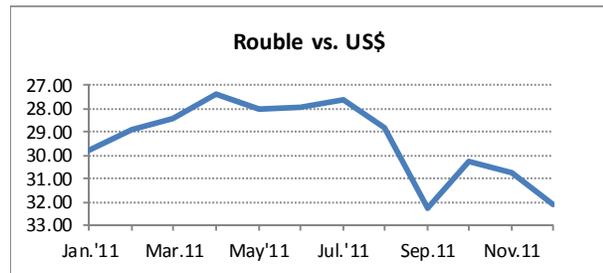


# Country Risk Update – Russia

January 2012

## Significant Recent Development

International sanctions imposed on Syria (another oil and gas producer) could bolster Russia's hydrocarbons prices. However, the unexpected announcement by OPEC in December that it plans to increase oil production quotas, amid weakened global growth prospects, will counteract this. The overall impact will be two-fold: lowering energy prices for importers of Russian oil and gas, and reducing Russia's budget revenue and FX inflows.



## Risk Outlook

Following a disputed parliamentary election held on December 4<sup>th</sup>, which returned the incumbent United Russia bloc to the 450-seat State Duma (albeit with a reduced majority), all eyes are now firmly fixed on the Russian presidential election to be held in March 2012. We expect a victory for Vladimir Putin, the former president and current prime minister. However, several prominent candidates are preparing to stand against him and Putin's popular appeal has undoubtedly waned.

Despite recent public demonstrations, Putin should retain a grip on power as the opposition remains divided. Plus, any attempt to bolster Russian democracy will be carefully stage-managed. There is unlikely to be a re-run of the parliamentary elections, and other concessions (such as webcams in polling stations and allowing smaller political parties to take part in elections) will have limited overall effectiveness. This creates the risk of the political demonstrations instigated by Putin's opponents erupting into more serious social unrest.

Putin is vowing to introduce moderate reforms aimed not only at strengthening democracy, but also modernising the economy. However, he is showing little appetite for a more transparent investor environment, with talk of protecting Russia from "foreign imposters". While aimed at US interference, we expect neither improvement in the investor

regulatory regime, nor in Russia's woeful corruption record - two major factors that blight the business operating environment.

There are economic problems, too, lying in store, connected to Europe's debt crisis and a tightening of credit availability. Russia will continue to endure capital outflows linked to the crisis. The country is particularly exposed to a prolonged downturn in Europe, which will dampen both commodity prices and the demand for non-oil exports. Currently, we predict 3.7% real GDP growth for 2012, which is slower than the 4.2% expansion we estimate for 2011, but our forecast is subject to downside risk.

Positively, the economy is more flexible compared to 2008. Banking sector vulnerability has been mitigated by reduced foreign exposures, plus there are stronger safeguards in place to protect the financial system and more exchange rate flexibility. However, the non-oil budget deficit, at around 10% of GDP, highlights underlying fiscal risks. Inflation is another problem. This creates a burden for firms dealing in Russia, when judging product and input costs, and dealing with wage demands. The Central Bank of Russia plans to move to a formal inflation-targeting framework in 2014, but we do not envisage that the 4-5% medium-term inflation objective will be achieved anytime soon.

Risk Level: <b>High</b>		Risk Trend: <b>Negative</b>		
Annual Avg. % change	2010	2011e	2012f	2013f
<b>Real GDP growth</b>	4.0	4.2	3.7	3.8
- IMF	4.0	4.3	4.1	na
- OECD	4.0	4.0	4.1	4.1
<b>Inflation (CPI)</b>	6.9	8.5	6.8	6.4
- IMF	6.9	8.9	7.3	na
- OECD	6.9	8.4	6.5	5.7
<b>Current Acc. (% GDP)</b>	4.8	5.2	3.0	3.5
- IMF	4.8	5.5	3.5	na
- OECD	4.7	5.6	4.0	3.3
<b>Budget Bal. (% GDP)</b>	-4.0	-1.5	-0.9	-0.5
<b>Head of State:</b>	President Dimitriy Medvedev			
<b>Head of Government:</b>	Prime Minister Vladimir Putin			
<b>Ruling Party:</b>	United Russia			
<b>Next Election:</b>	March 2012 (presidential)			
<b>Capital City:</b>	Moscow (GMT +3 hours)			
<b>Currency:</b>	Rouble (managed float)			
<b>GDP (USDbn)</b>	1465.1	<b>Doing Business</b>		123
<b>Population (m)</b>	142.5	<b>Competitiveness</b>		4.21
<b>Bank Debt (% GDP)</b>	9.6	<b>Corruption</b>		2.4
<b>Economic Freedom</b>	50.5	<b>Corporate Tax (%)</b>		20.0
Sources: BBC, IFES Election Guide, IMF, FT, MJE, OECD, The Times and; Index of Economic Freedom (The Heritage Foundation): 0-100; 100 is best Doing Business Ranking (World Bank): 1-183; 1 is best Global Competitiveness Score (World Economic Forum): 0-6; 6 is best Corruption Perceptions Index (Transparency International): 0-10; 10 is best Headline Corporate Tax Rate (Deloitte)				