



RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES 09'2010

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BASIC DEVELOPMENTS AND TRENDS IN SEPTEMBER 2010

Social and Political Background: Centralization is continued

The utmost political event of September was a conflict between the Presidential Administration and Yuri Luzhkov, Moscow Mayor, the outcome of which was the latter's resignation. However, Yuri Luzhkov's dismissal should be regarded not only as a result of a personal conflict, but as the development of a targeted policy pursued by the federal government. Luzhkov's dismissal was a logical completion of a series of resignations of regional elite representatives, started in the political scene back in the 1990's. (M. Rakhimov, E. Rossel, M. Shaimiev). Even being formally "appointed" Heads of the Subjects of the Russian Federation, they remained fairly independent political figures, who kept tight control over the regional elites, as well as political and economic activities in their regions. In this regard, they did not fit with the new standard of territories management, in which the Governor serves primarily as a clerk, acting by order and on behalf of the federal authorities. Luzhkov's refusal to leave "voluntarily" and, as a result, his forced dismissal by the President became the utmost public conflict within the Russian government in the recent years. It should be borne in mind that the Moscow Mayor has always been a reference point and a vanguard among the regional authorities in their relations with the federal government, both, when he headed the regional Fronde in the late 1990's, and when he gave ground to political position in the 2000-th. Moreover, the style of Luzhkov's retreat provides grounds to expect that the future process of taking control over the Moscow Mayor appointment by the federal government is not going to be free of conflicts.

In September, the federal government has taken the next steps to reform the law enforcement agencies, which were expected back in August. Dmitry Medvedev has signed a Decree on a separation of the Investigative Committee from the Prosecutor's Office and turning it into an independent federal agency, and has submitted a relevant draft law to the Duma. Reviewing that Decree in comparison with the draft law "On Police", one can note that their common concept delegates primary functions of preliminary investigation to the newly set up Committee, in particular, the function of investigation (mentioned in the Police functions as "interrogation" in the relevant draft law, rather than "preliminary investigation"). However, the reform is still controversial: the existence of independent investigators in the structure of other security agencies has not been resolved. Meanwhile, the results of discussion of the bill "On Police" summarized by Dmitry Medvedev, look disappointing: the fundamental issue of the actual withdrawal of the police functions from the authority of Public Prosecution was not "noted" by the President, but on the contrary, the statement on the intent to create a "Call Center" for the complaints from citizens demonstrates the commitment to preserve this status quo. In general, the bills are extremely contradictory: they strengthen the centralization of law enforcement agencies and their dependence on the executive branch of power (the Federal Council will not take part in the appointment of the Head of the Investigative Committee), and yet they do not impose a clear segregation of functions and mechanisms of mutual control in the field of law enforcement.

Macroeconomics and Finance: Alarms

In terms of macroeconomic dynamics, September was perhaps the least prosperous month of the current year. External background, influencing the situation in Russia, was dependent on the two factors, i.e., reduced recovery rates of the leading global economies and the statements of US officials about their readiness to continue a soft monetary policy in order to support the economy. Oil prices, after the traditional reduction in August from levels around USD 82 per barrel to the level of USD 72 per barrel (Brent, ICE) in September have returned to the level of USD 76-79 per barrel and sharply went up after the disclosure of the above-mentioned intentions of monetary authorities of the United States, once again having reached USD 82.16 per barrel on October 30. Russian stock indices have traditionally followed the trend of oil prices: after falling to the level of 1334 points in the MICEX index and 1385 points in the RTS index, showed an increase by 5-7% in late August - early

September, and then fluctuating for the major part of the month in the range of 1410 – 1440 points (in MICEX), and within 150-1500 points (in RTS) and then went up sharply after the announcement of the FRS comments.

One of the most important trends in the foreign currency market in September was the consistent strengthening of Euro against USD, starting from September 11 (dollar fell down from USD 1.27 per Euro on September 11 to USD 1.36 per Euro on September 30, by 7%), the RUR has respectively weakened against the European currency (RUR 39.17 per Euro on September 11 to RUR 41.35 per Euro on September 30, - by 5.6%). However, the dollar since late August to mid-September was varying in the range of RUR 30.57- RUR 30.89, but on September 17, its rate to the ruble has sharply raised, having surpassed the level of RUR 31 (+1%). This caused a nervous reaction on the part of market participants, expressed in a wave of rumors of a tentative devaluation. Sergey Ignatiev, Chairman of the Bank of Russia was forced to make a statement of rebuttal and announce that the Regulator has started to sell foreign currency to maintain the rate (for the first time in the current year). From the second week of September through September 22, the Central Bank sold about USD 600 million. However, the rumors about devaluation were supported not only by the fact that in the mid-month, the ruble was simultaneously weakening against the Euro and the dollar, but also in view of the information about the sharp fall in the surplus balance on the current account transactions, associated with the rapid growth of imports against the background of the stability of export earnings (according to the Federal Tax Service, in August, the growth of imports against July amounted to 12.9%, import amounted to 61.7% as compared with August 2009). Therefore, rumors have reflected the real structural problem of the Russian balance of payments. If the same trend in foreign trade is continued, pressure on the ruble will continue to grow, and the prospect of devaluation of the national currency will become a reality. As a result, within the month, the foreign currency basket has risen from RUR 34.53 on September 1 to RUR 35.33 as of September 30 (+ 2.3%). It is noteworthy, that the nervousness in the foreign currency market in September has taken place against the background of the continuing expressed growth of international reserves, which reached the level of USD 487.7 billion on September 24 (against USD 475.8 billion on August 27, i.e., by 2.5%)

The second unpleasant macroeconomic development has been the accelerating inflation, continued in September. As a result of the four weeks of September, Russian Statistical Service has recorded price growth by 0.9%, which is again (like in August) the worst indicator for that month ever since 2001. Therefore, the annual inflation, which by July 2010 has grown to the level of 5.5 %, will exceed 7% as per the results of September, i.e., it will return to the levels of the year beginning (7.2% in February). Cumulative inflation since the beginning of the year amounted to 6.35%. In view of the above, the Ministry of Economic Development has revised its inflation estimates for the year, indicating a new benchmark at 7-8%. However, given the traditional rise in prices in the recent months, as well as higher prices for fruit and vegetables in October and November, those estimates are hardly applicable. The rate of 8.5-9% looks more realistic.

Given that the acceleration of inflation in August and September is associated with abnormal heat, which has provoked the significant harvest losses, resulting, in particular, in the lack of a traditional price decline for fruit and vegetables, as well as other products in this time of the year, the speed of growth in prices for meat and dairy products in August have backed up the significant inflationary expectations. One should take into account also an intense increase in monetary supply over the previous months: on September 1, it amounted to RUR 17,663.8 billion (+1.9% against the value on August 1, 2010); in general, since the beginning of the year it has grown by 12.5%.

In addition, in the remaining months of the year an accelerated budget spending can be expected: on September 1, public commitments of the federal budget are fulfilled only for 58% of the estimated budget amount. In particular, the greatest delay in the funds delivery to the budget beneficiaries was noted under the “National Economy” line, which was by 9 p. p. lower than the relevant indicators of 2009.

Real sector: Pessimism is on the March

In the revised version of “Socio-Economic Development of the Russian Federation for 2011 and for the Planned Term of 2012 and 2013”, presented by the Ministry of Economic Development on

September 23, the expected growth in GDP by 4% was the indicator specified as the year result. However, this time the Ministry of Economic Development does not rule out the growth decrease to 3.5-3.7%. Given that as of the first six months the GDP growth made 4.2%, according to the Ministry of Economic Development, the macroeconomic situation in the last six months of the year should be accompanied by a weakening dynamics, observed since the beginning of summer.

In general, in August of 2010, as compared with the previous month, the industrial production growth amounted to 0.1%, including 0.4% of processing industry, whereas the volume of mineral production fell down by 1.4%. It should be noted that the sluggish dynamics of the industry was observed against the background of the slow expansion of the banks' lending to the real sector, and companies are observing the increased credit accessibility. Negative impact on the macroeconomic situation in the late summer was provided by agriculture: the agricultural output in August 2010 made 80.9% of the level of August in the last year. In addition, the depressing effect on the economic growth was provided by the low investment activity and, in all likelihood, the outpacing import growth. In general, the investment growth in August 2010 at 17.5% did not outweigh its dramatic collapse in July of this year. Overall, from January to August, investment in the fixed capital increased by 2.8% as compared with the relevant period of the last year, while reducing the amount of construction works by 1.9% and the introduction of the residential area by 4.0%.

The most important factor in the domestic demand, boosting the economic growth during the first six months of 2010 was a trend to recovery in consumer spending. Retail trade turnover in January-August of 2010 increased by 4.3% as compared with January-August of 2009 and supported the growth of real income by 5.6%. Herewith, in the structure of trade, the growth of sales of food products was increasing by faster rates (over January-August, the market turnover of food products increased by 5.7% and food prices by 3.1% as compared with the relevant period of the last year). However, in July-August the growth in food imports was observed (as compared with August 2009, the import of dairy products has almost doubled, and in beverages - times 1.5). According to the Ministry of Economic Development estimates, with the expected GDP growth in 2010 by 4.0% and growth in the domestic demand to 6.6%, imports should grow by 20.1%, while the domestic production for domestic consumption – only by 3.0%

Industrial surveys show that the trend reversal in September is unlikely. Estimates of current demand by enterprises in August have somewhat deteriorated as compared with the previous month, and demand forecasts have also shown negative dynamics. In September and October enterprises expect the worst rates of sales growth in 2010, and the indicators, estimated regardless the seasonal expectations confirm expectations of the industry for zero growth in demand in this autumn, while in the I-st quarter enterprises expected a growth. The estimated production growth has fallen down to the annual minimum in both, initial level, and the level estimated regardless seasonal factors. More intensive growth of production is expected only in the light industry. ●

THE POLITICAL AND ECONOMIC RESULTS OF SEPTEMBER 2010

S.Zhavoronkov

September 2010 saw the most striking dismissal of an official over the whole two-year period of D. Medvedev's presidency – he fired Moscow's Mayor Yu. Luzhkov, who had refused to retire from his post of his own accord. In addition to the 'natural (redistributive) causes' - the city's of Moscow's annual budget alone amounts to more than 1 trillion Rb – Luzhkov's dismissal was caused by a dramatic decline of his personal rating (which made his services unrequited from the point of view of the party in power on the eve of a new electoral cycle) couples with his provokingly dubious articles that appeared in the press where Luzhkov offered some admonishment to this country's leadership. Moscow's new head will evidently become somebody who does not belong to Luzhkov's team. E. Khudainatov was appointed head of 'Rosneft' - the post which for many years had been occupied by S. Bogdanchikov. As far as one can judge, Khudainatov's candidacy is the result of a compromise between the head of the company's board of directors, Vice Prime Minister I. Sechin, and Gunvor - the company's principal oil trader. D. Medvedev summed up the public discussion of the draft law "On the Police". With regard to fundamental amendments the President promised to introduce a narrow and specific definition of the right of policemen to enter any premises; he said nothing, however, of the issue of the expanded powers of the police in the economic sphere.

The main event in September 2010 became the dismissal, by RF President D. Medvedev, of Moscow Mayor Yu. Luzhkov from his post on 28 September, with the verdict 'in connection with a loss of the RF President's trust'. (Such a wording is indeed envisaged within the framework of the President's powers that came in force from the year 2005 onward. V. Putin had applied this particular wording three times, but each time it had to do with the not-so-famous heads of Koriak and Nenets Autonomous Okrugs, as well as the head of Amur Oblast. It was for the first time, however, that Medvedev took advantage of this opportunity). Luzhkov's dismissal was preceded by some rather turbulent political developments. In early September, *Rossiiskaia gazeta* ['The Russian Newspaper'] published an article signed by Luzhkov, which was full of arrogant recommendations addressed to Russian government leaders. Besides, the author criticized D. Medvedev's decision that the latter had made in late August after a series of large-scale protests – to suspend the work on the Moscow - St. Petersburg highway that was to pass through the Khimki Forest. At the same time, *Moskovskii Komsomolets* – a newspaper that was loyal to Luzhkov – published other articles where Luzhkov's retirement from his post was equaled to shattering the very foundation of the Russian political system; besides, the possibility of a split between V. Putin and D. Medvedev was discussed, and in this connection Luzhkov was described as Putin's loyalist. By the law, Luzhkov's term in office was to expire next summer, but these extraordinary events triggered a small revolution. The federal TV channels broadcasted a series of highly critical programs that voiced accusations aimed at Luzhkov's wife, E. Baturina (who during her husband's term in office became a dollar billionaire), exposed unlawful decisions of the Moscow Government, corruption in Moscow, some peculiar expenditure items on the Moscow budget like subsidies allocated to bee breeding, etc. Yu. Luzhkov's early retirement was considered to be the most likely scenario of the situation's further development, with a simultaneous settlement of mutual claims between the Mayor, the President and the Prime Minister. However, on 27 September Luzhkov declared that he was not going to apply for a voluntary retirement, and so on the next day he was dismissed from his post.

After his dismissal, Yu. Luzhkov declared that he would leave *United Russia* (whose electoral lists in Moscow he had topped during the 2007 parliamentary elections and the legislature elections in 2005 and 2009), describing that party as an organization which had refused to protect him from libel¹, and then said that he was going to engage in political activities, although without planning to run

¹ At the peak of the conflict *United Russia's* leader Yu. Gryzlov limited his comments to vague remarks that the situation in Moscow was 'ambiguous'.

for Russia's presidency in 2012. Vice Mayor V. Resin was appointed acting Mayor of Moscow, and he himself clearly stated that his task was to transfer the affairs to a new city head – who will evidently soon be appointed by the President from among the cohort of the so-called federal officials – which means that they have nothing to do with the Government of Moscow or Luzhkov's team. Of course, some people from his team may still remain in Moscow's Government on a temporary basis, or they may even come to terms about this with the new Mayor, but it has already become absolutely clear that the system of power and control over budget and property in Moscow is going to change very dramatically. V. Putin commented Luzhkov's dismissal in a reserved and neutral manner, noting that Luzhkov, although having done a lot for the benefit of the city of Moscow, had failed to establish good relations with the new President and so, by law of hierarchy, there could be no other outcome from the existing situation but his dismissal.

The majority of political commentators follow the suit of the pro-Luzhkov press and view the developments around the Mayor of Moscow's dismissal as an echo of the conflict between V. Putin and D. Medvedev. However, we believe that there are no grounds for such an opinion. The true cause lies elsewhere. In recent years – if not over the whole recent decade – the relationship between Luzhkov and the federal authorities have been shaping on the basis of a *quid pro quo* principle ('an exchange of assets'), when Luzhkov traded the investment of his own very high rating – which in Moscow topped the ratings of both Putin and Medvedev and that of *United Russia* – in the support of the party in power and its official candidate at the presidential elections for being allowed to keep his post and control over Moscow's assets. However, since 2009 Luzhkov's rating – which had already been progressively declining over a number of years – had reached an unacceptably low level. The 2009 election to the Moscow City Duma caused a scandal that reverberated throughout the whole country and attracted the attention of parliament and even the President – who on the basis of the results of that election introduced quite a few amendments to electoral legislation. Such scandals had previously been associated only with elections held in the republics of the North Caucasus. Moscow saw a series of massive rallies organized by the opposition, the last one taking place on the eve of Luzhkov's dismissal. By the autumn of 2010, sociological surveys had revealed that the percentage of Luzhkov's supporters in Moscow began to equal that of his opponents, and that his rating fell far below those of Putin and Medvedev. Even more glaring was Luzhkov's violation of the unspoken ban on the discussion of the controversies between V. Putin and D. Medvedev, as well as his criticism of D. Medvedev's decisions. Luzhkov's predecessor in violating the vow of silence – the former *Gosnarkokonrol's* [the State Committee for the Control of Narcotic and Psychotropic Substances] head V Cherkesov, who published a political article in *The Kommersant* in the autumn of 2007 – was demoted within six months after his 'deed', and by now he is actually 'kept in reserve'. However, as a matter of fact, Cherkesov in his publication stopped short of an actual discussion of Putin and Medvedev – he only referred to problems faces by some abstract 'elite' and power structures.

All this, taken together and multiplied by the 'demand for redistribution' that had always existed in the circles surrounding V. Putin, made Luzhkov's sacking inevitable. As far as the actual form of dismissing him from his post is concerned, it can be said that a public accusation of deeds verging on crime, by some TV channels, of a prominent member of the party in power and the political elite has discredited not only Luzhkov but authority as a whole, while Luzhkov's refusal to retire on a voluntary basis in a situation when his dismissal under existing legislation was just a technical matter can be estimated as a peculiar form of blackmailing the federal authority, which simply made his position even worse.

At present, Yu. Luzhkov has no real political prospects – for a variety of reasons. For one thing, in order to participate in an election one needs an operator, that is, a political party, while no new political parties has been registered in Russia in recent years, and there is no reason to believe that Luzhkov, as a noble jester on the part of the authority, will be allowed to proceed with such a registration – whereas all the other members of the opposition (for example, former Prime Minister M. Kasianov) have been granted such a permission. Secondly, none of the existing ideological segments of the opposition (the liberals, nationalists, leftists) consider Luzhkov as their comrade, and it is not clear what program he is going to offer Russian citizens. Thirdly, Luzhkov's wife still owns in Russia a huge legitimate business, which serves as a significant restricting factor

(Kasianov was not hindered by such a burden). In fact, Luzhkov's only real asset is the money that he can afford to spend on politics; however money, while being an important asset, can provide its owner with no actual guarantees (in this connection, it is worthwhile to remember the dubious success of *Otechestvo* ['Fatherland'] in 1999, when Luzhkov was an elected Mayor and enjoyed an incomparably more favorable position).

For the federal authorities Luzhkov's dismissal implies that they are going to lose, to a certain extent, their electoral status in Moscow (Luzhkov's rating – even when in decline – did not fully overlap that of the party in power, and even augmented it with some points), and that the political system will become less balanced – however not to a critical degree.

In September D. Medvedev made an intermediate summing-up of the discussion of the draft law 'On the Police', which was published in August and envisaged a dramatic expansion of the powers of this agency under the pretext of their 'concretization' including, among other things, an effective abolition of the amendments that were made to the corresponding legislation in recent years and limited the right of the police to interfere with the economic activity of enterprises.

Medvedev noted that the comments to the articles granting to the police the right of an unrestricted entry into any premises 'require some serious attention'. He pointed out in this connection that this must be applied only to some extraordinary instances associated with the need to save people's lives or to detain criminals, and promised to supply a detailed specification of such instances.

The President approved the idea of establishing one national toll-free call center, where people can call with their comments on the work of the law enforcing agencies, promised 'to inform the applicants of the progress and results of the checks conducted in respect to the content of their applications', and approved of the introduction of individual badges for police officials with their names and personal numbers, of the duty of police officials to inform detainees concerning their legal rights, and of the right of a detainee to make a telephone call. It is promised that the amount of the monthly money allowance of a police lieutenant from 1 January 2012 will be no less than 33,000 Rb.

At the same time, Medvedev offered no comments in connection with the reestablishment of the right of the police to control the activity of economic agents – a right that has been dramatically restricted during the past two years, i.e. by Medvedev himself.

The RF Government on the whole approved the draft budget for 2011, the planned targets and the draft of the main directions for monetary policy in 2012 – 2013. Prime Minister V. Putin referred to the possibility that the state budget might be drawn without a deficit before 2013: *'The orientation towards cutting deficit will be maintained further. By 2013 it will become less than 3 % of GDP, then we shall achieve a zero deficit, and perhaps this will happen even earlier than that'* – as V. Putin said at the Government's meeting. The Government relies on economic growth, growth of tax revenues, external loans in the amount of more than 4 bn USD, the raised excises on alcohol and tobacco, and revenues from privatization. However, the first two factors are not quite compatible, while we have been hearing promises of a switchover to large-scale privatization for a couple of years already – a measure that is actually very difficult to implement for political reasons, because it infringes on the interests of heads of big state companies who are close to the authorities¹. Besides, it should be noted that the budget, instead of conservative, contains 'static' forecasts of oil prices – within the limits of 75 – 79 USD/barrel (approximately the same level as in 2010). Budget projections also imply a ban on an increase in the number of civil servants. The complexity of the privatization theme is once again emphasized by the specific features of the auction (to take place in December) for access to the huge Roman Trebs and Anatoly Titov oil fields (estimated at more than 150 mln tons). Their starting price of 18 bn Rb is believed by experts to be evidently underestimated, while in September it was announced that only two companies – *Bashneft'* and *Surgutneftegaz* – were allowed to participate in the auction, the applications of all the other companies having been turned down on rather questionable grounds.

September also saw many staff reshufflings in big state-owned companies. Thus, it was declared that the representatives of two conflicting parties – General Director of Sviazinvest E. Yurchenko

¹ It is an illustrative fact that the budget revenues from privatization in 2010 will amount to less than 1 % of the sum necessary for covering the budget deficit, and for the next three years that index is planned in the amount of 20 – 25 % of budget deficit.

and the RF President's adviser, former Minister of Communications L. Reinan – had been dismissed from their posts. The conflict itself centered around some specific deals concluded by Sviazinvest, and it also had something to do with the parameters of its merger with Rostelekom. Although it was initially intended that the new general director would be appointed in September, the final decision was delayed, and it is clear that the struggle among different influential groups for this post is still going on.

Besides, in September Rosneft's president of many years (since 1998), S. Bogdanchikov, was dismissed from his post. For a long time he was considered to be one of the most influential oil magnates who played an important role in the technical formalization of the takeover by Rosneft of almost all the assets that had formerly belonged to Yukos (while Gazprom was initially considered to be the main contender). However, in recent years his powers have significantly shrunk; nearly all his appointees were forced to leave the company, and its charter was amended so that the powers of the board of directors headed by Vice Prime Minister I. Sechin were, on the contrary, expanded. For a long time already, rumors have been circulating on the market about a conflict between Bogdanchikov and Sechin and their parallel duty contacts with Prime Minister V. Putin to whom they both appealed in connection with various commercial matters. On the eve of his dismissal, Bogdanchikov had also denied its possibility, although the contract with him had not been renewed in July. In the end, the post of Rosneft's president was given to the company's first vice president E. Khudainatov, who had worked for a long time in the oil business but was hired by Rosneft only two years ago. Khudainatov's appointment is regarded as a compromise between head of the company's board of directors I. Sechin and Gunvor's main trader G. Timchenko.

In September, Novosibirsk Governor V. Tolokonsky replaced former General Staff's head A. Kvashnin on the post of the president Plenipotentiary Representative in Siberian Federal Okrug. Tolokonsky's successor is his former first deputy V. Yurchenko, who has topped United Russia's electoral list at the October regional elections. And Kalmykia's head K. Iliumzhinov now focuses on his activity as head of the World Chess Federation (FIDE), while A. Orlov, Kalmykia's representative under the RF President, has been appointed to his former post. The outcomes of the replacement of the two 'questionable' governors turned out to be quite favorable for them, in that the two corresponding regions are now headed by their own creatures. ●

INFLATION AND CREDIT AND MONETARY POLICY

N.Luksha

In August, consumer price growth rate accelerated to 0.6 per cent, a record for that month since 2001. In September, inflation has accelerated further, reaching up to 0.6 per cent over three weeks. Nevertheless, the cumulative inflation since the beginning of the year by September 20 made only 6 per cent and remained lower than in 2009 (8,1 per cent). Since the last week of August, foreign currency and gold reserves (with regard to minor adjustment) have grown, reaching the level of USD 481.3 billion by in the September 17. In August, the real effective exchange rate of ruble has strengthened by 0.3 per cent. In September the value of the two-currency basket has increased by 3 per cent, having reached RUR 36.38 as a result of four weeks by September 23, 2010. The State Duma approved the draft of Guidelines for the Unified State Monetary Policy for 2011-2013.

In August, consumer price index has increased as compared with July and in monthly terms made 0.6 per cent (against 0 per cent in 2009) (see *Fig. 1*). The largest contribution to the prices growth has made foodstuffs (+0.9 per cent). The rate of growth in their prices jumped up threefold as compared with the previous month. This was primarily contributed by a significant rise in prices for cereals and beans (+12.8 per cent), especially the buckwheat (+31.4 per cent) and millet (+8.8 per cent). In addition, significant growth was noted in granulated sugar (+4.7 per cent), butter (+3.7 per cent), milk and dairy products (+3.2 per cent). A further upsurge in food prices has been avoided due to the seasonal decrease in prices for fruit and vegetables (-1.4 per cent) and eggs (-1.3 per cent).

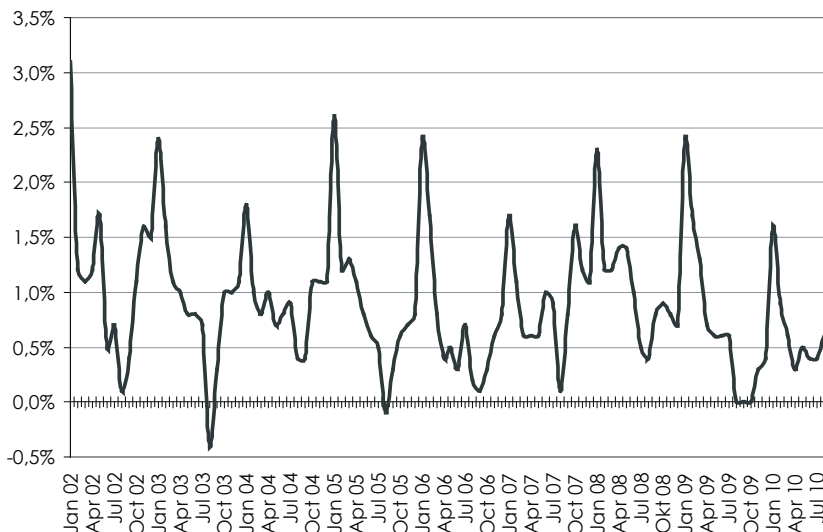
In August, the growth rate of prices for industrial goods have again accelerated slightly (+0.4 per cent). The highest rates were still observed in prices for tobacco products (+1.9). Construction materials rose by 0.9 per cent. Prices audio and video goods stopped to fall, their growth made 0.4 per cent. At the same time, prices for medicines continued to decline (-0.1 per cent).

Growth rates of prices for commercial services has decreased. In view of the end of the summer holidays the growth of prices has declined for international tourism services (+1.1 per cent) and health resort services (+0.6 per cent). Herewith, insurance services have become even cheaper (-0.2 per cent). They rose to the greatest extent in comparison with other types of services under review, however, compared to July, the growth in their prices has declined by three times. In anticipation of the new school year the prices of education services have also increased (+0.8 per cent). Herewith, price decline was again noted in communication services (-0.1 per cent).

Traditionally, the seasonal reduction in price of fruit and vegetables leads to a slowing of inflation or even deflation in the last summer month, but this year it did not happen. The largest contribution in August CPI growth was made by food products, which has reached 75.8 per cent¹. In addition to objective factors (short-term shortage of foodstuffs, in particular the buckwheat, as a result of summer abnormal heat and drought), a certain role also played by the psychological and monetary factors. On the one hand, the initial price shock has led to an increase in inflationary expectations. On the other hand, the money supply continued to extend: in July, its growth against June amounted to 0,8 per cent.

In September, the August trend was sustained: for three consecutive weeks inflation grew by 0.2 per cent in the week. Therefore, from the beginning of the month to September 20 consumer prices rose by 0.6 per cent and since the beginning of the year - by 6 per cent. Buckwheat and eggs, which have risen since the beginning of the month, respectively by 21.9 and 16.6 per cent, prevent to slow down the inflation. Additional pressure was provoked by rising prices for fruit and vegetables, especially potatoes, which went up by 6.7 per cent. In previous months, lower prices for fruits and vegetables was curbing acceleration of inflation.

1 "Inflation at the consumer market," Bulletin of the RF Central Bank of 13.09.2010, p. 7.



Source: RF Statistical Service.

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

Pursuant the estimates of the Ministry of Economic Development, in September inflation will be accelerated to 0.8 per cent. According to the revised forecast of the Ministry of Economic Development, inflation in general for 2010 will be 8.7 per cent, rather than 6-7 per cent. According to Sergey Ignatiev, the Head of the Central Bank, the effect of summer drought on inflation can be fully exhausted only by the fall of the next year.

As per approved by the State Duma on September 23, 2010 draft Guidelines for the Unified State Monetary Policy for 2011-2013, inflation in 2011 should slow down to 6-7 per cent (rather than to 5.5-

6.5 per cent), in 2012 - to 5.6 per cent and in 2013 - up to 4.5-5.5 per cent¹.

The basic CPI of consumer price index² in August 2010 has made 0.7 per cent (versus 0.5 per cent in the relevant period of 2009).

In August, the monetary base in broad definition has increased again to RUR 7257.4 bn (+2 per cent). On September 1, cash in circulation with regard to the fund balances in credit organizations has reached RUR 4.96 trillion (+0.4 per cent), correspondent accounts of credit organizations with the Bank of Russia made RUR 558.1 billion (- 7.8 per cent), mandatory reserves made RUR 179.3 billion (- 0.8 per cent), deposits of the banks with the Bank of Russia made RUR 517.5 bn (increased times 1.5), the value of shares of the Bank of Russia with credit organizations made RUR 1039.7 bn (+0.4 per cent).

In August, the excessive reserves of commercial banks³ have started to grow again, having reached as of the month result RUR 2115.3 bn. Thus, they increased by RUR 123.6 billion, or 6.2 per cent.

In August banks were continuing to extend the crediting volume. According to the estimate of G. Melikyan, the first Deputy Head of the RF Central Bank, in the last month of summer loans to the non-financial sector increased by 0.7 per cent (in July their growth made 0.1 per cent). Growth rate of retail lending amounted to 2.3 per cent (1.8 per cent in the preceding month)⁴.

According to the statement of G. Melikyan, the first Deputy Head of the RF Central Bank, in August the share of overdue arrears has been stabilized, but there is no steady trend to its decline⁵. The share of overdue debt in the loan portfolio of banks in August has decreased by 0.06 percentage points from 6.21 to 6.15 per cent. However, despite the decline in the share of overdue loans to physical persons in banks from 7.52 to 7.49 per cent, in absolute terms it still demonstrated a growth.

The accumulated excessive liquidity in the banking sector and a steady growth in lending volume have provided grounds for the formal statement of the Central Bank First Deputy Chairman A. Ulyukayev at the VIII International Banking Forum "Russian Banks - XXI Century" in Sochi, on

1 Prime-TASS. (<http://www.prime-tass.ru/news/0/%7B2FC40EA7-AE92-4B0B-B3BB-2B20E87DD38A%7D.uif>, 23.09.2010.

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

3 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.

4 RIA News (<http://www.rian.ru/economy/20100910/274460800.html>), 10.09.2010.

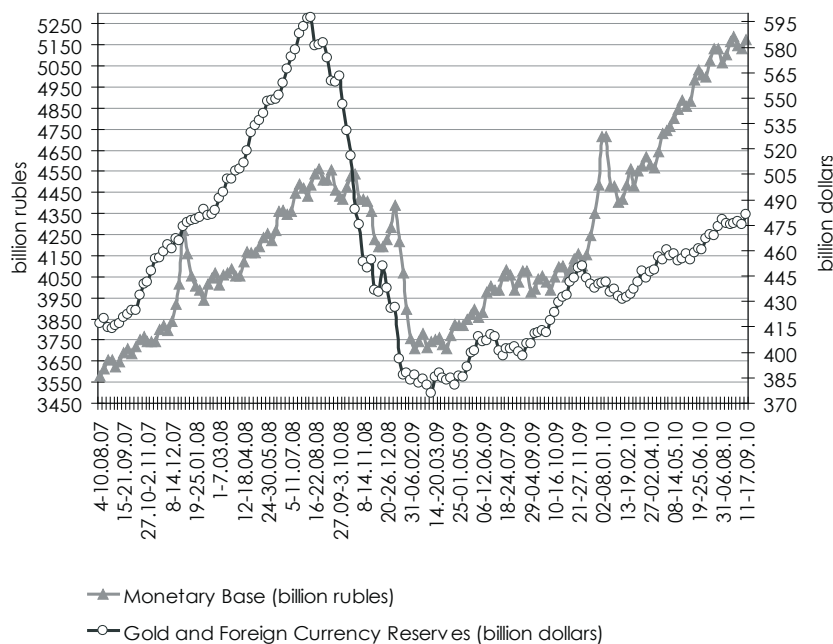
5 RIA News (<http://www.rian.ru/economy/20100924/278773337.html>), 24.09.2010.

the decommissioning of anti-crisis measures to support the banking sector. Firstly, this will affect the program of unsecured lending, the effect of which will be discontinued by the end of 2010. This crisis management tool is no longer in demand of the banks, so the need for it is elapsed as it is. Secondly, the RF CB is planning gradually to suspend lending to banks under a mutual guarantee. Limits for such loans to the banks will be reduced by 10-15 per cent. Thirdly, the Central Bank also intends to discontinue lending to banks by the Central Bank under the pledge of loans to the backbone enterprises. Now the Regulator, reviewing the issue of granting the funds will revert to a rigid procedure of assessing the borrower's financial standing. Finally, in the nearest future the RF Central Bank will consider the issue of reducing the Lombard list, which was extended nearly threefold by the inclusion of securities of certain backbone enterprises. In our view, the rejection of anti-crisis program to support the banking system is quite timely.

In August the growth of the volume of cash in circulation by 0.4 per cent with the simultaneous increase of mandatory reserves by 0.8 per cent urged the extension of monetary base in narrow definition (cash plus mandatory reserves)¹ by 0.3 per cent to RUR 5,142 bn (see Fig. 2). In August, foreign currency and gold reserves of the Central Bank continued to grow. Their volume increased within the month to USD 476.3 billion (by 0.2 per cent). In September foreign currency and gold reserves have grown again, having reached USD 481.3 bn on September 17.

In August the real effective exchange rate of ruble continued to strengthen (+0.3 per cent). Accordingly, the index of real effective exchange rate has also increased: as of the month results, it made 143.36² (see Fig. 3). In September, the behavior of the dollar against the ruble has been rather volatile. From late August to mid-September, the dollar fluctuated in the range of 30.57-30.89 per ruble, but on September 17 its exchange rate against the ruble rose sharply, surpassing the mark of 31 rubles. (+1 per cent), having gained back more than a two-month decline. However, already since September 25 ruble has once again started to win back the lost positions and within three days rose by 3 per cent. As a result of sharp ups and downs of the dollar, in four weeks of September it weakened to 30.61 rubles (by 0,2 per cent).

A sharp drop in the ruble exchange rate in the third week of September gave rise to rumors about a possible devaluation. However, the Bank of Russia Chairman S. Ignatiev was able to calm down some market participants, having made a statement that the Regulator started to sell foreign currency (for the first time this year) to support the national currency. From the second week of September to September 22 the Central Bank sold about USD 600 million. Mr. Ignatiev also presented his vision of the situation. In his view, the possible reasons for such a sharp weakening of the ruble were the trend of reduction of the surplus current account balance due to the rapid growth of imports, as well as speculation in currency market³.



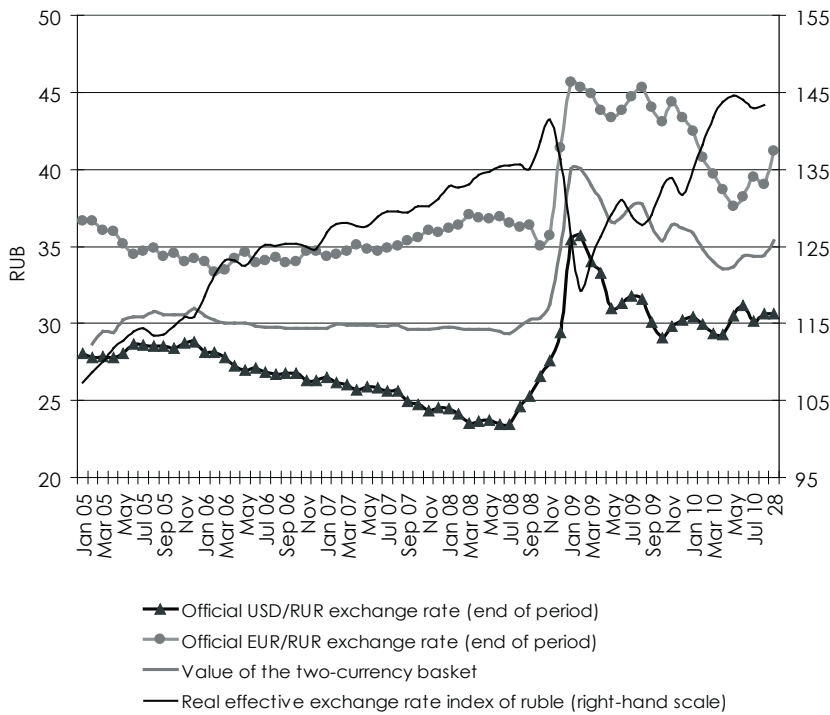
Source: RF Central Bank.

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 Interfax (<http://www.interfax-russia.ru/main.asp?id=177019>), 24.09.2010.



Source: RF Central Bank, author's estimates.

Fig. 3. Indicators of Ruble Exchange Rate Dynamics within January 2005 – September 2010¹

In addition to the causes of the devaluation of ruble, distinguished by the Head of the Central Bank, there may be other factors, affecting the situation. Thus, in September many corporate borrowers were engaged in buying the currency, who should pay off the external debt exceeding USD 31 billion in the IV quarter of the year. There is also a possibility that large currency purchases were undertaken by one or more local market participants. It could be “LUKOIL”, who was acquiring the USD to buy their own shares from an American oil company Conoco Phillips. There is also a possibility that US dollars were exported to foreign countries by the structures associated with the Mayor of Moscow Yuri Luzhkov in view of speculations about his tentative resignation.

If the ruble rate behavior against the dollar in the middle of

the month was based largely on the influence of adverse domestic factors, during the fourth week of September, it has joined the worldwide trend of strengthening of national currencies against the US dollar in the background of negative news from the USA. In addition, the ruble has been supported by the forthcoming large tax payments.

In September, the Euro rate growth has accelerated. On September 23, for the first time since February, the rate of European currency jumped up by more than 41 rubles. One of the reasons for the rapid growth of the Euro has been strengthening it against the USD in FOREX market, starting from the second week of September. By the end of September, the Euro/dollar was trading at the April values (1.35 dollars/Euro). Support for the Euro have been provided by on the one hand, the news of the likely mitigating the US Federal Reserve monetary policy, and on the other hand, by successful debt auctions, arranged in Portugal, Spain and Ireland.

Within four weeks of September Euro has strengthened against ruble to RUR 41.2 (by 6 per cent). As a result, in September the value of the two-currency basket has grown by 3 per cent and reached RUR 36.38.

In the Guidelines for the Unified State Monetary Policy for 2011-2013, the Central Bank has confirmed its intention to keep the fluctuations of the ruble within acceptable limits. Herewith, the Bank of Russia aims to gradually reduce the interference in the formation of the ruble rate in the framework of preparation for the transition to a floating foreign exchange exchange rate. The main factors influencing the change of exchange rate in the next three years, mentioned in the document are the balance of foreign trade and the dynamics of capital flows, whereas the contribution of the latter will grow. Due to the high volatility of the flows of foreign currency, the ruble exchange rate dynamics may be difficult to be estimated in the medium term. ●

¹ The level of January 2002 is accepted as 100 per cent.

FINANCIAL MARKET¹

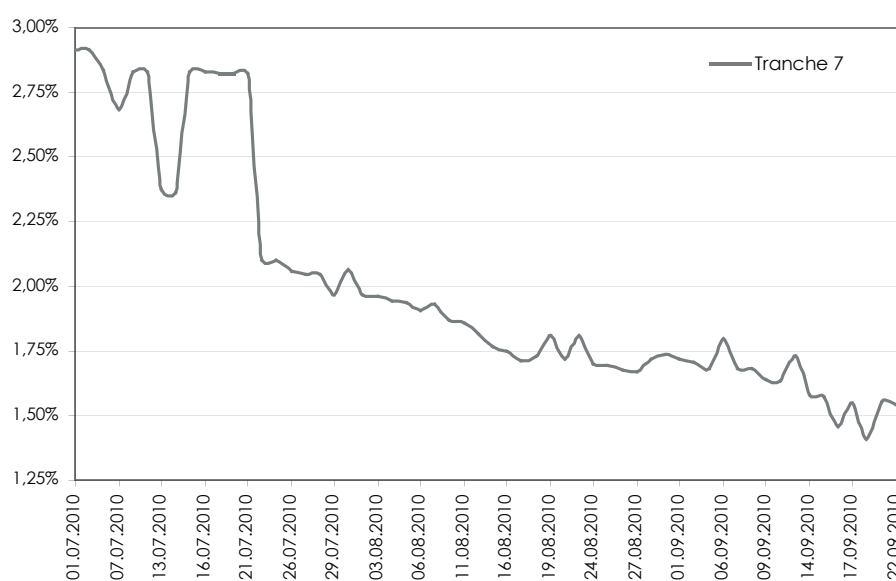
N.Burkova, E.Khudko

In¹ September 2010 there was a general upward dynamics in the Russian financial market. Stabilization of the global economy and positive investors' expectations, despite the elevated inflation expectations, have led to a sharp increase in the activity of bidders in the government securities (by 6.7 times). The growth in demand was mainly observed in the secondary market of government securities. Trading volumes in the stock market showed almost similar to the previous month indicators at the background of positive trends in view of to the improvement of the situation in the global financial markets, the CBR maintaining the refinancing rate, Budget surplus and growing reserves of international currency and gold. The volume of corporate bond market and its indices demonstrated a growth, and rates of secondary trading in bonds in the Stock Exchange, the number and volume of registered emissions have decreased as compared with the previous month. Average yields of corporate bonds and performance of IPOs remained virtually unchanged. The main problem remains with the failure by issuers to fulfill their obligations to the bondholders, although in September for the first time since the crisis started all issuers were able in due course to repay the face value of bonds.

Government securities market

Rising oil prices, stabilization of the world stock markets and the RF money market, strengthening of the Russian national currency, reduced fears of investors about the tightening of monetary policy of the Central Bank, maintaining the level of the key rate of the Russian Federation contributed to a substantial increase in investor interest in the government securities market in September 2010, alongside with the declined dynamics of the Russian Eurobonds yield to maturity. The growth in demand has been particularly noticeable over long-term emissions.

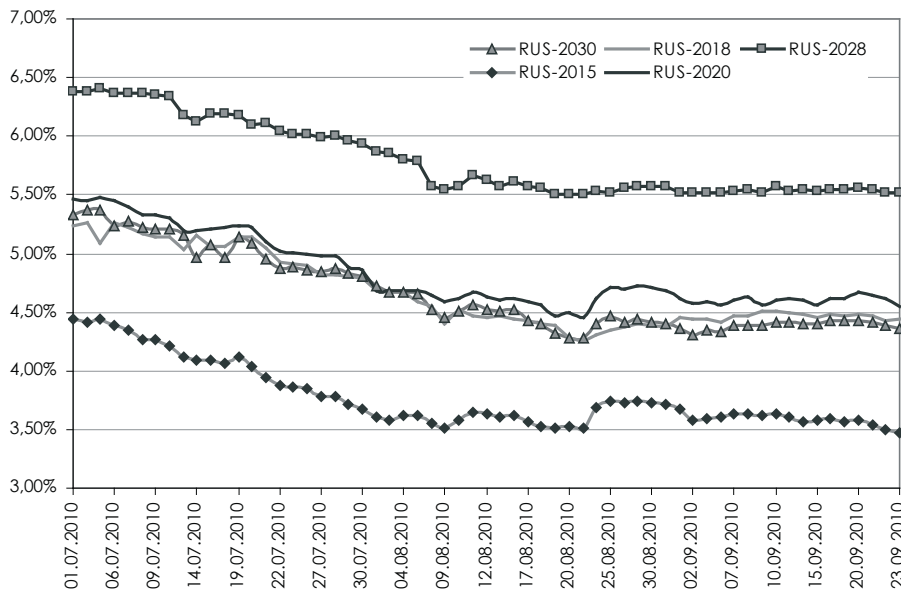
As of September 23 of the current year, the Russian Eurobonds RUS-28 yield to maturity has reduced as compared with the level of August 30 from 5.58 to 5.51 per cent per annum (by 1.18 per cent), RUS-30 – from 4.42 to 4.37 per cent per annum (by 1.15 per cent), RUS-15 – from 3.72 to 3.48 per cent per annum (by 6.63 per cent), RUS-20 – from 4.71 to 4.55 per cent (by 3.27 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 1.72 to 1.54 per cent per annum (by 10.36 per cent) (see Figs 1-2), having demonstrated during the month downward trend against the background of volatile trends. The only exception was Eurobonds RUS-18, the yield of which, by contrast, increased from 4.39 to 4.9 per cent per annum (at 11.62 per cent).



Source: "Finmarket" Information Agency data.

Fig. 1. Minfin bonds' yields to maturity in July – September 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 July – September 2010

Within the period from August 31 to September 23 the total turnover of the secondary market of government bonds amounted to approximately RUR 779.98 billion with an average daily turnover of RUR 43.33 billion (about RUR 162.23 billion with an average daily turnover of RUR 6.49 billion in August), which means the decrease of an average monthly turnover by 6.7 per cent.

In the period from August 31 to September 23, there were eight auctions on government bonds additional placement at the primary government bonds market (a month before there were ten

auctions). Thus, on September 1 there were two auctions for government bonds series 25073 and 25075 for the total volume of RUR 40 and 35 bn; the actual volume of placement made RUR 7.31 and 4.52 bn with an average weighted yield of 5.9 and 7.23 per cent per annum, accordingly. On September 8 there were two auctions on government bonds placement series 25072 and 26203; the total placement volume was RUR 25 and 40 bn, the actual volume of placement made RUR 20.36 and 18.92 bn with an average weighted yield of 6.22 to 7.43 per cent per annum, accordingly. On September 15 there were arranged two auctions on government bonds placement series 25074 and 25075 for RUR 5 and 35 billion, actual placement was RUR 4.99 billion and 34.65 billion with the average weighted yield of 4.25 per cent and 7.29 per cent per annum, accordingly. On September 22 there were also two auctions on additional government bonds placement series 25072 and 26203 with the total placement volume was RUR 30 and 40 bn each, actual volume of placement made 18,51 and 36.55 per cent with the average weighted yield of 6.19 и 7.49 per annum, accordingly. Therefore, the total volume of placement for the period under review was RUR 42.6 per cent of the estimated amount (49 per cent a month earlier), which demonstrates a decreased interest to the primary sector of government bonds in September. Herewith, there were no auctions in the secondary market (against one auction as of August 30).

Stock market

Stock market situation

In September 2010, trading volumes in the stock market showed almost similar to the previous month turnover (an increase of was observed by 1 per cent as compared to August) at the background of positive trends in view of improvement of the situation in the global financial markets, RF Central Bank sustained refinancing rate at 7.75 per cent, budget surplus of the Russian Federation (272.3 billion rubles) in the first half of 2010 and the growth of foreign currency and gold reserves. However, abnormal weather conditions in the country have contributed to rising prices and inflationary expectations, as well as upgraded estimates of inflation by the Ministry of Economic Development in 2011 (from 5.5-6.5 per cent to 6-7 per cent), which limited the growth of the stock market within the month.

The maximum value within the month the MICEX index has reached on September 13, having reached 1 441.58 points (1 429.36 points in the preceding month). The minimum value for the period the MICEX index has reached on September 1 – 1 394,57 points (against 1 334.66 points in the preceding month) (Fig. 3).

In general, within the period from July August 31 to September 23, the MICEX index has increased by 4.33 per cent, what makes about 59.35 points in absolute terms (within the year, from September 24, 2009 through September 23, 2010, the MICEX index has been upgraded by 21.48 per cent). Over the same period, the turnover of trades in securities included in the MICEX index made about RUR 729.06 bn at an average daily turnover of RUR 40.50 bn (against about RUR 1 004 bn with an average daily turnover of RUR 49.16 bn in the preceding period). Therefore, the investors' average daily activity in the

stock market in September has decreased as compared with the preceding period by 0.84 per cent. The indicators of maximum and minimum daily turnover in the market trades made, accordingly, RUR 53.36 bn (as of September 9) and RUR 19.44 bn (on September 6).

As of the month results (from August 31 through September 23), the majority of the "blue chips" securities have shown an upward dynamics. The leaders in the decline were VTB Bank and LUKOIL, whose shares have increased by 11.22 and 10.25 per cent, accordingly. They were followed by Rostelecom, increased by 8.86 per cent, Sberbank of Russia (7.65 per cent), Mosenergo (3.43 per cent), Gazprom Neft (3.38 per cent) and Rosneft (2.77 per cent). The lower rates of growth were demonstrated by Tatneft (1.06 per cent) and Gazprom (0.04 per cent). A reverse trend was demonstrated by GMK Nornickel and Surgutneftegas, whose value has decreased by 3.43 and 0.82 per cent, accordingly (Fig. 4).

In September of the current year the MICEX turnover leaders were: "Sberbank of Russia" (31.15 per cent of the total turnover), Gazprom (15.91 per cent), GMK "Nornickel" (7.78 per cent), LUKOIL (6

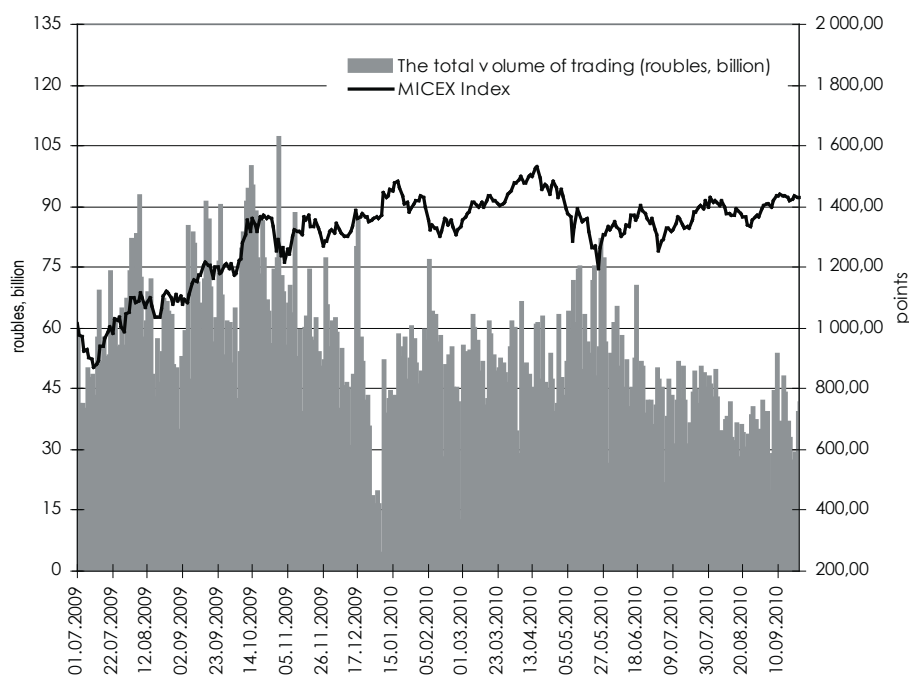


Fig. 3. Dynamics of MICEX Index and trading volume

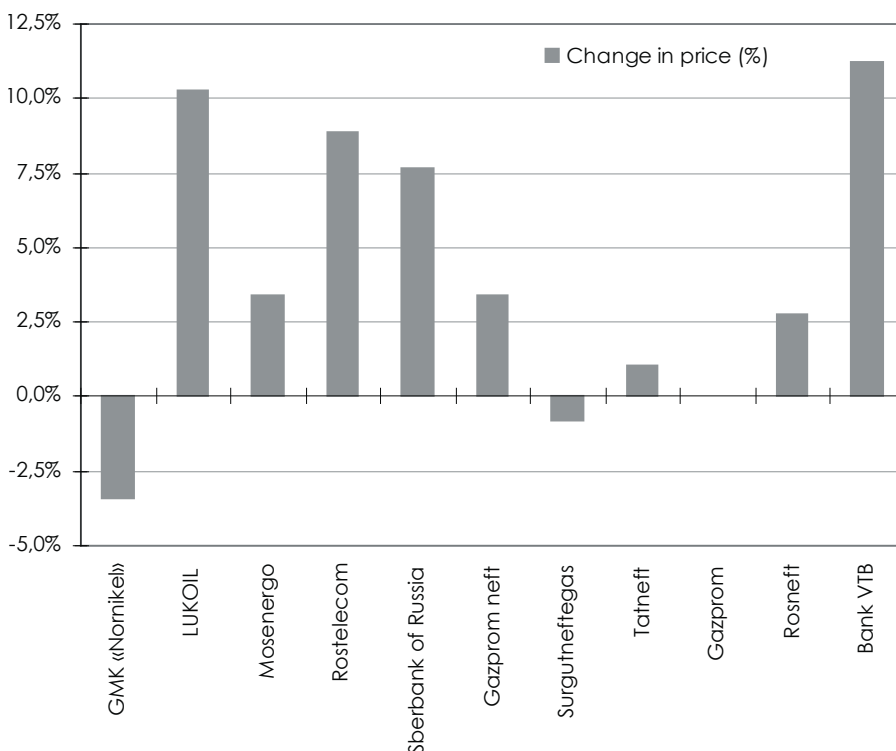


Fig. 4. Dynamics of the Russian Blue Chips from August 31 to September 23, 2010

per cent) and VTB Bank (5.87 per cent). Herewith, VTB Bank has once again superseded Rosneft among the top five leaders. The total volume of transactions with the shares of those five «blue chips» was about 67 per cent (all «blue chips» - 75 per cent) of the total trades in shares at the MICEX stock market over the period from August 31 through September 23.

According to MICEX information, as of September 23, the top five leaders of the domestic stock market in terms of capitalization were: “Gazprom” – RUR 3 782.32 bn (RUR 3 777.11 bn a month earlier), “Rosneft” – RUR 2 127.16 bn (against RUR 2 091.66 bn), “Sberbank of Russia” – RUR 1 797.76 bn (against RUR 1 677.95 bn), “LUKOIL” - RUR 1 524.01 bn (against RUR 1 416.13 bn) and Surgutneftegas - RUR 1 031.12 (against 1 015.26 bn rubles).

Futures and Options Market

In September the average daily turnover in the MICEX futures market has increased by 4.16 per cent as compared with the preceding month. Thus, in the period from August 31 through September 23 the total turnover in the MICEX (futures) market made approximately RUR 117.19 (437.6 thousand of transactions, 2.36 mln of contracts) with an average daily turnover of RUR 6.51 bn against about RUR 156.31 (1.98 thousand of transactions, 1.6 mln of contracts) with an average daily turnover of RUR 6.25 bn in August. The largest volume of trading in September, like a month before, was observed in contracts for futures and equity instruments, amounting to RUR 85.95 billion (331.04 thousand of transactions, 1.52 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 Norilsk Nickel, Gazprom, Sberbank and Lukoil. We would like to note, that the value of the MICEX index (the price of transactions) for December 2010 was mainly in the range of 1400 - 1440 points, and for March 2011 – at the level of 1 420–1 450 points.

The second place in terms of trading volume within the month of September was taken by foreign currency futures (RUR 27.85 bn). Herewith, contracts for the US dollar were in the first place in terms of trading in the MICEX futures market, followed by futures contracts for Euro rate and for Euro/USD rate. It is worth noting that prices of futures contracts, concluded in September for RUR/USD futures in the MICEX market were within RUR/USD 31–31.4 for December 2010, and RUR/USD 31.4–31.7 for March 2011. Trading volume in futures for commodity assets within the period under review has made 3.39 per cent. There were no contracts for interest rate in September.

Similar trends were observed in the RTS FORTS futures market, where the investors' average daily activity in September has increased by 5 per cent as compared with the previous month. Thus, in the period from August 31 through September 23 the total market turnover of futures and options in RTS made about RUR 2 026,56 billion (7.74 million of transactions, 43.08 million of contracts) with the average daily turnover at the level of 112.59 as compared with about RUR 2 676.93 billion (11.18 million of transactions, 55.41 million of contracts) with the average daily turnover of RUR 107.08 in August. 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 1 921.29 2 540.82 billion (7.59 million of transactions and 41.55 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 the dollar-ruble rate and for Euro/USD rate and for the shares of Sberbank of Russia and Gazprom shares. It should be noted that prices of the transactions, concluded in the RTS FORTS on futures contracts RUR/USD rate for the date of execution on December 15, 2010, were within RUR 30.9–31.2 /USD, and for March 15, 2011 - RUR 31.2–31.6/USD. The value of futures contract for the RTS index (based on the prices of recent contracts) with the execution date on December 15, 2010 was estimated on average at 1 450–1 490 points, for March 15, 2011 – 1 470–1 500 points. Options enjoyed far less demand, the turnover made about RUR 105.27 bn (149.34 thousand transactions and 1.53 mln of contracts). The maximum daily turnover in the short-term RTS futures market in the period under review made RUR 147.84 billion (as of September 22), and the minimum was RUR 56.51 bn (as of September 6). We would like to note that on September 2 in the FORTS market of futures and options, trades were started for the first time in Russia for the five-year futures contracts for the

USD exchange rate; this instrument became the most expensive long-term contract in the Russian stock market.

External factors behind the Russian stock market dynamics

In September the Russian financial market dynamics, as a month earlier, was largely dependent 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:

- growth in car sales in China as per August results, by 55.7 per cent as compared with August 2009;
- increase in the business activity indicators in China;
- GDP growth in EU countries in the II quarter of 2010 by 1 per cent (as compared with the previous quarter), as well as higher estimates of the European Central Bank for GDP growth of the EU countries by the end of 2010 (from 1 to 1.6 per cent) and for 2011 (from 1.2 to 1.4 per cent)
- the decision to keep interest rates by the European Central Bank at 1 per cent per annum;
- information on reducing the number of initial applications for unemployment benefits in the USA, as well as the growth of the industrial stocks;
- growth of oil prices in the global market to 78 dollars per barrel; payment of the second tranche to support the economy of Greece by IMF.

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

- decline in car sales in the USA in August by 23.5 per cent (as compared with August 2009);
- net losses of the British BP as of the II quarter in the amount exceeding USD 17 billion as a result of reserve funds accumulation for future expenses due to the oil disaster near the coast of the United States;
- continued growth in wheat prices in the world grain market, among other reasons provoked by the ban of the RF Government on grain exports up to the end of 2010;
- growing unemployment rate in the USA by 0.1 PP - to 9.6 per cent as of August results, and reduced business activity index in the US services sector by 2.8 points.

All those factors have generally resulted in the increased dynamics of the global stock indices in September, as of the month results. Thus, the markets of the developed countries were demonstrating a general increase in the indices by 1-9 per cent over the month, while the stock indices of the developing markets have grown by 4-10 per cent. The exception was the index of China Shanghai Composite, which has declined by 2.3 per cent ac. As compared with the indicators of early January 2010, there were observed upgrading trends in the basic global stock markets indices of the developed countries, as well as the indices of the developing countries, demonstrating a positive trend (See *Table 2* and *Fig. 5*).

Table 2

DYNAMICS OF THE GLOBAL STOCK INDICES (AS OF SEPTEMBER 23, 2010)

Index	Ticker	Value	Dynamics within the month(%)*	Dynamics within the month(%)
MICEX (Russia)	MICEXINDEXCF	1 430,12	4,33	4,39
RTS (Russia)	RTSI	1 477,13	3,50	2,25
Dow Jones Industrial (USA) Average (USA)	DJI	10 662,42	6,52	2,25
NASDAQ Composite (USA)	NASD	2 327,08	9,77	2,55
S&P 500 (USA)	SPX	1 124,83	7,24	0,87
FTSE 100 (UK)	FTSE	5 547,08	6,64	2,48
DAX-30 (Germany)	DAX	6 184,71	4,61	3,82
CAC-40 (France)	CAC	3 710,61	6,41	-5,73
Swiss Market (Switzerland)	SSMI	6 303,20	1,58	-3,71
Nikkei-225 (Japan)	NIKKEI	9 566,32	4,56	-9,29
Overpay (Brazil)	BUSP	68 794,32	7,05	0,30
IPC (Mexico)	IPC	33 091,13	5,44	3,02

Table 2, cont'd

Index	Ticker	Value	Dynamics within the month(%)*	Dynamics within the month(%)
IPSA (Chile)	IPSA	4 730,86	5,42	32,09
Straits Times (Singapore)	STI	3 083,13	4,26	6,40
Seoul Composite (South Korea)	KS11	1 832,63	4,12	8,91
ISE National-100 (Turkey)	XU100	64 192,60	8,17	21,52
BSE 30 (India)	BSE	19 861,01	10,14	13,72
Shanghai Composite (China)	SSEC	2 591,55	-2,30	-20,92
Morgan Stanley Emerging Frontier Markets Index	EFM	829,10	7,62	5,91

* – Versus index indicator valid on August 30, 2010.

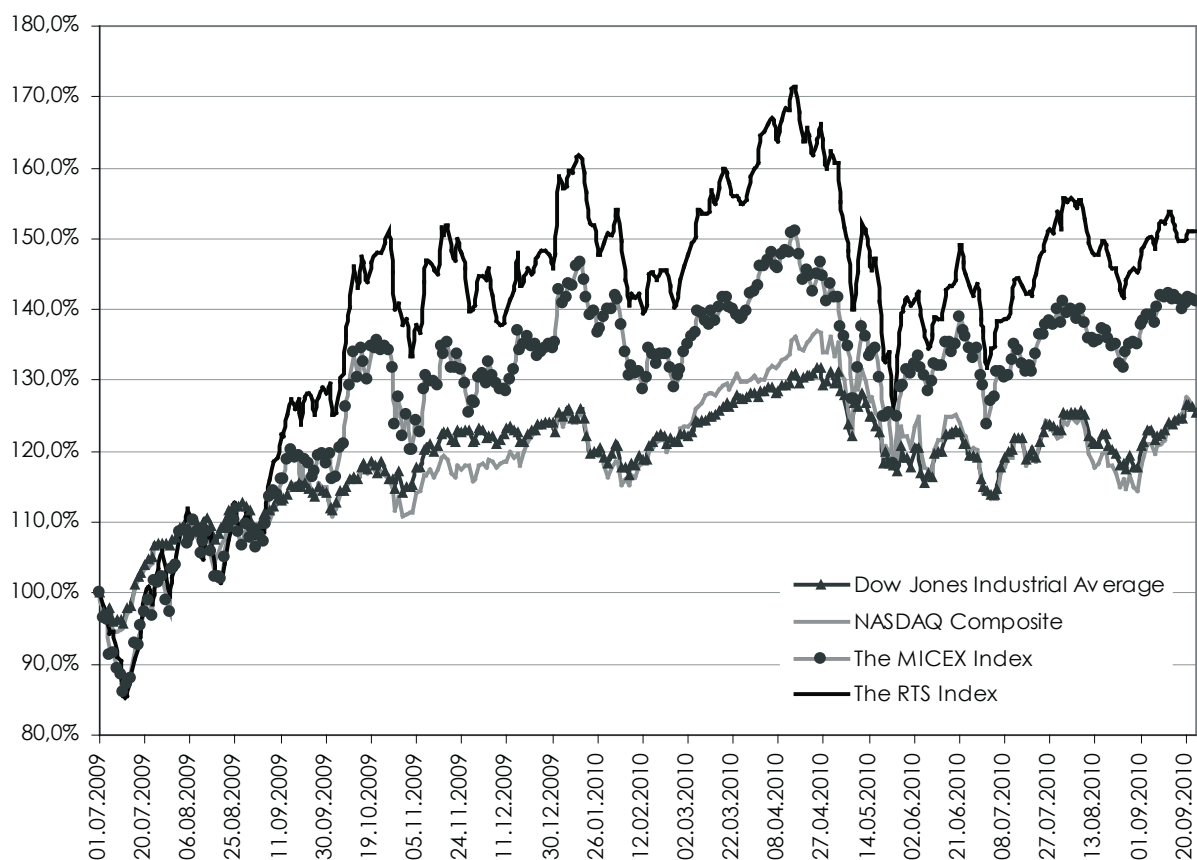


Fig. 5. Dynamics of the main USA and Russian stock indices (in % to the date 01.07.2009)

Corporate news

OAo "VTB Bank"

On September 2, 2010, VTB Bank has disclosed its unaudited financial reporting developed under IFRS for the first six months of 2010: net profit reached 25.1 billion rubles (against 31.5 billion rubles of net losses in the first six months of 2009), the loan portfolio before reserves deduction has grown by 11 per cent since the beginning of the year to 2.8 trillion rubles.; capital adequacy ratio remained at 19.3 per cent.

OAo «Gazprom»

On September 2, OAo "Gazprom" has disclosed its consolidated interim condensed financial report developed under IFRS for the I quarter of 2010: the profit for the period attributable to

equity holders of OAO “Gazprom” made 324,953 million rubles, which is by 221,274 million rubles (213 per cent) more than in the same period in 2009.

OAO «LUKOIL»

On August 31, OAO “LUKOIL” has disclosed its consolidated financial reporting developed under US GAAP for the first six months of 2010: net profit rose by 24 per cent to 4.002 billion US dollars. On September 3, OAO “LUKOIL” has carried out a partial loan redemption in the amount of 500 million US dollars raised in August 2009 in the amount of 1.2 billion US dollars for a period of 3 years.

OAO «Mosenergo»

On September 10, OAO “MOSENERGO” has disclosed unaudited interim consolidated financial reporting developed under IFRS for the first six months of 2010: net profit increased by 19.0 per cent to 4,237 million rubles, EBITDA rose by 2.9 per cent to 9,959 million rubles. On September 14, OAO “MOSENERGO” has repaid coupon income on bonds of series 01 and on September 19 has placed bonds series 01 in the volume of 5 billion rubles of 2006 for a period of 5 years.

Sberbank of Russia

On September 15, Sberbank of Russia has disclosed its financial reporting developed under RAS for 8 months of 2010: net profit made 88.5 billion rubles against 7.4 billion rubles for 8 months of 2009, assets grew by 7.7 per cent to 7,657 billion rubles; Russian enterprises were granted loans exceeding the amount of 2.4 trillion rubles; capital adequacy ratio made 18 per cent.

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 September of the current year continued its growth and at the end of the month made RUR 2 582.3 bn, which exceeds the relevant indicator of preceding month by 2.7 per cent¹. For the second consecutive month is based not only on the growing number of bond emissions in circulation, denominated in national currency (from 667 to 678), but on some extension of the number of emitters, which increased from 359 361. There is still one emission of bonds in circulation, denominated in US dollars and one in Japanese yens.

In September indicators of the secondary market of corporate bonds have reached the minimum level since May of the current year. Thus, the trading volume in corporate bonds in the MICEX market in the period from August 31 through September 23 amounted to RUR 90.8 billion (for comparison, from July 27 through August 30 the trading volume was equal to RUR 124.7 billion), and the number of transactions in the period under review made 19,1 thousand in the period (as compared with 27.2 thousand transactions in the preceding period)².

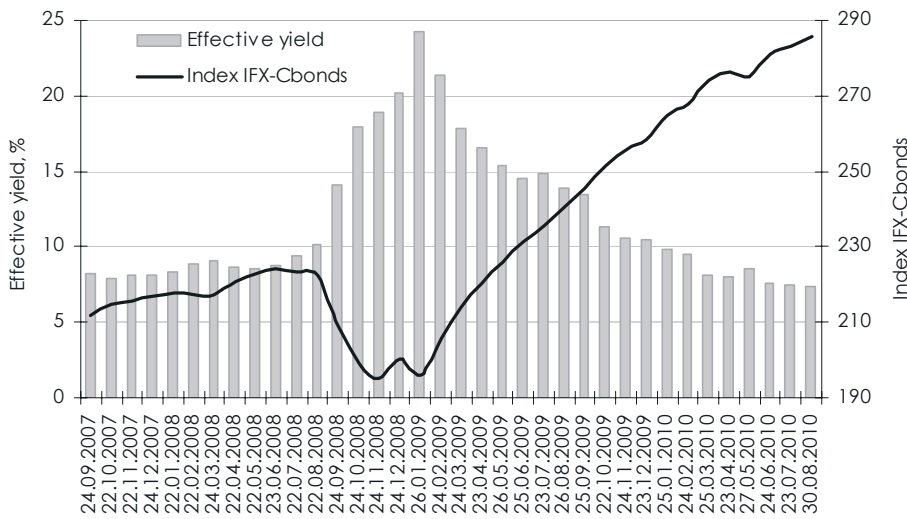
Index of the Russian corporate bonds market IFX-Bonds continued its upward trend emerging since the beginning of 2009. The increase by 1.6 points (0.6 per cent) was demonstrated in the period from August 30 through September 24. Effective yield is sustained over the last four months and its value is 7.33 per cent in late September as compared with 7.38 per cent in late August (See Fig. 6). The duration of corporate bonds market portfolio has regained a downgrading trend and made 650 days, which is by 17 days less against the last month indicator.

Among the most liquid emissions, the average effective yield in the period under review was rather volatile. The greatest decrease in effective yield of their emissions have demonstrated bonds many companies, including: OAO “Russian Agricultural Bank”, series 04 (-1.04 p.p.); CB “Renaissance Capital” series 02 and 03 (-0,8 p.p. and -0.96 p.p., accordingly), OAO “LUKOIL” series 03 and 04 (-0.18 p.p. and -0.80 p.p.), OAO «Mechel» series BO-01 and BO-03. The utmost growth was observed in the effective yield of the credit and finance companies bonds issues of OAO CB “Petrocommerts” series 07 (+1,54 p.p.), of OAO «NOMOSBANK» SERIES O9 (+0.40 points), of OAO “AIZHK” series 08 and 11 (+015 p.p and +0.19 p.p), of OAO “Gazprom Neft” series 04 (+0.76 p.p.)³.

1 As per Rusbonds information

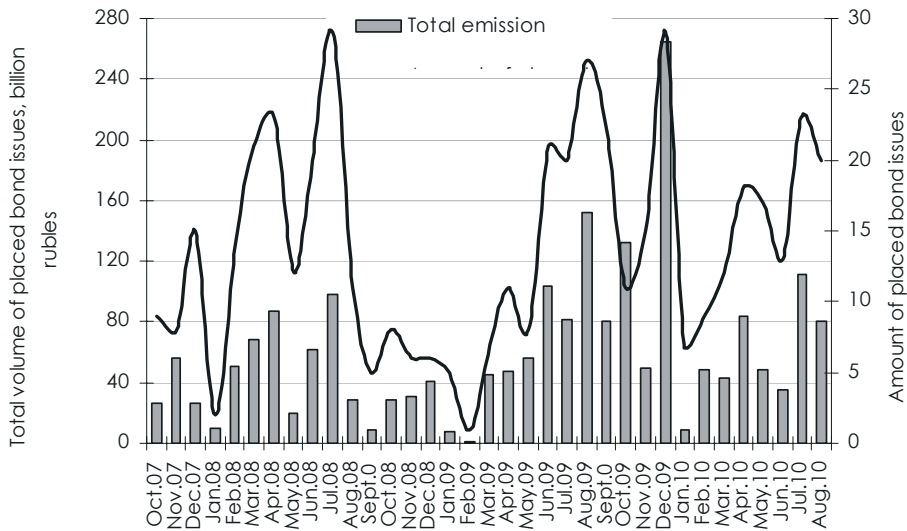
2 As per “Finmarket”Information agency.

3 As per “Finmarket”Information agency.



Source: Cbonds data.

Fig. 6. Russian corporate bonds index and average weighted yield dynamics¹



Source: Rusbonds data

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

In September companies were registering a large number of bond issues, though it was twice less than the record indicator of August. Thus, from August 31 through September 24, twelve emitters have registered 31 bond issues amounting to 105.6 billion rubles (as compared with seventeen emitters who registered 67 bonds issues worth of 352.8 billion rubles from July 24 through August 30). Over a half of the reported emissions were exchange bonds. The majority of registered emissions fell within two series of exchange bonds of OAO “RusHydro”, totaling to 20 billion rubles, three series of bonds of OAO “Glavnaya Doroga” for the amount of 17 billion rubles, six emissions of exchange bonds of OAO “St’ Petersburg Bank” for the amount of 15 billion rubles., three series of exchange bonds of OAO “X Finance” for RUR 15 bn. rubles, 7 series stock of exchange bonds of ZAO “AKB “Promsvyazbank” for the amount of RUR 31 bn.¹

From August 31 to September 24, all issuers have redeemed their bond issues on time (11 bond emissions of nine emitters

totaling to 24.5 billion rubles). Last month, six emitters have announced a technical default on repayment of their bonds for the total nominal value of 5.06 billion rubles. In October 2010, there expected to be redeemed 7 of corporate bonds for the total amount of 11.3 billion rubles².

The situation with the performance of current debt liabilities by emitters is still not easy. From August 31 through September 24, the real default on bonds coupon yield redemption was announced by four emitters (against eight emitters from July 24 through August 30). In regard to one emission the emitters managed to reach agreement with bondholders to restructure their debts. An 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 only by one emitter (as compared with five emitters in the preceding period)³.

1 Source: Rusbonds data.
 2 Rusbonds data.
 3 Cbonds data

REAL ECONOMY SECTOR: TRENDS AND FACTORS

O.Izryadnova

In July-August 2010 economic situation was determined by the decrease in business activity in nearly all types of economic activities. Versus the preceding month in August 2010 the index of industrial production made 100.1%, index of the agriculture – 101.9% and that of freight transportation – 100.2%. The reduction in the real incomes of the population in August versus June 2010 by 2.95 and in the real wages 0 by 2.5% accounted for the slow-down in the retail trade turnover down to 1.4%.

According to the forecast of the RF Ministry of Economic Development, under existing dynamics of the main indices, in the 2nd half of 2010 the rates of economic development are likely to decrease. The expected growth of the GDP over the year is 104.0%, which is 0.2 percentage point below the results of the 1st half of the current year and nearly 1.0 percentage point below the estimations of the economic development made by Russian and foreign experts at the beginning of 2010.

On September 23, 2010 the RF Ministry of Economic Development submitted corrected version of “Forecast for socio-economic development of the Russian Federation for 2011 and for the planning period of 2012 and 2013”. The expected GDP growth in 2010 will make approximately 104%. Taking into account the fact that as a result of the first half of 2010 the increase in the GDP made 104.2% the macroeconomic situation in the second half of the year will be characterized by the slackening of the dynamics.

Condition of the agriculture sector has a negative impact on the macroeconomic situation. The volume of agriculture production made 80.9% in August 2010 versus last August and 94.3% in January-August versus the corresponding period of 2009. According to the data of the Ministry of Agriculture the crops in the area of more than 13 million hectare died out, which makes 17% of the total area under crops or 30% of the total area under grains in the Russian Federation. As on September 22, 2010 54 million ton of grains was harvested, which, taking into account the reserves of 26 million ton of grains will make 90 million ton of grains, while the internal demand is equal to 77 million of ton.

As a result of the year the volume of agriculture production is estimated to be 90.1% versus the figure of the previous year. The decisions on temporary ban for grains and grain products export till the end of the year together with the subsidies for railway transportation of the grain and measures aimed at improvement of financial situation of agricultural enterprises and organizations contribute into the stabilization of the situation with both the provision of foodstuffs and in the agriculture sector on the whole. The Ministry of Agriculture envisages subsidies of RUR 98.1 billion for the state support to agriculture production and social development of rural areas, and more than RUR 70 billion has already been transferred to the regions that have suffered from the drought, which makes more than 70% of the annual limit for the State Program fulfillment. In order to support agriculture producers RUR 14.8 billion of budget credits were issued, but only RUR 6.24 has been received. The decrease of interest rate to 12.0% per annum by Sberbank will also have a positive effect on the financial situation of the agriculture producers.

According to the data of the Ministry for Economic Development, autumn sowing has been started in the majority of the subjects of the Russian Federation. As on September 17, 2010 autumn agriculture crops have been sown on 7.2 million hectare, which makes 39.3% of the forecast area under autumn crops for 2011 harvest. As on September 10, 2010 agriculture goods producers have purchased 2523.2 thousand tons of diesel fuel and 546.3 thousand tons of car petrol, which makes, correspondingly, 93.4% and 82.6% of the level of the previous year. From the date the Decree of the RF Government of March 18, 2010 No 129 came into effect to September, 10 1640.9 thousand tons of diesel fuel and 185.3 thousand tons of car petrol was purchased with 10% discount.

Investment activity throughout the year was also characterized by extraordinary instability. The growth of investment of 17.5% in August 2010 did not compensate dramatic contraction of investments in July. On the whole from January to August 2010 investments in fixed assets went up by 2.8% versus the corresponding period of the previous year while workload in construction decreased by 1.9% and commissioning of the residential floor area reduced by 4.0%. According to the forecast of the RF Ministry of Economic Development in 2010 investments in fixed assets will increase by 2.5% as compared with the previous year, whereas the trend for the reduction of workload in construction (99.6% versus 2009) and for stabilization of the rates for residential floor area will persist.

In 2010 export remains one of the main factors of economic development. However, as the trend for anticipating import growth versus external demand and the dynamics of domestic production is becoming more pronounced, the influence of net export on the economic dynamics is weakening. Import recovery growth which started in 2010, in the 1st half of the year took place primarily in the investment market and the market of intermediate goods. The proportion of investment goods in import expanded from 16.85 in the 1st quarter to 18.6% in the 2nd quarter 2010 and the share of the goods of intermediate demand – from 39.7% to 41.5%, correspondingly. The shift in the structure of consumer goods towards investment and intermediate goods is one of the factors determining the potential for recovery and further development of the economy. However, in July-August foodstuffs import growth rates were observed to intensify as compared with those for other types of goods, which may result in the weakening of investment goods positions. According to the forecast of the RF Ministry of Economic Development while in 2010 the GDP is expected to grow by 104.0% and the internal demand will expand by 6.6%, import will extend by 20.1% and domestic production for internal consumption – by 3.0%.

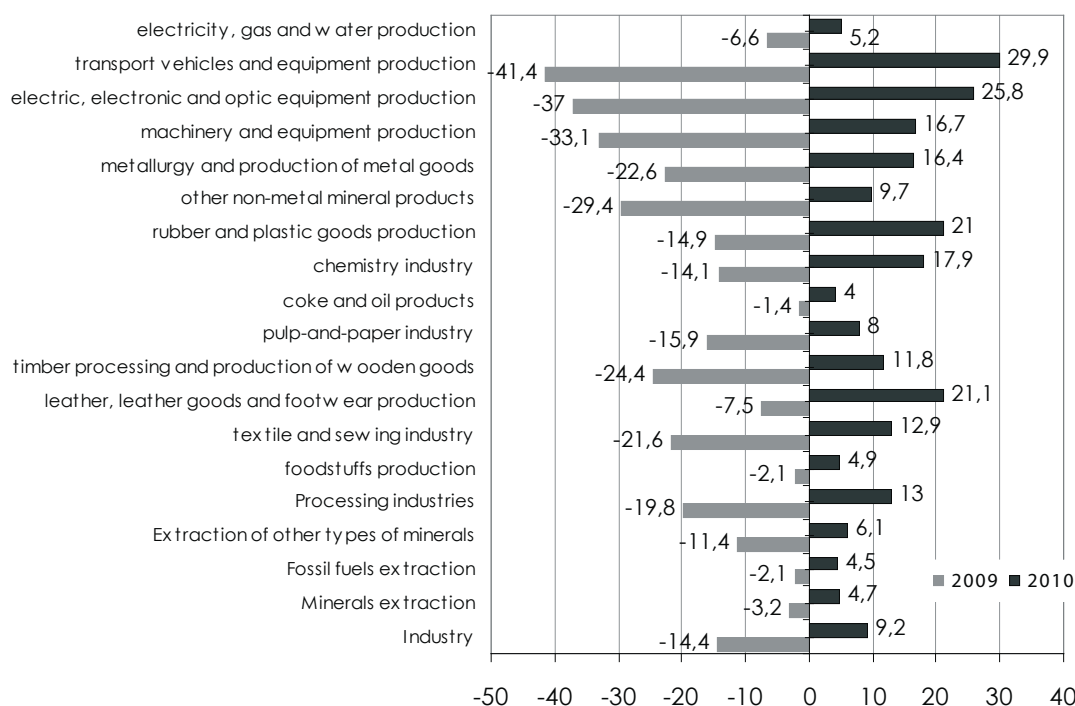
The trend for the recovery of consumer expenses was the most important factor influencing the internal demand in 2010. Retail trade turnover in January-August 2010 went up by 4.3% versus the corresponding period of the previous year and was maintained by the growth of real incomes of the population by 5.6%, increase in real wages – by 5.1%. The sales of foodstuffs have been increasing at anticipating rates in the structure of goods turnover. Over January-August 2010 as compared with the corresponding period of the previous year the turnover of the foodstuffs market went up by 5.7%, while that of non-food goods market – by 3.1%. according to the forecast of the RF Ministry of Economic Development the expected growth of the retail trade turnover will make 105.2% versus the figure of 2009, that of the real incomes of the population – 104.4%, of real wages – 104.9%. Under the forecast dynamics, the volume of goods turnover will reach the level of 2008 and the real wages will exceed the figure of pre-crisis period by 1.2%.

Throughout the current year considerable changes in the inflation background occurred. In the 1st half of 2010 low world prices for foodstuffs and considerable limitations of the demand secured fast inflation decrease. By July inflation has lowered to 5.5% in annual terms, which has been the record-breaking minimum. Over eight months the prices rose by 5.4% as compared with 8.1% in the corresponding period of the previous year. In August the inflation at the consumer market was equal to 0.6%. Highly unfavorable climate situation and recession of the production in agriculture sector increased the risks for inflation acceleration. In August 2010 prices for foodstuffs soared by 6.6% and for non-food goods – by 2.5% as compared with the beginning of the year.

Prices for sold agriculture products went up by 1.9% over January-August, including the increase of 2.8% in August, which partially compensated the drop of prices in January-July. Prices growth acceleration in July-August is also connected with the increase in world prices for foodstuffs and raw materials for foodstuffs production.

Against the background of difficult situation in the agriculture production, heightened inflation expectations in connection with the contraction in supply of some types of commodities and anticipating growth of prices both for raw materials suppliers and processors according to the forecast of the RF Ministry of Economic Development the growth of consumer prices will go up to 8.5% versus 6.7% that were expected earlier.

On the whole the industrial production for all the monitored sectors was characterized by sustaining positive dynamics, 2009 base being low (*fig. 1*).



Source: Federal State Statistics Service

Fig. 1 Changes in Dynamics of Industrial Production as broken by Types of Economic Activities in January-August 2009-2010, as percentage to the corresponding period of the previous year

As compared with the corresponding period of the previous year the increase in industrial production in January-August 2010 made 9.2%, that in minerals extraction – 4.7%, in processing industries – 13.0%, in electricity, gas and water production and distribution – 5.2%.

Industrial enterprises are cautious in both the production and investment policy. In extractive industries investments in fixed assets made 98.5% of the figure of the 1st half of 2009, in processing industries – 84.9% and only in electricity, gas and water production and distribution they went up by 23.7%. On the whole in the industry in January-August 2010 production volumes remained by 6.5% below the pre-crisis level of 2008. The pace of recovery from the crisis being different, in January-August 2010 versus the corresponding period of 2008 the increase in fossil fuels production made 2.3%, in coke and oil products production – 2.5%, in chemistry industry - 1.3%, in rubber and plastic goods production – 3.0%, in foodstuffs production – 2.7% and in leather, leather goods and footwear production – 12.3%. The volumes of machine-building production make 76-79% of the pre-crisis level of January-August 2008, of metallurgy production – 90%, of construction materials production – about 77%.

As compared with the preceding month in August 2010 the increase in industrial production made 0.1%, being 0.4% in processing industries, 1.7% in electricity, gas and water production and distribution, the volumes of minerals extraction reducing by 1.4%.

According to the forecast of socio-economic development the expected growth of industrial production in 2010 will make 107.6%, and that of processing industries – 109.9%.

It should be noted that starting with the 2nd quarter 2010 the industrial goods producers' prices were observed to grow at anticipating rates as compared with the dynamics of consumer prices. The increase in producers' prices in the industry made 3.3% over August 2010 and 9.6% since the beginning of the year. According to the estimation of the Ministry of Economic Development the growth of prices for exported goods made 113.3% in January-August, the increase in August making 104.5%, which was mainly due to the growth of prices for fossil fuels.

The prices for non-tradable goods were also observed to grow at accelerated rates this July-August. In the foodstuffs production prices went up by 5.05 since the beginning of the year, by 1.7% in July and by 2.8% in August. Prices for meat went up by 1.6%, for sunflower seed oil – by 3.1%, for flour-and-cereals goods – by 9.1%, for alimentary products – by 2.6%.

The aggregated price index being 109.5% in processing industry in August versus the beginning of the year, the growth of prices in chemistry industry made 117.6%, in metallurgy – 110.8%, in coke and oil products production – 109.8%. Machine-building complex was characterized by reserved growth of prices within the range from 104.7% to 109.0%, which is likely to be corrected under the influence of the trend for the goods of adjacent productions becoming more expensive. While the expected growth of industrial production is 107.6% in 2010, increase in industrial producers' prices will make approximately 112.8%.

It was the gradual improvement of the situation at the labor market that was one of the main factors positively influencing the economic growth in 2010. In August 2010 according to the preliminary results of the survey among the population concerning employments, the number of the unemployed decreased to 5.2 million or 6.9% of the economically active population (calculated on the basis of the International Labor Organization methodology). 1.7 million is registered as the unemployed at the state employment agency and 1.4 million of them received unemployment benefit. On the whole in 2010 the unemployment is estimated at the level of 7.7% of the economically active population versus 8.4% in 2009.

Low level of labor efficiency is one of the main problems in the Russian economy, which is accounted for by highly unsatisfactory technical and technological state of the fixed assets, unreasonable use of work force and deficit in highly-qualified staff. In the environment of the crisis the problems of employment optimization and reduction of labor costs have become acuter. In 2009 in Russia, according to the estimation of the RF Ministry of Economic Development labor efficiency taking into account the worked hours reduced by 2.2% the decrease of labor efficiency per one employed being 5.8%. Thus, the production recession during the crisis was not accompanied by the corresponding decrease in the number of the employed and the unemployment is latent in the form of partial employment and enforced leaves.

In 2003-2008 the labor efficiency in the economy went up at the rates exceeding 5% per year, but was behind the wages growth rates. The decrease in enterprises profits during the crisis of 2008-2009 resulted in the slow-down of wages growth, which was, however, not as pronounced as the production recession and reduction in labor efficiency. It is expected that in 2010 the rise in labor efficiency will make 3.0-4.5% and will remain below the forecast figures for wages growth. ●

RUSSIAN INDUSTRY IN AUGUST 2010

S.Tsukhlo

In August the Russian industry retained the previous rates for output, prices and employment growth. However, the forecasts for the demand, estimations of sales, plans of output and staff hiring, very cautious policy concerning stocks management, according to the surveys of Gaidar Institute for Economic Policy¹, testify that the industrial enterprises are becoming more and more uncertain in the dynamics of the current economic situation.

Official Statistics in July **Официальная статистика июля**

In July the official statistics disappointed experts. The Federal State Statistics Service reported that the industrial production has reduced by 0.1% versus June 2010 (in June the decrease versus May made 0.5%), the Center for Macroeconomic Analysis and Short-Term Forecasting gives different data for these months (reduction of 0.8% in July versus June, 0.0% in June versus May) and holds that “in the middle of the year the stabilization is the prevailing trend in the industry”, “it is too early to speak about the negative tendency”. The intensified competition with import against the background of high ruble exchange rate and abnormally hot weather are considered by experts to be the main reasons for the recession.

Demand for Industrial Goods

In August growth rates of the demand for industrial goods have worsened by 4 points and became formally negative. However, they still remain within the range near zero, in which they have stayed since February 2010, i.e. the enterprises have not registered appreciable growth for seven months and this situation seems to be becoming usual for them. The latter fact makes the respondents to estimate sale more realistically: in August 635 of enterprises considered their volumes as normal (growth by 13 points versus July) (fig. 1). The estimations of sales are, however, the most unstable index in 2010.

The forecast for the demand have also demonstrated negative dynamics in August. In September-October the enterprises expect the sales growth rates to be the worst in 2010. Both the initial expectations and those upon exclusion of seasonality testify that the industry is ready to experience zero growth rates of the demand this autumn, whereas in the 1st quarter the enterprises expected the sales to grow with the rate of +10...+13 balance points. Thus, the optimism of the beginning of the year has gradually disappeared (fig. 2).

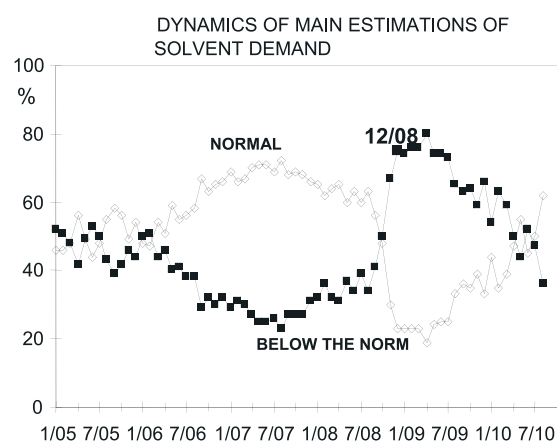


Fig. 1

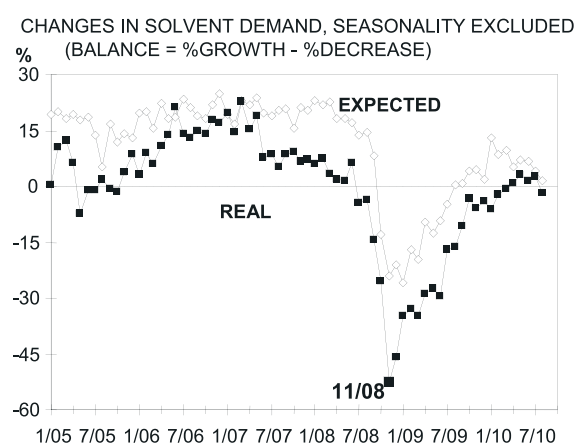


Fig. 2

1 The surveys among the directors of the industrial enterprises have been conducted by Gaidar Institute for Economic Policy monthly starting with September 1992 in concordance with the European harmonized methodology and embraces the whole territory of the Russian Federation. The panel is about 1100 enterprises at which more than 15% of all those employed in the industry work. The panel is shifted towards large enterprises for each of the singled sectors of industry. The return of questionnaires makes 65–70%.

Stocks of Finished Goods

For the second month in the row the enterprises report the absence of finished goods stocks excesses. The balance of estimations is becoming stable in the negative field, which testifies the growing prevalence of “below the norm” estimations over those “above the norm” (fig. 3). However,

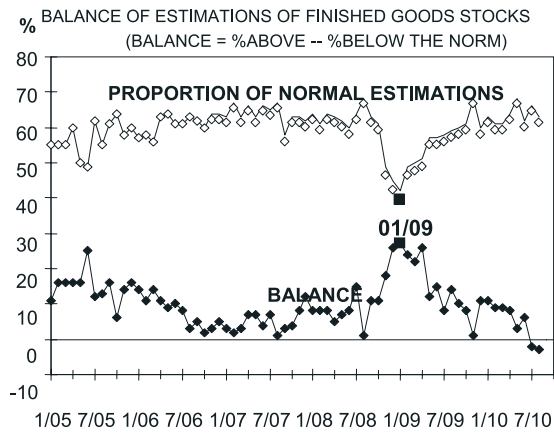


Fig. 3

the majority of enterprises (more than the half) are characterized by normal stocks of finished goods. As broken by sectors of industry, only the light industry is characterized by the excessive stocks, other branches of industry have negative balances of estimations. It should be noted that the stability of stocks estimations makes 76-79% in 2010, i.e. more than three quarters of enterprises retain their estimations of stocks unchanged in the following month. It should also be remembered that at the beginning of the 3rd quarter the producers declared the intentions to decrease the volumes (not the estimations) of stocks at the rate of -7 points after their real decrease in the 2nd quarter at the rate of -9 balance points.

Production Output

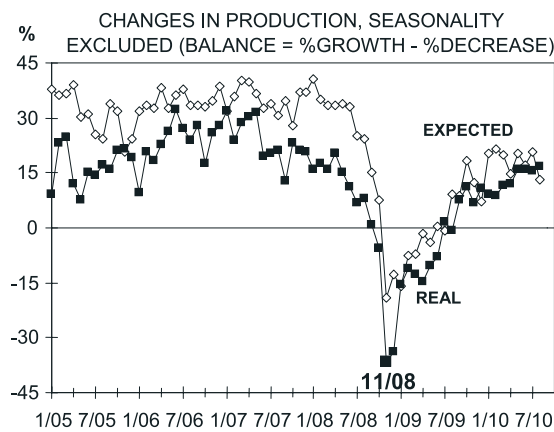


Fig. 4

In August, according to estimations of enterprises, the growth of output persisted and was not subject to considerable changes as compared with the previous months. However, it is possible that later official statistics of August will register changes in August production by several thousandth versus July. However in the forthcoming months the enterprises may retreat to less intensive growth rate. At least the situation is such according to their August plans. The supposed production growth rate has now reduced to the annual minimum both for initial data and those upon exclusion of seasonality (fig. 4). Only the light industry is planning a more intensive output growth.

Enterprises' Prices

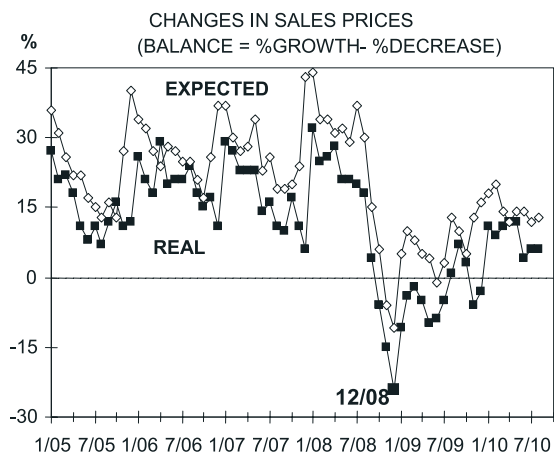


Fig. 5

For the last three months the industry has retained the growth of its prices at approximately the same level (the lowest for 2010) and on the whole has resisted the inflation fever of abnormally hot July and August (fig. 5). The foodstuffs production industry, however, that refused to increase process in May-July reported the most intensive increase in prices in 2010. The similar increase in prices growth rates has been observed in timber industry.

Pricing plans of enterprises have remained stable already for 6 months although in the last three months the enterprises were forced to increase them at lower rates than those planned. Comparatively higher growth of prices is planned in chemistry industry, foodstuffs production, light and timber processing industries.

Dismissals: Real Dynamics and Plans

In August the industry returned to previous rates (+5 points, the same as in March-May) rates of employee hiring after some fluctuations around the mentioned value in June-July. Thus, the enterprises continue to hire staff even though the demand is not growing and the forecasts for output and sales are worsening. In the forthcoming months however these positive processes may terminate. The plans for employment in September-October have decreased to the annual minimum and become zero – the industry is intending to contract the staff hiring (fig. 6). It is only the machine-building and light industries that are not going to contract staff hiring.

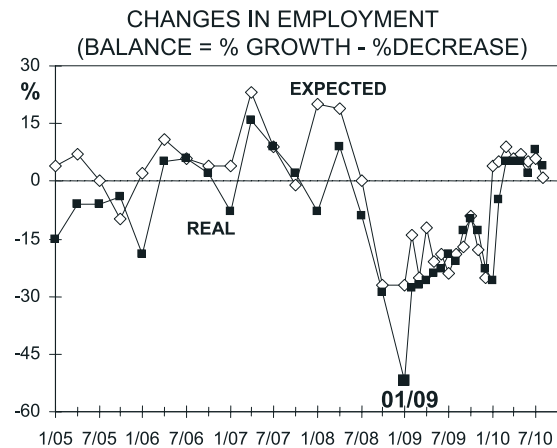


Fig. 6

Industry Crediting

After stabilization at the level of 65% in May-July, the credits availability increased to 69% in August – the banking system has once again lowered the requirements to the borrowers from industrial sector (fig. 7). In August the changes concerned mainly machine-building factories, for which the credits availability went up from 64% to 71%. The foodstuffs producing enterprise enjoy the same level of banks' disposition. The first place is still held by metallurgy (78%), however. The most disfavored sector is the light industry.

The average minimum interest rate at which banks offer loans in rubles has lowered to 13.5% per annum, while for normal credits availability it should make 12.5%.

The ability to serve the existing credits has remained at the level of 80% throughout the industry (of the total number of enterprises that have credits) since April 2010. 16-19% of enterprises recognized their inability to execute their liabilities towards banks in that period. Thus, the proportion of dab debts (borrowers) in the industry remains stable on the whole. The highest risk of credit default is registered in the industry of construction materials (31% of enterprises), light industry (29%) and timber processing (25%) industries.

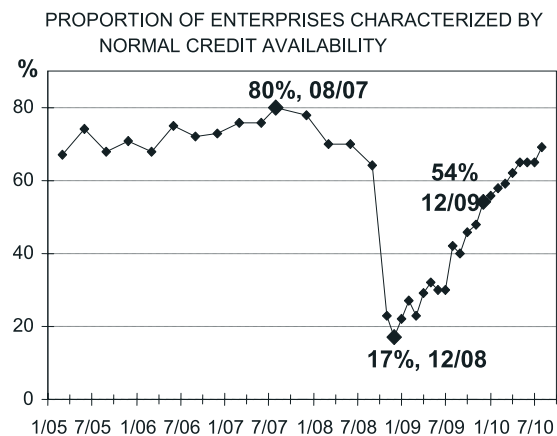


Fig. 7

Financial and Economic State of Enterprises

During the current crisis the majority of enterprises (the same as before the crisis) has been receiving “some profit” (the formulation of the response in the questionnaire). The proportion of such responses makes 54% as a result of the 1st half of 2010, whereas the crisis minimum (estimations of the 1st half of 2009) was equal to 40%. The pre-crisis maximum of the index was registered in the 1st half of 2007 and made 65%. The estimations of “some losses” hold the second place during the crisis, although their proportion even at the height of the crisis (28%) was considerably smaller than the proportion of enterprises receiving the profit, and has now lowered to 15%. As a result of the 1st half of 2010 13% of enterprises in the industry are characterized by “big losses”. Thus, 28% of enterprises finished the half of the year in the red, and 63% – in the black. At the worst point of the crisis the ratio was practically equal: 46 to 45.

In the 2nd and 3rd quarter of 2010 the resulting estimations of the real financial and economic situation (not accounting one for the taxation purposes) have stabilized. The prevailing part o producers (69%) estimate their situation as satisfactory, and it should be noted that the

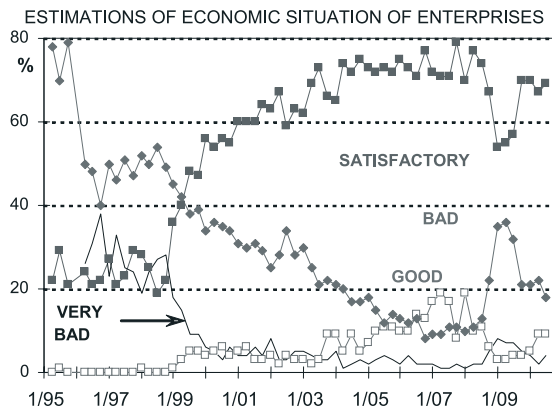


Fig. 8

proportion of such estimations has not been changing for four quarters in a row and has approximated the average value of this indicator in pre-crisis 2007 (73%). Thus, the industry is definitely out of the crisis financial depression. The second most frequent response in the Russian industry is the estimations of “bad” financial situation. They have also stabilized in the last four quarters and make on average 21%. However, there is still a long way to pre-crisis 10%. In the worst quarters during the current crisis the proportion of such estimations reached 36%. The proportion of estimations “good” in the last two quarters reached the crisis maximum of 9%, but is also far below the average values of 2007 (17%) (fig. 8).

FOREIGN TRADE

N.Volovik, K.Resenkova

In the recent months the positive trade balance was observed to decrease, which is connected with the contraction of the export physical volumes the export prices remaining unchanged and the import growth accelerating. According to the data of the RF Central Bank, in July foreign trade balance made USD 11 billion, which has been the lowest figure since August 2009. The formation of the unified trading policy is going on within the framework of the Customs Union.

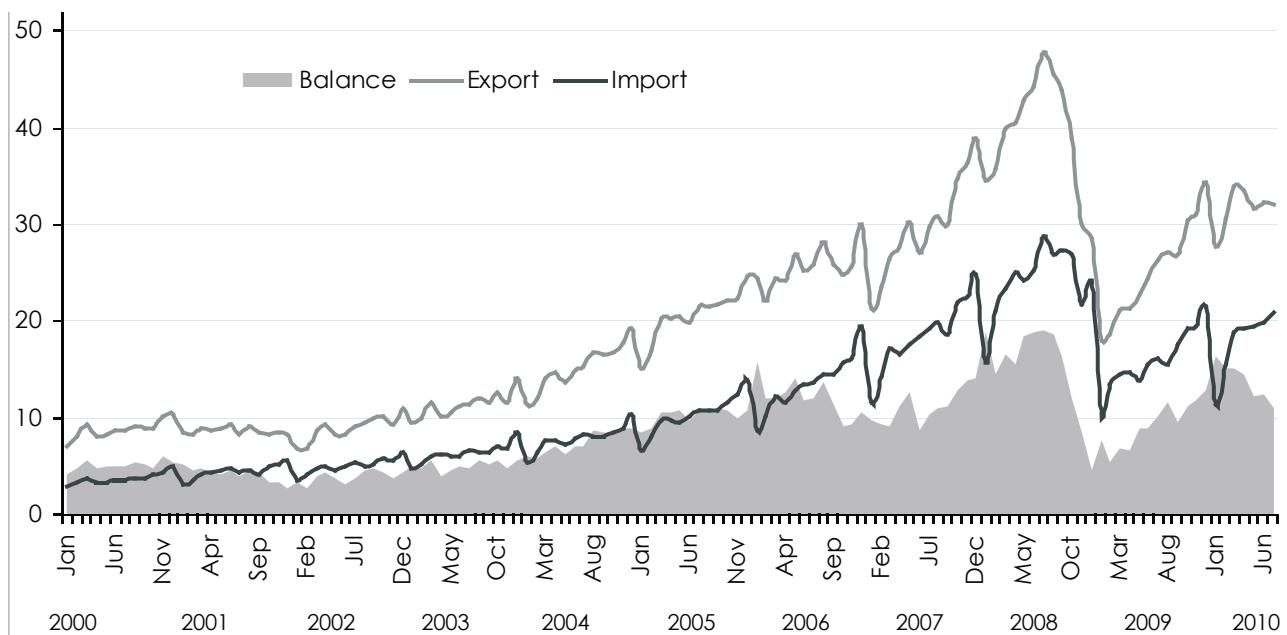
As compared with July 2009, in July 2010 Russia's foreign trade turnover calculated on the basis of balance-of-payments methodology increased by 25.3% and made USD 53 billion. The volume of Russian export in the same period reached USD 32 billion, which is 21.15 more than in July 2009, and the volume of import into the Russian Federation was USD 21 billion, which is 32.2% more than the corresponding figure of July 2009.

As a result of Russian export growth rates slow-down and import growth acceleration, the trade balance is contracting. According to the data of the RF Central Bank, in July the foreign trade balance was positive and made USD 11 billion, which has been the lowest figure since August 2009.

The increase in export value volume is mainly connected with the increase in prices for the main goods of the Russian export.

This July index of world prices and commodity markets according to IMF data increased by 1.2%. The growth of the total index of world prices was connected with the increase in prices for foodstuffs by 5.6% and in prices for non-ferrous metals – by 2.8%.

In July the growth of prices for foodstuffs was caused by the growth of world prices for wheat. The prices for Canadian wheat CWRS No1 went up by 10% over the month, for American HRW No1 and SRW No2 – 24% and 22%, correspondingly. According to the regular report of the International Grains Council, the fast growth of prices for wheat is connected with unfavorable weather conditions that resulted in the loss of this year's harvest and introduction of limitations for grains export in a number of countries.



Source: Central Bank of the Russian Federation

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

The world prices for meat have reached twenty-year maximum, which was mainly due to the growth of prices for mutton (up to 37-year maximum) and beef (two-year maximum), which in its turn was the result of the increase in prices for forage.

According to the data of the London Metal Exchange, in July 2010 as compared with July 2009, prices for aluminum, copper, nickel and steel went up by, correspondingly, 19.2%, 29.1%, 22.1% and 4.9%. as compared with June 2010 prices for aluminum, copper, nickel and ferrous metals rose by 2.9%, 3.6%, 0.7% and 2.2%, correspondingly.

In connection with the terminations in supplies in the Gulf of Mexico and in the North Sea prices for crude oil in July 2010 tended to increase. By the beginning of August, the prices have reached the three-month highest level but lowered afterwards due to apprehensions concerning the recovery rates of the global economy. During July the price for oil grade Brent grew with some fluctuations from the monthly minimum of USD 71.7 per barrel on June, 1st to the monthly maximum of USD 78.6 per barrel on July, 29th. ON the whole, in July the average monthly price went up to USD 75.6 per barrel, increasing thus by 1.1%.

In July 2010 the average price for Russian oil grade Urals was USD 74.17 per barrel versus USD 64.523 per barrel in July 2009 (+15%) being lower than this June (USD 74.25 per barrel). Over 7 months the average price for oil was registered at the level of USD 75.67 per barrel, whereas in January-July of the previous year it was at the level of USD 52.97 per barrel.

In the period of monitoring from August, 15 to September 14, 2010 the average price for oil made 75.01321 per barrel. Export duty rate for the Russian oil starting with October, 1st can thus reduced by USD 7 – from USD 273.5 per ton established in September to USD 266.5 per ton. The duty rate for oil from Eastern Siberia oil fields can decrease by USD 4.9 – to USD 82.1 per ton. Duty rate for light oil products can lower from USD 196.5 per ton to USD 191.8 per ton, duty rates for dark oil products – from USD 105.9 per ton, established on September, 1st, to USD 103.3 per ton.

The price for Russian gas exported into the Western Europe has increased to USD 305.3 per thousand cu m in July, which is the highest value over the last 13 months.

Table 1

AVERAGE MONTHLY PRICES IN JULY OF THE CORRESPONDING YEAR

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Oil (Brent), USD/barrel	28.4	24.62	25.7	28.25	38.2	56.4	72.5	75.09	139.23	65.74	75.6
Natural gas, USD/1 million BTU	4.01	3.15	2.94	5.021	6.034	7.554	6.305	6.539	11.22	3.608	5.16
Petrol, USD/gallon	0.935	0.732	0.804	0.896	1.306	1.601	2.271	2.182	3.313	1.771	2.06
Copper, USD/ton	1864.2	1541.4	1589.0	1730.3	2813.0	3614.0	7712	7962.7	8415.3	5215.5	6735.3
Aluminum, USD/ton	1565.9	1412.2	1338.4	1434.9	1710.0	1779.0	2513	2730.7	3071.2	1668	1988.3
Nickel, USD/ton	8202.0	5956.8	7143.1	8790.6	15038	14581	26585	33373	20160	15985	19518

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

As a result of the anticipating growth of export prices as compared with import prices, in July 2010 as compared with July 2009 the conditions for foreign trade have improved. Index of foreign trade conditions made 124 points in July 2010.

Table 2

INDEX OF RUSSIA'S FOREIGN TRADE (JULY 2010 AS PERCENTAGE VERSUS JULY 2009)

	Physical volume	Average Prices
Export	96.8	122.5
Import	127.6	98.8

Source: Ministry of Economic Development of the Russian Federation

In January-July 2010 Russia's foreign trade turnover went up by 38.7% as compared with the corresponding period of 2009 and made USD 346.9 billion. Over the same period export increased up to USD 221.7 billion (by 46.1%), import – up to USD 125.2 billion (by 27.3%). The positive foreign trade balance enhanced to USD 96.6 billion as compared with USD 53.5 billion in January-July 2009.

In year terms export growth rates increased only in the 1st quarter: from 54.5% in January to 61.1% over the first three months. In the 2nd quarter the growth started to slow down and as a result of the first half of the year the growth rates went down to 51.4%. Import, in contrast, has been increasing continuously, and the growth rates went up from 8% in January to 26.4% in the first half of the year. Import into the Russian Federation continues to recover rapidly due to the appreciation of ruble exchange rate versus the currencies of the main trading partners, gradual reviving of the economy and partial recovery of the internal demand as well as improvement in crediting conditions. At the same time export volumes are stagnant, and further growth of price for fuel and energy commodities seems to be unlikely. Besides, a considerable increase in export volumes of raw materials or the improvement in the situation with the non-primary goods export are hardly probable in the nearest future.

According to the decision of the Customs Union Commission, starting with September 17, 2010 import duty rates for some kinds of dairy products increase. Duty rates for milk and cream, not condensed and with no sugar added, will increase from 20% to 25%. Maximum levels of duty rates for a number of cheeses produced in the countries that are not members of the Customs Union will also increase from Euro 0.5 per kg to Euro 0.6 per kg.

The Commission adopted this decision to fill the market with dairy products from CIS countries and primarily from Belorussia. Production of dairy products in this republic has not suffered as much from drought as in Russia or Kazakhstan.

The increase in customs duty rates will pass unnoticed against the general background of retail prices growth for Russian dairy products, the prices for which in the retail trade has already risen by 10-30%.

Customs Union Commission has introduced 5% duty rates for import of some types of agricultural machinery. Duty rates for this type of commodities were nullified earlier. This decision, which will come into effect in the middle of October 2010, is aimed at stimulation of production and sale of the agricultural machinery produced in three countries that are members of Customs Union in the Customs Union, which in its turn will accelerate formation of the common market of goods and services of agriculture machinery.

The list of “some types” includes machinery and equipment for feedstuff milling and feeding equipment developed as hitches for field engines. Similar measures aimed at protection of the national markets of agricultural machinery within the Customs Union can be adopted for some types of harvesting and sowing agricultural machinery by the end of the current year.

On 20th and 21st of September, 2010 the 19th Meeting of Customs Union Commission took place in Moscow. The members of the Commission approved a number of regulatory legislative acts envisaged by the Customs Code of the Customs Union:

- Procedure for Control, Procedure for Declaration and Procedure for Correction of goods customs value (the two latter come into effect on January 1, 2011);
- Instructions on characteristics of transit declaration filling out during movement of international post packages;
- number of classifiers used to fill out customs declarations;
- new version of Instructions for filling out goods declarations.

Subcommission for customs and tariff and non-tariff regulations, protecting measures in foreign trade of the RF Government adopted a decision on abolition of import duty rates for some types of vegetables (potato, cabbage) and buckwheat for 6 months. Import supplies of goods to the market should solve the problem of deficit and high prices connected with poor harvest.

Russia has annually produced about 600 thousand tons of buckwheat, this year due to the drought the harvest contracted to 400 thousand of tons. Annual demand for buckwheat in Russia is 700 thousand of tons.

Country's demand for potatoes make about 29 million of tons, including 12 million tons for seeds and industrial processing and about 16 million tons for private consumption. This year the crop is estimated to be 22 million tons versus 31 million tons in 2009.

The abolition of import duty rates is to be coordinated with the members of Customs Union. In concordance with the Unified Customs Tariff of the Customs Union of Russia, Belorussia and Kazakhstan, which has been in effect since January 1, 2010, import duty rate for potatoes makes 15%, for cabbage – 15%, for buckwheat – 10%). ●

FOREIGN INVESTMENTS IN RUSSIAN ECONOMY

E.Ilukhina

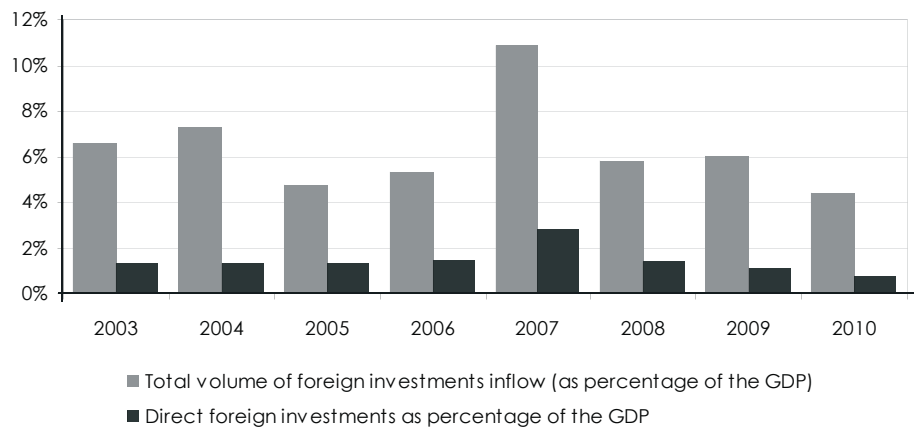
The first half of 2010 is characterized by reserved behavior of foreign investors in the Russian Federation. In the 2nd quarter the volume of withdrawn capital exceeded the incoming investments into the Russian economy. The proportion of direct investments in the structure of foreign investments receiver in January-June 2010 lowered to 17.9%. Foreign investments are concentrated in the industry, trade, transportation and communication, these sectors accounting for 84.7% of the total amount of foreign investments in the Russian economy in the first half of 2010. In the industry sector, the investors retain the interest in the processing sector. As to geographical structure, the biggest volume of foreign investments in the Russian economy comes from Germany, the Netherlands and Cyprus in the first half of 2010. Against the background of the decrease in foreign investments in the Russian economy, investments from Russian abroad continued to grow, exceeding by 64.9% the volume of foreign investments in the Russian economy in January-June of the current year.

In the first half of 2010 foreign investments in the Russian economy made USD 30.4 billion, which is 5.5% below the figure of the corresponding period of the previous year (in

the first half of 2009 the reduction of 30.9% versus the corresponding period of 2008 was observed). The level of foreign investments inflow (as percentage of the GDP) remains low.

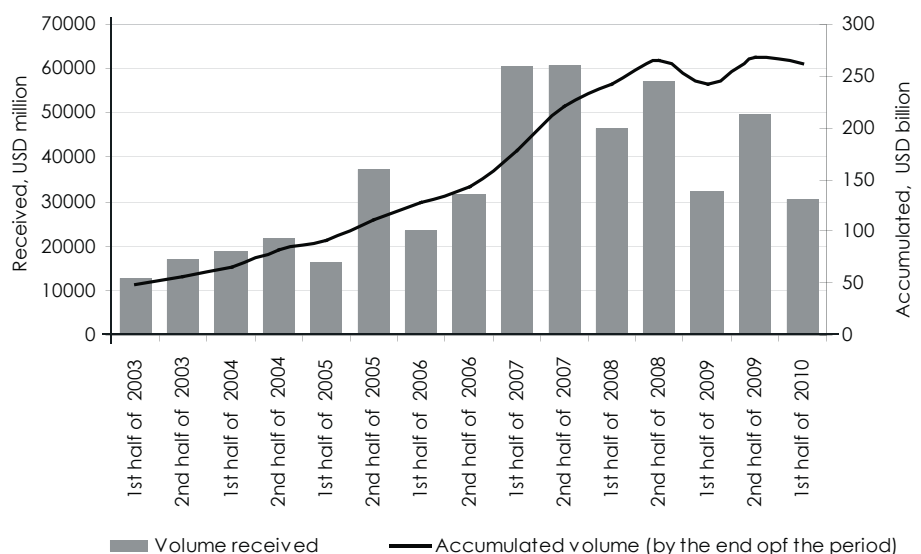
As on July 1, 2010 the accumulated volume of foreign investments in Russia including investments from CIS countries made USD 262.6 billion, which is 8.3% above the figure of July 1, 2009 and 2.1% below the level reached as on January 1, 2010. The decrease in the volume of foreign investments accumulated in the Russian economy in the 1st half of the year has been observed for the second year in a row.

USD 32.3 billion, which is 1.6% above the figure over the corresponding period of 2009, was withdrawn in the form of



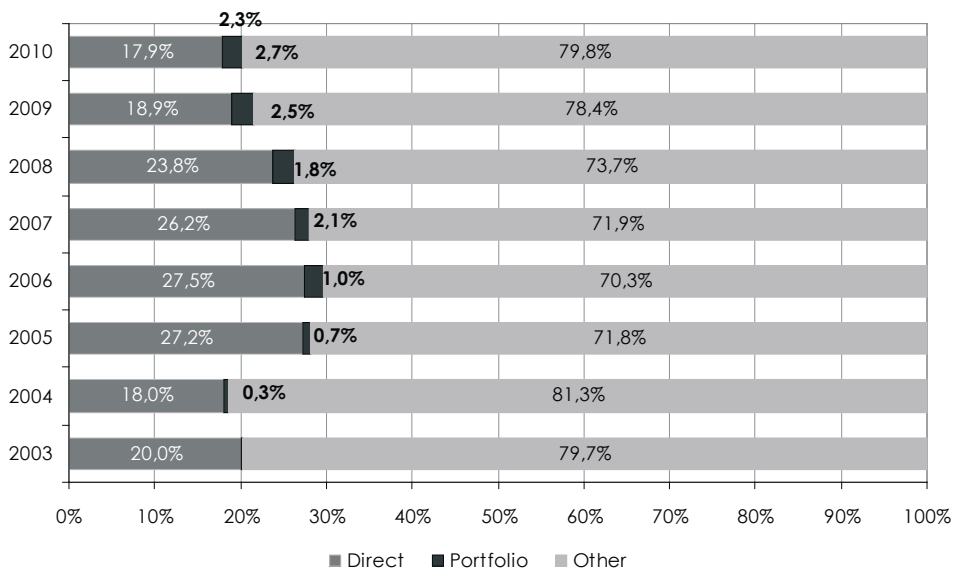
Source: Federal State Statistics Service

Fig. 1 Level of Foreign Investments Inflow in the Russian Economy in first six months of 2003–2010 (as percentage of the GDP)



Source: Federal State Statistics Service

Fig. 2 Dynamics of the Volume of Foreign Investments in the Russian Economy (Excluding Monetary and Credit Regulation and Banking Sector)



Source: Federal State Statistics Service

Fig. 3 Structure of Foreign Investments in the Russian Economy in the First Six Months in 2003–2010

profits of foreign investors transferred abroad as well as in the form of interests rate payment and credits repayment, was withdrawn. It should be noted that the volume of withdrawn capital over the period exceeded the volume of received foreign investments by 6.4% (98.9% of received foreign investments were withdrawn in the 1st half of 2009). Whereas in the 1st quarter of the current year the volume of withdrawn capital was roughly the same as the volume of received investments (99.1%), in

the 2nd quarter its level was estimated to be 112.1% of the volume of foreign capital invested into the Russian Federation.

The same as in the preceding years, it is other investments that account for the prevailing part of the investments received by the Russian economy (fig. 3).

In the first half of 2010 the rates of the decrease in foreign investments had higher absolute values than the corresponding figures for other and accumulated foreign investments, which resulted in the contraction of direct investments proportion to 17.9%. The volume of direct investments as a result of this period made USD 5.4 billion, which is 11.0% below the level of January-June 2009. At the same time, whereas in the 2nd quarter 2009 as compared with the preceding quarter there was a decrease in the inflow of foreign investments by 8.6% observed, in the 2nd quarter of the current year they were observed to grow by 6.7% as compared with January-March 2010.

The structure of investments received by the Russian economy as broken by sectors of economy in the first half of 2010 (table 1) is characterized by the reduction of the investments in trade and catering, transportation and communication together with a considerable increase in the investments in industry.

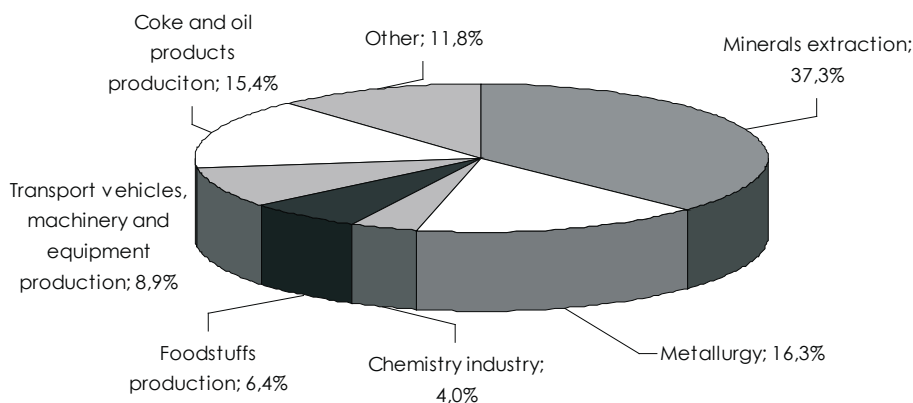
Table 1

STRUCTURE OF FOREIGN INVESTORS IN THE RUSSIAN ECONOMY AS BROKEN BY SECTORS OF ECONOMY IN THE FIRST SIX MONTHS OF 2007–2010

	As USD million				As percentage to the total			
	2007	2008	2009	2010	2007	2008	2009	2010
Industry	26 295	21 078	13 230	18 047	43.6	45.3	41.1	59.4
Transportation and communication	3 550	1 096	6 511	3 082	5.9	2.4	20.2	10.1
Trade and catering	25 973	13 479	7 995	4 620	43.0	29.0	24.9	15.2
Operations with real estate, rent and services rendering	2 071	7 101	2 670	2 553	3.4	15.3	8.3	8.4
Finances, crediting, insurance, pension provision	1 232	1 672	1 025	1 321	2.0	3.6	3.2	4.4
Other sectors	1 222	2 104	732	761	2.1	4.4	2.3	2.5

Source: Federal State Statistics Service

As compared with the corresponding period of 2009 in the 1st half of 2010 the volume of foreign investments in industry went up by 36.4%. Foreign investments in trade and catering have reduced by 42.4%, investments in transportation and communication sphere contracted by 52.7%. Over the period under consideration the volume of foreign investment in operations with real estate and in financial activity went up by 28.9%. Against the background of the decrease in the total investments and the reduction of investments in other sectors, the proportion of industry in the structure of investments expanded from 41.1% to 59.4%.



Source: Federal State Statistics Service
Fig. 4 Structure of Foreign Investments in Industry in the First Six Months of 2010

It is the processing sector of industry that was the most attractive in the first half of 2010, in which USD 10.9 billion or 60.5% of the total investments in to the industry was directed (USD 9.2 billion or 69.8%, correspondingly, in the 1st half of 2009). Investments in minerals extraction over the period under consideration increased to USD 6.7 billion (by 81.7%), in metallurgy – to USD 2.9 billion (by 65.3%), in coke and oil products production – to USD 2.8 billion (by 69.3%). Investments in foodstuffs production expanded to USD 1.2 billion (by 4.9%). Thus, the structure of foreign investments in the industry this year can be presented as follows (fig. 4).

In the first half of 2010 as compared with the same period of 2009 the proportion of foreign investments in the structure of foreign investments in the industry decreased from 25.7% to 17.0%. The proportion of other and portfolio investments in the industry is estimated to be, correspondingly, 81.3% and 1.7% (70.2% and 4.1% in the 1st half of 2009) (table 2).

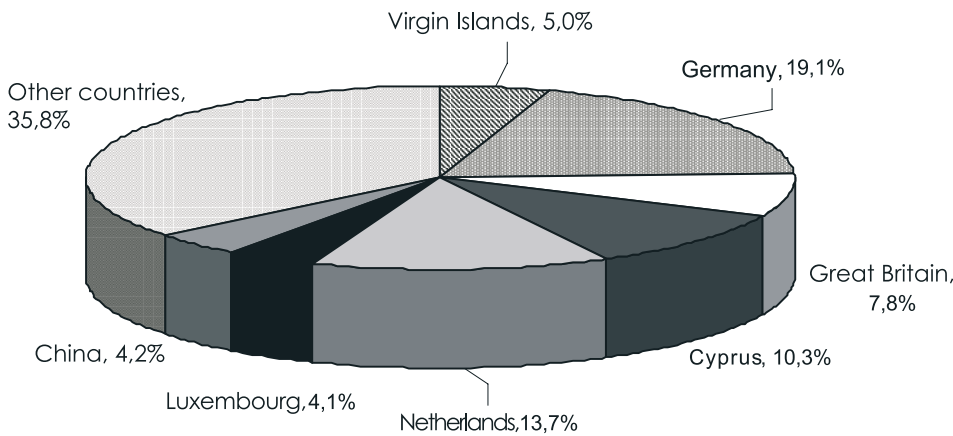
In January-June 2010 the industry accounted for 56.5% of direct, 44.6% of portfolio and 60.5% of other foreign investments in the Russian economy (55.8%, 63.8% and 36.8%, respectively, in January-June 2009).

Table 2
STRUCTURE OF FOREIGN INVESTMENTS IN INDUSTRY IN THE FIRST HALF OF 2010

	As USD million			As percentage to the first half of 2009		
	direct	portfolio	other	direct	portfolio	other
Industry	3 064	312.1	14 671	90.2	56.7	158.0
Including:						
Minerals extraction	930	0.1	5 800	57.4	0.03	332.6
Metallurgy	132	124	2 686	49.6	by 17.7 times	178.2
Chemistry industry	205	11	497	277.0	by 27.5 times	92.7
Foodstuffs production	245	3	907	177.5	–	96.9
Other sectors	1 552	174	4 781	119.6	85.9	105.4

Source: Federal State Statistics Service

In January-June 2010 17.1% of direct foreign investments (26.6% in January-June 2009) was concentrated in the extractive industry. 37.3% of the total direct investments (27.9% in 2009) was directed to processing industry, 14.8% (17.9% in 2009) – in trade and catering, 13.4% (14.4% in 2009) in operations with real estate and services rendering.



Source: Federal State Statistics Service

Fig. 5 Geographic Structure of Foreign Investments Received by the Russian Economy in the 1st half of 2010

For portfolio investors it was construction that became the priority sphere in the first half of 2010, 30.6% of the total volume of portfolio investments in the Russian economy being directed to this sector (0.2% in the first half of 2009). Processing industry accounted for 22.1% of portfolio foreign investments (15.7% in 2009), electricity, gas and water production and distribution – for 22.4% (13.6% in 2009).

The same as in 2009, the biggest volume of other investments in January-June 2010 – 36.0% of the total volume of other investments in the Russian economy (29.4% in January-June 2009) - was directed into processing industry. Investments in minerals extraction made 22.1% of the total volume of other investments (18.8% in the 1st half of 2009), in trade and catering – 15.7% (27.4% in 2009), in transportation and communication – 11.3% (24.9%).

As to the geographical structure of foreign investments received in the first half of 2010, it is Germany that occupies the leading position, which has increased its investments in the Russian Federation versus the corresponding period of 2009 up to USD 5.8 billion (by 2 times). Considerable growth rates of investments from Germany against the background of more moderate growth rates of investments from other leading capital exporting countries resulted in expansion of Germany's share in the geographical structure of foreign investments from 8.9% in the 1st half of 2009 to 19.1% in the corresponding period of the current year.

Luxemburg, which was the leader of the 1st half of 2009 and which accounted for 16.7% of the total foreign investments received by the Russian Federation, reduced its investments in the Russian economy as compared with the corresponding period of 2009 by 4.3 times down to USD 1.2 billion. The investments from the USA (down to USD 351 million, i.e. by 3 times) and Japan (down to USD 538 million, i.e. by 27%) were observed to go down. The biggest ten investing countries in the Russian economy do not include France in the 1st half of the current year. At the same time, China as a result of the elapsed six month holds the 6th place in the list, having invested USD 1.3 billion in the Russian economy. Cyprus has increased its investments by 8.6% in the first half of 2010 versus the corresponding period of 2009 (up to USD 3.1 billion), the Netherlands – by 15.9% (up to USD 4.2 billion), the UK – by 9.2% (up to USD 2.4 billion), the Virgin Islands – by 2.4 times (up to USD 1.5 billion), Ireland – by 2.8 times (up to USD 1.1 billion).

The structure of investments from three leading countries that directed the largest sums into the Russian economy in the first half of 2010, as broken by sectors of economy can be presented as follows (table 3).

Table 3

STRUCTURE OF FOREIGN INVESTMENTS FROM LEADING CAPITAL EXPORTING COUNTRIES INTO THE RUSSIAN FEDERATION IN THE FIRST HALF OF 2010 (DATA FOR THE FIRST HALF OF 2009 ARE PRESENTED IN PARENTHESES)

	Germany		Netherlands		Cyprus	
	As percentage to the total	As percentage to the total investments in the sector	As percentage to the total	As percentage to the total investments in the sector	As percentage to the total	As percentage to the total investments in the sector
Processing industries	23.6 (52.7)	12.5 (16.3)	10.3 (6.2)	4.0 (2.4)	14.9 (13.6)	4.3 (4.2)

Table 3, cont'd

	Germany		Netherlands		Cyprus	
	As percentage to the total	As percentage to the total investments in the sector	As percentage to the total	As percentage to the total investments in the sector	As percentage to the total	As percentage to the total investments in the sector
Trade and catering	17.5 (41.1)	21.9 (14.7)	10.5 (56.1)	9.5 (25.3)	no data (9.5)	no data (3.4)
Transportation and communication	no data	no data	28.8 (no data)	39.0 (no data)	no data (4.9)	no data (2.2)
Minerals extraction	53.4 (no data)	46.1 (no data)	36.4 (19.2)	22.6 (18.6)	no data (26.4)	no data (20.5)
Operations with real estate, rent and services rendering	no data	no data	no data	no data	24.0 (17.0)	29.3 (18.2)
Financial activity	3.0 (4.0)	13.2 (11.1)	no data	no data	10.1 (15.3)	23.8 (42.7)

Source: Federal State Statistics Service

In the first half of 2010 ten largest countries investing in the Russian economy accounted for 83.2% of the total volume of foreign investments accumulated by July, 1st (83.6% in the 1st half of 2009), including: 77.6% (80.1% in 2009) of the accumulated direct investments, 92.9% (96.9% in 2009) and 86.6% (85.0%) of portfolio and other investments, correspondingly.

Table 4

CHANGES IN ACCUMULATED FOREIGN INVESTMENTS AS BROKEN BY LEADING INVESTING COUNTRIES AS ON 1.07.2010

	As percentage versus 1.07.2009				As percentage versus 1.01.2010			
	total	direct	portfolio	other	total	direct	portfolio	other
Ireland	106.5	125.7	3000.0	105.6	105.5	120.2	120.0	104.8
Germany	139.1	115.8	184.6	155.9	117.6	100.8	171.4	129.1
Japan	142.3	101.8	100.0	147.8	104.4	84.5	66.7	106.7
UK	78.8	96.1	105.2	72.3	82.1	97.4	99.6	76.7
Cyprus	133.7	149.2	84.9	109.6	109.6	114.1	84.7	101.8
Netherlands	94.0	79.1	75.9	145.7	87.0	79.1	99.8	98.3
Luxemburg	99.8	107.3	106.1	99.5	98.6	88.6	101.8	98.9
China	no data for 1.07.2009				110.6	95.7	–	112.1
Other countries	90.1	111.0	142.9	71.0	92.7	97.5	164.2	83.9
Total	108.3	112.2	93.7	106.8	97.9	97.8	106.8	97.4

Source: Federal State Statistics Service

Against the background of contraction of foreign investments in the Russian economy the volume of investments from Russia abroad in 2010 continued to grow and made USD 51.1 billion as a result of the elapsed half of the year, which exceeds the figure for the corresponding period of the previous year by 17.9% and is by 64.9% more than foreign investments in the Russian economy in January-June of the current year. The biggest part of investments – USD 31.0 billion (60.6% of the total investments made from Russia abroad in the 1st half of 2010) – was directed into Switzerland, USD 6.9 billion (13.4%) – to Austria, USD 2.7 billion (5.3%) – to the Netherlands, USD 2.1 billion (4.1%) was exported to Cyprus and USD 2.2 billion (4.2%) – to Belorussia. ●

THE STATE BUDGET

E.Fomina

As it can be judged on the basis of budget statistics, the process of federal budget execution in the first 8 months of 2010 may be described as insufficiently well-balanced. As of 1 September 2010, budget revenue was executed only at the level of approximately 68 % as compared to the parameters consolidated in the budget law¹; as regards state obligations at the federal level, only 58 % of the planned budget revenue and expenditure had been actually executed. As a result, in the forthcoming months of 2010 one can expect an acceleration of the rate of spending of budget allocations.

An Analysis of the Main Parameters of the Execution of the General Government Budget in January – July 2010

As of 1 August 2010, the revenue volume in the general government budget was by 1.3 p.p. of GDP higher than in the same period of last year, while the volume of expenditure in the public sector of the national economy dropped in relative terms by 2.6 p.p. of GDP – bearing in mind that in nominal terms it increased by 787.9 bn Rb. As a result, in January – July 2010 the general government budget was executed with a surplus of 1.2 % of GDP, whereas in the corresponding period of 2009 the balance of the general government budget was executed with a deficit of 2.7 % of GDP (Table 1).

Table 1

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

	January – July 2010		January – July 2009		Deviation, p. p. GDP
	bn Rb	as % of GDP	bn Rb	as % of GDP	
Federal budget					
Revenue	4,658.4	18.7	3,805.8	18.0	+0.7
Expenditure	5,171.2	20.7	4,698.8	22.2	- 1.5
Deficit (-) /Surplus (+)	- 512.7	- 2.1	- 893.1	- 4.2	+ 2.1
Consolidated budgets of RF subjects					
Revenue	3,808.5	15.3	3,397.9	16.1	- 0.8
Expenditure	3,299.3	13.2	3,155.5	14.9	- 1.7
Deficit (-) /Surplus (+)	+ 509.2	+ 2.0	+ 242.5	+ 1.2	+ 0.8
General government budget					
Revenue	9,010.5	36.1	7,353.7	34.8	+ 1.3
Expenditure	8,717.0	34.9	7,929.1	37.5	- 2.6
Deficit (-) /Surplus (+)	+ 293.4	+ 1.2*	- 575.4	- 2.7	+ 3.9
For reference: GDP, bn Rb	24,956.0		21,159.6		

* The markedly high general government budget surplus, as compared to the level of federal budget deficit indices can be explained by the altered procedure for the transfer of money to the off-budget funds, which now bypasses the federal budget.

Source: RF Ministry of Finance; Gaidar Institute's estimates.

When comparing the volumes of budget revenues for the periods of January – July 2009 – 2010, one should bear in mind the necessity to adjust the reported values by the value of the additional investment-based revenues. It should be reminded that in January 2009 the budget received revenues from the management of the oil and gas funds for the years 2008 – 2009 in the amount of

¹ Federal Law No 308-FZ of 2 December 2009 "On the Federal Budget for the Year 2010 and the Planning Period 2011 – 2012".

275.2 bn Rb, and in January – April 2010 it received revenues from investments in the amount of approximately 134 bn Rb. Thus, growth of revenue resources in Russia's budgetary system in the first 7 months of 2010 (with due regard for the necessary adjustments) achieved the level of 2 p.p. of GDP as compared with the corresponding period of 2009.

The consolidated budget of RF subjects in January – July 2010 was executed with a surplus of 2.0 % of GDP (against 1.2 % of GDP in the same period of 2009). The volume of expenditure in the first 7 months of 2010 decreased by 1.7 p.p. of GDP; however, the federal authorities recommend that the policy of restricting the growth of budget expenditures of RF subjects should be continued.

There exists a noticeable discrepancy between RF subjects both by their levels of budget sufficiency and the levels of their post-crisis rehabilitation, and so the territorial budgets still remain dependent on federal financing. The federal center's experience of many years of applying the budget equalization mechanisms has demonstrated the fragility of the poorly diversified economies of RF subjects in situations of financial and economic crisis. In this connection, it appears necessary, in the next three-year period, to increase the regions' internal tax potential, as well as to look for some supplementary sources of financing.

While considering the structure of the general government budget revenue as it has been forming over this year's first 7 months (*Table 2*), it can be stated that their growth, as before, is mainly caused by the increasing revenues from foreign trade and the tax on mineral resources extraction.

The volumes of revenues from *the tax on mineral resources extraction* and *foreign trade* rose notably over the first 7 months of 2010 on their last year's levels by 0.8 p.p. of GDP and 1.5 p.p. of GDP respectively. This growth can be accounted for by a number of internal and external factors. The positive effect of the upward movement of the world prices for energy carriers was supplemented by the increase in the physical volumes of their extraction and export of hydrocarbons. In January – July 2010, growth in the volumes of gas extraction (natural and associated gas) amounted to 19 %, and that of oil – to approximately 3 % of the levels observed in the corresponding period of 2009¹.

Following the upward movement of the prices for oil and petroleum products, the rate of export duty was also increasing: from March through May 2010 it went up from 253.6 to 284 USD/ton, and then from 1 June it became 292.1 USD/ton. From 1 July 2010 the export duty was no longer being increased, its rate went down to 246 – 250 USD/ton against the background of a certain decline in oil prices in June. However, from 1 August 2010 the export duty on oil once again went up – to 263.8 USD/ton. At the same time, the export duty on the oil produced in East Siberia was established at the rate of 80.3 USD/ton, which is by 14.8 % higher than the rate that had been established since 1 July 2010. From 1 September 2010 its rate was further increased – to 273.5 USD/ton, and for the oil produced in East Siberia – to 87 USD/ton. From 1 October this year it may be decreased to 266.5 USD/ton, and the duty on the oil produced in East Siberia may be decreased by 4.9 USD – to 82.1 USD/ton². In this connection, a negative effect on the level of budget revenues from oil and gas in the first 7 months of was produced by the ruble's strengthening, which resulted in a decline of Rb-denominated revenues from foreign trade.

In the next three-years period the overall fiscal load on the national economy's extracting sector will become greater. Thus, in the framework of the package of tax measures designed to lower the deficit of the RF budgetary system, the RF Ministry of Finance intends to increase the load on the companies belonging to the oil and gas complex. It is suggested that from the year 2011 onward the rate of the tax on gas extraction should be raised by 61 % - from 147 to 237 Rb per 1000 mi, with a subsequent indexation depending on the expected growth of prices to 251 and 265 Rb per 1000 mi in 2012 and 2013 respectively. It is assumed that this measure will make it possible to replenish budget revenue in the amount of approximately 180 bn Rb over the next 3 years. Besides, it is also planned to increase the rate of the tax on oil extraction, its level from 2012 going up from 419 to 446 Rb/ton (by 6.5 %), and in 2013 increasing to 470 Rb (5.4 %). As a result of the implementation of this measure, budget revenue is expected to be increased by 225 bn Rb over the two years³.

1 Report of the RF Ministry of Economic Development 'On the current situation in the economy of the Russian Federation in January – August 2010'.

2 <http://www.neftegaz.ru/news/view/96757>

3 <http://bujet.ru/article/90146.php>

Against the backdrop of the substantially increasing oil and gas revenues (both in absolute and relative terms), the revenues unrelated to oil and gas have been demonstrating a less pronounced upward trend, which is indicative of the rate of their growth falling behind that of the rate of the national economy's rehabilitation.

The volume of revenues from *the tax on profits of organizations* in the general government budget in January – July 2010 increased in relative terms by 0.8 p.p. of GDP. It should be noted that over the period of January – March 2010 the dynamics of this index was lower than in the same period of 2009, and then in April it became possible to reverse the negative trend of the first few months of the new year. By all indications, this positive development was largely accounted for by the relative improvement of the general economic situation. Thus, in the first 7 months of 2010 the real sector yielded financial results in the amount of 3,318.6 bn Rb, which is by nearly 80 % higher than the corresponding index observed in the same period of 2009, while the share of profit-making organizations in the total number of organizations rose on the same period of last year by 2.6 p.p. and amounted to 66.6 %.

However, there still exists the probability of the growth of revenues from profits tax being restricted by the shrinkage of the taxable base as a result of the planned implementation of the zero rate for the profits tax levied on commercial and not-for-profit organizations operating in the spheres of health care and education. The purpose of this measure is to promote the use of the resources generated by this exemption for modernizing the activity of this particular category of economic agents.

The volume of revenues from the personal income tax in the general government budget declined to 3.9 % p.p. of GDP, which is by 0.5 p.p. of GDP lower than the previous year's level. At the same time, growth of real disposable money incomes of the population increased since this year's beginning by 5.6 % against last year's dynamics, the principal contributing factor of its growth being the valorization of pensions implemented early this year.

Table 2

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

	7 months of 2010	7 months of 2009	Deviation, p. p. of GDP
Tax burden level (1 + 2 + 3)	32.7	30.6	+ 2.1
Tax revenues (1), including:	20.5	21.5	– 1.0
Tax on profits of organizations	4.4	3.6	+ 0.8
PIT	3.9	4.4	– 0.5
SST*	0**	2.3	–
VAT	5.4	5.4	0
Excise	1.1	0.9	+ 0.2
Tax on mineral resources extraction	3.2	2.4	+ 0.8
Insurance contributions to mandatory pension insurance (2)	5.2	3.6	+ 1.6
Revenues from foreign trade (3)	7.0	5.5	+ 1.5

* less insurance contributions to mandatory pension insurance.

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

Source: RF Ministry of Finance; Rosstat; Gaidar Institute's estimates.

The volume of budget revenues from VAT in January – July 2010 remained at the same level as in the same period of 2009, and so amounted to 5.4 % of GDP, while in nominal terms it somewhat increased. The absence of any growth of VAT collectability – in face of the general improvement of the economic situation in Russia – is explained by the introduction of a declaratory procedure for tax refund. In this connection it should be noted that, judging by the budget projections for the years 2011 – 2013, no increase of the tax load in the form of growing VAT rates can be expected.

In January – July 2010 there occurred a noticeable growth of revenues from *excises* in the general government budget. Growth of the volume of revenues amounted to 0.2 p.p. of GDP by comparison with last year's dynamics. The cause of this growth was the increase, from 2010, of the

rates of excises on some excisable commodities. Besides, in accordance with the amendments to the RF Tax Code put forth in September, there exist plans for a large-scale indexation of excises on alcohol and tobacco in 2011 – 2013. The RF Ministry of Finance intends to raise the rate of excise on alcohol products with per cent volume of ethyl alcohol of over 9 % by 10 % (to 231 Rb) in 2011, by 9.95 % (to 254 Rb) in 2012, and by 10.2 % (to 280 Rb) in 2013. The excise on alcohol products with per cent volume of ethyl alcohol of up to 9 % inclusive will also be growing: by 20.2 % (to 190 Rb) in 2011, by 21 % (to 230 Rb) in 2012, and by 6.52 % (to 245 Rb) in 2013. Besides, in 2011 the excise on wines will be increasing at a higher rate – by 42 % (to 5 Rb). In 2012, the rate of excise will be 6 Rb per liter, and in 2013 – 7 Rb. In addition, the RF Ministry of Finance suggests that the indexation of excises on cigarettes should be implemented at an accelerated rate, while from the year 2012 onwards the rates of excises on filter-tipped cigarettes will be the same as those on cigarettes without filter – 360 Rb per 1,000 cigarettes plus 7.5 % of their estimated value (in 2012), and then 460 Rb per 1,000 cigarettes plus 8.5 % of their estimated value (in 2013). The rates of excises for 2011 are as follows: on filter-tipped cigarettes – 280 Rb per 1,000 cigarettes plus 7 % of their estimated value (the previously planned rate - 250 Rb), on cigarettes without filter – 250 Rb plus 7 % of their estimated value (the previously planned rate – 175 Rb)¹.

On the whole, it can be noted that the level of *tax load* on the national economy in the first 7 months of 2010 rose by 2.1 p.p. of GDP on the same period of 2009, having reached the level of 32.7 % of GDP. This happened in the main under the influence of external factors.

Against the backdrop of the growing general government budget revenue in January – July 2010 (as a share of GDP), the volume of *general government budget expenditure* in the first 7 months of 2010 was demonstrating a marked decline in relative terms, which is compatible with the concept of curbing the growth of expenditure adopted for the year 2010. Budget expenditure dropped by 2.6 p. p. of GDP. (Table 3). It is noteworthy that in absolute terms the volume of expenditures rose by 790 bn Rb.

Table 3

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

	January – July 2010		January – July 2009		Deviation, p.p. of GDP
	bn Rb	as % of GDP	bn Rb	as % of GDP	
Expenditure, total	8,717.0	34.9	7,929.1	37.5	– 2.6
including					
Nationwide issues	728.7	2.9	682.1	3.2	– 0.3
Of these, servicing of state and municipal debts	151.2	0.61	132.7	0.63	– 0.02
National defense	666.1	2.7	612.8	2.9	– 0.2
National security and law-enforcement activity	675.3	2.7	642.5	3.0	– 0.3
National economy	962.0	3.9	1,245.2	5.9	– 2.0
Housing and utilities system	439.7	1.8	417.5	2.0	– 0.2
Environment protection	13.0	0.05	13.9	0.07	– 0.02
Education	1,011.7	4.1	965.3	4.6	– 0.5
Culture, cinematography and mass media	173.8	0.7	166.5	0.8	– 0.1
Public health care and sports	847.6	3.4	832.6	3.9	– 0.5
Social policy	3,198.9	12.8	2,350.4	11.1	+ 1.7

Source: RF Federal Treasury; Gaidar Institute's estimates.

While examining the functional structure of general government budget expenditure in the first 7 months of 2010, it can be noticed that almost all its items demonstrated a noticeable drop in relative terms. Substantial cuts were made to the items *National Economy* – by 2.0 p.p. of GDP;

1 <http://www1.minfin.ru/ru/press/speech/index.php?pg4=2&id4=10471>

and *Public Health Care and Sports and Education* – by 0.5 p.p. of GDP each. Besides, the spending under Nationwide issues has been executed at a lower rate – by 0.3 p.p. of GDP below the level observed in the same period of 2009, while the expenditures allocated to the servicing of state and municipal debts in relative terms remained almost at the same level as last year. This type of dynamics is indicative of a slowdown of the growth rate of the funding allocated to the state apparatus, in particular to the salaries of civil servants.

An increased volume of financing over the period under consideration was allocated to the item *Social Policy* – by 1.7 p.p. of GDP higher than in 2009.

The Execution of the RF Federal Budget in January – August 2010

According to the preliminary data published by the RF Ministry of Finance, federal budget revenue in January – August 2010 amounted to 18.6 % of GDP, which is by 0.3 p.p. of GDP below the level noted in the same period of 2009 (Table 4). However, in nominal terms its volume increased by 655.4 bn Rb. Growth of federal budget revenue over the period under consideration was in the main caused by the increasing revenues of the fuel and energy complex as a result of the existing relatively favorable situation with regard to the prices and demand for Russian export commodities, as well as the reemergence of the upward trend displayed by the index of physical volumes of hydrocarbon extraction. At the same time, in August 2010 the rate of growth of budget revenue became slower by comparison with that of GDP growth.

Federal budget expenditure in January – August 2010 dropped on 2009 by 1.9 p.p. of GDP. However, in absolute terms its growth amounted to approximately 370 bn Rb. This decline of expenditure indices is a result of the budget policy that is aimed at limiting the adoption of additional obligations in order to reduce the amount of deficit in conditions of the dwindling federal budget revenue and the decreasing scope of the anti-crisis support provided to various sectors of the national economy.

As a result, in the first 8 months of the current year the federal budget was executed with a deficit of 2.3 % of GDP, against 3.8 % of GDP in 2009. On the contrary, the size of deficit unrelated to oil and gas, as shown by the preliminary data, slightly rose on its 2009 index and so amounted to 10.7 % of GDP. The existing level of deficit unrelated to oil and gas is rather substantial, which is indicative of the existence of voluminous government obligations that are not set off by any corresponding budget revenue unrelated to oil and gas. This situation is fraught with increased risks with regard to the budgetary system's stability.

Table 4

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

	January – August 2010		January – August 2009		as % of budget revenue and expenditure for 2010	Deviation	
	bn Rb	as % of GDP	bn Rb	as % of GDP		bn Rb	as % of GDP
Revenue, including:	5,301.2	18.6	4,645.8	18.9	68,1	+ 655,4	- 0,3
Revenues from oil and gas	2,421.4	8.5	1,635.0	6.7	65,7	+ 786,4	+ 1,8
Deductions to Reserve Fund and National Welfare Fund (Stabilization Fund)	26.5	0.1	277.1	1.1	–	- 250,6	- 1,0
Expenditure, including:	5,947.0	20.8	5,580.1	22.7	58,2	+ 366,9	- 1,9
interest	130.3	0.5	116.5	0.5	46,5	+ 13,8	0,0
non-interest	5,816.7	20.4	5,463.7	22.2	58,6	+ 353,0	- 1,8
Federal budget surplus (deficit)	- 645.8	-2.3	- 934.3	- 3.8	21,9	+ 288,5	+ 1,5
Deficit unrelated to revenues from oil and gas	- 3,067.2	-10.7	-2,569.3	- 10.4	50,0	- 497,9	- 0,3
GDP estimations	28, 574.0		24, 599.6				

Source: RF Ministry of Finance (preliminary estimations), Gaidar Institute's estimates.

The key source for financing the deficit in the federal budget remains the Reserve Fund (*Table 5*). In January – August 2010, a total of approximately 520 bn Rb was spent from the Reserve Fund on ensuring a well-balanced federal budget. On the whole, over 8 months its volume dropped by 601.6 bn Rb and amounted to 1,228.9 bn Rb. A negative effect on the dynamics of the Fund's volume was produced by the exchange rate's fluctuations. However, contrary to expectations, the Reserve Fund is not going to be spent in full by the end of the year 2010. Part of it will still be saved in order to cover the budget deficit of 2011. The volume of the National Welfare Fund (NWF) as of 1 September 2010 had dropped to 2.67 trillion Rb. It is intended that the NWF's resources will be spent exclusively on co-financing of pension savings or on covering federal budget deficit in an event of a sudden dramatic decline of oil prices.

Table 5

THE DYNAMICS OF THE FORMATION AND USE OF THE OIL AND GAS REVENUES
OF THE FEDERAL GOVERNMENT IN JANUARY – AUGUST 2010 – 2009, BN RB

Indices	Fund residuals, end of 2009	Approved for 2010 budget	Received in January – August 2010	Allocated in January – June 2010		Residual funds as of end of August 2010
				to maintaining well-balanced federal budget	to oil and gas transfer	
Oil and gas revenues in federal budget	X	2,057.2	2,421.4			X
Areas for allocating oil and gas revenues:	X	x				X
Oil and gas transfer	X	2,531.1	2,421.4			
Reserve Fund	1,830.5	5,147.5	0	519.5	0	1, 228.9
National Welfare Fund	2,769.0	x	26.5	2.5	–	2, 671.5
Total	4,599.5	x	1,661.5	522.0	0	3, 900.4

* residuals as recalculated at the exchange rate as of 1 September 2010

Source: RF Federal Treasury.

Table 6 shows the dynamics of the execution of the federal budget in cash terms over the first 7 months of 2010 in accordance with the functional classification of budget expenditure. The dynamics of spending over January – July 2010 was higher (by 2.4 p.p. of the annual budget revenue and expenditure) than the rate of budget execution in cash terms over the period of January – July 2009.

An accelerated rate of budget execution was noted with regard to the item *Interbudgetary Transfers* (a rise of 9.0 p.p. on last year's indices), which can be explained in the main by the significantly raised pensions in the current year, as well as by the more speedy transfer of resources to the RF Pension Fund. The execution of the federal budget in cash terms at an accelerated rate was also noted with regard to the items *National Defense, Housing and Utilities System, and Social Policy* - by 1.8, 15 and 3.7 p.p. higher respectively than the corresponding volumes of financing last year.

An opposite trend of delayed transfer of federal funding to its recipients was demonstrated by the items *National Economy* (a drop of 9.0 p.p. on last year's index) and by *Culture, Cinematography and Mass Media and Public Health Care and Sports* (a drop of 5.7 and 1.8 p.p. respectively).

Table 6

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

	January – July 2010	January – July 2009
Budget expenditure, total	50.5	48.1
including:		
Nationwide Issues	40.6	41.9
Servicing of State and Municipal Debts	40.2	43.8

Table 6, cont'd

	January – July 2010	January – July 2009
National Defense	52.1	50.3
National Security and Law Enforcement Activity	50.2	51.8
National Economy	35.9	44.9
Housing and Utilities System	44.0	28.9
Environment Protection	51.0	44.8
Education	50.1	51.4
Culture, Cinematography and Mass Media	46.2	51.9
Public Health Care and Sports	42.1	43.9
Social Policy	51.0	47.3
Interbudgetary Transfers	59.0	50.0

Source: RF Ministry of Finance; Gaidar Institute's estimates.

On the whole, the execution of the federal budget continues to fall behind the established schedule, thus creating a certain distortion in the form of an accelerated spending of the allocated budget funding in the year's last few months. Such an approach to the financing of government obligations (which has been practiced for some years already) is, in our opinion, totally unacceptable in a situation of the planned switchover to budgeting based on target programs that implies an even and predictable funding of state programs. Besides, delayed financing will make it difficult to properly monitor target programs and to evaluate their results over a reporting period.

An Overview of the Main Developments in the Sphere of Tax and Budgetary Policy in July 2010

On 20 September 2010, the RF Ministry of Finance presented a 'model law' for RF subjects that will make it possible to implement a reform of the network of budget-funded enterprises across RF subjects¹. It should be reminded that in the period between 1 January 2011 and 1 July 2012 it is planned to reform the budgetary network, namely to replace budget-based financing by state assignments. In order to carry out this innovation in the budgetary sphere, it is envisaged that all budget-funded institutions should be subdivided into budget-funded and treasury-funded ones. Budget-funded institutions will receive financing in the form of subsidies in the framework of the state assignments to be fulfilled by them, as well as will be granted the right to render commercial services and to independently dispose of the resulting revenues in order to ensure their upkeep and development. Treasury-funded enterprises will stick to their former principles of budget-based financing.

It is intended that the timelines established for the switchover to the new principles of operation will be different for the enterprises situated in different regions, depending on the socio-economic status of the latter. However, over the whole transition period the previously existing procedure of financing from the budgets of RF subjects will be preserved for enterprises operating in the sphere of public health care.

In our opinion, this innovation will be conducive to a consistently organized involvement of budget-funded institutions throughout the regions in the process of reforming the sphere of public finances, with the use of the instruments of strategic planning. The draft law presented by the Ministry of Finance is aimed at making the procedure of changing the status of the enterprises of the budgetary sphere more transparent.

On 23 September 2010, the draft federal budget for 2011 – 2013 was approved by the RF Government. By 1 October this year, this draft law is to be submitted to the State Duma².

The draft of this basic financial document for the next three-year period builds on some moderately optimistic indices of the socio-economic development of the Russian national economy that envisage

1 The Law 'On some measures designed to improve the legal status of the state institutions of RF subjects'.

2 <http://www.rg.ru/2010/09/28/budget.html>

that the rate of economic growth in 2011 will be 4.2 %, the price of Urals – 75 USD/barrel, and the inflation rate – no more than 6 – 7 %.

On the whole it can be noted that over the period of 2011 – 2013 it is planned that the federal budget will be executed with a deficit. However, its level will be lower every year, by 2013 dropping to the level of 2.9 % of GDP – while the deficit index expected in 2010 is 5.7 % of GDP.

In spite of the restrictions imposed on the rate of growth of budget expenditure, in 2010 – 2013 the social sphere will remain a priority area within the structure of federal budget expenditure. Thus, in the next few years it is planned to implement a reform of the public health care system. Besides, the state support of the RF Pension Fund will require some substantial budget allocations, against the backdrop of a planned indexation of pensions in the amount of 8 % (from 1 February 2011) and increased benefits. So, it is planned that in 2011 a total of 2.3 trillion Rb will be allocated to these items, while in 2013 the amount of allocations will rise to 2.8 trillion Rb.

Significantly increased funding will be allocated to the rearmament of the army – by 2013, the volume of expenditures allocated to the corresponding items will amount to 2.1 trillion Rb.

In face of the curbing of the anti-crisis measures aimed at supporting certain sectors of the national economy, some substantial investments are also planned in order to modernize the economy through financing the projects launched by the Presidential Commission for Modernization (about 10 bn Rb in 2011) and the projects being implemented within the framework of the Main Directions for the RF Government's activity.

It is intended to generate increased revenues for this country's budgetary system by means of raising indirect taxation, for example through raising the excises on tobacco and alcohol, as well as by increasing the tax load on the 'oil and gas' sector of the national economy. However, a more significant contribution to the growth of federal budget revenue can be made by means of implementing the program (planned for 2011 – 2013) of privatization of some big state-owned enterprises. According to the preliminary estimates of the RF Ministry of Finance, the privatization program – in the event of its successful implementation – may yield approximately 900 bn Rb. ●

ESTIMATION OF BUDGET SUSTAINABILITY IN MIDDLE-TERM PROSPECT

I.Sokolov, T.Tischenko

In the last ten days of September 2010 the RF Government approved the main directions for the budget policy development and characteristics of the federal budget for 2011-2013 developed on the basis of the Budget Address of 2010. The budget project is guided by the tasks of budget sustainability provision by contracting budget deficit, promotion of innovative development of the Russian economy and full execution of the obligations that were undertaken earlier.

The trends of the country's recovery from the crisis that have outlined allowed getting higher level of budget revenues than was expected in the previous year¹ (table 1).

Table 1

MAIN CHARACTERISTICS OF FEDERAL BUDGET IN 2008-2013, AS PERCENTAGE OF THE GDP

Indicator	Real		Budget expenses and revenues* 2010	Bill		
	2008	2009		2011	2012	2013
Revenues	22.4	18.8	17.4	17.6	17.0	16.8
including from oil and gas	10.6	7.6	8.3	8.1	7.9	7.5
Expenses	18.3	24.7	22.7	21.2	20.1	19.7
including provisionally approved	–	–	–	–	0.8	1.3
Deficit (–) /Surplus (+)	4.1	–5.9	–5.3	–3.6	–3.1	–2.9
Non oil and gas deficit	–6.5	–13.6	–13.5	–11.7	–10.9	–10.4

* According to the resulting budget revenues and expenses as on September 1, 2010

Source: Ministry of Finance of the Russian Federation

It is predominantly connected with more optimistic estimations of oil prices (in the bill for 2011-2013), which are built into the budgets at the level of USD 75-78 per barrel, which is by USD 10 more than the estimations of the previous year as well as acceleration of economic growth rates in the country. As it is resented in table 1, budget is still highly dependent on oil and gas revenues, which increases the risks of state financial system stability on the whole. Thus, in case oil prices go down to USD 50 per barrel, budget deficit in 2011 may go up to 6.15 of the GDP, i.e. by more than 70% of the bill figure. Under these circumstances the responsible budget policy, which, on one hand, provides necessary stability to the country's financial system, and on the other hand promoted innovative development of the country, is an objective necessity at this time.

Tax earnings remain the main source of federal budget revenues for three forthcoming years providing about 55% of the total budget revenues. It is expected that the proportion of budget oil and gas revenues will contract gradually due to expansion of non-oil-and-gas revenues, which should be promoted by lower growth rates for oil grade Urals and taxable export volumes as compared with the GDP dynamics and ruble appreciation. Besides, the revenues are forecast to grow due to the increase in dividends from joint-stock companies shares owned by the state, and in particular federal unitary enterprises profits at the level of RUR 49.3 billion in 2011 to RUR 53.3 billion in 2013. Profits from privatization (RUR 298 billion in 2011, RUR 309.0 billion in 2013) are intended to be used to close the budget deficit. Reserve Fund will be used to finance deficit only in 2011 at the rate of RUR 242.3 billion, and as a result the Reserve Fund will be exhausted by 2012. National Welfare Fund will be used in the volume equal to the formation of citizens' pension accumulation (RUR 5.5-7.5 billion, RUR 10.0 billion in 2011-2013, correspondingly) which will allow retaining earlier accumulated funds to provide for financial stability of the pension system.

¹ According to the law on the federal budget the revenues were planned at the level of 16.1% of the GDP in 2010, 15.5% and 15.0% of the GDP, correspondingly, in 2011 and 2012

Despite the contraction of the federal budget deficit, the increase in the state debt in terms of the GDP percentage (11.5% in 2010, 16.3% in 2013) may have a negative effect on the stability of financial and budget system, the changes in its structure towards internal borrowing (within 2010-2013 internal debt will increase from 11.5% of the GDP to 16.35% of the GDP, external debt remaining at the level of 4% of the GDP) testifies that the state's policy concerning debt is quite rational.

Against the background of rather unpredictable situation with the revenue part of the federal budget, expenses, although they tend to decrease in terms of GDP percentage still remain at quite high level which considerably exceeds the level of comparatively problem-free 2008 (see *fig.1*). Moreover, in real terms the trend for expenses contraction will reverse as soon as in 2013.

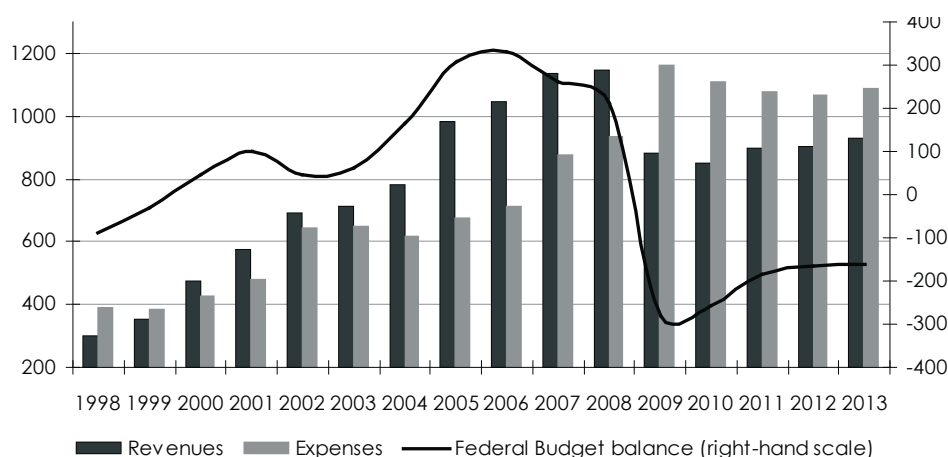
It should be noted that there are objective causes for the expenses growth. These include, first, the negative demographic situation connected with the population aging and necessity for social support of some categories of citizens, which requires undertaking of additional liabilities by the state. Second, the total expenses are fueled by the necessity to provide for liabilities in the field of education and health care, social guarantees for servicemen, social subsidies and compensations payment, to index wages of employees of government-financed organizations. Third, in concordance with the decision of the RF President within the framework of law enforcement system reform starting with 2011 financing of the police and public security is made at the expense of the federal budget. Besides, the RF Government had to execute the undertaken international liabilities and serving of the state debt.

According to the data of *table 2* the increase in expenses as percentage of the GDP is expected in the sections of "National security" and "State debt servicing", while the expenses for other kinds of activities will decrease, which is accounted for by the following circumstances.

Table 2

DYNAMICS OF EXPENSE LIABILITIES OF FEDERAL BUDGET IN 2010-2013,
AS PERCENTAGE OF THE GDP

	2010	2011	2012	2013	Deviation in 2013 versus 2010	
					as percentage of the GDP	as percentage in real terms
Expenses (excluding provisionally approved), total	22.7	21.2	19.3	18.4	-4.3	-8.3
including						
National issues	1.8	1.7	1.4	1.2	-0.5	-20.6
Serving of state and municipal debt	0.6	0.8	0.9	1.0	0.3	76.8
National defense	2.8	3.0	3.0	3.4	0.6	35.8
National security and law enforcement	2.5	2.4	2.1	1.9	-0.6	-12.3
National economy	3.3	3.4	3.0	2.5	-0.8	-13.9
Housing and communal services	0.5	0.4	0.2	0.1	-0.4	-70.9



Source: Ministry of Finance of the Russian Federation, authors' calculations
Fig. 1 Federal Budget revenues, Expenses and Deficit Dynamics, as RUR billion, in 1998 prices

Table 2, cont'd

	2010	2011	2012	2013	Deviation in 2013 versus 2010	
					as percentage of the GDP	as percentage in real terms
Environment protection	0.0	0.0	0.0	0.0	0.0	3.6
Education	1.0	1.0	0.9	0.8	-0.1	-3.2
Culture, cinematography, mass media	0.3	0.3	0.3	0.2	-0.1	-15.8
Health care and sport	1.0	1.0	0.9	0.7	-0.3	-18.4
Social policy	7.5	6.0	5.8	5.6	-1.9	-15.2
Interbudgetary transfers of general nature	1.3	1.1	0.8	0.7	-0.6	-36.4
Provisionally approved			0.7	1.3		

Source: Treasury of the Russian Federation, IET calculations

In the structure of health care financing it is envisaged to increase the volumes of financing at the expense of Federal Fund for Compulsory Health Insurance, decreasing the expenses of the federal budget for health care from RUR 375.6 billion in 2011 to RUR 356.1 billion in 2013. The biggest part of the means of the Federal Funds for Compulsory Health Insurance, it should be noted, will be distributed in the form of grants among the regions and directed to the projects of the sector modernization.

The financial support for education, culture and cinematography, mass media, physical education and sport in 2011-2012 will be maintained at the level of 2010 (taking inflation into account) and the expenses are planned to be decreased in 2013 due to optimization of the budgetary institutions optimization which should be completed by 2012.

Contraction of expenses in the sector of "Social policy" in 2011 as compared with 2010 is accounted for by the decrease in the demand for federal budget allotments to close the deficit of the state off-budget funds of the Russian Federation in connection with the increase of insurance contribution tariffs in the systems of compulsory pension, health care and pension insurance from 26% in 2010 to 34% in 2011, as well as completion of the measures to provide with housing the veterans of the Great Patriotic War. In 2012 and 2013 the expenses in the mentioned sector are planned to be increased by 8% per year on average.

The contraction of the volume of expenses for housing and communal services in 2012 and 2013 is determined by the reduction in the budget allotments to federal target programs (FTP) and non-program part of federal targeted investment program (FTIP), including those for provision of servicemen with service housing – from RUR 125.9 billion in 2010 to RUR 25.3 billion in 2013 due to the completion of the respective programs execution. Besides, in 2011 budget allotments for the subsidy to the state corporation – Fund for the Support of the Reform in Housing and Utilities Sector in the form of contribution for the recovery of the Fund's property which was transferred to the Russian Federation ownership in 2009 at the rate of RUR 15.0 billion, which are not envisaged in 2012 or 2013.

The number (from 43 in 2011 to 37 in 2012) and the volume of financing (from RUR 1364.8 billion in 2011 to RUR 1080.6 billion in 2013) of the federal target programs will reduce which is connected with both the completion of some of the programs in two next years and with the planned decrease of prices for construction materials. The contraction of budget expenses for FTP in the sector of transportation infrastructure is provided by redistribution of revenues from excises growth between the federal budget and the road funds of subjects of the Russian Federation.

Starting with 2011 5 new FTPs and 3 state programs will be financed, some of which are not included in the budget policy priorities defined by the President of the Russian Federation. For instance, FTP "Clean Water" developed, in the opinion of many experts, under the influence of parliamentary lobby and FTP "Development of Domestic and International Tourism" can hardly be regarded as priorities requiring additional financial support under the conditions of budget deficit,

especially taking into account the fact that the proportion of expenses for new FTPs makes nearly 20% of the total expense for FTPs in 2011–2013.

The analysis of the structure for disclosed FTPs demonstrates that although the total volumes of financing are observed to decrease in 2010-2013, the expenses for “innovative development and economy modernization” will expand (from RUR 436.5 billion in 2010 to RUR 579.3 billion in 2013), which is in concordance with the statements of the Budget Address.

In conclusion it can be observed that on the whole the RF Government when forming the federal budget for 2011-2013 succeeded in solution of the tasks set by the Budget Address aimed at provision of budget balance, curbing of the trends for “irresponsible” annual increase in expenses while the social liabilities are executed. At the same time budget system is still at the point of unsteady equilibrium which is severely dependent on the world prices for energy carriers, in which connection increase of spending for the defense and the financial provision of target programs not belonging to the priorities cannot be considered as responsible budget policy move. ●

THE RUSSIAN BANKING SECTOR

S.Borisov

The growth of the Russian banking sector's assets in July 2010 became more sluggish against the backdrop of a seasonal decline in demand for loans in the corporate sector. Growth of the retail portfolio of credits remains on the average at the level of 1.5 % per month, being strengthened by a revival on the labor market and a more robust retail turnover of commodities. The credit portfolio's quality remains stable, while growth of reserves against potential losses on bank loans has been minimal.

Table 1

THE MAIN INDICES OF THE RUSSIAN BANKING SYSTEM

	As of 01.08.2009, bn Rb	As of 01.01.2010, bn Rb	As of 01.08.2010		
			Nominal value, bn Rb	Growth since year's beginning, %	Year on growth, %
Assets	27, 829.5	29 430.0	30, 606.5	4.0 %	10.0%
Credits allotted to non-financial institutions	12, 805.2	12, 541.7	13, 077.8	4.3 %	2.1 %
Credits allotted to physical persons	3, 697.9	3, 573.8	3, 731.7	4.4 %	0.9 %
Credits allotted to banks	2, 800.6	2, 725.9	2, 729.5	0.1 %	— 2.5 %
Investments in bonds	2, 462.7	3, 379.1	4, 204.9	24.4 %	70.7 %
CB's deposits	1, 936.5	1, 423.1	397.0	— 72.1 %	— 79.5 %
Banks' deposits	3, 308.4	3, 117.3	3, 301.6	5.9 %	— 0.2 %
Deposits of legal entities	5, 206.5	5, 466.6	5, 463.1	— 0.1 %	4.9 %
Population's deposits	6, 613.6	7, 485.0	8, 616.6	15.1 %	30.3 %
Reserves against potential losses	1, 667.8	2, 050.6	2, 274.4	10.9 %	36.4 %
Profit (current year)	31.3	205.1	274.5		777.0 %

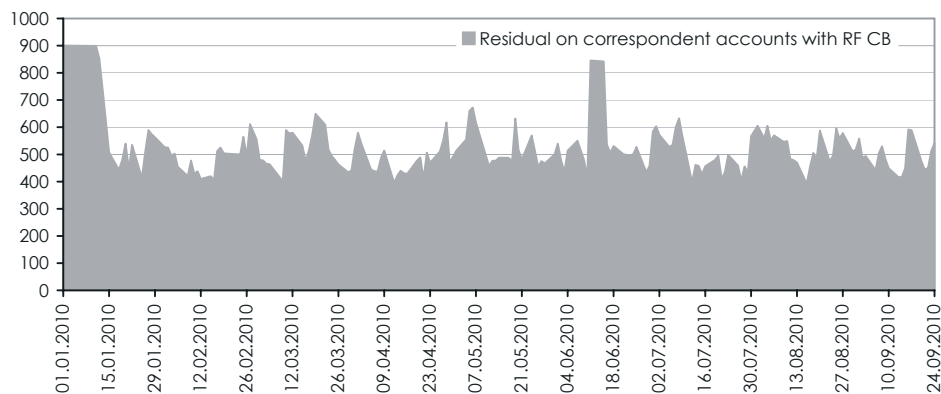
Source: Bank of Russia.

According to the RF CB, the value of assets in the Russian banking system in July rose by 0.6 % on the previous month (it should be reminded that their growth in June amounted to 2.3 %). The main cause of the slowdown in the growth of asset value was the seasonal factor of a decline in the crediting activity in the corporate sector. A separate contribution to the slowdown in the growth of the corporate credit portfolio in July was made by the anomalous weather conditions. As a result, the volume of credits issued to non-financial organizations over that month increased by only 0.3 %. At the same time, the growth rate of the volume of ruble-denominated credits issued to corporate resident borrowers increased by 1.1 %, while the part of the corporate credit portfolio denominated in foreign currencies shrunk by 2.6 %. As far as the retail sector is concerned, in July the demand for credits there remained stable: the monthly growth rate of 1.6 % appears to be quite justified in face of the positive trends on the labor market.

The quality of the banks' credit portfolio remains stable. The share of stale debt in the corporate credit portfolio has been declining for a second month in a row. In July it amounted to 6.2 %, having dropped by 20 basic points over one month. The share of stale debt in the retail credit portfolio remains at the level of 7.4 – 7.5 % for five months in a row. The stabilization of the credit portfolio's quality is also confirmed by the rise (by 40 basic points) in the share of standard loans (Quality Category I loans, with minimum risks) in the portfolio of the 30 biggest banks. The residual reserves formed by banks

as a compensation for potential losses on their loans increased in July by 1.5 % (or by 33 bn Rb).

The situation with regard to liquidity in the banking sector continues to improve, which has been confirmed by the behavior of Mosprime 3M (the indicative rate of the interbank credit market), which has been demonstrating a stable decline since this year's beginning (Fig 2). As of 28 September, the drop of



Source: Bank of Russia; BBS.

Fig 1. Behavior of Banks' Residuals on Correspondent Accounts with the RF CB, bn Rb

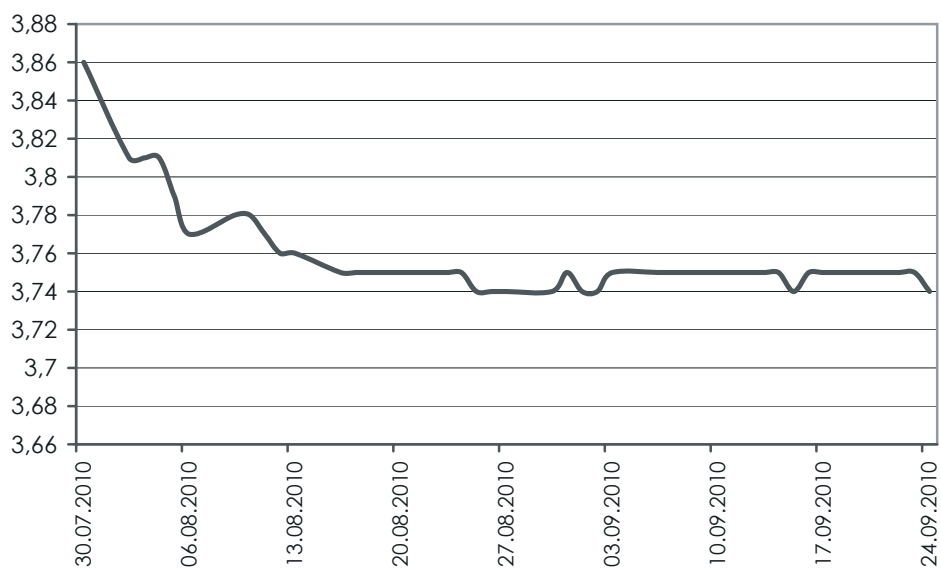
Mosprime 3M since early 2010 amounted to 2.8 p.p. Banks are eager to place their free assets on the interbank credit market, while credit risks in the real sector remain at a relatively high level. In the first 7 months of 2010, the deposits attracted from other credit institutions increased by 6 % alongside a declining share of the regulator's deposits. The RF CB continues to reduce the volume of its direct financial involvement in the banking system: since the year's beginning its deposits have dropped by 72 %. The amount of commercial banks' residuals on their correspondent accounts with the RF CB over the last 3 months have remained at the level of 500 bn Rb (Fig 1). One of the most important indices calculated by the RF CB as an estimation of the increased time horizon of crediting and the profitability in the banking sector in the medium term is the share of on-demand assets with periods over one year in the banking system's aggregate liquid assets. The share of such assets has markedly increased since the year's beginning – from 18.7 % to 25.5 %.

The population's deposits remain the main source of growth of the banking system's liabilities. Their share in the aggregate liabilities increased from 25.4 % as of the year's beginning to 28.2 % as of 1 August. The structure of growth displayed by the population's deposits still has an emphasis on short-term investments, but the behavior of deposits for periods of over one year displays an upward trend: thus, growth in July 2010, according to the RF CB's data, amounted to 2.2 %.

The behavior of the RF banking system's capital since this year's beginning has been determined by a slowdown in the growth of reserves against losses on loans coupled with a historic high achieved by the index of accumulated profit. In July, the banking system's capital increased by yet another 55 bn Rb (+ 1.2 %).

Below is the list of the most notable events that occurred in the banking sector in August-September:

- The Russian banking sector continues to consolidate its assets. *Nomos-Bank* announced its intention to purchase 52.2 % of shares in the



Source: National Currency Association.

Fig 2. Behavior of Mosprime 3M

Khanty-Mansi Bank. The deal will not involve a merger of its participants. Both banks will continue to develop as separate legal entities under their own brand names.

- Russian banks are actively attracting syndicated credits. *Gazprombank* attracted 900 mln USD for a period of 3 years, *Nomos-Bank* – 100 mln USD for a period of 1 year. The syndicated credits' value will amount to LIBOR +2.5 – 3.2 %. The result of the active attraction of comparatively cheap liabilities may be an enhancement of price competition on the credit market.

- The competition on the Eurobond market is on the rise. *VTB* became leader with regard to Eurobond placement, having come ahead of *Credit Suisse* and *Barclays*. The volume of Eurobond sales in Russia over 8 months amounted to 19.1 bn USD, having doubled by comparison with the corresponding period of last year.

- The scale of banking products belonging to the retail segments is expanding in Russia. In August, the Moscow Investment Bank became this country's first issuer of *MasterCard PayPass*. ●

REAL ESTATE MARKET IN THE RUSSIAN FEDERATION

G.Zadonsky

In the first half of 2010 immovable property turnover, according to the number of deals, went up by 18%. Over January-August 2010 the total floor area of new flats made 28.5 million of sq m or 96% versus the corresponding period of the previous year. The total floor areas in regions of the Russian Federation differ substantially. Moscow oblast with the figure of 537.6 sq m per one thousand people holds the first place. The growth of the volumes of housing crediting is going on, both the figures of relative and absolute figures for outstanding debts increasing.

In the 1st half of 2010 organizations of all forms of ownership constructed 248.8 thousand of new flats of the total floor area of 21.6 million sq m, which is 0.1% below the level of the 1st half of 2009. The proportion of housing built by individual contractors in the total area of housing implementation made 50.3% (50.6% in the 1st half of 2009). Over January-August the total area of new flats made 28.5 million sq m or 96% of the figure of the corresponding period of the previous year (table 1).

Moscow oblast still holds the first place in the list of subjects of the Russian Federation with the highest figure for the implemented square per one thousand of people (table 1). Whereas on average in Russia 200.5 sq m per one thousand people was built, the figure in Moscow oblast makes 536.7 sq m. However, if one did not take into account Khanty-Mansi and Yamal-Nenets Autonomous Okrugs, it would be Tyumen oblast that would be at the top of the list with 625.6 sq m per one thousand people. For reference: figures for Moscow make 88.3 sq m per one thousand people, for Saint-Petersburg – 238.1 sq m.

Table 1

CONSTRUCTION OF HOUSING IN TEN SUBJECTS OF THE RUSSIAN FEDERATION WITH HIGHEST FIGURES OF COMMISSIONED FLOOR AREA PER ONE THOUSAND OF IN JANUARY-AUGUST 2010

	Commissioned, thousand sq m of total floor area			Implemented, total floor area since the beginning of the year per one thousand of people, sq m	Commissioned by individual contractors, out of the total volume, thousand sq m of the total floor area		
	since the beginning of the year	in August	as percentage to the corresponding period of the previous year		since the beginning of the year	as percentage of the total area	as percentage to the corresponding period of the previous year
Russian Federation	28459.1	3802.5	96.0	200.5	14354.7	50.44	86.1
Moscow oblast	3623.9	726.3	97.6	536.7	1678.0	46.30	78.0
Krasnodar krai	2319.3	173.0	111.4	449.4	1292.9	55.75	81.0
Kaliningrad oblast	329.2	67.8	91.1	351.0	74.6	22.66	55.0
Leningrad oblast	556.5	31.6	86.0	341.5	276.9	49.76	73.0
Republic of Tatarstan	1260.5	192.1	91.0	333.6	581.4	46.12	103.0
Belgorod oblast	500.4	75.1	95.1	327.0	426.2	85.17	95.4
Republic of Chuvashia	394.5	87.0	115.4	308.6	288.7	73.18	114.9
Astrakhan oblast	300.2	45.7	100.2	298.1	181.7	60.53	115.1
Ryazan oblast	315.6	20.6	91.1	274.1	61.1	19.36	84.3
Tyumen oblast (figures excluding Khanty-Mansi and Yamal-Nenets Autonomous Okrugs in brackets)	1130.9 (841.6)	103.0 (58.9)	108.5 (116.7)	329.7 (625.6)	363.1 (271.0)	32.11 (32.20)	89.5 (96.5)

Source: on the basis of the Federal State Statistics Service data

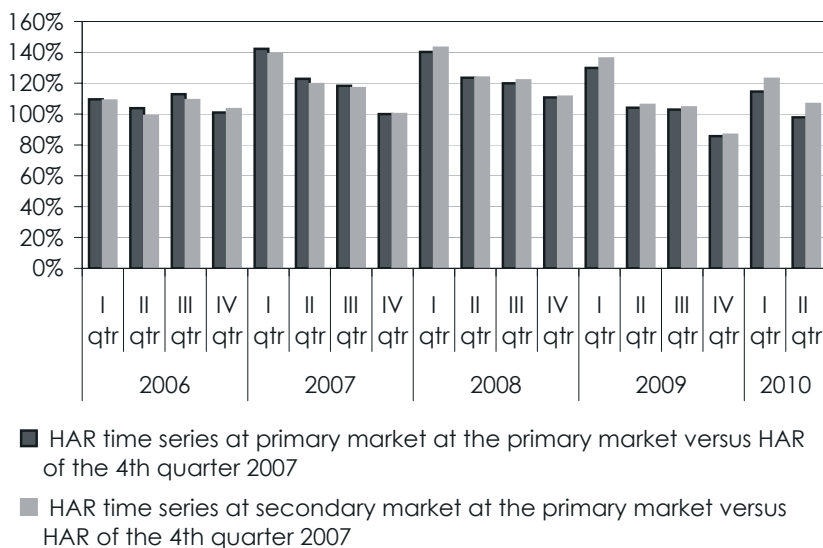
The average real cost of construction of 1 sq m of housing in the 1st half of 2010 increased by 2.95% versus 2009 (*table 2*), and the average real cost of construction of 1 sq m of housing in Khabarovsk (RUR 55379), Kamchatka (RUR 48100) kraiss, the Republic of Chechnya (RUR 45304), Sakhalin oblast (RUR 45560) and Yamalo-Nenetsk Autonomous okrug (RUR 58900) exceeded the average all-Russian level by 1.5 times or more.

Table 2

AVERAGE REAL COST OF CONSTRUCTION OF 1 SQ M OF RESIDENTIAL FLOOR AREA, RUR (APARTMENT BUILDINGS EXCLUDING EXTENSIONS, SUPERSTRUCTURES AND BUILT-IN AREAS AND EXCLUDING HOUSING CONSTRUCTED BY INDIVIDUAL CONTRACTORS)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 I quarter	2010 II quarter	2010 first half
Total	4779	7244	9025	10037	11720	13812	16840	20720	26622	30310	31135	31253	31205
Including:													
in towns and urban communities	4818	7307	9085	9988	11697	13708	16704	20644	26662	30321	26383	34668	30962
in rural areas	4030	5981	7669	11218	12349	16799	20817	22666	25886	30114	31447	31066	31219

Source: Federal State Statistics Service



Source: Federal State Statistics Service data

Fig. 1 HAR Dynamics at Primary and Secondary Markets versus HAR in 4th Quarter 2007

corresponding period of the previous year. The total number of registered rights for housing in the first half of 2010 (5 482 159) went up by 33% as compared with the 1st half of 2009, and the total number of registered records of mortgages (509 628) increased by 59% in the 1st half of 2010 as compared with the corresponding period of 2009. As to land plots turnover, an insignificant decrease in the number of registered rights for land plots (3 349 373) occurred – 2% below the figures of 2009.

According to the data of the RF Central Bank, as on August 1, 2010 177 316 home loans were issued at the sum of RUR 193.15 billion, including 133 199 mortgages at the sum of RUR 166.305 billion, which is 2.46 times higher than in the same period of 2009. The outstanding debt for mortgages made RUR 1.42 trillion as on August 1, 2010, which is 0.81% more than on July 1, 2010 (RUR 1.338 trillion). Over July stale debt for mortgages issued in rubles went up by 4.85% and made RUR 23.4 billion. Stale debt for mortgages issued in foreign currency increased at slower rates – by 1.59%,

In the 2nd quarter 2010 the housing at the primary market is still more affordable than at the secondary market (*fig. 1*). The housing affordability ratio (HAR) – the ratio of the cost of a standard apartment of 54 sq m to the annual incomes of a family of three, decreased in the second quarter as compared with the first, i.e. the housing has become more affordable (the coefficient value is close to the figure of the 4th quarter 2007).

According to the data of the Federal Service for State Registration, Cadastral Records and Cartography, in the 1st half of 2010 the immovable property turnover increased by 18% basing on the number of deals with property (12 630 589) as compared with the

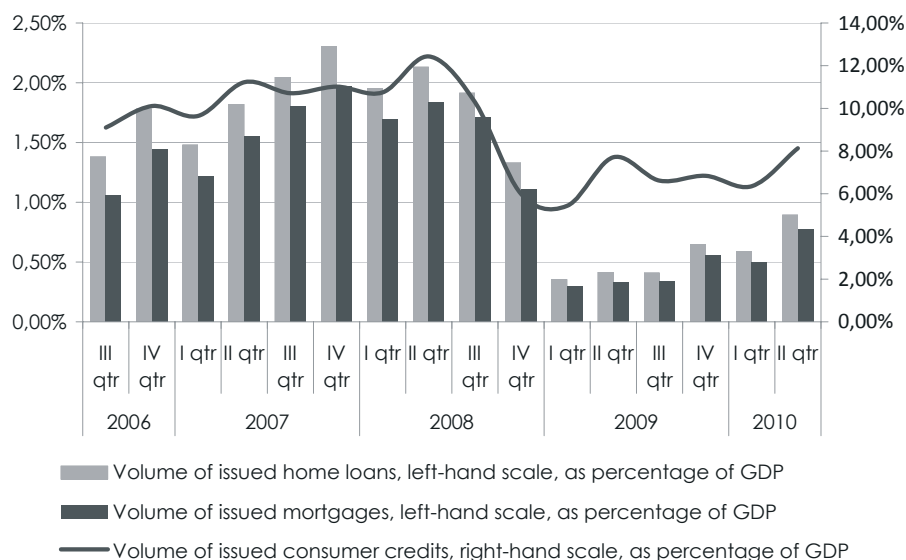
and the total state debt went up by 3.47% and made RUR 39.9 billion. As on August 1, 2010 state debt for mortgages issued in rubles made 2.73% of outstanding debt, and for mortgages in foreign currency – 8.91% of outstanding debt.

In terms of percentage of the GDP the volume of issued mortgages in increasing (fig. 2), making 0.78% in the 2nd quarter 2010, although it has not reached the level of the 4th quarter 2007 yet (1.97%). For reference: the volume of consumer credits as percentage of the GDP in the 2nd quarter 2010 made 8.13%, the maximum figure of 12.44% being observed in the 2nd quarter 2008. Outstanding debt for mortgages as percentage of the GDP made 2.59% in 2009, 2.58% in 2008 and 1.84% in 2007.

Average weighted interest rate (fig. 3) for mortgages issued in rubles continues to decrease and reached 13.2% as on August 1, 2010. Average weighted interest rate for credits issued in foreign currency made 11.2% as on August, 1st having risen by 0.1% over the month.

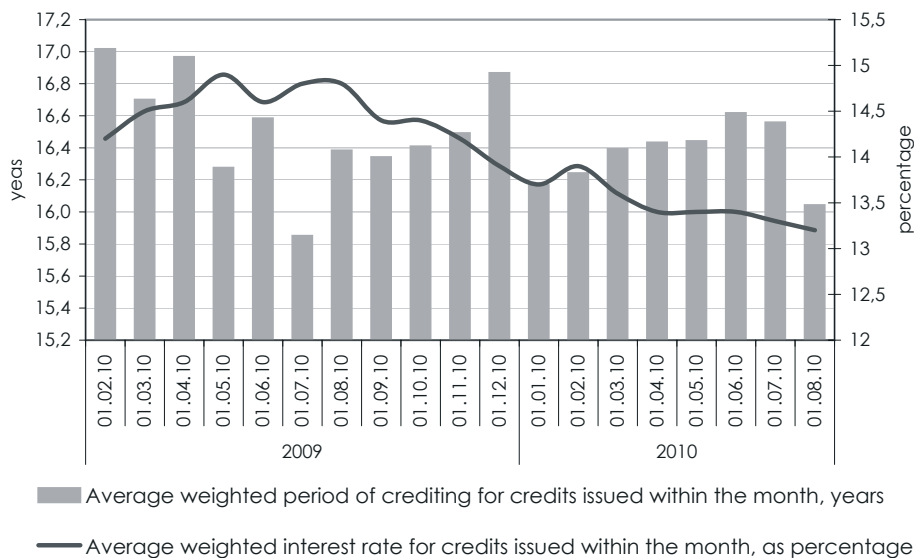
The proportion of foreign currency in the total outstanding debt in July reduced by 0.77% to 17.84%, and in the total issued credits volume – to 5.22%.

Outstanding debt for mortgages with arrears of payments (table 3) reduced from RUR 149 929 million on July 1, 2010 (14.5% of the debt), to RUR 142 152 million as on August 1, 2010 (13.64% of the debt).



Source: Federal State Statistics Service data

Fig. 2 Quarterly Volumes of Issued Home Loans, Mortgages and Consumer Credits as Percentage of the GDP over the Quarter



Source: data of the Central Bank of the Russian Federation

Fig. 3 Average Weighted Period of Crediting and Interest Rate for Mortgages Issued in Rubles within the Month

Table 3
CLASSIFICATION OF MORTGAGE DEBTS BY LENGTH OF PAYMENTS DELAYS* IN 2010

	Total sum of the debt for mortgages	Including:									
		without delayed payments		with payments delayed for 1-30 days		with payments delayed for 31-90 days		with payments delayed for 91-180 days		with payments delayed for more than 180 days	
		as RUR million	as %	as RUR million	as %	as RUR million	as %	as RUR million	as %	as RUR million	as %
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

Table 3, cont'd

	Total sum of the debt for mortgages	Including:									
		without delayed payments		with payments delayed for 1-30 days		with payments delayed for 31-90 days		with payments delayed for 91-180 days		with payments delayed for more than 180 days	
		as RUR million	as %	as RUR million	as %	as RUR million	as %	as RUR million	as %	as RUR million	as %
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
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.	1 033 815	883 886	85.5	54 113	5.23	22 433	2.17	15 976	1.55	57 407	5.55
01.08.	1 042 171	900 019	86.36	46 689	4.48	21 886	2.1	15 737	1.51	57 840	5.55

*)Columns 4;6;8;10;12 "as percentage to the total sum of the debt" Mortgage credits, which, according to the contract agreement are paid back by parts (installments) are recognized as a part of the debt with past due payments to the full extent with the maximum period of payment delay in case a part of the debt (installment) is not paid on time

Source: data of the Central Bank of the Russian Federation

Data of the RF Central Bank on the regional structure of mortgages issued in rubles since the beginning of the year to the borrowers of different regions (table 4) testify that the largest volume of mortgages in the Russian Federation is issued by Moscow crediting organizations (table 5). As on August 1, 2010 their proportion reduced to 85.86% as compared with 91.93% over the corresponding period of 2009, which is the evidence of the upsurge in mortgage crediting activity by banks located outside Moscow.

Table 4

VOLUME OF MORTGAGES ISSUED IN RUBLES SINCE THE BEGINNING OF THE YEAR TO BORROWERS IN DIFFERENT REGIONS, AS ON AUGUST 1, 2010, RUR MILLION

	Central		North-Western	Southern	North-Caucasian	Privolzhsky	Urals	Siberian	Far Eastern
	Total	out of which Moscow							
Central	41 462	16 559	13 487	8 266	3 007	21 699	18 773	22 140	6 768
out of which Moscow	39 715	16 470	13 276	8 236	3 000	21 608	18 594	22 126	6 757
North-Western	83	22	1 375	28	5	80	4	13	0
Southern	6	0	0	1 098	36	0	0	1	5
North-Caucasian	0	0	0	0	75	0	0	0	0
Privolzhsky	281	124	74	17	6	6 789	64	54	8
Urals	19	18	20	9	0	291	5 456	29	1
Siberian	6	5	4	0	0	25	6	3 446	2
Far Eastern	110	97	208	0	0	696	22	304	1 269

Source: data of the Central Bank of the Russian Federation

Table 5

PROPORTION OF MORTGAGES VOLUME ISSUED BY CREDIT ORGANIZATIONS LOCATED IN MOSCOW

Date	Mortgages Issued in Rubles	Mortgages Issued in Foreign Currency	Total
01.08.2009	92.21%	87.94%	91.93%
01.08.2010	85.24%	97.35%	85.86%

Source: on the basis of the data of the RF Central Bank

Table 6

INFORMATION ON SOURCES OF MORTGAGES REFINANCING (RECEIVABLES FOR MORTGAGES)

Source of refinancing	Date	Number of organizations units	Volume of refinanced mortgages (receivables for mortgages), RUR thousand		
			total	in rubles	in foreign currency
1. Mortgages refinancing selling mortgage pool (receivables for mortgages)	1.7.09	140	33 171 295	24 628 709	8 542 586
	1.7.10	125	29 283 406	24 843 755	4 439 651
1.1 Crediting organizations	1.7.09	33	9 905 916	6 590 801	3 315 115
	1.7.10	18	2 847 073	2 681 921	165 152
1.2 Special organizations, RF residents	1.7.09	93	15 772 474	11 939 118	3 833 356
	1.7.10	95	15 741 418	15 664 051	77 367
1.3 Special organizations, non-residents	1.7.09	3	6 955 393	5 561 278	1 394 115
	1.7.10	2	9 546 311	5 349 179	4 197 132
1.4 Other organizations	1.7.09	9	476 031	476 031	0
	1.7.10	10	1 148 604	1 148 604	0
1.5 Investment trust management companies, pools managed by banks	1.7.09	2	61 481	61 481	0
	1.7.10	0	0	0	0
2. Mortgages refinancing with retention of the assets on crediting organization books	1.7.09	0	0	0	0
	1.7.10	1	1 131	1 131	0

Source: data of the Central Bank of the Russian Federation

In 2010 AHML issued 5 series of corporate bonds secured with the state guarantees of the Russian Federation of the total worth of RUR 36 billion. In July 2010 AHML placed inconvertible certified interest-bearing housing bond by private subscription of the total worth of RUR 36 billion of the following classes: A1 – 45% of the issued bonds, with 9% per annum, A2 – 45% of the issued bonds with 6% per annum and B – 10% of the issued bonds (*table 7*), repayment date – November 20, 2042.

Table 7

ISSUE OF BONDS WITH MORTGAGE COLLATERAL BY AHML

Date of placement	Mortgage agent	Issue volume, RUR billion	Volume of senior tranche, RUR billion	Senior tranche rating
23.05.2007	First AHML mortgage agent	3.295	2.9	Current rating A3
27.02.2008	Second AHML mortgage agent	10.728	9.44	Current rating A3
25.12.2008	Mortgage agent AHML 2008–1	11.33	7.93	Current year Baa1
14.07.2010	Mortgage agent AHML 2010–1	13.5	12.192	Current rating Baa1

Source: Rusipoteka

In September 2010 bill “On introducing amendments to the Federal Law “On accumulative mortgage system for provision of military servicemen with housing” aimed at the expansion of opportunities for provision of servicemen with housing was submitted to the State Duma.

According to the Decree of the RF Government from July 19, 2010 “Strategy for the development of mortgage crediting in the Russian Federation up to 2030” was approved. It is envisaged that by 2030 various forms of housing financing will be affordable for 60% of Russian families. Average

weighted interest rate for a credit should lower to 5% per annum in rubles (upon assumption that inflation will make 4% per annum). Joint-stock company Agency for Home Mortgage Lending will remain the primary instrument of mortgage home lending support and development.

Starting with 2009 more than 157 thousand of Russian families have used maternal capital to pay off mortgage credits. Within the project “Maternal capital” AHML offers new mortgage product, which main advantage is low initial payment of 10%. ●

OIL AND GAS SECTOR

Yu.Bobylev

Recovery of the world economy and limited oil supply by OPEC countries favored comparatively high prices for oil in the world. In such an environment oil and gas production in Russia was observed to grow considerably. Increase in oil prices and measures aimed at alleviation of tax burden have resulted in the improvement of financial situation of oil companies and stimulates oil production. In recent months the RF Government has developed a number of new suggestions for oil and gas sector taxation.

Recovery of the economy growth in the leading industrially developed countries against the background of limited oil supplies from OPEC countries and decrease in oil production in some oil producing countries (the UK, Norway, Mexico) favored formation of comparatively high prices for oil in 2010. The average price for Russian oil grade Urals at the world (European) market made, according to preliminary estimation, USD 75.9 per barrel in January-September of the current year, which is 24.4% above the average level of the previous year (table 1). Data for monthly dynamics of world prices for oil in 2010 are presented in table 2. Under these circumstances the decision to maintain the existing quotes for oil production established for OPEC member countries were adopted at OPEC conferences held in 2010.

Table 1

WORLD PRICES FOR OIL IN 2007-2010, AS USD PER BARREL

	2007	2008	2009	2010 1 quarter	2010 2 quarter	2010 3 quarter*
Price for oil grade Brent, UK	72.5	97.7	61.9	76.2	78.3	76.8
Price for oil grade Urals, Russia	69.4	94.5	61.0	75.3	77.0	75.5

* Estimation

Source: IMF, OECD/IEA, OPEC.

Table 2

WORLD PRICES FOR OIL IN 2010, AS USD PER BARREL

	2010 January	2010 March	2010 June	2010 July	2010 August	2010 1-24 September
Price for oil grade Brent, UK	76.2	78.9	74.9	75.6	77.2	77.5
Price for oil grade Urals, Russia	76.1	76.9	74.4	73.9	75.5	77.1

Source: IMF, OECD/IEA, OPEC.

Under these circumstances dynamics of oil production in Russia remains positive. In January-August 2010 oil production in the country went up by 2.3% as compared with the corresponding period of the previous year (table 3). It can be noticed that in 2005-2007 annual increase in oil production made 2.1%-2.2%, whereas in 2008 for the first time in recent years the production was observed to decrease. In 2009 growth of oil production in Russia has recovered, although the increase was comparatively low (1.2%). It was the start of exploitation of several oil fields in the north of the European part of Russia and in the Eastern Siberia as well as a number of amendments to the RF Tax Code coming into force that are aimed at alleviation of the tax burden for oil sector and oil production stimulation that favored the positive dynamics of oil production. It should be expected that in 2010 annual oil production in Russia will exceed 500 million tons.

The largest increase in oil production volumes in January-August 2010 was registered in oil companies Rosneft (by 8.4% as compared with the corresponding period of the previous year) and TNK-BP (by 3%), which was mainly due to the production growth at new oil fields in the Eastern

Siberia. Investment activity has also intensified. According to the data of the RF Ministry of Energy the total volume of development and exploration drilling for oil in January-July 2010 went up by 14.2% versus the corresponding period of the previous year.

In 2010 oil processing the same as in the previous years excluding 2009 went up at higher rates as compared with production, which was mainly accounted for by the faster growth rates of oil products export, which are stimulated by lower export duty rates for oil products as compared with export duty rates for crude oil. In 2005-2008 growth rates for primary oil processing made 3.2%-6.2% annually, while in January-August 2010 they made 4.7%. It should be noted that the extent of oil processing has been increasing very slowly and did not exceed 72% in recent years, which in the leading industrially developed countries it reaches the figure of 90-95%. In January-August 2010 the extent of crude oil processing in Russia made 71.4%.

Table 3

OIL, OIL PRODUCTS AND NATURAL GAS PRODUCTION IN 2005–2010,
AS PERCENTAGE TO THE PREVIOUS YEAR

	2005	2006	2007	2008	2009	2010 January-August
Oil, gas condensate including	102.2	102.1	102.1	99.3	101.2	102.3
Primary oil processing	106.2	105.7	103.8	103.2	99.6	104.7
Car petrol	104.8	107.4	102.1	101.8	100.5	98.9
Diesel fuel	108.5	107.0	103.4	104.1	97.7	104.0
Furnace fuel oil	105.8	104.5	105.2	101.9	100.8	106.9
Natural gas	100.5	102.4	99.2	101.7	87.9	117.7

Source: Federal State Statistics Service

Natural gas production has increased considerably in 2010. It should be noted however that high growth rates of gas production result mainly from its dramatic reduction in 2009, which was accounted for by the contraction in internal and external demand due to economy recession and comparatively warm weather as well as forced contraction in gas supplies to Europe at the beginning of 2009 because of gas conflict with Ukraine.

In natural terms Russian oil export has grown (*table 4*). This can be accounted for by the decrease in oil supplies from other European producers (Norway and the UK), where it is connected with objective drop in production as a result of exhaustion of oil fields as well as with the limitation of oil production in OPEC countries.

Table 4

OIL, OIL PRODUCTS AND NATURAL GAS EXPORT FROM RUSSIA IN 2005-2010, AS PERCENTAGE
TO THE PREVIOUS YEAR

	2005	2006	2007	2008	2009	2010 January-July
Oil, total	98.4	98.0	104.0	94.0	101.8	100.2
including: to non-CIS countries	99.1	98.0	104.8	92.6	102.9	105.5
to CIS countries	94.9	98.0	99.4	102.6	95.4	70.9
Oil products, total	117.9	106.3	108.0	105.0	105.3	109.4
including: to non-CIS countries	119.1	104.5	107.6	102.0	107.1	113.3
to CIS countries	94.6	148.8	115.3	152.2	86.8	63.2
Gas, total	103.7	97.6	94.6	101.8	86.2	142.2

Source: Federal State Statistics Service

The proportion of oil products expanding somewhat, the crude oil export still predominates in export structure. The main part of oil products export was accounted for by furnace fuel oil that is used in Europe as raw material for further processing and diesel fuel. The proportion of export

in furnace fuel oil production made 90% in January-June 2010, in diesel fuel production – 62%, in car petrol production – 11.2% (for reference: in 2005 the proportion of export in car petrol production made 18.5%, in 2008 – 12.5%). The proportion of import to meet internal demand remains low: it makes only 1% in the resources of car petrol in 2010, 0.5% and 0.9%, correspondingly, for diesel fuel and furnace fuel oil.

At the same time has export in the 1st half of 2010 increased dramatically, which is mainly accounted for by the effect of low base: in the 1st half of 2009 due to considerable reduction in supplies to Europe gas export reduced significantly (by 43% versus the 1st half of the preceding year).

The growth of world prices for oil accounted for the noticeable increase in export revenues. Thus, whereas in the 1st half of 2010 the physical volume of oil export expanded by 0.2%, in value terms oil export went up by 59.6% versus the corresponding period of the previous year (*fig. 1*). The proportion of fuel and energy commodities in Russian export in January-July 2010 made 68.9%, that of crude oil being 34.6% and of natural gas – 12.0%.

Internal prices for oil and oil products (producers' prices) in dollar terms followed the dynamics of the world prices: in 2009 as a result of the increase in the world prices for oil they soared as compared with the end of 2008, while in 2010 prices for petrol and diesel fuel exceeded the level of the end of 2009 (*table 5*). At the same time internal prices for oil and gas in Russia still remain at the level considerably below the world prices. The gap between the levels of the world and the internal prices is accounted for by high export duty rate and additional transportation costs of export. Internal prices for gas belong to the sphere of the government regulation.

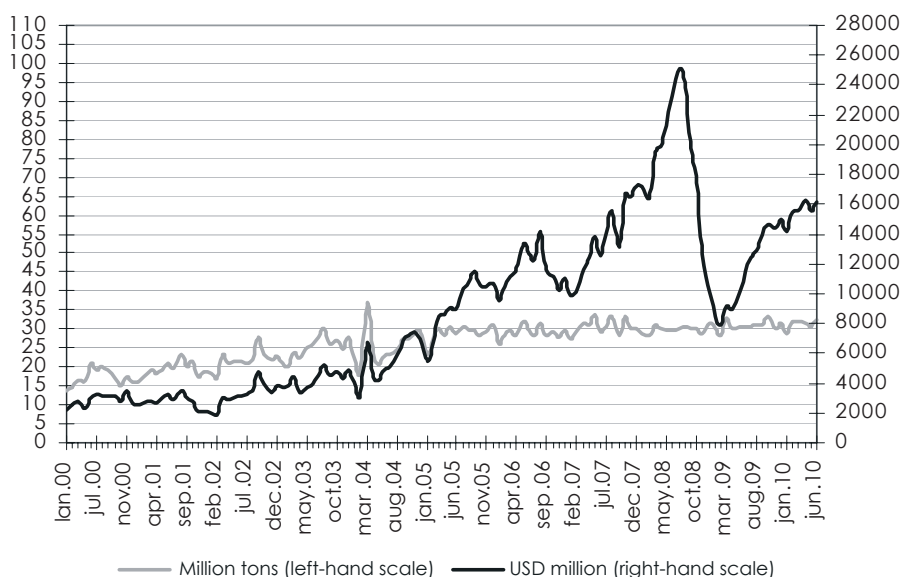
Table 5

INTERNAL PRICES FOR OIL, OIL PRODUCTS AND NATURAL GAS IN DOLLAR TERMS IN 2007-2010
(AVERAGE PRODUCERS' PRICES, AS USD PER TON)

	2007 December	2008 December	2009 December	2010 January	2010 June	2010 July	2010 August
Oil	288.2	114.9	219.3	196.5	196.7	204.6	225.6
Car petrol	581.2	305.1	457.4	483.0	529.2	549.3	539.4
Diesel fuel	692.5	346.5	394.8	429.5	406.7	433.8	426.0
Furnace fuel oil	276.5	125.0	250.8	195.3	236.3	247.0	246.8
Natural gas, USD/ thousand m ³	17.6	18.1	16.9	17.7	18.7	25.0	23.2

Source: calculated on the basis of the Federal State Statistics Service data

In 2009 the amendments to the Tax Code of the Russian Federation aimed at the reduction of the tax load on oil sector of economy, stimulation of deeper development of exploited oil fields and development of new oil fields in undeveloped regions and at the continental shelf came into effect. In the formula for the calculation of the coefficient C_p , which reflects the dynamics of world prices



Source: calculated on the basis of the data of the Federal State Statistics Service

Fig. 1 Oil and Oil Products Export in Natural and Value Terms in 2000-2010

for oil and is applied to the basic rate of the severance tax when producing oil, the price minimum that is not levied with tax has been increased from USD 9 per barrel to USD 15 per barrel (*table 6*), which resulted in considerable decrease of severance tax rate applied for oil production. Besides, the requirement for the application of the direct method for the control of the quantity of the produced oil at particular subsoil plots in order to use the established severance tax privileges (diminishing coefficient C_e) for the oil fields with a high level of exhaustion was excluded. This allowed application of the privilege mentioned at all the exhausted oil fields, which extends the period of their exploitation and additional oil production.

Table 6

SEVERANCE TAX RATE FOR OIL PRODUCTION IN 2005–2010

	2005	2006	2007	2008	2009	2010
Basic rate of severance tax for oil production, as RUR per ton	419	419	419	419	419	419
Coefficient characterizing the dynamics of world prices for oil (C_p)	$(P-9) \times R / 261$				$(P-15) \times R / 261$	
Coefficient characterizing the extent of subsoil plot exhaustion (C_e)	-		$3.8 - 3.5 \times N/V$			

Notes. P – is an average over the period level of price for oil grade Urals as USD per barrel; R – is an average ruble exchange rate of US dollar to ruble, established by the Central Bank of the Russian Federation, N – is the accumulated oil production in the subsoil plot, V – initial recoverable oil reserves of categories A, B, C1 and C2 at subsoil plot.

Source: RF Tax Code, Federal Law No 151-FZ from 27.07.2006, Federal Law No 33-FZ from 07.05.2004, Federal Law No No 126-FZ from 08.08.2001.

In order to stimulate the development of new oil provinces for new oil fields in the Eastern Siberia, in the territory of Nenetsk autonomous okrug and Yamal peninsula in Yamalo-Nenetsk autonomous okrug, at the northern continental shelf of the Russian Federation as well as in the Azov and Caspian seas tax vacations from the severance tax were established for oil fields

In order to additionally stimulate the development of oil fields of the Eastern Siberia oil and gas province starting with December 1, 2009 the Government of the Russian Federation established zero export duty rates for oil that were applied up to July 1, 2010. Then the Government transferred to application of decreased export duty rates. Thus, in September 2010 oil export duty rate of USD 87 per ton, which made 31.8% of the general rate, was applied to oil fields of this region.

In recent months the RF Government has developed a number of new suggestions concerning changes in oil and gas sector taxation. These suggestions have been formulated as projects of federal laws that are to be considered by the State Duma of the Russian Federation during the autumn session. The proposed changes should come into effect on January 1, 2011.

The project of the Federal Law “On introducing amendments to articles 342 and 361 of part two of the Tax Code of the Russian Federation” envisages a little increase in severance tax for oil and considerable rise in severance rate for natural gas. Basic severance tax rate for oil is to be indexed taking into account the inflation expected in 2012-2013, i.e. increase it to RUR 446 per ton in 2012 and to RUR 470 per ton in 2013. Severance tax rate for natural gas is to be increased more noticeably. This rate has remained unchanged since 2006 whereas wholesale prices for gas over the elapsed period have increased by 2.12 times. As a result severance tax rate for natural gas in recent years has gone down considerably both in real and relative (as percentage to price).

Under these circumstances it seems logical, in our opinion, to index severance tax rate for oil production in concordance with the prices growth at the internal market. The RF Government, however, retreated to a more moderate approach. Starting with January 1, 2011 this tax rate is envisaged to be indexed by 1.61 times, which in fact corresponds to the accumulated inflation over the period of 2007-2010. In 2012-2013 severance tax rate for natural gas is to be additionally increased in concordance with the expected inflation rate. As a result, starting with January 1, 2013 severance tax rate for oil production should make RUR 265 thousand cu m (*table 7*).

Table 7

SEVERANCE TAX RATES FOR OIL AND NATURAL GAS PRODUCTION IN 2010–2013

	2010	2011*	2012*	2013*
Severance tax for oil production, RUR per ton	419	419	446	470
Severance tax for gas production, RUR per thousand cu m	147	237	251	265

* Suggestions of the Government of the Russian Federation

Source: Ministry of Finance of the Russian Federation

In order to stimulate the development of small oil fields the project of the Federal Law “On introducing amendments to article 342 of part two of the Tax Code of the Russian Federation” suggests introducing special diminishing coefficient (Cr) applied to severance tax rate for oil that characterizes the reserves at a particular subsoil plot starting with January 1, 2011. This coefficient will be applied at subsoil plots with the initially produced oil reserves (Vr) of up to 5 million tons and the extent of reserves exhaustion (Ere) of up to 0.05. The coefficient will be calculated in concordance with the following formula:

$$Cr = 0.125 * Vr + 0.375 ,$$

where Vr – is initially produced oil reserves in million of tons, defined as a sum of oil reserves of categories A, B, C1 and C2 according to the data of the state balance of minerals.

The Extent of reserves exhaustion at a subsoil plot (Ere) is determined as the ratio of the accumulated oil production at a subsoil plot (N) to the amount of initially recoverable reserves at this subsoil plot (Vr).

At present the severance tax rate calculation does not envisage differentiation of taxation depending on the amount of oil reserves at a subsoil plot, which result in the fact that the development of small oil fields with the recoverable reserves of up to 5 million of tons is usually economically inexpedient due to high specific capital and exploitation costs. At the same time the state balance of minerals reserves includes at the moment about a thousand of fields with recoverable reserves of up to 5 million of tons and exhaustion of reserves of less than 5%, the total reserved at which make 1 billion ton of oil.

The introduction of special diminishing coefficient Cr is aimed at arrangement of conditions for new small oil fields development, which are unprofitable if the general taxation scheme is applied. This will allow starting the development of additional oil reserves and increase the extractive enterprises profitability. According to the calculations of the RF Government as a result of diminishing coefficient introduction the volume of additional oil production at subsoil plots with the initial recoverable reserves of up to 5 million tons will make 10.2 million tons in the first year and 214 million of tons within the first ten years.

In concordance with the policy of stimulation of new oil province development the RF Government has developed a project of the Federal Law “On making changes to article 342 part two of the Tax Code of the Russian Federation and invalidation of some legislative acts of the Russian Federation”. This bill suggests applying the regime of “tax vacation” that is already in effect in some regions to new oil fields in Yamalo-Nenetsk autonomous okrug that are located to the north from 65 degrees of latitude. For subsoil plots that are located in this region with the exception of those on Yamal peninsula zero severance tax rate is suggested for application until the accumulated oil production volume reaches 25 million of tons at a subsoil plot on condition that the period of the development does not exceed 10 years for the license for the right to use subsoil for the purposes of minerals exploration and production and does not exceed 15 years for the license for the right of simultaneous geological investigation (exploration) and minerals production since the moment of the corresponding license for subsoil plot use is registered by the state.

Such a regime is also applied to the subsoil plots the license for which was issued before January 1, 2011 and which extent of reserves exhaustion (Ere) does not exceed 0.05 as on

January 1, 2011. The period for zero tax rate application in this case is started on January 1, 2011.

The adoption of such a bill should arrange necessary economic conditions for the development of the fields in Yamalo-Nenetsk autonomous okrug which development is unprofitable in the general taxation regime is applied because of high volume of necessary investments in creation of infrastructure and geographic and geological characteristics of oil fields in the region. ●

THE CREATION OF A LEGAL BASE FOR THE OPERATION OF THE SKOLKOVO INNOVATION CENTER

A.Kireeva

In September, two new laws were adopted: Federal Law of 28 September 2010, No 244-FZ, 'On the Skolkovo Innovation Center'; and Federal Law of 28 September 2010, No 243-FZ, 'On the introduction of changes in some legislative acts of the Russian Federation in connection with the adoption of the Federal Law 'On the Skolkovo Innovation Center', whereby a legal foundation for the Center's operation was created, the set of customs and tax exemptions for its participants was determined, and a number of fundamentally new legal norms were introduced.

In September 2010, Federal Law of 28 September 2010, No 244-FZ, 'On the Skolkovo Innovation Center' and Federal Law of 28 September 2010, No 243-FZ, 'On the introduction of changes in some legislative acts of the Russian Federation in connection with the adoption of the Federal Law "On the Skolkovo Innovation Center"' were adopted.

Skolkovo represents a specifically designated territory with a special legal regime designed to promote research and development in a number of priority areas, which have been determined as follows: energy cost-effectiveness and energy saving, including the development of innovative power engineering technologies; nuclear technologies; space technologies, primarily in the field of telecommunications and navigation systems (including the creation of an appropriate land infrastructure); medical technologies (equipment, pharmaceuticals); strategic computer technologies and software.

The adopted legislation established certain requirements to the companies acquiring the status of participants in the Skolkovo project. First of all, these should be Russian legal entities with a standing executive body, as well as other bodies or entities endowed with the right to act on behalf of a legal entity without a power of attorney and permanently situated in the Center's territory¹. Secondly, their statutory documents must envisage that their research activity should be conducted exclusively in the aforesaid core areas.

The creation of the Skolkovo Innovation Center is associated with the introduction of the following fundamentally new norms in Russian legislation.

1. It is envisaged that in the territory of Skolkovo an investor-friendly system of state administration should be created. This is the first attempt, on the part of Russian legislators, to introduce special state administration in a limited territory.

It is intended, in order to overcome administrative barriers, that special subdivisions of bodies of state authority will be functioning in the territory of Skolkovo and interacting with the project's participants (by analogy with specialized tax inspectorates). Besides, it is planned to create specialized subdivisions of law enforcement agencies; a migration service; a tax control service; a customs service; a fire prevention and firefighting service; as well as services designed to protect the territory and its population from emergency situations; protection of consumer rights and personal well-being. Other subdivisions will be engaged in the protection of intellectual property, patents and trademarks.

2. The special status of Skolkovo's project manager and its affiliated organizations is established. The endowment of the project manager with a special status is also aimed, in principle, at creating an investor-friendly environment and simplifying the more complex authorization procedures associated with their operation.

¹ However, this requirement, in our opinion, does not completely rule out the participation of foreign companies in the Skolkovo project. In particular, this can be done by way of establishing their affiliated legal entities in the RF territory.

For this purpose, Law No 244-FZ suggests a version of outsourcing the functions of a body of state authority that is unique for the Russian Federation. It is intended that the project manager will be a private entity (that is, an entity other than a body of state authority or its subdivision – as it was, for example, in the case of the Federal Agency for the Management of Special Economic Zones (RosEZ)). Moreover, this entity will be able to delegate its functions to its affiliated organizations.

In this connection, the RF President will have to establish the procedure in accordance with which that private entity will be vested with the power to perform the functions relating to the management of the project (that procedure not being determined at the level of the Law). In particular, the project manager will be empowered to perform the regulating and supervisory functions in the territory of Skolkovo in the following spheres: the terms for participating in the project; urban development; attraction of labor migrants; establishment of sanitary, epidemiological, fire-safety, and other norms.

Lack of any experience of this kind in the RF makes it impossible to determine, at this stage, the potential consequences of the practice of outsourcing state functions in the sphere of normative regulation and control; however, it can be assumed that outsourcing can be fraught with certain risks. Even the stipulation in the Law that envisages that the persons participating in the project should be responsible for failure to comply with the rules established in the territory of Skolkovo cannot fully eliminate such risks.

In addition to some fundamental innovations, the legal base regulating the activity of the Skolkovo Innovation Center also contains a number of classical norms aimed at granting some customs and tax exemptions to the participants in the project. The ‘territorial’ nature of the exemption regime makes it comparable with that applied in special economic zones, the difference being that the scope of exemptions applied in the territory of the Skolkovo Innovation Center is unprecedentedly broad.

In particular:

1) The Law envisages refunding of customs import duties and VAT levied on the imported commodities used by project participants in the territory of Skolkovo (Article 11 of Law No 244-FZ ‘On the Skolkovo Innovation Center’).

It should be noted that some difficulties may arise in this connection. Thus, after the establishment of the Customs Union with the Republics of Kazakhstan and Belarus this exemption may entail some additional direct budget expenditures. The agreement on the introduction and application in the Customs Union of the procedure for calculating and distributing customs import duties (and other duties, taxes and levies of an equivalent effect)¹ that was concluded within the framework of the Customs Union envisages that customs duties should be distributed between the participant countries in the following way:

- the Republic of Belarus – 4.70 %;
- the Republic of Kazakhstan – 7.33 %;
- the Russian Federation – 87.97 %.

Thus, if the Russian Federation has levied on a participant in the Skolkovo project a customs duty in the amount of 100 Rb, 12,3 Rb will be ‘lost’ after its refund to the budgets of Kazakhstan and Belarus, and so the latter amount will have to be refunded to the project participant from the federal budget, to be covered by some other revenues.

Besides, the exemptions from customs payments envisage no mechanisms against tax optimization, and so there may arise some risks of the provisions of the new Law being misused. Thus, in particular, project participants may assist as intermediaries in import of equipment from abroad (on the basis of Article 11 of Law No 244-FZ, the amounts of value added tax and customs duties paid in this case are to be compensated to the project participants).

Later on, after a certain period of time, the imported equipment can be sold at any price to entities that do not participate in the project – because a project participant’s profit is levied by tax at a zero rate. In this connection, if the equipment is overpriced, the buyer can increase its depreciation costs.

2) The Law also establishes a very broad list of tax exemptions. In addition of refunds of the customs duties and VAT paid by project participants in connection with the import of commodities

1 http://www.tsouz.ru/MGS/mgs21-05-10/Pages/Sogl_o_mexanizme_zachisl_poshlin.aspx

necessary for their appropriate operation, Law No 243-FZ grants the following privileges to project participants:

- they are not obliged to keep accounting records;
- they are exempt from VAT (this right is granted to them for a period of 10 years from the moment of their registration in the capacity of a project participant and until the moment when the total amount of their profit exceeds 300 mln Rb from the beginning of the year that follows the year during which the amount of proceeds received by a given project participant exceeded 1 bn Rb, – from the first day of the tax period during which there occurred the aforesaid excess over the established threshold of the total amount of its profit, on condition that the amount of their profit should not exceed 1 bn 300 mln Rb);
- they are exempt from the tax on profit of organization until the moment achieving the level of return on investments in research determined by the draft federal Law (the conditions for the termination of the period of exemption are the same as for the exemptions from VAT), or until the moment of their loss of the status that entitles them to such tax exemptions. The exemption is granted in the form of a zero rate of that tax;
- they are exempt from the tax on property of organizations in respect of the property applied in their research activity; in addition, the entities involved in research activity in the Skolkovo Innovation Center are vested with the right to refuse to pay value added tax.

Besides, Law No 243-FZ envisages the lowering to 14 % of the total size of the contributions to mandatory pension, medical and social insurance being paid by the aforesaid entities.

The Law also envisages an exemption of the project manager – the owner of the land plots constituting the territory of the Skolkovo Innovation Center and a considerable portion of property situated on those land plots – from the payment of the land tax and tax on property of organizations in respect of the aforesaid objects.

It appears that the application of such exemptions, similarly to the exemptions granted in the sphere of customs payments, may give rise to certain problems, one of which may be as follows. It is envisaged that project participants should apply a zero rate to their payments of the tax on profit of organizations. At the same time, they do not keep accounting records, while tax records should not be kept by them in the procedure established for payers of the profit tax – instead they are to apply the procedure established for entities applying a simplified taxation system (in the procedure established by Article 346.24 of the RF Tax Code). Thus they are expected to apply the rate established for one tax and the procedure for keeping tax records that is established for another tax.

By Article 346.24 of the RF Tax Code, in accordance with which the participants in the Skolkovo project must keep their tax records, it is established that taxpayers are obliged to keep tax records with regard to their incomes and expenditures in order to calculate the tax base for the tax in a ledger of incomes and expenditures, the form of the ledger and the procedure for making entries in it being established by the RF Ministry of Finance. The corresponding form is at present approved by Order of the RF Ministry of Finance of 31 December 2008, No 154n.

It should be noted that the established ledger form implies that incomes and expenditures should be recorded by means of the cash receipts and disbursement method as a year-to-date total, but there is no place for ‘profit’ entries. Indeed, the object of taxation under the simplified taxation system are incomes or incomes less expenses (but not profit). Although in a general case profit represents incomes less expenses, the ledger’s form is inapplicable for the purpose of calculating the amount of profit in accordance with Chapter 25 of the RF Tax Code because, among other things, it takes no account of expenses in the form of depreciation of depreciable property. This happens because the expenses involved in the acquisition (or creation) of fixed and intangible assets are written off by the taxpayers applying the simplified taxation system in the period when they are incurred (Subitems 1 and 2 of Item of 1 Article 346.16 of the RF Tax Code).

Thus, the reference in Chapter 25 of the RF Tax Code to the procedure of keeping tax records established by Chapter 26.2 of the RF Tax Code is incorrect due to the existence of some significant discrepancies in the procedures for calculating the tax base. It seems that these discrepancies in the wording of the legal documents will result, in particular, in a situation when the restrictions on the application of tax exemptions by project participants (established, among other things, depending on the size of profit) can become unworkable.

Besides, it should be noted that the interpretation of the procedure for keeping tax records as established by the Law for project participants in accordance with Chapter 26.2 of the RF Tax Code will create some additional risks with regard to the actual workability of the restrictions on the application of the tax exemptions. Thus, for a project participant operating at the level of the established proceeds/profit threshold it would be sufficient, in order to preserve the right to an exemption, to purchase some equipment or a patent. In this connection, the feasibility of such a purchase will be unrelated to that equipment or patent being actually necessary for research purposes, because later on it can be resold (there being no ban on such operations effectuated by project participants if the activity in which they engage on a systematic basis is research).

Some risks for the workability of the restrictions on the application of exemptions are also associated with the fact that project participants are to apply the cash receipts and disbursement method. As this method records proceeds without receivables, and so the moment of recognizing an income may be easily shifted (it being sufficient to delay the receipt of a payment), the actual size of a project participant's proceeds may easily be in excess of 1 bn Rb, but the records will reflect it as being below that threshold. ●

REVIEW OF ECONOMIC LEGISLATION

I.Tolmacheva

In September the following changes were introduced into legislation: the transfer of maternal (family) capital funds from the federal budget to the budget of the RF Pension Fund will be made quarterly; grounds for dismissal of the head of a budget institution within jurisdiction of the RF Ministry of Finance were established.

I. Decrees of the Government of the Russian Federation

1. "ON INTRODUCING AMENDMENTS TO THE REGULATIONS FOR MATERNAL (FAMILY) CAPITAL FUNDS TRANSFER FROM THE FEDERAL BUDGET TO THE BUDGET OF THE PENSION FUNDS OF THE RUSSIAN FEDERATION" from 13.09.2010 No 719.

It is established that the transfer of funds of maternal (family) capital should be made quarterly no later than 3 work days since the beginning of the corresponding quarter on the basis of applications from the RF Pension Fund submitted to the RF Ministry of Finance up to the 20th of the month preceding the following quarter. Earlier the funds were transferred twice a year no later than 3 working days since the beginning of the corresponding half of the year (excluding the case envisaged by part 6.1 article 7 of the Federal Law "On additional measures of the state support to the families with children").

II. Instructions, Orders, Letters

1. Order of the RF Ministry of Finance "ON THE MAXIMUM VOLUME OF STALE CREDIT INDEBTEDNESS FOR A FEDERAL BUDGET INSTITUTION WITHIN JURISDICTION OF THE MINISTRY OF FINANCE OF THE RUSSIAN FEDERATION EXCEEDING OF WHICH RESULT IN TERMINATION OF EMPLOYMENT AGREEMENT WITH THE HEAD OF FEDERAL BUDGET INSTITUTION (DISMISSAL) IN CONCORDANCE WITH THE LABOR CODE OF THE RUSSIAN FEDERATION" from 30.08.2010 No 98n.

Registered in the Ministry of Justice of the Russian Federation on 21.09.2010 No 18492.

Comes into effect on January 1, 2011.

Grounds for dismissal of the head of a budget institution within the jurisdiction of the RF Ministry of Finance are established. According to paragraph 20 article 30 of the Federal Law no 83-FZ of May 8, 2010 "On introducing amendments to some legislative acts..." the head of a federal budget institution that allowed the credit indebtedness to exceed the maximum values established by the body acting as a founder of the institution can be dismissed. Thus, for instance, the head of the institution within the jurisdiction of the RF Ministry of Finance can be dismissed if: the delay in wages payment to the employees of the institution makes more than two months in the row; delay for making compulsory payments to the budgets of the Russian Federation (including for taxes and fees) is longer than three calendar months in a row. ●

REVIEW OF RF GOVERNMENT MEETINGS IN SEPTEMBER 2010

M. Goldin

The following issues were considered among others at the meetings of the Presidium of the RF Government in September: results of federal budget execution in the first half of 2010; the bill aimed at the indexation of excises rated for a number of excisable goods.

On September, 2nd at the meeting of the Presidium of the RF Government the results of the federal budget execution in the first half of 2010 were considered.

When considering the general parameters of federal budget execution it should be noted that in the first half of 2010 the revenues of the federal budget made RUR 3 997.9 billion. Expenses for cash execution made RUR 4 386.2 billion. Federal Budget deficit made RUR 388.3 billion.

Tax earnings made 51.4% of the total sum of the received revenues, non-tax revenues made 48.6%. The biggest part of the federal budget revenues was formed by value added tax (28.2%), customs duties (34.6%), severance tax (17.1%) and organizations' profit tax (2.9%).

In the first half of 2010 tax revenues of the federal budget made RUR 2 053.2 billion, which exceeds the sum envisaged in the forecast for the first half of 2010 by 31.2%. The largest part of tax revenues of the federal budget was provided by value added tax (54.9% of the total tax revenues), severance tax (33.2%), organizations' profit tax (5.7%) and excises for excisable goods (3.2%).

On the other hand, non-tax revenues of the federal budget in the first half of 2010 made RUR 1 944.7 billion (exceeding the sum envisaged in the forecast for the first half of 2010 by 22.3%). Revenues from customs duties in the structure of non-tax revenues made 71.1%, profits from Reserve Funds and Fund for National Welfare funds management made 5.5% of the total volume of non-tax revenues.

The total sum of cash expenses of the federal budget in the accounting period made RUR 4 386.2 billion or 44.3% of the budget quarterly revenues and expenses breakdown in 2010. It should be noted that in the 1st half of 2010 the level of cash execution of the federal budget expenses is the highest for the recent years being 44.3% to budget revenues and expenses breakdown. For reference: it made 40.4% of budget revenues and expenses breakdown in the first half of 2008, 29.8% in the first half of 2009. Such a high level of cash execution of the federal budget expenses is accounted for by the timely approval of regulatory legislative acts aimed at execution of the federal budget by the RF Government.

As on July 1, 2010 the volume of the state debt makes RUR 3 529.0 billion and has increased by RUR 295.8 billion as compared with the volume as on January 1, 2010.

As on July 1, 2010 the total volume of the Reserve Fund made RUR 1 226.6 billion, total volume of the Fund for the National Welfare - RUR 2 666.4 billion. Over the first half of 2010 the volume of the Reserve fund reduced by RUR 603.9 billion, and the volume of the Fund for National Welfare – by RUR 102.6 billion.

The RF Government approved the report on execution of the federal budget in the first half of 2010 and commissioned the RF Ministry of Finance to submit it to the State Duma, Federal Assembly and Clearing House of the Russian Federation.

On September, 23 at the meeting of the Presidium of the RF Government the project of the Federal Law "On making changes to chapter 22 part two of the Tax Code of the Russian Federation" aimed at indexation of excises rates for excisable goods in 2011, 2012 and 2013 was considered.

For instance, the excises for ethanol and alcoholic products, for tobacco goods, passenger cars and motorcycles will be indexed.

Indexation of excise rates for ethyl alcohol and alcohol products will make from 11.4% to 20.4% in 2011, from 8% to 23% in 2012, from 5.7% to 16.7% in 2013 depending on the kind of product.

Indexation of excise rates for tobacco products will make on average 24.5% in 2011, 20% in 2012, 7% in 2013 depending on the product denomination with the exception for filter-tipped cigarettes,

non-filter cigarettes and cigarettes with a cardboard holder, excise rates for which increases on average by 127% in 2011, 365 in 2012 and 27% in 2013. Ad valorem part of excise for filter-tipped cigarettes, non-filter cigarettes and cigarettes with a cardboard holder is supposed to be increased annually by 0.5 percentage points.

Excise rates for passenger cars with engine power from 67.5 kilowatt (90 h.p.) to 112.5 kilowatt (150 h.p.) inclusive, as well as for engine power above 112.5 kilowatt (150 h.p.), motorcycles with engine power of above 112.5 kilowatt (150 h.p.) are to be increased by 11.755 on average in 2011, by 8% in 2012 and by 7% in 2013.

Besides, the bill suggests introduction of changes in the existing procedure for calculation and payment of excises for ethyl alcohol, alcohol-containing and alcohol products, envisaging advance payment of excises for excisable goods when purchasing the alcohol, rates differentiation for excises for ethyl alcohol, as well as the possibility for exemption from the excise advance payment for purchased alcohol in case the alcohol and alcohol containing goods producer presents bank guarantee.

The bill envisages the sale of ethyl alcohol with zero excise rates to producers of medicine and cosmetics goods that are not recognized as excisable goods.

Additionally the law specifies the notion of alcohol containing and alcohol products that is applied for the purposes of excises calculation. It should be noted that in order to prevent illegal turnover cognac spirit is regarded as excisable goods. ●

REVIEW OF REGULATORY DOCUMENTS CONCERNING TAXATION OVER AUGUST – SEPTEMBER 2010

L.Anisimova

1. According to the Letter of the RF Ministry of Finance from August 23, 2010 No 03-07-11/360 the issue on VAT payment to the budget in case budgetary institutions provide services of leasing federal property.

For instance, the RF Ministry of Finance noted that in concordance with paragraph 3 article 161 of the RF Tax Code lessees are recognized as taxation agents only for lease agreements concluded with the government bodies or bodies of local government. Since a budgetary institution is not a government body, it should pay VAT to the budget independently.

This simple conclusion hides in fact a long story that required two rulings of the RF Constitutional Court (Ruling of the RF Constitutional Court from June 22, 2009 No 10-P and Definition of the RF Constitutional Court from 02.10.2003 No 384-O). In fact, in concordance with the existing budgetary legislation of the Russian Federation, sums of lease payments for the rented state (municipal) property belong to the owner of the property – i.e. initially they are transferred to the budget and only from the budget in the form of additional budget financing they are transferred to the budget institution that manages the property. Since the difference between the situation when the property is leased directly by the owner (a state government body or local government) and the situation when the lease agreement is concluded by a budget institution a special ruling of the RF Constitutional Court was required which declared that the budget institution in the lease agreement acts as party of civil rights agreement and thus the profit from the rent belongs to the institution. That is why according to the agreement signed with the state body (government or local government body) the lessee is recognized as a taxation agent for VAT payment and for the agreement signed with the budget institution the budget institution itself is recognized as VAT payer. In the first case the lessee pays VAT directly to the accounts of budget revenues, in the second case he transfers the sum of the lease (VAT excluded) to the account of budget revenues from the property and the VAT sum to the off-budget account of the budgetary institution according to article 180 of Operation Codes of State Management Sector 180 (purposeful investments) for the lessor to transfer VAT from rent profits to the budget.

2. According to the letter of the RF Ministry of Finance from August 24, 2010 No 03-05-05-02/67 it is clarified that the land tax is paid according to the rates established by the laws of municipal formations (not exceeding maximum rates established by the RF Tax Code) depending on the purpose of the land plot in question. It should be noted that in case the real owner of the land plot does not belong to the persons that can use the land plot purposefully the legal actions can be taken against him in concordance with article 8.8 of the RF Code on Administrative Offences, namely: the non-purposeful use of the land plot according to the allowed use results in administrative fine for citizens, officials and legal entities. The clarification was given to the land plot in the property of the organization that is envisaged for a personal subsidiary plot.

It seems that such an explanation of the RF Ministry of Finance is not exhaustive since the situation requires court ruling: the formal grounds for the property right for a personal subsidiary plot belonging to the legal entity (that has a right to conduct the activity envisaged by the Statutory) are not clear. Consequently, the presumption suggested by the RF Ministry of Finance for tax payment basing on the purpose of the land plot though fair at the first sight should be supplemented in our opinion by the liability of tax bodies to establish the proper owner of the plot basing on the court ruling and readdressing tax payment requirements to him.

3. According to the Letter of the RF Ministry of Finance from August 25, 2010 No 03-07-11/362 it is clarified that the privilege for VAT payment granted by the RF Tax Code when selling a residential house or a country house does not apply to non-residential constructions in the country house land plot. When selling such constructions, in the opinion of the RF Ministry of Finance, one should pay VAT. The possibility of such explanation concerning the sale of country house plot as the whole with the constructions in it (barn, toilet etc) is not obvious. As a matter of fact, initially there existed strict regulations concerning the types of auxiliary constructions that were allowed in the country houses plots. The country house itself did not originally belong to the objects of capital residential housing construction and the registration of a person at the place the country house is located in case he does not have any other housing was allowed not so long ago. In such a situation the application of VAT taxation regimes for the utility and sanitary objects different from those for a country house when selling a country house land plots built over in concordance with the standards existing on the date of its development and sold as a whole requires additional juridical investigation.

4. According to the Letter of the RF Ministry of Finance from August 27, 2010 No 03-03-06/4/81 the procedure for accounting of the cost of stolen goods and material assets among the expenses taken into account for the taxation purposes of organizations' profits is clarified. Recognition of the cost of stolen goods and material assets as losses (outstanding expense) is made as on the date the investigator of interior affairs body of the Russian Federation makes a decision to terminate the preliminary investigation in connection with the fact that the person that is to be impleaded was not discovered and when there is a certified copy of the decision mentioned.

6. According to the Letter of the RF Ministry of Finance from August 30, 2010 No 03-03-05/193 it is clarified that the object of capital construction which is completed can be leased also in the case if the property right for it has not been registered – on condition that in the period preceding registration the body in charge of the state registration of rights for immovable property and deals with it upon application of the right holder makes an inscription in the document submitted for registration. Such a procedure is in concordance with paragraph 3 article 131 of the RF Civil Code. Investor that has received the results of his investments in the form of completed construction can, in the opinion of the RF Ministry of Finance, lease such a property to a third party before the state registration of property right. In this case payments for temporary use the property in the form of fixed assets that passed state acceptance inspection property rights for which has not been registered yet are taken into account for taxation purposes according to general procedure.

7. According to the Letter of the RF Ministry of Finance from August 31, 2010 No 03-04-06/3-191 it is clarified that when defining services rendered to the population for which the taxation regime in the form of the single tax on the imputed income can be applied one should be guided by section 1 “Personal services” of the All-Russian Classification of Services Rendered to Population, taking into account statements of article 346.26 of the RF Tax Code. for instance, since services of provision of the population with billiards, bowling, amusement rides for children are not mentioned in section 1 “Personal services” of the All-Russian Classification of Services Rendered to Population, this entrepreneurial activity of rendering such paid services to population is not subject to chapter 26.3 of the RF Tax Code and is to be taxed in concordance with other taxation regimes.

8. According to the Letter of the RF Ministry of Finance from September 1, 2010 No 03-07-11/375 it is clarified that funds contributed to statutory capital of an organization even if the budget is its source are not regarded as budget allotments allocated for compensation of expenses for goods (works, services) purchase in concordance with quarterly budget revenues and expenses breakdown. In the latter case the monetary funds are purposefully allocated at the rate necessary to pay for goods (works, services) taking VAT into account. VAT sums are received directly by the budget and are not accepted for recovery. In case the monetary funds are contributed to the statutory capital they are considered as off-budget sources of the organization. Payment for goods (works, services) from these funds can be the grounds for compensation of the paid VAT.

9. According to the Letter of the RF Ministry of Finance from September 1, 2010 No 03-04-05/3-518 it is explained that an individual entrepreneur that applies simplified taxation regime, taxation object being “incomes deduced by expenses” or that has transferred to single tax on the imputed income payment and uses the labor of employees working for wages acts as a tax agent concerning the wages paid to these employees. Taxation payment in these cases is regulated by articles 226, 224 and 230 of the RF Tax Code.

When calculating and paying personal incomes taxes on employees’ incomes involved in activity to which single tax on the imputed income or simplified taxation system can be applied, the tax on employees’ incomes is collected by private entrepreneurs acting as a tax agent and paid to the budget by the place of his registration as an individual entrepreneur.

10. According to the Letter of the RF Ministry of Finance from September 2, 2010 No 03-07-11/376 it is clarified that in case collective (labor) contract postulated that the organization pays allowances for meals to employees, the sums of such allowances are not considered as goods (works, services) sale and are not subject to VAT taxation. On the other hand, it should be added that allowances for meals envisaged by labor contract (excluding compulsory dietotherapy established by the law for some categories of employees that is a form of social benefit) can be ascribed to the expenses of the organization for labor remuneration in natural terms. In this case the sums of allowances should be reckoned when calculating payments to state off-budget social funds. Besides, article 131 of the RF Labor Code establishes the maximum limit for such allowances. For instance, the proportion of labor remuneration in natural terms should not exceed 20% of the total sum of labor remuneration.

11. According to the Letter of the RF Ministry of Finance from September 10, 2010 No 03-03-06/4/87 it is clarified that incomes from placement of the means of self-regulating organizations compensation funds that are formed in concordance with the Federal Law of 01.12.2007 No 315-FZ “On self-regulating organizations” are to be levied with the profit tax according to general conditions.

It should be additionally explained that a self-regulating organization places the means of the compensation fund that is formed to provide for its members’ liabilities only through management companies (paragraph 5 article 13) on the basis of agreements concluded with the management company and special depository (paragraph 7 article 13). Incomes received from the placement of compensation fund means is directed to replenishment of this fund and compensation of expenses connected with the necessary conditions for fund investment formation (paragraph 7 article 13).

According to explanations of the RF Ministry of Finance contained in paragraph 2 of the Letter from 09.08.2005 No 03-03-04/2/43, for the tax to be calculated properly the trust management should inform the founder on types of incomes received during the trust management in each accounting (taxation) period regardless of whether this agreement envisages payments during the effect of the trust management agreement (paragraph 3 article 332 of the RF Tax Code). This includes the information on dividends, interests from the RF government notes, RF subjects government notes, interest from interest-bearing debt securities and other incomes, since, in concordance with article 284 of the RF Tax Code the types of incomes mentioned are levied with profit tax at different rates.

12. According to the Letter of the RF Ministry of Finance from September 10, 2010 No 03-03-06/1/584 it is explained that on the basis of subparagraph 2 paragraph 1 article 268 of the RF Tax Code, starting with January 1, 2010 when selling property discovered during inventory and (or) property obtained during dismantling or disassembling of fixed assets removed of service, as well as during repair, modernization, reconstruction, technical re-equipment, partial liquidation of fixed assets which is recorded as received before 2010 the taxpayer has a right to reduce incomes from such operations by the sum of expenses equal to the market value of sold property.

13. According to the Decree of the RF Government from 13.09.2010 No 711 considerable changes are made to the Procedure of zero VAT rate application when selling goods (works, services) to diplomatic missions and missions of the same status for private use by diplomatic or administrative

and technical staff of the mission, including members of their families living with them. The changes made considerably simplify the procedure for VAT recovery when purchasing goods (works, services) by cash. Missions or persons mentioned above can only submit to the taxation body payment and account documents, cash vouchers or accountable forms (or their copies certified by the foreign diplomatic mission or mission of the same status) that confirm the payment made. If VAT sum is not specified in the submitted document, it is the liability of taxation bodies to make a calculation. Moreover, taxation bodies that earlier refused to compensate VAT sums are to reconsider the documents and calculate vat compensation sums.

The Decree established the periods within which the submitted documents should be considered (3 months) and the decision should be made (7 days).

14. According to the Letter of the RF Federal Tax Service from July 23, 2010 No AC-37-2/7390@ the procedure for determination of the total taxation sum that gives grounds to apply declarative procedure of VAT recovery as postulated in subparagraph 1 paragraph 2 article 176.1 of the RF Tax Code. According to this article if total sum of organization's own VAT, excises, organization's profit tax and severance tax paid during three calendar years before the year in which the declaration is submitted makes no less than RUR 10 billion an organization can transfer to declarative procedure for VAT recovery.

15. Letter of the RF Ministry of Finance from August 26, 2010 No 03-07-11/370 elucidates the position of the RF Ministry of Finance concerning the lack of grounds to accept for deductions VAT sums for services rendered on the basis of invoices that were submitted upon violation of the period established in paragraph 3 article 168 of the RF Tax Code (no later than five calendar days counting from the day of goods shipping). It is obvious that such position is not undisputable and the RF Ministry of Finance will have to defend it in courts (see, for instance, the Ruling of the Federal Arbitrary Court from April 18, 2007, case No A19-22618/06-51-F02-1916/07).

16. Wire of open joint-stock company Russian Railways from August 2, 2010 No TsFTOOR-10.3/1783 explains the procedure for indirect taxes payment in the Customs Union in connection with the abolition of customs control at the internal customs borders. It is clarified that customs control, customs duties collection and enforcement of customs legislation is made only at the external border of the Customs Union. Changes are made only to the customs legislation without any amendments to the Tax Code of the Russian Federation.

The general scheme is as follows. When goods are transported inside Customs Union or from abroad – into the territory of the Customs Union (import) VAT rate of 18% is applied. When goods that are to be exported from the Customs Union are transported inside the Customs Union or when the goods are transported on the transit basis through the territory of Customs Union the rate of 0% is applied. In order to receive a documental proof for the right to apply 0% VAT rate to export transportation, the transportation documents should be stamped by a custom body of the Russian Federation “Export permitted” certified by personal numbered stamp of a customs officer. Customs clearance is made by a Customs Union participant from which territory freights (goods) shipping for export is made. To certify the right to apply 0% VAT rate the transportation documents should be stamped either with a customs body of the Republic of Belorussia “Выпуск дозволены” (“Export permitted”) or a customs body of the Republic of Kazakhstan “Шығаруға рұқсат” and (or) “Боцартуға рұқсат” (“Export permitted”), certified by a personal numbered stamp of a customs officer. When transit goods are transported through the territory of the Customs Union transit customs declaration is filled out and the customs body into which territory the goods arrived from abroad put a directing stamp.

17. According to the Letters of the RF Ministry of Finance from August 30, 2010 No ShS-37-3/10218@ and the RF Ministry of Finance from July 12, 2010 No 03-11-09/57 it is clarified that in concordance with subparagraph 2 paragraph 2.1 article 346.2 of the RF Tax Code the ownership of fishing vessels or their rent on the basis of affreightment contract (bareboat charter or time-charter) is a compulsory prerequisite for a fishing organization and individual entrepreneurs to

be recognized as agriculture goods producers. It is also elucidated which types of vessels belong to fishing vessel fleet.

18 Information letter of the RF Federal Customs Service from August 23, 2010 explains that in connection with the Agreement on introduction and implementation of the procedure for payment and distribution of the customs import duty rates (other duties, taxes and fees of similar action) in the Customs Union, customs duties transferred to the Russian budget are paid directly to the account of the federal budget revenues. Up to 1.04.2010 advance customs payments made before 1.09.2010 will be set off. After this date they will not be set off.

It should also be taken into account that monetary funds taken into account in budget revenues according to Budget Classification Code 153 1 10 11010 01 1000 180 “ Customs import duty rates (other duties, taxes and fees of similar action) paid in concordance with the Agreement on introduction and implementation of the procedure for payment and distribution of the customs import duty rates (other duties, taxes and fees of similar action) in the Customs Union” cannot be set off for any other payments.

19. According to the Letter of the RF Federal Tax Service from Septemembr 6, 2010 No ShS-37-3/10674 the position of taxation bodies regarding recognition of receivables as a bad debtis clarified. This letter does not dispute only such grounds for recognition of receivables as a bad debt as expiration of the period of limitations, liquidation of the debtor in concordance with bankruptcy legislation. Bailiff act on the termination of executory process is in the opinion of the RF Federal Tax Service insufficient to terminate such liabilities on such grounds listed in paragraph 2 article 266 as state body act or impossibility to execute liability. ●

CHANGES IN BUDGET PROCESS REGULATORY BASE

M.Goldin

In September the following changes concerning the regulatory base of the budget process took place: Regulations for formation and fulfillment of the federal targeted investment program and Procedure for formation of state orders for federal state institutions were approved.

Decision of the RF Government No 716 of September 13, 2010 “On Endorsement of Regulations of Forming and Implementation of the Federal Targeted Investment Program” defines the procedure for preparation and adoption of the federal program that determines investment distribution from federal budget funds to the objects of capital construction (further referred to as the Regulations).

Federal Targeted Investment Program (further referred as FTIP) is a document that determines the distribution of allocations envisaged in the federal law on the federal budget for the financial year and planning period among chief superintendants of budget funds. These allocations can be granted for fulfillment of construction, reconstruction, technical re-equipment of capital construction objects projects and (or) making other investments in the territory of the Russian Federation:

- into objects of capital construction, construction, reconstruction or technical re-equipment of which is planned to be executed to the full extent or partially at the expense of the federal budget funds;
- into other objects, including housing, that are purchased for the needs of the federal executive bodies and (or) their regional branches, which purchase is made in order to execute the RF legislation acts (further referred to as non-movable assets);
- into measures (consolidated investment projects) that can include any construction, reconstruction and technical re-equipment of capital construction objects, purchase of non-movable assets and other investments.

Budget allocations for investments from the budget granted to legal entities that are not state or municipal institutions and state or municipal unitary enterprises are also to be considered within FTIP framework.

FTIP is in effect from January, 1st to December, 31st of the financial year in which it was endorsed.

FTIP proposal is formed by the RF Ministry for Economic Development on the basis of suggestions on the determination of budget allotments from the federal budget in the next financial year and in the planning period concerning federal target programs and budget investments in capital construction objects and the suggestion on subsidies granting that are submitted by the subjects of the budget planning.

While the federal law on the federal budget for the next financial year is under consideration the RF Ministry for Economic Development makes corrections to the program project with the participation of the subjects of budget planning. The RF Ministry of Economic Development approves the Program in two-week window after the federal law on the federal budget for the next financial year and planning period comes into effect.

The regulations also define for instance the procedure for program implementation (mainly concerning the procedure for making amendments to it) and the procedure for implementation of “informational resource for federal targeted investment program”, including the liability to place the information on the objects of capital construction, measures (consolidated investment projects), non-movable assets that are to be included or are already included in the program on the official site that are not the state secret of the RF Ministry of Economic Development in the Internet .

Decision of the RF Government No 671 of September 2, 2010 “On Procedure of Formation of State Order Concerning Federal State Institutions and Financial Provision for State Order Fulfillment” approved the “Statement on Formation of State Order Concerning Federal Budget and Public Institutions and Financial Provision for State Order Fulfillment”.

The Decision of the RF Government No 671 of September 2, 2010 comes into effect on January 1st, 2011.

The state order is formed in concordance with the main kinds of activity envisaged by the statutory documents of the federal budget or federal public institution.

The state order determines the indicators characterizing quality and (or) volume (content) of the state service (work) and the procedure for its rendering (implementation).

State procedure is developed during formation of the federal budget for the next financial year and the planning period and is approved within one month after the day of official promulgation of the federal law on the federal budget for the next financial year and the planning period and is prepared:

a) for federal public institutions – by chief superintendants of federal budget funds responsible for federal public institutions;

b) for federal budget institutions – by federal executive bodies (state bodies) that act as founders of the federal budget institutions if not stated otherwise by the federal laws, regulatory acts of the RF President or RF Government (further referred to as a federal body acting as founder of federal budget institutions).

State order is formed on the basis of the federal budget approved by chief superintendants of the federal budget funds that are responsible for federal public institutions or a federal body acting as a founder for federal budget institutions, departmental list of state services (works) rendered (executed) by federal state institutions under its authority as main kind of activity and quality indicators of for state services (upon their determination).

The statement also established the procedure for determination of the standard expenses (their content and amount for budget institutions as well) taken into account when defining the budget of a public institution for financial provision for the state order.

It should be noted that starting with January 1st, 2011 the Decree of the RF Government No 1065 of December 12, 2008 that regulates the procedure for formation and financial provision of the state order for federal executive bodies and federal state institutions invalidates. ●