

# Moscow Financial Weekly

For the week ending March 21, 2003  
Treasury Attache's office, U.S. Embassy Moscow

## Highlights

- Russian bankers debate reform priorities.

## Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R31.3811	-0.00	-1.27
Monetary Base*	R936.7 bln	-0.23%	-0.38**
CPI	NA	NA	4.1
International Reserves*	\$54.7 bln	0.18	14.68
RTS Index (end of week)	368.58	-2.89	2.63%
Refinancing rate	18	0	-3

\*For week prior

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

## Economic Developments

The **Tax Ministry** reported that during the first two months of 2003, it was able to collect R195.8 billion to the federal budget, which is 29.7% more than during the same period of last year.

## Banking sector

Last week, Moscow bankers shared views on the current state of the Russian banking system at two conferences, but the tone at each conference was slightly different. The first of these was a **roundtable held by the Association of Russian Banks (ARB)** on March 18 entitled "Intermediate Results and Prospects of Banking Reform." At this event, ARB President Garegin Tosunian stressed in his opening remarks that both bankers and their clients are tired of reforms and suggested that the emphasis should be on evolutionary development. Bankers also expressed resentment at the CBR, MinFin, MEDT and the Duma about the absence of a protectionist policy towards their sector, especially on the eve of WTO accession. One of the main concerns expressed related to cross-border transactions. Bankers are afraid that depositors will flee the country if certain provisions in the new currency regulation and control bill are adopted which will allow Russian citizens and corporations to open bank accounts in OECD country banks. More importantly, Russian banks believe that they can not compete with foreign banks on the lending side, as foreign bank resources are significantly cheaper. The problem is

compounded, Sberbank President Kazmin noted, with an additional tax burden on Russian banks. When a domestic bank gives a loan at a rate lower than a certain proportion of the refinancing rate, it is subject to taxation. Kazmin also believes that the GOR is focusing on secondary problems in banking, such as state banks divestiture and transition to IAS, rather than more fundamental measures. Deputy Chairman of the Duma Banking Committee Pavel Medvedev expressed outrage at the latest version of deposit insurance law -- in particular, the provision according to which state guarantees for Sberbank deposits are to be lifted by 2007 ("too soon") and by the fact that Sberbank would have to make contributions into the same fund as all other banks. The issue of mandatory reserves, another longstanding issue, was raised by a number of speakers: bankers want to lower current reserve levels (now 7-10%) to increase profitability.

The other event, the **Fifth All-Russian Banking Conference**, organized by the Association of Regional Banks "Rossiya," took place on March 19-20. While the same issues of taxation, mandatory reserves, and cross-border transactions were raised, the focus was quite different. Aleksandr Mourychev, head of the "Rossiya" association, spoke about the current concentration of financial flows in Moscow, linking it to problems of inter-budgetary relations and the deteriorating quality of borrowers. Many of the concluding recommendations of the conference mirror those contained in the US-Russia Banking Dialogue from 2002. These include: creating a mechanism for partial state guarantees for SME loans; streamlining CBR regulations in order to make SME access to bank loans easier; improving the legislative basis for collateralized lending; taking additional measures to level the playing field in the financial services market; eliminating privileges to state banks; and to amending Article 837 of the Civil Code currently guaranteeing depositors a right for early withdrawal.

According to Oleg Vyugin, First Deputy CBR Chairman, the CBR has sent to Minfin for approval a **draft GOR resolution on issuance of CBR bonds** (a.k.a. "beaver bonds"). Vyugin explained that a new resolution is needed because the old one has expired. He believes that these bonds with maturities of six months and longer may appear in the market already in the first half of 2003 and will become a popular instrument for managing liquidity.

The CBR plans to allow new inflows into the 'S'-accounts and to **consolidate all foreign portfolio investment**, currently distributed among 'K'-accounts (for purchase of equities), 'N'-accounts (corporate bonds), 'F'-accounts (individual investment) and 'S'-accounts (government bonds and some corporate bonds meeting special CBR criteria), into 'S'-accounts once the new currency regulation and control bill is in place. Nonresidents previously invested in government securities through 'S'-accounts, but after the 1998 crisis funds in these accounts were frozen. Later, the CBR launched a series of auctions at which nonresidents bought foreign currency for repatriation with rubles from their 'S'-accounts. In the latest auctions that took place late last year demand was very low: in one of them where the CBR offered \$100 million, only a little more than \$6 million was bought. Current market value of the balances in 'S'-accounts is estimated at around R140 billion.

According to **Russian Standard Bank's** press service, on March 12 the CBR registered the bank's additional share issue: part of it worth \$10 million was bought by International Finance Corporation. This is the first time since 1998 that IFC became a shareholder in a Russian bank, according to Dmitry Levin, Board Chairman of Russian Standard. IFC has also given a subordinated convertible loan to Probusinessbank and has similar agreement with NBD bank.

Deutsche Bank AG London and Standard Bank London Limited will co-organize a **\$50-million syndicated loan to MDM bank**. According to MDM's press service, the 12-month loan will be given at LIBOR+2.95% and guaranteed by MDM Holding GmbH (Austria).

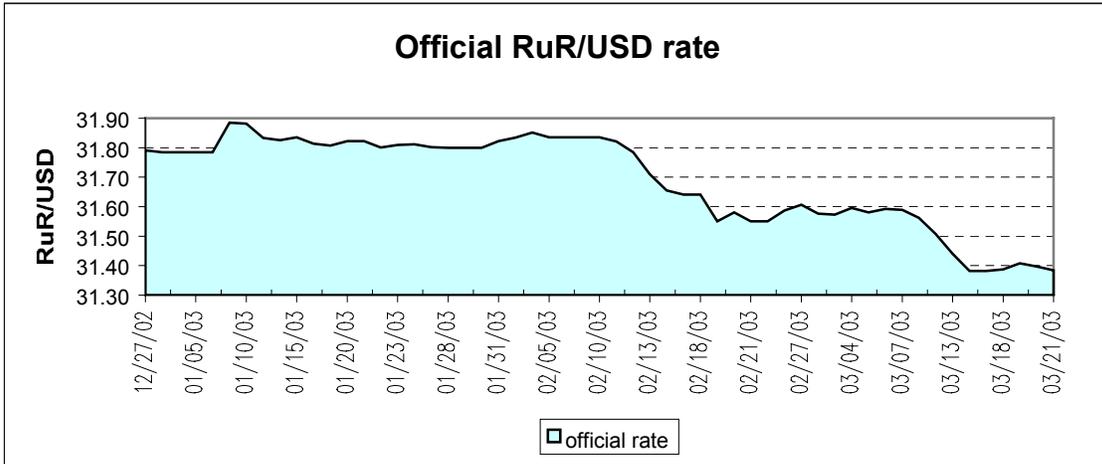
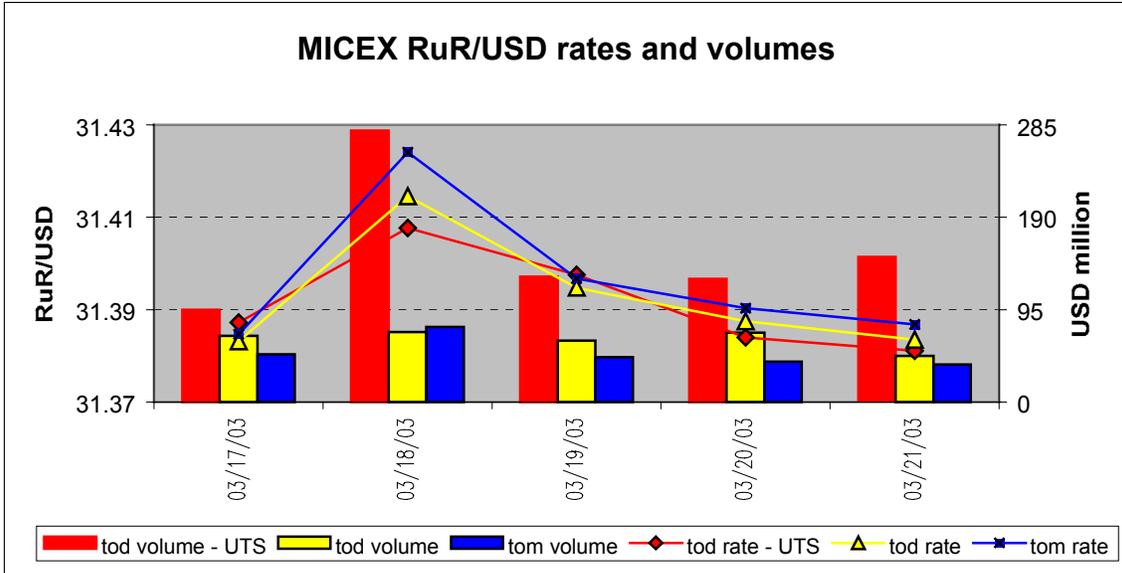
**NIKoil** plans to place in Europe **3-year eurobonds** worth \$100-150 million in the second half of 2003, Nikolay Tsvetkov, the president of NIKoil finance corporation said.

### **Financial markets**

#### **Forex Market**

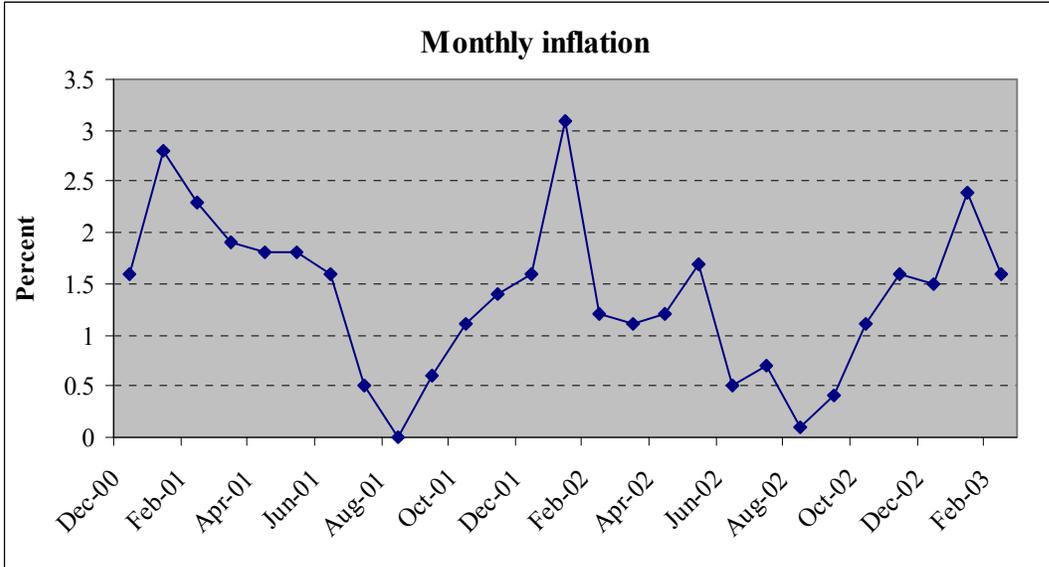
During the first two days of the week the dollar rose against the ruble, driven by its appreciation against major currencies in international markets and by falling oil prices. However, by Tuesday afternoon demand for rubles had already begun to increase as investors were getting ready for the government bond auction due on Wednesday, as well as a reverse repo auction and VAT payments due on Thursday. As a result, the dollar turned back downwards and by the end of the week had lost all the gains of Monday and the first half of Tuesday. During the week the CBR had minimal presence in the market on both sides.

For the week the dollar practically retained its value against the ruble, closing in the UTS on Friday at R31.3811/\$. MICEX weekly trade volumes were \$779.70 million, \$322.25 million and \$253.29 million for the morning (UTS), afternoon "tod" and "tom" sessions, respectively.



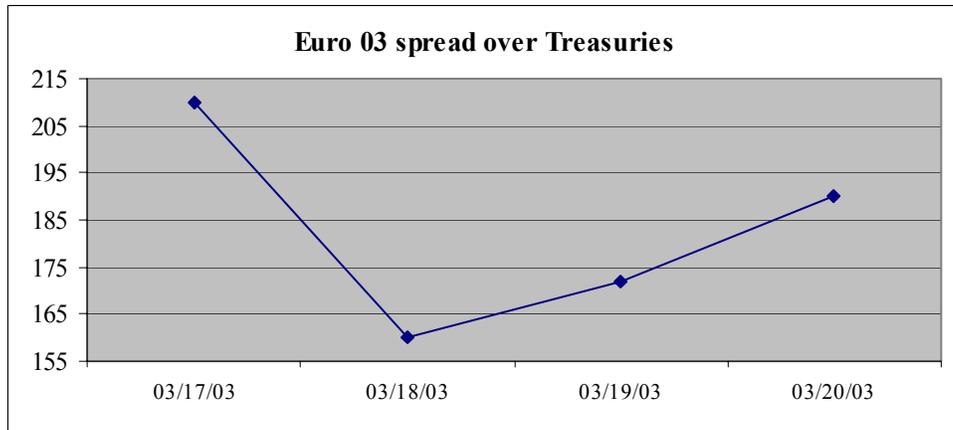
Prices

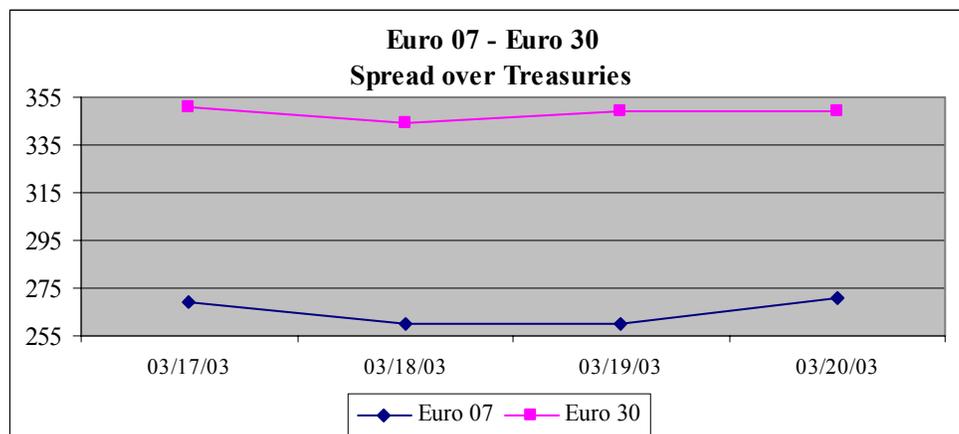
According to Goskomstat, the inflation rate during the first 11 days of March was 0.3% which corresponds to a 0.9% monthly rate. In February, prices were up by 1.6% and in January by 2.4%. The government and CBR are reviewing additional initiatives to make sure annual inflation for 2003 stays within government projections of 10-12%.



Eurobonds

The Russian Eurobonds sector fell again last week. The negative situation in the Turkish and Venezuela sectors, in Iraq, and the downward slide in oil prices were among the factors pushing prices down. The long-term issues lost more than the short-term ones during the slide. For instance, the price of the most liquid Euro-30 was down at 84.25% of par -- its level of a month ago. The market was able to recover slightly only during the last trading session, but still finished the week down from the levels of the previous week.





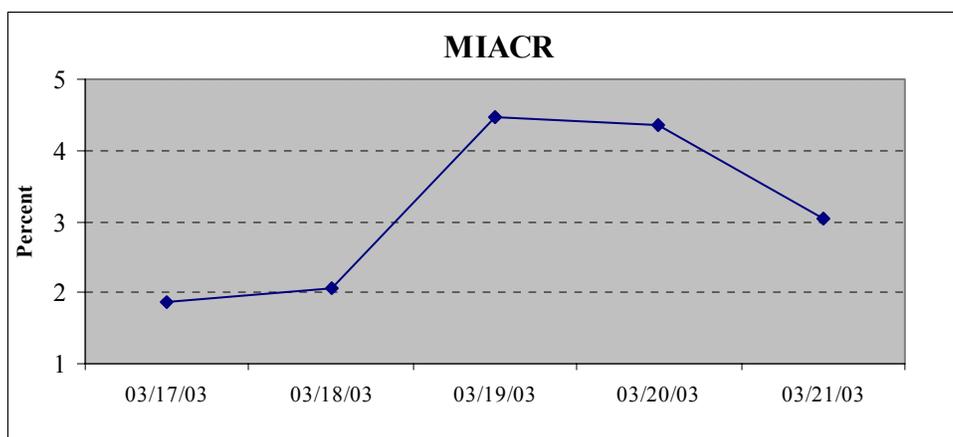
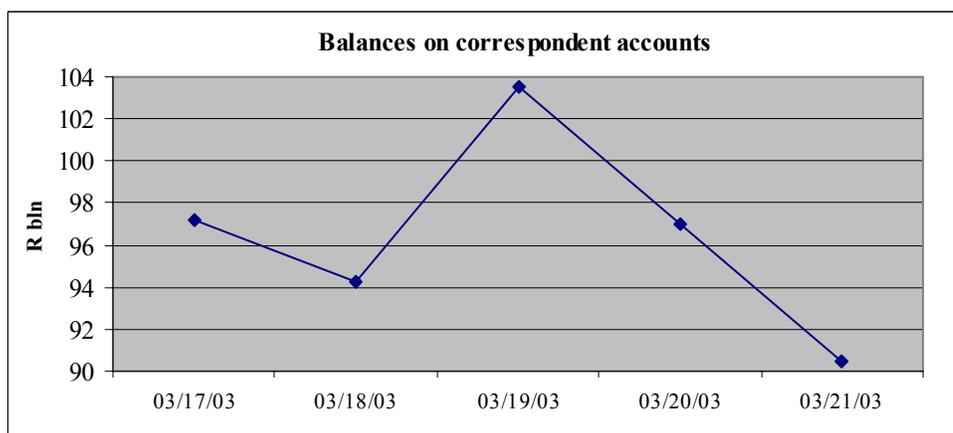
## Interest/Bond Market

### *Bonds/Bills*

The secondary OFZ/GKO market experienced a downward slide in the beginning of the last week. The decline was provoked by the beginning of the war in Iraq as well as the decline in Russian Eurobonds. Traders were also selling in preparation for the primary auction on Wednesday. The trend was supported by speculators who were willing to bid up yields on the market, which have been below the inflation rate for quite a long time. On Wednesday, the Finance Ministry held two auctions, the results of which were quite different. The first auction was for OFZ papers maturing in 2012, and supply exceeded demand, which is quite unusual given recent trends. Such an outcome shows that the market is already saturated with long-term paper. This is supported by the results of the second auction, for OFZs maturing in three years, in which demand exceeded supply. Unused money flooded the market, which contributed to price increases on the notes. The market finished the week on the same level as it started on Monday before the sharp slide.

### *Overnight rates*

The balances on banks' correspondent accounts remained at higher-than-average levels, with the average daily balance at R96.5 billion. Overnight rates were slightly up to 6-7% p.a., from 2-3% p.a. in the middle of the week, due to the flow of money to the primary OFZ auction as well as clients' VAT payments by the banks on Thursday. On Friday, the situation stabilized and rates were down to their levels of the beginning of the week (2-3% p.a.)

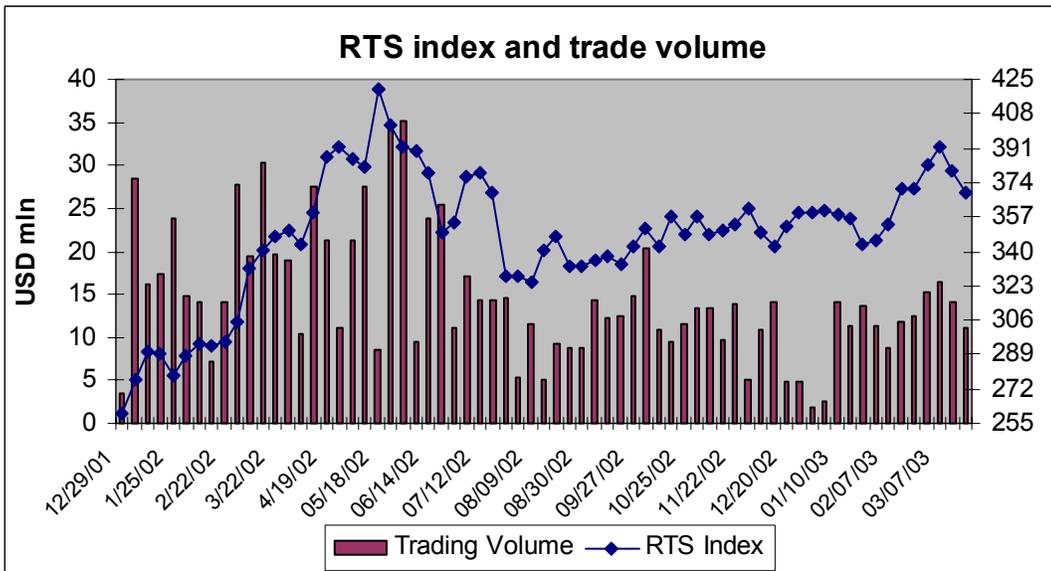
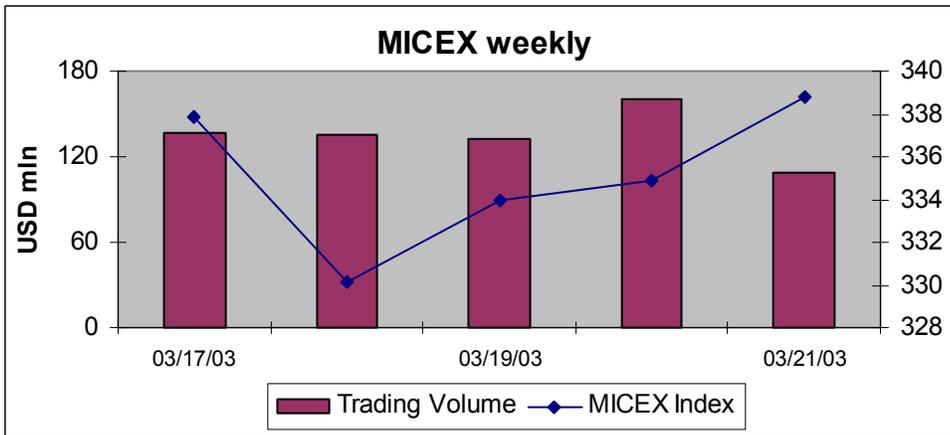
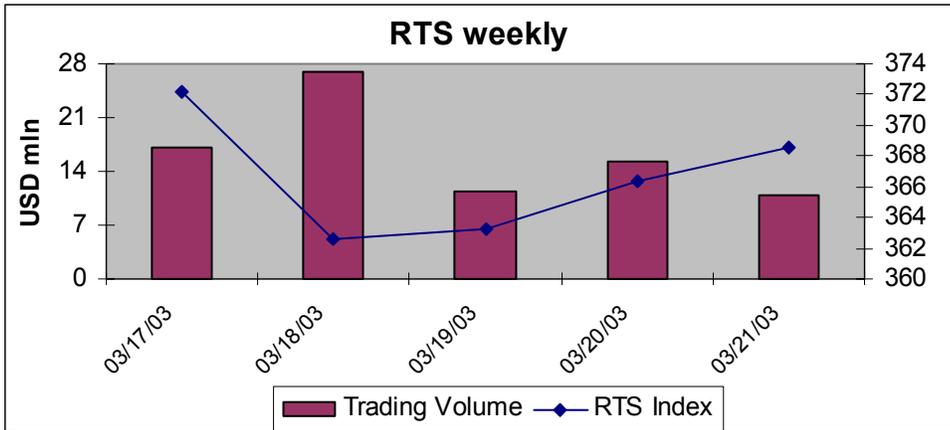


### Stock Market

The Russian stock market fell significantly during the first two trading sessions of last week, mainly under the pressure of sharply falling oil prices. The quite optimistic attitude of world markets last week had a limited influence on the Russian market. Mosenergo and Tatneft shares looked quite good (but still showed a loss for the week) compared to the rest of the market, on the wave of preparations for the shareholders meetings with elections to the BoDs. The market consolidated at a new level below 370 points as a result of the slide - a level last seen in mid-February. The RTS index was down by 2.89% in real terms on average volumes.

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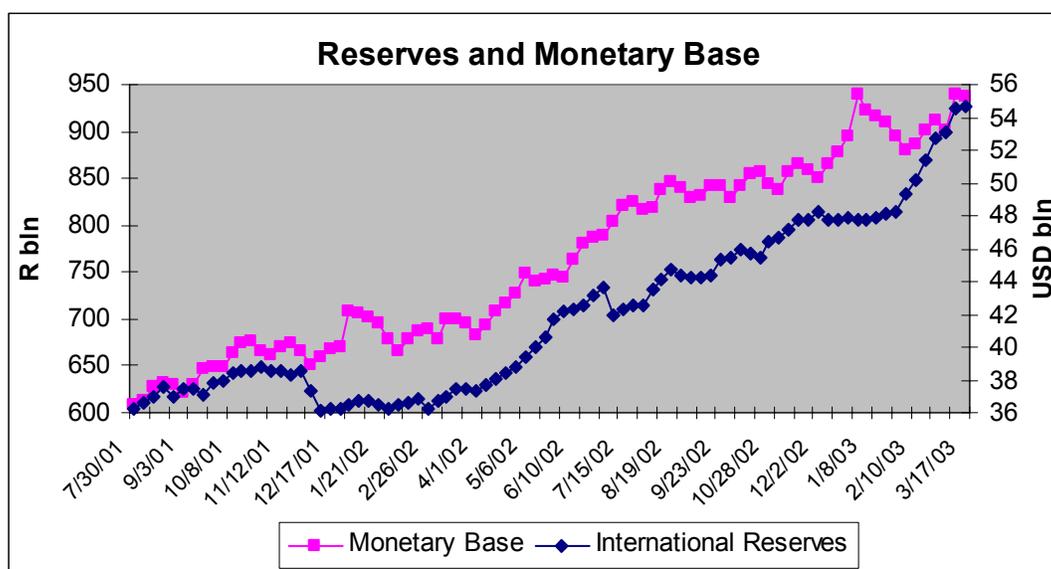


For the week ending March 21, 2003

International Reserves and Monetary Base

The CBR's international reserves were up again for the week ending March 14, but the rate of growth has slowed considerably. Reserves finished at \$54.7 billion, which is \$100 million higher than the week before -- quite a modest increase taking into the account the previous impressive dynamics: for example, the previous week the reserves were up by as much as \$1.5 billion.

The monetary base was down as of March 17. It totaled R936.7 billion, which is R2.2 billion lower than a week before. The base is still 0.38% lower than it was at the beginning of the year, after the seasonal increase.



## 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.