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Russia

The perceived perils of acceding to the WTO

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Investment summary

Positives

- Russia is rich with natural resources. Therefore, in the medium to long term, Russia has a significant potential, as all core materials are available within the country.
- We believe that WTO agreements, ratified by Russian Parliament on 10 July and signed by the president on 21 July, might bring positives to metallurgical sector and trade (the latter would increase the distribution of imported goods, which is not good for domestic producers). The benefits to the other sectors are under question.
- At the same time, we hope that the negatives from entering WTO would be limited because many existing inter-border trade conditions in Russia had already been close to WTO conditions, before Russia entered WTO.
- We hope that Russian domestic producers will be strong enough to sustain competition with large global companies at least on the local market, despite higher cost of capital and unfriendly weather conditions in Russia.
- Russian banking system looks stronger than Kazakhstan's banking sector, both in terms of portfolio growth (up 29% YoY versus 17% YoY growth in Kazakhstan) and of NPLs.
- While authorities rely on the inflow of FDI because of WTO membership, we hope that domestic investors will become more patriotic, and find efficient investments opportunities within the country, stimulating domestic producers to increase both the quality and amounts of non-resource outputs.
- We believe that the final state of Russian economy will highly depend on the power of domestic producers to expand their production and succeed in competition on Russian market.
- The ratio of foreign reserves to money supply in Russia declined to 64%, and the ratio of reserves to monetary base remained at around 200%. Though these metrics suggest that at the moment Russian Central Bank is powerful, a further fast monetary expansion might increase the risks for RUB, unless Russian producers manage to substitute a notable part of imported goods with domestic products (not very likely, in our view).
- We see upward trends in production of major commodities in Russia. January-October production of oil & gas condensate grew by 0.9% YoY, coal production – by 7.0% YoY.

Negatives

- We see appealing negatives and risks for Russian producers because of the ratification of WTO agreements. We believe that there is a serious risk that instead of improvements, WTO membership might freeze unsatisfactory position of domestic producers, at least. In an extreme case, the ratification can further increase a penetration of foreign goods into domestic market, and lead to a loss of a significant part of domestic market by domestic producers. In a medium-term scenario, foreign producers/investors would build more production facilities in Russia, but this might actually lead to an increase in net foreign currency outflow from the country (though investment income outflow), unless created enterprises will be exporting the principal part of its outputs abroad (quite questionable).
- Though Russia opened widely its markets for foreign goods back in early 1990s, this did not work like a right policy to build up new large manufacturing industries in Russia. We believe that countries targeting a success first make their manufacturing goods ready to compete on foreign markets, increase production capabilities, and only then enter WTO. This does not mean that Russia has no competitive manufacturing goods available for selling abroad, but Russian current "exporter's loss" (due to discrimination of Russian goods on foreign markets which would end because of entering WTO, as officials hope) is estimated (by Russian Ministry of Economic Development) at USD2.0bn/year, which is only 0.4% of Russian annual exports. This suggests that positives from WTO will be very limited for Russia, whereas negatives from loosing perspectives to change and tools to support own industries can overweight. Outside of WTO, Russia was potentially able to protect (but did not use this tool at large) its manufacturers through high import duties on industries' outputs, making particular industries profit from domestic market in exchange to obligation to increase both the quality of goods and production capacities, and only then decrease imports duties in combination with entering WTO. We understand that in this scenario, other countries would be largely against accepting Russia in WTO. The latter might be one of justifications of political decision to enter WTO, despite economic justification is under a big question, in our view.
- As Russian ratified WTO agreements, we expect now that imports in Russia might increase faster than oil price level suggests. Increase in imports would create some additional pressure on foreign reserves.
- Severe weather conditions, large size of the country (requiring more fuel for heating and internal transportation) and high cost of capital (Russian Central Bank does not act as a full-fledged emission centre) bring additional negatives to the level of competitiveness of Russian producers, who have limited access to cheap funding and modern technologies.
- We probably have already seen the first signs of negative effect from signing WTO agreements (signed by Russia representatives in December 2011) in GDP and investment statistics. As we can see, producers working in Russia (even domestic) and investors realize the risks from joining WTO, and therefore try to redirect funds to outside of the country.
- The share of manufacturing in 1H2012 nominal GDP decreased to 13.3% from 13.8% in 1H2011, while the share of trade in GDP (supported by

selling more imported goods) expanded to 16.5% from 16.3% in 1H2011 (1H2012 imports are up by 4.3% YoY). We also note that trade was the largest contributor to real GDP growth. In 1H2012, trade brought 1.3% YoY growth from 4.5% YoY total real GDP growth. In addition, both inward FDI withdrawal and outward FDI increased in 2011, as we believe at least partially due to WTO membership anticipation.

- We put a question mark on the massive FDI inflow Russia authorities anticipate after Russia enters WTO. Even in case of a positive outcome, withdrawal of dividends from Russia made by foreign investors can mitigate a significant part of positive effects for the country.
- We believe that not many investors would readily transfer their technologies into Russia, where cost of production is naturally higher due to weather conditions and other. Obviously, WTO membership does not guarantee that technology-owners would prefer to transfer production facilities to Russia instead of keeping them inside their own countries, especially in situation when global demand is falling since many global debts are reaching their limits (spending borrowed money has being increasing global demand).

Contents

Political situation in Russia

We believe that protest meetings in Russia in late 2011 – early 2012 indicate that people note a difference between claims made by officials and reality. At the same time, we believe that most of "opposition leaders" popular news media shows might make economic situation in Russia even worse if they come to power, as many of these "leaders" either personally participated in the chaos of 1990s or clearly mimic it by supporting deregulation strongly. In parallel, we probably only see the first steps truly patriotic people do on their way to direct the country from Russia's national interests' perspective. However, wide population does not know these people yet, as liberal concept still prevails in the news.

Though overwhelming majority (63.6%) of voting population finally supported Mr Putin on presidential elections this spring, his result was a bit lower than 71.3% votes he got in 2004.

We believe that the weaker support of Mr Putin was triggered by some contradictions the population feels between generally good intensions Mr Putin expresses and real implementations (sometimes mistakes) made by him, his team, and smaller officials (who are supposed to obey Mr Putin or "pro-Putin's" officials). At the same time, the majority of population strongly dislikes many of "new" and former "opposition leaders" (despite they try to show off) because of their personal roles in the chaos of 1990s and the support of deregulations. Therefore, people prefer to vote for Mr Putin who at least brought a number of positives to the country (resolved Chechen conflict problem, fought at least open criminals, stabilized the country), hoping that he is sincere and would have enough power (and support) to bring a better order to the country.

Entering WTO is one of the examples where the motivation behind the position of Mr Putin (and Mr Medvedev too) is not clear. Probably, his pro-WTO position can be explained by a combination of complex geopolitical factors, non-public details, limited power, and some other factors behind the scene. However, the fact is that Putin's party United Russia members gave 235 votes out of 238 total votes for WTO membership. Other 212 members (99% of other parties' representatives) did not support WTO membership.

Awarding St. Andrew' order to Mr Gorbachev by Mr Medvedev in spring 2011 is another unclear sign from "Putin's" people. Though Western countries praise Mr Gorbachev, Mr Gorbachev is extremely unpopular (despite massive PR campaigns) in Russia among broad population due to his and his team's role in the collapse of Soviet industries and finally in the collapse of USSR.

The discussions about "second privatization, which would be honest this time" also brings skepticism about real intentions of Putin's team. Broad population remains strongly negative about moving large industries to private hands.

When population sees these hardly-explainable decisions, it tries to protest. However, people, who responsible for even larger chaos in 1990s, claim themselves as leaders of "people's protest movements" or "leaders of unsystemic opposition"! In reality, protesting people (often showed as people supporting "unsystemic opposition") say that they do not like both Putin team's implementations and people who appear on the scene as "unsystemic opposition" during the meetings, because in fact they do not offer a better life, but more chaos. For sure, there are young people, who do not remember 1990s well enough and therefore are ready to support anyone who is not Putin.

As a reaction on such a disorder, patriotic powers (who both support positives that Putin brings and openly dislike negatives that Putin brings) are now joining and forming a new party "New Great Russia". On 4 February 2012, the joint coalition of these patriotic powers led "anti-orange" meeting in Moscow on Poklonnaya Gora, in which 135k people participated – which is more than the number of people visited the famous liberal "opposition" meeting on Bolotnaya Square the same day. The latter meeting was broadly screened on foreign channels, whereas the first either was not, or misinterpreted as a second anti-Putin meeting.

There is a strong anti-liberal trend in Russia these days. People demand more order, logical, patriotic and responsible decisions. People say "yes to Putin, but say that positives which Putin brings are not enough. We do not like negatives. We disagree with Putin on many important points, but existing opposition might be much worse than Putin". We note that the Communist Party on both parliament and presidential elections takes the second place.

Certainly, by the end of 1980s, people were disappointed by Communists' inability to organize economy transformations and set proper motivations for people, as well as by inability to balance national interests. However, people do partially remember positives that existed in USSR – free access to higher education for capable people, affordable for broad population kindergartens, State medicine, intensive construction works (including massive construction of multi-storey residential real estate), creation of fundamental industries (including aerospace and nuclear industries), science, and a lot more, which existed without a need for massive FDI. As in 1980s, people now expect improvements, but not destructions (which often were the case in 1990s) some "opposition leaders" are targeting by hiding the target behind democratic and liberal rhetoric. Unfortunately, not all of "protesting" people are ready (and have right knowledge) to work hard, some of them just "demand".

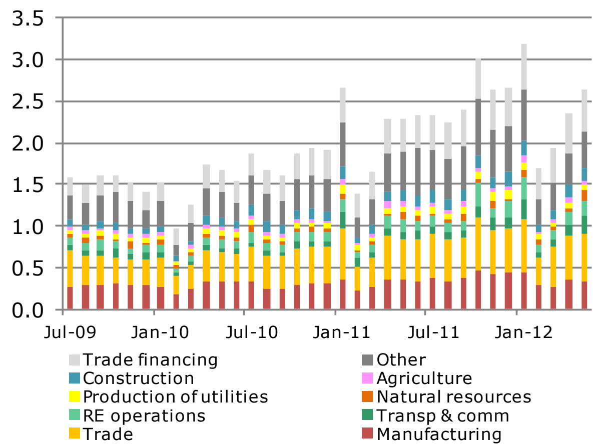
The bad point for Russia is that distinguishing a good thing from a bad thing requires both detailed information and qualifications. The majority of voting people does not have them, and therefore they can be highly influenced by PR technologies from all sides. It is a common practice for politicians these days (generally around the world) to use different kinds of manipulations. As a result, people in Russia become disoriented, and actually do not know what to demand and from whom to expect actual improvements, and who would really prioritize national interests of Russia, and would not get too much involved into political games with a lot of promises and no results.

Russian banking system

Russian banking system experienced a rapid 23% YoY growth in 2011. The growth was accompanied by a 15% YoY increase of overdue amounts (but the share in the total loan portfolio decreased moderately). We note that CBR currently provides a notable support to Russian banks through to REPO. We believe that the quality of loans might moderately deteriorate if loan growth slows down, However, the overall loan quality is likely to remain acceptable. We see some additional risks related to loans to manufacturing (20% of sector portfolio), because Russia joined WTO.

Russian banking system in 2011-2012 is characterized by moderately high monthly lending volumes (which lifted outstanding loans up by 23% YoY by YE2011, and further up by 29% YoY as of end of May, Figure 2), and moderate overdue amounts. Note that while currently overdue principal in Kazakhstan's banks totals 19.1% of outstanding loans, the same figure for Russian banks is 4.2% only. NPLs in Kazakhstan's banking system are at 37% (24% without BTA, Alliance and Temir banks), while NPLs in Russian banking system are at 10%.

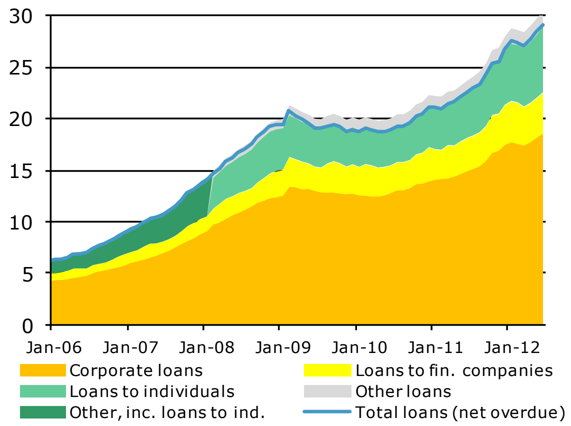
Figure 1. New loans by sector, RUBtr/month



Source: Central Bank of Russia

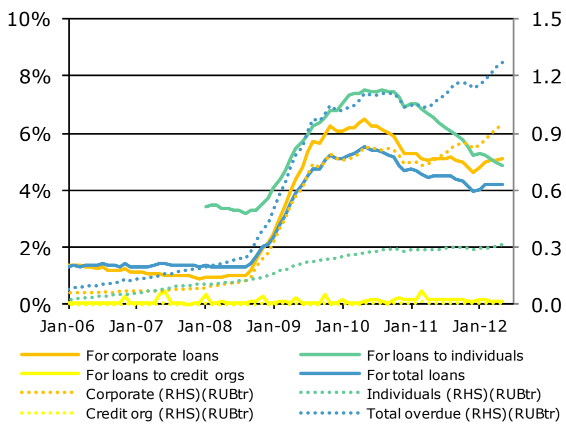
We note that in absolute terms, the overdue amounts for corporate loans have been growing since early 2011 (dot orange curve on Figure 3), which was the main driver of the growth in overall overdue amounts (dot blue curve on Figure 3). Overdue amounts for retail loans grew slowly.

Figure 2. Outst. loans by borrower type, RUBtr



Source: Central Bank of Russia

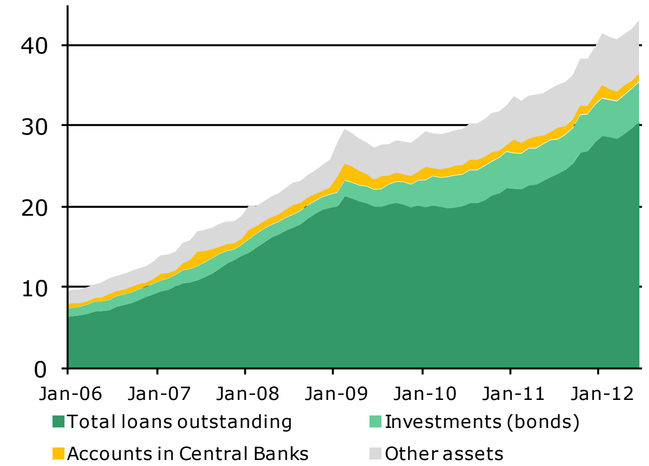
Figure 3. Overdue amounts by sector



Source: Central Bank of Russia

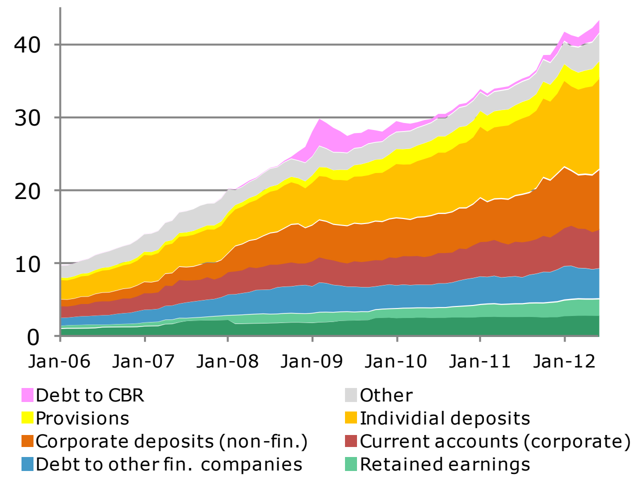
We note that by YE2011, the Central Bank of Russia increased the support of Russian banking system (purple area on Figure 5). Therefore, now the situation starts to resemble the situation in late 2008 – early 2009, when CBR had to expand its support to banking system rapidly with a peak at RUB3.6tr ($102bn) as of January 2009. As of May 2012, the outstanding support of CBR to Russian banking system was RUB1.7tr ($51bn). As we understand, the principal part of the support comes through REPO operations with CBR (Figure 6).

Figure 4. Banking sector by asset type, RUBtr



Source: Central Bank of Russia

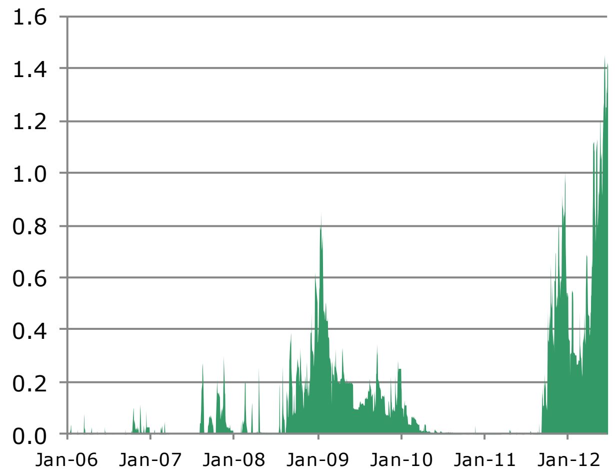
Figure 5. Banking sector liabilities, RUBtr



Source: Central Bank of Russia

We note that the share of deposits and current accounts in the structure of banking sector liabilities increased to 61% from 51% in early 2009, which suggests a lower sensitivity to wholesale funding, but a higher sensitivity to deposit withdrawal in case of turbulence.

Figure 6. Banking sector REPO /w CBR, outstanding, RUBtr

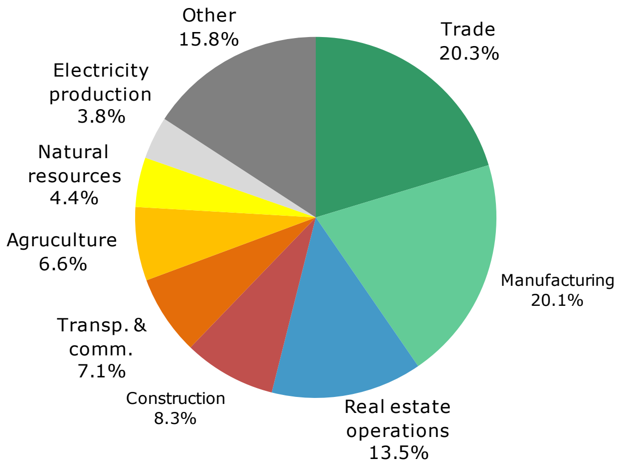


Source: Central Bank of Russia

A share of banking loans to manufacturing (20.1%, Figure 7) and agriculture (6.6%) is substantial, which is in some contrast to Kazakhstan's banks 8.3% (manufacturing) and 3.2% (agriculture). Therefore, Russian banks, compared to banks in Kazakhstan, provide higher share of loans to producing (supply side) of the economy. At the same time, loans to construction in Kazakhstan's banking system are

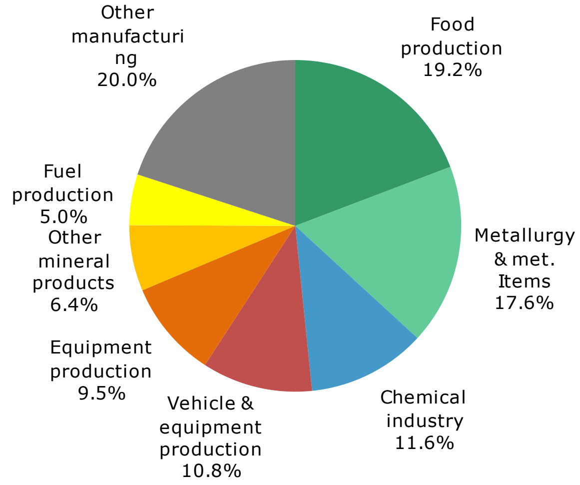
14.5% of outstanding portfolio, while loans to construction in Russia are at 8.3% of total sector portfolio.

Figure 7. Outstanding loans, USD597bn



Source: Central Bank of Russia

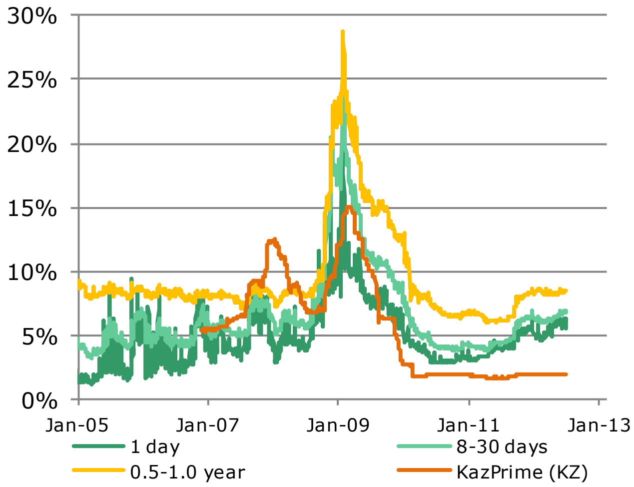
Figure 8. Loans to manufacturing, USD120bn



Source: Central Bank of Russia

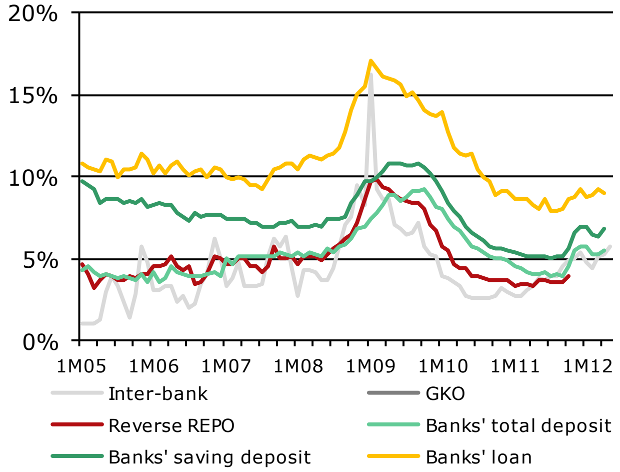
We note that both deposit and lending rates jumped up by 100-120bp in late 2011, when banks started to feel a need for extra funding (Figure 10). At the same time, MosPrime rate has also been growing through to 2011 (Figure 9).

Figure 9. MosPrime rates vs KazPrime



Source: Central Bank of Russia

Figure 10. Rates in Russia



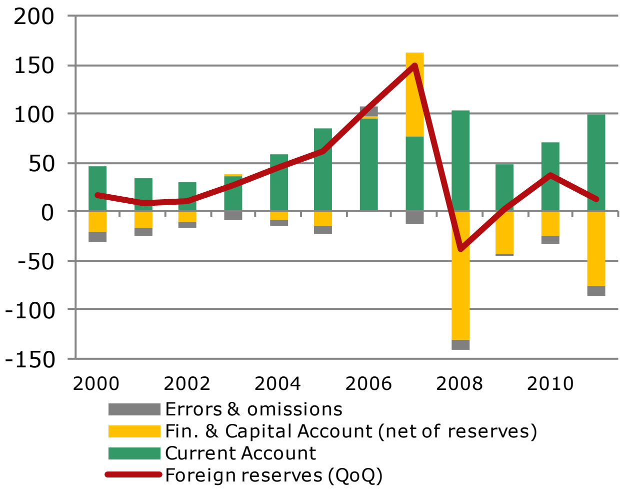
Source: Central Bank of Russia

Balance of Payments and USDRUB rate

We note that the growth of outward FDI, triggered by the activity of domestic investors spoils Financial Account and therefore foreign reserves statistics. At the same time, an inward FDI remains at a good level of $10bn/quarter. We believe that growing imports might moderately increase pressure on RUB. However, potential oil price drop remains the main short- to medium-term risk for the currency.

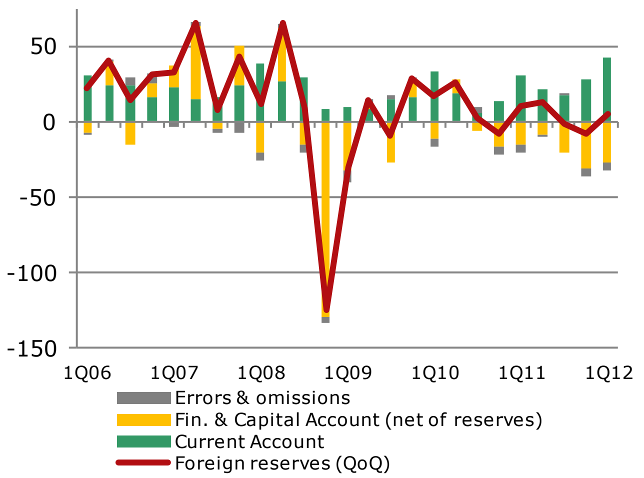
Russia remains dependent on energy price fluctuations, which is a result of oil & gas and metal products being the principal part of exports. At the same time, the total of Financial and Capital Accounts does remain an important driver influencing CBR foreign reserves (Figure 11), and therefore USDRUB rate.

Figure 11. Foreign reserves change, USDbn/y



Source: Central Bank of Russia

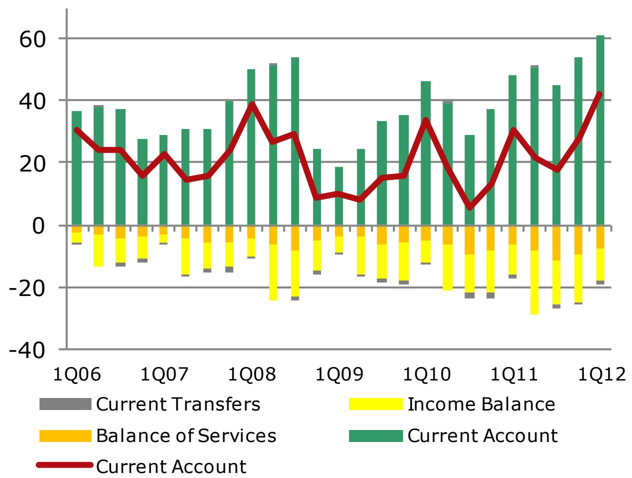
Figure 12. Foreign reserves change, USDbn/q



Source: Central Bank of Russia

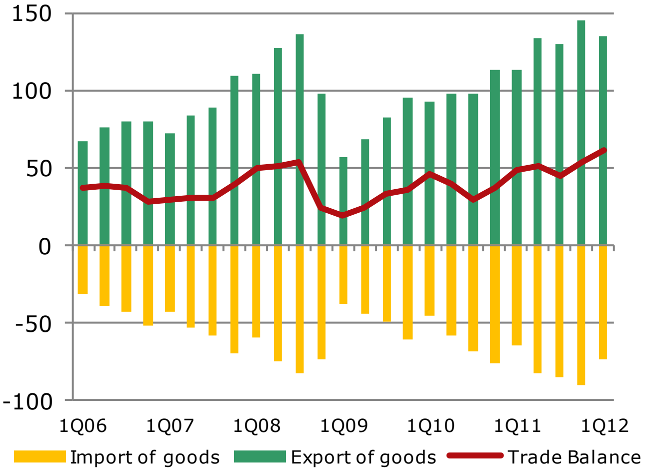
We note that back in 4Q2008-1Q2009, the negative Financial and Capital Account was a primary driver for foreign reserves decrease and, therefore, a driver for RUB weakening (orange bar in 4Q2008 on Figure 12). It looks like before oil dropped, the majority investors were bringing money only based on the perception of high oil prices.

Figure 13. Current Account by driver, USDbn/q



Source: Central Bank of Russia

Figure 14. Trade Balance, USDbn/q

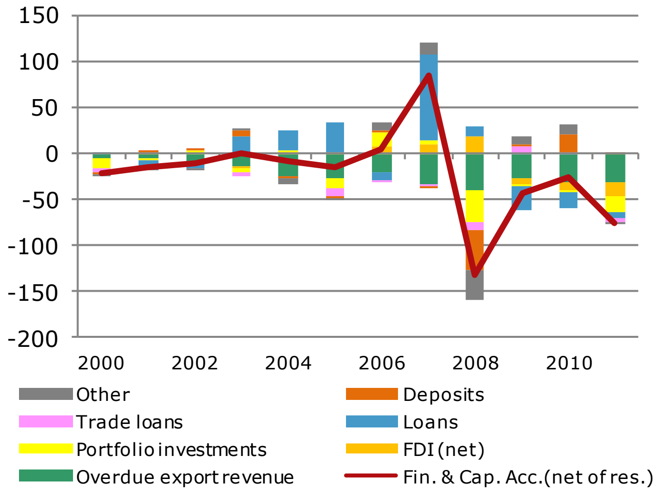


Source: Central Bank of Russia

We note that despite Brent prices in 1Q2009 declined below $50/bbl, both Russian Trade Balance and Current Account remained in the positive zone (Figure 13-18).

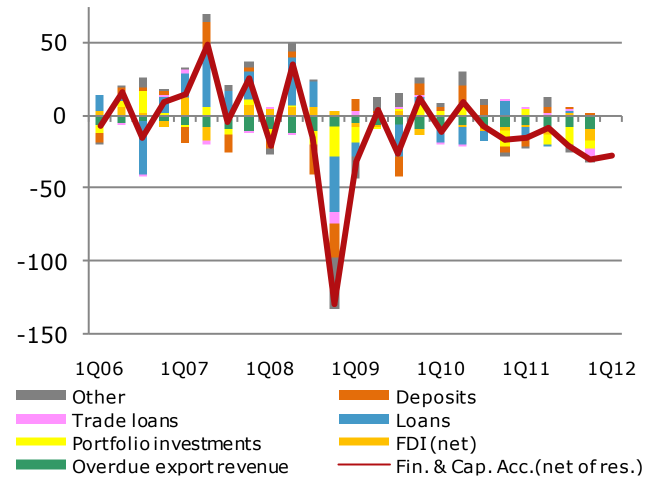
Therefore, it looks like there was an overreaction of markets on oil price drop in late 2008, supported by a need for funds on Western markets. Note the amounts that Russia received in loans in 2007 (blue bar on Figure 15-20), and the amounts investors withdrew in 4Q2008 from portfolio investments (yellow bar on Figure 16), loans (blue), and deposits (red).

Figure 15. Fin.&Cap. Acc. (net of res.), USDbn/y



Source: Central Bank of Russia

Figure 16. Fin.&Cap. Acc.(net of res.), USDbn/q

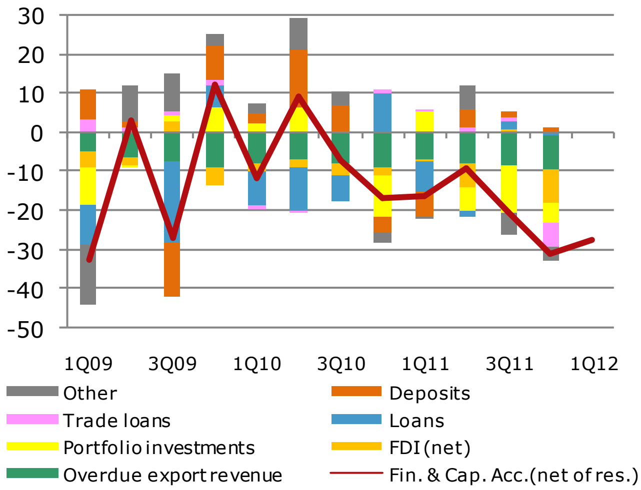


Source: Central Bank of Russia

We note that after stabilization in 3Q2009-3Q2010, the total of Financial and Capital Accounts started declining again. In 2H2011, the net outflow of capital from Russia intensified (Figure 17).

Apart from growing overdue payments for Russian exports (green bar on Figure 17), we identify other two major sources of negative Financial Account – net outflow of FDI and net outflow of portfolio investments.

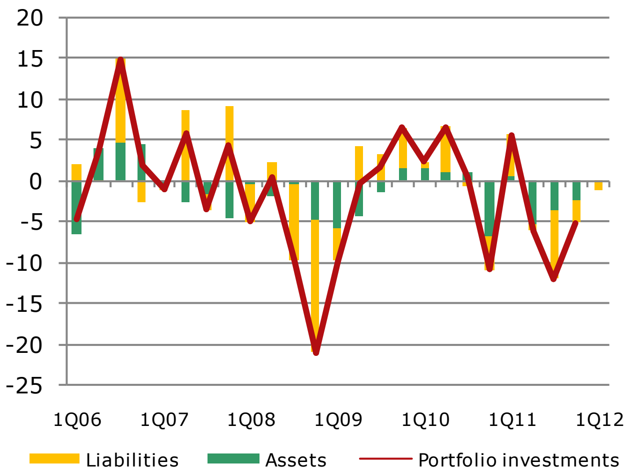
Figure 17. Fin.&Cap. Account(net of res.), USDbn/q



Source: Central Bank of Russia

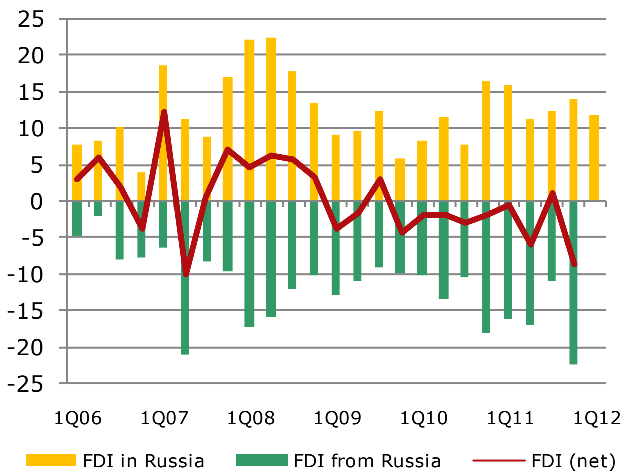
A closer look at Financial Account reveals the principal numbers behind the scene. First, there has been a moderate $3-8bn/quarter outflow of portfolio investments from Russia in 4Q2010 and 3-4Q2011 (orange bars on Figure 18. Second, Russian investors have been investing into foreign entities $2-7bn/quarter in 4Q2010 and in 2-4Q2011 (green bars on Figure 18). The latter might be investments made by CBR, as foreign reserves were growing then.

Figure 18. Portfolio investments, USDbn/y



Source: Central Bank of Russia

Figure 19. FDI by direction, USDbn/q

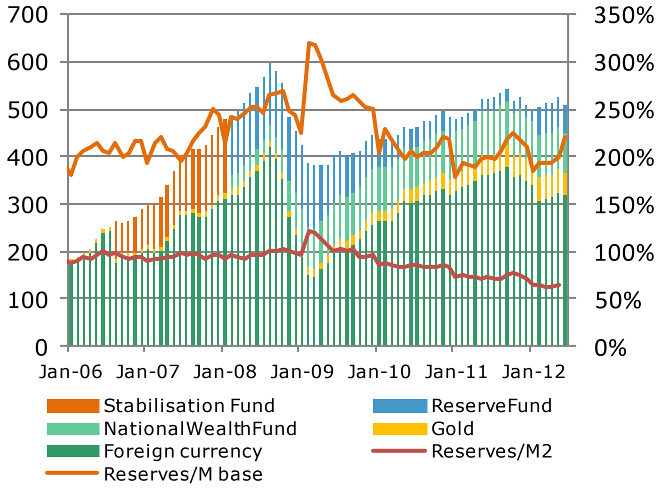


Source: Central Bank of Russia

We note that inward FDI in 1Q2011-1Q2012 remained above $10bn/quarter (orange bars on Figure 19), which is a good number for Russia. At the same time, in 4Q2010-2Q2011 and in 4Q2011, the outward FDI of Russia increased by 50-100% relative to average 2009 numbers (green bars on Figure 19), which means that Russia started investing more in other countries. Should these investments succeed, the amounts of investment income (dividends) Russian investors receive may increase further.

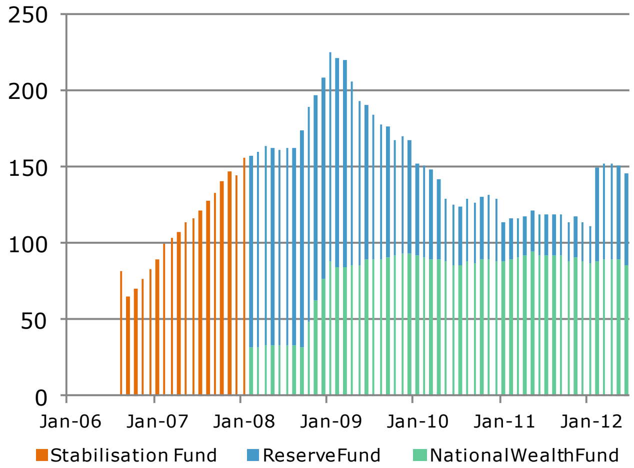
We note that 1Q2012 outward investments are likely to be high as savings in Government's Reserve Fund increased by $40bn in 1Q2012 (blue bars on Figure 21).

Figure 20. Russia foreign reserves, USDbn



Source: Central Bank of Russia

Figure 21. Government funds, USDbn



Source: Central Bank of Russia

Therefore, we believe that negative Financial Account numbers are, to much extent, driven by Russian domestic investors, who try to invest into foreign entities targeting income in foreign currency. We suggest that joining WTO can be one of the reasons for this strategy.

While the value of benefits Russian exporters (mainly metallurgical companies) will get after joining WTO is limited to $2bn/year, which is just 0.4% of Russian annual exports, the value of negatives can be significantly higher.

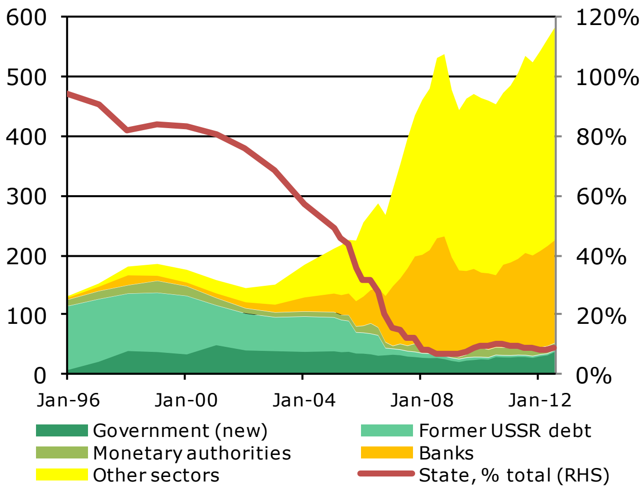
First, there is a huge difference in the cost of capital. In Russia, companies have to borrow at 15%, while companies in some WTO countries (close to reserve currency global emission centers) can borrow at 4-5%. This means that from the very beginning the conditions are not equal for Russian and foreign producers.

Secondly, severe weather conditions require more fuel and heat for production processes. Should internal fuel prices continue increasing (for instance because of joining WTO), the costs would make Russian agriculture and other industries even less competitive.

Because of these two factors, Russian companies can lose a part of its domestic market, which would automatically increase unemployment in Russia, and therefore decrease personal income per capita. In addition, higher amounts of imported consumer goods would increase country's expenditures in foreign currency, and therefore would increase further the threshold for break-even Brent price.

While the value of benefits for Russia from WTO membership is of the size of several billion dollars, the amounts of negatives (from loosing even domestic consumer market) might be as large as dozens of billion dollars per year. Finally, Russia would need these amounts in foreign currency, as imports must be paid not in RUB but in foreign currency.

Figure 22. Russia foreign debt, USDbn



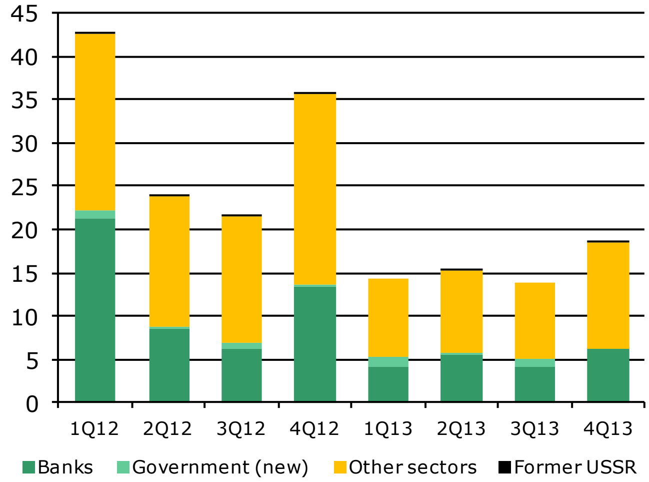
Source: Central Bank of Russia

Unfortunately, Russian WTO negotiators hesitate to understand these factors despite numerous appeals of companies from different sectors and Russian Industrial Council. This is one of the reasons (unfortunately) both domestic capital and producing companies try to find investment opportunities and diversify its business by investing also outside of Russia.

Foreign debt of Russia has reached $585bn in June 2012 – the highest level ever (Figure 22). The growth was driven by private sector borrowing. From the positive side, we note that State debt is only 9.0% of the total ($53bn).

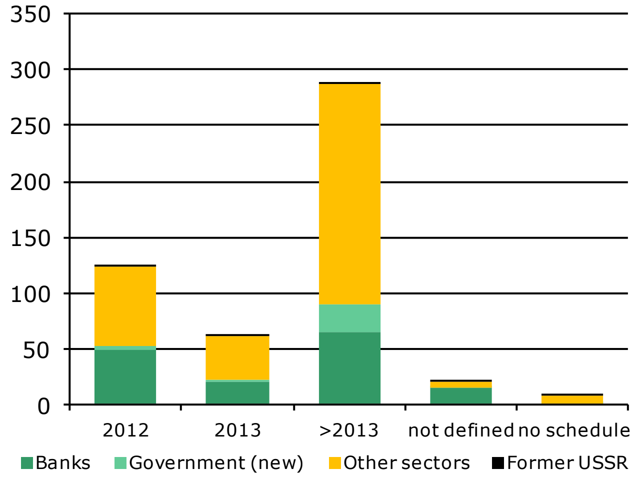
The repayment schedule (Figure 23, available as of 1 January 2012), suggests that repayments should moderate in 2013. However, most likely that the debt will be rolled over (which is usually the case in most of the countries).

Figure 23. Foreign debt repayments, USDbn/q



Source: Central Bank of Russia

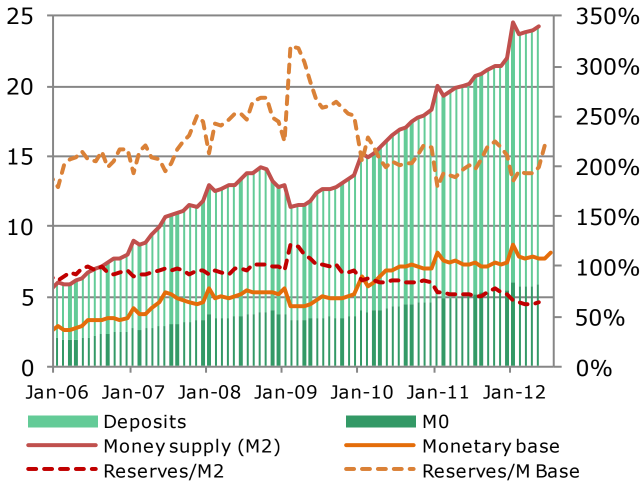
Figure 24. Foreign debt repayments, USDbn



Source: Central Bank of Russia

Total foreign reserves to money supply ratio declined to 64% (as of April 2012) from its peak of 121% in February 2009 (red dashed curve on Figure 21), which suggests that Central bank's power has decreased but still remains enough to manage USDRUB rate should any fast moves occur on foreign exchange market. At the same time, reserve to monetary base ratio is now above 200% again after RUB weakened in June (orange dashed curve on Figure 21).

Figure 25. Monetary aggregates, RUBtr



Source: Central Bank of Russia

As above ratios for Russia are significantly lower than they are for Kazakhstan (where reserves to money supply, for instance, at 120%), it is logical to expect a higher volatility of USDRUB rate than the volatility in

USDKZT rate. In order to keep its foreign reserves powerful enough from the medium- to long-term perspective, the Central Bank of Russia has to allow faster USDRUB rate change when oil price changes.

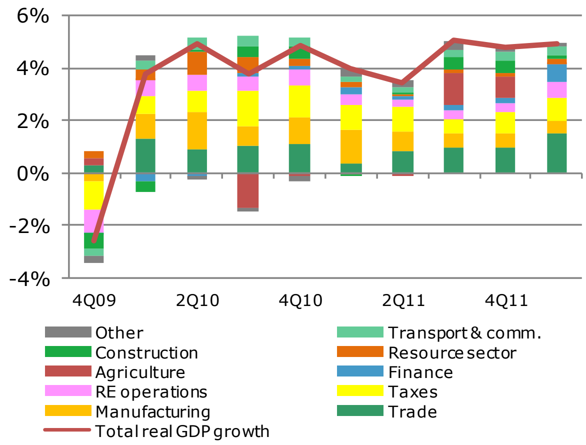
We believe that USDRUB rate is to remain dependent on the CBR perception of short- to medium-term oil price.

GDP and inflation

Real GDP of Russia grew by moderate 4.9% YoY in 1Q2012. Generally, this is a good figure, but we worry about the growth source structure, where trade, finance and operations with real estate prevail. We believe that because utility tariffs are set to increase in July-September, CPI YoY inflation is set to grow to 8.0% by YE2012.

Our estimates suggest that manufacturing contributed only 0.4% YoY to the total of 4.5% YoY GDP growth. At the same time trade (contributed 1.3% YoY), taxes (0.8% YoY), finance (0.6% YoY), and operations with real estate (0.7% YoY) were the principal drivers of YoY growth in 1H2012.

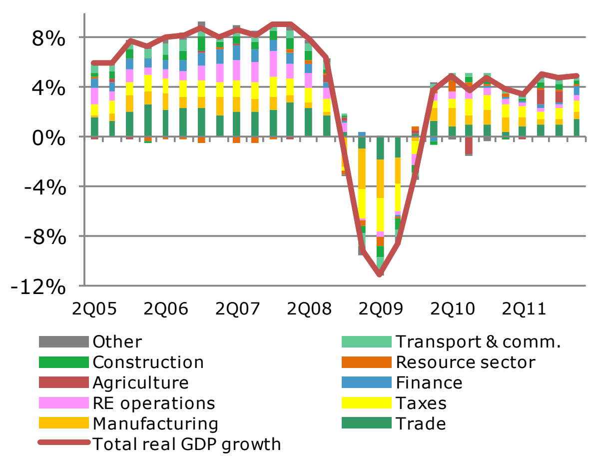
Figure 26. 4Q2010-1Q2012 YoY real GDP growth by driver



Source: Statistical Agency of Russia, Halyk Finance estimate

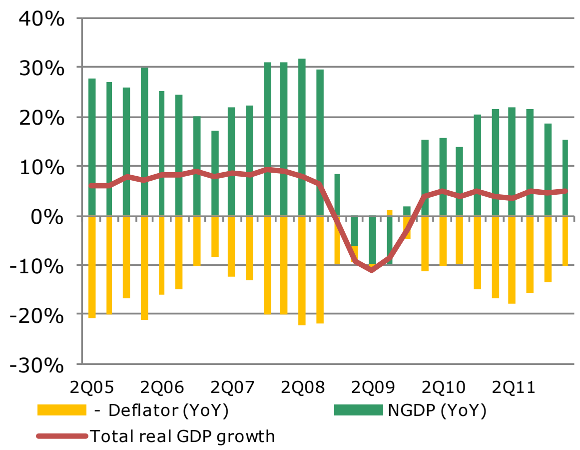
We believe that growing percentage growth rate in trade in combination with decreased growth rate in manufacturing supports our hypothesis about negative consequences of joining WTO for Russian non-resource industrial production. In 1H2012, the growth rate of GDP in manufacturing decreased to 3.2% YoY from 8.3% YoY in 1H2011. At the same time, the growth rate in GDP in trade increased to 8.0% YoY in 1H2012 from 3.5% YoY in 1H2011.

Figure 27. YoY real GDP growth by driver



Source: Statistical Agency of Russia, HF estimate

Figure 28. RGDP growth vs NDGP & deflator

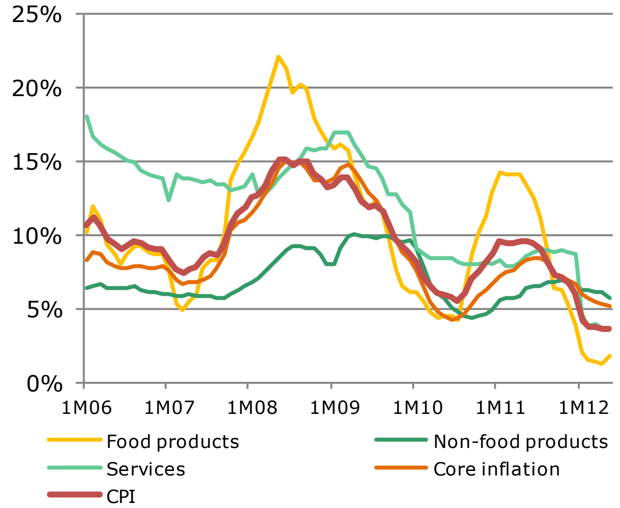


Source: Statistical Agency of Russia

The share of trade increased to 16.5% in 1H2012 from 16.3% of nominal GDP in 1H2011. The share of manufacturing decreased to 13.3% from

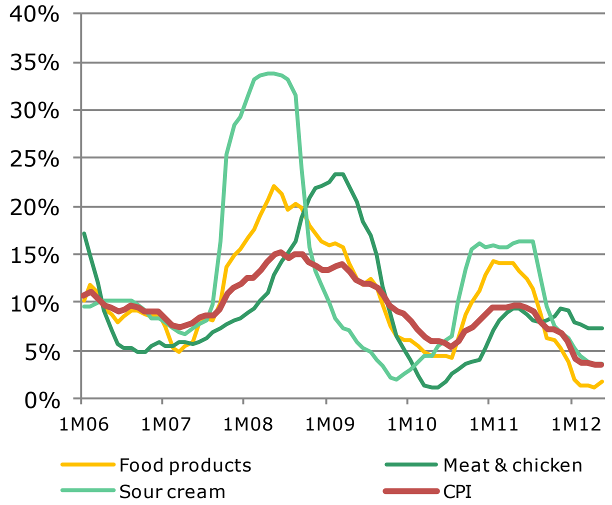
13.8%. This might be a first symptom that amounts of imported goods in the consumption increased. We believe that consumption of imported goods might increase further as Russian ratified WTO agreements.

Figure 29. CPI by main components (YoY)



Source: Statistical Agency of Russia

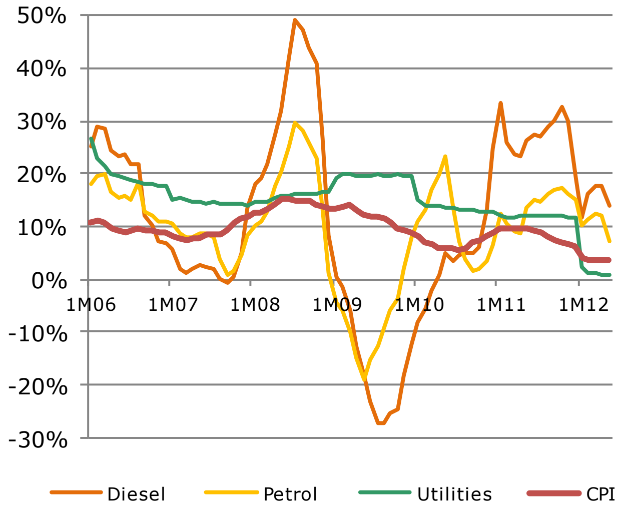
Figure 30. CPI vs food prices (YoY)



Source: Statistical Agency of Russia

We note that manufacturing sector and taxes brought the most of the negatives to real GDP drop in 2009 (Figure 27). As manufacturing is one of the three most important sectors for Russian economy (other two are obviously oil & gas and agriculture), the poor performance of this sector has significant consequences on Russian economy. Should such reactions continue, the dependence of Russia on imports and oil exports would only increase, despite officials announce opposite targets.

Figure 31. CPI vs domestic energy prices (YoY)



Source: Statistical Agency of Russia

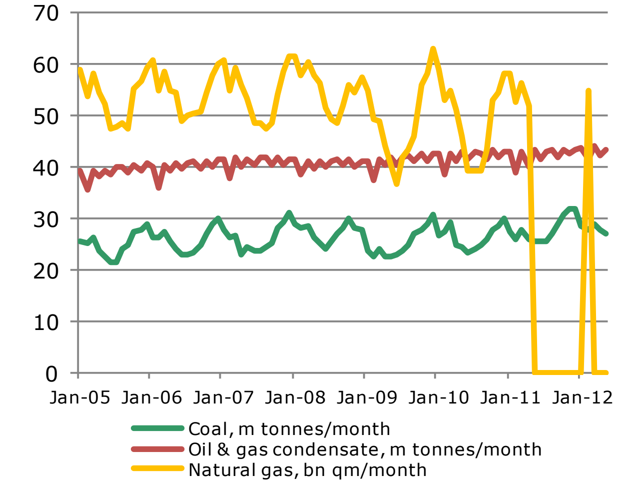
Official YoY inflation in Russia decreased to 6.5% in October 2012 from almost 10% a year earlier (red curve on Figure 29). As we understand, the slowdown in food price increase (Figure 30) along with limited price growth in utilities, and moderate growth of fuel prices (Figure 31) were the main factors behind lower inflation. We note that average utility prices are set to increase by 12% in July though to September this year, which would certainly increase YoY inflation in Russia.

Industrial production

We see upward trends in oil & gas condensate, coal and energy production in Russia. At the same time, as the quality of industrial production statistics deteriorated, it becomes difficult to derive statistics about many other manufacturing outputs.

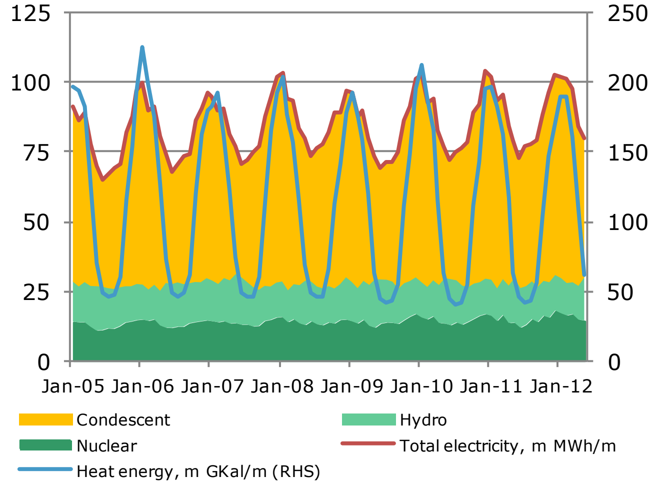
According to the Statistical Agency of Russia, January-October production of oil & gas condensate grew by 0.9% YoY, coal production – by 7.0% YoY. We believe that these are good numbers, given for instance that January-October oil & gas production in Kazakhstan decreased by 1.6% YoY, and coal production grew by only 2.1% YoY.

Figure 32. Energy commodity production



Source: Statistical Agency of Russia

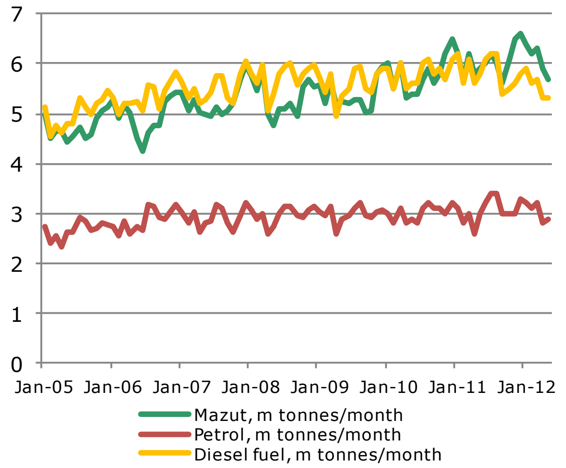
Figure 33. Energy production



Source: Statistical Agency of Russia

As there are data breaks for natural gas production statistics for Russia (orange line on Figure 32), we are not quite sure if the trend in 2011-2012 was really good (one point for February 2012 suggests 4.4% YoY growth in production of natural gas).

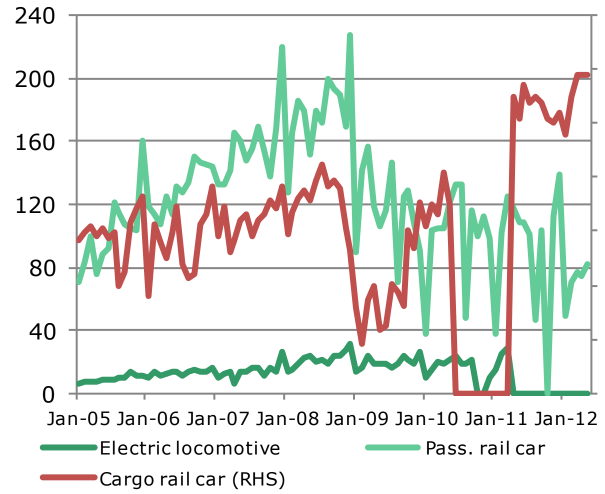
Figure 34. Oil product production



Source: Statistical Agency of Russia

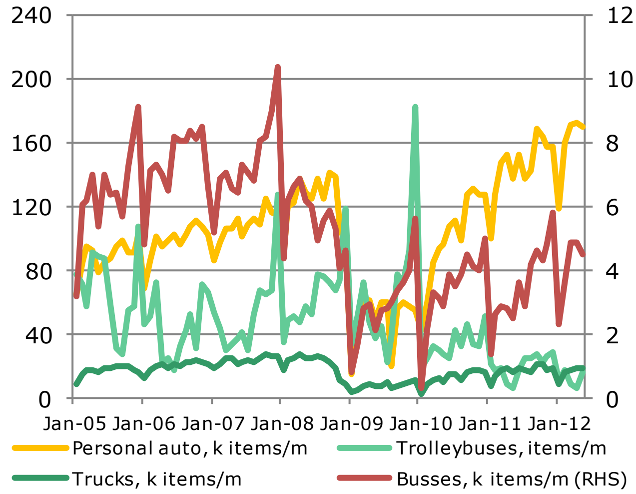
The production of petrol remains flat (red line on Figure 34), while production of diesel fuel decreases from the mid-2011. The production of mazut remains volatile (green line on Figure 34).

Figure 35. Industrial production



Source: Statistical Agency of Russia

Figure 36. Industrial production



Source: Statistical Agency of Russia

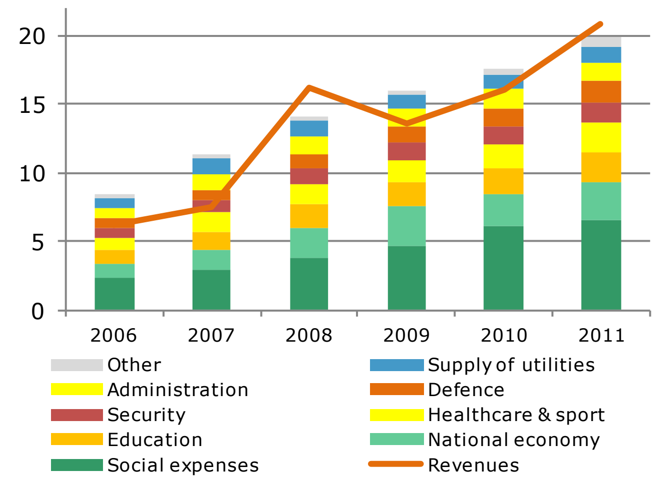
The data suggests that the production of passenger rail cars stagnates, relative to 2005-2008 numbers (Figure 35). We see a recovery in the production of personal automobiles (orange curve on Figure 36), some growth in trucks (still have not reached pre-2009 level), and some recovery in production of busses (red curve). Contrary to this, situation in trolleybus production is bad (light green).

Consolidated budget

We note a $29bn surplus in January-April Consolidated Budget. We believe that budget revenues remain vulnerable to oil price fluctuations, which has a break-even price of $84-90/bbl.

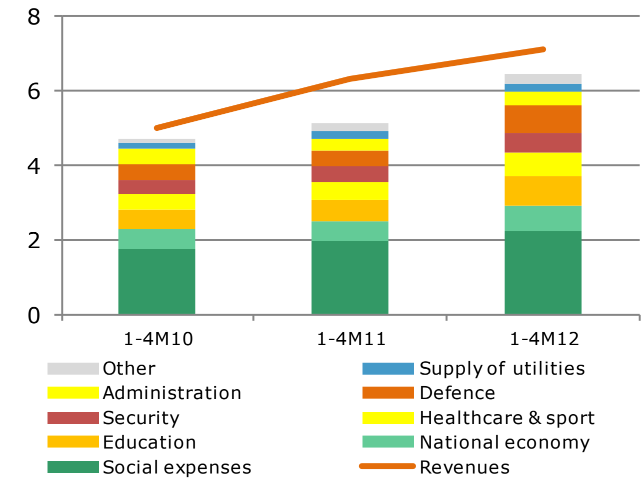
January-August Consolidated Budget surplus totaled RUB1593tln ($49bn, 11.9% of January-August expenditures), which is 32% less than January-August surplus was in 2011. As January-August expenditures grew by 21% YoY, high oil price (Brent was 1.9% higher YoY in January-August 2012 than in January-August 2011) was not able to keep the surplus at the previous level. Therefore, Russia became some more vulnerable to oil price drops from the fiscal point.

Figure 37. Consolidated budget exp., RUBtr/y



Source: Federal Treasury of Russia

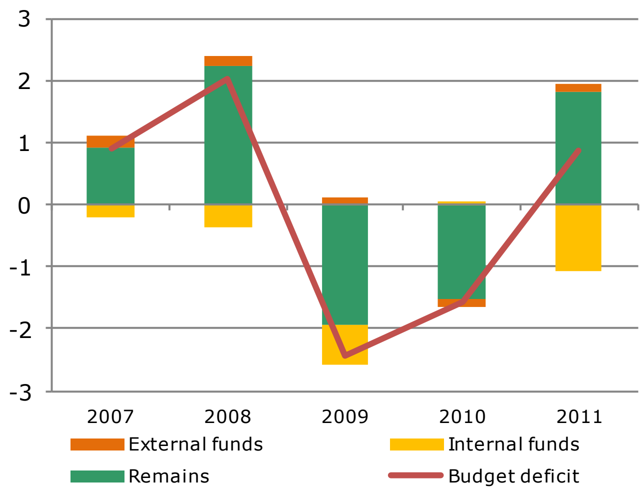
Figure 38. Consolidated budget exp., RUBtr



Source: Federal Treasury of Russia

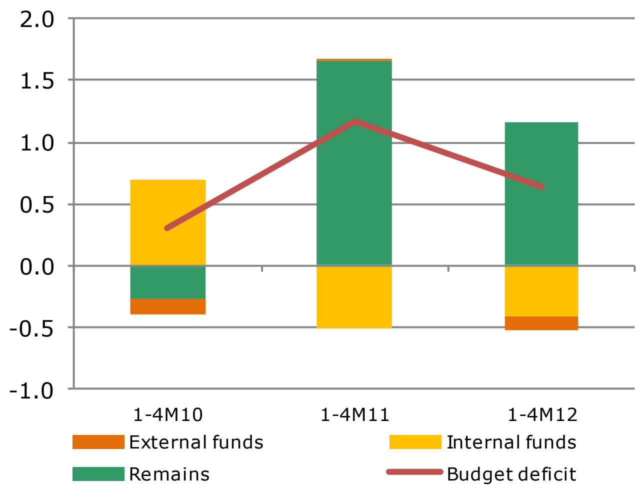
Given that approximately 30-40% of Russian Consolidated Budget revenues comes from commodity sectors, the 11.9% buffer (surplus) mentioned above, suggests that break-even Brent price for Russian Budget is at $84-90/bbl (25-30% below 1H2012 price), according to our estimate. This level is 10-15% higher than break-even price for Kazakhstan's Consolidated Budget.

Figure 39. Budget surplus (deficit), RUBtr/y



Source: Federal Treasury of Russia

Figure 40. Budget surplus (deficit), RUBtr



Source: Federal Treasury of Russia

Macroeconomic highlights

Figure 41. Russian macroeconomic indicators

	2007	2008	2009	2010	2011	2012F	2013F	2014F	2015F	2016F	2017F
Main indicators											
USDRUB rate, YE	24.6	29.1	30.0	30.5	32.1	32.0	34.0	37.0	37.0	37.0	37.0
USDRUB rate, aver	25.6	24.9	31.7	30.4	29.4	30.3	33.0	35.5	37.0	37.0	37.0
Foreign reserves, YE, USDbn	479	426	439	479	499	504	494	481	467	451	433
Real GDP, YoY	8.5%	5.2%	-7.8%	4.3%	4.3%	5.0%	4.7%	4.9%	5.0%	5.2%	5.3%
Nominal GDP, RUBtr	26.9	33.2	41.3	38.8	45.2	47.8	46.4	53.2	55.4	57.6	59.8
Nominal GDP, USDbn	1,053	1,337	1,301	1,278	1,537	1,494	1,364	1,438	1,497	1,556	1,615
CPI, YE, YoY	11.9%	13.3%	8.8%	8.8%	6.1%	8.5%	7.0%	6.5%	6.0%	6.0%	6.0%
Brent price ($/bbl)	73.2	99.9	64.6	81.1	110.0	103.8	95.0	100.0	104.0	108.0	112.0
Monetary indicators											
Money supply, RUBtr	12.9	13.0	15.3	20.0	24.5	23.9	23.2	26.6	27.7	28.8	29.9
Monetary Base, RUBtr	5.5	5.6	6.5	8.2	8.6	9.6	9.3	10.6	11.1	11.5	12.0
Banking sector portfolio, RUBtr	14.3	19.9	19.9	22.2	28.7	26.0	22.0	21.5	22.5	23.6	24.6
Banking sector portfolio, USDbn	578.8	684.1	661.8	725.9	894.2	832.0	747.0	795.2	833.8	872.4	910.9
Balance of Payments, USDbn/y											
Current Account	77.8	103.5	48.6	71.1	98.8	74.7	48.6	52.1	54.8	57.6	60.3
Trade Balance	130.9	179.7	111.6	152.0	198.2	168.3	134.2	142.2	148.6	155.0	161.4
Exports	354.4	471.6	303.4	400.6	522.0	492.6	450.6	474.4	493.4	512.5	531.6
Imports	-223.5	-291.9	-191.8	-248.6	-323.8	-324.2	-316.4	-332.2	-344.8	-357.5	-370.1
Balance of Services	-18.9	-24.3	-19.8	-28.7	-35.9	-34.1	-31.7	-33.1	-34.2	-35.3	-36.4
Income Balance	-30.8	-49.2	-40.3	-48.6	-60.2	-56.5	-51.2	-54.2	-56.6	-59.0	-61.4
Transfers	-3.5	-2.8	-2.9	-3.6	-3.2	-3.0	-2.7	-2.9	-3.0	-3.2	-3.3
Cap. & Fin. Acc., net of res.	84.5	-131.2	-43.5	-26.0	-76.2	-69.0	-58.8	-64.6	-69.3	-73.9	-78.5
FDI (net)	9.2	19.4	-7.2	-9.2	-14.4	-13.4	-11.9	-12.7	-13.4	-14.0	-14.7

Source: Central Bank of Russia, Statistical Agency of Russia, Halyk Finance estimates

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