

**RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
OCTOBER 2001**

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Economy and politics in October 2001

The foreign political situation in October still was pregnant with both new opportunities and new problems for the national economy. Russia's clearly antiterrorist stance has had a favorable impact on its relations with the West, which was proved, in particular, the country's contribution to G-8 Summit, including the discussion on the role and tasks of FATF.

At the same time the national economy continued to experience the impact of the domestic factors that increased the attractiveness of Russian economy, primarily the decline in political risks. The unification of the centrist faction in the Duma and the results of their voting for the 2002 draft budget law allow conclusion of the final consolidation of the Duma majority around the government. The reactivation of the General Attorney's office (raids at the Ministry of Railway Transportation and the Ministry of Emergency Situations) may be regarded as one of the methods of strengthening the power vertical.

As for the domestic politico-economic problems, it is the development of federative relations that once again became in the center of attention. At its hearings, the Duma considered the concept for building the relationship between the Federal Center and the regions that was developed by the newly established presidential Commission headed by D. Kozak. As well, in October the Duma continued to discuss the 2002 draft budget law (including the proportions of allocation of tax revenues), along with a regular Chapter of the Tax Code (options for changes in the sales tax

collectable to the regional budgets), and, finally, the Duma considered the draft law "On fundamentals of the federal support of depressive territories of RF". October was signified with the first more or less serious open conflict between the President's envoy and regional authorities with regard to bringing the regional law in line with the Constitution of RF. The President's Envoy in the Ural Super-region warned the Sverdlovsk Oblast Duma on his intent to submit to the President the proposal to dissolve that, should the legislators be unwilling to bring the Oblast Charter in line with the Constitution of RF.

The government so far proved to be effective in implementing their plans to reform the Federation, which is witnessed by the general rate of the revision of regional law, the establishment of the single Treasury system, and changes in the tax system. At the same time, as far as the noted draft law on depressive territories is concerned, in contrast to the original projections, the lack of a clear definition of "depressive territory" allowed discussion on the depressive state (and, consequently the need in a special support" of 40 regions.

Another alarming factor is the accumulation of considerable balances on accounts of the budget recipients, which may cause an inflation splash by the end of the year.

In other words, some haste and "generalization" of Center's operations, when the focus on a concept supplants concrete mechanisms of functioning out of sight, cannot help but toll alarm bell.

The state of the federal budget

TABLE 1. THE MONTHLY EXECUTION OF THE FEDERAL BUDGET OF THE RUSSIAN FEDERATION (IN COMPARABLE PRICES)

	VIII'01	00	I'01	II'01	III'01	IV'01	V'01	VI'01	VII'01	VIII'01
Revenues										
Corporate profit tax	2,5%	2,5%	1,4%	1,5%	1,9%	2,4%	2,6%	2,6%	2,5%	2,6%
Personal income tax	0,4%	0,4%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%
VAT, special tax and excises	7,3%	7,2%	9,0%	9,2%	9,0%	9,1%	9,3%	9,3%	9,2%	8,9%
Tax on foreign trade and foreign trade operations	3,2%	3,2%	3,6%	4,1%	4,1%	4,0%	3,9%	4,0%	3,9%	3,9%
Other taxes, duties and payments	0,3%	0,4%	1,1%	0,9%	0,8%	0,8%	0,7%	0,7%	0,7%	0,7%
Total- taxes and charges	13,7%	13,7%	15,2%	15,7%	15,7%	16,3%	16,6%	16,6%	16,4%	16,1%
Non- tax revenues	2,1%	2,3%	1,0%	1,1%	1,1%	1,2%	1,3%	1,2%	1,3%	1,3%
Revenues, total	15,8%	16,0%	16,2%	16,9%	16,9%	17,5%	17,8%	17,8%	17,7%	17,3%
Expenditure										
Public administration	0,3%	0,4%	0,1%	0,2%	0,3%	0,3%	0,4%	0,4%	0,4%	0,4%

**TABLE 1. THE MONTHLY EXECUTION OF THE FEDERAL BUDGET OF THE RUSSIAN FEDERATION
(IN COMPARABLE PRICES)**

National defense	2,5%	2,7%	1,3%	2,0%	2,2%	2,5%	2,7%	2,7%	2,7%	2,6%
International activities	0,2%	0,3%	0,3%	0,3%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%
Judicial power	0,1%	0,1%	0,0%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%
Law enforcement and security activities	1,3%	1,5%	0,7%	1,1%	1,3%	1,4%	1,4%	1,4%	1,4%	1,4%
Fundamental research	0,2%	0,2%	0,0%	0,1%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%
Services provided for the national economy	0,6%	0,9%	0,1%	0,3%	0,6%	0,6%	0,8%	1,0%	1,0%	1,0%
Social services	1,8%	1,9%	1,3%	1,6%	1,9%	2,1%	2,0%	2,1%	2,1%	2,1%
Servicing of public debt	2,9%	2,4%	3,2%	5,5%	4,7%	3,7%	3,3%	3,2%	2,9%	3,2%
Other expenditure	2,8%	3,0%	3,3%	3,1%	2,9%	3,0%	3,1%	3,2%	3,1%	3,0%
Expenditure, total	12,7%	13,5%	10,4%	14,4%	14,2%	14,1%	14,2%	14,5%	14,2%	14,3%
Loans, redemption exclusive	3,1%	2,5%	5,8%	2,5%	2,6%	3,4%	3,7%	3,3%	3,5%	3,1%
Expenditure and loans, redemption exclusive	-0,6%	0,0%	-3,7%	-0,8%	-0,6%	-1,1%	-1,7%	-1,3%	-1,1%	-1,2%
Budget deficit (-)	-2,6%	-2,4%	-2,1%	-1,7%	-2,1%	-2,3%	-2,0%	-2,0%	-2,4%	-1,9%
Domestic financing	-3,1%	-2,5%	-5,8%	-2,5%	-2,6%	-3,4%	-3,7%	-3,4%	-3,5%	-3,1%

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

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

The data on the execution of the federal budget over the eight months of 2001 is presented in Table 1¹. As of August 1, the revenues to the federal budget 2001 accounted for 17.3% of GDP, including tax revenues – 16.1%, while expenditure made up 14.3% of GDP (15.9% of GDP in terms of fulfilled funding²), including non-interest ones

11.1% of GDP (12.3% in terms of fulfilled financing). The level of budget profit accounted for 3.1% of GDP (1.3% of GDP in terms of fulfilled funding).

Between January through August 2001 the execution of the federal budget was characterized with the 2.4 per cent points excess of the level of tax revenues over the respective index of 2000, which, again, can be attributed to the rise in

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)

collection of indirect taxes, primarily VAT and excises (at 1.6 p.p.), and taxes on foreign trade (0.7 p.p.).

The execution of the expenditure part of the federal budget between January through August in terms of fulfilled financing accounted for 15.5%, while in cash execution equivalent- 14.3% of GDP.

The comparison of the budget execution indexes over the eight months of 2001 and with those of 2000 allows noting as follows: the expenditure on public debt servicing grew by 0.3 points (from 2.9% of GDP up to 3/2% of GDP) over the period in question vs. the respective period of the prior year. At the same time between January through August the government paid off Rb. 106 bln. of the principal foreign debt and effected another Rb. 171 bln. interest payments, plus, Rb. 40 bln. –worth domestic debt and Rb. 38.4 bln. –worth interest payments on that. The expenditure on the support of the economy’s sectors nearly doubled compared with last year (from 0.6% of GDP up to 1% of GDP).

The main difference between the cash execution of expenditure and the fulfilled funding falls under such budget outlays as “national defense” (0.3 p.p.), “law enforcement“ (0.3 p.p.), “ services to industry branches” (0.3 p.p.), and “the social sphere” (0.4 p.p.).

As of early August, the balances of accounts on accounting the federal budget funds (without regard to the funds accumulated on personal accounts of recipients of budget funds) dropped to Rb. 94 bln. . Overall, since early 2001 the aforementioned funds (including the moneys of the Road and Ecological Funds) grew by Rb. 13.8 bln.

The balances on the accounts on which the federal funds are held (without regard to the funds on personal accounts of recipients of budget funds) slid to Rb. 78 bln. as of early October. Overall, since the beginning of 2001 such funds (including the resources of the Road and Ecological funds) fell by Rb. 2.7 bln.

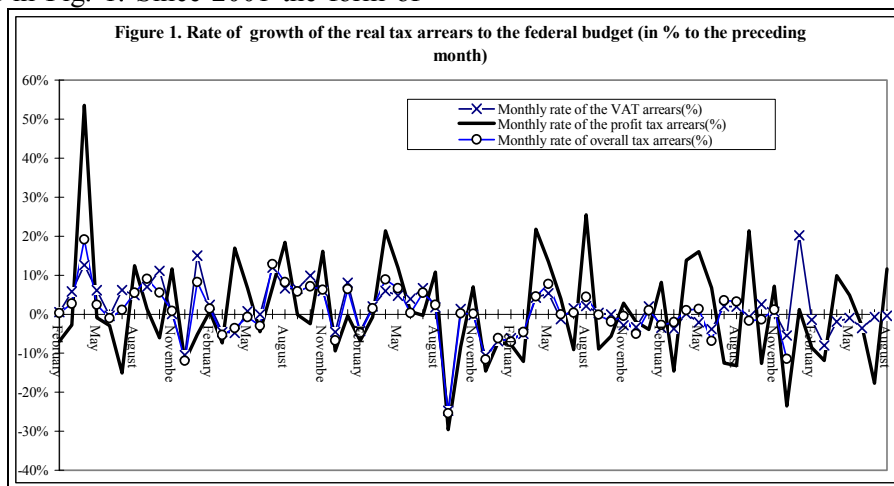
TABLE 3. ACTUAL TAX REVENUES TO THE FEDERAL BUDGET, ACCORDING TO THE DATA OF THE MTC (IN PRICES OF JANUARY 1998).

1999											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
10067	11586	12281	12287	10524	11369	12785	12838	12514	14238	16190	21455
2000											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
15030	16161	18247	20714	23469	18817	18219	18762	17422	18232	20306	25579
2001											
I	II	III	IV	V	VI	VII	VIII	IX			
20580	19978	22917	26959	25311	23491	23342	23716	22075			

Actual tax revenues to the federal budget, according to the data of the MTC (in prices of January 1998).

The dynamics of actual tax debts to the federal budget is given in Fig. 1. Since 2001 the form of

the MTC’s presentation of the respective statistical data has been changed, and the debts to the federal budget across all the taxes are no longer singled out.



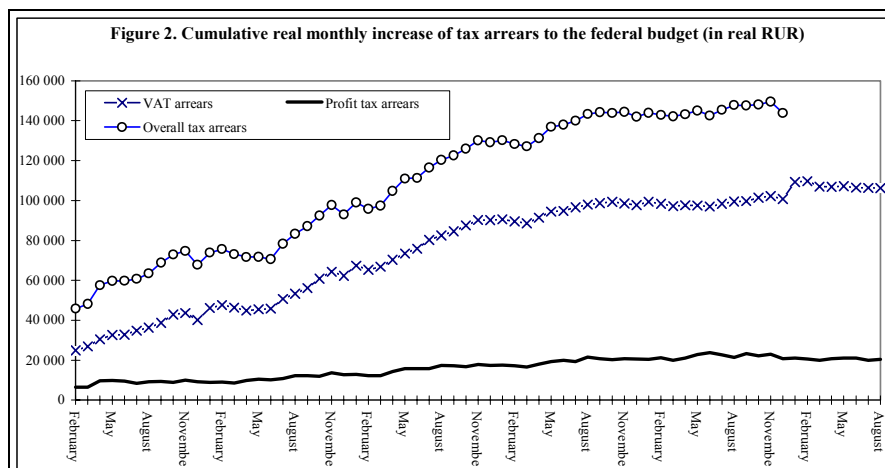


Table 4.

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				
Taxes	22,7%	23,6%	23,9%	25,4%	26,4%	26,0%	26,1%	25,9%				
Revenues	25,9%	27,1%	27,4%	29,3%	30,5%	29,8%	29,9%	29,7%				
Expenditures	16,8%	22,8%	23,7%	24,7%	25,1%	25,3%	25,5%	25,6%				
Deficit	9,1%	4,2%	3,7%	4,7%	5,4%	4,4%	4,4%	4,1%				

The execution of the consolidated budget between 1998 through 2001 is represented in Table 4.

On October 19, the State Duma passed in the second reading the draft 2002 federal budget law, which set the federal budget expenditure at the level of 17.8% of GDP, while the defense

expenditure should account for 2.6% of GDP, law enforcement- 1.6% of GDP, education- 0.7% of GDP, healthcare- 0.3% of GDP, public administration- 0.5% of GDP.

S. Batkibekov

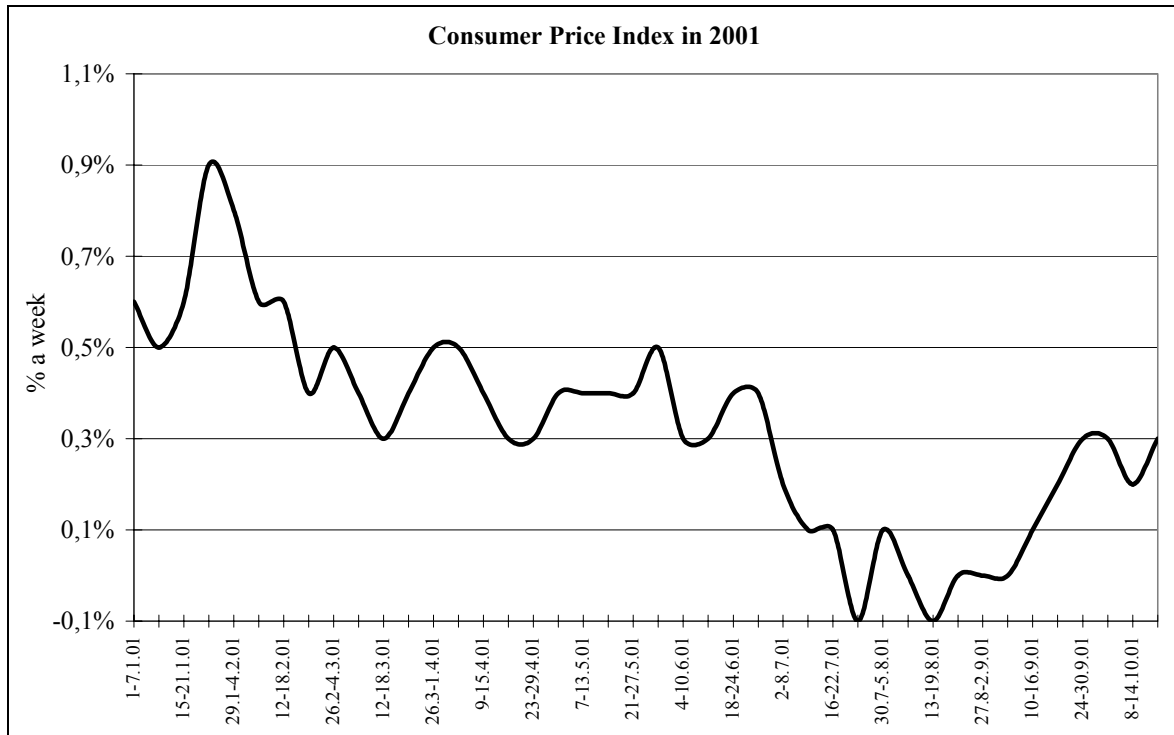
Monetary Policy

In late September 2001 the rate of consumer prices growth increased sharply (see Fig. 1). Thus, the increment in CPI accounted for 0.6% over the month. The sectoral structure of price growth testifies to the continuous effect of seasonal factors. Namely, in September the prices for food stuffs decreased by 0.2%, including 10.2% fall in prices for fruits and vegetables. Prices for non-food goods grew by 1.2%, and prices for services – by 2.6%. It

was the prices for educational services that showed the highest growth rate – 9.2%.

According to preliminary estimates, in October inflation rate reached 1.2–1.3%. Evidently, the further acceleration of price growth over the month was encouraged both by a weakening of seasonal factors and the impact of money supply expansion between April through July 2001. Notably, it was October that showed the maximum rate of CPI growth in autumn 2000.

FIGURE 1.



In October 2001 the Bank of Russia intensified accumulation of its foreign reserves. The latter reached \$38.6 billion by mid-month (see Fig. 2). Nevertheless, taking into account a huge foreign debt repayment on in November and December 2001 and the downfall in oil prices in the world

market during last two months, the RCB foreign reserves will likely not to exceed \$40 billion by the end of the year. At the same time, the rate of money supply growth rose: the narrow monetary base grew almost by 4% for the first three weeks of the month.

FIGURE 2.

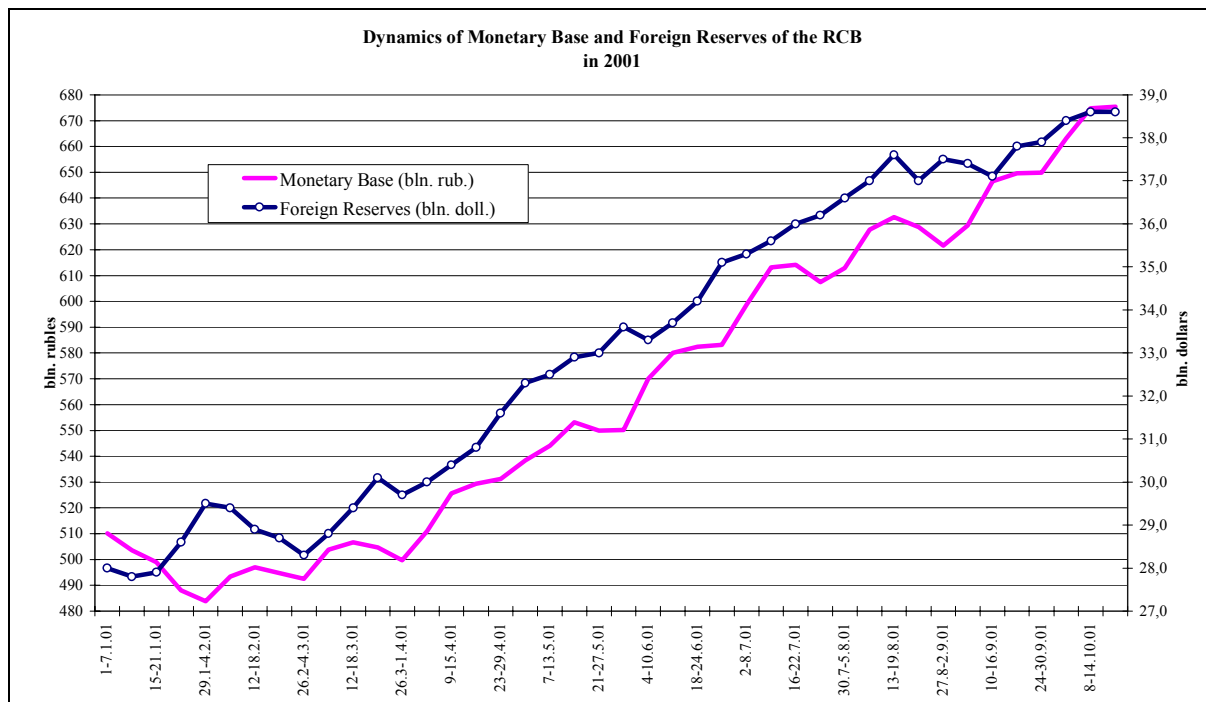
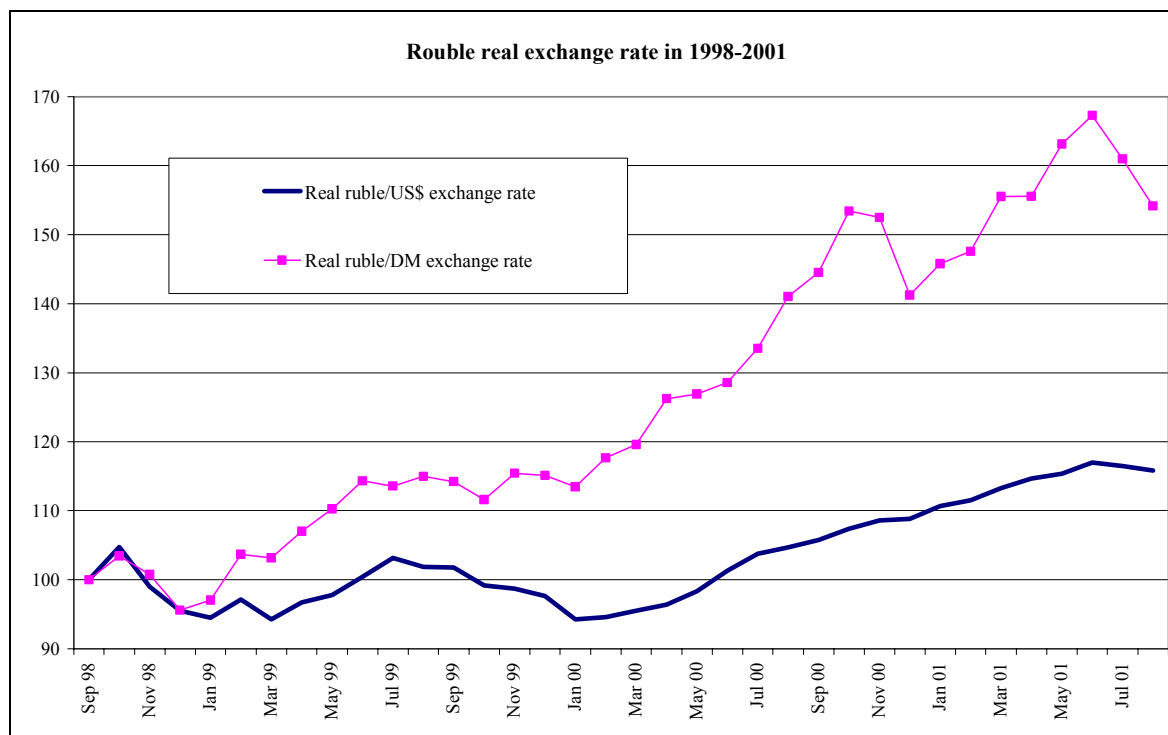


FIGURE 3.



The acceleration of inflation in Russia during spring 2001 caused a break in the trend of rouble real exchange rate pattern (see Fig. 3). Thus, the rouble/USD real exchange rate reached the post-crisis maximum in June 2001, sliding a bit afterwards. By late September the RUR/USD real exchange rate (calculated on basis of nominal RUR/USD exchange rate and CPI rates in Russia and the USA) amounted to 115.8% against September 1998. Therefore, rouble appreciated by 6.43% over nine months of the year.

In mid-2001 the rouble/DM real exchange rate (Actually, the rouble/euro real exchange rate changed at the same rate. However, since there is

no single indicator of CPI growth rates for euro, we calculate the rouble/DM real exchange rate.) sharply fluctuated due to the variation of nominal euro/USD (and, correspondingly, euro/rouble) exchange rate. However, the general pattern of rouble/DM real exchange rate coincides with the rouble/USD real exchange rate dynamics: after getting the maximum in June (167.3% against September 1998), rouble depreciated during next three months, and currently the rouble/DM real exchange rate accounts for 154.1%. For nine months of 2001 rouble appreciated by 9.14% against the European currencies.

S. Drobyshevsky.

Financial Markets

The market for government securities

In October 2001 practically all quotations of the Russian foreign debt securities grew (see Figs. 1 and 2). Thus, quotations of Minfin bonds rose by 3–6 percentage points, while yields to maturity on these securities dropped to 11–15.5% annualised. Namely, the prices for the 4th tranche of Minfin bonds got their historical maximum.

The prices for eurobonds grew by 2–4 percentage points, thus providing the decline in maximum yield to maturity to 12.6% annualised. The yield on

the shortest (one-month) issue fell to 2.5–3.0% annualised.

The main factors that contributed to the rise in quotations of the Russian debt securities were, first, the upgrade of the credit rating of Russia by Moody's and Fitch, and, second, – the continuous growth of the domestic economic activity. In addition, the worsening of the economic situation in Argentina could also become a positive factor for Russia, as it encourages a re-direction of capital flows to emerging markets towards the Russian assets.

FIGURE 1.

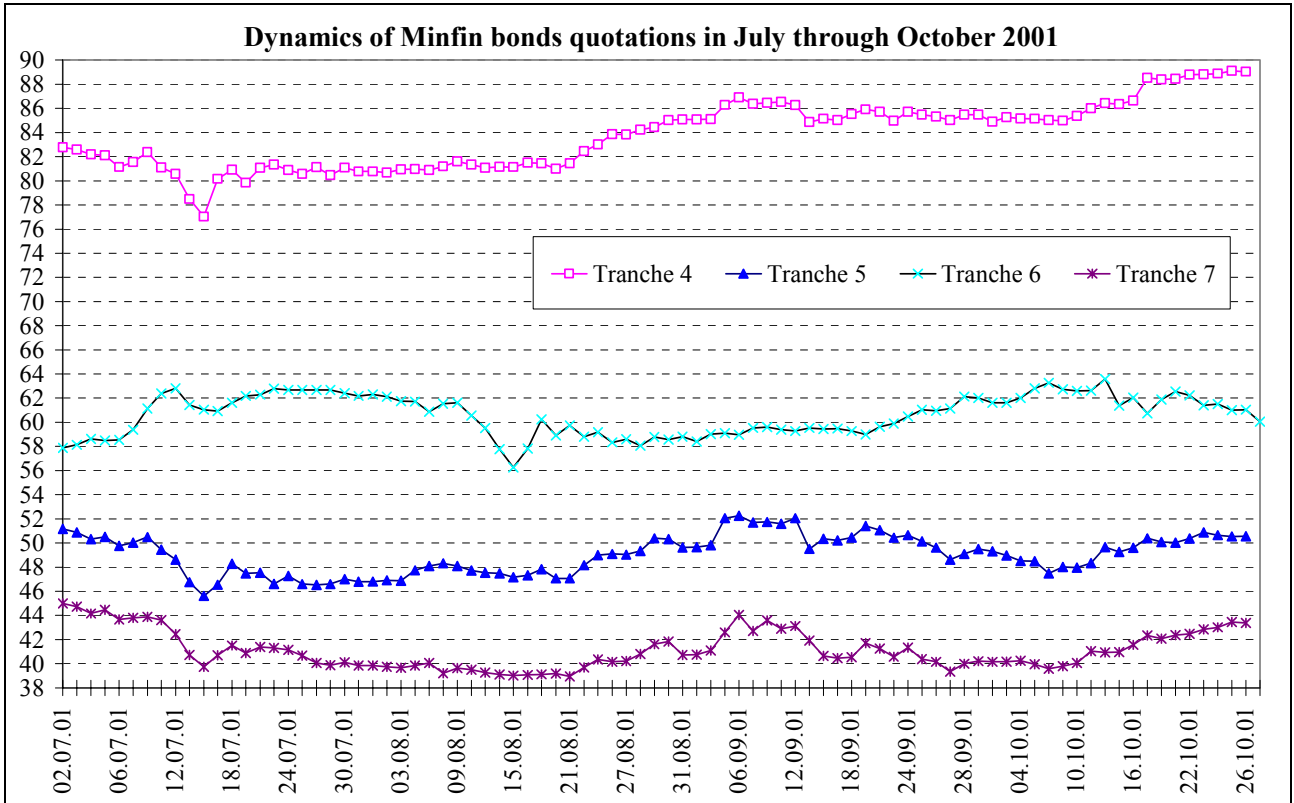


FIGURE 2.



The situation in the market for the Russian domestic debt was determined, first, by high balances on correspondent accounts of commercial banks in the Bank of Russia, and, second, - by a

decline in issuing activity of the RF Ministry of Finance. Thus, in October only one six-month GKO issue was placed totalled about 1.3 billion roubles (of 5 billion roubles supplied), and the

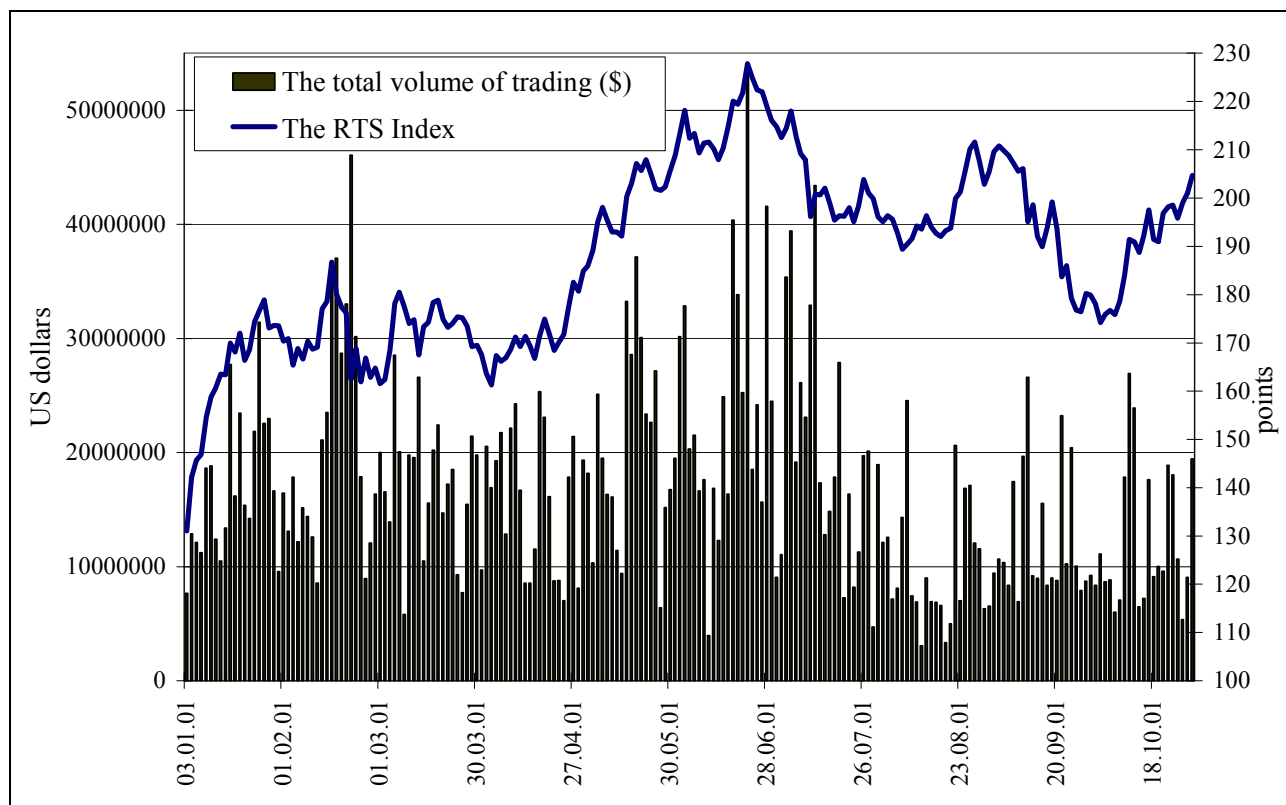
average auction rate amounted to 14.03% annualised. However, a high volume of liquidity within the banking system induced the growth of demand for rouble-denominated securities. The average-weighted yield to maturity in the market went down. By mid-month the GKO/OFZ yield reached the level of 14.66% annualised. However in the second half of October, with the USD/rouble exchange rate growing, the attractiveness of investments into GKO fell, and the yields slid to 15–15.5% annualised.

Stock market

The continuous slowdown in the world economy could not help but affect the Russian financial markets, the stock market in particular. The unstable geopolitical situation, low oil prices, the prospects of Argentina’s default n have a strong negative impact on expectations of foreign and domestic investors. However, in October prices of Russian stocks and trade volumes grew, compensating for the fall in September.

Between October 1 through October 30 the RTS index rose by 24.81 points (13.79%), the trade volumes also grew against September and exceeded \$270 million (+8%). The daily average trade volume practically remained unchanged and roughly amounted to \$12.3 million. The weekly average trade volume was about \$62.4 million. On October 26, the trade volume dropped to the two-month minimum – \$5.35 million. Between October 1 to October 3 the RTS index fell sharply - by 5.7 points (3%), and on October 3 it slid to the minimum value since April 25 - 174.2 points. Then the index grew gradually by the end of month. Another fall in the stock market was recorded on October 18-19, and that was related to a sharp fall in oil prices. On October 18 the RTS index lost 6.15 points, however, recovered after the stabilisation in the world commodity markets, and gained 5.91 points on October 20. In the end of month, the RTS index exceeded the level of 200, for the first time since September 11: on October 29 the market closed at 201.04 points.

FIGURE 3



Despite unfavourable external factors, the prices of stocks of the biggest Russian corporations grew vs. September. As mentioned above, affected by external factors the prices for the Russian stocks fell in September. The leader among *blue chips* (on October 29) was the stocks of “Sibneft” (28.65%), followed by “Rostelecom” (16.70%),

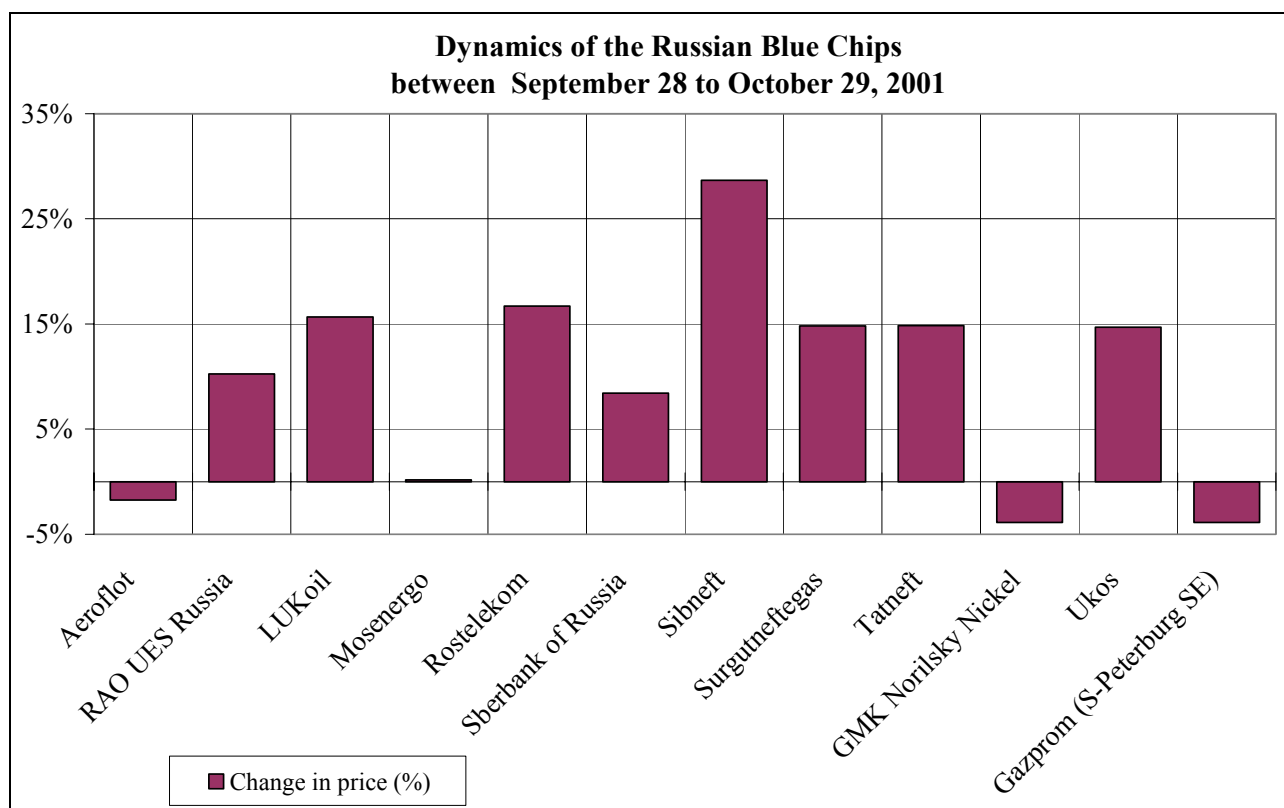
“LUKoil” (15.65%) and “Tatneft” (15.61%). The stocks of Sberbank (8.41%) and “Mosenergo” (0.16%) sank to the bottom of the list, while those of “Aeroflot” fell by 1.76% and MMC “Norilsky Nickel” - by 3.89%.

In October the RTS trade volume consisted of common stocks of RAO “UES Russia” – 23.74%

(29.95%, correspondingly, in September), “LUKoil” – 20.0% (20.90%), “YUKOS” – 9.853% (10.43%), “Surgutneftegas” – 7.83% (10.59%),

“Sibneft” – 7.53% (4.08%). Thus, in October the total share of the top five liquid stocks in RTS declined to 68.94% (in September – 76.58%).

FIGURE 4



The growth of activity in the sector for the “second echelon” stocks became a positive factor for the Russian stock market, which points out possible growth in mid run, is.

Over the month in question, the trade volume of “Gazprom” shares through RTS terminals accounted for \$25.4 million (56.9 million shares). Overall 2701 deals were stroked.

On October 19 the forward RTS market (FORTS) celebrated its one-month jubilee. The trade activity did not slacken during the month. On October 2, the maximum number of deals with options were stroked – 337. On October 11, the maximum turnover on options was recorded – 5.6 million roubles, and on October 12 the maximum number of options were negotiated - 2100. The share of deals with options grew up to 13.8% over the month. At the same time on certain days the number of deals with options reached 30% (on October 2 - 50%) of the total number of deals in FORTS. In total between October 1 to October 26 11039 deals were stroked in the system (363023 contracts) worth a total of 1089.59 million roubles, including deals with futures – 9384 (349998 contracts, 1054.96 million roubles), deals with

options – 1655 (13025 contracts, 34.63 million roubles).

RTS submitted to the FCSM a specification of futures on the Russian Investment Index RUIX and on Oil Stock Index RUIXOIL. The first index is calculated on basis of quotations of the top seven most liquid common stocks: RAO “UES Russia”, “Mosenergo”, “Rostelecom”, “LUKoil”, “Surgutneftegas” “Tatneft”, “YUKOS”. The oil index is based on prices of stocks of four oil companies in the above list.

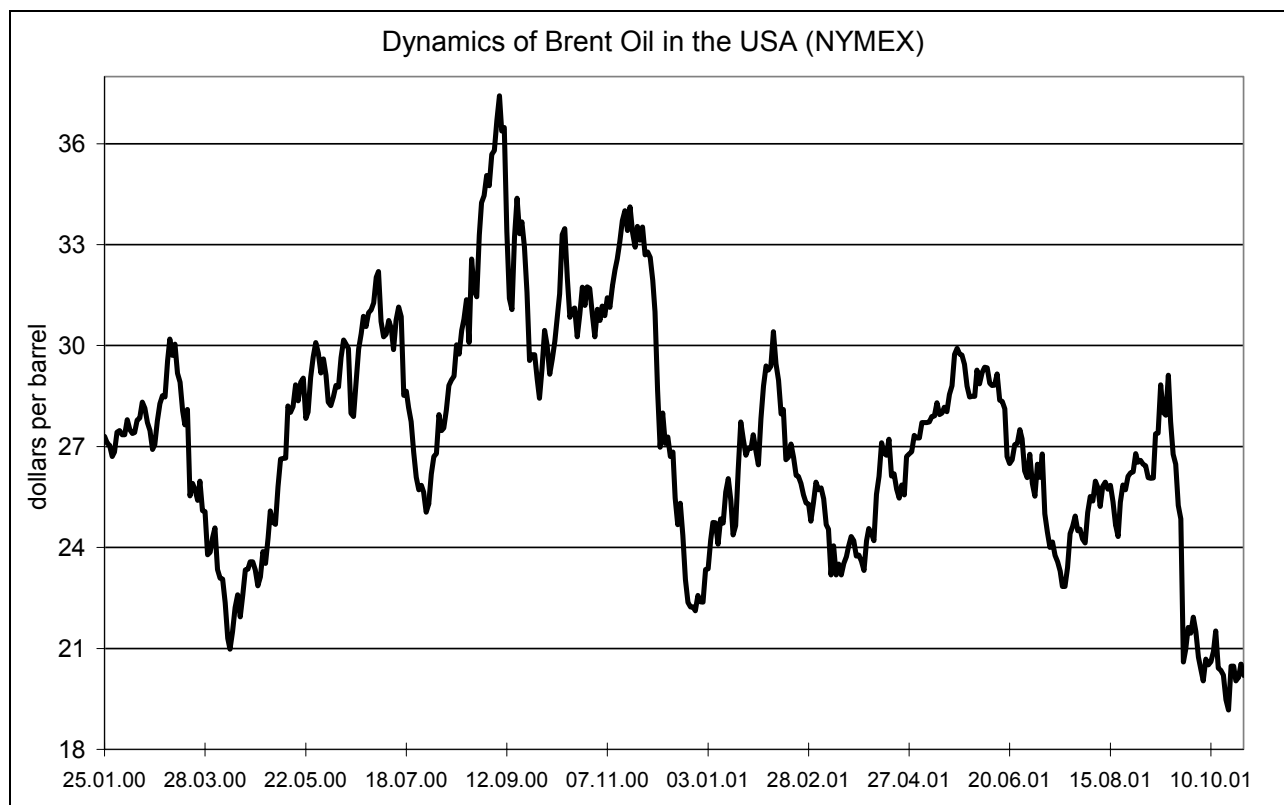
Oil

The pricing in the oil market is still affected by the decline in consumption of oil products due to the slowdown in the world economy and a lack of OPEC’s commitment to stabilise the market. The information on the absence of any OPEC’s plans to reduce oil production and on a possible lowering of the price band for the OPEC oil basket to 18-22 \$/bbl (now it is 22-28 \$/bbl) resulted in a sharp fall in oil prices. Thus, on October 19 the price for Brent dropped to the new two-year minimum - 20.63 \$/bbl. The increase in prices in late-October could be explained by the arrival of the information on the OPEC meeting (on November 14). At the meeting, the leaders of OPEC are likely

to decide on one billion barrel contraction of oil supply to the market. In total, between September

28 and October 27 the prices for crude oil fell by 7.89%.

FIGURE 5.



External factors

To preclude a further slowdown in the US economy, on October 2 the Federal Reserve System cut down the federal funds rate once again by another 50 basic points - to 2.5%, which became the minimum level ever reported since 1962. The main stock indices responded to the ninth cut of the rate this year with a growth : DJIA grew by 113.76 points (1.3%) up to 8950.59; NASDAQ Composite gained 11.87 points up to 1492.33.

The Bank of England lowered the key interest rate in the UK by 0.25 percentage points to 4.5%. The European Central Bank and the Bank of Japan retained their key interest rates unchanged, at 3.75% and 0.1%, correspondingly.

The positive shifts in the Russian economy were noted by the biggest international rating agencies. Fitch increased the long-term rating for foreign borrowings up to "B+", the long-term rating for domestic borrowings - up to "B". The forecast for the long-term rating is stable. Standard & Poor's confirmed the long-term and short-term sovereign ratings of Russia at "B" level and reconsidered its forecast from "stable" to "positive".

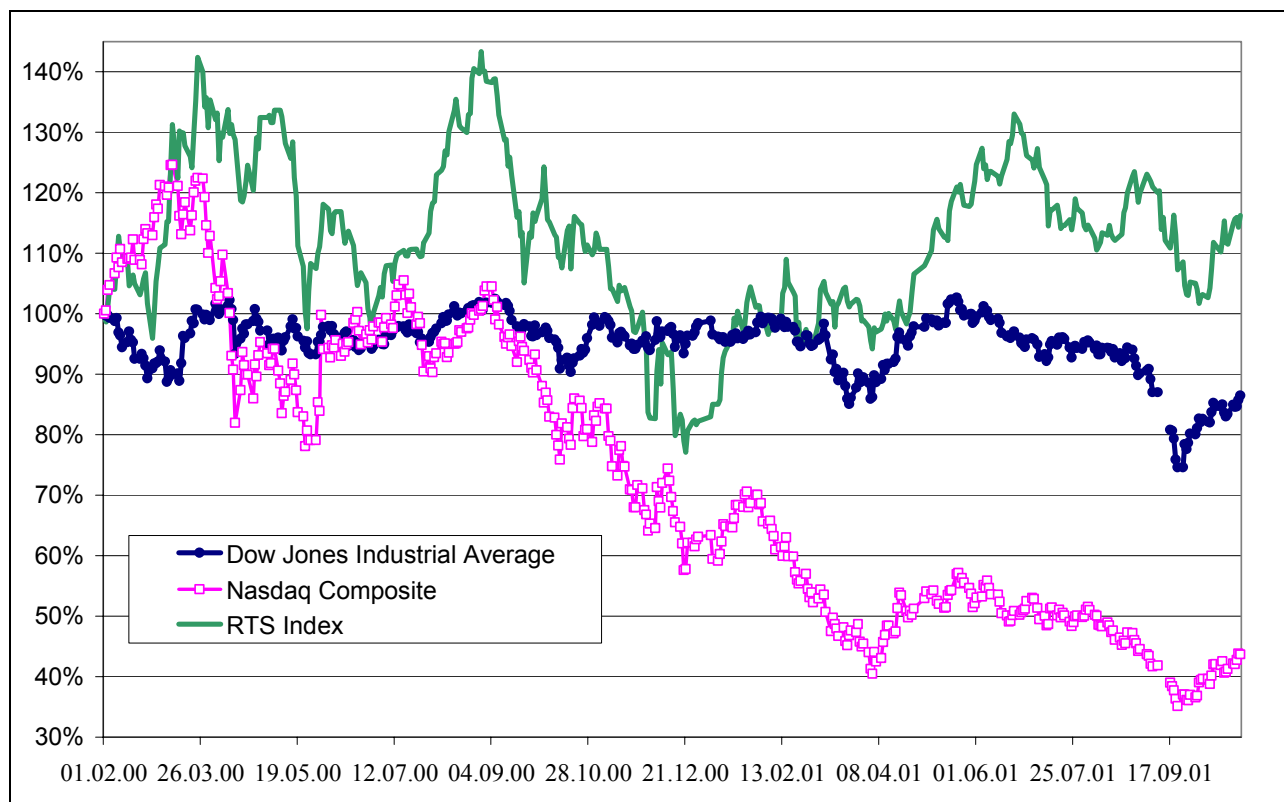
Corporate news

It is also noteworthy that the rating agencies acknowledged successes of certain Russian companies too. Standard & Poor's granted the corporate governance of "Petersburg Telephone Network" with rating CGS - 5.6 marks (from maximum 10) and increased the "LUKoil" rating forecast from "stable" to "positive" (the long-term company's rating remained at "B" level). The investment bank Nomura International raised the Russian telecommunication companies' (MTS and "Vympelcom") ratings from "hold" to "strongly buy". Fitch increased the long-term Sberbank's rating to "B+", and the Sberbank's individual rating from "D/E" to "D".

"LUKoil" acquired the both state stakes (40% and 45.36%) in the Nizhny Novgorod oil company "Norsi-Oil" for \$26 million, with the starting price for the both stakes being \$22 million.

Pursuant to the shareholders' decision to liquidate preferred stocks, "LUKoil" issued convertible preferred stocks. The FCSM registered their placement on September 28. The existing preferred stocks are exchanged for the new ones to be converted then into common "LUKoil" stocks. The preferred convertible "LUKoil" stocks are traded in the RTS since October 3, 2001. The face-value is 0.025 rouble, number of shares - 77 211 864.

FIGURE 6.



The end of the conflict between “Mosenergo” management and its main shareholder RAO “UES Russia” facilitated an increase in “Mosenergo” stock prices. The price growth was also influenced by the information on the Moscow City Government’s plans to increase its stake through an acquisition of stocks in the secondary market.

The “Surgutneftegas” oil production grew up to 32.5 million tons over the nine months of 2001 (a 7.9% rise when compared with the respective period of 2000). The company expects its oil output to rise up to 43 million tons this year, to 47 million tons in 2002 and to 50 million tons in 2003. In 2000 the production was 40.6 million tons.

RAO “UES Russia” and EBRD signed a memorandum on mutual understanding and agreement on 100-million euro credit.

“YUKOS” obtained the FCSM permit to issue common registered stocks in the ADR form abroad. “YUKOS” reported all formalities to issue the 1st level ADRs up to 20% of company’s equity were completed as early as in March 2001. The Board of Directors of “YUKOS” decided on intermediate dividends in 2001 at 2.64 roubles per share (\$200 million). The company announced its financial results according to GAAP for the first half of 2001: the net profit decreased to 44.77 billion roubles (46.08 billion roubles for the first

half of 2000), the net profit per one share accounted for 21.18 roubles (20.96 roubles). The annual forecast of oil output for 2001 is 57.5 billion tons (the previous forecast was 56.5 million tons).

Sibneft’s net profit in the first half of 2001 was \$613 million, while their sales for that period – accounted for \$1.663 billion, EBITDA – \$871 million (according to GAAP). It is envisaged that the company’s net profit in 2001 will amount to \$1.1 billion (prior to dividend payments), EBITDA will grow up to \$1.6 billion, revenues – \$3.3 billion. The company’s robust financial state has led to the increase in its stock prices up to \$0.66. However, the recent information on a sale of 27% shares from the company’s balance by its main shareholders compelled the market participants to fix their profits and stock quotations fell to \$0.6. Despite some investors’ bewilderment about operations with company’s stocks, prices of the “Sibneft” shares grew up to the maximum level in 2001 - \$0.69, after the company reported possible additional dividends worth a total about \$350 million. The final amount of dividends is likely to reach about \$900 million, the return, including dividends and price growth, – more that 215%.

According to RTS, the company’s capitalisation nearly doubled between December 2000 to September 2001) - from \$1.3 billion to \$2.4

billion. For the same period, the capitalisation of “Surgutneftegas” rose from \$8.1 billion to \$8.9

billion, and the capitalisation of “LUKoil” declined from \$7.3 billion to \$7.1 billion.

TABLE I. DYNAMICS OF THE FOREIGN STOCK INDEXES

as of October 30, 2001	value	change for last week (%)	change for last month (%)
RTS (Russia)	204.71	13.79%	56.24%
Dow Jones Industrial Average (USA)	9121.98	3.10%	-16.41%
Nasdaq Composite (USA)	1667.41	11.25%	-35.04%
S&P 500 (USA)	1059.79	1.81%	-20.52%
FTSE 100 (UK)	5003.6	2.04%	-19.11%
DAX-30 (Germany)	4543.98	5.47%	-28.74%
CAC-40 (France)	4251.93	4.24%	-26.89%
Swiss Market (Switzerland)	6008	-0.10%	-25.98%
Nikkei-225 (Japan)	10512.82	7.55%	-23.22%
Bovespa (Brazil)	11023.95	3.65%	-33.89%
IPC (Mexico)	5595.48	3.55%	-7.49%
IPSA (Chile)	103.13	4.39%	2.32%
Straits Times (Singapore)	1383.36	4.84%	-29.10%
Seoul Composite(Korea)	533.87	11.30%	-4.33%
ISE National-100 (Turkey)	9919.81	30.08%	-2.73%
Morgan Stanley Emerging Markets Index	205.597	5.75%	-20.55%

Foreign exchange market

In October 2001, the pace the fall of the nominal rouble/US dollar exchange rate accelerated substantially. In particular rouble devaluated by 0.4% as early as over the first week of the month and by 0.54% over the period October 24-31. In our view, the sizeable fall of rouble is explained, first, by seasonal factors – in October through December the rate of dollar/rouble exchange rate growth are obviously higher than over the rest of the year on the average. Second, in October the Bank of Russia intensified accumulation of its foreign reserves, while the decline in oil prices formed expectations of a contraction of foreign exchange supply to the market. This fact stimulated the demand for foreign exchange on the part of commercial banks. Third, the decline in oil prices worsens the balance of payments, and, in a hope for a real depreciation of the Russian currency, the RCB does not impede a faster rouble devaluation .

Thus, in October 2001, the official dollar exchange rate grew from 29.39 roubles/\$ to 29.7 roubles/\$,

i.e. by 1.05% (13.42% annualised, see Fig. 7). The ‘today’ dollar exchange rate in the SELT increased from 29.4575 roubles/\$ to 29.6154 roubles/\$ (as of October 25), i.e. by 0.54%. The ‘tomorrow’ dollar exchange rate grew from 29.4513 roubles/\$ to 29.6276 roubles/\$ (as of October 25), i.e. by 0.60%. According to preliminary estimates, in October the trading volumes by dollar in the SELT amounted to about 75 billion roubles.

In October the euro/dollar exchange rate dropped once again (see Fig. 8). The statistical data testify to a further slowdown in economies within the monetary union, while the UK and Swiss economies– the biggest European countries retaining their national currencies – demonstrated high growth rates. Therefore, investors withdrawing capital from the US assets conceive that investments in the British pound or the Swiss frank constitute a more attractive option compared to euro,. Thus, for the period after September 27 the euro exchange rate declined from 0.9237 to 0.9049 \$/euro, i.e. by 2.04%.

FIGURE 7.

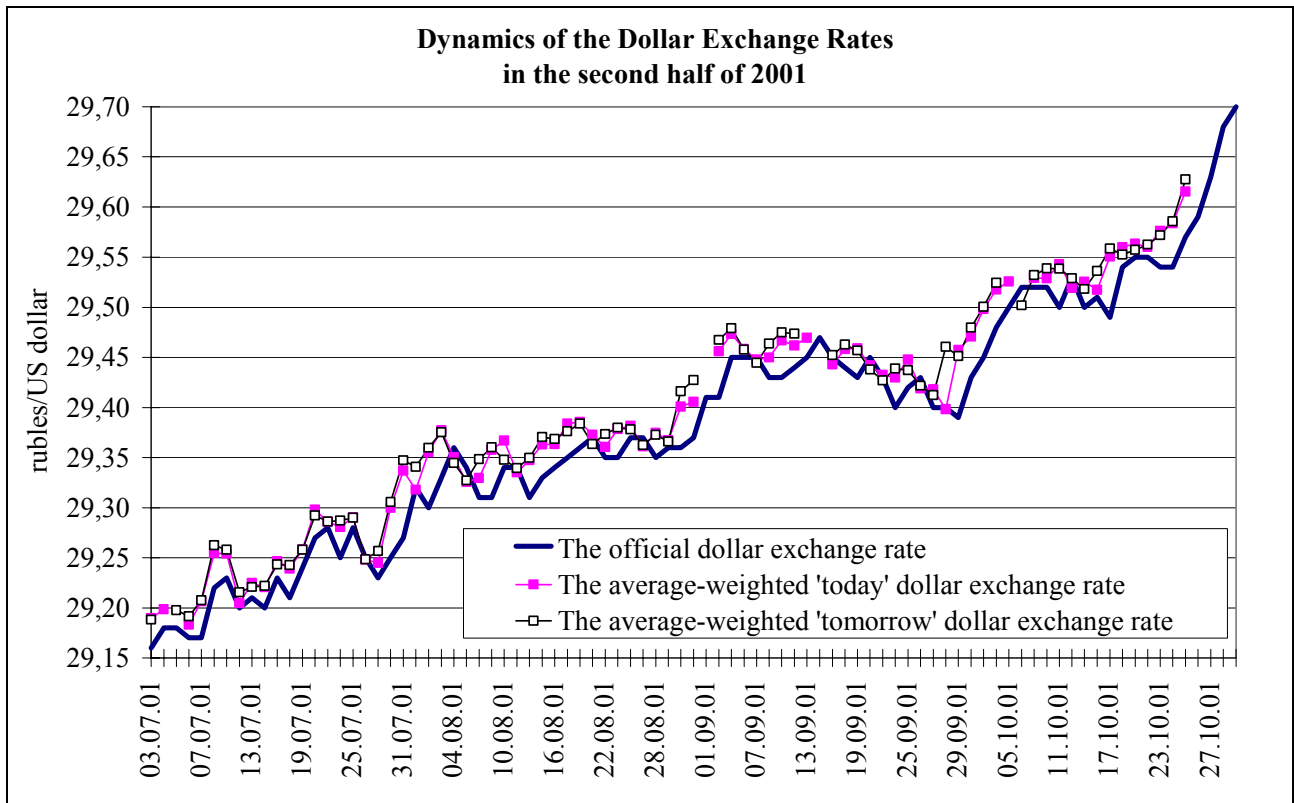
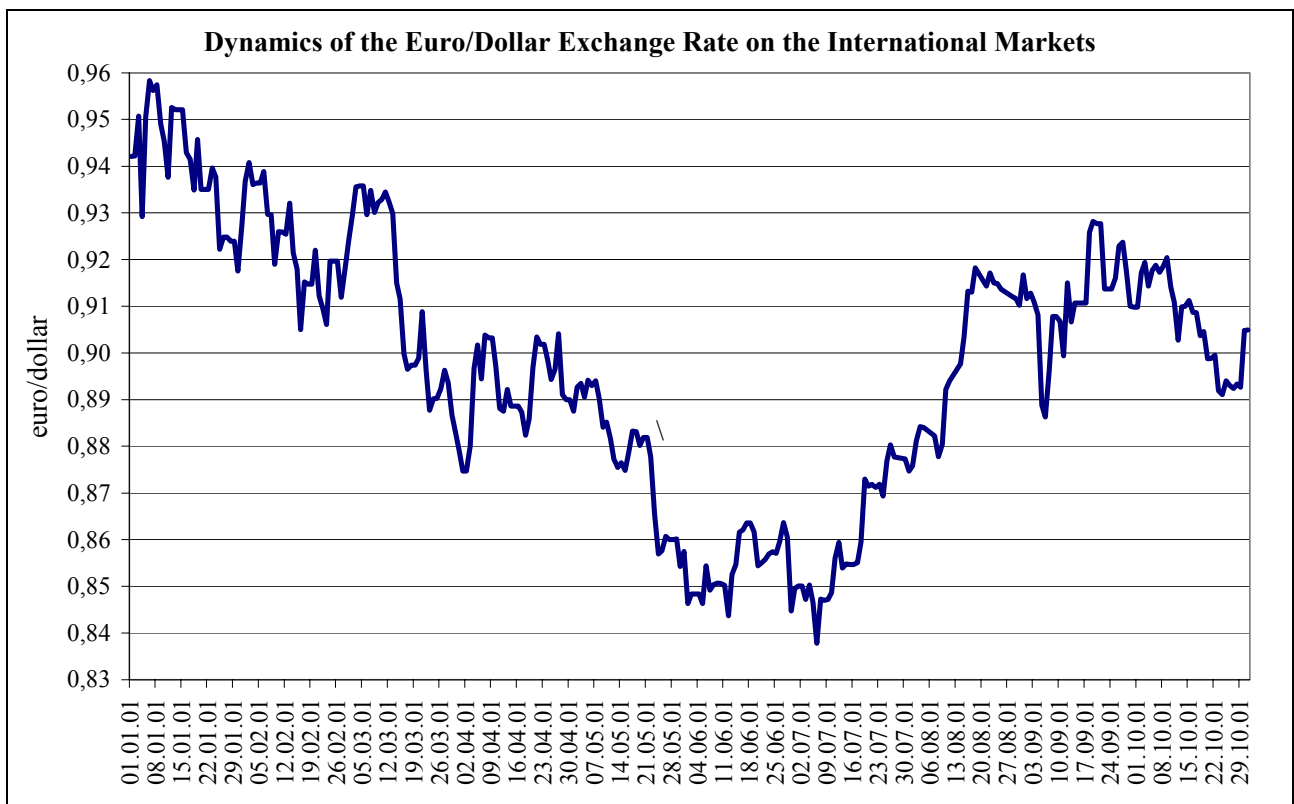


FIGURE 8.



In October 2001 the euro/rouble exchange rate was very volatile (see Fig. 9). The rouble/euro official exchange rate practically was stable, sliding from 26.86 roubles/euro to 26.87 roubles/euro, i.e. by

0.04%, over the month. According to preliminary estimates, in October 2001, the total trading volume on euro in the SELT made up about 2.9 billion roubles.

FIGURE 9.

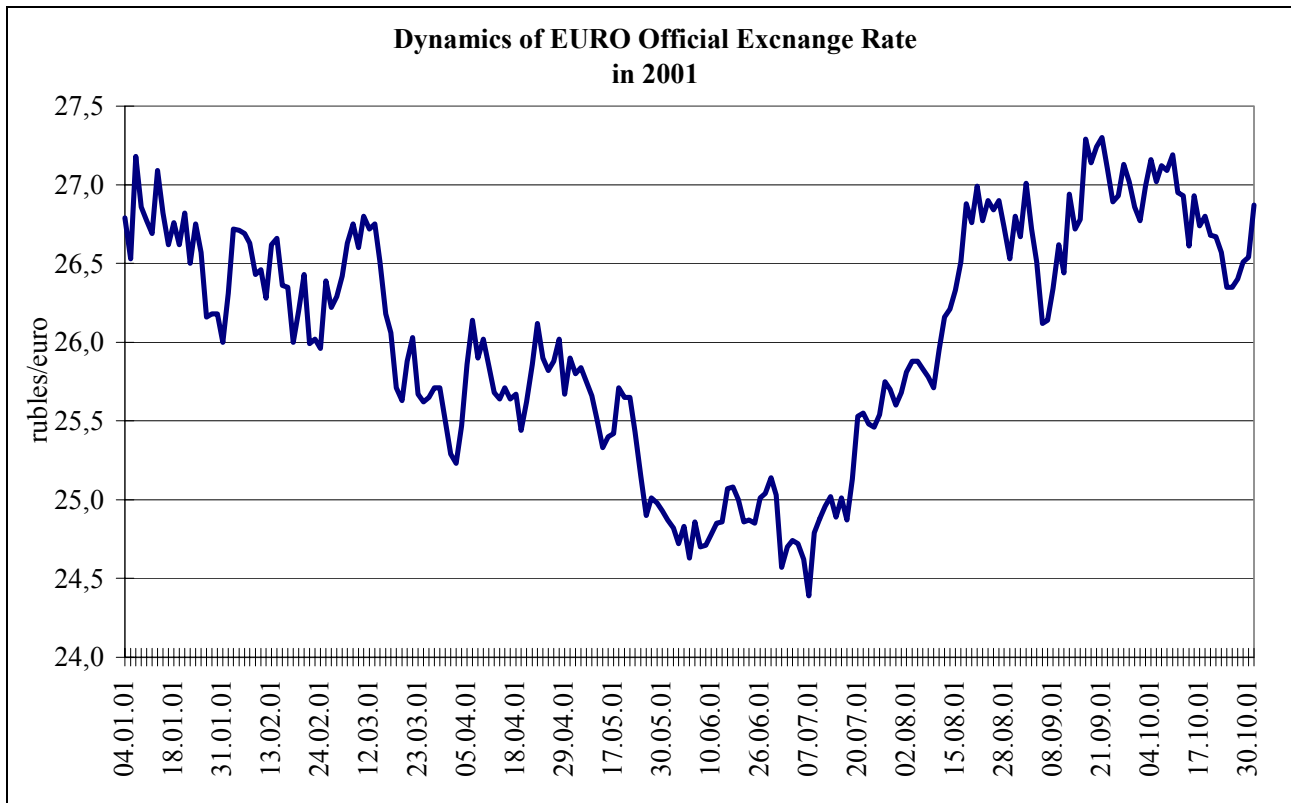


TABLE 2. INDICATORS OF FINANCIAL MARKETS.

	June	July	August	September	October*
inflation rate (monthly)	1.6%	0.5%	0.0%	0.6%	1.2%
annualised inflation rate by the month's tendency	20.98%	6.17%	0.0%	12.07%	15.39%
the RCB refinancing rate	25%	25%	25%	25%	25%
annualized yield to maturity on OFZ issues	17.03%	17.19%	16.13%	15.33%	15.1%
volume of trading in the secondary GKO-OFZ market a month (billion rubles)	7.92	11.67	7.44	8.89	8.3
yield to maturity on Minfin bonds by the end of the month (% a year):					
4th tranche	13.91%	15.90%	13.05%	13.19%	10.9%
5th tranche	14.59%	16.29%	15.53%	15.86%	15.45%
6th tranche	14.01%	15.54%	14.78%	15.63%	14.8%
7th tranche	13.26%	14.79%	14.70%	15.07%	14.05%
8th tranche	13.93%	14.76%	14.21%	14.75%	14.3%
INSTAR – MIACR rate (annual %) on interbank loans by the end of the month:					
overnight	29.95%	25.3%	9.33%	27.88%	6%

TABLE 2. INDICATORS OF FINANCIAL MARKETS.

1 week	29.49%	14.0%	10.28%	29.03%	12%
official exchange rate of ruble per US dollar by the end of the month	29.07	29.27	29.37	29.39	29.70
official exchange rate of ruble per Euro by the end of the month	24.57	25.60	26.67	26.86	26.87
average annualized exchange rate of ruble per US dollar growth	-0.07%	0.69%	0.34%	0.07%	1.05%
average annualized exchange rate of ruble per euro growth	-1.21%	4.19%	4.18%	0.71%	0.04%
volume of trading at the stock market in the RTS for the month (millions of USD)	490.4	436.8	232.0	249.9	270
the value of the RTS Index by the end of the month	216.11	196.12	205.41	180.25	203.6
growth in the RTS Index (% a month)	3.50%	-9.25%	4.74%	-12.25%	12.95%

* Estimates

S. Drobyshevsky, D. Skripkin

The real sector: factors and trends

According to preliminary data of the RF Ministry of Economic Development and Trade, between January to September 2001 the increment in GDP accounted for 5.4% relative to its respective period of the prior year. In the 2nd quarter 2001, the growth in output still was in place practically in all the sub-sectors of the industrial sector. When compared to the period between January to September 2000, the output of goods and services by the basic sectors of the economy showed a 5.7% growth. The analysis of the structure of industrial growth shows that the rise in output practically completely was back-upped by the advanced growth in the final industries oriented towards the

domestic market. According to the RF Ministry of economic development and trade, it was investment and consumer demand sectors that showed the highest rates of development. Between January to September 2001 the index of industrial production across these sectors accounted for 107.4 and 107.8%, respectively. The advanced growth rate in the domestic demand compared with the external one appears one of the major specifics of the development of the national economy this year. During the period in question the proportion of the domestic demand in the structure of GDP grew up to 86.2% vs. 79.4% noted in the analogous period of the prior year.

TABLE 1. THE STRUCTURE OF CONSUMPTION OF GROSS DOMESTIC PRODUCT OVER 2000- 2001, AS % TO RESULT

	2000				2001		
	By quarters				By quarters		
	I	II	III	IV	I	II	III*
GDP	100,0	100,0	100,0	100,0	100,0	100,0	100,0
Of which							
Spending on final consumption	63,6	62,5	56,8	67,0	64,8	66,4	65,1
including							
By households	48,1	45,0	42,3	49,2	49,9	48,4	49,7
Gross accumulation	12,0	16,5	26,0	13,1	16,1	19,5	22,3
including							
Gross accumulation of capital assets	12,7	16,0	18,2	23,4	14,3	17,6	20,0
Net exoprts	24,4	21,0	17,2	19,9	19,1	14,1	12,6

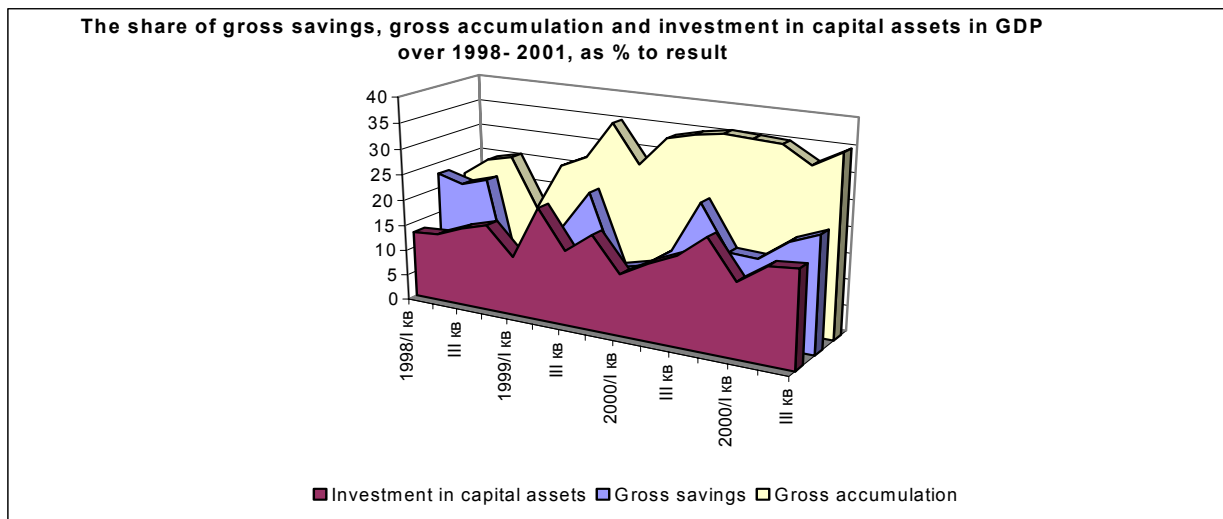
Source: Goskomstat of RF

*) calculated using the data of Goskomstat and the MEDT

When compared with the period between January through September 2000, the proportion of spending on final consumption grew by 2.7 per cent points, and, notably, this should be attributed fully to the rise in households spending. The dynamics expansion of the consumer demand is supported by a pro-active government policy aimed at increasing the population's living standards. When compared with the respective period of the prior year, the population's real incomes grew by 6.0%, real salaries and wages- by 19.1%, while real amount of pensions due- by 21.4%. The number of residents with their monetary income below the subsistence minimum level dropped by 15.0% compared with the 3rd quarter 2000. With account of the envisaged growth in the population's incomes in the 4th quarter, including the increase in salaries of the budget employees effective as of December 1, 2001, it is forecasted that the annual poverty level rate should slid to 27% of the overall population vs. 30.2% noted in 2000.

The trend to the rise in demand for workforce has a favorable impact on social climate this year. Since the beginning of this year the number of employees in the economy grew by 0.3 mln, while as of September, the share of jobless slid to 8.1% vs. 9.8% reported over the same period of the prior year.

FIG.1



Despite the positive dynamics of the growth in investment and considering the current technological, reproductive and age structure of capital assets, the latter prove to be clearly insufficient to pursue an active economic policy. Considering a traditionally high income concentration within the export-oriented sector and the absence of mechanisms for inter-sectoral

It is a dynamic expansion of the retail trade turnover along with the growth in output of domestic consumer goods that serve the most evident indicators of positive changes in the population's living standards. During the period in question, the increment in the households' spending on final consumption accounted for 8.7%, while the retail trade turnover showed a 10.1% growth vs. the respective period of the prior year. With the population's incomes rising, the purchases of non-food stuffs showed their advanced growth rate: given that this year the turnover of the retail trade with food stuffs grew by 7.1% compared with the respective period of the prior year, the respective index of the turnover of the retail trade with non-food products accounted for 12.8%. With the renewal of the level of consumption, the turnover of trade enterprises takes an advanced rate vs. the volume of sales at goods and food marketplaces. The positive impact of an intense rise of the consumer demand also manifested itself on the dynamics of the profitability rate of retail trade and investment activity in this sector of the economy.

The growth in investment in capital assets retains its dominating impact on production dynamics. The share of gross accumulation in GDP is steadily higher than in 2000.

capital flows, one can hardly count on cardinal changes in the nature of capital assets reproduction. The situation in the investment area appears more complex, given the fact that the economy needs both an increase in the scope of investment and the identification of a strategy of attraction of investment in the sectors that traditionally experience a lack of competitive

capacities. With the growth rates of enterprises' receipts slowing down, the current proportions are just reproduced, and in such a situation it is the sectors that in which the lack of capacities arises (namely, the oil-refining industry, chemicals, ferrous and non-ferrous metallurgy, machine

engineering, food and light sectors) that appear most sensitive in this regard. The absence of the developed mechanism for capital flows and transformation of savings into investment appears the factor that constrains economic growth rate.

O. Izryadnova

IET Monthly Trend Survey: October 2001

The slowdown of the growth rate of monetary sales in October forced enterprises to lower their rates of output. At the same time the combination of the decrease in the volume of the stock of finished goods with their continuous excess testifies to the fact that producers are pessimistic about the prospects of the rise in sales over the forthcoming months and have begun to adjust their production programs.

In October, the growth rates of monetary sales of industrial produce slid from 12 to 8 per cent points, which proved the results of the prior survey which registered the enterprises' forecast of a slowdown of the growth in effective demand. The slowdown in the growth in sales was registered in all the sectors except the machine building and the construction industry, while the respective report balances became negative for the metallurgical sector and the oil sector and chemicals that already showed a drop of the volume of their sales.

After the three-month growth, the rates of decline of barter operations began to slowdown, and, given the fall in the intensity of sales it appears quite natural – barter would help the national industrial sector survive. The analogous trend takes place with regard to transactions using promissory notes and off-sets. The decline rate in the volume of the noted transactions increasingly slows down from month to month. At present, the share of non-monetary deals in the Russian industrial sector roughly accounts for 25%, while in 1997 it used to reach 60%.

The last survey registered a sharp fall in the volume of finished products in stock. After zero growth rate of this index in mid- 2001, in early 4th quarter the enterprises began intense sales of their stock. The fall in this index was noted in all the sectors, while the most intense one took place in the metallurgical sector and in the forestry. However, while estimating their stocks, the enterprises still demonstrate the excess of the 'above norm' reports. Such a combination testifies to the aforementioned fact that the enterprises are pessimistic regarding a growth in their sales in the nearest future and started to adjust their production

programs to avoid an excessive accumulation of their stock, as it was noted in 1994 or 1996.

The slowdown of the growth rate in their monetary sales compelled the enterprises to decrease their growth rates of output. Having peaked its maximal value over the past six months in September, the growth in output slowed down roughly by one-third in October. The increase in output took place only in the sectors for electricity, construction, and the light industry, while in others sectors the growth in output slowed down, while the metallurgical sector has already reported an absolute fall in output. However, the situation appears more favorable when compared with the beginning of the 3rd quarter. First, the capacity loading rate is higher: in October, it reached 58%, which has proved to be the best value since 1994. Secondly, the share of enterprises with excessive capacities and employment dropped, and currently only 10% of enterprises have an excessive number of employees, while 27% have excessive capacities (see the Fig. Below). Thirdly, the share of enterprises that envisage a growth in the number of their employees began to grow once again.

At the same time, the enterprises' sufficiency with orders testifies to an unsteady industrial growth. In October, the respective index fell to 4.7 months, which is the worst value since early 1999.

The forecasts of the change in effective demand continued to deteriorate in October. The envisaged growth rates in monetary sales fell by another 4 points and became minimal over the past 23 months. The lowering of optimism was registered in all the sectors, except those for chemicals, petrochemicals, and the food industry. An absolute contraction in sales may become possible only in the non-ferrous industry and the construction industry. The volume of non-monetary kinds of demand is likely to continue its contraction over the forthcoming months, and according to enterprises' estimates, the this process should intensify.

Having reached their maximum in August, the forecasts of change in output have been declining over the past two months and, considering the

forecasts of all kinds of demand, their chances to become a reality are high. It is only the industry of construction materials that forecasts an absolute fall in output over the forthcoming months. The industrial sector conceives the lack of liquid capital and a low domestic demand for their products as major impediments to production growth, while non-payments sank to the second position, along with the lack of raw materials and personnel (see Fig. below).

To analyze the accuracy of enterprises' forecasts, let us employ the same natural indicator that was used to describe the accuracy of forecasts. Let us then calculate the share of enterprises whose forecasts did not justify in the month following the surveyed one. All the erratic forecasts, in turn, can be split into those that prove to be overoptimistic compared with the actual situation and those that proved to be too pessimistic. The difference between the proportion of optimistic and pessimistic forecasts is called the forecast errata

balance. Once negative, it testifies to the excess of pessimistic mistakes, while, accordingly, a positive one shows the prevalence of optimistic ones.

On the average the enterprises' forecasts prove to be more optimistic compared with the consequent actual changes. The minimal value of the errata balance was the one related to the forecasts of barter demand: the average index through all the surveys accounted for 1%. Hence, optimistic and pessimistic mistakes in forecasting this index practically compensate for each other in the generalized results of our surveys. At the same time the forecasts errata balances output, pricing and effective demand substantially differ from zero value, and their average values through all the surveys account for 11, 10, and 13%, respectively. Notably, after the 1998 default the forecast errata balance has improved greatly and, for example in 2000 accounted just for 5%.

S. Tsukhlo

Foreign trade

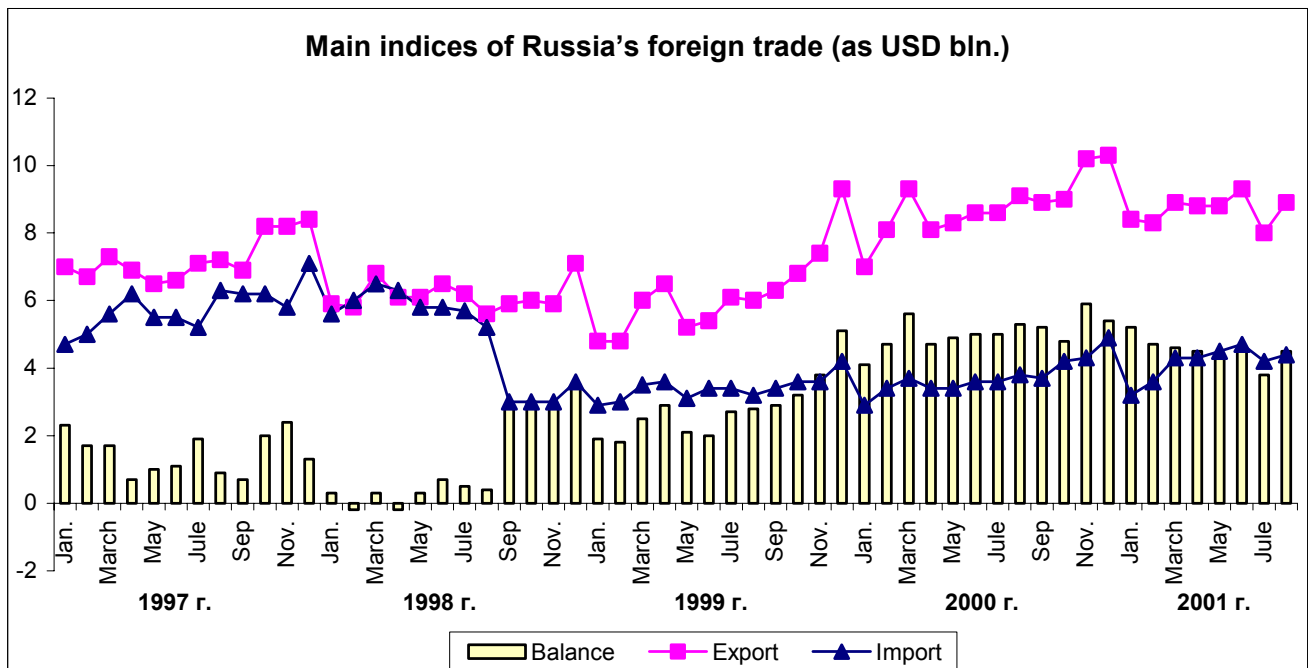
According to the new annual report released by WTO, in 2001 the overall volume of international trade should grow just by 2%, while last year the respective index made up 12%. The slowdown of the growth rate of the world trade turnover can be attributed to the general slowdown of the world economy which was intensified by the terrorist attack on September 11. Thus, the WTO experts have revised their previous forecasts in favor of their drop, while yet in May the Organization forecasted a 7% growth in the world economy. The scenario of the development of the situation in the world trade in the 4th quarter still keeps a great deal of uncertainty. One can single out three main factors that caused the contraction in the world trade turnover: a sharp fall in the volume of US exports, the contraction in demand in the Western Europe, and crisis in the market for Hi-Tech products worldwide.

Nonetheless, Russia's foreign trade turnover continues to grow: in August 2001 it showed the 6% rise vs. the prior month and accounted for USD 13.3 bln. (a 3.1% growth compared to the respective month of the prior year). However, in contrast to the previous months, in July and August 2001 the foreign trade turnover was growing thanks to the growth in the import volumes. In

August 2001 exports made up USD 8.9 bln. vs. 9.1. bln. reported in August 2000, i.e. showed the 3% growth, while imports stood at USD 4.4 bln. vs. 3.8 bln. reported in August 2000 (the 17.8% rise). As a result of these developments, Russia's balance of foreign trade slid to USD 4.4 bln. vs. 5.4. bln. reported in August 2000.

In August, the situation in the world market remained rather favorable for Russian exporters: the oil market was under the impact of the trend to price rise, while the US reported a sharp decrease in their stock of crude oil and petroleum derivatives; the political instability in the Middle East was accompanied with OPEC's declarations on the need in the discussion on new adjustment of quotas for oil production. In August, the average price for Brent oil accounted for USD 25.7/barrel (4.5% up vs. July), while the one for Urals was 24.4 (6.1% up). between January to August 2001 the average contract price for the Russian natural gas grew by 39.3% compared with its respective index of 2000. At the same time August 2001 showed the continuous instability in the major markets for non-ferrous metals, and the main factor contributing to that was a loose consumer demand.

FIG.1



Source: Goskomstat of RF

TABLE 1

	1996	1997	1998	1999	2000	2001
Oil (brent), USD/t	21,04	18,25	12,5	20,2	29,4	25,7
Natural gas, USD/mln.m ³	2,856	2,121	1,858	2,8	4,437	2,91
Petrol, USD/t	0,6299	0,5941	0,4128	0,6476	0,9021	0,776
Copper USD/t	2001,4	2481,7	1627,4	1646,6	1941,7	1499,4
Aluminum, UDS/t	1480,1	1563,7	1345,4	1421,1	1546,4	1374,9
Nickel, USD/t.	7100,4	6737,3	4137,1	6430,8	8092,9	5554

In 2001 the situation in the national ferrous metallurgy became complicated, too, which can be attributed chiefly to the deterioration of the world state of affairs, as the market for metal product has experienced saturation. (For reference: Russia's share in the world steel market accounts for 8.4%).

The economic situation in the country allows Russian metal producers to export their products at prices being lower than their competitors' ones. The sources for such a success are a low demand in the domestic market, a cheap labor force and relatively low prices for raw materials. The inflow of relatively cheap steep products from Russian and other transitional economies has caused a whole range of anti-dumping investigations launched by the US and some EU countries, which resulted in introduction of anti-dumping import duties or quotas on import supplies of certain kinds of metal products.

In summer 2001 the US Administration launched an initiative to contract the steel output worldwide. According to the US experts, at present the world

steel output is at 10% in excess of the respective demand. Should the world economy continue its growth rate, the gap would widen, while the metal prices would continue their decline. As a result, it is the US steel producers who will suffer at most, as the respective production costs in the US are among the highest in the world.

However, it is not possible to limit the world steel output as yet - that is why in an effort to force the US Administration to introduce prohibitive duties on the import of cold-rolled steel from 20 foreign countries, including Russia, in early October 2001 the US top four steel producers submit their petition to the US Department of Commerce. (For reference: the noted four companies dominate the US steel market with their share accounting for 69%, while the rest is import steel, of which Russia's share is one-tenth of it).

On October 22, the US Commission on Foreign Trade passed a positive ruling on the noted claim, which means that the US would introduce protectionist measures against the non-US steel

producers and there would not be an exception made for Russia. A best the US and Russia may sign an agreement that would constrain both the export volume to the US and the minimal price level for Russian steel, while the worst would be a complete shutting of the US market for the Russian exporters, because should the import of cold-rolled steel be subject to 150% duty, Russia would have to quit the US market.

It is worth noting that the market for hot-rolled products in the US was lost yet in 1999, upon the signing of a special agreement between the countries. Russia voluntarily limited the supplies of different kinds of steel to the US market in exchange for the discontinuation of anti-dumping investigations on Russian hot-rolled steel supplies to the US. Meanwhile, the Russian metal producers are going to break the agreements unilaterally, as they are clearly discriminative.

The situation and prospects with regard to the Russian ferrous metal supplies to the European market have not been clear as well. In the meantime the bilateral trade with steel products between Russian and EUSD is regulated by two main documents: "The Agreement on Partnership and Cooperation" of 1994 and "The Agreement on the Trade with Some Steel Articles between RF and EU" of 1997. An annex to the latter agreement sets annual quantitative restrictions on the Russian supplies to the EU of rolled steel greed upon between 1997 to 2001. The EU guarantees trade liberalization starting from 2002, should Russia comply with Protocol "B", according to which Russia must lift all the constrains in the domestic market and eliminate the government support to the sector except the R&D-related investment.

In November, the Russian side intends to discuss the further development of the situation both with the US and the EU, to set clear prospects in the area of trade with ferrous metals. Hence, the state of the national ferrous metallurgy depends greatly on Russia's authorities' ability to protect, along

with metal producers, the national interests on a non-discriminative basis.

As concerns Russia's trade with the CIS countries, the volume of their mutual trade accounted for USD 23.8 bln. in August 2001. At the same time the volume of import supplies to Russia continue their decline for the second month running, and the import supplies made up USD 1.0 bln., or at 16.6% down when compared with their respective index of the prior year, while Russia's exports grew by 25.8% vs. August 2000 and reached USD 1.38 bln.

In October, Russian and Ukraine signed new intergovernmental agreements on the gas debt restructuring and the Russian gas transit procedures. The Parties intend to increase the share of cash payments in the transit settlements and to fix its size by special intergovernmental agreements to be concluded annually. (For reference: according to the last calculations, the Ukrainian gas debt roughly amounted to USD 1.5 bln., while it is planned to start the repayment of that only in 2005).

As concerns other goods, this year Ukraine has increased the volume of its export supplies to Russia nearly by 50%, and until the end of the year the country plans to supply to Russia the goods worth a total of USD 1 bln., while the Russian supplies have fallen by 5%.

Thus, in contrast to the trends noted last year, when Russia enjoyed the positive USD. 2.5 bln.-worth balance in its trade with Ukraine, this year Ukrainian export supplies became superior to Russia's ones.

The problem of the gas debt is also very pressing for Moldova, where roughly over 40% of exports falls on Russia. The heads of the both countries arrived to the agreement to retain the price for the Russian gas on the last year' level (USD 80/cub.m.), while 25% of the price is to be paid after three years upon the delivery.

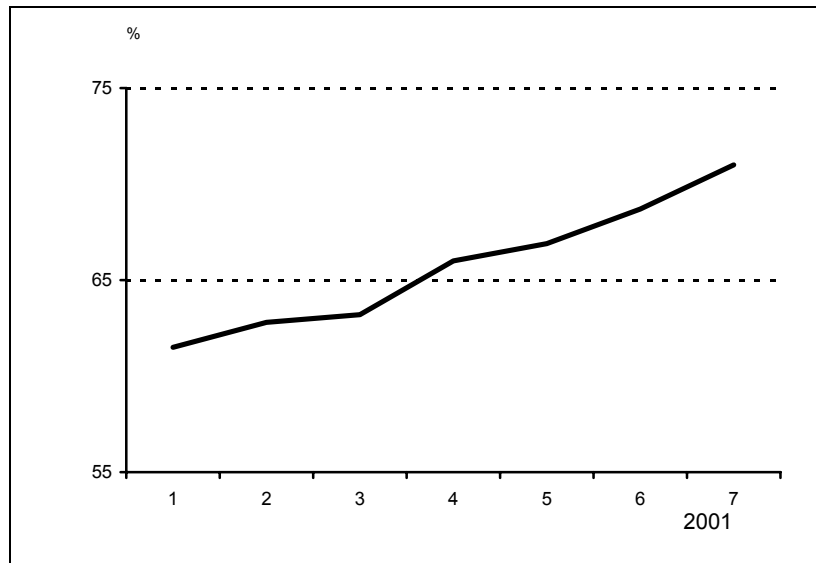
N. Volovik, N. Leonova.

Russian banks in the market for GKO-OFZ

Against the backdrop of the fall in the share of non-residents and the non-banking sector in the structure of the participants in the GKO-OFZ market noted since early 2001, the share of the banking sector has showed an opposite trend and has grown over the period in question. By late July the share of the non-banking sector reached 71% (vs. 61.5% as of early 2001).

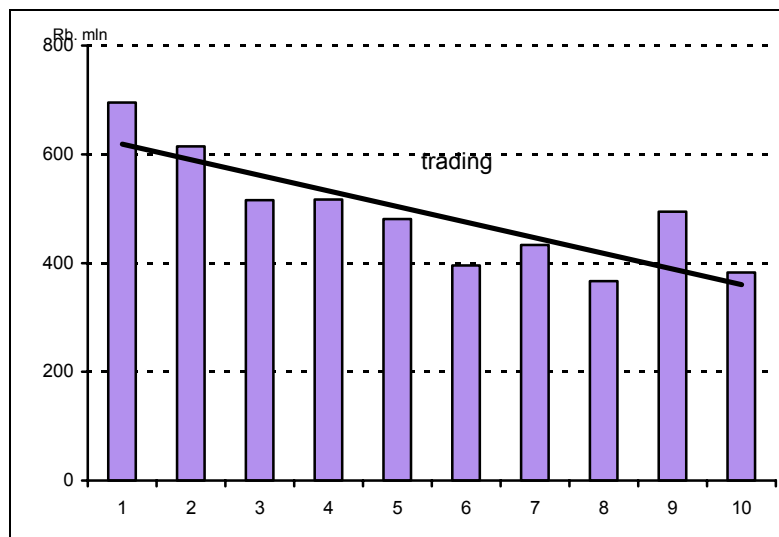
In September, the turnover of the market for government obligations denominated in Rb. accounted for Rb. 10.1 bln. That is at 19% more than in August, but slightly down compared with the respective average index over the first half year (10.6 bln.). As it is seen from Fig.2, the average daily volume of secondary trading sessions has been declining since early 2001.

FIG.1 THE DYNAMICS OF THE SHARE OF THE NON-BANKING SECTOR IN THE GKO-OFZ AGGREGATE PORTFOLIO IN 2001.



Source: CBR

FIG. 2 THE AVERAGE DAILY VOLUME OF SECONDARY TRADING SESSIONS WITH GKO-OFZ IN 2001, AS RB. MLN.



Source: Finmarket

The data on participants in the government obligation debt published by the Central Bank includes the information on the aggregate portfolio of GKO-OFZ owned by the Central Bank itself, while one can get the idea on commercial banks' participation in the respective overall portfolio from the data contained in their balance sheets.

As of early 2001, of over 1,3000 operating banks 648 ones held Rb-denominated federal debt obligations (FDO) in their portfolios, however, in January there were only 376 banks(exclusive of Sberbank), i.e. slightly over half of banks, that conduct operations with the papers. By-mid 2001 the number of the banks with the Rb.-denominated

FDO in their portfolios showed some growth and reached 679. At the same time the growth in the number of banks that conduct operations on GKO-OFZ took a faster pace and it was 420 banks that reported their turnover on Rb. denominated FDO over the period in question. Nevertheless in June, in absolute equivalent, the overall turnover of all the banks practically remained unchanged vs. January.

GKO-OFZ are trade at 8 Russian exchanges, and it is MICEX which appears a clear leader among them. It is banks that are active participants in the secondary market for Rb. -denominated FDO, and they account for over 90% of the total number of dealers at MICEX.

Below, we will focus in a greater detail on operations of some Russian banks that are the most active operators in the respective market. To analyze the situation, we built a sample that is comprised of the banks that were the most active operators. The sample was built on the base of the MICEX's list that usually includes the dealers on the market for GKO-OFZ that have the biggest trade turnover in the secondary trades during the period in question, given their own operations and transactions conducted on behalf of their clients. Hence, considering the data on August and September, the list includes 29 banks and 1 investment company, including the top 5 dealers - Sberbank RF, Deutsche Bank, Credit Suisse First Boston, Vneshtorgbank, and Citibank T/O. For the purpose of the consequent analysis, Sberbank RF was excluded from the sample, because its share in the Rb. denominated FDO in the Russian banks' (exclusive of Vneshtorgbank) accounted for over 70%.

As of July 1, the share of Rb.-denominated FDO in the assets of the banks- leading operators in the market for GKO-OFZ at MICEX made up 2.4% (without regard to Sberbank), so it fell 1.3 times since early 2001. The share of Rb.-denominated FDO in the assets of the average statistical Russian banks over the period concerned accounted for 2%, or fell by 23.1%. In absolute terms, the banks-leading operators in the market for FDO-OFZ at MICEX also experienced a fall in the volume of the Rb.-denominated FDO at more than 17% over the first half year, while overall the respective index across all the national banks (exclusive of Sberbank and banks managed by ARCO) accounted for 5.5%. Such a fall is quite logical, as long as the negative real profitability rate of the majority of issues of

TABLE 1. THE AGGREGATE TURNOVER OF BANKS-OPERATORS ON RB-DENOMINATE FDO AT MAIN EXCHANGES³

Banks-operators in the market for GKO-OFZ	The shares in the aggregate turnover on Rb.-denominated FDO (as %)	
	December 2000	June 2001
Leading operators at MICEX *	30.6	29.8
Participants in SPE	10.1	10.9
Participants in NNE	4.0	1.3
All the banks that have balances on Rb.0denominated FDO differing from 0**	100.0	100.0

Note:

*- banks operators with the biggest turnover at secondary trades in September 2001

**- exclusive of Sberbank and Vneshtorgbank

Calculated on the basis of the data of STiK company.

GKO-OFZ circulated in the secondary market is concerned.

As of mid 2001, the average assets of the banks-most active operators in the market for GKO-OFZ accounted for Rb. 19.6 bln. (without regard to Sberbank), thus showing a 18.8% growth since early 2001). The banks- active operators in the market for GKO-OFZ have proved to be much more profitable compared with both the average statistical Russian bank (2.5% vs. 2.1% annualized) and the average Moscow bank (2.5% vs. 1.9%).

Likewise the FDO denominated in foreign exchange, it is the papers bought for their further sales that account for the biggest share in the Rb.-denominated FDO portfolio.

In June the overall turnover of the banks- active operators in the market for GKO-OFZ at MICEX (exclusive of Sberbank) on Rb.-denominated FDO accounted for 29.8% of the overall turnover of all the operating banks (without account of Sberbank). Interestingly, the turnover on the papers acquired for their further sales accounted for 33% of the respective turnover of all the operating Russian banks exclusive of Sberbank. In June, in absolute terms, the turnover on Rb.- denominated FDO bought for investment purposes proved to be as much as 4-fold down compared with the trade portfolio and accounted for 22% of the respective turnover of all the banks without regard to Sberbank. The banks- the most active operators on MICEX reported the overall turnover of the Rb.-denominated FDO bought for their re-selling to be even at 2.2% lower than the respective aggregate balance.

³ The turnover was calculated as the sum of purchases and sales

Let us consider in a greater detail the situation on two regional exchanges- in St. Petersburg and Nizhny Novgorod.

The former reported the volume of the respective secondary trades being far lower than on MICEX, with the overall turnover of the banks - operators in the market for GKO-OFZ at SPE in June accounting for 10.9% of the overall turnover of all the banks, of which over 70% falls under the turnover of Rb.-denominated FDO acquired for their further re-selling. The banks-operators at SPE showed the ratio of the overall turnover of Rb.-denominated FDO to the balance of Rb.-denominated FDO bought for their re-sales accounted for 76%, which also testifies to their less intense operations compared to leading Moscow-based banks operators. On the other hand, during the first half 2001 the share of banks-participants in SPE in the overall turnover on Rb.-denominated FDO rose by 8% against the backdrop of a nearly 3% fall in the share of the most active banks-operators on MICEX in the overall turnover of all banks.

At the same time, in June another regional exchange- that is, the Nizhny Novgorod one - showed the overall turnover on Rb.- denominated

FDO of the banks-operators in the market for GKO-OFZ accounted for 1.3% of the overall turnover of all the banks. The share of papers bought for further re-selling accounted for 56%. The ratio of the overall turnover of Rb.-denominated FDO to the balance of Rb.-denominated FDO bought for their re-sales accounted for 29%. Overall, as of mid - 2001, the share of Rb.-denominated FDO in the noted banks' assets did not exceed 4%, nonetheless, being 1.7 times over the respective average index reported by the most active Moscow banks-operators (2.4%).

Thus, as far as the medium- and longer-term prospects are concerned, it is the government papers denominated in foreign exchange that still remains most attractive for the Russian banks' investment. This is proved by a considerable excess of the share of FDO denominated in foreign exchange over the Rb.-denominated ones in the overall volume of FDO in the banks' assets (as of mid-2001, the share of the former accounted for 72% for the average Russian bank vs. 28% falling within the share of Rb.-denominated FDO).

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Some innovations in the corporate governance area

The long process of the debate on and blockage of new amendments to the law "On joint stock companies" is over. Federal Law # 120-FZ of August 7, 2001 "On introduction of amendments to the Federal Law 'On joint stock companies'" will become effective as of January 1, 2001⁴. Among the most significant innovations in the sphere of security of stockholders' rights one should note the following ones:

- the right of shareholders for alienation of their own shares without the other stockholders' or the company's consent is specifically stipulated (Art.2);
- the law sets the possibility of limiting the conduct of a close subscription in OAO (in its Charter or in the respective federal legal statutes);

- the closed subscription (Art. 39) may be conducted only according to the decision of the general meeting of shareholders, provided the quorum of 3/4 votes (with a possibility to introduce a greater number of votes to pass such a ruling);
- the placement of ordinary shares through an open subscription (provided the placement of over 25% of earlier placed ordinary shares) requires analogous procedures;
- the law introduces a provision on the preferential right for acquisition of the shares placed by the means of closed subscription for the shareholders that voted against or did not take part in the voting;
- the shareholders that use their preferential right (within the period of 45 days upon the moment of notification) enjoy the right to pay for the additionally placed shares with money, even if the decision on their placement provides the payment with non-monetary means;

⁴ Articles 48 and 49 became effective as of the date of their publications - August 9, 2001. For the full text of the newly passed Law, please refer to: Jurnal dlja aktsionerov, 2001, # 9, pp.2-3; 9-40, and Gulyaeva I.A. Aktsionernye obschestva po-novomu.- In: Uchet, nalogi, pravo, 2001, # 30.

- the law sets a prohibition with regard to conversion of ordinary shares into privileged ones, obligations, or other kinds of securities.

Hence, for the first time since the epoch of incorporation and mass privatization of the early '90s, the government employed legislative procedures to introduce mechanisms preventing the most notorious method of abuse of stockholders' rights in the '90s, that is the dilution of outsiders' stakes through new issues. At this point, it is noteworthy to recall the background of the discussion on these amendments. The aforementioned measures de facto were developed yet since 1997, and the first draft was passed by the State Duma in the 3rd reading on June 2, 2000 and then blocked at the initiative of some largest companies. The new variant of the amendments passed by the Duma in late 2000 was effectively blocked, too. What has changed since that time?

The answer is likely to lay in the economic sphere. Between 2001 to 2002 the majority of the largest companies should undergo the completion of the property consolidation process (the transition to a single share, increase of their shares in their daughter companies nearly up to 100%, a legal registration of holdings as ZAO and OOO, etc.). Under such circumstances such a vehicle as dilution is any longer of no need. As a result, the minority shareholders should have legislative means to secure their interests. At the moment the area of its application increasingly narrows. At the same time there are numerous technical methods to avoid the innovation. Overall, the focus of the new version of the law on a formal security of minority shareholders strengthens the perception that these amendments appeared to be slightly late.

The law proved to treat the problem of transparency very cautiously- the solution of it in the present version is an analogue to the aforementioned situation with the dilution of shares (Art.91). The right to the access to the accounting papers of the AO and minutes of the meetings of the AO's collegial executive bodies is granted to the shareholders whose aggregate proportion of voting shares should account for not less than 25%.

Between 1998 to 2001 it was reorganization that became the most frequently used channels to get outsiders out. The new version of the law provides as follows:

- the shareholders of the reorganized, in a form of split or separation, AO=s that were against the reorganization or did not take

part in the voting enjoy the right for the receipt of the shares of each newly created company in proportion with the number of shares they owned;

- AO may be transformed both into OOO and production cooperative, and non-commercial partnership (should the shareholders vote for that unanimously).

The positive significance of the former innovation is very high. Apparently, it would be expedient to introduce the respective amendments to the Civil Code and/or/ develop a federal law "On reorganization of economic companies". The latter innovation is not less actual, either, because it corresponds to the objective process of transformation of OAO=s, which were established compulsory during the mass privatization stage, into other organizational and legal forms that appear more acceptable to concrete enterprises from the perspective of their size, profile, functions, etc. In the future, it would be necessary to develop a more detailed regulation of the respective options to ensure the security of interests of all the subjects of the corporate relations.

As concerns authorized capital, the law provides that its increase through the placement of additional shares may take place at the expense of the property of AO (i.e. capitalization). At the same time the authorized capital may be increased by means of the increase of the nominal value of shares and only at the expense of the AO's assets only.

As far as authorized capital is concerned, yet another problem arises - fractional shares that between 2000 through 2001(along with consolidation) have become a new lever to supplant outsiders and proved to remain unsolved as yet. On the contrary, it urgency has grown due to the adoption of the ruling of the shareholder's preferential right to redeem additional shares placed by the company. The new version of the law set that the fractional share grants the rights in a volume that corresponds to the part of the whole share that it constitutes. If such an approach is quite acceptable interns of paying dividends, there are obvious difficulties in the case of the voting according to "one share- one vote" principle (though fractional shares may be summed up).

The law also retains dualism in the area of AO=s' dividend policies. The decision on payment of dividends may be taken only once a year (not quarterly, as before). Nevertheless, the general meeting still does not have a right to increase the

amount of dividends against the one recommended by the Board of Directors. Accordingly, the ruling of the general meeting is purely formal.

One of the key tasks of the corporate law (as well as other branches of the law) is to create effective obstacles to the establishment of 'bubble' or 'single-day' AOs, thus ensuring real grounds for compensation for losses to the company's creditors that have relied upon the size of its authorized capital. Thus, this should serve to enhancement of the security of the creditors' rights in their capacity as financial investors to AO. The new version of the law apparently makes a step back, as of January 1, 2002, 50% of the company's shares distributed upon its establishment should be paid for within 3 months from the date of the government registration of the company (and not by the moment of its registration, as before).

Accordingly, the expediency of the number of further amendments are clear yet today, in particular:

- to prohibit the joint stock companies to enter into any deals not related to their establishment until their founders contribute in full to their authorized capital;
- to restrict the procedures for payments for shares: they should be paid for in full within 3 months after the company's government registration, while additional shares should be paid in full against their placement;
- to introduce the mandatory procedure of the attraction of an independent valuator for all the cases when payment for shares is made with non-monetary means and to set the responsibility of the founders, members of the Board of Directors and the independent valuator for an increase of the value of the assets that the founders contribute with to pay for shares.

In the Law, a whole number of innovations concerns the AOs' managing bodies:

- strict procedures for the suspension of the powers of the Director general is set (Art. 69);
- the Board of Directors is granted with a right, in a number of cases, to amend the Charter of the AO and to approve its registrar;
- the right of the Board of Directors to rule out the decision on an increase of the

authorized capital through a placement of additional shares may be stipulated in the Charter only (provided such a decision is unanimous);

- The right to make decision on participation in other entities is no longer in the list of powers of the Board of Directors;
- it is only physical entity that may become the member of the Board of Directors (Art.66), while the transfer of the vote is prohibited in principle;
- "the exclusive competence of the general meeting" (Art.48) has been canceled in favor of the rule according to which the matters falling under the competence of the general meeting may not be transferred to the Board of Directors or an executive body, while the meeting no longer is limited with the prohibition on consideration if matters that do not fall under their competence;
- the competence of the general meeting also covers the approval of the internal regulating documents;
- the possibility of the combined form the meeting is excluded, as the Law sets two alternative variants: the meeting and the voting in the absence.

Should the shareholders of the AO outnumbered 50, the law also provides that its register has to be run by a specialized registrar.

From the perspective of the domination of the general principle of securing property rights, it is also of the same importance to maintain the balance of interests between different groups of participants in corporate relations and to secure issuers and owners of control (blocking) stakes from the unscrupulous practices (blackmailing) on the part of minor shareholders. The new version of the law does provide a number of such constraints, however, the analysis of legislative possibilities of the **security from the corporate blackmail** has not reveal effective protective methods⁵. It does not mean, however, that the law needs special amendments - such a protection should be backed-up primarily by the court trials. One of innovations noted between 2000 to 2001 is the application of Art. 49 of the law "On joint stock companies" that allows a shareholder (including

⁵ The law sets a reduced limit of action prescription (6 months) to appeal against the general meeting's ruling, etc.

the owner of one share) to appeal against the decision of the general meeting of shareholders that cause the shareholder a potential harm. In the majority of cases it is made to prohibit a holding of next meeting of shareholders (which is intended to pass essential decisions for the AO or to approve the change in the company's heads) on the basis of the non-legitimacy of the Board of directors than convenes such a meeting. It is evident that such a conflict is initiated by competitors or one of actual sides in the internal conflict in the corporation, rather than a formal plaintiff, and obviously, being an owner of just one or a few shares, the latter is objectively unlikely to bear actual losses.

The list of examples falling under this problem includes the lawsuits to OAO "Krystal" (regarding the change of Director General), RAO "Norilsky Nickel" (with regard to the voting procedures at a meeting related to the RAO restructuring), OAO "Polymerstroyaterialy" (the attempt to ignore the court's ruling has just complicate the conflict), RAO Gazprom, the prohibition for OAO "Mosenergo" to hold an early meeting (to consider the change of Director General), an arrest to distraint a stake of OAO "Severstal", the prohibition to OAO "Transneft" to export Lukoil's oil, etc.

In September 2001 Mr. A. Volsky, President of the Russian Union of Industrialists and Entrepreneurs, appealed to the Supreme Court with the request, first to restrict the possibility for stockholders-private individuals to submit their lawsuits to corporations to the courts of general jurisdiction by their residence and to shift such trials to the arbitration courts by the place of the AO's registration and, secondly, to prohibit the courts of general jurisdiction to distraint companies' assets.

From the formal viewpoint, that should help eliminate a legal collision, when the arbitration court and the court of general jurisdiction (the latter acting pursuant to the private individual's lawsuit) may render opposite verdicts. As long as the further trial proceeds, the shares are under arrest to ensure the collateral to the lawsuit. From economic viewpoint, it appears a trivial capture of property which results in uncertainty in the AO's economic operations, destabilization and redistribution of property rights. The seriousness of the problem is evident, that is why as a temporary compromise measure (until the enforcement of new provisions of the Arbitration Code of RF and the Civil Code of RF) the plenum of the Supreme Court of RF 'does not recommend' the courts of general jurisdiction to rule out their decisions on

prohibition of meetings of shareholders following the lawsuits filed by shareholders-private individuals seeking securing their requirements⁶.

At the same time the possibility of an actual modification of the federal law through the decision made by the plenum of the Supreme Court of RF following Mr. Volsky's letter (as a precedent) makes the need in developing a new Arbitration Code (passed in the first reading in spring 2001) questionable in principle, while another problem is closely related to systemic corruption, particularly in this case - with a simple re-orientation of the parties concerned to arbitration courts following the same purposes, as before⁷.

At the same time the idea of passing a national **Corporate Governance Code** does not appear a priority against the background of the aforementioned innovations of 2001 and their possible development. At present the OECD Principles of Corporate Governance that generalize the best practices of corporate behavior appear sufficient as some standard for corporations in modern Russia.

The companies that are going to follow the recommendations of the Code would enjoy a formal advantage of demonstrating their positive image before the foreign investment community. Nonetheless, yet between 2000 to 2001 many Russian largest corporations have already adopted their own codes specifically for the said purpose, and it is likely there will be no serious difference between them. Furthermore, even a borrowing of single provisions from the unified Code by the national corporations would be effective only to the extent to which the latter would appear, first, interested in them due to a whole complex of various reasons, and, secondly, experiencing

⁶ The draft Arbitration Code of RF contains a provision that stipulates a complete list of trials with the participation of citizens that are not individual entrepreneurs subject to arbitration courts. In particular, the list of trials includes the disputes between a shareholder and a joint-stock company that proceed from operations of the said economic company (except labor disputes). For a greater detail, see: Gros L. Proekt APK-2000: meniya, suzhdeniya, predlozheniya.-In: Khozaystvo i Pravo, 2001, # 9, pp. 54-68.

⁷ At the same time the refusal of property distraining measures would lead to an obvious danger of capital dilution by the defendant in the course of the trial. At this point, it is rather expedient for defendants to file a counterclaim to avoid possible losses, should the court renders a verdict concerning property dsitraining measures. (See: Finansovaya Rossiya, 2001, # 37, p.3)

consolidation of corporate control. As the experience of the period between 2000 to 2001 shows, the formal transparency and openness of a number of companies for their small stockholders were rising exactly in the course of consolidation of assets of their daughter companies, and the consolidation was a primary driving force there.

Thus, the only possible form of such a Code is recommendation, however the compliance with the recommendation provisions in the companies that may face corporate conflicts or a threat of absorption appear impossible. This in principle implies a spontaneous nature of the process of emergence of corporate culture in the course of overcoming objective costs of property redistribution in the country. On the other hand, any attempts to employ the provisions of the Code

to ensure the access to the listing at exchanges would be useless due to the non-liquid market.

This notwithstanding, the educational role of the Code may become fruitful already at the present stage, while its effect would depend upon the compliance with the following principles:

- a strictly recommendation nature, with no penalty for non-compliance with its provisions (in the law and ministerial acts);
- the refuse of any duplication of the corporate and relative law;
- the selection of viable (in terms of Russian realities) norms of the Code in the course of accumulation of positive practices and their introduction to the law.

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