



RUSSIAN ECONOMY: TRENDS AND PROSPECTS

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MONTHLY BULLETIN:

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THE RUSSIAN ECONOMY IN MAY 2012: PRELIMINARY DATA AND MAJOR TRENDS

The Political Background: A Non-Festive Inauguration and a Two-Chamber Government

The main political events of May 2012 were the continuing showdown between the authorities and the opposition in Moscow and the process of formation of the RF Government and the RF President's executive Office by Vladimir Putin, who was officially inaugurated as President of the Russian Federation.

The mass rally held by the opposition on the eve of Putin's inauguration unraveled into a series of clashes between police and demonstrators. Fearing further unrest at the time of Putin's inauguration, the authorities were forced to carry it out under curfew conditions – the center of Moscow was virtually cordoned-off and cleared of people. However, the inauguration did not bring the expected calm, and the protests, periodically dispersed by police, continued in Moscow until the end of May. Repression against the protesters is relentlessly increasing: thus, especially for that purpose, the State Duma has initiated a number of amendments to the law on rallies, slapping harsher penalties on the participants and organizers of unsanctioned protests and exponentially increasing maximum fines for participation.

The new RF Government was being formed under the watchful eye of the President, while Prime Minister Medvedev's role in that process seemed to be secondary. This balance of forces is also clearly reflected in the resulting composition of the Cabinet: ministerial positions are mostly occupied by the former deputy ministers, while their former bosses have been transferred to the RF President's Executive Office which, therefore, is likely to become the key decision-making body ("Senior Government"). The role of the Kremlin's watchdog in the Government is given to Vladislav Surkov: he will be in charge of the Government's apparatus, monitor the implementation of the RF President's assignments, and supervise science, culture and the mass media. At the same time, the Government includes very few representatives of "Medvedev's team". And it should be noted that, although the formal powers of one of Medvedev's protégées, Deputy Prime Minister Arkady Dvorkovich, are far-reaching, he is deprived of the right to independently appoint any relevant ministers. Moreover, his freedom of action will be further curbed by the presence of yet another deputy prime minister in charge of economic issues – Igor Shuvalov.

Rashid Nurgaliev, an ex-FSB official, was replaced as Interior Minister by a career cop, General Vladimir Kolokoltsev. The Cabinet reshuffle was followed by a very interesting piece of news: former Deputy Prime Minister Igor Sechin became President of Rosneft. Just a few days after his appointment, BP announced that it was ready to sell its stake in TNK-BP. Bearing this in mind, it seems likely that Igor Sechin's task will consist in increasing the assets of and in creating, on its basis, a state-owned oil mega-company.

On the eve of the coming into force of the law that is designed to bring back direct gubernatorial elections, the authorities continued to hastily replace and reappoint governors. May saw the replacement of the governors of Omsk, Irkutsk, Sverdlovsk, Leningrad and Samara Oblasts, Stavropol Krai and Karelia. By means of replacing and reappointing governors the Kremlin is trying to postpone, for as long as possible, the actual introduction of the new procedure.

The Macroeconomic Background: The Approach of a New Wave of the Crisis

The macroeconomic background of May 2012 was shaped by the ongoing deterioration of the global economic situation. The political crisis in Greece, which increased the possibility of that country's departure from the eurozone, and the deepening of the debt crisis in Spain severely undermined the markets' faith in the European currency: over the course of May, the Euro to US dollar exchange rate dropped from \$ 1.32 to \$ 1.23 per Euro. Moreover, over the course of Q1 there was a decline in the rate of economic growth in India (by 1.5 times on Q1 2011) and China (by 2 p.p. on Q1 2011).

This bleak situation accelerated the ongoing decline in oil prices. As of 1 May 2012, the price of Brent crude had fallen 5.6% since its peak on 1 March 2012, while over the course of May it dropped by 17.6% – to below \$ 100 per barrel. The sharp decline in oil prices resulted in a considerable weakening of the ruble by the end of the month: from 29 April to 1 June 2012, the ruble fell 12% against the US dollar and dwindled 4.85% against the Euro. Russian stock market indices continued to fall: having already lost 10% in the previous one-and-a-half month (by comparison with its peak in mid-March), the MICEX Index dropped by 12% over the course of May, while the RTS Index shed 23% in one month (or 30% since its peak in mid-March).

In May, the State Duma adopted, in third reading, the amendments to the 2012 Budget which increased the 2012 oil price forecast from \$ 100 to \$ 115 per barrel. As a result, the revenue side of the federal budget increased by Rb 897.1bn, its expenditure side grew by Rb 88.7bn (to 21.0% of GDP), and the deficit dropped from 1.5% GDP to 0.1% of GDP. However, the fall in the deficit looks like a statistical trick: the actual budget deficit is diminished due to the growth of the non-oil-and-gas deficit. Thus, over the course of January–April 2012, the budget deficit amounted to 0.4% vs. 1.3% in the same period of 2011, while the non-oil-and-gas deficit rose to 12.5% vs. 9.4% in January–April 2011. With oil prices stuck in a downward trend, this development can actually play down rather than boost investors' faith in the bright future of the Russian economy, for it clearly demonstrates that the current level of expenditure makes Russia's public finance very vulnerable to shocks.

According to the Bank of Russia's preliminary estimates, the outflow of capital from Russia over the course of the first four months of 2012 amounted to \$ 42bn, thus representing a 1.5 times rise on the same period of last year. Thus, the break in the trend, which the Bank of Russia had expected to take place in April, did not materialize, although the rate of capital outflow slightly reduced (to \$ 7bn). Bearing in mind the situation on the markets at the end of May, it is likely that the outflow of capital in May will be at least as substantial as in April.

In May, inflation remained low, rising 0.5% on April 2012. At the same time, the growth rates of petrol prices significantly increased: in April petrol prices rose by 0.9%, while in May they climbed by 1.3%. The low growth rate of money supply gave rise to hope that the jump in inflation caused by the increase in tariffs postponed until mid-summer will be moderate. However, the weakening of the ruble will, apparently, also produce some inflationary impact on the price situation.

In April, the banking sector was confronted with a sharp decline in bank liquidity. Although the monetary authorities expanded the scope of bank refinancing almost to the level of autumn 2011, all formal banking sector liquidity indicators dropped to lows unseen for many years. The main reason for that decline in liquidity was the continuation of unrestrained credit granting against the background of a weak growth of the resource base (its growth rate remained low even despite the resumption of borrowing on external capital markets). The redundant resources of commercial banks reduced by almost one-quarter in April – to Rb 706.4bn by the end of that month. In May, the banking sector's debt on repo operations rose to a record high – above 1 trillion rubles. Meanwhile, on 22 May 2012, the RF Central Bank announced that it had decided to resume direct on-exchange repo operations with shares included in its Lombard List. The rapid rise in credits granted by the RF Central Bank to the banking sector against the background of a relatively slow growth of the deposit base heightens the potential for the emergence of financial instability, if the growth rate of credits extended to banks significantly drops.

The Real Sector of the Economy: Still Buoyed by Consumer Demand

According to preliminary estimates released by the Russian Federal Statistics Service (Rosstat), in Q1 2012 the physical volume index of GDP rose by 4% on Q1 2011. Although such an increase in this index is indeed a positive sign, this accomplishment may, more likely, be attributed to the successes achieved throughout last year as a whole. In January–April 2012, industrial production grew by 3.3% on the same period of 2011, while over the course of the first four months of 2011 it had risen by 5.5% on January–April 2010. In April 2012, industrial production rose by a disappointing 1.3% on April 2011 (in April 2011 it had grown by 4.5% on April 2010).

Economic growth was boosted by a robust growth in population incomes and a rapid increase in consumer credit. Over the course of the first four months of 2012, Russia's retail trade turnover rose by 7.2% on January–April 2011. In April 2012, it was up 6.4% from April 2011. The volume

of payable services rendered to the population in January–April 2012 and April 2012 alone rose by 4.3% and 2.4% respectively on the corresponding periods of 2011. In January–April 2012, the real incomes of the population grew by 2.2% on the same period of 2011, when they had dropped by 0.4% on January–April 2010. The distinctive feature of the beginning of 2012 was the exceptionally high growth rates of wages, which climbed up by 10.4% on April 2011. This rise in wages made it possible for the population to satisfy delayed demand. In Q1 2012, the population's expenditures on goods and services were up 7.9% from Q1 2011. The rise in consumer spending was accompanied in April 2012 by a decrease in the rate of savings and a 38.8% rise in consumer credit on April 2011.

In January–April 2012 and April 2012 alone, the growth rate of investment in fixed assets rose by 13.8% and 7.8% on the corresponding periods of 2011. According to preliminary estimates, in Q1 2012, fixed asset investment as a percentage of GDP amounted to 12.3%, which represented a 0.7 p.p. rise on Q1 2011. However, it should be noted that the rise in investment volumes was not accompanied by an adequate increase in the volume of construction work, while the supply of investment goods kept hovering around its pre-crisis levels. In March–April 2012, the housing construction industry registered a fall in the volume of living space commissioning and a drop in the growth rate of commercial real-estate construction on March–April 2011.

The consumer goods industry has been registering a steady increase in the annual decline rate of production since the beginning of 2012. In March–April 2012, negative annual growth rates were recorded for machinery and equipment, electrical equipment, electronic and optical equipment. As all these production fields are widely interconnected throughout industry, it can be expected that in the short-term perspective the machine-building industry will see a significant drop in the rates of production of investment goods. ●

THE POLITICAL AND ECONOMIC RESULTS OF MAY 2012

S.Zhavoronkov

In May 2012, Vladimir Putin demonstrated an interesting model of forming a government that implied keeping a balance between the necessity to rotate personnel, preserve continuity of policy and pay heed to the various interest groups. As a result, he formed a 'government of deputy ministers' where the former deputies of ex-ministers had a clear majority. The only changes that can be called fundamental were the replacement of two ministers – those of agriculture and communications. Igor Sechin lost his post as deputy prime minister in charge of the energy portfolio and was made the new head of Rosneft (the state company previously supervised by him during his tenure as deputy prime minister, where his influence had nevertheless been waning for a number of years). Vladislav Surkov became the new head of the RF Government's apparatus and thus the de-facto controller of the Government, safeguarding the interests of Vladimir Putin. The team of the nominal prime minister, Dmitry Medvedev, got only two ministerial posts, both relatively non-important – that of Minister for Interaction with the Open Government, taken by Mikhail Abyzov, and that of Deputy Prime Minister, gained by Arcady Dvorkovich. On 6 May 2012, Moscow became the scene of violent clashes between protesters and the police, which somewhat spoiled the inauguration of Vladimir Putin – like the proverbial fly in the ointment.

Everybody had expected that the formation of the RF Government and the inevitable bureaucratic reshuffles in Moscow's corridors of power would become the only noteworthy political events to be seen in May 2012 in the aftermath of Vladimir Putin's inauguration as President of Russia. However, May saw yet another notable event – mass riots on the very eve of that festivity. The Opposition had announced well in advance that the next rally of its supporters was to take place on 6 May 2012, on the eve of Putin's inauguration. Nothing spectacular had been expected of that rally because of the pronounced downward trend in protest rally attendance that had been visible throughout the spring 2012 and the anticipated departure of many Muscovites to the countryside, traditional for the May Day holidays. However, the rally was anything but uneventful. Having invited the citizens of Moscow to an officially sanctioned rally on Bolotnaya Square, its organizers instead staged a puzzling 'sitting strike' at the entrance to the square that resulted in some chaotic scenes and mass clashes with the police. The rally, in fact, did not take place, although tens of thousands of people took part in the demonstration (and tens of thousands of military personnel and police officers were concentrated in Moscow for the occasion). There were many injured on both sides. On 7 May, the day of Putin's inauguration, the authorities closed Metro exits throughout almost the whole of Moscow's center, and in fact banned any vehicle and pedestrian movement in the vicinity of the Kremlin. The inauguration was held in the absence of people, in a curfew style, which deeply shocked the global mass media. The events of 6-7 May clearly indicated that, despite the completion of the presidential election, Russian society is still far from being lulled into complacency, and that the radicals on both sides (the authorities and the Opposition) are steadily gaining strength and making statements which recall civil war rhetoric. At least for now, in terms of physical force, the authorities have the upper hand over their opponents.

The new composition of the RF Government turned out to be both predictable and surprising. The major principle of its formation was mass appointment to ministerial positions of the incumbent and former deputy ministers, representing the same team as the sacked ministers. Some unpopular and frequently criticized ministers lost their posts, including Minister of Internal Affairs Rashid Nurgaliev, Minister of Health Care and Social Development Tatiana Golikova, and Minister of Education and Science Andrei Fursenko. The afore-mentioned Tatiana Golikova and Andrei Fursenko, as well as former Minister of Economic Development Elvira Nabiullina, former Minister of Natural Resources and Ecology Yuri Trutnev, and former Minister of Communications and Mass Media Igor Shchegolev, became assistants to the RF President, while former Minister of

Transport Igor Levitin was appointed advisor to the RF President. Rashid Nurgaliev was appointed Deputy Secretary of the RF Security Council, thus becoming deputy of his patron, ex-FSB Director Nikolai Patrushev, and the former head of the RF Government's apparatus, Anton Vaino, became one of the deputies of the head of the RF President's Executive Office. It is highly unlikely that Nurgaliev and Vaino will manage to preserve their influence in their former domains, while in the case of the long-time ministers who have lost their posts this will depend on the loyalty of their protégés and Putin's personal attitude to them – past experience shows that the position of an assistant to the RF President can be either really meaningful (if the President assigns him or her important tasks), or purely nominal.

Nurgaliev was replaced by a professional policeman, Moscow's police chief Vladimir Kolokoltsev¹, whose career had rapidly risen in recent years. Not associated with any of the latest scandals in the RF Ministry of Internal Affairs, his appointment to the ministerial position was rather positively appreciated by the press. It is possible that this positive response was partly due to the fact that Kolokoltsev had been in charge of the police operation aimed at dispersing protesters in the center of Moscow on 6 May 2012, which had been carried out with sufficient skill, that is, without victims. Nabiullina was replaced by prominent economist Andrei Belousov, once the former Deputy Minister of Economic Development and Trade under German Gref and later on the staff of the RF Government's apparatus. Career physician Veronica Skvortsova was appointed Minister of Health Care, while Maxim Topilin became Minister of Labor and Social Development. Both of them had been deputy ministers of health care under Tatiana Golikova. The newly appointed Minister of Education and Science, Dmitry Livanov had once been Deputy Minister of Education and Science under Andrei Fursenko, and then spent several years as Rector of the Moscow Institute of Steel and Alloys. Vladimir Puchkov was appointed Minister for Emergency Situations; and Sergei Donskoi became Minister of Natural Resources and Ecology. Both of them had spent a number of years in the teams of their chiefs, who were then ministers. The newly appointed Minister of Transport, Maxim Sokolov had begun his career in St. Petersburg as a member of Valentina Matvienko's administration, while the new Minister of Energy, Alexander Novak had been RF Deputy Minister of Finance. Anton Siluanov and Denis Manturov retained their positions as Minister of Finance and Minister of Industry and Trade respectively. Both of them had been protégées of the recently retired ministers Aleksey Kudrin and Viktor Khristenko. Minister of Sport Vitaly Mutko, Minister of Justice Alexander Kononov, Minister of Foreign Affairs Sergei Lavrov, and Director of the Federal Security Service Alexander Bortnikov also retained their positions. Despite expectations, the frequently criticized Minister of Defense, Anatoly Serdiukov, was not given the sack either. It is likely that this man totally suits the authorities as a supervisor of the enormous defense budget of Russia.

New chiefs were appointed to the not very important Ministry of Regional Policy (where Victor Basargin, appointed Governor of Perm Krai, was replaced as minister by Oleg Govorun, one of Vladislav Surkov's collaborators) and the Ministry of Culture (former member of the State Duma and United Russia's functionary Vladimir Medinsky). Two new ministries with very vague functions were created – the Ministry for the Development of the Far East (to be headed by Victor Ishaev, former Governor of Khabarovsk Krai); and the Ministry for Interaction with the Open Government (under rich businessman Mikhail Abyzov).

More serious changes – possibly heralding some tectonic shifts in the distribution of public funds and in the current policy – took place in the Ministry of Communications (which passed into the hands of Nikolai Nikiforov, former Tatarstan Deputy Prime Minister and Minister of Communications) and in the field of agriculture, which saw two sackings – of the first deputy prime minister, Viktor Zubkov, who had been in charge of the agricultural portfolio, and Minister of Agriculture Elena Skrynnik, replaced in this position by former head of Chuvashia Nikolai Fedorov, one of the dignitaries of the All-Russian Popular Front. Viktor Zubkov retained the consolation title of Chairman of the Board of Directors of Gazprom, which had been previously held by him in conjunction with the post of Russia's Deputy Prime Minister.

¹ To a certain extent, the negative attitude towards Nurgaliev, shared by many top policemen, can be explained by his FSB past, and also by the fact that the secret police agency has always been seen as a traditional competitor of the Ministry of Internal Affairs.

The composition of Russia's team of deputy prime ministers was changed much less radically than that of her ministers. Igor Shuvalov remained First Deputy Prime Minister, while Vladislav Surkov, Dmitry Kozak, Alexander Khloponin and Dmitry Rogozin retained their positions as deputy prime ministers. In addition to his deputy prime ministership, Vladislav Surkov, formerly Deputy Head of the RF President's Executive Office and the de-facto supervisor of Russia's domestic policies, was appointed the new head of the RF Government's apparatus – a virtual “super-ministry” duplicating the functions of every Russian ministry. By comparison with his former (rather vaguely defined) duties dealing with “modernization”, this appointment can be seen as a considerable promotional push for Surkov. The new Deputy Prime Minister Olga Golodets, formerly one of Moscow's deputy mayors, was put in charge of the social portfolio. Igor Shuvalov remained in charge of financial and economic matters, including the adoption of the state budget, the state program, property issues, competition, trade, housing policy, the activities of Vneshekonombank (Bank for Development), and a lot of other issues, including the mapping of the main directions of Russia's socio-economic development. Dmitry Rogozin resumed his reign over the military-industrial complex; Dmitry Kozak remained in charge of Sochi's preparation for 2014 Winter Olympic Games, sport, regional policy and the housing and utilities sector; and Alexander Khloponin was once again entrusted with the task of tackling the problems of the North Caucasus Federal District. Arkady Dvorkovich, former assistant to President Medvedev, replaced Igor Sechin as the chief supervisor of Russia's industry, fuel-and-energy complex and communications, while the latter, having left the ranks of the government for good, was appointed the new head of the state company Rosneft. The new composition of the RF Government has once again indicated that Vladimir Putin continues to control all major appointments. Even the government formation episode itself was brimful of demonstrative meaning: Vladimir Putin refused to go on a diplomatic visit to the USA for a reason that was formulated by his press service as follows: “... will be unable to attend the G8 Summit on May 18-19 because by that date the formation of the structure and personal composition of Russia's Government will not apparently be completed as yet”. In his stead, Putin sent Dmitry Medvedev, who apparently was not occupied with any serious matters and thus was able to leave Russia at the time her Government was to be formed – with him as a nominal prime minister. The remaining handful of those who still believed that the nominal Prime Minister Medvedev wielded some influence were once again bitterly disappointed: in fact, the new government contained only two Medvedev's protégées, both holding not very influential positions. Mikhail Abyzov, rich businessman and former adviser to Dmitry Medvedev, became Minister for Interaction with his own self – that is, with the “Open Government”, a totally virtual structure. As far as Arkady Dvorkovich is concerned, it should be said that the worth of any deputy prime ministerial position under the existing model of power is determined exclusively by the particular functions associated with it. As such functions, by definition, belong to ministries and agencies, they can be exercised by a deputy prime minister only when he or she has managed to push through the creation of a new structure where his signature begins to be required. Thus, Igor Shuvalov was appointed chairman of a commission coordinating the activities of the RF Government in conditions of the current global financial crisis; in fact, that body was vested with the task of approving the allocation of financial aid to enterprises. Another such example is Dmitri Rogozin, who chaired the Military-Industrial Commission designed to form the state defense order. There is also another option for a deputy prime minister – a personal friendship with Vladimir Putin, that will enable him or her to regularly contact the boss and to influence the solution of practically all issues – as, for example, Igor Sechin did in the days of his deputy prime ministership (although, formally, he, like all the other deputy prime ministers, was the head of only a small secretariat). Therefore, real authority in the Government will remain in the hands of the key ministers with large budgets – such as the ministers of economy, finance, defense, and the head of the RF Government's apparatus, or some deputy prime ministers vested with real powers (as Shuvalov or Rogozin). At the same time, the status of Prime Minister and some of the deputy prime ministers will remain low. The inertia-dominated policy of the RF Government is not going to change in any fundamental way, either. Noteworthy in this respect is Vladimir Putin's warning to Igor Sechin who was embarking on his new role as energy tsar: “Fuel and energy complex enterprises are especially valuable, we believe that they are currently undervalued and do not want them to be privatized for “kopecks” and

then be sold dearly”; also noteworthy is Igor Shuvalov’s defense of the cutting-edge methods of privatization via “assets exchange” with “no money at all being transferred to the budget”. His words mean that the current economic governance model according to which the growing state sector is managed by friends and relatives of Russia’s leaders and financed from the budget is not going to be changed.

The top echelon of the RF President’s Executive Office remains exactly the same as in December 2011, when Sergei Ivanov was appointed Head of the Executive Office, and Viacheslav Volodin was appointed its First Deputy Head (while Aleksey Gromov was promoted to First Deputy Head of the Executive Office). However, in accordance with a long-standing tradition, the position of Deputy Head of the Executive Office in charge of Russia’s internal policy (Viacheslav Volodin) is deemed to be higher than that of his or her superior – Head of the RF President’s Executive Office. Within six months of him being in office, Viacheslav Volodin has managed to establish absolute control over all subordinate departments and has pushed through the appointment of his comrade in arms Oleg Morozov, formerly Deputy Speaker of the State Duma, to the position of head of the internal politics department, previously held by Vladislav Surkov’s protégée Konstantin Kostin (who left the Executive Office for good). It is still not clear what will be the style of internal politics management under Volodin and Morozov, who are now faced with the task of simultaneously preventing a serious erosion of the current political regime and that of functioning in the new political conditions, including the direct election of governors, free registration of political parties, etc. It can only be said that in any case it will be difficult to invent anything worse than the state of affairs under Vladislav Surkov, who spent his years in office diligently eradicating any vestiges of the multi-party system in Russia and trying to herd the whole of the country’s political elite into United Russia. And it is not by chance that Surkov’s departure from the RF President’s Executive Office took place after the scandalous parliamentary election marked by the people’s riotous protests against United Russia. ●

INFLATION AND MONETARY POLICY

N.Luksha

In April, there was deceleration in inflation: the CPI decreased by half as compared with March, to 0.3% (against 0.4% in April 2011). As per three weeks of May inflation made 0.3% (0.4% for the relevant period of 2011). As a result, the accumulated inflation since the beginning of the year reached 2.1%, which is nearly twice lower than in the same period in 2011. According to tentative estimates of the RF Central Bank, capital outflows in January–April 2012 amounted to \$42bn – about 1.5 times higher than in the last year and is comparable to the level of 2009. Ruble strengthening against other major currencies, observed at the beginning of the year, in May was replaced by a weakening trend: from late April through May 25 the dollar rate has grown by 7.7% up to Rb 31.62 /\$ and the Euro – by 2.2% to Rb/Euro 39.7. On May 22 the RF Bank announced the resumption of direct REPO transactions secured by shares.

As of April result the growth rate of consumer prices was twice lower than in March having made 0.3%. It is also lower than in April last year (+0.4%). The April slowdown in inflation is largely due to seasonal factors and is primarily inspired by a significant four-fold reduction in the rate of growth in food prices (+0.2%). In April of this year there was observed also a slowdown in non-food products inflation, as well as in the rate of prices of commercial public services.

In April, the largest decrease in the rate of growth of prices among the foodstuffs was registered for eggs (from 7.4% in March to 1.7%) and sugar (from 5.5% to 1.2%). The list of cheapening in recent months cereals and beans, pasta, and sunflower oil has included fish and seafood (-0.5%), butter (-0.3%), fruit and vegetable products (-0.4%).

The growth rate of prices for industrial goods has decreased by 0.1 p.p., amounting to 0.4%. The greatest contribution to the rise in prices, like in previous months, was made by more expensive tobacco products (+2.4%). It should be noted that April was the first month of this year, when gasoline price started to grow. Over the month its cost has increased by 0.7%. No decrease in prices for any of the non-food products was observed.

In April also a slower growth rate of prices for public commercial services (0.3% vs. 0.4% in March). Utility services became cheaper by 0.1%. The prices growth rate has slowed down nearly twice for healthcare services (+0.5%) and three-fold for communication services (+0.4%). At the same time, in view of the forthcoming vocational season, in April, prices for healthcare and recreation services have increased about three times (+0.9%). Foreign tourism services, prices which were decreasing before have also grown (+0.5%).

The annual inflation (April 2012 vs. April 2011) has slowed down to 3.6%. (*Fig. 1*). This is nearly 2.5 times lower than in the relevant period of 2011 (9.6%).

May did not make changes to the inflation trend, prevailing since the beginning of the year. Weekly inflation indicator again did not exceed 0.1%. As a result, by the results of the first three weeks of May, CPI made 0.3% (0.4% over the same period in 2011). Accumulated since the year beginning through to May 21 amounted to 2.1%, almost twice lower than that in 2011. The leader in prices growth in May was cabbage, which is got more expensive by 22.2%. The growth rate in gasoline prices has accelerated (+0.9% on May 21). At the same time, the most significant decline in prices affected eggs (-12.9%). Beginning from July 2011 the basic consumer price index¹ is permanently wobbling in the range 0.4–0.5%. April this year was no exception: after the March increase to 0.5%, in April BCPI has declined again to 0.4%.

We believe that until July, when there will be increased utility services rates, one should not expect changes in the inflation state. Moreover, given the slowdown in economic growth and low

¹ The core consumer price index reflects the level of inflation on 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. In Russia, it is calculated by the RF Statistics Service (Rosstat).



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

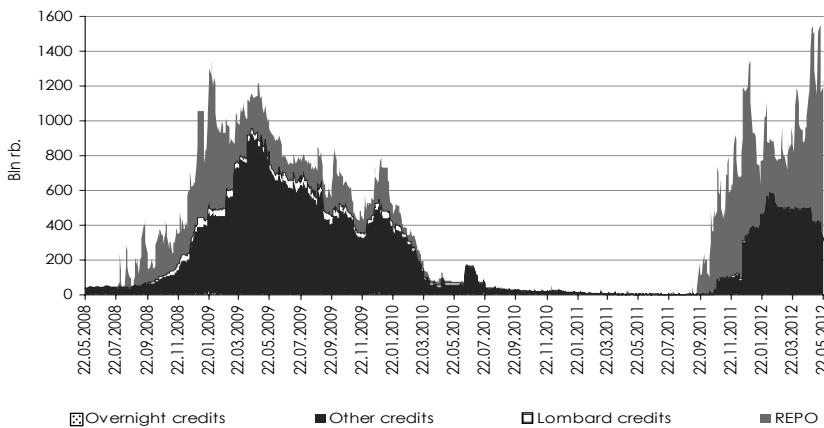


Fig. 2. Commercial banks' debts with the Bank of Russia in 2008–2012

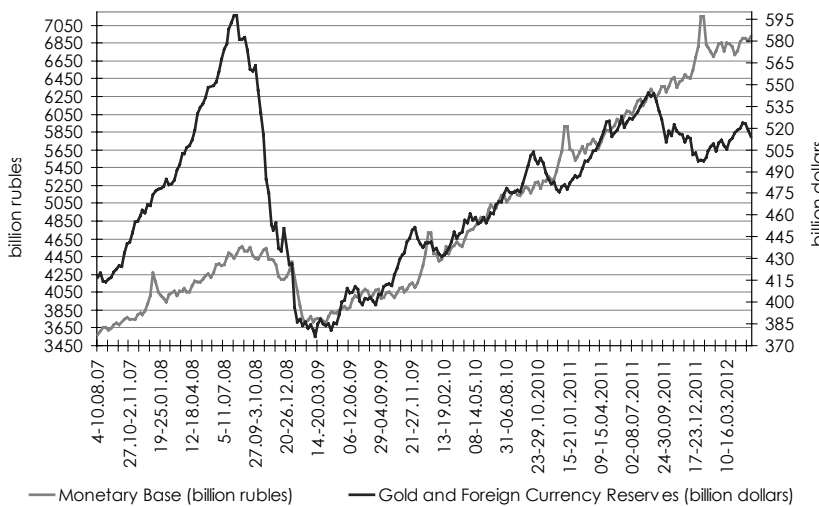


Fig. 3. Dynamics of the RF monetary base (in narrow definition) and gold and foreign currency reserves in 2007–2012

growth rate of monetary supply, inflation acceleration may be insignificant in summer.

In April the monetary base in broad definition has decreased again. As a result of the month, it decreased by 8.6% to Rb 7.8985bn (Fig. 2). The monetary base reduction is caused, on the one hand, by nearly 40% reduction in deposits of credit institutions with the RF Central Bank of Russia (\$ 86,4bn on May 1), and on the other hand, about 25 per cent reduction in commercial banks' correspondent accounts with the Bank of Russia (\$620bn as of May 1). After the March decline of cash in circulation, taking into account balances in credit institutions, in April they have rose to Rb 6639.7bn (+2.9%).

In April 2012, the surplus reserves held by commercial banks¹ have decreased by almost a quarter, reaching by the month results Rb 706,4 bn. Currently, the main contribution to the formation of the monetary base makes the banks' refinancing. Since autumn 2011 the Bank of Russia has considerably increased the amount of funds provided to commercial banks. A similar situation existed in the acute phase of the crisis of 2008–2009, when a significant impact on monetary supply was made by the operations of the RF CB to provide funds to commercial banks (Fig. 2). In May of the current year, the debt of banks under REPO transactions reached a record levels – more than Rb 1 trillion.

The increase in currency in circulation by 2.9% has led to the expansion of the monetary base in the narrow definition (cash plus mandatory reserves) by 2.7% to Rb 7022.4bn (Fig. 3).

Having reached in late April a maximum indicator since the beginning of the year – \$523.3 bn, the amount of international reserves began to decline. As a result, over less than three weeks, the

As a result, over less than three weeks, the

1 Under the excessive reserves of commercial banks in the 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.

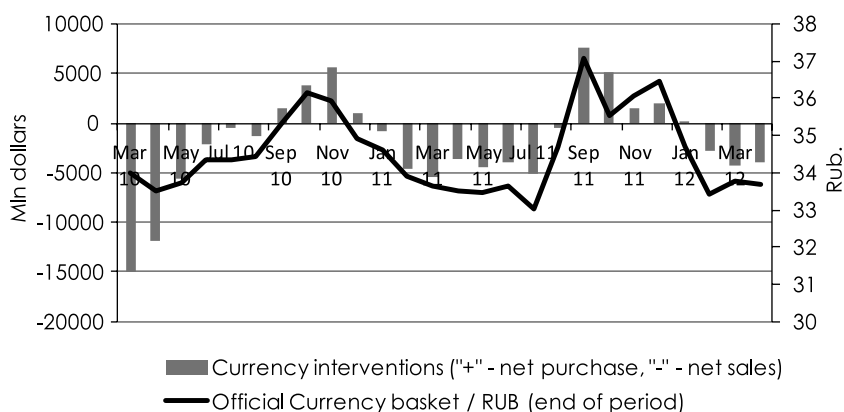
international reserves fell down to \$9bn, or 1.7%, to \$514. bn on May 18. The main reason for the reduction of reserves was, above all, a significant strengthening of US dollar against Euro in the global foreign exchange market due to the debt crisis aggravation in the Eurozone. As a result, the dollar amount of reserves denominated in Euro, has also reduced.

In April, as within previous three months, the Bank of Russia entered the domestic market with net purchases of foreign currency. However, in April, the cumulative foreign exchange interventions of the regulator declined by 6.6%. Over the month \$3.6bn and Euro 304.8m were purchased (Fig. 4)¹. Until mid-May, the interventions rate remained at the level of April and then declined sharply. The reason for the termination of foreign currency purchases by the RF CB was the change in the foreign exchange market situation, expressed in downward pressure on ruble exchange rate due to a decrease in prices for energy sources.

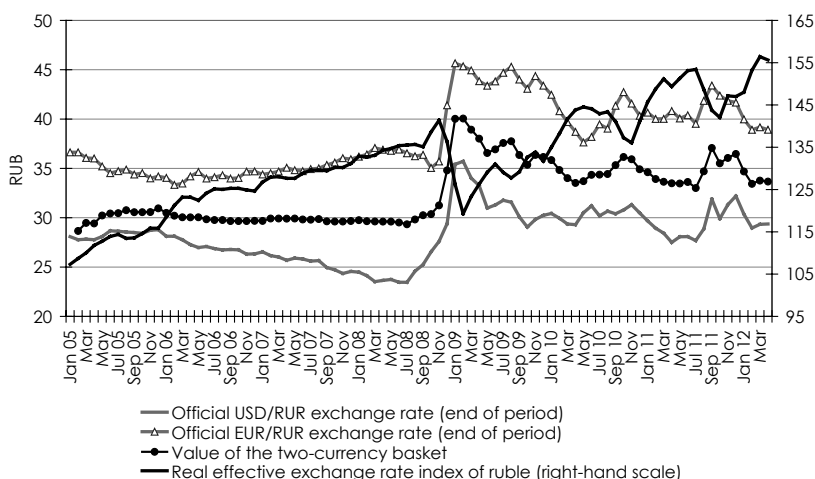
In April, for the first time since December last year, the ruble real effective exchange rate came to a halt. At the end of the month it has weakened by 0.5%. As a result, the real effective exchange rate index declined to 155.63 (Fig. 5).

Nearly 15-percent fall in oil prices from \$120-125 to 106/barrel has provoked a sharp weakening of ruble as against both, dollar and Euro. The reason for decline in the global oil prices was a negative external news background – resumed discussions on the exit of Greece from the Eurozone and the debt crisis exacerbation in Spain. US currency rate against ruble began to resume its growth in late April, regaining back its fall at the beginning of the year. Within 25 days of May dollar has strengthened against ruble by 7.7% to Rb31.62/ \$, having returned to the indicators of the 20s dates of January of this year. Euro has grown by 2.2% to Rb39.77/ Euro as of May 25, returning to the indicators of late January. As a result, over 25 days of May, the value of the two-currency basket rose to Rb 35.29 (+4.8%), having reached a maximum value since the beginning of the current year.

On May 22 the RF Bank announced the resumption of direct REPO transactions secured by shares included in the Lombard list. This step was taken by the Bank of Russia according to growth of the Russian banking system dependence on the funds provided to it by credit and monetary regulatory agencies. Recall that in the post-crisis period funds provided by the Central Bank to commercial banks became the main sources of formation of the monetary supply in the RF. In



Source: RF Central Bank, author's estimates.
Fig. 4. Central Bank currency interventions and dynamics of Ruble against currency basket March 2010 – April 2012



Source: RF Central Bank, author's estimates.
Fig. 5. Indicators of ruble exchange rate dynamics in January 2005 – April 2012

1 The level of January 2002 is taken as 100.

this situation, and in the state of increased instability in the global financial markets, the RF CB has decided to resume lending to banks secured by shares.

At the same time it should be noted that the rapid expansion of banks' lending by the RF CB at the background of rather slow growth of deposits creates grounds for the emergence of financial instability in the future, if such crediting is decelerated. In this situation, the RF BR should be more prudent with refinancing credit institutions and carefully control the banks risks. On May 25 the Bank of Russia has published a new version of the Regulation 110-I, which tightens the requirements on the formation of banks mandatory reserves from July 1, 2012. Since October 1, 2011 there were introduced increased rates of risk assessment applied in assessment of capital adequacy for a number of assets (loans to offshore companies, foreign currency loans, loans for the purchase of securities and other assets) in regard to the capital adequacy of banks assessment, which were applied earlier only to the new loans. From July 1 of this year, this provision should be applied to all transactions.

However, requirements to a number of companies in assessing calculating the coefficients are softer in the new version of the Regulation. This is applicable the companies included in the list of strategic enterprises, organizations of the military-industrial complex, the companies, whose loans do not exceed 0.1% of the bank's own funds, but no more than Rb 5m, as well as the organization, whose long-term rating under S & P or Fitch classifications is not beyond B level and no lower B2 according to the classification of Moody's rating agency. ●

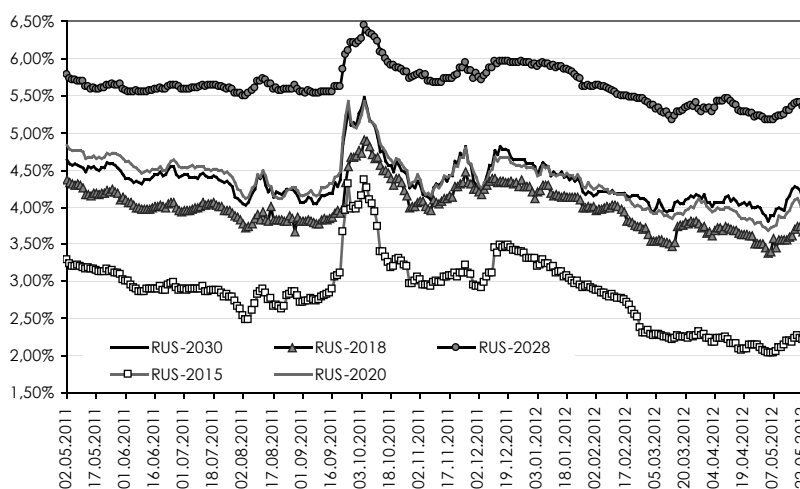
FINANCIAL MARKETS

N.Burkova, E.Khudko

New aggravation of the debt crisis in the Eurozone has led to a downfall in the Russian stock and futures market by 17% over the period from April 24 to May 23. The government securities market during this period decreased by 38%. The cost of some of the most liquid companies in the RF decreased by 25% as compared with the beginning of 2012. In the corporate bond market positive dynamics of such key factors as market scope and activity of the issuer for the registration of new securities issues were maintained. The situation with performance of the issuers of their current obligations to holders of placed securities has improved.

The deterioration in the market situation in May of this year has led to an increase in the yield to maturity in the government securities market by 2-5% (Fig. 1). Within the period from April 24 to May 23, 1012 the total turnover of the secondary market of government bonds amounted to Rb 43.6bn with an average daily turnover at the level of Rb 2.1bn, which makes the downfall of the daily average monthly turnover by 38% as compared with the preceding period.

In the period from April 24 to May 23 of the current year there was held one auction in federal loan bonds (OFZ) placement in the primary market (four auctions a moth earlier) (Table 1). The total actual amount of placement made 18% of the planned volume (51% in the preceding month). In addition, the planned auction on May 16 for OFZ issue 25079 was not held in the primary market due to the lack of applications, and the auction scheduled for May 23 for OFZ Series 26208 was canceled. There were no auctions on additional OFZ 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
25.04.2012	OFZ-25080-PD	35 000.00	6 452.00	7.59
Total:		35 000.00	6 452.00	

Source: Russian Ministry of Finance.

Stock market

Factors of the Russian stock market dynamics

Improving the of U.S. Federal Reserve forecast in regard to growth of national GDP and reduction of unemployment in the country in 2012, as well as promises to take additional measures for the support of the national economy, if necessary, contributed to the upsurge of the short-term indices of the Russian stock market in the last week of April 2012.

In May, the aggravation of the debt crisis in the euro zone has led to a downgrading in the global stock markets. The Russian stock market did not avoid the fall as well. Herewith, the decline in oil prices provokes additional pressure on the prices of Russian securities market. In general, over a month markets of developed countries fell down by 3–10%, while those of developing countries – by 1–11%. Basic Russian indexes fell down by 14–20%. However, since the beginning of the year those financial global markets have grown by 3–14%. The exception was the index of the French CAC-40, which has decreased by 2% (Table 2 and Fig. 2).

Table 2

DYNAMICS OF THE GLOBAL STOCK INDICES

Index	Value (as of 23.05.2012)	Dynamics within the month(%)*	Dynamics from the year beginning (%)
MICEX (Russia)	1 256.55	-14.31	4.57
RTS (Russia)	1 264.29	-19.62	13.82
Dow Jones Industrial Average (USA)	12 496.15	-3.33	5.81
NASDAQ Composite (USA)	2 850.12	-4.05	14.02
S&P 500 (USA)	1 318.86	-3.52	8.69
FTSE 100 (UK)	5 266.40	-7.05	1.67
DAX-30 (Germany)	6 285.75	-3.64	10.59
CAC-40 (France)	3 003.27	-3.07	-1.94
Swiss Market (Switzerland)	5 817.91	-4.86	3.01
Nikkei-225 (Japan)	8 556.60	-10.33	12.85
Bovespa (Brazil)	54 619.48	-11.24	8.43
IPC (Mexico)	37 422.38	-3.95	5.08
IPSA (Chile)	4 201.45	-7.69	8.95
Straits Times (Singapore)	2 780.42	-6.14	11.94
Seoul Composite (South Korea)	1 808.62	-8.31	8.05
ISE National-100 (Turkey)	55 734.34	-7.30	17.27
BSE 30 (India)	15 948.10	-6.72	10.62
Shanghai Composite (China)	2 363.44	-1.05	8.60
Morgan Stanley Emerging&Frontier Markets Index	709.71	-10.82	9.76

* Versus index indicators as of April 2012

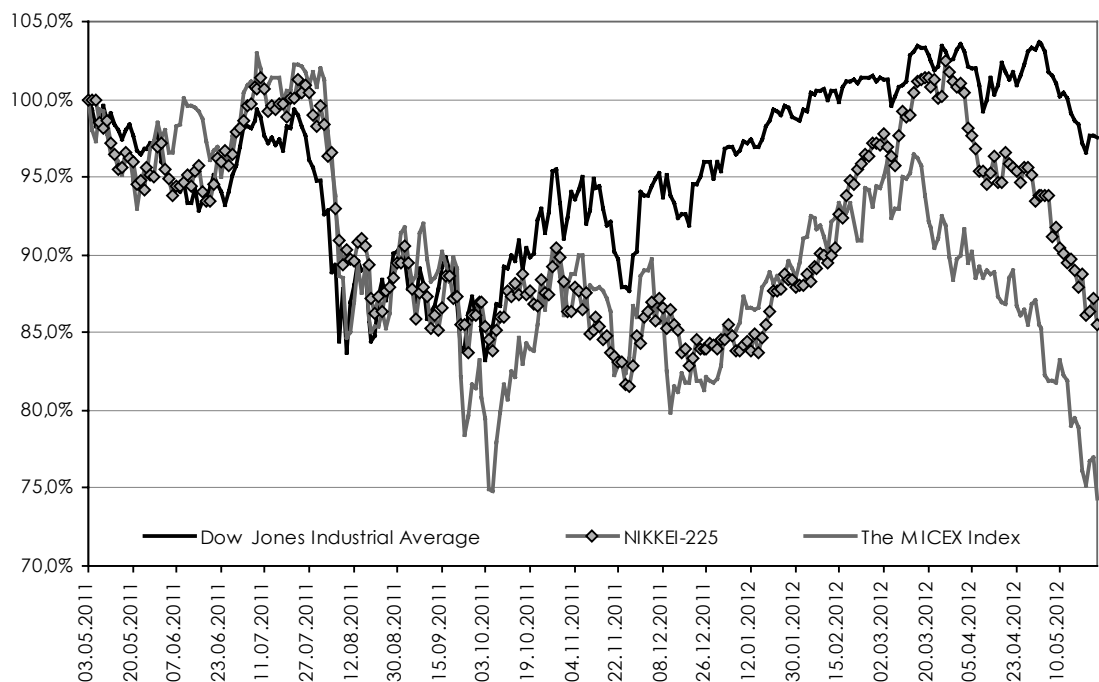


Fig. 2. Dynamics of the main USA, Japanese and Russian stock indices (in % to the date of May 1, 2012)

Stock market situation development

The maximum value within the month the MICEX index has demonstrated on May 2, having reached 1446 points (1550 points in the preceding month). The minimum value for the period the MICEX index has reached on May 23 – 1257 points (against 1466 points in the preceding month) (Fig. 3).

In general, within the period from April 24 to May 23, 2012, the MICEX index has decreased by 4.3, what makes about 209.8 points in absolute terms (from May 24 2011 to May 23 2012 the MICEX index has downgraded by 21.4%), whereas the turnover of trades in securities included in the MICEX index has reached Rb 806bn. The average daily level of investor's activity in the stock market in May has decreased by 17%.

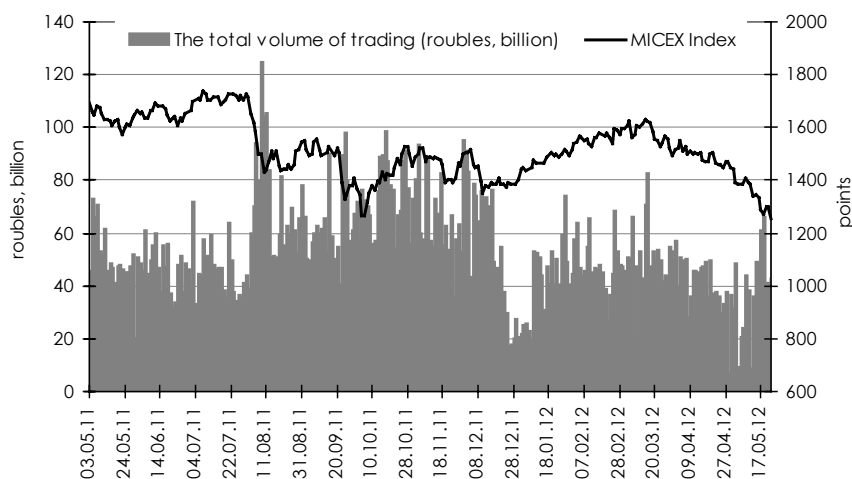
In the period from the beginning of the year through April 23, 2012, the leaders in the value decline among the "blue chips" were securities of Rostelecom and Mosenergo, which value has decreased by 24.8 and 21.8% accordingly (Fig. 4).

According to the OAO "MICEX-RTS", on May 23 of this year, five leaders of the domestic market capitalization was as follows: Gazprom – Rb 3,325bn (against Rb 3,975bn on April 23, 2012), Rosneft – Rb 2,077bn (against Rb 2,248bn), Sberbank of Russia – Rb 1,726bn (against Rb 2,011bn, LUKOIL – Rb 1,363bn (against Rb 1,510bn) and Nornickel – Rb 933bn (against Rb 989bn).

Futures and Options Market

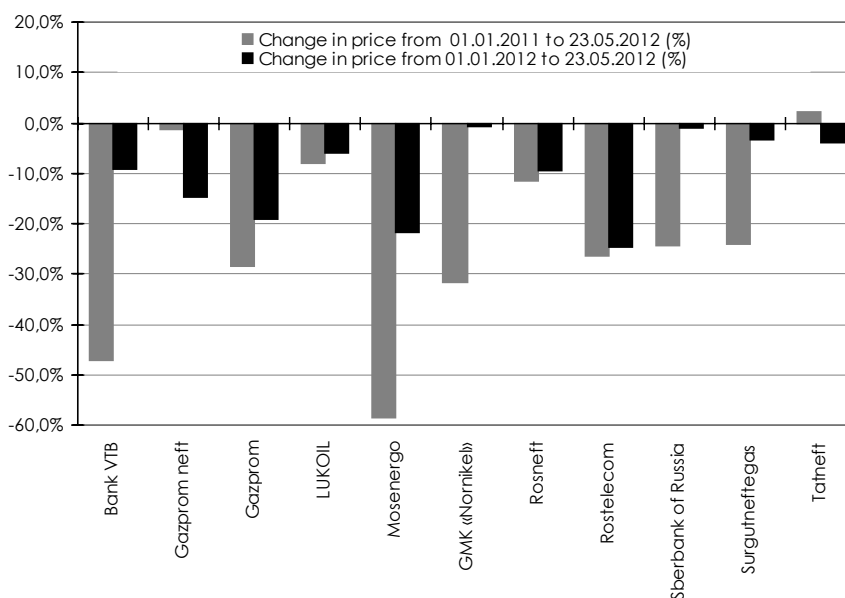
In May 2012 the volume of trading in the MICEX futures and options market amounted to Rb 100.1m (Rb1,5bn a month earlier). All 39 transactions occurred in the futures contracts Rb/\$. Prices of these futures with the date of execution on June 15, 2012 were concluded in the market mostly in the range 29.6–31.5 Rb/\$, i.e., expectations of market participants about the rates in the short term were split, suggesting the possibility of both, price reduction (up to 1.4%), and price increase (to 4.7%) of the ruble in comparison to the indicator of May 23, 2012 (31.06 Rb/\$).

In FORTS futures and options market average daily activity of investors in May dropped by 16.5% as compared with the previous month. Herewith, the leaders in terms of trading in futures contracts are contracts for the RTS index, followed with a significant lag by the contracts for Rb/\$



Source: OAO "MICEX-RTS".

Fig. 3. Dynamics of MICEX Index and trading volume



Source: OAO "MICEX-RTS".

Fig. 4. Dynamics of the Russian Blue Chips

rate, for the securities of Sberbank of Russia, for euro/\$ rate and securities of Gazprom. Prices of recent transactions concluded for futures contracts for Rb/\$ with the date of execution on June 15, 2012, were mostly within 29.5–31.7 Rb/\$ and within the 29.9–31.9 Rb/\$ with the date of execution on September 15, 2012, i.e., by September 15 the expected depreciation of the ruble in comparison with the indicator of May 23, 2012 is 0–2.7%. Prices of recent transactions concluded on futures contracts for Rb/euro with the execution date on June 15, 2012, were mostly in the range of 39–39.9 Rb/euro, i.e., strengthening of ruble in expected (0–1.9%) versus the value of April 23, 2012 (39.74 Rb/euro), and the date of execution September 15, 2012 – within 39.5–40.6 Rb/euro.

The value of the futures contract for RTS index (based on recent prices of transactions) with the execution date on June 15 made 1,280–1,550 average points, i.e., market participants expect 1.2–22.6% increase over the indicator of May 23, 2012, and growth to 1,250–1,540 points by September 15, 2012. Prices of recent transactions in futures contracts for the MICEX index with the date of execution on June 15, 2012 was 1,260–1,440 points on average, i.e., an expected increase in the index is by 0.3–14.6% as compared with the indicator of May 23, 2012.

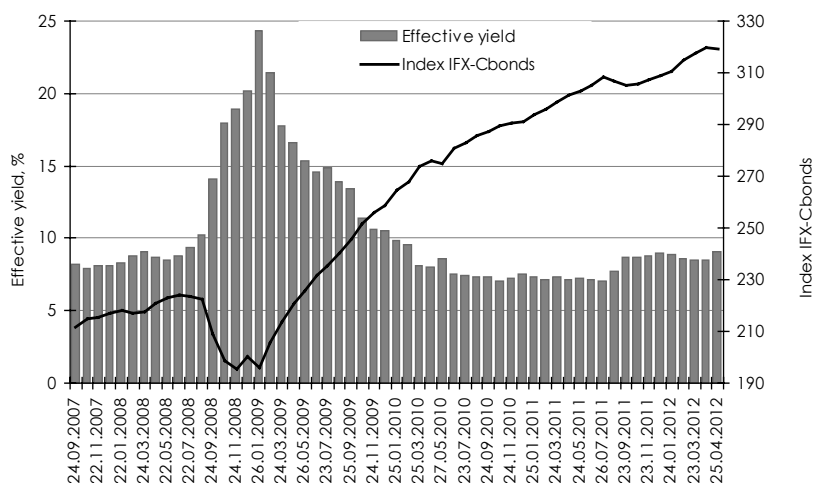
Options enjoyed far less demand, the turnover made about Rb 112.96bn (Rb 3,711.1bn). The leader in terms of daily turnover were the marginal options in futures contracts for RTS index.

Corporate bonds market

The volume of domestic corporate bonds market in Russia continued its growth in May (at par value of circulating securities denominated in local currency). At the end of the month the market scope reached Rb 3 722.7bn, which is by 2.4% more than its value at the end of March of this year¹. The growth of the market capacity has been associated with both, increased number of bond issues (817 issues of corporate bonds registered in the national currency, against 812 emissions at the end of the previous month), and the increasing number of emitters (339 against 335 companies at the end of April). Among the issues denominated in foreign currency, in circulation there is still one emission of bonds issued in Japanese yen, and one bonds issue in U.S. dollars.

The trade indicators of the secondary market of corporate bonds in May have decreased, but with regard to the seasonal factors, one can note a rather high investors' activity. From April 24 through May 23, the total volume of transactions in the MICEX stock exchange amounted to Rb 92.5bn (for comparison, from March 26 to April 23, the turnover made Rb 126.5bn), and the number of transactions in the period under review made 21.4 thousand (24.3 in the preceding period)².

Index of the Russian corporate bond market IFX-Cbonds has suspended its growth trend, started in Q3 2011: by the end of May its value decreased by 0.8 points (or 0.2%) as compared with the value of



Source: Rusbonds data.

Fig. 5. Russian corporate bonds index dynamics and average weighted yield

late April. However, the negative trend of the index dynamics in May was not so significant as in terms of average weighted yield. Its value in the past month has increased from 8.46% to 9.06%, having reached a maximum peak since February 2010 (Fig. 5). Such negative dynamics of the domestic debt market is based to external factors, primarily the negative news from the Eurozone countries.

The portfolio duration of corporate bonds indicator has decreased again and at the end of May amounted to 775 days, which is by 26 days less than at the end of the previous month. Although the duration is still at a high enough

1 Rusbonds Information Agency data.

2 "Finmarket" Information Agency data.

level, the trend of its gradual decline indicates a decrease in the offer of long-term corporate bonds in the market. The most liquid bond issues showed a uniform tendency to increase profitability. The maximum growth rates (more than 1 p.p.) was observed in the primary sector companies¹, as well as in energy companies. Interest rates on bonds of the major financial institutions have increased on average by 0.5–0.9 percentage points (“Alfa Bank”, “VTB Bank”, “Zenit Bank,” Commercial Bank “Renaissance Capital”, “Russian Agricultural Bank”). A similar increase in bond yields has demonstrated by high-tech companies – “VimpelCom”, “MTS” AFK “System”, although in April there was a pronounced downward dynamics of the yield in respect of securities in this sector. A relatively marked decline in profitability at the background of a general trend (in the range of 0.3–0.5 percentage points) was recorded in some series of bonds of SC “Vnesheconombank”, OAO “Promsvyazbank”, OAO “Rosbank”.

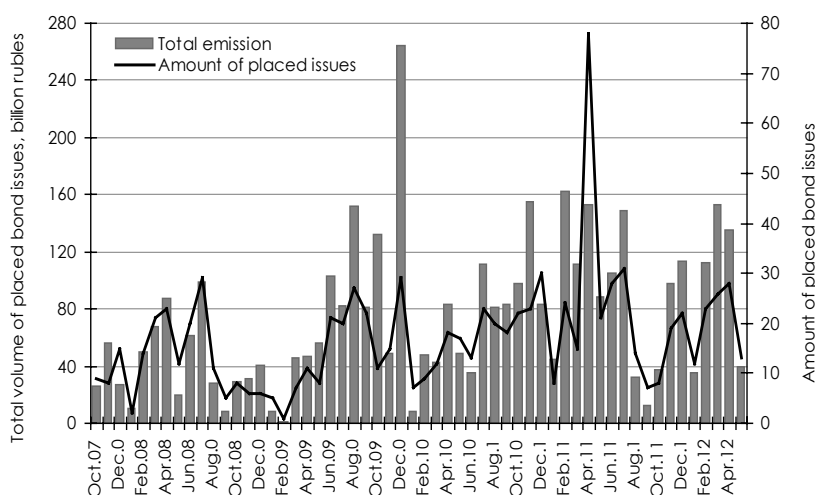
However, despite the rise in interest rates, emitters’ activity in the debt segment of the market remained at a high level². Thus, in the period from April 25 to May 25, eleven emitters registered 28 bond series with total face value of Rb191.1bn (for comparison, from March 24 to April 24 there were registered 43 bond issues with total face value of Rb 171.8bn). This situation stems from the fact that in May the largest emitters registered their issues, for which it became problematic to attract funding from external markets. In particular, the larger issues were registered by OAO “Russian Railways” (six series of bonds totaling Rb 90bn), OAO “Rostelecom” (eight bonds series in the amount of Rb 60bn.), OAO “Zenit Bank” (four series in the amount of Rb 18bn). Over a third of registered issues were stock obligations, and there were several debut issues of securities.

Despite the plans of major companies to place in the near future to place bond issues in the domestic market, investors’ activity in the primary market in May was quite low, which, incidentally, is also explained by seasonal factors. From April 25 to May 25 only thirteen emitters have placed fourteen bonds issues with a total nominal value of Rb 39.5bn (from March 24 to April 24 there were placed 28 bonds issues at face value of Rb 135.3bn) (Fig. 6). The largest bond issues were placed by OAO “Federal Grid Company UES” (one series of bonds worth Rb 10bn), OAO “Russian Standard Bank” (a series of bonds worth Rb 5bn) and OAO “Svyaz-Bank” (a series of bonds for the amount of Rb 5bn). Herewith, it is worth noting such a positive point as the successful placement of several debut bond issues of small denomination. Long-term bonds (with maturity of 10 years and more) were placed only by OAO “Svyaz-Bank”.

It should be noted that in May FFMS of Russia has not recognized as invalid any of the bond issues in connection with the non-placement of securities (in April the financial regulator has canceled two bond issues as invalid)³.

From April 25 to May 25, there were eleven emitters who were to pay off seventeen bonds. However, one failed to perform its obligations to bondholders when due, having announced a technical default (in April five emitters have announced a technical default). In June 17 corporate bond issues are expected to be repaid totaling to Rb 51.1bn⁴.

The situation with the announcement of the actual default (when the emitter is unable to



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 Information Agency data.

pay the income to the owners of the securities, even in the close days after the scheduled date of performance) had no significantly changes. From April 25 to May 25, all emitters have fulfilled their obligations under the current bonds and implemented early redemption of the securities (in December and January 2-3 Issuer declaring the real default on coupon payments). From April 25 to May 25, two emitters have announced a real technical default on coupon yield repayment. However, one emitter failed to repay the face value of outstanding bonds, even in the framework of technical default (in the previous period two emitters were unable to repay their debenture issues)¹. ●

1 Cbonds information.

REAL ECONOMY: TRENDS AND FACTORS

O.Izryadnova

According to the preliminary estimation of the Federal State Statistics Service the index of the GDP in the 1st quarter 2012 made 104.9% versus the first three months of the previous year. The retail trade turnover in the first four months of the current year went up by 107.2% versus the corresponding period of the previous year, in April 2012 – by 106.4% versus April 2011. The investments in fixed assets went up by correspondingly 7.8% and 13.8%. In April 2012 the industrial growth rates slowed down to 101.3% in annual terms.

According to the preliminary estimation of the Federal State Statistics Service the index of the GDP physical volume in the 1st quarter 2012 made 104.9% versus the first three months of the previous year (104.0% in the 1st quarter 2011 versus the 1st quarter 2010).

At the beginning of the current year it was the simultaneous expansion of the internal and external demand that served as the main factor of the economy growth. Despite the weakening of the world economy growth rates the Russian economy demonstrates the growth which is supported by high prices for hydrocarbons. In the 1st quarter of the current year the export growth by physical volume made 103.5% as compared with its decrease by 2.8% a year ago. At the same time the trend for the anticipating growth of import physical volume versus the export volume is maintained in the economy. In the 1st quarter 2012 the growth of import in terms of physical volume slowed down to 109.5% versus 135.4% in the 1st quarter 2011. Under the existing dynamics and structure of the foreign trade turnover the increase in the volume and proportion of the net export had a positive effect on the GDP growth rates acceleration in the 1st quarter 2012.

The situation at the internal market was formed under the trend of the anticipating growth of the investments demand versus the dynamics of the consumer demand which has been maintained since the second half of 2011. In January–April 2012 the growth rates of the investments in the fixed assets reached 113.8%, being 107.8% in April, versus the corresponding period of the previous year. The proportion of the investments in fixed assets in the GDP made 12.3% exceeding the figure of the previous year by 0.7%. However it should be noted that the expansion of the investments volumes was not supported by the adequate increase of the workload in construction and the offer of the investments goods remains approximately at the pre-crisis level. As compared with January–April 2011 the supply of the construction organizations with orders and contracts diminished. In March–April 2012 the implementation of the residential floor area was observed to decrease and the growth in the construction of the commercial immovable property – to slow down as compared with the corresponding period of the previous year. In April 2012 the volume of construction went up to 103.7% and the implementation of the residential floor area – reduced to 94.4%. It should be noted that in 2012 the attractiveness of the Russian economy for foreign investors has diminished. In the 1st quarter 2012 the inflow of foreign investments in the Russian economy made 82.4% of the level of the 1st quarter 2011, even though the direct investments did not decrease considerably.

Table 1

INFLOW OF FOREIGN INVESTMENTS BY TYPES

	1 st quarter 2011			1 st quarter 2012		
	USD million	1 st quarter 2010	As percentage to the total	USD million	1 st quarter 2011	As percentage to the total
Total	44349	340.0	100	36534	82.4	100
of which:						
direct investments	3890	148.3	8.8	3863	99.3	10.6
portfolio investments	122	41.8	0.3	1007	820.0	2.8
other investments	40337	390.0	90.9	31664	78.5	86.6

Source: Federal State Statistics Service

This year the growth rates of the consumer market were observed to increase. Over the first four months of the current year the volume of the retail trade made 107.2% versus January–April 2011 and 106.4% versus April 2011, the volume of the paid service rendered to the population – 104.3% and 102.4%, correspondingly. In April as compared with April 2011 the volume of retail trade with non-food goods went up by 8.6%, with foodstuffs – by 3.9%. The expansion of consumer demand was positively influenced by the slow-down of the inflation rates to 101.8% in January–April versus 104.3% a year ago, including for foodstuffs – to 102.5% versus 105.3%, as well as the recovery of the positive growth dynamics of the real incomes of the population. In January–April 2012 the real incomes of the population were 102.2% versus the corresponding period of the previous year, when they were observed to decrease by 0.4%. The beginning of 2012 was specifically characterized by the exceptionally high growth rates of wages – by 10.4% versus April 2011 which improved the possibilities to satisfy the deferred demand. The comparison with the pre-crisis level demonstrates that in April 2012 the real disposable incomes were 8.4% and the real wages – 14.6% higher than the figures of April 2008.

Table 2

GROWTH RATES OF MAIN ECONOMIC INDICES IN APRIL 2008-2012, AS PERCENTAGE VERSUS THE CORRESPONDING PERIOD OF THE PREVIOUS YEAR

	2008	2009	2010	2011	2012
Output volume in basic types of economic activities	109.6	85.1	107.7	103.3	
Industry	105.7	85.8	110.4	104.5	101.3
Minerals extraction	102.7	97.3	104.6	101.4	101.5
Manufacturing industry	108.8	77.6	116.5	105.3	103.6
Investment in fixed assets	125.0	80.4	101.7	102.2	107.8
Workload in construction	121.8	86.5	94.5	98.1	103.8
Retail trade volume	114.9	95.6	105.9	105.5	106.4
of foodstuffs goods	108.4	101.7	104.8	101.0	103.9
of non-food goods	120.4	90.2	106.9	110.1	108.6
Volume of paid services	107.2	96.2	100.7	104.1	102.4
Foreign trade turnover	149.5	54.5	147.2	133.6*	108.3
Export	148.0	52.3	149.2	128.4*	109.9
Import	152.0	58.0	130.1	143.2*	105.9
Real disposable incomes of the population	109.1	102.4	105.7	98.1	102.1
Real accrued wages	114.6	95.7	105.9	102.4	110.4
Employed in the economy	101.1	97.1	99.9	101.3	100.7
Total number of the unemployed	94.4	148.6	91.8	88.1	80.8

* March 2012 versus March 2011

Source: Federal State Statistics Service.

In the 1st quarter 2012 the volume of the monetary incomes of the population was Rb 8052.8bn, having grown by 7.3% versus the corresponding period of the previous year. For goods purchase and payment for services the population spent Rb 8311.4bn, which is 7.9% more than in the 1st quarter 2011. The growth in the volume of consumer expenses was accompanied by the reduction in the savings ratio and the expansion of consumer crediting. The proportion of savings made 7.2% in the 1st quarter 2012 as compared with 10.6% a year ago. It should be noted that this year the organized savings in the form of deposits and stocks have been observed to decrease, whereas the interest in foreign currency purchase has grown. In April 2012 as compared with the corresponding period of the previous year the credits issued for the population expanded by 38.8%.

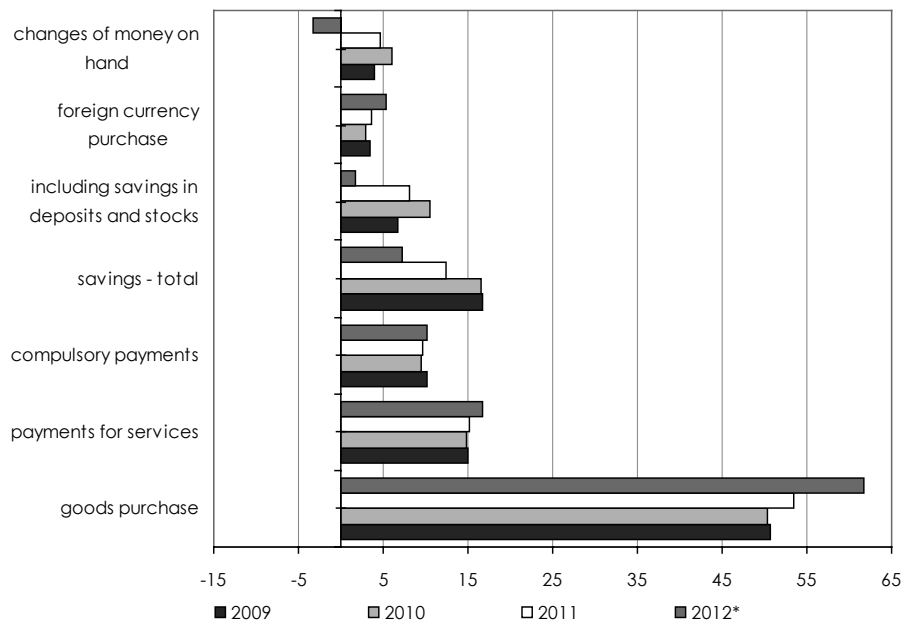
According to the data of the labor market monitoring the total number of the unemployed in April 2012 made 4.4m, having decreased by 1.0m people versus April 2011. Analyzing the dynamics of the population employment and unemployment one should take into account the ratio of the offer and demand for the workforce by types of economic activity.

Over the first four months of the current year the index of the industrial production made 103.3% versus January–April 2011, being 101.3% in April versus April 2011. The dynamics and

structure of the industry were predominantly influenced by the manufacturing industries. Manufacturing industries index went up to 104.2% versus January–April 2011 and 103.6% versus April 2011. The index of the extractive industries both over January–April and April of the current year versus the corresponding periods of 2011 made 101.5%.

It should be noted that the gradual slowdown of the growth rates in the manufacturing industry which has been observed for the past two years, the investments activity remaining low and liquid funds being scarce, determined the internal risks of the development at the beginning of 2012. This year the main contribution in the increase of the manufacturing industries output was made by the transport vehicles and equipment production (105.2% in April 2011), the metallurgy production (105.0%), the foodstuffs production (104.5%), coke and oil products production (103.5%) and construction materials production (103.7%). The growth rates for other consolidates positions were below the aggregated value for the manufacturing industry.

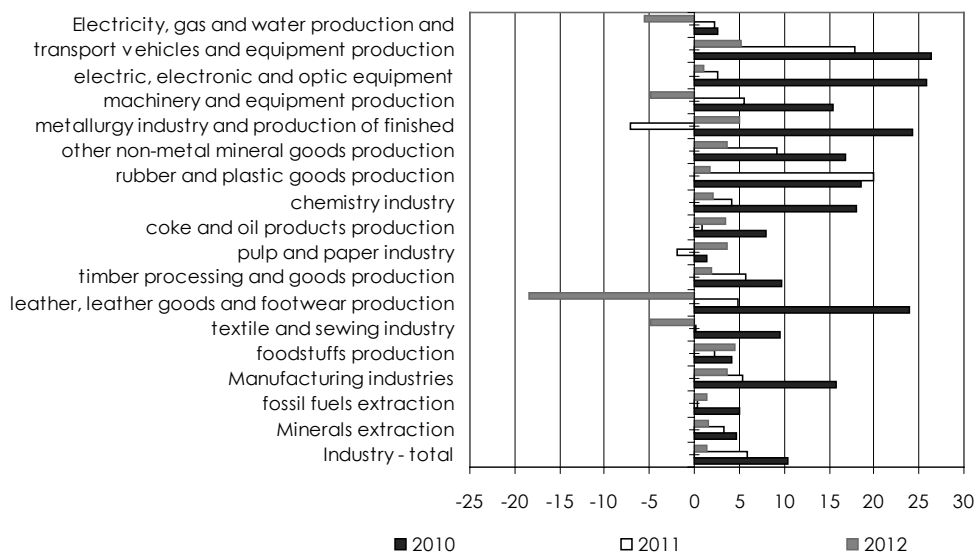
Since the beginning of the year the complex of consumer goods productions has been characterized by the intensification of the production decrease rates in annual terms. In March–April 2012 the growth rates in annual terms were negative in the machinery and equipment production, in electric, electronic and optic equipment production. Taking into account intersectorial connections



* preliminary data

Source: Federal State Statistics Service.

Fig. 1. Structure of Usage of the Monetary Incomes of Population in 2009–2012, as Percentage versus the Monetary Incomes



Source: Federal State Statistics Service.

Fig. 2. Growth Rates as Broken by Types of Activity in Industry in April 2009–2011, as Percentage versus the Corresponding Period of the Previous Year

of these types of activities one can expect the slowdown of the investment goods production rates in machine-building complex in the short run.

The nature of the business activity in the forthcoming months will be influenced by the level and the dynamics of the financial results of the organizations' and enterprises activity. According to the live data in the 1st quarter 2012 the balanced (profit minus losses) result of organizations and enterprises' activity made Rb +2185.0bn, having increased by 6.6% versus the previous year while the monthly growing rates reduced. The absolute reduction of profit volume is registered in the electricity, gas and water production and distribution, processing industries versus the 1st quarter 2011. ●

RUSSIAN INDUSTRY IN APRIL 2012

S.Tsukhlo

The latest surveys conducted by the Gaidar Institute¹ indicate that, in the eyes of Russian industrial enterprises, the modest positive changes registered in the dynamics of the demand for industrial products and in their output dynamics have not considerably improved their situation. The heads of the surveyed enterprises believe that in the nearest future they should expect an insufficient demand for their products, less optimistic output and workforce hiring plans, an increase in redundant production capacities and the disappearance of personnel shortages.

Industrial Optimism Index

The latest value of the Industrial Optimism Index (Fig. 1) demonstrates that the situation faced by the respondent enterprises has not fundamentally changed. Since the beginning of 2012, industrial enterprises have been assessing their current situation as barely sustainable, and have seen themselves as teetering on the brink of a new crisis.

In April, the index of industrial forecasts (Fig. 2) dropped to its lowest level since early 2010. On the whole, industry is still reluctant to increase production and hire additional workforce.

Demand for Industrial Products

In April, the rates of change in demand for industrial products indicated that that the sales growth was continuing with the same positive intensity as in March in regard to initial data. However, when cleared of seasonality, the value of that indicator drops to -2 points, which can be interpreted as the absence of changes (Fig. 3). On the other hand, when compared with the situation in the first few months of the current year, when the intensity of decline in demand could rise to -9...-7, the value of -2 points can be seen as a noteworthy achievement.

In March-April, demand forecasts rose to +8 points after having been surprisingly stable at the level of +4 points from September 2011 through February 2012. Sales satisfaction stabilized at the level of 53%. At the same time, demand increased its restraining influence on the behavior of output. In Q2 2012, it was considered to be an obstacle to output by 55% of industrial enterprises, while

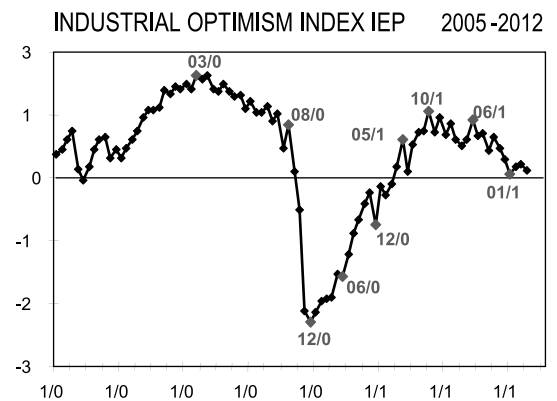


Fig.1

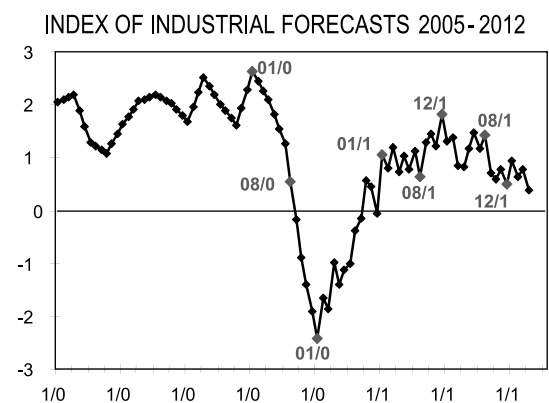


Fig.2

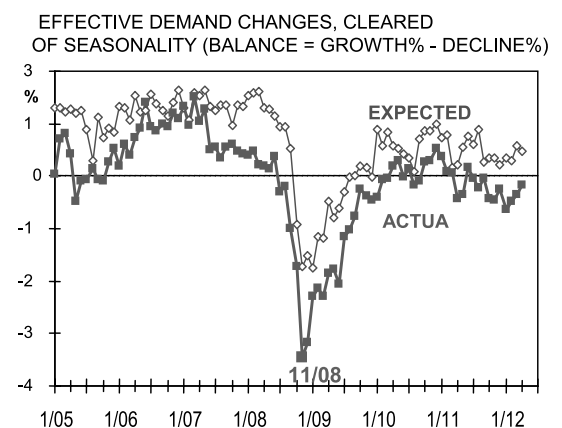


Fig.3

1 Monthly business opinion 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.

the minimum post-crisis percentage of references thereto, registered in Q4 2010, amounted to 45%. The crisis maximum of such references (67%) was recorded in 1Q 2012. It should also be noted that demand turned out to be the only restraint on output whose influence was on the rise in Q2 2012.

Stocks of Finished Products

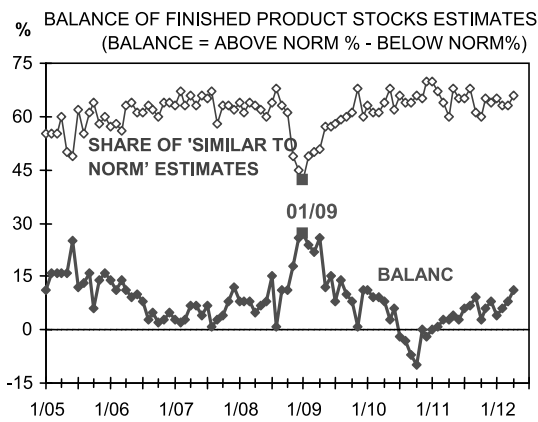


Fig.4

The balance of estimates of finished product stocks (Fig.4) displayed a level of redundancy that could be considered high in comparison with the past few years' average: in industry, the number of "above the norm" responses was higher than the number of "below the norm" responses. However, just like it had always been since early 2000, "similar to the norm" responses were in the absolute majority. In the 1990s, during the periods of especially severe falls in demand, an absolute majority of Russian industrial enterprises characterized their finished product stocks as "above the norm". In the immediate aftermath of the 1998 default, "below the norm" responses commanded an absolute majority in the surveys, which could be explained by the respondents' absence of faith in the stability of the industrial growth that had unexpectedly begun, seemingly out of the blue.

In March-April, the largest stocks of redundant finished products were accumulated by light industry (+46 bps), the timber industry (+ 23 bps), the chemical industry (+12 bps) and the construction industry (+12 bps). Those stocks were practically zero in machine-building, metallurgy and the food industry.

Output

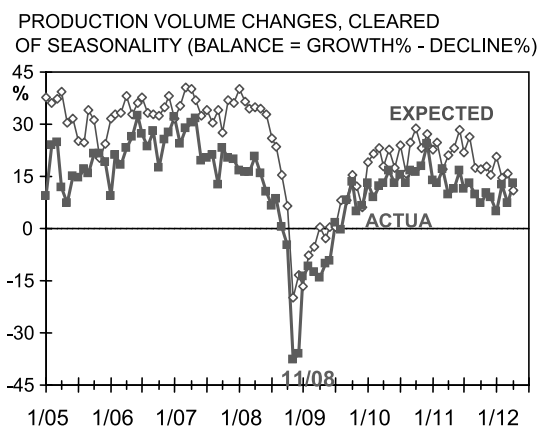


Fig.5

In April, the initial data on the dynamics of industrial production indicated that its growth rate remained at the level of March 2012. When cleared of seasonality, those data pointed to a rise to an 11-month high (Fig. 5). This output dynamics matches the changes in demand for industrial products recorded by 66% of industrial enterprises, which represents the best result of the past three months.

However, the output plans of enterprises do not envisage that the achieved rates of input growth will be maintained in May and June. Over the course of April, initial forecasts dropped by 13 points, and when cleared of seasonality – by 5 points. That was the worse result since early 2010. Yet another "negative" feature of the output plans was their lagging behind the respondents' demand forecasts. While previously, on average, only 6 percent of enterprises would have output plans lagging behind demand forecasts, in April such plans existed at as many as 12% of commodity producers. It seems that industry does not believe in the veracity of its own demand forecasts, and will prefer, in the next few months, to restrain rather than activate production processes.

CHANGES IN PRODUCER PRICES (BALANCE = GROWTH% - DECLINE%)

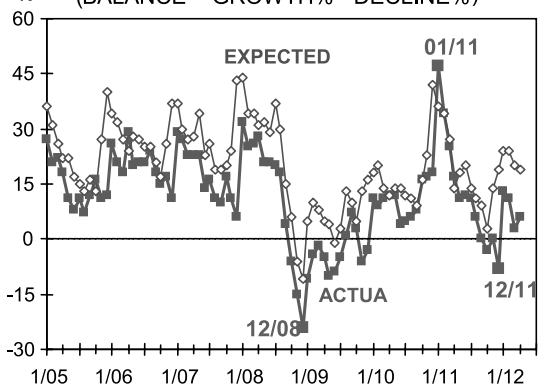


Fig.6

Producer Prices

It seems likely that the pricing policy of enterprises (Fig. 6) has already begun to anticipate the inflation leap of the second half-year 2012. Firstly, having faced in April a sharp reduction in the growth rate of prices, from +11 points to +3 points, enterprises have decided

to increase the intensity of price growth to +6 points. Secondly, over the course of the first four months of 2012, the pricing plans of enterprises have dropped by only 6 points, with no changes being registered in April. One year ago, as of 1 April 2011, they had already lost 22 points since the beginning of that year, and had become lower than those of April 2012. However it cannot be excluded that the new trends observed in the pricing policy of enterprises are being formed also under the influence of the positive changes in the actual and forecasted dynamics of demand.

Actual and Planned Job Cuts

In April, industrial enterprises once again slightly increased personnel recruitment (*Fig. 7*). This rise in recruitment coincided with the ongoing disappearance of personnel shortages in industry. For the second quarter in a row, due to the expectations of changes in demand, the respondents' personnel estimates displayed a zero balance (the share of "more than enough personnel" responses was fully balanced by the share of "less than enough personnel" responses, while 75% of the respondents answered that they had "enough" personnel. This means that industry as a whole has enough personnel to cope with the expected rise in output. Therefore it is unlikely that the current intensity of personnel recruitment will be maintained in the next few months.

Estimates of wages in industry (*Fig. 8*) show a steady rise in satisfaction with the size of wages paid to workers on the part of the heads of enterprises. In Q2 2012, the share of "normal" responses rose to 66%, a record high since the beginning of that index's monitoring in 2007. The pre-crisis high was 60%, while the crisis low amounted to 37%. In 2012, the largest share of enterprises with "normal" levels of wages has so far been registered in the electric energy industry (100%), metallurgy (85%), machine building (60%), the timber industry (60%) and the construction industry (60%).

Crediting of Industry

Since the beginning of 2012, the aggregate ("above the norm" + "similar to the norm") availability of credit has stabilized at around 71% (*Fig. 9*). In 2012, first place in that index has so far belonged to machine building (76% of enterprises), second place – to metallurgy (73%), and third place – to the chemical industry (72%). The lowest availability of credit is registered in light industry, where only 39% of enterprises have characterized it as "similar to the norm" or "above the norm". The percentage of such characteristics is much higher in the timber industry (51%) and the construction industry (66%). The availability of credit also considerably depends on the size of an enterprise. Thus, only 42% of small and medium-sized enterprises are satisfied with the availability of credit, while 53% of large plants (251–1000 employees) and 77% of very large plants (over 1000 employees) are happy with it. Over the course of the past two months, the average minimum rate of interest on ruble-denominated credits has dropped from 12.3% to 12.0% per annum. ●

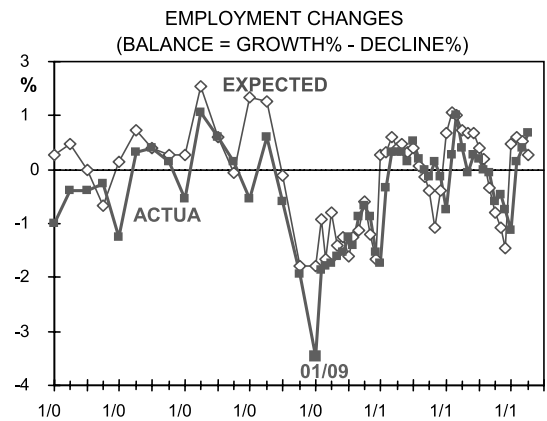


Fig.7

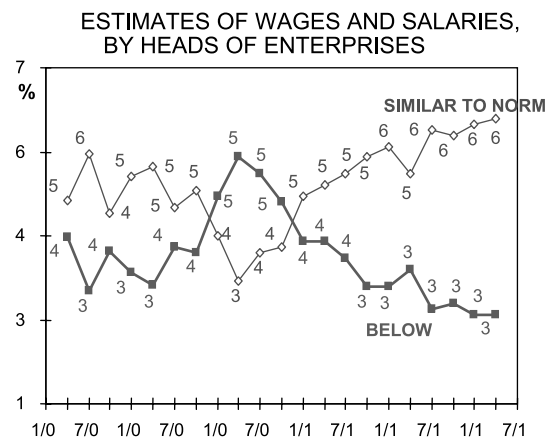


Fig.8

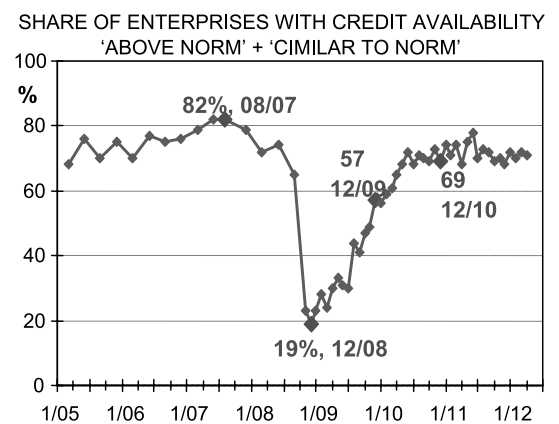


Fig.9

THE FOREIGN TRADE

N.Volovik, K.Kharina

Despite the favorable situation on the oil market for the Russian export and ongoing appreciation of the Russian ruble in the 1st quarter of 2012, the Russian foreign trade showed the signs of slowdown. In a situation of a drop in oil prices and weakening of the ruble, apart from a slowdown of growth, a decline of the main indices of the Russian foreign trade is expected, too.

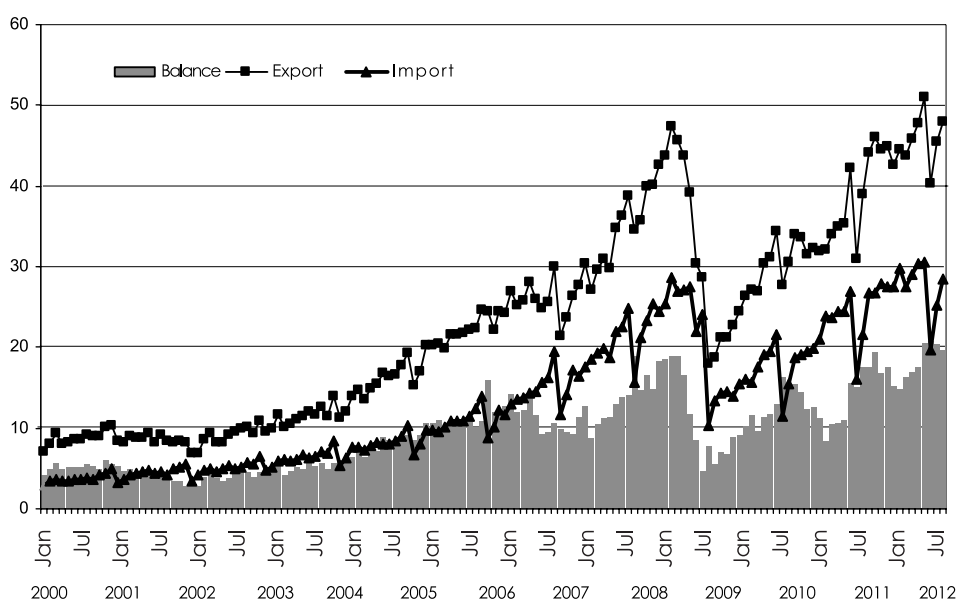
In March 2012, Russia's foreign trade turnover calculated on the basis of the methods of the balance of payments amounted to \$76.5bn which is 8.3% higher than the same index of 2011. In March 2012, the surplus on the foreign trade balance of the Russian Federation increased by 16.4% to \$19.4bn as compared to the same period of 2011.

In March, there was still a favorable situation on the oil market for Russian exporters of fuel and energy commodities. The price on Brent oil did not go down below \$120 per barrel. The minimum price – \$122 per barrel – was registered on March 6. In March, the monthly average price on Brent oil amounted to \$124.9 per barrel which was the maximum index since July 2008 (\$133.9 a barrel). In mid-March 2012, the price exceeded \$128 per barrel. The factors behind such growth in prices were, on one hand, stabilization of the situation in Greece after the Greek authorities declared their readiness to implement budget austerity measures and, on the other hand, escalation of the conflict between European states and Iran due to the Iranian nuclear program. European countries passed a decision to impose an embargo on oil supplies from Iran, while Iran stopped supplying oil to a number of EU countries.

In March 2012, the average price on Urals oil rose to \$122.6 per barrel against \$111.3 a barrel in March 2011 and by 3% as compared to February 2012. As a result, in the 1st quarter the average price on Urals oil increased by 14.3% as compared to January–March 2011 and amounted to \$117.2.

However, in April 2012 prices on oil started to go down. On April 16, the price on Brent oil fell to \$118.6 per barrel and have not exceeded the level of \$120 per barrel since then. In May a drop in prices continued. The price on Brent oil went down from \$119.6 per barrel on May 1 to \$106.1 per barrel on May 23.

In the past six months, due to concerns over reduction of oil supplies from Iran oil prices rose to the



Source: Central Bank of the Russian Federation.

Fig. 1. The main indices of the Russian foreign trade (billion \$)

level which is inadequate to the effective demand. The pace at which price quotations on oil went down points to the fact that a “bubble” has emerged in the oil market.

At present, the effect of factors which gives impetus to growth in oil prices becomes weaker. On May 17, 2012, Rostam Ghasemi, Iranian Oil Minister declared that the export of oil from Teheran was not reduced. Throughout 2012, the volumes of export of the Iranian oil remain at the

level of 1.5m barrels a day. It is evident that the main importers of the Iranian oil keep buying it despite the sanctions imposed by the European Union.

The debt crisis in the euro area is growing. China has sharply and unexpectedly reduced demand in oil. As a result, the OPEC forecasts that by the 3rd quarter of 2012 the supply of oil will exceed the demand which situation contributes to further drop in oil prices.

According to the monitoring which was carried out from April 15 till May 14, the average price on Urals oil amounted to \$114.18 per barrel. Thus, in accordance with Resolution No.503 of May 23, 2012 of the Government of the Russian Federation the export duty rate on crude oil was reduced from June 1, 2012 to \$419.8 a ton against \$448.6 a ton in May 2012 (-6.4%). The privileged export duty on oil for a number of deposits in Eastern Siberia and the Northern Caspian Region was reduced by \$21.6 to \$210.8 a ton from \$232.4 a ton. In June, the unified export duty rate on oil products amounted to \$277 a ton against \$296 a ton in May, while the increased export duty on petrol, to \$377.8 a ton against \$403.7 a ton in May.

In March 2012, prices on precious metals did not change much as compared to the previous month. The worst dynamics was demonstrated by nickel prices which fell by 8.5% as compared to the end of February 2012. In March prices on aluminum amounted to \$2,184 a ton after having decreased by 1.1% as compared to February. The price on copper was formed at the level of \$8,471 a ton which is 0.4% higher than in February 2012. As compared to March 2011, prices on aluminum, copper and nickel fell by 14.4%, 11.1% and 30.4%, respectively.

Table 1

MONTHLY AVERAGE GLOBAL PRICES IN MARCH OF THE RESPECTIVE YEAR

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Oil (Brent), USD/a ton	26.9	25.5	24.1	29.1	33.6	53.7	60.9	62.05	102.3	47.42	79.8	114.44	124.93
Natural gas*, USD/1000 M ³	3.51	4.57	2.97	3.74	3.86	5.52	7.99	8.37	11.04	10.9	8.93	9.37	11.97
Petrol, USD/a gallon	0.934	0.890	0.783	1.005	1.12	1.581	1.7	1.91	2,672	1,414	2.25	2.99	3.29
Copper, USD/a ton	1779.1	1780.3	1605	1681.6	3018.0	3254.4	5103	6452.5	8421.9	3749.8	7462.8	9530.7	8470.8
Aluminum, USD/a ton	1584.2	1511.2	1403.2	1393.1	1660.0	1988.6	2429	2761.7	2986.8	1335.8	2205.6	2552.6	2184.2
Nickel, USD/a ton	10270	6140.3	6503.3	8402.4	13730	16190	14897	46324.8	31005.7	9696.4	22461.3	26811.7	18660.8

* Market of Europe, average contract price, franco border.

Source: Calculated on the basis of the data of the London Metal Exchange (London, the UK) and the Intercontinental Oil Exchange (London).

In March 2012, the average value of the consumer price index of the UN Food and Agricultural Organization (FAO) amounted to 216 points and did not virtually change as compared to February (215 points). Nor did change much the average value of the price index as regards grain, sugar and meat as compared to the level of the previous month. There was only growth in prices on oils, but it was compensated by a drop in prices on dairy products.

Table 2

DYNAMICS OF AVERAGE GLOBAL PRICES ON SOME AGRICULTURAL PRODUCTS

	2007	2008	2009	2010	2011	2012		
						Jan.	Feb.	March
Wheat, USD/a ton								
Canadian, CWRS	300.4	454.6	300.5	312.4	439.64	381.62	379.94	372.85
American, HRW	255.2	326.0	224.1	223.6	316.26	274.89	277.77	283.88
American, SRW	238.6	271.5	186.0	229.7	285.91	253.9	263.08	259.78
American maize, USD/a ton	163.0	223.1	165.5	185.9	291.68	272.84	279.46	280.69
Barley, USD/a ton	172.0	200.5	128.3	158.4	207.21	210.56	213.4	222.79
Soya-beans, USD/per kg	384.0	523.0	437.0	450.0	540.67	498.0	512.0	543.0
Soya oil, USD/a ton	881.0	1258.0	849.0	1005.0	1299.33	1218.0	1255.0	1287.0

Table 2, cont'd

	2007	2008	2009	2010	2011	2012		
						Jan.	Feb.	March
Thai rice, USD/a ton	326.4	650.1	555.0	488.9	543.03	542.0	537.5	548.0
Raw sugar, FOB ports of the Caribbean sea, price/per kg	22.22	28.21	40.00	46.93	57.32	51.94	53.18	53.13

Source: The World Bank.

Despite a favorable situation on the oil market, in March the Russian foreign trade showed the signs of slowdown. As compared to March 2011, the Russian export increased by the mere 9.9%. Slowdown of the growth rates of import was more significant: as compared to the same months of the previous year it grew by 5.9%. Such a situation can be explained to a great extent by a very high base of the previous year: in March 2011 the export grew by 28.4%, while the import, by 43.4%. In a situation of falling prices on oil and depreciation of the ruble, not only a slowdown of growth, but also a decrease in key indices of the Russian foreign trade should be expected.

In the 1st quarter of 2012, Russia's foreign trade turnover calculated on the basis of the methods of the balance of payments amounted to \$207.1bn which is 16.2% higher than the same index of the previous year. It is to be noted that the export increased by 18.2% to \$133.8bn, while the import grew by 12.7% to \$73.3bn.

Growth in the monetary volume of Russian export supplies was justified both by growth in export in physical terms and price rises. In the 1st quarter of 2012, the index of export in physical terms amounted to 103.4%, while the index of average prices, to 103.0%. So, a change in the trend of the past years where growth in the monetary volume of the export was mainly determined by price rises took place.

Growth in import was determined entirely by an increase in the physical amount of import. The index of import in physical terms amounted to 109.5%, while the index of average prices, to 98.4%.

In the 1st quarter of 2012, the conditions of trade became worse: the trade condition index fell to 104.7 against 112.0 in the 1st quarter of 2011.

On May 2, 2012, at the meeting of the Government of the Russian Federation, the draft guidelines for the customs and tariff policy in the year 2013 and the 2014–2015 planned period were discussed. Russia's accession to the World Trade Organization (WTO) will become a factor determining the new tariff regulation. Another important factor is further development of the Eurasian economic integration.

In 2013–2015, Russian tariff obligations will be determined by the List of Concessions and Obligations in Respect of Goods enclosed to the Protocol of December 16, 2011 on Accession of the Russian Federation to the WTO.

By the time of accession to the WTO, the Russian Federation has to reduce import duties to the 2008 level, that is, only those duties which were raised during the crisis for urgent protection of the market. As regards some goods such as living pigs, meat by-products, milk and dried and condensed cream, rice and rice products, yeast and some chocolate confectionary, raw sugar and other sugar (except for white sugar), ferrous metals rolling, harvesters and trucks and cars, combined duties will be replaced by ad valorem duties (as a percentage of the customs value) or specific duties (absolute amounts in euro). All the above changes are to be introduced into the Unified Customs Tariff (UCT) of the Customs Union and commodity nomenclature of the foreign economic activities by July 2012. By September, the Eurasian Economic Commission will approve the new rates of customs duties.

To raise competitive edge of domestic producers, such instruments as tariff quotas will be used. In 2013–2015 period, the mechanism of tariff quoting in respect of imported meat and meat products will be preserved. Simultaneously, there will be space for maneuvering within the limits of tariff obligations, particularly, as regards those positions where the existing rates of duties are below the ultimate level.

As instruments of trading policy, it is expected to strengthen the role of the system of technical regulation and sanitary and phytosanitary measures which are unified and uniformly applied within the borders of the Customs Union.

Upon expiry of transition periods (from 1 to 5 years), obligations to the WTO provide for abolishment of export duties on all the goods, except for oilseeds, mineral fuel (oil, oil products and gas), unfinished skin and leather, unsawn timber and some types of sawn fine wood timber, iron and steel scrap and nonferrous scrap and track centerlines of railway engines.

In 2013, formation of the full-scale system of supranational regulation in the Customs Union and the Common Economic Space is to be completed. Within the frameworks of that system, new approaches to regulation of foreign economic activities with common interests of member-states of the Customs Union taken into account can be carried out.

In 2014–2015, an important line in implementation of the foreign trade policy will be fulfillment of obligations which arise from the Agreement on Free Trade in the CIS. In addition to that, it is planned to develop and conclude agreements on free trade with the European Free Trade Association, New Zealand, Vietnam and Mongolia and start active discussion on establishment of interblock zones of free trade between the Customs Union – ASEAN and the Customs Union – the European Union. ●

THE STATE BUDGET

T.Tishchenko

The State Duma approved, in third reading, the draft federal law submitted by the RF Government in late April whereby the 2012 federal budget should be adjusted in response to the then rising prices for hydrocarbons. The newly introduced budget alterations are based on an adjusted socioeconomic development forecast¹, and in particular on upward adjustment of the forecasted oil prices from \$ 100 to \$ 115 per barrel, while the average price is expected to be at the level of \$ 120 per barrel in the first half-year 2012, and then to decline to \$ 102–104 per barrel over the second half-year. Although the situation changed in May, and the probability of a further decline in oil prices became high, the RF Government chose not to revise its initial version of the draft law, thus establishing that federal budget revenue is to increase to Rb 12,677.0bn (or 20.9% of GDP) in 2012, which is by Rb 897.1bn higher than the initially approved volume of federal budget revenue. The volume of federal budget expenditure has been increased by comparison with the initially established figure by Rb 88.7bn, to Rb 12,745.1bn (or 21.0% of GDP). Thus, it is envisaged that federal budget deficit is to be significantly reduced to 0.1% of GDP (or by 1.4% of GDP).

Analysis of the Main Parameters of Federal Budget Execution in January–April 2012

Over the period of January–April 2012, federal budget revenue amounted to Rb 4,065.7bn, or 22.9% of GDP, which is by 1.6 p.p. of GDP higher than the corresponding index for the same period of last year (Table 1). Oil and gas revenues increased by Rb 547.3bn, or 1.9 p.p. of GDP, on the first four months of 2011. The volume of federal budget expenditure in January–April 2012 amounted to Rb 4,129.2bn (or 23.2% of GDP), which is by 2.7 p.p. of GDP above the level of the same period of 2011; in absolute terms, the increment has exceeded Rb 900bn.

In January–April 2012, the RF federal budget ran a *deficit* of Rb 63.5bn (or 0.4% of GDP), which represents a decline by 1.3 p.p. of GDP from the level of the first four months of 2011, when the federal budget was executed with a surplus. The volume of the non-oil and gas deficit increased to 12.5% of GDP, which is by 3.1 p.p. of GDP higher than in the same period of last year.

Table 1

MAIN PARAMETERS OF THE RF FEDERAL BUDGET IN JANUARY–APRIL 2011–2012

	January–April 2012		January–April 2011		Deviation, p. p. of GDP
	bn Rb	% of GDP	bn Rb	% of GDP	
Revenue, including:	4,065.7	22.9	3,340.0	21.3	1.6
Oil and gas revenues	2,147.8	12.1	1,600.5	10.2	1.9
Expenditure, including:	4,129.2	23.2	3,205.6	20.5	2.7
interest	122.7	0.7	91.9	0.6	0.1
non-interest	4,006.5	22.5	3,113.7	19.9	2.6
Federal budget surplus (deficit)	-63.5	-0.4	134.4	0.9	-1.3
Non-oil and gas deficit	-2,211.3	12.5	1,466.1	9.4	3.1
GDP estimations	17,800.0		15,682.0		

Source: RF Ministry of Finance (preliminary estimates); IEP's calculations.

The dynamics of federal budget revenue over the period of January–April 2012 (Table 2) demonstrates a significant rise in the volume of receipts of the tax on mineral resources extraction (by 0.8 p.p. of GDP) and customs duties (by 0.6 p.p. of GDP), as well as a slight growth of receipts of domestic excises – by 0.1 p.p. of GDP on the same period of last year. A slight decline in absolute terms, over the first four months of 2012, can be noted with regard to the volume of federal budget revenues from profits tax (by Rb 6bn) and domestic VAT (by Rb 60bn). As reported by *Rosstat*,

1 Letter of the RF Ministry of Economic Development No 6640-AK/DO34 of 11 April 2012.

in Q1 2012 the aggregate financial result in current prices achieved by organizations amounted to + Rb 2,185.0 bn, which is by 6.6% above the level registered in Q1 2011 (Rb 2,050.6bn). Thus, the taxable base for profits tax in Q1 2012 was increasing at an accelerated rate by comparison with the same period of last year and the movement of GDP in 2012¹.

Table 2

RECEIPTS OF THE MAIN TAXES IN THE FEDERAL BUDGET IN JANUARY–APRIL 2011–2012,
IN ABSOLUTE TERMS AND AS % OF GDP

	January–April 2012		January–April 2011		Deviation, p.p. of GDP
	bn Rb	% of GDP	bn Rb	% of GDP	
1. Tax receipts, including:	2,174.7	12.3	1,804.9	11.5	0.8
Tax on profits of organizations	99.6	0.6	105.9	0.7	-0.1
VAT on goods sold in RF territory	663.1	3.8	604.1	3.9	-0.1
VAT on goods imported into RF territory	471.4	2.7	414.3	2.7	0.0
excises on goods produced in RF territory	96.2	0.6	65.0	0.5	0.1
excises on goods imported into RF territory	15.7	0.1	12.6	0.1	0.0
Tax on mineral resources extraction	828.7	4.7	603.0	3.9	0.8
2. Revenues from foreign trade	1,544.0	8.7	1,259.6	8.1	0.6

Source: RF Ministry of Finance; Rosstat; IEP's calculations.

The bulk of federal budget expenditure growth over January–April 2012 on the same period of last year (*Table 3*) has been observed under the items “National Defense” – by 1.5 p.p. of GDP; “National Security and Law-enforcement Activity” – by 0.5 p.p. of GDP; “Education” – by 0.7 p.p. of GDP; “Health Care” – by 0.3 p.p. of GDP; and “Social Policy” – by 0.5 p.p. of GDP.

Table 3

FEDERAL BUDGET EXPENDITURE IN JANUARY–APRIL 2011–2012

	January–April 2012		January–April 2011		Deviation, p.p. of GDP
	bn Rb	% of GDP	bn Rb	% of GDP	
Expenditure, total	4 129.2	23.2	3 205.6	20.5	2.7
including					
Nationwide issues	218.8	1.3	179.5	1.2	-0.1
National defense	777.9	4.4	456.0	2.9	1.5
National security and law-enforcement activity	474.9	2.7	342.0	2.2	0.5
National economy	426.0	2.4	428.8	2.8	-0.4
Housing and utilities sector	16.0	0.1	75.7	0.5	-0.4
Environment protection	8.1	0.1	4.2	0.1	0.0
Education	260.0	1.5	126.8	0.8	0.7
Culture and cinematography	27.7	0.1	19.8	0.2	-0.1
Health care	216.9	1.2	130.4	0.9	0.3
Social policy	1320.8	7.4	1069.5	6.9	0.5
Physical culture and sports	15.4	0.1	14.9	0.1	0.0
Mass media	27.7	0.1	19.3	0.2	0.1
Government debt servicing	122.7	0.6	91.9	0.6	0.0
Interbudgetary transfers	216.4	1.2	246.2	1.6	-0.4

Source: RF Federal Treasury; IEP's calculations.

¹ It can be assumed that the decline in profits tax receipts alongside the increase in the size of taxable base resulted from either a rise in tax arrears or the postponement of the due dates for payment of profits tax for Q1 2012 and for advance payment of that tax from April to May 2012 in connection with the shifting of this year's holidays and days off in early May.

The expenditure indices as a percentage share of GDP for some budget items declined on the same period of 2011, including “National Economy”, “Housing and Utilities Sector” and “Interbudgetary Transfers” – by 0.4 p.p. of GDP each. The percentage share of GDP indices for the other federal budget expenditure items over the year’s first four months increased only slightly.

As reported by the RF Ministry of Finance, the Reserve Fund and the National Welfare Fund’s residuals as of the end of April 2012 remained at the same level as in March – Rb 1,825.3bn and Rb 2,624.8bn respectively. In April 2012, the volume of government debt increased by only Rb 30bn, thus amounting to Rb 3,796.6 bn as of 1 May 2012.

Execution of the Consolidated Budget of RF Subjects in January–March 2012

As reported by the RF Federal Treasury, the *consolidated budget revenue of RF subjects* in Q1 2012 amounted to 13.5% of GDP, which by 0.8 p.p. of GDP below its level achieved over the same period of 2011 (*Table 4*). In absolute terms, revenue growth amounted to Rb 95.9bn. The consolidated budget expenditure of RF subjects in January–March 2012 increased on the same period of last year by 0.4 p.p. of GDP and amounted to 11.2% of GDP, or to Rb 1,449.2bn. As shown by the results of the first three months of 2012, the current consolidated budget of RF subjects is executed with a surplus of 2.3% of GDP (or Rb 286.8bn), which is by 1.2 p.p. of GDP lower than the same index for Q1 2011.

Table 4

MAIN PARAMETERS OF THE CONSOLIDATED BUDGET OF RF SUBJECTS IN JANUARY–MARCH 2011–2012

	January–March 2012		January–March 2011		Deviation	
	bn Rb	% of GDP	bn Rb	% of GDP	bn Rb	p.p. of GDP
Revenue, including:	1,736.0	13.5	1,640.1	14.3	95.9	-0.8
– tax on profits of organizations	502.4	3.9	493.7	4.3	8.7	-0.4
– PIT	457.7	3.6	398.3	3.5	59.4	0.1
– VAT, domestic	0.9	0.0	0.7	0.0	0.2	0.0
– excises, domestic	95.8	0.8	76.6	0.7	19.2	0.1
– tax on aggregate income	57.8	0.5	43.3	0.4	14.5	0.1
– tax on property	121.7	1.0	137.2	1.2	-15.5	-0.2
– gratis transfers from other budgets of RF budgetary system	425.6	3.3	375.6	3.3	50.0	0.0
Expenditure, including:	1,449.2	11.2	1,239.7	10.8	209.5	0.4
Consolidated budget surplus (deficit)	286.8	2.3	400.4	3.5	-113.6	-1.2
GDP estimations	12,942.0		11,541.0			

Source: RF Federal Treasury; IEP’s calculations.

The slight increase in the volume of regional budget revenue in Q1 2012 on Q1 2011 was generated by higher receipts of excises, tax on aggregate income and PIT (by 0.1 p.p. of GDP each). The receipts of profits tax display a decline which can be regarded as significant for regional budgets (by 0.4 p.p. of GDP) when set against the same index for the same period of last year. Our analysis of the movement of profits tax in the federal budget over the first four months of has led to the assumption that the significant gaps in the levels of budget revenue between RF subjects will become less prominent when adjusted by the results of April 2012 – the period when quarterly and annual tax payments are effectuated.

Over the first three months of 2012, the receipts of property tax in the consolidated budget of RF subjects dropped by 0.2 p.p. of GDP on Q1 2011, in the main due to changes in the volume of receipts of tax on property and transport tax on physical persons. VAT receipts in the budgets of RF subjects in the first three months of 2012 remained at the pervious year’s level.

The consolidated budget expenditure of RF subjects in January–March 2012 (*Table 5*) amounted to Rb 1,449.2bn, or 7.2% of GDP, which is by 0.4 p.p. of GDP higher than the figure reported in

the first three months of 2011. The cash-based execution of consolidated budget expenditure of RF subjects in the first three months of 2012 was the same as in January–March 2011 – at about 18% of the approved target volume.

Table 5
CONSOLIDATED BUDGET EXPENDITURE OF RF SUBJECTS IN JANUARY–MARCH 2011–2012

	January–March 2012		January–March 2011		Deviation, p.p. of GDP
	bn Rb	% of GDP	bn Rb	% of GDP	
Expenditure, total	1 449.2	11.2	1 239.7	10.8	0.4
including					
Nationwide issues	93.1	0.8	91.8	0.8	0.0
National defense	0.5	0.0	0.5	0.0	0.0
National security and law-enforcement activity	14.8	0.2	52.6	0.5	-0.3
National economy	231.5	1.8	158.8	1.4	0.4
Housing and utilities sector	116.2	0.9	110.3	1.0	-0.1
Environment protection	3.2	0.1	1.8	0.1	0.0
Education	386.8	3.0	298.6	2.6	0.4
Culture and cinematography	46.0	0.4	37.8	0.4	0.0
Health care	240.9	1.9	206.9	1.8	0.1
Social policy	266.9	2.1	236.8	2.1	0.0
Physical culture and sports	24.4	0.2	22.4	0.2	0.0
Mass media	7.0	0.1	5.4	0.1	0.0
Government debt servicing	13.3	0.1	11.6	0.1	0.0
Interbudgetary transfers	4.3	0.1	4.3	0.1	0.0

Source: RF Federal Treasury; IEP's calculations.

The highest growth of expenditure in the consolidated budget of RF subjects over the period under consideration by comparison with the period of January–March 2011 was displayed by the items “Education” (by 0.4 p.p. of GDP), “National Economy” (by 0.4 p.p. of GDP), and “National Security and Law-enforcement Activity” – by 0.5 p.p. of GDP.

It should be noted that the per-annum expenditure targets set for 2012 under the item “Education” are by more than Rb 450bn higher than last year's targets; more than half of that sum is earmarked for universal education, and more than one-quarter – for pre-school education.

The bulk of the increase in spending on the item “National Economy” in January–March 2012, as compared with the same period of 2011, has been generated by the sub-items “Fuel and Energy Complex” (by Rb 1.4bn(2012) and “Communications and Informatics” (by Rb 1.1bn).

The item “Health Care” of the consolidated budget of RF subjects also demonstrated a slight growth of expenditure in January–March 2012 (by 0.1 p.p. of GDP on the same period of last year). This year's shrinkage, by 0.3 p.p. of GDP, of regional budget expenditure under the item “National Security and Law-enforcement Activity” was an expected development that resulted from the transfer of the powers to finance the police service from the regional to the federal level.

In January–March 2012, the levels of expenditure as percentage shares of GDP for the other budget items remained at the same level as in 2011, with the exception of the item “Housing and Utilities Sector” which displayed a drop in the volume of expenditure by 0.1 p.p. of GDP.

The volume of government debt of RF subjects as of 1 April 2012 amounted to Rb 1,163.9bn, which is by nearly Rb 8bn less than the debt volume recorded as of 1 March 2012. ●

THE RUSSIAN BANKING SECTOR

M.Khromov

In April 2012, Russia's banking sector was faced with a sharp decline in liquidity. The scale of refinancing carried on by the monetary authorities practically reached the level recorded in the autumn of 2011, while the formal liquidity indices plummeted below their lows of many previous years. The main cause of this phenomenon has been the continuing rapid growth of credits against the backdrop of a weak resource base (notwithstanding the renewal of borrowing on foreign capital markets).

In April 2012, Russia's banking system's aggregate assets increased by 1.5%¹. Their growth over the last 12 months amounted to 21.9%. It can be stated that the asset growth rate over the past few months (since the autumn of last year) became stabilized in the interval of 21–23% per annum. Asset growth since the year's beginning amounted to 3.4%.

Over the course of April, the banking sector's equity remained effectively unchanged (+0.3%), while its growth since the year's beginning amounted to 5%.

The banking sector's profit in April was Rb 74bn – a record low for the period since the year's beginning. April's rate of return in the banking sector (ROA – 2.1%; ROE – 18.0%) has turned out, nevertheless, only slightly worse than that for the entire year 2011. The main cause of banks' declining profit was the accelerated formation of reserves against potential losses, whose size over that month increased by Rb 31bn. If, however, the deductions to reserves are not taken into account, the level of profit displays a record high since the year's beginning: Rb 105bn.

The banking sector's attracted (borrowed) funds in April increased by 1.7%, thus becoming a foundation for the development of asset operations. However, the bulk of this growth was sustained by the support provided by the RF Central Bank.

Attracted Funds

The volume of the population's deposits and monies on accounts with banks in April 2012 increased by 2.1%, or Rb 254bn, thus hitting its record high since the year's beginning. The per annum rate of growth, nevertheless, continued to decline – to 18.5%. From the point of view of the currency structure of the population's monies kept with banks, the growth of accounts denominated in foreign currencies was effectively halted for the first time this year; their volume in US dollar terms increased by only 0.3%, whereas that of ruble-denominated accounts increased by 2.5%.

In April, the bank accounts of corporate clients shrank by 2.0%. This phenomenon was more typically displayed by ruble-denominated accounts, where decline amounted to 2.1%. The same index for accounts denominated in foreign currencies is lower – the drop was only 1.4% in US dollar terms.

The cause of the decline in the volume of bank accounts was an increasing capital outflow coupled with payments to the budget. According to the author's estimations, capital outflow from the non-state sector of the economy in April exceeded \$ 15bn. At the same time, the banking sector's external investments shrank by \$ 1bn. Thus, the entire outflow resulted from operations carried on by the non-banking sector.

Over the course of April, the banking sector's foreign liabilities increased by \$ 5bn, or 3.6%. Banks' foreign liabilities began to grow for the first time since November 2011. The main channel for attracting foreign loans was the placement of Eurobonds in the total amount of more than \$ 3bn, including by VTB in the amount of \$ 1.5bn and *Gazprombank* in the amount of \$ 500m.

Invested Monies

The growth of physical persons' payables continued in April at an accelerated rate. Their total volume increased by 3.7%, including that of ruble-denominated loans by 4.0%. The per annum

¹ Hereinafter, unless otherwise specified, the currency component adjustment factor is disregarded.

growth rate as seen by the results of April had increased to 41%. At the same time, in spite of the high growth rate displayed by payables, their increment in April (Rb 237bn) – for the first time since the year's beginning – did not exceed the volume of funds physical persons (Rb 254bn). However, the aggregate increment in the volume of lending to physical persons over the first four months of 2012 is still higher than the increment of the population's monies on accounts with banks.

Table 1

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

	12.07	12.08	12.09	12.10	06.11	09.11	12.11	01.12	02.12	03.12	04.12
Liabilities, bn Rb	20.125	28.022	29.430	33.805	35.237	38.443	41.628	41.150	40.874	41.533	42.151
Equity	15.3	14.1	19.3	18.7	18.5	17.3	16.9	17.3	17.6	17.5	17.3
Credits allotted by Bank of Russia	0.2	12.0	4.8	1.0	0.9	1.3	2.9	3.3	3.1	3.5	4.4
Interbank operations	4.1	4.4	4.8	5.5	5.2	5.4	5.7	5.7	5.3	5.1	4.9
Foreign liabilities	18.1	16.4	12.1	11.8	10.9	11.4	11.1	10.6	10.2	10.2	10.4
Physical persons' monies	26.2	21.5	25.9	29.6	30.4	29.0	29.1	28.7	29.4	29.4	29.6
Enterprises and organizations' monies	25.8	23.6	25.9	25.7	24.3	24.4	26.0	25.9	25.9	25.7	24.8
Accounts and deposits of state administrative bodies and local governments	1.5	1.0	1.0	1.5	3.5	4.9	2.3	1.8	1.4	1.4	1.4
Securities issued	5.8	4.1	4.1	4.0	4.0	3.8	3.7	3.8	4.4	4.8	4.6

Source: RF Central Bank; IEP's estimates.

Due to the high growth rate the quality of the retail credit portfolio so far has been gradually increasing. The volume of physical persons' outstanding debt to banks in April increased by 1.1%, and that of the reserves against potential losses against loans – by 1.5%. As a result, the share of debt outstanding shrank to 5.0%, and the ratio of reserves to aggregate payables – to 6.8%. Both these indices once again dropped to their post-crisis lows and correspond to the level of Q2 2009.

The rate of lending to corporate borrowers in April was on the rise. Payables increased by 2.6%, or Rb 422bn, which is higher than the index for the entire period of Q1 (Rb 369bn). In contrast to the lending market's retail segment, its corporate segment displayed a high growth rate of loans denominated in foreign currencies: 3.4% per month in US dollar terms against the growth rate of 2.4% displayed by ruble-denominated loans.

In April, the quality indices of the aggregate portfolio of corporate loans were demonstrating multi-vectored changes. The volume of debt outstanding increased by 3.8%, thus exceeding the growth rate of the aggregate credit portfolio, while its share became as high as 5.1%. The size of reserves increased by only 1.7%, thus bringing down to 7.9% the reserves to loans ratio.

Liquidity and Government Support

The situation with regard to bank liquidity as shown by the results of April 2012 had worsened. Firstly, the volume of the most liquid assets of banks¹ as of 1 May 2012 dropped to its historic low for the entire period of observation. Thus, the ratio of liquid assets to aggregate bank aggregate decreased to 4.3%, while their ratio to clients' accounts and deposits (physical persons and legal entities) – to 7.9%. In the previous phase of the crisis in the autumn of these 2011 these two indices amounted to 4.5% and 8.6% respectively. Prior to the onset of the crisis in 2008 the Russian

¹ We place in this asset category cash in vaults, monies kept on correspondent accounts and as deposits with the Bank of Russia, and banks' investments in the Bank of Russia's bonds.

banking sector's liquidity index was at the level of 4.9% of the volume of assets and 10% of that of clients' monies.

Secondly, even that minimum liquidity volume had been achieved mostly due to the refinancing granted by the RF Central Bank. According to the banking report as of 1 May 2011, the volume of liquid assets amounted then to Rb 1.78 trillion, while that of debt to the RF Central Bank – to Rb 1.84 trillion. As of the same date, another Rb 40bn had been received by banks from the RF Ministry of Finance. In other words, the sum of bank liquidity less the funding granted by the monetary market's regulators once again moved into negative zone.

It should be noted that the RF Central Bank and the RF Ministry of Finance still have sufficient reserves enabling them to provide the banking sector with resources. On some days in November and December 2011, the aggregate debt of banks to the regulatory bodies exceeded Rb 2.2 trillion, and at the height of the 2008–2009 crisis (as of 1 February 2009) it rose to Rb 3.6 trillion (less the funds granted to VEB and the Deposit Insurance Agency).

The third circumstance pointing to the systemic nature of the current problems is that the current liquidity decline involved all the main groups of banks (*Table 2*).

Table 2

SHARE OF LIQUID ASSETS IN AGGREGATE ASSETS, BY MAIN GROUPS OF BANKS,
IN THE PRE-CRISIS PERIOD AND AT PRESENT

	1.03.2008	1.09.2008	1.11.2011	1.05.2012
Banking sector, total	5.5	4.9	4.5	4.3
Sberbank	2.3	1.9	3.7	4.4
Big state banks	3.6	2.7	3.0	2.4
Big foreign banks	6.7	5.9	4.5	3.9
Big private banks	4.2	4.4	4.0	4.2
Medium-sized and small banks	10.1	9.1	7.1	6.1

Although the federal budget for the first four months of 2012 is executed with a deficit (according to the RF Ministry of Finance's preliminary estimates, the deficit amounts to Rb 60bn), the principal factor that has been bringing down money supply and negatively influencing bank liquidity is the increasing volume of monies on the general government's accounts with the RF Central Bank. Over the past 4 months it increased by Rb 1.9 trillion, which is comparable to the size of banks' aggregate debt to the regulatory bodies. The withdrawal of the deposits previously placed by RF Ministry of Finance with commercial banks amounted to Rb 500bn, which pointed to a partial redistribution of the instruments applied in supporting bank liquidity in favor of the RF Central Bank's assets.

Table 3

STRUCTURE OF RUSSIA'S BANKING SYSTEM'S ASSETS (AS OF MONTH'S END), AS % OF TOTAL

	12.07	12.08	12.09	12.10	06.11	09.11	12.11	01.12	02.12	03.12	04.12
Assets, bn Rb	20,125	28,022	29,430	33,805	35,237	38,443	41,628	41,150	40,874	41,533	42,151
Cash and precious metals	2.5	3.0	2.7	2.7	2.2	2.3	2.9	2.5	2.5	2.4	2.5
Monies placed with Bank of Russia	6.9	7.5	6.9	7.1	4.5	3.5	4.2	3.6	3.2	3.2	2.6
Interbank operations	5.4	5.2	5.4	6.5	6.4	6.2	6.4	6.6	6.3	6.2	6.0
Foreign assets	9.8	13.8	14.1	13.4	13.8	14.6	14.3	14.6	14.3	14.2	14.3
Population	16.1	15.5	13.1	13.0	14.0	14.2	14.4	14.6	15.0	15.3	15.6
Corporate sector	47.2	44.5	44.5	43.6	45.3	45.1	44.0	44.2	44.2	44.4	44.6
State	4.1	2.0	4.2	5.1	5.8	6.0	5.0	4.8	5.1	4.9	4.1
Property	2.2	1.9	2.7	2.6	2.5	2.4	2.3	2.4	2.4	2.4	2.4

Source: RF Central Bank; IEP's estimates.

MORTGAGE IN THE RUSSIAN FEDERATION

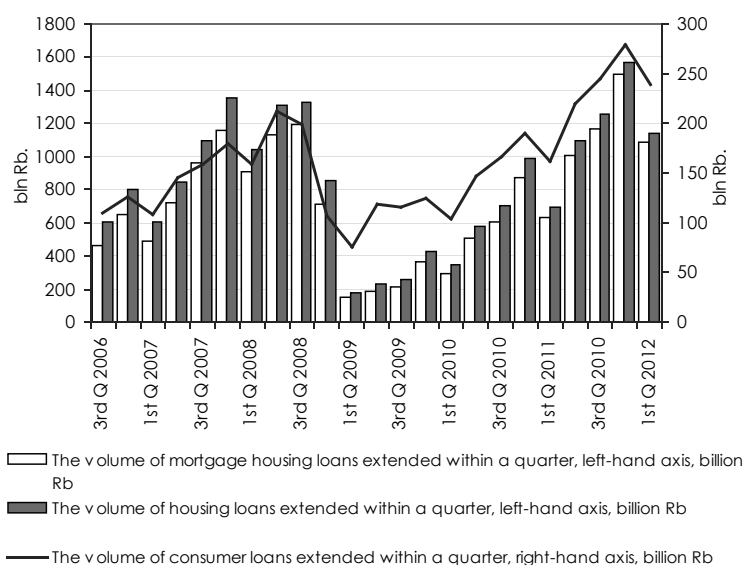
G.Zadonsky

In the 1st quarter of 2012, the volume of the extended mortgage housing loans (MHL) (Rb 181.09bn) exceeded by 72% the volume of loans extended in the 1st quarter of 2011. The share of the overdue debt on MHL in the outstanding debt fell to 2.89%, while the debt on loans with payments overdue for over 180 days decreased to 3.32%. The trend of decline of the average weighted rate on MHL in rubles extended from the beginning of the year changed to growth from 11.9% in 2011 to 12.0% in the 1st quarter of 2012.

According to the data of the Central Bank of the Russian Federation, in the 1st quarter of 2012 credit institutions extended 136,805 housing loans (HL), including 126,959 mortgage housing loans (MHL) for the amount of Rb 181.09bn and 9846 unsecured housing loans (UHL) – as a difference between HL and MHL – for the amount of Rb 8.88bn (Fig. 1). In the 1st quarter of 2012, the volume of the extended MHL exceeded by 72% that of the 1st quarter of 2011 (Rb 105.27bn). As of April 1, 2012, the outstanding debt on MHL increased by 32.72% as compared to April 1, 2011 and amounted to Rb 1,538 trillion. In the 1st quarter of 2012, the share of the volume of MHL in foreign currency in the total volume of mortgage lending decreased by 1.55 p.p. as compared to that in 2011 and amounted to 1.18%.

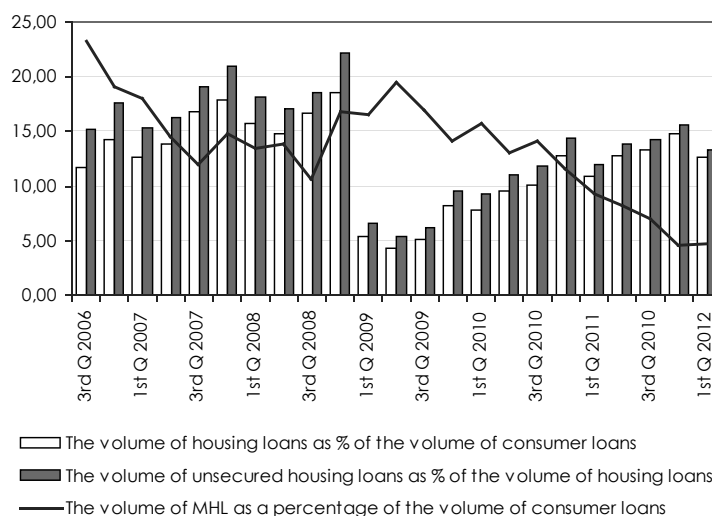
In the period from the 2nd quarter of 2009 till the 1st quarter of 2012, the share of unsecured housing loans in the volume of HL decreased from 19.47% to 4.67% (Fig. 2). In the 1st quarter of 2012, the share of HL in the volume of consumer loans (CL) amounted to 13.26%, which is 2.28 p.p. lower than in the 4th quarter of 2011 (Fig. 2).

According to the data of the Central Bank of the Russian Federation, as of April 1, 2012 the overdue debt on MHL amounted to Rb 44.47bn (Rb 25,454bn as regards loans in rubles and Rb 19,016bn as regards loans in foreign currency) (Fig. 3). As of the end of the 1st quarter of 2012, the total overdue debt was 1.89% lower than that as of January 1, 2012. It is to be noted that



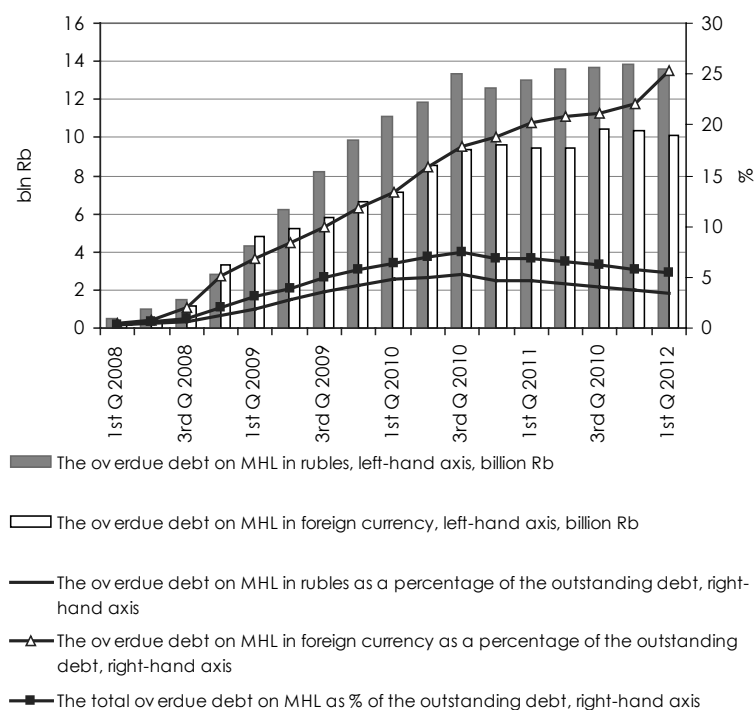
Source: On the basis of the data of the Central Bank of the Russian Federation.

Fig. 1. Dynamics of lending within a quarter



Source: On the basis of the data of the Central Bank of the Russian Federation.

Fig. 2. The ratio between the volumes of consumer lending and housing lending



Source: According to the data of the Central Bank of the Russian Federation.

Fig. 3. Dynamics of the overdue debt on mortgage housing loans as of the end of the quarter

the overdue debt on MHL in rubles decreased as compared to the end of the 4th quarter of 2011 both in money terms and as a percentage of the outstanding debt (from 1.97% as of January 1, 2012 to 1.82% as of April 1, 2012). Within the same period, the overdue debt on MHL in foreign currency decreased in volume terms, while as a percentage of the share of the outstanding debt in foreign currency rose from 11.77% to 13.49% (Fig. 3).

According to the data of the Central Bank of the Russian Federation, the amount of the debt on MHL without overdue payments increased from Rb 1398.42bn as of March 1, 2012 to Rb 1,449.03bn as of April 1, 2012. Within the same period, as a percentage of the total debt the growth amounted to 0.95 p.p., that is, from 93.26% to 94.21% (Table 1). In the same period, the volume of the debt on the defaulted MHL (with payments overdue for over 180 days) decreased from Rb 53.23bn to Rb 51.06bn, while as a percentage of the total debt, from 3.55% to 3.32% (Table 1).

Table 1

GROUPING OF THE DEBT ON MORTGAGE HOUSING LOANS BY THE PERIOD OF DELAY IN PAYMENTS IN 2012

	The total amount of the debt on MHL Million Rb	including							
		Without overdue payments Million Rb %*		With overdue payments					
				From 1 to 90 days Million Rb %*		from 91 to 180 days Million Rb %*		over 180 days Million Rb. %*	
Jan 01	1 478 982	1 391 130	94.06	27 805	1.88	5 916	0.40	54 131	3.66
Feb 01	1 477 175	1 377 466	93.25	40 327	2.73	6 647	0.45	52 735	3.57
Mar 01 ¹	1 499 489	1 398 423	93.26	42 136	2.81	5 698	0.38	53 232	3.55
Apr 01	1 538 084	1 449 029	94.21	32 146	2.09	5 845	0.38	51 064	3.32

* as a percentage of the total amount of the debt.

Source: Central Bank of the Russian Federation data.

According to the data of the Central Bank of the Russian Federation, in the 1st quarter of 2012 the decline trend of the average weighted rate on MHL in rubles extended from the beginning of the year changed to growth from 11.9% in 2011 to 12.0% in the 1st quarter of 2012. A decrease in the rate on MHL in foreign currency came to a halt (Fig. 4).

In the 1st quarter of 2012, the average weighted period of lending as regards MHL in rubles extended from the beginning of the year amounted to 14.7 years which is 1.68% lower than the period of lending in the 1st quarter of 2011. The above points to prevalence of the trend of decrease in the average weighted period of lending as regards MHL in rubles. The average weighted period of lending as regards loans in foreign currency lacks any explicit trend and amounted to 12.6 years in the 1st quarter of 2012 (Fig. 4). In March 2012, the average weighted rate on MHL refinanced by the AHML (the Agency for Housing

1 Data on debt along the dates of delay in payments given in the April bulletin as of 1 March 2012, adjusted by the CBR.

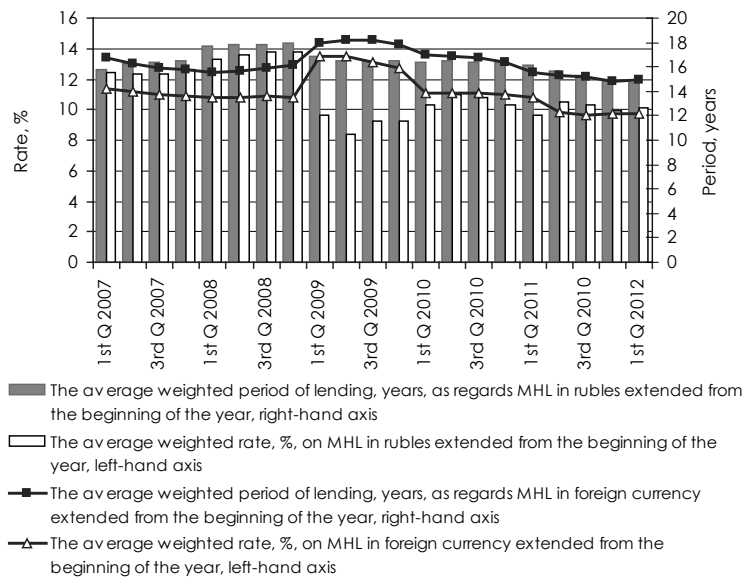
Mortgage Lending) amounted to 10.69%, while the average weighted period of lending, to 16.6 years.

The average value of the loan as regards MHL in rubles extended from the beginning of the year grew everywhere, except for Moscow and the Moscow Region as of April 1, 2012. It is to be noted that the average value of a loan in the Russian Federation amounted to Rb 1.41m (growth of 5.5% as compared to January 1, 2012). As of April 1, 2012, the largest average value of a loan (Rb 3.33m) was in Moscow, while the smallest one, in the Privolzhsky Federal District (Rb 1.01m). In the above district, the minimum rate on MHL both as of January 1, 2012 (11.6%) and as of April 1, 2012 (11.7%) was almost the same.

In the 1st quarter of 2012, the share of mortgaged property projects in the total number of property projects registered in transactions with housing amounted to 18.8% which is 3.8 p.p. and 6.0 p.p. higher than in the 1st quarter of 2011 and the 1st quarter of 2010, respectively (Fig. 5).

In the 1st quarter of 2012, OAO AHML refinanced 8715 mortgages for the amount of Rb 11.38bn which is 9.0% and 17.37% more in quantitative terms and money terms, respectively, as compared to the 1st quarter of 2011. In April 2012, the AHML refinanced 3,302 mortgages for the amount of Rb 4.14bn which is 0.9% and 0.59% lower in quantitative terms and money terms, respectively, than in April 2011.

In 2011, the Sberbank extended MHL under programs with low interest rates for the amount of Rb 68.1bn. It extended 14,000 loans for the amount of Rb 23.5bn under the program with the interest rate of 10% per annum in rubles and another 50,000 loans for the amount of Rb 44.6bn under the program with the interest rate of 8% per annum for the period of eight years. OAO AHML insured financial risks as regards a pool of mortgage loans with a volume of about 5,000 mortgages under the *Standard Mortgage* product with an initial payment of less than 30%; the above instruments were extended in the 2007–2009 period and are on the balance of the Agency. The total sum of insurance within the limits of which insurance payments are to be made in case of insured events amounts to nearly Rb 1.5bn. The new credit and insurance product permits to insure the creditor's risks as regards mortgage loans not at the stage where a loan is provided, but at the stage of refinancing of mortgages, as well as risks as regards entire pools of mortgages which are on the balance of the creditor.



Source: Central Bank of the Russian Federation data.
Fig.4. Average weighted rates and periods of lending as regards mortgage housing loans extended from the beginning of the year



Source: Rosreestr, OAO AHML.
Fig. 5. The dynamics of the number of mortgaged property projects in transactions with housing

THE LIVING STANDARDS OF THE POPULATION OF THE RUSSIAN FEDERATION

S.Misikhina

*In January–April 2012, the indices of the population's incomes in real terms were on the rise; the most noticeable phenomenon was a **climb in real wages**, which increased by 10.3% on the same period of last year.*

The money income of the population. In Q1 2012, the nominal indices of the population's money income increased on the same period of 2011 as follows:

- average per-capita money income of the population – by 7.2%;
- average monthly charged wage – by 16.0%;
- average monthly size of allotted pensions – by 8.5%;

The growth of the indices of the population's real income in Q1 2012 on Q1 2011 was as follows:

- real disposable money income of the population – by 2.6%¹;
- real average monthly charged wage – by 10.3%;
- real average monthly pension size – by 4.4%.

In April, the income indices continued to grow:

- average monthly charged wage in April 2012 increased:
 - on March 2012 in nominal terms by 0.5%, in real terms – by 0.2%;
 - on April 2011 in nominal terms by 14.3%, in real terms – by 10.4%;
- nominal money income of the population (per capita) increased in April 2012 by 7.3% on March 2012 and by 6.1% on April 2011;
- real disposable money income of the population increased by 7.7% on March 2012 and by 2.1% on April 2011.

These changes generated the following nominal indices of the population's incomes in April 2012:

- Rb 21,792 for average per-capita income of the population,
- Rb 25,614 for average monthly wage.

The average size of an allotted monthly pensions in March 2012 amounted to Rb 8,981.

Over the first four months of 2012, the real disposable money income of the population increased on the same period of 2011 by 2.2%, while the real average monthly charged wage increased by 10.3%.

Table 1

CHANGES IN THE REAL DISPOSABLE MONEY INCOME OF THE POPULATION IN JANUARY–APRIL 2011 AND JANUARY–APRIL 2012

	Real disposable money income of population, as percentage of	
	corresponding period of previous year	of previous period
2011		
January	102.2	55.4
February	100.1	120.2
March	98.1	100.1
Q1	100.0	77.0
April	98.5	108.8
January–April	99.6	
2012		
January	102.0	53.3
February	103.1	121.6
March	102.8	99.8

¹ Income less mandatory payments, adjusted by Consumer Price Index.

Table 1, cont'd

	Real disposable money income of population, as percentage of	
	corresponding period of previous year	of previous period
Q1	102.6	77.0
April	102.1	107.7
January–April	102.2	

Source: Data released by Rosstat.

Socioeconomic differentiation. As we have predicted¹, the slowdown in the growth rate of real money income of the population observed in 2011 by comparison with its rate in 2010 resulted in some positive changes in the distribution of the population's money incomes:

- the share of income taken up by the first quintile (lowest income group) remained at the level of 5.2% of the aggregate volume of the population's money income; the share of the first decile also remained at the level of 2010 and amounted to 1.9% of the aggregate volume of the population's money income;
- the shares of the second and third quintiles increased by 0.1 p.p. each;
- the share of the fourth quintile remained unchanged;
- and the share of the fifth quintile (highest incomes) dropped from 47.7% in 2010 to 47.5% in 2011. The fifth quintile also displayed a decline in the share of the aggregate volume of population's money income – from 30.9% to 30.8% (*Table 2*).

These changes in the distribution of the population's money incomes contributed to a slight decline, in 2011, of the main parameters of socioeconomic inequality in Russia:

- The Gini coefficient (income concentration index) shrank from 0.421 to 0.418;
- The ratio of the average income of the richest 10% to the poorest 10% (R/P 10%) dropped from 16.5 to 16.3.

Table 2

POPULATION DISTRIBUTION BY AVERAGE PER CAPITA INCOME IN 2010–2011

	2010	2011
Money income	100	100
including by population quintiles:		
first (lowest incomes)	5.2	5.2
second	9.8	9.9
third	14.8	14.9
fourth	22.5	22.5
fifth (highest incomes)	47.7	47.5
Gini coefficient (income concentration index)	0.421	0.418
R/P 10%	16.5	16.3

Source: Data released by Rosstat.

In Q1 2012, as compared to the corresponding period of 2011, the inequality in the distribution of the population's money incomes was on the rise, which was indicated by the increasing share (by 0.5 p.p.) of the incomes of the fifth quintile (with the highest incomes) alongside shrinking shares of the other quintiles with lower incomes (see *Table 3*).

The inequality growth in Q1 2012 was reflected by the parameters of socioeconomic inequality:

- The Gini coefficient (income concentration index) rose from 0.398 to 0.403;
- The ratio of the average income of the richest 10% to the poorest 10% (R/P 10%) rose from 14.0 to 14.5.

People with incomes below subsistence level. The slowdown, in 2011, in the growth rate of the Russian population's money income was also reflected by the poverty indices:

- the number of people with money incomes below subsistence level increased in 2011 by 0.2m – from 17.9m to 18.1m;

1 See Russian Economy: Trends and Perspectives. Gaidar Institute for Economic Policy. 2011. November. P.40.

- the proportion of people with money incomes below subsistence level increased from 12.6% to 12.8%.

Table 3

POPULATION DISTRIBUTION BY AVERAGE PER CAPITA INCOME IN Q1 2011–2012

	Q1 2011	Q1 2012.
Money income	100	100
including by population quintiles:		
first (lowest incomes)	5.6	5.5
second	10.4	10.3
third	15.4	15.2
fourth	22.8	22.7
fifth (highest incomes)	45.8	46.3
Gini coefficient (income concentration index)	0.398	0.403
R/P 10%	14.0	14.5

Source: Data released by Rosstat.

Table 4

NUMBER OF PEOPLE WITH INCOMES BELOW SUBSISTENCE LEVEL IN 2010–2011

	2010				2011			
	Q1	1st half-year	9 months	year	Q1	1st half-year	9 months	Year ¹
People with incomes below subsistence level								
million persons	20.6	19.1	19.0	17.9	22.9	21.1	20.2	18.1
as % of total population	14.5	13.5	13.4	12.6	16.1	14.9	14.3	12.8

Source: Data released by Rosstat. ●

1 Preliminary data.

RESEARCH AND EDUCATION CENTERS AND LABORATORIES: STATE MEASURES AND SUCCESSFUL APPROACHES

I. Dezhina

At present, state support to the integration of science and education is being implemented through the allocation of grants to science and education centers and the creation of laboratories headed by the world's leading scholars ("mega-grants"). The RF Government's current approach to assisting them does not take into account the successful practices that have recently emerged in the field of Russian science and clearly indicate that special attention should be paid to personnel, organizational and managerial issues. So far, the government's measures designed to promote the integration of education and science have failed to assign a high priority to these issues.

At present, the RF Government is carrying out a wide range of measures designed to promote science at Russia's higher educational establishments and to integrate education and science. The current undertakings aimed at the development of efficient forms of scientific and educational activities include the government's assistance to research and education centers (RES) and the creation of laboratories headed by the world's leading scholars (so-called *mega-grants*). In 2010-2011, such mega-grants funded the creation of 77 laboratories (up to Rb 150m in budget funds per facility; per three years); in 2009–2011, budget funds were allocated to more than 1,300 RESs (up to Rb 15m per facility; per three years).

Such laboratories are created from scratch, while the RESs include both long-existing centers and those established in the past three years in the aftermath of the government's decision to assist them within the framework of the Federal Target Program "*Science and Education Personnel for an Innovative Russia*" for the years 2009–2013. No models for the creation and functioning of such research and education structures have been prescribed apart from some very basic parameters (for RESs), such as the mandatory number of students, post-graduate students and young researchers who should in the work of a center, etc. Despite the abundance of performance indicators for assessing research and education capacity in RESs, no attention has been given to issues of project management and other key factors largely determining the direction of work and the success or failure of such structures.

As a result, the inspection of the RESs, completed in May 2012¹, has revealed that most of the RESs focus on the implementation of short-term research projects and devote much less time to education, while paying very limited attention to any issues pertaining to the integration of science and education. The RESs that are ranked best on science and education activities and are of significance for the international arena account for no more than 10% of the total number of federally-assisted projects.

It is still too early to judge whether or not the mega-grants allocated to the said laboratories, more than one half of which are headed by representatives of the Russian-speaking diaspora, have yielded the expected results. However, it should be said that the adopted model for the functioning of such laboratories has been inherently flawed by the frame conditions set for their creation, which include a provision to the effect that the foreign head of a laboratory should spend no less than 4 month per year in Russia, and also very lax requirements as to the actual results that should be obtained by the end of the three-year period of budget funding.

At the same time, Russia has already accumulated enough practical experience with regard to the integration of science and education to compare the relative effectiveness of various forms of such integration (this country's first initiatives to assist this process began as early as 1997, within the framework of the "Integration" program²). Since 1997, a number of good practices

1 The assessment of the research and education center's performance was carried out by the National Training Foundation.

2 *State Assistance to the Integration of Higher Education and Fundamental Science for the years 1997–2000*. Later, that program was granted the status of federal targeted program and was renamed *The Integration of Science and Higher Education in Russia*.

have emerged, but these are still too few to make any big difference. Mechanisms for promoting successful experience are still missing. Moreover, whenever the government is about to initiate new measures, it always begins with analyzing foreign rather than domestic experience, however successful the latter might be.

As far as this matter is concerned, attention should be paid to two successful models for the integration of education and science. The first model is so-called “mirror laboratories”. That model could have been used in the development of the mega-grants program, but was not applied in that field. It can still be of use, including during the creation of new laboratories within the framework of the State Program for Science and Technology Development (for 2013–2020), which is currently being mapped. The second model is a laboratory established in the form of an autonomous non-profit organization (ANO) based on public-private partnership in science. This model accentuates not the juridical status of one or other laboratory, but rather the principles of its work, its personnel selection methods and the organization of short- and long-term work planning.

The “mirror laboratories” experiment represents a rather unique attempt at creating internationally-oriented research and education centers with participation of representatives of the Russia-speaking academic diaspora¹. The essence of this initiative is that Russia should create, in its territory, a network of laboratories similar to foreign ones, and that those laboratories should be headed or supervised by expatriate Russian scholars living and working overseas. The expatriate head of such a laboratory should have a Russian counterpart. The coordination of research activities should be carried out remotely, while personal meetings should take place twice a year, when the foreign co-head of a laboratory comes to Russia for a one-month stay. This form of cooperation is sufficiently flexible and mutually advantageous in conditions when foreign specialists cannot spend longer time in Russia.

The organization of research in the form of ‘mirror laboratories’ has a number of advantages, including the possibility, for Russian specialists, to master foreign experience and to get involved in the implementation of foreign projects, to improve their qualification, to get easier access to auxiliary materials and reagents, to use state-of-the-art equipment and to develop wide and varied international contacts.

The term “mirror” has been chosen for the reason that, when created in Russia, such a laboratory can be fitted with equipment similar to that used by its partner laboratory abroad. This approach makes it possible for partner laboratories to develop and test standard methodologies and to delegate some experimental work to Russia. No duplication of work will ever take place, because some fundamentally important functions are shared between the laboratories in advance.

The organization and work of a “mirror laboratory” has a very important component – the overseas internships for its Russian researchers, especially for young researchers, offered by the foreign partner laboratory. The mobility of research personnel increases their professional competence through enabling them to acquire some new knowledge and new skills, which are especially important in experimental research.

One more example of successful science education practices is the activities of the Baikal Research Center, a laboratory organized in the form of an ANO. This joint research laboratory was created in 2006 at the Research Institute of Biology of Irkutsk State University².

The laboratory is funded by soft money, which means that it does not have any stable and guaranteed budget (base financing), and so has to rely on grants, subsidies, contract work and donations. The creation of the laboratory was financed by subsidies from Irkutsk Oblast, private donations, grants allocated by the Russian Foundation for Fundamental Research and the RF Ministry of Education and Science, grants from foreign partners, and proceeds from joint projects.

The major flaw of such financing is its instability, which is fraught with the risk of gaps in receiving funding, which would in turn lead to delays in wage payments and the impossibility of purchasing auxiliary materials and making other expenditures necessary for research purposes.

This model of financing provides for the implementation of a personnel policy which can make the laboratory attractive not only to its young researchers who are easily adaptable to conditions

1 A. Semianov. “Vozvrashchenie mozgov”: taktika zerkal’nykh laboratorii. [“The Return of the Brains”: the Tactics of the Mirror Laboratories]. http://opec.ru/analize_doc.asp?d_no=63767

2 www.baikal-research.org

of uncertainty, but also to its middle-aged research personnel. This personnel policy is based on the following principles whose realization is necessary for the achievement of competitive research results¹:

- 1) selection of ambitious, mobile and research-eager students should begin from their first or second year of studies or, in rare circumstances, from their third year of studies (the average age of a laboratory's researcher is 27 years);
- 2) courses for students should get a clear orientation towards the themes of their future candidate dissertations as early as the fourth or fifth year of their studies, while courses for post-graduate students – towards the themes of their doctoral dissertations. This approach implies that the process of education and professional skill improvement goes on continuously;
- 3) registration of formal performance indicators for all the members of a research group, including presentations at conferences, and the frequency of citations (the SCOPUS Citation Index, the Hirsch's H-Index and the Russian Science Citation);
- 4) researchers should pay special attention to learning English, including at foreign language courses;
- 5) mandatory overseas internships and joint work with foreign researchers in Russia. The maximum duration of an internship is 6 to 8 months for graduate students and up to 3 months for researchers. Such an approach, instead of encouraging an outflow of research personnel, results in their circulation – much to the benefit of their academic skills.

Yet another important success factor (rarely introduced into practice by laboratories and research institutions) is the realism of the short- and long-term development goals set by a laboratory. The development goals of the Baikal Research Center are as follows:

- 1) to upgrade the impact level of publications (i.e. to increase the number of papers published in high impact factor journals);
- 2) to launch new projects and to broaden the scope of international cooperation (including by participation in projects under the EU's framework programs);
- 3) preparation and defense of doctoral dissertations;
- 4) diversification of research themes.

The Baikal Research Center's avowed long-term goal is the establishment, in the Baikal region, of an international center for progressive bio-medical research.

The success stories of this kind are very few in number. They are not analyzed, and the approaches developed in their course are not taken into account, including in the mapping of new projects aimed at promoting development of science in Russia. Instead, innovations are mainly borrowed from abroad, with emphasis being placed on such prominent and universally known models as Silicon Valley (whose history is long and evolutionary), research universities, and innovation development zones and territories of various types (parks, poles of competitiveness, etc). Preference is given not to the optimization of organization and management, but to resource-intensive and infrastructure projects. At the same time, foreign experience can be useful not only from the point of view of transferring to Russia a number of instruments used in foreign countries, but also from that of applying their methods for evaluating the performance of agencies responsible for policy implementation. As far as this matter is concerned, it is necessary to determine what should have been done differently and what should have been done at a lesser expense. So long as Russia's science policy ignores such questions, successful domestic experiences will not be taken into account, either. ●

1 M.A. Timofeev. *Istoriia sozdaniia i opyt nauchnoi raboty molodezhnoi issledovatel'skoi laboratorii "Problemy adaptatsii biosistem" kak primer partnerstva gosudarstvennogo i chastnogo sektorov v fundamental'nykh issledovaniiaxh* [The history of creation and the work experience of the research laboratory *Biological Systems Adaptation* as an example of public-private partnership in the field of fundamental research]. Presentation at an international conference of science education centers. Irkutsk, 20 September 2011. <http://www.baikal-research.org/files/documents/NOC.pdf>

REVIEW OF THE MEETINGS OF THE GOVERNMENT OF THE RF

M. Goldin

In May 2012, at the meetings of the Presidium of the Government of the Russian Federation the following issues were discussed: draft guidelines of the tax policy in 2013 and the 2014-2015 planned period and the draft law simplifying the procedure for remote execution of labor relations between the employer and the employee.

On May 2, 2012, at the meeting of the Presidium of the Government of the Russian Federation, draft guidelines of the tax policy in 2012 and the 2014–2015 planned period were considered among other things.

In the draft, the outputs of implementation of the main lines of the tax policy in 2012 and the 2013-2014 planned period have been traditionally summed up and objectives of the tax policy which are planned to be achieved in 2013 and the 2014-2015 planned period have been set.

The draft proceeds from the fact that raising of tax rates, changing of the rules of calculation and payment of individual taxes and taking of measures in the sphere of tax administration may become the main sources of growth in tax revenues. In addition to the above, an individual line of policy in the sphere of upgrading of the revenues potential of the tax system will be optimization of the existing system of tax privileges and exemptions, as well as liquidation of the existing loopholes for tax evasion. At the same time, it is stated in the draft that the goal of the tax policy in the short-term prospect is “a tax maneuver which consists in reduction of the tax burden on labor and capital and raising thereof on consumption, including expensive real property and rental income arising in production of primary products as well as in transfer to a new system of taxation of real property”.

Upgrading of the tax legislation will be carried out by a number of principal lines.

Such lines include, primarily, implementation of tax incentive measures. It is planned, among other things, to support investments and development of human capital. To achieve that, it is planned to do the following:

1) exemption from taxation of a number of socially important payments (incomes), including those in the form of:

- Grants of the President of the Russian Federation allocated to young Russian scientists – PhD and Doctors of Science – for carrying out of research;
- Lump-sum payments to unemployed individuals in the form of a financial aid rendered within the frameworks of a public service as regards assistance in self-employment of unemployed individuals and a number of others;

2) specification of the procedure for provision of a property tax deduction;

3) specification of conditions of reestablishment of a depreciation premium: subject to reestablishment are the sums of capital expenditures only in case if capital assets realized prior to expiry of a five-year period from the date of their commissioning were assigned to a person which is a related party to the taxpayer;

4) support of modernization of production, including exclusion of individual types of real property – equipment and machines – from entities’ property tax;

5) simplification of fiscal accounting, including convergence of accounting and taxation rules and introduction of the procedure for provision of taxpayers instead of tax statements with calculations of advance payments prepared in accordance with a simplified form on the basis of the results of entities’ property tax periods.

In addition to the above, tax incentive measures will be undertaken in upgrading of taxation in operations with securities and financial instruments of forward and other financial transactions and special tax treatment of the small business and in development of mutually reconcilable procedures in tax relations.

Also, upgrading of the tax legislation will be carried out by the following key lines:

- measures providing for growth in revenues of the budgetary system of the Russian Federation;
- upgrading of entities' profit tax;
- upgrading of tax administration;
- prevention of tax evasion with use of low-tax jurisdictions;
- insurance contributions to mandatory pension, medical and social insurance.

On May 24, 2012, at the meeting of the Presidium of the Government of the Russian Federation federal draft law on Amendment of the Labor Code of the Russian Federation and Article 1 of the Federal Law on Electronic Signature were considered among other things. The above draft law was aimed at making simpler the procedure for labor relations between the employer and the employee who works beyond the place of location of the employer's premises (the remote work).

An important innovation of the draft law is a feasibility to enter into an agreement in an electronic format with such a category of workers. Also, a norm is introduced which permits not to enter details on the remote work in the worker's labor book at his/her will. In such a case, documents certifying the period of such employment are copies of the labor contract and the order on termination of the labor contract.

To make the procedure for remote execution of labor relations easier, the draft law provides for utilization of a reinforced electronic signature in conclusion, amendment and termination of the labor contract with the above category of workers, as well as in other instances envisaged by the Labor Code of the Russian Federation and related to a need of putting of a signature by parties to the labor contract.

In addition to the above, the Labor Code of the Russian Federation is supplemented with norms which permit a remote worker to submit documents in electronic format to the employer when taking employment and similarly with utilization of the reinforced electronic signature it is admissible for the worker to get acquainted with documents specified in Article 68 of the Labor Code (rules for internal labor order, local regulatory documents directly related to the employee's work and the collective agreement). ●

REVIEW OF THE ECONOMIC LEGISLATION

I.Tolmacheva

In May, the following amendments were introduced in the legislation: by Orders of the President of the Russian Federation measures were taken on implementation of the government policy in the sphere of education and science, as well as measures on provision of citizens of the Russian Federation with affordable and comfortable housing; a new Procedure for enrollment of people in educational establishments of basic vocational training.

I. Orders of the President of the Russian Federation

1. Order No. 599 OF May 7, 2012 ON MEASURES ON IMPLEMENTATION OF GOVERNMENT POLICY IN THE SPHERE OF EDUCATION AND SCIENCE

It is planned that by the year 2020 at least five Russian Universities will be included in the world's top one hundred universities. The Government of the Russian Federation has been instructed to:

- ensure by the end of December 2012 fulfillment of monitoring of efficiency of public educational establishments and restructuring of inefficient ones;
- increase the amount of a stipend of first-year and second-year full-time students undergoing training under Bachelor programs to the value of the minimum subsistence level until the end of 2012;
- increase the volume of domestic expenditures on R&D to 1.77% of GDP by the Year 2015;
- ensure 100% availability of kindergartens for children at the age of three to seven years old by the year 2016.

2. Order ON MEASURES TO ENSURE CITIZENS OF THE RUSSIAN FEDERATION WITH AFFORDABLE AND COMFORTABLE HOUSING AND UPGRADE THE QUALITY OF HOUSING AND PUBLIC UTILITIES SERVICES

It has been declared that 60% of Russian households which seek to improve their housing facilities will be given such an opportunity until the year 2020 through provision of affordable and comfortable housing. In order to improve housing conditions of citizens of the Russian Federation, the Government of the Russian Federation has been instructed, in particular, to ensure the following:

- until the year 2017, increase to 30% the share of borrowed funds in the total volume of capital investments in heat supply systems, water supply systems and systems of water discharge and waste-water treatment;
- until the year 2018, reduce maximum to 2.2 percentage points the value of the excess of the average level of the interest rate on a housing mortgage loan (in rubles) in relation to the consumer price index;
- increase the number of housing mortgage loans to 815,000 a year;
- create opportunities for citizens of the Russian Federation to improve housing facilities at least once in 15 years.

Also, the Government of the Russian Federation together with executive authorities of the constituent entities of the Russian Federation has to among other things develop the procedure for free allocation of land plots for building of economy-class housing, work out comprehensive measures on upgrading of housing facilities of households with three and more children, ensure formation of special conditions of mortgage lending to individual categories of people (young families and employees of the public sector), develop a plan of measures on prevention and preclusion of monopolistic activities and unfair competition by economic agents in the sphere of housing development and production of building materials and ensure formation of the market of affordable leased property and development of non-for-profit housing fund for low-income individuals.

II. Instructions, Letters and Orders

1. Order No.221 of March 22, 2012 of the Ministry of Education and Science of the Russian Federation ON APPROVAL OF THE PROCEDURE FOR ENROLLMENT OF PEOPLE IN EDUCATIONAL ESTABLISHMENTS OF THE BASIC VOCATIONAL TRAINING

Registered by the Ministry of Justice of the Russian Federation under No. 24096 on May 10, 2012.

From January 1, 2013, the new procedure for enrollment of people in educational establishments of the basic vocational training will come into force. The procedure regulates enrollment of citizens of the Russian Federation, foreign nationals, stateless persons, including compatriots living abroad in educational establishments of the basic vocational training for undergoing training under the main vocational educational programs of the basic vocational education at the expense of funds of the relevant budget, as well as under agreements with individuals and (or) legal entities on payment of the cost of education. The procedure includes provisions dealing with such issues as organization of enrollment of people in educational establishments, information of enrollees, acceptance of documents from enrollees, as well as admission in an educational establishment.

In particular, prior to acceptance of documents both on the official site of the educational establishment and the information board the admissions office has to place the following information: until February 1: annual rules of enrollment in an educational establishment, list of trades for which enrollment is announced by the educational establishment in accordance with the license to carry out educational activities (with underlying of forms of education (full-time, full-time-correspondence (part-time) and extern); requirements to education needed for enrollment (main general and (or) secondary (full) general education) and until June 1: the total number of places for enrollment by each trade, including by different forms of education; the number of budget places for enrollment by each trade, including by different forms of education; number of places by each trade under agreements on payment of the cost of education (if any); information on availability of a hostel and number of places in it allocated for applicants from other cities and sample agreement for applicants to places under agreements on payment of the cost of education.

Enrollment in educational establishments by main vocational training programs of the basic vocational education is carried out on the basis of a personal application of the individual. Applications to educational establishments for full-time education are to be submitted until August 31, but if there are available places at the educational establishment submission of documents is extended till December 25 of the current year.

Order No. 3 of January 15, 2009 of the Ministry of Education and Science of the Russian Federation by which the former procedure for enrollment was approved has been recognized as null and void. ●

AN OVERVIEW OF NORMATIVE DOCUMENTS ON TAXATION ISSUES IN APRIL-MAY 2012

L.Anisimova

The formation of a new Russian government was completed on May 21, 2012. It is still premature to draw conclusions about a temporary occurrence of prospective new trends in tax reform as a result of relocation of power and change in the status of key representatives of the economic sector of the Russian Government and Presidential Administration. In view of the budgetary process technology, draft guidelines for fiscal policy for 2013 and 2014-2015 were developed by the RF Ministry of Finance and submitted to the Russian government in early May 2012. In particular, the consideration of this draft in the RF Government and the newly elected State Duma will provide new material for the evaluation of positions and milestones in the reform and development of fiscal relations in Russia on a new stage¹. Meanwhile, the RF Ministry of Finance is trying to carefully balance the introduction of new tax incentives and relief measures for individuals and the financial sector, on the one hand, and the cancellation of previously existing benefits to shift the tax burden on the mining sector – on the other.

1. The first part of the Tax Policy Guidelines for 2013 and 2014-2015 outlines the changes made to the Tax Code in 2011 and the results for 2010-2011. Particular interest is paid to RF Ministry of Finance monitoring of tax incentives effectiveness. According to the RF Ministry of Finance, there are about 200 various benefits and preferences the Russian tax system. Due to the benefits, shortfalls to the state budget system (excluding the state extra-budgetary funds) in 2010 has exceeded over Rb 600bn. The share of tax revenues (including insurance contributions to the state extra-budgetary funds) decreased from 36.5% of GDP in 2005 to 35.6% of GDP as per 2011 results. A significant share of revenues is still made by the revenue from taxes and duties on the production and export of crude oil and petroleum products.

2. Proposed measures in the area of tax policy in 2013 and planning period of 2014 and 2015 on the most sensitive issue – contributions to the state social extrabudgetary funds – imply a preservation of the basic rate of 30% (plus 10% of the amount exceeding the base salary fund to which contributions are charged at the basic rate). The Russian government will have to make a decision on the reform of the pension system, which could affect the rates.

3. Among measures of tax incentives one should note the support of socially vulnerable population groups in the framework of personal income tax.

In regard to personal income tax, it is supposed to provide tax exemption on: 1) grants the RF President for young Russian scientists – candidates and doctors of science for research works, 2) nonrecurrent financial assistance to unemployed citizens in the framework public service to promote self-employment and for a period of training, retraining and qualification upgrade in accordance with the instruction of the employment services, as well as funds paid by the employment service to unemployed citizens and minors in the ages of 14 to 18 in the period of their participation in social services and temporary employment, and 3) subsidies granted to the head of husbandry farmers, engaged in business activity without establishment of legal entity at the expense of the Russian Federal budgets, and 4) the value of land plots owned by the state or municipalities, granted for free to the citizens who have three or more children, etc.

The Tax Code will include the Constitutional Court decisions on granting property tax refund to parents who purchase at their own expense a shared (joint) property with minor children, in regard to the shares attributable to minor children, as well as in case of property acquisition in the ownership of a minor child.

¹ “The Government will consider proposals on the tax system enhancement”, site vedomosti.ru of 01.05.2012.

At the same time the procedure for the refund distribution of cases of acquisition of common share or joint ownership in property among citizens will be specified. It means support of the rights of a person, who did not apply for a refund when acquiring a common or a joint share in the property of common ownership. Given that the tax refund is granted to the taxpayer, rather than to the object of property, the citizen will have the right for property tax on another object in full.

4. Corporate income tax will combine the introduction of incentives to modernize production and support the financial sector with the abolition of measures which lead to the tax base decrease.

4.1. The RF Ministry of Finance intends to limit the benefits which provide an opportunity for a lump-sum attribution to current expenditures of organization expenses on preparatory activities, including the cost of maintenance of production facilities that are partially loaded (used), but necessary for the preparatory plan, and to limit the scope of accelerated depreciation. Now, these measures allow organizations to significantly reduce the tax base. To reduce the costs attributed to current expenses, the RF Ministry of Finance proposes not to write them off as a lump-sum, but include them in the cost of fixed assets and attribute to expenses through depreciation.

4.2. To reduce the tax-free transfer of funds between the organizations, the RF Ministry of Finance proposes to cancel the benefits in the form of exemption from property tax, property or non-property rights granted by shareholders (participants) for the formation of the organization net assets. Now commercial organizations are allowed to receive from their shareholders or members any property, property rights or non-property rights, including the cash, without tax consequences, which, according to RF Ministry of Finance, in fact legitimizes the donation of property between the commercial organizations, recording as replenishment of the net assets for the tax purposes (in the RF Civil Code donations between commercial companies are not permitted).

4.3. Among the tentative benefits the following ones should be noted. The RF Ministry of Finance has agreed to reduce the amount of expenses on capital investments in renewable income of the organization for early sale of fixed assets (before the expiration of five years from the date of commissioning). Only one third of the so-called “depreciation bonus” (10% of the value of acquired assets, except for fixed assets included in the third – seventh depreciation groups – for those assets the existing order is applied, i.e., not more than 30%). This scheme is supposed to be applied only to the transactions between related parties. It looks that other taxpayers generally will be exempt from the recovery of depreciation bonus in the income of the seller.

The proposal of the RF Ministry of Finance is ambiguous. In case of such incentives are introduced, instead of transactions between related parties, incompliant taxpayers can use a “bronze” scheme to get depreciation premiums (similar to “bronze” promissory notes, when two poor friends gave such notes to each other and then they used them as documentary pledge in the banks).

The most simple conventional scheme looks as follows. For example, a commodity producer expects to receive taxable income in the amount of 200 units., after income tax applied at the rate of 18% (federal tax is still in effect) income will make 36 units. The producer buys expensive fixed assets for 100 units. This allows him to attribute 30 units to the depreciation bonus. The tax base will be reduced to 170 units., and corporate income tax – up to 30.6 units., i.e., decreased by 5.4 units. Leaving aside the standard depreciation assessment, assume that the producer has sold the fixed assets at book value – that is, for 70 units. Tax on profits from the sale of the fixed assets is inapplicable. The result of the operations is the net decrease in taxable operating profit by 15%. The scheme can be repeated until such fixed assets are purchased at a fair market value by the manufacturer who makes those production facilities cost-effective. Thus, in our opinion, the tax benefit in the form of non-recovery of depreciation bonus in fact, not only leads to excessive price growth, but also to the double losses of the budget funds (in case of payment for expensive equipment from budgetary resources and due to underestimation of the tax base in the subsequent resale).

4.4. According to the RF Ministry of Finance proposals, it is supposed to formalize in legislation that the redemption of depository receipts an acquisition of the Russian securities, the tax base for corporate profit tax is not estimated. The value of securities obtained as a result of depository receipts redemption of will be assessed on the basis of purchase price of depository receipts (including expenses for their purchase), as well as expenses for the sale of securities.

Losses on financial instruments of futures transactions issued in accordance with foreign law, and subject to legal protection under the effective legislation of foreign countries, will be taken into account for the taxation of profits of Russian companies.

Also, the situation will be resolved in regard to the assessment and deduction of corporate income tax on interest income of foreign companies in Eurobonds. The borrower will not bear the liability to identify the entire chain of Eurobonds owners, it is sufficient to identify the holders of the first level registered in the depository and clearing systems (for Eurobonds, which are either listed on one or the universally acknowledged stock exchanges, or those whose rights are recognized by depository and clearing organizations, such as Euro clear, Clearstream, DTC, subdivision of large multinational banks).

These proposals of the RF Ministry of Finance are challengeable.

The proposal to replace the tax-exempt depository receipts with securities does not specify what kind of depository receipts are considered. If depository receipts are issued by the Russian taxpayer in accordance with the Russian legislation, the tax on service fees will be addressed to the Russian budget, and tax authorities will have accurate information about the offering price of depository receipts, which will allow them to compare it with the market value of shares for which they are exchanged. Federal Financial Markets Service will be able to suspend the operation, if the prices of the depository receipts and commission services happen to be lower than the market value of certified stocks of Russian companies. If the depository receipts are issued by a foreign organization, as a result of the exchange, unjustified losses may be incurred by the Russian budget. We would like to note that in many countries there is a difficulty in capital investments in the IPOs in the territories of other states. For this purpose, the National Depository Receipts are issued – for example, ADR (United States). We believe that the same scheme should be applied in Russia, because it protects the system from the state budget unjustified losses.

Indeed, in the RF privatization was carried out free of charge, and securities (shares) were accounted in the balance of the owners at minimal cost. Issue of foreign depository receipts on Russian shares does not mean the privatization of Russian organizations in accordance with the Russian law. Similarly, it is also impossible to assess the relevance of offering price of foreign depository receipts with the actual market price of securities (shares) of Russian companies, as there is an intermediary (probably not the only one) between the holders of foreign and Russian depository receipts. In a direct exchange of foreign depository receipts for a share of the Russian company there may be a disparity in the cost of damage to the Russian budget. The person receiving the share of Russian companies in exchange for foreign depository receipt may have an income, the origin of which is the territory of the Russian Federation. The proposal made by RF Ministry of Finance (if the proposal of the Ministry applies to foreign depository receipts) violates the interests of the Russian budget, first, because the commission, included in the price of a foreign depository receipt and paid by its holder to a foreign issuer of the receipt should be (in case of exchange for the Russia share) recognized as the source of income derived in the territory of Russia, and, secondly, as we have noted in the case of inconsistency in the value of foreign depository receipts with the balance value of the shares of a Russian organization at the time of the exchange, an income from sources in Russia may take place. To solve this situation without a loss to the Russian budget is possible, if the tax on exchange of foreign depository receipts for shares of Russian companies is withheld from the seller's shares in the form of the difference between the balance cost of depository receipts (including issuer commissions), confirmed by the tax authority at the place of tax-residency of its owner and the balance value of the Russian shares (subject to the parity of the exchange). If the seller of the shares is outside the tax jurisdiction of the Russian Federation, not to recognize the transition of ownership of the share until the tax to the Russian budget as the state of the income origin. Foreign depository receipts are issued regardless the laws of the Russian Federation. Accordingly, we believe that the RF budget should not neglect its legitimate income, no matter what political interests are involved.

Proposal on the recognition of losses on financial instruments of futures transactions, issued in accordance with the laws of foreign countries, is also ambiguous, since the RF Ministry of Finance did not specify, whether it refers to derivative securities, circulated in the organized market of foreign countries and recognized by the Federal Financial Markets Service; whether it refers to the

countries, with which Russia has agreements on avoiding double taxation (for the issuer of such instruments). In addition, in the situation of financial crisis, provoked namely by the imperfection of financial instruments of futures transactions regulation, when the EU is introducing tax on financial transactions to limit speculations in derivatives, it is doubtful that Russia should be mitigating the tax laws to encourage investments in unsecured by real assets financial instruments, which in the crisis situation can generate the largest losses.

As to the benefits for operations with corporate Eurobonds, there is a background of this issue. The notion of “Eurobond” was originally applied only to the bonds issued by the Russian Federation for government borrowing in external markets (the RF, as the subject of extraterritorial borrowing was repaying interest also outside the RF territory, and therefore domestic legislation was not applied to it in relations with external borrowers, and it was not regarded as a tax agent liable to pay interest to external borrowers).

Russian organizations – bond emitters had the status of tax residents of the RF, i.e., the domestic law was applicable to them (subject to the provisions of agreements on avoidance of double taxation), but they also began to call their bonds distributed in foreign markets, the “Eurobonds”. In contrast to the government “Eurobonds”, in compliance with the Tax Code, issuers of corporate bonds were required to deduct tax when paying interest to non-residents at the rate specified either by relevant agreements, or at the rate established by domestic law, if the interest was paid to the RF residents and to the subjects who failed to prove their tax residency in the country-member of agreement with Russia on avoidance of double taxation. The scheme used by the Russian organizations – emitters, in which the emission in the external markets was carried out through an intermediary, according to the RF Ministry of Finance, did not release the issuer from the obligation to withhold tax from interest payments.

An attempt of the RF Ministry of Finance to enter in the Tax Code an explanatory scheme of taxation for the transfer of funds for interest payment to a foreign intermediary displeased the emitters, to whom foreign bond borrowing often turned out to be the most convenient form of raising funds (no bail was required, no dependence on credit history, required for bank loans, interest rates on borrowed funds are lower than in Russia, the losses could be attributed to reserves for depreciation of securities, etc.).

The RF Ministry of Finance happened to be in the midst of harsh criticism just at the time of replacement of the Deputy Corps and the Ministry top management. As a result, the position of the RF Ministry of Finance has been significantly mitigated, and eventually the draft law submitted to the State Duma provides for tax exemption of interest on bonds issued by Russian issuers outside the RF territory.

Commenting on the situation, the Chairman of State Duma Committee on Budget and Taxes A.Makarov said that “taxation of the interest on Eurobonds is impossible, because Russian companies have no information on the final recipient of these funds. At the same time, such tax can only worsen the position of domestic emitters in the debt markets¹.”

However, this solution is ambiguous. From an economic point of view, there is a high probability of emerging a new channel for tax-free transfer of funds offshore. The fact is, that interest rates in Russia are still significantly higher than in Europe. Interest to be paid (at high rates, but within the established range) in Russia are used to reduce the tax base of the issuer. The provisions for beneficial income tax rates for entities registered in the offshore zones, include their activities and income receipt outside the offshore territory.

We believe that it would be more expedient for the RF Ministry of Finance to start with an attempt to find a solution to the conflict with corporate “Eurobonds” emitters with the high judicial authorities of the Russian Federation.

4.5. An elegant solution to the issue of combating tax evasion of Russian legal entities through established subsidiaries in low tax jurisdictions (offshore) was developed by financial agencies at the request of the country government.

One of the key elements of combating tax evasion with the help of offshore companies and countries with low tax rates is the institution of taxation of retained earnings of foreign-controlled companies, which implies that income, not distributed between the founders (owners) of controlled

¹ Deputies found a way to release the companies from tax on Eurobonds. Lenta.ru 21.05.2012.

foreign company or part of it may be considered for tax purposes of corporate income tax as income of the owner (i.e., the parent company). Excluding expenses of the Russian company payments to recipients that are registered in offshore zones, recognized for tax purposes, the RF Ministry of Finance makes disadvantageous the capital transfer low-tax jurisdictions. The specific tax scheme for the Russian legal entities pay taxes to the RF budget with regard to the profits of foreign companies controlled by those Russian legal entities, proposed by the specialists of the RF Ministry of Finance and the Federal Tax Service, was analyzed in previous review.

5. In the framework of special tax regimes for small businesses, it is expected to gradually replace the tax on imputed income with patents (to be completed by 2018). Individual entrepreneurs, applying the patent system of taxation, will be permitted to use the employees, whose average number should not exceed 15 people. 90% of the proceeds from the patent tax system will be addressed to the budgets of municipalities and 10% – to the budgets of the Subjects of the Russian Federation.

6. Most significant proposals of the RF Ministry of Finance to replenish treasury, are related to the reform of the basic commodity tax – MET.

6.1. It is expected to increase the MET rates on oil and gas, and to level the tax burden on gas production and oil-producing industry.

This issue is of strategic importance, we will consider it in detail.

In particular, it is planned to bring the MET rate for OAO “Gazprom” to Rb 1,100 by 2015 for 1,000 m³ (versus the current rate of Rb 509 per 1,000 m³). For independent gas producers leveling of the tax burden with the rate established for OAO “Gazprom”, in practice, would mean a 4-fold increase in liabilities under this tax. Experts in the gas industry are warning of a possible reduction in gas production and the emergence of deficit¹. The RF government expects to receive budget revenue from the gas industry Rb 36bn in 2013, Rb 134bn in 2014 and Rb 270bn in 2015. Herewith, “Gazprom” has repeatedly stated that the tax burden increase will be only partially compensated by the increase in domestic gas tariffs.

The tentative MET reform is aimed at replacement of revenue from export customs duties with other taxes to the budget in order to prevent the threat of skill differences in the prices of hydrocarbons in the domestic and external markets as a form of implicit subsidies to domestic producers. The result of recognition of the implicit subsidies due to the lower prices in the domestic market for raw materials and energy as compared with the prices prevailing on the open market may be the payment of antidumping duties by the Russian producers, but not in the budget of the Russian Federation, but to the budgets of other states in view of accedence to WTO. Therefore, despite the expert opinion of the gas industry, the MET reform proposed by the RF Ministry of Finance is an unavoidable measure of protection of the interests of the Russian budget in the international market. It is obvious that shifting of tax burden on export prices directly to the production cost will lead to an increase in hydrocarbon prices in the domestic market, as well as affect the general prices growth for the goods (works, services) of the Russian producers. In terms of the balance in the economy and macroeconomic stability this is the right decision, because it meets the interests of regulating the money supply, thrown to the market due to increased pensions and salaries of power ministries staff, which had some impact on the ruble rate weakening. In addition to problems associated with risk in gas production reduction, there will be other negative consequences. The MET growth will increase pressure on budgets in the northern regions and regions with particularly difficult conditions of hydrocarbons extraction without adequate production of hydrocarbons to increase their income, as those regions MET zero rate is applied. Accordingly, to keep balance of the growing social tension in those regions, one can rely only on the federal budget funds to be allocated for leveling of social protection of the RF population. It should be noted also that the proposed measures are belated, because the rise in prices for goods (works,

1 *O. Mordyushenko*. Everybody is equal to “Gazprom”. MET for independent producers will grow four-fold, // Site kommersant.ru, Kommersant, No. 78 (4863) of 05/02/2012; *G. Osipov*. Starving vertical. “Gazprom” is the last reserve of power, who is decided to be thrown on the battlefield under the threat of budget gaps proliferation // Site gazeta.ru, of 03.05.2012.

services) of domestic producers will take place in the situation of Russia accession to the WTO and the opening a free access to the Russian market to competitors¹.

6.2. For the extraction of other minerals (except oil and gas), which the share in exports exceeds 50% of production the issue of establishing the MET rate will be worked out, depending on the global prices of respective minerals.

6.3. Proposals will be developed for enabling the system incentives for the extraction of hydrocarbons from difficult to access fields and in the extraction of hard-recoverable reserves of hydrocarbons, in particular from the lower horizons.

6.4. The issue of expediency of transfer to the taxation of the company's financial results (surplus income tax (SIT) carrying out new hydrocarbon deposits development will be assessed. The introduction of these mechanisms may involve in a change in the system of resource rent tax – from the MET and export customs duties to excise duties on petroleum products.

7. Excise taxation. With regard to alcohol and tobacco products it is planned to sustain the excise tax rates in 2013 and 2014 in the amounts established in applicable laws on taxes and duties. Since 2015 the rates will be increased: the rate of excise duty on a liter of “dry” ethanol – up to Rb 600, on alcohol with the ethyl alcohol exceeding 9% – up to Rb 500; beverages with the ethyl alcohol less than 9% (with the exception of beer, wine, wine drinks without rectified ethyl alcohol produced from food raw material). Excise duty on cigarettes and tobacco will be about Rb 1 for 1 pc. Excise tax rates on motor fuel and other excise goods in 2013 and 2014 will be kept at the current level, and in 2015 will be increased by 10% as compared with rates of 2014.

8. The work on the scheme of payment of property taxes is in progress. Cadastral value of the object is to be applied as the tax base for the real estate tax assessment. It is expected to establish a standard tax credit in the amount of the cadastral value of a certain number of square meters of the appropriate object of taxation. Beneficial categories of citizens are supposed to get social tax credit in the amount of cadastral value of a certain number of square meters of the corresponding real estate and/or the cadastral value of a certain number of square meters of land.

It is planned to address the issue of luxury facilities taxation through the tax on real estate and vehicle tax. The minimum tax rate on real estate is to be established per 1 person in size from 0.05 to 0.3% of the total land value of all real property in the ownership. For the expensive real estate (worth more than Rb 300m) increased tax rate will be applied regardless of who is the owner of these objects (organizations or individuals), and the number of owners.

Starting from 2013 the minimum rate will be introduced on vehicle tax for cars with the engine capacity over 410 hp at Rb 300 for 1 hp; it is also planned to increase by 5 times the average rates of vehicle tax for large motorcycles (with engine capacity of more than 130–150 hp), waverunners (over 150 hp), boats and yachts (above 300 hp).

Higher tax rates are proposed to apply to vehicles manufactured after 2000. Herewith, higher tax rate is not increased for sports cars and motorcycles used exclusively for participation in sports competitions.

9. In order to create incentives for upgrading the fixed assets, new objects of property of organizations tax related to movable property (machinery, equipment) are to be tax exempted.

10. To curb the increasing judicial expenses and reduce the costs of administration, mutual agreement procedures will be applied, in particular, a mandatory pre-trial procedure for dealing with disputes between tax authorities and taxpayers. According to experts, this will reduce the number of tax disputes in the courts presumably by two-fold.

Among the documents that explain the current tax issue the following points are of greatest interest.

1. By the Ruling of the Superior Commercial Court dated 27.4.2012 on the case number 1896/12 under the claim of representation OOO “Gide Loyrette Nouel East” Para. 6, P. 5.3 of Procedural recommendations to tax authorities on the application of certain provisions of Chapter 25 of the

1 Recall that the developers of the Strategy-2020 spoke of the need to abandon export customs duties back in 2010.

Tax Code, relating to the characteristics of tax revenue (income) of foreign organizations approved by the Ministry of Taxes and Duties on 28.03.2003 No. BG-3-23/150 is recognized as invalid. The problem is as follows.

Convention of 26.11.1996 between the RF Government and the Government of the French Republic on avoidance of double taxation of permanent establishment, incorporated by a foreign company in another country – member-state of the Convention, is granted an opportunity of deduction from the tax base expenses incurred by the foreign company for the purposes of the permanent establishment (including executive and general administrative expenses), irrespective of whether these costs are incurred in the state where there a permanent establishment is registered or outside the country territory.

According to Superior Commercial Court, P. 1 of Art. 252 of the Tax Code, the well-grounded and properly documented expenses incurred by the taxpayer are recognized as reasonable costs. Under the documentary confirmed expenses developed in accordance with Russian legislation, or documents furnished in accordance with the business practice applied in a foreign country in whose territory the related expenses were incurred. Since the costs of the representative office were confirmed by the documents issued by a foreign organization headquarters located outside the territory of Russia, the formal positions, including in terms of reflecting the costs of representative office, were not accepted by the tax authorities of Russia for assessment of the tax base of representation on an accrual basis (e.g., the contract was signed the parent company on its behalf for the delivery of the goods (works, services) to the address of the representation. Respectively, the primary document for representation, confirming the costs will not be the original contract, but invoices and bills for payments). Superior Commercial Court has covered the gap in the Russian legislation by a conclusion on the inadmissibility of forcing foreign companies operating in Russia through permanent representations, regarded as income tax payers, to recognize the date of transfer by a foreign organization to its representation expenses for tax purposes, as a circumstance that prevents integration of these expenses in the tax (reporting) period to which they relate, if the relevant report includes the information to identify the proper tax (reporting) period.

2. By the Order of the Federal Tax Service of May 10, 2012 @ MMV-7-2/297 a number amendments are introduced in the Order of the RF Federal Tax Service of 30.05.2007 No. MM-3-06/333 @ “On Approval of the Concept of planning field tax audits” (as amended by the Orders of the RF Federal Tax Service of 14.10.2008 No. @ MM-3-2/467, 22.09.2010 No. MMV-7-2/461 @ and 08.04.2011 No. MMV-7-2/258 @). The structure of objects subject to tax audits includes information delivered during the consideration of complaints and petitions of citizens, legal entities and individual entrepreneurs, law enforcement and other supervisory authorities, on the fact that the taxpayer paid the unrecorded wages (“in envelopes”), failure to document (document in breach of the order), labor relations and other similar information.

The same letter has provided information about the tax burden by type of economic activities, as well as the level of profitability of sold goods and assets in 2011.

3. Letters of the RF Ministry of Finance 23.04.2012 No. 03-11-09/30 and the RF Federal Tax Service of May 14, 2012 @ number ED-4-3/7849 clarified the issue of the taxation system in the form of a unified tax on imputed income with respect to the implementation of unclaimed items that have fallen into of ownership of the pawnshop.

In particular, it is explained that according to Para. 5, Art. 358 of the Civil Code in the event of no return in due time of the loan secured by a pledge of commodities in a pawnshop, the pawnshop after the one month period is entitled to sell the property in the manner prescribed by the law on the lombards (dated July 19, 2007 No. 196-FZ). The unclaimed item, on which was imposed a court-enforced collection, it should be its sold, including a public auction. If the estimated cost of the unclaimed item exceeds Rb 30,000, its sale is carried out only at a public auction. In the case of auction is [recognized as invalid, the pawnshop may reduce the initial price of things through rebidding, but not more than by 10% of the initial price of the previous auction. Repeated auctions can be conducted through a public offering.

Cash received by the pawnshop after the sale of unclaimed items are the funds received in repayment of the obligation of the borrower for the loan repayment and for interest payment, or payment of the depositor compensation for the items storage. It should be borne in mind that

the funds received by the pawnshop after the implementation of unclaimed items to the extent allocated to the payment of interest of the borrower under the loan agreement, are attributed to non-operating income and are subject to corporate profit tax.

Operations of pawnshops on the disposal of unclaimed items to the retail trade are not subject to the unified tax on imputed income for certain types of activities.

4. Letters of the RF Ministry of Finance and the Federal Tax Service on May 2, 2012 @ ED-4-3/7330 number and on May 3, 2012 @ number ED-4-3/7432 explained that to get the property tax credit for income tax, individuals must provide to the tax authorities documents on property right for the new housing. Tax credit is available, beginning from the tax period in which the right of the taxpayer for such tax credit has occurred. If the tax credit cannot be used in full in personal income tax base assessment, it can be used in subsequent tax periods – up to complete exhaustion of the amount of such credit. In this case interest paid by the taxpayer on loans borrowed for the construction (purchase) of housing, will be reimbursed to the taxpayer from the budget of the RF Subject and may be included in the property tax refund.

5. Order of the Federal Tax Service of April 24, 2012 @ number MMV-7-2/274 of the RF Federal Tax Service dated 16.05.2007 No. MM-3-06/308 @ was amended. The specified document defines new criteria for referring organizations – legal entities to the largest taxpayers subject to tax administration at the federal and regional levels. In particular, it is determined that a non-profit organization can now be regarded as a major taxpayer at the federal level, if the total income received exceeds Rb 20bn. At the regional level – if total income is in the range of Rb1bn up to Rb 20bn. Or if the total amount of federal taxes and fees is within the range of Rb 75m up to Rb 1bn. As a result, non-profit organizations are treated by the same criteria as established for commercial organizations. Previously, non-profit organizations were not included in the number of largest taxpayers. ●

CHANGES IN THE REGULATORY BASE OF THE BUDGETARY PROCESS

M. Goldin

In May 2012, approved by resolutions of the Government of the Russian Federation were the legal frameworks of control and supervision in the sphere of legal protection and utilization of such outputs of intellectual activities of military, specialized and dual purposes as were created at the expense of allocations from the federal budget, as well as forms and procedures for submission of reporting on investment of temporary available funds of a state corporation and state-run company.

Resolution No. 402 of April 26, 2012 of the Government of the Russian Federation On Carrying Out of Control and Supervision in the Sphere of Legal Protection and Utilization of Such Outputs of Intellectual Activities of Military, Specialized and Dual Purposes as Were Created at the Expense of Allocations from the Federal Budget, As Well As Control and Supervision in the Given Sphere of Activities in Respect of Public Customers and Entities – Executing Agencies of Public Contracts Providing For Fulfillment of R&D has approved the relevant Statute.

Fulfillment of the federal public control and supervision has been entrusted with the Federal Service for Intellectual Property which activities are aimed at prevention, identification and preclusion of violations by public customers and executing entities of requirements set by the legislation of the Russian Federation in the sphere of legal protection and utilization of outputs of intellectual activities (hereinafter – mandatory requirements), as well as protection of the rights of the Russian Federation to the specified outputs of intellectual activities by means of organization and carrying out of planned and unscheduled audits (hereinafter – audits) of public customers and executing entities and taking of measures provided for by the legislation of the Russian Federation as regards preclusion and (or) elimination of consequences of the identified violations.

An audit is carried out on the basis of the order (instructions) of the head of the Federal Service for Intellectual Property.

Federal public control and supervision is carried out in respect of the following:

- a) public customers making orders for R&D of military, specialized and dual purposes on the basis of public contracts and agreements which financing is carried out at the expense of allocations from the federal budget, including subsidies;
- b) executing entities with which public contracts and agreements have been concluded and financing under such contracts and agreements is carried out at the expense of allocations from the federal budget, including subsidies on R&D of military, specialized and dual purposes;
- c) executing entities participating in fulfillment of foreign trade contracts on delivery of military-purpose products, as well as produce which is controlled in accordance with the legislation of the Russian Federation on export control.

Audits are aimed, in particular, at checking compliance with mandatory requirements as regards the following:

- 1) disposing of the rights of the Russian Federation to the outputs of intellectual activities;
- 2) inclusion in public contracts and agreements which financing is carried out at the expense of allocations from the federal budget, including subsidies on carrying out of R&D of military, specialized and dual purposes of the terms of distribution and assignment of the rights to outputs of intellectual activities, fulfillment of public accounting and utilization of such outputs, identification of copyrightable outputs of intellectual activities and ensuring of legal protection of such outputs, as well as carrying out of patent research;
- 3) fulfillment of public accounting of the outputs of intellectual activities in the unified register of the outputs of R&D of military, specialized and dual purposes the rights which belong to the Russian Federation;
- 4) organization of utilization of the outputs of intellectual activities the rights to which belong to the Russian Federation;

5) carrying out of measures aimed at identification, prevention and preclusion of actions violating the rights of the Russian Federation to the outputs of intellectual activities;

6) ensuring of legal safeguard and protection of the rights of the Russian Federation to the outputs of intellectual activities used in the course of military and technical cooperation, as well as in export of products controlled in accordance with the legislation of the Russian Federation on export control;

7) granting to foreign customers of the right to utilization of the outputs of intellectual activities in production of such products of military, specialized and dual purposes as include such outputs.

In case of identification of violations of the rights of the Russian Federation, legal entities and individuals to the outputs of intellectual activities as well as a failure to fulfill (undue fulfillment) of instructions of the Federal Service for Intellectual Property, information on violations of the legislation of the Russian Federation and materials of the audit are sent by decision of the head of the Federal Service for Intellectual Property to law-enforcement agencies of the Russian Federation, the Accounting Chamber of the Russian Federation, Federal Service of Financial and Budgetary Oversight and other state authorities of the Russian Federation.

Resolution No. 387 of April 25, 2012 of the Government of the Russian Federation On Forms of Reports Related to Investment of Temporary Available Funds of a Public Corporation and a State-Run Company and the Procedure for Submission and Disclosure of Such Reports approves the forms of reports on investment of temporary available funds, as well as the volume and structure of income and expenditure related to investment of temporary available funds of a public corporation and a state-run company and the procedure for submission of such reports to the Ministry of Finance of the Russian Federation.

According to Resolution No. 387, public corporations and state-run companies are obliged on a quarterly basis to prepare as per specified forms reports on investment of temporary available funds, as well as the volume and structure of income and expenditure as of the end of the last calendar day of the reporting month and submit such reports to the Ministry of the Finance of the Russian Federation not later than the 11th day of the month following the reporting month.

In addition to the above, the information on income and expenditure related to investment of temporary available funds of a public corporation and a state-run company is formed on an annual basis by a state corporation and a state-run company as of the end of the last calendar day of the reporting year on an accrual basis and submitted to the Ministry of Finance of the Russian Federation not later than February 1 of the year following the reporting year.

Such information is subject to publication as a part of the annual report of a public corporation and a state-run company in accordance with the form which was approved by Resolution No. 387. ●