

## Lower Investment Levels Weaken Russia's Growth Outlook

**In April, Russia's Ministry of Economic Development lowered their growth forecast from 3.7% to 3.4% for 2012 citing lower than expected investment levels and a noticeable investment pause in March.**

### Monthly Overview

Relative to many countries in Europe and North America continuing to experience weak economic performance associated with the global downturn, Russia's forecast for 2012 appears to be in full swing. After a significant contraction in 2009, the economy has recovered to the pre-crisis level and the Ministry of Economic Development has raised its forecasts in April for real wage growth and retail sales. The former are expected to grow by 6.3%, up from the 5.5% forecast earlier, while the latter were raised also to 6.3%, up from the previous 4.9% forecast. Various forecasts of real GDP growth in 2012 have also ranged from the lower 3% range to low in the 4% range for Russia. The IMF's forecasts in April's *World Economic Outlook* for the advanced economies is 1.4%, the USA 2.1%, the Euro Area -0.3%, Japan 2.0%, and the U.K. 0.8% relative to their 4.0% growth projection for Russia.

After a strong start at the beginning of the year, by April the Ministry of Economic Development lowered its growth forecast for Russia in 2012 from 3.7% to 3.4% primarily based on a lower than expected investment trends. Investment growth for the year was lowered from 7.8% to 6.6% and GDP figures estimated during the first three months already suggested a slight slowdown by March (Figure 1 in the *Indicators*). Although many factors combined likely play a role in this drop ranging from foreign investors re-allocating funds to provide more liquidity at home to Russian investors potentially taking advantage of conditions abroad to make strategic investments, political risk seems to be continuing to play an important role. Monthly data from Russia's Central Bank show that net capital outflows began to increase last summer and continued to grow leading up to the Parliamentary elections in December, 2011. Net capital outflows reached an estimated \$35 billion in the fourth quarter of 2011 alone accounting for just over a third of last year's total net outflow of \$86 billion. Further, this level has appeared to continue during the first quarter of 2012 with no immediate signs of reversal.

As pointed out in BCDM's first *Quarterly Report* for 2012 released earlier last month, this element of political risk draws attention to the importance of who is in power as opposed to the integrity of government institutions and reforms to withstand changes in personnel. It also raises concern over the uncertainty of where the government is headed in terms of further concrete reforms for improving the investment climate.

**Despite the fact that the health of Russia's economy depends on many factors such as high oil prices, strong export market demand, amongst a variety of others, the element of political risk will likely continue to hinder investment levels until after Putin's inauguration when future policy reforms and directions are far less uncertain. This is the primary source of uncertainty in Q1, 2012, and the subject of our next issue.**

### Monthly Highlights

BCDM's highlights aim to provide a brief summary of announcements related to new investment activity that can reflect changes in the quality of Russia's business climate from one month to the next that could be overlooked in less frequent or more aggregate reports.

*In April there was a noticeable decline since March in new investment announces related to Russia's retail sector followed by agriculture and automobiles. Even the energy sector appeared to decline.*

### Energy

- *Exploration:* **Rosneft** and **ExxonMobil** could invest over \$500 bln in the coming decades to explore oil in the Arctic and Black Seas after entering a partnership agreement. The final decisions for investments in exploration and production are expected in 2016-17 for operations to potentially begin between 2018 and 2020; **Rosneft** and **Eni SpA**, an Italian multinational oil and gas company, signed an cooperation deal to jointly develop Russian offshore energy deposits in the Barents and Black Seas, the development costs are estimated at over \$ 100 bln;
- *Liquefied Natural Gas:* **Gazprom** and **NOVATEK** signed a memorandum of cooperation to consider the creation of joint ventures to increase the capacity of facilities for LNG production on the Yamal Peninsula and joint development of resources on the Gydan Peninsula. The projects are estimated to involve \$18 to 20 bln;
- **Lukoil-Nizhnevolzhskneft** entered an agreement with Italy's **Saipem** to construct undersea pipelines to transport oil and gas from the north of the Caspian Sea to be completed in July-December 2015. Financial details were not disclosed;
- **Gazprom** is considering increasing its investment program in 2012 by 8.62% to RUR 844 bln.

### Autos

- **Mazda Motor Corp** will set up a joint venture with **Sollers**, a Russian automaker, to produce Mazda's CX-5 SUVs, the next generation Mazda6 car, and a Sollers brand vehicle for sales in Russia with output to begin at 50 000 units per year, no investment sums were disclosed;
- **Pirelli** will invest EUR 100m on the modernization and upgrade of the Kirov Tire Plant by 2015;
- Russia's **Kamaz** and Ireland's **Timoney Technology Ltd** entered an agreement covering joint design and production of vehicles for construction works and geophysical prospecting;

### Metals and Mining

- China's **Nonferrous Metal Industry's Foreign Engineering and Construction Co Ltd.** entered a framework agreement with Russia's **Eastern Siberia Metals Corporation** to develop the Ozemoye polymetallic deposit in the Republic of Buryatia for an estimated \$ 1 bln;
- Austrian **Siemens VAI Metals Technologies** plans to open an engineering center from the company's regional office in the Chelyabinsk region to boost cooperation with Russia's nonferrous and ferrous metallurgical producers.

### Transportation and Infrastructure

- **RZHD**, Russian Railways, plans to invest an estimated RUR 560 bln to construct 18 cargo terminals with an expected net operational volume of 210 mln tons/year;
- **SpetsEnergoTrans**, a Russian railway operator, and **Rail Garant** have agreed to establish a joint venture, **RailSpetsTrans**, for roofed-in-cars cargo transportation with an initial 5000 cars in operation and expected annual revenue of % 80 to 100 mln;
- **Chinese entrepreneurs** plan to invest EUR 1.2 bln EUR to begin construction of the Yuzhnouralsky Transportation and Logistics Center in 2013 in the Chelyabinsk Region after reaching an agreement with the regional government;

- **Globaltrans**, Russia's largest private railroad operator, plans to invest RUR 21-22 bln to acquire new rolling stock in 2012.

#### Agriculture

- Citing expected growth into European markets in the medium term, **EuroChem**, Russia's top mineral fertilizer producer, plans to invest \$ 1.5 bln annually in organic growth projects between 2012 and 2020;

#### Non-energy sector investment activity

- *Research and Development*: Russia's **Rusnano** has invested \$ 40 mln in the California-based **NeoPhotonics** and plans to spend the funds on setting up research and production facilities in Russia covering a range of steps from development to processing and fabrication;
- *Financial Services*: **Bank of China (Elos)**, the Russian subsidiary of the Bank of China, plans to open its first branch in Kharbarovsk in the second quarter of 2012;
- *Business Support*: **VTB Capital**, a unit of VTB Group, plans to invest \$ 18 mln into Russian Internet business promoter and developer **Fast Lane Ventures** to develop services and finance the creation and maintenance of online firms;
- Russian LED producer **Optogan** has agreed to set up a joint venture with **Philips** to produce LED lamps and smart systems for road lighting for domestic use as well as for export to Kazakhstan and Belarus;
- Russia's **Severstal** and Germany's **Rutgers Group** agreed to invest \$ 26.6 mln to establish a joint venture to manufacture vacuumized pitch, industrial oils and naphthalene;
- Russia and Ukraine will set up a joint venture in Samara to make casing-head processing plants for the Yamal fields, no financial details were disclosed.
- *A number of investment plans in consumer retail were announced*:
  - **Rosinter Restaurants Holding** has entered a partnership agreement with **McDonald's** and will open McDonald's restaurants in Russia's transportation hubs;
  - British retailer **Mama's and Papa's** will open five stores in Russia in 2012 with plans to open 25 stores by 2015;
  - **Miratorg**, a Russian agricultural holding company, plans to invest an estimated RUR 10 bln to develop a retail chain and plans to open 500 stores within the next three years to sell its own meat products and may increase this number to 1000.

#### Outward New Investment Announcements

*Announcements related to Russia's new investment announcements outside the country in April were dominated by the energy sector.*

- *Entrepreneurs Abroad*: Russia's Yuri Milner, a co-founder of Mail.ru Group, and Britain's Richard Branson have jointly invested about \$ 30 mln in **Path**, a US developer of mobile applications for wireless connection exchange;
- **Foreign Offices**: **Gazprombank** is considering opening an office in Hong Kong in late 2012 or beginning of 2013 while **Gazprom** is planning to open an office in Brussels to ensure greater relations with EU institutions and the company's European partners;
- **China Petrochemical Corp.** signed an agreement with Russia's **Sibur** to form a joint venture to produce butadiene nitrile rubber in the city of Krasnoyarsk, the value of the investment has not been disclosed;

- **Yugorosgaz**, a joint venture between Gazprom, Serbiagaz and Central ME Energy & Gas AG, launched the first 52 km section of the 122 km gas pipeline Nish-Leskovats-Vranie in the south of Central Serbia and a 7km gas network in the city of Leskovats. The value of this first stage is \$ 14.6 mln and the whole project EUR 40 mln.

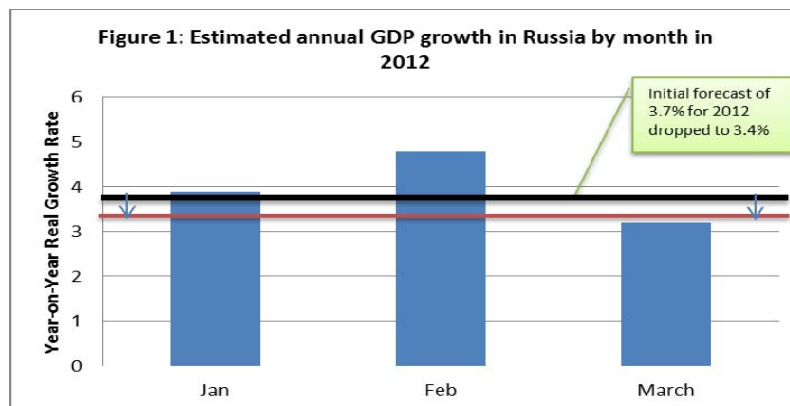
### *Business Climate Indicators*

BCDM's indicators aim to provide a monthly snapshot reflecting important trends, challenges, and changes related to Russia's business climate.

**Changes in forecasts in April for Russia's growth rate in 2012 have highlighted the country's reliance on global market conditions, lack of diversification away from the commodities sector, and the larger role of political risk after nearly 12 years of relative stability in the Kremlin.**

- At the beginning of 2012, forecasts for Russia's growth in 2012 ranged from low in the 3% range to low in the 4% range depending on the organization making the forecast and the types of assumptions they made concerning conditions in 2012. However, all of these forecasts shared in common a relatively positive outlook for Russia relative to other economies in the Euro Area, the USA, Japan and the U.K.
- In April, Russia's Ministry of Economic Development lowered its forecast for 2012 from 3.7% to 3.4% citing lower than expected investment levels. After a relatively strong start in 2012, Russia's year-on-year GDP growth began to show signs of slowing down in March (Figure 1) and estimates suggest the economy declined by possibly as much as 0.5% between February and March.
- The New Economic School's **RenCap** forecasts for Russia's GDP growth in 2012, however, were raised in [April](#) from the 2.3% forecast in September, 2011, to 3.0%. Part of the explanation for this improved outlook is due to adverse external conditions associated with the crisis in Europe appearing less severe now than it did last September and 2011's fourth quarter growth exceeding previous forecasts resulting in upward revisions.
- While Russia's Ministry of Economic Development forecast changes draw attention to the significant role investment levels play in Russia's performance, particularly in the energy sector, the RenCap forecast change draws attention to some degree of reliance on external conditions.

**Sluggish investment levels partly due to political risk continue to weaken overall economic performance and are expected to remain so until after Putin's inauguration when the new government is announced. Perhaps more important, credible business climate reforms with greater clarity on the policy direction over the medium term are needed to reduce uncertainty.**



Source: Russia's Ministry of Economic Development, March, 2012.