prices will remain below world prices (by the amount of the export duty and export transportation costs).

Table 10

DOMESTIC PRICES OF CRUDE OIL, PETROLEUM PRODUCTS AND NATURAL GAS EXPRESSED IN US
DOLLARS IN 2007 – 2010 (AVERAGE PRODUCERS' PRICES, USD / TON)

	2007 December	2008 December	2009 June	2009 December	2010 January	2010 February
Crude oil	288.2	114.9	194.7	219.3	196.5	203.9
Motor gasoline	581.2	305.1	481.5	457.4	483.0	481.3
Diesel fuel	692.5	346.5	382.1	394.8	429.5	413.2
Furnace fuel oil	276.5	125.0	210.8	250.8	195.3	238.8
Natural gas, USD / thousand cubic meters	17.6	18.1	22.0	16.9	17.7	18.2

Source: the estimates are based on data from the RF Federal State Statistics Service.

In 2009, a number of amendments to the RF Tax Code, designed to reduce the tax load on the oil sector, to stimulate deeper oil extraction from existing oil fields and to encourage the development of new oil deposits in untapped regions and on the continental shelf were put into effect. In particular,

in the formula for computing the C_p coefficient (which reflects the movement of world oil prices and is applied to the Mineral Resources Extraction Tax (MRET) basic rate for oil) the non-taxable minimum was increased from 9 USD per barrel to 15 USD per barrel (Table 11). This alteration of the formula for calculating the C_p coefficient resulted in a significant reduction in the MRET rate for oil extraction. In the economic situation of 2009, the reduction in the MRET rate caused by the alteration of the computation formula amounted to 12 %. This rate cut decreased the tax load on the oil sector, made it possible for oil companies to acquire additional financial resources, increased the profitability of investments in the development of new oil fields, and stimulated deeper oil extraction from depleted oil fields.

Table 11

THE MRET RATE FOR OIL IN 2005 - 2010

	2005	2006	2007	2008	2009	2010
MRET basic rate for oil, Rb / ton	419	419	419	419	419	419
Coefficient characterizing movement of world oil prices (C_p)	$(P-9) \times R/261$				$(R-15) \times R/261$	

Note: P = the average price per barrel of Urals crude oil (USD per barrel) for the tax period; R = the average Rb / USD exchange rate for the tax period as established by the RF Central Bank.

Source: RF Tax Code; Federal Law No 151 – FZ of 27 July 2006; Federal Law No 33 – FZ of 7 May 2004; Federal Law No 126 – FZ of 8 August 2001.

Also, the tax authorities have abolished the requirement that the direct method for calculating the physical quantity of oil extracted from each ring-fenced field should be used when applying the regressive coefficient to the MRET rate for highly depleted deposits. This measure has made it possible to extend this benefit to all depleted deposits, thus creating incentives for the prolongation of their exploitation and making some additional oil extraction feasible.

In order to stimulate the development of untapped basin provinces, the Russian tax authorities established MRET holidays for the new oil fields situated in the territory of Nenets Autonomous Okrug (in the north of the Timan-Pechora Oil and Natural Gas Basin Province), the Yamal Peninsula (in Yamalo-Nenets Autonomous Okrug), on the continental shelf of the Russian Federation to the north of the Arctic Circle, in the Sea of Azov, and in the Caspian Sea.

In order to additionally stimulate the development of deposits of the East Siberian Oil and Natural Gas Basin Province, the RF Government introduced, from 1 December 2009 onwards, the zero rate export duty on oil from new oil fields in East Siberia.

The differentiated reduction in the tax load on certain regions characterized by higher than average costs of deposit development seems justified within the framework of the existing tax system, because it will make it possible to ensure the required profitability of investments in the development of new oil fields. However, the mechanism of tax holidays (however simple it may appear from the point of view of tax administration), when applied for these purposes, is clearly inadequate. It implies that a single average approach is applied to all deposits of a certain region (or a continental shelf area), thus ignoring the existing considerable differences in their characteristics and in the costs of developing all the specific deposits of a given region.

In this connection, we believe that the authorities should switch over to some more advanced forms of taxation with regard to new oil fields – that is, to the regime of imposing tax on additional profits. Such an approach would ensure an automatic adjustment of the tax load to the conditions specific of the development of a given oil field. This would stimulate the development of those fields where capital, operating and transportation costs are higher. ●

THE RESULTS OF 2009 IN EDUCATION SYSTEM

T.Klyachko

Rosstat has published preliminary data on the development of the education system in 2009. They are concerned with three tiers of education: comprehensive (school) education; secondary vocational education; and higher professional education. Data on pre-school and primary vocational education are published for general consumption with a two-year delay.

The published data indicate that the above-mentioned tiers of the education system continue to experience demographic decline (Table 1).

Table 1

SELECTED INDICATORS OF THE ACTIVITY OF EDUCATION ORGANIZATIONS

	2009	As per-centage of 2008	For reference	
			2008	As per-centage of 2007
State and municipal comprehensive educational establishments (except for part-time (or in-shifts) comprehensive educational establishments)				
number of establishments	50,977	95.2	53,568	96.2
number of students, thousands	13,258.3	99.2	13,363.3	97.6
Non-state comprehensive educational establishments				
number of establishments	680	98.4	691	99.1
number of students, thousands	71.2	97.3	73.2	102.6
State and municipal secondary vocational educational establishments				
number of establishments	2,564	101.1	2,535	98.8
number of students, thousands	2,052.3	96.1	2,136.1	93.3
enrollment, thousands	666.6	99.5	670.1	91.7
graduation, thousands	593.9	94.0	631.7	96.1
State and municipal higher professional educational establishments				
number of establishments	662	100.3	660	100.3
number of students, thousands	6,135.6	98.7	6,214.8	100.1
enrollment, thousands	1,329.6	97.6	1,362.7	98.5
graduation, thousands	1,166.9	103.7	1,125.3	101.5
Non-state higher professional educational establishments				
number of establishments	452	95.4	474	105.3
number of students, thousands	1,283.3	98.8	1,298.3	103.6
enrollment, thousands	214.6	76.9	279.0	93.7
graduation	275.5	118.1	233.2	102.9

Source: Rosstat; *Rossia v tsifrah* [Russia in Figures].

On the whole, the rate of decline in the number of students has dropped: in 2009, their number decreased by 0.8 % against 2.4 % in 2008; at the same time, in 2009, the number of schools dropped by 4.8 % against 3.8 % in 2008.

The rate of decline in the number of students of secondary vocational educational establishments has also dropped: from 6.7 % in 2008 to 3.9 % in 2009. The drop is largely due to the fact that the number of graduates from secondary vocational educational establishments has decreased to a considerably greater extent than the numbers of individuals enrolled therein.

However, as far as demography is concerned, the most serious changes have taken place in the sphere of higher education. In fact, we can speak in terms of a trend change in this sphere: in 2008,

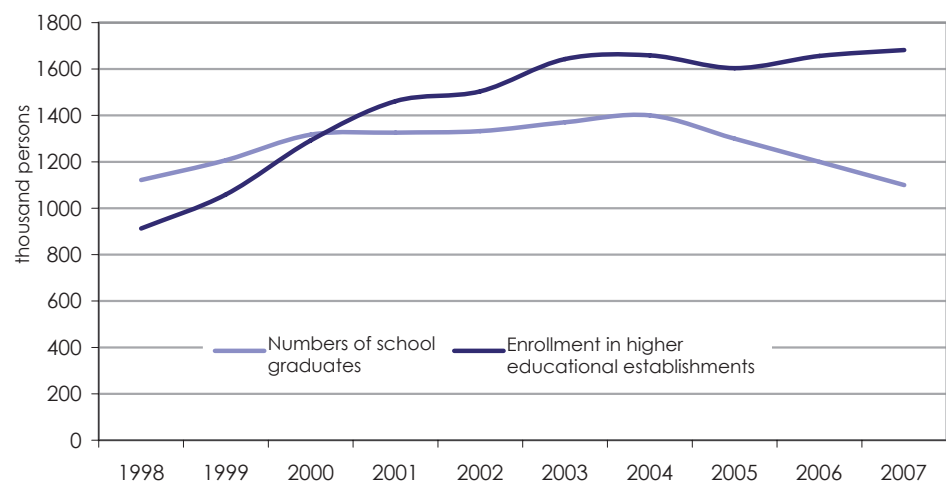
the number of students at higher educational establishments grew up, although insignificantly; in 2009, it began to decline. The drop in student numbers has occurred in both the state and non-state sectors: in the former the number of students dwindled by 1.3 %, while in the latter – by 1.2 %. On the whole, over the past year, the number of students in the system of higher education declined from 7.51 mln to 7.42 mln. The number of enrollees in non-state higher educational establishments dropped by as much as 23.1 %; their number also declined at state higher educational establishments – but only by 2.4 %. It is still too early to unambiguously determine the cause of this landslide drop in enrollment in non-state higher educational establishments. Actually, there could be several factors at work: a reduction in the total number of entrants could have made them more inclined to apply for admission to state higher educational establishments – bearing in mind that enrollment in these establishments had become easier. Another possible reason could be a drop in effective demand caused by the economic crisis. Part of the entrants have chosen to study at secondary vocational educational establishments where tuition fees are lower than those at higher educational establishments, or at the extramural branches of state (or municipal) higher educational establishments where education costs are much less than at the full-time departments of the same establishments.

It should be noted that the drop in enrollment in the full-time departments of state higher educational establishments amounted to 3.0 %, while at their extramural departments this figure stood at a mere 0.8 %. According to *Rosstat*, in the year 2009 the aggregate drop in enrollment in state and municipal educational establishments amounted to 33.1 thousand, with full-time enrollment decreasing by 20.2 thousand, and part-time enrollment – by 4.8 thousand. This means that part-time and externship enrollment has dropped by 8.1 thousand. In 2006¹, enrollment in externships amounted to 29.5 thousand, and part-time enrollment – to 60.8 thousand. It can be assumed that in 2007 and 2008 part-time enrollment decreased by another 8 to 10 thousand (judging by the dynamics of this indicator in 2001 – 2006), which means that in 2008 enrollment amounted to approximately 50 - 52 thousand. Accordingly, in 2009 the aggregate drop in the above-mentioned types of enrollment in state and municipal higher educational establishments amounted to about 10 % (or even more). Thus, in 2009, for the first time in the past 15 years, the system of higher education indeed experienced a considerable drop in the quantitative indicators relating to student cohorts and enrollment.

At the same time, in 2009 enrollment in higher educational establishments once again exceeded the number of secondary school graduates – a phenomenon that has been observed since 2000 (*Figure 1*).

Moreover, the gap between the number of secondary school graduates and the enrollment in higher educational establishments, instead of narrowing, continued to increase (*Fig. 2*).

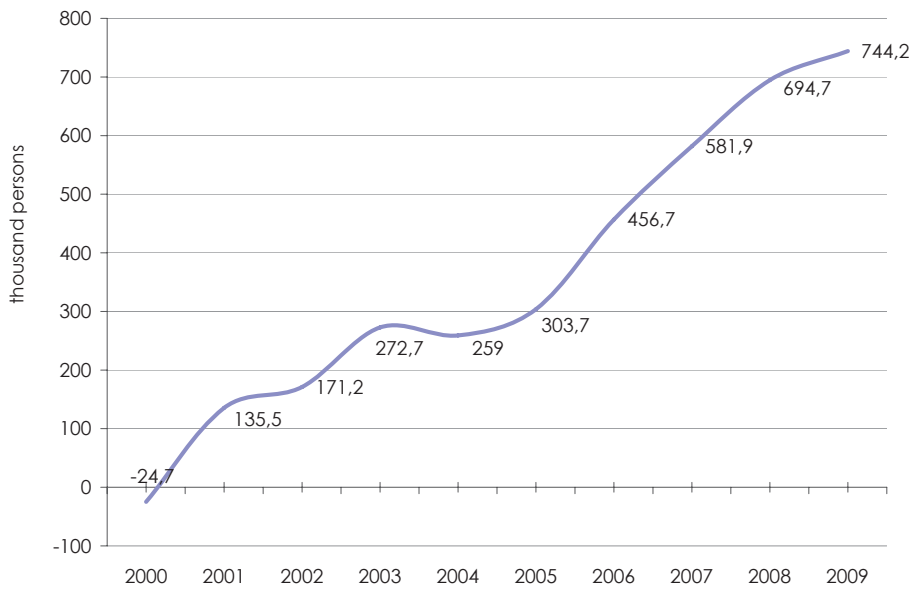
The above-mentioned excess is caused by the fact that a constantly increasing number of graduates of initial and secondary vocational educational establishments are enrolled in higher educational institutions. It can be expected that, as the demographic situation is becoming progressively worse, higher educational establishments will be more willing to enroll graduates of vocational



Source: *Rosstat; Rossiia v tsifrakh* [Russia in Figures].

Fig. 1. Numbers of comprehensive secondary school graduates and enrollment in higher educational establishments.

1 The latest available official data.



Source: Rosstat; *Rossia v tsifrah* [Russia in Figures].

Fig. 2. Excess of enrollment in higher educational establishments over the number of school graduates

percentage of those enrolled on the basis of their single state examination results was 47.2 % of the total. Judging by these figures, it can be assumed that the enrollment on the basis of single state examination results was to the full-time departments. As for extramural, part-time and externship enrollment, it was apparently carried out on some other basis. As regards budget-funded and student-funded enrollment in state and municipal higher educational establishments, by comparison with 2008, budget-funded enrollment dropped by a mere 1.0 thousand (0.2 %) – to 559.8 thousand. Student-funded enrollment decreased by 0.9 % - to 769.8 thousand, or 57.9 % of the total number of enrollees.

Overall, it can be concluded that higher educational establishments have begun to face an unfamiliar situation. For now, the demographic decline has had its strongest effect on the non-state sector of higher education, although some of its consequences have begun to be felt by state and municipal higher educational establishments as well. Accordingly, the latter continue to increase the proportion of extramural students. The numbers of part-time students continue to dwindle. So far, the share of self-paid students has remained predominant both in the total student cohort being taught by state and municipal educational establishments and in the enrollment statistics. However, student-funded enrollment has decreased more considerably than budget-funded enrollment. The economic crisis has played a significant role in the emergence of this situation, because a sharp reduction in budget-funded enrollments could indeed result in a negative response on the part of the population, especially when the Single State Examination became mandatory. So, everything was done to prevent people from thinking that the full-scale introduction of the Single State Examination would somehow entail a reduction in budget-funded enrollment in state and municipal higher educational establishments, thus decreasing the availability of free higher education. ●

training schools and secondary specialized technical educational establishments.

In 2009, the Single State Examination became mandatory, which means that all applicants to higher educational establishments have had to pass it. However, in 2009, according to *Rosstat*, 628.2 thousand persons were enrolled in state and municipal educational establishments on the basis of their single state examination results, which was by 62.2 thousand persons, or 11.0 %, more than in 2008. Therefore, as the total number of persons enrolled in state and municipal higher educational establishments amounted to 1,329.6 thousand, the per-

REVIEW OF ECONOMIC LEGISLATION

I.Tolmacheva

In March the following changes were made to the legislation: coefficients for additional increase of the insurance part of old-age pension, indexation of social pensions and index correcting severance tax rate with regard to oil were established for February 2010, Bank of Russia refinancing rate was lowered.

I. Decrees of the Government of the Russian Federation

1. "ON ESTABLISHING THE COEFFICIENT FOR ADDITIONAL INCREASE OF THE INSURANCE PART OF THE OLD-AGE PENSION, DISABILITY PENSION, SURVIVOR'S PENSION STARTING WITH APRIL 1, 2010" from 18.03.2010 No 167.

Comes into effect on April 1, 2010

The coefficient for additional increase of the insurance part of old-age pension, disability pension and survivor's pension starting with April 1, 2010 was established.

The value of the coefficient mentioned will make 1.063 (earlier it was equal to 1.175). The RF Pension Fund is commissioned to inform its regional bodies on the rate of the established coefficient for increase in pensions established by the Federal Law "On old-age pensions in the Russian Federation".

2. "ON ESTABLISHMENT OF INDEXATION COEFFICIENT FOR SOCIAL PENSIONS STARTING WITH APRIL 1, 2010" from 18.03.2010 No 169.

Starting with April 1, 2010 the indexation coefficient for social pensions is established at the rate of 1.088.

The RF Pension Fund is commissioned to inform its regional bodies on the rate of the established coefficient for increase in corresponding pensions established by the Federal Law "On state pension provision in the Russian Federation".

II. Orders, Letters, Instructions

1. Order of the Central Bank of the Russian Federation "ON REFINANCING RATE OF THE BANK OF RUSSIA" from 26.03.2010 No 2415-U

Starting with March 29, 2010 the refinancing rate of the Bank of Russia is established at the level of 8.25% per annum (earlier the refinancing rate of 8.5% per annum was in effect).

2. Letter of the Federal Tax Service of the Russian Federation "ON DATA NECESSARY TO CALCULATE SEVERANCE TAX ON OIL OVER FEBRUARY 2010" from 16.03.2010 No ShS-22-3/185@

Coefficient, correcting the severance tax rate concerning oil over February 2010 was defined to be 6.6693. The value of coefficient in January 2010 was higher and made 6.9644. The decrease of this coefficient is accounted for by the changes in the indices on which basis it is calculated. ●

MEETINGS OF THE GOVERNMENT OF THE RUSSIAN FEDERATION IN MARCH 2010 – REVIEW

M. Goldin

In March at the meetings of the Presidium of the Government of the Russian Federation the following issues were considered: tax and customs policy; course of execution of Federal target programs and fulfillment of Federal targeted investment program in 2009; improvement of state regulation of trading activity.

On **March, 10th** the RF Government Chairman V. V. Putin conducted the meeting concerning the issues of tax policy. At the meeting the project of the main direction of tax policy for 2011 and for the planning period of 2012 and 2013 (further referred to as the project) was discussed. During discussion much attention was paid to the tax privileges for enterprises conducting innovative activity. For instance, V. V. Putin pointed out that the load of burden on labor remuneration fund has grown which was a result of the increase of insurance contributions for compulsory social insurance. In this connection it is suggested to establish the insurance contributions rate of 14% for innovative enterprises. In fact it concerns organizations and individual entrepreneurs having the status of residents of special technological and implementation zone, as well as the organizations to conducting activity in the field of information technologies. At the same time for the latter category it was envisaged to maintain the existing mechanism of state accreditation as well as conditions to for privilege provision which was earlier in effect for single social tax payments. It should be remembered that earlier the privilege in the form of reduced single social tax rate was received by organizations if they met the following conditions:

- the proportion of incomes from the sale of computer software, transfer of property rights for computer software, from rendering services (execution of works) on development, adaptation and modification of computer software programs, databases (computer programs and information products), as well as services (works) on installation, testing and support provided for the computer programs mentioned as a result of nine months of the year makes no less than 90% in the sum of all the organizations' profit over the mentioned periods, including that from foreign parties – no less than 70%;

- average number of employees on the books over 9 months makes no less than 50 people.

In order to stimulate investment activity the project envisages defining the list of expenditures (wages, equipment amortization etc) in the RF Tax Code that will be referred to as R&D expenditures when calculating profit tax. It should be remembered that the RF Tax Code allows application of the step up coefficient of 1.5 to R&D expenditures for the directions established by the Decree of the RF Government. However, the uncertainty concerning the definition of list of R&D expenditures can lead to the abuse of the privilege.

According to the project it is planned to create reserves for impending incomes for R&D. The deduction sums to this reserves will be included in the list of outstanding expenses as on the last date of accounting (tax) period. At the same time the maximum deduction rates to the reserve mentioned should be established.

Additional stimulation measures will also be introduced for enterprises introducing new energy effective equipment. It is suggested to exempt them from property tax for the period of 3 years. In order for this privilege to be applied criteria allowing ascription of the equipment to energy effective should be developed.

The possibility of exemption from the property tax of organization of the following property should also be estimated: machinery, equipment, prototypes, models and other fixed assets, which could be transferred for tests and experiments gratuitously to education and scientific (innovative) organizations when fulfilling the contract (order) for creation of scientific and technological goods.

In order to expand the practice for granting of tax credits for profit tax and organizations' property tax it is suggested to transfer the authority to adopt decisions on granting investment tax credits for

the taxes mentioned from the RF Ministry of Finance to the subjects of the Russian Federation. At the same time the rate of such a credit should be increased from 30 to 100% of the cost of the equipment purchased by the interested organization.

On **March, 17th** at the meeting of the Presidium of the Government of the Russian Federation the report of the Ministry of Economic Development “on the course of execution of Federal target programs (FTP) and the Federal targeted investment program (FTIP) in 2009” by the Ministry for Economic Development was discussed.

The total volume of financing of 51 FTIPs made RUR 831.7 billion in 2009. Over 2009 the measures of FTP at the expense of the federal budget were financed at the rate of RUR 818.3 billion (98.4% of the budget assignments for 2009), which is by 7% more than in 2008.

Co-financing of programs at the expense of RF subjects budgets and local budgets as well as at the expense of off-budget funds in 2009 made RUR 840.9 billion (79.0% of that envisaged for the year), including RUR 344.5 billion (84.8%) at the expense of RF subjects’ budgets and local budgets and RUR 496.4 billion (75.5%) of off-budget funds. For reference, in 2008 real co-financing of FTP measures at the expense of all the sources made RUR 888.1 billion (80.8% of annual assignments), including RUR 325.7 billion (100.4%) at the expense of RF subjects’ budgets and local budgets and RUR 562.4 billion (72.6%) at the expense of off-budget funds.

In 2009 the volume of FTIP construction sights, objects and measures financing (including financing of project and exploration works but excluding construction sights and objects of the state defense order) at the expense of federal budget funds made RUR 488.6 billion (98.1% of the total volume of budget investments envisaged for FTIP realization in 2009).

Out of the volume mentioned within the FTIP program part RUR 291.3 billion (97.7%) and within non-program part – RUR 197.3 billion (98.5%) was financed.

In 2009 it was envisaged to implement (commission) 645 objects. Over the accounting period 445 objects were put into commission, which makes 69.2% of the planned quantity. Out of these 297 objects (69.3%) were envisaged by FTIP program part and 148 objects (68.5%) – by non-program part.

On **March, 24th** at the meeting of the Presidium of the RF Government the project of the main directions of customs and tariff policy for 2011 and for the planning period of 2012 and 2013 was considered. The development of this project was also connected with the burning task to stimulate innovative activity in the country. For instance, it is mentioned in the project that in the process of transition to innovative economy the role of customs and tariff measures in fulfillment of industrial and structural policy should be increased: it is necessary to increase the extent of tariff protection of certain markets at the initial cycles of innovative products output, to secure gradual opening of the market along with their development, segmentation and increase of competitive ability of domestic productions in order to support the competitive environment.

On **March, 25th** the first meeting of the working group on coordination of the work on fulfillment of the Federal Law “On the basis of the state regulation of the trade in the Russian Federation” from 28.12.2009 No 381-FZ took place.

At the meeting the issue of the preparation of the project of the Decree of the Government of the Russian Federation concerning the methodical guidelines for calculation of the foodstuffs volumes sold within the boundaries of administrative formations and determination of the proportion of such goods sold by an economic entity carrying out retail trade operations with foodstuffs through a trade chain, or, in other words “the dominating threshold” of trade chains.

It should be remembered that article 14 of the Federal Law “On the basis of the state regulation of the trade in the Russian Federation” restricts the development of chains in case their proportion at the market of a city district or municipal district exceeds 25%.

The issue of monitoring organization over the fulfillment of the law on trade was also discussed.

The meeting was conducted by the first deputy of the Government Chairman V. Zubkov. It should be noted that the meetings of this working group will become regularly. The task of the group is to analyze the influence of the law on the dynamics of the prices for the main kinds of foodstuffs and consumer goods. Monitoring of the observance of the conditions for the fair competition when producers access the services of the trading organizations will become another priority. There will be one more block of questions the working group is to deal with, which is the development of the retail trade and provision of the population with the trading objects and primarily in towns and of urban communities. ●

REVIEW OF REGULATORY DOCUMENTS CONCERNING TAXATION OVER FEBRUARY – MARCH 2010

L. Anisimova

1. According to the letter of the RF Ministry of Finance from February 25, 2010 No 03-03-06/1/88 the question on the procedure of accounting of the expenses in the form of interests from debt liabilities for the purposes of profit taxation is explained. In concordance with paragraph 1 article 29 of the RF Tax Code the interests accrued for a debt liability of any kind on condition that their rate is not substantially different from the average interest rate for debt liabilities issued in the same accounting (tax) period under comparable conditions are recognized as expenses decreasing the taxation base. The RF Ministry of Finance explains that the notion of “comparable conditions” concerning debt liabilities means correspondence of a number of parameters (the same currency, for the same period, comparable volumes and similar guarantees).

2. According to the letter of the RF Ministry of Finance from February 25, 2010 No 03-03-06/1/89 the question on the accounting for the purposes of profit taxation of the value of unused license for construction activity in connection with the cancellation of licensing of the activity on buildings design and construction, engineer explorations. The RF Ministry of Finance noted that all the participants of the construction activity that received licenses before January 1, 2009 have a right for non-recurrent reflection of the license value not taken off the books as on January 1, 2009 in the expenses when calculation the taxation base for the profit tax.

3. According to the letter of the RF Ministry of Finance from March 2, 2010 No 03-03-06/1/100 the dates and conditions for write-off of bad receivables are explained. Any debt to the taxpayer resulting from the sale of goods, execution of works, rendering services in case the debt is not settled within the period established by the contract and not guaranteed by a pledge, bail or banking guarantee is regarded as receivables. The following belongs to the bad receivables:

1) debt for which limitation period has started, limitations periods for the civil cases are regulated by articles 196 and 197 of the RF Civil Code (three years);

2) debts, which liability was ceased due to impossibility of repayment on the basis of the government body act. The impossibility to collect a debt should be proved for civil cases. The law suit of the organization to a default organization, act on the termination of court procedures, decree on the return of executive document and act on impossibility to collect the debt or a written motivated refusal of the court or arbitrary concerning debt recovery can serve as evidence of the measures adopted by an organization;

3) the debtor’s liquidation can also serve as grounds for write-off. The RF Ministry of Finance explains that in concordance with paragraph 8 article 63 of the RF Civil Code the liquidation of a legal entity is considered to be completed and the legal entity is considered to cease to exist when the record is done to the Unified state register of legal entities, that is why a bad debt can always be taken into account as expense for the purpose of profit taxation after it is registered in the Unified state register of legal entities that the organization’s liquidation is complete and it ceased to exist.

It should be noted that the mentioned letter of the RF Ministry of Finance also considers the conditions for the bad debt to be written off for civil deals. The bad debt for compulsory payments is written off in concordance with the Decree of the RF Government from 12.02.2001 No 100 taking into account the ruling of the Supreme Court of the Russian Federation from 03.12.2009 No KAS09-560.

4. According to the letter of the RF Ministry of Finance from February 25, 2010 No 03-03-06/2/34 the question concerning the bad debt for civil deals write-off is clarified, for instance the past due interest for banking credits (interests with elapsed period of limitation). The RF Ministry of Finance noted that in concordance with paragraph 2 article 266 of the RF Tax Code an organization

can on the basis of debt inventory form a allowance of doubtful accounts (that is ascribe the sums of accrued allowance to expenses) by the end of accounting period and write off a bad debt at the expense of this allowance, for bank these means – accrued but not received interests. The sums of interest for which the period of limitation has elapsed and that were not written off at the expense of allowance can be directly regarded as losses and are recognized as outstanding expenses according to subparagraph 2 paragraph 2 article 265 of the RF Tax Code.

5. According to the letter of the RF Ministry of Finance from February 26, 2010 No 03-11-06/2/22 the procedure for accounting the expenses for payments for raw materials when applying the simplified taxation system that was in effect before 1.01.2009 after this date was clarified. For instance, before 1.01.2009 the expenses for the purchase of raw materials were accounted in the list of expenses after they had been purchased (paid for, debt for them settled) as soon as the raw and initial materials were written off for production, and starting with January 1, 2009 the material expenses (including for purchase of raw and initial materials) by write-off the monetary fund from the taxpayer's account, cash payment and for other way of settlement – at the moment of such settlement.

The RF Ministry of Finance also explained that in connection with the change of the procedure of ascribing the costs for raw and initial materials for expenses, cost of raw and initial materials paid by taxpayer before January 1, 2009 and can be accounted to the full extent when defining taxation base for the tax paid in connection with application of the simplified taxation system over the 1st quarter 2009.

These regulations are not applied to the expenses of payment for goods purchased for further sale.

6. According to the letter of the RF Ministry of Finance from March 1, 2010 No 03-05-05-03/07 it is clarified that the payment of the state duty rate for the state registration of the goods for medical purposes and medical equipment that are allowed in the territory of the Russian Federation does not depend on the place of production and, correspondingly, is levied on the registration of both the Russian and import goods.

7. According to the letter of the RF Ministry of Finance from March 1, 2010 No 03-11-06/2/23 the question on the application of the simplified taxation system in connection with the receipt of the grant is clarified. When defining the taxation base for the simplified system of taxation the incomes envisaged by article 251 of the RF Tax Code are not taken into account. According to subparagraph 14 paragraph 1 article 251 the incomes in the form of property received by a tax payer within the framework of the targeted financing are ascribed to the incomes not taken into account when taxing according to the general scheme.

Consequently, the funds received by the organization within the framework of rendering assistance to small-scale entrepreneurship are regarded as targeted financing and are to be included in the taxation base for the simplified taxation system.

8. According to the letter of the RF Ministry of Finance from March 2, 2010 No 03-07-11/42 the question on the application of VAT towards the beautification of the territory paid at the expense of the fund of the program assisting the employment in the subjects of the Russian Federation.

The RF Ministry of Finance explained that in concordance with paragraph 1 article 146 of the RF Tax Code that the object of VAT taxation are the operation on sale of goods (works, services in the territory of the Russian Federation regardless of the source of payment.

9. According to the letter of the RF Ministry of Finance from March 2, 2010 No 03-04-06/2-19 the position in concordance with which an organization buying a share in a capital (fund) from a natural person who is a participant of a limited liability company is recognized as a taxation agent and has to withhold and pay a sum of a income tax from the total sum f paid income and submit the corresponding information to a tax body in the form of 2-NDFL.

This position is rather arguable. In connection with the change of the version of subparagraph 2 paragraph 1 article 228 of the RF Tax Code envisaged by the Federal Law No 224-FZ the natural

persons should pay the income tax independently not only in case they sell their property but also when they sell their property rights. Participation in a limited liability company in concordance with the legislation on the limited liabilities companies and subparagraph 3 paragraph 1 article 220 of the RF Tax Code is classified as a property right.

In our opinion, in the situation under consideration the limited liabilities companies buying the share in the capital from natural persons do not have a right to immobilize somebody else's property in the form of income tax withhold and payment. And it is even more so, regarding that the taxation base in such a situation is not the whole sum of the paid income but only the difference between the incomes and expenses of a natural person for purchase of the share in the limited liability company.

10. According to the letter of the RF Ministry of Finance from March 2, 2010 No 03-03-06/1/99 the issue on the accounting of expenses in the form of membership fee payment by the members of self-regulating organization was clarified. In concordance with the Federal Law from 01.12.2007 No 315-FZ "On self-regulating organizations" non-commercial organizations based on membership belong to such organizations. In order to conduct some kinds of activities, for instance, design and exploratory work, construction etc. it is necessary to be a member of self-regulating organizations. That is why the RF Tax Code (subparagraph 29 paragraph 1 article 264) includes fees, contributions and other compulsory payments paid to non-commercial organizations by their members to the list of other expenses connected with the production and sale for the purposes of profit taxation. According to paragraph 1 article 272 of the RF Tax Code such expenses decrease the taxation base in the accounting (taxation) period in which they evolve basing on the condition of deals.

11. According to the letter of the RF Ministry of Finance from March 4, 2010 No 03-03-06/1/111 the question on the definition of profit tax base when selling a land plot for agriculture purposes. The RF Ministry of Finance draws attention to the fact that in concordance with paragraph 2 article 256 of the RF Tax Code the land and other objects of nature management (water, subsoil and other natural resources) and some other objects are not subject to amortization. Thus, the sale of a land plot for agriculture purposes can reduce the income from the sale of such a land plot by the price of its purchase (including costs connected with the expenses for purchase).

12. According to the Decree of the Government of the Russian Federation from February 24, 2010 No 84 the new version of the Standard agreement between the Russian Federation and foreign countries aimed at avoiding the double taxation and prevention evasion from property and income taxes was adopted as a basis for negotiation.

According to the new version of the Standard agreement former article number 1 was divided in two separate articles: one of them defines the persons to whom the agreement is applied – residents, the second (newly introduced article 4) defines the notion of "resident". That is instead of the term "the person of permanent residence" the new version employs the term "resident" which on the whole corresponds to the international practice. The criteria for recognition of a person as a resident is introduces, which if the place of management (governing). This criterion is registered in the majority of Russia's agreement currently in effect. In the previous version of the standard agreement the reference to the real place of management was included in paragraph 3 article 1.

The Decree gives a comprehensive notion of "a person", supplementing it with the notion "company" (any entity regarded as person for taxation purposes). At the same time the term "enterprise managed by a resident" is introduced. This term is not defined according to the Russian legislation (according to the RF Civil Code the enterprise is just a complex of property, while according to the Standard agreement this term suggests some activity, which is managed by the resident). The uncertainty of the term "enterprise" will complicate the application of other articles, where this term is used, as well.

The accents were shifted in paragraph 2 article 3 "General definitions". Now in case the term is not defined by the international agreement the term of the resident's country tax legislation is recognized as prevailing, and not the definition of this term in other (non-tax) legal acts of resident's country.

The regulation by paragraph 3 article 4 “Resident” of the issue on unambiguity of residence definition in case of companies’ double residence is an innovation. If the residence is not defined unambiguously the company will not be a subject to tax privileges.

According to article 5 “Permanent representative” only construction sites of assemblage and installation objects will enjoy privileged 12-month period, i.e. well drills and vessels for the development of natural resources are not subjects to privilege. The possibility to prolong the privilege period to 24 months is excluded. “Preparation and conclusion of agreements” is excluded from the list of activity not resulting in the formation of the permanent representative office. The prevailing of taxation basing on the principle of the real management of transport vehicle is included to international transport (article 8).

New article 9 “Associated enterprises” is introduced, which will allow correcting the profit (that is additional accrual of profit).

According to article 10 new regulations for application of 10 and 15% tax rate for dividends are introduced in the sourcing country. Changes were made to the notion of “dividends”- not it also includes the interests re-qualified to dividends according to the rules of “insufficient capitalization”, and also the incomes from the participation in unit investment funds.

New articles are introduced: article 29 “Limitation of privileges”, article 27 “Cooperation in tax collection” etc. ●

CHANGES IN REGULATORY BASIS OF BUDGET PROCESS

M. Goldin

In March 2010 the following events took place in the regulatory basis of budget process: the rules for definition of the limits for co-financing of the expense liabilities of RF subjects were regulated; conditions and procedure for granting subsidies from the budgets of the RF Pension Fund to RF subjects for some social programs in 2010 were established.

Decree of the Government of the Russian Federation from 23.03.2010 No 175 “On making changes to the Decree of the Government of the Russian Federation from May 26, 2008 No 392 “On formation, provision and distribution of subsidies from the federal budget to the budgets of subjects of the Russian Federation” was supplemented with the statement, according to which, in case the level of the calculated budgetary provision of a subject of the Russian Federation upon distribution of subsidies for 2010 makes less than a threefold excess of the average level of calculated budgetary provision of the subjects of the Russian Federation when granting and distributing the subsidies in 2010 (excluding the subsidies whose distribution is established by the Federal Law “On the federal budget for 2010 and for the planning period of 2011 and 2012”) the level of co-financing of an expense liability for such a subject could not be established at the level below 40% or above 95%.

Thus, the rule on the limitation for co-financing of an expense liability of a subject of the Russian Federation in case the level of the average throughout Russia budgetary provision is exceeded by threefold, which was in effect in 2009, was prolonged for 2010.

It was also established that when granting in 2010 and 2011 the subsidies for fulfillment of additional measures aimed at the decrease of the tension on the labor market of RF subjects, the level of co-financing of expense liabilities of RF subjects is defined according to the rules established by the Decree of the Government of the Russian Federation from 14.12.2009 r. No 1011.

According to the decree of the Government of the Russian Federation from 17.03.2010 No 154 “On establishing the rules for provision of subsidies from the RF Pension Fund to the budgets of the RF subjects for some social programs connected with the reinforcement of the material and technical basis of social services institutions and rendering targeted social service to unemployed pensioners, who are recipients of old-age pensions and disability pensions in 2010” the conditions and procedure for granting subsidies from the RF Pension Fund to some social programs in 2010 were defined.

The rules establish that the subsidies for co-financing of social programs for RF subjects connected with the reinforcement of material and technical basis of social services institutions are granted on condition the programs include measures envisaging also the finishing of thorough repair works and construction of social services institutions, as well as their fitting with the necessary equipment in order to eliminate the queue for the unemployed pensioners to be placed in these institutions. The volume of financing of the measures mentioned by the federal budget should not be below 50%.

Subsidies for co-financing of the targeted social assistance to unemployed pensioners are granted on condition the programs of RF subjects envisage granting nonrecurring material assistance, including for a partial compensation for gasification of houses in the ownership of the unemployed pensioners which is their place of residence and rendering material assistance to them in connection with the celebration of the Victory Day, conduction the Day for the Elderly and the Day for the Disabled. The subsidy financing targeted assistance to unemployed pensioners makes up to 60% of the total sum of the subsidy. ●