

## Russian Overview. December 17-23

### FX

- USD/RUB followed USD dynamics against the euro. The ruble stood stable against CBR's bi-currency basket. The year-end USD/RUB forecast scenarios will depend on EUR/USD and the CBR.
- CBR's FX reserves rose to a new record high

### MONEY MARKET

- The overnight interest rates stood at low levels despite the end-of-month tax payments. Liquidity has recovered on inflows from the FX market. Demand for extra CBR's financing further decreased as liquidity rose. Interest rates are likely to remain relatively low in the coming week.
- CBR's refinancing rate to be cut

### SOCK INDEX

- President Putin has signed the decree, liberalizing Gazprom shares' market

### ECONOMY

- The Economy and Trade Ministry has revised its 2005 forecasts: down the upper bound of expected inflation and up economic growth. We have also revised up GDP growth forecast.
- Positive economic results in November:
  - ✓ Producer prices dropped due to a moratorium on price rises on oil products
  - ✓ Fixed investments rose at a 17-month high rate
  - ✓ A rise of the population's incomes moderated
  - ✓ Unemployment rose

### FX

*USD/RUB followed USD dynamics against the euro*

During the week under review USD/RUB rate continued to follow USD dynamics against the euro. It hovered in the range of 28.60-28.85, reflecting EUR/USD movements between 1.1800 and 1.2050.

The change of EUR/USD rate for the week (0.96%) was split between changes in RUB/USD and EUR/RUB in the proportion of 46/54, respectively.

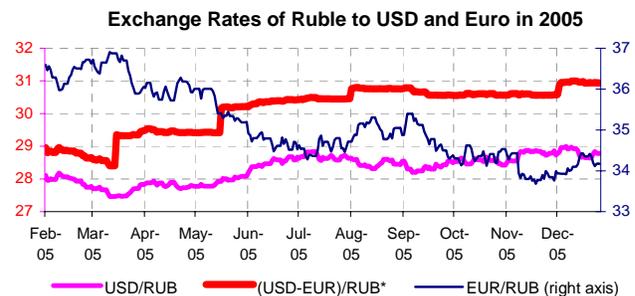
- As we have noticed earlier, using various proportions in the translation of EUR/USD changes into changes of the exchange rates of the ruble against the USD and the euro, the CBR can make adjustments in a pace of the real effective exchange rate (REER) change of the ruble, other things being equal (see more details in the Overview of September 30).

*The ruble stood stable against CBR's bi-currency basket*

The exchange rate of CBR's bi-currency basket (60% USD and 40% euro) versus the ruble stood effectively stable, while USD/RUB rose 0.5%, and EUR/RUB dropped 0.5%.

On Friday the ruble traded around the level of 28.78, while EUR/USD—at 1.1830-1.1880.

CBR's USD/RUB rate increased by 0.45% and was fixed at RUB28.7799 for December 26. The MICEX average daily trading volume increased by 20% to \$2.5 bn.



\* Euro share in the USD-EUR basket was set at 10% from 02/01/05, 20% from 03/15/05, 30% from 05/16/05, 35% from 8/1/2005 and 40% from 12/2/2005

FX MARKET	12/23/05	Change,%				YTD Average	Expected	
		1-week	1-month	YTD	YTD Real*		Average	End of Year
USD/RUB (UTS)	28.7780	0.4	0.1	3.9	-2.81	28.3003	28.33	29.00
Volume-MICEX, USD million	2960.6	23.6	63.8	209.2		1709.0		
CBR's FX and gold reserves, USD bn	171.3	1.3	4.5	37.6				182

\*Estimate. For reference: real RUB/USD change YTD

2.89%

*The market to continue watching EUR/USD dynamics and CBR's interventions*

In the coming week the market will continue watching USD dynamics in the world market and CBR's interventional behavior. In case of a EUR/USD fall to 1.15, USD/RUB can be seen around 29.10, should EUR/USD rise to 1.23, USD/RUB will tend to 28.30.

*The year-end USD/RUB forecast scenarios will depend on EUR/USD and the CBR*

EUR/USD volatility has been increasing in the recent weeks on the growing market perception that the series of interest rate rises in the U.S. may come to the end soon. This is expected to trigger a major reversal in EUR/USD downward trend, which has been observed this year and already by the end of Q.1 2006 we foresee EUR/USD at 1.28, while by the end of 2006—at 1.36. Possible high volatility of EUR/USD will continue to affect USD/RUB forecast for the very end of the year. Moreover, likely CBR's attempts to stay within the ruble appreciation target may also influence ruble exchange rate dynamics.

#### RUBLE EXCHANGE RATE FORECASTS for 2005-08

	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06	2006*	2007*	2008*
USD/RUB, eop	28.70	27.88	27.27	27.38	27.10	27.41	26.30	25.68
EUR/RUB, eop	34.58	35.69	36.54	36.55	36.86	36.02	37.61	38.53

\*Average for the year

As of 23-Dec-05

ZAO Citibank Moscow

*CBR's FX reserves rose to a new record high*

During the week ended December 16 the **FX and gold reserves of the CBR** (excluding CBR's short-term obligations) increased by \$2.2 bn to a new record high of \$171.3 bn. The next reserves' reading due on the coming Thursday is likely to show a further rise in the reserves.

## MONEY MARKET

*The overnight interest rates stood at low levels despite the end-of-month tax payments*

The **average overnight interest rates** stood at relatively low levels of 2-4%, only sometimes touching 6%, despite monthly tax payments.

The daily average commercial banks' correspondent account **balances with the CBR** increased to RUB400 bn from RUB303 bn. On Friday the balances stood at RUB451 bn, which provided **comfortable liquidity**.

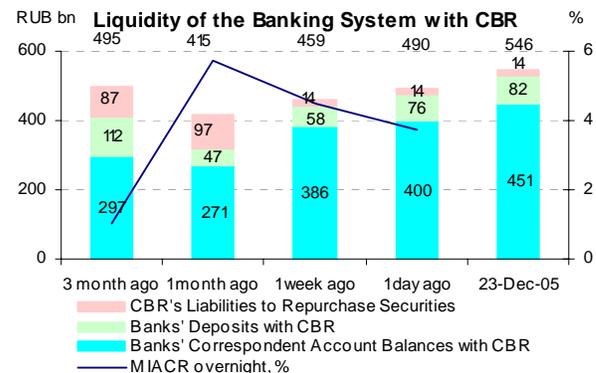
Date	MONEY MARKET	Current Value	Average			
			1-week	1-month	YTD	1-year
12/22/05	MIACR overnight, %	3.73	4.57	5.28	2.97	5.39
	MIACR 1-month, %	8.70	5.59	6.08	3.80	6.08
12/23/05	Commercial banks' balances with CBR, RUB bn	450.6	400.1	304.5	251.8	289.5
	Commercial banks' deposits with CBR, RUB bn	81.6	78.8	53.5	115.5	114.8

By Friday the total amount of commercial banks' funds, attracted by the CBR (through deposits, reverse repo deals and OBRs), **increased** by RUB24 bn compared with previous week to RUB96 bn (\$3.3 bn).

**Liquidity has recovered on inflows from the FX market**

The **total liquidity with the CBR** (in the correspondent account balances and attracted by the CBR through deposits, reverse repo deals and OBRs) **increased** by RUB87 bn to RUB546 bn (\$18.9 bn).

**Liquidity rose** due to quite active sales of the USDs by banks in the market. The CBR was the main buyer of the USDs, supplying the market with the rubles.



**Demand for extra CBR's financing further decreased as liquidity rose**

Improved liquidity led to a reduction in demand of banks for the financing from the CBR by means of overnight repo deals. Their total volume decreased to RUB39 bn from RUB53 bn previous week.

**Interest rates are likely to remain relatively low in the coming week**

**In the coming week** interest rates are likely to stay mostly within normal levels despite coming tax payments. The overnight rates are expected to remain below the level of 6% most of the time with relatively low possibility of their surge to 8-12%.

**CBR's refinancing rate to be cut**

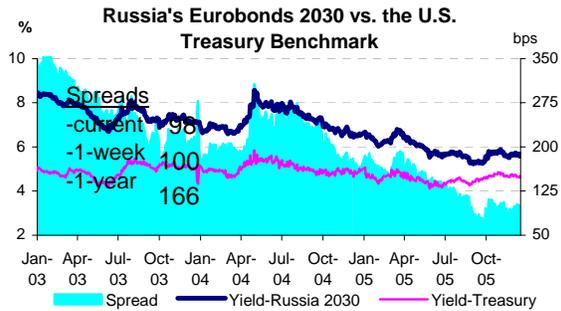
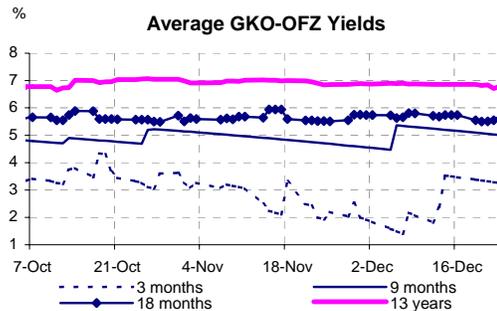
The CBR has announced a **refinancing rate** cut to 12% from 13% effective December 26. The previous rate cut (from 14%) was made on June 15, 2004. Above all, this is a signal to the market that the authorities have succeeded to bring inflation further down (to around 11% expected this year) after 11.7% in 2004 and despite fears that it could accelerate up to 13% in 2005. Overall, the refinancing rate has still been playing largely a **symbolic role** in the Russian economy, being a reference rate for setting fines and penalties. Only the CBR's overnight USD swap rate for commercial banks implies the refinancing rate. Therefore, we do not expect any serious immediate positive effect for the market from this generally good news.

## FIXED INCOME SECURITIES

The government **ruble bonds** remained stable (see table and chart below). The OFZs volume outstanding amounted to around \$21 bn.

The **spread** on the Russian sovereign **Eurobonds** 2030 stood around 100 bps (as of 5:00 p.m. Moscow time on December 23), being noticeably lower than a year ago—166 bps.

OFZ	12/23/05	Average, %			
		1-week	1-month	YTD	1-year
Yield 3-month, %	3.26	3.36	2.44	3.29	3.32
Yield 9-month, %	5.01	5.08	4.96	4.53	4.54
Yield 18-month, %	5.59	5.57	5.66	5.46	5.45
Yield 15-year, %	6.79	6.86	6.89	7.59	7.61
Trading volume, RUB million	1223.8				1513.3
Date of a New Issue	Maturity Date	Volume at Face Value, RUB bn			Average Yield, %
		Auctioned	Demand	Placed	
12/21/2005	4/30/2008	3.3	0.0	2.0	6.22



## STOCK INDEX

RTS-INTERFAX STOCK INDEX	Current Value	Change, %			
		1-week	1-month	YTD	1-year
12/23/05	1128.38	2.6	10.9	83.7	89.5

*President Putin has signed the decree, liberalizing Gazprom shares' market*

On December 23 President Putin signed the decree, lifting limitations on the market of **Gazprom's** shares. The government promised to liberalize it after the assuming control over the monopoly. Before the total foreign investors' share in Gazprom was limited to 20%. The liberalization is expected to boost the market capitalization of the largest Russian company, which is estimated at \$159 bn currently.

## ECONOMY

*The expansion of the monetary base accelerated seasonally*

The **monetary base** expanded 1.9% to RUB2103.5 bn in the week ended December 19, continuing a **seasonal end-of-year spurt**. The aggregate increased by 27.9% y-t-d well outpacing the rate of the previous year (13.3%). In the year-on-year terms, the aggregate's rise (33.3%) also well exceeded the last year figure (22.5%). We expect that this year the monetary base will expand by 31-33% compared with 18% in 2004 and 49% in 2003.

*A greater expansion of the aggregate looks acceptable under the current macroeconomic parameters*

- The slowdown of 2004, above all, was related to a radical cut of reserve requirements to commercial banks, which led to a reduction of the banks' reserve portion of the monetary base by 56%. At the same time, the cash portion of the aggregate rose 34%. Therefore, the acceleration of the monetary base expansion this year **should not be treated, as an extraordinary inflation-threatening tendency**. Should the expansion stay within the expected bounds, it follows mainly the economy's growth and a rise of the population's money incomes under the expected inflation level. The CBR forecasts that in **2006** the monetary base will rise 17-23%.

### MONETARY BASE, RUB bn

12/19/2005	2005			12/19/2004	2004		
	Change, %				Change, %		
	1-week	YTD	Y/Y		1-week	YTD	Y/Y
2103.5	1.9	27.9	33.3	1577.9	3.6	13.3	22.5

***The Economy and Trade Ministry has revised its 2005 forecasts: down the upper bound of expected inflation and...***

Economy and Trade Minister German Gref said on December 24 that the **CPI** rose 0.5% in the first 19 days of December after 0.7% for the whole November. He expected that inflation would not exceed 1.0% in December. According to Deputy Economy and Trade Minister Andrei Sharonov, the ministry has revised down to 11.2% from 11.5% the upper bound of inflation forecast for 2005. The ministry is expecting now that the CPI will increase by 11.0-11.2%. This coincides effectively with our current forecast of 11.1-11.2%.

***...up economic growth***

Economy and Trade Ministry has raised its **GDP** growth forecast for this year to 6.4% from 6.0%, while **industrial output** growth to 4.1% from 4.0%. Last year GDP grew 7.2%, while the industrial output—by 7.3%. The ministry has estimated GDP growth at 7.5% y/y in November and 6.3% y/y in January-November compared with 7.2% a year ago.

The ministry looks to be taken by **surprise** after the unexpectedly strong GDP growth of 6.2% in Q.1-3 from the Federal Statistics Service (FSS) last week, as just a month ago the ministry estimated GDP growth at 5.9% y/y in January-October.

***We have also revised up GDP growth forecast***

Given the latest data, we have also revised up to 6.3% from 6.0% the forecast of GDP growth, seeing main risk for it, coming from the rapidly rising imports. However, the intensively increasing consumption (and the booming trade sector, as its reflection) will support a stronger economic expansion—at 6.3-6.5%.

The surprising acceleration of economic growth may be attributed partially to **GDP counting issues**. From this year the FSS has transited to new **statistical standards** (which are closer to the international standards), particularly, a new economy structure by sectors. Therefore, at the beginning of the year it revised some figures for previous periods. For example, industrial output growth in 2004 was revised up quite noticeably to 7.3% from 6.1%. It cannot be ruled out that the latest increase in the rate of GDP growth is a result of unsettled issues of the statistical methodology.

***Positive economic results in November***

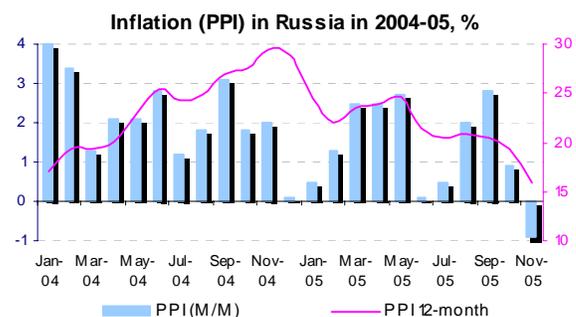
The latest macroeconomic figures for November, published by the **Federal Statistics Service** (FSS) showed encouraging signs: an accelerated expansion of the industrial output, a faster rise of investments in fixed assets and a drop in producer prices. At the same time, a rise of the population's incomes moderated.

***Producer prices dropped due to a moratorium on price rises on oil products***

- In November **PPI** decreased for the first time since May 2003 by 0.9% m/m compared with a 0.9% rise in October and 2.0% a year ago.

- ❖ Prices dropped (3.7%) in the **mining** (including 4.2% in the energy sector, particularly, 3.8% in the oil sector), in the **manufacturing** prices rose

just 0.2% (including a 2.8% drop in prices on **oil products** after over 3.0% rise previous month), while in the **production and distribution of electricity, natural gas and water sector** declined by 0.2% (see below). Thus, the government's appeal to producers of refined oil products to suspend a rise of prices this year has helped to slow the price rally.



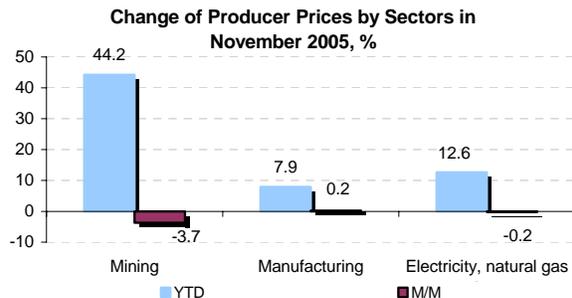
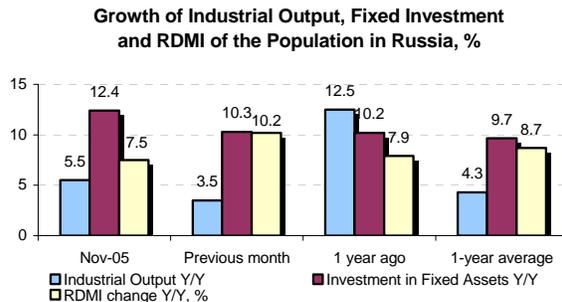
In the three industrial sectors, in the **year-on-year** terms, producer prices rose 15.4% compared with 17.6% a month ago. In **January-November** the prices rose 15.8% y-t-d—noticeably slower than a year ago (28.7%). We expect that for the whole year the PPI will rise 17%.

***Fixed investments rose at a 17-month high rate***

- **Fixed investments** rose 12.4% y/y (10.3% previous month and 11.1% a year ago) and 7.5% m/m (dropped 5.8% previous month and rose 5.5% a year ago) to RUB348.1 bn in November. In January-November the investments increased by 10.2% y/y compared with 11.1% a year ago. Given the exceptionally strong energy export revenues, we expect that **for the whole year** the investments will rise around 10.5%.

❖ In 2004 the investments increased by 10.9% (12.5% in 2003) to RUB2729.8 bn (\$95 bn).

In the first eleven months of the year the level of **investments relative to the GDP** declined to 14.9% from 15.1% in 2004 (16.3% for the whole 2004). However, a much higher level (of around 30% of GDP) of the investments for a number of years is necessary to overcome structural and technological backwardness of the economy.



***A rise of the population's incomes moderated***

- Nominal monthly **average salary** rose 24.9% y/y and 2.0% m/m to RUB8875 (\$310) in November. In January-November the average monthly salary increased by 23.3% y/y.

❖ In 2004 the average monthly salary increased by 22.6% to RUB6740 (\$234).

In November the **real disposable money incomes (RDMI)** of the population increased by 7.5% y/y and 0.8% m/m. In January-November the RDMI increased by 9.1% y/y.

❖ In 2004 the RDMI of the population increased by 8.4%.

We expect that the RDMI of the population will increase by around 9.0% this year.

- In November **wage arrears** in the economy decreased by 7.2% m/m to RUB9.0 bn (including RUB8.3 bn arrears of business entities or 4% of the monthly payroll and RUB0.7 bn of the federal and regional budgets).

The wage arrears—an indicator of financial soundness of businesses and fiscal performance of the government, halved in Russia in 1999-2000, remained relatively low and stable in 2001-03 and fell again twice to RUB12.0 bn in 2004.

**Unemployment rose** • In November **unemployment** increased to 5.81 million or 7.8% of the labor force compared with 5.62 million previous month and 6.14 million a year ago.

**In 1998-2004** unemployment decreased from 8.9 million of unemployed or 13.2% of the labor force to 6.19 million or 8.6% of the labor force. However, due to a significant share of the “black”/“grey” market, the figures are not very reliable, and the committee rectifies them periodically conducting special studies.

**Financial conditions kept on to improve in October** • In October the **share of overdue payables in the total volume of the payables** in the economy increased by 0.8 percentage points to 15.7% (19.9% a year ago). The overdue payables amounted to RUB1038.2 bn as of November 1, 2005.

**Overall strong financial results of the economy in January-October**

• In January-September the **population** of Russia reduced by 616 thousand residents (by 0.439%) to 142.9 million. This is a long-term trend. In 1994-2004 the population decreased by 400-900 thousand per year.

• In January-October the **aggregate financial result** (profits less losses) of the Russian businesses increased by 37% y/y to RUB2450.4 bn (\$86.5 bn). Overall, this increase continued to outpace nominal GDP growth (27%). However, the situation differed in **rich export-oriented sectors**, concentrated, above all, in the mining and the sectors oriented to the local market (see below). The improvement of the financial result by sectors was as follows:

❖ Mining .....	77.5%
❖ Manufacturing .....	17.5%
❖ Production and distribution of electricity, natural gas and water .....	41.7%
❖ Trade and repair of motor vehicles and durable goods .....	38.3%
❖ Transportation and communication .....	22.1%
❖ Construction .....	3.7%
❖ Operations with the real estate .....	58.4%

There were 45,200 of businesses (excluding small ones, as well as agricultural, financial, insurance and budget entities), which had **profits** (RUB2690.8 bn). At the same time, 25,000 of businesses had losses (RUB240.4 bn). The share of the businesses, which had **losses**, decreased by 3.6 percentage points y/y to 35.6% of the total.

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