



RUSSIAN ECONOMY: TRENDS AND PROSPECTS

08'2012

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RUSSIA'S ECONOMY IN AUGUST 2012: PRELIMINARY DATA AND MAJOR TRENDS

Political Background: A Lull Before ...?

So frequently a month of political surprises and cataclysms, this August turned out to be relatively calm with regard to Russia's internal situation.

At the same time, August witnessed a number of alarming signs pointing to a certain aggravation of the situation in the North Caucasus. In Dagestan, Islamist militants murdered the prominent Sufi theologian, Said Atsaev, who had had hundreds of thousands of followers. In the medium-term perspective, this atrocity will weaken the position of the underground terrorist groups because wide circles of the local general public will certainly cast their lot with the police in their efforts to eradicate terrorism. All the same, the situation in the region has definitely taken a turn to the worse. It should be remembered that the situation in the North Caucasus is traditionally regarded as an important factor of Russia's internal politics: any rise in its volatility inevitably increases the importance of the "power" component of the country's internal politics and sidelines its "civilian" agenda. In this connection, equally noteworthy are the newly emerged tensions between the authorities of Chechnya and Ingushetia.

Within the context of the ongoing political reform, the RF Government introduced in parliament a draft law making it mandatory that all city mayors must be directly elected. At first glance this initiative looks like a step towards democratizing Russia's internal political life (in recent years the RF federal authorities have been moving in the opposite direction, doing their best to maximally restrict the practice of direct election). Most likely, this step should be regarded in the context of the RF Government's previous initiatives stipulating a return (although with some notable reservations) to the practice of direct gubernatorial elections. It should be said that many Russian regions are characterized by a confrontation between the governor and the mayors of the biggest cities of a region. With the election of mayors having been made compulsory, these conflicts (which clearly weaken the position of an elected governor) will receive a further impetus, thus furnishing the federal center with some additional opportunities to exert its influence in the capacity of the final arbiter in intraregional disputes.

After a pre-election surge in the spring, Vladimir Putin's approval rating was steadily sliding down throughout the summer. According both to the Public Opinion Foundation (FOM) and the Levada Center, in August his approval rating dropped to (or even below) the lowest levels registered in December 2011. This trend will certainly have a serious impact on Russia's internal political situation in the autumn.

The RF Government and the Executive Office of the RF President were forced to halt the counter-modernization pension reform hurriedly prepared during the summer. The draft project of the reform was brought to life by opportunistic fiscal motives. Aimed at decreasing the deficit of the Pension Fund, it clearly testifies to the fact that the Government has no coherent strategy in the sphere of economics.

Macroeconomic Background: When Oil Brings no Joy

The first ten days of August saw yet another round of oil price increases – the third in a row. As a result, in the second half of August the price of oil (Brent, ICE) stabilized at \$ 112–115 per barrel. Oil price had begun its rise in the last ten days of June, from the starting point of about \$ 90 per barrel. By the end of August, its price had risen by 28.5%, thus having gained back a significant part of its spring 2012 losses. However, the Russian market had by that time become relatively adapted to such oil price fluctuations. The holiday season and the extreme volatility of oil prices were yet another likely reason for the Russian stock market's weak response to that price rise: after having collapsed in late July, stock market indices rose in early August and then fluctuated around 1,450 (MICEX) and 1,440 (RTS) points.

The beginning of Q3 2012 was marked by the resumption of capital flight from Russia, which put an end to a month-long capital inflow into that country. According to the RF Central Bank's preliminary estimates, in July capital outflow from Russia amounted to about \$ 5bn, while the RF Ministry of Economic Development put the figure at between \$ 3bn and \$ 5bn. The Ministry's forecasted that the outflow would continue in August, while at the same time hoping that it would be weaker than in July. The annual capital outflow forecast was increased from \$ 15–25bn to \$ 50–60bn. In all likelihood, however, the forecast minimum will be reached already by the end of August, thus making it necessary to revise the annual capital outflow forecast once again.

From the fourth week of July through the first ten days of August, the ruble was strengthening; then the trend reversed, and the ruble was weakening against both the US dollar and the euro throughout the rest of that month. In August, the volume of the Bank of Russia's interventions in the currency market considerably decreased in comparison with July (when \$ 1,044.84m and € 69.41m was sold on the domestic market). Also, judging by the available data on liquidity formation factors, the RF Central Bank practically abstained from interfering in the exchange rate formation process. The weakening of the ruble in the second half of August that was taking place against the background of persistently high oil prices was apparently caused by the large-scale capital outflow from Russia. Over the course of August, the exchange rate of the Russian ruble against the US dollar demonstrated only minor changes, effectively remaining at 32.29 Rb/USD. At the same time, the ruble weakened 2.5% against the euro to 40.53. Thus, the bi-currency basket rose by 50 kopecks to 36.0.

Owing to the 10-percent growth in commercial banks' correspondent accounts in the Bank of Russia, their excess reserves rose, in July, by 8.8% to Rb 1,008.1bn. On the one hand, consumer lending is on the rise, while on the other hand the volume of deposits held at credit institutions is on the decline. The credit institutions' debt to the Bank of Russia is steadily increasing: in early August it amounted to Rb 1.7 trillion.

The indexation of tariffs for the services provided by the housing and utilities sector and the expectations of a relatively poor harvest in the south of Russia propelled summer-2012 inflation to much higher levels than in the summer of 2011. Having accelerated to 0.9% in June, the rate of inflation continued to climb in July (to 1.2%), and in August prices grew by 0.1% (while August 2011 saw deflation of 0.2%). As a result, by the end of August, inflation accumulated since the beginning of the year had grown to 4.6% (vs. 4.8% in 2011).

It is noteworthy that at the year's beginning the difference between Russia's price-growth rates and the average price-growth rates of EC countries was small (within 1 pp), while in the summer months of 2012 the corresponding curves began to diverge so rapidly that by the end of August Russian inflation accumulated since the year's beginning exceeded average European inflation by 3.7 pp (0.9% and 4.6% respectively).

In the next few months, the inflation backdrop will largely be determined by non-monetary factors. Poor grain harvests in a number of Russia's regions and rapidly rising global food prices will certainly increase inflationary pressures. Yet another stimulus to inflation will be the postponed effect of the tariff indexation augmented by the second round of tariff increases scheduled for September. On the other hand, inflation will be restrained by the annual growth rate of money supply having dropped from 22% to 18% as of 1 August 2012.

The Real Sector: One Step Forward, One Step Backward

According to the RF Ministry of Economic Development, in the first half-year of 2012, the physical volume index of GDP amounted to 104.4%, with the rate of growth falling from 104.9% in Q1 to 104.0% in Q2 by comparison with the corresponding periods of 2011. By comparison with the first half-year of 2011, Russia's economic situation in Q1 and Q2 2012 was characterized, on the one hand, by higher growth rates of population incomes (103% in the first half-year of 2012 vs. 99.4% in the first half year of 2011) and retail trade turnover (7.1% vs. 5.4% respectively), and by a considerable decline in the growth rate of industrial production, on the other (3.1% in the first half-year of 2012 vs. 5.4% in the corresponding period of 2011). The general drop in the rate of industrial growth resulted from a substantial reduction in the growth rates of extraction industries (0.9% in the first half-year of 2012 vs. 2.5% in the same period of 2011) and processing industries (4.5% vs. 8% respectively). In July, the economic situation in Russia noticeably changed: the rate of growth of

the Russian retail market declined (owing to a fall in the retail turnover growth rate of the non-food commodity market, which dwindled from 111.3% in July 2011 to 108.6% in July 2012) by 1 p.p. below the level of last year, while industry, on the contrary, saw a turn to the better: the growth rates of processing industries went up (in July 2012 the volume of industrial production output rose by 5.7% on July 2011, while in July 2011 it had risen by 5.5% on July 2010).

At the same time, it is unlikely that the Russian economy will manage to rectify the difference between its growth rates in 2012 and 2011, because the economic situation will be influenced by the ongoing decline in investment activity. The beginning of the current year was characterized by an investment upsurge: in Q1 2012 investments in fixed assets rose by 16.6% on Q1 2011; in Q2 2012 the growth rate of investment dropped twofold, to 8.5%; in July it dwindled to 3.8%. Although the July drop in the growth rate of investment was seasonal and cyclical in nature, this cannot obviate the fact that the July 2012 index was 4 pp below that of July 2011.

It is noteworthy that in the first half-year of 2012 the balanced financial result of organizations (less small enterprises, banks, insurance organizations and budget-funded institutions) dropped by 4.8% on the corresponding period of 2011, owing to a sharp decline in indices in Q2 2012. Moreover, in July 2012 the growth rate of the volume of credits attracted by non-financial institutions resident in Russia dropped to 22.6% vs. 23.2% in June 2011. These data indicate that, most likely, the autumn of 2012 will be a time of moderate investment activity. Moreover, one should not cherish much hope that the influx of foreign investments will be strong enough to significantly boost Russian industry. In the first half-year of 2012, the inflow of foreign investments into Russia's economy amounted to \$ 74.8bn, which represented a 14.7% drop on the same period of 2011. Although the first half-year of 2012 saw an 8.0% rise in foreign direct investment by comparison with the first half-year of 2011, the share of foreign investment in the total volume of investments in fixed assets continues to decline. ●

THE POLITICAL AND ECONOMIC RESULTS OF AUGUST 2012

S.Zhavoronkov

August saw a considerable deterioration of the situation in Dagestan – the most volatile region of Russia, where a prominent Sufi scholar, Said Atsayev, who had hundreds of thousands followers, was assassinated by Islamist militants. In the medium-term perspective, this atrocious act is likely to be counterproductive for the terrorists, because they will not only be increasingly targeted by the police, but will also have to cope with the intensified hostility of the general public. The RF Government introduced in parliament a draft law on the mandatory election of city mayors, which can be considered to be an important step towards democracy. Almost everybody who had submitted an application to run in the October regional and municipal elections was granted registration. No progress has been made so far in the inter-departmental dispute on the parameters of the long-promised pension reform.

August 2012 turned out to be relatively calm, except for one gruesome incident: the murder, in Dagestan, of Said Atsayev (al-Chirkavi), a prominent religious figure and the most renown representative of Sufism (a trend in Islam) in Russia, who had been an outspoken supporter of the regional and federal authorities. The scale of the public response to this crime was apparent at Atsayev's funeral, attended by more than one hundred thousand mourners. The responsibility for his murder was claimed by the Islamist underground activists headed by Doku Umarov. Atsayev's way of life, which included the regular reception of numerous pilgrims, had always made him an easy target for an assassin. That Atsayev had survived for so long can be apparently explained by a number of factors, first of all by the terrorists' fear of the imminent revenge of his countless followers. Most likely, Atsayev's fate had been sealed by his participation in the negotiations with the political wing of the Islamists, which had resulted in the joint statement that the parties would try to settle any divisive issues through religious dialogue. In effect, this meant the parties' mutual recognition – while the radical approach to that problem consisted in deeming the opposing side as infidels that should be annihilated. The armed underground activists had apparently decided that the dialogue should be discontinued. From a strategic point of view, it is most likely that the August crime will be detrimental to the armed underground Islamist groups, because the murder of the 74-year-old has definitely undermined their prestige, and so will certainly swell the ranks of the power structures by many new volunteers to be recruited among Atsayev's followers. And these newcomers to the power structures will combat the underground Islamist groups without necessarily abiding by the established law. Maybe, they have shot themselves in the foot as gravely as in 1999 when they supported Basaev's invasion of Dagestan.

The RF Government introduced in the State Duma a draft law which would make it impossible for the representative body of a municipal formation to elect the corresponding town's mayor from among the members of that representative body. The draft law can be seen as an important step towards democracy, especially bearing in mind that in the past few years the authorities have been doing their best to cancel direct mayoral elections, and succeeded in nearly one-half of the RF's subjects. However, the draft law still allows the possibility for the representative body of a municipality to appoint, in parallel with the elected mayor, a so-called city manager. *United Russia* has already announced that it will certainly support the draft law. Thus, its approval by the State Duma is guaranteed. This legislative episode has clearly indicated that the government's course towards the toughening of legislation is not all-embracing: the authorities are ready to encourage political competition when it does not threaten their standing at the federal level. The election of a mayor representing the opposition, while inflicting no serious harm on the "vertical of power", will nevertheless in part relieve Vladimir Putin and the ruling party from responsibility for any possible failures, which will now be attributed not to them but to the voters who have elected the wrong mayor.

Equally optimistic results were achieved in the course of registration of candidates for the gubernatorial posts, to be contested in the forthcoming elections in fifteen RF subjects: the opposition candidates had encountered almost no problems with their registration, and in the few cases when such problems had arisen (e.g. in Riazan Oblast), they were quickly resolved without much ado. Moreover, it is quite possible that in Riazan and Briansk oblasts the candidates put forth by *United Russia* can be defeated at the polls. Of course, the probity of the election process should be assessed *post factum*, but so far the behavior of the Russian authorities has been more or less within the boundaries of political correctness.

In London, Boris Berezovsky lost his long-running legal battle with his former business partner Roman Abramovich, deemed to be one of the Russian oligarchs with the closest connections to the Kremlin. Berezovsky's court defeat was caused by his failure to produce any documents confirming his right to part of the contested share capital and by the judge's decision not to take into account the existing indirect evidence thereof. Although the Russian authorities did not participate in the trial, the outcome of this court case is undoubtedly favorable to them.

RF President Vladimir Putin introduced into the State Duma a draft federal law on the introduction of amendments to the existing federal law on subsoil and subsoil use. The draft law unambiguously stipulates that any public sales of subsoil plots should be invariably carried out in the form of auction (at present, it is also possible to conduct tenders like those that have caused numerous scandals arising from the subjective assessments of future investments, ecological guarantees, etc.). Although such alterations can only be welcomed, they leave unattended the serious problems associated with *Gazprom's* and *Rosneft's* monopoly on development rights for the hydrocarbon resources of the Russian continental shelf. These state companies apparently fail to exercise their monopoly on their own (or act as rentiers by inviting other companies to become minority shareholders and the *de-facto* developers), while other companies are forbidden to work on the continental shelf. This issue has as yet remained unresolved.

The RF Government continued to actively discuss the issue of pension reform. It is expected that, as early as 1 October 2012, the RF Ministry of Labor and Social Development would submit to the RF Government a coordinated concept of this reform. The departments in question have so far failed to reach an agreement on the issue: the RF Ministry of Finance and the RF Ministry of Labor and Social Development disapprove of any initiatives on the abolition of the funded part of labor pensions (although the initiators of its abolition have offered a couple of compromise solutions – a reduction in the funded part or its voluntary accumulation). As it is extremely unlikely, for political reasons, that the pension age will be raised in the foreseeable future, the ministries are discussing the alternative scenarios – the cancellation of the mandatory inflation adjustment of pensions and a reduction in the number of pensioners entitled to early retirement pensions. It is still not clear whether or not the funded part of labor pensions, a potent stimulus for the laborer to legally earn a high wage, will be preserved in Russia. ●

INFLATION AND MONETARY POLICY

N.Luksha

In July, there was no traditional slowdown in inflation due to the indexation of regulated tariffs for housing and public utilities. In contrast, the CPI has increased markedly, from 0.9% in June to 1.2% over the month (in July 2011 prices were not growing). Due to the seasonal reduction of foodstuff prices in August, the growth rate of consumer prices has slowed down. However, the decline did not reach the level expected by the Russian Ministry of Economic Development. As of 27 days of August results, prices rose by 0.2%. Thus, the inflation accumulated since the beginning of the year is very close to the same period of the last year, amounting to 4.7% as of August 27 (against 4.8% in 2011). In July, the net capital outflow from the country continued. After three-month reduction, the real effective exchange rate in July started to grow again: as of the end of the month, the Russian currency has strengthened by 3.2%.

Indexation of tariffs for housing and public utilities and fading effect of the high base in food prices contributed to the growth of consumer price inflation in July. By the results of the month, the consumer price index has increased from 0.9% in June to 1.2%. Recall that in the same period of 2011 prices were not growing.

The utmost contribution to the increase in consumer prices, as expected, was made by the increased prices for public commercial services (+2.7%). In July, *tariffs for housing and public utilities* have grown by 5.7% at a time. As in the previous month, in the midst of summer holidays prices for healthcare and recreation services were rapidly growing (+4.2%), as well as passenger transportation services due to higher prices for tickets for long-distance trains (+3.1%). There was no reduction in any type of commercial services in July.

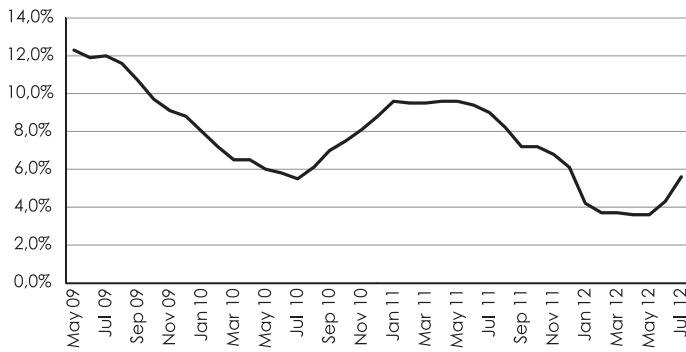
In the second summer month the growth rate of foodstuff prices has slowed down by 0.5 p.p. as compared to June of this year to 1.1% (in July 2011 there was a decline in relevant prices by 0.7%). First and foremost, this was associated with a reduction in the growth rate in prices for fruit and vegetables by more than 3.5 times: in July fruit and vegetable products prices have increased by 3.5%. Despite the slowdown in the rate of growth in prices for fruit and vegetables, they still continued to go up, which is not typical for the month. This year it was due to the unfavorable weather conditions in the south of Russia, wherefore the harvest was started later and was less than expected. In July the price for sugar was rising quickly (+2.7%), as well as for alcohol (+2.2%). At the same time, eggs were getting cheaper (-0.1%).

In July, the growth rate of non-food items prices increased from 0.2 to 0.3%, having matched the relevant period of the last year. The greatest contribution to the rise in prices, as in previous months, was made by tobacco (+1.5%). Gasoline prices in July did not grow up in July (in June it went up by 0.2%). The only cheapening products were still video and audio appliances (-0.1%).

In July, the annual inflation (July 2012 against July 2011) has accelerated to 5.6%, whereas in the relevant period of the last year, that indicator was 9% (*Fig. 1*). The core consumer price index¹ rose by 0.1 p.p. to 0.5%.

In August, despite the seasonal decline in fruit and vegetables prices, no deflation was observed. Two weeks out of four consumer prices were not rising. Nevertheless, the index of food prices over 27 days in August made 0.2% (against a decline in prices by 0.2% in August 2011). As a result, the inflation accumulated from the beginning of the year became very close to the relevant period of the last year, amounting to 4.7% as of August 27 (vs 4.8% in 2011). In August, seasonal food products became cheaper. At the same time, as of nearly four weeks results, price for gasoline

¹ The core consumer price index reflects the level of inflation in the consumer market after adjustment for the seasonal (prices of vegetable and fruit products) and administrative (regulated tariffs for certain types of services, etc.) factors, which is also calculated by the RF Statistical Service (Rosstat).



Source: RF Statistical Service.
 Fig. 1. The Growth Rate of the CPI in 2009-2012
 (% year to year)

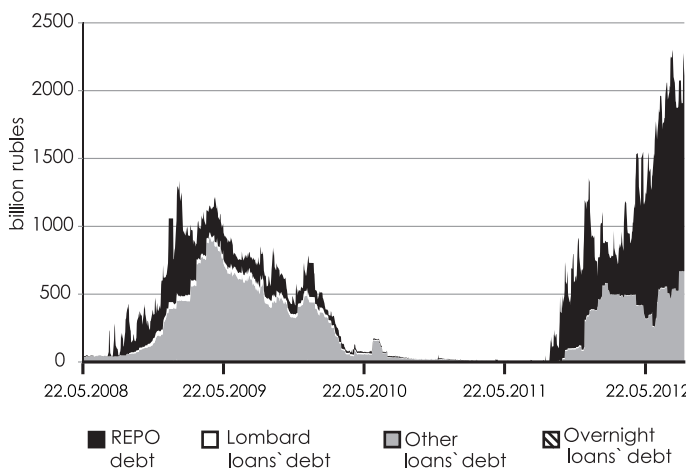


Fig. 2. Arrears of commercial banks with the Bank of Russia in 2008–2012

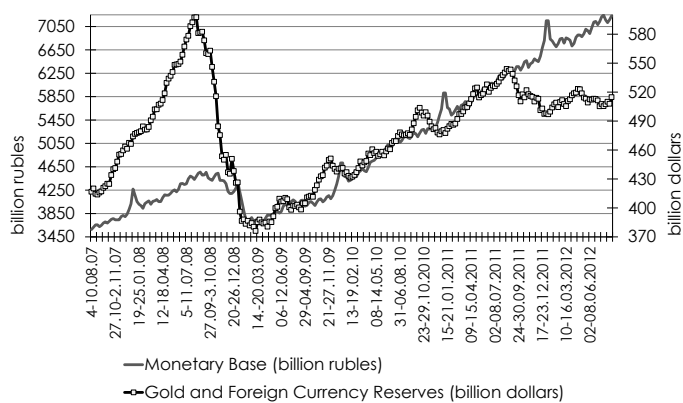


Fig. 3. Changes in the RF Monetary base (in narrow definition) and gold and foreign currency (international) reserves in 2007–2012

increased by 0.7% on August 27. The largest increase in prices in that period was observed in wheat flour (+5.1%).

In the coming months, inflation will to a great extent depend on non-monetary factors. The wreckage of grain crops in some regions of the country, plus the growing global foodstuff prices will entail a pro-inflationary effect. In addition, the delayed effect of tariffs indexation, supported by the second phase of increase in tariffs for housing and public utilities will be visible in September. At the same time, slowing down the monetary supply from 22% to 18% as of August 1 will serve as a factor of inflation curbing.

In July, the volume of monetary base in broad definition increased by 1% to Rb 8,214.6bn. The growth of monetary base in broad definition was based on the increase of commercial banks correspondent accounts with the Central Bank of Russia (+10.6%) and mandatory reserves (+2.6%). The amount of cash in circulation has not changed, reaching Rb 6,803.4bn. Deposits of commercial banks decreased by 1.8% to Rb 133.3bn.

Due to the ten-percent growth of commercial banks correspondent accounts with the Bank of Russia, their excessive reserves¹ in July increased by 8.8% to Rb 1,008.1bn. Nevertheless, the banks' demand for liquidity of the RF Central Bank remains high. On one hand, the consumer lending is extending, on the other hand, the volume of deposits of credit institutions are decreasing. The debt of credit institutions to the Bank of Russia is growing: in early August it reached Rb 1.7 trillion (Fig. 2). To reduce the dependence of banks on financing from the Central Bank, the latter has applied to the Ministry of Finance of Russia with a request to allocate the temporary uncommitted budget funds in the bank deposits.

In July the monetary base in narrow definition (cash plus mandatory reserves) remained practically unchanged, having reached at the end of the month Rb 7,206.6bn (Fig. 3).

In July, in the framework of foreign exchange interventions, the RF Central Bank entered the market with a net sale of foreign currency again, even though the amount of interventions was twice lower

1 Under the excessive reserves of commercial banks with the RF Central Bank is understood the sum of correspondent accounts of commercial banks, their deposits with the RF CB and the RF CB bonds of commercial banks.

than a month earlier. \$1,044.84m and Euro 69.41m were sold in the domestic market (Fig. 4).

In August the volume of interventions has significantly reduced; the RF Central Bank did not practically intervene in the exchange rate formation mechanism, which is confirmed by the data on liquidity factors. From August 7 to 28, the Bank of Russia did not participate in foreign currency trading. Thus, the RF Central Bank continues to implement priority objective in the exchange rate policy, namely the transition to the free exchange rate.

In July, the international reserves fluctuated between \$505–507 bn. In August they started to grow and as a result of little more than three weeks, they reached \$514.8bn (as of August the beginning of the month). The core reason of international reserves growth during this period was the revaluation of reserves denominated in Euro, and gold, included in the reserves. As noted above, foreign currency interventions of the Central Bank were insignificant.

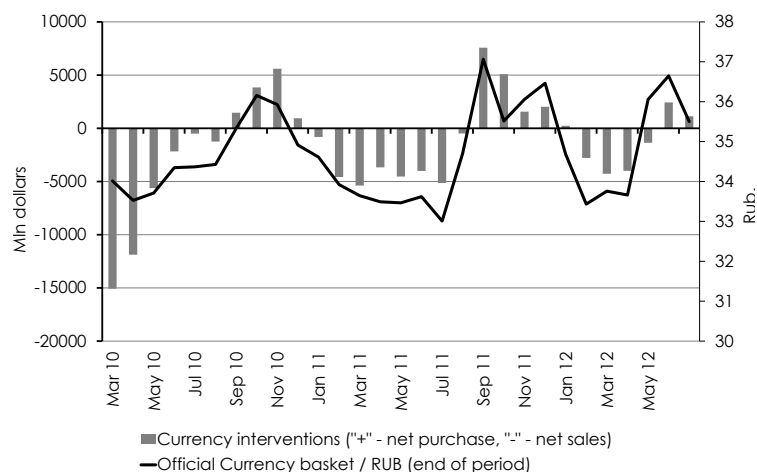
QIII started with the resumption of capital flight from the country, which had been replaced by its inflow only for one month. In July, according to the tentative estimates of the Central Bank, capital outflow was about \$5bn, while according to the Ministry of Economic Development of Russia, made from \$3 to 5bn.

In August the Russian Ministry of Economic Development has revised

annual forecast for capital outflow from the current \$15-25bn to the upward trend. According to the updated data, the annual net capital outflow will reach \$50-60bn. The revision of the Ministry forecast is quite expectable, as in the first six months capital outflow has already reached \$43.4 bn.

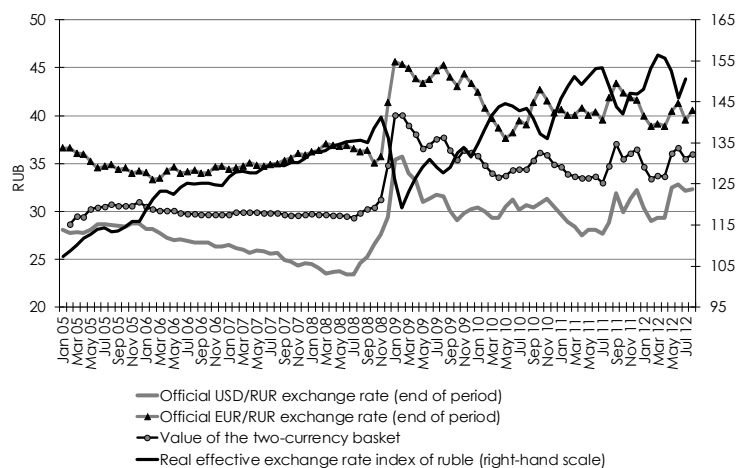
The trend of the ruble real effective exchange rate weakening, which was observed throughout the QII, was suspended in July. Within the month it strengthened by 3.2%. As a result, index of the real effective exchange rate increased to 150.63¹ (Fig. 5).

From the fourth week of July through the first week of August ruble was strengthening, and then until the end of August it was weakening against both, the American and European currencies. The growth rate of the Russian currency in late July and early August against dollar reached 4.5%, and 3.9% against Euro, while further correction made 2.1% and 1.7%, respectively. The Russian currency was supported at the beginning of August by the rising global oil prices. At the same time, the weakening of the ruble in the second half of the month at the background of sustained high oil prices and a peaceful external news background was based, apparently, on capital outflow from the country.



Source: RF Central Bank, author's estimates.

Fig. 4. Central Bank currency interventions and ruble exchange rate against the currency basket in March 2010 – July 2012



Note: The level of January 2002 is accepted as 100%.

Source: RF Central Bank, author's estimates.

Fig. 5. Indicators of ruble exchange rate dynamics in January 2005 – August 2012

1 The level of January 2002 is accepted as 100%.

Note the increased ruble volatility due to the RF Central Bank policy aimed at further exchange rate flexibility (recall that in July the Regulator has expanded again the operating range of ruble value of the two-currency basket). As per August results, the Russian currency exchange rate against US dollar practically did not change and amounted to 32.29 R /\$. At the same time, ruble exchange rate against Euro has decreased by 2.5% to 40.53 Rb/Euro. Thus, the two-currency basket has grown by 50 kopecks to Rb 36 (-1.4%).

From August 7, 2012 the Bank of Russia switched to a new format of publications on its website for the information on the scope and structure of the indicator “monetary mass M2 (national definition)”. From January 1, 2011, the data on monetary aggregates is presented as broken down by the level of liquidity (with designation of M0, M1 and M2), as well as grouping the deposits by sectors – assets of non-financial and financial (excluding credit) organizations and funds of individuals.

The decision of the RF CB objective is to increase transparency of the Bank of Russia policy. It is aimed at increasing confidence in economic agents in the Regulator monetary and credit policy and promoting its effectiveness. ●

FINANCIAL MARKET

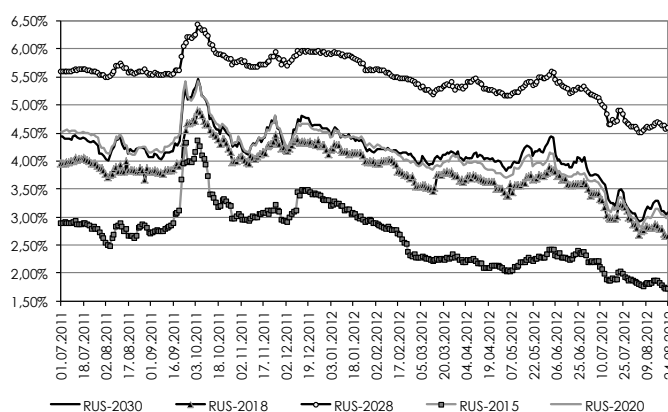
N.Burkova, E.Khudko

The absence of significant external events in the global financial markets, as well as the holiday season encouraged peaceful developments in the Russian financial market in August 2012. An average monthly turnover in the government securities market during this period decreased by 28%, the market of futures grew by 7%, while the volume of the Russian stock market turnover was similar to the preceding month. In the domestic Russian corporate bond market positive dynamics was noted in the primary and secondary markets in terms of indices, volume, sales. The emitters' activity in respect of bonds issues remained at a high level. There were no defaults in the emitters' performance of their liabilities to the bondholders. However, the bonds high yields are sustained.

Government securities market

In August, the lack of significant growth factors in the global financial markets, as well as the holiday season provoked stagnation in the Russian government securities market: the yield to maturity of the government securities market continued to decline (by 3–12%) despite a decline in investors' activity in the sector (Fig. 1).

Within the period from July 23 to August 26, 2012, the total turnover in the secondary market of government bonds amounted to Rb 98.5bn with an average daily turnover at the level of Rb 3.94bn, which makes the downfall of the average monthly turnover by 28.4% as compared with the preceding period. In the period from July 23 to August 26 of the current year, like a month earlier, there were held seven auctions in federal loan bonds (OFZ) placement in the primary market (Table 1). The total actual amount of placement made 55% of the planned volume (against 79% in the preceding month). There were no auctions on additional OFZ issues placement in the secondary market.



Source: "Finmarket" Information Agency data.

Fig. 1. Yields to maturity of the Russian Eurobonds with maturity in 2015, 2018, 2020, 2028 and 2030

Table 1

OFZ PLACEMENTS IN THE PRIMARY MARKET

Auction date	Emission	Emission volume, RB m	Emission volume at face value, RB m	Average weighted yield
25.07.2012	OFZ-25080-ПД	15 000.00	2 724.00	7.91
01.08.2012	OFZ-25080-ПД	35 000.00	13 010.00	7.68
01.08.2012	OFZ-26209-ПД	15 000.00	9 323.00	7.92
08.08.2012	OFZ-26207-ПД	15 000.00	13 595.04	8.25
08.08.2012	OFZ-26208-ПД	15 000.00	14 763.43	7.69
15.08.2012	OFZ-25080-ПД	15 000.00	6 502.38	7.62
22.08.2012	OFZ-26208-ПД	15 000.00	8 464.00	7.80
Total:		125 000.00	68 381.86	

Source: Russian Ministry of Finance.

Stock market

Factors of the Russian stock market dynamics

ECB confirmation on its readiness for taking expansionary actions to improve the situation in the Eurozone, as well as the growth of the US GDP in Q2 2012 by 1.5% as compared with the previous

quarter) and to maintain the level of the US Federal Reserve interest rate at the same level have contributed to the support of the Russian stock market in late July – early August 2012. Over the following three weeks there was observed a sideways trend in the Russian stock market in general due to the lack of significant external news, as well as an ongoing low activity of market participants during the summer season. However, one can highlight the following major developments, which served as the factors of market volatility during this period: the publication of the US macroeconomic data on the improvement in the labor market and the financial performance of the global largest companies, the continued slowdown of Chinese economy, the confirmation by Fitch Ratings of the German emitter long-term default rating in foreign and national currency liabilities at the AAA level with a “stable” outlook. In general, over a month, the markets of developed countries have grown by 1–7%, while those of developing countries – by 3–8%. Basic Russian indices increased by 3–14% (Table 2 and Fig. 2).

Table 2

DYNAMICS OF THE GLOBAL STOCK INDICES

Index	Value (as of 26.08.2012)	Dynamics within the month (%)*	Dynamics from the year beginning (%)
MICEX (Russia)	1 454.08	2.73	0.94
RTS (Russia)	1 436.84	3.25	0.70
Dow Jones Industrial Average (USA)	13 157.97	2.62	4.95
NASDAQ Composite (USA)	3 069.79	4.94	12.29
S&P 500 (USA)	1 411.13	3.56	8.35
FTSE 100 (UK)	5 776.60	2.21	1.43
DAX-30 (Germany)	6 971.07	5.14	12.40
CAC-40 (France)	3 433.21	7.49	1.08
Swiss Market (Switzerland)	6 475.94	3.04	5.87
Nikkei-225 (Japan)	9 070.76	4.62	2.54
Bovespa (Brazil)	58 425.76	7.81	-4.51
IPC (Mexico)	40 211.41	-1.46	10.06
IPSA (Chile)	4 188.11	-4.48	4.95
Straits Times (Singapore)	3 050.49	1.16	13.95
Seoul Composite (South Korea)	1 919.81	5.31	-0.15
ISE National-100 (Turkey)	65 654.31	6.25	20.53
BSE 30 (India)	17 783.21	3.64	11.02
Shanghai Composite (China)	2 092.10	-3.53	-1.40
Morgan Stanley Emerging&Frontier Markets Index	762.30	3.01	2.06

* Versus index indicators as of July 22, 2012.

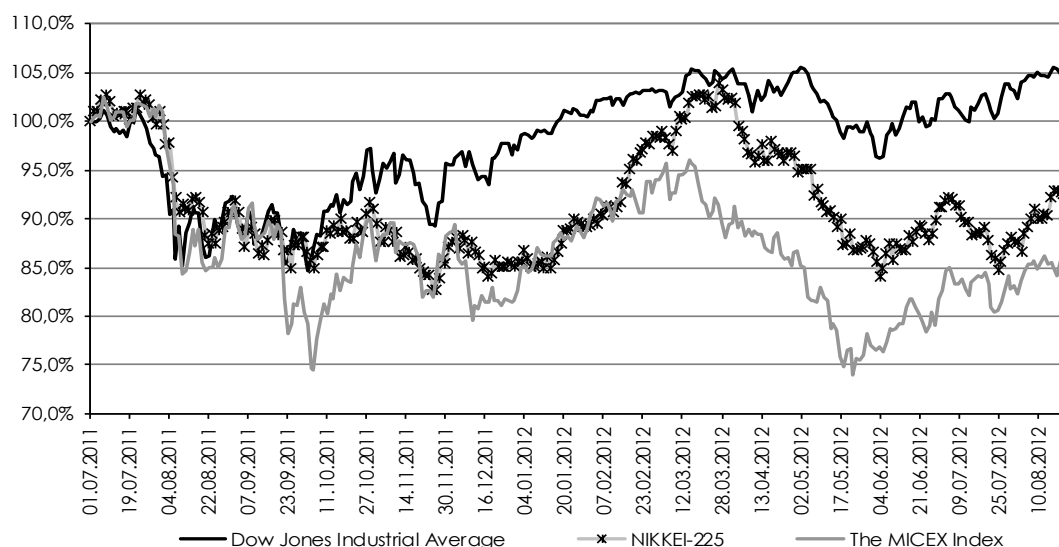


Fig. 2. Dynamics of the main USA, Japanese and Russian stock indices (in % to the indices values as of July 01, 2012)

Stock market situation development

Within the month, the maximum value of the MICEX index was demonstrated on August 14, having reached 1,462.6 points (versus 1,444 points in the preceding month). The minimum value of the MICEX index has reached 1,397.1 points on August 2 (against 1,394 points in the preceding month) (Fig. 3).

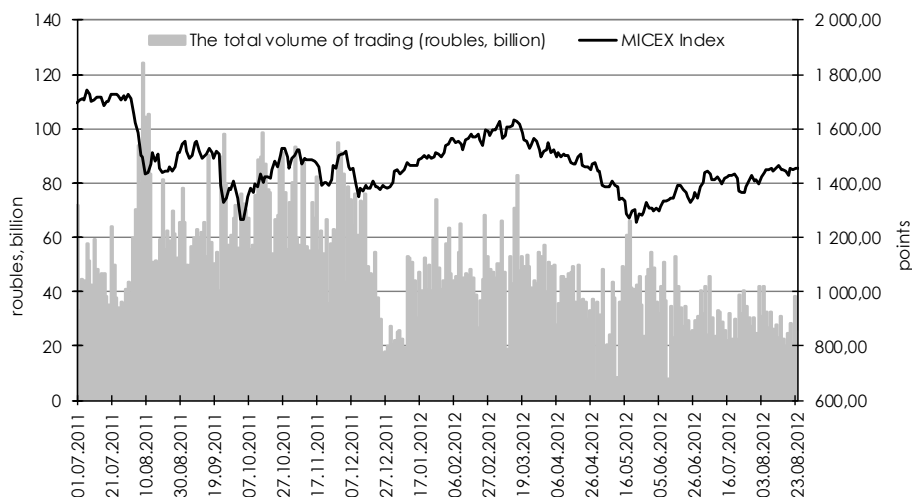
In general, within the period from July 23 to August 26, 2012, the MICEX index has increased by 2.7% (from August 27, 2011 to August 26, 2012 the MICEX index has downgraded by 0.3%), whereas the turnover of trades in securities included in the MICEX index has reached Rb 777.2bn. The average daily level of investor's activity in the stock market in August has remained the same as in preceding month.

In the period from the beginning of the year through August 26, 2012, the leaders in the value decline among the "blue chips" were securities of Tatneft and Rostelecom, which value has decreased by 26 and 17.1% accordingly (Fig. 4).

According to the OAO MICEX, on August 26 of this year, five leaders of the domestic market capitalization were as follows: Gazprom – Rb 3,708bn (against Rb 3,658bn on July 26, 2012), Rosneft – Rb 2,117bn (against Rb 2,179bn), Sberbank of Russia – Rb 2,002bn (against Rb 1,958bn), LUKOIL – Rb 1,595bn (against Rb 1,538bn) and Sugrutneftegas – Rb 1,007.3bn (against Rb 896bn).

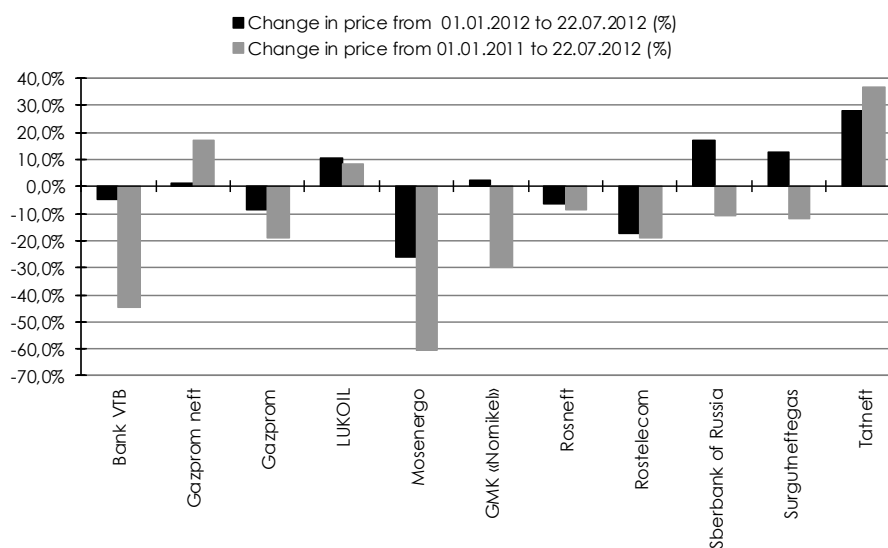
Futures and Options Market

In FORTS market average daily activity of investors from July 23 to August 26, 2012 has increased by 7% as compared to the previous month. Herewith, the leaders in terms of trading in futures are contracts for the RTS index, followed with a significant lag by the contracts for Rb/\$ rate, for Rb/Euro rate, for the securities of Sberbank of Russia, and for Brent crude oil. Prices of recent transactions concluded for futures contracts for Rb/ \$ with the date of execution on September 15, 2012, were mostly within 31.8–33 Rb/\$ (i.e., a depreciation of the ruble by 0–3.7% is expected as compared to the indicator of August 26, 2012 (31.81 Rb/USD) and with the date of execution on December 15, 2012 – within Rb/\$ 32.3–33.5. Prices of recent transactions concluded on futures



Source: OAO MICEX.

Fig. 3. Dynamics of MICEX Index and trading volume



Source: OAO MICEX.

Fig. 4. Dynamics of the Russian Blue Chips

contracts for Rb/Euro with the execution date on September 15, 2012 were mostly in the range of Rb/Euro 39.3–40.1. Thus, expectations of a rather short-term ruble exchange rate dynamics are variable as compared to the indicator of August 26, 2012 (Rb/Euro 39.9), and with the date of execution on December 15, 2012, they are within Rb/Euro 40–40.8.

The value of the futures contract for RTS index (based on recent prices of transactions) with the execution date on September 15 was within 1,310–1,440 points, i.e., market participants expect a 0.9% decline against the indicator of August 26, 2012. By December 15, 2012 market participants expect the RTS index value to be in the range of 1,300–1,430 points. Prices of recent transactions in futures contracts for the MICEX index with the date of execution on September 15, 2012 were in the range of 1,260–1,440 points, i.e., an increase in the index is expected by 0.5% as compared with the indicator of August 26, 2012, and with the date of execution on December 15, 2012 – in the range of 1,400–1,470 points.

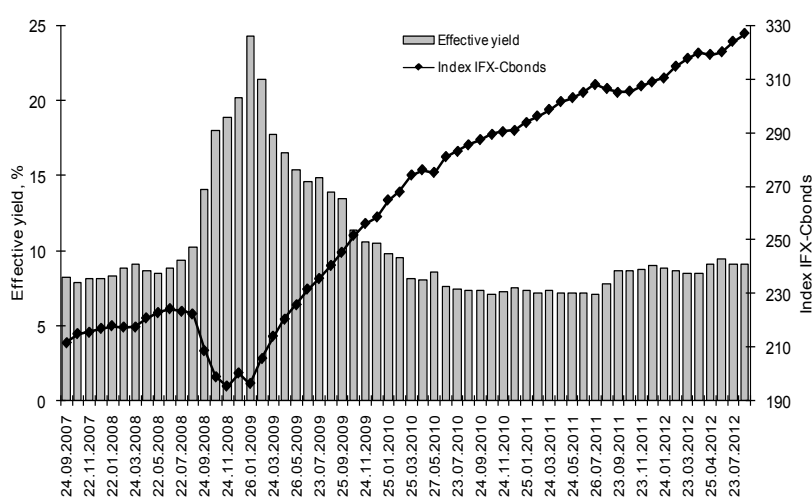
Options enjoyed a far less demand, from July 23 to August 26 2012 the turnover made about Rb 343.9bn (versus Rb 4,692.5bn in futures). The leaders in terms of daily turnover were the marginal options in futures contracts for the RTS index.

Corporate bonds market

The volume of domestic corporate bonds market in Russia (at par value of circulating securities denominated in local currency) has resumed its growth in August after an insignificant decline in preceding month. At the end of the month the market volume reached Rb 3,768.6bn, which is by 2.1% more than its value at the end of July¹. Therefore, the indicator has reached its historical maximum. The growth of the market capacity has been associated with both, increased number of bond issues (823 issues of corporate bonds registered in the national currency against 810 emissions at the end of the previous month), and with the increasing number of emitters registered in the debt sector (339 against 345 companies at the end of July). The list of issues denominated in foreign currency has been extended again: in circulation there are still six emissions of bonds issued in US dollars (in July there were only two bonds issues in circulation in the secondary market) and one bonds issue in Japanese yen.

Investment activity in the secondary market for corporate bonds in August has also increased and reached the level of trading performance in March-April of this year. From July 23 to August 24, the total volume of transactions in the MICEX amounted to Rb 129.3bn (for comparison, from June 26 to July 20, the turnover was equal to Rb 111.0bn), and the number of transactions for the period made 25.7 thousand (against 24.2 thousand in the previous period)².

Index of the Russian corporate bond market IFX-Cbonds continued its growth. By the end of August



Source: Cbonds data.

Fig. 5. Dynamics of the Russian corporate bonds index and average weighted yield

its value increased by 2.8 points (or 0.9%) as compared with the value of late July. However, a positive trend of the index dynamics was noted in terms of average weighted yield: its value in the past month has decreased from 9.10% to 9.06%, which is still a very high indicator for the period from the beginning of 2010 and is significantly higher than the refinancing rate of the RF Central Bank (Fig. 5). The portfolio duration of corporate bonds indicator has decreased again and at the end of August amounted to 661 days, which is by 29 days less than at the end of the previous month. The declining trend of portfolio duration reflects both, the

1 Rusbonds Information Agency data.

2 Finmarket Information Agency data.

reduction in the term of maturity of bonds in the corporate sector, and the high level of the effective interest rates.

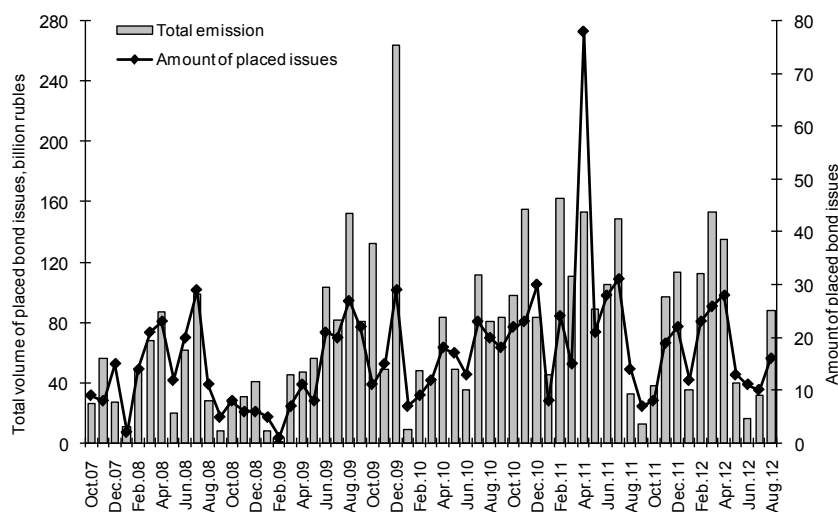
It is noteworthy that while the average weighted yield in the bonds market has practically remained unchanged, the most liquid bond issues showed a significant reduction in the yield, particularly in the high-tech sector and the securities of energy companies. There were ambiguous trends in the financial and business sectors. The greatest volatility in the yield of various bond issues in both, downward and upward terms was demonstrated by the following issuers: “VTB Bank”, “Russian Agricultural Bank” and “Mechel”¹.

However, despite the high interest rates, emitters’ activity in the debt segment of the market remained at a high level, though in August the indicators of the bonds issue registration did not reach the record peak of July. Thus, in the period from July 24 to August 27, thirteen emitters registered 32 bond series with the total face value of Rb 254.5bn (for comparison, from June 26 to July 23 there were registered 67 bond issues with the total face value of Rb 566.3bn). The reason for this activity of the companies is the same as in recent months, i.e., the difficulty in raising funds in the external markets. The largest issues were registered by OAO “Vimpel-Communications” (four series of bonds totaling Rb 50bn), OOO “VimpelCom-Invest” (four bonds series for the amount of Rb 50bn.), and ZAO ACB «Promsvyazbank» (six series for the amount of Rb 40bn)². One third of registered issues were stock bonds.

Like in the last month, investors’ activity in the primary market was significantly lagging in the volume of issues registration, although it should be noted that the indicators of IPOs have increased as compared with July. From July 24 to August 27, 16 emitters have placed 19 stock bonds with the total nominal value of Rb 87.5bn (from June 26 to July 23 there were placed only 11 bond issues with the nominal value of Rb 31.7bn) (Fig. 6).

It should be noted that in August FFMS of Russia has not recognized as invalid any of the bond issues due to the non-placement of securities (in the last months 2–4 bonds issues were recognized as invalid monthly)³.

From July 24 to August 27 eight issuers have paid off their issues for the total amount of Rb 42.5bn. Herewith, all issuers have fulfilled their liabilities to bondholders in due time (in the previous months, 2-3 emitters have announced a technical default). In September 2012, ten corporate bond issues totaling to Rb 28.1bn are expected to be paid off⁴. In contrast to the situation with the announcement of actual default (when the emitter is unable to pay off the interest on securities to the holders even in the nearest days after the due date of their liabilities performance) has improved. In the period from July 24 to August 27, none of the emitters has announced a real default in fulfillment of their current obligations or in paying off the loans at face value (from 26 June to 23, one emitter failed to perform its current obligations and two emitters failed to pay off the issues placed at face value even in the framework of technical default). Herewith, in the period under review, as in recent months, all issuers have executed an early redemption of the securities under offer in due time⁵.



Source: Rusbonds data.
Fig. 6. Dynamics of primary placement of corporate bonds, denominated in national currency

- 1 Finmarket Information Agency data.
- 2 Rusbonds Information Agency data.
- 3 FFMS of Russia data.
- 4 Rusbonds data.
- 5 Cbonds data.

REAL ECONOMY: TRENDS AND FACTORS

O.Izryadnova

In July 2012 the situation in the Russian economy aggravated. In July 2012 the investments in fixed assets growth rates in annual terms made 103.8% as compared with 107.8% in July 2011. The increase in the retail trade turnover in July 2012 made 5.1% being by 1.0% below the corresponding figure of the previous year. In July 2012 as compared with the corresponding period of the previous year the industrial output growth rates were observed to slow down to 103.4% versus 105.2% a year ago. It is the high growth rates of the transport vehicles production and adjacent types of economic activities that positively affects the dynamics of the manufacture output. The drop of the production volumes in agriculture in July of the current year by 3.4% as compared with July 2011 was a negative factor affecting the economic activity slowdown.

According to the data of the RF Ministry of Economic Development in H1 2012 index of the index of the GDP physical volume made 104.4% the growth rates slowing down from 104.9% in Q1 2012 to 104.0% in Q2 2012 versus the corresponding periods of 2011. It was the slackening of the investment in fixed assets dynamics as well as of the dynamics of the retail and foreign trade versus the corresponding period of the previous year that were the main factors determining the conditions for the economic development in Q2 2012.

In January–July 2012 versus January–July 2011 the growth rates of the main indices of the Russian foreign trade changed considerably. At the same time in contrast to the previous year the export was characterized by anticipating growth rates as compared with the import. In January–July 2012 foreign trade turnover went up by 5.4% (34.9% in January–July 2011), export – by 5.7% (32.1%), import – by 4.9% (39.9%). Thus, the changes in the net export made a positive influence on the GDP dynamics which allowed the RF Ministry of Economic Development increasing the forecast for the RF GDP growth rates to 3.5% for 2012.

Throughout the current year the dynamics in the investment sector remained very unstable. In January–July 2012 investments in fixed assets went up by 10.2%¹, the workload in construction – by 3.7%, implementation of the residential floor area – by 3.9%. After a sharp upsurge in the investment demand in Q1 2012, a gradual decrease in its rates has been observed. In July 2012 the growth rates of the investments made 3.8% in annual terms and were 4% below the figure of the corresponding period of the previous year. It should be noted that in July 2012 the workload in construction made 96.8% of the corresponding figure of the previous year. The situation in the investment construction sector was considerably influenced by the low level of investments in housing (4% of the aggregated volume of investments in fixed assets). The volume of housing construction in Q2 2012 lowered by 1.3% as compared with the level of Q2 2011 after a growth of 5.7% in Q1 2012. Despite the fact that the commissioning of the total residential floor area in July 2012 was 15.5% above the level of the previous year, the comparison with June 2012 reveals a drop of 19.4%.

The dynamics of the investments in fixed assets was significantly and negatively affected by the worsening of the financial indices of enterprises and organizations' activity. In H1 2012 the balanced financial result of the organizations (not taking into account the subjects of small-scale entrepreneurship, banks, insurance companies and budget organizations) decreased by 4.8% versus the corresponding period of the previous year due to the plummeting of the indices in Q2 2012. Besides, in July of the current year the growth of the volume of funds attracted by non-financial resident entities slowed to 22.6% as compared with 23.2% in June 2011.

¹ The Federal State Statistics Service specified monthly dynamics of the investments in fixed assets in H1 2012: the growth of the investments in Q2 2012 as compared with the corresponding period of the previous year was increased from 6.5% to 8.5%.

Table 1

BALANCED FINANCIAL RESULT (PROFIT MINUS LOSSES) IN JANUARY–JUNE 2011 AND 2012

	Rb billion		As percentage to corresponding period of the previous year	
	2011	2012	2011	2012
January	+660.6	+824.1	156.5	124.8
January-February	+1268.9	+1515.6	137.6	119.4
Q1 2012	+2050.6	+2185.0	133.1	106.6
January–April	+2864.8	+2808.2	130.7	98.0
January–May	+3579.5	+3393.0	145.0	94.8
Q2 2012	+2010.2	+1680.3	153.0	83.6
H1 2012	+4060.8	+3865.3	142.6	95.2

Source: Federal State Statistics Service.

In H1 2012 the Russian economy received \$74.8bn in the form of foreign investments, which is 14.7% below the level of H1 2011. Although direct foreign investments in H1 2012 grew by 8.0% versus the corresponding period of the previous year, the proportion of the investments from abroad in the total volume of the investments in fixed assets continues to decrease.

The net outflow of the capital from Russia is continued. Thus, according to the preliminary estimation of the RF Central Bank, the net outflow of the capital in January-June 2012 made \$43.4bn. The RF Ministry of Economic Development under such circumstances corrected the forecast for the net outflow of the capital in 2012 to \$50-60bn, which exceeds the earlier forecast for this index by 2.0-2.4 times.

In January–July 2012 as compared with the corresponding period of the previous year the retail trade turnover went up by 6.8%, the foodstuffs turnover increasing by 4.2%, non-food goods – by 9.1%. It is the slackening of the consumer demand dynamics by quarters as well as versus July 2011 that is characteristic for the current year. The growth rates of the retail trade turnover in annual terms in July 2012 made 5.1% and were 1.0% below the corresponding figure of the previous year. It should be noted that the slowdown of the consumer demand growth rates is accounted for by the reserved growth of the non-food goods retail trade market – 108.6% in July 2012 as compared with 111.3% in July 2011.

The market of foodstuffs in July 2012 was characterized by the acceleration of sales growth rates in annual terms up to 101.3%, which is 0.3% above the corresponding figure of 2011.

It should be noted that the slowdown of the consumer demand takes place against the background of the real incomes of the population and real wages¹. Real incomes of the population in July of the current year versus July 2011 went up by 2.2% (0.2% in July 2011) and real wages – by 10.2% (2.4%). According to the corrected data of the RF Ministry of Economic Development real incomes of the population in 2012 will go up by 3% in contrast to the expected 5.0%, which will result in the slowdown of the retail trade turnover as compared with the previous year.

The increased inflation expectations among the population and the weakening of the ruble exchange rate versus the foreign currency basket contributed into the increase of expenses for foreign currency purchase to the detriment of savings.

In July inflation at the consumer market accelerated to 1.2%, which was accounted for by the increase in tariffs for services by 2.7% and the prices for foodstuffs by 1.1%. Over seven months the growth rates of the consumer prices made 4.5% as compared with 5.0% in the corresponding period of the previous year. The priced for foodstuffs went up by 5.9% in July 2012 as compared with the beginning of the year (4.2% in 2011), for non-food goods – by 2.6% (3.8%). Under the existing dynamics of prices the RF Ministry of Economic Development estimated the annual inflation at the level of 7.0% versus the forecasted earlier range of 5-6%.

As a result of January–July 2012 as compared with the corresponding period of the previous year the growth rates of industrial production made 103.2%, of agriculture – 102.1%.

It is the structure factors that have a considerable impact on the dynamics of the development in the manufacturing industries sector. In January–July the situation in the industry was determined

¹ In July 2012 the Federal State Statistics Service published specified data for the real incomes and real wages. In June the dynamics of the real wages versus the corresponding period of 2011 was lowered to 10.2% versus 12.9%.

by the reserved changes in the volumes of demand for the domestic fuel and energy commodities and products of final consumption both at the external and the internal market. The manufacturing industries production growing by 104.9% over January–July 2012, the highest growth rates were characteristic for transport vehicles and equipment production (121.4% versus January–July 2011), electric, electronic and optical equipment production (105.2%), machinery and equipment production (103.0%), rubber and plastic goods production (105.3%), chemistry industry (101.8%). The structure of the internal demand changing, the growth rates of the metallurgy and finished metal commodities production made 5.9%, construction materials production – 8.4% versus January–July 2011.

The index of the industrial production in July 2012 as compared with the previous month of the current year made 101.9%, minerals extraction index being 100.9%, manufacturing industries – 105.7%, electricity, gas and water production and distribution – 100.8%. The general trend being towards the slowdown of the industry growth rates, insignificant acceleration of the dynamics was observed only in the manufacturing industries when compared with July 2011. However, estimating the dynamics of the manufacturing industries development till the end of the year one should take into account the decrease in the balanced financial result in H1 2012 by 10.1% versus the corresponding period of the previous year and the intensification of the trend towards the growth of production expenses due to the increase in the regulated prices and tariffs as well as expenses for labor remuneration.

Anticipating growth of the foodstuffs production (106.9% versus January–July 2011) relative to the free index for the manufacturing industry is accounted for by the increase in supplies of the domestic agriculture produce for processing and development of import-substituting production. In H1 2012 as compared with the corresponding period of 2011 the positive trend in domestic meat, dairy and fat-and-oil industries production was formed, the competitive abilities of commodities growing under the existing dynamics of the prices at the internal market. Besides, according to the data of the Federal State Statistics Service, the contraction of the foodstuffs and agriculture raw materials import by 13.6% versus January–June 2011 acted as an additional stimulus the expansion of the domestic foodstuffs production. However, in July 2012 the drop of foodstuffs production by 4.1% as compared with the previous month of the current year was observed together with the weakening of the growth rates as compared with July 2011. This is accounted for by the problems emerging in the agriculture sector.

In July 2012 the index of agriculture production made 96.6% of the figure of the corresponding month of the previous year. By the beginning of August 2012 the volume of milled grain decreased by 10.3% as compared with the corresponding period of the previous year, the volume of milled wheat contracting by 19.3%. At the beginning of August the stocks of grain in agriculture, marketing and processing organizations made 85.2% of the volumes of the previous year. According to the live data of the Federal State Statistics Service the losses in the drought-stricken subjects of the Russian Federation are estimated to be Rb 36.5bn. The allotments of the total volume of Rb 118.5bn are envisaged for the state support of the agriculture and the social development of rural areas this year, of this sum as on 01.08.2012 Rb 81.1bn (68.5%) was financed.

The negative changes in the dynamics of the main macroeconomic indices in June-July 2012 suggest further correction of the three-year Russian economy development forecast towards worsening. ●

RUSSIAN INDUSTRY IN JULY 2012

S.Tsukhlo

The latest estimations of the situation in Russian industry based on the surveys conducted by the Gaidar Institute¹ have yielded a rather mixed picture. The Industrial Optimism Index returned to its previous level after its sharp decline in June, because in July the forecasts of production and finished stock levels were markedly better. However, demand and employment continue to decline, and at an accelerating rate.

Industrial Optimism Index

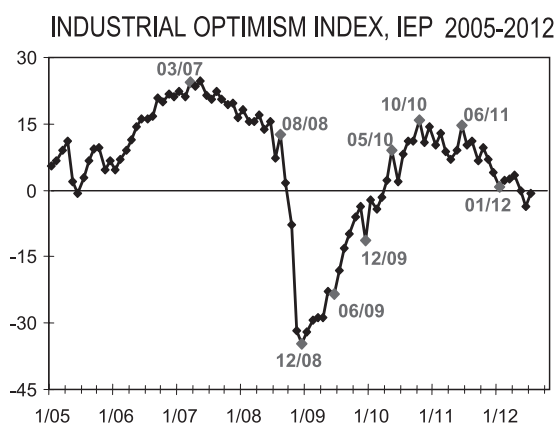


Fig. 1

Demand for Industrial Products

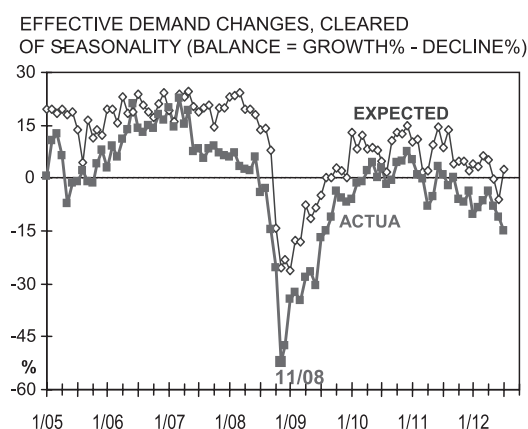


Fig. 2

In July, the rates of change in demand for industrial products remained roughly the same and continued the trend of the previous three months: an increasing slowdown in sales. Over June, when cleared of seasonality, the value of that indicator dropped by another 4 points (to -15 points), thus reaching a three-year low (i.e., no similar level of decline intensity has been observed since July 2009) (Fig. 2). The initial data on the movement of sales, at a first glance, provide no grounds for optimism because these were found to be negative (-9), with the dynamics of sales being at its lowest level since March 2012.

However, the majority of enterprises (54%) estimated this situation as normal and even slightly better than in June (then demand was estimated as normal by 52% of enterprises), when demand was demonstrating a lower intensity of decline (Fig. 3). It seems that industry had been expecting a sharper

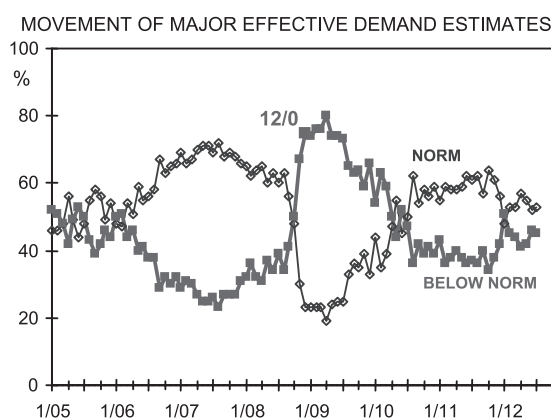


Fig. 3

1 Monthly business surveys of directors of industrial enterprises have been conducted by the Gaidar Institute on the basis of European harmonized methodology since September 1992 across the entire territory of the Russian Federation. The panel consists of approximately 1,100 enterprises employing more than 15% of the total number of industrial employees. The panel is skewed towards big enterprises in each selected subsector. Of the questionnaires posted, 65 to 70% were returned.

drop in sales, and so modest (far from crisis) worsening of that indicator was estimated to be a positive, rather than negative, phenomenon. This circumstance probably was the reason why industry dramatically revised the forecasts of sales. After four months of worsening initial data and three months of worsening of these data when cleared of seasonality, the expectations in June improved by 5 points with regard to initial data and by 9 points by data cleared of seasonality.

Stocks of Finished Products

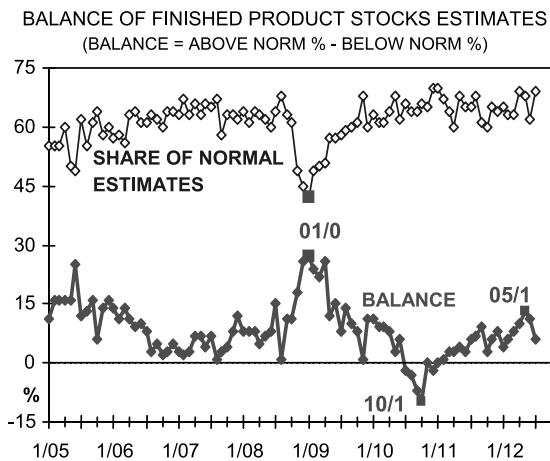


Fig. 4

In July, industry continued to reduce its redundant finished product stocks: the balance of estimates moved down by another 5 points, and the total drop of that indicator (after it reached in May a 33-month low) amounted to 7 points (*Fig. 4*). This downward movement occurs in conditions of an unquestionable decline in demand, which points to the fact that enterprises are more inclined to expect some negative developments in the nearest future, rather than a renewed growth of sales. The reduction of finished product stocks (at least their physical volume) will continue over the next few months: the balance of plans for changes amounts at present to -19 points, which is only slightly above the indicator of plans for the previous quarter (-23 points)

Output

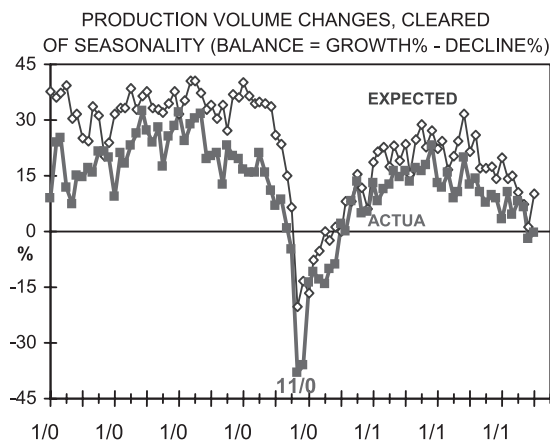


Fig. 5

The dynamics of industrial production demonstrated no fundamental changes in July by comparison with the situation in June: output growth stalled, no crisis-like decline (similar to late 2008) was observed. At the same time, the output plans of enterprises – similarly to demand forecasts – possibly point to a reversal of the previously observed trend, because after five months of increasingly negative values, which in June reached their three-year record low, in July this indicator surged by 9 points (*Fig. 5*). Similar expectations of changes in both demand and output are reported by 75% of enterprises, and only 8% of enterprises expect output to be ahead of demand. At a first glance, industry is sufficiently careful in developing production plans in view of the sufficiently positive – for the present moment – forecasts of demand. However, enterprises have low confidence in the success of their actual realization.

Producer Prices

In July, enterprises could no longer sustain the very moderate growth rate of prices observed over the period of March through June, and so this indicator reached its January values. This happened in conditions of an evident slowdown in demand and after attempts, over several previous months, to revive its growth by applying a very cautious pricing policy (*Fig. 6*). Thus, the traditional annual growth of prices and tariffs occurred in part during the period that was difficult for Russian industry even without this additional aggravating factor. In this connection, enterprises estimated very highly the incorporation in the anti-crisis package of the measure aimed at suppressing the growth of regulated tariffs.

The pricing plans of enterprises, which over the period of March through May were declining, now became stabilized and seem to be in expectation of the emergence of some new trend – downward if the crisis phenomena happen to be stronger, or upward if the world markets remain at least uncertain, while the Russian government manages not to further aggravate the situation by its activity – or lack of action.

Actual and Planned Job Cuts

In July, large-scale dismissals of workforce began in industry. The intensity (or balance) of dismissals over that month dropped by another 12 points and displayed values that are comparable to the worst indicators usually registered in January (Fig. 7). When cleared of seasonality, the intensity of dismissals in July (2012) becomes record high for the last three years. Nevertheless, judging by the initial data, the July result actually represents a continuation of the trend that first became evident in May, when industrial enterprises, after two months of personnel recruitment, first no longer demonstrated any prevalence of recruitment, and then switched over to increasingly intensive dismissals. However, the resulting number of employees is estimated as quite satisfactory by enterprises, 78% of which consider it to be adequate for the expected demand levels. Their recruitment plans demonstrate no cardinal changes in their human resources policy: dismissals will continue. ●

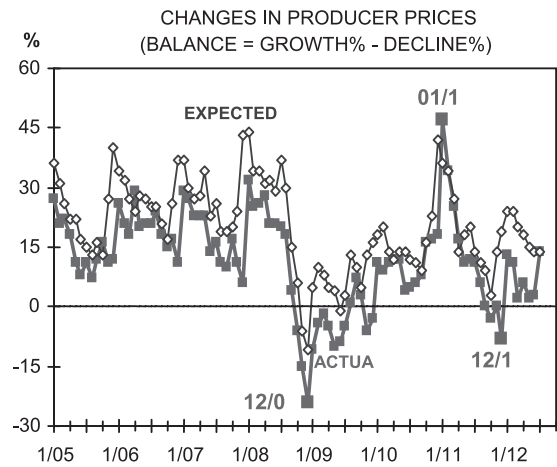


Fig. 6

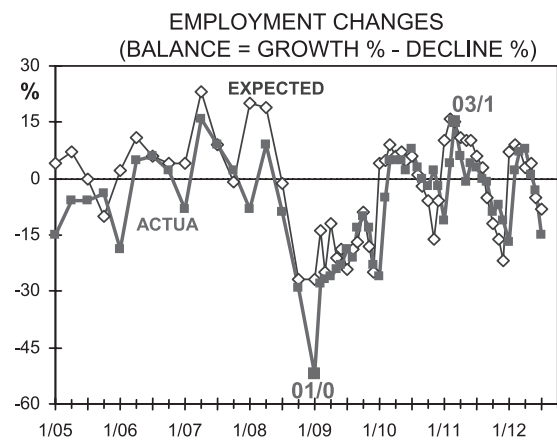


Fig. 7

FOREIGN TRADE

N.Volovik, K.Kharina

In June 2012, the major indicators of Russia's foreign trade dropped on the same period of last year. The decline in exports resulted, first of all, from the shrinking volume of sale of natural gas. In imports, the most significant reduction was noted in the volume of imported foodstuffs and raw materials for the production of foodstuffs.

In June 2012, Russia's foreign trade turnover, calculated in accordance with the balance of payments methodology, amounted to \$ 67.6bn, representing a 6 percent decline on the same index for 2011. Both exports and imports were shrinking. In June 2012, exports dropped on June 2011 by 7.7% – to \$ 40.8bn; imports dropped by 3.4% до to \$ 26.8bn. Exports had been declining for a third month in a row. Russia's balance of trade in June 2012 remained positive (\$ 14bn), although it dwindled in comparison with June 2011 by 14.8%. Thus, the foreign trade surplus in June dropped to a 19-month low, which marked a return to levels recorded in November 2010, when the said surplus amounted to \$ 10.8bn.

The situation for Russia's foreign trade in the first half-year of 2012 was favorable: the "trade conditions" index for January–June 2012 amounted to 107.8. This value represents a significant decline on the period of January–June 2011, when it had been 115.9.

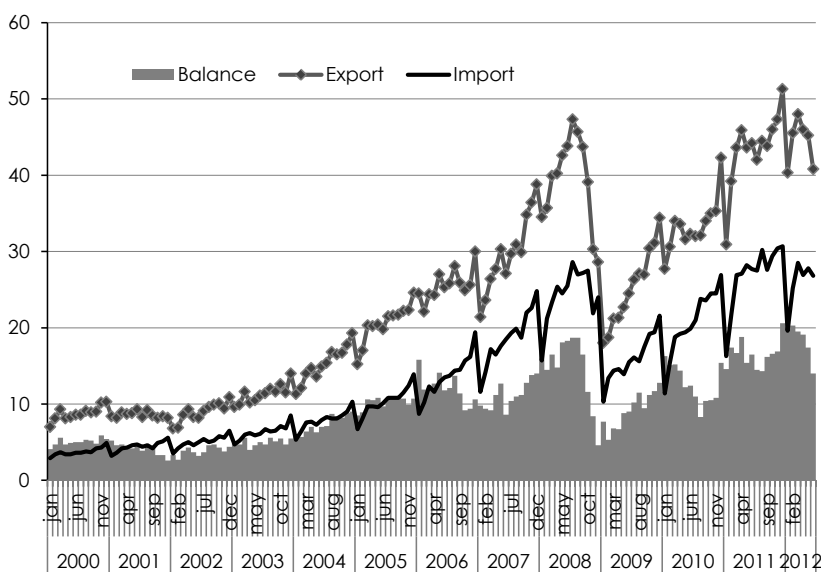
In June 2012, in response to the slowdown in the world economy and the debt crisis in the Eurozone, the international oil prices had been on the decline for a second month in a row. The downward movement of oil prices was also caused by the switchover of the former consumers of Iranian oil onto the other available channels for the supply of energy resources: Saudi Arabia, the UAE and Kuwait, where the volumes of oil extraction continue to be on the rise.

In late June, the price of Brent crude oil – for the first time since January 2011 – slid below \$ 100 per barrel. However, after reaching on 21 June its lowest level since November 2010 of \$ 89.46 per barrel, the price of Brent once again began to increase, and since 11 July 2012 it has remained at levels above \$ 100 per barrel.

The price of Urals, also in response to the movement of the world market, in early 2012 was demonstrating a sharp rise: in March, its average monthly price increased above \$ 123 per barrel,

thus hitting its record high since July 2008. But later on the price of Urals began a downward slide. By June 2012 in had been declining for a third month in a row, and then reached this year's record low – \$ 93.44 per barrel, which is 16.4% below the index for June 2011. The mean price of Urals for the first six months of 2012 was \$ 112.06 per barrel, having risen on the same period of 2011 by 3.6%.

The average price of oil for the period of monitoring from 15 July through 14 August 2012 was \$ 108.25 per barrel. By the RF Government's Decree No 850 of 25 august 2012, from 1 September 2012 the export duty on oil was increased from \$ 336.6 per ton to



Source: RF Central Bank.

Fig 1. Major Indicators of Russian Foreign Trade (bn US dollars)

\$ 393.8 per ton. The preferential duty on oil was increased by 29% – to \$ 191.3 per ton against \$ 148.4 per ton in August. The duty on white and dark petroleum products from 1 September onwards is set at \$ 259.9 per ton (in August its rate was \$ 222.1 per ton). The export duty on gasolines in September, based on coefficient 0.9, will increase to \$ 354.4 per ton against \$ 302.9 per ton in August.

The world market for natural gas in 2012 has been extremely heterogeneous. In USA, due to huge supplies of shale gas, its price over the entire period of the first half-year of 2012 was below 2.68 \$ per 1mln BTU. In April, the price of US natural gas dropped to \$ 1.95 per 1 mln BTU. Although in May and June it slightly increased, US natural gas has remained cheapest in the world. A different situation was observed in the Southeast Asia, where as a result of last year's major earthquake in Japan the demand for liquefied natural gas has surged. The price of gas in that region is highest in the world. In Europe, natural gas prices are also significantly higher than in the USA. However, when Qatar – whose supplies of liquefied natural gas to the US market until recently were huge – had to re-orientate its trade towards Europe, the European prices for natural gas began to decline: the natural gas spot price on the exchange is 320 \$/1000 m³.

A stable growth of demand and prices on non-ferrous metal markets can be expected only after the introduction of new measures designed to stimulate economic development in those countries that act as their major consumers. In June there was no growth in the level of consumption of base metals. As a result, the prices of aluminum dropped to a 33-month low, the prices of nickel – to a 35-month low, and the price of copper returned to its historic low registered 10 months previously. When compared to their levels in June 2011, the prices of aluminum, copper and nickel declined by 26.2%, 18.0% and 26.0% respectively. In the first half-year of 2012, aluminum was sold 18.6%, copper – 14.0%, and nickel – 28.1% cheaper than in the same period of 2011.

Table 1

MONTHLY AVERAGE WORLD PRICES FOR JUNE (2002–2012)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Oil (Brent), \$/barrel	24.66	27.06	35.2	53.9	68.3	70.13	135.2	65.7	75.36	113.76	95.59
Natural gas (USA), \$/mln BTU	3.22	5.77	6.27	7.19	6.19	7.3	12.68	3.8	3.43	4.55	2.46
Natural gas (Europe), \$/mln BTU	2.90	4.05	4.01	5.91	8.29	8.03	12.63	7.95	7.74	10.26	11.49
Natural gas (Япония), \$/mln BTU	4.06	4.77	5.04	5.68	7.10	7.11	12.07	7.18	11.13	14.52	17.0
Gasoline, \$/gallon	0.767	0.858	1.228	1.499	2.107	2.213	3.435	1.90	2.08	3.13	3.18
Copper, \$/ton	1,686	1,703	2,669	3,524	7,198	7,469	8,263	5,014	6,499	9,067.0	7,423
Aluminum, \$/ton	1,355	1,410	1,676	1,731	2,477	2,672	2,957	1,570	1,931	2,558.0	1,890.0
Nickel, \$/ton	7,110	8,761	13,322	16,160	20,755	41,407	22,556	14,960	19,378	22,421	16,549

Source: calculations based on data published by the London Metal Exchange (London, UK), the Intercontinental Exchange (London, UK), and the World Bank.

The FAO Food Price Index in June 2012 dropped by 1.8% on May 2012 – to 201 p.p., its lowest level since September 2010. In May 2012 it was 205 p.p. At present the Index is 15.4% below its historic high recorded in February 2011. The mean prices of all commodities constituting its basket are below their May values. The most impressive decline is demonstrated by the FAO Oils/Fats Price Index.

The cost volume of Russia's exports in January–June 2012 amounted to \$ 263.4bn, having increased by 6.7% on the period of January–June 2011, including exports to the countries of the far abroad increased – \$ 223.0bn (growth by 7.7%), and exports to the CIS countries – \$ 40.4bn (growth by 1.1%).

The increase in the cost volume of Russia's exports in the first half-year of 2012 on the first half-year of 2011 was caused entirely by growth in the mean price index of exported commodities, which amounted to 105.3%, whereas exports in terms of physical volume amounted to 99.4%.

More than 67% of the cost volume of products exported over the first half-year of 2012 was constituted by crude oil, petroleum products and natural gas. The cost volume of oil exports increased in response to the price factor alone, whose positive influence was limited to the period of January–April 2012. The physical volumes of oil exports rose on the same period of 2011 by only 0.5% – to 120.3 m tons. The positive movement of exports was mainly generated by an almost 70% surge in the sales of oil to Belarus, which climbed to 10.8 m tons.

According to the RF Ministry of Energy, Russia's natural gas exports in the first half-year of 2012 amounted to 96.8 bn m³, which is by 17% less than in the first half-year of 2011. The volume of exports of natural gas to the countries of the far abroad and the Baltic States was 59.5 bn m³, which constituted a reduction amounting to 2.1%. The exports of natural gas to the CIS countries dropped by nearly 28.4% – to 31.9 bn m³. This happened due to the 44% shrinkage in the volume of supplies to Ukraine caused by that country's attempts to revise the terms of its contract with Russia (signed in January 2009) as regards the volume of supplies volume and the formula for calculating the price of gas.

Gazprom, in its half-year report, has also published data on the decline in its overseas natural gas sales volume. In comparison with last year, the volume of sales dropped by 16.5% to 104.6 bn m³. This decline was caused in the main by the plummeting exports to Ukraine. However, as can be seen from *Table 2*, almost all consumer country decreased their purchases of Russian natural gas in the first half-year of 2012.

Table 2

EXPORTS OF NATURAL GAS BY JSC GAZPROM (BN M3)

Country	First 6 months of 2011	First 6 months of 2012
Ukraine	27.36	15.92
Belarus	10.57	10.44
Moldova	1.64	1.65
Lithuania	1.86	1.73
Latvia	0.92	0.74
Estonia	0.52	0.3
Kazakhstan	0.52	0.51
South Osetia	0.014	0.02
Armenia	0.83	1.02
Georgia	0.137	0.13
Germany	19.24	17.13
Italy	8.93	6.62
Turkey(2)	12.77	14
France	5.73	4.55
Finland	2.53	2
Austria	3.11	2.98
Greece	1.38	1.34
The Netherlands	2.22	2.1
Switzerland	0.168	0.15
Denmark	0	0.15
UK	4.16	3.85
Total	104.609	87.33

Source: <http://www.gazprom.ru/f/posts/21/499896/gazprom-emitent-report-2q-2012.pdf>

According to the International Monetary Fund (IMF), the mean contractual prices of Russian natural gas at Germany's border increased in June 2012 on June 2011 by 25.6%, to \$ 452.2 per 1000 m³. However, it is most likely that, as a result of the growing volumes of shale gas extraction

in the USA and the increasing share of spot contracts, *Gazprom* will no longer be able to maintain high prices under its long-term contracts.

Exports of petroleum products in the first half-year of 2012 rose by 22.4%, which can be explained by both the increased physical volumes of supplies (by 13.6%) and the climb in contractual prices (by 7.7%).

Exports of non-energy commodities rose, while amounting to \$ 85.3bn, dropped on the period of January–June 2011 by 6.6%. The supplies of ammonia were reduced by 22.7%, unprocessed timber – by 22.7%, and cellulose – by 8.3%.

The volume of Russian imports over the period of January–June 2012 amounted to \$ 154.2bn and increased on January–June 2011 by 4.1%. Imports from the countries of the far abroad rose by 5.6% to \$ 132.4bn, imports from the CIS declined by 3.9% to \$ 21.9bn.

The cost volume of Russia's imports in the first half-year of 2012 rose on the first half-year of 2011 due to increased physical volumes of imported commodities. The imports physical volume index over that period amounted to 102.9%, while the average import price index amounted to 97.7%.

The specific feature of the first half-year of 2012 was a slowdown in the growth rate of imports in January–March 2012 by comparison with the first six months of 2011, and a general decline in imports over the course of the April–June period. Alongside the expected decline in the imported volumes of foodstuffs and agricultural raw materials, there was also a drop in the in the cost volume of Russia's imports of metals timber, and pulp-and-paper products. The increments in imports of other commodities were lower than the corresponding indices for the same period of last year, and were observed predominantly in January–March 2012.

The balance of trade in the first half-year of 2012 rose on the first half-year of 2011 by 10.4% – to \$ 109.2bn. ●

STATE BUDGET

T.Tishchenko

Within January–July 2012, the revenues of the federal budget made Rb 7,247.600bn or 22.1% of GDP. Expenditures of the federal budget in January–July this year amounted to Rb 6,965.0bn or 21.2% of GDP. As of seven months result, the budget is executed with a surplus of 0.9% of GDP. The main growth of the federal budget was provided by the oil and gas revenues, which reached 11.4% of GDP, having exceeded the indicator of January–July 2011 by 0.9 p.p.

Analysis of the federal budget execution in January–July

According to the Federal Treasury, federal budget revenues over seven months of 2012 reached 22.1% of GDP, which by 0.8 p.p. of GDP exceeds the value of January–July 2011, in absolute terms this amounts to more than Rb 1 trillion (Table 1). As of August 1, execution of the budget in terms of revenue was more than 57.2% of the annual budget plan, while in the same period of the last year, the federal budget revenues made 60% of the approved revenue amount.

Table 1

KEY INDICATORS OF THE RF FEDERAL BUDGET IN JANUARY–JULY 2011–2012

	January–July 2012		January–July 2011		Execution against annual budget plan for 2012, %	Change	
	Rb bn	GDP%	Rb bn	GDP%		Rb bn	p.p. of GDP
Revenues, including:	7 247.6	22.1	6 233.8	21.3	57.2	1 013.8	0.8
Oil and gas revenue	3 734.5	11.4	3 019.8	10.3	58.5	714.7	0.9
Expenditures, including:	6 965.0	21.2	5 511.4	18.9	54.6	1453.6	2.3
Percentage expenditures	184.5	0.6	134.9	0.5	48.2	49.6	0.1
Non-percentage expenditures	6 780.4	20.6	5 376.5	18.4	54.8	1403.9	2.2
Federal budget surplus (deficit)	282.6	0.9	722.7	2.5		–440.1	–1.6
Non-oil and gas deficit	–3 451.9	10.5	–2 297.1	7.9		–1 154.8	2.6
GDP estimates	32917		29 290				

Source: Federal Treasury, Gaidar Institute assessments.

The basic growth in federal revenues over the period under review was provided by oil and gas revenues, the total volume of which reached 11.4% of GDP, which exceeds the value of January–July 2011 by 0.9 p.p.

The federal budget expenditures within January–July 2012 amounted to Rb 6 965.0bn, (21.2% of GDP), which is by Rb 1,453.6bn, or by 2.3 p.p. of GDP higher than expenditures over seven months of the last year. Budget expenditures for debt service increased by 0.1 p.p. of GDP against the same period of the last year. Cash execution of the federal budget expenditures as of August 1, 2012 reached 54.6% of the annual budget plan against 50% in the same period of 2011.

As of seven months of 2012, the federal budget is executed with a surplus of 0.9% of GDP against a deficit in the amount of 2.5% of GDP for the same period in 2011. In general, during the year, the Ministry of Finance of Russia is planning budget execution at 0.1 % of GDP.

Dynamics of the revenues to the federal budget within January–July 2012 (Table 2) demonstrates a slowdown in the growth of revenues from mineral extraction tax (MET). If as of four months of

the current year, revenues from mineral extraction tax increased by 0.8 p.p. of GDP against the same period of the last year, according to the results of seven months of 2012, the revenue growth made only 0.5 p.p. of GDP as compared with January–July of the last year.

Revenues to the federal budget revenues from foreign trade in January–July of this year increased by 0.5 p.p. of GDP against seven months of the last year.

Table 2

DYNAMICS OF FEDERAL BUDGET REVENUES FROM BASIC TAXES IN JANUARY–JULY 2011–2012
IN ABSOLUTE TERMS AND GDP P.P.

	January–July 2012		January–July 2011		Change, GDP%
	Rb bn	GDP%	Rb bn	GDP%	
1. Revenue, including:					
corporate profit tax	207.9	0.7	190.8	0.7	0.0
VAT on goods sold in the RF territory	1 134.0	3.5	1 042.0	3.6	-0.1
VAT on goods imported to the RF territory	911.6	2.8	782.0	3.2	-0.4
Excise duties on goods manufactured in the RF territory	197.9	0.6	127.8	0.5	0.1
Excise duties on goods imported to the RF territory	28.9	0.1	23.0	0.1	0.0
MET	1 405.7	4.3	1 111.7	3.8	0.5
2. Revenue from external economic activities	2 847.8	8.7	2402.3	8.2	0.5

Source: Federal Treasury, Gaidar Institute assessments.

Slight growth in January–July 2012 is observed in the federal budget revenue from domestic excise taxes – by 0.1 p.p. of GDP against seven months of 2011.

The amount of the federal budget revenue for the seven months of this year from VAT on goods imported to the territory of the Russian Federation is significantly reduced – by 0.4 p.p. of GDP against the relevant period of the last year. Due to the current downgrading trend in the volume of imports, there is a high probability of failure to collect federal revenues from VAT on goods imported to the territory of the Russian Federation in full, as for January–July 2012 the federal budget received only 50.2% of the planned amount of the annual revenue from that tax.

The decrease in federal revenues for seven months of this year from the VAT on goods sold in Russia, as compared to January–July of the last year is insignificant – 0.1 p.p. of GDP, but the scope of revenue from that tax has a tendency to slow down: if in January–April 2012 revenue amounted to 3.8% of GDP, for the seven months of this year it made only 3.5% of GDP. In total, for January–July of 2012 the federal budget received 60.7% of the estimated revenue.

Revenues to the federal budget from income tax and excise duties on goods imported to the territory of the Russian Federation, as a GDP share in January–July of this year remained the same as in the relevant period of the last year. Over seven months of 2012 the federal budget received 59.0% of the estimated revenue from that tax.

Growth in federal budget expenditures was observed in January–July of the current year as compared to the same period of the last year under the following budget lines: “National Defense” – by 0.8 p.p. of GDP, “Social Policy” – by 0.8 p.p. of GDP, “National Defense and Law Enforcement” – by 0.6 p.p. of GDP, “Healthcare” – by 0.3 p.p. of GDP, “Education” – by 0.2 p.p. of GDP, and “Public Debt Service” – by 0.1 p.p. of GDP (*Table 3*).

Within seven months of the year there was a reduction in some lines of federal budget expenditures in terms of GDP share against the relevant period of the last year, including “Housing and Public Utilities” – by 0.2 p.p. of GDP and “Intergovernmental transfers” – by 0.1 p.p. of GDP. In other sections of the federal budget expenditures as a GDP share, in January–July 2012 they remained at the level of January–July 2011.

As of August 1 of the current year, the Reserve Fund amounted to Rb 1,927.1bn (there was a decline in July by Rb 58.4bn), the volume of the National Welfare Fund – Rb 2742.9bn (there was a decline in July by Rb 67.6bn).

Table 3

FEDERAL BUDGET EXPENDITURES IN JANUARY–JULY 2011 – 2012 IN ABSOLUTE TERMS AND GDP P.P.

	January–July 2012		January–July 2011		Change, GDP%
	Rb bn	GDP%	Rb bn	GDP%	
Expenditures, total:	6 965.0	21.2	5 511.4	18.9	2.3
Including					
Federal issues	420.0	1.3	367.3	1.3	0.0
National defense	1 109.5	3.4	758.6	2.6	0.8
National defense and law enforcement	865.2	2.7	602.6	2.1	0.6
National Economy	845.0	2.6	748.0	2.6	0.0
Housing and public utilities	42.8	0.2	120.0	0.4	–0.2
Environmental protection	13.5	0.1	7.8	0.1	0.0
Education	397.7	1.2	279.8	1.0	0.2
Culture and cinematography	47.8	0.2	37.2	0.2	0.0
Healthcare	333.1	1.1	223.3	0.8	0.3
Social policy	2 280.7	7.0	1 791.6	6.2	0.8
Physical training and sports	26.1	0.1	24.9	0.1	0.0
Mass media	46.4	0.2	35.7	0.2	0.0
Public and municipal debt servicing	184.5	0.6	134.9	0.5	0.1
Interbudgetary transfers	350.9	1.1	345.5	1.2	–0.1

Source: Ministry of Finance of Russia, Federal Treasury, Gaidar Institute assessments.

RF Subjects consolidated budget execution in the first six months of 2010–2012

According to the Federal Treasury, the *consolidated budget of the Russian Federation Subjects* in H1 2012 amounted to 13.9% of GDP, which is by 1.2 p.p. of GDP lower than in the same period of 2011 (*Table 4*). In absolute terms, the growth of regional budgets' revenues amounted to Rb 182.1bn. The RF Subjects consolidated budget expenditures in January–June of this year increased against the same period of the last year by 0.3 p.p. of GDP and accounted for 12.5% of GDP, or Rb 3496.6bn. As of H1 of this year, the consolidated budgets of the RF Subjects was executed with a surplus of 1.5% of GDP (Rb 403.0bn), which is by 1.4 p.p. of GDP lower than in H1 2011.

Table 4

KEY INDICATORS OF THE RF SUBJECTS CONSOLIDATED BUDGET EXECUTION IN THE FIRST SIX MONTHS OF 2010–2012

	January–June 2012		January–June 2011		Change	
	Rb bn	% GDP	Rb bn	% GDP	Rb bn	p.p. GDP
Revenues, including:	3 899.6	13.9	3 717.5	15,1	182,1	–1,2
– Corporate profit tax	1 119.9	4.0	1 091.0	4,5	28,9	–0,5
– Individual income tax	1 006.4	3.6	885.7	3,6	120,7	0,0
– Excise duties in the RF territory	209.7	0.8	172.4	0,7	37,3	0,1
– Aggregate income tax	142.3	0.5	105.3	0,5	37,0	0,0
– Property tax	351.0	1.3	335.6	1,4	15,4	–0,1
– Non-repayable proceeds from other budgets of the RF fiscal system	795.3	2.9	806.7	3,3	–11,4	–0,4
Expenditures,	3496.6	12.5	3009.2	12,2	487,4	0,3
Surplus/Deficit of the RF Subjects consolidated budget	403.0	1.5	708.3	2,9	–305,3	–1,4
GDP estimates	28 075		24 718			

Source: Federal Treasury, Gaidar Institute estimates.

There was some increase in revenues of regional budgets over January-June 2012 only due to revenues from excise taxes – by 0.1 p.p. of GDP versus the first half of the last year. In regard to income tax there is a significant reduction in the regional budgets revenue in H1 2012 to 0.5 p.p. of GDP, as compared to the same period in 2011. The analysis of revenue from income tax to the federal budget over seven months of this year reveals that a significant gap in income tax may get reduced in January–July of the current year.

Within January–June of this year there is decrease in revenues of the consolidated budget revenues of the RF Subjects in regard to property tax: it was reduced by 0.1 p.p. of GDP against H1 2011, and intergovernmental transfers – by 0.4 p.p. of GDP. For the six months of the year revenue from personal income tax and aggregate income tax of the regional budgets remained at the level of January–June of the previous year.

The utmost expenditures growth (*Table 5*) of the RF Subjects consolidated budget for H1 2012 as compared to H1 last year occurred under the budget lines “Education” – by 0.3 p.p. of GDP, “Federal issues “ and “Healthcare” – by 0.1 p.p. of GDP.

Table 5

EXPENDITURES OF THE RF SUBJECTS CONSOLIDATED BUDGET EXECUTION
IN THE FIRST SIX MONTHS OF 2010–2012

	January–June 2012		January–June 2011		Change, GDP p.p.
	Rb bn	GDP%	Rb bn	GDP%	
Expenditures, total:	3496.6	12.5	3009.2	12.2	0.3
Including					
Federal issues	218.9	0.8	202.6	0.9	0.1
National defense	1.4	0.0	1.3	0.0	0.0
National defense and law enforcement	35.0	0.2	115.9	0.5	–0.3
National Economy	561.7	2.0	429.0	1.8	–0.2
Housing and public utilities	314.5	1.2	288.3	1.2	0.0
Environmental protection	7.1	0.1	5.3	0.1	0.0
Education	985.7	3.5	769.9	3.2	0.3
Culture and cinematography	111.8	0.4	92.8	0.4	0.0
Healthcare	560.2	2.0	465.5	1.9	0.1
Social policy	584.8	2.1	533.0	2.2	–0.1
Physical training and sports	57.5	0.2	52.2	0.3	–0.1
Mass media	16.0	0.1	13.3	0.1	0.0
Public and municipal debt servicing	33.0	0.2	31.8	0.2	0.0
Interbudgetary transfers	0.8	0.0	0.7	0.0	0.0

Source: Federal Treasury, Gaidar Institute estimates.

In other sections of consolidated regional budget of the RF Subjects a decline was observed either in expenditures volume of H1 2012 in the range 0.3 – 0.1 p.p. of GDP, or the same indicators remained in GDP percentage against January–June 2011.

Cash execution of the consolidated budget of the RF Subjects for January–June 2012 amounted to 39.9% of approved amounts against 38.5% for the same period of the last year.

In the first half of 2012 the consolidated budget of the RF Subjects was executed with a surplus of Rb 403.0bn, or 1.5% of GDP, which is by 1.4 p.p. of GDP lower than in January–June 2011.

In general, the situation in the budget system of the regional level as of the first half of the year can be assessed as stable. There is a concern in regard to the tentative reduction in the second half of the year in the growth rate of significant tax revenue of the regional budgets, such as income tax and personal income tax, due to a slowdown in the economic growth. ●

THE LIVING STANDARDS OF RUSSIA'S POPULATION

S.Misikhina

Growth, in nominal terms, of the population's income in January–June 2012 demonstrated practically the same rate as in 2011 against the background of a significantly lower inflation rate, which resulted in a rise in the real incomes of the population – in contrast to last year's situation, when that index had been on the decline. The population's differentiation by income level became somewhat more pronounced in the first half year of 2012. However, the movement of the poverty indices over the period of 2010–2011 and in Q1 2012 has made it possible to hope that the said index may display a downward trend towards the end of the year 2012, if the positive trends demonstrated by the population's income and inflation rate should continue.

The money income of the population. Over the period of January–July 2012, the nominal per capita indices of the population's money income were increasing at a somewhat lower rate than in the same period of 2011 (7.7% in that period of 2012 against 8.8% in the corresponding period of 2011), which resulted in the index of the population's average per capita money income achieving the level of Rb 22,897 in July. As in the first 7 months of 2012 the inflation rate became much lower, the consumer price index over that period rose by 4.1% on the same period of last year (during the corresponding period of 2011, growth of consumer prices was 2.3 times higher – by 9.5%), while the population's real disposable money income increased by 2.9% – in contrast to last year's situation, when it dropped by 0.5%.

Table 1

CHANGES IN THE REAL DISPOSABLE MONEY INCOME OF THE POPULATION, %

	As percentage of	
	corresponding period of previous year	of previous period
2011		
Q1	100.2	77.2
Q2	98.7	112.4
1st half year	99.4	
July	100.2	98.4
January–July	99.5	
2012		
Q1	102.4	77.1
Q2	103.6	113.7
1st half year	103.0	
July*	102.2	96.2
January–July*	102.9	

* preliminary data.

Source: data released by Rosstat.

Growth of the population's money income in 2012 occurred largely in response to rising wages. The average nominal monthly charged wage per worker in January–July 2012 increased by 15.2% on the same period of last year, thus amounting in July to Rb 27,219. Over that period of 2012, the real average monthly wage increased by 10.7%, while growth of this index over the same period of last year amounted to only 2.1%.

The pension size was on the rise in 2012, but its growth rate was below that of wages. Over January–July 2012 the average allotted monthly pension size increased by 9.8% and in July 2012 amounted to Rb 9,145. The real size of an allotted monthly pension in January–July 2012 rose by 5.5% on the same period of last year, which points to an improvement of this year's situation by

comparison with last year, when over the period of January–July the real pension size increased by only 0.8%.

Socioeconomic differentiation.

In the first half year of 2012, the population's increasing income resulted in a slightly more pronounced **socioeconomic** inequality in terms of money income: the income of the richest (fifth) quintile of the population increased, while the incomes of all the other (less wealthy) groups of the population declined.

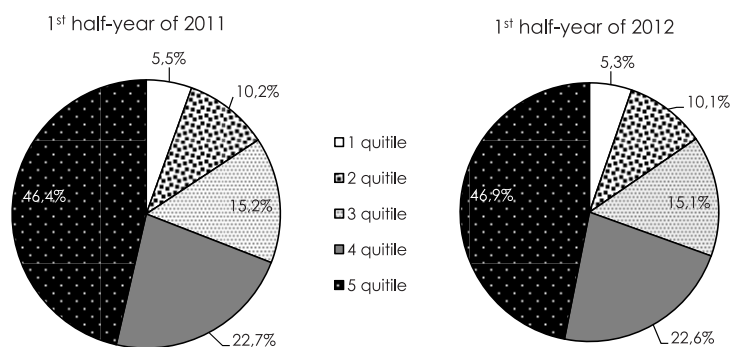
The changes in the distribution of the population's incomes in 2012 appear to be as follows:

- the share of income taken up by the first quintile (lowest income group) in the first half year of 2012 was 5.3%, while in the same period of 2011 it had been 5.5%;
- the share of the first (the least wealthy) decile in the first half year of 2012 dropped to 1.9% against 2.0% over the same period of last year;
- the decline in the share of the second-to-fourth quintiles was somewhat less pronounced;
- the share of the fifth quintile (highest income) rose in the first half year of 2012 by 0.4 p.p. on the same period of last year – from 46.4% to 46.9%;
- the share of the most wealthy decile in the population's total income increased from 29.8% to 30.2%.

The growing inequality was reflected by the values of the basic inequality indices:

- The Gini coefficient¹ over that period rose by 0.6 p.p. – from 0.405 to 0.411;
- The ratio of the average income of the richest 10% to the poorest 10% (R/P 10%)² increased by 4.1% – from 14.8 to 15.4 times.

Poverty level. Only the Russian Federation's poverty data for Q1 2012 have been made available so far. The seasonal drop in incomes in Q1 2012 gave rise to an increase in the number of people with income below the subsistence level to 19.1m, and in the poverty level to 13.5% by comparison with the same indices for Q4 2011 and the entire year 2011. Nevertheless, the upward trend, first displayed by the poverty indices in 2011 in response to the nearly zero growth rate of the population's income over that period, has most likely been reversed: the number and share of the population with money income below the subsistence level in Q1 2012 is markedly lower than the values of the same indices for in Q1 2011. Thus, it may be expected that the poverty indices in Russia will be declining this year. However, due to the insufficiently high growth rate displayed by the population's income over the period of January–July 2012, it is unlikely that any further and more significant decline in that index can be achieved without resorting to some additional social policy measures.



Source: data released by Rosstat.

Fig. 1. Distribution of the Population's Total Money Income, as a Percentage of the Population's Total Money Income

Table 2
CHANGES IN THE NUMBER OF PEOPLE WITH INCOMES BELOW SUBSISTENCE LEVEL

	Million persons	As % of total population
	2010	
Q1	20.6	14.5
Q2	18.0	12.7
1st half year	19.1	13.5

1 The Gini coefficient or the income concentration/wage size index measures the degree of deviation of the actual distribution of income/wages from their equal distribution. The coefficient's value may vary from 0 to 1; the higher the value, the greater the inequality in the distribution of income/wages.

2 The ratio of the average income of the richest 10% to the poorest 10% or income differentiation coefficient describes the degree of social differentiation across society.

Table 2, cont'd

	Million persons	As % of total population
January–September	19.0	13.4
Annual	18.1	12.8
2011		
Q1	22.9	16.1
Q2	19.5	13.8
1st half year	21.1	14.9
Q3	18.3	12.9
January–September	20.2	14.3
Q4	13.7	9.7
Annual*	18.1	12.8
2012		
Q1*	19.1	13.5

* data released by *Rosstat*.

Source: data released by *Rosstat*.

The population's consumer expectations. The improved socioeconomic situation in 2012 by comparison with last year – as demonstrated increased wages and pensions, low inflation rate, declining poverty – has contributed to some positive changes in the population's consumer expectations. The consumer confidence index¹ in Q2 2012 rose on Q1 2012 by 1 p.p. and amounted to 4%. Positive changes in the value of the consumer confidence index in Q2 2012 were displayed by all age groups of the population. ●

1 Consumer confidence index describes the aggregate consumer expectations and intentions of the population. Its value may vary between -100 and +100: negative values point to prevalence of negative outlooks across society, and positive values reflect positive outlooks. The index is calculated by Rosstat as the arithmetic mean of five separate indices: actual and expected changes in individual material wealth levels; actual and expected changes in the economic situation in Russia; and favorability of conditions for purchasing expensive items.

RUSSIAN BANKING SECTOR

M.Khromov

In July 2012, the growth rate of the banking sector was supported by external lending and increased refinancing of the Bank of Russia. Herewith, the growth of lending to the economy (to enterprises and individuals) has decreased. The Bank of Russia loans in view of their short maturity term are hardly acceptable for long-term lending to the economy, and the increased inflow of foreign borrowings are not transformed into domestic loans so far and are kept in correspondent accounts with non-resident banks.

In July 2012, relatively high growth rate of bank assets was sustained at 2.3% for the month¹. The annual growth rate of assets (over the last 12 months) made 22.9%, having actually reached the post-crisis maximum of 23.4%, recorded as per January results. The highest growth rate in July was reached by assets of small and medium-size banks (2.7%), as well as by the state-owned banks (2.8%).

Equity capital of the banks has increased over the month by 1.7%, and regulatory capital² – by 1.9%. Accordingly, the funds raised by banks were growing somewhat faster than total assets, by 2.4%. At the same time, capital adequacy in July has significantly declined (from 13.8 to 13.3%), having once again renewed its historical minimum. At the background of the above-mentioned indicators, such dynamics of regulatory capital adequacy means an accelerated formation of the banks assets weighted by risk level by about 6% over the month, or more than Rb 2 trillion. Probably, this is a result of the change in the procedure for capital adequacy assessment, effective from July of the current year.

The aggregate profit of the banking sector in July made Rb 83bn, which corresponds to the return on assets (ROA) at the level of 2.2% and return on equity (ROE) at 19.5%. The profitability of the banking sector remained stable over the last year. The post-crisis peak in financial performance of banking activities was noted last summer, when the return on assets reached 2.5% and return on equity made 20%.

Raised funds

Assets of individuals with the banks in July were practically not growing – their growth rate amounted only to 0.2%. The annual growth rate of deposits continued to decline: in twelve months assets of individuals with the banks increased only by 17.2%. The July slowdown in deposits of individuals cannot be explained solely by seasonal factors. Indeed, in summer months the growth rate of savings is usually decreased, but in recent years the local minimum was noted in August.

In terms of currency structure of deposits, in July there was an insignificant replacement of ruble deposits with those denominated in foreign currencies. Thus, while ruble accounts of individuals with the banks have decreased by Rb 20bn, in contrast, the accounts in foreign currency increased by \$0.9bn.

The volume of corporate customers assets with the banks in July has also remained practically at the same level, having increased less than by 0.1%. However, for the corporate sector the July decline in balances growth rate at the bank accounts happened apparently due to payment of taxes to the budget. This is confirmed by analysis of the currency structure dynamics of corporate clients. The volume of ruble accounts declined by Rb 92bn (1.1%) – all payments to the budget are denominated in national currency. The dollar equivalent of foreign currency accounts, on the contrary, increased by \$3.1bn, or 4.5%. The latter may be due to the increase in export proceeds – the price of oil in July, after the June decline, has exceeded \$100/Bbl again.

1 Hereinafter growth rates of balance sheet are already adjusted for exchange rate revaluation of foreign currency component, unless otherwise indicated.

2 Estimated by reporting form No.0409134 for credit institutions.

In July, banks continued active fund raising in external markets. Foreign liabilities increased over the month to \$ 6.9bn. In Eurobond market in July, the Russian banks have emitted over ten additional placements with maturity terms from six months (B&N Bank) to ten years (Sberbank, AK BARS).

The largest volume of foreign loans was raised by the state-owned banks. Sberbank raised \$15bn, Gazprombank made two emissions for \$1bn and CHF 500m, VTB has also raised two loans: for SGD 400m and for \$1bn. The latter loan is of interest because these bonds have no preset maturity terms. As a result, the total debt of the state-owned banks (including Sberbank) to non-residents has grown in July by \$4.7bn.

Table 1

STRUCTURE OF THE RUSSIAN BANKING SYSTEM LIABILITIES (END OF MONTH), AS % OF TOTAL

	12.07	12.08	12.09	12.10	06.11	12.11	01.12	04.12	05.12	06.12	07.12
Liabilities, Rb bn	20125	28022	29430	33805	35237	41628	41150	42151	43225	44266	45090
Own assets	15.3	14.1	19.3	18.7	18.5	16.9	17.3	17.3	17.0	16.8	16.8
Loans of the Bank of Russia	0.2	12.0	4.8	1.0	0.9	2.9	3.3	4.4	3.9	5.1	5.7
Interbank operations	4.1	4.4	4.8	5.5	5.2	5.7	5.7	4.9	4.7	4.8	4.8
Foreign liabilities	18.1	16.4	12.1	11.8	10.9	11.1	10.6	10.4	11.0	11.3	11.4
Private deposits	26.2	21.5	25.9	29.6	30.4	29.1	28.7	29.6	29.4	29.4	28.8
Corporate deposits	25.8	23.6	25.9	25.7	24.3	26.0	25.9	24.8	24.9	24.0	23.5
Deposits and balances of state agencies and local authorities	1.5	1.0	1.0	1.5	3.5	2.3	1.8	1.4	1.7	1.5	1.7
Securities issued	5.8	4.1	4.1	4.0	4.0	3.7	3.8	4.6	4.6	4.5	4.5

Source: Central Bank of Russia, IEP estimates.

Investments

Retail lending growth rate has somewhat declined in July. For the first time over 5 months arrears of individuals payable to the banks increased less than by 2.9%. The annual growth rate also stopped to grow, though still remains at a rather high level of 41.4%.

Overdue debt on loans to individuals, as well as the value of provisions for tentative losses on loans to individuals are still lagging behind against credit portfolio growth rate, which results in improved quality of retail loans. Thus, the share of overdue debt and the ratio of reserves/loans further decreased by 6.5 p.p., having made 4.6 and 6.4%, accordingly.

Lending to individuals is still largely effected in rubles. Portfolio loans denominated in rubles increased during the month by 3.1%. Arrears of individuals on loans in foreign currency (in US dollars) continue to decline. As of the end of July, its volume decreased below \$9bn, which corresponds to the level of mid-2006, but at that time the share of foreign currency loans accounted to more than 15% of total loans to individuals, and now it is less than 4%.

The share of new loans in the final consumption of households has slightly decreased. If in QII more than 27% of final consumption was covered by new loans, in July this indicator was less than 26%. Overall, within seven months of the year, every fourth ruble in household final consumption was used from a bank loan. In the relevant period of 2011, the banks lent only every fifth ruble spent on public consumption of the goods and services.

Growth rates of *lending to corporate borrowers* in 2012 remain unstable. During July, the amount of corporate loan portfolio has grown by 1.6%. Annual growth rates remain close to the indicator of 20%, falling behind the growth rate in retail lending more than twice.

Key indicators of the quality of corporate loan portfolio did not change in July. The share of overdue debt loans remained the same – 4.9%, and the ratio of the ratio of provisions for tentative losses/debt on loans has decreased by 0.1 p.p. to 7.9%.

We would like to highlight the fact that currently, in contrast to the pre-crisis period (2006-2008), the quality of loans to individuals is much higher than that to the corporate borrowers.

Whereas in regard to the ratio “reserves/loans” lending to legal entities has become more risky since summer 2009, in the last months lending in the corporate segment of the credit market is distinguished by even higher share of overdue debt than retail lending.

Liquidity and state support

In July, the liquidity situation continued to improve gradually. The share of liquid assets increased by 0.1 p.p. to 4.8%. However, it is still quite a low level. For comparison, recall that before the crisis in 2008, the minimum level of liquidity did not decline below 4.9%.

Along with the domestic ruble liquidity, in July external liquidity was increased – funds in correspondent accounts with non-resident banks increased by about \$4bn, which is a natural consequence of the extended activity in the markets of foreign banks loans – it takes some time to transform new loans into the loans of domestic economy.

Among the major groups of banks, the dynamics of ruble liquidity remains volatile. Thus, the most favorable situation can be observed among the small and medium-sized banks, where liquidity is increasing for the third month in succession, reaching up to 7.4% as of July results. At the same time, in the group of state-owned banks, excluding Sberbank, liquidity has significantly decreased in July – from 3.0 to 2.5%.

Overall stabilization of the ruble liquidity is ensured exclusively by refinancing of the Bank of Russia. Less the Regulator lending, the banking sector liquidity would be steadily moving to a negative zone and reach by 1.08.2012 the indicator of 0.9% of total assets, or nearly 6% of the banks own assets. The most dependent on the support of the Bank of Russia is the Sberbank, which is controlled by the Bank of Russia (the latter owns 58% of the authorized capital of Sberbank). Thus, as of 1.08.2012, the Sberbank own liquidity made 5.0% of assets or 30% of its equity.

This is not surprising, given that in July, Sberbank has increased its indebtedness to the Bank of Russia by Rb 367bn, while the entire banking sector – only by Rb 326bn. Other banks have reduced the amount of total refinancing involvement.

Overall, banks’ debt to the Bank of Russia has reached by the end of July Rb 2.6 trillion, or 5.7% of total banking sector assets. The contribution of the Russian Ministry of Finance, resumed from June placement of funds in bank deposits, to support the banking sector is much more modest. On 1.08.2012, the Ministry of Finance allocated in banks deposits Rb 69bn, which is much less than the last year volume.

Table 2

STRUCTURE OF THE RUSSIAN BANKING SYSTEM ASSETS (END OF MONTH), AS% OF TOTAL

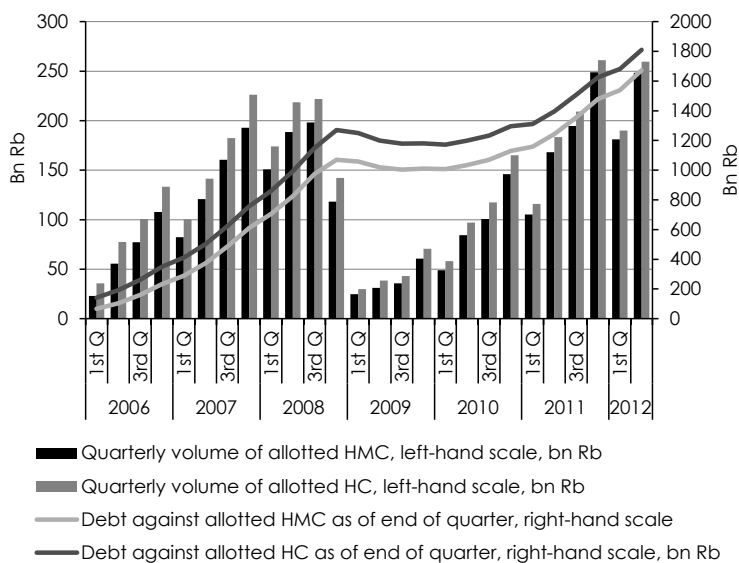
	12.07	12.08	12.09	12.10	06.11	12.11	03.12	04.12	05.12	06.12	07.12
Assets, Rb bn	20125	28022	29430	33805	35237	41628	41533	42151	43225	44266	45090
Cash and precious metals	2.5	3.0	2.7	2.7	2.2	2.9	2.4	2.5	2.4	2.5	2.5
Deposits with the Bank of Russia	6.9	7.5	6.9	7.1	4.5	4.2	3.2	2.6	2.6	3.0	3.2
Interbank operations	5.4	5.2	5.4	6.5	6.4	6.4	6.2	6.0	5.7	5.8	5.7
Foreign assets	9.8	13.8	14.1	13.4	13.8	14.3	14.2	14.3	14.6	14.2	14.5
Individuals	16.1	15.5	13.1	13.0	14.0	14.4	15.3	15.6	15.8	16.0	16.1
Corporate sector	47.2	44.5	44.5	43.6	45.3	44.0	44.4	44.6	44.1	43.6	42.7
Government	4.1	2.0	4.2	5.1	5.8	5.0	4.9	4.1	4.5	3.8	3.4
Property	2.2	1.9	2.7	2.6	2.5	2.3	2.4	2.4	2.3	2.3	2.3

Source: Central Bank of Russia, IEP estimates.

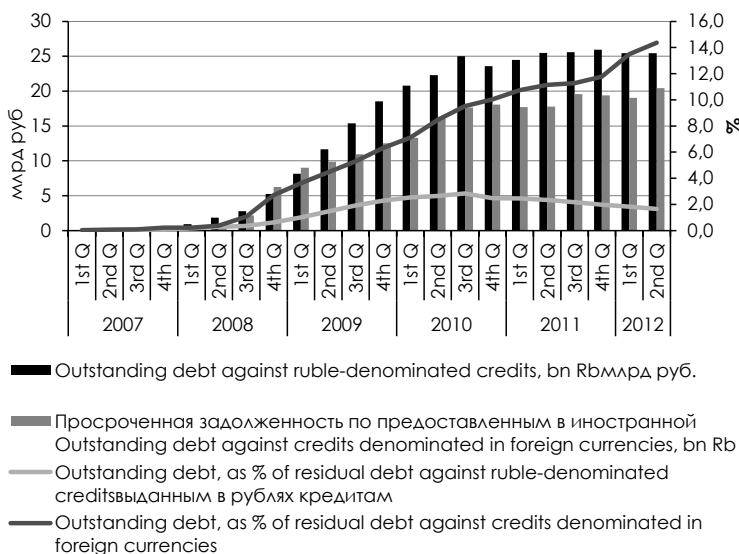
HOUSING MORTGAGE IN THE RF

G.Zadonsky

In the first half year of 2012, against the backdrop of increasing volumes of housing mortgage lending, the interest rate's weighted average for the period since the year's beginning on credits denominated in rubles rose to 12.1 %, and its monthly weighted average – to 12.2%. The share of outstanding ruble-denominated debt against housing mortgage credits relative to the sum of residual debt also continued to decline (1.66% as of 1 July 2012), while the corresponding share of outstanding debt denominated in foreign currencies was on the rise (14.37 %). The share of debt against defaulted housing mortgage credits (HMC) (with payments overdue for periods over 180 days) in the sum of total debt shrank to 3.06%.



Source: data released by the RF Central Bank.
 Fig. 1. Dynamics of Allotted Credits and Debt (Quarterly Data)



Source: data released by the RF Central Bank.
 Fig. 2. Changes in Outstanding Debt Against Housing Mortgage Credits, As of End of Quarter

In the first half year of 2012, according to data published by the RF Central Bank (CB), credit institutions issued a total of 319,418 housing credits (HC) in the amount of Rb 449.409bn. Of these, 182,613 housing mortgage credits (HMC) in the amount of Rb 259.445bn were issued in Q2 2012. The total number of housing mortgage credits allotted in the first half-year of 2012 was 295,513, their total volume – Rb 429.425bn; of these, in Q2 2012, a total of 168,560 credits in the amount of Rb 248,325bn were allotted. The volume of housing mortgage credits allotted in Q2 2012 was 48% above the same index for the period of Q II 2011. In terms of credit value, the share of HMC denominated in foreign currencies and issued over the first half year of 2012 in the total volume of allotted HMC was 1.48% against 2.98% in the first half year of 2011. The sum of residual debt against housing mortgage credits as of 1 July 2012 amounted to Rb 1.57 trillion, including Rb 1.53 trillion against ruble-denominated credits (Fig. 1). At the same time, the share of debt outstanding against HMC denominated in foreign currencies was 8.5%, or by 4.33 pp. lower than the same index registered as of 1 July 2011.

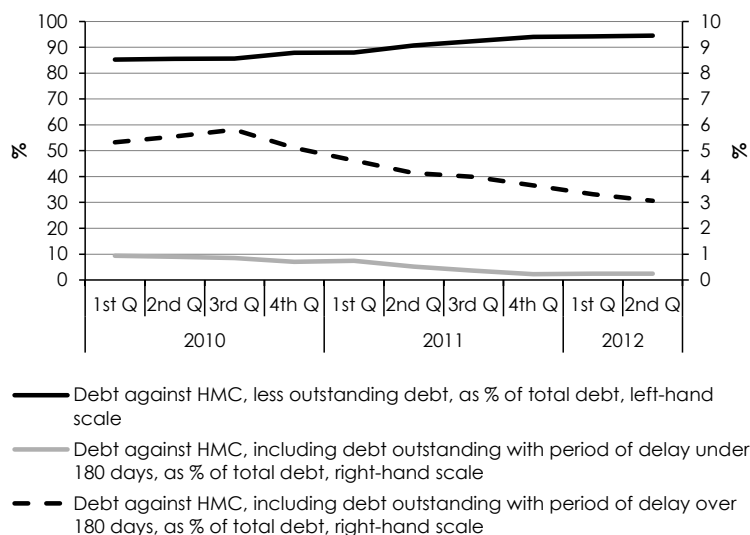
As of 1 July 2012, according to the RF CB, a total of 658 credit institutions were operating on the primary market (the same number as registered as of

1 January 2012), of which 511 credit institutions were issuing HMC, while the others were only servicing their previously issued loans.

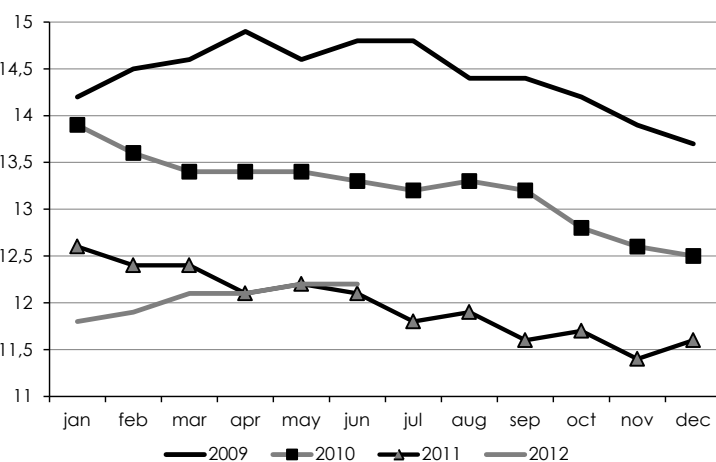
According to data published by the RF CB, the amount of debt outstanding against HMC as of 1 July 2011 was Rb 45.87bn (Rb 25.42 bn against ruble-denominated credits and Rb 20.44bn against credits denominated in foreign currencies). The sum of total outstanding debt against ruble-denominated credits as of 1 July 2012 was 0.12 % less in money terms than that recorded as of 1 April 2012, while in terms of per cent share of residual debt it dropped by 0.16 pp. Over the same period, outstanding debt against HMC denominated in foreign currencies rose in money terms by 5%, while in terms of per cent share of residual debt it increased by 0.88 pp. (Fig. 2). According to data published by the RF CB, the total sum of debt against HMC, less outstanding debt, as of 1 July 2012 amounted to Rb 1,581.15bn, having increased in money terms on the same index registered as of 1 July 2011 by Rb 453.58bn (Fig. 3). Over the same period, the sum of debt against defaulted HMC (i.e., credits with payments in arrears for over 180 days) dropped by Rb 291bn (by 0.34 pp. in terms of per cent share of total debt) (Fig. 3).

As reported by the RF CB, in the first half-year of 2012, the average weighted interest rates on HMC denominated in rubles were on the rise – both for those allotted since the year's beginning and on a monthly basis. The average weighted interest rate on HMC issued since the year's beginning amounted, as of 1 July 2012, to 12.1%, thus having gained 0.1 pp on its value recorded as of 1 April 2011; the average weighted interest rate on HMC allotted over the previous month was 12.2% for the same period, having also gained 0.1 pp (Fig. 4). The average weighted interest rate on HMC denominated in foreign currencies and allotted since the year's beginning did not climb above 9.6% in Q1 2012. The average weighted buyout rate offered by the Agency for Housing Mortgage Lending (AHML) over the first half-year of 2012 on the products *Standart* [Standard] and *Novostroika* [New Housing] was 10.71%, and that on standard products and *Voennaia ipoteka* [Military Housing Mortgage] – 10.54%. The AHML believes that, thanks to its refinancing programs, its partner banks in the first half-year of 2012 were offering the lowest ruble-denominated interest rates on the market: the average weighted interest rates offered by banks belonging to the group rated between 201st and 500th and 501st and below, in terms of their asset size, were, as reported by the RF CB, at the levels of 11.5% and 11.6% respectively – against the market's average rate of 12.1%.

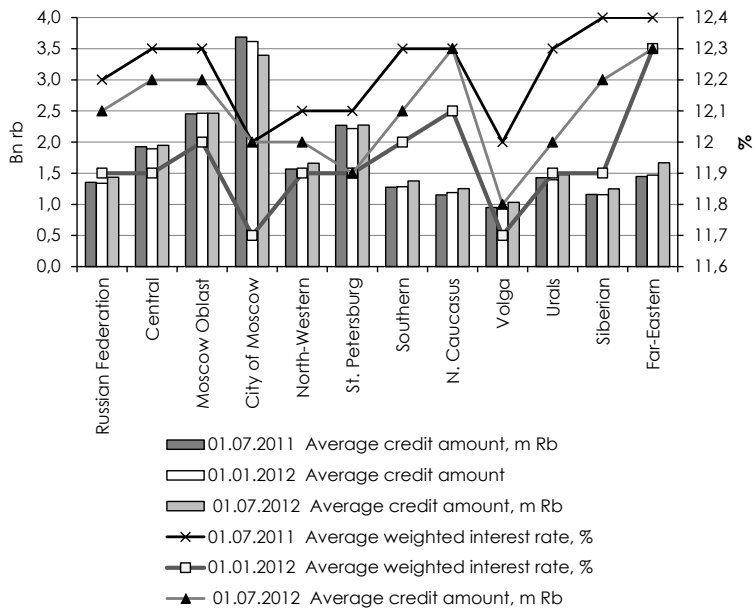
As of 1 July 2012, the average weighted crediting period for HMC issued since the year's beginning increased, as compared to 1 April 2012, by 0.19 years to 14.85 years for ruble-



Source: data released by the RF Central Bank.
Fig. 3. Debt Against Housing Mortgage Credits Broken by Period of Delay in Payment, As of End of Quarter



Source: data released by the RF Central Bank.
Fig. 4. Average Weighted Interest Rate on Ruble-denominated HMC Allotted Over Month



Source: data released by the RF Central Bank.
 Fig. 5. Average Average Weighted Data on Housing Mortgage Credits Allotted Since Year's Beginning, by Region

HMC as of 1 July 2012 increased in all the regions except the city of St. Petersburg, where the interest rate remained unchanged since 1 January 2012.

The lowest interest rate (11.8%) and the lowest average credit amount were, as before, recorded in the Volga Federal District (*Fig. 5*).

Over the first half year of 2012, the Agency for Housing Mortgage Lending refinanced 20,006 HMC in the total amount of Rb 26.14bn, which is by 10.26% in quantitative and 16.54% in money terms more than in the first half year of 2011. The HMC refinanced by the AHML amounted to 6.79% in quantitative and to 6.12% in money terms of the total sum of HMC allotted over that period.

According to the Decree issued by the Plenum of the Supreme Court of the Russian Federation, it will be lawful for banks to transfer their rights under credit agreements with individual borrowers, including housing mortgage agreements, if a clause to that effect is stipulated in a given credit agreement. ●

denominated HMC, while for HMC denominated in foreign currencies – by 0.22 years to 12.82 years. The average weighted crediting period in the first half-year of 2012 for ruble-denominated HMC refinanced by the AHML was 16.5 years (against the average weighted crediting period for 2011 of 17.4 years).

As of 1 July 2012, the average credit amount for ruble-denominated HMC allotted across the Russian Federation since the year's beginning (Rb 1.436m) had risen both on the first half-year of 2011 and on its average index for the year 2011 (*Fig. 5*). The average by-region credit amount in the first half-year of 2012 increased across the board except in the city of Moscow which, nevertheless, displayed the highest average HMC value as of 1 July 2012 – Rb 3.396m. The lowest value (Rb 1.032m) was recorded in Volga Federal District.

The average weighted interest rates on

ECONOMIC GROWTH FACTORS IN 2011 – HI 2012

E.Astafieva

The results of the industrial production decomposition rate witness to the fact that in 2011 – HI 2012 major cost factors played the dominant role in the growth rate of GDP. Labor and capital costs determine on average 70% of GDP growth rate, i.e., the current growth of the Russian economy is achieved mainly due to extensive factors. An increase of labor and capital costs was carried out at the expense of the increase of reserves (number of employees and productive capacity), while in 2012, there are changes in the structure of growth, characterized by an increase in the intensity value of the main factors reserves (time worked by employee and capacity utilization).

According to Rosstat, the period of 2011 – HI 2012 is characterized by positive quarterly GDP growth rates, averaging to 4.3%. In QI-III 2011, the quarterly GDP in real terms made about 98% of the pre-crisis level, and only in QIV 2011 the GDP has approached the volume of 2008, having compensated for the decline, experienced during the recession.

Within 2011 – HI 2012, changes in GDP and the main cost factors are characterized by one-way dynamics: output growth is accompanied by an increase of the basic extensive factors.

In accordance with the results of decomposition (*Table 1, Fig. 1*), in the period under review GDP growth rates are based on the changes in labor costs by 20% on average. The contribution of this component is decreased in the QII and QIV 2011, making in these periods 9% and 7%, respectively; in HI 2012 labor costs account for 29% of output growth rates. Contribution to GDP growth rate due to changes in the capital volume involved in the process of production, make 53% on average. As in the case of labor costs, capital costs are characterized by an increase in the contribution to GDP growth in HI 2012: in this period, they account for an average of 60%. Herewith, during the overall period under review (except for QIV 2011) the capital cost is the most important factor of economic growth, defining the greater part in GDP growth. In 2011 – HI 2012 the TFP determines an average of 27% of GDP growth.

Table 1

GDP GROWTH RATES STRUCTURE (AS COMPARED WITH THE RELEVANT PERIOD OF THE LAST YEAR)

	QI 2011	QII 2011	QIII 2011	QIV 2011	QI 2012	QII 2012
Growth rates						
GDP	4.0	3.4	5.0	4.8	4.9	3.91
I. Factors costs	2.6	2.7	3.4	2.4	4.5	3.4
I.1 Labor	1.1	0.3	1.1	0.3	1.4	1.1
Employment	1.2	0.5	0.5	0.5	0.4	0.7
Hours worked	-0.1	-0.2	0.6	-0.2	1.0	0.4
I.2 Capital	1.5	2.4	2.4	2.0	3.1	2.2
Fixed assets	1.3	1.4	1.5	1.6	1.5	1.5
Capacity utilization	0.2	0.9	0.9	0.5	1.6	0.7
II. TFP	1.4	0.7	1.6	2.4	0.4	0.5
% of growth rates						
GDP	100.0	100.0	100.0	100.0	100.0	100.0
I. Factors costs	63.8	78.4	68.9	49.3	91.8	86.1
I.1 Labor	26.7	9.0	21.8	6.6	28.5	29.1
Employment	29.0	14.1	10.7	11.4	7.3	19.0
Hours worked	-2.3	-5.1	11.1	-4.8	21.3	10.2

1 Assessment of the Ministry of Economic Development of Russia ("Monitoring the results of socio-economic development of the Russian Federation in HI 2012").

Table 1, cont'd

	QI 2011	QII 2011	QIII 2011	QIV 2011	QI 2012	QII 2012
I.2 Capital	37.1	69.4	47.1	42.7	63.3	56.9
Fixed assets	33.1	41.7	30.0	32.4	29.7	39.7
Capacity utilization	4.0	27.7	17.2	10.3	33.6	17.2
II. TFP	36.2	21.6	31.1	50.7	8.2	13.9

Note. In QII 2012 hours worked indicators are obtained under the regression model, in which the accountable variable is the time worked by all employees, and the factor is the number of employees working full time, working part time and having holidays, estimated from the data for previous years.

The structure of labor costs in the period under review is variable by quarters. In 2011, the positive contribution of labor costs to output growth rate is based on an increase in the number of employees, accompanied with the reduced hours worked. The only exception is QIII 2011, which is characterized by an increase in the intensity of employees utilization, so that the contribution of both components of labor costs in output growth rates during this period was the same. In 2012, hours worked by employees increases, and as a result, the contribution of the intensity of labor resources utilization in the output growth rate becomes positive. In QI 2012 hours worked by employees is growing at a faster rate as compared with the number of employees, so the contribution of labor resources in the GDP growth rate gets nearly three-fold less than the contribution of the intensity of their workload, but in QII an increase in the number of employees again becomes a more important component. The average quarterly increase in the growth of hours worked made 0.2 p.p., while the average quarterly growth rate of the number of employees reduction was 0.1 p.p. It should be noted that changes in labor resources are mainly based on an increased share of the employed population in the total number of economically active population, with almost the same values of the share of the working population in the total population and the share of the economically active population in total population.

The period under review is characterized by the dominant contribution of capital costs to the output growth rates. In accordance with the assessment methodology¹, the dynamics of capital reserves is based on the changes in the volume of investment in fixed assets, the growth rate of which was increasing quarterly by 1.5 p.p. on average (from 0.8% in QI 2011 to 6.5% in QII 2012). It should be noted that, despite the growth in the period under review, the volume of investment in fixed capital in real terms remains below the level of 2008. As a result, under the current depreciation degree of fixed assets, which amounted to 51.3% of the end of 2011, the growth rate of the capital reserves remains almost unchanged. On average, in 2011 – HI 2012 the growth rate of fixed assets generated 34% of GDP growth, and the fluctuations in the scope of their utilization – 18%. As in the case of labor costs, the capital cost structure is based on an increase in the contribution, dependent on the degree of the factor reserve utilization. The average increase in the rate of growth of the intensity of fixed assets utilization over the Quarter accounted to 0.2 p.p., and the amount of assets – to 0.1 p.p. However, during the overall period, changes in the capital reserves show a more significant contribution to the GDP growth rate in comparison with the contribution based on fluctuations in the degree of their capacity utilization. The exception is QI 2012, when the contribution of both components of the capital costs was virtually identical.

In the period under review the impact of total factor productivity (TFP) on growth rate was irregular as broken down by quarters: in QI – III 2011, this component generated an average of 30% of GDP growth rates; in QV its contribution increased to 51%, and in HI 2012 TFP accounts for only 11% of GDP growth rates. Therefore, there is a tendency to decrease in the dynamics of TFP growth: during the quarter, average decline in growth rates made 0.2 p.p. (0.1 p.p. in accordance with the linear trend²).

¹ In the absence of quarterly statistics, assessment of the growth of fixed assets is based on the assumption that the coefficient of fixed assets disposal and the consistency of investments allocated for updating thereof. It should be noted that the assessment obtained in such way may be biased due to the fact that it does not take into account the time lag between the moment of receiving investment and the time of their utilization.

² Estimates of the growth rate slowdown made in accordance with the linear trend are considered with the purpose of reduction the dependence of assessment results on the choice of inception or final period.

The observed effect of TFP on the dynamics of production reflects the impact of not only the productivity factors, based on technological changes. It also includes elements, omitted in assessing the main factors and a bias associated with the assessment method, in particular, a bias based on uneven dynamics in the cost indicators used in the decomposition (output and capital)¹. As demonstrated by the estimates obtained for the earlier periods, in the

Russian economic environment, which is highly dependent on the changes in the global commodity markets, such biases are significant, especially in the short term.

In accordance with the obtained results², the GDP growth dynamics is to a great extent based on oil prices. In the period under review, the average price factor impact accounts for about 60% of the output growth rates, while the technological performance (“total balance”) were slowing down GDP growth rates. The result based on the factor of pricing policy in the global commodity market in regard to changes in the growth rates of “technology” component are different from the TFP dynamics. Growth rates of the “balance” in QI-III 2011 and in QI 2012 were negative. But in general, the dynamics of “technology” component shows a reduction in the average rate of decline by 0.8 p.p. for the quarter (by 0.9 p.p. in accordance with the linear trend). ●

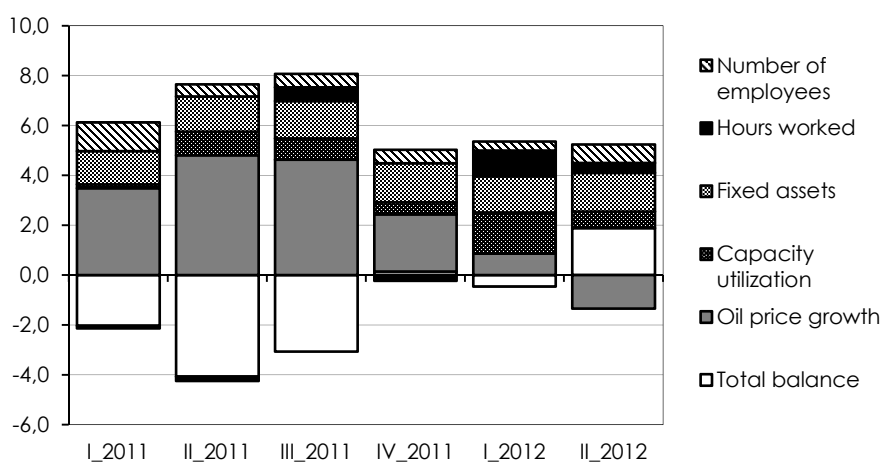


Fig. 1. Decomposition of GDP growth as broken down by factors (as compared to the relevant period of the last year) with the assessment of oil price impact

1 “Cost” assessment matches the “physical” one, if the economy is in the situation of a long-term equilibrium and perfect competition. In other words, when all possible exogenous shocks are taken into regard in the current system equilibrium.

2 Selection of market situation component in the TFP, and further decomposition of output growth rates are based on statistically significant correlation between the TFP growth rate and the growth in the global oil prices, which is assessed with the help of regression based on annual data from 1993 to 2010. As a result, the “total balance”, cleared from the effects of changes in the global market prices for raw materials, is a more precise indicator of technological performance, i.e., an intensive component of output growth.

AN OVERVIEW OF THE RF ECONOMIC LEGISLATION INTRODUCED IN AUGUST 2012

I.Tolmacheva

Over the period from late July through August 2012 the following alterations were introduced in Russian legislation: Russian public television companies were granted the right to create target capital and carry on public fundraising campaigns in order to sustain their target capital; it was established that the submitting of information on paper carriers concerning operations that are subject to state control to the Federal Financial Monitoring Service (Rosinfomonitoring) should be preliminarily coordinated with a relevant state body; those students whose families have average per capita income below the subsistence level were granted an opportunity to apply for an increased scholarship.

I. Federal Laws of the Russian Federation

1. “ON INTRODUCING ALTERATIONS IN ARTICLE 28 OF FEDERAL LAW ‘ON NONPROFIT ORGANIZATIONS’ AND FEDERAL LAW ‘ON THE PROCEDURE FOR CREATING AND USING THE TARGET CAPITAL OF NONPROFIT ORGANIZATIONS’ ” of 28 July 2012, No 134-FZ.

The principal alterations introduced in the Federal Law “On the Procedure for Creating and Using the Target Capital of Nonprofit Organizations” are designed to expand the list of purposes for which target capital can be created and to regulate the use of revenues generated by target capital. The creation of target capital and the use of revenues generated by target capital is allowed in the spheres of education, science, health care, culture, physical culture and sports (with the exception of professional sports activities), arts, archives, social welfare (support), environment protection, free-of-charge legal assistance to citizens and explanation of legal matters to them; from now on, this list is augmented by the purposes relating to the functioning of an all-Russian universally accessible public television channel. Russian public (non-government) television thereby has been granted the right to launch public campaigns with the purpose of raising funds in order to create its target capital, while other nonprofit organizations are allowed to launch public fundraising campaigns only in order to replenish their already created target capital. In an event of a public fundraising campaign aiming at creating its target capital, a nonprofit organization is to provide free access to the documents and information specified in the Federal Law “On the Procedure for Creating and Using the Target Capital of Nonprofit Organizations”. Thus, “Russian Public Television” – a nonprofit organization to be created “for the purposes of mandatory functioning of an all-Russian universally accessible public television channel” – will be obliged to post to its website, in particular, its financial plan, the information on its asset manager and audit organization, the information on the amount of its expenditures on its administration and management, and a report on the creation of its target capital and its use.

Article 28 of the Federal Law “On Nonprofit Organizations”, whereby the fundamental principles of managing a nonprofit organization are established, has been augmented, for the purposes of creating Russian public television, by a new provision stipulating that, in the event of the founder of an autonomous nonprofit organization being the Russian Federation, the following regulations may be envisaged by an act issued by the RF Government in connection with its establishment and by that organization’s charter: 1) a different procedure for the formation of the administrative bodies of an autonomous nonprofit organization and different timelines for the powers of those bodies being in effect; 2) the creation of administrative bodies of an autonomous nonprofit organization that are not specified in the Federal Law “On Nonprofit Organizations”; 3) a distribution of powers between the administrative bodies of an autonomous nonprofit organization that will be different from that envisaged in the Federal Law “On Nonprofit Organizations”.

II. Letters, Orders, Clarifications

1. Informational Letter of *Rosinfomonitoring* “CLARIFICATION OF THE PROCEDURE FOR SUBMITTING INFORMATION TO THE FEDERAL SERVICE FOR FINANCIAL MONITORING OF INFORMATION” of 24 August 2012, No 19.

The submitting, to *Rosinfomonitoring*, of information on paper carriers concerning operations that are subject to state control must be coordinated in advance with a relevant state body, for which purpose a written request, composed in a free form and explaining the reasons why the information cannot be relayed electronically, is to be sent to *Rosinfomonitoring*. No preliminary written coordination for submitting information on paper carriers is necessary if an organization submits less than 10 messages within one calendar year, or if for natural or technical reasons that are beyond the control of a given organization (or individual) it has no possibility for sending the necessary information in an electronic form. It is also specified that the submitting of electronic information implies the application of an automated software package (ASP Organizatsiia [Organization]). The procedure for obtaining and using the package is explained on *Rosinfomonitoring*'s website.

2. Order of the RF Ministry of Education and Science "ON APPROVING THE CRITERIA FOR PLACING FIRST- AND SECOND-YEAR FULL-TIME STUDENTS OF FEDERAL STATE ESTABLISHMENTS FOR HIGHER VOCATIONAL EDUCATION, WHO RECEIVE INSTRUCTION ON A FULL BASIS AT THE EXPENSE OF FEDERAL BUDGET ALLOCATIONS UNDER BACALAUREATE PROGRAMS AND SPECIALIST TRAINING PROGRAMS AND WHOSE GRADES ARE 'GOOD' AND 'EXCELLENT', IN THE INDIGENT CATEGORY" of 06 August 2012, No 591.

Registered at the RFR Ministry of Justice as of 24 August 2012, No 25260.

Those students whose average per capita family income is below the subsistence level may apply for an increased scholarship. In accordance with the RF Government's Decree of 2 July 2012, No 679, the size of scholarship to be paid to students belonging to the indigent category may not be less than Rb 6,307. The right to apply for that scholarship is granted to first- and second-year full-time students who successfully study on a full basis at higher educational establishments at the expense of budget allocations and answer the established criteria. The indigent category includes, in particular, students who are orphans or were left as children without the care of parents; students who were victims of nuclear disasters, etc. ●

AN OVERVIEW OF THE RF GOVERNMENT'S MEETINGS IN AUGUST 2012

M. Goldin

In August 2012, at the meetings of the Government Presidium of the Russian Federation, the following issues were discussed: the alterations introduced in the Federal Law “On the Central Bank of the Russian Federation (the Bank of Russia)”, whereby the powers of the RF Central Bank are expanded; the draft law whereby a ban is imposed on entrepreneurial activity in the sphere of customs exercised by organizations and enterprises that report to and depend on the Federal Customs Service; and the draft decree of the RF Government on the procedure for the disclosure, by federal bodies of executive authority, of information on the elaboration of drafts of normative legal acts and the results of their public discussion.

At the RF Government’s Meetings on **2 August 2012**, the draft of the Federal Law “On Introducing Alterations in the Federal Law ‘On the Central Bank of the Russian Federation (the Bank of Russia)’ ” was considered.

It is intended that the draft law should grant the following additional powers to the Bank of Russia:

- the right to impose limits on the size of the interest rate to be determined by a credit institution in the framework of bank deposit agreements;
- the right to appoint its empowered representatives at the credit institutions making up the list of one hundred biggest credit institutions (by the size of their assets and (or) monies attracted as deposits, or if the amount of the monies attracted as deposits constitutes 5 or more per cent of the aggregate value of the monies attracted by them as deposits in the territory of a RF subject.

The limits on the size of the interest rate, determined by a credit institution in its bank deposit agreements concluded (or prolonged) during the period for which a limit is imposed, may be introduced as an interest rate ceiling (but no less than 2/3 of the refinancing rate established by *the Bank of Russia* for bank deposits denominated in rubles, and no lower than the Libor rates established for bank deposits denominated in foreign currencies as of the date of introducing a limit) for a period up to one year. In this connection, the estimated interest rate will incorporate, alongside interest, any other non-interest payments paid by a credit institution to its individual depositors.

The right to impose limits on the size of the interest rate on deposits is established in connection with the attempts undertaken by many banks to attract cash, in face of a crisis on the money market and shortage of sources of cash, by means of offering unreasonably high interest rates on individual deposits.

The draft law’s authors believe that this measure will make it possible to regulate the risks of those banks that resort to an unreasonably aggressive policy on the individual deposit market, as well as to avoid excessive payments from the mandatory deposit insurance fund in case of an insurance event.

In accordance with Article 76 of the Federal Law “On the Central Bank of the Russian Federation (the Bank of Russia)”, the Bank of Russia enjoys the right to appoint its empowered representatives at credit institutions whenever those credit institutions are granted government support in the form of credits, loans or deposit. The draft law established one more substantiation for appointing authorized representatives at credit institutions, which is unrelated to government support.

The draft law was approved and submitted to the RF State Duma.

At the RF Government’s Meeting on **9 August 2012**, the draft of the Federal Law “On Introducing Alterations in the Federal Law ‘On Customs Regulation in the Russian Federation’ ” was considered. The draft law had been elaborated in compliance with Item 6 of the RF Government’s Assignment

of 5 May 2012, No VP-ShZ-2599 in the form of a federal law, for the purpose of introducing a number of alterations in Federal Law of 27 November 2010, No 311-FZ “On Customs Regulation in the Russian Federation”.

The draft law envisages the imposition of a ban on entrepreneurial activity in the sphere of customs exercised by organizations and enterprises that report to and depend on the Federal Customs Service – in particular, entrepreneurial activity in the capacity of a customs representative, customs carrier, the owner of a warehouse for temporary storage of goods, the owner of a customs warehouse, or the owner of a duty-free retail outlet.

This measure is aiming at minimizing the risk of any excessive influence of state bodies on the customs services market. The elimination of any opportunity for the organizations and enterprises that report to and depend on the Federal Customs Service to engage in any entrepreneurial activity in the sphere of customs, according to the authors of the draft law, will help create more favorable conditions for honest competition between the legal entities operating in the sphere of customs services which, in its turn, will improve the quality of such services and bring down their prices.

The draft law was approved and submitted to the RF State Duma.

At the RF Government’s Meetings on **16 August 2012**, the draft of a government decree on the procedure for the disclosure, by federal bodies of executive authority, of information on the elaboration of drafts of normative legal acts and the results of their public discussion.

This draft decree of the RF Government had been prepared in response to the RF President’s Edict of 7 May 2012, No 601 “On the Main Directions of Improvement of the System of Government” whereby the RF Government was vested with the task to create, before 1 September 2012, a system for disclosing information on the drafts of normative legal acts being elaborated and the results of their public discussion.

It is intended that the draft decree is to approve the procedure for the disclosure of information by federal bodies of executive authority concerning the elaboration of drafts of normative legal acts and the results of their public discussion. This normative legal act represents an important step on the way towards introducing an institution for regulatory impact assessment (RIA) within the framework of implementing the assignments formulated in the RF President’s Edict of 7 May 2012, No 601 “On the Main Directions of Improvement of the System of Government”.

The procedure for disclosing information on the elaboration of drafts of normative legal acts and the results of their public discussion is to be applied in regard of draft federal laws being prepared by federal bodies of executive authority, the RF President’s edicts, the RF Government’s decrees and normative legal acts issued by federal bodies of executive authority, with the following exceptions:

- a) draft federal laws on the federal budget for each financial year and planning period (or on introducing alterations in the federal law on the federal budget for a given financial year and planning period), and federal laws on the budgets of state off-budget funds and the execution of those budgets;
- b) draft federal laws on the following issues: ratification and denunciation of the international agreements concluded by the Russian Federation; the status and protection of the RF state border; war and peace; changes in the number of justices of the peace and the number of justice court precincts in RF subjects;
- c) drafts of normative legal acts that contain information classified as state secret, or confidential information;
- d) draft technical regulations;
- e) drafts of administrative regulations for the execution of state functions and administrative regulations for the rendering of government services;
- f) drafts of normative legal acts prepared by federal bodies of executive authority and establishing mandatory requirements (unrelated to the sphere of technical regulation) to the implementation of work, services and projects (including research), and the implementation of manufacturing, construction, installation, fitting, exploitation, storage, transportation, sale and recycling;
- g) drafts of normative acts being elaborated with the purpose of bringing legislation in conformity with newly introduced normative legal acts;

h) drafts of normative legal acts prepared by federal bodies of executive authority, for which no State registration at the RF Ministry of Justice is required.

The main venue for placing information on the preparation of drafts of normative legal acts by federal bodies of executive authority and the results of their public discussion is an official website.

The procedure for the publication of the aforesaid information is to be approved by the RF Ministry of Economic Development.

The process for disclosing information is broken up into three stages:

- the placement of a notification on the preparation of a draft normative legal act for its subsequent public discussion;
- the placement of the text of a draft normative legal act for its public discussion, expert's estimations as envisaged by legislation, and coordination with relevant federal bodies of executive authority;
- the placement of information on a draft normative legal act being submitted to the RF Government, or on a draft normative legal act adopted by a federal body of executive authority being submitted for registration to the RF Ministry of Justice. ●

AN OVERVIEW OF NORMATIVE DOCUMENTS ON TAXATION ISSUES FOR JULY–AUGUST 2012

L. Anisimova

Over the period under observation, the lawmakers once again brought to the fore the initiative first voiced more than a year ago by former RF President Dmitry Medvedev. The essence of that initiative is that Moscow should become an international financial center. Its consequence, evidently, has been the adoption of a law whereby VAT is no longer to be levied on the services of intermediaries in financial speculations. The new governor of Moscow Oblast, Sergey Shoigu, put forth a proposal that revenues from PIT should be redirected (at least in part) towards the local budgets at the place of residence of the employees who pay that tax. By doing so, he raised an issue of key importance for the Russian economy's further development. The RF Ministry of Economic Development began to deliberate on and thoroughly analyze the political and economic risks for the Russian economy resulting from Russia's entry in the OECD.

In the current rather complicated phase of the Russian economy's development it is very important, while reforming this country's tax system, to go beyond some superficial cosmetic improvements and minor specific alterations introduced in the interests of certain lobbyists and to follow only the logic of necessary and relevant transformations.

Now, within the framework of preparing the budget for the next financial year, the scramble for financing is getting increasingly intense. We should like to point out the problems surrounding the process of elaborating the budget. These are: the general slump in the world economy; the continuing capital outflow from Russia to safer (from the point of view of capital owners) regions; the additional and as yet uncompensated load imposed on domestic producers in the form of an increased rate of insurance contributions to welfare funds that resulted in an enforced growth of costs and a declining competitive capacity of Russian products (or work, or services); the expected losses in the Russian budget in response to decreased rates of customs import duties and the somewhat worsened financial situation faced by domestic producers as a result of Russia's entry in the WTO and the arrival of the world market with its comparatively lower prices directly in RF territory; lack of any real possibility to increase any further the budget revenues generated by sale of hydrocarbons; the need to deal with the urgent issues created by the existing distortions in the distribution of sources of revenues between budgets that was directly stated in the Budget Message of newly elected RF President Vladimir Putin. All these factors are expected to shape Russia's economic, budgetary and tax strategies for the next few years, but so far they have not been dealt with adequately, nor reflected in RF tax legislation. Meanwhile, the lawmakers revived the initiative that had first been put forth more than a year ago by the then RF President Dmitry Medvedev. The core idea is to turn Moscow into an international financial center. This had evidently led to the adoption of a law whereby a VAT was granted to the services of intermediaries in financial speculations. This decision cannot be expected to improve Russia's financial situation in the nearest future, because the exemption can do little in terms of reducing capital outflows therefrom and relieving the financial troubles experienced by Russian producers in connection with the existence of all the afore-mentioned factors, but in the current crisis conditions it will certainly result in losses of federal budget revenue.

The authorities, while granting a VAT exemption, gave no consideration to the fact that there already exists an established market price for the services of intermediaries in financial speculations, and so the State will voluntarily hand over part of its budget revenue to intermediaries. Investors will, however, have no gains – they will simply pay the amount of VAT incorporated in the price of intermediary services. The content of that law will be discussed in more detail later in our overview.

From our point of view, another recent proposal is much more important at the present moment (in face of financial slump) than the one having to do with turning Moscow into an

international financial center. The new governor of Moscow Oblast, Sergey Shoigu, suggested that the revenues generated by PIT should be redirected (at least in part) towards the local budgets at the place of residence of the employees who pay that tax. By doing so, Governor Shoigu has indeed raised one of the issues of key importance for Russia's future economic development. This initiative, quite expectedly, was met with a negative reaction on the part of the federal financial agencies. They pointed out that it would be very difficult, for technical reasons, to redirect the cash flows. The reaction of heads of big cities was also unfavorable. It should be reminded that nobody has suggested that citizens must pay the tax themselves at the place of their residence (although this is the main argument of the initiative's opponents) – that would be unrealistic, and indeed unnecessary. With the Internet, the task of redirecting cash flows becomes a technical solution, especially given the fact that the Federal Tax Service with its experience of handling individual Taxpayer Identification Numbers (INN) and Tax Registration Reason Codes (KPP) (which, by the way, can be applied to employers and employees alike), the Federal Treasury (with its experience of organizing interbudgetary settlements) and the police (who keep records of citizens' current residence registration) are all federal agencies capable of working together at finding an appropriate solution to the problem¹. Even in the present circumstances, the recent court rulings have provided ample proof of the Federal Treasury's and tax agencies' capability to obtain specific information on PIT payers to local budgets in those cases when tax agents enter a wrong code from the All Russian Classifier of Administrative and Territorial Division (OKATO) in their payment documents².

We believe it to be worthwhile to consider in more detail the suggestion that PIT should be transferred (in part) to the regional and local budgets at the place of residence instead of at the place of work. At present, PIT flows are centered in the main in big cities whose accelerated development is thus being fed by a huge additional source of PIT levied on the earnings of labor migrants who come from other regions. As a result, the urbanization process in the RF is being artificially spurred up by the draining of labor and financial resources from "the provinces". The artificial pumping of excessive money into big cities gives rise to economically unjustified distortions, alters the structure of consumer demand and undermines the operation of small and medium-sized businesses in the regions³.

1 If a "taxpayer personal page" can be made available on an agency's website, an employee will then enter there – on an annual basis or at the request of an employer – the information concerning his or her current place of residence (or permanent or temporary residence registration). The police must be empowered to confirm the personal information entered there. On the basis of that residence information (confirmed by the police), tax inspectors and treasurers will determine the codes of those regional and local budgets where the tax is to be transferred. After that, neither employers nor employees should have any problems with the identification of the budgets corresponding to the employees' places of residence and the transfer of relevant payments. It is the responsibility of employers (stipulated in the RF Tax Code) to properly perform their tax agent duties that presents the biggest problem.

2 By Decree of the Federal Arbitration Court (FAC) for the West-Siberian District of 12.July.2012, No A-45-15055/2011 the payment of PIT for an employee who works in a company's independent subdivision to the budget at the place where the employer's main office is situated is not recognized as a tax agent's failure to fulfill its tax obligation. The FAC ruled that if the amount of PIT for a given employee who works in an independent subdivision is paid at the place where the employer's main office is situated, the duty of a tax agent is to be recognized as performed. 'An entry of an erroneous OKATO code in the payment documents (of the main office instead of a relevant independent subdivision, – Author's note) when paying PIT did not influence the performance of the duty to pay the tax, nor did it entail a failure to transfer the tax to the RF budgetary system with the entry of the Budget Classification Code corresponding to that specific amount of PIT... The Inspectorate, in accordance with Subitem 4 of Item 4 and Item 7 of Article 45 of the RF Tax Code, Part 1 of Article 65 and Part 5 of Article 200 of the RF Code of Administrative Procedure, failed to present as part of evidence in this case any proof of the impossibility to apply the procedure of verification of payment ... The name of the Society in the payment orders, the type of payment, the Budget Classification Code, the Society's INN, the amount of tax to be paid are stated correctly, thus making it possible to personify the taxpayer and identify all the other necessary details'. This standpoint of the Arbitration Court is based on the RF Ministry of Finance's Order of 5.September.2008, No 92n in the wording as of 22 December 2011, whereby it was established that the records are to be kept and the distribution of tax revenues between budgets is to be handled by the Federal Treasury's agencies, including on the basis of notifications concerning the verification of types and destinations of payments submitted by tax agencies.

3 The effect of the inadequacy of regional tax policies was most strongly felt in the 1990s in the road construction sector. For example, at that time approximately 56% of the aggregate resources of this country's federal and regional road funds was pooled at Moscow, because all the major taxpayers had their main offices in the capital, and so paid the road taxes to the city of Moscow. The Moscow government could dispose of this money as it saw fit. Probably that is why in a few years' time the cost of road construction in Moscow surged far above that of similar roads in other major cities in Europe and elsewhere.

Artificially created price distortions speed up inflation of wages in metropolitan areas and upset the balance between earning levels in big cities, on the one hand, and in small towns and rural areas across Russian regions, on the other. This indirectly speeds up the process of destitution among those who live outside of big cities, and the regions are losing their labor and financial resources because the active workforce are migrating from their home regions to those areas where excessive demand for labor has been artificially created and fed by budget money.

The existing structure of PIT flows gives rise to a situation where big investments made by the federal government in the territory of a region result in an increasing number of employees and the amount of PIT paid by them, thus automatically increasing the size of revenues received by the regional and local budgets in that territory. So, a region's development largely depends on the loyalty of its residents to the central authority, because it is the investments flowing from the center that determine the region's living standards of the population. The transfer of PIT to those regions where each of its payers is registered as resident will level down that dependence, help stabilize each region's financial base and support the budgets of 'depressive' regions with stable revenue flows.

What is the drawback, as we see it, of the system based on transfer of PIT in the main to the budget at the place of employment? If the authority begins to fund the development of a certain region from federal sources, it will inevitably be done at the expense of other regions. As soon as big money is allocated, it is followed by government orders, and so that region's wages fund (hereinafter – WF) begins to increase. People from other regions start coming there to make some money, and the money paid to them go back to that region's budget. Meanwhile, other regions are abandoned by able-bodied and active people, who often also abandon their families and houses, and so those regions irrevocably lose their former revenue base. So we believe that the region where the government is investing money must receive profits tax and not labor-generated PIT, and the regions¹ that had "brought up" the PIT-generating workforce must be entitled to the latter. Possibly, it would be worthwhile also to alter the structure of PIT distribution between regional and local budgets. At present, in accordance with Article 226.1 of the RF Tax Code, the aggregate amount of PIT calculated and withheld by a tax agent (that can be represented, in particular, by a Russian organization that pays its employees for their labor) is paid to the budget at the place of that tax agent's registration with a tax agency. In accordance with Article 56, Item 2 and Article 61.1 of the RF Budget Code the withheld PIT is then distributed between the budget of a RF subject and the budgets of municipal formations in the following way: 80% goes to the RF subject's budget; 10% – to the budgets of municipal formations or city budgets; and 10% – to the budgets of settlements or city districts. Thus, the role of PIT in generating the revenues of budgets of all levels is very prominent.

No adequate solution can be provided by the replacement of Russian workforce by labor migrants. In that case, investors will get somewhat higher profits, but the qualification level of Russian workforce will inevitable deteriorate because it will remain unrequited. Meanwhile, the earnings of migrants will flow outside of the RF territory. Thus, all the problems faced by an imports-dependent economy will resurface, the imported product being foreign workforce.

Sometimes in the economic press we come across suggestions that PIT should not be redistributed, and its loss should instead be compensated for by other methods, for example by raising taxes on expensive immovable property². This scenario deserves some more detailed consideration. The

1 *M. Liutova, F. Sterkin*. Ministerstva ne soglasny s uplatoi NDFL po mestu zhitelstva [The ministries are against the payment of PIT at the place of residence]. See *vedomosti.ru*, 03.August.2012.

In 2011, PIT revenues amounted to Rb 2 trillion. Nearly one-quarter of that amount went to Moscow (Rb 476.8bn), which constitutes approximately one-third of the city's aggregate revenue. The city's planned revenue for the year 2012 is Rb 1.46 trillion, of which Rb 543.6bn is generated by PIT. Over last year, the amount of Moscow Oblast's budget revenues from PIT was roughly one-quarter of that sum – Rb 121bn (but also only slightly less than one-third of the oblast's aggregate budget revenue). As estimated by Moscow Oblast Minister of Finance Tatiana Krikunova, if PIT were to be paid at the place of residence, Moscow Oblast would be receiving annually an additional Rb 50bn. Out of Moscow Oblast's population, 1.2 to 1.3m work in Moscow.

Leningrad Oblast could also become richer if PIT were to be paid at the place of residence. In 2011, the city budget of St. Petersburg received Rb 118.7bn, while the budget of Leningrad Oblast – only Rb 20.7bn; at the same time, according to the federal Tax Service, the oblast's residents paid Rb 9.4bn to the city budget.

2 *S. Kulikov*. Ocherednoi zakhod na nalogovyi kusok. Vlasti Podmoskov'ia ne ostavliaiut popytok zastavit' grazhdan platiť nalogi po mestu zhitel'stva [Moscow Oblast's authorities do not give up attempts to make citizens pay taxes at the place of their residence.] See *ng.ru*, 3.August.2012.

existence of any immovable property usually implies (hopefully, this might some day be true also for Russia) that there also exist some tax residents who are paying to the regional budget the tax on immovable property as well as some other taxes (PIT, transport tax), and growth of expenditures on products and services triggers growth of regional budget revenues generated by the profits of retail outlets and providers of services and entertainment. It is not feasible to introduce a progressive rate of tax on immovable property. In actual practice it will result in a situation when it will become unprofitable to invest in any immovable property in that region other than prefabricated housing construction or some other type of cheap housing because of the risk of paying increased taxes. Any subsequent sale of property in such a region will be fraught with financial losses for its owners, because the clusters of standard houses or cheap buildings erected across a region inevitably creates a low profile for the entire residential area. Consequently, the number of wealthy tax residents in the region will decline alongside declining revenues in its budget.

We are certain that the issue of transferring PIT to the place of residence (or at least division of the tax amount between regions by the place of residence and the place of employment) needs to be resolved, no matter how difficult and expensive the resulting solution could be, and irrespective of the aspirations of big cities based on the future revenues from PIT generated by labor migrants arriving from other regions. Russia's territory is too large, and so in contrast to countries with a more compact distribution of the population it needs some more predictable sources for sustaining the existence and development of its regions.

One more reason why Russia must begin restructuring its domestic tax flows, thus preventing excessive concentration of the population in big cities, is that the level of government revenues from extensive exploitation of hydrocarbon resources is evidently approaching its ceiling. At least the implementation of the program for developing natural gas production from the continental shelf, as estimated by the RF Ministry of Economic Development, involves high costs and so is not going to be very cost-effective, and the high degree of monopolization in that sector implies low investments in geological prospecting because that area is not profitable for ordinary investors. Vice Prime Minister Arkady Dvorkovich who is in charge of the fuel and energy complex has stated that there are almost no further opportunities at the present moment to raise the rate of mineral extraction tax (MET) any further¹. The probability of reduced federal budget revenues from export duties as a result of Russia's accession to the WTO should be overlooked, either.

The shrinkage of the revenue base of the federal budget after the opportunities for any further extensive exploitation of natural resources are exhausted will create a situation when the central authority will no longer be capable of generating investment flows at the same high rate as before. The expenditures on government purchases will be cut; the number of officials in the government apparatus will be reduced; there will be arrears of salaries in the budget-funded sector; and the payments to state corporations and companies depending on those corporations or on government orders will also slow down. As it is very costly to maintain a good infrastructure in a big city, further growth of metropolitan areas can only be possible as long as their residents enjoy high incomes. However, as Russia can offer no competitive products other than raw materials, a decline in revenues generated by natural resources will bring down the incomes of city dwellers, while the cost of maintaining social stability will, on the contrary, be on the rise. Consequently, the budgets of big cities can also look forward to hard times.

When speaking of the key directions for further elaboration of the taxation system, it should be noted that these may be strongly influenced by the requirements envisaged by the Organization for Economic Cooperation and Development (OECD) for its member countries, because Russian authorities expect that Russia may enter it as early as 2013². *The RF Ministry of Economic Development* has begun analyzing the potential political and economic risks for the Russian economy that may arise in connection with Russia's accession to the OECD. According to the RF Ministry of

1 I. Naumov. Rossiia mozhnet ostat'sia s nikomu ne nuzhnym gazom. Dmitriy Medvedev prizval uskorit' dobuchu uglevodorodov, poka na nikh est' spros, [Russia may be left with gas that nobody will want. Dmitry Medvedev has called for increasing the production of hydrocarbons while there is still demand for them.] See ng.ru, 3.August 2012; Pravitel'stvo Rossii skoree vsego primet reshenie ob umen'shenii NDPI na gaz. [The Government of Russia will, most likely, decide to lower the MET on natural gas.] See ng.ru, 3.August 2012.

2 V. Sitnina. Rossiia vser'ioz sobralas' stat' razvitoi [Russia seriously intends to become a developed country]. 24 August 2012. See slon.ru.

Foreign Affairs, there exist five major economic risks, including: the permission for foreign banks and insurance companies to open their affiliations in the RF territory; bringing the ecological safety standards for the products manufactured in Russia to the level established by the OECD; certification of Russian pharmaceuticals, pesticides, food supplements and cosmetic products in conformity with the criteria established by the OECD; disclosure of the rules for granting export credits (the size of advance payments, the timelines and procedure for their redemption, the size of interest rates – and the government guarantees against them; disclosure of information concerning subsidies and other measures of government support of domestic producers).

In contrast to Russia's accession to the WTO, her entry into the OECD is a matter of prestige. Russia's accession to the WTO became an economic necessity from the point of view of integrating the Russian economy in the global market (it finally became imperative to do away with an economy based on simple distribution of revenues generated by sale of raw materials, because to maintain such an economy was equal to setting some entirely wrong requirements to the professional and qualification parameters of domestic workforce, and also had negative impact on the structure of prices and demand on the domestic market) and removing excessive barriers to the movement of Russian commodities (or work, or services), cash and capital flows across the global economic space. However, hasty voluntary introduction in Russia (whose economy has not yet become adapted to the world market economy) of the additional – very tough – OECD criteria may give rise to crisis-like consequences, first of all for the financial sector and state finances. This issue requires very careful consideration and analysis.

Below we discuss in more detail the normative documents and commentaries to them issued by the leading financial agencies over the past month.

1. Federal Law of 28 July 2012, No 145-FZ introduced alterations in the legislation on joint-stock companies and investment funds. In particular, it established a new type of a mutual fund – an exchange investment fund; the law expands the rights of participants in the fund, on the one hand, and those of asset managers on the other; besides, it extends the powers of the Federal Securities Markets Service to suspend the deals concluded by asset managers at the expense of the fund (including the payment of fees for the services rendered by third parties) if those deal are contrary to the interests of stakeholders.

In this connection, the following alterations are introduced in the RF Tax Code.

Exemption from VAT is established for the services rendered on the securities, commodities and currency markets by registrators, depositories, dealers, brokers, asset managers of mutual funds and non-state pension funds, clearing organizations, as well as the services involving the effectuation, control and record-keeping of supplies of commodities authorized for clearing rendered by commodity supply operators accredited in accordance with Federal Law of 7 February 2011, No 7-FZ “On Clearing and Clearing Activity”; and services that involve the maintenance of prices, demand, supply and (or) volume of organized trading rendered by market makers in accordance with Federal Law of 21 November 2011, No 325 “On Organized Trading”.

This recent decision with regard to the aforesaid types of services certainly means tax exemptions for a certain group of intermediaries. Of course, it can be substantiated by technical reasons – the cost of these services is low by comparison with the volume of transactions, and besides, these are very often cross-border transactions (and VAT is paid at the place of registration of consumer services, so no obligation to pay VAT to the Russian budget arises for intermediaries with regard to cross-border transactions). Nevertheless, tax exemptions granted to one category of taxpayers rendering intermediary services represent, from the point of view of tax legislation, a violation of the principle of neutrality and fairness of the tax system, and is detrimental to the interests of the other taxpayers.

2. The decision to exempt from tax the amount of interest paid on individual deposits with banks within the limits of the rate established by the RF Central Bank as of the date of opening the deposit increased by 5% appears to be more logical than the above-mentioned decision in a situation of economic slump. It is a well-known fact that during the period of economic slump the RF Central Bank's policy will be aimed at supporting the solvency of the banking sector, which

means that the rate of refinancing, most probably, will be lowered. Thus, it may turn out to be so that, as of the day of a deposit's redemption to an individual, the rate of refinancing increased by 5% may become lower than the rate of interest established as of the opening of the deposit. To avoid a situation when people will start to withdraw their deposits every time the RF Central Bank's regulated rate of refinancing is lowered, the most feasible solution, indeed, is to take as a base, when levying tax on the interest paid to individual depositors, the rate that was established as of the date of concluding the deposit agreement. Letter of the Federal Tax Service of 15 August 2012, No ED-4-3/13520 clarifies the wording of Item 27 of Article 217 of the RF Tax Code with regard to taxation of interest paid by banks in an event of the discount rate of the RF Central Bank being lowered before the expiry of a bank deposit agreement.

3. Letter of the Federal Tax Service of 16 August 2012, No ED-4-3/13610 and Letter of the RF Ministry of Finance of 30 July 2012, No 03-03-10/84 are aimed at clarifying the issue of taxation of the amounts of dividends that are paid in amounts disproportional to stakes in a society's charter capital. In particular, it is explained the prevailing legislation allows a society, in accordance with its Charter unanimously approved by all the participants thereto, to independently establish the procedure for distributing its profits between its participants. But in accordance with Item 1 of Article 43 of the RF Tax Code, dividends are understood as the distribution of the amount of profit after taxes in proportion to the stakes of shareholders (or participants). Therefore, when net profit is distributed disproportionately, the amount of net profit distributed between its participants not in accordance with their proportional stakes in a society's charter capital is not recognized to be dividends for the purpose of taxation, and so tax is levied as on property received on a gratis basis.

4. Due the expiry, on 1 July 2012, of the transition period established for the coming in force of Federal Law No 83-FZ, of 8 May 2010, "On the Introduction of Alterations in Some Legislative Acts of the RF in Connection with Improving the Legal Status of State (Municipal) Institutions", the status of budget allocations granted to budget-funded and autonomous organization has been likewise altered. These monies are no longer treated as direct budget allocations; instead, they are deemed to be subsidies earmarked for covering the state services rendered by the aforesaid non-profit organizations. By Letter of the RF Ministry of Finance of 2 August 2012, No 02-03-09/3040 the issues relating to the payment of VAT and tax on profit of state (municipal) institutions as a result of that transition are clarified. At present, distinction is made between treasury institutions (whose commercial activities and property incomes are regulated by the RF Budget Code) and budget-funded and autonomous institutions (these have been made subject to regulation by legislation on non-profit organizations).

The Letter explains that the services rendered by budget-funded and autonomous institutions within the framework of government assignments are to be regulated by the norms on budget subsidies stipulated in the RF Budget Code, and so they are exempt from VAT and tax on profit. The RF Ministry of Finance announced that it has also prepared proposals concerning exempting from these taxes the fees paid by parents for the upkeep of their children in pre-school establishments.

The incomes received by treasury institutions from lease of their property are to be treated as budget revenues and so are exempt from these taxes.

However, the clarifications offered in the Letter in regard of the specificities of levying VAT and tax on profit on the incomes generated by sale of state property require some additional comments.

The Letter explains that the sale of state property by treasury institutions is to be recognized as an object for levying VAT and tax on profit. The amounts of VAT and tax on profit are subject to the limits established for treasury institutions (on a budget basis) in accordance with Budget Classification Code (hereinafter to be referred to as BCC) 290 (VR 852).

It is established that, for budget-funded and autonomous institutions, the amounts of VAT and tax on profit are usually subtracted by applying BCC 130 "Incomes from rendering commercial services" or BCC 180 "Other incomes". But the incomes from the sale of state property by budget-funded and autonomous institutions are recognized as treasury revenues, and in this connection,

according to the Letter, VAT is levied (and evidently withheld) by the tax agent, while tax on profit is not paid because public legal entities are not payers of profits tax.

We believe that these comments could be further specified. In reality, sale of state property is reflected on the accounts of a treasury institution as commercial activity carried by the State (or a municipal formations), while budget-funded and autonomous institutions reflect on their accounts the treasury money received from sale of state property as a kind of transit. A budget-funded or autonomous institution simply cannot have any profit from selling treasury property. Therefore, in our opinion, it is not quite correct in this particular instance to substantiate the absence of any obligation to pay tax on profit by the general exemption granted to public legal entities. ●

CHANGES IN THE NORMATIVE BASE OF THE BUDGETARY PROCESS

M. Goldin

In August 2012, the Rules on the disposal of the Russian Federation's exclusive right to the results of intellectual activity in the field of geodesy and cartography and the Rules for the granting, in the year 2012, of the government guarantees of the Russian Federation against credits or bonded loans attracted by juridical persons for purposes established by the RF Government in the framework of measures designed to improve the stability of economic development in conditions of a deteriorating situation on financial markets were approved.

By Decree of the RG Government of 03 August 2012, No 793, “On the Disposal of the Russian Federation’s Exclusive Right to the Results of Intellectual Activity in the Field of Geodesy and Cartography” the Rules for the disposal of the Russian Federation’s exclusive right to intellectual products created in the field of geodesy and cartography are approved.

The exclusive right, on behalf of the Russian Federation, is to be exercised within the limits of their competence by those federal bodies of executive authority that placed a government order the fulfillment of which resulted in the creation of intellectual products in the field of geodesy and cartography.

The disposal of the exclusive right is effectuated by means of concluding a licensing agreement on granting the right to dispose of the results of intellectual activity in the field of geodesy and cartography, the rights to which belong to the Russian Federation, between the body disposing of that exclusive right and the entity interested in acquiring such a right (hereinafter to be referred to as the Agreement and the Applicant respectively).

The right to dispose of the results of intellectual activity in the field of geodesy and cartography is granted to the applicant on conditions of a simple (non-exclusive) license.

In order to conclude a licensing agreement, the applicant is to submit to the body disposing of the exclusive right an application in which the suggested period of a licensing agreement and the conditions for the use of the results of intellectual activity in the field of geodesy and cartography are to be stated.

By Decree of the RF Government of 29 August 2012, No 825, the Rules for the granting, in the year 2012, of the government guarantees of the Russian Federation against credits or bonded loans attracted by juridical persons for purposes established by the RF Government in the framework of measures designed to improve the stability of economic development in conditions of a deteriorating situation on the financial markets were approved. The Rules were approved in accordance with the Federal Law “On the Federal Budget for 2012 and the 2013 and 2014 Planning Period”.

In accordance with the Decree, the guarantees are to be granted within the framework of measures aiming to improve the stability of economic development in face of a deteriorating situation on financial markets against credits or bonded loans attracted by Russian juridical persons for periods from 3 to 7 years and in accordance with purposes established by the RF Government.

The guarantees are granted in order to ensure the fulfillment of obligations assumed by the following categories of Russian juridical persons (hereinafter – principals):

a) the strategic organizations belonging to the military-industrial complex and included in the list of strategic enterprises and strategic joint-stock companies approved by the RF President’s Edict of 4 August 2004, No 1009, and (or) in the list of strategic organizations and the federal bodies of executive authority responsible for implementing the government’s uniform policy in those branches of the national economy where the aforesaid organizations are operating, approved by Regulation of the RF Government of 20 August 2009, No 1226-p, on conditions that the aforesaid organizations are included in the general register of organizations belonging to the military-industrial complex in accordance with the RF Government’s Decree of 20 February 2004, No 96,

and are the implementers of a government military order; the guarantees are for the repayment of loans (the payment of the face value of bonds at the moment of their redemption) in the amount of up to 70% of the aforesaid obligations;

b) other organizations – for the repayment of loans (the payment of the face value of bonds at the moment of their redemption) in the amount of up to 50% of the aforesaid obligations.

The guarantees are to be granted to juridical persons selected in the procedure established by the RF Government. The selection of a juridical person with an outstanding debt of the aforesaid category for granting the government guarantees regulated by the Rules is to be done by a the Government Commission for Economic Development and Integration created by the RF Government's Decree of 30 December 2009, No 1166, on the basis of a presentation submitted by the Interdepartmental Commission to be created under the RF Ministry of Finance or by the Interdepartmental Commission to be created under the RF Ministry of Economic Development.

The Commission under the RF Ministry of Finance is to carry out preliminary selection of the principals – strategic organizations of the military-industrial complex; and the Commission under the RF Ministry of Economic Development is to do the same in regard of all the other categories of organizations.

If the total planned volume of a guarantee granted to one principal is up to Rb 5bn, the aforesaid commissions are to select the principals independently, each commission within the limits of its powers.

The decision concerning the eligibility of principals is made on condition that:

- a) the principals ensure the transparency of their financial and economic activity and property structure;
- b) the principals fulfill the established employer obligations regarding the dismissal of their employees, as well as the preservation of guaranteed jobs for disabled persons and other socially vulnerable categories of workforce;
- c) the creditors submit to the Government Commission and the relevant Interdepartmental Commission a confirmation of a completed analysis of the principals' financial situation and the decisions adopted by creditor committees concerning the issuance of loans on the basis of business plans presented by the principals;
- d) the principals submit to the Government Commission and the relevant Interdepartmental Commission information concerning the availability of other means (beside the guarantees) for securing the fulfillment of their obligations against the credits (or bonded loans) issued to them (specifying the type, amount and duration of the security guaranteed). The content and volume of the other means (in addition to the guarantees) for securing the fulfillment of their obligations bonded loans are to be determined by the principals, and that for credits – by the principals in coordination with the creditors.

The guarantees are to be granted if the following conditions are complied with:

- a) a principal has no outstanding (unregulated) debt against monetary liabilities to the Russian Federation and no arrears of mandatory payments to the budgets of the RF budgetary system;
- b) a principal assumes an obligation to reduce the size of remuneration (bonuses and other money incentives) to be paid to its managerial staff (members of the board of directors (or supervisory board), members of its collegial executive body, single-member executive body and its deputies, head accountant, heads of independent structural subdivisions) during the period when the government guarantees specified in the Rules are being granted.

The Rules also establish one additional condition for the granting of guarantees: that no insolvency (or bankruptcy proceedings have been initiated against a given principal. ●