

Fears of isolation as investors flee Russia

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By CATRINA STEWART

MOSCOW (AP) — At the outset of this year, Russia proudly proclaimed itself an island of stability at the annual economic gathering in Davos, setting itself apart from the tumult of the global financial crisis.

Then came the war with Georgia, which some here regard as Russia's 9/11.

Within hours of Russia's retaliation to Georgia's move to take back its breakaway republic of South Ossetia, Russia had attracted widespread condemnation and threats of isolation and expulsion from the international community.

"For the first time since the Crimean War, Russia has no allies," said Garry Kasparov, chess grandmaster turned opposition politician. "We are encircled by countries that are either suspicious or alienated and very angry."

On the economic front, investors are hightailing out of Russia, while Western politicians have hinted at sanctions, visa restrictions and even the denial of Russia's right to host the 2014 Sochi Winter Olympics.

Increasingly cut off from the global world, Russian President Dmitry Medvedev risks undoing many of the successes of the past 10 years, ranging from the country's robust economic growth to a growing sense of national prestige and purpose.

Stock markets plunged, and more than \$7 billion was pulled out of the country in just three days, exposing the fragility of Russia's nine-year economic boom.

The economy was already under strain.

The five-day war followed months of bad news on Russia's corporate front, led by a high-profile shareholder tussle for control at TNK-BP, the Anglo-Russian joint venture.

In early summer, Bill Browder's Hermitage Capital blew the lid on a catalog of intimidation and corporate theft at the hands of Interior Ministry officials, and in July Prime Minister Vladimir Putin publicly attacked steelmaker Mechel, sending its shares into a tailspin. Inflation was running at nearly 15 percent.

But while the storm clouds gathered, investors clung on.

The war was the tipping point, said James Fenkner, managing partner at Red Star Asset Management.

French investment bank BNP Paribas has estimated that more than \$25 billion has been withdrawn from the country since the outbreak of the conflict, and Russian stock markets have plunged more than 30 percent since May.

It's a far cry from last December, when investors and analysts said 2008 was the year that Russia's stock markets would recover from the previous year's mediocre performance, even in light of the global turmoil.

Now investors are pulling their money out in droves.

"Very few investors have to be here now," said Fenkner. "Unless they are Russia-dedicated, they will move to friendlier environments. Sentiment is just very bad."

To many, Russia's fundamentals look very attractive.

"Russia is extremely cheap, and most of the growth dynamics are still in place," said Peter Halloran, whose hedge fund Pharos Fund has \$150 million under management in Russia. "If I look forward 12 months, I want to own Russia."

But as the uncertainty continues, Russia could be seen as a high-stakes geopolitical gamble.

"If there is a perception of Russia as a risky place or as an undesirable place to invest, then the damage will be more long term," said Chris Weafer, chief strategist at UralSib. "It will restrict the development of the economy and hurt the government's plans to create a more diversified the economy."

The war has played well at home. Russians have rallied to the government's decision to punish Georgia for what it calls aggression and recognize the independence of South Ossetia and another separatist-controlled region, Abkhazia.

Alexander Konovalov, president of Moscow's Institute of Strategic Assessment, said many in Western countries see a "big, strong, unmanageable Russia" attacking "a small, democratic, innocent Georgia."

"In Russia," he said, "it is big, aggressive, undemocratic and irresponsible Georgia who took small and innocent South Ossetia."

As Western politicians warn of sanctions and consequences, many ordinary Russians feel increasingly isolated — and blame the Western media for painting a distorted picture of the conflict.

Russians "are sad about the situation and I have had many e-mails from people asking why the media is reporting the situation only from one side," said Lioudmila Siegel, chairman of an organization for Russians in Sweden.

A minority of Russians, though, have denounced the government's decision to use military force in the conflict.

The Union of the Committee of Soldiers' Mothers, for instance, has railed against the use of conscripts in Georgia, despite promises by the Defense Ministry that it would not do so.

Boris Nemtsov, an opposition politician, has said the invasion was a blunder, and that ordinary Russians will pay for it.

"This is a strategic and long-term mistake, the effects of which will be felt by virtually all Russians," Nemtsov wrote. "This is the beginning of a new arms race."

It could, he predicted, also mean visa restrictions, expulsion from the G8 group of countries, discrimination against Russian business abroad and a reversal of the decision to give Russia the 2014 Winter Olympics.

But for the most part, liberal opposition to Russia's actions has been relatively subdued. "The liberals have been extremely quiet," said Konovalov. To stand up for "democratic values and cooperation with the West ... will be seen as a betrayal."

David Cameron, head of Britain's Conservative opposition party, called for the British government to suspend visas for some Russian nationals and even, possibly, suspend Russia's membership of the G8 club of rich nations.

Since the murder of Alexander Litvinenko on British soil nearly two years ago, relations between London and Moscow have deteriorated, and British tabloids were quick to pick up on anti-Russian sentiment.

On Thursday, the Daily Mirror tabloid newspaper condemned British foreign secretary David Miliband for allowing "hundreds of Russian oligarchs who prospered under Vladimir Putin" to use "Britain as a bolthole."

But while there is some popular bashing of Britain's very rich Russians — who the tabloids have long loathed because they benefit from Britain's relatively generous expat tax laws — the overwhelming political and business view of Russians in Britain is still positive.

But analysts warn that, even if Russians themselves are welcomed abroad, it may become more difficult for Russian big business to expand there — especially in sensitive areas such as defense and energy.

In a fit of pique two years ago, then-President Putin canceled foreign participation in the Shtokman gas project after European objections to a move by VTB, a major Russian bank, to acquire a minority stake in Europe's EADS aerospace and defense group.

"This Russia phobia is nothing new," said Fenkner. "But it's going to turn up a couple of notches. It's not a trend reversal."

Associated Press writers Emily Flynn Vencat in London and Malin Rising in Stockholm contributed to this story.
