Country update **RUSSIA**

Summary

Russia's economic recovery from the global financial and economic crisis has been disappointing. Real GDP growth amounted to a slightly lower than expected 4% last year. In spite of recent high oil prices, growth actually slowed in the first quarter of this year. Increasing inflation, estimated to average 9% in 2011, is hurting consumer confidence and spending. The Central Bank was slow to act, and raised the policy interest rate by 50bp to 8.25% only recently. Meanwhile, investor confidence is subdued by the political uncertainty surrounding the upcoming presidential election in March 2012 and the prospect of higher interest rates. The government is benefitting from high oil prices, as the resulting extra revenues have put the government ahead of schedule with regard to the medium-term fiscal plan. The current account will start to weaken in the years ahead, as import growth outpaces growth of Russia's undiversified exports. Meanwhile, Russia is closer than ever in joining the WTO, with only one hurdle left to take: support from Georgia.

Things to watch:

- Slow and disappointing economic recovery
- Weakening of the current account on the medium term
- Russia joining the WTO

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Russia

National facts		
Type of government	Federation	
Capital	Moscow	
Surface area (thousand sq km)	17,098	
Population (millions)	141.9	
Main religions	Rus. orthodox (15-20%)	
	Muslim (10-15%)	
Main ethnic groups	Russian (80%)	
	Tatar (4%)	
	Ukrainian (2%)	
Head of State (president)	Dmitriy Medvedev	
Head of Government (PM) minister)	Vladimir Putin	
Monetary unit	Ruble (RUB)	
Economy		2010
Economic size	*bn USD*	*% world total*
Nominal GDP	1465	2.35
Nominal GDP at PPP	2231	3.01
Export value of goods and services	442	2.38
IMF quotum (in mln SDR)	5945	2.74
Economic structure	*2010*	*5-year av.*
Real GDP growth	4.0	4.1
Agriculture (% of GDP)	4	5
Industry (% of GDP)	37	36
Services (% of GDP)	59	58
Standards of living	*USD*	*% world av.*
Nominal GDP per head	10337	105
Nominal GDP per head at PPP	15745	135
Real GDP per head	6380	80

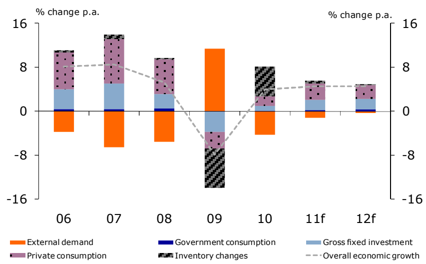
Social and governance indicators			rank / total
Human Development Index (rank)			65 / 169
Ease of doing business (rank)			123 / 183
Economic freedom index (rank)			143 / 179
Corruption perceptions index (rank)			154 / 178
Press freedom index (rank)			140 / 178
Gini index (income distribution)			43.7
Population below $1.25 per day (PPP)			2.0%
Foreign trade			2009
Main export partners (%)		*Main import partners (%)*	
Germany	12	Germany	14
Netherlands	7	China	13
Turkey	5	Japan	5
Italy	4	Ukraine	5
Main export products (%)			
Oil, fuel & gas			67
Metals			13
Machinery & equipment			6
Chemicals			6
Main import products (%)			
Machinery & equipment			43
Food & agricultural products			18
Chemicals			17
Metals			7
Openness of the economy			2010
Export value of G&S (% of GDP)			30
Import value of G&S (% of GDP)			22
Inward FDI (% of GDP)			2.5

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

Introduction and update

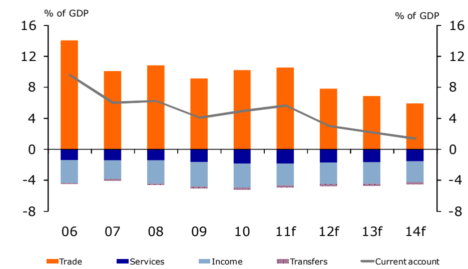
Russia's economic recovery has been disappointing, with real GDP growth slightly below expectations at 4% in 2010, against earlier estimates of 4.2%. Recent high international oil prices have also not (yet) given a boost to Russia's economy. The importance of the oil and gas sector to Russia's economy would suggest some positive impact on growth. However, compared to the last quarter of 2010, when real GDP increased by 4.5% year-on-year, economic growth actually slowed to 4.1% in the first quarter of 2011. The slowdown is a reflection of the headwinds Russia's economy is facing, which are adversely affecting the two main contributors to GDP growth (private consumption and investments). Private consumption growth is being subdued by rising inflation, which has risen from a low of 5.5% in July 2010 to 9.5% year-on-year in March this year, mainly on the back of higher food and energy prices. Annual inflation is estimated to average 9.1% in 2011, which is higher than the 7.8% estimated before. The Russian Central Bank has been slow in raising interest rates, as it wants to continue to support the lacklustre economic recovery and stimulate credit expansion. The policy interest rate was raised by only two small 25bp steps since mid-2010 to 8.25%, but further interest rate hikes are expected in the remainder of the year. Investor confidence is already being negatively affected by increased political uncertainty because of the March 2012 presidential election and the anticipation of more interest rate hikes. This will further reduce confidence amongst foreign and domestic investors. As a result, investment growth, which was negative in the first quarter, will continue to disappoint. Government income, meanwhile, benefits directly and indirectly (through taxes) from high oil prices. With the presidential election approaching, it is likely that the bulk of the extra income will be spent. Nonetheless, the windfall revenues are helping to achieve the government's budget plans more rapidly. Instead of a deficit of 3.9% of GDP, as predicted earlier, a budget deficit of 2.7% of GDP is currently estimated for 2011. As a result, Russia is ahead of schedule on the planned reduction of the budget deficit under the government's medium-term program. With the anticipated increase of government spending in the second half of the year, and barring a sudden decrease of oil prices, economic growth will accelerate again in the second half of the year. For the whole of 2011, real GDP growth is estimated at 4.5%, implying an ongoing but slow recovery.

Chart 1: Growth performance



Source: EIU

Chart 2: Current account



Source: EIU

Current account set to weaken in the medium term

Russia's current account will expectedly weaken in the coming years, with the current account surplus starting to narrow from 2012 onwards. Because oil and gas prices are expected to remain more or less steady in the coming years, export growth will depend on either increased output of the oil and gas sector or on higher non-oil hydrocarbon exports. However, investments in the oil and gas sector are thought to be insufficient to significantly increase output in the long-term. At the same time, the non-hydrocarbon sector has largely been rendered uncompetitive as a result of the symptoms of Dutch disease (Russia's real exchange rate appreciated by 49% since end-2003), which makes a strong increase of non-hydrocarbon exports unlikely. Meanwhile, import growth is expected to remain strong on the back of an appreciating currency and an ongoing recovery of domestic demand. As a result, the trade surplus will narrow from 2011 onwards, which will lead to a deterioration of the current account surplus from 5.6% of GDP in 2011 to an estimated 3% of GDP in 2012. While the current account will deteriorate, capital inflows will continue to suffer from Russia's poor investment climate and, at least until the elections in March 2012, increased political uncertainty. The latter will undermine FDI inflows, which are not expected to pick up significantly until after the elections. Furthermore, portfolio inflows are subdued as well, while private capital outflows remain large. Although troubling, the weakening of the current account is a medium-term concern. Russia currently has ample FX-reserves valued at over USD 500bn, which is equal to 17 months of imports, and the country's liquidity ratio is very strong at 220%.

Russia close to joining the WTO

Russia is very close to joining the World Trade Organisation (WTO). Other BRIC countries have supported a quick accession of Russia to the WTO, an agreement was reached with the EU, and the president of the United States has endorsed Russia's bid to join. There is one more hurdle left to take: Russia has to reach an agreement with Georgia, a small country that is a WTO member and can thus veto Russia accession, about the issue of whether or not to maintain border posts between the countries. This is proving a tricky subject and the timetable has been pushed back as a result. Russia is now expected to join the WTO in the second half of 2011 at the soonest.

Russia

Selection of economic indicators	2006	2007	2008	2009	2010	2011f	2012f
Key country risk indicators							
GDP (% real change pa)	8.2	8.5	5.2	-7.8	4.0	4.5	4.5
Consumer prices (average % change pa)	9.7	9.0	14.1	11.7	6.9	9.1	7.7
Current account balance (% of GDP)	9.6	6.0	6.2	4.0	5.0	5.6	3.0
Total foreign exchange reserves (mln USD)	295568	466750	411750	416649	443586	524590	552740
Economic growth							
GDP (% real change pa)	8.2	8.5	5.2	-7.8	4.0	4.5	4.5
Gross fixed investment (% real change pa)	18.0	21.0	10.6	-14.4	3.5	8.0	7.8
Private consumption (real % change pa)	12.2	14.3	10.6	-4.8	2.7	4.5	4.0
Government consumption (% real change pa)	2.3	2.7	3.4	-0.5	0.7	1.5	2.0
Exports of G&S (% real change pa)	7.3	6.3	0.6	-4.7	11.1	5.5	5.1
Imports of G&S (% real change pa)	21.3	26.2	14.8	-30.4	25.4	8.4	5.7
Economic policy							
Budget balance (% of GDP)	7.4	5.4	4.1	-5.9	-4.1	-2.7	-2.9
Public debt (% of GDP)	9	7	7	8	9	10	10
Money market interest rate (%)	6.3	6.9	9.4	15.3	5.6	5.4	6.2
M2 growth (% change pa)	49	48	2	16	29	27	19
Consumer prices (average % change pa)	9.7	9.0	14.1	11.7	6.9	9.1	7.7
Exchange rate LCU to USD (average)	27.2	25.6	24.9	31.7	30.4	29.0	28.0
Recorded unemployment (%)	7.2	6.1	6.4	8.4	7.5	6.8	6.2
Balance of payments (mln USD)							
Current account balance	94686	77768	103661	49365	72600	98860	59550
Trade balance	139269	130915	179742	111585	149200	185840	154260
Export value of goods	303550	354401	471603	303388	398000	470120	457020
Import value of goods	164281	223486	291861	191803	248800	284280	302750
Services balance	-13614	-18888	-24336	-19883	-27300	-32200	-34390
Income balance	-29432	-30752	-48980	-39475	-45201	-49580	-54010
Transfer balance	-1537	-3506	-2765	-2862	-4100	-5200	-6320
Net direct investment flows	6551	9159	19408	-7743	1000	3000	11000
Net portfolio investment flows	-1623	-30952	-50840	-1972	-11261	-19970	-20470
Net debt flows	37252	110482	12792	-11813	17610	28180	23370
Other capital flows (negative is flight)	-15374	8572	-137500	-14674	-40022	-26150	-45910
Change in international reserves	121492	175030	-52479	13163	39927	83920	27540
External position (mln USD)							
Total foreign debt	250747	368075	402453	387537	402208	429740	449960
Short-term debt	40453	79106	54655	42133	48458	49980	43330
Total debt service due, incl. short-term debt	60631	82264	147044	100125	105670	118160	127420
Total foreign exchange reserves	295568	466750	411750	416649	443586	524590	552740
International investment position	-38543	-150220	255474	118385	n.a.	n.a.	n.a.
Total assets	731590	1092560	1011380	1109160	n.a.	n.a.	n.a.
Total liabilities	770133	1242780	755906	990775	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	14.1	10.1	10.8	9.1	10.2	10.6	7.8
Current account balance (% of GDP)	9.6	6.0	6.2	4.0	5.0	5.6	3.0
Inward FDI (% of GDP)	3.0	4.2	4.5	3.0	2.5	2.4	2.6
Foreign debt (% of GDP)	25	28	24	32	27	24	23
Foreign debt (% of XGSIT)	68	82	68	100	82	75	79
International investment position (% of GDP)	-3.9	-11.6	15.4	9.7	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	16	18	25	26	22	21	22
Interest service ratio incl. arrears (% of XGSIT)	4	4	4	2	2	2	2
FX-reserves import cover (months)	17.0	19.9	13.5	19.7	16.6	17.3	17.0
FX-reserves debt service cover (%)	487	567	280	416	420	444	434
Liquidity ratio	226	231	189	224	214	220	210

Source: EIU