

Moscow Financial Weekly

For the week ending July 11, 2003
Treasury Attache's office, U.S. Embassy Moscow

Highlights

- Stock market slides 9.9% on YUKOS news
- GDP growth forecast increased to 5.7% for 2003
- Approval of banking-related legislation expected in November

Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R30.3867	0.28	-4.47
Monetary Base*	R1148.0 bln	2.17	22.09**
CPI	NA	0.25	8.17
International Reserves*	\$64.9 bln	0.78	36.06
RTS Index (end of week)	462.20	-9.21	28.72
Refinancing rate	18	0	-3

*For week prior

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

Economic Developments

The Ministry of Economic Development and Trade has increased the annual **GDP** forecast from 4.6% to 5.7%. Even though the estimate is preliminary and needs to be approved by the Central Bank to become the official Cabinet forecast, it reaffirms the positive trend in Russian economic growth. The initial forecast had been 3.5-4.4%, and had already been raised once earlier this year, to 4.6%, due to strong growth figures at the beginning of the year. Meanwhile, Minister Gref has reported to the President that GDP rose by 7.2% during the first half of 2003. This growth is attributed mainly to the flourishing world prices of oil and other natural resources, as well as increasing investment and growing consumption within the country.

Banking sector

On July 8 Andrey Kozlov, CBR First Deputy Chairman, and some members of the Duma Banking Committee expressed optimism that **banking-sector-related legislation** could be passed by the Duma by November. The statements took place at a press conference held jointly by the Association of Russian Banks (ARB) and the Institute of State and Law of the Russian Academy of Sciences (ISL). All of the speakers (among them

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Kozlov, Valery Zubov, Chairman of the Duma Committee on Credit Organizations and Financial Markets, his deputy Pavel Medvedev and, of course, ARB President Garegin Tosunian) unanimously expressed confidence that the "banking package" (deposit insurance bill, bank bankruptcy bill and the bill on mortgage securities) could be passed by the Duma by November. They put the main blame for the delay on the GOR, but also admitted some fault on their part: the initial drafts had not been thoroughly worked out. To rectify this, ARB and ISL signed an MOU, according to which ISL lawyers are to help in eliminating all the shortcomings in the banking bills by the fall Duma session. Simultaneously with the press conference, Aleksandr Zhukov, Chairman of the Duma Committee on Budget and Taxes, gave a radio interview in which he also said that the "banking package" could be passed in October.

According to the CBR website, during the month of April the volume of loans issued by **Alfa bank** to individuals more than quadrupled - from R5.5 billion to R23.5 billion. This single-month increase, R18 billion, exceeds the total amount of loans to individuals, or "natural persons", given by all the other Russian banks in the whole first quarter of 2003. Aleksey Simanovsky, Head of the CBR Department of Regulation and Supervision, told *Vedomosti* on July 7 that the situation with Alfa's reporting "was being examined." Meanwhile, the newspaper claims that most of the loans were given to employees of Alfa Group, which seems to have paid 2002 bonuses in the form of loans and life insurance in order to reduce its taxes -- in particular, the unified social tax. Also according to *Vedomosti*, the means for issuing the life insurance was the Vesta insurance company (which had been bought by Ildar Karimov, Alfa bank's Deputy Board Chairman, in 2002). Vesta issued the new life insurance contracts that increased its total volume of premiums by 36,000%. According to this version of events, questionable operations were brought out of Alfa Group, while still remaining under the control of its management.

The British magazine *The Banker* admitted that it had mistakenly rated **Alfa bank** 760th in the world and 9th among Russian banks in the rankings by first-tier capital (see previous weekly). The correct figure for Alfa's capital is \$362 million, which puts it 635th in the list of world's largest and 7th in Russia, right between Vnesheconombank and Globex. The mistake was caused by a typo during the early stages of compiling the rankings, *The Banker* explained.

Michinoku Bank, the only Japanese bank operating in Russia, opened a rep office in Khabarovsk. It plans to spend \$100 million on housing mortgage loans to citizens of Khabarovsk, Michinoku Bank Chairman said at the opening ceremony. Loans of up to \$30 thousand will be given for 15 years at 6% p.a.

Financial markets

Forex Market

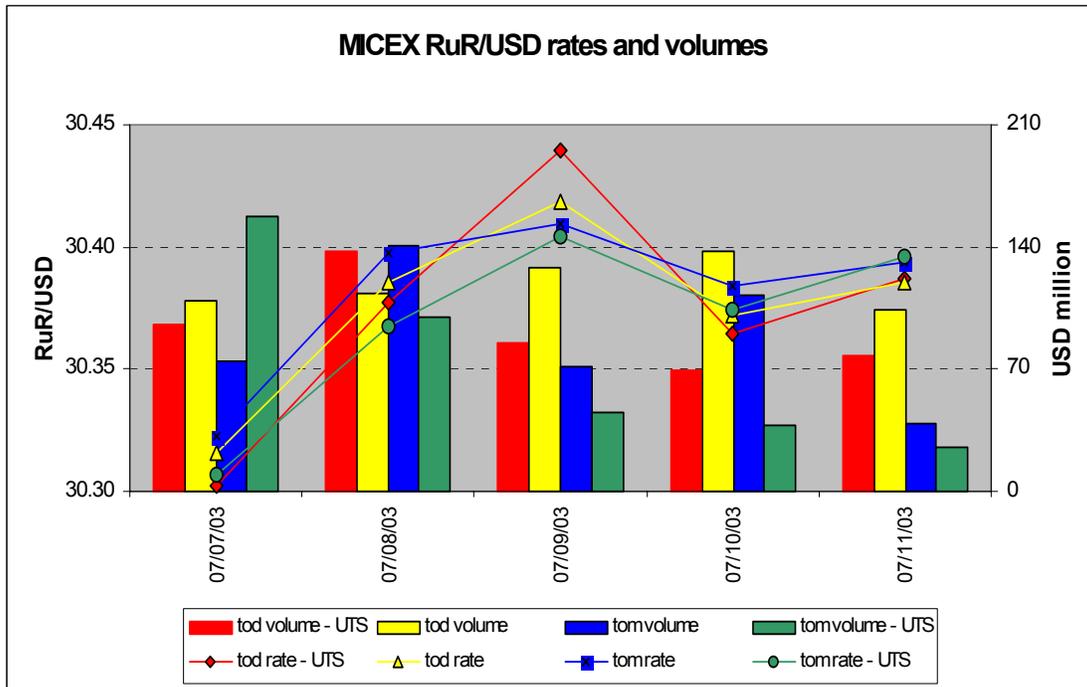
The ruble/dollar market was fairly calm all through the week, so the CBR had no need to intervene. Volumes were moderate, and the ruble/dollar rate reflected fluctuations in the euro/dollar rate, but at smaller magnitudes. The cut of the hard-currency surrender cap

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from 50% to 25% that came into effect in the middle of the week apparently had no impact on the market, but the continuing investigation of YUKOS may have slightly increased the demand for dollars.

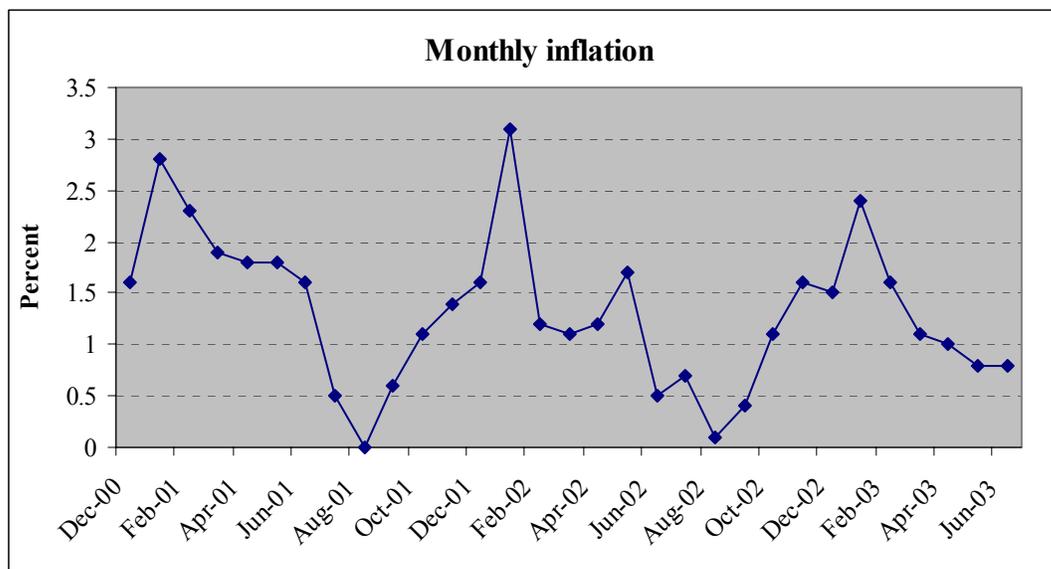
For the week the dollar firmed 0.28% against the ruble, closing in the UTS "tod" on Friday at R30.3867/\$. MICEX trade volumes were \$465.09 million and \$366.16 million, \$591.52 million and \$436.65 million for the UTS "tod" and "tom" sessions, and SELT "tod" and "tom" sessions, respectively.



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Prices

During the first seven days of July, price growth totaled 0.25%. (Inflation since the beginning of the year is 8.17%.) If this rate persists through the rest of the month, the July monthly rate should end up at about 1%. The GOR's target for annual inflation remains unchanged at 12%, although on an annualized basis, it has already exceeded that target.

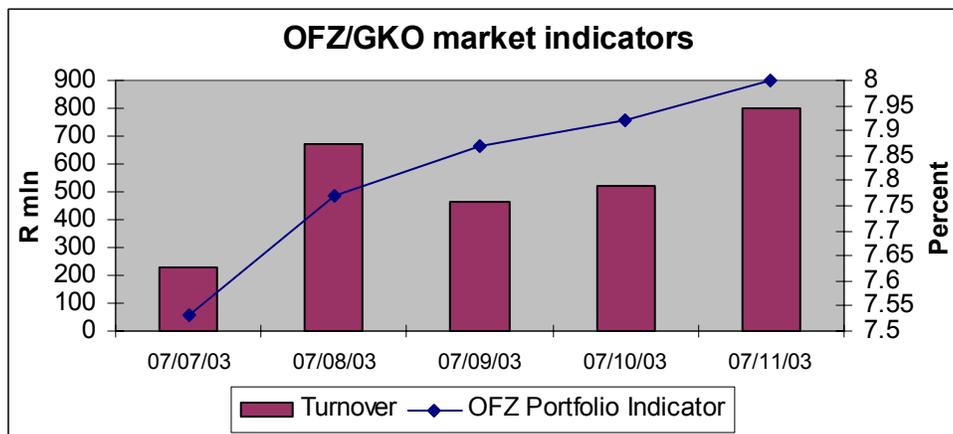
Eurobonds

The Russian Eurobonds sector was negatively affected by falling prices of US Treasuries at the beginning of the week, as well as the slide in Turkish and Brazilian Eurobonds. The market was able to recover slightly in the middle of the week, but later began to fall again, on the news of continued YUKOS inspections as well as the resumption of the decline in US Treasuries quotes. Trading activity was low again due to the uncertainty over the trend of the market, but the overall pace of downward movement slowed last week compared to the past several weeks.

Interest/Bond Market*Bonds/Bills*

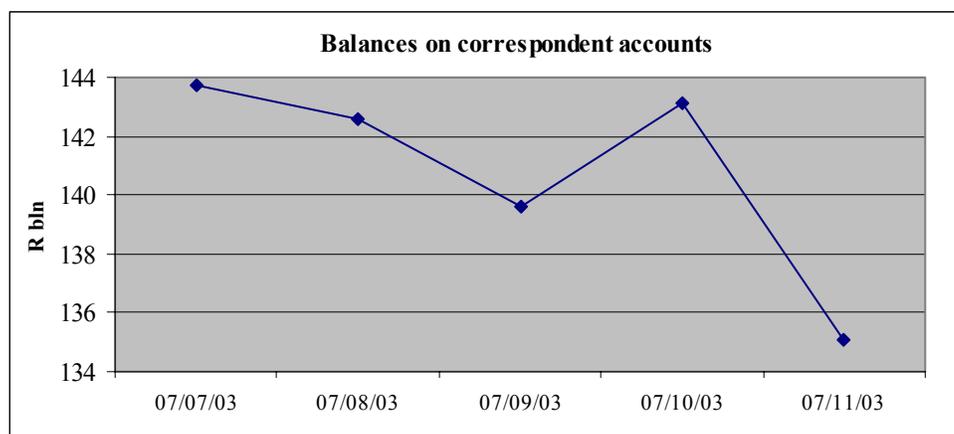
The downward trend persisted on the secondary OFZ/GKO market throughout last week, affecting mainly the longer-term sector of the market. On Wednesday, the Finance Ministry held an auction of the OFZ issue 27024 with maturity on April 16, 2006. The Ministry was able to satisfy most of the demand, but the interest of the market was not very large. The issue was placed at approximately the current secondary-market yield

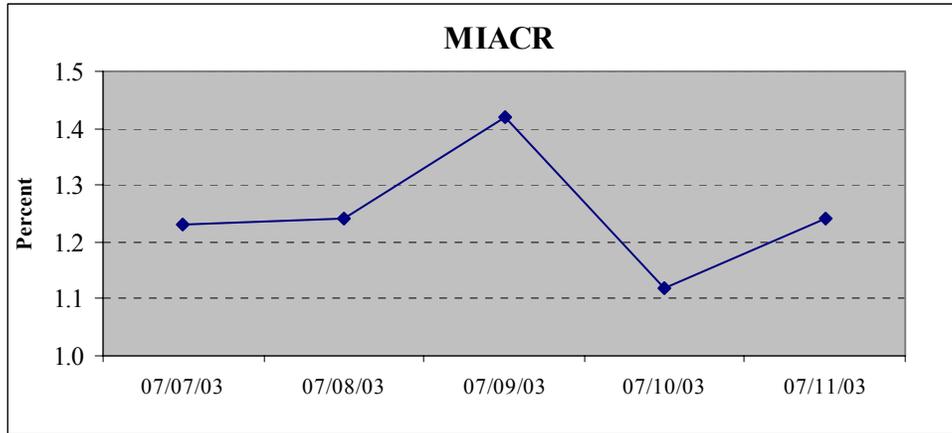
levels, so the results of the auction had no effect on the mood of the secondary market. Selling pressure was felt by the end of the week, bringing longer-term yields to 8% p.a. – a level last seen in the middle of May.



Overnight rates

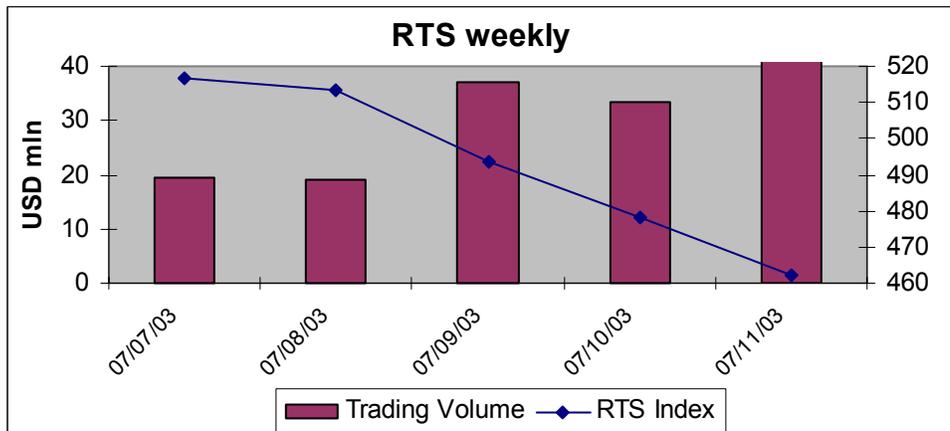
Ruble liquidity remained as usual last week: that is, the quantity of rubles in the banking system was high and stable. The balances on banks' correspondent accounts at the CBR never dropped below R135 billion throughout the week. Overnight ruble interbank credit rates increased substantially, eventually fixing in the range of 1-2.5% p.a. which is also became the traditional level of the rates in the past couple of months.

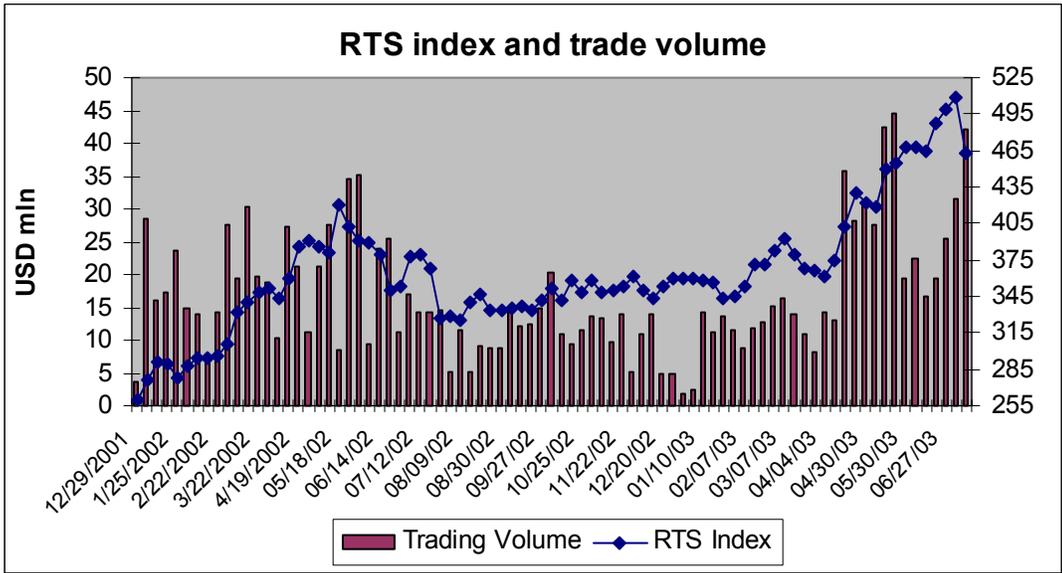




Stock Market

The RTS index started the week up, but during the following four consecutive sessions it lost 9.21% w-o-w, which set it back to its level at the beginning of June. Although world markets were going up last week on positive corporate news, the Russian market moved in the opposite direction because of the news of tax investigations at YUKOS and Sibneft. First, traders began to dump oil shares, but later in the week the downward correction spread to the rest of the market. YUKOS shares dropped by 13.3% for the week, LUKoil fell by 13.7%, and Sibneft was down by more than 18% for the week. RAO UES was an “island of stability” in the falling market – its common shares declined by only 4.2% (supported by strategic investors) and preferreds actually increased by 0.5% for the week.

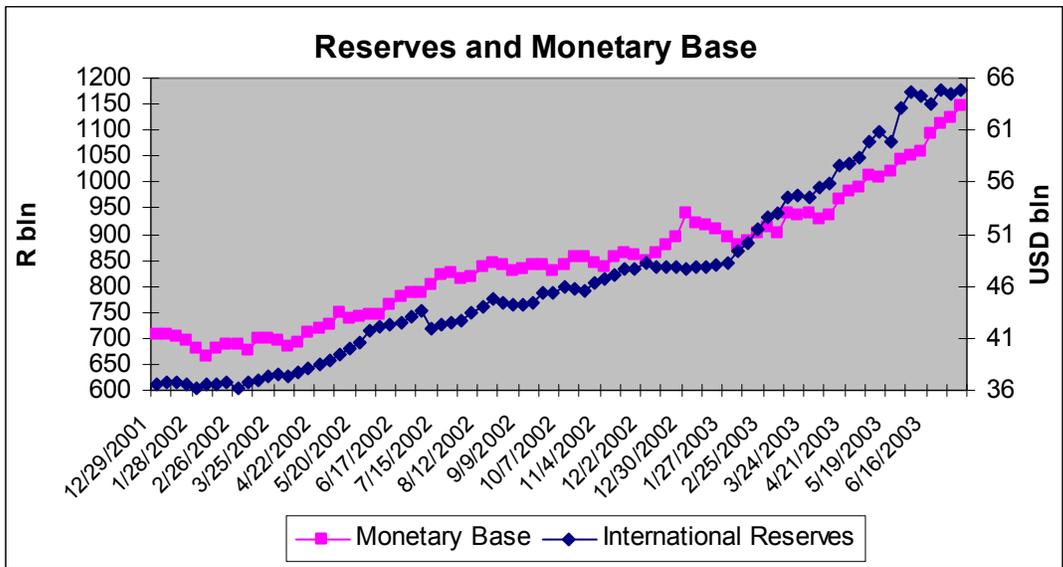




International Reserves and Monetary Base

The reserves gained back the losses posted as of June 27, regaining the level of \$64.9 billion on July 4, up by 0.78%.

The monetary base increased again last week by 2.17% or R24.4 billion, reaching a new maximum level of R1148 billion as of July 7.



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.

