Moscow Financial Weekly

For the weeks ending January 2 & 9, 2004
Treasury Attache's office, U.S. Embassy Moscow

Highlights

- Capital outflows down sharply in 2003
- Banking system deposits up
- New Stabilization Fund begins life with RUB 103.5 billion
- Tax code changes take effect

Key Economic Indicators

Indicators	Level	chg 1 week	chg since Jan. 1	chg 12 months
RUB/USD (MICEX) UTS (changes in %)	RUB 29.0160	1.02	1.02	8.99
RUB/EUR (changes in %)	RUB 36.7305	0.99	0.99	-10.45
Monetary Base* (changes in %)	RUB 1398.6 bln	0.47	0.47	48.02
CPI	NA	NA	11.8	NA
International Reserves* (billions)	USD 77.1	- USD 700	- USD 700	29.4
RTS Index (changes in %)	597.33	5.28	5.28	68.37
Urals Crude (changes in %)	USD 28.0	-4.83	-7.62	-2.20
JPMorgan EMBI+ RUS spread (changes in bp)	232	-9	-25	-23
CBR Time Deposits Two-week term (changes in bp)	1.5%	0	-560	

*For one week prior

Economic Developments

According to MinFin's estimate, the **2003 Federal budget** was executed with a surplus of RUB 216.8 billion, or 1.6% of the GDP forecast for January-December of 2003. Revenues totaled RUB 2588.3 billion, or 101.0% of the budgeted sum, and expenditures were RUB 237.5 billion, or 98.2% of the planned amount. Primary surplus reached RUB 437.7 billion, or 3.3% of the GDP forecast. MinFin also announced that amount in the Financial

Reserve, as of January 1, 2004, amounted to RUB 255 billion. RUB 103.5 billion will be transferred from the Financial Reserve to the newly established Stabilization Fund.

By the end of 2003, Russia's **external debt** fell to 27% of GDP, according to First Deputy Finance Minister Aleksey Ulyukaev. He also commented that this could be considered a fairly low level, since according to international practice 60% of GDP is considered quite acceptable. "As of today, external debt totals USD 119 billion, guarantees included, or USD 115 billion without guarantees," Ulyukaev said on the last week of 2003.

According to MinFin's Domestic Debt Management Department, Russia's **domestic debt** as of January 1, 2004, totaled RUB 663.53 billion, having increased over December 2003 by RUB 3.16 billion and by RUB 9.02 billion over the whole year.

The Moscow Narodny Bank **Purchasing Managers' Index** (PMI) was 53.9 after the seasonal adjustments in December, which is only slightly lower than the November figure of 54.1. (A PMI above 50 on this index indicates growth in the manufacturing sector.). Even though the December level showed the decrease from the previous month, it still reflects the continuous expansion in the sector which in turn fuels growth in employment. The Moscow Narodny Bank Employment Index rose to 51.6 in December from 50.9 in November, which continues eight months of continuous growth in this indicator.

Goskomstat has **revised GDP data** for the years 2001 and 2002. This was done after the CBR revised its balance-of-payments data and the Government revised its budget data for those years. Annual GDP for 2001 was upgraded from 5.0% to 5.1% , and 2002 GDP was revised to 4.7% from 4.3%. According to the latest estimate of the Ministry of Economic Development and Trade (MEDT), GDP growth will likely total 6.8% in 2003, which is a bit lower than PM Kasyanov's public estimate last week of 7% for last year.

Starting from January 2004, the new **amendments to the Tax Code** came into force. The most notable ones are the decrease of the value-added tax from 20% to 18% and the elimination of the 5% sales tax. Another important item is the decrease of the tax on the issuance of the securities, which is now 0.2% of the total volume of issuance, down from 0.8%. At the same time, the government increased the tax on companies' property from 2.0% to 2.2%, while simultaneously eliminating some of the loopholes used to avoid this tax. In addition, several internal tax-free zones in Russia, which had helped some oil companies to decrease their effective tax rates, were eliminated.

Banking sector

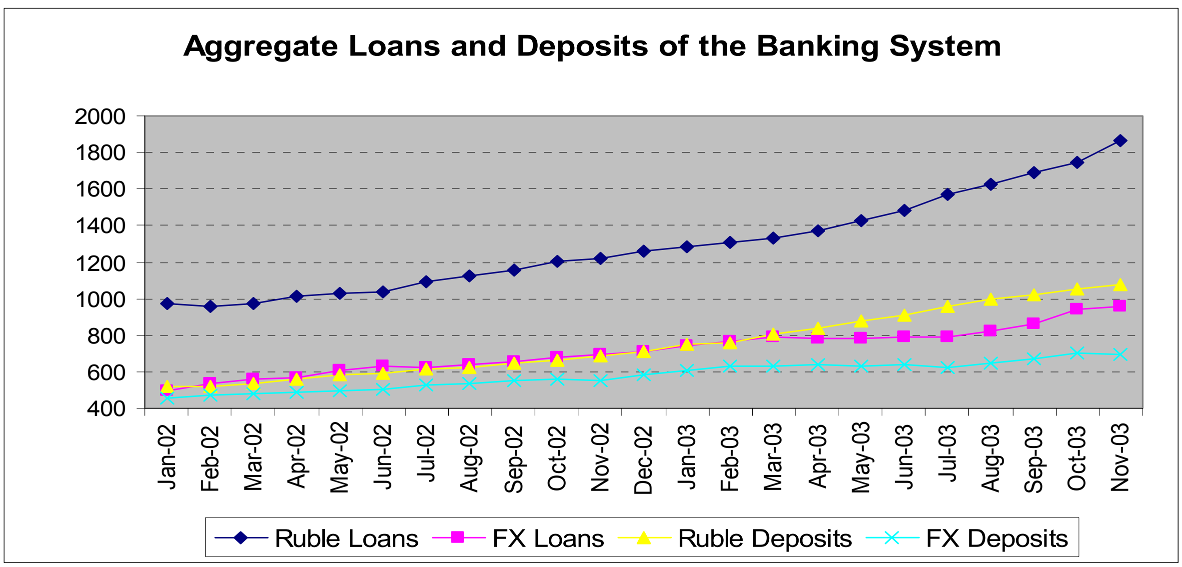
On January 5, the CBR published its estimate of **private capital outflow in 2003**. The number fell to USD 2.9 billion, compared to USD 8.1 billion in 2002. Net import of capital by the banking sector increased in 2003 to USD 9.6 billion compared to USD 2.5 billion in the previous year. Net outflow of capital by non-financial enterprises and households totaled in 2003 USD 12.5 billion against USD 10.6 billion in 2002. A breakdown of historical capital outflows by quarter, based on CBR data, is shown in the attached table. The activities of Russian banks showed the biggest change in these figures for 2003: in Q4 they increased their foreign liabilities by USD 5.4 billion, the largest since 1994, and by USD 10.7 billion for the whole of 2003. The reasons for that are most likely a combination of continuing ruble appreciation, and (probably less importantly) Russia's upgrade to "investment grade" by Moody's last fall. Banks also decreased their foreign assets in Q4 by USD 2.3 billion after a hike of USD 4.2 billion in the previous quarter. At the same time outflow of capital from the sector of non-financial enterprises and households in Q4 went on, although at a slightly slower pace, USD 5.1 billion in Q4, compared with USD 6.3 billion in Q3. In particular, both foreign portfolio and foreign direct investment went down. One of the possible explanations for the latter is that formal ownership in some Russian companies was transferred from foreign entities to the ultimate Russian owners for the sake of transparency of business. The estimate for Q4 private capital flows is based on preliminary BOP data. By the way, the CBR has made some changes to the BOP statistics methodology and accordingly revised the BOP data starting from 2001; these changes are also reflected in the table below.

	Net outflow of private sector capital, total (2+5)	Net capital outflow by banks (3+4)	of which: Foreign assets	Foreign liabilities	Net capital outflow by non-financial enterprises and households (6+7+8)	of which: Foreign assets	Foreign liabilities	"Net errors and omissions" of balance of payments**
	1	2	3	4	5	6	7	8
2001	**-14.8**	**1.3**	**-1.4**	**2.7**	**-16.1**	**-10.5**	**3.7**	**-9.3**
Q1, 2001	-6.9	-3.3	-3.5	0.2	-3.6	-1.4	0.2	-2.5
Q2, 2001	-2.9	-0.3	-1.9	1.6	-2.6	-1.9	0.7	-1.4
Q3, 2001	-1.4	2.2	1.3	0.9	-3.6	-1.9	1.0	-2.8
Q4, 2001	-3.6	2.7	2.7	0.0	-6.2	-5.4	1.7	-2.6
2002	**-8.1**	**2.5**	**-1.1**	**3.6**	**-10.6**	**-18.4**	**14.3**	**-6.5**
Q1, 2002	-3.1	-0.9	-0.9	0.0	-2.3	-3.6	2.3	-1.0
Q2, 2002	1.2	1.6	0.1	1.5	-0.4	-3.4	4.0	-1.0
Q3, 2002	-2.3	0.4	0.1	0.3	-2.7	-3.0	2.5	-2.2
Q4, 2002	-3.8	1.4	-0.4	1.8	-5.2	-8.4	5.5	-2.2
2003	**-2.9**	**9.6**	**-1.1**	**10.7**	**-12.5**	**-16.8**	**10.3**	**-5.9**
Q1, 2003	-0.4	0.9	0.2	0.6	-1.3	-3.6	4.1	-1.7
Q2, 2003	3.6	3.4	0.6	2.7	0.2	-2.5	4.5	-1.9
Q3, 2003	-8.7	-2.3	-4.2	1.9	-6.3	-6.3	3.1	-3.1
Q4, 2003*	2.5	7.6	2.3	5.4	-5.1	-4.5	-1.4	0.8

The CBR announced that in H2 2004 it would release into circulation **modified currency notes**, in denominations of RUB 10, RUB 50, RUB 100, RUB 500 and RUB 1000, with enhanced security features. Arnold Voylukov, CBR Deputy Chairman, commented that of the total RUB 1239 billion cash in circulation, about RUB 100 million is counterfeit. The

RUB 100 bill is counterfeiters' favorite: 35% of all counterfeits notes found are in this denomination. Next is the RUB 500 note, with a share of 30%. Voylukov said that the modified notes would have 26 security features instead of the current 22. The CBR also announced that in 2005 it plans to release a bill with new denomination, RUB 5000.

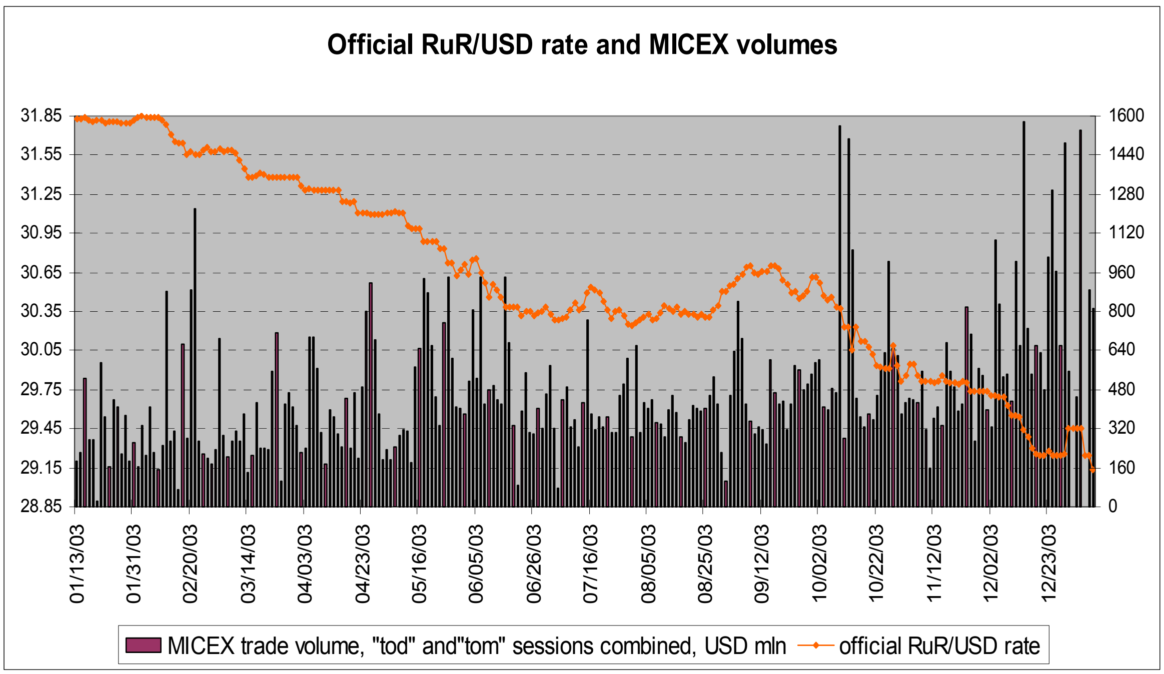
According to the latest CBR data, the aggregate volume of household ruble **deposits in Russian banks** increased during the first ten months of 2003 by 44.8%, to RUB 940.051 billion. The volume of corporate ruble deposits increased over the same period by 34.5%, to RUB 136.293 billion, and total ruble deposits increased by 43.3%, to RUB 1,079.933 billion. The aggregate volume of foreign currency deposits grew between January 1, 2003 and November 1, 2003 as well, but at much slower pace, by 14.1%, to a total of RUB 694.571 billion (the CBR publishes these figures in ruble-equivalent amounts), including RUB 471.841 billion in household deposits (18.7% growth) and RUB 179.008 billion in corporate deposits (2% growth). The aggregate volume of ruble loans went up the most over the past ten months: by 45.2% to RUB 1864.376 billion (of which 79.5% accounted for corporate loans and 11.8% for personal loans), while the volume of foreign currency loans increased by 28.6% to RUB 957.927 billion (of which 73.6% accounted for corporate loans and 13.6% - for loans to banks).



Financial markets

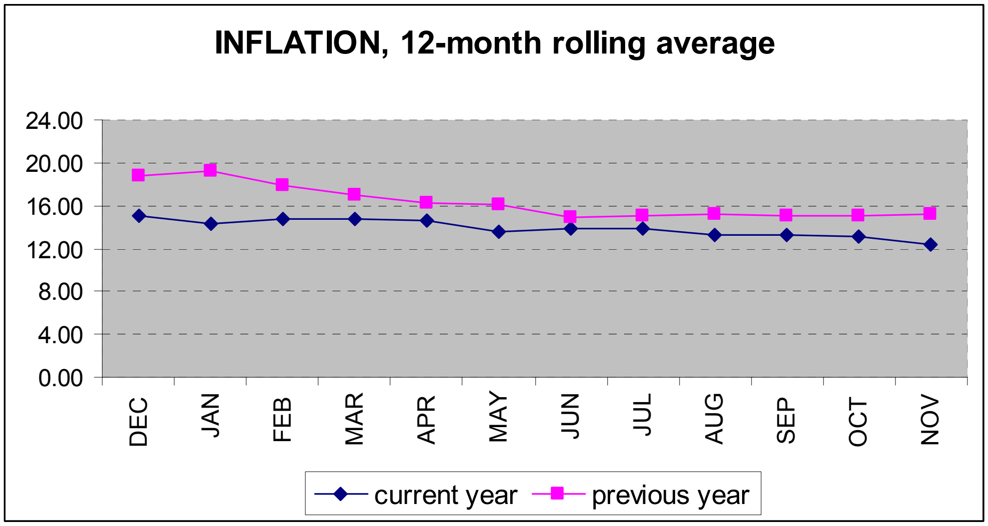
Forex Market

In the last days of 2003, demand for dollars temporarily increased, and for the first time in many weeks the CBR intervened in support of the ruble, only to leave the official rate at R29.4545/USD for the period 12/30/03 - 01/06/04 (because of the longer local holidays). Meanwhile, the dollar continued to weaken on international markets, which resulted in real panicking on the Russian money market. On the first full MICEX trading day of 2004, January 6, the CBR already had to intervene on the side of the dollar, at the level R29.2450/USD. In the last two trading days of the week, after the Orthodox Christmas, the CBR abandoned the market and on Friday afternoon the dollar fell below the psychologically important R29/USD level.



Prices

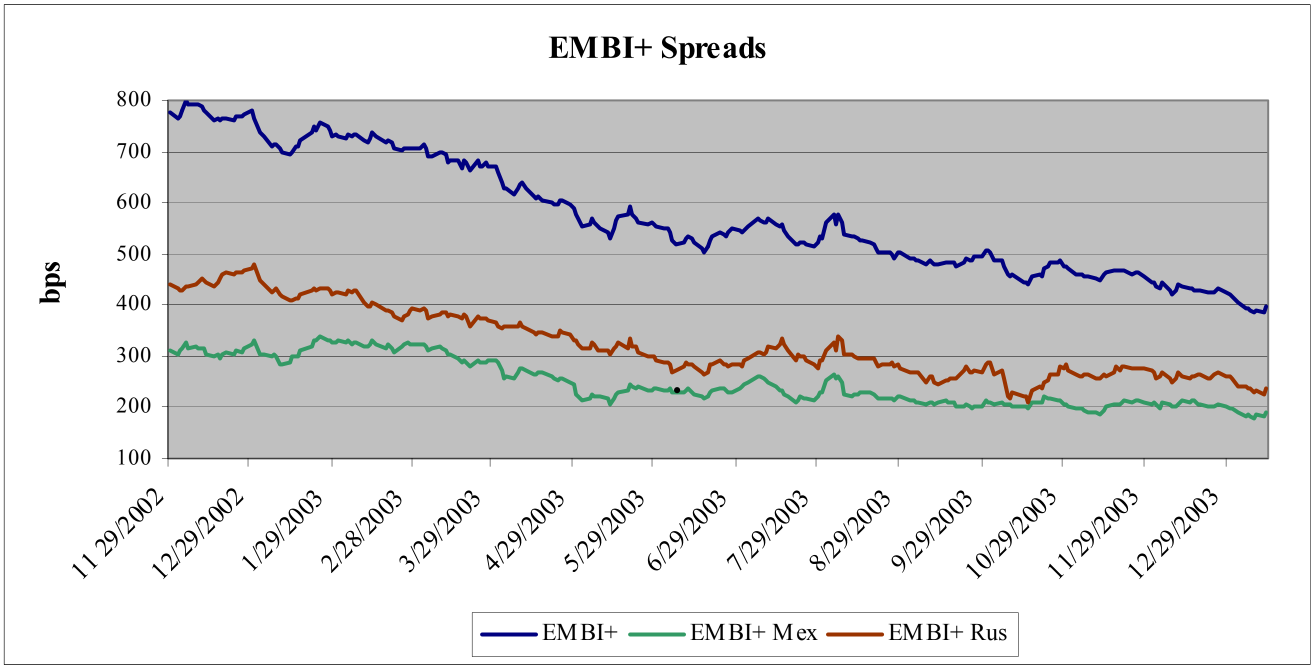
According to Goskomstat, the inflation rate was 1.1% in December. During the fourth quarter, average monthly inflation was lower than in the same period of 2002, which can be explained by the deliberate restraining of growth in services prices by the government ahead of the Duma elections in December 2003. Annual inflation for 2003, as expected, was 12%, which met the government's yearly target for the first time since 1997. This rate was one of the lowest since 1990, the lowest being 1997, when prices grew by 11%.



<u>Eurobonds</u>

The Russian Eurobonds sector experienced a strong positive trend during the first week of January. The most liquid paper, Euro-30, was the leader, with its spread narrowing to 255 bps which corresponds to 100% par (6.68% ytm). New investors entered the market during the first week of the year, driving the prices up: many foreign funds have increased investment limits on Russia beginning in January, mainly as a result of the positive economic developments in Russia.

COMPONENT	COMPONENT SPREAD & DATE				SOVEREIGN RATING		
JPMorgan's	01/09/04	01/02/03	12/08/03	01/06/03	S&P	Moody's	Fitch
EMBI Russia	232	241	255	426	BB	Baa3	BB+
EMBI+	388	404	429	711	N/A	N/A	N/A
EMBI Brazil	406	446	484	1280	B+	B2	B+
EMBI Mexico	187	191	204	300	BBB-	Baa2	BBB-
EMBI Turkey	300	297	321	695	B+	B1	B



Interest/Bond Market

Bonds/Bills

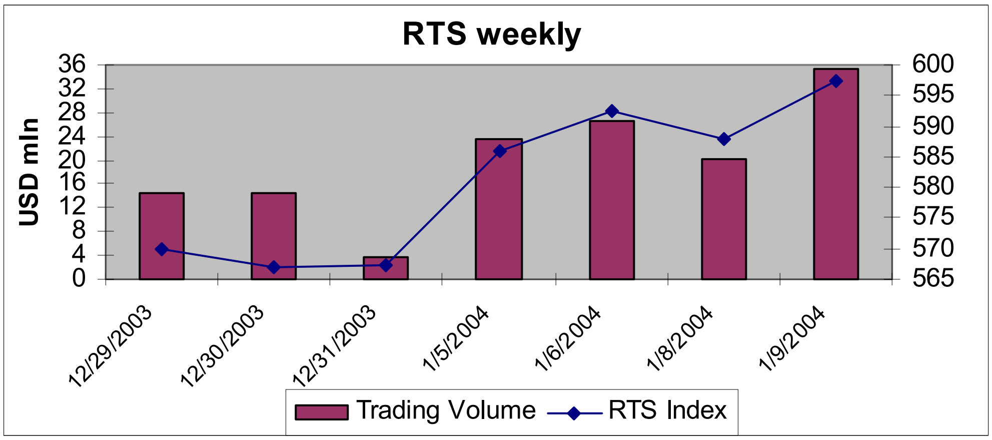
The strong demand on the secondary OFZ/GKO market drove down yields practically to the lowest levels ever seen. The upward movement in prices was felt across the board, but most in demand were the longest-term issues, for which yields were down from 8.2-8.3% p.a. to 7.65-7.7% p.a. Increased ruble liquidity and high demand for the Eurobonds also supported the market.

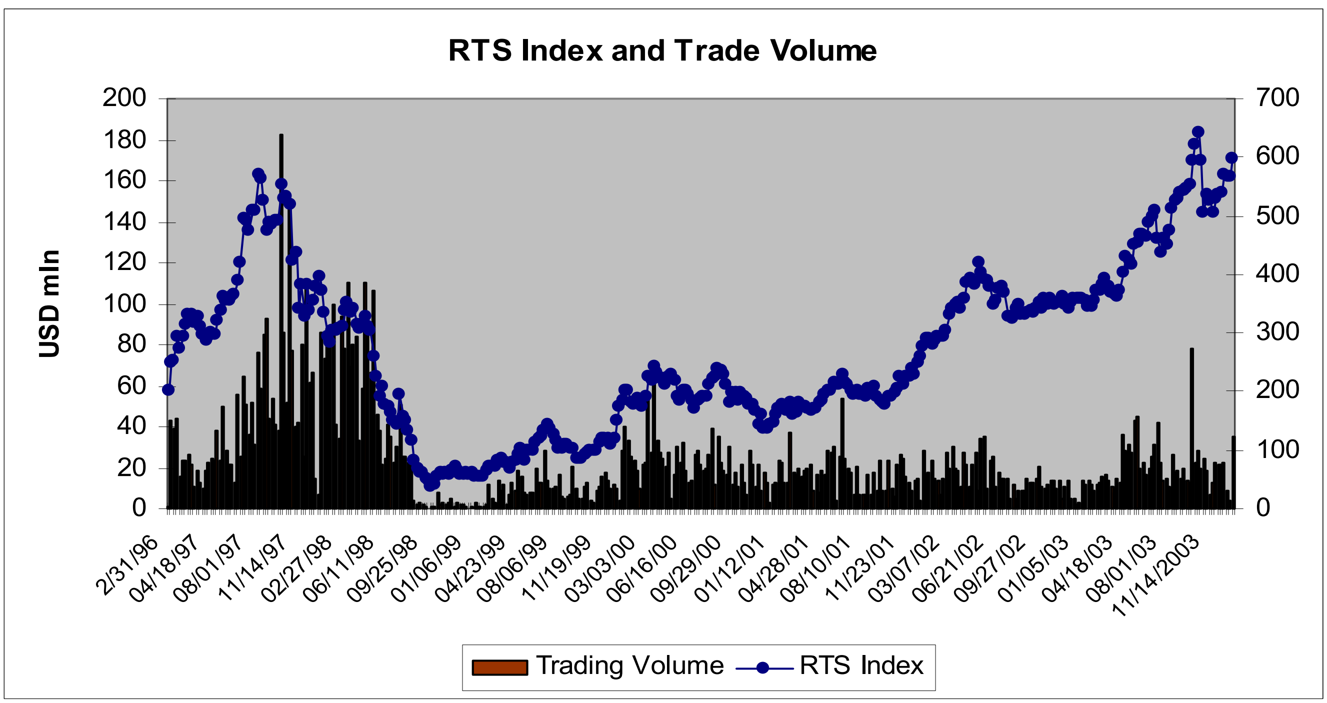
Overnight rates

Balances on the banks' correspondent accounts at the CBR were hitting historic high during the last week of 2003. They reached maximum of RUB 304.8 billion on January 5, the first business day of the new year, and then began to fall. By the end of the last week, balances were down by RUB 45 billion, stopping at RUB 258.8 billion. These patterns are traditional for this period of the year, because banks accumulate ruble resources for end-of-quarter and end-of-year obligatory tax payments for their clients and close their balances. Interbank overnight ruble rates were kept down by strong ruble liquidity and fluctuated in the range of 0.80-0.89% p.a.

Stock Market

During the last week of 2003, the Russian stock market was very quiet with no clear-cut trend, reflecting the slow holiday period. Prices remained stable and trade volumes were low. During the first week in January, however, the market began to climb, breaking through the 560-570 level and finishing the week almost at 600, on substantially increased trade volumes. The RTS index was up by 5.28% for the week.





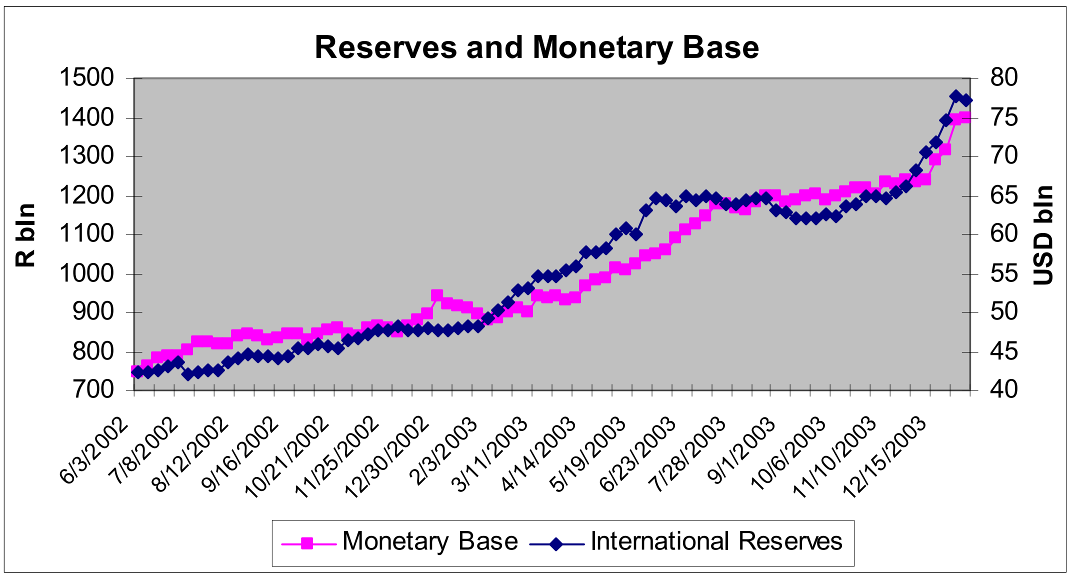
International Reserves and Monetary Base

International reserves of the CBR and the Finance Ministry increased by $3.3 billion (4.43%) during the last week of December, which was the second highest increase in 2003.

For the weeks ending January 2 and January 9, 2004

(During the third week of May, reserves had increased by 5.34%.) The reserves rose to a maximum of $77.8 billion by the end of the year, which is a $30.1 billion increase from the beginning of the year. The falling dollar, as well as higher prices of gold, were driving reserves up. As of January 2, however, the reserves fell by 0.9% to a total of $77.1 billion. This could be a result of external debt payments made by the Finance Ministry.

The monetary base rose by RUB 74.3 billion at the end of the year, to a record high of RUB 1392.1 billion as of December 29, 2003. This can be explained by the extensive interventions of the CBR on the currency market as well as by the seasonal social transfers made by the government at the end of the year. The following week, however, growth of the base monetary base slowed. As of January 5, it totaled RUB 1398.6 billion, or only 0.47% higher than the previous 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 repatriated currency. Minimum lot size for each of the dollar instruments is USD100,000. 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.

7. **JPMORGAN EMERGING MARKETS BOND INDEX PLUS** (EMBI+) tracks total returns for traded external debt instruments in the emerging markets. The instruments include external-currency-denominated Brady bonds, loans and Eurobonds, as well as U.S. dollar local markets instruments. The EMBI+ may be separated into individual components (such as by sovereign issuer). The source of all EMBI+ data in this publication is JPMorgan.

8. **CBR TIME DEPOSIT RATE** is set by periodic auctions held by the CBR that allow banks to hold money there at fixed terms for interest. The interest rate is set by the auction process, but the CBR sets the terms, which range from one week to several months and are not always the same at each auction. The benchmark time-deposit rate we will try to use is the shortest one. These auctions are not necessarily held on a regular weekly basis, so some data related to this indicator may not always appear in the Financial Weekly.