

# MOSCOW Financial Weekly

For the week ending June 6, 2003  
Treasury Attache's office, U.S. Embassy Moscow

## Highlights

- Government approves 2004 budget
- Deposit Insurance bill -- first Duma reading delayed until fall
- CBR announces 2004 target date for IAS reporting by banks

## Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R30.5680	-0.54	-3.83
Monetary Base*	R1049.5 bln	0.61	11.61**
CPI	NA	NA	7.1
International Reserves*	\$64.7 bln	2.54	35.64
RTS Index (end of week)	467.06	-0.01	30.08
Refinancing rate	18	0	-3

\*For week prior

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

## Economic Developments

On June 5, the cabinet approved the **2004 budget**, which will be sent to the Duma for consideration. The proposal includes a budget surplus of 0.6 percent of GDP (R95.1 billion) with revenues at R2.69 trillion and expenditures at R2.59 trillion. Increased spending is planned for national security defense, law enforcement and social programs, as well as wage increases for federal employees. The budget assumes an average Urals oil price of \$22 per barrel. All surpluses earned above this level will be put into the proposed stabilization fund, with foreign debt payments covered by refinancing and domestic borrowing, Finance Minister and Deputy Prime Minister Kudrin said.

MinFin announced results of **first quarter 2003 budget** execution. The budget surplus was R89.3 billion (\$2.8 billion) or 3.2% of GDP, with revenues of R580.9 billion and spending of R491.6 billion. The surplus is lower than for the same period last year (4.7%), although revenues were strong, almost 21% of GDP, given strong oil prices over the quarter.

The Russian economy continues to grow rapidly, according to the May results of the **Moscow Narodny Bank Purchasing Managers Index and the Services Manager Index**, 53.7 and 59.6, respectively. (A score above 50 is indicative of expansion.) Strong domestic demand and increased investment are likely reasons for increase in both indices, with employment in services accelerating to its fastest level in over a year. Interestingly enough, the business morale index slipped to its lowest level in the survey's history.

### **Banking sector**

On June 3 the Duma Council deferred the **deposit insurance** bill until the fall session. Reportedly, the OVR faction initiated the postponement. The GOR agreed to provide some amendments for the first reading, including 100% coverage on deposits and the corresponding changes to enlarge the insurance fund.

The **Twelfth International Banking Congress (IBC-2003)** took place in St. Petersburg from June 4-7. The Congress included separate sessions on: international competition, retail banking, real estate finance, SME lending, banking supervision, and IAS and transparency. CBR Chairman Sergey Ignatiev told the Congress that de-dollarization of Russian economy had begun. The share of foreign-currency liabilities in total liabilities of the banking sector in April declined slightly, from 30.5% to 29.2%, Ignatiev said, pointing out that it was the first time this indicator dropped since July 1, 1998, when the share of foreign-currency liabilities stood at 29.4%. In his presentation Ignatiev made a special emphasis on cleansing banks of inflated, fictitious capital, noting that he will closely watch the implementation of CBR norms and would personally support his staff's efforts in this task.

According to Aleksey Simanovsky, head of the CBR Department of Bank Regulation and Supervision, the CBR has audited 60 banks looking for artificially **inflated bank capital**. In more than 30 banks, CBR's suspicions proved to be true. In most cases, banks acknowledged that some schemes to inflate capital had been used, Simanovsky said. However, the Committee on Bank Supervision will need to review two cases in which banks involved strongly disagree with the results of the audit.

Andrey Kozlov, CBR First Deputy Chairman, shared his personal vision of the **future structure of the Russian banking system**. He believes that in about ten years, the sector will consist of five layers: 1) Five or six large banks to support global expansion of Russia's biggest businesses; 2) 20 to 30 banks would service Russian corporations on the domestic market as well as in CIS; 3) another 20-30 banks with broad branch networks providing universal services domestically; and 4) few dozen banks will service specialized niches such as mortgages and consumer lending; and 5) the remaining 200-300 will service SMEs.

The CBR officially announced the transition to **International Accounting Standards (IAS)** effective January 1, 2004. Banks will begin providing IAS-compliant reports for

the period January 1- September 30, 2004, and thereafter will report on a quarterly basis. RAS financials will be used as the base in formulating IAS reports, with transformation algorithms to be published later this year. Interestingly enough, Tatyana Paramonova, CBR First Deputy Chairman, told the St.-Petersburg Banking Congress that the International Accounting Standards Board is to blame for the delay, not the CBR, because IASB has not yet completed the certified translation of IAS into Russian. The result is that the first IAS report for Russian banks will cover the first nine, not six, months of 2004, as was originally envisaged.

In a presentation made at the IBC-2003, Andrey Borodin, **Bank of Moscow** President, accused Sberbank of unfair competition - dumping retail lending rates. (Sberbank Supervisory Board member Vadim Kleiner is being sued by Sberbank for making similar accusations.) Sberbank President Andrey Kazmin responded immediately, explaining reduction of lending rates to below market levels as caused by "competition with cross-border banking institutions."

**European Bank for Reconstruction and Development** is ready to invest up to \$300 million in Russian banks to help them finance private sector, mortgage lending and leasing projects, Kurt Geiger, head of EBRD department of financial institutions, told IBC-2003. Geiger noted that these investments are in addition to the Vneshtorgbank deal.

The Bank of Russia does not have concrete buyers for **Eurobank and Moscow Narodny Bank** (MNB) shares, and the CBR has not yet formulated proposals regarding the sale of its stakes in these banks, Oleg Vyugin CBR First Deputy Chairman told journalists. Vyugin added that the National Banking Council plans to discuss CBR's divestiture at the end of this month. The CBR owns more than 80% in Eurobank and in MNB. As for the remaining stakes, "the state, in the person of the CBR, has to retrieve them, as they have been transferred for free," Vyugin said. He also said that selling some stakes to the management might be considered as an option, however, national regulators in the UK and France might not allow sell more than 10-15% to the management.

**Bank Zenith** is placing a Eurobond issue worth \$125 million. ING Bank and WestLB are the lead-managers. The deal is structured in the form of loan participation notes issued by WestLB, priced at par, and having a 9.25-% coupon.

**Sberbank's** press service announced that Aleksandr Zakharov was appointed Deputy Board Chairman responsible for international relations and Sberbank's depository. Until late April Zakharov was General Director of MICEX.

## **Financial markets**

### **Forex Market**

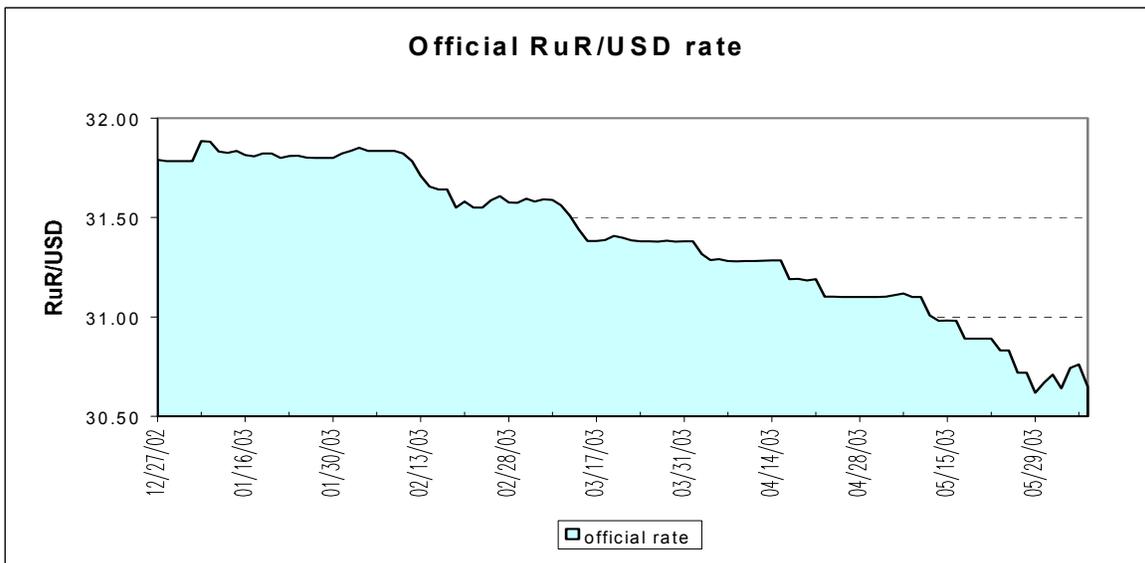
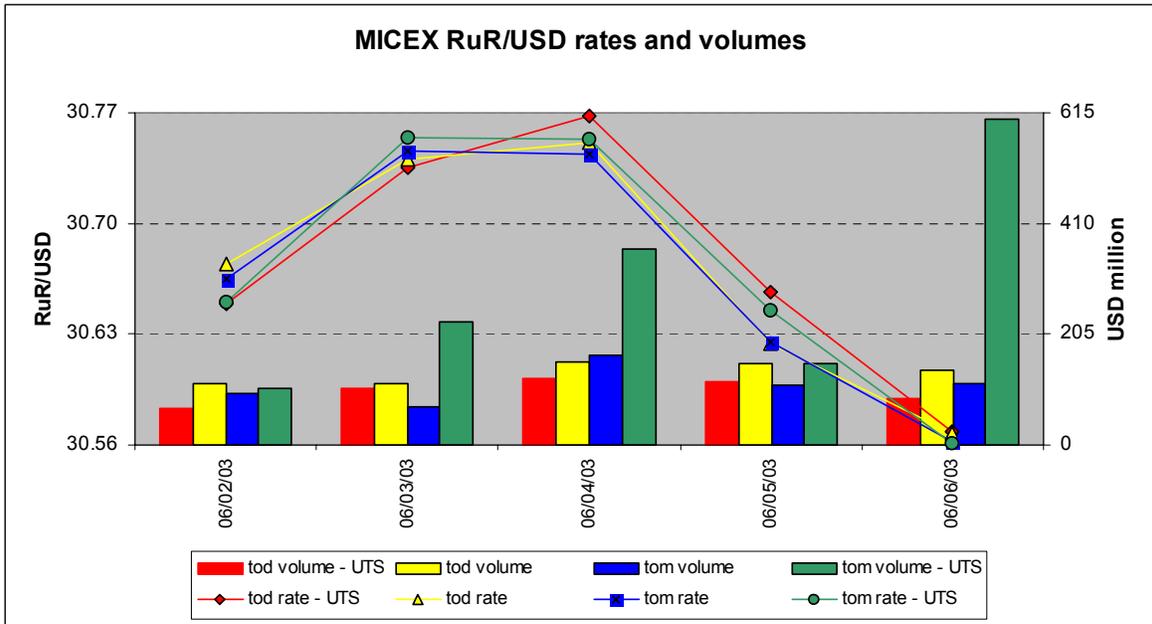
Last week the ruble/dollar market was even more volatile than in the previous period. On Monday the ruble gained 7 kopeks against the dollar. On Tuesday and Wednesday, on

MOSCOW FINANCIAL WEEKLY

-4-

the contrary, the dollar firmed by 10 and 2 kopeks, respectively. The CBR put a limit to dollar appreciation, selling US currency at R30.76/\$. On Thursday the dollar lost more than 11 kopeks at once, and it was the biggest single-day drop since December 2001. On Friday the dollar went on sliding down and was stopped only by a new CBR intervention, this time on the other side. That day the CBR bought back all the dollars sold in the middle of the week, but significantly cheaper.

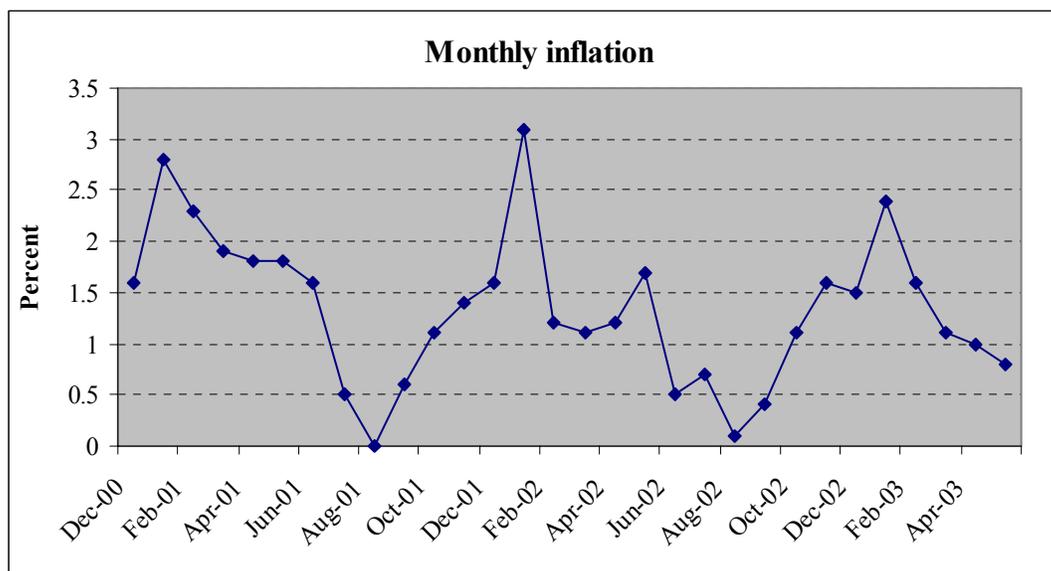
For the week, the dollar weakened against the ruble 0.54%, closing in the UTS on Friday June 6 at R30.5680/\$. MICEX weekly trade volumes were \$496.78 million and \$1448.77 million, \$669.86 million and \$554.11 million for the UTS "tod" and "tom" sessions, and SELT "tod" and "tom" sessions, respectively.



For the week ending June 6, 2003

## Prices

According to Goskomstat data, inflation in May was 0.8% which is the lowest monthly figure seen yet in 2003, as is also the lowest May inflation figure seen since 1998. May inflation turned out to be unexpectedly lower, as the forecast was for 1-1.2%, due to increased amounts of ruble savings held by the public. While this may increase the probability that the government's annual target of 12% will be achieved, continued increases in the money supply may push inflation up by fall. For the first five months of 2003, inflation now stands at 7.1%.



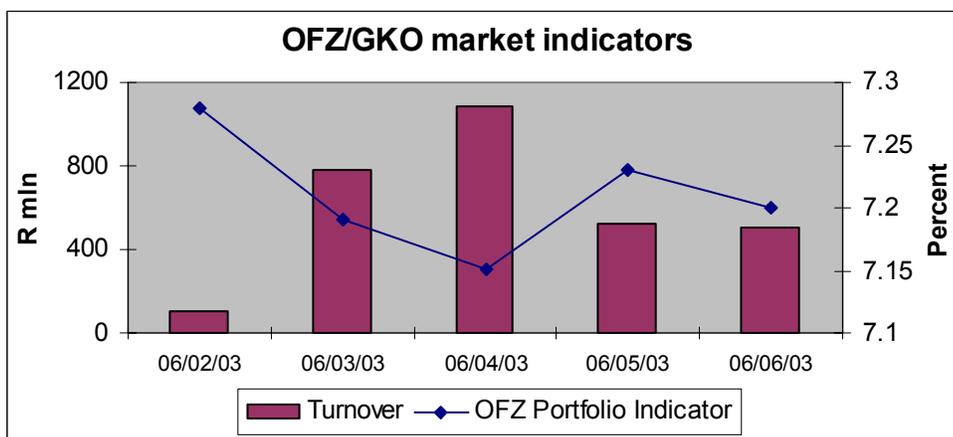
## Eurobonds

The Russian eurobond market saw another leap forward last week, bringing the Euro-30 price quotes close to par and the yield down to a new historic levels of 6.6% p.a. Price growth in shorter-term papers was more modest. The emerging debt market saw the upward corrections too, which were caused by the decreasing US Treasury yields, as well as a cut of the European deposit rate down to 2.0%. Growth in the Russian sector was also fueled by increased liquidity among the domestic participants and favorable Russian fundamentals, including continued budget surpluses, increases in foreign exchange reserves, and good macroeconomic data.

Interest/Bond Market

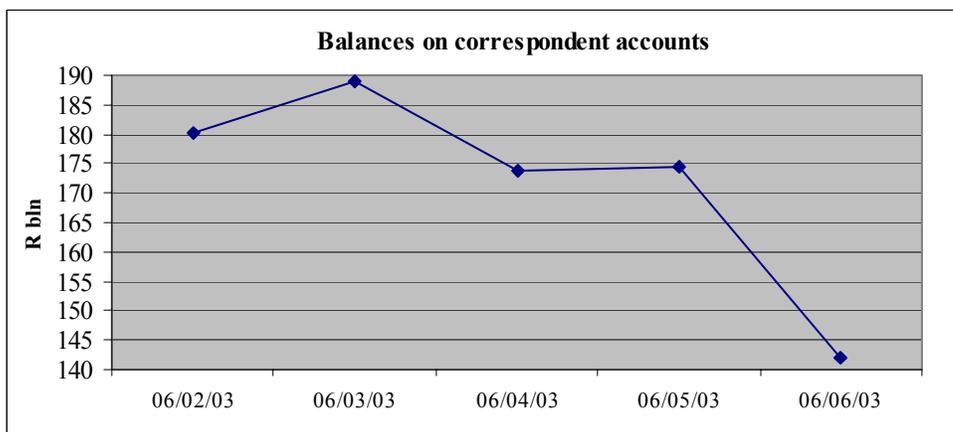
*Bonds/Bills*

The secondary OFZ/GKO market did not have a clear-cut trend last week. On the one hand, increasing ruble liquidity and the lack of alternatives forced players to refrain from selling, while on the other hand, low yields were unattractive for buyers. The OFZ auctions held on Wednesday revived the market somewhat; however, the overall demand for the offered issues was lower than usual, and the Finance Ministry was only able to place issues at yields prevailing in the secondary market. (Previously, MinFin was able to obtain higher bids.) Buying resumed on Friday, and most issues finished the week at higher prices.

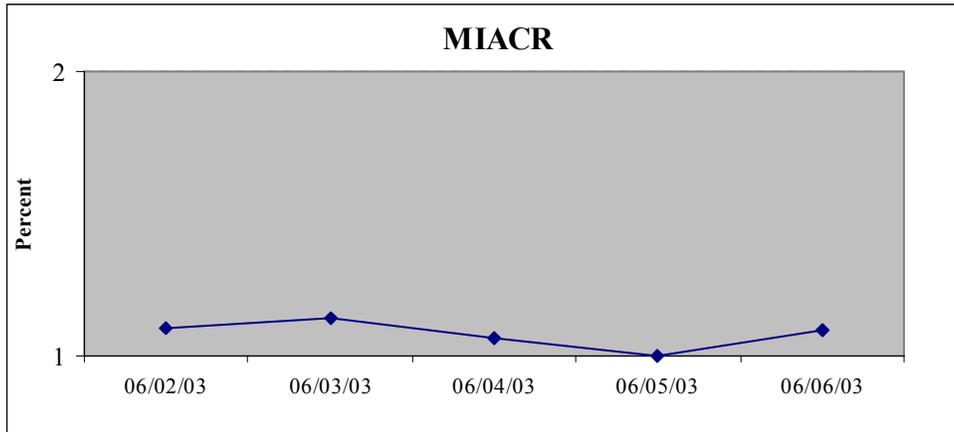


*Overnight rates*

The supply of rubles continued to increase last week with the balances on banks' correspondent accounts reaching the historic high of R189.1 billion on Tuesday. Balances started to drop afterwards and stopped at the R142 billion, still a very high level. Given the high liquidity, overnight interbank ruble loan rates were depressed at 1-2% p.a.

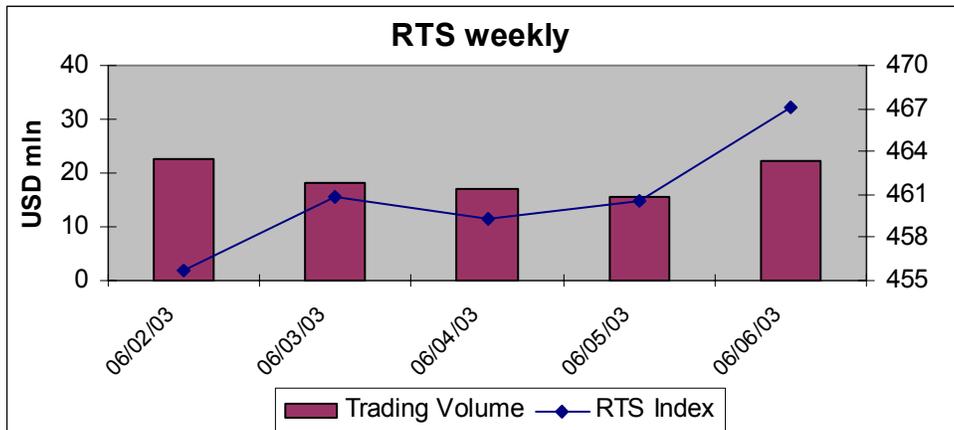


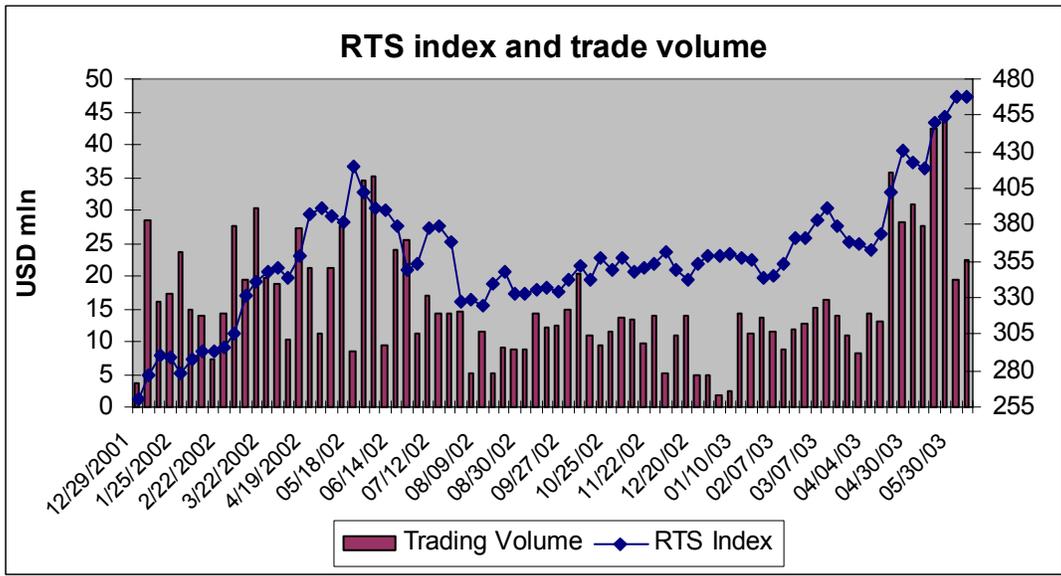
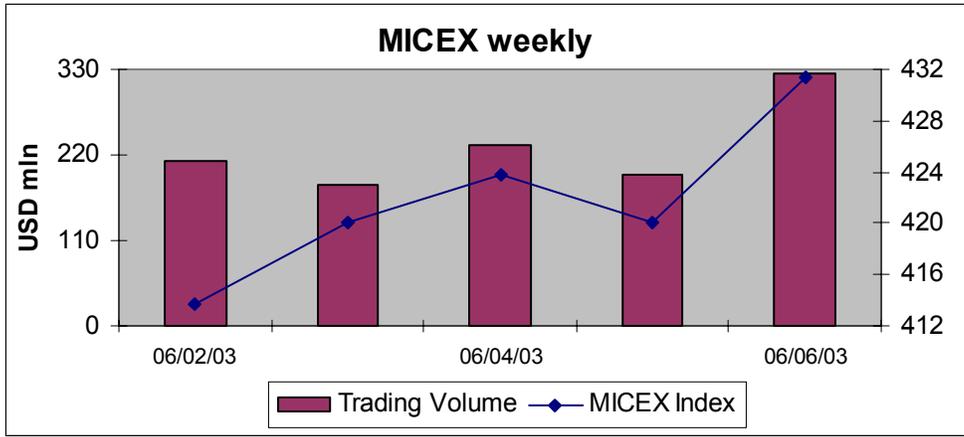
For the week ending June 6, 2003



Stock Market

Last week, the Russian stock market consolidated, given the high level of trading from the week before. Trade volumes fell to an average daily level of \$19 million on RTS. The RTS index fluctuated in a narrow 2 percent range throughout the week. On Friday, the stock market showed life with gains in RAO UES and Norilsk Nickel. These shares became the top-gainers for the week, with RAO UES preferreds rising by 16.3% and Norilsk by 8.3%. Such positive results are explained by the positive economic news from both companies, in addition to higher world nickel prices in case of Norilsk. The RTS index was down by a modest 0.01% for the week in dollar terms.

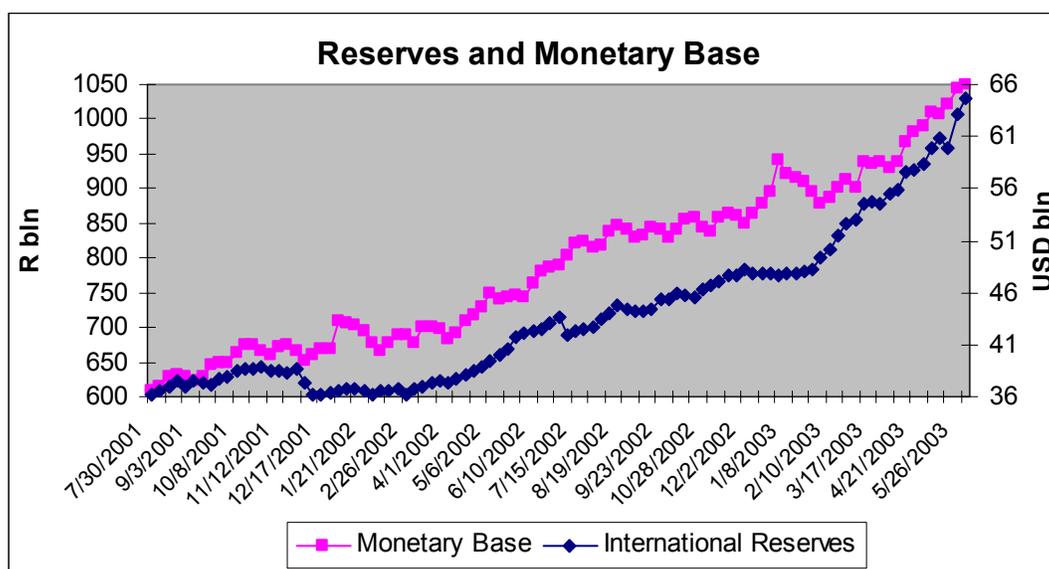




International Reserves and Monetary Base

International reserves of the CBR notched up by \$1.6 billion, reaching \$64.7 billion as of May 30. However, according to the First Deputy Chairman of the CBR Oleg V'yugin, the rate of growth will likely decline in June. Based on official estimates, reserves were expected to rise in May by \$2 billion compared to \$5 billion growth actually achieved.

The monetary base modestly increased, and as of June 2, it stood at R1049.5, which is 0.61% or R6.4 billion higher than a week before.



## 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.