

FOREIGN DIRECT INVESTMENTS IN RUSSIA

Peter Westin
RECEP, Moscow

In recent years Russia's investment performance has been very disappointing. The Asian crisis, and then Russia's own economic turmoil are currently jeopardizing plans for much needed investments. At the same time, the devaluation has created a situation in which investors could benefit from increased price competitiveness if producing domestically. Despite the current crisis, some foreign companies have recently made plans to expand their activities in Russia, taking advantage of the small, but real window of opportunity that has arisen due to the devaluation. These are companies that either rely on domestic inputs for their production, or are able to shift from imported to indigenous inputs, and thus take advantage of the increased price competitiveness.

This report looks at the recent history of FDI into Russia in a comparative framework. It also analyses the characteristics of FDI to Russia. Finally, the problems facing investors are discussed, and some policy recommendations are made. In order to gain a fuller picture of the current problems facing investors, and what changes are needed to legislation, taxes, etc. interviews with a number of investors, currently in Russia, have been conducted.

World investments

World FDI has continued to increase and is estimated to amount to \$430 bn in 1998. FDI into developing and transition economies (DTE) has increased both in absolute terms and as a share of total FDI. In the first half of 1980s, on average it accounted for 20% of total FDI, increasing to 40% in 1996. Another feature is that aid as part of capital flows has diminished, and also that commercial loans have fallen dramatically since the 1980s and the Latin American debt crisis. As can be seen in Figure 2 the majority of FDI into DTEs are still going to Latin America and South East Asia. Although this report focuses on FDI and excludes portfolio investments, the development of functioning stock markets in these countries have been an important factor assisting this development.

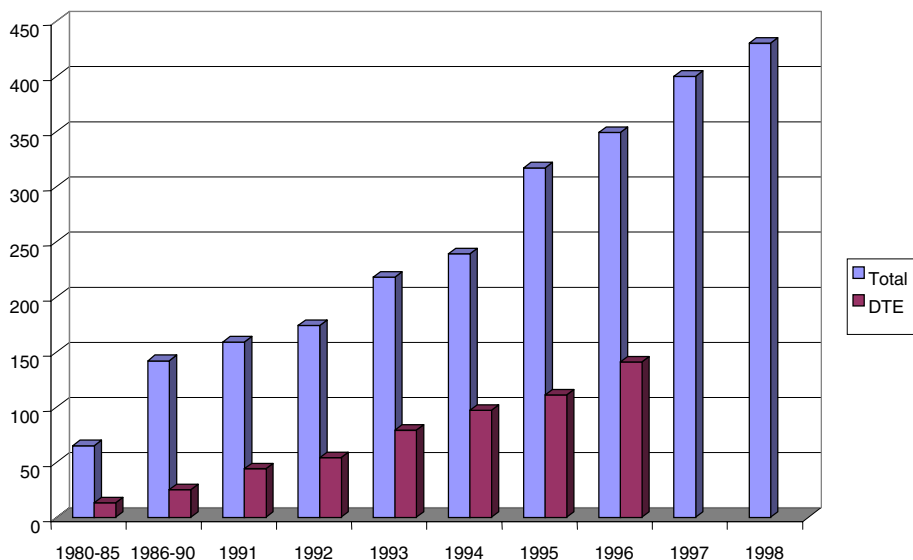
Initially, the main motive for FDI into developing countries was the low cost of labour. However, as these countries have progressed economically, technological skills and capital intensity have increased in importance. Thus, FDI, especially in the case of South East Asia is going into relatively high-tech industries. Investors are therefore increasingly basing investment decisions on the access of high quality supply of parts and components, access to high-skill workers, and to what extent supporting services and infrastructure are available.

Understandably, before 1991 FDI into Central and Eastern Europe (CEE) and the Commonwealth of Independent States (CIS) was almost negligible. However, as reforms commenced the interest from investors grew. In the late 1980s and early 1990s economists discussed the possibility of a Marshall Plan for transition economies¹. It was estimated that in order for these countries to catch up with their Western counterparts, in terms of GDP, investments equal to \$2,000 bn was needed over a 20 year

¹ *It should be mentioned that, although foreign investments will have a positive effect on these economies, many other factors have great influence on economic growth and increase in living standards.*

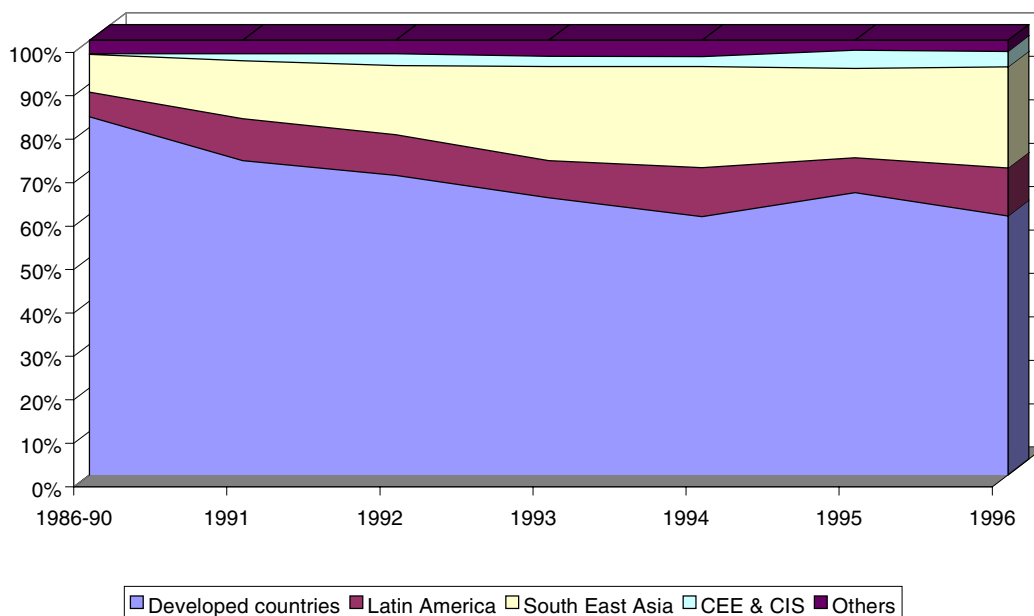
period, an unlikely scenario as such sums of money would be impossible to generate. A more modest estimate was that in order to raise living standards and thereby create support for continued reforms, investments in the order of \$100 bn were needed over a 10 year period. So far (1989-98) FDI into the region amounts to \$74.5 bn. More than half of these investment flows have gone to three countries: the Czech Republic, Hungary, and Poland (\$8.5, \$16.9, and \$12.4 bn respectively). It is clear that countries with more successful reforms attracted more FDI. Compared with the CIS, the countries of CEE have received the bulk of investment into transition, although in the last couple of years FDI into other countries has increased. In 1998 CEE received 65% of FDI into the region, compared to 83% in 1993.

Figure 1. World FDI 1980-98* (\$ bn)



*For the period 1980-85 and 1986-90 average yearly inflow
 Source: United Nations, EBRD.

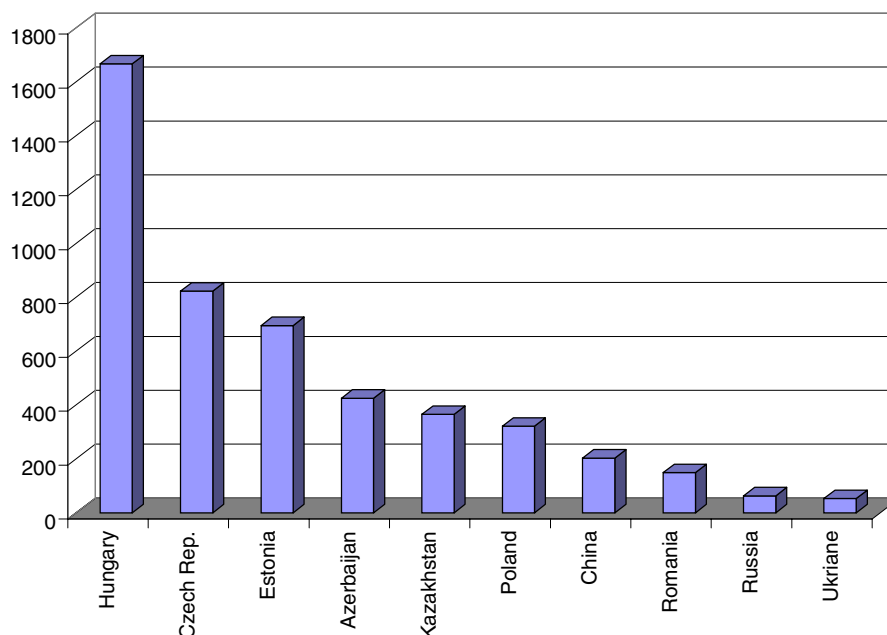
Figure 2. The structure of World FDI (%).



Source: United Nations, EBRD.

This story is further confirmed when looking at FDI per capita (Figure 3). Hungary is outstanding, with FDI between 1989-98 equal to \$1,667. Hungary was the first country to initiate market oriented reforms. Also, the privatisation process encouraged FDI (see below).

Figure 3. FDI per capita 1989-98*, (\$)



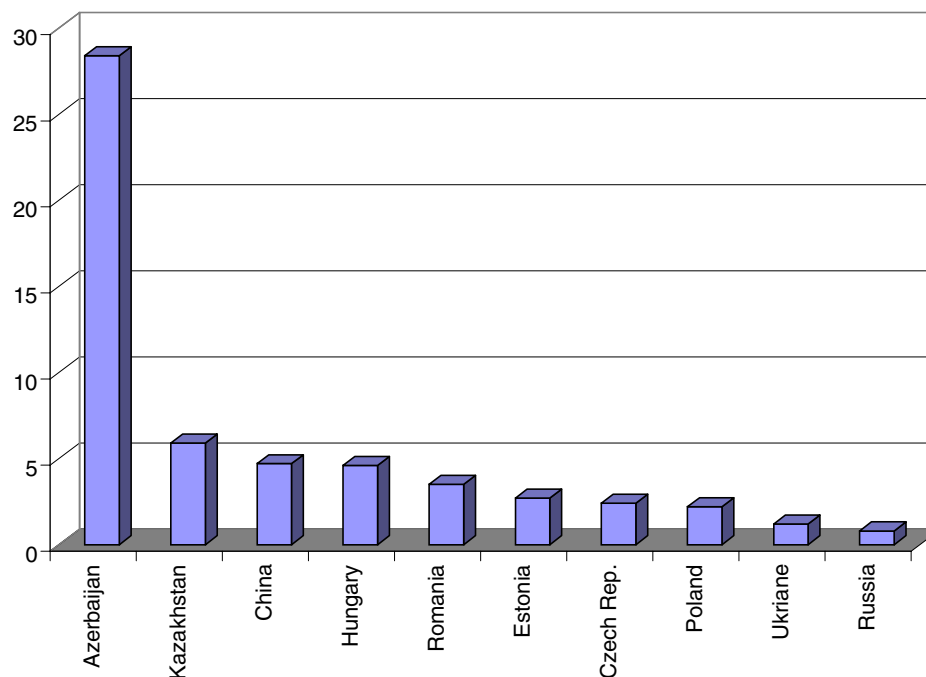
*For the CIS countries the figures refer to the period 1993-98, except for Moldova, Ukraine, and Uzbekistan.
Source: EBRD, United Nations, RECEP.

The relatively high numbers for Azerbaijan and Kazakhstan (\$425 and \$365 respectively) is explained by their ability to attract investments into the oil and gas sectors. Russia, however, has managed to attract FDI per capita equal to just \$63. Only four of the 25 CEE and CIS countries have attracted less on a per capita basis than Russia.

Related to GDP, the FDI picture changes. Azerbaijan, in 1997, attracted FDI equal to an impressive 28% of GDP, and Kazakhstan received FDI close to 6% of GDP. Of the CEE countries Hungary attracted 4.6% of GDP worth of FDI. Of the CIS countries Russia had the lowest level of FDI in relation to GDP, only 0.8%. In fact, only one country, of both CEE and the CIS has received less FDI as a share of GDP in 1997 than Russia, the Slovak Republic.

The statistics also reveal that FDI is very sensitive to external shocks and financial crisis that enhance the risk involved in new investments. In a global perspective Latin America saw a fall in FDI in 1995 following the Mexican crisis. South East Asia and the countries of CEE and CIS, on the other hand, benefited as investors sought alternative markets. Similarly, when the Czech Republic suffered a financial crisis in 1996-97 FDI fell compared to its 1995 level. 1998 was the year of the Asian and Russian Crises. Despite the financial crisis inflows of world FDI rose in 1998 (United Nations Conference on Trade and Development). However, for the first time since 1985 FDI to developing and transition countries fell. Of the Asian countries, most notably Indonesia and China, were affected, Malaysia and the Philippines less so. In Russia FDI declined throughout 1998.

Figure 4. FDI as a share of GDP in 1997 (%).



Source: EBRD, United Nations, RECEP.

Conditions and benefits of FDI in transition economies

FDI can bring large benefits to the host country, as well as to the investor. For transition economies, the progress of reform remains the main key to attracting FDI. Creating a good investment climate does not only mean macroeconomic stability but also progress in micro-level and institutional reforms such as privatisation, restructuring, legal and taxation frameworks. For the host country FDI can compensate for shortfalls in domestic investments, and also create spill-over effects. The latter occurs when foreign companies make use of domestic financial institutions and distribution networks, or when new (supporting) businesses are created as a consequence of FDI. In addition, FDI provides the country with know-how, especially regarding management and organisational skills. Although it is clear that a successful investment climate created by market oriented reforms is important for attracting investments, FDI in itself can help to push reforms forward. This is especially true with regard to enterprise restructuring, as FDI contributes to the creation of market institutions, e.g. more stringent legal requirements and improved enterprise behavior. It can also foster competition among domestic producers.

The current trend is that the cost motive for FDI, i.e. relocating production due to lower cost of production, has diminished in importance. Instead other factors such as market access, market share, and the proximity to the European Union (EU) and the Central European Free Trade Area (CEFTA) can explain investors' interest in the post-communist economies. Also, it was clear early on that some of the CEE countries would seek EU membership, making them more attractive as host countries than others.

The nature of the privatisation process helps determine the access to assets of interest to investors. Mass privatisation *a la* Russia and the Czech Republic, in which previously state-owned assets were more or less given away for free means that restructuring of these enterprises is postponed only to become the headache of the new owner. Trying to sell at the highest price, as in Hungary, means that restructuring has to take place before the sale so that a higher price can be set. It is critical for the privatisation process to be fair, transparent, and allow foreigners to take part. In the first privatisation

wave in Russia that ended in the summer of 1994, foreigners could not participate. As the second wave started, in which strategic enterprises were put up for sale, domestic interest groups crowded out foreign participation, mainly via the 'loans-for-shares scheme', which created poor initial conditions for FDI into Russia.

FDI in Russia

FDI could play an important role in taking Russia out of the crisis. However, investors are unlikely to take large risks until concrete measures are taken to improve the economic and legal climate. Thus, it looks like FDI will not lead the way out of the crisis but rather follow a turnaround. The common view among investors seems to be that Russia cannot expect large investments until after the next presidential election in the summer of 2000. In 1997 the Ministry of Economy stated that Russia needed foreign investments equal to \$10-12 bn per year in order to achieve economic growth and to assist serious restructuring, i.e. more than it has received in six years. Russia attracted \$9.2 bn worth of FDI between 1993-98 (which on average means \$1.5 bn per annum).

As seen in Table 1 the regional distribution of investments (FDI and portfolio investment) has been concentrated to a few regions, mainly the Central region which includes Moscow city. In recent years the FDI pattern has become more regionally diversified. Moscow alone received almost 50% of investments in 1995, rising to 70% in 1997, boosted by the booming stock and bond markets. Data for the regional distribution of FDI alone are not available. However, here we use 1995 aggregated investment data as a proxy for the distribution of FDI since portfolio investments were small. Resource rich areas such as Povolzhsky (which includes the republic of Tartarstan), West Siberia (which includes Novosibirsk and Tyumen oblast), and the Far-East (which includes Primorsky krai and Sakhalin oblast) have benefited from FDI inflows. In the preceding years investments into consumer goods increased, mainly located around the two major cities Moscow and St. Petersburg.

Germany has been the main foreign direct investor in CEE followed by the United States, Austria and the Netherlands. The domination of EU countries is not surprising considering the proximity, and also the EU's process of eastward enlargement. In Russia, close to 50% of FDI originates from the United States, followed by Germany and other EU countries. The interest from the US has mainly been in the oil and mineral sectors, while EU countries have increasingly focused on the consumer goods sectors.

For the sectoral structure of foreign investments Goskomstat, again, only produce aggregate data which includes portfolio investments. Although 1995 aggregated investment data is again used as a proxy, one should be aware that the low level of FDI, means that a major investment made in one year can shift the structural composition significantly. Not surprisingly, industry has been attracting the bulk of FDI (in Table 2 the share of investments into industry fell in 1996-97 due to large inflow of portfolio investments into finance and market operations). Food processing was the largest recipient of FDI in 1995 (see Figure 5), followed by the fuel and oil sector.

So far, the strategy of foreign investors with regards to the food processing industry have differed compared to those made in CEE where the aim was to produce both for the domestic market and for exports. In Russia, the main purpose of foreign investors has been to supply the vast domestic market. However, with the devaluation this may change. Although the bulk of production will still be consumed in Russia, and this also seen as the main objective of the investor, there should be a potential for some export activity.

Table 1. Regional distribution of investments in 1995-97, %

	1995	1996	1997
Nothern	2.7	1.3	0.5
North-West	6.8	5.3	4.1
Central	57.9	73.0	71.1
Moscow	46.9	65.5	68.9
Volga-Vyatka	2.2	2.5	1.4
Central-Chernozemny	0.2	0.4	1.0
Povolzhsky	9.6	2.8	7.1
Norther Caucasus	1.7	1.1	0.7
Ural	2.1	1.0	1.2
West-Siberia	8.8	6.2	7.0
East-Siberia	0.8	0.2	3.6
Far-East	6.6	5.9	2.2
Kaliningrad	0.5	0.3	0.1

Source: Goskomstat.

Table 2. Sectoral distribution of investments in 1995-97, %

	1995	1996	1997
Industry	43.3	32.7	29.4
Construction	7.3	1.4	2.2
Transport & communications	3.3	3.9	1.6
Commerce	17.0	5.4	6.0
Finance	13.6	29.0	38.7
Market operations	4.9	23.4	18.7
Science	4.6	0.7	0.9
Others	6.1	3.5	2.6
Total	100.0	100.0	100.0

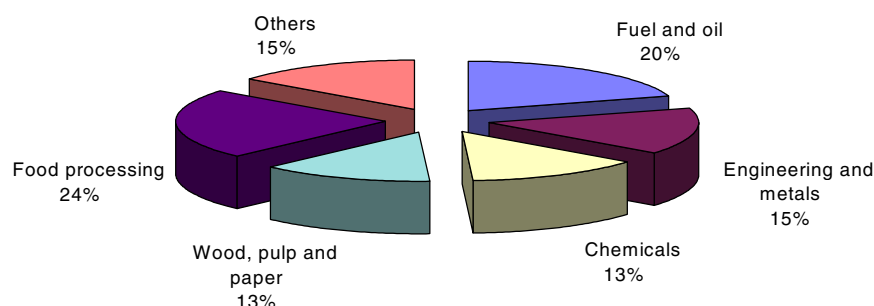
Source: Goskomstat.

Unlike Azerbaijan and Kazakhstan, Russia has not been able to attract large investments into its oil sector. The reason for this has, until now, been the delay in implementing the very important law on production sharing agreement (PSA). A PSA is an agreement between the government and the investor, foreign as well as Russian, related to investments into the oil and mineral sectors. According to the adopted PSA law the government is obliged to comply with rules, including on taxation, drawn up in the agreement. In addition it sets out the terms of how proceeds from oil and mineral production will be shared between the investor and the Russian government, and how the cost of development of these deposits can be recovered by the investor. Most important, such agreements are recognised by international law.

With the passing of the PSA law the first crucial step has been taken. Next is the enactment of the 'list law', which will identify the wells and deposits that will be subject to the PSA. This will be a time-consuming process, as regions will negotiate with the federal government to get their deposits on the list. An Omnibus Enabling Law has to be passed, which will conform some federal laws to the PSA.

The PSA only covers the actual production or mining. Oil, for example, has to be transported via pipe-lines, and this is not covered by the PSA law. Further, the cost of Russian oil is still high by international standards, and with world market prices low investors will be wary. One investor remarked that it will take years before any FDI related to the PSA is undertaken. However with a functioning PSA law, which would give investors tax and legal stability, it is believed that potential investments into oil and minerals could amount to as much as \$200 bn (UN ECE, 1998).

Figure 5. Investment into industry by sector in 1995.



Source: Goskomstat

Problems facing foreign investors

A number of foreign companies with a presence in Russia are involved in import activities, mainly in the consumer goods sector, and although many of them see the benefits of investing into local production they have been deterred from making a commitment. The devaluation has meant that the cost of imports has risen dramatically, affecting domestic demand, and forcing many importers, as well as foreign investors, to scale down their activities. In addition they face cash-flow problems, as many of their Russian customers had their accounts frozen following the August crisis. One importer recognised the benefit of producing locally, but said that the strategy now was to focus on risk management and delay any investment decision until after the presidential election. A few foreign companies are planning further investments, and to localise production. Nevertheless, these companies are a minority and also already established in Russia.

Although the current rhetoric from both the government and the Duma is supportive of FDI, concrete measures still have to be taken. Too many obstacles remain that severely inhibit both current and future investments. The main problems stated by foreign investors and importers are:

- high tax burden and unfair taxation combined with a complicated tax system;
- lack of international accounting standards;
- unclear and over-bureaucratic system of standards, licensing, and certification;
- crime and corruption;
- unsatisfactory protection of property rights;
- problems with customs and check-points;
- the devaluation has hurt investors relying on imports.

One investor revealed that the tax burden for investors could be as high as 55-66%, but that the actual tax burden depends very much on one's connections. A well-connected business can significantly reduce its tax bill. This *ad hoc* system creates uncertainty and risk, thus discouraging much needed investments.

In order to set the rules of the game and to give economic actors an incentive to reinvest their profits and to make other capital investments, international accounting standards need to be adopted. Non-greenfield investments, i.e. where the foreign investor invests into an existing firm, are very problematic as Russian accounting makes it very difficult for foreign companies to evaluate the financial situation of a potential acquisitions or partners, creating non-transparency and deters joint ventures. Furthermore, companies cannot make deductions on loans taken for capital investment. Updating technology and modernising become very difficult, for example, if a firm can only write off a computer after 10 years, as in Russia, instead of 3-5 years according to international standards. Equally, expenses related to advertising and training are not deductible. On a positive note imported technology and spare parts thereof are relieved of VAT, and commodities that are brought in by enterprises with foreign participation and that is part of fixed productive assets are relieved of customs duties. If the investment exceeds \$100m, and related to industry, commodities can be brought into Russia at 50% of existing customs duties.

Policy implications

- It is vital for the government and the Duma to pass legislation which would improve the investment climate. A proper framework for the implementation of legislation, including property rights protection has to be created.
- The government and the Duma have to create a stable tax environment. With the passing of the first part of the new tax code the number of taxes has declined. The passing of the second part should be a priority as, among other things, it aims at eliminating tax exemptions and significantly expands the scope of deductions businesses can make. Taxation has to become non-discriminatory. Equally, tax appeals disputes have to be made more structured.
- Once the rules are set the bureaucratic procedures, especially at regional and local levels, have to be simplified in order to reduce rent-seeking behaviour of government officials.
- International accounting standards must be adopted to ensure transparency and reduce uncertainty.
- The bank restructuring programme has to be implemented in order to build trust in Russia's financial sector, and allow foreign banks to participate fully in retail banking. Foreign, as well as domestic investors need access to a well functioning banking sector to support their activities.
- On a more general note, it is important that the government does not step away from market oriented reforms. These have to include both macroeconomic stabilisation as well as micro and institutional reforms.

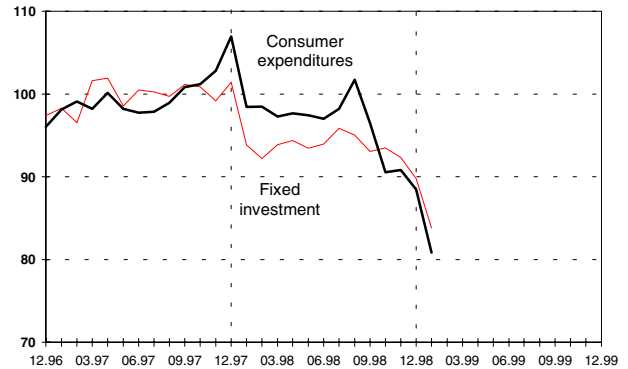
ECONOMIC UPDATE

Aggregate demand

In January seasonally adjusted real consumer expenditures on goods and services declined by 8.6% to a level 17.9% lower than in January 1998. Real expenditures on food were 13.4% lower than a year ago, expenditures on non-food items dropped by 24.8%, and expenditures on public catering shrank by 30.6%. Only expenditures on paid services remained unchanged compared to January 1998.

In January seasonally adjusted real expenditures on new construction and equipment (a proxy for gross fixed investment) continued to decline (by 6.6% in a month) and were 10.7% lower than in January 1998.

Components of aggregate demand (1997 = 100, seasonally adjusted)



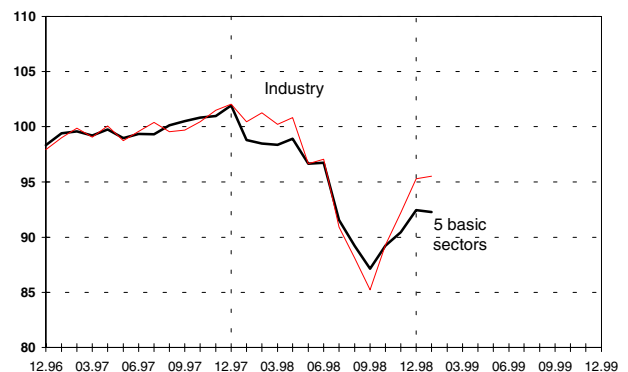
Source: Goskomstat.

Output

As we predicted a month ago, a continued fall of real income (both personal and business) and a respective decline of demand put an end to the growth of output observed in the last three months of 1998. In January 1999 the seasonally adjusted index of aggregate output, covering 5 basic industries, decreased slightly compared to previous the month, standing 6.6% lower than a year ago.

The same trend was observed in all the key industries. In January the short period of recovery came to an end, and seasonally adjusted output remained more or less unchanged with respect to the December level. In January 1999 industrial production was 4.9% lower than a year ago, the volume of construction 7.6% lower, and agricultural output 4.5% lower than in January 1998.

Gross output (1997 = 100, seasonally adjusted)



Note: index of gross output of 5 basic sectors include industry, construction, agriculture, transportation and trade.

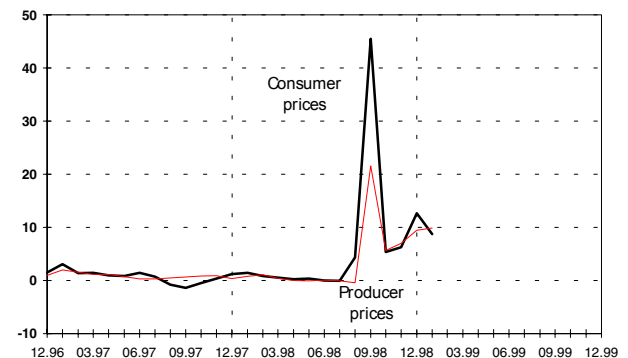
Source: Goskomstat.

Prices

In February total CPI increased by 4.1% compared to 8.5% in January, and the yearly inflation rate reached 103.4%. Inflation continues to be concentrated in the consumer sector. The price increase for imported goods, resulting from the devaluation of the rouble, is reflected in producer prices. In October 1998 – January 1999 consumer prices for consumer goods (i.e. excluding services) increased at the same rate as domestic producer prices for consumer goods (see chart). In January relevant CPI grew by 8.8% and PPI by 9.9%. In turn, the growth of industrial prices for food processing is supported by an increase in agricultural PPI. For example, in January PPI for animal products grew by 16.8%.

Composite PPI increased in January by 6.9%, and the same price growth was observed in industry. Among particular sub-industries the highest rates of

Monthly growth of prices for consumer goods, %



Source: Goskomstat.

inflation were observed in non-ferrous metallurgy, increasing 26.2% to become 122% higher than a year ago.

Labour

In January the seasonally adjusted real wage due dropped by 6% and was 38% lower than a year ago. The decline in wage due was somehow compensated for by repayment of wage arrears, both by enterprises and the government. Wage arrears of enterprises decreased by 1.1%, to R56.7 bn in the month of January. Budgetary wage arrears decreased by 1.8%, reaching R19.4 bn. Still, the stock of budget wage arrears, in terms of the monthly wage fund, by end-January was 2.2 times larger than a year ago. As a result, a high level of strike activity continues to persist, mainly among school teachers. In January there were 5,305 strikes with 134,000 participants, compared to 246 strikes and 20,000 participants in January 1998.

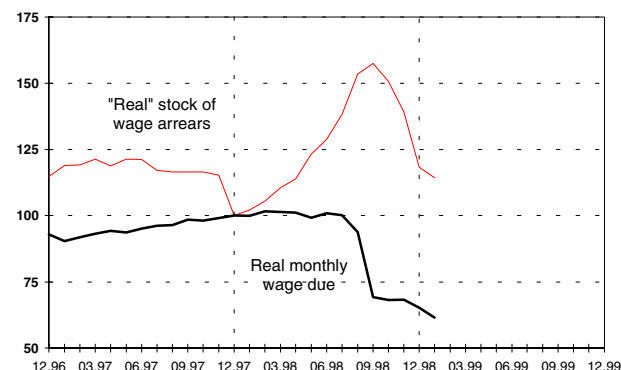
Foreign trade

It is clear that the devaluation has had a positive effect on Russia's trade balance. The trade surplus in December amounted to an impressive \$3.5 bn, leading to a surplus of \$14.4 bn for the year as a whole. Exports in December reached \$7.1 bn, taking overall exports for 1998 to \$73.9 bn, compared to \$88.7 bn in 1997. However, the main contribution to the recovery of the trade balance in 1998 has been imports which fell throughout the year, but more so after August. In the fourth quarter imports amounted to \$9.6 bn, compared to \$18.1 bn in the first quarter. In December imports, reaching \$3.6 bn, recovered somewhat from the previous monthly level, although this was also due to seasonal factors. For the year as a whole imports reached \$59.5 bn, compared to \$73.6 bn in 1997.

Preliminary data for January show that imports plummeted to \$2.6 bn, more than half of pre-crisis monthly levels. Exports also fell to \$4.7 bn, resulting in a surplus of \$2.1 bn. The compulsory sale of 75% of export revenues, introduced in January, is likely to have a negative effect on recorded exports.

The government has lifted export duty on oil as the world market price has fallen below \$9.8 per barrel. From February 25 a 5% export duty will be levied on nonferrous metals and products thereof.

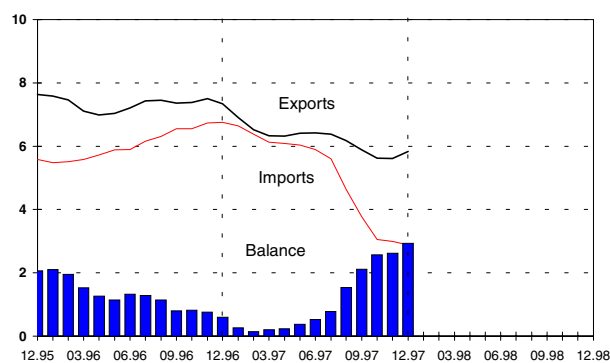
Real wages and wage arrears (Dec-1997 = 100, seasonally adjusted)



Note: index of "real" wage arrears is calculated in terms of monthly wage fund.

Source: Goskomstat.

Merchandise exports and imports (\$ bn, seasonally adjusted)



Source: Goskomstat

Enterprise finances and banking

Growth in enterprise arrears stalled at the end of last year. Moreover, in December, the stocks of debts to employees and to the state declined. The latter was due to a strong comeback of the government off-set policy at the end of 1998 (see *Budget section of February RET*).

Lack of decisive government policy left the banking sector to continue melting away, while absorbing state credits. Outstanding loans from monetary authorities stood at R37 bn at the end of November 1998, almost four times higher than at the end of November 1997. The number of licenses withdrawn by the CBR every month remains at the low pre-crisis level. Left to themselves, troubled banks are merging and spinning off new banks.

According to Goskomstat data, retailed deposits transferred from SBS-Agro, Mosbiznesbank, MENATEP, Most-bank and Promstroibank to Sberbank totaled R4.4 bn, or about 40% of all deposits at these troubled banks. By the end of January, Sberbank paid over 50% out of these savings in cash back to the depositors. Rossiiski Kredit will soon finalize its agreement with Sberbank to transfer a substantial part of its deposits.

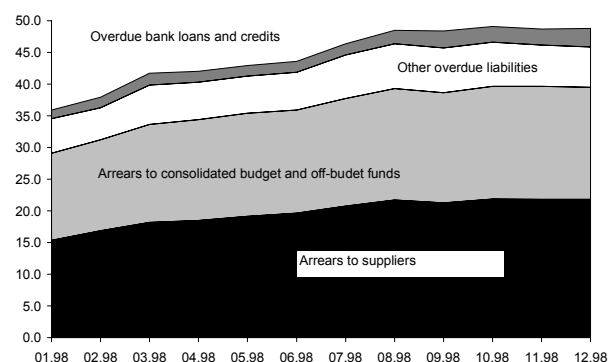
The Agency for Restructuring of Credit Organizations, intended to be the key institution in the banking reform but still lacking power and money, held its first board meeting in early March. At the meeting appointments for deputy director positions were made. Quite logically, responsibility for anti-crisis management and restructuring methodology was given to the two persons who have worked in the area of bank supervision at the CBR. Work with bank assets was assigned to the representative of the Ministry of State Property.

The budget

At the time of writing, data on regional budgets for January were not available. In December, regional and local governments ran a nearly balanced budget. Expenditures and revenues both stood at around R76.4 bn. Housing subsidies in December comprised almost 30% of total expenditure, partly due to seasonal factors. In 1998 expenditures of the regional and local budgets comprised 14.7% of GDP (R395.5 bn), and revenues stood at 15.2% of GDP (R407.1 bn), creating a deficit of 0.4% of GDP, or R11.7 bn.

The federal government ran a small deficit of R0.5 bn in January (preliminary figures). Revenues comprised R27.7 bn, and expenditures R28.2 bn. Almost 40% of expenditures were interest payments (R8.5

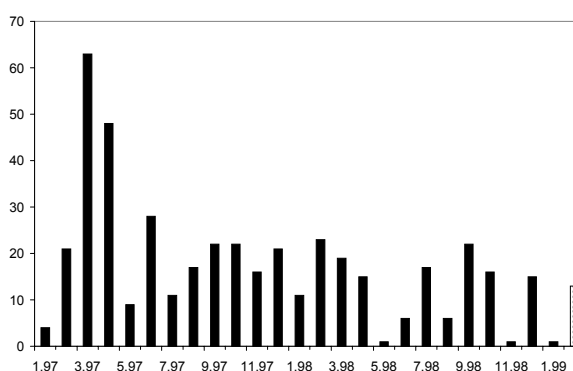
Arrears, % of GDP*



* Data is for 9 main sectors of the economy (see Table 7 in statistical appendix for the list of sectors). September 1998 GDP data were used in calculating October arrears ratio, full year 1998 data were used in calculating November arrears ratio.

Source: Goskomstat

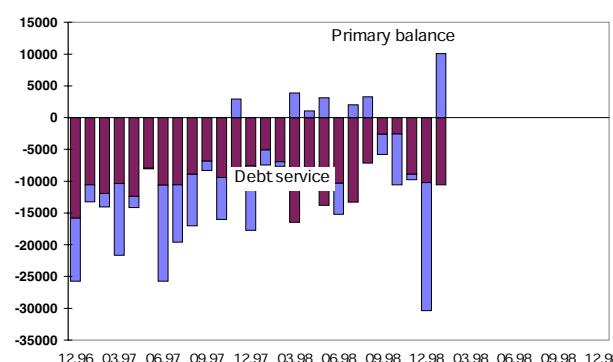
Number of bank licences withdrawn by the CBR*



* February 1999 data is a preliminary estimate

Source: CBR

Federal budget deficit, R mn

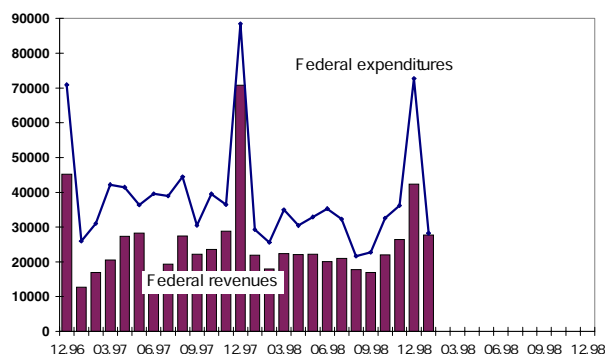


Source: Ministry of Finance.

Federal revenues and expenditures, R mn

bn), most payments on foreign debt. The government continued its new policy of tax off-sets (“earmarked financing”), which in January amounted to approximately R2 bn.

On March 3 the Duma was voting for the tax package in the second reading. The profit tax was lowered from 35% to 30%, and the reduction of the value-added tax from 20% to 15% postponed till July 1.

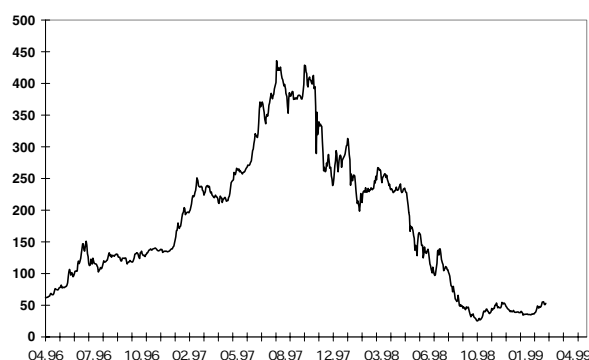


Source: Ministry of Finance
IMF definitions of revenues, expenditure and deficit are used.

Financial markets

Russia’s stock market is rallying amid assumptions that holders of the frozen GKO’s will be able to swap them for shares. In February the Moscow Times \$ Index rose more than 40%. Foreigners hold about \$10 bn of GKO’s/OFZs at face value, and the restructuring deal could mean that between \$100-200 mn will be spent on Russian shares.

Moscow Times \$ Index (The Russian bubble)

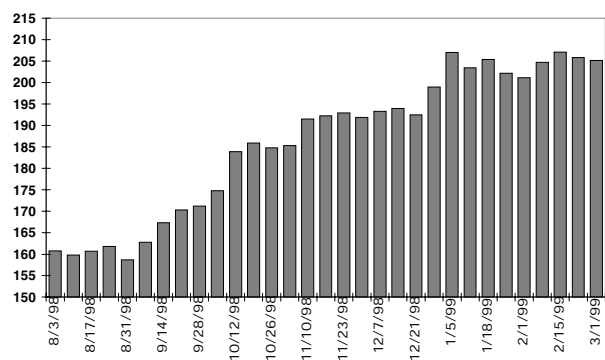


Source: Moscow Times

Money

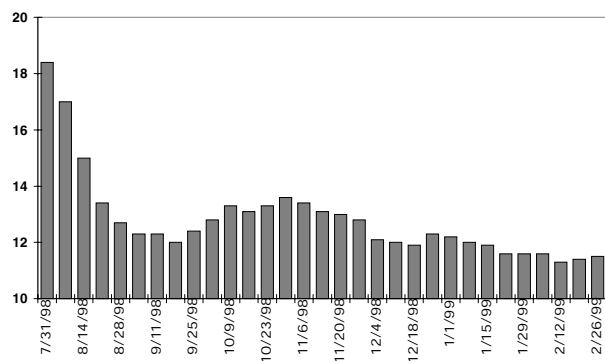
Monetary policy has remained extremely tight, with base money standing at R205.2 bn (March 1) compared to R199 bn at the end of 1998, an increase of a mere 3% in two months. Pressure may soon be mounting on the government to order the CBR to speed up emissions. Within the 1999 budget the government foresees emissions of about R30 bn (of which R13 bn in the first quarter). However, plans to raise the minimum wage to R200 from the current R83.5 would require the government to find an additional R12 bn.

Monetary base (weekly data, R bn)



International reserves fell by \$100 mn in February, and currently stand at \$11.5 bn. Minister of Finance, Michail Zadornov recently expressed grave concerns about the health of Russia’s reserves, explaining that without IMF support, reserves could be depleted within weeks. Taking into consideration Russia’s debt service obligations in the coming months (about \$4.5 bn March-May) the situation looks increasingly worrisome.

Gross reserves (weekly data, \$ bn)

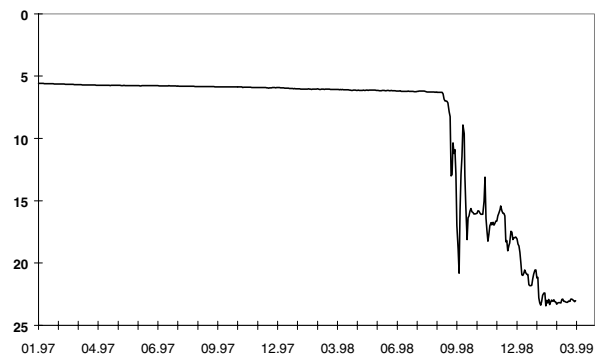


Source: CBR

The exchange rate

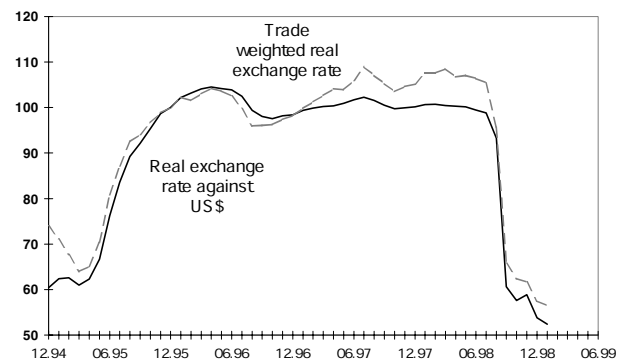
The rouble has shown a certain degree of stability in the first two months of this year, fluctuating around R22-23/\$ since mid-January. Although the CBR has managed to narrow the room for speculation, we believe that the rouble could soon come under renewed pressure. The main factor is Russia's inability to reach an agreement with the IMF coupled with low international reserves, that fuel speculations about a near-future default. Also, the 75% sale of export revenues and the ban on certain banks to act on the foreign exchange market are creating only an artificial stability. It is clear that the demand for roubles remains low.

The rouble exchange rate (R/\$)*



* MICEX exchange rate till 17th August. CBR rate from then on. Source: CBR

The real exchange rate



Source: Moscow Times, Goskomstat, Financial Times