



Summary

The social unrest which marred Putin's presidency has not escalated, due to the government's fierce crackdown on opposition protests. A recent rise in militancy and ethnic tensions is a cause for concern. On the back of high oil and gas export revenues, the external position and public finances remain in healthy shape. However, the budget balance is estimated to record a small deficit in 2012. The high dependence on the hydro-carbon sector remains a structural weakness of the economy. Economic growth is forecast at a moderate 3.8% in 2012 and 3.9% in 2013. Economic diversification, a smaller role of the government, improvement of the business environment and eradication of widespread corruption are key to increase sustainable long-term economic growth, but no progress is expected.

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Russia			
National facts		Social and governance indicators	
Type of government	Federation	Human Development Index (rank)	66 / 187
Capital	Moscow	Ease of doing business (rank)	112 / 185
Surface area (thousand sq km)	17,098	Economic freedom index (rank)	144 / 179
Population (millions)	142.9	Corruption perceptions index (rank)	143 / 183
Main religions	Rus. orthodox (15-20%)	Press freedom index (rank)	142 / 178
	Muslim (10-15%)	Gini index (income distribution)	40.11
Main ethnic groups	Russian (80%)	Population below \$1.25 per day (PPP)	n.a.
	Tatar (4%)		
	Ukrainian (2%)		
Head of State (president)	Vladimir Putin	Foreign trade	
Head of Government (PM)	Dmitriy Medvedev	2010	
Monetary unit	Ruble (RUB)	<i>Main export partners (%)</i>	<i>Main import partners (%)</i>
		Germany	8
		Netherlands	7
		Italy	6
		China	4
		Germany	15
		China	14
		Ukraine	6
		Italy	4
Economy		2011	
<i>Economic size</i>		<i>bn USD</i>	<i>% world total</i>
Nominal GDP	1858	2.69	
Nominal GDP at PPP	2386	3.00	
Export value of goods and services	575	2.61	
IMF quatum (in mln SDR)	5945	2.74	
<i>Economic structure</i>		<i>2011</i>	<i>5-year av.</i>
Real GDP growth	4.3	3.7	
Agriculture (% of GDP)	5	4	
Industry (% of GDP)	37	36	
Services (% of GDP)	59	59	
<i>Standards of living</i>		<i>USD</i>	<i>% world av.</i>
Nominal GDP per head	12991	120	
Nominal GDP per head at PPP	16682	134	
Real GDP per head	6623	81	
		<i>Main export products (%)</i>	
		Oil, fuel & gas	69
		Metals	11
		Chemicals	6
		Machinery & equipment	5
		<i>Main import products (%)</i>	
		Machinery & equipment	45
		Chemicals	16
		Food & agricultural products	15
		Metals	7
		<i>Openness of the economy</i>	
		Export value of G&S (% of GDP)	31
		Import value of G&S (% of GDP)	22
		Inward FDI (% of GDP)	2.8

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Economic structure and growth

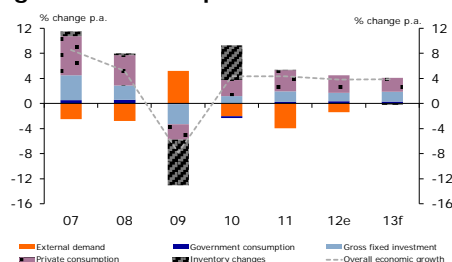
When measured in nominal GDP, which amounted to USD 1,858bn end-2011, Russia is the 10th largest country in the world. With 143 million inhabitants, GDP per capita amounts to USD 12,991 or USD 16,682 in PPP terms. The population of Russia is shrinking, as a census revealed that the population has decreased from 148 million in 1991 due to an unhealthy life style and alcohol abuse among men specifically. The business environment is hampered by a plethora of factors. The Russian labor force is skilled, but there are shortages in banking and other professional services, and unemployment is elevated at 6% of the labor force. While the level of infrastructure varies throughout the country, the roads are generally poor. Corruption remains deeply embedded in Russia and is a widespread problem.

Although the country's economy is somewhat diversified, the non-energy sector is largely uncompetitive. Therefore, the economy is highly dependent on commodity production, particularly on the oil and gas sector. This sector accounts for around 28% of GDP and 67% of total exports. Gazprom alone accounts for 8% of GDP, 20% of exports and 85% of total Russian gas output. The rebound of oil and gas prices in 2010 and 2011 has had a positive effect on Russia's overall economic performance. At the same time, falling oil prices pose a downside risk to Russia's economic performance in the coming years. Oil, fuel, gas and metals are Russia's main export



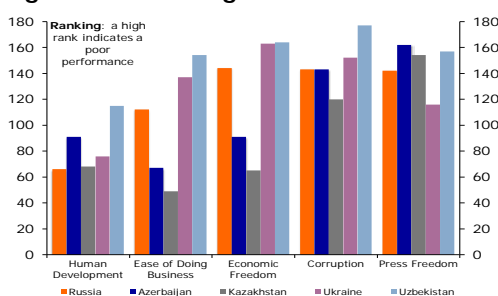
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Figure 1: Growth performance



Source: EIU

Figure 2: Social & governance indicators



Source: EIU

products and Italy and Germany are the country's main export partners. Russia's economic growth is estimated at 3.8% in 2012. In the strong 1H12, growth was boosted by the government's pre-election spending and strong consumer demand. However, in 2H12 we estimate that growth will slow as the government's pre-election spending spree is over. Furthermore, a hike of utility prices in July and the drought and wildfires this summer, which severely affected agricultural output and has boosted food prices, will erode consumers' purchasing power and decrease domestic consumption. For 2013, we forecast economic growth to remain stable at a moderate 3.9%.

Political and social situation

The political unrest that followed parliamentary elections in November 2011 and which preceded the presidential election in March 2012 has not diminished. Although this is not on the scale of the Arab Spring, it is likely to continue during Putin's presidency. While Putin made large spending commitments prior to and during his election campaign, these appear to have carried little weight with the disaffected middle class, who continue to express their discontent. Mass demonstrations were most recently held in June and September, but the government continues to crack down hard, in particular by repressive measures such as harsh new penalties on illegal demonstrations and the prosecution of 17 people for participation in clashes during a May rally. In addition to demands for Putin's resignation and early presidential and parliamentary elections, protesters added to their list of demands support for trade unions and caps on utility payments. A significant development in the most recent protests was the prominence of communists, even though the Communist Party of the Russian Federation had kept a distance from the protest movement so far. However, the opposition remains too fragmented to make a unified stand against Putin and his ruling United Russia Party.

As a large multi-ethnic state, Russia faces a number of security concerns, most of which originate from the North Caucasus region, resulting from the two bloody military campaigns in Chechnya. The guerilla fighters from Chechnya have become more religious and have included members of Muslim Caucasian ethnic groups. In 2012, the number of terrorist attacks in the North Caucasus has increased and has become a larger concern. Russia has improved relations with the West after the low point in 2008, following its involvement in the separatist conflict in Georgia. Especially with the US, relations improved in the field of containing Iran's nuclear ambitions and supporting the Western coalition fight in Afghanistan. The signing of a treaty to reduce the nuclear arsenal in the US and Russia last year was another milestone as well as Russia's accession to the WTO after 18 years of negotiations. However, thorny issues remain, especially NATO's plans on an anti-ballistic



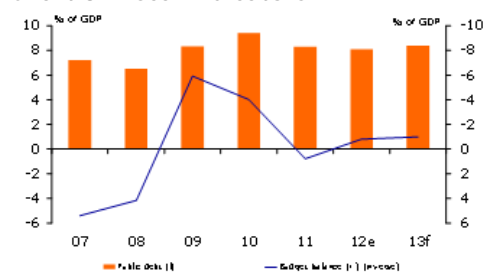
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missile shield in Eastern Europe and Russia's opposition to a regime change in Syria via an international, but mostly Western, intervention.

Economic policy

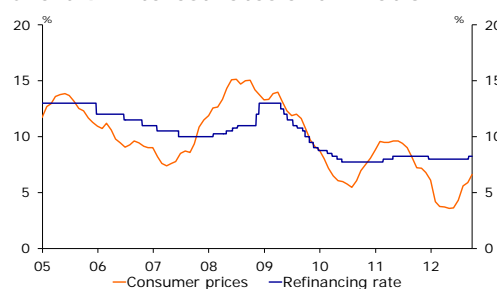
Public finances are healthy, since public debt is low at an estimated 8% of GDP in 2012 and we estimate a slight 0.8% of GDP budget deficit in 2012. Fiscal policy will actually remain mildly restrictive, if we believe the 2013 draft budget. The main departure from previous years is that the budget calculations are based on a formal restriction on the use of oil and gas revenue. For the 2013 budget, an average oil price of USD 91 per barrel is assumed. All revenue arising from prices above this ceiling will be set aside in a special fund. By contrast, the current 2012 budget projection is based on an oil price of USD 115 per barrel, which is too optimistic. As such, significant downside risks are present to the 0.8% of GDP budget deficit forecast for 2012. The government remains highly reliant on hydro-carbons for its revenues. Tax collection remains inefficient and tax evasion is widespread. Another revenue source could be the large-scale privatization program of 5,500 businesses announced in 2011. However, for this to be successful, the government needs to severely boost foreign investor confidence regarding the safety and transparency of the privatization process, which is rife with corruption. However, given the track record of the Russian government, no significant progress is expected. On the expenditures side, aside from the need for pension reform, Mr. Putin has pledged to increase spending on the military, health care and public sector wage hikes. If delivered, these increases could add up to 6% of GDP over his six-year term. The government has argued that it should be possible to absorb the additional costs of these election pledges within existing budget targets by making savings elsewhere in the budget. At this stage, it remains unclear how this will be achieved and it is unlikely this will succeed. Overall, the fiscal position is healthy but the risks of deterioration are high given the government's optimistic budget assumptions.

Chart 3: Fiscal indicators



Source: EIU

Chart 4: Interest rates and inflation



Source: EIU

Inflation was boosted in 2012 by a hike of utility prices in July and the drought and wildfires in the summer months, which severely affected grain harvest. As such, we estimate inflation to average 5.3% in 2012, and rise to 6.5% in 2013. The Russian central bank (CB) has increased its main policy rate from 8% to 8.25% in September in response, but is cautious to raise rates further, as this could adversely affect economic growth. The CB shifted to a more flexible exchange rate regime, which has helped reduce financial instability. Previously, the ruble was officially allowed to trade in a band between 24 and 41 against the 55% USD/ 45% EUR basket. Since 2010, the CBR does not target any level of the exchange rate and allows changes to be largely driven by the market. However, the CBR maintains the ruble exchange rate against the 55% USD/45% EUR



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basket and leans against the wind as it allows a RUB 0.05 change in the rate for every USD600m of FX interventions it has to make. By allowing a larger two-way flexibility, the CBR has enhanced the credibility of the new regime.

Balance of Payments

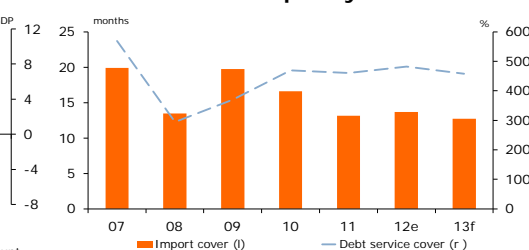
Russia's exports are undiversified and rely heavily on oil and gas exports and to a lesser extent on metals exports. Driven by these commodity exports, however, Russia's trade balance has shown healthy surpluses year after year. In the past 5 years, as import growth outpaced export growth, the trade surplus has started to narrow. Russia's current account balance has, due to the large surplus on the trade balance, also been in surplus since 1999, averaging 9.3% of GDP from 2000-2010. In 2012, the current account surplus will decrease to 4.4% of GDP from 5.4% in 2011. Going forward, several downside risks prevail. An escalation of the eurozone peripheral crisis will reduce external demand from Russia's major export markets such as Italy, the Netherlands and Germany. China is also a major export market for Russia, and the possible economic slowdown in China will adversely affect demand for Russia's export. Thus, a prolonged fall in global oil prices is a serious concern for the health of Russia's balance of payments. Furthermore, the risk of a sudden reversal of capital inflows pose a downside risk to Russia's economy and the health of the external accounts, as Russia is prone to capital flight in times of economic stress. FX-reserves are estimated to increase to USD 517bn end-2012 from USD 454bn at end-2011, but such a steep rise is unlikely to be repeated in 2013.

Chart 5: Current account



Source: EIU

Chart 6: External liquidity



Source: EIU

External position

Russia's external position is very healthy. With total external debt estimated at USD 455bn at end-2012 and FX-reserves at USD 517bn, Russia is a net external creditor. The overall level of external debt, most of which private sector debt, is also relatively low at 24% of GDP and debt service is manageable at 16% of total export receipts. Furthermore, short term debt amounts to only 9% of total external debt. Also, the high level of FX-reserves offers cover for 14 months of imports and 482% of debt service, both very sound levels. Finally, due to the current account surplus and the high level of FX-reserves, the external liquidity ratio stands at above 200%.



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Russia							
Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
<i>Key country risk indicators</i>							
GDP (% real change pa)	8.5	5.2	-7.8	4.3	4.3	3.8	3.9
Consumer prices (average % change pa)	9.0	14.1	11.7	6.9	8.4	5.3	6.5
Current account balance (% of GDP)	6.0	6.2	4.0	4.8	5.4	4.4	2.8
Total foreign exchange reserves (m USD)	466750	411750	416649	443586	453948	517110	529550
<i>Economic growth</i>							
GDP (% real change pa)	8.5	5.2	-7.8	4.3	4.3	3.8	3.9
Gross fixed investment (% real change pa)	21.0	10.6	-14.4	5.8	8.0	6.0	7.0
Private consumption (real % change pa)	14.3	10.6	-5.1	5.2	6.8	5.4	4.1
Government consumption (% real change pa)	2.7	3.4	-0.6	-1.4	1.5	2.0	2.0
Exports of G&S (% real change pa)	6.3	0.6	-4.7	7.0	0.4	5.4	6.9
Imports of G&S (% real change pa)	26.2	14.8	-30.4	25.8	20.3	13.4	8.9
<i>Economic policy</i>							
Budget balance (% of GDP)	5.4	4.1	-5.9	-4.0	0.8	-0.8	-1.0
Public debt (% of GDP)	7	7	8	9	8	8	8
Money market interest rate (%)	6.9	9.4	15.3	5.6	5.3	5.0	5.1
M2 growth (% change pa)	43	1	18	31	23	23	20
Consumer prices (average % change pa)	9.0	14.1	11.7	6.9	8.4	5.3	6.5
Exchange rate LCU to USD (average)	25.6	24.9	31.7	30.4	29.4	31.3	31.9
Recorded unemployment (%)	6.1	6.4	8.4	7.5	6.6	6.2	6.1
<i>Balance of payments (m USD)</i>							
Current account balance	77768	103661	49365	71129	100342	85060	58350
Trade balance	130915	179742	111585	151393	197967	184320	158900
Export value of goods	354401	471603	303388	400131	520284	542450	559450
Import value of goods	223486	291861	191803	248738	322317	358130	400550
Services balance	-18888	-24336	-19883	-27300	-37192	-36190	-35380
Income balance	-30752	-48980	-39475	-48373	-57240	-59290	-61070
Transfer balance	-3506	-2765	-2862	-4097	-3193	-3780	-4100
Net direct investment flows	9159	19408	-7166	-9234	-14404	-1000	7000
Net portfolio investment flows	-30952	-50840	-213	-16561	-32947	-20780	-25240
Net debt flows	103567	46394	-19351	13663	35094	37690	37940
Other capital flows (negative is flight)	15487	-171102	-9472	-19070	-68814	-38520	-65590
Change in international reserves	175030	-52479	13163	39927	19271	62460	12460
<i>External position (m USD)</i>							
Total foreign debt	361338	402726	373419	384739	423394	455160	491930
Short-term debt	72001	54801	32303	38756	38320	39900	36520
Total debt service due, incl. short-term debt	82099	139920	112659	94579	98624	107340	115500
Total foreign exchange reserves	466750	411750	416649	443586	453948	517110	529550
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	10.1	10.8	9.1	10.2	10.7	9.5	7.7
Current account balance (% of GDP)	6.0	6.2	4.0	4.8	5.4	4.4	2.8
Inward FDI (% of GDP)	4.2	4.5	3.0	2.9	2.8	2.6	2.8
Foreign debt (% of GDP)	28	24	31	26	23	24	24
Foreign debt (% of XGSIT)	80	68	96	79	68	70	73
Debt service ratio (% of XGSIT)	18	23	29	19	16	16	17
Interest service ratio incl. arrears (% of XGSIT)	4	4	5	4	2	2	2
FX-reserves import cover (months)	19.9	13.5	19.7	16.6	13.1	13.7	12.7
FX-reserves debt service cover (%)	569	294	370	469	460	482	458
Liquidity ratio	231	192	223	223	211	209	199

Source: EIU

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