

## Economic

### Credit Agency Ratings

Moody's: Baa1  
S&P: BBB  
Fitch: BBB

### Nominal GDP (2010)

USD 1.569 trillion

### Population (2010):

141.7 million

### Total Trade / GDP:

40%

### Currency:

Russian ruble

### Exchange Regime:

Managed float

### Merchandise Imports from

#### Canada (2010):

CAD 1,056 million

### Main Sources of Foreign Exchange (excl. FDI):

Foreign borrowing, energy exports

### Largest Trading Partners:

Netherlands, Germany, Italy  
China, Ukraine

### Main Imports:

M&E, motor vehicles, steel products, medicine, and communications equipment

Sources: IMF, EIU & Statistics Canada

### Risks to the Outlook:



Continuing strong commodity prices  
Progress on privatization



Escalating Debt crisis in Europe  
Delayed Structural Reforms

## Economic & Political Intelligence Centre

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**MARKET SPOTLIGHT:** A combination of spillover effects from the sovereign debt crisis in the Eurozone and the heightened political uncertainty following the largest protests since 1991 has led to a sharp uptick in capital flight, putting pressure on the ruble and equity markets. The stressed market conditions experienced by many European banks have translated into tighter liquidity conditions within Russia, and volatility in Russian financial markets. However, the economy is expected to grow by a robust 4.5% in 2011 while the cyclical improvement in the credit environment continues as non-performing loans decline and Russian banks gradually increase lending. The central bank's foreign exchange reserves are sizeable and sufficient to mitigate pressure from volatile international financial markets.

**Real Economy:** With fourth quarter data yet to be released, leading indicators point to growth of 4.5% in 2011 thanks to recovering credit, robust oil prices and a healthy rebound in the agricultural sector. Strong domestic demand has been supported by a steadily-recovering domestic banking sector that has seen reduced pressure from loan-loss provisioning which has fallen in tandem with impaired loans that peaked early last year. The accompanying credit growth has been robust, with loan growth (y/y) rates in the double-digits throughout 2011, rising to 27% by year end. Going forward, economic momentum will ease, and growth is projected to slow to sub-4% this year as the European crisis is felt in Russia's real and financial sectors. The medium term outlook is clouded by unfavourable demographics and productivity constraints. In addition to a challenging investment environment, Russia's history of volatile growth and inflation are key impediments to foreign investment and stable growth.

**Fiscal policy:** High oil prices have been extremely beneficial for Russia's fiscal position enabling the Federal government to post a small surplus in 2011, beating expectations. Spending pressures are mounting, however, as the authorities are likely to resort to populist policies in the face of demonstrations and public discontent. Indeed even before the protests, the draft 2012 budget was expansionary, with large spending increases including a doubling of military and police force wages and benefits, up 15% above 2011 levels. Also of concern is the growing dependence on energy revenues and the widening non-oil deficit which will remain above 10% of GDP over the medium term and will amplify fiscal vulnerabilities and undermine economic stability.

**Monetary & Exchange Rate Policy:** Inflationary price pressures have eased considerably, with headline inflation dropping to 6% (y/y) by year end, largely due to weakening food prices. The ruble has come under downward pressure, losing 14% of its USD value since the summer, as monetary policy shifts gear and capital flight accelerates in the face of growing domestic political uncertainty and foreign bank deleveraging. The Central bank has intervened to the tune of USD 35 billion since June, however ruble support has been much more modest than during the last crisis and the increasingly flexible FX rate policy is a favourable development and serves as a necessary step towards building much-needed external buffers.

**External Accounts:** The current account is expected to shift into a deficit in the medium term, because strong domestic demand will ensure robust import growth over the forecast horizon, while range-bound commodity prices and capacity constraints (associated with under investment) will limit export growth. The persistence of low natural gas prices, as significant new capacity comes online in the shale gas plays in North America, is reducing Russian producers' competitive advantage that arises from domestic price subsidies. Deteriorating economic and financial conditions in Western Europe could have adverse effects on trade and capital flows and represents a material short term external risk.

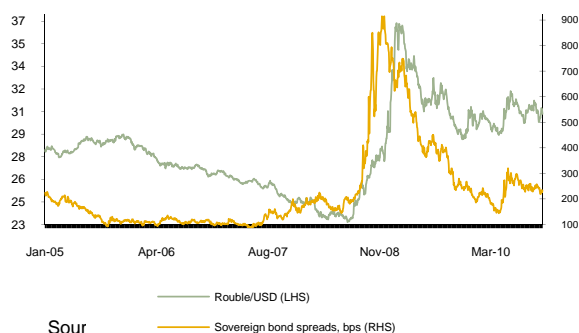
**Outlook:** The cyclical recovery is being supported by growing consumer demand and improving conditions in the financial sector however the deteriorating conditions in the Euro zone and heightened political uncertainty represent significant downside risks. Despite medium term structural challenges, public debt is just 12% of GDP and will remain manageable for the foreseeable future.

### ECONOMIC INDICATORS

	0-5-09 avg.	2011	2012	2013
GDP (% growth, real)	3.9	4.5	3.8	3.6
Inflation (%chg, pa avg.)	11.4	8.5	6.5	6.1
Fiscal Balance (% of GDP)	3.7	-0.5	-2	-1.5
Exports (% , comp. annual growth)	10.6	26%	-1%	7%
Imports (% , comp. annual growth)	14.5	30%	10%	9%
Current Account (% of GDP)	7.3	4.9	2.4	2.3
Reserves (months current debits)	12.6	16.7	17.7	16.9
External Debt (% of GDP)	27.9	24.3	25	24.2
Debt Service due, to Curr. Acct. Rcpts	9.7	4.0	4.2	4.0
Exchange Rate (RUB to USD; eoy)	27.9	30.2	29.66	30.1

Sources: EIU, IIF, IMF, EDC Economics

### Bond Spreads & the Exchange Rate



Source

## Political

### Political Structure

Federal Republic

#### President

Dmitry Medvedev

#### Prime Minister

Vladimir Putin

### National Legislative Bodies

- Lower House: State Duma (directly elected)
- Upper House: Federation Council (indirectly elected; comprised of regional officials)

#### Major Parties

(seats in assembly)

- United Russia: 315
- Communist Party: 57
- Liberal Democratic Party of Russia (Zhirinovskiy): 40
- A Just Russia: 38

#### Last Elections

- Duma: December 2011
- Presidential: March 2008

#### Next Elections

- Duma: December 2017
- Presidential: March 2012

#### Press Freedom Survey:

2011 Score: 81 (Not Free)  
(0: Free; 100: Not Free)  
[FreedomHouse.org](http://FreedomHouse.org)  
(en anglais seulement)

#### Control of Corruption Index:

2010 Score: -1.07  
(-2.5: Worst; +2.5: Best)  
[World Bank Governance Indicators](http://WorldBankGovernanceIndicators)  
(en anglais seulement)

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**General Political Environment:** The ruling United Russia party suffered significant losses in the parliamentary elections on December 4th 2011, seeing their two thirds constitutional majority drop to a slim majority with 49% of votes. Despite a significant decline in popular support (down from 70% in the 2008 Duma elections) there were allegations of widespread vote-rigging which led to demonstrations, highlighting the authorities' growing challenge of retaining legitimacy. Protesters have clear demands including the release of political activists and the immediate organization of fair and open elections. Despite the demonstrations and the waning support for United Russia, it is widely expected that Putin will win the Presidential election in March as he remains the most popular political figure in Russia and there is no credible alternative. Under a new law that came into effect under Medvedev, presidential terms have been extended to 6 years (from 4) which will see Putin's holding the President's office at least until 2018.

**Political Structure:** Political power in Russia is highly centralized in the President and the Presidential Administration within the Kremlin which exert their influence over all aspects of domestic and foreign policy. Following the election of former President Vladimir Putin in early 2000, political stability and policy predictability gradually increased, which has been continued under President Dmitry Medvedev, Mr. Putin's protégé. The State *Duma* is a body that is loyal to the Kremlin and has little autonomy. Given the dominance of United Russia in the *Duma* and Mr. Putin's position as Prime Minister, the legislative and executive branches are for all intents and purposes now fused with little effective opposition to the ruling party.

**Investment Environment:** The Government regards trade and investment matters as strategic areas for domestic and foreign policy. There have been cases in which the government has intervened in sectors deemed to be strategic to Russia's foreign and security or commercial policies, such as oil and gas, minerals, defense and aerospace. While fighting graft has become a key policy focus of the Medvedev government with notable effort on tackling low-level corruption, the government has acknowledged that more progress is needed. On the heels of the economic crisis, President Medvedev promoted the notion of modernization as a means to revitalize the Russian economy and bring in foreign capital in order to plug the budget deficit. Specifically, he noted that Russia was seeking foreign investment and foreign capital in order to promote innovation in specific sectors. As part of this effort, Russia is undertaking a large-scale privatization programme from 2011-13 which will offer up stakes in key companies and also open up significant opportunities for foreign investors. That said, high corruption levels remain an ongoing concern and a key challenge for the state in encouraging new foreign investment.

After 18 years of negotiation, Russia has finally succeeded in joining the WTO. The immediate impacts will include reduced tariff rates on specific products; the ancillary benefits of ameliorating operating environment and protection of Intellectual Property (IP) rights will be much more gradual and should lead to a marked improvement in the predictability, transparency and dispute resolution options available to exporters selling into the market. Also, the successful resolution will free up resources to focus on the ongoing yet separate negotiation around the Canada-Russia Bilateral Investment Treaty (BIT; aka Foreign Investment Protection Agreement, FIPA) which has stalled of late- more positive news for Canadian investors interested in the Russian market.

**Political Violence:** The 24 January 2011 terrorist attack against Domodedovo airport highlighted the security challenge that Russia faces due to the instability in the North Caucasus region. While insurgent activity is normally isolated to this region, sporadic attacks in and around major cities remains a risk. In the run up to the Sochi 2014 Olympics, the government will likely escalate its clampdown on any potential security risks.

### Political Outlook

Due to recent protests and demonstrations political uncertainty will remain heightened in the runup to the Presidential elections on March 4<sup>th</sup>. Putin and United Russia will come under increasing pressure to deliver systemic reforms. Higher public spending is also to be expected as the government will likely resort to populist measures to appease growing popular discontent.