



RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES 08'2010

MONTHLY BULLETIN:	
BASIC DEVELOPMENTS AND TRENDS IN AUGUST 2010	2
THE POLITICAL AND ECONOMICAL RESULTS OF AUGUST 2010 (S.Zhavoronkov)	5
INFLATION AND CREDIT AND MONETARY POLICY (N.Luksha)	9
FINANCIAL MARKETS (N.Burkova, E.Khudko)	13
REAL ECONOMY SECTOR: TRENDS AND FACTORS (O.Izryadnova)	23
RUSSIAN INDUSTRY IN JULY 2010 (S.Tsukhlo)	26
INVESTMENTS IN REAL ECONOMY SECTOR (O.Izryadnova)	30
FACTORS FOR ECONOMIC GROWTH IN 2009–1ST HALF OF 2010 (E.Astafieva)	36
FOREIGN TRADE (N.Volovik, K.Resenkova)	40
STATE BUDGET (E.Fomina)	44
THE RUSSIAN BANKING SECTOR (S.Borisov)	51
HOUSING MORTGAGE IN RF (G.Zadonsky)	54
SOME ISSUES CONCERNING TAXATION OF ORGANIZATIONS' PROFIT ARTICLE 282.1 OF RF TAX CODE (T.Malinina)	61
REVIEW OF MEETINGS OF GOVERNMENT OF THE RF IN AUGUST 2010 (M.Goldin)	64
REVIEW OF ECONOMIC LEGISLATION (I.Tolmacheva)	66
REVIEW OF REGULATORY DOCUMENTS CONCERNING TAXATION OVER JULY–AUGUST 2010 (L.Anisimova)	68
CHANGES IN REGULATORY BASE OF BUDGET PROCESS (M.Goldin)	75

BASIC DEVELOPMENTS AND TRENDS IN AUGUST 2010

The extreme heat and forest fires became the main news of August. Besides the organization of fire suppression and punishment of those responsible for the lack of preparedness to them (in particular, A. Savinov, Head of the Federal Forestry Agency (Rosleskhoz), the Russian government has informed of several measures aimed at combating the effects of the drought. Thus, Prime Minister Vladimir Putin has signed a decree imposing a temporary ban on grain exports from August 15 to December 31, which is applied to the effective contracts (this measure has caused doubts among experts in terms of its economic feasibility and the enthusiastic support of exporters declaring force majeure on the low profitable contracts). Russian government authorities also announced that they will actively use the tools via FAS price control over agricultural products. Herewith, Elvira Nabiullina, Minister of Economic Development has opposed price control, even in cases where their growth on certain items exceeds 30%.

Among other events of August one can note the imposition to the public discussion of the draft law «On Police». The very form of the draft law initial publication (in the Internet) for public discussion, as well as the name change of the national security service gave a liberal trend to the initiative of President Medvedev. However, the contents of the draft law in general is estimated by experts as negative: the project continues and improves the trend for the centralization of management bodies of internal affairs, contrary to the global trends, and actually enhances the uncontrolled activity of those bodies, expanding their rights without a corresponding expansion of external control mechanisms (in fact, the activities of the police are removed from the Public Prosecutor's supervision). The Project draft publication was accompanied by changes in the management of the Prosecutor's Office and the central Internal Affairs Ministry powers, which are regarded by some experts as a preparation for creation a single investigative body.

The conflict around Khimki Forest came out in August to a new level. It has involved federal leadership of the "United Russia", which organized a hearing in support of the ongoing project, Yuri Luzhkov, the Mayor of Moscow, who also supports the construction of the road through the forest, and finally, President Dmitry Medvedev, who issued an order to suspend the project. On the other hand, defenders of the forest held a protest action in the center of Moscow with the participation of rock musicians, which has attracted a wide public response.

Finally, in August President Dmitry Medvedev has appointed the new Governor of Kaliningrad region. Thus, Mr. Boos has failed to retain the Governor's seat after the massive protests held in the region at the beginning of the year. However, the place of the Regional Governor was proposed to N.N. Tsukanov, who had the greatest support from G. Boos and the least (out of three candidates) support on the part of the local elites.

Sociological surveys (of "Public Opinion" Fund) have demonstrated some reduction of "positive" assessment of the current and expected economic dynamics, and such assessment was rather characteristic for the last summer month. However, those surveys have not yet reflected the significant effect of rising food prices in August.

Macroeconomics and Budget

Macroeconomic situation in August was dependant on the sustained uncertainty about the prospects of the global economy recovery and already traditional fluctuations in oil prices in the range of USD 71-82 per barrel (ICE. Brent); this price range became traditional for the global oil prices from October 2009. Having reached the new local maximum within the last four months in July (USD 82.6 per barrel), in August 24 the price dropped to USD 72.21 per barrel, but then returned to the level of USD 75-77 per barrel. Traditionally the stock prices indices followed the Russian ones: from the highs of recent months, achieved in the first days of August (MICEX 1429 points, RTS 1523.8 points), the indices got down by 7-9%, and then, following the dynamics of oil

prices, have regained a significant part of this fall. Accordingly, the dollar, which was falling down against ruble during July (from the level of RUR 31.31 / USD 1 to RUR 29.80/ USD 1) started to increase again and reached on August 31 RUR 30.66 rubles/ 1 USD. The value of the two-currency basket, which was decreasing in early July from the level of 34.70 to 34.10 in early August, was also growing throughout August and reached the level of RUR 34.55 in early September.

Foreign currency and gold reserves of the Central Bank in August continued to grow and fluctuated between USD 474-478 billion, which demonstrated a new level as compared with the previous indicator (in May - early July the volume of reserves was wavering around the level of USD 460 billion) made 79.5% of the pre-crisis maximum peak.

The main event and a major surprise in August was a significant acceleration of inflation, which amounted to 0.6% within the month instead of the usual rate for this time of year, close to zero values. The cause of acceleration of inflation upsurge was the drought, which was aggravated by the increased inflationary expectations. For example, a wave of panic in grain prices has inspired a rapid increase in prices for milk and meat, while the usual lag between rising prices for grain versus meat and dairy products is 3-6 months. The coming months will show how important the monetary component of inflation acceleration (from the beginning of the year through July, M2 monetary base has increased by 10.4%), but the experts and the Ministry of Economic Development have already increased the annual estimates of price growth (the forecast of the Ministry of Economic Development has increased from 6-7% to 7-8% and comments of the Ministry representatives indicate that the expected figure is closer to the upper indicators of that range).

Another change in the trend of previous months has been the decline by 11.1% at a time of excess reserves of commercial banks in July. This was due to the reduction of the banks' deposits with the Central Bank by 45%, which in turn is associated with a reduction in foreign exchange interventions of the Bank of Russia at the background of falling oil prices.

Favorable commodity market situation has formed positive trends in public finance. The volume of the extended government budget revenue exceeded the level of the relevant period of 2009 by 1.9 p. p. of GDP, while expenditures in relative terms decreased by 2.6 p. p. of GDP and budget expenditures in absolute terms growth reached 711 billion rubles. This was possible due to a significant growth in revenues from foreign economic activities, revenue from mineral extraction tax and tax on corporate profit. In general, it can be noted that the level of tax burden on the economy for 6 months of 2010 increased by 2.6 p. p. of GDP as compared with the relevant period of 2009 (from 29.8% to 32.4% of GDP). In relative terms, a reduction occurred in all major areas, whereas the increase of revenues was observed only in the budget line of "social policy" and amounted to 1.7% of GDP in relative terms and 37.5% in absolute terms (expenditures have grown by RUR 739.6 billion), while the largest reduction was observed under the line of "national economy" - by 2.1% of GDP in relative terms and by 23.5% in absolute terms (reduction by RUR 243.5 billion).

In August 2010 the Treasury of Russia has disclosed preliminary results of the federal budget execution for the first six months of this year: federal budget revenues in January-July 2010 amounted to 18.8% of GDP, which is by 0.8 p.p. of GDP higher than the indicator in the same period of 2009, while federal expenditures for seven months in 2010 decreased by 1.2 p. p. of GDP against their level in the same period of the last year.

As a result, within January-July the federal budget is executed with a deficit of 2.2% of GDP against 4.2% of GDP in 2009. However, the amount of non-oil sector deficit, according to preliminary data, has increased by 0.2 p. p. of GDP against the parameters of the previous year and amounted to 10.7% of GDP. We would like to remind that according to recommendations of the World Bank, its value should not exceed 5% of GDP. The the Reserve Fund remained the key source for the federal budget deficit funding. Its size in 7 months has decreased by RUR 605.3 billion to RUR 1.2252 trillion, though its total depletion before the end of 2010 will not happen due to the expected amount of the federal budget deficit, and part of the funds will be allocated to cover the budget deficit in 2011.

Real Sector

The preliminary data of July again demonstrated the instability of the trend towards economic recovery. The data on economic growth and industrial production in July are below the expectations for the second consecutive month. After GDP growth by 2.9% in the first quarter and by 5.2% in

the second quarter of 2010 in comparison with the corresponding period of previous year, in July, according to the Ministry of Economic Development, GDP has declined by 0.3% against June of this year (with the exception of seasonal factors). Therefore, according to preliminary results of seven months of 2010, GDP growth reached 3.8% against 4.0% in the first six months of the relevant period of the previous year. In July, as compared with the preceding month, industrial production growth in general was 1.0% with an increase in mineral production and distribution of electricity by 2.9% , gas and water supply by 2.0% and the downgrading in manufacturing by 0.4%. The decrease in investment demand was most pronounced in the dynamics of machinery and equipment production (74.8% against June of 2010) and vehicles production (92.2%).

A reduced demand for labor in the industries, especially in construction and agriculture has led to a resumption of growth in unemployment of the economically active population from 6.8% in June to 7.0% in July. The number of unemployed in July (assessed by the Ministry of Economic Development methodology) amounted to 5.4 million people, which has exceeded the rate of June 2010 by 0.2 million people. Moreover, it should be noted, that in June-July a wider practice of part-time employment was recorded.

The main obstacles for the accelerated economic recovery were the unstable dynamics in demand and low investment activity.

Capital investments in January-July 2010 increased by 1.3% at the background of the decreased investment demand to 20.4% against the relevant period of the previous year. The dynamics of investment during the current year remained extremely volatile, reflecting continuing influence of the factors that have emerged in the acute phase of crisis in the late 2008 - first half of 2009. In 2010, index of business activity in construction sector remained within negative values. The scope of works in construction during January-July 2010 amounted to 97.0% of the 2009 level, residential area commissioning - to 95,9%. One factor that strengthened the decline in investment activity in July 2010 was a distraction of resources in view of the adverse climate conditions. In July 2010, as compared with June of this year, the reduction of investment in fixed assets amounted to 10.7%, the work scope in construction – by 2.8% and residential area commissioning - by 39%.

Industrial surveys of Gaidar Institute demonstrate uncertainty about the dynamics of demand among producers. Number of demand rating as «normal» and «below normal» ranges in recent months are fluctuating around the point of equilibrium – there is no certain trend in demand, which creates a disincentive in the industry. In the August surveys there prevailed negative assessments and expectations, whereas estimates of expected demand were worsening for the second consecutive month. The optimism of the year beginning, when the companies expected sales growth at the rate of +11-13 p.p. have nearly faded away. This problem is also evident in regard to the estimates of stocks of finished products and plans for their replenishment. For the second consecutive month the companies report there is a lack of surplus stock of finished products in their warehouses, while only 8% of enterprises have no intention to increase the stocks.

Finally, the surveys demonstrate that the balance of assessments of the actual enterprises output (those declared an increase in the output minus reported decline) in August remained at the level of preceding months (+15 points). However, the balance in the estimates of the expected rate of output has declined in August as compared with the July estimates and are lower since the beginning of the year. This is all the more remarkable, as the August surveys show a further increase of confidence in business credits availability - in August, 69% of the enterprises have confirmed the availability of credits. Therefore, the surveys testify in favor of the conclusion that not the lack of financial resources, but the uncertainty in the dynamics of demand remains the main obstacle to economic growth.

In general, we can say that the stagnation of economic activity and the inflation upsurge were dominating among the economic trends at the end of summer 2010. How long or short their term is, and to what extent they are dependent on climate anomalies will be the major issues this autumn. ●

THE POLITICAL AND ECONOMICAL RESULTS OF AUGUST 2010

S.Zhavoronkov

In August, Russia suffered some serious losses as a result of an anomalous heatwave that spread across the entire Central Region causing large-scale fires and destruction of crops and forests. This time, fires reached such an intensity that they got out of control, and so firefighting presented a serious issue necessitating the introduction of emergency regimes in a number of regions. As a protective measure against an upsurge of grain prices, the RF Government established a ban on grain exports until the end of this year – the effect of this measure being rather doubtful in a situation where there exist sufficient government and private reserves. The new draft law ‘On the Police’ was published in order to be discussed; it contains no fundamental innovations and, in fact, it reendows the law enforcement agencies with many of the powers that have been taken from them over the last two years as part of a campaign aimed at limiting the State’s interference in the economy. The politically minded citizenry were stirred by the results of some large-scale rallies; thus, in Kaliningrad, Governor G. Boos was dismissed from his post; and in Moscow Oblast it was announced that the construction of the new Moscow - St. Petersburg Highway was suspended, to provide time for an additional discussion.

This August, the principal news had to do with the climate situation. In Central Russia, an anomalous heatwave that hit this country in July continued until nearly the very end of August. Nothing like this has been remembered by the residents of Moscow and the neighboring oblasts – at least by the current generation of them, while synoptic weather compilers insist that no such weather has been recorded for centuries. The end of July was marked by an onset of some serious fires, and on 2 August D. Medvedev, by a President’s Edict, introduced a state of emergency in several regions that were suffering from fires: Riazan Oblast, Vladimir Oblast, Voronezh Oblast, Moscow Oblast, and Nizhnii Novgorod Oblast; the Republic of Marii El and the Republic of Mordovia. According to official statistics, there were 53 fatalities, housing was destroyed on a large scale (mainly in villages, but in some places fire managed to spread into oblast capitals – as it happened, for example, in Voronezh). Agriculture incurred considerable losses: thus, planned targets for wheat crops were decreased from 90 mln tons in spring to 65 – 70 mln t in August, a level that roughly corresponds to the actual level of Russia’s domestic consumption. Other areas of agriculture also suffered – first of all, livestock breeding; and there arose a deficit of buckwheat. In some regions bread and dairy prices went up significantly. Meanwhile, the food situation in the country remains rather stable – both due to the available stock (the draught affected only part of the country but by no means its entire territory, and so there still remains nearly 10 mln tons of last year’s rich crops in the intervention fund, and there are also some reserves – by no means small – in government strategic reserve funds and in private storehouses) and to import of some types of food (first of all, meat); while revenues from agriculture have never played a key role in the state budget.

In August, Prime Minister V. Putin signed a decree concerning the introduction of a temporary ban on export of wheat, barley, rye, corn, and wheat and mixed wheat/rye flour – from 15 August through 31 December, extending this ban onto the already concluded contracts. *‘How we are going to behave after this December – we are going to speak of it later, judging by the results of the harvesting campaign... Stocks are never too big for one’s pocket.’* It is not the exporters that his decision hits hardest – they may abstain from fulfilling their contracts because of the *force majeure* circumstances, and for some the ban may even be beneficial because it had been becoming problematic for them to actually fulfill their contractual obligations that were agreed upon on the basis of a very different situation on the market, before Russian domestic prices began to grow. In fact, it were grain producers that suffered most, particularly in the south of Russia where it was for most part grown for export. Theoretically, this decision is designed to protect consumers – but for their

protection there already exists a special measure, namely the government intervention fund that can be used as a source of grain reserves that can be sold on exchanges or distributed under quotas between the regions affected by poor harvest.

Russian authorities also declared that they would be strengthening, through the Federal Antimonopoly Service, the special instruments of control over the level of prices. In particular, D. Medvedev urged officials ‘... to explain, to inform as to what stocks we have in store, so that cut short any attempts at speculation... There are always people who try to take advantage of the situation... It is necessary to explain, and as for those who are trying to present situation as more horrible than it actually is – they must be punished instantly. You and the antimonopoly structures have all the necessary mechanisms’. However, it is unlikely that this can produce any real results on such a highly diversified market as the agricultural one.

In this connection, it is still unknown what measures are being planned in the sphere of forestry and with regard to the Ministry for Emergency Situations, where the existing situation in terms of preparedness to adequately respond to the threat of fires has been found to be catastrophic. Thus, for example, it appears that the entire territory of Russia is served by only four specialized firefighter airplanes, while in the spring of 2010 *Rosleskhoz* (Federal Forestry Agency) made large-scale cuts of its staff across the central oblasts, thus reducing their number by 20 – 25 % (while the total number of forest wardens dropped by several times during the ‘zero years’). There was no coordination of the large-scale volunteer movement to combat fires, there were shortages of firefighting equipment, and so on. Meanwhile, the only thing that has actually been done was the dismissal of *Rosleskhoz*’ head A. Savinov, with the appointment to his vacant post of his deputy – V. Masliakov, the former personal assistant of V. Zubkov .

When speaking of natural disasters, one cannot overlook one big manmade disaster – a blackout that occurred in the St. Petersburg’s grid which in its scale is compatible with that which happened in May 2005 in Moscow, at the electric power sub-station *Chagino*. Late on 20 August the sub-station *Vostochnaia* shut down, it being part of FGC UES [Federal Grid Company – Unified Energy System] (Unified National Electric Grid), then - just as it happened in Moscow five years ago – there followed a cascade of shutdowns of other sub-stations belonging to the FGC UES and of TGC-1’s power plant. About half of the city of St. Petersburg and Leningrad Oblast were left for a few hours without electricity. *Vostochnaia* – similarly to *Chagino* – is one of the oldest sub-stations, where capital repairs have been in progress for two years. In contrast to what happened five years ago, the blackout gave rise to no political scandal and no dismissals of officials. According to official declarations, the cause of the disaster was one of the last remaining old wires that had not yet been replaced. At the same time, this second big manmade disaster raises the issue of the efficiency of the very concept of FGC UES being a state-owned company. When reforming of the power engineering industry was just being mapped, it was justly pointed out that it needed investments, and primarily private investments. In actual practice it happened so that its most technologically backward and disaster-prone component – the grid system – remained in the hands of the State.

In August the public was at long last presented with the long-awaited draft Federal Law ‘*On the Militia*’ – or, more correctly, ‘*On the Police*’ (because the force’s new name is envisaged in the new law). According to D. Medvedev, the public discussion of the law is to continue till mid-September. However, as it has turned out, the draft law contains few innovations – it completely overlooks the much-discussed concept of dividing the Ministry of Internal Affairs (MIA) into ‘the police’ responsible for dealing with some limited areas of crime like organized crime, corruption, terrorism, etc., and the regional or local ‘militia’ performing its habitual functions of keeping public order and preventing domestic crimes¹. The new Law says nothing at all with regard to the MIA’s structure – there is only a statement that it is to be determined by the RF President.

The published draft law is effectively a large-scale ‘counter-reform’ aimed against all those changes that have been introduced by the Federal Law ‘*On the Militia*’, in order to specify the acts of the militia personnel and to minimize their interference with economic activity. The core idea of the Law is to considerably expand the rights granted to the militia personnel, in particular it effectively reintroduced the notorious Item 11 of Article 25 of the existing law that granted to the

¹ Even at present, the militia responsible for public safety is in part financed from regional budgets; now it is suggested that it should be financed in full from the federal budget.

militia personnel the right to check everybody and to confiscate anything, and was then abolished (in the new draft Law it is formalized as Item 3, Item 5, Item 12 of Article 13, and as stipulations in some other articles). Any action undertaken by a policeman is *apriori* declared to be lawful until a court decision is made (Item 2 of Article 32 of the draft Law), the actions of the police are no longer subject to prosecutor supervision (which previously served as a major counterbalance). The draft Law contains numerous legal and even lexical oddities, and in many places is contrary to the RF Constitution's provisions – the latter envisaging that citizen rights cannot be restricted other than by the law (consider, for example, Item 2. of Article 5 of the new Law: *'The activity of the police which restricts the rights and freedoms of citizens shall be immediately discontinued if the lawful goal is achieved, or it has been found out that it cannot or must not be achieved in such a manner'*). There are also many seemingly trifling but actually important provisions designed to significantly expand the powers of the police. Thus, for example, by Article 14 it is established that means of transportation can be checked by any police official, and not only by the GIBDD [State Inspectorate for Road Traffic Safety] - as it happens at present. Article 15 considerably expands the right to enter citizen's homes; Article 19 established the right to use firearms without warning if the latter is 'not appropriate', instead of only in an event of a crime directly being committed – as it is done now; Article 47 reestablished the in-kind benefits in the form of free medical services, etc.

At the conference held in August at Piatigorsk, D. Medvedev noted that *'... I periodically look though the comments, a considerable part of these are critical, and this is normal.'* Medvedev said that in the distant future *'... it will be necessary to create such a police system that would possess a powerful federal component, a powerful regional component, and a municipal one.'* But at first, *'in the draft law the federal model is consciously applied, it is necessary to consolidate, to put together the system itself.'* D. Medvedev rejected the idea of a special professional training of policeman, citing as an substantiation for his viewpoint the fact that *'many people who studied with me at the same department [at the University] have become respected militiamen.'*

As a matter of fact, it can be said that the draft Law, instead of the expected fundamental innovations, offers a throw-back to the Law *'On the Militia'* as it existed many years ago. Of course it is by no means certain that all the counter-reform components of the Law are going to be approved by parliament – some of them will probably be removed by the results of the discussion.

August also saw further development of two regional political conflicts that are now resonating at the federal level. Both these conflicts have to do with mass protests on the part of the public. In Kaliningrad, G. Boos was not re-appointed to the post of Oblast Governor. Back in January, the region witnessed the most prominent protest action over the last few years, where more than 10,000 people rallied in order to voice their economic and political demands directed personally against Boos, as well as against authority at large. The Governor, however, has not been idle during the next six months: he managed to come to terms with some of his public and non-public opponents (who previously spoke about property redistribution in the region and the dominance of 'Muscovites'). As a result, they now supported his re-appointment. Besides, the Governor abolished the raising of transport tax in the oblast and generally declared a course towards 'correction of mistakes'. A few more rallies were held across the Oblast, but these were no longer on such a mass scale. As early as May, *United Russia's* leader B. Gryzlov spoke of re-appointing Boos for a new term in office. However, in the end it was promised to Boos that he would get a job in Moscow, and the region is now headed by a local – N Tsukanov, head of Gusevskii raion, the smallest in the oblast but the one that is developing rather rapidly.

In Moscow, a concert – rally was held which drew a few thousand people; it was not, however, the number of spectators that made the headlines but the active participation in the concert of a large group of rock musicians led by Yu. Shevchuk who has been represented in the media over the last few months as one of the main – if not the most prominent – opposition figure. The concert's declared goal was to support the Khimki Forest, or more specifically – to fight against the cutting down of a part of it in order to clear the way for the new Moscow - St. Petersburg highway. Just as it happened in Kaliningrad, these events were by no means of a purely political character – they were backed by some strong economic interests because the available alternative routes will involve the necessity to buy out lands owned by big businesses, while the formal leader of the movement 'For the Khimki Forest' O. Chirikova for a long time worked with O. Mitvol, Pre-

fect of the Northern Okrug of Moscow. D. Medvedev issued a regulation that suspended the construction work (that had already been half-completed), so as to provide more time for an additional consideration of the issue.

Towards the end of summer, V. Putin gave a long interview to *The Kommersant*' newspaper, mainly dealing with domestic political issues – one of the key themes being the protest actions: *'What does existing legislation say about a march? It is necessary to get the permission of the local authorities. You got it? Then go and demonstrate. If not – you have no right to do so. You have gone out without having a right to do it – so get hit on the head with a truncheon. That is all!'* This time, he spoke specifically of the actions that had been held for more than a year on *Triumfal'naia Ploshchad* [Square of Triumphs] in Moscow on the 31st of each month by a variety of opposition figures voicing their demands for executing their right to the freedom of gatherings¹. These actions have never drawn a lot of people, but gradually they began to attract public attention because of the detainment by the police of many well-known participants, and also by the absurd reasons for the authorities' refusal to allow a rally that were given in their official replies to applications (in the most recent reply it was officially (!) suggested that the applicants should change their surnames), thus becoming something like a soap opera for the Russian and foreign press. As a result, in August it was announced that the construction of an underground parking facility would be started in *Triumfal'naia Ploshchad*, and so the future refusals to allow a rally would sound logical from the point of view of the law, but it is by no means certain that there would be no more rallies elsewhere.

Although in the case of the Khimki Forest there is no guarantee that the protesters will eventually win, nevertheless both these cases have demonstrated that mass protests remain an effective method of exerting pressure on the authorities, especially if the political activists do not demand too much, and their demands can be satisfied without actually overthrowing the existing political regime in the country. Moreover, even minor radical actions like the unsanctioned rallies on the 31st draw public attention in a situation of absence of any competitive policies – at least at the federal level.

Also in August, D. Medvedev rather perplexed the analysts by declaring that someone else beside himself and Putin could aspire to become head of the State at the 2012 election. *'I do not know what will happen, I do not know who would run [for presidency] ... It can be Medvedev, it can be Putin, and it can be a third person. It is necessary to provide this country with opportunities for stable development; the country must live according to a predictable scenario.'* This time, the statements made by the head of the State caused practically no response - first, people have already got used to their vagueness; secondly, they confirm that in future we can expect some 'coordinated decision', and thirdly, time has begun to work against Medvedev – as the year 2012 is drawing nearer, while no fundamental changes are occurring in this country, Putin's return to the execution of official presidential powers in 2012 becomes an inertia-oriented basic scenario of development. ●

1 A reference to Article 31 of the RF Constitution establishing the right of citizens '...to gather peacefully, without weapons, and to hold meetings, rallies, demonstrations, marches and pickets'.

INFLATION AND CREDIT AND MONETARY POLICY

N.Luksha

In July, the CPI remained unchanged as compared with June, remaining still lower than in the past year (0.4 per cent against 0.6 per cent). However, in the first three weeks of August inflation accelerated noticeably to 0.6 per cent, having exceeded the relevant period of 2009 by three times. Nevertheless, the cumulative inflation since the beginning of the year to August 23 (5.4 per cent) remains significantly below the previous year (8.3 per cent). During July and three weeks of August foreign currency and gold reserves increased to 475.2 billion dollars. In July, the real effective exchange ruble rate continued to decline (-0.8 per cent). In July and August, the Bank of Russia has kept its refinancing rate unchanged.

In July, consumer price index remained unchanged as compared with June and in monthly terms made 0.4 per cent, having matched the upper limit of the Ministry of Economic Development estimates (see Fig. 1). The largest contribution to the rise in prices in July has made a rise in public services sector (0.6 per cent).

Growth rate of prices for commercial services has accelerated. In the midst of the summer holidays prices continued to rise in for international tourism services (+3.4 per cent), passenger transport (+2.5 per cent) and health resort services (+1.9 per cent). Herewith, insurance services have become even cheaper (-0.2 per cent). Price decline was also noted in communication services (-0.3 per cent).

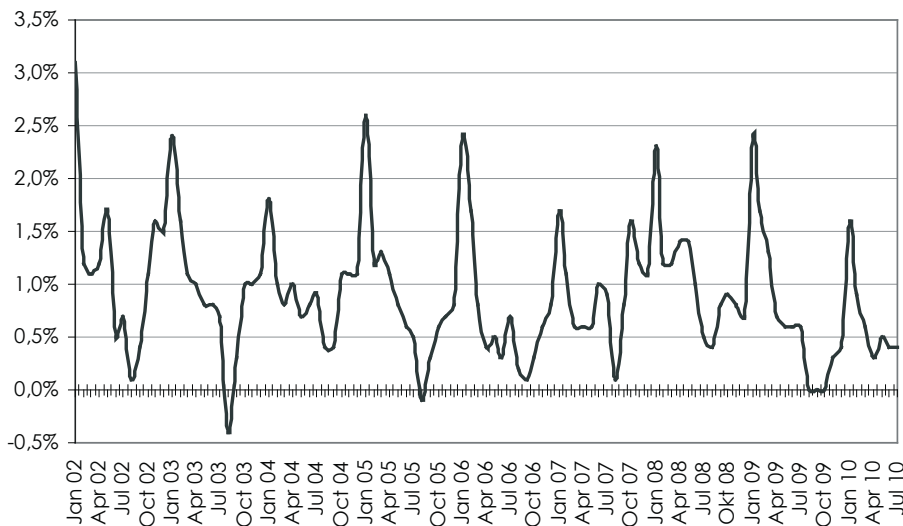
The growth rates in food products prices has somewhat slowed down as compared with the previous month and amounted to 0.3 per cent, which was contributed most to the seasonal decline in prices for fruit and vegetables (-0.6 per cent). In turn, the continued price increase for buckwheat (in July it increased by 12.6 per cent, and since the beginning of the year by 38.9 per cent) has spurred up the price for cereals and beans, which rose by 3.9 per cent over the month. In July, sugar has ceased to decline in price, its price increase amounted to 6.6 per cent.

In July, the growth rate of prices for industrial goods has somewhat accelerated (+0.3 per cent). As in previous months, the utmost increase in this commodity group prices was observed in tobacco products (+1.1) and gasoline (+0.9 per cent). In July, audio-video goods and medicines continued a decline in prices (-0.3 per cent). Prices of electrical goods and other household appliances, in contrast, have ceased to decline (+0.1).

In August, inflation has accelerated, having reached 0.6 per cent within three weeks (against 0.2 per cent in 2009). Consumer prices increased steadily by 0.2 per cent in the week. Accelerating inflation was not unexpected. First, in the third week of seasonal downgrading rate of fruit and vegetables from 0.6-0.8 per cent and in the first week to 0.2 per cent, which was the result of the lean dry summer. Growth in consumer prices has also inspired consumer demand for some food products, such as buckwheat, flour and millet. In addition, the wave of panic unexpectedly pushed up prices for dairy products, meat and poultry (usually a lag between the increase in grain prices and the rising cost of meat and dairy products, according to experts, is 3-6 months). Apart from objective reasons for the rise in prices (crop damage), there occurred as unjustified increase in prices for some foodstuffs, associated with high monopolization of the food market. In this regard, from the second half of August, FAS has initiated several proceedings against producers.

Drought and inflation expectations will make an upward pressure on consumer prices in the next month. An additional acceleration of inflation factor in the autumn will be the continuing growth in monetary supply (since the beginning of the year to July, the monetary supply M2 increased by 10.4 per cent).

In late August Ministry of Economic Development has increased the official estimates of annual inflation from 6-7 per cent to 7-8 per cent. However, in the opinion of A. Klepach, Deputy Head



Source: RF Statistical Service.

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

(+2.4 per cent), correspondent accounts of credit organizations with the Bank of Russia made RUR 605.2 billion (+ 0.3 per cent), mandatory reserves made RUR 180.8 billion (+3 per cent), deposits of the banks with the Bank of Russia made RUR 350.7 bn (declined times 1.8), the value of shares of the Bank of Russia with credit organizations made RUR 1035.8 bn (+3.6 per cent).

It is worth noting, that in the third quarter a seasonal restriction of the monetary base is observed traditionally. On the one hand, this is explained by the dynamics of household incomes. In June, the vacation bonuses release inflated the monetary base. As a result of additional consumer spending, money were transferred from cash to the non-cash form and the monetary base has decreased.

On the other hand, if you pay attention to the structure of the broad monetary base, you can see that its decline was due to almost two-fold reduction in deposits of credit institutions with the Central Bank. The banks accumulate excessive liquidity in deposits with the Central Bank, which in previous months, was accumulated due to at the purchases of foreign currency by the Bank of Russia to curb the ruble rate growth. In July, in view of lower oil prices, the Central Bank lowered the foreign exchange intervention by more than 3.5 times to nearly USD 500 million. The outflow of deposits from the banks happened due to the paid taxes, which were not offset by foreign currency intervention.

In July, the excessive reserves of commercial banks² have stopped their growth, having reached as of the month result RUR 1991.7 bn. Thus, they decreased by RUR 248.7 billion, or 11.1 per cent. This happened because of the reduced deposits of the banks with the Central Bank by 45 per cent.

Crediting volume is growing in the banking sector for the fourth consecutive month. According to the RF Central Bank, credit portfolio in the banking sector increased by 3.4 per cent. In July of loans to non-financial sector increased by 0.3 per cent, which was nevertheless lower than the June growth of 2.1 per cent. Growth rate of retail lending in July remained unchanged, amounting to 1.6 per cent per month.

In June the growth of the volume of cash in circulation by 2.4 per cent with the simultaneous increase of mandatory reserves by 2.9 per cent urged the extension of monetary base in narrow

of Ministry for Economic Development and Trade, apparently the inflation will stay within the range of 7.5–7.8 per cent.

The basic CPI of consumer price index¹ in July 2010 has made 0.4 per cent (versus 0.3 per cent in the relevant period of 2009).

In July, for the first time from February, the monetary base in broad definition has decreased: as of the month results, it has decreased to RUR 7117.6 bn (by 1.7 per cent). Cash in circulation with regard to the fund balances in credit organizations on August 1 has reached RUR 4.9 trillion

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

2 Under the excessive reserves of commercial banks in the Central Bank rating if understood the sum of correspondent accounts of commercial banks, their deposits with the CB and the CB bonds from commercial banks.

definition (cash plus mandatory reserves)¹ by 2.4 per cent to RUR 5,125.8 bn (see Fig. 2).

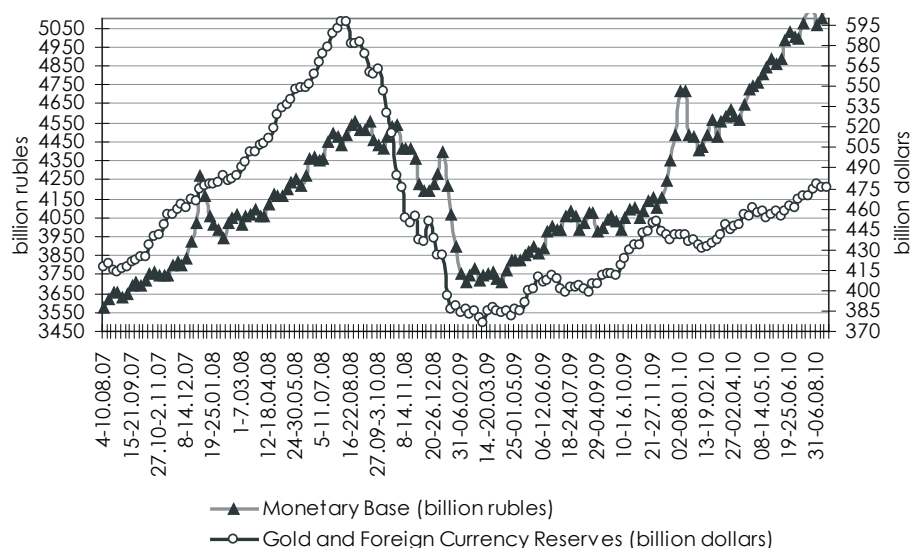
In July, foreign currency and gold reserves of the Central Bank continued to grow. Their volume increased within the month by 3 per cent to USD 475.3 billion. In three weeks in August foreign currency and gold reserves remained virtually unchanged.

The real effective exchange rate in July continued to decline (-0.8 per cent). Accordingly, the index of real effective exchange rate has also decreased: as of the month results, it made 142.93² (see Fig. 3).

In late August, Ministry of Economic Development has revised the outlook for the growth of real effective exchange rate for the next 3 years³. The amendment of the assessment caused by the adjustment of inflation expectations and lowered estimates of Euro against the US dollar. Thus, according to the new assessment, in 2010 growth of the real effective exchange rate will amount to 10.7 per cent (against 12.3 per cent against previous outlook); in 2011 – 5.7 per cent (against estimated 4.8 per cent), in 2012 - 0.1 per cent (versus 2 per cent). Ruble strengthening will stop, according to the latest assessments, in 2012, rather than in 2013, as estimated before. In 2013, the weakening will make 2.1 per cent (against the forecasted growth of 0.4 per cent).

Over the total month of July the dollar was falling down, having reached the minimum of August 5 (RUR 29.8 per US dollar). The dollar dropped down below USD 30 rubles per USD 1 for the first time since May. The weakening of the USD had an impact, on the one hand, of the rise of oil prices above USD 80 per barrel on the other hand, and the tense economic situation in the global markets on the other hand. Since early August for nearly three weeks the dollar was growing, which was due in particular to the behavior of the Euro / dollar rate in FOREX market. We would like to recall that within a month of July and at the beginning of August, the Euro was going up rapidly against the dollar, and then market participants have started to record their profits. However, the growth of the dollar was short-time. At the end of the month the emergence of negative data on the U.S. housing market, unemployment and adjusted data on the US GDP in the second quarter (economic growth was 2 percentage points lower than in the first quarter) once again pushed the dollar downwards. In general, during July and August, the dollar weakened by 1.9 per cent, to RUR 30.7.

The fall of Euro after its sustainable strengthening in July - early August was a reflection of worries about the state of the Euro zone economy: nearly in all EU countries economic growth has slowed down. In addition, the credit rating was lowered in one more of the Euro zone countries - Ireland. The next month is likely to reduce the rating for Spain as well. Such news had a negative impact on the Euro rate. Within two recent years Euro has strengthened by 2.1 per cent to RUR 39.



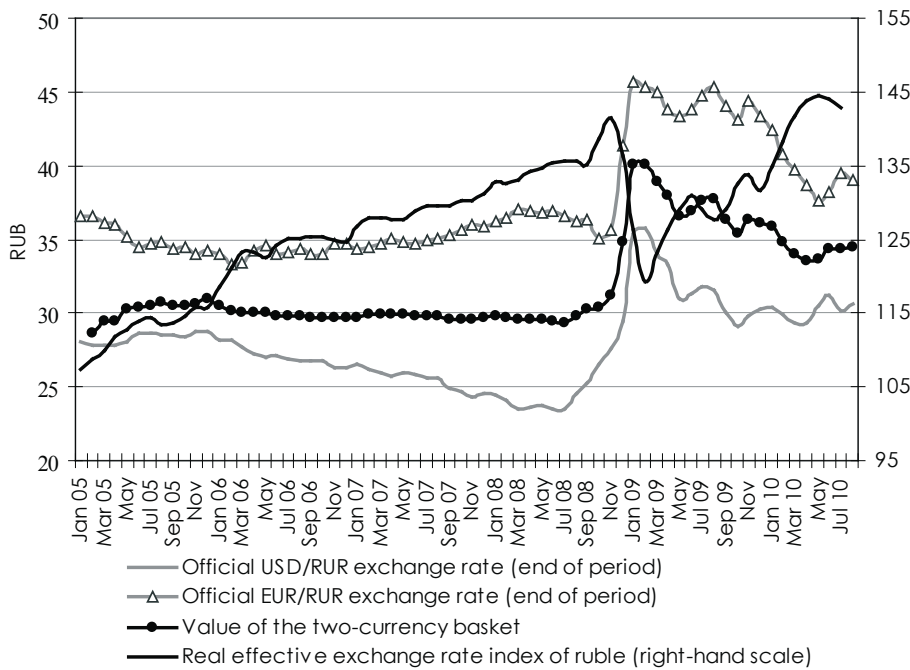
Source: RF Central Bank.

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

1 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.

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

3 RIA News (<http://www.rian.ru/economy/20100830/270503161.html>), 30.08.2010.



Source: RF Central Bank, author's estimates.

Fig. 3. Indicators of Ruble Exchange Rate Dynamics within January 2005 – August 2010²

Bank explained by the fact that the August price peaks are short-term and apparently will not have a medium-or long-term negative impact.

The RF Central Bank also states that if the current macroeconomic trends and moderate inflationary risks are sustained, the Central Bank, probably in the coming months, will leave the interest rates unchanged. However, in our view, the trend of accelerated inflation, outlined in August, can to raise the question of raising the interest rates in the near future. ●

As a result, in July-August, the value of the two-currency basket¹ has grown and reached RUR 34.43.

On July 30 and August 31, 2010 the Bank of Russia decided to leave unchanged its refinancing rate and other key interest rates on the RF Central Bank operations.

In July the reason for retaining the rates at the current level was the continued recovery in lending to the economy by the banking sector, improved the basic economic indicators, as well as the slowing inflation. In August, despite a slowdown in economic recovery and accelerated growth of consumer prices, the Bank of Russia nevertheless left interest rates at the existing level. That decision, the

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.

FINANCIAL MARKETS¹

N.Burkova, E.Khudko

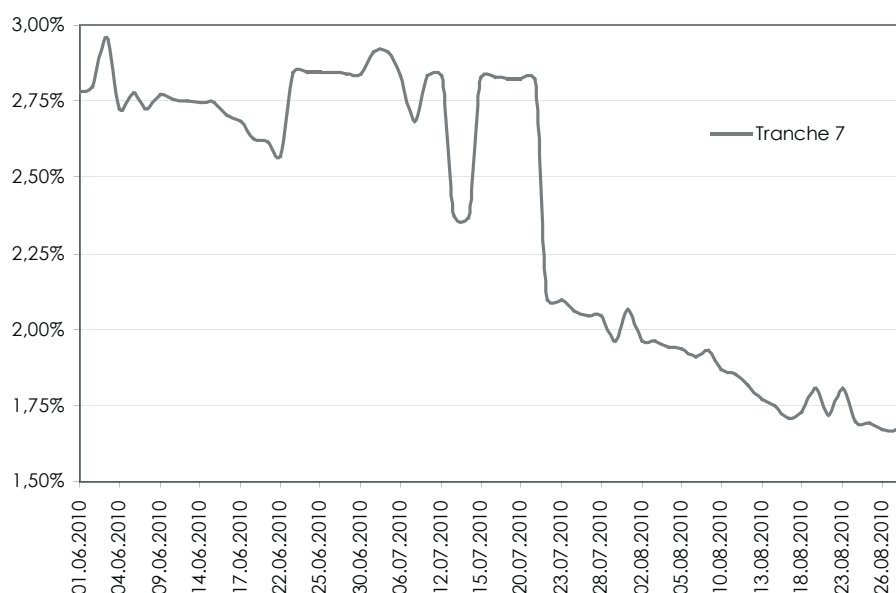
In August 2010 a general volatile dynamics was observed in the Russian financial market. Reducing the recovery rate of the world economy, volatile trends in oil prices, fluctuations in national currency, the reduction in gold and international currency reserves of Russia, the weather anomalies in the territory of Russia were reducing the activity of the bidders in the government securities market and in the MICEX derivatives market. However, the positive financial performance of several international and Russian companies and the high level of ruble liquidity contributed to the growth of government securities market by 12.5 per cent. Key indicators of the Russian domestic market of corporate bonds, i.e., market volume, the index of corporate bonds, indices of secondary trading, the number and volume of registered emissions have shown considerable growth. Average yield of corporate bonds remained at the historic lowest level, whereas the investors' interest remains high to the long-term investments in municipal obligations. The main problem remains the failure of the issuers to perform their obligations to the bond holders and rare cases of debt restructuring.

Government securities market

The volatile dynamics of oil prices, volatility of global stock markets and the national currency of Russia, as well as the high liquidity level have contributed to the growth of investors' interest in the government securities market in August 2010 against the background of downward dynamics of the Russian Eurobonds yield. Herewith, the demand of market participants was selective and more evident in the most liquid emissions.

As of August 30 of the current year, the Russian Eurobonds RUS-28 yield to maturity has reduced as compared with the level of July 26 from 6.02 to 5.56 per cent per annum (by 7.38 per cent), RUS-18 – from 4.9 to 4.39 per cent per annum (by 10.43 per cent), RUS-30 – 4.85 to 4.42 per cent per annum (by 8.97 per cent), RUS-15 – from 3.85 to 3.72 per cent (by 3.17 per cent), and RUS-20 – from 4.99 to 4.47 per cent (by 5.71 per cent). As of the same date, a similar downgrading trend was observed in the yields of external currency debt bonds. Thus, the yield to redemption of the seventh tranche of external currency debt bonds has decreased from 2.06 to 1.72 per cent per annum (by 16.52 per cent) (see Figs 1- 2).

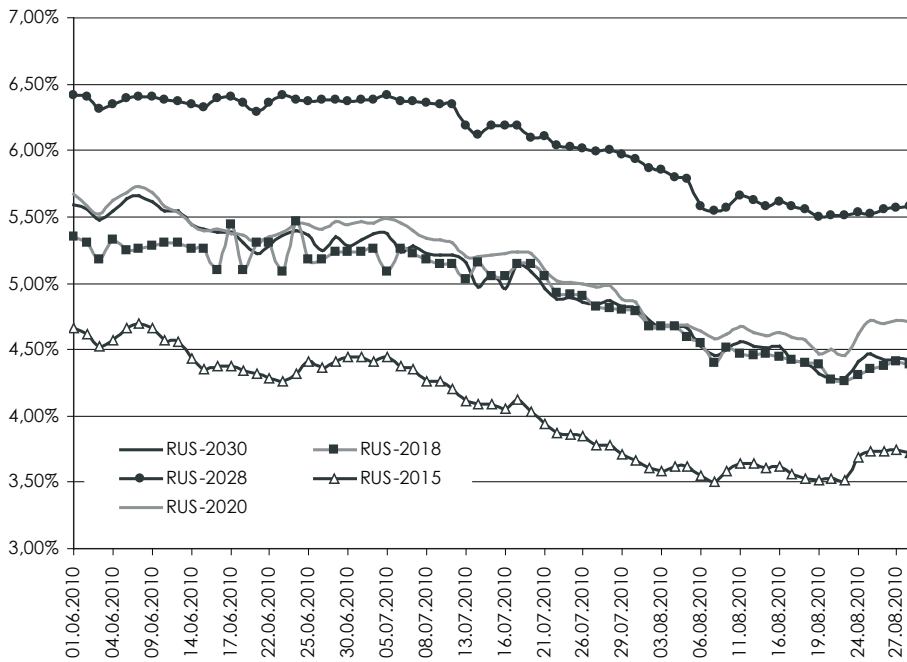
Within the period from July 27 to August 30 the total turnover of the secondary market of government bonds amounted to approximately RUR 162.23 billion with an average daily turnover of RUR 6,49 billion (about RUR 127 billion with an average daily turnover of RUR 5,77



Source: "Finmarket" Information Agency data

Fig. 1. Minfin bonds' yields to maturity in June – August 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 June – August 2010

billion in July), which means the decrease of an average monthly turnover by 12.5 per cent.

In the period from July 27 to August 30, there were ten auctions on government bonds additional placement at the primary government bonds market (a month before there were seven auctions). Thus, on July 28 there were three auctions for government bonds series 25073, 25074 and 25075 for the total volume of RUR 25, 10 and 30 bn; the actual volume of placement made RUR 1,69, 1,39 and 26,53 bn with an average weighted yield of 5.82, 4.39 и 7 per cent per annum, accordingly.

On August 4 there were two auctions on government bonds placement series

25072 and 26203; the total placement volume was RUR 8,76 and 23,08 bn each with the average weighted yield of 6.14 to 7.15 per cent per annum. On August 11 there were arranged two auctions on government bonds placement series 25074 and 25075 for RUR 5 and 20 billion, actual placement was RUR 3.87 billion and 7.02 billion with the average weighted yield of 4.38 per cent and 7.07 per cent per annum, accordingly. On August 18 there were also two auctions on additional government bonds placement series 25071 and 25073; the total placement volume was RUR 20 bn each, with the average weighted yield of 1,15 and 18,57 per cent per annum, accordingly. On August 25 there was an auction on government bonds placement series 26203; the total placement volume was RUR 1.34 bn with the average weighted yield of 7.39 per cent per annum. . Moreover, in the Therefore, the total volume of placement for the period under review was RUR 49 per cent (42 per cent a month earlier), which demonstrates a increased interest to the primary sector of government bonds period under review there was an auction on additional placement in the secondary market of government bonds series 25074 (there were no auctions in this market a month before); the total placement volume was RUR 33.54 bn with the average weighted yield of 4.48 per cent per annum. Therefore, the total volume of placement for the period under review was RUR 52.6 per cent (34 per cent a month earlier), which demonstrates an increased interest to additional placements in the sector of government bonds in March. This trend reflects an upward dynamics in the market of government bonds.

As of August 30, the volume of government bonds market made RUR 1,637.84 bn at face value and RUR 1,659.37 bn at the market value (as compared with RUR 1 541.75 bn and RUR 1 574.39 bn accordingly as of July 26). The duration of the OFZ market portfolio was 1 511.72 days, having decreased by 31.54 days as compared with the preceding month (as of July 26).

Stock market

Stock market situation

In August 2010, the volume of trading in the stock market continued to decline against the background of ongoing volatility in the global financial and commodity markets, the federal budget deficit of the Russian Federation as of January-July 2010 results, according to tentative estimates, amounting to RUR 538.8 billion (2.2 per cent of GDP), growing level of unemployment in July, up

to 7 per cent, higher inflation in Russia due to the drought, decline in foreign currency and gold reserves, on the one hand, and the Russian government plan to privatize 11 national companies, sustained refinancing rate of the RF Central Bank at 7.75 per cent, information about the growth of Russian GDP to 3.8 per cent within 7 months of 2010 and trade surplus Russia (up to USD 37.4 billion) in the II quarter of 2010, changes in international rating agency Standard & Poor's (S & P) rating outlook of OAO "Gazprom Neft" and OAO "Gazprom" from "negative" to "stable", on another hand.

We would like to note, that the abnormal weather in the country and smog in the capital had a strong effect on the stock market and led to a reduction in the number and activity of the bidders during the first half of the month.

The maximum value within the month the MICEX index has reached on August 2, having reached 1 429.36 points (1,396.92 per cent points in the preceding month). The minimum value for the period the MICEX index has reached on August 25 – 1 334.66 points (against 1 254.65 points in the preceding month) (Fig. 3).

In general, within the period from July 27 through August 30, the MICEX index has decreased by 1.87 per cent, what makes about 26.15 points in absolute terms (within the year, from August 31, 2009 through August 30, 2010, the MICEX index has been upgraded by 25.5 per cent). Over the same period, the turnover of trades in securities included in the MICEX index made about RUR 1,004 bn at an average daily turnover of RUR 40.16 bn (against about RUR 945.59 bn with an average daily turnover of RUR 42.98 bn in the preceding period). Therefore, the investors' average daily activity in the stock market in August has decreased as compared with the preceding period by 6.56 per cent. The indicators of maximum and minimum daily turnover in the market trades made, accordingly, RUR 49.5 bn (as of August 4), and RUR 25.87 bn (on August 30).

As of the month results (from July 27 through August 30), the majority of the "blue chips" securities have shown a downward dynamics. The leaders in the decline were Sberbank of Russia and Surgutneftegas, whose shares have decreased by 8.65 and 7.83 per cent, accordingly. They were followed by Rosneft, declined by 5.96 per cent, Gasprom Neft (5.05 per cent) and VTB Bank (3.52 per cent). The lower rates of decline were demonstrated by Gazprom (3.23 per cent), Tatneft (3.21 per cent) and LUKOIL (2.08 per cent). A reverse trend was demonstrated by Rostelecom, GMK Nornickel and Mosenergo, whose value has increased by 6.54, 4.44 and 2.1 per cent, accordingly (Fig. 4).

In August of the current year the MICEX turnover leaders were: "Sberbank of Russia" (33.33 per cent of the total turnover), Gazprom (17.37 per cent), GMK "Nornickel" (8.16 per cent), LUKOIL (5.97 per cent) and Rosneft (5.17 per cent). The total volume of transactions with the shares of those five «blue chips» was about 70 per cent (all «blue chips» - 8.16 per cent) of the total trades in shares at the MICEX stock market over the period from July 27 to August 30.

According to MICEX information, as of August 30, the top five leaders of the domestic stock market in terms of capitalization were: "Gazprom" – RUR 3 777.11 bn (RUR 3 829.90 bn a month earlier), "Rosneft" – RUR 2 091.66 bn (against RUR 2 155.03 bn), "Sberbank of Russia" – RUR 1 677.95 bn (against RUR 1,811.58 bn), "LUKOIL" – RUR 1 416.13 bn (against RUR 1 438.79

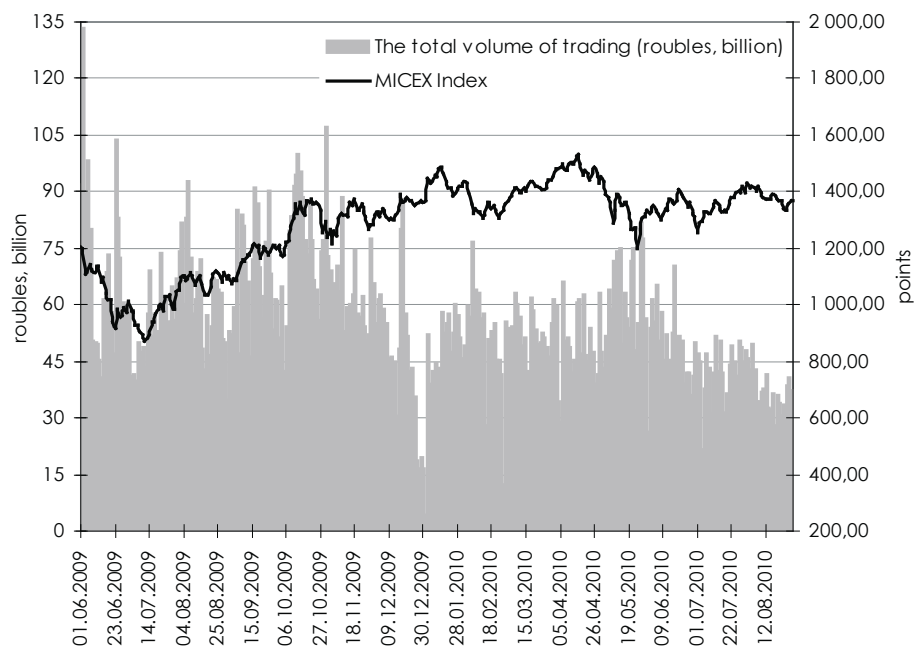


Fig. 3. Dynamics of MICEX Index and trading volume

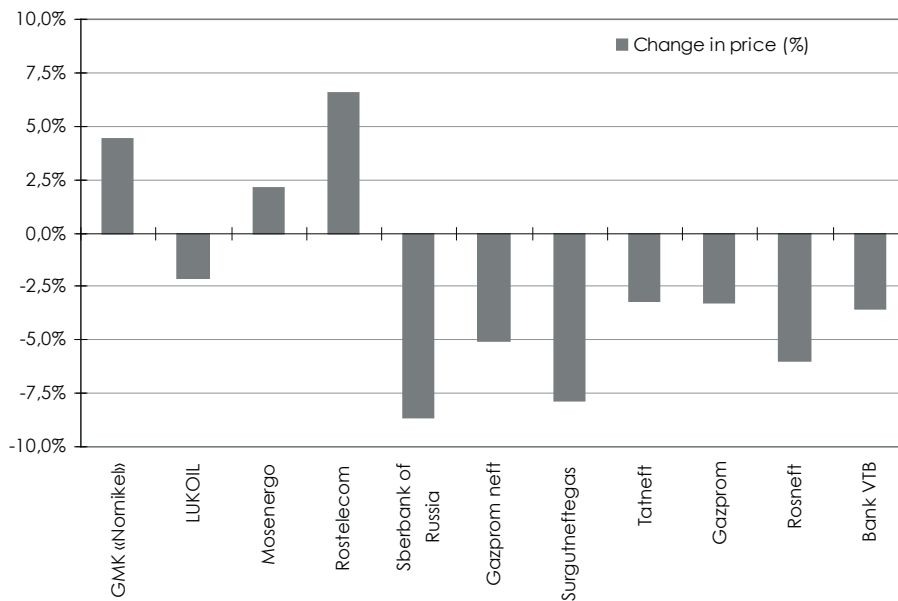


Fig. 4. Dynamics of the Russian Blue Chips from July 27 to August 30, 2010

(964.54 thousand of transactions, 3.23 mln of contracts) with an average daily turnover of RUR 6.55 bn in July. The largest volume of trading in August, like a month before, was observed in contracts for futures and equity instruments, amounting to RUR 121.29 billion (1.39 thousand of transactions, 1.22 mln of contracts).

In this case, in terms of the trading volume in this section, the MICEX derivatives market after the settlement of futures contracts for the MICEX index are followed by the futures supply contracts for the shares of Sberbank, Gazprom, Lukoil and Norilsk Nickel. We would like to note, that the value of the MICEX index (the price of transactions) for September 2010 was mainly in the range of 1 330-1 400 points, and in December – at the level of 1 330-1 410 points.

The second place in terms of trading volume within the month of August was taken by foreign currency futures (RUR 30.55 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/USD and for Euro rate. It is worth noting that prices of futures contracts, concluded in July for RUR/USD futures in the MICEX market were within RUR/USD 30–30.9 for September, and RUR/USD 30.5–31 for December. Trading volume in futures for commodity assets within the period under review has increased by 1.4 per cent (from RUR 4.4 billion to RUR 4.46 billion). There were no contracts for interest rate in August.

Opposite trends were observed in the RTS FORTS futures market, where the investors' average daily activity in August has increased by 3.5 per cent as compared with the previous month. Thus, in the period from July 27 through August 30 the total market turnover of futures and options in RTS made about RUR 2 676.93 billion (11.18 million of transactions, 55.41 million of contracts) with the average daily turnover at the level of 107.08 as compared with about RUR 2 276.23 billion (10.71 million of transactions, 50.41 million of contracts) with the average daily turnover of RUR 103.47 in July. 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 2 540.82 billion (10.98 million of transactions and 53.35 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, for Euro-USD rate and Gazprom shares. It should be noted that prices of the transactions, concluded in the RTS FORTS on futures contracts for the date of execution on September 15, were within RUR 30–30.8/USD, and for December 15, 2010 – RUR 30.1–31/USD.

The value of futures contract for the RTS index (based on the prices of recent contracts) with the execution date on September 15 was estimated on average at 1,400–1,500 points, for December 15, 2010 – 1,380–1,510 points. Options enjoyed far less demand, the turnover made about RUR 136.11

bn), Surgutneftegas – RUR 1 015.26 (against 1 081.78 bn rubles.

Futures and Options Market

In August the average daily turnover in the MICEX futures market has decreased nearly by 4.6 per cent as compared with the preceding month. Thus, in the period from July 27 through August 30 the total turnover in the MICEX (futures) market made approximately RUR 156,31 bn (1.98 thousand of transactions, 1.6 mln of contracts) with an average daily turnover of RUR 6.25 bn against RUR 144 bn

bn (197 thousand transactions and 2,06 mln of contracts). The maximum daily turnover in the short-term RTS futures market in the period under review made RUR 128.96 billion (as of August 11), and the minimum was RUR 82.58 bn (as of August 30).

External factors behind the Russian stock market dynamics

In August 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:

- net profit receipt for the first six months of 2010: by Swiss bank UBS in the amount of CHF 4.20 billion (against 3.37 billion Swiss francs of net losses in the first six months of 2009), by PSA autoconcern Peugeot Citroen SA – EURO 680 million (against Euro 962 million net loss in the first six months of 2009), by HSBC Holdings Plc. Group – USD 6.76 billion (against USD 3.35 billion a year earlier); in the II quarter of 2010: by the company Royal Dutch Shell- USD 4,5 billion (by15 per cent more than a year earlier), by Volkswagen autoconcern

- Euro 1.25 billion (4.4 times more than in the previous year), by banks, BNP Paribas – Euro 2,1 billion (against Euro 1.6 billion a year earlier), by Societe Generale – Euro 1,08 billion (3,5 times more than a year earlier), by Commerzbank AG – Euro 352 million (Euro 761 million net loss a year earlier);

- growth of U.S. GDP in the II quarter of 2010 as compared with the previous quarter by 2.4 per cent, according to preliminary data, and the review of data on the U.S. GDP growth for the I quarter of 2010 from 2,7 per cent to 3,7 per cent;

- information on reducing the number of initial applications for unemployment insurance in the U.S.;

- message of the European Central Bank about strengthening the economic activity in the II quarter of 2010 in the Euro area;

- a decision to keep interest rates by the European Central Bank unchanged at 1 per cent level, by the Bank of England - at the level of 0.5 per cent, by the Bank of Japan - at the level of 0.1 per cent, by the U.S. Federal Reserve - in the range of 0-0.25 per cent per annum;

- the Bank of Japan decision on mitigation of the national monetary policy;

- GDP growth in Germany in the II quarter 2010 by 2,2 per cent;

- increase in the trade surplus of China in July to USD 28.7 billion.

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

- publication of negative macroeconomic U.S. data about reduction the volume of orders for durable goods in June 2010 by 1 per cent against the previous month;

- information of the U.S. Federal Reserve about the slowing down the U.S. economy growth rates and of the Institute of Economic and Social Studies of Japan Government on a slowdown in the growth of the Japanese economy;

- consumer price index growth in the Eurozone by 1.4 per cent in June 2010 as compared with the same month in the preceding year;

- sustained rate of unemployment at 10 per cent in the Euro area in June 2010;

- reduction of the rating forecast of Iceland from “stable” to “negative” by the international rating agency Moody's Investors Service ;

- decrease of the bank UniCredit net income in the II quarter of 2010 by 70 per cent - up to EURO 148 million and the bank's plans to reduce the staff by 4.7 thousand employees;

- growing U.S. trade deficit in June 2010 to USD 49.9 billion;

- revision of the Bank of England forecast for GDP growth in the UK in 2010 from 3.4 to 2.5 per cent;

- decline in GDP in Greece in the II quarter of 2010 by at 1.5 per cent as compared with the I quarter;

- volatile dynamics of the global oil prices.

All those factors have generally resulted in the declined dynamics of the global stock indices in August, as of the month results. Thus, the markets of the developed countries were demonstrating a general decline in the indices by 3-7 per cent over the month, while the stock indices of the developing markets were reduced by 1-4 per cent. The exception was the indices of Switzerland Swiss Market, Chile IPSA, India BSE 30 and China Shanghai Composite, which have grown by

0.09, 2.77, 0.07 and 2.47 per cent accordingly. Herewith, there were observed decreased trends in the basic global stock markets indices of the developed countries, whereas those indices of the developing countries were demonstrating a positive trend (See Table 2 and Fig. 5).

Table 2

DYNAMICS OF THE GLOBAL STOCK INDICES (AS OF AUGUST 30, 2010)

Index	Ticker	Value	Dynamics within the month(%)	Dynamics since the year beginning(%)
MICEX (Russia)	MICEXINDEXCF	1 370,77	-1,87	0,06
RTS (Russia)	RTSI	1 427,11	-2,76	-1,21
Dow Jones Industrial (USA) Average (USA)	DJI	10 009,73	-4,90	-4,01
NASDAQ Composite (USA)	NASD	2 119,97	-7,68	-6,57
S&P 500 (USA)	SPX	1 048,92	-5,93	-5,93
FTSE 100 (UK)	FTSE	5 201,56	-2,79	-3,90
DAX-30 (Germany)	DAX	5 912,41	-4,55	-0,76
CAC-40 (France)	CAC	3 487,01	-4,10	-11,41
Swiss Market (Switzerland)	SSMI	6 205,24	0,09	-5,20
Nikkei-225 (Japan)	NIKKEI	9 149,26	-3,73	-13,25
Bovespa (Brasil)	BUSP	64 260,79	-3,28	-6,31
IPC (Mexico)	IPC	31 382,67	-4,78	-2,30
IPSA (Chile)	IPSA	4 487,45	2,77	25,30
Straits Times (Singapore)	STI	2 957,06	-0,33	2,05
Seoul Composite (South Korea)	KS11	1 760,13	-0,51	4,60
ISE National-100 (Turkey)	XU100	59 345,93	-0,27	12,34
BSE 30 (India)	BSE	18 032,11	0,07	3,25
Shanghai Composite (China)	SSEC	2 652,66	2,47	-19,06
Morgan Stanley Emerging&Frontier Markets Index	EFM	770,43	-1,25	-1,58

* – Versus index indicator valid on July 26, 2010.

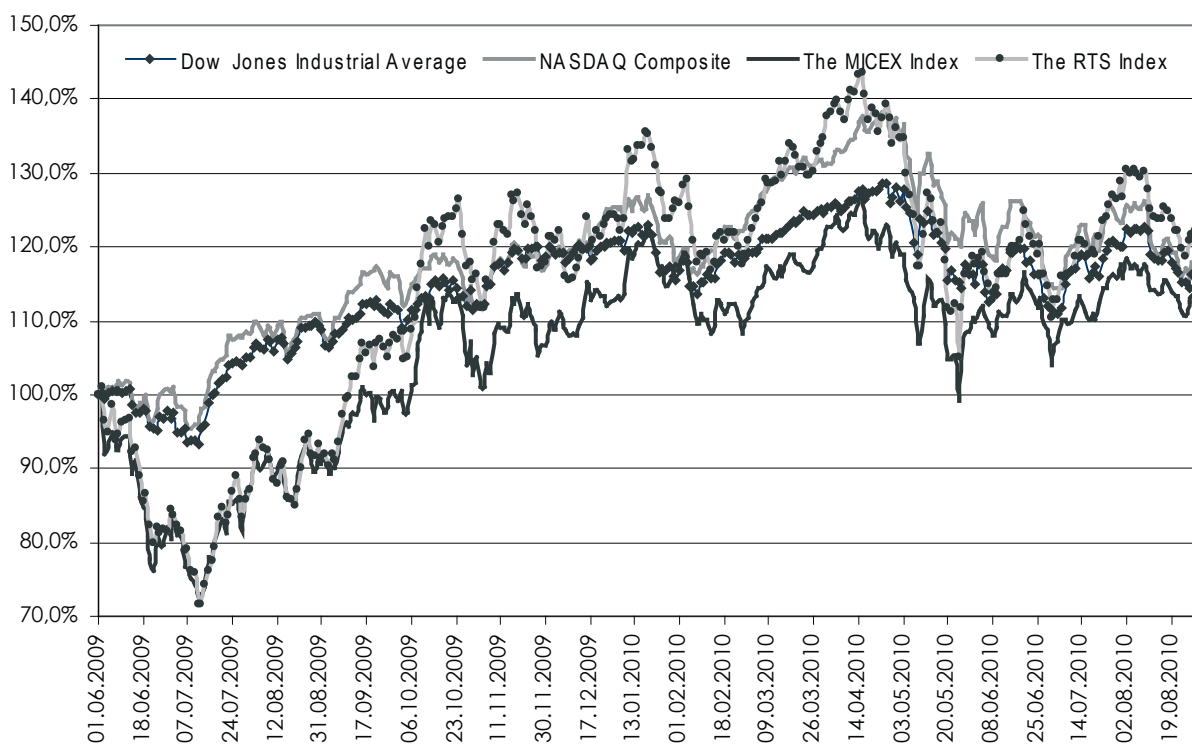


Fig. 5. Dynamics of the main USA and Russian stock indexes (in % to the date June 1, 2009)

Corporate news*OAO "VTB Bank"*

On July 29, 2010, VTB Bank completed the placement of the first issue of Eurobonds for the amount of 400 million Singapore dollars. The Eurobonds will be issued by VTB Capital SA, Luxembourg, with maturity in 2012 with a fixed coupon rate of 4.2 per cent per annum. Herewith, Singapore Exchange Securities Trading Limited has given a principle agreement to the inclusion of Eurobonds in its official quotation list. On August 10, VTB Bank completed the placement of Eurobonds in the amount of 400 million Swiss francs. Eurobonds with a fixed coupon rate of 4 per cent with maturity in 2013 will be issued by VTB Capital SA, Luxembourg, at face value. Listing of the bonds will be made in the Swiss Stock Exchange.

On July 28, VTB Bank was granted the JP Morgan «Quality Recognition Award» for the quality of international payments performance. On July 30, VTB Bank has been assigned a rating of corporate governance «RID-Expert RA», corresponding to the rating of «Developed Corporate Governance Practice».

OAO «GazpromNeft»

On July 30, OAO «Gazprom Neft» signed a loan agreement to provide five-year secured loan of up to 1.5 billion dollars, the proceeds of which will be used for general corporate purposes and for refinancing existing debt. On August 5, OAO «Gazprom Neft» acquired a retail network of fuel station in Kazakhstan. On August 13, OAO «Gazpromneft-Aero» (a subsidiary of OAO «Gazprom Neft»), and the airline «Region-Avia» signed a general agreement on cooperation. On August 18, OAO «Gazprom Neft» has published its financial results under the US GAAP for the first six months of 2010: net profit rose by 42 per cent to USD 1,501 million compared with USD 1,060 million during the same period of 2009

OAO «LUKOIL»

On July 28, Company «LUKOIL Finance Ltd.» (100 per cent subsidiary of OAO «LUKOIL») signed a contract with Springtime Holdings Ltd. (Affiliate of ConocoPhillips) to acquire her 64,640 mln (7.6 per cent) ordinary shares of OAO «LUKOIL» for USD 53.25 each for the total amount of 3.44 billion dollars. On August 13 the company «LUKOIL Finance Ltd.» (100 per cent subsidiary of OAO «LUKOIL») has attracted a loan of 1.5 billion dollars for one year for general corporate purposes.

OAO «Mosenergo»

On August 5 «Mosenergo» has disclosed financial results under Russian accounting standards for the first half year of 2010: net profit amounted to 3,425 million rubles, which is by 46,3 per cent lower than in 2009. On August 26 «Mosenergo» has repaid the coupon yield on the bonds of series 02, and redeemed the bonds issue of series BO-02

GMK «Norilsk Nickel»

On July 27 the Standard & Poor's agency confirmed the credit rating of GMK «Norilsk Nickel» at the level of «BBB-» and changed the rating outlook from «negative» to «stable». On August 3 GMK «Norilsk Nickel» has placed a three-year stock bonds BO-03 for the face value of 15 billion rubles with maturity of 3 years at a coupon interest rate of 7 per cent per annum.

OAO «Rostelecom»

On August 4, OAO «Rostelecom» has disclosed its unaudited financial results developed under RAS for the first half year of 2010: net profit made 2.23 billion rubles, having decreased as compared with the relevant period of 2009 by 5.5 per cent.

Sberbank of Russia

On August 3 Sberbank of Russia has made additional placement of Eurobonds for the amount of USD 500 million. On August 16 Sberbank of Russia has disclosed its financial results developed under RAS for the seven months of 2010: net profit made 76.8 billion rubles against 6.8 billion rubles

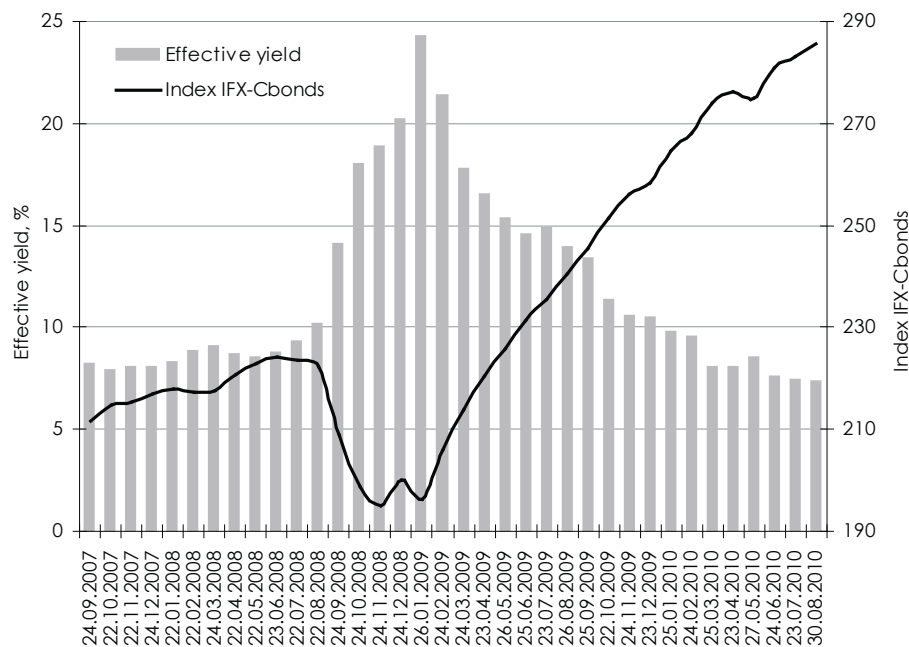
over seven months of 2009, assets grew by 6.9 per cent to 7,597 billion rubles; Russian enterprises were granted loans amounting to over 2.1 trillion rubles; capital adequacy ratio was 18 per cent. On August 24 Sberbank of Russia and a consortium of German banks AKA Ausfuhrkredit-Gesellschaft mbH have signed a new version of the framework agreement on financing the export of capital-intensive commodities and services to Russia under the guarantee of export credit agencies. And on August 25 Sberbank of Russia has disclosed an abbreviated interim consolidated financial reporting developed under IFRS for the first half year of 2010: net profit made 64.3 billion rubles against 6.0 billion rubles over the first half of 2009, total capital adequacy ratio in accordance with Basle Committee Agreement has made 17.3 per cent, assets grew by 6.7 per cent to RUR 7 579.4 bn.

Corporate bonds market

The volume of the Russian domestic corporate bonds market (as per nominal value of shares in circulation, denominated in national currency) in August of the current year continued its growth and at the end of the month made RUR 2 514.1 bn, which exceeds the relevant indicator of preceding month by 2.3 per cent¹. For the first time in the recent months the number of bond emissions in circulation, denominated in national currency has grown from 651 to 667 and the number of emitter has also increased from 355 to 359. There is still one emission of bonds in circulation, denominated in US dollars and one in Japanese yens.

After the seasonal decline the activity of investors in the secondary market of corporate bonds has significantly increased, having reached the maximum level since April of the current year. Thus, the trading volume in corporate bonds in the MICEX market in the period from July 27 through August 30 amounted to RUR 124.7 billion (for comparison, from June 25 through July 27 the trading volume was equal to RUR 99.1 billion), and the number of transactions in the period under review made 27.2 thousand in the period (as compared with 23.7 thousand transactions in the preceding period)².

Index of Russian corporate bonds market IFX-Cbonds continued its upward trend emerging since the beginning of 2009. The increase by 2.5 points (0.9 per cent) was demonstrated in the period from July 23 through August 30. Effective yield is sustained over the last two months and its value is



Source: Cbonds data.

7.38 per cent in late August as compared with 7.46 per cent in late July (See Fig. 6). The duration of corporate bonds market portfolio has regained a downgrading trend and made 667 days, which is by 31 days less against the last month indicator.

Among the most liquid emissions, the effective yield in the period under review remained practically unchanged. The greatest decrease in effective yield of their emissions have demonstrated metallurgical and energy companies, including: OAO “Mechel” (series 02 by 0.71 percentage points, BO-02 by 0.27 percentage points, BO-03 by 0.25 n . n), OAO “Magnitogorsk Iron & Steel

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

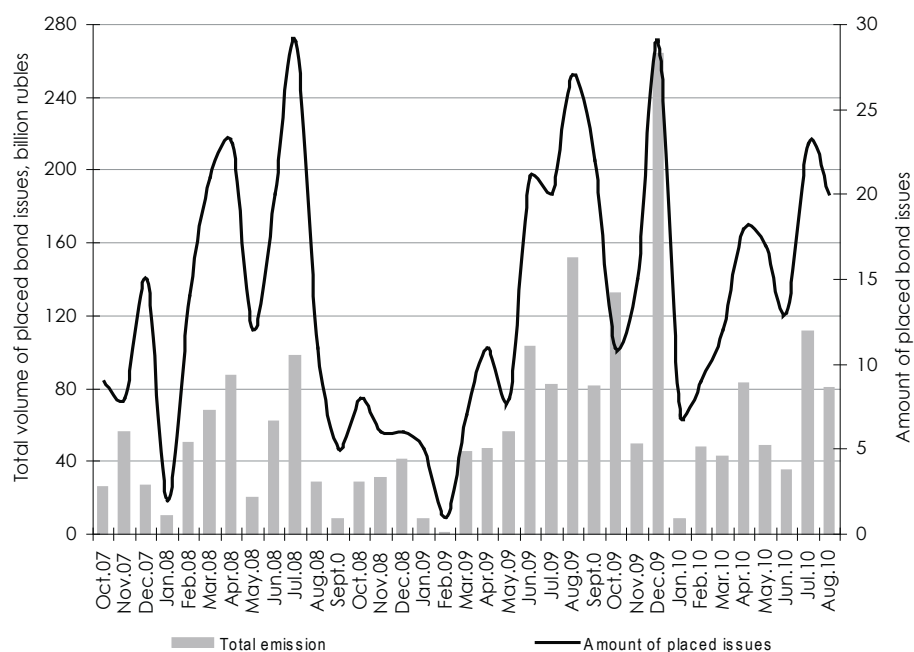
1 As per Rusbonds information
 2 As per “Finmarket”Information agency.

Works” (Series BO-02 by 0.30 percentage points), OAO “The Fifth Power Generation Company of Wholesale Electricity Market” (series 01 by 1.33 percentage points), OAO “Territorial generating company № 1” (series 02 by 0.61 percentage points), as well as some financial companies - OAO “Joint-Stock Financial Corporation “Sistema” (series 01 by 0.56 percentage points), OAO “Commercial Bank “ROSBANK” (series 02 by 0.28 percentage points). The utmost growth was observed in the effective yield of the bonds issue of series 06 of OAO “Russian Railways” (+0.69 points), series 04 of OAO “Mosenergo” (+0.37 pp), series 03 of OAO “Russian Agricultural Bank” (+0.30 p.p.).

In August companies were registering a record number of bond issues, which allows to expect further growth of the corporate bonds market. Thus, from July 24 through August 30, seventeen emitters have registered 67 bond issues amounting to 352.8 billion rubles (as compared with twelve emitters who registered 38 bonds issues worth of 161.4 billion rubles from June 25 through July 23). A half of the reported emissions were exchange bonds. The majority of registered emissions fell within 11 series of exchange bonds of OAO “LUKOIL”, totaling to 100 billion rubles, five series of bonds of OAO “Gazprom Neft” for the amount of 50 billion rubles, 10 emissions exchange bonds of “V.D. Shashin Tatneft” for the amount of 50 billion rubles., 7 series of exchange bonds of OAO “Mechel” for RUR 35 bn., 7 series stock of exchange bonds of ZAO “AKB “Promsvyazbank” for the amount of RUR 31 bn.¹

In August, the primary bond market has been successfully placed in a sufficiently large number of issues, although the main market indicators were slightly lower than the values in the previous period. Thus, in the period from July 24 through August 30 there were placed 20 corporate bonds emissions totaling to RUR 80.8 billion (for comparison, from June 25 through July 23 there were placed 33 bonds emissions for the total amount of RUR 111.5 billion) (See Fig. 7). Over the period under review the largest bond emissions were placed by OAO “Mining and Metallurgical Company Norilsk Nickel” (one series of stock bonds for the total amount of RUR 15 billion), OOO “VTB-Leasing Finance” (two series of bonds worth 10 billion rubles), Eurasian Development Bank (two series of stock of bonds worth 10 billion rubles). Again some companies have succeeded in attracting investments through bond issues on a sufficiently long period. Circulation term of OAO “Oil Company Alliance” bonds is 10 years, of OOO “VTB-Leasing Finance”, OAO “NOMOS-BANK”, OAO “Territorial generating company No. 9” is 7 years. Besides, OAO “Agency for Restructuring of Mortgage Loans” has successfully placed its debut bond emission with maturity of 20 years. Herewith, over the last four months no emissions were recognized as invalid by the Federal Financial Monitoring Service (FFMS) due to non-placement of any bonds, which testifies a sustained demand for the bonds of Russian emitters².

In the period from July 24 through August 30, fourteen emitters were supposed to redeem their 15 bond issues totaling to RUR 18.0 billion. However, six emitters have announced a technical default on repayment of their



Source: Cbonds data

Fig. 7. Dynamics of corporate securities primary placement, denominated in national currency.

1 Source: Rusbonds data.

2 FFMS of Russia data

bond loans for the total amount of RUR 5.6 bn (against four emitters, who announced a technical default on repayment of their bond loans, totaling to RUR 6.5 bn in the relevant preceding period). In addition, one issuer – OAO “Platan” timely redeemed the bond emission denominated in foreign currency for the nominal value of 200 million dollars. In September 2010, redemption of eleven emissions of corporate bonds for the total amount of RUR 24.5 bn is expected¹.

The situation with the performance of current debt liabilities is still not easy. From July 25 through August 30, the real default on bonds coupon yield redemption was announced by eight emitters (against ten emitters from June 25 through July 23). In regard to two emissions the emitters managed to reach agreement with bondholders to restructure the debts. Offer (bonds purchase) was carried out by all emitters in due time, like in the preceding reporting period. A real default on bonds redemption at the nominal value of their bonds was announced by five emitters (as compared with three emitters from June 25 to July 23), though only one of them managed to restructure its debt)².

1 Rusbonds data.

2 Cbonds data

REAL ECONOMY SECTOR: TRENDS AND FACTORS

O.Izryadnova

In July 2010 index of goods and services output as broken by basic types of economic activity versus the corresponding period of the previous year made 103.0% versus 106.9% in June. The rates depreciation versus the previous month is observed in all types of economic activities. The rates are registered to fall most dramatically in construction, which is connected with the contraction of investments in fixed assets by 10.7% as compared with the preceding month of the current year. The fact that production volumes in agriculture and foodstuffs production are decreasing is a worrying sign. The situation is aggravated by both the negative impact of abnormal nature and climate conditions in July and the aftermaths of the system crisis of 2008.

Positive trends of the economic recovery of the first half of 2010 did not sustain in July. After GDP going up by 2.95 in the 1st quarter 2010 and by 5.2% in the 2nd quarter versus the corresponding period of the previous year, in July 2010, according to the estimation of the RF Ministry of Economic Development, GDP decreased by 0.3% versus this June (seasonality excluded). Thus, according to the preliminary results of seven months of 2010 the growth of the GDP made 3.8% versus 4.0% in the 1st half as compared with the corresponding period of the previous year. Whereas in the 2nd quarter the growth was observed to accelerate for the majority of macroeconomic indices, in July abnormally hot weather resulted not only in the decrease in agriculture production but also in the sharp deceleration of the investment activity. It was the consumer demand that remained the main growth factor in July 2010.

The influence the agriculture has on the macroeconomic situation is accounted for by its position in the structure of the Russian national economy. The agriculture accounts for 4.0% of the GDP, 9.8% of the average annual number of the employed in the economy and 4.5% of the investments in fixed assets. In July 2010 index of agriculture production made 94.1% versus July of the previous year. According to the data as on August 6, 2010 the subjects of the Russian Federation that suffered from the drought lost crops in nearly 1/7 of the total area under crops. At the end of July 2010 laying-in of fodder per animal unit reduced by 7.8% as compared with the previous year. By the beginning of August 2010 the volume of milled grain reduced by 3.0%, that of wheat – by 8.3%, the livestock in all the agriculture producing enterprises contracted by 2.3%, milk production – by 0.8% versus the corresponding period of the previous year.

As compared with the corresponding period of the previous year, in January-June 2010 the sale of cattle and poultry by agriculture producers went up by 14.9%, of milk – by 1.2%, while that of crops – reduced by 3.9%. The proportion of foodstuffs import in the volume of trading resources made 35% in the 1st half of 2010 and remained at the level of the previous year.

The subsidies of RUR 98.1 billion are envisaged for the state support for the agriculture production and social development of rural areas. As on August 1, 2010 the subsidies mentioned were financed at the volume of RUR 67.6 billion (69%).

In January-July 2010 investments in fixed assets went up by 1.3%, however, it should be taken into account that the contraction of the investment demand in the corresponding period of the previous year reached 20.4%. Throughout the current year the dynamics of investments proved to be highly unstable, which testified that the impact of factors formed during the acute phase of the crisis at the end of 2008 and the first half of 2009 sustained. Business activity index in construction remained positive in 2010. The workload in construction over January-July 2010 made 97.0% versus the corresponding figure of 2009, commissioning of the residential floor area – 95.9%. In July 2010 the withdrawal of resources in connection with unfavorable climatic situation acted as a factor intensifying the decrease in investment activity. As compared with June, in July 2010 the investments in fixed assets contracted by 10.7%, workload in construction – by 2.8%, commissioning of residential floor area – 39%.

In January-July 2010 retail trade turnover went up by 3.9% as compared with the corresponding period of the previous year and was supported by the growth of population real incomes by 5.1%, real wages – by 4.9% and real volume of accrued pensions – by 41.0%.

The sales of foodstuffs are increasing at anticipating rates in the structure of goods turnover. Over January-July 2010 as compared with the corresponding period of the previous year foodstuffs market turnover went up by 5.3%, while non-food market turnover – by 2.6%.

In July inflation at the consumer market made 0.4%. Over 7 months the increase in prices made 4.8% versus 8.1% in the corresponding period of the previous year. Adverse climate situation and the recession of agriculture production made inflation acceleration more probable. Prices for foodstuffs went up by 5.7% in July versus the beginning of the year and prices for non-food goods – by 2.2%. The acceleration of prices growth in July and August are also due to the worsening of the forecast for the harvests in the main countries exporting grains and the increase in prices for raw materials for foodstuffs production that started afterwards.

On the whole the base of 2009 being low the industrial production was characterized by positive dynamics in all types of industries observed. In January-July 2010 the increase in industrial production made 9.6% versus the corresponding period of the previous year, in minerals extraction – 5.3%, in manufacturing industries – 13.3%, in electricity, gas and water production and distribution – 5.3%.

As compared with the previous month, in July the industrial production went up by 1.0%, minerals extraction increasing by 2.9%, electricity, gas and water production and distribution – by 2.0%, and the manufacturing industries production dropping by 0.4%. The contraction of the investment demand had the most profound effect on machinery and equipment production (74.8% versus June 2010) and transport vehicles production (92.2%). Comparatively high dynamics was observed for production of rubber and plastic goods (107.0%), coke and oil products production (104.2%), metallurgy production (103.8%).

Over July the increase in producers' prices in the industry made 0.7%, being equal to 6.2% since the beginning of the year. The price for the goods traded at the foreign markets decreased by on average 1.9% in July. The markets were mainly characterized by stabilization of prices, with the exception for metallurgy goods, prices for which started to drop after a swift growth in the first half of the year. The prices for non-traded goods (with the exception for electric energy) went up by 1.3% in July, the growth being equal to 8.4% since the beginning of the year.

In foodstuffs production the prices have increased by 2.8% since the beginning of 2010, the growth in July being 1.7%. The prices in meat production went up by 1.6%, in fish and canned fish industry by 3.3%, in sunflower oil production – by 3.1%, in flour grinding and cereals production – by 9.1%, in pasta production – by 2.6%; the growth of prices for mixed fodder is still insignificant – 1.3%.

The decrease in the demand for labor in the industry, construction and agriculture resulted in the renewed growth of the unemployment. The unemployment among the economically active population increased from 6.8% in June to 7.0% in July.

In July the number of the unemployed (calculated on the basis of ILO methodology) made 5.4 million, exceeding the figure of June 2010 by 0.2 million. The number of the officially registered unemployed was equal to 1.8 million, the figure for the registered unemployment being 2.3% (for reference: 3.0% in the 1st quarter and 2.7% in the 2nd quarter). The general unemployment going up, the decrease in the registered unemployment is probably connected with the delay in visiting the employment service bodies due to the weather conditions.

It should be noted that in June-July the practice of part-time employment was observed to expand, which is partially accounted for by the negative influence of climatic factors. According to the data of the survey among the enterprises conducted by the Federal State Statistics Service, in July 0.9% of the total number of employees worked part time as suggested by the employer, 1.1% – according to the agreement between the employer and employee, in June the figures were 1.05 and 1.3%, correspondingly. The proportion of employees remaining idle through employer's fault and due to the causes neither employer nor employees can influence made 0.6% in July and 0.7% of the total number of registered employees. In July the proportion of employees being on non-paid holidays in concordance with the written application by the employee made 4.0% of the total number of registered employees versus 4.0% in June.

The demand for the workforce registered at the population employment services reduced by 8.9 thousand over July and made 1.27 million by the end of the month. The tension coefficient (per 100 registered vacancies) lowered to 156.9 versus 2112.5 in the corresponding period of the previous year. The decrease in the tension coefficient allows hoping for the improvement of the situation at the labor market and contraction of the time of job hunting by the unemployed.

The changes in the dynamics of the main macroeconomic indices taking place in July-August 2010 imply corrections made to the main indicators of Russian economy development for three-year period. Under existing prices dynamics the planned level of inflation is likely to be exceeded. Low investment activity and changes in the structure of business activity support by the types of economic activities will have a negative impact on the GDP dynamics. Besides, despite the sustention of comparatively favorable foreign economic situation, import structure and dynamics can be changed towards consumer goods, which may result in the contraction of investment in economy's material and technology potential development due to the changes in the machinery and equipment import supply volumes.

Problems of the state support for agriculture producers and food security are becoming more and more acute due to the existing dynamics of agriculture production and the volume of losses connected with the drought. ●

RUSSIAN INDUSTRY IN JULY 2010

S.Tsukhlo

Absence of positive trends in sales dynamics disorients the enterprises, worsens the forecasts and limits the output growth. However the absence of demand growth increases the probability of its upsurge in the forthcoming months. This forces the industry to gather all the strength to get ready for post-crisis leap and accumulate resources for it.

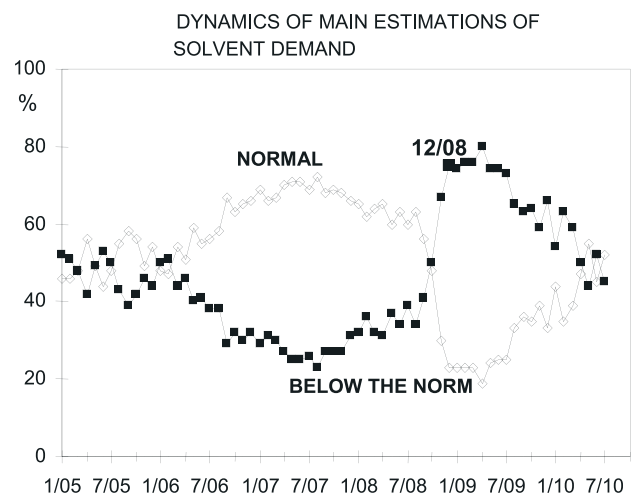
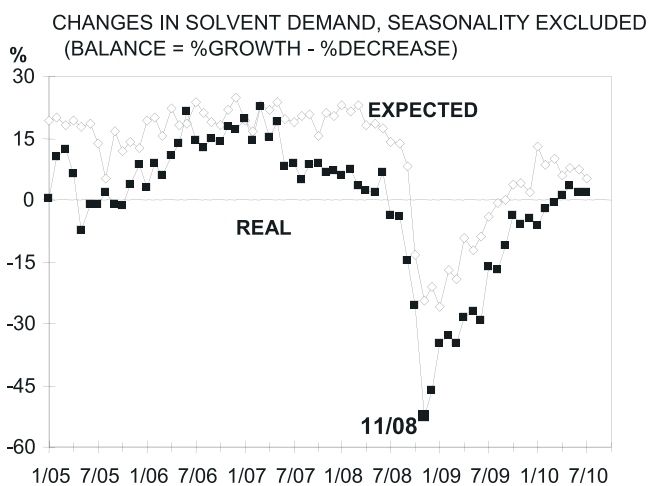
Official Statistics in June

According to the data of the Federal State Statistics Service, in June 2010 as compared with June 2009 the production went up by 9.7% (12.6% in May on May 2009, 10.4% in April on April 2009). As compared with May 2010, in June the output has decreased by 0.4% (upon exclusion of seasonality) compared with 1.1% growth in May versus April. According to estimations of the Centre for Macroeconomic Analysis and Short-term Forecasting, in June versus May upon exclusion of seasonality the growth made 0.2%. Although June statistics turned out to be below expectations, they did not cause much apprehension among the experts: “the trend is positive. The recovery is going on. Industrial dynamics is unsteady”, “this can hardly be the cessation of growth. One cannot judge by only one month figures”, besides “statistics is still highly unreliable”.

Demand for industrial goods

Demand growth intensity in July was not subject to considerable changes as compared with June and remains at practically zero level: there is neither definite growth, nor obvious decrease in sales in the industry (*fig. 1*). Such a situation has been registered by the surveys since February 2010. The picture is similar for initial data (before exclusion of seasonality), although in this case absolute levels are somewhat higher. The conclusion however is the same: the enterprises have not noticed any changes in the dynamics of the demand for industrial goods since the beginning of the year (*fig. 2*).

Such a situation leaves enterprises confused. As a result, in July the estimations of the demand improved by 13 points (in May they went down by 17 points) and are again positive – the proportion of answers “below the norm” is outnumbered. Since the beginning of 2010 this figure has remained highly volatile, which testifies that the industry does not have settled estimations of the existing situation. The situation is aggravated by the confusion with the state industrial statistics.



The absence of positive trends in the dynamics of the demand lowers the optimism of enterprises' forecasts. In July the expected changes of the demand turned out to be the most pessimistic in 2010. The forecasts have worsened in all the sectors of industry except for chemistry, petrochemistry and industry of construction materials. It is the light industry and foodstuffs production that are characterized by the worst expectations.

Stocks of Finished Goods

In July excessive stocks of finished goods were eliminated in the industry as a whole: i.e. the proportion of answers "below the norm" became equal to that of "above the norm" (fig. 3). Such a situation is quite rare for the post-default period: the enterprises still prefer to have some excess of finished goods in store to satisfy the unplanned orders. Now the proportion of the responses "above the norm" reached the record-breaking minimum, while the proportion of responses "normal" - record-breaking maximum value. This is the result of the intensive decrease in volumes (not to be confused with estimations) of stocks in the 2nd quarter. In the 3rd quarter the industry plans, despite the forecasts of the RF Ministry for Economic Development, to continue decreasing the stocks volume, and it is going to be the most intensive diminution in 2010. Only 8% of enterprises can increase the stocks.

Production Output

Feeble demand limits output growth in the Russian industry to higher and higher extent. In the 2rd quarter its citation as an obstacle for the output growth became 9 points more frequent and reached 61%. The second place is now occupied by the lack of liquid funds, though the frequency of this obstacle citation has now reduced to 30%, which is the absolute (!) minimum of all the period of monitoring since 1993. The picture is supplemented by 5% of citation of credit shortage, which has been registered by surveys for the second quarter in the row. The third place of lack of staff (a quarter of enterprises have been suffering from it for the second quarter in the row) does not give evidence for the current problems of the industry but testifies high readiness of enterprises to react to the expansion of the demand and vivid memories of staff problems before the crisis (fig. 4). In July concurrence of sales and production dynamics reached 71%, while in the first half of

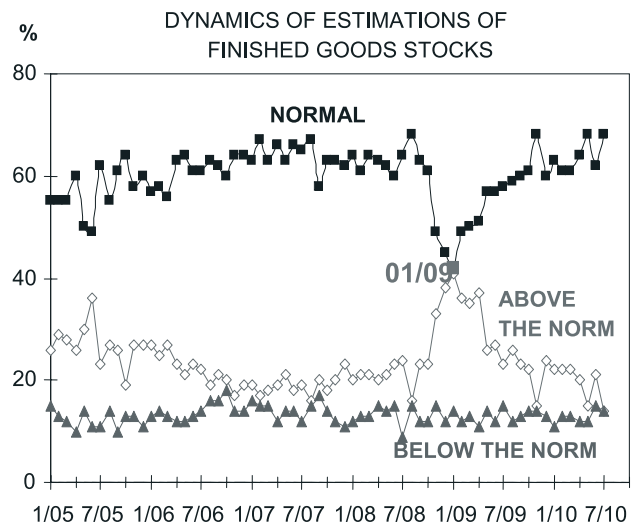


Fig. 3.

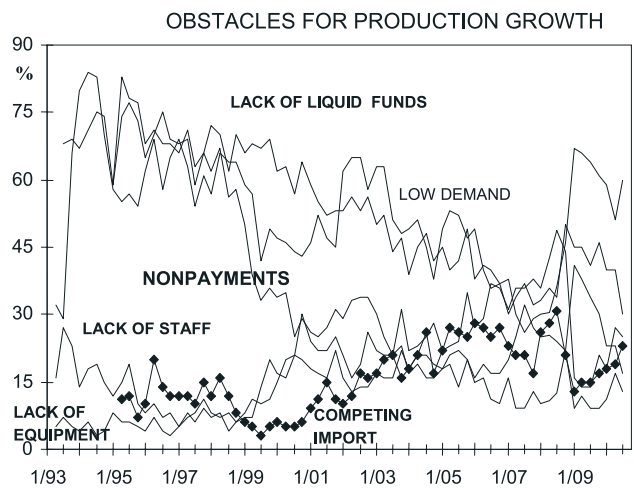


Fig. 4.

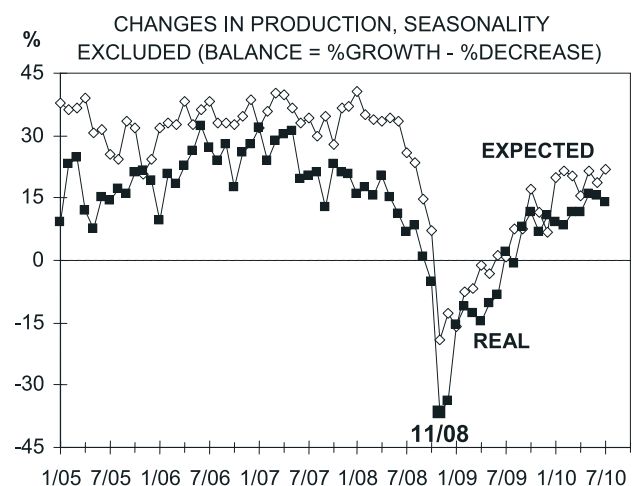


Fig. 5.

the year the figure averaged 65%. The enterprises have to correct the production volumes taking into account demand dynamics. As a result output growth rates have not been changing in the last three months either basing on the initial data and on those upon exclusion of seasonality (fig. 5).

Prices of Enterprises

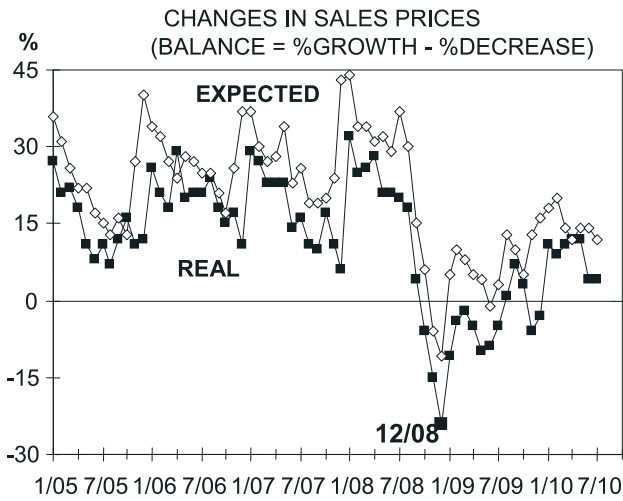


Fig. 6.

After five months of stable and comparatively high (for the crisis) growth of sales prices the enterprises have been trying to upsurge the demand for their goods for the second month in the row by more moderate increase in prices. Whereas in January-May 2010 the prices went at the rate of 11 balance points per month in June-July the rates decreased to 4 balance points. However such correction of the price policy was not expected. This is testified by price plans of enterprises. Even now (from March up to July, inclusive) they sustain high (+13 balance points) forecast prices growth rates (fig. 6).

Dismissals: Real Dynamics and Plans

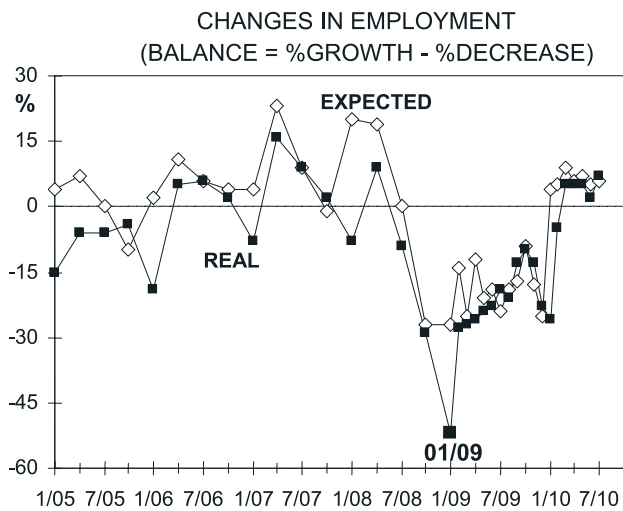


Fig. 7.

Staff policy at the enterprises is forged under the influence of two opposite trends. On one hand, the absence of the growth makes enterprises be cautious when hiring employees. On the other hand, the very absence of growth makes it more and more possible with every month that in the following month the demand will revive. The latter fact forces enterprises to increase their readiness to post-crisis leap and accumulate resources (or even reserves) for it, and primarily the reserves that are scarce, which in pre-crisis years were staff. As a result, at the beginning of the 3rd quarter the enterprises again returned to earlier (as in March - May) growth rates of employees' numbers (fig. 7). The hiring of the staff was most intensive in machine building and in the industry of construction materials. Only timber complex was characterized by absolute decrease in the number of employees.

Estimations of the current number of employees prove that the enterprises are ready to increase the output. In the 3rd quarter the scales of staff shortage in the industry went up in connection with the expected changes in the demand. For the first time the shortage of staff (i.e. prevalence of "less than enough" estimations) was registered by the surveys in the 2nd quarter 2010. Now the balance has already reached -6 points (fig. 8). The shortage of staff was registered in all the sectors of industry in July with the exception for timber industry.

There is no shortage of facilities for the post-crisis growth in the industry. The balance of facilities estimations is positive, i.e. responses "more than enough" prevail. In the 3rd quarter the overhang of excessive facilities even increased somewhat as compared with the 2nd quarter 2010, when there were more hopes for soon recovery from the crisis (fig. 8). The struggle for staff that is scarce makes enterprises increase the wages. In the 3rd quarter 2010 normal level of labor remuneration

(according, however, to the estimations of heads of enterprises) was reached at 56% of the plants. In pre-crisis 2007 this figure went up to 60%, and during the crisis in 2009 it fell to 37%. Thus, now the ratio of estimations of employees' wages reached pre-crisis level. It should be noted that this concerns only estimations and not the values of salaries (fig. 9).

Industry Crediting

Banks continue to decrease the minimal interest rate for credits in rubles offered to enterprises. In July this figure dropped to 13.7% on average through the industry. In July the lowest rates are offered to chemistry enterprises (12.1%) and metallurgy enterprises (13%), the highest – to enterprises of the industry of construction materials (15%) and light industry (15.2%). The rate of 13% per annum is now regarded as normal by the enterprises (fig. 10).

The decrease in the offered interest rate does not increase credits' accessibility for industrial enterprises. During last three months this figure stabilized at the level of 65% (fig. 11). It seems that banks retreated to “non-price” methods of choosing the debtors.

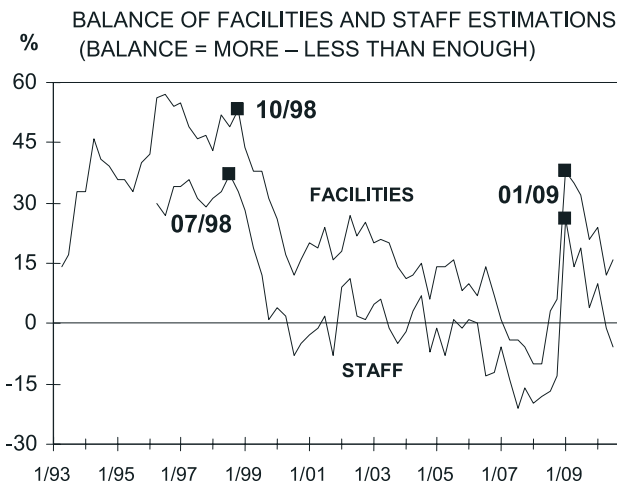


Fig. 8.

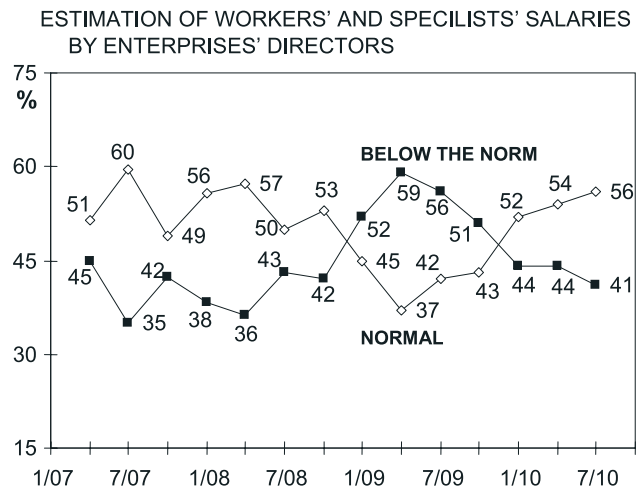


Fig. 9.

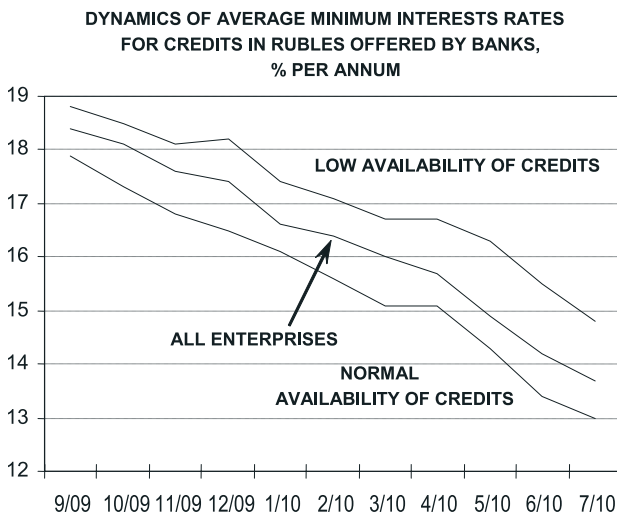


Fig. 10.

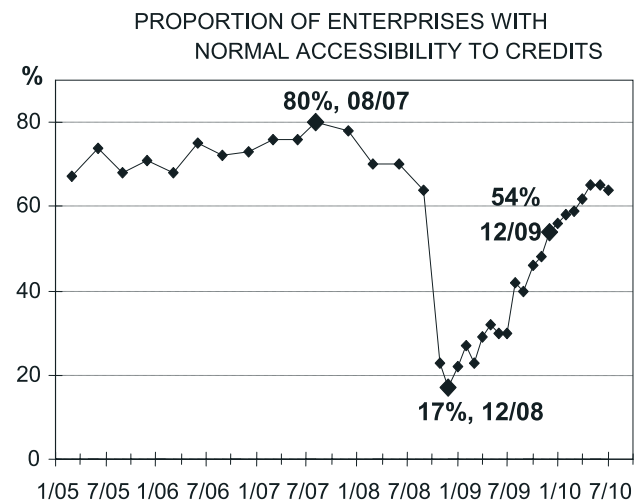


Fig. 11.

INVESTMENTS IN REAL ECONOMY SECTOR

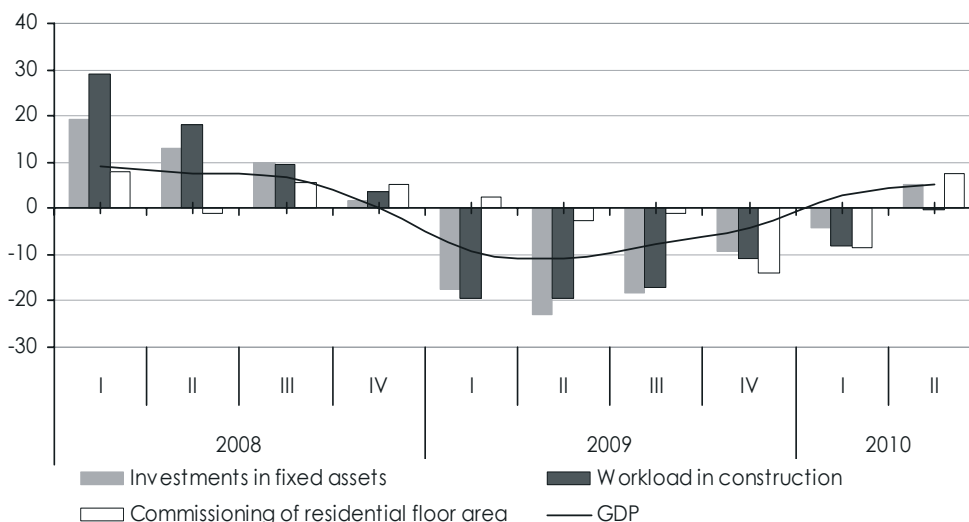
O.Izryadnova

In the 1st half of 2010 the recovery of investment activity was extremely weak and unstable and was accompanied with the sustention of negative trends in the construction. As a result of this half of the year investments in fixed assets made 101.3% versus the corresponding period of the previous year. The enterprises' own funds being limited and the level of banks' capital participation in investment program financing being low, the investments market did not overcome the aftermaths of the crisis and was vulnerable to the changes in macroeconomic situation in June-August 2010.

In the first half of this year investments in fixed assets made RUR 3174.1 billion or 101.3% versus the corresponding period of the previous year. This period was characterized by the change of the trend: against the background of low investment activity in large and medium-sized companies, small business actively increased its participation in the investment process. Whereas in the first half of 2009 the proportion of small business investments, including investments that cannot be registered by direct statistical methods, accounted for 25.2% of the total volume of investments in fixed assets throughout the economy, in the corresponding period of 2010 this proportion expanded to 32.5%. Thus, the amount of investments in fixed assets at large and medium-scale enterprises decreasing by 10.2% versus the 1st half of 2009 it was the growth of investments at small-scale enterprises by nearly 30% that was the factor contributing in the recovery of the positive dynamics of investments in the national economy.

Unsteady dynamics of investments in fixed assets throughout the 1st half of 2010 acted as one of the causes for quite sudden fluctuations in the dynamics of workload in construction and commissioning of residential floor area. Although the dynamics of investment in construction in the 2nd quarter 2010 demonstrated quite goods results, in July 2010 the investments and the workload in construction was again observed to drop. As compared with July 2009 the decrease in the volume of workload in construction made 2.8%, that in the residential floor area implementation - 39.0%.

While the GDP went up by 4.0% in the first half of 2010 versus the corresponding period of



Source: Federal State Statistics Service

Fig. 1. GDP, Investments in Fixed Assets, Workload in Construction, Commissioning of Residential Floor Area Growth Rates as Broken by Quarters in 2008-2010, as Percentage to Corresponding Period of Previous Year

the previous year, the workload in construction reduced by 3.1% and the commissioning of the residential floor area – by 0.1%. Low business activity in this period is accounted for by both underinvestment of construction works at the beginning of the year and the absence of significant amount of groundwork. The dynamics of residential floor area commissioning was considerably influenced by the contraction in financing of share participation in

construction by both organizations and population. In January-June of the current year the structure of investments was characterized by the reduction in the investment expenses for construction of housing by RUR 8.9 billion as compared with the corresponding period of 2009.

It should be noted that while the absolute scale of investments in fixed assets reduced in the 1st half of 2010 as compared with the corresponding period of the previous year, the investment expenses were observed to decrease for all types of fixed assets with the exception for machinery and equipment. The latter went up by RUR 20.9 billion, the increase in investments into domestic models increasing by 38.6 billion. Investments for the purchase of import machinery, equipment, transport vehicles (excluding the subjects of small-scale entrepreneurship and the volume of investments not registered by the direct statistical methods) made RUR 138.8 billion in January-June 2010 or 20.1% of the total volume of investments in machinery, equipment, transport vehicles versus the indices of the 1st half of 2009 - RUR 156.3 billion or 23.5%, correspondingly.

Table 1

STRUCTURE OF INVESTMENTS IN FIXED ASSETS AS BROKEN BY TYPES OF FIXED ASSETS IN THE 1ST HALF OF 2009-2010 (EXCLUDING SUBJECTS OF SMALL-SCALE ENTREPRENEURSHIP AND PARAMETERS OF INFORMAL ACTIVITY), AS PERCENTAGE TO TOTAL

	RUR billion		As percentage to the total	
	2009	2010	2009	2010
Investments in fixed assets	2188.7	2108.1	100	100
including: housing	131.7	122.8	6.0	5.8
buildings (excluding housing) and constructions	1190.2	1108.2	54.4	52.6
machinery, equipment, transport vehicles	671.2	692.1	30.7	32.8
other	195.6	185.0	8.9	8.8

Source: Federal State Statistics Service

As to the sources of financing, the structure of investments was subject to considerable changes. In the 1st half of 2010 the proportion of investments made at the expense of own funds of enterprises went up by 4.8 percentage points, and the proportion of attracted funds decreased, correspondingly. The profitability in the economy made 11.1% and was 0.4 percentage points below the corresponding period of the previous year. The proportion of investments financed from the enterprises' profit contracted to 16.3% versus 16.9% in the first half of 2009.

The lag between the financial sphere and the real sector is maintained during the recovery from the crisis. Stagnation of banking and crediting sector, difficulties connected with debts restructuring, slow trend for the reduction of interest rates had a negative impact upon the investment activity. The sustention of the tendency towards capital withdrawal in the 1st half of 2010 had the same effect on the business activity. According to the preliminary estimation of the Central Bank of the Russian Federation, net export of the capital by the private sector made USD 16.7 billion in this period (USD 14.8 billion in the 1st quarter, USD 1.9 billion in the 2nd quarter). Besides that, in January-June 2010 foreign investments in the Russian economy reduced on the whole by 5.5% versus the level of the corresponding period of the previous year and made USD 30.4 billion; it should be noted that their structure did not contribute into the increase in investment activity in the real sector of the economy. Direct foreign investments made USD 5.4 billion or 89% versus the figure of the first half of 2009, portfolio investments – USD 0.7 billion or 81.1%, other credits, including trade credits, - USD 24.3 billion or 96.2%. As a result the proportion of foreign investments in fixed assets made 5.3%, which is by 0.4 percentage point less than the corresponding figure of the previous year.

Scantiness of own funds could not be compensated by attraction of banking credits and borrowed funds. In January-June 2010 banking credits accounted for RUR 193.0 billion or 16.6% (20.1% in the 1st half of 2009) of the total of RUR 1160.7 billion of borrowed funds. At the same time the role of the budget funds among the funds borrowed for the purposes of investments in fixed assets financing was observed to change. In the 1st half of 2010 RUR 327.3 billion of investments in fixed assets was financed at the expense of budget funds (16.7% of the total volume of investments in the economy), of which RUR 159.6 billion (8.2%) at the expense of the federal budget and RUR

148.9 billion (9.2%) at the expense of budgets of subjects of the Russian Federation. The expansion of investments financing from the federal budget funds did not compensate the contraction of the expenses for investment purposes from the budgets of subjects of the Russian Federation by RUR 51.6 billion and from the budgets of other levels (by RUR 2.9 billion).

Table 2

STRUCTURE OF INVESTMENTS IN FIXED ASSETS AS BROKEN BY SOURCES OF FINANCING IN THE 1ST HALF OF 2009-2010 (EXCLUDING SUBJECTS OF SMALL-SCALE ENTREPRENEURSHIP AND PARAMETERS OF INFORMAL ACTIVITY), AS PERCENTAGE TO TOTAL

	RUR billion		As percentage to the total	
	2009	2010	2009	2010
Investments in fixed assets	2188.7	2108.1	100	100
including by sources of financing: own funds	878.5	947.4	40.1	44.9
of which: profit remaining at organizations' disposal	369.3	342.8	16.9	16.3
amortization	437.2	516.0	20.0	24.5
borrowed funds	1310.2	1160.7	59.9	55.1
including: banks' credits	263.2	193.0	12.0	9.2
of which credits of foreign banks	80.9	60.0	3.7	2.8
borrowed funds from other organizations	179.3	139.3	8.2	6.6
budget funds	364.7	327.3	16.7	15.5
of which: federal budget funds	142.	159.6	6.5	7.6
funds of budgets of RF subjects	200.5	148.9	9.2	7.1
off-budget funds	4.7	8.8	0.2	0.4
other	498.3	492.3	22.8	23.4
of which: funds of superior organizations	371.3	355.6	17.0	16.9
funds for share participation in construction (from organizations and population)	50.6	46.0	2.3	2.2
including population's funds	20.8	23.1	1.0	1.1
funds from corporate bonds issue	0.2	0.9	0.01	0.04
funds from stocks issue	10.4	34.8	0.5	1.7
Foreign investments in the total amount of investments in fixed assets	124.6	111.3	5.7	5.3

Source: Federal State Statistics Service

Public demand for the production and services of the Russian enterprises was supported through the fulfillment of the planned investment projects in the sphere of transportation, telecommunication etc. within the framework of FTP and FTIP as well as large investment projects of the Investment Fund.

RUR 611.5 billion from the federal budget was envisaged to fulfill the measures included in FTIP in 2010 versus RUR 589.3 billion in 2009. The financing of objects included in federal target programs (FTIP program part) is planned at the rate of RUR 402.7 billion or 65.3% of the total FTIP volume versus RUR 353.1 billion (59.9%) in 2009. Financing of special works included in the state defense order is planned at the amount of RUR 62.2 billion, which is by RUR 7.2 billion more than the figure of 2009. The construction of objects and fulfillment of measures included in non-program part of FTIP is envisaged to be financed at the amount of RUR 213.8 billion or 34.7% of the total FTIP volume, the figure of 2009 being RUR 236.2 billion or 40.1%. Financing of special works included in the state defense order within the non-program part is provided with RUR 44.5 billion, the figure of 2009 being RUR 35.9 billion.

Taking into account the changes made, as on August 1, 2010 RUR 61.7 billion of the federal budget funds is allocated for the construction of objects and fulfillment of measures included in FTIP. The funds of RUR 345.2 billion (55.5% of the total FTIP volume) are envisaged for financing federal target programs (FTIP program part). RUR 169.7 billion or 27.3% of the total FTIP volume is

provided for financing of objects construction and measures fulfillment within non-program part of FTIP. Financing of special works included in the state defense order makes RUR 106.7 billion or 17.2% of the total FTIP volume in 2010.

In concordance with the corrected list of construction sights and objects for federal state needs established by the Decree of the RF Government from December 30, 2009 No 2130-r and included in the Federal Targeted Investment Program, as on August 1, 2010 it was envisaged to allocate government investment for 1827 construction sights, objects and measures fulfillment. This year, 995 objects are planned for commissioning, out of which 15 objects were put into commission to the full extent in January-July 2010 and 4 objects – partially. Besides, 1 object out of objects that are planned for commissioning in the forthcoming years was partially put into implementation. As on August 1, 2010 580 objects were financed to the full extent.

In January-July 2010 RUR 229.7 billion of state investments was financed from the federal budget, which makes 46.5% of the annual limit; RUR 3.3 billion was allocated from the budgets of RF Subjects and other sources.

Table 3

OBJECTS ENVISAGED FOR TARGETED INVESTMENT PROGRAM AND OBJECTS OF STATE INVESTMENTS IN 2010 (EXCLUDING CONSTRUCTION SIGHTS AND OBJECTS INCLUDED IN STATE DEFENSE ORDER)

	Number of objects in 2009		Put into commission in January-October 2009		Limit of state investments in 2009		Financed from the federal budget in 2009	Investments used at the expense of all sources of financing in 2009
	total	with the deadline of implementation in 2009	to full extent	partially	total	from the federal budget		
	Units				RUR billion			
Total	18275	955	15	5	525.4	493.5	229.7	120.0
including:								
transportation complex	355	209	5	2	245.0	218.7	119.6	62.1
agriculture complex	173	87	1	-	6.6	6.5	3.9	1.9
special complex	265	120	1	-	28.7	27.7	5.1	2.4
social complex	947	502	8	3	225.7	224.3	94.6	50.6
other objects	87	37	-	-	19.4	16.2	6.5	3.0

Source: Federal State Statistics Service

On the whole in January-July state customers used RUR 120.0 billion of the state investments or 22.8% of the annual limit of funds envisaged for their construction.

The annual limit of investments in transportation complex has been financed to a considerably higher extent (25.3%) than in general construction sights and objects. In the special complex budget allotments were financed at 8.5% and social complex – at 22.4%.

On average in Russia over 7 months of the current year 52.2% of the total volume of funds allotted at the expense of all sources of financing. The highest percentage of financed funds is registered in social complex (53.4%). At the same time the use of financed funds in special (47.0%) and agriculture (48.7%) complexes remain below the average values.

As broken by regions, the use of funds limit envisaged for FTIP construction sights and objects is above average in Siberian, North-Western, Urals, Far Eastern and North Caucasian federal okrugs. Privolzhsky, Southern and Central federal okrugs are characterized with the below average use of budget investments.

Table 4

USE OF FUNDS AT CONSTRUCTION SIGHTS AND OBJECTS AS BROKEN BY FEDERAL OKRUGS
IN JANUARY-JULY 2010

	Limit of allotments at the expense of all the sources	Limit of state allotments over the year	Really used at the expense of all sources of financing	
			RUR million	As percentage of annual limit
Russian Federation	525.4	493.5	120	22.8
Central federal okrug	200.6	199.4	30.1	15.0
North-Western federal okrug	75.9	69.2	25.4	33.5
Southern federal okrug	95.4	85.2	17.4	18.2
North Caucasian federal okrug	8.4	8.4	2.6	31.0
Privolzhsky federal okrug	21.9	20.3	4.4	20.1
Urals federal okrug	5.1	4.7	1.6	31.4
Siberian federal okrug	21.1	20.5	8.0	37.9
Far Eastern federal okrug	97.0	885.8	30.5	31.4

Source: Federal State Statistics Service

The structure of investments in fixed assets as broken by the types of economic activities was subject to considerable shifts throughout 2009-2010. The general trend being towards the decrease in the investment activity at the enterprises of large and medium business, in the 1st half of 2010 the proportion of investments in industry in the total volume of investments went up by 2.6 percentage points as compared with the corresponding period of the previous year and made 48.3%. The concentration of investment expenses in the industry was accompanied with the contraction of investment activity scale in extracting and manufacturing sectors by 2.5% and 15.1% as compared with the corresponding period of 2009 and their growth in electricity, gas and water production and distribution by 23.5%.

Table 5

INVESTMENTS IN FIXED ASSETS (EXCLUDING SUBJECTS OF SMALL-SCALE ENTREPRENEURSHIP
AND VOLUME OF INVESTMENTS NOT REGISTERED BY DIRECT STATISTICAL METHODS)
IN 1ST HALF OF 2009-2010

	RUR billion		As percentage to the total		Growth rates versus the corresponding period of the previous year	
	2009	2010	2009	2010	2009	2010
Total	2188.7	2108.1	100	100	95	89.8
agriculture, hunting and forestry	75.7	70.9	3.5	3.4	74.8	96.3
fishing, fish breeding	1.1	1.5	0.1	0.1	85.8	117.2
industry	987.6	1019.6	45.7	48.3		
minerals extraction	416.5	429.1	19.0	20.4	90.7	98.5
manufacturing industries	375.5	344.7	17.8	16.3	97.8	84.9
electricity, gas and water production and distribution	195.6	245.8	8.9	11.6	100.6	123.5
construction	78.7	61.0	3.6	2.9	97.5	98.4
wholesale and retail trade	44.9	46.9	2.1	2.2	96.2	89.3
hotels and restaurants	8.6	9.9	0.4	0.5	89.9	111.7
transportation and communication	558.5	537.4	25.5	25.5	105.4	92.0
railway transportation	90.4	140.4	4.1	6.7	61.4	121.4

Table 5, cont'd

	RUR billion		As percentage to the total		Growth rates versus the corresponding period of the previous year	
	2009	2010	2009	2010	2009	2010
pipelines transportation	232.5	197.2	10.6	9.4	147.4	87.3
communication	66.6	67.6	3.0	3.2	75	104.0
financial activity	32.1	24.7	1.5	1.2	135.3	78.6
operations with real estate	233.0	188.5	10.6	8.9	76	74.0
state management, military security; social insurance	33.7	26.9	1.5	1.3	106.7	77.2
education	32.8	32.0	1.5	1.5	80.9	94.4
health care and social services rendering	38.7	41.3	1.8	2.0	93.2	107.9
utilities, other social and personal services	48.8	47.5	2.2	2.2		98.4

Source: Federal State Statistics Service

In the 1st half of 2010 the proportion of transportation in the total volume of investments made 22.3% and that of communication – 3.2%. The absolute volume of transportation financing in the 1st half of 2010 reduced by RUR 22.0 billion. At the same time the investments in railway transportation development went up by 21.4%, while investments in pipeline transportation made 87.3% versus the figures of the corresponding period of the previous year. However in the 2nd quarter 2010 the investments in pipeline transportation were observed to increase by 5.6% versus the corresponding period of the previous year. Investment plans of oil and gas companies envisage the increase in investments as a result of the year. The Investments of open joint-stock company Gazprom in pipeline transportation development in 2010 are expected to reach RUR 405 billion, which by more than 30% exceeds the level of 2009.

The investments in the types of economic activities that are traditionally characterized by high proportion of budget funds in financial sources were at satisfactory level. Thus, the growth of investments in health care made 7.9% versus the corresponding period of the previous year, that in scientific research and development – 2.4%. Contraction of investments in fixed assets in the sector of education can be regarded as a negative factor.

Decrease in investments in fixed assets in the sector of “operations with real estate, rent and services rendering” by 26.0% versus the first half of 2009 can be accounted for by the changes in the traditional investment behavior of the population, which since recently prefers bank deposits to the investment activity (increase in deposits made 26.2% in the first half of 2010 versus the corresponding period of 2009).

The drop of investment in fixed assets of 10.7% observed this July as compared with the previous month and the change in the direction of investment flows towards the compensation of losses caused by nature and climate anomaly will certainly result in the correction of investment programs and expected estimation of the investments structure and dynamics till the end of the year. ●

FACTORS FOR ECONOMIC GROWTH IN 2009–1ST HALF OF 2010¹

E.Astafieva

The results of decomposition of output index (GDP) in 2009 and in the 1st half of 2010 are presented in the section. According to the decomposition made in the period under consideration GDP growth rates are on average by 30% accounted for by the changes in labor input, the input of this components decreasing by nearly half throughout 2009 (from 41.4% in the 1st quarter to 20.4% in the 4th quarter), increasing again up to 40.3% by the 2nd quarter 2010. The changes in the volumes of capital involved in production process had a more considerable impact on GDP growth rates: whereas in the 1st half of 2009 capital input growth rates were but one third of the labor input growth rates, starting with the 3rd quarter 2009 capital input has been becoming a more important factor than labor input, exceeding the latter input by nearly two times in the 2nd quarter 2010.

According to the data of the Federal State Statistics Service, 2009 is characterized by negative quarterly GDP growth rates, although, it should be noted that during the year the decrease rates were observed to reduce: whereas in the 1st quarter the decrease in the GDP as compared with the corresponding period of the previous year made 9.4%, in the 4th quarter it was equal to 3.8%. in the 1st half of 2010 the growth rates of the real volume of the GDP became positive making 2.95 in the 1st quarter and 5.2% ² in the 2nd quarter.

With the exception for the 4th quarter 2009 in which negative GDP growth rates were observed against the background of the increase in labor and capital input, changes in GDP volume and input of the main factors are characterized by uniform dynamics: the output contraction is accompanied with the decrease in the main extensive factors (1st03rd quarters of 2009), while output growth – by their increase (1st02nd quarters 2010).

According to the decomposition made (*table 1, fig. 1*), in the period under consideration GDP growth rates are on average by 30% accounted for by the changes in labor input, the input of this components decreasing by nearly half throughout 2009 (from 41.4% in the 1st quarter to 20.4% in the 4th quarter), increasing again up to 40.3% by the 2nd quarter 2010. The changes in the volumes of capital involved in production process had a more considerable impact on GDP growth rates, on average, with the exception for the end of 2009, it was equal to 54%. Thus, in 2009 it is the total factor productivity that is the main factor determining the dynamics of output growth rates, which changes account for on average 70% of the GDP growth, in 2010, though, the input of this factor is negative.

Table 1

STRUCTURE OF GDP GROWTH RATES
(AS COMPARED WITH THE CORRESPONDING PERIOD OF THE PREVIOUS YEAR)

	1 st quarter 2009	2 nd quarter 2009	3 rd quarter 2009	4 th quarter 2009	1 st quarter 2010	2 nd quarter 2010
Growth rates						
GDP	-9.40	-10.80	-7.70	-3.80	2.90	5.20
I. Input of factors	-4.89	-4.18	-4.13	1.08	5.10	5.75
I.1 Labor	-3.90	-3.05	-1.93	-0.77	0.77	2.10
Employment	-1.33	-1.54	-1.00	-0.66	-0.20	0.50

¹ The results of the decomposition of the growth of the output index (GDP) in 2009 and in the 1st half of 2010, which have been obtained in concordance with the method, described in IET's work ("Factors of Economic Growth", series of Scientific Works, No 70, IET, Moscow, 2003, www.iet.ru) are presented in this. The decomposition is based on the breakdown of the economic growth into extensive and intensive components that allows estimating the growth quality, forecast further trends of economic development.

² Estimation by the Ministry of the Economic Development of the Russian Federation

Table 1, cont'd

	1 st quar- ter 2009	2 nd quar- ter 2009	3 rd quarter 2009	4 th quar- ter 2009	1 st quar- ter 2010	2 nd quar- ter 2010
Hours worked	-2.56	-1.50	-0.93	-0.11	0.98	1.60*
I.2 Capital	-0.99	-1.14	-2.19	1.85	4.33	3.65
Fixed assets	1.44	1.54	1.68	1.64	1.59	1.58
Degree of facilities load	-2.43	-2.68	-3.88	0.22	2.74	2.07
II. TFP	-4.51	-6.62	-3.57	-4.88	-2.20	-0.55
As percentage to the GDP						
GDP	100.0	100.0	100.0	100.0	100.0	100.0
I. Input of factors	52.0	38.7	53.6	-28.4	176.0	110.6
I.1 Labor	41.4	28.2	25.1	20.4	26.7	40.3
Employment	14.2	14.3	13.0	17.5	-7.0	9.6
Hours worked	27.3	13.9	12.1	2.9	33.7	30.7
I.2 Capital	10.5	10.5	28.5	-48.8	149.3	70.2
Fixed assets	-15.3	-14.2	-21.9	-43.1	54.8	30.5
Degree of facilities load	25.8	24.8	50.4	-5.7	94.5	39.8
II. TFP	48.0	61.3	46.4	128.4	-76.0	-10.6

* - in the 2nd quarter 2009 the figure for hours worked were obtained on the basis of the regression model, in which the hours worked by all the employed is considered to be the explained variable, while the number of the employed that worked full-time, part-time and on holidays estimated on the basis of the data of the previous years are the factors.

The structure of labor input is not uniform by quarters: while in the 1st half of 2009 the decrease rates of hours worked were nearly 1.5 times more intensive than the decrease rates of the number of the employed, later the significance of input is shifted towards the labor stocks, so in the 2nd quarter 2009 the input of changes in the number of the employed is twice as important as the input accounted for by the changes in the hours worked by them, and in the 1st half of 2010 the latter component again dominates. It should be noted that on average in the period under consideration it is the changes in the hours worked that is the most significant component of labor input defining their input in GDP growth rates. The situation observed testifies the fact that the number of hours worked is a more flexible instrument for adaptation to the changes in the situation at the market and consequently reacts more rapidly to the changes in the economic conditions. Responding to the outlining positive trends in the economy development, the intensity in the use of labor resources demonstrates the acceleration of growth rates: negative figure of this index reduced in absolute value from 4.5% in the 1st quarter 2009 to 0.2% in the 4th quarter and became positive in 2010. On average the growth rates of hours worked were observed to increase by 1.5 percentage points in a quarter. The increase in the growth rates of the number of the employed average for a quarter is significantly below (makes 0.7%) and they were registered to become positive only later, in the 2nd quarter 2010. It should be noted that the changes in labor input are mainly accounted for by the increase in the proportion of the employed in the economically active population, while the proportion of economically active population in the total number of population as well as the proportion of economically active population in the number of able-bodied population remained practically unchanged.

The period under consideration is characterized by the increase in the capital input: whereas in the 1st half of 2009 the capital input growth rates were only a quarter of the growth rates of labor input, starting with the 3rd quarter 2009 capital input has been becoming more and more important factor as compared with labor input, exceeding the input of the latter by nearly two times in the 2nd quarter 2010. It should be noted that the prevailing of the capital input over the labor input in the structure of the output growth rates is characteristic for GDP decomposition in the pre-crisis period. The same as in the case of labor input, positive phenomena in the economy were reflected by the fact that capital input growth rates became positive, though this was registered not at the beginning of 2010 but in the 4th quarter 2009.

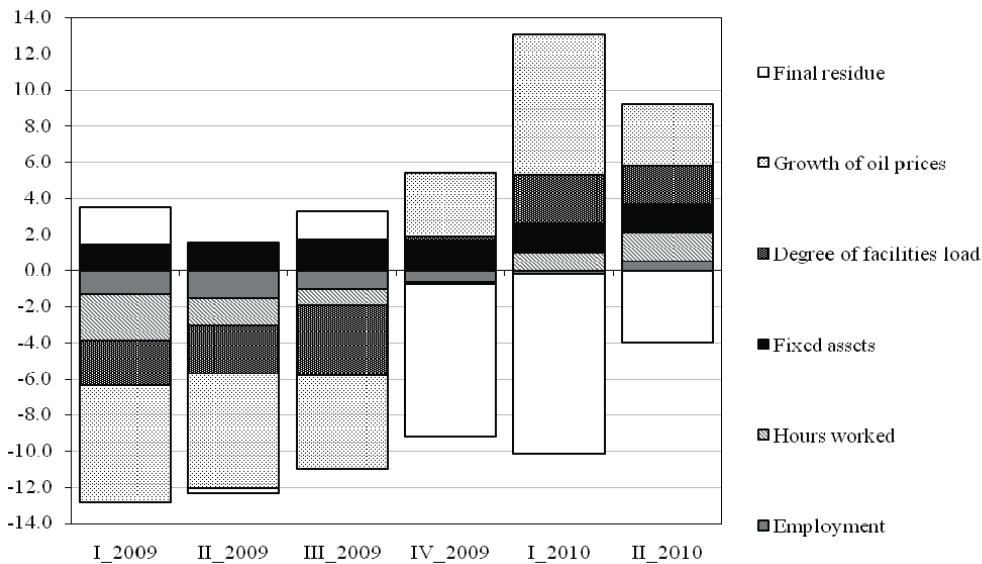


Fig. 1. Decomposition of GDP Growth Rates as Broken by Factors (As Compared with the Corresponding Period of Previous Year) and Estimation of Oil Prices Impact

remain practically unchanged. In the period under consideration it is the fluctuations in the degree of capital use that, as in case of labor input, are the most important component in the changes of capital input. It should be noted that the volatility of fixed assets use intensity also defines the direction of the capital input changes.

Total factor productivity (TFP) is the dominating factor for the GDP growth rates in 2009, accounting as it does on average 71% of the output growth rates. In 2010, however, the productivity contributes into the decrease in output growth rates. It should be noted that in contrast to the extensive factors, TFP is characterized by negative growth rates throughout the whole period though their dynamics is characterized by the decrease in absolute values: on average by quarter the decrease rates were observed to decelerated by 0.8 percentage points (0.9 percentage points in concordance with the linear trend²).

The observed negative impact of TFP on the output dynamics reflects the influence of not only the factors productivity defined by technological changes. It also includes the components that were not accounted for when estimating main factors and shifts connected with the method of estimation, for instance shifts determined by the uneven dynamics of the value indices used for decomposition (output and capital)³. As it is shown by estimations received for earlier periods, in the Russian economic system, which is dependent on the price situation at the world markets of raw materials, these shifts play an important role especially in the short run.

In concordance with the results obtained⁴, the large part of GDP growth rates is accounted for the dynamics of oil prices. On average in the period under consideration the changes in price factor defined about 72% of the output growth rates, while technological productivity ("final

In concordance with the estimation methodology¹ the dynamics of the capital stocks is determined by the changes in investments in fixed assets, which growth rates in the period under consideration increased on average by 4.5 percentage points by quarter (from -17.3% in the 1st quarter 2009 to 5.4% in the 2nd quarter 2010). As a result, taking into account the existing degree of fixed assets depreciation, capital stocks growth rates re-

1 There being no quarter-by-quarter statistics available, the estimation of the growth of physical volumes of fixed assets in 2009 is based on the supposition that the coefficient of fixed assets withdrawal and the proportion of investments in their renewal is constant. It should be noted that the estimation obtained in such a way can be shifted in connection with the fact that it does not take into account the time lag between the moment the investments are received and the time they are used.

2 The estimations for the deceleration of growth rates according to the linear trend are considered only to decrease the dependence of the results on the choice of the initial and final year of the period under consideration

3 "Value" estimation of productivity coincides with "physical" in case the economy is characterized by long-term equilibrium and perfect competition. In other words, in case all possible exogenic shocks are taken into account in the current system equilibrium.

4 Allocation of component dependent on economic situation in TFP and conduction of further decomposition of output growth rates is based on the statistically valid connection between the TFP growth rates and growth rates of world prices for oil, which is estimated with the help of regression basing on the annual data in the period from 1993 to 2009. The "final residue" obtained as a result cleared from the influence of prices at the world markets of raw materials, is a more accurate estimation for technological productivity, i.e. intensive component of output growth.

residue”) – (-40%). The changes in “technological” component growth rates obtained upon allocation of influence of price situation at the world markets of raw materials as a separate factor are somewhat different from TFP dynamics. The growth rates of the “residue” are positive only in the 1st and the 3rd quarters of 2009, but on the whole over the period the dynamics of “technological” component demonstrated the acceleration of decrease rates on average by 1 percentage points over the quarter (by 1.7 percentage points in concordance with the linear trend). ●

FOREIGN TRADE

N.Volovik. K.Resenkova

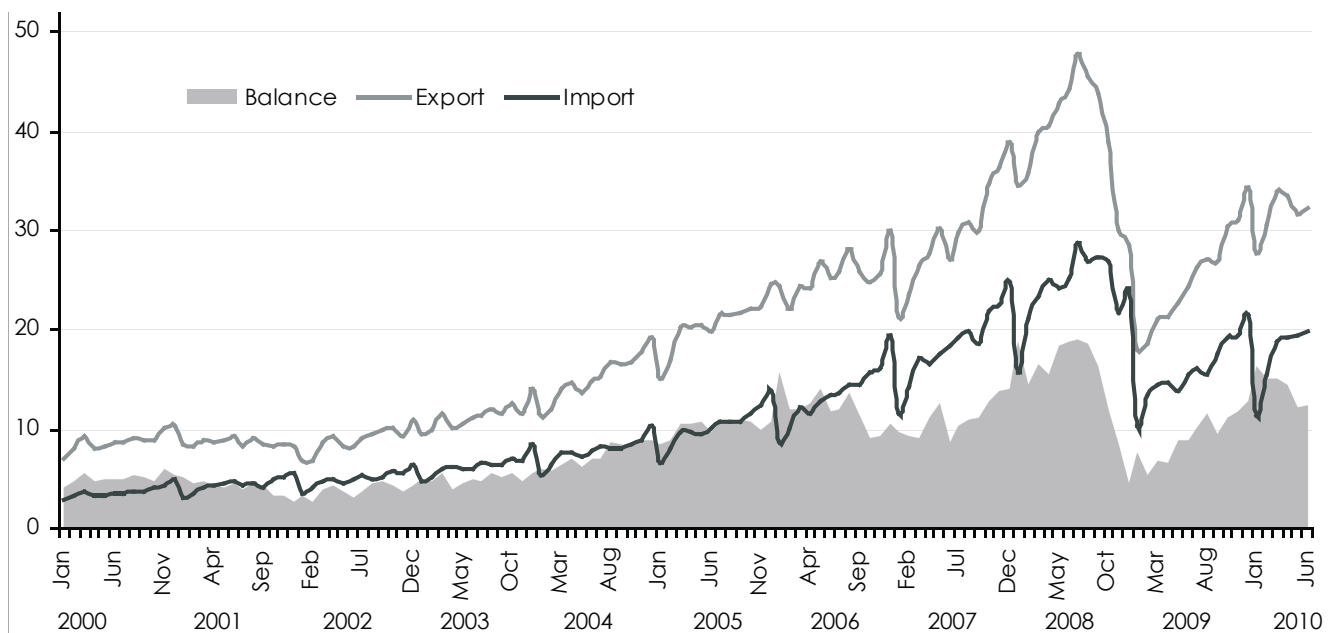
Russia's foreign trade turnover in the 1st half of 2010 made USD 293.9 billion, having increased by 41.5% versus the corresponding period of the previous year. Export of goods went up from USD 125.4 billion to USD 189.8 billion. Over the half of the increase was accounted for by the growth of average contract prices for oil and oil products. As a result of the 1st half of 2010 value volume of import supplies went up from USD 82.4 billion to USD 104.2 billion. Nearly two thirds of the growth is due to the expansion of physical volume of supplies. The proportion of machine-building goods broadened in the goods structure, while the import of passenger cars has shrunk considerably.

In June 2010 Russian foreign economic turnover calculated on the basis of balance-of-payments methodology made USD 52.2 billion, which exceeds the corresponding figure of 2009 by 30.8%. In June 2010 as compared with June 2009 the volume of export went up by 32% and made USD 32.3 billion, the increase versus May being 2.2%. the volume of import in June 2010 as compared with the corresponding period of the previous year went up by 29% and made USD 19.9 billion, growing by 2.3% versus May 2010. In June 2010 foreign trade balance of the Russian Federation was positive and made USD 12.4 billion, which is by 1.9% more than in May 2010 and by 37.1% - than in June of the previous year.

In the 1st half of 2010 the situation at the world markets was much more favorable for Russian exporters than in the 1st half of 2009.

Despite some decrease of prices at the beginning of the month, in June 2010 the dynamics of oil quotation was on the whole characterized by an upward trend.

In June 2010 price for oil grade Urals made USD 74.25 per barrel, which is by 8.7% higher than the level of June 2009, having increased by 1.25 versus May 2010. On average in the 1st half of 2010 price for oil grade Urals at the world market was equal to USD 75.9 per barrel, which is by nearly 1.5 times more than the average of the corresponding period of 2009.



Source: Central Bank of the Russian Federation

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

The dynamics of prices for oil products generally corresponded to the changes in oil prices. On the 1st half of 2010 versus the corresponding period of the previous year the prices for oil products, similar to those for oil itself, on average increased by 1.5 times, car petrol becoming by 46% more expensive, diesel fuel – by 43%, furnace fuel oil – by 58% (in the 1st half of 2009 the prices for these goods decreased by, correspondingly, 47%, 55% and 43% versus the analogous period of 2008).

Following the increase in oil prices for oil and oil products, export duty rate for oil has been rising consecutively: starting with September 1, 2010 it will grow by USD 9.7 versus the figure of August 2010 and will make USD 273.5 per ton. Export duty rate for oil from oil fields of the Eastern Siberia will increase by USD 6.7 – up to USD 87 per ton. Duty rate for light oil products will increase from USD 190 per ton, established on August 1, 2010, to USD 196.5 per ton, while the duty for dark oil products – from USD 105.9 per ton to USD 102.4 per ton.

Growth of prices at the world market for non-ferrous metals, which started in the 2nd quarter 2009 under the influence of the expanding demand, especially the demand from China, continued up to May 2010. According to the data of London Metal Exchange, in June 2010 versus June 2009 the prices for nickel and copper went up by 29.6%, prices for aluminum – by 22.7%, for ferrous metals – by 12.0%. As compared with May 2010 prices for nickel dropped by 1.9%, for aluminum – by 5.3%, for copper – by 4.9%, for ferrous metals – by 14.7%. as a result of the 1st half of 2010 as compared with the corresponding period of the previous year prices for aluminum went up by 1.5 times, for copper and nickel – by 1.8 times (in the 1st half 2009 prices for aluminum and copper decreased by 2.0 times, prices for nickel -by 2.3 times versus the corresponding period of 2008).

Table 1

AVERAGE MONTHLY WORLD PRICES IN JUNE OF CORRESPONDING YEAR

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Oil (Brent), USD/barrel	15.99	29.41	27.14	24.66	27.06	35.2	53.9	68.3	70.13	135.2	65.7	75.36
Natural gas, USD/1 million BTU	2.358	4.245	3.704	3.254	5.891	6.409	7.12	8.99	7.62	12.8	3.91	5.42
Petrol, USD/gallon	0.485	0.970	0.820	0.767	0.858	1.228	1.499	2.107	2.213	3.435	1.90	2.08
Copper, USD/ton	1552.1	1752.0	1615.3	1686	1703	2669	3524	7198	7469	8263	5014	6499
Aluminum, USD/ton	1327.3	1510.2	1467.7	1355	1410	1676	1731	2477	2672	2957	1570	1931
Nickel, USD/ton	5241	8384.3	6629.2	7110	8761	13322	16160	20755	41407	22556	14960	19378

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

The situation in the world economy has also influenced the price dynamics of other basic goods of the Russian export. While in the first four months of 2010 the prices for lumber resumed, in May and June the prices went down. The prices for mineral fertilizers under the influence of contraction of the world demand continued to decrease throughout the 1st half of 2010.

The dynamics of prices for foodstuffs and agriculture raw materials was not uniform in the 1st half of 2010. After prices for sugar reached maximum values in January 2010, they ere observed to drop dramatically up to June 2010. In May versus January 2010 the prices for raw sugar went down by 1.9 times, for white sugar – by 1.6 times. Despite the growth of prices in June, in the 2nd quarter versus the previous quarter raw sugar became 37% cheaper, white sugar – 29% cheaper. It was the forecasts for good harvest and expectations of growing sugar supplies to the world market by India and Brazil that were the main factors influencing the world market of sugar. Despite the decrease the sugar prices at the world market remained at the high level. In the 1st half of 2010 sugar was 1.5 times more expensive than in the corresponding period of the previous year (and in the 1st half of 2009 it was nearly 1.2 times as expensive as in the corresponding period of 2008).

In the 1st half of 2010 prices for grains (with the exception for barley, prices for which have been stable throughout the 1st half of 2010) continued to decrease due to considerable accumulated volumes of world stocks, increase in estimations of carry-over storage of grains, expansion of grain export supplies to the world market from Russia, Ukraine, Kazakhstan, Turkey and other regions

of the world. As a result, in the 1st half of 2010 versus the corresponding period of the preceding year prices for American wheat and corn decreased by 23% and 6.5%, correspondingly, Canadian wheat becoming 17% less expensive (in the 1st half of 2009 prices for these grains decreased by, correspondingly, 36%, 28%, 41% and 46% versus the analogous period of 2008). Prices for barley were 18% higher in the 1st half of 2010 than in the 1st half of the previous year.

The facts that the Asian countries of rice production expanded cultivation areas and increased crop capacity, as well as expectations of good harvests of this grain and increase in rice export supplies by the majority of countries contributed into the decrease of prices. In the 1st half of 2010 the prices for rice were 13% lower than in the 1st half of 2009 (and in the 1st half of 2009 – 15% lower than in the corresponding period of 2008).

However after the Russian Prime Minister announce a temporary ban for grain export in August 2010, December futures for wheat became 60 vents more expensive, making USD 8.155 per bushel, which is the maximum established by the exchange. The last time prices reached such a figure in August 2008. This decision also caused the leap in prices for rice and corn. Prices for rice went up by 2.8% up to USD 11.61 per 100 pounds, and corn became 4.5% more expensive, making USD 4.335 per 1 bushel.

Table 2

DYNAMICS OF AVERAGE WORLD PRICES FOR SOME AGRICULTURE GOODS

Wheat, USD/ton	2006	2007	2008	2009	2010					
					I	II	III	IV	V	VI
Canadian, CWRS	216.8	300.4	454.6	300.5	287.2	279.0	270.7	264.7	256.7	261.3
American, HRW	192.0	255.2	326.0	224.1	201.2	194.0	191.1	192.9	181.6	157.7
American, SRW	159.0	238.6	271.5	186.0	198.8	191.8	190.0	187.8	190.3	182.6
American corn, USD/ton	122.9	163.0	223.1	165.5	167.3	161.8	159.0	157.1	163.4	152.7
Barley, USD/ton	117.0	172.0	200.5	128.3	146.5	137.4	147.0	151.7	143.0	145.9
Soybeans, USD/kg	268.4	384.0	523.0	437.0	436.0	406.0	408.0	411.0	407.0	407.0
Soy oil, USD/ton	598.6	881.0	1258	849.0	923.0	914.0	915.0	903.0	865.0	859.0
Thai rice, USD/ton	304.9	326.4	650.1	555.0	568.8	535.0	505.3	466.0	451.3	440.0

Source: World Bank.

In the 1st half of 2010 Russian foreign trade turnover made USD 293.9 billion, having increased by 41.5% versus the corresponding period of the previous year. Export of goods went up from USD 125.4 billion to USD 189.8 billion. More than a half of the growth was due to the increase in average contract prices for crude oil and oil products. Physical volumes of natural gas supplies expanded by 1.4 times the average contract prices decreasing a bit. The total export of three main fuel and energy commodities made USD 122.1 billion versus USD 76.9 billion in the 1st half of 2009. Their proportion in the export structure expanded from 61.3% in the 1st half of 2009 to 64.9% in the corresponding period of 2010. The increase in export of non-energy commodities (by 36.2%) was both due to the increase in prices and the growth of export physical volumes.

Among the positive indicators in export development in the 1st half of 2010 one can note the formation of the trend for the improvement of lumber export and production of timber processing industry. Thus, over January-June 2010 processed timber export went up by 17.2%, wood-particle boards export – by 47.7%, plywood export – by 17.4%, whereas export of non-processed timber over the period under consideration reduced by 0.9%.

The acceleration of goods import growth was affected by some upsurge in the internal demand and appreciation of real effective ruble exchange rate. As a result of the 1st half of 2001 import value volume went up from USD 82.4 billion to USD 104.2 billion. Nearly two thirds of the increase value is accounted for by the expansion of physical volume of supplies. While the proportion of machine-building production in the import goods structure expanded, the import of passenger cars contracting noticeably.

In the 1st half of 2010 foreign trade balance made USD 85.6 billion, which is nearly twice the figure of the corresponding period of 2009.

As compared with the corresponding period of the previous year, in the 1st half 2010 conditions for the Russian trade have improved: export prices grew at considerably higher rates than import ones.

Table 3

RUSSIA'S FOREIGN TRADE INDICES (%)

	1st half of 2010 versus 1st half of 2009		June 2010 versus June 2009	
	Physical volumes	Average prices	Physical volumes	Average prices
Export	109,6	119,4	107,5	114,2
Import	122,6	101,8	130,2	97,2

Source: RF Ministry of Economic Development

In March 2010 largest Russian, Belorussian and Kazakhstan companies, for instance, Aeroflot, Transaero, Air Astana and Belavia applied to the Customs Union Committee with the request to abolish duties, referring to the fact that Russian aircraft industry cannot meet the demands of the companies and the necessity to pay duty rates for import equipment makes competing conditions for carriers and foreign carries unequal.

On July 16, 2010 the Customs Union Committee of Russia, Belorussia and Kazakhstan adopted the decision to nullify customs duty rates for airplanes. This measure, which comes into effect on August 19, 2010, is temporary and applies only to leasing schemes. Besides, it does not concern aircrafts of capacity from 50 to 111 seats and from 160 to 219 seats.

Zero duty rate will apply to aircrafts imported for the period up to the end of 2018 according to the contracts concluded up to 2014. In 2013 the parties will consider the prolongation of action of zero duty rates.

Earlier zero duty rates were already in effect in Belorussia and Kazakhstan. These countries do not have aircraft industries and did not put obstacles to the import of civil aircrafts from abroad. However during the process of the Customs Union formation this question was one the acutest since Russia did not want to allow competition for its companies with the foreign counterparts.

Earlier, in Russia zero duty rates for passenger aircrafts were applied only to aircrafts of two types – of less than 50 seats and more than 300 seats. From now on nearly all types of aircrafts are allowed for duty free import, the tariff protection applying only to domestically produced SSJ-100 (95 seats) and MS-21 (150–230 seats) and Russian-Ukrainian model An-148 (68–99 seats).

Duty rates nullification can stimulate the airlines to renovate their flying stock.

At the end of September 2010, the decision of the Customs Union Committee No 347 from August 17, 2010 “On correction of Common Customs Tariff of the Customs Union for used and recovered tires”, which increase import duty rates for used and recovered tire casings. The duty rate will make 20% of the total customs value but no less than Euro 20 per unit. The duty rate that is currently in effect makes 20% of the value of both recovered and used tires of all types with the exception for the tire casing for passenger cars – the duty rate for them makes 20% but no less than Euro 6.9 per unit.

It was the Russian producers – open joint-stock company SIBUR – Russian Tires and open joint-stock company Nizhnekamskshina. Open joint-stock company SIBUR Russian tires observes that the exploitation of used and recovered tires “decreases the safety on the roads and damages the environment”. In 2009 there were about 932 thousand of used tires imported into Russia, out of which 105 thousand were recovered ones.

Used and recovered truck tires are in highest demand. The whole market of the Russian truck tires made 4.23 million in 2009 (RUR 26.8 billion), import accounting for 34%. In 2010 the market is expected to grow by 23% up to 5.23 million (RUR 33.3 billion), and the share of import may grow up to 39% (47% in monetary terms).

New duty rates struck primarily small importing companies and garages that recover tires. They used to import tire casing declaring their minimum value.●

STATE BUDGET

E.Fomina

In August 2010, the Treasury Russia summarizes preliminary results of the federal budget for the first six months of this year. At the background of significant growth in budget revenues there was decreased its expenditure component, which led to a marked reduction in relative amount of the federal budget deficit by more than 2.5 percentage points of GDP, as compared with the relevant period of 2009. Deficit reduction over the first six months of 2010 was the result of cutting down measures of fiscal policy to support economy, taken by the Russian authorities in the recession period of 2008-2009.

Analysis of the main parameters of the expanded government budget execution in January-June 2010

According to the available statistics on the execution of the *budget of the expanded government* over the six months of 2010, the volume of the budget revenues has exceeded the level of the relevant period of 2009 by 1.9 percentage points. Herewith, the expenditures in relative terms has been reduced by 2.6 p.p. of GDP, whereas in absolute terms it has grown by approximately RUR 700 bn. As a result, as of July 1, 2010, the budget of the expanded government has been executed with the surplus of 1.3 of GDP, whereas in the relevant period of 2009 the expanded government budget balance was negative and made 3.2 per cent of GDP (See *Table 1*).

Table 1

EXECUTION OF THE BUDGET OF ALL LEVELS IN TERMS OF REVENUE AND EXPENDITURES
IN JANUARY-JUNE 2009-2010

	January-June 2010		January-June 2009 г.		Change, against GDP, p.p.
	RUR, bn	% of GDP	RUR, bn	% of GDP	
Federal budget					
Revenues	3997,9	19,0	3172,2	17,9	+1,1
Expenditures	4386,2	20,8	3893,9	22,0	-1,2
Deficit (-) /Surplus (+)	-388,3	-1,8	-721,7	-4,1	+2,3
Consolidated budgets of the RF Subjects					
Revenues	3155,7	15,0	2711,3	15,3	-0,3
Expenditures	2747,6	13,0	2611,7	14,8	-1,8
Deficit (-) /Surplus (+)	408,1	2,0	99,6	0,5	+1,5
The budget of the expanded government					
Revenues	7603,5	36,1	6042,7	34,2	+1,9
Expenditures	7331,2	34,8	6619,7	37,4	-2,6
Deficit (-) /Surplus (+)	272,3	1,3*	-577,0,9	-3,2	+4,5
For reference: GDP, bn rubles	21073,0		17679,6		

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

Source: The Ministry of Finance of the Russian Federation, assessments of Gaidar Institute for Economic Policy (IEP)

Consolidated budget of the Subjects of the Russian Federation over January-June of the current year was also executed with a surplus of 2.0 per cent of GDP against 0.5 per cent of GDP over the

same period of 2009. Herewith, the amount of expenditure for the 6 months of 2010 decreased by 1.8 p.p. GDP. Federal authorities recommend to pursue the recommend policy of restraining the growth of budget expenditures of the RF Subjects.

When exploring the volume of revenues to the budget of the country one should take into account the low base effect in the first six months of 2009. Then the budgeted revenues were low due to falling oil prices and a general economic growth recession. Comparison of the revenues for the first half of this year with their volume over the relevant period in 2008 shows that the current level of income is significantly below the pre-crisis level. Moreover, in early 2009 and 2010 investment income from the oil and gas funds assets management in the amount of 275.2 and 134 billion rubles accordingly was credited to the budget.

Exploring the structure of the formation of expanded government revenues (*Table 2*) it may be noted that their volume largely depends on revenues from profit tax, tax on personal income (PIT), tax on mineral extraction (MET) and the value added tax (VAT). Herewith, the dynamics of budget revenues in January-June of 2010 was largely based on foreign trade and tax on mineral extraction and to a lesser extent on an increase in corporate income tax, as well as contributions for mandatory pension insurance.

Revenue from *mineral extraction tax (MET) and income from foreign economic activity* over the 6 months of 2010 increased by 0.9 percentage points of GDP and by 2.0 percentage points of GDP, respectively. The grounds for high tax collection level were provided by the growth of global oil prices against the relevant period of preceding year. The positive effect of growth of global energy prices has been backed up by increase in the physical volume of production and export of hydrocarbons. In addition, following the increase of the global prices for oil and petroleum products, the export duties were consistently increased: from March to May 2010 the duty has grown from USD 253.6 to 284 per ton, and from June 1 it increased to USD 292.1 per ton. From July 1, 2010 the increase of export duty on oil was stopped, its value dropped to USD 246-250 per ton at the background of a decline in oil prices in June. However, since 1 August 2010 the value of export duty on oil rose to USD 263.8 per ton. Herewith, the duty on the East Siberian oil was set at USD 80.3 per ton, which is by 14.8 per cent more than the rate effective on July 1, 2010.

The rate of export duty on crude oil from September 1, 2010 may rise to USD 274-277 per ton, and to USD 87-89 per ton for oil fields in Eastern Siberia¹.

With the continued favorable prices trend and demand for commodities of oil and gas sector, the Russian government is reviewing the possibility of increasing the budget revenues by increasing the tax burden in the oil and gas sector. Currently there is discussed a possibility of increasing severance tax in 2011 by 61 per cent, which would replenish the state treasury in 2011-2013 by about 50, 60 and 70 billion rubles respectively. In addition, an increase of export duty on crude oil and oil products are under review, which will bring in additional 80 billion rubles to the budget². The above measures will increase revenue to the national budget system, thereby reducing the size of the deficit and reducing the need for the external market borrowings. However, the implementation of these measures will increase the tax burden on the oil and gas sector of the economy and decrease the profitability of the industry.

At the same time, to compensate for the increased tax burden on oil and gas sector, the government plans to introduce a zero rate of severance tax for new deposits throughout the Yamalo-Nenets Autonomous area³. However, the extent of the impact of this measure on the situation in the industry is doubtful, especially in view of the insignificant number of new fields in the said territory.

In general it may be noted that in the situation of the need to improve the sustainability of the budgetary system of the country, Russian authorities have chosen the policy of “targeted taxes growth”, in contrast to the European governments who chose to implement “head-on taxes growth”.

1 <http://www1.minfin.ru/ru/press/speech/index.php?id4=10393>

2 <http://www.kommersant.ru/doc.aspx?DocsID=1481244>

3 Currently the zero rate of severance tax for new deposits for the Yamal-Nenets Autonomous area is in effect within Yamal Peninsula.

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–JUNE 2009 AND 2010, % OF THE GDP

	6 months of 2010	6 months of 2010	Change, percentage points of the GDP
Level of tax burden (1+2+3)	32,4	29,8	+2,6
Revenues from taxes (1), including:	20,3	20,9	-0,6
Corporate profits tax	4,4	3,6	+0,8
Individual income tax	3,8	4,2	-0,4
Single social tax*	0**	2,3	-
VAT	5,4	5,4	0
Excise duties	1,1	0,9	+0,2
Severance tax	3,2	2,3	+0,9
Insurance contributions for mandatory pension insurance (2)	5,1	3,6	+1,5
Revenues from foreign economic activity (3)	7,0	5,3	+1,7

*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 Gaidar Institute assessments.

At the background of a tangible increase of oil and gas revenues, both in absolute and relative terms, other than oil industries demonstrate a weaker trend of revenue growth (*Table 2*). The share of revenue from *corporate profit tax* in the expanded government budget within January-April 2010 has increased by 0.8 percentage points of GDP as compared with the relevant period of preceding year. It should be noted that during the January-March 2010 the dynamics of revenue from that tax was less than the indicator of the relevant period of 2009, but in April the trend of the first months of this year was reversed. Most likely, this dynamic has developed under the influence of the relative improvement of the general economic background. .

Personal income tax revenues in the expanded government budget has declined to 3.8 per cent of GDP, which is by 0.4 percentage points of GDP lower than in the relevant period of the last year. At the same time, the real disposable monetary incomes of the population has grown over January-June by 5.1 per cent versus the level of the last year mostly under the influence of valorization of pensions in January 2010. The volume of revenue from the *VAT* in the first six months of 2010 remained at the level of the corresponding period of 2009 and amounted to 5.4 per cent of GDP, though in nominal terms one can note some growth. This dynamics is associated with improvement of tax administration and the gradual revival of business activity of economic agents. However, despite the stability of VAT collection indicators in relative terms, it should be noted that in absolute terms its indicator is somewhat lower than in pre-crisis period of the first half of 2008.

In January-June of 2010 there was a marked increase in *excise tax* revenue to the budget of expanded government. The increase in revenue was 0.2 percentage points of GDP as compared with to last year indicator. The reason for this growth was the rapid increase in tax rates on a number of excisable goods from 2010. In 2011-2013 it is planned to continue the indexing of specific rates of excise duties on tobacco products (on filtered cigarettes in 2011 – to the level of 280.4 rubles for a thousand units; in 2012 - to 360 rubles, in 2013 – to 460 rubles.; on non-filtered cigarettes, and mouthpiece cigarettes - to 250 rubles for a thousand pieces, to 360 rubles, 460 rubles, respectively). According to preliminary estimates, this tax measure will increase revenue from this tax in the amount of 105 billion rubles for the total period.

In general it can be noted that the level of the *tax burden* on the economy in 6 months in 2010 has increased by 2.6 percentage points of GDP as compared with the same period in 2009 and reached 32.4 per cent of GDP. To a large extent the increase of this indicator is due to the influence of external factors.

Against the background of growing revenue of the budget of expanded government within six months of 2010, expenditures demonstrated an explicit reduction. Budget expenditures decreased by 2.6 percentage points of GDP (*Table 3*). Herewith, it may be noted that in nominal terms expenditures increased by 711.5 billion rubles.

Table 3

EXECUTION OF THE BUDGET OF THE EXPANDED GOVERNMENT IN TERMS OF EXPENDITURES
IN JANUARY–JUNE 2009 AND 2010, % OF THE GDP

	January–June 2010		January–June 2009		Change, percentage points of the GDP
	RUR bn	p.p. of GDP	RUR bn	p.p. of GDP	
Total budget expenditures	7331,2	34,8	6619,7	37,4	–2,6
Among them					
Federal issues	615,2	2,9	567,8	3,2	–0,3
Including expenditures associated with the servicing of federal and municipal debt	131,0	0,62	112,4	0,64	–0,02
National defense	563,2	2,7	527,3	3,0	–0,3
National defense and law enforcement	578,6	2,8	546,3	3,1	–0,3
National Economy	791,0	3,8	1034,5	5,9	–2,1
Housing and public utilities	352,3	1,7	329,2	1,9	–0,2
Environmental protection	10,5	0,05	11,6	0,07	–0,02
Education	860,5	4,1	817,1	4,6	–0,5
Culture, cinematography and mass media	141,5	0,7	132,1	0,8	–0,1
Health care and sports	705,2	3,4	680,1	3,9	–0,5
Social policy	2713,1	12,9	1973,5	11,2	+1,7

Source: RF Treasury, Gaidar Institute estimates.

The worst decline in public expenditures in relative terms was based on the reduced funding for «National Economy» budget line - by 2.1 percentage points of GDP, for «Health Care and Sports» and «Education» - by 0.5 percentage points of GDP. In addition, lower rates in spending are noted in the direction of «Federal issues», «National defense and Law Enforcement» - by 0.3 percentage points of GDP lower than in the corresponding period of 2009 for each of these areas. An explicit growth of funding in the period under review was observed in «Social policy» budget line - by 1.7 percentage points of GDP.

RF federal budget execution within January–July 2010

According to the tentative estimates of the RF Ministry of Finance, *federal budget revenues* in January–July 2010 amounted to 18.8 per cent of GDP, which is by 0.6 percentage points of GDP exceeds the indicator of the relevant period of 2009 (*See Table 4*). The growth of federal budget revenues during the period under review was based primarily on an increase of revenue from the fuel and energy complex as a result of sustained relatively favorable market prices and demand for the Russian exports, as well as the resumption of the physical volume of production of hydrocarbons. According to the RF Tax Service, about 43 per cent of federal budget revenue in 2010 derived from severance tax and 42 per cent from VAT¹.

Federal budget expenditures in the seven months of 2010 decreased by 1.2 percentage points of GDP against the level of the corresponding period of the last year.

As a result, over January–July of this year, the federal budget is executed with a deficit of 2.2 per cent of GDP against 4.2 per cent of GDP in 2009. However, according to tentative assessments, the amount of non-oil deficit has grown by 0.2 p.p. of GDP as compared with the indicator of the preceding year and reached 10.7 p.p. of GDP. We would like to remind that the value recommended

1 <http://bujet.ru/article/86044.php>

by the World Bank experts should not exceed 5 per cent of GDP. Such a large amount of non-oil deficit shows a significant scope of the accepted state obligations not secured by non-oil budget revenue.

Table 4

BASIC INDICATORS OF THE RF FEDERAL BUDGET IN JANUARY-JULY 2009–2010

	January–July 2010		January–July 2009		Budget execution in % versus 2010 year estimates	Change	
	RUR, bn	% GDP	RUR, bn	% GDP		RUR, bn	% of GDP
Revenues, including:	4659,2	18,8	3805,8	18,0	59,9	853,4	+0,8
Oil and gas	2105,9	8,5	1325,8	6,3	56,2	780,1	+2,2
Contributions to the Reserve Fund and National Welfare Fund (Stabilization Fund)	26,5	0,1	277,1	1,3	–	–250,6	–1,2
Revenues, including:	5198,1	21,0	4698,8	22,2	50,9	499,3	–1,2
Interest expenditures	112,6	0,5	103,0	0,5	40,2	9,6	0,0
Non-interest expenditures	5085,4	20,5	4595,8	21,7	51,2	489,6	+1,2
Deficit / Surplus of the federal budget	–538,8	–2,2	–893,1	–4,2	18,3	+354,3	+2,0
Non-oil deficit	–2644,8	–10,7	–2218,8	–10,5	43,1	–426,0	–0,2
GDP estimates	24 795,0		21 159,6				

Source: RF Ministry of Finance (tentative estimates), Gaidar Institute estimates

The key source of funding for the federal budget deficit remains the Reserve Fund (*Table 5*). Its volume over 7 months has decreased by 605.3 billion rubles to 1225.2 billion rubles. However, as opposed to the expectations for its complete exhaustion before the end of 2010 to cover the federal budget deficit, it will not happen. A part of the Reserve Fund assets will be save money and spent to cover the budget deficit in 2011.

As of August 1, 2010 the volume of the Reserve Fund has reduced to 2663.8 billion rubles.

Table 5

DYNAMICS OF FEDERAL BUDGET OIL AND GAS REVENUE AND EXPENDITURE WITHIN JANUARY-JULY 2010, RUR BN.

Indicators	Balance as of late 2009	Estimated for 2010 budget	Revenue within January–July 2010	Utilized over January–July 2010		Balance as of early August 2009
				Support of the federal budget balance	Support to oil and gas transfer	
Oil and gas revenue of the federal budget	X	2057,2	2105,9			x
Areas of oil and gas revenues expenditure:	X	x				x
• Oil and gas transfers	X	2531,1	2105,9			
• Reserve Fund	1 830,5	5147,5	0	519,5	0	1225,2
• National Welfare Fund	2 769,0	x	26,5	2,5	–	2663,8
Total	4599,5	x	2132,4	522,0	0	3889,0

* balances are calculated at the rate of August 1, 2010

Source: Federal Treasury

Table 6 shows the dynamics of the cash execution of the federal budget for the six months of the current year, according to the functional classification of budget expenditures. It should be noted that in general the dynamics of federal budget expenditures over January-June 2010 exceeded (by 4.3 per cent against the annual budget estimates) the rate of the cash budget execution for the first six months of 2009. The accelerated rates are noted in the funds expenditures under the line of “Intergovernmental transfers” - by 12.3 percentage points in excess of the last year dynamics. This increase in the intergovernmental transfers is explained, in the first place, by a substantial increase of pensions in the current year, as well as by an accelerated transfer of funds to the Pension Fund. Cash execution of the federal budget in terms of the “Social Policy”, “Housing and public utilities”, “Culture, cinematography and mass media” is also executed at an accelerated rate.

Table 6

CASH EXECUTION OF THE FEDERAL BUDGET WITHIN JANUARY-JUNE 2009-2010
(% VERSUS BUDGET ESTIMATES FOR THE YEAR)

	January–June 2010	January–June 2009
Total Budget Expenditures	44,3	39,8
Including		
Federal issues	33,8	34,7
Including expenditures associated with the servicing of federal and municipal debt	31,4	36,8
National defense	44,5	43,3
National defense and law enforcement	43,5	43,3
National Economy	31,2	39,4
Housing and public utilities	47,5	23,3
Environmental protection	42,8	36,9
Education	41,4	39,9
Culture, cinematography and mass media	43,1	38,1
Health care and sports	34,5	32,5
Social policy	46,0	39,4
Interbudgetary transfers	53,0	40,7

Source: RF Ministry of Finance, Gaidar Institute estimates.

The greatest lag in bringing the federal funds to the recipients was noted under the “National Economy” budget line, it was by 8.2 percentage points lower than the values of the 6 months of 2009.

Despite the significantly advanced indicators of the federal budget execution in terms of expenditure in the current year against the last year dynamics, there is some lag from the estimates rates of budget expenditures for the complete year. According to tentative data, it was about 0,7 per cent for the first six months of the year.

Review of the key developments in the fiscal policy in August 2010

On August 2, 2010 the Russian government approved procedure for development, implementation and assessment of the government programs effectiveness (Decree No. 588 of August 2, 2010)¹.

It is worth to recall that in 2011, the introduction of a new format for the federal budget representation was planned, under which the amount of public funds from the federal budget will be allocated to the national programs. All national programs are divided into 6 sections (in the latest version of the document the total number of national programs has been decreased up to 38 against the initially planed 44. The majority of programs has are targeted at social support, and will be administered by the Ministry of Healthcare and Social Development of Russia. The amount of funding for each of the programs will be estimated after the approval of the annual budget plan for 2011.

1 <http://www.kommersant.ru/doc.aspx?DocsID=1485091>

Following the introduction of Program principle at the federal level, the structure of the regional budgets representation will be rearranged, which will also adhere to program-targeted approach¹. It is planned to revise the equalizing approach to different regions funding from the budget. In general, it is assumed to limit the amount of financial assistance from the federal budget in order to optimize public spending by reducing subsidies and intergovernmental budget transfers. ●

1 <http://bujet.ru/article/85392.php>

THE RUSSIAN BANKING SECTOR

S.Borisov

The increase of the Russian banking system's balance value in June 2010 was further strengthened by growth of the portfolio of credits allotted to non-financial organizations that reached its historic high. According to the statement of profits and losses of the banking system in Q II published by the RF CB, the main sources of profit generated by banks were net income from interest on credit allotted to non-financial organizations and net income from operations with securities. Incomes from credits allotted to the population were increasing at a low pace because of the high interest rates on deposits attracted in late 2009. Expenditures allocated to reserves dropped by 67 % on Q II 2009.

Table 1

THE MAIN INDICES OF THE RF BANKING SECTOR

	As of 01.07.2009, bn Rb	As of 01.01.2010, bn Rb	As of 01.07.2010		
			Nominal value, bn Rb	Growth since year's beginning, %	Year on growth, %
Assets	27, 776.2	29, 430.0	30 416.7	3.4	9.5
Credits allotted to non-financial institutions	12, 829.3	12, 541.7	13, 032.3	3.9	1.6
Credits allotted to physical persons	3, 697.9	3, 573.8	3, 672.4	2.8	- 0.7
Credits allotted to banks	2, 376.8	2, 725.9	2, 709.4	- 0.6	14.0
Investments in bonds	2, 225.9	3, 379.1	4, 082.5	20.8	83.4
CB's deposits	2, 002.8	1, 423.1	510.3	- 64.1	- 74.5
Banks' deposits	3, 409.3	3, 117.3	3, 237.7	3.9	- 5.0
Deposits of legal entities	5, 180.1	5, 466.6	5, 396.4	- 1.3	4.2
Population's deposits	6, 491.2	7, 485.0	8, 435.3	12.7	29.9
Reserves against potential losses	1, 572.2	2, 050.6	2, 241.2	9.3	42.6
Profit (current year)	6.8	205.1	249.6		3,570.6

Source: Bank of Russia.

Growth of assets in the Russian banking system in June amounted to a record 2.3 %, which was backed up not only by growth credit operations but also by investments in securities. Thus, despite the drop, by 1.2 %, of MICEX index in June, banks' investments in debt securities over that month increased by 5.6 % (interestingly, the highest growth rate was displayed by banks' investments in debt securities issued by resident non-financial organizations). As it traditionally happens in June, the size of the debt securities portfolio, including investments in bonds of the Bank of Russia, increased by 13 %. Banks continue to be interested in non-credit alternative investments, however the key role in the revival of the banking system's growth is being played by the continuing expansion of crediting granted to the real sectora. According to the RF CB's data, the portfolio of credits allotted to non-financial organizations in June increased by 2.1 %, while credits allotted to physical persons increased by 1.6 %.

The quality of the credit portfolio continues to improve: in June, the coefficient of ourstanding debt against credits allotted to legal entities dropped by 2 basic point – to 6.3 %, while with regard to retail credits this coefficient has remained at the level of 7.4 % - 7.5 % for a fourth month in a row. At the same time, the share of 'problem' and 'bad debt' loans (Categories 4 and 5) in the portfolios of Russia's 30 biggest banks dropped to 9.6 %, thus reaching its historic low since early 2010. The main consequence of the improved quality of the banking sector's credit portfolio has remained the slowdown of the rate of growth of reserves earmarked as insurance against potential losses on bank

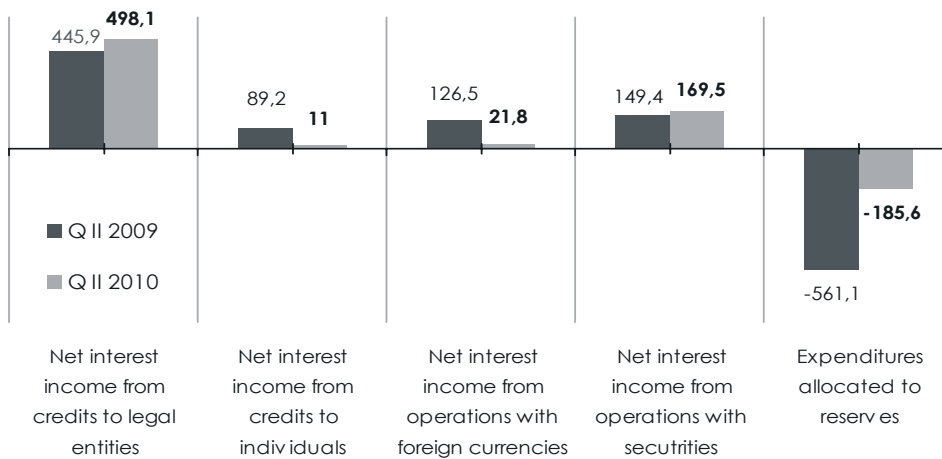


Fig. 1. Main parameters of the statement of profits and losses of the Russian banking system, bn Rb

loans, which in its turn conduces to a lower pressure on the profit of credit institutions.

The Bank of Russia published its summary statement of profits and losses of the Russian banking system based on the results of Q II 2010 (Fig. 1). The impressive growth of accumulated profit in the banking system by comparison with the same period of 2009 (249.6 mn Rb against 6.8 mn Rb a year ago) was determined by the following factors:

- Net interest income from crediting allotted to legal entities rose by 12 % by June 2009;
- Net interest income from crediting allotted to the population dropped on the same period of 2009 by 87 %, first of all due to the 33-percent increase of interest income. High interest expenses can be explained by the high interest rates on deposits attracted in Q III - IV 2009;
- Low volatility of the currency market in 2010 caused a substantial drop in credit institutions' incomes from their operations with foreign currencies (- 83 % by comparison with Q II 2009);
- the revival of the stock market was conducive to an increase of banks' net income from operations with securities – by 13 % by June 2009;
- the improved quality of the credit portfolio resulted on lower costs of the formation reserves against potential losses – by 67 % as compared to the same period of last year.

It is noteworthy that in June the rate of growth in the amount of assets attracted by banks was on the whole consistent with that of the growth of crediting volumes. According to data published by the RF CB, the increase over the month of the aggregate portfolio of attracted assets amounted to 2 %. In this connection, in June the highest rate of growth was displayed by the volume of organizations' monies on their settlement accounts with banks (+ 5 %) and bank deposits made by individuals (+ 3 %), as well as by the amount of credits received from other credit institutions (+ 4 %). In terms of speed, the most rapid growth was displayed by the population's demand deposits and deposits for periods of less than 30 days; their growth over the month was 7.2 %.

The size of banks' capital in June increased by 23 bn Rb (+ 0.5% per month), while the index of capital sufficiency is fixed at the level of 18.9 %.

Below is the list of the most notable events that occurred in the banking sector in July and August 2010:

- The Supervisory Board of the Bank for Development and Foreign Economic Affairs (Vnesheconombank) approved the creation of a special agency for export insurance. This export credit insurance agency is being established in order to implement market mechanisms for supporting the export activity of Russian companies. The agency will be an 100 % affiliation of Vnesheconombank, and it will begin to operate already in 2010.

- The volume of attracted syndicated credits in the first half-year (6.5 bn USD) was nearly equal to the total result of last year (6.7 bn USD). The biggest syndicated deals in 2010 were transacted by *Tatneft* (2 bn USD) and *Gazpromneft* (1 bn USD).

- In the draft of the RF Ministry of Finance's report 'On protection of the rights of consumers of financial services' it is suggested that a ceiling should be established for the amount of a credit's full value and the monthly redemption payments as a percentage of the borrower's income, while the size of fines and penalties should be pegged to the volume of outstanding debt.

- The Federal Treasury has initiated a project for modernizing the methods of transferring payments due to the budget. The goal here is to create a system of instant payments on the basis

of billing technologies. The participants in the projects can be *Sberbank*, *Uralsib*, *AK Bars Bank*, *VTB 24*, and other banks.

– After merging with *Sobinbank* and *Gazpromenergobank*, the *Russia Bank* joined the top 20 Russian banks. Its share in the sector's aggregate assets is 1%, and the share of its portfolio of credits allotted to legal entities – about 0.5 % of the market's total volume. ●

HOUSING MORTGAGE IN RF

G.Zadonsky

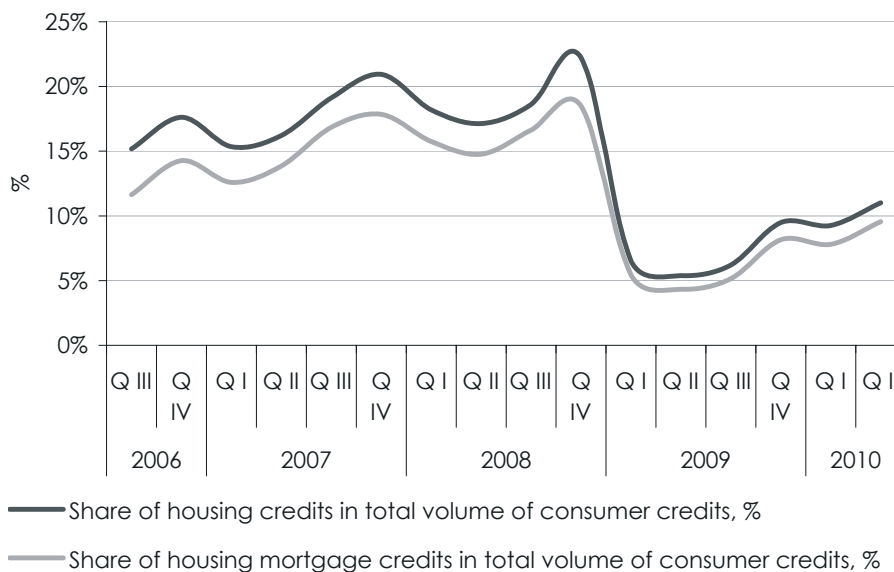
Over the first half-year 2010 the volume of allotted housing mortgage credits amounted to 133,34 bn Rb, which exceeds by 2.38 times the volume of the housing mortgage credits allotted in the first half-year 2009. Outstanding debt as of 1 July 2010 amounted to 3.73 % of the sum of residual debt, while the sum of debt against defaulted credits and credit arrears was 14.24 % of the total sum of debt. The Agency for Housing Mortgage Crediting, within the framework of the 'Stimul' Program concluded an agreement with banks for the implementation of 52 housing construction projects in different regions across the country, to the total sum of 14.3 bn Rb

According to the data of RF CB, in the first half-year 2010 credit institutions received a total of 142,590 housing credits (HC) in the amount of 155,298 mln Rb, including 107,208 housing



Source: RF Central Bank.

Fig. 1. Dynamics of crediting allotted to physical persons



Source: RF Central Bank.

Fig. 2. The share of housing credits and housing mortgage credits in the total volume of consumer credits, over quarter

mortgage credits (HMC) in the amount of 133,362 mln Rb. The total sum of the 105,609 Rb-denominated housing mortgage credits was 125,899 mln Rb. Residual debt against housing mortgage credits as of 1 July 2010 amounted to 1,033,809 mln Rb (in Q I 2010 – to 1,006,714 mln Rb), including 841,388 mln Rb against Rb-denominated credits. The volume of housing mortgage credits allotted in the first half-year 2010 was by 2.38 times higher than the same index for the period of the first half-year 2009, and by 2.54 times lower than that for the first half-year 2008 (339,183 mln Rb). In Q II 2010 the volume of allotted housing mortgage credits was 2.72 times higher (Fig. 1) than in Q II 2009.

According to Rosreestr (RF Federal Service for State Registration, Cadastre and Cartography), the total amount of registration entries concerning housing mortgage in the first half-year 2010 rose on the same period of 2009 by 59 %, thus amounting to 509,628, of which 242,795 entries

represent mortgaging by physical persons of the premises acquired (or constructed) by them against credits or targeted loans.

The share of housing mortgage credits denominated in foreign currencies in the volume of all housing mortgage credits in the first half-year 2010 dropped by comparison with the first half-year 2009 from 6.36 % to 5.60 %, while the share of debt against housing mortgage credits denominated in foreign currencies in the amount of aggregate debt against housing mortgage credits dropped from 21.67 % as of 1 July 2009 to 18.61 % as of 1 July 2010. Growth of the volume of consumer credits in 2010 (*Fig. 1*) was accompanied by an accelerated growth of the volume of housing mortgage credits (*Fig. 2*). By comparison with Q II 2009 the share of housing mortgage credits in the volume of all consumer credits actually allotted in Q II 2010 rose by 2.2 times (*Fig. 2*).

As of 1 July 2010 (*Fig. 3*), residual debt against Rb-denominated housing mortgage credits had risen by 5.43 % on 1 July 2009, while the amount of outstanding debt also increased – by 91.3 % and thus amounted to 22.27 bn Rb, or 2.65 % of residual debt. Residual debt against credits denominated in foreign currencies as of 1 July 2010 had dropped by 12.86 % on the end of Q II 2009, while the amount of outstanding debt over the same period increased by 65 % and reached the level of 16.3 bn Rb, or 8.47 % of that of residual debt.

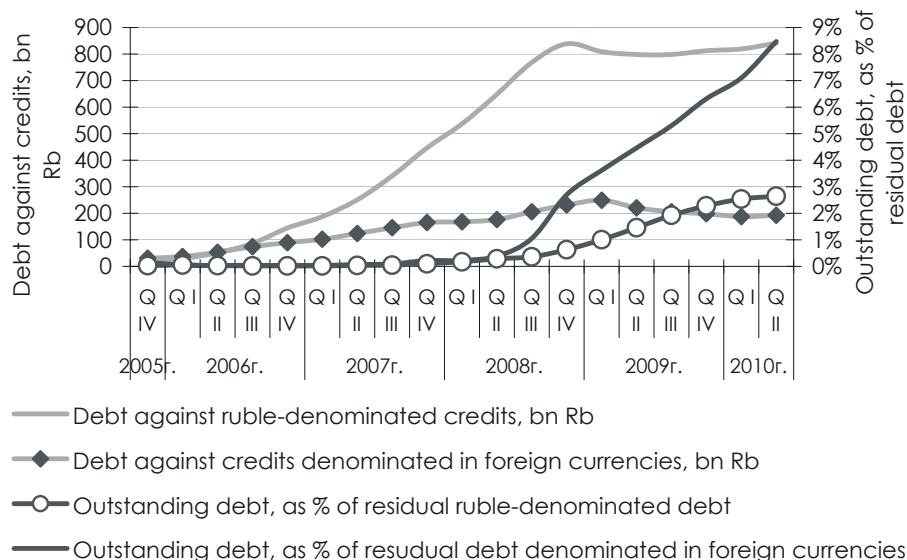
According to the data published by the RF CB, the amount of outstanding debt as of 1 July 2010 was 38,580 mln Rb, or 3.73 % of residual debt. The leader among regions by its share of outstanding debt is the Chechen Republic (18.10 %) followed by the Republic of North Osetia – Alania (12.13 %). These two are followed by Moscow Oblast (7.37 %), Tver Oblast (7.30 %), the city of Moscow (7.07 %), and Kaliningrad (6.48 %).

The share of debt against HMC less payments in arrears in the total amount of debt in 2010 decreased (*Table 1*) from 85.76 % (as of 1 February) to 85.50 % (as of 1 July). While the amount of outstanding debt as of 1 July 2010 was 3.73 % of residual debt, the sum of debt against defaulted credits and credit payments in arrears constituted 14.24 % of the total amount of debt.

Table 1

DEBT AGAINST HOUSING MORTGAGE HOUSING CREDIT BROKEN UP BY PERIOD OF DELAY IN PAYMENT

	Total amount of debt against HMC	Including									
		less payments in arrears		with payments in arrears between 1 and 30 days		with payments in arrears between 31 and 90 days		with payments in arrears between 91 and 180 days		with payments in arrears for over 180 days	
		in mln Rb	as %	in mln Rb	as %	in mln Rb	as %	in mln Rb	as %	In mln Rb	as %
2010											
01.02.	1, 008, 449	864, 843	85.76	49, 447	4.9	24, 120	2.39	17, 676	1.76	52, 363	5.19
01.03.	1, 005, 626	859, 381	85.46	51, 685	5.14	23, 573	2.34	17, 674	1.76	53, 313	5.3
01.04.	1, 006, 837	858, 600	85.28	53, 319	5.3	23, 604	2.34	17, 688	1.76	53, 626	5.32



Source: RF Central Bank.

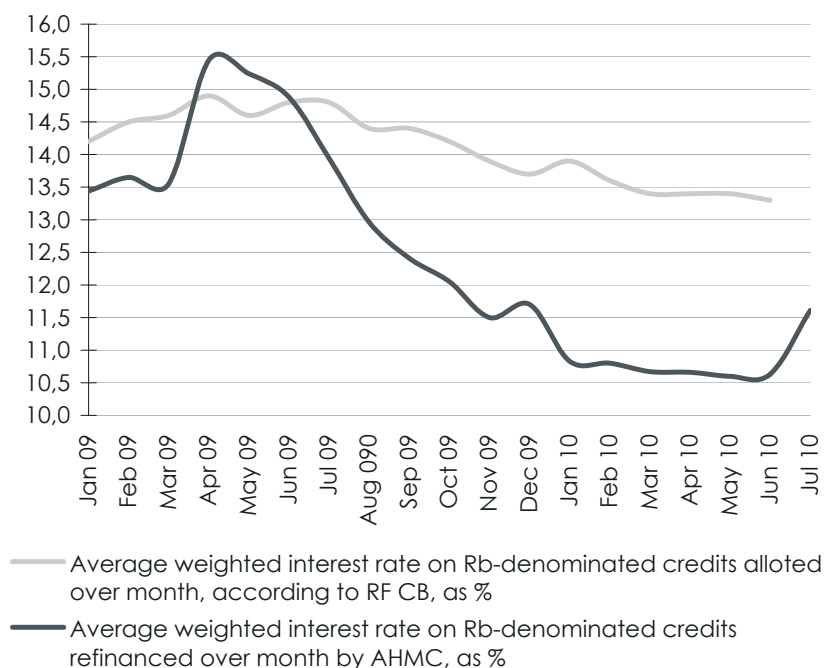
Fig. 3. Changes in residual and outstanding debt against housing mortgage credits

Table 1, cont'd

	Total amount of debt against HMC	Including									
		less payments in arrears		with payments in arrears between 1 and 30 days		with payments in arrears between 31 and 90 days		with payments in arrears between 91 and 180 days		with payments in arrears for over 180 days	
		in mln Rb	as %	in mln Rb	as %	in mln Rb	as %	in mln Rb	as %	In mln Rb	as %
01.05.	1, 013, 685	867, 253	85.55	52, 200	5.15	22, 518	2.22	19, 815	1.95	51, 899	5.12
01.06.	1, 025, 036	874, 010	85.27	53, 538	5.22	22, 680	2.21	18, 850	1.84	55, 958	5.46
01.07.	1, 033, 809	883, 880	85.50	54, 113	5.23	22, 433	2.17	15, 976	1.55	57, 407	5.55

Note. Columns 4; 6; 8; 10; 12: as % of total amount of debt.

Source: RF Central Bank.



Source: RF Central Bank; Agency for Housing Mortgage Crediting.

Fig. 4. Average weighted interest rates on Rb-denominated housing mortgage credits allotted over month

In the first half-year 2010 the decline of the interest rates on Rb-denominated housing mortgage credits continued (Fig. 4). However, with regard to the credits refinanced by the Agency for Housing Mortgage Crediting (AHMC), the period of July 2010 demonstrated growth of the average weighted rate on credits issued over that month (from 10.63 % in June to 11.61 % in July). The decline - in the first half-year - of the average weighted interest rate on credits denominated in foreign currencies that were allotted since the year's beginning gave way in June to an opposite trend, and so the rate went up to 11.1 % (in May - 10.9 %). The first half-year 2010 saw continuation of an upward trend displayed by the length of the period of Rb-denominated housing mortgage credits (Fig. 5). As for credits denominated in foreign currencies, in June growth of their

average period gave way to decline - from 14.16 years as of 1 June to 13.73 years as of 1 July.

Table 2

RATING OF FEDERAL OKRUGS BY LEVEL OF DEVELOPMENT OF HOUSING MORTGAGE CREDITING

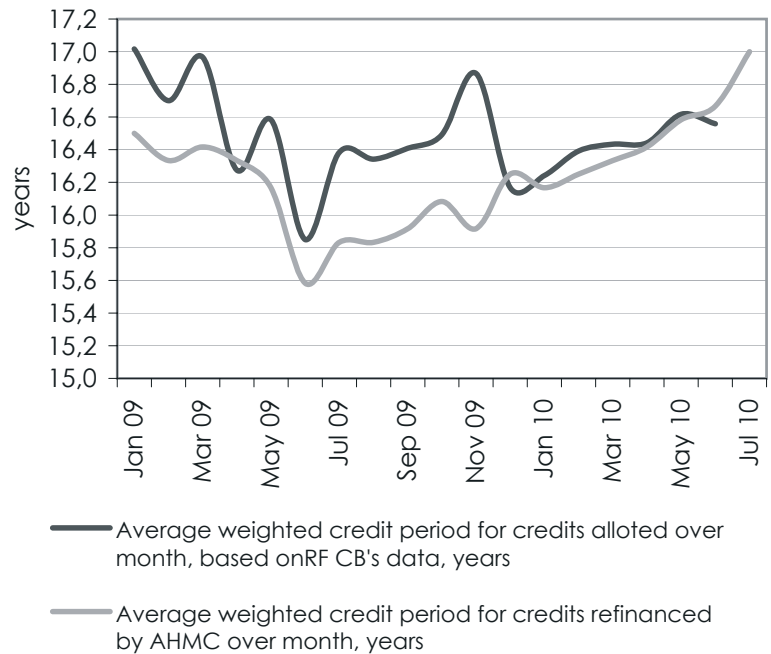
Federal okrug	Region's place by number of HMC per 100,000 population over 1 st half-year 2009	Region's place by number of HMC allotted over 1 st half-year 2009	Region's place by number of HMC per 100,000 population over 1 st half-year 2010	Region's place by number of HMC allotted over 1 st half-year 2010
CENTRAL	8	2	7	3
Moscow Oblast	10	10	8	9
City of Moscow	7	7	10	8
NORTH-WESTERN	3	5	5	5
St Petersburg	5	9	6	10
SOUTHERN	8	6	9	6
NORTH-CAUCASIAN	11	11	11	11
VOLGA	4	1	3	1
URALS	1	4	1	4

Table 2, cont'd

Federal okrug	Region's place by number of HMC per 100,000 population over 1 st half-year 2009	Region's place by number of HMC allotted over 1 st half-year 2009	Region's place by number of HMC per 100,000 population over 1 st half-year 2010	Region's place by number of HMC allotted over 1 st half-year 2010
SIBERIAN	2	3	2	2
FAR-EASTERN	6	8	4	7

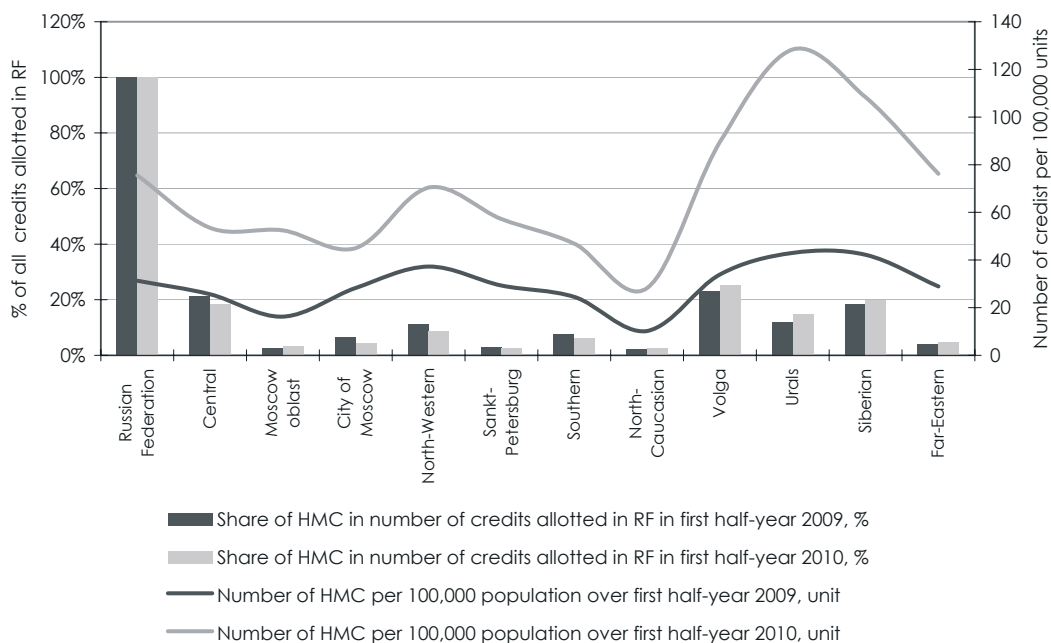
Source: RF Central Bank; Rosstat.

By the volume of housing mortgage credits allotted over the first half-year in 2009 and 2010 the top place (Fig. 6 and Table 2) belongs to the Urals Federal Okrug, followed by the Siberian Okrug. Third place in 2009 was occupied by the North-Western Okrug, where in 2010 it was replaced by the Volga Okrug – formerly the fourth. The leader by the number of credits issued per 100,000 of population is the Volga Okrug. First and second places in 2009 were occupied by the Central and Siberian Okrugs respectively, and in 2010 – by the Siberian and Urals Okrugs. The city of Moscow, Moscow Oblast and St. Petersburg by these parameters indicating the level of development of housing mortgage crediting fall behind the Urals, Siberian, Volga, and even the Far-Eastern Okrugs.



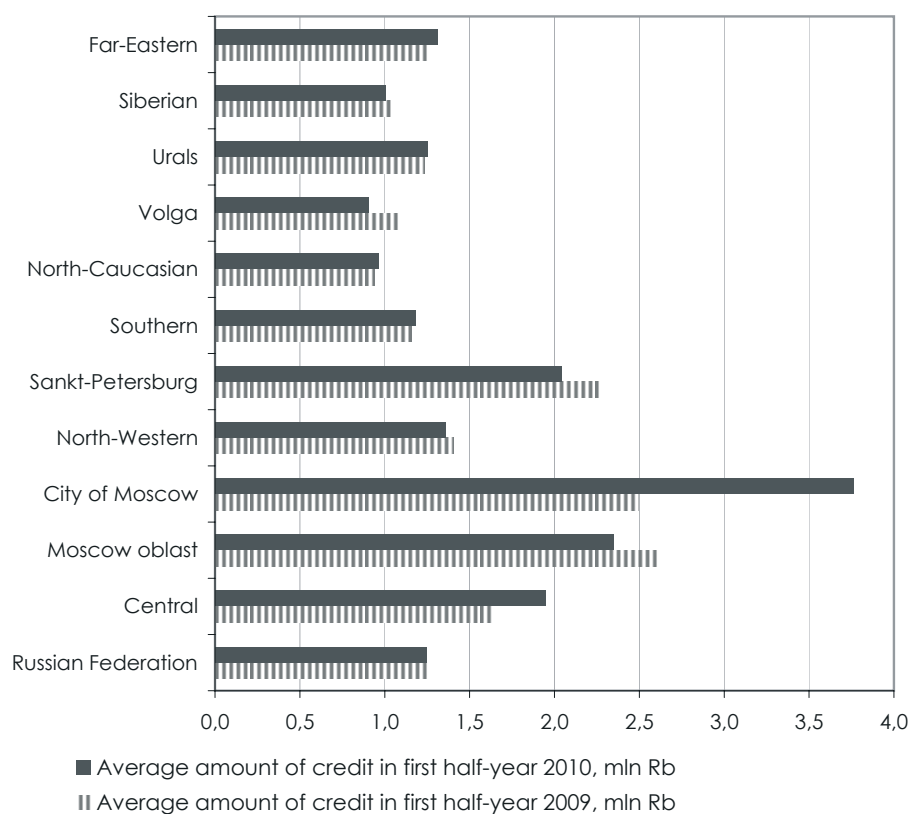
Source: RF Central Bank; Agency for Housing Mortgage Crediting.

Fig. 5. Average weighted periods on Rb-denominated housing mortgage credits over month



Source: RF Central Bank; Rosstat.

Fig. 6. Distribution, by federal okrug, of allotted housing mortgage credits.



Source: RF Central Bank.

Fig. 7. Behavior of average amount of housing mortgage credit, by federal okrug

The greatest change of the average amount of housing mortgage credit over the period from the first half-year 2009 to the first half-year 2010 (Fig. 7) was observed in Moscow, where it increased by 51 %.

According to the RF CB, as of 1 July 2010 housing mortgage crediting is part of activity of 585 credit institutions, while refinancing of housing mortgage credits with pool sales (rights of claim on housing mortgage credits) – 125 institutions. The top ten most productive banks in 2010 are presented in Table 3.

In the first half-year 2010 the volume of Rb-denominated housing mortgage credits, due to sale of mortgaged property (1,974.0 mln Rb), by 3.58 times exceeded the volume of credits redeemed ahead of schedule in the first half-year

2009 (551.9 mln Rb) (Table 4). The same index with regard to the volume of credits denominated in foreign currencies and redeemed ahead of schedule is 2,4. The volume of early redemption from borrower funds is almost the same both with regard to Rb-denominated credits and credits denominated in foreign currencies. The volume of early redemption from funding obtained as a newly allotted credits (re-crediting) is negligible.

Table 3

RESULTS OF OPERATION OF LEADING HOUSING MORTGAGE BANKS IN THE FIRST HALF-YEAR 2010

Bank	Volume of credits allotted mln Rb	Number of credits allotted	Growth on January-June 2009 of volume of credits allotted, %
Sberbank*	78,819	88,259	52
VTB	11,301	7,016	78
Gazprombank	5,799	3,150	120
Deltakredit	4,300	1,822	-
Transkreditbank	2,106	1,247	-28
Zapsibkombank	1,811	1,226	31
Zhilfinans	1,475	9,25	569
Bank ITB	1,342	1,096	196
RosEvroBank	1,321	373	100
Nordea Bank	1,266	428	159

*- data based on housing loan programs.

Source: Rusipoteka, based on primary sources.

Table 4

INFORMATION ON EARLY REDEMPTION OF HOUSING MORTGAGE CREDITS (RIGHTS OF CLAIM AGAINST HOUSING MORTGAGE CREDITS), MLN RB

	Volume of early redemption of housing mortgage credits (rights of claim against housing mortgage credits)							
	Rb-denominated, allotted (received)				Denominated in foreign currencies, allotted (received)			
	from borrower funds	from newly allotted HMC	from sale of mortgaged property	from other sources	from borrower funds	from newly allotted HMC	from sale of mortgaged property	from other sources
2009								
01 January	84, 846.60	110.5	350	6, 314.20	43, 091.90	20	279.7	10, 828.20
01 July	42, 650.60	5.5	551.9	17, 123.90	12, 471.30	9.6	204.3	2, 388.40
2010								
01 January	75, 113.00	5.5	1, 695.50	30, 680.40	22, 597.20	9.6	978.7	7, 532.50
01 July	42,672.00	30.00	1,974.00	9,932.00	11,699.00	5.00	492.00	784.00

Source: RF Central Bank.

Over the first half-year 2010 the AHMC refinanced 23.8 thousand housing mortgage credits in the total amount of 24.99 bn Rb, which constituted 22.2 % in quantitative and 18.7 % in money terms of all the credits allotted over that period. In the first half-year 2009 the AHMC refinanced 12 thousand mortgages in the total amount of 12.9 bn Rb, which in terms of value constitutes 23 %, and in terms of quantity – 27 % of all the credits allotted over that period.

According to the data provided by the RF CB, the refinancing of housing mortgage credits with the sale of housing mortgage credit pool (rights of claim against HMC) without creating an additional financial instrument in the first half-year 2010 was found to be at the same level as in the first half-year 2009 – both with regard to Rb-denominated credits and credits denominated in foreign currencies (Table 5). As for refinancing with subsequent emission of housing mortgage securities, in the first half-year 2010 there was none.

Table 5

THE VOLUME OF REFINANCED HOUSING MORTGAGE CREDITS (RIGHTS OF CLAIM AGAINST HOUSING MORTGAGE CREDITS), MLN RB

	Refinancing of housing mortgage credits, with pool sale of housing mortgage credits (rights of claim against HMC)				Refinancing of housing mortgage credits, with assets kept on credit institution's balance sheet	
	without creating an additional financial instrument		with subsequent emission of housing mortgage securities		Rb-denominated	Denominated in foreign currencies
	Rb-denominated	Denominated in foreign currencies	Rb-denominated	Denominated in foreign currencies		
2009						
01.01	53, 065,00	13, 903,50	18, 677,30	11, 374,30	2, 000,00	0
01.07	24, 289,20	4, 094,40	339,6	4, 448,20	0	0
2010						
01.01	36, 279,80	5, 158,30	17, 530,20	6, 434,00	15, 000,00	0
01.07	24, 847	4 441	0	0		

Source: RF Central Bank.

From 1 July 2010 it became possible to reduce the size of initial installment to 10 % of the value of the premises being purchased. These opportunities are now provided by Sberbank under the *Young Family* and *Housing Mortgage+* Programs and by the AHMC and VTB-24's partners, on

condition of insurance, on a mandatory basis, of the borrowers' responsibility for failure to fulfill their obligations of credit redemption or for improper fulfillment of those obligations.

On the basis of *The Monitoring of Effective Demand for Immovable Property and the RF Population's Expectations in Q II 2010* – a survey conducted by the AHMC's Analytical and Research Administration in cooperation with the International Institute for Marketing and Social Studies 'GFR-Rus' – it was determined that 13 % of Russian were planning to buy immovable property in the next 5 years, and that 2 % intended to do it over the next year. Among those who plan to buy property within the five-year period, the share of persons who intend to get a housing mortgage credit rose from 23 % in February 2009 to 31 % in July 2010, although in Q II 2010 the share of potential housing mortgaggers dropped by 3 % (from 19 % to 16 %), thus returning to the February 2009 level.

The AHMC, within the framework of the *Stimul* [Stimulus] Program, concluded agreements with banks that envisaged allocation of 14.3 bn Rb to the implementation of 52 housing construction projects in various regions across this country.

The amount of outstanding debt against the housing mortgage credits restructures by the AHMC is lower than that against the credits restructured by banks on their own, and its share is 8.4 %: 2.1 % - arrears over period more than 90 days, 1.9 %; 1.9 % - arrears over period between 60 and 90 days, and 4.4 % - arrears over period between 30 and 60 days. ●

SOME ISSUES CONCERNING TAXATION OF ORGANIZATIONS' PROFIT ARTICLE 282.1 OF RF TAX CODE

T.Malinina

By Federal Law of 25 November 2009, No 281-FZ, Chapter 25 of the RF Tax Code (TC) is augmented by Article 282.1 whereby the specific features of taxation of transactions involving loans of securities are specified. In accordance with the provision stipulated in Article 282.1 of the RF TC that came in force from 1 January 2010, the procedure for determining the tax base for the tax on profit of organizations in connection with the aforesaid operations was altered.

Prior to 1 January 2010, Chapter 25 of the RF TC contained no special provisions regulating the procedure for determining the tax base for operations of loaning securities (involving marginal transactions¹), as well as operations with securities attracted in the framework of loans. This lack of legal certainty was fraught with certain risks for taxpayers.

Thus, on the one hand, the norms stipulated in Subitem 10 of Item 1 of Article 251 and Item 12 of Article 270 of the RF TC contain provisions to the effect that property received (or given away) under credit or loan – no matter how this borrowing transaction may be formalized – as well as property given away (or received) as redemption of such borrowing transactions – is not to be included in the incomes and expenditures taken into account when estimating the tax base for tax on profit of organizations. Thus it can be concluded that when securities are loaned, taxable incomes are derived by neither the creditor (with the exception of receiving interest on the loan) nor the borrower participating in that transaction.

On the other hand, on the basis of the provisions stipulated in Article 280 of the RF TC and determining the specificities of determining tax base for operations with securities, tax base should always be calculated in an event of sale *or other disposal* of securities. In this connection, the term *other disposal* has no single definition in existing tax legislation², which means that in actual practice it can be interpreted in a variety of ways.

It should be noted that, in the opinion of the RF Ministry of Finance, transfer of securities in the form of loan is not treated as *other disposal* in the framework of Article 25 of the Code because in accordance with the RF Civil Code 'loan agreement shall be an independent civil legal contract unrelated to the notions of "sale" and "disposal"³. At the same time, as letters of the RF Ministry of Finance are not normative-legal acts, there still remained some risks associated with the possibility that there may arise a requirement that the tax base for tax on profit of organization should be applied to the allotment or redemption of a loan received in the form of securities.

In conditions of absence in tax legislation of any special provision concerning this issue, some problems also arose when determining tax base for operations with securities attracted within the framework of a loan. As borrowing of securities is not recognized as income for the purposes of levying tax on profit of organizations on the basis of Subitem 10 of Item 1 of Article 251 of the RF TC, it can be supposed that in an event of sale of securities attracted under a loan the resulting income for the purposes of taxation must be put on records in relation to their sale price (the acquisition charges are equal to zero). In this connection, if the redemption of a loan is not regarded as *other disposal* of securities in the framework of Article 280 of the RF TC, the expenses borne by

1 According to Item 4 of Article 3 of Federal Law of 22 April 1996, No 39-FZ 'On the Securities Market', marginal transactions are understood as transactions concluded by means of using monies and/or securities transferred by a broker as a loan.

2 In terms of Article 280 of the RF TC, *other disposal*, among other things, is understood as redemption and exchange of securities.

3 See, for example, Letter of the RF Ministry of Finance of 17 February 2006, No 03-03-04/2/37.

a taxpayer when repurchasing securities in order to redeem a loan are reflected for the purposes of taxation as losses¹.

This approach is fraught with no significant risks for taxpayers only if the date of sale of securities received as a loan and the date of their repurchase for the loan's redemption fall within one and the same tax period. Otherwise the aggregate tax base of an organization which has paid tax on income from the operations involving the attraction of securities during the period of their sale can be overestimated if the losses arising as a result of repurchasing these securities in future periods are not compensated in full².

From 1 January 2010, a new taxation procedure was introduced for the operations involving loaning of securities by organizations, as well as for operations with securities attracted as part of loans, which is established by Article 282.1 of the RF TC. This procedure is applied to loans of securities if the following basic conditions are complied with:

- the contract must envisage payment of interest in the form of money; the interest rate or the procedure for determining it is established by the contract³;
- the period of contract must not exceed 1 year⁴.

The existing procedure is as follows:

1) in an event of transferring securities as a loan and receiving securities as a redemption of a loan, the creditor does not determine the tax base in accordance with Article 280 of the RF TC (with the exception of instances of failure to fulfill or incomplete fulfillment of obligations to return securities; in such cases the loan is redefined as a transaction of purchase and sale of securities). The expenditures on the acquisition of securities given away under a loan agreement are put on record by the creditor during the subsequent (after the loan's redemption) realization of those securities (Item 4 of Article 282.1 of the RF TC);

2) in an event of realization (disposal) of securities received under a loan agreement, the borrower is subject to the provisions stipulated in Item 9 of Article 282 of the Code, i.e. the procedure established for taking and closing out short positions in REPO operations. In accordance with that procedure, the incomes and expenditures related to the operations with securities attracted as part of loans are taken on account for the purposes of taxation as of the date of repurchase of the securities;

3) the interest due to be paid by the borrower and received by the creditor under a loan agreement with regard to securities is recognized to be the borrower's extraordinary charges (the creditor's non-realization income). These charges are taken for the purposes of taxation with due regard for the provisions stipulated in Article 269 of the RF TC whereby the specific features of charging the interest on debt obligations to expenditures are established.

4) it is necessary to keep separate tax records for those securities that are given away (or received) within the framework of loan agreements. In this connection, analytic accounting should be kept for each granted (or received) loan (Item 10 of Article 282.1 of the RF TC).

Let us consider an example illustrating the changes introduced in the procedure for establishing the tax base for operations with securities attracted under loan agreements. Suppose that an organization, which is not a professional participant in the securities market, sells shares received under a loan agreement. The shares attracted as part of the loan and circulating on the organized securities market are sold for 15 thousand Rb; in 3 months, those same shares are repurchased for 12 thousand Rb in order to redeem the loan. The market value of the shares as of the moment of the loan's attraction is 16 thousand Rb, the rate of interest under the loan agreement is 10 %. Below the tax consequences of such an agreement in cases when it is concluded before and after 1 January 2010 are presented.

1 In particular, this viewpoint is shared by the RF Ministry of Finance (see, for example, Letter of 28 July 2008, No 03-03-06/1/433).

2 See below an illustrative example.

3 In order to determine the amount of interest payable on a securities loan agreement the market price of securities is applied, and in its absence – an estimated price. The market price or the estimated price of securities is determined in accordance with Items 5 and 6 of Article 280 of the RF TC.

4 In this connection it should also be noted that the problems and risks associated with the procedure for calculating the tax base for the operations of loaning securities that were concluded prior to 1 January 2010 are still relevant with regard to agreements for periods over 1 year.

Table 1

Interest	Prior to 1 January 2010	After 1 January 2010
	expenditures 400 Rb. (16 000 x 0,1 x 3/12)	expenditures 400 Rb (16 000 x 0,1 x 3/12)
Operations with securities received under loan agreement:		
As of date of attraction of loan	None	None
As of date of realization of securities	income 15 thousand Rb	None
As of date of repurchase of securities	loss 12 thousand Rb	income 3 thousand Rb (15 000 – 12 000)
As of date of loan redemption	None	None

The loss incurred by the the organization in the conditions existing prior to 1 January 2010 can decrease that period's income from operations with circulating securities (since the organization is not a professional participant in the securities market engaged in dealer activity, it determines separately the tax bases for operations with securities circulating and not organized securities market on the organized securities market), or it can be carried forward within the limits of the tax base for operations with circulating securities. Thus, the tax compensation of the loss will be less than in full (due to the factor of the time value of money) if the dates of sale and repurchase of the securities attracted under the loan agreement fall within two different tax periods.

It should be noted that the postponement of the determining of the tax base for the operations in question until the moment of repurchase of the securities attracted under a loan agreement is essentially not a tax credit. It is true that it is impossible to correctly estimate the amount of income to be received by a borrower organization until the moment of repurchase of securities. If the selling and purchasing price of securities attracted under a loan agreement during the period of the agreement grows instead of decreasing, the borrower will incur a loss as a result of the loan transaction; however without such a postponement tax will have to be paid on the entire cost of attracting securities as of the date of their realization. The taxation procedure for the operations involved in loans of securities that came in force from 1 January 2010 makes it possible to provide a solution to this problem. ●

REVIEW OF MEETINGS OF GOVERNMENT OF THE RF IN AUGUST 2010

M. Goldin

Among other issues considered at the meetings of the Presidium of the RF Government this August the project of the Federal Law “On making changes to the Federal Law “On making changes to part two of the Tax Code of the Russian Federation and some other legislative acts of the Russian Federation” was discussed.

On **August, 5th** at the meeting of the Presidium of the RF Government the project of the Federal Law “On making changes to the Federal Law “On making changes to part two of the Tax Code of the Russian Federation and some other legislative acts of the Russian Federation” was considered.

According to article 213 of the RF Tax Code in the version that was in effect from January 1, 2005 to January 1, 2008, the personal incomes taxation base included sums of insurance contributions paid in accordance with the agreements of voluntary pension insurance of employees if these sums were paid from the employers’ funds for the benefit of employees. The incomes received in the form of insurance payouts from these agreements were in their turn exempted from taxes if these payments were made upon benefits crystallization events in concordance with the legislation of the Russian Federation.

Starting with January 1, 2008 amendments to article 213 of the RF Tax Code came into effect, according to which insurance payouts for the agreements of voluntary pension insurance concluded by employers for the benefit of their employees are subject to taxation. At the same time incomes in the form of insurance contributions paid from employers’ funds for the benefit of employees according to the agreements of voluntary pension insurance were still exempted from taxation. Statements of article 213 of the RF Tax Code were challenged in the Constitutional Court since the new procedure of personal incomes taxation which came into effect on January 1, 2008 places the persons that were insured with the agreements of voluntary pension insurance concluded after January 1, 2008 and persons insured with the agreements concluded before January 1, 2008 in the positions of inequality, the first party having to pay personal incomes tax only from the sums of insurance payout, while the latter party having to pay the taxes both from insurance payouts and insurance contributions.

The RF Constitutional Court agreed with applicant’s reasons in its Ruling from 19.01.2010 No 137-O-P, indicating the fact that in the latter case double taxation of taxpayer’s incomes (economic benefit received by the insured person) takes place, which is inadmissible. In the opinion of the Court, the legislator changing the procedure for taxation with the personal incomes tax should have envisaged the specific consequences of new version of article 213 of the RF Tax Code coming into effect.

In order to resolve the existing situation the bill envisages changes being made to the Federal Law “On making changes to part two of the Tax Code of the Russian Federation and some other legislative acts of the Russian Federation” and legislatively state the possibility to calculate and pay personal incomes taxes on insurance payouts for the agreements of voluntary pension insurance concluded by employers for the benefit of their employees, contributions for which were paid by employers before January 1, 2008 to the full extent and according to the procedure that was in effect before January 1, 2008.

The RF Government approved the bill and decided to submit it to the State Duma.

At the meeting of the Presidium of the RF Government on **August, 9th** the decision was made to sell feed grain of intervention fund without bidding at the exchange, adopting the corresponding act of the RF Government that establishes the procedure for formation of volumes of feed grain to be sold in regions.

The procedure for sale mentioned above should take into account the volume of meat and milk production in the region, head of livestock and poultry, regional balance of production and consumption of forages and feed grain, volume of plant growing production damage this year.

The sale of feed grain will be made at the price of purchase, establishing the deadline for withdrawal of grain volume assigned for the region.

The deadlines for grain withdrawal are planned to be established from 1 to 2 months from the date the acts of the RF Government are adopted and the head of the subject of the Russian Federation submits the list of grain purchasers that is approved by the Government of the RF subject. ●

REVIEW OF ECONOMIC LEGISLATION

I.Tolmacheva

The following changes to the legislation were made in August: the period for submission of the application on managing maternity capital was prolonged; procedure for regulation of trade markets analysis with the aim to define their correspondence to antimonopoly legislation was regulated.

I. Instructions, Letters, Orders

1. Order of the RF Ministry for Health Care and Social Development from 17.08.2010 No 673n “ON MAKING CHANGES TO REGULATIONS FOR SUBMISSION OF APPLICATION ON MANAGING MATERNITY CAPITAL FUNDS (PART OF FUNDS), ESTABLISHED BY THE ORDER OF THE MINISTRY FOR HEALTH CARE AND SOCIAL DEVELOPMENT OF THE RUSSIAN FEDERATION FROM DECEMBER 26, 2008 No 779N”

Registered in the RF Ministry of Justice, 20.08.2010, No 18213.

In concordance with the changes introduced in the regulations for managing funds (part of funds) of maternal (family) capital, from now on the application can be submitted at any time after three years after the birth (adoption) of the second, third or following children have elapsed (according to the earlier version the application could be submitted at any time after 2 years and 6 months from the date of birth (adoption) of the second, third and following children have elapsed, but no later than May, 1st so that maternal capital funds can be used in the second half of the current year and no later than October, 1st of the current year so that maternal capital can be used in the first half of the year that followed the year when the application for use of maternal capital is submitted). It has also been specified that the application for cancellation of the application for the used of funds that was submitted earlier can be submitted before the regional body of the RF Pension Fund transfers maternal (family) capital or part of it in concordance with the application within two months since the application to use it was accepted.

2. Order of the Federal Antimonopoly Service of the Russian federation from 28.04.2010 No 220 “ON ESTABLISHING PROCEDURE TO CONDUCT ANALYSIS OF COMPETITION AT THE GOODS MARKET”

Registered in the RF Ministry of Justice on 02.08.2010 No 18026 The established “Procedure to conduct analysis of competition at the goods market” should be used by antimonopoly bodies for the analysis of the competition in order to establish the dominating position of an economic entity and revealing other cases of competition barring, limitation or elimination. The procedure prescribes to determine specific period for analysis of goods market (define the necessity of retrospect analysis), define product boundaries of goods market (find goods that do not have a substituent or interchangeable goods that circulate in the same goods market), define geographical boundaries of the goods market (boundaries of the territory in which customers purchase or have economic, technical or other possibility to purchase goods and do not have such possibility outside its boundaries), define the structure of economic entities operating in the market and calculate the volume of the goods market and shares of economic entities in the market. On the basis of the indices mentioned and with the use of coefficients established by the Procedure the level of goods market concentration as well as presence of barriers to enter the market can be determined, which, in their turn, serve as grounds to ascribe the market to the markets with developed competition, underdeveloped competition or undeveloped competition, as well as grounds for defining the prospects of changes in the competition at the goods market under consideration. In case the characteristics mentioned are insufficient to draw a conclusion to which type of the markets the market under consideration belongs, it is necessary to ana-

lyze the behavior of economic entities at the market, for instance , to study innovative activity and marketing strategy of sellers, establish the facts of privileges for certain customers, reveal agreements of economic entities as well as discover the sources of information on the goods that a customer can access, estimate reliability and novelty of the available information and estimate the expenses connected with receipt of such information.●

REVIEW OF REGULATORY DOCUMENTS CONCERNING TAXATION OVER JULY–AUGUST 2010

L.Anisimova

1. According to the Federal Law from July 27, 2010 No 229-FZ changes were made to the RF Tax Code and a number of other laws. The adopted Federal Law will be later associated mainly with the implementation of digital technologies in the relations between the taxpayers and taxation bodies. Some changes however concerned either directly or indirectly a number of acute problems which have not been solved so far. This concerns the relations between taxation bodies and banks as well as accounting contribution to the state social off-budget funds in the production expenses of employers.

Review of amendments made to the general part of the RF Tax Code

1) The question on the registering a natural person at a taxation body in case he does not have a place of permanent residence in the territory of the Russian Federation was specified – registration for taxation purposes is carried out in the place of his temporary residence

2) The opportunity to apply electronic documents when interacting with taxation bodies through telecommunication was postulated on condition these documents are certified with the electronic signature

3) The mechanism for electronic interaction between taxation bodies and banks was established by the law, for instance (article 60) it is envisaged that the taxation bodies can submit requirement to banks to transfer the tax sums of the payment orders received from the clients that were not transferred before within three months of revelation of such sums by taxation bodies. This is quite a necessary regulation. Three months are the period that is established by the Law for the bank to resolve the question why the sum of taxation payment is delayed with the client. As a matter of fact the bank can delay the transfer of tax sum due to the absence of funds at its (bank's) correspondent account, which can result both through the bank's and through its other clients' faults. Establishing quite a long period of three months from the day the untrasferred tax sums are revealed the RF Tax Code solves one of the key problems – defines the period for the bank to take measures to refinance or reclaim the debt from the client through whose fault the bank has a deficit of funds at its correspondent accounts. Unfortunately, up to the present moment the taxation bodies violating the RF Tax Code continue to account arrears in the taxpayers' files, who submitted order payments for taxes form the sums that are deposited in their accounts (i.e. those who fulfilled all the requirements of the Law concerning tax payments) in case the budget does not receive the funds due to the lack of money at the banks' correspondent accounts. This results in the lawsuits for tax recovery to bona fide taxpayers and artificially complicates the operation of the system of justice. The establishment of three-month period for the bank to transfer tax payments can allow the taxation bodies to organize the control over the path of clients' tax payments directly in the bank according to the data of the card file No 2.

4) According to the changes to the RF Tax Code adopted the responsibility of heirs to pay tax arrears for the deceased from the inherited property (article 59) was specified. There are taxation disputes possible, since the formal right for the property is granted to the heir from the date of legator's death registration. As to the execution of documents that testify the heir's rights for the property, the procedure can take years. The reference contained in the RF Tax Code to the fact that the debts are paid according to the general procedure envisaged by the RF Civil Code does not solve the question about possible penalty fees accrued to the heir for the period from the legator's death is registered to the execution of the right for property (receipt of the document confirming the right) by the heir. It seems that this issue requires further juridical specification.

5) The amendments to the RF Tax Code specify the mechanism for recognition of tax debt as non-recoverable and making decision on writing the debt off. The RF Subjects and municipal formations receive the right to establish additional grounds for the debt for regional and local taxes to be recognized as non-recoverable and its write-off.

6) The adopted amendments limit the possibility to receive investment tax credit in the period of three years from the moment of deferment (credit) for tax payments or investment tax credit became invalid due to the violation of the payment deadlines.

7) The question on the procedure for the changes in the period of tax payments to regional (local) budgets and the maximum sum of tax credit is considered in detail (articles 61-64). Tax credit (deferment) can be granted to an organization for the sum not exceeding its net assets value, to a natural person – for the sum not exceeding the value of its property excluding the property that in concordance with the RF legislation is not subject to sanctions.

8) The rate of investment tax credit is increased from 30% to 100% for the research and development or experimental design works, technical re-equipment of the production, including that aimed at creation workplaces for the disabled or at the protection of the environment from pollution with industrial wastes, increase in production energy efficiency and construction of objects characterized by the highest degree of energy efficiency.

9) The changes to the RF Tax Code regulate in detail the procedure to cease the operations with the taxpayer's accounts in banks in connection with tax legislation violations (article 76) and established the liability of banks to cease operation with clients' accounts and refuse accounts opening. Thus, from now on the issues of accounts opening and servicing are also regulated by the RF Tax Code as well – in fact the RF Ministry of Finance receives the authority to give explanations concerning some issues connected with accounts opening and servicing. It can be regarded as a positive sign that the amendments made do not give the RF Ministry of Finance the power to limit the application of banks' licenses despite possible tax legislation violations. However the introduction of independent rules concerning opening and servicing accounts to the Las other than the legislation on banks and banking activity is, in our opinion, a negative trend and can possibly lead to the conflict between the taxation legislation and special banking legislation, within which the licenses are issued.

10) The amendments consider in detail the procedure of registration and deregistration at taxation bodies of all groups of taxpayers, branches, permanent representative offices and separate structural branches of Russian legal entities and foreign organizations (articles 84-85).

11) The penalties for violation of registration period, submission of declaration (calculation) etc were increased

Review of changes made to special (second) part of the RF Tax Code

12) It is allowed to make detailed tax invoices in electronic form (article 169)

13) The value of the minimum cost of the amortized property was changed – increased from RUR 20- thousand to RUR 40 thousand (article 254)

14) Article 264 of the RF Tax Code was supplemented with the contributions to the state off-budget social funds. The RF Ministry of Finance holds the position according to which insurance contributions for any incomes the natural person receives as a result of relations with the employee should be regarded as employer's expenses taken into account when taxing its profit. This means that the contribution to social funds will be taken into account as production expenses regardless of the fact whether the resulting employee's incomes are labor remuneration or not. This violates the basic principle of profit taxation according to which only the expenses directly connected with goods (works, services) production and sale are taken into account. The payments for the benefit of employees that are not connected with labor remuneration are not regarded as such and, consequently, should not be regarded as producer's expenses. Taking into account the fact that social contributions are exempted from the control over the maximum tax burden on producers according to the legislation, it seems fair for these payments to be accrued not in addition to labor remuneration (which in fact is the subject of labor contract) and other employee's incomes but were deduced from the sums paid to the employee. This will solve two problems simultaneously: recover the control of employers over the level of production expenses and eliminate the contradiction between insurance contributions accrued to the wages and insurance contributions accrued to other types of employees' incomes that are not regarded as wages. In our opinion this issue will become the subject of court trial at some point since producers' expenses become dependent on factors that are not connected with the production which violated one of the basic principles of taxation in the market environment.

15) Other changes made to the RF Tax Code concerning the expenses taken into account for the purposes of profit taxation should be noted: they now include the expenses for drilling and conservation (abandonment) of wells. The direct inclusion of this regulation in the text of the RF Tax Code takes into consideration the interests of geological exploration enterprises.

16) Coefficients applied when calculating the expenses in the form of interest rates regarded as such for the purposes of profit taxation when using the method of thin capitalization (article 269) are changed. This is a forced decision that is a part of the complex of measures aimed at driving the country out of the financial crisis of 2009. Thus, the correcting coefficient when defining the interest payments for credits regarded as expenses has been temporarily increased: for 2010 it is allowed to apply the refinancing rate of the RF Central Bank multiplied by 1.8 for credits in rubles, and the rate of 15% for credits in foreign currency, the increasing coefficient of 1.8 will be maintained throughout 2011 and 2012 for credits in rubles, and for the maximum interest rate for credits in foreign currency the diminishing coefficient of 0.8 will apply.

17) Article 270 is supplemented with specifications concerning the refusal from recognition of aggregated differences for advance payments. In some Letters of the RF Ministry of Finance, for instance, from July 30, 2010 No 03-03-06/1/504, has already explained the issue of definition of accounting value of the property purchased for the foreign currency. However some complicated points require additional specification, which, unfortunately, are not clarified by the amendments to the RF Tax Code under consideration. The particular mechanism for formation of the taxation base for the profit tax in case of partial payment or payment by installments is not quite clear. The earnings are taken into account in rubles and is defined as on the date of sale (recognition of property transfer of goods (works, services). It is not clear how the earnings to (withdrawal from) banking account will be considered in case sum in rubles as on the date of final payment plus advance payment in rubles is higher (lower) than the price of the goods (works, services) as on the date of sale. In case the sums that are really received exceed the earnings there is an outstanding income, and in case the ruble sum is less than earnings there is a loss. The refusal from advance payments re-estimation, in our opinion, does not eliminate the question on accounting the evolving differences in the taxation base since the currency received as advance payment is to be sold for rubles on the date of receipt and ruble equivalent is reflected on the books of the organization.

18) Similar to the scheme for accounting for the purposes of personal incomes taxation of the payments received as a result of self-employment of the unemployed, the scheme for the formation of the profit taxation base for filmmaking companies that received the funds from the Federal fund for social and economic support of the domestic filmmaking for the purposes of production, distribution, demonstration and promotion of a national film with the budget allotments as a source of financing is formed (article 271, 273). According to this scheme for three years the sums received from the Fund are simultaneously taken into account among the incomes equal to the expenses really made in concordance with the conditions under which the funds were received. If the conditions under which the funds were received are violated, fund that were not used purposefully are included in the list of outstanding expenses of the corresponding financial year.

19) Amendments to the RF Tax Code allow the primary employers of towns, the number of employees at which makes no less than 25% of the total number of the economically active population of the corresponding town, to take the expenses of the structural divisions for housing fund maintenance for deduction when taxing the profit (article 275.1).

20) The legal confirmation of the fact that losses from the property that was transferred for trust management are not recognized as losses of the founder (beneficiary) is of importance. It should be noted that the new version of article 276 is quite rigid and testifies that the operations of trust managements of the property are subject to the regime of taxation base formation that is similar to the taxation of operations with non-marketable securities and futures (losses lower than incomes are taken into account).

21) The figure for earnings from each quarter that gives the right to transfer to quarterly advance payments as a result of the accounting period for the profit taxation was increased from RUR 3 million to RUR 10 million.

22) The positive re-estimation of contributions of founders in foreign currency into the statutory capital is excluded from taxable incomes of a bank; insurance payments within the unpaid sums

of credits and interest rates that are due to the bank in case of the death of the debtor as well as unsettled sums and interests for agreements of property insurance that serve as a warranty (mortgage) for the credit, that were accrued by the bank and recognized in the court and settled by the bank with insurance payments are exempted from taxation.

23) Corrections are made to rates of some state duties, and some amendments of form to the text of the RF Tax Code.

2. According to the Federal Law from July 27, 2010 No 207-FZ amendments are made to chapter 23 of the RF Tax Code on personal incomes taxation. The section concerning taxation of personal incomes from share participation in an organization is supplemented by the article regulating the determination of the taxation base when receiving the incomes in the form the payment for the use of monetary funds of the credit consumer cooperative members (shareholders), interests for the use of funds attracted in the form of loans from the members of agriculture credit consumer cooperative or associated members of agriculture credit consumer cooperative. For instance, interests within the refinancing rate of the RF Central Bank increased by 5 points for the period for which the interests were accrued are recognized as non-taxable profits. The personal incomes tax at the rate of 35% is paid from all the interest sums received by a natural person that exceed non-taxable volume.

3. The Federal Law from July 27, 2010 No 217-FZ makes amendments to the procedure of VAT taxation concerning the situations when there should be no recovery of VAT sums that were earlier paid when importing fixed assets, non-material assets and other property that is referred to the expenses for the purchase (written off through amortization) in the list of outstanding incomes. Normally VAT sums that were not written off are recovered if these fixed assets, non-material assets or other property are taken off the taxpayer's books. The privilege for residual VAT sum not to be recovered in outstanding incomes was earlier issued only when the property and property rights were transferred to a legal successor (successors) when legal entities are reorganized; transfer of the property to a participant of the partnership (agreement on cooperation) or its legal successor in case its share is allotted from the property that is in common ownership of the participants of the agreement or division of property.

Now this privilege is granted in case works (services) are executed out of the boundaries of the Russian Federation by Russian airlines within the framework of peacemaking and international cooperation aimed at solution of international humanitarian programs within the UN (concerns aircrafts, engines and spare parts for them).

4. According to the Letter of the RF Ministry of Finance and the RF Federal Tax Service from August 13, 2010 No ShS-37-2/9030@ some technical issues connected with VAT payment upon the start of the Customs Union operation have been clarified. The Letter, however, does not contain detailed description of the mechanism for the interaction between the taxation bodies of the Customs Union member countries. The approximate scheme for Customs Union members' interaction can be described as follow. Indirect taxes for the goods imported from the third countries will be paid at the boundaries of the Customs Union. The information exchange between taxation bodies of the Customs Union members will be made in the electronic form on the basis of the Application for goods import and indirect taxes payment with the mark of the country that is the member of the Customs Union into which territory the goods were imported certifying the payment of indirect taxes. When goods are imported into the territory of one member country of the Customs Union into the territory of another member-country of the Customs Union indirect taxes are collected by taxation bodies of the importing country.

5. According to the Letter of the RF Ministry of Finance from August 12, 2010 No 03-04-05/3-451 it is clarified that the income received by a natural person when quitting limited liability partnership is defined for the purposes of personal income taxation according to the procedure similar to the incomes of general partnership participants. In contrast to the participants of the

general partnership, not all the participants of the limited liability partnership bear the risk of losses connected with the operation of such a partnership. Some participants are responsible only to within the amount of contributions they made.

According to paragraph 1 article 78 of the Civil Code the participant that quits the general partnership receives the value of the partnership's property corresponding to the share of this participant in common capital (or is paid to him in kind). The share of the property or its value is defined by the balance made by the partnership at the moment of the member dropout. The difference between the sums contributed and received by a member of limited liability partnership is to be levied with the personal incomes tax according to general regulations.

6. According to the Letter of the RF Federal Tax Service from August 12, 2010 No ShS-37-3/8932@ changes are made to the procedure of tax declaration filling-out in connection of the Federal Law from 17.06.2010 No 119-FZ coming into effect which concern the specification of the procedure for the state registration of the rights for immovable property and deals with it. The corresponding addenda were made to the RF Tax Code. Paragraph 3 article 149 of the RF Tax Code was supplemented with subparagraph 23.1 according to which developer services in accordance with the agreement on participation in share construction of apartment blocks and other objects of immovable property are not levied with VAT (excluding the services of the developer rendered when constructing the objects for production purposes). This required the positions of the tax declaration to be specified.

7. According to the Letter of the RF Ministry of Finance from August 11, 2010 No 03-07-11/353 the question on VAT payment when selling the property of debtor organization is clarified.

According to subparagraph 1 paragraph 1 article 146 of the RF Tax Code operations of goods sale including the sale of collateral are subject to VAT taxation. Organizations and persons that are authorized to sell the mortgaged property act as tax agents and must deliver an invoice to customers for VAT payment. Since the corrected is in effect starting with 1.01.2009, when the collateral is sold before this date, in the opinion of the RF Ministry of Finance, VAT is to be paid to the budget by the property owner.

8. According to the Letter of the RF Ministry of Finance from August 9, 2010 No 03-04-06/6-173 the question on the procedure for accounting of personal incomes in the form of the material benefit from interests savings upon receipt of the loan.

Taxation base is defined as the excess of the interests sums calculated basing on two thirds of the refinancing rate of the RF Central Bank that is in effect as on the date of incomes receipt over the interests that were in fact accrued for the part of the debt that remained from the previous payment over the number of days that elapsed from the moment of previous payment (or loan issue).

The date of the real receipt of incomes in the form of material benefit is the day the taxpayer pays interests for the received borrowed (credit) funds (paragraph 1 article 223 of the RF Tax Code). In case the organization issued interest free loan, the date of the real repayments of borrowed funds should be recognized as the date of receipt of the incomes in the form of material benefit.

9. Letters of the RF Ministry of Finance from July 21, 2010 No 03-03-06/1/469 and from August 9, 2010 No 03-03-06/1/535 reflect two different approaches when ascribing the sums that are additionally accrued to the employee by the employer on the basis of the legislation requirements to expenses taken into account for the purposes of profit taxation. In one case it concerns the payment of wages to the employees for the time of forced idle time in connection with the accident at work, in the second – with the additional payment to the minimum labor remuneration level established by the existing legislation.

In the first case, the RF Ministry of Finance with the reference to article 255 of the RF Tax Code in concordance with which the taxpayer's expenses for labor remuneration include any payments in monetary or in natural terms envisaged by the legislation of the Russian Federation, labor contracts (agreements) and (or) collective agreements, explains that the organization has a right

to ascribe the expenses for labor remuneration for the forced idle time during the accident at work accrued in concordance with article 157 of the RF Tax Code to the expenses taken into account when taxing the profit. In the second case, additional payments to the level of the minimum wages in the opinion of the RF Ministry of Finance are ascribed to the expenses only on condition that such additional payments are envisaged by labor or collective contracts. It seems that the question of deduction when taxing the profit of the expenses for payments to the employee the liability to make which is stipulated for the taxpayer by the Law in case these payments are for some reason not reflected in collective agreement (labor contract) needs to be examined by law experts.

According to the general rule if the agreement (in this case collective agreement or labor contract) does not correspond to the norms of Legislation, it should be brought into accordance with the Law. Consequently, in our opinion, in such a situation an employer has a right to ascribe the sums for additional payments made in concordance with the Law to expenses when forming profit taxation base. The corresponding specification should be reflected in collective agreement (labor contract) and persons that did not provide for timely accounting of Law regulations should be responsible for the violation committed.

10. According to the Letter of the RF Ministry of Finance from August 6, 2010 No 03-03-06/1/528 the question on creation of the allowance for doubtful accounts envisaged by chapter 25 of the RF Tax Code for taxpayer's receivables in case he has stale debt to the same counteragents is clarified.

In concordance with article 40 of the RF Civil Code the liability ceases its effect upon the application of one of the parties to the full extent or partially by setting off a uniform counterclaim, the deadline for which has not come yet or is defined by the moment of claiming. Stale receivables in case the same taxpayer has a stale debt for the credit to the same counteragent in the opinion of the RF Ministry of Finance cannot be recognized as unsecured (i.e. ascribed to doubtful accounts) due to the fact that the taxpayer can set off counterclaims unilaterally.

In this situation the reserve should be formed to the amount of the receivables that exceed taxpayer's debt for the credit to the counteragent.

11. According to the Letter of the RF Ministry of Finance from August 5, 2010 No 03-11-06/2/123 the procedure for budget allotments taxation is clarified. Article 251 of the RF Tax Code defines the list of the sources for purposeful financing the funds of purposeful financing are not levied with taxes according to the general procedure of profit taxation. For the purposes of simplified taxation system article 251 is not applied, i.e. these funds are also exempted from the taxation.

The RF Ministry of Finance draws attention to the fact that due to technical reasons the list of purposeful financing in article 251 includes allotments to the budget institutions and subsidies to autonomous organization. Due to this fact the taxation base does not include all the subsidies to autonomous organizations and allotments to budget institutions (to which the funds allocated for the purposes of functioning and development of the budget institution in accordance with the approved calculation and limits of budget financing belong). As to the subsidies to organizations (including budget organizations) that are allotted to compensate for the expenses and underreceived incomes due to application of prices regulated by the state, such subsidies are accounted as incomes from the entrepreneurial activity when forming profit taxation base according to the procedure established by chapter 26.2 (simplified taxation system) and 25 (general system) of the RF Tax Code.

As to subsidies taxation, in case the organization that transferred to the single tax on the imputed income receives such, the RF Ministry of Finance explains that such subsidies are recognized as incomes for the activity that is transferred to the single tax on the imputed income system and hence they are not levied with taxes (the volume of the single tax on the imputed income is established basing on the natural indices, other regimes- general or simplified taxation system – do not apply to the activity transferred to the single tax on the imputed incomes system). At the same time subsidies allotted to the single tax on the imputed income taxpayer for the purposes not connected with expenses or underreceived incomes from sold goods (works, services) compensation due to the application of the prices regulated by the state are included in the list of outstanding incomes levied with the tax according to chapter 25 or 26.2 of the RF Tax Code.

12. According to the Letter of the RF Ministry of Finance from August 4, 2010 No 03-03-06/2/139 the procedure for accounting for the purposes of profit taxation of the losses from money impropriation. Such losses are included into outstanding expenses. The date for recognition of the loss from shortage of material funds in case there is no guilty party is the date the investigator issues the corresponding order.

13. The Letter from July 30, 2010 No 03-03-06/2/134 contains short description of the position of the RF Ministry of Finance concerning accounting of leaseholder's investments in the leased property in the form of inseparable improvements.

In case such investments are made by the leaseholder upon agreement with the lessor and are compensated to the leaseholder by the lessor that are accounted on the books of the lessor as the increase in fixed assets value and are set off through amortization. The sum of the compensation received is reflected on leaseholder's books as incomes from sale.

Investments made the leaseholder upon agreement with the lessor which cost is not compensated by the lessor is amortized by the leaseholder within the period of lease contract basing on the sums of amortization calculated taking into account the useful exploitation of the leased property in concordance with the fixed assets classification, which is established by the RF Government. The expenses in the form of the accrued amortization are subject to the requirements of their necessity and their documental proof established by paragraph 1 article 252 of the RF Tax Code.

The expenses of the leaseholder in the form of investments in the leased property not written off during the period of lease cannot be reflected among his expenses recognized for the purposes of profit taxation.

14. According to the Letters of the RF Ministry of Finance from July 29, 2010 No 03-07-11/320 and July 30, 2010 No 03-07-11/325 it is clarified that the sale of the municipal property is carried out at the redemption price equal to the market value defined by an independent appraiser as the maximum that is suitable for the customer and minimum suitable for the seller and includes VAT sum. When purchasing the immovable property belonging to the municipal treasury of the corresponding toe now rural settlement or another municipal formation the purchaser of such property according to paragraph 3 article 161 is recognized as a VAT tax agent and receives the liability to transfer the tax to the federal budget.

At the same time in the opinion of the RF Ministry of Finance VAT taxation base should be increased by the sum of the accrued interests in case the property is paid for by installments. The payment of the tax should be made according to the generally established procedure- as a result of each taxation period basing on the sum of the tax calculated for the elapsed taxation period in equal shares no later than the 20th day of each of three months following the end of the taxation period.

15. According to the Letter of the RF Ministry of Finance from July 22, 2010 No 03-03-06/1/481 the scheme is given and the list of conditions is defined upon observance of which the funds received from organizations can qualify as grants for the purposes of profit taxation.

At the same time the RF Ministry of Finance noted that in case the conditions mentioned in the letter are observed, grants received from Russian non-commercial organizations for conduction of particular programs in the spheres of education, culture, science, health care are not taken into account when determining profit taxation base of the organizations that receive grants regardless of whether Russian non-commercial organization that issued the grant is included in the List of organizations approved by the Decree of the RF Government from 15.07.2009 No 602. ●

CHANGES IN REGULATORY BASE OF BUDGET PROCESS

M.Goldin

The following events took place in the regulatory base of budget process in August: procedures for financing of federal budget institutions' activity aimed at executing public liabilities towards natural persons that are to be made in monetary form was regulated; the procedure for development, fulfillment and efficiency estimation of the Russian Federation state programs was approved.

According to the Decree of the RF Government from 02.08.2010 No 590 "On the procedure for federal budget institutions to which the authority of the federal executive body (state body) was delegated with the aim to execute public liabilities towards natural persons that are to be execute in monetary form and financial provision for their execution" (further referred to as – Decree No 590) the procedure of financial activity of federal budget institutions, to which the authority of federal executive bodies was delegated, was regulated.

In other words, the procedure mentioned consists in the following: in order to endorse the volumes of budget funds for the institutions they are in charge of, chief superintendants of budget funds submit the following information to the RF Ministry of Finance:

- legal basis for public liability;
- type of payment in concordance with public liability;
- the amount of payment and procedure for calculation according to the normative legislation act;
- category of recipients.

After the planned volumes of budget allotments for execution of public liabilities the authority for which execution will belong to the institutions are approved by the RF Ministry of Finance, chief superintendants of budget funds should approve the order of delegating the authority of federal executive body (government body) to execute public liabilities, information on which execution has been endorsed with the RF Ministry of Finance, to the institution.

The order should include the specification of:

- public liabilities, the authority to execute which is delegated to the institution by the federal executive body (government body);
- rights and responsibilities of the institution when executing the delegated authority of federal executive body (government body);
- responsibility for failure to execute or improper execution of the delegated assignments of the federal executive body (government body);
- procedure for supervision over execution of delegated assignments of federal executive body (government body) by the federal executive body (government body);
- bank details of the regional department of the Federal Treasury, in which the account will be serviced, which reflects the operations executed in accordance with the delegated authority and that was opened for the federal executive body (government body) as the recipient of the budget funds.

The Decree No 590 comes into effect on January 1, 2011 and is applied to the federal budget institutions which the chief superintendants of federal budget funds have chosen to grant subsidies from the federal budget.

According to the Decree of the RF Government from 02.08.2010 No 588 "Procedure for development, fulfillment and efficiency estimation of the Russian Federation state programs" (further referred to as Decree No 588) was adopted. The Decree does not apply to the state armament program (federal program for the development, making and production of armaments and military equipment for the ten-year period), which is envisaged by the Federal Law "On the state defense order".

According to the Decree No 588 the term "government program" is defined as the system of measures (interconnected as to the tasks, deadlines and resources) an instruments of the state

policy, which within the framework of key government functions fulfillment ensure the achievement of state policy priorities and goals in the sphere of socio-economic development and safety. This definition is roughly similar to the definition of “federal target program”, which is included in the Procedure for the development and fulfillment of federal target programs and international target programs, in which fulfillment the Russian Federation participates, the latter Procedure being established by the Decree of the RF Government from 26.06.1995 No 594. However, there are differences between a state program and a federal target program. Being an instrument of budget expenses financial planning, a state program embraces federal target programs and subprograms, which in their turn include department target programs and separate measures undertaken by the government bodies (further referred to as subprograms).

Requirements for the content of a state program resemble on the whole the requirements for the content of a federal target program.

A state program should contain:

- a) registration certificate of the state program in the form that is in concordance with the supplement;
- b) characteristic of the current situation of the corresponding sphere of socio-economic development of the Russian Federation, main indices and analysis of social, financial and economic and other risks of the state program fulfillment;
- c) priorities and goals of the state policy in the corresponding sphere of socio-economic development, description of the main goals and targets of the state program, forecast for the development of the corresponding socio-economic sphere and planned macroeconomic indices as a result of the state program fulfillment;
- d) forecast of the final results of the state program which characterize the target level and quality (change in the level and quality) of the life of population, social sphere, economy, public security, state institutions, degree of fulfillment of other socially important interests and demands in the corresponding sphere;
- e) periods for state program fulfillment as a whole, milestones and periods for their achievement with the specification of intermediate indices;
- f) list of the main measures of the state program, stating the period for their fulfillment and expected results, as well as other information in concordance with the methodological guidance on development and fulfillment of state programs that are approved by the RF Ministry for Economic Development upon agreement with the RF Ministry of Finance (further referred to as methodological guidelines);
- g) main measures of legal regulation in the corresponding sphere that are aimed at achieving the aim and (or) final results of the state program, containing explanation of the main statements and periods for adoption of the necessary regulatory legislative acts;
- h) list and short description of federal target programs and subprograms;
- i) list of target indices and indicators of the state program containing deciphering of planned indices by years of its fulfillment, as well as the data on the interconnection between the measures and the results of their fulfillment with the generalized target indices of the state program;
- j) substantiation of the content and values of the corresponding target indices and indicators of the state program as broken by the stages of its development and estimation of external factors and conditions influence on their achievement;
- k) information on resources provision for the state program at the expense of the federal budget (specifying the breakdown by chief superintendants, federal target programs, main measures of subprograms as well as by the years of state program fulfillment);
- l) description of measures of state regulation and risk management in order to minimize their influence on achievement of the state program goals;
- m) methodology for state program efficiency estimation.

Development of state programs is carried out on the basis of the list of the state programs established by the RF Government.

It should be noted that the project of the state programs list is formed by the RF Ministry for Economic Development together with the RF Ministry of Finance on the basis of Federal Laws,

envisaging fulfillment of state programs in order to fulfill separate decrees of the RF President and the RF Government taking into account suggestions made by federal executive bodies.

Development of the state program project is made by the responsible executor together with associates in concordance with the methodological guidelines.

The project of a state program is subject to obligatory endorsement with the RF Ministry for Economic Development and the RF Ministry of Finance. ●