Alexander Abramov

2012: A Year of the State's Increasing Presence in the Stock Market

During the recent financial crisis, governments in many countries around the world took on the role of an agency responsible for calming down market upheavals. This global trend has found expression in the adoption of measures designed to save systemically important financial institutions, in various quantitative easing policies, in turning private debt into public debt, and in a switchover to new internal control and risk management standards.

All those developments did not bypass Russia. In 2012, the Russian financial market saw further strengthening of the government's role, which manifested itself in its decision that a mega-regulator should be created; in the increased volume of credit resources issued by the Bank of Russia to the banking system, and primarily to state-owned banks; in the increased share of the government structures participating in the exchange trade in shares and bonds; in the putting forth, by the government, of various legislative initiatives in the sphere of financial markets; and in the increasingly prominent role of the Bank of Russia in the management of the Moscow Exchange. In late 2011, the unified exchange was turned into an organization whose controlling block of shares is held by government structures. In 2012, the Bank of Russia, state-owned banks and the Russian Direct Investment Fund (RDIF) owned 57.5% of the Exchange's charter capital.

Oftentimes, an increasing presence of the government on a financial market helps to eliminate certain problems that financial organizations are unable to tackle on their own in conditions of a well-developed market. Thus, for example, in 2012 the Bank of Russia dramatically increased the volume of loans issued to banks through REPO operations on the Moscow Exchange. As a result, over that year the banks managed to keep the growth rate of their credit portfolios at a high level without resorting to their formerly applied risky methods of capital attraction, including through the carry trading strategy [1]. As shown in *Table 1*, this enabled Russia's stock exchanges to smooth over, on the stock market, the adverse consequences of the global-scale downward trend displayed by the exchange stock trade in response to investors' avoidance of risky investments. For reference: in 2012 the volume of trade in shares on US stock exchanges amounted to only 54.5% of its 2007 level; the value of that index for the London Stock Exchange, *Euronext* (Europe), and Deutsche Börse was 21.3%, 27.9%, and 37.9% respectively.

[1] Cheap short-term currency borrowed abroad and then invested in ruble-denominated financial assets.

Table 1

Behavior of Market Transactions with Shares on Major Global Stock Exchanges in 2007–2012, in Terms of Value (2007 = 100%)

	2007	2008	2009	2010	2011	2012
USA (NYSE и NASDAQ)	100	150.2	109.7	71.5	72.2	54.5
China (two exchanges)	100	70.2	114.9	103.1	98.5	63.8
Japan (Tokyo and Osaka exchanges)	100	90.5	64.5	65.9	64.0	55.5
UK	100	62.8	33.0	29.1	28.8	21.3
Euronext	100	78.2	35.1	35.8	37.8	27.9
Germany	100	92.3	38.3	41.8	52.3	37.9
Hong Kong	100	177.4	162.5	174.2	169.2	120.6
Canada	100	107.6	75.3	83.0	92.4	82.5
Australia	100	76.9	57.6	92.4	94.2	70.8
Russia (MICEX – market transactions)	100	74.5	90.5	106.0	151.9	44.7
Russia (MICEX – all trade modes)	100	117.2	71.4	84.1	134.6	125.7
NASDAQ OMX Nordic Exchange	100	73.6	40.3	41.3	45.6	32.3

Source: calculations based on data published by the World Federation of Exchanges (WFE).

The current situation on the Moscow Exchange (MICEX-RTS) is very controversial. The volume of market exchange transactions with shares in 2012 dropped to only 44.7% of its 2007 level, while those of the transactions in shares carried on in all trade modes rose by 25.7%. We believe that the reason why, in contrast to many foreign exchanges, the overall volume of trade in shares on the Moscow Exchange in 2012 managed to remain above its 2007 level, was the indirect support of the stock market's liquidity by the Bank of Russia[2].

Nevertheless, the fact that, throughout 2012, the role of the government agencies on the stock market continued to gain in prominence have given rise to some thoughts as to where the limits for such an expansion should be set, and how high might be the risk that the attempts to prevent market downfalls may lead to government downfalls. The essence of one of the current problems is that the concentration of financial flows at the government agencies' level coupled with the Bank of Russia's liberal policy in refinancing the banking system significantly undermine any impetus for state departments and state-owned banks to create a system of domestic private savings.

In 2012, some measures were implemented in order to reduce the amount of deductions to the funded component of the pension system in favor of its distributive component. As far as private pension saving is concerned, Russia has been following Argentina's example, with frequently changing rules of game on the pension saving market, complicated functioning of private pension institutions and shrinking deductions to the funded pension component[3]. At the same time, so far the government has failed to offer the Russian public any new and attractive

---

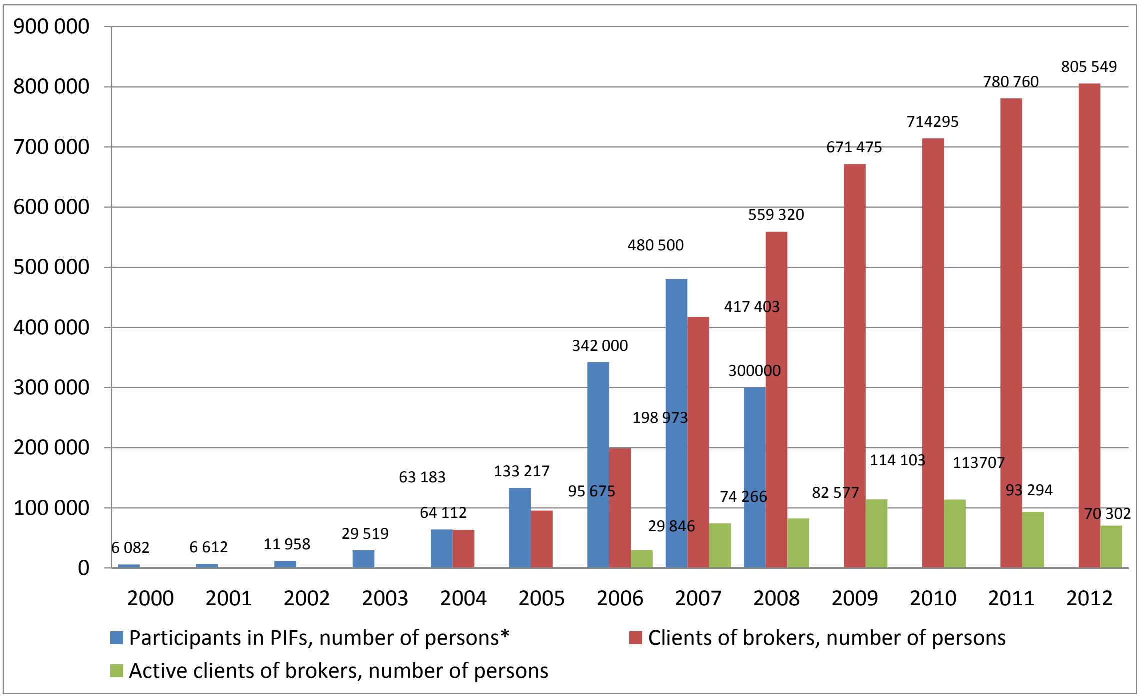
[2] As a rule, the Bank of Russia carries out a very limited number of REPO operations on the exchange stock market. However, the high liquidity volume channeled by it to biggest banks through the market for REPO bonds enables the latter to use part of their excessive liquidity thus obtained to provide brokers and their clients with credits on the market for REPO shares.

[3] A similar pension system development scenario in Argentina ended up in an enforced nationalization of private pension funds. As a result, as far as effective solutions to the pension provision problem are concerned, Argentina – a country with nearly a century-old history of pension system reforming – now lags decades behind Brazil and Chile.

voluntary pension saving schemes. The year 2012, similarly to a number of previous years, saw no significant tax exemptions introduced for the purpose of encouraging people to invest in long-term saving, although such measures are indeed envisaged in the *Strategy for the Development of the Financial Market*, approved by the RF Government as of 29 December 2008, No 2043-r.

Although the period of 2011-2012 saw a number of major positive changes in the Russian stock market's infrastructure, including the merger of RTS and MICEX with the creation of a single Moscow Stock Exchange (MICEX-RTS), the adoption of legislation on a central depository, the implementation of an exchange strategy, the extension CCP stock market clearing with T+n (n>3) settlements, no solution to the problem of attracting to the exchange a broad range of private investors has been found so far. Moreover, a reverse trend has manifested itself after the merger, when the number of private investors operating on the Moscow Exchange continues to decline, the scale of participation of state-owned banks and the Bank of Russia in the exchange trade in shares and bonds is on the rise, and their influence in the structure of property on the new exchange is becoming stronger. So far, no qualitative changes have been seen with regard to attracting global foreign investors to its trading activity, either.

As a result, for a third year in a row, the MICEX – and now the Moscow Exchange – have been witnessing a shrinking number of active private clients of brokers, which are defined as individual investors completing at least one transaction with shares on an exchange (*Fig. 1*). A record high number of active clients of brokers – 114.1 thousand – was seen in 2009. According to our estimations, as of 1 January 2013 it was as low as 70.3 thousand. There has been a noticeable slowdown in the growth rate of the number of registered clients of brokers. In 2012 it increased by 24.7 thousand against 42.8 thousand in 2010 and 66.5 thousand in 2011.



** Participants in PIFs*
2007-2008 estimated;
2009-2010 no data
Source: the author's calculations based on data released by the National League of Management Companies and the Moscow Exchange.

***Fig. 1.* Number of Management Companies' Private Clients and Brokers**

In the structure of exchange transactions with shares, the percentage of market transactions declined from 62.4% in September 2009 to 13.0% in December 2012 (*Fig. 2*). The percentage of REPO operations whereby market participants attract necessary resources for margin credits to their clients rose in 2012 to 85.6%. This means than the bulk of the turnover of shares on the MICEX-RTS stock exchange is constituted by speculative leverage transactions, while the role of classical private investors on that market is limited.

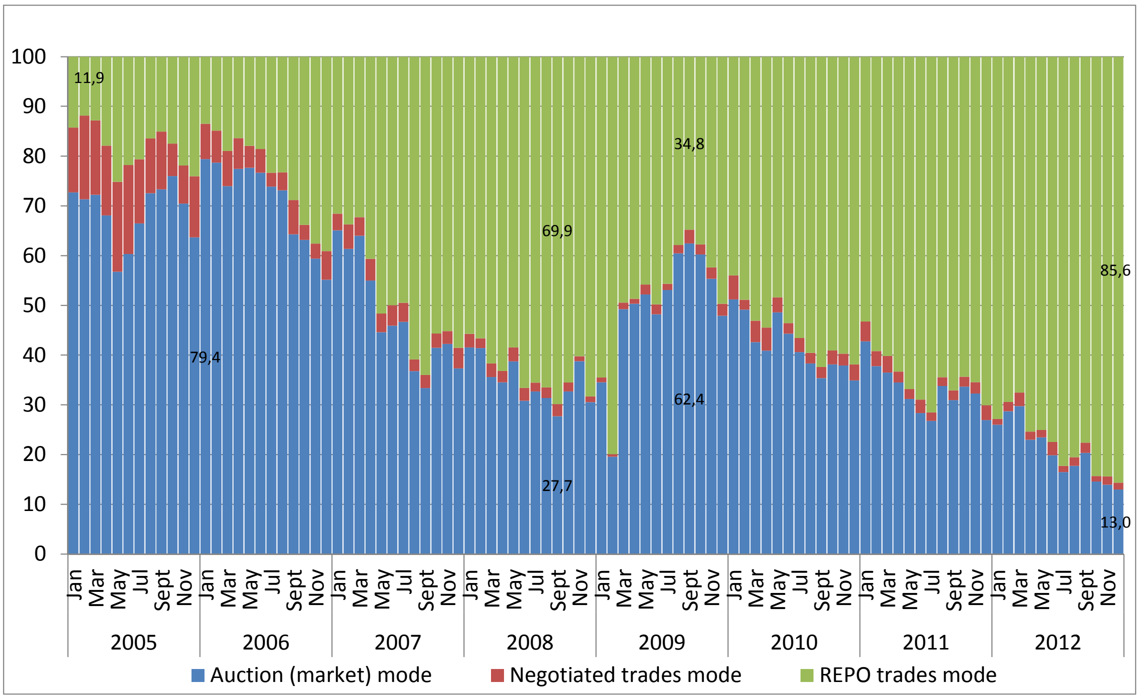
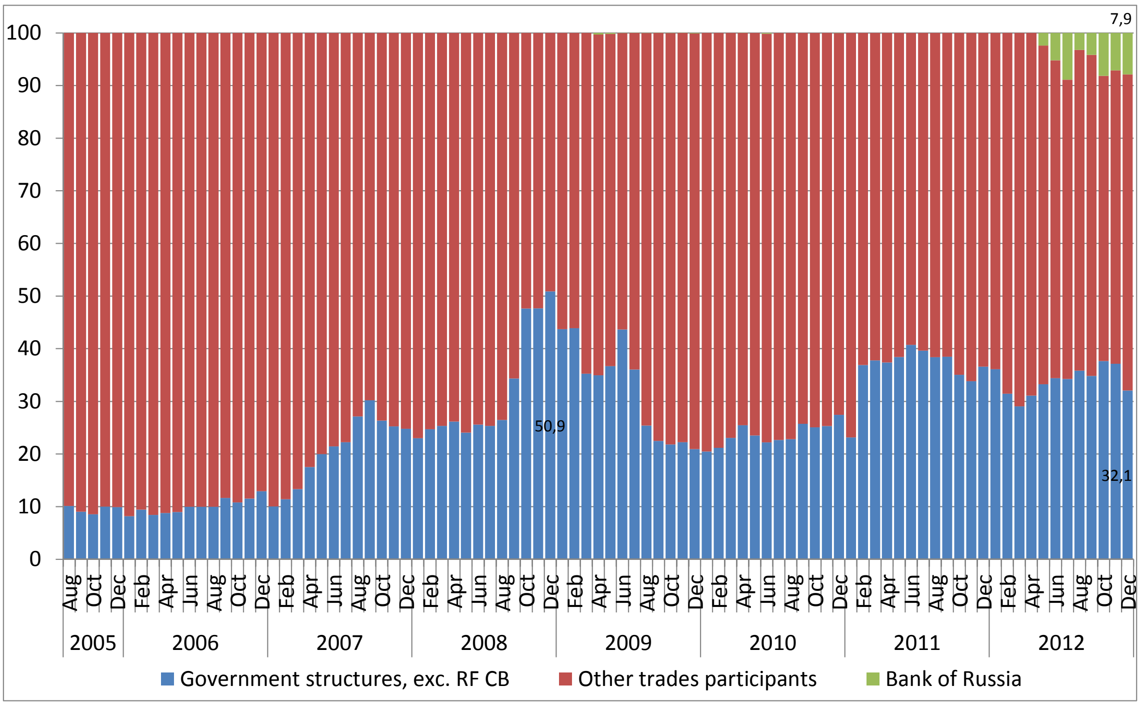


***Fig. 2.* Structure of Transactions with Shares in the Moscow Exchange's Main Market, %**

Fig.3 shows the results of transactions with shares on the MICEX-RTS Main Market carried out by state-owned banks and related structures[4]. During the period of market recovery after the 2008 crisis the participation of state-owned banks and their affiliated structures in exchange trades in shares had declined, but from February 2011 it was again on the rise, hitting the mark of 32.1% in December 2012. This can be explained by *Sberbank*'s acquisition of the *Troika Dialog* investment company coupled with its increasing trade activity. Besides, in 2012 the Bank of Russia began to be actively involved in exchange trades in shares – since April, its operations have been varying between 2 and 8% of the total trade volume. These operations are associated with loans issued by the Bank of Russia to banks and secured by shares on the REPO market. Consequently, the volume of participation of private structures in exchange trading in shares so far has been displaying a downward trend.

[4] VEB, VTB, VTB Capital, VTB24, Gazprombank, Sberbank, KIT Finance, Sviaz Bank, Bank of Moscow, TransCreditBank, and since 2011 – the *Troika Dialog* investment company.



Source: the author's calculations based on data released by the Moscow Exchange.

***Fig. 3.* Participation of Private and Public Brokers in the Trade in Shares on the Moscow Exchange, %**

On the bond market, which is used by private companies as a source of funding for their medium- and long-term investment, the situation in recent years has also been shifting in favor of the public sector. The secondary market has also been sustained mostly by state-owned banks acting in unison with the Bank of Russia. Moreover, it is state-owned banks that also act as underwriters and investment consultants in connection with the placement of corporate bonds. This fact is confirmed by the data presented in *Table 2*. In 2007–2012, state-owned banks were the underwriters in approximately 40 to 60% issues of corporate and regional bonds (in terms of value).

Table 2

Participation of Public and Private Financial Organizations in the Market of Services Provided by the Organizers of Domestic Bond Loans in Russia

	Issuers:					
	corporate bonds			regional bonds		
	Public financial organizations	Private financial organizations	Total	Public financial organizations	Private financial organizations	Total
2007						
Million rubles	169, 668	298, 302	467, 970	7, 551	45, 481	53, 032
Share, %	36.3	63.7	100.0	14.2	85.8	100.0
2008						
Million rubles	219, 892	249, 900	469, 792	42, 227	29, 716	71, 943
Share, %	46.8	53.2	100.0	58.7	41.3	100.0
2009						
Million rubles	620, 044	373, 978	994, 022	133, 325	22, 511	155, 836
Share, %	62.4	37.6	100.0	85.6	14.4	100.0
2010						
Million rubles	393, 743	461, 292	855, 035	86, 613	28, 288	114, 901
Share, %	46.0	54.0	100.0	75.4	24.6	100.0

	Issuers:					
	corporate bonds			regional bonds		
	Public financial organizations	Private financial organizations	Total	Public financial organizations	Private financial organizations	Total
2011						
Million rubles	620, 698	374, 146	994, 844	7, 767	46, 177	53, 944
Share, %	62.4	37.6	100.0	14.4	85.6	100.0
2012						
Million rubles	734, 697	502, 831	1, 237, 528	61, 925	57, 637	119, 562
Share, %	59.4	40.6	100.0	51.8	48.2	100.0

Source: the ratings of bond placement organizers, see www.cBonds.ru for 2007–2012.

The fact that the increasing interference of the State with the functioning of Russia's stock market has been giving rise to more problems is also confirmed by the competitiveness data released by the World Economic Forum (WEF). The WEF's Global Competitiveness Report 2012–2013, published in the autumn of 2012, shows that as far as a number of key indicators are concerned Russia's competitiveness position remains relatively weak. For example, Russia ranks 130th (out of 144) on the 'financial market development' indicator, 132nd on the 'soundness of banks' indicator and 114th on the 'regulation of securities exchanges' indicator. Besides, Russia's 'financial market development' indicator and the 'soundness of banks' indicator have deteriorated by comparison with the previous year.

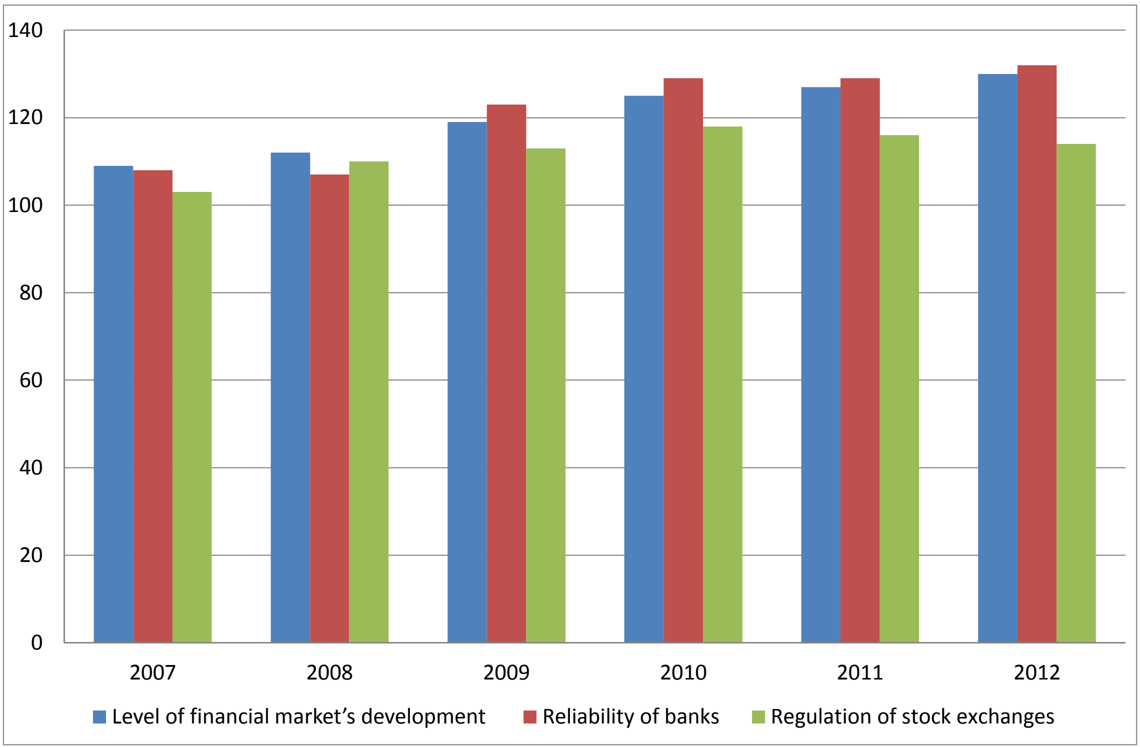


Fig. 4. **Russia's Ranking in the World Economic Forum's Global Competitiveness Report**

Thus, the model based on the State's increasing role in the regulation and development of Russia's financial market have so far found no appreciation among global or domestic investors.