



RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES 12'2010

MONTHLY BULLETIN:

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RUSSIAN ECONOMY IN DECEMBER: TENTATIVE DATA AND BASIC TRENDS

Social and Political Background: Depressing Outcome

The main developments of the socio-political background in December were the riot in Moscow and conviction of Khodorkovsky and Lebedev under the second lawsuit. The riots that occurred during an unauthorized rally at the Manege Square, arranged by football fans to protest against the release of participants of the fight, in which Yegor Sviridov was killed, had a nationalist and xenophobic tinge. A few days later young immigrants from the North Caucasus and Russian teenagers were trying to organize fights in different parts of Moscow, but all of them were stopped by police.

While President Medvedev emphasized impermissibility of the riots, Prime Minister Vladimir Putin, calling on all parties to a national peace and respect to the law, in fact expressed open support to the “fans” by visiting the grave of the murdered man with the fans’ leaders. It should be noted that, according to sociologists assessments, in early 2000s no acute nationalist trends were observed in Russia (one could rather note a reverse the trend); however, in 2009-2010 negative attitude towards migrant workers has somewhat strengthened, which reflects exacerbation of social problems.

At the annual live TV broadcast of Prime Minister Vladimir Putin was rather tough in his opinions on Khodorkovsky and Lebedev lawsuit, as well as the political opposition, which was regarded by analysts as a demonstration of tough political line, which Prime Minister intends to follow in the election year. Dmitry Medvedev has traditionally used a softer wording in his annual TV speech, he spoke about freedom of speech on television and declared impermissibility of pressure on the court in connection with the Khodorkovsky lawsuit. In the unanimous opinion of observers and experts, the evidence base in the second court proceedings was practically absent, and the wording of the charges is incompetent and absurd. There is no doubt that the indictment of the judge will be negatively perceived by Western public, which - in turn - will strengthen the image of Russia as a nonlegal, non-democratic state and provide a negative impact on the dynamics in relations with the most developed countries in general, and in particular, in terms of investment and innovation.

Index of Social Sentiment, assessed by “Levada Center» at the end of the year was getting somewhat reduced, while for the year in general the index fluctuated within the range of values achieved by the end of 2009. It is noteworthy that the index estimates for the current status of the family welfare was increasing slightly throughout the year, while the index of expectations was demonstrating a downward trend. Index of the situation in the country, assessed by “Levada Center”, and estimates of the economic situation, made by the Fund of Public Opinion reflect the same pattern: the growth of estimates in the first half of the year and their decline in recent months to the values of the year beginning.

Macroeconomics and Finance

The major developments of the end of the year in macroeconomic sphere were accelerated inflation and a significant outflow of capital outside the country.

These trends were developing at the background of fairly favorable external environment. From December 2, the price of Brent crude oil exceeded the level of USD 90 per barrel and did not drop below that mark, having reached in the second half of the month the post-crisis peak of USD 94.25 per barrel. Therefore, an expressed growth in oil prices has been observed for the fourth consecutive month: as compared with the average price of the end of August (USD 74.9 per barrel for Brent), the average price of a barrel of oil within 20 days of December (USD 93.5/bbl.) increased by 25%. As of the month results, the average price of crude oil in December will exceed the average monthly price in August by nearly 20%. In this regard, at the end of the year we should expect at least the stability of trade balance indicators. We would like to remind that the August trade surplus dropped down to USD 7.96 billion in October, then it rose to USD 10.45 billion due to rising oil prices against the

background of slowing import. Despite the fact that import in December is likely to increase slightly (in November, according to tentative data of Customs Service statistics, imports remained at the level of October), due to the growth of export, the trade balance in December will be rather high, which will have a stabilizing effect on macroeconomic indicators .

After positive outcome of quarter II, the capital outflow in quarter III was registered at USD 4.2 billion, which means that as per results of the first three quarters, the outflow of USD 16 billion in the IVth quarter, according to statements made by the Bank of Russia management, has accelerated considerably and in the first 11 months of the year amounted to USD 29 billion, having exceeded the adjusted estimates of the Bank of Russia by USD 22 billion. This process was reflected in the dynamics of gold and foreign exchange reserves, which were decreased from October 15 to December 17 by USD 25.7 billion. However, in December this process was clearly decreased (from USD 481.5 billion on December 3 to USD 478.0 on December 17), while during the previous 4 weeks, those reserves decreased on average by USD 4.5 billion per week.

The turning point in another trend occurred in December: in spite of usual growth of oil prices during October-November, it was accompanied by a weakening of the ruble against the US dollar, but in December the ruble began to strengthen. As a result, the dollar fell down to RUR 31.45/USD 1 on December 2 and to 30.RUR on December 27. RUR was strengthening also against Euro as well (continuing the trend of November); as a result, the two-currency basket fell down from RUR 35.72 to RUR 34.77. In addition to market factors, the impact (selling foreign exchange earnings by exporters in anticipation of tax payments) on the changing dynamics was provided by the stabilization of the foreign trade balance.

However, the signs of macroeconomic instability and uncertainty in external markets has “smeared” the New Year’s rally in the stock markets. At the turn of November and December stock indices rose sharply (+7.5% ..+7.8%) due to the increase in oil prices together with the growth in European and American markets, but subsequently remained almost at the same levels. Therefore, during September-December the stock indices rose overall by about 25% (MICEX index from the level of 1.340 points at the end of August to 1.670 at the end of December, the RTS indices – from the level of 1.390 points to 1.760 points), which serves also as an indicator of the overall growth for the year.

In December, consumer price inflation has accelerated in comparison with the previous month; within 20 days prices rose by 0.7%, the cumulative inflation since the beginning of the year made therefore 8.4%, and as of the year-end inflation rate almost reached the indicator of the previous year, 8.6 %. Therefore, a sharp deceleration of inflation in spring and summer months were offset by its growth at the end of the year. In contrast to the situation in early autumn, when the monetary authorities expected a quick slowdown in inflation, now, on the contrary, the likelihood of significantly high inflation during the first half of 2011 is expected, which will be contributed by both, seasonal factors (increase in the intensity of budget spending in December and January’s increase in tariffs and pensions), as well as external factors - growth of the global market prices for food, and finally, increased insurance contributions. Companies intend to compensate their increased expenditures at the expense of consumers, it is worth noting that in November there was a significant upsurge in producers’ prices for industrial goods: if throughout December 2009 prices growth was 15.5%, in November versus December it was 4.4%, and early next year, this price increase is likely to spread to the consumer market.

Real Sector: Tax Burden Growth

In November 2010, the growth of investment in fixed capital, as well as the demand in the consumer market, which was observed in the previous two months have slowed down. After growth in September and October, industry demonstrates a decline. In November 2010 index of basic economic activities volume amounted to 95.4% against the previous month. The rates of agricultural production have sharply decreased: in November, the volume of production amounted to 67.5% versus the rate of October 2010. Production in mining industry decreased by 2.0% as compared with October, and in the manufacturing industry - by 0.6%. Growth continues in the chemical industry and machinery and equipment. The annual increase in construction in October amounted to 6.3%, in November – by 2.3%, the volume of construction in October amounted to 97.3%. Therefore, in general, the dynamics in production, as before, is defined by the cycle “growth - slowing down”.

Herewith, the November market industrial surveys demonstrate that despite the background of sustained optimism as per results of previous months, the industry is preparing for the complications in view of an increase in the tax burden and inflation acceleration.

Although the initial estimates of demand dynamics demonstrated a zero growth in November, at the background of smoothed seasonal factors (and the expectations of low demand at the beginning of the new year) it becomes evident that the estimates dynamics remains positive. One of the indicators of positive expectations can be regarded a change of policy in respect to the stocks of finished goods: in the previous 5 months the inventory estimates were getting worse and their balance became negative (-11 points), having reached a 10-year minimum, but in November it returned to zero. However, one can not exclude that the growth of surplus stocks is associated with a change in pricing policy and the transition to a more intensive price growth.

Indeed, the greatest concern today is provoked by the acceleration of price growth, which has reached the post-crisis peak in November - selling prices of enterprises have not been growing so intensively since August 2008. According to tentative estimates, companies are willing to continue to raise their prices, apparently even to the detriment of the volume of sales. In November, outpacing price growth against the demand growth was registered in 29% of industrial enterprises, whereas in previous months of 2010 (except for the first months, when inflation reached its peak) such ratio was noted only in 18-22% of enterprises. One could assume that the industry is preparing for the growth rate of insurance contributions (the former UST).

According to the special survey of the Gaidar Institute, conducted in May 2010, increased selling prices will be the most common reaction of businesses to that tax innovation. Such answer was given by 70% of respondents. It seems that companies have already begun proactively to raise prices, reducing the effectiveness of anti-inflationary policy of the government authorities. The second most common response to the growth of insurance contributions should be reduced profits of enterprises, and the third one - reduced staff costs. Indeed, in November in the Russian industry there was registered the highest expected growth in costs over the past 7 years: the balance of this index increased in September-November to 26 points and reached +50. Accordingly, plans to change the number of employees continued to deteriorate: personnel reduction is planned in all sectors, except for timber industry, the most intense - in the construction industry and mechanical engineering.

Dynamics in availability of credits, though increased in November up to the crisis peak, seems to slow down its upward trend. Month by month banks face a greater difficulty to find reliable borrowers in the industry. Positive trend is stopped in regard to interest rates on ruble loans offered to enterprises by the banks. Since September, this indicator can not overcome the rate of 13% per annum for the industry in general. Although in metallurgy loans in November were offered at 10.5%, in chemical industry - at 11.4%, in food industry - at 12.4% per annum.

Therefore, at the background of general instability of the positive developments in the industry within 2010, the tax burden growth in 2011 may provoke new challenges in the economic recovery progress. ●

DECEMBER 2010: POLITICO-ECONOMIC OUTCOMES

S.Zhavoronkov

The front-page news in December 2010 became the mass unrest in Moscow triggered by assassination by a group of migrants from the North Caucasus of a soccer fans' leader Yegor Sviridov. The authorities were compelled to enter into negotiations with the infuriated mob. They subsequently detained a number of the initially released suspects and made a number of reconciliatory statements on the current ethnic challenges and essentially called everyone to order. However, these events exposed the gravity of ethnic tensions and a significant demand for nationalistic ideas. In their televised speeches, Messrs. V. Putin and D. Medvedev in somewhat different way reflected on the Khodorkovsky's case and the national liberal opposition. More specifically, their views ranged from Mr. Putin's sharply negative to Mr. Medvedev's neutral ("wait for the court's verdict" – on Khodorkovsky and "politicians with their own electoral base" – on the opposition leaders) ones. But because of the three-year-long absence of any legislative and cadre decisions, which would evidence political changes, Mr. Medvedev's statements are not perceived of as hallmark ones.

The most notable development in December became the mass unrest on Manezhnaya Square in Moscow on the 11 day of the month. It was the summer of 2002 when Russia's capital saw a similar riot, however, that unrest bore no political hue. At the time, a mob of soccer fans was breaking window glasses and vandalized cars after Russia had been beaten by Japan at the World Cup.

By contrast to the 2002 incident, the recent disorders exposed a clearly ideological sub-text. Late into the night of 6 December, a soccer fan, some Yegor Sviridov, was shot from a traumatic gun and his fellow mate was seriously wounded in a street punch-up. Assassins were a group of young North Caucasians who were detained hotfoot. The man who had left fingerprints on the gun- some Alan Cherkessov - was put behind the bars, while the others were let free. Two days later, soccer fans and groups of nationalists (some 500 people) held an unsanctioned, albeit peaceful, march along Leningradsky avenue and vowed 'actions' on Manezhnaya square. On 11 December, some 10,000 crowded Manezhnaya Square. They broke window glasses, gave the works to some individuals whom they took for migrants from the North Caucasus¹ and clashed with the police and the SWAT. The police forces were clearly incapable to handle the situation, and Mr. V. Kolokoltsev, Moscow police chief, had to enter into negotiations with the rioters. He vowed an objective investigation into the case and detainment of all those who had taken part in the scuffle². Shits with Mr. Kolokoltsev communicating with a balaclava-headed leader of the mob spread through all the media.

Four days later, groups of radical migrants from the North Caucasus announced a retaliatory action, but it failed. On 15 December, the police made some 1,000 pre-emptive detainments of suspicious individuals who resembled soccer fans or Russian or Caucasian nationalists. All the detainees offered no resistance. It was only in the south-west area of the city that a group of ethnic migrants from the North Caucasus rounded on policemen, but they were seized.

On 13 December in the morning, Pres. Medvedev noted that, "...recent events in Moscow – pogroms, assaults on people – should be qualified as crimes, and those who committed them – must be punished". Later, in his interview right before the New Year Pres. Medvedev articulated that, "the police should be reasonable towards those who do not break the law, very reasonable. But those who practice violence, who punch others, who raid the city – there must not be any sentimentality towards them, they should received their dues in full...Such kind of actions will be checked, their participants – seized and, subsequently, if they have committed crimes, and this did take place, they shall face a trial and be sent behind bars".

However, participants in the unrest were seized only under the administrative law ("disobedience to the police's legal demands") and were released shortly thereafter. Several days later, the police

1 As many as thirty-more people got hurt, and seven were put in the hospital

2 Within several days three of them were detained, while another two were put on the wanted list

seized a few people who had assassinated a Kyrgyz citizen in Moscow outskirts on 11 December, but there was no hard evidence they organized the riots or were in one way or another associated with them. In parallel with that, a criminal case was filed against the investigator who had let the suspects go on December 6.

Prime-Minister Putin also reacted to the events on Manezhnaya Square, but accentuated his vision differently. During his “live-TV dialogue” with the country, he said: “It was not the assassination of the ‘Spartak’ fan that sparked the grievous events on Manezhnaya Square, but the authorities’ failure to react to that adequately... Though it does not grant a right to anyone to break the law in turn”. Furthermore, Mr. Putin paid homage to Yegor Sviridov by visiting his tomb and met with representatives of official soccer fan clubs. At the meeting, he emphasized in particular that he believes that Russia’s ethnic diversity is a huge plus, but, at the same time, “...there also exists a danger of ethnic conflicts. That’s a trap in this, and the danger is very serious”. He went on elaborating that there is no land in the Caucasus for those who disrespect the Koran (“I won’t give a penny for one’s life”), which is why residents of the Caucasus should treat with respect traditions in localities wherein they come. If it does not happen, he quite murkily threatened “to improve the registration procedures in large cities”. As a separate issue, Mr. Putin asked soccer fans to stay out of politics and forewarned them that “extremists are keen to stick to them”. Meanwhile, Mr. V. Surkov, Pres. Medvedev’s first deputy chief of staff, accused of the riots the Russian opposition activists who for a year and a half have been rallying on Triumfalnaya Square every 31st day of the month. Notably, the rally on 31 October 2010 was for the first time ever approved, and so was the rally scheduled for 31 December. In all fairness, unlike participants in the December events, the opposition have not ever practiced violence, and every time they cared to submit a formal request to obtain a permit for holding a rally.

The Manezhnaya events stirred a heated debate. Opinions differ greatly: while some views them as fascist rallies, other regard as a provocation orchestrated by the authorities¹, or the civil society’s self-defense against the ethnic crime. In any case, in the course of a public televised discussion in which vigorous participation were the authorities, the subject of ethnic crime in general and the North Caucasian one in particular was legalized, and the taboo was broken. Something similar had been noted in the wake of the Kondopoga events in 2006 and henceforward (in Karagay (the Perm krai), Salsk (Rostov oblast), Stavropol, etc.), but the magnitude of events in Moscow does not allow speculation of individual or unique cases (in parallel with Moscow, fairly large-scale, albeit less mass, actions took place in St. Petersburg and Rostov-on-Don).

While striving for an ultimate conservatism in assessments, it is possible to state the following: the Russian nationalists (who practically positively perceive of all the Slavic ethnic groups and, fairly frequently, many non-Slavic ones, which they consider “complementary” groups) manifested themselves as a serious political force which compels the authorities to launch a dialogue with them. No matter who should be considered organizers of the rally on Manezhnaya Square – whether some political organizations, or nationalistic network structures, or soccer fans’ ones (politization of soccer fans under rightist or ultra-rightist banners is characteristic of many countries, as exemplified by UK, Italy or Hungary, among others), - it was the showcase of their might. The ideological hue of these people ranges from the explicitly Nazi to fairly moderate one. The latter prevailed, otherwise with 10,000 people on Manezhnaya, there would not have been a meager seven hospitalized victims. They also broke the myth about the invincible police (though it had been broken back in 1993, when most of the police simply hid at the critical moment) that keep things under control. Everybody has now realized there is the problem of a specific, anti-social behavior of many residents of the North Caucasian republics in Russia, but neither protesters, nor the authorities have any sound program to address the challenge. It would be good, however, if all this would form a matter for a reasonable public debate.

The last month of 2010 saw another two developments directly associated with public protests: the government commission led by Mr. S. Ivanov, Deputy Prime-Minister, announced that it gave preference to the construction project of a new super highway Moscow-St. Petersburg that would run through the Khimky wood, ie taking the originally approved route. The project has

1 On December 15, among teenagers deliberately making the fascist hailing sign with their right hands in TV cameras were members of the pro-Kremlin youth movement “Ours”.

long stemmed vigorous protests by environmentalists, at-large community, and some politicians. After a mass rally and a concert in defense of the wood in August 2010, Pres. Medvedev ordered to suspend the construction (although two-thirds of the felling had been already made), and protesters calmed down and did not hold any rallies. There existed at least two comparable alternative routes, but they meant holding new tenders, while Mr. A. Rotenberg's structures had won the original ones (though the compensation for the felling is negligible compared with the overall value of the contract). The result was a bizarre sequence of events: first the government commission publicly announced that the project the President had suspended was correct, and the President did not break the silence; then Ms. Natalia Timakova, the Kremlin spokeswoman, for some reason accused Mr. Luzhkov, whose spouse had bought a site on an optional route and, finally, at the end of the month, Mr. Medvedev commented on the above in his TV interview explaining that, "At the end of the day, all ended up in a positive way, in my view, but one had to exercise his powers, suspend the construction, and this is a very bizarre decision... We have listened to the community's voice, but did not kill the project. It (the forest) will grow in its volume, the decision was made to plant five new trees against each chopped one". So, the community's reasoning was ultimately ignored (and the promise that one day, say, in twenty years from now, something will grow there, was stipulated in the initial project outlay). So, in this case it is not clear at all why the construction work was suspended for the purpose other than to deceive the community and stop the protests.

Meanwhile in St Petersburg, the other capital city, a very notorious construction project was canceled - namely, the "Ochta centre". The project foresaw erecting a 400 meter-high skyscraper at the heart of the city. It was "Gazprom" that bought the site for construction and also became an investor in the development works (so far design works, the territory cleaning, and trenching have been underway). In early December, Ms. Valentina Matvienko, the St. Petersburg governor, announced there would be no construction in the planned area (right across the Smolny Cathedral), and in late December she claimed the project would be terminated and the effective permits would be revoked. Gazprom's head Alexey Miller confirmed the information. Perhaps, the secret of the St. Petersburg protesters' success lies in their running non-stop actions for several straight years. But earlier the authorities courted them in the same vein as the Khimky wood defenders (for example, in 2008 Rosokhrankultura lodged a protest against the construction, while it was not completely clear whether it falls under the agency's mandate). *Apropos*, Pres. Medvedev commented on this seemingly popular decision in no less bizarre way: "I am no expert and did not take such decisions. That was the City Hall's decision to first initiate the construction in tandem with Gasprom and then shut it down or move the architectural object to some other location. But I had to go public about it (*though it is not clear from the context about what exactly- S.G.*) to draw a huge attention to it, so that the processes would advance in a more civilized fashion and the community's voice would be heard of. In this respect, the president's voice is fairly strong".

As noted above, in December both Mr. Putin (in the format of a four hour-long "hot-line" interview and Mr. Medvedev (in the format of a televised interview with the editors-in-chief of the federal TV channels) communicated with the people, and, quite unexpectedly, entered into an indirect debate.

Mr. Putin broke the ground with his oration on economic successes (the projected 3.8% growth of GDP and the economy hitting the pre-crisis level already in the first half of 2012) and the emphasis on the government's individual good actions (eg, relief to victims of wildfires and the disaster at Rapskaya coalmine). He elaborated on some of the government's economic ideas and plans: more specifically, he vowed not to introduce a 60 hour-long working week and aggravate the teachers' financial standing (to dissipate concerns stirred by the new law on reforming budget institutions); he also promised to continue to regulate prices of medicines and make sure they decrease, to develop "the small aviation" and the Trans-Siberian railway, and to toughen punishments for violation of traffic laws, to name a few things.

The address also comprised a brief political section, which was voiced in a fairly frivolous and unofficial fashion, with the use of numerous colloquialisms and the style that has long become Mr. Putin's trademark. While referring to M. Khodorkovsky's case, Mr. Putin cited the court's verdict and, at the same time, asserted that, "the thief should be behind bars". He also hinted on Mr. Khodorkovsky's engagement in assassinations, for which one of the ex-tycoon's juniors, a

YUKOS security staffer, A. Pichugin, had been earlier sentenced. It is common knowledge that Mr. Pichugin's case was established following the modern tradition – that is, with no hard evidence and with the use of testimonies of an earlier sentenced to life associate of his. Meanwhile, Mr. Putin enthusiastically narrated about “brains found in a garage”. Mr. Putin informed that he believes that, “The procedure of direct elections should be retained on the municipal level”. In reality, however, such elections are abolished and replaced by appointment of so-called “city managers”¹, as it has already taken place in a good one-third of urban localities and most regional capitals. For instance, at the mayoral elections in regional capital cities in October 2010 it was only two cities where the elections were direct ones, while in other seven cities only city councils were elected. Mr. Putin once again explained Mr. Luzhkov's ousting by his soured relations with Mr. Medvedev, which is not right from the perspective of the subordinate-superior relationship. He also pointed a finger to the major inner enemy. As it might be expected in an authoritarian system, that was the liberal opposition, rather than communists or nationalists. While responding to the question as to what objectives Messrs. B. Nemtsov, V. Ryzhkov and V. Milov pursued, Mr. Putin remarked: “Fortune and power. <They> have been running wild at their time, in the '90s, and steal away, together with Berezovsky and the others who we already spoke about, some billions <in cash>. Now they have been dragged away from the feeder and became flat broken and desperate to get back and replenish their pockets. If we let them do it, they will not stop on several billions, but will sell out the whole Russia”.

As for Mr. Medvedev, his statements on a number of issues (the police reform, the wildfires in the summer of 2010, Mr. Luzhkov's dismissal, the situation in Kuschevskaya, restrictions on traumatic weaponry, problems of strategic nuclear armaments limitation) echoed Mr. Putin's and were not unique in any way. Two questions were likely to be deliberately accentuated: the first one concerned Khodorkovsky. Mr. Medvedev rebuked Mr. Putin: “As President, I think as follows: neither the President, nor any other public official in office has any right to express his stance on this matter or any other case prior to the verdict has been rendered” (though speaking of organizers of the Manezhnaya events the same month, Mr. Medvedev believed they should be deprived of liberty without any trial). The other question concerned the non-parliamentarian opposition in general and the liberal one in particular (Mr. Medvedev, by the way, equaled the latter to the parliamentary parties: “I cannot help but recall such outstanding individuals as heads of factions in our State Duma – they indeed are well-known politicians – no irony, mind you. They have been on the political sky for more than a decade... There also are fairly renowned politicians who are not the Duma members, - such as Mikhail Kasyanov, Boris Nemtsov, Eduard Limonov, Garry Kasparov. They also are public politicians. They face different attitudes. Each of them has his own electoral base”. In this context, it seems rather bizarre, however, that the authorities failed to register new parties of these and other politicians for six years already. There arose another polemic in the interview with regard to the so-called “Bychkov case”². While Mr. Putin limited himself only to following the court of law's judgment of illegality of Mr. Bychkov's activities, Mr. Medvedev showed some sympathy to the convict: “Of course, violence is bad, and it causes anger. Meanwhile, this is the problem of choice: I think the decision should ultimately be taken by the drug addict himself or, perhaps, by his relatives, for otherwise there would be no chance to release him”, ie Mr. Medvedev de-facto backed Mr. Bychkov's standing on drug addicts whom he viewed as legally incapable individuals and demanded release and waiver papers from their relatives.

While assessing Mr. Medvedev's statements, one should first of all proceed from how one conceives of his status. If this is the status of the RF President, his periodically voiced critical comments on Russia's political system were supposed to evoke some legislative modifications as well as cadre decisions with respect to certain staffers in the presidential administration. After the November presidential address, which the national media labeled “*childish*”, as it was full of discourses on

1 Formally, the city manager is picked on the competition basis

2 Mr. Ye. Bychkov, an activist of the “City without drugs” foundation (Nizhny Tagyl) was sentenced to jail (later the sentence was changed for a suspended one) for the illegal deprivation of drug addicts of liberty. Having collected applications from them or their relatives, the foundation staff de-fact isolated drug addicts from narcotics by handcuffing them. No drug addict died, many of them were grateful for the treatment, but some, on the contrary, filed claims to police.

children and comprised just one, fairly ambiguous, political novelty- that is, introduction of party lists at municipal elections, words do not suffice any longer. If Mr. Medvedev's status is merely nominal and in reality does not foresee any adequate political powers, then dozens of other authors, including journalists, opposition activists, philosophers, reflect on democratization in a far more mind-boggling and provocative way than the President. More than this, unlike Mr. Medvedev, they do not engage in bizarre speculations on "referendums with the use of the Internet", while the country has not seen real referendums over the past 17 years. In this case, time works against Mr. Medvedev, as do equivocal phrases, like the one recently dropped by Mr. A. Dvorkovich, his aide: "Judging what I've heard from President Medvedev, he does not rule out the possibility to run for office, and he certainly wishes this".

In December, three much celebrated criminal cases advanced. First, the Moscow city court of law sentenced Mr. A. Bulbov, ex- head of Department for operative provision of the Federal Anti-Narcotics Service, to suspended 3-year sentence for fraud and abuse of office. The closest associate to the once powerful *silovik* A. Cherkesov, ex- head of the FANS and the St. Petersburg branch of the FSB, Mr. Bulbov spent two year behind bars and another year under investigation. Many believe he fell prey to rivalry between different *siloviki* clans.

Meanwhile, up in the North, the Syktyvkar city court sentenced Mr. G. Chekalin, ex-Deputy Prosecutor of the city of Ukhta, to spend 1.5 years in the settlement colony. Back in 2009, he posted on the Internet an address to Pres. Medvedev on practices of falsification of criminal cases in his city. He was subsequently accused of perjuring himself: that is to say, posting a videotaped address to the Russian President is a risky venture, after all.

In the late-December, the Supreme Court of RF left in force a verdict of not guilty the jury had rendered in the case of Mr. V. Kvachkov, ex- *silovik* and presently a radical nationalist, who was brought to trial on charges of assassination attempt against A. Chubais. The case was built on no hard evidence, but his fellow mate's words, who later refused them as given under investigators' pressure. But just a day later, Mr. Kvachkov was detained again following the executive order by the local court of law. Again, behind his detainment was an oral evidence by some person, who accused Mr. Kvachkov of organization of an armed rebellion. So, in December 2010, the national judicial system gave no cause for optimism. ●

INFLATION AND CREDIT AND MONETARY POLICY

N.Luksha

In November, inflation accelerated again: the CPI for the month amounted to 0.8 per cent (0.5 per cent in October 2010). Having stayed for the past six weeks at the level of 0.2 per cent, during the third week of December the weekly inflation rate jumped to 0.3 per cent: therefore, within 20 days of the month, consumer prices rose by 0.7 per cent. Cumulative inflation since the beginning of the year reached 8.4 per cent, rapidly approaching the indicators of the previous year (8.8 per cent). In December, international reserves continued to decline, having reached 478 billion dollars on December 17 (-1 per cent since the beginning of the month). The real effective exchange rate decreased again (-0.9 per cent). In December, the nominal value of the two-currency basket has decreased by 2.3 per cent to RUR 35.11 at December 22.

In November, inflation accelerated from 0.5 per cent in October to 0.8 per cent (see Fig. 1). This was provoked especially by the doubling of food prices growth rate (+1.4 per cent). The largest contribution to rising prices was made, as a month earlier, by sunflower oil (+6.9 per cent), sugar (+4.5 per cent), cereals and beans (+3.6 per cent). Prices for fruit and vegetables ceased to decline, they rose by 4 per cent, and eggs has risen in price by 1,3 per cent. At the same time in November, the price for meat and poultry slightly decreased (-0.1 per cent).

The growth of prices for industrial goods in November made 0.7 per cent. Due to the rising cost of diesel fuel by 8.2 per cent in non-food goods had the utmost increase was noted in prices of petrol (1.3 per cent). Just as quickly the prices for tobacco and knitwear products were growing (by 1 per cent). None of the groups of consumer goods price reduction was observed.

In November, after a two-month pause, prices for commercial services rose by 0.2 per cent. The utmost growth was noted in heating, the rates of which rose by 1.5 per cent. Services of cultural organizations have also increased in price (+0.9 per cent). At the same time, communications and insurance services fell down by 0.2 per cent. As in the previous month, services for foreign tourism and health-care and recreation services became cheaper.

The basic CPI of consumer price index¹ in November 2010 has made 0.7 per cent (versus 0.8 per cent in the relevant period of 2009).

In the first two weeks of December the rate of growth in prices has not changed: the weekly inflation rate remained at 0.2 per cent. However, by the third week, it accelerated to 0.3 per cent. Thus, from the beginning of the month by December 20, consumer prices rose by 0.7 per cent and since the beginning of the year - by 8,4 per cent.

This was not unexpected, since inflation traditionally accelerates in anticipation of Christmas and New Year holidays. Surplus inflationary pressure, in addition to seasonal factors had a food shock after the summer drought and crop failures as well as the accelerating growth of monetary supply (the growth rate of monetary supply in January-October 2010 amounted to 15,3 per cent as compared with 2.8 per cent a year earlier).

The utmost price growth, as before, involved fruit and vegetables (in particular, cabbage (+13.4 per cent) and potatoes (+9.7 per cent), as well as cereals (millet (+9.8 per cent) and buckwheat (+ 9.6 per cent)). According to the Head of the Central Bank S. Ignatiev, the results of December inflation will be 0.8 per cent².

In mid-December, Ministry of Economic Development has raised the official annual inflation forecast from 7.8 per cent to 8.3-8.5 per cent³. Thus, by the 20th of December inflation has already exceeded the lower limit of the new annual estimates growth in consumer prices.

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

2 RBC News (<http://www.rbc.ru/fnews.frame/a/top////////20101020171955.shtml?>), 20.10.2010.

3 RBC News (<http://www.rian.ru/economy/20101215/308994426.html>), 15.12.2010.

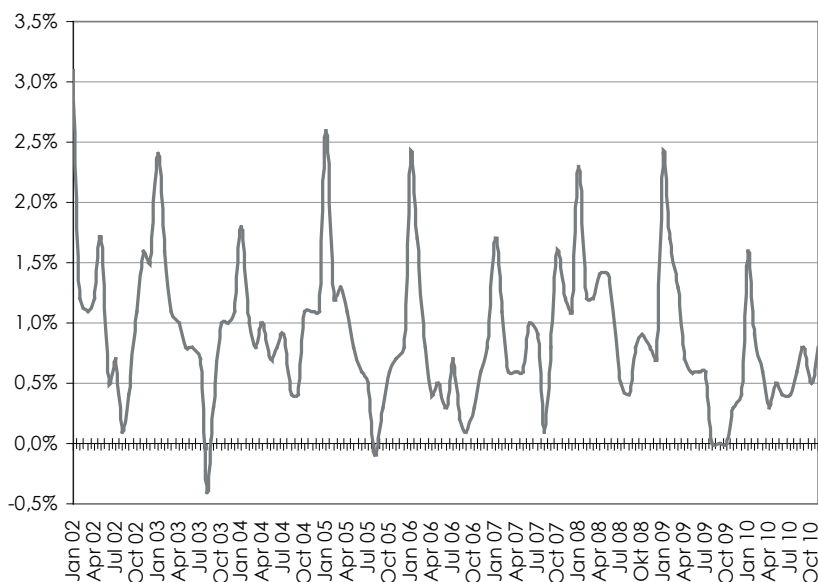
In January 2011 we can expect a seasonal acceleration in inflation. Firstly, in the first month of the year there takes place a traditional tariffs indexing of natural monopolies and municipal utilities, as well as increase in pensions. Secondly, the effect of summer food shock has not been fully exhausted as yet. Thirdly, additional factors in the growth of prices will be contributed by high inflationary expectations, as well as the restoration of the purchasing activity. According to A. Ulyukaev, First Deputy Chairman of the Bank of Russia, a decline in prices can be expected only in the II quarter of 2011¹, when food products inflation would have a less impact on the overall consumer price index than at the end of 2010.

In November, the monetary base in broad definition continued to decrease: as of the month results, it has declined to RUR 6,945.4 bn (-0.2 per cent). Reduction of monetary supply is observed since August 2010. On December 1, cash in circulation with regard to the fund balances in credit organizations has reached RUR 5.1 trillion (+0.9 per cent), correspondent accounts of credit organizations with the Bank of Russia made RUR 599.9 billion (+2.5 per cent), mandatory reserves made RUR 185.7 billion (-0.3 per cent), deposits of the banks with the Bank of Russia made RUR 146.2 bn (decrease by 1.5-fold), the value of shares of the Bank of Russia with credit organizations made RUR 871.1 bn (+0.6 per cent).

In November, the excessive reserves of commercial banks² continued to reduce and reached by the end of the month RUR 1,617.2 bn (-3.4 per cent). This was due to sharp decline in banks' deposits with the Central Bank to 146.2 billion rubles, which is three and a half times lower than at the beginning of the year and almost four and a half times lower than the maximum, reached in July 2010. Continuing decline in excess reserves reflects the recovery of credit activity of banks for which the economy crediting becomes more attractive than funds depositing with the Central Bank. According to the results of 2010 the Central Bank expects growth in lending to non-financial companies at a rate of 12 per cent, and individuals - 13-14 per cent³. According to Sergey Ignatiev, the Head of the Central Bank retail lending continued to grow, but its rate is slowing for the third consecutive month. In November, growth in lending to individuals amounted to 1.7 per cent (regardless the Sberbank)⁴.

In November the growth of the volume of cash in circulation by 0.9 per cent with the simultaneous decrease of mandatory reserves by 0.3 per cent urged the extension of monetary base in narrow definition (cash plus mandatory reserves)⁵ by 0.9 per cent to RUR 5328.2 bn (see Fig. 2).

Starting from mid-October, foreign currency and gold reserves except for insignificant corrections, were reducing. During this period, the reserves scope fell by 5.1 per cent, and from early December they decreased by 1 per cent, amounting to 478 billion dollars on December 17. The main reason for



Source: RF Statistical Service.

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

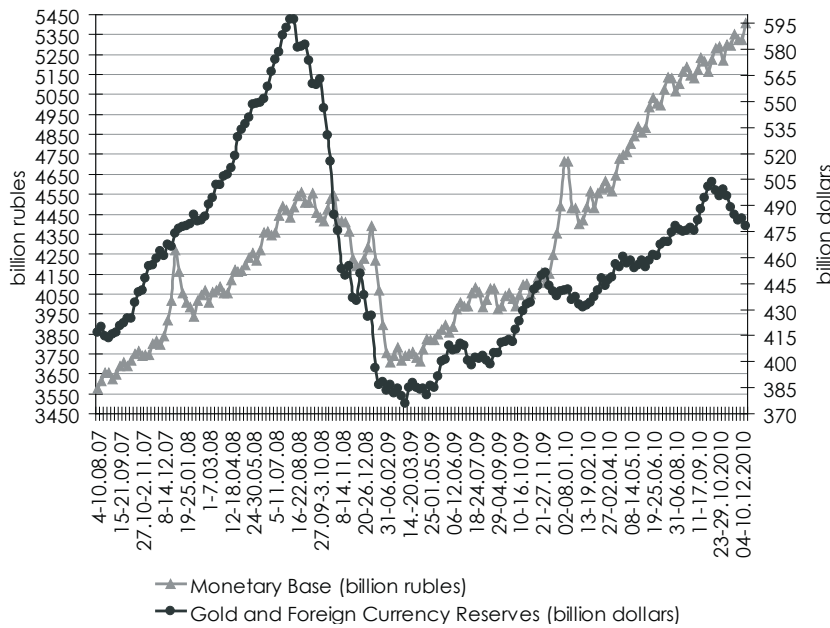
1 RBC News (<http://www.rian.ru/economy/20101201/303109003.html>), 1.12.2010.

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

3 РБК Новости (<http://www.rbc.ru/fnews.frame/a/top/////20101213122229.shtml?>), 13.12.2010.

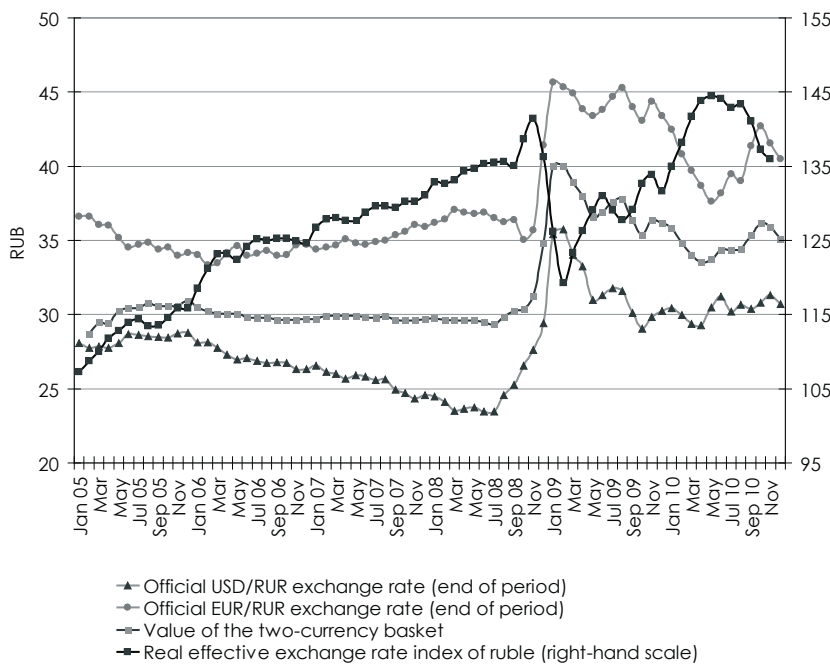
4 Банки не выдерживают темп. // Ведомости, 9.12.2010.

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



Source: RF Central Bank.

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



Source: RF Central Bank, author's estimates.

Fig. 3. Indicators of Ruble Exchange Rate Dynamics within January 2005 – December 2010

dollar rate began to weaken gradually, and within 22 day of December it fell down by 1.9 per cent to 30.72 RUR/USD.

the sharp decline in international reserves began, in the first place, was boosted by capital outflow from the country.

In November, the outflow of capital has accelerated, having reached, according to S, Ignatiev, Head of the Central Bank, 9 billion dollars¹. Therefore, from the beginning of the year it amounted to 29 billion dollars, surpassing the new estimates of the Central Bank for the annual net capital outflow from the country in the amount of USD 22 billion. In the first week of December the outflow continued.

With this in mind, as well as with regard to the expectations of the Central Bank for only small inflows in the last month of the year, the annual forecast of the outflow is likely not to be expected. While in September and October the main sources of the acceleration of capital flight has been the growth of foreign assets with non-profit institutions, in November he was an increase in the banks' foreign assets². In addition, the growth of capital flight has also been linked with illegal withdrawal of capital from the country³.

In November, the real effective exchange rate of ruble continued to decline: as of the month result, it has lost 0.9 per cent. Accordingly, the index of real effective exchange rate for the month fell to 136.03⁴ (see Fig. 3)⁵.

The growth of the dollar rate against ruble, which started from the second week of October, lasted until early December. On December 2, it has reached 31.46 RUR/USD, having returned to the values of mid-June. Then the

1 Новости Infox.ru (http://www.infox.ru/business/finances/2010/12/08/Ottok_kapitala_vvyro.phtml), 8.12.2010.
 2 Ditto.
 3 General Prosecutor's Office stopped the outflow of capital. RBC News, 2.12.2010.
 4 The level of January 2002 is accepted as 100 per cent
 5 The level of January 2002 is accepted as 100 per cent.

In December of European currency rate against the ruble remained volatile. Despite brief periods of growth, the Euro rate was weakening for the second consecutive month. Over 22 days of December Euro fell down by 2.6 per cent, to 40.47 RUR / EURO. The cost of the two-currency basket for the same period decreased by 2.3 per cent, to 35.11 rubles.

Therefore, within three weeks of December the ruble strengthened against the dollar and Euro. Growth rate of the ruble against the currencies of both contributed to, firstly, the high world oil prices (in December, they did not drop below the USD 90 per barrel), and secondly, the active sale of foreign exchange earnings by exporters in anticipation of tax payments by year's end and, thirdly, expectations of an increase in refinancing due to the acceleration of inflation. Similar behavior of the ruble against the dollar and Euro was due to, apparent significant changes in the exchange rate of EUR / USD FOREX. Market.

Since the beginning of the year the European currency has decreased against the ruble by about 7 per cent (similar dynamics of the Euro was demonstrated to the American currency). In contrast, the dollar rate to the ruble, despite significant fluctuations during the year, has grown in January, although less markedly - by 1.8 per cent.

From November 26, 2010, the Board of Directors of the Bank of Russia has once again upheld the refinancing rate and other key rates. We would like to remind, that from June 1, the refinancing rate was set at historic minimum at 7.75 per cent. However, according to S. Ignatiev, Chairman of the Central Bank, in the near future - at the end of December or the first quarter of 2011 - in connection with the acceleration of inflation, the refinancing rate may be upgraded¹. Already, the real refinancing rate is negative and amounts to -0.65 per cent. ●

1 Прайм-Тасс (<http://www.prime-tass.ru/news/0/%7BE177E16F-73F3-4661-BF7A-E190E7815419%7D.uif>), 21.12.2010.

FINANCIAL MARKET¹

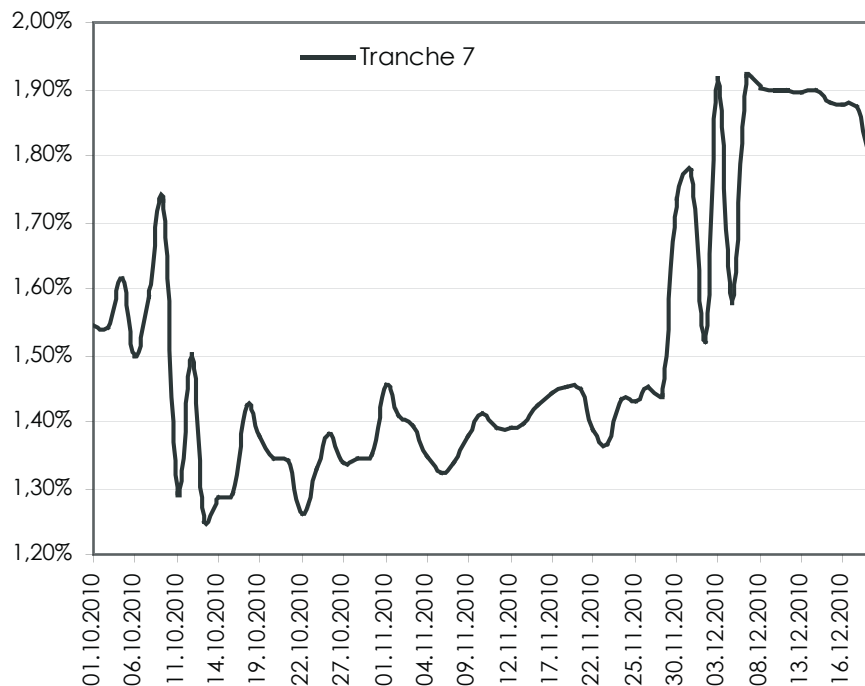
N.Burkova, E.Khudko

In December 2010, an upward dynamics in the Russian financial market was prevailing. Positive financial results of a number of major international and Russian companies, the growth of GDP in the Euro zone, growth in the world oil prices and the sustained key interest rate of the RF Central Bank contributed to the increased activity of market participants in the markets of government securities and corporate bonds in Russia. However, the futures market showed a volatile dynamics. In the domestic corporate bond market December 2010 was a period of relative stability. Key market indicators were recorded at the level of average monthly values: turnover in the secondary market, the average weighted yield, the amount of registered and placed emissions. Among the negative phenomena one should note cancellation of several bond issues of large emitters in view of non-placement of the securities and delay in repayment of some bonds.

Government securities market

A positive external background, increased ruble liquidity, on the one hand, and the volatility of the national currency, rising inflation, the RF Ministry of Finance forecast on deficit of the federal budget by the end of 2010 in the amount of 4.3 per cent of GDP - on the other hand, contributed to the growth of investors interest in the market government securities in December 2010 against the background of generally rising yield dynamics of Russian Eurobonds.

As of December 20 of the current year, the Russian Eurobonds RUS-28 yield to maturity has grown as compared with the level of November 25 from 5.76 to 5.92 per cent per annum (by 2.78 per cent), RUS-18 – from 4.48 to 4.57 per cent per annum (by 1.99 per cent), RUS-30 – from 4.65 to 4.9 per cent per annum (by 5.38 per cent), RUS-20 – from 4.81 to 5.05 per cent (by 11.2 per cent)



Source: "Finmarket" Information Agency data.

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

and RUS-15 from 3.24 to 3.61 per cent (by 4.95 per cent). Herewith, at the beginning of the month a downgrading trend in the yields of Eurobonds was recorded. In the same period, a similar trend was observed in the yields of external currency debt bonds. Thus, the yield to redemption of the seventh tranche of external currency debt bonds has increased from 1.43 to 1.79 per cent per annum (by 25.31 per cent) (see Figs 1-2), demonstrating an expressed growing trend against the background of general volatility.

Within the period from November 26 to December 20 the total turnover of the secondary market of government bonds amounted to approximately RUR 111.28 billion with an

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.

average daily turnover of RUR 6.55 billion (about RUR 96.51 billion with an average daily turnover of RUR 4.2 billion in November), which means a significant increase of an average monthly turnover by 56 per cent.

In the period from November 25 through December 20, there were no auctions for government bonds placement at the primary government bonds market (there were two auctions a month before). However, in the period under review there were three auctions for additional government bonds placement in the secondary market (six auctions a month earlier). Thus, on December 8 there were two auctions for government bonds series 25073 and 25075 for the total volume of RUR 6.54 bn and 12.28 bn; the actual volume of placement made RUR 6.54 bn and 10.34 bn with an average weighted yield of 6.1 and 7.26 per cent per annum accordingly. On December 15 there was an auction on government bonds placement series 26203; the total placement volume was RUR 9.64 bn, the actual volume of placement made RUR 72 with an average weighted yield of 6.4 per cent per annum. Therefore, the total actual volume of placement of the government bonds series in the secondary market for the period under review made 60 per cent of the estimated volume.

As of December 20, the volume of government bonds market made RUR 1,916.63 bn at face value and RUR 1,925.39 bn at the market value (as compared with RUR 1,899.66 bn and RUR 1,911.94 bn accordingly as of November 25). The duration of the government bonds market portfolio was 1,377.06 days, having decreased by 28.38 days as compared with the preceding month (as of November 25).

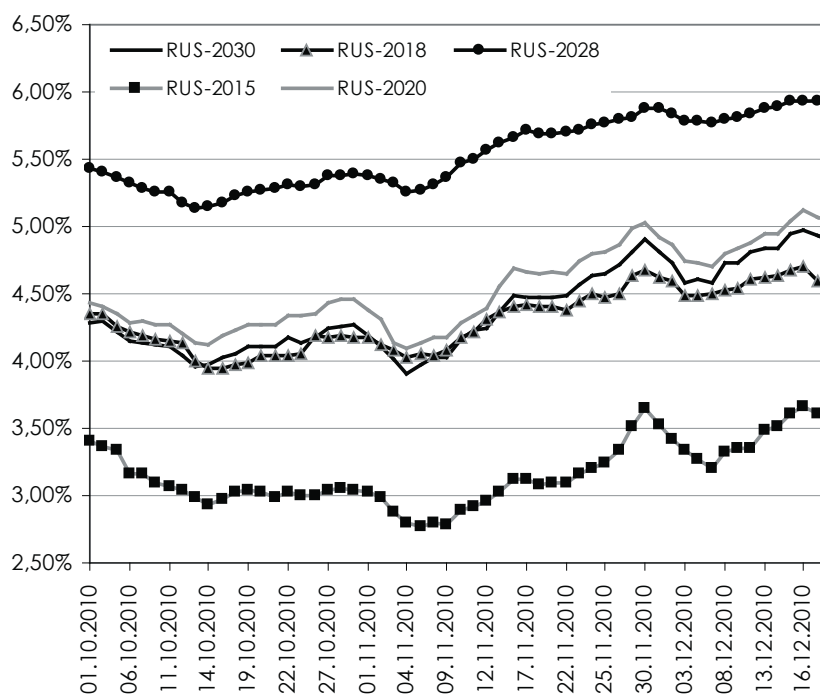
Stock market

Stock market situation

In December 2010, trading volumes in the stock market showed some growth in the market turnover as compared with the previous month at the background of positive financial reporting disclosed by a number of the largest Russian companies for the nine month of 2010, the RF Central Bank sustained refinancing rate at the level of 7.75 per cent, increased estimates of the Ministry of Economy for industrial output growth in 2010 from 7.6 to 8 per cent and oil prices growth.

The maximum value within the month the MICEX index has reached on December 7, having reached – 1,676.41 points (1,594.72 points in the preceding month). The minimum value for the period the MICEX index has reached on December 1 – 1,601.76 points (against 1,526.64 points in the preceding month) (Fig. 3).

In general, within the period from November 26 to December 20, the MICEX index has increased by 5.84 per cent, what makes about 91.8 points in absolute terms (within the year, from December 21, 2009 through December 20, 2010, the MICEX index has been upgraded by 20.7 per cent). Within a month, the turnover of trades in securities included in the MICEX index made about RUR 1,038.73 bn at an average daily turnover of RUR 61.1 bn (against about RUR 1,099.83 bn with an average daily turnover of RUR 47.82 bn in the preceding period). Therefore, the investors' average daily



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 October – December 2010

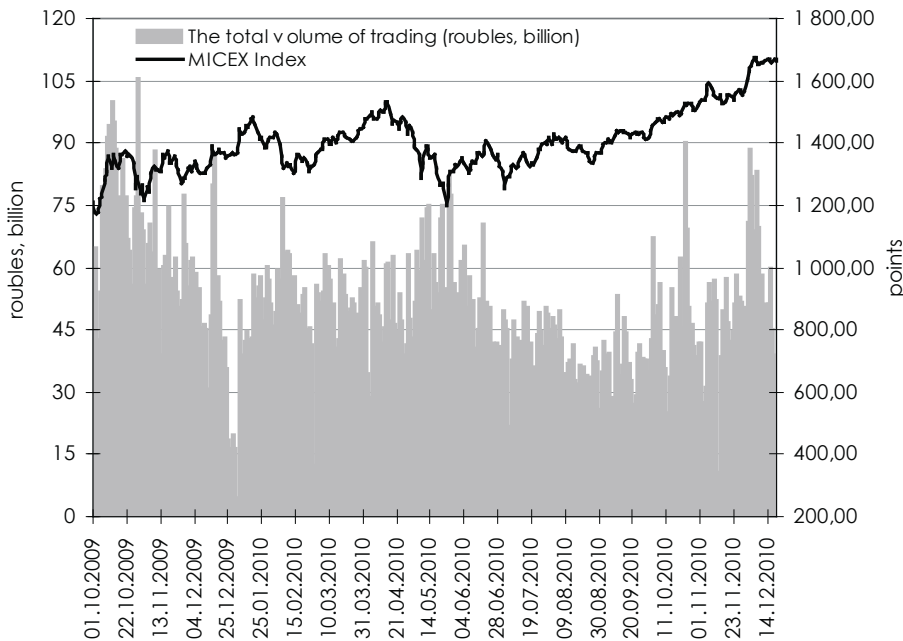


Fig. 3. Dynamics of MICEX Index and trading volume

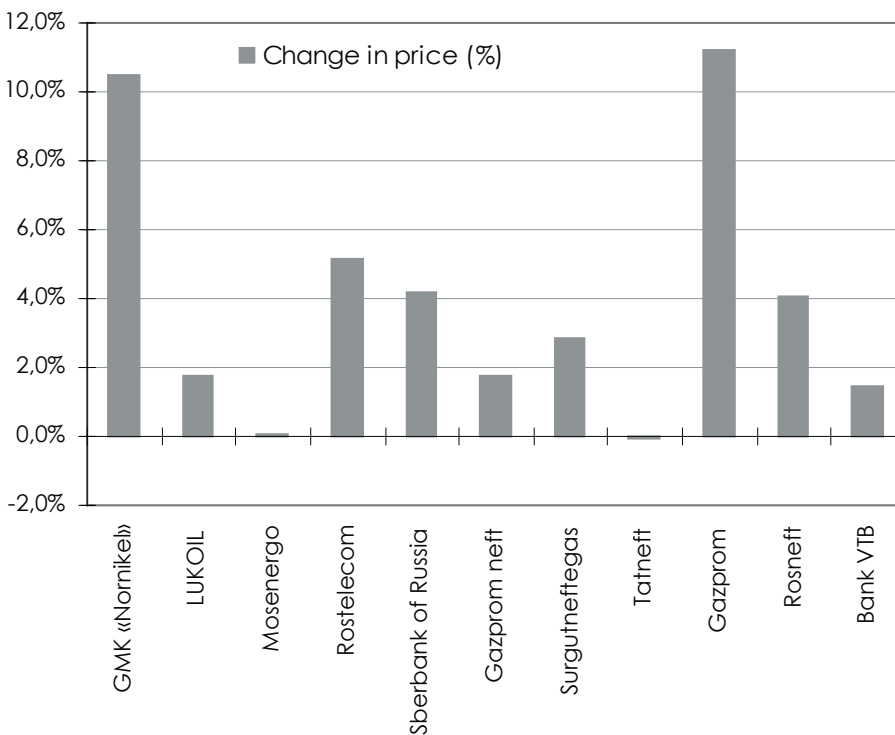


Fig. 4. Dynamics of the Russian Blue Chips from November 26 to December 20, 2010

activity in the stock market in December has decreased as compared with the preceding period by 28 per cent. The indicators of maximum and minimum daily turnover in the market trades made, accordingly, RUR 88.38 bn (as of December 2) and RUR 31.82 bn (on December 20).

As of the month results (from November 25 through December 20), the “blue chips” securities have shown a growing dynamics. The leaders in the growth were Gazprom and GMK Nornickel, having increased by 11.2 and 10.47 per cent, accordingly. They were followed by Rostelecom, increased by 5.16 per cent, Sberbank of Russia (4.18 per cent), Rosneft (+4.07 per cent) and Surgutneftegaz (+2.83 per cent). Significantly lower rates of growth were demonstrated by Gazprom Neft (+1.78 per cent), LUKOIL (+1.73 per cent), VTB Bank (+1.48 per cent) and Mosenergo (+0.06 per cent). A reverse trend was demonstrated by Tatneft securities, which decreased by 0.04 per cent (Fig. 4).

In December of the current year the MICEX turnover leaders were: Sberbank of Russia (29.35 per cent of the total turnover), Gazprom (25 per cent), GMK “Nornickel” (9.11 per cent), LUKOIL (6.39 per cent) and Rosneft (5.1 per cent). The total volume of transactions with

the shares of those five «blue chips» was about 75 per cent (of all «blue chips» - 81 per cent) of the total trades in shares at the MICEX stock market over the period from November 26 through December 20.

According to MICEX information, as of December 20, the top five leaders of the domestic stock market in terms of capitalization were: “Gazprom” – RUR 4,587.45 bn (RUR 4,080.6 bn as of November 25), “Rosneft” – RUR 2,328.74 bn (against RUR 2,264.62 bn), “Sberbank of Russia” - RUR 2,281.31 bn (against RUR 2,202.73 bn), “LUKOIL” - RUR 1,487.72 (against RUR 1,470.51 bn) and GMK Nornickel – RUR 1,279.06 (against 1,165.68 bn rubles).

Futures and Options Market

In December the average daily turnover in the MICEX futures market has decreased by 14 per cent as compared with the preceding month. Thus, in the period from November 26 through December 20 the total turnover in the MICEX (futures) market made approximately RUR 151.92 bn (327.94 thousand of transactions, 3.69 mln of contracts) with an average daily turnover of RUR 8.94 bn against about RUR 239.14 (687.05 thousand of transactions) with an average daily turnover of RUR 10.4 bn in November. The largest volume of trading in December, like a month before, was observed in contracts for futures and equity instruments, amounting to RUR 77.15 billion (313.22 thousand of transactions, 1.62 mln of contracts). Herewith, in terms of the trading volume in this section, the MICEX derivatives market after the settlement of futures contracts for the MICEX index are followed by the futures supply contracts for the shares of Sberbank, Gazprom, Norilsk Nickel and LUKOIL. We would like to note, that the value of the MICEX index (the price of transactions) for March 2011 was at the level of 1,560–1,680 points and for June 2011 – at 1,660 – 1680 points.

The second place in terms of trading volume within the month of December was taken by foreign currency futures (RUR 71.2 bn). Herewith, contracts for the US dollar were in the first place in terms of trading in the MICEX futures market, followed by futures contracts for Euro/USD rate and for Euro/RUR rate. It is worth noting that prices of futures contracts, concluded in December for RUR/USD futures in the MICEX market were within RUR/USD 31–31.8 for March 2011, and RUR/USD 31.3–31.7 for June 2011. Trading volume in futures for commodity assets within the period under review has made 3.57 per cent. There were no contracts for interest rate in December.

Reverse trends were observed in the RTS FORTS futures market, where the investors' average daily activity has increased by 13 per cent as compared with the previous month. Thus, in the period from November 26 through December 20 the total market turnover of futures and options in RTS made about RUR 2,993.74 billion (9.57 million of transactions, 58.43 million of contracts) with the average daily turnover at the level of 176.1 bn as compared with about RUR 3,571.07 billion (11.07 million of transactions, 72.73 million of contracts) with the average daily turnover of RUR 155.26 in November. The greatest demand among the market participants, as before, was demonstrated in futures: trading volume in them during the period under review amounted to RUR 2,800.5 billion (9.32 million of transactions and 55.96 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 latest transactions, concluded in the RTS FORTS on futures contracts RUR/USD rate for the date of execution on March 15, 2011, were within RUR 31–31.8 /USD, and for June 15, 2011 - RUR 31.3–32.1/USD.

The value of futures contract for the RTS index (based on the prices of recent contracts) with the execution date on March 15, 2011 made 1,600–1,750 points and for June 15, 2011 was estimated on average at 1,730–1,750 points. Options enjoyed far less demand, the turnover made about RUR 193.24 bn (237.27 thousand transactions and 2.49 mln of contracts). The maximum daily turnover in the short-term RTS futures market in the period under review made RUR 232.75 billion (as of December 2), and the minimum was RUR 98.18 bn (as of December 20). We would like to note that on December 1 in the FORTS market of futures and options, trades were started for futures in pound sterling /U.S. dollar and Australian dollar/U.S. dollar. And on December 2, RTS has got the best rating as per results of 2010 in nomination the "Best Stock Innovation in Eastern Europe" according to the Futures and Options World magazine.

External factors behind the Russian stock market dynamics

In December 2010 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 December, one should mention:

- European Union's decision on the allocation of Euro 85 billion to Ireland' as financial assistance;

- increase by the European Commission forecast growth of GDP of the euro zone in 2010 from 0.9 to 1.7 per cent;
- increase by the European Commission the forecast of GDP growth of the Euro zone in 2010 from 0.9 to 1.7 per cent;
- growth index of business expectations in November 2010 as compared with the previous month in the Euro zone by 1.5 percentage points up to 105.3 points and in the US - from 60.6 to 62.5 points;
- Global world prices growth;
- preservation of key interest rates by the European central bank at the level of 1 per cent;
- growth of the US GDP in the III quarter of 2010 by 0.4 per cent as compared with the previous quarter;
- German Federal Bank, the Bundesbank increased forecast for GDP growth in Germany in 2010 from 3 to 3.6 per cent;
- International rating agency Standard & Poor's upgraded long-term credit ratings of China's national and foreign currencies from "A +" to "AA-" with "stable" outlook, as well as confirmation of short-term credit ratings of China at 'A-1 + " level.

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

- tense situation between China and South Korea, as well as the conflict between North and South Korea;
- unemployment growth in the Euro area in October 2010 by 0,2 percentage points up to 10.1 per cent per annum in the US in November 2010 - by 0.2 percentage points as compared with the previous month to 9.8 per cent;
- inflation growth in China in November to 5.1 per cent in annual terms (the official assessment for inflation is 3 per cent in 2010);
- federal budget deficit the U.S. in November 2010 in the amount of USD 150 billion;
- reduction by Moody's sovereign credit rating of Ireland' by 5 points - from "Aa2" to "Baa1" rating and Hungary by two points - from «Baa1» to «Baa3» with the "negative" outlook.

All those factors have generally resulted in the increased dynamics of the global stock indices in December, as of the month results. Thus, the markets of the developed countries were demonstrating a general increase in the indices by 1-4 per cent over the month, while the stock indices of the developing markets have grown by 1-7 per cent. The exception was the index of Brazil Bovespa, Singapore Straits Times, Turkey ISE National-100, and China'Shanghai Composite, which have demonstrated a positive trend, like the basic global stock markets indices of the developing countries, demonstrating a downgrading trend by 1-5 per cent on average. Compared to the beginning of January 2010, the majority of stock indices of developed countries, as well as emerging markets have shown a similar volatile trend (See *Table. 1* and *Fig. 5*).

Table 1

DYNAMICS OF THE GLOBAL STOCK INDICES (AS OF DECEMBER 20, 2010)

Index	Ticker	Value	Dynamics within the month(%)*	Dynamics from the year beginning (%)
MICEX (Russia)	MICEXINDEXCF	1 663.11	5.84	21.39
RTS (Russia)	RTSI	1 739.67	7.48	20.42
Dow Jones Industrial (USA)	DJI	11 478.13	2.60	10.07
NASDAQ Composite (USA)	NASD	2 649.56	4.19	16.76
S&P 500 (USA)	SPX	1 247.08	4.07	11.84
FTSE 100 (UK)	FTSE	5 891.61	3.38	8.84
DAX-30 (Germany)	DAX	7 018.60	2.02	17.81
CAC-40 (France)	CAC	3 885.08	3.32	-1.30
Swiss Market (Switzerland)	SSMI	6 521.25	0.29	-0.38
Nikkei-225 (Japan)	NIKKEI	10 216.41	1.36	-3.13
Overpay (Brazil)	BUSP	67 263.60	-3.02	-1.93

Table 1, cont'd

Index	Ticker	Value	Dynamics within the month(%)*	Dynamics from the year beginning (%)
IPC (Mexico)	IPC	37 975.48	2.72	18.23
IPSA (Chile)	IPSA	4 992.94	0.09	39.41
Straits Times (Singapore)	STI	3 132.96	-0.83	8.12
Seoul Composite (South Korea)	KS11	2 020.28	4.80	20.06
ISE National-100 (Turkey)	XU100	63 501.58	-5.43	20.21
BSE 30 (India)	BSE	19 888.88	2.95	13.88
Shanghai Composite (China)	SSEC	2 852.92	-1.56	-12.94
Morgan Stanley Emerging Frontier Markets Index	EFM	880.17	1.10	12.44

* – Versus index indicator valid on November 24, 2010.

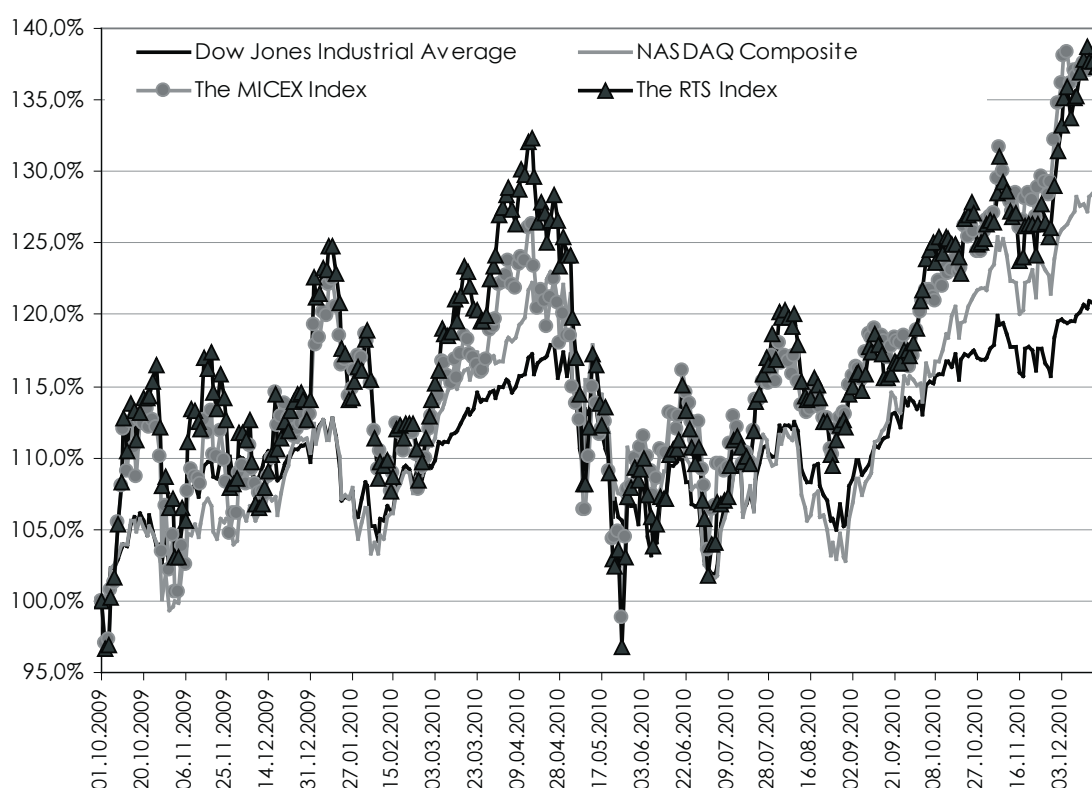


Fig. 5 Dynamics of the main USA and Russian stock indexes (in per cent to the date 01.10.2009)

Corporate news

OAO "VTB Bank"

On December 2, 2010, VTB Bank has disclosed its financial results under IFRS for the first 9 months of 2010: net profit made 38.8 billion rubles. (against net loss of 45.5 billion rubles for the same period in 2009); capital adequacy ratio reached 18.8 per cent. On December 10, VTB Bank has placed in the market of China the bonds issue worth of 1 billion yuan with a fixed coupon rate of 2.95 per cent and maturity in 2013, the share of investors from Asia amounted to about 90 per cent of the amount of emission.

OAO «LUKOIL»

On November 30, OAO «LUKOIL has disclosed its consolidated financial reporting developed under US GAAP for 9 months of 2010: net profit amounted to 6.820 million dollars, which is

29.0 per cent higher than that for the first 9 months of 2009, EBITDA index (earnings before interest, taxes, depreciation and amortization) increased by 17.1 per cent to 11,985 million. On December 16 OAO "LUKOIL" completed the issue of non-subordinated unsecured convertible bonds under 2,625 per cent for 1.5 billion dollars with a maturity in June 2015, proceeds from which will be used for general corporate purposes.

OAO «Mosenergo»

On December 3 Mosenergo has paid the second coupon income under bonds of the 03 series worth of 255.55 million rubles; the amount of payments on one bond made 51.11 rubles. On December 6, 2010 OAO MOSENERGO started its shares' trading in the RTS Standard trading floor. On December 21 OAO MOSENERGO has disclosed unaudited interim consolidated financial statements under IFRS for the first 9 months of 2010: net profit increased by 3,1 times and amounted to 3,398 million rubles., EBITDA rose by 17.4 per cent to 11,671 million rubles .

OAO «Rostelecom»

On December 8 ratings agency Standard & Poor's confirmed long-term credit rating of OAO "Rostelecom" at 'BB' level with stable outlook. On December 13, OAO Rostelecom has disclosed its unaudited consolidated reporting developed under IFRS for the first 9 months of 2010: net profit made 3.3 billion rubles. (the same rate as in 2009).

Sberbank of Russia

On November 26 Sberbank of Russia has raised from HSBC Bank Plc a credit for trade financing in the amount of USD 100 million for one year. On December 14, Sberbank of Russia has signed an agreement on syndicated loan amounting to USD 2 billion for a period of 3 years from 26 banks – participants of the syndicate at a rate of LIBOR + 1.5 per cent per annum. On December 6, the Sberbank of Russia has disclosed a condensed interim consolidated financial statements under IFRS for the first 9 months of 2010: net profit amounted to 109.6 billion rubles. (10.3 billion rubles for the 9 months of 2009), assets grew by 13 per cent to 8,028.7 bn rubles. On Dec. 15 Sberbank of Russia has disclosed its unconsolidated financial reporting developed under RAS for the first 11 months of 2010: net profit amounted to 152.5 billion rubles against 18.5 billion rubles within 11 months of 2009, assets of the bank increased by 15.5 per cent to 8,210 billion rubles.; Russian enterprises were granted credits for more than 3.7 trillion rubles; capital adequacy ratio amounted to 18 per cent. On December 8, Sberbank of Russia concluded a deal valued at 3.4 billion rubles. to acquire 25 per cent +1 share in OAO "Detsky Mir - Center". On December 10 Savings Bank of Russia began selling mutual funds of MC Sberbank.

OAO "Tatneft"

On December 15 OAO Tatneft published its consolidated interim condensed financial statements developed under US GAAP for 9 months of 2010: net profit made 30.37 billion rubles (1.004 billion dollars) against 46.42 billion rubles (1.43 billion dollars) for the first 9 months of 2009, total assets increased from 495.74 billion rubles (16.39 billion U.S. dollars) on December 31, 2009 to 559.44 billion rubles (18.4 billion dollars) on September 30, 2010.

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 December 2010 continued its growth and at the end of the month made RUR 2,791.6 bn, which exceeds the relevant indicator of preceding month by 1.4 per cent¹. The growth of the market, like in preceding month is based on the growing number of bond emissions in circulation, denominated in national currency (from 708 to 714). However, the number of emitters has declined (from 363 to 357). Such interest in bond loans on the part of issuers and investors proves an increase in the average number of issues per emitter. There is still one emission of bonds in circulation, denominated in US dollars and one in Japanese yens.

1 As per Rusbonds information

In December 2010 indicators of the secondary market of corporate bonds has somewhat declined as compared with preceding month. Thus, the trading volume in corporate bonds in the MICEX market in the period from November 26 through December 20 amounted to RUR 100.3 billion (for comparison, in the period from October 25 to November 25 it was equal to RUR 124.7 billion), and the number of transactions with corporate bonds in the period under review made 21 thousand (as compared with 25 thousand transactions in preceding month)¹. Nevertheless, these figures are at the average monthly indicators since the beginning of this year.

In December index of the Russian corporate bonds market IFX-Cbonds demonstrated a slight upward trend – less than 0.6 point from November 24 to December 23 (by 0.2 per cent). Effective yield for the second consecutive month showed an increase from 7.27 per cent at the end of November to 7.51 percentage points at the end of December (*Fig. 6*). However, since June of the current year its level varies from about 7.1 per cent to 7.6 per cent. The relative stabilization of the weighted average effective yield of corporate bonds, in our view, can be explained by two interrelated factors: the inflation rate and the level of refinancing. On the one hand, already in the III quarter of 2010 experts estimated the annual inflation rate at approximately 7.5-8 per cent, which probably stopped the steady decline in yields on corporate bonds, observed with the I quarter of 2009. Indirect connection between the two indicators confirms the relatively high correlation ration between the monthly CPI and the yield of corporate bonds at the end of the relevant month (from January 2009 to December 2010 the ratio was equal to 0.56. If reviewed over a short period - from January in December 2010, the correlation increased – the ration is 0.63). On the other hand, the Central Bank retains the refinancing rate unchanged from June this year at 7.75 per cent.

A slight increase in yield can be attributed to the decline in portfolio duration of corporate bonds over a month this indicator fell by a further 17 days to 588 days, which was a continuation of the trend of recent months.

The most liquid bond issues in this period demonstrated the growing dynamics of the average weighted yield. The maximum growth from November 26 to December 20, 2010 was recorded for the bonds emissions of the major financial institutions: Bank “AK Bars” (OAO), OAO Gazprombank, OAO “NOMOS-BANK”, CB Petrokommerts (OAO) (on some bond issues increase in the yield reached from 0.5 to 1.0 percentage points) and leaders of the growth yield bonds were series 02 of CB Renaissance Capital (OOO) (+1.96 p.p.) and series 05 of Bank Zenit (+1.57 p.p.), while the yield of bonds of the Bank Zenith is rapidly growing for second consecutive month². There was also recorded substantial increase in bond yield of real sector companies, including: OAO Mechel (series BO-2 +1.01 p.p. and series 04 +0.79 points), OAO “Russian Railways” (Series 12 +0.55 percentage points), OAO LUKOIL (Series 03 +0.52 percentage points), AFC “Sistema” (OAO) (series 02 +.52 p.p.) OAO “Gazprom” (Series 13 + 0.51 pp). Leaders of decline in the yield were securities of OAO “Russian Railways” (series 13 -1.94 percentage points), OAO “Petrocommerce” (series 04 -1.80 p.p.). Also, a significant reduction in the bonds average weighted yield were energy companies (in particular, OAO “Federal Network Company of Unified Energy Systems”, OAO “Territorial generating company № 9”, OAO “Moscow Regional Electricity Company”).

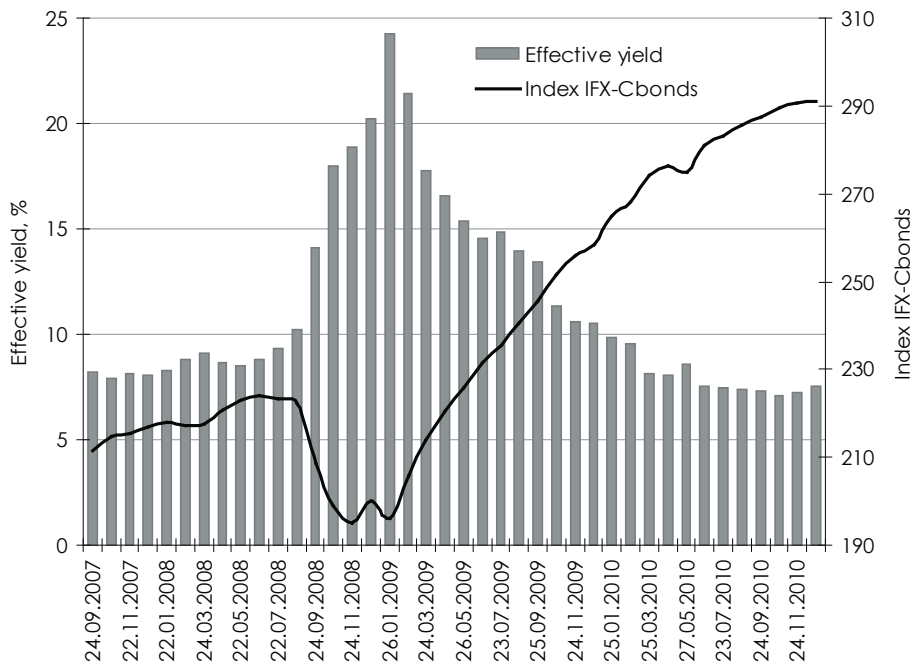
In December of this year, there were significantly more bond issues as compared with the previous month. Thus, from November 25 to December 23, 16 emitters have registered 42 bond issues totaling to 169.5 billion rubles, the majority of whom are, like in all recent months, exchange bonds (for comparison, in the period from October 25 to November 25 13 emitters registered 27 bond issues totaling 77.7 billion rubles). During the reporting period there were a lot of debut bond issues, made mainly by financial institutions. The major amount of issues was registered in 3 series of GC “Rosnanotech” bonds for the total volume at face value of 33 billion rubles, 3 series of MegaFon-Finance bonds for 30 billion rubles., 7 series of exchange bonds of OOO “Home Credit and Finance Bank” for the amount of 28 billion rubles., 4 series of OAO “Alfa-Bank” bonds for 20 billion rubles.³

Indicators of primary bond market showed a volatile trend: the total volume of registered issues had fallen by nearly 2-fold (from November 25 to December 23, the amount of placed issues was

1 As per “Finmarket” Information agency.

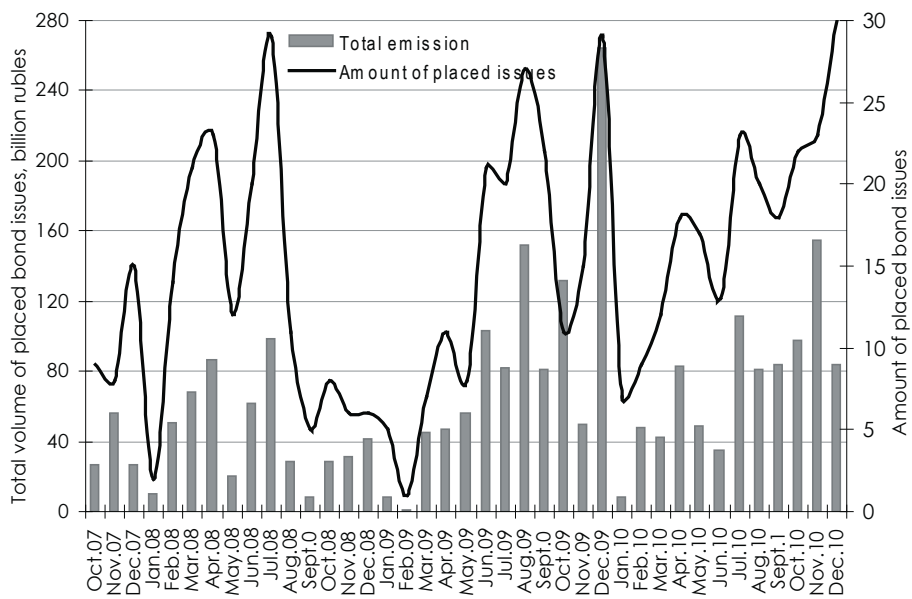
2 Source: Rusbonds data.

3 Source: Rusbonds data.



Source: Rusbonds data

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



Source: Rusbonds data

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

83.6 billion rubles against 155 billion rubles at the end of October - November), and the number of placed issues increased significantly (in the period under review 30 issues of bonds were placed, whereas in the previous period there were 23 issue). Such dynamics is due to the fact that in the second half of this year there were a lot of bond issues of small amounts, as the emitters wanted to place issues on the Stock Exchange before the end of the year. Nevertheless, the aggregate amount of outstanding bonds remained at the level of the average monthly value since the beginning of the year (Fig. 7). During the period under review, the largest bond issues were placed by OAO "Raiffeisenbank" (two series of stock bonds for the total amount of 15 billion rubles.), by OAO "Gazprombank" (one series of stock bonds worth 10 billion rubles.) and OAO "Agency for Housing Mortgage Lending" (one series of bonds amounting to 8 billion rubles.). After a series of successful placements of long-term bonds in recent months, in December, were mainly placed the traditional 3-5-year bonds, and even more short-term issues with maturity term of 1-1.5 years. The exception was OAO "Scientific Production Corporation "Dzerzhinsky Uralvagonzavod", which has placed bonds with maturity of 7 years.

In late November, Russian Federal Financial Markets Service has canceled seven issues of bonds of Nuclear Power Complex", one bond issue of OAO "VTB-Leasing Finance", and one bond issue of OAO "UTair-Finance" as a result of non-placement of any bonds, although over six months the Service canceled only a few bond issues¹.

1 Data of the Russian Federal Financial Markets Service

In the period from November 25 to December 23, twenty four bond issues were to be redeemed (for the total nominal value of 71.8 billion rubles), but seven issuers have announced a technical default on redemption of their bonds with the total nominal value of 6.7 billion rubles. This has become a negative signal to investors in the debt market since in the last 3-4 months all emitters performed their obligations as scheduled. In January 2011, 13 corporate bond issues totaling to 6.1 billion rubles were expected to be redeemed¹.

The situation with the performance of current debt liabilities by emitters was still not easy: from November 25 to December 23, the real default on bonds coupon yield redemption was announced by six emitters (against three emitters from October 26 through November 24). One emitter managed to reach agreement with the bondholders to restructure the debt. An offer (bonds purchase) was carried out by all emitters in due time or in the framework of technical default². ●

1 Rusbonds data.
2 Cbonds data

REAL ECONOMY SECTOR: TRENDS AND FACTORS

O.Izryadnova

In October-November 2010 macroeconomic situation has aggravated. In November 2010 investments in fixed assets and demand at consumer market, which were observed to grow in two preceding months, became stagnant, export growth rates slowed down and agriculture production indices dropped sharply. Growth rates in industry stabilizing, in November 2010 volumes of processing industries production lowered by 0.4% versus October figures. As a result index of physical volume for the basic types of economic activities made 95.4% in November 2010 versus the level of the previous month. According to estimations of the Ministry for Economic Development, as a result of the year GDP will grow by 3.8%, prices – by 8.5%.

Throughout the whole 2010 the macroeconomic situation was characterized by unsteady dynamics of main indices. In the 3rd quarter 2010 GDP growth rates slowed down to 2.7% on the corresponding period of 2009 versus 5.2% in the 2nd quarter and 3.1% in the 1st quarter of the current year. The slackening of the GDP dynamics in the 3rd quarter 2010 is connected with the structural features of the economic growth. Whereas in the first six months of 2010 the recovery of investments in fixed assets positive dynamics and the increase in the retail trade turnover contributed into acceleration of GDP growth rates, in the 3rd quarter the slowdown of industrial production growth rates and the drop in agricultural production volumes had a prevailing influence. In the 1st half of 2010 the production index in agriculture made 102.9%, whereas in the 3rd quarter the drop of 18.6% versus the corresponding period of 2009 was observed.

Slowdown of economic growth rates in the crisis environment of 2008-2009 was accompanied by the simultaneous reduction of both the internal and the external demand. The change in the situation in the 4th quarter 2009 - 1st quarter 2010 was driven by the dynamic growth of export, whereas in the 1st half of 2010 – by the recovery of positive dynamics at the internal market. In the 1st half of 2010 the internal market expanded by 3.8% export growing by 10.8% versus the corresponding period of 2009. In the 1st half of 2010 thee domestic production for internal consumption stabilized at the level of the previous year and as a result the trend towards the increase of the import share in the retail trade turnover and investment expenses has become more prominent. The proportion of import in retail trade resources throughout 2010 increased systematically and made 47% by the 3rd quarter.

In October-November 2010 the situation in the Russian economy aggravated. The growth of the investments in fixed assets in August-October 2010 together with the stoppage of consumer demand contraction process did not compensate for the negative influence of the agriculture production drop and slackening of foreign trade dynamics. In November 2010, same as during the crisis, the activity at the investment and consumer markets dropped again. Besides, the dynamic growth of industrial production in August-October, in November 2010 became stable, negative dynamics in processing production becoming worrying. In November agriculture production volumes made 67.5% of the figure of October 2010. As a result, physical volumes index for the basic types of economic activities made 95.9% in October 2010 on the level of the previous month, and 95.4% - in November 2010.

In 2009-2010 the demand at the internal market was supported by the redistribution of incomes from enterprises to population. The proportion of labor remuneration in GDP made 51.9% in the first half of 2010, which roughly corresponds to the figure of 2009. The comparison of the dynamics of population employment, labor remuneration and GDP reveals that anticipating growth of wages versus labor efficiency has increased the load on the economy.

The improvement of the enterprises' financial situation that started in the second half of 2009 continued in 2010. According to live data in January-September 2010 positive finance balance of organizations' activity was observed of RUR 4305.5 billion, which is by 51.7% above the

corresponding figure for the previous year. In 2010 the dynamics of financial results of enterprises and organizations' activity was determined by the production growth in nearly all types of economic activity. Profitability of sold goods, production and services as a result of January-September 2010 made 11.6%. The drop of production and other negative phenomena in different types of activities were not comparable and, consequently, the development processes in 2010 went on unevenly and each of them had specific features. It was minerals extraction that was the most profitable type of activity in January-September 2010.

Thanks to favorable situation at the world market of energy carriers, as a result of January-September 2010 the minerals extracting enterprises got positive financial balance of RUR 959.4 billion, which is 45% above the corresponding figure of the previous year. The financial situation at enterprises of processing industries has somewhat improved: in January-September 2010 positive balanced financial result of this sector producers made RUR 1134.6 billion, which is by 59.7% above the previous year figure over the corresponding period.

The business activity dynamics in the construction sector being unstable, as a result of January-September 2010 positive financial balance of construction sector enterprises made RUR 49.7 billion or only 80.7% on the corresponding figure of 2009.

Abnormal nature and climate conditions had a negative effect on the agriculture production and, consequently, on the financial results of agriculture organizations activity. As a result of January-September positive financial result in the agriculture made RUR 54.9 billion, which is by 12.5% below the corresponding figure of 2009. The figure of agriculture organizations' losses went up by 84% as compared with January-September 2009.

Table 1

PROFITABILITY OF SOLD ORGANIZATIONS' GOODS, PRODUCTION, SERVICES AND ASSETS AS
BROKEN BY TYPES OF ECONOMIC ACTIVITY IN JANUARY-SEPTEMBER 2008-2010,
AS PERCENTAGE

	Profitability of sold goods, production, works and services			Assets profitability			For reference		
							January- September 2010 versus January- September 2009		September 2010 versus December 2009
	2008	2009	2010	2008	2009	2010	Financial result	Physical volume	Prices index
Total	15.8	11.2	11.6	6.8	3.8	5.1	152.6	104.8	
including:									
agriculture, hunting and forestry	15.0	11.4	12.2	4.5	2.9	2.5	90.7	89.3	108.3
fishing, fish breeding	10.7	25.9	25.0	4.8	13.0	12.5	121.5	90.0	
minerals extraction	36.2	31.3	32.8	14.6	8.5	10.4	145.0	104.2	101.8
processing industries	20.6	12.3	14.4	12.1	3.9	6.0	159.7	112.6	110.5
electricity, gas and water production and distribution	3.6	7.3	6.9	0.6	2.9	3.6	140.7	105.1	113.6
construction	5.6	5.0	4.1	2.6	1.5	1.2	80.9	99.2	107.3
wholesale and retail trade; repair of motor vehicles, motorcycles, household items and items personal use	11.3	7.0	8.3	7.0	3.6	5.7	169.9	104.4	106.2
transportation and communication	16.4	15.8	15.0	5.0	3.9	3.7	115.8		145.0

Source: Federal State Statistics Service

92% of the employed are comprised of wage earners; consequently, the problems of labor remuneration and population employment were of primarily importance. As compared with 2009,

in 2010 the number of the employed in the economy rose by 0.7 million and made 71.1 million. As a result of the 3rd quarter 2010 the level of unemployment dropped to 6.6% versus 8.8% in the 1st quarter, the total number of the unemployed calculated by ILO methodology made 5.3 million versus 6.1 million a year ago. The number of unemployed registered in the state employment agencies contracted to 1.7 million and the level of the registered unemployment made 2.0% versus 3.0% at the beginning of 2010. The improvement of the situation in the economy was accompanied by a steady trend towards the reduction in the number of employed who were transferred to part-time work regime, put on mandatory leaves and stayed idle from 1.6 million in January 2010 to 0.9 million in November 2010. Tension coefficient (number of the unemployed registered in the state employment agencies per 1000 vacant positions) lowered from 310.6 in January 2010 to 149.0 in November.

In January-November 2010 index of industrial production made 108.4% as compared with the corresponding period of the previous year, being 103.7% in minerals extraction and 112.1% in processing industries. In November 2010 production in processing industries reduced by 0.6% and in extractive industries – by 2.0% versus the previous month.

The dynamics of processing industries is considerably differentiated by types of economic activities, the ratio of investment and consumer goods production growth rates having the biggest influence. The dynamics of machine-building production output was a factor driving the changes in business activity of the adjacent production of construction materials and other types of intermediate goods output. In 2010 the dynamics of machine-building industry became positive. In January-November machinery and equipment production went up by 11.5% versus the corresponding figure of the previous year, electric, electronic and optical equipment production – by 23.7%, transport vehicles and equipment production - decreased by 32.0%. It could be noted that the production of transport vehicles alone increased by 4.1%, which is mainly due to the fulfillment of government anti-crisis program that included measures aimed at internal demand maintenance, for instance, utilization programs, as well as instruments to guarantee support for producers and regulation of import duty rates for motor transport vehicles.

In 2009 the total sum of the additional anti-crisis support for automobile industry and farm machinery building made RUR 90 billion (24.1% of the total support for the real sector), of which RUR 39 billion was allocated from the federal budget. In 2010 federal budget funds for fulfillment of immediate anti-crisis measures made RUR 34.55 billion; it should be noted that they were directed both for the continuation of the programs that were started last year and for the development of new programs connected with motor vehicles utilization.

The analysis of the main trends allows drawing conclusion that although in 2010 the Russian economy recovered from the acute phase of the crisis, the development prospects in short term are limited due to unsteady dynamics of macroeconomic indices, low indicators of investment and crediting spheres, complicated situation at the labor market. ●

RUSSIAN INDUSTRIAL SECTOR IN NOVEMBER 2010

S.Tsukhlo

The first data of the November Gaidar Institute surveys¹ mirror positive developments, with a series of negative factors still in place, so far as the industrial dynamic is concerned. The indicators of demand and output continued their growth, and their forecasts still are at their highs in the crisis period. Changes in assessments of finished product inventories, perhaps, speak for the corporations gearing up for a larger-scale rise in demand. However, the price rise acceleration and anticipation of an intense growth in costs (most likely due to increased insurance contributions) should have an adverse impact on sales dynamics. The positive dynamic of availability of loans was losing momentum.

Demand for Industrial Products

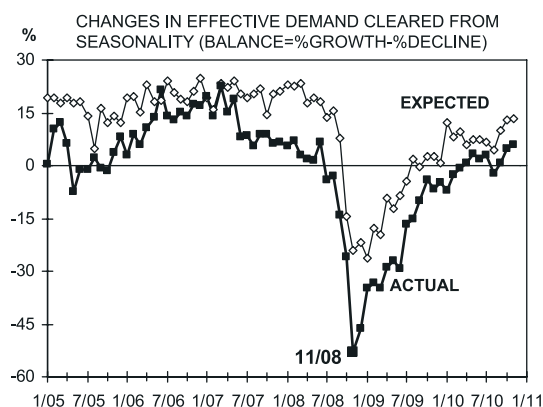
Original (inclusive of seasonality) data on the dynamic of demand still display zero growth, i.e. the share of responses on rise in sales equals the one of reports on its decline. Such a situation has been in place for the fourth straight month. However, once cleared from seasonality and the calendar factor, the growth rate in sales gains a positive value: demand is on the rise, with its growth rates in October and November being record-breaking over the current crisis period (*Graph 1*).

A similar situation is noted with regard to projections of sales. On the eve of the New Year holidays, corporations anticipate sales of their products to fall – the phenomenon to which manufacturers, consumers, and analysts alike have grown accustomed already. But once cleared from seasonality, the industrial sector displays a record-breaking for the crisis period level of optimism in their forecasts of demand.

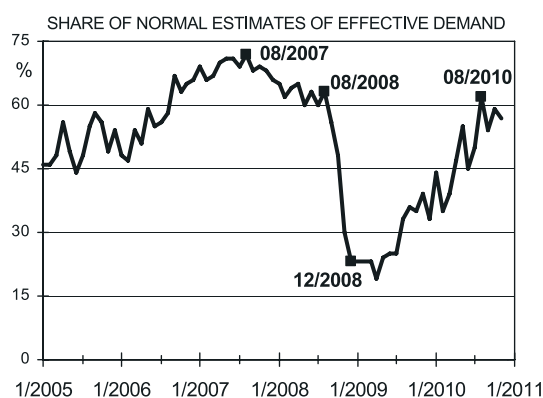
The positive dynamics of actual sales and forecasts stabilized demand satisfaction assessments. After reaching a peak 62% in August, fluctuations of the share of normal estimates of sales have been fading gradually and now entrenched at the level of 58% (*Graph 2*). The highest rates of satisfaction with sales between September and November were noted in metallurgy (76%), the chemical industry (72%), and forestry (70%). On the opposite pole sits the construction sector (38%) and the machine-engineering one (43%). It looks like there begins to emerge stability in the industrial sector, so far as assessments of the current state of affairs are concerned.

Finished Products Inventories

In November, corporations may have refrained from minimizing their finished goods inventories and once again switched to maintaining their reasonable surplus (*Graph 3*). During the 5 past months, the share of assessments “below norm” has been rising slowly but steadily at the expense of

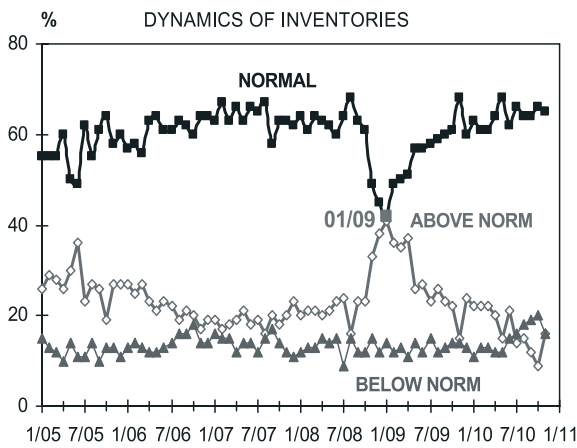


Graph 1



Graph 2

1 The Gaidar Institute has run monthly surveys on corporate heads by the European harmonized methodology since September 1992. The surveys cover the whole territory of the Russian Federation. The panel size is some 1,100 corporations that employ over 15% of industrial labor. The panel is biased towards large corporations by each individual sub-sector, with the questionnaire return rate making up 65–70%.

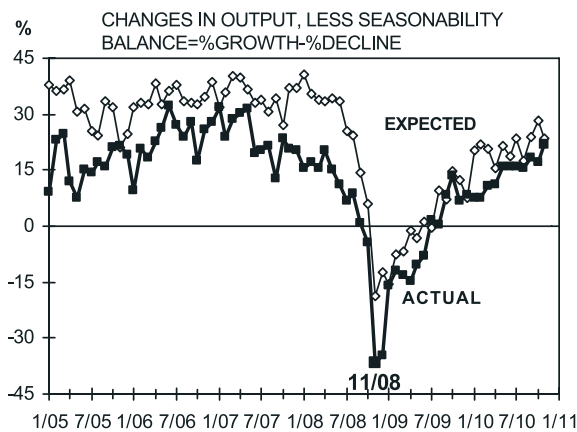


Graph 3

the industrial sector has grown confident it would soon exit the crisis. However, it cannot be ruled out that the upsurge in the inventories in question is associated with refusal of a conservative price policy and transition (perhaps, a compulsory one) to a more intense price rise.

An analysis of responses on the microlevel shows that most enterprises that changed their finished goods inventories between October and November have transited from the level “normal” to the “above norm” one. The change of assessments from “below norm” to “normal” has so far come off second best.

Output

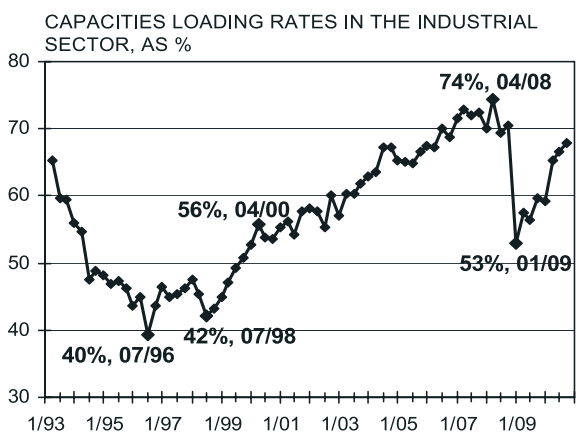


Graph 4

the falling share of “above norm” responses. As a result, the balance of estimates of finished goods inventories became negative and slid to its 10-year lows. The industrial sector was clearly losing confidence in a swift renewal of demand and minimized its finished products inventories designated to promptly meet new customers’ demand. Such a policy is a reminiscence of the ‘90s, with its heyday falling on the period after the August 1998 crisis, when the growing demand and the absence of confidence in sustainability of the post-default renewal sent the balance of inventories estimates down to record-breaking -25...-21 points in late-1998.

After -11 points registered in October, the balance became zero in November 2010. Should the trend be in place over the months to come, it might be ascertained

Cleared from seasonality, data on the actual output dynamic demonstrates a rise in the output growth rate by another several balance points and the indicator hitting yet another crisis-period highs. All industries reported a continued growth in output, with the highest rates registered in the chemical and metallurgical sectors. Before the New Year holidays, the original plans of output had undergone a serious negative adjustment, which was smoothed down by the seasonality clearance. As a result, the planned growth rate in output remained one of the highest ones over the current crisis period, with the ferrous metallurgy and the chemical sector nurturing the most optimistic plans (Graph 4).



Graph 5

The production capacities loading rate evidences growth in the intensity of use of machinery and equipment in the industrial sector. In Q4 2010, the indicator soared to 68% and hit the end-2005 level (Graph 5). However, the loading rate has increased only by meager 3 percentage points since Q2 2010. The capacity redundancy assessments remained unchanged over the period in question, either – it is for the third straight quarter that the industrial sector reports some 13% overhang of excessive relative to the envisaged demand equipment. Meanwhile, 71% of corporations believe their capacity sufficiency rate is adequate, so far as a possible rise in demand for their output is concerned. The latter indicator has already hit its pre-crisis level.

Producer Prices

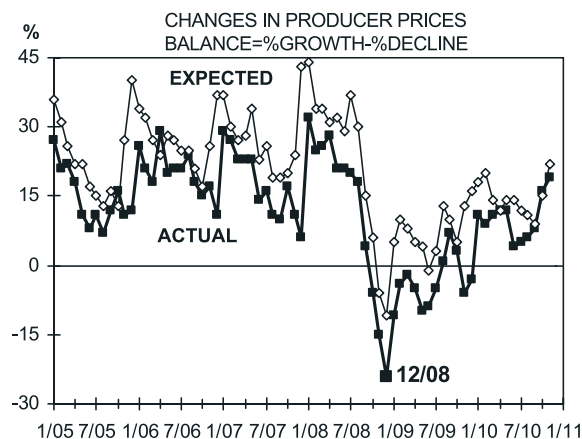
In November, the price rise rate gained another few points and hit the crisis-period high – producer prices have not risen at such a pace since August 2008 (*Graph 6*). After a moderate price rise between June and September the industrial sector demonstrated their record-breaking growth for the second month in a row. Corporate forecasts suggest that enterprises are ready to raise their prices further on, most likely to the detriment of sales volumes. The growth rates in sales, indeed, still appear negligible and do not form a sufficient footing for the industrial sector to demonstrate its market might. Furthermore, a comparison of changes in demand with those in prices allows ascertaining that it already was 29% of enterprises that reported an advanced price rise vs. growth in demand in November, while in the previous months (except for the first, most inflationary ones) of 2010 such a ratio was reported only by 18-22% of corporations.

The traditional January price and tariff spikes should occur only within next 1.5-2 months (relative to the period of the issue under consideration). There only remains for us to assume that the industrial sector is gearing up for the growth in the insurance contributions tariff (ex-UST). According to results of a special survey the Gaidar Institute ran in May 2010, price increases should form the most widespread corporations' reaction to the tax novelty in question – as many as 70% of respondents were going to do this. It looks like enterprises have already begun raising prices in anticipation of the novelty, thus lowering efficiency of the government's anti-inflationary policy. The second most widespread reaction to the increase in insurance payments should become a fall in corporate profits, while the third one – a drop in social spending.

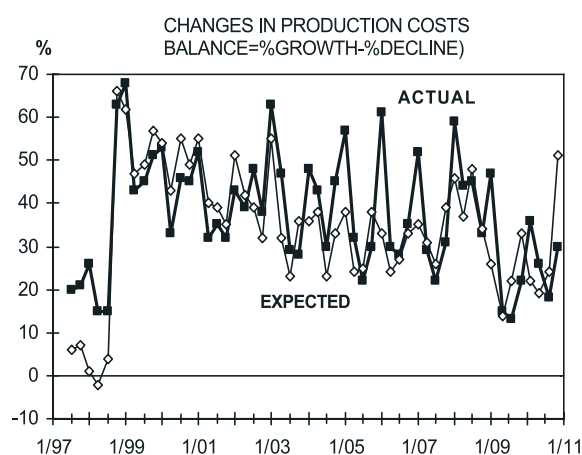
The acceleration of the actual price rise rate and the strive to keep it are backed by forecasts of increase in costs. In November, the national industrial sector reported the highest projected increase in costs over the past 7 years. The balance of the indicator in question rose by 26 points between September and November and hit +50 (*Graph 7*).

Actual Lay-Off Dynamic and Plans

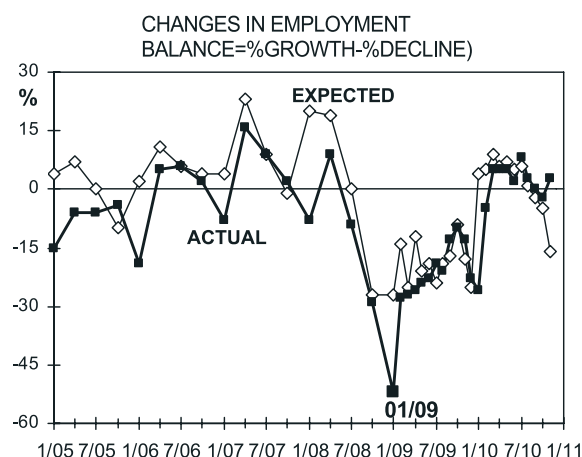
In November, the industrial sector did not contribute to aggravation of the general situation on the labor market. The employment growth rate did not slid to negative values over the month, as it may have expected basing on the October forecasts – it stayed in the zero zone, which shows discontinuation of employment, but does not speak for a start of notable lay-offs (*Graph 8*). It looks like corporations have not shaped their HR policy as yet. The absence of a positive dynamic of sales adds to the general uncertainty. In Q2 2010 the industrial sector ridded itself (as a result of lay-offs and growing hopes for rise in demand) of the overhang of excessive workforce, while explicitly



Graph 6



Graph 7

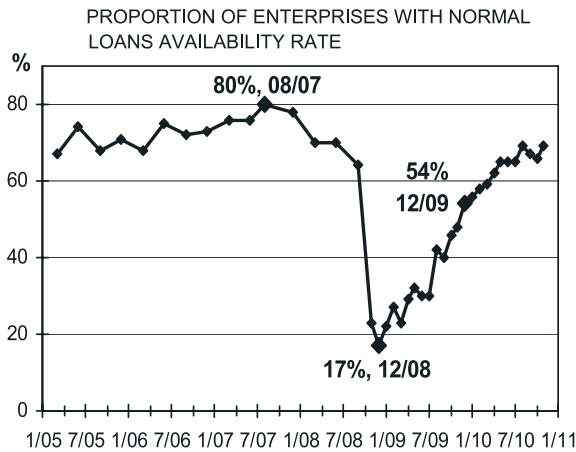


Graph 8

citing a lack of cadre in Q3, the last quarter of the year broke this positive for the crisis period tendency – the cadre shortage indicator tumbled by 7 points and became nearly invisible.

Plans on changes in the number of employees continue to darken and hit their annual low in November. Job cuts are planned in all the industries, bar the forestry sector, with the construction and machine-engineering industries foreseeing the most intensive ones.

Lending for the Industrial Sector



Graph 9

While in November the loans availability rate formally hit the crisis maximum, it looks like its positive dynamic began to decelerate (*Graph 9*). Banks have found it increasingly challengeable to identify trustworthy borrowers in the industrial sector. Credit organizations' priorities have remained the same – that is, metallurgy, the chemical sector, and food-processing corporations.

The positive dynamic of interest rates banks offer by Rb-denominated loans is no longer there, either – since September this index has not been able to outpull the level of 13% annualized across the industrial sector on the whole; however, in November, loans to metallurgical corporations were offered under 10.5% annualized, chemical ones - 11.4%, and food-processing – 12.4%.

The corporate sector's need in loans should increase in the upcoming months – 24% of enterprises across the industrial sector on the whole reported a planned

growth in demand for loans vis-a-vis 5% of those which assume its decline (the balance 24-5=19 points). It will be ferrous metallurgy that should emerge as an absolute leader in terms of demand for borrowed money (the balance of demand +42 points). Other sectors fall far behind in terms of the foreseen intensity of the process (the respective balances in the machine-engineering and construction sectors are +24 points each, those in forestry and the light industry - +20 points each). The chemical sector is not going to boost borrowings, while the food-processing industry plans to cut back on lending. ●

FOREIGN TRADE

N.Volovik, K.Kharina

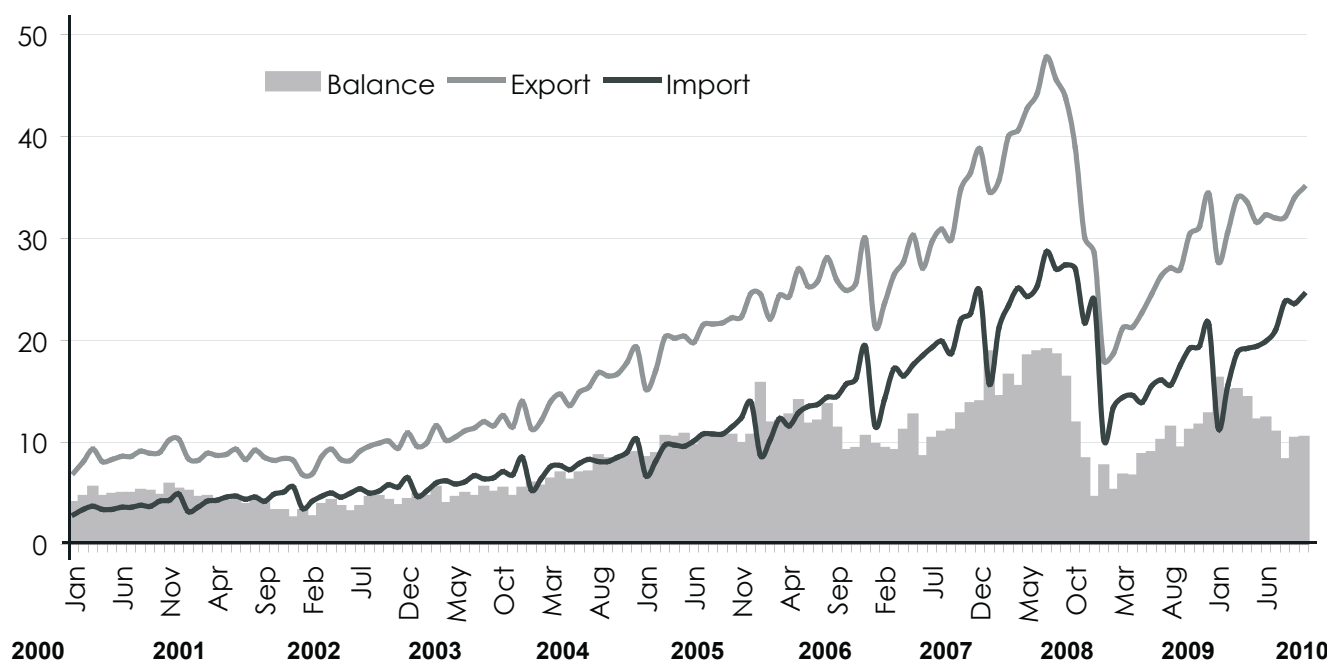
The month of October 2010 saw continuation of the trend to deceleration of growth of export against acceleration of growth rates of import – a combination that has caused contraction of the trade balance. The wheat export ban was extended through the end of the first half-year 2011. Since 18 December 2010 Russia has introduced the 10% customs duty on export of copper, while the export duty on nickel ranging between 5 and 10% became effective since 19 December 2010.

Russia's foreign trade balance calculated by the balance-of-payments methodology accounted for USD 59.6 bln. in October 2010, or at 19.6% more than in the same period of the prior year.

Growth in the external demand for Russian exports had slowed down by the late-2010. While in Q1 2010 the value volume of Russian exports surged by 61.1% vs. the same period of 2009, the respective index in Q3 was just +17.7%. In October, the value volume of export accounted for USD 35.0 bln, or up by 14.9% vs. the analogous indicator of 2009. The rise in the value volume of export was still fueled by a favorable state of affairs on overseas markets.

In October, the world oil prices were oscillating due to fluctuations of the USD exchange rate and following publications of the US statistical data. In the beginning of the month the quotations were on the upsurge primarily against a favorable external background. As a result, they hit two-month highs. At the end of the month the oil prices found themselves affected by fluctuations of the USD and displayed multidirectional dynamics. The last trading session in October ended up with a price downfall for energy sources, and the average prices of Brent in October 2010 slid by 0.15% and made up USD 83.56/bbl.

Meanwhile, the average price of Urals in October 2010 was USD 81.53/bbl vis-a-vis USD 72.5/bbl. back in October 2009. The price of Urals averaged over the 10 months of 2010 was USD 76.43/bbl vs. USD 58.31/bbl. reported over the same period of 2009 (+23.7%).



Source: the CBR

GRAPH 1. Main Indicators of Russia's Foreign Trade (as USD bln.)

During the period of monitoring – between 15 November and 14 December 2010 – the average price of Russian oil was 85.77574/bbl. So, since 1 January 2011 the oil export duty should rise from USD 303.8/t to 317.5/t (+4.5%). Meantime, the duties on oil produced at 22 fields in Eastern Siberia and 2 fields in the Northern Caspian region should make up USD 117.5/t. (+USD 9.5 vs. the previously charged USD 108/t.). Basing on the formula, the duty on light oil products should be up to USD 226.2/t. vs. the previous USD 217/t., while the one on dark oil products – from USD 121,9/t to 116.9/t., respectively.

By the late-October 2010 prices for non-ferrous metals had been slightly down compared with the beginning of the month. The quotations fell prey to general concerns about the global macroeconomic situation and the situation with inventories in Asia. The latter strengthen the market's sentiment about possible subsidence of China's demand. By the end of the month copper quotations had gained 2.3% at the LME, while aluminum ones remained practically unchanged (-0.2%), and nickel quotations had been down by 2.1%.

Table 1

AVERAGE WORLD PRICES IN OCTOBER OF RESPECTIVE YEARS

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Oil (Brent), USD/bbl	32,14	21,45	27,2	29,6	49,8	58,2	57,9	81,4	79,63	73,21	83,56
Natural gas, USD/MMBTU	5,767	2,649	4,144	5,162	7,7	12,2	12,76	7,47	6,824	5,008	3,64
Gasoline, USD/gall	0,895	0,603	0,801	0,841	1,43	2,056	1,484	2,13	4,195	1,903	2,09
Copper, USD/t	1838,6	1405,1	1519,0	1916,4	3012,0	4060	7500	8008	4925,7	6286,8	8292,4
Aluminum, USD/t	1473,5	1280,8	1313,2	1474,8	1822,8	1929	2659	2442	2121,4	1877,8	2447,0
Nickel, USD/t	7353,2	4836,8	6840,9	11030	14483	12403	32348	30999	12140	18514	22167

Source: calculated on the basis of the LME and IOE data (London).

In October 2010, Russia saw its trade conditions with other countries improve against the same period of 2009, with export prices rising at a pace far greater than import ones. The October 2010 terms of trade index accounted for 123.5 points vs. 70.5 points reported in the prior year.

According to the CBR, between January and October 2010 Russia's foreign trade turnover stood at USD 518.8 bln. (133.3% vs. the respective period of 2009), including export – USD 322.0 bln. (135.1%) and import – 196.8 bln. (130.5%).

The FCS data suggest that the physical volume of export of crude oil was down slightly during the period in question vs. the same period of 2009 (204.3 mln. t. , or -0.7%). Behind the drop was the dynamic of oil supplies to the CIS countries (a 34.8% fall in supplies, including a 41.7% one to Belarus alone). Meanwhile, the volume of supplies to Far-Abroad countries was slightly (by 5.1%) on the rise. During the period in question the physical volumes of export of oil products soared by 7.5% (including a 8.4% surge *in* those to the Far-Abroad countries) and accounted for 108.3 mln. t.

Export of natural gas (in natural terms) surged by 10.1% on the year-on-year basis, driven mostly by the base effect (lower volumes of supplies in the early-2009).

In contrast to trends reported between January and October 2009 , when export supplies of food stuffs have been rising dramatically, in 2010, the respective exports, as well as supplies of raw food products, plummeted by 7%. The aggregate value of supplies of these categories of commodities is estimated at the level of USD 7.6 bln., and their proportion in the aggregate Russian export tumbled from 3.5% to 2.4%. As a reminder, in anticipation of a poor harvest, back in the summer 2010 the RF Government introduced a temporary ban on exportation of wheat, barley, rye, corn and flour effective between 15 August and 31 December 2010.

In compliance with Resolution of the RF Government of 20.10.2010 №853 “On introducing a temporary ban on exportation of some kinds of agricultural goods from the territory of the Russian

Federation”, the temporary ban on exportation of wheat and meslin, barley, rye and corn from the territory of the Russian Federation was extended from 2 January through 30 June 2011.

Imports have been on the rise consistently since the beginning of 2010 relative to the same period of the previous year: up by 18.7% in Q1, 33.1% - in Q2, and 38.7% in Q3. In October alone they rose by 30.5% (up to USD 24.5 bln.).

According to Rosstat, the import pattern in Q3 saw a continuous surge of the proportion of investment import (up to 19.7% after the record-low 16.8% in Q1 and 18.6% in Q2), which testifies to renewal of investment activity in the country.

Table 2

SPECIFIC WEIGHT OF CONSUMER, INTERMEDIATE AND INVESTMENT GOODS IN THE AGGREGATE VOLUME OF RUSSIAN IMPORTS (AS %)

	Consumer goods		Investment goods		Intermediate goods	
	2009	2010	2009	2010	2009	2010
Q1	46.8	43.5	19.4	16.8	33.8	39.7
Q2	44.0	39.5	19.3	18.7	36.7	41.8
Q3	42.9	42.1	20.6	19.8	36.5	38.1
Q4	43.9		19.5		36.6	
Annually	44.3		19.7		36.0	

Source: Rosstat.

Between January and October 2010 the nation was in the shopping mood: purchases of equipment, machinery and transportation vehicles were up by 38.9% vs. the same period of the prior year; the value of import of passenger cars surged by 24.7%, while that of trucks - 2.3 times; the physical volume of importation of passenger cars rose by 23.7% and that of trucks – 2.3 times.

The October 2010 export surplus was USD 10.5 bln., or down by 6.1% vs. the respective period of 2009. The export surplus over the 10 months of 2010 hit USD 125.2 bln. vs. 87.5 bln. reported over the period between January and October 2009.

Since 18 December 2010 Russia has introduced the 10% customs duty on export of copper, while the export duty on nickel ranging between 5 and 10% became effective since 19 December 2010. As a reminder, in the early-2009 the Government satisfied the Norilsk Nickel’s request to slash to zero export duties on nickel and cathode copper (which accounted for 5 and 10%, respectively). At the time, the Russian non-ferrous metal producers faced a drastic decline in demand and prices on global markets. More specifically, in January 2009 copper prices plunged to USD 3,000-3,200/t. or 2.5. times lower than in the early-2008, while nickel prices nosedived nearly 3-fold and were under USD 10,000/t.

In the spring 2009, China began to vehemently buy up raw materials, including non-ferrous metals, to beef up its public inventories, while the general economic background started improving shortly thereupon. In December 2009, the Government Resolution on imposition of the 5% duty on export of non-alloyed nickel was signed.

The comeback of the copper export duties was expectable. Russia is one of the biggest copper exporters. According to the FCS, the nation’s 2008 copper exports to Far Abroad amounted to 201,000 t. worth a total of USD 1.22 bln. These figures practically doubled in 2009, with the supplies accounting for 507,200 t. (USD 2.5 bln.). In the 10 months 2010, the respective indices were 375,200 t. (USD 2.6 bln.).

The lion’s share of Russian copper production falls on the “Big Three”- that is, Norilsk Nickel, Ural Mining-Refinery Company and JSC Russian Copper Company, with Norilsk Nickel exporting 75% of its copper production, thus securing a half of Russian export supplies.

The MinFin calculations suggest that thanks to the newly introduced export duties on copper the 2011 federal budget should gross an extra Rb. 8.8 bln. in revenues, while another 6.5 bln. should be collected from the increased export customs duties on nickel. ●

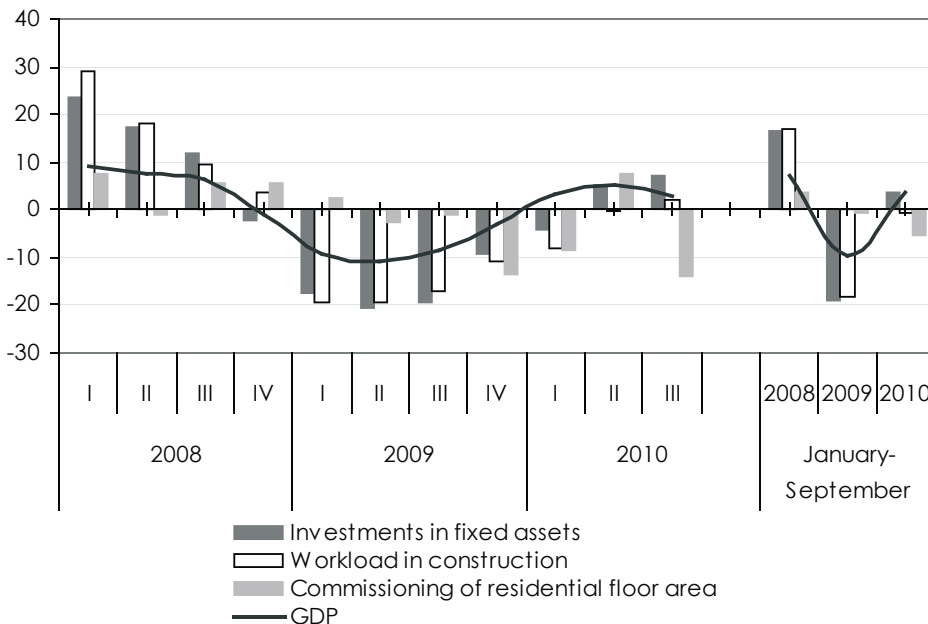
INVESTMENTS IN REAL ECONOMY SECTOR

O.Izryadnova

In January-November 2010 investments in fixed assets made RUR 7480.1 billion and went up by 5.4% versus the corresponding period of the previous year. The increase in investments has resulted in stabilization of workload dynamics in construction, but was insufficient to overcome business activity recession in housing construction. Commissioning of residential floor area made 96.2%, while workload in construction – 100.4% versus the corresponding indices of January-November 2009. Under existing dynamics the main indicators of the investments in fixed assets in January-November 2010 made 86.1% of problem-free January-November 2008, workload in construction – 82.8%, commissioning of residential floor area – 85.5%.

While state of the internal market was improving in 2010, the situation in the sector of investment was observed to change gradually. The peak of the investment crisis was passed in the 1st half 2009, and starting with the 3rd quarter the trend towards the slow-down of investment decrease was observed, which was supported by the improvement of the financial situation of enterprises. In the 2nd-3rd quarters 2010 the dynamics of investments became positive and investments growth rates were higher than GDP growth rates. On the whole, over January-September 2010 the increase in investments in fixed assets made 3.7%, GDP growing by 3.6% versus the corresponding period of 2009.

Dynamics of investments in fixed assets is considerably different for large- and small-scale enterprises. In the segment of small business in January-September 2010 investments in fixed assets went up by 22.8% (by 25% over the corresponding period of 2009) and their proportion in the total volume of the investments in the economy went up to 33.3% versus 29.9% a year ago. At the same time investments in fixed assets at large-scale enterprises reduced by 3.8% over January-September 2010, and by 13.3% over the same period of 2009.



Source: Federal State Statistics Service

Fig. 1 Growth Rates of GDP, Investments in Fixed Assets, Workload in Construction and Commissioning of Residential Floor Area as Broken by Quarters in 2008-2010, as percentage to the corresponding period of the previous year

The trend towards the decrease in commissioning of residential floor area was another characteristic feature of 2010. Over January-September 2010 the implementation of residential floor area reduced by 5.5%. A sharp decrease in the groundwork for housing construction in 2008-2009 has negatively affected the situation in 2010. Besides, the situation with financing has worsened considerably. In 2009 the funds received for owners-builders' construction under shared ownership terms contracted by RUR 74.3 billion, the means of population reducing by RUR 32.0 billion as

compared with 2008. The share of investments in housing construction reduced by 20% on the whole throughout the economy in January-September 2010 versus 2.6% and 3.5% over the corresponding periods of 2008 and 2009.

The volumes of industrial construction decreasing, the proportion of expenses for buildings construction is observed to diminish, whereas the proportion of expenses for machinery and equipment is observed to expand up to 32.6% versus 31.1% in January-September 2009. It should be noted investments for the purchase of import machinery, equipment, transport vehicles (not taking into account the subjects of small business and parameters of informal activity) made RUR 244.6 billion in January-September 2010, which is 20.2% of the total volume of investments in machinery, equipment, transport vehicles versus RUR 257.2 billion or 23.0% in the corresponding period of 2009.

In 2010 the trend towards the decrease in the scale of budget-financed investments scale in absolute terms sustained because of the contraction of the RF subjects participation. In January-September 2010 RUR 644.9 billion of investments in fixed assets was financed from the budget versus RUR 676.3 billion a year ago. The expansion of the volumes of investments financing from the federal budget up to RUR 316.9 billion (growth of RUR 7.2 billion as compared with January-September 2009) did not compensate to decrease in expense for investments by the RF subjects (decrease by RUR 39.6 billion down to RUR 288.1 billion).

Table 1

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

	2009	Including			2010		
		1 st quarter	1 st half	Jan-Sep	1 st quarter	1 st half	Jan-Sep
Investments in fixed assets - total	100	100	100	100	100	100	100
including by sources of financing:							
Own funds	36.3	40.9	40.1	38.3	45.1	44.9	43.0
of which:							
profit	14.8	18.1	16.9	15.5	15.0	16.3	16.0
Attracted funds	63.7	59.1	59.9	61.7	54.9	55.1	57.0
of which:							
banking credits	9.4	13.4	12.0	11.0	9.5	9.2	9.1
including credits by foreign banks	2.8	4.3	3.7	3.4	3.2	2.8	2.7
borrowed funds from other organizations	10.7	9.2	8.2	8.9	6.4	6.6	6.6
budget funds:	21.5	13.0	16.7	18.7	12.9	15.5	17.4
from federal budget	10.8	4.1	6.5	8.6	5.5	7.6	8.5
from budgets of RF subjects and local budgets	9.5	8.1	9.2	9.1	6.6	7.1	7.8
other	21.9	23.3	22.8	22.8	25.9	23.4	23.6
of which funds received for owners-builders' construction under shared ownership terms	2.3	2.2	2.3	2.6	2.0	2.2	2.0
Including means of population	1.0	0.9	1.0	1.0	1.0	1.1	1.1
investments from abroad in the total volume of investments	4.6	6.7	5.7	5.4	5.8	5.3	4.8

Source: Federal State Statistics Service

The state demand for the production and services of Russian enterprises was supported through the fulfillment of the planned investment projects in the sphere of transportation, telecommunication etc. within the FTP and FTIP projects. In concordance with the List of construction sights and objects for federal state needs specified as on November 1, 2010 in 2010 it is planned to commission

1048 objects. In January-October 2010 54 objects were put into commission to the full extent and 20 objects – partially.

As on November 1, 2010 the total volume of funds envisaged for financing of federal targeted investment program made RUR 683.1 billion, including RUR 353.3 billion for financing of program part (51.7% of the total FTIP volume), RUR 223.1 billion (32.7%) for non-program part and RUR 106.7 billion (15.6%) for special works included into the state defense order. As compared with January-October 2009 expenses for FTIP went up by RUR 93.8 billion, expenses for program part increasing by RUR 20.8 billion.

In concordance with the data of the Federal State Statistics Service, the federal allotments for FTIP construction sights and objects that are monitored by the Federal State Statistics Service are financed at 54.6% of the year limit or to RUR 302.9 billion in January-October 2010. As on November 1, 2010 791 objects were financed to the full extent, 546 objects had the technical readiness of 51-99%.

Table 2

OBJECTS ENVISAGED BY FEDERAL TARGETED INVESTMENT PROGRAM AND VOLUMES OF STATE INVESTMENTS IN JANUARY-OCTOBER 2010
(EXCLUDING CONSTRUCTION SIGHTS AND OBJECTS OF THE STATE DEFENSE ORDER)

	Number of objects for 2010		Commissioned in January-October 2010		Limit of state investments in 2010		Financed from the federal budget in 2010	Used investments from all sources of financing in 2010
	total	Including with the commissioning deadline in 2010	to the full extent	partially	total	including from the federal budget		
	units				RUR billion			
Total	2009	1048	54	20	590.9	555.1	302.9	219.2
including: transportation complex	388	231	31	8	248.7	222.5	158.6	112.4
agriculture complex	195	92	8	2	7.0	6.8	4.5	3.5
special complex	277	122	1	–	29.5	28.3	11.8	10.0
social complex	1066	568	14	9	288.8	285.8	121.5	84.1
other objects	83	35	–	–	16.9	11.7	6.2	9.2

Source: Federal State Statistics Service

In January-October 2010 the customers used RUR 219.2 billion of state investments or 37.1% of the year limit of funds envisaged for construction. Extremely low level of investments funds use in the social complex – 29.1% - is worrying.

Unsteady economic dynamics throughout January-October 2010 as well as slow recovery rates of the internal market and economy earnings accounted for the sustention of the trend for more frequent use of own funds for investment programs financing. In January-September 2010 own funds of enterprises use for investment purposes made RUR 1597.7 billion versus RUR 1378.8 billion over the corresponding period of the previous year, their share increasing from 38.3% to 43.0%. The volumes of attracted funds decreasing in absolute terms, the trend towards the contraction of banks' capital and borrowed capital participation in the structure of financing sources has become more prominent. In January-September 2010 RUR 337.7 billion or 16.0% of RUR 2114.8 billion of attracted funds accounted for banks' credits, whereas a year ago the figure was 17.9%.

Structure of banks' credits in the sources of investments in fixed assets financing was subject to considerable changes. After a sharp increase in credits of foreign banks in January-September 2009, in the same period of 2010 the credits of foreign banks were observed to diminish in absolute

terms by RUR 23.5 billion. As a result the proportion of investments received from abroad in the total volume of investments in fixed assets in January-September 2010 decreased to 4.8% versus 5.4% a year ago. The formation of such a trend occurred against the background of net capital outflow and the decrease in the inflow of foreign investments.

Situation at the market of capital in January-September 2010 was aggravated by the weakening of domestic banking sector participation in investments in fixed assets financing. As compared with January-September 2009 credits of domestic banks for investments in fixed assets decreased by RUR 37.5 billion. It should be noted that whereas in 2008-2009 the shortage of own funds and banking credits was compensated by the expansion of borrowed funds offered by other organizations (insurance and investments companies, trading enterprise etc.), in 2010 the reduction of funds in this position made RUR 75.9 billion.

In January-September 2010 structural changes in the investments in fixed assets were determined by the increase in the share of industry up to 47.2% of the total volume of investments in fixed assets. At the same time the investments growth rates were observed to differentiate substantially by types of economic activities. In January-September 2010 investments in fixed assets by extractive industries enterprises made 96.2% of the figure of the previous year, by processing industries enterprises – 95.9%. Over the same period the growth of investments of 16.3% was observed in electricity, gas and water production and distribution. The positive dynamics of investments in coke and oil products production (120.3% versus January-September 2009) is notable among other processing industries. The drop of investments in transportation development in 2009-2010 is worrying.

In January-September 2010 it was the recovery of the positive dynamics of investments in machine-building complex that is a characteristic feature of investment activity. As compared with January-September 2009 the increase of investments in machinery and equipment production made 6.3%, in electric, electronic and optical equipment production – 21.5%, in transport vehicles production – 0.1%. It should be noted that in 2010 the shortage of own finances at the enterprises of machine-building complex was compensated by fulfillment of the program of the state support for domestic production.

According to the preliminary estimation of the Ministry for Economic Development, the growth of investments in fixed assets will make 102.5% on the whole as a result of 2010 versus the level of the previous year. ●

FOREIGN INVESTMENTS

E.Ilyukhina

The period between January and September 2010 saw the level of foreign investors' activity in RF be lower than in the prior year. The phenomenon was coupled with a steady growth in the quarterly pace of decline in the volume of influx of foreign investment in the country. Foreign investors continued to abandon the Russian market, and the capital withdrawn to the volume of foreign investment in Russia's economy ratio increased in the period in question. The proportion of direct investment in the structure of foreign investment in Russia's economy over the 9 months of 2010 slid to 17.3%. As many as 85.6% of the aggregate volume of foreign investment in Russian economy over the period in question falls on the industrial sector, transport and communications. Within the industrial sector, foreign investors retained interest in manufacturing industries (67.7% of foreign investment in the industrial sector). Geography-wise, it was Germany, the Netherlands and Cyprus that ensured the greatest inflow of foreign investment in Russia over the period in question – they combined secured 43.5% of foreign investment in the country.

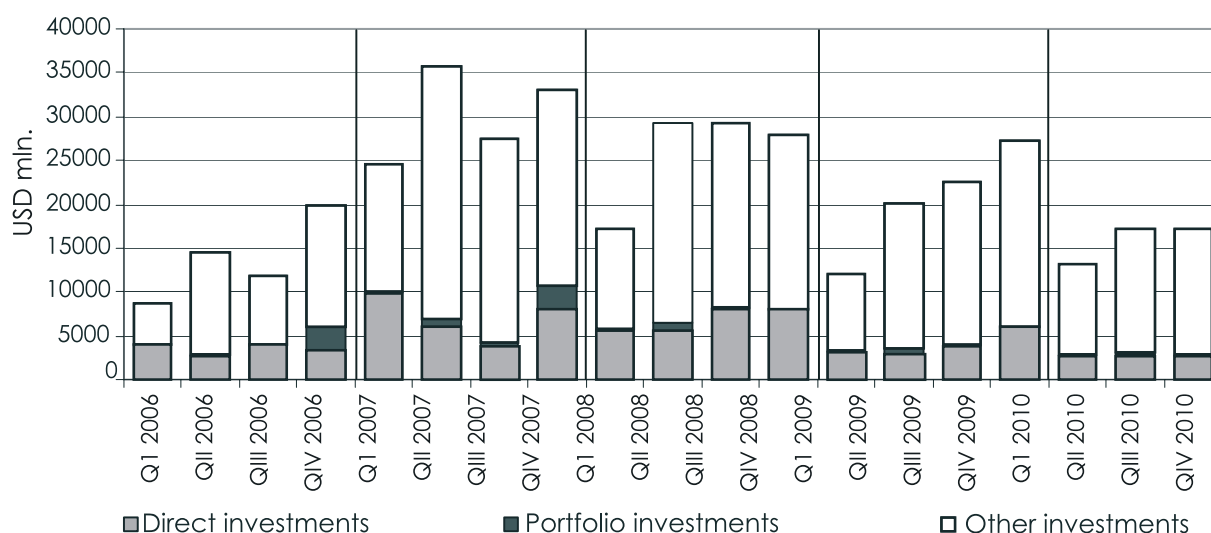
As of late-September 2010, the accumulated foreign capital, exclusive of monetary-credit regulatory bodies, commercial and savings banks, and inclusive of Rb-denominated investments calculated into the USD equivalent, accounted for some USD 266,0 bln., or down by 0.8% relative to 1 January 2010 and up by 1.4% compared with figures reported as of 1 October 2009.

Table 1

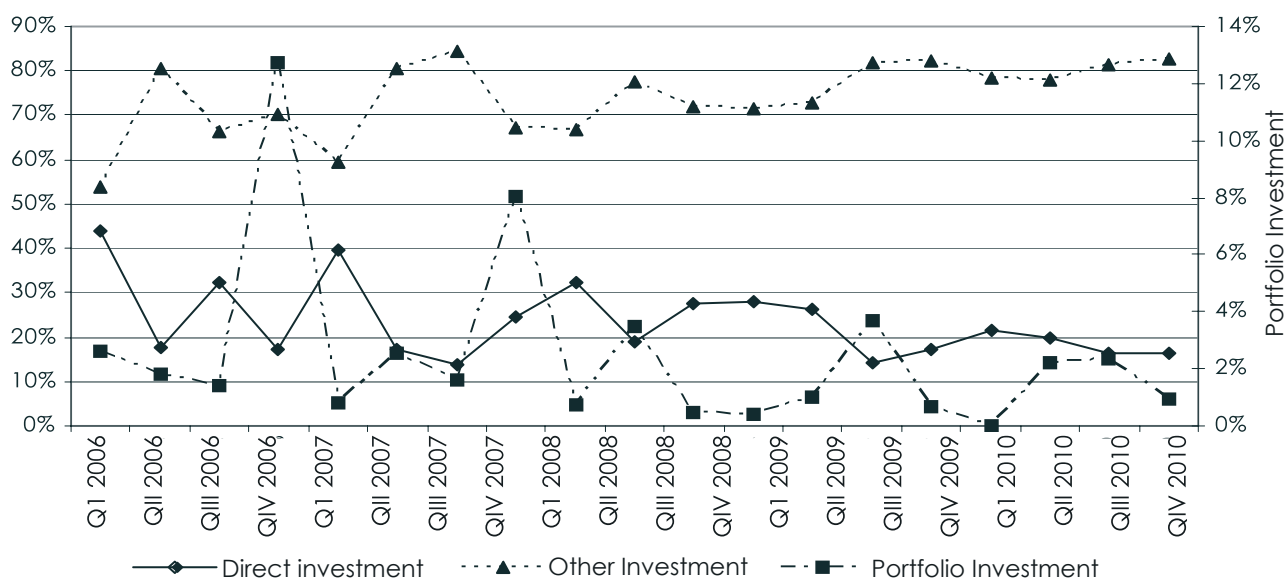
THE FOREIGN INVESTMENT INFLOW IN RUSSIA'S ECONOMY IN JANUARY-SEPTEMBER 2006–2010

	As USD mln.				As % to the prior year			
	Total	Direct	Portfolio	Others	Total	Direct	Portfolio	Others
2006	35 323	10 268	665	24 390	131,7	155,5	182,3	22,8
2007	87 936	19 644	1 547	66 745	248,9	191,3	232,6	273,7
2008	75 792	19 201	1 296	55 259	86,2	97,7	83,8	82,8
2009	54 738	9 975	1 019	43 744	72,2	51,9	78,6	79,1
2010	47 488	8 196	866	38 426	86,8	82,2	85,0	87,8

Source: Rosstat.



Graph 1. Quarterly Dynamic of Foreign Investment Inflow in RF in 2006–2010



Graph 2. Structure of Foreign Investment in Russia's Economy in 2006-2010

The total volume of foreign investments in Russian economy in 2010 was down due to the fall in all their components.

Other foreign investments in the national economy have been declining between the 3rd Quarter 2008 and the 3rd Quarter 2010 compared with respective periods of the prior year. The only exception was the 4th Quarter 2009 and the 1st Quarter 2010, when this type of foreign investment was on the rise by 6.8% and 17.1% vs. the same periods of the prior year. In the 2nd and 3rd quarters 2010 it plummeted by 14.8 and 23.6%, respectively.

FDI in Russia's economy has steadily declined vis-a-vis respective periods of the prior year since the 4th Quarter 2008 and the tendency was there in 2010, too: the decline rate in the 1st Quarter was 17.6%, in the 2nd Quarter – 3.7%, and in the 3rd one - 28.6%.

In contrast to direct and other investments, portfolio ones posted a notable growth vs. the respective figures of the prior year: they rose 2.5 times in the 1st Quarter and by 5.7% in the 3rd Quarter 2010, but tumbled by 45.5% in the 2nd Quarter of the year.

The multidirectional dynamic of foreign investment in Russia's economy displays changes in the quarterly structure of foreign investment as follows (*Graph 2*).

In 2010, foreign investment continued to concentrate in the industrial sector and trade, which combined accounted for 77.3% of the aggregate volume of foreign investment in RF between January and September 2010 (vs. 68.3% reported over the same period of 2009). By results of the 9 months 2010 foreign investments in the industrial sector were up by 32.6% vs. the same period of 2009, while those in trade plunged by 46.6%.

In the period in question, foreign investors have been losing interest in real estate, transport, and communications: foreign investments in real estate were down by 31.3%, while those in transport and communications sank 2.2 times.

A substantial contraction of investments in trade, real estate, transport and communications against growth in investment in the industrial sector has resulted in a new structure of foreign investment, with the respective proportions being lesser than in the previous year.

In the 9 months of the year, foreign investments in the manufacturing industries were up by 26.0% vs. the 2009 figures (while by results of the 9 months 2009 they were down by 43.2%). Foreign investment in production of fuel and energy minerals increased 1.9 times vis-a-vis the same period of 2009 (16.0%). In the manufacturing sector, investments in the food-processing industry rose by 26.5%, in chemicals – by 69.8%, accounting for USD 1.9 bln. and 1.7 bln., respectively. Meanwhile, foreign investment in metallurgy surged up to USD 5.1 bln. vs. the 2009 figures (by 50.5%)

The analysis of the 2010 quarterly dynamics of foreign investment in the industrial sector evidences that foreign investors' interest in investing in Russia's industrial sector was increasing vs. the respective periods of 2009.

Table 2

SECTORAL STRUCTURE OF FOREIGN INVESTMENT IN RUSSIA'S ECONOMY
BETWEEN JANUARY AND SEPTEMBER 2008–2010

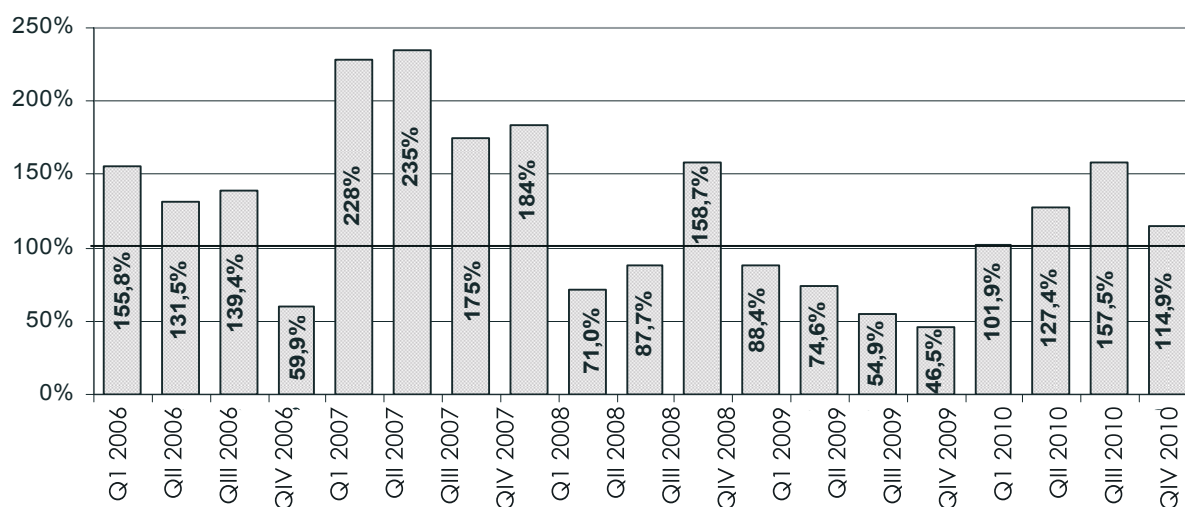
	As USD mln.			Change to the prior year, %			As % to result		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Industrial sector	38 074	21 130	28 022	102,9	55,5	132,6	50,2	38,6	59,0
Transport and communications	2 237	8 512	3 952	39,1	380,5	46,4	3,0	15,6	8,3
Wholesale and retail trade, motor vehicles, motorcycles, consumer goods and home appliances repair	17 917	16 277	8 688	48,2	90,8	53,4	23,6	29,7	18,3
Real estate transactions, leasing and provision of services	10 767	5 593	3 843	254,2	51,9	68,7	14,2	10,2	8,1
Financial operations	3 249	1 971	1 764	151,0	60,7	89,5	4,3	3,6	3,7
Other industries	3 548	1 255	1 219	220,6	35,4	97,1	4,7	2,3	2,6

Sources: Росстат.

Foreign investments in metallurgy rose by 15.8% in the 1st Quarter compared with the respective figure of 2009, and they consequently increased 2.3 times and by 34.1% in the 2nd and 3rd quarters vs. the same periods of 2009, respectively. Foreign investors' investment in mineral production also posted a notable growth in the first half-year of 2010 (by 52.2%), but slightly plunged (by 4.8%) in the 3rd Quarter. Foreign investments in the food-processing sector in the 1st Quarter 2010 remained at the prior year's level, but grew by 14.9% and 1.9 times in the 2nd and 3rd quarters, respectively. Increase in foreign investments in the chemical industry in 2010 was: in the 1st Quarter -19.8%, the 2nd Quarter-17.3%, and 2.5 times – in the 3rd Quarter.

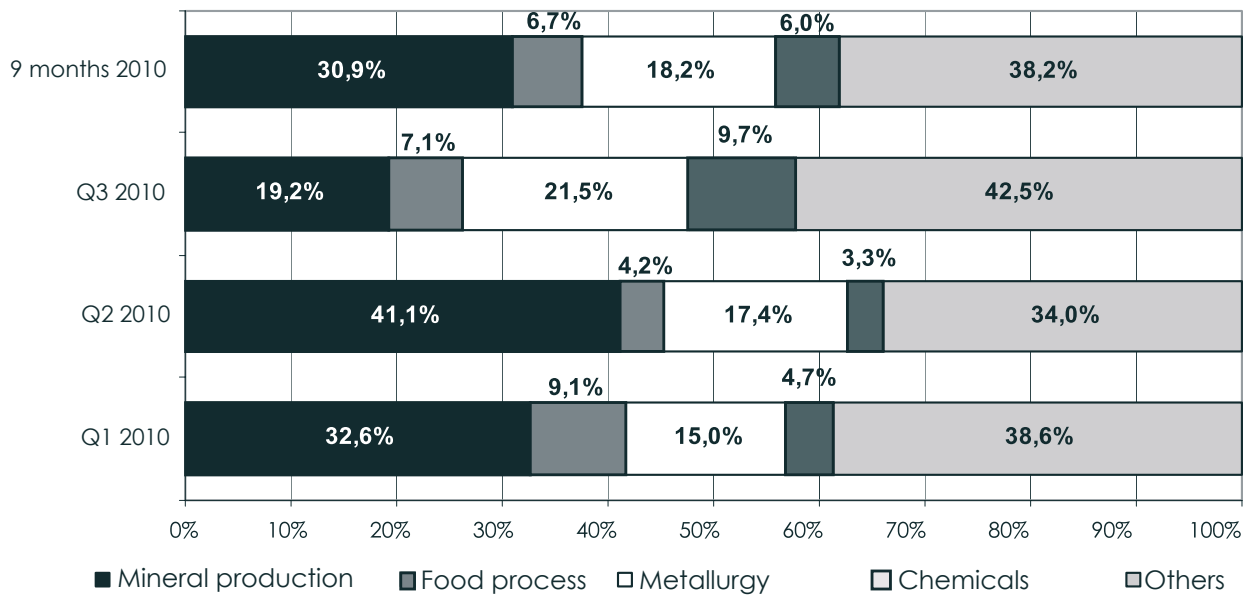
Peculiarities of the sectoral dynamics are mirrored by the quarterly sectoral structure of foreign investments in the industrial sector. The specific weight of direct investments in the industrial sector was down from 24.0% in January-September 2009 to 16.2% in the same period of 2010, while the proportion of "other" investments rose from 73.1 up to 82.5%. The quarterly dynamic demonstrates the tendency to growth in the share of "other" foreign investments in the industrial sector.

The structure of foreign investments by types of economic activity in the industrial sector likewise underwent certain changes. More specifically, between January and September 2010 the mineral sector saw direct foreign investments continue to contract – they tumbled by 38.8% (down to USD



Source: Rosstat

Graph 3. Foreign Investment in the Industrial Sector in 2006–2010, Change Relative to the Respective Period of the Prior Year, as %



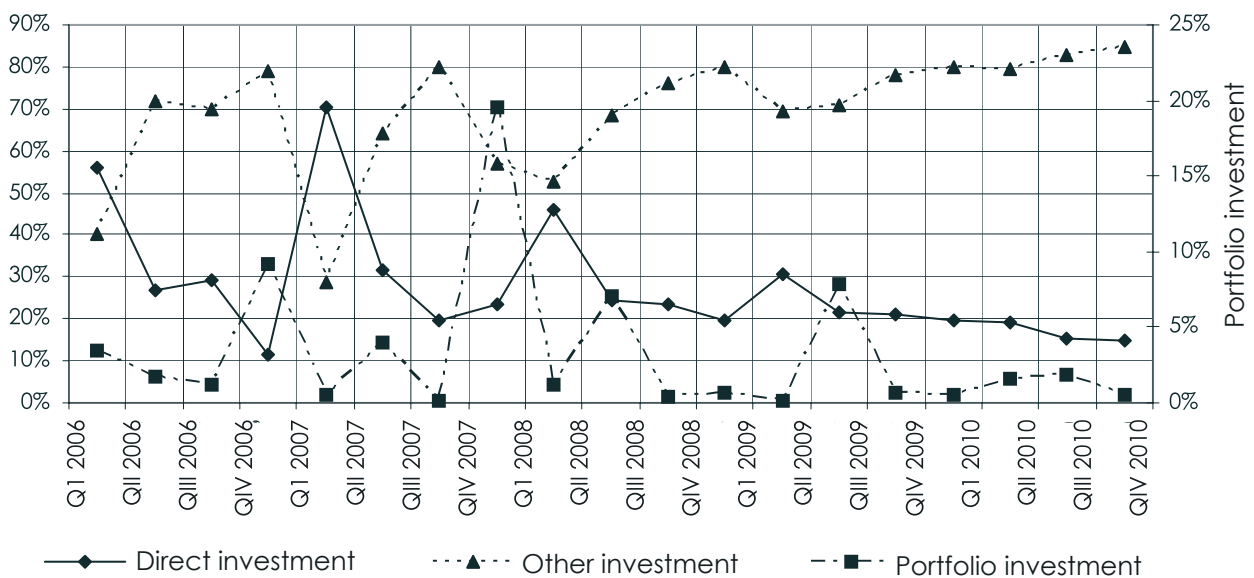
Graph 4. Sectoral Structure of Foreign Investments in the Industrial Sector in 2010

1.4 bln.). That led to decline in their share in aggregate investment in the sector from 39.0% between January and September 2009 to the current 15.8%. The proportion of “other” investments in the mining sector, whose growth over the 9 months of the year is estimated at the level of USD 7.2 bln. (up 2.9 times), soared up to the current 83.8%.from the prior year’s figure of 55.0%

On a year-on-year basis, “other” investments formed the bulk of investments in the manufacturing sector – their proportion increased by 29.5% and accounted for 82.9% (vs. 80.6% reported in 2009). Lower growth rates of FDI in the processing industries (+10.8%) resulted in a drop of their specific sector-wise weight by results of the 9 months of 2010 to 16.2% (vs. 18.4% in 2009).

As concerns the geographical structure of foreign investments in Russia’s economy over the 9 months of 2010, atop the list sits Germany with USD 7.52 bln. in investments (3rd position with USD 5.51 bln. in 2009), followed by the Netherlands with USD 7.51 bln. (8.35 bln.), and Cyprus – 5.64 bln. (4th position with USD 5.23 bln. in 2009).

Meanwhile, Ireland was a clear forerunner in terms of investment growth rate: on a year-ago basis the Irish investment pool in Russia grew 2.1 times. On the opposite pole sits Luxemburg,



Source: Rosstat.

Graph 5. Structure of Foreign Investment in the Industrial Sector in 2006–2010

which cut back on investments in Russia 7.1 times. German investments increased by 36.6%, those from Cyprus- by 7.7%, while the Dutch ones tumbled by 10.1%, French – by 50.2%, and the US ones – by 32.6%. Growth in the UK investment in Russia remained flat on a year-on-year basis.

Table 3

QUARTERLY DYNAMICS OF FOREIGN INVESTMENTS IN RUSSIA, COUNTRY-WISE IN 2010

	Received, as USD mln.			As % to the respective period of 2009			As % to result		
	The 1st quarter	The 2nd quarter	The 3rd quarter.	The 1st quarter	The 2nd quarter	The 3rd quarter.	The 1st quarter	The 2nd quarter	The 3rd quarter.
Germany	2106	3696	1718	171,6	226,1	65,0	16,0	21,4	10,0
UK	1060	1308	1872	132,8	95,4	90,8	8,1	7,6	10,9
Cyprus	1435	1682	2518	142,1	90,4	106,6	10,9	9,8	14,7
The Netherlands	2524	1651	3332	138,1	93,1	71,7	19,2	9,6	19,5
Luxemburg	833	408	17	66,1	9,9	0,5	6,3	2,4	0,1
Other countries	5188	8493	7647	87,8	244,1	199,0	39,5	49,3	44,7

Source: Rosstat

The differences in the investment dynamics have entailed changes in the geographic structure of foreign investment in Russia's economy. More specifically, Germany's specific weight on a year-ago basis grew from 10.1% to 15.8%, the one of Cyprus – from 9.6% to 11.9%, UK - from 7.7. to 8.9%, France – from 2.9% to 4.4%, Ireland – from 1.1% to 2.6%. The Netherlands's specific weight remained practically unchanged, while the one of Luxemburg shrank from 16.3% to 2.6%.

Judging results of the first 9 months 2010, German investors focused primarily on the mineral sector, manufacturing industries and trade, wherein they invested, accordingly, 43.2, 31.3 and 19.7% of the aggregate volume of their investment in Russia over the period in question.

The Dutch investment structure saw a rise in the share of investments in the mineral sector from 12.6% to 21.9% on a year-on-year basis, while 34.2% of investment was channeled to trade (vs. 60.7% over the same period of 2009).

The Cypriots were keen to invest in the manufacturing sector – as many as 39.8% of the Cypriot aggregate investment in Russia went to the said sector. The proportion of real-estate transactions in the Cypriot investment surged from 20.8% between January and September 2009 to 23.0% a year later, while the one of investments in the mineral sector plummeted from 15.3% to 10.6%.

By results of the period between January and September 2010 the Top Five in terms of the overall volume of accumulated foreign investment in Russia was: Cyprus, the Netherlands, Luxembourg, Germany, and UK, with their aggregate proportion accounting for 66.0% (vs. 68.5% in 2009). The Top Five's share in the segment of direct investment remained practically unchanged – 68.6% (69.6%), but it slid in the structure of portfolio investment (from 83.8% to 78.9%) and other investments (from 66.5% to 63.1%).

Against the background of declining foreign investments in Russia's economy the volume of expatriated proceeds and interest payments and loan redemptions increased by 5.3% on a year-ago basis and stood at USD 53.3 bln., or accounted for 112.3% of the volume of foreign investment in Russia over the 9 months 2010 (vs. 92.5% reported in 2009). Notably, in the 1st Quarter, foreign investors expatriated an amount comparable to the volume of foreign investment inflow in the country over the same period of time, while in the 2nd and 3rd quarters the former volume exceeded the latter one at 12.1 and 22.7%, respectively.

As well, by results of the 9 months of 2010, Russian investments overseas exceeded the inbound investments at 17.7%. The tendency was characteristic of the 1st and 2nd quarters, with the excess rate accounting, accordingly, for 72.6% and 64.9%, while in the 3rd Quarter Russian overseas investments made up just 28.0% of the volume of foreign investments poured in the country over that particular quarter.

THE STATE BUDGET

E.Fomina

According to the budgetary statistics over the 11 months 2010, the value of the federal budget shrank by 2.7 p.p. on a year-ago basis against the background of substantial cuts in its expenditure volume. Meanwhile, as of 1 December 2010, the government obligations were fulfilled at the level of some 81% of the annual budget breakdown. The unspent fraction of budget funds shall be earmarked to recipients in December. So, the year of 2010 saw continuation of the recent years' trend of earmarking a considerable part of budget limits in the last months of the year. This practice stems "transcendence" of effects from their use over next year.

Analysis of Main Parameters of Execution of the Enlarged Government Budget between January and October 2010

As of 1 October 2010, the enlarged government budget, with respect to revenues, had been executed with a dynamic, which was at 0.8 p.p. of GDP greater than the prior year's one¹. The expenditure volume of the public sector dropped by 2.2 p.p. of GDP in relative terms, while in nominal ones it rose by more than Rb. 1,020 bln. As a result, between January and October 2010 the enlarged government budget posted a surplus of 0.1% of GDP, while in 2009 the balance of the enlarged government budget posted a deficit of 2.9% of GDP (*Table 1*)

Table 1

EXECUTION OF BUDGET REVENUE AND EXPENDITURE BY BUDGETS OF ALL TIERS OF GOVERNMENT BETWEEN JANUARY AND OCTOBER 2009–2010

	January-October 2010		January-October 2009		Deviation in p. p.p. of GDP
	As Rb. bln.	as % of GDP	As Rb. bln.	as % of GDP	
Federal budget					
Revenue	6,721.5	18.2	5,787.6	18.2	0
Expenditure	7,481.5	20.3	7,268.9	22.8	-2.5
Deficit (-) /Surplus (+)	-759.9	-2.1	-1481.3	-4.6	+2.5
Consolidated budgets of RF Subjects					
Revenue	5,380.7	14.6	4,820.5	15.1	-0.5
Expenditure	4,908.9	13.3	4,617.5	14.5	-1.2
Deficit (-) /Surplus (+)	+471.8	+1.3	+202.9	+0.6	+0.7
Budget of the enlarged government					
Revenue	12,766.1	34.6	10,785.8	33.8	+0.8
Expenditure	12,729.9	34.5	11,706.2	36.7	-2.2
Deficit (-) /Surplus (+)	+36.3	+0.1*	-920.4	-2.9	+3.0
For reference: GDP, as Rb. bln	36,893.4		31,871.8		

* The surplus in the enlarged government's budget vis-a-vis the deficit of the federal budget is ascribed to a different way of accrual of funds into extrabudgetary funds by bypassing the federal budget.

Source: The RF Ministry of Finance, calculations by the Gaidar Institute.

The consolidated budget of RF Subjects between January and October 2010 was likewise executed with a surplus of 1.3% of GDP vs. 0.6% of GDP over the same period of 2009. The volume of expenditures over the 10 months 2010 tumbled by 1.2 p.p. of GDP. The revenue amount dropped

¹ While comparing volumes of budget revenues between January and October 2010 with those of 2009, one should factor in the need for adjustment of their values by the value of additional revenues of investment nature. In January 2009, Rb. 275.2 bln. in proceeds from the 2008-2009 management of oil-and-gas funds' resources was collected to the budget, while between January and April 2010 an investment income worth a total of some Rb. 134 bln. was.

by 0.5% on a year-ago basis. In the 11 months 2010, regional revenues posted a 13% growth, and there was a renewal of rates of collection to regional budgets across a string of taxes¹. While the consolidated budget of RF Subjects appears balanced, the federal government recommends them to continue the policy of capping a rise in their budget expenditures and to accelerate the pace of development of the tax potential on the sub-federal level.

Whilst considering the structure of formation of the enlarged government budget revenues emerged over the 10 months of the year (*Table 2*), it can be ascertained that their growth was still driven by increase in revenues from foreign trade, the mineral tax, the corporate profit tax, and contributions to the compulsory medical insurance.

The volume of revenues from *the mineral tax and foreign trade* in the 10 months 2010 surged by 0.5% of GDP and 0.6% of GDP, respectively. Behind this phenomenon were a number of external and internal factors. The positive effect from the price rise for energy sources (the price of Urals between January and November 2010 averaged USD 72.2/bbl, or 1.3 times as high vis-a-vis 2009; between November and October 2010 it soared to USD 84.4/bbl, or by 3.5%) was complemented by growth in physical volumes of production and export of carbohydrates. Between January and October 2010, the growth rate of production of gas (natural and oilwell combined) was 12.2%-plus and oil – some 2.2% vs. the respective period of 2009²).

Following fluctuations of the international prices for oil and oil products during the year, the government has been adjusting upwards parameters of the export duty, whose value is tied to the dynamic of international oil prices.

Against the background of a whole lot of factors that fuel the oil-and-gas budget revenues, the appreciation of the Rb. over the 10 months of the year had an adverse impact on the value of the flow of the said revenues, as it diminished the volume of revenues from foreign trade in Rb. equivalent.

In the forthcoming three-year period (2011-13), the fiscal pressure on the mining sector should generally increase. More specifically, in the frame of a tax package aimed to diminish the deficit of the budget system the MinFin is going to increase the burden on the oil-and-gas corporations.

In addition, December 2010 saw debates on the possibility to raise the export duty on oil products. As a member state of the Customs Union, Russia saved this right and may resort to it already in the medium term. The government considers two options in this regard:

- A gradual equalization of duties on light and dark oil products in tandem with getting their levels up to 60% of the crude oil duty by 2013;
- Raising the average-weighted rate of the duty on oil products to the level of 85-90% of the crude oil duty on the external borders of the Customs Union.

Under the latter scenario, the government will be seeking other opportunities for supporting the domestic oil-refining sector, meaning an intense, rather than primary, processing.

With oil-and-gas revenues rising in absolute and relative terms as a background, non-oil-and-gas ones displayed a looser tendency to growth, which evidences the fact that their growth rate lags behind the domestic economy's revival dynamic. The exception in this regard is the *corporate profit tax* – the rise in revenues from it over the 10 months of the year appeared in tune with the growth dynamic of oil-and-gas revenues and accounted for some 0.6 p.p. GDP vs. the respective period of the prior year. It should be noted that between January and March 2010 the dynamic of revenues from the tax in question was slower than a year ago, but April saw the trend be reversed. In the 10 months of the year the real sector boasted an aggregate result of Rb. 4,931 bln., or up by nearly 48.5% on a year-on-year basis, while the proportion of profit-making corporations in their overall number surged by 3.p.p. vs. on a year-ago basis and stood in the region of 69%. According to statistics, it can be noted that it was manufacturers whose financial standing improved drastically, while the hot and droughty summer battered the agrarian production heavily, which consequently affected agricultural corporations' performance.

This dynamic emerged largely under the influence of a relative improvement of the general economic background. However, in the upcoming periods the growth of revenues from the tax in

1 <http://rus.ruvr.ru/2010/12/18/37135285.html>

2 The report of the RF Ministry of Economic Development "On the current situation in the economy of the Russian Federation in January-November 2009"

question might be tamed by a narrowing tax base due to the planned launch of the zero rate of the corporate profit tax for commercial and non-for-profit organizations in the medical and educational sectors. Plus, there are plans to cut some slack with regard to procedures of identification of the tax base for the purpose of payment of the corporate profit tax in the R&D sphere. This particular measure should fillip spending of thus freed resources on modernization of the respective economic agents' operations.

The revenue volume from the *personal income tax* to the enlarged government budget shrank to 3.8% of GDP, or down by 0.3 p.p. of GDP on a year-ago basis. Meanwhile the indicator of the population's real disposable income had grown (on a cumulative total basis) by 4.3% from the early-2010 vs. the past year's dynamic, which was largely due to valorization of pension payments in January 2010. Overall, it can be noted that the population's incomes growth rates are lower than the economy's revival ones.

Table 2

DYNAMIC OF THE LEVEL OF TAX BURDEN AND REVENUES FROM MAIN TAXES TO THE BUDGET OF THE ENLARGED GOVERNMENT OF RF BETWEEN JANUARY AND OCTOBER IN 2009–2010, AS % OF GDP

	10 months 2010 r.	10 months 2009 r.	Deviation, as p. p. of
Level of tax burden (1+2+3)	31.8	30.3	+1.5
Tax collection (1), including:	19.9	20.6	-0.7
Corporate profit tax	4.0	3.4	+0.6
Personal income tax	3.8	4.1	-0.3
UST*	0**	2.1	-
VAT	5.5	5.3	+0.2
Excise taxes	1.1	0.9	+0.2
Mineral tax	3.1	2.6	+0.5
Contributions on mandatory pension insurance (2)	5.0	3.4	+1.6
Revenues from foreign trade (3)	6.9	6.3	+0.6

*without regard to insurance contributions on mandatory pension insurance.

** since 2010 UST has been transformed into insurance contributions collected directly to extrabudgetary funds

Source: the RF Ministry of Finance, Rosstat, the Gaidar Institute calculations.

The volume of budget revenues from VAT was up at 0.2 p.p. of GDP between January and October 2010 and hit 5.5% of GDP. The progress in collection of VAT was due to the general improvement of the business climate in Russia and adopted measures on improving its administration (introduction of the declarative procedure of its refund).

The growth in the volume of collection of excise taxes to the enlarged government budget accounted for 0.2 p.p. vs. the past year's dynamic. The revenues grew thanks to the increased rates on a string of excised goods since 2010.

Overall, it can be noted that the level of *tax burden* on the economy was up by nearly 1.5 p. p. of GDP over the 10 months 2010 vis-a-vis the same period of 2009 and hit the mark of 31.8% of GDP. The growth of the indicator was fueled by external and domestic factors.

Against the background of growth in revenues to the enlarged government budget in shares of GDP between January and October 2009, the volume of the *enlarged government budget expenditures* over the period in question displays a notable fall in public expenditures in relative terms, which does not contradict the 2010 concept of their curbing. The budget expenditures were down by 2.2 p.p. of GDP (*Table 3*), while it can be noted that the expenditure volume was up by Rb. 1,023 bln. in absolute terms.

The cuts in public expenditures are associated chiefly with limited financing of directions "National economy"- by 2.1 p.p. of GDP, followed by "Health care and sport" and "Education" – by 0.4 p.p. of GDP each. In addition, "National security and law enforcement activities" has been financed at a pace lower than foreseen in the budget- at 0.3 p.p. of GDP on a year-ago basis.

As well, expenditures on "General government matters" were slashed by 0.2p.p. of GDP, while expenditures on servicing the public debt remained stable in relative terms (0.6% of GDP). This

dynamic evidences slowdown of growth rate in financing the public administration's operations, including public servants' salaries in particular. Meanwhile, a 20% cutback in the civil service by 2013 was planned, which should result in a further decline in the respective expenditures.

Expenditures on "Social policy" went up by 1.6 p.p. of GDP vs. the respective period of 2009. It should be noted that a growth in the government's social obligations to the population intensifies pressure on the budget.

Table 3

THE ENLARGED GOVERNMENT BUDGETARY EXPENDITURES BETWEEN JANUARY
AND OCTOBER 2009–2010, AS % OF GDP

	January-October 2010		January-October 2009		Deviation in p.p. of GDP
	As Rb. bn.	as % of GDP	As Rb. bn.	as % of GDP	
Expenditures, total	1,2729.9	34.5	1,1706.2	36.7	-2.2
Including:					
General government matters	1,072.3	2.9	976.1	3.1	-0.2
Including on servicing the public and municipal debts	225.8	0.61	194.3	0.61	0
National defense	883.8	2.4	833.0	2.6	-0.2
National security and law-enforcement activities	975.1	2.6	936.1	2.9	-0.3
National economy	1,528.1	4.1	1,965.1	6.2	-2.1
Housing and communal sector	717.8	2.0	695.8	2.2	-0.2
Environment protection	19,7	0.05	20.8	0.07	-0.02
Education	1389,3	3.8	1,324.5	4.2	-0.4
Culture, motion picture industry, media	257,1	0.7	242.1	0.8	-0.1
Health care and sport	1,247,7	3.4	1,223.7	3.8	-0.4
Social policy	4,638,9	12.6	3,488.7	11.0	+1.6

Source: the RF Treasury, the Gaidar Institute's calculations.

Execution of the Federal Budget of RF between January and November 2010

According to the RF Ministry of Finance's preliminary data, over the 11 months 2010 *the federal budget revenues* accounted for 18.1% of GDP, or down by 0.1 p.p. of GDP vs. the same period of 2009 (Table 4), while in nominal terms they posted a Rb. 990 bln. growth. The growth was powered primarily by soaring proceeds of the fuel and energy complex that benefited from a relatively favorable state of affairs with regard to prices of, and demand for Russian exports, accrual of extra investment revenues generated by the oil-and-gas funds, and the renewal of growth in the physical volume of hydrocarbon production.

The federal budget expenditures over the period between January and November 2010 plummeted by 2.8 p.p. of GDP vs. their respective volume in 2009; however, they rose by some Rb. 165 bln. in absolute terms. The "pension pressure" on the federal budget has remained substantial and may hit nearly 20% in its expenditures structure by results of the year. A significant prevalence of social expenditures in the budget leads to cuts in other kinds of expenditures, primarily budget investments which would otherwise fillip economic growth

As a result, over the period of the 11 months of the year, the federal budget had been executed with a deficit of 2.2% of GDP vs. 4.9% of GDP in 2009. It is envisaged that within next decade the federal budget deficit should not plunge below the mark of 2% of GDP annually¹.

According to preliminary data, the size of the non-oil-and-gas deficit somewhat reduced vs. the values reported over the prior periods of the year, but remained quite high nonetheless – over 10% of GDP - while the World Bank experts recommend to hold it under 5% of GDP. Such a considerable

1 <http://www.openbudget.ru/articles/index.php?ID=3334>

size of the deficit in question still evidences a substantial amount of government obligations that are not backed by non-oil-and-gas budget revenues, which intensifies the budget system's reliance on the external background.

Table 4

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

	January-October 2010		January-October 2009		Execution of the 2010 annual budget breakdown, as %	Deviation	
	As Rb. bn.	as % of GDP	As Rb. bn.	as % of GDP		as % of GDP	As Rb. bn.
Revenues. including:	7,432.4	18.1	6,445.9	18.2	94.4	+986.5	-0.1
Oil-and-gas revenues	3401.0	8.3	2596.6	7.3	91.0	+804.4	+1.0
Deductions to the Reserve Fund and the National Welfare Fund (Stabilization Fund)	26.5	0.1	770.3	2.2	–	-743.8	-2.1
Expenditures. including:	8,343.9	20.3	8,178.8	23.1	81.4	+165.1	-2.8
Interest costs	186.9	0.5	160.4	0.5	85.0	+26.5	0.0
Non-interest costs	8156.9	19.9	8018.4	22.7	81.3	+138.5	-2.8
Surplus (deficit) of the federal budget	-911.5	-2.2	-1732.9	-4.9	38.3	+821.9	+2.7
Non-oil-and gas deficit	-4,312.5	-10.5	-4,329.5	-12.2	70.5	-17.0	+1.7
GDP. estimated	41,084.7		35,386.8				

Source: the RF Ministry of Finance (preliminary estimates), the Gaidar Institute calculations

It is the Reserve Fund that has remained a major source of financing of the federal budget deficit (*Table 5*). Over the 11 months of the year its volume shrank by some Rb. 543.5 bln.- down to Rb. 1, 287.0 bln. However, as the envisaged value of the federal budget deficit should be lower than expected, the Fund will not fully dry up by the end of the year – a fraction of its resources will still be there to cover the 2011 budget deficit.

As of 1 December 2010, the volume of the National Welfare Fund had grown at Rb. 3,8 bln. Its resources are envisaged to be spent solely on co-financing pension savings or covering the federal budget deficit, should oil prices plunge drastically. Should the oil-and-gas funds substantially shrink or completely exhaust by 2012, the nation's financial system will find itself unprotected in the teeth of external shocks.

The announced privatization program also aims at beefing up federal revenues and reducing the value of the deficit within next three years. Sales of large public assets are scheduled through 2015, thanks to which, as preliminary estimates suggest, the government should gross Rb. 1.800 trln. over the period in question. As well, the redistribution of public property is associated with the desire to hand over a fraction of government funds to the private, more efficient, management.

Meanwhile, it was proposed to use privatization revenues to replenish the NWF. Some estimates suggest that to ensure the national financial system's sustainability in the face of external shocks, Russia's NWF needs to make up 60% of GDP (as of the early-2009, it accounted for 17.9% of GDP).

Table 6 presents the dynamic of cash execution of the federal budget over the 10 months of the year according to the functional classification of budget expenditures. Despite a slight underrun of the pace of execution of budget expenditures on the whole (at some 0.1 p.p.) a more substantial delay with their execution was registered across a string of items, except social by their nature expenditures. As well, it can be noted that the level of cash execution across all the items of the functional classification of the federal budget, bar the item "Interbudgetary transfers", notably fell behind the median value, which, should they have been spent evenly during the year, would have account for some 80-83% over the 10 months.

Items “Health care and sports”, “National economy”, “Culture, motion picture industry, and mass media” were financed at a rate lower (at 4.4.-4.8 points each) than the 2009 dynamic. In addition, a serious backwardness was noted with regard to the pace of spending on the item “Servicing the public and municipal debts” – at 12 p.p. lower than the 2009 values.

Meanwhile, the pace of spending on the item “Housing and utilities sector” proved to be at 14 p.p. higher than a year ago. Cash execution of items “Social policy”, “National defense”, “Interbudgetary transfers”, “Environment protection” has likewise taken an accelerated pace – they are funded at between 0.1 to 7 p.p. greater than in 2009.

Table 5

DYNAMIC OF FORMATION AND CONSUMPTION OF THE FEDERAL GOVERNMENT'S OIL-AND-GAS REVENUES IN JANUARY-NOVEMBER 2010–2009, AS RB. BLN.

Наименование показателя	Indicator	Balance as of end-2009.	Approved in the 2010 budget	Collected between January and October 2010		Spent between January and October 2010
				To balance the federal budget	To secure the oil-and-gas transfer	
Oil-and gas- revenues to the federal budget	X	2057.2	3401.0			x
Directions of spending oil-and-gas revenues:	X	x				x
The oil-and-gas transfer	X	2531.1	3401.0			
Reserve Fund	1830.5	5147.5	0	519.5	0	1287.0
National Welfare Fund	2769.0	x	26.5	2.5	–	2772.8
Total	4599.5	x	3427.5	522.0	0	4059.8

* The end-period balances of the Funds take into account both spending from and revenues collected to them, as well as forex calculations. The balances were recalculated using the 1 December 2010 exchange rate

Source: The Federal Treasury

Table 6

CASH EXECUTION OF THE FEDERAL BUDGET BETWEEN JANUARY AND OCTOBER 2010-2009, AS % TO THE ANNUAL BUDGET BREAKDOWN

	January-October 2010 г.	January-October 2009 г.
Expenditures, total	73.1	73.2
Including:		
General government matters	61.5	65.4
Including on servicing the public and municipal debts	62.1	74.1
National defense	69.1	69.0
National security and law-enforcement activities	72.6	75.2
National economy	60.8	65.3
Housing and communal sector	69.8	55.9
Environment protection	74.1	66.9
Education	67.6	69.8
Culture, motion picture industry, media	71.1	75.9
Health care and sport	61.4	65.8
Social policy	77.5	71.8
Interbudgetary transfers	82.7	82.1

Source: the RF Ministry of Finance, the Gaidar Institute calculations

In all, it can be noted that the government's fiscal function should tighten in the years to come. This should manifest itself in raising individual tax rates and axing "quasi-fiscal" public expenditures on granting tax benefits. This strategy is necessary to compensate for shortfalls in the budgetary system revenues. In all likelihood, the increase in the tax burden would be laid upon the mining sector. Meanwhile, the government has so far accumulated an excessive amount of its obligations before the population, a part of which appeared inefficient. There exist huge reserves to enable the government to optimize its spending on public procurements and enhance efficacy of the respective funds. However, implementing necessary, albeit unpopular, changes in the budgetary policy on the eve of the presidential election is too daunting a task.

As concerns main developments in the fiscal policy area, *the adoption of the 2011-2013 Federal Budget Act in December 2010* deserves a special notice. The budgetary framework calculations rest upon moderately optimistic projections of main macroeconomic indicators of Russia's economy – that is, the oil prices (Urals) reaching the mark of USD 79/bbl by 2013 vs. USD 75/bbl projected in 2011; inflation accounting for 7-5.5% between 2011-2013, while economic growth making up 4.3% by 2013.

During the whole medium-term period in question, the federal budget is envisaged to be a deficit one. The value of the deficit will tend to decline to 2.9% of GDP by 2013 vs. 3.6% of GDP in 2011. However, the non-oil-and-gas deficit will undergo no sizeable contraction in the medium term, and its value will not sink below 10% of GDP. Contraction in the value of the deficit will be fueled largely by decreasing budget expenditures in relative terms. Thus, the volume of the federal budget expenditures will drop by 1.5 p.p. of GDP by 2013 vis-a-vis its 2011 value, while the volume of federal budget revenues will tumble by 0.8 p.p. of GDP over the same period.

As concerns the expenditure structure of the federal budget, its main priorities will remain social expenditures and public spending on economy modernization. Apart from these, substantial volumes of expenditures are planned on the military re-equipment. In all, it is planned to spend some Rb. 20 trln. on these programs over the next 10 years, but the 2011-2013 budget failed to foresee the respective funding in an explicit form¹.

It is also planned to implement the health care sector reform in the nearest years; plus, securing robustness of the Pension Fund of RF will require sizeable volumes of budget funds against the background of the looming 8% indexation of pension payments (since 1 February 2011) and increase of the amount of benefits. It is planned to spend Rb. 2.3 trln. on these programs in 2011 alone, with the volume of the respective spending reaching an astronomic Rb. 2.8 trln. by 2013. ●

1 http://www.vedomosti.ru/newspaper/article/252259/vybor_sleduyushego_prezidenta

RUSSIAN BANKING SECTOR

S.Borisov

The main factor propelling the growth of the banking system's assets in October was an increased interest in investing in corporate bonds. The reserves continued plummeting against the backdrop of the decrease in the proportion of delinquencies. In the corporate sector, it was the wood-working industry, automobile industry and trade that remained most exposed to credit risks. In October, concomitant with the growth in the banking system's capital was a slight drop of H1 ratio.

Table 1

MAIN INDICATORS OF RUSSIAN BANKING SYSTEM

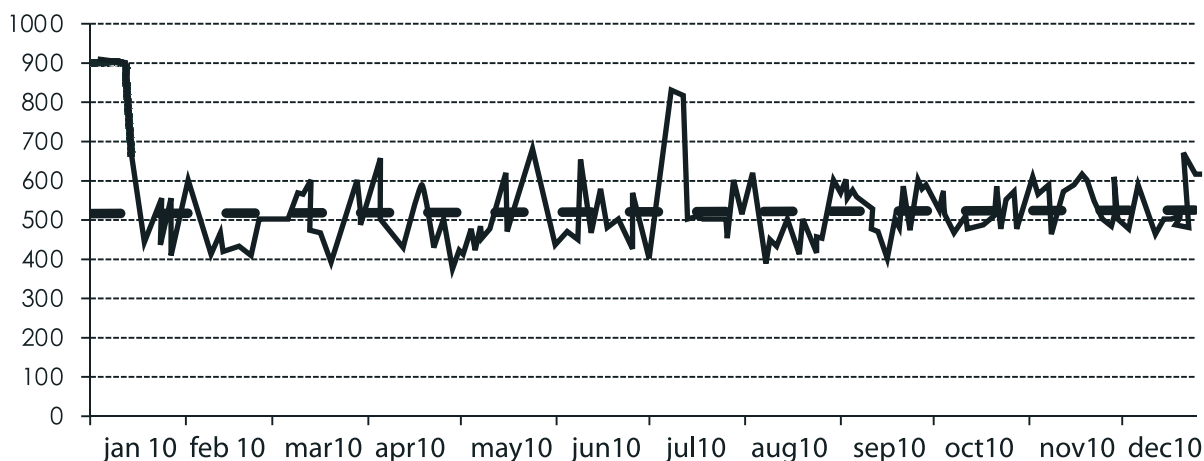
	As of 01.11.2009, as Rb. bln..	As of 01.01.2010, as Rb. bln	As of 01.11.2010		
			In nominal terms, as Rb. bln	Growth since the start of the year, as %	Growth since the start of the year, as %
Assets	27 999,4	29 430,0	31 907,0	8,4%	14,0%
Loans to non-financial organizations	12 656,8	12 541,7	13 691,0	9,2%	8,2%
Loans to private individuals	3 593,5	3 573,8	3 938,1	10,2%	9,6%
Loans to banks	2 639,4	2 725,9	2 954,9	8,4%	12,0%
Investments in bonds	2 850,7	3 379,1	4 434,3	31,2%	55,6%
Deposits with the CBR	1 305,3	1 423,1	330,0	-76,8%	-74,7%
Banks' deposits	3 179,6	3 117,3	3 603,0	15,6%	13,3%
Corporate deposits	5 284,1	5 466,6	5 594,6	2,3%	5,9%
Private deposits	6 801,2	7 485,0	9 080,7	21,3%	33,5%
Impairment	1 881,2	2 050,6	2 268,2	10,6%	20,6%
Profit (in the respective year)	67,7	205,1	441,1		551,6%

Source: the Bank of Russia.

By results of October 2010, the national banking sector posted a 0.6% increase in its reserves, which is somewhat below the average monthly pace over the 10 month of the year (0.8%). That said, a moderate rise in loans to non-financial organizations (+0.5% over the month) and private individuals (+1.7% a month) was a sharp contrast to a spike of investments in papers. According to the CBR, the Russian banks' October bond portfolio gained another Rb. 243 bln. (up by 5.8%). That Russian banks continue being fond of this segment of the financial market is explained by excessive liquidity (which is particularly true, as far as large public banks) on the one hand, and a positive dynamic of the financial market, on the other. Thus, the MICEX index was up from 1,455.6 to 1,533.7 (or +5.4%) in October. The banks are not at pains to sell papers in the hope for further gains in the last month of 2010.

According to the official data, between October and November the volume of commercial banks' balances on corresponding accounts with the CBR averaged between Rb.520-560 bln. A substantial liquidity influx was registered on 16 December (*Graph 1*).

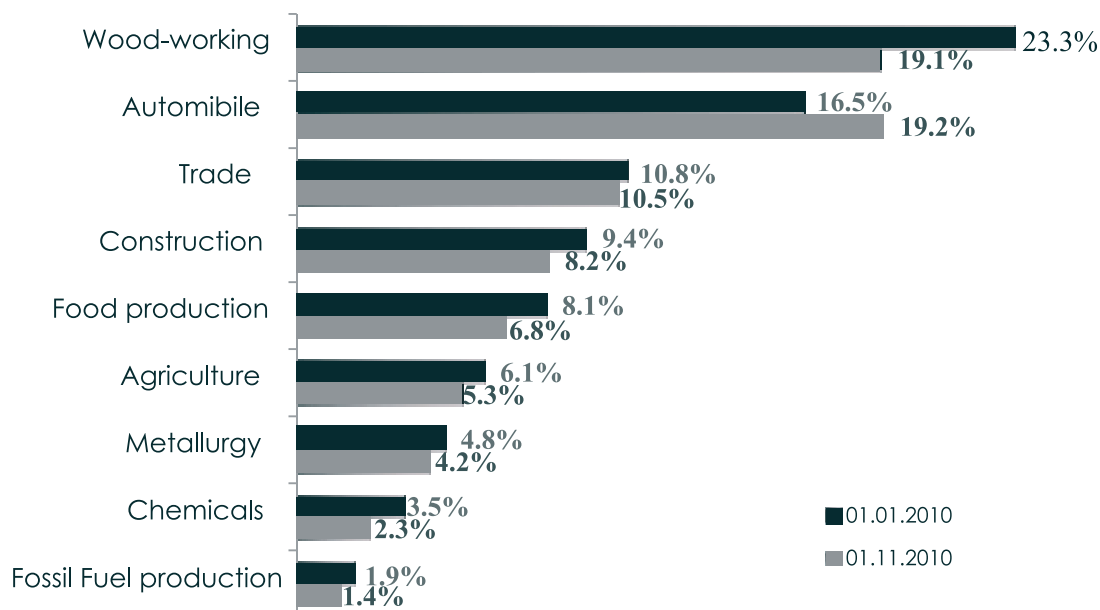
The proportion of corporate and private delinquencies in the banks' credit portfolio was once again down and accounted for 5.9% and 7.4%, respectively, as of 1 November. The most critical consequence of the deceleration of growth in delinquencies in the banking system became a fall in impairment. It is for the second straight month that the banking system's reserves shrank in nominal terms. In October, the drop was Rb. 43 bln., or equivalent of some 10% of the banks' aggregate profit since the start of the year. It is becoming evident that the decline in impairment has formed one of major factors propelling growth in the banking system's profits in the post-crisis 2010.



Graph 1. Commercial Banks' Balances on Corresponding Accounts with the CBR, as Rb. Bln.

According to the CBR, it is the wood-working sector that appears the most problematic sector from the perspective of concentration of credit risks. The record-breaking level of delinquencies noted in the early-2010 is still there, even despite its substantial decline from 23.4% as of 1 January to 19.1% as of 1 November. Yet more pessimistic situation may have emerged in the automobile sector. In contrast to the general trend, the level of delinquencies in this sector did not drop but gained another 2.6 percentage points since the beginning of the year. Retailers and wholesalers have not grown into first-class borrowers, either – despite the surging trade, the level of delinquencies in the sector has remained practically unchanged over the past 10 months and is twice as high the banking system's averages (10.5%). It is export-oriented sectors that remained the most credible borrowers in the bankers' eyes. For example, as of the early-2010, the proportion of delinquencies in the fossil fuel production sector was not above 2% and slid by another 0.4 percentage points over the 10 months. The chemicals and metallurgical sector displayed a similar trend – their low levels of arrears as of the beginning of the year are coupled with a record-breaking pace of their contraction over the past 10 months: from 3.5% to 2.3% and from 4.8% to 4.4%, respectively (*Graph 2*).

Between the early-2010 and the late October the banking sector grossed Rb. 441 bln., or in 5.5. times more than over the same period of 2009. Of the above amount the share of the largest



Source: the Bank of Russia

Graph 2. The Dynamics of the Proportion of Arrears in the Corporate Loans Portfolio across Sectors, as %

bank accounted for Rb. 341.4 bln. The banks' capital was rising by Rb. 32.1 bln. a month, with the capital adequacy ratio H1 sliding from 18.4% to 18.2% in October. Profit remained a major source of growth in the banks' capital – its proportion in the banks' own liquidity rose by 1 percentage point (from 35% to 36%) in October.

Below we reference to the most significant developments in the banking sector between October and November 2010.

- Since the early-2011 the state-owned Agency for Mortgage Restructuring (AMR) established to give a lending hand to affected borrowers should start exercising the collector's functions. The Agency will offer banks to work on the agency basis – that is, to enhance the quality of mortgages on the basis of commission fees. The Agency's program *de-facto* constitutes an attempt to create a public mortgage clearance house which will collect commission fees for mortgage restructuring.

- The Bank of Russia's PR Department informs that with executive order of 03.12.2010 # OD-598 the CBR revoked banking licenses previously granted to joint-stock commercial banks Trado-Bank and Slavyansky Bank due to their failure to comply with the federal law that regulates banking activities and the CBR's normative documents, and the establishment of facts of repudiatory falsity of returns.

- The volume of suspicious transactions on which banks reported to Rosfinmonitoring (the agency tasked to counter money laundering) accounted for some Rb. 120 trln. over the 10 months, the CBR reports. This is in the region of 60% of the volume of all the banking operations associated with the economy and thrice as great the nation's GDP.

- The MinFin submitted to the Government draft amendments to the Act "On insuring private individuals' deposits with banks in the Russian federation". The amendments are supposed to allow the Deposit Insurance Agency (DIA) to open forex-denominated accounts with Russian and foreign banks. Today, the DIA has no such possibility and, consequently, the Agency may not use a whole range of instruments foreseen by the law to place temporarily idle funds it manages. More specifically, without forex-denominated accounts, the Agency cannot invest in such assets as Russia's papers denominated in foreign currencies or in OECD member states' ones, albeit the possibility for such operations has been stipulated in the Act.

- On its meeting on 24 December 2010, the CBR Board ruled to keep the refinancing rate and interest rates on the Bank's operations on providing liquidity unchanged, while interest rates on deposit operations should be raised by 0.25 percentage points, effective as of 27 December 2010. ●

REAL ESTATE MARKET IN THE RF

G.Zadonsky

Over January-October 2010, 441.7 thousand new apartments were commissioned with a total floor area of 37.7 million of sq m or 95.1 per cent versus the corresponding period of the previous year. By number of transactions (18,930,174) real estate market turnover over January-September 2010 increased by 1.5 times as compared with the first six months of 2010. Within January - October 218,029 mortgage loans in the amount of RUR 272.9 bn were granted, that it 2.53 times more than during the relevant period of 2009. In October outstanding debts for mortgages increased by 1.80 per cent to 43.42 billion rubles and a stale debt on loans with overdue payments for more than 180 days amounted to 5.72 per cent of the total amount, or 62.13 billion rubles.

In the January-September of 2010 organizations of all forms of ownership constructed 383.0 thousand of new flats of the total floor area of 33 million sq m, which is 5.5 per cent below the level of the 1st half of 2009. In September the total area of new flats made 53.4 million sq m and in October – 58.7 million sq m. Within January-October 441.7 thousand new apartments were commissioned with a total floor area of 37.7 million of sq m, or 95.1 per cent of the figure of the corresponding period of the previous year (Table 1). The share of housing constructed by individual contractors in the total area of housing implementation made 50.36 per cent (54.6 per cent in January-October of 2009).

Table 1

HOUSING COMMISSIONING DYNAMICS IN 2010

	Total floor area, sq. m	% versus	
		relevant period of previous year	preceding period
January	3,1	99,9	
February	2,9	103	93,5
March	3,6	79,2	125,2
Quarter I	9,6	91,7	38,2
April	3,8	116,2	105,6
May	3,1	104,1	81,9
June	5,1	103,7	163,5
Quarter II	12	107,5	125,6
I six months	21,6	99,9	
July	3,1	75,4	61
August	3,8	96,1	122,4
September	4,5	86,4	119,4
Quarter III	11,4	85,9	95,4
January-September	33	94,5	
October	4,7	99,8	102,5
January-October	37,7	95,1	

Source: Russian Statistics Service data

Moscow Region holds the first place in the list of the top ten Subjects of the Russian Federation with the highest rate for the implemented square per one thousand of people and the absolute leader in January-October 2010 (704.01 sq m per thousand of people), exceeding the Tyumen region (without regard to Khanty-Mansi and Yamal-Nenets Autonomous Areas (668.02 sq m) (Table 2).

Table 2

SUBJECTS OF THE RUSSIAN FEDERATION WITH THE HIGHEST FIGURES OF COMMISSIONED FLOOR AREA PER ONE THOUSAND OF POPULATION IN JANUARY-OCTOBER 2010

	Commissioned, thousand sq m of total floor area			Total area implemented (sq m per 1000 of people.)	Commissioned by individual contractors, out of the total volume, thousand sq m of the total floor area	
	Since the beginning of the year	Including in October	as percentage to the corresponding period of the previous year		Since the beginning of the year	as percentage to the corresponding period of the previous year
Russian Federation	37653,3	4654,8	95,1	265,32	18962,8	87,6
Moscow Region	4754,0	590,9	95,7	704,01	2242,0	82,8
Krasnodar krai	2839,1		104,4	550,14	1623,7	78,6
Belgorod Region	695,8	124,2	94,5	454,73	568,6	94,7
Leningrad Region	721,6		83,9	442,81	354,9	73,2
Republic of Chuvashia	547,9		104,4	428,60	409,0	105,8
Kaliningrad Region	395,7		85,4	421,89	95,2	58,3
Republic of Tatarstan	1518,2		92,5	401,80	730,8	107,7
Tyumen Region	1353,4		103,3	394,54	454,6	88,7
Lipetsk Region	420,1	34,6	105,0	362,83	360,5	115,1
Tyumen Region (excluding Khanty-Mansi and Yamal-Nenets Autonomous Okrugs)	898,6		110,3	668,02	303,6	98,9

Source: Russian Statistics Service data

The average real cost of construction of 1 sq m of housing in January-September of 2010 increased by 6.5 per cent versus the relevant period of 2009 (Table 2), and the average real cost of construction of 1 sq m of housing in January-September of 2010 in Khabarovsk (RUR 53386), Kamchatka (RUR 48100) kraies, the Republic of Chechnya (RUR 45304), Sakhalin oblast (RUR 46642) and Yamalo-Nenets Autonomous okrug (RUR 57407) exceeded the average all-Russian level by 1.5 times or more.

Table 3

AVERAGE REAL COST OF CONSTRUCTION OF 1 SQ M OF RESIDENTIAL FLOOR AREA

	Apartment buildings excluding extensions, superstructures and built-in areas and excluding housing constructed by individual contractors		
	Total	Rural areas	Towns and urban communities
2009 r.			
Quarter I	28814	28597	28826
Quarter II	28763	29994	28673
I half of the year	28790	29358	28754
Quarter III	29294	28393	29338
January-September	29002	29011	29002
Quarter IV	31622	31169	31649
Year	30312	30111	30324
2010 r.			
Quarter I	31135	26383	31447

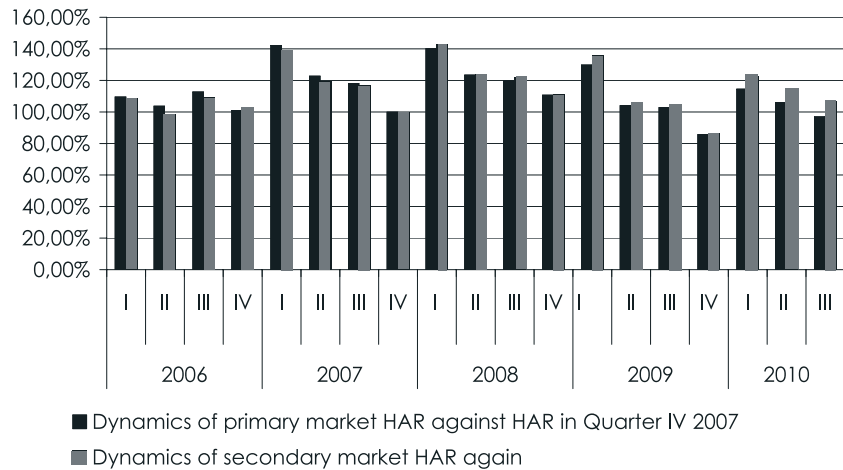
Table 3, cont'd

	Apartment buildings excluding extensions, superstructures and built-in areas and excluding housing constructed by individual contractors		
	Total	Rural areas	Towns and urban communities
Quarter II	31253	34668	31066
I half of the year	31205	30962	31219
Quarter III	30326	28365	30438
January-September	30902	30085	30950

Source: Russian Statistics Service data

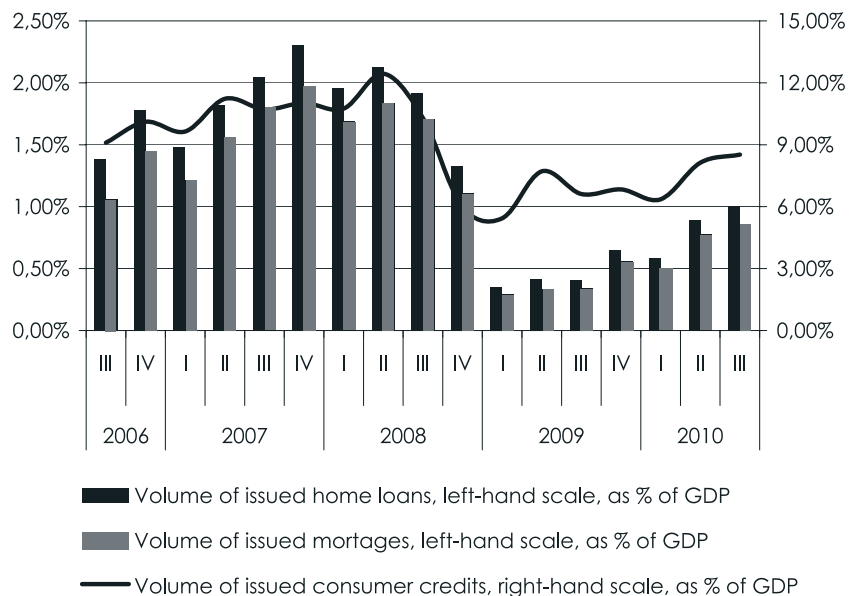
In the III quarter 2010 the housing at the primary market is still more affordable than at the secondary market (Fig.1). The housing affordability ratio (HAR) – the ratio of the cost of a standard apartment of 54 sq m against the annual income of a family of three, decreased in the third quarter as compared with the first and second quarters, i.e. the housing has become more affordable, HAR of the primary market (3.81 as per the year) is by 2 per cent lower, and that of the secondary market (4.56 as per the year is by 6.8 per cent higher than in the fourth quarter of 2007). According to the data of the Federal Service for State Registration, Cadastral Records and Cartography, within January-September of 2010 the immovable property turnover increased by 1,5 times against the first six months of 2010 in terms of the number of deals with real estate (18 930 174). The total number of registered rights for housing in January-September of 2010 (7 827 415) went up by 42.8 per cent as compared with the 1st half of 2010, and the total number of registered records of mortgages (887114) increased by 74.1 per cent as compared with the 1st half of 2010. As to land plots turnover, the number of registered rights for land plots (5023634) has grown 1.5 times as compared with the 1st half of 2010.

According to the data of the RF Central Bank, as of November,



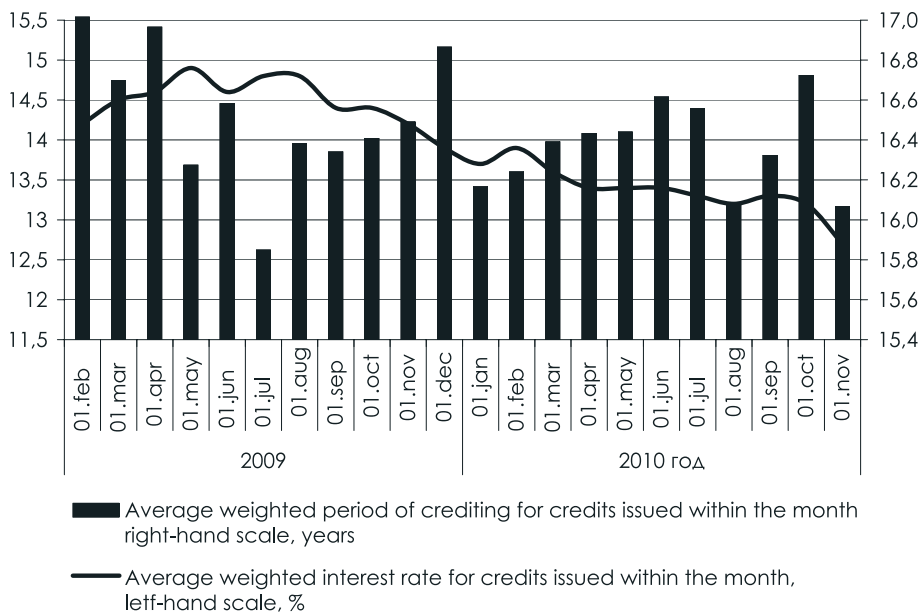
Source: Russian Statistics Service data

Fig. 1. Dynamics of primary and secondary markets HAR against HAR in Quarter IV 2007



Source: RF Central Bank.

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



Source: RF Central Bank.

Fig. 3 Average weighted period of crediting and interest rate for mortgages issued in rubles within the month

289,277 housing loans were issued for the amount of RUR 316.5 billion, including 218 029 mortgages for the amount of RUR 272.9 billion, which is 2.53 times higher than in the same period of 2009. The outstanding debt for mortgages made RUR 1.86 trillion as on November 1, 2010, which is 1.5 per cent more than on October 1, 2010 (RUR 69.6 trillion). Over October stale debt for mortgages issued in rubles went up by 1.26 per cent and made RUR 25.34 billion. Stale debt for mortgages issued in foreign currency increased at by 2.57 per cent, and the total amount of stale debt has grown by 1.80 per cent and made RUR 43.42. On November 1, 2010 the outstanding debt for mortgages made in rubles, made 2.81 per cent of the stale debt and in foreign currency – 8.73 per cent of the stale debt. The volume of mortgages as a percentage of GDP (Fig. 2) in the third quarter of 2010 continued to grow and amounted to 0.86 per cent of GDP, though it remained significantly lower than in the 4th quarter 2007 (1.97 per cent of GDP). For comparison – the volume of consumer credits in the III quarter. 2010 was at 8.52 per cent of GDP with the maximum value of 2 quarter of 2008 was 12.44 per cent of GDP.

Average weighted interest rate (Fig. 3) for mortgages issued in rubles continued to decrease and reached 12.7 per cent as on August 1, 2010. Average weighted interest rate for credits issued in foreign currency in August, September and November made 11.1 per cent.

In the III quarter the share of foreign currency in the total outstanding debt and in the total issued credits volume continued to decrease, and on November 1, the share of foreign currency made in the total outstanding debt 17.1 per cent and in the total issued credits – 4.58 per cent. Outstanding debt for mortgages with arrears of payments (table 3) reduced from RUR 149 929 million on July 1, 2010 (14.5 per cent of the debt), to RUR 142 152 million as on August 1, 2010 (13.64 per cent of the debt).

The share of foreign currency in the total outstanding debt for mortgages in the III quarter was within the range of 41.5 per cent, and on November 1 made 41.64 per cent.

The debt for mortgages with no late payments against the total debt (Table 4) on November 1 made 86.71 per cent, with a stale debt on loans with overdue payments exceeding 180 days amounted to 5.72 per cent of the total amount, or 62,126 million rubles

Table 4

CLASSIFICATION OF MORTGAGE DEBTS BY LENGTH OF PAYMENTS DELAYS

	Total sum of the debt for mortgages	Including:									
		without delayed payments		c with payments delayed for 1-30 days		c with payments delayed for 31-90		with payments delayed for 91-180 days		with payments delayed for more than 180 days	
		RUR mln.	%*	RUR mln.	%*	RUR mln..	%*	RUR mln.	%*	RUR mln.	%*
01 Feb.	1 008 450	864 947	85,77	49 414	4,9	24 102	2,39	17 648	1,75	52 339	5,19
01 March	1 005 629	859 411	85,46	51 689	5,14	23 532	2,34	17 699	1,76	53 298	5,3

Table 4, cont'd

	Total sum of the debt for mortgages	Including:									
		without delayed payments		c with payments delayed for 1-30 days		c with payments delayed for 31-90		with payments delayed for 91-180 days		with payments delayed for more than 180 days	
		RUR mln.	%*	RUR mln.	%*	RUR mln..	%*	RUR mln.	%*	RUR mln.	%*
01 Apr.	1 006 838	858 532	85,27	53 362	5,3	23 560	2,34	17 720	1,76	53 664	5,33
01 May	1 013 685	867 308	85,56	52 205	5,15	22 504	2,22	19 767	1,95	51 901	5,12
01 June	1 025 020	874 137	85,28	53 506	5,22	22 653	2,21	18 860	1,84	55 864	5,45
01 July	1 033 813	883 910	85,5	54 068	5,23	22 434	2,17	16 024	1,55	57 377	5,55
01 Aug	1 042 163	900 012	86,36	46 689	4,48	21 885	2,1	15 737	1,51	57 840	5,55
01 Sept	1 055 983	905 400	85,74	54 172	5,13	20 803	1,97	14 467	1,37	61 141	5,79
01 Oct	1 069 618	916 342	85,67	55 941	5,23	21 178	1,98	14 012	1,31	62 145	5,81
01 Nov.	1 086 126	941 781	86,71	47 898	4,41	19 767	1,82	14 554	1,34	62 126	5,72

* % against the total debt amount.

Source: RF Central Bank.

According to RF CB, there were no significant changes in the number of credit institutions that provide housing credits and mortgages or outstanding debts on the relevant loans, from July 1, 2009 to July 1, 2010 (*Table 5*).

Table 5

NUMBER OF CREDIT INSTITUTIONS THAT PROVIDE HOUSING CREDITS (MORTGAGES)

	2009		2010	
	01 Jan.	01 July.	01 Jan..	01 July
Number of effective credit institutions	1 108	1 083	1 058	1 038
Number of credit institutions that provide housing credits	729	695	699	691
Number of credit institutions that provide mortgages	602	571	584	587
Number of credit institutions, acquiring the right to claim for residential mortgages	108	110	117	120
Number of credit institutions offering refinancing for the credits issued by other credit institutions involved in mortgage financing	25	5	5	12
Number of credit institutions, attracting the refinancing in the secondary mortgage market	204	139	167	130

Source: RF Central Bank.

In November 2010, OAO «Agency for Housing Mortgage Lending» (HMLA) has refinanced 3,146 mortgages for RUR 3,273.46 mln. Volume of orders placed in November for the housing mortgage-backed bonds (senior tranche) ZAO «Mortgage Agent HMLA 2008-1» exceeded the allocation by more than 2.6 times. HMLA signed an agreement on funding for the program «Stimulus» 65 projects for construction of housing a total area of 866 thousand sq m worth over RUR 18 billion and further considers 118 projects worth RUR 35.4 billion for the total construction floor area of 1,600,000 sq m. The agency also plans to redeem the senior tranches of mortgage-bond market participants in the amount of 20 billion rubles.

In connection with the Russian State Duma the Federal Law «On Amendments to the Federal Law «On the status of servicemen and provision for accommodation to individual categories of citizens», adopted in the third reading on November 26, 2010, RUR 36 billion were allocated from of the federal budget for housing or monetary compensation therefore to 23,373 servicemen who were included in the waiting list before January 1, 2005. ●

RECENT TRENDS IN EDUCATION DEVELOPMENT

T.Kyachko

Adoption of the Federal Law No. 83-FZ made significant changes to the legal status of public educational institutions. The risks of these changes impact on the education system are currently not clear. At co-existence of different types of institutions, there arises an issue of criteria for allocation the government orders between the institutions and, consequently, the budget funds. However, it is not yet clear yet, how this problem will be resolved.

Following the adoption of 8 May 2010 the Federal Law No. 83-FZ «On Amendments to Certain Legislative Acts of the Russian Federation in connection with the improvement of the legal status of public (municipal) institutions», there occurred a series of new trends in education associated with the new law.

Prior to its adoption by the main argument of transition of universities into autonomous institutions (AI) was as follows: public institutions will serve exclusively public functions and to be funded strictly on cost estimates to perform these functions. All off-budget revenues of budgetary institutions, which are non-tax revenues of the budget according to the Budget Code, will be withdrawn to the budget and will be disposed by the legislator, i.e., these revenues will be not necessarily returned to those who earned the money (after the Law No. 83-FZ is adopted. this rule applies only to official institutions).

In this case, supporters of the transfer of non-budgetary funds to the budget, especially from commercial educational activities, have a «strong» argument - «extra-budgetary funds are earned from the use of national property». But then the question arises: what is changed in case of transition of a high school to the AI, if the property is still national? Thus, there is a risk that some time after the transformation of the university in the AI government may start charging rent for what it decides to regard as surplus property of the university, or at least, may refuse to pay for its maintenance, and such surplus property is likely to be everything that allows the institution to earn additional income by training students on commercial basis. With considerable reduction of the students' amount in Russia in the coming years, such concerns may be quite tangible reality. And actions of the Ministry for Economic Development and the Russian Ministry of Finance so far only reinforce these fears of universities, because according to the developed methodical recommendations¹, only 10% power supply and 50% of heat supply will be paid, if the assets of a high school for one reason or another will not be used in the training process.

Adoption of the Law 83-FZ created a fundamentally new situation, because now public and municipal educational institutions can operate as a state-owned, low cost and autonomous ones. Herewith, “new” public institutions in their organizational and economic status of the said law are to a great extent close to the autonomous institutions (see *Table 1*).

Table 1

BASIC DISTINCTIONS OF THE PUBLIC (MUNICIPAL, STATE), BUDGET AND AUTONOMOUS INSTITUTIONS

Status	Public institutions	Budget institutions	Autonomous institutions
	Non-commercial institution	Non-commercial institution	Non-commercial institution
Financing of activities	On the basis of budget estimates by economic classification codes of the RF budgets	In the form of grants allocated to ensure the implementation of government (municipal) order (assignments)	In the form of grants allocated to ensure the implementation of government (municipal) order (assignments)

¹ Methodical recommendations on calculation of standard consumption rates of providing federal government agencies, public services and costs for the property of federal state institutions (approved by joint order of Ministry of Finance and Ministry for Economic Development of Russia No. 137n/527 dated 29.10.2010).

Table 1, cont'd

Status	Public institutions	Budget institutions	Autonomous institutions
	Non-commercial institution	Non-commercial institution	Non-commercial institution
Property	Established on the basis of operational management (Art. 296, CC)	Established on the basis of operational management (Art. 296, CC)	Established on the basis of operational management (Art. 296, CC)
Procedure of operations with monetary assets	Through accounts opened in the offices of the Federal Treasury	Through accounts opened in the offices of the Federal Treasury	AI has the right to open accounts with credit institutions in the established order
Owner's responsibility	The owner of the property has secondary responsibility for the liabilities of the institution	The owner of the property has no secondary responsibility for the liabilities of the institution	The owner of the property has no secondary responsibility for the liabilities of the institution
Government procurement	In accordance with Federal law No. 94-FZ	In accordance with Federal law No. 94-FZ	Federal law No. 94-FZ is not applicable
Incorporation of other legal entities (participating in the share capital)	Cannot incorporate	Can incorporate upon agreement with the founder	Can incorporate under Supervisory Board control
Opportunity to take a credit	Not available	Not available	Available
Status of financing from public budget	Yes	No	No

Outcomes and risks of the Federal Law No. 83-FZ for the education system are still not fully clear. At the federal level, public educational institutions can only operate in the status of budget and autonomous ones (except for specialized agencies), at the level of the Federation Subjects, the transition into the state educational institutions is in principle possible: the decision to transfer to one or another type of institution should be taken before the end of 2010.

At co-existence of different types of institutions, there arises an issue of criteria for allocation the government orders between the institutions and, consequently, the budget funds.. Answers to this question, are given like this: “the decision will be taken by the founder (the Senior Manager of budgetary funds), who knows the institutions” or “government orders will be distributed with regard to quality of educational services”, can not satisfy anyone. Until now, the founder allocated budget funds between the same type of institutions and the selection process, despite some non-transparency, still was mostly clear of the participants. Now, if the procedures and principles for the allocation of funds remains the same, it becomes quite unclear why all those changes were introduced. If the procedure is changed, we would like to have clear understanding the basis of these changes.

Another problem is a new draft law “On education in the Russian Federation”, which is proposed for the nation-wide discussion. This law should replace the Law “On Education” of 1992, which is, as a result of numerous amendments, became a patchwork quilt. But the decision on the procedure for the development of a new law - to collect all that is in the legislation on education, add to that all the legal documents governing the operation of educational institutions, somehow to bring it in order and to call the resulting “the law” is, to put it mildly, bewildering. Meanwhile, the subject of discussion is hardly even to call the draft law, and, as rightly pointed the rector of the HSE Frenkel Kuzminov, when discussing the bill “On Education” in the Public Chamber, this is rather the materials on the law. The major concern is the baseline of these materials: it turned out that the new draft law key focus is the activities of educational institutions, rather than education of Russian citizens.

On August 31, 2010 a joint meeting of the State Council on Education and the Commission on Modernization and Technological Development of the Russian economy was held. The subjects of the meeting were the priorities in the development of professional education. Judging from combining the two events, education is now regarded as a factor in the transition to an innovation

economy. However, issues discussed during this meeting, inspire no hopes for a real modernization of professional education. For example, M. Prokhorov, who spoke on behalf of employers, called for reduced admission to universities and extend the number of initial professional education (NPO) and secondary professional education (SPO) institutions. He stated that now only 20% of the graduates of professional education are graduates of vocational schools and colleges, and 80 % – from higher education institutions (VPO). In fact, that ratio is approximately 45 to 55. But this is not the point. The system of NPO is now working with efficiency coefficient of 25-30%, because only this percentage of graduates actually entering the labor market, while others are recruited to the army, go to colleges and universities, seek another profession. In recent years, there is a wide discussion about the fact that half of university graduates not working in their specialty, but in primary and secondary professional education the situation is even worse, this proportion reaches 70-75%.

There is no less dispute about the attempt of the State Council to relocate university professors, where staff reduction takes place, NPO and SPO institutions. Firstly, in primary and secondary professional education there is also a decline in the number of students, and secondly, the salaries at these levels of education are much lower than in VPO, although compared with the average for the economy, even in higher education, it is only 90% (*Table 2*).

In general, in the decisions of the State Council there is a common trend to continue the direction of development of professional education that has emerged in recent years. As noted in the report which was prepared by a working group of the State Council to the meeting on education issues, the results of policies in education will have a deferred effect and cannot be immediately observed.

Table 2

AVERAGE MONTHLY WAGES OF EDUCATIONAL INSTITUTIONS EMPLOYEES IN THE FEDERAL REGIONS AS BROKEN BY LEVEL OF PROFESSIONAL EDUCATION FOR JANUARY - MAY 2010 (RUR)

	Total in economy	Education - total	Including:						Salaries in education versus the average for the economy, %	Wages in pre-school education versus the average for the economy, %	Salary in the initial general education versus the average in the economy, %	Wages in the basic and secondary general education versus the average for the economy, %	Wages in the NPO versus the average for the economy, %	Wages in the SPO versus the average for the economy, %	Salary in the VPO versus the average in the economy, %
			preschool education (prior primary professional education)	Primary education	Basic general secondary education (complete general education)	NPO	SPO	BVPO							
Russian Federation	21144	13363	9948	10089	13029	11810	15663	19351	63,2	47,0	47,7	61,6	55,9	74,1	91,5
Central Federal Region	26459	17527	14273	10280	17405	11508	20657	22395	66,2	53,9	38,9	65,8	43,5	78,1	84,6
North-West Federal Region	24056	15574	11140	13454	15472	14912	17048	21592	64,7	46,3	55,9	64,3	62,0	70,9	89,8
South Federal Region	15343	10630	7110	9567	10849	10438	12291	14962	69,3	46,3	62,4	70,7	68,0	80,1	97,5
North Caucasus Federal Region	12097	8372	6131	7963	8157	9115	10859	11642	69,2	50,7	65,8	67,4	75,3	89,8	96,2
Ural Federal Region	25349	14658	10689	14081	15468	13405	16399	21189	57,8	42,2	55,5	61,0	52,9	64,7	83,6
Siberian Federal Region	18744	12011	8271	9678	11587	11199	14051	19341	64,1	44,1	51,6	61,8	59,7	75,0	103,2
Far East Federal Region	26445	16363	11351	14731	16800	16407	19606	22294	61,9	42,9	55,7	63,5	62,0	74,1	84,3

Source: Russian Statistical Service.

AN OVERVIEW OF ECONOMIC LEGISLATION

I.Tolmacheva

In December, the following alterations were introduced in legislation: the system of temporary disability payments, including maternity allowances, was changed; and the procedures for allocating mother capital to the improvement of housing conditions were defined more specifically.

I. Federal Laws of the Russian Federation

1. 'ON THE INTRODUCTION OF ALTERATIONS IN FEDERAL LAW 'ON MANDATORY SOCIAL INSURANCE IN AN EVENT OF TEMPORARY DISABILITY AND IN CONNECTION WITH MATERNITY' of 8 December 2010, No 343-FZ.

The Law enters into force from 1 January 2011.

By this Federal Law, alterations have been introduced in the system of temporary disability payments. In particular, the procedure for estimating a mean level of earnings for the purpose of calculating temporary disability, maternity and child-care allowances. As far as these allowances are concerned, the mean earnings will have to be estimated on the basis of an insured person's mean earnings during the two preceding calendar years, instead of one calendar year. For those women who were on a maternity leave during the aforesaid period, the relevant calendar year may be replaced (if certain conditions are satisfied) by still earlier calendar years (or year). It is established that the employer is obliged to issue to an employee a statement of the sum of his or her earnings for a current calendar year, as well as a similar statement for the two calendar years preceding the year in which the employee requested the issuance of such a statement, or the year of termination of his or her employment. The Federal Law established the mechanism for the issuance, to citizens, of earnings statements for the purpose of assigning and paying an allowance for the two preceding calendar years for which insurance contributions were charged. The period of temporary disability payable by the employer has been increased from two to three days.

II. Resolutions of the Government of the Russian Federation

1. 'ON THE INTRODUCTION OF ALTERATIONS IN THE RULES FOR THE USE OF MATERNITY (FAMILY) CAPITAL (OR PART THEREOF) FOR IMPROVEMENT OF HOUSING CONDITIONS' of 27 November 2010, No 937.

In accordance with the alterations introduced in 'The Rules for the Use of Maternity (Family) Capital (or Part Thereof) for Improvement of Housing Conditions' (confirmed by Resolution of the RF Government of 12 December 2007, No 862), the procedure for the allocation of maternity capital funds to the construction or reconstruction of an individual housing construction object, without employing the services of a construction organization, is now regulated in detail, in particular the sequence of the allocation of funds is established, which is designed to take into consideration the amount of work that has actually been carried out. It is especially important that the previously existing obligation, when formalizing the right of joint ownership to a newly constructed or acquired dwelling, to include in the number of owners 'other' family members residing together with the person who has been issued a State certificate, in addition to his or her spouse and children. Besides, the procedure for granting maternity capital funds in an event of acquisition of a dwelling under an installment purchase agreement has become subject to more detailed regulation. The lists of documents to be submitted to the territorial bodies of the RF Pension Fund in order to obtain maternity capital funds for improvement of housing conditions have been made more specific; at the same time, the requirement that, in an event of acquisition, at the expense of maternity capital, of a dwelling under a purchase contract, copies of the documents confirming the seller's right of ownership to the dwelling being sold should be also submitted, as well as of the documents confirming absence of any encumbrance attached to the dwelling, has been abolished.

2. 'ON THE MEDIATOR TRAINING CURRICULUM' of 3 December 2010, No 969.

From 1 January 2011, Federal Law of 27 July 2010 r. No 193-FZ, 'On an Alternative Procedure for the Settlement of Disputes with Participation of a Mediator (Mediation Procedure) comes into force, whereby the mediation procedure may be used to resolve disputes arising in civil-law relationships, including those related to entrepreneurial or other economic activities, as well as labor and family relationships. The mediation procedure represents a method for settling disputes with the assistance of a mediator, that is, an independent natural person attracted by the parties in the capacity of an intermediary in order to achieve a mutually acceptable solution. The mediation procedure may be used in an event of a dispute both before the submission of a claim to a court of justice or an arbitration court and after the onset of judicial proceedings or arbitration proceedings, including when suggested by the judge or arbitrator. A mediator may act either on a professional or non-professional basis.

Non-professional mediators must be aged at least 18 years, have full legal capacity and must have not convicted of any crime. Professional mediators must be aged at least 25 years and possess a higher professional education. They must also have completed after they have completed a training course within a special mediator training curriculum. By this Resolution it is established that such a program must be approved by the RF Ministry of Education and Science in coordination with the RF Ministry of Justice. ●

AN OVERVIEW OF THE RF GOVERNMENT'S MEETINGS IN DECEMBER 2010

M. Goldin

At its meetings on 1 December 2010, the Government of the Russian Federation considered the Draft Law 'On the Introduction of Alterations in the Federal Law 'On Investment Funds', and on 7 December – the report delivered by the RF Ministry of Economic Development 'On Measures Designed to Improve the Performance of State-Owned Corporations'.

At its meeting held on 1 December, the RF Government considered a draft of the Federal Law 'On the Introduction of Alterations in the Federal Law 'On Investment Funds' (hereinafter – Draft Law). The Draft Law was submitted to the RF Government's meeting by the Federal Financial Markets Service (the FFMS of Russia).

According to the Draft Law's authors, its main purpose is to promote venture investments in innovative projects by means of investment funds, as well as to create favorable conditions for investing retail investor resources in the Russian stock market.

The Draft Law puts forth the following innovations.

1. In the opinion of the Draft Law's authors, one of the shortcomings of the existing procedure for regulating the management of investment funds is that it imposes restrictions on the composition of a closed-end mutual fund's investment committee, which may include only the owners of investment securities held by the mutual fund.

It should be reminded that, in accordance with Item 6 of Article 17 of the Federal Law 'On Investment Funds', an investment committee is created when the necessity for obtaining the approval, by all or several of the stakeholders of a closed-end mutual fund, of transactions with property held by the mutual fund, is envisaged by the rules for the trust management of the fund.

At the same time, the Federal Law 'On Investment Funds' does not allow the participation in the investment committee of any third parties, including independent experts with specific knowledge in that field, and so, as the Draft Law's authors believe, this may give rise to situations when it will be difficult to actually make efficient decisions when selecting relevant investment projects.

In order to eliminate this restriction, it is suggested in the Draft Law that the owners of stakes in a mutual funds should be allowed to include other physical persons in their investment committees. In this connection, the Draft Law envisages that the members of an investment committee may be paid remuneration at the expense of property held by the mutual fund. Thus, the work of attracted experts will be paid for at the expense of a fund's property.

2. The next amendment stipulates that the rules of trust management of a mutual fund whose investments are restricted in their turnover should envisage the necessity of obtaining the asset manager's consent to alienation of its investments (including those that have not been completely redeemed) for the benefit of parties who own no shares in a given mutual fund, as well as the right of its asset manager to refuse a request of any person to purchase the fund's shares.

This proposal has been initiated because in many cases when a mutual fund is created as a venture fund, its asset manager plays a key role both in its creation and in attraction of investors. In this connection, it is essential for the asset manager to apply appropriate instruments for the control and selection of investors aspiring to the ownership of shares in the fund. However, at present asset managers have no right to influence in any way the composition of investors in mutual funds.

3. Besides, the Draft Law envisages the possibility for the asset manager of a closed-end mutual fund, whose investments are restricted in their turnover, to acquire those investments when forming the fund. In this connection, an asset manager will enjoy the right to transfer only monies in lieu of shares. The shares thus acquired will not endow the asset manager with a voting right at a general

investor meeting. The Draft Law also envisages some restrictions imposed on transactions with the shares held by the asset manager.

As intended by the authors of the Draft Law, this amendment must be introduced so that investors would be able to get aware of the extent to which the venture portfolio manager shares with them the risk of owning this portfolio.

4. The Draft Law introduces a new type of mutual funds – exchange traded funds (ETF). An analog of an exchange traded fund in international practice is an index fund that trades on stock exchanges. Its shares are listed on a stock exchange and can be sold or purchased on the stock exchange market as ordinary shares. Their circulation on a stock exchange makes it possible for investors to follow their real time index and so make decisions as to their trading during one trading session.

One key distinction of an exchange traded fund from a mutual fund is that the right of an investor to demand from an asset manager the redemption of an investment and the payment of its money value is replaced by an owner's right to demand from a market maker that the investment be bought out at a price that would differ insignificantly from its estimated value. In this connection, the market maker will enjoy an exclusive right to demand from the asset manager that the bought-out investments be redeemed by it.

In order to execute the right of an investor in an exchange traded fund, the market maker authorized by the asset manager is obliged to publicly quote on a stock exchange the buy and sell prices of the aforesaid instruments.

It should be noted that in Russia there already de facto exists the practice of creating and operating exchange traded funds. Thus, in the summer of 2010, the company Troika Dialog launched the open-ended exchange traded fund Troika Dialog – RTS Index Standard, whereby investors were given opportunities to acquire as a single security (an investment fund share) a whole portfolio of securities representing RTS Index Standard¹.

6. The Draft Law also envisages the introduction of some alterations designed to more specifically define the legal regime for fractional investment fund shares; the legal status of a specialized depository; the restrictions imposed on an asset manager who assumes responsibilities involving the payment of remuneration for services at the expense of the property constituting a mutual fund; a more specific definition of the regime for distributing information concerning a fund the circulation of whose shares (or investments) is subject to restrictions.

At its meeting held on 7 December, the RF Government heard the report 'On Measures Designed to Improve the Performance of State-Owned Corporations' delivered by the RF Deputy Minister of Economic Development Andrei Klepach.

The report contained a description of measures to be implemented in order to ensure a comprehensive improvement of the performance of state corporations.

Thus, in particular, the RF Ministry of Economic Development prepared a draft of the Federal Law 'On the Introduction of Alterations in the Federal Law 'On Non-commercial Organizations' and Some Other Legislative Acts of the Russian Federation'.

By the provisions stipulated in the Draft Law it is envisaged that the Federal Law 'On Non-commercial Organizations' should consolidate the status of a state corporation's board of directors or supervisory board. The powers of such a board should be as follows:

1) to approve a state corporation's long-term activity and development program envisaging the achievement of certain production, investment and/or financial targets (hereinafter – a strategy) or another long-term planning document as envisaged by the Federal Law on the creation of a state corporation;

2) to approve the system of remuneration of a state corporation's employees envisaging that the size of remuneration should depend on the achievement of key performance targets;

3) to determine the procedure for using a state corporation's profits.

Similarly to economic societies, it is suggested that state corporations should have opportunities for creating a special institution for approval of large-scale transactions.

1 <http://www.rts.ru/ru/standard/etf.aspx>

In this connection, a large-scale transaction effectuated by a state corporation is understood as a transaction (including loan, credit or guarantee) or several related transactions involving disposal of money, attraction of money, or acquisition, alienation or possibility of direct or indirect alienation of property by a corporation, the price (for acquisition) or balance-sheet value (for alienation) of that property amounting to 5 or more per cent of the balance-sheet value of the state corporation's total assets as determined on the basis of its accounting report as of the last reporting date, unless a smaller size of a large-scale deal is envisaged by the federal law on the creation of a state corporation.

In an event of alienation or an arisen possibility of alienation of property, the balance-sheet value of the state corporation's total assets is to be compared with the highest of the following two values: the balance-sheet value of that property or the price of its alienation. In an event of acquisition (or possibility of acquisition) of property, the balance-sheet value of the state corporation's total assets is to be compared with the offering price of the property to be acquired, and if the deal has already been completed - with the price of acquisition of that property.

The Draft Law envisages the possibility of a state corporation being audited by the Audit Chamber of the Russian Federation and by other state agencies, as well as of a mandatory annual revision of its accounting reports by an independent audit organization. In this connection, the audit organization must be selected on the basis of the results of an open tender.

Besides, the RF Ministry of Economic Development is completing the elaboration of a draft of the Federal Law 'On purchases of goods, or work, or services by state corporations (or companies), subjects of natural monopolies, and organizations belonging to the utilities complex'. By the Draft Law, the general principal and main requirements for purchases of goods, or work, or services by state corporations are established in order to more efficiently use the money allocated for this purpose and to ensure transparency of purchases.

Simultaneously, a draft of the Federal Law 'On the Introduction of Alterations in the Civil Code of the Russian Federation, in the Federal Law 'On Joint-stock Companies' and in Some Other Legislative Acts of the Russian Federation' is being prepared, the purpose of the new law being the improvement of regulation of affiliated relations, large-scale transactions, and transactions involving a conflict of interests. ●

AN OVERVIEW OF THE NORMATIVE DOCUMENTS ON TAXATION ISSUES ADOPTED IN NOVEMBER AND DECEMBER 2010

L. Anisimova

1. In connection with the coming into force of the new rules regulating the movement of goods (in the course of export, import, transit and other operations) within the framework of the Customs Union (CU), a number of alterations were introduced in the texts of Part 1 and 2 of the RF Tax Code in order to synchronize the conceptual and terminological apparatus of the CU's customs legislation with that of the RF Tax Code. The said alterations are also designed to introduce a kind of methodological unity with regard to qualification of transactions for the purposes of application of RF tax legislation and CU normative documents.

Those alterations were reflected in Federal Law No 306-FZ, of 27 November 2010 (which resolved a number of issues regarding the mechanism of excise duty payment) and Federal Law No 309-FZ, of 27 November 2010, on the introduction of alterations in Chapter 21 of the RF Tax Code (the Law is primarily aimed at resolving some major issues regarding the application of a zero VAT rate to hydrocarbon transactions in connection with the establishment of the CU).

The aforesaid laws are also designed to resolve some other technical issues concerning the upgrading of the mechanisms of excise tax and VAT payment in the RF.

Thus, Federal Law No 306-FZ establishes a new list of excisable goods (including cognac alcohol); introduces a new article, 186.1, in the RF TC, which determines a specific procedure for collecting the excise taxes imposed on the goods subject to be marked with excise stamps, when imported into the RF from the territory of a Customs Union member state; establishes a mechanism of mandatory advance excise duty payment, by the producers and buyers of alcohol-containing products, which envisages the subsequent set-off of the advance payment and the possibility of an exemption from such payment in the case of submission of a bank guarantee to the effect that the excise duty is to be paid by way of an indisputable write-off of money from the bank account; increases the rates of excise duties on some types of goods (the rates of excise duties levied on sale of some types of alcohol-containing products and oil refined products have been raised by 30 % and more). The Law establishes that excise duties should be paid in the event of alcohol-containing products being transferred among the structural subdivisions of one legal person, situated in different territories.

Apart from this, the Law extends the list of legally significant actions whose undertaking should be exempt from excise duty. For example, the list now includes the State registration of pharmaceuticals, the adoption of decisions on the introduction of changes in the documents regarding a registered pharmaceutical, and the issuance of permits to conduct clinical trials of pharmaceuticals.

Equally noteworthy are the changes introduced in the terminology of the RF Tax Code in connection with the establishment of the Customs Union. The term 'frontier of the Russian Federation' is changed to 'frontier of the Customs Union', and the term 'Customs Code of the Russian Federation' is changed to 'customs legislation of the Customs Union'. And a new concept has been introduced in legislation – 'other territories under the jurisdiction of the Russian Federation'.

As regards the alterations introduced in the RF TC by Federal Law No 309-FZ, the following should be noted.

In order to concretize the rules regulating the application of the zero VAT rate to external trade transactions, a large number of technical adjustments were introduced in the text of the RF TC.

The concept 'international shipments with the use of various means of transportation' was accorded a definition; such terms as 'the reloading and transshipment of oil and petroleum products' were legislatively defined; the circle of persons subject to the taxation rules established for the participants of an external trade transaction was made more specific.

The text of the RF TC was altered in order to reflect the specific features of the relations which had emerged among the residents of the Customs Union's member countries, as well as the specific aspects of the execution of documents pertaining to export-import and transit operations conducted by contracting parties both within the territory of the Customs Union (with the use of various means of cargo transportation) and with transaction participants situated outside of the territory of the CU.

The new version of the RF TC includes detailed information on the sets of documents that should be submitted in order to justify the application of the zero VAT rate to export-import transactions conducted with the use of specific means of cargo transportation and to various types of work (or services) performed (or provided) in connection with cargo transportation. Special attention is paid to the submission, to a tax body, of a bank statement confirming that the proceeds has actually been transferred, by a foreign or Russian person-buyer of work (or services) to the taxpayer's account at a Russian bank. The right, based on foreign exchange legislation, not to enter the foreign exchange proceeds derived from the performance of work (or from the provision of services) in the territory of the Russian Federation should be documentarily confirmed.

2. Federal Law, of 8 December 2010, No 339-FZ should be viewed as a continuation of the efforts to improve previously adopted legislation on payment of insurance contributions to state social off-budget funds.

By analogy with tax legislation, legislation on insurance contributions to state social off-budget funds has undergone the inclusion of the concept 'legal or authorized representative of the payer'.

The Law introduces the norms replicating the content of the General Part of the RF Tax Code and compensating for the absence, in previous legislation on insurance contributions, of the mechanism of the payer's interaction with the banking system, the treasury and the bodies of local self-government playing the role of administrators of insurance contributions in the regions where the banking network is nonexistent – the mechanism which is exhaustively described in the RF TC. Also, the Law introduces a mechanism for establishing the responsibility of banks and local administrations for a failure to transfer the collected insurance contributions to the aforesaid funds, etc.

At the same time, the Law resolves the issue of establishing favorable tariffs for payments to off-budget funds for the period 2011-2014 for payers engaged in the production, issuance (or release) and (or) publishing mass media resources (except for those specializing in reports and materials of an advertising (or erotic) character). The direct link between this benefit and the oncoming elections of 2011 and 2012 is clearly discernible.

3. Federal Law, of 29 November 2010, No 324-FZ envisages that the recovery of arrears of taxes (or levies) at the expense of a natural person-debtor could be postponed by up to three years, provided that the total amount of arrears accumulated during that period does not exceed 1.5 thousand Rb.

4. Federal Law, of 29 November 2010, No 313-FZ introduces a number of alterations in the RF TC in connection with the adoption of the Federal Law 'On Compulsory Medical Insurance'. The alterations were concerned with the consolidation, in the RF TC, of a special procedure for taxation of medical institutions participating in the system of compulsory medical insurance for citizens. The Law exempts from VAT the monetary means provided to medical organizations by a territorial fund of compulsory medical insurance in accordance with an agreement for financing compulsory medical insurance (targeted financing); and the monetary means received from the said fund as a remuneration for the performance of actions under a compulsory medical insurance contract. It is established that the monetary means provided to medical institutions by the funds as targeted financing should be charged to income and be levied with profits tax. The monetary means provided to medical institutions in order to finance their functioning (meaning the maintenance and upkeep of medical institutions) and the monetary means transferred as a remuneration (or a fee) for the performance of actions under a compulsory medical insurance contract should be included in the tax base of the profits tax. Thus, the scope of the tax benefit established for VAT turns out to be broader than that of the tax benefit established for the profits tax.

5. Federal Law, of 27 November 2010, No 307-FZ introduces alterations in Chapter 26 of the RF TC with regard to mineral extraction tax (MET) and in Chapter 28 of the RF TC with regard to transport tax. The approved increase in the rate of tax levied on oil extraction lags behind the level of actual inflation (in absolute terms, the rates should be annually increased by 3.2 % in the period before the end of 2012, and by another 5.4 % as of 1 January 2013). The rates of tax levied on the extraction of natural gas in 2011 should be immediately increased by 61 %, and then they should be annually increased by 5.6-5.9 %.

There is no abolition of transport tax for the current year, despite the previously declared intention to replace it with an increase in the excise duties on gasoline. The general public believe that transport tax does not take into account the intensity of the use of motor vehicles by various categories of owners, and also creates unjustified problems in the sale of transport means (when a transport means is sold under a letter of authorization, its former owner frequently becomes a blatant tax evader through the fault of the new owner). The alterations introduced in Chapter 28 reduce the basic rates twofold for some categories of transport means. Also, the legislative (representative) bodies of authority of RF subjects have been vested with the unlimited right to establish reduced rates of transport tax with regard to passenger motor-cars with engine power of up to 150 HP inclusive.

6. In accordance with the existing general procedure for levying profits tax, the simplified system of taxation cannot be applied by those organizations where other organizations hold participating interests in excess of 25 %. Exceptions are made for the organizations founded by social organizations of disabled persons, the consumer cooperative organizations and their unions, whose activities are regulated by RF Law, of 19 June 2006, No 3085-1, and the economic societies founded by these consumer cooperative organizations and their unions.

Federal Law, of 27 November 2010, No 310-FZ establishes that the possibility for a switch-over to the simplified profit taxation system, envisaged by the RF TC, should also be granted to the economic societies created by budget-funded scientific and educational institutions and the Academies of Sciences, provided that their activities consist in the practical application (or introduction) of the results of intellectual activity (software, databases, inventions, useful models, industrial samples, selection achievements, integral microcircuit topologies, production secrets (know-how), the exclusive rights to which belong to the founders of the above-mentioned economic societies.

7. Federal Law, of 27 November 2010, No 308-FZ introduces alterations in the procedure for levying tax on profits of organizations and land tax. Exemption from taxation was granted to already functioning hydraulic structures for navigating on inland waterways, hydraulic structures in ports (including sea ports), and the air transport infrastructure facilities (excepting centralized aircraft and spacecraft refueling systems), accounted for in the book value of the said facilities.

The Law also contains a very important provision designed to ensure a comprehensive and timely payment of tax for property belonging to a mutual investment fund. It is established that property constituting a mutual investment fund should be taxable at the management company, although the tax should be paid at the expense of the mutual investment fund. This approach should also be materialized with respect to land tax.

8. Decree of the RF Government, of 27 November 2010, No 933 establishes that, from 1 January 2011, the maximum base for charging insurance contributions to state social off-budget funds should be indexed 1,1164 times, and that the base for charging these contributions should not exceed the amount of 463 thousand Rb per natural person.

9. Letter of the RF Ministry of Finance, of 26 November 2010, No 03-04-05/9-690 clarifies the issue concerning the procedure for granting a property-related tax deduction in the event when a natural person sells an apartment bought on a mortgage loan repayable with interest.

In brief, the position of the RF Ministry of Finance can be characterized as follows. There exist two types of property-related deductions from tax on the income of natural persons. 1) In the event

when a dwelling has been sold, the income from its sale should be excluded from the taxable base (if the dwelling had been owned by the taxpayer for less than three years, the amount of the deduction should not exceed 1 mln Rb). 2) When calculating the tax base for some period, a taxpayer has the right to exclude, from his (or her) total income, the expenses incurred in acquiring of a dwelling during this and subsequent periods. As the interest paid on a mortgage loan falls into the category of the expenses related to the acquisition of a dwelling, they cannot be taken into account as a factor reducing the income from selling the dwelling.

10. Letter of the RF Ministry of Finance, of 29 November 2010, No 03-07-08/333 is concerned with the issue of applying the zero VAT rate to services involving the organization and escort of international shipments (excepting railway shipments). We believe that the Ministry's conclusion that services involving the organization of the loading and transshipment of goods imported into the Russian Federation should be subject to VAT at 18 % would have been more convincing if it had been based on an analysis of the methodology forming the foundation for the norms materialized in Articles 164 and 165 of the RF Tax Code, as it was done, for example, in Letter of the RF Ministry for Taxes and Levies, of 5 April 2002, No 03-06/893/32-N435. The RF Ministry for Taxes and Levies had clarified that a Russian taxpayer (a ship owner or a ship charterer) directly performing the carriage of exported (or imported) goods and actually being a carrier paid for the provision of services concerned with the carriage of exported (or imported) goods should be entitled to exercise the right to use a zero tax rate and tax deductions, provided that the said taxpayer has submitted to the tax authorities all the documents envisaged by Article 165 of the RF Tax Code. At the same time, the application of the zero tax rate and tax deductions to services concerned with the carriage of imported (or exported) cargos was permitted only with regard to the services included in the customs value of the goods. The other services and work of this type, directly related to the production and selling of the goods and listed in subparagraph 1 of paragraph 1, Article 164 of the RF Tax Code (that is, the services concerned with the carriage of exported or imported goods), include the services and work involving the loading, reloading, unloading, escorting, shipping, storing, and sorting of goods, provided or performed by Russian carriers or other persons.

Thus, the zero VAT rate should not be applied to services that are provided additionally, outside of the framework of import-export contracts.

11. Letter of the RF Pension Fund, of 18 October 2010, No 30-21/10970 clarifies some issues concerning the formation of an organization's base for charging insurance contributions with regard to its employees and non-employees.

It has been clarified that compensations paid to workers under labor and collective contracts should be included in the base for charging insurance contributions, while compensations established by federal laws should be excluded from it. According to the RF Pension Fund, organizations should be obliged to charge and pay insurance contributions under civil law contracts, contracts of author's order, contracts of alienation of the exclusive right to works of science, literature and art, publisher license agreements, and license contracts of granting the right to use a work of science, literature or art.

We believe that the norms stipulated in Federal Law, of 24 July 2009, No 212-FZ 'On Insurance Contributions to the Pension Fund of the Russian Federation, the Social Insurance Fund of the Russian Federation, the Federal Fund of Compulsory Medical Insurance of the Russian Federation and Territorial Funds of Compulsory Medical Insurance', which actually limit the right of organizations to possess, use and dispose of their property and oblige them to exercise, at their own expense, social patronage of other market participants, their equals (third parties with whom the said organizations are bound only by contractual civil law relations, that is the by relations in which both parties are recognized as equals), should be expertly examined by the supreme judicial bodies in order to determine whether or not they correspond to Articles 34, 36, paragraph 3 of Article 55 and Article 56 of the RF Constitution, and paragraph 2 of Article 1 of the RF Civil Code.

According to paragraph 2 of Article 1 of the RF Civil Code, civil rights (in particular, the right to possess, use, and dispose of property) may be limited on the basis of a federal law and only to the extent that this is necessary for the purposes of defending the fundamental principles of the

constitutional system, morality, public health, and the rights and legal interests of other persons, and to ensure the defense of the country and the security of the State. It is not clear why the duty to pay compulsory social contributions (and to bear full responsibility with regard to this payment) at the expense of one's own property should be imposed on the party which is an organization, and not on the third party who has actually received the income and who, therefore, has the possibility to pay the aforesaid compulsory social contributions at the expense of this income.

12. Letter of the RF Federal Tax Service, of 24 November 2010, No ShS-37-3/16198@ clarifies the issue concerning the tax consequences, for a taxpayer, of a loss of his status of an agricultural commodity producer during a tax period. According to Article 346.7 of the RF Tax Code, as far as payment of the Single Agricultural Tax (SIT) is concerned, the tax period should be deemed to be a calendar year calculated from the date of an agricultural commodity producer being registered as payer of SIT. The criteria for an agricultural commodity producer being placed in the category of SIT payers are defined as follows: the share of the income derived from the sale of agricultural products produced by the agricultural commodity producer, including the primary processed products produced of agricultural raw stuff of the producer's own production should amount to at least 70 % of the total income derived from the sale of goods (or work, or services). According to paragraph 4 of Article 346.3 of the RF Tax Code, in the event the aforesaid share amounts to less than 70 %, or the sale of agricultural products has not taken place at all, the taxpayer should be deprived of the right to use SIT from the moment of his or her being registered at the taxation body.

A taxpayer who has lost the right to use SIT, should recalculate, within one month from the date of expiry of the tax period during which such violation has been committed, the tax commitments with regard to VAT, tax on profits of organizations, tax on the income of natural persons, tax on the property of organizations, and tax on the property of natural persons for the whole amount of the tax, and pay a fine for the failure to timely pay the aforesaid taxes and the advance payments thereof.

14. Letter of the RF Ministry of Finance, of 6 December 2010, No 03-07-08/355 clarifies the issue of the application-based VAT recovery procedure, which requires that a bank guarantee should be submitted to a taxation body simultaneously with the tax declaration (paragraphs 2 and 6 of Article 176 of the RF Tax Code). Taxpayers can submit their applications for VAT refund / offset during the period of 5 days following the submission of their tax declarations and valid bank guarantees. The decision that VAT should be refunded is to be adopted by the taxation body within the period of 5 days following the submission of the application, provided that the taxpayer has no outstanding arrears on VAT and other taxes, penalties and fines.

15. Letter of the RF Federal Tax Service, of 6 December 2010, No ShS-37-3/16955 clarifies the issue of the procedure for writing off accounts receivable with an expired limitation period. In particular, it has been clarified that the fact of the emergence of a debt should be confirmed by source documents conforming to paragraph 1 of Article 9 of Federal Law, of 21 November 1996, No 129-FZ 'On Accounting'. A loan agreement in itself should not be deemed a source document, and the fact of a transaction should be confirmed by payment documents, invoices, etc. A debt reconciliation certificate also should not be deemed to be a source accounting document. Moreover, the RF Federal Tax Service clarifies that, in accordance with the content of Articles 195, 196 and 203 of the RF Civil Code, the time period of limitation of actions should be interrupted by the signing of a debt reconciliation certificate, and the running of the time period of limitation of actions should start anew. The time that passed before the interruption should not be counted in the new time period.

In this connection, according to the RF Federal Tax Service, an organization should be endowed with the right to reduce the tax base by the sum of the outstanding accounts receivable not earlier than three years from the date when the last debt reconciliation certificate was signed. ●

CHANGES IN THE NORMATIVE BASE OF THE BUDGETARY PROCESS

M. Goldin

In December 2010, the normative base of the budgetary process underwent the following changes: the Federal Law 'On the Federal Budget for 2011 and the 2012 and 2013 Planning Period' was adopted; some provisions of a number of legislative acts were suspended.

By Federal Law of 13 December 2010, No 357-FZ, 'On the Federal Budget for 2011 and the 2012 and 2013 Planning Period' the major characteristics of the federal budget for 2011 – 2013 were approved.

Federal budget revenue for the year 2011 is planned in the amount of 8, 844.6 bn Rb (of which oil and gas revenues will amount to 4, 090.0 bn Rb). Federal budget expenditure is established in the amount of 10, 658.6 bn Rb

As of 1 January 2012 the ceiling established for the Russian Federation's domestic government debt is planned in the amount of 5, 148.3 bn Rb, while the ceiling for the Russian Federation's government foreign debt will amount to 55.6 bn USD, or 44.9 bn euro.

The federal budget deficit for 2011 is established at the level of 1, 814.0 bn Rb

The total revenue of the 2012 federal budget is planned in the amount of 9, 503.4 bn Rb, and for 2013 - in the amount of 10, 379.8 bn Rb; its total expenditure in 2012 will amount to 11, 237.9 bn Rb, including the conditionally approved expenditures in the amount of 419.3 bn Rb, while its expenditure in 2013 will amount to 12, 175.5 bn Rb, including the conditionally approved expenditures in the amount of 798.3 bn Rb

In this connection, the 2012 federal budget deficit is expected to be in the amount of 1, 734.4 bn Rb, and the 2013 federal budget deficit – in the amount of 1, 795.6 bn Rb.

It is intended that in 2011 the federal budget deficit will be covered by funding from the Reserve Fund (284.4 bn Rb), the National Welfare Fund (5 bn Rb), and some other sources traditionally used for covering the federal budget deficit (1, 524.6 bn Rb). These will be the proceeds from privatization of federal property and the government's borrowings. It should be noted that as the bulk of the resources accumulated in the Reserve Fund was spent on covering the 2009 federal budget deficit, and the oil and gas revenues in the federal budget were earmarked in full to covering the expenditure (or deficit unrelated to oil and gas), no funding will be allocated to the Reserve Fund and the National Welfare Fund in 2010 – 2013. In this connection, the size of the Reserve Fund by 2012 will amount to 47.1 bn Rb.

By Federal Law of 13 December 2010, No 358-FZ, 'On the Introduction of Alterations in Article 31 of the Federal Law 'On the Introduction of Alterations in Some Legislative Acts of the Russian Federation' and the Suspension of Some Provisions of a Number of Legislative Acts of the Russian Federation in Connection with the Federal Law 'On the Federal Budget for 2011 and the 2012 and 2013 Planning Period', some provisions stipulated in those legislative acts are suspended due to the fact that no funding for their implementation is envisaged by the law on the federal budget for the period of 2011 – 2013.

Thus, in particular, Part 4 of Article 62 of Federal Law 'On Motor Roads and Road Activity in the Russian Federation and on the Introduction of Alterations in Some Legislative Acts of the Russian Federation' of 8 November 2007, No 257-FZ, in the part relating to the 100 % provision for the costs of capital repairs, maintenance and upkeep of federal motor roads is suspended until 1 January 2012. ●