

Investors Upbeat About New Duma

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United Russia won enough seats to usher government-sponsored bills through the State Duma, but the decline in popular support for the ruling party as revealed by Sunday's elections will likely have consequences that reach beyond law making.

Led by President Dmitry Medvedev and Prime Minister Vladimir Putin, the party will occupy 238 seats in the new Duma, while a bill requires at least 226 votes to pass.

The loosening of the tight grip that United Russia had on the previous Duma, where it counted 315 deputies, could trigger earnest liberal reforms and a few showcases in the tepid fight on corruption. This could allow the government to win over voters who are not placated by the state's increased social spending.

"Its good news because it will hopefully give the message to the leadership that it will have to change to continue to be successful," said Jochen Wermuth, chief investment officer at Wermuth Asset Management.

Some of the changes would have to appeal to the 47 million-strong Internet-using middle class who hardly have any representation in the new Duma, he said.

"To not lose these people who want to modernize the country, the Russian authorities will have to start implementing reforms that will make them happy — independent judges, rule of law, fighting corruption," Wermuth said. "There could be a war on corruption — not with words but actions — for example, putting in prison high-level people who have taken or given bribes at the high level. That would be a chance to impress people."

Some investment banks and asset managers predicted that the swollen ranks of the leftist forces in the Duma could prompt the government to undermine their support by expanding social spending. The Duma election results could "induce extra populist steps on the part of the country's leadership to move the needle of public opinion" ahead of the presidential election March 4 where Putin will run, VTB Capital said in a note to investors Monday.

Tim Ash, head of emerging markets research at Royal Bank of Scotland in London, said: "The natural instinct for Putin will be to pump more money into the economy," Bloomberg reported.

Viktor Szabo, who helps manage about \$7 billion in emerging market debt, including Russia's ruble eurobond, at Aberdeen Asset Management in London, also agreed about the prospect of increased spending, saying it could stoke inflation.

But the most plausible interpretation of the success at the polls for the Communist Party and A Just Russia is venting frustration with United Russia, both Alfa Bank and Wermuth said.

"We do not see this necessarily as nostalgia for Soviet times, but rather as an indication of protest voting," Alfa Bank chief economist Natalia Orlova and analyst Dmitry Dolgin wrote in a note to investors Monday. "Supporting the Communists as a prominent second party was the most obvious way to vote against United Russia in the absence of a legal means to express this view."

Therefore, the government should think twice before dipping into the budget to spend more in response, an option that would strain state finances further, Wermuth said.

"I have some faith that the Russian government is professional enough to understand that they have already overcommitted themselves in the 2012 budget and there's no room for more social expenditures," he said.

In terms of Duma operations, United Russia's majority will provide enough support for Putin as the likely next president and Medvedev as the likely next prime minister.

"It will allow us to work calmly and rhythmically," Putin said at a Presidium meeting Monday.

United Russia's faction will still be able on its own to confirm prime ministers, express votes of no confidence to the Cabinet, appoint and remove Central Bank chairpeople and pass any legislation — though it doesn't have enough seats to unilaterally change the Constitution.

"They still have a chance to pass through the parliament all the required reforms," Wermuth said. "United Russia can still rubber-stamp anything. It's positive in a sense because if they

are serious about reforms they can make a difference."

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