

Moscow Financial Weekly

For the weeks ending August 15 and 22, 2003
Treasury Attache's office, U.S. Embassy Moscow

Highlights

- CBR rejects German request for bank branching
- CBR steps up inspections on quality of bank capital

Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R30.3989	0.33	-4.36
Monetary Base*	R1198.2 bln	1.15	27.43**
CPI	NA		8.7
International Reserves*	\$64.7 bln	0.16	35.64
RTS Index (end of week)	524.28.08	2.63	46.01
Refinancing rate	16	0	-23.8

*For week prior

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

Economic Developments

Prime Minister Mikhail Kasyanov has signed the government's **2004 privatization** program and forwarded it to the State Duma for consideration. The program proposes a privatization volume of R35 billion, with the major item being the sale of 6% of LUKoil. Also proposed are the sales of 7.2% of Tsentrtelcom and 4.367% of Uralsvyazinform - both interregional telecom companies. Shares of the Novorossiisk, Vladivostok and St-Petersburg ports would be sold as well.

The inflow of **foreign investment** has increased 1.5-fold in the first half of 2003 compared to the same period of 2002, totaling \$12.7 billion. As in previous years, the bulk of the investments -- 71% this time -- were made by the following countries: Germany, the United States, the UK, France, the Netherlands and Cyprus. At the same time, Russian investments abroad totaled \$9.7 billion for the same period, which is 3% lower y-o-y. It remains to be seen whether the Yukos investigations have had any impact on foreign investment during the second half of the year.

Goskomstat confirmed that **production growth** was 7.1% during July y-o-y. The Ministry of Economic Development and Trade annual forecast for this year is 5.8% and

for 4.7% for 2004. During the first seven months of the year production of 12 industries showed growth:

Industry	Jan-July 2003	Jan-July 2002
Electricity	5.1	-1.8
Fuel	9.9	5.8
Ferrous metals	9.4	0.9
Non-ferrous metals	6.5	10.2
Chemical	4.7	2.6
Machinery	7.5	3.2
Forest	2.7	2.5
Construction materials	5.7	4.9
Glass	7.1	5.5
Light	-1	8.5
Food processing	4.6	8.5
Medical	9.9	-11.7

The breakdown shows that the growth is strongest in the extractive industries, with fuel and ferrous metals as the leaders. High natural resource prices stimulated increased capital investment, which in turn helped the machinery industry to expand production. Also noteworthy is the higher growth in the production of construction materials, which was also stimulated by increased capital investments. However, some other industries oriented towards domestic demand were not doing as well: for instance, light industry lost 1% during the first seven months of the year.

Banking sector

The Financial Monitoring Committee (FMC) has conveyed to the CBR the list of banks that do not provide it with required information with respect to **money laundering or terrorism finance**. According to FMC head Viktor Zubkov, originally there were more than a hundred banks on the list. However, it has been getting shorter since the CBR started inspections at these banks. The FMC has no authority to inspect the banks for compliance, and has to rely on the CBR in this matter, Zubkov noted. However, if the CBR fails to act, the issue can be referred to "other organs, for example, the General Procuracy." Zubkov hopes that in fall the CBR will launch massive inspections of commercial banks.

According to Alexey Simanovsky, **CBR Bank Regulation and Supervision** Department Director, the CBR has finished reviewing about 180 commercial banks, or 15% of the total number of operational credit institutions, looking specifically into the correctness of capital calculation. They found indications of inflated capital in about 60 banks, or about one third of them. However, Simanovsky stressed that the banks were not picked randomly; the CBR went only to those ones that were already suspected of inflating capital.

On August 21 the GOR approved the main objectives of **monetary policy** for 2004. According to the document, inflation in 2004 should fall to 8-10%, real effective appreciation of the ruble should not exceed 7%, and the monetary base should grow by 18-25%. The document considers two macroeconomic scenarios: the first is based on an average price of Urals of \$22 per barrel, the second – at \$18.50 per barrel. In the first of these, foreign reserves would increase by \$10 billion and in the second – by \$2 billion. On August 25 the document was also approved by the CBR Board of Directors.

In a letter signed by CBR First Deputy Oleg Vyugin, the CBR turned down the request by Bundesverband Deutscher Banken and the Financial Leaders Group to allow **foreign bank branches** to open in Russia. The CBR is not even considering it as an option and will continue to insist on having only subsidiaries of foreign banks in the country, Vyugin commented. “Since there is no investment into bank capital, branches can be shut down in case of any shock to the domestic market,” he explained. Meanwhile, Aleksandr Khandruev, VP of the Association of Regional Banks and formerly CBR Deputy Chairman, said that no law or regulation prohibits the opening of branches, and urged the CBR to properly legalize its position on this issue.

CBR First Deputy Chairman Oleg Vyugin said that effective January 1, 2004 the CBR planned to impose **currency controls on derivatives** transactions, but refused to provide further details.

Financial markets

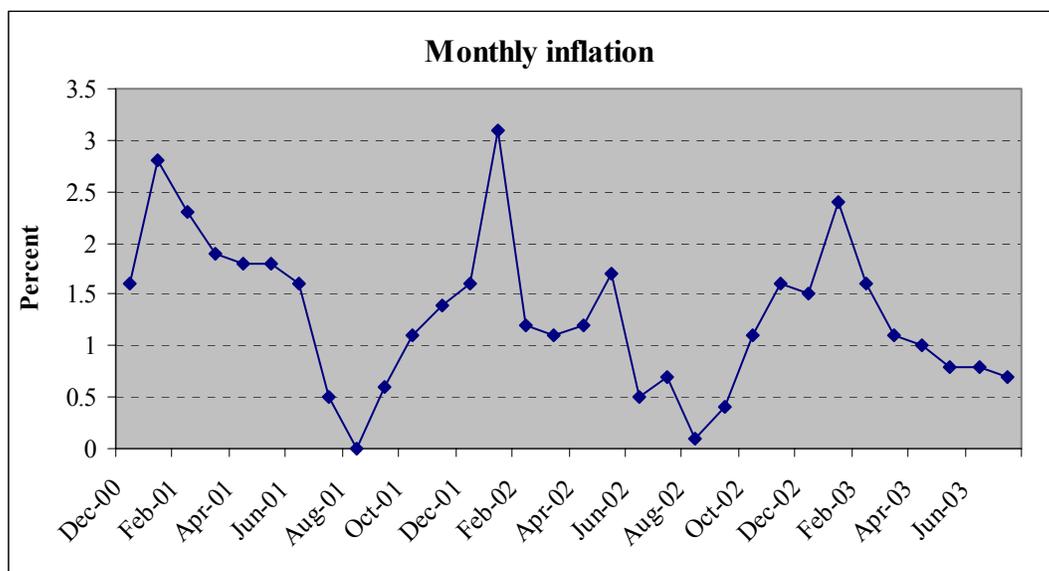
Forex Market

The ruble/USD market remained quietly stable during the two-week period. The CBR's presence in trading was not noticed at all. An increase in demand for rubles caused a moderate weakening of the dollar against the ruble towards the end of the week of August 18.

For the week of August 11 the ruble firmed against the dollar 0.16%, closing in the UTS on Friday at R31.3516/\$. MICEX weekly trade volumes were \$445.07 million and \$352.58 million, \$598.82 million and \$414.21 million for the UTS "tod" and "tom" sessions, and SELT "tod" and "tom" sessions, respectively. For the week of August 18 the ruble firmed against the dollar 0.13%, closing in the UTS on Friday at R31.3116/\$. MICEX weekly trade volumes were \$588.17 million and \$251.65 million, \$628.91 million and \$357.06 million for the UTS "tod" and "tom" sessions, and SELT "tod" and "tom" sessions, respectively.

Prices

(No new data.)



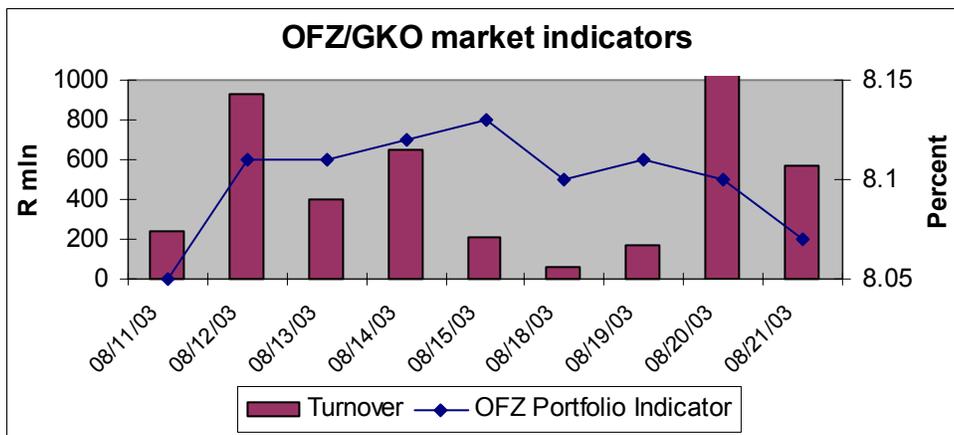
Eurobonds

The Russian Eurobonds market fell during the week of August 11. The situation is still heavily influenced by the fluctuations in U.S. Treasury bond prices. During that week, Treasury yields continued to increase after a slight decline in the beginning of August; Russian Euros followed the pattern. The yield of the most liquid Euro-30 increased to 7.9% during the week. During the week of August 18, however, the Russian market was quite resistant to external pressures and was able to recover from the previous week's decline, with the Euro-30 yield going up to 7.7% p.a. Accordingly, that week saw a wave of interest in the market.

Interest/Bond Market

Bonds/Bills

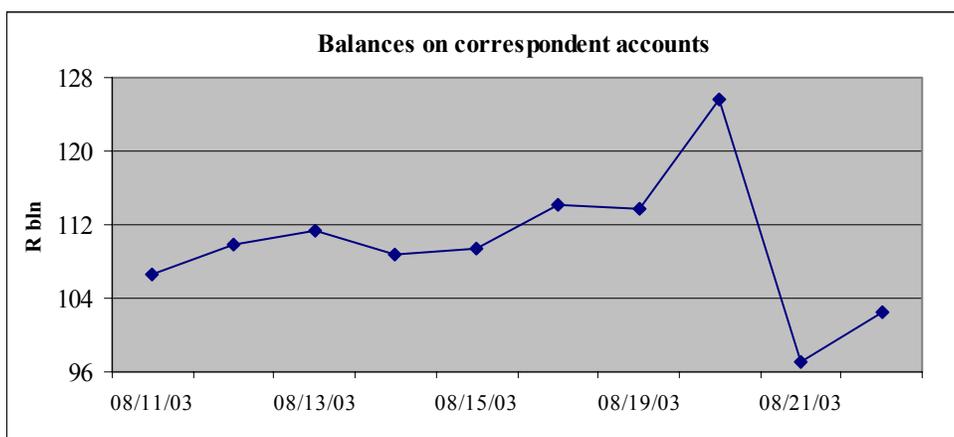
Negative dynamics prevailed on the secondary OFZ/GKO market during the week ending August 15. Although at the beginning of the week, the large players were supporting government paper, later they left the market and it began to slide. The downward pressure came from uncertainty over the Russian Eurobonds market and the local currency market. The week of August 18, the market was slightly up following the positive trend on the Eurobonds market. On Wednesday, money from coupon payments entered the market, increasing trading substantially and provoking a slide in the yields. Otherwise, trade volumes remained at low levels as a result of the traditional slowed activity in August.

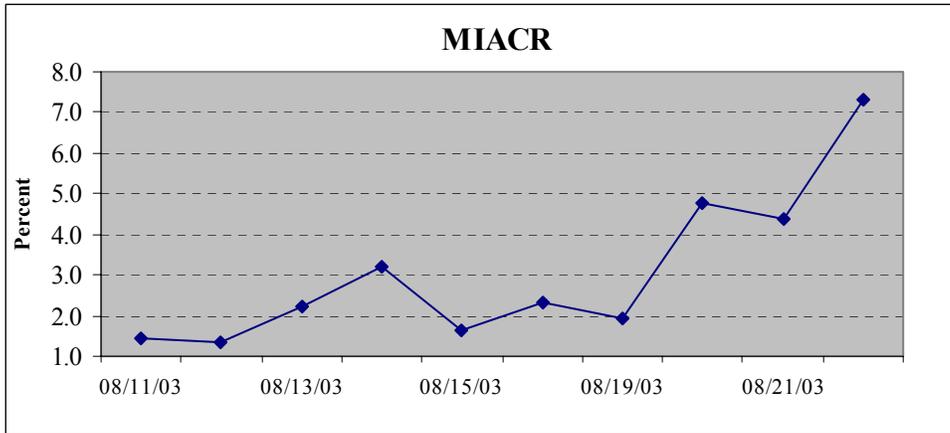


Overnight rates

Ruble liquidity remained at slightly higher than moderate levels throughout the two-week period. Balances on banks' correspondent accounts at the CBR remained at high levels before declining during the last two days of the month as a result of obligatory tax payments.

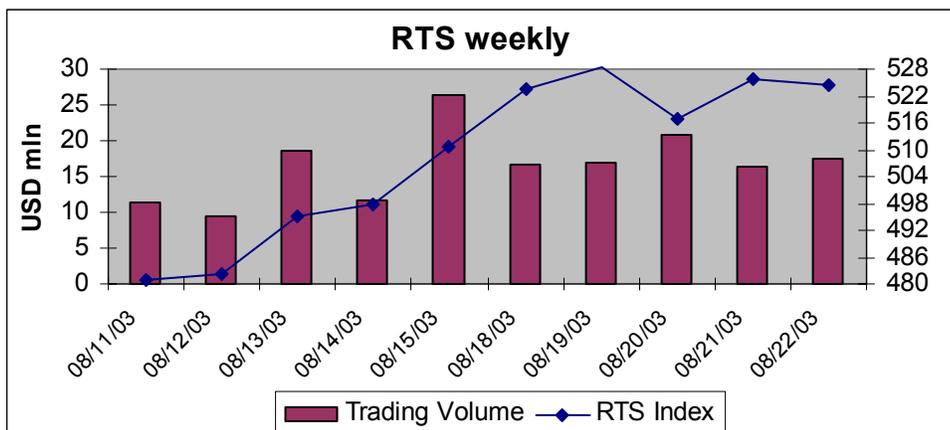
The interbank short-term ruble loan rates increased to 8-10% p.a. at the end of last week, in response to a decreased quantity of rubles in the banking system.



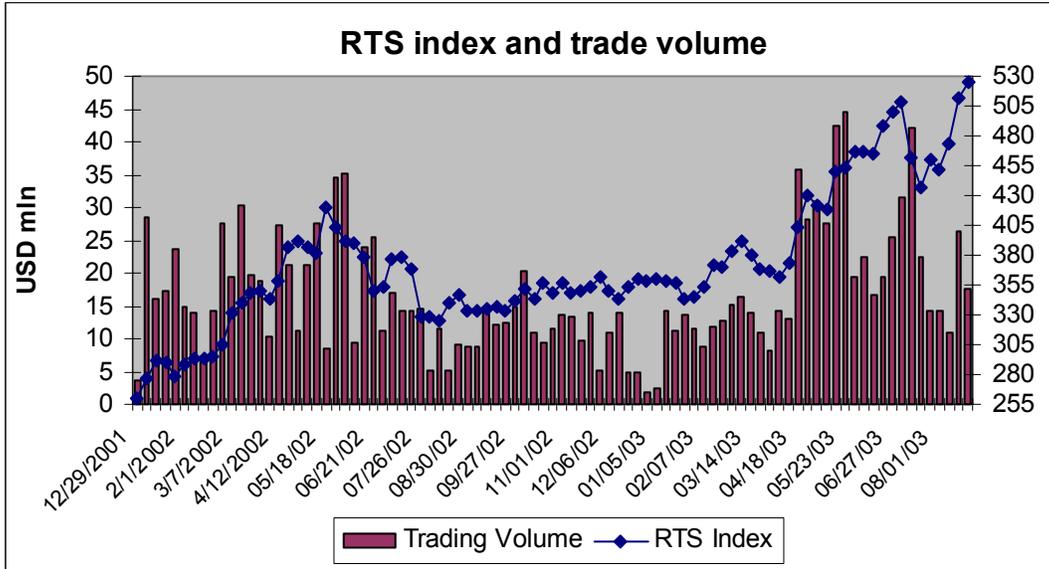
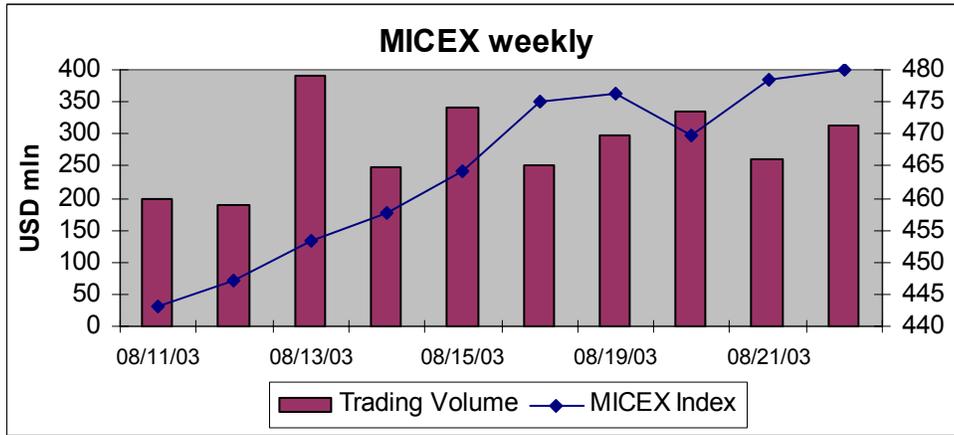


Stock Market

The Russian stock market has been gaining for the past three weeks in a row. During the first week observed, the RTS index climbed by 7.98% on increased trade volumes. Last week, the index was up again, but by a more modest number - 2.63%, also on higher volumes. Oil shares were holding the market back, especially YUKOS and Surgutneftegaz (both common and preferred shares). Gazprom and Rostelecom began to grow as well after the consolidation. Second-tier shares were in demand as well, especially securities of the regional telecoms and metallurgical companies. The RTS index is up by 46% since the beginning of the year, with last week's results bringing it back to the levels seen in October of 1997.



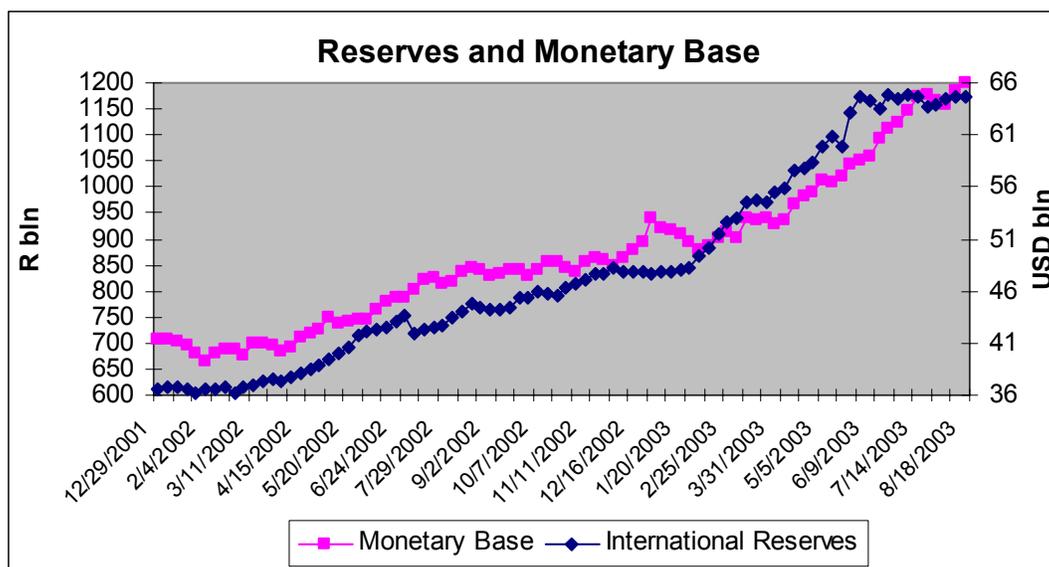
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International Reserves and Monetary Base

Reserves grew by a total of \$300 million from July 31 to August 14, totaling \$64.7 billion, just \$200 million lower than the maximum level ever reached. (Reserves may dip later this month, with a \$2.1 billion payment to the Paris Club on August 20.) First Deputy Chairman of the CBR Oleg Vyugin does not foresee a high growth pace of reserves during the second half of the year. He estimates reserves of approximately \$67 billion by the end of the year. During the second half of the year, capital outflow traditionally increases.

After a two-week decrease, the monetary base resumed its growth. As of August 11, it was R1184.6 billion, increasing by R24.9 billion. It grew again the following week, but at a lower pace, and was up to R1198.2 billion as of August 18.



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 "tom" weighted average as of 11:30 becomes the "official" exchange 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.