Moscow Financial Weekly

For the week ending February 14, 2003
Treasury Attache's office, U.S. Embassy Moscow

Highlights

- Discussion between Duma Budget Committee and Expert Council on Currency Control Law
- CBR Chairman Ignatyev announces strong ruble policy
- VEB, Roseximbank, and VTB benefit from Putin's visit to France

Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/$ (MICEX) UTS	R31.6406	-0.61	-0.45
Monetary Base*	R886.7 bln	0.87%	-5.70**
CPI	NA	NA	2.3
International Reserves*	$50.2 bln	1.83	5.24
RTS Index (end of week)	370.91	4.94	3.29%
Refinancing rate	18	0	4

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

Economic Developments

Goskomstat has published official GOR data on Russia's **external trade in 2002**. Exports increased by 5.8% to a total of $105.8 billion, mostly due to high natural resource prices, while imports were $46 billion - up by 9.8% y-o-y. Import growth has slowed due to the higher cost of goods from Europe, which is Russia's main trade partner. The trade surplus was $59.8 billion, up by 2.9%. The official Goskomstat figures differ from the Ministry of Economy figures (as noted in last week's Weekly) because the Goskomstat does not count shuttle trade (i.e., small private importers), which contributes mostly to the imports side. Germany ranks as Russia's largest trading partner in 2002, with a trade turnover of $14.6 billion (down 2.9% from 2001), but trade with China was up 26.8% ($9.2 billion).

Banking sector

On February 6, the government approved a regulation on the **Financial Monitoring Committee** (the GOR's financial intelligence unit) giving it the right to freeze transactions on which there is information "obtained in accordance with established procedure," meaning that either an entity or a physical person, is involved in terrorist activity. Transactions in which either party is an entity directly or indirectly owned or controlled by legal or physical persons suspected in terrorist activity, or acting on behalf of such persons will be frozen as well. This regulation will help implement amendments to the anti-money laundering law, which entered into force on January 2, 2003, that allow Russia to implement domestic freezes of terrorist assets, including those terrorists and terrorist organizations designated by the UN.

The Duma Budget Committee and the Expert Council, after a joint meeting that took place on February 13, recommended that the Duma pass the government draft of the **currency regulation and control law** at its first reading. However**,** Aleksandr Zhukov, Chairman of the Committee, said that the draft is well-developed and adequate to the state of the economy, but would need a substantial revision after the first reading. Zhukov's concern is that reserve requirements may be issued by the GOR and/or the CBR at their discretion. Others pointed to the lifting of the mandatory surrender requirement in 2007 (in a previous weekly, we erroneously wrote that the government draft does not stipulate when this requirement will be lifted). For example, Pavel Medvedev, Deputy Chairman of the Banking Committee and member of the National Banking Council, suggested including a timetable for gradual elimination of the surrender requirement into the bill. While the participants at the meeting rejected the other two drafts on the table, on the same day Valery Zubov, Chairman of the Banking Committee, told a press conference that the new version of the currency regulation law would have a first reading at the beginning of March. During the first reading, he said, two drafts would be considered: the one submitted by the GOR as well as the one by the Union of Industrialist and Entrepreneurs, which takes a more liberal approach than the government draft.

Two top CBR officials made a series of statements that had particularly strong impact on the **domestic currency market** this week. First, CBR Chairman Sergey Ignatiev, at a presentation in Warsaw, said that in 2002 the Bank of Russia "paid too much attention" to preventing ruble strengthening and as a result missed the GOR's inflation target. In 2003 inflation and not the exchange rate, he declared, would be the priority for the CBR, adding that the ruble may appreciate 4-6% in real effective (trade weighted) terms. Later Ignatiev's first deputy Oleg Vyugin reiterated that the CBR considers acceptable for the ruble's real effective rate to increase 6% in 2003 (vice a 2.9% decline in 2002, per CBR statistics). He elucidated that the weighting is about 60% for the dollar and 40% for the euro. He also gave reassurances that the CBR, adhering to a "managed float" exchange rate policy, would not allow sharp fluctuations of the ruble rate. Vyugin also said that at present exchange rate dynamics are determined by financial investment transactions rather than by exporters' revenues. With the influx of capital into Russia expected to continue through the rest of 2003, ruble firming is "absolutely normal," he said. He also pointed that the dollar does and will continue to prevail in the Russian market: as of today the number of transactions completed in dollars is approximately 10 times greater than the number of transactions in euros.

According to the CBR, in 2002 authorized banks imported $14,400 million worth of **cash foreign currency** and shipped out $1,312.7 million worth. Thus, net imports amounted to $13,087.6 million. Banks sold $11,835.39 million worth of foreign cash to natural persons and bought from them $7,605.82 million worth. In December 2002, imports of foreign cash doubled to $2,943.7 million compared to the previous month, while exports slightly declined to $91.8 million. Individuals bought $1,242.38 million worth of foreign cash (including $851.74 million in dollars) that month and sold to banks $603.67 million worth, of which $486.70 million was in dollars.

In the course of President Putin's visit to France, **Vnesheconombank** (VEB), **Roseximbank** and AFB-export, a French bank association, signed a cooperation agreement according to which they are going to jointly develop large-scale projects in third countries. This is the first international agreement signed by Roseximbank, VEB underscored in a press release. In implementing the agreement, Roseximbank will act as a specialized export-import bank, while VEB will be its financial consultant and also may serve as a co-creditor and co-guarantor in certain projects implemented within the framework of this agreement.

Also during the President's visit **Vneshtorgbank (VTB)** signed an agreement with Natexis Banques Populaires under which the latter would open a 300-million-euro credit line to VTB. According to the agreement, VTB will finance import of goods and services from France. Insurance will be provided by COFACE without additional sovereign guarantees from the Russian side. VTB may also use credit resources allocated under the agreement towards financing its clients who buy goods in other countries of the EU, the U.S. and Canada.

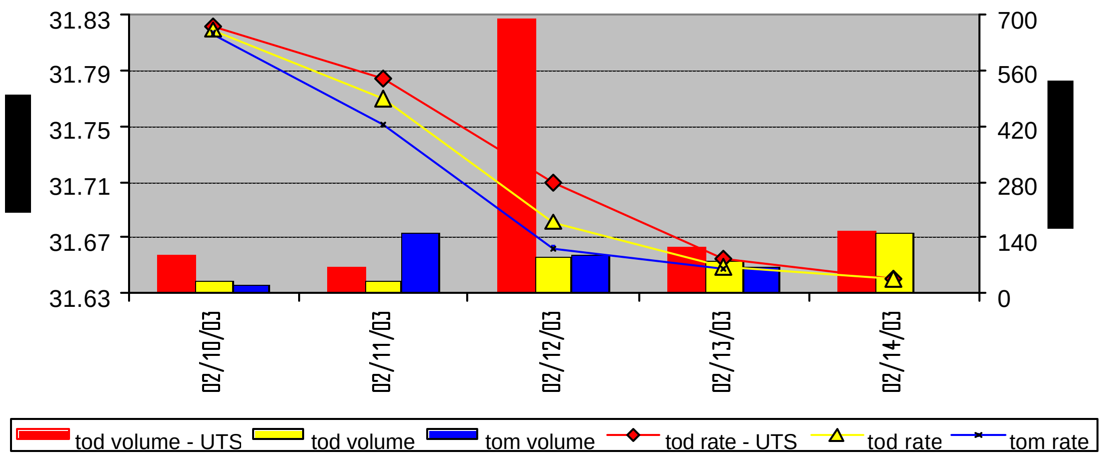
Financial markets

Forex Market

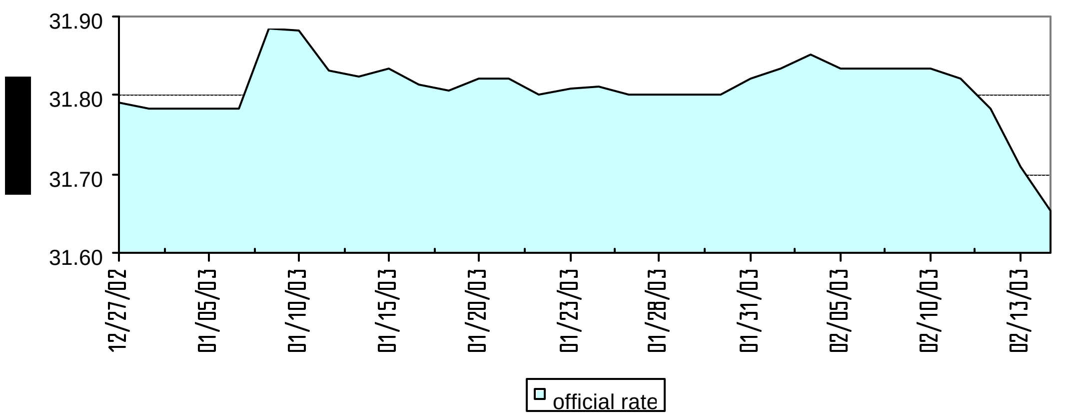
The dollar fell steadily against the ruble throughout the week. Although this took place on a background of low liquidity (the sum of balances in correspondent accounts with the CBR was slowly declining), the real cause was the CBR's decision to cease its massive interventions in support of the dollar: on Monday it shifted its bid down and on Tuesday afternoon simply removed it. On Wednesday the dollar declined particularly steeply and the UTS trade volume set a new record high of $692.12 million. Less than 30 minutes after the morning session opened, the CBR had to return to the market with a bid at R31.70/$ in order to stop the stampede and it bought about $650 million in that session only. After Wednesday, the dollar's slide slowed down without much effort from the CBR: it only occasionally appeared in the market but with bids lower and lower each time.

For the week the ruble appreciated against the dollar 0.61%, closing in the UTS on Friday at R31.6406/$. MICEX weekly trade volumes were $1132.85 million, $392.07 million and $343.58 million for the morning (UTS), afternoon "tod" and "tom" sessions, respectively.

MICEX RuR/USD rates and volumes

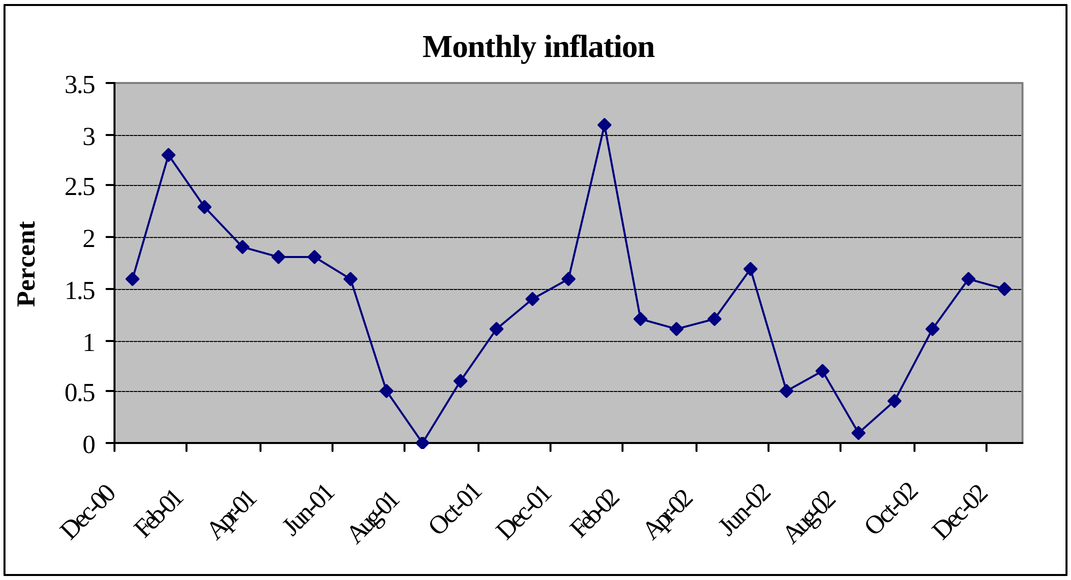


Official RuR/USD rate



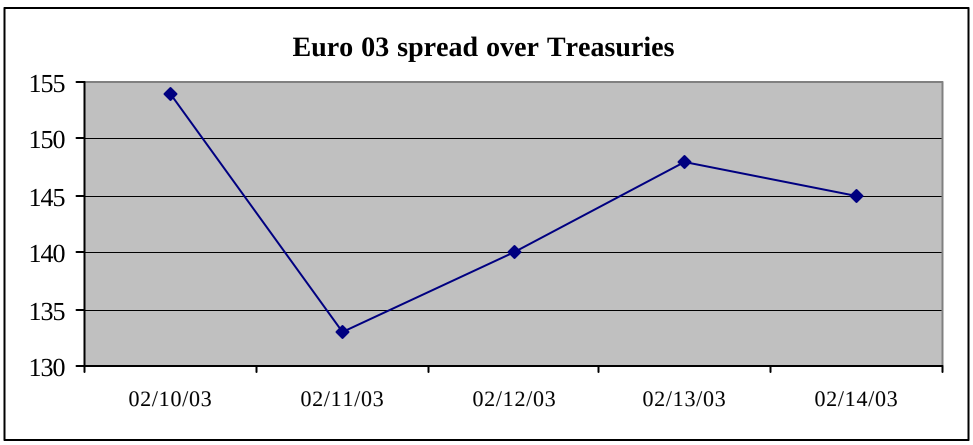
<u>Prices</u>

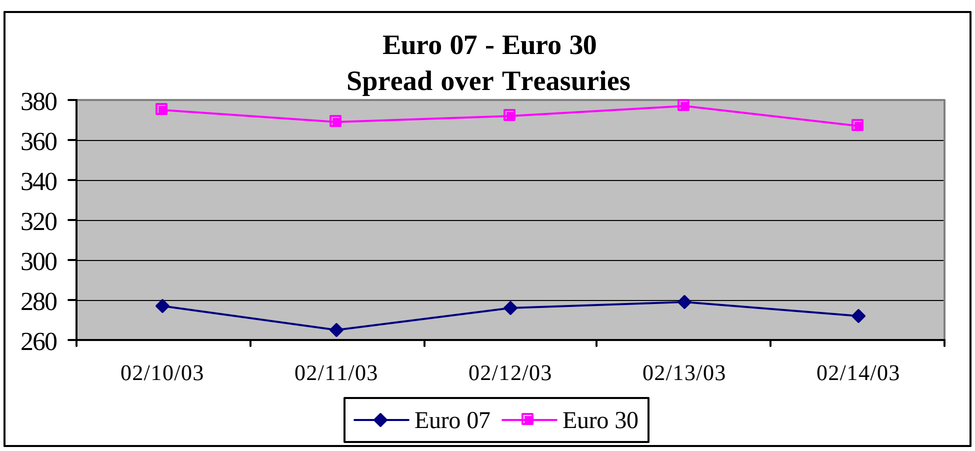
No weekly Goskomstat inflation data for this week.



Eurobonds

Russian Eurobonds experienced downward price corrections last week after the previous week's increases. The upward potential is somewhat limited these days, taking into account the uncertainty over Iraq, despite soaring oil prices.





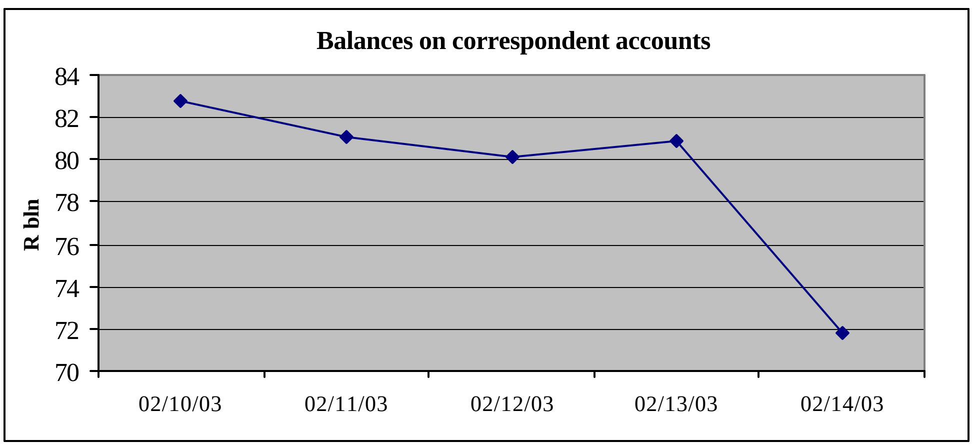
Interest/Bond Market

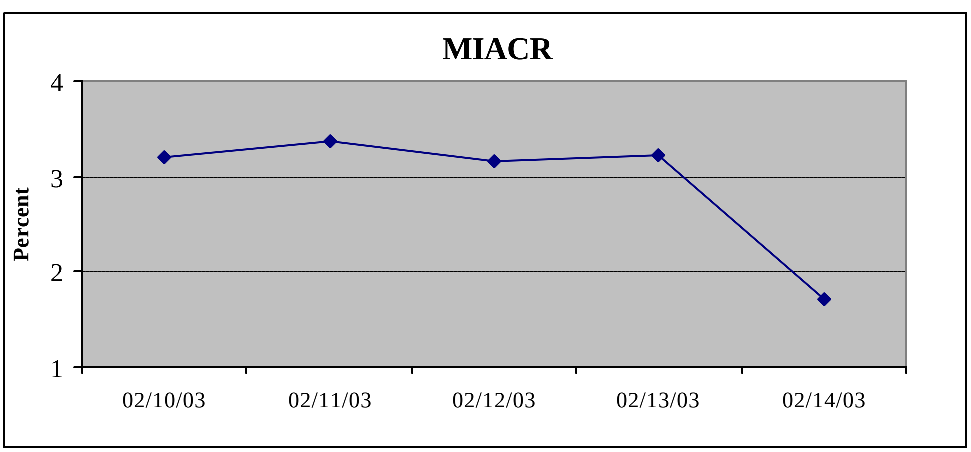
Bonds/Bills

Yields on the secondary OFZ/GKO market continued to decrease quite consistently last week. The currency market was again viewed as unattractive, so rubles flew to other areas including the local state debt market. At the end of the week, some players preferred to take profits in the short-term sector in the expectation of the upcoming lower liquidity resulting from tax payments.

Overnight rates

Balances on banks' correspondent accounts at the CBR fluctuated in the range of R80-83 in the first four days of the week, reflecting a high-to-moderate saturation of banks with rubles. By the end of the week, balances fell to R71.8 billion - somewhat lower than average, taking into account the dynamics of the past several weeks, while overnight rates remained on low levels.

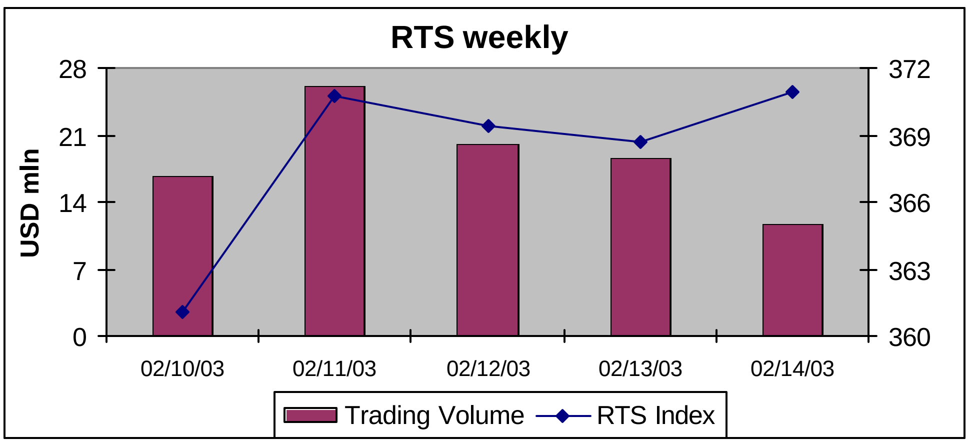


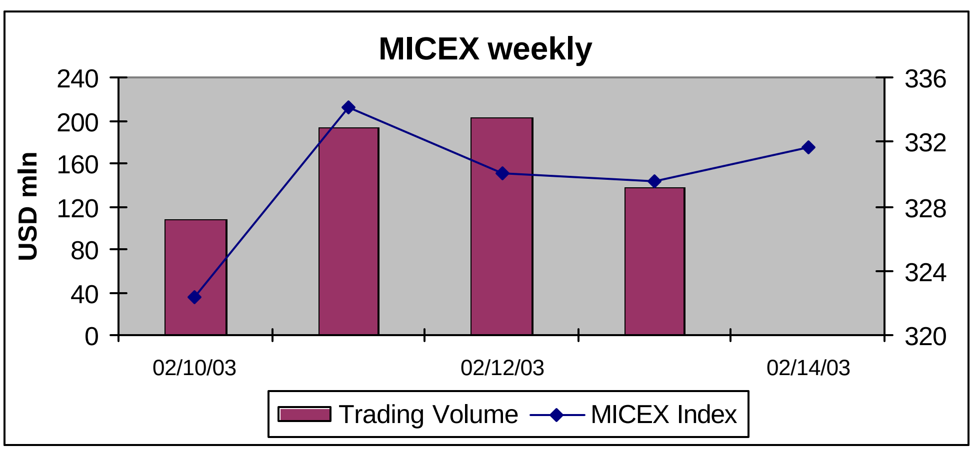


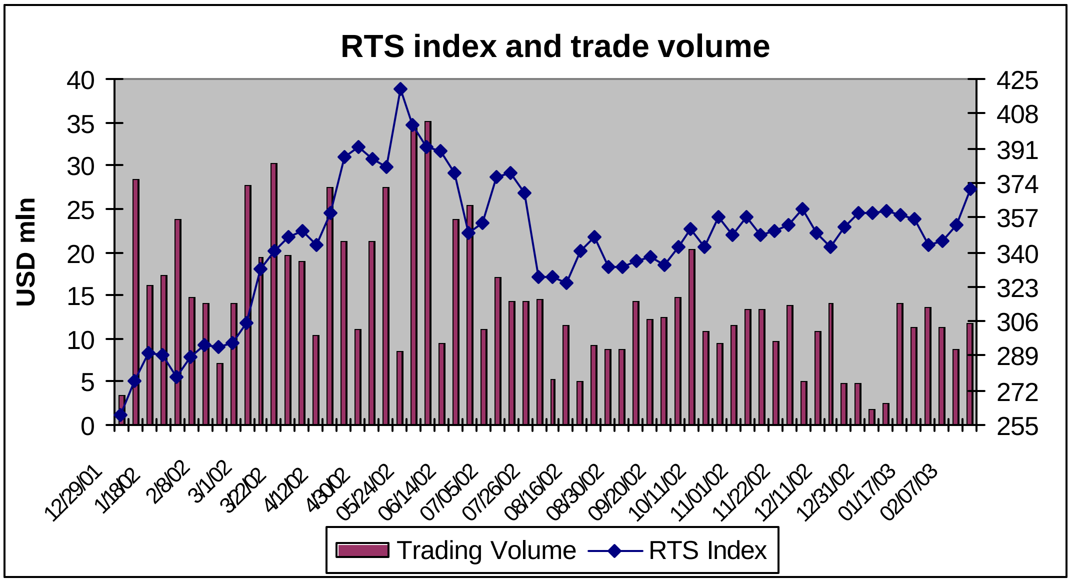
Stock Market

The stock market was considerably up in the first two trading sessions of the week. The market opened up on Monday, increased by 2.16% during the day's session and then notched up again by 2.67% on Tuesday. It was encouraged first by the rumors of the BP-TNK deal and then by official confirmation of this event. Growth was supported by rather high trade volumes. During the next trading day the market corrected downwards and on Friday, it pierced through the 370 level for the second time in a week and also for the second time this year. News about the planned Duma hearings, and then passage in the second reading of the energy reform laws supported the energos last week, which grew considerably.

For the first time since the first short week of January, the RTS index was able to end higher than the level of the end of the year. It was up at 370.91 on Friday, 4.94% higher than last week in dollar terms and 3.29% higher that at the end of 2002.



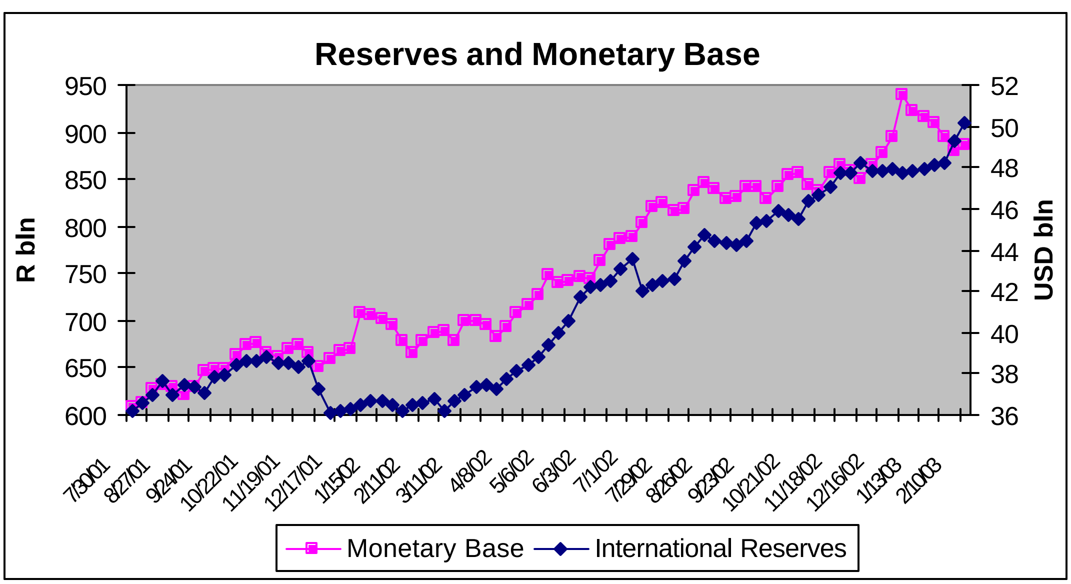




International Reserves and Monetary Base

The international reserves of the CBR notched up by $900 million during the week ending February 7, piercing through the $50 billion level and hitting another record high of $50.2 billion. The second week of the impressive upsurge is explained by the increased export proceeds, as well as lack of intervention to support the ruble. However, the week of February 17 Russia has to make approximately $1 billion in foreign debt payments, which should slow growth in reserves a little.

The monetary base has increased for the first time this after a 5-week decrease, marking the end of a decline after a seasonal spike at the end of the December. Base money grew slightly by R7.6 billion or 0.87% to R886.7 billion.



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.