



RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES 05'2010

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RUSSIAN ECONOMY IN MAY 2010: TENTATIVE INDICATORS AND MAJOR TRENDS

The most notable developments in the **political sphere** in May became the miners's manifestations provoked by the accident at Rospadskaya mine, the dispersal of an opposition rally in Moscow, the actual breakdown of the start-up of full operation of the Customs Union since July 1, 2010 and the low efficiency of the jubilee Russia-EU summit held on May 31 – June 1 in Rostov-on-Don.

In the Kemerovo Region and in Moscow local authorities have demonstrated a tough attitude to the opposition demonstrations, which led to the open collisions of the miners with police in Kemerovo Region. Police actions against the opposition in Moscow were convicted by Vladimir Lukin, Human Rights Ombudsman.

Entry into force of the Customs Code and the start of full operation of the Customs Union was thwarted by the tough position of Belarus. Despite the expressed "verbal" warming in relations between Russia and the EU in the recent years, the jubilee summit happened to be actually inconclusive: the Russian part has approached the center with the "no-go" for the EU issue of visa-free regime, whereas the EU action plan for the program "Partnership for Modernization" was not included in the agenda. In the approach to the issue of "Modernization" of cooperation the EU Commission emphasizes the institutional aspects (improvement of legal environment, combating against corruption), while the Russian officials mean technological aspects.

The most important factor that influenced the **macroeconomic dynamics** in May became the problems of the Euro zone, provoked by the situation in Greece. An indirect consequence of these problems were, in particular, the sharp fluctuations in oil prices, which in turn led to the fall of the Russian stock indices and net capital outflow, estimated as a result of the month. Dollar exchange rate in May, for the first time since early 2010, started to grow. Dollar is getting stronger not only against the ruble, but also to the other international currencies, and, above all, against Euro. As a result, in May, for the first time since November of the last year, the value of the two-currency basket has grown to RUR 34.1 on May 28 (1.7%).

Inflation in May (as of three weeks results) remained at a stable low level: prices rose only by 0,3%. Since the beginning of the year, the inflation amounted to 3.5%, while in annual terms (April 2010 against April 2009) - by 6%. Low inflation has allowed the Bank of Russia once again to reduce the refinancing rate by 0.25 percentage points. However, there are several factors that increase the risk of inflation by the end of 2010. Thus, producer prices are growing substantially more rapidly than the CPI. In addition, the acceleration of inflation will contribute to the dynamics of M2 monetary base: its rate of growth is increasing (in April, an increase of monetary supply was 2.7% as compared with the previous month, and 4.7% versus the beginning of the year). However, the lack of dynamics of demand remains the main deterrent factor to the price growth.

Foreign currency and gold reserves of the Central Bank in May have been slightly declined and on 21.05.2010 amounted to USD 453.4 billion. Therefore, after the steady growth of reserves over 2009, in the last six months there was observed an unstable stabilization: the level of USD 451 billion has been reached as of 27.11. 2009, and since then, the amount of reserves varied within the range of USD 430-460 billion.

High prices for energy resources in the 1st quarter of 2010 increase the likelihood of reducing the federal budget deficit:: according to the tentative estimates, its amount may fall to 5.2-5.4% of GDP against 6.8% of GDP estimated in the budget law. According to the Ministry of Finance operational data, federal budget revenues over January-April amounted to 19.9% of GDP, which is by 0.7 percentage points of GDP higher than the values over the relevant period in 2009, while expenses made 23.3% of GDP, which is by 1.1 percentage points of GDP higher than the values of the previous year. Herewith, the non-oil revenues of the federal budget, as a result of a number of innovations in the tax administration system, were lower than in 2009. A relative increase in expenditures, in turn, is apparently based not on absolute increase thereof, but on a more regular schedule of budget assets

distribution among the end users . As a result of the volatile changes of parameters within the four months, the federal budget is executed with a deficit of 3.4% of GDP against 3.2% of GDP in 2009. The amount of oil and gas deficit, according to the tentative estimates increased to 12% of GDP.

Despite the uncertainty of statistical data, provoked by the revision of the Rosstat methodology, the totality of direct and indirect indicators demonstrate positive trends in the **real sector** in April. Growth in industrial production within January-April against the same period in 2009 amounted to 6.9%. There was resumed growth in retail trade turnover: as compared with the same period in 2009, it increased by 4.2%, and in January-April - by 2.0%. The recovery of the consumer market is supported by higher incomes of population, changing situation in the consumer credit sector and stabilization of the labor market. In the 1st quarter of 2010, the volume of monetary incomes of population increased by 13.7%, as compared with the same period of 2009. People spent by 8.4% more funds for the purchase of goods and services than in the 1st quarter of 2009. Herewith, the share of social benefits in the structure of monetary incomes in the 1st quarter of 2010 has increased by 2.4 p.p. as compared with the relevant period of 2009.

In general, growth of industrial production is based mainly on an increase of producing and processing industries by 8.3% and by 15.7% respectively, largely due to the effect of low base of the last year. It should also be noted that the effect of the preceding year devaluation was nearly completely depleted at the beginning of the current year. As a result, monthly dynamics of imports has once gone ahead of the pace of changes in exports and domestic market. Therefore, the structure of the domestic market resources once again was under the impact of trends that characterized the pre-crisis period.

At the background of demand stabilization, the gap between the financial sector and real sector was particularly noticeable. The stagnation of the banking and credit sector, the complexity of the debts restructuring, the slow motion to the lower interest rates provide a negative effect on investments. The impact of those factors has been increased due to the collapse of investment programs within 2009 and reduction of the reserves, which has led to a decrease in the scope of work in construction within January-April 2010 to 6.2%, input of residential area - by 2.4%, and Investment in fixed assets – by 3.3%.

IET industrial surveys have demonstrated the best results, obtained since mid-2008 estimates of the current demand by enterprises, although the positive expectations in terms of the future growth have decline in comparison with January 2010. In April, the satisfaction level of sales has been dramatically increased. Estimates of reserves from December 2009 remained stable, all industries have got rid of excessive reserves in their warehouses. Output estimates indicators are growing at a sufficiently slow rate - these estimates are essentially unchanged from September 2009. However, the expected rate of output in April have undergone a tangible negative adjustment in the estimates of demand as well, and the optimism is markedly decreased as compared with the estimates of the beginning of the year. The main barrier to the growth of production, in the companies view, mentioned by 45% of enterprises is the lack of demand. In the second place is the lack of working capital. In third place came a shortage of staff. In the fourth place is the non-payment of customers and competing imports. Mentioning of non-payment is decreased during recovery from the crisis, and the reference to imports is increased. In April, companies managed to keep the growth rate of prices at the level of the previous months, although the March estimates indicate the possibility of slower growth. Thus, from the beginning of 2010, the industry demonstrates the highest and most stable rate of price growth since the crisis beginning. In April, industry has continued to increase the number of employees. Employment growth remained unchanged at the March level, when hiring for the first time during this crisis exceeded the dismissal level. The availability of loans for the industry continued to grow, though at a slower pace. Average minimum refinancing rate offered by banks to the industries under ruble loans in general was decreased in April to 15.7% per annum. ●

POLITICAL AND ECONOMIC RESULTS OF MAY 2010

S.Zhavoronkov

The main news of May 2010 was a major accident at Rospadskaya Mine which caused many human deaths and subsequent riots in the city of Mezhdurechensk. M. Gutseriev returned to Russia, and termination of a criminal case against I. Linshits was announced – that was not the only termination of notorious criminal cases in the economic sphere. Such a fact points to the authorities' willingness to reduce the level of costs related to doing business. A new legislation on budget-funded entities was adopted. It has caused concern with public sector's employees as it fails to clearly specify the main criteria of future financing.

In May 2010, the main news took place in the economic sphere.

In the early morning on May 9, a methane explosion killing 86 people took place at Rospadskaya Mine in the city of Mezhdurechensk, the Kemerovo Region. The mine was considered to be safe and no accident had happened there before. It was reported that the accident was caused by a violation of safety arrangements and continuation of the work in a mine where there was too high gas content in the air (actually, there are special technologies for detection of pollution measuring equipment which can be used both individually and by entities). On V. Putin's demand, I. Volkov, General Director of Rospadskaya Mine was removed from office and a criminal case was brought against him. He is subject to recognizance not to leave. Unlike another recent tragedy – a fire at a nightclub in Perm – no claims were made to the owners of the mine (G. Kozova, A. Vagin, A. Abramov and R. Abramovich). Capitalization of OAO Rospadskaya fell by one-third, while production of coal, by 83.3% which situation caused much concern with consumers, that is, metal-makers. On May 14, riots of miners took place in the city of Mezhdurechensk. Miners blocked railway lines and clashed with OMON (a special purpose police unit). The workers demanded a pay rise, amendment of the principles of payroll calculations (an average pay at the mine amounts to about RUR 30,000, but a larger part of it – the bonus – depends on the volume of production of coal) and higher control over safety arrangements. A formal (but rather substantial) pretext for those riots was the fact that contrary to the standard procedure a nationwide mourning was not declared.

As a result, at the meeting of the Government of the Russian Federation a number of decisions were made. In particular, owners declared that new fans for the mine were bought and compensations were paid to the families of those killed in the accident. Rostekhnadzor was granted the authority to temporarily remove from office those responsible for technical violations until court proceedings. From now on, Rostekhnadzor would be subordinated to the Prime Minister of the Russian Federation and not to the Ministry of Natural Resources.

Prime Minister V. Putin suggested that mine owners should increase miners' constant portion of a pay from 48% to 70%, but nothing was said about a pay-rise. However, it is unknown if that decision has been fulfilled. Nor is it clear whether owners' request to provide the enterprise with RUR 6 billion worth of financial aid (such was the amount of the damage estimated by mine owners) will be met. Prime Minister V. Putin stressed that part of the blame was on miners themselves by mentioning the fact that some miners drank alcohol and took drugs in the mine.

Late in May, in connection with the accident at the mine and in the interests of iron and steel industry I. Sechin, Vice Premier proposed introduction of temporary limitation on exports of coking coal.

In May, a number of precedented decisions in the sphere of the big business were taken. Firstly, some notorious criminal cases were closed. Thus, the last month information regarding termination of all the criminal cases against M. Gutseriev, co-owner of Russneft turned to be true. M. Gutseriev returned to Russia after two and a half years of exile. Also, it was announced that a criminal case against I. Linshits, former owner of a group of companies and Neftyanoi Bank was terminated (I. Linshits left Russia in 2006 while a number of the bank's employees were sentenced to different

terms in prison). The prosecutor's office found the refusal to terminate a criminal case against V. Boiko, owner of large land assets in the Moscow Region to be illegal. Earlier, in February, T. Ismailov, owner of the shut-down Cherkizovsky Market who was charged with smuggling returned to Russia. Also, in April V. Makhlai, owner of Tolyatiazot, who was charged with tax-related crimes returned to Russia.

Also, businessmen who failed so far to be acquitted became more active in pursuit of that goal. A number of public actions with use of a video address were undertaken by E. Chichvarkin, former owner of Evroset who told about the fate of the company's imprisoned employees and a threat to health of one of such persons. Also, the fate of E. Chichvarkin was discussed at the meeting of Delovaya Rossia with V. Surkov, First Deputy Head of the Administration of the President of the Russian Federation. V. Surkov's answers could be interpreted as favorable in relation to E. Chichvarkin. M. Khodarkovsky declared a hunger strike demanding a response from President Medvedev to his appeal. (Khodarkovsky protested against the refusal by the court to change the measure of restraint to him and Lebedev in accordance with recent amendments to the Code of Criminal Procedure). N. Timakova, Press Secretary of the President said that the President was aware of that appeal and Khodarkovsky stopped his hunger strike.

The reasons for termination of criminal cases can be different, in particular, changes in the situation with assets of Russneft (the sale of the company to O. Deripaske in 2007 eventually failed to be approved by the Government of the Russian Federation and a large equity stake was recently sold to AFK Sistema owned by V. Evtushenkov). The above reasons may include both direct payments (those to the budget) and indirect payments (for instance, T. Ismailov declared that he would make investments in Sochi, as well as the Terek Football Club which is important (as a symbol) to the Chechen authorities. To some extent, considering the reaction of the authorities to a number of scandals related to the penal system and removal from office of some senior officers of the Interior Ministry and the Federal Penal Service it can be stated that there is some softening of the authorities' position as regards application of custodial sanctions and involvement of law enforcement units in resolution of "disputes between economic entities". However, at the same time the case of Chichvarkin and the case of Khodorkovsky show that no radical changes have occurred.

At the same time, the Higher Court of Arbitration of the Russian Federation has recognized as legal the decision by the Federal Antitrust Service (FAS) on imposition of a penalty in the amount of RUR 1.1 billion on TNK-BP. A similar lawsuit against LUKOIL is tried in court now. Earlier, FAS tried to bring charges of price collusion against oil companies (in the past two years claims for the total amount of RUR 1 billion were laid to large oil companies, however, the Higher Court of Arbitration always took their side and the sums of such payments were reduced almost to nil). Commenting on the court decision, I. Artemiev, the Head of FAS said that it was proved that petroleum was overpriced by 15-20%. I. Artemiev expects prices to go down.

It is not excluded that the Higher Court of Arbitration of the Russian Federation is willing to form a new judicial practice proceeding largely from the general political concepts, rather than judicial ones – oil companies were accused even before that they did not reduce at all or reduced insufficiently petroleum prices in a situation where prices were falling on the international market. However, nothing can be said for certain about it until the ruling of the Presidium of the Higher Court of Arbitration is made.

In May, amendments to the electoral legislation came into effect. They set tougher requirements to early voting participants (earlier, such a measure was promised by D. Medvedev in his President's letter). Under those amendments, the early voting is permitted in exceptional cases: in hard-to-reach areas, on boats which are at sea on the election day, at polar stations and abroad. Earlier, with use of technology of early voting (which made it impossible for monitors to check integrity of envelopes) at some elections voting of up to 20-30% of voters, mainly, public sector employees who are dependant on the authorities was ensured. It is to be noted that early voting was possible only at municipal and regional elections, but it concerns in no way the federal elections.

Also, The President of the Russian Federation has introduced in the Duma a draft law which calls an absentee ballot the document of strict accountability. Production of forged absentee ballots will be deemed equal to criminal offences which are specified in Article 142 of the Criminal Code

of the Russian Federation (for “Forgery of election documents and referendum documents” an imprisonment of up to 4 years is provided for). However, a measure of punishment for illegal issuing and receiving of such documents will be an administrative fine in the amount of several thousand rubles. The above draft law can be characterized as plain simulation as the main technology of “carousel” voting (that is, voting by the same person at many polling stations where in defiance of the law such a document is not withdrawn) used on a large-scale at elections of any level consists specifically in securing of quite a genuine absentee ballot for illegal purposes.

A. Kudrin, the Minister of Finance has declared that thanks to a more favorable macroeconomic situation the deficit of the federal budget of the Russian Federation will amount to 5.2–5.4% instead of 6.8% provided for in the Law on Budget, while Prime Minister V. Putin has confirmed that it is important to comply with the schedule of reduction of the budget deficit to 3% of the GDP in 2012 and then to a zero in 2015. Prime Minister V. Putin said that a zero budget deficit should become a norm and when the crisis was over Russia should return to the policy of accumulation of the reserves. One cannot but agree with the above, however, it is not quite clear why that period is so far away – in four years from now.

Passed in May was the law on reform of budget-funded entities which has caused quite a concern among workers of the social sphere. The above law amends the legal status of budget-funded entities. Without taking into account institutions related to the law enforcement, military and state security (such institutions are restructured into government ones and their status remains virtually unchanged), the other public institutions are assigned the status either of autonomous institutions or so-called new budget-funded institutions.

The autonomous institutions will not be responsible to report to the state their income. Also they will be in command of their property (except for the most valuable one). But the state will not be responsible for such institutions, either. New budget-funded institutions will be financed by the state through a public assignment in the form of subsidies. Such a type of institutions will include healthcare institutions, institutions of culture, schools and other (though theoretically they may become autonomous institutions). They will receive funds in accordance with the number of students (patients) they deal with and only within the limit of education (medical treatment) guaranteed by the state. Nothing is known so far about those limits and handling of such an important issue is scheduled for the end of the year, that is, it will actually take place shortly before that law comes into effect (the law is to take effect starting from January 1, 2011, while a transition period lasts till July 1, 2012). Should the volume and quality of services fail to comply with the public assignment, financing will be either reduced or terminated.

The very opportunity for institutions to make money autonomously (except for budget financing) is quite attractive. However, there is a risk that such an additional income may turn into the main one if budget financing is cut. It surprises that no wide and open discussion on that matter is expected to be held.

In May, the State Duma of the Russian Federation passed the law which made it easier for migrants from countries which Russia has no visa regime with (that is, mainly from CIS states) to obtain a work permit. For such migrants, a paid license to work (worth RUR 1,000) for the period of stay of from one to 3 months has been introduced. Officially, the above law concerns only some, but not all spheres of economic activity. However, such jobs as “an assistant in business” or “a watchman” permit to expand the sphere of application of such licenses to an unlimited range of persons. It is to be noted that on the basis of such a license a residence permit is issued for relatives of the migrant worker as well. Along with the above, such persons are granted a tax regime of the resident of the Russian Federation (13% income tax). Thus, the Government of the Russian Federation is switching over again from limitation of labor migration which has been registered in the past two years to the policy which encourages it. By doing so, the Government, probably, keeps in mind the prospect of future economic growth. Such a measure is rather controversial. Incidentally, in issuing of the license to work migrants’ finger prints are required now.

In May, it was declared that introduction of the single Customs Code of Russia, Kazakhstan and Belarus which was scheduled to come into effect starting from July 1 was transformed into the Customs Code of Russia and Kazakhstan (according to official representatives of Belarus their country was not happy about duties on oil and petroleum products being equalized). Instead, A.

Lukashenko, President of Belarus offered Russia to buy the other half of Beltransgas's equity, but at a market price (which is calculated rather strangely) and in return for reduction of gas prices to the level which prevails inside Russia (Belarus's debt to Russia for gas has exceeded USD 150 million and keeps growing despite the fact that it pays the lowest gas price of USD 169 per 1000 cubic meters in the CIS). However, I. Sechin, Vice Premier said that the above offer did not suit Russia. Nevertheless, negotiations are carried on.

In May, Yuri Trushin, Chairman of Rosselekhobank, the third largest state-run bank as regards the size of the capital resigned ahead of time after holding that office for many years (his contract was extended less than a year ago). Dmitri Patrushev, son of N. Patrushev, Former Head of the Federal Security Service was appointed to that office. No particular complaints were made about the bank: small profit and a significant share of accounts payable can be explained by the fact that during the crisis the bank kept granting loans to the agrarian sector thus fulfilling instructions of the President of Russia. Also, the bank bears high costs related to maintenance of its branch network.

In May, two serious acts of terror took place in North Caucasus. A bomb went off close to the government loge at the hippodrome in Nalchik killing one person and wounding a number of officials, including H. Shogenov, the Republic' Former Interior Minister. Luckily, the number of casualties was small. An explosion in Stavropol before the beginning of the concert of a group of artists from Chechnya had more serious consequences. It killed 7 people. Responsibility for the first terrorist attack was taken by Islamists from North Caucasus, while for the other one, by no one so far. ●

INFLATION AND CREDIT AND MONETARY POLICY

N.Luksha

According to the April 2010 results, inflation in Russia has reduced again: CPI amounted to 0.3 per cent, what is nearly twice lower than in the relevant period of March. During the three weeks of May prices rose by 0.3 per cent. Thus, the increase in consumer prices since the beginning of the year to May 24 reached 3.8 per cent, up to 3 percentage points lower than same period last year. In April, foreign currency and gold reserves of Russia increased by 3 per cent, but within three weeks of May have slightly decreased, reaching on May 21 USD 453.4 billion. The Bank of Russia continued the policy of mitigating interest rate: from April 30, the refinancing rate was once again lowered by 0.25 p.p. to 8 per cent per annum. The real effective ruble rate continued to strengthen: in April, the growth made 1.5 per cent.

In April the consumer price index was twice lower than the March values, reaching up to the month 0.3 per cent (see Fig. 1). The largest contribution to the growth in prices was made by both, food and nonfood products (+ 0.3 per cent).

In the group of food products price upsurge for fruit and vegetables was again higher than the general price growth (+ 1.1 per cent). Also, rapidly growth was observed in alcoholic beverages (+ 0.8 per cent), eggs, cereals and beans (+ 0.6 per cent). In addition to sugar (-5.5 per cent), pasta (-0.5 per cent), meat and poultry (-0.1 per cent), whose prices have continued to decline in April, cheaper became sunflower oil, fish and seafood (by - 0.3 per cent).

In the group of non-food prices in April, prices largely repeated the dynamics of March. As in the previous month, most of all, prices for tobacco products (+2 per cent) and petrol (1.1 per cent) were the highest. Medicines, TV-and Radio items on the contrary, continued to fall in price by 1,1 per cent and 0,8 per cent respectively.

In December there was also observed an increase in prices for commercial services. The main contribution to the observed rise in prices was made by prices for gas (+ 7.8 per cent), as well as the more expensive healthcare services (+0.7 per cent), household and health-improving services (+ 0.6 per cent). At the same time, foreign tours and certain types of municipal facilities became cheaper.

In May there was also observed an increase in prices for commercial services, the prices of which rose by 0.5 per cent (against 0.1 per cent in November, 2008). On the eve of New Year and during Christmas holidays prices have traditionally increased for overseas tours (+1.8 per cent), for passenger transport (+1.5 per cent) and healthcare and resort services (0.1 per cent). Prices for household and healthcare services, as well as services of cultural organizations continued to grow (by 0.7 per cent). There was no reduction in prices on any group of services sector in December.

Lowering of inflation continued in May against the previous year. During the first three weeks of May, prices rose by 0.3 per cent, and within a week from May 12 to 17 there was recorded a zero growth in the consumer price index. One of the reasons for the slowing of consumer inflation, according to Victor Zubkov¹, the First Deputy Prime Minister was the Law on State Regulation of Trade, came into force on February 1, 2010, which has allowed to lower in the first quarter prices for some food stuffs (reduced prices for cereals, sugar, butter and vegetable oils, and meat prices remaining unchanged for several months). It should be noted that reducing the price of cereals has also contributed to overall decline in grain prices and falling prices for butter due to seasonal factors. Slower growth in consumer prices, among other things, due to the effect of the base and the general downgrading in the economy, was accompanied by stagnation in consumer demand. According to the forecast Sergey Ignatiev, the Chairman of the Bank of Russia, in Au-

1 RIA News (<http://www.rian.ru/analytics/20100519/236172307.html>), 19.05.2010.

gust and September the deflation is not excluded, which will be based on the seasonal fruits and vegetables cheapening¹.

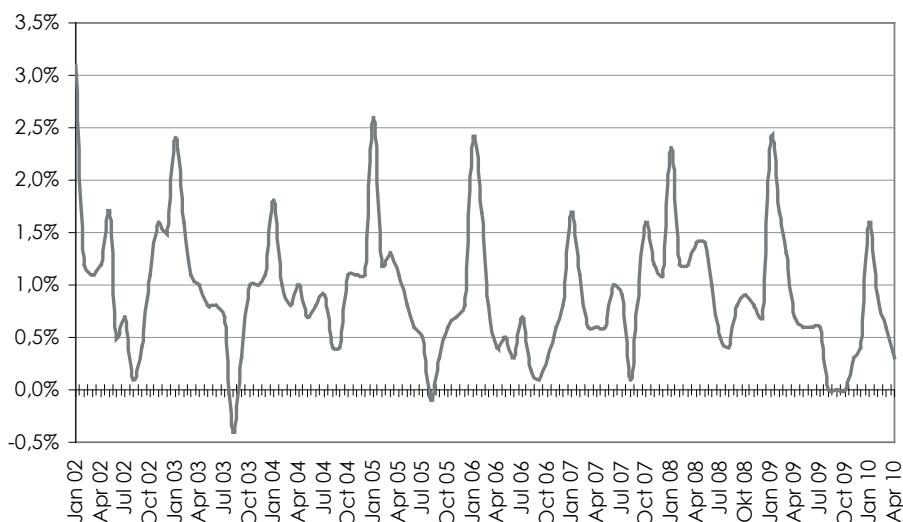
However, there are several factors that increase the risk of inflation by the end of 2010. One of them will be the acceleration of growth of wholesale prices of manufactured goods manufacturers. Thus, in April the producer price index of industrial production has grown by 3.2 per cent (as compared with 1.8 per cent in March, 2010). Since the beginning of the year the growth in producer prices made 6 per cent. Most of all, prices have risen in

the mining sector (in the extraction and enrichment of iron ore - by 36.7 per cent, in the oil sector - by 6 per cent). Prices have grown in the processing sector as well (the cost of coke production - by 22.7 per cent). The main causes of price growth in the industry has been rising oil prices and energy sources, as well as the recovery of demand. In addition, the acceleration of inflation will be contributed by the dynamics of broad monetary mass M2: its rate of growth is increasing (in April, an increase of monetary supply was 2.7 per cent against the previous month, and - 4.7 per cent against the beginning of the year). An attempt of the Bank of Russia to retrain strengthening of the national currency will also accelerate the growth of Consumer prices.

The basic CPI of consumer price index² in April 2010 has made 0.2 per cent (versus 0.8 per cent in the relevant period of 2009). As of April results, the monetary base (in broad definition) has increased by 6.8 per cent and amounted to RUR 6,795 bn. Cash in circulation with regard to the fund balances in credit organizations on May 1 has reached RUR 4.6 trillion (+5.2 per cent), correspondent accounts of credit organizations in the Bank of Russia made RUR 554.8 billion (decreased by 4.3 per cent), mandatory reserves made RUR 183.1 billion (+9.1 per cent), banks' deposits with the Bank of Russia made RUR 576.7 bn (+22.8 per cent), the value of shares of the Bank of Russia with credit organizations made RUR 836.8 bn (+13.7 per cent).

In April, the excessive reserves of commercial banks³ have increased, amounting as a result of the month to RUR 1,968.3 billion. Therefore, the growth made RUR 183.3 billion, or 10.3 per cent. Due to the accumulated excessive liquidity, there is still observed interest rates downgrading in the banking system, having reached 3.3 per cent.

In April, the situation in the sphere of bank crediting has somewhat improved. According to G. Melikyan, the first Deputy Chairman of Central Bank, in April the volume of crediting has grown: credits to companies and businesses were extended by 1.7 per cent and to physical persons - by 1 per cent⁴. It is worth noting, that retail lending has shown steady growth for the first time since February 2009. In general, the credit portfolio of banks (excluding Sberbank) rose in April by 1.1per



Source: RF Statistical Service.

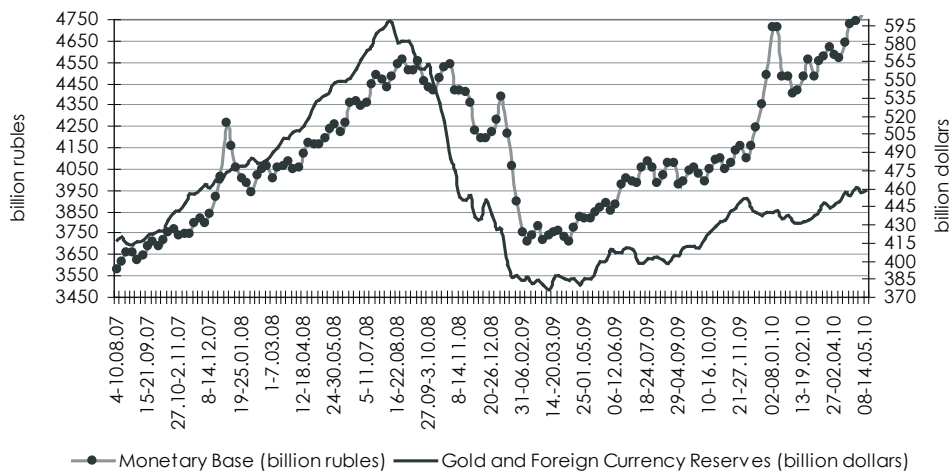
Fig. 1. The Growth Rate of the CPI in 2002 - 2010 (% per month).

1 From the speech of S. Ignatiev, Chairman of the Central Bank of Russia at a press conference during the XIX International Banking Congress on May 27, 2010. (<http://www.rian.ru/economy/20100527/239293855.html>)

2 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

3 RIA News (<http://www.rian.ru/economy/20100115/204718318.html>), 15.01.2010.

4 RIA News (<http://www.rian.ru/economy/20100514/234456307.html>), 14.05.2010.



Source: RF Central Bank.

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

per cent. In his opinion, this figure is close to the maximum, and the amount of «bad debts» should get soon stabilized. Nevertheless, currently maintaining growth of «bad debts» does not allow to speak about the formation of stable positive trend in the development of the banking system.

In April the growth of the volume of cash in circulation by 5.2 per cent with the grown mandatory reserves by 9.1 per cent urged the extension of monetary base in narrow definition (cash plus mandatory reserves)³ by 5.4 per cent (see Fig. 2).

In April the volume of foreign currency and gold reserves of the RF Central Bank has increased by 3 per cent and by the end of the month amounted to USD 460.7 bn. As opposed to that, within three weeks of May foreign currency and gold reserves have been reduced to USD 453.4 bn.

In April, the inflow of capital into the country was sustained: According to the estimates of A. Ulyukhaev, First Deputy Chairman of the Central Bank, it has reached he was USD 3-4 billion⁴. As a result, in April, the real effective ruble rate continued to be strengthened (+1.5 per cent). As of the month result, the real effective exchange rate rose to 143.8⁵ (see Fig. 3). However, in May, according to the dynamics of foreign exchange intervention, the Bank of Russia expects a small net outflow of private capital from Russia. According to tentative estimates of the Central Bank of Russia, in May they have purchased foreign currency for about USD 5 billion, nearly twice less than in April.

In April and May, the downfall of Euro was continued. Herewith, in the second decade of May its decrease has markedly accelerated. Suddenly, a sharp upgrading of Euro against the dollar (to 1.78 per cent) on April 20 was associated with optimistic expectations of the market participants on the meeting between EU finance ministers, which was aimed at developing additional measures to curb the debt crisis in the Eurozone. This jump of Euro in the Forex market at the beginning of the third week of May was reflected in the Russian market: the European currency has strengthened by more than RUR 1.5.

However, the Euro was not supported by fundamental factors, and therefore, already from May 24, Euro once again began to fall down. The main reason for depreciation of the European currency remain insolvency of Greece, as well as the risks associated with servicing the public debt of Spain, Portugal and Iceland. The difficult financial situation of these countries continued to harass the members of the global stock market, despite the decision to establish the European Stabiliza-

1 Regardless Sberbank data. RBCdaily (<http://rbcdaily.ru/2010/02/08/finance/457387>), 8.02.2010.

2 RBK News (<http://www.rbcdaily.ru/2010/05/25/finance/481048>), 25.05.2010.

3 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.

4 RIA News (<http://www.rian.ru/economy/20100514/234400005.html>), 14.05.2010.

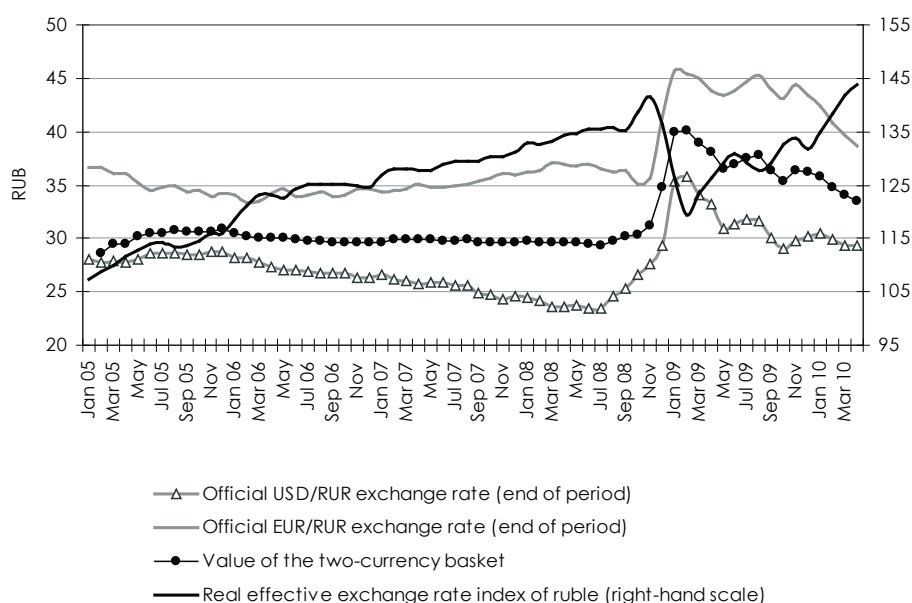
5 The level of January 2002 is accepted as 100 per cent.

tion Fund of USD 1 trillion and the decision of the IMF and the EU to provide financial support for Greece in the amount of USD 110 billion.

In general, since late April through May 28, Euro rate has been downgraded against RUR by 1.8 per cent, to the level of RUR 37.99.

Throughout April the USD rate to RUR was relatively stable: the range of USD fluctuation did not exceed 57 kopecks, varying within RUR/USD 28.93-29.5. However, since early May, and this is the first time since 2010, the dollar started to grow. The dollar was significantly enhanced: from late April to 28 May the nominal value of the dollar against the ruble grew by 5.4 per cent to 30.88 rubles. It should be noted that the dollar has strengthened not only to the ruble, but also against other world currencies, and above all, the Euro. When disposing of the Euro, market participants were again to the dollar. In addition, the reason for the sharp weakening of the ruble in May was the fall in oil prices, which fell from USD 80 to USD 70 per barrel. As a result in May for the first time since November of the last year the value of the two-currency baskets has grown to USD 34.1 as of May 28¹ (+ 1.7 per cent).

Since April 30, 2010, for the third time in the current year, the Bank of Russia decided to reduce the refinancing rate and other key interest rates on the Central Bank operations. The refinancing rate was set up at the rate of 8 per cent per annum (see *Table. 1*).



Source: RF Central Bank, author's estimates.

Fig. 3. Indicators of RUR exchange rate within January 2005 – April 2010²

Table 1

INTEREST RATE UNDER RF CENTRAL BANK CREDIT OPERATIONS

| | Term | From 29.03.10 | From 30.04.10 |
|---|-----------|---------------|---------------|
| Lombard credits (lowest interest rates) | 7 days | – | 5.25 |
| | 14 days | 5.5 | – |
| | 3 months | 7 | 6.75 |
| | 6 months | 7.5 | 7.25 |
| | 12 months | 8 | 7.75 |
| Direct Repo through an auction (Stock Exchange and OTC) (minimum interest rate) | 1 day | 5.5 | 5.25 |
| | 7 days | 5.5 | 5.25 |
| | 90 days | 7 | 6.75 |
| | 6 months | 7.5 | 7.25 |
| | 12 months | 8 | 7.75 |
| Overnight credits | Overnight | 8.25 | 8 |
| «Foreign currency swop» (RUR share) | 1 day | 8.25 | 8 |
| Lombard credits (under fixed interest rate) | 1 day | 7.25 | 7 |
| | 7 days | 7.25 | 7 |
| | 30 days | 7.25 | 7 |
| Direct Repo (under fixed interest rate) | 1 day | 7.25 | 7 |
| | 7 day | 7.25 | 7 |
| | 12 months | 8 | 7.75 |

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

Table 1, cont'd

| | Term | From 29.03.10 | From 30.04.10 |
|--|-------------------------------------|------------------|------------------|
| Credits, secured by assets or warranty (Credit, secured by assets or warranty) | Up to 90 days | 7.25 | 7 |
| | From 91 to 180 days | 7.75 | 7.5 |
| | From 181 to 365 days | 8.25 | 8 |
| Deposit operations (Credit, secured by assets or warranty) | «tom-next», «tom-next», «on demand» | 3 | 2.75 |
| | «Week 1», «Spot-week» | 3.5 | 3.25 |

Source: RF Central Bank.

We would like to remind, that the Bank of Russia has reduced the interest rates already for the thirteenth consecutive time since April of the last year. The reasons for this decision, as stated in the Central Bank press release does not differ from those that caused previous rate reductions. In particular, the persistent tendency to reduce inflation (annual inflation rate for April 26 was 6.1 per cent, as compared with 6.5 per cent in March 2010), as well as the need to encourage credit activity of commercial banks to ensure the recovery of economic growth. In addition, reducing the difference in the refinancing rates of the Russian and international markets will be directed at limiting the inflow of speculative capital.

Despite the persistent policy aimed at the interest rate mitigation, the Bank of Russia has not yet managed to achieve its objectives. Recently, inflation rate has slowed down faster than the declining rate of the Central Bank, so the stakes have grown in real terms and as a result, speculators have the opportunity to earn on the difference in interest rates. In addition, despite the fact that since the beginning of the year the average weighted rate on ruble credits to non-financial institutions for up to 1 year decreased from 13.9 per cent in January to 11.8 per cent in March, there are no obvious signs of crediting growth so far. The banking sector is characterized by excessive liquidity, against which further downgrading of interest rate policy provides no visible effect on credit policy.

Apparently, the potential for further reduction of refinancing rates has been largely exhausted in view of the expectation of growth of inflation risks in the second half of 2010. On the one hand, inflationary pressures will be contributed by «the effect of the monetary base» of the last year, and on the other hand, by the expansion of money supply in early 2010. ●

FINANCIAL MARKETS¹

N.Burkova, E.Khudko

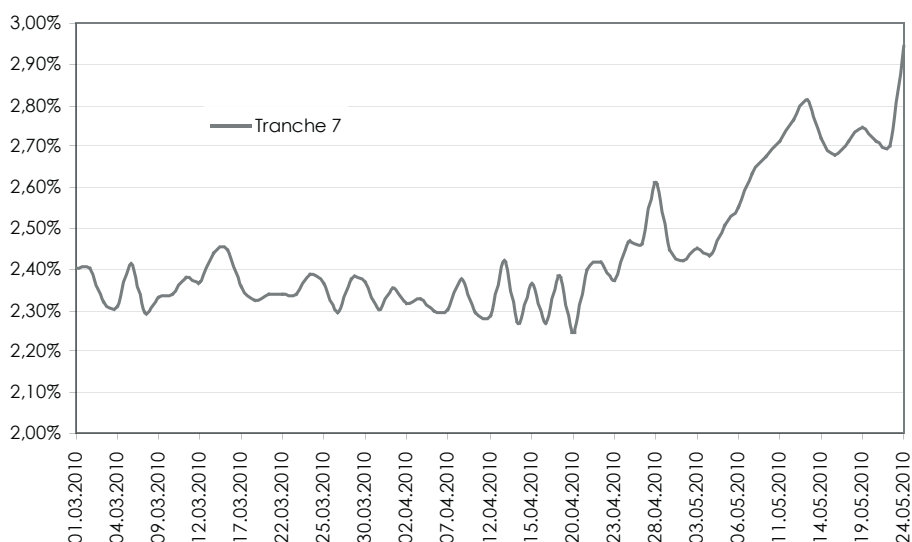
In May, there was volatile dynamics in the Russian financial market under the impact of both, external and internal factors. Severe volatility in the global economy, downgraded credit ratings in Greece, Portugal and Spain, the depreciation of the Euro rate, the sharp fluctuations in oil prices, the increase of the Russian external debt in January–April 2010 contributed to the compression of the trading volume in the market of government securities by 3,4 times. However, positive financial results of a number of major international and Russian companies for the I-st quarter of 2010, the EU decision to establish a counter-crisis fund for the EU economy stabilization and the allocation of financial assistance to Greece, preservation of the U.S. Federal Reserve Fund and the key interest rate at the same low level, the forecast of Standard & Poor's forecast for the Russian GDP in 2010 by 4.5 per cent helped to support the market of corporate shares and to increase the average daily turnover by 10 per cent. The record growth in May was characterized by the volume of registered corporate bond issues, which suggests a likely increase in the market volume in the coming months. There has been noted a decline in the wave of defaults, which began since mid-2008. Other key indicators of corporate bond market showed a moderate negative dynamics.

Government securities market

In May 2010, Russian Eurobonds have demonstrated a general upgrading trends at the background of volatility in the global financial markets, financial problems in Greece, Portugal and Spain and the sharp decline in investor interest to the government securities market, which has resulted in the announcement as invalid of the single auction for additional OFZ placement.

As of May 24 of the current year, the Russian Eurobonds RUS-28 yield to maturity has grown as compared with the level of April 25 from 5.73 to 6.35 per cent per annum (by 10.82 per cent), RUS-18 – from c 4.69 to 5.26 per cent per annum (by 12.15 per cent), and RUS-30 from 5 to 5.64 per cent per annum (by 12.8 per cent), RUS-15 – from 4.06 per cent to 4.69 per cent (by 15.52 per cent), and RUS-20 – from 5,25 to 5.77 per cent (by 9.90 per cent). As of the same date, a similar upgrading trend was observed in the yields of external currency debt bonds. Thus, the yield to redemption of the seventh tranche of external currency debt bonds has increased from 2.37 to 2.94 per cent per annum (by 24.05 per cent) (see Figs 1–2). Herewith, the 15th coupon of the seventh tranche of external currency debt bonds was redeemed on May 14, 2010 at the rate of 3 per cent per year.

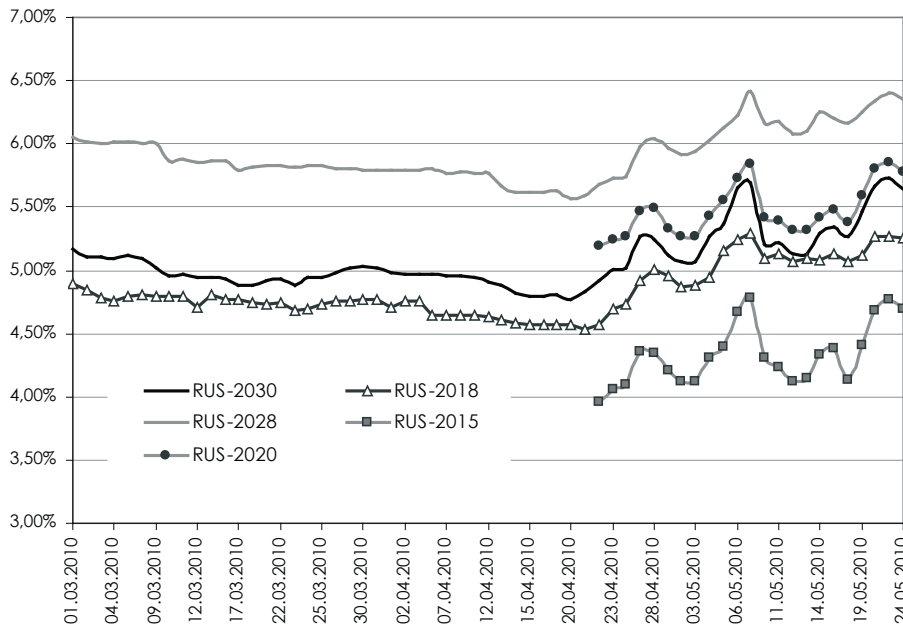
Within the period from April 26 to May 24 the total turnover of the secondary



Source: "Finmarket" Information Agency data

Fig. 1. Minfin bonds' yields to maturity in March – May 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, 2015, 2018, 2020, 2028 and 2030 in March – May 2010

As of May 24, the volume of government bonds made RUR 1 448.42 bn at face value and RUR 1 461.79 bn at the market value (as compared with RUR 1,490.93 bn and RUR 1,508.42 bn accordingly as of April 25). The duration of the OFZ market portfolio was 1,635.6 days, having increased by 18.65 days as compared with the preceding month (as of April 25).

Stock market

Stock market situation

In May, like in the previous month, trading volumes in the stock market showed an increase at the background of the sustained volatility of the global financial markets, reduction of the RF Central Bank refinancing rate since April 30 to 8 per cent, positive financial performance of a number of /the largest Russian as per the results of 2010, changes in the international rating agency Standard & Poor’s forecast on the Russian GDP growth by 4.5 per cent in 2010, as well as the Russian trade surplus growth times 2.3 and amounting to USD 46 billion as of the first Quarter of 2010, reduced unemployment in the RF in April 2010 by 0.4 p.p. to 8.2 per cent, increased level of foreign investments in the RF in the first quarter by 9.3 per cent on the one hand, and negative impact of the Greece problem settlement, sharp volatility of the global oil prices, reduced foreign currency and gold reserves in the RF, growth of external and domestic Russian debt in January–April of 2010 by 11.3 per cent to 41.9 bn dollars and the deficit of Russia in April 2010 in the amount of 5.7 per cent of GDP, on the other hand.

The maximum value within the month the MICEX index has reached on May 4, having reached 1,393.07 points (1,530.93 per cent points in the preceding month) (Fig. 3). The minimum value for the period of May 20 – 1,263.99 points (against 1,443.36 points in the preceding month).

In general, within the period from April 26 through May 24, the MICEX index has decreased by 3.68 per cent, what makes about 198.25 points in absolute terms (within the year, from May 25, 2009 through May 24, 2010, the MICEX index has been upgraded by 20.78 per cent). Over the same period, the turnover of trades in securities included in the MICEX index, made about RUR 1,150.13 bn at an average daily turnover of RUR 60.53 bn (against RUR 1,102.89 bn with an average daily turnover of RUR 55.14 bn in the preceding period). Therefore, the investors’ average daily activity in the stock market in May has grown as compared with the preceding period by 10 per cent. The indicators of maximum and minimum daily turnover in the market trades made, accordingly, RUR 74.94 bn (as of May 21), and RUR 47.91 bn (on May 24).

market of government bonds amounted to approximately RUR 39.38 billion with an average daily turnover of RUR 2.07 billion (about RUR 139.86 billion with an average daily turnover of RUR 6.99 billion in April), which means the decline of an average monthly turnover by 3.4 times.

In the period from April 26 through May 24, there were no auctions on government bonds placement at the primary government bonds market (like a month before). Moreover, in the period under review the auction arranged for government bonds additional placement in the secondary market was recognized as invalid.

As of the month results (from April 26 through May 24), the “blue chips” securities have shown negative dynamics. The leaders in the decline were Gazprom Neft, whose shares have decreased by 24.10 per cent, Rostelecom (22.67 per cent) and Sberbank of Russia (17.51 per cent). Some less upgrading rates were noted in securities of Gazprom (15.16 per cent), Mosenergo (14.98 per cent), GMK Nornickel (14.81 per cent), Rosneft (14.63 per cent) and LUKOIL (14.42 per cent). They were followed by the securities of Tatneft and Surgutneftegas, having declined by 13.70 per cent, 12.48 per cent and 7.88 per cent, accordingly (Fig. 4). In May of the current year the MICEX turnover leaders were: “Sberbank of Russia” (35.15 per cent of the total turnover), Gazprom (17.98 per cent), GMK “Nornickel” (11.27 per cent), LUKOIL (5.48 per cent), and VTB Bank (4.71 per cent).

Herewith, a significantly increased demand for the shares of Sberbank of Russia led to the return of Sberbank of Russia to the top leader, which was previously kept by Gazprom.

The total volume of transactions with the shares of those five «blue chips» was about 74.6 per cent (all «blue chips» – 81.12 per cent) of the total trades in shares at the MICEX stock market over the term from April 26 to May 24 (in April the share of operations with the “blue chips” accounted for 73 per cent).

According to MICEX information, as of May 24, the top five leaders of the domestic stock market in terms of capitalization were: “Gazprom” – RUR 3,552.21 bn (RUR 4 100.96 bn a month earlier), “Rosneft” – RUR 2 214.17 bn (against RUR 2 548.33 bn), “Sberbank of Russia” – RUR 1 514.76 bn (against RUR 1 829.49 bn), “LUKOIL” – RUR 1 255.81 bn (against RUR 1 445.37 bn) and GMK “Nornickel” – RUR 916.64 bn (against RUR 1 047.03 bn).

Herewith, a greater rate of capitalization growth of GMK “Nornickel” in May (RUR 916.64 bn) has led to regaining the fifth place with Surgutneftegaz rating (RUR 916.64). Herewith, the lower

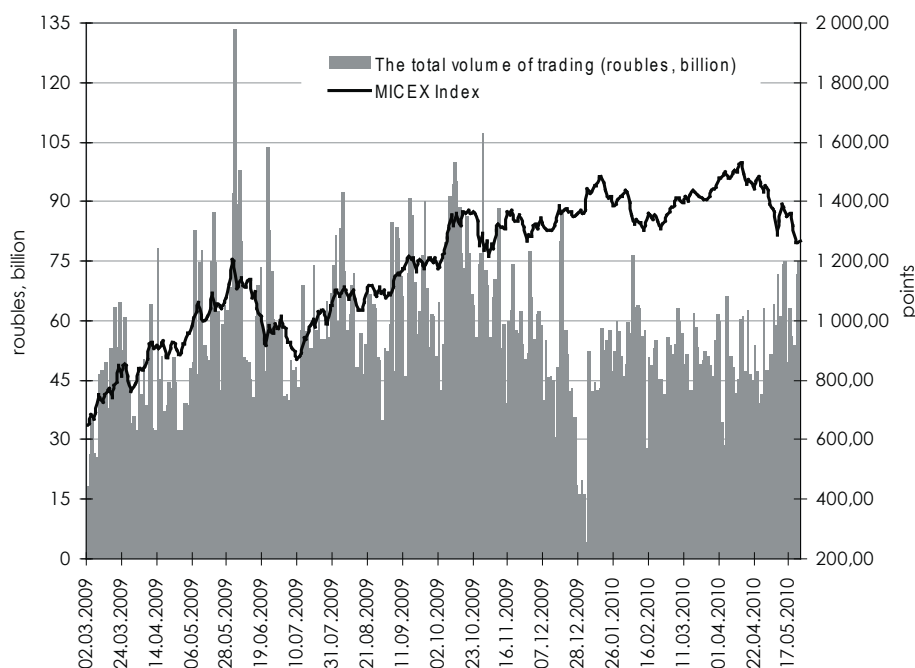


Fig. 3. Dynamics of MICEX Index and trading volume

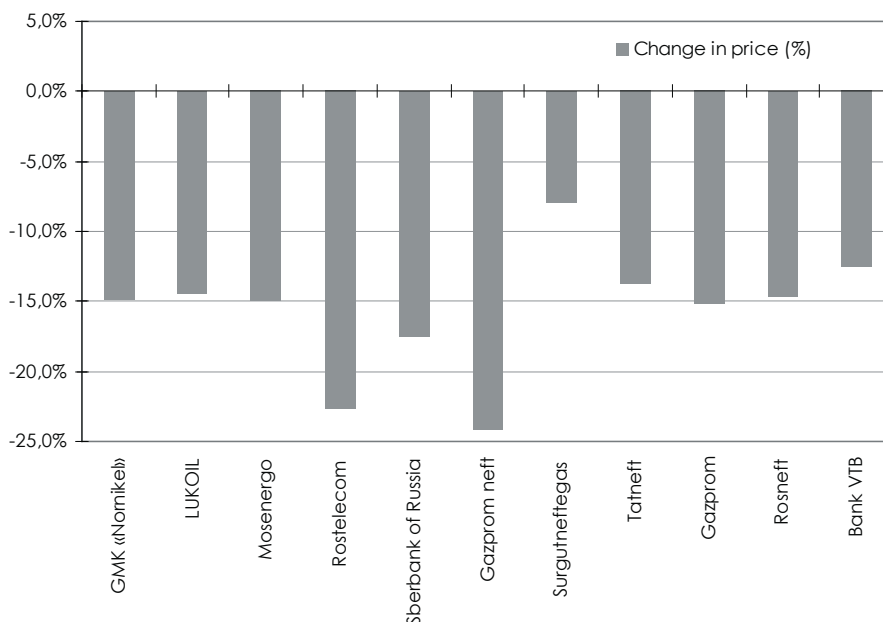


Fig. 4. Dynamics of the Russian Blue Chips from April 26 to May 24

growth rate of capitalization of GMK Norilsk Nickel (RUR 916.64 bn) In May led to Surgutneftegaz return to fifth place in Surgutneftegaz rating.

Futures and Options Market

High volatility and the ongoing tensions in the world markets have resulted in May in a general growth of the activity of Russian participants in the market, derivatives allow to hedge against the risk of losses in investment portfolios.

In May the total turnover in the MICEX futures market has declined by 2 per cent as compared with the preceding month. Thus, in the period from April 26 through May 24 the total turnover in the MICEX (futures) market made approximately RUR 90.95 bn (510.02 thousand of transactions, 2.11 mln of contracts) against approximately RUR 92.63 (451.81 thousand of transactions, 1.53 mln of contracts) in April.

The largest volume of trading in May, like a month before, was observed in contracts for futures and equity instruments, amounting to RUR 62.04 billion (551.63 thousand of transactions, 1.26 mln of contracts). Herewith, futures for the MICEX index in the short-term MICEX market section in terms of the volume of trade were followed by contracts for “Gazprom”, “LUKOIL”, “Nornickel” and «Sberbank of Russia», shares. It should be noted, that the value of the MICEX index (the price of transactions) for June and September 2010 was basically within the range of 1,260–1,460 points.

The second place in terms of trading volume within the month of May was taken by foreign currency futures (RUR 28.94 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 May for RUR/USD futures in the MICEX futures market were within RUR/USD 29.3–31.6 for June, RUR/USD 30–31.8 for September, RUR/USD 30–31.5 for December. Trading volume in futures for commodity assets within the period has increased by 8.71 per cent (from RUR 2.64 billion to RUR 2.87 billion). There were no contracts for interest rate in ay.

Opposite trends were observed in the RTS FORTS futures market, where the investors' activity in May has also significantly increased as compared with the previous month (by 53 per cent). Thus, in the period from April 26 through May 24 the total market turnover of futures and options in RTS was about RUR 2,814.79 billion (12.27 million of transactions, 60.92 million of contracts) as compared with about RUR 1,839.08 billion (7.57 million of transactions, 37.62 million of contracts) in April. The greatest demand among the market participants, as before, was demonstrated in futures: trading volume in them during the period under review amounted to RUR 2,691.28 billion (12.08 million of transactions and 58.22 million of contracts). Herewith, In the first place in terms of futures trading volume were the futures contracts for the RTS index, which were followed with a significant margin by the futures contracts for dollar–ruble rate and for the shares of Sberbank of Russia and Gazprom. Volatility of Euro rate in the global market provoked the growth in Euro/USD futures contracts in the RTS market. Those contracts took the fourth place among the five leaders of the turnover. It should be noted that prices of the recent transactions, concluded on futures contracts for the date of execution on June 15, were within RUR 29.3–31.7/ USD, on September 15, 2010 – RUR 29.6 – 31.4 USD, and on December 15, 2010 – RUR 29.9–30.6/ USD. The value of futures contract for the RTS index (based on the prices of recent contracts) for June 15, 2010 was estimated on average at 1 300–1 560 points, for September 15, 2010 – 1 310–1 570 points. Options enjoyed far less demand, the turnover made about RUR 123.51 bn (177.76 thousand transactions and 2.7 mln of contracts). The maximum daily turnover in the short-term RTS futures market in the period under review made RUR 194.81 billion (as of May 7), which demonstrated the maximum peak since 2001, and the minimum was RUR 95.34 bn. (on April 26).

External factors behind the Russian stock market dynamics

In May 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 April, one should mention:

– information about the increase of net profit in I quarter 2010 of Deutsche Bank AG by 49 per cent to 1.76 billion, of the oil company Royal Dutch / Shell Plc. by 57 per cent to 5.48 billion dollars,

the German Chemicals Group BASF Group – by 174 per cent to 1.03 billion Euro, Swiss UBS bank – to 2.2 billion, Swiss franc (1.53 billion Euro) (1,97 billion Swiss francs of net losses in the I quarter of 2009); French bank Societe Generale – up to 1.06 billion Euro (278 million Euro net loss in quarter I, 2009), the German company Bayerische Motoren Werke (BMW) – up to 324 million Euro (182 million Euro net loss in quarter I, 2009), the Japanese auto concern Honda Motor – as of the 2009–2010 fiscal year ending on March 31 – by 95.9 per cent, up to 268.4 billion yen (2.87 billion U.S. dollars) ;

- U.S. Federal Reserve decision to maintain the key interest rate in the range of 0–0,25 per cent per annum;

- reaffirmation by the international rating agency Fitch Ratings credit rating of Spain at the AAA level with a "stable" outlook;

- decline in unemployment in Germany to 7,8 per cent;

- reduction of unemployment level in Germany to 7.8 per cent;

- IMF decision on the allocation of Greece the loan of 30 billion Euro for three years in the support to overcome the financial crisis;

- the EU decision to create a pan-European anti-crisis fund amounting to 750 billion Euro in order to stabilize the economic situation in member countries of the European Union, as well as to allocate 110 billion Euro for the three-year program of assistance to Greece to recover from the financial crisis;

- GDP growth for the I quarter of 2010, according to estimated data, in the Euro zone by 0.2 per cent; GDP in Germany – by 0.2 per cent; GDP in France – by 0.1 per cent

- information about the merger of the US United Airlines and Continental air carriers.

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

- in late April, the downgrading by the international rating agency Standard & Poor's of Portugal the long-term sovereign credit ratings foreign and local currencies at once by two levels at a time to the level of A– and short-term ratings of foreign and local currency – up to A–2; forecast – "negative";

- decline in late April of the rating agency Standard & Poor's the long-term credit rating of Greece by three steps at once – to BB+, the short-term credit ratings of Greece – to A–2 rating outlook – "negative";

- a ban by the Government of Greece to "short" selling in the stock market following the downgrading of the country rating;

- decrease by Moody's financial rating and ratings on bank deposits and liabilities of nine Greek banks in view of the pessimistic forecasts regarding the economic future of Greece;

- decline in late April of the rating agency Standard & Poor's long-term credit rating of Spain from AA + from to AA; rating outlook – "negative";

- Moody's rating of Portugal government bonds at Aa2, in the list for review of tentative reductions, as well as confirmation of the short-term sovereign rating of Portugal at the same level of Prime – 1;

- growing unemployment in Spain in the I quarter 2010 to 20.05 per cent (for the first time since 1997);

- increased unemployment in the U.S. in April by 0,2 PP to 9,9 per cent;

- decline in sales of passenger cars in the EU in April 2010 by 7,4 per cent;

- the introduction by the Government of Germany from May 19 the ban for opening of short positions on a number of unsecured assets;

- net loss of Air France–KLM Group as of 2009–2010 fiscal year ended March 31, 2010, amounting to Euro 1.55 billion (91.5 per cent increase in losses versus a year earlier).

All those factors have generally resulted in the downgrading dynamics of the global stock indices in May, as of the month results. Herewith, the markets of the developed countries were demonstrating a general decline in the indices by 7–12 per cent over the month, while the developing markets – by 2–18 per cent. Moreover, there was observed a decrease in the basic stock indices in the global stock indices as of by 1–5 per cent, with the exception of the Chinese Shanghai Composite index, which has declined by 2.5 per cent. Herewith, there was observed an increase in the basic stock market indices as compared with early January 2010 results (See *Table 1* and *Fig. 5*).

All those factors have generally resulted in the downgrading dynamics of the global stock indices as of the month results. Herewith, the markets of the developed countries were demonstrating a general decrease in the indices by 7–12 per cent, and stock markets, while there was a decline by 2–18 per cent in the developing countries. At the same time, there was observed a decrease in the basic stock indices as of January 2010, with the exception of the Chilean IPSA and Turkish National-100 indices, which have grown by 5.4 per cent and 3.28 per cent, accordingly. (See *Table 1* and *Fig. 5*).

Table 1

DYNAMICS OF THE GLOBAL STOCK INDICES (AS OF MAY 24, 2010)

| Index | Ticker | Value | Dynamics within the month (per cent) | Dynamics since the year beginning (per cent) |
|--|--------------|-----------|--------------------------------------|--|
| MICEX (Russia) | MICEXINDEXCF | 1 269.37 | -13.51 | -7.35 |
| RTS (Russia) | RTSI | 1 311.70 | -18.17 | -9.20 |
| Dow Jones Industrial (USA) Average (USA) | DJI | 10 066.57 | -10.15 | -3.47 |
| NASDAQ Composite (USA) | NASD | 2 213.55 | -12.51 | -2.45 |
| S&P 500 (USA) | SPX | 1 073.65 | -11.80 | -3.72 |
| FTSE 100 (UK) | FTSE | 5 069.61 | -11.43 | -6.34 |
| DAX-30 (Germany) | DAX | 5 805.68 | -7.25 | -2.55 |
| CAC-40 (France) | CAC | 3 430.93 | -13.17 | -12.84 |
| Swiss Market (Switzerland) | SSMI | 6 206.59 | -8.29 | -5.18 |
| Nikkei-225 (Japan) | NIKKEI | 9 758.40 | -10.59 | -7.47 |
| Bovespa (Brasil) | BUSP | 59 915.14 | -13.80 | -12.65 |
| IPC (Mexico) | IPC | 30 759.48 | -9.14 | -4.24 |
| IPSA (Chile) | IPSA | 3 774.86 | -1.59 | 5.40 |
| Straits Times (Singapore) | STI | 2 723.87 | -8.85 | -6.00 |
| Seoul Composite (South Korea) | KS11 | 1 604.93 | -7.60 | -4.63 |
| ISE National-100 (Turkey) | XU100 | 54 558.16 | -6.48 | 3.28 |
| BSE 30 (India) | BSE | 16 469.55 | -6.92 | -5.70 |
| Shanghai Composite (China) | SSEC | 2 673.42 | -10.39 | -18.42 |
| Morgan Stanley Emerging Markets Free Index | EFM | 708.54 | -12.75 | -9.49 |

* – Versus index indicator valid on April 25, 2010.

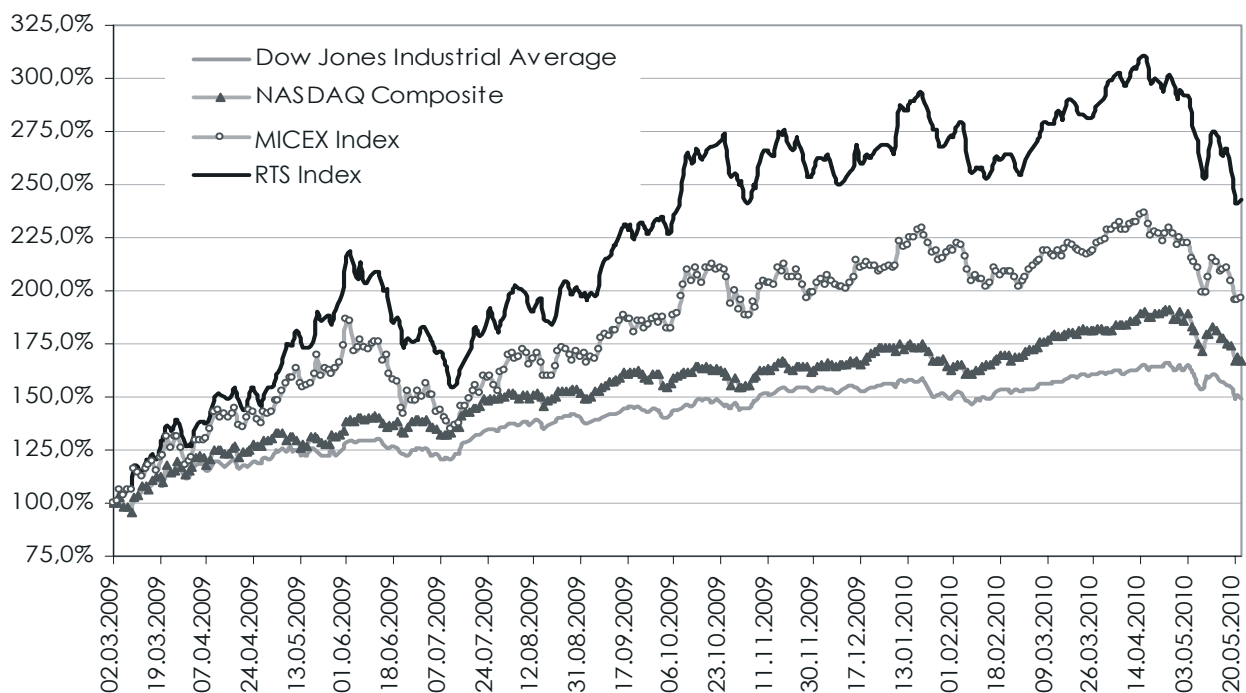


Fig. 5. Dynamics of the Main USA and Russian Stock Indexes (in per cent to the date 01.03.2009)

Corporate News***OAO "VTB Bank"***

On April 26, VTB Bank has signed a cooperation agreement with the largest bank in Portugal Caixa Geral de Depositos SA, defining the key directions of cooperation between the parties, in particular, infrastructure development, financing of export–import contracts between Russian and Portuguese companies. On April 27, VTB Bank has signed a memorandum of understanding with the state export insurance agencies in Denmark Eksport Kredit Fonden, providing for the exchange of information on potential projects between Russian and Danish companies. On May 17, VTB Bank has signed an agreement with the State Export–Import Bank of Ukraine on the interbank cooperation aimed at strengthening partnerships between the banks. On May 19, VTB Bank has signed a framework loan agreement with the Swiss bank UBS AG for 250 million Swiss francs, providing for the granting of UBS AG bank of long–term resources to the VTB Bank in Swiss francs, dollars and Euro to finance the purchase of the goods and services from Switzerland and other countries under the safeguards of national export insurance agencies by Russian importers.

OAO «Gazprom»

On April 29, OAO "Gazprom" has submitted an audited consolidated financial reporting, developed under IFRS for 2009: net profit made 793.79 billion rubles, which is by 22.41 billion rubles, or by 2,9 per cent more than in 2008

GMK «Norilsk Nickel»

On May 18, "Norilsk Nickel" announced has disclosed financial results under IFRS for 2009: net income made USD 2,651 million as compared with the loss of USD 555 million in 2008, earnings per share reached USD 14.9; assets increased by 10 per cent to 22,760 million, while capital and reserves increased by USD 25 per cent to USD 14,755 million.

NC «Rosneft»

On May 17, NC «Rosneft» has disclosed the consolidated financial reporting, developed under US GAAP for the I quarter of 2010: EBITDA increased by 92 per cent to USD 4,443 million, net profit increased by 19.4 per cent to USD 2,447 million. On May 19 "Rosneft" and Crescent Petroleum (UAE) have signed an agreement on strategic cooperation in oil and gas sector in the Middle East and North Africa.

OAO «Rostelecom»

On May 7 "Rostelecom" has disclosed financial (unaudited) results under IFRS for the I quarter of 2010: net profit amounted to RUR 1 028.9 million (by 48.0 per cent lower than in the I–st quarter of 2009); index OIBDA (revenues less expenses from ordinary activities, excluding depreciation) made RUR 2,963.6; profitability under OIBDA – 21.0 per cent. On May 21, COMSTAR–UTS and OAO "Rostelecom" have signed contracts for the sale of ordinary shares of Svyazinvest to OAO "Rostelecom", constituting 25 per cent of its authorized capital plus one share, for RUR 26 billion.

Sberbank of Russia

On May 19, Sberbank of Russia has repaid the first tranche of subordinated credit to the Bank of Russia in the amount of RUR 200 billion. Also on May 19, Sberbank of Russia has disclosed the financial reporting under RAS for the results of 4 months in 2010: net profit totaled to RUR 47.4 billion against RUR 0.8 billion within 4 months of 2009; assets increased by 5.2 per cent to RUR 7.478 billion; Russian enterprises were granted loans amounting to about RUR 1.1 trillion; capital adequacy ratio made 21 per cent.

Corporate bonds market

The volume of the Russian domestic stock market (as per nominal value of shares in circulation, denominated in national currency) in May of the current year, has somewhat grown again and at the end of the month reached RUR 2, 402.3 bn, which is more than the relevant indicator of preceding

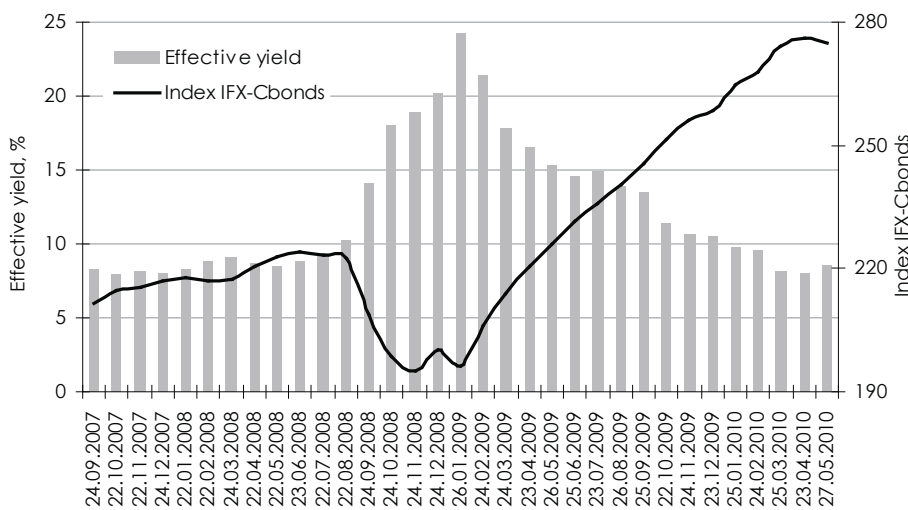
month by 2.6 per cent¹. Herewith, the total number of emitters and emissions in circulation and denominated in the national currency has increased from 650 to 655 emissions and from 368 to 361 emitters. There is still one emission of bonds in circulation, denominated in Japanese yens and two emissions denominated in US dollars.

In May the activity of foreign investors in corporate bonds was decreased, what affected the volume of trading in the secondary corporate bonds market . Thus, the trading volume in the MICEX market in the period from April 26 through May 24 of the current year amounted to RUR 86.6 billion (for comparison, from March 29 through April 23 the trading volume was equal to RUR 107.4 billion)². In the period under review on the MICEX Stock Exchange there were committed 19.7 thousand of transactions (22.2 transactions in the preceding period). Therefore, the indicators of the secondary market were the lowest since the beginning of the current year.

During this month there was a turning point in the index of Russian corporate bond market of IFX–Cbonds. For the first time since 2009 the index showed a prolonged negative dynamics, although the overall decline in the period from April 23 to May 27 was only 1.1 points (or 0.4 per cent). Effective yield after a period of stabilization at the same level over the past two months has increased by more than 0.5 per cent (See Fig. 6). The duration of corporate bonds market portfolio is declining for the third month in succession and in late May made 692 days (in late April the duration was equal to 729 days).

Despite the negative situation in the bond market, in May the companies were actively registering bond issues. The total volume of registered issues of corporate bonds was several times higher than in the previous similar period, and approached the peak indicator of the 4th Quarter of 2009. Thus, from April 24 to May 27, twenty nine emitters have registered 58 bond issues amounting to 327.8 billion rubles. (For comparison, from March 26 to April 23, twelve companies have registered twenty one issue bonds worth of 91.9 billion rubles). More than one third of registered issues were once again exchange bonds. The greater part of the reported issues were the exchange bonds of Gazprombank, totaling to 50 billion rubles, six series of OAO Novolipetsk Steel exchange bonds, totaling to 50 billion rubles, three series of stock of bonds of OAO “Mobile TeleSystems” for the amount of 35 billion rubles, four series of OAO “Agency for Housing Mortgage Lending” bonds for the amount of 31 billion rubles³

The dynamics of primary bond market was unstable in the last months after the double growth of primary bond emissions market. Thus, in the period from April 24 through May 27



Source: Cbonds data.

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

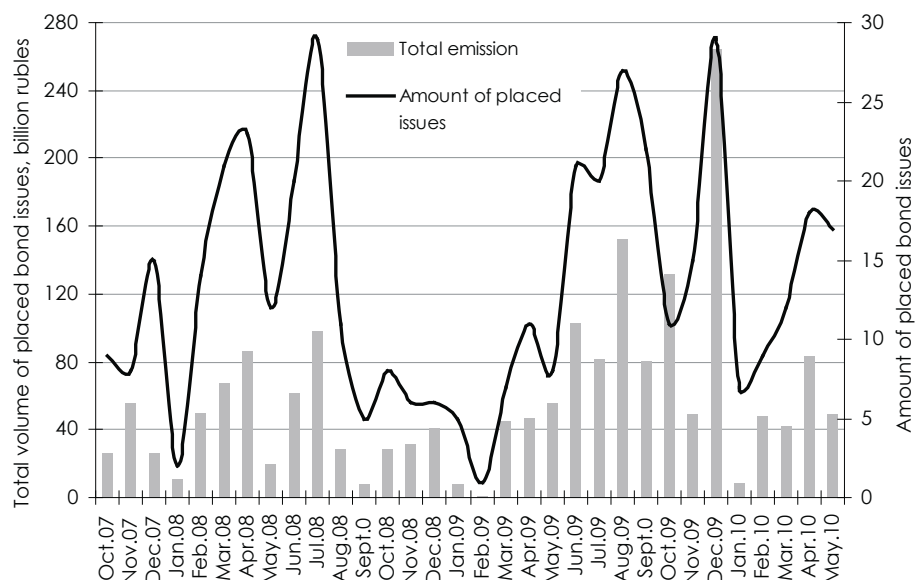
there were placed 17 corporate bonds emissions, including 5 stock bonds issues totaling to RUR 48.8 billion (for comparison, from March 26 through April 23 there were placed 18 bonds emissions for the total amount of RUR 83.3 billion (See Fig. 7). During the period under review the largest bond issues were placed by OAO “Mechel” (two series of bonds for the total amount of RUR 20 billion) and OAO “Mineral and Chemical Company EuroChem” (one series of stock bonds worth RUR 15 billion) and OAO “Aeroflot” (two series of stock bonds for the

1 As per Rusbonds information
 2 As per “Finmarket”Information agency.
 3 Source: Rusbonds data.

total amount of RUR 10 billion). Herewith, in the period under review no emissions were recognized as invalid by the Federal Financial Monitoring Service (FFMS) due to non-placement of any security¹.

Within April 24 through May 27, sixteen emitters were supposed to redeem their bond issues totaling to RUR 83.8 billion. However, two emitters have announced a technical default on repayment of their bond loans for the total amount of RUR 2.5 bn (against three emitters, announced a technical default on repayment of their bond loans, totaling to RUR 2.5 bn in relevant preceding period). In addition, OAO “Atomic Energy Power Corporation” has decided to early repayment of two bond issues worth 60 billion rubles. In May 2010, twenty six issues of corporate bonds redemption for the total amount of RUR 24.7 bn are expected.²

From April 24 through May 27, the real default on bonds coupon yield redemption was announced by five emitters for nine emissions (since March 26 through April 23 – four emitters). Offer (bonds purchase) was carried out by all issuers in due time during the reporting period, (in the last month one emitter has announced a default on the offer). In regard to two emissions, the emitters managed to reach agreement with bondholders to restructure the debts. The situation with the performance of current debt liabilities has improved. A real default on bonds redemption of the nominal value of their bonds was announced by three emitters, among them two emitters managed to restructure their debt (in the preceding relevant period – six emitters failed to redeem their loans under seven emissions)³.



Source: Rusbonds data

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

1 FFMS of Russia data
 2 Rusbonds data.
 3 Cbonds data

REAL ECONOMY SECTOR: TRENDS AND FACTORS

O.Izryadnova

According to the data of the Federal State Statistics Service, the GDP growth in the 1st quarter 2010 made 102.9% versus the corresponding period of the previous year. The main factor contributing to the positive dynamics recovery is fast growth of the net export. The limitation of the budget support rendered top the economy which was not compensated by the measures aimed at overcoming the stagnation in economy and population crediting resulted in rather moderate increase in consumer demands (101.2% versus the 1st quarter 2009) and in the sustention of the trend to the investments in fixed assets reduction (95.3%).

In concordance with the scenario conditions project prepared by the Ministry for Economic Development, the basic variant forecasts the GDP growth at the level of 4.0% in 2010, investments growing by 2.9% at the expense of broadening the state expenses for this purpose. Depending on the level of oil prices (USD 76-79 per barrel) and limitations for the state investments the GDP growth is assessed to be at the level of 3.1-4.5%. The Ministry of Finance of the Russian Federation suggests applying the oil price of USD 70 per barrel as the basis for the development of the scenario conditions for socio-economic development of the country.

In January-April 2010 the economic situation was determined by the domestic business activity and solvent demand recovery.

This year the positive dynamics is observed for nearly all types of economic activity. The increase in industrial production over January-April versus the corresponding period of 2009 made 6.9%, including the increase in minerals extraction by 6.3%, in processing industries – by 8.3%. The absolute growth in the production output volumes defined the expansion of the demand for the services of natural monopolies. The freight turnover went up by 12.4%, railway transportation increasing by 14.3%, electricity, gas and water production and distribution – by 6.0%.

The crisis and the trends of the Russian economy recovery have once again revealed the vulnerability of raw materials export model. It is the net export that remains the main factor for the economy growth. When analyzing the influence of the foreign economy component on the situation in the Russian economy it should be noted that in 2009 the import contraction against the background of ruble devaluation was accompanied with the broadening of the niches for the domestic goods at the internal market, and the positive monthly export dynamics starting with February 2009 against the background of the favorable situation at the world market stimulated the growth of export-oriented productions of extractive and processing industries. However at the beginning of the current year the devaluation effect was exhausted: ruble exchange rate in real terms returned to the pre-crisis level; monthly import dynamics again had higher growth rates than export dynamics or changes at the internal market. Thus, the structure of the internal market resources formation was defined by the trends characteristic for pre-crisis period.

The gap between the financial sphere and the real sector sustained through the way out of the crisis. Stagnation in bank and crediting sector, complication involved in debt restructuring, delayed decrease in interest rates had a negative impact on the investment activity. The influence of these factors became more intensive due to the contraction of the investment programs throughout 2009 and the reduction of the sufficient groundwork, which has led to the decrease in the workload in construction by 6.2% over January-April 2010, residential areas implementation – by 2.4% and investments in fixed assets- by 3.3% versus the corresponding period of the previous year. The level of the business activity in the 1st quarter 2010 was also negatively affected by the recovery of the trend towards capital withdrawal. According to the preliminary estimation of the Central Bank of the Russian Federation the net capital export by private sector made USD 12.9 billion in January-March 2010, whereas in the 4th quarter 2009 the inflow of the capital was equal to USD 8.3 billion. Besides, although on the whole the foreign investments in the Russian economy went

up by 9.3% in the 1st quarter 2010 versus the level of the corresponding period of the previous year, their structure did not contribute to the increase in the investment activity in the real sector of the economy. Direct foreign investment decreased by 17.6% versus the 1st quarter 2009 and made USD 2.6 billion, while portfolio investments in debt securities went up by 5.7 times and in trade credits – by 1.3 times. The indirect evidence of the expected upsurge in the construction activity in summer and autumn is the growth of the construction materials production and output of some machinery and equipment for construction purposes that was observed in April of the current year for the first time after a dramatic drop of production at the end of 2008 – the beginning of 2010. Average provision of the construction organizations with orders made 4 months in the 1st quarter 2010 and 6 months for large-scale construction companies. Entrepreneurial activity index in the 1st quarter 2010 as compared with the corresponding period of the previous year went up by 2 percentage points.

In April the growth of the retail trade turnover recovered. As compared with the corresponding period of 2009 retail trade turnover went up by 4.2%, and as a result of January-April – by 2.0%. The sustention of the trend for the increase in foodstuffs production proportion is characteristic for the structure for the consumer market. In January-April 2010 the foodstuffs turnover went up by 4.1%, and non-food goods and paid services rendered to the population turnover – by 0.2% versus the corresponding period of the previous year.

The recovery of the consumer market is supported by the increase in incomes of the population, change in the situation in consumer crediting sector and stabilization at the labor market. In the 1st quarter 2010 the volume of the monetary incomes of the population made RUR 6718.6 billion and increased by 13.7% in nominal terms as compared with the corresponding period of the previous year. The population spent RUR 4887.0 billion for goods and services purchase, which is by 8.4% more than in the 1st quarter 2009. Savings over the same period made RUR 1279.6 billion, which is by 14.2% more than in the corresponding period of the previous year.

As compared with the corresponding period of 2009 in the 1st quarter 2010 the proportion of social payments in monetary incomes of the population went up by 2.4 percentage points, while the proportion of labor remuneration (including hidden wages) reduced by 1 percentage point and the proportion of the incomes from entrepreneurial activity and property - by 1.3 percentage point.

Since the beginning of the current year the consumer inflation went up by 3.5% versus 6.2% in January-April 2009. At the same time price index for foodstuffs made 104.1% versus 105.8% in January-April 2009, and for non-food goods – 101.3% versus 104.8% a year ago, for paid services rendered to the population – by 105.6% versus 108.7%. The inflation growth rate decelerating the increase in real incomes of the population versus January-April 2009 made 6.5%, and in real wages – 3.8%.

As compared with March the number of the employed in April 2010 went up by 632 thousand of people and made 68.9 million of people. The growth of the employed and the reduction in the number of the unemployed is accounted for by both the enlivenment in the economy and the increase in the demand for workforce and by the seasonal factor. It should be noted that the level of unemployment is still above the pre-crisis one. The number of the unemployed (calculated by the ILO methodology) reduced by 278 thousand over April of the current year and made 6.14 million of people (8.2% of the economically active population). Since the end of February 2010 the number of the registered unemployed has been decreasing. In April the number of citizens officially registered in the employment services went down by 82 thousand and made 2152 million by the end of April. At the end of April 2010 the total number of the advertised vacancies made 1174 million, exceeding by 187 thousand the March figure. The tension coefficient (number of the unemployed registered in the state employment services per 1000 of the advertised vacancies) reduced as compared with April 2009 from 2.4 to 2.0.

In January-April 2010 the increase in the industrial production of 6.9% and of 10.4% in April versus the corresponding period of the previous year is mainly accounted for by the growth of processing industries by 8.3% and 15.7%, which is accounted for by the effect of last year's low base.

Index of minerals production versus January-April and April 2009 made, correspondingly, 106.3% and 105.0%, being 105.9% and 104.7%, correspondingly, for fossil fuels extraction. In January-April 2010 the production of primary fossil fuels went up by 11.3% as compared with the corresponding period of the previous year.

The volume of oil production in January-April 2010 increased by 2.9% versus January-April 2009 and made 165 million of tons. Starting with March 2009 the trend for the monthly growth of oil production versus the corresponding period of the previous year is sustained. In January-March 2010 the general volume of drilling versus the level of January-March 2009 went up by 9.1%, including the volume of production drilling increasing by 8.1%, of exploratory drilling – by 26.9%. The use of resources of the produced oil is characterized by an anticipating growth of supplies to the domestic market. The proportion of oil processing in its production went up by 48.5% versus 47.5% over the corresponding period of the previous year. In January-April 2010 there was 80.2 million tons of crude oil processed at Russian oil processing plants (105.0% versus the corresponding period of 2009)

The depth of crude oil processing in January-April 2010 was somewhat worse and made 70.5% versus 70.8% over the corresponding period of the previous year. A comparatively low extent of processing is accounted for by the insufficient use of processing deepening schemes for furnace fuel processing. The structure of output is still characterized by domination of furnace and diesel fuels, which supply exceeds the demand of the domestic market, as a result of which furnace fuel and diesel fuel are exported as fuel and raw materials for further processing. At the same time, taking into account export duties and the level of world and internal prices export supplies were more attractive than their sale at the domestic market, in contrast to car petrol and diesel fuel.

Production of natural and associated gas in January-April 2010 made 238.4 billion cu. M, which is by 20.4% more than the figure of the corresponding period of 2009, while Gazprom Group Enterprises produced 188.6 billion cu. m and exceeded the level of the corresponding period of the previous year by 19.4%.

The growth of gas production is connected not only with the increase of the demand in the sector of the housing and communal services and power industry in the period of unusually cold winter but also with a gradual recovery of the demand for gas in Russia and Europe. At the domestic market in January-April 2010 there were 191.5 billion of cu. m. Used, which makes 109% versus the corresponding period of 2009, including 62.4 billion cu. m (106.7%), used by boiler and heating stations of the Unified Energy Systems of Russia.

Index of electricity, gas and water production and distribution in January-April 2010 made 106.0% versus the corresponding period of 2009.

The growth of electricity production by 5.5% and consumption – by 5.7% versus the level of January-April 2009 is accounted not only by the increase of production growth rates in a number of energy-consuming types of economic activities, but also by the existing weather conditions in the heating season.

The production of electricity at hydro power plans in January-April 2010 has lowered by 7.9% when compared with the corresponding period of 2009, but increased at heat and nuclear power plants by 7.7% and 9.6%, correspondingly. The proportion of energy produced by heat power plants in the total energy production expanded from 68.6% in January-April 2009 to 70.1% in January-April 2010, by nuclear power plants – from 15.1% to 15.7%, and that produced by hydro power plants decreased, correspondingly, from 16.2% to 14.2%. a considerable decrease in electricity production is connected with unfavorable hydrological situation at a number of rivers of the European part of Russia and with the catastrophe at Sayano-Shushensk hydropower plant. Thus, in January-April 2010 the electricity production at Volga-Kama cascade as compared with January-April 2009 decreased by 14.5% (by 2.02 billion kW-h) and at Angara-Yenisei cascade – by 12.5 % (by 3.61 billion kW-h).

Frontal growth of the processing industry versus January-April 2009 was defined by the anticipating output recovery rates in electric, electronic and optical equipment production (129.8%), chemical industry (125.2%), leather, leather goods and footwear production (125.1%); production of rubber and plastic goods (119.3%), transport vehicles and equipment production (116.4%), metallurgy and production of finished metal goods (112.0%).

In January-April 2010 machinery and equipment production index made 109.1% versus the corresponding period of 2009. It was the increase in mechanical equipment production (by 36.6%), which production dynamics is characterized by considerable fluctuations connected with the specific nature of the production cycle of this type of commodities, that made the main contribution

into this growth. Thus, production of steam turbines increased by 2.4 times, of internal combustion engines – by 65.4%, while the production of gas turbines went down by 70.0%.

Metallurgy production and finished metal goods production index in January-April 2010 made 112.0% versus January-April 2009, metallurgy production index being 118.0% and finished metal goods index – 90.5%.

Demand for ferrous metal at the domestic market was secured by development rates of metal-consuming sectors of economy. In January-March 2010 the capacity of domestic market for rolled metal made 155.0% versus the corresponding period of the previous year. It should be noted that the growth rates of flat iron (158.6%) are above those for section iron (150.3%), which is accounted for by slower demand recovery rates in construction and machine-building sectors of the economy that consume section iron.

The production of steel pipes in January-April 2010 made 146.2% versus the corresponding period of 2009. Domestic consumption of steel pipes versus January-March 2009 went up by 82.1% and reached the pre-crisis level of January-March 2008. In January-March 2010 steel pipes import went up by 25.5% versus the corresponding period of the previous year, while export supplies of steel pipes made 43.6% of the corresponding period of the previous year. At the same time the proportion of import pipes at the domestic markets was 9.1%, which is lower than the average annual figure of 2009 – 10.8%. Thus, it can be stated that against the background of demand reduction in the period of crisis the program of import substitution and expansion of Russia steel pipes consumption proportion.

In April 2009 the works on construction of the Northern flow gas pipeline underwater part, which length is about 1.2 thousand km, started. As compared with January-April 2009 in January-April 2010 the production of the main kinds of pipes by the main kinds of production processes made: 115.9% for tubing, 106.3% for tubing, 135.3% for drilling rods, 127.7% for seamless pipes, 128.2% for welded pipes, 189.2% for electric welded pipes of big diameter, 132.1% for other electric-welded pipes.

The expected positive changes in the situation in construction allowed output growth recovery for some kinds of machinery and equipment used in housing and road construction: production of excavation machines went up by 2.6 times, of tower cranes – by 69.2%, of elevators – by 8.9%. At the same time the reduction in the number of new construction objects caused the decrease in the volumes of track-type tractors by 74.3 and bulldozers – by 54.0%.

As a result of the improvement of the economic situation in a number of industrial production sectors in January-April 2010 versus January-April 2009 the volume of machine tools output was observed to increase by 35%, there being considerable differentiation by their kinds. The growth of lumber processing and production of wooden goods (by 11.5%) contributed into the increase in output volumes of wood-working machines by 2.3 times. At the same time the reduction and cessation of investment programs fulfillment at some industrial enterprises resulted in the decrease of metal-cutting machines production by 14.4%, of forge-and-press machines – by 9.2%, and of the equipment used in metallurgy sector of industry, namely, rolling-mill equipment – by 17%, steel-smelting equipment – by 22.2%.

In January-April 2010 index of transport vehicles and equipment production made 116.4% versus the level of the corresponding period of 2009. Thus, in January-April 2010 the production of railway passenger cars reduced by 25.7%, mainline electric locomotives – by 1.5%. At the same time the purchase and production of freight cars went up by 2.2 times.

Production of passenger cars in January-April 2010 as compared with January-April 2009 rose by 54.7%, of trucks – by 34.7%, which is mainly accounted for by low production volumes in 2009 due to a dramatic drop of demand and cessation of some enterprises operation.

Fulfillment of the RF Government measures aimed at stimulation of the demand for automobiles and stabilization of financial and economic situation at automobile industry enterprises will contribute into the increase of the orders for nearly all car assembling plants, which, in its turn, will increase the production volumes in 2010.

In connection with the beginning of the cycle of work on the preparation of development budget for 2011-2013 the Ministry for Economic Development submitted a project of scenario conditions, according to which the forecast GDP growth over the period is estimated to be at the level of 116%, increase in the investments in fixed assets – 128.6% and labor efficiency – by 114.8%. According to the basic variant of socio and economic development forecast for the period of 2011-2013 the Minis-

try for Economic Development the growth of the GDP is estimated to be 4% in 2010, 3.5% in 2011 with the acceleration up to 4.2% in 2013, while the prices for oil are to grow from USD 76 per barrel to USD 79 per barrel. The achievement of forecast GDP growth in 2010-2011 is assumed thanks to the increase in the state investments. The forecast for the increase in investments in 2010 made 2.9% in 2010 and 8.85 in 2011.

According to the pessimistic variant, the state investments being limited, the GDP growth in 2010-2011 is forecast to be at the level of 3.1% and 2.7%, correspondingly, and 2.3-2.4% by 2013 in case the foreign economic situation will continue to worsen (oil falling in price to USD 62 per barrel by 2013).

In contrast to the basic variant the optimistic one corresponds to the upper limit of the range of consensus forecast by the world agencies concerning the price for oil: the price of oil grade Urals being USD 79 per barrel in 2010 the economy will grow by 4.5% in 2010.

The Ministry of Finance of the Russian Federation suggests using the oil price at the level of USD 70 per barrel for the development of scenario conditions and making socio-economic development forecast for the forthcoming three years. In such a case the planned budget deficit in 2010 is estimated at the level of 4% of the GDP. ●

RUSSIAN INDUSTRY IN APRIL 2010

S.Tsukhlo

At the beginning of the 2nd quarter the industry demonstrates the sustention of on the whole positive trends that evolved in the 1st quarter, 2010. The situation with the demand for the industrial goods remains the best since the middle of 2008. The growth of prices and employment, decrease of the average credit rate, reduction in the number of excessive workforce also testify that the positive trends in this sector of economy are sustained.

Demand for Industrial Goods

Demand for industrial goods growth rates was stabilized both according to the initial data (where the growth typical for pre-crisis years was observed) and to those upon exclusion of seasonality (the drop of the demand has stopped, the sales growth has not started). In any case the results obtained are the best since the middle of 2008. At the branch level the growth of the demand is registered now in ferrous metallurgy, chemistry industry and timber processing.

The forecasts of demand that rose sharply in January are starting to decrease. In the forthcoming two or three months the growth of sales is expected to be at the rate of +7 balance points, where January expectations made +13 balance points (fig. 1).

This April the satisfaction with sales volumes has soared (fig. 2). The proportion of “normal” estimations has reached 47%, which is the best result since October 2008. The growth of satisfaction was registered in all the branches except timber processing, where the proportion of normal estimations decreased down to 17% versus 40% in December-February. The estimations of the demand remaining at the current level in the forthcoming months will signify that the enterprises are getting used to the situation formed in the industry in the 1st quarter 2010.

Stocks of Finished Goods

The estimations of the stocks remain surprising stable since December 2009 – the industry is characterized by a slight excess of stock accumulation which was typical for pre-crisis months. However the stable majority of enterprises (60-64%) regarded their stocks as normal as early as September 2009 (fig. 3). All branches of industry have eliminated the crisis excess of finished goods, and timber processing and light industry are complaining about insufficient stocks.

In the 1st quarter the reduction of the physical volumes of finished goods. Indeed the decrease rates are slowing down but the plans for the second quarter testify that the enterprises intend to

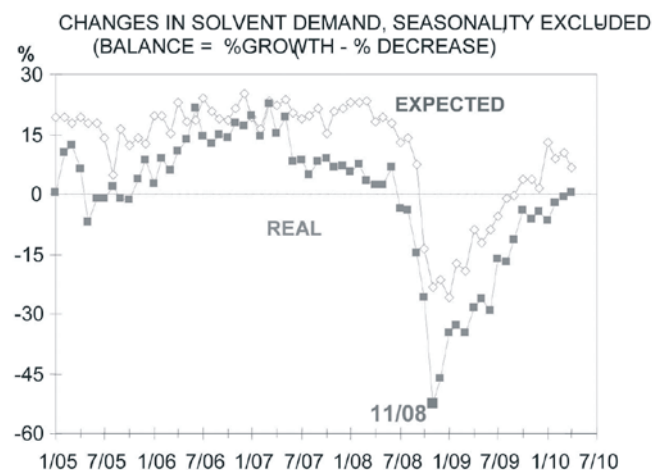


Fig. 1

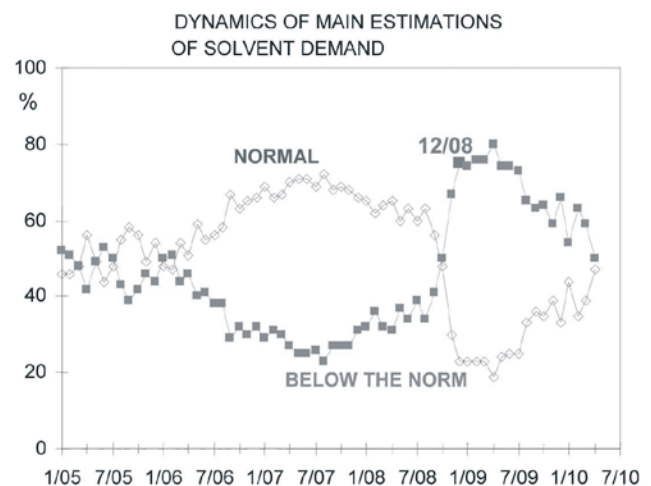


Fig. 2

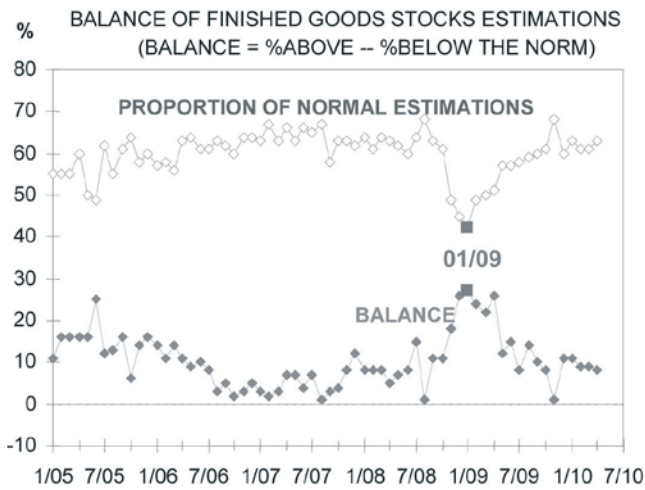


Fig. 3

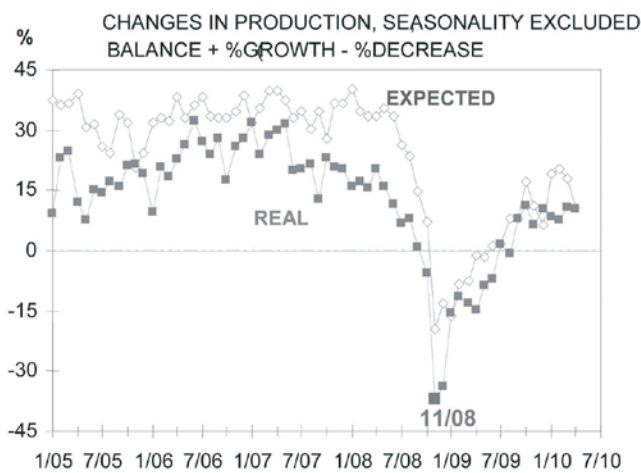


Fig. 4

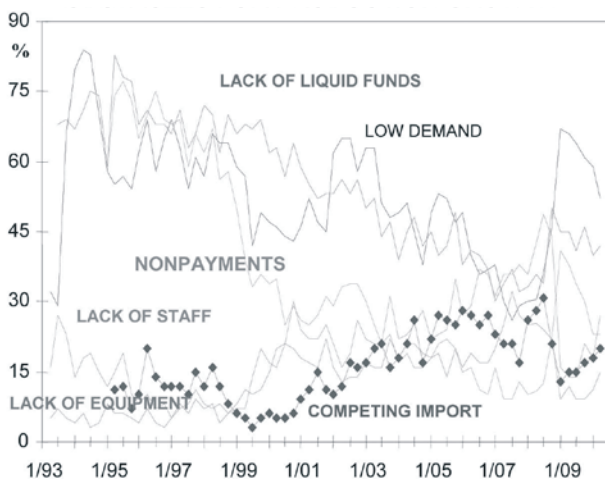


Fig. 5

increase their savings reduction rates. The growth of stocks is possible in the light industry.

Production Output

The output growth rate was not subject to fundamental changes in April 2010 (fig. 4). The production continued to grow at moderate (from pre-crisis point of view) rates, which, according to the estimation of enterprises do not alter since September 2009. The absolute decrease of the output was observed (upon exclusion of seasonality) only in foodstuffs production, chemistry and petrochemistry industry.

Obviously, the enterprises do not count on the considerable growth of demand. This April the output plans suffered the most serious negative correction since January 2009. The output growth in May-June is likely to sustain but will clearly be below that the enterprises predicted in January-March.

Low but steady production growth rates increased the average production load in increased up to 66% (fig. 5). That was the intensity the equipment was used before the crisis in 2005. The crisis minimum of this index was registered in January 2009 and made 53%. The estimation of facilities excess testify the positive dynamics of their use. Now the proportion of enterprises with excessive facilities decreased to 24%, which corresponds to the level of 2005 as well. In January 2009 the responses of “more than enough” were received from 43% of respondents. Pre-crisis and absolute minimum for this figure (January and April 2008) made 11%.

Obstacles for production growth

It is insufficient demand for the goods that is still regarded by the enterprises as the main obstacle for further production growth. In the 2nd quarter 2010 it is cited by 53% of producers (crisis maximum being 67% observed in 1st quarter 2009). The second place is held by the lack of liquid funds, which is cited as an obstacle by 45% of enterprises. The decrease of the limiting influence of this factor over the previous 6 quarters made only 5 points – that is no considerable changes regarding this aspect were observed.

The lack of staff occupies the third place in the list of obstacles. It is now cited by 26% of enterprises, crisis minimum observed a year ago making 14%.

Consumers’ defaults of payments and competing import are in the fourth place. The frequency of nonpayment quotation decreased from 41% to 22% over the period of crisis overcoming, whereas the frequency of import quotation increased from 13% to 21% (fig. 5).

Non-transparency of the current economic situation now complicates the adoption of decisions by only 20% of industrial enterprises managers. A year ago this factor was considered as an obstacle by 45% of the IET respondents (among which 90% are the directors of enterprises, their deputies and heads of economic departments). Thus, enterprises managers have obviously become better at understanding the situation.

Prices of Enterprises

In April the enterprises managed to sustain the prices growth rate at the level of previous months whereas in March forecasts demonstrated the possibility of them slowing down in April-May (fig. 7). Thus, starting with 2010 the industry demonstrates the highest and most stable intensity of price growth since the beginning of the crisis. The absolute decrease in prices was registered in April only in light industry, and the most intensive growth – in metallurgy, chemistry and petrochemistry industry.

As compared with March, price plans in April have changed but little. The enterprises seek to sustain the current trend of prices. The decrease in prices is unlikely in any of the sectors, and the most intensive growth is possible in metallurgy, timber processing, chemistry and petrochemistry.

Dismissals: Real Dynamics and Plans

In April Russian industry continued to increase the number of its employees (fig. 8). The rates of employment growth were maintained at March level, when hiring for the first time in the current crisis exceeded dismissals. In April employment growth was registered in all the sectors of industry, the most intensive being in the industry of construction materials and machine building.

Staff plans of enterprises have changed but slightly – the intentions to increase the number of staff have prevailed the industry for the fourth month in the row. As a result, by the beginning of the 2nd quarter 2010 the excessive workforce disappeared in the Russian industry in connection with the expected changes in the demand: the balance of estimations “more than enough” became equal to those “not enough” and the balance became zero (fig. 9). The crisis maximum for this figure was registered in the 1st quarter 2009 and made +26 points, whereas the pre-crisis minimum was -20 points and was observed in the 1st quarter 2008. At the level of separate sectors the lack of staff is becoming acute: responses

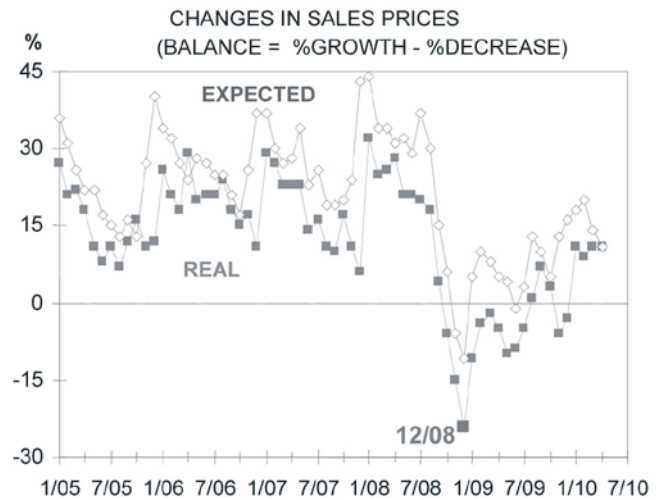


Fig. 6

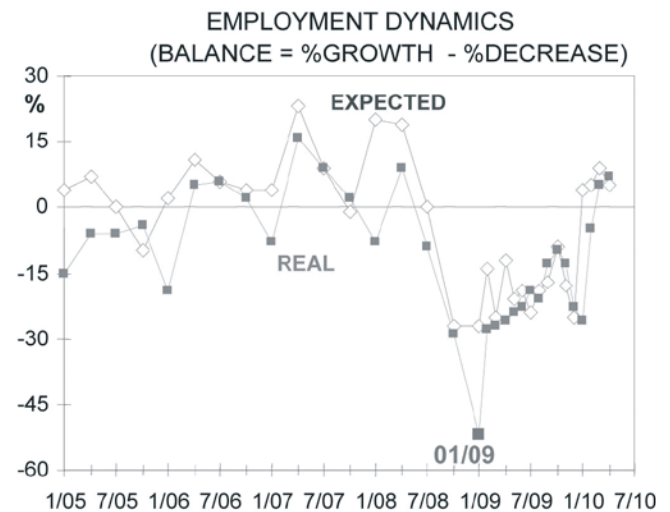


Fig. 7

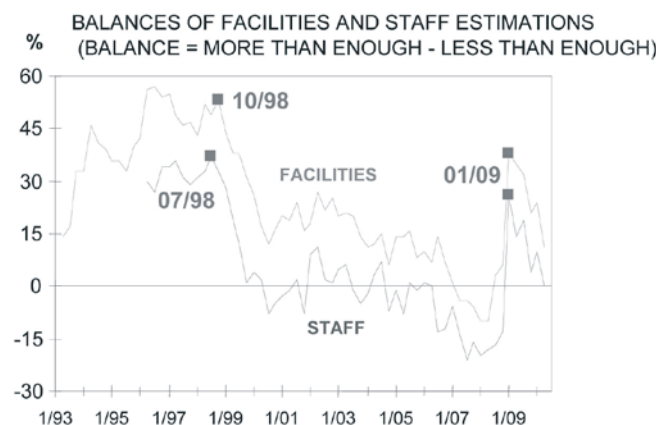


Fig. 8

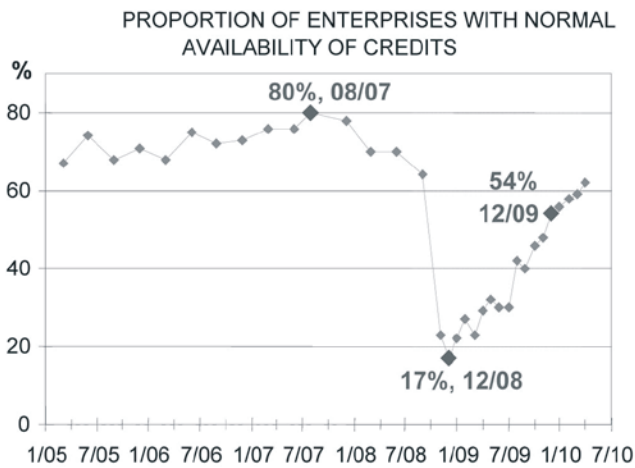


Fig. 9

“insufficient staff” are now prevailing in the light industry and industry of construction materials.

Industry Crediting

Availability of credits for industry is still increasing: in April the proportion of enterprises with normal access to borrowed funds was equal already to 61% (fig. 10). Over 4 months of 2010 this figure went up by only 7 points, whereas over the 4th quarter 2009 – by 14 percentage points. The recovery of Russian industry crediting has evidently slowed down. The sector priorities of banks do not change: it is easiest for metallurgy enterprises to get the credit (89% of enterprises having normal access), chemistry and petrochemistry industry (62%). Light industry (43%) and industry of construction materials

(35%) experience the biggest difficulties. The average minimum rates for ruble credits suggested by banks lowered to 15.7% per annum in April on the whole throughout the industry.

The ability of enterprises to service the existing debt continues to increase. In April 2010 already 78% of credit recipients are of that opinion as compared with 72% in February. The crisis minimum of this figure (50%) was registered in April 2009. It is machine building (only 24% of enterprises having a credit consider themselves as able to service debts), industry of construction materials (also 24%) and timber processing (22%) that are characterized by the lowest paying capacity. The highest self-estimation of paying capacity was registered in metallurgy: only 2% of enterprises of the sector consider themselves as unable to service debts. ●

FOREIGN TRADE

N.Volovik, K.Resenkova

In March 2010 the volumes of Russian foreign trade continued to recover, which was accounted for by the growth of world prices for the main goods of Russian export and ruble strengthening. As a result of multilateral consultations that took place in Geneva at the end of May 2010 the working group on Russia's accession to the WTO decided to resume negotiations on Russia's joining to this organization.

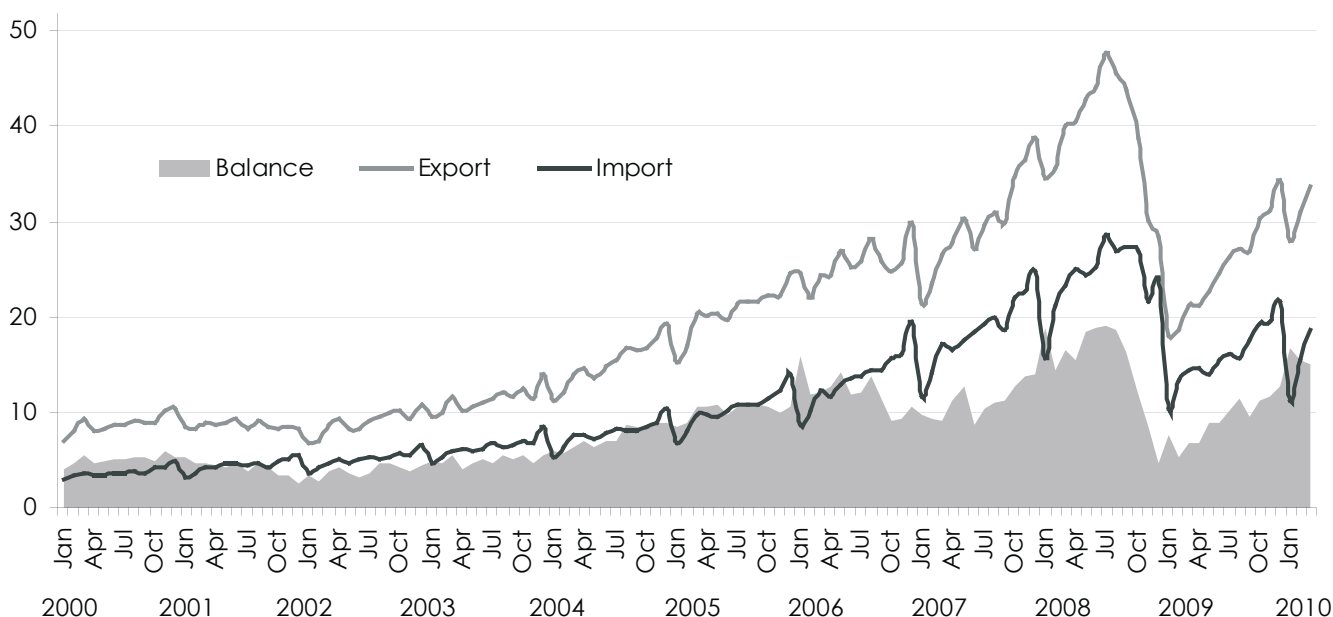
Russia's foreign trade turnover calculated on the basis of balance-of-payments methodology made USD 52.4 billion in March 2010, exceeding the volume of foreign trade in March 2009 by 48.6%. Russian export increased by 62.2%, import – by 29.1%. The RF foreign trade balance in March 2010 went up as compared with the corresponding period of 2009 by 2.4 times (up to USD 15 billion).

The increase in export value is still accounted for by the growth of prices for the main goods of Russian export and, primarily, for oil. Thus, in January 2010 average price for OPEC oil barrel made USD 76.01 per barrel, in February – USD 72.99 per barrel, in March – USD 77.21 per barrel, in April – USD 82.33 per barrel.

The main reason for oil prices growth is a fast recovery of the world economy and the increase in the demand for energy carriers. According to the USA Department of Energy, in March 2001 the world oil consumption made 85.13 million of barrel a day, which is only 3% below the maximum registered in February 2008 and exceeds by 4% the minimum level of world consumption registered in May 2009 in the period of acute phase of the global crisis.

This March the average price of oil grade Urals made USD 76.71 per barrel as compared with USD 45.17 per barrel in March 2009 and USD 72.74 per barrel in February 2010. In the 1st quarter 2010 the price for Russian oil went up to USD 75.2 per barrel versus USD 43.5 per barrel a year ago.

The average price for oil over the period of monitoring from April, 15th to May, 14th, 2010 inclusive made USD 80.42149 per barrel. Basing on that, the export customs duty rate for crude oil in-



Source: Central Bank of the Russian Federation

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

creases from June 1, 2010 from USD 284 per ton to USD 292.1 per ton (decree of the RF Government No 369 from May 26, 2010). Export duty rates for light oil products are raised from USD 203.7 per ton to USD 209.1 per ton, and for dark oil products – from USD 109.7 per ton to USD 112.7 per ton. The duty rate for export of oil from 22 oil fields of Eastern Siberia remains zero in June.

Monthly prices dynamics for non-ferrous metals was uneven. The cost of non-ferrous metals was affected by the sudden changes in US dollar exchange rate, which increased versus Euro and Asian currencies over nearly the whole month. After the February drop in March prices for copper and aluminum returned to the level of January, whereas prices for nickel continued to grow steadily over the whole quarter.

After a dramatic drop of production and prices last year the demand for aluminum started to rise quickly. The prices went up by more than 50% from last February to the current spring. According to the data of London Metal Exchange (LME) the world prices for primary aluminum over January-March 2010 made USD 2235.15 per ton, whereas in January-March 2009 it made USD 1365.1 per ton. On the one hand, the demand for aluminum is influenced by the rates of Chinese economy development, which consumes nearly a third of the aluminum produced in the world. On the other hand, the toughening of the requirements to carbon dioxide emissions by cars planned by the developed countries (EU, for instance) results in the increase of the demand for aluminum.

Copper is very sensitive to the cyclic fluctuations of economic activity. Whereas in 2007 its price at the world markets made USD 7000 per ton, by the beginning of 2009 it dropped to nearly USD 3000 per ton, i.e. by more than a half. The recovery was not less vigorous. By December 2009 at the London Metal Exchange copper was quoted at USD 7070 per ton, and after Christmas holidays – at USD 7221 per ton. In March 2010 the price for copper went up to USD 7462.8 per ton versus USD 6848.2 per ton in February and USD 7386.25 per ton in January 2010 as compared with USD 3453.2 per ton in the 1st quarter 2009.

In March the price for nickel went up to the level of USD 22461.3 per ton versus USD 18976.0 per ton in February and USD 18439.25 per ton in January 2010. The price dynamics was supported by the information on the temporary ceasing of the nickel enterprise BHP Kwinana operation, delay in Goro project start, continuing social conflict at the Canadian plant of Vale company and expected shipping stop by Norilsk nickel company from Dudinka port due to high water. The World Bureau of Metal Statistics (WBMS) data demonstrated that nickel production in the world lowered by 2% in January 2010. The main sphere of nickel consumption – stainless steel production- demonstrates the recovery.

Thus, in March 2010 as compared with March 2009 the price for nickel has increased by 2.3 times, for copper – by 2 times, for aluminum – by 1.7 times as compared with February 2010 the prices for nickel went up by 18.4%, for copper – by 9%, for aluminum – by 7.6%.

Table 1

AVERAGE MONTHLY WORLD PRICES IN MARCH OF CORRESPONDING YEAR

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|--------------------------------|--------|--------|--------|--------|--------|--------|--------|-------|---------|---------|--------|---------|
| Oil (Brent), USD/barrel | 13.7 | 26.9 | 25.5 | 24.1 | 29.1 | 33.6 | 53.7 | 60.9 | 62.05 | 102.3 | 47.42 | 79.93 |
| Natural gas, USD/1 million BTU | 2.120 | 2.828 | 5.200 | 2.996 | 5.757 | 5.267 | 7.234 | 6.123 | 7.25 | 9.655 | 4.03 | 4.65 |
| Petrol, USD/gallon | 0.527 | 0.934 | 0.890 | 0.783 | 1.005 | 1.12 | 1.581 | 1.7 | 1.91 | 2.672 | 1.414 | 2.25 |
| Copper, USD/ton | 1477.1 | 1779.1 | 1780.3 | 1605 | 1681.6 | 3018.0 | 3254.4 | 5103 | 6452.5 | 8421.9 | 3749.8 | 7462.8 |
| Aluminum, USD/ton | 1251.1 | 1584.2 | 1511.2 | 1403.2 | 1393.1 | 1660.0 | 1988.6 | 2429 | 2761.7 | 2986.8 | 1335.8 | 2205.6 |
| Nickel, USD/ton | 4934.5 | 10270 | 6140.3 | 6503.3 | 8402.4 | 13730 | 16190 | 14897 | 46324.8 | 31005.7 | 9696.4 | 22461.3 |

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

According to the World Bank data the prices for industrial raw materials of agricultural origin (cotton, wool, natural caoutchouc, timber) increased by 2.1% in March 2010 versus the previous

month, and versus march 2009 the growth made 53.6%. it should be noted that the world prices for foodstuffs have remained stable since last May, which is accounted for by the drop of prices for grains. Thus, wheat, corn and rice became by 4.5%, 5% and 11.3%, correspondingly, since the beginning of 2010.

Table 2

DYNAMICS OF AVERAGE WORLD PRICES FOR SOME AGRICULTURE GOODS

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | | |
|-------------------------------|-------|-------|-------|--------|-------|---------|----------|-------|
| | | | | | | January | February | March |
| Wheat, USD per ton | | | | | | | | |
| Canadian, CWRS | 197.6 | 216.8 | 300.4 | 454.6 | 300.5 | 287.2 | 279.0 | 274.3 |
| American, HRW | 152.4 | 192.0 | 255.2 | 326.0 | 224.1 | 201.2 | 194.0 | 191.1 |
| American, SRW | 135.7 | 159.0 | 238.6 | 271.5 | 186.0 | 198.8 | 191.8 | 190.0 |
| American corn, USD per ton | 98.7 | 122.9 | 163.0 | 223.1 | 165.5 | 167.3 | 161.8 | 159.0 |
| Barley, US D per ton | 95.0 | 117.0 | 172.0 | 200.5 | 128.3 | 146.5 | 137.4 | 148.9 |
| Soybeans, USd per kilo | 274.4 | 268.4 | 384.0 | 523.0 | 437.0 | 436.0 | 406.0 | 408.0 |
| Soy oil, USD per ton | 545.1 | 598.6 | 881.0 | 1258.0 | 849.0 | 923.0 | 914.0 | 915.0 |
| Thai rice, USD per ton | | 304.9 | 326.4 | 650.1 | 555.0 | 568.8 | 535.0 | 504.8 |

Source: World Bank.

In the 1st quarter 2010 the Russian positive foreign trade balance increased by 2.5 times versus the 1st quarter 2009 and made USD 47.0 billion. Such a considerable growth of trade balance was caused by a swift growth of export value volume, import recovering slowly. Thus, goods export went up from USD 57.4 billion in the 1st quarter 2009 to USD 92.6 billion in January-march 2010 (growth of 61.6%). Two thirds of export growth were secured by the rise in contract prices, and one third – by the growth of physical volumes. The increase of average contract prices for crude oil made 75.5%, for oil products – 77.8%, for non-ferrous metals – 49%. The twofold increase in natural gas export has significantly affected the physical volumes of supplies.

Due to comparative anticipation of export growth rates of three main fuel and energy commodities, their share in the structure of export has considerably exceeded the average figure of the previous 10 years and reached historical maximum of 68.7% (60.8% in the 1st quarter 2009).

In the 1st quarter 2010 the goods import went up by 18.6% and made USD 45.6 billion. Nearly all the increase was due to the expansion of import physical volumes while the prices have grown but slightly. The expansion of foodstuffs and raw materials for their production proportion, chemistry industry production proportion, proportion of metals and goods thereof were observed to expand. The proportion of the prevailing article – machine-building production – continued to reduce. The increase in these goods import was substantially below the general import dynamics.

The development of foreign trade in the 1st quarter 2010 was characterized by a considerable gap in the dynamics of average export and import prices. Average export prices in the 1st quarter 2010 rose by 19.5% versus the corresponding period of 2009, while the import prices went up by 3.1%. In connection with the significant growth of export prices the trading conditions in the 1st quarter 2010 were favorable for Russia: index of foreign trade conditions made 115.9.

A considerable gap was also observed between the dynamics of export and import physical volumes. In the 1st quarter 2010 export physical volumes went up by 20.4% versus the 1st quarter 2009, while the import in physical terms rose by 12.9% over the period under consideration.

On May 25, 2010 within the framework of the working group on Russia's accession to the WTO informal multilateral consultations took place, at which the decision to resume negotiations on Russia's joining to the WTO was adopted. Shortly before that Russia, Belorussia and Kazakhstan declared that they were not able to agree on positions concerning some sensitive points within the framework of Customs Union formation and that it won't start operating to the full extent, as it was planned earlier, from July, 1st. It is the agreements on export duties for oil when it is exported to Belorussia from Russia, customs fees for cars import by natural persons, planes import customs fees and the norm for goods importation of by natural persons that are the most sensitive issues.

Russia, in which there are 25% import duties for new cars and prohibitive duties for used cars insists on maintaining high customs rates for imported cars, whereas Belorussia, in which the duty rates are several times lower holds that this measure will hit its citizens. The privileged regime for cars import to Belorussia there being no customs boundaries with the Russian Federation will pose a threat to the Russian passenger cars market. The potential of grey import from Belorussia is estimated at 200000 cars a year.

The situation with air crafts is similar. Minsk and Astana suggest nullifying the import duties for these goods whereas the Russian authorities introducing recently prohibitive duty rates started restructurizing the Russian aircraft producing enterprises with the aim of their competitive ability increase.

Belorussia in its turn demands abolition of the export duty rates for oil and oil products that were introduced at the beginning of the year. At the end of this January after a long discussion Moscow and Minsk signed the agreement on oil supplies to Belorussia, which absence represented a threat for oil transit from Russia to Europe. In concordance with the agreement Russia promised to supply 6.3 million tons of oil duty free and other 15 million tons used by the Belorussian oil processing plants to produce and export oil products with 100% duty rates, whereas earlier Belorussia paid only one third of this rate. Simultaneously Russia started to collect export duty rates from oil products when trading with Belorussia.

The Belorussian party maintains that under conditions of newly created Customs Union all the supplies should be carried out duty free, whereas Russia wants the question of the duties on oil and oil products to be carried out of the framework of new formation.

Kazakhstan insists on maintaining the norm existing in it, according to which natural persons can import in its territory up to 2 tons of the foreign goods at lowered import duty rate (Euro 0.6) without any limitation to the number of such supplies. The Russian Federation holds that this will damage the Russian light industry due to inundation of Chinese goods.

In the forthcoming two weeks the heads of three countries' governments are to find a compromise. The history of international unions is quite complicated and nobody was able to solve all the issues quickly.

Negotiations on Russia's accession to the WTO have lasted for already 16 years. The Russian Federation has concluded the bilateral negotiations with 60 partner countries, the EU and the USA however regularly advance new demands and conditions. In June 2009 Russia stopped negotiation process, since it was declared that Russia, Belorussian and Kazakhstan will arrange simultaneous accession to the WTO on equal conditions.

On April 1, 2010 the memorandum was sent to the countries participating in working groups on Russia's accession to the WTO which described the institutes and procedures of the Customs Union. Multilateral discussions on the document mentioned took place in May during consultations of the working group on Russia's accession to the WTO. In the opinion of the working group representatives the memorandum allows estimating the basic principles of the Customs Union. In the nearest future the agreement on Customs Union itself will be submitted to the working group.

Within a month the changes to the report of the working group on WTO accession basing on newly evolved situation will be prepared. After that the decision on the date of the next formal meeting will be adopted.

Simultaneously the negotiations on the most acute issues will resume. For instance, at the end of June it is planned to conduct informal consultations concerning the support of agriculture and accession of meat to the Russian market. As to the issues concerning the Customs Union, the positions will be coordinated with Kazakhstan and Belorussia. At the same time the agreements reached for the questions regulated by the Customs Union will be sooner the basis of the negotiating positions of Kazakhstan and Belorussia. ●

STATE BUDGET

I.Fomina

In May 2010, expectations regarding reduction of the federal budget deficit have strengthened: according to the preliminary data the budget deficit may decline to 5.2–5.4% of the GDP, as against 6.8% of the GDP stipulated in the law. According to the updated information of the Ministry of Finance of the Russian Federation, in January-April 2010 the federal budget revenues amounted to 19.9% of the GDP which figure is 0.7 percentage point of the GDP higher as compared to that of the same period in 2009, while the expenditures increased by 1.1 percentage points of the GDP to amount to 23.3% of the GDP.

The analysis of the main parameters of utilization of the budget of the expanded government in January-March 2010.

According to the preliminary results of utilization of the budget in January-March 2010, the volume of the revenues of the budget of the expanded government (as a percentage of the GDP) fell 0.1 percentage points as compared to that of the same period in 2009. (See Table 1). In the 1st quarter 2010, expenditures of the budget of the expanded government increased by 0.1% to amount to 33.2% of the GDP.

Table 1

UTILIZATION OF REVENUES AND EXPENDITURES OF BUDGETS OF ALL THE LEVELS IN JANUARY-MARCH 2009 AND 2010

| | January-March 2010 | | January-March 2009. | | Change, percentage of the GDP |
|--|--------------------|-----------------------------|---------------------|-----------------------------|-------------------------------|
| | In billion RUR | As percentage of the GDP, % | In billion RUR | As percentage of the GDP, % | |
| Federal budget | | | | | |
| Revenues | 1954.9 | 20.2 | 1732.7 | 20.4 | -0.2 |
| Expenditures | 2199.5 | 22.7 | 1762.4 | 20.8 | +1.9 |
| Deficit (-) / Surplus (+) | -244.6 | -2.5 | -29.7 | -0.4 | -2.1 |
| Consolidated budgets of constituent entities of the Russian Federation | | | | | |
| Revenues | 1390.9 | 14.3 | 1219.3 | 14.4 | -0.1 |
| Expenditures | 1111.7 | 11.5 | 1051.3 | 12.4 | -0.9 |
| Deficit (-) / Surplus (+) | 279.2 | 2.8 | 168.0 | 2.0 | +0.8 |
| The budget of the expanded government | | | | | |
| Revenues | 3463.2 | 35.7 | 3033.5 | 35.8 | -0.1 |
| Expenditures | 3220.8 | 33.2 | 2807.1 | 33.1 | +0.1 |
| Deficit (-) / Surplus (+) | 242.4 | 2.5* | 226.4 | 2.7 | -0.2 |
| For reference: GDP, in billion RUR. | 9701.0 | | 8482.8 | | |

* A significant surplus of the budget of the expanded government as against the deficit of the federal budget can be explained by the procedure for crediting of funds to extra-budgetary funds by way of bypassing the federal budget as it was done before.

Source: The Ministry of Finance of the Russian Federation, calculations of the Institute for the Economy in Transition (IET).

According to the data of the Federal Treasury, in the 1st quarter 2010 the budget of the expanded government was administered with surplus; its value turned to be 0.2 percentage points of the GDP lower than that of the same period in 2009 and amounted to 2.5% of the GDP.

In analyzing the dynamics of revenues of the budget of the expanded government in the 2009–2010 period, the volume of the revenues should be adjusted by the value of additional revenues of

the investment nature. It is to be reminded that in the 2009-2010 period revenues received from management of financial resources of oil and gas funds in the 2008-2009 period were credited to the budgetary system. In January 2009, RUR 272.0 billion (about 3.2% of the quarterly GDP) was credited to the budgetary system. In January 2010, budget revenues from the investment income were as follows:

- RUR 52.0 billion was credited to the federal budget from management of the financial resources of the Reserve Fund;
- RUR 40.4 billion was credited to the federal budget from the Bank of Russia for management of the financial resources of the National Welfare Fund (NWF);
- RUR 33.5 billion was credited from management of the financial resources of the National Welfare Fund with the Bank for Foreign Economic Affairs, of which funds RUR 6.9 billion was credited to the federal budget, while the others, to the NWF.

In January-March 2010, the total of about RUR 126 billion of the investment income (nearly 1.3% of the quarterly GDP) was credited to the budget. To have a better idea of the actual situation with the revenues of the budgetary system, it would be expedient to “clear” them from additional revenues related to the income of earlier periods. Thus, in the 1st quarter 2010, the growth of revenues to the budgetary system amounted to around 1.7 percentage points of GDP as against the same period in 2009.

In the 1st quarter 2010, resources of the budgetary system were still formed under the influence of quite a favorable foreign economic situation with prices on Russian export goods, as well as the demand in them. The dynamics of oil and gas related revenues which still account for 40% of the total budget revenues fluctuated depending on global market prices on products of the fuel and energy sector, as well as the demand in such products. In addition to the above, in January-March 2010 growth in physical volume of production of primary products in general amounted to 6.7% as compared to that of the same period in 2009. It is to be noted that “starting from March 2009 there has been monthly growth in production of oil as compared to the same period of the previous year¹.”

With improvement of the foreign economic market situation, dramatic growth in oil and gas related revenues has been registered again due to *severance taxes payments and revenues from foreign economic activities as compared to the dynamics of such indices in the previous year (Table 2)*. In the 1st quarter 2010, the above tax revenues to the budget of the expanded government increased by 1.3 percentage points of the GDP and 1.5 percentage points of the GDP, respectively.

In a situation of stable growth in international oil prices, starting from 2010, rates of export duties on crude oil have been revised upwards on a monthly basis. The rate is calculated on the basis of the average oil price in a certain period. Starting from May 1, 2010, the rate of duties was set at the level of USD 281–284 per ton, while from June 1st it is to amount to USD 291–294 per ton. The duties on refined oil products will amount to USD 208–210 a ton, while those on dark oil products, to USD 112–113 a ton. Such a measure will still contribute to further growth in budget revenues from oil and gas.

At the same time, starting from May 1st a zero export rate on oil (it was introduced on December 1, 2009) produced at deposits in Western Siberia has remained in effect. According to the data of the Ministry of Finance of the Russian Federation, extension of the effect of such a measure till the end of 2010 may result in a loss of budget revenues in the amount of nearly RUR 120 billion.² However, there is a possibility that a zero export rate on oil produced at 22 deposits of Western Siberia will be preserved till the end of this year, while starting from 2011 a special procedure for charging of export duties may be established in respect of three of such deposits.³ The effect of such a measure will reduce fiscal pressure on industries of the fuel and energy sector and permit to preserve an acceptable level of profitability of new deposits.

In a situation of growth in oil and gas revenues, the oil and gas industry demonstrates some trend to decline. In January-March 2010, revenues from *corporate profits taxes* to the budget of the expanded government fell in relative terms by 0.3 percentage points of the GDP. To a great extent,

1 Report of the Ministry of Economic Development of the Russian Federation on the Current Situation in the Economy of the Russian Federation in January-April 2010

2 <http://www1.minfin.ru/ru/press/speech/index.php?id4=9554>

3 <http://www1.minfin.ru/ru/press/speech/index.php?id4=9695>

such dynamics was created due to reduction in the tax base rate and changes in the procedure for calculation and payment of taxes.

Following the decline of the revenues from corporate profits tax, the volume of revenues from individual income tax to the budget of the expanded government fell to 3.7% of GDP which is 0.3 percentage points of the GDP lower than the value registered in the respective period last year. At the same time, from the beginning of this year the index of households' real income increased by 7.6% as compared to the dynamics of last year mostly due to valorisation of pension payments in January 2010.

Table 2

THE DYNAMICS OF THE LEVEL OF THE TAX BURDEN AND REVENUES FROM THE MAIN TAXES TO THE BUDGET OF THE EXPANDED GOVERNMENT OF THE RUSSIAN FEDERATION IN JANUARY-MARCH 2009 AND 2010, % OF THE GDP

| | 3 months of 2010 | 3 months 2009 | Change, percentage points of the GDP |
|---|------------------|---------------|--------------------------------------|
| Level of tax burden (1+2+3) | 32.6 | 30.3 | +2.3 |
| Revenues from taxes (1), including: | 20.8 | 21.3 | -0.5 |
| Corporate profits tax | 3.9 | 4.2 | -0.3 |
| Individual income tax | 3.7 | 4.0 | -0.3 |
| Single social tax* | 0** | 2.1 | - |
| Value added tax | 6.3 | 6.2 | +0.1 |
| Excise duties | 1.1 | 1.0 | +0.1 |
| Severance tax | 3.4 | 2.1 | +1.3 |
| Insurance contributions for mandatory pension insurance (2) | 4.7 | 3.4 | +1.3 |
| Revenues from foreign economic activity (3) | 7.1 | 5.6 | +1.5 |

* without taking into account insurance contributions for mandatory pension insurance.

** Starting from 2010, the single social tax has been transformed into insurance contributions which are credited to extra-budgetary funds.

The source: The Ministry of Finance of the Russian Federation, Rosstat and IET calculations.

In January-March 2010, the volume of the VAT related revenues to the budget of the expanded government shows some growth in relative terms. An increase in the above revenues amounted to 0.1 percentage points of the GDP (*Table 2*). Such a dynamics is related to improvement in administration of that tax and higher regularity of credit of those tax revenues to the budget as compared to the situation last year, as well as a post-crisis revival of business activities of economic agents. However, in comparison of the revenues in the periods under review it is to be noted that VAT related revenues in the 4th quarter 2009 were subject to credit to the budget in January 2010.

In January-March 2010, a significant growth in excise duties related revenues to the budget of the expanded government was registered. The growth in such revenues amounted to 0.1% of the GDP as compared to the last-year dynamics. The factor behind such a growth in revenues was higher growth of rates on a number of excisable goods.

In general, it is to be noted that in the 1st quarter 2010 the level of tax burden on the economy increased by 2.3 percentage points of the GDP as compared to that of the same period in 2009 and amounted to 32.6% of the GDP. Such a growth of that index can be explained to a great extent by the effect of the external factors.

In a situation of decline of budget revenues of the expanded government (as a percentage of the GDP) in January-March 2010, in the 1st quarter 2010 the budget expenditures of the expanded government showed some growth though it was agreed to keep it in check in 2010. Budget expenditures increased by 0.1 percentage points of the GDP (*Table 3*). Also, it is to be noted that in the 1st quarter 2010 budget expenditures increased by over RUR 400 billion.

Table 3

UTILIZATION OF THE BUDGET OF THE EXPANDED GOVERNMENT AS REGARDS EXPENDITURES
IN JANUARY-MARCH 2009 AND 2010, % OF THE GDP

| | January-March 2010 | | January-March 2009 | | Change, percentage points of the GDP |
|--|--------------------|--------------|--------------------|--------------|--------------------------------------|
| | Billion RUR | % of the GDP | Billion RUR | % of the GDP | |
| Total expenditures | 3220.8 | 33.2 | 2807.1 | 33.1 | +0.1 |
| including | | | | | |
| Federal issues | 296.9 | 3.1 | 274.6 | 3.2 | -0.1 |
| Including public and municipal debts service | 86.6 | 0.89 | 72.9 | 0.86 | +0.03 |
| National defense | 273.4 | 2.8 | 220.6 | 2.6 | +0.2 |
| National security and law enforcement | 279.8 | 2.9 | 262.3 | 3.1 | -0.2 |
| National economy | 376.1 | 3.9 | 392.9 | 4.6 | -0.7 |
| Municipal housing economy | 111.5 | 1.2 | 123.3 | 1.5 | -0.3 |
| Environment protection | 4.1 | 0.04 | 3.6 | 0.04 | 0 |
| Education | 335.0 | 3.5 | 309.9 | 3.7 | -0.2 |
| Culture, cinematography and mass media | 56.8 | 0.6 | 55.3 | 0.7 | -0.1 |
| Healthcare and sports | 295.3 | 3.0 | 300.9 | 3.6 | -0.6 |
| Social policy | 1191.8 | 12.3 | 863.4 | 10.2 | +2.1 |

The source: The Treasury of the Russian Federation and IET calculations.

In the period under review, the volume of financing in the budget items *Social Policy* and *National Defense* increased by 2.1 percentage points of the GDP and 0.2 percentage points of the GDP as compared to the 2009 figures, respectively, while other budget expenditures by the functional classification tended to decline. The largest decrease as compared to the 2009 figures was registered in the budget items *National Economy* and *Healthcare and Sports*. It amounted to as much as 0.6–0.7 percentage points of the GDP. Change in other budget items did not exceed 0.3 percentage points of the GDP.

Utilization of the federal budget of the Russian Federation in January-April 2010

According to the updated information of the Ministry of Finance of the Russian Federation, in January-April 2010 federal budget expenditures amounted to 19.9 % of the GDP which is 0.7 percentage points higher than the value of the same period in 2009.

The growth of the federal budget revenues was influenced by a number of factors, including increase in the revenues of the fuel and energy sector. As a result, budget revenues from severance tax payments and foreign economic activity increased. At the same time, due to realization of a number of innovations and administration of the fiscal system oil and gas related revenues of the federal budget were lower than those in 2009.

In January-April 2010, the expenditures of the federal budget increased by 1.1 percentage points of the GDP and amounted to 23.2% of the GDP as compared to that of the same period in 2009 (*Table 4*). However, in January-April 2010 growth in expenditures does not point to inevitable growth in expenditures as a whole on the basis of the results of 2010, but can be explained by higher rates of spending and delivery of funds to ultimate recipients of budget funds.

Starting from 2010, there has been a dramatic reduction in the volume of financing of anti-crisis measures; the volume of budget support allocated for those purposes can hardly be compared with parameters of 2009 when over RUR 1.2 trillion was spent out of the budget. In the 1st quarter 2010, of the total volume of RUR 195 billion planned for such purposes the government spent only RUR

14 billion to overcome the consequences of the crisis.¹ It is to be noted that a larger portion of those funds was spent on maintenance of social stabilization, that is, regional employment programs and social support of the population. Less than RUR 2.5 billion was spent on support of the real sector of the economy. The above funds were meant specifically for some backbone industries of the defense and industrial complex (Oboronprom, OAK, Uralvagonzavod and other). In the 1st quarter 2010, support of the domestic demand and implementation of measures aimed at modernization and technical overhaul cost the state only RUR 1 billion. In our view, such a structure of expenditures contradicts the declared 2010 budget concept as “an instrument of development of innovation economy”.

In January-April 2010, as a result of differently directed changes in the parameters of the federal budget, the latter was utilized with a deficit of 3.4% of the GDP, as against 3.2% of the GDP in 2009. According to the preliminary data, the volume of oil and gas deficit increased to 12% of the GDP. Such a considerable increase of that deficit points to large public spendings which are not ensured by oil and gas related budget revenues. It may eventually result in weakening of the budgetary system in conditions of prevailing dependence of Russia on the situation on the international market.

The main source of financing of the deficit of the federal budget is the Reserve Fund. In January-April 2010, it declined by RUR 519.5 billion to RUR 1,188.7 billion. It is expected that by the end of 2010 the Reserve Fund will be spent up completely to cover budget expenditures. In the same period, the National Welfare Fund decreased by RUR 167 billion to RUR 2.61 trillion (*Table 5*).

Table 4

THE MAIN PARAMETERS OF THE FEDERAL BUDGET OF THE RUSSIAN FEDERATION
IN JANUARY-APRIL 2009 AND 2010

| | January-April 2010 | | January-April 2009 | | Administration as per the annual budget outlay in 2010, % | Change | |
|--|--------------------|--------------|--------------------|--------------|---|-------------|------------------------------|
| | Billion RUR | % of the GDP | Billion RUR | % of the GDP | | Billion RUR | Percentage points of the GDP |
| Revenues, including | 2618.3 | 19.9 | 2221.5 | 19.2 | 37.7 | 396.8 | +0.7 |
| Oil and gas related revenues | 1149.5 | 8.7 | 677.8 | 5.9 | 36.0 | 471.7 | +2.8 |
| Allocations to the Reserve Fund and the National Welfare Fund (the Stabilization Fund) | 0 | 0 | 272.6 | 2.4 | – | | |
| Expenditures, including: | 3062.9 | 23.3 | 2573.2 | 22.2 | 31.0 | 489.7 | +1.1 |
| Interest income | 77.4 | 0.6 | 68.5 | 0.6 | 25.5 | 8.9 | 0.0 |
| Non-interest income | 2985.5 | 22.7 | 2504.7 | 21.7 | 31.2 | 480.8 | +1.0 |
| Surplus (Deficit) of the federal budget | -444.6 | -3.4 | -371.8 | -3.2 | 15.1 | -72.8 | -0.2 |
| Non-oil and gas deficit | -1594.1 | -12.1 | -1029.5 | -8.9 | 26.0 | -564.6 | -3.2 |
| GDP evaluation | 13 150.0 | | 11 567.8 | | | | |

The Source: The Ministry of Finance of the Russian Federation (preliminary evaluation) and IET calculations.

Table 5

THE DYNAMICS OF FORMATION AND UTILIZATION OF OIL AND GAS RELATED REVENUES OF THE FEDERAL GOVERNMENT IN JANUARY-APRIL 2009 AND 2010, IN BILLION RUR

| Index name | Funds' balances as of the end of 2009 | Approved in the 2010 budget | Revenues in January-April 2010 | Utilization in January-April 2010 | | Funds' balances as of the end of April 2010 |
|--|---------------------------------------|-----------------------------|--------------------------------|--|--|---|
| | | | | Funds allocated to ensure federal budget balance | Funds allocated for oil and gas transfer | |
| Oil and gas related revenues of the federal budget | X | 2057.2 | 1149.4 | | | x |

1 <http://www.vedomosti.ru/newspaper/article/2010/05/14/234209>

Table 5, cont'd

| Index name | Funds' balances as of the end of 2009 | Approved in the 2010 budget | Revenues in January–April 2010 | Utilization in January–April 2010 | | Funds' balances as of the end of April 2010 |
|---|---------------------------------------|-----------------------------|--------------------------------|--|--|---|
| | | | | Funds allocated to ensure federal budget balance | Funds allocated for oil and gas transfer | |
| Lines of utilization of oil and gas related revenues: | X | x | | | | x |
| Oil and gas transfer | X | 2531.1 | 1149.4 | | | |
| The Reserve Fund | 1 830.5 | 5147.5 | 0 | 519.5 | 0 | 1188.7 |
| The National Welfare Fund | 2 769.0 | x | 26.5 | 2.5 | – | 2601.6 |
| Total | 4599.5 | x | 1175.9 | 522.0 | 0 | 5372.3 |

* Balances were calculated at the rate prevailing on May 1, 2010.

The source: The Federal Treasury.

The *Table 6* illustrates the dynamics of spending of the federal budget funds in January–March 2010 in accordance with the functional classification of budget expenditures. Spending of the federal budget funds was carried out more promptly as compared to that in 2009; the change in financing in general as regards expenditures of the federal budget amounted to 3.3 percentage points of the annual budget outlay. In the 1st quarter 2010, the higher rates of spending with utilization of budgetary funds as compared to those in the same period last year were registered in the budget item: *Inter-budgetary Transfers*. An increase in spendings in that line amounted to about 6 percentage points. Such a growth in inter-budgetary transfers can be explained primarily by a significant increase in pensions this year, as well as a prompt transfer of funds to the Pension Fund.

Also, higher rates of financing were registered in budget items: *National Defense, Federal Issues* and *Education*. Higher rates of spending of budgetary funds in the above lines varied from 2.0 to 5.4 percentage points.

On the contrary, utilization of federal funds at a lower rate as compared to the last-year rates of spending was registered in the following budget items: *National Economy, Healthcare and Sports* and *Public and Municipal Debts Service*. As of April 2010, utilization of funds as regards the above budget items was 1.7–7.9 percentage points lower than that last year.

Table 3

CASH ADMINISTRATION OF THE FEDERAL BUDGET IN JANUARY–MARCH 2009 AND 2010
AS PER ANNUAL BUDGET OUTLAY, %

| | January–March 2010 22,2 | January–March 2009 18,9 |
|--|----------------------------|----------------------------|
| Including | | |
| Federal issues | 17,2 | 15,4 |
| Public and municipal debt service | 23,4 | 31,3 |
| National defense | 21,7 | 16,3 |
| National security and law enforcement | 21,0 | 19,6 |
| National economy | 16,7 | 20,3 |
| Municipal housing economy | 11,5 | 7,4 |
| Environment protection | 17,7 | 13,0 |
| Education | 17,7 | 14,4 |
| Culture, cinematography and mass media | 17,3 | 16,4 |
| Healthcare and sports | 12,2 | 13,2 |
| Social policy | 16,7 | 16,2 |
| Inter-budgetary transfers | 28,7 | 23,0 |

The source: The Ministry of Finance of the Russian Federation; IET calculations.

According to the updated information of the Ministry of Finance of the Russian Federation, in January-March 2010 99.8% of all such expenditures of the federal budget as were planned for utilization during that period was transferred to the ministries and governmental agencies¹, while the latter in their turn transferred only 59% of such funds to institutions which are subject to their jurisdiction. Nor received such institutions all the quotas provided for under federal purpose programs. The factors behind such a slowdown in provision of funds to ultimate recipients of budget funds include, primarily, administrative and legal factors: of 107 statutory acts required for administration of the budget only 97 such acts have been issued so far. For that purpose, the remaining statutory acts need to be adopted as soon as possible so that slowdown in further utilization of budget funds could be prevented.

Review of the main events in the fiscal policy in May 2010

*On May 20, 2010, the program of upgrading of the efficiency of budgetary expenditures in the period till 2012 was adopted at the meeting of the Government of the Russian Federation.*² The above program provides for a switchover to 'a program budget' where each program has its own goals, purposes, performance benchmarks, volume of financing and responsible persons. Such a reform in the public finances is aimed at gradual introduction of components of the BOR system. The 2012 budget will be formed on the basis of the new program principles with amendment of classification of budget expenditures. According to the preliminary data, there will be 40 programs altogether and they will be clustered by seven main sections. The list of the programs is expected to be approved by the beginning of June 2010.

*In May 2010, the Government of Russia approved the draft of the main fiscal policy guidelines in 2011 and the planned 2012-2013 period*³. *The above draft was proposed by the Ministry of Finance of the Russian Federation.* In addition to the above stated innovations which include raising of the base rate on insurance contributions and introduction of a preferential rate on insurance contributions for innovation enterprises and the mass media, it has become known that the Ministry of Finance intends to carry out other reforms as well.

It has been proposed to introduce tax holidays as regards payment of the severance tax in respect of deposits in Yamal, Eastern Siberia and the Far East starting from 2011. Such a possibility is provided for regarding deposits at the initial stage of development. Also, statutory acts required for introduction of severance tax holidays in respect of production of primary products in the aquatorium of the Black Sea and the Sea of Okhotsk are expected to be approved in 2010.

It has been proposed to raise a tax burden on gas industry through an increase of the rate of the severance tax on gas production with subsequent annual indexation of such a rate in accordance with the dynamics of domestic gas prices. Raising of the severance tax (from RUR147 to RUR162 per cubic meter) and export duties (from 30% to 35%) on gas was planned to be introduced in 2010, however, such a measure was not carried out due to rather unstable post-crisis economic situation.

In the 2011–2012 period, further indexation of excise rates on alcohol and tobacco is planned to be carried out. The above rates are expected to be raised ahead of the general price rise. ●

1 <http://www.rbc.ru/rbcfreenews/20100412155428.shtml>

2 <http://www1.minfin.ru/ru/press/speech/index.php?id4=9716>

3 <http://www.minfin.ru/ru/press/speech/index.php?id4=9304>

THE RUSSIAN BANKING SECTOR

S.Borisov

In January, the aggregate nominal book value of the Russian banking sector increased insignificantly. It was driven mostly by growth in securities investments by credit institutions. For the first time in the past two years, slowdown of growth rates of overdue debts justified reduction of loan loss provisions. The optimistic data as regards the accumulated profits in the first quarter is a major consequence of reduction of pressure on banks on the part of the reserve system. A sufficient level of provision of banks with liquidity gave an impetus to further reduction in interest rates on the inter-bank lending market while the Central Bank of Russia kept pursuing the policy aimed at reducing its direct regulation of the banking sector by means of provisions-free credit instruments.

In March 2010, for the first time since the beginning of the year the nominal value of assets of the banking sector of the Russian Federation increased as compared to the previous month. However, that growth is not yet related to renewal of lending to the real sector of the economy and households. The main factor behind that assets growth of the banking sector in March was investments in securities. Such investments became quite popular during the past few months. It is natural that the problem of maintaining the quality of the credit portfolio and unstable financial situation of the borrower make banks look for alternative ways of investing their excessive liquidity. Bonds suit the best the criteria of acceptable level of liquidity with a rather low market risk ratio. According to the Central Bank's data, as of April 1st growth in banks' corporate bonds portfolio amounted to 15%, while investments in equity securities increased 20% in the first quarter 2010 in a situation where recovery of the domestic stock market was observed.

Table 1

ASSETS OF THE BANKING SECTOR (BILLION RUR, %)

| | 01.04.2009 | 01.01.2010 | 01.04.2010 | | |
|-------------------------------------|------------|------------|------------|--|------------------------|
| | | | Nominal | Growth from the beginning of the year, % | Year-on-year growth, % |
| Assets | 28 527 | 29 430,0 | 29 284,2 | -0.5 | 2.7 |
| Loans to non-financial institutions | 13 115,8 | 12 541,7 | 12 424,0 | -0.9 | -5.3 |
| Loans to individuals | 3 871,7 | 3 573,8 | 3 536,3 | -1.0 | -8.7 |
| Loans to banks | 2 664,6 | 2 725,9 | 2 779,5 | 2.0 | 4.3 |
| Investments in bonds | 1 994,4 | 3 379,1 | 3 885,6 | 15.0 | 94.8 |
| The Central Bank's deposits | 3 293,5 | 1 423,1 | 685,9 | -51.8 | -79.2 |
| Banks' deposits | 217,6 | 273,1 | 184,4 | -32.5 | -15.3 |
| Legal entities' deposits | 4 912,7 | 5 466,6 | 5 275,1 | -3.5 | 7.4 |
| Household' deposits | 6 197,3 | 7 485,0 | 7 797,7 | 4.2 | 25.8 |
| Provisions for possible losses | 1 325,1 | 2 050,6 | 2 144,2 | 4.6 | 61.8 |
| Profit (the current year) | 58,3 | 205,1 | 116,7 | | 100.2 |

Source: The Bank of Russia.

In March 2010, though the dynamics of the aggregate credit portfolio remained to be negative, there was the first evidence of slowdown in decline of the volume of lending. In March, the volume of corporate loans remain practically unchanged at the level of RUR 12.4 billion, while the retail credit portfolio of the Russian banking sector showed a slight increase of 0.3% as against February.

Another important factor pointing to banks' progress in overcoming the crisis of the credit portfolio quality was the data on the level of the overdue debt and provisions for possible losses in March 2010. According to the Review of the Banking Sector, the share of the overdue debt in the corporate portfolio stabilized at the level of 6.2%, while its growth in the retail credit portfolio slowed down a great deal (to the level of 1 percentage points in a month). The main reaction of the banking community to slowdown of the growth rates of overdue loans became the reduction of the volume of provision for possible losses. Such a reduction which amounted in March to RUR 5.1 billion (for the entire banking sector) was the first one in the past two years. As of April 1st, individual banks, including ING Bank (-38.5% from the beginning of the year), Gasprombank (-13.2% from the beginning of the year), Citibank (-5.3% from the beginning of the year) reduced the level of the aggregate provisions at a higher rate.

From the point of view of securitization, in March 2010 the banking sector in Russia had excessive liquidity. The influx of funds in deposits was registered both in the corporate and retail segments and amounted to 5.5% and 1.6%, respectively as against February. The most popular deposits for individuals were deposits in RUR with a maturity of over a year (+4.2% to February), while the banks' corporate customers built up volumes of RUR deposits with a maturity of up to 30 days and demand deposits (+14.1% to February). An important factor which points to an excessive level of liquidity in the banking sector was the record high level of the banks' correspondent account balances with the Central Bank of Russia in the third part of April (RUR 552 billion), as well as further decline of interest rates on the inter-bank lending market.

According to the Central Bank, in the first quarter 2010 Russian banks earned RUR 116.7 billion which is twice as much the entire Russian banking sector earned in the same period last year. The main source of income was the net interest income on loans extended to non-financial institutions (RUR 252 billion). (The net interest income received from retail lending amounted to USD 5 billion). In the first three months of 2010, securities transactions yielded banks a net income of RUR 107 billion. It is the second largest source of income of the Russian banking sector in the first quarter 2010. Also, it is worth mentioning a considerable reduction of pressure on profitability of the Russian banking sector on the part of costs related to setting up of provisions for possible losses. Thanks to the fact that in the first quarter 2010 the quality of assets did not deteriorate, the total provisions for possible losses amounted to the sheer RUR 93.6 billion, while at the same period last year their growth was more active and they amounted to RUR 302.4 billion.

Main Events of April 2010

The average maximum interest rate on RUR deposits at ten banks – leaders in attracting households' funds – fell to 10.4% per annum. The Bank of Russia advises credit institutions not to exceed the average maximum interest rate on deposits by more than 1.5 percentage points.

The Bank of Russia has published the draft instructions which starting from July 1, 2010 permits the banks to apply a favorable regime of provisions-making (Instructions No.2156 of the Central Bank of Russia on the Specifics of Evaluation of the Credit Risk on Loans, Principal Debts and Debts Made Equal to Them) to loans which are not overdue.

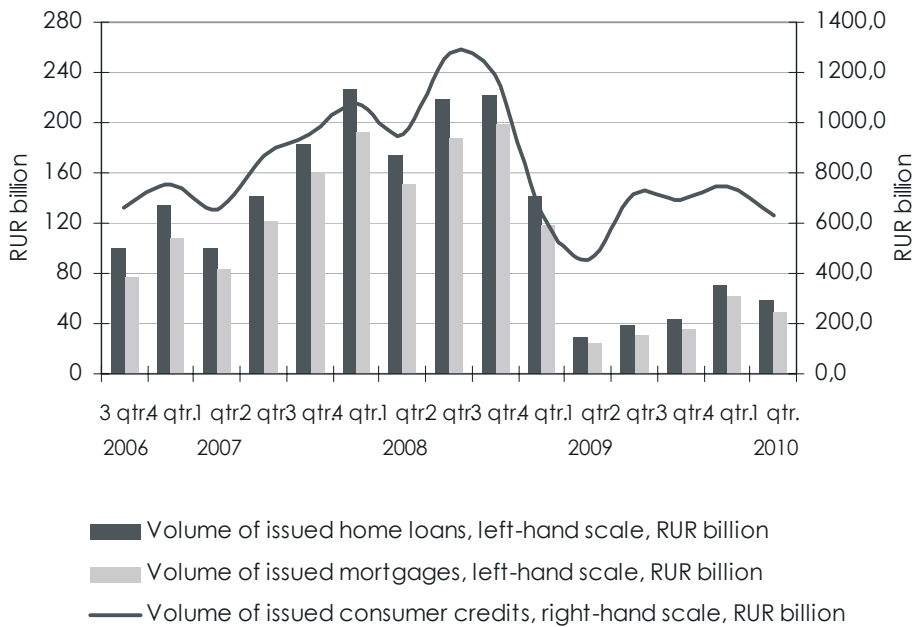
On loans extended to banks without loan loss provisions made, the Central Bank earned the interest income of about RUR200 billion. In April 2010, the aggregate debt on such loans amounted to RUR60 billion, while rates at auctions did not exceed 11%.

Due to stabilization of the situation on the financial market and the loss of effect of the Central Bank's recommendations as regards limitation of the growth of foreign assets, the Central Bank proposes to credit institutions to terminate starting from June 1, 2010 agreements on correspondent accounts in foreign currency with the Central Bank.

In April 2010, the Presidium of the Higher Court of Arbitration (HCA) permitted banks to close by judicial means customers' accounts if they failed to provide information about the change in their address. Thus, the highest court expanded the list of reasons for which banks may terminate bank account agreements specified in the Civil Code. Such a measure is expected to help banks fight money laundering and reduce risks of the Central Bank's complaints to them that they fail to fulfill the laws on prevention of money laundering. ●

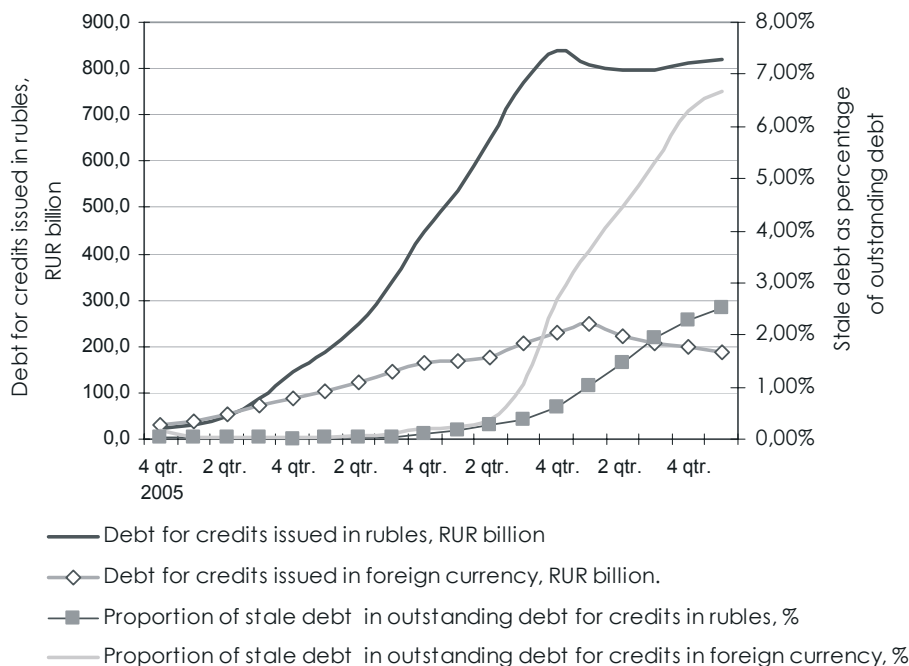
MORTGAGES MARKET IN THE RUSSIAN FEDERATION

G.Zadonsky



Source: data of the Central Bank of the Russian Federation

Fig. 1. Credit Issue Dynamics to Natural Persons over the Quarter



Source: data of the Central Bank of the Russian Federation

Fig. 2. Dynamics of Outstanding and Stale Debts for Mortgages

In the 1st quarter 2010 interest rates for home loans and mortgages continued to decrease. The volumes of issued credits continue to grow but they are still considerably below the corresponding figure of pre-crisis period. The increase in stale debts is going on. The rate for subordinated credit for the open joint-stock company Agency for Home Mortgage Lending (AHML) has been decreased legislatively from 9.5% to 6.5% per annum.

According to the data of the Central Bank of the Russian Federation the volume of home loans issued by crediting organization over the 1st quarter 2010 made RUR 58109 million, including 40408 mortgage credits of RUR 48 947 million. There were 39779 mortgage credits issued in rubles at the total sum of RUR 46152 million. The outstanding debt for mortgages as on April 1, 2010 made RUR 1006714 million, including RUR 819323 million for credits issued in rubles. The volume of mortgage credits issued in the 1st quarter 2010 is double the volume of credits issued in the 1st quarter 2009 (RUR 24863 million) but still only one third of the volume of credits issued in the 1st quarter 2008 (RUR 150759 million).

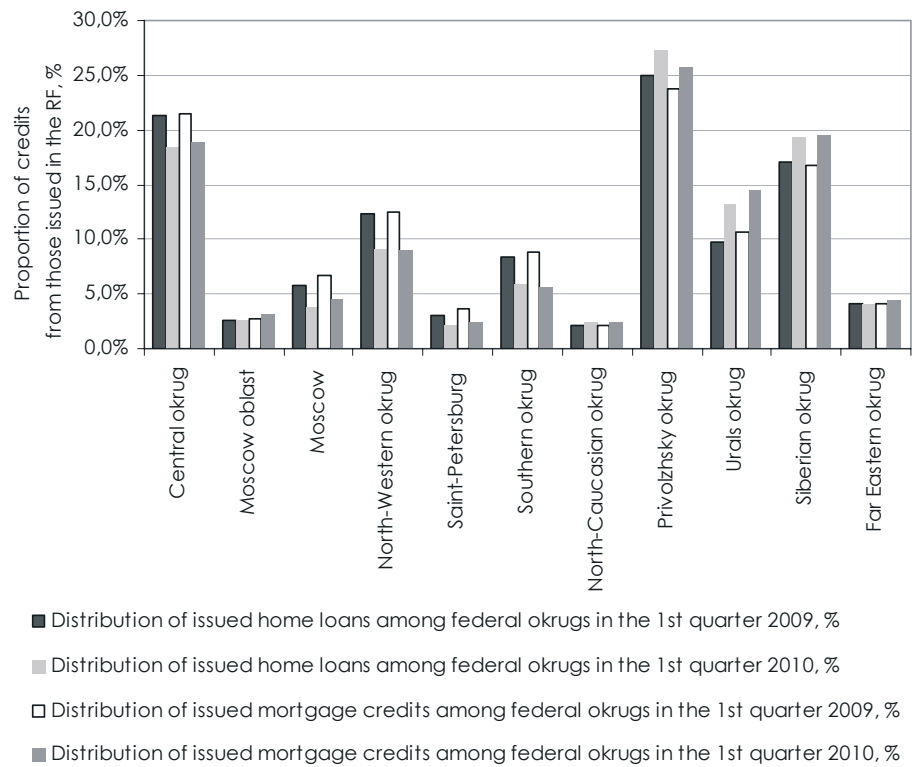
As compared with the beginning of the year (fig.

2) the outstanding debt for mortgage credits in rubles in the 1st quarter of the current year increased by 0.8%, whereas stale debt went up by 10.8% and made RUR 20.7 billion or 2.54% of the outstanding debt. The outstanding debt for credits in foreign currency in the 1st quarter went down by 5.7% as compared with the beginning of the year, and the stale debt remained practically unchanged – RUR 12.5 billion, but considerable increase as proportion in outstanding debt, reaching 6.68%.

The proportion of home loans in foreign currency in the volume of credits issued in the 1st quarter 2010 as compared with the 1st quarter 2009 reduced from 6.17% to 5.71%, while the proportion of the debt for mortgages in foreign currency reduced from 19.6% to 18.6% over the 1st quarter 2010.

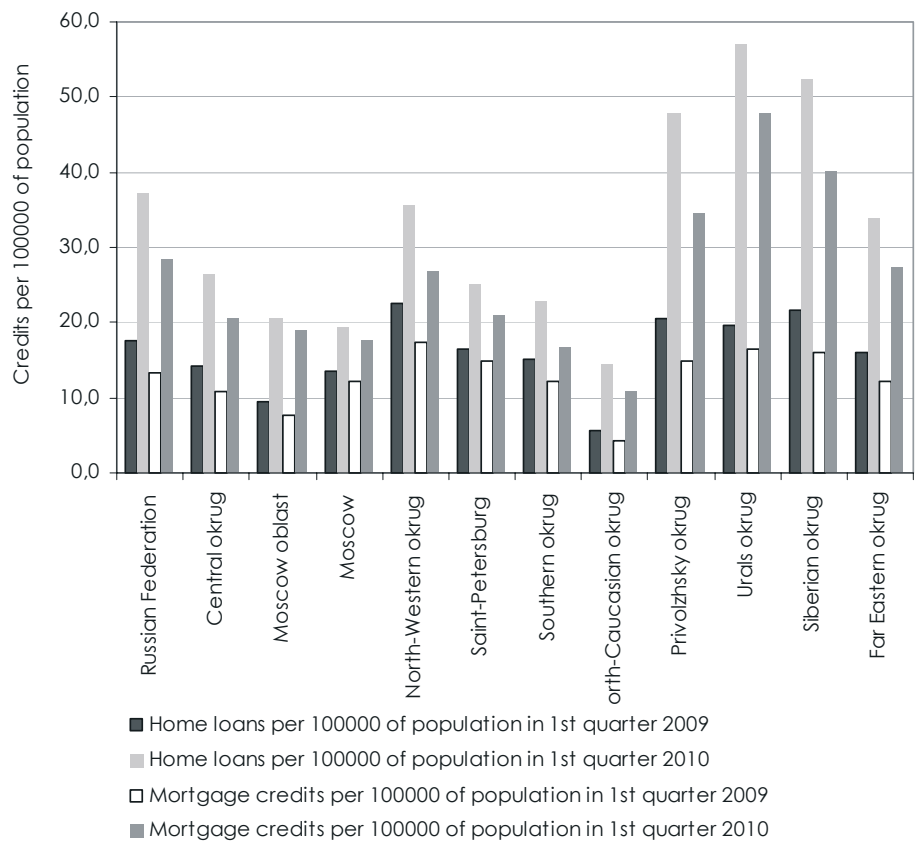
The general nature of home loans and mortgage credits distribution among the federal okrugs was not subject to any significant changes from the 1st quarter 2009 to the 1st quarter 2010 (fig. 3). The leadership is still held by Siberia and Privolzhsky federal okrugs, whose shares have even expanded, whereas the shares of the Central and North-Western Federal okrugs have reduced. As to the number of credits per 100 thousand of population the first place is occupied by Urals federal okrug (fig. 4), followed by Siberian, Privolzhsky and Central okrug, which occupies only the fourth place.

The biggest number of credits per 100 thousand of



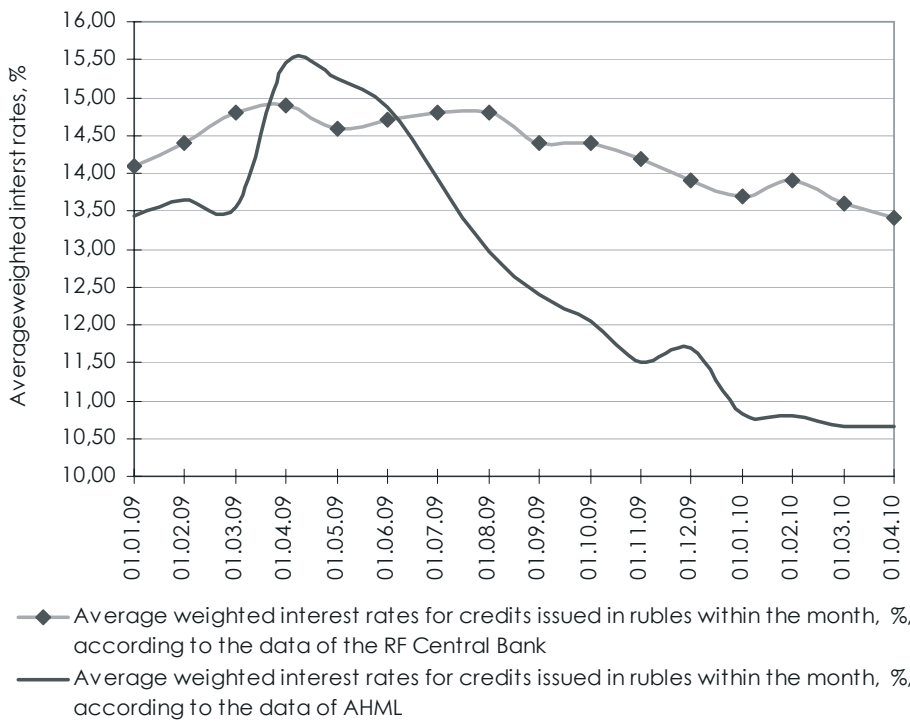
Source: Central Bank of the Russian Federation data

Fig. 3. Distribution of Issued Home Loans and Mortgage Credits among Federal Okrugs in the 1st quarter 2009 and the 1st quarter 2010



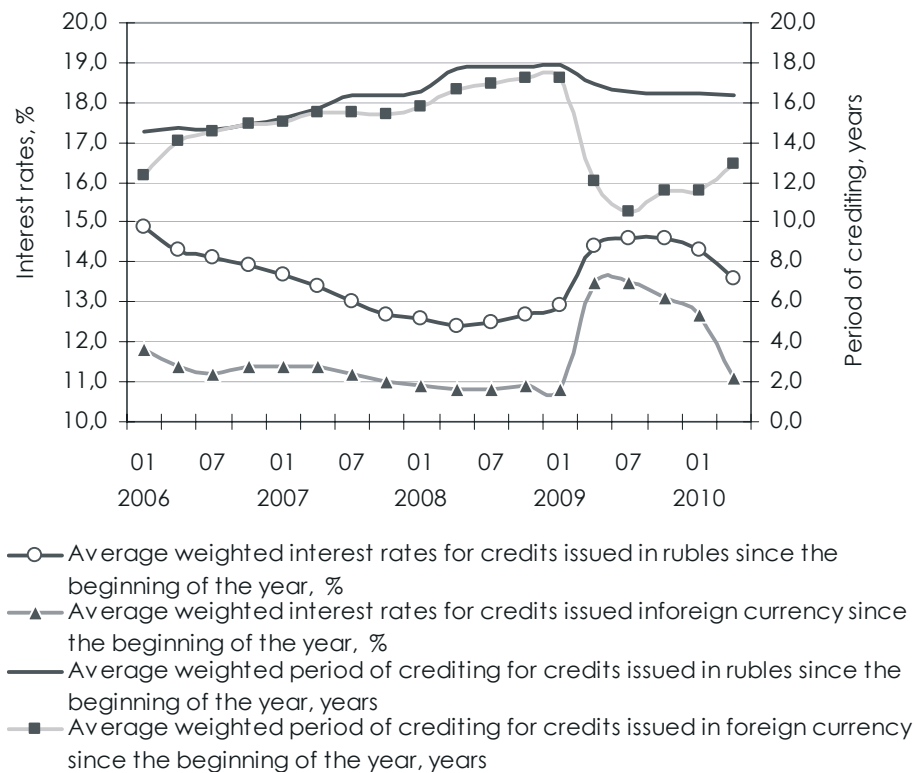
Source: according to the data of the Federal State Statistics Service and the Central Bank of the Russian Federation

Fig. 4. Number of Issued Home Loans and Mortgage Credits per 100,000 of Population Living Permanently in Federal Okrugs



Source: according to the data of the Central Bank of the Russian Federation and OJSC AHML

Fig. 5. Average Weighted Interests Rates for Mortgage Credits Issued Within the Month in Rubles



Source: data of the Central Bank of the Russian Federation

Fig. 6. Average Weighted Data for Mortgage Credits, Issued since the beginning of the Year

population was issued in the Republic of Altai -210 credits and in the Nenetsk autonomous okrug – 128 credits.

Starting with April 30, 2010 the refinancing rate of the Central Bank of the Russian Federation was lowered to 8%. According to the data of the Central Bank of the Russian Federation average weighted interest rate for mortgages issued in rubles is decreasing (fig. 5), and the rate for credits that were refinanced by AHML is lowering at faster rates. The interest rates for home loans in foreign currency is also decreasing (fig. 6).

Average weighted period for mortgage credits in rubles has remained practically unchanged since the beginning of the year – about 16 years, and the period for credits in foreign currency, while the interest rates are decreasing demonstrates the growth – about 13 years (fig. 6). According to the data of the Central Bank of the Russian Federation outstanding debt for mortgage credits reduced to RUR 105860 million as on April 1, 2010 as compared with RUR 109001 million as on January 1, 2010. OJSC Agency for Home Mortgage Lending refinanced 9400 mortgages worth RUR 9144.74 million in the 1st quarter 2010, which is by 28% in number of credits more than in the 1st quarter 2009 and by 18% more by the volume of debt. In April 2010 the Agency refinanced 4006 more mortgages at the sum of RUR 4002.15 million.

The president of the Russian Federation has approved the Federal Law “On making

changes to the Federal Law “On additional measures of RF financial system support”, which envisages the decrease in the interest rates for subordinated credit for the Agency for Home Mortgage Lending from 9.5% to 6.5% per annum. The changes also envisage prolongation of the period within which Vnesheconombank has a right to give credits to AHML up to December 31, 2011.

The draft of the amendments to the law “On hypothecation (mortgage)” concerning simplifications of mortgage clearing off was submitted to the State Duma. It is suggested to introduce the possibility of the government registration of the agreement between the mortgagor and the mortgagee on extrajudicial procedure for mortgage credit debts settling.

As on May 1, 2010 the mortgage credit portfolio of VTB 24 bank exceeded RUR 169 billion (more than 92 thousand of effective mortgages). Nevertheless, the proportion of mortgages for the purchase of the housing under construction in VTB portfolio has reduced from 30% to 10%. Starting with June 1, 2010 the VTB client will be granted the opportunity to attract mortgage credits within the program of the state support of the mortgage market that envisages issuing mortgages with 11% per annum in rubles. ●

A NEW INITIATIVE AIMED AT LIMITATION OF SETTLEMENTS' RIGHTS HAS BEEN STOPPED

I.Starodubrovskaya, N.Mironova

Pursuing its policy aimed at liquidating guarantees of local government, the Legislative Assembly of the Leningrad Region has put forward a legislative initiative as regards establishment of a joint administration of the municipal district and the district center. Should that initiative be approved, the danger of both command methods of government on the part of the district authorities and resolution of the existing conflict between the district authorities and the authorities of district centers in favor of the former may greatly increase. So far, the above initiative has not been supported at the federal level, but the issue cannot be considered resolved once and for all.

The actual abandonment of the ideology of the municipal reform at the federal level and violation of guarantees of local government provided for in the initial draft of Federal Law No. 131-FZ on Guarantees of Local Government (possibility of dismissal of the elected head of a municipal entity by extrajudicial means and uniting of different settlements into a single one without asking for the opinion of their residents or by means of voting) have created conditions for similar initiatives to arise. In Spring 2010, the Legislative Assembly of the Leningrad Region introduced in the State Duma of the Russian Federation a legislative initiative which permits establishment of a joint administration for the municipal district and the settlement which is an administrative center thereof. Under amendments which were proposed to be introduced in Federal Law No.131-FZ, statutes of both the municipal district and the urban municipal entity (which is an administrative center of the municipal district) may provide for fulfillment of powers of the administration of the urban municipal entity (which is an administrative center of the municipal district) by the local administration of the municipal district. The head of such a joint administration should be determined by the tender committee. The two-thirds of members of such a committee are appointed by a representative body of the municipal district (one-third of such members, by presentation of the representative body of the urban settlement), while the remaining one-third, by decision of the constituent entity of the Federation. According to the authors of the initiative in question, such a measure could permit to reduce administrative costs and the level of uncertainty with residents of local centers as regards which administration they should refer to for solution of one or another problem.

In principle, establishment of joint administrations of municipal entities may in some cases be an instrument which contributes to higher efficiency of management. In the course of discussion of the draft of the Federal Law No. 131-FZ, a possibility of establishment of joint administrations at the level of settlements -- which measure could help relieve to some extent a shortage of personnel and optimize expenses as it is particularly important to rural settlements -- was expected to be envisaged. However, at that stage the proposal in question was not approved. The new municipal legislation provided for mandatory establishment in each municipal entity of not only the representative body of the local government in the same way as before, but also the office of the head of the municipal entity and the local administration.

At present, the problem arose again, but in different light. To understand the origin of that problem it is necessary to consider the evolution of the system of local government in the Leningrad Region in conditions of the municipal reform. Prior to the reform, the region in question had a large number of urban centers which had the status of independent municipal entities. During the reform, the situation radically changed, but not for the better: in Leningrad Region only one urban district was established, while other towns were assigned the status of urban settlements and, thus, became a part of municipal districts¹. As a result, organization of local government in the Leningrad Region has the following specifics:

¹ In particularly, such budget donors as Gatchina, Vyborg, Volkhov, Pikalevo and other failed to receive the status of an urban district.

- All the administrative centers of municipal districts are situated in urban places which are, at the same time, administrative centers of urban settlements;
- A large part of representative bodies of municipal districts is formed in accordance with the “model of delegation”, that is, it is not elected at general elections, but consists of leaders and deputies of settlements which are a part of the municipal district;
- Heads of urban settlements are, as a rule, in charge of the representative body of the municipal entity;
- Elected as heads of municipal districts are, as a rule, persons who simultaneously hold office of the head of an urban settlement where the administrative center of the municipal district is situated in;
- Heads of local administrations of districts, an urban district and a majority of settlements are appointed under contract by the representative body of the relevant municipal entity.

The legislative initiative regarding establishment of joint administrations of a municipal district and a district center was the latest one in the row of other initiatives of the Leningrad Region to that effect. Late in 2009, the Governor of the Leningrad Region wrote a letter to Ilya Klebanov, Authorized Representative of the President of the Russian Federation in which he proposed to carry out a relevant experiment in the Region¹. Efforts to carry out such an integration have already been taken at the level of individual municipal districts. For instance, in a number of districts where the head of the urban settlement is in charge of the representative body the person who was appointed as the head of the administration of the municipal district was recommended by the tender commission to the office of the head of the administration of the settlement. However, referring to the Law on Municipal Service in the Russian Federation the prosecutor’s office specified that it was illegal to hold simultaneously those offices².

At present, it has been admitted at the federal level that the proposed version of the draft law cannot be approved as it needs substantial revision. In particular, the draft law has failed to specify the issues of mutual relations between the representative bodies and heads of two municipal entities with one administration. Nor is solved the issue of the ban specified in Article 17 (3) of the Federal Law on General Principles of Organization of Local Government in the Russian Federation on subordination of bodies of one municipal entity to those of another municipal entity, as well as other issues.

Against approval of the draft law, the following considerations were put forward³:

- Establishment of joint administrations runs counter both to the principle of division of issues of local importance between different types of municipal entities and implementation of the *Settlements for People, Municipal Districts for Settlements* approach;
- Legislators of the Leningrad Region do not differ the definition of the urban settlement from that of the populated area; the administrative center of the municipal district is a populated area, not a settlement;
- The proposed wording of the draft law stems from the specific system of organization of local government which was established only in the Leningrad Region while in Russia in general such a system is much varied;
- It is not evident that as a result of the reform those positive gains which the authors of the proposed amendments refer to in order to defend their position will be achieved.

Not all the reasons stated above can be accepted without reservation. For instance, in conditions a multi-level system of local government taxpayers and the business may encounter additional problems as they need clear understanding of which level of authorities is responsible for specific functions. International experience points to existence of such a problem, as well. However, that can be the case in favor of a more fundamental transformation, that is, a switchover to a single-

1 L. Petrova Municipal Know-How: The Head of the Administration “Two in One” // 47News, 10/02/2010 11:56. <http://www.47news.ru/2010/02/10/005/>.

2 Ibid. See also: <http://www.47news.ru/2010/02/10/005/>.

3 See: O. Motyakova. To the Issue of the District Administration and the City Administration Being United // Municipal Power, No. 2 (March-April) 2010, pp. 14-15.

level system of local government, for example, in the form of reassignment of the status of an urban district to large urban entities of the Leningrad Region.¹

Within the logic of a two-level system it is more important to understand what effect such innovations will have on guarantees of local government, particularly, in district centers. District centers are generally the most significant municipalities with a greater potential for development where the most valuable resources are concentrated in. In such conditions, the conflict between the district authorities and the settlement authorities as regards the principles of allocation and utilization of such resources is inevitable and with issues of corruption put aside reflects the conflict between utilization of such resources for purposes of development and purposes of adjustment. The problem in question is absolutely objective. To solve it, it is necessary to put the conflict between the district authorities and settlement authorities within institutional frameworks. It is obvious that in establishment of joint administrations the above problem cannot be solved as one of the parties to the conflict (in most cases it is the party which represents the center of development) is seriously weakened. In such a situation, there are virtually no mechanisms left which could prevent use of command methods by regional authorities in handling of such issues (nothing prevents the hired manager put by joint effort of regional authorities and district authorities in charge of the joint administration from carrying out the policy favored by the municipal district as regards solution of controversial issues).

In some cases, the fact that the head of the municipal district can simultaneously hold office of the head of a district center may be favorable, while in other cases it may be not as it will create an internal conflict of interests with the same official. However, as was stated above such a scheme of organization of municipal government is the specifics of the Leningrad Region. In other regions, consequences of proposed innovations may be far more devastating. Also, it is to be noted that the draft law does not regulate the situation where decisions of district authorities and settlement authorities of local government are of conflict nature (such a situation is quite possible as the spheres of duties of the above authorities actually overlap) and, thus, it would be practically impossible to fulfill such decisions within the frameworks of a joint administration. Nor is there a possibility to appeal to the head of the joint administration in a situation where he/she explicitly gives preference to decisions of one of the levels of local government.

Proceeding from the above-stated reasons, it seems prudent to agree with a more radical opinion shared by a majority of experts in that area: establishment of a joint administration for different types of municipalities is unacceptable in principle. ●

¹ It is to be noted that establishment of a single-level organization of local government in highly urbanized areas inside districts is a topical issue not only to the Leningrad Region, but other regions as well. It is known that in the course of the municipal reform many self-sufficient cities of the Moscow Region and the Irkutsk Region were deprived of their rights. Such cities were granted the status of urban settlements, rather than that of urban districts.

SCIENCE AND INNOVATIONS: BIG PROJECTS

I.Dezhina

The fulfillment of “big projects” becomes a priority task in the state innovative policy, the most significant of which is the construction of the innovation city in Skolkovo. The analysis of positive and negative aspects of the adopted decisions concerning this project allows drawing a conclusion that the biggest success of this project could consist in model development of the whole mechanism for state regulation of the innovative activity in the country.

The discussion as to how to stimulate the innovative development in the country – whether to pursue the way of imitative innovations (borrowing – through the purchase of the equipment, technological lines, patents, licenses abroad) or the way of breakthrough innovations due to our own science in order to secure Russia a leading position in a number of the development directions has been going on for several years. The desire to fulfill “big projects” can be regarded as the heritage of the USSR, which was a “closed country”, with the prevailing view on the necessity of securing independence, defense ability and the opinion that the borrowing creates a threat to the national security. The stake on a “technological breakthrough” still dominates the state policy today.

Moreover, “big projects” are gradually becoming a priority for the state innovative policy. The “big projects” mean quite different undertakings – for instance, the formation of conglomeration called National Research Centre “Kurchatov institute”, creation of nanotechnology network, fulfillment of five priority directions defined by the President of the Russian Federation, creation of the network of federal and research universities and, finally, the project of innovative city “innocity” in Skolkovo. Top authorities are calling different departments and structures with the participation of state – from Russian Academy of Science to Russian venture company – for active participation in big projects.¹

The foundation of innovative city in Skolkovo in Moscow region is one of the most widely discussed government projects, plans for which creation were declared as long ago as February 2010 by D. Medvedev. Innovative center in Skolkovo is to become an ultra-modern scientific and technological complex of the development and commercialization of new technologies, a model of the city of the future and at the same time the proving ground for new innovative policy of the government. According to the President of the Russian Federation, the project is planned to be “completely competitive”, which “makes it different from all the things we did before”².

The project was a state one from the very beginning³, which influenced on the choice of the place for the new city, which was made by the government without public justification. When defining the place such criteria as infrastructure development and its availability was taken into account⁴. Such centers as Tomsk, Novosibirsk, Saint-Petersburg, Obninsk, Dubna met these criteria and were ready to compete. Moreover, only some representatives of business were attracted for the development of Skolkovo project, while other interested parties – for instance governors⁵, including those of the most innovations-welcome regions, did not participate.

1 Waiting for the effect. Vice PM commissioned the Ministry of Education and Science with “checking the real effectiveness” of scientific work” //Poisk, №13, 26.03.2010, p.3 (in Russian).

2 Verbatim record of the meeting of the Committee on modernization and technological development of the Russian economy. Obninsk, 29.04.2010 <http://news.kremlin.ru/transcripts/7585>

3 See, for instance, the report on the meeting of the first deputy of RF President administration head Vladislav Surkov with the members of the all-Russian business organization “Business Russia”. Source: “Business Russia” will undertake innovative projects // Izvestia, 21.05.2010, p.2.

4 Dmitriy Medvedev held a special meeting concerning foundation of the center for modern research in Russia Moscow, 09.03.2010 <http://news.kremlin.ru/news/7061>

5 Heads of innovative regions will discuss Skolkovo development at SPIEF-2010. RIA News, 21.05.2010 <http://www.i-russia.ru/all/news/483/>

It can be assumed that two positions competed in the government: (1) construction of the city from scratch in order to avoid the influence of the old heritage in anything; (2) construction on the basis of one of the existing science towns or academy towns, where the funds in innovative infrastructure development have already been invested and only minimal additional construction is required. In the first case the main argument is that it is easier to build something new in Russia than to change the consciousness of the people that had been formed for decades. The only problem is that it is certainly possible to build something new but it is not possible to find “new people” for it. This is proved by the foreign experience: American experts claim that it is impossible to build the Silicon valley but it is possible to create conditions under which it emerges on its own¹ (even in the USA the creation of Silicon valley could not be copied). In case of construction of the city on the basis of the existing groundwork it is the regions with the considerable amount of budget funds being invested into innovation infrastructure development in recent years that should have been the most attractive – for instance, technical and innovation zones (Zelenograd, Dubna, Saint-Petersburg, Tomsk). These complexes are also the closest to the idea of innovative city from a conceptual point of view.

But the final choice was made for the place that does not fully correspond to the criteria that were announced, which casts doubt on the effectiveness of many government measures in the field of innovations. Thus, if widely promoted successes of Dubna, Obninsk or Tomsk are real, why then one cannot develop this success, making one of these towns a basis for innocity? If there are no such successes, why the past experience of mistakes is not analyzed?

The choice of the place to build a city of innovations was followed by a number of unprecedented government decisions on the creation of extremely favorable economic conditions to work and live in it. The package of the corresponding bills is to be submitted to the State Duma in the second quarter of 2010. They concern the following aspects of innovative city organization and functioning:

1. Introduction of diversified system of tax privileges for companies that will work in Skolkovo: ten-year tax vacations from profit, land and property taxes, privileged rate for compulsory insurance contributions- 14% instead 34%, the right to chose VAT for companies pursuing innovative activity in the area, customs privileges;

2. Adoption of simplified technical regulations;

3. Simplification of the procedure for transferring land plots from one category to another;

4. Introduction of special sanitary rules and fire safety rules;

5. Simplification of the conditions for interaction with the government due to the formation of the special departments in the federal bodies such as the Ministry for Internal Affairs, Federal Migration Service, Federal Tax Service, Federal Customs Service and a number of other departments;

6. Creation of new R&D centers (research and development centers) for five directions of “technological breakthrough” – in the field of power industry, information technologies, telecommunication, biotechnologies and nuclear technologies. It is assumed that no less than two centers for each of the directions will be created², that means about ten centers;

7. Foundation of special departments of Rospatent which will register and protect the rights for intellectual property in more friendly and accelerated regime;

8. Attraction of foreign scientists and entrepreneurs by securing them free arrival in Russia and movement through the territory of the country. The Federal Law “On making changes to the Federal Law “On the legal status of the foreign citizens in Russian Federation” (from 19.05.2010 No 86-FZ), which comes into effect on July 1, 2010, has already been adopted. According to it, the work permission for foreigners that are highly-qualified specialists are now issued for three years with the possibility of its multiple prolongation. They will also be granted the tax regime of RF resident, according to which the incomes tax rate will be equal to 13%. It should be noted that a highly-qualified specialist is referred to as a foreign citizen having experience, skills or achievements in

1 Litvinov A., Ivanitskaya N., Taratuta Yu. Alien body // Russian Newsweek, №13, 22-28.03.2010 <http://www.runewsweek.ru/science/33180/>

2 Meeting of the RF President and Viktor Vekselberg. May 13, 2010. Moscow oblast. Gorki <http://news.kremlin.ru/news/7743>

a particular field if the conditions of his work in the Russian Federation envisage his salary (labor remuneration) being RUR 2 million or more over the period not exceeding one year.

At the same time the scale of expenses has not been defined yet, including the magnitude of figures. Such uncertainty is connected with the fact that not all the projects have been approved. Thus, the question on the Massachusetts Institute of Technologies (MIT) in R&D center construction is still discussed, as well as organization of a new technical university taking into account MIT experience. Foreign experience and expertise are really important since, as it is testified by the existing history of institutes development – such as ROSNANO or Russian Venture Company – the access to goods projects remains a problem and world-class specialists to search promising innovative projects both in Russia and abroad are needed. It is expected that Skolkovo projects will start to bring fruits no sooner than in 2015. Indeed, construction of a whole city is a long process, and in this connection a question on the possibility to start fulfillment of the projects before the whole infrastructure is built, i.e. in the “virtual regime” arises. So far the reaction of the RF President to this suggestion is negative, since it is important to avoid the situation when “a large number of structures not connected with it will operate” under the mask of the center¹. Such a threat does exist because the project executors will enjoy considerable benefits.

Despite high hopes for future the process of this special project justification will once again unveil the problems in the state innovative policy. These are, in the first place, retardation of the adopted decisions compared with the global trends of innovative systems development. Thus, the very approach of building a closed city is against the logic of innovative development. Innovations are rare in isolation², especially nowadays, when the networks are growing and the connections of stakeholders, institutes and final consumers are expanding. That is why the trend is to avoid the closedness in all its displays, to transfer to “open innovations” and global innovative networks, to overestimate the significance of different zones.

Second problem consists in situational nature of decision adoption, when not economical or science and technological factors are taken into account but the balance of political interests.

Third drawback is that the foreign experience is idealized. Often foreign experience is absolutized disregarding the wider economic context of the country of its origin. Adapted measures are rarely regarded from the point of view of pluses and minuses ratio as well as peculiar features of their evolution. Thus, for instance, the foreign experience cannot answer directly as to how important the tax privileges are for innovations. That is why a swift transfer from an effective negation of tax stimulation role in innovations, which was prevailing in the government circles for years, to the introduction of a large number of tax privileges seems controversial.

Fourth, the domestic innovative policy obviously lacks hindsight – that is retrospective analysis which would allow more effective movement forward looking backwards and analyzing the projects that have failed.

The chance to enter the world markets with innovative products appears when there are not only the funds but also the strategy of big projects development and this will secure higher development stability for the country. So far there were no necessary components for the breakthrough, which is testified by the results of large infrastructure projects fulfillment so far – for instance IT-parks, technical and innovation zones. The project of innovative city in Skolkovo may help to exit the vicious circle if this example will be used to develop regulating measures, which in its turn, creates the image of how in fact state agencies and departments should work throughout all the country and not in a separate town of the future. ●

1 Meeting of the RF President with Viktor Vekselberg. 13 May 2010, Moscow region, Gor'ki <http://news.kremlin.ru/news/7743>

2 Draft Ministerial Report on the OECD Innovation Strategy: Innovation to Strengthen Growth and Address Global and Social Challenges. Key Findings. Paris: OECD, February 26, 2010, p.6.

REVIEW OF MEETINGS OF THE RF GOVERNMENT IN MAY 2010

M. Goldin

In May at the meetings of the Presidium of the Government of the Russian Federation the following issues were considered: the project for the Program for budget expenditures efficiency increase in the period up to 2012 and for the Plan of measures aimed at fulfilling the Program for budget expenditures efficiency increase in 2010 submitted by the RF Ministry of Finance; “Main directions of tax policy of the Russian Federation in 2011 and the planning period of 2012 and 2013”; the amendments made to article 258 of the RF Tax Code were approved that envisage “innovation privilege” for profit tax in the form of amortization period reduction for some non-material assets.

On **May 20**, 2010 at the meeting of the RF Government the project for the Program for budget expenditures efficiency increase in the period up to 2012 and for the Plan of measures aimed at fulfilling the Program for budget expenditures efficiency increase in 2010 submitted by the RF Ministry of Finance was considered.

The Program for budget expenditures efficiency increase in the period up to 2012 (further referred to as the Program) was developed in concordance with the Address of the RF President to the RF Federal Assembly from November 12, 2009 and the Budget Address of the RF President to the RF Federal Assembly from May 20, 2009 “On budget policy in 2010-2012” as well as with the main statements of the Concept for long-term socio-economic development in the Russian Federation for the period up to 2020, approved by the RF Government on November 17, 2008 No 1662-r, and with the main directions of the RF Government work approved by the RF Government Decree from November 17, 2008 No 1663-r.

The aim of the Program is to increase the efficiency of the public legal bodies efficiency which provide the citizens and the society with state and municipal services, to increase their availability and quality, execution of state (municipal) functions, realization of long-term priorities and aims of socio-economic development.

The RF Government in 2010 within the framework of the program of budget efficiency increase is to fulfill more than 40 different measures. This includes:

- Adoption of basic laws (primarily those introducing system amendments to the RF Budget Code) for further development of normative legislative acts and methodological materials;
- Beginning of formation and analytical representation of the Russian Federation state programs when making a project for the federal budget;
- Development and approval for the sector (departmental) plans for expenditures efficiency and financial management quality increase.

Besides, at the Meeting of the RF Government on **May, 20** the “Main directions for tax policy in the Russian Federation in 2011 and for the planning period of 2012 and 2013” were approved, which is the main program document of the RF Government, defining tax policy directions in the Russian Federation for short- and middle-term prospects (up to three years).

In 2011 and in the planning period of 2012 and 2013 in the field of the tax policy it is planned to fulfill a number of measures for instance to stimulate innovation activity, which include:

1. The decrease of the aggregated insurance contributions rate to 14% within the limits of the insured annual income up to 2015 and up to 2020 for some categories of taxpayers (payment of the contributions to the full rate will be made at the expense of the federal budget). This concerns the organizations and individual entrepreneurs that have a status of technological and innovative special economic zones resident and make payments to natural persons that work in the territory of the technological and innovation economic zone, as well as organizations operating in the field of information technology. At the same time for mass media organization it I planned to establish special transitional period for the growth of the aggregated insurance contribution rates reaching the maximum value of 34% in 2015;

2. Simplification of the main assets classification into groups and of the procedure for definition of amortization norms for these groups;

3. Specification of the procedure to account the expenses for research and (or) development (the establishment of the single procedure for tax accounting of R&D expenditures in order to eliminate the possibility to abuse the privilege). For instance the list of the expenditures should be defined in the RF Tax Code (wages, equipment amortization etc., which will be attributed to R&D expenditures for profit tax);

4. Creation of the reserves for the forthcoming R&D expenditures of organizations. The sums of assignments to this reserve will be included in the list of outstanding expenditures as on the last date of the accounting (tax) period. The limits for assignments to this reserve should be established;

5. Reduction of the list of documents necessary to prove the legibility of zero VAT rate when conducting export operations;

6. Exemption of taxation with organizations' property tax for energy efficiency equipment for the period of 3 years from the moment of commissioning as well as the equipment used to make scientific and technological production;

7. Creation of favorable conditions for tax administration for innovative companies including the creation of special taxation bodies and decrease of the frequency and periods for making inspections;

8. Transfer of authorities to adopt decisions on giving investment tax credit for the Organization's profit and property taxes to the organizations of the Russian Federation subjects and the increase of its volume;

9. Improvement of the taxation of organizations working in socially important fields. This concerns the exemption from profit tax of non-commercial organizations (including budget organizations), working in socially important fields (primarily, science, culture, education, health care) concerning the incomes received from the entrepreneurial activity;

10. Introduction of special tax regime for organizations participating in Skolkovo technological park.

On **May, 20** the RF Government approved the project of the federal law "On making changes to article 258 part two of the Tax Code of the Russian Federation", which was submitted by the Ministry of Finance of the Russian Federation.

The bill envisages the reduction of the period of amortization for such non-material assets as exclusive rights for inventions, industrial samples, useful models, selection achievements, integral circuits topologies, computer programs, databases, know-how's.

At the same time the amortization period for these assets is established by a taxpayer independently, but it should not exceed two years.

As to such non-material assets as works of science, literature and art, brand names, trade marks and service marks, as well as other objects of intellectual property not connected with innovative and scientific and technological activity, the previous procedure for definition of the period of their use for the purposes of profit taxation is maintained.

The Bill was submitted to the RF State Duma. ●

REVIEW OF ECONOMIC LEGISLATION

I.Tolmacheva

The following changes were made to the legislation in May: the legal status of state and municipal institutions was specified; the subsistence level for the 4th quarter 2009 was established; starting with April 30, 2009 the refinancing rate of the Central Bank of the Russian Federation was again lowered.

I. Federal Laws of the Russian Federation

1. "ON MAKING CHANGES TO SOME LEGISLATIVE ACTS OF THE RUSSIAN FEDERATION IN CONNECTION WITH THE IMPROVEMENT OF LEGAL STATUS OF STATE (MUNICIPAL) INSTITUTES" from 08.05.2010 No 83-FZ

In order to strengthen the property independence of the state and municipal institutions their legal status was specified.

State (municipal) institutions were divided into budget and public. The budget institutions are granted the right for greater property independence.

For instance it is established that a budget institution has a right to fulfill the works, render services connected with their main activity (that is fulfillment of government and local government authority in the field of science, education, health care, culture, social security, employment, physical education sport and other spheres), for citizens and legal entities on equal conditions when rendering the same services. The procedure for definition of payment is established by the corresponding body carrying out the functions and authority of the founder.

It is also established that the financial provision of state (municipal) task fulfillment by a budget institution will be made at the expense of subsidies from the corresponding budget. The procedure for state (municipal) tasks formation and for financial provision of their fulfillment, procedure for definition of the most valuable movable property and big deals, the right to manage and make which budget institutions receive only upon approval of the institution owner, list of data on the budget institution operation that is compulsory for publication are regulated in detail.

The specific characteristics of a public institution legal status are also specified, including the specific features of its liquidation.

In concordance with the newly introduced norms regulating the legal status of institutions many amendments and addenda were made to the legislative acts regulating the operation of bank and budget systems, sphere of state and municipal orders, competition protection as well as local governments, education, defense, archiving and museums.

The law comes into effect on January 1, 2011 excluding some statements that come into effect on other dates. Many transitional statements concerning, for instance, the procedure for the execution of liabilities by budget institutions, procedure for budget institutions financing, creation, transformation and liquidation are established.

II. Decrees of the Government of the Russian Federation

1. "ON ESTABLISHING THE MINIMUM SUBSISTENCE LEVEL PER PERSON AND FOR MAIN SOCIAL AND DEMOGRAPHIC GROUPS OF POPULATION ON THE WHOLE THROUGHOUT RUSSIAN FEDERATION IN THE 4TH QUARTER 2009" from 21.04.2010 No 259

In the 4th quarter 2009 the minimum subsistence level is established to be lower than in the previous quarter. On the whole throughout the Russian Federation the minimum subsistence level per person made RUR 5144 (RUR 5198 in the 3rd quarter), for able-bodied population - RUR 5562 (earlier – RUR 5620), for pensioners - RUR 4091 pyб. (earlier – 4134), for children - RUR 4922 (RUR 4978 in the preceding quarter). The minimum subsistence level is defined quarterly on the basis of the consumer's basket and Federal State Statistics Service data on the level of consumer prices for foodstuffs, non-food goods and services and expenses for compulsory payments and fees.

III. Orders, Letters, Instructions

1. Order of the Central Bank of the Russian Federation “ON REFINANCING RATE OF THE BANK OF RUSSIA” from 29.04.2010 No 2439-U

Starting with April 30, 2010 the refinancing rate of the Bank of Russia is established at the level of 8% per annum. Earlier from March 29, 2010 the refinancing rate of 8.25% per annum was in effect. The decision of the Bank of Russian to decrease the refinancing rate is aimed at further stimulation of crediting activity in banking sector. ●

REVIEW OF LEGISLATIVE DOCUMENTS CONCERNING TAXATION OVER APRIL-MAY 2010

L.Anisimova

1. Letter of the RF Ministry of Finance from May 7, 2010 No 03-11-06/2/73 clarifies the issue on exclusion of the sums of targeted budget financing allocated to conduct thorough repair works in apartment blocks within the framework of fulfillment the Federal Law from 21.07.2008 No 185-FZ "On the Fund for assistance to the reform of housing and communal services" from the list of taxable incomes when applying the simplified taxation system. In concordance with subparagraph 1 paragraph 1.1 article 346.15 of the RF Tax Code when defining the taxation object of the simplified taxation system, the incomes listed in article 251 of the RF Tax Code are not taken into account. The budget financing funds are included in subparagraph 14 paragraph 1 of this article.

2. According to the Letter of the RF Ministry of Finance from May 07, 2010 No 03-05-06-02/43 the question connected with land tax payment is clarified and attention is drawn to the ways of overcoming technical difficulties which arise due to the specific nature of taxation of the land of common use. For instance, the RF Ministry of Finance explained that in concordance with article 388 of the RF Tax Code the land tax payers are defined as organizations and natural persons that own the land plots recognized as taxation objects according to the right of property, right of permanent (infinite) use and the right of life inheritable possession. Since, according to paragraph 4 article 14 of the Federal Law from 15.04.1998 No 66-FZ "On gardening, horticultural or country-house non-commercial unions" the land plots that belong to the property of common use are granted to gardening, horticultural or country-house non-commercial unions as a legal entity to ownership, it is the legal entity that acts as a taxpayer. In such a situation, as it was clarified by the RF Ministry of Finance, the administration board of a non-commercial union can adopt a decision which envisages the compensation of a land tax on the land of common use in the form of membership contributions of the members of this non-commercial union.

3. According to the Letter of the RF Ministry of Finance from May 06, 2010 No 03-07-14/32 the procedure for VAT payment by individual entrepreneurs after losing the right for exemption from this tax was clarified. The RF Ministry of Finance explained that according to paragraph 1 article 145 of the RF Tax Code the individual entrepreneurs is exempted from VAT if in three successive calendar months the proceeds from goods (works, services) sale did not exceed RUR 2 million in total. In concordance with paragraph 5 of the same article if in the period of exemption from VAT the proceeds over three successive months exceeds RUR 2 millions in total, then, starting with the 1st day of the month, when the excess took place, the entrepreneur loses the right for VAT privilege and should pay VAT at the rate of 18% up to the end of exemption period.

4. According to the Letter of the RF Ministry of Finance from April 29, 2010 No 03-07-11/156 the question on formation VAT taxation based in autonomous institution concerning the subsidies granted to the autonomous institutions from budget was explained.

At present the questions concerning the taxation of autonomous institutions are becoming more and more urgent due to the reform of the state and municipal institutions carried out within the framework of the Federal Law from May 8, 2010 No 83-FZ. The application of the principles of financial relationships with the budget organization that are characteristic to the autonomous institutions to the budget organizations is one of the components of the reform. That is why it is purposeful to regard the specific nature of autonomous organization taxation with VAT in more detail.

VAT. In case an autonomous institution buys (purchases) goods (works, services) at the expense of the federal budget funds (from subsidies) they are paid with the incoming VAT. In this case the sums of incoming VAT are accepted for deduction (compensation from the budget) since this deduction (offset) would result in transfer of budget sources into non-budget. In case the monetary

funds (subsidy) is allocated to an autonomous institution from the budget for the compensation of the made expenditures for the purchased goods (works, services), such sums of compensations are not included in VAT taxation base (see, for instance, the letter of the RF Ministry of Finance from 30.01.2009 No 03-07-11/27). When defining the compensation sum, the same as in the first case, the situation when budget sources are transferred to non-budget, should be avoided.

When a taxpayer sells its goods (works, services) at the prices regulated by the state taking into account the subsidies granted from the budget to maintain the profitability level or in connection with the privileges established by the legislation for some categories of goods (works, services) consumers it is necessary to use the following regulations as guidance: VAT taxation base in concordance with article 154 of the RF Tax Code is defined basing on the real sales prices, sums of subsidies, compensating the prices losses to the seller, are not taken into account when defining the VAT taxation base.

Profit tax. In concordance with subparagraph 14 paragraph 1 and paragraph 2 article 251 of the RF Tax Code the taxation base for organizations' profit tax does not include the property received within the framework of purposeful financing for its maintenance and conduction of statutory activity (see, for instance, the explanation of the RF Ministry of Finance from 10.12.2009 No 03-03-06/1/800).

As to subsidies received by organizations as compensation for expenses or lost profits in connection with production (sale) of its own goods (works, services), they are taken into account when forming taxation base for profit tax. The exception is made to autonomous institutions that on the basis of direct record in article 251 of the RF Tax Code at present have a direct privilege for profit tax concerning such subsidies.

5. According to the information letter of the Supreme Arbitrary Court Presidium from April 27, 2010 No 138 the question on the procedure for settling the debt for insurance contributions for the compulsory pension insurance during the case of bankruptcy.

Two types of liabilities are distinguished in the organization which undergoes the bankruptcy procedure: current (evolving after the procedure of bankruptcy was started) and included in the list of creditors' requirements that are paid off at the expense of the contest mass (evolving before the procedure of bankruptcy started). When defining the order of priority for paying off the creditors' requirements that do not belong to current liabilities, that is those included in the list of liabilities that are paid off from the contest mass, one should be guided by a legal nature of the insurance contributions for compulsory pension insurance as compulsory payments. Compulsory payments are to be satisfied in the 3rd order of priority. In case in the list of requirements they are reflected among the liabilities of other order of priority, the changes are made on the basis of the application of the body authorized to conduct the bankruptcy procedure (contest manager) or definition made by the judge independently.

6. According to the Federal Law from May 8, 2010 No 83-FZ changes are made to some legislative acts of the Russian Federation in connection with the improvement of the legal situation of the state (municipal) bodies. The sharp distinction between the status of public, budget and autonomous institutions is to be noted. In the Budget Code the term "budget institution" is substituted with the term "public institution". In fact this means that public institutions with all their incomes and expenditures are included in the system of budget relations, while budget institutions are brought to the market relationships. At present the situation is as the following: there is a special legislation for the public and autonomous institutions (budget legislation or the legislation on autonomous institutions), while the budget institutions are now directly regulated by the legislation on non-commercial organizations (the only specific feature being that they are founded by the state or by the local government).

Public institutions are budget recipients and are provided with budget funds on the basis of limits, while the budget institutions lose the status of budget recipients, and, together with the autonomous institutions are transferred to the regime of work on the state task execution, which is provided with the subsidy. Besides, autonomous and budget institutions are provided with funds for the maintenance of the state property that are given to them for day-to-day management.

The transfer of the right to manage the property purchased at the expense of off-budget funds (excluding immovable and very valuable property) to budget and autonomous institutions, which will be defined in the statutes and registers, is quite remarkable. Very valuable property of autonomous institutions is defined as movable property of more than RUR 50 thousand per unit.

Budget and autonomous institutions are allowed upon the approval of the owner to act as founders or participants of non-commercial organizations and economic entities in concordance with the law.

The codes of budget classification are no more important for budget institutions. There is also no need to keep special budget accounts.

This resulted in changes in tax legislation. The lessees of the property that is in day-to-day management of the budget institution can no longer act as tax agents for the leased property. That is, starting with 1.01.2011 budget institutions, together with autonomous institutions pay VAT sums from lease payments independently. At the same time the question of whether the earning from the lease are transferred from the budget account in a Federal Treasury body to the budget institution account from other profitable activity has not been regulated yet.

In Chapter 25 “Profit tax” the version of article 251 “Profits not taken into account when defining taxation base” was changes – subsidies to autonomous institutions and budget organization are defined as such profits, limits of budget financing of public institutions are added to this list. At the same time the expenses of the public (municipal) institutions in connection with rendering government (state) services or execution of government (municipal) works are excluded from the list of expenses taken into account when forming the taxation base for profit tax.

The earlier existing procedure for advance payments of profit tax (paragraph 3 article 286) will still be applied to the budget institutions. This procedure will also be applied to autonomous institutions. The article that established the peculiar features of profit tax by a budget institution was recognized as invalid. That is budget and autonomous institutions are nearly transferred to the general scheme of profit tax payment, while the public institutions are excluded from the general scheme of profit taxation regarding both the profits and expenses, i.e. all their incomes are regarded as budget incomes and all their expenses – as budget expenses.

It is only the public institutions that are exempted from the state fee payment.

Public, budget and autonomous institutions are not allowed to transfer to single agriculture tax payment.

However, public and budget institutions, in contrast to autonomous institutions, can apply the simplified taxation system.

7. According to the Letter of the RF Ministry of Finance from April 29, 2010 No 03-03-05/98 the position of the RF Ministry of Finance on the procedure of accounting of losses from futures for the purposes of profit taxation.

Clarifying article 301 of the RF Tax Code, according to which the agreement which requirements are not subject to protection in court in concordance with the civil legislation of the Russian Federation is not recognized as a financial instrument, the RF Ministry of Finance draws a conclusion that the losses arising from such agreements are not taken into account when defining taxation base for organizations’ profit tax. Article 1062 of the RF Civil Code define “bet” deals on changes in prices for goods, currency exchange rates, level of inflation etc between the participants, one of which is not, according to the legislation of the Russian Federation, a bank or a professional participant of the market as such deals.

Such a limitation the RF Ministry of Finance allows only for futures contracts made in concordance with the Russian legislation and not subject to the court protection in the Russian Federation. If the parties of the agreement have not chosen the legislation of some other country, the losses from futures concluded by a taxpayer with a foreign organizations in concordance with the foreign organization according to foreign legislation are subject to court protection in concordance with the applied legislation of foreign countries. It should be noted that for the purposes of maintaining stable profit base of the RF budget in concordance with the position of the RF Ministry of Finance the losses from the operations with derivatives even those recognized on the basis of foreign country’s loss should be accounted for the purposes of taxation according to the procedure established by

chapter 25 of the RF Tax Code. This means that for common investors the losses are taken into account within the limits of profits for similar operations and professional participant of the financial market have a right to accept the total sum of losses for deduction. In practice this means that the Russian clients (whose losses will not be accepted to the full extent) should trust their funds to professional participants very carefully. Thus, the Russia's taxation system lowers the stimuli to make investments into financial instruments and focus the investors' attention on real investments. As a result the Russian financial system becomes less dynamics but potentially more resistant to the financial crisis. ●

CHANGES IN REGULATORY BASIS OF BUDGET PROCESS

M. Goldin

In May 2010 according to amendments made to the federal law “On the federal budgets for 2010 and for the planning period of 2011 and 2012” the volumes and directions of federal budget expenses for 2010, 2011 and 2012 were specified. When estimating the efficiency of executive bodies operation of the subjects of the Russian Federation and the local government the activity in the field of energy saving and increase of energy efficiency will be taken into account from now on.

According to the Federal Law from 04.05.2010 No 71-FZ “On making changes to the Federal Law “On the federal budget for 2010 and for the planning period of 2011 and 2012” the volumes and directions of federal budget expenses for 2010, 2011 and 2012 were specified. For instance, upper limit for the state guaranteed internal debt of the Russian Federation was raised (by more than RUR 50 billion as on January 1, 2011 and January 1, 2012, and by more than RUR 70 billion as on January 1, 2013). The lists of state guarantees of the Russian Federation that are to be given in 2010-2012 were specified.

The Government of the Russian Federation was granted a right to direct the funds of the federal budget for purchasing the shares of the joint Russian-Indian enterprise “System Shyam Teleservices Ltd” at the sum equivalent to USD 676.0 million at the expense of the sums received as India state credit debt settlement, which were earlier issued by the USSR and the Russian Federation.

The question in which Vnesheconombank can act as an agent of the Government of the Russian Federation, i.e. represent the interests of the Russian Federation at courts have also been specified – it is established that Vnesheconombank acts as an agent of the RF Government also in the questions of giving and fulfilling of the state guarantees for credits or bonds attracted by the state corporations Rosnano and Rosavtodor, for some bonds attracted by the open joint-stock company Unified Aircraft Corporation and open joint-stock company United industrial corporation Oboronprom.

Besides, the reasons for introduction of changes in the indices of the aggregated budget revenues and expenses of the federal budget in 2010 concerning budget assignments envisaged by subsection “Other issues in the field of the national economy” section “national economy” budget expenses classification; the list of such grounds was supplemented by the assistance rendered to international organizations on securing non-proliferation of nuclear weapons within the frameworks of the expenses volume established earlier.

According to the Decree of the RF President from 13.05.2010 No 579 “On estimating the efficiency of executive bodies of subjects of the Russian Federation operation and local governments of city okrugs and municipal districts in the field of energy saving and increase of energy efficiency” the list of indices for estimating the efficiency of executive bodies of the Russian Federation for achievement of the best results in which fields subjects of the Russian Federation can receive grants from the federal budget was supplemented by indices characterizing successes of executive bodies of RF subjects and local governments in the field of energy saving and energy efficiency.

The following indices are included in the list for estimation of the efficiency of the RF subjects executive bodies:

- energy capacity of the gross regional product;
- proportion of energy resources, calculations for whose consumption are made on the basis of recording devices;
- proportion of energy resources produced with the use of renewable energy sources;
- proportion of energy resources consumption (electricity, heat, water, natural gas) in apartment blocks;
- proportion of expenses of consolidated budget of a subject of the Russian Federation for fulfillment of the regional program in the field of energy saving and increase of energy efficiency.

The list of indices for estimation of operating efficiency of the local government bodies of city okrugs and municipal districts was supplemented by the following indices:

- the proportion of energy resources consumption in blocks of flats;
- the proportion of energy resources consumption by the municipal budget institutions. ●