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## Executive summary

- > **While Vladimir Putin is still expected to return to the presidency, his legitimacy has started to crumble as tensions are expected to linger on. This implies a growing disruption risk.**
- > **Russia is increasingly exposed to disruptive terms of trade shocks as its dependency on (energy) commodities has risen. Moreover, the recovery since the 2009 crisis has been unimpressive considering the favourable evolution of commodity prices.**
- > **Oil-fuelled expansion is over and new growth drivers are needed, requiring investment and new technology, which in turn necessitates improvement of the troubled business climate.**
- > **Capital – physical as well as human – has been fleeing the country. With political uncertainty rising, outflows are set to continue while a steady decline in labour force undermines the long-term potential.**
- > **Debt ratios are very favourable, as is the case for liquidity, with Russia having the world's third largest foreign exchange reserves.**

### Short-term political risk:

Russia: 2/7  
Poland: 1/7  
Turkey: 3/7

## Country risk assessment

### Political situation

Constitutionally prohibited to run for a third consecutive presidential term in 2008, Vladimir Putin put forward Dmitry Medvedev as his successor and became Prime Minister himself. It was clear that ultimately Putin and not his formal superior Medvedev, was the one pulling the strings in Russia. Therefore, the announcement in September 2011 that he planned to return to the office he had never really left, was little surprising. However, the statement by Medvedev that their job switch had been agreed upon years ago, stirred up commotion both within the ruling elite and among Russian citizens. Medvedev has been given the prospect of becoming Prime Minister after the presidential elections in March, which caused tensions with other contenders for the function. Especially quick to denounce the agreement was Alexei Kudrin, who had been running the Finance Ministry since 2000 and was the most respected cabinet member, being widely credited with having rebuilt Russia's public finances following the 1998 financial collapse. Following the September announcement, Kudrin resigned.

More troubling for the ruling pair, however, was the public reception of their job swap. By stating this scenario had been written years ago, they came close to dismissing elections in Russia as irrelevant. This has been largely true for the past decade, when a popular Putin and his political vehicle United Russia would have won elections probably even in the absence of widespread vote rigging, but no longer holds. Following the September announcement, Medvedev and Putin as well as their United Russia party registered fast-waning support in opinion polls. So, while a setback for United Russia was expected in the Duma elections of 4 December, the magnitude still came as a surprise. The party saw a sharp fall in support, from 64% of votes casted in 2007 to a little over 49% - with abundant evidence of vote fixing. United Russia renewed its majority by taking 238 out of

### MLT political risk:

Russia: 3/7  
Poland: 2/7  
Turkey: 4/7

### Commercial risk (A to C):

Russia: C  
Poland: A  
Turkey: C

450 seats, a much slimmer majority than Kremlin leaders had hoped for and, more importantly, the first electoral setback for Putin since he rose to power in 1999.

Still, the elections did not bring about a systemic overhaul. Real opposition parties were prohibited to participate or did not pass the electoral threshold. The parties that took votes from United Russia are either openly xenophobic nationalists (Liberal Democratic Party), neo-communists (Communist Party) or populists (A Just Russia, a party with close links to United Russia). None of the three can be considered a genuine opposition party capable of reforming state and society. Political pressure in Russia needs thus to come from the street.

By trading places in a high-handed manner, without the slightest suggestion that popular participation would play a role in the process and by a blatant manipulation of the electoral process, documented extensively on the internet, the Kremlin overplayed its hand. Immediately following the announcement of the results, several thousand Muscovites went out to dispute the validity of the elections. On December 10, political risk returned to Russia when 50,000 disgruntled Muscovites shook out of political passivity and took to the streets to denounce peacefully the parliamentary elections and demand political liberalisation. Other cities saw comparable, though smaller, protests. The protests were larger than anything seen since the failed coup against Gorbachev in August 1991. Building on this success, two weeks later another nationwide anti-government demonstration was staged. This time, as much as 80,000 Muscovites showed up. The loosely organised and ideologically heterogeneous demonstrators are united by an anti-Putin feeling and have a number of clear demands such as the release of political activists and immediate organisation of fair elections open to all parties. Demonstrators are thus not looking to overhaul the political system overnight, even though they want a clear break with past habits.

The ruling elite's legitimacy has been put into question. Russia's middle class feels politically unrepresented and demands to have economic progress matched by institutional progress, including political involvement. The Kremlin's artificial political process, in which supposedly competing parties are created and replaced as the Kremlin sees fit, has sailed its course. It was tolerated as it brought stability following the chaotic nineties, but with memories fading away and an articulate middle class claiming its civil rights, things have changed. Regime fatigue has set in, with people growing tired of the rampant corruption and nepotism they associate with United Russia, commonly referred to as "a party of crooks and thieves", a term coined by a popular blogger. Also, Putin's power base has been largely passive, based on a lack of alternatives and on the backing from elderly voters.

Head of the State: President Dmitry Medvedev  
Head of the government: PM Vladimir Putin

Description of electoral system:

- presidential: 6-year term  
next election: March 2012
- legislative: 4-year term  
last election: December 2011

Structural features:

Population: 141.9mn  
Per capita Income (USD): 9340  
Income group: upper middle income  
Main export products: Oil and gas (54% of current account receipts), manufactured goods (13.7%), factor receipts (6.7%), metals (4.8%), transport (3.2%)

Even if protests may abate, with presidential elections scheduled on 4 March, the stage is set for political turmoil to continue. In heavily centralised Russia, presidential elections are generally perceived as more important than parliamentary elections. Even though recent protests have been clearly targeting the person of Vladimir Putin, his chances of reclaiming the presidency seem broadly intact as he remains the most popular and best known politician. Oligarch Mikhail Prokhorov has announced an independent bid for the presidency, though he is generally perceived as a Kremlin-backed candidate, handy to split the opposition vote. Besides, as oligarchs are loathed in Russia for the shady way they accumulated their fortune during the nineties, Prokhorov's bid is not seen as posing a real threat. Leaders of the 'tolerated' opposition parties are running as well, but none of them posed a credible threat in the past.

If Putin would play it by the rules, he would most likely face a second round. Probably the best way to reclaim legitimacy, though this implies he would have to acknowledge that his popularity has dropped. In the run-up to the elections, Putin is likely to resort to the tactics that worked well in the past: highlight the contrast between his rule and the shaky 1990s, operate a strong nationalistic rhetoric with an openly anti-Western stance and tougher immigration policies. Following his expected election, some modest electoral reforms such as the restoration of direct gubernatorial elections and the creation of a liberal party should be expected. While this could restore stability in the short term, it is doubtful whether disgruntled voters will be pleased. Moreover, as higher public spending can be expected as well, this strategy of appeasement relies heavily on the assumption that commodity prices remain elevated. It is questionable altogether whether Putin would be able to deliver the demanded systemic reforms after more than 12 years in power – especially as protestors are targeting him personally. It is hard to see how Putin could resolutely fight the corruption and nepotism on which his political system is based. He would have to act against the vested interests of an elite he created himself. If he tries, he may soon face his Gorbachev moment: accelerate the expiration of a failing system by trying to reform it.

## Security situation

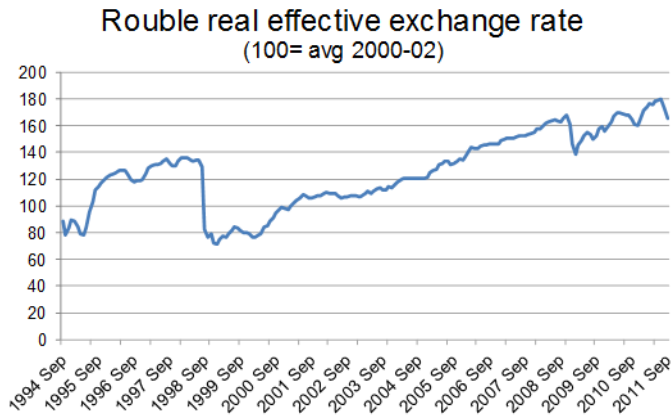
The Northern Caucasus is deemed to remain a powder keg as the Russian government has failed to find a lasting solution for its instable southern republics, preferring to install local strongmen instead. This strategy has backfired as the repressive and rent-seeking regimes fostered a situation of utter lawlessness and radicalisation of the poor and disillusioned Muslim youth. A string of violent abductions, brutal killings and murder attempts has created a state of near-civil war in what are Russia's poorest regions. While violence is largely contained to the Northern Caucasus, Moscow is regularly reminded of its troubled southern flank. A bloody attack at the busy Domodedovo airport in January 2011 was preceded by attacks in 2010 on the metro and a high-speed train between Saint Petersburg and Moscow. In the short term, further clampdowns can be expected, especially as the government will do everything in its power to safeguard the 2014 Winter Olympics in nearby Sochi. This risks, however, triggering a new and prolonged armed conflict between the Russian army and Islamist insurgents.

## General economic situation

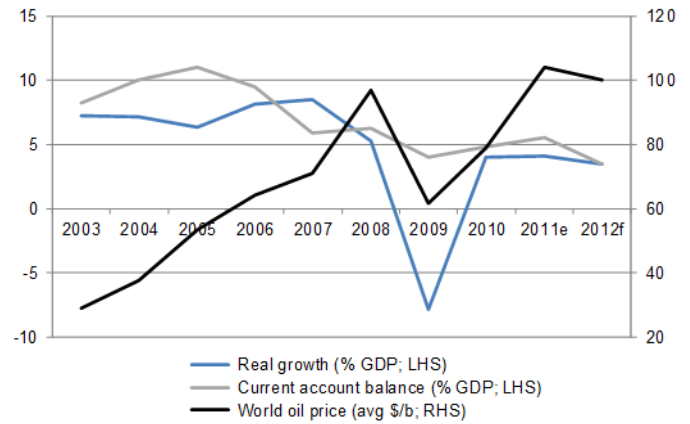
The Russian economy is vastly dependent on energy. Oil revenues represent roughly 50% of federal budget revenues and make up 25% of GDP. Together, oil and gas account for about two thirds of merchandise exports and more than half of hard currency receipts. But while energy has endowed Russia with abundant money, dependence on energy exports has become a hindrance to the country's long-term development as it is trapped in a vicious cycle. Oil dollars exert upward pressure on the rouble exchange rate and push up wages disproportionately to productivity. The rouble's real effective exchange rate, a good indicator of the country's overall competitiveness, has been steadily appreciating since 2003, only shortly interrupted during the crisis. While such an appreciation does not hurt the export position of commodities, denominated generally in dollar terms, manufacturing activities see their competitiveness eroded. Russia is in fact exchanging commodities for finished products, much as the Soviet Union did back in the 80s: exchanging oil and gas wealth for imported goods, while no quality goods are available to export as the economic policy of the past 20 years has led to the deindustrialisation of the Russian economy. While in 1996 less than half of merchandise imports were, currently more than  $\frac{3}{4}$  of all imported items are manufactured goods. Inversely, modern Russia has seen a steady decline in manufactured exports: from 26% in 1998 to 16% in 2010. Moreover, only about 8% of these manufactured exports are considered high tech, mostly weaponry. As a consequence of a general 'de-technologisation', Russia trails developed countries in terms of innovation, despite the great scientific edge the country used to hold in Soviet times. This puts in perspective all the rhetoric by Russian leaders about becoming quickly a leading knowledge economy.

20 years after the collapse of the Soviet Union, Russia still drags a heavy legacy with it. Not only does industrial production amount to only  $\frac{3}{4}$  of the 1989 level – a consequence of the disastrous 1991-96 period –, but infrastructure and equipment also often date back to Soviet times and require an immense catch-up effort. Several dramatic events in recent years illustrate this gradual degradation, e.g. the explosion in 2009 of Russia's largest hydropower plant and the poor handling of the massive bush fires during the summer of 2010. The 1990s saw little new investments while during the boom of the 2000s, companies focused on expansion instead of efficiency. Over the past decade, soaring consumption translated into strong economic growth, but this was largely achieved through underinvesting in new activities and infrastructure and using up spare capacity of Soviet assets, eventually resulting in easy productivity gains. This potential is close to exhaustion, however, and new capacity needs to be created.

Swelling oil and gas revenues allowed Russia to hide its industrial decline somewhat, yet, not in 2009. Despite substantial spending stimulus, the economy contracted by a staggering 8% and the model showed structural weaknesses. While the crisis hit countries around the globe, the pains inflicted on Russia caught the eye as the country experienced the sharpest downturn within the G20 league. Hovering around 4% since, growth lies significantly below the 2000-08 average of 7%. The Russian economy being basically a function of oil, gas and – to a lesser extent – other commodities, its recovery has been very modest,



(source: IMF/IIFS)



(source: IMF, World Bank)

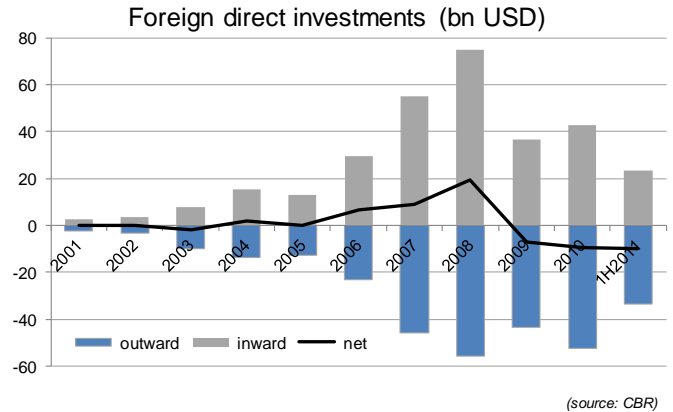
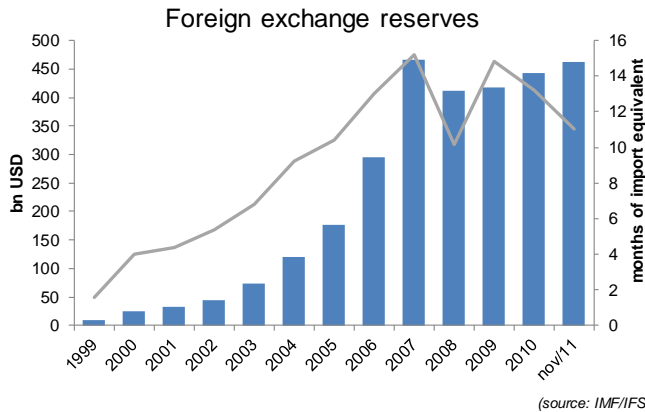
bearing in mind the general commodity price hike since 2009. With forecasts over the medium term falling below 4% annual GDP growth, economic expansion is not only weaker than pre-2008 levels, the Russian economy is also lagging behind other major emerging countries and the prosperity gap with the developed world will narrow slowly. Though the deep 2009 recession caused panic in Moscow and authorities realised at that time that an economic overhaul had become imperative, this sense of urgency soon abated as commodity prices resurged. Complacency in the face of favourable terms of trade would be a mistake as the impact of a next shock will only be more severe.

## Oil and gas sector

Though the presence of oil and gas as such is obviously not a problem for a country, for Russia the increasing addiction to and misuse of abundant energy revenues are. The latter are primarily used to keep in place an inefficient economic and shady political system, not to upgrade outdated economic infrastructure or boost human capital – combined government spending on health and education reaches only about 8% of GDP, roughly half of the average OECD level.

Russia has the world's largest natural gas reserves and vies with Saudi Arabia for the title of world's largest oil producer. Crude oil production hit a post-Soviet high of 10.7m barrels/day in October 2011, up from 6m in 1996. Production is not expected to increase substantially in coming years though. Current investments in the oil and, especially, gas sector are too low to replace traditional fields in Western Siberia and the Ural region which have passed their peak production. While Russia holds significant reserves, these require enormous investments as new fields are in general smaller, remote and technically hard to develop, e.g. in Eastern Siberia and off the Arctic Sea.

Russia cashed in on turmoil in the Arab world and the ensuing steep rise in global energy prices. While they did not reach the record levels of 2008, with \$104/b, the average price in 2011 was the highest ever observed. Ironically, if political stress in Russia should intensify, this would exert upward pressure on international energy prices of which Russia would be one of the principal beneficiaries.



## Balance of payments

High energy prices have compensated for a surge in imports and helped strengthen Russia's current account position, though the overall balance of payments position has been weakening given the evolution of the capital and financial account, which has seen increasing capital outflows over the past years. The IMF projects the current account surplus to dwindle over the next years due to swelling imports and despite high oil prices assumptions. A noticeable evolution as Russia booked double-digit surpluses in terms of GDP as recently as 2005 with an oil price little over \$50/b.

General investor enthusiasm for emerging markets during 2010 and the first half of 2011 did not extend to Russia. While many countries struggled with massive amounts of liquidity flowing in, threatening to overheat their economies, Russia has seen exactly the opposite: sizeable and continuous capital outflows. During 2011 as much as \$84bn of private capital left Russia, compared to \$34bn in 2010. Part of the outflow is the result of outward investments by energy majors, remarkably enough if we consider the many investment opportunities in Russia, seldom easily to digest though. While return on investment runs high, they prefer to take out their money, looking for less rewarding but more easily accessible investments. The underdeveloped financial system, which fails to intermediate inflows from commodities export and domestic savings to the Russian economy, enhances the massive outflows, as does the uncertain political outlook. Curiously, outflows often consist of small amounts, which imply individual Russian citizens are shifting their money out of the country.

The same trend applies with regard to foreign direct investments (FDI), crucial for the development of a country over the longer term as FDI do not just imply capital flowing in, but foreign technology as well, e.g. through the erection of local production facilities, equipped with modern techniques. Net FDI into Russia had been sluggish over 2000-05, with on average even a slight outflow. Despite increasing outflows, net inflows rose sharply over 2006-08. Alas, the global crisis and the following hike in risk aversion triggered a massive outflow both in 2009 and 2010. This trend has only intensified during the first half of 2011 with a net FDI outflow of \$10bn, larger than for entire 2010.

## Public finances

Not only the balance of payments is subordinate to energy prices, also the public finances are. Looking at the simple fiscal balance for the general government, one could conclude Russia's books are sound: an average surplus of about 7% of GDP turned into a deficit of over 6% in 2009 while in 2011 a slight surplus was realised with moderate deficits expected in upcoming years. However, for an oil-producing country like Russia where state revenues depend to a large degree on oil export and hence the price on international markets, the non-oil balance should be taken into consideration to assess in earnest the shape of the budget.

This non-oil budget deficit has soared during 2008-09 to 15% of GDP and remains near 10% of GDP, compared to a deficit of 4% before 2008. This reflects an insufficiently counter-cyclical fiscal policy. Whereas oil-price windfalls were partly saved prior to 2008, nearly all energy revenues are currently needed to finance structurally higher spending. This is a direct consequence of the massive fiscal expansion of 9% of GDP during the crisis which helped avoid an economic meltdown but relied excessively on permanent measures, which prove hard to withdraw. The Reserve Fund – fed by the windfall revenues – has been almost depleted in recent years. In December 2011, the Reserve Fund contained \$26bn or less than 2% of GDP, compared to \$41bn a year earlier, despite an average oil price of \$104/b over the same period. Though offsetting the budgetary impact of oil price fluctuations is exactly the purpose of this fund, its use (e.g. greater pension outlays) has resulted in a high structural non-oil deficit. Whereas in 2007, Russia's budget balanced with an average oil price of \$26/b, for 2011 \$108/b was required while the 2012 budget balances at \$126/b. It is clear that the Russian treasury is extremely exposed to prices on international energy markets.

Under current budgetary plans, the non-oil deficit would start to decrease somewhat only as of 2014. Pushing back the non-oil deficit decisively would create the needed fiscal reserves to withstand a next external shock. However, such a fiscal consolidation implies tax hikes, deep welfare reforms and a reversal of defence spending, all unlikely to occur any time soon given the tense political situation. Reforms of the pension system, confronted with growing shortfalls made up by the overall budget will in all likelihood be further postponed as the Putin administration can ill afford to lose support from pensioners. Even before the recent street protests, a spending spree was planned by the Kremlin. A large part of it is dedicated to the military. In 2010, President Medvedev announced a 10-year defence modernisation programme worth \$650bn. While the conflict in August 2008 with the tiny Georgian army demonstrated that an upgrade of the armed forces is long overdue, this programme will further complicate any effort to push back the non-energy deficit.

The budget for 2012 foresees spending to increase by 15% compared to 2011, anticipating higher revenues from the oil and gas sector. Salaries and pensions for military and police forces are set to surge. Given recent events, this spending hike will be executed even faster so as to assure support from Putin's core constituencies like pensioners and the military in the March elections. The handling of the last big social reform is telling: following widespread dissatisfaction over a monetisation of social benefits in 2005, the Kremlin acted fast to buy off protestors

by raising both pensions and military wages sharply. This readiness to keep on spending in order to guarantee the system survival implicates that oil prices do not just have to stay at current levels. They would need to rise further. Kudrin's resignation also bodes ill in this context. While he had been arguing relentlessly to contain fiscal profligacy and return to the creation of fiscal buffers, his resignation has opened the door towards more populist spending hikes.

## Debt dynamics

The total public debt stock has been stable in recent years at the very modest level of about 12% of GDP, compared to almost 100% back in 1999. Outstanding debts to the IMF and Paris Club were early repaid. What's more, public financial assets exceed by far gross public debt with Russia being among the countries to be looked at in Europe to help refinance maturing sovereign debt. If Russia's budgetary policy is not corrected, public debt will start rising again, though obviously from a low level. In April 2010, the Russian sovereign successfully issued its first Eurobond since the 1998 default. Besides, a February 2011 rouble bond attracted heavy investor interest.

With GDP and exports recovering on the back of rising commodity prices, external debt ratios have improved. As the events in 2008-09 demonstrated, this picture could change very quickly, though, in case of a terms of trade shock. The same applies with regard to the debt service. Nevertheless, it should be stressed that debt (service) ratios are very favourable at the moment. What's more, these ratios stand at the lowest level observed in decades, both in terms of GDP and export receipts.

Russia can bow on the world's 3rd largest stock of foreign exchange reserves, after China and Japan. These reserves equal 11 months of imports and over 650% of short-term debt. This very strong liquidity position explains the country's favourable classification for short-term political risk (2/7).

## Business environment

Kudrin has also been outspokenly critical of the business environment, which he blames for holding back growth and economic modernisation. Russia needs foreign capital and technology to upgrade its Soviet-era capital stock, but currently the miserable business climate acts as a deterrent for FDI. Endemic and pervasive corruption makes Russia the world's most corrupt major economy. Transparency International consistently ranks Russia among the weaker countries in the – not so terrific – region with a score comparable to the most corrupt African nations. Furthermore, the World Bank estimates that annually bribes are being paid equal to about 25% of GDP, up from 10% in 2002. At the same time, the rule of law remains weak. Though the judicial framework is largely present, the application of laws is arbitrary. While Medvedev announced in 2008 that Russia would put an end to "legal nihilism", little has changed since. Notwithstanding these serious problems, operating in the Russian market is still rewarding for large

international companies with deep pockets who have generally done well in the country.

In mid-December, after a negotiation process of 18 years, the door was finally opened for Russia to join the World Trade Organisation (WTO) with effective membership expected in upcoming months. At the moment, the Russian economy is the largest outside the WTO. Under the agreement, average import duties will fall from about 10% at present to below 8%, with the reduction phased in over 2 to 3 years for most goods, though sensitive sectors have been granted longer transition periods. As mentioned, the bulk of consumption goods are imported. Lower tariffs will only add to this trend. Not only with regard to trade in manufactured goods, but also with respect to services, intellectual property and non-tariff barriers, Russia will have to abide by international rules. Joining the WTO could thus provide the much needed leverage for an overall enhancement of the business climate. Direct economic gains seem limited however as energy products are not governed by WTO-rules and usually enjoy near zero import tariffs. At the same time, many of the sectors governed by WTO rules struggle with low competitiveness, whereas joining the trade bloc would imply more competition from foreign suppliers. As a consequence, uncompetitive Russian companies could see their domestic market share shrink.

As the Russian state controls about 50% of the entire economy, the scope for privatisation is huge. The government has announced ambitious privatisation plans which should bring in almost \$60bn in revenue by 2015. Stakes in 20 state majors are up for sale. These companies are located in the financial, hydrocarbons and electricity sectors. In February 2011, 10% of state-owned VTB bank was sold, followed in October by 75% of the rail shipping company Freight One. A hoped for bidding war did not materialise however. As a consequence, plans have been delayed: a planned divestment of 7.6% in Russia's largest financial company Sberbank and an IPO for shipping giant Sovkomflot have already been delayed. How Putin proceeds with the privatisation plan once he is back in the presidential seat will shed some light on his economic policies. After all, pushing for divestment would reverse the state capitalism he has created since he rose to power in 2000. As privatisation runs against vested interests from government officials and management, internal resistance will probably slow down the process. Authorities will have to tread carefully now in order to dispel any suspicion of cronyism, which could remind an already irritated population of the botched privatisation process of the nineties.

## Banking sector

In recent months, Russian banks have been forced to rely increasingly on central bank credit given the tight liquidity situation both on international and interbank markets since early August. Money market rates have surged and repo auctions by the CBR have returned to levels last seen during the height of the credit crisis early 2009.

While with a loan-to-deposits ratio of about 95% compared to 120% back in 2008, the banking sector is less leveraged, non-performing loans (NPLs, i.e. troubled

bank assets) are close to 10%, compared to less than 3% in 2008. With growth slowing and banks squeezed for liquidity, NPLs can reasonably be expected to rise, heralding trouble in particular for several hundreds of smaller banks which have questionable access to state support. Though aggregate capital ratios seem resilient, the CBR has indicated that according to recent stress tests about 20 of the 200 largest banks could face capital shortfalls.

Related-party lending is a feature specific to the Russian banking system whereby loans to management and shareholders represent up to 50% of the capital invested by Russian banks and are often uncollateralised and granted below market terms. The issue surfaced in August 2011 when the Bank of Moscow failed and the authorities had to bail-out the country's fifth largest bank for as much as \$14bn in what was the country's largest bail-out ever.

## Monetary policy

Between early August 2011 and early October 2011, the rouble lost almost 14% against a euro-dollar basket, partly due to a global hike in risk aversion and partly due to a changed risk perception given the political uncertainty amid an election season. Since October, the rouble has regained much of the loss as energy prices – the rouble exchange rate is highly correlated with the oil price – have been resilient. Capital outflows are expected to peak in the run-up to the presidential elections while downward pressure on commodity prices seems likely considering the state of the world economy. Both factors could result in a weaker rouble. The aim is to complete the transition towards an inflation-targeting monetary policy by 2014, reaching an inflation rate of 4 to 5%. In the meantime, the rouble rate remains an implicit policy target. An inflation-focused monetary policy implies that shielding the Russian economy from oil price fluctuations has to be executed entirely by the budgetary policy, which once more underscores the importance of a countercyclical fiscal policy and the creation of fiscal reserves.

Over the past year inflation has been moderate in Russia, approaching its lowest level since the collapse of the Soviet Union. From 9.6% in May, headline inflation eased to 6.1% in December, largely thanks to a decline in food prices. Given a pending public spending surge and the fact that Russia is running out of spare capacity, inflation will nevertheless struggle to fall much further. Furthermore, the current levels can still be considered high, both compared to other large emerging markets and to Central and Eastern Europe.

## Social problems

Russia faces a series of socio-economic issues that undermine its long-term potential. The most quantifiable is the steady population decline since the collapse of the Soviet Union in 1991. Over the past two decades, the Russian population has decreased on average by 340,000 persons a year, losing almost 7m people. According to UN projections, the total population will shrink by a further 14mn individuals by 2030. This reflects other social problems: a low life expectancy with a high mortality rate, a low birth rate, high alcohol and drug abuse and continuing

outward migration of (highly skilled) labourers. This demographic evolution has profound effects on the labour market as the labour force is shrinking. The ratio of pension-age to working-age Russians is projected to shift from 1/3 to 1/2 by 2030 due to a population both ageing and shrinking – mortality is especially high among working-age men. By 2025 there are expected to be 10 million fewer working-age people in the country. Moreover, many people work in shrinking sectors, located in regions far away from the urban centres in need of labour forces. Indeed, shortages of labour emerged already in 2007-08 in Saint Petersburg and Moscow. The drop in working-age Russians could be compensated by immigration from neighbouring CIS countries, though a rising tide of (ethnic) nationalism and increasingly stringent immigration rules act as deterrent. Furthermore, the Russian labour force is relatively highly skilled with over 50% enjoying higher education, while immigrant workers are in general lowly skilled.

## Conclusion

Russia's economic and political models are up for revision and will be tested to their limits in upcoming years. Whether the shift to a politically more liberal and economically more balanced model could happen without the disruptions seen so often in the country's eventful history, remains to be seen. Nevertheless, thanks to strong oil revenues, Russia's external accounts remain solid with robust debt fundamentals, a very favourable liquidity situation and a surplus, though declining, on the current account. These compensate for structural weaknesses of the Russian economy over the long term and explain why ONDD still grades Russia in 3 (out of 7) for medium and long term political risk.

Strengths	Weaknesses
Outstanding liquidity	Growing political disruption risk
Low public and external debt	Weak business environment
Current account surplus	Prone to capital flight
Abundant mineral wealth	High and rising oil dependency
Highly skilled labour force	Declining and ageing labour force

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