

Russia's Next Pyatel'etka

Jonathan Schiffer

VP-SCO

Sovereign Risk Unit

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Moody's Investors Service

Russia Since 2000

- Tame oligarchs
- Capitalize on favorable global environment
 - Low interest rates
 - High/growing commodity prices
 - Cheap energy
 - Spare capacity
 - Excess L
 - Cheap RUR
 - Small/weak bureaucracy
- Grow “power vertical” and complete Fiscal Federalism project



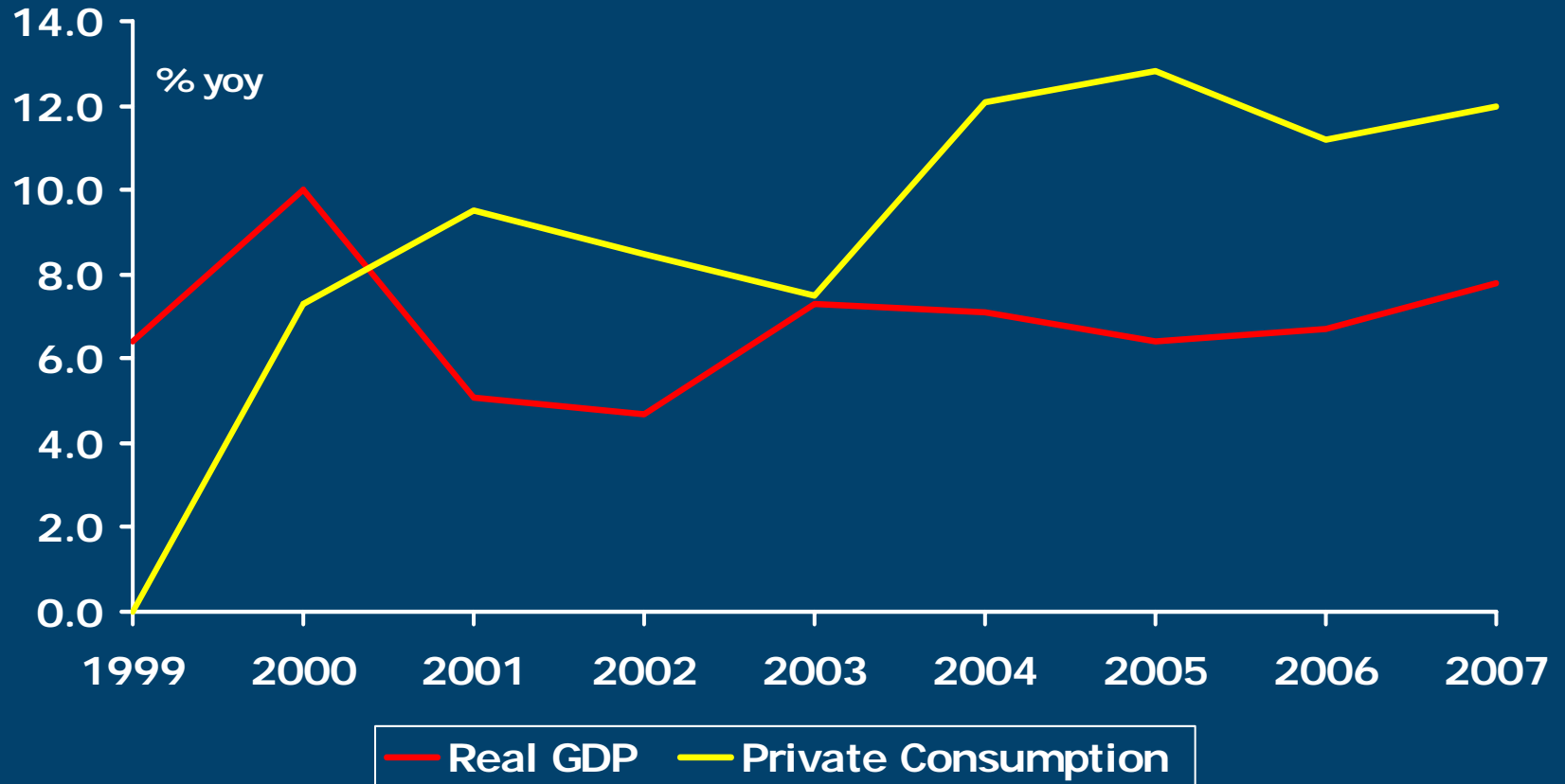
Russia Since 2000

	2000	2002	2004	2006	2007F	2008F
Real GDP, % yoy	10.0	4.7	7.1	6.7	7.8	6.7
Budget balance/GDP, %	2.4	1.8	4.2	7.3	5.2	0.5
Stabilization fund, \$ bln	--	--	18.8	89.1	170.0	--
CPI Year end, % yoy	20.2	15.1	11.7	9.0	8.5	6.5
Current account, \$ bln	46.8	29.1	59.0	94.5	55.0	28.0
Reserves (excl. gold), \$ bln	24.2	44.1	120.8	294.9	450.0	510.0
External debt/GDP % year avg	65.1	43.6	33.7	29.2	32.2	32.6

Source: Troika Dialogue



Domestic Demand Driving GDP Growth



Source: ABN AMRO



Real Wages Fuel Private Consumption

% Change yoy	2003	2004	2005	2006	2007F	2008F
Real wages	12.4	12.3	14.4	16.4	18.1	12.8
Private consumption	7.5	12.1	12.8	11.2	12.0	11.0

Source: ABN AMRO & Moody's



Russia's Consumption-Oriented Growth

	2000	2001	2002	2003	2004	2005	Cumulative
Russia							
GDP growth	10.0	5.1	4.7	7.3	7.2	6.4	48.1
Real wages	20.9	19.9	16.2	12.4	12.3	14.4	126.6
Kazakhstan							
GDP growth	9.8	13.5	9.8	9.3	9.6	9.2	79.0
Real wages	7.1	11.1	10.9	7.0	14.6	12.0	81.2
Ukraine							
GDP growth	5.9	9.2	5.2	9.6	12.1	2.4	53.1
Real wages	-0.9	19.3	18.2	15.2	23.8	20.3	139.8
China							
GDP growth	8.4	8.3	9.1	10.0	10.1	9.9	70.5
Real wages	11.4	15.2	15.5	12.0	10.5	10.0	101.8



New Russian Middle Class

- 21% population = 30 million @ \$6600/annum or more
- Western MC = 60/80% population
- Strange Russian MC = gov/SOE officials, employees
- Another 35% pop “at margins” of MC
- Public sector salary push NOT sustainable in MLT

(Above GDP and L productivity growth rates)



The New Conjunction

- High interest rates
- Slowing of commodity price rises
- Capacity utilization bottlenecks
- Shortage L
- Appreciation RUR
- Domestic energy shortage
- Pressing need for higher KI



Problems and Possible Answers

- Low export volumes
- Low investment rates
- Poor energy sector investment incentives

(The Soviet Growth Model)

- Poor financial intermediation
- State-led investment?
- Addiction to RUR appreciation and ext borrowing
- Stubborn inflation rate



Shrinking "Twin Surpluses"

	2000	2002	2004	2006	2007F	2008F
Budget						
Budget balance/GDP, %	2.4	1.8	4.2	7.3	5.2	0.5
Stabilization fund, \$ bln	--	--	18.8	89.1	170.0	--
Balance of Payments						
Merchandise exports, \$ bln	105.0	107.3	183.2	303.9	330.0	335.0
Merchandise imports, \$ bln	44.9	61.0	97.4	164.7	225.0	265.0
Trade balance, \$ bln	60.2	46.3	85.8	139.2	105.0	70.0
Current account, \$ bln	46.8	29.1	59.0	94.5	55.0	28.0
FDI, \$ bln	2.7	3.5	15.4	28.7	40.0	50.0
Reserves (excl. gold), \$ bln	24.2	44.1	120.8	294.9	450.0	510.0

Source: Troika Dialogue



Banking Sector Performance

	Jun-06		Jun-07	
	RUR bn	% y/y	RUR bn	% y/y
Total Assets, o/w:	9,750.3	36.6	14,045.6	44.1
Loans to non-banks	4,274.8	30.8	5,966.2	39.6
Loans to individuals	1,179.3	90.6	2,437.1	106.7
Investment in securities	1,539.4	41.6	1,961.4	27.4
Total Liabilities, o/w:	8,430.1	37.5	12,707.3	50.7
Client Deposits, o/w	5,818.9	40.2	8,467.3	45.5
Individual Deposits	2,817.1	39	3,793.5	34.7
Own Funds, o/w:	1,320.2	31.2	1,338.3	1.4
Profit for the current year	262.1	47.3	444.7	69.7
Monthly Profit	9.8	1.2	35.3	259.1

Source: ABN AMRO



Sources of Investment Financing

	1Q07	1Q05
Total	100.0%	100.0%
Own Funds	46.7%	47.8%
Bank loans	9.2%	5.7%
Loans from enterprises	7.2%	12.5%
Budget	13.4%	14.0%
Off-budget funds	0.4%	0.4%
Other	23.1%	19.6%
o/w share placements	2.5%	--

Source: Troika Dialogue



Structure of Investment (1Q07)

	Yoy chng.	Breakdown
Total	18.9%	100.0%
Agriculture	62.8%	3.8%
Extraction of natural resources	31.3%	23.1%
Manufacturing	4.0%	17.9%
Metal goods	-8.8%	4.5%
Electricity, gas & water product.	12.1%	5.2%
Transport	17.6%	20.0%
Communications	-5.4%	4.6%
Real estate	36.1%	12.4%
Other	--	8.5%

Source: Troika Dialogue



Paradigm Shift in Budget Spending on Debt and KI

	2004	2005	2006	2007F	2008F	2009F
In US\$ billion						
External debt repayment, of which	14.1	37.7	33.7	9.9	9.1	6.8
Interest payments	5.7	5.4	4.6	3.3	3.3	3.2
Principal payments	8.3	32.2	29.1	6.6	5.8	3.6
Investment from the federal budget	8.0	13.7	21.0	32.1	31.9	34.0
In % of GDP						
External debt repayment, of which	2.4	4.9	3.4	0.8	0.7	0.5
Interest payments	1.0	0.7	0.5	0.3	0.3	0.2
Principal payments	1.4	4.2	2.9	0.6	0.4	0.3
Investment from the federal budget	1.4	1.8	2.1	2.7	2.4	2.4



National Programs and Russian Growth

	2007	2008-9
National Projects	0.12-0.16	0.17-0.26
Investment fund and Venture fund	0.03-0.05	0.1-0.17
Special economic zones	up to 0.05	up to 0.1
Developing oil and gas sector	up to 0.04	up to 0.15
Implementing federal investment programs	0.1-0.2	0.18-0.3
Reforms in the tax sphere	0.1	0.1-0.15
Financing the social sphere	up to 0.02	up to 0.04
Supporting small businesses	up to 0.07	up to 0.1
Total	0.3-0.7	0.55-1.3



Consolidation in Energy Sector

Gazprom (Medvedev/Surkov)

Sibneft

Sakhalin

Kovytko/East Siberia

Gas pipeline system

TNK (December)

Rosneftgaz/Rosneft (Ivanov/Sechin)

Yukos

Transneft?

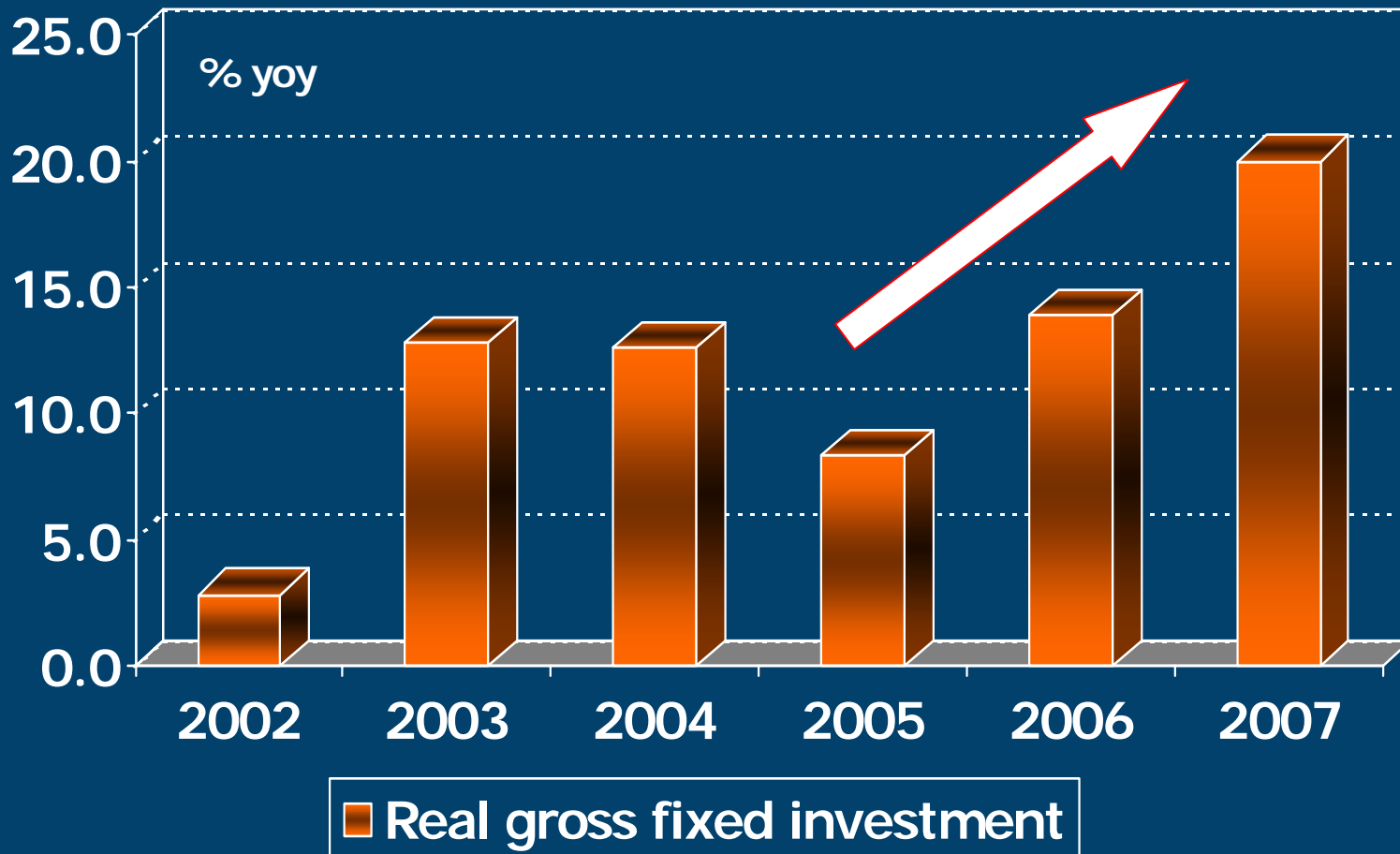
Surgutneftegaz

Zarubezhneft

Bashkir oil-related assets



Is State-led KI Working?



Addicted to Borrowing and RUR Appreciation?

	2000	2002	2004	2006	2007F	2008F
External private debt, \$ bln	31.3	48.0	108.9	260.7	400.0	460.0
External private debt, % GDP	12.7	13.7	17.1	24.6	29.0	29.9
RUR/\$ avg. exchange rate	28.1	31.4	28.8	27.2	26.0	25.5
Reserves (excl. gold), \$ bln	24.2	44.1	120.8	294.9	450.0	510.0
Real fixed investment, % yoy	18.1	2.8	12.6	13.9	20.0	12.0

Source: Troika Dialogue



RUR Appreciation and External Borrowing

- $>$ FX reserves \longrightarrow $>$ money supply
- $<$ interest rates \longrightarrow $>$ credit growth
- $>$ HH Demand \longrightarrow $>$ KI

... BUT stubborn inflation rate

... AND rapid growth external private sector debt

No problems now...

BUT large problem if Dollar appreciates



Stabilization Fund: de-politicization in “transition period”

- Old system: price caps and arguments in Duma
- New system: bypass Duma and send money straight to SF
- Select committee decides when/how much SF subsidizes Budget
- Budget exp cap = non-energy revenues + SF subsidy (ca. 3% GDP)
- Subsidy to cover current exp + KI + debt servicing
- SF = “Reserve Fund” (for budget subsidy = 10% SF) + “Fund for Future Generations” (90%)
- Maintain macro balances at time of uncertainty, < revenues, > pressure



Successful Sequencing of Policies

- Fiscal federalism (shift resources) and flexible L markets
- Lower non-oil taxes
- Build state champions and husband energy revenues (SF)
- Complete “project independence” from capital markets
- Fiscal federalism (shift responsibilities) and “power vertical”
- Tariff re-balancing and enterprise restructuring
- Banking reform, Currency and K market liberalization
- Promote K investment (“national projects”) and diversification
- De-politicize SF in period of greater political-economic uncertainty



Russia = Australia

China is to Russia TODAY

What Japan was to Australia YESTERDAY...

A source of continual demand for its
commodities



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