

Russia: Strengthened Optimism

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September 2006, Moscow

A vast country

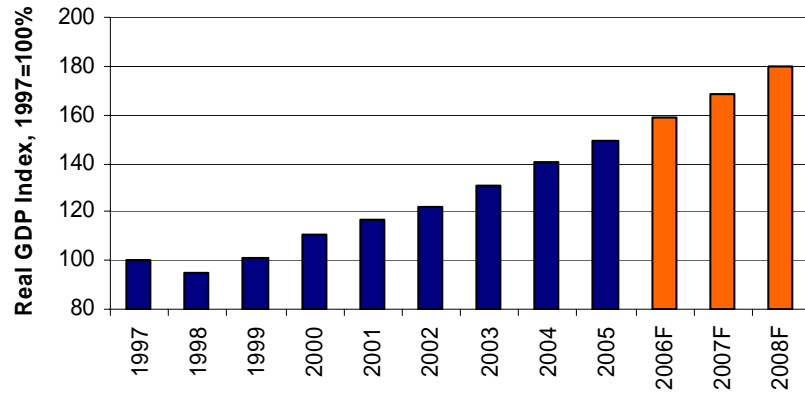
Population (2005): 142.75 million Area: 17098.2K sq km Population density (2005): 8.3 per sq km



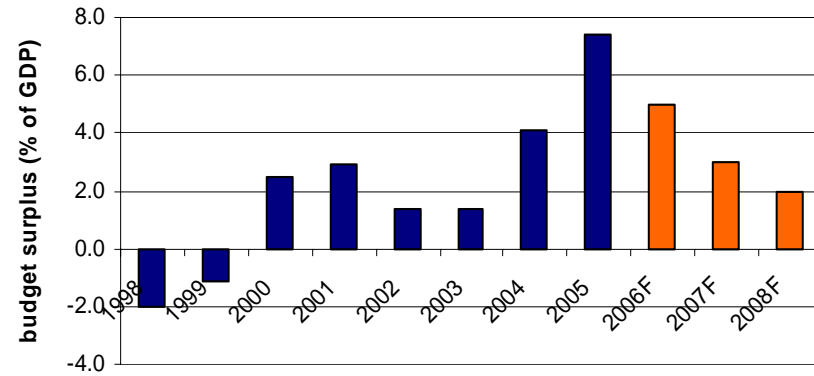
Population growth (2005): -0.5% GDP growth (2005): 6.4% GDP per capita (2005): US\$5318

Strong economic recovery *August 1998 is a distant memory*

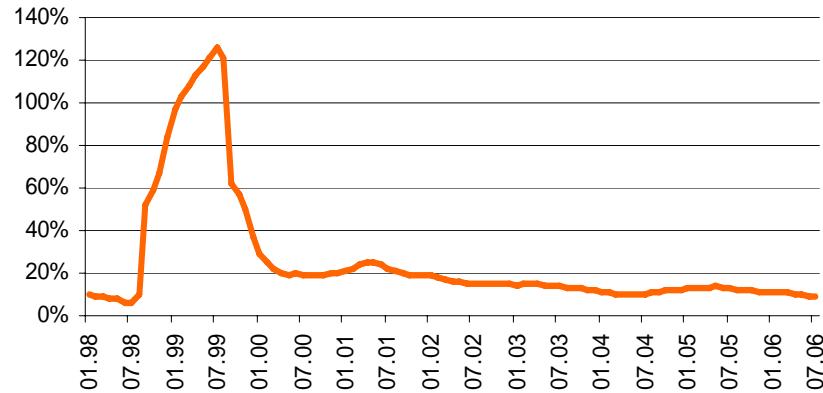
GDP growth is impressive



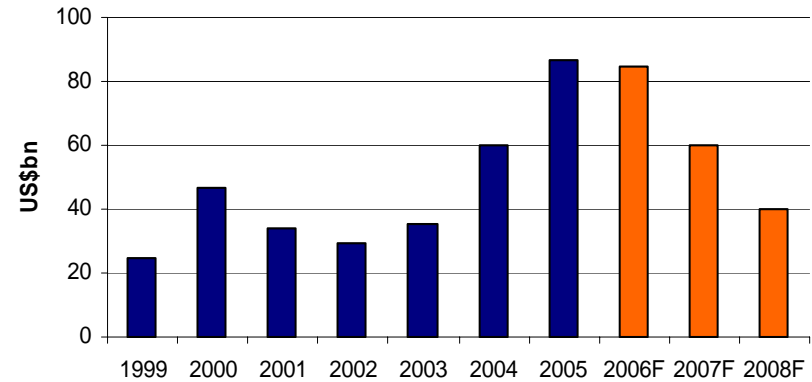
Fiscal performance is strong



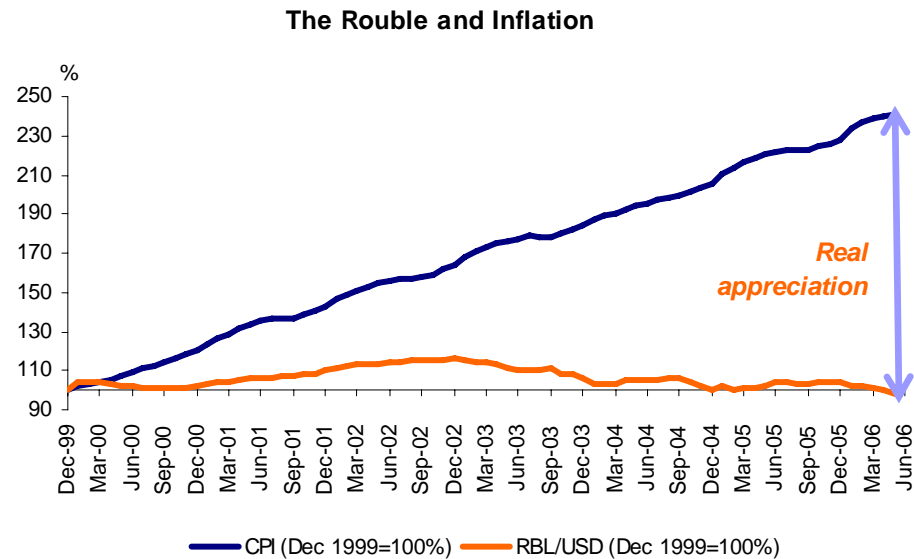
Inflation is falling



Current Account Surplus (US\$bn)



ING views on the macroeconomic situation



- **CPI should continue to slowly decline in 2006–08, although inflationary pressure will remain sufficiently high.**
- **The rouble remains under strong upward pressure.**
- **In 2006, the CBR will allow the rouble to appreciate vs. the bi-currency basket to reduce inflation.**
- **RBL/US\$26: an important threshold for oil & gas sector.**

The rouble and inflation in 2003-08

	2003	2004	2005	2006F	2007F	2008F
RUB/USD (year-end)	29.5	27.8	28.8	26.0	26.0	26.0
CPI (year-end), %	12.0	11.7	10.9	9.0	8.0	7.0
Real appreciation (%)	18.7	15.6	4.9	20.7	8.0	7.0

Politically, things have changed...

- **Federal authority is growing stronger.**
- **Regional power has been curbed.**
- **The government has been reformed into a political/technocratic tool.**
- **A new relationship between the Kremlin and business has emerged.**
- **New election law: higher concentration of political parties.**



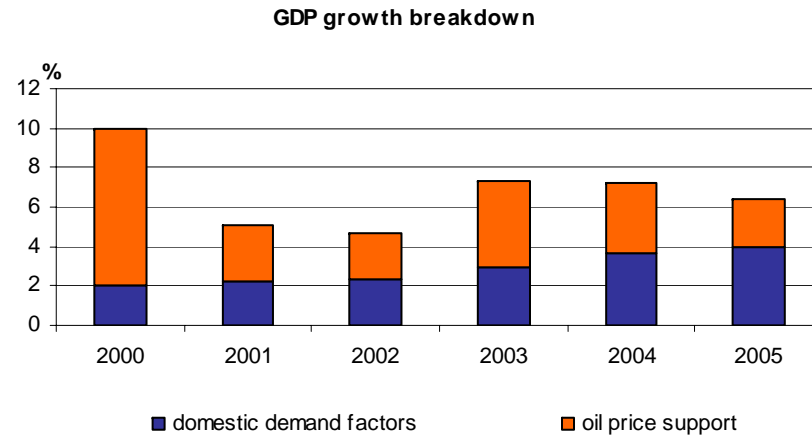
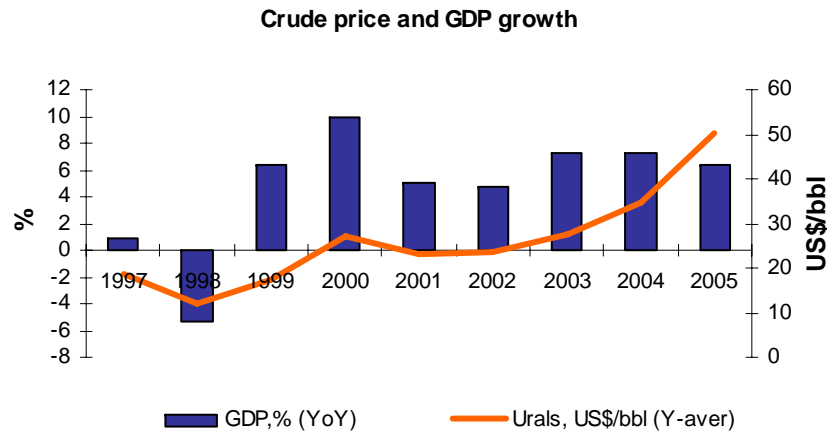
Political climate

- **The Yukos story is fading from the memory of investors. Thankfully, the Yukos case was not the start of a more general redistribution of assets. Political risks are declining.**
- **Russia is still not a fully functioning democracy in the Western sense.**
- **Of its investment grade peer group, Russia is more akin to China and Kazakhstan than to Mexico.**
- **Kremlinisation: the Kremlin has remained the only decision-making centre in Russia.**
- **The government wants to increase its presence in economic activity, which raises some concerns.**
- **Presidential succession: the main political risk.**

Some risks remain on the economic side

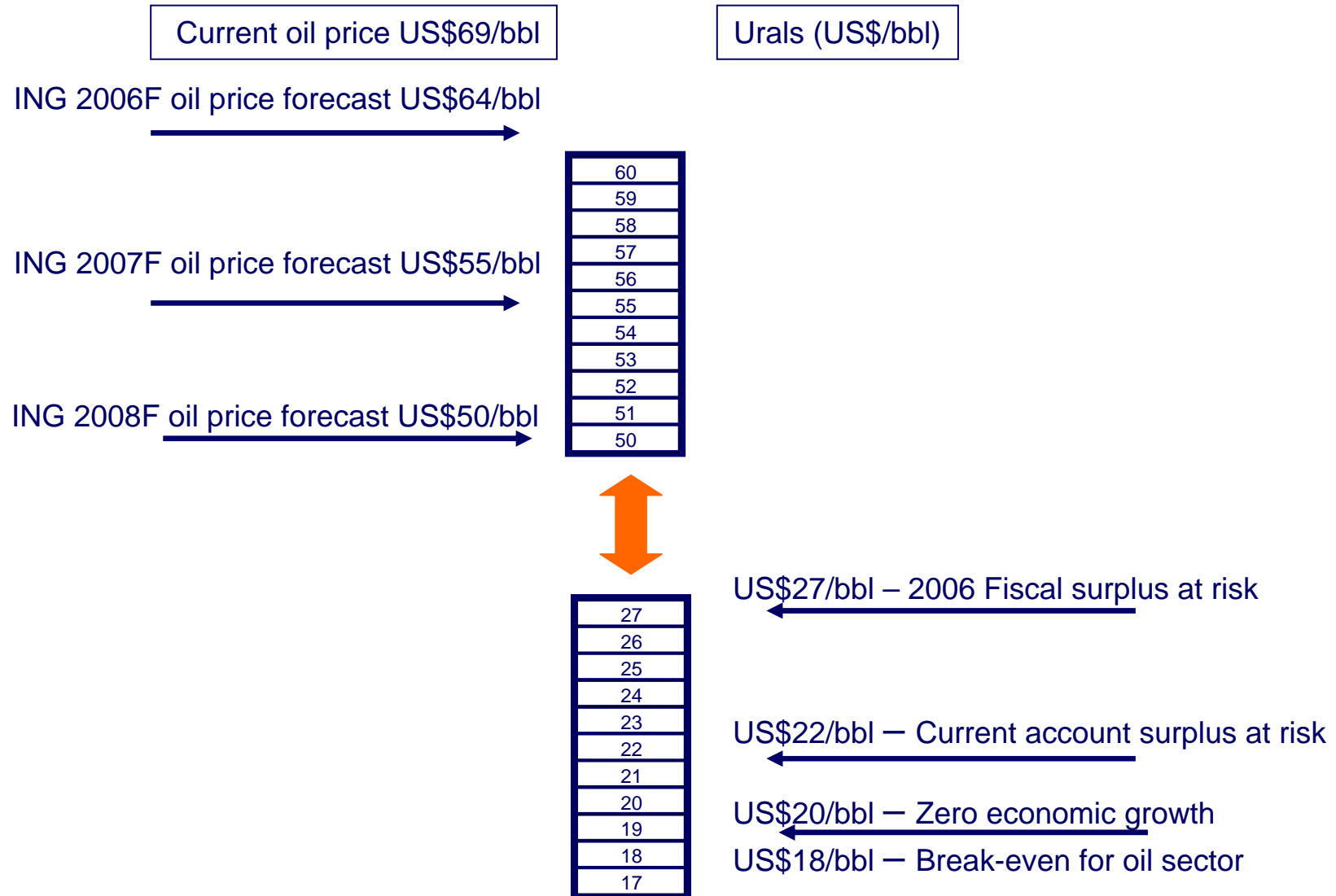
- **A dominant raw materials sector.**
- **Relatively low efficiency due to obsolete equipment and technology on the back of insufficient investment flow.**
- **A weak banking system.**

Oil prices remain important for economic growth...

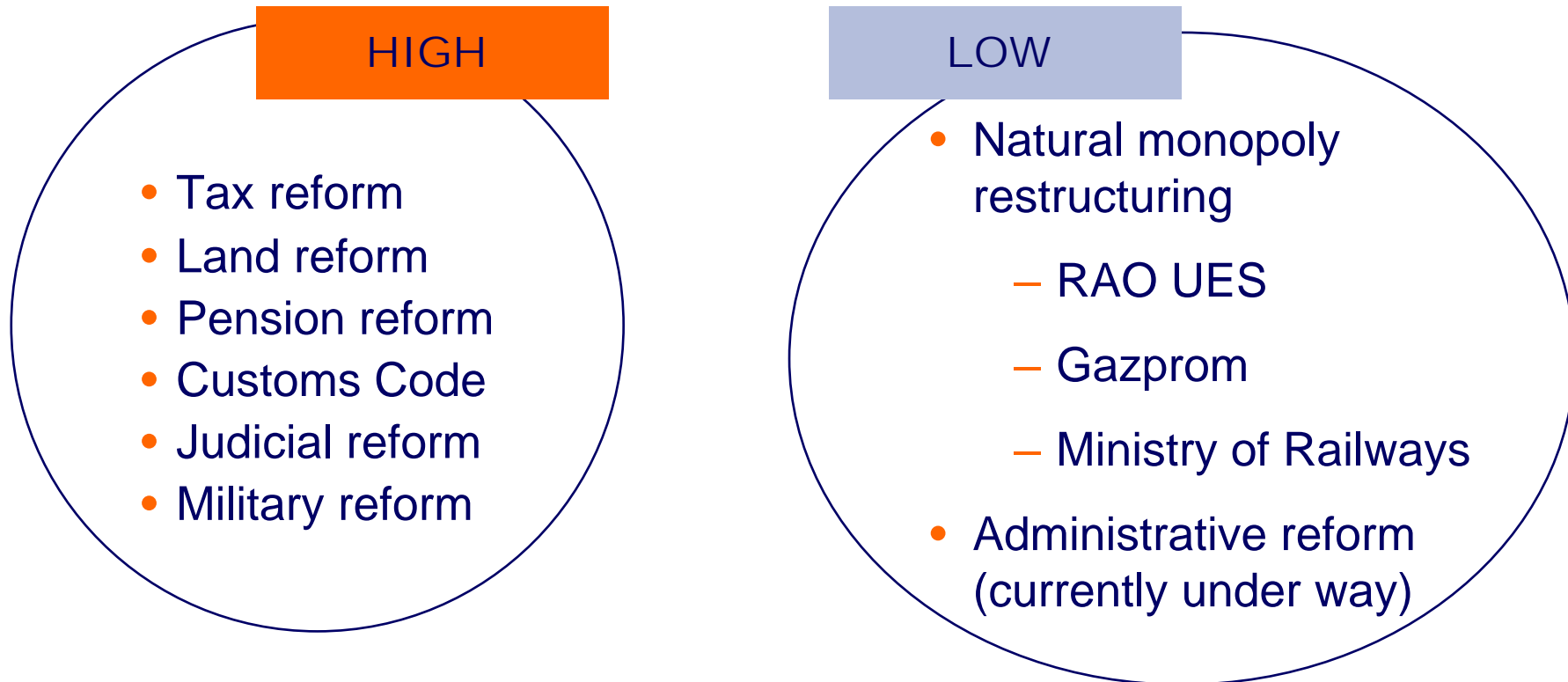


...although the expansion of domestic demand has become the main factor.

The economics of oil prices



Progress on structural reforms



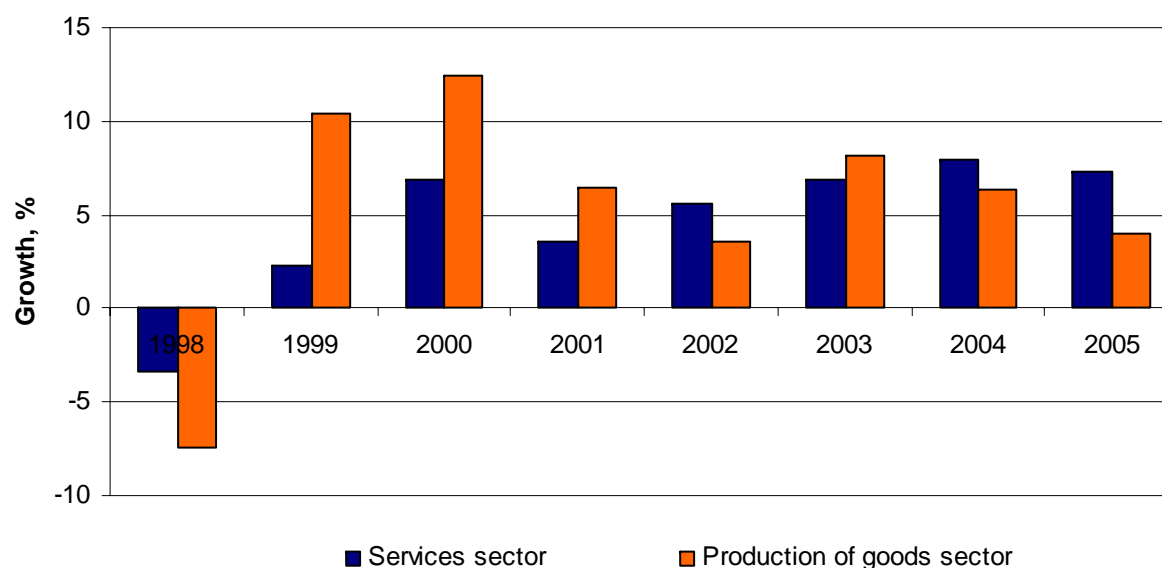
- **Banking reform is coming into a critical phase.**
- **Re-packaging of unpopular reforms into the so-called National projects (housing, education, healthcare, agriculture).**

Sector growth

- Sustained economic growth of 6+% in 2006–10.
- Domestic demand factors are becoming increasingly important.
- Budget as a tool to redistribute petro-revenues.
- Steady growth of disposable income and government investment.
- New leaders of economic growth.
- The oil sector is suffering from high tax pressure.
- Real appreciation of the rouble and further international integration will make competition even tougher.

Sector growth forecasts							
	2004	2005E	2006F	2007F	2008F	2009F	2010F
GDP	7.2	6.4	6.3	6.3	6.5	6.0	6.0
Raw materials	7.2	1.8	5.5	5.5	5.5	5.0	5.0
Manufacturing production	6.6	4.4	6.0	6.0	6.7	5.9	5.8
Production and distribution of electricity, water and natural gas	0.9	2.2	2.0	3.0	3.0	3.0	3.0
Construction	10.1	9.7	8.5	8.5	8.5	8.0	8.2
Agriculture	2.9	1.1	2.5	2.3	2.3	2.0	2.0
Transport and communication	10.6	8.5	7.3	7.0	7.0	6.5	6.5
Trade	11.2	12.3	10.0	10.0	11.0	9.5	9.0

Services sector vs. production of goods

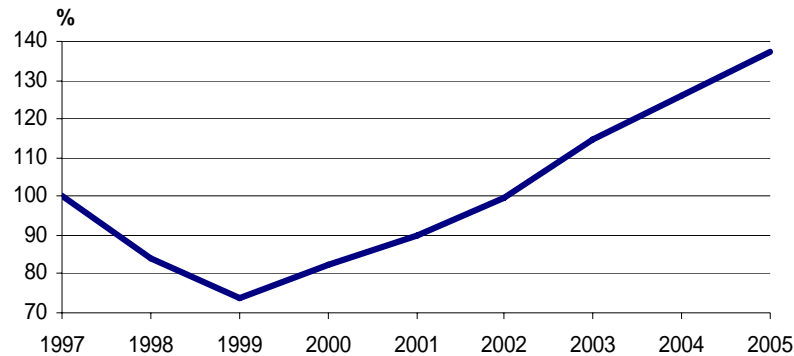


The main trend in the medium term is accelerated growth in the services sector because it is:

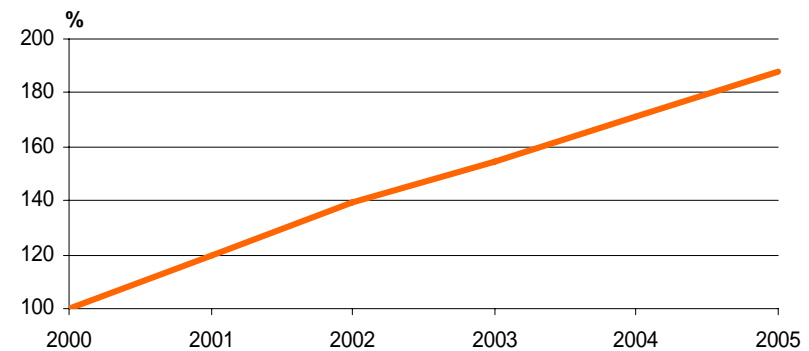
- less vulnerable to rouble appreciation.
- was pretty underdeveloped in the USSR era.
- oriented towards final demand.

Booming incomes stimulate consumption...

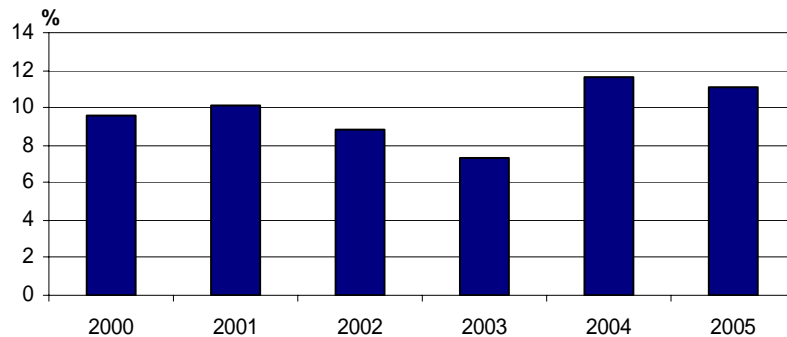
Real disposable income growth (1997=100%)



Real wage growth (2000=100%)

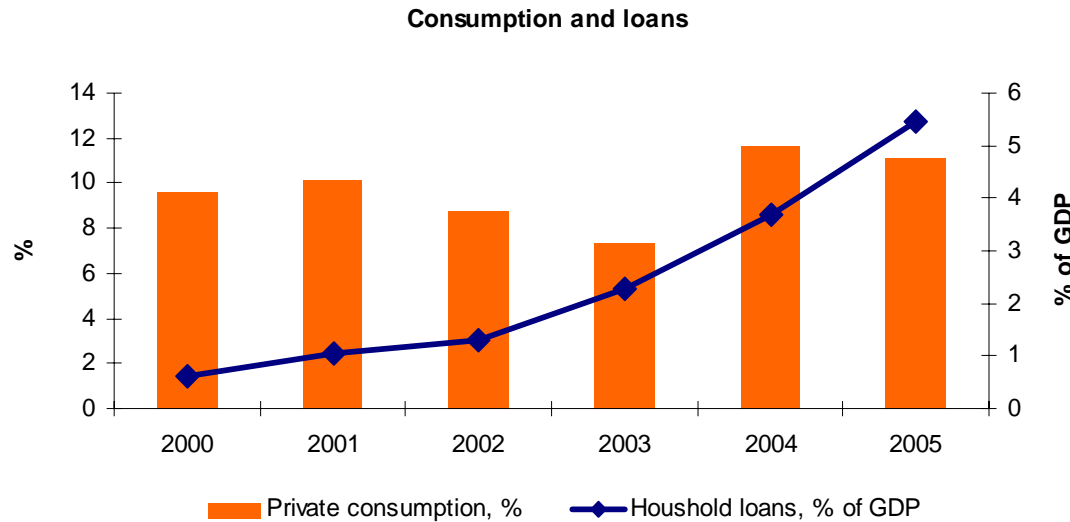


Private consumption



- The second-round effect of high oil prices is income growth.
- But regional distribution is not uniform.
- The poverty level has dropped significantly ...
- ...although the gap between the rich and poor widened.

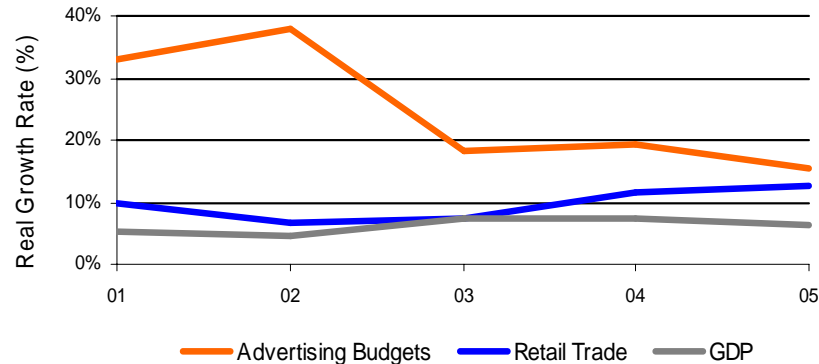
...credit growth is becoming essential



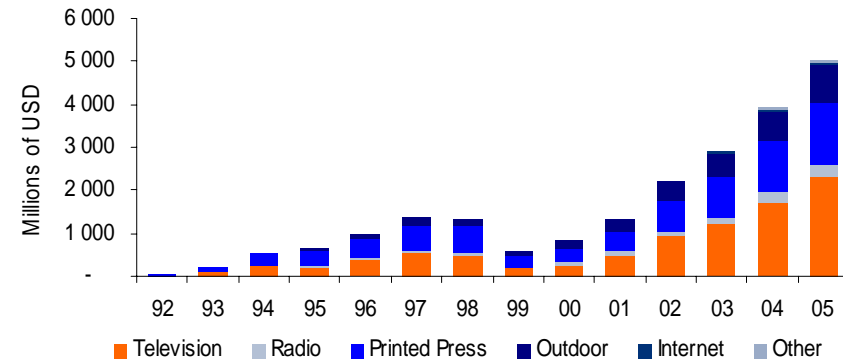
- **Household loans in 2005 was 5% of GDP – very significant but still lower than in CEE.**
- **For 2006 and beyond, the credit boom should continue (longer maturities, higher average amounts, mortgages).**
- **The important threshold of 10–15% of GDP could be reached in the coming years.**

The advertising market

Historical Real Growth Rates



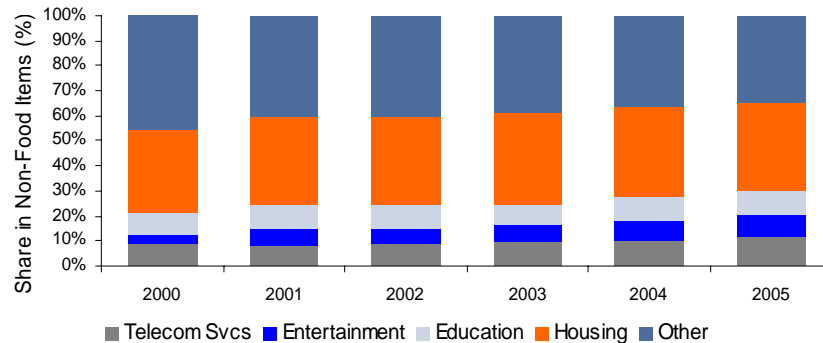
Advertising Spend Market Size



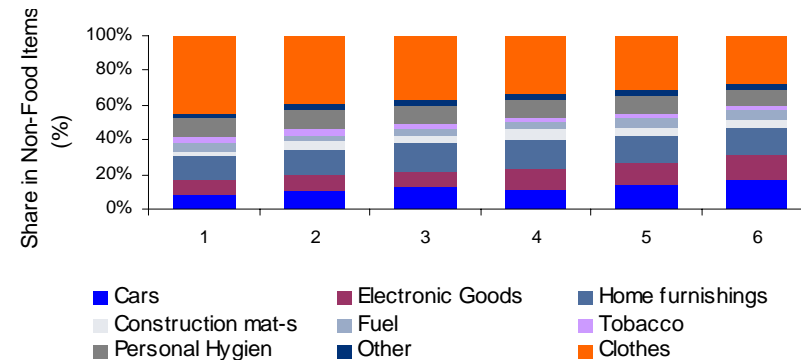
- Main driver of advertising spending in Russia is a tremendous increase in purchasing power of Russian citizens, fueled by economic recovery, which, in turn, is driven by high commodity prices
- Russian advertising market has grown at 42% per year on average over the last five years, outpacing GDP and retail trade growth as producers fight to establish themselves and secure customer loyalty

The advertising market

Overall Expenditure Trends



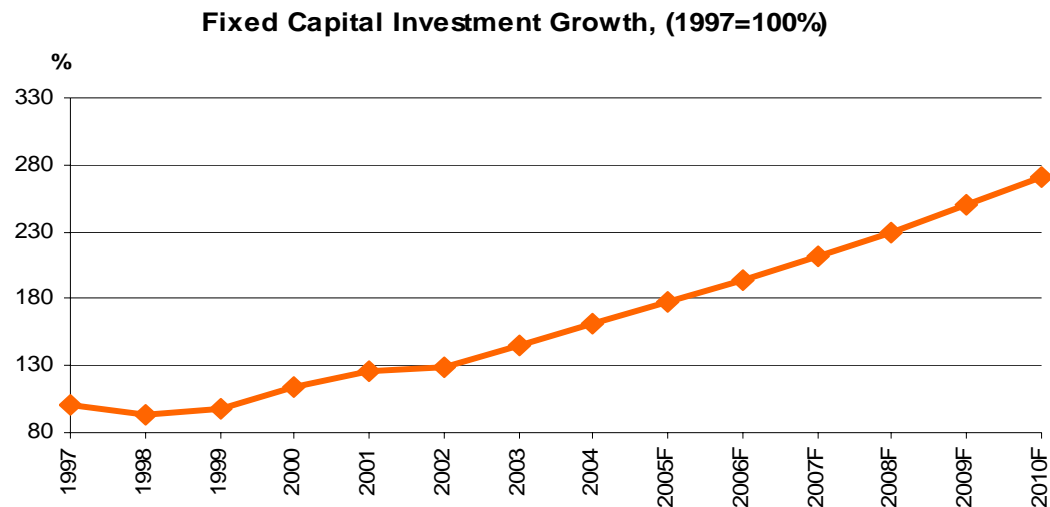
Non-food Expenditure Trends



- Changes in structure of personal consumption have led to spending shift from food items to durable goods and services
- Growing discretionary income has allowed for expenditure on big tag items such as cars, homes and home furnishings, and household electronics. We are also seeing a growing expenditure in the services sectors such as telecom and entertainment

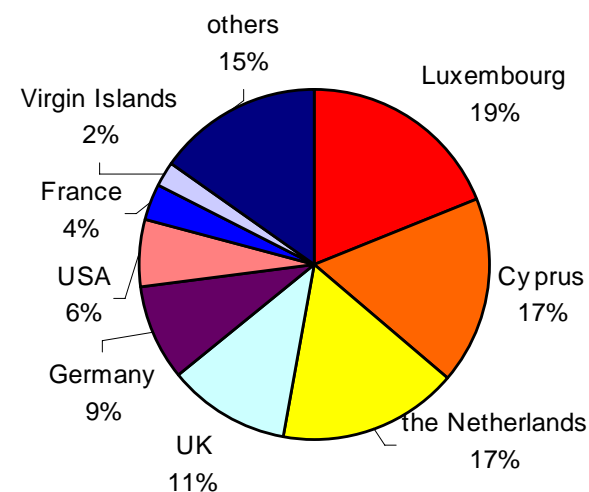
Investment boom

- Investment rose by 10.6% per year on average in 2000–05 and is forecast to stay around 9+% in 2006–10.
- Government investment has a new priority (the Investment Fund vs. the Stabilisation Fund).



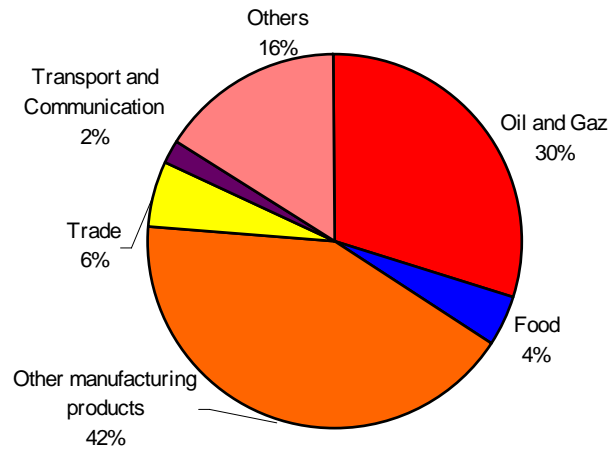
Russia in the eyes of international investors

- Foreign investment: dynamic growth.
- Other investment: Russian capital repatriation.
- Portfolio investment: capital account liberalisation is very supportive.

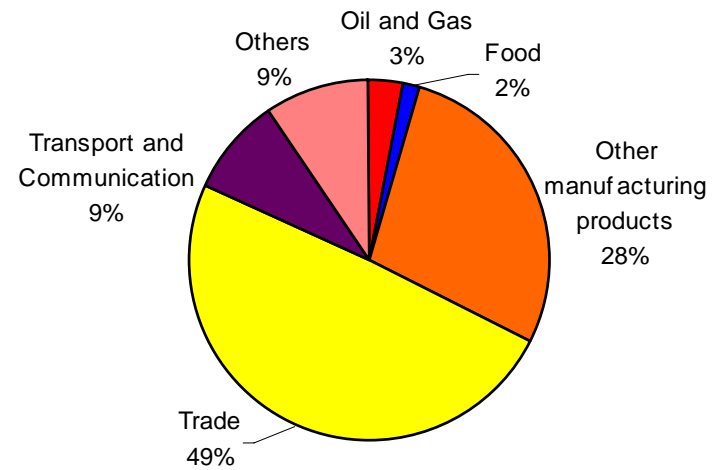


Foreign investment: sector breakdown

Direct Investments in 2005

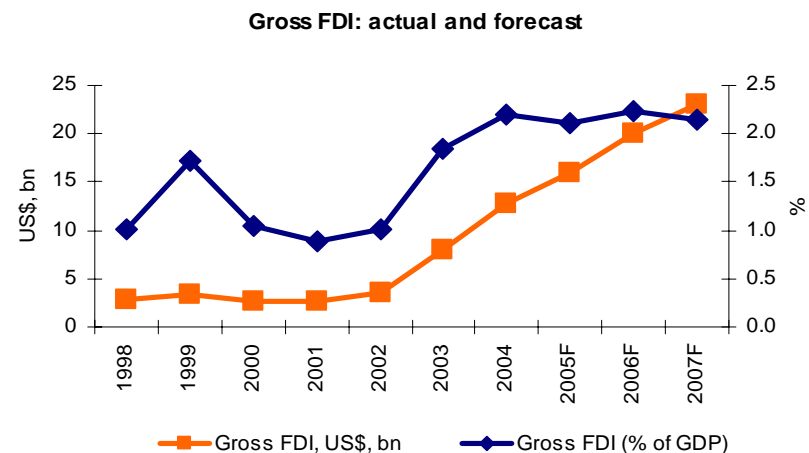
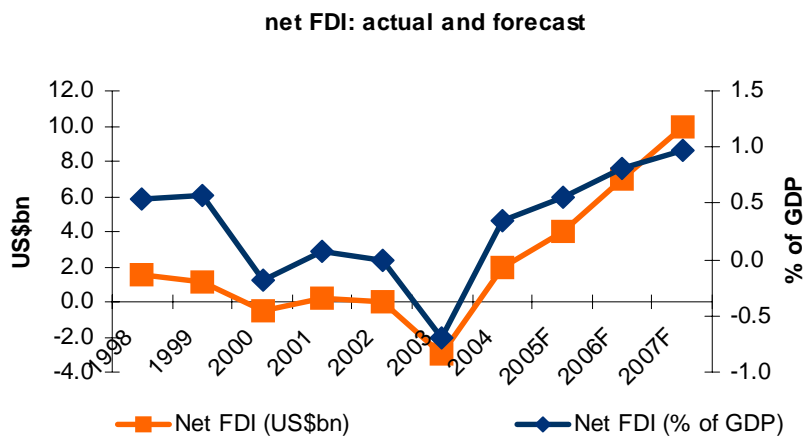


Other Investments



FDI: a positive story

- A dramatic increase was observed in 2005 with net FDI exceeding 2004's result.
- 2006 is seeing an investment boom.
- In 2006–10, growth is likely although Russia is unlikely reach the CEE's average net FDI level (3–5% of GDP).



Conclusions

- **We are optimistic regarding macroeconomic and political stability in the coming years.**
- **Structural changes will likely accelerate and the new leaders of growth will strengthen their positions in the Russian economy.**
- **Orientation towards exports has lost some of its advantages, including the 'privileges' of accelerated growth.**
- **WTO accession is seen on the horizon in 1H07. Competition will likely become tougher.**
- **The expansion of domestic demand is crucial. The services sector and sectors oriented towards consumer demand will become leaders of growth.**
- **The current investment boom, additionally supported by new government policies, is likely to continue in 2006 and beyond.**
- **Consumption boom is supported by growing incomes and the expansion of credit facilities.**