

Moscow Financial Weekly

For the week ending May 23, 2003
Treasury Attache's office, U.S. Embassy Moscow

Highlights

- Currency control bill stalled
- Finance Ministry monitors private sector foreign borrowing

Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R30.7281	-0.55	-3.32
Monetary Base*	R1027.1 bln	1.87	9.23**
CPI	NA	NA	6.2
International Reserves*	\$59.9 bln	-1.48	25.58
RTS Index (end of week)	454.03	0.81	26.45
Refinancing rate	18	0	-3

*For week prior

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

Economic Developments

Goskomstat announced that **industrial production** increased 7.1% y-o-y in April; however, on a month on month basis, production declined by 3.8%. Most notable was that certain domestic industries showed more robust growth than in recent months, with machine-building rising by 10.9% y-o-y and food processing by 4.7%. It remains to be seen whether these industries can adjust to the competitive pressures of an appreciating ruble, however. Ferrous and non-ferrous metals experienced slower growth at 5.8% and 5.6%, respectively. This is partially explained by a slow down last month in electricity production, as metals industries are large consumers of electricity. As in past months, the fuel industry experienced considerable growth: production increased 9.9% y-o-y in April.

According to Goskomstat data published on May 19, **Russian investment abroad in Q1** totaled \$3,124 million, having decreased 28.7% compared to Q1 2002. At the same time **foreign investment into Russia** in the first three months of this year went up to \$6,268 million, twice the amount of Russian investment abroad, versus \$3,789 million a year ago. However, Russian investment abroad is, in most cases, short-term in bank or time deposits, and soon returns home. This is why accumulated capital abroad at the end of March stood only at \$3, 987 million. Meanwhile, the stock of foreign capital in Russia exceeds \$43 billion.

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Deputy Finance Minister Kolotukhin said that the second stage of the **FTO debt** settlement will start later this autumn, rather than July as previously announced, due to the number of unreconciled claims. Of the \$481 million of claims submitted, \$100-150 million are still being verified.

Banking sector

At present, the CBR has three **prudential norms** concerning credit risk exposure: N6 (single borrower exposure may not exceed 25% of bank capital), N9 (single borrower-shareholder exposure may not exceed 20% of bank capital) and N10 (insider exposure may not exceed 2% of bank capital). For N10, "insider" is defined as any natural person that can influence decisions regarding loan disbursements. According to Aleksey Simanovsky, Director of CBR Department of Bank Regulation and Supervision, CBR may keep just one norm, N6, which is consistent with international practice.

Meanwhile, **Sberbank** announced that it had brought N6 in compliance with CBR requirement: as of April 1 its exposure to a single borrower declined to 20.5%. Vadim Kleiner, member of Sberbank Supervisory Board representing minority shareholders and long-time opponent of bank management, admitted that the problem of Sberbank's credit portfolio, though still serious, is being broadly alleviated: the share of 10 biggest borrowers in the loan portfolio fell over Q1 this year from 32% to 27%.

On May 21 **Avtobank's** AGM voted to repay ahead of schedule the remaining R100 million of the R2.5 billion stabilization loan received from the CBR after the 1998 financial crisis, and to settle with Credit Agricole Indosuez on 1998 forward contracts, following the recent example of National Reserve Bank. *Kommersant* claims (but the bank does not confirm this) that these are the two necessary conditions for placing R4 billion-worth of additional shares, which would allow Avtobank to comply with the CBR regulation regarding offshore ownership. On May 26, Avtobank repaid the CBR's loan in full.

Bank **Uralsib** bought controlling stakes in Volgoinvestbank (Saratov) and in Tyumenprofbank (Tyumen), Uralsib President Azat Kurmanaev said. He also said Uralsib decided not to buy a bank in the Samara region, but open a branch there instead.

The CBR, together with MICEX, is considering **consolidation of UTS and SELT currency trading sessions** into one, Konstantin Korischenko, CBR Deputy Chairman and MICEX Board Chairman said. Although over the years two systems developed and operated for different purposes, the fact remains that MICEX has two different prices for the same asset at the same point in time, a problem which needs to be resolved, he said.

On May 19, First Deputy Finance Minister Ulukayev said that the Finance Ministry **would not limit foreign borrowings** of private corporations just yet, clarifying recent statements by his colleagues Deputy Finance Minister Kolotukhin and Bella Zlatkis.

While it is a well-known policy that the Russian government intends to strengthen its domestic debt market and has limited its own borrowings abroad, it is also clearly worried about the effect of the rapid increase in private sector Eurobond borrowings on inflation and ruble appreciation. Borrowings totaled \$5.5 billion in 2002, with another \$5 billion in the first quarter of this year alone (reflected in the foreign investment statistics noted above). Ulukayev said that the government considers the state and corporate debt as an integral whole, and that (unspecified) legislation allows the government to place restrictions on private borrowing in cases of threat to stability of Russia's economy and exchange rate. It will be difficult to control corporate behavior, given the favorable rates abroad, an underdeveloped banking sector in Russia, and the demand for more investment. In addition, it may also become a problem in the future for those Russian banks that have excess liquidity and need to compete with lower foreign rates, without adequate risk management techniques yet in place.

The bill on **currency control and currency regulation** seems to have suffered the same fate as deposit insurance and the second reading, scheduled for May 23, was delayed. The currency control bill was brought to the Duma by the GOR at the very end of 2002, went through first reading on March 14 and was expected to go into the second reading at the end of May. However, on May 23, President Putin sent a letter to the Duma with a multitude of critical comments on the bill. Kremlin lawyers believe that clauses allowing the CBR, together with the GOR, to impose various foreign exchange restrictions are unconstitutional. The letter demands that all restrictions proposed in the law, and the conditions that trigger such restrictions, be explicitly stated. It should be noted that Kremlin lawyers have been consistent in their opinions and have commented similarly on other legislation, ostensibly to reduce opportunities for discretionary decision making and possible corruption on the part of government officials. In the case of currency controls, the GOR (in particular, Finance Minister and Deputy Prime Minister Aleksey Kudrin) believes it to be technically impossible to meet Kremlin demands, and many independent experts support his opinion. In any event, redrafting the bill and/or negotiating with Kremlin will take some time.

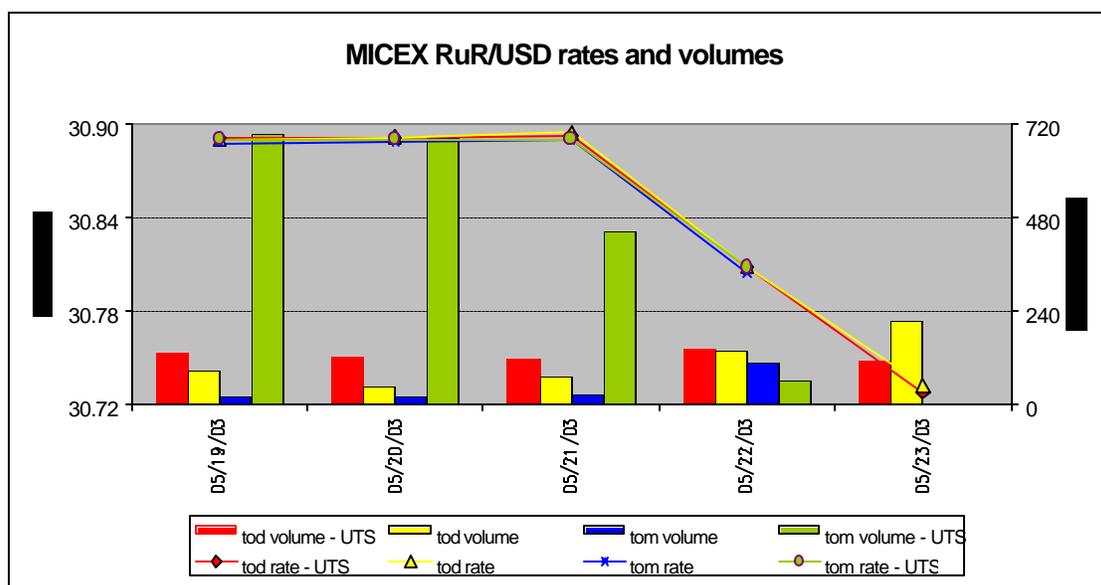
Meanwhile, a number of parliamentarians, including Chairman of the Budget and Taxes Committee Aleksandr Zhukov, his Deputy Mikhail Zadornov and Chairman of the Committee on Credit Organizations and Financial Markets Valery Zubov proposed an amendment to Article 6 of the existing law on currency control and currency regulation. The amendment entitles the CBR to set **export revenues surrender requirements**, but not to exceed a 30% ceiling (versus 50% currently in effect). Although it is quite similar to one of the clauses contained in the currency control bill under Duma consideration, Duma Deputies decided not to wait for adoption of the larger bill, but hope to satisfy more quickly demands from business to reduce the surrender requirement, as well as those of the Central Bank and government, trying to manage increasing levels foreign capital inflows. Meanwhile, Maksim Medvedkov, Deputy Minister of Economic Development and Trade and chief Russian negotiator on WTO accession, last week said that his agency would draft amendments to the currency control bill under discussion in the Duma to make it compatible with WTO regulations.

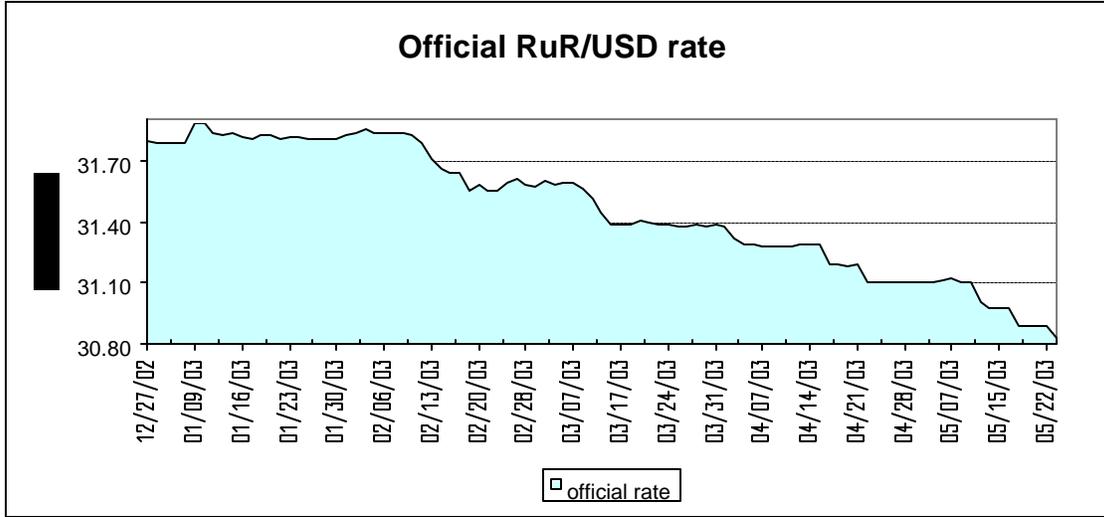
Financial markets

Forex Market

The ruble continues appreciating against the dollar, the pace being set by the CBR. Thus for the first 3 days of the week of May 19, the CBR kept its bid at R30.89/\$ and bought only in these 3 consecutive UTS sessions over \$2 billion. On Thursday the CBR removed its bid and the ruble immediately strengthened against the dollar roughly by 8.5 kopeks. On Friday in the absence of the CBR in the market the ruble went further up by 8 kopeks.

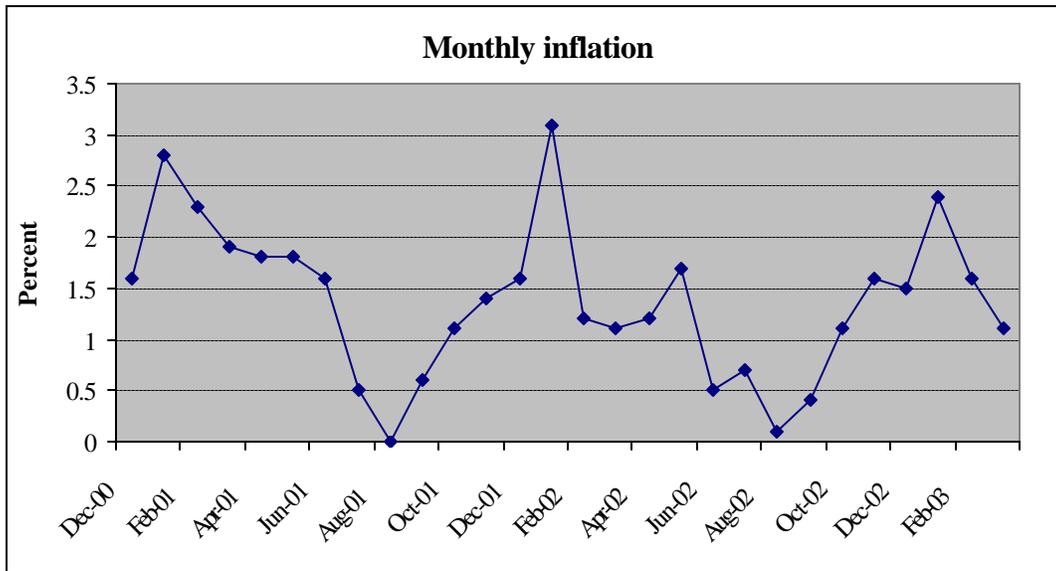
For the week the dollar weakened 0.55%, closing in the UTS "tod" on May 23 at R30.7281/\$. MICEX weekly trade volumes were \$628.36 million and \$1886.59 million, \$344.66 million and \$175.11 million for the UTS "tod" and "tom" sessions, and SELT "tod" and "tom" sessions, respectively.





Prices

No data has been released.



Eurobonds

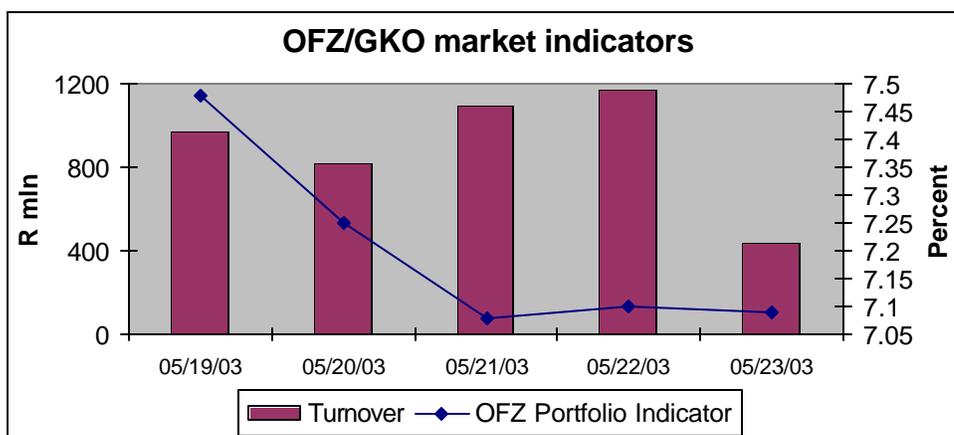
The Russian Eurobond market experienced a price rally again last week. The Euro-30 has almost surpassed the record of 94% of par achieved last week, stopping short at 93 13/16 of par. The market continues to react positively to Russia's financial stability, compared

to other emerging markets, which is due to its large foreign exchange reserves, continued favorable oil prices, and full timely external debt payments.

Interest/Bond Market

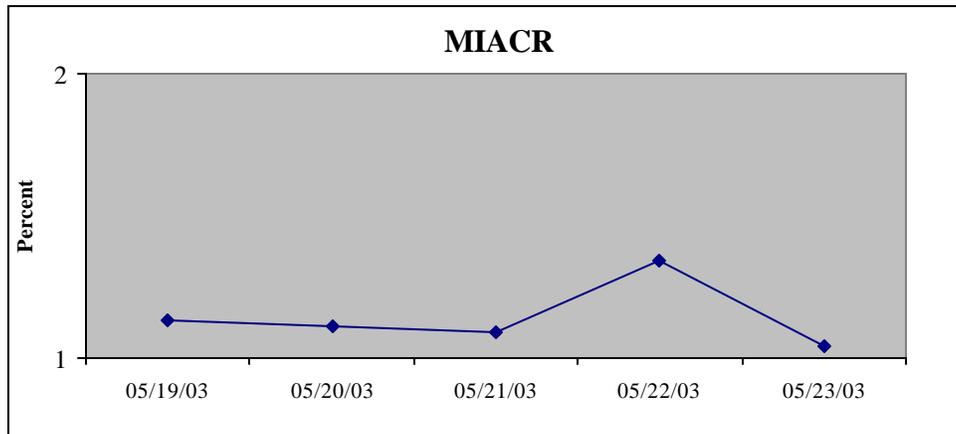
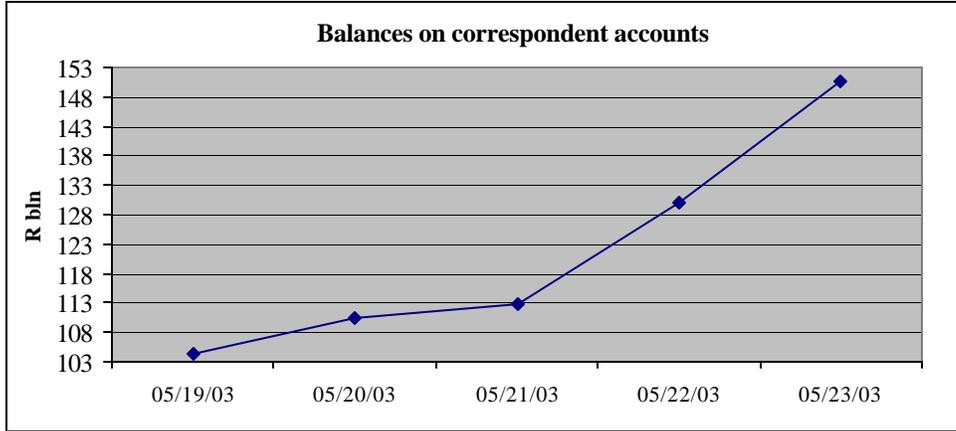
Bonds/Bills

The secondary OFZ/GKO market was active again, with prices rising and yields for papers with the longest maturities falling below 8% p.a. A strong ruble exchange rate combined with significant ruble liquidity continues to support the domestic debt markets. On Wednesday last week, market players, unable to purchase enough securities in the government auction, turned to the secondary market, thus contributing to the upsurge in prices. The Finance Ministry was able to place R6 billion of a 2-year OFZs with an average-weighted yield of 6.75% p.a. and R4.8 billion of OFZs maturing in August of 2018 with the yield of 7.59% p.a.



Overnight rates

Balances on banks' correspondent accounts increased throughout the week, reaching maximum of R151 billion on Friday, higher than usual. The overnight inter bank ruble loan rates fluctuated at 1-3% p.a. all through the week.

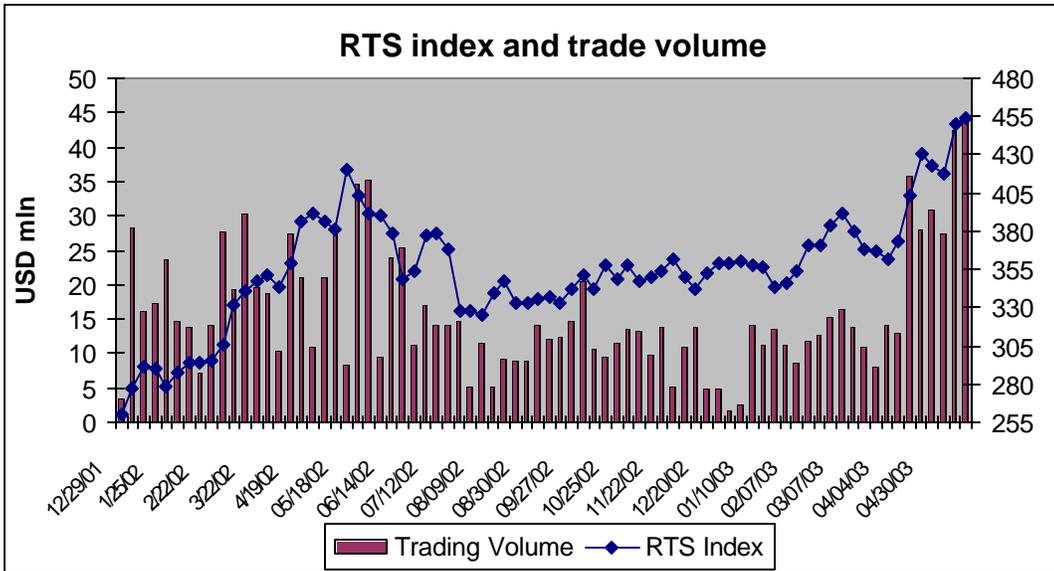
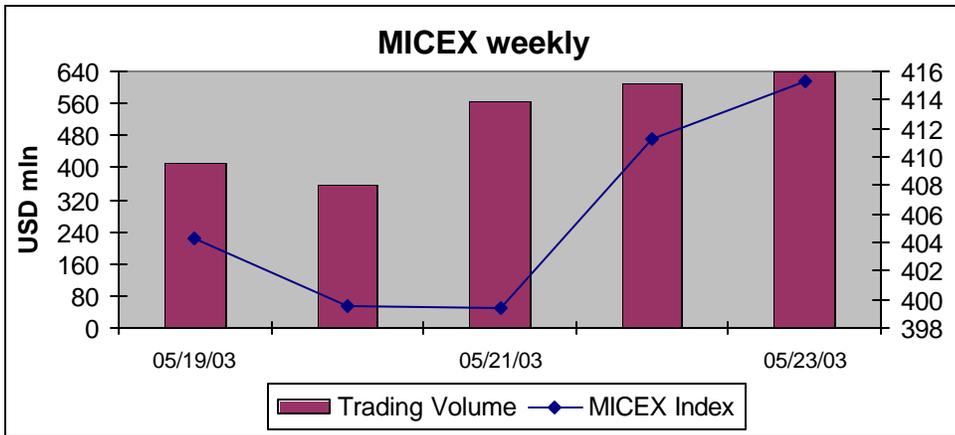
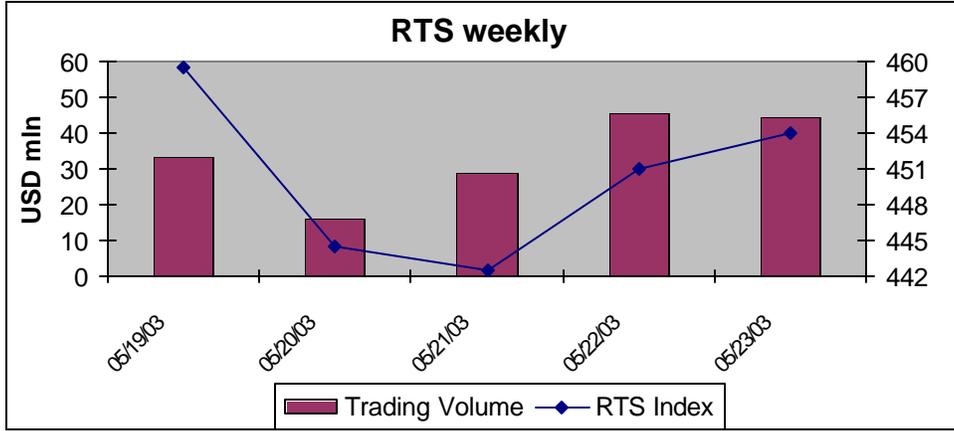


Stock Market

The stock market was up considerably up Monday, almost piercing the 460 level, but then experienced downward price corrections during the following two sessions. Growth in the RTS market index resumed on Thursday and as a result, it gained a modest 0.81% for the week. Since the beginning of the year, the index has grown by 26.45%. Last week, RAO UES shares were the hit on the market. The preferreds were up by 19.4% and common shares were up by 27.7% for the week. Gazprom shares, which are relatively undervalued compared to other natural resources, experienced a nice rally last week as investors sought bargains in an active equities market.

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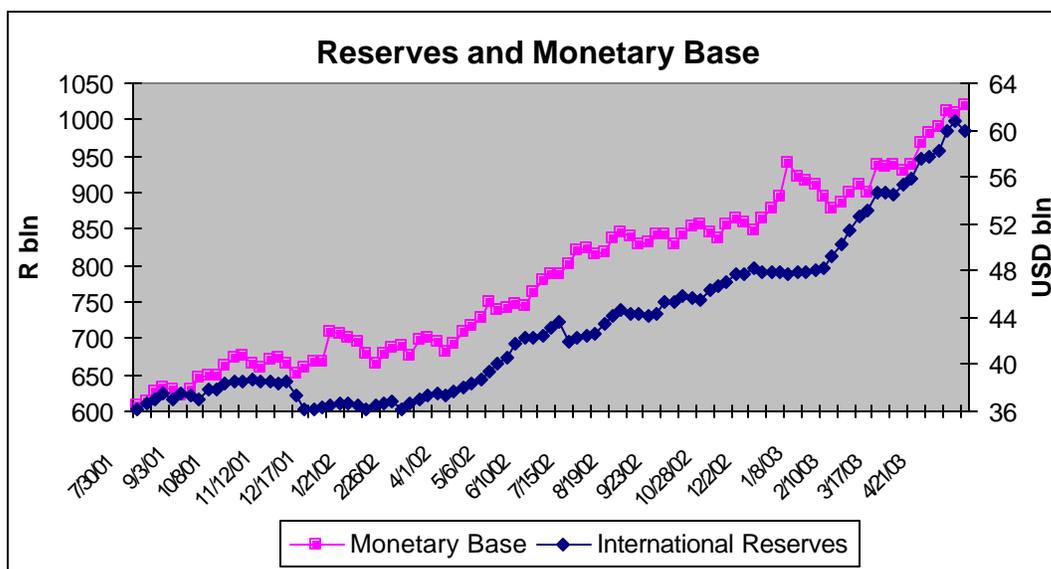


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International Reserves and Monetary Base

The CBR's international reserves were down by \$900 million, ending at \$59.9 billion as of May 16, 2003 - returning to the level seen in early May. The drop was due to foreign debt payments that week.

The monetary base resumed growth after declining last week -- it was up at R1027.1 billion as of May 19, representing an increase of 1.87% or R18.8 billion for the week.



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.