

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
March 2003

MONTHLY BULLETIN

Moscow
2003

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The State of the Federal Budget

In January of 2003, the revenues of the state budget (cash execution) made 21.2 % of GDP, while expenditures made 13.0 % of GDP (see Table 1). Therefore, the federal budget surplus made 8.2 % of GDP.

Table 1

The monthly execution of the federal budget of the Russian Federation (in % of GDP¹, in comparable prices)

	I'02	II'02	III'02	IV'02	V'02	VI'02	VII'02	VIII'02	IX'02	X'02	XI'02	XII'02	I'03	II'03
Revenues														
Corporate profit tax	1,4%	1,4%	1,5%	1,9%	1,9%	1,7%	1,7%	1,7%	1,6%	1,7%	1,6%	1,6%	1,3%	
Personal income tax	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	
VAT, special tax and excises	4,9%	4,4%	4,0%	3,9%	3,6%	3,5%	3,5%	3,3%	3,2%	3,1%	3,1%	3,1%	2,4%	
Tax on foreign trade and foreign trade operations	9,3%	9,1%	9,3%	9,3%	9,3%	9,3%	9,3%	9,1%	9,0%	8,9%	8,9%	8,9%	11,5%	
Other taxes, duties and payments	6,9%	6,4%	6,8%	6,9%	7,0%	7,0%	7,0%	7,0%	6,9%	6,9%	6,9%	6,9%	8,7%	
Total- taxes and charges	2,4%	2,6%	2,5%	2,4%	2,3%	2,3%	2,2%	2,1%	2,0%	2,0%	1,9%	2,0%	2,8%	
Non- tax revenues	3,2%	3,3%	3,2%	3,0%	2,9%	2,9%	2,9%	2,8%	2,8%	2,8%	2,9%	3,0%	3,5%	
Revenues, total	9,7%	9,1%	8,7%	8,7%	8,4%	1,8%	2,0%	2,0%	2,0%	2,1%	2,1%	2,1%	0,5%	
Expenditure	20,4%	19,6%	19,6%	19,9%	19,6%	19,3%	19,4%	18,9%	18,5%	18,6%	18,5%	18,6%	19,2%	
Public administration	2,1%	1,6%	1,4%	1,3%	1,2%	1,3%	1,4%	1,4%	1,4%	1,6%	1,4%	1,4%	17,9%	
National defense	22,4%	21,2%	20,9%	21,2%	20,9%	20,6%	20,9%	20,4%	20,0%	20,2%	20,1%	20,1%	21,2%	21,2%
International activities														
Judicial power	0,1%	0,2%	0,3%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,5%	0,3%	
Law enforcement and security activities	1,0%	1,5%	1,9%	2,3%	2,4%	2,5%	2,5%	2,5%	2,4%	2,4%	2,5%	2,7%	-0,3%	
Fundamental research	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,3%	0,3%	0,3%	0,3%	0,3%	1,5%	
Services provided for the national economy	0,0%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%	0,2%	0,2%	0,2%	0,1%	
Social services	0,6%	0,9%	1,0%	1,2%	1,2%	1,3%	1,4%	1,4%	1,4%	1,4%	1,5%	1,7%	1,2%	
Servicing of public debt	0,0%	0,1%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,3%	0,3%	0,1%	
Other expenditure	0,1%	0,3%	0,4%	0,5%	0,6%	0,7%	0,8%	0,8%	0,8%	1,2%	1,3%	1,5%	0,2%	
Expenditure, total	3,7%	4,8%	4,8%	5,3%	5,2%	5,2%	5,2%	5,1%	4,9%	5,5%	5,6%	5,6%	1,5%	
Loans, redemption exclusive	2,0%	3,4%	3,4%	2,6%	2,5%	2,4%	2,3%	2,4%	2,4%	2,2%	2,0%	2,0%	1,7%	3,0%
Expenditure and loans, redemption exclusive	2,9%	3,3%	3,6%	3,9%	4,0%	4,0%	4,0%	3,9%	3,8%	3,9%	3,9%	3,8%	6,7%	
Budget deficit (-)	10,9%	15,0%	16,1%	16,9%	17,1%	17,2%	17,2%	17,1%	16,9%	17,8%	18,0%	18,7%	13,0%	17,3%
Domestic financing	11,5%	6,2%	4,8%	4,3%	3,8%	3,4%	3,7%	3,3%	3,1%	2,4%	2,1%	1,4%	8,2%	3,8%
Other taxes, duties and payments	-11,2%	-4,6%	-2,7%	-2,0%	-1,8%	-1,6%	-1,8%	-1,3%	-1,2%	-0,5%	-0,2%	0,6%	-6,8%	-1,4%
Total- taxes and charges	-0,4%	-1,6%	-2,1%	-2,3%	-1,9%	-1,8%	-1,9%	-1,9%	-1,9%	-1,9%	-1,9%	-2,0%	-1,5%	-2,5%
Non- tax revenues	-	-6,2%	-4,8%	-4,3%	-3,8%	-3,4%	-3,7%	-3,3%	-3,1%	-2,4%	-2,1%	-1,4%	-8,2%	-3,8%

* в % ВВП; ** ЕСН включен в налоговые доходы

As compared with the figures registered in January of 2002, the budget revenues decreased by 1.2 p.p., while expenditures declined by 2.1 p.p. and budget surplus decreased by 3.3 p.p. At the same time, without SST the budgetary revenues increased by almost 1.3 p.p. of GDP and made 18.8 % of GDP, while expenditures (without taking into account the transfer to the RF Pension Fund at the expense of SST) grew by almost 1.5 p.p. of GDP and made 10.0 % of GDP.

In January of 2002, VAT accounted for the major share of federal tax revenues – 45 % of the total tax revenues what is practically at the level observed in the respective period of 2002.

According to preliminary estimates, the cash execution of federal budget revenues made 21.2 % of GDP in January through February of 2003, what is at the respective level observed in January through February of 2002. At the same time the cash execution of expenditures made 17.3 % of GDP (15 % of GDP in 2002); therefore, the surplus made 3.8 % of GDP (6.2 % of GDP in 2002).

According to the preliminary estimates of the Finance Ministry, in terms of fulfilled funding² the expenditures of the federal budget in January through February of 2003 made 21.1 % of GDP (see Table 2),

¹ Because of the estimated data on GDP, the indices may be subject to revision.

² The execution of the budget in terms of fulfilled (actual) financing is equal to the sum of the funds transferred to managers of budget funds, while the cash execution of the budget is equal to the sum of funds spent by managers of funds (i.e. without account of funds remained on their accounts).

while on March 1 of 2002 this indicator was at 18.7 % of GDP. As a result, the surplus of the federal budget in terms of fulfilled funding in the first two months of 2003 has also decreased by 2.2 p.p. in comparison with the figures registered in the respective period of 2002 and made 0.1 % of GDP.

Table 2

**The monthly execution of the federal budget of the Russian Federation
(in % GDP, fulfilled funding).**

	I'02	II'02	III'02	IV'02	V'02	VI'02	VII'02	VIII'02	IX'02	XII'02	I'03	II'03
Total	22,2%	21,0%	20,9%	21,2%	20,8%	20,5%	20,5%	20,5%	20,0%	20,1%	21,4%	21,2%
Public administration	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,6%
National defense	1,7%	2,4%	2,4%	2,7%	2,7%	2,7%	2,7%	2,7%	2,6%	2,6%	2,5%	3,2%
International activities	0,4%	0,2%	0,4%	0,5%	0,4%	0,4%	0,4%	0,3%	0,3%	0,3%	-0,4%	0,1%
Judicial power	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%
Law enforcement and security activities	1,6%	1,4%	1,4%	1,5%	1,5%	1,6%	1,9%	1,6%	1,6%	1,7%	1,9%	2,3%
Fundamental research	0,3%	0,3%	0,2%	0,3%	0,3%	0,3%	0,2%	0,3%	0,3%	0,3%	0,3%	0,3%
Services provided for the national economy	0,3%	0,6%	0,8%	0,9%	1,0%	1,0%	1,1%	1,1%	1,0%	1,5%	0,6%	0,8%
Social services	5,0%	5,7%	5,3%	5,9%	5,7%	5,5%	5,6%	5,4%	5,2%	5,7%	2,6%	2,8%
Servicing of public debt	1,9%	3,4%	3,4%	2,7%	2,5%	2,4%	2,6%	2,4%	2,4%	2,0%	1,7%	3,0%
Other expenditure	3,5%	4,0%	3,9%	4,0%	4,6%	4,2%	4,0%	4,0%	4,0%	3,8%	7,0%	7,8%
Total expenditure	15,5%	18,7%	18,6%	19,1%	19,4%	18,9%	19,1%	18,6%	18,2%	18,7%	16,9%	21,1%
Профицит (+) дефицит (-)	6,8%	2,3%	2,3%	2,1%	1,4%	1,6%	1,4%	1,8%	1,7%	1,4%	4,5%	0,1%

According to the estimates of the Revenue Ministry, in February of 2003 tax revenues of the federal budget made Rb. 98.5 billion (without the single social tax). In real terms the revenues made 229.2 % of the level registered in January of 1999, while the respective indicator was at 187.1 % in 2002 and 198.4 % in 2001 (see Table 3).

Table 3

**Actual tax revenues to the federal budget, according to the data of the MTC
(in % of the data for January of 1999)³.**

1999											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
100,0%	115,1%	122,0%	122,1%	104,5%	112,9%	127,0%	127,5%	124,3%	141,4%	160,8%	213,1%
2000											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
149,3%	160,5%	181,3%	205,8%	233,1%	186,9%	181,0%	186,4%	173,1%	181,1%	201,7%	254,1%
2001											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
204,4%	198,4%	227,6%	267,5%	252,2%	233,3%	231,9%	235,6%	219,4%	237,5%	247,3%	360,6%
2002*											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
218,7%	187,1%	234,8%	277,8%	239,6%	218,0%	284,4%	246,5%	254,8%	299,7%	241,0%	250,2%
2003*											
I						II					
230,0%						229,2%					

* Без учета ЕСН.

³ It was decided to choose January of 1999 as the benchmark in order to render the comparison more reliable. January of 1999 is not a remarkable date in terms of tax revenues.

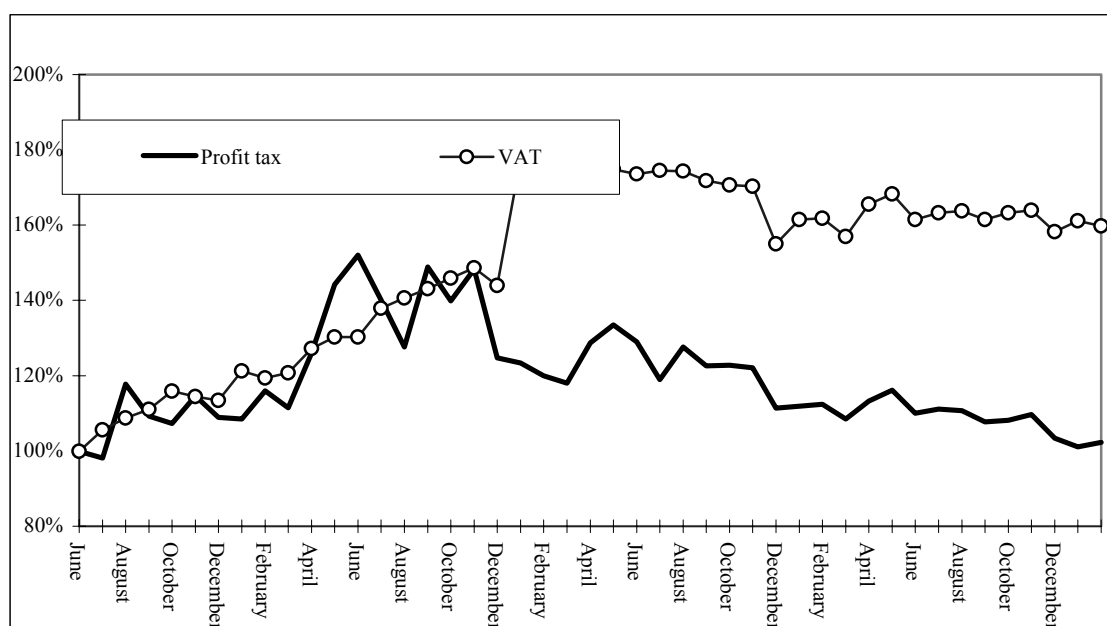


Fig. 1. Rate of growth of the real tax arrears to the federal budget (in % to June of 1999)

The debts related to the payments due to the federal budget made for VAT Rb. 243.6 billion as on March 1, 2003, the arrears of the profit tax made Rb. 33.4 billion. The dynamics of real arrears relating to major debts since June of 1999 is presented in Fig. 1. On the whole, the dynamics and the latest data demonstrate a gradual decrease in the level of accumulated arrears as concerns the profit tax and a certain trend towards a decline in VAT arrears.

Table 4

Execution of the RF consolidated budget (in % of GDP)

1998												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes	16,2%	17,4%	18,1%	19,3%	19,7%	19,8%	19,8%	19,4%	18,8%	18,5%	18,6%	19,6%
Revenues	18,8%	20,1%	21,2%	22,4%	23,0%	23,2%	23,2%	22,9%	22,3%	22,0%	22,0%	24,5%
Expenditures	25,3%	23,8%	27,0%	28,1%	28,6%	29,5%	29,4%	28,6%	27,4%	26,9%	27,1%	29,5%
Deficit	-6,5%	-3,7%	-5,8%	-5,7%	-5,7%	-6,3%	-6,2%	-5,7%	-5,2%	-5,0%	-5,0%	-5,1%
1999												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes	16,8%	16,6%	18,1%	19,9%	20,1%	20,5%	20,8%	20,8%	20,3%	20,2%	20,9%	22,1%
Revenues	19,2%	18,9%	20,6%	22,7%	23,2%	23,9%	24,3%	24,5%	24,1%	24,0%	24,8%	26,3%
Expenditures	18,6%	20,3%	23,6%	25,6%	26,6%	27,3%	27,4%	27,4%	26,7%	26,3%	26,7%	29,2%
Deficit	0,6%	-1,5%	-3,1%	-3,0%	-3,4%	-3,4%	-3,1%	-2,9%	-2,7%	-2,3%	-1,9%	-2,9%
2000												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes	20,8%	21,4%	22,6%	24,2%	25,5%	25,4%	24,9%	24,8%	24,1%	23,7%	24,0%	24,6%
Revenues	24,4%	24,8%	26,4%	28,2%	29,7%	29,7%	29,3%	29,2%	28,4%	28,0%	28,6%	30,0%
Expenditures	19,6%	21,1%	23,8%	24,8%	25,2%	25,5%	22,3%	25,1%	24,5%	24,2%	24,6%	27,0%
Deficit	4,7%	3,7%	2,6%	3,4%	4,5%	4,3%	7,0%	4,1%	3,9%	3,8%	4,0%	3,0%
2001												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes	22,7%	23,6%	23,9%	25,4%	26,4%	26,0%	26,1%	25,9%	25,0%	24,8%	25,4%	27,1%
Revenues	25,9%	27,1%	27,4%	29,3%	30,5%	29,8%	29,9%	29,7%	28,3%	28,2%	28,8%	29,5%
Expenditures	16,8%	22,8%	23,7%	24,7%	25,1%	25,3%	25,5%	25,6%	24,9%	24,7%	25,0%	25,6%
Deficit	9,1%	4,2%	3,7%	4,7%	5,4%	4,4%	4,4%	4,1%	3,5%	3,5%	3,8%	3,9%

2002												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes	28,7%	23,6%	24,3%	26,5%	26,6%	25,9%	26,4%	25,9%	25,2%	25,4%	25,4%	25,5%
Revenues	32,9%	31,3%	31,4%	33,6%	33,6%	32,7%	33,3%	32,5%	31,7%	32,0%	32,1%	32,1%
Expenditures	18,3%	23,7%	26,0%	28,4%	28,4%	28,8%	29,1%	28,9%	28,4%	29,3%	29,7%	31,1%
Deficit	14,6%	7,7%	5,4%	5,3%	5,2%	3,8%	4,2%	3,7%	3,3%	2,7%	2,4%	1,0%
2003												
	I											
Taxes	25,6%											
Revenues	32,0%											
Expenditures	20,7%											
Deficit	11,3%											

* Без учета ECH

The revenues of the consolidated budget in January of 2003 made 32.0 % of GDP, including tax revenues (without SST) at 25.6 % of GDP (see Table 4). Expenditures of the consolidated budget increased by 2.4 p.p. in comparison with the figures registered in January of 2002 and made 20.7 % of GDP. The surplus of the consolidated budget in January of 2003 made 11.3 % of GDP, what is below the level observed in January of 2002 (14.6 % of GDP).

S. Batkibekov

Monetary Policy

In February the rate of inflation decreased. Despite considerable external debt payments, foreign reserves of the CB RF continued to grow throughout Quarter One.

In February 2003 the CPI growth was 1.6 percent, a considerable decrease after the January value of 2.4 percent (see Fig. 1). Thus, the dynamics of consumer prices demonstrated traditional month-on-month growth rate fluctuations (in 2002 the January CPI was 3.1 percent and in February it fell to 1.2 percent). In February prices for fruit and vegetables continued to grow, but at slower rates. E.g., prices for foodstuffs grew 1.2 percent, while the price growth without account for fruits and vegetables was only 0.8 percent. Prices for payable services to the population quickly grew to 4.2 percent in February, the greatest price-growth factor in that month. In particular, housing and communal services grew in price 7.3 percent. Prices for non-foods grew 0.9 percent.

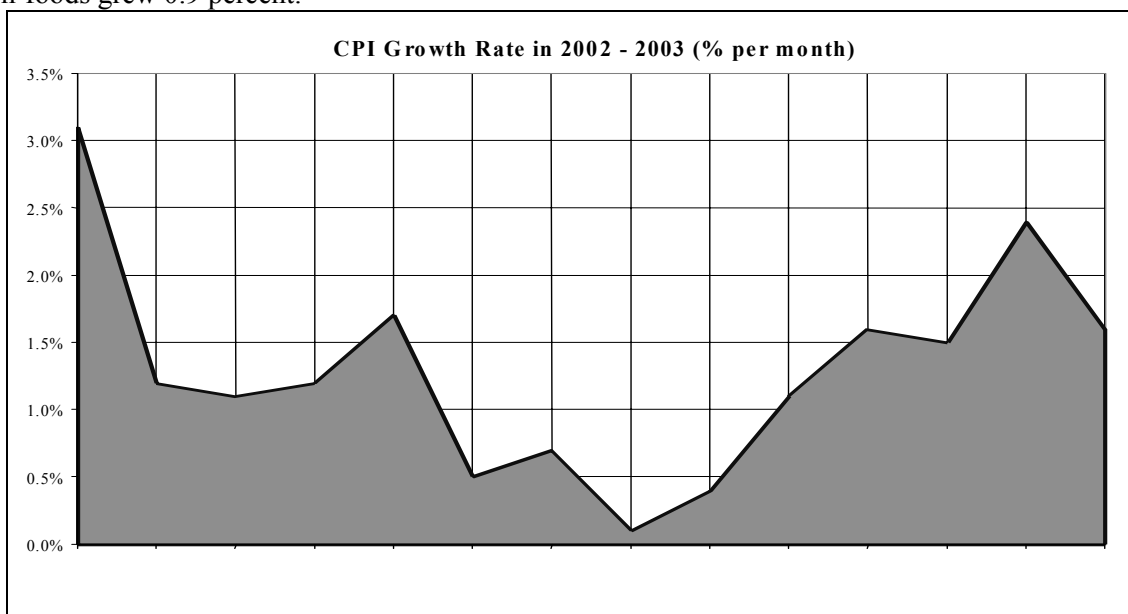


Fig. 1

Thus, during the first two months of 2003 consumer prices grew 4.1 percent (CPI growth in the corresponding period of 2002: 4.3 percent). According to preliminary estimates, in March the consumer price index grew 1.2 to 1.3 percent.

In February - March foreign reserves continued to grow (See Fig. 2). At March 1, 2003, they amounted to US\$ 53.061 billion, or 7.7 percent more than at the end of January 2003 (in January the increase in foreign reserves was only 3.1 percent). During the first three weeks of March foreign reserves grew US\$ 1.5 billion more. The considerable growth in reserves became possible owing to the remaining high oil prices and weakening demand for currency on the part of commercial banks. This makes the Bank of Russia buy currency on the market to avoid an even greater jump in the Rouble's nominal rate.

In February the money supply (in its broad definition) grew from RUR 1140.1 billion up to RUR 1240.7 billion (+8.8 percent). This may be explained above all by the significant growth of the Central Bank's foreign reserves. Considering the January contraction of the money supply, its total growth during two months was 0.7 percent.

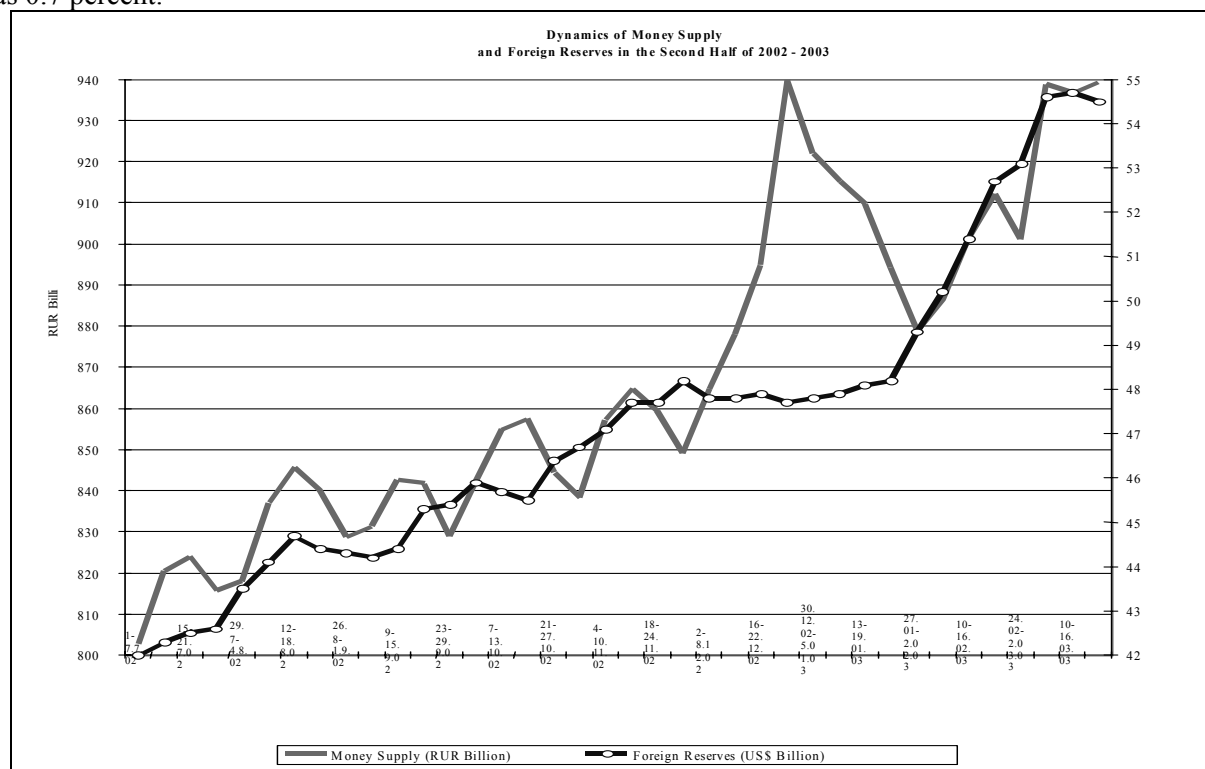


Fig. 2

S. Drobyshevski, P. Trunin

Financial Markets

The Market for Government Securities

In March a correction of prices was observed at the market for Russian external debt. Bond quotations decreased 0.5 to one percent. It should be noted in this connection that quotations were growing during the first half of the month. The growth of Brazil's bonds brought about by the IMF's consent to extend another US\$ 4.1 billion as part of the US\$ 30 billion aid programme entailed a price increase in eurobond markets in other countries, including Russia. News of new record amounts reached by the foreign reserves also added to investors' optimism. When the military action began, some of the players preferred to fix the profits, which resulted in reduction of the prices of Russian securities. The decrease in prices for 'black gold' due to the war in the Gulf was another important factor that made the players take their funds out of the Russian segment of the debt market and invest them in other emerging markets. Price reduction leaders are Minfin, 7th tranche (-1.67 percent); Minfin, 5th tranche (-1.1 percent); Rus-05 (-0.91 percent); Rus-07 (-0.68 percent); Rus-28 (-0.55 percent).

In March the RF Ministry of Finance repaid US\$ 1.48 billion out of the Russian external debt (repayment of the principal amount: US\$ 650.85 million; interest payments: US\$ 832.15 million).

A number of various factors affected the pricing process in the Rouble bond market in March. On the one hand, large amounts of free Rouble liquidity and lack of alternative instruments determined the stable demand in the internal debt market and the decreasing offer of government securities. On the other hand, as a result of low yields in the market, players start to lose interest in the government debt. The first two weeks Rouble bond quotations were increasing and their weighted average yield was decreasing.

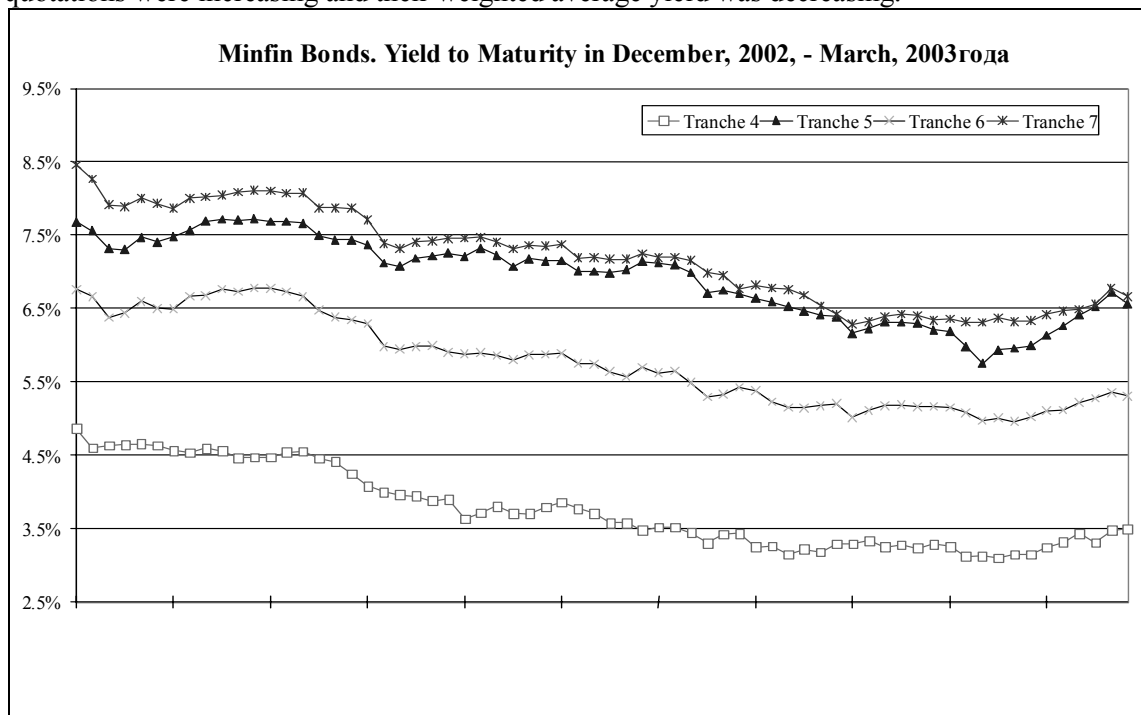


Fig. 1.

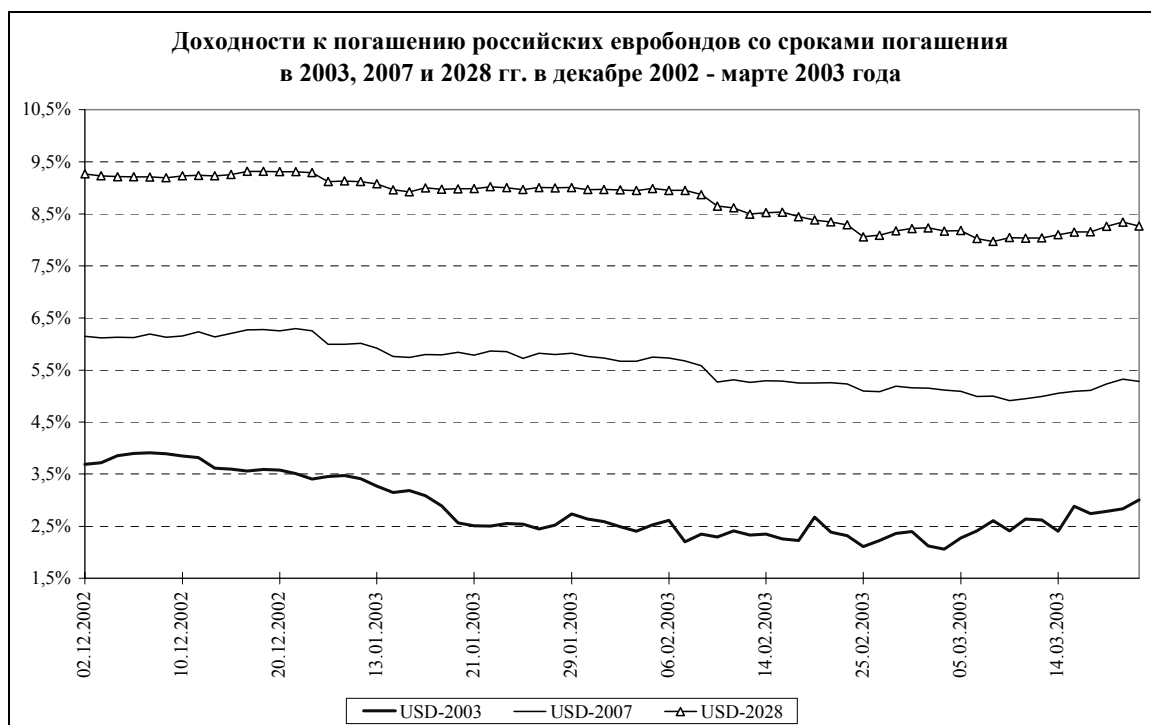


Fig. 2

We would like to mention the auction on March 5, in which three issues were placed worth a total of RUR 22 billion, including the 'longest' issue OFZ-AD 46014 that matures in 2018. The high level of funds secured the auction's success. Participants' interest in the new security № 46014 was especially high, with demand exceeding the offer by RUR 2 billion. The total issue was RUR 10 billion, and the Ministry of Finance has placed over 83 percent to the amount of more than RUR 8 billion. The weighted average yield of OFZ-AD 46014 at the auction was 9.7 percent p.a., which corresponded to the yield of OFZ-AD 46002 reached at the auction on March 4. The REPO auction and deposit auction held by the Russian Federation Central Bank on March 6 aimed at binding excessive RUR liquidity failed to affect the market significantly. On the whole, at the auction of March 7, the weighted average yield was 9.07 percent p.a. in the OFZ-PD segment and 8.16 percent p.a. in the OFZ-AD segment. The auction turnover was cca. RUR 7.4 billion during the first week of March and RUR 5.2 during the second week of March.

After the military action in Iraq began, a correction in the foreign currency segment of the bond market was followed by a correction in the Rouble segment of the government debt market; 'long' securities led the reduction. However, by 20-21 March prices for Rouble debentures started to grow again, and on March 21 the weighted average market yield was 8.96 percent p.a.

As at March 25, the volume of the GKO-OFZ market was RUR 269.6 billion in nominal terms (RUR 282.1 billion in money terms). The duration of the market portfolio was 761.5 days.

The Market for Corporate Securities

The Stock Market. In March the index of the Russian stock market and leading indices of the developed countries moved in different directions. Positive domestic news, a considerable inflow of petrodollars and the uncertainty prevailing in Western markets resulted in investors' interest to the Russian stock market. In the beginning of March the RTS index demonstrated excellent results amid the reduction of the main Western indices. However, after the military operation in Iraq commenced, priced on the oil market stabilised at a level below US\$ 28 / barrel. Stock indices of the developed countries leaned on their historic lows, while the Russian index, 70 percent of which depends on the oil market, began to 'lose weight'.

During the month, the RTS index diminished 4.86 percent, reaching 364.61 points on 26 March. The trade volume increased in comparison with the previous month, reaching US\$ 269 million. The average daily volume amounted to US\$ 15.8 million. The dynamics of the RTS index may be subdivided into three periods. During the first week of March the volume of auctions was significant (average daily amount: US\$ 22 million) and the stock indicator demonstrated growth. The highest index value, observed on March 6, was 397.47 points⁴ (3.7 percent as compared with the end of February). Then the stock indicator began to decline abruptly, reaching on 18 March the month's lowest level, 362.58 points. Thereafter the index stayed in the range of 363-369 points. The end of the month was marked by very low turnover values (less than US\$ 10 million per day). The lowest trade volume, US\$ 3.9 million, was observed on 26 March; the highest trade volume, US\$ 26.9 million⁵, was observed on 18 March. Such index dynamics have been caused by the military action in Iraq.

Despite the positive quotation dynamics in the first half of the month, during the period under review shares of the majority of the Russian blue chips showed weaker results than expected. As at 26 March, the Mosenergo shares were again the growth leaders with 25.53 percent. The RAO UES stock followed with 2.83 percent. The prices for shares of MMC Norilsk Nickel (0.42 percent), Sibneft (0.35 percent) and Tatneft (0.34) remained practically unchanged. Prices for the stock of Gazprom (-1.94 percent), Rostelekom (-2.01 percent) and Sberbank (-2.64 percent) somewhat diminished. The largest oil companies – Lukoil (-6.04 percent), Surgutneftegas (-7.79 percent) and Yukos (-12.56 percent) formed the March outsider group. Mosenergo's quotations whirled upward owing to buying up of its shares by strategic investors.

During the period under review common stock of RAO UES again accounted for the highest proportion in the total turnover on the RTS (22.94 percent as against 30.43 percent in the previous month). Lukoil's stock took the second place by turnover, reaching 17.55 percent in March (against 15.47 percent in February). Yukos's stock retained the same proportion of 16.47 percent (16.44 percent), that of Surgutneftegas was 9.73 percent (7.69 percent), and of Mosenergo, 7.08 percent

⁴ The highest value since 27 May, 2002.

⁵ The highest value since 26 September, 2002.

(5.43 percent). The total proportion of five most liquid securities in the total March RTS turnover somewhat diminished, reaching 73.77 percent (February: 75.56 percent).

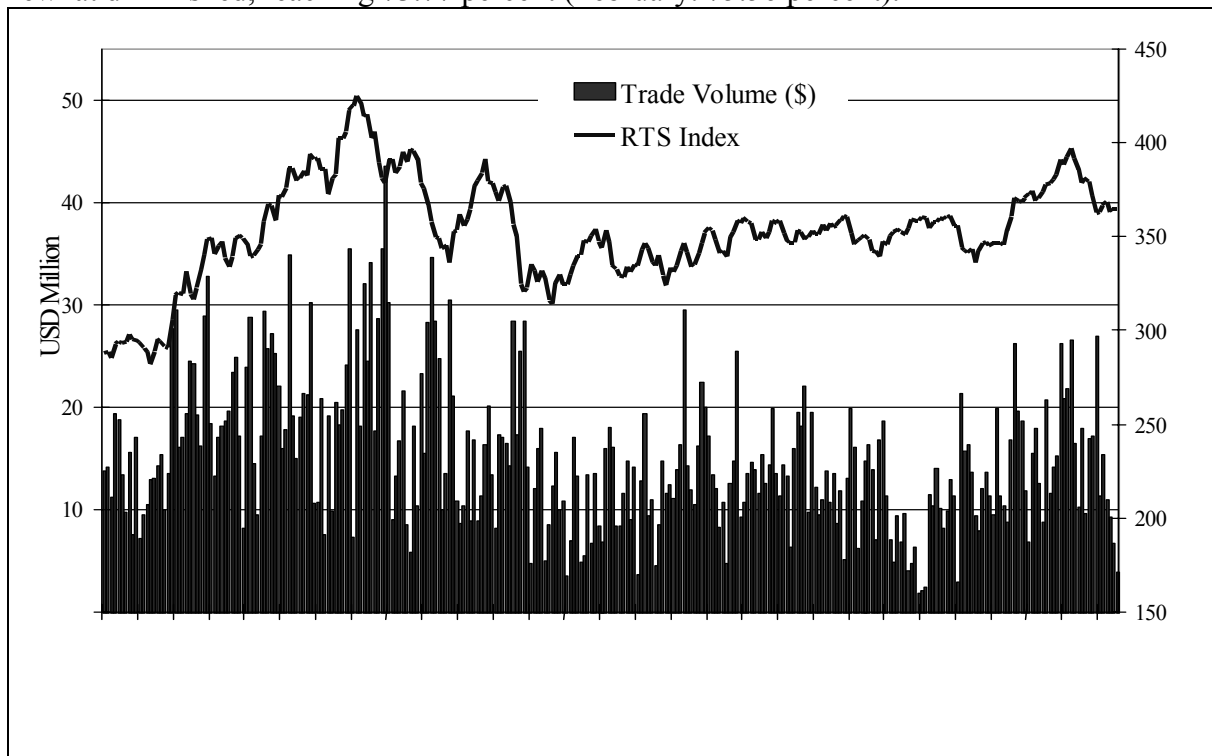


Fig. 3

**Dynamics of Russian blue chip quotations
from 28 February till 26 March, 2003**

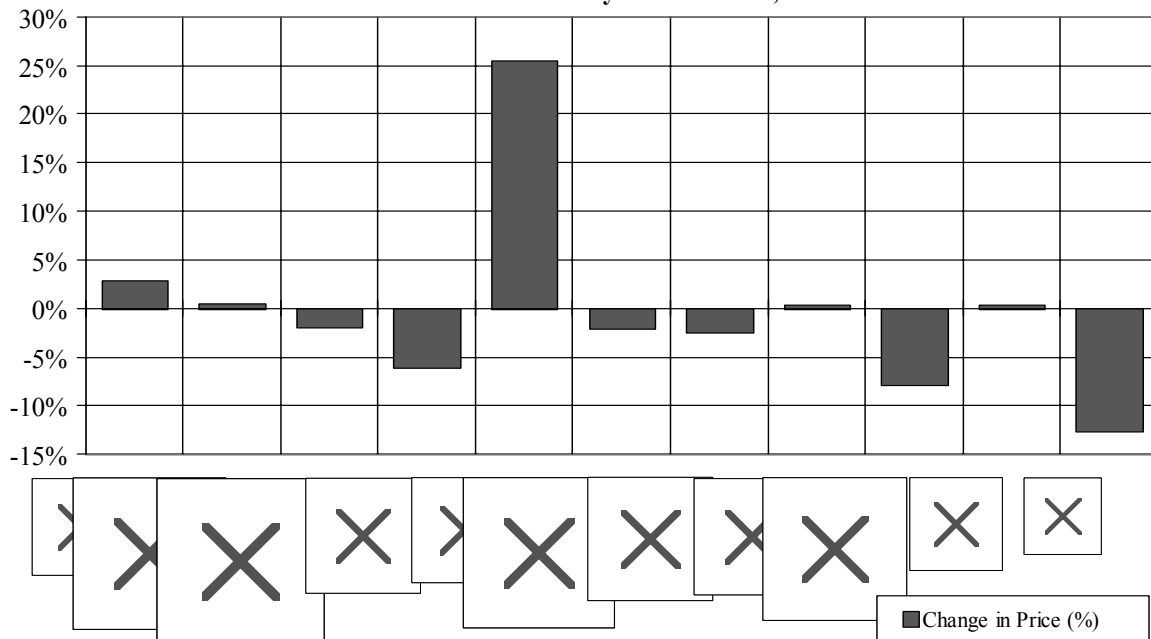


Fig. 4

In the period from 1 till 26 March the volume of trade in Gazprom shares via RTS terminals grew 1.5 times as compared with the previous period, reaching US\$ 133.5 million (or cca. 161 million shares). A total of 8.6 deals with the company's shares have been concluded.

In March the five top Russian companies by capitalisation (according to RTS) remained the same as in February: Yukos, US\$ 21.5 billion; Gazprom, US\$ 19.2 billion; Lukoil, US\$ 11.8 billion; Surgutneftgas, US\$ 10.5 billion; and Sibneft, US\$ 10.3 billion.

The market for term contracts. The turnover in the FORTS market for term contracts exceeded RUR 10 billion (56.14 thousand deals, 2.22 million contracts) in March. Futures contracts accounted for RUR 9.85 billion (54.47 thousand deals, 2.18 million contracts) in that amount. The highest trade volume was observed on 20 March: RUR 754 million (1.49 million contracts, 3946 deals). The average daily turnover was more than RUR 590 million.

On 17 March, 2003, March futures contracts were executed. The amount of executed liabilities was RUR 178 million. The highest execution volume was observed for the futures contract on RAO UES stock: RUR 72 million.

On 17 March, instead of settlement futures contracts for the common stock of RAO UES, OAO Surgutneftgas and OAO Rostelekom, delivery contracts for these shares, to be executed in September, 2003, were introduced.

External factors affecting the dynamics of the Russian stock market. On March 6, the European Central Bank announced it was reducing the base rate by 0.25 percentage points. Thus, the new base interest rate in the European Union was fixed at 2.5 percent.

The main US stock indices once again hit historic lows. On 11 March, DJIA closed at 7524.06, and the hi-tech NASDAQ reached 1271.47 points. European indices also went down to the lowest levels in six years, and NIKKEI fell below 8,000 points, reaching the 7862.34 mark, which is the lowest value since January, 1983.

Following the beginning of the military campaign in Iraq, stock indices on the world's leading floors began to grow. During the first week of war DJIA demonstrated the quickest weekly growth since 1982, and NIKKEI grew to the highest mark in four months. On the whole, from 28 March till 24 DJIA grew 4.1 percent, NASDAQ, 2.41 percent, and NIKKEI, 0.86 percent.

The instability in connection with Iraq, high oil prices and the unfavourable situation in the labour market resulted in a significant reduction of the Consumer Confidence Index in the USA. The preliminary report by the Michigan University states that the Index sank to 75 points. This value is the lowest since 1992, when the Index hit 73.3 points.

The US Federal Reserve System decided in its meeting on 18 March to leave the interest rate at 1.25 percent, the lowest level in 40 years. We would like to remind that previously the US Fed decreased the federal funds rate by 0.5 percentage points in November, 2002.

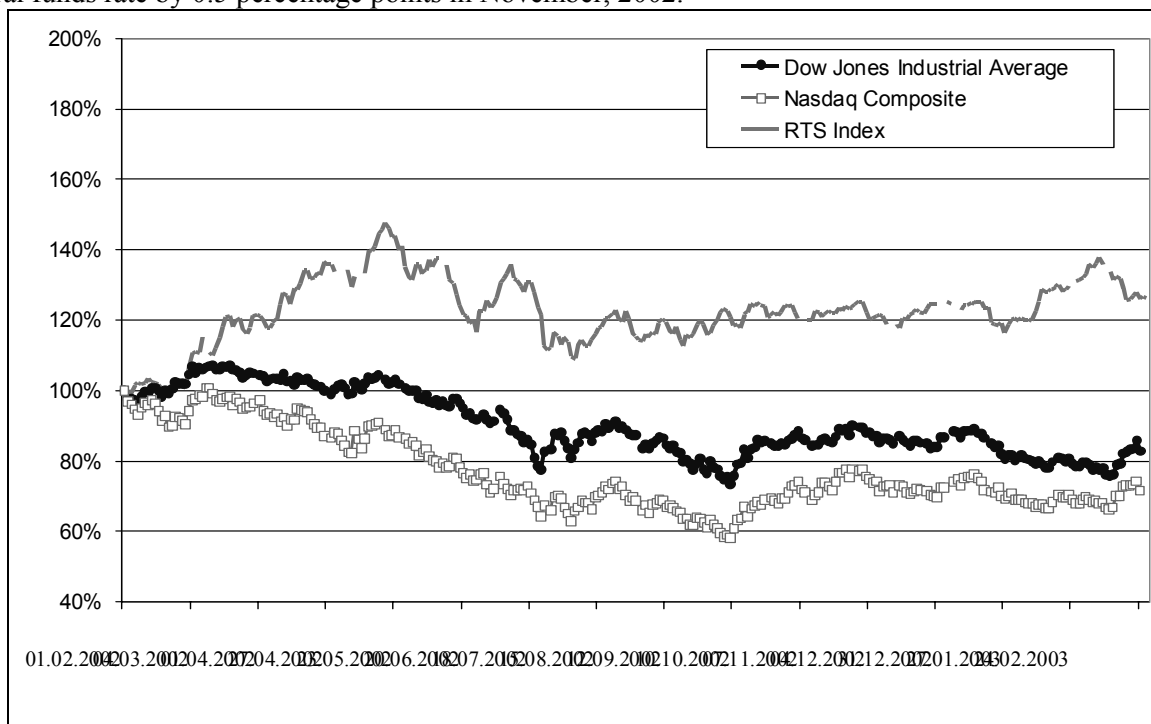


Fig. 5

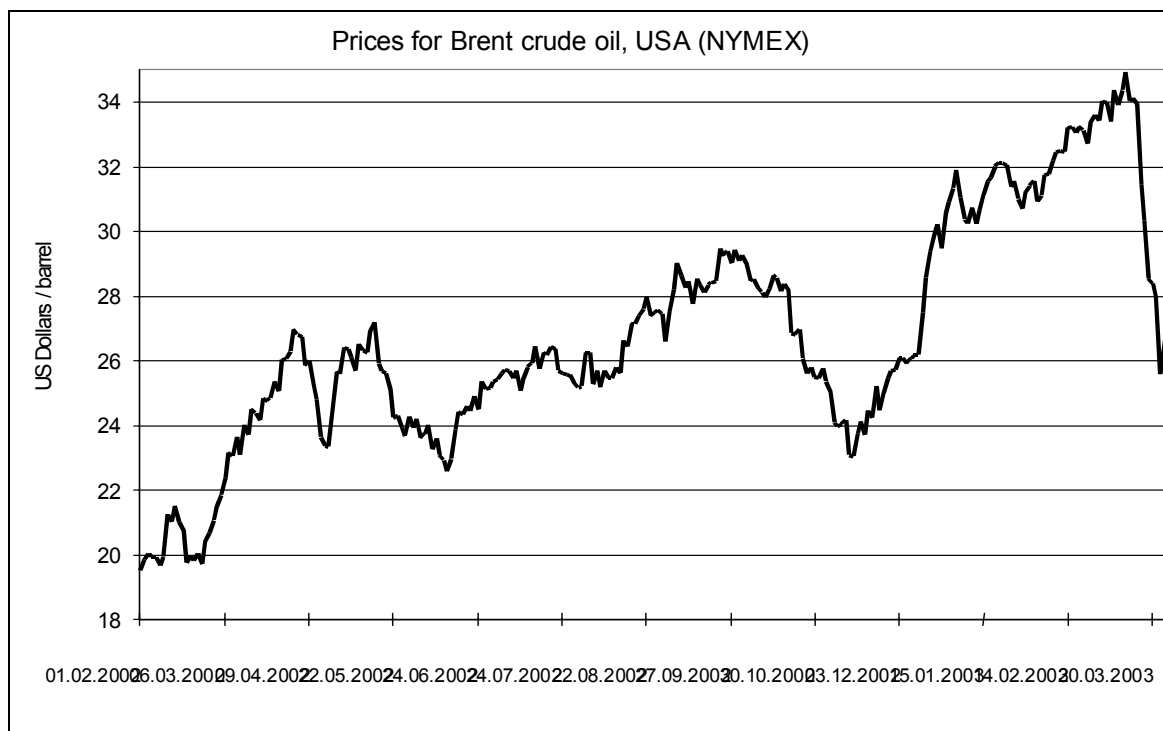


Fig. 6

Corporate News

OA0 Mosenergo

Mosenergo published a report on its operations for 2002. The net profit in 2002 amounted to RUR 646 million, dropping to almost one third of this indicator in 2001. The reasons for the significant profit reduction include a delay in the introduction of new tariffs by the Moscow Regional Power Commission and a considerable growth of amortisation deductions due to revaluation of the fixed assets.

The company's gains from realisation of commodities reached RUR 54 billion in 2002. The profit from sales reached RUR 4.6 billion in 2002. On the whole, the profitability of power production reached 9.5 percent in 2002. In 2001 this indicator amounted to 25 percent.

OA0 Sibneft.

Sibneft's Board of Directors recommended the Annual Meeting of Shareholders to pay a dividend of US\$ 0.23 per one share; this corresponds to a total of US\$ 1.09 billion. Market participant reacted to this news with animation: a virtual boom in demand for Sibneft's securities was observed in the RTS that day; in the course of the day they grew 7 percent as compared to the previous day's closing value.

Standard & Poor's announced that it revised the forecast of Sibneft's rating, upgrading it from Negative to Stable. At the same time, S&P's confirmed the company's long-term credit rating and the rating of its priority unsecured liabilities at B+. Analysts say that the factors contributing to the revision include the decision to divide the assets of the oil company OA0 Slavneft with TNK, to sell Sibneft's minority blocks of ONAKO and its key production subsidiary Orenburgneft. In this connection S&P's also upgraded the company's national rating from ruA+ to ruAA-.

ZAO AK Alrosa

Standard & Poor's announced that it upgraded the long-term credit rating of the Russian diamond production company ZAO AK Alrosa from B- to B since the company obtained a five-year quota on export of diamonds; forecast: stable.

The agency's representatives point out that the upgrading reflects the obtaining of the quota (that will make the sales more predictable), the improving operational conditions in Russia and better access to global markets as well as the progress that the company made in deep mining.

OA0 Mobile Telesystems

Standard & Poor's announced that it included OA0 Mobile Telesystems' corporate governance rating (7.4) in the GovernanceWatch list, forecast: developing. This happened after AFK Systema, which owns 40.4 percent of MTS's shares, announced that it had concluded an option agreement with T-Mobile International AG (a subsidiary of Deutsche Telekom AG), which owns 40.1 percent of MTS's shares, on a possible buy-

out of 10 percent of its shares in MTS's capital. According to the terms and conditions of the option agreement, AFK Systema shall be entitled to acquire the said share at market value at any given time before 30 September, 2003. In the beginning of the month Deutsche Telekom also announced that it intended to sell another 5 percent of MTS stock on the stock market. If both deals take place, the share of AFK Systema will grow up to 55.4 percent, and the share of Deutsche Telekom will diminish to 25.1 percent.

The rating agency's experts believe that these changes in the ownership structure may affect the corporate governance process in MTS. When the agency assigned the CGR for the first time (7.4, the highest rating in Russia), its experts noted that the high quality of governance and control was ensured by a parity in influence by the two largest strategic shareholders. This parity implied a rigid system of internal control, equal representation and active participation by both parties in the Board's activities. Any changes in the ownership structure may disturb the achieved balance of influence by two largest shareholders and affect the standards of corporate governance in MTS negatively.

Table 1

Dynamics of the World's Stock Indices

As of 24 March, 2003	Value	Change During the Month (%)	Change Since the Beginning of the Year
RTS (Russia)	363	-5.28%	1.09%
Dow Jones Industrial Average (USA)	8214.68	4.10%	-1.52%
NASDAQ Composite (USA)	1369.78	2.41%	2.57%
S&P 500 (USA)	864.23	2.74%	-1.77%
FTSE 100 (UK)	3743.3	2.40%	-5.00%
DAX-30 (Germany)	2548.37	0.05%	-11.90%
CAC-40 (France)	2726.85	-0.99%	-11.00%
Swiss Market (Switzerland)	4230.7	1.99%	-8.64%
Nikkei-225 (Japan)	8435.07	0.86%	-1.68%
Bovespa (Brazil)	11053	7.51%	-1.91%
IPC (Mexico)	5924.34	-0.05%	-3.31%
IPSA (Chile)	1012.22	-0.27%	
Strait Times (Singapore)	1299.56	2.02%	-3.09%
Seoul Composite (Korea)	569.85	-0.97%	-9.19%
ISE National-100 (Turkey)	8892.65	-23.17%	-14.25%

Foreign Exchange Market.

High oil prices and government bond auctions brought about additional offer of foreign currency in the internal market. It should be noted that the increased reserves of the Bank of Russia allow it to have total control over the currency market.

On the whole, from 28 February till 2 March the RUR / US\$ rate decreased 19.18 kopecks (0.61 percent), from RUR / US\$ 31.5829 at 28 February, 2003, to RUR / US\$ 31.3811 on 21 March, 2003. From 3 till 7 March the rate hovered around the RUR / US\$ 31.58 mark, and the daily amounts of trade were cca. US\$ 80 million, with the exception of Tuesday, 4 March, when the trade volume almost tripled in comparison with the previous auction. The additional offer of currency resulted from the necessity to create Rouble provisions before the Wednesday auctions, in which large Rouble government bonds were to be placed. The Bank of Russia bought currency at the rate of RUR / US\$ 31.58, which prevented the market from great falls. As a result, from 11 till 13 March the Dollar rate sank 18.01 kopecks, reaching RUR / US\$ 31.3818. Buying the currency at RUR / US\$ 31.38, the Bank of Russia stopped further decrease. Thus, in the period under review, the Dollar rate fell to the level of last July. According to preliminary estimates, the volume of trade in the US currency in the SELT will amount to cca. US\$ 2.68 billion.

Just like in the previous month, the Rouble liquidity remained at a rather high level: balances in corresponding accounts stayed in the range of RUR 80 - 100 billion. The overnight rates grew from 1 to 2 percent in the first half of the month to 4.5 to 5 percent in the period from 19 till 25 March.

The US Dollar - Euro rate in the FOREX market decreased 1.24 cents (1.15 percent) in the period from 28 February till 25 March, reaching the level of US\$ / Eur 1.0635. It should be noted that, amid negative news about the US economy, the Dollar rate grew to US\$ / Eur 1.1 level, in the period from 28 February till 8 March. The rate remained at this high level until 13 March; however, after the military campaign in Iraq began, it dropped sharply to the levels of US\$ / Eur 1.7 - 1.6.

The changes of RUR / Euro rate followed the world's leading floors. The highest mark reached in March was RUR / Eur 34.7741 (the historic maximum) on 07 March 2003, the lowest mark was RUR / Eur 33.277 on 21 March, 2003. On the whole, in March the rate fell 69.02 kopecks, or 2.03 percent; the trade volume was cca. 82.42 Euros.

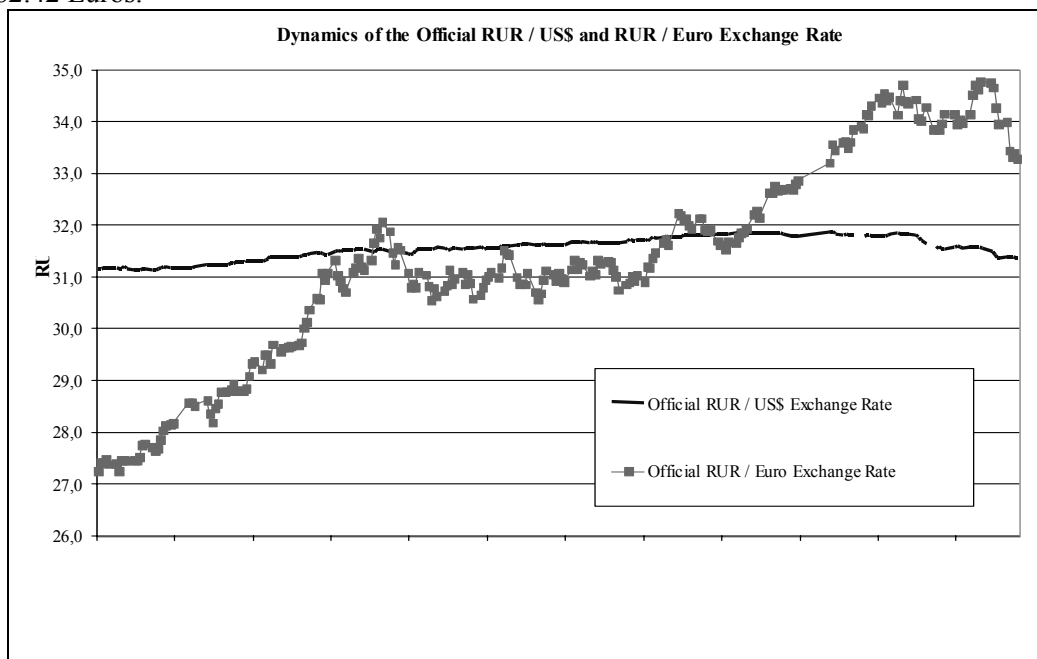


Fig. 7

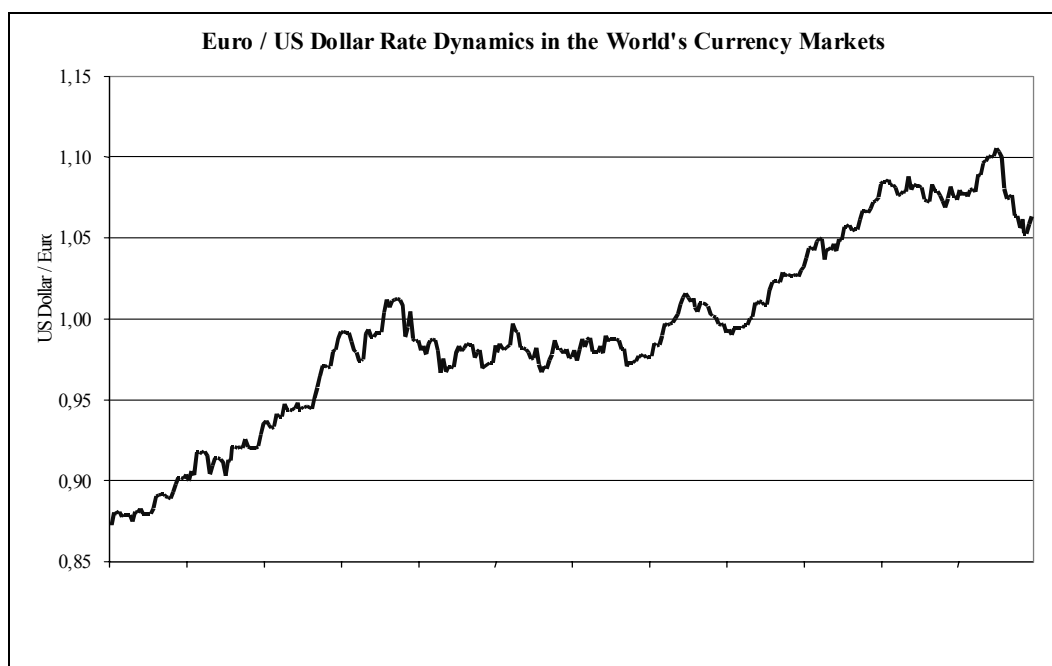


Fig. 8

Table 2

Financial Market Indicators

Month	November	December	January	February	March
Monthly inflation rate	1.6%	1.5%	2.4%	1.6%	1.2%
Inflation rate annualised on the basis of this month's trend	20.98%	19.56%	32.92%	20.98%	15.39%
CB RF refinancing rate	21%	21%	21%	18%	18%
Annualised yield to maturity on OFZ issues	14.02%	13.41%	12.31%	9.66%	9.0%
Volume of trading in the secondary GKO-OFZ market for the month (RUR billion)	11.15	15.11	11.88	34.53	32.0
Yield to maturity on Minfin bonds at the end of the month (% p.a.)					
4 th tranche	4.83%	4.55%	3.70%	3.28%	3.5%
5 th tranche	7.83%	7.66%	7.01%	6.31%	6.6%
6 th tranche	6.78%	6.66%	5.74%	5.19%	5.3%
7 th tranche	8.50%	8.08%	7.19%	6.43%	6.7%
8 th tranche	6.81%	6.61%	5.82%	5.32%	5.4%
INSTAR-MIACR rate (% p.a.) on interbank loans at the end of the month:	4.68%	10.11%	3.74%	2.16%	3%
Overnight	31.8424	31.7844	31.8222	31.5762	31.3805
Official RUR / US\$ exchange rate at the end of the month	31.6736	33.1098	34.4443	34.0549	33.5865
Official RUR / Euro exchange rate at the end of the month	0.32%	-0.18%	0.12%	-0.77%	-0.62%
Average annualised growth in RUR / US\$ exchange rate	1.59%	4.53%	4.03%	-1.13%	-1.38%
Average annualised growth in RUR / Euro exchange rate	260.20	219.92	217.31	276.19	320
Volume of trading at the stock market in the RTS for the month (US\$ million)	361.15	359.07	347.63	383.23	363
Value of RTS Index at the end of the month	0.70%	-0.58%	-3.19%	10.24%	-5.3%
Change in value of RTS Index during the month (%)					

* Estimate

D. Skripkin

Banks on the market of Ruble denominated state securities

The banking sector remains the main holder of the Ruble denominated bond public debt. However, in 2002 the process of concentration of federal debt instruments (FDI) denominated in Rubles in the banking sector somewhat slowed down (see Fig. 1). While in 2001 its share increased from 61.5 % to 75.6 % in 11 months, in 2002, after a peak registered in February and March, when the share of the banking sector made 78.2 %, no clear trend might be traced further, and by the beginning of 2003 it made 76.7 %. The deceleration of growth in the share of the banking sector in the total amount of internal bond debt is usually associated with the launch of the accumulating element of the pension system and investment of collected insurance fees in GKO-OFZ in 2002. However, an analysis of the dynamics of the share of the banking system in the total amount of debt does not justify this unequivocal conclusion. As Fig. 1 demonstrates, the growth in its share ceased yet in the autumn of 2001, a few months before the first fees to the accumulating component of the pension system were collected, while the start of investment of fees in April of 2002 resulted in a decrease in the share of the banking sector only in the next month, although not to the levels below those registered in the end of 2001.



Source: CBR

Fig. 1. The share of the banking sector in the aggregate GKO-OFZ portfolio in 2001 through 2003

According to information about the holders of public bond debt published by the Central Bank of Russia, the data on the portfolio of commercial banks is combined with the data on securities owned by the Central Bank, and therefore do not allow to evaluate the share of commercial banks in the aggregate GKO OFZ portfolio. The data on the participation of commercial banks per se in the aggregate GKO OFZ portfolio may be obtained only basing on their balance sheets.

In the beginning of 2002, less than 500 banks out of more than 1300 operating banks⁶ had Ruble denominated federal debt instruments in their portfolios. By the end of the year, the number of banks holding Ruble denominated FDI decreased to 440. However, the aggregate GKO OFZ portfolio of commercial banks increased by 41 % (from Rub. 114.1 to Rub. 161 billion in current prices) over 12 months of 2002. At the same time, the rate of increase in the Sberbank portfolio was below the respective indicator of other banks (34 % as compared with 72.4 %), what resulted in a certain decline of its share in the aggregate GKO OFZ portfolio of commercial banks (from 81 % in the beginning of the year to 77.3 % in the end of the year). In 2001, the growth in the total portfolio of Ruble denominated FDI was much less pronounced (10.8 %) and was generated primarily by Sberbank, the portfolio of which increased from Rub. 63.4 to Rub. 92.9 billion (by 46.5 %), while the rest of operating banks demonstrated the opposite trend – their aggregate GKO OFZ portfolio decreased from Rub. 39.5 billion to Rub. 21.2 billion (i.e. by 46.4 %) over the same period.

The share of GKO OFZ in the Sberbank assets somewhat decreased over 2002 (form 12 % to 11.5 %). It was observed that for the rest of the sample this share increased from 1.0 % to 1.3 %.

The number of banks engaged in GKO OFZ operations considerably fluctuated over the year – while in December of 2001 the turnover⁷ of these instruments was reported by 378 banks, in November the number of banks engaged in FDI operations in Rubles decreased to 285. In absolute terms, the aggregate turnover of all operating Russian banks demonstrated the following dynamics: while in December of 2001 the turnover made Rub. 51.4 billion, in September of 2002 this value declined to Rub. 31.2 billion. However, in November the turnover increased again and made Rub. 54 billion, reflecting, as it seems, the general recovery of the secondary market observed in the last quarter of 2002. At the same time, Sberbank operations in this market segment were rather stable.

The trade activity of the operators on the GKO OFZ market remains low. It would suffice to note that the turnovers on respective accounts calculated as the sum of purchases and sales over the month remain below the balances on accounts, while in the pre-crisis period the monthly turnover exceeded the balances on accounts used by banks to reflect GKO OFZ operations 2 to 3 times. In November of 2001, the ratio between turnovers and balances on accounts made 54.8 % (91 % without Sberbank), however, by December of 2002 this indicator declined making 34 % (87 % without Sberbank). For comparison purposes, the ratio between turnovers and balances on accounts relating to forex denominated FDI made 153 % in November of 2002 (283 % without Sberbank).

⁶ Here and below without banks under ARCO management.

⁷ Here and below the turnover is calculated as the sum of purchases and sales.

Eight trading organizations (MICEX is the leader) are engaged in GKO OFZ operations. Banks make more than 90 % of dealers on MICEX. A more thorough analysis of the operations conducted by Russian banks playing the leading role on the GKO OFZ market in the respective MICEX section is carried out below. In order to form the sample there were used the lists compiled by MICEX, which include the dealers on the GKO OFZ market demonstrating largest trade turnovers in the course of secondary bidding over the period under observation. According to the data collected in November of 2001 and 2002, the list included 22 banks. For the further analysis Sberbank was excluded from the sample, since its indicators have a strong distorting impact on the averages.

The aggregate turnover of bank being the leaders of the MICEX section of Ruble denominated state securities (without Sberbank) made 52.3 % of the aggregate GKO OFZ turnover of all operating Russian banks without Sberbank in November of 2002 and increased 1.5 times in comparison with the respective indicator registered in November of 2001 (35.6 %).

The share of Ruble denominated FDI in the assets of banks being the leaders of the MICEX GKO OFZ market remained above the share of the average Russian bank (1.9 % as compared with 1.0 % in the beginning of December of 2001 and 1.8 % as compared with 1.3 % in the beginning of December of 2002).

In the end of November of 2002, the average size of assets of banks most active on the MICEX GKO OFZ market exceeded the value demonstrated by the average Russian bank more than 17 times (Rub. 34.4 billion as compared with Rub. 2 billion).

Although since recently the low activity on the Russian GKO OFZ market has been associated with low profitability of investment in Ruble denominated FDI, the comparison of profitability indicators of the banks actively operating on this market with the average indicators of the banking system at large does not confirm such a relationship. In any case, the banks actively operating at the MICEX section of Ruble denominated state securities in 2002 proved to be much more profitable than the average banks (the average ratio between profits and assets made 3.5 % and 2.5 % respectively).

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Investment in fixed assets

The specifics of the investment situation in January through February of 2003 were that the traditional for the beginning of the year investment pause was overcome. In February of 2003, the monthly rates of growth in investment were highest since last January. In January through February of 2003, the amount of investment in fixed assets increased by 9.5 % in comparison with the figures registered in the respective period of the preceding year and made Rub. 204.1 billion.

The major factors positively affecting investment activity were increasing rates of growth in production of goods and services of the base economic sectors; increasing household investment resources (due to growing real disposable cash incomes); expanding investment potential of the export oriented industries (because of improving external business situation). At the same time, the lack of own financial resources of enterprises, insignificant amounts of financing of state investment, and relatively high rates constrained investment activity.

The dynamics of investment operations were rather significantly affected by trends formed in 2000 through 2001. In 2002, the amount of investment in fixed assets made Rub. 1758.7 billion increasing by 2.6 % in comparison with the figures registered in the preceding year. In 2002, consumer demand outpaced investment demand in terms of growth rates. As a result, the trend towards outpacing rates of growth in GDP in comparison with dynamics of investment in fixed assets was restored.

The lesser intensity of investment inflows in the real sector of the economy in 2002 was observed at the background of persistence of the sectoral structure of investment. The share of investment in fixed assets of manufacturing industries has stabilized at about the level observed in the preceding year and made 48.7 %. As the share of investment in industry stabilized at 42,7 %, the proportions of investment across the sectors of the economy were practically completely determined by the decrease of investment in transport. As compared with the figures registered in 2001, the share of investment aimed at the development of transport fell by 4.0 p. p. At the same time, the share of investment expenditures for communications grew by 1.0 p. p. and housing construction – by 2.1 p. p.

In 2002, the decreasing share of fuel complex in the total amount of investment in fixed assets in the economy on the whole and in industry is a significant factor behind the nature and dynamics of investment

demand. Investment in the fuel and energy complex made 20.6 % of the total amount of investment in fixed assets of all sectors of the economy in 2002 decreasing by 1.5 p. p. in comparison with the figures registered in the preceding year. Taking into account the fact that transport, communications, and the fuel complex account for almost ½ of the total amount of investment in the national economy, it becomes evident that the financial and economic standing of these industries has the most strong impact on the dynamics and structure of investment demand.

Fuel industry maintains its dominating position in the structure of investment, its share makes 48.9 % of the total investment in industry; at the same time, almost 30 % of investment flows in oil extracting industry, 11 % - in natural gas industry. In spite of the fact that in 2002 there was observed an increase in the share of investment in the processing sector of the economy, it shall be taken into account that the share of investment intensive industries account for 6.8 % and industries of the consumer complex account for 4.6 % of the total investment in industry. Under the existing age, technology, and reproduction structure of fixed assets, low rates of investment in manufacturing industries are a factor slowing down the rates of economic growth.

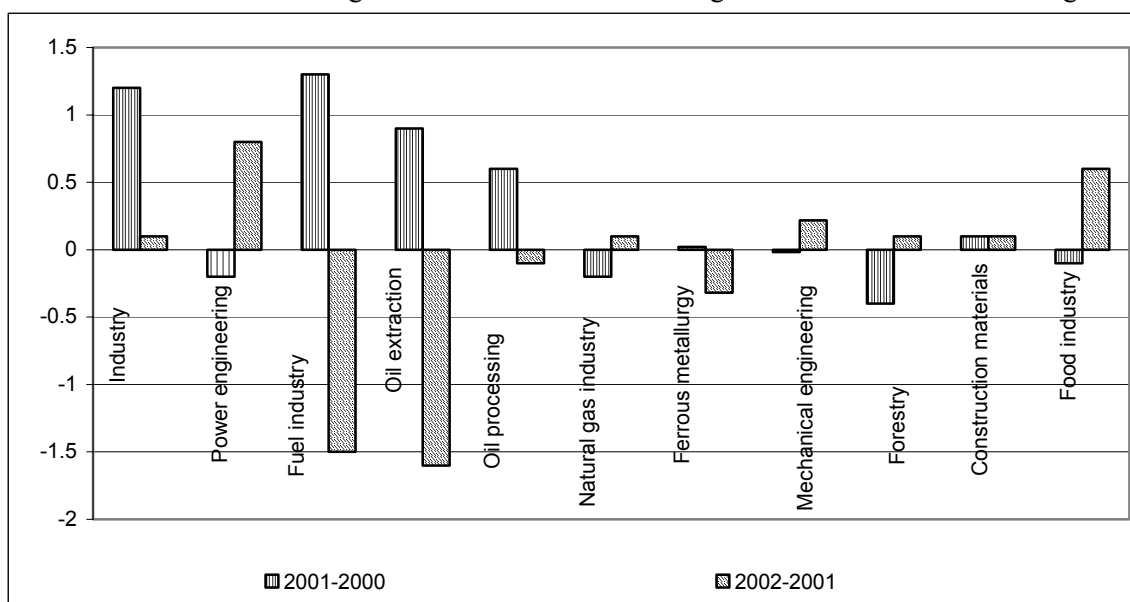


Fig. 1. Changes in the structure of investment across industries in 2002 through 2002, in %

Table 1

Structure of investment in fixed assets across sources of financing in January through September of 2001 through 2002, in % of the total

	2001	2002
Investment in fixed assets	100,0	100,0
Including		
1. <i>Internal funds</i>	49,4	48,0
Of which:		
Profits at the disposal of organizations	24,0	20,5
Amortization	18,5	23,5
2. <i>Borrowed funds</i>	50,6	52,0
Of which:		
Budgetary means	20,4	19,6
Including:		
Federal budget	5,8	6,0
Budgets of RF subjects	12,2	12,5
Bank credits	4,4	4,8
Borrowed funds	4,9	6,0
Extra-budgetary funds	2,6	2,6
Other	28,3	19,0
Foreign investment (out of the total investment in fixed assets)	4,6	4,1

Source: RF Goskomstat

As concerns the structure of the sources of financing of investment in fixed assets in 2002, the share of internal funds decreased, while the share of borrowings grew. The share of own funds decreased at the expense of profits, which declined from 24 % in 2001 to 20.5 % in 2002. Partially, the decline in the share of profits was compensated by increasing share of depreciation from 18.5 % to 23.5 %. In the situation, where proceeds of enterprises are diminishing, the internal funds are limited, and it is impossible to borrow funds for a long term, the Russia's economy reproduces the conditions provoking deceleration of rates of internal investment demand. The investment dynamics are negatively affected by the lack of a developed mechanism of transformation of household savings.

As concerns the structure of borrowings, in 2002 there was registered an increase in the share of bank credits. No doubt, that a positive factor behind this process improving investment ranking of Russia. In 2002, the international ranking agency Standard & Poor's three times upgraded Russia's rankings. The last time the agency upgraded the Russia's ranking on December 5, 2002: the long term sovereign forex denominated liabilities ranking was increased by 1 degree to BB level, and by 2 degrees (from BB- to BB+) as concerns liabilities denominated in domestic currency, what is the maximal Russia's ranking according to the S & P scale over the whole period. The forecast of rankings remain "stable."

O. Izryadnova

Foreign investment in the Russia's economy

As on January 1, 2002, the accumulated foreign capital in the Russia's economy, including the investment from CIS member countries, made US \$ 42.9 billion. The total amount of foreign investment in the non-financial sector of the Russian economy (not taking into account the monetary and credit regulating authorities, commercial and savings banks, and including Ruble denominated investment in US \$ equivalent made US \$ 19.78 million in 2002. A positive development was that for the first time in the last 3 years investment from Russia corresponded to the amount of foreign investment in the Russia's economy.



Source: RF Goskomstat

Fig. 1

A decline in the share of foreign direct investment in the aggregate investment in the Russia's economy is a negative factor of the investment activity in the Russia's economy.

The major share of foreign investment in the Russia's economy in 2002, similarly to previous years, consisted of "other" investment formed primarily at the expense of credits of international financial organizations and funds investors assign for purchase of state securities. The European Bank of Reconstruction and Development (EBRD) is the largest non-state creditor of Russia. In 2002, EBRD investment in the Russia's economy increased by 50 per cent in comparison with the figures registered in the preceding year making Euro 1.29 billion (in 2002, EBRD made one third of its aggregate investment in Russia).

The changes in the amounts of foreign investment across sectors of the Russia's economy were uneven, what resulted in structural shifts: the share of investment in non-production sphere grew.

Table 1

The structure of foreign investment in the Russia's economy

	Total, US \$ mil..				In % of the preceding year				In % of total		
	Total	Direct	Portf.	Other	Total	Direct	Portf.	Other	Direct	Portf.	Other
1998	11 773	3 361	191	8 221	- 4,2	- 37,0	-72,0	30,9	43,4	5,5	51,1
1999	9 560	4 260	31	5 269	- 18,8	26,7	6,2 times less	- 35,9	44,6	0,3	55,1
2000	10 958	4 429	145	6 384	14,6	4,0	4,7 times more	21,2	40,4	1,3	58,3
2001	14 258	3 980	451	9 827	30,1	- 10,1	3,1 times more	53,9	27,9	3,2	68,9
2002	19 780	4 002	472	15 306	38,7	0,6	4,7	55,8	20,2	2,4	77,4

Source: RF Goskomstat.

Table 2

Sectoral structure of foreign investment in the Russia's economy in 2000 through 2002.

	Total, US \$ mil..			In % of the preceding year			In % of total		
	2000	2001	2002	2000	2001	2002	2000	2001	2002
Industry	4 721	5 662	7 332	- 3,2	19,9	29,5	43,1	39,7	37,1
Transport and communications	1 947	1 259	610	114,7	- 35,3	- 51,5	17,8	8,8	3,1
Trade and public catering	1 954	5 290	8 800	20,5	170,7	66,4	17,8	37,1	44,5
Commercial activities relating to market servicing	271	792	1 355	42,6	192,3	71,1	2,5	5,6	6,9
Finance, credit, insurance, pensions	274	127	130	140,4	-53,6	2,4	2,5	0,9	0,7
Other sectors	1 791	1 128	1 553	- 3,2	- 37,0	37,7	16,3	7,9	7,9

Source: RF Goskomstat

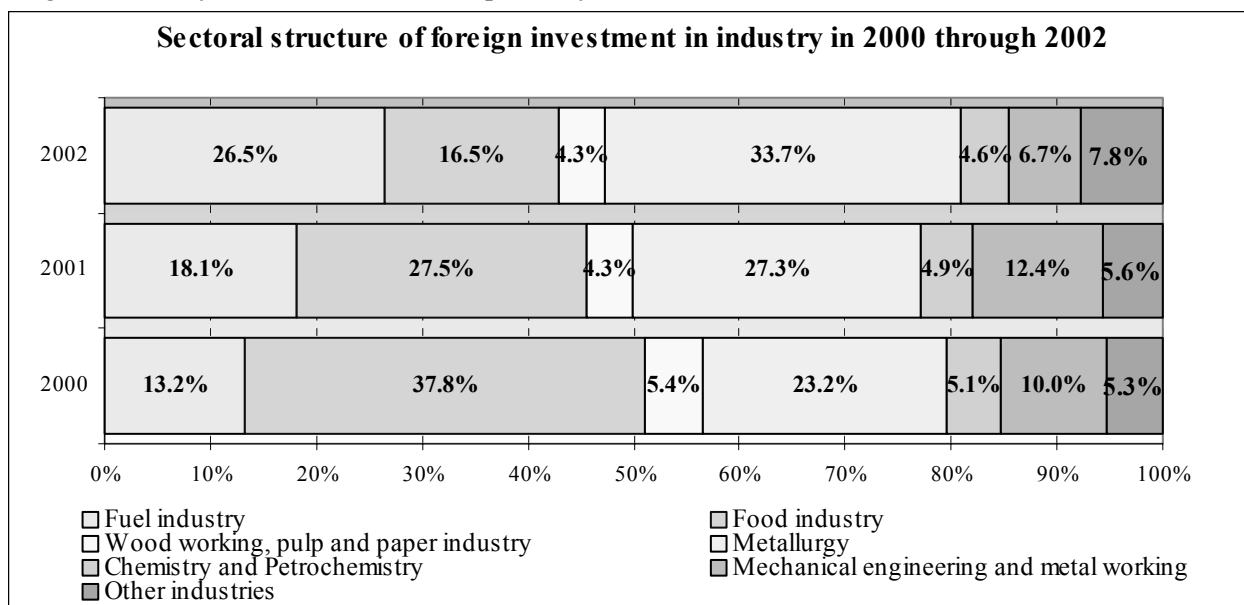
In the last years, in the investment preferences of foreign investors there persists the stable growth of the specific weight of trade and public catering, since this sector is characterized by short payback periods. At the same time, 86.7 % of the total investment in this sphere made in 2002 were formed by other investment, which mostly comprise credits.

Industry is the second sphere in terms of attraction of foreign investment. The significant changes in the structure of foreign investment in industry made in 2002 occurred due to the fact that foreign investment in the Russia's fuel and energy complex increased almost twofold, while investment in metallurgy grew by 59.6 %. A decline in the amounts of foreign investment in base industries in 2002 as compared with 2001 figures was registered in mechanical engineering and metalworking (- 30.3 %) and food industry (- 22 %).

In 2002, direct investment in industry increased by 10.2 % in comparison with the figures registered in 2001 and made US \$ 1932 million (48.2 % of the aggregate foreign investment in the Russia's economy). Other investment in industry grew by 43.3 % over the same period and made US \$ 5246 billion (34.3 % of the aggregate other investment in the RF economy). Portfolio foreign investment in industry declined by 37.9 %.

As concerns the regional distribution of foreign investment, it shall be noted that foreign investment continue to concentrate in 15 RF subjects due to their higher investment attractiveness. In 2002, the highest rates of growth in foreign investment were registered in the Siberian federal okrug (2.4 times in comparison with the level observed in 2001). Foreign investment in the Far East federal okrug increased by 48.9 % in comparison with the figures registered in 2001, while investment in the Central and Ural federal okrugs grew

by 47.2 % and 41.0 % respectively. At the same time, foreign investment in North-West and South federal okrugs declined by 10.9 % and 40.5 % respectively in 2002.



Source: RF Goskomstat.

In 2002, investment from 93 countries exporting capitals flowed in the Russia's economy (in 2001 – 109 countries). Five largest investing countries accounted for 63.8 % of the total amount of foreign investment accumulated by January 1, 2002, while the respective indicators registered in 2000 and 2001 made 73.2 % and 67.7 %. Five largest investing countries also account for 60.1 % of direct accumulated investment, 67.0 % and 55.2 % of portfolio and other investment respectively (in 2001 the respective indicators made 63.7 %, 57.9 % and 72.9 %).

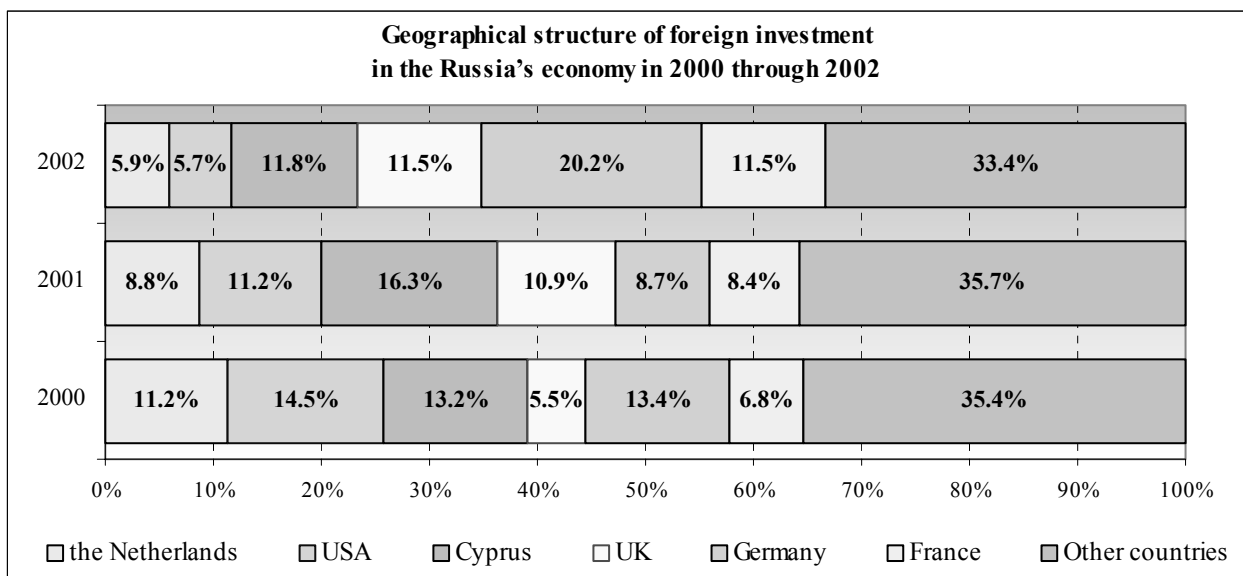
Table 4

The structure of accumulated foreign investment as broken down by major investing countries.

	Accumulated by 01.01.2003, US \$ mil.				Change to 01.01.2002, %			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
USA	5 522	4 220	68	1 234	- 1,8	3,4	- 24,4	- 15,0
Germany	8 146	1 714	384	6 048	33,8	13,4	в 13,7 раза	33,0
France	3 033	303	0,1	2 730	- 7,6	-14,4	0,0	- 6,8
UK	5 054	2190	128	2 736	32,6	15,4	1,6	53,0
Cyprus	5 627	3 927	305	1 395	6,0	5,3	- 34,8	25,7
The Netherlands	2 850	2 398	21	431	12,1	11,6	- 4,5	15,9
Other countries	12 696	5 599	567	6 530	41,5	26,0	14,3	62,1
Total	42 928	20 351	1 473	21 104	20,5	12,0	19,8	30,1

Source: RF Goskomstat.

At the background of growth in investment from other countries, the inflow of capital from USA declined and made US \$ 1.1 billion (- 29.4 % in comparison with the respective period of the preceding year), French and Dutch investment decreased by 1.4 % and 6.5 % making US \$ 1.2 billion and US \$ 1.17 billion respectively. In the preceding year, German investment made US \$ 4 billion (3.2 times above the respective indicator in 2001), and UK investment made US \$ 2.3 billion (+ 46.2 % as compared with the figures registered in 2001). For the geographical structure of the inflow foreign investment in the Russia's economy, see the diagram below:



Source: RF Goskomstat.

The priority sectors for German and British investors are trade and public catering, where they invested US \$ 3065 million (76.6 % of the aggregate investment from Germany) and US \$ 1071 million (47.2 % of the aggregate investment from UK) in 2002. US investors were interested in investment in industry (US \$ 431 million, or 38 % of the total US investment).

An analysis of the business situation on the investment market reveals that the interest of foreign investors in Russia persists, what permits to hope that the amounts of foreign investment in the Russia's economy will increase in 2003.

E. Ilyukhina

Regions: attracting foreign investment

This review focuses on the key specifics of attraction of foreign investment in Russia's regions in 2002 in comparison with preceding post-crisis period (1999 through 2001).

A main persisting trend related to the distribution of foreign investments across regions is the instability of investment inflow. Certain regions demonstrated a stable growth or stable decline in investment in 2000 through 2002 (in Russia at large, the inflow of foreign direct investment was also unstable, however, the total amount of foreign investment has increased over the last years). The share of foreign direct investment in the total amount of investment also varied across regions (for instance, the Voronezh and Chelyabinsk oblasts may be singled out since there the stable increase in the total amount of investment was accompanied by the stable decline in direct investment).

Each year, the indicator of the share of direct investment in the total amount of investment varied from 0 to 100 per cent. On the whole, it may be noted that the share of direct investment is often relatively high in regions where industry primarily orients towards the domestic market, while there are regions with lower shares of direct investments (for instance, the Belgorod, Chelyabinsk, Omsk oblasts, the Krasnoyarsk krai, Yakutia) among the regions with raw materials and export oriented industries. Although there are many exceptions from this rule, the credibility of this regularity is clearly confirmed by the lists of regions, which were *leaders in terms of total amounts of attracted foreign investment and per capita foreign direct investments* (see Table 1). Only three regions out of 14 regions where the total amount of foreign investment exceeded US \$ 100 per capita may not be characterized as export oriented ones (Moscow, St. Petersburg, and the Moscow oblast). In 9 regions out of 14 regions leading in terms of amounts of per capita foreign direct investment the economy is oriented towards the domestic market (alongside with the three regions mentioned above they include the Leningrad, Kaluga, Samara, Kostroma, and Novgorod oblasts, and the Krasnodar krai).

Table 1

Regions leading in terms of per capita amounts of foreign investment in 2002

Foreign investment, total		Foreign direct investment	
RF subjects	US \$ per capita	RF subjects	US \$ per capita
Nenets AO	5178	Nenets AO	1800
Sakhalin oblast	1210	Sakhalin oblast	1164
Omsk oblast	1129	Yamal Nenets AO	263
City of Moscow	989	City of Moscow	177
Sverdlovsk oblast	298	Moscow oblast	92
Rep. of Sakha (Yakutia)	296	Leningrad oblast	70
Yamal Nenets AO	273	Kaluga oblast	33
Chelyabinsk oblast	220	Astrakhan oblast	31
City of St. Petersburg	192	Samara oblast	30
Rep. of Tatarstan	171	RF average	28
Khanty Mansi AO	163	Sverdlovsk oblast	22
RF average	138	City of St. Petersburg	18
Krasnoyarsk krai	123	Krasnodar krai	18
Kamchatka oblast	114	Kostroma oblast	17
Moscow oblast	108	Novgorod oblast	17

Foreign investors take decisions relating to direct investment basing on such factors as raw materials industries, or capacity of domestic sales markets. The list of regions leading in terms of per capita foreign direct investment are four largest Russia's regions in terms of population (Moscow and the Moscow oblast, St. Petersburg and Krasnodar krai), Samara oblast, where the third agglomeration of Russia (in terms of population) is situated. Other regions (the Leningrad, Kaluga, Kostroma, and Novgorod oblasts) are situated exclusively in the center and north-west of Russia. It shall be specifically mentioned that the Moscow and Leningrad oblasts were among the leaders, what is due to their proximity to the largest cities, while production costs there are lower. The same factor may be applied to the Kaluga oblast (its border is second closest to Moscow). The Novgorod oblast has created the favorable investment climate, in the Krasnodar krai exist the best conditions for the development of food industry related to processing of agricultural produce.

In spite of the instability of inflow of foreign investment in terms of years, a considerable number of regions leading in terms of amounts of investment (both total and direct) in 2002 were also among the leaders in the preceding years. The Nenets AO is the most unstable region, since in 2000 it did not attract any foreign investment. Although this region was among leaders in terms of the total per capita amount of foreign investment in 1999, it could attract a considerable amount of direct investment only in the last year.

As concerns the total per capita amounts of investment in fixed assets, the Sakhalin oblast has been the second in the last four years, the Omsk oblast – third and fourth, while Moscow, after being the first in 2000 through 2001, was only the fourth in 2002. The Chelyabinsk oblast and St. Petersburg also have been among the leaders. As concerns other regions, their positions have been volatile in the preceding years. In 1999 through 2001, the Leningrad oblast was among the leaders, however, it was only 21st in 2002. The Sakhalin oblast was the first in terms of per capita foreign direct investment in 1999 through 2001, the Yamal Nenets AO, Moscow, the Moscow oblast, St. Petersburg and the Leningrad oblast, and the Novgorod oblast were also among the leaders. The Krasnodar krai, which was third and fourth in 1999 through 2001, lost its leading position in 2002, while the Astrakhan oblast was registered among leaders for the first time.

The leading positions of regions in terms of their *shares in the total amounts of foreign investments attracted to the country* was determined not only by the factors discussed above, but also the size of their territory (see Table 2).

Table 2

**Regions leading in terms of absolute amounts of attracted foreign investment in 2002
(shares of regions in the attracted foreign investment)**

Foreign investment, total		Foreign direct investment	
RF subjects	Share, %	RF subjects	2002
RF	100	RF	100
City of Moscow	42,68	City of Moscow	37,69
Omsk oblast	12,14	Sakhalin oblast	16,98
Sverdlovsk oblast	6,85	Moscow oblast	14,72
City of St. Petersburg	4,45	Yamal Nenets AO	3,34
Chelyabinsk oblast	4,04	Leningrad oblast	2,88
Sakhalin oblast	3,57	Sverdlovsk oblast	2,49
Moscow oblast	3,49	Samara oblast	2,44
Rep. of Tatarstan	3,25	Krasnodar krai	2,25
Tyumen oblast	1,95	City of St. Petersburg	2,10
Krasnoyarsk krai	1,84	Nenets AO	2,02
Samara oblast	1,54	Rostov oblast	1,32
Rep. of Sakha (Yakutia)	1,47		
Nenets AO	1,18		
Khanty Mansi AO	1,18		
Krasnodar krai	1,02		

Note: the table includes regions whose share in attraction of foreign investment makes over 1 per cent.

Moscow has been among the leaders in terms of the absolute amount of foreign investment over the last four years, and its share increased each year (in 1999 it was at 28 per cent). The dynamics of the Moscow share in foreign direct investment was not so stable, however, on the whole the upward trend is perceptible (in 1999, Moscow was the second after the Sakhalin oblast in terms of the share in foreign direct investment – 18 per cent).

Economically underdeveloped subjects of the Russian Federation still remain *outsiders in terms of attraction of foreign investment*. According to Goskomstat reports, all republics in the Southern federal okrug (with the exception of Adygea) failed to attract any foreign investment (Dagestan, Ingushetia, Kabardino-Balkaria, Kalmykia, Karachayev-Cherkesiya, North Osetia), the south Siberian Republics of Altai and Tyva, the Evenk, Ust Orda, Buryat, Aginski Buryat, and Chukotka AOs failed to attract foreign investment also in the last three years). Negligible amounts of foreign investment were registered in Khakasia and Mari El in 2002.

The *comparison of the amounts of attracted foreign investment and investment in fixed assets* reveals that certain regions are similarly attractive and non-attractive for both foreign and domestic investors. Foreign investors are more than domestic investors interested in Moscow (it is at the top of the second ten regions in terms of extra-budgetary per capita investment in fixed assets). The similar situation, especially as concerns foreign direct investment, is registered in a number of oblasts situated in the Central Russia and in the North West (first of all, the Moscow, Kaluga, Vladimir, and Leningrad oblasts). As concerns other regions, there may be singled out the Sverdlovsk and Ulyanovsk oblasts, and the Primorski krai (the latter is more attractive to foreign investors because of its favorable location in the Eastern part of the country).

The opposite situation, where regions are more attractive for domestic investors is primarily characteristic of economically underdeveloped regions-corporations, which include the Taimyr, Evenk, and Chukotka AOs (all of them were among the first ten regions in terms of extra-budgetary per capita investment in fixed assets in 2002, however, the Evenk and Chukotka AOs failed to attract any foreign investment in the last 4 years, while the Taimyr AO attracted foreign investment only in 2002). Tatarstan and Bashkortostan are also relatively less attractive for foreign investors. Although Tatarstan attracts rather large amounts of foreign investment, no direct investment are made in this Republic (Tatarstan was at the top of the seventh ten regions in terms of per capita foreign direct investment in 2002). The most apparent factor behind this situation may be the economic policies pursued by the regional administration.

O. Kuznetsova

The Real Sector: Factors and Trends

In January through March of 2003, the increase in output of the base economic sectors made 6.3 % in comparison with the figures registered in the respective period of the preceding year, including a 5.7 % growth in industry and 13.6 % in construction. The relative acceleration of the rates of growth in output was determined by the persistence of the trends formed in base sectors of industry since the second half of 2002. The major structural shifts in production were determined by changes in the business situation on the domestic and external markets.

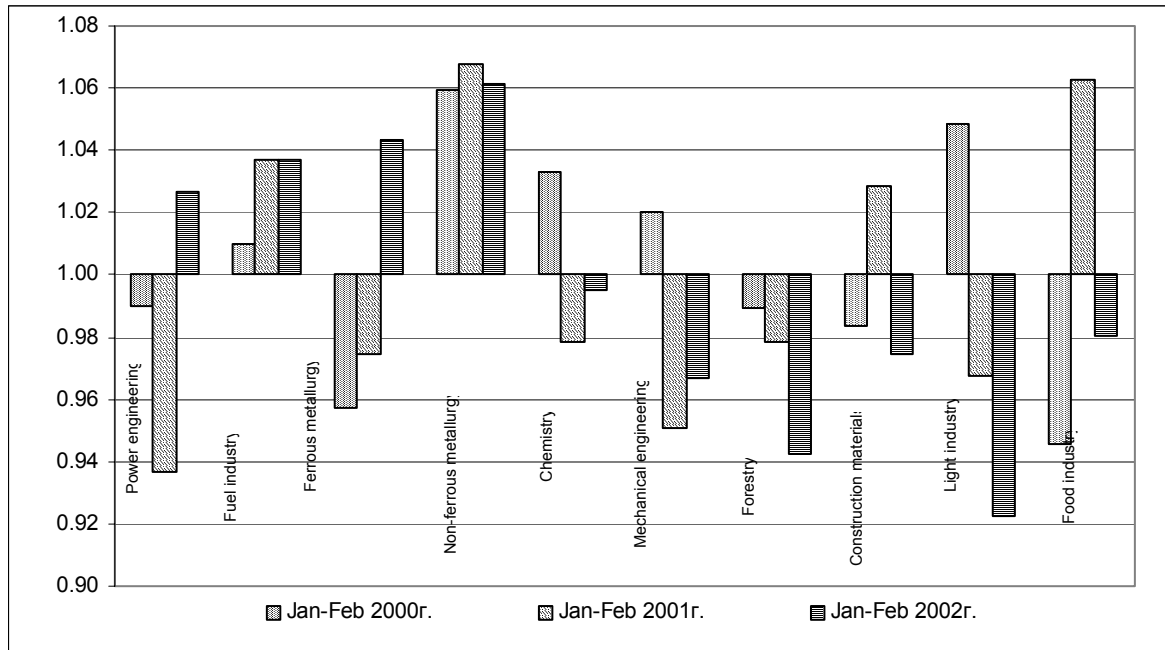


Fig. 1. Changes in output dynamics across industries in January and February of 2001 through 2003, industry = 1

The favorable business situation of world markets still creates incentives for growth in output of fuel industry and ferrous metallurgy. Besides, in the beginning of this year there was registered an increase in output of non-ferrous metallurgy, which compensated for the decline in production observed in the 3rd quarter of 2003. The expansion of output of industries belonging to fuel and raw materials complexes accounted for more than 80 % of the total growth in industrial output.

The increase in output of final production, primarily oriented towards the domestic market, made 2.5 % in comparison with the figures registered in January and February of 2002. In the situation, where rates of growth in import of consumer goods outpaced the dynamics of domestic production, insufficient competitiveness of domestic goods remains a key factor constraining output. According to estimates of the RF Ministry of Economic Development, in January and February of 2003 import of goods grew about 1.2 times in comparison with the figures registered in the respective period of the preceding year, while output of food industry increased by 3.6 % and production of light industry declined by 2.5 %.

As the rates of growth in domestic production of consumer goods decelerate, the share of imports in the structure of commodity resources increases. While in 2002 the share of imports in the food group was within 30 %, the specific weight of domestically produced non-food goods in the structure of consumer market declined by almost 12.8 p.p.

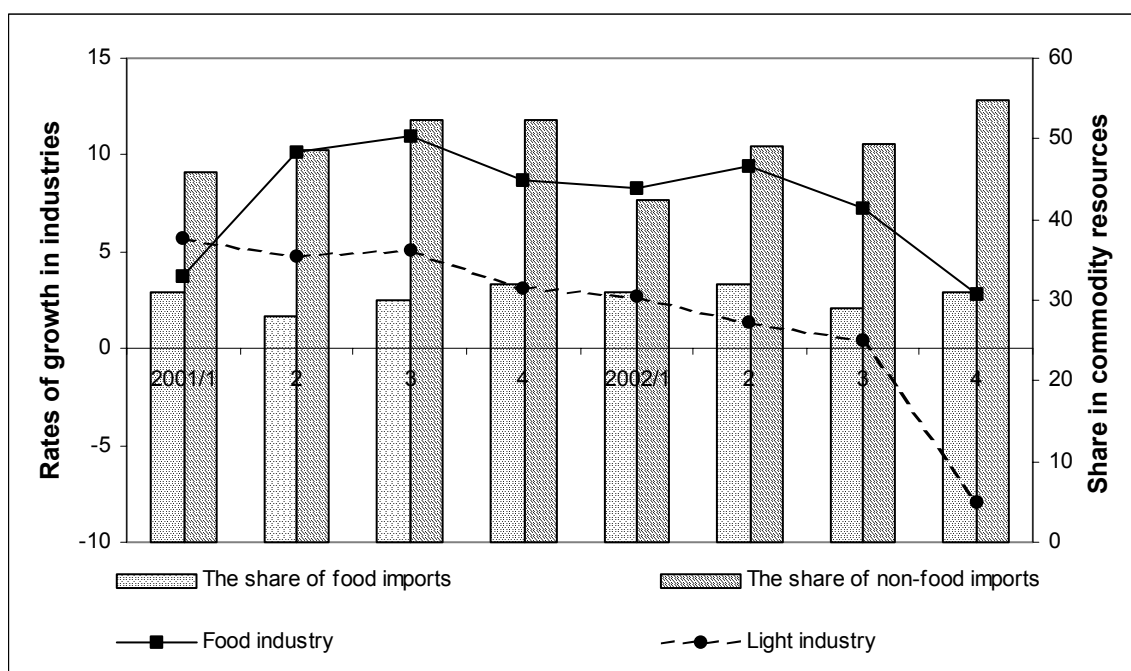


Fig. 2. Changes in output dynamics of light and food industries and the share of imports in commodity resources of the consumer market in 2001 through 2002, in %

In the first months of 2002, there was overcome the trend towards a decline in investment demand, what had a positive impact on the dynamics of industrial output. The recovery of positive dynamics in processing industries in January and February of 2003 was supported by a 2.3 % increase in the output of mechanical engineering and 3.0 % growth in construction materials industry. In January through February of this year, there was observed an expansion of the market of domestic investment goods.

As enterprises of ferrous metallurgy increased the number of orders due to the favorable business situation in the industry persisting in the last months, the output of metallurgical mechanical engineering grew by 38.9 %. Since high levels of demand for services of transport and communications persisted, the production of railway mechanical engineering increased 1.42 times and communications engineering – 1.64 times as compared with the figures registered in January through February of 2002. A gradual decline in the intensity of decrease in production of mobile equipment was observed in February of 2003. However, in spite of a growth in output of motor industry registered this February, the volume of production was at 82.9 % of the level of the first two months of the preceding year. The decrease in production of cars by 1/3 in comparison with the figures registered in January and February of 2002 has traditionally negatively affected the dynamics of output of the industry, which does not expect a radical improvement of the situation in the nearest future, since according to the AvtoVAZ plans the enterprise will continue to check its production until April of 2003.

It shall be noted that the trend towards deceleration of growth rates in profits of industries belonging to the real sector of the economy became more perceptible. In January of this year the balanced financial results of industry and construction decreased by 22.9 % and 32.1 % respectively in comparison with the figures registered in January of 2002. Industrial organizations accounted for only 37.4 % of the total financial results of the economy at large, what is by 10.7 p.p. below the levels observed in January of 2002. As concerns processing industries oriented towards the domestic market, there the situation was further aggravated by outpacing growth in production costs resulting from the rise in prices of and tariffs on products and services of natural monopolies and outpacing growth of wages and salaries in comparison with labor productivity. Tariffs on electric power for all types of consumers increased by 4.1 % in February (the rise in tariffs in this year made 5.8 %). It shall be noted that the Government set a 14 % limit on the growth in tariffs for 2003. In January of 2003, natural gas prices increased by 20 %, while tariffs on freight grew by 6.7 %. The higher levels of costs result in a relative decline in profitability of production and growing deficit of own working capitals, what in turn affects solvency of enterprises and the dynamics of investment activity.

O. Izryadnova

IET Business Survey: Industry

In March, the situation of the Russia's industry continued to improve. The index of industrial optimism calculated by IET according to the adjusted European methods increased by 14 points in February through March reaching record highs since October of 2001.

The main positive factors behind the growth in the index were changes in effective demand. According to assessments made by enterprises, the intensity of growth in cash sales has increased (without seasonal adjustment) by 42 balance points since the beginning of the year. While in January cash demand contracted rather intensively (the balance made -24 %), in March sales intensively grew (+ 18 %). Such high growth rates have not been registered since October of 2001. An increase in demand was registered across all industries except (due to the season factors) power engineering. The most intensively sales grew in mechanical engineering, construction industry, and metallurgy.

Although real profits continued to decline across industries, the rates of decrease decelerated to -7 % (in terms of the balance) in the industry at large. An absolute growth of this indicator (positive balance values) were registered in metallurgy and forestry complex. As concerns other industries, the profits continue to decline, although not so intensively as a month ago.

Table 1

The share of enterprises reporting about an actual decline in their tax arrears, in % of the total number of enterprises in the respective industry

Industries	10/01	2/02	5/02	8/02	11/03	2/03
Power engineering	50	48	28	50	73	79
Ferrous metallurgy	13	3	0	28	0	2
Non-ferrous metallurgy	20	2	16	13	24	8
Chemistry and petrochemistry	25	20	5	23	5	12
Mechanical engineering	36	31	32	33	28	29
Forestry, woodworking, and pulp and paper industries	16	20	22	37	8	12
Construction industry	17	22	34	34	25	18
Light industry	33	23	8	20	21	13
Food industry	18	24	12	19	16	13

An increase in demand created a favorable situation for a growth in output. The balance of changes in production increased by 23 points during the month making at present + 34 %. (It is interesting to note that a month ago the balance of forecasts of output made exactly + 34 %). Production has not grown so intensively since March of 2000. Only 15 per cent of enterprises reported diminishing output in March of 2003. Growth was registered across all industries except power engineering.

Table 2

Impact of lower tax rates and abolition of the investment benefits on investment plans of enterprises, in % of the sum of reports

Industries	Planned amount of investment		
	increased	did not change	decreased
Industry, total	10	71	19
Power engineering	13	74	13
Ferrous metallurgy	9	73	18
Non-ferrous metallurgy	11	45	44
Chemistry and petrochemistry	14	72	14
Mechanical engineering	10	77	13
Forestry, woodworking, and pulp and paper industries	11	73	16
Construction industry	14	68	18
Light industry	4	70	26
Food industry	13	62	25

Source: IET investment survey (12/02-02/03)

Evaluations of finished stocks also indicate that positive trends in industry develop. The share of answers “normal” increased in March up to 50 %, what is the absolute record for all 130 surveys. Never, since March of 1992, so many enterprises have evaluated their finished stocks as adequate to the actual and expected changes in output, demand, and prices. The balance of assessments (above norm – below norm) increased by 7 points over the month, however, it was within the fluctuation band of this indicator observed over the last two years. An increase in excessive finished stocks is related to the adjustment of foreseen demand: in the nearest future enterprises expect a decline in the intensity of sales. The largest excessive stocks were registered in chemistry, petrochemistry, and mechanical engineering.

After the forecasts of demand reached the peak in February, in March this indicator decreased by 5 points, primarily due to the situation in power engineering, where all enterprises expected a decline in cash sales (balance made –4 %). In other industries, there prevailed expectations of a growth in sales, especially in chemistry, petrochemistry, and construction industry. Non-cash types of demand will, as it seems, decline across all industries in the few next months. A growth in barter is possible only in ferrous metallurgy, while the amounts of promissory notes and offsets may increase in metallurgy and construction industry.

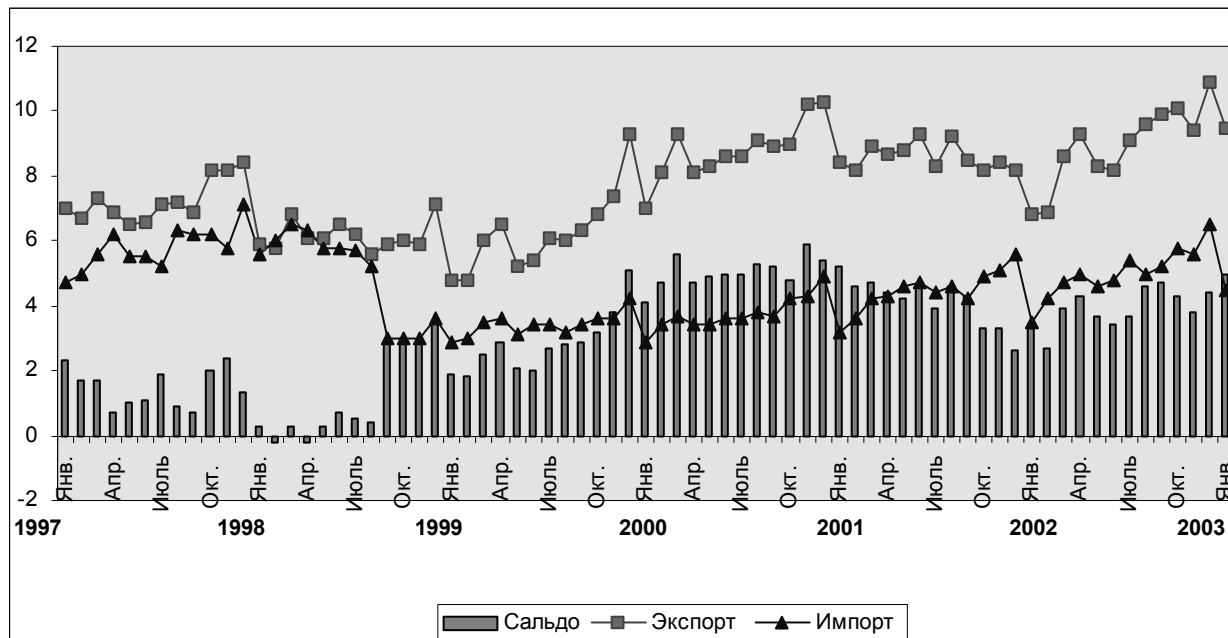
Forecasts of changes in output did not change in March. On the whole, industries maintain rather high expectations of growth in production. A decline in production (due to the decrease in demand) in the few next months is planned only in power engineering and light industry. The most intensive growth in production (similarly to demand) is probable in chemistry, petrochemistry, and construction industry.

The plans of changes in prices continue to lose “optimism.” The balance of reports decreased in March by 3 points, however, it remains positive and highest in the last two years. An absolute decline is possible only in ferrous metallurgy.

S. Tsukhlo

Foreign Trade

According to the Central Bank of Russia, in January of 2003 the foreign trade turnover made US \$ 14.0 billion. The 35.9 % increase in turnover as compared with the figures registered in January of 2002 may be explained by a considerable growth in amounts of both exports and imports.



Source: RF Goskomstat

Jan. Apr. Jul. Oct. Jan. Apr. Jul. Oct. Jan. Apr. Jul. Oct. Jan. Apr. Jul. Oct. Jan.
Balance Export Import

Fig. 1. Main indicators of Russia's foreign trade (in US bln.)

In January of 2003, the amount of export of goods made US \$ 9.5 billion, what was by 42 % above the level registered in the respective month of 2002. This significant increase in amounts of exports registered in January of 2003 may be explained both by growing prices and volumes of export. According to IMF

estimates, in January of 2003 world prices of staple Russian exports were by 14 % above the level registered in the same month of the preceding year.

In January of 2003, the growth in oil prices continued. In January, the average price of BRENT oil made US \$ 31.3 per barrel (an increase by 60.9 % and 13.9 % respectively). The major factors behind the rise in prices were the US preparations for a military action in Iraq and the political crisis in Venezuela.

The average price of URALS oil in January through February made US \$ 29.68 per barrel. As a result, the export duty on crude oil exported from the RF territory in countries outside the customs territory of the Customs Union shall be increased from US \$ 25.9 to US \$ 40.3 per metric ton since April 1, 2003. The export duty on oil products has been increased from US \$ 23.3 to US \$ 36.3 per metric ton. The new duty rates shall be in effect until June 1, 2003.

Contract prices of Russian natural gas increased by 48.9 % in comparison with the figures registered in January of 2002..

In January of 2003, there were registered no significant changes in prices on the markets of ferrous metals. Basic export European prices of reinforcing steel, commercial steel, hot, and cold rolled steel remained at the level registered in December of 2002 and made US \$ 250 to 310, 270 to 300, 295 to 315 and 265 to 385 per metric ton respectively. However, in comparison with the figures registered in January of 2002 prices increased by 35 % to 48 %, 22 % to 28 %, 55 % to 57 %, 41 % to 46 % respectively.

In January of 2003, the situation on the majority of key markets of non-ferrous metals was characterized by positive price dynamics. The factor behind this development was rather high demand for non-ferrous metals. There shall be noted a persistent growth in nickel prices, which reached a two-year maximum in January making US \$ 8595 per metric ton. The average price in January of 2003 exceeded the respective indicator registered in the last year by 25.4 %. The average copper and aluminum prices insignificantly changed in comparison with the indicators observed in the preceding year.

Table 1

The average monthly world prices in January of the respective year

	1996	1997	1998	1999	2000	2001	2002	2003
Oil (Brent), USD / metric ton	137,5	170,2	111,6	82,4	185,7	189,6	141,58	204,62
Natural gas, USD / thous. m ³	-	88,8	74,9	71,3	86,8	260,7	76,7	180,3
Gasoline, USD / metric ton	142,5	184,5	133,9	176,5	263,8	308,8	204,5	304,5
Copper, USD / metric ton	2553	2400	1682	1528,2	1887,9	1849,6	1557,8	1571,3
Aluminum, USD / metric ton	1554	1598	1480	1301,4	1695,5	1641,50	1377,85	1291,11
Nickel, USD / metric ton	7956	7485	5496	4550,8	8338,1	7091,33	6094,58	7643,93

Source: calculated in accordance to the data presented by London Metal Exchange (UK), International Oil Exchange (London)

The share of countries outside CIS in exports has somewhat increased: from 85 % in January of 2002 to 86 % in the same month of the current year. In the commodity structure of Russian exports to countries outside NIS, the share of fuel and energy resources made 66.3 % in January of 2003 (61.4 % in January of 2002), export of metals and metal articles – 14.4 % (16.5 %), products of chemistry – 5.6 % (6.1 %), timber and pulp and paper products – 4.4 % (5.4 %), products of mechanical engineering – 3.7 % (5.6 %).

In January of 2003, the real Ruble / US \$ exchange rate exceeded the level registered in the respective month of 2002 by 7 %. Besides, the level of GDP increased by 5.7 % in comparison with the figures observed in January of 2002. A stronger national currency and a growth of incomes in the economy were objective factors behind higher levels of imports. On the other hand, as Euro appreciated in relation to US \$, prices of Europe-made goods increased and, accordingly, constrained a growth in the volume of Russian imports.

As a result of impact of these and other factors, in January of 2003 the amount of imported goods increased by 28.6 % in comparison with the level registered in the same month of 2002 and made US \$ 4.5 billion. At the same time the growth in imports from countries outside CIS was somewhat higher than the increase in imports from the CIS member countries. As a result, the share of countries outside NIS in imports grew from 78 % in January of 2002 to 79 % in January of 2003. As concerns the commodity structure of Russian imports from these countries, machinery and equipment made 38.6 %, food and respective raw materials made 24.9 %, and products of chemistry made 17.4 %.

As a result of the outpacing growth in exports, the active balance of trade made US \$ 5 billion in January of 2003, what was by 51.5 % above the level registered in January of 2002.

In January of 2003, the amount of Russia's trade vis-à-vis CIS member countries made US \$ 2.32 billion. Imports grew by 18.7 % in comparison with the figures registered in January of 2002 and made US \$ 0.97 billion, while exports increased by 32.6 % and made US \$ 1.35 billion.

For instance, due to the favorable business situation on world markets and increasing world output of steel, in January through February of 2003 Russian export of iron ore products grew by 22 % in comparison with the figures registered in the respective period of the preceding year and made 2.57 million metric tons, including 891 thousand metric tons of concentrate, 1.43 million metric tones of pellets, and 171 thousand metric tons of iron containing briquets. At the same time, almost 40 % of the total amount of Russia's iron ore were exported to Ukraine (960 million metric tons in January of 2003).

In March, there was held a meeting of representatives of customs services from the member countries of the Eurasian economic community. Among the issues discussed in the course of the meeting were customs control over export and import of alcohol and tobacco products, ethyl alcohol, and customs control in the sphere of transfer of objects of intellectual property.

Besides, there were discussed measures aimed at further formation of the common customs territory, what involved a comparative analysis of draft Customs Codes of three countries – Kazakhstan, Kirghizia, and Russia.

In March of 2003, the issue of so called tolling was raised again. Tolling is processing of imported give-and-take raw materials. It means, that raw materials or intermediate products are imported in the country for processing. Finished products are exported by the supplier, while the processor is paid for the use of its capacities. A specific feature of the scheme is that raw materials and finished products are exempted from taxes on condition that all finished products are exported. In Russia it means that firms tollingers do not pay export duty, while the charged amount of VAT is returned after export of finished products.

Last year, tolling accounted for production of 1.85 million metric tons of Russian aluminum, while the total production was at 2.5 million metric tons.

In 2002, a group of deputies of the State Duma Budget and Tax Committee twice attempted to pass an amendment to the Tax Code removing tolling related VAT privileges from Article 164.

In March of 2003, the Governmental commission on protective measures in foreign trade and customs and tariff policy proposed to abolish export 5 % duties on aluminum and aluminum alloys and import duties on aluminum oxide (since January 1, 2004), but instead restrict the use of the customs regime of processing of goods in the customs territory as concerns aluminum industry (also since January 1, 2004). In fact, it means the abolishment of tolling schemes for aluminum industry, although in Russia the majority of printing houses, pharmaceutical plants, tolling is used in textile, atom, pulp and paper, ship building, and some other industries.

Representatives of aluminum industry retain hopes to persuade the Government that the abolishment of tolling will negatively affect the positive development dynamics observed in the industry in the last years.

N. Volovik N. Leonova

The law “On the stock market”: key novations and possible impact on the market

The necessity to introduce serious changes in the law “On the stock market,” enacted yet in 1996, has been obvious for a long time. However, the amendments, similarly to the law itself in the mid-1990s, were approved as a result of a complicated process. Federal law No. 185 FZ “On amendments to the federal law ‘On the stock market’ and amendments to the federal law “On not-for-profit organizations”” was approved only on December 28, 2002, after long debates in the State Duma and the professional community, the initial approval of the State Duma and the Federation Council vetoed by the RF President, and introduction of new amendments. Below there are analyzed the principal amendments to the law “On the stock market” (hereinafter referred to as the law) and possible practical consequences.

1) The amendments removed certain *contradictions* between the law and other regulatory and legal acts of the RF. For instance, the federal law “On joint stock companies” sets forth that shares in joint stock companies shall be registered stocks, the previous version of the law stipulated that shares may be both registered and bearer securities. The amendments eliminate this contradiction and therefore bring the law in conformity with the federal law “On joint stock companies.”

At the same time, certain amendments affect the competence of the Civil Code and special laws regulating operations of joint stock and other companies, what is unacceptable from the viewpoint of the legislative

technology. For instance, Article 17 of the law stipulates the procedure governing the corporate decision making process as concerns the issuance of securities. Article 2 (the definition of bonds, definition of shares as bearer securities) also overlaps the respective provisions of the Civil Code and the RF law “On joint stock companies.” The law also fails to remove more fundamental contradictions, for instance, to the provisions of the RF Civil Code (as concerns documentary securities, the definition of “public placement of securities,” borrowing and pledge of securities, etc)⁸.

2) The law introduces the concept of *financial adviser* on the securities market. The financial adviser is defined as a “legal entity licensed to carry out broker and / or dealer activities on the securities market and rendering the issuer services relating to the elaboration of the prospectus of securities” (Article 2). While previously the employment of a financial adviser for the issuance of securities had been a voluntary action, according to the amended law the prospectus of securities issue should be certified (signed) also by a financial adviser in the case of public floatation and / or public circulation of issued securities (Article 22).

Apparently, this novation can not provide additional guarantees for investors. However, the consequences of this novation are ambiguous. First, the introduction of the requirement of the mandatory certification of the prospectus by a financial adviser will result in a sharp rise in the costs of services provided by financial advisers and the process of securities issuance per se (although RF government officials repeatedly stated the necessity to reduce the costs of this process). Second, due to the creation of a new market of professional services, which the authorities are to regulate somehow, there arise possibility of different abuses.

It is also necessary to note that the law sets forth a provision according to which persons signing the issuance prospectus are jointly responsible and subsidiary responsible with the issuer for the damage to owners of securities caused due to unreliable, not complete and / or misleading information contained in the prospectus (item 3, Article 22.1). Indeed, the introduction of responsibility for the aforesaid actions shall positively affect the market of securities on the whole and improve the protection of investors rights and lawful interests in particular. However, there may arise difficulties as concerns the practical enforcement of this stipulation, since it is difficult to establish and prove the guilt of each person who signed the prospectus. It does not seem quite fair to establish the joint responsibility of all signatories for the damage caused because of the aforesaid actions. It seems feasible to introduce the requirement of mandatory insurance of professional responsibility of financial advisors on the securities markets in relation to the introduction of the institute of financial advisor and responsibility for the damage caused by unreliable, not complete and / or misleading information contained in the prospectus.

3) The requirements relating to the *disclosure of information* were somewhat changed:

- the right to access the information contained in the prospectus of securities issue is granted not only to “potential owners” but to all interested persons notwithstanding the purposes of obtaining of such information (item 1, Article 23);

- there was introduced the differentiation of the procedure governing the publication of information relating to the state registration of the issue (additional issue) of securities depending on the nature of subscription (closed or public) what is a positive development both for issuers and investors;

- the stipulation according to which the registration of the prospectus was necessary in the case the amount of issuance exceeded 50000 minimal wages was removed (the prospectus shall be registered in two cases: floatation of issued securities by open subscription and floatation by closed subscription among more than 500 persons). It is a significant amendment, since the registration of the issue determines the responsibility of the issuer to disclose information about substantial facts (developments, actions) affecting the financial and economic operations of the issuer, while the disclosure of information in the form of quarterly report is more actual for companies with larger numbers of shareholders than for companies where the amount of an issue exceeds 50000 minimal wages. However, it remains unclear if the issuers who float issued securities amounting to more than 50000 minimal wages among less than 500 persons must disclose aforesaid information in the future? This question remains actual for many companies and it is necessary that the RF FCS clarified the problem⁹.

⁸ See, for instance, Makeyev A., Gudkov F. O porokakh zakona, vnosyashchego izmeneniya v zakon “O rynke tsennykh bumag (On flaws of the law amending the law “On the security market”). – Rynok tsennykh bumag, 2003, No. 2, pp. 47 – 50.

⁹ At the same time, a shorter list of requirements necessary for the registration of the prospectus of securities, may bring about negative consequences. Shareholders may encounter additional risks in the case a company where the number of shareholders is below 500 hostile to its shareholders places additional issue of shares. In this situation, state registration

- there were changed the requirements pertaining to the contents of the issuer's quarterly report: according to Article 30, the quarterly report of the issuer shall contain information the composition and amount of which conform with the requirements set forth by the law "On the securities market" applicable to the prospectus of the issue of securities, excluding information pertaining to the procedure and conditions of the issuance of securities.

It shall be noted that after the enactment of the aforesaid amendments the composition of information disclosed by issuers in the form of the quarterly report was expanded. For instance, earlier quarterly reports disclosed only information relating to transactions concluded in the reporting quarter and the amounts of which (or respective value of property) made 10 per cent or more of the issuer's assets as on the date of the transaction. According to the amended law, quarterly reports shall disclose: first, information on significant transactions where the amount of respective obligations is at or above 10 per cent of the balance sheet value of the issuer's assets over the last 5 completed financial years, or over the each completed financial year if the issuer carries out operations for less than 5 years, and, second, information about the transactions concluded by the issuer if the interest in these transactions existed for the same period. Since the quarterly report is a substantial source of information about the company's operations for shareholders, more stringent requirements will increase the degree of knowledge about the issuer's activities both on the part of shareholders and professional securities market operators, what is, obviously, a positive development.

4) The law stipulates *broader powers* of the "federal executive authority" (i.e. FSC). Thus, according to the amended law, the regulations pertaining to the *listing* (de-listing) of securities shall correspond to the requirements set forth in regulatory and legal acts of the "federal executive authority responsible for the securities market." At the same time, the quotation lists may include only the securities meeting the requirements set by the legislation, regulatory and legal acts of the federal executive authority responsible for the security market¹⁰. According to available assessments, enforcement of this stipulation will result in inclusion in quotation lists only of securities meeting the requirements set forth by the FSC. At present, it is difficult to evaluate the consequences of the introduction of this provision. It will become clear if the rights of issuers and professional securities market operators are really infringed upon only after the federal executive authority responsible for the security market sets forth the requirements pertaining to the listing (de-listing) of securities.

Russian issuers have the right to float *securities outside the RF territory*, including floatation in accordance with foreign law of securities issued by foreign issuers certifying the rights of Russian issuers in relation to issued securities of Russian issuers, only as approved by the federal executive authority responsible for the securities market (Article 16). The law sets forth a number of terms the issuer should comply with in order to be granted such permission; however, this procedure is not detailed. The exhaustive list of documents necessary to obtain the permission to float the aforesaid securities outside the RF territory shall be determined by the same "federal executive authority responsible for the securities market." It is obvious that vesting the FSC with the right to determine such a list of documents at its discretion may result in the constant and uncontrolled expansion of the list and, therefore, substantially limit the right of Russian issuers to float securities outside the RF territory.

The stipulation of the law (Articles 20 and 25) vesting with the "federal executive authority responsible for the securities market" the right to determine the *exhaustive list of documents necessary for the state registration* of the issue (additional issue) of securities and set forth the exhaustive list of documents, which shall be submitted to the registration authority in order to register the report about the results of the issuance (additional issuance) of securities may also result in infringements on the rights of operators of the security market.

is an important stage for owners of shares in terms of information and control. However, the law fails to remove the risk that shareholders may be informed about additional issuance only after its results are registered and not at the stage where it is still possible to stop it (assessment of E. Krasnitskaya, Troyka Dialog).

¹⁰ At the same time, the expert findings "On amendments to the law 'On the securities market'" (approved by the RF President on October 10, 2002), which clarified the reasons behind the President's decision to veto the initial version of the law, pointed out, as a reason for the veto, that the "federal law contains provisions stipulating that a federal executive authority shall determine the requirements applicable to securities subject to mandatory access to the listing on the stock exchange, inclusion of securities in a respective list of securities, and exclusion from such a list. In practice, it means that a federal executive authority is vested with the function to select issuers whose securities may be floated on the organized market, what infringes on the rights of both issuers and professional stock market operators." See also the web site of the "Bureau of Legal Information" (<http://www.bpi.ru>).

The expansion of powers relating to the regulation of *marginal transactions* also gives rise to doubts. Thus, the original version of the law stipulated that the list of securities being the subject of marginal transactions should be determined in accordance with regulations and legal acts approved by the “federal executive authority responsible for the securities market.” The expert findings concerning this law (approved by the RF President) states that this provision in fact creates opportunities to limit the rights of the parties of the agreement basing on a regulation issued by an executive authority, what contradicts to the RF Constitution and the principles of the civil law fixed by the RF Civil Code. However, the law sets forth that only liquid securities included in the quotation list of the organizers of trade may be accepted as backing of loans granted by brokers¹¹. At the same time, the regulatory and legislative acts of the federal executive authority responsible for the securities market shall determine the criteria of liquidity of the aforesaid securities, the minimal discount, the procedure of determining the market value of securities accepted by brokers as backing, the procedure and terms of their reevaluation, as well as requirements pertaining to terms, procedures, and conditions of realization of securities serving as the backing of clients’ obligations relating to loans granted by brokers. Apparently, the amended wording does not change the nature of the acquired powers. Similarly to the listing regulations, at present it is difficult to evaluate the consequences of this measure. It may be monitored only after FSC approves the respective regulations setting forth the procedure governing the determination of liquidity of securities backing clients’ obligations, etc.

5) The law introduces the concept of “issuer’s option” defined as a “bearer security fixing the right of its owner to purchase the number of its issuer’s shares at the price determined in the issuer’s option within its term and / or under the stipulated conditions” (Article 2).

This novation also causes an ambiguous reaction in the investment community. First of all, it shall be noted that options are not securities, but derivative financial instruments. Indeed, the security is not the “option” per se, but the option certificate, while the option is not a security, but a transaction. For instance, according to the Letter of the Commission on commodity exchanges and the State Anti-Monopoly Committee (No. 16-151/AK of July 30, 1996) the option (or option transaction) is defined as a document certifying the right to receive (transfer) property (including money, forex denominated values, and securities) or information on condition that the holder of the option contract may unilaterally waive the respective rights. As concerns the securities market, the object of option is the future transfer of rights and obligations pertaining to securities. The fact that the law defines the issued security not as an option, but as the “issuer’s option” does not change the legal nature of the option and does not transform this derivative financial instrument in an issued security.

It is a well known fact that certain rules were set forth yet by the FSC resolution of January 9, 1997 (“On option certificates, its use and approval of standards pertaining to the issuance of option certificates and prospectuses of issuance”). There is no doubt that legislative fixation of such a financial instrument as option is a very positive development. It relates, in particular, to the fact that in 2001 through 2002 largest companies developed their option programs. Companies granting their top managers options to purchase their shares traditionally view it as an effective instrument to increase capitalization and managers’ interest in the companies’ development strategies, although the “Enron affair” resulted in a certain rise in pessimism as concerns the generally accepted views and posed the question about the necessity to tighten the respective regulations. Among negative consequences of options there may be noted misrepresentation of financial reporting of companies on the part of their management.

The first issue of option certificates (pertaining to shares in Tatneft) was registered in May of 2001. In August of 2001, RAO Gazprom approved the program of granting options for purchase of its shares by employees. The Board of Directors of the oil company YUKOS approved the program of rewarding its personnel with options and “under condition” shares in April of 2001. The program envisages both the use of options and granting to employees shares “under condition.” The total number of shares available to employees in the three next years shall be below 85 million, or 3.8 per cent of the total number of shares issued by the company. At the same time, the company does not plan additional issues of shares in order to implement this program. In October of 2002, there was also announced a long term program of “rewarding best employees with company’s shares” (via deeds of gifts).

A program of options for employees (management of subsidiaries and affiliates) of power engineering enterprises was envisaged in the framework of the general project of UES Russia reform. According to the

¹¹ See: Myazina E. Rynok tsennykh bumag snova popravilsya (The securities market has recovered again). – Vedomosti, 2002, November 2.

scheme approved by the Board of Directors in June of 2002, it was planned that managers of the main company UES Russia would have options for 1 per cent of UES Russia shares, while managers of regional companies might be offered 0.5 to 5 per cent of shares in their respective companies. At the same time, the general problems relating to the UES Russia restructuring, including the relations between the management and minority shareholders, noticeably complicate the prospects of implementation of such schemes.

As concerns companies originally created as private firms, similar programs were worked out by Vypelkom (the system of participation in profits for rank and file employees and the system of options for top managers). Apparently, evaluation of the effectiveness of these schemes in the context of companies' capitalization is possible only after 3 to 5 years since the start of implementation. Equally, the use of such schemes is possible only at a certain stage of companies' maturity. Obviously, beside capitalization motives, the possibility of application of option schemes in Russia may open in the context of consolidation of corporate control and legalization of managers' incomes.

Yet another problem the companies concluding option transactions and adopting option plans may encounter in the future is the insufficient legislative regulation of this institute. It may result not only in difficulties in practical implementation of the aforesaid provision of the law, but also in abuses in this sphere. Accordingly, the existing regulations need serious further elaboration.

6) The law amends the legal *status of stock exchanges*. While earlier stock exchanges might be established only in the form of not-for-profit partnerships, at present they may be joint stock companies. The necessity to introduce this stipulation has been felt for a long time and shall be viewed as a positive development. The introduction of this stipulation will favorably affect liberalization of the securities market, since now professional market operators may choose between two types of exchanges – those in the form of joint stock companies or not-for-profit partnerships¹².

At the same time, in accordance to amendments to the federal law “On not-for-profit organizations” a not-for-profit partnership may be transformed in a joint stock company. Accordingly, all stock exchanges operating in the form of not-for-profit partnerships may be transformed in joint stock companies.

The list of other activities stock exchanges have the right to engage in has also been amended. While earlier stock exchanges might engage in only depositary and clearing operations, the enactment of the law makes it possible to combine the activities of stock exchanges with activities of currency and commodity exchanges, clearing operations relating to clearing of securities and investment shares of mutual investment funds, activities relating to information, publishing, and lease of property. The introduction of these amendments to the law is a positive development, since earlier legal entities operating as stock exchanges had had to establish and operate via separate firms in order to lease property or publish a magazine on exchange trade. The law sets forth the requirements pertaining to the activities of stock exchanges, for instance, the requirements relating to the approval of internal documents of stock exchanges, requirements relating to transparency and public oversight over trading operations by informing the participants about the place and time of such operations, etc., what also is a positive development, since earlier these issues had not been regulated.

Among *other novations*, there shall be singled out the following:

- more precise definition of the legal status of brokers (the legal definition of brokers and the procedure governing respective operations);
- legal fixation of the concept of marginal transactions;
- introduction of provisions defining the responsibilities professional securities market operators shall bear for price manipulation on the securities market (Article 51 of the law contains the exhaustive list of actions, which may be qualified as price manipulations on the securities market)¹³;

¹² According to the law, only members of the stock exchange have the right to be participants of exchange operations on the exchange established in the form of not-for-profit partnership, what somewhat hinders professional participants to access the market. It is not necessary to be a shareholder of an exchange created in the form of a joint stock company to participate in its operations.

¹³ At the same time, in practice there may arise difficulties to call to account the respective offenders. For instance, the law stipulates that such operations as “carrying out transactions with securities on stock exchanges and other organizers of trade on the securities markets not resulting in the change of the owner of such securities” as price manipulation. However, the law fails to define what number of such transactions shall a professional operator of the securities market conclude in order that such operations might be qualified as price manipulation. Also, it would be rather difficult to establish the cause – effect relationship between the actions aimed at price manipulation on the securities market and

- amendments to the definition of bonds, determination of issuance and circulation specifics of secured bonds (mortgages, warranties, bank, state, or municipal guarantees, etc.).

It is apparent that in the future there shall be resolved problems associated with practical enforcement of the stipulations set forth by the law and to evaluate their impact on the activities of market operators. Besides, some time is required to bring all regulatory and legal acts, first of all those issued by FSC, in conformity with the law.

At the same time, it shall be clearly understood that in the medium term perspective this market will not become a serious source of investment resources for enterprises due to a wide range of objective and subjective factors. Accordingly, the practical significance of this segment shall not be overestimated in the course of elaboration of social and economic strategies. In the future, ideas of market liberalization and transparency of regulatory norms shall make the basis of the state regulation of this sector. Meanwhile, the existing model of market regulation should remain the administrative (permission-based) one, although ideally it would be necessary to balance a combination of 6 principles: 1) detailed legal procedures relating to the activities performed by issuers and professional operators; 2) varied legislative requirements (control, transparency, guarantees, etc.) relating to procedures governing the activities of different types of economic agents (differing in terms of professionalism, client base, quantities, etc.); 3) a priori assumption of the conscientiousness of market operators and, therefore, minimization of necessary approvals and permissions on the part of governmental agencies in favor of notification approach (for instance, as concerns the issuance of shares and bonds, granting of the status of professional market operator of certain types, etc.); 4) transparency of all procedures, which would exclude all ambiguity and possibilities of administrative selection of market operators for any type of activity; 5) a two-tier system of enforcement in the case there would be detected actions in bad faith – arbitration courts of self-regulating organizations (enhancement of the role they play) and the state judiciary system. At the same time, the development of the system of arbitration courts will result some lightening of the burden on the budget as concerns the financing of the judiciary system; 6) a wide range of sanctions (from expulsion from a self-regulating organization and prohibition to engage in certain types of operations to criminal prosecution) for detected offences.

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respective damage. It shall be noted that due to the fact that this regulation is relatively new, at present it is difficult to evaluate its effectiveness.

