

Moscow Financial Weekly

For the week ending December 26, 2003
Treasury Attache's office, U.S. Embassy Moscow

Highlights

- 2004 Budget, Deposit Insurance Bill signed into law
- 2003 growth at 7%, inflation at 12%

Key Economic Indicators

Indicators	Level	chg 1 week	chg since Jan. 1	chg 12 months
RUB/USD (MICEX) UTS (changes in %)	RUB 29.2505	-0.05	7.92	8.63
RUB/EUR (changes in %)	RUB 36.4305	-0.37	-9.49	-11.06
Monetary Base* (changes in %)	RUB 1317.8 bln	2.27	40.15	50.06
CPI	NA	NA	11.8	NA
International Reserves* (billions)	USD 74.5	USD 2.7	USD 26.8	26.7
RTS Index (changes in %)	567.40	-0.39	58.02	61.54
Urals Crude (changes in %)	USD 28.0	-4.83	-7.62	-2.20
JPMorgan EMBI+ RUS spread (changes in bp)	263	0	-215	-202
CBR Time Deposits Two-week term (changes in bp)	1.5%	0	-560	

*For one week prior

Economic Developments

On December 23, President Putin signed the **2004 Federal Budget** into law. The budget is based on the following assumptions: average price of Urals will not go below USD 22 per barrel, average exchange rate will be RUB 31.3/USD, inflation (consumer prices growth between December 2003 and December 2004) will not exceed 10%. GDP forecast is RUB 15300 billion. Expenditures will total RUB 2659.447 billion, revenues – RUB 2742.8504 billion, and the difference (which would have been called “budget surplus” in previous years) in the amount of RUB 83.4034 billion will be transferred into the Stabilization

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Fund, as stipulated by the new budgetary legislation. The main expenditure items are: Defense – RUB 411.47 billion (2.69% of GDP), Law Enforcement and State Security – RUB 310.58 billion (2.03%), Debt Service – RUB 287.57 billion (1.88%), Social Policy – RUB 161.19 billion (1.05%), Education – RUB 117.79 billion (0.77%) and Financial Aid to Sub-federal Budgets – RUB 813.97 billion (5.32%).

Prime Minister Mikhail Kasyanov has announced that **economic growth in 2003** will total 7%. In 2000, the highest-recorded year of GDP growth, the figure was higher, at 9%, but inflation was 20% for that year. (GDP growth and inflation were 4.3% and 15.1% (respectively) in 2002, and 5.0% and 18.6% in 2001.) This year the target annual inflation rate of 12% seems to be realistic: price growth through December 22 was 11.8%. At the same time, Goskomstat reported that the GDP increased by 6.7% during the first nine months of the year, totaling RUB 9.72 trillion.

Banking sector

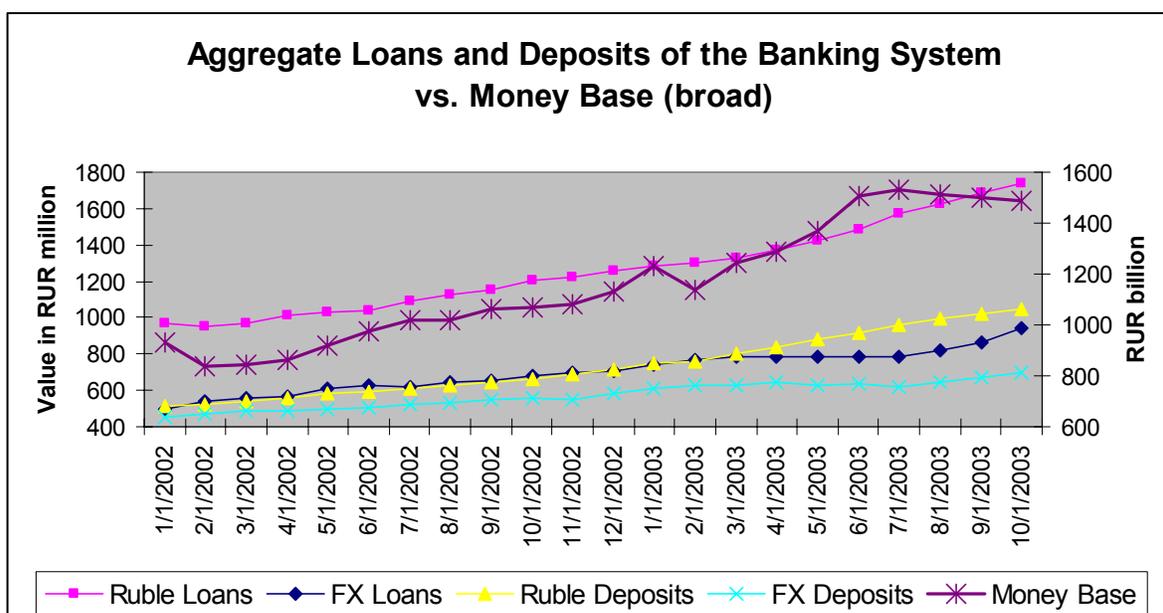
On December 23 the **Deposit Insurance Law** was signed by President Putin and thus came into force. (See Financial Weekly for the week ending December 12.)

In 2003, the CBR completed 1,470 **inspections of commercial banks**, looking specifically at compliance with anti-money laundering (AML) legislation, according to CBR Deputy Chairman Viktor Melnikov. It discovered 317 violations in passing information to the Financial Monitoring Committee, 152 defects in internal control systems, 75 violations in client identification and 29 infractions of rules for storing information. Most big banks fully comply with the AML law, Melnikov said, but the CBR is worried about smaller, poorly capitalized banks that implement schemes that, while not formally illegal, "smell bad." The CBR issued 362 injunctions to eliminate violations, charged 57 banks with penalties and imposed restrictions to perform certain operations on six more banks. Meanwhile, the Association of Regional Banks has set up an expert group that will, in cooperation with the CBR and other interested agencies, develop a national AML strategy.

Despite the problems that **Moscow Narodny Bank** (MNB), a CBR subsidiary, is facing (see previous weekly), on December 24 it announced the completion of the merger of its Russian daughter, Mosnarbank, with Eurofinance bank. MNB claims that it retains a 19.9% stake in the newly created entity called Eurofinance-Mosnarbank. According to the CBR, MNB, 88.89% of which belongs to the CBR, owned 99.9% of Mosnarbank. The owners of Eurofinance were VEB (19.98%), Federal Corporation Roskontrakt (19.94%), VTB (19.07%), Troika Dialog Investment Company (9.98%), another CBR foreign subsidiary, BCEN-Eurobank (9.95%), ZAO Vtorchermet (8.9%) and ZAO Slavneft-Megion. Meanwhile, MNB released a press statement "regarding recent speculation" with the following quote from its Director and COO : "we have no debt in our books that is due to the Government/ Government Ministries/ Vnesheconombank or Vneshtorgbank."

A comparison of banking system **assets vs. loans** at several points in 2003 reveals that loans make up only about a third of the assets of Russian banks. As reported last week, on January 1, total assets were RUB 4,145 billion and total loans were approximately RUB

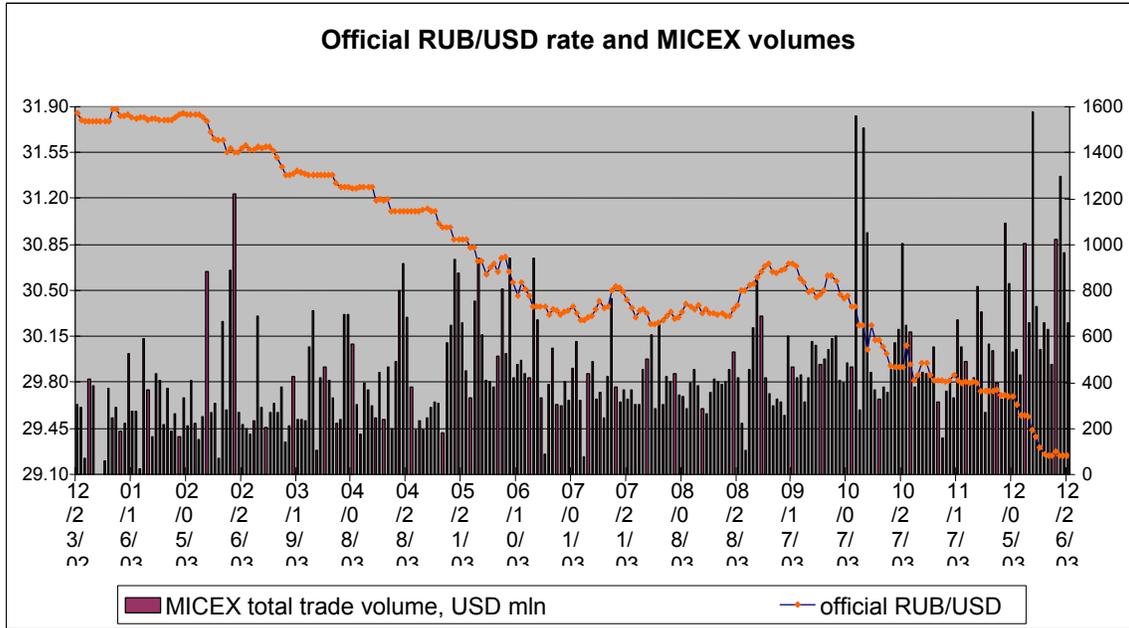
1,300 billion (a ratio of about 3.2:1); and on November 1, assets were RUB 5,351 billion and loans approximately RUB 1,800 billion (a ratio of about 3:1). The non-loan assets are probably the usual mix of other asset classes -- securities, real estate, correspondent accounts, reserves, cash, etc. Detailed data on total assets for the Russian banking system as a whole are not regularly published by the CBR. Nevertheless, the proportion of loans to total assets is still rather low compared to Western norms, reflecting the fact that banks still do not efficiently play their central role as financial intermediaries in the economy. However, over the past year or so, confidence in the banking system has been slowly increasing, based on stronger economic growth, the boom in consumer lending, and several other factors, which have in turn caused deposits in Russian banks to grow. The following graph shows that deposits and loans in the Russian banking system track generally, but not precisely, with growth in the money supply.



Financial markets

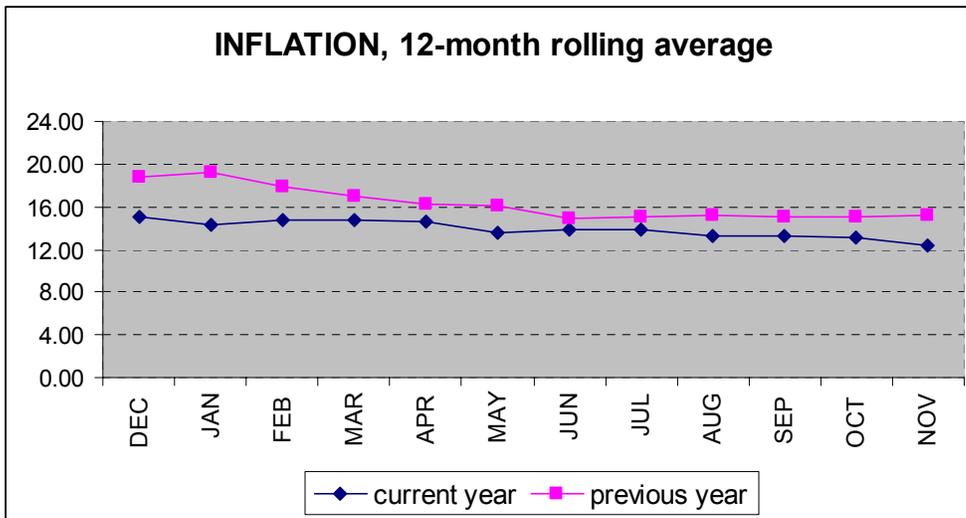
Forex Market

For most of the week, the CBR continued to restrain the rise in the ruble with interventions at RUB 29.245/USD. However, on the last day of the week, after Prime Minister Kasyanov, in his review of the economic results of 2003, reproached the CBR and MinFin about excess ruble appreciation and stated that in 2004, the ruble would not go on firming at the same pace, the ruble suddenly lost about 6 kopeks to the dollar, and at some instances at midday the rate even reached RUB 29.40/USD.



Prices

The inflation rate from January 1 through December 22 totaled 11.8%. The government is therefore very likely, as expected, to make its target of 12% inflation for this year, helped by proactive policies of the CBR. The 2004 government target is 10% for the year.



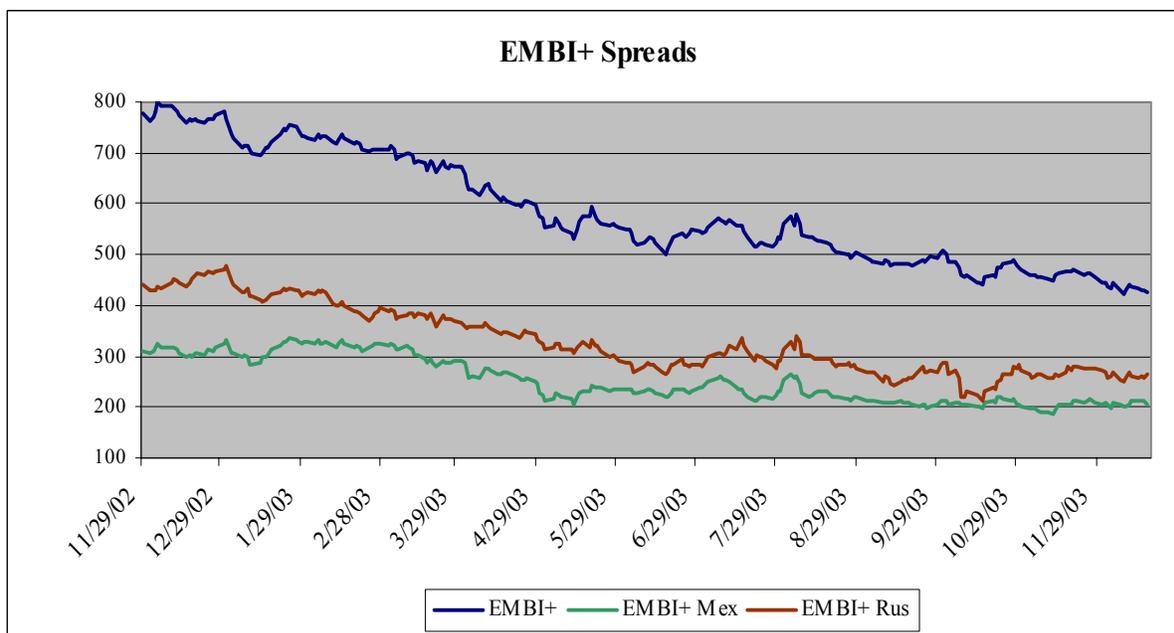
Eurobonds

There was no clear-cut trend on the Russian Eurobonds market last week. Trade volumes and trade activity were very low as many players left for the Christmas holidays last week.

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COMPONENT	COMPONENT SPREAD & DATE				SOVEREIGN RATING		
	12/26/03	12/18/03	11/28/03	12/31/02	S&P	Moody's	Fitch
JPMorgan's							
EMBI Russia	263	264	275	478	BB	Baa3	BB+
EMBI+	424	427	455	765	N/A	N/A	N/A
EMBI Brazil	473	473	533	1460	B+	B2	B+
EMBI Mexico	205	208	208	329	BBB-	Baa2	BBB-
EMBI Turkey	309	309	368	696	B+	B1	B



Interest/Bond Market

Bonds/Bills

The Gazprom Board of Directors has decided to issue additional new corporate bonds on February 3, 2004. These will be 3-year ruble bonds, for a total of RUB 10 billion (USD 340 million) at a coupon rate of 8.11%.

The Central Bank has sold, from its own portfolio, government bonds of coupon OFZ number 26198 on the secondary market, with a total sum of RUB 200 million and an average-weighted yield of 8.56% p.a. The relatively high demand at the auction was positive, taking into account that the market players are typically quite inert at the end of the year and that interest in these auctions for the last two months has been relatively low. The final maturity of the issue is in 2012.

The yields on the secondary market fell slowly throughout the week. Trade volumes were low due to the pre-holiday lull.

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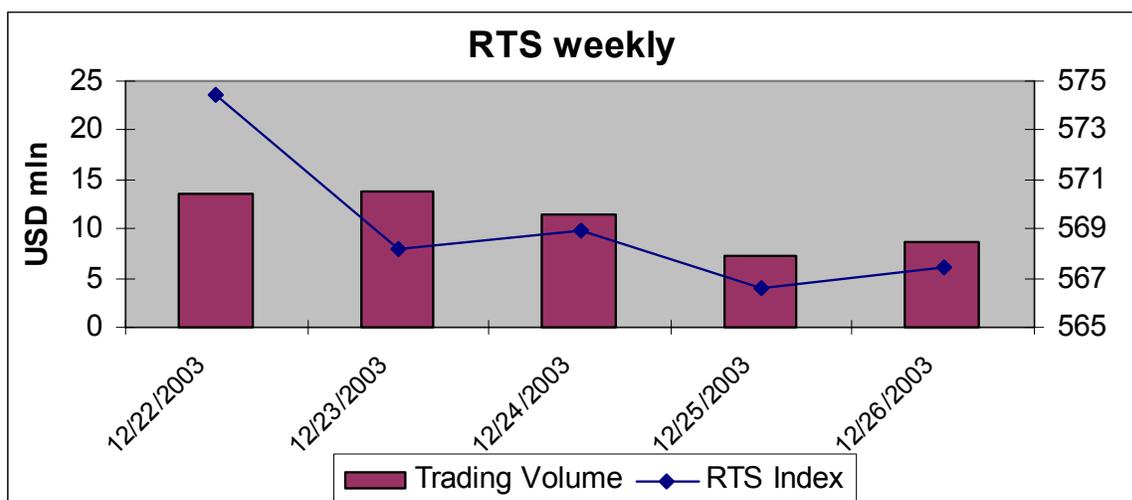
Overnight rates

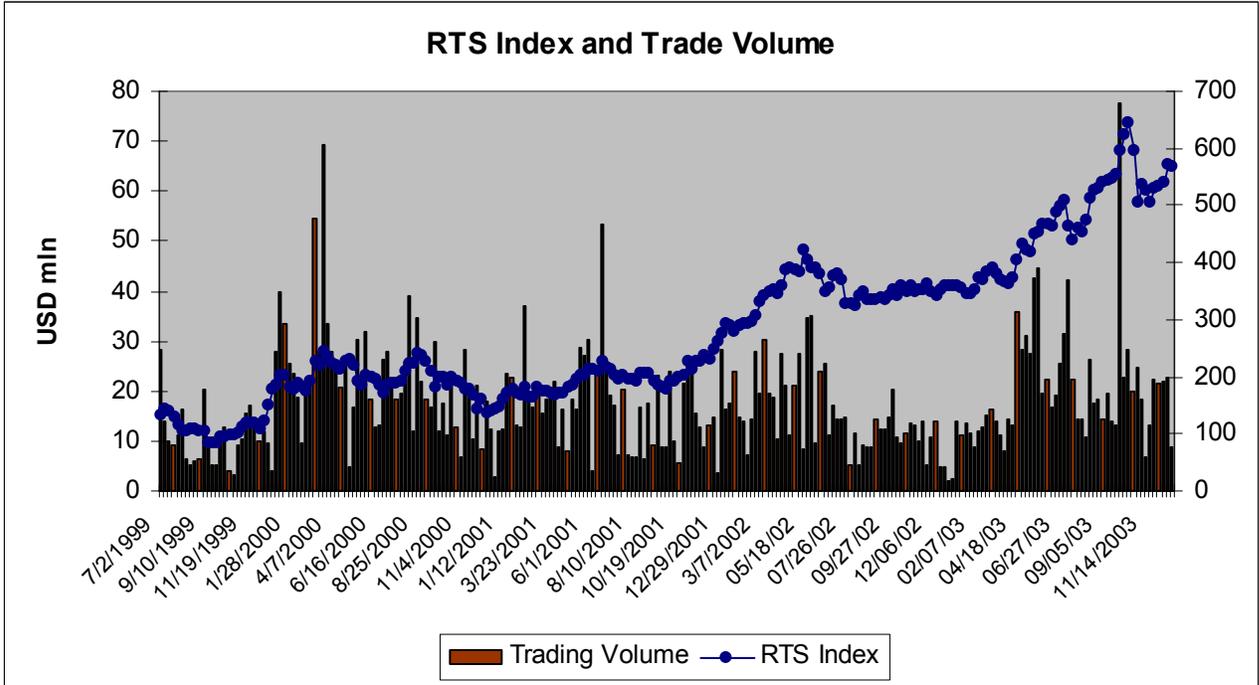
Banks continued to accumulate rubles on the correspondent accounts at the CBR ahead of the close large tax payments for the clients at the end of the year. Balances continuously increased throughout the week, reaching a historic high of RUB 249.5 billion on Thursday and falling slightly lower by Friday. Interbank overnight ruble rates fluctuated at a low level and in a narrow range of 1.15-1.25% p.a. throughout the week.

Stock Market

BP, the biggest European oil company, is getting ready to buy one-fourth of Slavneft shares. The approximate amount of the deal is USD 1.35 billion. At the same time, Slavneft shareholders approved dividends on the total amount of RUB 3.7 billion (78 kopeks/share) for the first nine months of the year. This is 75% of the Net Income of the company which is quite a high number for an oil company. The dividends will be paid by February 20th; the date of record is November 20th, 2003.

The stock market opened up at the beginning of the week, piercing through the local maximum of 570 and stopping at 574.48 -- the highest since October 24, 2003. Later in the week, the market experienced some technical negative price corrections. The tone of news was moderately negative. Trading volumes were low, which is traditional for the last days of December. The RTS index was down by a modest 0.39% for the week.

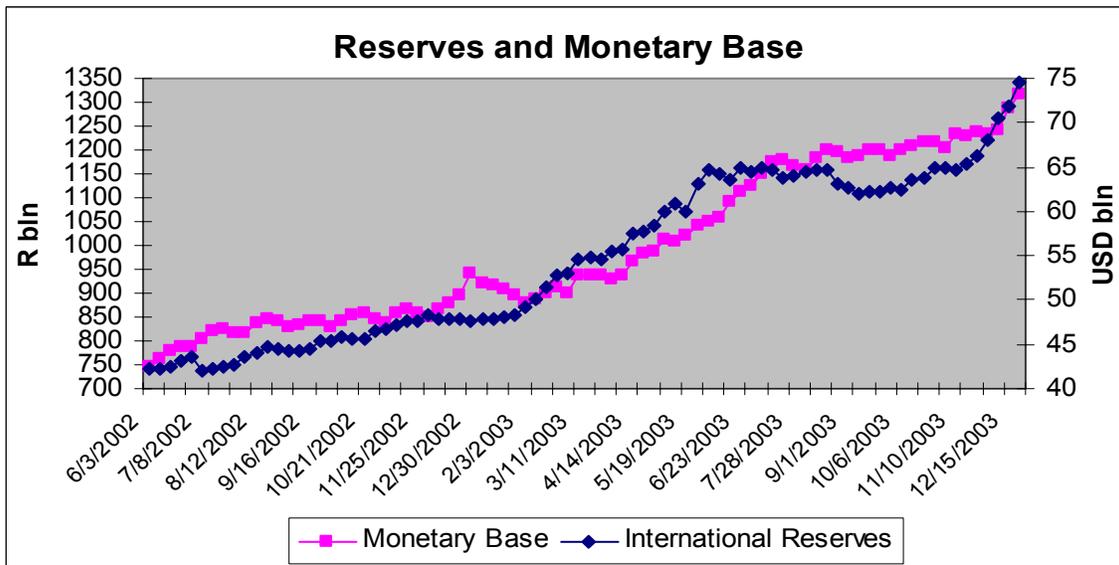




International Reserves and Monetary Base

International reserves of the CBR and the Finance Ministry increased for the sixth week in a row, reaching another record of USD 74.5 billion as of December 19, 2003. Last week's increase of 3.76% was the largest since the third week of May when the increase was 5.34% for the week. The jump is explained by CBR interventions to prevent a more rapid appreciation of the ruble.

The monetary base increased again at a slightly lower pace, and as of December 22, it totaled RUB 1317.8 billion - another record high, 2.27% higher than the week before.



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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 repatriated currency. Minimum lot size for each of the dollar instruments is USD100,000. 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.

7. **JPMORGAN EMERGING MARKETS BOND INDEX PLUS (EMBI+)** tracks total returns for traded external debt instruments in the emerging markets. The instruments include external-currency-denominated Brady bonds, loans and Eurobonds, as well as U.S. dollar local markets instruments. The EMBI+ may be separated into individual components (such as by sovereign issuer). The source of all EMBI+ data in this publication is JPMorgan.

8. **CBR TIME DEPOSIT RATE** is set by periodic auctions held by the CBR that allow banks to hold money there at fixed terms for interest. The interest rate is set by the auction process, but the CBR sets the terms, which range from one week to several months and are not always the same at each auction. The benchmark time-deposit rate that this document uses, when available, is the two-week time deposit rate. These auctions are not necessarily held on a regular weekly basis, so some data related to this indicator may not always appear in the Financial Weekly.

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