

# Moscow Financial Weekly

For the weeks ending June 27 and July 4, 2003  
Treasury Attache's office, U.S. Embassy Moscow

## Highlights

- Export surrender requirement drops from 50% to 25%
- UK and French regulators agree to CBR divestiture from Moscow Narodny and Eurofinance Banks

## Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R30.3013	-0.12	-4.67
Monetary Base*	R1123.6 bln	1.02	19.49**
CPI	NA	NA	7.1
International Reserves*	\$64.4 bln	-0.77	35.01
RTS Index (end of week)	509.07	1.96	41.78
Refinancing rate	18	0	-3

\*For week prior

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

## Economic Developments

According to the Ministry of Finance, the **financial reserve** totaled \$5.5 billion as of July 1, which is down \$2 billion (24%) from its level at the beginning of 2003. During the period, foreign debt payments were \$3.8 billion, half of which was financed by previously accumulated reserves. The drop in the reserve is likely due increased non-interest expenditures (the primary surplus reached 3.2% of GDP in the first half of 2003, vs. 4% in first half 2002), as well as payment of the remaining foreign debt service due during this time.

**The Purchasing Managers Index and the Services Manager Index** published by **Moscow Narodny Bank** increased to 54.1 and 60, respectively in June. This suggests the further expansion in the domestic economy. (A score above 50 signals economic expansion.) The PMI index has grown for five consecutive months and is highest since October 2001. The Bank attributes growth to the increasing volumes of orders and new product lines of Russian producers. The output index is also encouraging, as about 40% of the survey paneled said that output at their plants was higher than a month ago, noting that rising production is the result of stronger domestic demand.

Goskomstat has confirmed that **industrial production** totaled 8.5% in May y-o-y. During the first five months of 2003, production was up by 6.7% y-o-y (compared to 3%

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y-o-y during the same period of last year). The positive news was that machinery and production of construction materials (which are domestically-oriented industries) started to pick up in May. Growth in these industries was 14.5 and 8.9% respectively, and can be explained by increased demand from the extraction industries. The growth in industries oriented to domestic demand was less impressive; for instance, the food processing industry was up by 3.6%. Growth in electric energy production slowed to 4.3% y-o-y, which may be due to the warm weather in May. The fuel sector, which includes gas and oil extraction, was up by 10.1%, demonstrating stable and high growth since the beginning of the year.

### **Banking sector**

The Central Bank has cut the **export surrender requirement** to 25% as of July 9. The Central Bank lowered the percentage from 30%, as is the ceiling contained in the amendment to the Currency Control Law, which entered into force on July 8.

The CBR has published a survey of the performance of the **domestic currency market** in May. According to this document, the ruble went up by 8.3% against the dollar in real terms during the month; however, this appreciation was outweighed by a sharp weakening of the ruble against the euro, so the real effective rate of the ruble fell in May by 2.6%. However, during the first five months of 2003, the real effective rate of the ruble remained virtually unchanged, with the ruble having strengthened by 8.3% in real terms against the dollar and weakened against the euro by 3.9%. It reflects, the CBR claims, a neutral effect of the exchange rate policy on the competitiveness of domestic commodities on both internal and foreign markets. This is borne out in the trade statistics, with the foreign trade surplus rising 14.5% y-o-y to \$4.365 billion in May, after dropping 3.1% y-o-y in April. Excess supply of foreign currency from increased export earnings necessitated "corrective" interventions in the currency market, resulting in a peak of net currency purchases by the Bank of Russia in May. Average daily turnover in the interbank currency market in was \$16.2 billion. Average daily turnover in the ruble/\$ segment of the interbank market was 7% larger than in April, while in the \$/euro segment the increase was more substantial, 63%.

French and British regulators no longer have objections to the CBR's divestiture of London-based **Moscow Narodny Bank** (MNB) and Paris-based **BCEN-Eurobank**, according to Aleksey Ulyukaev, First Deputy Finance Minister. Ulyukaev said that national supervisors would agree to a purchase of MNB and Eurobank by a credit institution from Russia. So far two Russian banks, Vneshtorgbank (VTB) and Evrofinance, and their affiliated companies, have expressed interest in purchasing MNB and Eurobank. VTB is GOR-owned, and a majority stake in Evrofinance belongs to GOR-owned entities. They recently proposed formation of a special purpose vehicle, which would include a number of larger Russian enterprises in addition to themselves, for the purpose of purchasing MNB and Eurobank. To offer the "roszaganbanks" for sale, the CBR will need approval from the National Banking Council (NBC). Ulyukaev said that NBC would discuss this issue in mid-July (just few weeks ago Oleg Vyugin, CBR First Deputy Chairman, said that the issue would be considered by NBC by the end of

June). Interestingly, and almost simultaneously with Ulyukaev's statement, Oleg Vyugin gave an interview in which he said that the CBR was not able to start pre-sale appraisal of MNB because of a court suit filed by VTB against MNB concerning a delinquency on a \$100-million loan. Vyugin believes the two state-owned banks should resolve the dispute out of court. He explained that the existence of a suit lowers the value of MNB to be assessed by an independent auditor. Thus, if the bank is sold before the dispute can be resolved, the CBR would lose money. Another interesting fact is that at the end of June, the International Finance Corporation decided to extend a 5-year \$100-million loan to each MNB and Eurobank. However, in contrast to the IFC loan to VTB, these two are not convertible.

**Sberbank's** AGM took place on June 27 in Moscow. It approved the annual report for 2002, elected the Supervisory Board and Auditing Commission, amended the charter and procedures for future AGMs. It was decided to pay dividends of 218% of the face value of an ordinary and 232% of the face value of the preferred share. Noteworthy, the IAS financials for 2002 were not released, and PriceWaterhouseCoopers instead of Ernst&Young was chosen as the auditor for 2003 financial year. Also interesting is that Vadim Kleiner, representing minority shareholders, whom Sberbank has recently sued for defamation damaging its business reputation, was re-elected to the Supervisory Board, together with the other minority shareholder representative, Boris Fedorov. Kleiner reportedly received more votes than anybody else did. Here is some of the statistics released at the AGM:

Sberbank equity rose over 2002 by 164%, from \$1.4 billion to \$3.7 billion. Revenues increased by 37.2% to reach R157.1 billion. The share of lending in the total revenues went up from 52.6% to 57%. Credit portfolio grew by 40% to R596.3 billion, of which 83% accounted for loans to the real sector. More than one third of the loans was extended for over one year.

The number of Russian banks in the **Top 25 in Central and Eastern Europe** in 2002 list published by the Banker magazine went up to 14 from 12 a year earlier. Russian banks' presence in Top 1000 in the World increased as well to 17. The new names on the CEE list are Bank of Moscow and Trust and Investment Bank. Sberbank is ranked first in CEE and 155-th in the world with (first-tier) capital of \$2,339 million, Vneshtorgbank is the second in CEE and 168-th in the world with capital of \$2,118 million and Gazprombank is the third in CEE and 371-st in the world with capital of \$833 million. Then, among Russia's biggest, come two privately-owned banks, International Industrial, 569-th in the world with capital of \$440 million, and MDM, 582-th in the world with capital of \$424 million. They are followed by Vnesheconombank, 633-rd in the world with capital \$365 million. The rest from the Top-1000 are: Globex, Bank of Moscow, Alfa bank, UralSib, Rosbank, Citibank, Petrokommerts, NOMOS, Raiffeisen, TRUST and International Moscow Bank. The Banker notes that despite impressive presence of Russian banks in the charts, only 20% of Russians have bank accounts, only 7% - have credit cards, only 9% apply for bank loans and just 5% received loans in the last 10 years.

On July 2 **Vneshtorgbank** Supervisory Board approved a new development strategy and forwarded it to the GOR. According to Andrei Kostin, VTB President and Board

Chairman, the strategy provides for radical reform in order to overcome lagging behind in a number of key areas (retail, investment banking and technology) by the end of 2004. The document stipulates that by that time VTB would complete "aggressive expansion into regions" by means of acquiring banks, primarily in the regions where it has no branches. As a result, VTB plans to double its share in the deposit market and increase its share of consumer and mortgage loans to 10% of the total Russia's volume. Privatization is an important item of the strategy. "A significant portion of shares belonging to the GOR will be sold, mainly through public offerings at exchanges in Moscow, London and New York". As a result, VTB hopes to become one of the 100 largest banks in the world by capital. An important role is also given to reorganization of the network of "roszagranbanks". According to the plan, there should be just one such a bank left after reorganization is completed, "with branches in Western and Eastern Europe, as well as in CIS countries". Kostin said that so far there is only an agreement with AFK Systema regarding the sale of controlling stake in East-West United Bank, but Luxembourg regulators have not yet authorized the deal.

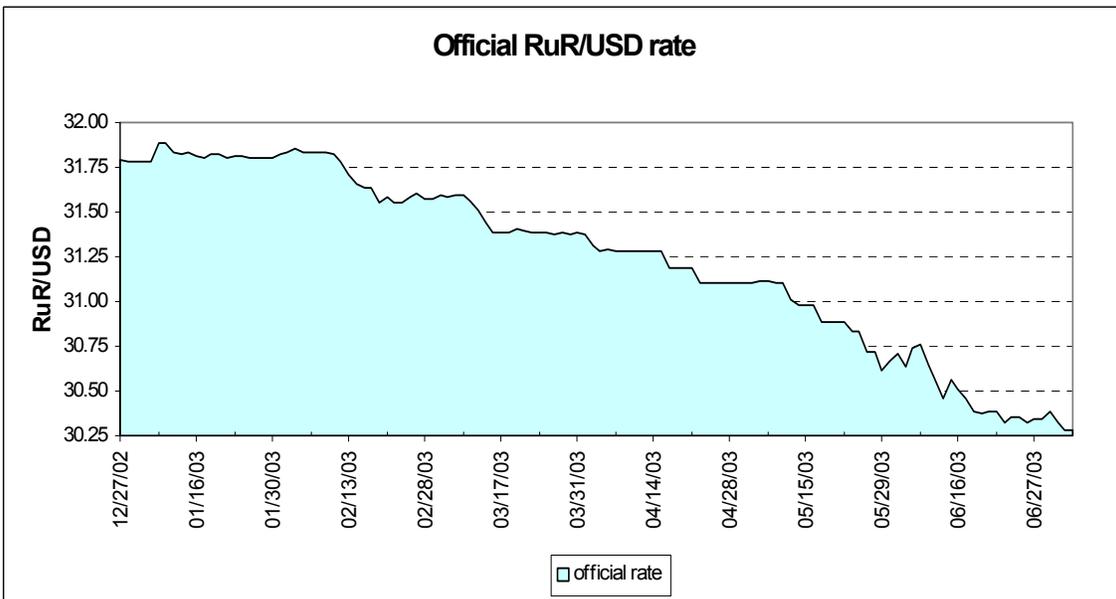
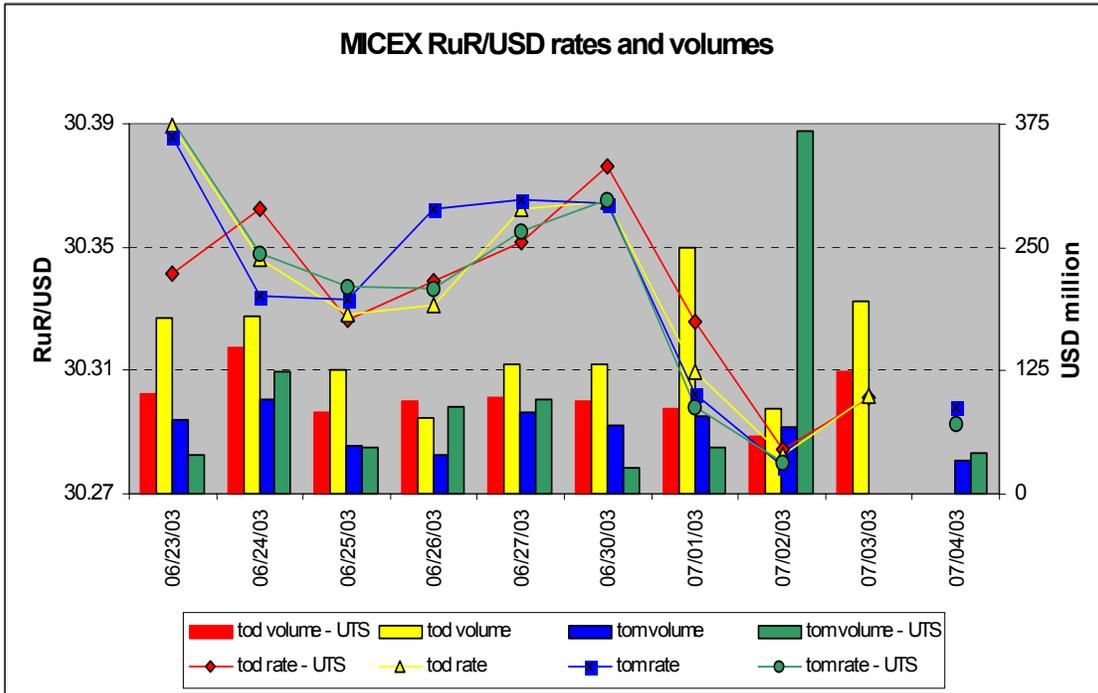
## **Financial markets**

### Forex Market

After steadily going down against the ruble for three weeks in a row, during the last week of June the dollar settled in the relatively narrow range R30.30 - R30.35/\$. The amendment to the currency law that sets a ceiling to the surrender norm at 30% recently passed by the Federal Assembly must have cooled those bearish traders, and the dollar's strengthening on the international forex market finally impacted the ruble/\$ market as well. The CBR appeared in the market during the week only once - on Wednesday - with just an "indicative" bid at R30.30/\$.

July, however, began with rapid dollar sliding against the ruble, triggered once again by its deteriorating position on international forex markets. On July 2 afternoon the CBR appeared with the bid at R30.28/\$ and stayed at this level until Friday. As a result of this intervention, official rate appeared to stay unchanged straight at R30.2800/\$ for two days in a row, July 3 and 4, and volume in UTS-tom on Wednesday surged to \$367 million. On the 4-th of July, when there was no trading with same day delivery, the market was dull, yet the dollar gained a little against the ruble, following its strengthening against the euro.

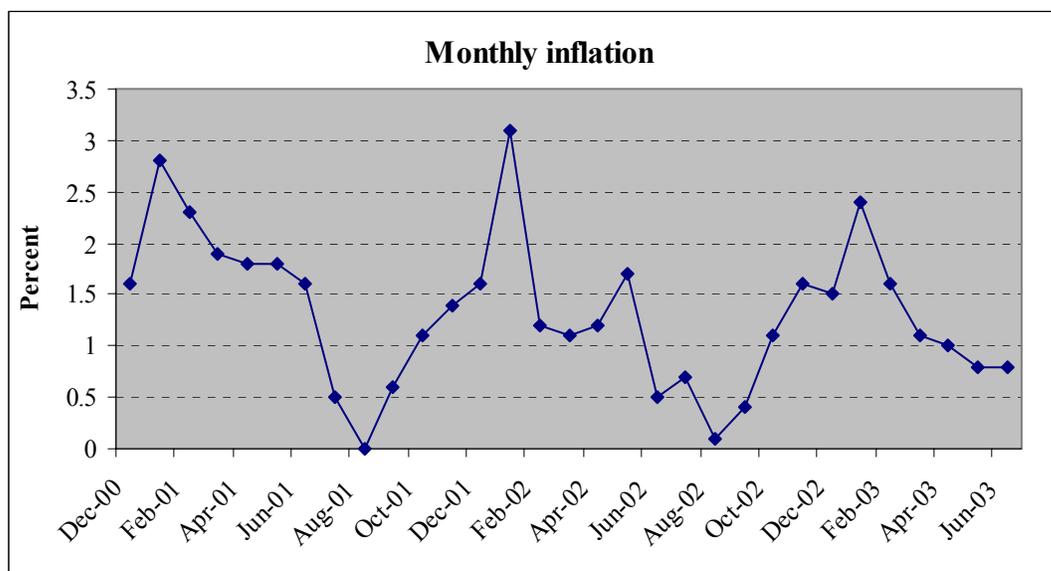
For the last week of June the dollar firmed 0.03% against the ruble, closing in the UTS "tod" on Friday at R30.3515/\$. MICEX trade volumes were \$521.02 million and \$392.33 million, \$693.44 million and \$338.98 million for the UTS "tod" and "tom" sessions, and SELT "tod" and "tom" sessions, respectively. For the first week of July the dollar weakened 0.12% against the ruble, closing in the UTS "tod" on Thursday (there was no T+0 trading on Friday) at R30.3013/\$. MICEX trade volumes were \$361.68 million and \$482.20 million, \$661.01 million and \$248.60 million for the UTS "tod" and "tom" sessions, and SELT "tod" and "tom" sessions, respectively.



Prices

According to Goskomstat data, inflation totaled 0.8% in June, for a total of 7.9% year to date, and 13.9% on an annualized basis. The trend of inflation over the past few months is downward. While in the beginning of the year, prices grew by 2.4%, the pace of

growth slowed to 1% in April and 0.8% in May and June. Inflation in May and June was fueled by services, mostly from health and recreation, for which prices rose by almost 7%. Another price level driver is bread, which increased by almost 5% in June. These slower trends are likely not to continue over the rest of the year, given that core inflation (adjusted for seasonal effects) has not fallen over the first half of the year. Also the money supply (M2) expanded at a rate of 4.5% per month in March - May, the inflationary effects of which will show up over the next 4-7 months.



### Eurobonds

During the first week observed, the Eurobond market was affected mainly by the decision of the Federal Reserve to decrease the U.S. discount rate by 25 bp, which led to the decline in yields of U.S. Treasuries. The Russian market therefore had no clear-cut trend that week. On Friday, the Russian sector was already up, but prices of all Eurobonds declined w-o-w. The positive news on the Eurobond coupon payments by Russia and increase of the international reserves to a record high level had a modest positive effect on the market.

Last week the overall trend was negative. The Russian sector actually under-performed mostly due to the high growth pace experienced earlier. The market is still very dependent on U.S. Treasury market trends. Later on the week, the arrest the Chairman of the Menatep group (Yukos) had some negative effects on the market as well, causing market players to reevaluate risk factors. As a result, prices of the most liquid Russian Eurobonds decreased to the levels last seen at the end of May. For instance, the price of Euro-30 dropped down to 95.1% of par, while the yield finished the week at 7.1% p.a.

According to Deputy Finance Minister Sergei Kolotukhin, Russia may consider a Eurobond issuance next year of up to \$3 billion (as compared to the \$2.2 billion that had been proposed earlier), with a maturity of up to 30 years. The last time Russia borrowed

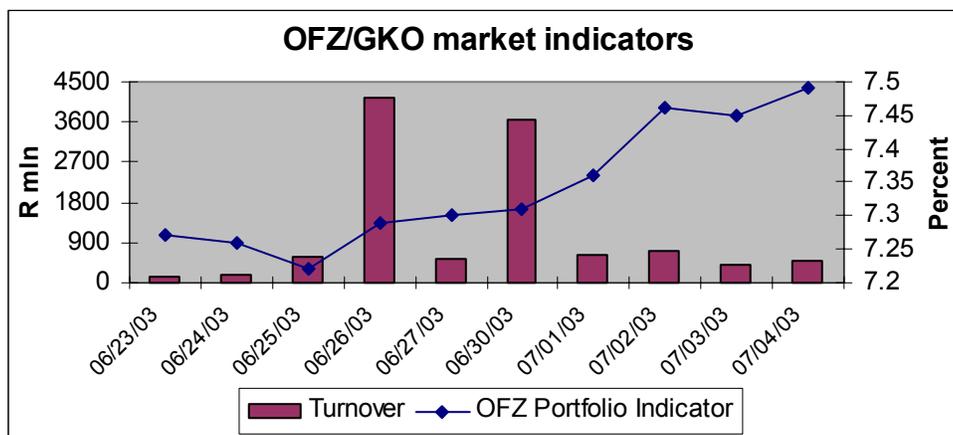
on the external market was in 1998, before the August crisis of that year. An increase in Russia's sovereign rating by the rating agencies to investment grade would make borrowing more attractive in 2004, when the famed 2003 external debt spike will have passed. At the same time, there are plans to borrow up to R263.1 billion (\$8.4 billion) on the local market, where debt servicing is less costly. Payments on the state debt in the domestic market are planned at R118.3 billion. Meanwhile, on June 24, the head of the State Pension Fund Mikhail Zurabov said yesterday that the Fund has invested R17.6 billion (\$570 million) since the beginning of 2003 in state bonds, of which about \$500 million is invested in Russian sovereign Eurobonds. In 2002, the Fund invested R37.7 billion (\$1.2 billion), of which 61.5% was placed in Russian sovereign Eurobonds.

Interest/Bond Market

*Bonds/Bills*

Trading activity on the secondary OFZ/GKO market was minimal during the week ending June 27, with the prices of almost all issues experiencing small downward corrections. OFZ prices were down by 0.2-0.6% on average. The negative factors that were effecting the market last week were the uncertain situation on the currency market, low yields offered by the secondary OFZ market, and large placement of corporate debt at the end of June. Trading volumes increased substantially on Thursday due to the repo auction cancellation that day (only one player bid) which caused money to flood into the OFZ market. However, by the next day volumes had already fallen to the previously low levels.

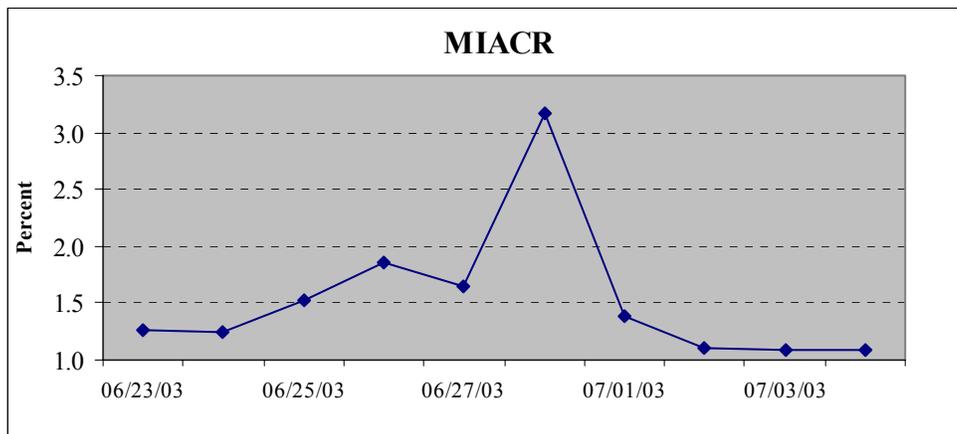
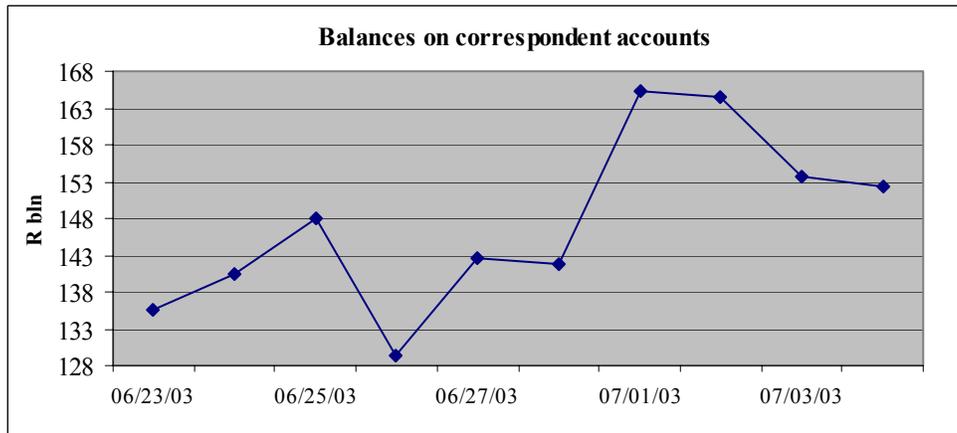
Last week, the activity remained on low levels, while prices continued to decrease at a slow pace. Low levels of yields on the market as well as large corporate bond placements were the main factors driving the market. An increase in ruble liquidity in the first days of the month played no role on the market.



*Overnight rates*

The overnight ruble interbank credit rates gradually increased until Friday of the first week observed, when the market saw a jump in the balances on banks' correspondent accounts at the CBR, to a total of R142.7 billion. The rates remained in the narrow corridor of 1-2% p.a. while balances slightly decreased compared to the previous week's level, but still remained at above average levels all through the week. The decrease is attributed to the obligatory tax payments of banks for their clients at the end of the month.

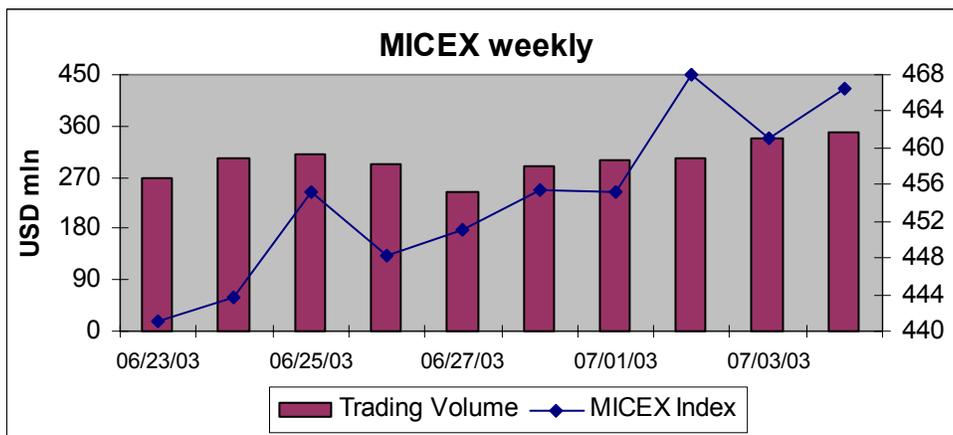
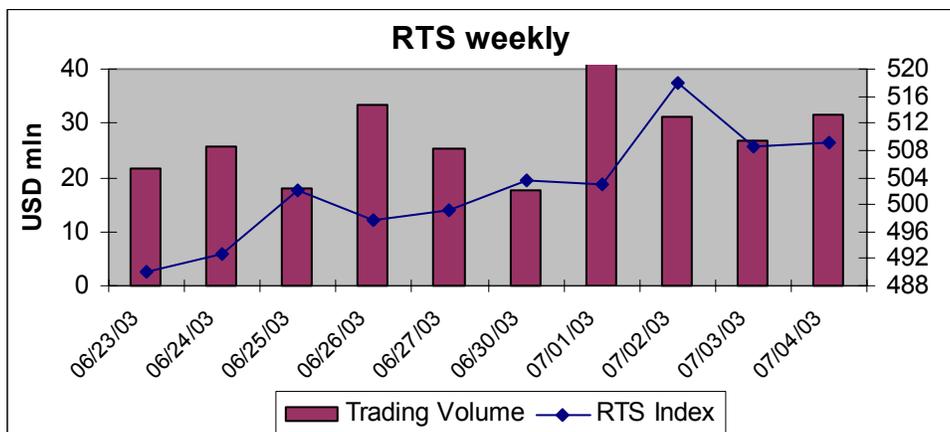
Last week the balances on banks' correspondent accounts at the CBR increased substantially after a slight drop on Monday (last day of the month). The next day balances jumped to R165 billion, knocking down the overnight interbank ruble loan rates to traditional level of 1-2% p.a. The average daily balances increased last week to R155.5 compared to R139.2 billion during the previous week.



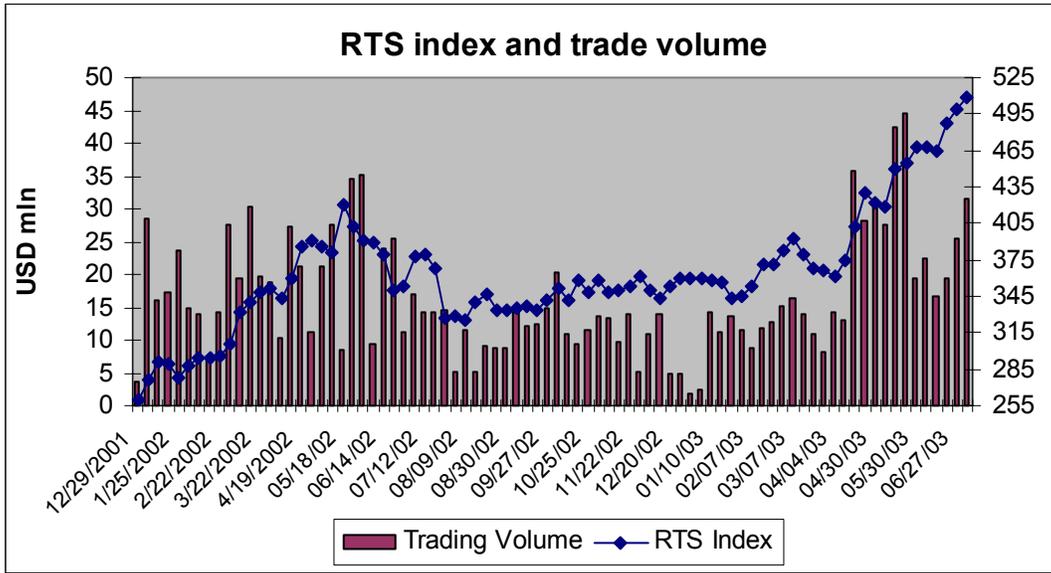
Stock Market

During the week of June 23, the stock market continued to rise until Wednesday, when it pierced through the very important psychological level of 500, stopping at 502.11. This is another record high, representing levels not seen since October 1997 and the beginning of the Asian crisis. The increase was fueled by stable demand for the oil shares during the first three sessions of the week with the leaders being YUKOS and Sibneft shares. The market experienced downward price corrections on Thursday which were caused by profit-taking after a good rally, as well as the closing of positions ahead of the end of the quarter. Trade volumes remained at average levels throughout the week increasing only on Thursday (the profit-taking day). The leaders of the week were Gazprom and RAO UES shares, which were up by 3.6 and 3.4%, respectively. The RTS index was up by 1.53% for the week in dollar terms.

Last week, the prices on the Russian stock started the week up. After a modest slide on Tuesday, the RTS index jumped up as high as 518.07 level but corrected downwards, finishing the week at 509.07 level which is 1.96% higher than the week before. The leader of the week was Gazprom which shares' prices leaped up by 25% for the week on the news about the imminent start of trading on MICEX, as well as the overall undervaluation of these shares. RAO UES were up again by 12.9% on low volumes, which suggests considerably lowered liquidity of these shares on the market. The RTS index is currently up by 41.78% since the beginning of the year.



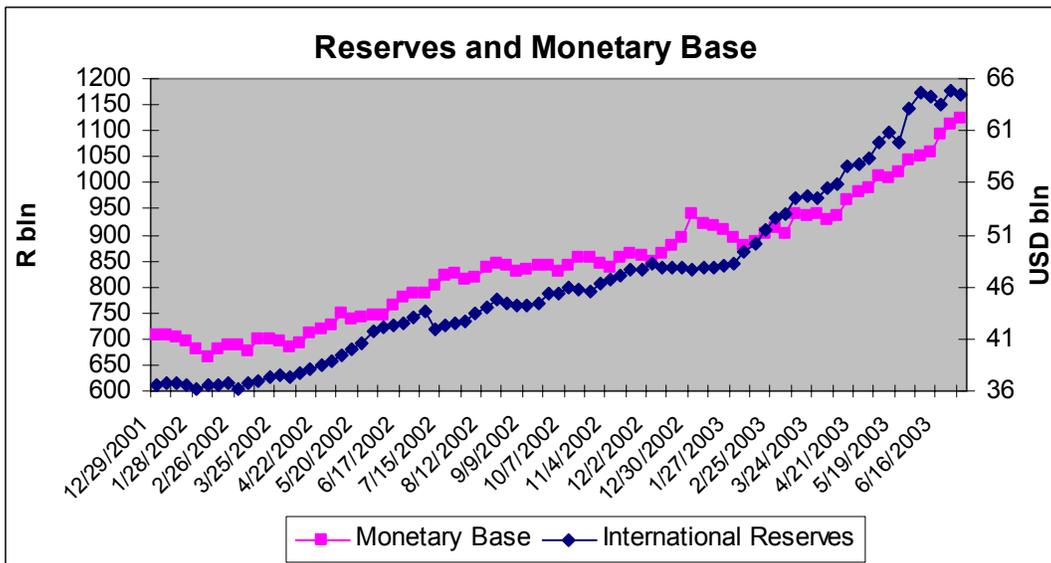
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International Reserves and Monetary Base

After two weeks of sliding, international reserves of the CBR and Finance Ministry increased by as much as \$1.3 billion and totaled \$64.9 billion as of June 20 -- another record high. However, next week reserves dropped to \$64.4 billion.

The monetary base continued to climb and as of June 23 it was R1,112.3. This is R20.9 billion higher than a week before. The next week the base was up again and totaled R1,123.6 billion as of June 30 billion. It is 1.02% or R11.3 billion higher than a week before, and 19.49% or R183.3 billion higher than in the beginning of the year.



## 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.

