



RUSSIAN ECONOMY NEWS

By LegalLife LLC

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This “Russian Economy News”, as the name suggests, is not intended to be a widely circulated newsletter but a concise digest of some of the most relevant news for LegalLife’s clients in the Russian Federation.

Sources include *The Moscow Times*, *modernrussia.com*, *USRBC Daily Update*, *Bloomberg*, *Itar-Tass*, *Financial Times*, *Ria Novosti*, *Kremlin.ru*, *Alfa Bank Morning Brief*, *Vnesheconombank news*, *Russia Today*, *World Bank Country Office in Russia news*.

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F O C U S

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After assisting Alfa Bank - one of Russia's main private banking groups – on due diligence work for several M&A projects throughout 2009, during the second semester of 2010 LegalLife started advising also Gazprombank, one of Russia's three largest banks serving over 45,000 corporate and 3 million private clients. LegalLife also assisted Société Générale, one of the world's largest banks with about 30 million customers. In addition to banking, after advising Russian media companies for several years, LegalLife provided legal counselling to Pearson, the global media company that owns the Financial Times.

NEWS

▼ **The Central Bank of Russia (CBR) has left its interest rates unchanged for the fifth consecutive month.** The refinancing rate was kept at a record low of 7.75 percent and the repurchase rate on one- and seven-day loans was left at 6.75 percent. The CBR last cut rates on May 31. The Bank noted that the economic recovery still faces risks, with weakening consumer demand and uncertain prospects for the development of the global economy.

▼ **Weekly fund flows: Russia the clear winner among BRICs in the last week of October.**

EPFR weekly fund flow data show that, for the week ending October 27, Russia-dedicated funds saw an inflow of some \$98 mln, the fifth consecutive week of positive flows. Total AUMs for the Russian funds in the weekly survey were some \$13.3 bln, meaning inflows totaled some 0.7% of AUMs for the week. By comparison, for the week Chinese funds (both China and Greater China) saw inflows of some \$96 mln, or 0.1% of AUMs, Brazilian funds added \$67 mln (0.3%), and Indian funds added \$51 mln (0.2%). EMEA funds overall saw inflows of \$318 mln, or 0.7% of AUMs. Year-to-date, Russian funds have managed cumulative inflows of some \$2,500 mln, or 22.8% of average AUMs over the period, posting positive numbers for 32 of the 43 weeks in that period. Comparable Indian inflows for the period have totaled \$1,745 mln, or 6.5% of average AUMs, while Chinese funds have seen inflows of \$8,711 mln, or 6.1%, and Brazilian funds have received \$1,476 mln, or 7.1% of AUMs.



▼ **Government forecasts 4.5-4.7% GDP growth in 4Q10 in order to keep annual target of 4.0%.**

On October 27th, Deputy Economic Development Minister Andrei Klepach indicated that the government expects 4Q10 GDP growth to be 4.5-4.7% y/y. Alfa Bank's interpretation of this comment is that the government is taking a positive view to avoid downgrading its full-year GDP growth target of 4.0%, which would require it to recalculate key macro parameters for the 2011 budget. Inflationary pressure threatens the recovery in consumption, while investment growth is far from stable. The only fundamental reason GDP would grow as much as the government forecasts is its plan to spend 34% of the annual budget in Q4. However, growth will be supported only if fiscal spending is not postponed until December, as has happened in the past, and if CPI growth slows. Last week's inflation of only 0.1% hid a modest acceleration in prices for several food items (non-essential grains, vegetable oil and milk), suggesting that the effects of the summer grain price surge will come in waves. This will reduce disposable income growth and limit purchasing power, eliminating the basis for the government's optimistic view.

▼ **Number of Russian Internet Users Growing.** Manager of the Internet World Project Pavel Lebedev announced that Russia's Internet audience grew by 20 percent during the past year. An estimated 44 million Russian users visit the world wide web each month, and 30 million of them are active users. Most users are aged 18 to 30 years, most are men, college-educated, and resident in large cities.

▼ **Real Estate: PIK Group 3Q10 cash collections confirm recovery in retail residential demand.** The ongoing shift in mix to a greater proportion of retail cash collections is seen as a positive, reflecting continued recovery in consumer demand for real estate. New apartment sales contracts with individuals advanced 241% y/y in the quarter to RUB5.1m, reflecting a 105% y/y



increase in sales volumes to 1,197 units (69,098 sq m). Average sales to retail customers for 9M10 amounted to RUB1.3m per month, or 16.2 apartments per business day, against only 4.8 apartments per business day for 9M09. The trading statement confirms the recovery in retail residential real estate demand. Improving sales volumes also reflect better mortgage availability (on average, 9% of apartment sales were funded by mortgages in 3Q10 against only 3% in 1Q10) and the group's increased level of sales and marketing activity.

▼ New Report: Russia's modernisation and innovation from the perspective of foreign investors. This month, Russia's Foreign Investment Advisory Council (FIAC) released a white paper titled "Russia's Modernisation and Innovation from the Perspective of Foreign Investors". The report used a series of interviews and research to look at the modernisation and innovation (M&I) of Russia's economy and its effect on foreign investment in Russia. Overall, the study found many reasons to be positive and optimistic about the prospects for increased M&I and higher levels of foreign direct investment into Russia. However, it also identified seven key challenges the nation must overcome. Infrastructure investment and development. The first step to modernise Russia's economic climate is to invest in the country's infrastructure. More important than the specific improvements would be the government's commitment to invest in and improve infrastructure. Reform of the education system to develop "commercial scientists". Russia's major strength is its human resources. To take its workforce to the next level, the scientific community needs to move from being highly theoretical to thinking like business people. This can be done through reforming the education system to focus on both scientific and economic elements. Boost internal market demand for high tech innovation. In order to spur M&I, Russia needs to create domestic demand for high tech products. Russian companies can do this by investing in the modernisation of their own products to compete globally. Additionally, financial incentives should be awarded to those companies that genuinely move forward the M&I agenda. Encourage and refine domestic entrepreneurship to drive internal market. The Russian government needs to introduce new legislation simplifying the legal aspects of starting, financing and running a small business. Develop policies designed to encourage international partnerships and investment. Russia is in the unique position where its modernisation and growth will depend on leveraging what it knows best: intellectual services. The government needs to enact policies that support the development of intellectual partnerships by easing visa/travel laws, reforming import/export duties and removing VAT on ICT. Improve transparency and ensure that current laws are effective. Investors do not want new legislation to regulate the market. Instead they ask for a consistent application of existing legislation. By applying the laws in a consistent manner, it will clear up confusion, decrease perceived corruption and instill confidence in regulatory bodies. Communicate successes. Not only should the government communicate positive stories, but it should encourage senior executives from companies who have succeeded in Russia to do the same.



▼ On October 18th, Putin took notes at foreign investors meeting. In a closed meeting in Moscow, Prime Minister Vladimir Putin talked, listened and took extensive notes as companies such as Ernst & Young, Siemens, Procter & Gamble and UniCredit shared their views on the investment climate in Russia, explaining how administrative barriers and the lack of proper infrastructure were preventing more investment from flowing into Russia. Addressing some of those concerns, Mr Putin outlined the current state of the economy, mentioning that Russia's 2010 federal budget deficit may turn out to be much lower than forecast, as he pledged to foreign investors the same level of protection as Russian businesses: "In terms of investors' rights and interests, we don't divide businesses into Russian and foreign ones. Together we are obtaining gains and overcoming difficulties".

▼ Russia ranked 63rd out of 139 nations in the recently released 2010-2011 Global Competitiveness Index by The World Economic Forum – the same position it held in the previous year. Switzerland tops the overall ranking in The Global Competitiveness Report 2010-2011 released by the World Economic Forum. The United States falls two places to fourth position, overtaken by Sweden (2nd) and Singapore (3rd). The Nordic countries continue to be well positioned in the ranking, with Sweden, Finland (7th) and Denmark (9th) among the top 10, and with Norway at 14th. Sweden overtakes the US and Singapore this year to be placed 2nd overall. The United Kingdom, after falling in the rankings over recent years, moves back up by one place to 12th position. Italy maintained its position at 49th.

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