

Moscow Financial Weekly

For the weeks ending February 28 and March 7, 2003
Treasury Attache's office, U.S. Embassy Moscow

Highlights

- Deposit insurance bill submitted to Duma
- Tax revenues for 2002 totaled R1.15 trillion (\$36.7 billion), excluding UST
- Statistics on commercial bank deposits with the CBR made public

Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R31.5619	-0.03	-0.70
Monetary Base*	R901.3 bln	-1.20%	-4.15**
CPI	NA	NA	4.1
International Reserves*	\$53.1 bln	0.76	11.32
RTS Index (end of week)	391.73	2.22	9.10%
Refinancing rate	18	0	-3

*For week prior

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

Economic Developments

State Pension Fund Deputy Chairman Kurtin has said that a technical flaw could delay private asset managers' access to pension funds until 2005, vice January 1, 2004, as specified in legislation. He argues that the Pension Fund must review the list of eligible asset managers before any transfers from the Fund can take place. While some believe that this was intentionally designed to delay implementation until after federal elections, other experts close to the process view this as part of the originally envisaged "transition period" to private asset managers.

Deputy Finance Minister Sergei Kolotukhin commented last week that **Paris Club** creditors agreed to allow swaps for up to 10% of the stock of official debt, which would cover approximately \$4 billion in claims. Italy had previously announced its intention to swap some of its Russian debt, but further details on this deal are not yet available. Paris Club swaps are typically for equity or environmental projects, but tend not to be widely utilized by creditors. While such operations would lower Russia's debt burden further, it is often difficult to determine the overall financial effect of the transaction due to lack of information from both creditors and debtors. Also, Kolotukhin said that the government would submit a new proposal to the Paris Club on securitization. If creditors securitized their Russian claims, the GOR could buy back the new bonds on the secondary market at a discount, thus retiring even more official debt. This proposal is likely to be very

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controversial, as a similar Polish proposal in the mid-90's involved a protracted debate among creditors.

According to Deputy Finance Minister Bella Zlatkis, the Finance Ministry is developing a resolution that would prohibit any one party from purchasing more than 30-35% of a **GKO/OFZ** issue at primary auction. Currently, big players as Sberbank and the Pension Fund are buying a large percentage of these papers, decreasing their attractiveness for the rest of the market. Limiting participation in such a way could be an effective tool to promote liquidity and market-based pricing in the domestic debt market.

Tax Minister Gennady Bukayev recently announced that **federal tax revenues for 2002**, excluding UST, amounted to R1.15 trillion (\$36.7 billion), which was 4.6% short of the annual target. The revenue shortfall was mainly due to a reduction in VAT (due to low domestic oil prices at the beginning and end of 2002, and lower profit tax collection (due to lower rates). Including social taxes, however, revenues came in 0.2% above target at R1.49 trillion.

Banking sector

On February 27, Prime Minister Kasyanov signed an order to submit the **draft bill on deposit insurance** to the Duma. This bill, which has been sitting in the GOR since last November, went to the Duma without any changes. It will be accompanied by amendments to the Civil Code, Tax Code, laws on banking, on the CBR, on bank restructuring, on bank bankruptcies, on insurance and on non-profit organizations -- all the provisions in these areas that need to be brought into harmony with the new deposit insurance regime. When both houses of the Federal Assembly consider this bill, the GOR will be represented by Deputy Minister of Economic Development and Trade Arkady Dvorkovich.

Effective March 7, the CBR started publishing daily updates of the total amount of **commercial banks' deposits** with it. This is another breakthrough in CBR transparency, as the previous management did not make this data public, and will compliment the data currently released on the sum of balances in correspondent accounts. Both pieces of information will make it easier to analyze the liquidity of the market and to forecast developments in the money and currency markets. On March 7 the total volume of bank deposits with the CBR amounted to R123.8 billion.

The head of **Vneshtorgbank (VTB)**, Andrei Kostin, announced on March 6 that by the end of 2003 its controlling stake in **East-West United Bank** would be sold to AFK Sistema, which had recently increased its share in the Luxembourg bank to 35%. Also, according to Kostin, the Board of the IFC has approved a \$200-million loan to VTB that may be converted into shares. At the same time, the EBRD Board has not yet made a final decision on the size of its participation in VTB's capital. Kostin also said that auditors from J.P. Morgan and Ernst & Young would complete assessment of VTB within two weeks, and that the EBRD and IFC "have already started due diligence of VTB". Kostin promised that VTB would propose a scheme for "rationalization" of its

presence in the capital of other "roszagranbanks" (Russian banks incorporated abroad by the Soviet Union) by May. "Probably, we would propose to reduce the number of banks or establish unified management of banks in a holding company," Kostin said.

On March 6 **Mosnarbank and Evrofinance** announced in a joint statement that they would merge their businesses by the end of 2003. Both banks were founded by two "roszagranbanks", London-based Moscow Narodny Bank and Paris-based BCEN Eurobank, in which 90% and 87%, respectively, belong to the CBR. At present, Moscow Narodny Bank owns 99% of Mosnarbank. As for Evrofinance, Vnesheconombank and Roscontract own 20% each, Vneshtorgbank owns 19%, Troika Dialog owns 13% and BCEN Eurobank, Vtorchermet and Slavneft own 8-10% each. The joint statement stressed that the new banking structure created as a result of the merger would be owned by current shareholders of Mosnarbank and Evrofinance.

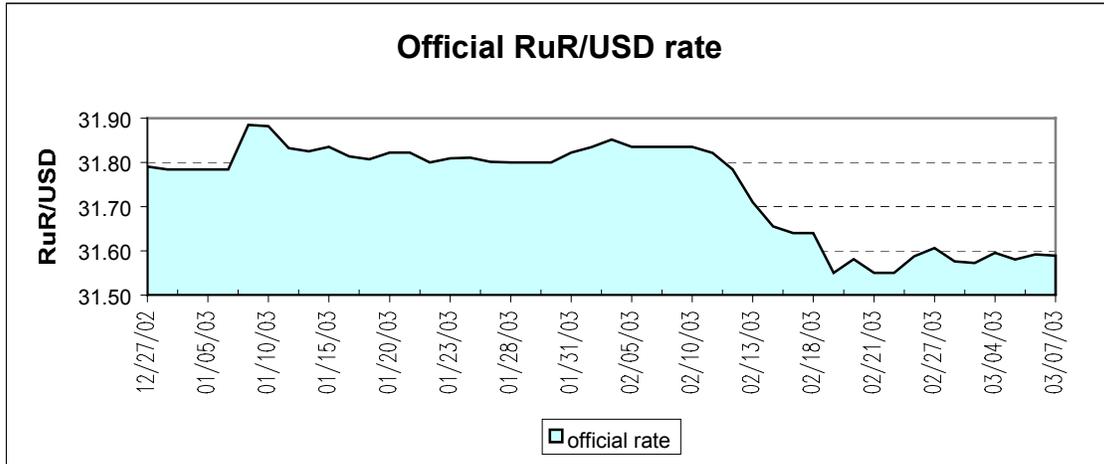
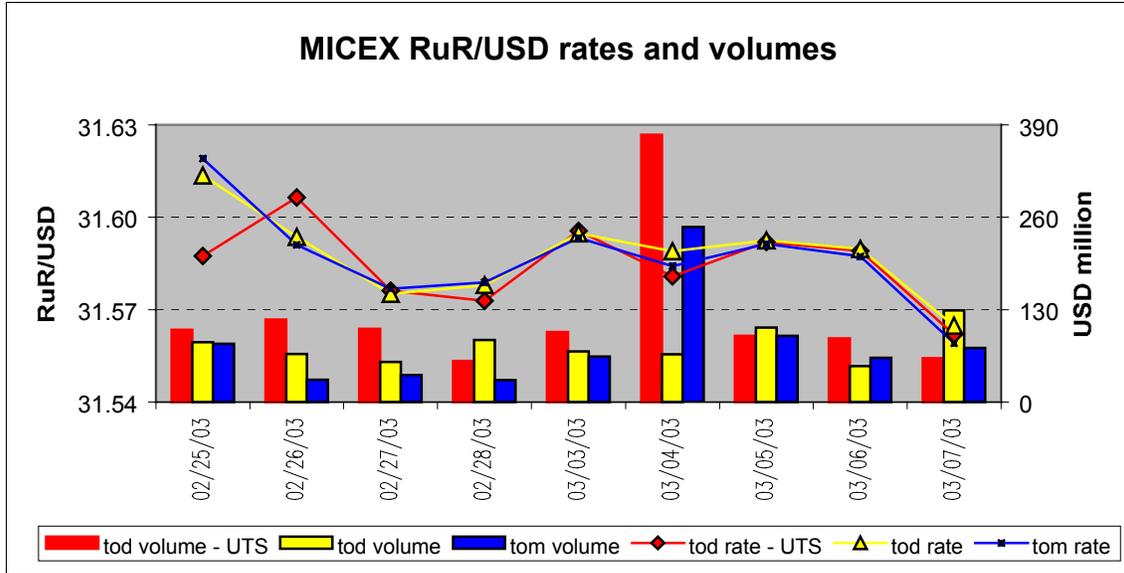
The CBR has issued a banking license to **Standart Bank**. 100% of the authorized capital of the bank, equal to R650 million, belongs to SBIC Investments S.A. (Luxembourg), member of Standard Bank Group registered in South Africa. Standart Bank became the 27th in Russia with 100% foreign capital.

Financial markets

Forex Market

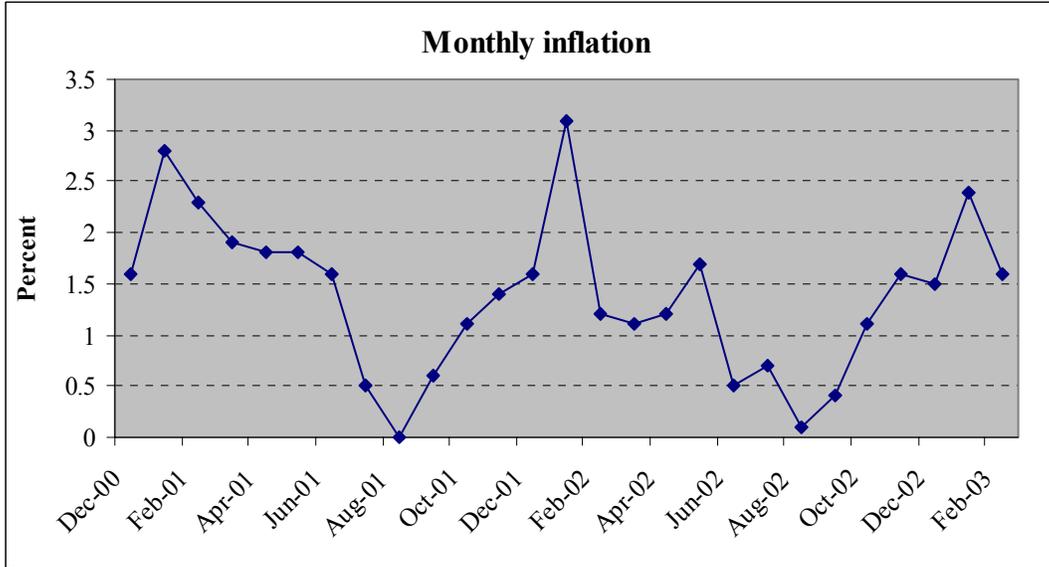
The dollar-ruble market was fairly stable during the last two weeks, most of the time with moderate CBR presence at both sides. The only day when the CBR had to intervene heavily in support of the dollar was March 4, when the market rapidly responded to the Treasury Secretary's comment that he was not concerned by dollar weakening. On March 7 the CBR abandoned the market and the dollar immediately weakened against the ruble almost by 3 kopeks.

For the last week of February, the dollar firmed 0.07%, closing in the UTS on February 28 at R31.5729/\$. MICEX weekly trade volumes fell to \$378.65 million, \$229.21 million and \$182.57 million for the morning (UTS), afternoon "tod" and "tom" sessions, respectively. For the first week of March the dollar weakened 0.03%, closing in the UTS on Friday at R31.5619/\$. MICEX weekly trade volumes went up back to "normal": \$719.83 million, \$423.16 million and \$543.02 million for the morning (UTS), afternoon "tod" and "tom" sessions, respectively.



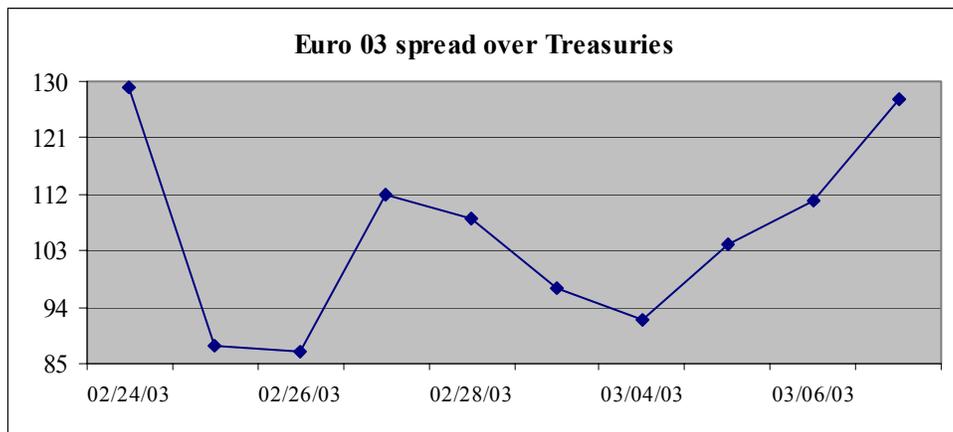
Prices

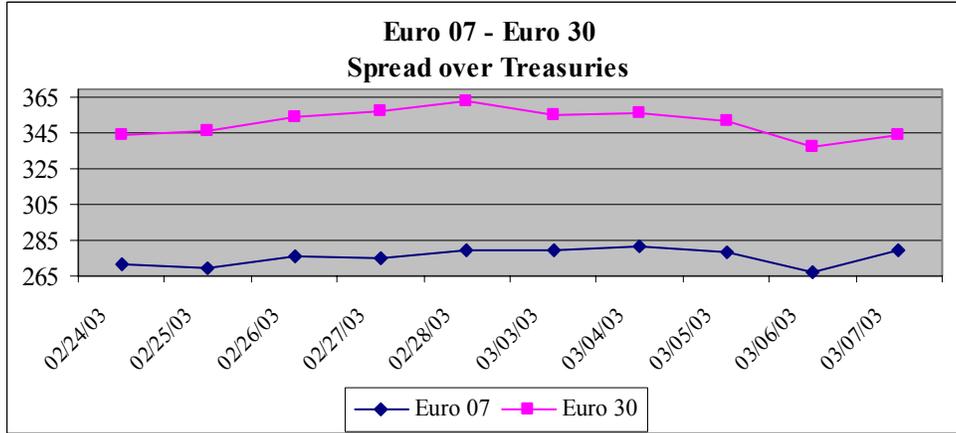
According to Goskomstat, the inflation rate in February was down to 1.6%, compared to 2.4% in January. Last year the corresponding rates were 1.2% in February and 3.1% in January. Communal-services prices were up by 7.3%, which was one of the main factors pushing the total inflation number up, but also higher public sector wages and pensions have also played a significant role. Overall, services prices were up by 4.2%. Finance Minister Kudrin, speaking after the February figures were released, noted that keeping inflation in check this year was a difficult but achievable task. He said that inflation may end the year at the upper end of the government's 10-12% target.



Eurobonds

Russian Eurobonds followed the domestic debt market trend, achieving new highs over the last two weeks. On March 6, the Euro-30 issue yield reached a historic high of 87.5% of par value, with a YTM of 8%. This growth was stimulated by the price rally in Brazil and Turkey and backed by huge turnover. Yields on long-term paper are already close to Mexican Eurobonds (which have investment-grade rating from S&P) and below South African yields on comparable issues. In light of possible war in Iraq, Russian debt seems to be the most protected compared to other emerging market bonds. However, market players fear that the rally is almost over and that the market's growth potential is limited.

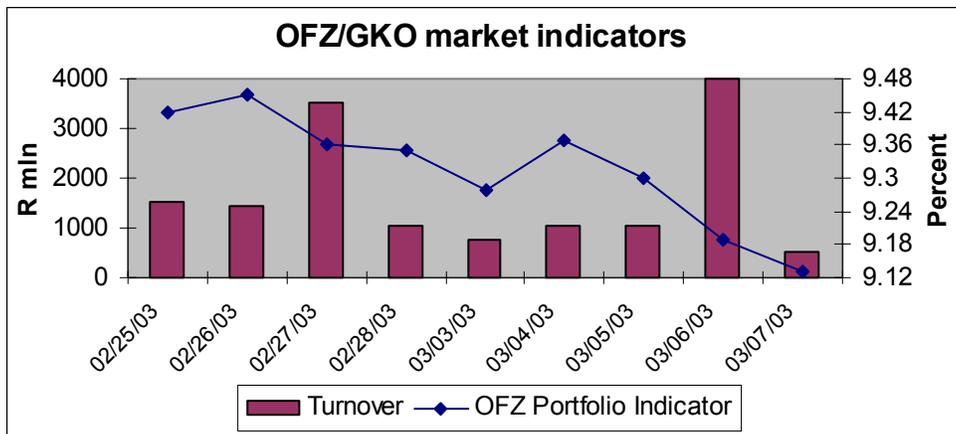




Interest/Bond Market

Bonds/Bills

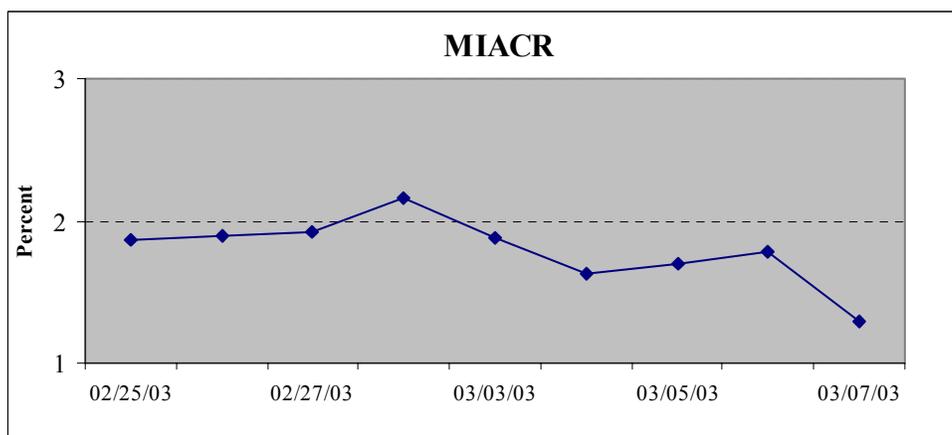
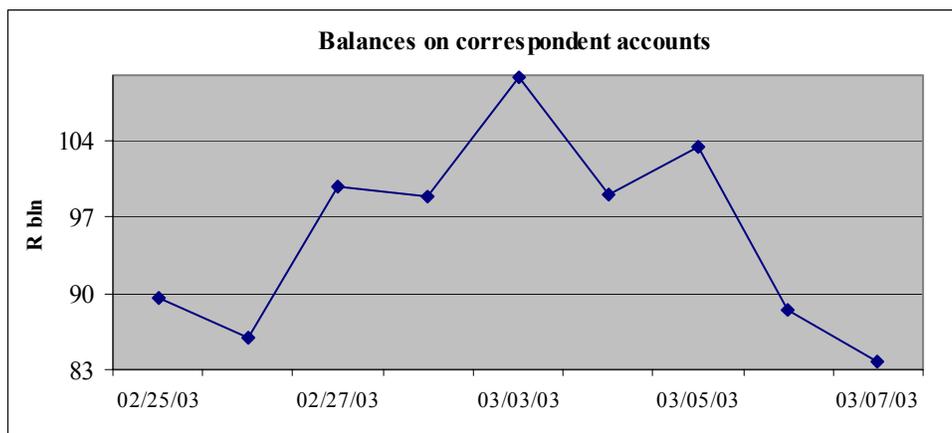
The secondary OFZ/GKO market continued to soar during the two weeks observed, reaching new highs last week. Yields on 2003-2006 notes were down to 5-9% p.a., while 2006-2018 papers' yields dropped to 9.4-9.5% p.a. on Thursday. Yields on the new 15-year OFZ issue placed on March 5th, the longest-term OFZ to date, dropped from 9.7% to 9.53% p.a. the next day. Demand exceeded supply again for this issue, not only because the market is saturated with rubles and the exchange rate is flat, but also because players were hoping for a repeat of last month's situation: in February, the Ministry tested the waters with a 10-year OFZ, accepting a yield of 12.9%, which has since dropped 9.6%, allowing traders to make impressive profits. This time, the players had no doubts that the secondary market would continue to soar given unsatisfied demand in the primary market, allowing them to sell the long-term issue at a premium. The Finance Ministry was also able to place an additional OFZ and GKO issue (also with excess demand), making the total volume of all three issues R22 billion. However, the rally may be short-lived, especially since if higher inflation causes real yields in 2003 to be negative.



For the weeks ending February 28 and March 7, 2003

Overnight rates

The market didn't experience any ruble liquidity problems during the past two weeks. The high volume of rubles seems to have banished the end-of-month factor - banks did not lack rubles at the end of February again. Last week the situation was the same -- balances on banks' correspondent accounts were above average levels, with daily average as high as R97 billion. The overnight rates were kept down at 1.5-4% p.a. through the period, reaching the highest level of 4.5% p.a. (still relatively lower than average) at the last day of February. Last week the ruble overnight rates were mostly down below 2% p.a.

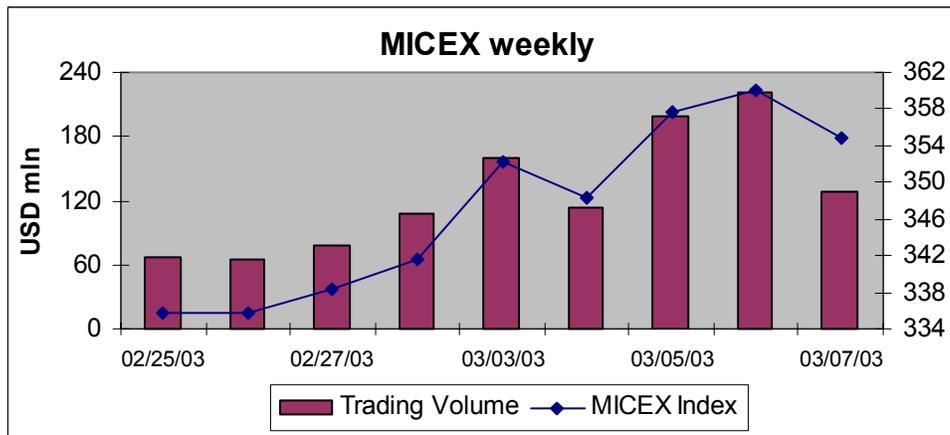
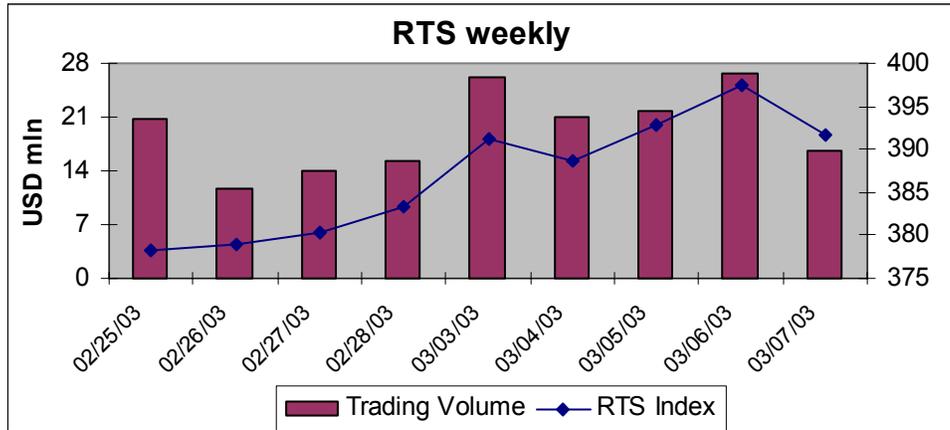


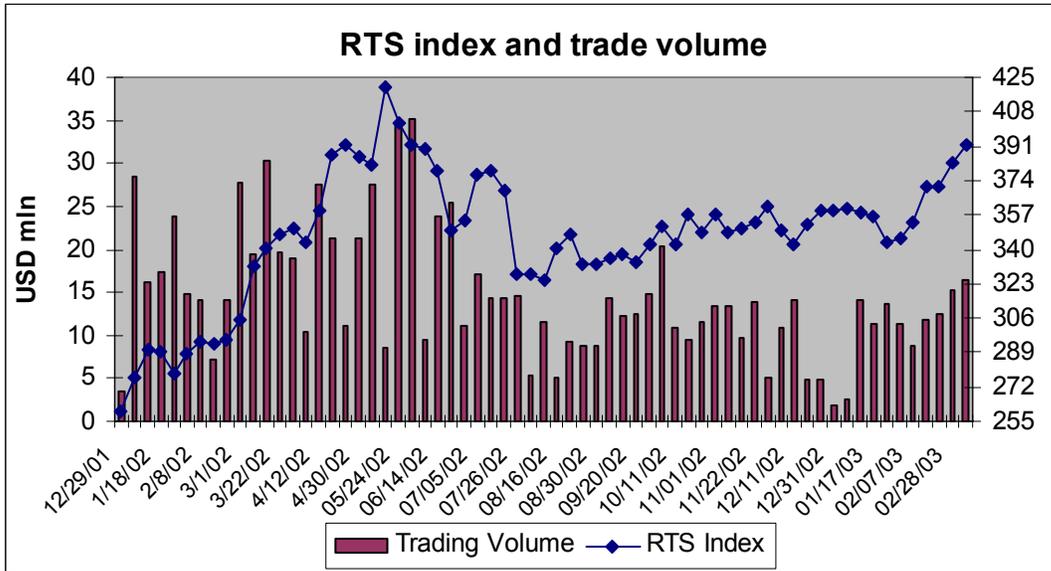
Stock Market

Although world markets were weak, the Russian stock market continued showing good results. During the short week ending Feb.28, the Russian stock market rose continuously, falling slightly only during the last trading session. The positive tone of domestic news drove the market: good macroeconomic data as well as positive news from many listed companies were supporting factors. In addition, soaring oil prices

helped push oil shares up - these shares were the leaders of growth during that week. YUKOS and Sibneft grew by approximately 4%. The "expected high dividends" rush continued bringing RAO UES preferreds, Rostelecom and Tatneft shares up. Overall, the RTS index was up by 2.5% during the week ending Feb.28.

Last week, the results were impressive as well. The market started considerably up on Monday, supported by higher than average trade volumes. The next day, trade was disturbed by technical problems on MICEX. On Thursday, the RTS index pierced through the 400 level within the session, but finished the day at 397 -- the highest level since May 2002. The closeness of the record dates was again the driving force of the market. Sberbank, which showed the promising net income to pay high dividends, saw its shares soaring that day. Mosenergo was up by 12.05% : market players suspect a strategic investor is accumulating shares to propose a candidate for the BoD. However, in the middle of the session, brokers began to take profits. By Friday, the index was down to Monday's level, but with lower trading volume. The index was up by 2.22% for the week and during the two-week period, the index grew by 4.77% in dollar terms.

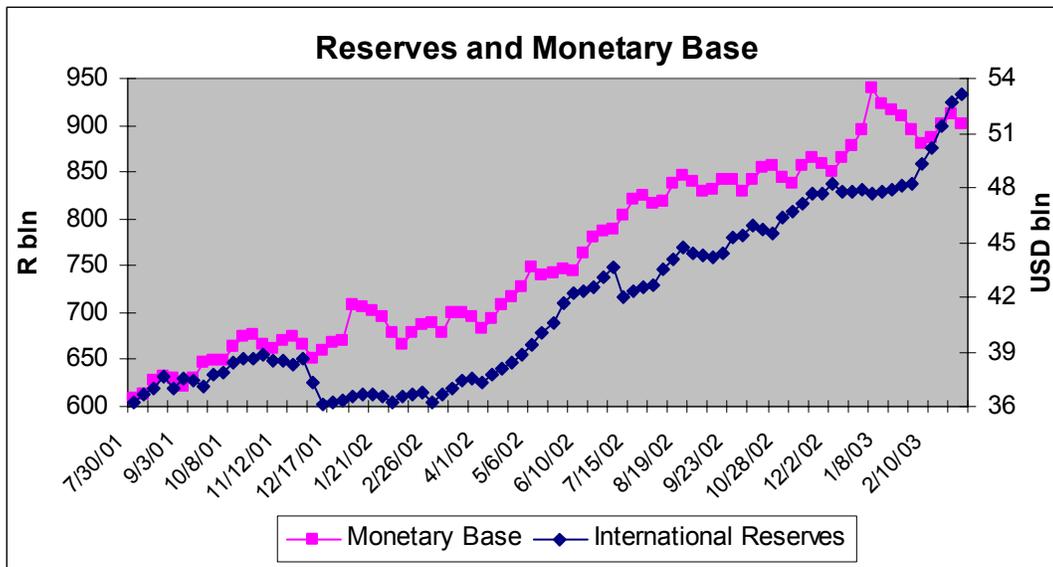




International Reserves and Monetary Base

International reserves of the CBR were up over the period February 17-28, finishing at the record high level of \$53.1 billion, despite a \$1.8 billion payment to the Paris Club during this time.

The monetary base increased during the week of February 17 and the following week it was down by the same amount, finishing at R901.3 billion, which is 1.2% lower than a 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 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.

