



INSTITUTE FOR THE ECONOMY IN TRANSITION

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MAY 2001

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RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES

MONTHLY BULLETIN

**Moscow
2001**

Economic and political situation in May 2001

The main economic and political plots of May were determined by tendencies of the prior months, and they mostly centered on measures laid out in the program for priority measures for 2000-2001 (so-called Government Resolution # 1072).

It was the debate on the reforming of RAO "UES Russia" that was in the center of attention. The debates entailed serious clashes within the executive power: there has been two seriously different approaches of government authorities towards the problem. That to a certain extent reflected the conflict between the "centralist" trends of the RAO's management and the part of the Government that advocated this stand, on the one hand, and rather a contradictory system of interest of their opponents represented by regional authorities and some minority shareholders, on the other hand.

In the course of intensive discussions, the RAO management's stand prevailed and earned the Cabinet's support. Thus, the sector for electric power should enter the period of a serious reform. With the concept of a radical reform of the Ministry of Railway Transportation approved in April, that means another important step in the area of reforming natural monopolies. The both decisions have an important feature in common: it was the reform concept suggested by the monopolist's management that was approved.

Another important component of implementation of the Government program is the complex of deregulation measures. The package that comprised three bills was submitted to the Duma after a half-year discussion. The destiny of the package should serve as a specific criterion for estimation of the executive power's capability of controlling the situation in the legislature. The

deregulation measures face a serious counteraction of various interest groups, including the executive power itself. It is very likely that the struggle around the package will be shifted to the Duma. The first votings on the bills (for instance, on the law on inspections) showed that so far the advocates of deregulation have been fairly successful in controlling the voting process.

Finally, a sharp discussion emerges around the Chapter of the Tax Code that should regulate taxation of corporate profit, and that will remain in the center of the tax reform, - at least until the beginning of the summer recess.

The Government also proceeded with its work on the Medium-term Action Plan for 2002-2004. The document appears a natural component of the Long-Term Program for 2001-2010 developed for the presentation to President in April.

There was yet another event in May that may become of a key significance to Russia. In the course of the work of Russia-EU summit, the EU authorities have put forward a proposal on activation of the work on formation of the single economic zone between the EU and Russia. In principle, such a proposal was laid down in earlier documents (in 1994 and 1999), however, the EU has not showed yet any readiness to hold active negotiations in this respect. The close future should show to what extent the EU proposal is practical. It is not clear yet, whether this issue was elaborated in detail among all the EU members, nor it is clear what the message is: that is, whether it implies Russia's integration in the current European economic area. In any case, such a proposal establishes grounds for incorporation of European criteria and standards in the system of long-term guidelines of Russia's economic reform policy.

S. Batkitbekov

State of the federal budget

TABLE 1. THE MONTHLY EXECUTION OF THE FEDERAL BUDGET OF THE RUSSIAN FEDERATION
(IN % GDP, CASH EXECUTION)

	I'00	II'00	III'00	00	I'01	II'01	III'01
Revenues							
Corporate profit tax	1,6%	1,6%	2,0%	2,6%	1,4%	1,5%	1,9%
Personal income tax	0,3%	0,3%	0,3%	0,4%	0,0%	0,0%	0,0%
VAT, special tax and excises	8,2%	8,3%	8,0%	7,3%	9,1%	9,4%	9,0%
Tax on foreign trade and foreign trade operations			3,1%	3,4%	3,5%	3,3%	3,6%
Other taxes, duties and payments			0,3%	0,3%	0,3%	0,4%	1,1%
Total-taxes and charges			13,6%	14,0%	14,1%	13,9%	15,3%
Non-tax revenues			1,9%	1,8%	1,8%	2,3%	1,0%
Revenues, total			15,5%	15,8%	16,0%	16,2%	16,0%
Expenditure							
Public administration			0,1%	0,2%	0,3%	0,4%	0,1%
National defense			0,0%	2,5%	3,0%	2,7%	1,3%
International activities			0,7%	0,9%	0,8%	0,3%	0,3%
Judicial power			2,8%	0,1%	0,1%	0,1%	0,0%

TABLE 1 (CONT`O)

	I`00	II`00	III`00	00	I`01	II`01	III`01
Law enforcement and Security activities	0,8%	1,2%	1,3%	1,5%	0,7%	1,1%	1,3%
Fundamental research	0,0%	0,1%	0,1%	0,3%	0,0%	0,1%	0,2%
Services provided for the national economy	0,3%	0,4%	0,5%	0,9%	0,1%	0,3%	0,6%
Social services	1,3%	1,5%	1,8%	1,9%	1,2%	1,7%	1,9%
Servicing of public debt	3,8%	3,1%	2,9%	2,5%	3,2%	5,6%	4,7%
Other expenditure	5,6%	2,7%	3,0%	3,1%	3,3%	3,2%	2,9%
Expenditure, total	12,6%	12,7%	13,8%	13,7%	10,4%	14,6%	14,3%
Loans, redemption exclusive	2,9%	3,1%	2,2%	2,5%	5,8%	2,5%	2,6%
Expenditure and loans redemption exclusive	-0,5%	-1,5%	-0,3%	0,0%	-3,7%	-0,8%	-0,6%
Budget deficit (-)	-2,4%	-1,6%	-1,9%	-2,5%	-2,1%	-1,7%	-2,1%
Domestic financing	-2,9%	-3,1%	-2,2%	-2,5%	-5,7%	-2,5%	-2,6%

* in % GDP

TABLE 2. THE MONTHLY EXECUTION OF THE FEDERAL BUDGET OF THE RUSSIAN FEDERATION (IN % GDP, ACTUAL FINANCING)

	I`01	II`01	III`01	IV`01
Public administration	0,5%	0,5%	0,5%	0,5%
National defense	2,4%	2,5%	2,8%	2,8%
International activities	0,5%	0,4%	0,2%	0,3%
Judicial power	0,2%	0,2%	0,1%	0,1%
Law enforcement and security activities	1,7%	2,0%	1,9%	1,8%
Fundamental research	0,3%	0,3%	0,3%	0,3%
Services provided for the national economy	0,5%	0,9%	1,0%	1,1%
Social services	2,4%	2,6%	2,5%	2,7%
Servicing of public debt	3,2%	5,6%	4,7%	3,7%
Other expenditure	3,7%	3,5%	3,2%	3,2%
Expenditure, total	15,3%	18,5%	17,2%	16,5%
Profit(+)/deficit(-)	0,9%	-1,4%	-0,3%	1,1%

The preliminary data on the execution of the federal budget for the first quarter of the year 2001 are represented in table 1¹. For the first quarter of the year 2000 the level of the federal budget revenues made up 16.9% of GDP, including tax revenues – 15.8% of GDP, and the expenditure – 14.3% of GDP (17.2% of GDP in actual financing), including the non-interest expenditure - 9% of GDP (12.5% of GDP in actual financing). The level of the budget profit thus made up 2.6% of GDP (the profit of 0.3% of GDP in actual financing).

Between January to March 2001, the execution of the federal budget is characterized with a higher level of tax revenues, which is at 1.7 percent point superior to the respective index of 2000. The main reason for such a growth is the increase of indirect tax revenues, especially of the value added tax and of the foreign trade tax revenues.

Fundamental reasons for the growth of tax revenues as compared to the respective index of 2000, should be divided into several groups. The first reason for the growth of the tax revenues is the extension of the tax base: as for foreign trade tax, it is the growth of prices for the traditional export (raw and mineral materials), as for the Value added tax - it is the growth of prices in the economy, and as for the income tax - it is the redistribution of

¹ Because of the estimative nature of the data on GDP, indicators are subjects for revisions.

payments to employees from the end of the previous year to the beginning of the current year, because of expectations of a reduction of the marginal tax rate and also because of a broad rejection of the tax evasion schemes. The second reason comes as a result of administrative measures: the part of the execution of the federal budget rose, which results in the improvement of settlements in the economy.

At the same time one should keep in mind that this year the level of profit tax revenues in shares of GDP declined compared to the previous year. The tax arrears stand at the same level in their absolute terms compared to the respective period of the previous year, and they roughly account for Rb. 26-30 bln.

The estimation of the execution of the expenditure part of the federal budget varies depending on the method of calculations of operations – calculation of an actual financing or of a cash execution. In the former case the value of expenditures made up 17.2% of GDP, while in the latter – 14.3% of GDP.

If we use the official data on the cash execution of the federal budget for the first quarter, we can note that, when compared to the respective period of the previous year, the growth of expenditures on the servicing of public debt (from 2.9% of GDP to 4.7 of GDP) and also a reduction in defense expenditures (from 3% of GDP to 2.2% of GDP).

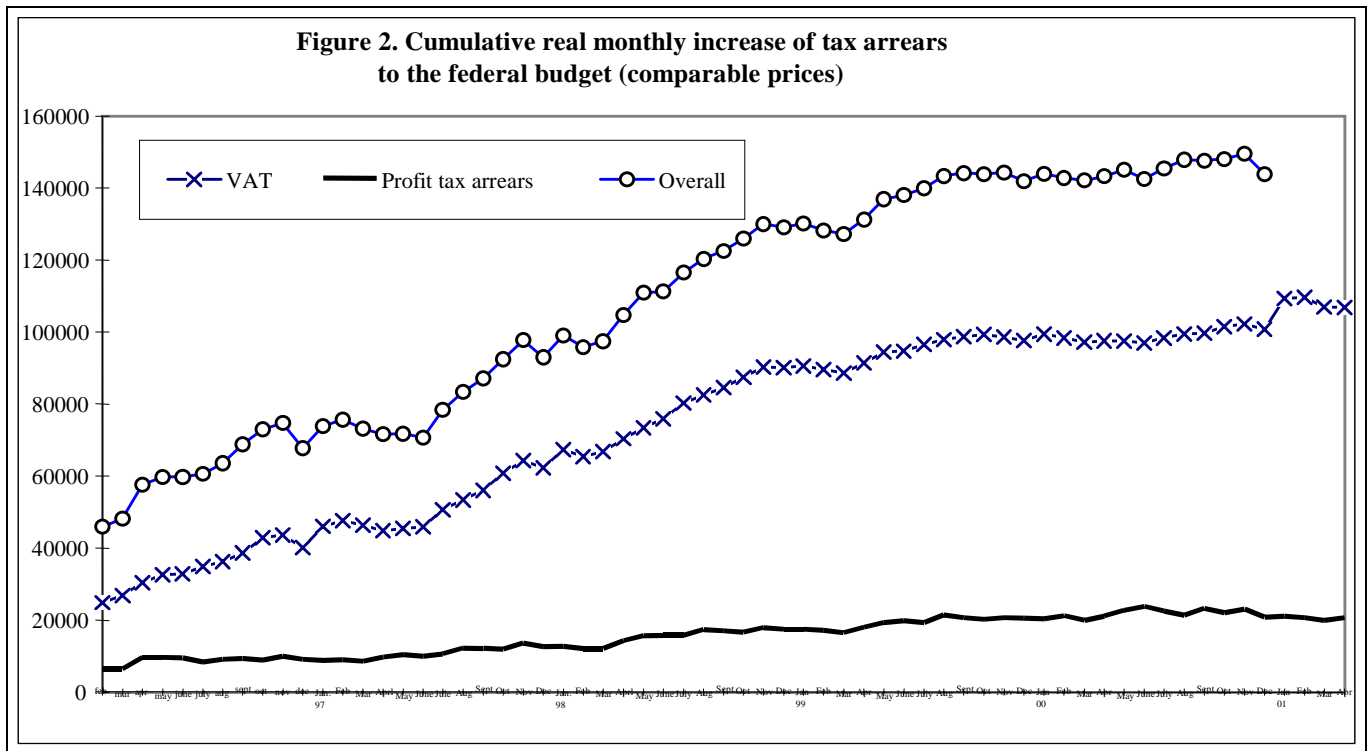


TABLE 5. EXECUTION OF THE CONSOLIDATED BUDGET OF THE RF (IN % OF GDP).

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%	50482
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			
Taxes	22,7%				23,6%				23,9%			
Revenues	25,9%				27,1%				27,4%			
Expenditures	16,8%				22,8%				23,7%			
Deficit / Profit	9,1%				4,2%				3,7%			

S. Drobyshesky.

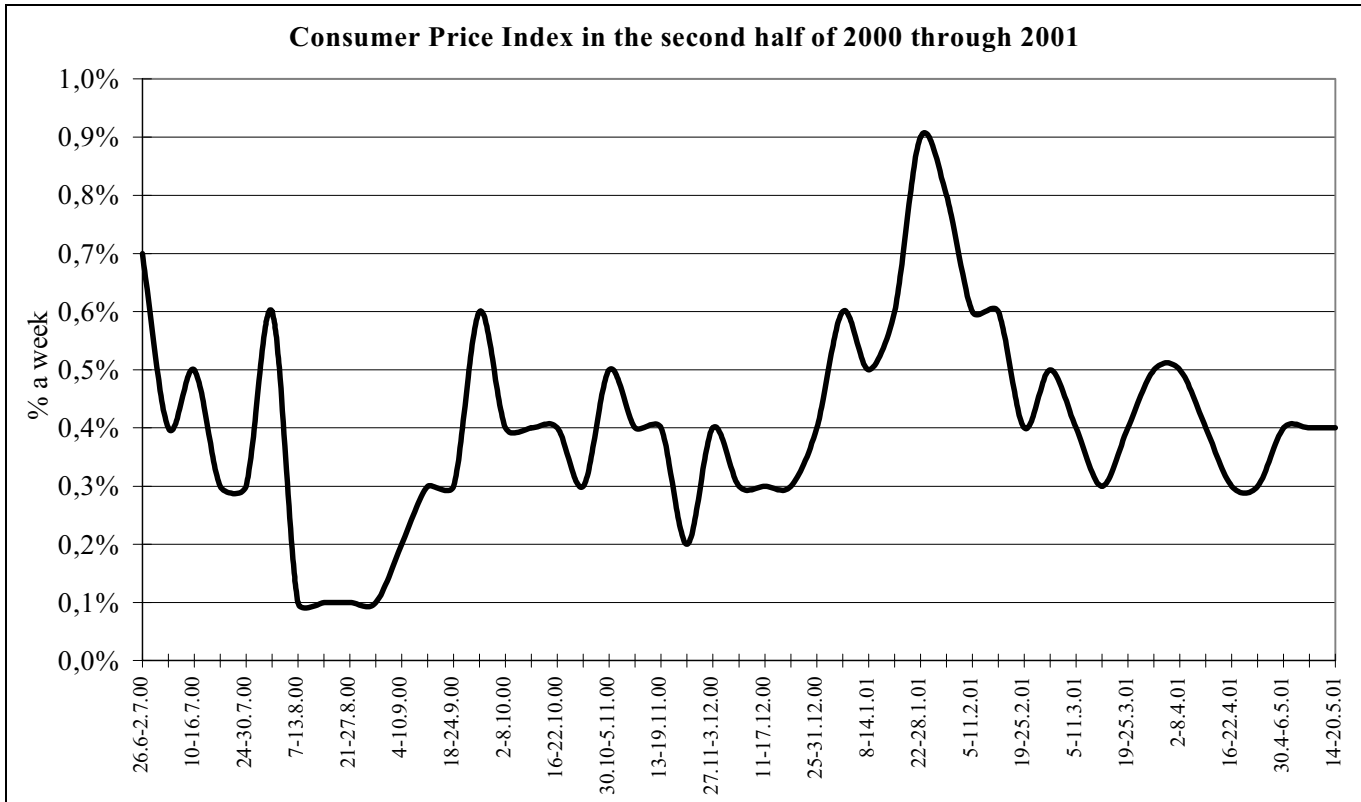
Monetary Policy

In April 2001 the rates of consumer prices growth were slightly lower than during preceding months. Thus, the CPI grew by 1.8%, the food stuffs price index – by 2.0%, non-food goods price index – by 0.9%, services – by 2.8%. A deterrent for inflation growth is the stable nominal exchange rate ensuring lower price growth rates across non-food goods. The price dynamics in April was affected by seasonal factors: e.g., the highest growth rates were registered on prices for meat and poultry (4.2%), for fruits and vegetables (4.9%) and recreation (4.5%). Also high

growth rates were fixed on prices for housing (3.6%) and communication services (5.2%).

In May the weekly CPI increments decline slightly (see Fig. 1). According to preliminary estimates, the CPI grew by 1.5–1.6%. Hence, the inflation rate was likely to exceed 10.5% for the first five months of 2001 (6.8% for respective period in 2000). Minding possible acceleration of price growth in June and July due to the CBR money expansion and the schedule of external debt payments (see below), the final CPI value for 2001 can exceed one for 2000 and will reach 21–22%.

FIGURE 1.



In April and May 2001 the narrow monetary base grew at higher rates in comparison with early-2001 (see Fig. 2). Thus, in April it made up 6.31%, and for the first 20 days of May – another 4.16%. Such a pattern is typical for last three years, and it originates from seasonal fluctuations in export receipts and accumulation of foreign reserves by the Bank of Russia on the eve of payments on the Russian external debt (in June and July). E.g., in 2000 the monthly monetary base growth rates were 9.63% in April, 4.41% – in May, and 8.82% in June against 1.2%

in average during the first quarter of 2000. The *deja vu* in seasonal fluctuations of money supply is an additional factor supporting expectations of high final CPI values in 2001.

By the end of May the Bank of Russia foreign reserves attained the level of \$33 billion (see Fig. 2). Therefore, Russia entered the top-20 countries in the world by foreign reserves volume. Nevertheless, the rates of foreign reserves growth slightly slowed down (see section *Foreign exchange market*), and we expect their stabilisation or

FIGURE 2.

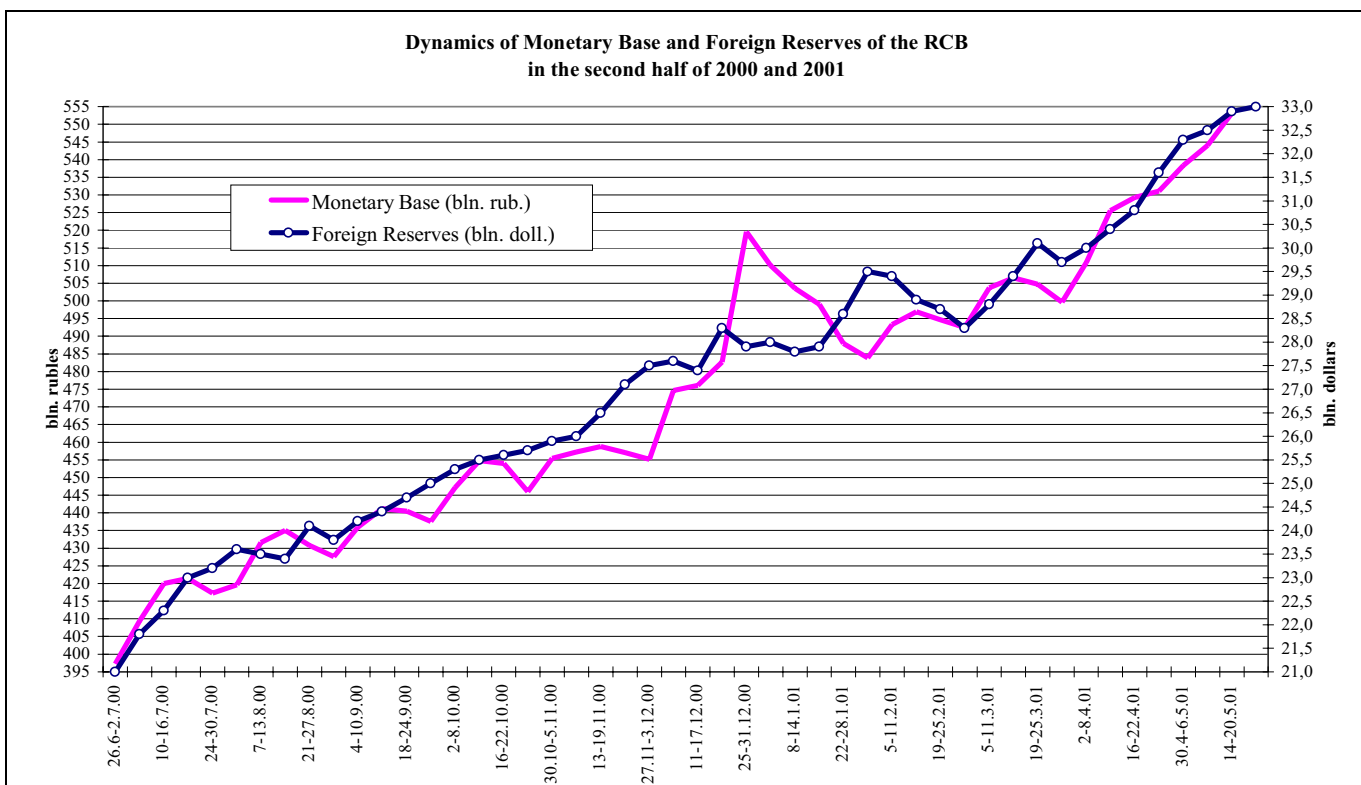
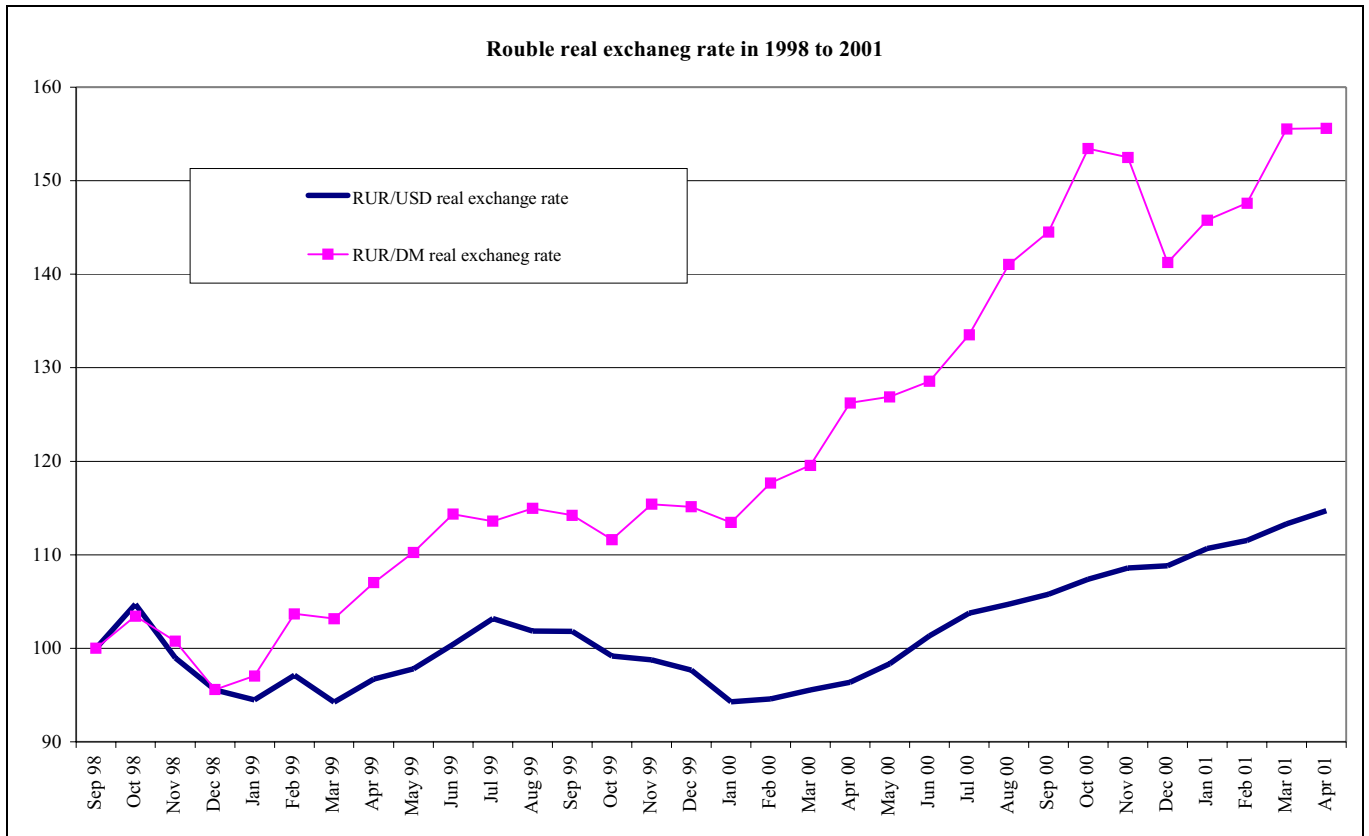


FIGURE 3.



even some decline during next few months.

In 2001 the tendency to the ruble appreciation has been held out (see Fig. 3). Thus, for the first four months the RUR/USD real exchange rate (calculated on basis of ruble/\$ nominal exchange rate and CPI rates in Russia and the

USA) grew by 5.4%, and the RUR/DM real exchange rate – by 10.2%¹. Therefore, for the period after September 1998 (the time of maximum rubel devaluation) the real appreciation of ruble against the US\$ reached 14.7%, and 55.6% – against the Deutsche Mark.

S. Drobyshesky, D. Skripkin

Financial Markets

The government securities market.

In May 2001 the quotations grew in the market for the Russian foreign debt securities (see Figs. 1 and 2). The highest price growth was fixed on the fourth issue of Minfin bonds – about 7 percentage points, or about 10%. Prices of other bonds increased by 3–5 percentage points. Hence, by the end of May yields to maturity on the Russian eurobonds amounted to from 5.6% (maturity in November 2001) to 14.1% (maturity in 2018) annualised, and yields on Minfin bonds – from 13.3% (maturity in 2011) to 17.7% (maturity in 2003) annualised. The ‘hump’ on the yield curve of the Russian eurobonds moved from 2007–2010 to 2010–2018.

This rise in securities quotations in May can be explained by a combination of few favourable factors.

First, permanently high oil prices make consider the situation in Russia as more stable than in other emerging markets. Second, in May 2001 the situation in Argentina, Brazil and Turkey stabilised, and that fact reduced the general risk of investments in bonds of developing countries. Third, the cuts in basic interest both in the USA and Europe push down interest rates on all debt securities denominated in the US dollars and euro.

In May 2001 the yields in the market for the Russian domestic debt also went down. In the second half of the month the average-weighted yield to maturity did not exceed 17% annualised. But, that happened against decreasing trade volumes. On May 16 the RF Ministry of Finance held an auction on placement of six-month GKO issue, and succeeded in placing about 65% of the total volume at cut-off auction rate 15.21% annualised.

¹ In fact, this figure indicates change in RUR/EUR real exchange rate. But, as there is no common inflation value for EURO, we calculate the RUR/DM real exchange rate.

FIGURE 1.

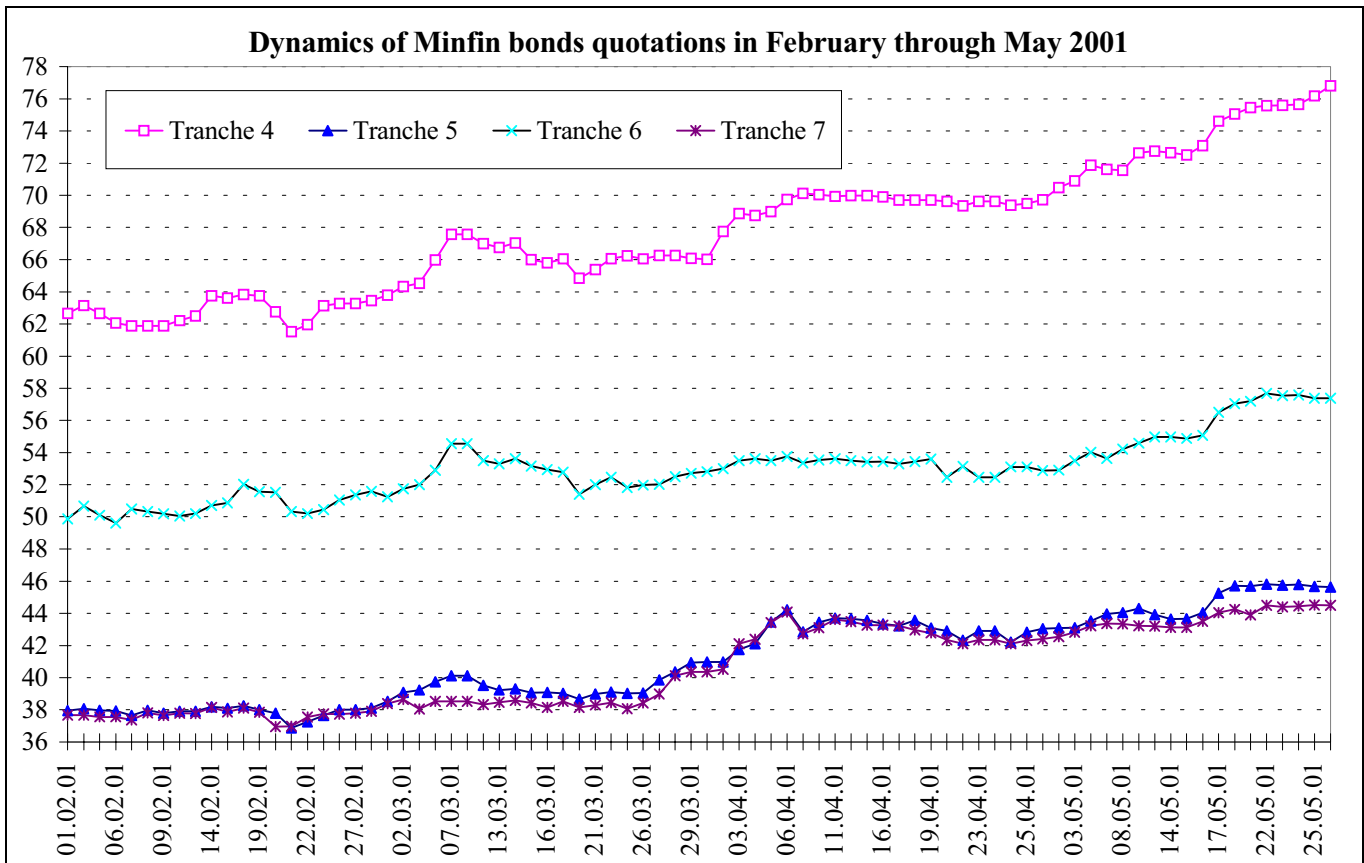


FIGURE 2.



Stock market.

In May the prices of the Russian stocks were determined by closing of company registers. In particular, the

quotations predominantly rose before the time of closing and fell just after that time. The demand rose for both common and preferred shares as high dividends for 2000 had been expected. Thus, e.g., closing of Gazprom register

on May 4 resulted in a 5% fall in share prices for one day. The increase in the RTS Index, which had started in late-April, continued in May, and on May 18 the index broke through the point of 200. The growth of quotations and trade volumes in the Russian market was induced by active actions of domestic investors as well as capital inflow from abroad. Because of high oil prices and positive financial results of oil company, the foreign investors bought primarily shares of companies from this sector.

Totally in May the RTS Index grew by almost 30 points and amounted to 208.8 (as of May 31). The total trade

volume for this month equalled more than \$405 million (see Fig. 3). Thus, the tendency to a declining in trade volumes, which had been observed since the beginning of the year, left behind. The maximum trade volumes were registered the third week of May with the daily average volume of about \$28 million, and the weekly volume at \$140 million. The decline in the RTS Index by 0.6% for the third week of May we explained by a sharp fall in quotations of the UES Russia shares (about 13%), while prices for other securities were stable.

FIGURE 3.

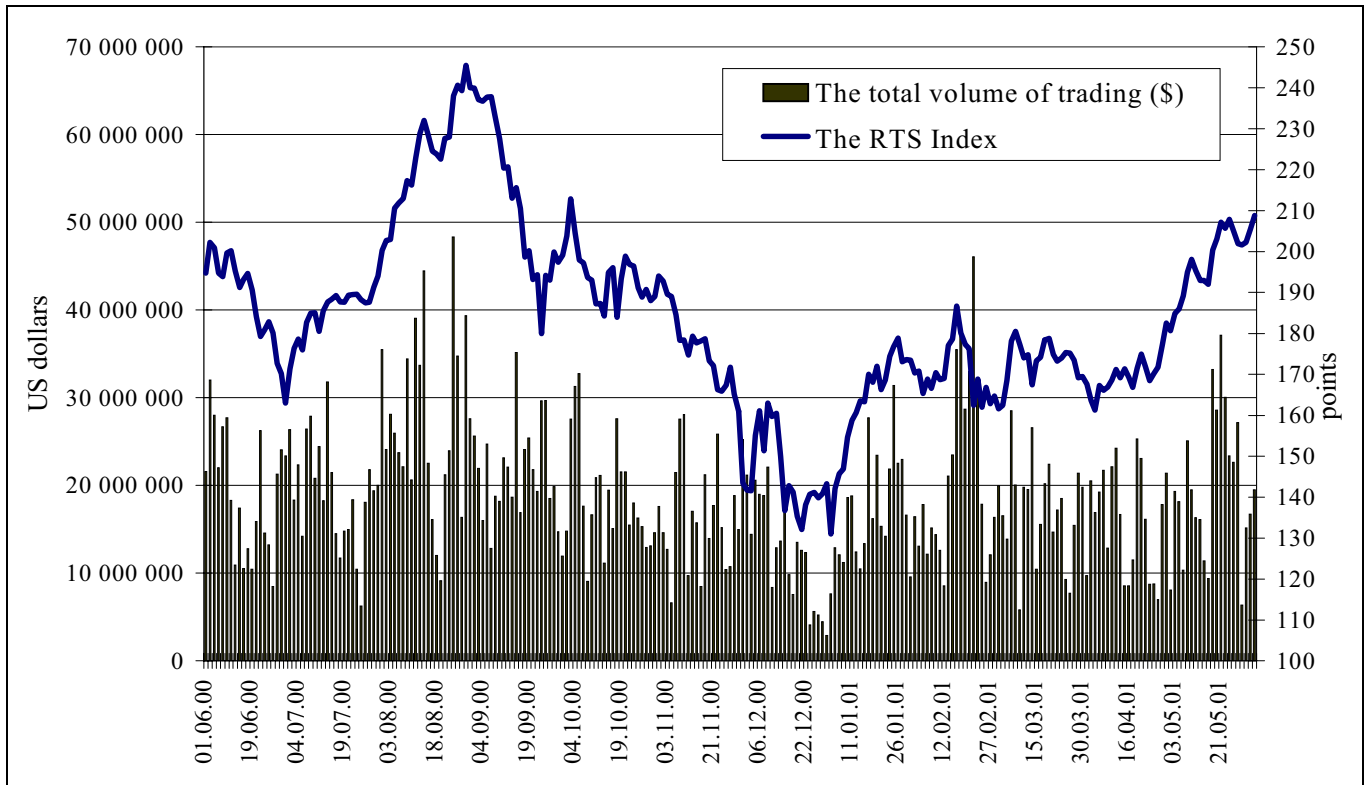
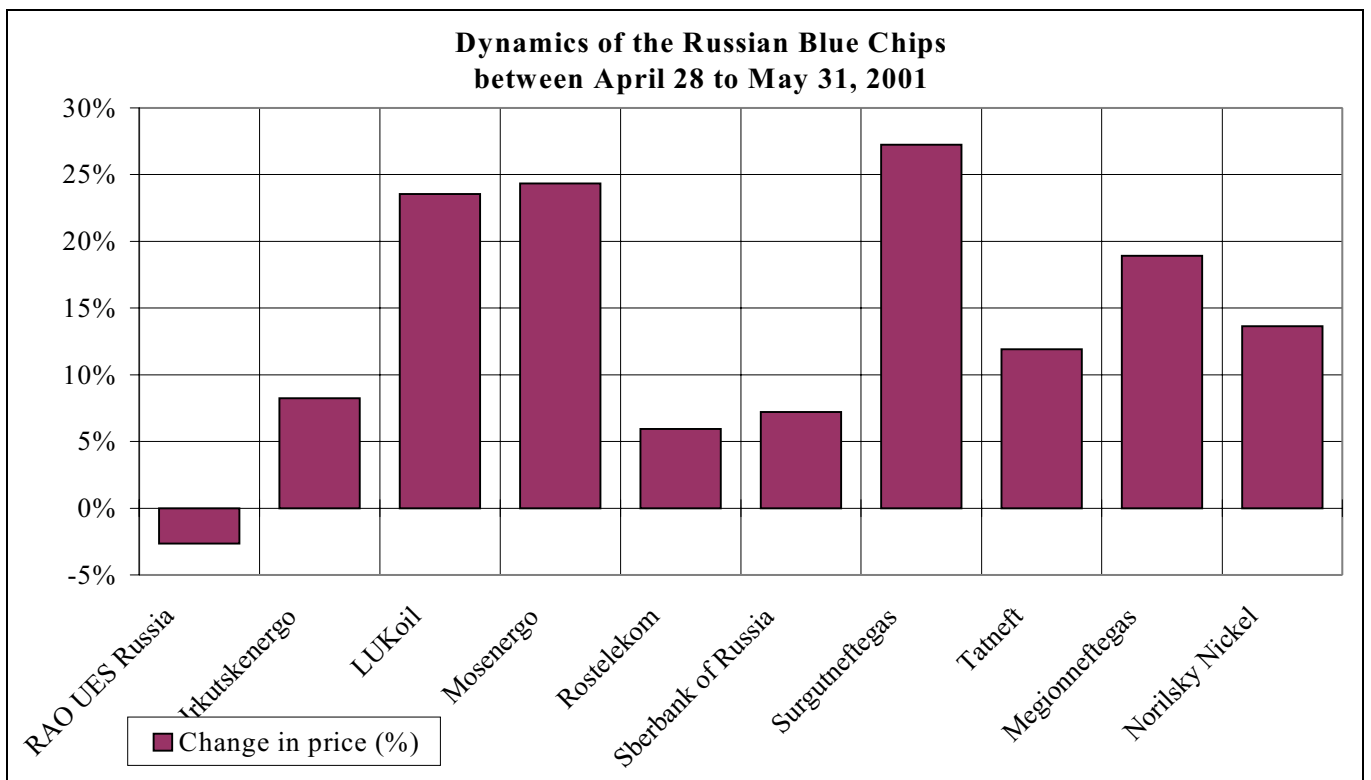


FIGURE 4.



The share of common stocks of RAO 'UES Russia' in the total trade volume in the RTS was 34.1% (37.4% in April), the share of 'LUKoil' stocks – 14.3% (12.3%), 'Surgutneftegaz' – 11.3% (8.9%), 'YUKOS' – 10.0% (11.6%), 'Norilsky Nickel' – 5.8% (6.0%). Thus, in May the total share of the five most liquid stocks in the RTS was 75.3% (in April – 76.1%).

In May, stock prices for the Russian blue chips soundly grew (see Fig.4). During the last month, it was common stocks of 'Surgutneftegaz' (+27.2%), 'Mosenergo' (+24.3%) and 'LUKoil' (+23.5%) the quotations of which grew most significantly among blue chips. The fall was fixed on common stocks of RAO 'UES Russia' only (-2.6%). The latter was related to an uncertainty about the company restructuring.

On April 28 the RAO UES Russia stockholders' meeting took place. The meeting approved the dividends at 0.02 ruble per common share and 0.0738 ruble per preferred share. Also, the meeting approved some amendments to Company By-law and elected the Board of directors. Among the new members of the Board of directors there is only one representative of minor stockholders – David Hern (Brunswick Capital Management). Despite approval of a number of amendments to the RAO By-law, aimed at protection of minor stockholders' rights, the result led to a situation, when important decision can be made without any taking into account minor stockholders. Though the final decision on the RAO UES Russia restructuring plan was postponed by time, investors still are of interest in power sector and shifted to regional energy companies. After announcing the preliminary reform draft, prepared by the RAO UES and the Ministry of economic development and trade, the company's shares fell by almost 11% for a week, while Mosenergo's shares rose by 8%. This growth can be also explained by inclusion Mosenergo to the MSCI Index, and demand for the shares from part of foreign index funds.

On May 30 the Board of directors of Gazprom held a meeting and elected Alexey Miller as a new president of the company. Recently, Miller was a deputy-minister of energy. The replacement of Ram Vyakhirev means a start of irreversible reforms in the gas monopoly. The information on changes in the Gazprom top-management induces a rise in stock prices in the second half of May. This growth offset the fall related to closing of company register and the scandal around attachment of shares held by UFG and its affiliated firms (2.3% of shares) as well as exclusion from voting paper four of five candidates to the Board of directors risen by minor stockholders. Namely, from the last week the prices grew by 12.62%, and for May 30 – 2%.

The leader in share price growth among blue chips was 'Surgutneftegas'. This fact was also contributed by announcement on issuing the 3rd level ADR and being listed on the NYSE in 2002 or 2003. Arthur Andersen committed itself to audit 'Surgutneftegas' in accordance with the US standards GAAP as early as by December 15, 2001. In any case, by next stockholders' meeting,

which will take place in a year, the company is obliged to have financial and book-keeping reports in conformity with international standards. Another important incentive for growth of quotations was publication of positive current financial results.

Norilsky Nickel is another company planning entering the international market. This plan is a step of restructuring programme. Taking into account that the application to the FCSM was submitted on April 28 and the standard time of consideration is 30 days, one can expect issuing ADR in the beginning of summer. Positive financial results also contributed to the growth of share prices in May. In particular, the net profit of Norilsky Nickel in 2000 made more than \$2 billion, i.e. two times higher than net profit reported by LUKoil. The total sum of dividends is arranged about \$10 million.

The news on concentration of blocking stock in Aeroflot by firms closely related to Sibneft and Russian Aluminium pushed down the credit rating of the aircompany and caused the fall in share prices by near 4%.

On April 25 the Sberbank of Russia started placement of additional shares (the total number of new shares is 4998). Recently the Sberbank shares were quoted rather low – at about \$27. Thus, the issuing of additional shares in the situation of undervaluation seems to be inefficient to enlarge own capital. But, the issuer did not make any actions to increase its capitalisation and to raise larger funds. Evidently, the Sberbank had to issue shares to attract funds for matching bank regulation requirements, not to enlarge own capital. Despite the fact and disagreement between stockholders and bank management, quotations of Sberbank shares reached about \$36 after the official information on the issue.

For the first two decades of May the oil prices grew from 27.33 to 29.92 \$/bbl, i.e. by 9.4%. However, in the end of month a reverse tendency was observed: by May 29 the oil price fell to 28.49 \$/bbl (see Fig. 5).

On April 28 the preliminary data on the US GDP in the first quarter of 2001 were published. In annual terms the GDP rose by 2% for the quarter, while analysts forecasted a 1% growth or less. The market reacted by a rise in stock indices: Nasdaq rose 0.80%, S&P 500 – 2.34%, Dow Jones – 2.64%. But as early as May 4 the correction took place: Nasdaq fell by 3.35%, S&P 500 – by 1.49%, Dow Jones – by 0.74% (see Fig. 6).

A concern on cutting down in fixed capital investments and some other negative signs made the Fed reduce the interest rate once again – for the fifth time in 2001. On May 16, the head of the FRS Alain Greenspan made decision on cutting down the rate by another 50 basic points, i.e. to 4.0%. The decision inspired a boom in the US stock market. In particular, that day the DJ exceeded 11000 and by the end of that week it grew by 4.03%, Nasdaq – by 5.44%.

An important event in May was the ECB decision on reduction the euro discount interest rate at 50 basic points. That was ambiguously perceived by the market. On the one hand, the rates of economic growth in the eurozone

slowed down, and the reduction in interest rate should stimulate economic activity. On the other hand, the ECB stated many times that its object was a decline in inflation rate and stability of euro. Thus the reduction in interest rate in the situation of higher (in comparison with targeted

values) price growth rates and falling euro exchange rate has a negative impact on the expectations of the market participants. The latter could have important consequences for monetary policy and success of European Monetary Union, since earning a reputation for such a new central bank as the ECB is of key importance.

FIGURE 5.

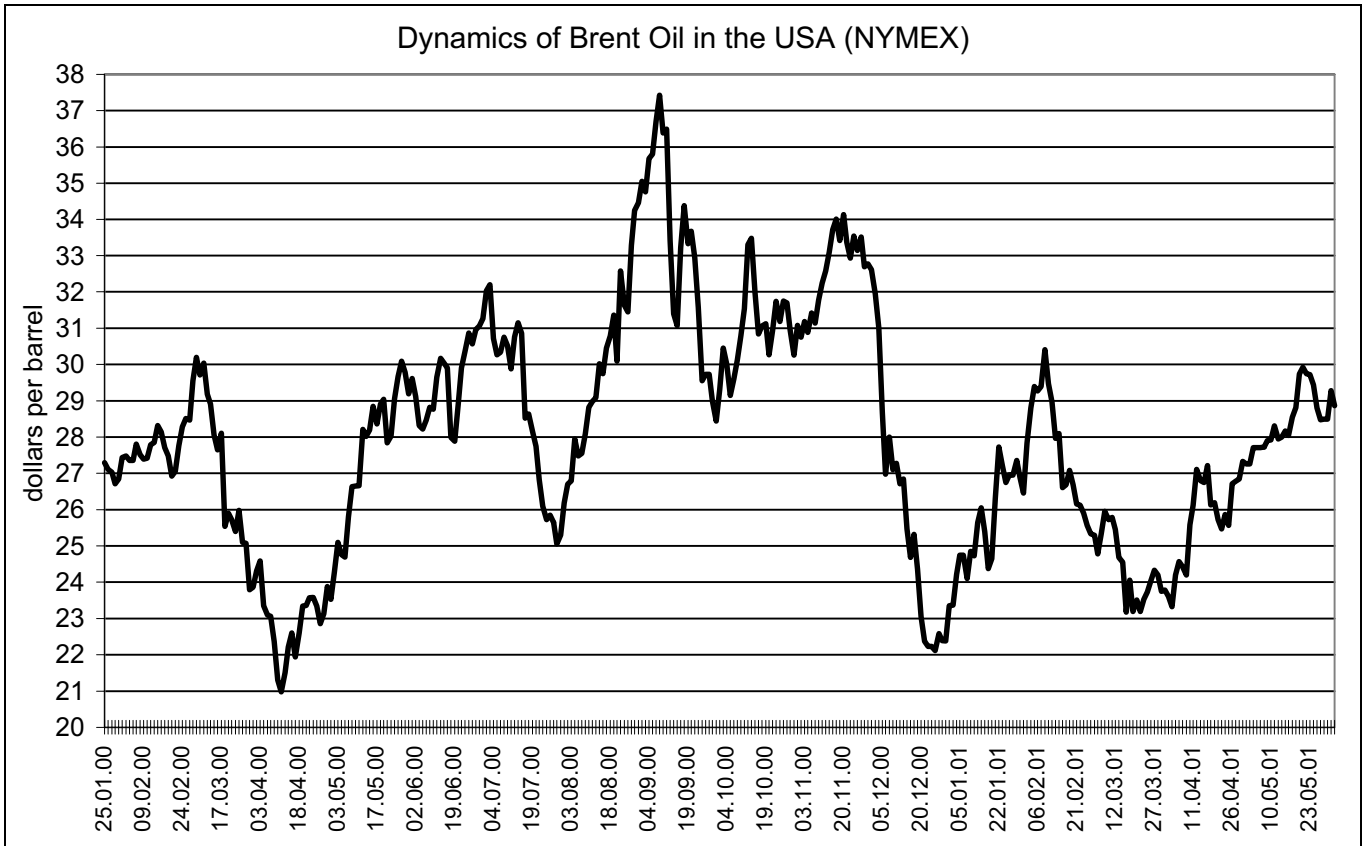


FIGURE 6.

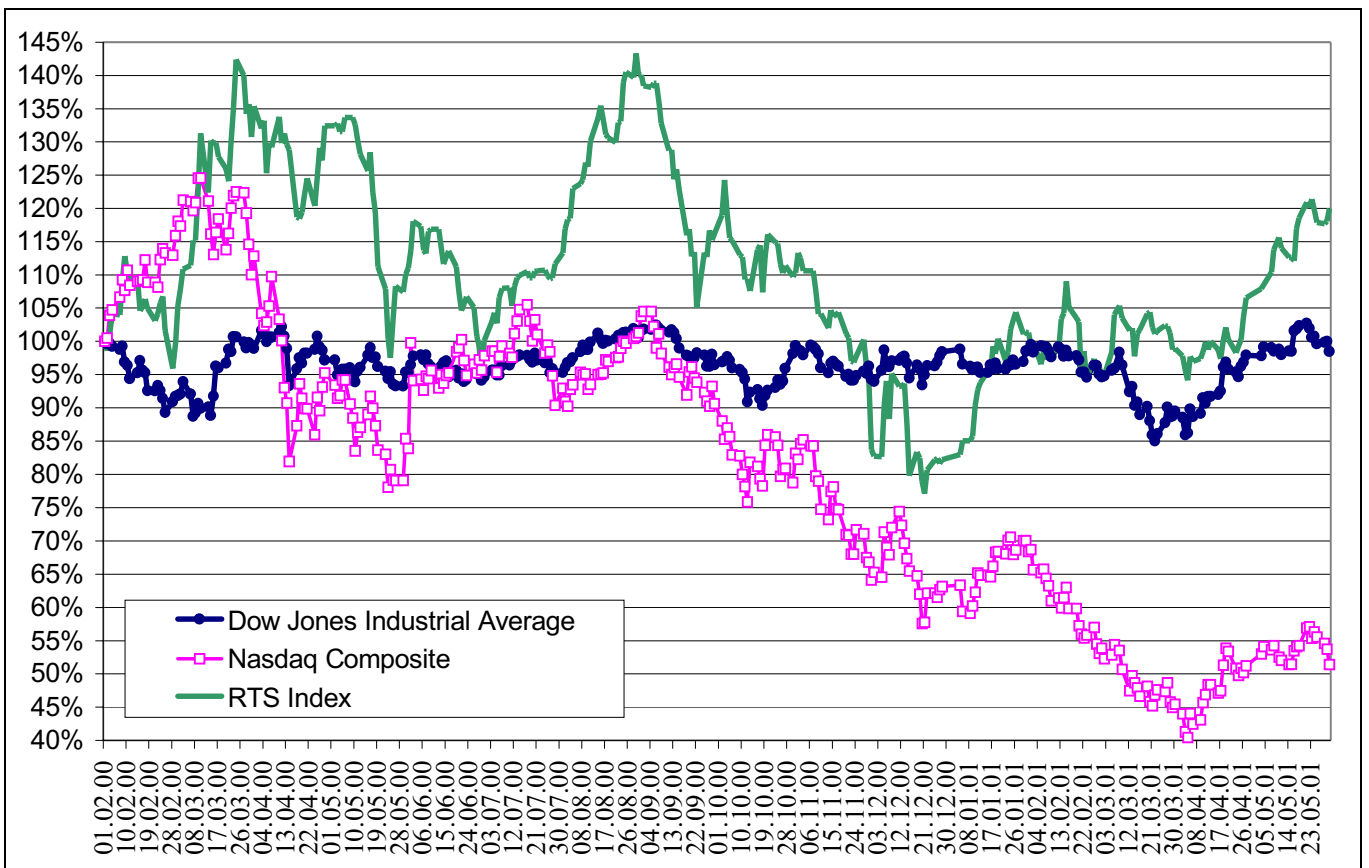


TABLE 1. DYNAMICS OF THE FOREIGN STOCK INDEXES

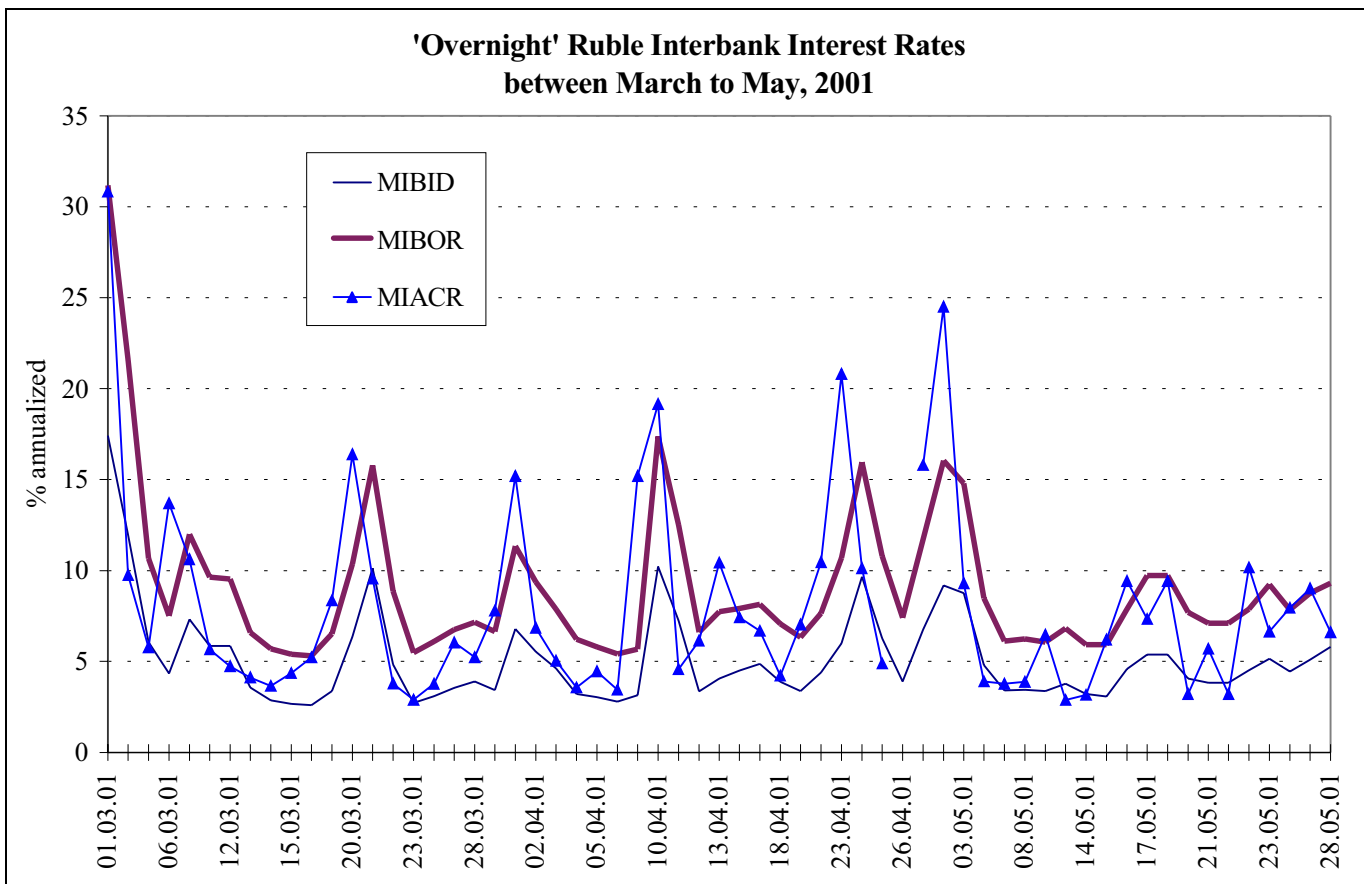
as of May 30, 2001	Value	change for last week (%)	change for last month (%)
RTS (Russia)	205.55	12.61%	45.97%
Dow Jones Industrial Average (USA)	10872.64	1.28%	0.04%
Nasdaq Composite (USA)	2084.5	0.42%	-18.50%
S&P 500 (USA)	1248.08	-0.40%	-6.46%
FTSE 100 (UK)	5796.9	-2.60%	-28.90%
DAX-30 (Germany)	6041.22	-2.17%	-35.99%
CAC-40 (France)	5444.27	-2.36%	-14.55%
Swiss Market (Switzerland)	7559	4.28%	27.67%
Nikkei-225 (Japan)	13493.35	-3.16%	-3.25%
Bovespa (Brazil)	14489	-2.94%	-5.05%
IPC (Mexico)	6586.93	9.64%	17.79%
IPSA (Chile)	109.8	8.01%	14.00%
Straits Times (Singapore)	1662.74	-1.41%	-12.51%
Seoul Composite (South Korea)	628.42	12.90%	24.53%
ISE National-100 (Turkey)	10687.1	-13.56%	71.73%

Interbank loan market.

In April and May 2001 the situation in the market for ruble interbank loans was rather calm (see Fig. 7). Increases in interest rates related to end-of-month effects and GKO auctions were not so substantial as in the first

quarter of the year. Thus, the highest overnight rates on the eve of public holidays in May did not exceeded 25% annualized. Later on, the overnight interest rates fell to 5–10% in annual terms.

FIGURE 7.



Foreign exchange market.

In May 2001 dynamics of ruble nominal exchange rate was mainly affected by the CBR's policy aimed at an increase in its foreign reserves as well as changes in the market participants' expectations induced by conflicting announcements of V. Gerashchenko, the Head of the Bank of Russia, concerning the ruble exchange rate as of the end of 2001 (30 or 31 rubles per US\$). In mid-May the

Bank of Russia let the ruble exceed the level of 29 rubles/USD, i.e. provoking an attack against the ruble, and, according to our estimates, had to spend about \$500 million to defend the exchange rate. The latter could explain a slowing down in the rate of foreign reserves accumulation in this period.

In May 2001, the official dollar exchange rate grew from 28.83 rubles/\$ to 29.09 rubles/\$, i.e. by 0.90% (11.35% annualized, see Fig. 8). The 'today' dollar

exchange rate in the SELT grew from 28.8868 rubles/\$ to 29.1647 rubles/\$ (as of May 25), i.e. by 0.96%. The 'tomorrow' dollar exchange rate grew from 28.9500 rubles/\$ to 29.0957 rubles/\$ (as of May 28), i.e. by 0.49%.

In May the trading volumes by dollar in the SELT continued to decline. According to the preliminary *FIGURE 8.*

estimations, during the last month the overall trading volume by 'today' and 'tomorrow' contracts made up 40 billion rubles and 25 billion rubles, respectively, in the united trade session – about 70 billion rubles. If so, the total volume of turnover by these contracts in May 2001 dropped at about 24% compared to the respective index registered in April.

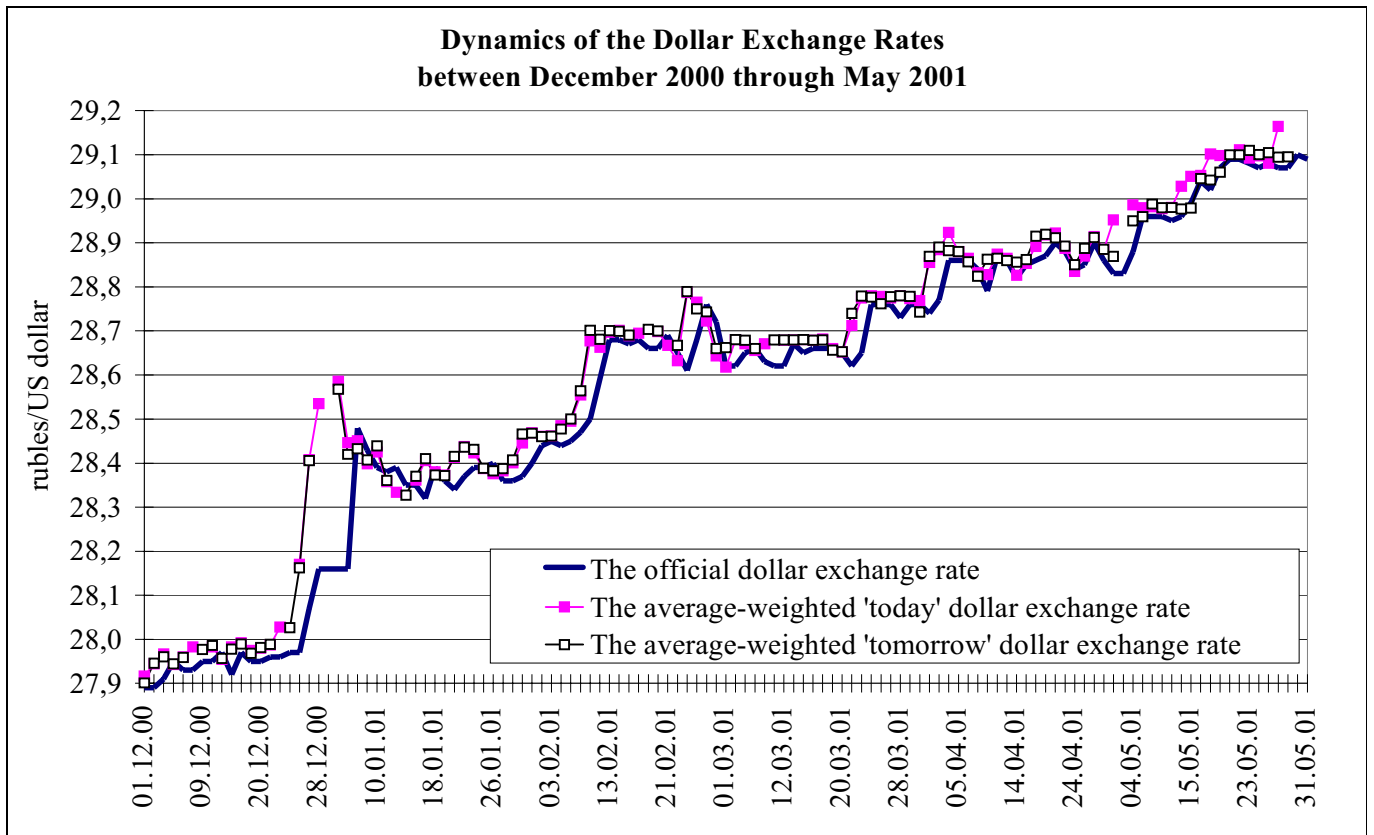
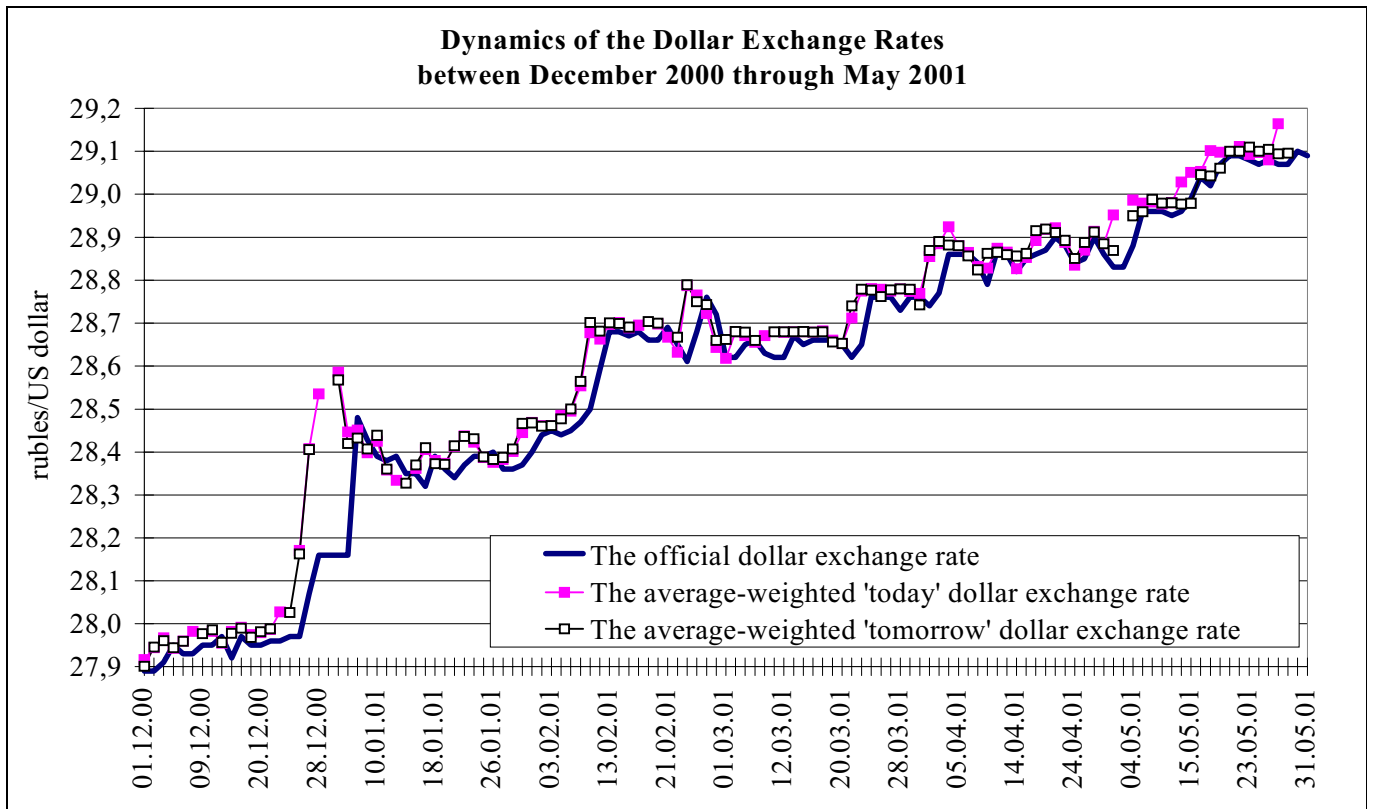


FIGURE 9.



In May 2001 the 'euro/dollar' exchange rate fell sharply (see Fig. 9). The first downfall fell on the end of the first decade of May and was related to the ECB decision on

lowering its basic interest rate (the exchange rate from 0.89 to 0.875 \$/euro), but the most striking fall in the euro exchange rate happened in the third decade of the

month, and by May 31 the 'euro/dollar' exchange rate slid to 0.8479 \$/euro. That is the lowest value since autumn 2000. Hence, in May the euro exchange rate decreased by 5.38%, and since early-2001 – 10.36%.

Following the fall in euro exchange rate in the world foreign exchange market, in May the ruble/euro official

exchange rate grew from 25.67 rubles/euro to 24.87 rubles/euro, i.e. by 3.12% (see Fig. 10). According to preliminary estimations, in May 2001, the total trading volume on euro in the SELT made up about 3 billion rubles, i.e. it practically did not change since April (3.07 billion rubles)

FIGURE 10.

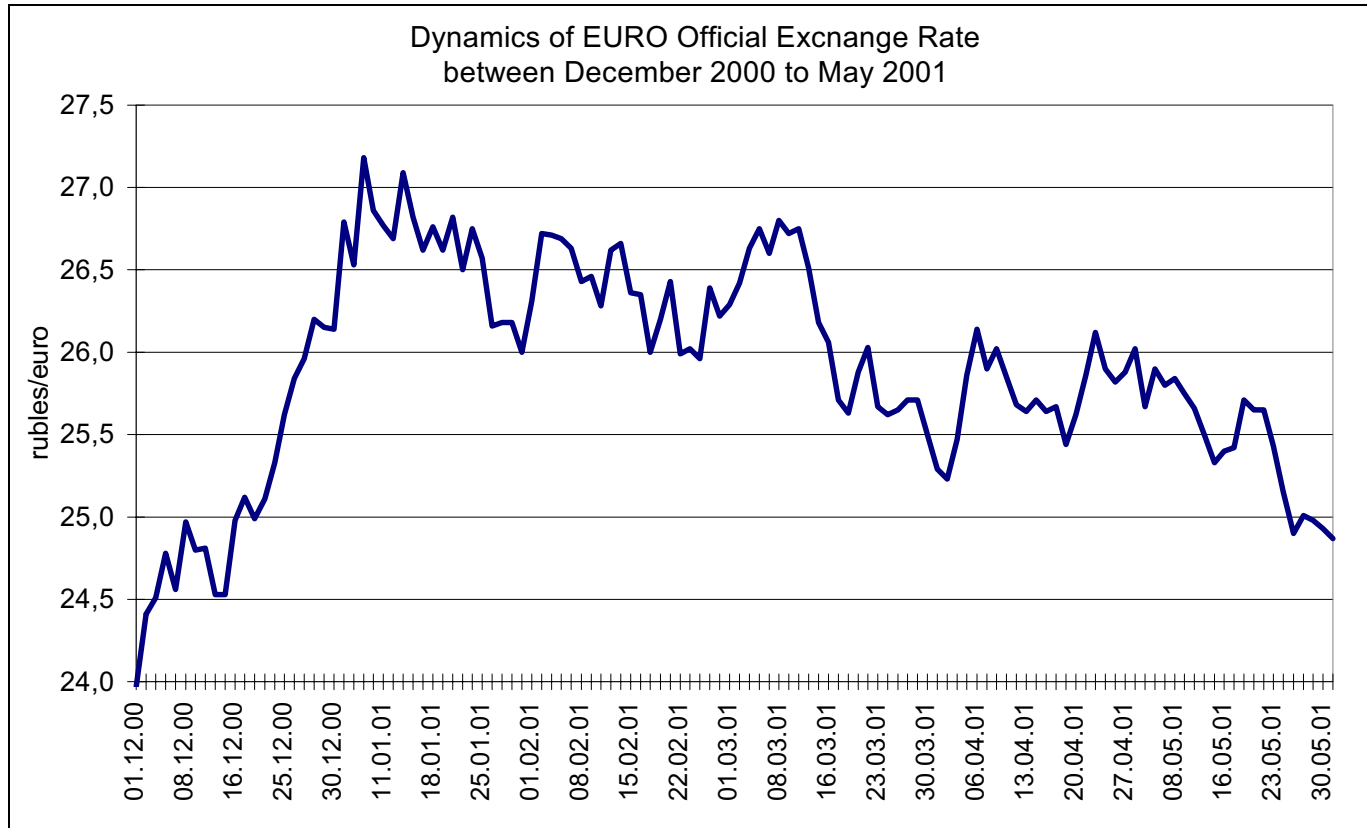


TABLE 2. INDICATORS OF FINANCIAL MARKETS.

month	January	February	March	April	May*
inflation rate (monthly)	2,8%	2,3%	1,9%	1,8%	1,6%
annualised inflation rate by the month's tendency	39,29%	31,37%	25,34%	23,87%	20,98%
the RCB refinancing rate	25%	25%	25%	25%	25%
annualized yield to maturity on OFZ issues	20,12%	19,52%	20,38%	16,33%	17%
volume of trading in the secondary GKO-OFZ market a month (billion rubles)	11,82	12,29	10,83	15,14	7
yield to maturity on Minfin bonds by the end of the month (% a year):					
4th tranche	26,55%	26,79%	25,39%	22,12%	17,7%
5th tranche	19,17%	19,70%	18,37%	17,55%	16,7%
6th tranche	18,62%	17,96%	17,58%	17,71%	16,0%
7th tranche	15,04%	15,26%	14,52%	13,83%	13,3%
8th tranche	18,72%	18,57%	17,84%	17,57%	15,7%
INSTAR – MIACR rate (annual %) on interbank loans by the end of the month:					
overnight	14,12%	54,38%	15,20%	24,50%	7%
1 week	13,84%	16,78%	11,65%	28,06%	13%
official exchange rate of ruble per US dollar by the end of the month	28,37	28,72	28,74	28,83	29,09
official exchange rate of ruble per Euro by the end of the month	26,00	26,22	25,29	25,67	24,87
average annualized exchange rate of ruble per US dollar growth	0,75%	1,23%	0,07%	0,31%	0,90%
average annualized exchange rate of ruble per euro growth	-0,54%	0,85%	-3,55%	1,50%	-3,12%
volume of trading at the stock market in the RTS for the month (millions of USD)	339,5	420,5	363,5	329,1	405,7
the value of the RTS Index by the end of the month	173,53	164,76	169,46	180,68	208,80
growth in the RTS Index (% a month)	21,10%	-5,05%	2,85%	6,62%	15,56%

* Estimates

Investment in the real sector

Between January to April 2001 the volume of investment in the real sector from all the sources of funding accounted for Rb. 334.9 mln., or at 4.0% more than in the respective period of the prior year.

It should be noted that the increment rate of investment in capital assets have slowed down since September 2000. After dome growth noted between February-March, in April 2001 investments in capital assets slid by 0.6% compared with the prior month. That can be attributed both to seasonality and a general change in the state of affairs on the investment market. The slowdown in the investment demand rate is proved by the decrease in the growth rate in the industry of construction materials and branches of the machine-building complex. The decline in the growth rates in the volume of contracting works in April testifies to an emergence of an unambiguous situation in the market for constructing services. However the volume of agreements concluded in the sector as of early May is as much as nearly twice exceeded the respective index of the prior year, which allows optimistic estimates prospects of the respective market. With the current dynamics of main macroeconomic indicators, the growth in investment in capital assets in 2001 possibly may make up 6.0% vs. 2000.

It was the basic sectors, particularly machine-building complex that formed the basis for the growth of investment activity in the 1st quarter 2001. According to the RF Ministry of Economy and Trade, between January to February the volume of the sector's output of investment nature grew by 22.9% against its respective period of the prior year, which is a substantially greater rate than the one of the output of machine-building and metal-processing sectors. However, even with such growth rates the machine-building sector cannot match the demand. The complexity of the investment situation is intensified by the economy needing an investment maneuver towards the sectors that begin to experience shortages of competitive production capacities rather than a simple growth in investment. The analysis shows that such shortages began to emerge in a whole number of sectors: the sector for chemicals and petrochemicals, the non-ferrous metallurgy and the food-processing industry. The main part of investments in capital assets are used to maintain the existing production capacities.

The projections of the 2001 federal budget in regard to funding public investment estimate the respective allocations to total Rb. 28.2 bln., including: to repay credit liability for earlier accomplished works - 4.3 bln., funding of construction and objects under the federal targeted investment program- 23.8 bln.. In the 1st quarter the Program was funded at 12.2% (Rb. 2.9 bln.) of its annual limit, while 1.1 bln. was earmarked to repay the credit liabilities for the earlier accomplished works.

Nowadays, it is the ongoing rise in tariffs for energy sources and high inflationary expectations of producers

of investment goods that are the factors affecting enterprises' investment capacity.

Another factor constraining an activation of investment activity may become the worsening situation in the world oil market. This year, it is fuel sector that experienced the investment inflow at the most - 50.3% of the total volume of investment in capital assets of large and medium-size industrial enterprises.

As concerns spare capacities allowing to raise the intensity of investment activity, one may mention a more vigorous use of borrowed capital, including banking credits, issuance of corporate obligations, and the development of leasing operations.

The capacity of the market for equipment supplied under leasing agreements finds itself at the level of a. USD 500 mln. At the same time the share of leasing in the overall volume of investment accounts for just 2-3%. To improve the situation in this area, the RF Government approved its Resolution of February 1, 2001, # 80 "On approval of the Statute on licensing financial rent (leasing) in the Russian Federation" which is aimed at simplification of procedures of obtaining licenses for the right of conducting leasing operations. The government has also developed a bill on introduction of amendments to the law "On leasing" that should harmonize its with the current legislation, and the bill on the second part of the Tax Code of RF has been submitted to the Duma. The latter provides the maintenance of a favorable tax climate in regard to leasing deals.

While analyzing the current macroeconomic environment from the perspective of its impact on development of investment activity in the short run, one should note the renewal of the growth in industrial output as a clear positive factor.

The emerging national market still retains its attractiveness for foreign investors. In the 1st quarter 2001 the volume of foreign investment in the Russian economy grew by 11.1% when compared with its respective period of the prior year and currently stands at USD 2.7 bln., of which FDI account for over 1.0 bln.

The foreign banking sector, too, shows its interest in the national economy. On May 10, the stockholders of the Mezhdunarodny Moskovsly Bank and Austria Kreditanshtalt have ruled out the merger of the two banks. As a result, the renewed MMB should become the fourth biggest Russian bank by the volume of its assets (a. USD 3 bln.). The Bank of Austria, along with Raffaisen Bank, obviously is an indisputable leader among foreign banks in terms of operations with private clients. As of early 2001, the volume of private deposits with the Bank accounted for over Rb. 1.6 bln., or at 1.4% more than the overall amount of all other Russian banks (exclusive of Sberbank), and it held the 10th line among all the operating banks.

Needless to reiterate, it is the stability in the legal area that forms an necessary precondition for the formation of a favorable investment environment for both the domestic and foreign capital.

The real sector: factors and trends

According to the Goskomstat, the results of the planned revision of its data showed substantial adjustments in regard to indices of volume, dynamics and structure of output and use of GDP over 1998 to 2000, with the most substantial changes being those in GDP indices in 1999. That matches some Russian experts' comments on inadequately low level of estimates of the GDP indicator relative to the dynamics of industrial output and the sectors in the share of services. The adjusted volume of GDP production in 1999 accounts for Rb. 4745.2 bln., with a 5.4% growth in its real volume vs. the prior period (while the previous estimated growth made up 3.5%).

According to more accurate data, in 2000 GDP accounted for Rb. 7063.4 bln. and grew by 8.3% compared to the prior year. Changes in the statistic data base indicators allowed exclusion of the effect of inaccurate initial estimates and increase in objectiveness of calculations of GDP this year.

After some decrease in GDP production rate in the IVth quarter last year and in January 2001, since February the respective reports showed the renewal of a positive dynamics. According to results of the Ist quarter, GDP growth accounted for 4.4% compared with its respective period of the prior year and for 1.4% compared with last quarter, which is somewhat down than the government's original projections made in the course of elaborating the 2001 budget.

Between January through April 2001 Russia's economic growth became possible thanks to both domestic and external demand. Despite a relatively less favorable state of affairs in the world markets for traditional Russian exports, the growth in export supplies over the first quarter 2001 accounted for 3.7% compared with its respective period of the prior year. Along with the growth in exports in the first quarter, the active foreign trade balance was declining, because of a 8% import of goods and a 15% growth in import services. The share of net export in final demand remained roughly at the level of the IVth quarter 2000 (20-21%), which is slightly lower than in the Ist quarter 2000.

In contrast to 2000, the structure of consumer demand was emerging against the background of the advanced growth in consumer demand relative to investment demand. Between January through April the volume of retail trade grew by 9.0% with a 4.0% growth in investment in capital assets. The changes in the structure of domestic final demand were emerging against the background of rising inflation. CPI made up 109.0% compared with December 2000, thus exceeding the 2001 budget projections.

During the period in question there has been an acceleration of price rise noted in different sectors, with the price rise in industrial sector accounted for 5.7%, and the price rise rates being most significant in the sectors for electric power and coal mining. With the current level

of price differentiation for electric power and fuel for boilers, the measures were undertaken to optimize price ratio for single kinds of fuel. However, the measures have not yet had any substantial impact on price level in other sectors. It should be noted that main industries-consumers of electric power continue to pursue a moderate price policy. When compared with December 2000, the producers of non-ferrous metals decreased their prices by 3.9%, while the ones of ferrous metals raised them by 0.9%. It is the sector for chemicals that reported the most intensive price rise for its produce among other mineral sectors. That can be attributed to the advanced price rise for main chemicals. Among industries of the consumer sector it was the food industry that reported the biggest price rise caused, primarily, by a change in price levels for cattle-breeding products. At the same time, it was the increase in tariffs for electric power that has also become an important factor for price rise: thus, the price rise in the milling industry accounted for 110.2% over the first quarter this year.

The most complicated situation has emerged in investment sectors- that is, machine building and the industry for construction materials. The prices for the produce of these sectors took an advanced pace and grew by 8.6% and 9.5%. The intensive price rise for investment goods and construction services is one of the factors that suppress investment process.

The rising expectations of producers, growth in the level of consumer activity, along with changes in such standard inflation guidelines for monetary policy as dynamics of Rb. exchange rate determine the emergence of a high inflation background.

Since January 2000 Goskomstat has reported an advanced rise of consumer prices relative to the prices of industrial producers. That is determined by price dynamics for specific commodity groups and is not related directly to the change of the overall macroeconomic environment. The comparative evaluation of changes in consumer prices across groups of goods shows that it was the growth in services to population and, primarily, housing and communal services, and the price rise for food stuffs that contributed at most (with the respective indices of price rise rates being 16.1%, 21.7%, and 9.4%, accordingly) to the noted phenomena. Such a high level of price rise for housing and communal service was caused by the consistent implementation of the policy aimed at liquidation of budget subsidies to the housing and communal services, on the one hand, and by intensification of differentiation and growth in regional tariffs for heating and electric power.

The change in the inflation environment has caused a substantial impact on the structure of the population's expenses. In the 1st quarter 2001 the share of the population's expenses grew up to 84.3% vs. 76.9% reported in the IVth quarter 2000. Along with some

stagnation of revenues, the ongoing gradual growth of consumer expenses has entailed the 3.4% contraction in the share of “organized” forms of savings vs. 5.0% registered over the prior period. According to results of the 1st quarter, the population invested as much as 6.2% of its monetary income in buying foreign exchange. In such a situation, the population prefers to spend their incomes thus stimulating price rise rather than to accumulate savings.

With the income growth rates slowing down, there have been substantial changes in their formation. In the 1st quarter 2001 the proportion of social transfers in the structure of the population’s income rose up to 15.9% vs. 13.4% reported over the respective period of the prior year. This can be attributed to the fulfillment of obligations related to the increase of the level of social protection of pensioners and non-able bodied part of the population. The incomes from entrepreneurial activity and property slid to 19% vs. 21.3% reported last year, while the share of labor compensations (with account of its hidden part)- to 63.4% vs. 64.2%. The contraction in the share of income of economically active part of the population is directly related to the slowdown in the economy growth rate.

The positive dynamics of industrial output noted between January to April was retained by the growth in output practically in all the sectors of the economy.

S. Tsoukhlo

IET Monthly Trend Survey: May 2001

Even with the slowdown in the growth of sales observed in May, the acceleration of the decline rate of non-monetary transactions over the month was caused by the seasonality factors. Enterprises reacted to sales problems by slowing down their output and prices. That, however, has proved to be an insufficient measure, and the surplus of the stock of finished produce renewed its growth.

The survey held in May registered a seasonal slowdown in the growth rate of sales and a higher growth rate in the volume of barter, promissory-note, and off-set sales schemes. The balances of changes in these indicators reached the level of May 2000. While the sector for electric power, forestry, wood-working and light industries retained an absolute contraction in their volume of monetary sales, the other sectors increased their sales, with the industry of construction materials and the metallurgical sectors showing the most intensive increase rate.

The growth rate in the decline in the volume of non-monetary sales happened in May regardless of the slowdown in the growth of effective demand. In the past, while experiencing a slowdown of the growth in sales (or with an absolute contraction, as it was the case between January to February 2001), the enterprises tended to constrain the reduction in barter, promissory-note and off-set schemes. That was happening over the previous 6 months in the event of barter, and 3 months- in the case of the use of promissory notes and off-sets. Meanwhile, a more large-scale contraction in barter was registered in

However, this year, with the change in the situation in the domestic market, the industry branches of the investment and consumer complexes are inferior to the output of intermediary goods in terms of their growth rate. With the growth in the volume of industrial output at 4.0% compared with the period between January to April 2000, the increment in output in investment complex made up 3.5%, while in the consumer sector- 2.8%.

With the economic growth rate slowing down and effective demand contracting, the share of the stock of finished produce in commodity resources has grown since the beginning of this year. This trend emerges against the background of some decrease of the proportion of monetary settlements and rise in barter deals.

The negative trends are related to a slowdown in the production increment rates in such export-oriented sectors as metallurgy, forestry, wood-working and paper and pulp industries, chemicals. This was caused by a relative deterioration of the external market situation as well as the intensification of shortages in regard to domestic food raw materials and primary materials for the light industry. So far the accumulated growth potential and production growth in the fuel and energy sector have compensated for the impact of negative factors on the overall situation in the industrial sector.

Overall, it is envisaged that in 2001 the GDP and industrial output growth rates should make up 4.0% vs. the prior year.

all the sectors, but the construction industry. The change in the decline rate in operations with promissory notes and off-sets is not that significant and can be attributed chiefly to a more intensive reduction of them in the ferrous metallurgy and machine building. Overall, the supplanting of non-monetary settlements with regular deals is still underway. Naturally, the intensity of such a process is not as great, as it was over the second half of 2000. Nonetheless, there is an ongoing growth in the indicator calculated on the basis of reports on the vector of changes in main kinds of demand.

Enterprises favor monetary settlements even in the conditions of excessive stock of finished produce. The reports “stock above norm” have already prevailed over estimates “below norm” for the third month running, and such a situation was reported in May by all the sectors, except the non-ferrous metallurgy. It is the ferrous metallurgy, chemicals and petrochemicals that reported especially great surplus of their stock of finished produce. Between March through May, the share of monetary sales has been 71 to 73%, or over the respective indices of the prior year. However May also showed another trend – that is, among the enterprises that estimate their stock as excessive, the share of money accounted for 76%, while among those with an insufficient stock it made up 68%.

The output growth rate demonstrate their decline for the second month running. In May, the respective balance fell by another 9 points, and an absolute decline in output

was reported by enterprises of the sector for electric power, forestry, wood-working, paper and pulp, and light industry branches, while the other sectors increased their output. The growth in producer prices has been slowing down for the fourth month running. The demand constraints, unwillingness to be involved in non-monetary settlement schemes, along with the growth in the stock of finished produce have forced enterprises to recall the possibility of using the price factor to solve their sales problems. May 2001 has showed the most moderate price rise since August 1998. Furthermore, the reports by enterprises of the non-ferrous metallurgy, chemicals, petrochemicals, and forestry complexes mostly reported a decrease in their prices: the sectoral balances became negative.

The forecasts of changes in effective demand experienced no changes in May. Since early 2001 the enterprises have retained their hopes for fairly high growth rates in sales, with just the sector for electric power envisaging an absolute contraction in monetary deals in

summer. The forecasts of barter, promissory-note and off-set deals have not changed as well and remained the most "optimistic": that is, the enterprises still envisage the slowest contraction in non-monetary transactions. The minimal growth in such transactions is envisaged only in the light industry, while other sectors mostly expect them to contract. As well, the share of enterprises ready to expand their non monetary operations to compensate for contraction in monetary sales has not changed in May: while comparing to April, that account for 20%. Meanwhile, it is forestry and the light industry in which such intents are most popular (38% and 34%, respectively).

The forecasts of changes in output deteriorated by another 5 points in May and have proved to be most pessimistic since January 1999. Nevertheless, the growth in output is envisaged by all the sectors, except the sector for electric power.

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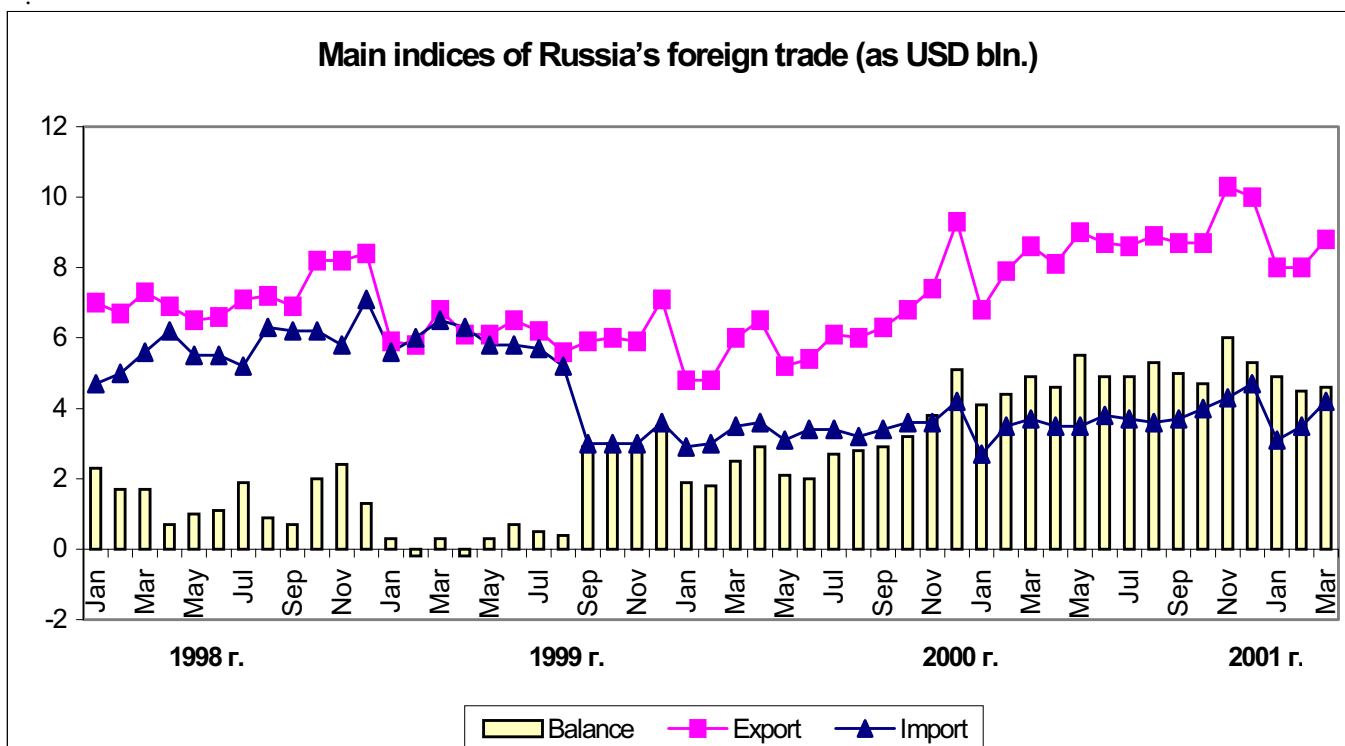
Foreign Trade

The volume of Russia's foreign trade in March 2001 accounted for USD 13 bln. That is at 0.5% more than its respective index of last year. The Russian exports fell by 5.1% relative to the respective period of last year and accounted for USD 8.8 bln. That can be attributed to the downfall in oil prices vs. March 2000. Given that between January to early February 2001 the oil prices demonstrated a steady growth and reached their maximum value (on 8 February the price for Brent was USD 30.58/barrel, while Urals prices stood at 28.83 USD), there was a change in the trend that resulted in the downfall in international oil

prices: in March 2001 the average world prices for Urals did not exceed USD 21.5 - 21.7/barrel vs. 25.7-25.9 noted in March.

Russian imports grew by 14.7% vs. March 2000 and accounted for USD 4.2 bln. Such a substantial growth in import supplies was caused primarily by the increase in business activity in the country on the background of the further strengthening of the national currency. Because of the rise in industrial output, the demand for import raw materials, machinery and equipment for far Abroad countries tended to grow.

FIGURE 1



The share of export supplies in the overall goods turnover accounted for 67.7%, while the one of import-32.3%, with the foreign trade balance accounting for USD 4.6 bln. (5.5 bln. reported in March 2000)

Despite some fall in the world prices for oil, petroleum derivatives and non-ferrous metals, the position of Russia's foreign trade is still determined by relatively favorable external conditions – the price level for Russia's

TABLE 1

The average monthly prices in March of the respective year

	1996	1997	1998	1999	2000	2001
Oil (brent), USD/t	139	139,8	94,5	99,4	195,9	185,9
Natural gas, USD/mln.m ³	-	66,8	77,5	75,7	101,0	185,7
Petrol, USD/t	215,5	230,4	166,8	188,3	333,5	318,0
Copper USD/t	2584,7	2424,8	1772	1477,1	1779,1	1780,3
Aluminum, UDS/t	1600,8	1635,5	1441,3	1251,1	1584,2	1511,2
Nickel, USD/t.	7955,7	7929,5	5380	4934,5	10269,6	6140,3

Source: calculated by the data of the London Metal Exchange and new York Mercantile Exchange

Thus, to protect the domestic leather production, the Commission consider it expedient too set the export customs duty rate for leather at the level of Euro 500/t. Such a decision is related to the situation in Europe: due to the outspread of the foot and mouth disease, the prices for leather have began to grow. However, the said rate is an "exceptional protective measure and may not be a strategic one. Until the end of the year the government intends to monitor the situation on the market and, if such a necessity arises, will address this issue once again.

The government should introduce soon 15% protective import duties on a number of Hungarian food stuffs soon. Since 1999 Hungary has been introducing various discriminative duties on Russian goods, including fertilizers, wood-working products, etc, and now the RF Government responds adequately. The noted duties will be imposed on vegetables, fruit and vegetable juice (15%, but not less than 0.07 Euro/l.), ready-made soups and bullion, and vegetable oil).

In response to the discriminative action of EU to decrease the quotas on the import of Russian steel goods, the RF government is going to introduce protective import duties on various steel articles made in EU. Thus, in particular the duties are to be imposed on rolled stainless steel plates with a width over 60 cm., some kinds of pipes, metal constructions, tanks made from ferrous metals, etc. Russia would loose as much as USD 30 mln. because of the EU decisions, and the responsive measures should compensate the losses and will be effective until the EU cancels its decision.

The protective import duties ranging between 10 up to 30% in addition to the current rate will also be imposed on natural starch. The import of starch grew several times, and, as a result, the RF Government decided to introduce an 30% additional special duty rate for potato starch (but not less than 0.11 Euro/kg) and for corn starch – 10%(but not less than 0.04 Euro/kg) effective for three years. The said duties are to be collected in addition to the current 10% rate. The duties should be of no effect with respect

major exports remains relatively high. As well, the prices for natural gas remain high: march 2001 showed the European average gas prices being roughly as much as twice higher that in March 2000.

In May, the government Commission for protective measures in the area of foreign trade has made a number of decisions as to the support and protection of domestic producers.

to the starch imported from the countries- members of the Customs Union.

The amount of export duties for gas will be raised from 5 to 10%, because from the moment of introduction of the 5% duty rate in January 2000 the prices for natural fuel grew from USD 72 to 130/cub.m.).

In compliance with the federal law "On measures on protection of economic interests of the Russian Federation in the course of foreign trade with goods". The RF government introduces a special duty on ferrous metal pipes of Ukrainian origin imported to the customs territory of RF, which is to be effective for 3 years. According to the respective document, the customs duty is set at the level of 40% of the customs value of pipes, hollow and seamless profiles and tubes made from ferrous metals, other pipes and tubes with a round profile whose external diameter is over 406.4 mm., made from ferrous metals, as well as other hollow pipes, tubes and profiles made from ferrous metals.

The duty rate should make up 20% of the customs value of submerged arc-welded straight-seamed steel pipes for oil and gas pipelines, whose external diameter is 1,420 mm. It is stipulated in the Resolution that the special rate should also be collected with respect to ferrous metal pipes originated from Ukraine and imported to Russia via Belarus.

In response to the noted measures, Ukraine is to commence an investigation on the dumping related to Russian supplies of petroleum derivatives.

The Ukrainian structure of import petroleum derivatives in 2001 is as follows: gasoline- 41%, diesel fuel-51%, and black oil-4%.

Russia's share in gasoline supplies grew from 14 to 22% over 2000, while the share of diesel fuel accounted for 46%, and these indices continue to grow.

In the 1st quarter 2001 the volume of Russia's oil exports to the Near Abroad countries fell by 10.4% (to 0.8 mln.t.) The amount of supplies made up USD 0.8 bln., with the average contract price of USD 249.4/t. However, despite

of this, the increment in the import of single kinds of petroleum derivatives to Ukraine accounted for over 10% in 2001.

Since January 2001 the Ukrainian importers have been granted with special benefits. That was made for the purpose of raising the fuel supplies for the needs of the country's agrarian sector. In addition, in compliance with the new Tax Code of RF, since July 1, 2001 petroleum derivatives exports from Russia will become subject to

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Change in positions of the banks with 100% foreign capital on the Russian market for banking services.

In May 2001, there was an announcement of the largest merger in the Russian banking history. The both participants in the merger - Moscovsky Mezhdunarodny Bank (ranking 5th by the amount of its assets, as of March 1, 2001) and Bank Austria (the 36th position) - are among the banks that are controlled by foreign capital. As well, the CBR and the Government expressed their intent to elaborate by late September "measures facilitating expansion of operations of the banks with foreign participation"¹ The above allows a pretext to center in a greater detail on the change in positions of the banks with 100% foreign capital in the national market for banking services compared with the period prior to August 1998.

From the perspective of the number of banks with foreign investment, there is a notable trend to consolidation of foreign stockholders' stakes. Given that as of August 1, 1998 there were 137 banks with foreign capital operating in the domestic market, by March 1, 2001 their number slid to 116. However, at the same time among the group of survivors there was a growth in the number of banks with the share of foreign capital accounting for 50% and more (from 30 to 37 banks), and in the number of banks with the foreign capital participation close to 100% (from 19 to 27 banks²). The latter group appears to be of a special interest to us. Its composition expanded both thanks to 5 banks that obtained their licenses from CBR after August 1998 and due to the growth in the share of foreign participants (as it occurred in the Pervy Czesky Bank, Yapy-Credibank or Russko-Turetsky Bank). However the overall share of assets of this group of banks in the assets of the national banking system on the whole has not experienced any substantial changes. As of August 1, 1998 their proportion in the assets roughly accounted for 5%, while as of March 1, 2001- 6%. Considering another 10 banks whose capitals comprise the non-resident's share of 50% and more, the noted index should rise up to 10%³.

The crisis has had an ambiguous impact on positions of the banks with 100% foreign capital. On the one hand,

zero tax rate, while VAT and excises will be retained for oil exports.

Russian biggest oil producers and specifically Lukoil have their oil refineries in Russia, and under new conditions it would be more profitable to them to supply petroleum derivatives to Ukraine rather than to import and refine oil, which would undermine Ukrainian producers' position. Hence, the problem of creating a flexible petroleum derivatives import quotas system should become the hottest issue for the Ukrainian oil market.

due to the nature of their operations, they have proved to be especially sensitive both to the government's freezing of its obligations in regard to servicing GKO and OFZ, and to Ruble devaluation. On the eve of the crisis, the proportion of the banks with 100% foreign capital in the overall amount of all foreign banking capital attracted by Russian banks accounted for 30%, while in the Russian banks' aggregate balance sheet obligations made up over two-thirds of liabilities. Notably, the Russian banks' assets comprised a 30% proportion of Rub.-denominated national government bonds. The aforementioned group of banks with 100% foreign capital was operating very efficiently compared with their Russian "colleagues": their share in the aggregate profit earned in the domestic market over first 7 months 1998 accounted for 27%. However, currency risks⁴ undertaken by this group roughly was as much as twice over their overall balance sheet capital. The inevitable losses bore in the wake of the 1998 crisis rather promptly resulted in negative capital of some banks. A sharp contraction in the volume of stock market, the operations on which were the profile of the biggest banks of the group, entailed their withdrawal of a significant part of their assets from the country. Against the backdrop of the overall growth of assets of the Russian banking system placed abroad (from USD 12 to 20 bln.), the share of the banks with 100% foreign participation in the overall amount of foreign assets grew from 3.4% as of August 1, 1998 to 14% by the end of the 3rd quarter 2000 (see Fig.1), while considering the group of banks with the foreign capital participation of 50% and more, their aggregate proportion accounted for 27% of all the assets placed by Russian banks abroad.

¹

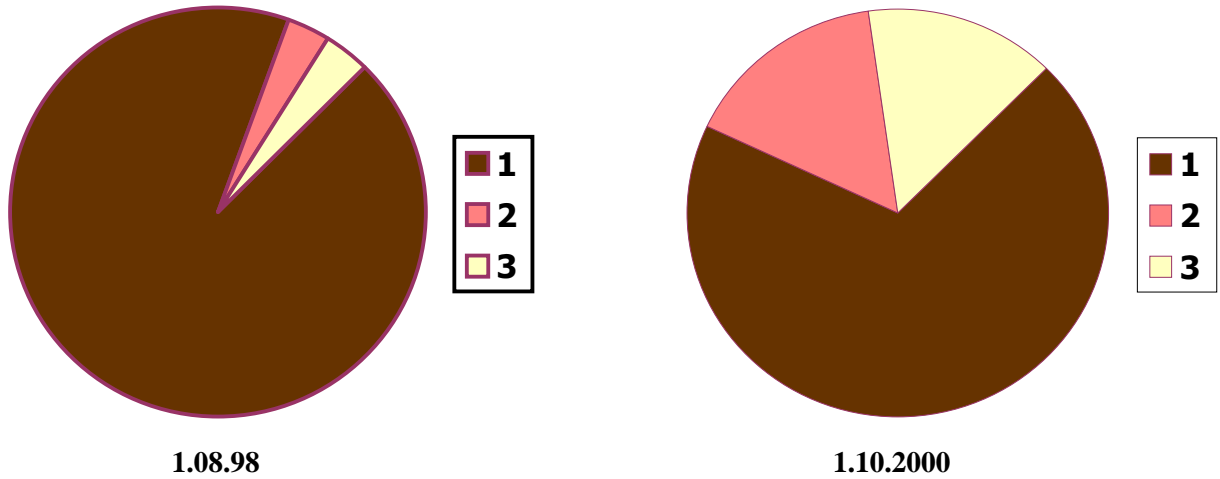
The Statement of the RF Government and the Central Bank of RF on economic policy in 2001 and some aspects of the medium-term strategy

² At this point and henceforward, it is the banks with the share of non-residents' capital over 98% that form the group in question

³ The overall amount of assets of the national banking system does not include assets of the banks run by ARCO, as well as Vneshekonombank, and banks with their licenses revoked

⁴ The difference between assets and liabilities denominated in foreign exchange; off-balance positions are not accounted for.

FIG.1 FOREIGN ASSETS OF RUSSIAN BANKS



1- the share of Moscow banks, Sberbank inclusive
 2- the share of regional banks
 3- the share of banks with 100% foreign capital
 Calculated using the date of STiIK company

FIG.2. PROFIT ERANED BY RUSSIAN BANKS IN 2000 (EXCLUSIVE BANKS RUN BY ARCO).



1 - доля Сбербанка
 2 - доля столичных банков, включая Сбербанк
 3 - доля региональных банков
 4 - доля банков со 100%-ным иностранным капиталом
 Рассчитано по данным фирмы СТИИК

Government reforms> step by step. May 2001

Background.

In December 1999 the Chairman of the RF Government Mr. V. Putin initiated an establishment of the Center for Strategic Elaborations. The Center should have gotten together the cream of the Russian intellectual elite to develop the first in the post-reform Russian history long-term program. The mission was over by June 2000, and, somewhat amended and reduced, it was approved as Main Guidelines for the Socio-Economic Policy of the RF Government for the Long-Term Perspective. While covering the whole period of 10 years, the Strategy mostly focused on priority measures. That is why the natural idea appeared to single out the latter as a separate document which should comprise the references to concrete legislative acts, the term of their accomplishment, as well as the list of those who would be involved into this mission. As a result, on 26 July 2000 the Government passed its Resolution # 1072-p with which it approved

the Action Plan of the RF Government in the Area of Social Policy and Economy Modernization for 2000-2001. The Plan comprises 119 points that contain specific measures on implementation of provisions of Main Guidelines between 2000-2001. It was planned to implement 65 measures over 2000, which required passing 72 legislative acts.

General comments on implementation of the Plan.

It was the term of the submission of a document to the Government that was made an indicator of the accomplishment of the respective measure; that has both positive and negative features. On the one hand, such a criterion provides the parties concerned (federal executive power authorities) with concrete term for their elaboration of the respective statutes, while on the other, as the evaluation of the implementation of the Action Plan in 2000 showed, once submitted to the Government, the

implementation of the measure is still far from its end. Usually such a submission entails a long-lasting conciliatory procedure, the return of the document for its “refining”, introduction of amendments, and a new conciliatory process. It usually takes at least two months or even more (depending on the time allotted for “refining” and the number of comments on the document) between its submission to the Government and its final passing or submission to the State Duma. Thus, the real date since which the respective measures become effective is procrasted minimum for 2 months, and maximum for a half of year (taking into account the process of the passing of the document through the Duma), or even more. Naturally, though such a procedure of statutes development partly facilitates the elimination of a conflict of interests between various agencies and lobbyist groups, however, from the perspective of the envisaged effect of

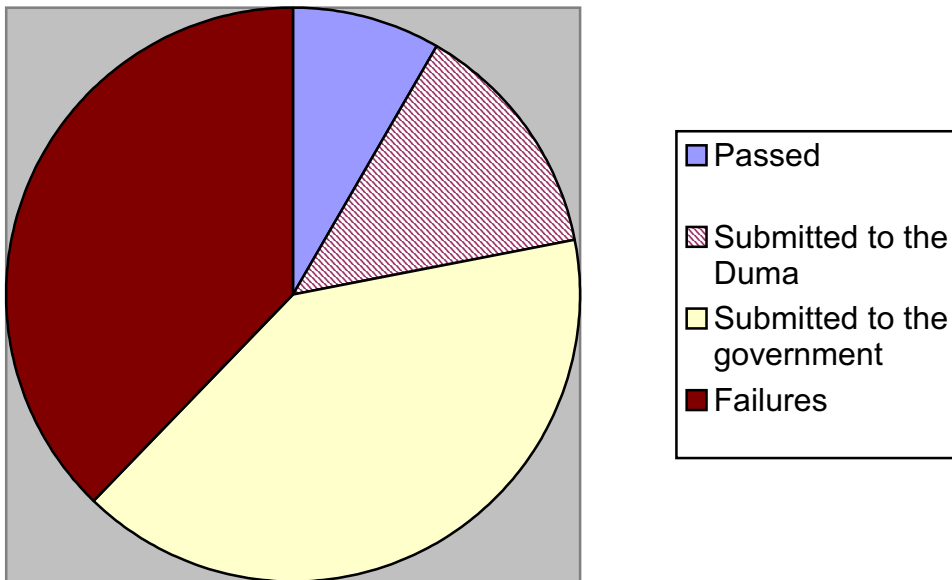
the measures proposed the quality of the final documents often prove to worsen rather than to improve: a great number of researvations, exceptions for the sphere of the law’s effect arise - what is known in politology as “the lard barrel”. With a great volume of organizational work of ministries and agencies, the output is relatively low: of the formally implemented issues under the Action Plan just a minor part was effectively accomplished (see the Chart), however, a creatin progres has been there over last months.

Generat Statistics

It was envisaged 119 measures (154 statutes under the action Plan)

As of May 8, 2001: Passed: 13 statutes

Submitted to the State Duma: 21 bill



Submitted to the Government: 62 draft statutes

Between March to May 2001, the Government demonstrated a serious progress in regard to carrying out the measures under the Action Plan both in the sphere of social policy and in the area of the economy modernization.

There has been a significant progress in terms of elimination of the excessive government involvement in the economy. It took over one year to implement the measures elaborated by the Center. Should the Duma pass the legislative package on debureacratization submitted by the Government in March, entrepreneurs should have an additional strong incentive to develop their businesses. It is envisaged in the package of bills to cut down the number of regulating agencies, the number and periodicity of inspections. The “Single window” procedure is to be introduced for registration of legal entities. One of the major components of the package is the list of amendments

to the licensing law that provides a contraction of the licensed activities, regulation ad simplification of the unified licensing procedure throughout Russia. As well, the package contains a number of legislative innovations, which are envisaged to encourage the entrepreneurial initiative by eliminating administrative barriers by the enter to the market and stimulate carrying out entrepreneurial activities along with an adequate increase in amenability for illegal operations.

On March 15 the Government submitted a bill that suggested amending the current privatization law and focused on improving the procedure of the transformation of unitary enterprises into joint-stock companies whose 100% stake should be owned by the government. If passed, the law should have a favorable impact on business climate in the country. Such a transformation of unitary enterprises should enable them to be real economic agents, while the government would exercise an efficient control over the state property.

Considering the area of education among major factors that determine the future competitiveness of the national economy, the government has undertaken an important step in this sphere: that is, the decision was made to launch an experiment on a new structure and contents of secondary education. The current system of education does not allow having school graduates to be duly prepared for new socio-economic realities, and it does not pay enough attention to the problems related to pupils' socialization, his natural entering the modern informatization world with the emerging market economy.

According to the medium-term Government program, it is economic infrastructure as a sector that mostly determines the efficiency of the whole economic system's functioning that forms a priority area for public investment. To improve this area, yet in 2000-2001 a number of measures were planned the implementation of which currently is underway.

On March 31 the Government submitted to the State Duma a number of amendments to the civil law: thus, they provide in particular a simplified order of seizure upon mortgaged property, including real estate, formation of favorable conditions for banks issuing syndicated credits. Important amendments are the provision of banks with a possibility to adjourn a deposit withdrawal prior to the expiration of the term stipulated in the respective contract, should there be a direct reference to this possibility in said contract. As well, it is envisaged to eliminate a strict ratio between the volume of obligations issued by banks and their capital. Such amendments undoubtedly should help rise the banking system's capitalization, reliability and competitiveness, and they should allow banks to form their credit portfolios in a more efficient fashion. The increase in the "quality" of the banking system should have a positive effect on the quality of the financial mediation system and lift obstacles on the way of the inter-sectoral capital flows. As concerns prevention of legalization of illegally earned monies, the respective amendment proposes regulation amendments for "dubious" currency operations and adoption of a number of other measures provided by the respective federal government bills submitted to the Duma on April 24.

During the period in question, key decisions were made in regard to reforming natural infrastructure monopolies - the gas sector, the sector for electric power, and railway transportation. The Government discussed the concept of development of the gas market (the draft Resolution "On approval of the Concept (Guidelines) for the functioning and development of the gas market was submitted to the Government on April 26), while on May 3 the Government approved with its Resolution the set of measures on ensuring a non-discriminative access to gas transportation

systems.

There will be no exaggeration to argue that on May 18 there was made a historical step in the sphere of railway transportation reform: the Government approved its Resolution "On the program of structural reform on the railway transport". In its essence, that is the first step towards a radical enhancement of the efficiency of railway transportation, development of competition in the market for railway transportation, enhancement of transparency of operations of the remaining natural monopoly for the eyes of the government regulating agencies.

Another step with longer-term prospects the Government made by approving at its meeting on May 19 the Draft Guidelines for reforming the sector for electric power. The document identifies the government's priorities in the area of the sector restructuring, stages of implementation of organizational measures on development and functioning of the market for electric power, development of competition in the sector, increase of its efficiency and attractiveness.

In contrast to the above, the Government has not proved to be that radical in the area of telecom infrastructure, though its Resolution of March 11 "On introduction of a separate account of operators for revenue and expenditure by types of communication services" became a serious progress in regard to enhancement of telecom operators' financial transparency.

When compared with its progress in the area of the economy modernization, the Government has not been so vigorous in the social policy area, though over the period between March to May 2001 there have been some serious successes.

As long as the enhancement of the efficiency and transparency of arrangements related to the provision of social support and intensification of its targeted nature, the government agencies undertook some measures to transfer natural benefits and payments set for certain categories of civil servants, military personnel and interior stuff into the form of labor compensation and monetary allowances: the respective bill was submitted to the Duma on 12 April. The Duma passed in the first reading the bill "On amending Art. 16 of the federal law "On government subsidies to citizens with children" that provided a change in the principles and sources of financing of the regular monthly child subsidy for families with children that have the respective right for that.

On March 30 the draft Housing Code of RF was submitted to the Government. If passed, it should become a fundamental document in the area of protection of citizens' housing rights: for property, rent, lease, social employment. Its significance can hardly be overestimated, since the document lays the grounds for the emergence and development of the civilized market for real estate. That should become a crucial factor for the establishment of stable and clear rules of the game in the market, growth of the volume of house building, which should ensure mobility of working force.