

Equities

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Russia's rising middle class

Ready for power

- **Russia has become a middle class country** — Rising wealth levels over the last decade have turned Russia into a middle class country for arguably the first time in its history. We expect this fact increasingly to be reflected in its politics, and see the current protests as the start of a long process of change.
- **An educated population** — Tertiary education levels are high in Russia: 55% amongst young people aged 25 to 34, or 44% among those aged 55 to 64.
- **Urban home-owners** — 74% of the population of Russia is urban, and 82% of people own their own home, a higher level than in most European countries.
- **Now with money in their pockets** — The vital missing component for the formation of a middle class was money, but that has now come. Income per capita in Russia is over \$900 per person per month in PPP terms, nearly half of the European level.
- **Wealth is widely distributed** — The top three income deciles all enjoy income of over \$1,000 per person per month in PPP terms, and the top six have income over \$500.
- **Able to enjoy discretionary consumption** — The Russian car fleet is nearly as big as the German one, almost all households have the major electrical goods, and over half the population has money for discretionary spending on non-food items.
- **Aware of themselves as a middle class** — More than a third of the country sees itself as middle class.
- **Enjoying internet access** — Around half of the population uses the internet and this is increasingly where people turn for their news.
- **The start of change** — The political consciousness of the urban middle class has been awakened by the controversy over the Duma election results. We believe that the recent protests will lead to the middle class taking more of a role in the running of the country.

■ Equities

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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What is the middle class

There is no standard definition of what is the middle class, and academic debate tends to focus on self-perception, education, and income levels, to which we add assets as they are a tangible reflection of income. For our purposes we define the middle class as those who have a reasonable level of discretionary income and do not live hand to mouth, but we also lay out below the number of people who qualify under different criteria. We believe there are two key conclusions to be made:

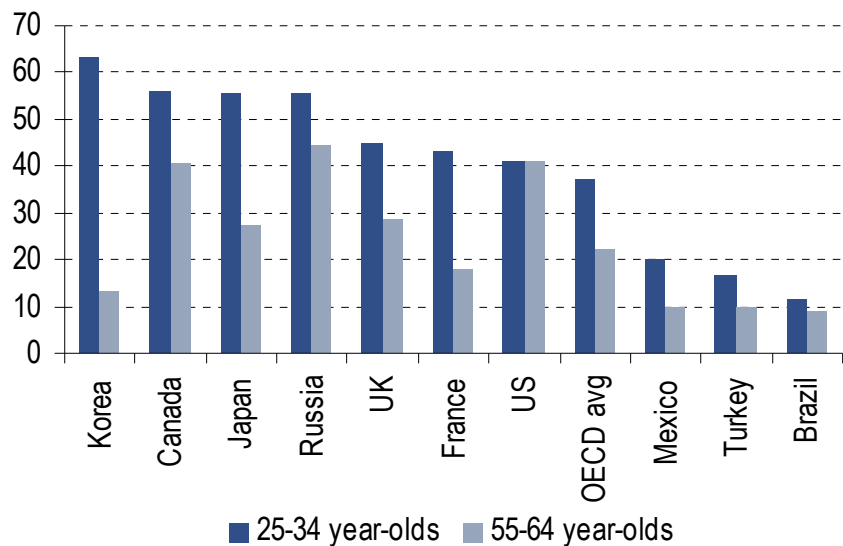
- The Russian middle class is larger than commonly perceived. We would argue that it is between a third and half of the population.
- It is only in recent years that the middle class has had enough spending power to be defined as such; prior to 2005 it would be fair to say that there was a proto-middle class.

Education

Tertiary education

Education levels in Russia are high. According to OECD statistics, Russia ranks amongst the highest in the OECD for the proportion of its youth (25 to 34) with a tertiary education, at 55%.

Figure 1. Percentage of population with tertiary education



Source: OECD

Internet access

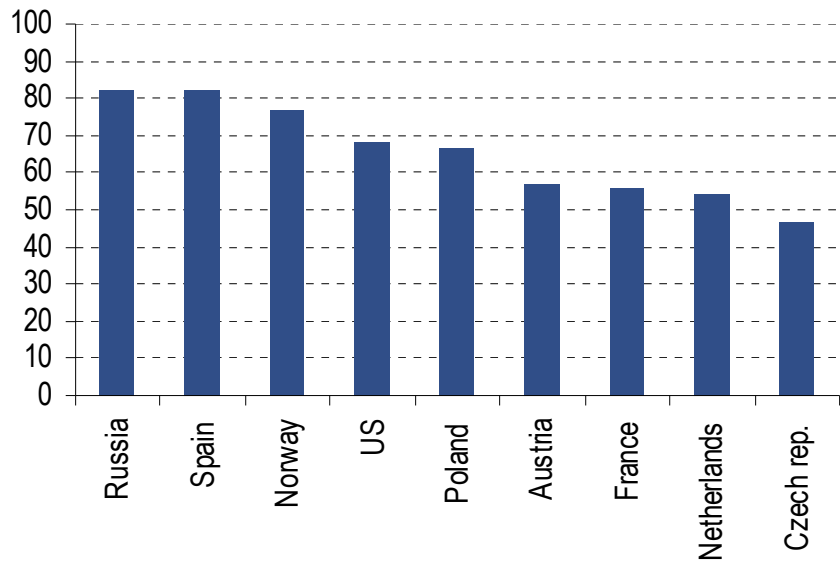
In March 2011 Russia had 60 million individual users of the internet, according to the Internet World Stats website, or 42% of the population. The Russian Minister of Communications announced that at the end of 2011 Russia had overtaken Germany in terms of the number of users; given the experience of mobile phone penetration in Russia (now well over 100% and the largest market in Europe by far) we would expect internet penetration to continue to rise rapidly.

Assets

Housing

74% of Russians live in cities according to Rosstat. As a result of the way privatisation of flats took place after 1991, 82% of people own their own homes, amongst the highest proportion in Europe. Moreover, mortgages levels are very limited, at under 3% of GDP.

Figure 2. Home ownership percentage

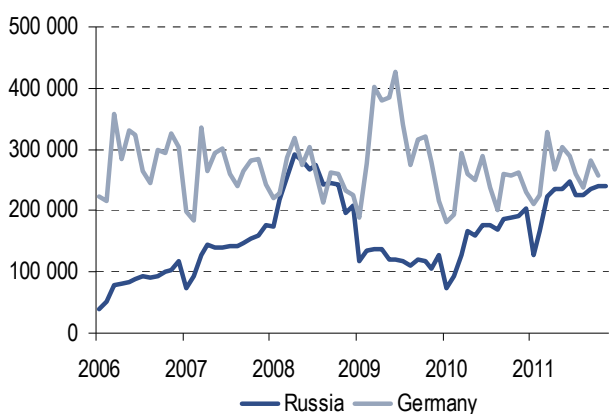


Source: Rosstat

Cars

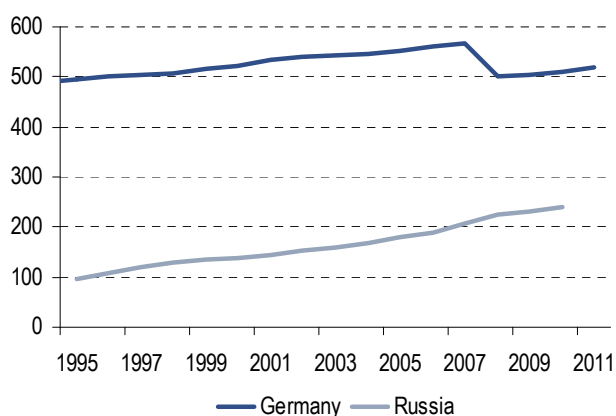
There are around 36 million cars in Russia; this is one for every four people, compared to Germany (42 million cars) where it is one for every two people. Russia stands poised to overtake Germany as Europe's largest car market at 3 million units a year. We believe that the existence of such a large pool of cars is the best answer to skeptics who believe that Russia has very few people with middle class incomes.

Figure 3. Monthly car sales in Russia and Germany



Source: Datastream, AEB

Figure 4. Russian and German car penetration, per 1000

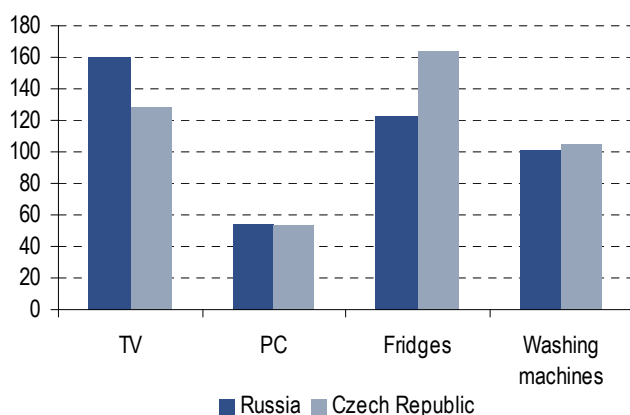


Source: Datastream, Rosstat

Household equipment

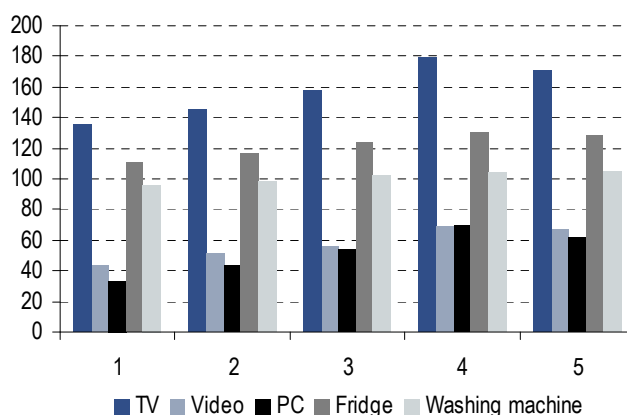
Russian households have most of the medium ticket electronic items such as fridges, washing machines and, increasingly, computers. The distribution of these assets down the wealth groups is very notable; data from Rosstat indicates that even the bottom quintile of houses by income have most of this equipment.

Figure 5. Household penetration of key items 2009 – items per 100 households



Source: Rosstat

Figure 6. Electrical items by household income quintile 2011 - items per 100 households



Source: Rosstat

Financial assets

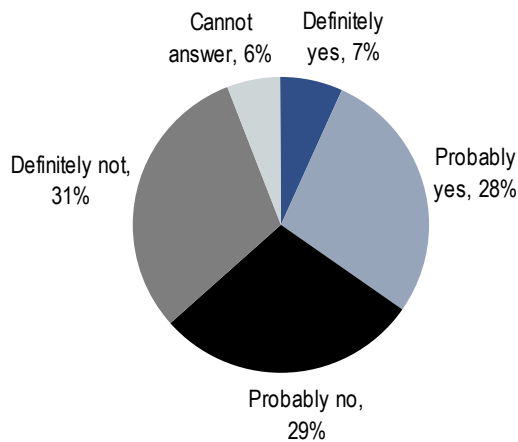
The main area where Russian citizens are deficient is in financial assets; pensions, shares, savings and so on are minimal. However, debts are also very low. We believe this reflects the history of Russia during turbulent times and the culture of spending not saving.

Self perception

Surveys

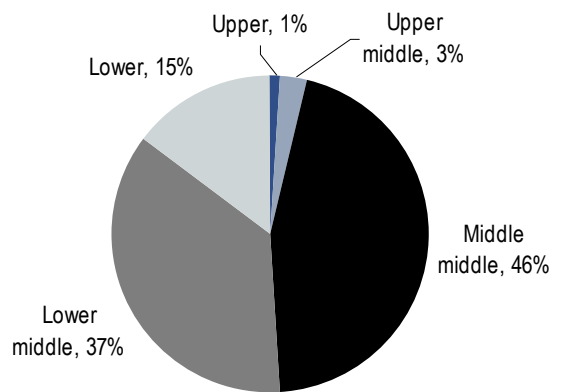
Self-perception is a little more tricky. When asked direct whether they were middle class, a mere 35% of Russians, perhaps thinking of wealth levels seen in US soaps, saw themselves as certainly or probably middle class. However, when asked what social group they belonged to, over 80% placed themselves somewhere in the middle classes.

Figure 7. Are you in the middle class? (Feb 2011)



Source: Levada Center

Figure 8. What social group are you in? (Sep 2011)

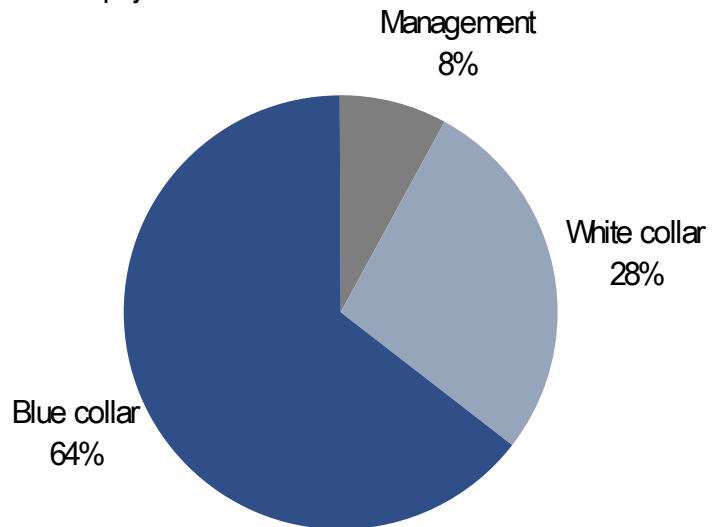


Source: Levada Center

Jobs

Russia has a service economy which makes up two thirds of GDP, so not surprisingly it has a similar distribution of blue collar and white collar jobs to other service economies. Our interpretation of Rosstat data implies that 36% of Russians have white collar jobs and 64% have blue collar jobs.

Figure 9. Russian employment structure



Source: Rosstat, Citi estimates

Income and expenditure

Total

The average monthly disposable income per person in Russia in 2010 was \$921, just under half of what it was in major European countries. For the sake of clarity, disposable income per person is total post-tax income divided by the population, and is not of course the same as the average salary, which will be higher.

Figure 10. Disposable income per month per person in Russia and major European countries, 2010

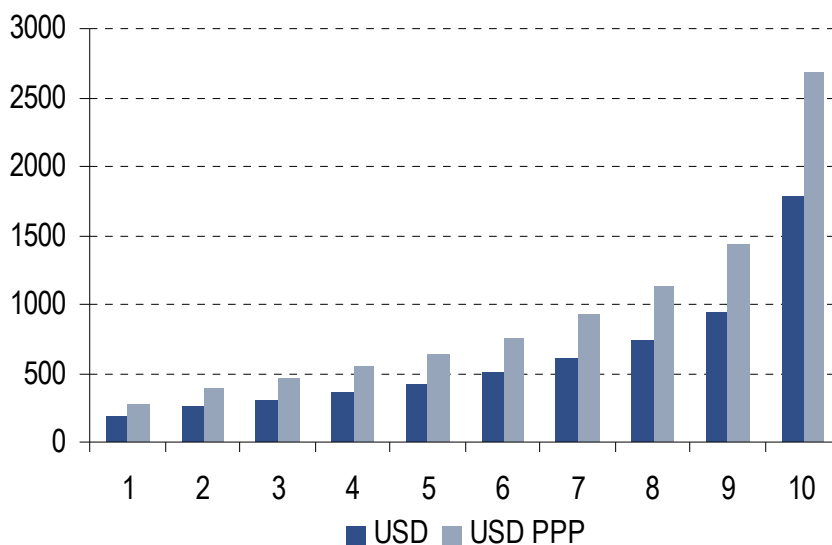
	USD	USD PPP
Russia	611	921
Germany	2 178	1 952
France	2 269	1 890
UK	1 946	1 864

Source: Datastream, Rosstat

Income Distribution

Russia's Gini coefficient is 42, which implies a more equal society than the US where it is 45 but less equal than European countries like Germany. The top three deciles have income per person of over \$1,000 in PPP terms per month, while the top six have monthly income of over \$500 in PPP terms.

Figure 11. Monthly income per capita by decile 2010 (USD)

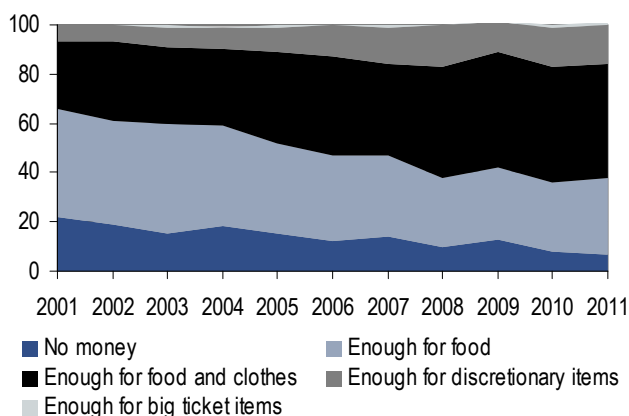


Source: Rosstat

Discretionary spending

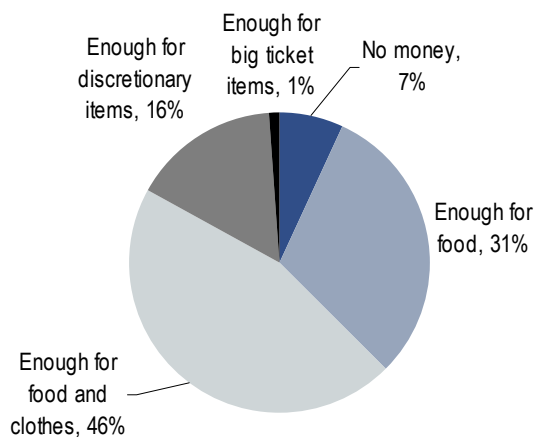
In order to get a different fix on this issue, we looked at the data from the Levada Institute on people's capacity to spend. The question asked was whether people had enough money for different levels of spending, ranging from no money up to enough to buy big ticket items like houses. Around 10% said they had no spare income, and a further 31% said they only had enough for spending on food but need to save to buy clothes. 45% said they had enough for spending on food and clothes but need to save to buy discretionary items, and 16% said they had enough to buy discretionary items as well. We believe the upper middle class could be defined as the top 16% and the middle middle class as the next 46%.

Figure 12. Capacity to spend over time (% of the population)



Source: Levada Center

Figure 13. Capacity to spend, 2011 (% of the population)

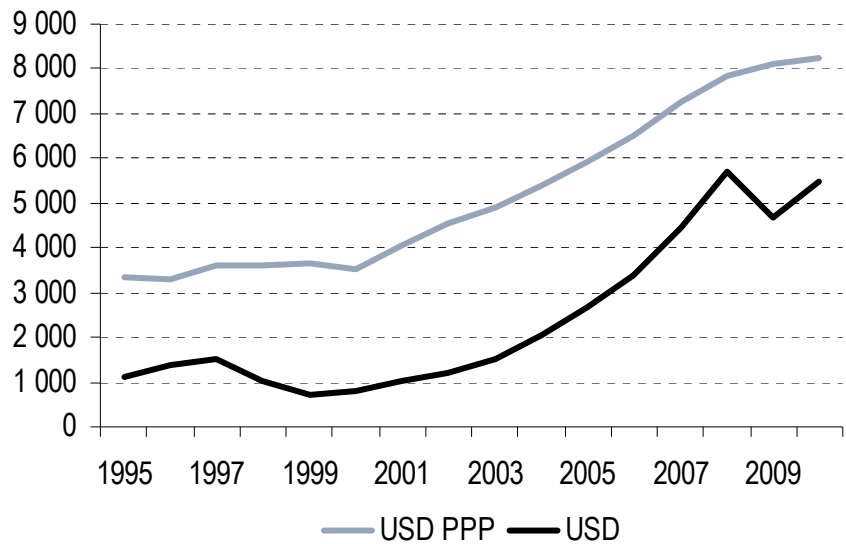


Source: Levada Center

Change over time

The most notable aspect of the Russian data on consumption per capita is how it has changed over time. Back in the early 2000s there was almost no discretionary money, especially to buy imported goods with weak rubles; spending was under \$1,000 per person per annum in \$ terms. As the ruble has risen and as wealth has increased, that has changed dramatically.

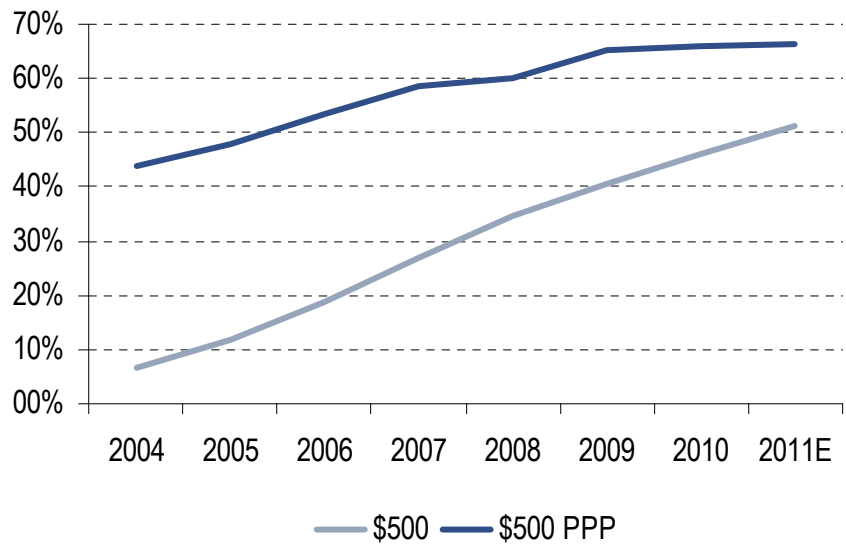
Figure 14. Consumption per capita per annum in Russia in USD and USD PPP



Source: IMF, Rosstat

And as a result the proportion of the population with income per capita higher than \$500 per month is now 50% in dollar terms and over 65% in PPP terms.

Figure 15. Percentage of population with monthly disposable income over \$500

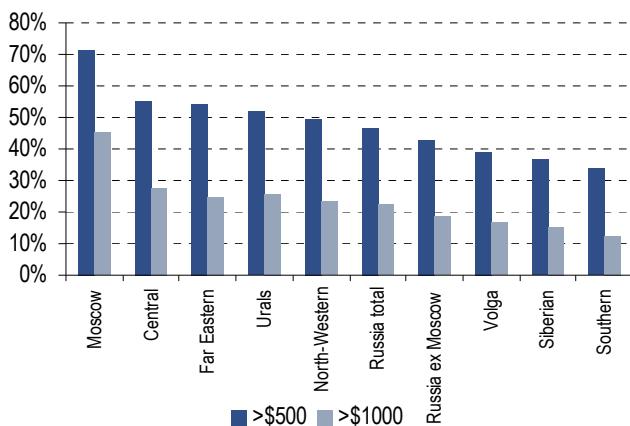


Source: Rosstat, Citi estimates

Location

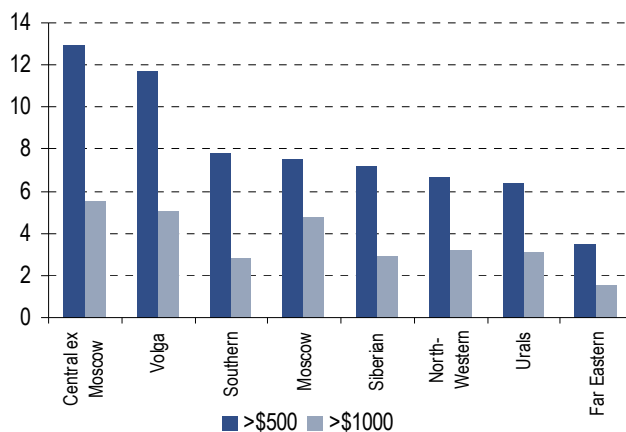
Wealth is concentrated in Moscow but distributed across Russia. Moscow has almost five million people with income per capita in dollar terms of over \$1,000 per month, but Moscow makes up only 15% of the total of such people in Russia.

Figure 16. Proportion of those with monthly income per capita exceeding \$500 and \$1000, by region (2010)



Source: Rosstat, CIRA calculations

Figure 17. Population with monthly income per capita exceeding \$500 and \$1000, mln (2010)



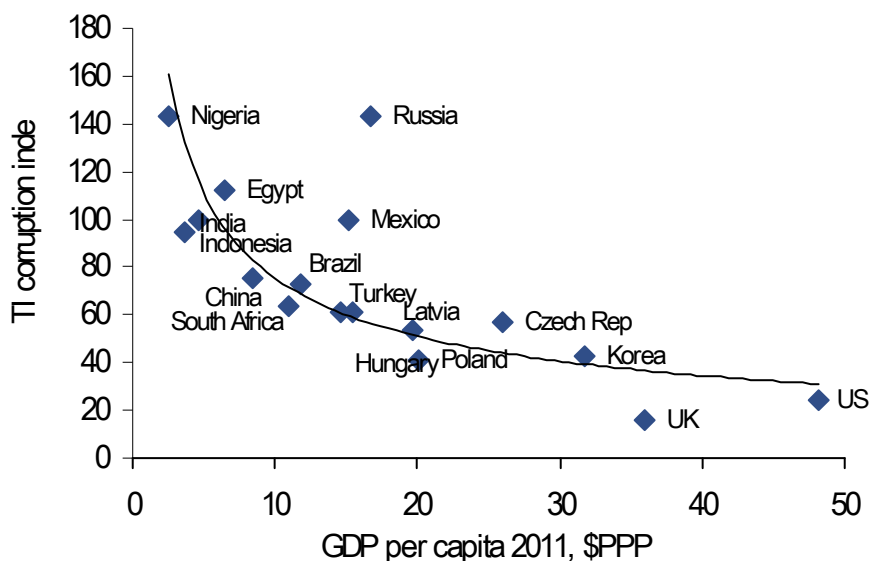
Source: Rosstat, CIRA calculations

Corruption and wealth

The link from income to good government

The experience of many other countries has been that as wealth levels increase so corruption levels decrease. The easiest illustration of this is to plot the ranking on Transparency International's corruption perception index against GDP per capita.

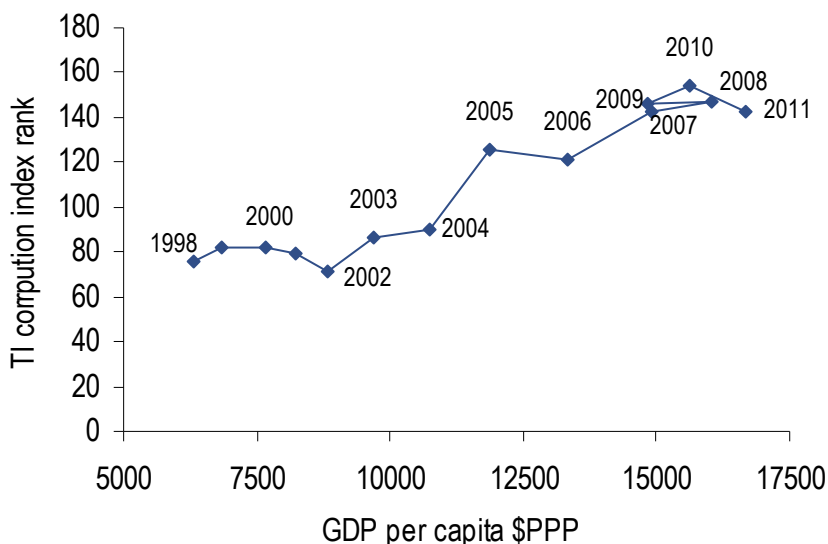
Figure 18. Corruption vs GDP per capita 2011



Source: Transparency International, IMF. Note the lower the ranking the better.

Russia over the last decade has gone in the opposite direction; the country has grown richer but slipped down the Transparency International rankings.

Figure 19. Corruption vs GDP in Russia



Source: Transparency international, IMF. Note the lower the ranking the better

The implication of this is arguably that the situation is unstable. We believe that the controversy over the Duma election results will lead to increasing protest against corruption. We believe it is likely that this will lead ultimately to change to reduce corruption and improve governance.

Urban elites cause change

A number of commentators have argued that Russia will remain highly resistant to change as it is only a few upper-middle class socialites in Moscow who wish to change the status quo. They point to the high popularity levels of Putin in the regions and argue that change will be slow to come.

We believe that this analysis is incorrect for two reasons. First, as we have sought to lay out above, the middle class is far more numerous and more widely spread than is commonly realized.

The second point is that the experience of other countries, as pointed out by Huntington in his pivotal 1968 book 'Political Order', is that it is urban elites that cause change, especially urban elites in the capital. Indeed he goes so far as to say that the key drivers of regime change are the cities; within them the middle class is key; within them the intelligentsia is key; and within them students are key. So the well-known recent picture of a student holding up a picture of an apparently falsified Gaussian distribution at Bolotnaya Ploshad is an important symbol.

Citi Coverage In Russia and the CIS

Company	RIC	Price USD	Target price	Rating
			USD	
Sberbank	SBER.MM	2.63	4.29	1
Gazprom	GAZP.MM	5.54	10.30	1
Norilsk Nickel	GMKN.MM	154.46	225.00	2
Rosneft	ROSN.MM	6.97	9.90	1
LUKoil	LKOH.MM	54.99	70.60	1
VTB	VTBRq.L	3.77	5.28	2
Uralkali	URKAq.L	35.37	41.00	2
NOVATEK	NVTKq.L	131.00	170.00	1
Severstal	CHMF.MM	12.80	17.00	1
Surgutneftegaz	SNGS.MM	0.81	1.21	1
Transneft	TRNF_p.MM	1579.66	1880.58	1
Novolipetsk Steel	NLMK.MM	2.15	3.30	1
Mechel	MTL.N	9.16	8.00	3
Kazakhmys	KAZ.L	15.13	24.11	1
Vimpelcom Ltd	VIP.N	10.11	16.20	1H
Evraz Group	EVZRq.L	18.60	13.00	3
Magnit	MGNTq.L	22.50	26.50	1
Raspadskaya Coal	RASP.MM	3.21	6.00	1
X5 Retail Group	PJPq.L	23.35	41.00	1
ENRC	ENRC.L	10.78	14.38	1
Polymetal	PMTLq.L	16.24	28.00	1
Petropavlovsk	POG.L	10.28	12.89	1
Alliance Oil Company	AOILsdb.ST	12.90	15.51	1
UC Rusal	0486.HK	0.60	1.03	1
Gazprom Neft	SIBN.MM	4.65	6.30	1
Ferrexpo	FXPO.L	4.47	6.88	1
Eurasia Drilling Company	EDCLq.L	22.60	35.00	1
TNK-BP Holding	TNBP.MM	2.64	3.27	1
TMK	TRMKq.L	10.13	18.00	1
KazMunaiGas EP	KMGq.L	14.80	17.00	2
Globaltrans	GLTRq.L	12.33	24.25	1
Kernel	KERN.WA	20.18	23.88	1
M.Video	MVID.MM	5.84	10.00	1
Mostotrest	MSTT.MM	5.64	7.06	1
O'Key	OKEYq.L	6.90	9.50	1
Pharmstandard	PHSTq.L	14.40	25.00	1
Synergy Group	SYNG.MM	15.75	41.50	1H
MHP	MHPCq.L	10.80	18.50	1
Dragon Oil	DGO.L	7.32	13.60	1
Dixy Group	DIXY.MM	9.63	17.00	1
PhosAgro	PHORq.L	8.80	21.00	1
Integra Group	INTEq.L	1.75	5.50	1
Cherkizovo Group	CHEq.L	12.24	21.00	1
Halyk Bank	HSBKq.L	5.03	8.10	1
NOMOS Bank	NMOSq.L	9.05	14.04	1
ZhaikMunai	ZKMq.L	9.90	13.00	1
Vozrozhdenie Bank	VZRZ.MM	18.34	29.00	2
Kazkommertsbank	KKGBYq.L	2.80	3.80	2H
Rosinter	ROST.MM	4.17	8.50	1H
Avangard	AVGRq.L	6.88	22.50	1
CAT oil	O2C.DE	5.73	12.77	1

Source: Datacentral

Appendix A-1

Analyst Certification

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