

Moscow Financial Weekly

For the week ending January 24, 2003
Treasury Attache's office, U.S. Embassy Moscow

Highlights

- Pension Fund earns 4.4% return on investments in 2002; VEB named as state manager
- CBR to issue two-week plans of bank liquidity
- Currency control compromise: foreigners and residents to be allowed to export \$3,000 without customs declaration and up to \$10,000 with declaration

Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R31.8015	-0.07	0.05
Monetary Base*	R909.8 bln	-0.60	-3.25**
CPI	NA	NA	15.1
International Reserves*	\$48.1 bln	0.42	0.84
RTS Index (end of week)	343.31	-3.67	-4.39%
Refinancing rate	23	0	4

*For week prior

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

Economic Developments

Last week Goskomstat published the first set of official data on 2002 economic developments. The statistics confirmed what analysts already suspected. Growth in **industrial production** came in at 3.7% in 2002, lower than the 4.9% achieved in 2001 and 11.9% in 2000, confirming that the economic jolt from devaluation in 1998 has played itself out. The main sources of growth were in three sectors: oil and gas, which was up by 7% for the year; non-ferrous metals (up 6%) and food processing industry (up 6.5%). While the first two sectors are export-oriented, accounting for 80% of total Russian exports, food processing was supported by strong domestic demand. Real incomes were up by 8.8% and nominal wage increases by 37%, supporting the second straight year of strong private consumption. Real wage increases were more modest but still impressive - up by 17.3%. Retail turnover was up by 9.1%. As industrial production growth in 2002 is lower than GDP growth (estimated at 4.1%), this means that growth is becoming less dependent on industrial production and more on other sectors such as construction, agriculture and services. However, restructuring in other manufacturing industries such as light industry and machine building would improve productivity and make these industries less vulnerable to exchange rate movements.

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Goskomstat also reported a 16% decrease in **wage arrears** in December, which currently stand at R30.6 billion, of which the public sector represented R3.4 billion (a decrease of 23.4%) and the private sector R27.1 billion (decrease of 14.6%). Arrears began to grow, reaching a peak of R35.9 billion on August, due primarily to an 80% public sector wage increases earlier in the year. The government increased budget expenditures to pay down the arrears and will likely keep them in check prior to Duma elections later in 2003. Private sector arrears were ostensibly lowered due to better than expected oil prices.

According to the **Pension Fund**, in 2002 it obtained a 4.4% return (\$48.4 million) from fund investments. The Pension Fund was limited last year to investments only in Russian government debt. More than half the investments were made in Euro-30, the rest in long-term ruble-denominated paper. In 2003 the Fund will be allowed to invest in foreign bonds and currencies as well as Russian stocks.

Banking sector

With a resolution signed by Prime Minister Kasyanov on January 22, the GOR appointed **Vnesheconombank** (VEB) as the state management company to act as trustee for pension accumulations for those individuals who have not executed their right to choose a private investment manager. The recently-adopted pension law stipulates that effective January 1, 2004, pension funds will be invested through designated fund managers, of which one (which the new resolution establishes as VEB) is to be a state company and the others -- no fewer than three -- private ones, thus giving Russians a choice. Analysts estimate that VEB will manage from \$4 billion to over \$5 billion in pension assets. Many market participants expressed concern that this GOR decision creates a conflict of interest between VEB's function of state debt management and the new asset management function, and are worried that pension funds will be used to pay external debt.

The **CBR** plans to begin issuing **regular two-week forecasts of bank liquidity**, CBR First Deputy Chairman Oleg Vyugin said. Moreover, the CBR is going to extend the basis period for bank refinancing to 2 weeks. At present the CBR systematically provides banks with overnight refinancing, and occasionally as long as 3 days. The banks themselves are not yet ready for longer terms, but once the two-week refinancing is implemented, it will become the main instrument of monetary policy, Vyugin declared.

The Finance Ministry will soon submit to the GOR a **draft federal bill on control over real owners of commercial banks**. Anton Siluanov, in charge of macroeconomic policy and banking at MinFin, said the draft had already been coordinated with the CBR and as soon as comments are received from the Ministry for Antimonopoly Policy, it will be forwarded to the Ministry of Justice. The bill will oblige banks to disclose information not only on nominal holders of their shares, but on the real owners of bank capital. It will also forbid entities registered in offshore zones to be bank founders. This bill will help the CBR evaluate the soundness of bank capital and obtain a truer measure of capital adequacy.

The CBR permitted Russian banks with general licenses (that comply with legislation, meet all norms and requirements of the CBR and are current on all credit agreements) to buy stakes, including up to a controlling share, in banks of FATF- and OECD-member countries.

The Duma reconciliation commission working on amendments to the **law on currency regulation and control** approved a version of the bill that gives both residents and non-residents the right to carry out of the country up to \$10,000 in cash without any kind of voucher. Sums over \$3,000 need to be reported in a customs declaration. It is not permitted to take more than \$10,000 in cash out of the country at all.

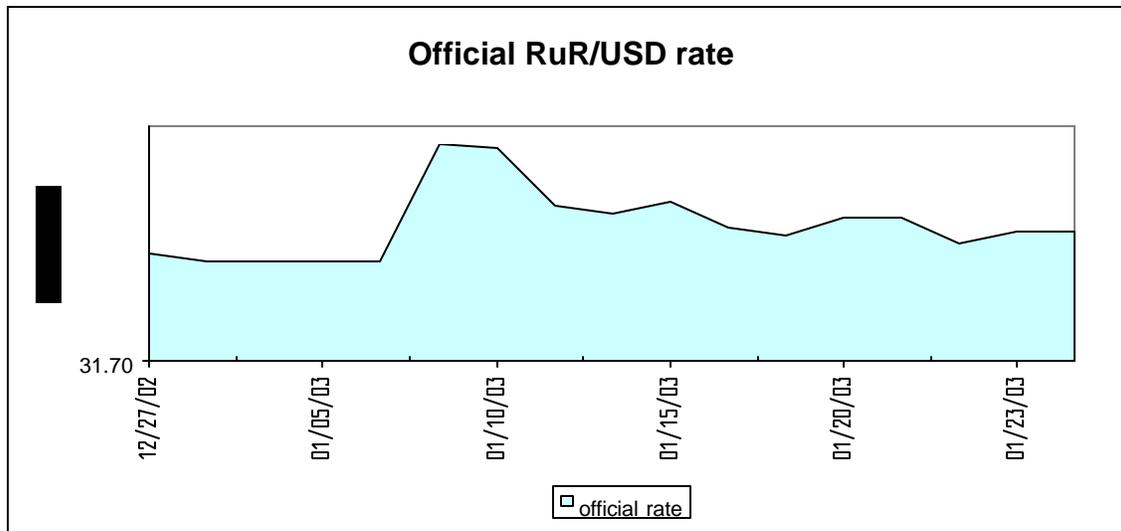
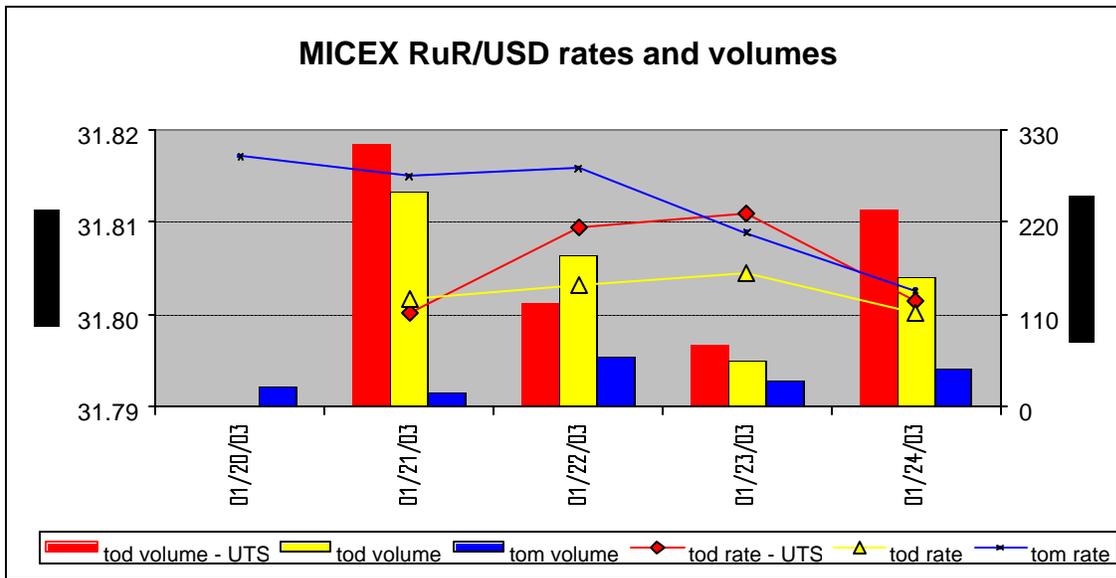
The Railroad Ministry will transfer a controlling stake in **Transcreditbank** to the Property Ministry in February-May, press secretary of the Railroad Ministry said. The bank had planned to place a new share issue in February, which seemed to show an intent to dilute the government's stake and sell the bank to entities affiliated with the Ministry's top management. It reportedly infuriated Prime Minister Kasyanov, who, at a recent GOR meeting, gave the order to immediately transfer the shares to the Property Ministry.

Financial markets

Forex Market

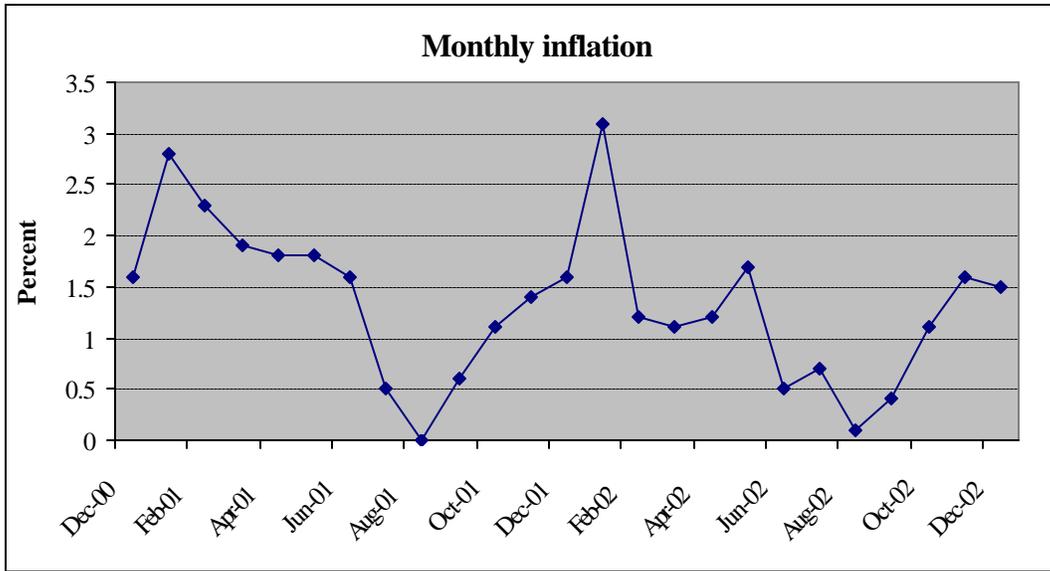
The dollar continued to fluctuate against the ruble in a narrow band as the euro continued to appreciate. The weakening of the dollar relative to major world currencies reduced the demand for it, which was outweighed by the supply from exporters. Exchange rate stability was maintained by the CBR buying the excess dollar at R31.80/\$.

For the week the ruble firmed 0.07% against the dollar, closing in the UTS on Friday at R31.8015/\$. MICEX weekly trade volumes were \$747.94 million, \$647.41 million and \$179.31 million for the morning (UTS), afternoon "tod" and "tom" sessions, respectively.



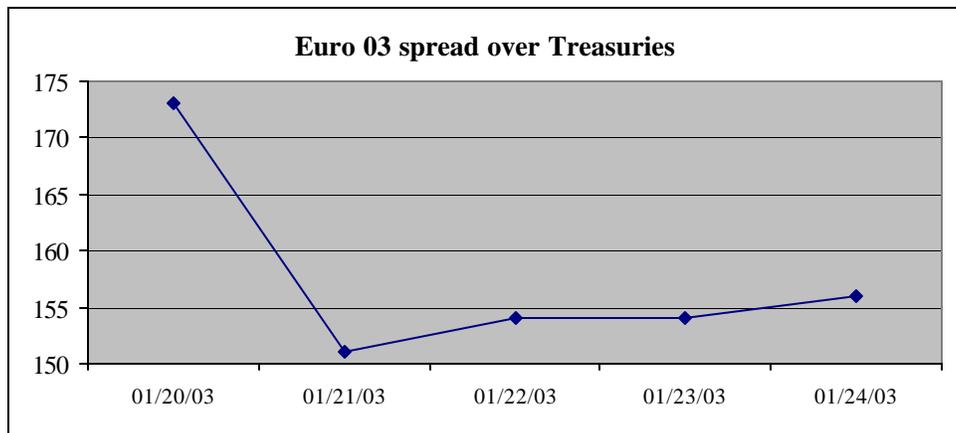
Prices

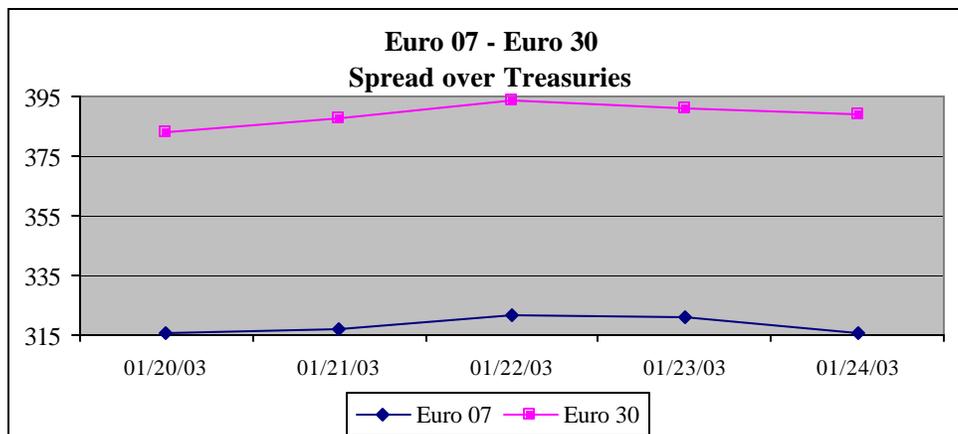
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Eurobonds

Russian Eurobonds market was quite stable last week with no clear-cut trend. In the very beginning of the week the activity was minimal due to the MLK holiday in the States. Activity increased on Tuesday; however, most players preferred to stay on sidelines due to the instability with the Iraq situation. Interestingly, the Russian segment was the most resistant to pressures from negative external news. The market was up by the end of the week on positive news from other emerging markets. Russian banks were buying Eurobonds, which also helped to push the market up as well.

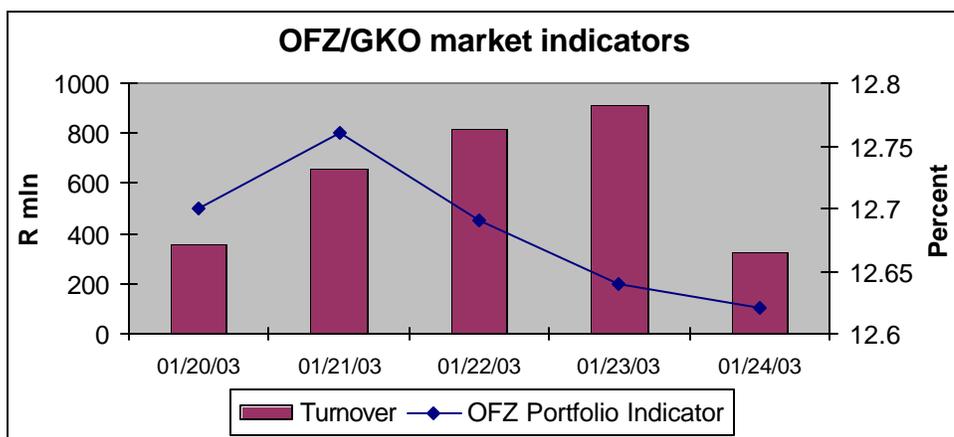




Interest/Bond Market

Bonds/Bills

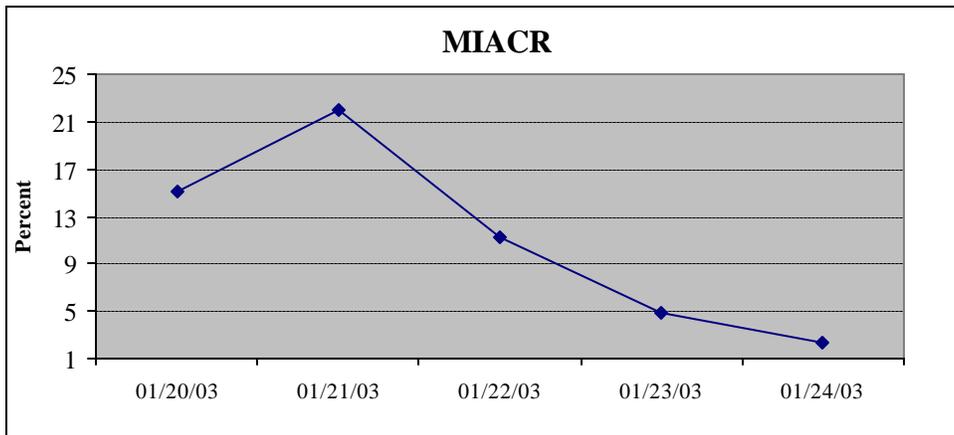
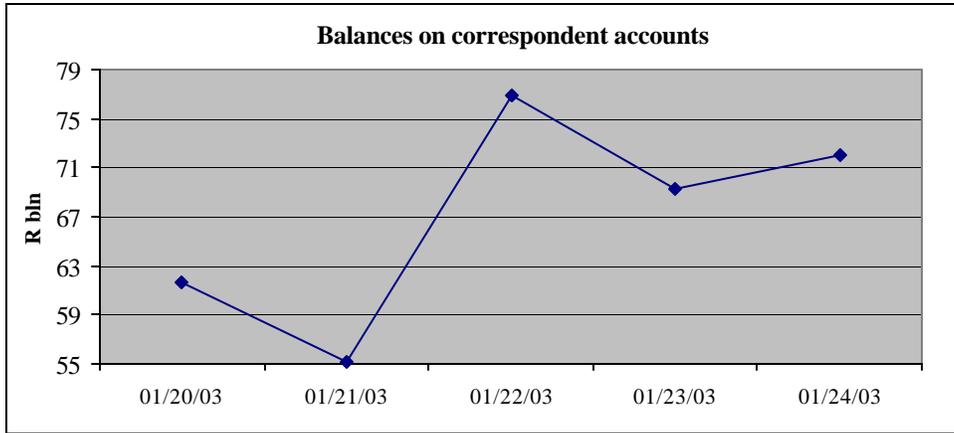
The secondary OFZ/GKO market was affected by the ruble shortage on Tuesday, which led the banks to scramble for rubles and redeem OFZ notes as is the normal pattern mid-month. On Wednesday, liquidity seemed back to normal, as MinFin sold almost all of its R4.94 billion in OFZ papers offered at 12.79%, which mature in April 2005. However, it sold only half of a longer term issue of R10 billion which matures in September 2008, at an average yield of 13.34%. These sales helped yields to fall later in the week, as expected.



Overnight rates

At the beginning of last week, the market experienced a very significant problem with ruble liquidity. The payment of \$1.86 billion equivalent in rubles to the government for Slavneft shares caused a sharp decrease in the balances on banks' correspondent accounts at the CBR down to R55 billion -- the lowest level since November 1999. Overnight rates were up to 20-25%. The usual mid-month obligatory tax payments added to the

tension as well. However, the banks were able to recover by Wednesday and the situation remained calm through the reset of the week.

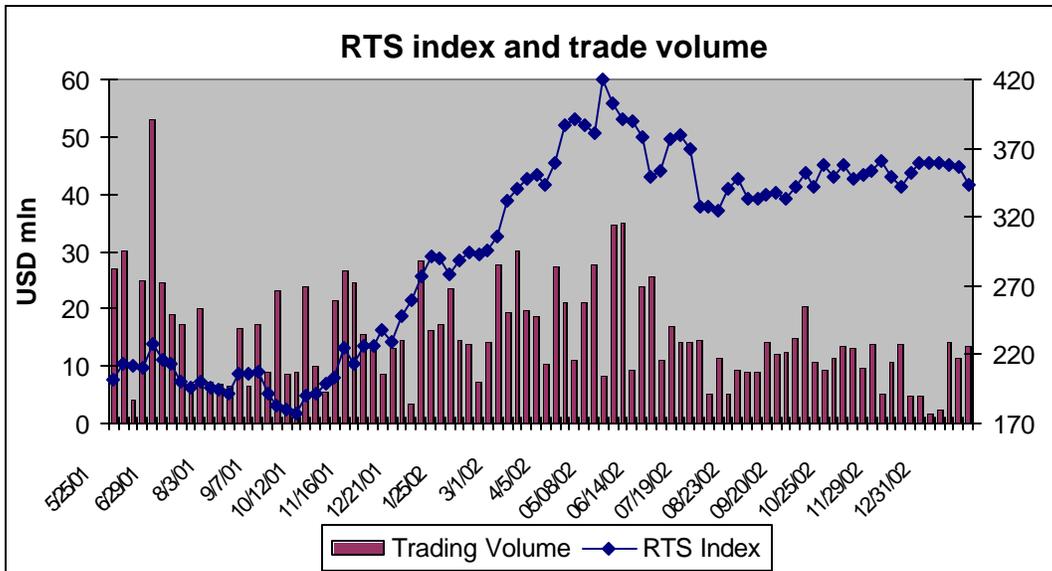
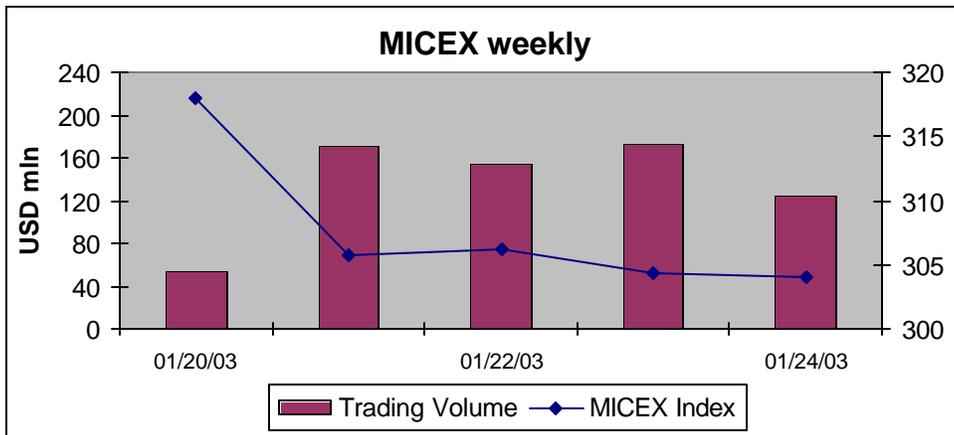
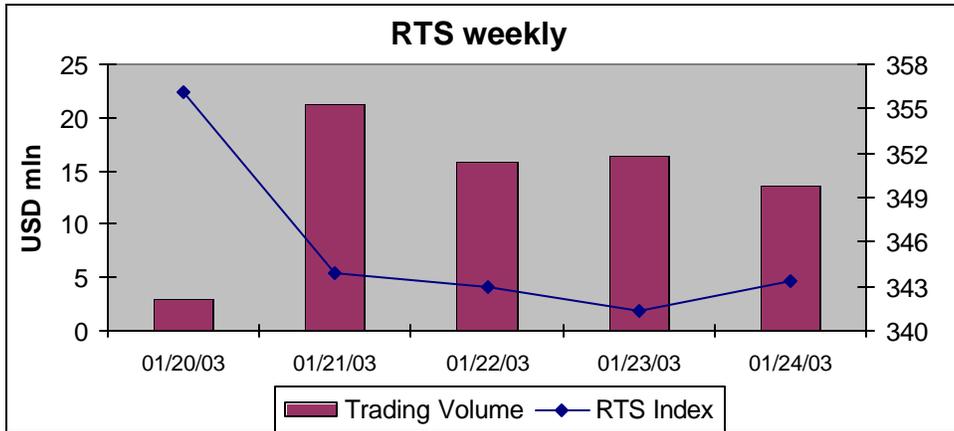


Stock Market

Last week, the Russian stock market declined under the influence of the falling foreign markets. A sharp drop in ruble liquidity at the beginning of the week caused banks to sell equity shares in panic. Also, domestic news about the delay of natural-monopoly reform further depressed the market. By the end of the week, the market was able to slightly recover at the 339-342 level, mainly due to oil shares. For the week, the RTS index was down by 3.67% in dollar terms, and is down 4.39% since the beginning of the year.

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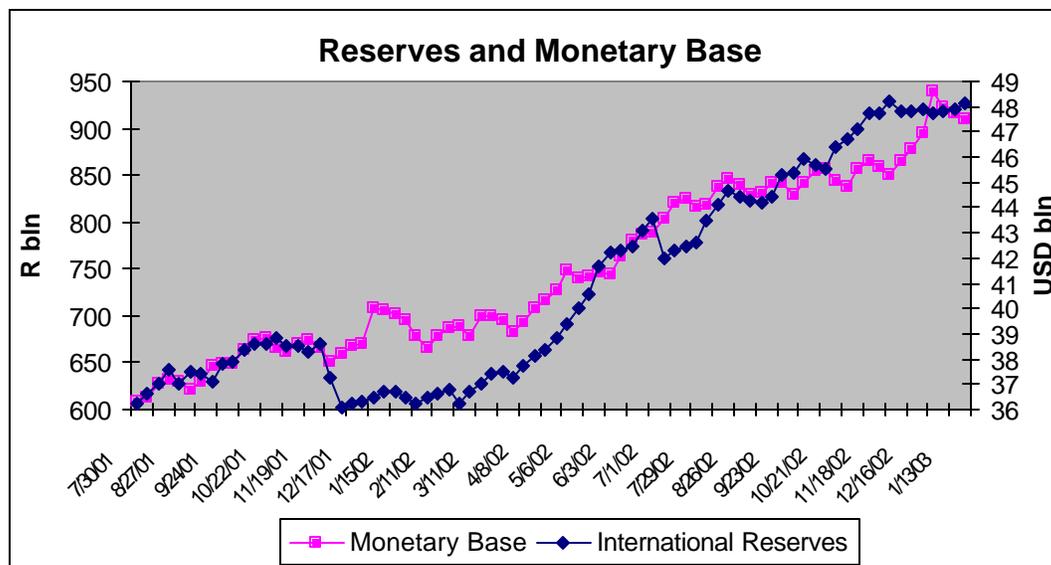
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International Reserves and Monetary Base

The international reserves of the CBR continued to grow and were up by \$200 million, which is just \$100 million lower than the record high level reached at the beginning of December. The monetary base continued to decrease at a slower pace; however, it fell by R5.5 billion to a level of R909.8 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.