Bank of Moscow

Economic Monthly

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L or V – Risks and Expectations

Center of Strategic Investigations

The situation in the world economy is heading toward stabilization. Along with stabilizing production volumes that were punctured by recession, experts are noting growth in various indexes that measure business expectations and confidence. The problems experienced by large companies and banks are gradually being resolved. Oil and metals prices have picked up and cargo shipment volumes are surging, signaling recovery in global demand. Despite the differing forecasts, the global recession is expected to come to an end late this year or in 2010. Nobody can say today whether it will be a firm recovery (accompanied by a sharp upturn in the banking system and financial markets) or if the process will be spread out over several years.

Today, Russia is deeply integrated with the global economy and depends to a considerable extent on global demand for raw materials in physical volumes and their prices. The world economy will thus determine the path of Russia's emergence from the crisis. The major scenarios are either gradual recovery (L-path) or a sharp upturn (V-path), the latter quickly bringing the Russian economy back to the growth trend of the preceding five years. Gradual recovery is expected by the Economics Ministry, which cautiously forecasts Russian real GDP to change by plus or minus 0.5% in 2010. The conservative stance of the Finance Ministry is reflected in the draft budget being worked out for next year.

A rapid recovery, which some experts are anticipating, does seem plausible. The Russian economy has no production constraints (labor force and available production capacities) and thus can quickly return to its pre-crisis levels. Aggregate demand can bounce back relatively fast as well. Another argument is the price rally on financial markets, which has taken place alongside the ruble's appreciation against world currencies.

What is most important for Russia today? Growing prices for raw materials, or expanding demand for exports in physical volumes? In many respects, the pattern of recovery in the economy will be determined by the extent of Russia's dependence on global demand, world prices and internal problems. Recovering global demand will spur raw material export volumes, providing an impetus to growth in interim demand sectors. World prices for raw materials (which are already at levels that were recently so attractive) will help revive demand and improve the structure of the balance of payments and the budget. Actually, the Russian economy had been successfully growing in 2003–05, when prices stood at current levels. There is a threat, however, that raw material revenues will again be compensated by growth in imports.

Internal problems cannot be resolved by external factors – the beneficial economic environment only delays their solution. The policy of gradual economic recovery in step with an improving quality of growth looks more attractive. This scenario seems more realistic in the context of the current state of the banking system and corporate and household debt. Finally, the shape of the recovery curve will depend considerably on financial policy, in particular how efficiently it can boost production and at the same stabilize price growth and the exchange rate.

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Economic policy

L-stimulation of V- declining aggregate demand

The latest economic performance data look bleak, even in the context of the global economic crisis. In the first quarter, GDP dropped 9.5%, industrial output skidded 14.3% and fixed capital investment plunged 15.6%. In April, industrial production and investment activity suffered even more, sagging a further 16.9% and 16.2%, respectively. Official forecasts of economic activity this year are being revised downward. In the first quarter, GDP was projected to decline 2.2% (adjusted for the effect of the government's stabilization package). Currently, with no stabilization efforts anywhere is sight, the slump is already projected at 6–8%.

Potentially, the Russian economy is ready to resume growth by virtue of having at its disposal available labor and free production capacities. However, this potential can materialize only in conjunction with a rebound in demand, both globally and locally. Most forecasts call for the world economy to rebound only in 2010 alongside a gradual recovery in demand (L-path). For the Russian economy, that would signify a *slow recovery* in interim consumption sectors.

Despite extremely low interest rates in developed economies, no large-scale foreign investments in Russia are in the pipeline in the near term. There are some optimistic projections relating to the restructuring of foreign debts of Russian companies and banks. Nevertheless, the capital outflow resulting from servicing private debt will total $60–100 bln this year. This figure is a direct indication of the "deduction" from investment demand. The financial performance of Russian companies in 1Q09 was less than one third last year's level (R366.5 bln, or 29% of the corporate financial performance of 1Q08). During these two quarters, manufacturing industries remained loss-making, which means that corporate resources for investment purposes are very limited. Therefore, investment activity in the coming year will not be propped up by foreign capital or internal resources of Russian companies – and in fact, industries involved in the production of investment goods face a long spell at the "bottom" level, if not a protracted slump.

In conditions of the global economic crisis, the economic slump can be slowed by expanding domestic demand. However, the effect of direct state stimulation of demand through faster growth in budget expenditures (as opposed to revenues) or the expectation of its growth on the back of improving export prices should not be overestimated. In the negative macroeconomic setting (commonly referred to as the "crisis") and a poorly competitive environment (triggering price hikes and supply contraction), efforts to boost demand will warm up inflationary and devaluation expectations. Moreover, expansion of demand via budget expenditures will be insignificant due to monetary policy constraints (i.e. the threat of accelerating inflation and devaluation) and will only match the L-shaped scenario.

Bank lending will be a weak driver of consumer demand. Substantial volumes of consumer loans issued before the crisis and mounting arrears resulting from sharp deterioration in the labor market (falling real wages and spiraling unemployment, including hidden unemployment) will rein in bank lending to households.

Hence, despite the ostensible growth opportunities for the Russian economy, there are no objective factors favoring growth recovery. Even in the event of reduced investment risks and rising expectations of a global economic upturn, the above factors will only contribute to a slight blip in the economy in 2010. The V-type growth will be a working scenario for experts, whereas the L-type recovery will be a more realistic course, provided that no fresh disruptions envelop the country. If this happens, the Russian economy may find itself struggling through a new crisis phase and talk will be more focused on survival than growth.

Monetary Policy

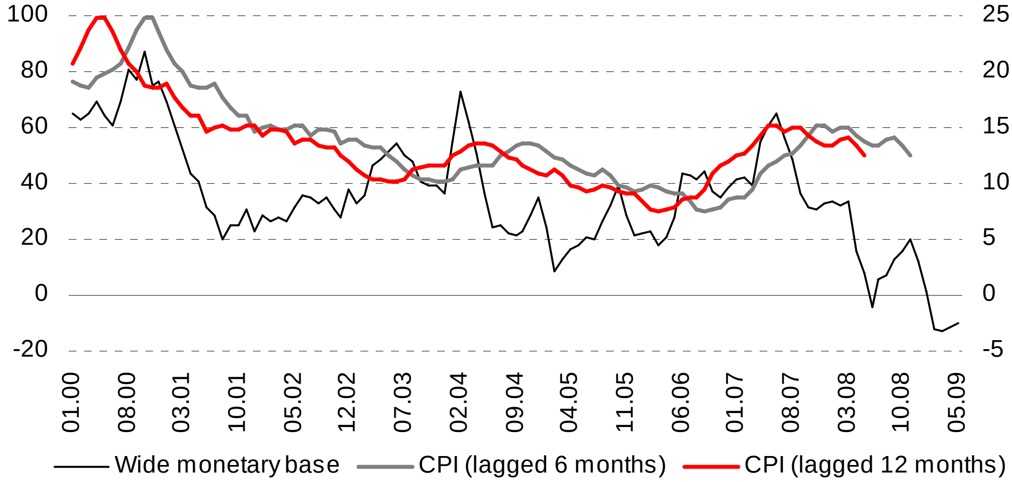
Too late for easy money policy

Traditionally, reducing inflation and ensuring a stable ruble have been the primary tasks of the CBR's monetary policy and were behind the decision to keep interest rates high. Being the major lender to the banking system, the CBR raised interest rates to 11–15% at the beginning of the year (from minimal rates on intra-day repo transactions to the cost of three to six-month uncollateralized loans). The final cost of borrowing was determined by way of auction. The weighted-average interest rate set at the uncollateralized loan auctions was above 18% in February-March. The subsequent level of interest rates suggested a cost of borrowing for the real sector of 20–27%. Considering the negative profitability of industry early this year and its growth of only 2–4% in the second quarter, the monetary policy parameters were absolutely restrictive. However, any lobbying efforts to lower the refinancing rate (or the cost of public funds) so as to reduce the cost of corporate bank loans were rebuffed by the CBR's arguments in favor of reducing inflation and stabilizing the ruble.

The ruble not only stabilized this spring, it also appreciated substantially versus major currencies. From February through May, the ruble's average monthly exchange rate against the dollar rose 11.5% and increased 4.8% versus the euro. The devaluation component of inflation has been fully utilized by now, thus completing the cycle in which the "sale of import goods –> purchase of new goods at a new exchange rate –> sale of available inventory –> purchase of new inventory at a lower exchange rate". The "after-effects" associated with expectations of ruble depreciation this autumn may have a certain impact, but the sinking demand almost fully levels out this effect.

Over the first six months of 2009, the money supply did not satisfy the need to support contracted demand and was very restrictive. As the money supply significantly influences the rate of price growth, an *econometric analysis* would lead one to expect deflation. Currently, however, inflation is rather stable, suggesting that other factors are having a greater effect on price growth.

Money supply growth rates (broad monetary base, lhs), consumer price growth rates (with a lag of 6 and 12 months, rhs), % change y-o-y



Source: CBR, CSI Bank of Moscow.

The monetary authorities expect inflation to subside in the coming months. In terms of the inflationary effect this year (the current target is 13.5%), deflation is expected this summer and the final figure may eventually be cut to 12.0%. It seems that the regulators have been trapped by “false expectations”, having put in place all of the monetary conditions necessary to mitigate price growth (a restricted money supply and stable ruble). Inflation, however, will not subside (or will decline only slightly) due to other, more important factors, including a poorly competitive environment and growing prices for products of natural monopolies. At the same time, these monetary policy parameters will negatively impact the business activity and competitiveness of Russian producers.

The CBR *formally* responded to the “lobbyist appeals” and steadily lowered the refinancing rate to 11.5%. If in prior periods (2000–08) this would have been a minor event, today it represents a *delayed step.*

Until the second half of 2008, the cost of refinancing provided by the CBR had only a mild impact on the level of interest rates, as these transactions were not significant for the functioning of the financial system. In late 2008 – early 2009, the situation changed radically. The outcome of discussion on the level of the refinancing rate was crucial for the entire economy, as in the fourth quarter of 2008, refinancing was the only available source of funding for banks and the share of CBR loans in total banking system liabilities widened from 0.2% to 12.0% on an annualized basis. Amid contraction or stagnation in other forms of borrowing, the decision to cut the refinancing rate was of principal importance *at that time*.

As time passed, the strategy of attracting financing through the banking system changed in response to stabilization of the ruble. On the one hand, demand for lending on the part of companies was climbing. On the other, funding provided by the CBR was limited and expensive. The combination of these factors laid the groundwork for extremely aggressive strategies. Major banks lifted interest rates on ruble-denominated household and corporate deposits while lowering rates on currency deposits. Today, all major banks offer 14–15% on annual household and corporate deposits denominated in rubles. Actually, this level determines the cost of banking liabilities, as deposits from the non-financial sector account for more than 50% of all borrowing.

The volume of refinancing this year will be stable and may even fall. Today, lowering the refinancing rate can only slightly trim the cost of borrowing for the real sector. The level of banking debt to the CBR has been decreasing since February.

Additional risks in the banking system are associated with a declining interest margin between household deposits, the only steadily growing source of funding in recent months, and corporate loans, which have been expanding steadily as a means of placing banking assets. From January to April, the weighted-average interest rate edged up 1.0 pp on ruble term deposits and fell 1.5 pp on corporate loans, thereby narrowing the interest margin from 5.9 pp to 3.4 pp. That signals a potential decline in banks’ income in the months ahead and the logical contraction of domestic sources of funding to boost capitalization and viability in the face of mounting credit risks.

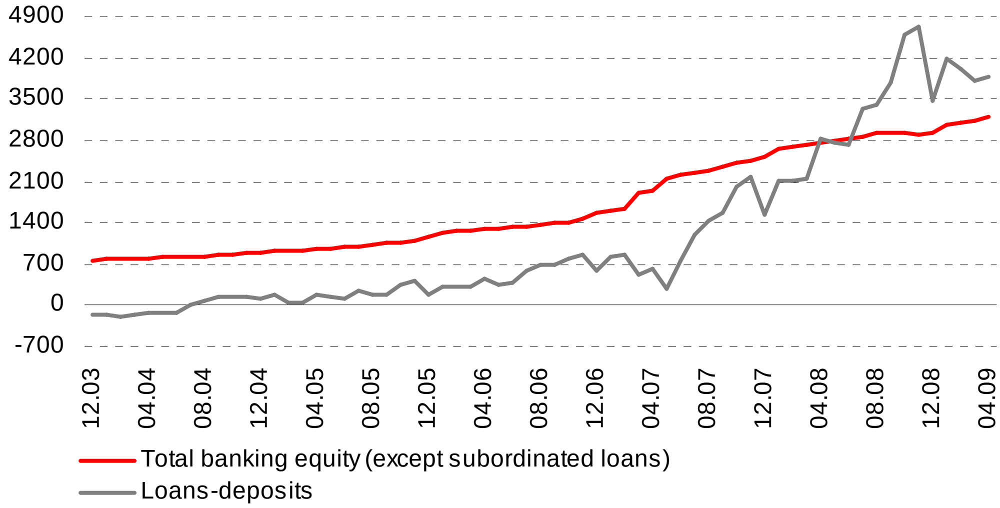
Furthermore, growing interest rates help reduce the “credit pit” (the mismatch between loans and deposits of the non-financial sector). After having increased by R700 bln in January, in February-April the mismatch narrowed by R300 bln.

The fairly stable dynamics of aggregate indicators were shaped on the basis of opposing trends in the corporate and household segments. Growth in corporate loans was accompanied by contracting corporate deposits and accounts, mostly due to decreasing balances on settlement accounts. In January-April, the gap between corporate loans and deposits widened by more than R1 trln.

Households, however, were net creditors of the banking sector. The loan-based liabilities of households were dwindling against the background of a resumed inflow of household deposits. Accordingly, during the same four months, household deposits exceeded the level of consumer loans by more than R600 bln. The ratio of bank loans to deposits in the household sector decreased from 72% to 64%.

In such a situation, banks are exposed to the risk of losing potential profits, as more expensive assets (consumer loans) are replaced with cheaper assets (corporate loans), whereas cheaper liabilities (corporate accounts) are replaced with more expensive liabilities (household deposits). This is another factor denting internal sources of capitalization, apart from the declining interest rate margin.

Gap between loans and deposits of the non-financial sector and banking sector equity, R bln

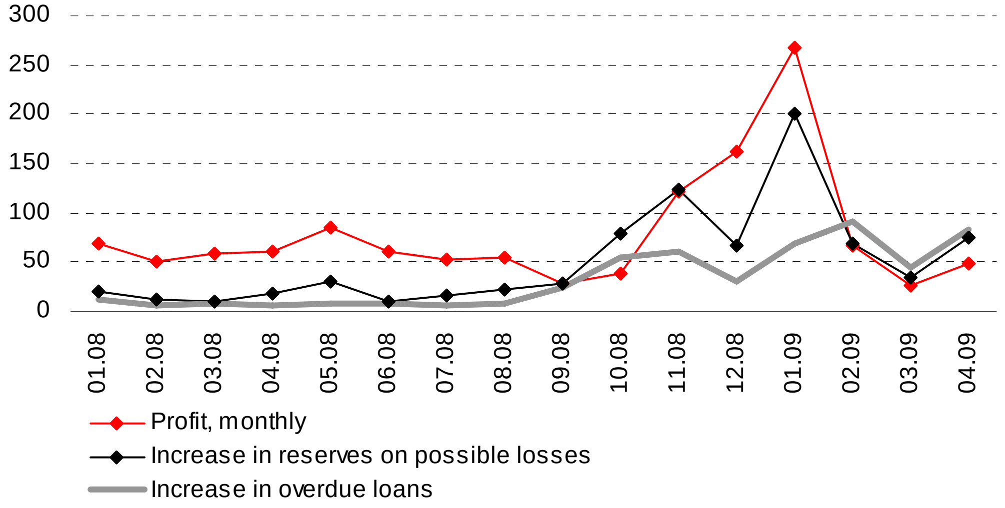


Source: CBR, CSI Bank of Moscow

Moreover, the situation is exacerbated by the ongoing problem of bad debts. Most steps by the authorities aimed at resolving the bad debt issue are temporary in nature and have essentially only shifted the risks into next year. Thus, easing the standards for loan classification and provision for possible losses will be in effect until end 2009, and the program of mortgage loan restructuring carried out by the Agency for Restructuring Housing Mortgage Loans will also be in effect for one year.

The actual depth of the "bad debt" issue has not been adequately assessed by either the banking community or the monetary authorities. The fact that current indicators of the quality of loans (i.e. the amounts of past due debt and provisions for possible losses reported in financial statements) hardly reflect reality is proved by their correlation with banking profits. In fact, the amount of bad debt being reported by banks will not have a material effect on financial performance indicators. Over the past few months, growth in past due loans and provisions for possible losses had a strong statistical effect on the amount of banks' profits before provisions.

Movements in profit and asset quality parameters (growth in provisions for possible losses and past due loans issued to the non-financial sector), R bln



Source: CBR, CSI Bank of Moscow.

Therefore, costly money policy will be continued for the next 12 months and the banking sector's key issues – capitalization sources and the quality of loan portfolios – will remain unresolved. With a beneficial course of events, interest rates will decline (in step with abating inflation), but that will be a gradual process (L-type growth). Potential economic growth cannot be underpinned by induced expansion of lending activity because of a high cost of borrowing stemming from a high cost of liabilities and considerable credit risks.

Real Sector

Industrial output contracted 16.9% y-o-y in April. Formally, the moderate 13.5% fall in industrial production in February-March gave way to a more severe slump the following month.

The manufacturing industries were hit the hardest. Production output in this sector touched a half-year low (down 25.1% y-o-y) in April. Output in the mining and quarrying and electricity, gas and water supply sectors declined at the same rates of the previous month (1.8% and 2.6%, respectively).

The trends observed in the manufacturing sector can be summarized as follows:

Most *final demand sectors* showed *deceleration of the output slump in April*. Production contraction slowed in industries manufacturing textiles and textile products, leather, leather products, shoes, pulp, paper and paper products; publishing and printing: their April numbers were much better compared with the dismal performance at the start of the year. Food manufacturers showed no sign of worsened performance, output contracting just 2.5% y-o-y in March-April. A drastic slump was observed in other sectors specializing in the production of furniture, sport facilities and other consumer goods. The output contraction in these industries was the reason for the formal aggravation of the output slump in final demand sectors in April.

Manufacturing output in final demand sectors and imports in 2009, % change y-o-y

	March	April	January-April
Manufacturing	**-20.5**	**-25.1**	**-22.0**
Final demand sector	*-8.8*	*-11.0*	*-9.4*
Manufacture of food products, including beverages and tobacco	-2.5	-2.6	-3.1
Manufacture of textiles and textile products	-19.3	-17.6	-20.2
Manufacture of leather, leather products and shoes	-9.6	-4.2	-13.6
Manufacture of pulp, paper and paper products; publishing and printing	-15.2	-12.7	-16.6
Other sectors	-20.4	-30.2	-23.3
Retail trade turnover	-4.0	-5.3	-2.2
Cost of imports		1Q09	
Food products having domestic equivalents – meat, meat products and canned meat, poultry, fish, milk, cream, butter, vegetable oil, alcoholic and non-alcoholic beverages, grain		-29.5	
Textile, clothes and shoes		-1.8	
Furniture		-18.5	

Source: Russian Statistics Service, Federal Customs Service, CSI Bank of Moscow.

Amid persistent contraction of consumer demand and retail trade volumes, most domestic producers managed to *halt* their output slump. Depreciation of the ruble had a substantial impact on the performance of final demand sectors. However, even in this segment, which is oriented primarily toward the domestic market, the devaluation effect cannot be treated as absolutely positive or negative.

Devaluation supported domestic food manufacturers: imports of food products with domestic analogs shrank almost 30% in the first quarter, while the output of domestic products edged down 3%. The situation was different only in industries manufacturing textiles, textile products, shoes and furniture. Against the background of an 18.5% fall in furniture imports, production of furniture fell by more than 27%. Similarly, with a 1.8% decrease in imports, the output of textiles, textile products, leather and shoes dropped 19.0%.

Therefore, depreciation of the ruble had no positive effect on non-food goods – domestic products that are competitive with imports in terms of their consumer qualities are technologically dependent on imports of materials and components. Therefore, in the context of ruble depreciation, the prices of domestic products approach those of their imported analogs. Indeed, depreciation contributed to a minimal contraction of output in the food industry (as compared with the overall output slump in Russian industry). However, the ruble's depreciation failed to lay the groundwork for output recovery in all final demand sectors and will not do so in the future (due to appreciation of the ruble, which began in March).

In all likelihood, most final demand sectors have passed the low points of their slump, and in the near term their performance should rebound to the levels seen in January-April. Only the food industry has a chance to regain last year's production volumes in 2009. Manufacturers of leather, leather products and shoes may see a single-digit decrease in production volumes, whereas output in other final demand sectors will fall at double-digit rates.

The slump deepened *in investment demand sectors* in April, registering a 39.5% output contraction versus 34.3% in March y-o-y.

The severity of April's slump owes mainly to the plunge in output by machinery and equipment manufacturers (down 51.7% y-o-y in April versus a 31.4% fall in March). Therefore, the scale of the production slump in the investment demand sector in April should not be overdramatized, as it largely reflects the long production cycle of most types of machinery and equipment as well as accounting factors, and will correct over the next few months. Of greater importance was the *aggravation of the sector-wide slump*: accelerating contraction of production was observed in all industries of the investment demand sector. Output in the manufacturing of transport and electrical equipment dropped another 0.4-0.7 pp m-o-m in April, and 3.2 pp m-o-m in the manufacturing of building materials.

Manufacturing output in investment demand sectors and imports in 2009, % change y-o-y

	March	April	January-April
Manufacturing	**-20.5**	**-25.1**	**-22.0**
Investment demand sectors	*-34.3*	*-39.5*	*-36.3*
Manufacture of other non-metallic mineral products	-29.4	-32.6	-32.3
Manufacture of machinery and equipment	-31.4	-51.7	-34.3
Manufacture of electrical, electronic and optical equipment	-37.9	-38.3	-42.0
Manufacture of transport and other equipment	-36.7	-37.4	-36.4
including motor cars	-52.5	-55.9	-60.9
trucks	-69.6	-68.1	-73.3
Fixed capital investment	-15.4	-16.2	-15.8
Cost of imports		1Q09	
Machinery and equipment		-48.7	
Motor cars and trucks		-66.8	

Source: Russian Statistics Service, Federal Customs Service, CSI Bank of Moscow.

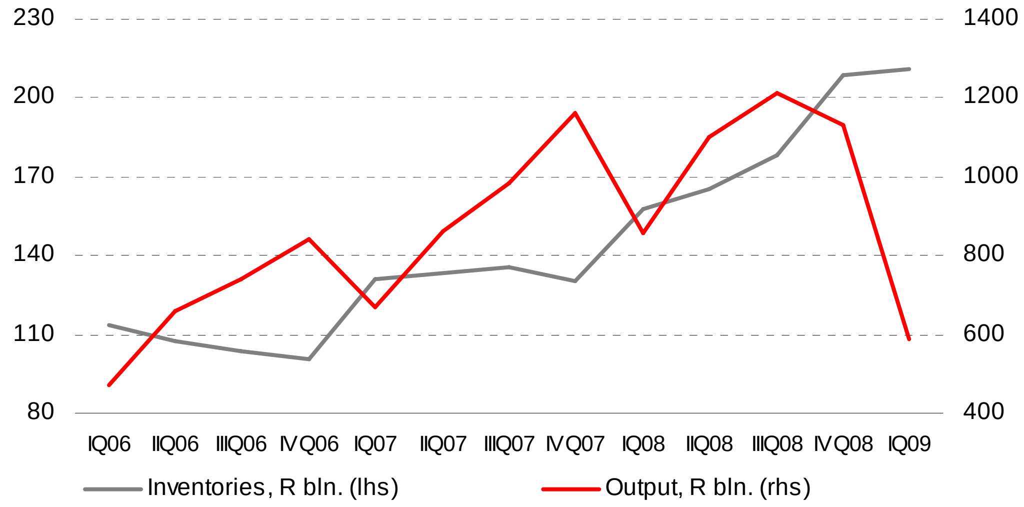
The ongoing downturn in output of the investment demand sectors was brought about by shrivelling investment activity (fixed capital investment dropped 16.2% y-o-y in April after having declined 15.4% y-o-y in March). Sliding demand for equipment, vehicles and building materials was registered not only with respect to domestically produced goods, but imports were decreasing at comparable rates as well. In the first quarter of 2008, imports of autos plummeted 66.8% y-o-y (production volumes of autos in January-April fell 65%), while those of machinery and equipment were down 48.7% (the output of domestically manufactured analogs fell 38% in January-April). Such data point to an acceptable competitive level for Russia's machinery and equipment sector – its products are quite competitive versus their imported analogs. However, dependence on foreign materials and components levels off the advantages of the ruble devaluation effect. The key condition for curbing the output slump and stimulating growth recovery is the *revival of investment activity* among Russian enterprises and households.

Apart from the ongoing pause in investment, overstocking has been another catalyst for the slump in the investment demand sectors. The cost of finished goods inventories has not decreased despite the falling production volumes. In the fourth quarter of 2008, the cost of finished goods inventories in the investment demand sectors amounted to R209 bln and R211 bln as of April 1, 2009. Even taking into account the seasonally adjusted decline in shipments of goods and finished goods inventories, we see that the problem of overstocked inventories since September 2008 has not been resolved, judging by first-quarter data.

Expansion of finished goods inventories other than that caused by seasonal factors or producer price trends was registered for five consecutive quarters. Initially (i.e. during the first half of 2008), the increase in stocks was triggered solely by the optimistic expectations of producers during a period of overheated economic activity and high investment. The strategy of building output in that period was justified by shipment volumes – the cost of investment demand goods shipped was rising steadily (seasonally adjusted).

In the third quarter of 2008, the growth in shipments slowed and in 4Q08 – 1Q09 their cost began to decline. This had no impact, however, on finished goods inventories, which continued to rise. Falling investment demand and output inertia in the respective industries over the three quarters resulted in large volumes of stocked goods.

Cost of finished goods inventories and goods shipped in investment demand sectors



Source: Russian Statistics Service, CSI Bank of Moscow.

Falling output and shipments without any corresponding contraction of inventories shows that despite the considerable slump in output of the investment demand sectors, production had not fully adapted to the conditions of declining demand and overstocking by April 2009. In the months to come, investment demand sectors will face the prospect of *sustaining negative "adaptation" trends*. We expect a more than 32% y-o-y contraction of output in May-July, with bottom lows off as much as 40%.

In fact, of the two necessary conditions for growth recovery in the investment demand sectors – free capacities and falling inventories – only the first condition is currently in place. In this context, the potential revival of investment activity will not bolster production output: given the complex financial circumstances, producers are unlikely to cut prices and liquidate their inventories in order to boost production.

Investment demand sectors have probably not yet reached a bottom from which they will rebound along with revived investment activity. The period of output stagnation will be preceded by a final stage of adaptation (adjustment of final goods inventories) to much slimmer demand. Thereafter, the output of investment demand sectors will be directly determined by investment trends. We expect a more than 30% slump in output of these sectors should existing trends (such as a continuing pause in investment at the current scale) persist.

In the manufacturing industries of *the intermediate demand sector,* output dropped 20.8% y-o-y in April. The deepening slump relative to March (when output fell 17.9% y-o-y) can be attributed to the notable contraction in woodworking and the manufacture of timber, rubber and plastic products (which fell another 2.8 pp and 9.1 pp, respectively). Manufacturers of metal products and chemicals were less affected by the slump, with their output off 0.7 pp and 1.5 pp m-o-m, respectively. Contraction slowed in industries manufacturing coke and refined petroleum products in April.

Manufacturing output in intermediate demand sectors in 2009, % change y-o-y

	March	April	January-April
Manufacturing	**-20.5**	**-25.1**	**-22.0**
Intermediate demand sectors	*-17.9*	*-20.8*	*-19.9*
Woodworking, manufacture of timber products	-25.4	-28.2	-28.9
Manufacture of coke, refined petroleum products	-1.8	-0.8	-2.9
Manufacture of chemicals	-13.5	-15.0	-20.5
Manufacture of rubber and plastic products	-11.6	-20.7	-18.5
Manufacture of basic metals and fabricated metal products	-25.2	-25.9	-27.4
Cost of exports		1Q09	
Metals		-44.5	
Fertilizers, ammonia, methanol, rubber		-38.1	
Lumber, plywood, cellulose		-46.4	
Refined petroleum products		-47.9	

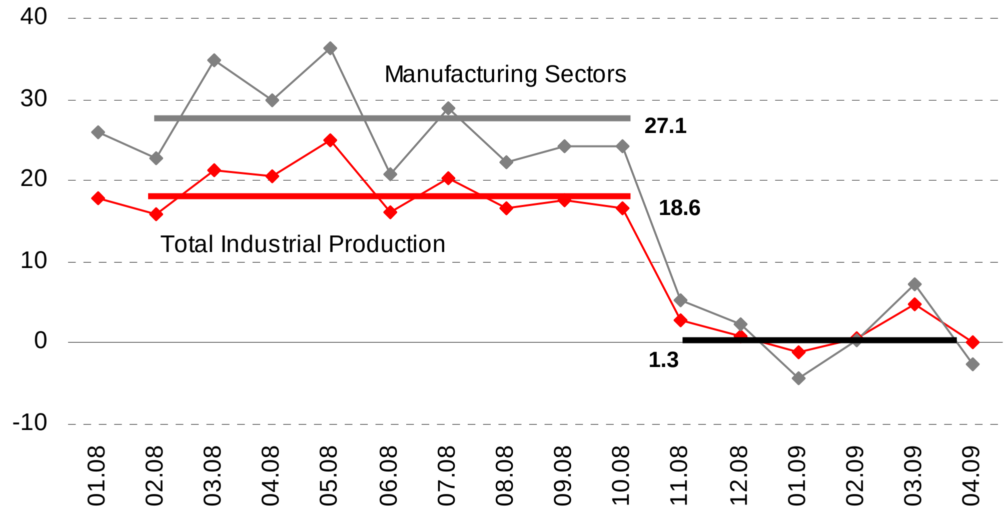
Source: Russian Statistics Service, Federal Customs Service, CSI Bank of Moscow.

The downward pressure on interim demand sectors was focused more on exports than the domestic market and stemmed from falling external prices and dwindling demand on global commodity markets. In the first quarter, exports by key commodity groups in these sectors dropped 38–48% y-o-y. Exports declined faster than output (especially in the context of falling export prices), demonstrating the high dependence of this segment of Russian industry on foreign trade and suggesting that the slump there can be halted and growth resumed only with recovery in the world economy. Overstocked inventories will also put the brakes on output growth in the intermediate demand sectors, such as the investment demand sectors, albeit to a smaller extent. In September 2008 – March 2009, the cost of finished goods in the intermediate demand sectors totaled about R155 bln and showed no signs of falling.

We expect the bottom levels in the intermediate demand sectors to be passed in April-May (a more noticeable contraction of up to 21% can be expected in May), with the output slump slowing thereafter. Should the current trends on domestic and world markets continue, output in the intermediate demand sectors will shrink by around 15% this year.

Overall, the March-April data support our hypothesis put forward two months ago regarding the level of resistance for the production slump in Russian industry. Output in the manufacturing sectors and industry as a whole remains at a level slightly (1.3%) above the respective volumes registered in 2005.

Monthly industrial output growth vs 2005, %



Source: Russian Statistics Service, CSI Bank of Moscow.

A steep downturn in demand on global commodity markets, halted capital inflows and subsequent outflows, decelerated investment growth and the onset of an investment pause, the curtailment of consumer lending programs, rocketing costs of corporate loans and unpredictable fluctuations in the ruble knocked Russian industry back to the levels registered at the start of the economic upturn in 2005 and continue to keep it at this "bottom".

Further implementation of an inertia-based "bottom" scenario in terms of industrial performance indicators should occur as follows. Over the next three months, we can expect a sizable contraction in industrial output (May and July should be the critical months). Output in these months could fall as much as 15.8% y-o-y, with the contraction in the manufacturing sectors reaching 21.0% y-o-y. In August-October, the slump should moderate to 13.3% y-o-y. Thereafter, in November-December, we can expect industrial output to approach its respective volumes of the previous year. As a result, Russian industrial output should fall 11.9% in 2009 (with output 17.0% lower y-o-y in the manufacturing sector).

Inertia-based scenario for Russian industrial growth in 2009, % change y-o-y

	Actual				Estimate			
	Nov-Dec '08	Jan '09	Feb-Mar '09	Apr '09	May-July '09	Aug-Oct '09	Nov-Dec '09	2009
Industry, total	-9.5	-16.0	-13.5	-16.9	-15.8	-13.3	-0.4	-11.9
Manufacturing	-11.8	-24.1	-19.5	-25.1	-21.0	-18.0	-2.3	-16.8

Source: Russian Statistics Service, CSI Bank of Moscow.

Visible improvement of industrial performance indicators this summer and their approaching zero late in the year would only signify that Russian industry is sustaining the output levels already demonstrated in 2005.

Four years ago, high world prices for Russian exports and capital inflows triggering explosive growth in consumer and corporate lending were the main drivers of Russian industrial growth. In 2009, however, the list of possible industry growth drivers is much shorter.

Forecast of key economic indicators

	Actual				Forecast		
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Macroeconomic indicators							
Nominal GDP:							
R. trln	21.6	26.9	33.1	41.7	42.9	50.4	58.6
$ bln	764	993	1 293	1 680	1 328	1 529	1 700
Real GDP, % y/y	6.4	7.4	8.1	5.6	-6.3	0.6	2.9
Industrial production, % y/y	5.1	6.3	6.3	2.1	-11.0	0.5	3.0
Retail turnover, real, % y/y	12.8	13.9	15.2	13.5	-4.0	0.0	4.0
Gross fixed investments, real, % y/y	10.9	13.7	21.1	9.8	-11.0	2.0	4.0
Exports, real, % y/y	6.5	7.3	6.4	11.8	-9.9	5.0	3.4
Imports, real, % y/y	16.6	21.3	26.6	23.3	-21.2	7.3	6.6
Monetary Aggregates							
M0 (year end), % y/y	30.9	38.6	32.9	2.5	5.6	13.7	15.4
M2 (year end), % y/y	38.5	48.8	47.5	0.9	8.4	12.1	12.4
M2X (year end), % y/y	36.3	40.6	44.2	13.8	10.7	15.4	15.0
Total banking assets, % GDP	44.8	51.9	60.8	67.3	75.1	77.9	83.8
Inflation							
CPI (year end), %	10.9	9.0	11.9	13.3	14.0	11.0	10.0
CPI (year average), %	12.5	9.8	9.1	14.1	13.5	12.3	10.5
Core CPI (year end), %	8.3	7.8	11.0	13.7	13.5	10.5	9.5
Budget							
Federal budget revenues, % GDP	23.7	23.3	23.5	22.2	17.5	17.7	16.8
Federal budget expenditures, % GDP	16.3	15.9	18.1	18.1	22.6	18.6	17.5
Federal budget balance, % GDP	7.5	7.4	5.4	4.1	-5.1	-0.9	-0.7
Reserve fund, year end, $ bln	43.0	89.2	156.5	137.0	64.0	92.4	131.8
National wealth fund, year end, $ bln				74.3	58.9	57.8	56.8
Balance of Payments							
Exports of goods, $ bln	244	304	354	472	330	430	470
Imports of goods, $ bln	125	164	223	292	210	230	260
Current account, % GDP	11.0	9.5	5.9	6.1	4.6	9.0	8.6
Net capital inflow/outflow, $ bln	2.0	41.9	82.8	-132.7	-119	-10	10
International reserves, year end, $ bln	182	304	479	427	364	481	624
External Debt							
Foreign public debt, % GDP	10.0	5.2	3.5	2.4	2.8	2.3	1.9
Foreign private debt, % GDP	3.9	3.8	3.8	3.9	4.8	5.4	6.1
Exchange Rate							
R/$:							
end of period	28.8	26.3	24.6	29.4	32.0	33.5	35.0
year average	28.3	27.1	25.6	24.8	32.3	33.0	34.5
Exogenous Parameters							
Urals, $ p/bbl	50.4	60.9	69.6	94.4	64.0	85.0	90.0
$/€	1.24	1.26	1.37	1.47	1.36	1.35	1.33

Source: Rosstat, Bank of Russia, Russian MOF, CSI Bank of Moscow forecast.

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