

# **Economic situation and investment environment**

**Events and trends in July-September 2007**

Moscow 2007

## 1. General overview

In the third quarter of 2007 the Russian economy enjoyed further successful development. The growth mechanism is fed with growing domestic demand, increased investment dynamics and high export earnings.

The Ministry of Economic Development and Trade forecast, announced in September, a prediction of 107,5% growth in GDP following the results of 2007. This forecast considerably exceeds the estimated GDP% growth, predicted early this year, to be 106,5-106,7%. Estimates were adjusted due to growth in world oil prices and a considerable upturn in investment.

The data of the Federal State Statistics Service (FSSS) show that the industrial production index in the first nine months of this year amounted to 106,6 % of this index level as of January-August of 2006 (last year - 104,2%); retail turnover - 114,8% (113,3%), capital investment - 121,2% (111,8%), nominal household disposable income - 112,4% (110,6%).

**Table 1. Main indices of economic development in January-September 2006-2007, %**

	January-September 2007	January-September 2006
<b>GDP<sup>1</sup></b>	<b>107,7</b>	<b>106,2</b>
<b>Industrial production index</b>	<b>106,6</b>	<b>104,2</b>
<b>Agricultural products, bln roubles</b>	<b>102,2</b>	<b>101,6</b>
<b>Freight ton-miles, bln</b>	<b>102,2</b>	<b>103,0</b>
<b>Paid services to the population</b>	<b>107,3</b>	<b>107,7</b>
<b>Retail turnover, bln roubles</b>	<b>114,8</b>	<b>113,3</b>
<b>Paid services to the population, bln roubles</b>	<b>107,6</b>	<b>107,6</b>
<b>External turnover, including<sup>2</sup></b>	<b>118,8</b>	<b>128,9</b>
<b>exported goods</b>	<b>109,6</b>	<b>129,5</b>
<b>imported goods</b>	<b>137,4</b>	<b>127,7</b>
<b>Capital investment, bln roubles</b>	<b>121,2</b>	<b>111,8</b>
<b>Consumer price index</b>	<b>108,2</b>	<b>109,9</b>
<b>Producer price index</b>	<b>109,3</b>	<b>113,9</b>
<b>Nominal household disposable income</b>	<b>112,4</b>	<b>110,6</b>

*Data of FSSS*

A high level of economic activity promotes employment growth rates in Russian economy. FSSS estimates the unemployment rate, calculated by ILO methods, in August 2007 to amount to 4,3 mln people or 5,7% of the economically active population, which is 12,2% down on August of the last year. Officially registered unemployed amounted to 1,5 mln people (2,0% of the economically active population), which is 14,8% down on August of the last year.

<sup>1</sup> MEDT estimates January-August

<sup>2</sup> Data as of January-August

Though, in the third quarter of this year the economic growth rates dropped. The slowdown in the economic growth rate in August-September is determined by a reduced rate of production growth in the manufacturing sector and the occurrence of a recession in the U.S. mortgage market that brought instability to global capital markets, including a temporary deterioration in the Russian financial system.

The economic activity index<sup>3</sup>, calculated by Managers Association together with the Kommersant Publishing House, starting in May, stabilised and did not grow in summer due to differently-directed dynamics of indices in different sectors of the economy. In particular, the resource index, which had been growing during the second quarter, dropped in summer. The index of Financial dynamics in the last few months are unstable, trade and consumer indices grow slowly, and the industrial production index grows faster. Business estimates and expectations index have also been more or less the same for the last few months, though in August it grew stronger compared to previous months.

Diagram 1. **Economic activity cumulative index**

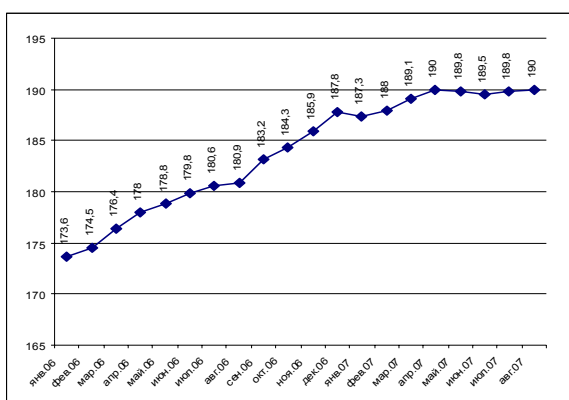
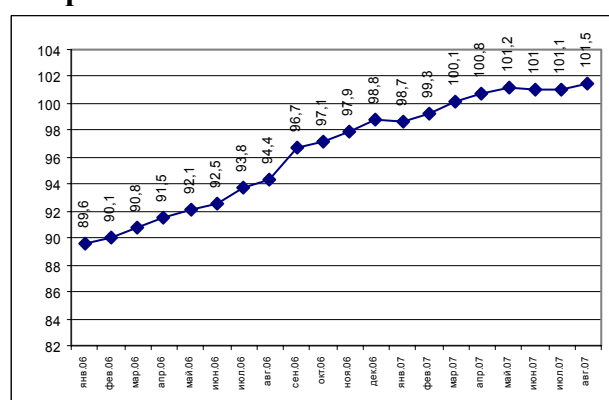


Diagram 2. **Business estimates and expectations index**



*Data of Managers Association*

Nonetheless, the economy remains stable and is full of growth tendencies, and 2007 will be one of the most successful years for Russian economy for the whole post-Soviet period of development.

Though, notwithstanding the fact that the economic growth will exceed initial forecasts of the Russian Government, the inflation for the whole-year in spite of estimations, built up in the first half of the year will be 8 % over the planned target limit and can rise above the 9% level of last year. Accelerated inflation is determined by growing prices in the world markets and highly increased liquidity this year which proved to be too much for the rate of increase in the economy.

<sup>3</sup> <http://www.amr.ru/research/wa>

The condition in the financial markets remains on the whole favourable. Though, deterioration in global markets at the end of summer temporarily increased capital drain from the Russian economy, creating a problem of liquidity in the banking sector and the temporarily decline of stock indices. Notwithstanding preserved risks in the loan sector, the stability of Russian financial system on the whole is high, and in the nearest future this sector will be developing with prevailing positive tendencies.

In August Standard & Poor's and Fitch Ratings confirmed current sovereign ratings for Russia with a stable outlook.

**Table 2. Sovereign ratings of the Russian Federation as of 1 September 2007**

	Domestic exchange long-term ratings	Foreign exchange long-term ratings	Outlook	Date of the rating
Standard & Poor's	A-	BBB+	Stable	14.09.2006 (confirmed on 21.08.2007)
Fitch Ratings	BBB+	BBB+	Stable	25.07.2006 (confirmed on 16.08.2007)
Moody's	Baa2	Baa2	Stable	25.10.2005

*Data of Standard & Poor's, Fitch Ratings, Moody's*

Though, it should be noted that the Russian rating has not been growing for over a year in spite of the good condition of the economy. This is caused by a slowdown in structural reforms and the upcoming presidential and parliamentary elections.

In the third quarter of this year political forces are actively preparing for parliamentary elections that will be held this December and for the presidential elections due next March.

In September, M.E. Fradkov's government resigned. The position of the Head of the Cabinet of Ministers was occupied by V.A. Zubkov who previously headed the Federal Financial Monitoring Service. The President said that the Government resigned because of its reduced efficiency before oncoming elections. Nonetheless, most ministers remained in their positions and there were only three significant replacements<sup>4</sup>. G.O. Gref, the Minister of Economic Development and Trade, was replaced by E.S. Nabiullina, the Minister of Health and Social Development M.E. Zurabov - by T.A. Golikova, the Minister of Regional Development V.A. Yakovleva – by D.N. Kozak.

The New Ministers have considerable experience in working on high-ranking positions in different executive bodies and are reputed to be good professionals which allow us to positively

<sup>4</sup> Replacements in the Cabinet of Ministers were accompanied with its structural changes. The main Government members include five vice-premiers, including two first ones.

regard their appointment. It can also be predicted that the economic policy of the new Cabinet of Ministers will change little. Though, it appears that the efficiency of the current Cabinet of Ministers should only be evaluated in a short-term perspective as Presidential elections can bring considerable changes in the membership and structure of the Government.

In early October President V.V. Putin announced he was going to lead the federal list of candidates from the Yedinaya Rossia Party. This is expected to strengthen the position of Yedinaya Rossiya during parliamentary elections, though previous public-opinion polls also showed that this party is highly supported by the electorate. The President's decision was viewed as proving that the Government will move in the current direction in the nearest future, and it reduced any current estimate of political risks.

Though the presidential elections are due in over six months, it is still unclear who the odds-on favourite is. A specific feature of the situation in Russia is that low political competition and considerable administrative influence create conditions for power to be transmitted to the successor appointed by the current President. Who will be appointed and how it will change forces on the field of politics it will be clearer closer to the elections.

It should be noted though, that despite the high probability that the new Government and President will move in the same direction as the current authorities, it is possible that their will be a heavy correction in state policy. It is possible because of the large concentration of power in the hands of the federal executive authorities and the President predetermines a decisive influence of subjective factors on the political decision making and execution process. Thus, the beginning of the new political cycle will be accompanied by a growing uncertainty in the midterm external and internal policies.

In early July of 2007 the International Olympic Committee has chosen Sochi, a Russian city, as home city for the 2014 Winter Olympics. It shows that the world community highly regards the economic potential of Russia in that it should in the next eight years construct all Olympic facilities and strongly modernise and develop the infrastructure in Sochi. It is a formidable challenge for the country, to implement such huge projects as organisation of the Olympics not only heavy capital investment (at present, the estimate for preparation of Sochi for the Olympics will cost USD 12 bln) but also a well designed management and coordination system for all parties in the preparation process, including construction contractors and sponsors of the Olympics will be needed. At the same time, the Olympics in Sochi will make it possible to develop the economy quickly and to restore recreation and tourist potential of the Russian Black Sea coastal area.

## **2. Monetary sector and financial system**

The situation in the monetary sector in the third quarter of the current year was less stable compared to the previous six months. The indices dynamics were influenced by the deterioration in global financial markets. The aggravated situation in the American mortgage market created problems of liquidity in the global financial system, and considerable flows of capital investment were redirected to safer financial instruments (first of all to American Treasury Bonds). It triggered a massive outflow of speculative capital from countries with transitional and developing economies. This situation was repeated in August in the Russian economy also creating problems with liquidity of the bank system. But the accumulated assurance factor of the financial system reduced the negative effects to zero, and by the end of September the situation has been improved and on the whole remains safe.

The tendency that prevails on the foreign exchange market in recent years is that currency supply exceeds demand. This circumstance pushed the Central Bank of the Russian Federation to make considerable investments to sterilise excess foreign exchange and avert strong currency exchange fluctuations. The established policy resulted in steady strengthening of the RUB exchange rate vs. USD and growing forex/gold holdings.

In the third quarter the foreign exchange dynamics were, as before, largely influenced by the tendencies in global financial markets and intervening of the Central Bank. Against the negative events in American financial system, USD vs. EUR exchange rate dropped more rapidly causing faster strengthening of RUB vs. USD exchange rate after considerable moderate dynamics observed earlier this year.

The nominal RUB vs. USD exchange index in the first nine months of this year has gone 3,7% (7,7%) up. The real RUB vs. USD exchange index reached solid 8,6% (11,4%). At the same time RUB vs. EUR exchange rate in the said period dropped 1,2% (-0,1%), and the dynamics of the real valid RUB vs. foreign exchange rate index after strengthening in the first months of the year has changed its tendency, and as of the nine months of this year this index increased by 4,0% (7,8%).

**Table 3. Production indices of RUB exchange rate dynamics in 2007**

	January	February	March	April	May	June	July	August	September
Nominal USD vs. RUB exchange rate as of the period end	26,53	26,16	26,01	25,69	25,90	25,82	25,60	25,65	24,95
Nominal EUR vs. RUB exchange rate as of the period end	34,39	34,52	34,69	35,07	34,82	34,72	34,93	35,01	35,35
The nominal RUB vs. USD exchange index (in % of increment by December 2006)	-0,7	-0,2	0,7	1,7	1,8	1,4	2,9	2,6	3,7
The nominal RUB vs. EUR exchange index (in % of increment by December 2006)	0,8	1	0,5	-0,4	-0,5	-0,1	-0,8	-0,4	-1,2
The nominal valid RUB vs. foreign exchange index (in % of increment by December 2006)	0,2	0,5	0,4	-0,1	-0,4	-0,2	-0,3	-0,2	-0,5
The real RUB vs. USD exchange index (in % of increment by December 2006)	0,7	1,8	2,7	3,3	3,4	3,8	6,3	6,1	8,6
The real RUB vs. EUR exchange index (in % of increment by December 2006)	2,6	3,5	3,2	2,3	2,6	4,1	4,3	4,8	4,5
The real valid RUB vs. foreign exchange index (in % of increment by December 2006)	1,7	2,6	2,7	2,4	2,4	3,3	3,9	3,9	4,0

*Data of the Central Bank of the Russian Federation*

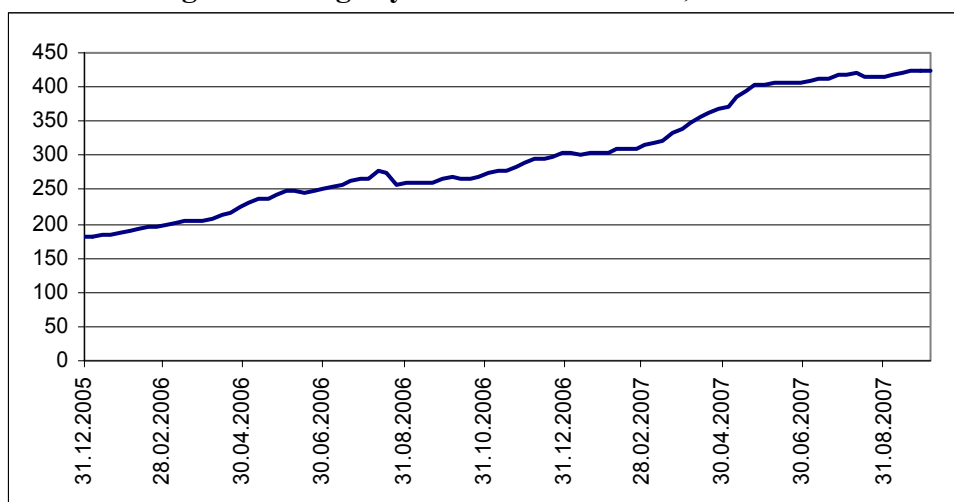
The growth dynamic of forex/gold holdings in the third quarter were unstable due to fluctuations on financial markets. In August, the capital outflow pushed the Central Bank to employ forex/gold holdings to maintain foreign exchange stability. Due to this measure forex/exchange holdings have practically not changed in the last summer month. In September the situation has stabilised and started growing again. The Drop in USD exchange rate enhanced this tendency.

According to data from the Central Bank of the Russian Federation as of 5 October 2007 forex/gold holdings amounted to USD 424,8 bln, having increased for the year to date almost by USD 121,8 bln Or 40,2% (in the first nine months of 2006 forex/gold holdings have grown by USD 85,7 bln or 47,0%).

The last months of the year will have a considerable influx of foreign exchange flows into the Russian economy though, maybe, less intensive compared to the first six months. It will be provided by the positive balance from foreign commerce and the influx of foreign capital to the

private sector. These conditions will maintain forex/gold holdings growing, though the rate may slow down.

Diagram 3. **Forex/gold holdings dynamics in 2006-2007, bln USD**



*Data of the Central Bank of the Russian Federation*

Amid a growing capital influx into the Russian economy, the large IPO of Sberbank and VTB, steadily high level of income from foreign commerce, the first half of 2007 witnessed a faster, compared to the same period of the previous year, growth of liquidity in the Russian economy. Monetary aggregates grew faster compared to the previous year, and higher economic activity permitted an expectation that demand for currency will grow together with currency supply. However, liquidity growth appeared to be too high.

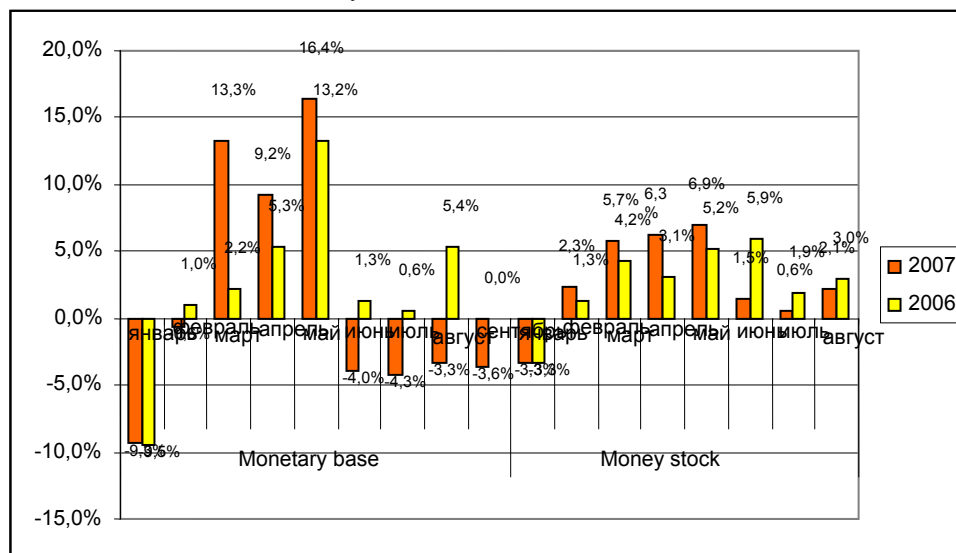
Monetary authorities took measures to reduce currency supply apprehending excess liquidity in the economy. The Central Bank and the Ministry of Finance took efforts to sterilise the excess. Mainly, traditional instruments were used: forex/gold holdings, deposits, stock of the Central Bank, Stabilisation Fund and increased interest rates on reserve requirement of banks in RUB and foreign exchange.

However, in the second half of summer external factors changed the situation in the Russian financial system. The negative tendencies in global capital markets, caused by the crisis in the mortgage market in USA, reduced the possibilities to attract foreign finance (it will be mentioned below) in the Russian economy, which considerably complicated the situation with liquidity of Russian banks. It slowed down the growth of monetary aggregate and even reduced the monetary base. It cut the intensity of the problem with excess liquidity and even created its deficit in august. Nonetheless, in the first eight months of this year the money supply (in the national

context) increased by 24% (while in the same period of the last year - 19,6%)<sup>5</sup>, the monetary base – 15,4% (19,6%). The stronger growth of monetary aggregate was one of the main reasons for increased price dynamics that has appeared in the third quarter.

Diagram 4. **Monetary aggregate dynamics, in % compared to the previous month**

Data source: The Central Bank of Russia



2007 started with slower inflation compared to the same period of the previous year. Disinflation was caused by a number of factors Firstly; there is a considerable growth in supply of consumer goods and services. It is encouraged by growing imports, production growth in manufacturing industries and steadily high growth rates of the market services sector. Secondly, the Russian Government has lately been actively applying anti-inflation measures<sup>6</sup>.

At the same time a number of factors enhanced inflation pressure. In particular, fast-growing household disposable income and monetary aggregate (due to considerable capital influx into the economy) of the late spring spurred an additional increase in prices<sup>7</sup>. In the summer, the influence of seasonable factors on inflation reduced it; however, CPI growth rate appeared to be higher than in the same months of the last year. In particular, CPI grew in September by 0,8%, and base inflation<sup>8</sup> – by 1,6%. Following the results of the first nine months of 2007 CPI grew by 7,5% (for the same period of 2006 – by 7,2%), BCPI – by 6,7%. Increased inflation of this period was also enhanced by a price increase for food products in global commodity markets

<sup>5</sup> The supply of money going by the monetary survey methods for this-year January-August, has grown by 21,7% and reached RUB 12352,6 mln.

<sup>6</sup> In particular, the Ministry of Finance tries to finance budget expenses more steadily tending to eliminate traditional costly expenses in the end of reporting periods; the Ministry of Economic Development and Commerce develops rates for natural monopolies for the whole year ahead.

<sup>7</sup> Besides, MEDT estimated the price surge for fruits and vegetables in the second quarter was caused by lack of product supply provoked by ban on using foreign labour at retail markets starting from April 1 of this year.

<sup>8</sup> The base index prices consumer (BCPI) is calculated without consideration of the influence of administrative, event-triggering and seasonal factors.

that caused relevant prices in Russian economy to grow. Paid serviced to the population still remains at a high level..

**Table 4. Consumer prices dynamics by groups of goods and services**

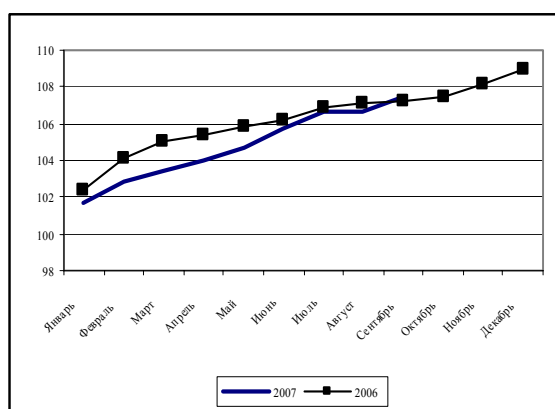
	January-September 2007	January-September 2006
Consumer price index, including for	107,5	107,1
food commodities	108,1	106,7
food commodities excluding fruit and vegetables	108,1	106,6
non-food commodities	104,0	104,3
paid serviced to the population	111,6	112,0

Data of FSSS

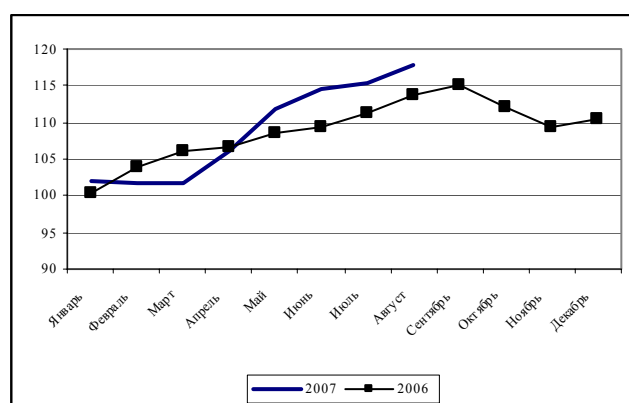
Based on the results of three quarters it is possible to claim that inflation is ready to exceed the planned 8%, despite that the price dynamics at the beginning of the year which gave hope for its reduction.

Also, this year there was an acceleration in producer price index (MPI) growth. In the January-August period PPI grew by 117,7% against 113,7% of the last year. The most considerable price increase occurred in the mining sector, where price index grew by 40,1% (in the same period of the last year – 22,2%) following the price increase in global commodity markets. In the manufacturing sector prices increased by 110,4% (111,6%). PPI in power, gas and water generation and distribution sector amounted to 115,2% (110,1%).

**Table 5. CPI dynamics in 2006-2007**



**Table 6. PPI dynamics in 2006-2007**



Nonetheless, according to the plans of the Russian Government and the Central Bank the midterm perspective has inflation falling. In particular, in early October the head of the Central Bank claimed that in 2008 inflation will reach 7%. This CPI level can be reached but it will be difficult.

The Russian economy has objective reasons for a rather high inflationary background. Primarily, the Central Bank does not have all the necessary instruments for efficient control over money supply. Considerable currency influx into the Russian economy determines rapid growth of either liquidity or currency exchange, where strong fluctuations in capital flows (what is characteristic in the third quarter) additionally complicate the situation. The possibilities of the Central Bank to solve two tasks at the same time (keep price growth and rouble strengthening rate in check). Sterilisation instruments applied to the Russian economy (forex/gold holdings and Stabilisation Fund) do not provide for accurate control over the liquidity dynamics, that create the background for inflation surges at the time of demand for currency reduction and for lack of liquidity at the time of increased economic activity.

Besides, notwithstanding high annual economic growth, the economic activity is not stable, and fluctuations depend both on changes at the market and rapid and unexpected governmental decisions.

Finally, the next few years will be characterised by increased growth of gas and power prices, what is determined by the need to level the Russian system of relative prices and to create conditions for stable production in the energy sector.

In addition, the background for consumer prices growth lately was also created by high household consumption resting on sped-up household income growth and rapidly developing consumer credit.

This year, growth rates in the consumer credit sector remain high, though they are lower than indexes of the last year. In the first eight months of this year, the volume of granted credits grew by 36,3% (in the same period of the last year - 44,2%).

**Table 7. Bank Sector development indices for 2006-2007, % in the year beginning**

Date	Assets	Net worth	Loans to non-financial institutions	Household credits	Deposits of natural persons	Finances from organisations
01.01.2006	100	100	100	100	100	100
01.02.2006	100,3	102,1	100,5	100,4	99,9	99,1
01.03.2006	103,5	104,8	102,3	103,4	102,5	101,6
01.04.2006	106,9	105,5	105,1	109,1	105,2	107,8
01.05.2006	109,4	110,1	107,7	114,3	107,8	109,4
01.06.2006	114,7	111,1	110,0	121,0	109,6	120,7
01.07.2006	117,7	112,9	115,7	128,8	113,5	126,9
01.08.2006	120,4	114,4	120,1	135,9	115,7	127,1
01.09.2006	124,0	118,0	122,7	144,2	118,3	130,0
01.10.2006	127,4	120,6	126,5	152,1	121,1	135,8
01.11.2006	130,1	122,3	129,4	158,7	123,8	138,5
01.12.2006	136,1	126,5	133,8	165,5	127,0	145,8
01.01.2007	100,0	100,0	100,0	100,0	100,0	100,0
01.02.2007	100,6	101,7	102,2	101,1	100,0	99,1
01.03.2007	103,1	102,4	105,1	104,0	103,2	102,1

01.04.2007	111,1	119,2	108,4	108,4	105,8	115,8
01.05.2007	113,2	121,7	111,6	113,3	109,1	118,0
01.06.2007	121,2	136,7	115,8	118,2	111,0	133,2
01.07.2007	122,4	137,8	119,7	123,9	114,7	128,6
01.08.2007	124,4	141,2	125,4	129,8	117,2	128,0
01.09.2007	127,9	143,9	130,9	136,3	119,8	131,1

*Data of the Central Bank of the Russian Federation*

It should be noted that the late rapid growth in credit to consumers increased the risk of defaults on credit<sup>9</sup>. According to the Central Bank overdue household credits (to residents and non-residents) increased in the first six months of this year by 60% and amounted to RUB 87bln. or 3,3% of household credit. At that, the last two years showed high growth dynamics of this index: the volume of overdue credit was increasing annually 2,5 times.

In the third quarter of this year, as it was mentioned before, the bank system faced problems with liquidity. Lately, Russian banks actively used external loans for a quick increase of their resources.<sup>10</sup> Due to destabilisation of the world financial system in the second half of summer, attracting capital to countries with developing and transitory economies became more difficult. That is why it became less possible to attract borrowed capital from external markets to the Russian bank system. The internal financial market is still rather flat to sufficiently credit the bank system. Under these circumstances the short-term financial solvency of Russian credit organisations has deteriorated<sup>11</sup>.

The Bank of Russia used its available means to eliminate negative processes in the bank sector and promoted faster growth of currency supply by reducing control over the currency market. In particular, financial volumes at REPO auctions were increased and the balance limits for correspondent accounts of banks in the Bank of Russia were lowered. The list of stock that can be secured was extended.<sup>12</sup> However, all these measures are in effect only for a short term, and to solve the liquidity problems for the long term banks will have to raise their efficiency and

<sup>9</sup> Since July of this year the Central Bank obligated banks granting loans to the population to disclose the information on effective interest rates on loans. This measure is aimed to reduce the risks of defaults on consumer credit. Until now it was difficult for potential borrowers to exactly calculate the real cost of suggested credits, as besides payment of interest rate on credit there was a number of mandatory payments (including, opening and maintaining an account, withdrawal, payment for notary services, insurances service charges, etc.). As a result, it was rather difficult to compare the cost attractiveness of credit offers, that required from the consumer both experience and a considerable amount of time to gather information.

<sup>10</sup> In particular, from January 2005 to March 2007 the external debt of banks has increased 3,4 and reached USD 110 bln.

<sup>11</sup> At the same time, there increased bank system risks related to the handling of previous loans. If January 2005 showed that the estimated interest rate risk share in the market risk structure of the bank sector was equal to 41,8%, then in August 2007 it has grown to 51,2%.

<sup>12</sup> The standards on enlisting the bonds of banks to Lombard list of CBR were lowered. From 11 October 2007, the temporary (for three months) limit of reserve requirement on bank obligations to natural persons (in roubles) has been lowered, to non-resident banks (in roubles and foreign exchange) and on other obligations (in roubles and foreign exchange). From 1 November 2007 the averaging ratio for calculation of reserve requirement average volumes was raised (from 0,3 to 0,4).

accumulate their assets by attracting new deposits, for which purpose interest rates on deposits will have to be increased.

At present, it is possible to predict that under the increased instability in global financial markets will restore and even increase investment flow into the Russian financial system within the next few months, as the steady development of Russian economy makes it highly appealing to investors. In this case, recession in the bank system will be eliminated in more favourable circumstances. In the third quarter of this year the stock market was unstable mainly due to a deterioration in global financial markets. In particular, it pushed large institutional investors to withdraw their capital from the stock markets of the countries with transitory economies. This process also affected the Russian economy, though Russian stock market indices started growing again after a short-term decline.

Diagram 5. **RTS dynamics indices for the third quarter of 2007**

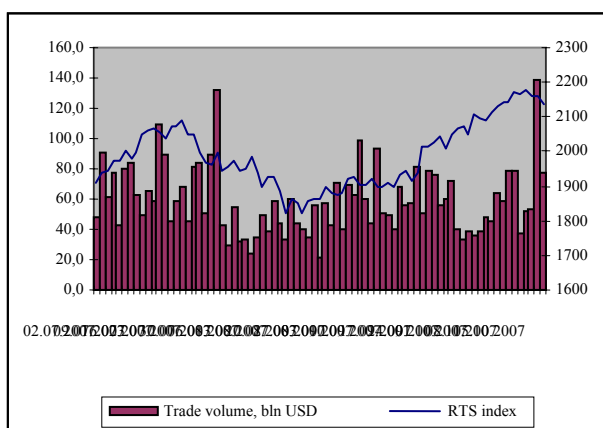
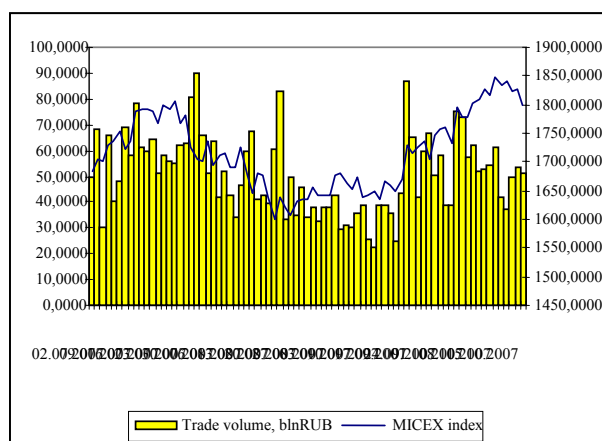


Diagram 6. **MICEX dynamics indices for the third quarter of 2007**



It should be noted that compared to previous years when the Russian stock market was one of the world fastest growing markets, in 2007 the indices dynamics slowed down. In particular, at the end of the third quarter the RTS index growth rate amounted to 15,1%, while in the same period of the last year it was at 30,2%. However, fundamental characteristics of Russian economy make it possible for the stock market to grow further: high economic growth rate, sovereign credit rating at investment level, still high liquidity growth and slow but steady strengthening of the exchange rate and liberalisation of exchange regulations. The year end RTS index can reach the level of 2300-2600 points.

### 3. Balance of payments

The balance of payments in RF still undergoes structural changes that appeared in the first half-year. At the same time, there is a reduction in the balance of current transactions caused by the anticipated growth of imports vs. exports, and there is an increase in the balance of financial transactions largely caused by growing borrowing by Russian companies abroad as well as by an influx of direct foreign investment. Exchange reserve continues growing fast.

**Table 8. Estimate payment balance for January-September 2007, bln USD**

	January-September 2007	January-September 2006
<b>Current account</b>	<b>57,1</b>	<b>79,7</b>
Balance of trade	94,1	111,2
Balance of services	-14,0	-9,9
Balance of wages	-5,3	-3,3
Balance of investment income (interest, dividends)	-15,7	-17,6
Balance of current transfers	-37,0	-31,5
<b>Capital and financial account</b>	<b>59,5</b>	<b>-5,1</b>
<b>Financial account (capital transfers)</b>	<b>-0,8</b>	<b>0,1</b>
<b>Financial account (except reserve assets)</b>	<b>60,3</b>	<b>-5,2</b>
<b>Obligations ('+' – increase, '-' – drop)</b>	<b>143,6</b>	<b>38,5</b>
State control and money and credit regulatory authorities	-5	-30,2
Banks	57,0	27,8
Other sectors	91,6	40,9
<b>Assets, except the reserve ('+' – drop, '-' – increase)</b>	<b>-83,3</b>	<b>-43,6</b>
State control and money and credit regulatory authorities	-1,1	1,2
Banks	-19,4	-12,1
Other sectors	-62,8	-32,8
<b>Net faults and miss-outs</b>	<b>-10,2</b>	<b>1,5</b>
<b>Change of exchange reserve ('+' – drop, '-' – increase)</b>	<b>-106,4</b>	<b>-76,2</b>

*Data of the Bank Russia*

An important feature of this year is an accelerated capital influx to the private sector of the economy. The Central Bank of Russia estimates that the first half of this year had a net capital inflow rapidly growing and amounting to USD 67 bln, including capital inflow to the bank sector amounting to around USD 37 bln and to other sectors around USD 31 bln<sup>13</sup>.

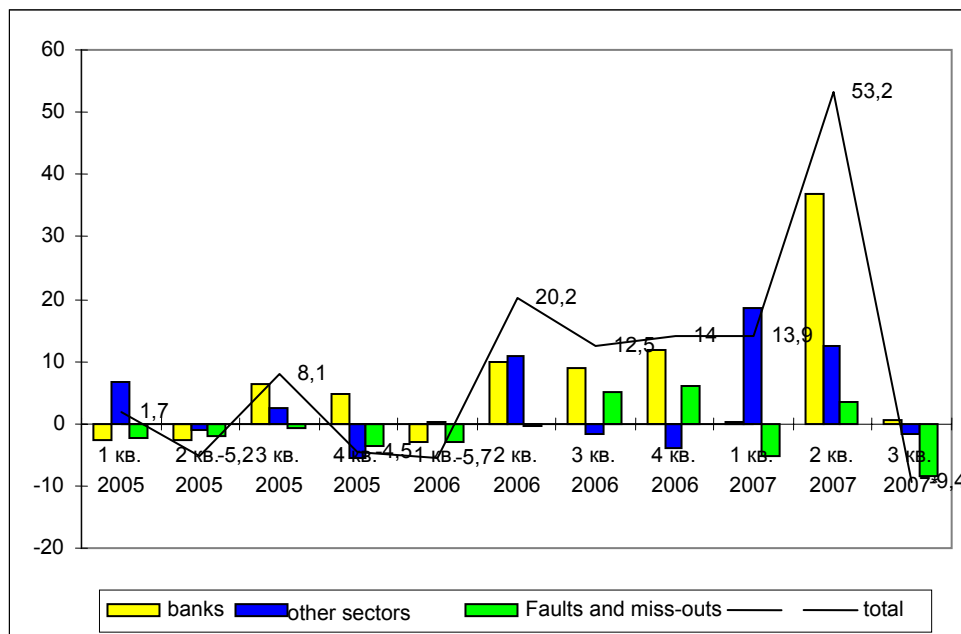
As mentioned above, the destabilised global financial market triggered a temporary speculative capital outflow from the Russian economy in the third quarter. The Central Bank of

<sup>13</sup> A considerable amount of finance inflows is the result of growing foreign borrowing by Russian corporations, including around 22 bln attracted by Rosneft to finance the merger and purchase acquisition.

Russia and the Ministry of Finance estimated the capital outflow this August-September to be equal to USD 9,4-10,8 bln.

It is possible to suggest that the capital outflow from the Russian economy is temporary, which is testified by improvement in early October. Fundamental factors of the Russian economy remain favourable and the Russian economy will remain rather attractive for investment.

**Table 9. Net capital inflow to the private sector (by the balance of payments), bln USD**



Data of the Central Bank of the Russian Federation

#### 4. Budget

The budget, in the third quarter of this year, remains stable and steady. According to the Federal Treasury the extended budget of RF received RUB 7924,3 bln, spent – RUB 5804,3 bln, profited – RUB 2120,0 bln.

**Table 10. RF budget system indices for January-August 2006 and 2007**

	2006	2007	Increase
	RUB bln	RUB bln	%
<b>Income</b>	6715,3	7924,3	1,18
Federal budget	4028,7	4509,9	1,12
consolidated budget of RF subjects	2378,4	3044,8	1,28
Budgets of state extra-budgetary funds	1125,5	1341,4	1,19
Budgets of mandatory health insurance territorial funds	210,5	274,7	1,31
<b>Expenses</b>	4737,8	5804,3	1,23
Federal budget	2539,3	3054,4	1,20

consolidated budget of RF subjects	1979,4	2535,6	1,28
Budgets of state extra-budgetary funds	1040,6	1199,5	1,15
Budgets of mandatory health insurance territorial funds	206,5	261,2	1,27
<b>Profit</b>	1977,5	2120,0	1,07
Federal budget	1489,4	1455,4	0,98
consolidated budget of RF subjects	399	509,2	1,28
Budgets of state extra-budgetary funds	84,9	141,8	1,67
Budgets of mandatory health insurance territorial funds	4	13,5	3,38

*Data of the Federal Treasury of RF*

According to the Ministry of Finance the profit of the Federal Budget in the first three quarters exceeded the budget financial target by 0,2% and amounted to RUB 5084,8 bln. The Federal Budget spent in January-September of this year RUB 3950,0 bln which amounts to 95,1% of the budget financial target for this period, where cash executions are equal to RUB 3483,7 bln or 83,8% of the target. The Federal Budget profited RUB 1601,0 bln, including primary budget surplus equal to RUB 1717,6 bln.

**Table 11. Federal Budget implementation data for January-September 2007**

	2007 budget	Cash execution for January-September 2007			Reference: for January-September 2006	
		RUB bln	RUB bln	To the adopted budget	% to GDP	RUB bln
Income	6 965,3	5084,8	73,0	22,5	4561	23,5
Expenses, incl.	5 463,5	3950,0	72,3	17,5	2866,5	16,5
paid interest	156,8	116,6	74,3	0,5	136,8	0,7
non-interest expenses	5 306,6	3833,4	72,2	16,9	2729,7	15,7
Deficit/Surplus	1 501,8	1601,0	106,6	7,1	1694,6	8,7
GDP	31220	22632		100,0	19372	100,0

*Data of the Ministry of Finance, EEG*

Reduced budget expenses are largely determined by oil price drop in the world market, which reduced fiscal payments from exporters of energy carriers. The Federal Customs received 96,6% of the budget target in the first nine months. At the same time, growing world oil prices triggered an increase in duties for oil and petroleum products. Since August 1 oil rate was equal to 223,9 USD/t, and since October 1 it has been increased to 250,3 USD/t.

The Federal Tax Service received 100,4%. At the same time, the Federal Property Management Agency and other federal authorities exceeded the budget target and received 148,9% and 133,6% respectively.

In the first nine months of this year the Stabilisation Fund has increased by RUB 1245,8 bln and by October end it was RUB 3519,1 bln or over USD 141 bln In August, the Stabilisation Fund was used to pay the additionally confirmed debt of USSR to France in the amount of RUB 0,07 bln and to preliminary satisfy the rest of the debt to Portugal in the amount of RUB 2,14 bln.

Diagram 7. **Federal Budget income structure by administrations in January-September 2007, bln RUB; % of the total**

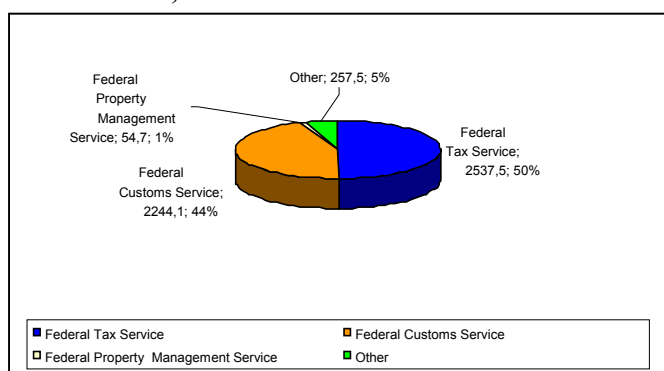
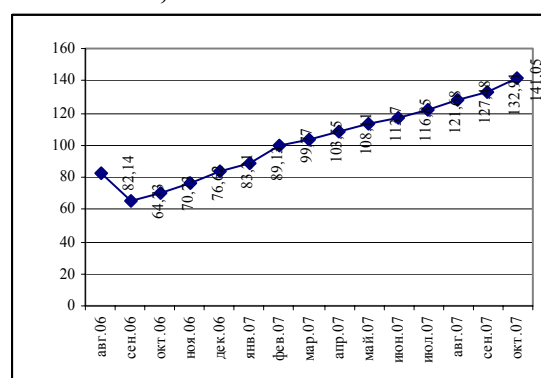


Diagram 8. **Stabilisation Fund volume, bln USD**



Data of the Ministry of Finance

In July, there was adopted a three-year budget for 2008-2010.<sup>14</sup> For the next few years a rapid increase in budget spending is planned causing as soon as 2010 a surplus reduction to zero.<sup>15</sup> The implementation of this policy is associated with certain macroeconomic risks. If budget income appears to be lower than the target (which is possible, in particular, if the world oil price drops considerably), there will be a budget deficit with a negative effect on financiers.

In the budget being considered for 2008-2010 the Emergency Fund will amount to around RUB 3 bln in 2008, RUB 3,7 bln in 2009 and RUB 4,1 in 2010. The future Fund will in the same

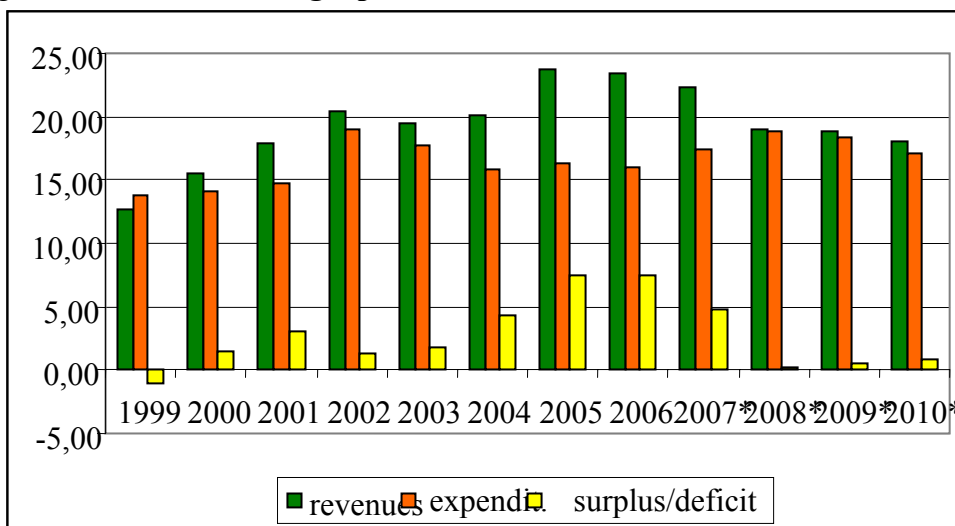
<sup>14</sup> The budget for the next three years is based on the macroeconomic forecast which determines a drop in prices for the Urals grade of oil (down to 53 USD/bl in 2008, and in 2009 and 2010 down to 52 and 50 USD/bl respectively). In the next three years GDP growth is expected to be 6-6,2% per annum. In 2008 GDP is expected to be around RUB 35 bln, in 2009 – RUB 39,7 bln, and in 2010 – RUB 44,8 bln. At that, the rate of inflation rate will be reduced: 6-7% in 2008, 5,5-6,5% in 2009 and 5-6% in 2010. This forecast seems to be conservative, and thus, feasible. The Russian economy has accumulated sufficient potential for mid-term development in the context of the Western scenario.

<sup>15</sup> Federal Budget income in 2008 will amount to around RUB 6,644 bln (19% GDP), spending – RUB 6,570 bln (18,8% GDP), surplus – RUB 74,1 bln. In 2009 income will amount to RUB 7,465 bln (18,8% GDP), spending - RUB 7,451 bln, surplus – RUB 14,2 bln. In 2010 income will be equal to spending and will amount to RUB 8,89 bln. (18,1% GDP).

year's amount to RUB 470,7 bln, RUB 492,7 bln, RUB 504,4 bln respectively. To prevent crises in the state financial system the oil and gas budget is limited to 4,7% GDP.

The Government intends to accumulate its budget spending in proportion to the rate in the growth of GDP, further reducing fiscal load on economy. However, further growth of non-interest spending of the Federal Budget in the next few years accompanied with the reduction of relative income will cause an abrupt reduction in the Federal Budget surplus.

Diagram 9. **Federal Budget parameters for 1999-2010, % GDP**



*Data of the Ministry of Finance of the Russian Federation  
data from the laws on the Federal Budget*

The implementation of this policy is associated with certain macroeconomic risks. If budget income<sup>16</sup> appears lower than the target (which is possible, in particular, when world oil price considerably drops)<sup>17</sup>, there will be budget deficit causing tensions in financing conventional authorised spending. In the mid-term perspective the accumulated reserves of the Stabilisation Fund will help to maintain financial stability even in the negative course of events, however, further economic development requires a stable and balanced budget.

## 5. Real sector

During the summer, The Russian economy maintained rapid growth, though the growth rate has been somewhat reduced compared to the second quarter. According to MEDT, GDP grew in

<sup>16</sup> Budget balance, excluding oil and gas income, will amount to 6,1% GDP in 2008, 5,3% GDP in 2009 and 4,5% GDP in 2010. At that, the transfer to the Federal Budget to maintain current spending at the target level will amount to RUB 2135 bln or 6,1% GDP in 2008, 5,9% GDP and 5,2% GDP in the following two years.

<sup>17</sup> The Budget for the next tree years is developed according the scenario which provides for drop in the world oil price, which will reduce mid-term income to the Federal Budget from oil and gas from RUB 2383,1 bln (6,8% GDP) in 2008 bln to 2348,3 bln (5,2% GDP) in 2010. However, it is possible that prices will drop much lower causing additional budget losses.

the first eight months by 107,7%. A surplus (excluding seasonal factor) in July amounted to 0,5%, in August – 0,4%, while in the first quarter it was at the level of 0,7% and in the second – 0,8%. The growth mechanism is based on the high domestic demand in the investment and consumption sectors, as well as on the rather favourable conditions on the main export markets.

The GDP production structure undergoes changes determined by the difference in the production dynamics of economy sectors. The data of FSSS on GDP production shows that the first half of this year is characterised by high growth in the construction and financial sectors, manufacturing industry, trade, transport and telecommunication, as well as in the real estate sector, hotel, restaurant and other services. There is a considerable growth in the state administration and security activities, which is caused by a significant increase in state spending in the last few years. At the same time, the growth is slow in the education, health care, agricultural and fishing sectors.

**Table 12. Dynamics of actually produced GDP on quarterly basis, in % against the same period of previous year**

	2006			2007		
	1 quarter	2 quarter	I half of the year	1 quarter	2 quarter	I half of the year
<b>Agriculture, hunting and forestry</b>	100,3	100,1	100,2	102,9	102,6	102,7
<b>Fishing, fish farming</b>	110,6	115,5	113,3	107,5	96,9	101,5
<b>Mining</b>	101,1	104,2	102,7	102,4	101,4	101,9
<b>Manufacturing industries</b>	102,3	105,9	104,2	111,8	106,2	108,8
<b>Power, gas and water generation and distribution</b>	104,7	103,4	104,2	94,1	100,4	96,7
<b>Construction</b>	101,1	110,1	106,3	123,2	122,0	122,5
<b>Wholesale and retail</b>	109,4	110,1	109,7	109,1	110,9	110,0
<b>Hotels and restaurants</b>	109,5	110,3	109,9	113,9	107,9	110,6
<b>Transport and telecommunication</b>	107,6	109,1	108,4	107,9	108,6	108,3
<b>Financial industry</b>	110	110,4	110,2	109,9	111,3	110,6
<b>Real estate industry</b>	101,9	103,9	103,0	107,4	109,4	108,4
<b>State management and security</b>	103,5	104,9	104,2	107,6	108,1	107,8
<b>Education</b>	101,8	101,6	101,7	101,6	102	101,8
<b>Health care</b>	102,2	103,3	102,8	102,2	103,1	102,6
<b>Other services</b>	108,6	110,2	109,5	110,7	107,3	108,9
<b>Financial mediation services indirectly measured</b>	111	111,1	111,1	112,5	112,8	112,6
<b>Net tax on products</b>	108,1	109,3	108,7	108,4	108,8	108,6
<b>Gross domestic product (in market price)</b>	105	107	106,0	107,9	107,8	107,9

*Data of FSSS*

The structure of GDP production is undergoing changes predetermined by the rapid development of manufacturing industry sectors<sup>18</sup>, financial sector, construction, hotel and restaurant business, education and health care systems. However, GDP production structure was not subjected to radical changes due to difference in the scale of a sectors significance in the economy, and diversification which remains desirable but has not been implemented.

**Table 13. Gross value added (GVA) production indices by types of economic activities in the first half of 2006 and 2007**

	real GVA production dynamics, % against the first half of the previous year		share in GVA production, % against total	
	2006	2007	2006	2007
agriculture, hunting and forestry	100,2	102,7	2,7	2,5
fishing, fish farming	113,3	101,5	0,4	0,3
mining	102,7	101,9	10,9	9
manufacturing industries	104,2	108,8	19,5	20,5
power, gas and water generation and distribution	104,2	96,7	3,9	3,7
construction	106,3	122,5	4,8	5,6
wholesale and retail, repair of vehicles and other household appliances	109,7	110	19,4	19
hotels and restaurants	109,9	110,6	0,9	1
transport and telecommunication	108,4	108,3	9,5	9,5
financial industry	110,2	110,6	4,3	4,7
real estate	103	108,4	9,5	9,5
state management and security	104,2	107,8	5,8	5,9
Education	101,7	101,8	3	3,1
health care and social services	102,8	102,6	3,4	3,6
other communal and social services	109,5	108,9	2	2,1

*Data of FSSS*

This year is characterised by higher industry growth rates compared to the previous year. The Industrial production index for January-September amounted to 106,6% compared to the same period of the last year (in 2006 – 104,2%). At that, the third quarter of this year, the same as the last, is characterised by reduced growth rated after acceleration of the first half-year. In the first

<sup>18</sup> The production index in manufacturing industries has amounted in the first eight months of this year to 110,9% (compared to 104,3% in the same period of the previous year), and the whole industry – 107,0% (104,3%). High growth is observed in machine and equipment building – 125,4%, rubber and plastic products – 121,8%, electrical, electronic and optical equipment – 117,1%, means and equipment for transportation – 116,2%, production of other non-metal mineral products – 115,0%. The lowest production growth dynamics is observed in textile and garment industry – 102,1%, metallurgical industry – 103,0%, coke and petroleum products production – 103,7%.

three months of this year the industry growth reached 108,4% compared to the same period of the previous year (in 2006 – 103,0%), and in April-June the index growth amounted to 106,7% (106,0), and in June-September – 104,9% (103,8).

But the dynamics of the main production sectors differ from that of the last year. Here, production index in Power, Gas and Water Generation and Distribution in the first eight months of this year amounted to 97,9% compared to the index of the same period of the previous year (in 2006 – 105,2%). Production slowdown in this sector was caused by a warm winter in 2006-2007 which reduced demand for in this industry early this year: production growth in the first quarter amounted to 94,3% (106,5%) compared to the same period of the previous year. However, the second and third quarters showed increased production growth rates which amounted to 101,0% (104,9%) and 103,2% (104,9%) respectively. High business activity in the economy and intensive power consumption growth in the non-industrial sector (households, trading and recreation centers, etc.) spur the demand for power and gas.

The production index in Mining is characterised by mild growth, which slowed down in the last month of this year. In January-September 2007 it amounted to 102,2% (in 2006 – 102,4%), where in the third quarter – 100,8% (102,9%).<sup>19</sup>

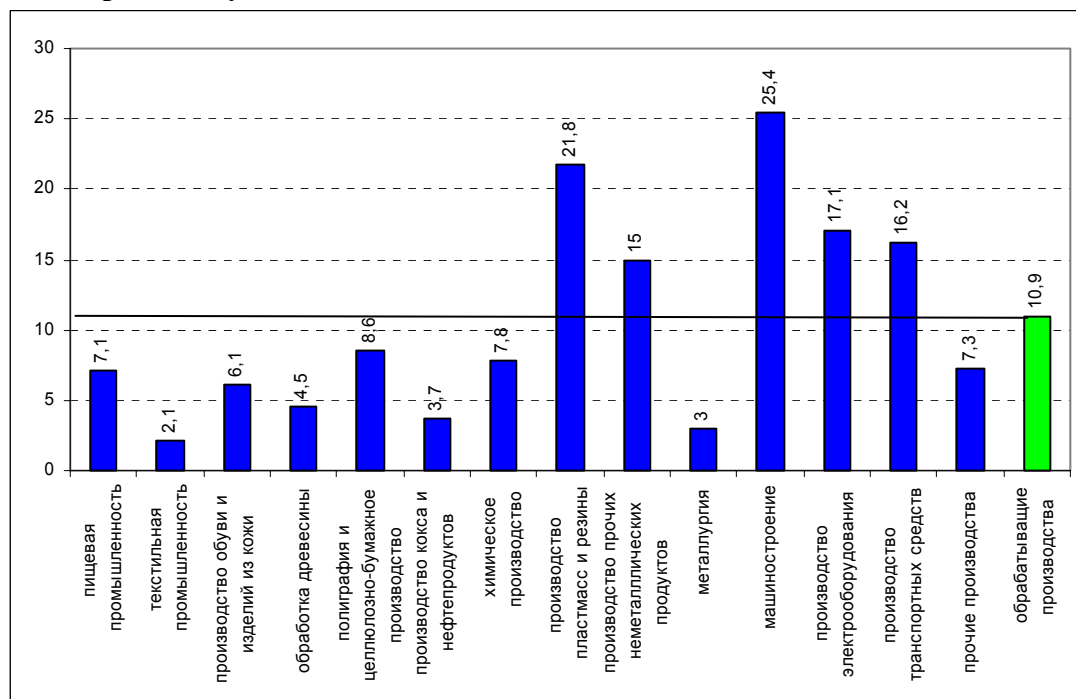
An important tendency in 2007 is an accelerated production in the manufacturing sectors of industry. In the first nine months of this year, the production index in this sector amounted to 110,0% compared to the same period of the previous year (in 2006 – 104,3%).<sup>20</sup> Production growth is observed in all main sectors of the manufacturing industry.

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<sup>19</sup> The dynamics of the energy transmission/ mining sector production, the results of three quarters, appeared to be close to that of the last year. For the first nine months of this year 367 mln tons of oil were extracted (102,5% compared to the same period of the last year), 478 bln m<sup>3</sup> of natural gas (98,7%), 225 mln tons of coal (1006%). In the non-fuel and energy carriers mining sector the production tendencies are differently directed. Iron ore mining amounted to 464k tons (103,0%), and calciferous and dolomite powder reduced to 1,5 mln tons (95,3%); extraction of construction non-metallic materials amounted to 275 mln m<sup>3</sup> (464), but production rates in the third quarter has considerably reduced compared to the same period of the last year.

<sup>20</sup> High growth is observed in machine and equipment building – 125,4% in the first eight months of this year, rubber and plastic products – 121,8%, electrical, electronic and optical equipment – 117,1%, means and equipment for transportation – 116,2%, production of other non-metal mineral products – 115,0%. The lowest production growth dynamics is observed in textile and garment industry – 102,1%, metallurgical industry – 103,0%, coke and petroleum products production – 103,7%.

Diagram 10. **Production gain in January-August 2007 against the same period of the previous year, %**



*Data of FSSS*

GDP application structure changes due to high consumption and investment demand, as well as budget spending increase. In particular, final consumption spending in the second quarter of this year amounted to 69,5% (67,7% in the same period of the previous year), including households 49,7% (48,7%), state administration - 19,3% (18,5%), gross capital formation increased to 19,6% (16,4%). Changes in the foreign trade tendencies triggered the reduction of the net GDP export to 9,4% (14,8%).

**Table 14. GDP application in the first half-year 2006 vs. 2007**

	GDP consumption structure			GDP elements application dynamics	
	RUB bln	% of total		% vs. the same period of the previous year	
		2 quarter of 2007	2 quarter of 2006	I half of 2007	I half of 2006
<b>Gross domestic product, including</b>	<b>7647,5</b>	<b>100</b>	<b>100</b>	<b>107,9</b>	<b>106</b>
<i>final consumption expenditure, including</i>	<i>5223,5</i>	<i>69,5</i>	<i>67,7</i>	<i>109,8</i>	<i>108,5</i>
Households	3738,2	49,7	48,7	112,1	110,2
state administration	1449,1	19,3	18,5	104,5	104,6
non-commercial organisations providing services to households	36,2	0,5	0,5	99,7	89,9
<i>gross saving, including</i>	<i>1576,3</i>	<i>21,1</i>	<i>17,5</i>	<i>128,5</i>	<i>111,2</i>
gross capital formation <sup>2)</sup>	1461,2	19,6	16,4	121,7	111
change in stock resources	115,1	1,5	1,1	2 times	113,9
<i>net export (export minus import)</i>	<i>706,3</i>	<i>9,4</i>	<i>14,8</i>	<i>76,6</i>	<i>90</i>
<i>statistical discrepancy</i>	<i>141,4</i>				

Data of FSSS

An important tendency of this year is an acceleration in investment rates. All the main indices of investment grow, and they appear to be surpassing the record for all post-Soviet period of the development of the Russian economy.

A positive role for capital investment acceleration was played by the considerable growth of economic income in the last few years, investment mechanisms, created last year (in particular, the Investment Fund, special economic zones), as well as increased state investment spending, growing positive estimate of investment environment from foreign investors. Among the factors that enhanced the growth of foreign investment, it is worth noting liberalisation of exchange regulation creating a more favourable environment for cross-border capital movement, as well as Russian sovereign ratings reaching investment levels. The investment activity was also stimulated by zero duties on the import of a wide range of machinery, equipment and other investment goods, shortening the time of investment goods import.

According to FSSS, the first eight months of this year are characterised by a volume of capital investment equal to RUB 3380,7 bln what makes 122,1% of the capital investment level of the same period last year (in January-August 2006 investment grew by 111,1%).

High investment activity produces considerable construction activity. The scope of works here amounted, in the first eight months of this year, to around RUB 1811,5 bln, what is 24,4% higher than in the same period of last year. However, the third quarter showed a slowdown in these indices.

Diagram 11. **Capital investment dynamics, % against the same period of the last year**

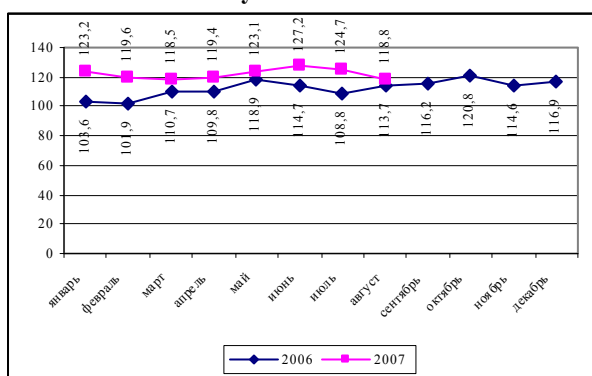
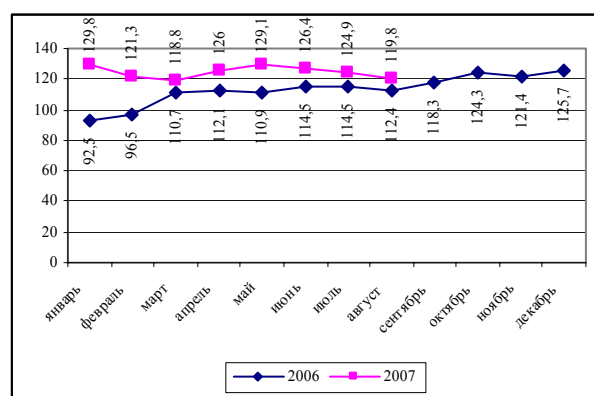


Diagram 12. **Construction dynamics, % against the same period of the last year**



Data of FSSS

The capital investment structure was not subjected to any significant changes compared to the first half of the last year. 18,5% of the total investment consists of fuel and energy resources mining (against 17,9% in the same period of last year). The share of investment in the manufacturing sectors of industry amounted to 17,5% (18,7%), in the gas, steam and hot water generation and distribution – 6,9% (6,3), in construction – 2,9% (3,6%), transportation and telecommunications – 23,3 (25,7%), real estate – 12,0% (11,1%). At the same time, it should be noted that a number of sectors of economy, with their share in the total volume of capital investment being small and changing little, are characterised by a considerable investment growth. In particular, capital investment in education grew by 51,2% against the that of the first half of last year, machinery and equipment production – 57,3%, transportation means and equipment – 40,0%, ready metal goods – 71,6%. Though, the structure of capital investment on the whole still gives no grounds to assume that considerable diversification of the Russian economy has started.

**Table 15. Capital investment structure by types of activities in the first half of 2006 vs. 2007**

	I half of 2007			I half of 2006
	RUB bln	% of I half of 2006	% of total	% of total
<b>Total</b>	<b>1666,4</b>	<b>117,5</b>	<b>100</b>	<b>100</b>
agriculture, hunting and forestry	78	155,7	4,7	3,7
fishing, fish farming	1	78,5	0,1	0,1
mining, including	339,4	120,6	20,4	19,5
fuel and energy raw materials mining	307,6	118,6	18,5	17,9
manufacturing industry, including	291,7	111,5	17,5	18,7
food production	53,9	117,5	3,2	3,2
textile and garment production	2,4	181,8	0,1	0,1
leather and shoe production	0,3	37,1	0,02	0,1
wood treatment	5,6	116,1	0,3	0,3
printing	11,4	133	0,7	0,7
coke and petroleum products production	25,9	99	1,6	1,9
chemical industry	30,9	98,2	1,9	2,3
rubber and plastic goods production	11,4	183,1	0,7	0,3
production of other non-metallic products	23,3	120	1,4	1,3
metallurgy	67,8	93,6	4,1	5,3
production of ready metal goods	5,9	171,6	0,4	0,2
machinery and equipment production	18,3	157,3	1,1	0,8
electrical and electronic production	9,7	129	0,6	0,6
transportation means and equipment production	17,6	140	1,1	0,9
power, gas and water generation and distribution	115,3	129,5	6,9	6,3
construction	47,9	118,4	2,9	3,6
trade	47,7	116,2	2,9	2,8
hotels and restaurants	7,1	102,3	0,4	0,4
transport and telecommunication	388,2	107,3	23,3	25,7
financial industry	30	168,8	1,8	1,2
real estate	199,8	123,2	12	11,1
state administration and security	20,3	103,1	1,2	1,4
education	31,9	151,2	1,9	1,5
health care	31,2	118,5	1,9	1,9
Other services	36,9	124,2	2,1	2,1

*Data of FSSS*

The positive tendency of late is the growth of attracted funds share in the structure of capital investment sources. If at the turn of 2000 the correlation between own and borrowed funds for capital investment was 48:52, in the first half of 2007 it has changed to 44,5:55,5 (in the same period of the last year 47:53).<sup>21</sup>

An important result of 2007 will be the record influx of foreign capital. According to FSSS, the first half of this year is characterised by the total volume of foreign investment of USD 60,3 bln, what is 2,6 times exceeds the same period of the last year. There were some shifts

<sup>21</sup> The share of own funds for capital investment amounted to 44,5% (in the same period of the last year – 47%), including income share – 20,1% (20,8%), amortisation – 21,3% (23,2%).

in the structure of the received investment, but on the whole, the correlation of direct, portfolio and other investment has changed little. Almost 72% of the receive capital investment consists of other investment, direct investment makes 26,3%, portfolio – less than 2%.

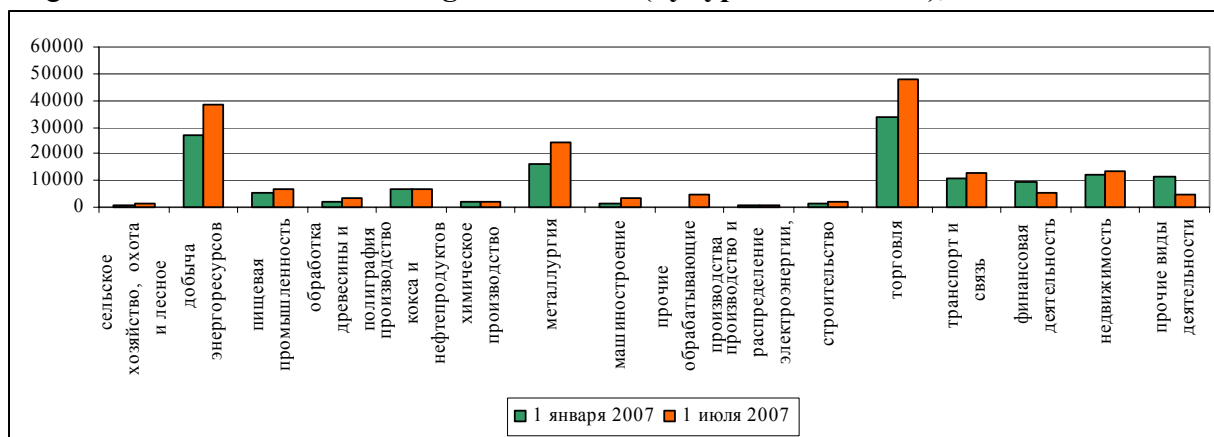
**Table 16. Foreign investment in non-financial sector in the first half of 2006 vs. 2007**

	I half of 2007			I half of 2006		
	USD bln	% of		USD bln	% of	
		I half of 2006	total		I half of 2005	total
<b>Investment</b>	<b>60,3</b>	<b>2,6 times</b>	<b>100</b>	<b>23,4</b>	<b>141,9</b>	<b>100</b>
direct	15,8	2,5 times	26,3	6,4	143,6	27,5
portfolio	1,1	2,2 times	1,8	0,5	2,9 times	2,1
other	43,4	2,6 times	71,9	16,5	139,1	70,4

Data of FSSS

By July 2007 the accumulated foreign investment in the Russian economy has amounted to USD 178,5 bln. It should be noted that there is a considerable misbalance in distribution of foreign investment between the sectors of Russian economy. Their main part is concentrated in the segments with high commercial potential with export-oriented enterprises or companies working in the rapidly developing internal consumer goods and services markets and trade. The total share of foreign investment in such sectors as fuel and energy mineral resources mining, metallurgy, real estate, financial activities, transportation and telecommunications amount to 76,8% of the total amount of foreign investment accumulated since 1 July 2007. Other sectors of the economy, and primarily, many manufacturing branches of industry remain rather unattractive for foreign investors, which can be explained by their low profitability.

**Diagram 13. Accumulated foreign investment (by types of activities), USD bln**



Data of FSSS

In 2007, capital investment in the Russian economy was performed by investors from the traditional range of investing countries. The largest shares of accumulated foreign investment in the Russian economy belong to Cyprus, the Netherlands, Luxemburg and Great Britain. It should also be noted that this year shows a rapid increase in investment by Russian companies abroad. It is both connected with the interests of developing business in new markets and results from the use of the profit reinvestment mechanism.

**Table 17. Foreign investment by investing countries in the first half of 2007**

	accumulated as of 1 July 2007		received in the first half of 2007	
	USD bln	% of total	USD bln	% of total
<b>Total investment</b>	<b>178,5</b>	<b>100</b>	<b>60,3</b>	<b>100</b>
Cyprus	37,5	21	8,0	13,3
the Netherlands	34,1	19,1	11,8	19,6
Luxemburg	29,2	16,3	6,7	11,2
Great Britain	19,2	10,8	15,0	24,9
Germany	10,1	5,7	2,0	3,3
USA	7,4	4,2	1,1	1,9
France	6,6	3,7	3,5	5,9
Switzerland	5,9	3,3	3,7	6,2
Virgin Islands (Brit.)	4,0	2,2	1,1	1,8
Ireland	3,9	2,2	2,0	3,3
Other	20,6	11,5	5,3	8,7

*Data of FSSS*

**Table 18. Foreign investment of Russian companies in the first half of 2007**

	accumulated as of 1 July 2007		directed in the first half of 2007	
	USD bln	% of total	USD bln	% of total
<b>Total investment</b>	<b>25,9</b>	<b>100</b>	<b>36,8</b>	<b>100</b>
Cyprus	8,1	31,3	6,5	10,8
the Netherlands	6,7	25,7	5,8	9,7
Austria	1,5	5,7	5,8	9,6
Great Britain	1,5	5,7	8,9	1,5
Luxemburg	1,0	3,9	2,0	0,0
Ukraine	0,9	3,4	0,2	0,4
USA	7,5	2,9	9,3	15,3
Belarus	0,7	2,8	0,9	1,5
Virgin Islands (Brit.)	0,7	2,6	0,7	1,1
Germany	0,6	2,2	3,	5,0
Other	3,6	13,8	3,7	45,1

*Data of FSSS*

Foreign commerce in early 2007 is characterised by rather high activity and preserved tendencies of the last years: import grows faster than export.

According to the balance of payments published by the Central Bank, in the first eight months of this year the external turnover of Russia amounted to USD 351,8 bln, which is 18,8% higher than the same period of the last year. At that, foreign commerce with non-CIS countries amounted to USD 298,3 bln (17,7% increase), with CIS countries – USD 53,5 bln (25,5%).

Import growth slowed down compared to the last year and in the first nine months amounted to 109,6% against 123,1% of the same period of the previous year. Export amounted to USD 217,0 bln (USD 198,0 bln), including to non-CIS countries – USD 183,8 bln. (8,0% increase), with CIS countries – USD 19,6 bln (19,6%). While the beginning of the year was characterised by a reduction in exports against the same period of the previous year, since spring steady growth has been observed. Export dynamics slowed down mostly due to a drop in oil prices in global markets, but closer to summer there was a prevailing tendency towards growth. The third quarter of this year showed notable excess in average monthly prices for oil Urals grade oil compared with the previous year. According to the Central Bank of Russia, July prices grew 107,8%, August – 101,0% and September – 126,8%. In all nine months of this year the average level of price for oil Urals grade oil amounted to 64 USD/bl or 102,4% of the same period of the previous year.

Diagram 14. **Foreign commerce dynamics, bln USD**

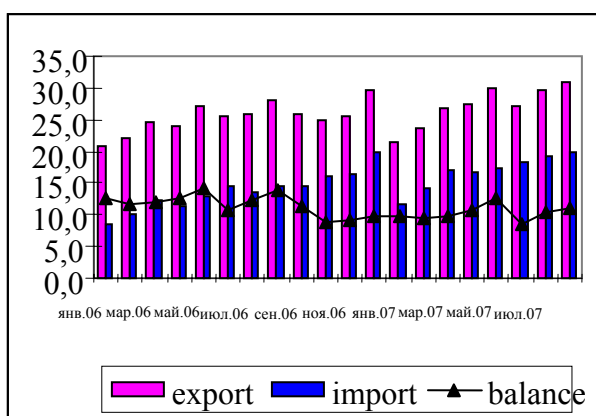
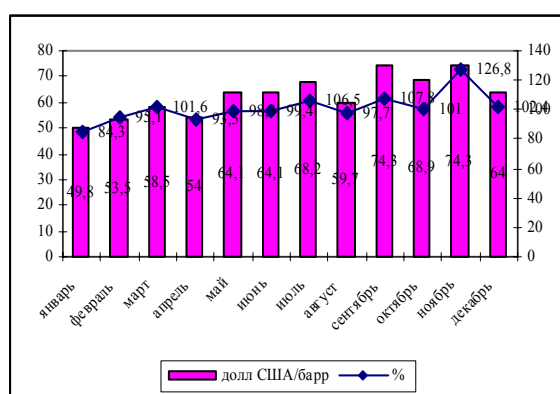


Diagram 15. **Urals oil price dynamics**



Data of the Bank Russia

The price environment for other export goods is rather favourable. According to MEDT, the first half of 2007 is characterised by the prices for the main commodity groups of Russian

export, excluding fuel and energy, machinery, transportation means and equipment, were exceeding the level of the previous year. Here, the physical volume of supply increased for all the main categories. It had a positive effect on the Russian export cost dynamics. Only the index of prices for exported fuel and energy commodities has dropped compared to that of the first half of the previous year, by this category of commodities dominating the structure of Russian foreign commerce the dynamics of its indices on the large determines export growth. However, due to overlapping of the above tendencies in Russian export, this year showed the growth of commodities outside the group of energy carriers.<sup>22</sup>

The first eight months of this year showed import growing to 37,4% (34,6%) and making USD 134,7 bln (USD 98,0 bln), including from non-CIS countries – USD 114,5 bln (37,5% increase), from CIS countries – USD 20,2 bln (36,7%). Import growth was promoted by high investment and consumer demand which also influences the changes in the external supplies structure.

Balance in the balance of trade for 2007 is USD 82,3 bln (USD 100,0 bln), what is 17,7% lower than in the same period of the previous year.

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<sup>22</sup> According to the Federal Customs Service, the share of energy resources in the structure of export to non-CIS countries amounted to 66,1% of the total export cost in the first eight months of this year (compared to the same period of the last year). There was an increase in metal export – 16,0% (13,0%), chemical commodities export – 5,7% (5,0%), wood and cellulose and paper commodities export – 3,8% (3,2%), machinery and equipment – 3,1% (2,9%). The share of energy carriers in the export to CIS countries has dropped to 37,6% (43,3%), metal and metal commodities cost has amounted to 14,2% (11,7%), chemical commodities – 9,5% (9,2%), machinery and equipments – 21,0% (19,8%).