

First Quarter Marked by Political Uncertainty

Quarter in Brief: After 12 years of relative certainty over who was in charge in the Kremlin, political risk returned to Russia. Protests grew in response to Parliamentary elections in December, 2011, and worry carried over to the March presidential elections in 2012, likely having some impact on investment flows and raising concerns over the integrity of the business climate to withstand personnel changes.

Quarterly Highlights

On the eve of the first quarter, the OECD released an economic survey of the Russian Federation citing a poor business environment as a key factor constraining Russia's growth given the country's rich natural resource endowments and population's skill level. According to this report, policy makers should focus on energy efficiency and improving productivity across sectors rather than focusing on high-tech development.

After 18 years of negotiations, an agreement was finally reached at the end of 2011 for Russia's entry into the World Trade Organization. Membership will require Russia to reduce certain tariff and non-tariff barriers granting greater access to domestic markets in exchange for access to foreign markets. Membership is expected to provide an important stimulus for much needed business climate reforms that will improve efficiency, enhance the country's ability to attract investments, improve trade flows and ultimately stimulate higher levels of GDP growth.

In early 2012, Russia's Central Bank estimated that net capital outflows for 2011 reached \$84 billion, up 150% from 2010's \$33.6 billion. Further, in the fourth quarter alone net capital outflows were estimated at \$36 billion. Although the country has typically experienced net capital outflows during the past two decades, the possibility that both international and domestic investors might be choosing to place investments elsewhere due to political risk associated with the December Parliamentary elections and the then upcoming presidential elections indicates a lack of integrity in business climate reforms; who's in power might matter more than the system they are in charge of. The Bank's estimate for Q1, 2012, is a net outflow of \$35 billion indicating that political uncertainty will not likely be resolved until government appointments are announced and first steps are taken.

The World Economic Forum's (WEF) most recent Global Competitiveness Report for 2011-2012 ranked Russia 66 out of 142 countries in terms of competitiveness. While Russia performed relatively well in terms of market size, infrastructure and education and training, it performed worse in terms of institutions and goods and financial market efficiency. The WEF in late January highlighted Russia's need to further modernize and diversify, ease administrative barriers while also strengthening state institutions.

The fifth consecutive Russia Forum took place in Moscow from January 30 to February 4. This forum provides a platform for an economic dialogue for individuals who can play an influential role in Russia's future. Highlights included Russia's potential to provide a counterbalance to a lack of growth in developed economies due to the current crisis and that despite relatively high growth rates forecast for the next few years, Russia could be performing even better given its natural resources and skilled labor supply if it addresses weak private sector performance due to a poor business climate.

The March 4th Presidential election returned Vladimir Putin to the presidency, having served two terms from 2000 to 2008 and then as Prime Minister for the past four years. If his speech at the Russia Forum, held only a month prior to the election, is an indication of what is on his agenda, Russia's Business Climate should improve. Putin said Russia's current rank in 120th place on the World

Bank's *Ease of Doing Business Survey* was unacceptable as he announced an ambitious goal of climbing 100 places. In later speeches, he clarified that this would probably take 8 years.

Business Climate Indicators

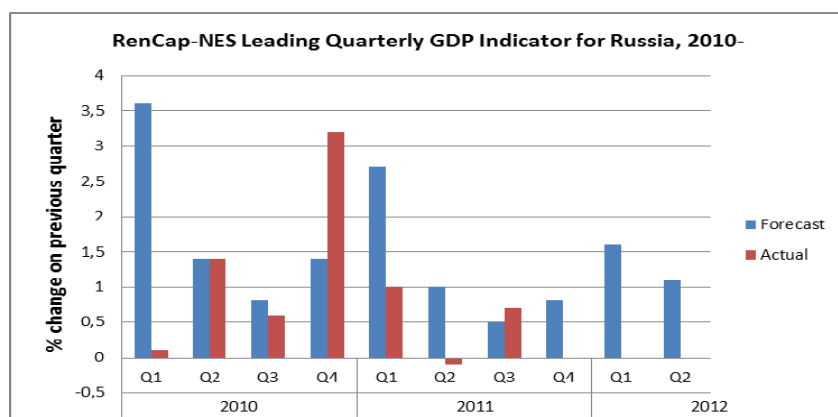
BCDM quarterly's indicators aim to provide a brief look at statistics related to investment activity that can reflect changes in the quality of Russia's business climate from one quarter to the next that could be overlooked in less frequent or more aggregate reports.

Russia's Growth Outlook in the Near Term

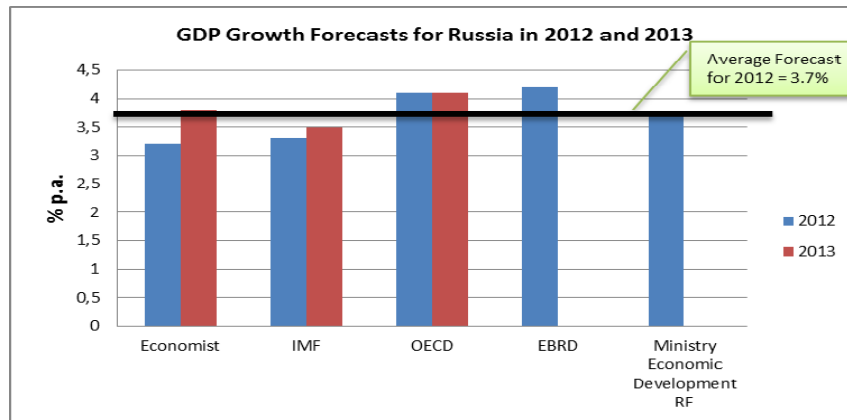
Since 1999, Russia's GDP has grown on average at an annual compound rate of 5.1%. Forecasts of GDP growth in 2012 as of Q1 generally range from a low of 3.2% to a high of 4.2%. Despite the fact that these forecasts are high relative to many other economies suffering from a global economic downturn, there is reason to believe that Russia could and should be doing even better.

Given the country's rich natural resource endowments, namely energy and agricultural land at a time when demand conditions are forecast to grow further for both, coupled with growing retail markets and a skilled population, Russia is achieving these rates while ranking 120 out of 183 in the World Bank's Ease of Doing Business Index and 66 out of 142 in the WEF's Global Competitiveness Index. Improving the Business Climate should further improve the country's ability to attract investments, reduce inefficiencies, and boost GDP growth even further.

- The following figure shows [RenCap-NES's](#) quarter-on-quarter actual and forecast GDP growth figures starting from Q1, 2010. It is important to note that Russian state statistics, Rosstat, revised its methodology at the end of 2010 which partially accounts for changes in the accuracy of RenCap-NES's forecasts.
- GDP is expected to grow by 1.6% in the first quarter of 2012, up from the estimate of 0.8% in the last quarter of 2011, before slowing to 1.1% in the second quarter.



- The next figure shows forecasts of Russia's growth in 2012 and 2013 (where available) across different organizations. Estimates for 2012 range from 3.2% by the Economist to 4.2% by the EBRD, and are on average 3.7%. Forecasts for 2013 range from 3.5 to 4.1%.
- As of going to print, Russia's Ministry of Economic Development reduced their forecast for 2012 from 3.7 to 3.4% due to weaker than anticipated investment activity.

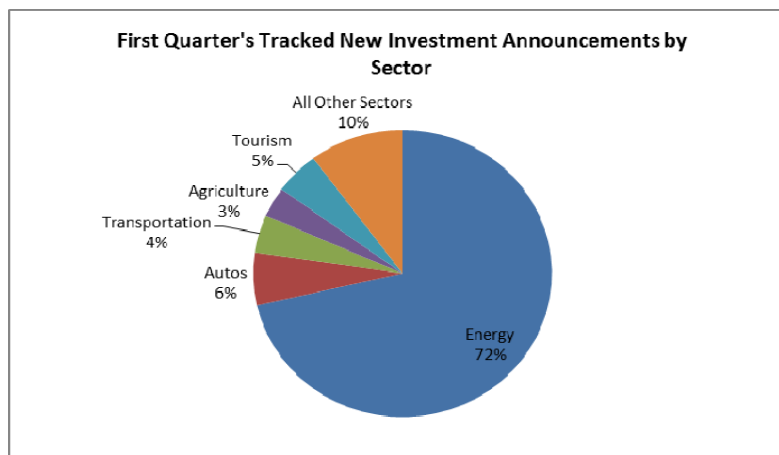


New Investment Announcements

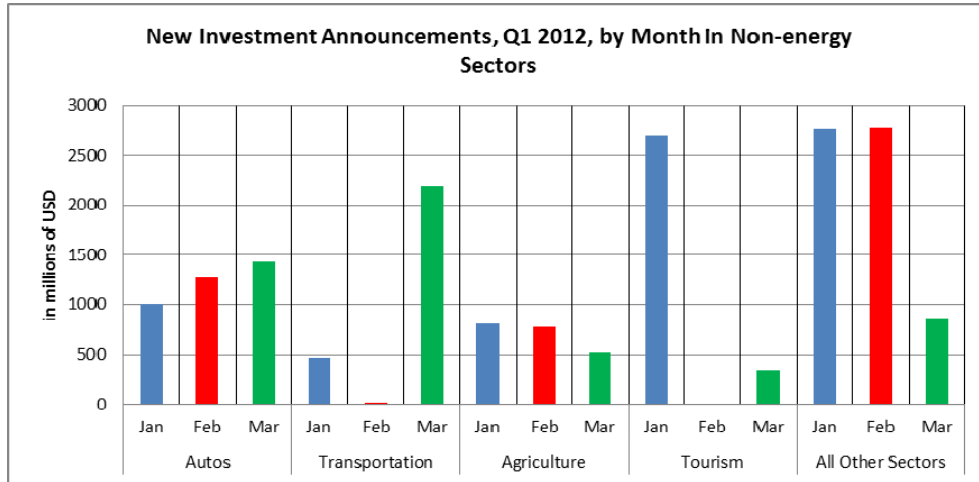
BCDM tracks new investment announcements monthly. A new investment announcement usually reflects an intention to follow through with an investment in a particular activity over a future period and does not reflect an actual investment expenditure made. Tracked announcements monthly can help identify important changes and trends that reflect, in part, changes in the quality of the Business Climate in the short term that may be missed or overlooked in less frequent or more aggregate reports.

During the first quarter of 2012, tracked new investment announcements were concentrated in terms of value in the energy sector while there was also a noted increase in activity associated with investments in retail expansion.

- During the first quarter of 2012, tracked new investment announcements for which there was an investment figure disclosed totaled **\$62.9 billion**.
- The overwhelming majority of these announcements, 72%, were in the energy sector. This not only reflects in part the relative importance of energy production in Russia's economy, but also that many investments in this sector are by their nature large-scale and over a longer number of years than in other sectors. Adding to this relative difference even further is the fact that many retail investment announcements included in "All Other Sectors" did not disclose investment figures, were excluded from the data as a result, and therefore relatively underrepresented.



- During the first quarter, investment announcements broken down by month indicate stable and growing activity in the auto sector, increased activity in March in transportation, and relatively stable activity in agriculture. Larger tourism related investments were announced in January while other other sectors, dominated primarily by retail, dropped in March largely due to lack of disclosure of investment sums rather than a lack of announcements overall.

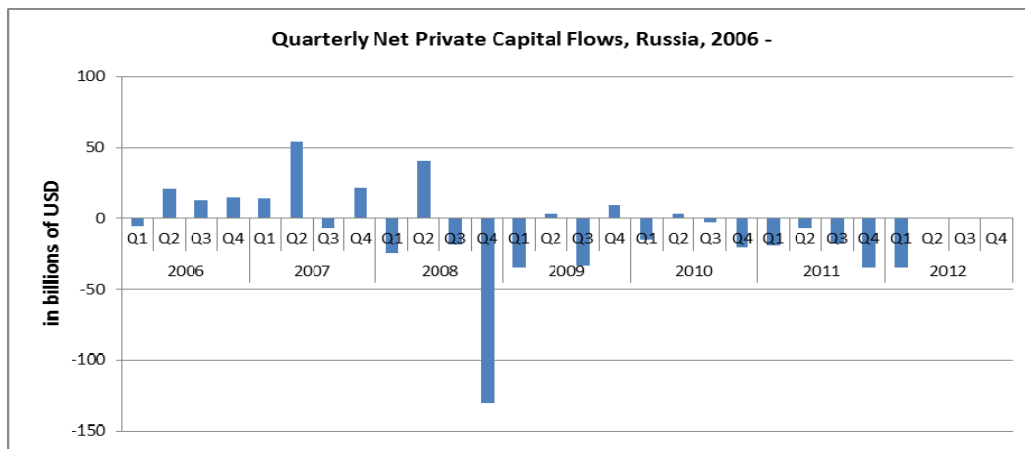


Note on Data : New investment announcements are tracked monthly and totaled in USD only for those announcements for which figures were disclosed. The monthly edition of the BCDM discloses both announcements for which figures were and were not disclosed, but nevertheless tracked. Disclosed sums in other currencies were converted for each month using European Central Bank figures for the last day of the month of the announcement. New investment announcements do not capture all investment intentions nor do they represent actual investment expenditures made. They represent only the total amount disclosed in the month of the announcement.

Capital Flows and FDI

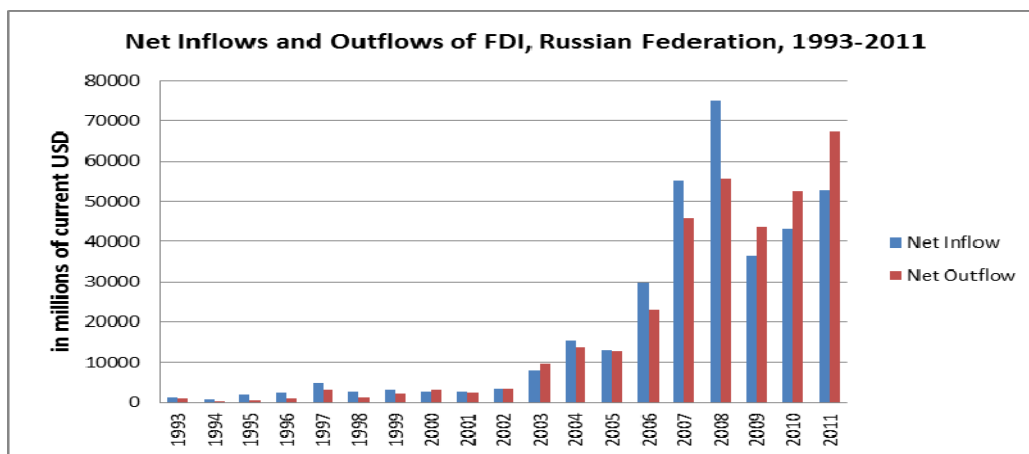
Estimates of net private capital flows for the fourth quarter of 2011 and the first quarter of 2012 indicate that significantly more capital continues to leave Russia than enter. Net inflows of Foreign Direct Investment for 2011 recently revealed that net inflows were up over 2010. At the same time, Russia continues to directly invest abroad in greater volume.

- The following figure provides quarterly figures on private net capital flows for Russia beginning in Q1, 2006. Both 2006 and 2007 were exceptional years when Russia had net capital inflows rather than net outflows. More recently, net private outflows began to grow again after Q2 in 2011 and reached \$35 billion in Q4 and continued at this level in Q1, 2012.



Source: Bank of Russia

- The following figure shows both net inflows and outflows of FDI since 1993. Starting in the late 1990s, both flows grew rapidly and Russia's stocks of FDI doubled worldwide growth rates. Since the onset of the global crisis in 2008, both flows have grown each year with net outflows generally higher than inflows as Russia acquired more direct assets abroad.



Source: FDI figures are from Russia's Central Bank and were cross checked with those available from UNCTAD up to 2010. Figures for 2011 are solely based on estimates from the Bank of Russia.

Readers' Business Climate Corner

BCDM quarterly's Business Climate Corner provides readers with the opportunity to submit questions to relevant government authorities concerning the quality of the business climate.

In order to provide relevant information to its readers on Business Climate issues in future editions, BCDM quarterly would like to invite its readers to submit questions and comments. Questions should address an issue concerning the quality of the business climate, current changes or challenges, which are important but all too often left out of large annual reports that cannot address specific issues in detail.

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