

Key developments and challenges

The economic downturn and fall in global commodity prices has emphasised the importance of further diversifying output and exports for sustainable long-term economic development. This will rely on upgrading infrastructure, strengthening competition and promoting innovation.

Timely measures such as ample liquidity support and the extension of deposit insurance, have helped to preserve financial stability. It is important that the supervisory authorities closely monitor the loan portfolio, enhance the standards of asset quality disclosure and preserve competition among private and public banks.

Prudent management of the resource boom helped the government accumulate substantial fiscal and foreign currency reserves, enabling it to deploy a sizeable stimulus package for the economy. The government must balance the prudent management of reserves and measures to boost domestic demand to achieve and sustain economic recovery.

Country data

Population (in millions)	142.0
Area ('000 sq km)	17,075.0
GDP (in billion US\$, 2008)	1,676.6
Average transition score (scale: 1 to 4.33)	3.04

Progress in structural reform

Liberalisation and privatisation

To support struggling domestic industries during the financial crisis, Russia introduced a number of temporary protectionist measures in individual sectors including, for example, higher import duties on used cars from January 2009. While World Trade Organization (WTO) accession remains firmly on the agenda, recent statements by the authorities have been conflicting, leaving it unclear whether Russia will seek entry on its own or as part of a customs union with Belarus and Kazakhstan. The uncertainty casts doubt over the prospects of swift accession.

During the early stages of the crisis a few sizeable banks on the brink of failure, including Svyazbank and Globex, were swiftly nationalised through take-overs by state-owned entities. In the enterprise sector the role of state corporations has also been gradually increasing.

Business environment and competition

A number of measures have been adopted to fight corruption and improve the business environment. In December 2008 parliament passed a new law to combat corruption as well as a law protecting companies and entrepreneurs from predatory behaviour by regulators and supervisory agencies. More recently, in March 2009, a five-year programme of state service reforms was announced that includes the introduction of performance incentives for public servants. In April 2009 the Prosecutor General's Office created a new unit with offices in

all regions to tighten enforcement of the law on protection of the rights of entrepreneurs whose businesses are subject to inspection by state agencies. In the same month a new law on the public disclosure of assets held by government officials and their families was implemented. The law constitutes a step towards greater transparency and higher ethical standards in government. Registration procedures for small and medium-sized enterprises (SMEs) in selected sectors, such as hotels and textiles, were streamlined in July 2009. Effective implementation of these laws and measures is yet to be tested.

The competition authority reviewed a growing number of cases of suspected violations of the competition law. It imposed heavy fines on several large oil and gas companies for abuse of market power.

The business environment remains difficult, in particular for SMEs, as reflected in their relatively modest shares in output and employment. Excessive regulation, notably in the form of licensing and permit procedures, negatively affects economic activity and innovation. Almost one in five respondents of the 2008/09 Business Environment and Enterprise Performance Survey (BEEPS IV) named corruption or the need to obtain various licences and permits as the main obstacles to doing business.

Infrastructure

In June 2009 one of the landmark public-private partnerships (PPP) tenders a long-term concession for the redevelopment and operation of Pulkovo airport in St. Petersburg was successfully completed. The winner was a consortium of the state-owned bank, VTB, and Fraport, a foreign strategic investor. Following the unbundling and privatisation of electricity generation companies, the share of electricity traded in the liberalised market had increased from 30 to 50 per cent by mid-2009. However, the economic downturn risks delays or even reversals in the implementation of power sector reform, including the further planned liberalisation of energy trading and development of the capacity market.

Financial sector

The difficult operating environment in the banking sector forced many private banks to deleverage their balance sheets. The authorities responded with a series of measures, deployed in a timely manner and benefiting a wide range of players, to preserve financial stability. These measures included the provision of uncollateralised loans, expansion of deposit insurance coverage, capital injections into state-owned banks and placement of Treasury deposits with select commercial banks. The result has been a gradual increase in the market share of state-owned banks, albeit at a relatively slow pace.

The effect of the economic downturn on the consolidation in the financial sector has so far been limited, but may become more pronounced over time. In addition to a few banks that were nationalised, several smaller banks on the verge of failure were taken over by private banks, backed by long-term funding from the Deposit Insurance Agency. The new minimum capital requirement of 90 million roubles (€2 million), due to come into force in January 2010, will mean that around 150 small banks will be required to raise new capital or seek mergers. A further increase in minimum capital requirements – to 180 million roubles – is planned from 1 January 2012 and this could affect another 200 banks. While the situation with non-performing loans has remained manageable to date, the recession highlighted the need to strengthen the standards of asset quality disclosure by banks.

Macroeconomic performance

The Russian economy has been adversely affected by the global crisis through a number of channels. First, the economy has been exposed to a sharp terms-of-trade shock as the price of Urals brand oil plummeted from US\$ 138 per barrel (pb) in July 2008 to an average of around US\$ 44 pb in the first four months of 2009 before recovering to US\$ 65 to US\$ 70 pb in June. Prices of ore, metals and steel also fell sharply from their mid-2008 levels. Second, in August 2008 Russia experienced a large scale capital outflow as well as a withdrawal of deposits from the banking system, in particular from medium-sized and regional banks. These events prompted the central bank to inject large amounts of liquidity into the banking sector and to permit a gradual depreciation of the rouble by about 25 per cent against the dollar-euro basket. The stock market also lost around three-quarters of its capitalisation before bouncing back somewhat by mid-2009. The availability of trade finance and micro, small and medium-sized enterprises (MSMEs) credit has been sharply reduced, and the syndications markets have been shut for all but a few major borrowers.

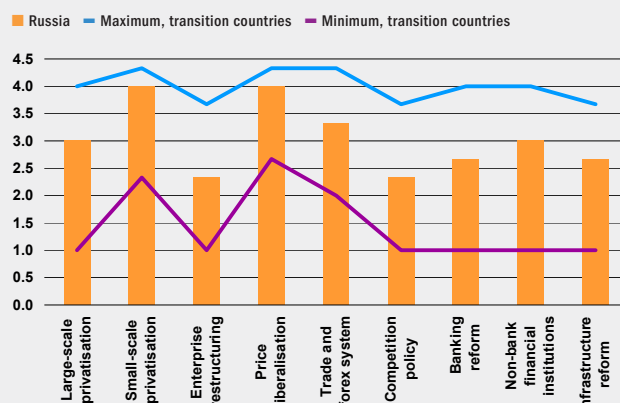
Lastly, weaker domestic and external demand and tight credit conditions have had a marked impact on the real sector. In the first half of 2009 industrial production declined by 15 per cent year on year, with the steepest declines in the automotive and construction-related sectors. Large corporates have been forced to scale down, postpone or cancel large modernisation projects, including those with important energy efficiency components. In the first and second quarters of 2009 output contracted by 9.8 and 10.9 per cent, respectively, year on year.

The government adopted a comprehensive fiscal stimulus package in April 2009, backed by its large fiscal reserves. The package centres on social transfers (unemployment benefits, retraining programmes, pensions, transfers to subnational governments primarily responsible for education, health and housing), as well as support for selected companies in single-industry towns. The budget deficit is expected to be less than 9 per cent of GDP in 2009, declining to around 7 per cent in 2010. In order to establish a market benchmark should the downturn prove to be longer than expected and external financing subsequently needed, a eurobond issue is being considered and a roadshow planned for late in 2009.

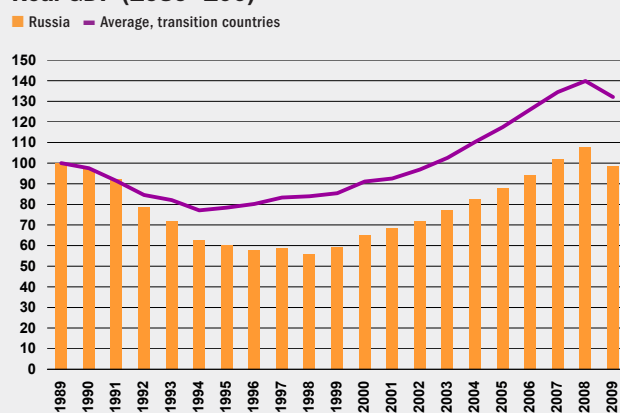
Outlook and risks

The stimulus provided by the fiscal package and liquidity injections into the banking system are expected to arrest the sharp fall in output observed in early 2009, with the economy returning to growth in late 2009 or 2010, supported by a combination of higher commodity prices, fiscal stimulus and a gradual recovery of external demand. However, the economy remains highly dependent on oil and gas export receipts, and the main risk is of a further decline in commodity prices which could delay recovery and put pressure on the rouble and the financial system.

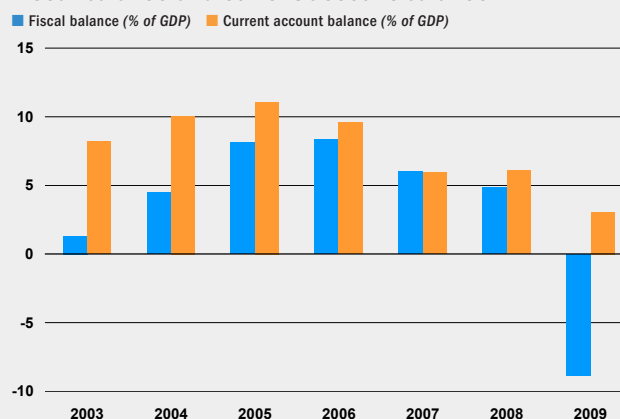
Transition indicators 2009



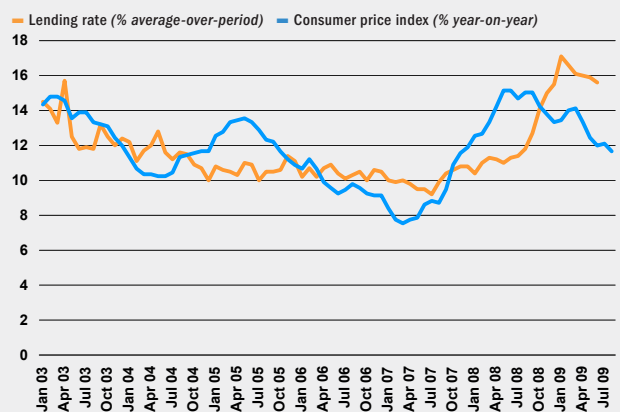
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility – full	Competition office – yes	Telecoms regulatory assessment compliance – medium	Capital adequacy ratio – 10-11 per cent	Share of population living in poverty – <2.0 per cent (2005)
Controls on inward direct investment – yes ¹	Quality of insolvency law – medium	Independence of electricity regulator – partial	Deposit insurance system – yes	Government expenditure on health – 3.7 per cent (2008)
Interest rate liberalisation – full	Secured transactions law – under development	Separation of railway infrastructure from operation – partial	Private pension funds – yes	Government expenditure on education – 4.0 per cent (2008)
Exchange rate regime – managed float		Independence of the road directorate – partial		Household expenditure on power and water – 6.6 per cent
Wage regulation – no				
Tradeability of land – limited de facto				

Structural and institutional change indicators

	2003	2004	2005	2006	2007	2008	2009
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	5.6	6.2	6.3	6.4	6.5	6.5	na
Private sector share in GDP (in per cent)	70.0	70.0	65.0	65.0	65.0	65.0	65.0
Private sector share in employment (in per cent)	na	na	na	na	na	na	na
Budgetary subsidies and current transfers (in per cent of GDP) ²	4.3	3.7	3.5	3.5	4.7	5.4	na
Share of industry in total employment (in per cent)	22.6	22.2	21.7	21.3	21.2	21.2	na
Change in labour productivity in industry (in per cent)	8.4	8.9	6.2	5.8	6.4	6.5	na
Investment/GDP (in per cent)	20.8	20.9	20.1	21.4	24.3	25.5	na
<i>EBRD index of small-scale privatisation</i>	4.0	4.0	4.0	4.0	4.0	4.0	4.0
<i>EBRD index of large-scale privatisation</i>	3.3	3.3	3.0	3.0	3.0	3.0	3.0
<i>EBRD index of enterprise reform</i>	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Markets and trade							
Share of administered prices in CPI (in per cent)	13.0	13.0	13.0	6.7	6.7	na	na
Number of goods with administered prices in EBRD-15 basket	2.0	2.0	2.0	1.0	1.0	1.0	na
Share of trade with non-transition countries (in per cent)	66.5	71.5	69.4	71.2	69.4	68.6	na
Share of trade in GDP (in per cent)	49.1	47.4	48.3	47.3	44.6	45.5	na
Tariff revenues (in per cent of imports) ³	19.4	30.6	47.4	51.6	42.1	49.4	na
<i>EBRD index of price liberalisation</i>	4.0	4.0	4.0	4.0	4.0	4.0	4.0
<i>EBRD index of forex and trade liberalisation</i>	3.3	3.3	3.3	3.3	3.3	3.3	3.3
<i>EBRD index of competition policy</i>	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Financial sector							
Number of banks (foreign-owned)	1329 (41)	1299 (42)	1253 (52)	1189 (65)	1136 (86)	1108 (102)	na
Asset share of state-owned banks (in per cent)	na	na	na	na	na	na	37.5
Asset share of foreign-owned banks (in per cent)	7.4	7.6	8.3	12.1	17.2	18.7	na
Non-performing loans (in per cent of total loans)	5.4	3.5	2.7	2.6	2.6	3.9	na
Domestic credit to private sector (in per cent of GDP)	21.0	24.1	25.7	30.9	37.9	41.0	na
Domestic credit to households (in per cent of GDP)	1.9	3.2	4.9	7.1	9.0	9.6	na
– Of which mortgage lending (in per cent of GDP)	na	0.1	0.2	0.9	1.9	2.5	na
Stock market capitalisation (in per cent of GDP)	51.0	43.9	73.0	103.3	111.4	93.2	na
Stock trading volume (in per cent of market capitalisation)	46.0	53.0	39.0	64.1	58.9	75.0	na
Eurobond issuance (in per cent of GDP)	1.2	2.8	2.3	2.1	2.5	1.1	na
<i>EBRD index of banking sector reform</i>	2.0	2.0	2.3	2.7	2.7	2.7	2.7
<i>EBRD index of reform of non-bank financial institutions</i>	2.7	2.7	2.7	3.0	3.0	3.0	3.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	25.0 (25.0)	26.8 (51.2)	28.0 (83.8)	30.8 (105.7)	31.1 (115.1)	31.1 (132.6)	na
Internet users (per 100 inhabitants)	8.3	12.9	15.2	18.0	21.1	21.1	na
Railway labour productivity (1989=100)	101.6	108.1	115.7	117.1	132.9	151.2	na
Residential electricity tariffs (USc kWh) ⁴	2.6	3.2	3.9	4.8	5.7	6.7	na
Average collection rate, electricity (in per cent)	92	95	97	95	96	na	na
GDP per unit of energy use (PPP in US dollars per kgoe)	2.2	2.4	2.6	na	na	na	na
<i>EBRD index of infrastructure reform</i>	2.3	2.7	2.7	2.7	2.7	2.7	2.7
– Electric power	3.0	3.0	3.0	3.0	3.0	3.3	3.3
– Railways	2.3	2.7	2.7	2.7	3.0	3.0	3.0
– Roads	2.3	2.3	2.3	2.3	2.3	2.3	2.3
– Telecommunications	3.0	3.0	3.0	3.0	3.0	3.3	3.3
– Water and wastewater	2.3	2.3	2.3	2.3	2.3	2.7	2.7

¹ FDI in non-financial companies requires an authorisation from the Central Bank of Russia.

² Expenditures on national economy of the consolidated budget (including industry, agriculture, the energy sector and housing subsidies of regional budgets).

³ Refers to all taxes on international trade.

⁴ For flats without electric ovens.

Macroeconomic indicators

	2003	2004	2005	2006	2007	2008 Estimate	2009 Projection
Output and expenditure	<i>(Percentage change in real terms)</i>						
GDP	7.4	7.1	6.4	7.4	8.1	5.6	-8.5
– Private consumption	7.5	12.1	11.8	11.4	13.7	11.3	na
– Public consumption	2.2	2.1	1.3	2.4	3.4	2.5	na
– Gross fixed capital formation	12.8	12.6	10.6	18.0	21.1	10.0	na
– Exports of goods and services	12.5	11.8	6.5	7.3	6.3	0.5	na
– Imports of goods and services	17.7	23.3	16.6	21.3	26.5	15.0	na
Industrial gross output	8.9	8.0	5.1	6.3	6.3	2.1	na
Agricultural gross output	1.3	3.0	2.3	3.6	3.3	10.8	na
Employment	<i>(Percentage change)</i>						
Labour force (end-year)	0.6	0.1	1.2	0.5	1.2	0.6	na
Employment (end-year)	1.3	0.0	2.2	0.8	2.4	-1.7	na
	<i>(In per cent of labour force)</i>						
Unemployment (end-year)	7.8	7.9	7.1	6.7	5.7	7.8	na
Prices and wages	<i>(Percentage change)</i>						
Consumer prices (annual average)	13.6	11.0	12.5	9.8	9.1	14.1	12.3
Consumer prices (end-year)	12.0	11.7	10.9	9.1	11.9	13.3	11.9
Producer prices (annual average)	16.4	23.4	20.6	12.4	14.1	21.4	na
Producer prices (end-year)	12.5	28.8	13.4	10.4	25.1	-7.0	na
Gross average monthly earnings in economy (annual average)	26.1	22.6	26.9	24.3	27.8	26.7	na
Government sector¹	<i>(In per cent of GDP)</i>						
General government balance	1.3	4.5	8.1	8.4	6.0	4.8	-8.8
General government expenditure	29.9	27.4	31.5	31.1	34.4	33.6	na
General government debt	27.0	20.4	13.5	9.0	7.3	6.5	na
Monetary sector	<i>(Percentage change)</i>						
Broad money (M2, end-year)	50.5	35.8	38.6	48.8	47.5	1.7	na
Domestic credit (end-year)	30.6	20.9	5.0	30.0	43.6	29.6	na
	<i>(In per cent of GDP)</i>						
Broad money (M2, end-year)	24.3	25.6	28.0	33.4	40.1	32.4	na
Interest and exchange rates	<i>(In per cent per annum, end-year)</i>						
Central Bank refinance rate (uncompounded)	16.0	13.0	12.0	11.0	10.0	13.0	na
Treasury bill rate (all maturities)	5.4	4.5	3.9	na	na	na	na
Deposit rate	4.4	3.8	3.6	4.0	5.2	7.0	na
Lending rate	12.4	10.0	11.1	10.5	10.8	15.5	na
	<i>(Roubles per US dollar)</i>						
Exchange rate (end-year)	29.5	27.7	28.8	26.3	24.5	29.4	na
Exchange rate (annual average)	30.7	28.8	28.3	27.2	25.6	24.9	na
External sector	<i>(In millions of US dollars)</i>						
Current account	35,410.0	59,511.7	84,602.2	94,686.4	77,011.8	102,399.3	39,021.9
Trade balance	59,859.3	85,824.9	118,364.0	139,269.0	130,915.0	179,742.0	112,414.8
– Merchandise exports	135,929.0	183,207.0	243,798.0	303,550.0	354,401.0	471,603.0	282,961.8
– Merchandise imports	76,069.7	97,382.1	125,434.0	164,281.0	223,486.0	291,861.0	170,547.0
Foreign direct investment, net	-1,769.0	1,662.4	118.3	6,550.4	9,157.6	20,424.5	707.8
International reserves, excluding gold (end-year)	73,172.1	120,805.0	175,690.0	295,277.0	466,376.0	411,494.0	na
External debt stock	186,000.0	213,500.0	257,200.0	313,200.0	471,000.0	483,500.0	na
	<i>(In months of imports of goods and services)</i>						
International reserves, excluding gold (end-year)	8.5	11.1	12.8	17.0	19.8	13.4	na
	<i>(In per cent of exports of goods and services)</i>						
Debt service	26.0	24.1	26.3	28.0	28.3	29.5	na
Memorandum items	<i>(Denominations as indicated)</i>						
Population (end-year, million)	145.0	144.2	143.5	142.8	142.2	142.0	na
GDP (in billions of roubles)	13,243.2	17,048.1	21,625.4	26,903.5	33,111.4	41,668.0	40,795.1
GDP per capita (in US dollars)	2,975.8	4,103.1	5,328.0	6,928.8	9,102.6	11,806.9	na
Share of industry in GDP (in per cent)	27.4	31.5	33.7	32.9	31.8	30.6	na
Share of agriculture in GDP (in per cent)	6.3	5.7	5.2	4.8	4.7	4.8	na
Current account/GDP (in per cent)	8.2	10.1	11.1	9.6	5.9	6.1	3.1
External debt - reserves (in US\$ million)	112,827.9	92,695.0	81,510.0	17,923.0	4,624.0	72,006.0	na
External debt/GDP (in per cent)	43.1	36.1	33.6	31.7	36.4	28.8	na
External debt/exports of goods and services (in per cent)	122.2	104.8	95.7	93.6	119.6	92.5	na

¹ General consolidated government includes the federal, regional and local budgets and extra-budgetary funds, and excludes transfers.