

# Moscow Financial Weekly

For the week ending March 28 and April 4, 2003  
Treasury Attache's office, U.S. Embassy Moscow

## Highlights

- Strong macro indicators for 1Q03 inspire new projections of 2003 GDP growth
- Central Bank moves to implement prudential requirements on lending concentration, bank capital

## Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R31.3811	-0.00	-1.27
Monetary Base*	R930.4 bln	-0.95%	-1.05**
CPI	NA	NA	5.2
International Reserves*	\$55.4 bln	1.65	16.14
RTS Index (end of week)	362.16	-1.14	0.86%
Refinancing rate	18	0	-3

\*For week prior

\*\* % chg from the abnormally high seasonal level at the end of the year.

## Economic Developments

According to the Ministry of Economy, the **trade surplus** was \$9.4 billion during the first 2 months of the year. Exports increased by 43.2% y-o-y and totaled \$18.9, while imports were up by 23.4%. The heavy volume of exports is still explained by the increased world prices for natural resources. Imports' growth is stimulated by the increased real incomes of the population as well as ruble appreciation.

According to Goskomstat, **GDP** was 6.1% y-o-y during the first 2 months of the year. Industrial production was 5.7%, due to high world oil prices which stimulate investments into the extraction industries (oil/gas, non-ferrous metals, etc.) and machinery. Growth in the manufacturing sector is substantiated by an increase in the Moscow Narodny's PMI index in March of 51.3 percent compared to 50.3% in February, indicative of a growing recovery, despite high ruble appreciation during that time. This is the highest level of index during the last 5 months. Manufacturers report rapidly growing domestic and export demand. Given strong macro indicators for the first part of the year and a longer than expected Iraq conflict, many analysts and the Russian government have been revising GDP estimates -- the GOR expects growth of at least 4.4% for the year. However, if oil prices are higher than \$25/brl on average for the year, this figure could be even higher. The IMF, however, has taken a more conservative approach. Their

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assessment is that oil price growth is a short-term, volatile factor and that the long term factors for sustainable growth, such as reforms in public administration, natural monopolies, banking sector, and WTO accession are slowing. Combined with lower global growth trends, these factors will conspire to slow Russian GDP growth. The IMF is planning to decrease the 2003 GDP projections for Russia, currently at 4.9%, to approximately 4%.

According to a company spokesperson, Standard&Poors would consider increasing **Russia's sovereign rating** (which is now at "BB") in the near term only if the pace of structural and institutional reforms were intensified. Currently, Russian macroeconomic indicators are on the same level (and in some instances even higher) than that of the countries with the investment rating; however, experts expect a re-rating no earlier than March 2004 after Russian presidential elections.

### **Banking sector**

On April 1 CBR's Regulation 215-P, designed to combat **inflation of bank capital**, entered into force. (No joke!) According to this document, "improper assets" - when bank's own funds via a chain of mediators return to the bank in the form of contribution to its capital - must be excluded when calculating bank capital. The procedure for investigation of suspected violators is also clarified. If CBR inspectors discover a possible violation, they will report this fact to respective main territorial branch of the CBR for review. If it agrees, the CBR branch will forward the information on the case to the CBR's Bank Supervision Committee. Once the Committee rules that the capital is inflated, it will instruct the territorial branch to apply sanctions, in particular, it will require that the bank publish the number for capital as calculated by the CBR. Alexey Simanovsky, CBR Department of Bank Regulation and Supervision head, said that the first banks with inflated capital will be named as early as May 2003. He said that the CBR would review the history of each banks' capital, even when banks changed owners. Up to a quarter of Russian banks' combined capital is probably inflated, experts estimate.

The Ministry of Economic Development and Trade has finished drafting its version of the bill on **credit bureaus** and forwarded the draft to interested agencies for review. According to the proposal, banks must send information to the credit bureau in cases when the loan amount exceeds R50 thousand for commercial entities and R5 thousand for individuals. Creditors must be notified in writing about the proposed loan before the loan agreement is signed. Each credit history will consist of an open (title) part and a confidential part. The former will contain basic information identifying the borrower, while the latter will contain full information on the current loan. For individuals the residence address (both as registered in passport and actual) will remain confidential. The credit bureau will have information on all persons with the right to sign legally binding documents on behalf of corporate borrowers, and any natural or legal person having more than 5% equity in the borrower. Information on bankruptcy proceedings and court rulings with respect to the borrower will also be gathered. A creditor may use the services of one or several credit bureaus. The confidential part of credit history may be disclosed only provided the borrower agrees. Any person may review his own credit

history once a year for gratis, and any number of times after that for a fee. Borrowers may challenge the information he or she believes is incorrect. The charter capital of a credit bureau may not be less than R50 million. Founders of a credit bureau are not allowed to leave the company for 3 years after registration. The entity to regulate credit bureaus must be determined by GOR. The bill will come into effect 6 months after it is officially published. MEDT's bill will compete in the Duma with the one drafted by Chairman of the Banking Committee Valery Zubov, Deputy Chairman Pavel Medvedev and Anatoly Aksakov. That draft is called "On the Federal Bureau of Credit Histories of the Russian Federation" and provides for creation of a single credit bureau affiliated with the CBR.

On March 17 Gazprom repaid **Vneshtorgbank** (VTB) part of the credit extended in December 2001 ahead of schedule, Vassily Titov, VTB Vice President told *Izvestia*. This payment, amounting to \$310 million, brought VTB into compliance with CBR norm 'N6' (exposure to a single borrower must not exceed 25% of bank capital). The remaining \$360 million should be repaid in January 2004. The former CBR management allowed exceptions from its own rules when its daughter banks made loans to "preferred" borrowers such as Gazprom and RAO UES. The new team has publicly stated that it intends to apply prudential requirements uniformly to all banks, and is now backing up words with action.

**Sberbank** President Andrey Kazmin also said recently that Sberbank no longer violates any CBR requirements, but did not provide any details. Meanwhile, in October 2002 Sberbank's 'N6' stood at 42.8% (this is the most recent data publicly available). Interestingly, on March 27, 2003, the state-owned oil pipeline company Transneft announced that it would draw a \$1-billion loan from Sberbank. Again, details were not disclosed. It is not clear how Sberbank will manage to meet the 'N6' requirement in this case.

On March 31 **Avtobank's** shareholders decided to change the name of the bank to Avtobank-NIKoil and increase its authorized capital from R1.377 billion to R5.377 billion. NIKoil Consulting, a 100% daughter of NIKoil financial corporation, will purchase all 40 million new ordinary shares. The new name of the bank reflects the integration of Avtobank and NIKoil, leading to the creation of the first Russian "financial supermarket," NIKoil said in a press release. Avtobank used to be among Russia's top 25 just a couple years ago, but lost its market position during a prolonged controversy over its ownership and a series of court hearings, lost by the bank's founder Andrey Andreyev. Andreyev, whose share in the bank shrank from 75% to 15% as a result of the previous additional share issue, claims that the only purpose of the new one is to further dilute his stake. He plans to contest the newest share issue in court as well.

**Bank UralSib** has signed a \$32-million syndicated loan facility from a consortium of 12 banks from 9 different countries. The 12-month loan with an option to extend for another year is co-arranged by Standard Bank London Ltd. and Moscow Narodny Bank and is given at LIBOR+3.5%. Ufa-based UralSib has the second largest and the fastest growing branch network in Russia, covering not just its native Bashkortostan, but Moscow, St.Petersburg, Urals, Siberia, and North-West of Russia as well. The bank is increasing

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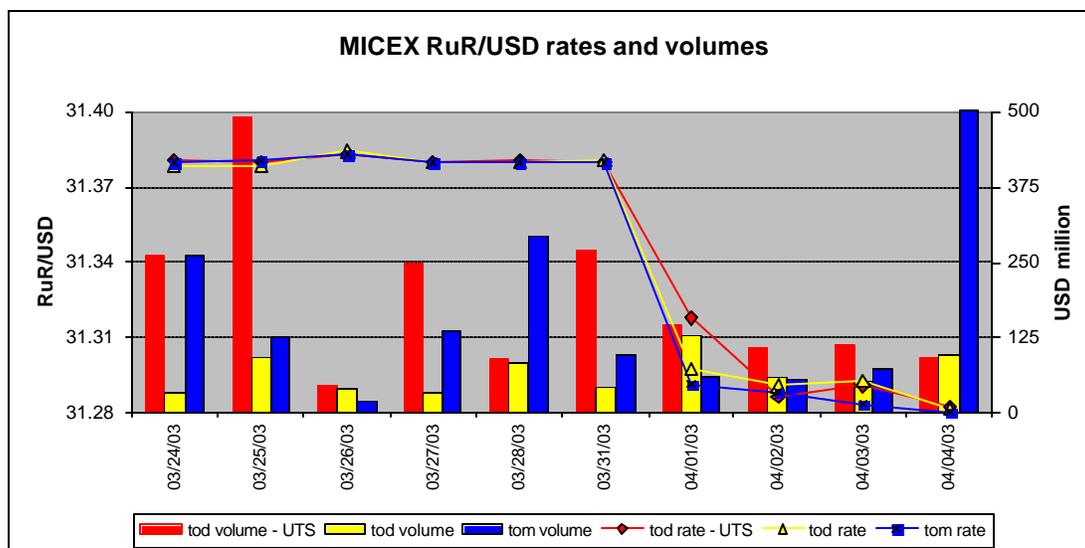
its authorized capital to R7.6 billion through an additional share issue worth R1.9 billion. As a result, the Bashkortostan government, currently owning 50% +1 share, may lose its controlling stake in UralSib. The bank plans to sell 5-15% to foreign investors, and reportedly entered into negotiations with EBRD and Cargill. Also, UralSib recently acquired a 19.9-% stake in the Metropol investment company with an aim to diversify its business and, in particular, to expand into asset management.

### Financial markets

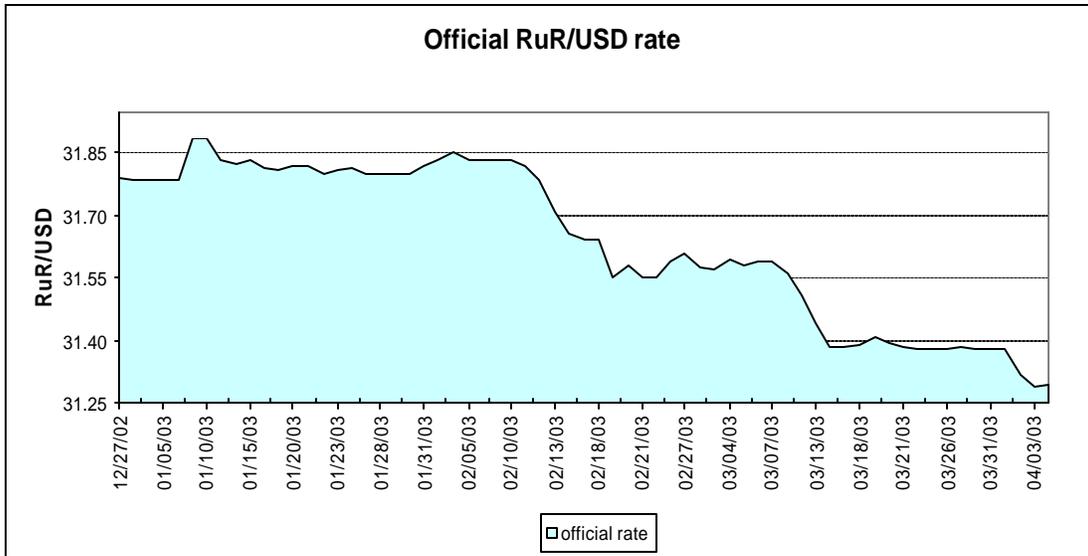
#### Forex Market

Since March 24 through the end of month the CBR bought dollars at the same level, R31.38/\$. Interventions were considerable most of time, but the next day after the peak on March 25, when in UTS only turnover approached \$493 billion, demand for dollars fell sharply. On the morning of April 1 the CBR unexpectedly abandoned the market letting the dollar down, and resumed buying only by close of business at R31.28/\$.

For the week of March 24 the dollar practically retained its value against the ruble, closing in the UTS on Friday, March 28 at R31.3805/\$. MICEX weekly trade volumes went up to \$1137.07 million, \$284.12 million and \$832.93 million for the morning (UTS), afternoon "tod" and "tom" sessions, respectively.

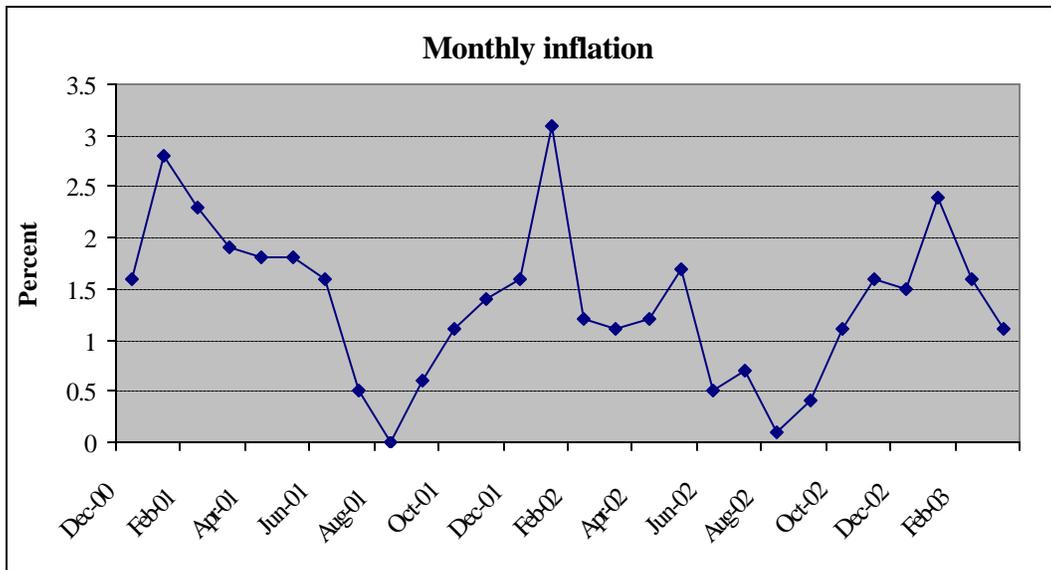


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Prices

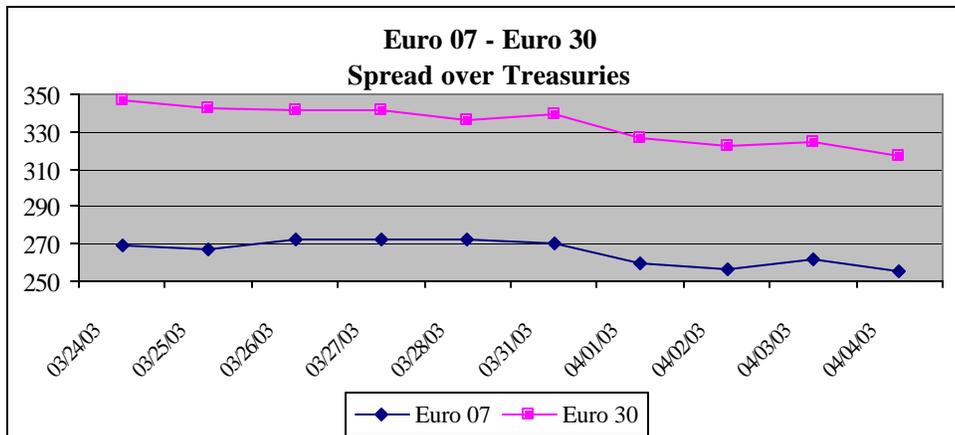
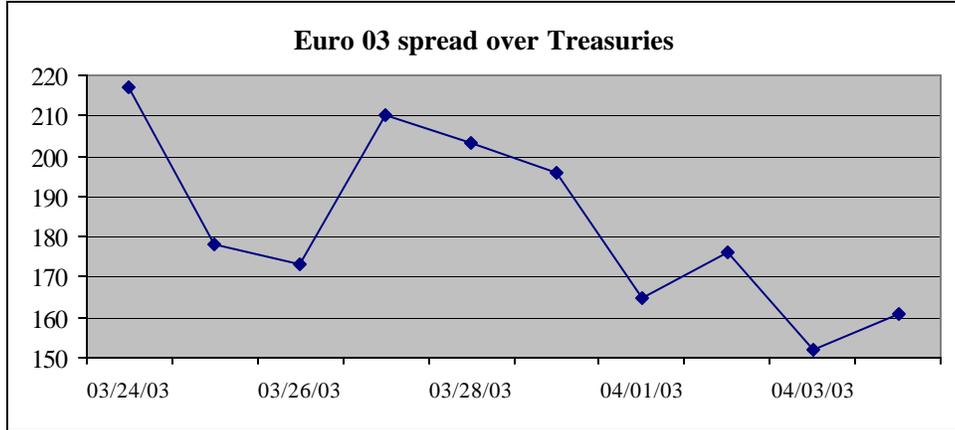
According to the Goskomstat, the inflation rate was 1.1 percent during March 2003 (the government and CBR projected 0.9% growth). As a result, the price growth was 5.2% during the first quarter of the year. The foodstuffs prices rose 1%, while non-foodstuff prices grew 0.8% for the month. Again, services prices were the main driving factor and were up 1.7% last month.



Eurobonds

After falling the week before, Russian Eurobond prices stabilized during the first week observed. The main factor driving the market was the uncertain situation around the Iraq.

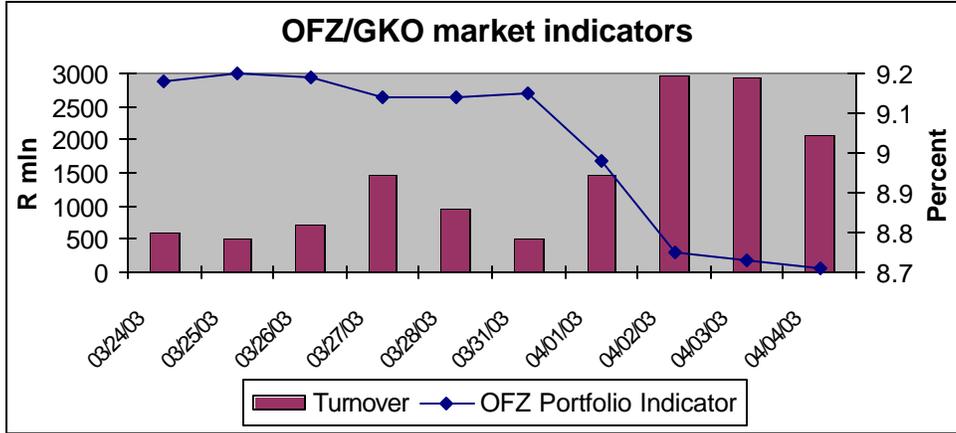
Market players preferred to stay on sidelines and as a result, the trade volumes were down. Last week the prices started growing again, with most demand concentrated in the longer-term sector of the market.



Interest/Bond Market

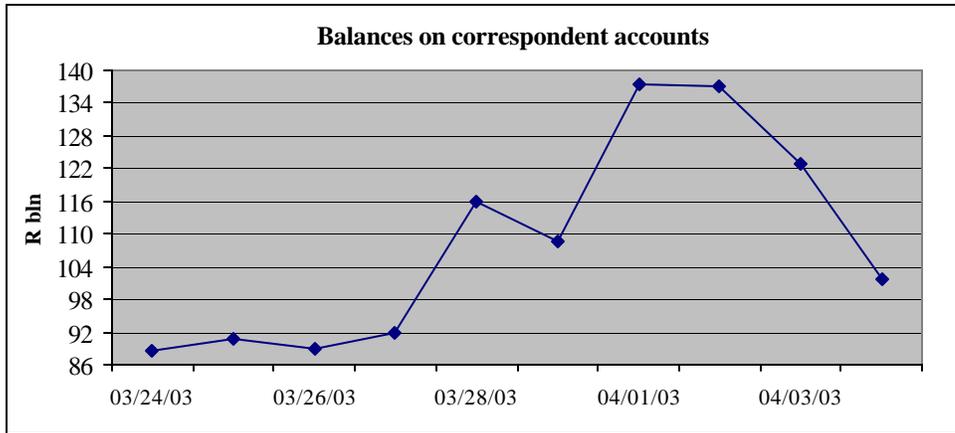
*Bonds/Bills*

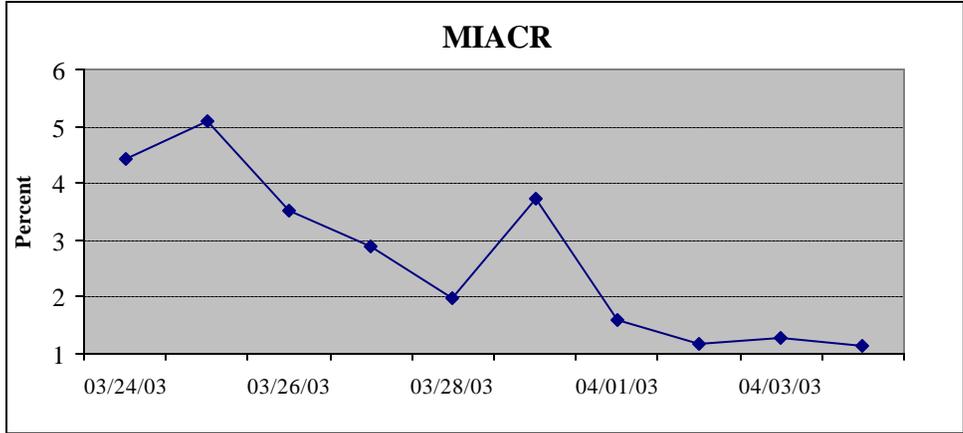
The secondary OFZ/GKO market was stable during the first week observed with yields going slightly up due to the end-of-the-quarter factor. The trade activity was relatively low. Last week, the yields dropped while trade volumes increased substantially, ostensibly as a result of the substantial ruble liquidity. The medium-term issues were the most popular last week - for the first time after the prolonged period of the ignorance from the side of the market players.



*Overnight rates*

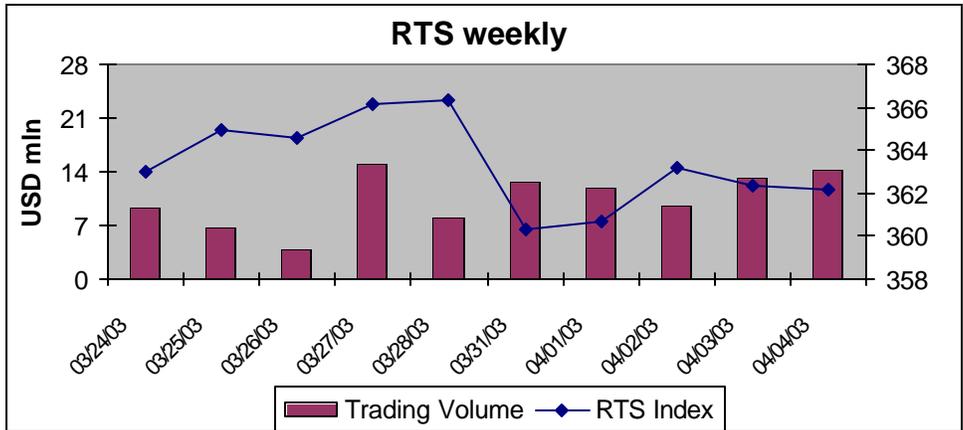
The balances on banks' correspondent accounts remained on somewhat average levels during the first week observed, despite the increased overnight rates. Last week, the balances increased substantially, reaching maximum of R137.5 billion on Tuesday. This is the highest level since the beginning of the year. The balances decreased through the rest of the week but still remained on substantially higher than average levels. The increased liquidity is explained by the end of the quarter factor.

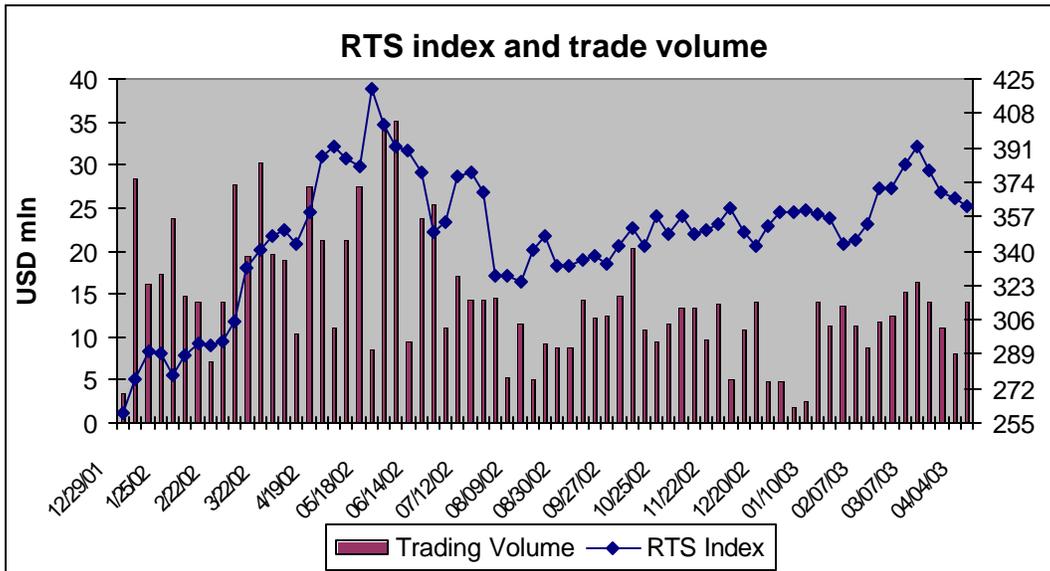
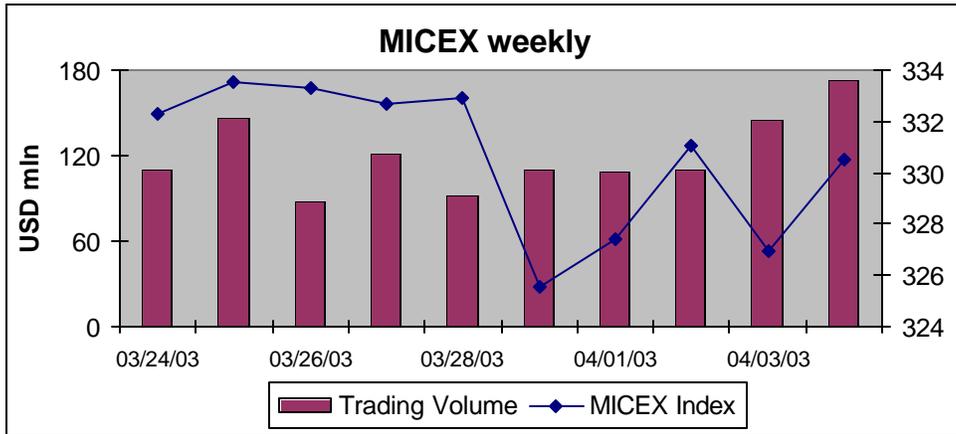




Stock Market

The stock market has been fluctuating in a narrow range during the two weeks observed. During the week ending March 28, the trade activity lowered and the market was overshadowed by external events: no clear trend was observed and the hopes of a quick end to hostilities were not realized while world oil prices continued to soar. The RTS index was down by 0.61% that week. Last week, the market consolidated in the narrow range of 360-362 on lower than average trade volumes. The end of the quarter has influenced some players to sell and realize their profits, while the depressed world market was another factor forcing the prices down. The prices of many shares are now very close to the support levels. The RTS index was down by 1.14% for the week with the major loss being on Monday - down 1.64% for the day.



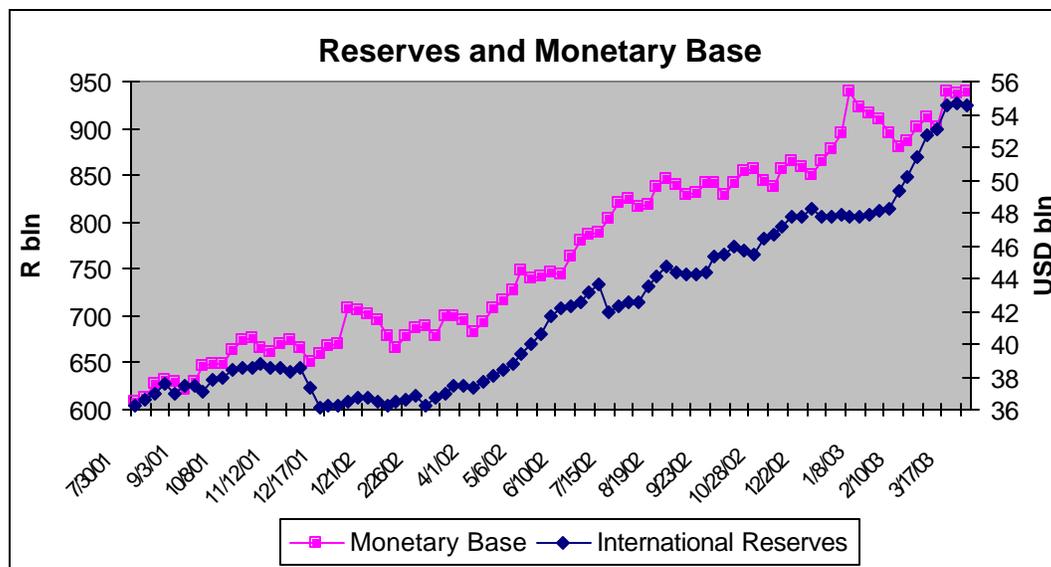


International Reserves and Monetary Base

The CBR's international reserves were down by \$200 million as of March 21 and totaled \$54.5 billion. This was the first decrease in the reserves this year. The decrease is attributed to payment of external debt. However, the following week exhibited a return to the upward trend, with the reserves rising to a new historic high of \$55.4 billion - \$900 million higher than a week before. The CBR First Deputy Chairman has Oleg V'yugin has increased the forecast for the reserves to \$62 billion this year. (Only three weeks ago, the CBR projected reserves to be \$60 billion by the end of the year!)

The monetary base increased up to R939.3 billion as of March 24. This was the closest to the historic high level number since the beginning of the year, reflecting the struggle that

the CBR has in trying to sterilize the dollar inflows and prevent a rapid appreciation of the ruble. Next week, base money was down to R930.4 billion, which is 0.95% lower than a week before. It totaled R936.7 billion - R2.2 billion lower than a week before.



## EXPLANATORY NOTES

**1. EXCHANGE RATES:** SELT - "System of Electronic Lot (currency) trading" -- a computer based OTC-style trading system organized by the Moscow Interbank Currency Exchange (MICEX). MICEX Unified Trading Session (UTS) is the one in which exporters have to sell 50% of the repatriated currency. UTS fix (rounded) becomes the "official" ruble rate for the next day. "\$-tod" price is the price of the dollar with same day delivery. "\$-tom" is the price of the dollar with delivery on the next day. Minimum lot size for each of the dollar instruments is \$100,000. Average price is quoted as the weighted average of all actual deals entered into the system by various banks.

**2. INTEREST RATES:** Moscow InterBank Actual Credit Rate is calculated as the average-weighted rate on the volume of actual transactions in interbank loans by commercial banks.

**3. STOCK INDICES:** The RTS index is the only official indicator of the Russian Trading System. It is calculated every 30 minutes of the RTS trade session, starting at 12:00. It comprises 60 shares of 35 leading companies. These shares are included in so-called Category "A" listings. The index indicates over-the-counter stock prices. The index represents the ratio of the total market capitalization of the shares of the companies selected for the index to the total market capitalization of the same shares as of the initial date multiplied by the index value as of the initial date (31 December 1997) using a base of 100 beginning September 1, 1995. The ruble-adjusted index is a derivative of the main dollar index, using the same base. The MICEX index is calculated by the stock

section of the Moscow Interbank Currency Exchange and is based on the price fluctuations of 17 shares of the MICEX's first and second listings.

**4. INTERNATIONAL RESERVES OF THE RUSSIAN FEDERATION** represent the amount of reserve assets of the Bank of Russia and Finance Ministry. Those reserve assets are comprised of monetary gold, special drawing rights, the reserve position in the IMF and other liquid foreign assets. The latter include short-term deposits in non-resident and resident banks, balances in current accounts, foreign government securities, repo agreements with these securities made with non-residents, and other liquid assets (accrued interest on these assets is not included). Monetary gold is evaluated at a floating rate, revised periodically, but not always reported immediately. Foreign currency assets are converted into U.S. dollars on the basis of the cross rates of foreign currencies to the dollar, calculated using the official rates of the ruble to these foreign currencies, as set by the CBR.

**5. MONETARY BASE (M1)** is comprised of cash and reserves of commercial banks on deposit in the CBR. It is the basic part of the money supply (M2).

**6. LOMBARD CREDITS**, distributed through auctions, are aimed to provide liquidity to the banking sector. These credits are extended to banks on the basis of collateral.