

Equity Strategy

Moscow is a Long Way from Cairo

If I were there, protest music would be important. But I'm not going.

Nina Simone

Yesterday's sharp fall in the Russian equity market was an over-reaction to reports of Moscow street protests. While events across North Africa and the Middle East earlier this year suggest it is foolish to dismiss such events as not having consequences, in Russia, those consequences are much more likely to play out over the term of the next parliament rather than dramatically at present.

Sharp market reaction

- **Equities and the ruble took a hit.** Russian equities fell hard yesterday as a reaction to media reports of widespread public protests against Sunday's parliamentary election. Reports referred to multiple protests and arrests alongside a heightened security presence in Moscow and other major cities – the clear impression being that Russia is in danger of experiencing its own Arab Spring event and that the election outcome may mark the start of a winter of discontent in Russia marked by social instability and political uncertainty. That fear was the major reason for the 4.7% fall in the RTS Index, the 4.0% loss on MICEX and the 6.4% decline in the IOB GDR index. Those losses compared with a fall of 1.3% for the MSCI EM Index. The ruble was another casualty, falling 24 bps against the dollar and 11 basis points against the euro by the close of MICEX trade yesterday.
- **ADRs fell against a rising S&P 500.** While the S&P 500 Index ended with a gain of 0.1%, Russia's ADRs lost heavily, with VimpelCom Ltd and MTS off between 5.5% and 6.0% and Mechel down 11.0% – again, the major reason being the headlines from Moscow.
- **News taken out of context.** The first point to note is that protests in Moscow are not as uncommon as was the case several years ago. Several groups regularly attract the relatively small number of protestors that were seen yesterday. The Strategy 31 Group holds a regular protest meeting on the last day of every 31-day month in central Moscow, and the mayor's office has made it easier for groups to protest than was the case under the previous Moscow regime. Secondly, it is also not an unusual sight to see OMON police stationed in central Moscow. It is a familiar sight on weekends around the popular tourist locations and at central city metro stations. During football match days, for example, the presence is usually ratcheted up. Current events, therefore, should not be taken out of that context and are certainly not a reason to justify a market sell-off.

- **More important short-term market worries.** At this point in time, the much more important issues for investors in the Russian market include the following.
 - S&P's warning about possible downgrades across the Eurozone countries.
 - The still-serious threat to the global economy should the EU leaders fail to contain the debt threat.
 - China's economic growth and demand for imported commodities.
 - Where the price of oil trades.
- **China data on Friday.** Friday will be the next important day giving an update on several of those issues, as that is when the EU leaders will meet to try to agree a framework to contain the debt and deficit problems. It is also when China reports its November macro data. Investors in China clearly fear negative surprises, as evidenced by the relatively weaker equity market last week (i.e. when global markets were rising) after the Central Bank announced the reserve requirement cut. It is a case of "what do they know that we don't yet know" for investors.

Important differences

- **Prudent not to totally dismiss fears.** So, while the memory of how quickly events in Egypt, Syria and Libya escalated earlier this year suggests it is foolish to dismiss any protests, in any country, as not relevant, the situation in Russia is very far from the conditions that led to the Arab Spring. Russia is on course for GDP growth of 4.8% this year, inflation is headed for a post-Soviet low (6.5%), unemployment is at 6.4%, real wage growth was 5.0% y-o-y at end October and other macro indicators, such as 8.8% y-o-y growth in retail sales last month, point to more stable conditions than was the case in the Arab countries. According to the World Development Report, the Gini coefficient, a measure of wealth distribution, is 42.3 in Russia and just better than that of the US with a reading of 45.0.

Game changer?

- **Growth of the middle class has altered the landscape.** Frustrations are clearly evident and, to a large extent, this weekend's election result may well turn out to be a game changer. People have made their views very clear and, as is the case everywhere, governments ignore such strong statements at their peril. But in Russia, changes are expected to come slowly rather than dramatically. Our Chief Economist wrote about the implications for budget policy in a report issued yesterday ("Chief Economist's View – Economic Policy to Maintain Macro Stability and Keep Electorate Calm"). There may also be implications for the reform agenda, as many of those who migrated from United Russia to other parties in Sunday's vote are those who opinion polls show have become very frustrated with the lack of progress in dealing with corruption among state officials and also those with a declining level of confidence in Russia's economic future. The emergence of a significant middle class has made a very material difference to the economic, social and political backdrop in Russia. Expectations are a lot higher and tolerance much lower than was the case during the previous Duma elections in late 2007.
- **Hope for a pragmatic rather than purely spending response.** During the crisis of 2009, Prime Minister Vladimir Putin reacted with pragmatism to economic problems that were threatening to become social and political problems. His response to the crisis in Russia's motor industry that year, and his active personal involvement in trying to acquire GM's OPEL division as a strategic partner to Russian industry, are good cases in point. While the pessimists expect only a spending response to the threat of social instability, the optimists hope for a repeat of the pragmatism shown in mid-2009.

Next steps

- **New Duma may meet by month end.** The deadline for the Central Electoral Commission to deliver the official election result is December 19. By law, the next Duma, Russia's sixth, should hold its first session within 30 days of the declaration of the official result. However, party leaders have already said that they hope the new Duma will meet before month end.
- **Putin's election manifesto is expected in January.** Prime Minister Putin usually holds a three to four-hour live televised Q&A session each December, with questions invited from people and community groups from across the country. As yet there is no confirmation as to whether the event will take place this year or not. The prime minister's press spokesman recently said that Putin will publish his manifesto for the presidential election in January. Either of these events will provide an opportunity for him to address public concerns and the current protests.

Livelier next Duma

- **United Russia has a small majority.** United Russia will have a small simple voting majority in the next Duma. It is expected to take 238 seats and command a 52.9% share of the votes. In theory, that allows the party to pass legislation without the need for support from another party. President Dmitri Medvedev has, however, already said that United Russia may seek to cooperate with one of the opposition parties to ensure trouble-free passage of legislation. Either way, the next Duma is expected to be much more lively and fractious than the last.
- **WTO debate is expected in early 2012.** Among the first pieces of legislation that the Duma will debate will likely be the draft law on Russia's admission to the WTO. This debate will occur if, as expected, the WTO Council votes to admit Russia as a member of the world trade body at its next meeting on December 15. That debate may reveal a lot about the policy preferences of the opposition groups.
- **Communists are the next biggest.** The Communist Party is expected to have 92 seats and a 20.4% share of the Duma vote. Cooperation with United Russia is not a realistic option. That leaves the other two parties as possible bedfellows for United Russia.

A Just Russia

A Just Russia is expected to have 64 Duma seats giving it a 14.2% share of the vote. The party was created with the support of the Kremlin in 2006 when three small parties were merged. It had an 8.4% share of the vote in the outgoing Duma. The party was regarded as part of the loyal opposition until this year, when the leadership fell out of favor with the Kremlin ideologists. The party was headed by Sergei Mironov, the former head of the Federation Council, from inception until April this year. He was ousted from the Federation Council and as head of the party. His replacement as party leader is Nikolai Levichev.

The party's slogan is "New Socialism for the 21st Century", which it describes as the antithesis of "barbarous, oligarchic capitalism". The ideology does not eliminate the market but transfers power over it from the oligarchs to the people. In the State Duma, the party emphasizes its role as "constructive opposition" that opposes high-level corruption and supports further democratization of the political system. In the 2007-11 Duma, A Just Russia declared opposition to Putin's government, voting against the budgets in 2010 and 2011, while remaining strongly supportive of President Medvedev and the modernization program.

The party has said it wants to replace Russia's flat 13% income tax with a system of progressive taxation while seeking higher spending on employment programs.

LDPR (Liberal Democratic Party of Russia)

LDPR, which is expected to have 56 Duma seats giving it a 12.4% share of the vote, is one of Russia's oldest political parties having been founded in 1991. The party is centered around the personality of its charismatic leader Vladimir Zhirinovskiy. It is associated with strong nationalist policies and has a focus on law and order. Officially, it describes itself as a centrist, pro-reform democratic party and calls for a mixed economy and revival of Russia's great-power status.

LDPR favors a mixed economy with private ownership but with a strong management role reserved for the state. It has supported the restoration of a greater Russia with its "natural borders" that include Belarus and Ukraine and other former Soviet republics.

Voting structure of the Duma*

	2007-11 Duma		Next Duma	
	Seats	Share of vote	Seats	Share of vote
United Russia	315	70.0%	238	52.9%
Communist Party	57	12.7%	92	20.4%
A Just Russia	38	8.4%	64	14.2%
LDPR	40	8.9%	56	12.4%
Total	450	100.0%	450	100.0%
Voter turnout		63.7%		60.2%

* provisional as of December 7

Source: Central Electoral Commission, Moscow Times

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