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The State of the Federal Budget

In the first seven months of 2003, the revenues of the state budget (cash execution) made 20.4 per cent of GDP, while expenditures made 17.4 per cent of GDP (see Table 1). Therefore, the federal budget surplus made 3.0 per cent of GDP.

Table 1

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

	VII'02	VIII'02	IX'02	X'02	XI'02	XII'02	I'03	II'03	III'03	IV'03	V'03	VI'03	VII'03	VIII'03
Revenues														
Corporate profit tax	1.7%	1.7%	1.6%	1.7%	1.6%	1.6%	1.2%	1.1%	1.4%	1.5%	1.4%	1.4%	1.4%	
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	3.5%	3.3%	3.2%	3.1%	3.1%	3.1%	2.4%	2.7%	2.8%	2.9%	2.9%	2.8%	2.8%	
Tax on foreign trade and foreign trade operations	9.2%	9.1%	9.0%	8.9%	8.9%	8.9%	11.2%	10.1%	9.9%	9.6%	9.6%	9.2%	9.1%	
Other taxes, duties and payments	7.0%	7.0%	6.9%	6.9%	6.9%	6.9%	8.5%	7.4%	7.2%	7.2%	7.2%	6.9%	6.9%	
Total- taxes and charges	2.2%	2.1%	2.0%	2.0%	1.9%	2.0%	2.7%	2.7%	2.6%	2.4%	2.3%	2.2%	2.2%	
Non- tax revenues	2.9%	2.8%	2.8%	2.8%	2.9%	3.0%	3.4%	3.4%	3.4%	3.5%	3.5%	3.4%	3.4%	
Revenues, total	2.0%	2.0%	2.0%	2.1%	2.1%	2.1%	0.5%	1.7%	2.0%	2.2%	2.1%	2.0%	2.0%	
Expenditure	19.3%	18.9%	18.5%	18.6%	18.5%	18.6%	18.8%	19.0%	19.4%	19.6%	19.4%	18.8%	18.7%	
Public administration	1.4%	1.4%	1.4%	1.5%	1.4%	1.4%	17.5%	8.5%	1.3%	1.2%	1.7%	1.6%	1.5%	
National defense	20.7%	20.4%	20.0%	20.2%	20.1%	20.1%	20.8%	20.6%	20.9%	21.0%	21.3%	20.6%	20.4%	20.0%
International activities														
Judicial power	0.4%	0.4%	0.4%	0.4%	0.4%	0.5%	0.3%	0.3%	0.4%	0.4%	0.4%	0.4%	0.4%	
Law enforcement and security activities	2.5%	2.5%	2.4%	2.4%	2.5%	2.7%	1.5%	2.1%	2.6%	2.7%	2.7%	2.6%	2.6%	
Fundamental research	0.4%	0.3%	0.3%	0.3%	0.3%	0.3%	-0.3%	0.0%	0.2%	0.2%	0.3%	0.2%	0.2%	
Services provided for the national economy	0.1%	0.1%	0.1%	0.2%	0.2%	0.2%	0.1%	0.1%	0.1%	0.2%	0.2%	0.2%	0.2%	
Social services	1.3%	1.4%	1.4%	1.4%	1.5%	1.7%	1.1%	1.4%	1.7%	1.7%	1.7%	1.8%	1.7%	
Servicing of public debt	0.2%	0.2%	0.2%	0.2%	0.3%	0.3%	0.1%	0.2%	0.2%	0.2%	0.3%	0.3%	0.3%	
Other expenditure	0.8%	0.8%	0.8%	1.3%	1.3%	1.5%	0.2%	0.4%	0.5%	0.6%	0.7%	0.8%	0.8%	
Expenditure, total	5.1%	5.1%	4.9%	5.5%	5.6%	5.6%	1.5%	1.8%	2.0%	2.3%	2.2%	2.2%	2.2%	
Loans, redemption exclusive	2.2%	2.4%	2.4%	2.2%	2.0%	2.0%	1.7%	2.9%	3.0%	2.3%	2.1%	2.0%	1.8%	
Expenditure and loans, redemption exclusive	4.0%	3.9%	3.8%	3.9%	3.9%	3.8%	6.6%	7.1%	7.0%	7.0%	7.1%	7.1%	7.1%	
Budget deficit (-)	17.1%	17.1%	16.9%	17.8%	18.0%	18.7%	12.7%	16.4%	17.7%	17.7%	17.7%	17.5%	17.4%	17.5%
Domestic financing	3.6%	3.3%	3.1%	2.4%	2.1%	1.4%	8.1%	4.2%	3.2%	3.3%	3.6%	3.0%	3.0%	2.5%
Other taxes, duties and payments	-1.8%	-1.3%	-1.2%	-0.5%	-0.2%	0.6%	-6.6%	-1.7%	-1.0%	-1.0%	-0.5%	0.3%	0.0%	0.4%
Total- taxes and charges	-1.9%	-1.9%	-1.9%	-1.9%	-1.9%	-2.0%	-1.4%	-2.5%	-2.2%	-2.3%	-3.1%	-3.3%	-3.0%	-2.9%
Non- tax revenues	-3.6%	-3.3%	-3.1%	-2.4%	-2.1%	-1.4%	-8.1%	-4.2%	-3.2%	-3.3%	-3.6%	-3.0%	-3.0%	-2.5%

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

As compared with the figures registered in January through July of 2002, the budget revenues decreased by 0.3 p. p. of GDP in January through July of 2003, while expenditures increased by 0.3 p. p. and budget surplus respectively decreased by 0.6 p. p. of GDP. At the same time, without SST the budgetary revenues increased by 0.4 p. p. of GDP and made 17.6 per cent of GDP.

VAT accounted for the major share of federal tax revenues – 33.8 per cent 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 20.0 per cent of GDP in January through August of 2003, what is by 0.4 p. p of GDP below the respective level observed in January through August of 2002. At the same time the cash execution of expenditures made 17.5 per cent of GDP (17.1 % of GDP in 2002); therefore, the surplus made 2.5 per cent of GDP (3.3 per cent 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 August of 2003 made 18.6 per cent of GDP (see Table

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).

2), while on August 1 of 2002 this indicator was at 19.2 per cent of GDP. As a result, as the amount of aggregate revenues decreased by 0.2 per cent of GDP (in January through July of 2003 the level of revenues made 20.0 per cent of GDP) the surplus of the federal budget in terms of fulfilled funding in the first eight months of 2003 has also increased by 0.4 p. p. in comparison with the figures registered in the respective period of 2002 and made 1.4 per cent of GDP.

Table 2

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

	VII'02	VIII'02	IX'02	XII'02	I'03	II'03	III'03	IV'03	V'03	VI'03	VII'03	VIII'03
Total	20.0%	20.2%	20.1%	20.1%	20.8%	20.5%	20.9%	21.0%	21.3%	20.5%	20.4%	20.0%
Public administration	0.5%	0.5%	0.6%	0.5%	0.5%	0.6%	0.6%	0.6%	0.6%	0.5%	0.5%	0.5%
National defense	2.6%	2.7%	2.9%	2.6%	2.5%	3.1%	3.3%	3.2%	3.1%	3.0%	2.9%	2.8%
International activities	0.3%	0.3%	0.3%	0.3%	-0.2%	0.1%	0.1%	0.3%	0.3%	0.3%	0.3%	0.2%
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%	1.7%	1.8%	1.7%	1.9%	2.2%	2.3%	2.2%	2.2%	2.0%	2.0%	1.9%
Fundamental research	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Services provided for the national economy	1.0%	1.5%	1.5%	1.5%	0.6%	0.8%	0.9%	0.9%	1.0%	1.0%	1.0%	1.0%
Social services	5.2%	5.7%	5.8%	5.7%	2.5%	2.7%	2.7%	2.9%	2.7%	2.6%	2.5%	2.4%
Servicing of public debt	2.4%	2.2%	2.0%	2.0%	1.7%	2.9%	3.0%	2.3%	2.1%	2.0%	1.9%	2.0%
Other expenditure	3.9%	3.9%	4.0%	3.8%	6.8%	7.5%	7.3%	7.3%	7.4%	7.3%	7.3%	7.2%
Total expenditure	18.2%	19.2%	19.4%	18.7%	16.8%	20.5%	20.8%	20.2%	19.9%	19.2%	18.8%	18.6%
Профицит (+) / дефицит (-)	1.8%	1.0%	0.7%	1.4%	4.0%	0.1%	0.1%	0.8%	1.3%	1.3%	1.6%	1.3%

According to the estimates of the Revenue Ministry, in August of 2003 tax revenues of the federal budget made Rb. 104.6 billion (without the single social tax). In real terms the revenues made 242.4 per cent of the level registered in January of 1999, while the respective indicator was at 246.5 per cent in 2002 and 235.6 per cent in 2001 (see Table 3).

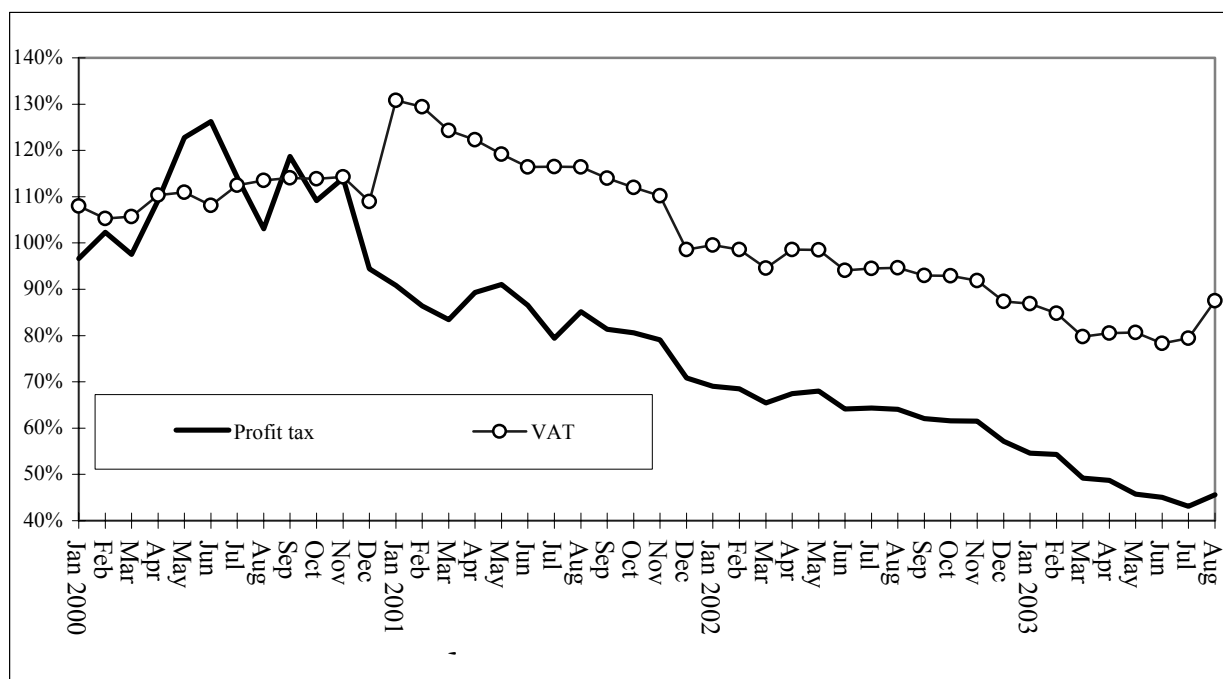
Table 3

**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	III	IV	V	VI	VII	VIII				
230,0%	229,2%	265,5%	280,4%	233,2%	240,0%	260,4%	242,6%				

* 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.

Figure 1.**Real tax arrears to the federal budget (in % to July 1999)**

The dynamics of real arrears relating to major debts since January of 2000 is presented in Fig. 1. The debts related to the payments due to the federal budget made for VAT Rb. 252.0 billion as on September 1, 2003, increasing by almost Rub. 13.7 billion in August of 2003, what in real terms corresponds to the level of indebtedness registered on January 1, 2003, while the arrears of the profit tax increased by practically Rb. 0.4 billion and made about Rb. 28.1 billion. On the whole, the dynamics observed over the last 2 years still demonstrate a gradual decrease in the level of accumulated arrears as concerns not only the profit tax, but VAT as well.

*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	II	III	IV	V	VI	VII					
Taxes	25,6%	24,4%	25,6%	27,4%	27,1%	26,0%	26,1%					
Revenues	32,0%	30,3%	31,5%	33,4%	33,6%	32,2%	32,2%					
Expenditures	20,7%	25,3%	27,7%	28,8%	28,8%	28,6%	28,7%					
Deficit	11,3%	5,0%	3,8%	4,5%	4,7%	3,5%	3,6%					

* Без учета ECH

The revenues of the consolidated budget in July of 2003 made 32.2 per cent of GDP, including tax revenues (without SST) at 26.1 per cent of GDP (see Table 4). Expenditures of the consolidated budget decreased by 0.1 p. p. in comparison with the figures registered in June of 2002 and made 28.7 per cent of GDP. As on September 1, 2003, the surplus of the consolidated budget made 3.6 per cent of GDP, what is by 0.6 p. p. of GDP below the level observed in the respective period of 2002.

S. Batkibekov

Monetary Policy

According to the RF State Committee for Statistics, in August, for the first time since September, 1997, deflation was observed in the consumer market. As at the end of the month its indicator reached -0.4 percent. In August – first half of September foreign reserves of the Central Bank and, at the same time, the monetary base grew. At the end of last month the Bank of Russia actively engaged in direct repo operations.

The CPI value amounted to 99.6 percent in August (year to month: 108.3 percent). A reduction in consumer prices for goods and services was marked in 48 constituent entities of the Russian Federation. In Moscow the CPI did not exceed 99.0 percent (ytm: 108.1 percent), in St. Petersburg, 98.5 percent (ytm: 108.3 percent). The Base Consumer Price Index (BCPI), which leaves out of account short-term irregular price fluctuations caused by various factors of administrative, occasional or seasonal nature, reached 100.7 percent in August (ytm: 106.2% percent).

The seasonal drop of foodstuff prices (-1.4 percent) was the most important factor affecting the price reduction, chiefly owing to fruit and vegetables. Tariffs on services to the population also grew slower: 0.7 percent as opposed to 1.9 in July of the current year. Prices for non-foods rose 0.6 percent, which corresponds to the July level.

The factors that were conducive to the inflation rate reduction also include a slower growth of the monetary base caused by a sag in the excessive offer of foreign currency, which made the Central Bank issue more Roubles to contain the nominal strengthening of the Rouble.

According to preliminary data, in the first nine months of 2003 the estimated inflation in the RF is approximately 8.5 to 8.7 percent. Hence, in order to meet the forecast for the year (12 percent), inflation in the remaining time should not exceed 1 percent per month. It should be noted in this connection that the basic inflation, i.e. the inflation that depends on monetary factors, has consistently kept approximately in the 0.8 to 0.9 percent range in the past months.

In August, 2003, foreign reserves went down 2.6 percent, from US\$ 64.4 billion to US\$ 62.7 billion. In September this tendency continued: in the first half of the month the reserves diminished 0.6 percent more, primarily owing to the Central Bank's operations on the smoothing of the US Dollar rate fluctuations at the MICEX and external debt payments. However, the Bank of Russia intends to boost them by year-end to US\$ 65 billion. Despite the decrease in foreign reserves, in August the monetary base in narrow terms grew from RUR 1159.7 to RUR 1183.5 billion (+2,1%) (See Fig. 2). During the first two weeks of September the monetary base expanded 1.3 percent more.

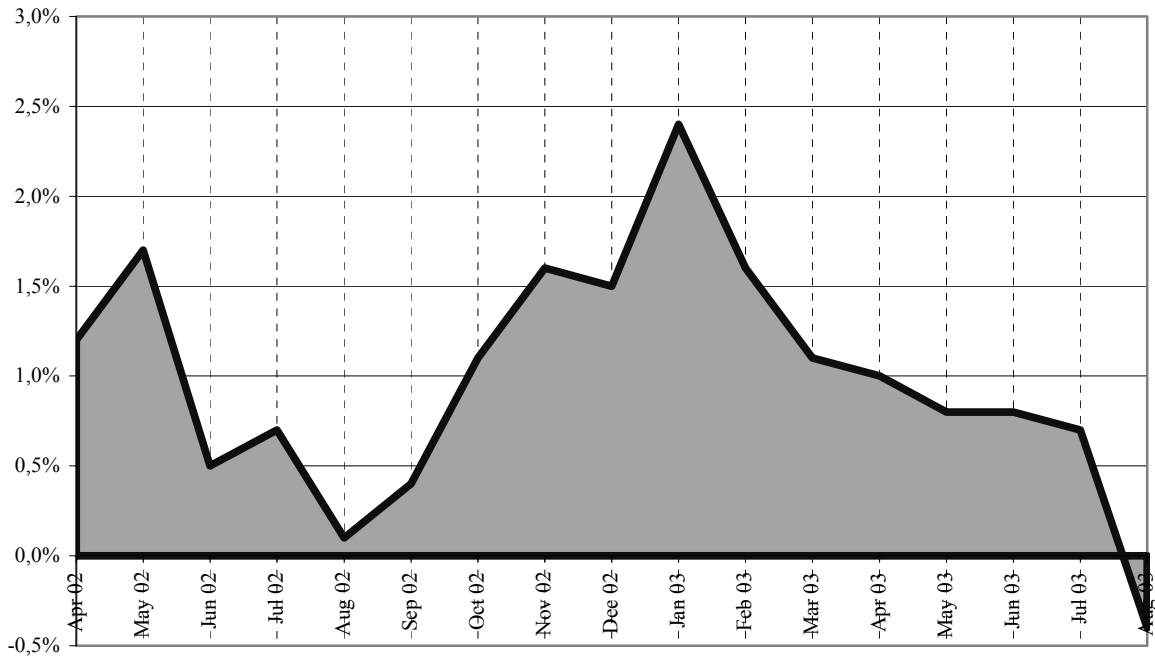


Fig. 1. CPI Growth Rate in 2002 – 2003 (% per month).

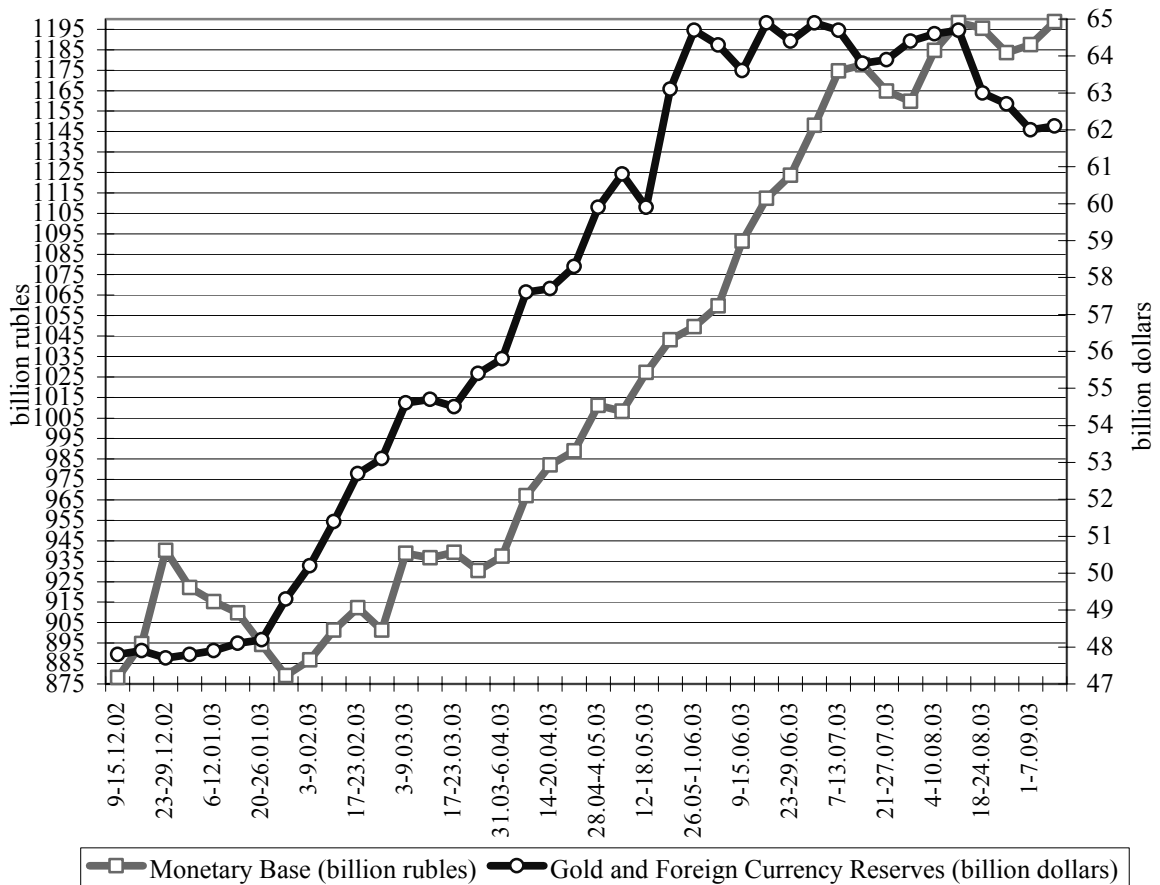


Fig. 2. Dynamics of the Monetary Base (in narrow terms) and foreign reserves of the RF in late 2002 – 2003.

The RF monetary base in broad terms⁴ diminished in August 0.66 percent, from RUR 1,511 billion to RUR 1,501 billion on 1 September (the main reason is the reduction in the funds of commercial banks in correspondent accounts with the Central Bank). In the said amount cash in circulation grew over the month from RUR 992.0 billion to RUR 1020.6 billion, or 2.88 percent. The funds of credit institutions in their correspondent accounts at the Central Bank totaled RUR 130.4 billion on 1 September as opposed to RUR 144.0 billion in early August (-9.44 percent).

In September Russian external debt payments reached approximately US\$ 1.024 billion, including US\$ 354.467 million paid as debt redemption and US\$ 669,32 million as debt servicing. Official creditor countries, banks and companies received US\$ 128.566 million as debt redemption and US\$ 47.631 as debt servicing. US\$ 600.362 million were allocated for Eurobond coupon payments in September.

According to the draft federal budget submitted to the Duma by the RF Government, in 2004 the RF Ministry of Finance plans to convert its obligations before the RF Central Bank totaling up to RUR 70 billion into Minfin bonds. The conversion will be carried out in co-operation with the Central Bank in order to implement the uniform governmental monetary policy, under observation of the existing payment schedule with year-by-year breakdown. It should be noted that in 2003 the RF Minfin converted RUR 300 billion worth of bonds from the CB RF portfolio. Besides, the 2004 draft budget permits the RF Government to assign RUR 15.9 billion from the financial reserve for early repayment of Minfin bonds issued in exchange for Vneshtorgbank shares.

Under the program for state external borrowings of the RF for 2004, Russia is planning to place eurobonds worth up to US\$ 3 billion next year. Bond terms are from 5 to 30 years. Furthermore, it is planned to carry out targeted foreign borrowings worth US\$ 612 million next year. Taking into account various indirect expenses, the average cost of borrowing these resources is higher than that of eurobonds, amounting cca. 9 percent for tied loans and up to 11 percent for the loans of international financial institutions. In 2004, out of US\$ 8.9 billion of the total principal amount of the external debt subject to repayment, around US\$ 5 billion worth of redemption payments will be refinanced out of internal sources. It is proposed to refinance the remaining redemption payments by placing financial loans in foreign currency.

In late August, against a background of growing interbank deposit rates caused by tax payments and a relative increase in demand for foreign currency, the Bank of Russia actively carried out direct repo operations. Total funds granted are RUR 39.4 billion, extended at the weighted average rate of 6.62 percent. In addition to granting short-term resourced under direct repo transactions, liquidity deficit in the banking sector was also abated by cutting the inflow of credit institutions' fund to deposits with the Bank of Russia. In August 2003 average daily balances in deposit accounts fell by 28 percent in comparison to the previous month.

P. Trounin.

On classified expenditures of the 2004 Federal Budget

In the course of discussion on the draft federal law "On the Federal Budget for year 2004," the Russian Parliament and public recurred to the issue of the degree to which our budget is transparent and what are the potentialities of extra-departmental control over governmental expenditures.

The classifying of certain budgetary items is objectively justified. The only problem here is the reasonable degree of such classifying.

There are also other forms of classified expenditures in the presented draft budget. For instance:

- the use of such a category as "Other expenditures" in the budget structure does not permit to form a notion about the exact nature of these expenditures,
- numerous and differently formulated categories of expenditures related to financing of research and development projects (by the way, each having its own budget classification code) make it more difficult to estimate the total amount of budget expenditures relating to this category.

Below there are discussed the results of the analysis of the structure of classified expenditure items as broken by responsible agencies, assessed the degree to which these items and the budget are transparent, and provided recommendations aimed to increase the budget transparency. An analysis of other forms of classified expenditure items is underway.

⁴ The monetary base in broad terms is comprised of cash in circulation, mandatory reserves and funds in the correspondent accounts of commercial banks with the Central Bank of Russia.

Non-transparent expenditures: an analysis and indicators.

The degree of non-transparency of the expenditures of the Federal Budget for 2004 was assessed basing on the following materials of the draft budget law:

Draft Federal law “On the Federal Budget for year 2004” (FB – 04)

Supplements 6 – Breakdown of FB - 04 expenditures by Section (S) and Subsection (SS) of the functional classification of the RF budget expenditures;

Supplements 21 – Breakdown of FB – 04 allocations by Sections, Subsections, Targeted Items (TI), and Types of Expenditures (TE) of the RF budget functional classification;

Supplements 32 – Breakdown of allotments aimed at the equipment of the RF Armed Forces and RF military formations;

Supplements 7 – the FB – 04 expenditure structure as broken down by agencies:

Draft Federal law “On amendments to the Federal law ‘On the RF budget classification’” (BC – 04) as concerns:

Supplement 11 – FB expenditure classification as broken down by agencies..

The total amount of expenditures earmarked in the budget at Rub. 2 659 447.0 million set forth in Article 1 of the FB – 04 draft law.

In Supplement 6, this amount is broken down by S and SS of the RF budget expenditure functional classification. The fact that the amounts of the expenditures as shown in SS correspond with the total amounts of expenditures as shown in respective S and equally the amounts of expenditures as shown in S correspond to the total amount of budget expenditures as determined in Article 1 demonstrates that the budget is absolutely transparent at the level of S and SS.

Supplement 21 presents the further specification of expenditures including TIE and TE levels. At the same time, the total amount of budget expenditures calculated as a sum of TE, TIE, SS, and S levels is somewhat less as compared with the amount indicated in Article 1. The amounts of expenditures as shown in certain S and SS also differ. These differences make the values of non-transparent budget expenditures at TIE and TE levels caused by their classified nature. The information about these expenditures are entered in the respective Supplements to the FB – 04 closed for the public review..

The share of the amount of the classified expenditure in the total amount of expenditures is defined as the indicator of the degree to which expenditures are classified.

The values of this indicator are calculated at three levels: S, SS, and the budget at large. This method of calculation has permitted to evaluate the degree to which not only the budget, but also structure units of its budget classification, including breakdown of classified expenditures by agencies, are non-transparent.

The materials pertaining to Supplement 32 to the budget indicate that in addition to the data contained in Supplement 21, for the agencies listed in Supplement 32 the respective expenditures pertaining to certain subsections were declassified only at the TIE, while expenditures at the TE level remained non-transparent. Because of this fact, separate evaluation of the degree to which these expenditures are non-transparent had to be carried out for each of the aforementioned level.

The combined analysis of materials pertaining to Supplement 7 to the draft FB – 04 and Supplement 11 to the draft FB – 04 permitted to determine that agencies participated in the classifying of respective structural units of the budget classification. This publication focuses exclusively on the data relating to the SS budget. The agencies’ involvement in the classifying of the S budget is easily identified using the presented materials relating to the respective SS. Similar information on the structural units of expenditures at the level of TIE and TE can not be presented due to the large amount of related data.

The comparison of the obtained assessments of the degree to which TIE and TE are non-transparent permitted to make, for instance, an estimate of how the obtained indicators of the degree to which the budget at large and its S and SS change, as well as how the shares contributed by respective SS in the total amount of classified expenditures redistribute after the disclosure of TE by TIE presented in Supplement 32. The requirement to declassify these TE has been already voiced in the State Duma in the course of discussion of the draft budget in the first reading.

Outcomes of the evaluation

The outcomes of the analysis and evaluations are presented in Tables 1, 2, and 3. Titles S, SS, TIE, and TE, as well as the respective codes correspond to the draft adjusted version of the budget classification of 2004..

Similar estimations of the 2003 budget expenditures are presented in the left section of Table 1 as a benchmark.

Table 2 demonstrates the total amount of classified expenditures in the presented draft FB – 04 (it shall be taken into account that the types of expenditures related to TIE of agencies are not declassified). There were calculated amounts of classified expenditures by each section. There were also determined and ranked in descending order the shares of expenditures pertaining to each subsection in the total amount. The right column of the table demonstrates the lists or number of agencies involved in the classifying of expenditures in respective subsections. There were also calculated the shares of cumulative amounts of expenditures by the set of subsections permitting to determine the subsections, whose aggregate contribution to the total amount of expenditures makes over 95 per cent. This group of subsections is defined as the group of significant influence on the total amount of expenditures. The rest subsections make the group of insignificant influence at or below 5 per cent. These subsections are shown in the table in italics.

Table 3 contains similar data obtained on the condition that the TIE shown in Supplement 32 are declassified.

The comparison between the data shown in tables 2 and 3 permits to evaluate the effectiveness of declassifying of these TIE and detect changes in the list of agencies determining non-transparency of the domestic budget.

Conclusions

1. The classified amount of expenditures of the Federal budget for year 2004 makes: Rub. 262 427 million (almost 10 per cent of the total amount of expenditures at the level of the types of expenditures and Rub. 113 341 million (more than 4 per cent of the total amount of expenditures at the level of target items of expenditures)
1. The fully or partially classified sections and subsections of the 2004 budget were the same as in the budget for 2003. There were not detected significant changes as concerns the degree to which the respective expenditures were classified.
2. The IET recommendations on declassifying of types of expenditures included in the composition of a number of target items, which were declassified in 2003, as well as the target items and types of expenditures of subsection 1302 "Prevention and liquidation of the results of emergencies" and subsections 2201 and 2202 of section 22 "Utilization and liquidation of armaments" in the course of elaboration of the budget for 2004, were not taken into account. These recommendations were again voiced in the State Duma in the course of discussion concerning the draft Federal budget for year 2004 in the first reading.
3. Declassifying of the types of expenditures related only to target items declassified in 2003 would more than twice decrease the amount of classified expenditures (see Tables 2 and 3). In this case, the Defense Ministry, traditionally leading as concerns the issue of classified expenditures would be ranked below the group of agencies relating to state security agencies also traditionally escaping public scrutiny as concerns their classified expenditures. The expenditures of agencies listed in table 3 are 100 per cent classified. This issue requires an additional study, since the analysis of the expenditure items of these agencies in spite of their understandable non-transparency allows to surmise that there are still some reserves there.
4. It is also necessary to study the justification of classifying of subsections included in the group of significant influence on the total amount of expenditures other than agencies related to the state security. Their aggregate contribution in the amount of classified expenditures makes 50 per cent. For instance, subsection 1302 "Prevention and liquidation of the results of emergencies" is classified by almost 60 per cent, although MES own expenditures are totally transparent. It is absolutely unclear why the expenditures for "Utilization and liquidation of armaments, excluding the fulfillment of international obligations" are 100 per cent classified (subsection 2202), while the expenditures for utilization and liquidation relating to international treaties are classified by 46 per cent (subsection 2201).
5. On the whole, the issue of a **transparent budget, a necessary condition for ensuring civilian control over the traditionally non-transparent sphere of state activities**, still remains an urgent problem, since not all its possibilities and avenues have been exhausted.

IET proposals and recommendations submitted to the State Duma

1. It seems feasible to declassify types of expenditures included in target items declassified in 2003, as well as the target items and types of expenditures of subsection 1302 "Prevention and liquidation of the results of emergencies" and subsections 2201 and 2202 of section 22 "Utilization and liquidation of armaments" in the course of elaboration of the budget for 2004.

2. The final resolution of the State Duma concerning the approval of the budget for 2004 shall include the following instruction for the RF Government:
 - Quarterly reports on the execution of the budget for year 2004 shall be presented taking into account the declassified information and comply with the requirements set forth in Article 272 of the Budget Code stipulating that quarterly reports shall fully correspond to the approved budget, including all supplements thereto. Starting in 2004, simultaneously with a detailed report on the execution of the budget, the Government shall submit to the State Duma information on the RF military expenditures presented to the UN and other international organizations.
 - In the course of elaboration of the Federal budget for year 2005, there shall be reviewed possibilities to continue the effort to ensure the reasonable degree of transparency of expenditures.
3. In the interests of civilian control over the dynamics of expenditures across years, it would be feasible to refrain from the practice of yearly changes in the budget classification of expenditures and introduce such changes only when absolutely necessary.

Table 1.

Amounts of classified expenditures and evaluations of the degree to which budgets for years 2003 and 2004 are non-transparent

Expenditure	S	SS	FB for 2003 (approved)					Draft FB for 2004 (1 st reading)							
			Total expenditures		Classified expenditures as broken down by S and SS at the TIE level		Classified expenditures as broken down by S and SS at the TE level		Total expenditures		Classified expenditures as broken down by S and SS at the TIE level		Classified expenditures as broken down by S and SS at the TE level		
			Amount	Amount	Degree of non-transparency	Amount	Degree of non-transparency	Amount	Amount	Degree of non-transparency	Amount	Amount	Degree of non-transparency	Amount	Degree of non-transparency
			Rub. mil.	Rub. mil.	%	Rub. mil.	%	Rub. mil.	Rub. mil.	%	Rub. mil.	Rub. mil.	%	Rub. mil.	%
TOTAL			2345641	105690	4,51	222216	9,47	2659447	113341	4,26	262427	9,87			
INTERNATIONAL ACTIVITIES	03	00	44384	10907	24,57	10907	24,57	45085	11223	24,89	11223	24,89			
International cooperation	03	01	35416	9318	26,31	9318	26,31	35614	9830	27,60	9830	27,60			
Implementation of international obligations pertaining to military and technical cooperation	03	06	1588	1588	100,00	1588	100,00	1393	1393	100,00	1393	100,00			
NATIONAL DEFENSE	04	00	344525	14824	4,30	124641	36,18	411473	18406	4,47	156082	37,93			
Development and maintenance of RF Armed Forces	04	01	325564	1812	0,56	111629	34,29	389402	1580	0,41	139256	35,76			
Military program of the RF Ministry for Nuclear Energy	04	02	13012	13012	100,00	13012	100,00	16826	16826	100,00	16826	100,00			
LAW ENFORCEMENT AND STATE SECURITY	05	00	244794	48004	19,61	54714	22,35	310577	49142	15,82	60552	19,50			
Agencies of the RF Interior Ministry	05	01	69305	0	0,00	1587	2,29	116128	0	0,00	3101	2,67			
Troops of the RF Interior Ministry	05	02	18490	0	0,00	2010	10,87	21531	0	0,00	2262	10,50			
State security agencies	05	05	47992	47992	100,00	47992	100,00	49737	49142	98,80	49142	98,80			
Border service agencies	05	06	24065	11	0,05	3124	12,98	29993	0	0,00	6047	20,16			
INDUSTRY, POWER ENGINEERING AND CONSTRUCTION	07	00	63404	100	0,16	100	0,16	66598	176	0,26	176	0,26			
Other industries	07	05	457	100	21,84	100	21,84	538	176	32,78	176	32,78			
PREVENTION AND LIQUIDATION OF RESULTS OF EMERGENCIES AND NATURAL CALAMITIES	13	00	21208	15698	74,02	15698	74,02	26258	9347	35,60	9347	35,60			
Prevention and liquidation of results of emergency situations	13	02	10984	5474	49,84	5474	49,84	15705	9347	59,52	9347	59,52			
REPLENISHMENT OF STATE STOCKS AND RESERVES	20	00	20956	20482	97,73	20482	97,73	20270	18942	93,45	18942	93,45			
State material reserve	20	02	20482	20482	100,00	20482	100,00	18942	18942	100,00	18942	100,00			
UTILIZATION AND LIQUIDATION OF ARMAMENTS (UaLA):	22	00	10760	5400	50,18	5400	50,18	10365	5005	48,29	5005	48,29			
UaLA relating to international treaties	22	01	9991	4631	46,35	4631	46,35	9863	4503	45,66	4503	45,66			
UaLA not relating to international treaties	22	02	768	768	100,00	768	100,00	501	501	100,00	501	100,00			
MOBILIZATION PREPAREDNESS OF THE ECONOMY	23	00	500	500	100,00	500	100,00	1100	1100	100,00	1100	100,00			
Mobilization preparedness of the economy	23	01	500	500	100,00	500	100,00	1100	1100	100,00	1100	100,00			

Table 2

Classified expenditures of subsections at the level of types of expenditures.

Expenditure	S	SS	Amount	Share in the total amount	Share of the cumulative sum	Agencies
			Rub. mil.	%	%	
TOTAL			262427			
Development and maintenance of RF Armed Forces	04	01	139256	53,06	53,06	Defense Ministry
State security agencies	05	05	49142	18,73	71,79	SVR, FSB, FSO, State Technical Commission
State material reserve	20	02	18942	7,22	79,01	Russian Agency for State Reserves
Military program of the RF Ministry for Nuclear Energy	04	02	16826	6,41	85,42	RF Ministry for Nuclear Energy
International cooperation	03	01	9830	3,75	89,17	Ministry for Industry and Science, SVR, FSB, Foreign Ministry, Defense Ministry
Prevention and liquidation of results of emergency situations	13	02	9347	3,56	92,73	Ministry for Economic Development, GU SPP
Border service agencies	05	06	6047	2,30	95,03	FSB (FPS)
<i>Utilization and liquidation of armaments relating to international treaties</i>	22	01	4503	1,72	96,75	4 agencies
<i>Agencies of the RF Interior Ministry</i>	05	01	3101	1,18	97,93	Interior Ministry (Interior Ministry agencies)
<i>Troops of the RF Interior Ministry</i>	05	02	2262	0,86	98,79	Interior Ministry (Interior Ministry Troops)
<i>Implementation of international obligations pertaining to MTC sphere</i>	03	06	1393	0,53	99,32	Defense Ministry, FSB
<i>Mobilization preparedness of the economy</i>	23	01	1100	0,42	99,74	25 agencies
<i>Utilization and liquidation of armaments not relating to international treaties</i>	22	02	501	0,19	99,93	5 agencies
<i>Other industries</i>	07	05	176	0,07	100,00	7 agencies

Table 3

Classified expenditures at the level of target items of expenditures.

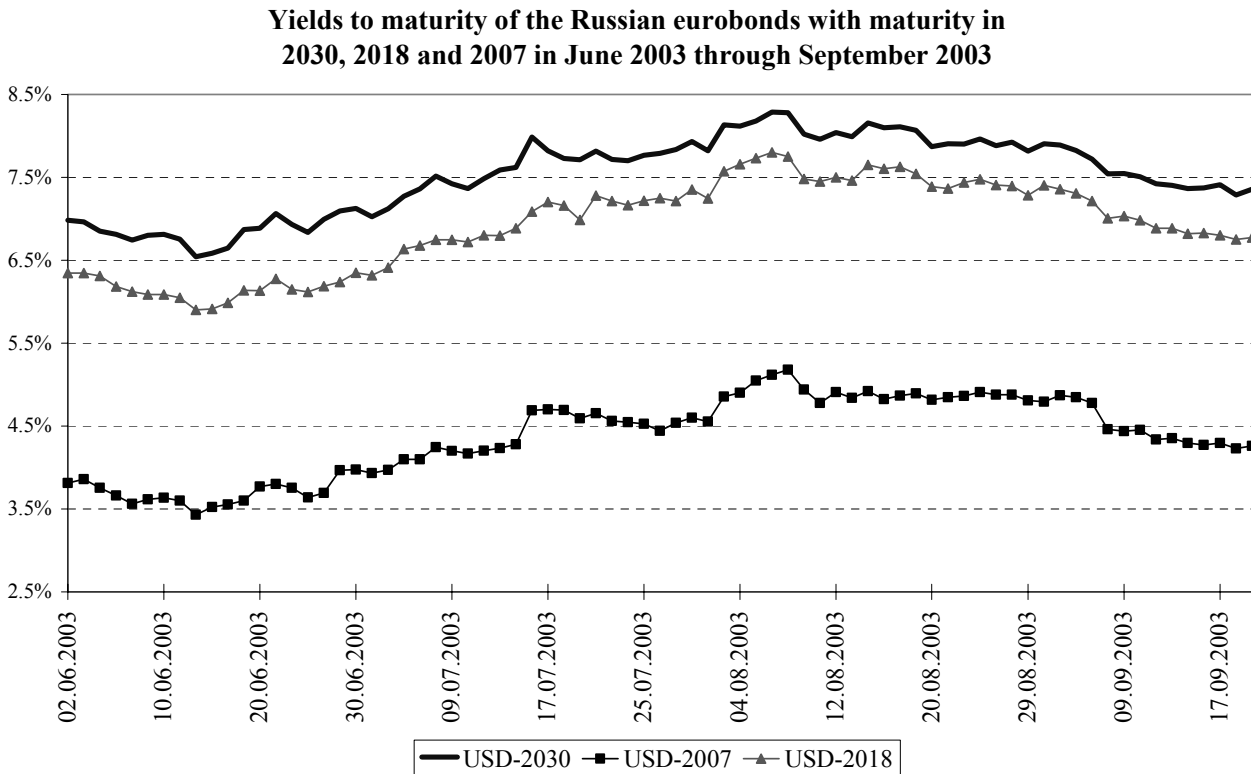
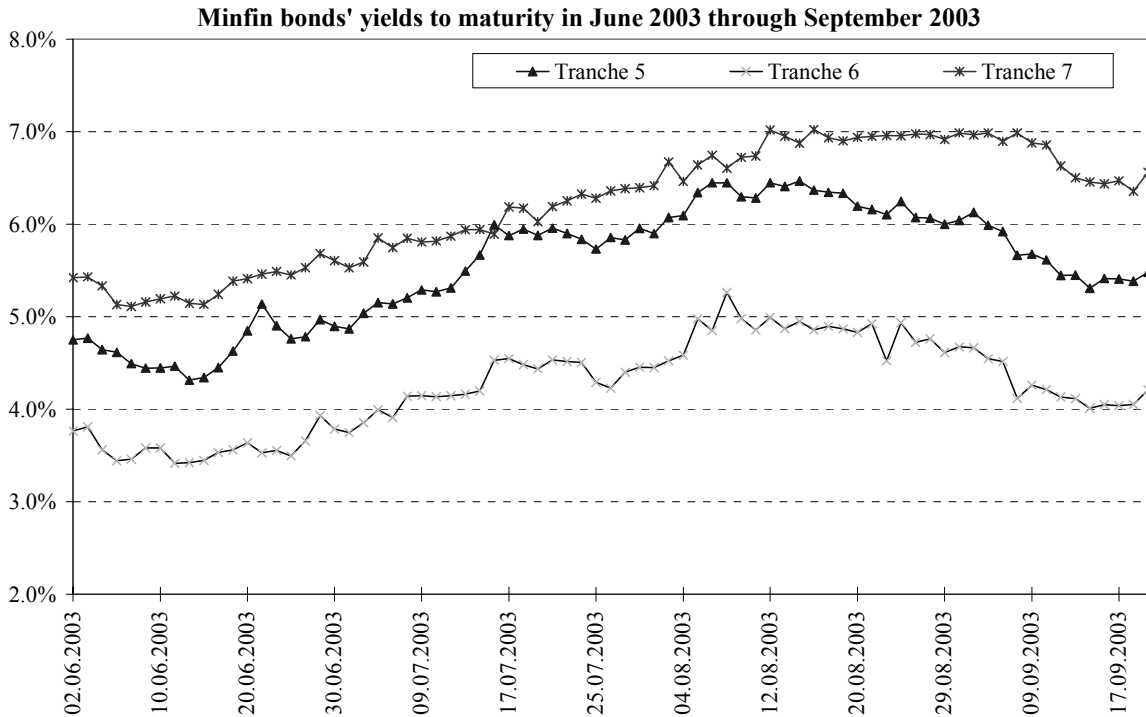
Expenditure	S	SS	Amount	Share in the total amount	Share of the cumulative sum	Agencies
			Rub. mil.	%	%	
TOTAL			113 341			
State security agencies	05	05	49 142	43,36	43,36	SVR, FSB, FSO, State Technical Commission
State material reserve	20	02	18 942	16,71	60,07	Russian Agency for State Reserves
Military program of the RF Ministry for Nuclear Energy	04	02	16 826	14,85	74,92	RF Ministry for Nuclear Energy
International cooperation	03	01	9 830	8,67	83,59	Ministry for Industry and Science, SVR, FSB, Foreign Ministry, Defense Ministry
Prevention and liquidation of results of emergency situations	13	02	9 347	8,25	91,84	Ministry for Economic Development, GU SPP
Military program of the RF Ministry for Nuclear Energy	22	01	4 503	3,97	95,81	4 agencies
<i>Development and maintenance of RF Armed Forces</i>	04	01	1 580	1,39	97,20	Defense Ministry
<i>Implementation of international obligations pertaining to MTC sphere</i>	03	06	1 393	1,23	98,43	Defense Ministry, FSB
<i>Mobilization preparedness of the economy</i>	23	01	1 100	0,97	99,40	25 agencies
<i>Utilization and liquidation of armaments not relating to international treaties</i>	22	02	501	0,44	99,84	5 agencies
<i>Other industries</i>	07	05	176	0,16	100,00	7 agencies
<i>Agencies of the RF Interior Ministry</i>	05	01	0	0,00	100,00	Interior Ministry (Interior Ministry agencies)
<i>Troops of the RF Interior Ministry</i>	05	02	0	0,00	100,00	Interior Ministry (Interior Ministry Troops)
<i>Border service agencies</i>	05	06	0	0,00	100,00	FSB (FPS)

E. Vatolkin, V. Tsymbal

Financial Markets

Market for Government Securities

In September, 2003, investors demonstrated high demand for Russian currency obligations on the whole, and a growth in quotations was observed in the market. E.g., by 19 September the yield to maturity of Eurobonds RUS-30 had reached 7.36 percent p.a. (end of August: 7.81 percent); RUS-18: 6.77 percent p.a. (end of August: 7.28 percent).



In the course of September the dynamics of the Rouble public debt was in many respects determined by the situation in the currency market and the liquidity level in the banking sector. Due to Dollar-Rouble rate fluctuations the exchange rate risk was included in the price of Rouble instruments, which resulted in lower quotations.

From 25 August till 19 September the turnover in the secondary GKO-OFZ totaled RUR 20.67 billion, which corresponds an average daily turnover of RUR 1.03 billion. Thus, in the period under review the activity of market participants remained at the average level of the past months.

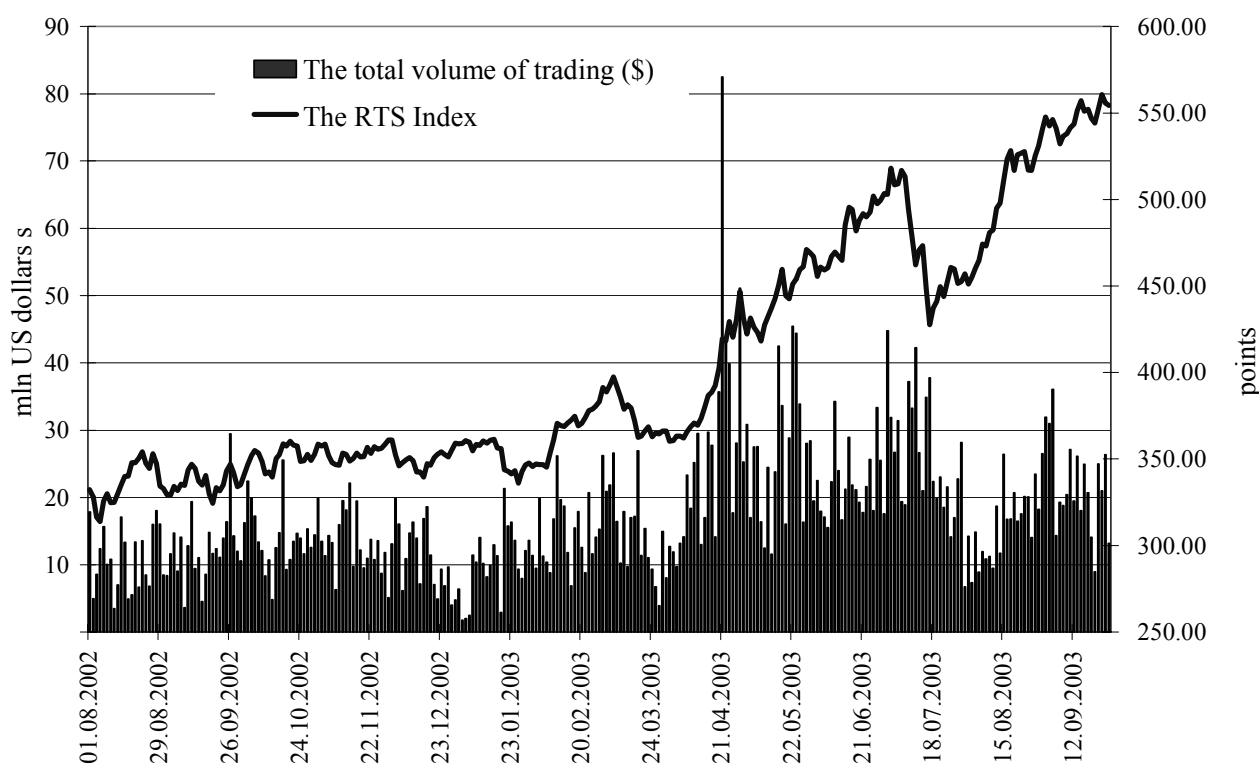
In September a number of auctions were held for the placement of state bonds with maturities from two years six months up to nine years. Total amount offered was RUR 19 billion, and total amount placed was RUR 6.88 billion. The weighted average yield of the placed securities at the cut-off price was 8.36 percent p.a. As at 26 September the GKO-OFZ market totaled RUR 294.59 billion at par and RUR 311.07 billion at the market value. The duration of the GKO-OFZ market portfolio was 862.76 days.

The Market for Corporate Securities

The Stock Market

The positive trend in quotations that started in August, 2003, prevailed in September, too. The RTS index grew 37.6 points (+7.28 percent) since 27 August. Furthermore, in the course of the month the index again grew to its post-crisis maximum, reaching 560.69 points⁵ (day closing on 24 September). In the period from 01 till 26 September the volume of turnover in the RTS reached US\$ 443 million, which is higher than in the previous month (in the period from 28 July till 27 August it totaled US\$ 362.8 million). The average daily turnover in the RTS in the period under review was US\$ 22.16 million, or more than US\$ 6 million higher than in the corresponding period in August, 2003.

The highest market activity was observed on 4 September when the daily turnover of RTS trade exceeded US\$ 36 million. The lowest trade volume in September was US\$ 8.9 million (22 September). Резюмируя, it should be noted that in September the rise in stock market quotations was accompanied by a noticeable increase in the activity of its participants after the summer downturn partially caused by the seasonal factor.

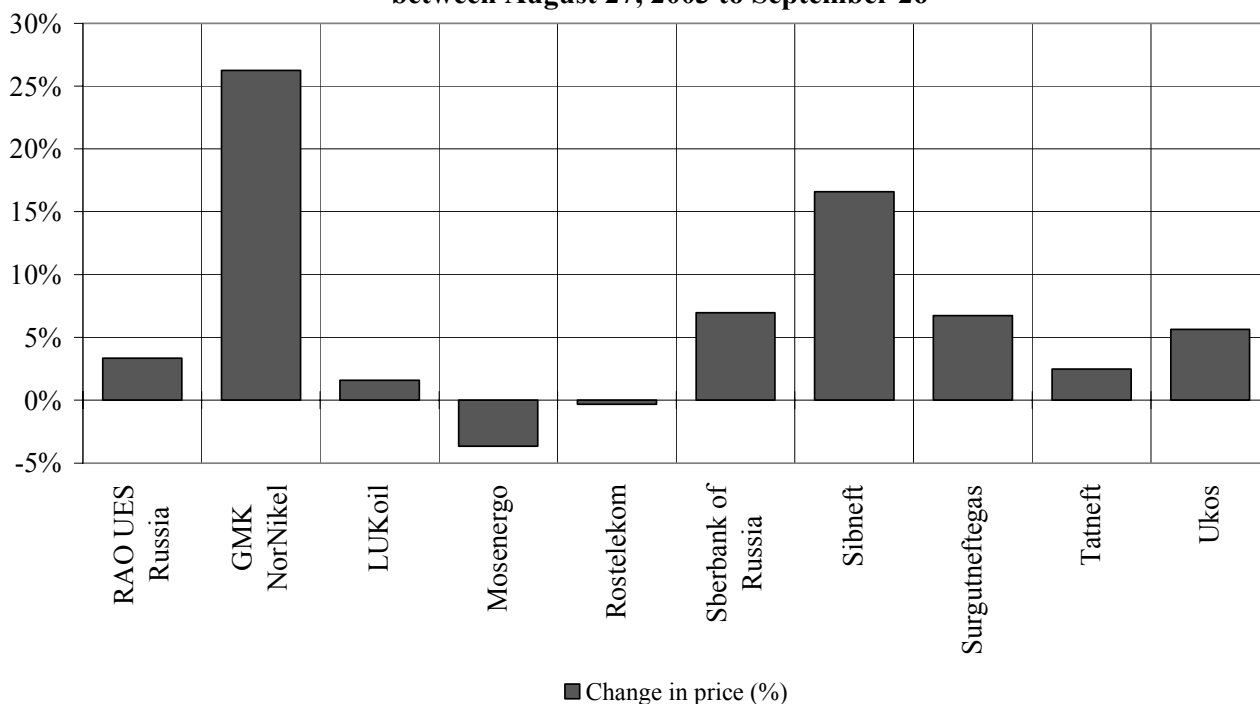


In September the rates of practically all blue chips at the Russian stock market showed a positive change. In particular, the shares of Norilsk Nickel demonstrated the highest growth in September (26.3 percent), followed the shares of Sibneft (+16.58 percent). These are followed by the stocks of Sberbank,

⁵ The index had reached a higher value on 6 October, 1997

Surgutneftegas and YUKOS, whose shares grew, respectively, 6.96 percent, 6.74 percent and 5.64 percent in September. The shares of RAO UES (+3.35 percent), Lukoil (1.60 percent) and Tatneft (2.48 percent) showed a relatively lower growth. The only outsider among all blue chips were the securities of Mosenergo and Rostelecom, whose quotations diminished in the four weeks of September 3.67 percent and 0.32 percent, respectively.

**Dynamics of the Russian Blue Chips
between August 27, 2003 to September 26**



In August the shares of RAO UES, as usual, were leading in turnover: the energy holding's trade volume in the total RTS turnover over the four weeks of September reached 33.55 percent. The energy company was followed by YUKOS shares (16.29 percent of total turnover) and Lukoil (12.33 percent of total turnover). The volume of trade in the shares of Surgutneftegas appreciably lagged behind the leaders, totaling 6.62 percent in September. Thus, the consolidated share of these four securities in the total RTS turnover was 68.79 percent.

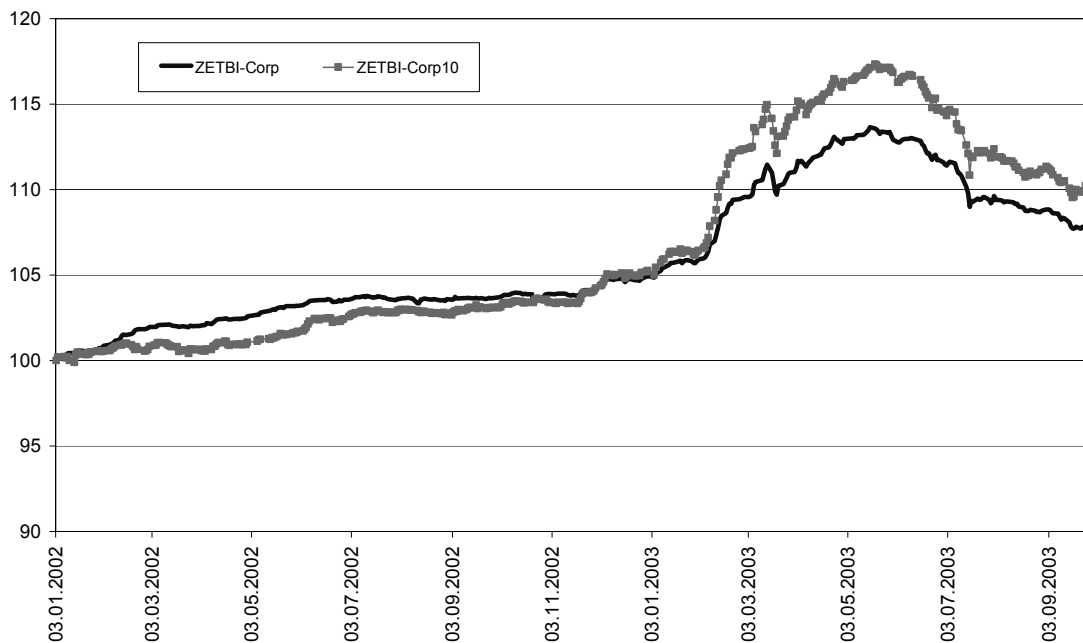
According to RTS data, on 26 September the five leaders by capitalization of the Russian stock market looked as follows: YUKOS, US\$32.9 billion, Lukoil, US\$16.57 billion, Surgutneftegas, US\$15.55 billion, Sibneft, US\$13.7 billion, and RAO UES, US\$13.1 billion.

The Market for Term Contracts. During the first four weeks of September an upsurge was observed in the FORTS market as compared to August. In this period the volume of trade in futures and options amounted to RUR 20.3 billion (65.9 thousand deals, 2.42 million contracts), which slightly exceeds the corresponding indicators for August (turnover, RUR 17.3 billion; 69.5 thousand deals and 2.26 million contracts). Futures contracts are still in the greatest demand – the turnover in futures takes up the biggest share of the total turnover. The volume of trade in futures was RUR 18.85 billion (2.2 million contracts, 63.8 thousand deals). The highest trade volume, RUR 1.537 billion, was observed on 24 September in the market, and the lowest, RUR 665.76 million, was observed on 25 September.

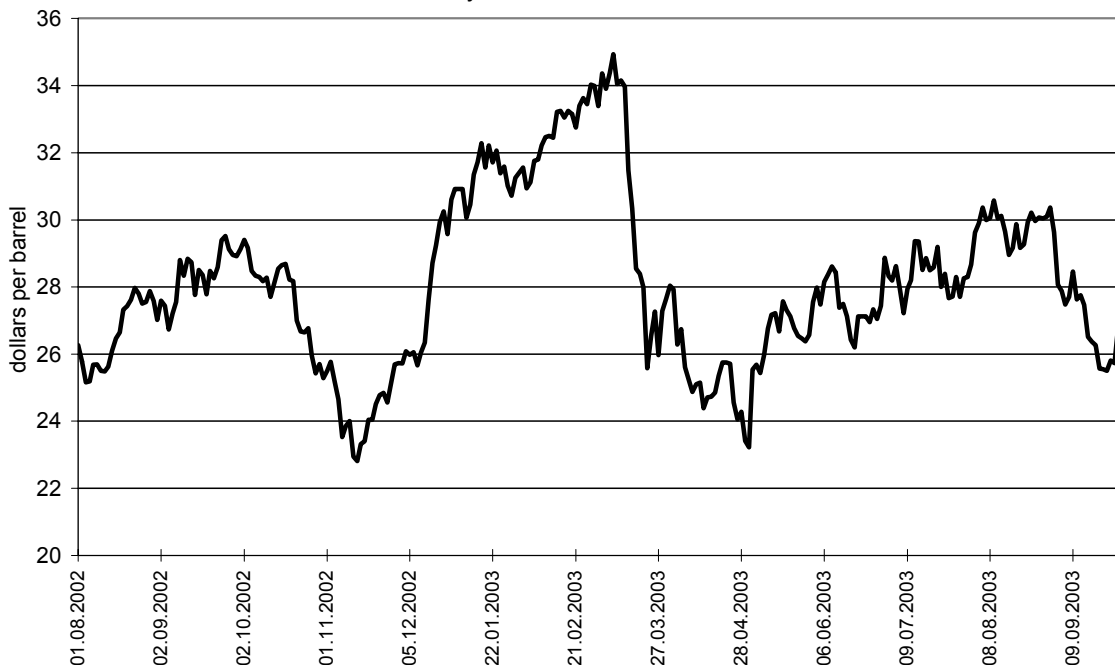
The Market for Corporate Bonds. In the first three weeks of the month limited liquidity affected the quotations of corporate bonds. Increasing interbank loan rates, the strengthening of the Dollar against the Rouble and the beginning of the bank tax payments lowered the already low liquidity and increased the rates at the interbank market thus creating pressure on bond prices. At the same time, the offer of securities in the primary market also created conditions for the lowering of prices. However, the fourth week of the month was marked by a check in the fall of quotations and an increase in demand for Moscow securities, which automatically ensued a growth in the interest to the corporate sector securities. Nevertheless, non-residents were the main buyers: the increase of the Rouble instrument spread over Eurobonds to 4-5 percent was enough to compensate the exchange rate risk. In the period from 22 August till 19 September the turnover in

the MICEX bond section totaled RUR 14.2 billion, which corresponds the average daily turnover of RUR 679.2 million. In the period from 29 August till 29 September the price index of corporate bonds traded in the MICEX⁶ decreased 0.75 points (-0.69 percent) and the index of top ten corporate sector bonds by liquidity diminished 0.66 points (-0.59 percent). Auctions for the placement of corporate bonds totaling RUR 7.8 billion were held at the MICEX in September.

Dynamics of corporate bond indices



Dynamics of Brent Oil

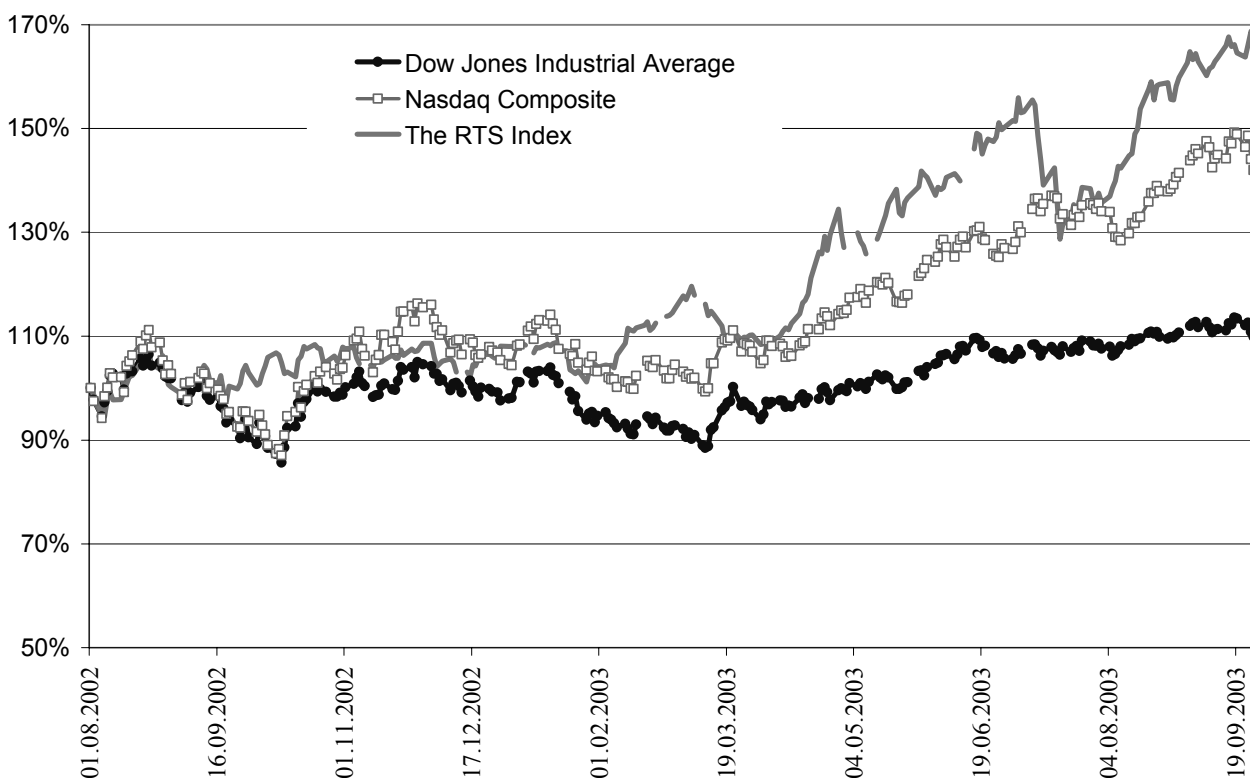


External Factors Affecting the Dynamics of the Russian Stock Market. A downward trend was on the whole observed in world oil markets in September. Having reached the 30.37 US\$/ bbl mark on 1 September, the price for Brent oil started to glide down in the first three weeks of the month and reached

⁶ The indices of corporate bonds traded in the MICEX calculated by the bank Zenith have been used as a basis for the calculation.

25.5 US\$/bbl on 22 September. One of the causes for the reduction was that investors preferred closing a considerable part of their long positions in gasoline futures. The growth in oil reserves in the USA, brought about by a growth in imports, can also be regarded as a factor that contributed to the lowering of world oil prices. Nevertheless, large funds, in their turn were not particularly eager to sell on a large-scale, which led to a downward glide in quotations.

Still, contrary to expectations OPEC announced a 900 thousand bbl cut in the oil delivery quota that will be 24.5 million bbl starting with 1 November. This measure can be regarded as the cartel's wish to uphold the prices at a fairly high level (cca. 30 US\$/ bbl) because the existing rules only permit a reduction in quotas in the event that prices fall to the 22 US\$/ bbl, and this was not the case. A moderate rise in the US oil reserves has not affected the market appreciably, therefore subsequently a certain adjustment was observed in the market: world oil prices gradually returned to the 27 US\$/ bbl level. Thus, in September Brent oil became US\$ 3.08 cheaper in comparison with the last day of August, and by 26 September the price had reached 27.01 US\$/bbl.



In September a change in the situation in the stock markets of foreign countries was observed. E.g., US stock exchange indices demonstrated extremely slow growth rate in the first four weeks of the month. Since 26 August NASDAQ and S&P500 grew over the month (year) only 1.21 percent (29.20 percent) and 0.01 percent (9.71 percent), respectively, and DJIA even dropped 0.29 percent (year-to-month: grew 8.27 percent). European stock indices diminished in comparison to the late August levels: FTSE 100 (United Kingdom) reduced in the course of the month (year) by 0.49 percent (+3.8 percent); DAX 30 (Germany), 3.78 percent (+7.5 percent), CAC-40 (France), 1.23 percent(+0.91 percent). The situation observed in the markets of the developing countries was relatively better, and positive dynamics of the developing countries' composite index calculated by the agency MSCI demonstrate it. The growth in the course of the month (since the beginning of the year) was 1.99 percent (18.96 percent).

In the first two weeks of September the dynamics of the US stock market were mainly determined by the nature of publications of the data on economic statistics and of corporate news that was on many occasions contradictory. As a result, a rise in quotations during the first week was then followed by a decline. One of the most significant factors was a growth in unemployment, which was evidenced by increasing numbers of applications for unemployment benefit payout during the first half of the month. The current rates of US stock already include expectations about potential growth of the US economy, so any negative publication could lead to immediate corrections. The growth of US stock prices during the third week was caused,

among other things, by the US Fed's decision to leave the discount rate unchanged and by the publication of economic statistics demonstrating that positive trends prevail in the US economy. Still, the subsequent weakening of the Dollar against the largest world currencies, increase in oil prices and publications containing information that was on the whole negative made the situation in the US stock market worse and subsequently resulted in its decline.

The situation in US markets continued to a great extent to determine the state of affairs in European stock markets. The dynamics of EC stock markets have one peculiarity: when internal news is lacking, the market follows the movements of the US market. Furthermore, owing to the dependence of the European economy on the US economy, share quotations of export-oriented companies react to the situation in the currency market. It was that factor that determined the dynamics of the European indices in September: a perceptible strengthening of the Euro against the Dollar immediately influenced the rates of export-oriented companies' shares, which ensued a decrease of stock exchange indices.

Corporate News

MMC Norilsk Nickel

In early September MMC Norilsk Nickel announce the results of the bidding to purchase the shares from the shareholders of Stillwater Mining Company, which ended on 26 August, 2003. Norimet Ltd., a 100-percent daughter company of MMC Norilsk Nickel, will buy 4.35 million shares, which makes 12.8 percent of the total amount of shares offered for sale.

Furthermore, in the middle of September OOO Prospect, which represents the interests of the MMC, won the open auction on the sale of the state-owned controlling block of shares of the Open-end Joint-Stock Company Lenzoloto. The initial price for the block of shares was RUR 1,065 million, and the final price reached RUR 4,655 million

OAO NGK Slavneft

On 12 September NGK Slavneft redeemed the third coupon of the bonds of the third issue. The coupon rate was 12.89 percent p.a., or RUR 63.92 per each bond with RUR 1,000 par value. Thus, the total amount paid out will be RUR 127.84 million.

On 20 September an extraordinary meeting of shareholders decided to pay out interim dividends for the first six months of 2003 in the amount of RUR 2.24 per one ordinary share with par value of 0.1 kopek. Total amount due will be RUR 10.65 billion, payable till 28 November, 2003. It was also decided not to distribute dividends for 2002 and to allocate the net profit of the company for the period (RUR 9.78 billion) to the company's equity.

Table 1.

Dynamics of world stock-exchange indices

Data for 26 August, 2003	Value	Change over the month (%)	Change since the beginning of the year (%)
RTS (Russia)	554.32	7.22%	53.64%
Dow Jones Industrial Average (USA)	9313.08	-0.29%	8.27%
NASDAQ Composite (USA)	1792.07	1.21%	29.20%
S&P 500 (USA)	996.85	0.01%	9.71%
FTSE 100 (UK)	4157.10	-0.49%	3.80%
DAX-30 (Germany)	3324.85	-3.78%	7.50%
CAC-40 (France)	3216.76	-1.23%	0.91%
Swiss Market (Switzerland)	5131.30	-0.49%	4.73%
Nikkei-225 (Japan)	10318.44	-0.14%	18.42%
Bovespa (Brazil)	15811	6.27%	36.30%
IPC (Mexico)	7786.22	4.69%	24.51%
IPSA (Chile)	1370.04	1.98%	32.99%
Straits Times (Singapore)	1627.54	1.72%	21.46%
Seoul Composite (South Korea)	697.40	-7.38%	5.49%
ISE National-100 (Turkey)	13758.78	17.24%	26.95%
Morgan Stanley Emerging Markets Free Index	376.66	1.99%	18.96%

OAO NK YUKOS

On 4 September NK 4 YUKOS acquired 20 percent minus one share of OAO Sibneft. This was carried out as part of the merger agreement between NK YUKOS and OAO Sibneft concluded in April. Besides, a

daughter company of NK YUKOS signed an agreement to acquire from Harvest Natural Resources, Inc. (Houston, USA) its 34-percent block of shares in OOO Geoilbent, which owns the license agreement on the right to develop a number of deposits in the Yamal-Nentsi Autonomous Okrug. The value of the deal is US\$ 75 billion, including the US 5.5 million debt of OOO Geoilbent to Harvest Resources.

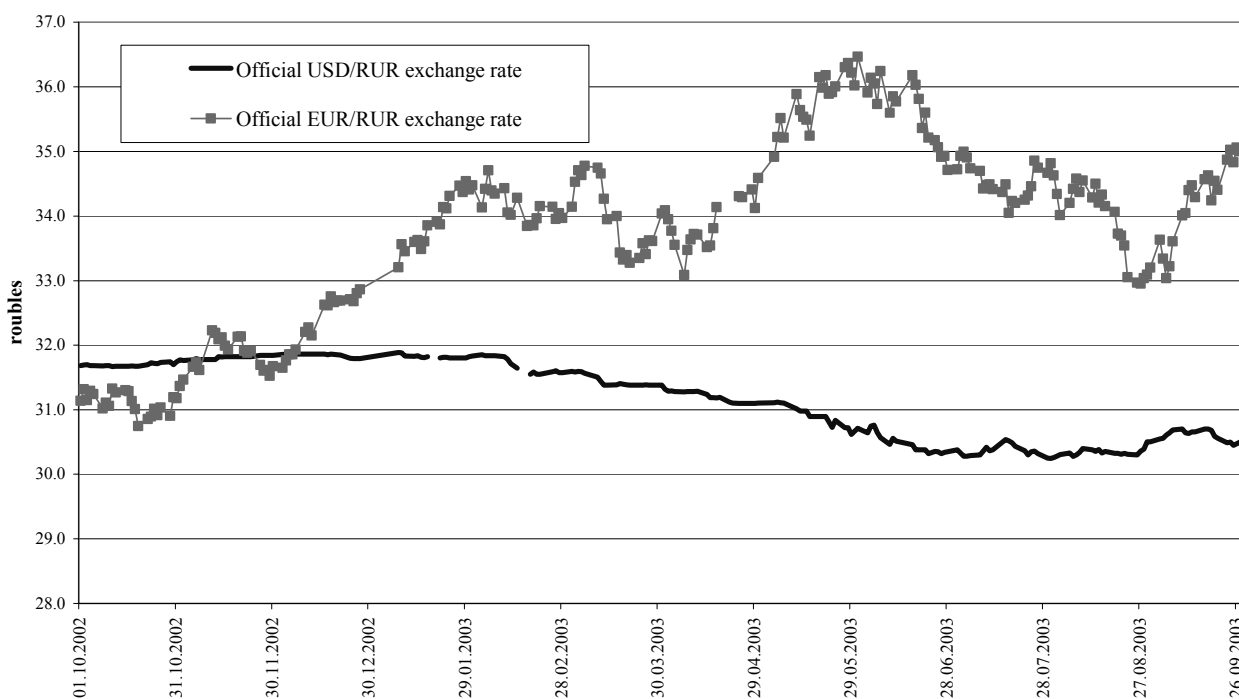
In its meeting on 25 September, 2003, the Board of Directors of NK YUKOS decided to summon an extraordinary meeting of shareholders on 28 November, 2003. The agenda of the meeting will include issues pertaining to the termination of powers of the existing shareholders, election to the New Board of Directors, approval of the new wording of the Charter and payment of dividends for nine months of 2003.

Foreign Exchange Market. In September the foreign exchange market was characterized by a slight decline in activity. This was caused to a considerable extent by a decrease in Rouble balances in the banking sector and by the situation in world foreign exchange markets. As a result, by the end of September the Dollar exchange rate had grown RUR 0.11 (0.36 percent), reaching the 30.61 RUR/ US\$ mark.

According to our estimates, in September the trades in the US currency performed in the SELT totaled cca. US\$ 11 billion. During the four weeks of September the highest volume of trade in the US Dollar, US\$ 838.9 million, was observed on 4 September, and the lowest volume, US\$ 106.4 million, on 1 September.

In September Rouble liquidity in the banking sector diminished, thus continuing the trends prevailing in July and August. As at 26 September, balances in the correspondent accounts of credit institutions at the Bank of Russia were RUR 95.3 billion (RUR 126.4 billion in July, RUR 112.8 billion in August).

Dynamics of the Official USD/RUR and EUR/RUR Exchange Rates in 2002-2003



The Euro-Dollar exchange rate in world foreign exchange markets grew perceptibly, increasing by 5.9 cents (5.44 percent). As at 30 September it reached the 1.148 Dollar/Euro mark. It should be noted that the positive trend in the exchange rate dynamics prevailed throughout the month. Macroeconomic news on the situation in the USA, which is on the whole negative, was the main factor affecting the Euro-Dollar exchange rate dynamics

The strengthening of the Euro against the currencies of most of the countries in world foreign exchange markets was followed by a considerable rise of the Euro against the Rouble: in the period from 30 August till 30 September the European currency went up in price by RUR 1.87 (5.65 percent), growing from RUR / Euro 33.20 to 35.08. According to estimates, in the period from 1 till 30 September the trades in Euro in the SELT totaled Euro 116 million. During the period under review, the highest volume of trade in the Euro was observed on 2 September (Euro 9.037), and the lowest on 5 September (Euro 3.86 million).

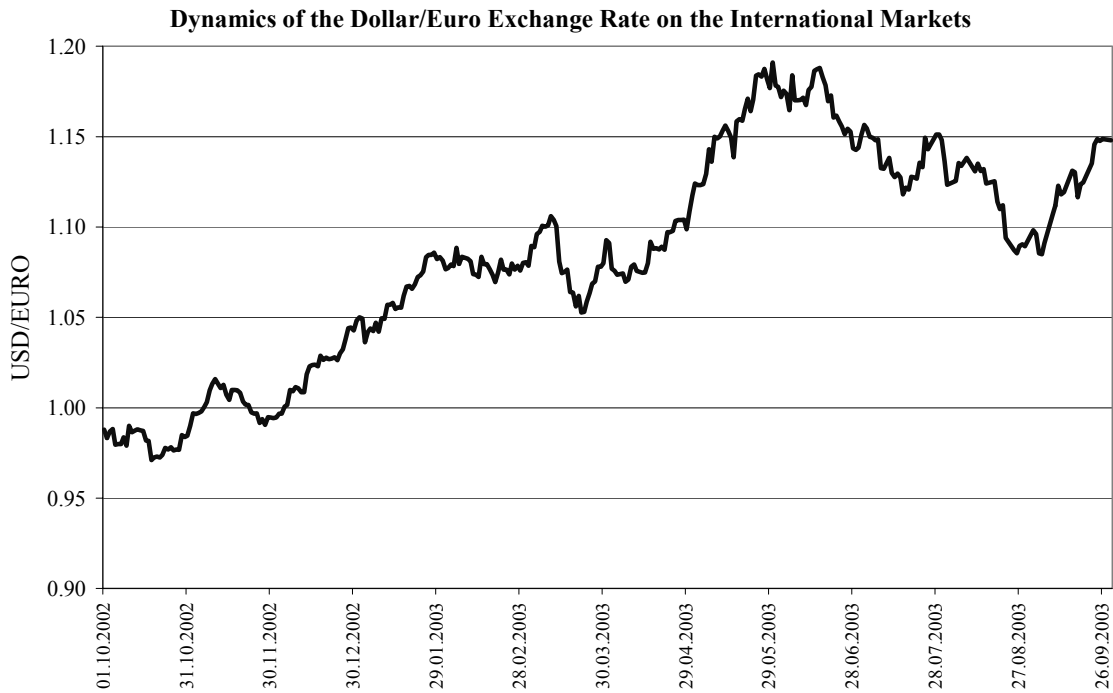


Table 2

Financial Market Indicators

Month	May	June	July	August	September*
Monthly inflation rate	0.8%	0.8%	0.7%	-0.4%	0.3%
Inflation rate annualised on the basis of this month's trend	10.03%	10.03%	8.73%	-4.70%	3.66%
CB RF refinancing rate	18%	16%	16%	16%	16%
Annualised yield to maturity on OFZ issues	6.44%	5.31%	7.11%	6.54%	5.7%
Volume of trading in the secondary GKO-OFZ market for the month (RUR billion)	20.68	40.12	17.08	13.00	13.5
Yield to maturity on Minfin bonds at the end of the month (% p.a.)					
5 th tranche	4.78%	4.90%	5.90%	6.00%	5.5%
6 th tranche	3.87%	3.79%	4.45%	4.61%	4.2%
7 th tranche	5.40%	5.61%	6.42%	6.92%	6.6%
8 th tranche	4.17%	4.20%	5.32%	5.60%	4.8%
Yield to maturity of Eurobonds at the end of the month (% p.a.)					
2005	2.74%	2.74%	3.13%	3.35%	2.8%
2007	3.93%	3.97%	4.55%	4.81%	4.3%
2010	5.27%	5.37%	5.86%	6.09%	5.7%
2018	6.43%	6.35%	7.24%	7.28%	6.8%
2028	6.88%	6.91%	7.76%	7.64%	7.2%
2030	6.99%	7.13%	7.82%	7.81%	7.4%
INSTAR-MIACR rate (% p.a.) on interbank overnight loans at the end of the month	1.3%	1.4%	4.1%	3.9%	7.0%
Official RUR / US\$ exchange rate at the end of the month	30.7090	30.3483	30.2596	30.5036	30.6119
Official RUR / Euro exchange rate at the end of the month	36.4669	34.7124	34.6291	33.2001	35.0751
Average annualised growth in RUR / US\$ exchange rate	-1.26%	-1.17%	-0.29%	0.81%	0.36%
Average annualised growth in RUR / Euro exchange rate	6.80%	-4.81%	-0.24%	-4.13%	5.65%
Volume of trading at the stock market in the RTS for the month (US\$ million)	497.74	442.10	600.12	329.97	480
Value of RTS-1 Index at the end of the month	469.93	503.51	457.02	530.94	566
Change in value of RTS-1 Index during the month (%)	9.50%	7.15%	-9.23%	16.17%	6.6%

* Estimate

D. Polevoy

The Real Sector: Factors and Trends

In September, the RF Goskomstat made public the first estimates of GDP production over the first six months of 2003. In the first half year of 2003, the amount of GDP made Rub. 6003.81 billion increasing by 7.0 per cent in comparison with the figures registered in the first six months of 2002. The specific feature of this year is that output of goods is growing at a faster rate as compared with the dynamics of production of services. The added value in industry increased by 6.8 per cent in real terms, while in construction it grew by 14.3 per cent. As concerns the sector of services, the sector of market services is still developing most dynamically, where transport, communications, and trade account for practically all increase in added value. While in the first quarter of 2003 there was registered a decline in production of GDP by 9.1 per cent in comparison with the figures observed in the 4th quarter of 2002, the recovery of the dynamic expansion of investment demand in February of this current year resulted in a 7.2 increase in GDP in the 2nd quarter as compared with the figures registered in the preceding period.

In 2003, the acceleration of the rates of growth in production was accompanied by a trend towards an increase in labor productivity. In the 1st and 2nd quarters, the increase in the productivity of labor made about 8.0 per cent, while in 2002 this indicator fluctuated within the band from 0.2 per cent (1st quarter) to 3.6 per cent (4th quarter). According to the data obtained in the course of sample surveys of households on employment issues (Goskomstat), in August the number of employed in the economy diminished by 0.7 million people as compared with the figures registered in the respective period of the preceding year and made 66.8 million people. The number of jobs declined by 876 thousand in the first six months of 2003 as compared with the figures observed in the respective period of the preceding year.

A decline in employment was mainly registered in industries producing goods, while in the sector of services employment grew by 271 thousand people. The comparison of the data on employment size across industries and other macroeconomic indicators demonstrates that increasing productivity of labor, especially in the sector of production of goods, allows enterprises to diminish labor costs via the restructuring of employment. This assumption is confirmed by the fact that the decline in the number of employed occurs at the background of growing profits of enterprises and their increasing investment activity. The growing demand for labor on the part of the sector of services, which demonstrates higher rates of growth due to expanding consumer demand, positively affect the situation on the labor market.

Table 1

Dynamics of real GDP and gross added value across industries in the first six months of 2002 and 2003, in % of the respective period of the preceding year.

	2002			2003		
	<i>1 quarter</i>	<i>2 quarter</i>	<i>1 half year</i>	<i>1 quarter</i>	<i>2 quarter</i>	<i>1 half year</i>
GDP	103,0	104,1	103,6	106,8	107,2	107,0
Including:						
Production of goods	102,9	103,7	103,3	106,6	107,8	107,2
of which:						
Industry	102,8	103,9	103,4	106,0	107,6	106,8
Construction	102,5	103,0	102,8	113,6	114,7	114,3
Agriculture	103,5	102,5	103,0	101,1	98,8	99,8
Production of services	103,3	104,5	103,9	107,1	106,7	106,9
Market services	103,6	104,9	104,2	108,0	107,5	107,7
of which:						
Transport	103,2	104,3	103,8	106,7	106,1	106,4
Communications	116,0	116,0	116,0	124,3	128,2	126,3
Trade	105,0	106,5	105,7	109,6	109,7	109,7
Non-market services	101,6	102,1	101,8	102,1	102,0	102,1

Source: RF Goskomstat

In January through August of this year, the trends towards recovery of the Russia's economy continued to develop. Growth in production was observed across practically all sectors of the economy and industry. The trend towards abating inflation rates certainly was a positive factor facilitating the trend towards a growth in business activity. An additional factor behind the growth in final consumption was the zero inflation rate registered in August. According to the preliminary estimates published by the Ministry of Economic

Development, in January through August of 2003 the increase in GDP made 6.6 per cent as compared with 3.4 per cent registered in the respective period of the preceding year.

The factors behind the accelerating rates of growth in production were both high external demand, and the development of the processes of transformation of proceeds from external economic activities in domestic demand. In January through August of 2003, according to the data published by the Ministry of Economic Development, export of goods made US \$ 83.5 billion increasing by 25.8 per cent in comparison with the figures registered in the respective period of the preceding year. Due to the exceptionally favorable business situation on world markets of energy resources and metals, the impact of prices became the decisive factor facilitating the expansion of production in these industries. In January through August of 2003, the rate of growth in industrial output of the fuel and energy complex made 108.3 per cent, including a 111.5 per cent increase in oil extracting industry, as compared with the figures registered in the respective period of the preceding year. The growth in production of industries producing raw materials made 5.3 per cent (output of ferrous and non-ferrous metallurgy increased by 9.4 per cent and 4.8 per cent respectively).

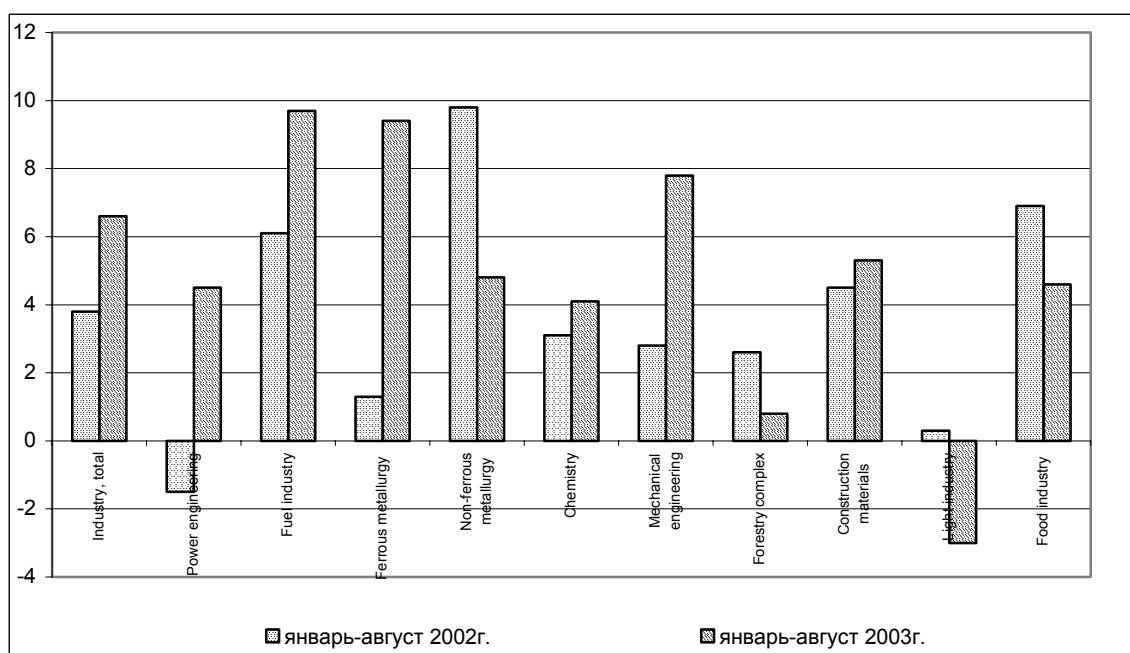


Fig. 1. Changes in the dynamics of output across branches of industry in January through August of 2002 and 2003, in % of the preceding period

The growing proceeds of exporters impacted other sectors of the economy. Rather high rates of growth were observed in final demand industries. The rates of output of final production exceeded the figures registered in January through August of 2002 by up to 6 per cent at the background of changes in the branch structure of industry. This year, the branches belonging to the investment complex developed at the fastest rates. In January through August of 2003, the index of production in the consumption complex made 104.2 per cent as compared with 107.3 per cent registered in the respective period of the preceding year, while respective indicators in the investment complex made 107.1 per cent and 103.0 per cent. As investment demand expanded, accelerating rates of production in mechanical engineering and construction materials industry became the specific feature of the Russia's economy. The increase in output of mechanical engineering and metal working made 7.8 per cent. The recovery of production in branches belonging to metallurgical, railroad, and electrical engineering, instrument making and communications industry, as well as a significant growth in the export of defense products permitted to compensate for the consequences of overproduction of cars.

The development of branches within the consumer complex is characterized by more modest dynamics. As concerns food industry, there the rates of growth decelerated and made 104.6 per cent as compared with 108.1 per cent registered in January through August of 2002. The trend towards a decline in output persists in light industry.

In the situation, where final demand branches demonstrate more smooth dynamics of growth in comparison with the more intensive expansion of investment and consumer demand, the saturation of the market was compensated by increasing amounts of import up to US \$ 45.8 billion, what is by 21.5 per cent above the level registered in January through August of 2002. As concerns the structure of imports, in contradistinction to the preceding year, there was observed a growth in import of machinery and equipment in stead of consumer goods. The share of machinery and equipment in the total amount of imports increased by 2.9 p. p. as compared with the figure registered in July of 2002.

The gap between the rates of growth demonstrated by domestic mechanical engineering and import of machinery and equipment is increasing at the background of the present dynamics and production structure of mechanical engineering. Since domestic mechanical engineering lacks capacities to meet the growing demand for production of new technologies, in the structure of investment the expenditures for purchase of imported equipment systematically increase. In the economy at large, in the first six months of 2003 the expenditures for imported machinery and equipment made Rub. 55.1 billion, or 24.1 per cent of the total amount of investment in machinery and equipment.

The commodity saturation of the consumer market mainly corresponded to the effective household demand for key types of food and non-food products.

In January through August of 2003, the retail trade turnover made Rub. 2807.1 billion and exceeded the level registered in the respective period of the preceding year by 8.4 per cent. At the same time, the turnover of retail trade with non-food products (109.3 per cent) grew at a rate outpacing the dynamics of food products (107.3 per cent). As the rates of growth in output of domestically produced consumer goods decelerated, the share of imports in the formation of retail trade turnover resources increased by 2 p. p. as compared with the figures observed in the 2nd quarter of 2002 and made 45 per cent. While the share of imported food products made 34 per cent of the structure of commodity resources in the 2nd quarter, the respective indicator of non-food goods was at 53.6 per cent, or by 1.4 p. p. above the level registered in the 1st quarter of this year.

The formation of this trend resulted from the persistence of outpacing rates of growth in real household incomes in comparison with the dynamics of domestic production and changes in the household expenditures structure. The decreasing share of expenditures for purchase of food products and mandatory payments creates conditions for a growth in savings. As on July 1, 2003, the amount of household deposits increased by 21.5 per cent as compared with the figures registered in the beginning of 2003, and by 45.8 per cent in comparison with the figures observed on the respective day of 2002. The additional pressure on the commodity markets is caused by the lack of a developed mechanism of transformation of household savings in investment.

In spite of the positive estimates concerning the prospects of development of the final demand branches in comparison with the raw materials sector, it shall be noted that in 2004 there will persist outpacing rates of growth in turnover of retail trade and imports as compared with the dynamics of domestic production. Therefore, the increasing impact of imports will persist in the formation of resources of final household consumption and affect the trends of formation of national savings.

O. Izryadnova.

Oil and Natural Gas Sector

The development of the oil and natural gas sector of the economy in 2003 is characterized by persisting trend towards an increase in extraction of oil and oil products formed in 2000 through 2002. In January through August, the total volume of oil output increased by 11.3 per cent in comparison with the figures registered in the respective period of the preceding year reaching the record high in the post-reform period, while the output of primary processed oil increased by 3.1 per cent. An increase in extraction of natural gas first registered the last year, continued (see Table 1). There was observed a certain increase in investment activity: in January through July the volume of production drilling grew by 7.6 per cent as compared with the respective period of the preceding year, while natural gas surveying drilling increased by 17.0 per cent in the first six months of 2003. at the same time, due to a certain decline in the volume of drilling observed last year, the commissioning of new oil wells was down by 9.1 per cent. The decline in the volumes of surveying drilling continued (oil drilling decreased by 6.8 per cent in January through July, while natural gas drilling fell by 11.8 per cent in the first six months of the year), what may be explained by due a rather large surplus of oil reserves. The degree of processing of oil in the oil processing industry increased from 69.6 per cent in

January through July of 2002 to 70.2 per cent in the respective period of this year. The share of high octane gasoline in the total amount of motor gasoline increased from 48.2 per cent in January through July of 2002 to 50.6 per cent this year.

Table 1

Oil, oil products, and natural gas output, in % of the respective period of the preceding year

	1999 г.	2000 г.	2001 г.	2002 г.	2003 г. January - August
Oil	100,3	105,9	107,7	108,7	111,3
Gas condensate	104,7	103,8	106,7	112,8	108,1
Primary oil processing	102,9	102,7	103,2	103,3	103,1
Motor gasoline	102,2	103,6	100,6	104,9	102,7
Diesel fuel	104,2	104,9	102,0	104,7	102,1
Furnace fuel oil	94,8	98,3	104,2	107,1	101,1
Natural gas, cub. m. billion	99,7	98,5	99,2	101,9	103,1
Oil gas, cub. m. billion	103,2	102,5	105,0	110,5	124,2

Source: RF Goskomstat.

Over the last few months, there was observed a significant growth in prices of oil and oil products occurring on the domestic market. In August, the average domestic oil price (producers' price) in dollar terms increased to US \$ 65.8 per metric ton. The average motor gasoline price has reached US \$ 211.8 per metric ton, what is the record high over the whole post reform period. In the last few months, prices of natural gas were rather stable and close to the pre-devaluation level (see Table 2, Fig. 1 and 2).

Table 2

Domestic oil, oil products, and natural gas prices (in US \$) in 1999 through 2003 (average wholesale prices of enterprises, US \$ / metric ton)

	1999 Dec.	2000 Dec.	2001 Dec.	2002 Dec.	2003 March	2003 June	2003 July	2003 August
Oil	37,0	54,9	49,9	60,7	54,3	53,8	60,4	65,8
Motor gasoline	171,9	199,3	151,5	168,8	192,4	191,9	201,4	211,8
Diesel fuel	125,0	185,0	158,5	153,8	201,9	182,2	186,3	191,0
Furnace fuel oil	46,1	79,7	47,1	66,1	78,2	59,9	76,6	82,4
Gas, US \$ / thos. c. m.	2,2	3,1	4,8	5,9	6,2	6,2	6,0	6,1

Source: calculated on the basis of RF Goskomstat data.

In the first six months of 2003, the oil exports increased by 11.4 per cent in comparison with the figures registered in the respective period of the preceding year, while export of oil products grew by 6.9 per cent (see Table 3). In the first half year, the share of exports in commodity resources of diesel fuel made 58.6 per cent, furnace fuel oil – 47.9 per cent, motor gasoline – 14.8 per cent. The high level of world oil prices was the factor behind the significant growth in export proceeds. In the first six months of 2003, the amount of oil exports increased by 37.3 per cent as compared with the figures registered in the respective period of the preceding year. In the first half year of 2003, the aggregate amount of export of oil and base oil products made US \$ 22.9 billion, what was by 44.5 per cent above the level registered in the first six months of the preceding year.

The import of oil products also significantly increased. For instance, in the first six months of 2003, imports of motor gasoline grew by 81.1 per cent in comparison with the level registered in the respective period of the preceding year, while the share of imports in the gasoline resources increased from 0.1 per cent to 0.2 per cent. However, the specific weight of imports remains rather low. For instance, in the first six months of 2001 the specific weight of imports in the gasoline resources made 0.6 per cent, while in the first half year of 1998, i.e. before the Ruble devaluation, it was at 8.7 per cent.

Table 3

Export of oil, oil products, and natural gas from Russia, in % of the respective period of the preceding year

	2001 first half year	2002 first half year	2003 first half year
Oil, total	109,2	114,3	111,4
including:			
Export to non-CIS countries	107,2	106,8	111,4
Export to CIS countries	125,2	164,3	111,1
Oil products, total	101,5	114,3	106,9
Including:			
Export to non-CIS countries	103,5	115,1	106,2
Export to CIS countries	67,4	95,4	125,5
Natural gas, total	87,0	104,0	102,5

Source: RF Goskomstat.

This year, the decline in the Iraq oil extraction and the limitations on production of oil set by OPEC member countries resulted in a rather high oil prices on the world markets and stable exceeded US \$ 25 per barrel. In August, the average price of the oil basket of OPEC member countries was above the upper target price threshold (US \$ 22 to US \$ 28 per barrel) set by the organization and made US \$ 29.69 per barrel (see Table 4).

Table 4

World oil prices in 1999 through 2003, US \$ per barrel

	1999	2000	2001	2002	2003 1 quart	2003 2 quart	2003 July	2003 August
Brent, UK	17,97	28,50	24,44	25,02	31,49	26,03	28,35	29,79
Urals, Russia	17,30	26,63	22,97	23,73	29,24	23,86	26,84	28,74
OPEC oil basket	17,47	27,60	23,12	24,34	30,45	25,87	27,50	28,69

Source: OECD International Energy Agency.

At the regular OPEC conference held on September 24, 2003, the member countries of the organization decided to decrease oil extraction by 900 thousand barrels a day starting on November 1 of this year. Both this decision of OPEC and a certain recovery observed in the world economy allow to expect that oil prices will remain at a rather high level in the short term even in case Iraq increases its oil exports. According to the base variant of the last forecast (September, 2003) of the US Department of Energy, world oil prices defined as the average US oil import price will make about US \$ 27.1 per barrel in the 3rd quarter of 2003, and US \$ 24.74 per barrel in 2004 (see Table 5). In the case this forecast is correct, it would mean the persistence of rather favorable external conditions for the Russia's oil industry and the national economy on the whole.

Table 5

World oil prices in 1999 through 2004

	1999	2000	2001	2002	2003 (estimate)	2004 (estimate)
US import oil price, US \$ / barrel	17,22	27,72	22,01	23,69	27,74	24,74

Source: U.S. Department of Energy/Energy Information Administration.

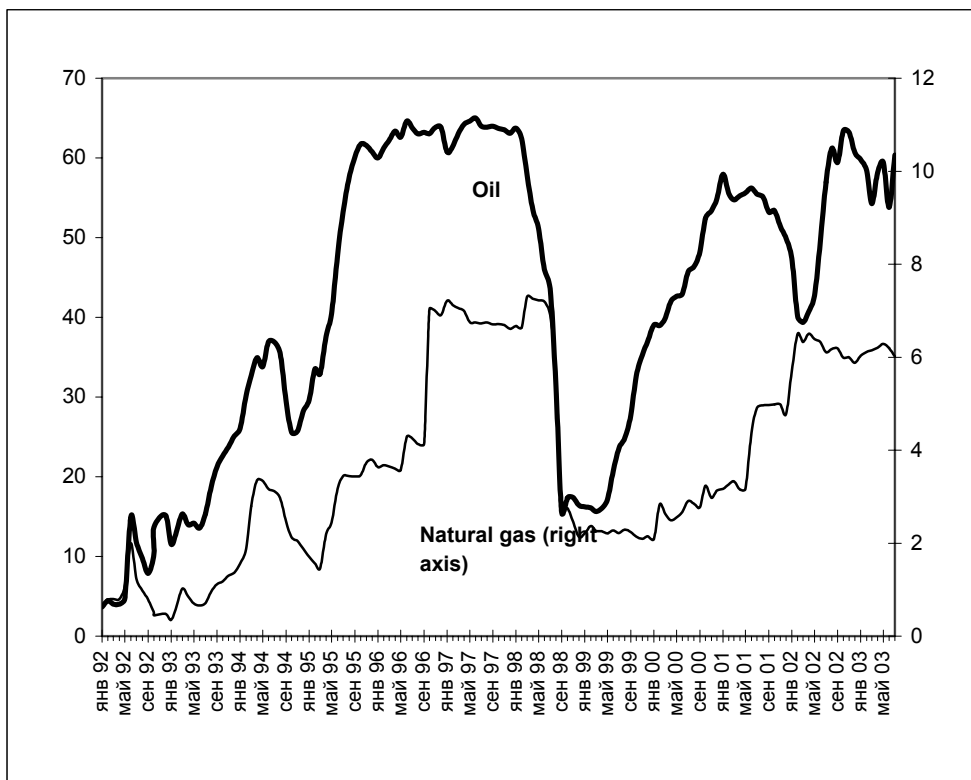


Fig. 1. Average wholesale oil and natural gas prices set by enterprises in US \$ terms in 1992 through 2003, US \$ / metric ton, US \$ / thous. c. m.

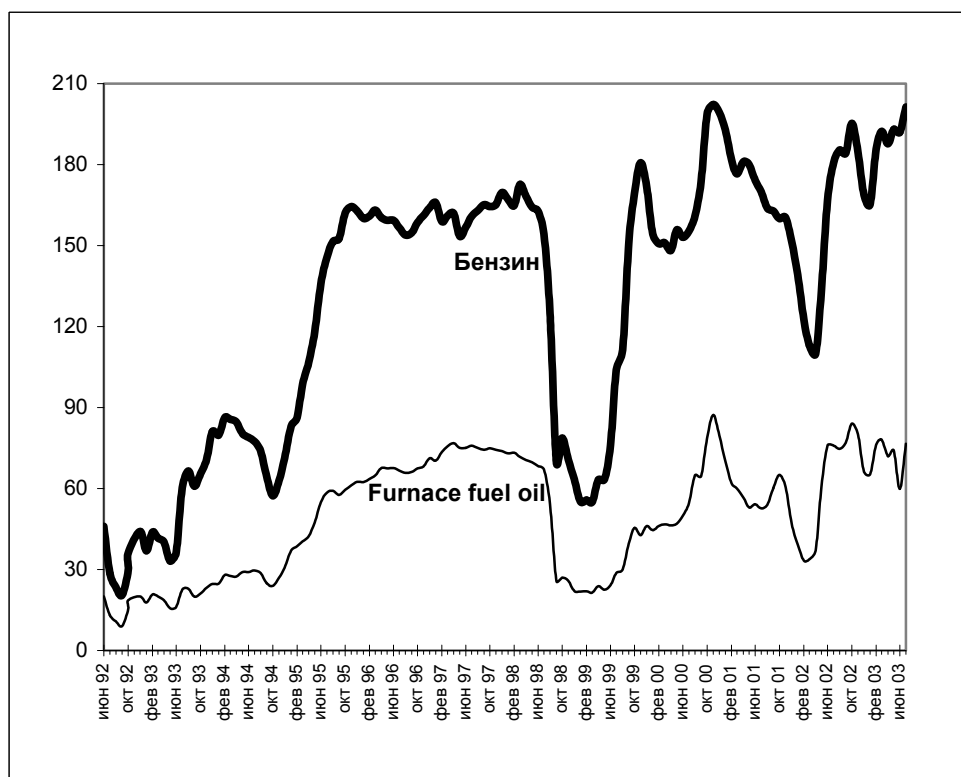


Fig. 2. Average wholesale motor gasoline and furnace fuel oil prices set by enterprises in US \$ terms in 1992 through 2003, US \$ / metric ton

Yu. Bobylev

IET Business Survey: Industry

According to the evaluations of the Center for Macroeconomic Analysis and Short Term Prognostication (CMASTP), the official statistical data on the dynamics of the Russia economy indicate a sharp deceleration in the economic growth in July and August. The average monthly rate of growth in GDP has declined to 0.1 per cent as compared with 0.7 per cent and 0.5 per cent observed in the 1st and 2nd quarters respectively. At the same time, in August GDP diminished, according to estimates, by 0.3 per cent. The situation in the industry is somewhat better, although certain deceleration of growth here is also clearly perceptible. The rate of growth in industrial output made only 0.4 per cent a month in July and August mainly due to a decline in dynamics observed in August.

The deceleration of growth in the 3rd quarter was caused by the negative shift in the balance of favorable and unfavorable factors affecting the key macroeconomic trends. The summer slide of Euro relative to US \$ has accelerated an increase in imports, what facilitated a decrease in the dynamics of output in final industries (2nd quarter – 0.8 per cent a month, July and August – 0.4 per cent). The trend towards the outpacing growth in wages and salaries as compared with the productivity of labor has become noticeable again. It caused a decline in profitability in the industry. The growth in investment has sharply (almost three times in terms of dynamics) decelerated, while in July and August there was registered no growth at all. The dynamics of export volumes decelerated each quarter. The key factor behind this development is diminishing exports of mechanical engineering products, which sharply decreased in July and August.

Two industries, where recovery continues, account for the persistence of the positive dynamics observed in the Russia's economy. The growth in output of food industry is facilitated by the export of fish and sea products (fish industry) and growing competitiveness on the domestic market (meat and milk industry). However, the decelerating dynamics of domestic demand for food items and especially a sharp increase in food imports registered in July and August put the stability of this growth to the question. Fuel industry resumed export of oil, what supported the dynamics of oil extraction. Aggregately, these two industries accounted for more than half of the total increase in industrial output registered in July and August.

The first September results demonstrate that in the few next months there is probable a further deceleration in growth in the Russia's industry. The September survey registered a decline in the rates of growth in sales, stabilization of growth in output, and decreasing forecasts of changes of these indicators. As a result, the aggregate industrial confidence index calculated by IET in accordance with the adjusted European methods declined by 6 points. The growth in confidence registered in the Russia's industry since April has stopped.

In September, the intensity of growth in effective demand dropped by 7 points. At the moment, the changes in the dynamics of sales resulted only in stabilization of the rates of growth in output. In September, this indicator, according to enterprises' estimates, did not change in comparison with the figures registered in August. As a result, 31 per cent of enterprises reported that their output dynamics began to outpace the dynamics of sales, while the correlation between output and demand declined to 59 per cent from 68 per cent observed in August. A month ago the surge in demand allowed producers to increase the degree of this correlation by 12.5 percentage points at once, what became the maximum over the whole post-default period. The decrease in the share of enterprises demonstrating equal dynamics of output and demand occurred across practically all industries. This decrease was especially sharp in power engineering (by 27 percentage points), forestry complex (14 p. p.), chemistry and petrochemistry (13 p. p.). A closer correlation between output and demand was registered only in construction industry (demonstrating a decline in the rates of growth and demand) and food industry where these rates accelerated.

The persistence of the balance of evaluations (above norm – below norm) at the September level may be also considered as a negative factor. Over the preceding 8 months of 2003, this indicator has increased from –65 per cent to –39 per cent with the only seasonal “delay” in May. However, the share of “normal” evaluations in September increased reaching 56 per cent, what is the absolute maximum.

The excess of the share of reports on a growth in profits over the share of reports on its decline may be also listed among positive September developments. As a result, the balance of this indicator became positive. Such a development has been registered for the first time since the beginning of the monitoring in early 2002. At the moment, this excess is minimal (+ 1 p. p.), it was registered mainly in power engineering, metallurgy, light, and food industries.

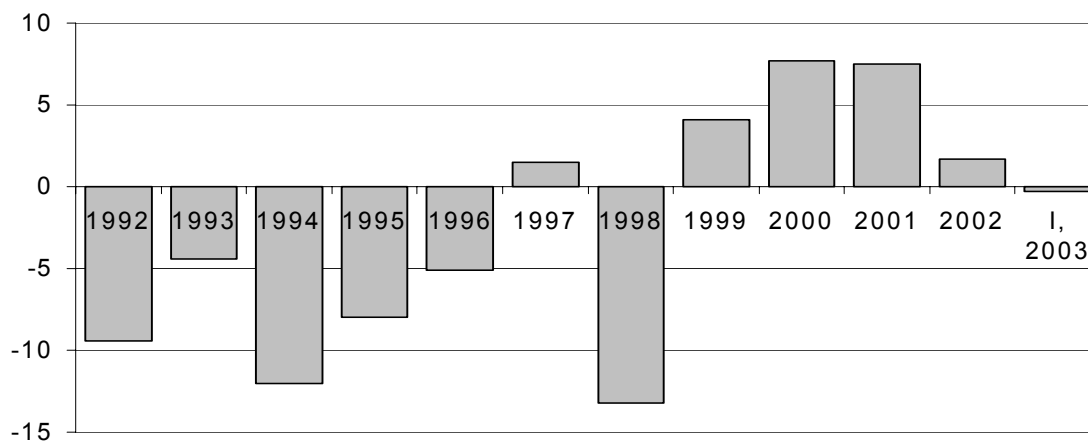
In September, the estimates of changes in effective demand lost 12 points of confidence at once. At the moment, only 21 per cent of enterprises hope to increase their volumes of sales in the few next months, while early in the year there were registered 36 per cent of such expectations. A decrease in confidence was observed across all industries with the exception of power engineering and food industry, while the full stop of growth in cash demand is probable in metallurgy, chemistry, and petrochemistry.

Forecasts of changes in output were also principally adjusted in September. While in the preceding months the balance of these forecasts increased from 21 to 36 points, at the moment it decreased to 28 p. p. This change has allowed enterprises to follow rather closely to the expected changes in demand. Over the month, the share of correlated respective estimates decreased from 73 to 68 per cent across the industry. Enterprises across almost all industries adjusted their plans of output. Only in power engineering and metallurgy enterprises demonstrated increasing optimism with regard to their plans. At the same time, it shall be noted that power engineering lags rather far behind the “demand security” of its production plans: the correlation between the forecasts of demand and output in the industry makes 47 per cent, while this indicator registered in metallurgy makes 75 per cent. As concerns mechanical engineering, there this indicator is at 69 per cent.

S. Tsukhlo

Russian agrifood sector in 6 months 2003

In January-June 2003 Russian agricultural production fell for the first time since 1998 crisis. The fall was minor – only 0.3%, and can surely be attributed to unfavourable weather conditions that resulted in, first, the shrinkage of areas planted, and, second, in harvesting delays⁷. The annual growth rates will most likely be positive – although the grain crop is poor, the crop of sunflower seeds, sugar beets and vegetables is good, and livestock production growth is rather stable. Nevertheless, the 2002 and 2003 indicators evidence that the after-crisis growth factors in the agrifood sector are exhausted while new impulses haven’t been created. In this situation state policies aim to sustain the sector’s dynamics with the help of protectionist measures. There is also one more incentive for applying them – the tactics of on-going negotiations on Russia’s accession to WTO. However, the 2002 and 2003 experience shows that trade protectionism is unable to solve the problem – the sector’s growth rates continue to fall (Picture 1).

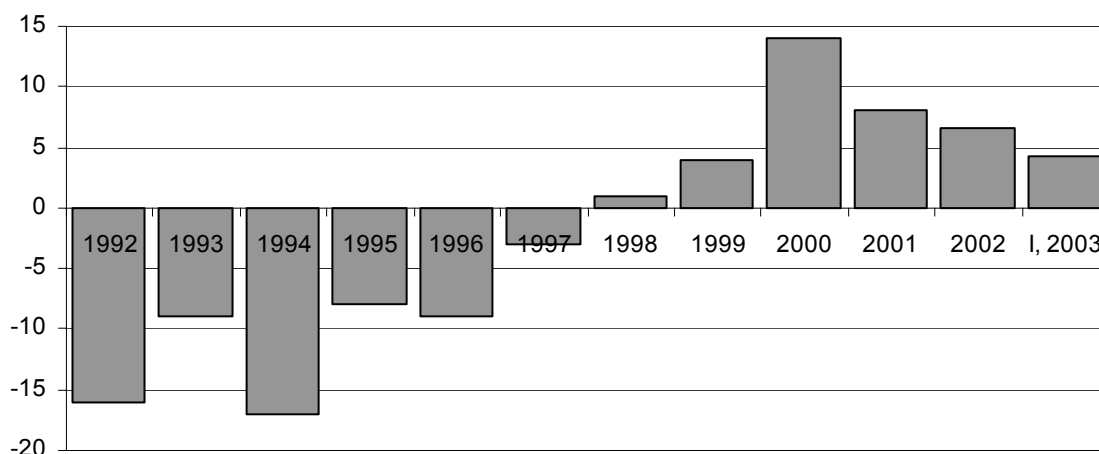


Source: RF State Committee for Statistics.

Picture 1. Russian agriculture: percent change of annual output in 1992 - 6 months 2003

Growth in the food industry still continues (4.3%) but is noticeably slowing down (Picture 2).

⁷ Smaller grain crop could not yet fully affect the 6 months gross agricultural production indicators. But their deterioration (as compared with the same period previous year) was predetermined by 6% reduction of areas planted and serious delays in harvesting all crops (including fodder crops that are harvested in the first half of a year).



Source: RF State Committee for Statistics.

Picture 2. Russian food industry: percent change of annual output in 1992 - 6 months 2003

Agricultural production

The total size of areas planted reduced by 6.3% down to 78.9 million hectares. In major grain-growing regions producers shifted to planting sunflower and sugar beets instead of grains. This was due to both weather conditions (winter-kill of winter grains, late spring preventing re-sowing of killed areas in summer grains) and economic factors: over-production of grain in 2002 resulted in a sharp drop of prices for it on the domestic market. Still, it's worth noting, that growth of areas planted in sunflower, sugar beets and vegetables has become a trend (Table 1).

Table 1

Areas planted in major agricultural crops, million ha

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Grains	54.7	53.4	53.6	50.8	46.8	45.9	47.6	48.2	42.5
Sunflower	4.1	3.9	3.6	4.1	5.5	4.6	3.8	4.089	5.3
Sugar beets	1.1	1.1	0.9	0.8	0.9	0.8	0.8	0.814	0.924
Potatoes	3.4	3.4	3.4	3.3	3.3	3.2	3.3	3.2	3.2
Vegetables	0.8	0.7	0.7	0.7	0.8	0.8	0.8	0.8	0.9

Source: Social and economic situation in Russia, corresponding years.

Expert estimates⁸ of 2003 grain crop range from 62 to 70 million tons. Forecast of sunflower seeds crop is more optimistic – 4.8 million tons as compared with 4.2 million tons in 2002.

Growth in the livestock sector slowed down (Table 2) due to smaller production in household and individual private farms.

Production of slaughter livestock and poultry in corporate farms is growing. Large farms primarily expand production of pork (by 20.1%).

Table 2

Total production of major livestock products, January-June as % of the same period previous year

	1999	2000	2001	2002	2003
Slaughter livestock and poultry, live weight	91.0	103.2	99.4	106.0	106.0
Milk	95.9	99.38	101.7	101.3	98.7
Eggs	97.6	104.8	101.1	105.8	100.9

Source: Social and economic situation in Russia, corresponding years.

⁸ Estimates of “Sov-Econ” and “Unidell” companies.

After the 2002 drop of purchase prices the production of milk is decreasing. At the same time its efficiency in corporate farms is improving: the output falls at a slower rate (5.9%) as compared with herd reduction (8.3%), i.e. the production of milk per 1 cow continues to grow.

Production of food

In 6 months 2003 food industry grew by 4.3%. Similar to the previous year the fastest growth is observed in production of meat and milk products (8.6%) (Table 3).

Table 3

Production of major food products, January-June as % of the same period previous year

	2000	2001	2002	2003
Meat	113.2	109.8	113.0	114.1
Sausage	115.3	109.2	114.8	111.4
Butter	103.5	106.1	109.3	95.1
Whole milk products	111.5	107.4	112.4	108.2
Vegetable oils	191.6	98.1	66.3	156.4
Sugar	103.2	91.4	92.4	82.1
Flour	97.2	101.6	89.0	102.5
Groats	97.8	129.6	94.0	78.4
Macaroni	97.6	108.4	115.9	102.9
Margarine products	121.4	113.7	97.4	117.8
Canned meat	87.7	98.6	108.0	93.1

Source: Social and economic situation in Russia, corresponding years, January-June.

Active investments in production of domestic vegetable oil and derivative products started to bring results: the output of oil grew by almost 60%, the output of margarine – by 18%. In the first three months 2003 exports of sunflower oil were up more than 5 fold while imports in the first half of the year reduced by 16%. Russia is approaching the self-sufficiency level in this product. In the 4 recent years domestic sunflower processing capacities expanded so that now they exceed gross output of the crop. The expected 2003 crop is suggested to cover only 80-85% of demand for raw input.

Production of vine continues to grow at a high rate. In the first 6 months 2003 it was up 20% although domestic consumption increased only by 6-7%. Given that Russian vine is not an export item, one can suppose an active import substitution on the respective domestic market.

Production of butter continues to fall while its imports grow. However, output of other major milk products is up more than 8% (except for ice-cream – only 4%).

Production of agricultural inputs

Worsening of agricultural producers' performance in 2002 resulted in further reduction of demand for agricultural machinery and the corresponding production drop in agricultural machine building. Our studies revealed that the potential demand for machinery in the farm sector is over-estimated: after discontinuation of state leasing (intended to satisfy need in tractors and harvesters) agricultural producers' demand shifts towards equipment for livestock farms being the basic limitation factor. For instance, it was the case in Perm oblast in 2002-2003 when producers were given the right to make a free choice of machinery and equipment bought under state support programs.

Table 4

Production of agricultural inputs as % of January-June previous year

	2000	2001	2002	2003
Tractors	153.0	81.2	67.5	69.9
Tractor ploughs	154.6	125.7	74.1	38.3
Tractor seeders	182.6	119.1	96.4	65.9
Tractor cultivators	2.4 fold	108.7	108.3	107.2
Grain harvesters		2.4 fold	100.8	63.0
Tractor mowers		67.3	125.6	38.3
Mineral fertilizers	110.5	105.7	102.6	100.7

Source: Social and economic situation in Russia, corresponding years, January-June.

Slower growth of mineral fertilizers' production is primarily due to unfavourable situation on foreign markets. Anti-dumping proceedings against Russian suppliers of mineral fertilizers started in late 2002 in the US, Brazil, Poland and some other countries entailed shrinkage of exports (98% as compared with January-May 2002). Domestic demand cannot yet make up for losses on foreign markets.

Growth in the livestock sector induces demand not only for respective equipment but also for high quality feeds. Production of protein and vitamin additives has been growing for several years and only in 6 months 2003 is up almost 2 fold.

Financial performance of agricultural producers

The first half of 2003 saw the continuation of trend that originated in 2002, i.e. the strengthening of budget discipline in agrifood sector financing. In January-August agriculture has received 82% of funds to be allocated to it within 9 months under budget section "Agriculture and fishery" (in August 2002 – 74.4%).

In the first 3 months 2003 the major contributors to agrifood sector budget financing were regional budgets. The share of federal budget was then less than 20% but by the end of July it grew up to 51%. For the first time in several recent years the contribution of federal budget to agrifood sector financing exceeded 50%.

In addition to stabilization of budget financing, the sector was positively affected by growth of foreign investments that started this year. In the first half of 2003 foreign investments in Russian agriculture amounted to 37 million US dollars while in the same period previous year they were as small as 7 million dollars.

Similar to the previous year, the lowering of prices for agricultural products in 6 months 2003 became the basic factor of deteriorating financial performance of farm producers. During 7 months prices received by them dropped not only in real but also in nominal terms. At the same time prices for agricultural inputs grew, although to a lesser extent than in 2002. Prices for electricity rose by 13%, for fuels and oils – by 9%. Price disparity aggravated financial problems of agricultural producers.

The number of farms having outstanding debts reduced from 21.3 thousand in May 2002 to 19.1 thousand in May 2003. At the same time net profit received by corporate farms in the first half of the year is more than twice less than in the same period previous year. The share of profitable farms reduced from 52.4% in 2002 (i.e. over one half) to 48.2%.

According to the data of Commission for financial recovery of agriculture (formed in the Ministry of Agriculture) by the beginning of 2003 agrifood sector's debts to budget and non-budget funds exceeded 120 billion rubles, its total creditor indebtedness amounted to 330 billion rubles including 147.7 billion rubles of outstanding debts.

The federal government made an attempt to solve the sector's financial problems by adopting in July 2002 the Law "On financial recovery of agricultural producers". But the full year of operation revealed its insufficiency since the law does not cure deeper problems the solution of which requires actions beyond restructuring of debts and reorganization of farms. Besides, there are factors hindering the law's implementation. The basic of them are the persisting price disparity preventing agricultural producers from meeting the restructuring terms and the compulsory bankrupting of non-efficient farms. Not the least by their negative effect are bureaucratic hindrances encountered by producers when preparing required documents.

According to the Ministry of Agriculture's data as of July 1, 2003 only 6124 farms (whose debts total 44.5 billion rubles) could join the restructuring program. The rest are either undergoing bankruptcy proceedings or cannot sustain the 3-months schedule of current payments.

In the first half of the year the program of financial recovery was put into practice only in 131 farms, with which agreements were signed on restructuring of debts amounting to 1.2 billion rubles, or about 1% of the total indebtedness. So, the year of the Law's operation has proved its non-workability.

In order to encourage producers joining the financial recovery program the Government resolved to write off by April 1, 2004 57 billion rubles of penalties and fines imposed on farms for delayed payments to the budget. However, only farms that joined the restructuring program are eligible for this writing-off, and since they are still very few such an amount is unlikely to be written off by the specified date.

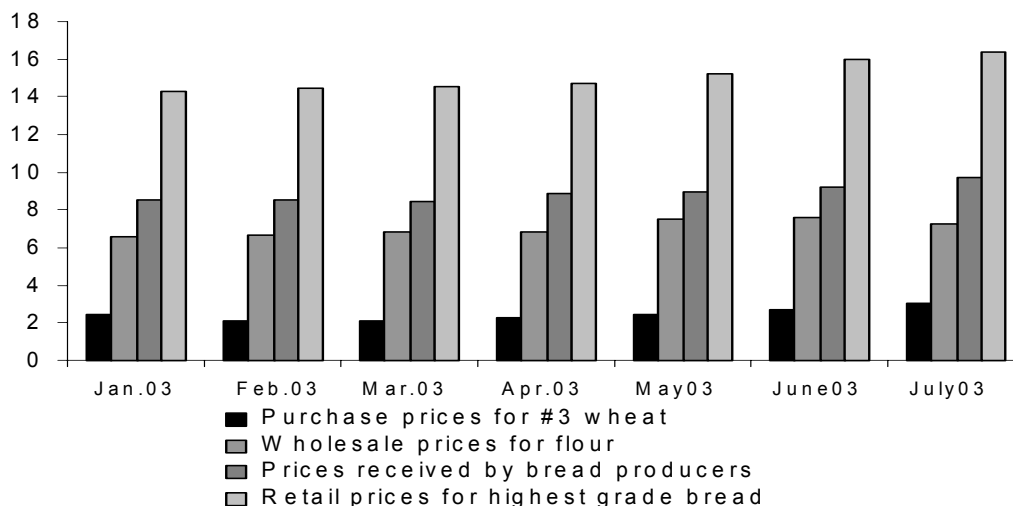
Situation on agricultural and food markets

In the first half of the year personal incomes grew faster than in the same period previous year while retail prices – slower. This situation created favorable conditions for the expansion of potential demand for food and, respectively, for the growth of its domestic production. Consumption and sales of price-elastic items,

first of all meat products, noticeably enlarged. Prices for bread and potatoes rose at the highest rate resulting in smaller consumption of these products.

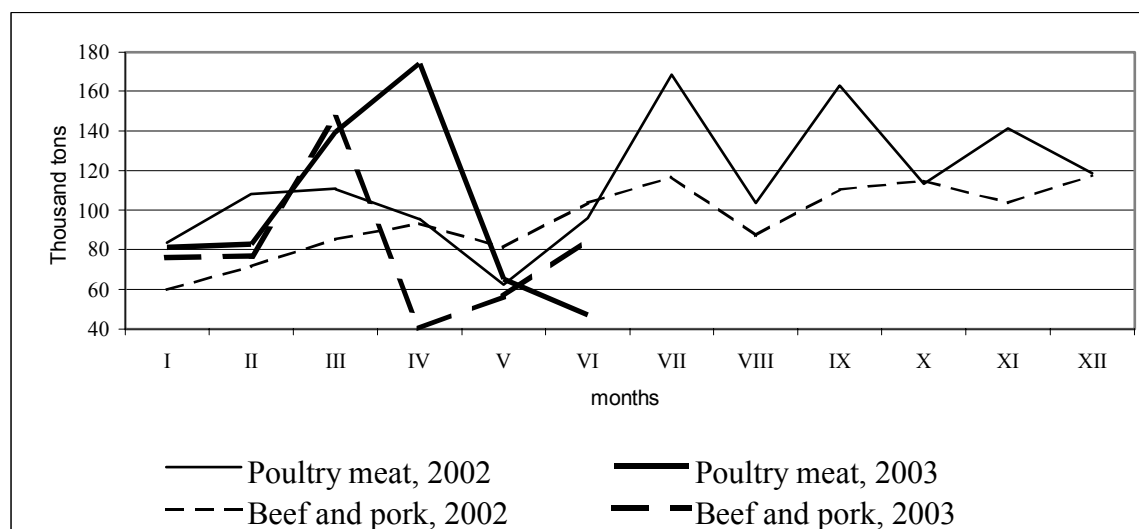
The situation on grain market in the first half of the year was shaped by relatively large domestic grain crop in the past two years and high demand for grains on the world market. These factors determined two correlating trends on the Russian market: low domestic prices for grain and massive grain exports. 2002 grain interventions produced a certain stabilization effect, although only in Siberian regions.

Still, record grain exports resulted in strengthening of purchase prices for grain and in higher prices for flour and all other grain products by spring 2003. The trend was supported by sharp rise of prices for electricity (by 12% in January-March 2003 as compared with 5% in the same period previous year). The largest contributor to the final price for bread is retail margin; throughout the first half of the year it didn't fall below 40%.



Source: calculated using data of the RF Ministry of Agriculture and "Social and economic situation in Russia, January-July 2003".

Picture 3. Prices at different levels of the grain chain, rubles per kg



Source: Social and economic situation in Russia, January-June 2003.

Picture 4. Imports of poultry, beef and pork to Russia

In the current year the output of grain will be far below those of the two previous years. It is estimated at 70 million tons that is not a bad crop for Russia. Together with 9.5 million tons of beginning stocks it is sufficient to cover domestic demand and to export at least 3-5 million tons of grain.

The dominating factor on domestic meat market in the first half of the year was the introduction of import quotas. Domestic production and sales of livestock and poultry by corporate farms as well as meat

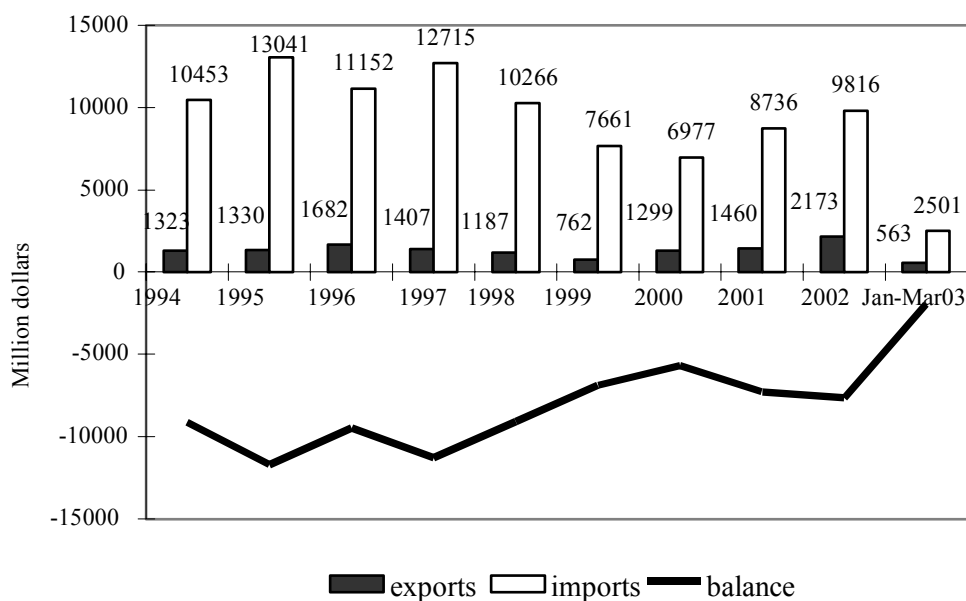
consumption continued to grow. As it was expected, the share of CIS countries in meat imports expanded, first of all due to bigger supplies of fresh and frozen meat. Besides, large stocks of meat were imported just before the enforcement of quotas (Picture 4).

Shorter imports of poultry at the beginning of the second part of the year resulted in sharp rise of prices for it (according to some expert estimates – up to 50%). Since the current legislation does not allow to import poultry in excess of the quota, by the end of the year consumer preferences can shift towards beef and pork, the share of which in the total meat consumption in Russia is too high as it is.

Consumption of milk and milk products grows since 2000. Expanding demand is increasingly covered by dairy imports, the volume of which in the first half of 2003 was the largest in the 6 recent years.

Foreign trade in agricultural and food products

Growth of both imports and exports of agrifood products continuing for the third successive year has become a sustainable trend. Consequently the negative balance of trade in these items that notably improved after 1998 crisis started to aggravate again (Picture 5).



*- less trade with Belarus.

Source: Customs *statistics of RF foreign trade*.

Picture 5. Russian agrifood exports and imports in 1994-2003*

At the beginning of 2003 Russian agrifood exports continued to demonstrate growth (by 56% in January-March as compared with the same period previous year), the basic factors of which were supplies of grain, sunflower seeds (the domestic output of which in 2002 was rather large) and sunflower oil. In the second half of the year exports will be shaped by smaller grain crop but rather good new crop of sunflower seeds as well as continuing revival in the food industry.

The total Russian grain exports in 2002/2003 MY amounted to about 17 million tons. In the current season grain crop is expected to be 20% smaller, and export supplies are unlikely to exceed 5 million tons. The profitability of grain export given rising domestic prices will depend on the world prices. An additional incentive for exporting grain will be high demand in Ukraine where grain crop this year is poor.

In 2003 areas planted in sunflower expanded by 30% and larger crop is expected. Thus prices for it on the domestic market will be below those a year ago. This can foster export of sunflower seeds, the more so as USDA forecasts higher world demand for oilseeds in 2003/2004, especially in the EU.

The third factor of Russian agrifood export in 2003 is the production growth in domestic food industry. Producers of macaroni and bakery products begin to benefit from their competitive advantages and to enter the world market. From 1997 exports of these items grew 10 and 5 fold, respectively.

This year Russian import of agricultural and food products is shaped by contradictory factors. On the one hand, its positive dynamics is supported by higher real personal incomes (up 8.8% in 2002 and 14% in the

first half of 2003) and larger demand of processing industry, also experiencing growth and used to consume imported raw inputs. On the other hand, the strengthening policies of agrarian protectionism aim to suppress food imports.

In 2002 import supplies actually restored to the level of 1998 that became a turning point for Russian agrifood import. In January-March 2003 import of agricultural and food products was 14.3% above the corresponding 2002 indicator.

A noteworthy fact is the growth of grain imports that started from April due to pessimistic forecasts of new crop. As a result imports of wheat in the first half of 2003 exceeded the corresponding 2002 indicator by 44.4%. Supplies from Kazakhstan began to account for a noticeable share of Russian grain imports. The fact is due to low price for Kazakh grain (in the situation of growing domestic prices) encouraging Russian traders to re-export it to the world market.

Import of basic meat products (beef, pork and poultry) in 2003 was affected by introduced meat quotas. Quota constraints on import of poultry came into force in May, on import of beef and pork – in April. Starting from this moment imports of meat products began to decline. Still, traders haven't missed the opportunity to prepare for the expected drop of supplies after introduction of quotas, and imported large quantities of meat in preceding months. Thus on the whole no notable changes have occurred in the supply of imported meat on the Russian market in the first half of 2003.

Agricultural policies

Agrarian policies of the two recent years were determined by three basic factors, the combination of which resulted in stronger government's adherence to protectionist measures. First, the exhaustion of sector's growth factors engendered by 1998 crisis urges to look for new short-term and efficient mechanisms to support lowering rates. As paradoxical as it may seem, the second factor of stronger protectionism are negotiations on Russia's accession to WTO. The WTO Agreement on Agriculture requires all countries to reduce support to agriculture by a single percent beginning from the base (i.e. effective by the date of the Agreement's enforcement) level⁹. Respectively, the newcomers have an incentive to elevate this base level by rapidly enhanced protectionism. As a result, Russia hurries to introduce such measures that are probably not needed and even contradict national interests.

On the other hand, budget opportunities for funding agrarian protectionism are very constrained, and thus it's enhanced by means of "free" for budget measures – import quotas and tariffs.

For instance, the three years of conducting sugar quota auctions have proved their inefficiency for supporting agricultural producers (although this goal was declared at the moment of their introduction) and immense detriment for consumers (price for sugar on the domestic Russian market is one of the highest in the world). In 2003 the auctions were abolished but ways are still found to maintain quoting in order to strengthen position at negotiations with WTO. Similarly, meat quotas introduced this year demonstrate both inefficiency (they didn't help to constrain import of meat) and negative effect on domestic meat processors and traders. Still, instead of abolishing the quotas the lawmakers keep on modifying their mechanism.

In 2003 the Law on agricultural land transferability came into force. As we predicted a year ago, it did not foster the transfer of farmland. But what is more important, the Law actually does not work – contrary to its provisions the practice of renting land shares persists. On the one hand, it helps to retain in agribusiness large investors that in the recent 4-5 years secured the inflow of capital in the sector. But on the other hand, it supports legal nihilism in the agrarian community since violation of the law is not punished.

Foreign trade regulation

In 2003 foreign trade is regulated in accordance with principles of rigid agrarian protectionism that became more diversified from the point of view of its instruments and affected imported commodities. Export support hasn't got enough attention from the government although it could encourage positive trends in the agrifood sector that are gradually vanishing.

Due to the inefficiency of auction distribution of raw sugar import quotas, it won't be prolonged.

In 2003 quotas were also applied on the meat market. Although they were put in force only in April, their senselessness for supporting domestic production (as we forecasted much earlier) has already revealed. First, restrictions on import from non-CIS countries were offset by shadow supplies through the CIS. The CIS

⁹ Here we do not take into account preferences to developing countries since they have no bearing on the following conclusions.

share in the total imports of pork and beef grew from 20% in 2002 and early 2003 to 46% in April, 32% in May and 27% in June. Second, fresh and chilled beef was included in the list of quoted meat products only in August. Earlier exporters could benefit from this omission: imported meat crossed Russian border in a chilled form and then was frozen for further transportation inside the country

In 2003 import duty on rice and rice flour was introduced – 10% but not less than 0.03 EUR per kilogram. Protection of domestic producers is hardly the main goal of this measure. Rice growing in Russia is not a traditional business. Besides, no massive imports of this crop that could depress domestic production are observed. On the contrary, the latter demonstrates some growth. Similar to meat and sugar quotas this restriction has obviously become one more victory of interested lobbyist groups representing food industry.

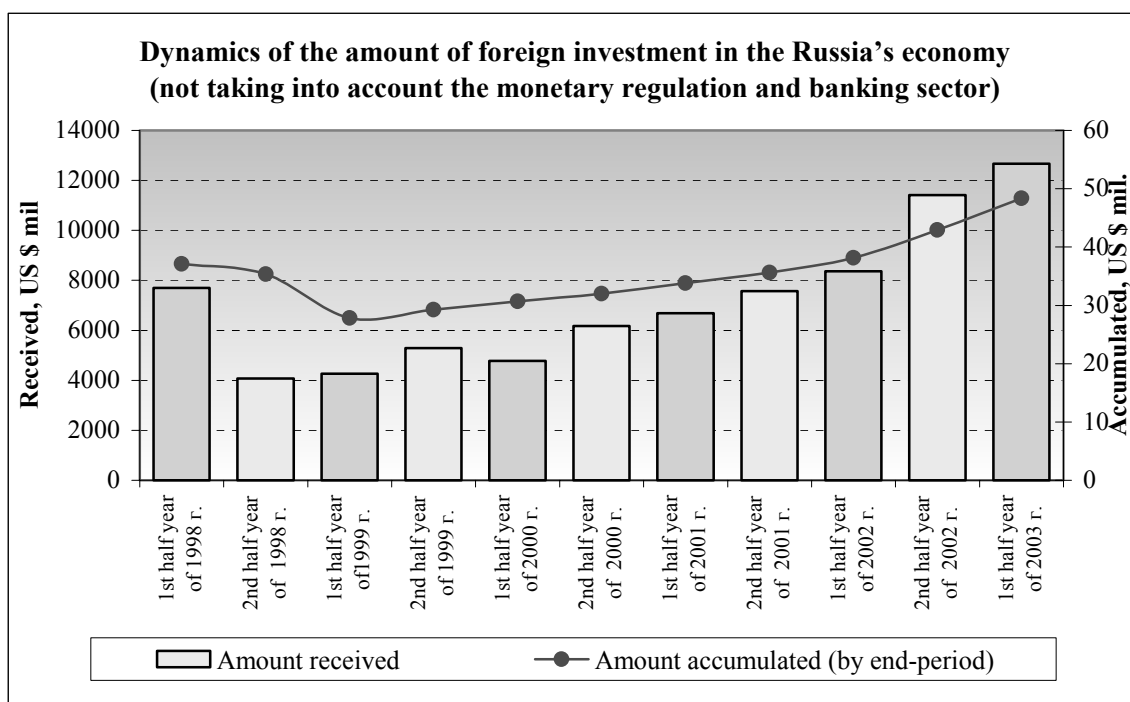
E.Serova, I.Khramova, T.Tikhonova, N.Karlova, O.Shick

Foreign investment in the Russia's economy

This year, the RF investment sphere is characterized by growing business activity facilitated by an improvement in the investment climate and stable growth in the Russia's economy. According to the FDI Confidence Index published by the consulting company Kearny¹⁰ in September of 2003, this year Russia was ranked 8th (in 2002 it was 17th, in 2001 – 32nd).

In the first six months of this year, the total amount of foreign investment in the Russia's economy increased by 51.3 per cent in comparison with the figures registered in the first half year of 2002 and made about US \$ 12.66 billion. As on July 1, 2003, the amount of accumulated foreign investment in the Russia's economy, including investments from the CIS member countries, was estimated to make US \$ 48.3 billion (see Fig. 1).

Figure 1.

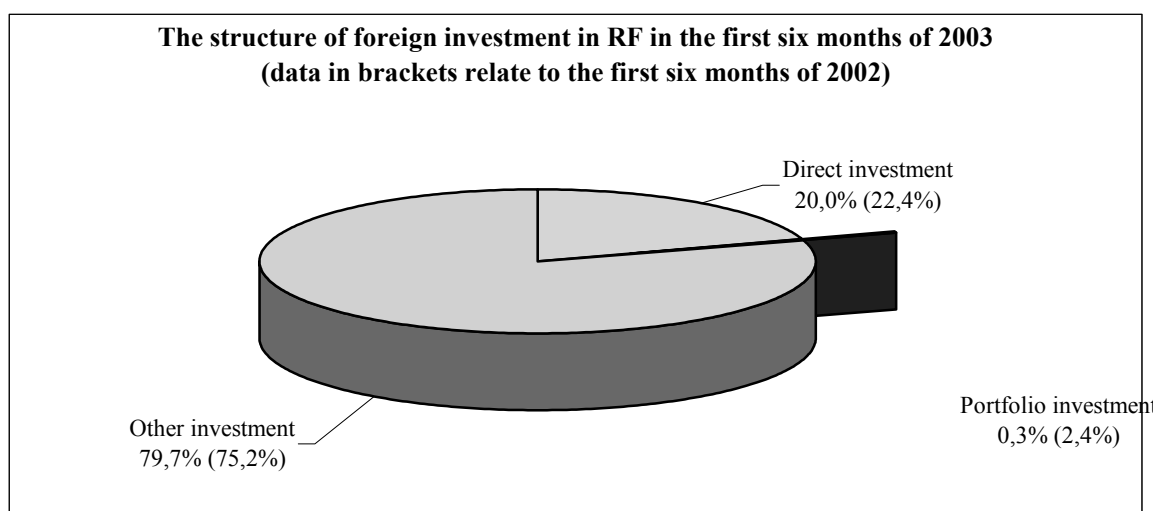


Source: RF Goskomstat.

The most significant growth was registered in “other investment,” which increased by 60.2 per cent in comparison with the figures observed in the respective period of 2002, and made US \$ 10.1 billion. The amounts of direct investment are estimated to be at US \$ 2.5 billion, what is by 25.4 per cent above the indicator registered in the first six months of 2002. This year portfolio investment decreased 5.2 times and made only US \$ 38 million (US \$ 199 million in the first six months of 2002). Therefore, the following changes occurred in the structure of invested capital (see Fig. 2).

¹⁰ The ranking characterizes investment attractiveness of countries reflecting not the current amounts of direct investment, but only perceptions and intentions of investors.

Figure 2.



Source: RF Goskomstat.

An analysis of the business situation on the investment market reveals that foreign investors are still interested in a number of industries, the sphere of trade and public catering. For the distribution of foreign investment across base sectors of the Russia's economy, see Table 1.

Table 1

Sectoral structure of foreign investment in the Russia's economy in the first six months of 2001 through 2003

	2001		2002		2003	
	US \$ mil.	% of the total	US \$ mil.	% of the total	US \$ mil.	% of the total
Industry	2487	37,2	3245	38,8	4326	34,2
Transport and communications	607	9,1	350	4,2	741	5,9
Trade and public catering	2426	36,3	3596	43,0	5686	44,9
Commercial activities ensuring the functioning of the market	403	6,0	533	6,4	1072	8,5
Finance, credit, insurance, pensions	99	1,5	41	0,5	112	0,9
Other sectors	662	9,9	603	7,1	725	5,6

Source: RF Goskomstat

The sectoral structure of foreign investment is characterized by a growth in investment across practically all spheres of the economy. The only exception is food industry and the sphere of management, where in the first six months of this year investment made US \$ 443 million and US \$ 0.3 million respectively, what is by 31 per cent and 85 per cent below the levels registered in the first half year of 2002.

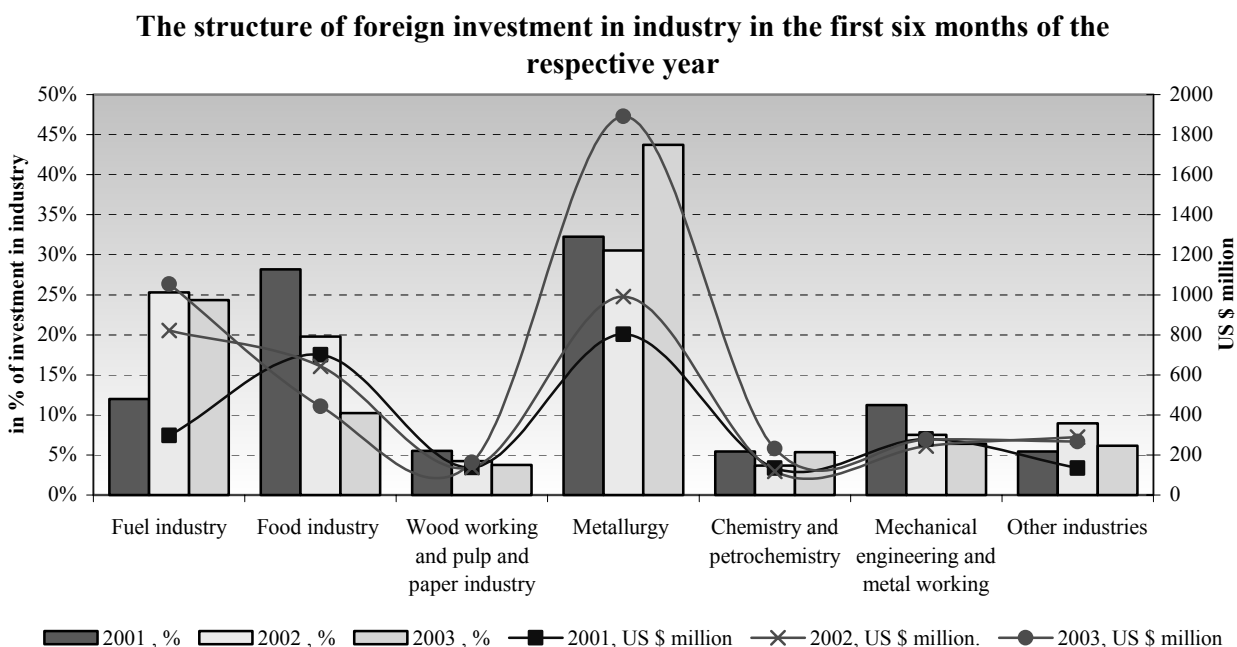
In the first six months of this year, the rates of growth in foreign investment in industry (+ 33.3 per cent) were above the respective indicators of increase in the aggregate amount of foreign investment in the Russia's economy. At the same time, direct investment in industry increased by 31.3 per cent in comparison with the figures registered in the first six months of 2002 and made US \$ 3.14 billion (31.1 per cent of the total "other" foreign investment in the RF economy). The amount of foreign portfolio investment in industry declined 4.5 times.

This year, the stable growth in the specific weight of trade and public catering in investment preferences of foreign investors persisted. This sector accounted for 45 per cent of the total foreign investment in the Russia's economy in the first six months of 2003. At the same time, 92.6 per cent of the total amount of US \$ 5.7 billion invested in the sphere of trade from abroad made "other" investment (about 83 per cent in the first half year of 2002).

The high rates of investment in metallurgy at the background of falling investment in food industry resulted in the growth of the share of metallurgy in the total amounts of foreign investment in industry from 30.5 per cent registered in the first six months of 2002 to 43.7 per cent in the first half year of 2003. In comparison with the figures observed in the first six months of 2002, the investment in ferrous metallurgy increased by 47.1 per cent, while investment in non-ferrous metallurgy increased 2.3 times (see Figure 3).

Figure 3.

The structure of foreign investment in industry in the first six months of the respective year



Source: RF Goskomstat.

The structure of foreign investments in industry does not differ from the respective structure of their aggregate amount and is characterized by falling share of foreign direct investment at the background of increasing specific weight of “other” investment. However, in comparison with the figures registered in 2002, certain changes may be observed (see Table 2).

Table 2

The structure of foreign investment in industry in the first six months of 2003.

	US \$ mil.			Changes in comparison with the first 6 months of 2002		
	direct	portfolio	other	direct	portfolio	other
Industry	1165	21	3140	31,3%	-77,7%	38,7%
including:						
Fuel industry	639	0,2	414	2,6 times	100,0%	-28,4%
Food industry	150	0,4	293	-9,6%	4,0 times	-38,4%
Forestry, wood working, pulp and paper industry	92	0	71	2,4 times	-100,0%	-22,8%
Metallurgy	44	5	1843	-25,4%	-93,6%	2,2 times
Chemistry and petrochemistry	41	0,1	191	-22,6%	-90,0%	2,9 times
Mechanical engineering and metal working	83	1	192	-54,9%	10,0 times	3,2 times
Other industries	116	14,3	136	-18,9%	85,7%	-2,2%

Source: RF Goskomstat.

In the first six months of 2003, the major part of foreign investment made by direct investors was directed in fuel industry (25.2 per cent), trade and public catering (16.4 per cent), and the general commercial activities ensuring the functioning of the market (14.2 per cent). The same indicators made 13 per cent, 33.2 per cent, and 5.4 per cent respectively in the first six months of 2002.

In the first half year of 2003, investment from 97 countries exporting capitals flowed in the Russia's economy (in the first six months of 2002 – 93 countries). At the same time, similarly to the situation observed in the preceding year, in the first half year of 2003 10 largest investing countries accounted for 83 per cent of the total amount of foreign investment accumulated by July 1, 2003.

Ten largest investing countries exporting capitals in Russia also accounted for 78.8 per cent (79.4 per cent as in the first six months of 2002) of the total amount of accumulated foreign direct investment, 76.2 per cent (68.4 per cent) and 87.9 per cent (87.9 per cent) of portfolio and other investment respectively (see Table 3).

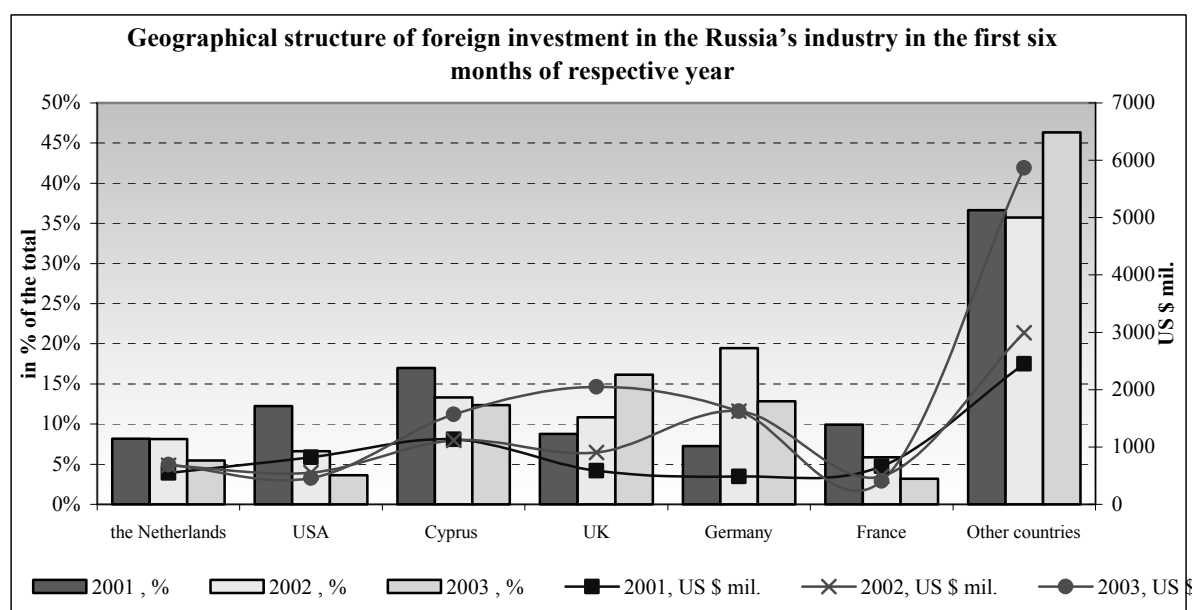
Table 3

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

	Accumulated by 01.07.2003 US \$ mil.				Change to 01.01.2003, % (*)			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
USA	5558	4412	37	1109	0,7 (3,8)	4,6 (7,7)	-45,6 (-45,6)	-10,1 (-7,0)
Germany	10671	2344	385	7942	31,0 (49,0)	36,8 (53,8)	0,26 (0,3)	31,3 (51,1)
France	2670	278	0,1	2392	-12,0 (-20,6)	-8,3 (0,7)	0,0 (0,0)	-12,4 (-22,5)
UK	5887	2407	108	3372	16,5 (40,5)	9,9 (22,0)	-15,6 (-24,5)	23,3 (62,7)
Cyprus	6606	4432	295	1879	17,4 (37,4)	12,9 (23,3)	-3,3 (-11,9)	34,7 (2,1)
The Netherlands	2941	2329	6	606	13,2 (11,5)	2,9 (3,8)	-71,4 (-71,4)	40,6 (1,6)
Other countries	14008	6364	359,9	7284	10,3 (31,7)	13,7 (30,6)	-36,5 (-26,7)	11,6 (38,2)
Total	48341	22566	1191	24584	12,6 (26,7)	10,9 (21,5)	-19,1 (-17,4)	16,5 (35,6)

* changes (as compared with the data registered on 1.07.2002) are in brackets
Source: RF Goskomstat.

Figure 4.



Source: RF Goskomstat.

In the first six months of this year, the activity of American and French investors continued to decrease, their investment in the Russia's economy declined by 17.3 per cent and 17.5 per cent as compared with the figures registered in the first half year of 2002 making US \$ 458 million and US \$ 406 million respectively.

This year, Germany remained the leader as concerns the amount of invested capital as its investment made in the first six months of 2003 are evaluated at US \$ 3.1 billion, what is 1.9 times above the level registered in the first half year of 2002. UK investment increased 2.2 times up to US \$ 2 billion.

As concerns the most attractive for foreign investors sphere of trade and public catering, the majority of investment here was made by entrepreneurs from Germany (35.6 per cent of the aggregate investment in the sphere of trade, or 64.4 per cent of the total amount of German investment made in the first six months of 2003), UK (19.0 per cent or 52.9 per cent), and Cyprus (14.4 per cent or 56.9 per cent).

The results of the first half year of 2003 demonstrate that UK is the first in terms of the amounts invested over this period in industry: US 587 million making 28.7 per cent of the total investment from UK. As concerns the amount of direct investment in industry, Japan is leading with US \$ 263 million of direct investment in industry, 94 per cent of this amount were invested in the fuel and energy complex.

The following of the legislative initiatives, which may in the future affect the RF investment climate, shall be mentioned. There is elaborated a draft law on special economic zones (SEZ), according to which SEZ residents may be exempted from the profit tax for the payback period of the project (although not exceeding three tax periods since the start of its implementation). Aiming to create more favorable conditions for investors, the Ministry of Industry and Science has elaborated the concept of development of venture industry including the issues pertaining to establishment of technical parks. On June 17, there was enacted the new Federal law "On peasant (farming) businesses" permitting foreigners to establish farming businesses in Russia.

E. Ilykhina

Foreign Trade

In July of 2003, the Russia's foreign trade turnover grew by 19.7 per cent in comparison with the figures registered in the respective month of the preceding year (US \$ 14.7 billion) and made the record high of US \$ 17.6 billion in the last 13 years (according to the balance of trade methodology). The turnover increased by 2.3 per cent in comparison with the figures registered in the preceding period (this June it made US \$ 17.2 billion), as in July export of goods and services made US \$ 11 billion and imports reached US \$ 6.6 billion.

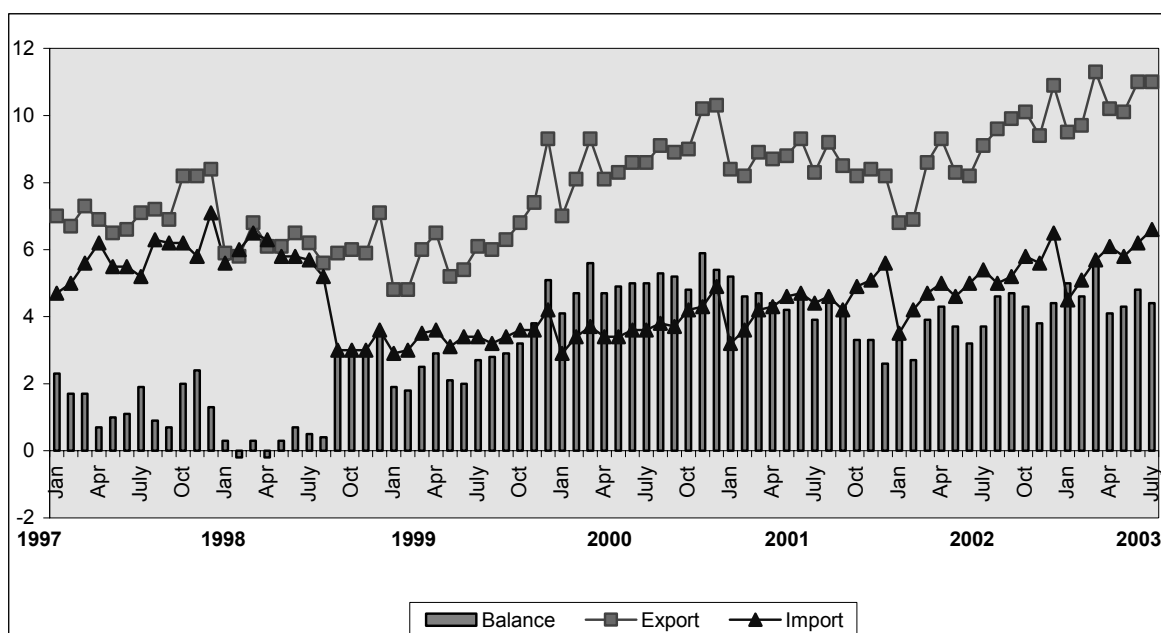
The active balance of trade made US \$ 4.4 billion, while in the respective period of 2002 this indicator made US \$ 3.7 billion and in June of 2003 - US \$ 4.8 billion. At the same time, the active balance of trade vis-à-vis CIS member countries increased by US \$ 27 million up to US \$ 346 million in comparison with the figures registered in the respective period of the preceding year, while the same indicator for countries outside NIS grew by US \$ 0.6 billion and made US \$ 4 billion.

As compared with the level registered in July of 2002, the growth in the amount of exports made 19 per cent. At the same time, the exports in CIS member countries increased at outpacing rates. In July of 2003 the amount of exports in these counties grew by 32 per cent in comparison with the figures observed in July of 2002. At the same time, exports in countries outside CIS increased by 17 per cent. As a result, the share of CIS member countries in exports decreased from 85 per cent in July of 2002 to 83 per cent in the respective month of 2003.

High prices registered on the world oil market were at the level close to the maximal threshold indicator set by OPEC (as on July 30, the reference price of the OPEC oil basket made US \$ 27.3 per barrel).

In July, the average URALS oil price made US \$ 26.9 per barrel (a growth by 5.1 per cent in comparison with June figures), while BRENT prices were at US \$ 28.3 per barrel (a 4.4 per cent growth). The upward price trend was determined by a low level of reserves (5 per cent below the level registered in 2002), higher rates of the global economic growth, increasing consumption of gasoline in USA, uncertainty relating to the recovery of the Iraq oil exports, and expected seasonal increase in demand for energy resources.

In July and August, the prices of Russian oil made US \$ 27.8 per barrel, or US \$ 203.2 per metric ton. As a result, on October 1, 2003, the rates of export customs duty on crude oil were increased by US \$ 8.7 in comparison with the rate in force since August 1 – up to US \$ 33.8 per metric ton. As on October 1, 2003, the duty on oil products was set at US \$ 30.4 per metric ton, what is by US \$ 7.8 above the previous rate.



Source: RF Goskomstat

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

The prices of the Russian natural gas have significantly increased in comparison with the figures registered in the preceding year.

The situation on the world markets of non-ferrous metals remained on the whole rather stable. Average July prices made: aluminum – US \$ 1434.9 per metric ton (a 1.8 per cent increase in comparison with June of 2003), copper – US \$ 1730.3 per metric ton (a 1.6 per cent growth), nickel – US \$ 8790.6 per metric ton (0.3 per cent).

Table 1

The average monthly world prices in July of the respective year

	1996	1997	1998	1999	2000	2001	2002	2003
Oil (Brent), USD / barrel	20,66	18,25	12,96	18,8	28,4	24,62	25,7	28,25
Natural gas, USD / 1 mil Btu	-	2,121	1,983	2,363	4,01	3,15	2,94	5,021
Gasoline, USD / gallon	0,6338	0,5941	0,4234	0,6002	0,935	0,732	0,804	0,896
Copper, USD / metric ton	1935,9	2481,7	1754,3	1744,8	1864,2	1541,4	1589	1730,3
Aluminum, USD / metric ton	1455,4	1563,7	1377,7	1403,5	1565,9	1412,2	1338,4	1434,9
Nickel, USD / metric ton	7350	6737,3	4620	5273	8202,0	5956,8	7143,1	8790,6

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

In June of 2003, the real Ruble / US \$ exchange rate exceeded the level registered in the respective month of 2002 by 16 per cent. Besides, the level of GDP increased by 5.8 per cent in comparison with the level observed in July of 2002. Higher purchasing power of Ruble in relation to US \$ and growing proceeds in the economy objectively facilitated higher levels of imports. On the other hand, the increase in Euro rate in relation to US \$ by 17 per cent raised prices of European goods, what, accordingly, hindered a growth in volumes of Russian imports.

As a result of opposite influence of these and other factors, in July of 2003 the amount of imports increased by 21.3 per cent in comparison with the levels registered in the respective month of 2002 and made US \$ 6.6 billion. At the same time, imports from CIS member countries grew significantly more: by 38.4 per cent as compared with the level registered in July of 2002, while imports from countries outside CIS increased by 17.1 per cent. As a result, the share of CIS member countries in imports decreased by 3 p. p. in comparison with the level registered in July of 2002 and made 78 per cent.

In September of 2003, the Ministerial conference of WTO member countries had place in the Mexican town of Cancun. In the course of negotiations, there were revealed serious contradictions between developing and developed countries represented at the summit.

The Cancun negotiations should have determined the principles of the future regulations of the World Trade Organization, which were first discussed in November of 2001 at the Ministerial conference taking place in Doha, Qatar. The novations should have affected agriculture (a decrease in state support of farmers, lowering and eventual abolition of export subsidies, lowering of tariffs on agricultural produce), services and manufactured goods (easier access to markets), antidumping procedures, electronic trade, as well as procedures governing dispute settlement within WTO and principles of development of the world trade (easier access to markets for the least developed countries, access of such countries to modern medicines). The agenda of the Doha round also includes four “Singapore issues”: regulation of investment, competition, transparency of state procurement operations, and simplification of trade procedures (including customs treatment). These problems were included in the discussion program of the WTO Singapore Ministerial conference taking place in 1996. It was planned to approve the new regulations in the course of the Cancun conference in September of 2003 and enact them in 2005.

Delegations from 146 WTO member countries participated in negotiations, which came to an impasse in just few days after the beginning of the conference. The differences of opinion between developed and developing countries were voiced across all agenda issues, the most important of which were agrarian subsidies, trade barriers, tariffs, and investment.

Developing countries insisted that the USA and European Union should abolish subsidies to farmers. In their turn, the USA and European Union demanded lowering of customs duties and implementation of serious reforms of economies and legislations of developing countries. After developing countries refused to negotiate the issue of foreign investment, it was announced that no serious documents would be signed in the course of the summit. The only agreement reached in Cancun was the decision to sell cheap patents for production of widely used medicines (against AIDS, tuberculosis, malaria, etc.) in developing countries. Both developing and developed countries accused each other about the failure of the negotiations.

The collapse of the WTO summit may pose serious problems for the world economy. The world trade grows at a slower rate and the level of investment is significantly below the figures registered in 2002 because of slowing down rates of economic growth and recession in developed countries. According to World Bank estimates, if the new trade agreements were signed in Cancun, in 2015 it would enable 144 million people to step over the poverty line, while the additional increase in the global GDP would make US \$ 520 billion in the same year.

It is expected that an extraordinary summit of WTO member countries will be held in December in order to discuss the issues pertaining to the resumption of negotiations on the future agreement concerning global trade.

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Forecasting certain macroeconomic indicators¹¹

Below are presented the results of forecasting the real wages and salaries and real disposable cash household incomes. For the estimates of these indicators, there were used the statistics from the collection “Short Term Economic Indicators of the Russian Federation” published by the RF Goskomstat. The estimated values were calculated basing on the single variable econometric models (models of the ARIMA class). For the evaluation of the indicators there were chosen data pertaining to the time intervals from January of 1999 till July of 2003. Besides, there are presented the results of prognostication of the tax revenues of the consolidated (singling out profit tax, VAT, and the income tax) budget and revenues of the federal budget generated by the profit tax in October through December of 2003. For the evaluation of the indicators by the ARIMA models there were chosen data pertaining to the time intervals from January of 1999 till July of 2003.

The obtained forecasts, on the whole, indicated the persistence of the positive trend observed in the dynamics of the household living standards. According to ARIMA model based forecasts (see Table 1), the average growth in real disposable cash incomes is estimated to be at the level of 12 per cent over October, November, and December of 2003 as compared with the figures registered in the respective months of the preceding year. The similar indicator of growth in real wages and salaries, according to the obtained

¹¹ For the purposes of this presentation, a forecast is defined as an estimate of the future values of the indicator obtained basing on a model with the best statistical qualities. For more details of the modeling of time series see, for instance: S. Sinelnikov-Murylev, R. Entov, S. Drobyshevski, V. Nosko, A. Yudin (2001) “Econometric Analysis of Time Series of Key Macroeconomic Indicators,” Moscow, IET.

forecasts, shall be below 9 per cent. It shall be noted that the 33 per cent increase in wages and salaries of the employees of the budgetary sphere will most probably affect the dynamics of the indicators under observation in the few next months.

Table 1.

Forecast of household living standards

	Real disposable cash household incomes (1991.01=100)	Real wages and salaries (1991.01=100)
ARIMA model based forecast		
October 2003	179.55	220.58
November 2003	182.45	221.38
December 2003	218.18	255.89
ARIMA model based forecast in per cent of the actual data obtained in the respective period of 2002		
October 2003	111.65%	109.47%
November 2003	113.45%	110.31%
December 2003	110.39%	105.90%

Forecast of tax revenues

The average decline in the income tax revenues in October, November, and December of 2003 in comparison with the figures registered in the respective period of the preceding year makes about 0.15 percentage points (p. p.) of GDP according to the ARIMA model (see Table 2). The predicted average decline in the VAT revenues in the period under observation will make about 0.8 p. p. of GDP. The forecasted average decline in the profit tax revenues of the consolidated budget in October, November, and December of 2003 in comparison with the figures registered in the respective months of the preceding year will be below 0.6 p. p. of GDP. Similarly, the revenues of the federal budget generated by the profit tax will on the average decline by 0.3 p. p. of GDP. As concerns the indicator of the aggregate revenues of the federal budget in October, November, and December of 2003, there is expected a decline in revenues by 2.1 p. p. of GDP, while the aggregate revenues of the federal budget will on the average decrease not more than by 1.25 p. p. of GDP.

Table 2.

Forecast of tax revenues (in % of GDP)

	Consolidated budget				RF federal budget	
	Amount of the aggregate tax revenues	Amount of the profit tax revenues	Amount of VAT revenues	Amount of income tax revenues	Amount of the aggregate tax revenues	Amount of the profit tax revenues
Actual values of tax revenues in respective periods of 2002						
January – October of 2002	25.40%	4.45%	6.90%	3.10%	15.48%	1.67%
January – November of 2002	25.44%	4.32%	6.91%	3.12%	15.47%	1.62%
January – December of 2002	25.54%	4.23%	6.88%	3.27%	15.49%	1.57%
REM model based forecast						
January – October of 2003	23.03%	3.79%	6.12%	2.93%	14.16%	1.30%
January – November of 2003	23.43%	3.74%	6.23%	2.99%	14.35%	1.29%
January – December of 2003	23.80%	3.70%	6.27%	3.18%	14.53%	1.27%
ARIMA model based forecast						
January – October of 2003	23.24%	3.83%	6.02%	2.93%	13.80%	1.34%
January – November of 2003	23.39%	3.77%	6.02%	2.99%	14.02%	1.29%
January – December of 2003	23.39%	3.75%	6.05%	3.16%	14.49%	1.34%

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