

THE CENTRAL BANK OF THE RUSSIAN FEDERATION



A N N U A L 2 0 0 3 R E P O R T



Approved by the Bank of Russia Board of Directors on May 12, 2004

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# Contents

<b>Introduction</b> .....	<b>8</b>
<b>I. The economic and financial situation in Russia</b> .....	<b>11</b>
I.1. The economic situation in Russia .....	12
I.2. Government finance and domestic government debt .....	21
I.3. The financial sector .....	24
I.3.1. Credit institutions .....	29
I.3.2. Other financial institutions .....	37
I.3.3. Financial markets .....	40
I.4. Balance of payments and foreign debt .....	51
I.4.1. Balance of payments .....	51
I.4.2. Foreign debt .....	55
I.5. The world economy and international financial markets .....	56
<b>II. Bank of Russia activities</b> .....	<b>63</b>
II.1. Monetary policy .....	64
II.1.1. Objectives and results of monetary policy .....	64
II.1.2. Monetary programme implementation and the use of monetary policy tools .....	69
II.1.3. Exchange rate policy and reserve management .....	76
II.2. Banking regulation and supervision .....	80
II.2.1. Off-site supervision and inspection of credit institutions .....	80
II.2.2. Registration and licensing of banking activities .....	86
II.2.3. Bank bankruptcy (insolvency) prevention and phasing out insolvent credit institutions from the banking services market .....	89
II.3. The Russian payment system .....	91
II.3.1. The state of the Russian payment system. Developing and upgrading the Bank of Russia payment system .....	91
II.3.2. The development of the technical infrastructure of the Bank of Russia payment system .....	97
II.4. Foreign exchange regulation and foreign exchange control .....	99
II.5. Bank of Russia activities aimed at countering money laundering and terrorist financing .....	102
II.6. Bank of Russia activities with respect to government finance .....	104
II.7. Cash issue management .....	106
II.8. International co-operation .....	109
II.8.1. Co-operation between the Bank of Russia and international financial and economic organisations .....	109
II.8.2. Co-operation between the Bank of Russia and foreign countries and their central (national) banks .....	112
II.9. Upgrading the Bank of Russia operating system and improving its efficiency .....	114
II.9.1. The Bank of Russia organisational structure and measures taken to improve it .....	114
II.9.2. Co-ordinating the activities of Bank of Russia regional branches .....	115
II.9.3. Staffing and personnel training .....	116

II.9.4. Bank of Russia activities aimed at improving banking legislation. Managing suits and claims in Bank of Russia establishments .....	118
II.9.5. Bank of Russia internal audit .....	121
II.9.6. Bank of Russia participation in the capital of Russian and foreign credit institutions and other organisations .....	122
<b>III. Bank of Russia annual financial statements as of January 1, 2004 .....</b>	<b>125</b>
Introduction .....	126
Annual balance sheet as of January 1, 2004 .....	127
Profit and loss account .....	128
Capital, funds and profit allocation .....	129
Notes to the Annual Financial Statements as of January 1, 2004 .....	130
1. Accounting and financial reporting principles .....	130
2. Impact of economic conditions on Bank of Russia financial statements .....	133
3. Funds placed with non-residents and securities issued by non-residents .....	133
4. Loans and deposit accounts .....	134
5. Securities .....	135
6. Other assets .....	138
7. Cash in circulation .....	140
8. Funds in Bank of Russia accounts .....	140
9. Float .....	140
10. Other liabilities .....	141
11. Relations between the Bank of Russia and the Ministry of Finance .....	142
12. Interest income .....	143
13. Income from operations with securities .....	144
14. Net income from the recovery of provisions .....	144
15. Other income .....	145
16. Interest expenses .....	145
17. Expenses on operations with securities .....	145
18. Cash turnover management expenses .....	146
19. Other operating expenses .....	146
20. Personnel costs .....	146
Statement on profit received and its allocation .....	147
Statement on Bank of Russia reserves and funds .....	148
Statement on Bank of Russia management of securities and stakes in the capital of organisations that are Bank of Russia property .....	149
Statement on Bank of Russia personnel costs .....	152
Statement on capital investment budget performance .....	153
<b>Auditor's Report .....</b>	<b>154</b>
<b>IV. Addenda .....</b>	<b>163</b>
Principal measures carried out by the Bank of Russia in 2003 to implement the single state monetary policy .....	164
Principal measures carried out by the Bank of Russia in 2003 to improve banking regulation and supervision .....	170
Statistical tables .....	177

## *List of charts*

1. Dynamics of consumer prices, core inflation and regulated service prices and tariffs .....	13
2. Unemployment rate according to ILO methodology .....	14
3. GDP and industrial output dynamics .....	15
4. Production growth rates in individual industries in 2003 .....	16
5. Real money income, wage and pension dynamics .....	17
6. Dynamics of major balance of payments components and international reserves of the Russian Federation .....	18
7. Foreign trade and oil prices .....	19
8. Federal budget expenditure in 2003 .....	21
9. Federal budget expenditure and balances of federal budget ruble accounts in the Bank of Russia in 2003 .....	22
10. Interest rates on ruble operations .....	26
11. Interest margin on banks' ruble lending and deposit operations with all non-financial clients .....	27
12. Banking sector growth rates in real terms .....	30
13. Structure of banking sector liabilities .....	31
14. Structure of banking sector assets .....	32
15. Overdue debt on loans, deposit accounts and other placements .....	33
16. Capital adequacy indicator dynamics .....	34
17. Banking sector assets by credit institution classified in terms of financial stability .....	35
18. Sources of growth in the banking sector's own funds (capital) .....	35
19. Offered and actual interest rate dynamics of overnight interbank ruble loans in 2003 .....	40
20. Ruble/dollar exchange turnover structure in 2003 .....	41
21. GKO—OFZ market structure by type of securities .....	43
22. GKO—OFZ secondary market turnover and yield in 2003 .....	43
23. Volumes of resident operations with non-residents to buy and sell outstanding Russian government foreign currency debt obligations on the secondary market in 2003 .....	45
24. MICEX share trading dynamics in 2003 .....	48
25. MICEX corporate bond trading dynamics in 2003 .....	49
26. Trade in futures contracts for basic assets in 2003 .....	50
27. Real GDP growth rates in leading industrialised nations in 2003 .....	57
28. Dynamics of exchange rates of foreign currencies against the US dollar in 2003 .....	60
29. Average annual stock price index growth in 2003 .....	61
30. Projected and actual M2 growth rates .....	65
31. Ratio of bank deposit accounts with Bank of Russia and exchange modified repo operation volumes to broad monetary base in 2002—2003 .....	66
32. M2 growth rates in 2002 and 2003 .....	67
33. M2 and consumer price growth rates .....	68
34. M2 velocity and consumer price index in 2001—2003 .....	68

35. Exchange rate dynamics and sources of money supply in 2002—2003 .....	70
36. Money market interest rate dynamics in 2003 .....	72
37. Dynamics of banking sector net foreign assets in 2001—2003 .....	74
38. Dollar/ruble, euro/ruble and euro/dollar nominal exchange rate dynamics in 2002—2003 .....	77
39. Bank of Russia operations on the domestic foreign exchange market in 2003 .....	78
40. Average monthly real exchange rate dynamics of the ruble in 2003 .....	78
41. Growth dynamics of average annual real rates of the ruble in 1996—2003 .....	79
42. Number of registered operating credit institutions and banking licences granted to them .....	87
43. Number of operating credit institutions with foreign interest in authorised capital .....	87
44. Dynamics of registered authorised capital of operating credit institutions .....	88
45. Structure of payments effected by the Russian payment system .....	93
46. Payments effected through the Bank of Russia payment system electronically and on paper .....	95
47. Operations conducted by the Bank of Russia payment system for a fee and free of charge .....	95
48. Changes in the amount of cash in circulation in 2003 .....	107
49. Dynamics of detection of counterfeit Bank of Russia currency .....	107
50. Dynamics of detection of counterfeit foreign currency .....	107
51. Dynamics of personnel structure by length of employment with the Bank of Russia .....	116
52. Executives and specialists with higher professional education as a percentage of total number .....	116
53. Methods and areas of Bank of Russia personnel training in 2003 .....	117

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## INTRODUCTION

The year 2003 was the most successful one for the Russian economy in the entire reform period. The main results were faster-than-expected GDP growth rates, a rise in real incomes, increased investment activity, a strong balance of payments and an unprecedented expansion of the country's international reserves. At the same time, the Russian Government and Bank of Russia managed for the first time to ensure that the actual rate of inflation met the target set for the year.

External economic conditions significantly influence the Russian economy owing to its dependence on energy exports and increasing integration into global capital markets. Last year saw continuing high world oil prices and low interest rates on global financial markets. These processes affected Russia's economic development in different ways. On the one hand, favourable international commodity and financial market conditions for Russia maintained Russian export earnings at a high level, brought additional revenues to all sectors of the economy and the federal budget, and encouraged the inflow of foreign capital. As a result, domestic demand expanded significantly due to growth in public consumption and fixed capital investment.

On the other hand, the massive inflow of foreign exchange created serious problems for the implementation of monetary policy and forced the Bank of Russia to choose between letting the banking sector's surplus liquidity increase, potentially creating the risk of more rapid consumer

price growth, and strengthening the real effective exchange rate of the ruble, potentially threatening the competitiveness of Russian commodity producers. In this situation, determined to meet the inflation target, the Bank of Russia had to perform a balancing act between monetary and exchange rate policies. To prevent the excessive growth of both interest rates and the ruble exchange rate. Although the volume of the absorbed money supply doubled, the effect of liquidity growth on the economy was so strong that the Bank of Russia decided to allow the ruble to strengthen slightly against the dollar in nominal terms. The Russian Government also had to step up its efforts to check the growth of regulated prices and the prices charged by the natural monopolies. In addition, the government's sensible finance policy played a major role in reducing inflationary pressure amid high liquidity, especially the expansion of the financial reserve.

In pursuing the exchange rate policy within the framework of the managed floating regime, the Bank of Russia took into account such fundamental factors as growth in labour productivity, a reduction in private capital outflow and structural changes in the economy. As a result, the extent of the ruble's gains allowed Russian commodity producers to remain competitive on the domestic and foreign markets.

The coordinated actions of the Bank of Russia in the field of monetary and exchange rate policy and the Russian Government in the field of budget and tariff policy in 2003 enabled Russia to



meet the target it set for the general rate of inflation. These results boosted confidence in the national currency, had an encouraging effect on economic agents and facilitated the stable development of the financial markets and interest rate cuts.

The country's increased macroeconomic and financial stability provided the impetus for the financial sector of the Russian economy to develop further. The dynamics of major banking sector indicators and their ratio to gross domestic product show that credit institutions retained their leading role in the financial sector in 2003. At the same time, the consolidation of non-bank financial institutions and the expansion and modernisation of the domestic financial market increasingly confirmed the importance of competition in the financial sector, which opens up broader opportunities for borrowing, ensures the more effective use of domestic savings for internal investments and stimulates economic growth.

The banking sector's increasing role in the Russian economy and the expansion of bank lending to enterprises and the population have resulted in the increased stability and credibility of credit institutions. In 2003, the Bank of Russia made efforts to improve the quality of credit institutions' capital, introduce new internationally recognised principles of loan loss provisioning, increase control over the liquidity of credit institutions and ensure the transparency of the ownership structure of credit institutions.

The adoption of the Personal Deposit Insurance Law in 2003 and the measures taken by the Bank of Russia to put this law into practice help banks improve their credibility and stimulate the flow of savings to the banking sector. This is extremely important, taking into consideration the public's increased desire to save and the increasingly marked "de-dollarisation" of savings.

The reliable functioning of the Bank of Russia payment system and its modernisation through the adoption of advanced data processing and transmission technologies constantly reduce operational risks involved in effecting payments and settlements by credit institutions and their clients.

In 2003, the Russian Government and the Bank of Russia worked together on drafting a new version of the Russian Banking Sector Development Strategy for 2004 and for the Period until 2008. This document stipulates that the main objective of the next stage of the banking sector's development will be to accumulate the banking sector's creative potential, significantly increase the banking sector's role in economic growth and implement socio-economic development programmes.

The Bank of Russia's financial statements, verified by an auditor's report, faithfully reflect the financial standing of the Bank of Russia, connected with the implementation of the functions assigned to it by law, ensuring a reliable level of transparency for the Bank of Russia for all economic agents and being one reason for the increased confidence in its work.



**THE ECONOMIC AND  
FINANCIAL SITUATION  
IN RUSSIA**

I

## I.1. THE ECONOMIC SITUATION IN RUSSIA

Rapid economic growth, a rise in investment activity and increased household income, against the backdrop of continuing falling inflation, were the major achievements of the Russian economy in 2003. Gross Domestic Product (GDP) expanded by 7.3% year on year, fixed capital investment by 12.5% and real disposable money income by 14.6%. At the same time, consumer price inflation slowed to 12%. World economic growth and external economic conditions that surpassed expectations contributed to economic progress in Russia. The average annual price of Russian oil far exceeded the projected levels. Prices of major Russian exports rose by an estimated 17% on average. Exports hit an all-time high and the balance of payments surplus stood at 8.3% of GDP.

The increased importance of internal factors on economic growth was evident not only in the high level of expenditure on final consumption, but also the year-on-year expansion of gross capital formation. This provided the basis for sustainable economic growth. Rapid economic growth rates in 2003 were largely due to a rise in labour productivity, which increased by an estimated 7.8% as against 2.3% in 2002.

The balanced monetary and exchange rate policy facilitated the successful development of the Russian economy in 2003. Inflation slowed while the nominal rate of the ruble increased against the dollar and the rise of the real effective rate of

the ruble was accompanied by a strong balance of payments. The exchange rate policy implemented by the Russian authorities led to price growth slowing and the dollar being phased out of the Russian economy, while it increased the competitiveness of Russian commodity producers at home and abroad. Russia's international reserves increased significantly in 2003, ensuring the long-term stability of the domestic currency.

The budget policy pursued by the Russian Government was a major factor of macroeconomic progress. The 2003 Federal Budget Law established a federal budget surplus at 0.6% of GDP. Although the continuation of the tax reform reduces tax revenues in the short-term, the Russian Government managed to end 2003 with a federal budget surplus of 1.7% of GDP as against 1.4% in 2002. The budget surplus was a major factor of growth in the financial reserve in 2003, which is designed to safeguard medium-term budget stability and reduce inflation.

In 2003, the Russian Government serviced all its foreign debts in full and on time, enabling leading international rating agencies to upgrade Russia's sovereign rating and making the country more attractive to investors.

External economic factors created conditions conducive to production growth in export-oriented industries. The expansion of output in the fuel and non-ferrous metallurgy sectors accounted for about one-third of the growth in industrial

**DYNAMICS OF CONSUMER PRICES, CORE INFLATION  
AND REGULATED SERVICE PRICES AND TARIFFS  
(growth as % of corresponding month of previous year)**

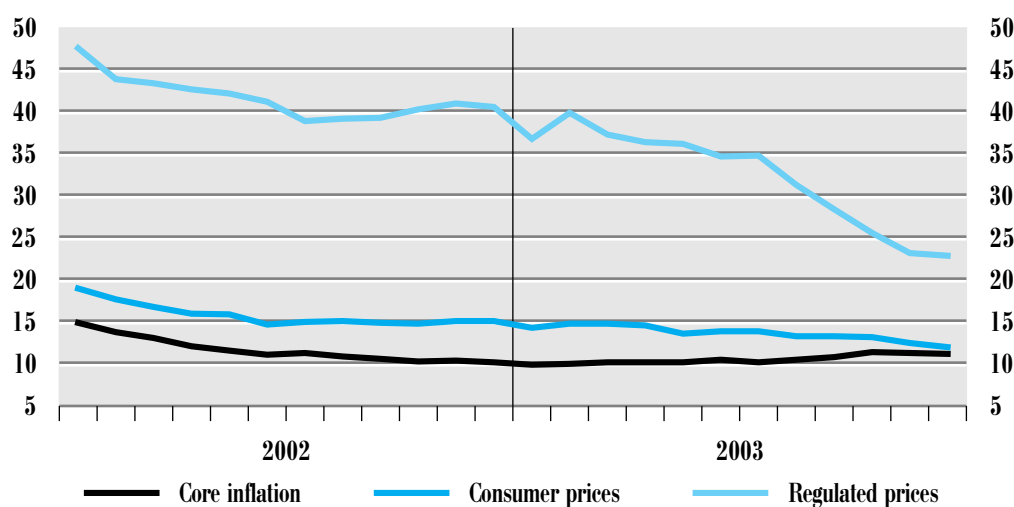


Chart 1

output in 2003. Growth in the export-oriented industries stimulated demand for the output of affinity industries and led to growth in production as a whole. As a result sales increased across most sectors as did the incomes of different branches of the economy. Investment activity and consumer demand growth were also encouraged. This had a favourable effect on production growth rates in investment industries, such as the machine-building and building materials industry. The contribution of the manufacturing sector, especially machine-building, to overall industrial output growth increased in the year under review, reflecting improvements in the structure of production.

Economic growth and the increased minimum wage and pensions brought about a rise in household incomes and, consequently, expenses on final consumption. The real wage continued to rise faster than GDP in 2003. Another positive characteristic of the year was that wage dynamics in 2003 were more commensurate with growth in labour productivity than in the previous year.

The structure of growth in the major components of aggregate demand improved significantly. In 2002, growth in fixed capital investment was considerably slower than the expansion of consumer spending (2.8% against 8.2%), whereas in 2003 the reverse was true. Growth in investment exceeded the expansion of consumer expenses by 1.6 times. The accelerated growth in

investment reflected entrepreneurs' positive demand expectations and created a basis for future increase in production activity.

The direction and structure of capital flows between the various sectors of the Russian economy in 2003 were affected by growth in sector incomes and the increased interest in ruble-denominated financial instruments. The trend towards less foreign currency in the household sector's portfolio of financial assets and its replacement, especially with ruble deposit accounts, increased and net borrowings of household funds by the banking sector expanded.

The change of the household sector's saving preferences, lower borrowing costs and the increased production and investment activity of enterprises, as well as their improved financial standing, led to an appreciable year-on-year rise in bank lending to the non-financial enterprise sector, which showed that the role of the banking system as an intermediary continued to grow. Net borrowings of banking sector funds by non-financial enterprises in 2003 were a major source of finance for the non-financial enterprise sector.

There was a significant rise in the value of foreign loans taken by the non-financial enterprise sector in 2003. At the same time, the value of assets placed by enterprises abroad also expanded.

As a result of the concerted actions of the Bank of Russia and the Russian Government, **consumer price growth slowed** significantly in

**UNEMPLOYMENT RATE  
ACCORDING TO ILO METHODOLOGY**  
(as % of economically active population,  
annual average)

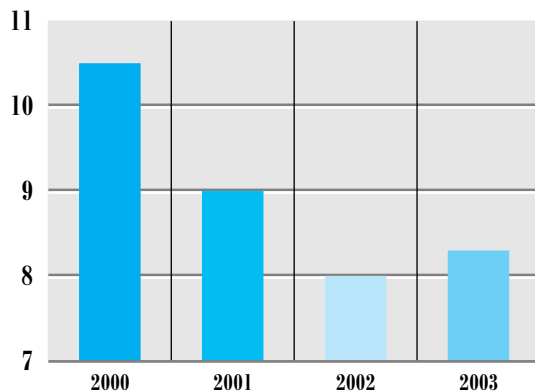


Chart 2

2003 year on year. In December 2003, consumer prices rose by 12.0% as compared with December 2002 (in December 2002, they rose 15.1% as compared with December 2001). At the same time, owing to higher grain prices, caused by a poor harvest in Russia and Europe, core inflation<sup>1</sup> was faster than expected at 11.2% as against 10.2% in 2002.

Although there was no slowdown in core inflation, Russia met its consumer price growth target owing to the significant reduction of growth in service prices and lower vegetable and fruit prices.

Food prices, excluding vegetable and fruit prices, grew faster in 2003 than in 2002 (11.8% against 8.5%), largely due to growth in bread and bakery product prices, which increased by six times year on year as a result of the increased grain selling prices. Vegetable and fruit prices fell by 4.2% in 2003 (in 2002, they rose by 33.3%).

Non-food prices rose by 9.2% in 2003 as against 10.9% in 2002. The slowing growth in non-food prices as compared with 2002 was largely due to the exchange rate dynamics.

Prices and tariffs of paid services provided to the public increased by 22.3% in 2003 as against 36.2% in 2002. Rent and communal service

charges rose more than for any other service (28.7%).

**Industrial producer prices** grew by 13.1% in 2003 as against 17.1% in 2002. Producer price dynamics by sector in 2003 differed from the previous year. In 2002, the most significant growth in producer prices was registered in the non-ferrous metallurgy sector, electric-power industry, fuel sector and ferrous metallurgy sector, whereas in 2003 the biggest price increases were registered in the ferrous metallurgy sector (28.8%), non-ferrous metallurgy sector (27.2%) and building materials industry (17.0%).

While overall producer price growth in the fuel sector stood at 1.4%, prices in the oil-extracting industry rose by 1.6% as against 25.6% a year earlier and in the oil-refining industry by 14.8% as against 19.9%. Producer prices in the gas industry fell by 22.9%, whereas in 2002 they rose by 30.2%.

There was a significant rise in producer prices in light and food industries (15.2% and 14.8% respectively). Producer price growth in other industries ranged from 7.9% in the timber, wood-working and pulp-and-paper industry to 15.1% in the chemical industry.

Despite growth in the production of goods and services, the **number of jobs** in the economy declined in 2003, while the **unemployment rate** increased. In 2003, Russia had an economically active population of 71.7 million, of whom 91.7% were employed in the economy and 8.3% were classified as unemployed, according to ILO methodology. In 2002, the respective figures stood at 71.7 million, 92.0% and 8.0%.

The number of jobless registered with the government employment service rose faster than the number of reported vacancies in 2003, a process indicating the escalation of tension on the labour market. In 2003, the jobless-vacancy ratio was 19 to 10, an increase of 11.8% on the previous year.

**GDP** increased by 7.3% year on year as against 4.7% in 2002. Unlike the situation in 2002, in 2003 the fastest growing component of

<sup>1</sup> The base consumer price index (core inflation) has been calculated by Russia's State Statistics Committee since January 2003 on the basis of the set of consumer goods and services used in the calculation of the composite consumer price index, except some commodity groups and goods and services whose prices are largely regulated at the federal and regional levels and which are highly susceptible to seasonal fluctuations.

**GDP AND INDUSTRIAL OUTPUT DYNAMICS**  
(as % of corresponding quarter of previous year)

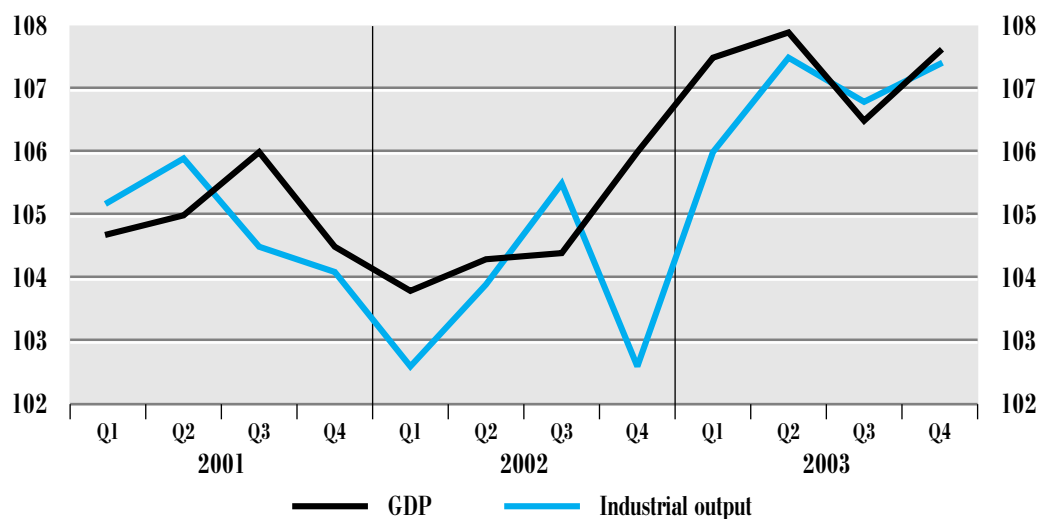


Chart 3

GDP was the production of goods, which increased by 7.6%. The production of services grew by 7.1%. At the same time, the value of market services rose by 8.0%. In 2002, the respective percentages stood at 3.6%, 5.5% and 6.0%.

Industrial output increased by 7.0% in 2003 year on year, owing to higher world oil prices, which led to rapid growth in the extraction industries. The expansion of investment and consumer demand stimulated the manufacturing sector.

Estimates show that the biggest contribution to industrial production growth was made by the fuel sector, machine-building and food industries (in 2002, it was the fuel sector, food industry and non-ferrous metallurgy sector).

The fuel sector continued to demonstrate sustained growth in output, which increased by 9.3% in 2003 as against 7% in 2002. There was a significant increase in oil, gas and coal deliveries to foreign and domestic markets. Output in the ferrous and non-ferrous metallurgy sectors in 2003 grew by 8.9% and 6.2% respectively. The food industry increased production by 5.1%, the chemical and petrochemical industry by 4.4% and the wood-paper industry by 1.5%. Electricity production rose by 1%. The only key industry where output fell (by 2.3%) was light industry.

The high level of investment activity, typical of 2003, was accompanied by production growth in the machine-building and building materials

industries. Output growth in the machine-building industry in 2003 accelerated by 7.4 percentage points year on year to 9.4% and in the building materials industry by 3.4 percentage points to 6.4%.

Agricultural output rose by 1.5% in 2003, as in 2002. At the same time, gross grain output at all types of farms declined by 22.6%. The decrease in the supply of grain was the main reason for the rapid growth in grain prices.

Industrial production growth and the increased activity in the construction sector led to the expansion of the freight turnover of transport companies, which increased by 7.6% in 2003.

Favourable external economic conditions, the expansion of foreign and domestic demand and the stability of government finance and financial markets had a positive effect on the **financial standing of enterprises** in 2003. In addition, the tax burden on the economy was alleviated in 2003 (the taxes on road users and car owners were abolished and the taxation system for small businesses was simplified) and this also contributed to the improvement of the financial condition of enterprises. There was a rise in profits and the efficiency of production and rate of return on assets increased.

At the same time, enterprises faced higher costs and increased competition from imports. In this situation, the sector differentiation by profitability continued to grow. As profits were con-

**PRODUCTION GROWTH RATES  
IN INDIVIDUAL INDUSTRIES IN 2003  
(as % of 2002)**

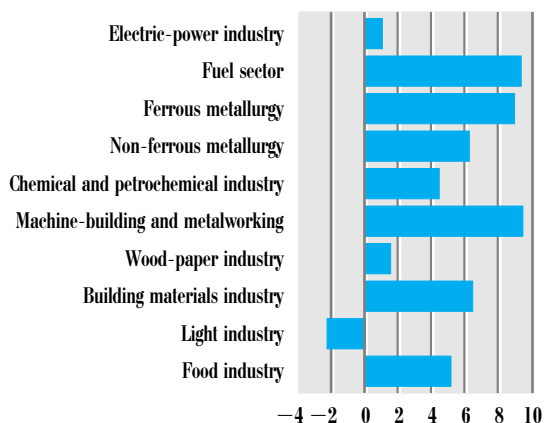


Chart 4

centrated in the export-oriented industries, the Russian economy remained dependent on raw materials.

In 2003, enterprises and organisations, excluding small businesses, banks, insurance companies and budget-financed organisations, recorded a profit (profit net of loss) of 1,342.9 billion rubles, an increase of 42.5% on 2002. This represents 10.1% of GDP as against 8.7% in 2002. There were still too many loss-making enterprises, however: 41.3% of the total number, a decrease of 2.1 percentage points from the previous year.

The profitability of production<sup>1</sup> in the economy increased from 7.2% in 2002 to 8.5% in 2003 and in industry from 7.5% to 8.4%. In 2003, unit costs in earnings from the sale of products (work and services) declined a little. At the same time, the profitability of production rose mainly in export-oriented industries, such as the fuel industry, ferrous and non-ferrous metallurgy sector and foreign trade. At the same time, some industries oriented to the domestic market could not adequately offset growth in costs by raising prices because of competition from imports and government control over the prices and tariffs charged by the natural monopolies. This led to a fall in the profitability of production in the machine-building and metalworking, food and gas indus-

tries and an increase in losses in the coal, light and microbiological industries. The housing and communal services sector remained in the red.

Payments and settlements continued to improve in 2003. The share of products shipped, work carried out and services provided by the major taxpayers and industrial monopolies that were paid for in cash in 2003 expanded by 3.8 percentage points year on year to 85.8%, while the share of virtually all non-pecuniary settlements contracted.

There was a contraction in all kinds of overdue debt in 2003. Overdue receivables amounted to 876.5 billion rubles as of January 1, 2004, a decrease of 3.8% on a year earlier and their share in total receivables narrowed from 24.9% to 21.2%. As a result of the settlement of enterprises' overdue debt obligations on all major kinds of payables, overdue payables declined by 8.8% in 2003 to 1,306.1 billion rubles. The overdue part of payables contracted from 29.7% in 2002 to 24.7% in 2003.

Continued economic growth in 2003 led to a rise in **household money income**.

According to Goskomstat data, nominal household income rose by 29.2% year on year to 8,770.8 billion rubles. Money income relative to GDP increased by 3.3 percentage points to 66.0% in 2003.

Real money income rose by 13.6% and disposable money income increased by 14.6%. The real imputed average monthly wage grew by 10.3% and the real imputed monthly pension by 4.5%.

The share of wage and income from property in the structure of household money income expanded from 66.5% to 66.7% and from 4.8% to 5.4% respectively in 2003, while the share of income from entrepreneurial activity and social allowances contracted.

Despite the rise in real income, the income differentiation of the population remained high. In 2003, 20% of the highest-income population received 46.1% of total money income (against 45.8% in 2002), while 20% of the lowest-income population received 5.6%, as was the case in 2002.

<sup>1</sup> The profitability of production has been calculated on the basis of Goskomstat data as the ratio of the enterprise's financial result to its earnings from the sale of goods, products, work and services.



REAL MONEY INCOME, WAGE AND PENSION DYNAMICS  
(trend, December 2000 = 100%)

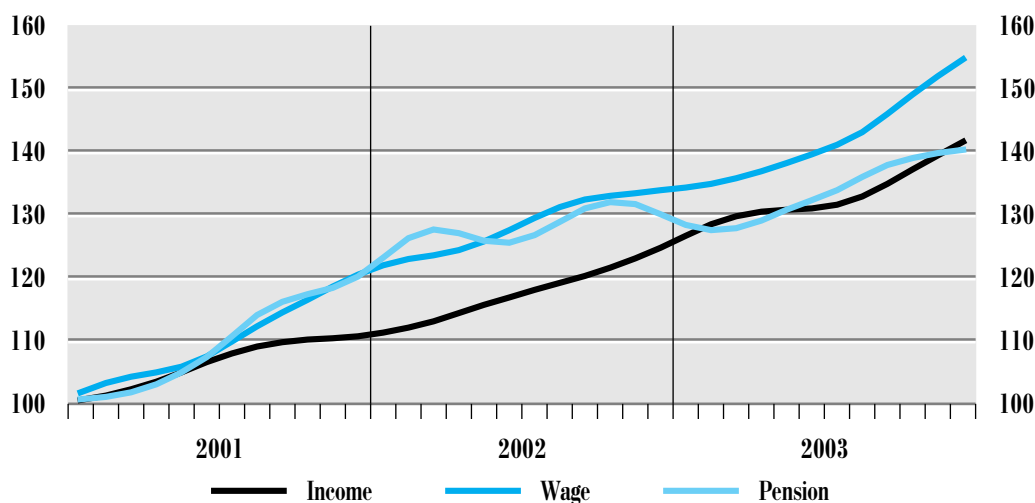


Chart 5

At the same time, the ratio between household money income and the subsistence minimum changed for the better in 2003. The ratio between the average per capita imputed monthly wage and the subsistence minimum established for the able-bodied population stood at 215.4% in 2003 Q1, 227.5% in Q2, 239.4% in Q3 and 273.4% in Q4.

The average imputed monthly pension in 2003 exceeded the subsistence minimum established for pensioners by 2% (in 2002 they were the same).

The number of people whose average per capita money income was below the subsistence minimum established for the country as a whole stood at 29 million (20.4% of the total population) in 2003 as against 34.6 million (24.2%) in 2002.

The share of expenses on goods and services in the structure of household income use contracted to 69.3% in 2003 from 73.2% in 2002. Real money income increases led to a rise in consumer demand and, consequently, an increase in retail trade turnover, which expanded by 8.4% in comparable prices in 2003. Foodstuffs accounted for 46.3% of retail trade turnover and non-food products 53.7% as against 46.5% and 53.5% respectively in 2002. The non-food trade turnover grew faster than the food trade turnover in 2003 (9.2% as against 7.5%).

**Household sector real expenses on final consumption** increased at a rapid rate in 2003, as was the case in 2002 (7.9% as against 8.8%).

A major budget policy objective in 2003 was to prevent government expenditures from increasing faster than economic growth and to restrain non-interest federal budget expenditures. **Government sector expenditures on final consumption** rose by 2.2% year on year as against 2.6% in 2002.

There was a rise in the investment activity of Russian enterprises and organisations in 2003. **Fixed capital investment growth** exceeded production growth in 2003, which was not the case in 2002. Fixed capital investment expanded by 12.5% in 2003 year on year, which represents a significant increase on the previous year's 2.8%.

The major factors of growth in investment were the accelerated growth in the production of goods and services and the significant improvement of enterprises' financial condition.

In 2003, as in the previous years, the fixed capital investments of large and medium-sized enterprises went to the fuel sector, transport and housing and communal services sector. Data for 2003 indicate that these sectors accounted for 20.5%, 18.0% and 14.3% of total fixed capital investment respectively. The share of other sectors was considerably smaller.

In 2003, Russian industry continued to invest fixed capital mainly in the raw material sectors.

**DYNAMICS OF MAJOR BALANCE OF PAYMENTS COMPONENTS  
AND INTERNATIONAL RESERVES OF THE RUSSIAN FEDERATION**  
(billion US dollars)

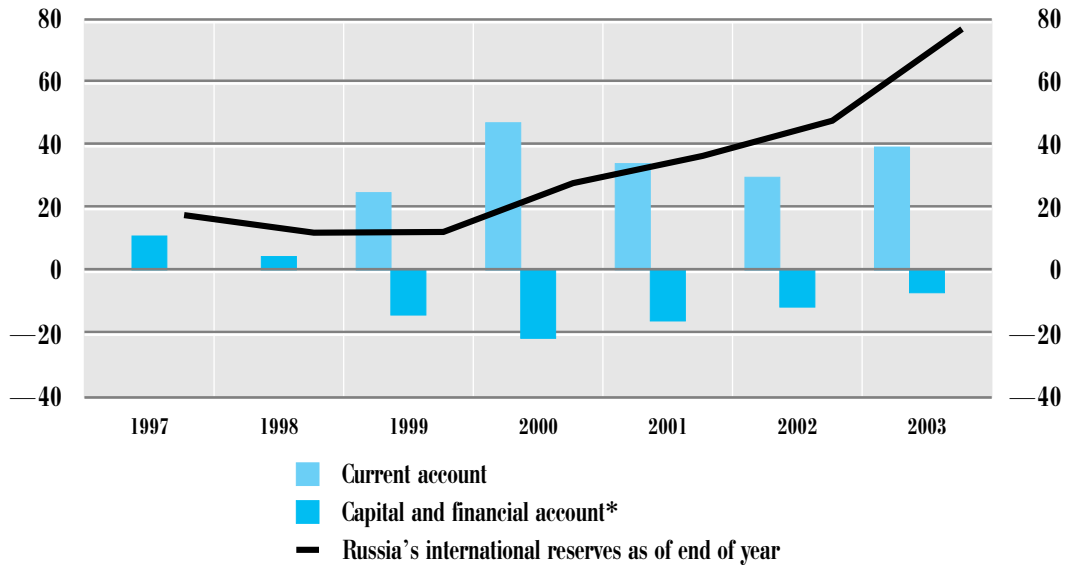


Chart 6

\* Net of change in reserve assets.

As in 2002, the electric-power industry, fuel sector and metallurgy sector accounted for more than 70% of all investments made by large and medium-sized enterprises in industry.

Just like in the previous years, enterprises' own funds remained the major source of investment financing. The ratio between own and borrowed funds in the structure of fixed capital investment financing by large and medium-sized enterprises stood at 45.6% and 54.4% in 2003 as against 45% and 55% in 2002.

As for borrowed funds, budget funds, mainly regional budget funds, accounted for 18.7% of total investment. In recent years, the share of budget funds in the structure of fixed capital investment financing has tended to contract. As in the previous years, a large part of federal budget funds allocated for investment in 2003 went to finance vital social programmes, most of which had no other sources of financing.

Bank loans still accounted for a small part of funds borrowed to finance the fixed capital investment of large and medium-sized enterprises and in 2003 it further contracted to 5.3% from 5.9% in the previous year (in 2002, it expanded by 0.4 percentage points). Growth in bank lending for fixed capital investment purposes in 2003 was constrained by the risks involved in long-

term lending to enterprises, flaws in legislation and the lack of information transparency about the financial state of enterprises. The share of funds borrowed from other organisations remained larger than the share of bank loans. According to data for 2003, 9.2% of investments were financed by enterprises with funds borrowed from other organisations (as against 6.5% in 2002). In 2003, the share of other sources amounted to 20.1% as against 20.3% in 2002. Foreign investment accounted for 5.7% of fixed capital investment in 2003 as against 4.9% in 2002.

Growth in **gross capital formation**, which increased by 13.5% as against a reduction of 2.2% in 2002, reflected the increased investment activity of enterprises and the expansion of gross fixed capital formation.

**Net exports** rose by 3.0% in 2003 as against 2.2% in 2002 and their share in GDP consumption expanded by 1.0 percentage point year on year to 11.5%.

Positive trends continued to consolidate in **foreign trade** in 2003. The acceleration of global economic growth rates, especially in developing and emerging market countries, the expansion of international trade volumes, the extremely favourable world commodity market situation for

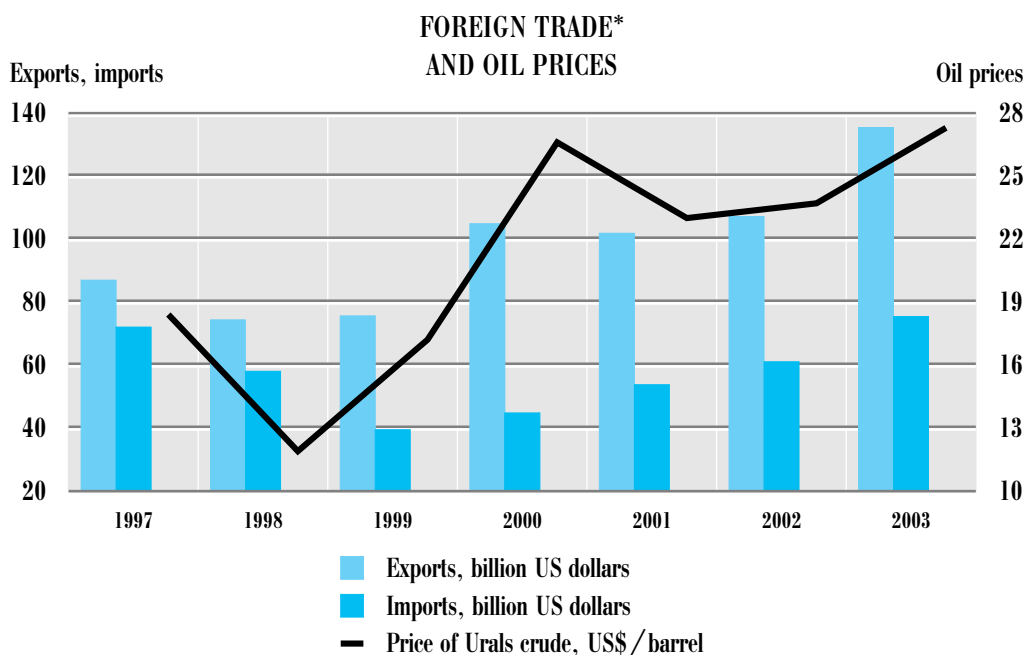


Chart 7

\* According to balance of payments data.

Russian exporters and growth in the demand for Russian products, strengthened the country's balance of payments. Russia posted significant growth in its current account surplus, foreign capital inflow to the private sector of the Russian economy increased significantly, net capital outflow decreased and international reserves rose to record levels. Russia's current account surplus rose by almost one-quarter in 2003 to an estimated 8.3% of GDP (as against 8.4% of GDP in 2002), while the capital and financial account deficit (net of change in reserve assets) contracted to an estimated 0.5% of GDP against 3.3% of GDP in 2002.

The principal source of foreign exchange for Russia was exports. Growth in the value of exports resulted not only from the significant rise in prices, but also from the massive expansion of Russian export volumes. In 2003, the value of energy exports increased by 1.3 times year on year and reached the highest level since 1994. The value of non-energy exports rose by 22% in 2003 as against 3% in 2002. Non-energy export volumes also reached the highest level and their growth was due to a rise in prices and also the expansion of export volumes of some commodities.

Positive changes in the Russian economy, the improved investment climate in the country, sustained economic growth, political stability and the

reduction of net private capital outflow did not pass unnoticed by international rating agencies. In October 2003, Moody's Investors Service raised Russia's sovereign rating to the investment grade for the first time.

The biggest demand for foreign currency on the domestic foreign exchange market came from the importers of goods and services. The acceleration of import growth in 2003 was due to a rise in demand, caused by higher economic growth rates and household incomes. However, imports grew more slowly than exports. Imports of investment goods increased more rapidly than consumer goods imports. The share of investment goods and raw materials and intermediate industrial products in imports expanded, while the share of consumer goods contracted.

Considerable foreign currency receipts from exports and foreign investments in the private sector led to an excess of the supply of foreign exchange over demand on the domestic foreign exchange market. This, along with the monetary policy pursued by the Bank of Russia, which aimed to prevent excessive growth of the real effective rate of the ruble and thus mitigate the negative effect of this process on the competitiveness of national commodity producers, led to a significant increase in the country's foreign exchange reserves.

Foreign trade remained a major source of federal budget revenue in 2003. High energy prices and the expansion of export volumes in 2003 brought about a significant rise in tax revenues, despite the reduction or cancellation of customs duties on some imported and exported goods.

**Institutional changes in the economy** affected economic developments in Russia in 2003.

The decisions taken by the Russian Government in 2003 in the field of economic legislation, the regulation of prices and tariffs charged by the natural monopolies, foreign exchange regulation, support for household income and employment, the restructuring of enterprises and foreign trade regulation created favourable conditions for further economic progress and the elimination of imbalances in the Russian economy.

## I.2. GOVERNMENT FINANCE AND DOMESTIC GOVERNMENT DEBT

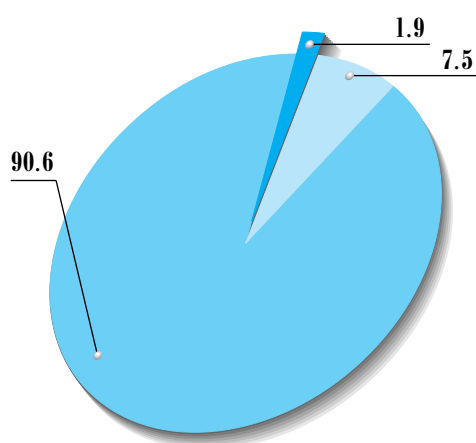
The 2003 budget policy aimed to complete the tax reform on the whole, prevent government expenditure from growing faster than the economy, set a limit on non-interest federal budget expenditures, maintain a balance between budgets of all levels and continue to optimise and upgrade government debt servicing. It was part of the economic development plan and the single state monetary policy.

Economic growth and the continuing favourable external economic conditions allowed the Russian Government to surpass the federal budget revenue and federal budget surplus targets set in the 2003 Federal Budget Law and, at the same time, honour all its foreign debt obligations, which required making considerable payments.

According to the Finance Ministry's preliminary data, Russia's federal budget revenue amounted to 2,583.1 billion rubles in 2003, exceeding the approved revenue target by 0.8%. However, federal budget revenue relative to GDP declined by 0.9 percentage points year on year to 19.4%. Taking into consideration that the average price of Urals crude in 2003 was considerably higher than in 2002 (\$27.3 per barrel as against \$23.7 per barrel respectively), the Russian Government failed to use all the possibilities for increasing federal budget revenue.

Federal budget expenditure equalled 2,354.9 billion rubles, or 97.5% of the approved amount. Relative to GDP, federal budget expenditure stood at 17.7% against 19.0% in 2002. The federal budget surplus amounted to 228.2 billion rubles, or 1.7% of GDP against 1.4% in 2002.

FEDERAL BUDGET EXPENDITURES  
IN 2003 (%)



- Non-interest expenditures
- Government foreign debt service expenditures
- Domestic government debt service expenditures

Chart 8

**FEDERAL BUDGET EXPENDITURE AND BALANCES  
OF FEDERAL BUDGET RUBLE ACCOUNTS IN THE BANK OF RUSSIA IN 2003**  
(billion rubles)

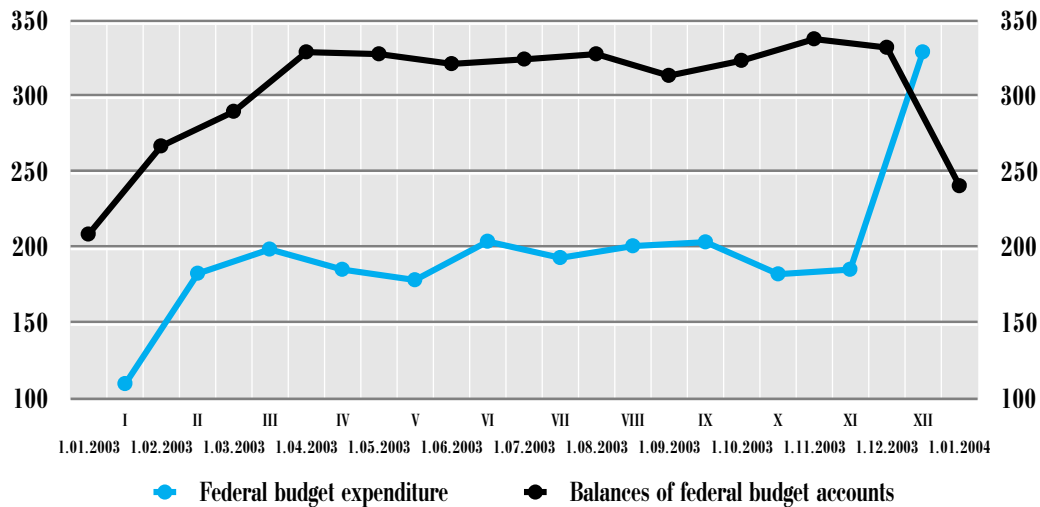


Chart 9

Federal budget expenditure by quarter stood at 20.9%, 24.1%, 25.4% and 29.6% of the full-year amount in 2003 as against 17.7%, 22.6%, 24.5% and 35.2% in 2002. These figures show that in 2003 budget expenditures were distributed by quarter more evenly than in the previous years, making the dynamics of the balances of federal budget accounts in the Bank of Russia more stable and the fluctuations of federal budget funds that exert pressure on the liquidity of credit institutions more predictable.

The ruble balances of federal budget accounts in the Bank of Russia increased by 32.1 billion rubles, or 15.4%, in 2003 and as of January 1, 2004, amounted to 240.9 billion rubles.

According to Finance Ministry data, Russia's consolidated budget revenue amounted to 4,135.6 billion rubles, or 31.1% of GDP, in 2003, expenditure 3,955.4 billion rubles, or 29.7% of GDP, and surplus 180.2 billion rubles, or 1.4% of GDP. Of these, regional consolidated budget revenue amounted to 1,930.2 billion rubles, expenditure 1,978.2 billion rubles and deficit 48.0 billion rubles.

According to preliminary data, the revenues of the Federal Pension Fund amounted to 816.4 billion rubles and expenditures 851.1 billion rubles in 2003, the revenues of the Social Insurance Fund 135.2 billion rubles and expenditures 135.4 billion rubles, and the revenues of the

Federal Compulsory Health Insurance Fund 5.80 billion rubles and expenditures 5.81 billion rubles.

According to Finance Ministry data, Russia's domestic government debt amounted to 681.5 billion rubles as of January 1, 2004 (the upper limit set by the 2003 Federal Budget Law was 842.1 billion rubles). This represents an increase of 1.6 billion rubles on the amount registered as of January 1, 2003. Russia's domestic government debt relative to GDP stood at 5.1% as of January 1, 2004, as against 6.3% as of January 1, 2003.

Substantial changes took place in the structure of Russia's domestic government debt in 2003: the share of outstanding government securities on the organised securities market expanded significantly (from 31.9% as of January 1, 2003, to 46.2% as of January 1, 2004).

Debt depreciation federal loan bonds with a nominal value of 375.4 billion rubles accounted for the largest portion (55.1%) of Russia's domestic government debt. This was largely the result of the restructuring into these bonds of permanent coupon-income federal loan bonds with a nominal value of 300.0 billion rubles by the Finance Ministry and Bank of Russia in pursuance of Article 134 of the 2003 Federal Budget Law. For the same reason, the value of permanent coupon-income federal loan bonds decreased by 6.9 times to 50.5 billion rubles.

The value of fixed coupon-income federal loan bonds decreased by 7.8 billion rubles in 2003 and as of January 1, 2004, it amounted to 199.3 billion rubles, of which 163.9 billion rubles were traded on the organised securities market. The value of variable coupon-income federal loan bonds and non-marketable loan bonds was unchanged at 24.1 billion rubles and 11.5 billion rubles respectively.

The value of short-term government bonds declined by 16.1 billion rubles, or 6.9 times, as a result of Finance Ministry redemptions.

The Finance Ministry's ruble debt to the Bank of Russia at the nominal value of government securities amounted to 304.4 billion rubles as of January 1, 2004. This represents a decrease of 84.5 billion rubles, or 21.7%, from the previous year, which resulted from the restructuring in 2003 of permanent coupon-income federal loan

bonds into debt depreciation federal loan bonds, the redemption of Bank of Russia-owned promissory notes by the Finance Ministry and the sale of federal loan bonds from the Bank of Russia portfolio. The Finance Ministry's debt to the Bank of Russia, which has a nominal value of 234.5 billion rubles, or 77.0%, is represented by long-term government securities (due in 2014 to 2029) with a coupon income of 0% to 4%.

In addition, the Finance Ministry's debt to the Bank of Russia on the first coupon payment on permanent coupon-income federal loan bonds, received by the Bank of Russia as a result of the exchange of Vneshtorgbank shares under Article 108<sup>1</sup> of the 2002 Federal Budget Law, amounted to 2.6 billion rubles as of January 1, 2004. In accordance with this article, the Finance Ministry is to repay this debt within nine years from 2004 in equal instalments.

## I.3. THE FINANCIAL SECTOR

The financial sector of the Russian economy developed dynamically in 2003. The number of financial institutions and their capitalisation continued to increase and the scale of financial intermediation expanded. As of the end of 2003, Russia had 1,329 operating credit institutions, 1,397 registered insurance companies, 136 unit investment funds (PIFs) and 283 non-governmental pension funds. Credit institutions continued to play a leading role in the financial sector. The ratio of banking sector capital to GDP stood at 6.1% in 2003 as against 5.4% in 2002; the corresponding ratio for non-governmental pension funds was 0.9% as against 0.5% in 2002.

A major internal factor of the financial sector's growth was a rise in competition. Household savings played a major role in rising competition in 2003. The acceleration of growth in household income and the increased inclination to save were additional stimuli for public demand for the services provided by financial intermediaries.

Although bank deposits remained the most popular form of organised savings, favourable conditions emerged in some segments of the financial market for non-bank financial institutions' competition with banks. Specifically, there were signs of gradually rising competition between banks and PIFs, which were vying with one another for savings of the highest-income population group seeking to make big gains from

the diversification of their investment portfolio and long-term investments. Non-bank financial institutions, which are rapidly building an agent network in the regions with a shortage of banking services, may soon rival banks.

Many non-bank financial institutions have broadened the range of their services significantly, reviewed their investment strategies, made their services more affordable and, as a result, considerably improved their quantitative performance indicators. The rates of growth in household funds attracted by non-bank financial institutions (insurance premiums, pension contributions and investment share payments) exceeded on average the rates of growth in household funds attracted by credit institutions.

As the household and small business sectors' solvent demand for financial services increased in 2003, the development of non-bank financial institutions operating on the basis of mutual participant financing continued.

Owing to the accelerated growth in the flow of household sector funds, the share of household deposit accounts in banking sector liabilities expanded by 2.2 percentage points in 2003 to 27%. Another qualitative change in the structure of household deposit accounts was the expansion of their ruble component from 61.5% to 69.4% and the increase in the share of deposit accounts with terms longer than one year from 39.8% to 44.3%. Throughout 2003, average interest rates on



household ruble deposit accounts with terms from one year to three years were higher than interest rates on time deposits with terms shorter than one year. This was the result of the interest rate policy pursued by credit institutions, which encouraged the public to deposit their savings for longer terms.

The value of the Russian financial market, including the capitalisation of the stock market, the debt on bank loans to the non-financial sector and the market portfolio of government and corporate securities, reached 85% of GDP in 2003. For the first time ever, Russia was assigned an investment grade rating. On the whole, the Russian financial market retained its status as an emerging market, characterised by stability and good investment potential.

For the third consecutive year, various segments of the financial market registered growth in value and turnover and demonstrated a distinct trend towards growth in quoted prices and a decline in interest rates. The harmonious development of various sectors of the Russian financial market shows that the tendency towards the establishment of a single financial environment and more similar conditions of market financial operations is becoming more consolidated.

The foreign exchange market remains a key sector of the financial market from the viewpoint of both turnover and influence on the overall market situation. For the first time since the beginning of the reform, the foreign exchange market demonstrated a tendency towards growth in the nominal rate of the ruble against the US dollar. This led to the expansion of conversion turnovers and the shift of investor interest to ruble-denominated financial instruments, which resulted in the predominant growth in quoted prices and a decline in yields on such instruments to levels comparable with inflation.

As in the previous year, the corporate securities market, which is the most risky sector of the financial market, expanded at the most rapid rates. The Russian corporate securities market's susceptibility to political and legal risks largely depended on the specifics of this market: shares account for a larger part of the market than other debt instruments and the market is not adequately differentiated by issuer. For most of the year, share prices tended to rise and the stock market gradually approached the historical highs of ma-

ior Russian stock indices. The corporate bond market demonstrated an increase in the number of issuers and the value of instruments. Corporate bonds are increasingly used as an alternative source of borrowings not only by large but also medium-sized enterprises. The decision taken late in 2003 to cut the tax on operations with securities, which will lead to a reduction in the cost of issuing them, is designed to make corporate bonds more attractive to investors.

On the GKO—OFZ market, the Finance Ministry in 2003 continued to improve the structure of domestic government bonded debt and reduce the cost of servicing it. When tackling these problems, it expanded the market volume and duration and enlarged outstanding issues. The government securities market interest rate served as an indicator of the cost of financial resources.

The upgrading of the financial sector's infrastructure in 2003 was designed to create a more effective market mechanism capable of meeting the needs of the economy in reallocating investment resources at minimum risk. Russia also upgraded its legislative and regulatory framework to ensure the more effective protection of the rights of issuers and investors. This required, among other things, increasing the transparency of professional market participants' activity and establishing additional information disclosure requirements. The Securities Issue Standards were elaborated in compliance with international principles of information disclosure and protection of investors' legal rights and interests to reduce to a minimum the possibility of abuses in issuing securities and make the securities issuing procedures more transparent for investors.

According to the Federal Securities Commission's data, professional securities market participants had the following licences in 2003: 1,472 had broker licences, 1,538 had dealer licences and 1,097 were licensed to manage securities. In practice, a market participant often combines these activities. In addition, the licensed professional stock market participants include register-keeping institutions (78 licences), depositories and clearing houses (804 licences and 11 licences respectively) and institutions that organise trade in securities (nine licences). The development of modern technologies has led to the concentration of exchange trade volumes on several of the larg-

INTEREST RATES ON RUBLE OPERATIONS (% p.a.)

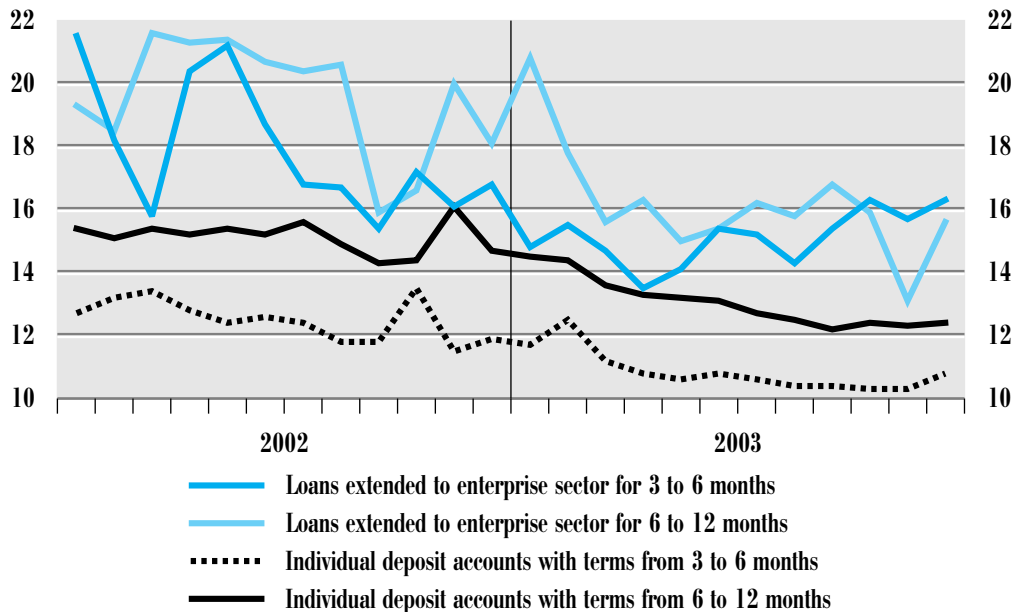


Chart 10

est trading floors. The bulk of exchange operations with securities in 2003 were conducted on the Moscow Interbank Currency Exchange (MICEX), which has a licence to organise trade. Regional currency exchanges access trade via the MICEX infrastructure. Of the five licensed stock exchanges that were in operation at the end of 2003, the largest in terms of securities operation volumes was the Russian Trading System (RTS).

Credit institutions occupy an important place among the professional market participants. As of the end of 2003, there were 258 credit institutions on the list of 302 GKO—OFZ market dealers. Financial consultants became a part of the system of professional securities market participants in 2003 and managing companies stepped up their activities.

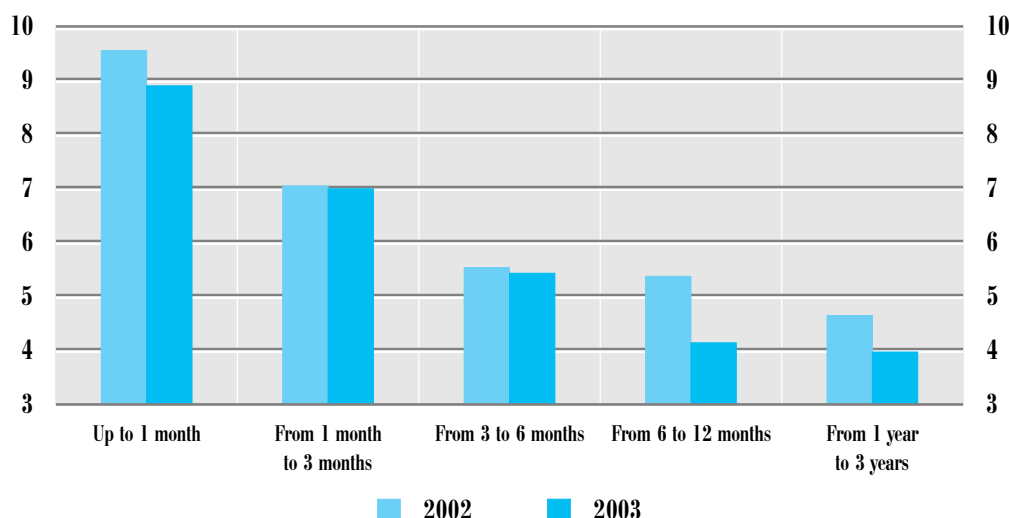
The dynamics of major financial market price indicators were an important factor for all institutions of financial intermediation. As in the previous year, the reduction of money market rates and yields on securities brought the prices of ruble financial instruments with correspondent terms to redemption closer together. In 2003, the average annual effective GKO—OFZ market portfolio indicator fell by more than 6 percentage points to 8.7% and the average annual interest rate on ruble promissory notes discounted by

banks declined by 3.2 percentage points to 13.5%. Interest rates on the interbank loan market remained lower than in other sectors of the financial market. The average annual rate on interbank ruble loans extended for all terms fell to 4.2% p.a. in 2003 from 8.2% p.a. in 2002.

The growing supply of alternative financial instruments and the narrowing of the gap between yields stimulated the activity of financial intermediaries. At the same time, credit institutions faced competition from foreign banks when extending loans to prime Russian borrowers. As a result, the demand for big loans from leading Russian companies was largely met by foreign creditors, who offered resources at more favourable prices and for longer terms.

Closer yields on major financial market instruments led to a reduced cost of borrowing for non-financial enterprises and households. The increased affordability of credit resources was a major precondition of growth in the demand for loans in the enterprise and household sectors. Lending to individuals grew most rapidly in 2003: it increased by 2.1 times and its share in the banking sector's loan portfolio expanded from 6.6% to 9.8%. The average annual interest rate on ruble loans extended to individuals for all terms also declined from 23.3% p.a. in 2002 to 21.1% p.a. in 2003, although interest rates on these opera-

**INTEREST MARGIN ON BANKS' RUBLE LENDING AND DEPOSIT OPERATIONS  
WITH ALL NON-FINANCIAL CLIENTS (annual average, percentage points)**



*Chart 11*

tions remained higher than on loans to enterprises.

The average annual interest rate on ruble loans extended to the enterprise sector for all terms stood at 13.1% p.a. in 2003 as against 15.8% p.a. in 2002. The increased competition between banks, including foreign banks, for borrowers, slower inflation and reduced interest rates in the adjacent segments of the financial market, mainly the bond market, played a significant role in bringing about the downward trend of interest rates on loans to end-use borrowers. There was an appreciable fall in interest rates on medium- and long-term loans: from January to December, interest rates on ruble operations with terms from six to twelve months and from one year to three years fell by 5.2 percentage points and 3.6 percentage points respectively to 15.6% and 14.5% p.a.

The increased competition in banking sector operations with non-financial clients in 2003 caused the average annual interest margin to fall year on year in operations for all terms and this decline reflected gradual improvement in the efficiency of financial intermediation. The margin decreased by 0.1 percentage points to 1.3 percentage points, depending on the term, except in operations with terms from one month to three months, on which the margin remained unchanged. The tendency towards more rapid reductions in the average annual margin on longer-term operations continued: a significant decline

in margins was registered in operations with terms from 6 to 12 months and 1 year to 3 years (from 5.4 percentage points to 4.1 percentage points and from 4.7 percentage points to 4.0 percentage points respectively), reflecting the higher level of competition on lending and deposit operations conducted for these terms.

The average annual margin on operations with non-financial clients for terms from one year to three years (4 percentage points) in 2003 was smaller than the margin on similar operations with other terms, a trend reflecting banks' desire to extend the terms of operations. For this purpose, banks offered more favourable conditions for longer-term operations, such as somewhat higher interest rates on deposit accounts.

The market for bank lending and deposit operations with non-financial enterprises was characterised by tougher competition than the market for operations with the household sector. The average annual margin on ruble lending and deposit operations with enterprises in 2003 ranged from 2.6 percentage points in operations with terms from one year to three years to 8.7 percentage points in operations with terms up to one month.

The interest margin on operations with individuals for all terms up to one year, excluding demand deposit accounts, was 10 percentage points on average in 2003. At the same time, the predominant trend in both segments of the loan

and deposit market was year-on-year decline in the interest margin. In the future, when the deposit insurance system has been established and the number of retail banks grows, competition in this segment of the financial market will increase and the interest margin will fall.

Credit institutions located in the Central Federal District, especially Moscow banks, made the biggest contribution to the average national level of interest rates. In other regions, banks con-

ducted fewer lending operations, while their interest rates varied significantly. The regional differentiation of interest rates reflected the objective differences in the risk levels of regional borrowers, the largest of which have access to resources of Moscow banks and the international bank loan market. At the same time, the absolute majority of Russian regions in 2003 registered a tendency towards falling interest rates on loans extended to the economy.

### I.3.1. CREDIT INSTITUTIONS

The dynamics of major banking sector performance indicators in 2003 were largely the result of the favourable macroeconomic situation: Russia enjoyed stability on its foreign exchange and financial markets, had a strong balance of payments, and domestic demand expanded. Further growth in real household income and the restoration of the banking sector's public credibility led to the rapid development of the retail segment of the banking services market.

In this situation, credit institutions managed to broaden significantly the scale of financial intermediation. As of January 1, 2004, banking sector assets relative to GDP stood at 42.2% as against 38.3% as of January 1, 2003, capital 6.1% as against 5.4%, loans to the domestic non-financial enterprise sector 17.1% as against 14.7% and funds attracted from the enterprise and household sectors 21.8% as against 19.6%. At the same time, banks continued to play the leading role among other financial intermediaries, their capabilities far surpassing those of insurance and finance companies and collective investment institutions.

Banking sector assets rose by 35.1% in 2003 and in real terms<sup>1</sup> they increased 28.1% against 18% in 2001—2002. Banks' active operations in rubles grew at particularly rapid rates: the ruble component of banking sector assets expanded from 63.8% to 70.1%.

The Russian banking sector continued to grow faster than the economy as a whole. Banking sector capital, for instance, expanded 3.5 times faster than GDP in real terms, banking sector assets 3.9 times faster, lending to the non-financial sector 5.2 times faster and household deposit accounts 5.4 times faster.

The level of capital and asset consolidation achieved by large banks remained virtually unchanged in 2003. The number of credit institutions with a capital in excess of five million euros increased from 423 to 462 in 2003, while the share of these banks in aggregate banking sec-

tor capital was unchanged during the last two consecutive years at about 93%. The largest 200 banks in terms of assets accounted for 88.0% of banking sector assets as of January 1, 2004, against 88.5% as of January 1, 2003.

As the demand for banking products and services expanded, imbalances remained in the development of the banking sector at the regional level. There was only a rise in the number of credit institutions in Moscow and the Moscow Region. As of January 1, 2004, more than half of all Russia's operating credit institutions were based in Moscow and the Moscow Region.

As different regions have different levels of economic development, they also differ in the provision of banking services. The regions that are best provided with banking services after Moscow and the Moscow Region in terms of both lending to the real economy and retail banking are the Northwestern and Volga Federal Districts. The Siberian Federal District remained the region worst provided with banking services.

#### STRUCTURE OF BANKING SECTOR LIABILITIES.

Household deposit accounts were the principal source of growth in the banking sector's resource base in 2003, accounting for one-third of the entire increase in banking sector liabilities. In 2003, the value of personal deposit accounts rose by 47.1% to more than 1.5 trillion rubles. As in the previous year, 74% of operating credit institutions registered a rise in the value of their household deposit accounts in 2003. As of January 1, 2004, this source accounted for 27.0% of banking sector liabilities.

Another important trend was the extension of household deposit terms. Household deposit accounts with terms longer than one year accounted for 43.7% as of January 1, 2004, as against 35.3% as of January 1, 2003. Deposit accounts with terms longer than one year accounted for 11.8% of banking sector liabilities as of January 1, 2004, against 8.8% as of January 1, 2003.

<sup>1</sup> Here and below the consumer price index and official ruble/dollar exchange rate dynamics for the corresponding period have been used in calculating banking sector real growth rates.

BANKING SECTOR GROWTH RATES IN REAL TERMS (% a year)

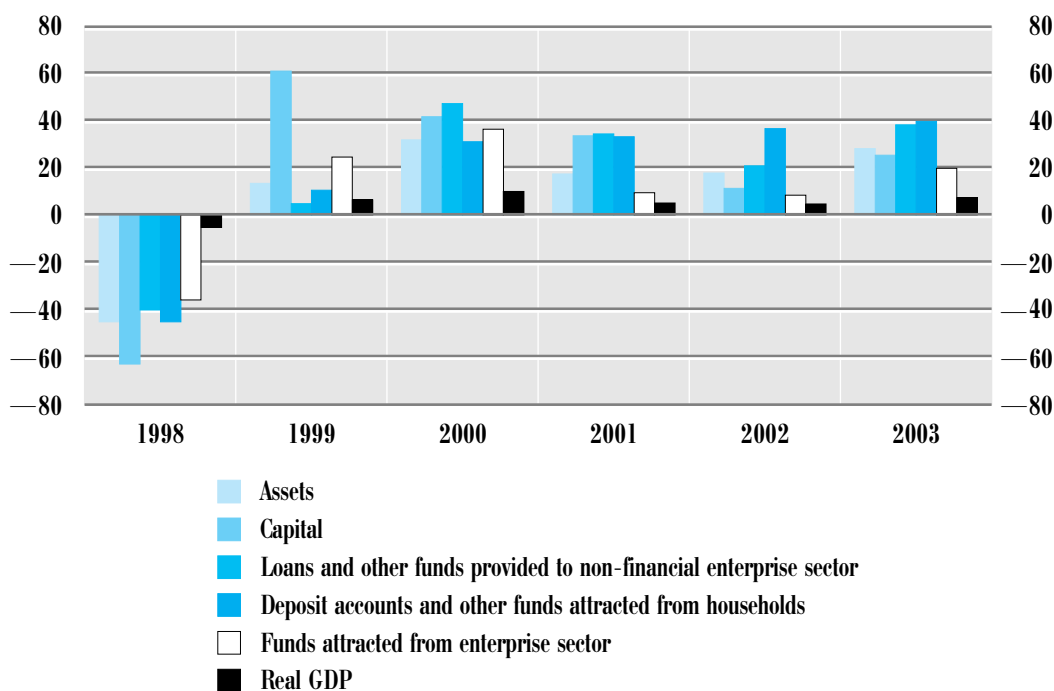


Chart 12

For the first time in three years, growth in household ruble deposit accounts was faster than growth in household foreign currency deposit accounts. As a result, the share of household ruble deposits expanded from 61.5% to 69.4% of the total value of household deposit accounts.

Competition has increased on the household deposit market: although the Savings Bank (Sberbank) has retained its leading position in this market segment, its share in the market continues to contract: from 67.3% as of January 1, 2003, to 63.3% as of January 1, 2004. The introduction of the deposit insurance system will enhance this trend and help create a more balanced and competitive structure of the household deposit market.

Funds attracted from the enterprise sector are the second most important source of resources for the banks (in 2003, they accounted for more than one-fifth of the total growth in banking sector liabilities). Over the past year, the value of funds attracted from the enterprise sector increased almost 26.9% to 1,384.8 billion rubles as of January 1, 2004. At the same time, the share of this source of resources in banking sector liabilities declined to the lowest level in five years (24.7%).

In 2003, credit institutions stepped up their activity in raising funds by issuing securities. In the period under review, the value of debt obligations issued by banks rose by 40.8% to 634.5 billion rubles as of January 1, 2004. It accounted for 11.3% of banking sector liabilities, while more than 32% of debt obligations were issued by banks for terms longer than one year.

As before, promissory notes predominated in the structure of debt obligations issued by banks, despite growth in the share of other debt instruments (promissory notes accounted for 73.4% of all banking sector debt obligations as of January 1, 2004).

Fund-raising operations on the interbank market expanded unevenly during 2003: most of the growth occurred in the second half of the year. The value of loans, deposit accounts and other funds received by banks from other banks grew 66.5% to 525.3 billion rubles and this source of funds accounted for 9.4% of banking sector liabilities as of January 1, 2004, as against 7.6% as of January 1, 2003. More than two-thirds of interbank loans were foreign currency loans received from non-resident banks, of which 53% were taken for terms longer than one year.

STRUCTURE OF BANKING SECTOR LIABILITIES (%)

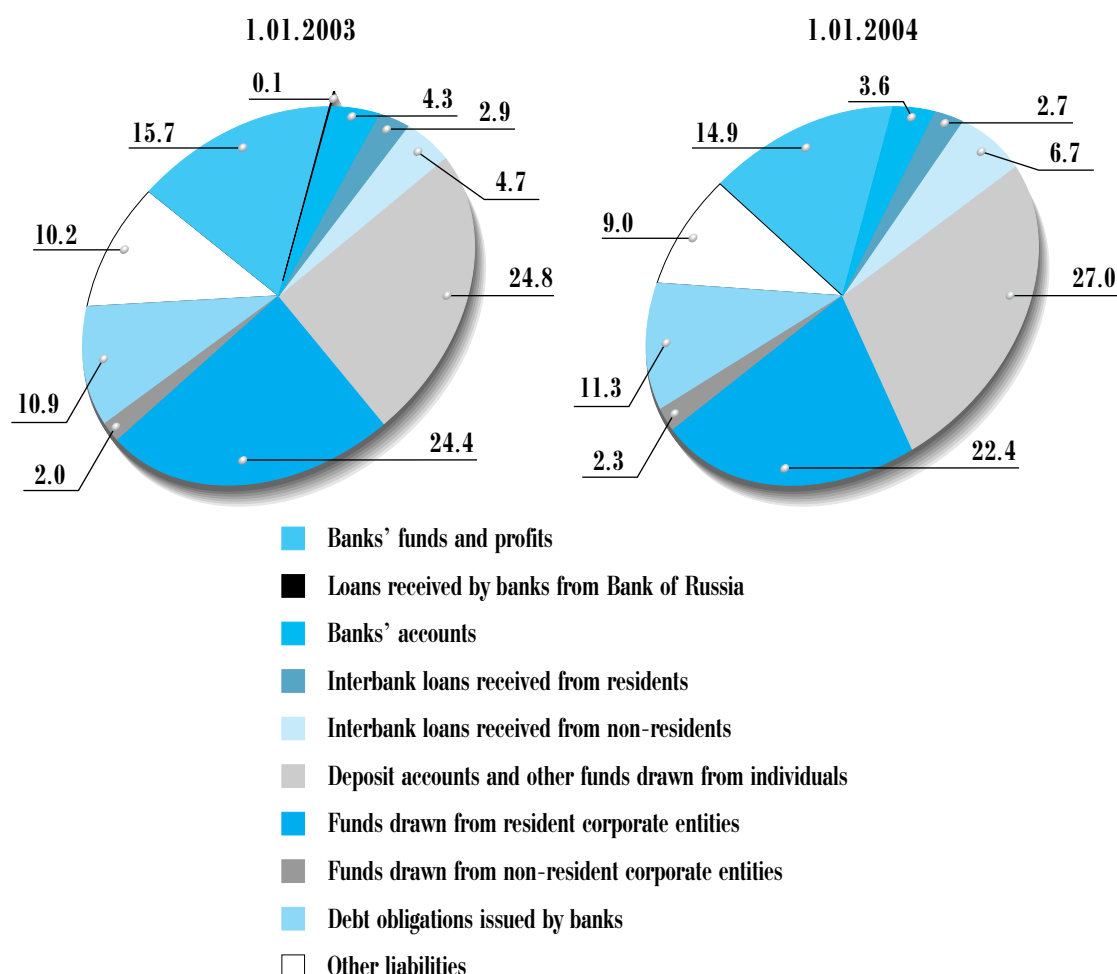


Chart 13

However, the long-term resource base built up by credit institutions still does not quite meet the needs of dynamic growth in long-term bank lending to the non-financial sector of the economy. The sources of funds with terms longer than one year account for no more than 15% of the total value of banking sector liabilities.

**STRUCTURE OF BANKING SECTOR ASSETS.** The expansion of bank lending operations with the real economy was the main factor of growth in banking sector assets in 2003. Loans extended by banks to resident non-financial enterprises increased by 42.4% in 2003, a rise of 7.2 percentage points on 2002 growth, and totalled 2,266.9 billion rubles as of January 1, 2004. These loans accounted for 40.5% of banking sector assets as of January 1, 2004, against 38.4%

as of January 1, 2003. In 2003, 74.3% of credit institutions expanded lending to the non-financial sector.

About two-thirds of the total value of loans to the non-financial sector were extended in rubles. Loans with terms longer than one year grew faster (by 70%) than other loans extended to Russian non-financial enterprises, accounting for 38% of the value of this kind of loans against 32% at the beginning of 2003.

The expansion of the retail segment of the loan market was one of the most notable trends of 2003. Consumer lending is growing fast and it has become a core business for some banks. Fierce competition on this market led to a fall in interest rates and encouraged banks to modernise their technical facilities and raise the quality of customer service. As a result, consumer credit has become

## STRUCTURE OF BANKING SECTOR ASSETS (%)

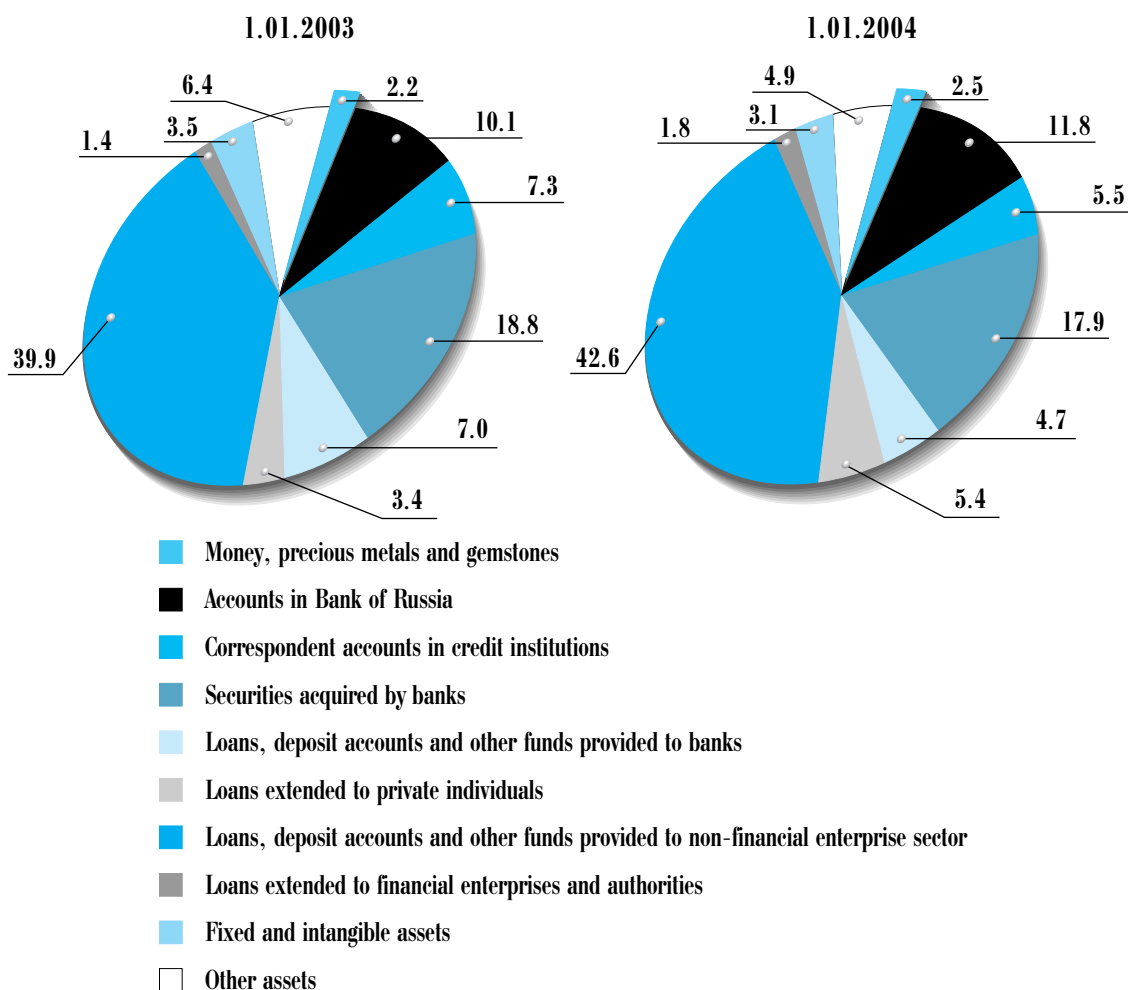


Chart 14

more affordable and attractive for Russian citizens. Against this backdrop, the value of loans extended to resident individuals continued to rise at rapid rates: in 2003, it more than doubled and as of January 1, 2004, stood at 298.4 billion rubles (in 2002, it grew by 50%). The share of such loans in banking sector assets expanded from 3.4% as of January 1, 2003, to 5.3% as of January 1, 2004.

According to banks' data, the quality of the loan portfolio remained satisfactory on the whole: the quantitative characteristics of overdue debt on loans and loan loss provisions allow one to evaluate banking sector credit risk as moderate.

The share of overdue debt contracted from 1.9% to 1.6% in the total value of loans. As of January 1, 2004, standard loans accounted for 90.7% of the total value of debt on loans against 90.1% as of January 1, 2003. Loans classified by

banks as belonging to credit risk Group 3 and Group 4 were completely covered by loan loss provisions.

Banks' investments in securities increased by 28.5% in 2003 and as of January 1, 2004, they were worth 1,002.2 billion rubles. At the same time, the securities portfolio grew more slowly in 2003 than other active operations, especially lending. As a result, investments in securities accounted for 17.9% of banking sector assets as against 18.8% a year earlier.

Investments in debt obligations, especially Russian government debt obligations, continued to dominate the banking sector's securities portfolio, accounting for 11.2% of banking sector assets. However, the share of government debt instruments in banking sector assets contracted from 10.0% to 8.0% in 2003.



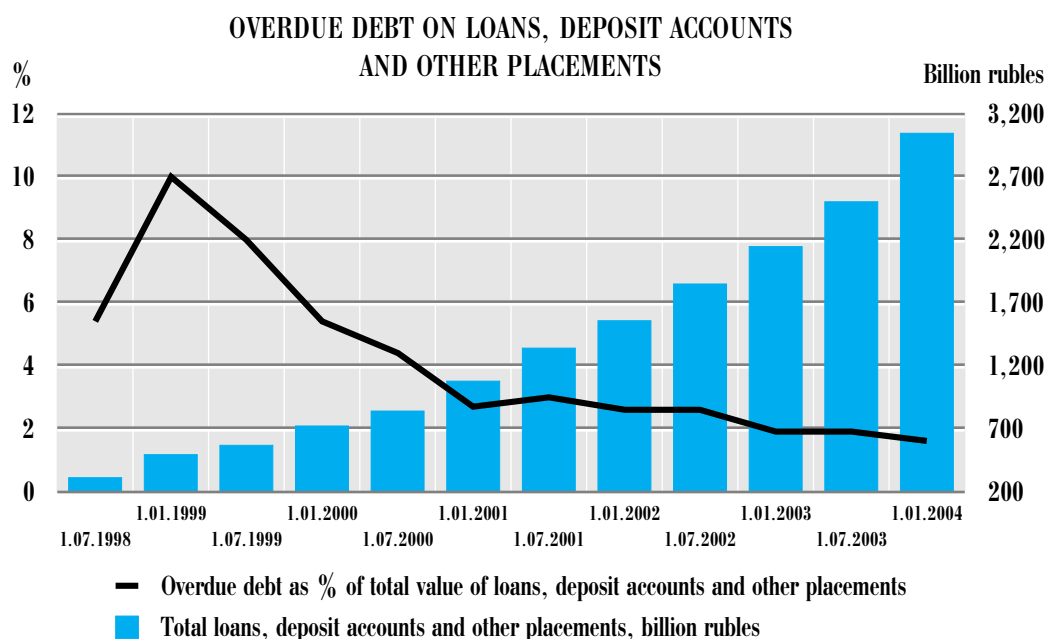


Chart 15

At the same time, credit institutions stepped up their operations with corporate securities, which yield higher returns than government debt obligations. Thus, bank investments in corporate bonds rose by almost 80% in 2003 to 59.0 billion rubles, and their share expanded from 0.8% to 1.1% in banking sector assets. Bank investments in stocks increased by 68.4% to 115.8 billion rubles, but their share in banking sector assets remained small at 2.1% as of January 1, 2004, as against 1.7% in the same period last year.

The role of bank investments in promissory notes declined from 5.0% of banking sector assets as of January 1, 2003, to 4.7% as of January 1, 2004.

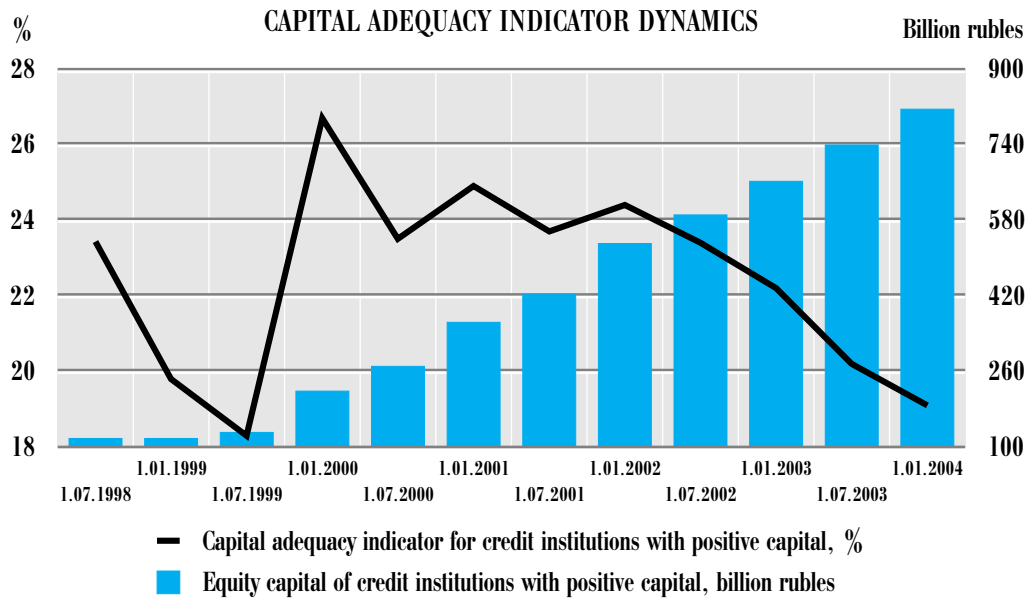
The overall dynamics of banks' active operations and the changes that are taking place in their structure show that the number of important factors for the banking sector's risk profile has increased. As the expansion of lending to the non-financial sector makes banks increasingly dependent on the financial condition of borrower enterprises, specific risks connected with the dynamics of prices of individual financial assets and the situation on the real estate market play an ever growing role. The practice of extending loans to affiliated parties leads to high risk concentration levels in some banks.

In addition, banking sector stability is still affected by risks arising from the shortage of long-term resources and the transformation of short-term liabilities into long-term investments. The existence of these trends is confirmed by assessments of the financial stability of the Russian banking sector and its vulnerability to the change of major risk factors, including assessments made by stress testing.

**FINANCIAL STANDING OF CREDIT INSTITUTIONS.** Taking advantage of the favourable economic situation, Russian banks in 2003 expanded the range of their activities and introduced new banking products. As a result, their profits rose and financial condition improved.

The distribution of banks across the financial stability groups shows that their financial condition was stable on the whole. As of January 1, 2004, the number of financially sound banks, that is, banks without shortcomings (Group 1), and banks with some shortcomings (Group 2) stood at 1,279 against 1,269 as of January 1, 2003. They accounted for almost 96% of the total number of operating credit institutions and 99% of banking sector assets. Almost all corporate funds, household savings, budget funds and interbank loans are kept in financially sound banks, while problem banks

Chart 16



(Group 3 and Group 4) account for less than 1% of the above funds.

In 2003, operating credit institutions made a profit of 128 billion rubles, an increase of 38% on the banking sector's financial result of 2002 (93 billion rubles). The profit of operating credit institutions, calculated taking into account the banking sector's results of the previous years, amounted to 114.7 billion rubles as of January 1, 2004, as against 27.4 billion rubles as of January 1, 2003.

The tendency towards growth in the number of profitable banks, which was noted during the previous three years, continued in 2003 (the number of profitable banks rose from 1,279 in 2002 to 1,284 in 2003), while the number of loss-making banks declined (from 46 to 41 in 2003).

The past year was characterised by the stabilisation of bank profitability indicators. Banking sector asset profitability<sup>1</sup> in 2003 was unchanged from 2002 at 2.6%.

Banking sector capital profitability<sup>2</sup> was high at 17.8%, virtually unchanged from the previous year's 18.0%.

In terms of capital profitability, the banking sector has surpassed many other sectors of the Russian economy. According to Goskomstat data, capital and reserve profitability in the Russian economy as a whole stood at 10.8% and in industry at 13.2%.

The structure of banking sector incomes<sup>3</sup> evolved under the influence of trends typical of the past few years, such as the expansion of lending and operations with securities amid the reduced possibilities for profit-making on the foreign exchange market.

Net interest income, usually the most stable component of the financial result, made up the largest part of the banking sector's net income (55.6% as against 60% in 2002). Net income from operations with securities accounted for 24% as against 16% in 2002, while the share of net income from operations with foreign ex-

<sup>1</sup> Asset profitability is calculated as the ratio of profit to assets. The year's financial result before taxation (profit-and-loss balance) and the average annual (average chronological) value of banking sector assets are used for the calculation.

<sup>2</sup> Capital profitability is calculated as the ratio of profit to capital. The year's financial result before taxation (profit-and-loss balance) and the average annual (average chronological) value of banking sector capital are used for the calculation.

<sup>3</sup> The financial result before allocation (recovery) to provisions and net of maintenance and management costs constitutes net income. It is calculated in accordance with the Profit and Loss Account of Credit Institutions (Form I02).

**BANKING SECTOR ASSETS BY CREDIT INSTITUTION  
CLASSIFIED IN TERMS OF FINANCIAL STABILITY (%)**

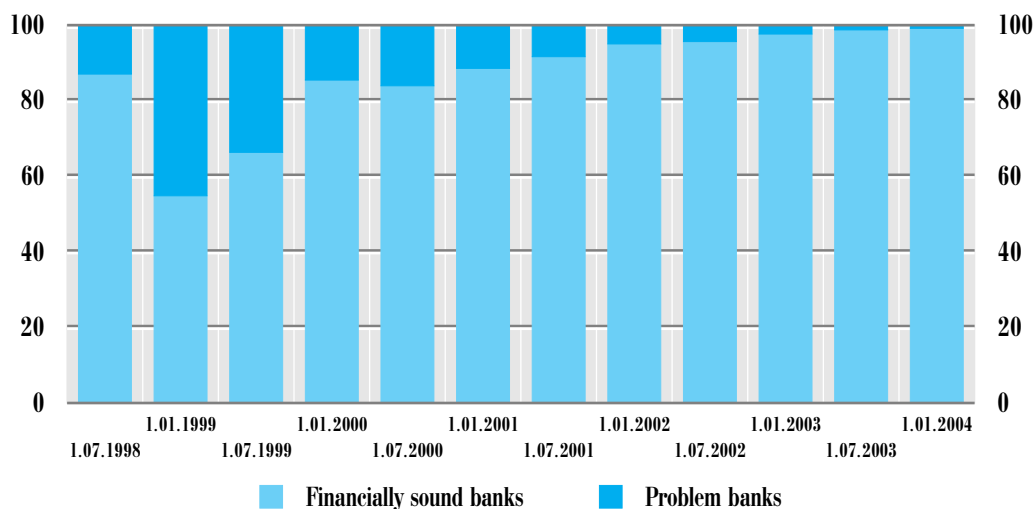


Chart 17

**SOURCES OF GROWTH IN THE BANKING SECTOR'S OWN FUNDS (CAPITAL) (%)**

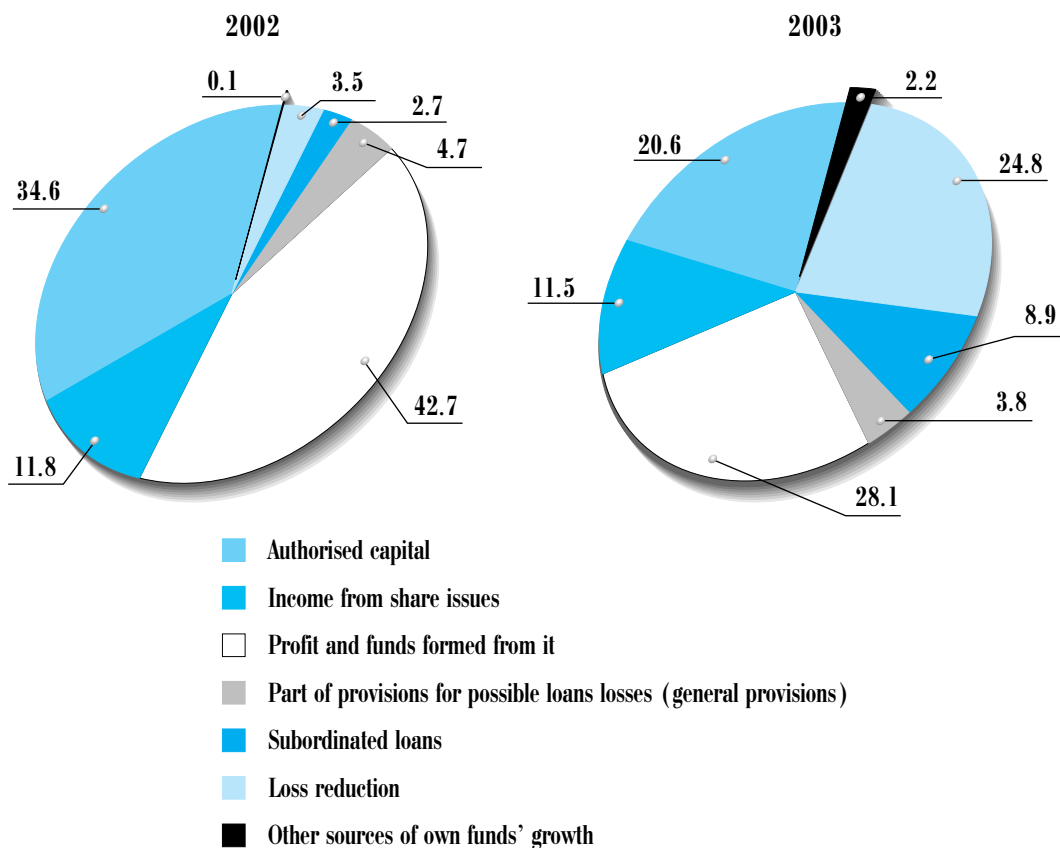


Chart 18

change and foreign currency valuables contracted to 1.8% from 8.8% in 2002 (taking account of the exchange rate differences). There

was a trend towards the expansion of the share of net commission income, which increased from 17.0% as of January 1, 2003, to 19.0% as of

January 1, 2004. The role of net commission income will increase probably due to a decrease of the banking margin.

As of January 1, 2004, the own funds (capital) of operating credit institutions amounted to 814.9 billion rubles, an increase of 40.2% year on year<sup>1</sup>. The ratio of banking sector capital to assets increased from 14.0% to 14.6% in 2003.

The increase in banking sector own funds (capital) in 2003 mainly resulted from growth in profits and funds formed from profit (28.1% of total growth in own funds), the reduction of banking sector losses (24.8%), increment in the paid-up capital of operating credit institutions, included in the own funds' calculation (20.6%) and income from placement of shares (11.5%). Other sources accounted for less than 15% of total capital growth.

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<sup>1</sup> Due to the revocation of the licence from AKB SBS-AGRO Bank, negative capital decreased dramatically (from —81.0 million rubles to —5.0 million rubles) and this resulted in capital growth of the banking sector as a whole. AKB SBS-AGRO capital excluded, banking sector capital grew 27.8%.

### I.3.2. OTHER FINANCIAL INSTITUTIONS

**INSURANCE COMPANIES.** According to Finance Ministry data, the total sum of insurance premiums received by 1,222 insurance companies that presented their statements for 2003 (1,193 as of January 1, 2003)<sup>1</sup>, amounted to 432.4 billion rubles, an increase of 144% on 2002 (as against an increase of 108.1% registered in 2002 as compared with 2001). Insurance indemnities totalled 284.5 billion rubles, an increase of 122.8% on the previous year (as against 127% in 2002). The per capita insurance premium rose to 2,998.6 rubles as of January 1, 2004, from 1,927.9 rubles as of January 1, 2002, and 2,096.3 rubles as of January 1, 2003. The aggregate authorised capital of insurance companies amounted to 52.9 billion rubles and in the year under review it tended to increase. The accelerated growth of the insurance market resulted from a rise in the demand for insurance services in the enterprise and household sectors, caused by the improved social and economic conditions, and the expanded range of insurance services on offer.

Voluntary insurance premiums accounted for the largest part of aggregate insurance premiums (76.2%). Year on year they increased 38.2% as against 0.7% in 2002. The biggest growth in insurance indemnities in 2003 was registered in property and liability insurance (60.1% and 36.3% year on year respectively), while the biggest increase in insurance premiums (43.8% as against a decrease of 25% in 2002) was registered in life insurance.

Compulsory medical insurance premiums accounted for the bulk of compulsory insurance premiums (71.5%), although compared to 2002, their share contracted by 23.7 percentage points as a result of the enforcement from July 1, 2003, of compulsory third party liability car insurance. As of the beginning of 2004, 154 insurance companies had licences to provide compulsory third

party liability car insurance and in 2003 compulsory third party liability car insurance premiums amounted to 24.9 billion rubles, or 24.2% of the total amount of compulsory insurance premiums) and indemnities 1.3 billion rubles, or 1.7% of total compulsory insurance indemnities).

The improved ratio between insurance indemnities and premiums (65.8% as of January 1, 2004, as against 77.1% as of January 1, 2003) showed that in 2003 insurance was a more profitable business than in 2002. Bank deposit accounts and securities<sup>2</sup> were the principal investments made by insurance companies in 2003.

The adoption of the federal law that amended the Federal Insurance Law and invalidated some other Russian laws was a major event in 2003. Drafted in compliance with the requirements of international insurance law, the amended document gave more accurate definitions of the insurance market and insurance licensing procedure, set requirements for the minimum paid-up authorised capital of insurance companies and provided for their specialisation and the facilitated access of foreign capital to the Russian insurance market.

**UNIT INVESTMENT FUNDS (PIFs).** The favourable situation on the stock market, fall in interest rates on bank deposit accounts and the ruble's rally against the dollar contributed to the accelerated growth of PIFs in 2003<sup>3</sup>. As in 2002, growth in the share value registered by most PIFs in 2003 allowed shareholders not only to protect their savings against inflation, but also receive greater incomes than they would have received from investments in bank deposit accounts.

According to the National Managers League, the number of PIFs rose by 76 in the period under review (in 2002, it increased by nine) to 136 as of January 1, 2004. Eighty-seven of them were open-end PIFs (an investment shareholder may

<sup>1</sup> As of January 1, 2004, 1,397 insurance companies were registered in the Finance Ministry's State Insurers Register (against 1,408 as of January 1, 2003).

<sup>2</sup> According to data from surveys conducted by the Russian Government's Centre for Economic Studies.

<sup>3</sup> All figures here and below apply to PIFs that have been completely formed.

demand the managing company to redeem his shares on any business day), 35 interval PIFs (the above right is exercisable within the term established by the rules of the trust management fund) and 14 closed-end PIFs (the above right may not be exercised before the expiry of the fund's term, except in cases stipulated by law).

By the end of 2003, there were seven fully-fledged PIFs, which were not previously represented on the market although they belonged to the categories permitted by law (money market funds, venture investment funds, real estate funds and index funds). Thus, by the beginning of 2004, there were seven categories of PIFs, which included 44 stock funds (there were 24 a year earlier), 24 bond funds (10), 61 mixed investment funds (26), four real estate funds, one index fund, one money market fund and one venture investment fund. The changes in the structure of PIFs by category led to more financial instruments being put on offer for investment and helped popularise collective investment instruments.

As in 2002, the biggest growth in 2003 was registered in the number of open-end PIFs, which increased from 32 to 87 (in 2002, their number rose from 28 to 32). The number of interval funds grew by 10 and closed-end funds by 11. The accelerated growth in the number of open-end PIFs was largely due to their success with investors, who appreciated the opportunity to withdraw their money from these funds quickly. As for exchange trade in shares, which allowed restrictions on the purchase and sale of the shares of interval and closed funds to be lifted, more than 200 deals with shares in seven PIFs were struck on MICEX in 2003 worth a total of 95 million rubles. In addition, several deals with PIF shares were struck on the RTS. The underdevelopment of the secondary market for PIF shares is largely the result of the sluggishness of managing companies and their reluctance to go to additional expense to participate in trade.

PIFs' aggregate net asset value amounted to 77.2 billion rubles as of January 1, 2004, an increase of 6.1 times on the same date in 2003 (2002 growth stood at 40.3%). However, it remained negligent compared to the value of bank deposit accounts. At the beginning of 2003, PIFs' aggregate net asset value accounted for about 1%

of the aggregate balance of personal and corporate deposit accounts, whereas at the beginning of 2004 its share stood at 4.2%.

Closed-end PIFs accounted for nearly 80% of growth in PIFs' aggregate net asset value in 2003, whereas in 2002 it was the interval unit investment funds that accounted for most of the increment (about 50%) in PIFs' aggregate net asset value. At the same time, closed-end PIFs do not yet have a long financial history, as the establishment of 11 out of 14 PIFs was not completed until 2003. In addition, while accounting for 67.8% of PIFs' aggregate net asset value as of the beginning of 2004, closed-end PIFs were practically inaccessible to small shareholders owing to some specifics. In 2003, the aggregate net asset value of PIFs other than closed-end PIFs increased by 2.1 times, while its average per PIF value (calculated in a similar way) even decreased a little during that period (from 208.6 million rubles as of January 1, 2003, to 203.8 million rubles as of January 1, 2004).

The majority of big closed-end PIFs were in the stock fund category and, therefore, growth in their assets led to the expansion of the share of stock funds in the aggregate net asset value. In 2002, stock funds of all kinds accounted for 76.9% of the aggregate net asset value (of which closed-end stock funds accounted for 6.4%), whereas in 2003 their share expanded to 85.8% (and that of the closed-end stock funds increased to 64.2%). Mixed investment funds accounted for 19.5% of PIFs' aggregate net asset value as of January 1, 2003, and 8.3% as of January 1, 2004 (of these, closed-end funds accounted for 0.5%).

Managing companies adopted a wide range of strategies to attract shareholders. The number of such companies rose by 47 in 2003 to 129 as of January 1, 2004, of which 52 managed PIFs. Some PIFs reduced the initial share payment, widened the network of regional outlets that issue and redeem shares and reconsidered, partly or wholly, their investment strategies. However, these changes primarily affected the most financially sound PIFs and, therefore, had little effect on the collective investment market as a whole.

**NON-GOVERNMENTAL PENSION FUNDS (NPFs).** According to the Labour Ministry's Inspec-

torate for Non-governmental Pension Funds, own assets of 283 operating NPFs amounted to 125.6 billion rubles as of January 1, 2004, an increase of 196.9% on January 1, 2003, when there were 284 operating NPFs. Of this, pension reserves, made up mostly of members' contributions, aggregated 89.6 billion rubles (a growth of 173.7%). The value of property required for the implementation of the authorised activities by the NPFs, most of which is made up of founders' contributions, trebled in the period under review and stood at 31.5 billion rubles, accounting for 34.3% of growth in the aggregate value of NPFs' own property. The value of investments made from pension reserves and property for the purpose of conducting authorised activities totalled 116.5 billion rubles as of January 1, 2004, an increase of 56.3 billion rubles, or 93.5%, on the same date a year earlier.

The total number of NPF members exceeded 5 million as of January 1, 2004, against 4.5 million as of January 1, 2003, but it was just 7.2% of the country's economically active population (6.3% as of January 1, 2003). A total of 428,000 people were receiving an additional non-government pension as of January 1, 2004 and although this represents an increase of 20% on a year earlier, it is still negligible compared with the total number of pensioners. In January—September 2003, the average monthly pension in the NPFs was 2.5 times smaller than in the compulsory pension insurance system (in the same period of 2002, it was 3.2 times smaller). Thus, the social role of the NPFs remained virtually unchanged in 2003. To make NPFs more attractive, the government lifted from January 1, 2004, the individual income tax on pension contributions if the employer paid them within the amount of 5,000 rubles a year per person (previously pen-

sion contributions up to 2,000 rubles a year were exempt from tax)<sup>1</sup>.

As in the previous year, the dynamics of the NPF market in 2003 were predetermined by the largest NPFs, mostly corporate ones, which sought not only to make pension provisions for their staff, but also finance current and long-term production programmes of the founding companies. This policy told on the structure of the NPFs' overall investment portfolio. As of October 1, 2003, shares and bonds accounted for 52.2% of the 66.2 billion rubles of invested pension reserves (against 52.9% of 42.9 billion rubles as of the same date in 2002); promissory notes accounted for 16.3% (against 16.1%) and bank deposits 15.2% (against 14.8%). As of October 1, 2003, NPFs had allocated 8.2% of pension reserves for the purchase of government securities as against 10.7% as of the same date in 2002. Securities issued by founders and members accounted for 29.4% of pension reserves invested by NPFs as of October 1, 2003.

The procedure for the NPFs' participation in the compulsory pension insurance system was finalised in the course of preparations for and implementation of the pension reform in 2003<sup>2</sup>. More stringent requirements have been made for the aggregate contribution of the NPF founders and their experience, length of work and current financial standing. To make NPFs more secure financially, the Russian authorities adopted a new regulation on licensing the NPFs' pension and pension insurance activities<sup>3</sup>. Under this Regulation, to receive a licence, an NPF must have at the time of submitting the required documents a property worth at least 3 million rubles (from January 1, 2005, the property requirement will be at least 30 million rubles and from July 1, 2009, 50 million rubles)<sup>4</sup>.

<sup>1</sup> Federal Law No. 163-FZ, dated December 8, 2003, "On Amending Some Russian Federation Laws on Taxes and Duties."

<sup>2</sup> Federal Law No. 14-FZ, dated January 10, 2003, "On Making Amendments and Addenda to the Federal Law 'On Non-governmental Pension Funds.'"

<sup>3</sup> Russian Federation Government Resolution No. 735, dated December 5, 2003.

<sup>4</sup> Federal Law No. 163-FZ, dated December 8, 2003, "On Amending Some Russian Federation Laws on Taxes and Duties."

### 1.3.3. FINANCIAL MARKETS

#### INTERBANK LOAN MARKET

The main aspect of the interbank loan market in 2003 was that it further stabilised. As the financial standing of credit institutions improved and they came to trust one another more, the principal factor of the Russian interbank loan market in 2003 was the ruble's nominal gains against the US dollar. Growth in the ruble liquidity of commercial banks and the reduced attractiveness of short-term foreign currency assets for investors caused a slight fall in the demand for ruble interbank loans, while interest rates continued to fall.

The total value of Russian banks' funds put into interbank loans fell slightly in 2003 due to a noticeable decrease in funds placed into foreign currency interbank loans. The debt on interbank loans in the ruble segment of the market kept on growing.

The continued improvement of the financial standing of Russian banks and the reduction of the risks involved in extending loans to them had a favourable effect on the quality of the interbank loan portfolio. For most of 2003, overdue debt in the total value of interbank loans extended to resi-

dent banks contracted and by the end of the year it stood at 2.7% as against 4.6% a year earlier.

The average monthly rates on overnight ruble loans ranged from 1.5% to 10.2% p.a. in 2003 as against 4.4% to 15.1% in 2002. In 2003 Q3, there was a local rise in interest rates, connected with the temporary halting of the ruble's rise, but in 2003 Q4, interbank interest rates continued to decline.

The fall in ruble interbank interest rates was accompanied by a significant decrease in interest rate volatility and interest rates became more predictable. A tendency towards the reduction of intramonth cyclic interbank interest rate variations emerged. The stabilisation of the interbank loan market was facilitated by the expansion of the Bank of Russia presence on the money market (the Bank of Russia conducted operations to absorb surplus liquidity and refinance commercial banks) and the decline in interest rates in other segments of the money market.

The influence of the fluctuating conditions of the world financial market on Russian banks' interbank foreign currency loan and deposit opera-

OFFERED AND ACTUAL INTEREST RATE DYNAMICS  
OF OVERNIGHT INTERBANK RUBLE LOANS IN 2003 (% p.a.)

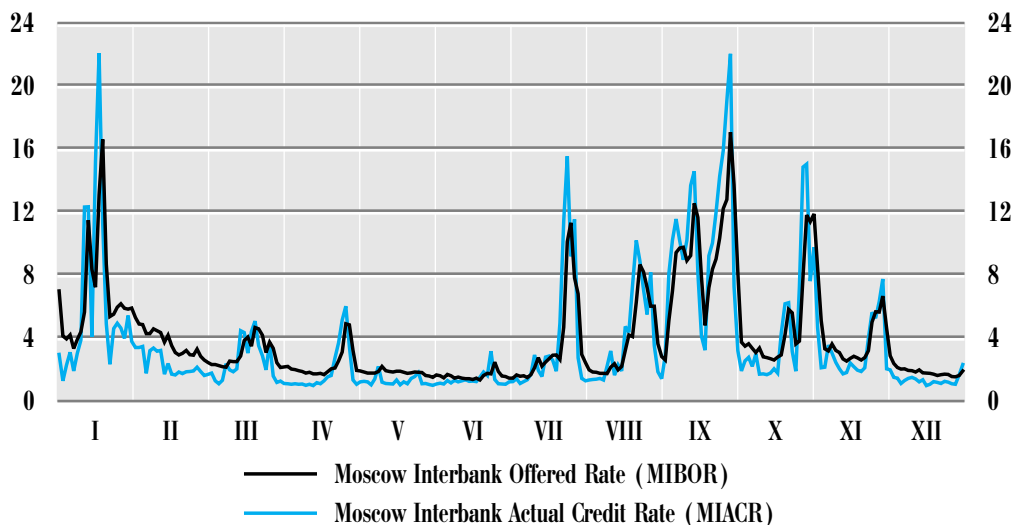


Chart 19



tions decreased a little in 2003. Although for most of the year interest rates on Russian banks' dollar interbank loans were close to world money market rates, in some periods, especially in the last 10 days of the month, significant differences were registered as the demand for short-term foreign currency resources grew on the domestic market.

The nominal strengthening of the ruble against the US dollar made borrowing on the world market increasingly attractive. Throughout last year

Russian banks remained net borrowers on the world market and the excess of the funds borrowed from non-resident banks over the funds lent to non-resident banks had a tendency to grow.

In 2003, as in the previous years, most of the interbank lending operations were conducted in Moscow and the Moscow Region. Significant volumes of interbank lending were also registered in the Northwestern, Volga and Urals Federal Districts.

### FOREIGN EXCHANGE MARKET

The situation on the domestic foreign exchange market in 2003 was affected by growth in foreign currency receipts from exports and significant inflow of investments, including foreign loans to enterprises in the real sector. It should be noted that the demand for foreign exchange, which was determined by factors such as payments for imports of goods and services and considerable payments on corporate foreign debt, lagged far behind supply and this led to a 7.3% fall in the nominal rate of the US dollar against the ruble in 2003.

Taking into consideration the dynamics of the fundamental economic factors, the Bank of Russia sought to prevent the emergence of a tendency towards significant growth in the nominal rate of the ruble against the US dollar. As the supply of foreign exchange constantly exceeded demand, the Bank of Russia was the net buyer of foreign exchange on the domestic market for most of the year and the prices it quoted for the purchase of foreign currency served as the most important guide for the market exchange rate dynamics.

The dynamics of operation volumes on the domestic foreign exchange market were influenced by two major factors: the increase of the current account surplus and the reduction by credit institutions of their long currency positions.

A massive inflow of foreign exchange to the Russian economy, stimulated by a favourable world market situation, led to the further expansion of the aggregate turnover of conversion transactions. As in the previous years, the currency

structure of the interbank market was dominated by ruble/dollar deals, which reflected the leading role played by the US dollar in international settlements. At the same time, euro trade turnovers grew at rapid rates, reflecting the increased interest in the European currency on the part of

RUBLE / DOLLAR EXCHANGE TURNOVER STRUCTURE IN 2003  
(excluding currency swap transactions, %)\*

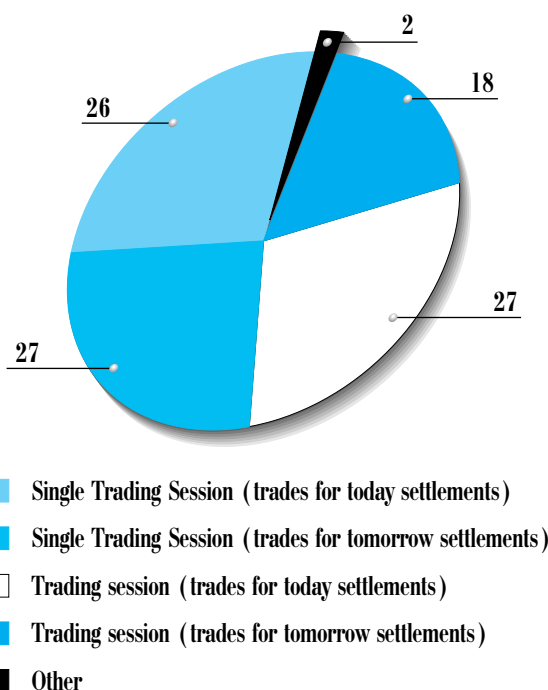


Chart 20

\* Based on MICEX data, taking into account STS trading.

both credit institutions and their customers, including private individuals. The average daily interbank ruble/euro trade turnover rose by 2.3 times in 2003 to the equivalent of 122.6 million US dollars.

The average daily ruble/dollar spot trade turnover on the interbank market in 2003 almost trebled compared to 2002 and reached \$12.7 billion. The average daily US dollar/euro spot trade turnover stood at about \$3 billion.

The overall volume of ruble/dollar exchange operations more than doubled<sup>1</sup> in 2003 compared to 2002, while operation volumes at the Single Trading Session (STS) increased by 2.8 times. The main reason for growth in exchange trade turnovers was the upgrading of the clearing mechanism (the requirement to make a 100%

deposit in advance of a transaction was abolished). The aggregate volume of transactions in ruble/euro exchange operations rose by 1.3 times in 2003.

Turnovers in the forward exchange segment of the foreign exchange market remained small owing to legislative problems with financial derivatives. The principal trading floors for futures contracts were, as before, the Moscow Interbank Currency Exchange (MICEX) and St Petersburg Currency Exchange (SPCEX). The value of average daily US dollar open positions of MICEX and SPCEX traders rose from \$6.5 million in 2002 to \$29.7 million in 2003. The average daily ruble/dollar forward over-the-counter foreign exchange market turnover stood at about \$66 million.

## GOVERNMENT SECURITIES

**G**KO—OFZ MARKET. The situation on the government bond market in the period under review was affected by the domestic debt management policy pursued by the Finance Ministry and the overall monetary situation connected with the inflow of liquidity to the banking sector. At the end of the year, the Moody's rating agency's decision to raise Russia's sovereign rating to investment grade became an additional factor of demand for government securities.

The nominal value of outstanding government securities (couponless short-term government bonds, or GKO, and federal loan bonds, or OFZ) increased 45.0% in the period under review and as of the end of 2003 it stood at 314.6 billion rubles. GKO—OFZ yield fell by 5.7 percentage points to 7.8% p.a. and average daily trade turnover expanded 61% year on year to 950.1 million rubles.

Two periods can be singled out in the development of the situation on the GKO—OFZ market on the basis of the yield dynamics of government securities.

In the first half of 2003, the increased demand for financial assets, caused by a massive inflow of foreign currency receipts from exports, led to the improvement of borrowing conditions and became the principal factor of growth in investor interest in government securities. The inflow of money to the GKO—OFZ market was caused, among other things, by the opportunity to make profits on short-term operations. As investors actively bought government securities, operations with ruble-denominated assets became increasingly attractive. The ruble's gradual nominal rise against the US dollar, a process controlled by the Bank of Russia, contributed to investment growth in all segments of the domestic financial market, causing a fall in yields on the instruments denominated in the national currency.

The decline in interest rates on domestic government debt instruments encouraged the Finance Ministry to step up its bond issuing activity and in the first half of 2003 the total value of borrowings in the process of primary GKO and OFZ bond placements amounted to 86.7 billion rubles.

<sup>1</sup> The calculation of this indicator included MICEX turnovers taking into account STS trading.

In the latter half of 2003, the GKO—OFZ yield steadied as market participants' activity declined and the value of funds raised by the Finance Ministry fell to 24.4 billion rubles compared to the first half of the year. The main reasons for the halting of growth in quoted prices were the reduction of demand for government securities, which became less attractive for speculators, and the negative level of real interest rates, established as a result of growth in government bond prices at the beginning of 2003.

In the period under review, the Finance Ministry and Bank of Russia continued to work together in implementing the policy of extending market duration and floating big indicative issues, which serve as a price guide for funds attracted for various terms. The expansion of the nominal value of the domestic government debt market was largely due to the placement of debt depreciation federal loan bonds (OFZ-AD) and for the first time since 1998 investors were offered long-term government bond issues.

Twenty-eight auctions of GKO and OFZ bonds were held in 2003 and the total value of borrowings topped 111 billion rubles, not counting operations on the secondary market.

In 2003, the Finance Ministry reduced the share of additional government securities sales in the total value of borrowed funds. A significant rise in the demand for ruble assets brought the yield to acceptable levels for the issuer even dur-

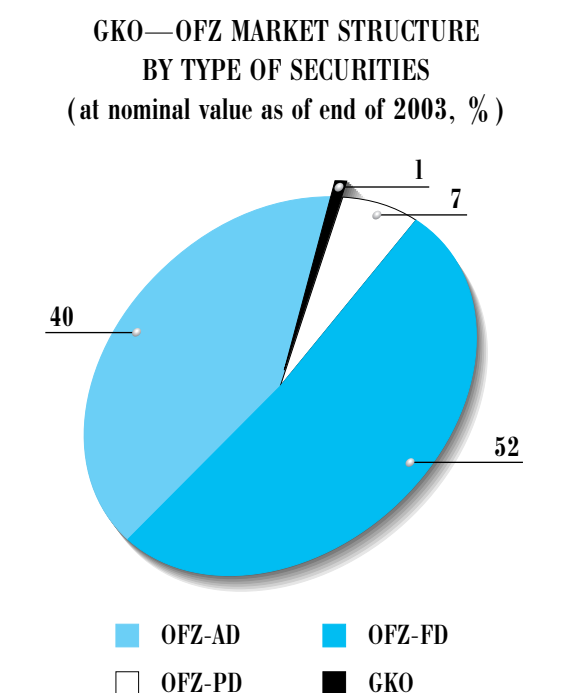


Chart 21

ing the primary placement of government bonds and this allowed the Finance Ministry to meet investors' bids practically without any premium to market rates.

The efforts made to promote the use of domestic government debt instruments seriously affected the market turnover structure: in the period under review, transactions with OFZ-AD, the largest and most liquid government bond is-

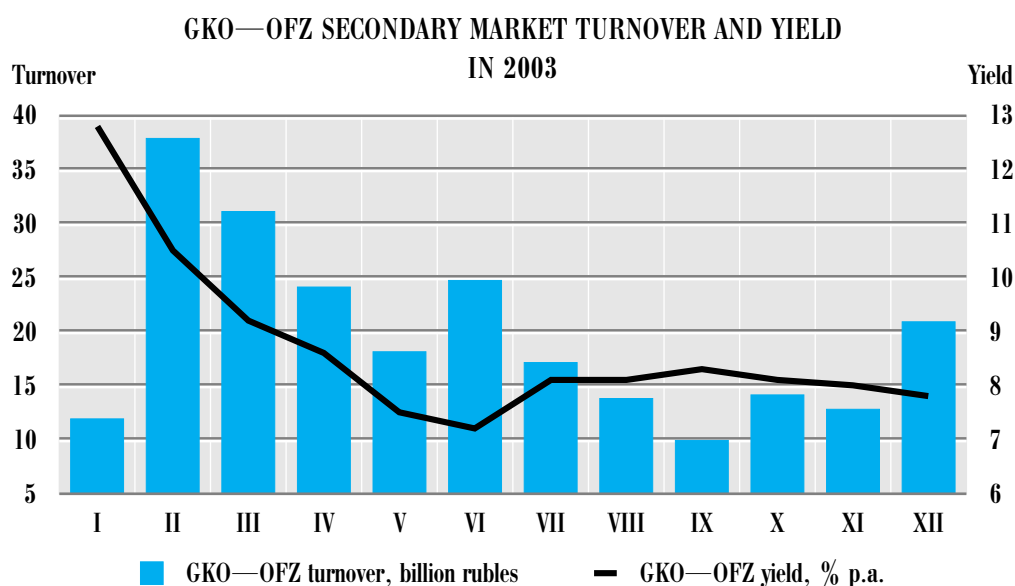


Chart 22

sues, accounted for more than half of the total trade volume.

The enforcement of new regulations, which gave market participants broader opportunities to borrow through inter-dealer repo transactions, was an important step in the development of the domestic government debt market.

Dealers (the professional securities market participants who have concluded an agreement with the Bank of Russia on performing dealer functions on the government securities market and have the right to strike deals with bonds on their own behalf for their own account and on the instructions of investors for the account of the latter) remained the owners of the largest portfolio of government securities in 2003. One should bear in mind here that a high concentration of government securities in the portfolios of several major market participants, who invest for the long term to receive investment income, is a factor restraining growth in liquidity on the domestic borrowing market, because the turnover of bond issues in their portfolio is close to zero.

The GKO—OFZ bond portfolio owned by foreign market participants continued to contract. In the period under review, the non-resident share of the GKO—OFZ market decreased from 7.0% to 1.17% at nominal value. Most of non-resident operations were speculative. Bank of Russia Ordinance No. 1319-U, which lifted restrictions on the repatriation of foreign market participants' incomes, came into force in September. It allowed non-residents freely to withdraw from C-type accounts their proceeds from operations on the GKO—OFZ market. Taking into consideration that the Bank of Russia has consistently liberalised the C-type account regime during the entire post-crisis period, the above ordinance did not provoke any massive sales of government bonds by non-residents.

The decrease of interest rates on government securities in 2003 was one of the reasons for the reduction in the cost of raising funds on the corporate market and this led to the expansion of the range of issuers, especially enterprises in the real sector. The policy pursued by the Finance Ministry and Bank of Russia on the GKO—OFZ market allowed the corresponding instruments of monetary regulation to be used more energetically

and this made the management of banking sector liquidity more effective.

**REGIONAL AND MUNICIPAL GOVERNMENT BOND MARKET.** Twenty-four constituent entities of the Russian Federation and seven municipalities registered their bond issues with the Finance Ministry in 2003 (as against 20 constituent entities and five municipalities in 2002). Primary regional bond placements were made in the exchange and over-the-counter segments of the stock market. MICEX consolidated its dominant position in the exchange segment. In 2003, 16 regional issuers (in addition to Moscow) floated 23 issues of their bonds on MICEX.

Growth in the nominal value of the regional government securities market was largely due to the issue of Moscow government bonds. In the period under review, the Moscow government placed by auction on MICEX internal municipal loan bonds (OGOZ) with a nominal value of 22.9 billion rubles (against 8.9 billion rubles in 2002). The average annual auction yield of OGOZ bonds fell by 6.5 percentage points year on year to 10.5% p.a. In 2003, the Moscow government resumed the issue of savings loan bonds, which were floated on the over-the-counter market and were allowed for placement on the MICEX secondary market. The overall volume of secondary trade in Moscow government bonds on MICEX increased by five times compared to 2002 to 93 billion rubles.

St Petersburg's government securities in 2003 were represented by government registered bonds (GIO), government savings registered bonds (GSO) and medium-term government bonds (SGO). The total nominal value of GIO bond placements at primary auctions on the SPCEX amounted to 3.3 billion rubles in the period under review as against 3.0 billion rubles in 2002.

In addition to the principal bond issuers (Moscow and St Petersburg), significant bond placements were made by the governments of the Khanty-Mansi and Yamal-Nenets Autonomous Areas, the Moscow, Novosibirsk and Samara Regions and the Krasnoyarsk Territory. Dynamic growth of the primary market boosted operations on the secondary regional government bond market. The aggregate turnover of secondary trade in regional government bonds on the principal

trading floors expanded significantly in the period under review and totalled 138 billion rubles. MICEX consolidated its leading position in terms of trade turnover and the number of traded regional government debt instruments. Moscow government bonds accounted for the largest part of the exchange's trade volume and a high level of activity was registered in trade in government bonds of the Moscow Region, the Khanty-Mansi Autonomous Area, Komi Republic and some other territories. The effective yield of regional government bonds declined on the secondary market as GKO—OFZ yields fell.

#### RUSSIAN FOREIGN CURRENCY DEBT MARKET.

The Russian government's bonded foreign debt in 2003 was represented by the following financial instruments denominated in foreign currency:

- 1) Finance Ministry foreign loan bonds, including
  - eurobonds placed in 1997—1998 by open subscription and due in 2003—2028;
  - eurobonds issued in 2000 during the restructuring of debt to the London Club of commercial bank creditors and due in 2010 and 2030;
  - bonds issued in 1998 during the restructuring of GKO and OFZ bonds and due in 2005 and 2018;
- 2) Series IV—VII domestic government foreign currency loan bonds (OVGVZ) issued in 1993 and 1996 and due in 2003—2011 and government foreign currency loan bonds (OGVZ) issued in 1999 during the restructuring of Series III OVGZ bonds due in 2007.

According to Finance Ministry data, the total nominal value of the above bonds stood at \$46.2 billion as of the beginning of 2003. The Russian government did not issue any new debt instruments denominated in foreign currency in 2003. Last year, it redeemed two eurobond issues denominated in Italian lira and US dollars and placed in 1998 and Series IV OVGZ bonds issued in 1993. The sum it paid on the principal amount of debt on these instruments stood at \$3.7 billion.

Coupon income payments on all issues of foreign currency-denominated bonds were effected in full and on schedule. The total amount of interest payments stood at \$3.0 billion.

#### VOLUMES OF RESIDENT OPERATIONS WITH NON-RESIDENTS TO BUY AND SELL OUTSTANDING RUSSIAN GOVERNMENT FOREIGN CURRENCY DEBT OBLIGATIONS ON THE SECONDARY MARKET IN 2003 (at market prices, billion US dollars)

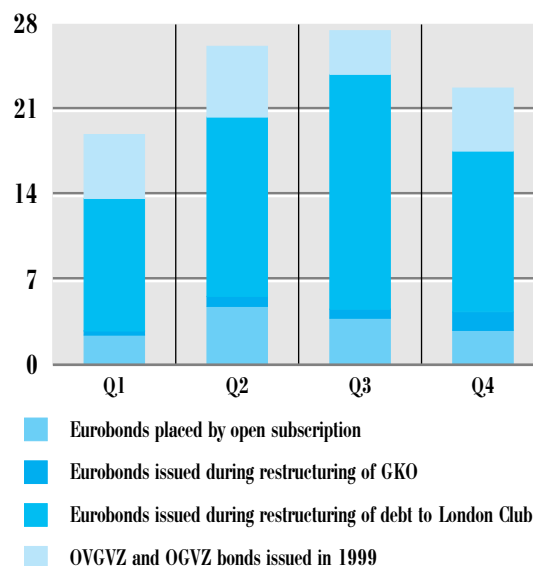


Chart 23

The bulk of Russia's foreign currency bonds continued to be traded on the wholesale international over-the-counter market for the debt instruments of emerging market countries.

In the period under review, investors conducted operations with Russia's US dollar-denominated eurobonds on the domestic organised securities market. The prices of these instruments on the domestic market corresponded to those on the international market. The value of transactions at actual prices amounted to \$35.6 million on MICEX and \$2.3 million on RTS. The small volumes were partly due to the fact that as the ruble strengthened against the dollar, the yield of the Russian government's foreign currency-denominated debt instruments for most of the year was lower than the comparable yield of the ruble-denominated federal loan bonds.

The situation on the foreign currency bond market was affected by the continued growth of the Russian economy, the significant increase in the country's international reserves, the success with which the Russian government had negotiated the peak of foreign debt payments and the

continuing high world oil prices. The improvement of the country's solvency allowed international rating agencies to upgrade Russia's long-term sovereign rating and the ratings of Russia's foreign currency debt instruments.

The yield of Russian foreign currency-denominated debt instruments tended to decline in 2003. The average annual offered yield of OGVZ and OGVZ bonds in 2003 stood at 5.6% p.a. as

against 9.2% p.a. in 2002 and the average annual offered yield on the Russian government's dollar-denominated eurobonds fell in that period from 5.7% p.a. to 8.3% p.a. The brief periods of stabilisation and decline in quoted market prices and the corresponding growth in yields registered in the second half of the year were connected with the fluctuating conditions on world stock markets.

## SECURITIES OF CREDIT INSTITUTIONS

The bank promissory note market continued to expand dynamically in 2003 and the value of ruble-denominated notes issued by banks rose by 1.3 times to 335.9 billion rubles as of January 1, 2004. In the period under review, bank ruble notes were used most frequently as a means of payment and an instrument of short- and medium-term investment and the fall in the average weighted maturity of ruble promissory notes issued by banks bears this out. Bank notes and other instruments of the financial market demonstrated similar yield dynamics during the year.

To promote money market instruments, the Bank of Russia registered 100 certificate of deposit issues and 10 savings certificate issues. As in 2002, credit institutions based in the Moscow Region accounted for most of the certificate issues in terms of value (443 billion rubles). At the same time, the value of certificates sold in the Moscow Region increased by 2.3 times year on year.

The tendency towards decline in the overall value of securities issued by credit institutions continued in 2003.

In the period under review, the Bank of Russia registered 300 share issues worth 41.4 billion rubles, whereas in 2002 it registered 336 share issues with a total value of 52.1 billion rubles.

Owing to the expansion of authorised capital, 268 additional share issues worth 34.6 billion rubles were registered in the period under review, of which six issues worth 2.6 billion rubles were registered in connection with the enlargement of credit institutions through mergers as against

three issues worth 200 million rubles registered in 2002.

Six share issues worth 1.4 billion rubles were registered when credit institutions were set up as joint-stock companies.

Nine share issues worth 2.8 billion rubles were registered in 2003 as credit institutions were reorganised from limited liability companies into joint-stock companies, whereas 43 share issues worth 9.2 billion rubles were registered in 2002 and 67 share issues worth 63.9 billion rubles were registered in 2001. These figures show that the number of cases when credit institutions are transformed from limited liability companies into joint-stock companies has decreased.

Seventeen share issues worth 2.6 billion rubles were registered in connection with the change in nominal value and consolidation, dilution and conversion of shares. The highest levels of the share-issuing activity of credit institutions was registered in Moscow, St Petersburg, the Irkutsk, Nizhni Novgorod, Rostov, Samara and Saratov Regions, the Stavropol Territory and the Republic of Bashkortostan, Republic of Tatarstan and Republic of Sakha (Yakutia).

Three credit institutions floated share issues worth more than one billion rubles each to the total amount of 5.5 billion rubles in 2003, whereas in 2002 seven credit institutions floated share issues worth more than one billion rubles each to the total amount of 16.2 billion rubles.

In 2003, credit institutions registered 17 bond issues with a total nominal value of 12.2 billion rubles. Most of the issuers were large banks based

in the Moscow Region. Four credit institutions floated bond issues worth 6.0 billion rubles, or 49% of the total value of registered bond issues. There are no medium-sized and small banks on the bond market because they have inadequate own funds (capital) and, as a consequence, their debt obligations on the open market are in low demand.

Several amendments to the Federal Securities Market Law came into force in the year under review, bringing about significant changes in the share-issuing procedure and the contents of registration documents of the share-issuing credit institutions and making the activities of such institutions more transparent for investors.

In pursuance of Article 2 of Federal Law No. 185-FZ, dated December 29, 2002, "On Amending the Federal Securities Market Law and the Federal Law on Non-Commercial Organisations," the Bank of Russia in the period from June 1 to 30, 2003, unified 72 securities issues of credit institutions and changed the state registration numbers of 415 securities issues of credit institutions.

When fulfilling their supervisory functions, the Bank of Russia and its regional branches constantly monitored the activities of share-issuing credit institutions to ensure that the latter pro-

vide complete information in their share issue documents, comply with the legislative and regulatory requirements for the share issuing procedure and disclose information on substantive events relating to their activities in order to protect shareholders' rights.

Credit institutions conducted primary bond placements in 2003 mainly by directly selling bonds at auctions, held on organised trading floors, and most such auctions were held on MICEX. To enhance the efficiency of placing new bond issues, banks enlisted underwriters and financial consultants. The parameters of bank bond issues took into account investors' current needs and early redemptions were possible.

Bank share prices on the secondary market tended to rise in 2003, while overall trading volumes contracted in the period under review. The trade in bank shares contracted to about 2% of the total volume of secondary trade on MICEX and RTS. Bank bonds remained in demand on the secondary market. The trade in bank bonds in 2003 accounted for about 8% of the total volume of secondary trade in corporate securities on MICEX and RTS. The yield dynamics of the most liquid bank bonds were similar to the yield dynamics of government bonds with the same maturities.

### NON-FINANCIAL SECTOR CORPORATE SECURITIES MARKET

The Russian stock and corporate bond market grew dynamically in 2003 due to positive macroeconomic developments and the improved financial standing of most of the major issuing companies. Operations with corporate securities were conducted in the exchange and over-the-counter segments of the stock market. MICEX and RTS accounted for the bulk of exchange operations with these instruments. Using the advanced infrastructure of the Russian securities market, regional market participants intensified their operations on the major exchange floors. The most active operations with corporate securities were conducted by regional market participants on MICEX through the stock sections of seven currency exchanges. The biggest of them

in volume terms were the stock sections of the Siberian Interbank Currency Exchange, the St Petersburg Currency Exchange and the Samara Interbank Currency Exchange. Another factor that contributed to the stock market's dynamism was that market operators, including regional ones, could use remote terminals and Internet trading in conducting operations.

Primary **share** issues were usually floated on the over-the-counter market by open or closed subscription. Secondary trade turnovers grew significantly on the Russian organised stock market in the period under review. As before, the shares of electric-power and fuel companies accounted for the largest share of the exchange trade volume.

### MICEX SHARE TRADING DYNAMICS IN 2003

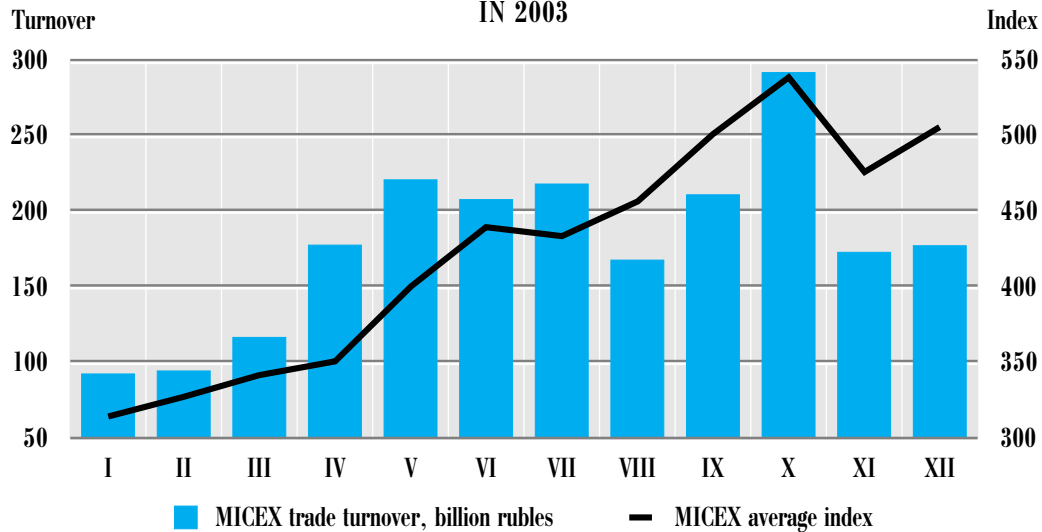


Chart 24

The MICEX index rose by 61% and the RTS index gained 58% in 2003. The capitalisation of the RTS stock market amounted to \$158 billion as of the end of the period under review, which represents an increase of 71% on the previous year. Market prices remained highly volatile, however.

**Corporate bonds** continued to play a greater role in financing the real sector of the Russian economy in 2003. Growth in the key branches of the economy encouraged enterprises to attract investments in the form of bond loans. Corporate bond loans remained attractive for investors as the dynamics of incomes of institutional investors and private individuals were positive, while the yield of government bonds, which represent a major risk-free alternative to corporate bonds, continued to decline. Eighty-four corporate bond issues with a total value of 78 billion rubles were floated on MICEX in the period under review, an increase of 60% on the previous year.

Bonds were floated mostly at exchange auctions (MICEX) with the participation of financial intermediaries, such as organisers, underwriters and payment agents for the placement of corporate bonds, a role usually played by banks. The active floating of new corporate bond issues stimulated activity on the secondary corporate bond market.

The MICEX corporate bond secondary trade turnover grew by 3.5 times in 2003 year on year

and totalled 252 billion rubles. The yield of corporate bonds on the secondary market varied due to changes in the financial condition of the issuers that entered the market and the general situation and state of banking sector liquidity.

Various sectors of the economy were represented in secondary trade in corporate bonds on MICEX in 2003, but the leaders in the trade in debt instruments were enterprises in the fuel sector, diamond mining industry, metallurgy sector and electric-power industry.

The over-the-counter corporate securities market mainly expanded in its segment of shared securities and its development was determined by the scale of transactions that involved the transfer of ownership rights to large blocks of shares, including transfers in the privatisation of state property, and the extent to which strategic investors enlarged their share blocks at the expense of minority shareholders, usually workers and employees of the share-issuing companies. In addition, the over-the-counter market was used for conducting operations with securities to create larger blocks of securities that met the requirements of exchange trade. The specific feature of the corporate bond market is that it is developing mainly in its exchange segment, because the primary placements of most bond issues take place on the organised market and it is convenient to conduct transactions with them on the secondary market by using exchange depositories.



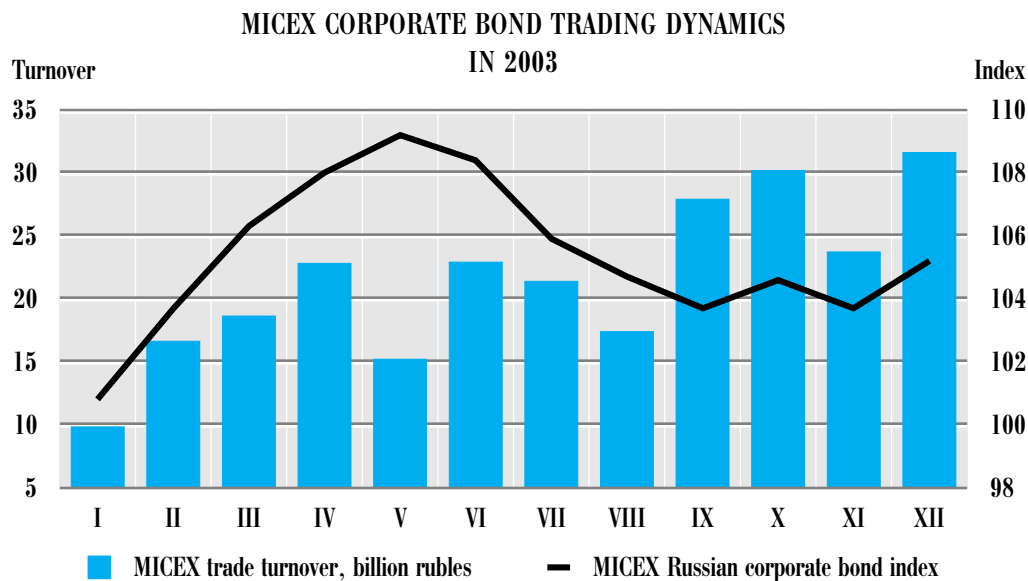


Chart 25

The situation on the **non-bank promissory note** market in 2003 was determined by borrowers' needs in medium-term financial resources and influenced by the adjacent sectors of the financial market. Although promissory notes continued to be gradually replaced by corporate bonds in the period under review, owing to the suspen-

sion of promissory note programmes by some leading non-financial issuers, notes were widely used as a financial instrument performing settlement functions. At the same time, the importance of promissory notes as an instrument of payment declined as the monetisation of the Russian economy increased.

### DERIVATIVES MARKET

The rapid rates of growth in the non-financial sector of the economy and stock market led to the expansion of trading volumes and diversification of contracts on the financial derivatives market. The aggregate futures and options trade turnover on the principal floors increased by more than 2.5 times in 2003 year on year and equalled about 300 billion rubles. Market growth rates were slower than in the previous year.

Growth in the derivatives market turnovers in 2003 was accompanied by changes in the structure of trade in forward exchange instruments. Stock futures trade was the most developed segment, accounting for 66% of the total market turnover. The options segment grew at the most rapid rate in 2003 and its share of the forward exchange contract market expanded to 29% from

1% in 2002. As for the currency segment of the market, which accounted for over 3% of the total trade volume, the volume of trade in euro futures expanded significantly, while the volume of dollar futures trade remained virtually unchanged. The share of commodity futures, a new segment of the market, slightly exceeded 1%.

While the ruble's exchange rate dynamics remained stable and predictable and trading activity in the foreign exchange segment of the market declined, the stock futures segment, especially FORTS, the floor on which futures for the shares of major Russian issuers were actively traded, expanded. A new segment appeared on the stock futures market — futures for the Moscow internal loan bonds, interest in which was stimulated by the development of the basic asset market. Market players were also offered futures contracts

TRADE IN FUTURES CONTRACTS FOR BASIC ASSETS IN 2003 (billion rubles)

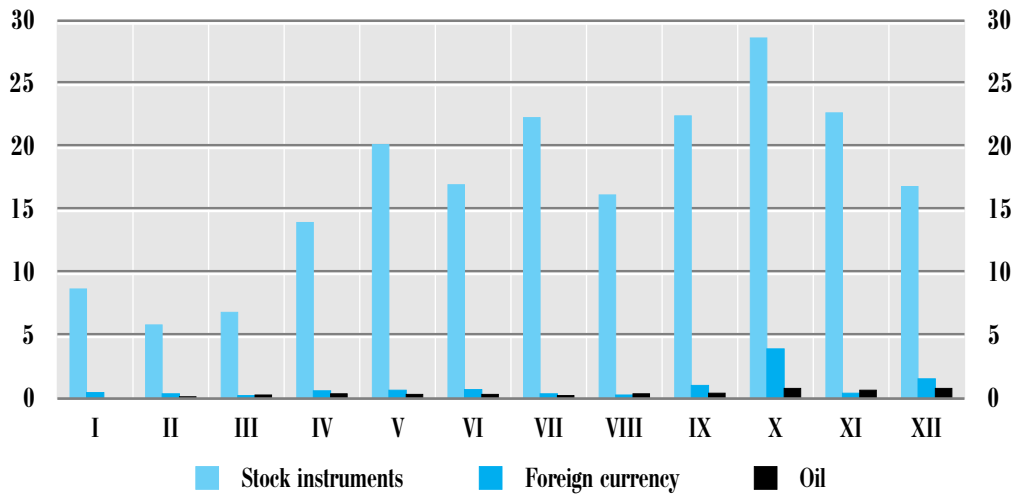


Chart 26

for Brent crude, which were actively traded throughout the year.

In addition to the stock options traded earlier, new options for the shares of Russian issuers, European ruble/dollar and euro/dollar option contracts and several commodity (non-deliverable) options began to be traded in the options contract segment in 2003.

As the dynamics of the nominal rate of the ruble against the dollar changed, the expansion of trading volumes resulted from the significant increase in euro futures trade and this led to the expansion of the share of this instrument to one-third of the currency futures market turnover.

The average term of exchange derivatives continued to increase in 2003 as some market participants tried to hedge their risks on the futures exchange market.

The organisational and technical infrastructure of the derivatives market continued to improve. A new system of access to trading through the Internet was introduced in the MICEX futures section in August. As market players' interest in options trading on SPCEX increased, a set of criteria for granting the status of primary options dealer was elaborated and put into practice to reduce financial risks in conducting operations in this segment of the market. The status of primary dealer was granted to 12 section members, including 10 banks.

Although positive trends and dynamic growth continued on the derivatives market, it was characterised by short-term operations and the lack of an adequate legislative framework. The lack of long-term contracts and credit and interest derivatives pointed to the immaturity of this market.

## I.4. BALANCE OF PAYMENTS AND FOREIGN DEBT

### I.4.1. BALANCE OF PAYMENTS

The stability of the balance of payments in Russia in 2003 was due to the increased inflow of receipts from foreign trade and a significant decline in the net outflow of capital from the private sector.

Russia continued to increase its international reserves and honoured all its foreign debt obligations.

#### CURRENT ACCOUNT

The current account surplus grew by 23% in 2003 year on year to \$35.9 billion. The main factor of growth was the record level of exports, which made up for the outflow of funds in import operations and as income payments on foreign capital brought into the country.

Foreign trade turnover reached an all-time high of \$211.4 billion.

The terms of foreign trade improved: growth in export contract prices exceeded import price growth by 10 percentage points. The expansion of external demand encouraged Russian exporters to increase export volumes, especially of raw materials. As a result, the trade surplus increased by 31% to \$60.5 billion.

**Exports of goods** amounted to \$135.9 billion, an increase of 27% on the previous year. The

value of exports to non-CIS countries stood at \$114.6 billion and to CIS countries at \$21.3 billion.

The contract price of Russian oil in 2003 rose by 13% on average and ferrous and non-ferrous metal prices increased by 20%.

The total value of exported oil, petroleum products and natural gas reached \$73.7 billion as against \$56.3 billion in 2002 and the share of these products in total exports expanded from 52% to 54%.

As for other groups of commodities, metals and metal products accounted for 14% of total exports, machinery, equipment and vehicles 9% and chemicals and related products 7%.

As in the previous year, the major consumers of Russian export products were Germany, the Netherlands, Italy, China, Belarus and Ukraine.

**Imports of goods** were valued at \$75.4 billion and their growth accelerated significantly (to 24% in 2003 from 13% in 2002). Imports from non-CIS countries amounted to \$60.2 billion and from CIS countries \$15.2 billion.

The accelerated growth in imports was due to the increased incomes in the economy, which were transformed into growth in household real disposable income and fixed capital investment, the improved financial standing of enterprises and

the rise of the ruble's real effective rate (by 0.8% year on year).

The period under review saw the expansion of import volumes of all major commodity groups, including intermediate consumer and investment goods. The most significant increases in the value of imports (in US dollar terms) were registered in metals and metal products (41%) and machinery, equipment and vehicles (27%).

There was also a rise in consumer goods imports: the imports of goods manufactured by light industry grew by 17% and food imports increased by 16%.

The imports structure by country has remained virtually unchanged for several years in terms of both the trading participants and their share in import volumes. The leading non-CIS exporters were Germany, China, the United States, Italy and France and the major CIS exporters were Belarus, Ukraine and Kazakhstan.

The deficit of the **balance of services** increased by 12% year on year to \$11.1 billion.

The services turnover expanded by \$6 billion to \$43.2 billion.

**Exports of services** amounted to \$16.0 billion, an increase of \$2.4 billion, or 18%, on the previous year. Other business services accounted for 40% of growth in service exports, transport services 26%, construction services 15% and travel-related services 14%.

The value of international transport services provided to non-residents expanded 12% to \$6.1 billion; all types of international transport demonstrated upward dynamics.

Exports of services relating to international travel were estimated at \$4.5 billion (as against \$4.2 billion in 2002). It should be noted that as the number of foreigners travelling to Russia decreased, the positive dynamics were ensured by the increased expenses of foreign citizens, especially of non-CIS countries, on travel for personal reasons. Non-resident expenses on staying in the country for business reasons declined (this particularly applies to citizens of CIS countries).

The value of **imported services** rose to \$27.1 billion as against \$23.5 billion in 2002. Travel-related services accounted for 44% of this growth, construction services 18% and other business services 13%.

The services used by Russian citizens during their trips abroad are valued at \$12.9 billion and as a year earlier, they accounted for the largest part (47%) of total imports. Most of the growth was due to the increased expenses of Russian citizens on the trips they made to non-CIS countries for personal reasons.

As for other types of services, the most significant rates of growth were registered in royalties and licence payments (110%) and insurance services (162%).

There was a \$100-million deficit in the balance of payments related to **wages and salaries**, whereas a year earlier there was a surplus of \$200 million.

Wages for foreigners working temporarily in this country increased from \$500 million to \$900 million. The number of foreigners working in Russia rose by 45% despite slower growth in their wages and salaries.

The incomes of Russians working abroad totalled \$800 million, an increase of 16%. The number of Russian citizens working in foreign countries rose by 3%, while their average wage increased by 12%.

The deficit of the **balance of investment incomes** grew from \$6.8 billion to \$13.0 billion. Taking into consideration that government sector external borrowings were minimal, this growth was due to rapid increment of foreign obligations of commercial banks and non-financial enterprises and the specifics of the dividend policy pursued by some large Russian companies in 2003.

The private sector's deficit of the balance of incomes increased 2.6 times to \$10.3 billion.

On the whole, investment income payable decreased from \$5.0 billion to \$4.7 billion, as investment income due to the government sector contracted significantly (by \$800 million).

In the meantime, income due to non-residents increased by 50% to \$17.7 billion. In 2002, payments on portfolio investments accounted for 30% and other investments 45%, whereas in the period under review their share contracted to 28% and 34% respectively. Payments connected with direct investments led the way with 38%, of which payments connected with equity capital accounted for 36%. As noted above, the change in the structure of this indicator was the result of

the record amount of dividends announced due to the shareholders of oil majors.

### CAPITAL AND FINANCIAL ACCOUNTS

**CAPITAL ACCOUNT.** There was a deficit of \$1.0 billion in the balance of capital transfers. The main factor of the significant year-on-year contraction of this deficit, which stood at \$12.4 billion last year, was the balance of transfers connected with foreign debt forgiveness, whose negative value decreased from \$11.9 billion to \$400 million.

A negative net result of \$600 million was also registered in transfers connected with international migration. This signified, as a year earlier, net outflow of migrants' property and money from the country. However, the direction of the flows differed by group of countries: non-CIS countries accounted for the entire outflow of property and money, whereas the balance of migrants' transfers across CIS countries was positive.

**FINANCIAL ACCOUNT.** The economy's **foreign liabilities** increment amounted to \$21.4 billion, twice the previous year's amount (\$10.4 billion)<sup>1</sup>.

The federal government was the net payer with regard to non-residents in 2003, just as it was in 2002. Its external obligations declined by \$4.9 billion. In addition, \$0.3 billion in foreign debt was written off as part of the settlement of the Soviet-era debt. The foreign obligations of Russia's regional governments remained virtually unchanged.

The year under review saw the repayment of a significant amount of government foreign debt, while new foreign borrowings were small.

The payment on the principal debt amounted to \$9.6 billion, while \$6.2 billion (65%) went to repay new Russian debt obligations. Payments on Russia's Soviet-era debt totalled \$3.4 billion (35%), of which \$1.6 billion (17%) were paid to the Paris Club of creditor nations.

Despite the increased debt payments, the debt burden on the economy was slightly reduced, owing to growth in external sector incomes and the stability of government finance: the foreign

debt service ratio (the ratio of foreign debt payments, including interest payments, to exports) decreased from 9.9% to 9.5%, while the ratio between payments to non-residents and consolidated budget revenue was unchanged at 10.6%.

Loans taken by the Russian Government amounted to \$800 million and a large part of this amount came from international financial organisations under previously concluded agreements on financing projects in Russia.

The direction and dynamics of the cross-border movement of *banking sector capital* were determined by favourable conditions in 2003. Investment in the domestic economy was more profitable than operations with foreign financial instruments. The considerable interest shown by international investors in the Russian market, which was particularly manifest in the increased foreign capital inflow, also confirmed this. Calculated on an annualised basis, banking sector foreign liabilities rose by a record \$11.2 billion. The inflow of foreign resources to the sector more than trebled year on year and most of these resources were provided by non-residents for terms shorter than one year.

The increased activity of Russian banks in attracting foreign capital resulted in 70% growth in their foreign liabilities compared to the previous year. As of January 1, 2004, the Russian banking sector's foreign liabilities amounted to \$27.5 billion, taking into account the exchange rate revaluation and other changes, as against \$16.0 billion as of the beginning of 2003. Short-term instruments accounted for 60% of their total value. Debt instruments denominated in foreign currency accounted for 87%. US dollar-denominated instruments accounted for 81%, euro-denominated instruments 6% and ruble-denominated instruments 13% of foreign liabilities.

Non-resident investments in the *real sector* amounted to \$15.3 billion as against \$14.3 billion. The major borrowers were enterprises in the fuel and metallurgy sectors, whose creditworthiness was not doubted by foreign partners as world raw material prices continued to rise.

The share of capital raised through the issue of eurobonds increased in foreign resources. The

<sup>1</sup> Data for the period under review and base period cited here and below do not take into account operations connected with debt forgiveness.

leader in issuing eurobonds was the gas monopoly Gazprom, which issued about \$3 billion worth of eurobonds.

The structure of new borrowings by term of financial instruments did not change much: long-term resources provided by non-residents accounted for about 90% of net capital borrowing.

Compared to the previous year, the value of foreign direct investment in the Russian non-financial enterprise sector (including reinvested income and the withdrawal of capital that was attracted earlier) decreased to \$600 million in 2003 as against \$3.2 billion. In most cases, the decline was due to technical reasons: the merger of several large companies with foreign interest had not been completed in the year under review. The balance of payments reflected, among other things, the operations to buy out the shares of Russian companies from non-residents as part of the process of the merger of the Yukos oil major and the Siberian Oil Company (Sibneft). These excluded, the net inflow of foreign direct investments was valued at \$6.8 billion, a 110% increase on the previous year.

The deficit of the balance of operations conducted by foreign portfolio investors with Russian issuers' securities stood at \$400 million.

Residents' **foreign assets** (net of the official foreign exchange reserves) increased by \$23.1 billion as against \$21.1 billion in 2002. The entire growth resulted from the expansion of private sector operations.

*Federal government* claims on non-residents rose by \$1.2 billion, mainly due to the increase of claims on accrued but unpaid interest on loans extended by the former USSR.

*Banking sector* foreign assets grew by \$1.0 billion. Their components changed in different directions: while the balances of current and deposit accounts and assets on direct investments

and derivatives decreased, the value of loans, portfolio investments and foreign exchange in bank tills increased.

As of January 1, 2004, banking sector foreign assets totalled \$21.5 billion, of which short-term financial instruments accounted for 78%. Assets denominated in US dollars made up 76% of the figure, euros 11%, rubles 6% and other currencies 7%.

The banking sector's international currency position changed from that of net creditor to net borrower. As of January 1, 2004, this indicator, calculated as the difference between foreign assets and foreign liabilities, became negative and equalled \$6.0 billion (as of January 1, 2003, it was positive and stood at \$3.5 billion).

Capital outflow from the *non-financial enterprise and household sector*, excluding debt on deliveries under intergovernmental agreements, expanded to \$20.5 billion as against \$18.5 billion in 2002. At the same time, the amount of foreign exchange accumulated by this sector decreased significantly (by \$6.6 billion as against an increment of \$800 million a year earlier) amid growth in virtually all categories of assets.

On the whole, net capital outflow from the private sector declined considerably (to \$2.1 billion in 2003 as against \$8.1 billion in 2002).

**FOREIGN EXCHANGE RESERVES.** Russia's official foreign exchange reserves increased by \$29.1 billion in the period under review, of which operations included in the balance of payments accounted for \$26.4 billion. Taking into account monetary gold, Russia's international reserves amounted to \$76.9 billion as of January 1, 2004.

The country's international reserves were big enough to finance imports for nine months as against 6.8 months as of January 1, 2003.

## I.4.2. FOREIGN DEBT

Russia's foreign debt in dollar terms increased by \$28.9 billion, from \$153.2 billion to \$182.1 billion. Owing to the operations conducted by all sectors and included in the balance of payments (new borrowings, principal debt repayment and forgiveness, secondary market operations and change in the debt on unpaid interest), its increment amounted to \$20.9 billion and other changes (mainly exchange rate revaluation) accounted for \$8.0 billion of growth.

As of January 1, 2004, the debt structure was as follows: general government liabilities accounted for 54% (\$99.2 billion) of the debt, monetary authorities 4% (\$7.8 billion), the banking sector 14% (\$24.8 billion) and the non-financial sector 28% (\$50.3 billion).

Russia's Soviet-era debt accounted for 59% of general *government sector* foreign liabilities (\$58.1 billion). Debt to the Paris Club of creditor nations accounted for 74% of this debt (\$42.7 billion), debt to ex-socialist bloc countries 6% (\$3.6 billion), Tranches III, IV and V of OVGZ bonds 2% (\$1.4 billion) and other foreign liabilities, including debt to countries that are not members of the Paris Club, the International Investment Bank and the International Bank for Economic Co-operation and commercial debt, accounted for 18% (\$10.4 billion).

The Russian debt accumulated after 1991 decreased by \$1.2 billion in 2003 to \$39.8 billion. As before, foreign currency-denominated securities accounted for the largest part of the new Rus-

sian debt (\$26.8 billion, or 67%). Russia's debt to international financial organisations also contracted and stood at \$6.6 billion (17%). Russia's debt obligations to the IMF decreased by \$1.4 billion in 2003 to \$5.1 billion. The debt on inter-governmental credits amounted to \$4.9 billion (12%) and ruble liabilities to non-residents in the form of GKO and OFZ bonds declined from \$500 million to \$100 million (less than 1%), while other debt grew a little (to \$1.4 billion, or 4%).

The foreign debt of regional governments increased by \$100 million to \$1.2 billion.

The *banking sector's* foreign debt expanded significantly (from \$14.2 billion to \$24.8 billion), but the biggest growth was registered in the *non-financial enterprise sector's* debt obligations to non-residents, which as of the reporting date were valued at \$50.3 billion. Compared to the beginning of the year, this debt grew by \$16.5 billion. Growth in the value of loans (from \$24.8 billion to \$40.5 billion) accounted for most of the increase.

The structure of foreign debt of all sectors by term was unchanged on the whole and as before, foreign currency-denominated liabilities predominated in its foreign currency structure (97%).

As of January 1, 2004, the ratio of all sectors' foreign debt to GDP stood at 42% as against 44% a year earlier. As for the general government sector debt, including debt to the IMF, this ratio declined from 30% to 24%.

## I.5. THE WORLD ECONOMY AND INTERNATIONAL FINANCIAL MARKETS

World economic growth accelerated significantly in 2003 compared to 2002. The weakening of the US dollar had a major effect on the economic situation in the world, as it made US goods more competitive. Domestic demand came to play a more important role as a factor of production and employment dynamics in the countries that are the leading trading partners of the United States.

Although imbalances in trade between countries continued to increase, the dollar's decline created preconditions for a gradual contraction of the US current account deficit. The budget deficit problem became more acute in the United States and some European countries. A tendency towards growth in long-term interest rates emerged in the industrialised nations on predictions that the government sector would have to borrow more to finance the budget deficits.

**ECONOMIC GROWTH.** According to an IMF estimate, the world production of goods and services increased by 3.9% in real terms in 2003 as against 3% in 2002. Real GDP growth in the industrialised nations stood at 2.1% as against 1.7% in 2002, while economic growth rates in the developing and emerging market countries (excluding the new industrial countries of Asia) accelerated to 6.1% from 4.6% in 2002.

US real GDP expanded by 3.1% in 2003 as against 2.2% in 2002, an increase caused by the acceleration of growth in domestic demand. It is significant that the principal factor of growth was the expansion of fixed capital investment in production, which was connected with a decline in interest rates.

US final domestic demand grew by 3.4% in real terms as against 2.4% in 2002 due to a 4.4% rise in investment expenditures following a 3.7% fall in 2002. Fixed capital investment in production increased by 3% after a 7.2% fall in 2002. Growth in expenditures on individual consumption slowed to 3.1% from 3.4% in 2002, owing to the slowing of growth in expenditures on services. Government sector expenditures on consumption and investment increased by 3.3% as against 3.8% in 2002. The main factor of growth was increased expenditures, especially on national security.

Real GDP growth in Europe's Economic and Monetary Union (EMU) slowed to 0.4% in 2003 from 0.9% in 2002. The expansion of the output of goods and services in the EMU was the result of the increased domestic demand, mainly expenditures on individual consumption, while fixed capital investment contracted. EMU exports in 2003 were virtually unchanged from 2002, while imports to the eurozone increased. Output in the



REAL GDP GROWTH RATES IN LEADING INDUSTRIALISED NATIONS IN 2003  
(as % of 2002)

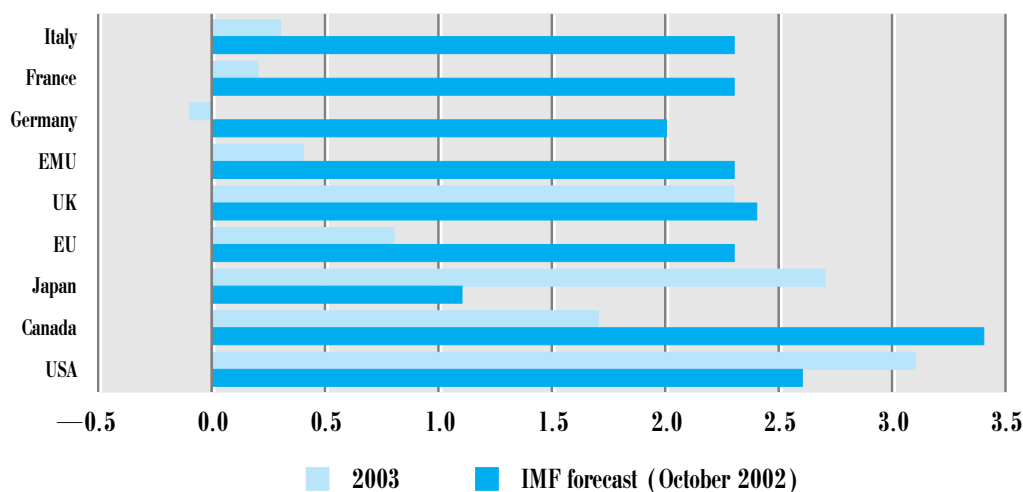


Chart 27

European Union (EU) countries that are not members of the eurozone grew more rapidly than in the EMU. UK economic growth accelerated to 2.3% in 2003 as against 1.7% in 2002.

Japan's real GDP rose by 2.7% in 2003 after a contraction of 0.3% in 2002. Economic growth rates in the developing countries of Asia accelerated to 7.8% in 2003 from 6.4% in 2002, while China's real GDP expanded by 9.1% as against 8% in 2002. The main factors behind the accelerated economic growth rates in China were the expansion of export volumes and a high level of investment activity.

The economic situation in Asian countries in 2003 was largely determined by the situation on export markets, which remained favourable on the whole due to growth in US demand. In addition, many Asian countries either peg their currencies to the US dollar or strictly control the exchange rate dynamics.

The production of goods and services in Latin America rose by 1.7% in 2003 after a drop of 0.1% in 2002. Firstly, the improvement of the economic situation in the region was brought about by factors that stimulated exports. Secondly, more favourable conditions for the external financing of developing countries through borrowing on the international capital market played a positive role.

Economic growth rates in the Central and Eastern European economies in transition accelerated to 4.5% in 2003 from 4.4% in 2002. Eco-

nomical growth in the region was largely the result of the expansion of exports and increased domestic demand. The inflow of foreign direct investments, connected with the integration of Central and Eastern European countries into the EU, remained a major factor of their long-term development. The output of goods and services in the countries of the Middle East rose by 5.4% in 2003 as against 4.2% in 2002 and Africa's economic growth rates accelerated to 4.1% from 3.5% in 2002.

Production growth in the Commonwealth of Independent States (CIS) accelerated to 7.6% from 5.1% in 2002. Ukraine's real GDP grew by 9.3% in 2003 as against 5.2% in 2002 as a result of the expansion of domestic demand and exports. Belarus's real GDP increased by 6.8% in 2003 as against 5% in 2002 due to lower inflation, the increased real disposable income and growth in fixed capital investment. The dynamic growth of Kazakhstan's economy in 2003 (unchanged from 2002 at 9.5%) was the result of the increased money income and favourable situation on world commodity markets, especially high energy and metal prices.

**INFLATION AND EMPLOYMENT.** According to IMF estimates, consumer price growth accelerated in 2003 owing to the cyclic economic upsurge. The increase in fuel and energy prices played a significant part in the world's consumer price

growth. Inflation in the transitional economies continued to slow as structural reforms consolidated.

US consumer price growth accelerated to 2.3% in 2003 as against 1.6% in 2002 due to the expansion of domestic demand, the dollar's decline against the currencies of the United States' leading trading partners and higher oil prices. A major factor restraining consumer price growth in the United States was the reduction of unit wage costs caused by the continued rise in labour productivity. EMU consumer price growth slowed to 2.1% from 2.3% in 2002, mainly as a result of the stronger euro. Deflation caused by structural problems continued in some Asian countries: consumer prices fell by 0.3% in Japan, 2.6% in Hong Kong and 0.3% in Taiwan. In some other Asian countries deflation ended: consumer prices rose by 1.1% in China and 0.5% in Singapore. As for the largest countries of Latin America, inflation accelerated in 2003 in Brazil, Chile and Venezuela and slowed in Argentina and Mexico. Most countries of Central and Eastern Europe saw consumer price growth slow down.

Inflation rates accelerated in most of the CIS countries in 2003. In Ukraine, the acceleration of inflation (from 0.8% in 2002 to 5.2%) was the result of considerably higher food prices and the acceleration of service price growth rates. The main reason for the slight increase in inflation in Kazakhstan, where consumer prices rose to 6.4% from 5.9% in 2002, was a sharp increase in the prices of some food products owing to the raising by the state of the purchasing price of grain. The reduction of the inflation rate in Belarus to 28.4% from 42.6% in 2002 was the result of slowing growth in government-regulated prices of goods and services and the implementation of a monetary policy designed to restrain growth in the prices of other goods and services.

Employment rates continued to fall in some industrialised nations in 2003. The US jobless rate rose to 6% of the workforce as against 5.8% in 2002 and the eurozone unemployment rate increased to 8.8% from 8.4% in 2002. At the

same time, the unemployment rate in Britain slowed to 5% from 5.2% in 2002 and in Japan to 5.3% from 5.4%. In the second half of 2003, job numbers began to rise appreciably as investment activity increased in the industrialised nations.

**GOVERNMENT FINANCE.** The budget performance indicators for the United States and leading European countries continued to deteriorate in 2003 due to increased defence spending in the United States, slow economic growth in the eurozone and the erosion of the legislative framework ensuring tax and budget stability. In 2003, Germany and France allowed their budget deficits to exceed the 3% of GDP envisaged by the Stability and Growth Pact. However, the provisions of the Pact concerning the use of sanctions for non-compliance with budget deficit recommendations were effectively suspended with regard to the two countries.

The US federal budget deficit rose to 4.1% of GDP in 2003 as against 2.5% in 2002 and the US consolidated federal budget deficit increased to 4.9% of GDP as against 3.3% in 2002. The EMU aggregate consolidated budget deficit amounted to 2.8% of GDP in 2003 as against 2.3% in 2002. Germany's budget deficit stood at 4% of GDP and France's 4.1%. Japan's consolidated federal budget deficit expanded to 8.2% of GDP as against 7.9% in 2002.

Belarus's consolidated budget deficit stood at 1.3% of GDP in 2003 as against 0.2% in 2002. Ukraine's consolidated budget surplus of 0.7% of GDP, registered in 2002, gave way to a deficit of 0.2% of GDP in 2003. Kazakhstan had a budget deficit of 0.9% of GDP in 2003, whereas in 2002 it had a budget surplus of 0.03%.

**INTERNATIONAL TRADE AND BALANCES OF PAYMENTS.** According to an IMF estimate, international trade in goods and services in 2003 expanded by 4.5%<sup>1</sup> as against 3.1% in 2002. Growth in exports from the industrialised nations accelerated to 2.7% from 1.9% in 2002 and growth in imports to these countries accelerated

<sup>1</sup> Changes in international trade volumes and exports and imports are calculated by the IMF for groups of countries in the period under review as compared with the base period in comparable prices by weighing the rates of growth in foreign trade turnover, exports and imports of individual countries. Ratios are calculated on the basis of foreign trade turnover, exports and imports of individual countries in the base period, converted into dollar terms at the exchange rates effective in the base period.

to 3.5% from 2.3% in 2002. Trade imbalances between the United States and the rest of the world continued to increase. The US trade deficit rose to \$490.2 billion in 2003 as against \$418 billion in 2002.

The US current account deficit rose to 4.9% of GDP in 2003 as against 4.6% in 2002. The EMU's current account surplus contracted to 0.4% of GDP in 2003 as against 0.9% in 2002, Japan's current account surplus increased to 3.2% of GDP as against 2.8% in 2002. The UK's current account deficit was unchanged from 2002 at 1.7% of GDP.

According to an IMF estimate, growth in exports and imports in the developing nations and transitional economy countries accelerated in 2003. Imports grew faster than exports in these countries owing to the expansion of domestic demand and inflow of foreign investments. A major contributing factor in the European economies in transition was the strengthening of their national currencies against the dollar.

The CIS aggregate current account surplus grew a little year on year in 2003. A current account surplus in Kazakhstan (2.4% of GDP as against a deficit of 2.8% of GDP in 2002) was the result of high energy prices and growth in world metal prices. Economic growth and the improved condition of the export-oriented industries brought about a significant increase in the inflow of foreign capital to Kazakhstan. Belarus's current account deficit increased in absolute terms in 2003 due to a deterioration in the terms of trade caused by a rise in the price of oil and petroleum products, but relative to increased GDP, it remained unchanged from 2002 at 2.6%. Ukraine's current account surplus contracted to 6% of GDP in 2003 from 7.5% in 2002.

**COMMODITY MARKETS.** Prices increased on world raw material markets in 2003. Energy prices grew more rapidly than non-energy prices. The main reasons for growth in the price of oil were the war in Iraq, the tough position taken by OPEC on oil production quotas, the extremely low level of oil and petroleum product stocks in the United States and the rise in the demand for energy products, which was caused by accelerated economic growth in the world. According to IMF data, the average price for the Brent, Dubai and

WTI brands of crude increased 15.8% to \$28.89 per barrel.

The principal factors of growth in metal prices were the hostilities in Iraq, the signs of a recovery in the world economy, which pushed the demand for industrial metals up, and the weakening of the US dollar. The gold and platinum prices rose owing to the increased investor interest in these metals. Prices grew at especially rapid rates on the gold, platinum, nickel, copper and steel markets. There was also a rise in the prices of foodstuffs and agricultural raw materials, grain, fertiliser, timber and chemical raw materials.

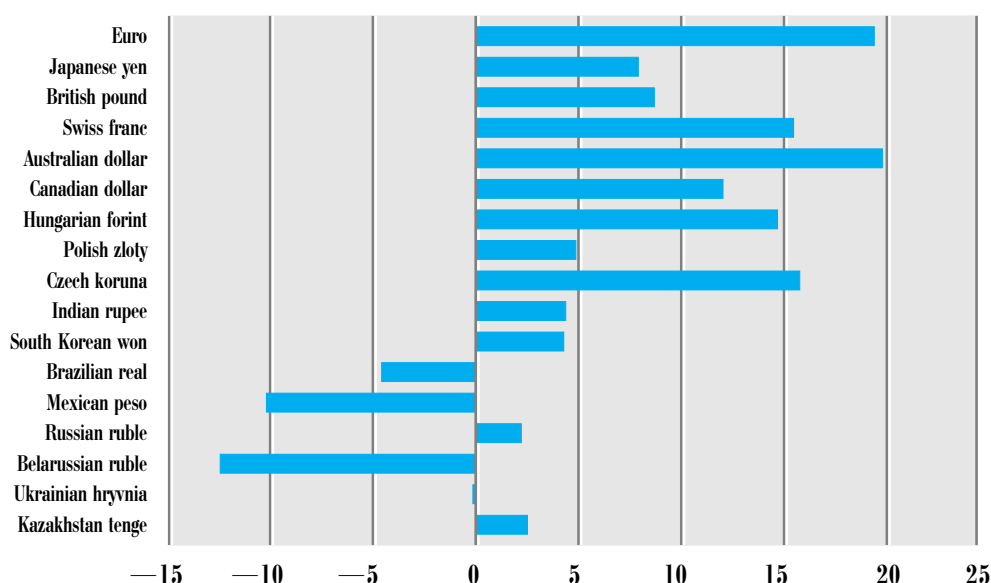
**CURRENCY MARKET.** The US dollar lost much of its value against other major world currencies in 2003. On average, compared to 2002, it fell 19.7% against the euro, 8.8% against the British pound, 15.7% against the Swiss franc and 8% against the Japanese yen. The dollar also declined against many other currencies: it lost 20.1% against the Australian dollar, 16% against the Czech koruna, 12.2% against the Canadian dollar and 14.9% against the Hungarian forint. The US dollar rose against the Mexican peso, Brazilian real and Belarussian ruble and was virtually unchanged against the Ukrainian hryvnia.

The US dollar weakened in 2003 as a result of growth in the current account deficit and interest rate cuts in the United States.

The weakening of the dollar made US goods more competitive and undermined the competitive power of the United States' trading partners, especially eurozone countries, and to a lesser extent some Asian countries, which actively use exchange rates as a means of regulating the competitiveness of domestic products. The countries that do not allow their national currencies to float freely were in a comparatively better state but came under strong criticism from the United States and other trading partners.

**MONEY MARKET.** The policies pursued by the monetary authorities of the industrialised nations in 2003 were chiefly designed to stimulate economic activity through low interest rates. The US Federal Reserve in June cut the benchmark federal funds rate by a quarter of a percentage point to 1%.

**DYNAMICS OF EXCHANGE RATES OF FOREIGN CURRENCIES  
AGAINST THE US DOLLAR IN 2003 (as % of 2002) \***



\* — denotes appreciation, + depreciation of dollar.  
Source: Reuters.

Chart 28

In the European countries, the changes in interest rates were predetermined by central banks' commitment to the achievement of the targets set for domestic consumer price growth. The Bank of England cut the refinancing rate twice in 2003 by a quarter of a percentage point, in February, when the rate was lowered to 3.75% and in July, when it was reduced to 3.5%. In November, however, it raised it again to 3.75%. The slowing of inflation in the EMU, caused by the strengthening of the euro, allowed the European Central Bank (ECB) to cut the refinancing rate twice in 2003. In March, the ECB reduced it from 2.75% to 2.5% and in June to 2%.

Interest rates on dollar-denominated deposit accounts on the London Interbank Offered Rate (LIBOR) market in 2003 ranged from 1.2% to 1.4% on average, which represents a decrease of 0.6—0.8 percentage points on 2002.

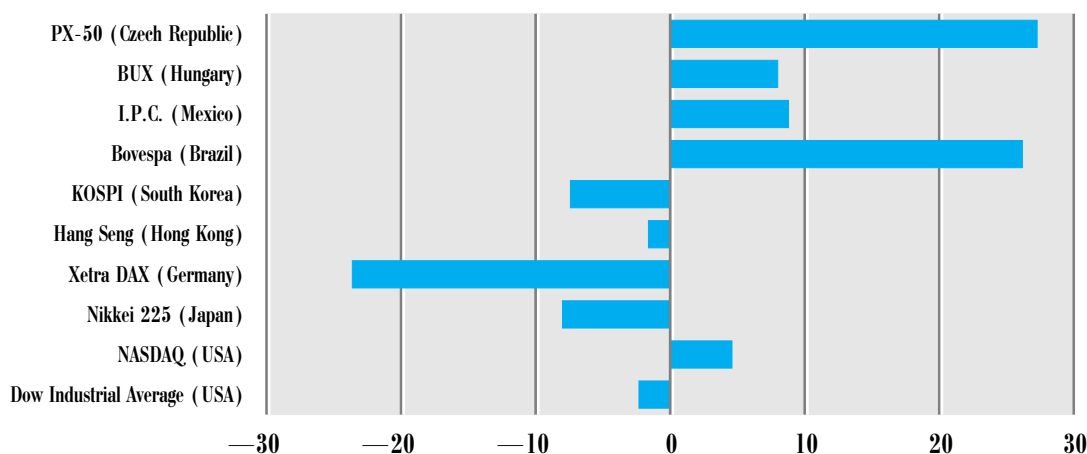
**STOCK MARKET.** The average level of prices on the world's major stock markets in 2003 was on the whole lower than in 2002, mainly due to a wide gap between share prices at the beginning of 2002 and at the beginning of 2003. Share prices started to rise in March in the United States and in April—May in Western Europe and Asia. The

dollar's depreciation in 2003 had a negative effect on the stock markets in the countries which exported most of their merchandise to the United States.

The Dow Jones, the stock price index of the core sector of the US economy, in 2003 was 2.3% lower than in 2002, but the hi-tech NASDAQ index gained 4.6%. Germany's Xetra DAX-30 was down 23.6% and Japan's Nikkei 225 fell 8%.

Share price growth on the stock markets of the industrialised nations in the second, third and fourth quarters of 2003 was due to the reduction of geopolitical risks after the end of the conflict in Iraq, interest rate cuts, a rise in economic activity and the improvement of corporate profit forecasts. Japanese corporate stock prices rose on the inflow of foreign capital to the country's stock market. Investors' attitude to the new industrial and developing nations of Asia changed dramatically in 2003. The wariness that prevailed with regard to these countries after the 1997 crisis has given way to optimism about the future of their stock markets. There was a rise in the level of prices on the stock markets of Latin American and Central European countries.

**AVERAGE ANNUAL STOCK PRICE INDEX GROWTH IN 2003**  
(as % of 2002)



*Chart 29*

Source: Reuters.

**CAPITAL MARKET.** The yield of government securities of the world's industrialised nations in 2003 was lower on average than in 2002. The average annual yield on 3-month government securities fell by 0.6 percentage points year on year in the United States, 1 percentage point in the eurozone and 0.3 percentage points in Britain and was close to nought in Japan. The average annual yield on 10-year government bonds decreased by 0.6 percentage points in the United States, 0.7 percentage points in the EMU countries, 0.4 percentage points in Britain and 0.3 percentage points in Japan.

However, in the second half of 2003 (mainly in the period from the middle of June to the beginning of September) the yields on medium- and long-term government securities rose in the United States, Europe, especially in Britain, and Japan. This growth was the result of the im-

proved medium-term macroeconomic forecasts and the heightened risks connected with the increased budget deficits in the United States and leading European countries. At the end of 2003, the yields on US treasury bills with a maturity from 2 to 10 years was higher by 0.2–0.5 percentage points than at the end of 2002.

As a result of the extremely low interest rates in the industrialised nations in 2003 and increased investor confidence in private companies, developing nations and emerging markets, the net value of debt instruments on the international capital market, especially fixed-interest bonds, increased by 1.5 times to \$1.5 trillion. The difference between the terms of borrowing by the governments of developing and developed countries became less obvious. International rating agencies in 2003 repeatedly upgraded the credit ratings of developing countries and economies in transition.



**BANK OF RUSSIA  
ACTIVITIES**

**III**

## II.1. MONETARY POLICY

### II.1.1. OBJECTIVES AND RESULTS OF MONETARY POLICY

The main objectives and principles of the monetary policy pursued by the Bank of Russia in 2003, as in the previous years, were determined by the task of consistently reducing the inflation rate and ensuring the national currency's stability in order to bring about growth in real income, savings and investment and create conditions for long-term sustainable economic growth. According to the Guidelines for the Single State Monetary Policy in 2003, the ultimate goal of the monetary policy was to reduce the inflation rate to 10—12% a year, which corresponded to the projected GDP growth of 3.5—4.4%.

When making the interval assessment of the ultimate goal of the monetary policy for 2003, the Bank of Russia took into consideration the fact that inflation in Russia is affected not only by monetary, but also structural factors, whose medium-term dynamics are not the direct consequence of monetary policy. Therefore, to make sure that the monetary policy decisions it took facilitated the attainment of the target set for the general rate of inflation, the Bank of Russia took into account the rate of core inflation, which, taking into consideration the projected increase in government-regulated prices of goods and services in 2003, was expected to stand at 8.0—8.5%.

In 2003, the Bank of Russia continued to adhere to the managed floating exchange rate regime. As foreign exchange flowed into the coun-

try in large quantities owing to high oil prices and the private sector's foreign borrowings, a transition to a free floating exchange rate regime without an efficient stabilisation fund could have provoked an outbreak of the Dutch disease and abruptly change the relative attractiveness of assets denominated in rubles and foreign currency. The managed floating allowed the real sector to adapt itself gradually to the changes in the value of the ruble, which were caused by fundamental factors.

During the year under review, the Bank of Russia continued to use the M2 aggregate as a major intermediate monetary policy benchmark. Although the interdependence between the inflation rate and money supply growth became less evident, money supply dynamics remained the necessary indicator for evaluating the influence of the monetary factors on the development of the medium-term inflation trend.

In evaluating the demand for money in 2003, the Bank of Russia realised that it would be affected by such processes as continuing economic growth, further increases in real disposable money income and the greater inclination to save money, and the increased attractiveness of assets denominated in the national currency. Growth in the demand for rubles in 2003 was projected at 20—26%. At the same time, the Bank of Russia did not rule out that the economic situation could



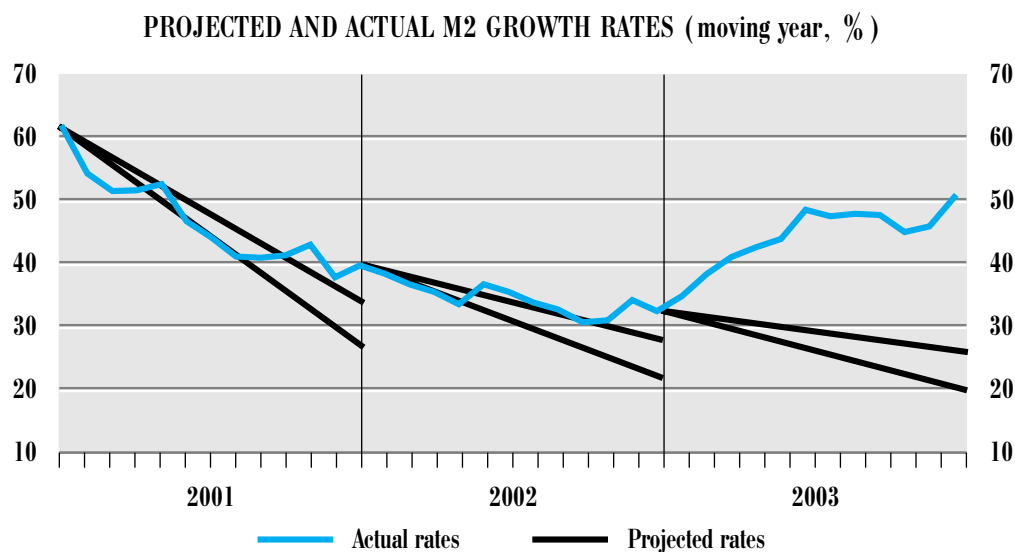


Chart 30

cause the demand for the national currency to change during the year.

In 2003, the Bank of Russia implemented its monetary policy in a macroeconomic situation that was quite different from the prerequisites made in the Guidelines for the Single State Monetary Policy in 2003. They were different not so much in terms of the trends of the current processes as in their intensity. The inflation rate slowed last year amid high prices of major Russian export commodities, a stronger-than-expected balance of payments and economic growth rates that were almost twice as fast as their projections.

The strengthening of the balance of payments in 2003 created difficulties for the implementation of the monetary policy. Growth in the supply of foreign exchange on the currency market due to a large current account surplus and the increased capital inflow caused upward pressure on the exchange rate of the national currency. In a bid to slow down the rise of the real effective rate of the ruble and protect the competitiveness of domestic commodity producers, the Bank of Russia increased international reserves and this accelerated the expansion of the ruble supply. The task of slowing growth in the money supply meant tightening the monetary policy, but the rise in interest rates needed for this could have stimulated the inflow of foreign capital due to low interest rates on world markets and put additional upward pressure on the ruble rate. In the given situation, the exchange rate policy had to be changed and a wider range of meth-

ods and instruments of monetary regulation used to attain the targets set for 2003.

After February 2003, the Bank of Russia, while implementing its monetary policy, allowed the ruble slightly to rise against the US dollar in nominal terms. These exchange rate dynamics of the ruble had a restraining effect on consumer price growth and made it possible, to some extent, to contain growth in the money supply as a result of the purchase of foreign exchange by the Bank of Russia through interventions on the domestic market.

However, the inflow of foreign exchange to the country was so great during the year that, even despite the ruble's nominal rise against the dollar, the Bank of Russia ruble interventions were accompanied by a sharp increase in banking sector liquidity. While in 2002 the average annual value of funds in credit institutions' correspondent accounts rose by 2.4% year on year, in the year under review it grew by 48.9%. In this situation, the importance of sterilising and absorbing the surplus money supply increased significantly for the maintenance of the trend towards reducing inflation. The principal means of absorbing surplus liquidity by the Bank of Russia was taking bank funds on deposit and actively conducting open-market operations with government securities from its portfolio. On the whole, the amount of free liquidity sterilised in 2003 on an average monthly basis was almost twice the amount sterilised in 2002.

The dynamics of the ratio of bank deposit accounts in the Bank of Russia and exchange modi-

**RATIO OF BANK DEPOSIT ACCOUNTS WITH BANK OF RUSSIA  
AND EXCHANGE MODIFIED REPO OPERATION VOLUMES  
TO BROAD MONETARY BASE IN 2002—2003 (%)**

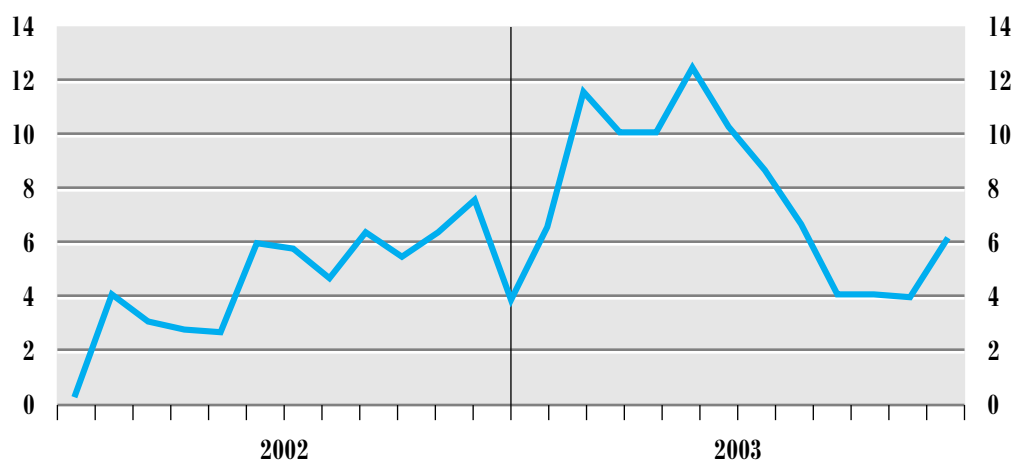


Chart 3.1

fied repo transaction volumes to the broad monetary base<sup>1</sup> may serve, to some extent, as a measure of the effectiveness of the sterilisation measures carried out by the Bank of Russia. In 2002, this ratio stood at 4.6% on average, whereas in 2003 it rose to 7.6% (in some months it stood as high as 11–12%), mainly due to the increased volume of deposit and exchange modified repo operations.

Growth in the balances of general government accounts in the Bank of Russia also contained the expansion of the money supply in 2003. However, this means of restraining the money supply in 2003 was used to a lesser extent than in 2002.

On the whole, money supply growth in 2003 exceeded by far the targets set in the Guidelines for the Single State Monetary Policy in 2003, owing to objective growth in the demand for money in the economy.

As GDP growth by far exceeded the previous year's growth and projections for 2003, demand increased significantly for cash balances for transactions conducted by real-sector enterprises. Funds in corporate demand accounts, most of which are enterprises' settlement and current accounts, increased by 37.7% in the year under review to almost twice the amount registered in 2002.

On the one hand, growth in household money income was accompanied by an increase in consumer spending and rapid expansion of retail trade turnover, which caused the demand for transaction money, especially cash, to rise. On the other hand, it contributed to growth in household savings in bank accounts. In 2003, the M0 aggregate increased by 50.3% as against 30.7% in 2002 and the value of household ruble bank accounts rose by 64.8% as against 45.1%. The value of time household ruble deposits increased by 67.9% in 2003 as against 54.9% in 2002.

The exchange rate policy played a significant part in stimulating demand for the national currency. As a result of the nominal rise of the ruble against the dollar last year, the return from ruble investments far surpassed the return from foreign currency investments, including bank accounts. The average return from household ruble time deposit accounts opened at the beginning of the year was 10.9% p.a. in 2003, whereas the average return on US dollar-denominated deposit accounts was negative in ruble terms (–1% p.a., taking into account the change in the exchange rate during the year). As a result, the changed preferences of economic agents in the choice of the currency of savings also contributed to growth

<sup>1</sup> The broad monetary base includes cash in circulation, banks' required reserves for funds attracted in the national and foreign currency, banks' correspondent and deposit accounts in the Bank of Russia and Bank of Russia obligations of reverse repurchase of securities.

M2 GROWTH RATES IN 2002 AND 2003 (%)

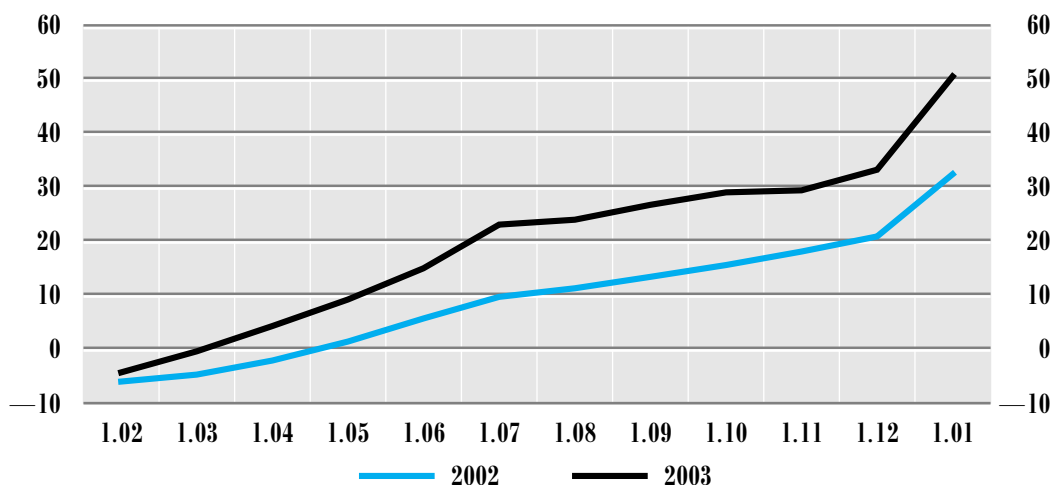


Chart 32

in the demand for rubles. As has been noted above, balance of payments data for 2003 indicate that the value of foreign exchange held by the non-financial sector decreased by \$6.6 billion, whereas in 2002 it rose by \$800 million. According to monetary survey data for 2002, the value of commercial banks' foreign currency deposit accounts increased by \$202.5 billion, whereas in 2003 it grew by \$21.8 billion. As for the structure of the money supply, evaluated according to monetary survey methodology and comprising foreign currency deposit accounts, the latter's share contracted from 25.4% to 18.9% in the year under review. The fact that the ruble aggregate M2 increased far more than the money supply comprising foreign currency deposit accounts (50.5% as against 38.5%), whereas in 2002 the money supply including foreign currency deposits expanded more than the M2 aggregate (33.9% as against 32.4%), indicates that in the year under review economic agents were more active in transferring their foreign currency assets into ruble assets.

The contraction of the share of cash in the M2 structure in 2003 (from 36.0% in 2002 to an annual average of 35.1%) and the fact that the share of household ruble time deposits expanded more than other components of the money supply (from 24.6% to an average annual of 27.0%) testified to the improvement of the money supply (M2) structure. As non-financial agents shied away from the dollar and the public started to save more, the velocity of money declined more rapidly than expected and even more rapidly than in 2002. The average

annual velocity of money, calculated by the M2 aggregate, decreased from 6.2 in 2002 to 5.3 in 2003, or by 14.8% as against 9.9% in 2002.

As the ruble rallied against the dollar in nominal terms and ruble savings grew at rapid rates, the Bank of Russia refrained from containing the increase in the rate of the economy's monetisation.

Massive growth in the money supply, additional budget revenues and the increased banking sector liquidity led to a fall in money market interest rates and interest rates on commercial bank operations. The average monthly Moscow Interbank Actual Credit Rate (MIACR) on overnight ruble loans declined in 2003 from 7.3% p.a. to 1.4% p.a. The average annual interest rate on ruble loans extended by banks to the non-financial and household sectors in 2003 fell by 2.7 percentage points and 2.2 percentage points respectively.

It should be noted that interest rates on ruble loans to the household sector remained rather high: the average interest rate on loans extended to individuals for all terms stood at 21.1% p.a. in 2003 as against 13.1% p.a. on similar loans extended to corporate borrowers. Bank interest rates on the household time deposit market stood at 11.1% p.a. on average during the year. The average annual margin on ruble credit and deposit operations conducted by banks with all non-financial clients for terms up to 1 year (excluding demand deposit accounts) fell to 6.2 percentage points in 2003 from 8.3 percentage points in 2002. At the same time, the level of interest rates in 2003 allowed the banking sector significantly

Chart 33

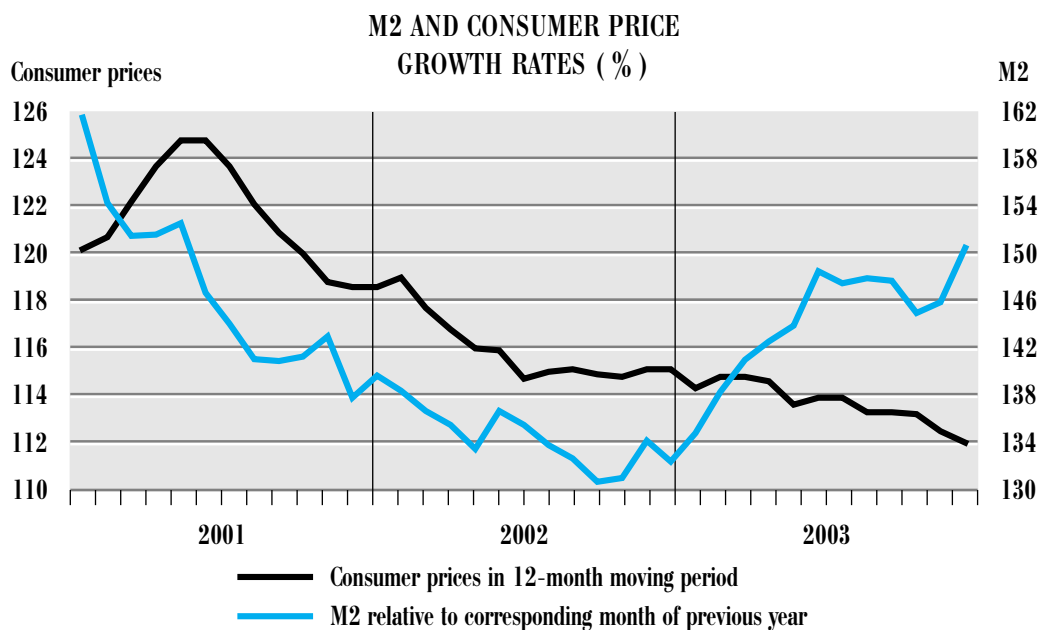
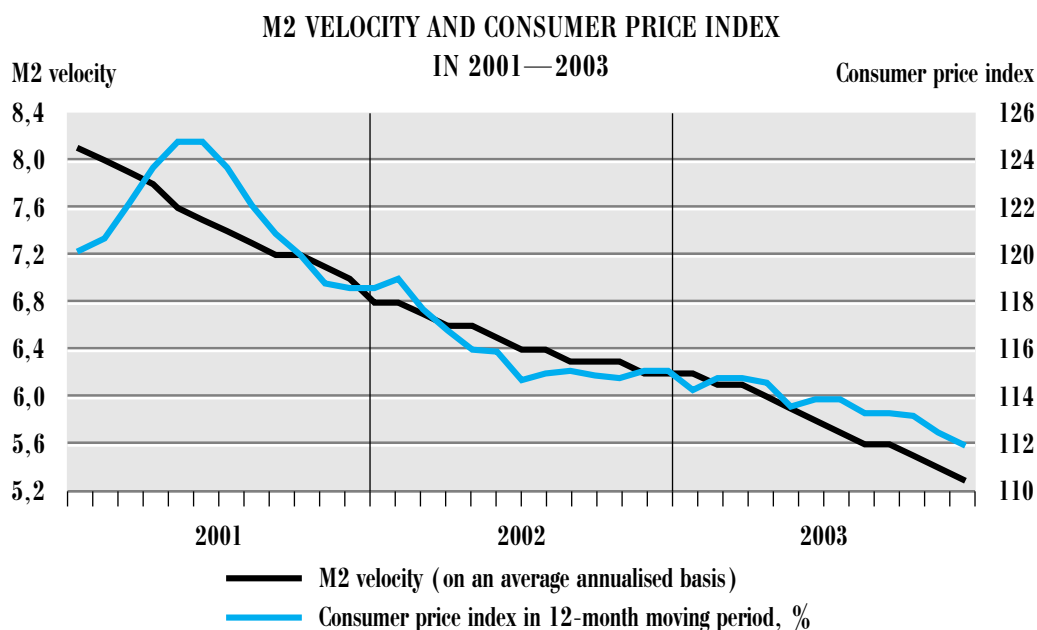


Chart 34



to expand lending to the non-financial enterprise and household sectors.

Taking into consideration the monetary situation, the Bank of Russia in the second half of 2003 revised its forecast for the dynamics of demand for money (42—45% as against 20—26% by the M2 aggregate). Nevertheless, the actual rates of growth in the money supply (M2) exceeded these projections and stood at 50.5% as against 32.4% in 2002. The monetisation of the

economy (calculated by the M2 aggregate) in 2003 increased from 16.2% to 19% of GDP.

On the whole, the monetary policy pursued by the Bank of Russia in 2003 helped maintain economic growth and create conditions for an increase in household income and expenses. The fall in inflation makes it possible to boost investment activity and stimulate growth in savings, while the achievement of the target set increases economic agents' confidence in the economic policy pursued.

## II.1.2. MONETARY PROGRAMME IMPLEMENTATION AND THE USE OF MONETARY POLICY TOOLS

To meet the inflation target, the Bank of Russia, when pursuing its monetary policy in 2003, sought to ensure that the dynamics of the money supply matched those of the demand for money, taking into account the changes in internal and external factors that affected these dynamics. To this end, the Bank of Russia, taking into consideration the results of an analysis of current economic conditions and trends, used the entire range of monetary policy instruments at its disposal. In implementing monetary regulation, it took into account the dynamics of a broad range of economic indicators, including monetary programme indicators, compiled with the balance of payments and budget indicators.

The Guidelines for the Single State Monetary Policy in 2003 contain two versions of the monetary programme, elaborated on the basis of the principal scenarios of Russia's social and economic development in 2003, the corresponding balance of payments projections and taking into account the parameters of the draft federal budget for 2003. At the same time, the Bank of Russia realised that monetary programme parameters could not be set rigidly and might be altered if the macroeconomic situation changed. Specifically, in one of the worst-case scenarios, when monetary indicators grew faster than expected due to an additional inflow of foreign exchange, it was assumed that the inflation target could be met despite the ruble's more significant rise against the US dollar and the acceleration of growth in the demand for money.

The actual economic development trends in 2003 were close to this scenario and, therefore, the inflation target had to be met despite deviations of monetary programme indicators from the basic scenario.

The acceleration of growth in the money supply by the monetary authorities was due to the significant strengthening of the Russian balance of payments as compared with the previous year,

largely as a result of the expansion of the trade surplus and the contraction of net capital outflow from the private sector. A key role was played in this process by the expansion of external demand for Russian export commodities and high world prices of these commodities, growth in the private sector's foreign borrowings, stimulated by low interest rates on international financial markets, and the contraction of the share of dollar-denominated assets held by the household and non-financial enterprise sectors. Russia's international reserves increased by \$29.1 billion dollars in 2003, or 120% year on year<sup>1</sup>.

As there was an imbalance on the domestic foreign exchange market, one of the main problems for the Bank of Russia was to find a compromise between preventing a sharp rise in the nominal value of the ruble against the dollar and deteriorating conditions for the real sector, on the one hand, and meeting the ultimate inflation target, on the other hand. At the same time, the Bank of Russia had to take into account the influence of the ruble/dollar exchange rate dynamics on the consumer price dynamics and on the inflow of foreign capital to Russia, as well as the ability of the monetary authorities to sterilise a part of the money supply created by Bank of Russia interventions on the foreign exchange market.

The broad monetary base expanded by 681.7 billion rubles, or 55.3% in 2003 (38.7% in real terms), whereas in 2002 it grew by 32.8%, or 15.4% in real terms. The net international reserves of the monetary authorities (calculated at the fixed ruble/dollar rate as of January 1, 2003) increased by 879.5 billion rubles in 2003, or \$27.7 billion (the basic balance of payments and monetary programme projection set this growth at \$8.8 billion).

Thus, the greater-than-expected strengthening of the balance of payments and the resultant nominal gains of the ruble against the dollar instead of the expected gradual devaluation, as well

<sup>1</sup> Net of Bank of Russia short-term liabilities denominated in freely convertible currencies.

EXCHANGE RATE DYNAMICS AND SOURCES OF MONEY SUPPLY IN 2002—2003  
(quarterly change, billion rubles)

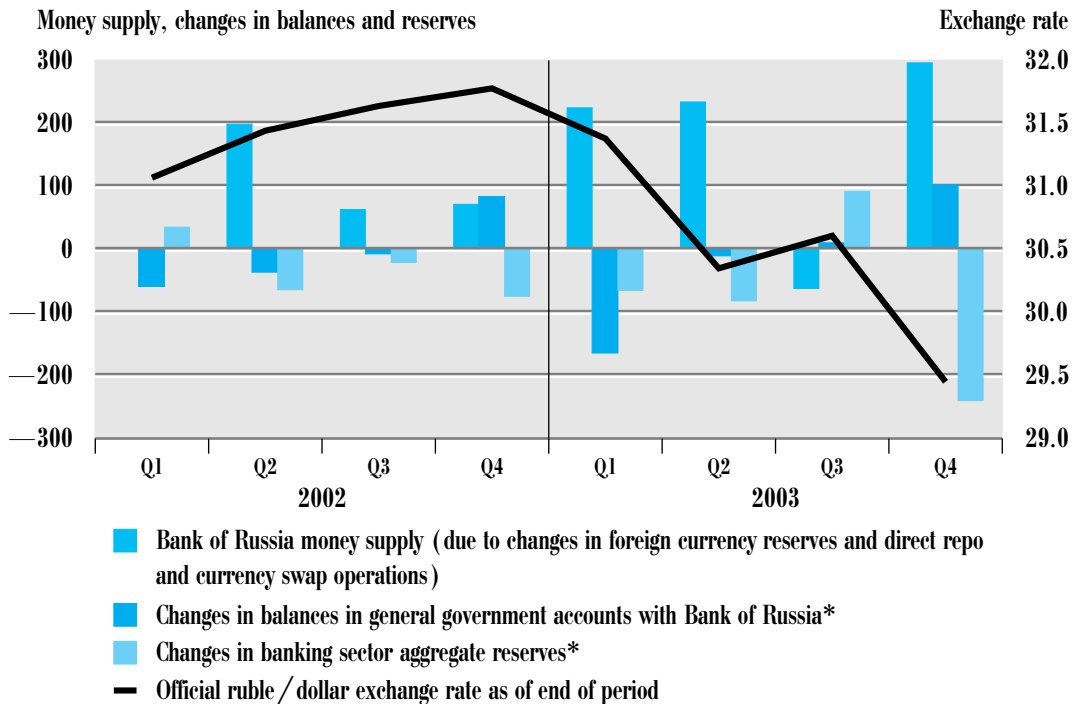


Chart 35

as the more rapid rates of economic growth than those in the basic social and economic development scenario, were the main reasons why the real indicators deviated from the monetary programme indicators included in the Guidelines for the Single State Monetary Policy in 2003. In this situation, the attainment of the inflation target required matching money supply and demand dynamics at a different, higher level.

The total amount of liquidity withdrawn as a result of the sterilisation operations conducted by the Bank of Russia in 2003 exceeded 99 billion rubles. In addition, the balances in general government ruble accounts in the Bank of Russia increased by about 66 billion rubles in 2003. On the whole, thanks to their co-ordinated efforts, the monetary authorities managed to withdraw nearly one-fifth of the entire money supply created due to the increment in international reserves.

In 2003, the Bank of Russia continued to use actively market instruments of monetary regulation, which allowed it to regulate money and credit, including interbank interest rates, more

flexibly and efficiently. The economic conditions required the Bank of Russia to use mostly medium- and short-term instruments of absorption of the banking sector's free liquidity. However, whenever necessary, the Bank of Russia conducted operations to provide money to credit institutions.

The Bank of Russia expanded the range of its monetary policy instruments last year. It began to conduct operations on a more regular basis, extended their tenor and brought interest rates closer to market levels. These measures made it possible to meet the needs of credit institutions more completely, when there was either a surplus or shortage of liquidity, and to reduce the interest rate volatility of the interbank loan market.

In seeking to reduce yields on the interbank loan market and government securities market and slow inflation, the Bank of Russia cut interest rates on its own operations and the refinancing rate. As has been noted above, another major reason for the cuts in interest rates on Bank of Russia operations was to prevent ad-

**MONETARY PROGRAMME IMPLEMENTATION INDICATORS IN 2003**  
(billion rubles)\*

	1.01.2003 actual	1.01.2004	
		programme**	actual
<b>Narrow monetary base</b>	<b>935.1</b>	<b>1,145</b>	<b>1,398.5</b>
— cash in circulation (outside Bank of Russia)	813.9	979	1,224.7
— required reserves	121.2	167	173.8
<b>Net international reserves</b>	<b>1,313.1</b>	<b>1,594</b>	<b>2,192.6</b>
— gross international reserves of the Bank of Russia and Russian Government	1,519.1	1,742	2,340.0
— international reserve obligations of the Russian Government	206	147	147.4
<b>Net domestic assets</b>	<b>—378</b>	<b>—449</b>	<b>—794.1</b>
<b>Net credit to general government</b>	<b>34.3</b>	<b>65</b>	<b>—121.8</b>
— net credit to federal government	101.9	170	—20.5
— balances of regional and local government accounts and accounts of federal government extrabudgetary funds	—67.6	—105	—101.3
<b>Net credit to banks</b>	<b>—196</b>	<b>—273</b>	<b>—405.5</b>
— gross credit to banks	21.6	25	16.7
— credit institutions' correspondent accounts, banks' deposit accounts in Bank of Russia and other instruments to absorb free banking sector liquidity	—217.6	—298	—422.2
<b>Other net unclassified assets</b>	<b>—216.2</b>	<b>—241</b>	<b>—266.7</b>
<b>For the record (growth rates in % unless indicated otherwise):</b>			
GDP (against previous year)	4.7	4.4	7.3
M2 (over year)	32.4	26	50.5
Average annual velocity of money (against previous year)	—9.9	—6.1	—14.8
Official average annual ruble/dollar exchange rate	31.4	33.0***	30.7

\* Indicators calculated at fixed exchange rate are based on official ruble rate as of the beginning of 2003.

\*\* The second version of monetary programme included in the Guidelines for the Single State Monetary Policy in 2003, taking account of recalculation at official ruble rate as of the beginning of 2003.

\*\*\* Forecast based on Economic Development and Trade Ministry data.

ditional inflow of short-term capital to the domestic market.

To absorb free banking sector liquidity, in the period under review the Bank of Russia held weekly deposit auctions and exchange modified repo auctions and, at the same time, conducted daily deposit operations on standard conditions, such as overnight (until March 7, 2003), tomorrow, spot-next, 1 week, spot-week and on call, at fixed interest rates, using the Reuters Dealing System, and operations to sell bonds from its trade portfolio. To extend the terms of absorption of banking sector liquidity, at the end of May 2003 the Bank of Russia began to hold regular 3-month deposit auctions and to auction longer-term Bank of Russia bonds with the obligation of reverse repurchase.

The total value of Bank of Russia debt on **deposit operations** with credit institutions in 2003

rose from 47.4 billion rubles to 87.3 billion rubles and in some periods it exceeded 150 billion rubles. The average daily debt on deposit operations amounted to 78.6 billion rubles in 2003, an increase of 7.4% on the previous year. In line with its interest rate policy, the Bank of Russia reduced the level of fixed interest rates on deposit operations from 1—3% p.a. to 0.5—1% p.a., while the cut-off rate set by the Bank of Russia upon the results of deposit auctions decreased from 7.2% to 1.5% p.a. for two-week auctions and from 4% to 3.5% p.a. for three-month auctions.

Starting from April 2003, the Bank of Russia collected credit institutions' bids through the Reuters Dealing System and through its regional branches in order to ensure all credit institutions, including regional ones, equal conditions of access to money and credit regulation instruments at deposit auctions.

MONEY MARKET INTEREST RATE DYNAMICS IN 2003 (% p.a.)\*

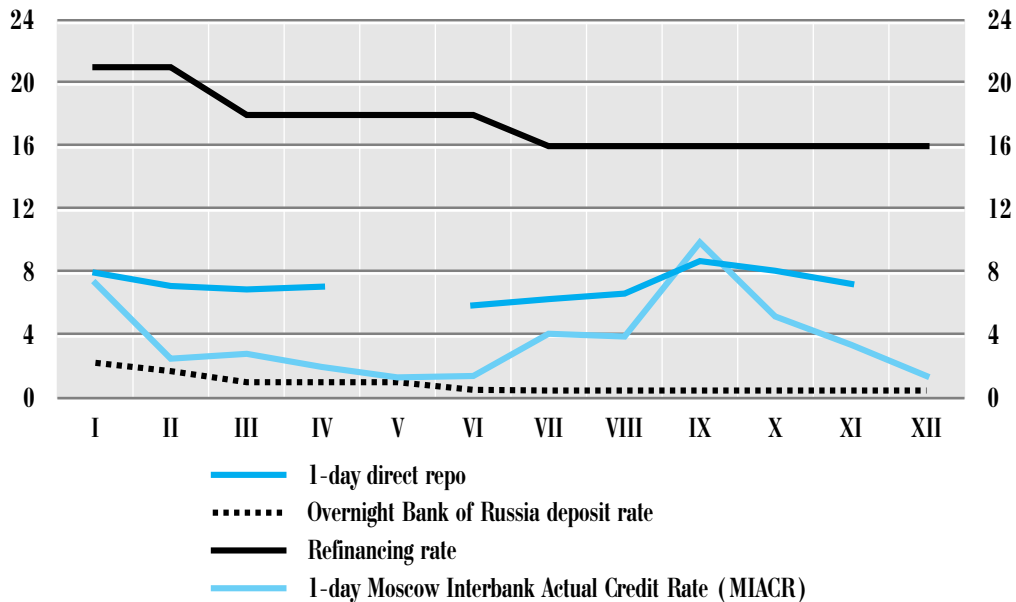


Chart 36

\* The Bank of Russia did not conduct direct repo operations in May and December 2003.

To promote the development of market mechanisms designed for the prompt regulation of banking sector liquidity and to provide credit institutions with new technical facilities for the rapid management of their assets, last year the Bank of Russia carried out the necessary work to organise the conduct of deposit operations using the software of the authorised trading system known as the Electronic Trading System of the Moscow Interbank Currency Exchange. Such operations began to be conducted in March 2004.

In 2003, the Bank of Russia regularly conducted 28-day **exchange modified repo auctions** and placed four federal loan bond (OFZ) issues with the obligation of reverse repurchase in 125, 182, 183 and 804 days. The average daily value of the Bank of Russia debt on exchange modified repo operations stood at 64.1 billion rubles and 95% of all deals were concluded in the first half of the year.

In setting interest rates on exchange modified repo operations, the Bank of Russia tried to avoid influencing the market situation and the conditions of borrowing by the Ministry of Finance. In 2003 as a whole, the cost of borrowing through the above operations for 28 days declined from 9.8% to 2.5%.

After restructuring its own portfolio, the Bank of Russia received the opportunity to **sell government securities on the open market** (without the obligation of reverse repurchase). The Bank of Russia placed government securities from its portfolio in secondary trades, including auctions. In the period from March to December 2003, the Bank of Russia sold a total of 29.8 billion rubles of OFZ bonds from its portfolio. To avoid provoking growth in the cost of borrowings for the Finance Ministry, the Bank of Russia held bond auctions only when demand was high and when the market situation allowed it to sell a large amount of government bonds without premium to the current yield of issues.

In the second half of the year, after Bank of Russia Regulation No. 219-P, dated March 25, 2003, "On Servicing and Circulation of Federal Government Securities Issues" came into force, the Bank of Russia began to conduct exchange modified repo operations and sell federal loan bonds from its portfolio for settlements on the next business day, allowing market participants to enhance the efficiency of managing their own funds.

As there was an oversupply of money, the demand for the instruments used by the Bank of Russia to provide liquidity to banks fell significantly. Gross credit to banks decreased from



21.6 billion rubles to 16.7 billion rubles. At the same time, owing to the segmentation of the Russian financial market and differentiation of credit institutions by the level of liquidity, these instruments were in demand on the market and when necessary, they helped reduce fluctuations of banking sector liquidity levels.

In 2003, the Bank of Russia provided liquidity to credit institutions that complied with its conditions and requirements, using such instruments as intraday loans, overnight loans and Lombard loans backed (blocked) by securities included on the Bank of Russia Lombard List, and conducting direct repo and currency swap operations.

Demand was particularly high for these instruments in the third quarter of 2003 when, after the massive inflow of foreign exchange to Russia in the first half of the year, which was accompanied by growth in the money supply, adequate interest rate cuts on the financial market and the ruble's nominal rise against the dollar, the direction of the short-term capital flow changed: according to balance of payments data, there was a net outflow of private sector capital of \$8.8 billion, whereas in the second quarter there was a net inflow of capital of \$3.9 billion. At the same time, the federal government continued to need large amounts of foreign exchange to repay and service its foreign debt. In that situation, the Bank of Russia had to conduct large-scale currency interventions on the domestic market to meet the increased demand for foreign exchange and this caused a reduction of banking sector liquidity and compelled credit institutions to expand borrowing. In addition to reducing its debt on deposit accounts kept by credit institutions in the Bank of Russia and its obligations of reverse repurchase of securities, the Bank of Russia conducted daily direct repo operations, whose value increased significantly amid growth in interest rates on them. Whenever necessary, the Bank of Russia extended overnight loans and conducted currency swaps with banks. The value of gross credit to banks rose to 54.0 billion rubles as of October 1, 2003.

In 2003, the Bank of Russia extended **overnight loans** to the amount of 14.7 billion rubles. This represents a 10% increase on the previous year, while the number of credit institutions that took such loans rose by more than 40%. Begin-

ning from February 17, 2003, the interest rate on overnight loans and the refinancing rate were set at the same level. Thus, the overnight loan rate is the highest interest rate set by the Bank of Russia. In 2003, it was cut from 18% to 16% p.a.

To be able quickly to back up their liquidity, credit institutions in 2003 widely used Bank of Russia **intraday loans**. In 2003, intraday loans were granted to credit institutions in 16 regions and they totalled 1.5 trillion rubles, 4.6 times the amount granted in the previous year.

In accordance with the decision of its Board of Directors (Protocol No. 23, dated October 3, 2003), in October 2003 the Bank of Russia resumed holding 14-day **Lombard loan auctions** throughout the country. These auctions were held every Tuesday with mostly regional credit institutions participating in them.

In spring 2003, the Bank of Russia Board of Directors decided to increase the adjusted rates used to correct the market value of securities accepted as collateral for Bank of Russia loans. Specifically, the adjusted rates for GKO bonds were raised from 0.9 to 0.95 and OFZ bonds of all kinds from 0.8 to 0.9. In accordance with a decision taken by the Bank of Russia Board in December 2003, the Bank of Russia Lombard List included Russian government external loan bonds and 1999 foreign currency loan bonds. After the necessary technical support procedures are completed, these securities will be accepted as collateral for Bank of Russia loans.

To ensure that regional banks have equal access with Moscow banks to Bank of Russia financial resources, in 2003 the Bank of Russia continued to lengthen the list of regions whose credit institutions had access to intraday and overnight loans. As of January 1, 2004, Bank of Russia branches in 34 regions had the right to grant intraday and overnight loans to credit institutions (four regional branches had this right at the beginning of 2003).

During the year under review, the Bank of Russia actively used **direct repo operations** to provide liquidity to banks. A total of nearly 330 billion rubles were provided to banks through overnight repo operations. In accordance with a Bank of Russia Board decision, on October 14, 2003, the Bank of Russia began to hold regular 1-week and 3-month direct repo auctions. In de-

DYNAMICS OF BANKING SECTOR NET FOREIGN ASSETS IN 2001—2003\*  
(billion US dollars)

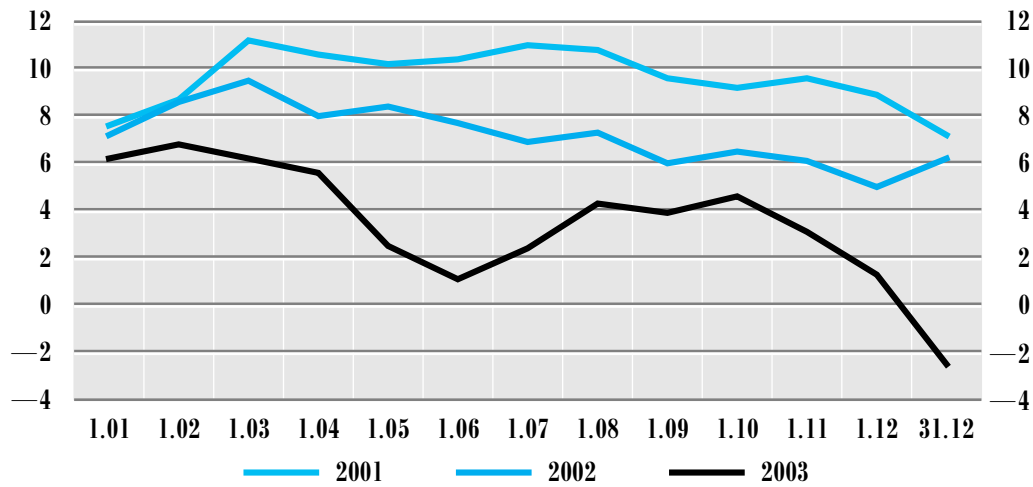


Chart 37

\* The net foreign assets of credit institutions have been calculated on the basis of monetary survey data, which are compiled according to methodology that is different from the methodology of calculating the banking sector's international investment position, especially the accounting for data on non-resident investments in the capital of Russian credit institutions.

termining the interest rate on direct repo operations, the Bank of Russia was guided by the need to reduce interbank market volatility: whenever the threat of a shortage of funds appeared, the repo interest rate represented the upper limit of the overnight interbank rate, containing its further growth.

An additional source of short-term borrowings for credit institutions in the period under review was **currency swap operations**, conducted by the Bank of Russia on the domestic foreign exchange market. These operations were conducted on fixed terms: the swap difference was determined on the basis of the overnight interest rate (and from February 17, 2003, on the basis of the refinancing rate) and funds were provided for one day. The total value of currency swap operations in 2003 stood at \$1.9 billion.

Taking into consideration the liquidity situation in the banking sector, the Bank of Russia refrained from changing reserve requirements and made no unscheduled changes in the required reserves.

The changes in the internal and external economic conditions described above had a significant effect on the development of the banking system in 2003. Growth in funds attracted by banks allowed them significantly to expand lending to the real economy.

The principal sources of the increased funds attracted by credit institutions were, in addition to growth in household and non-financial enterprise sector deposit accounts, banks' external and internal borrowings.

As the ruble made gains against the dollar in nominal terms and interest rates declined on world markets, banks rapidly increased foreign liabilities, while the value of their foreign assets decreased. The absolute reduction of banking sector net foreign assets continued in 2003 and was far more significant than in the previous year (268.8 billion rubles as against 9.5 billion rubles). Moreover, as of January 1, 2004, the value of net foreign assets of credit institutions became negative for the first time since December 1998. These dynamics were the result of the accelerated growth (by 66.5%) in banks' foreign liabilities amid a low level of interest rates on international financial markets. The significant nominal devaluation of the US dollar against the ruble amid the expansion of the non-financial enterprise sector's demand for borrowings was an important contributing factor. The reduction in net foreign assets of credit institutions remained an additional source of growth in banking sector domestic credit.

As the financial standing of non-financial enterprises improved and economic growth acceler-

ated in 2003 and as credit risk declined while the range of potential borrowers expanded and interest rates on loans fell, the volume of bank lending to the non-financial enterprise sector increased by 43% as against 31.1% a year earlier. Taking into consideration a 34.3% rise in the value of funds borrowed from residents (in rubles and foreign currency), this increase was partly financed from other sources, including banking sector foreign liabilities. Growth in credit institutions' foreign liabilities accounted for 31% of the growth in banks' claims on non-financial enterprises and households in 2003 against 14% in 2002.

The increase in claims on non-financial enterprises and households, which amounted to 877.5 billion rubles in absolute terms, became the principal source of growth in the money supply, calculated by monetary survey methodology. At the same time, the value of banking sector net credit to the general government declined by 132.8 billion rubles in 2003, mainly as a result of a significant contraction in the monetary authorities' net claims on the government. This decrease was due to the contraction of the Bank of Russia's government securities portfolio and the expansion of balances in general government accounts.

### II.1.3. EXCHANGE RATE POLICY AND RESERVE MANAGEMENT

**EXCHANGE RATE POLICY.** In line with the Guidelines for the Single State Monetary Policy in 2003, the Bank of Russia pursued its exchange rate policy in 2003 under the conditions of the managed floating exchange rate regime.

The favourable price situation on international markets for major Russian export commodities and the financial market situation, which encouraged Russian companies to increase external borrowings, brought about a massive inflow of foreign exchange to this country in the period under review: the value of funds entered into transit foreign currency accounts rose by almost 50% year on year. A significant increase in the current account surplus created conditions for the strengthening of the Russian national currency. In this situation, the Bank of Russia tried to cushion sharp exchange rate fluctuations that were not caused by fundamental factors and prevent the real effective rate of the ruble from rising too high.

The principal instrument used by the Bank of Russia in implementing its exchange rate policy in 2003 was conversion ruble/dollar operations on the domestic foreign exchange market, which it used along with other monetary policy tools. In conducting currency interventions in the period under review, the Bank of Russia, as a rule, used conversion operations with settlements on the next business day.

The Bank of Russia conducted foreign exchange operations in the course of exchange trading as well as on the over-the-counter interbank foreign exchange market with credit institutions — Bank of Russia counterparties — within the limits established for these credit institutions. The main segment of the market on which the Bank of Russia conducted operations was the Single Trading Session (STS). The value of transactions concluded by the Bank of Russia in the STS by far exceeded the value of its operations in afternoon trading in the Electronic Lot Trading System (SELT) on MICEX and the value of its over-the-counter operations. As the supply of foreign exchange far surpassed demand on the domestic foreign exchange market, the net value of foreign

currency purchased by the Bank of Russia on the domestic foreign exchange market during the period under review increased by 93% year on year to \$33.3 billion (not counting operations with the Finance Ministry).

Banks' strategies on currency positions exerted considerable influence on the exchange rate policy in the period under review. In January—May 2003, when the dollar declined against the ruble in nominal terms, investments in ruble-denominated instruments were extremely attractive and the expectations of the nominal ruble/dollar exchange rate dynamics were positive on the whole, credit institutions mostly cut their long currency positions and opened short currency positions. Nevertheless, most of the short currency positions opened in this period, which created additional supply on the market amid the increased outflow of capital from Russia, were closed in July—September and this also contributed to the stabilisation of the exchange rate. It was not until October—December that banks started re-opening short currency positions, again creating an additional supply of foreign exchange on the market.

On April 15, 2003, the Bank of Russia began to use the average weighted rate of the US dollar at 11.30 a.m. in the STS interbank currency exchange trades for tomorrow settlements as the basis for calculating the official rates of foreign currencies against the ruble. Unlike the previously used STS average weighted dollar/ruble rate in trades for today settlements, this indicator was less susceptible to the influence of fluctuating short-term factors, such as changes in market participants' current liquidity, and was more representative. The date of settlements on conversion transactions in this case coincides with the date on which the official rate set upon the results of these transactions comes into effect. The Bank of Russia virtually stopped conducting STS trades for today settlements, providing the banking sector with some other instruments to manage current liquidity.

As the dollar weakened on world markets in 2003, its nominal rate against the ruble tended

**DOLLAR/RUBLE, EURO/RUBLE AND EURO/DOLLAR  
NOMINAL EXCHANGE RATE DYNAMICS IN 2002—2003**

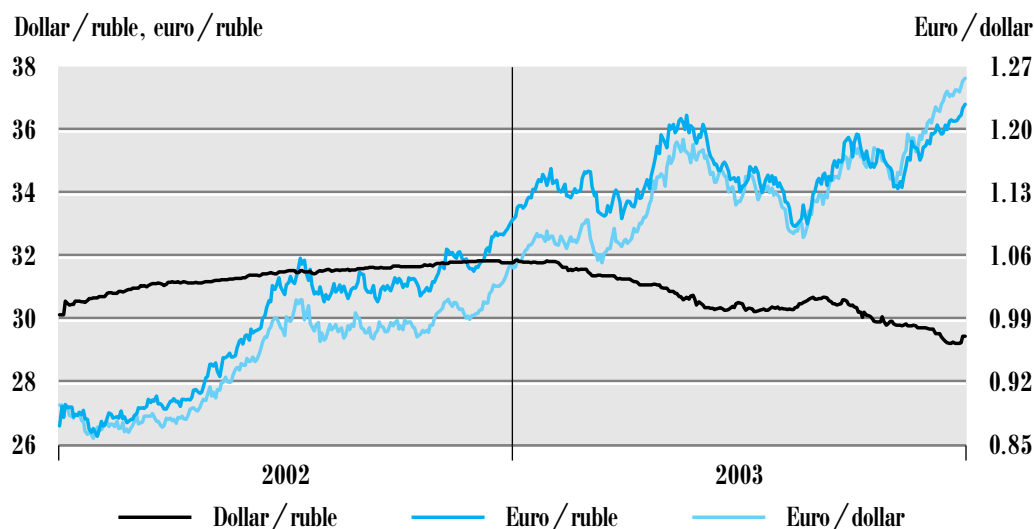


Chart 38

to fall. The duration and scale of the ruble's gains against the dollar were unprecedented since Russia switched to the market exchange rate setting mechanism in the middle of 1992. In 2003, the official rate of the dollar against the ruble declined by 7.3% and as of January 1, 2004, it stood at 29.4545. The ruble's nominal gains against the dollar during the year contributed to the reduction of inflationary expectations and facilitated the attainment of the principal goal of the monetary policy in 2003 — reducing the inflation rate to 12% by the end of the year under review.

The intrayear dynamics of the nominal rate of the dollar against the ruble were characterised by the continuous decline of the US currency in the first half of 2003. On the whole, this trend did not run counter to the exchange rate benchmarks: as the real effective rate of the ruble remained stable (in the first half of the year it rose by just 1.7% compared to December 2002), the export-oriented sectors continued to make windfall profits and GDP and investment grew at stable rates, the Bank of Russia focused its efforts on maintaining smooth exchange rate dynamics.

The second half of the year saw the dollar-ruble exchange rate volatility increase against the background of an oversupply of rubles on the interbank market. In September, credit institutions stepped up their activity in opening long currency

positions, as devaluation expectations on the Russian foreign exchange market increased a little owing to a sharp fall of the euro against the dollar on the world currency market and a rise in the number of clients' orders to buy and sell foreign exchange. The expectations of the dollar's rise against the ruble amid a sufficiency of free resources caused market participants to play more actively for the dollar's rise at the beginning of the month, but massive currency interventions conducted by the Bank of Russia prevented the dollar from making any significant gains against the ruble.

In October—December 2003, the ruble made steady gains against the dollar in nominal terms. A major factor of the ruble's growth in that period was the weakening of the US currency on the international currency market: in December, for instance, the dollar lost 5% against the euro.

Taking into consideration the difference between the inflation rates in Russia and the United States, the dollar's fall against the ruble in nominal terms in 2003 caused the real rate of the ruble to rise significantly against the dollar (by 18.9% December on December). And taking into consideration the euro's gains against the dollar on international markets and the corresponding euro/ruble dynamics, the change in the real rate of the ruble against the euro as compared with

**BANK OF RUSSIA OPERATIONS ON THE DOMESTIC FOREIGN EXCHANGE MARKET  
IN 2003 (billion US dollars)**

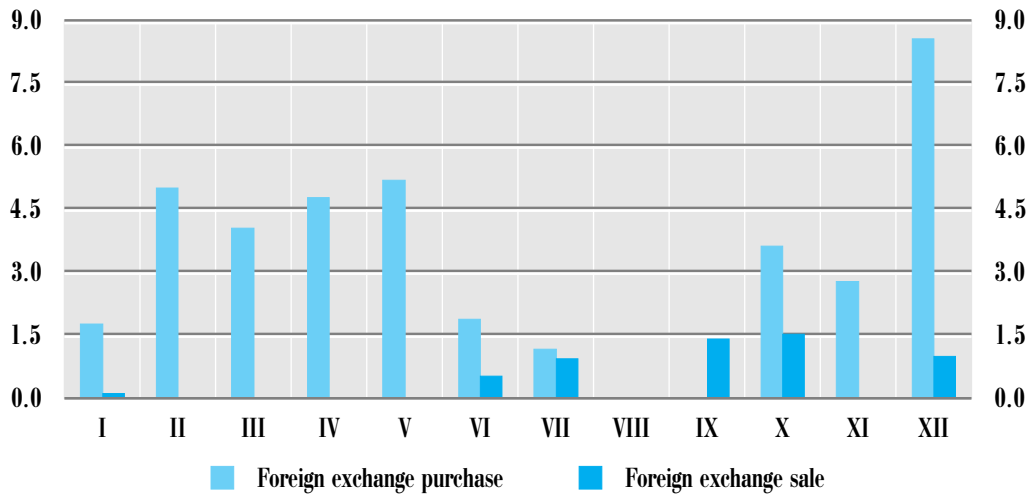


Chart 39

**AVERAGE MONTHLY REAL EXCHANGE RATE DYNAMICS OF THE RUBLE IN 2003  
(% growth on December 2002)**

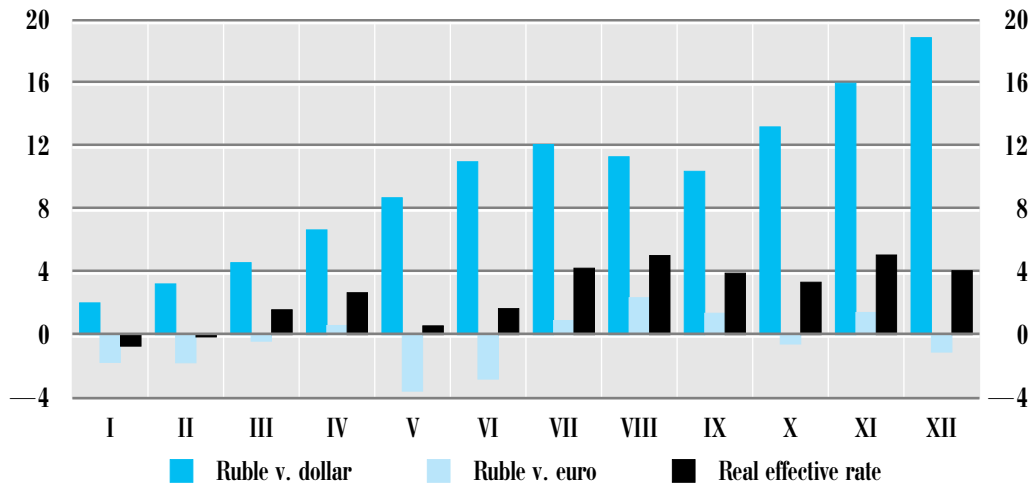


Chart 40

December 2002 was both positive and negative. As a result, in December 2003, the ruble was down 1.1% against the euro year on year. The real effective rate of the ruble demonstrated moderate growth in the period under review and at the end of the year the increase amounted to 4.1% compared to December 2002.

On an average annualised basis, the ruble gained 13.6% against the dollar in real terms but lost 4.7% against the euro, while its real effective rate rose by an insignificant 0.8%.

Therefore, to ensure the competitiveness of Russian merchandise on the domestic and inter-

national markets, in 2003 the Bank of Russia did everything possible to prevent the real effective rate of the ruble from rising too high. In so doing, it accomplished two interrelated tasks: on the one hand, it contained the ruble's growth and on the other hand, it prevented the money supply on the domestic foreign exchange market, caused by its foreign currency purchases, from rising to a level that could have had serious consequences for medium-term inflation. The attainment of this goal was facilitated by the extensive use of market instruments in managing banking sector short-term liquidity amid a

**GROWTH DYNAMICS OF AVERAGE ANNUAL REAL RATES OF THE RUBLE IN 1996—2003**  
(growth as % of previous year)

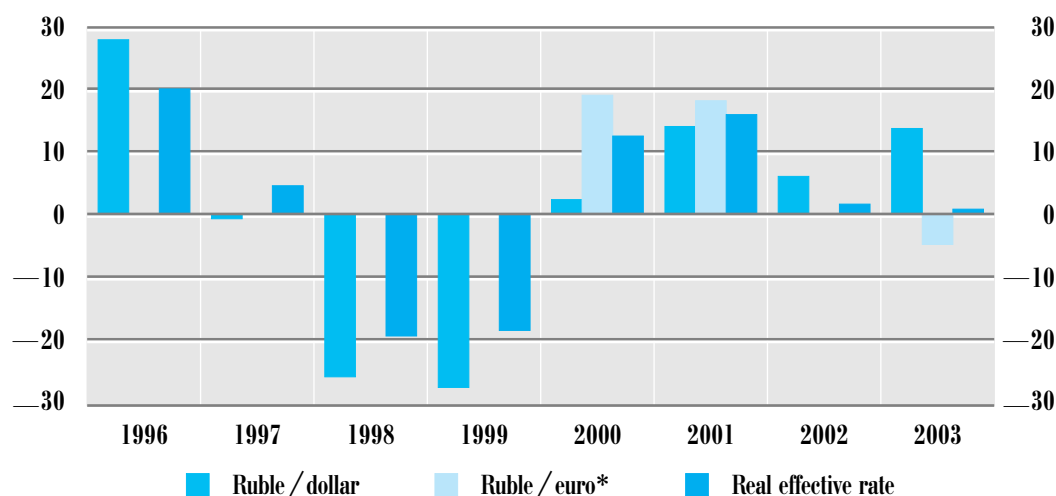


Chart 4.1

\* Ruble/euro real rate dynamics since 2000.

relatively small inflow of short-term capital. As a result, growth in the real effective rate of the ruble did not exceed the parameters set in the Guidelines for the Single State Monetary Policy in 2003.

**FOREIGN EXCHANGE RESERVE MANAGEMENT.** The Bank of Russia managed foreign exchange reserves in line with the Main Principles of Managing Bank of Russia Foreign Exchange Reserves, approved by the Bank of Russia Board of Directors.

The principal objective of managing the reserves was to maintain an optimal level of safety, liquidity and profitability of reserve assets. The Bank of Russia tackled this task by actively diversifying investments with the aid of operations on international currency and financial markets. In addition, it restricted credit risks by setting credit risk limits on its counterparties.

The Bank of Russia took account of the following factors in managing reserves in 2003: a large trade surplus, which ensured a stable inflow of foreign exchange, cuts in interest rates on major instruments of the international financial

market and significant exchange rate fluctuations of major world currencies.

Reserve management was based on the portfolio principle, which means that all funds were divided between operational and investment portfolios. The operational portfolio includes the most liquid instruments of the money market and some of the capital market. The investment portfolio funds are put into longer-term and, consequently, more profitable instruments of the international capital market.

In the period under review, Bank of Russia foreign exchange reserves increased by 67%, from \$42.1 billion to \$70.3 billion. Thanks to the monetary and exchange rate policies pursued by the Bank of Russia in 2003, Russia's international reserves increased to \$76.9 billion, a rise of more than 60% on the end of 2002 (\$47.8 billion). In 2003, the international reserves grew by \$29.1 billion against \$13.2 billion in 2002<sup>1</sup>. The main reason for the growth in gold and currency reserves was Bank of Russia operations on the domestic foreign exchange market, which were designed to prevent excessive growth in the ruble's real effective rate.

<sup>1</sup> Net of Bank of Russia short-term liabilities denominated in freely convertible currencies.

## II.2. BANKING REGULATION AND SUPERVISION

### II.2.1. OFF-SITE SUPERVISION AND INSPECTION OF CREDIT INSTITUTIONS

In 2003, the Bank of Russia implemented a series of measures to accomplish the tasks set in the Russian Banking Sector Development Strategy and banking legislation. The principal objectives of the supervisory policy pursued by the Bank of Russia were, as before, to maintain the stability of the Russian banking sector, protect the legitimate interests of creditors and depositors of credit institutions and take sound decisions in the field of banking regulation and supervision.

In pursuance of Federal Law No. 177-FZ, dated December 23, 2003, “On the Insurance of Personal Deposits in Russian Federation Banks,” the Bank of Russia elaborated and issued regulations designed to ensure the implementation of this Law. Bank of Russia Regulation No. 248-P “On the Procedure for Considering a Bank’s Request by the Bank of Russia to Announce its Decision on the Bank’s Compliance with the Requirements for the Participation in the Deposit Insurance System” and Bank of Russia Regulation No. 247-P “On the Procedure for Considering by the Bank of Russia an Appeal against its Decision to Reject the Repeat Request Concerning a Bank’s Compliance with the Requirements

for the Participation in the Deposit Insurance System” stipulate the procedures for selecting banks for the deposit insurance system. Bank of Russia Ordinance No. 1379-U “On the Evaluation of the Financial Soundness of a Bank for the Purpose of Recognising it as Sufficient to Participate in the Deposit Insurance System”<sup>1</sup> establishes the set of indicators, the methodology of calculating them and the determination of the final result on them for the purpose of recognising if a bank is financially sound to participate in the deposit insurance system. This Ordinance sets out new principles of evaluating the financial stability of a bank, including the use of indicators that make it possible to evaluate the quality of its management, profitability, the transparency of its ownership structure and the organisation of its risk management system and internal control service.

The most important step was the adoption of regulations designed to improve the quality of capital of credit institutions. Bank of Russia Regulation No. 215-P, dated February 10, 2003, “On the Methodology of Calculating the Own Funds (Capital) of Credit Institutions,” excluded from

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<sup>1</sup> Bank of Russia Regulation No. 247-P, Bank of Russia Regulation No. 248-P and Bank of Russia Ordinance No. 1379-U were adopted on January 16, 2004.





the capital calculation those sources of own funds (authorised capital, income from the issue of securities, profit, etc.) which were formed by investors through using inappropriate assets.

Should it be discovered that inappropriate assets were used in forming the sources of fixed and/or additional capital or a part thereof, the Bank of Russia will order the credit institution to exclude these sources of own funds or a part thereof from the capital calculation. In addition, the Bank of Russia has introduced a requirement whereby in calculating their required ratios, credit institutions should use their own funds (capital) as established by the Bank of Russia evaluation and these funds should be accounted for in the reports of credit institutions and banking groups.

At the same time, the Bank of Russia issued Ordinance No. 1246-U, dated February 10, 2003, "On Actions to Be Taken upon the Discovery of the Instances (Signs) of the Formation of Sources of Own Funds (Capital) or a Part Thereof Using Inappropriate Assets," which specified the procedure for ordering credit institutions to correct their capital and established the sequence of actions to be taken by the corresponding Bank of Russia divisions.

The Bank of Russia upgraded its loan loss provisioning regulations and took steps to introduce internationally accepted practices. Regulation No. 232-P, dated July 9, 2003, "On the Procedure for Making Loss Provisions by Credit Institutions," which came into force on March 1, 2004, provides for the further development of the principle of using professional (informed) judgement in evaluating the quality of assets. The document allows credit institutions to take into account a high-quality security in making provisions and introduces the criterion of substantiality, allowing credit institutions to create a reserve for the portfolio of homogeneous claims (liabilities) of no substantial importance from the viewpoint of the scale of activity without making an informed judgement on each element individually.

To ensure that banks adequately assess the risks they assume, in 2003 the Bank of Russia issued a number of operating instructions, which established a special procedure for applying supervisory measures with regard to the compul-

sory ratios N5 (Instruction No. 44-T, dated March 26, 2003), N13 (Instruction No. 124-T, dated August 21, 2003) and N8, N9, N11, N11.1 and N14 (Instruction No. 121-T, dated August 20, 2003 and Instruction No. 130-T, dated September 1, 2003). In addition, taking into account the requirements of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), which invalidated a number of compulsory ratios, the Bank of Russia drafted the Instruction "On Compulsory Bank Ratios,"<sup>1</sup> which took into consideration the national and international expertise in banking supervision. The Instruction reduced the number of compulsory ratios and changed the methodology of calculating some compulsory ratios in order to ensure a more appropriate evaluation of risks. The numerical values of the instant liquidity ratio (N2) and current liquidity ratio (N3) were reduced, while the Instruction changed the methodology of calculating the adequacy ratio of banks' own funds (capital) and established a requirement for banks to observe the required ratios on a daily basis.

To implement Articles 62 and 69 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), the Bank of Russia issued Ordinance No. 1317-U, dated August 7, 2003, "On the Procedure for Establishing Correspondent Relations by Authorised Banks with Non-resident Banks Registered in States or Territories which Grant Tax Benefits and (or) Do Not Require the Disclosure and Provision of Information in Conducting Financial Operations (Offshore Zones)" and Ordinance No. 1318-U, dated August 7, 2003, "On the Creation and Size of a Reserve for Operations Conducted by Credit Institutions with Residents of Offshore Zones." The documents divide offshore zones into three groups (depending on the development level of the corresponding states' legal infrastructure, if they have an effective anti-laundering system and the extent to which their supervisory authorities are prepared to co-operate in the field of banking supervision and information exchange) and establish different provisioning requirements for operations with residents in offshore zones depending on which of the three groups of offshore zones they belong to.

<sup>1</sup> *Instruction No. 110-I, passed by Bank of Russia on January 16, 2004.*

To upgrade the legislative framework of reporting, in 2003 the Bank of Russia specified the requirements for publishing reports by credit institutions and parent banks of banking/consolidated groups, including the reporting times and the mandatory publishing of the annual consolidated report of a consolidated group (Bank of Russia Ordinance No. 1270-U, dated April 14, 2003, “On the Reports Published by Credit Institutions and Banking/Consolidated Groups”). In addition, the Bank of Russia drew up a list of reports (model) by the members of a group that must be used in compiling consolidated reports and specified the list of compulsory ratios for banking/consolidated groups and the procedure for calculating a group’s own funds (net assets) and indicators by non-credit institutions — members of a group used in calculating compulsory ratios (Bank of Russia Regulation No. 246-P, “On the Procedure for Compiling Consolidated Reports by the Parent Credit Institution of a Banking/Consolidated Group”)<sup>1</sup>.

As regards the methodology and organisation of current supervision, the Bank of Russia continued to bring the existing system of banking regulation into compliance with internationally accepted standards, especially the Basel Committee’s Core Principles for Effective Banking Supervision. The overall idea behind the upgrading of regulatory and supervisory procedures in 2003 was to continue to promote the use of substantive principles of evaluating the situation in the banking sector as a whole and in each credit institution in particular.

As for off-site supervision, the Bank of Russia focused its efforts on the implementation of the proactive function of banking supervision<sup>2</sup>. Specifically, it took steps to upgrade the early warning system based on documentary analysis data and promote the use of supervision on a consolidated basis. In determining the banking supervision regime and the use of specific supervisory measures, the Bank of Russia was guided above all by the nature of risks assumed by the

credit institution and the quality of risk management.

The Bank of Russia paid particular attention to improving the quality of banking capital and preventing fictitious capitalisation practices. During the year, the Bank of Russia inspected 562 banks, or 42% of the total number of operating credit institutions, to detect the use of inappropriate assets in the formation of the sources of own funds (capital). Evidence of fictitious capital was discovered or suspected in 118 credit institutions, or almost in one in five of the credit institutions inspected.

Of the above 118 credit institutions as of January 1, 2004:

- 13 credit institutions corrected their capital at the order of the corresponding regional branches of the Bank of Russia to the total amount of 316.4 million rubles;
- two credit institutions were ordered to correct their capital to the total amount of 3,494.2 million rubles upon the results of the examination by the Bank of Russia Banking Supervision Committee (BSC) of the materials provided by Bank of Russia regional branches;
- one credit institution had its banking licence revoked by the decision of the BSC;
- 35 credit institutions reported they had dealt with the violations of own funds formation requirements discovered and their explanations were accepted by the corresponding regional branches of the Bank of Russia;
- the corresponding regional branches of the Bank of Russia prepared materials on 14 credit institutions for examination by the BSC;
- materials on the remaining credit institutions are under consideration at the moment.

After Bank of Russia Regulation No. 215-P, dated February 10, 2003, came into force, 10 credit institutions independently corrected their capital to the total amount of 167.5 million rubles.

The number of violations of rules and regulations decreased in 2003 and this was reflected in

<sup>1</sup> Adopted by the Bank of Russia on January 5, 2004.

<sup>2</sup> In accordance with advanced international banking supervision practices and recommendations of the Basel Committee on Banking Supervision, proactive supervision means that the supervisor has effective procedures and information and analysis systems to monitor the current financial state of credit institutions and their compliance with applicable laws and regulations, detect negative trends in the activities of credit institutions at the earliest possible stages and take pre-emptive supervisory measures in response.

the dynamics of sanctions used against credit institutions. As the frequency of using sanctions against credit institutions continued to decline, the main emphasis was on preventive measures. An adequate level of supervision was ensured by a balanced assessment of the situation in credit institutions, which took into account the most likely prospects for their future, and the optimal implementation by the supervisory authority of its powers and functions assigned to it by the applicable legislation.

As a result of the analysis of credit institutions' reports, in 2003 the Bank of Russia informed the management and/or board of directors (supervisory board) of 1,188 credit institutions about shortcomings in their work and held meetings with the managers of 367 banks.

As for sanctions used in 2003, 75 banks had restrictions imposed on them or were banned from taking household savings on deposit (as against 123 banks in 2002) and 51 banks were prohibited from opening branches (as against 83 banks in 2002); 342 banks were fined for violations of prudential standards (as against 473 banks in 2002); 149 banks were ordered to comply with the required ratios established by the Bank of Russia (as against 150 banks in 2002).

When carrying out the functions assigned to it, the Bank of Russia exercised control over the presentation of reports on the mandatory annual audit of the reports of credit institutions and banking groups. In compliance with the requirement of the Federal Law "On Banks and Banking Activities" concerning the mandatory annual audit, audits were conducted in 1,319 credit institutions, or 99.2% of the total number of credit institutions that had banking licences as of January 1, 2003. Nine credit institutions failed to present auditors' reports to the Bank of Russia, mainly because their banking licences had been revoked.

Twenty-five credit institutions that had banking licences as of January 1, 2003, were parent banks within the banking groups and as such, they were required by the law to conduct audits to confirm the veracity of the consolidated reports of their respective banking groups. All credit institutions that were parent banks within banking groups complied with this requirement and published consolidated reports confirmed by auditors in the general press.

To optimise banking supervision, in 2003, the Bank of Russia upgraded its instruments to analyse the financial state of credit institutions. It updated recommendations on the analysis of the financial state of credit institutions and modernised the computer system designed to analyse the financial standing of banks.

In 2003, the Bank of Russia and the Russian Government worked together to draft a new version of the Russian Banking Sector Development Strategy for 2004 to 2008, which is to be adopted in 2004.

In 2003, the International Monetary Fund and the World Bank published their final report on the survey of the Russian financial system they had conducted in collaboration with the Bank of Russia (Financial Sector Assessment Programme). They examined the reports of Russian credit institutions (which account for 80% of banking sector assets), including those compiled to international standards, to determine their financial stability in the event of a crisis. The study showed that the Russian banking sector was fairly stable. It also contained recommendations on ways to improve the banking system and banking supervision in Russia. The Bank of Russia is applying them in practice and they have been included in the new version of the Russian Banking Sector Development Strategy.

To upgrade banking supervision and make it more effective, the Bank of Russia conducted an experiment to introduce the institute of bank curators. The results formed the basis of the Bank of Russia Draft Regulation on the Curator of a Credit Institution.

In line with international practice to disclose information on banking supervision, the Bank of Russia published the Report on Banking Sector and Banking Supervision Development, which was also placed on the Bank of Russia Web site. The Report offers a comprehensive survey of the Russian system of banking regulation and supervision, evaluates its compliance with internationally accepted standards and contains information on the principal areas of work of the supervisory divisions of the Bank of Russia. It also describes in detail the implemented and planned measures to upgrade the system of banking regulation and supervision.

In continuing its efforts to make the banking sector more transparent and bolster market dis-

cipline, in 2003 the Bank of Russia disclosed information, placing monthly data on the state of the banking sector on its Web site. In addition, at the proposal of the Bank of Russia, credit institutions began more actively to use the opportunity to place data on their activities, including profit and loss accounts, on the Bank of Russia site. Initially (April 2003), 198 credit institutions, including 15 of the top 30 Russian banks, disclosed information on their activities on the Bank of Russia Web site. By January 1, 2004, 687 credit institutions had taken the opportunity, including 27 of the top 30 banks.

To carry out measures in preparation for the transition to international accounting standards (IAS), envisaged by Russian Banking Sector Development Strategy, the Bank of Russia drew up the Plan for the Conversion of the Russian Banking Sector to IAS from January 1, 2004. The Plan provides for the elaboration of rules and regulations on compiling IAS-compatible financial reports and making the necessary amendments to the applicable legislation and Finance Ministry and Bank of Russia regulations and sets out the general principles and rules of conversion to IAS.

To implement this Plan, the Bank of Russia issued directives on how credit institutions should compile and present financial reports and methodological recommendations on the procedure credit institutions should follow when compiling and presenting financial reports. It elaborated training programmes for staff of the Bank of Russia and credit institutions to teach them international standards in 2003—2004. Training for specialists from the Bank of Russia and credit institutions, including internal auditors, began in September 2003 and one-day seminars on IAS and their application were held for CEOs from commercial banks.

The aim of the **Bank of Russia inspections** conducted in 2003 was to determine the real financial standing of and prospects for the development of credit institutions on the basis of a risk-oriented analysis of existing and possible problems in their activity.

In conducting inspections, particular attention was paid to:

- compliance by credit institutions with Russian legislation and Bank of Russia regulations;

- the state of accounting and credibility of financial, statistical and accounting reports presented to the Bank of Russia;
- how credit institutions made provisions in good time and in full;
- the size and sufficiency of own funds (capital) of credit institutions;
- the quality of assets of credit institutions;
- bank liquidity characteristics;
- risk management systems and the management and effectiveness of internal control systems of credit institutions.

In accordance with the Annual Consolidated Plan of Comprehensive and Thematic Inspections of Credit Institutions and Branches of Credit Institutions for 2003, the Bank of Russia conducted 1,341 inspections of credit institutions and branches of credit institutions (702 credit institutions and 639 branches of credit institutions). Inter-regional inspections were conducted in 61 credit institutions and 184 branches of these credit institutions. The Bank of Russia conducted 814 comprehensive inspections of credit institutions, which included inspections of their branches, and 527 selective inspections of credit institutions and their branches.

The inspection divisions of Bank of Russia regional branches conducted 839 unscheduled inspections of credit institutions and their branches. Unscheduled inspections were conducted whenever it was necessary to verify the results of off-site inspections and prevent possible threats to the interests of creditors and depositors of credit institutions. The prime objectives of unscheduled inspections were to check the credibility of reports and accounts, the observance of own funds (capital) formation procedures, credit institutions' compliance with the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism, accounting discipline and cash operations conducted by credit institutions and their branches.

The inspections of credit institutions and their branches revealed 25,427 violations of Russian federal laws and Bank of Russia regulations, of which 3,447 violations, or 13.5%, had a negative effect on the financial standing of credit institutions and their branches.

Most of the violations that adversely affected the financial standing of credit institutions were

committed in operations with clients. More than 1,287 violations of this kind, or 37% of the total, were discovered, of which:

- 451 violations were connected with loan classification and loan loss provisioning;
- 293 violations were committed when conducting deposit operations;
- 163 violations were committed in the book-keeping of lending operations;
- 152 violations were connected with the analysis of borrowers' finances.

As for the violations of loan classification and loan loss provisioning procedures, most of them consisted of classifying loans in lower risk groups than the Bank of Russia regulations required and making inadequate provisions for probable losses on loans.

In the book-keeping of lending operations, credit institutions committed violations such as failing to account in time for accrued interest in their balance sheets, failing to transfer in time overdue debt on principal and interest to the overdue debt balance-sheet accounts, failing to transfer in time accrued interest from balance-sheet to off-balance-sheet accounts and incorrectly entering debt on fixed-term loans to accounts that did not correspond to the time of the operations.

The violations in conducting deposit operations were connected with discrepancies between the dates on which funds were recorded in balance-sheet accounts and the dates indicated in deposit agreements, late or incomplete interest payments under deposit agreements and interest payments on deposits and deposit accounts of some categories of individuals and corporate entities at inflated rates.

Other typical violations that affected the financial standing of credit institutions were non-compliance with the required ratios, false reporting and distortions in income and expense accounting.

In addition to violations of the law, Bank of Russia inspections revealed other shortcomings (1,663) in the work of credit institutions.

Proceeding from the inspection results, inspectors sent prescriptive orders to credit institutions to eliminate the shortcomings discovered in their work or took other corrective measures stipulated

by Article 74 of the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)."

To implement the provisions of the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)," the Bank of Russia issued the following regulations on Bank of Russia inspections: Instruction No. 105-I, dated August 25, 2003, "On the Procedure for Conducting Inspections of Credit Institutions and their Branches by Authorised Representatives of the Central Bank of the Russian Federation," and Instruction No. 108-I, dated December 1, 2003, "On Organising Inspections by the Central Bank of the Russian Federation (Bank of Russia)." These instructions aim to create an effective mechanism of co-operation between credit institutions and the authorised representatives of the Bank of Russia in conducting inspections of credit institutions and their branches and improve the organisation of Bank of Russia inspections in accordance with the recommendations of the Basel Committee on Banking Supervision.

The principal objectives of the above Bank of Russia regulations are to improve the organisation of inspections and, in conducting inspections of credit institutions and their branches, implement the principle of evaluating their performance on the basis of the professional judgement concerning the risks they assume, the system and quality of management and internal control and the financial standing of credit institutions and prospects for their future.

In 2003, the Bank of Russia took steps to implement the provisions of the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism, conducting inspections of credit institutions and their branches from the viewpoint of the requirements of this law.

A new system of on-site supervision was introduced in 2003 to implement the concept of the development of inspections. The introduction of the institute of inspectors-general created conditions for more effective off-site and on-site supervision and co-operation between the Bank of Russia's authorised representatives inspecting credit institutions and bank curators and the provisional administrations of credit institutions.

## II.2.2. REGISTRATION AND LICENSING OF BANKING ACTIVITIES

The total number of operating credit institutions in 2003 was unchanged from 2002 and stood at 1,329. In 2003, the Bank of Russia registered 16 credit institutions (as against 41 in 2002 and 30 in 2001), of which 14 were banks and two non-bank credit institutions. Sixty-five credit institutions, or 4.9% of the total, broadened the range of their activities in 2003 (as against 101 credit institutions, or 7.6% of the total, in 2002) by obtaining additional banking licences from the Bank of Russia.

To accomplish the tasks set in the Russian Banking Sector Development Strategy and comply with the requirements of banking legislation, the Bank of Russia ensured the fulfilment of the following requirements in taking decisions on the state registration of credit institutions and licensing of banking operations in 2003:

- it took action to prevent the establishment and expansion of the activities of credit institutions incapable of ensuring the appropriate level of financial stability;
- it ensured that managers of credit institutions met qualification and business reputation requirements;
- it made sure that a credit institution had a transparent ownership structure;
- it made sure that credit institutions formed their authorised capital by legal means to prevent the payment of shares (stakes) in credit institutions with inappropriate assets.

In 2003, the Bank of Russia prohibited 12 credit institutions from expanding the range of their activities. Three of them were penalised for having an opaque structure of share (stake) ownership and nine for violations of the law and Bank of Russia regulations on authorised capital formation, financial instability and failure to comply with Bank of Russia requirements for the size of own funds.

While tackling the problem of making the ownership structure of credit institutions more transparent, the Bank of Russia tightened requirements for the financial condition of the founders (members) of credit institutions. The procedure established by the Bank of Russia to

evaluate the financial condition of the corporate founders (members) of credit institutions is based on the principle of using professional judgement as a result of the examination of the purchasers' performance indicators, taking into account the nature and scale of their activities and sectoral and regional affiliation.

The Bank of Russia actively used the requirement to provide and disclose information on the ownership structure of credit institutions in taking decisions on granting credit institutions permission to broaden the range of their banking operations, especially taking household savings on deposit.

In continuing to optimise procedures for giving banks access to the banking services market, the Bank of Russia issued a regulation which simplified bank merger and acquisition procedures and reduced the time of and simplified the procedure for bank re-organisation (it optimised the itinerary and duration of the movement of documents between the Bank of Russia, credit institutions and the registration authority).

The Russian banking sector remained attractive to foreign investors in 2003. Three wholly foreign-owned banks were set up in Russia and the total number of such banks rose to 32. The non-resident part of the authorised capital of the Russian banking sector amounted to 18.9 billion rubles as of January 1, 2004, or 5.2% of the registered authorised capital of operating credit institutions. The share of wholly foreign-owned banks amounted to 45 billion rubles, or 5.5% of the aggregate own funds (capital) of the Russian banking sector, and 13 billion rubles, or 3.6% of the aggregate authorised capital of the Russian banking sector.

The capital base of credit institutions expanded at rapid rates in 2003. As of January 1, 2004, the registered authorised capital of operating credit institutions increased from 300.4 billion rubles to 362.0 billion rubles. Most of the growth was due to the increase in resident funds (95% of increment in authorised capital). During the year under review, the number of credit institutions divided into two

**NUMBER OF REGISTERED OPERATING CREDIT INSTITUTIONS  
AND BANKING LICENCES GRANTED TO THEM**

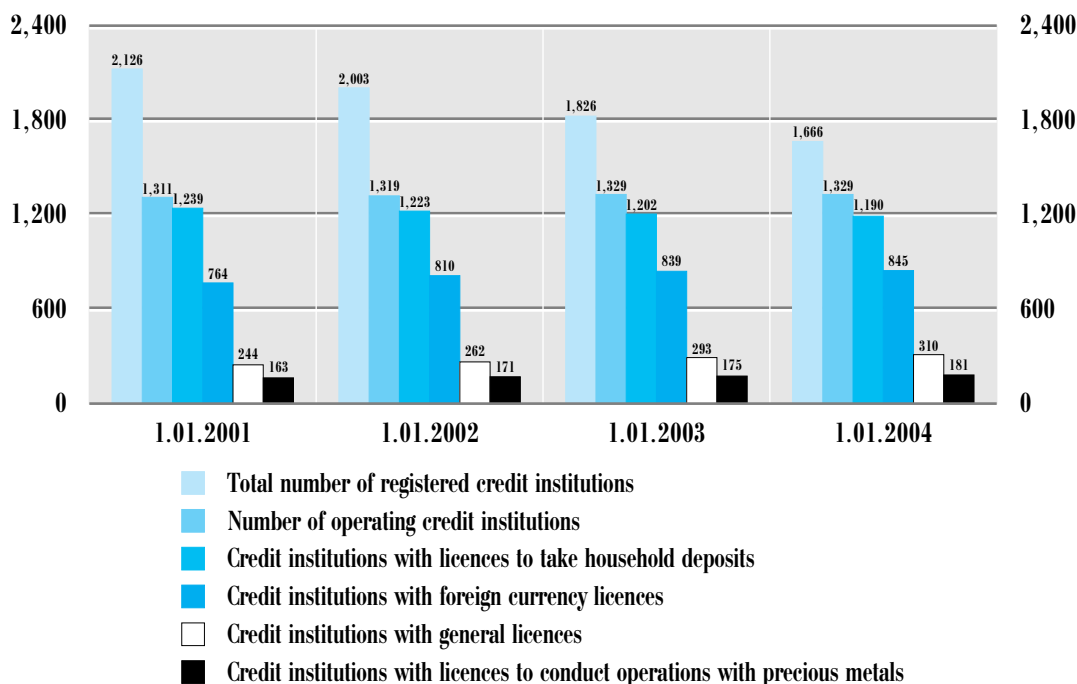


Chart 42

**NUMBER OF OPERATING CREDIT INSTITUTIONS WITH FOREIGN INTEREST  
IN AUTHORISED CAPITAL**

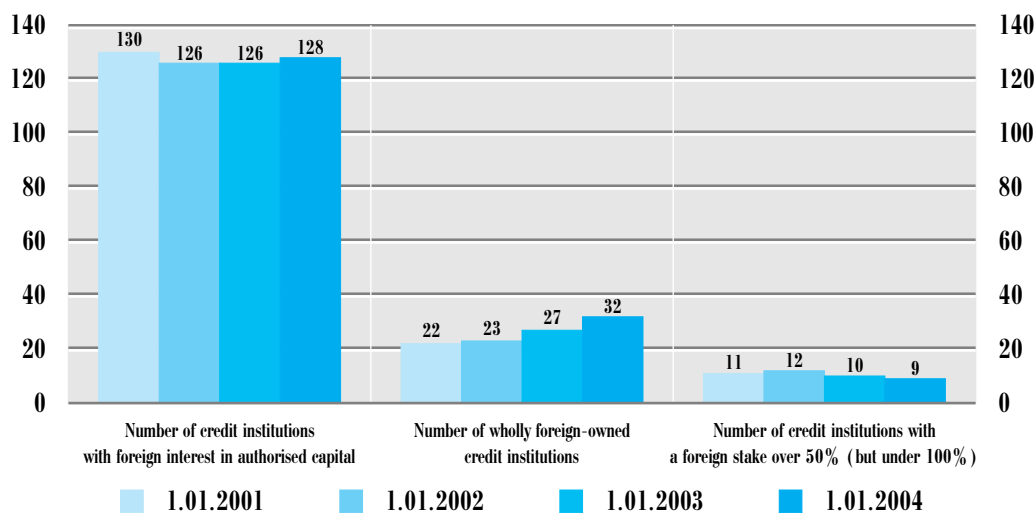


Chart 43

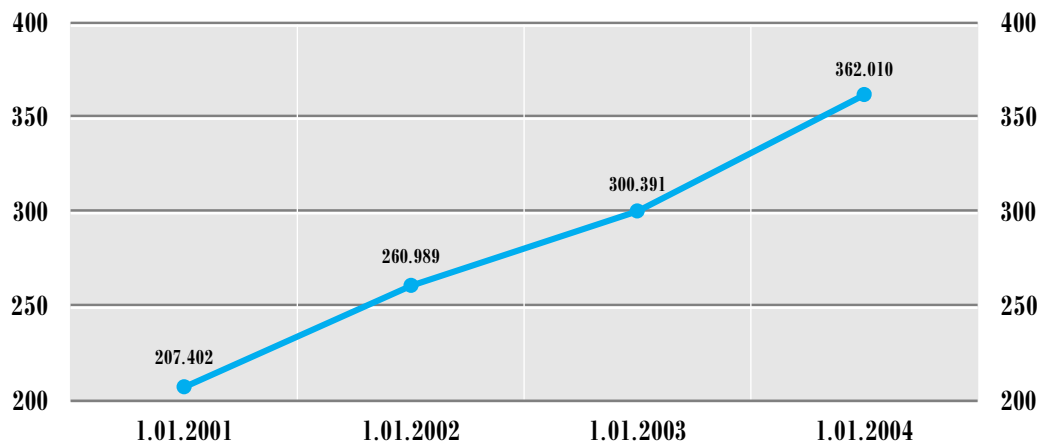
categories in terms of authorised capital increased as follows:

- the number of credit institutions with an authorised capital of more than 300 million rubles rose by 38 to 208, or 15.7% of the total;

- the number of credit institutions with an authorised capital from 60 million to 300 million rubles increased by 50 to 371, or 27.9% of the total.

Seven credit institutions were reorganised through mergers in 2003 as against four in 2002.

**DYNAMICS OF REGISTERED AUTHORISED CAPITAL OF OPERATING CREDIT INSTITUTIONS  
(billion rubles)**



*Chart 44*

The Savings Bank (Sberbank) closed 117 branches to optimise its branch network. The total number of bank branches decreased by 107 as 10 new bank branches opened. At the same time, the number of internal bank structures that provided customer services outside bank branches

and main offices rose from 23,884 to 26,468 (Sberbank increased the number of such structures from 17,766 to 19,197). Of these, the number of additional offices (a kind of bank structural units) rose by 1,021 over the year (of which, additional Sberbank offices increased by 501).



## II.2.3. BANK BANKRUPTCY (INSOLVENCY) PREVENTION AND PHASING OUT INSOLVENT CREDIT INSTITUTIONS FROM THE BANKING SERVICES MARKET

To upgrade the legal and organisational status of the provisional administrations of credit institutions in compliance with the requirements of federal legislation, the Bank of Russia issued Regulation No. 241-P, dated November 26, 2003, “On the Provisional Administration of a Credit Institution.”

Bank of Russia Ordinance No. 1241-U, dated January 21, 2003, “On the List of Data and Necessary Documents for the State Registration of a Credit Institution in Connection with its Liquidation and the Procedure for Presenting Them to the Bank of Russia,” is designed to increase Bank of Russia control over the compliance of a liquidating body with the requirements of the Civil Code of the Russian Federation and the applicable bankruptcy legislation at all stages of the bankruptcy (liquidation) proceedings, beginning from the publication in official sources and the media of the report on the decision to declare a credit institution insolvent (bankrupt) or the adoption of the liquidation decision by the owners to the closing of the liquidator’s account and the transfer of the liquidated credit institution’s documents to the archives.

As the situation in the banking sector improved in 2003, the number of credit institutions liable for insolvency (bankruptcy) prevention procedures under Article 4 of the Federal Law “On the Insolvency (Bankruptcy) of Credit Institutions” continued to decrease. The number of such credit institutions declined from 26 as of January 1, 2003, to 20 as of January 1, 2004. In 2003, 18 credit institutions independently rectified the faults that made them liable to insolvency (bankruptcy) prevention procedures. They were not ordered to do so by the Bank of Russia.

The Bank of Russia controlled the implementation of the financial rehabilitation (re-organisation) plans of 30 credit institutions, of which 16 restored their financial standing and

were taken off the Bank of Russia watch list during the year.

The number of credit institutions which had allowed their own funds (capital) to become smaller than their authorised capital by the end of the accounting month continued to decrease in 2003. In the year under review, the Bank of Russia ordered 29 credit institutions to match their authorised capital with the size of own funds (capital), of which two credit institutions had their banking licences revoked for failure to comply with this requirement in time. The number of credit institutions which allowed their own funds (capital) to become smaller than their authorised capital, registered in accordance with the established procedure, decreased from nine as of January 1, 2003, to seven as of January 1, 2004.

In 2003, the Bank of Russia controlled the activities of 29 provisional administrations of credit institutions, of which 14 were appointed in the period under review. Of these 14 provisional administrations, nine were appointed in connection with the revocation of banking licences from credit institutions and five were appointed to operating credit institutions (the functions, powers and terms of office of these provisional administrations were later changed in connection with the revocation of banking licences from the corresponding credit institutions). Twenty-three provisional administrations were disbanded in the period under review as arbitration courts pronounced credit institutions insolvent (bankrupt) or ordered their liquidation.

Pursuant to Article 74 of the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia)” and Articles 20 and 23 of the Federal Law “On Banks and Banking Activities,” the Bank of Russia in 2003 issued orders to revoke (cancel) the banking licences of 16 credit institutions, of which 11 credit institutions had their licences revoked in compliance with the require-

ments set in paragraph 2 of Article 20 of the Federal Law “On Banks and Banking Activities;” nine of these 11 credit institutions had their banking licences revoked for failing to meet their obligations to creditors in time.

As of January 1, 2004, 336 credit institutions were set to be liquidated; of these, 330 credit institutions were to be liquidated by their founders (members) in accordance with the decisions of arbitration courts (liquidation decisions on 57 credit institutions were taken in 2003). Thanks to the improved application of the Federal Law “On Insolvency (Bankruptcy)” and the Federal Law “On the Insolvency (Bankruptcy) of Credit Institutions,” the period between the revocation of a banking licence and the beginning of bankruptcy proceedings was cut. Liquidation commissions were set up and receivers and liquidators were appointed to 307 credit institutions, including 76 in 2003.

In 2003, the Bank of Russia took the decision on state registration with regard to liquidation of 166 credit institutions, of which 151 were to be liquidated in accordance with arbitration court rulings on the completion of bankruptcy proceedings, two credit institutions were to be liquidated by their members of their own accord, seven credit institutions were to be liquidated in accordance with the decision of their members and creditors

to wind them up through bankruptcy proceedings, and six were to be liquidated by enforcing court rulings.

Pursuant to Article 6 of the Federal Law “On the Insolvency (Bankruptcy) of Credit Institutions,” the Bank of Russia appointed its employees as the receivers of 32 credit institutions declared bankrupt as debtors in absentia; in five of these credit institutions bankruptcy proceedings were completed in 2003.

Thirty-six inspections of receivers (liquidators) were conducted in 2003, after which the receivers (liquidators) were ordered to eliminate the shortcomings discovered in their work within a specified period of time.

In 2003, the Bank of Russia issued 111 bank receivers’ (liquidators’) certificates, extended the term of 394 receivers’ (liquidators’) certificates, cancelled nine receivers’ (liquidators’) certificates and denied receivers’ (liquidators’) certificates to 71 applicants, of whom 10 failed to have the terms of their certificates extended.

The restructuring of credit institutions undertaken to overcome the aftermath of the financial and economic crisis of 1998 was completed in 2003. The Bank of Russia controlled the restructuring of three credit institutions managed by the State Agency for the Restructuring of Credit Institutions.

## II.3. THE RUSSIAN PAYMENT SYSTEM

### II.3.1. THE STATE OF THE RUSSIAN PAYMENT SYSTEM. DEVELOPING AND UPGRADING THE BANK OF RUSSIA PAYMENT SYSTEM

**The Russian payment system**, which comprises the Bank of Russia payment system and private payment systems, met the country's needs in money transfers and continued to switch to electronic means of effecting non-cash settlements in 2003.

As of January 1, 2004, the Russian payment system's members were 1,139<sup>1</sup> Bank of Russia establishments (main cash settlement centres and cash settlement centres), 1,331<sup>1</sup> credit institutions, including 46 settlement non-bank credit institutions, and 3,219 branches of credit institutions. In addition, settlement services were provided to customers by 7,408 additional offices of credit institutions and branches of credit institutions.

The general trend of the organisational structure of the Russian payment system was towards a gradual replacement of branches by additional offices of credit institutions and branches of credit institutions. While the number of credit institutions was unchanged, the number of branches of credit institutions declined by 107, or 3.2%, whereas the number of additional offices of credit

institutions and branches of credit institutions increased by 1,021, or 16.0%

Growth in the number of additional offices, which provide a wide range of services, increasingly brought banking services within the reach of customers (the public and economic agents) and improved the population's provision with settlement services: the number of Bank of Russia establishments, credit institutions, branches of credit institutions and additional offices of credit institutions and branches of credit institutions per one million of the population increased by 6.2% over the year to 90.2.

As of January 1, 2004, members of the Russian payment system had opened 283.7 million resident and non-resident customer accounts, which are used in effecting payments in the Russian currency; of these, 4.6 million accounts, or 1.6% of the total, were opened for corporate clients other than credit institutions and 279.1 million, or 98.4%, for private individuals. The number of bank accounts per resident of the Russian Federation increased on average from 1.9 to 2.0 over the year, mainly due to the opening of ac-

<sup>1</sup> Based on data from the BIC Directory of the Russian Federation.

counts for individual bank card holders. This trend indicates the expansion of non-cash settlements with individuals.

In 2003, the Russian payment system effected 855.3 million payments to the amount of 182.2 trillion rubles. The volume of payments grew by 140.0% as against 122.0% in 2002, while growth in the number of payments slowed down from 116.5% to 115.9%. As a result, the average amount of payment increased from 176,300 rubles to 213,000 rubles, or 21%.

The ratios of non-cash payments effected through the Bank of Russia payment system, through intrabank payment systems for settlements between the divisions of one credit institution, between clients of one division of a credit institution or branch of a credit institution, through payment systems of credit institutions for settlements on correspondent accounts opened in other credit institutions and through payment systems of settlement non-bank credit institutions changed insignificantly in 2003 as compared with 2002.

Non-cash payments effected by the Bank of Russia payment system accounted for 48.1% of the total number of payments effected by the Russian payment system and 59.3% of the total volume of payments.

The increase in the number and volume of payments in the Russian payment system was largely due to the Bank of Russia payment system and intrabank payment systems effecting settlements for clients within one division of a credit institution or branch of a credit institution, which accounted for 51.9% and 23.6% of the growth in the total number of payments in the Russian payment system and 61.1% and 24.0% in volume respectively.

In 2003, the Russian payment system continued increasingly to use electronic means of payment, which accounted for 77.5% of the total number of payments and 86.8% of the total volume of payments (as against 72.3% and 84.0% in 2002).

The structure of non-cash payments in 2003 did not differ greatly from 2002 in terms of the instruments of payment used.

The main instrument of payment was, as before, the payment order, whose share in the total number of payments stood at 77.9% and in the

total volume of payments at 90.6% against 77.1% and 90.6% in 2002.

The predominance of this form of settlements is due to its extensive use in settlements on economic transactions (payment for goods and services) as well as non-commodity operations, such as the transfer of taxes, duties and other compulsory payments to budgets of all levels and extrabudgetary funds and the widespread use of electronic payments, which are mostly effected by payment orders.

The use of payment requests and collection orders, letters of credit and cheques issued by credit institutions and payment orders used in partial payments of settlement documents owing to a shortage of funds in a client's accounts remained unchanged.

The trend towards the wider use on the banking services market of such payment instruments as payment cards, which were issued and/or acquired by 698 credit institutions as against 642 credit institutions at the beginning of the year, continued. A total of 410.5 million operations to the amount of 1,235.6 billion rubles were conducted with the use of payment cards in Russia (the respective growth rates stood at 145.9% and 169.0%).

Cash withdrawals prevailed over card payments in the year under review, as in the previous years, but their ratio improved to 90.0% and 10.0% as against 91.6% and 8.4% in 2002). The growth in the number and volume of card payments (by 126.1% and 200.0% respectively) was due to the provision by credit institutions of customer services such as customs payments, payments for the use of community amenities and mobile phone payments, and the dynamic development of the infrastructure designed for conducting bank card operations. The number of trading establishments and services that accepted payment cards increased by 32.0% in 2003 to 64,800 as of January 1, 2004.

At the same time, the dynamic development of the payment card sector did not significantly affect the use of cash in retail payments. In the year under review, cash turnover expanded a little faster than non-cash payments (140.7% as against 140%).

The average daily cash turnover increased by 13.1 billion rubles to 45.3 billion rubles.

STRUCTURE OF PAYMENTS EFFECTED BY THE RUSSIAN PAYMENT SYSTEM (%)

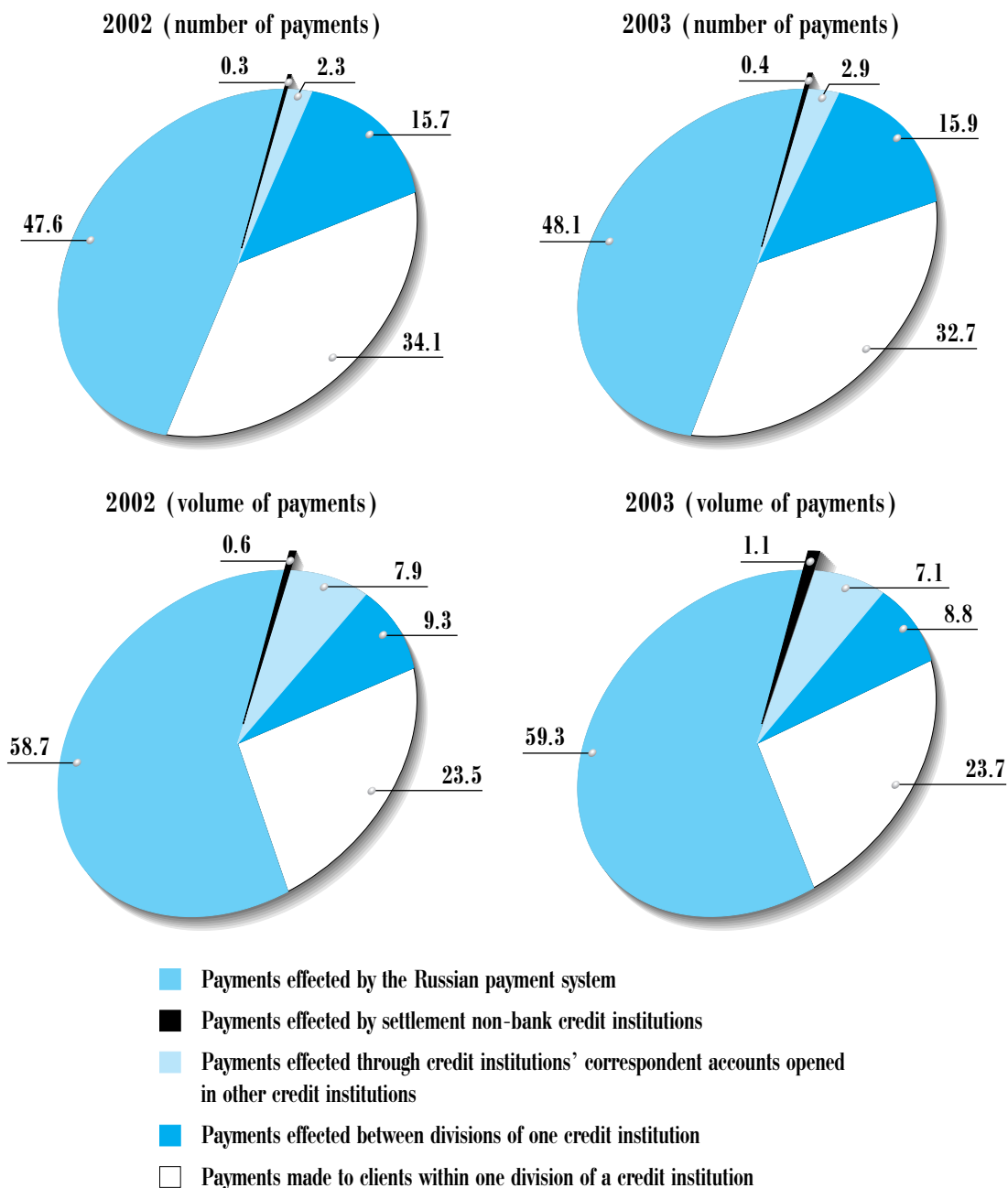


Chart 45

Bank of Russia establishments and credit institutions met 94.1% of customers' needs in cash from their own cash receipts as against 96.1% in 2002.

The Bank of Russia payment system had the following characteristics.

As of January 1, 2004, it comprised 1,139 Bank of Russia establishments, main cash settlement centres and cash settlement centres.

In continuing to optimise its settlement network, the Bank of Russia Board of Directors decided to close more than 200 cash settlement centres by the end of 2004. In line with this decision, the Bank of Russia closed 44 cash settlement centres and ordered the closure of another 49 cash settlement centres.

As of January 1, 2004, the Bank of Russia effected interbank settlements with 1,331 credit

institutions, the same number as at the beginning of the year, and 1,805 branches of credit institutions, which had correspondent accounts opened for them in the Bank of Russia. This represents an increase of 1.8% on the beginning of the year, when the Bank of Russia effected settlements with 1,773 branches of credit institutions.

The number of Bank of Russia customers other than credit institutions decreased from 66,388 to 62,702, or 5.6%, over the year, mainly due to the continued consolidation of federal treasury accounts at the departmental level, the transition of budget-financed institutions and regional and local government budgets to the services provided by federal treasury bodies, the creation of treasuries in Russian regions and municipalities and similar reforms conducted by them and the transfer of customers of the closed cash settlement centres to the settlement services provided by credit institutions or their branches.

The number and volume of payments effected by the Bank of Russia payment system in the year under review grew a little faster (117.4% and 141.7%) than the number and volume of payments effected through the Russian payment system as a whole (115.9% and 140.0%). The average daily number of payments effected by the Bank of Russia payment system in 2003 stood at 1.6 million as against 1.4 million in 2002, an increase of 14.3%.

In 2003, as in the previous years, credit institutions and their branches accounted for most of the payments effected through the Bank of Russia payment system: 83.1% in number and 82.8% in volume as against 82.4% and 79.5% in 2002. The share of payments effected by Bank of Russia customers other than credit institutions and Bank of Russia establishments on their own settlement operations contracted to 16.9% in number and 17.2% in volume as against 17.6% and 20.5% in 2002.

The main reasons for growth in the number of payments effected through the Bank of Russia payment system by credit institutions and their branches and their clients were that the Bank of Russia payment system was free from credit risk, was reliable and used advanced and constantly upgraded information processing and transmission facilities.

To reduce operational risks in its payment system, the Bank of Russia issued Regulation No. 225-P, dated May 6, 2003, "On the Directory of the Bank Identification Codes of Settling Participants Effecting Payments through the Bank of Russia Settlement System," which came into force on November 1, 2003. The document specified a number of standards relating to control over permission for settlement operations and providing opportunities for giving advance notice through the BIC Directory about any coming changes in settling participants' particulars owing to the reorganisation and liquidation of credit institutions and Bank of Russia cash settlement centres.

Intraregional payments made up the bulk of the payments effected through the Bank of Russia payment system (87.8% of the total number and 83.5% of total volume in 2003). Interregional payments accounted for 12.2% and 16.5% respectively.

The increased use of electronic settlements was a major trend reflecting the Bank of Russia's constant efforts to make its payment system more efficient. It was accompanied by the elaboration of new conceptual decisions relating to the development of the Bank of Russia real-time gross settlements system.

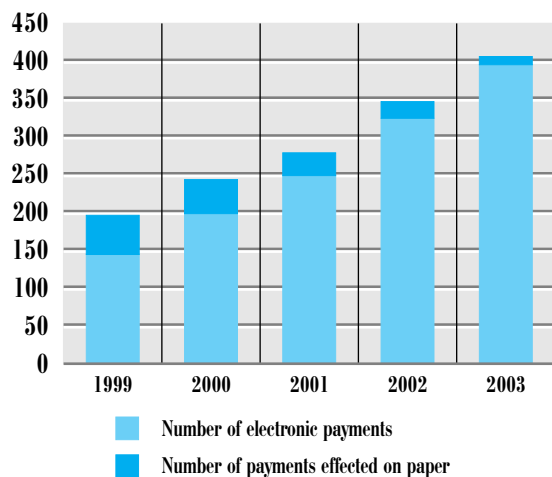
Electronic payments accounted for 96.4% of the total number of payments and 94.7% of the total volume of payments effected in 2003 as against 92.7% and 92.1% in 2002.

Intraregional electronic payments were effected within one day, according to the exchange and processing timetable. Interregional electronic payments were effected within one day or no later than the next day if the payer and payee were located in distant time zones.

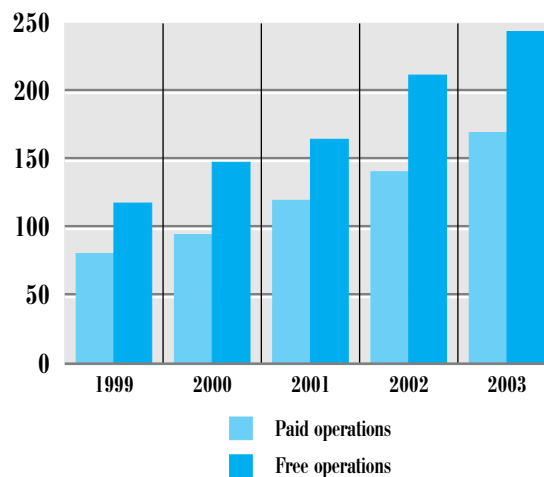
As of January 1, 2004, 1,111 out of 1,139 Bank of Russia establishments, or 97.5% of the total as against 97.1% as of January 1, 2003, participated in intraregional electronic payments and 1,088 Bank of Russia establishments, or 95.5% of the total as against 92.4% as of January 1, 2003, participated in interregional electronic payments.

The number of credit institutions and their branches involved in the exchange of electronic documents had increased by the end of 2003: 2,897 credit institutions and branches of credit

**PAYMENTS EFFECTED THROUGH  
THE BANK OF RUSSIA PAYMENT SYSTEM  
ELECTRONICALLY AND ON PAPER**  
(million payments)



**OPERATIONS CONDUCTED  
BY THE BANK OF RUSSIA PAYMENT SYSTEM  
FOR A FEE AND FREE OF CHARGE**  
(million operations)



*Charts 46, 47*

institutions, or 92.4% of the total number of credit institutions and their branches serviced by the Bank of Russia (3,136), were involved in this exchange (as against 2,771 out of 3,104 credit institutions and their branches, or 89.3% of the total, as of January 1, 2003). Measures were implemented at the same time to include other Bank of Russia customers that are not credit institutions, especially federal treasury bodies, in the exchange of electronic documents. By the end of 2003, 37.2% of the total number of federal treasury bodies (1,340) were involved in the exchange of electronic documents with the Bank of Russia as against 28.8% (399 out of 1,384) in 2002, which represents an increase of 8.4 percentage points.

As a result, the electronic payments that passed through the Bank of Russia payment system in 2003 accounted for 90.1% of the total number of payments as against 86.7% in 2002.

As a result of the measures taken, the share of payments effected through the Bank of Russia payment system on paper contracted by 3.7% in number and 2.6% in volume.

The reduction of postal and electronic payment times in 2003 led to shorter average settlement times in the Bank of Russia payment system (taking into account the number of payments effected by using each method) to 0.94 days as

against 0.96 days in 2002 at the intraregional level and to 1.21 days against 1.3 days at the interregional level.

In compliance with federal legislation, the Bank of Russia conducted operations with budget funds of all levels free of charge and these operations accounted for 59.0% of the total number. Operations conducted by the Bank of Russia on a paid basis accounted for 41.0% and the prices charged were unchanged from the previous year.

As of January 1, 2004, the value of settlement documents unpaid owing to a lack of funds in correspondent accounts (subaccounts) of credit institutions and branches of credit institutions decreased 2.6 times to 3.3 billion rubles as against 8.5 billion rubles as of January 1, 2003. Credit institutions that had their licences revoked accounted for 97.3% of this sum as against 59.1% as of January 1, 2003. Operating credit institutions accounted for 2.7% of the total value of unpaid settlement documents (as against 40.9% as of January 1, 2003) and measures were taken against them under Article 74 of the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)."

The Bank of Russia continued to upgrade the legislative framework of the Russian payment system.

In collaboration with the Ministry of Taxes and Duties, it carried out work to further automate accounting in the tax bodies to enable them to exert better control over corporate entities making tax payments on time and in full and accelerating the transfer of taxes, duties and other compulsory payments to the federal budget and their allocation for financing expenditures.

To this end, at the request of the Ministry of Taxes and Duties, the Bank of Russia introduced additional details in the settlement documents used in effecting the above payments to identify the taxpayer, the tax paid and the payment date.

To improve the regulation of non-cash settlements effected by private individuals, the Bank of Russia issued Regulation No. 222-P, dated April 1, 2003, "On the Procedure for Effecting Non-cash Settlements by Private Individuals in the Russian Federation," which established the

procedure for opening accounts by individuals, effecting all kinds of non-cash settlements in compliance with legislation, which grants equal status to private individuals and corporate entities, and implementing money transfers by credit institutions at the request of individuals without opening bank accounts.

In the year under review, the Bank of Russia continued to oversee payment systems and carried out measures designed to raise the level of information disclosure and transparency.

For this purpose, the Bank of Russia and the Committee on Payment and Settlement Systems of the Bank for International Settlements completed the publication Russian Payment Systems, known as the BIS Red Book. It was a major step forward in improving people's understanding of the operating principles of the Russian payment systems at national and international levels.



## 11.3.2. THE DEVELOPMENT OF THE TECHNICAL INFRASTRUCTURE OF THE BANK OF RUSSIA PAYMENT SYSTEM

The technical infrastructure of the Bank of Russia payment system comprises automated settlement and information systems, telecommunications networks and message delivery, information security and maintenance facilities, which are an inalienable part of the integrated information and telecommunications infrastructure of the Bank of Russia.

In the period under review work to upgrade the Bank of Russia payment system was undertaken in the following areas:

- maintaining the reliability and uninterrupted functioning of operating automated bank settlement systems;
- introducing a centralised payment data processing system in Bank of Russia regional branches;
- harmonising and standardising payment data processing software;
- reducing the variety of payment data processing hardware systems;
- upgrading the system of interregional and intraregional settlements and electronic exchange of payment data with Bank of Russia customers;
- raising the information safety and security level of the Bank of Russia settlement system.

In the period under review, the Bank of Russia kept its payment system in working order, ensuring the timely transfer of funds to customers' accounts despite the 15.9% year-on-year increase in the number of payment documents. It monitored the state and productivity of the payment system's computer centres and replaced obsolete computers and telecommunications systems with up-to-date facilities. Payment data processing centres were modernised in 17 Bank of Russia main divisions and regional banks and up-to-date cash settlement software and hardware systems were installed in 24 main divisions and regional banks. Efficient maintenance and support systems were installed in Bank of Russia regional branches to ensure the reliable operation of the entire Bank of Russia information and telecommunications system.

The Bank of Russia continued to centralise the processing of payment data. It has completed the transfer of two Bank of Russia regional branches to a centralised system and carried out the necessary preparatory work for transferring four Bank of Russia regional branches to this system in 2004. At present, there is a centralised banking data processing system in 61 out of 78 Bank of Russia regional branches, which accounts for almost 90% of all settlements effected through the Bank of Russia payment system.

The data processing centre put into operation in the Bank of Russia Main Division for St Petersburg is designed to organise the processing of payment data of several Bank of Russia regional branches in one centre.

To standardise payment data processing software systems and streamline the decision-making process in the Bank of Russia settlement network, one system used in Bank of Russia field establishments was taken out of operation. Preparations have been completed for the transfer of all applied payment data processing software systems to standard electronic message formats for electronic exchange purposes with credit institutions and Bank of Russia customers. This will happen in 2004.

A standard transport subsystem of the regional automated bank settlement systems has been put into operation in 75 Bank of Russia main divisions and regional banks. Work has also begun to develop standard transport subsystems for interregional electronic settlements and settlements between regional branches and credit institutions. The standardisation of transport subsystems for the delivery of payment data at regional and interregional levels ensures a guaranteed exchange of electronic messages between settling participants and the centralised monitoring and management of the delivery of information.

In the year under review, the Bank of Russia continued to reduce the variety of the payment data processing software systems in use.

In taking consistent steps to expand the electronic exchange system of payment data with its customers, the Bank of Russia additionally included 40 cash settlement centres and 22 field institutions in the system of interregional electronic settlements and 34 field institutions in the system of intraregional electronic settlements.

Work continued to develop and install information security subsystems for major Bank of Russia information and telecommunications systems.

The Bank of Russia information and telecommunications system is an integrated infrastructure for transmitting messages and incorporates a developing system of centralised management. To enhance its efficiency, the Bank of Russia continued to develop an integrated control system for the applied programs of the operating accounting systems. Such a system has been installed and is being test run in seven Bank of Russia regional branches using the ABS-Ural system, two regional branches using the RABIS-NP system and the Bank of Russia Interregional Computer Technology Centre. Work has begun to develop applied

program control systems for the RABIS-2 and ASBR-Ryazan accounting systems. The analytical monitoring system of the largest Bank of Russia settlement system ASBR-Moskva was put into operation for testing in 2003.

The technical modernisation of the payment system made it possible to improve the quality and broaden the range of information services provided to Bank of Russia specialists. Specifically, the Bank of Russia corporate Intranet portal, which provides centralised access to information contained in it, is expanding rapidly: 10 central office departments, 74 Bank of Russia regional branches and six Bank of Russia organisations have been connected to it and more than 7,000 users have been registered.

To upgrade its maintenance system, the Bank of Russia has begun to test run the Bank of Russia Information and Telecommunications System Technical Maintenance Centre and drafted documents to regulate relations between the Bank of Russia and government agencies in operating and upgrading the Bank of Russia information and telecommunications system.

## II.4. FOREIGN EXCHANGE REGULATION AND FOREIGN EXCHANGE CONTROL

In 2003, the Bank of Russia continued to upgrade the country's foreign exchange regulation and control system. The favourable price situation on world raw material markets and the improved investment climate in Russia led to a massive inflow of foreign exchange and significant growth in its supply on the domestic foreign exchange market. Against this backdrop, the Bank of Russia gradually continued to ease foreign exchange regulation and control procedures.

A major step in this direction was a new cut in the percentage of foreign currency earnings exporters are required to sell on the domestic foreign exchange market. Guided by the provisions of Federal Law No. 116-FZ, dated July 7, 2003, "On Changing Article 6 of the Federal Law on Foreign Exchange Regulation and Foreign Exchange Control," and seeking to encourage market principles of operation on the domestic foreign exchange market and taking into account an analysis of almost two years experience of requiring resident exporters to sell 50% of their earnings from the export of goods, work, services and results of intellectual activity, the Bank of Russia set the required sale ratio at 25%, effective as of July 10, 2003.

The change in the required sale ratio and the procedure for the mandatory sale of export earnings on the whole had no effect on the correlation between demand and supply on the domes-

tic foreign exchange market. Despite the reduction in the compulsory sale ratio, residents sold \$47.5 billion of foreign currency earnings on the domestic foreign exchange market in 2003, or just 2% less than in 2002 (\$48.3 billion). At the same time, as the ruble made gains against the dollar in nominal terms, the reduction of the foreign exchange supply from compulsory sales was accompanied by growth in sales of foreign exchange that remained at the disposal of exporters after compulsory sales and increase in funds borrowed from non-residents.

The real sector's demand for foreign exchange in 2003 increased by \$15.9 billion, or one-third, year on year and stood at \$63.6 billion. At the same time, the structure of demand for foreign exchange by purpose of purchase did not change much: 48% of foreign exchange (\$30.7 billion) was bought to repay non-financial sector debts on loans (of which \$6.4 billion was paid as debt on loans from non-residents) and 44% (\$27.7 billion) was purchased to pay for imports.

At the same time, the demand for foreign exchange on the Russian foreign exchange market by non-residents due to their K-type and F-type accounts increased by more than 70% in 2003 to \$57.9 billion in dollar terms as against \$33.8 billion in 2002. The most significant increase in the structure of sources of ruble funds entered to the above non-resident accounts and used for the purchase of foreign exchange was registered in

resident payments for securities acquired from non-residents and dividends paid to non-residents. In addition, the ruble's nominal rise against the dollar led to considerable growth in ruble payments to non-residents for imported goods.

The year 2003 saw significant changes on the domestic foreign exchange market, brought about by the nominal rise of the ruble against the dollar and the dollar's fall against the euro. In this situation, household sector net demand for foreign exchange (the difference between the amount of foreign exchange sold to private individuals and paid from their accounts and the amount of foreign exchange bought from individuals and entered to their accounts) decreased in 2003 to \$8.3 billion in dollar terms from \$12.7 billion in 2002. At the same time, the share of cash dollars in net demand contracted from 79% in 2002 to 44% in 2003 amid the adequate expansion of the euro's share. For the first time in many years of monitoring resident operations with foreign exchange, demand exceeded supply by \$2 billion in dollar terms.

Unlike the situation with residents, demand for non-resident operations on the domestic foreign exchange market continued to exceed supply. Non-resident net demand for foreign exchange in 2003 stood at \$10.4 billion as against \$7.3 billion in 2002.

When regulating the procedure for conducting foreign exchange operations connected with the movement of capital, the Bank of Russia, taking into consideration the continued improvements in the Russian economy, went on taking measures to reduce the number of operations that required permission. In 2003, it abolished the permit system and allowed residents and non-residents freely to conduct transactions involving the purchase of goods abroad without bringing them to the customs territory of Russia and the subsequent sale of these goods outside Russia and to transfer contracts on exports or imports of goods from authorised banks that have signed transaction passports on these contracts to other authorised banks.

The Bank of Russia granted residents the right to conduct operations without special permission through authorised banks to acquire and alienate foreign currency-denominated securities issued by

residents on the organised market for foreign currency and rubles.

To create more favourable conditions for the development of the banking sector, the Bank of Russia established a notification procedure for foreign exchange operations connected with the minority interest of authorised banks with general banking licences in the authorised capital of foreign credit institutions, established and operating in compliance with the legislation of FATF and OECD member countries. The right to use this procedure was only granted to financially sound authorised banks, which as of the investment date had not violated Russian federal laws or Bank of Russia regulations, and had no unsettled claims from creditors and unfulfilled obligations on compulsory payments.

At the same time, the Bank of Russia made amendments to the regulatory framework, setting a more flexible procedure for regulating the establishment of correspondent relations between authorised banks and non-resident banks registered in offshore zones. Taking into account the recommendations of international organisations, which have articulated a set of indicators that make it possible to characterise a jurisdiction as offshore, the Bank of Russia divided the countries and territories which grant tax benefits and/or do not require the disclosure or furnishing of information on financial operations (offshore zones) into three groups. With regard to the countries and territories in the first group, which have highly developed legal infrastructures and supervisory systems and effective anti-laundering procedures, the Bank of Russia lifted special requirements that had to be met in establishing correspondent relations. At the same time, the Bank of Russia preserved special requirements for the size of own funds (capital) of non-resident banks, long-term credit ratings assigned by leading rating agencies and the size of assets in those cases when resident banks decide to establish correspondent relations with non-resident banks registered in countries and territories with inadequate legal infrastructures and supervisory practices (second and third groups).

As a result of the measures taken to simplify the procedure for conducting foreign exchange operations connected with capital movement, the number of permits issued to residents continued

to decline. In 2003, the Bank of Russia and its regional branches issued 1,126 permits (a decrease of almost 20% on 2002) to the total amount of \$7.6 billion as against \$6.5 billion in 2002. Growth in volume of licensed foreign exchange operations was largely due to the issue of permits to residents to conduct operations connected with guarantees and sureties given to non-residents: the value of such operations increased from \$600 million in 2002 to \$3 billion in 2003.

Control over and the accounting of resident operations in foreign trade (from the viewpoint of the completeness and timeliness of the receipt of foreign currency earnings from exports and payments and the delivery of goods under import contracts) continued to be effected within the framework of the customs-cum-banking foreign exchange control system. The main result of the implementation of the customs-cum-banking foreign exchange control was the fall in illegal capital outflow through foreign trade operations (non-delivery of export earnings and unpaid advances on imports) to \$700 million from \$1.6 billion in 2002. Illegal capital outflow relative to foreign trade turnover stood at 0.3% as against 1% in 2002.

However, overall unauthorised capital flight (calculated on the basis of balance of payments data as the sum total of the budget item "Non-receipt of export earnings, non-delivery of goods and services against money transfers under import con-

tracts and transfers in fictitious operations with securities" and half of the sum of the budget item "Net errors and omissions") increased to \$19 billion in 2003 as against \$15.5 billion in 2002.

A major development last year was the adoption of Federal Law No. 173-FZ, dated December 10, 2003, "On Foreign Exchange Regulation and Foreign Exchange Control," which came into force on June 18, 2004. Drafted with the active participation of the Bank of Russia, this law, unlike its predecessor, which was based on the principle "everything that is not permitted is prohibited," has completed the transition to a new system of foreign exchange legislation and relations, based on the principle "everything is permitted that is not prohibited."

The law prohibits the issue of individual permits to residents to conduct foreign exchange operations, establishing a free procedure for conducting them, although it allows the Government and Bank of Russia to use economic means (with regard to a restricted list of operations) of regulating capital inflow and outflow, such as establishing the requirement to make a reserve in conducting foreign exchange operations. It is important that the new law emphasises that the use of such measures is only possible when it is necessary to prevent a significant fall in international reserves and sharp fluctuations of the ruble's exchange rate and maintain balance of payments stability in the country.

## II.5. BANK OF RUSSIA ACTIVITIES AIMED AT COUNTERING MONEY LAUNDERING AND TERRORIST FINANCING

In 2003, the Bank of Russia continued to fulfil the tasks and functions stipulated by the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism” and to make the banking sector’s work in this area more effective. To combat money laundering and terrorist financing, the Bank of Russia focused its efforts on developing the corresponding regulations and methodologies, monitoring the observance of legislation by credit institutions, providing training and participating in Russia’s co-operation with international organisations.

Federal Law No. 131-FZ, dated October 30, 2002, “On Amending the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism” came into force on January 3, 2003, extending the legal and organisational anti-laundering practices to the financing of terrorism and giving credit institutions more powers to bar the proceeds from crime from entering the banking system and prevent the use of the banking sector for money laundering and terrorist financing. To bring its regulations into conformity with the above law and make credit institutions’ work in this area more effective, the Bank of Russia issued a number of regulations on the organisation and modernisation of

internal control systems in credit institutions to counter money laundering and terrorist financing, including through the identification of the persons who have concluded bank account (deposit) agreements with a credit institution. The Bank of Russia also developed special programmes establishing the procedure for refusing to conclude a bank account agreement, fulfil a customer’s operation order and suspend terrorist operations. It set the procedure for establishing correspondent relations with credit institutions in some countries and territories and tightening control over money transfers without opening accounts and operations with prepaid financial products.

To prevent the use of the banking system for the financing of terrorism, the Bank of Russia supplied credit institutions with the Financial Monitoring Committee’s lists of persons suspected of being involved in extremist and terrorist activities. Five lists containing information on 111 corporate entities and 754 private individuals were supplied to credit institutions in 2003.

Building upon the experience gained in 2002 and 2003 of monitoring credit institutions’ compliance with legislation and seeking to bring its regulations into conformity with the above law, the Bank of Russia amended the procedure for controlling credit institutions’ compliance with

Russian legislation and Bank of Russia standards and regulations against money laundering and terrorist financing and improved the methodology for conducting such monitoring.

To monitor the banking sector's compliance with money laundering and terrorist financing legislation, in 2003 the Bank of Russia conducted 1,699 inspections of credit institutions and branches of credit institutions. The inspections showed that most credit institutions were fulfilling the functions assigned to them by law. At the same time, violations of the applicable legislation and Bank of Russia regulations designed to counter money laundering and terrorist financing were discovered during 689 inspections, or almost 40% of the total number of inspections. The main cause of the violations was inadequate control exercised by the management of credit institutions over the activities of their various structures. Some violations were technical and they were eliminated in the course of the inspection.

In 353 cases, the managements of credit institutions were informed about the violations discovered during the inspections; in 135 cases credit institutions were ordered to eliminate the violations discovered; in five cases credit institutions

were prohibited from conducting some banking operations; in two cases credit institutions were not allowed to open branches; in 81 cases credit institutions were fined and one credit institution had its licence revoked.

When implementing its programme for training staff at its regional branches and credit institutions' employees in matters relating to the fight against money laundering and terrorist financing, the Bank of Russia organised and held 11 seminars, in which 525 people received training.

In compliance with Russian Government Resolution No. 6, dated January 8, 2003, "On the Procedure for Approving Internal Control Rules in Organisations Conducting Operations with Money and Other Property," the Bank of Russia completed the approval of credit institutions' internal control rules on countering money laundering and terrorist financing by the end of the third quarter of 2003.

The Bank of Russia actively participated in preparations for Russia's joining the Financial Action Task Force (FATF). This was highly appreciated by FATF when it made the decision on Russia's membership of this international organisation.

## II.6. BANK OF RUSSIA ACTIVITIES WITH RESPECT TO GOVERNMENT FINANCE

The Bank of Russia and Finance Ministry continued to co-ordinate their budget and monetary policies, paying great attention to the forecasting and analysis of federal budget revenue and expenditure, the movement of federal budget funds in accounts opened in the Bank of Russia and ensuring that federal budget funds were spent evenly during the year and reached their recipients on time.

In 2003, pursuant to Article 134 of the 2003 Federal Budget Law, the Bank of Russia and the Finance Ministry restructured permanent coupon-income federal loan bonds with a nominal value of 300.0 billion rubles in the Bank of Russia portfolio into debt depreciation federal loan bonds, allowing operations to be conducted with these securities to regulate credit institutions' liquidity.

The Bank of Russia continued to maintain effective co-operation with the federal treasury bodies in assisting the implementation of the Concept of the Finance Ministry Federal Treasury Single Federal Budget Revenue and Funds Account, and in upgrading regulatory standards and rules. The latter included those designed to accelerate the transfer of revenues to budgets of all levels; raise the automation level by federal treasury bodies in the accounting and allocation of funds from budgets of all levels; provide information assistance to the Finance Ministry in transferring federal treasury bodies to the single ac-

count scheme as soon as possible; finance organisations from the federal budget using personal accounts opened in the federal treasury accounting registers; and organise the electronic exchange of documents between federal treasury bodies and Bank of Russia establishments.

The total number of Bank of Russia customers other than credit institutions decreased by 3,700 in the year under review and the number of accounts opened by them fell by 17,900. The decline resulted from the transfer to financing through personal accounts opened in the accounting registers of federal treasury bodies, organisations financed from the federal budget and bodies executing the budgets of other levels of the Russian budget system, as well as the closure of federal budget revenue accounts, the accounts opened to distribute revenues by federal treasury bodies between the various levels of the Russian budget system and the accounts opened for funds of budgets of all levels. However, the number of payments (write-offs) effected by the Bank of Russia payment system from Bank of Russia customers' accounts other than credit institutions increased by 13.2% in 2003 to 65.1 million.

To implement the Concept of the Finance Ministry Federal Treasury Single Federal Budget Revenue and Funds Account, on January 1, 2003, the Bank of Russia changed the procedure for transferring federal budget revenue to the financing of federal budget expenditure, reducing the



time federal budget funds took to reach their recipients.

The centralisation of accounts opened for revenues distributed by federal treasury bodies between the different levels of the Russian budget system was completed at the level of the Finance Ministry federal treasury departments last year, while the centralisation of federal budget accounts opened for payments not connected with cash payments was completed at the level of the federal treasury departments in 80 Russian Federation constituent entities. This work is continuing in nine constituent entities.

Pursuant to the 2003 Federal Budget Law, the Bank of Russia continued the transition to financing through personal accounts opened in the federal treasury accounting registers by bodies executing the budgets of other levels of the Russian budget system. These included organisations financed from these budgets and organisations financed from the federal budget to account for the funds received from entrepreneurial and other gainful activities. As of January 1, 2004, Bank of Russia establishments had opened 1,126 regional budget accounts for 1,115 federal treasury bodies and 1,424 local budget accounts for 1,231 federal treasury bodies.

To accelerate the transfer of funds to federal treasury accounts, a series of measures were implemented in compliance with Bank of Russia Order No. OD-38, dated January 31, 2003, "On Measures to Be Carried Out by the Bank of Russia to Ensure the Exchange of Electronic Documents between the Bank of Russia and Finance Ministry Federal Treasury Bodies during the

Transfer of the Revenue Part of the Federal Budget to the Single Federal Treasury Account."

During the year, Bank of Russia regional branches consistently implemented measures that made it possible to transfer the above funds to the accounts of the federal treasury bodies participating in the exchange of electronic documents with the Bank of Russia at the intraregional level, using full-format electronic payment documents on the basis of not only payment orders, but also collection orders and payment warrants.

To expedite the transfer of funds to the budgets of all levels and ensure financing with budget funds, the Bank of Russia set the closing time for the receipt of electronic payment documents from customers for being entered to or written off from federal treasury accounts in the Bank of Russia settlement network at 17.00 hours local time.

At present, 497 out of 1,340 federal treasury bodies which have accounts opened for them in Bank of Russia establishments exchange electronic documents with Bank of Russia establishments.

To ensure that the information contained in settlement documents intended for the federal treasury bodies is processed automatically during the accounting of revenues of the budgets of all levels, the Bank of Russia upgraded in collaboration with the Ministry of Taxes and Duties, State Customs Committee and Finance Ministry regulations on the transfer of taxes, duties and other compulsory payments to the Russian budget system, designed new formats of settlement documents and established a procedure for handling them.

## II.7. CASH ISSUE MANAGEMENT

The aim of cash issue management in 2003 was to ensure the uninterrupted supply of the money turnover with cash and implement measures to optimise cash turnover in Russia.

According to the cash issue balance sheet, as of January 1, 2004, there were 1,228.9 billion rubles in Bank of Russia notes and coins in circulation, including 1,227.8 billion rubles of the 1997 issue (1,219.0 billion rubles in notes and 8.8 billion rubles in coins, including coins made of precious metals), Bank of Russia notes of the 1993 issue and their 1994 modification, Bank of Russia notes of the 1995 issue, USSR coins and Bank of Russia coins of 1961—1996 issue and USSR 1-kopek, 2-kopek and 3-kopek coins minted before 1961 and not surrendered for exchange by the deadline set by Federal Law No. 86-FZ, dated July 10, 2002, “On the Central Bank of the Russian Federation (Bank of Russia)” with a total new nominal value of 1.1 billion rubles. Banknotes of the 1997 issue accounted for 99.3% of the total amount of cash and coins of the 1997 issue accounted for 0.7%.

The amount of cash of the 1997 issue increased by 411.3 billion rubles, or 50.4%, in 2003. Growth in the amount of cash in circulation was caused by objective factors, such as the expansion of cash turnover due to the increase in nominal money income and consumer prices.

The increase in average per capita income and the continued growth in consumer prices in 2003

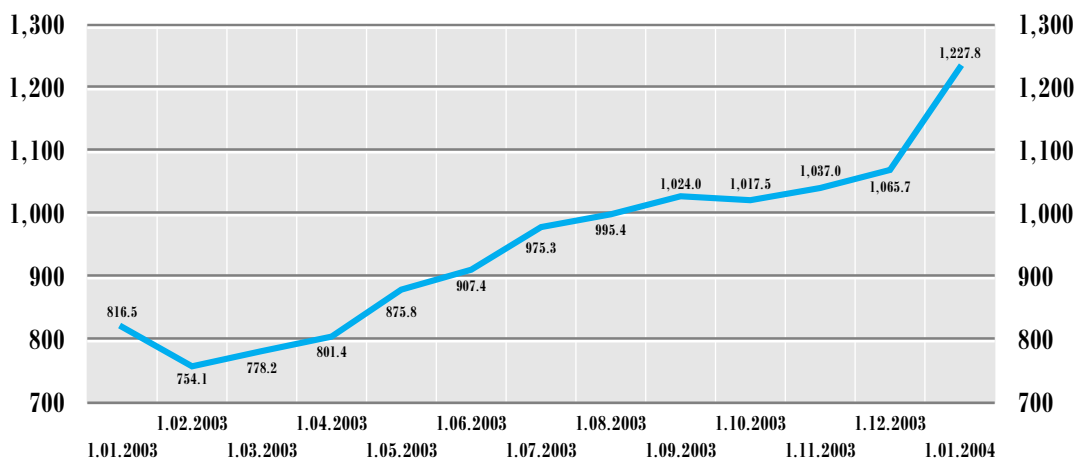
brought about some changes in the note structure of the money supply in circulation. The share of 1,000-ruble notes expanded by 12.9 percentage points to 43.6% of the total as of January 1, 2004, while the share of 10-ruble, 50-ruble, 100-ruble and 500-ruble notes contracted to 56.4% from 69.3% as of January 1, 2003.

Guided by the results of the analysis of the note structure of cash, the Bank of Russia predicted and managed the production of banknotes and coins, ensuring their regular delivery to reserve funds in amounts that made it possible to meet fully and in time the needs of the economy and population in cash.

On January 1, 2003, the Bank of Russia stopped exchanging Bank of Russia notes of the 1993 and 1995 issues, USSR and Bank of Russia coins of 1961—1996 issue and USSR coins minted before 1961, held by individuals for 1997 currency. All operations by Bank of Russia regional branches to move old money from their cash settlement centres to interregional depositories of the Bank of Russia Central Depository and to destroy it have been completed.

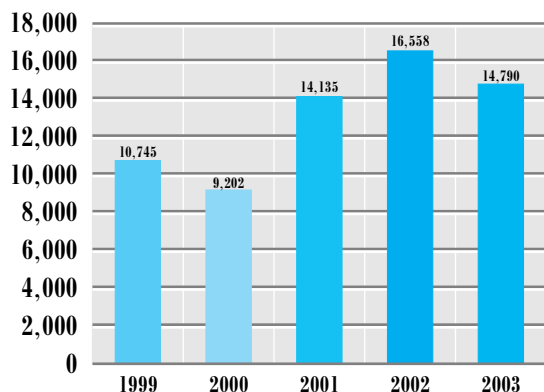
In 2003, authorised banks brought Russian currency to and took it from Ukraine, Belarus, Armenia, Tajikistan, Kyrgyzstan and Georgia. Such operations were needed to replenish the correspondent accounts of foreign banks with cash rubles and support their operating cash funds for paying travel expenses to enterprises and organisations, as well as to supply exchange of-

**CHANGES IN THE AMOUNT OF CASH IN CIRCULATION IN 2003**  
(billion rubles)

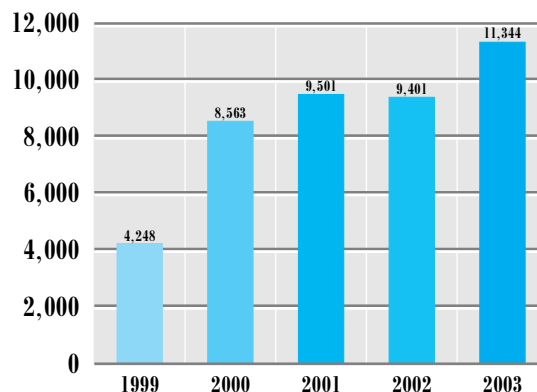


*Chart 48*

**DYNAMICS OF DETECTION OF COUNTERFEIT BANK OF RUSSIA CURRENCY**  
(number of notes and coins)



**DYNAMICS OF DETECTION OF COUNTERFEIT FOREIGN CURRENCY**  
(number of notes and coins)



*Charts 49, 50*

ices opened in the above countries. In 2003, 3,241.2 million rubles were brought into Russia and 260 million rubles were taken out of Russia (as against 2,839.6 million rubles and 287.4 million rubles in 2002).

As of January 1, 2004, Bank of Russia establishments provided cash services to 5,607 credit institutions and their divisions and 125,317 organisations other than credit institutions. As for the Bank of Russia system as a whole, the number of credit institutions and their divisions which received cash services from Bank of Russia establishments increased by 74 in 2003, while the number of organisations other than credit institutions rose by 1,491.

According to data provided by Bank of Russia regional branches, 14,790 counterfeit Bank of Russia notes and coins were detected, withdrawn from circulation and passed to Interior Ministry bodies, a decrease of 11% in comparison with 2002. Most of the counterfeit Bank of Russia currency was detected in the form of 500-ruble and 100-ruble notes and 5-ruble coins.

As in 2002, most of the counterfeit currency was detected in the Central Federal District, which accounted for 44.2% of the total number of counterfeit Bank of Russia notes and coins.

In the period under review, Bank of Russia establishments examined 28,239 foreign banknotes of 16 currencies, which were sent for

expert analysis by credit institutions. Bank of Russia establishments and credit institutions detected and passed to Interior Ministry bodies 11,344 counterfeit foreign banknotes, which represents an increase of 20.7% on 2002.

In 2003, the Bank of Russia continued to equip its regional branches with new cash processing machines to replace obsolete and worn-out equipment and completed fitting out all interregional depositories of the Bank of Russia

Central Depository with up-to-date digital television systems. To automate cash issue operations, the Bank of Russia installed and put into operation a standard automated cash issue system in some of its regional branches.

In 2003, the Bank of Russia continued to issue commemorative and investment coins. During the year, it issued 58 commemorative coins, of which 18 were made of gold, 36 silver and four copper-nickel alloys.

## II.8. INTERNATIONAL CO-OPERATION

### II.8.1. CO-OPERATION BETWEEN THE BANK OF RUSSIA AND INTERNATIONAL FINANCIAL AND ECONOMIC ORGANISATIONS

In 2003, the Bank of Russia continued to co-operate with the International Monetary Fund, World Bank Group, the Bank for International Settlements and some other international organisations and forums.

It participated in meetings of the **International Monetary Fund and World Bank**, which discussed ways to ensure international financial stability, create mechanisms for the orderly settlement of sovereign debt, reducing poverty and measures to counter money laundering and the financing of terrorism.

The Bank of Russia continued to co-operate with IMF and World Bank missions to make Bank of Russia monetary policy and banking supervision more effective. Among the problems discussed were the inflation targeting, financial and currency market developments, liquidity management, the sterilisation policy, open-market operations, mandatory provisioning, refinancing and ruble convertibility. Discussions also centred on interest risk regulation, the evaluation of operational risks related to mortgage securities, the methodologies of stress testing in banks, compiling financial stability indicators in compliance with the IMF guidelines, and licensing and banking procedures, especially in the context of the Federal Law “On Personal Deposit Insurance.”

The discussion ended in a decision on the further development of the monetary policy instruments used to absorb and provide liquidity to credit institutions.

The Bank of Russia continued to work together with the IMF and World Bank to compile modules of a report on Russia’s compliance with international standards and codes of transparency in monetary and financial policies and data dissemination.

The Bank of Russia regularly published information on major issues discussed by its Board of Directors and extended the list of indicators published daily on Bank of Russia operations with credit institutions. The IMF and World Bank noted that the measures taken by the Bank of Russia ensured a high degree of monetary policy transparency. To achieve full compliance of disseminated information with the requirements of the IMF Special Data Dissemination Standard (SDDS), in October 2003 the Bank of Russia published data for the first time on the structure of international reserves and foreign currency liquidity. The IMF declared the Bank of Russia’s data dissemination practices to be in compliance with most international requirements.

The Bank of Russia began to take steps to upgrade the methodology of monetary statistics to

bring it into conformity with the IMF's new Monetary and Financial Statistics Manual. To improve the international compatibility of data, Bank of Russia representatives participated in a session of the **International Statistical Institute**, the largest international organisation that brings together compilers and users of statistical data.

In April 2003, the FATF analysed within the framework of the FATF, IMF and World Bank world financial system assessment pilot programme how Russia and its Central Bank were observing standards relating to the fight against money laundering and the financing of terrorism. In its report, the FATF highly praised the efforts made by Russia and the Bank of Russia in this area and this eventually ensured Russia's admission to the FATF.

The Bank of Russia continued to work with IMF experts on issues relating to financial system stability and in December the main findings and conclusions of the joint IMF and World Bank report on the Financial Sector Assessment Programme for Russia were placed on the Bank of Russia Web site.

In the year under review the Bank of Russia took part in analysing the activities of the IMF permanent representation in Russia to enhance its efficiency in the interests of the Russian Federation.

The Bank of Russia regularly participated in central bankers' meetings in the **Bank for International Settlements** (BIS), which discussed prospects for the world economy and financial markets, crucial issues relating to central banking, including the creation of foreign exchange reserves, external financing and foreign direct investment in the banking sector. Bank of Russia representatives took part in the work of BIS committees, such as the Committee on Payment and Settlement Systems and the Basel Committee on Banking Supervision. For the first time ever, the Bank of Russia and the BIS jointly prepared a report on the Russian payment system compiled to international standards, known as the Red Book. The Bank of Russia participated in the work carried out by the BIS to integrate international information resources. Since August 2003, the Bank of Russia has been a member of the BIS Data Bank, which contains major economic indicators on more than 70 countries, including data

on the Russian banking sector. After consultations with the State Statistics Committee, the Bank of Russia took the decision to provide a wider range of data to the BIS Data Bank, including major macroeconomic indicators.

In 2003, the Bank of Russia ensured the preparation of seven reports on Russian projects of the **European Bank for Reconstruction and Development** (EBRD). As a result of close co-operation between the Bank of Russia and Finance Ministry, steps were taken to promote the development of the **International Investment Bank** and **International Bank for Economic Co-operation**.

The Bank of Russia conducted negotiations with the top management of the **Inter-American Development Bank** (IADB) on the conditions of Russia's entry to the IADB and on the provision of technical assistance by the latter for the establishment of a CIS regional development bank.

To expand co-operation with international organisations, the Bank of Russia took part in drafting proposals for the Russian Government's report "On Core Principles and Areas of Further Co-operation with International Financial Organisations" and plans for co-operation with them in 2004.

The Bank of Russia continued to broaden co-operation with the **Organisation for Economic Co-operation and Development** (OECD), participating in 2003 in meetings of the Russia-OECD Liaison Committee and Financial Markets Committee.

Bank of Russia representatives participated in the discussion of a wider range of issues at the **Group of Eight** meetings of finance ministers and central bankers, held in Paris in February, in Washington in April and in Dubai in September. These were, above all, issues relating to the need to accelerate economic growth, increase aid for development, prevent and settle financial crises, and counter money laundering and terrorist financing. The Dubai meeting devoted particular attention to exchange rate policies and negotiations within the framework of the WTO.

The Bank of Russia participated in the **Group of 20** meeting of finance ministers and central bankers, which discussed the problem of balancing economic growth between major regions of the world, institutional developments in the fi-

nancial sector and measures to combat abuses in the international financial system.

Bank of Russia representatives took part in the **Asia-Pacific Economic Co-operation** (APEC) meeting of deputy finance ministers and central bankers, which discussed financial and economic co-operation in the Asia-Pacific region, including the development of the regional bond market. To ensure that Russia fulfils its obligations as an APEC member, the Bank of Russia submitted proposals to the Economic Development and Trade Ministry on a list of measures to cut administrative expenses in cross-border trade.

In the period under review, the Bank of Russia continued to participate in the negotiations on Russia's accession to the **World Trade Organisation** (WTO) and in drafting the financial services sections of the final report, a key document that needs to be approved for Russia's admission to the WTO. The Bank of Russia carried

out this work in compliance with government directives and in collaboration with the Economic Development and Trade Ministry. In 2003, Russia conducted negotiations on financial services with 30 member countries of the WTO.

The Bank of Russia took part in the 17<sup>th</sup> session of the **Consultative Council for Foreign Investments in Russia** (CCFI), held in Moscow in September. At the meeting of the working group on banking sector and financial market development, headed by the Bank of Russia, Russian representatives discussed issues with foreign investors relating to the regulation of the banking system, conversion to IAS and the draft law on foreign exchange regulation and foreign exchange control (it was, in effect, an examination of the draft law by international experts before its adoption by the State Duma [lower house of parliament] of the Russian Federation).

## II.8.2. CO-OPERATION BETWEEN THE BANK OF RUSSIA AND FOREIGN COUNTRIES AND THEIR CENTRAL (NATIONAL) BANKS

Steps were taken in 2003 to implement the provisions of the Russia-Belarus Union Treaty of December 8, 1999, which envisages the introduction of a common currency and the establishment of a single emission centre.

This work is being co-ordinated by the Inter-bank Currency Board of the National Bank of the Republic of Belarus and the Central Bank of the Russian Federation.

The Bank of Russia and the National Bank of the Republic of Belarus elaborated in co-operation with the Russian and Belarussian Finance Ministries the draft **Agreement on the Use of the Russian Ruble as the Only Legal Tender in the Republic of Belarus** and drafts of the Agreement between the Central Bank of the Russian Federation and the National Bank of the Republic of Belarus on the Procedure for Determining the Limit of Increment of the Principal Part of Assets of the National Bank of the Republic of Belarus, the General Credit Agreement on Granting Interest-Free Permanent Loans for the Acquisition of Russian Rubles by the National Bank of the Republic of Belarus, the Agreement on Opening a Credit Line and the Agreement on the Procedure for Settling Mutual Claims and Liabilities in the Event of the Termination of the Agreement between the Government and Central Bank of the Russian Federation and the Government and National Bank of the Republic of Belarus on the Use of the Russian Ruble as the Only Legal Tender in the Republic of Belarus. The Bank of Russia drafted proposals on the establishment of a single emission centre of the Russia-Belarus Union State, which formed the basis of Russia's official position on the issue.

In 2003, the Bank of Russia actively participated in drafting documents designed to promote integration within the **Commonwealth of Independent States, the Eurasian Economic Community and the Single Economic Environment**.

The Bank of Russia was one of the preparers of the draft Concept of Co-operation and Co-or-

dination of Efforts of the CIS Member States in the Monetary Field.

The Bank of Russia worked together with the central (national) banks of the CIS member countries to harmonise their settlement agreements with Russian currency laws.

The Subcommittee on Banking and Investment Co-operation between Russia and Kazakhstan met in Almaty in April and in Moscow in September to discuss banking co-operation between the two countries and harmonise their currency, securities market and investment laws.

The Bank of Russia took part in refining Priority Areas of the Eurasian Economic Community (EurAsEC) Development Plan for 2003—2006 and the Subsequent Period and the Implementation Plan Section “Creating a Common Financial Market and Promoting Currency Integration.”

Working within the framework of the **EurAsEC Council of Central (National) Banks**, the Bank of Russia and the EurAsEC Integration Committee elaborated drafts of the Agreement on Co-operation in Organising an Integrated Currency Market and the Concept of Co-operation between the EurAsEC Member States in the Monetary Field and some other documents aimed at fostering integration. The Council met twice to discuss guidelines for the development and reform of the banking systems, the monetary policies of the central (national) banks and ways to upgrade co-operation between the national payment systems.

In the year under review, the Bank of Russia participated in working out a set of priority measures designed to create **a single economic environment covering Belarus, Kazakhstan, Russia and Ukraine** in the following areas: the harmonisation of macroeconomic indicators, monetary and foreign exchange policy, supervision and control over credit institutions and financial organisations and foreign exchange regulation and control.



In collaboration with the Finance Ministry and other government agencies, the Bank of Russia participated in working out Russia's position on the re-organisation of the **Interstate Bank**. The purpose of this work is to transform the bank into a CIS investment institution charged with the task of assisting the economic integration of the CIS member states.

In 2003, the Bank of Russia co-operated on a bilateral basis with foreign central banks, inter-bank commissions and working groups and took part in the work of bilateral intergovernmental commissions on trade, economic, scientific and technological co-operation.

In July, the Bank of Russia and People's Bank of China discussed at the fourth meeting of the Russian-Chinese Subcommittee on Interbank Co-operation ways to expand the network of correspondent relations and improve settlements between the two states.

The Bank of Russia continued to co-operate with the Reserve Bank of India (RBI) within the framework of the Russian-Indian Subgroup for

Banking and Financial Affairs to expand inter-bank co-operation.

Bank of Russia representatives participated in the meetings of intergovernmental commissions set up by Russia with Austria, Egypt, Iran, Cyprus, South Africa and the European Union, discussing, among other things, the diversification and upgrading of interbank co-operation, especially in the provision of banking services in foreign trade.

In April 2003, the Bank of Russia signed a memorandum of understanding with the Bank of Indonesia and in pursuance of this memorandum, a delegation of the Indonesian Bankers Institute visited the Bank of Russia to exchange information on the training of banking specialists and the development of the banking business in the two countries.

In July 2003, the Bank of Russia and the Central Bank of Mongolia signed an Agreement on Settlements in External Economic Relations, which enabled Russian and Mongolian commercial banks to effect settlements between them in the national currencies.

## II.9. UPGRADING THE BANK OF RUSSIA OPERATING SYSTEM AND IMPROVING ITS EFFICIENCY

### II.9.1. THE BANK OF RUSSIA ORGANISATIONAL STRUCTURE AND MEASURES TAKEN TO IMPROVE IT

In 2003, the Bank of Russia continued to optimise its organisational structure and reduce its staff. As a result, the number of Bank of Russia employees decreased by 920, or 1.1%.

To optimise the Bank of Russia settlement network, the Bank of Russia Board of Directors made the decision to close more than 200 cash settlement centres by the end of 2004. When carrying out this decision, the Bank of Russia closed 44 and ordered the closure of 49 cash settlement centres.

The closure of cash settlement centres allowed the Bank of Russia to reduce its staff by 617 employees.

In 2003, the Bank of Russia set up a new organisational structure, the Main Inspectorate for Credit Institutions, with interregional inspectorates in all federal districts.

In line with the decision of its Board of Directors, the Bank of Russia reorganised the network

of its educational institutions, closing seven banking schools and transforming six schools into independent legal entities.

Fulfilling its statutory functions to provide banking services to military units, national security structures and servicemen, in 2003 the Bank of Russia opened a field establishment in the city of Grozny.

As of January 1, 2004, the Bank of Russia structure included the central office, 59 main divisions, 19 regional banks, the Office of the Bank of Russia Representative in the Chechen Republic, 1,120 cash settlement centres, five divisions and the operations department of the Moscow Branch, and field establishments and units, which handle cash turnover and ensure the functioning of the Bank of Russia.

The Bank of Russia average staffing level in 2003 decreased by 618 employees, or 0.7%, to 82,094 employees.

## II.9.2. CO-ORDINATING THE ACTIVITIES OF BANK OF RUSSIA REGIONAL BRANCHES

In the year under review, the Bank of Russia co-ordinated the activities of its regional branches to facilitate the implementation of the single state monetary policy, improve banking regulation and supervision procedures, enhance the efficiency of the banking sector, ensure the efficient and uninterrupted functioning of the payment system, fulfil the requirements of the federal law on countering money laundering and terrorist financing, exercise foreign exchange control, and monitor enterprises and their demand for banking services.

The Bank of Russia co-ordinated the activities of its regional branches by issuing regulations and recommendations on various aspects of work, holding seminars and conferences on current problems in Bank of Russia activities and sending specialists from the central office on inspection trips and to provide assistance to regional branches in carrying out their tasks and duties.

To make co-operation between the various divisions of its central office and regional branches more effective, the Bank of Russia issued Order No. R-140, dated March 24, 2003, changing the procedure for considering the Bank of Russia regional branches' annual reports for 2002 and the methods of tackling problems relating to them.

The corresponding divisions of the Bank of Russia central office not only studied the problems of the Bank of Russia regional branches and their proposals and issued statements on them, but also reported the measures taken to solve the above problems.

In compliance with Bank of Russia Order No. R-31, dated January 23, 2003, "On Measures to Prepare for the Practical Use of the Results of Bank of Russia Monitoring of Enterprises for the Needs of the Banking Community," work began in 2003 to create the Bank of Russia data bank "Monitoring Enterprises and their Demand for Banking Services." Bank of Russia regional branches began to conduct quarterly surveys of enterprises to obtain information about their banking services needs and the extent to which these needs were met, the effect of major factors on the use of banking services by enterprises, the criteria used by enterprises in choosing credit institutions, the evaluation by enterprises of the quality of banking services and the factors that influence this evaluation, and the expected changes in the demand for individual banking services.

To prepare the introduction of the Regional Branch Passport information analysis system as a means for co-ordinating and analysing the activities of the Bank of Russia regional branches, the Bank of Russia tested with its regional branches the procedure for systematising data and using the indicators formed within the system.

In the year under review, the Bank of Russia continued to work on methodologies of conducting a comparative analysis of resources allocated to its regional branches and evaluating how effectively they are used, taking into account the scale of activity of each regional branch.

### II.9.3. STAFFING AND PERSONNEL TRAINING

In 2003, personnel policy was designed to continue improvements in the procedures and techniques of selecting, promoting and providing advanced training to specialists. In addition, it aimed to make the most of the professional and personal qualities of each employee.

As of January 1, 2004, the staffing level in the Bank of Russia was 98.2%. Most Bank of Russia employees were aged between 30 and 50 (64.6%) and had worked in the Bank of Russia system from three to 15 years (67.3%). The educational level of Bank of Russia employees has risen in the past few years. More than 5,000 employees had studied at higher education establishments (as of January 1, 2004), majoring in economics, management and law, and 1,568 employees finished training in the year under review.

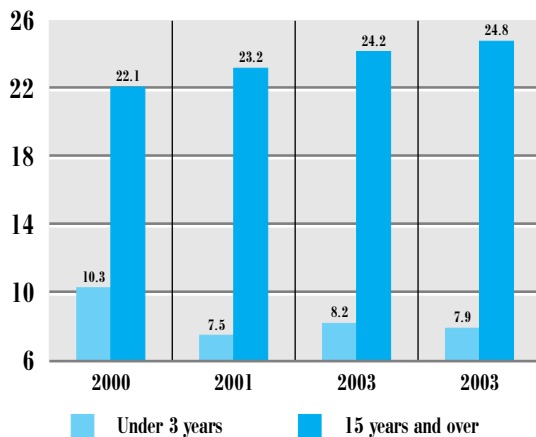
In 2003, the Bank of Russia continued to provide its personnel services with regulatory documents. The following documents were approved and put into effect to regulate labour relations in the Bank of Russia and establish uniform standards in personnel management: the Regulation on Bank of Russia Employees, the Regulation on the Procedure for Appointing and Dismissing Bank of Russia Employees and the Procedure for Drafting and Approving Bank of Russia Job De-

scriptions. A set of standard requirements was introduced for the employment, promotion and demotion and advanced training of employees, containing standard qualification characteristics of executive and specialist positions in all spheres of activity of Bank of Russia divisions.

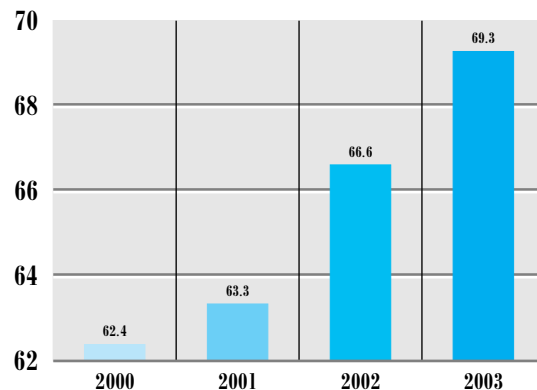
Considerable attention was paid to improving personnel expertise by implementing programmes for additional vocational training. Over 20,000 Bank of Russia employees, or more than a third of executives and specialists, received advanced training in banking, computer technologies and foreign languages in Bank of Russia banking schools (colleges) and other educational establishments, as well as in certified training centres and higher education establishments in 2003.

Specialists with Bank of Russia supervisory divisions receive advanced training and retraining in leading Moscow higher education establishments, such as the Russian Government's Economic Academy, the State University Higher School of Economics and the Russian Government's Financial Academy. In 2003, 123 specialists from 50 Bank of Russia regional branches and central office units received training under the following programmes: Commercial Bank Curator — Bank Manager and Commercial Bank In-

**DYNAMICS OF PERSONNEL STRUCTURE  
BY LENGTH OF EMPLOYMENT  
WITH THE BANK OF RUSSIA (%)**



**EXECUTIVES AND SPECIALISTS  
WITH HIGHER PROFESSIONAL EDUCATION  
(as a percentage of total number)**



spector — Bank Manager. The Bank of Russia will continue this practice in 2004.

In connection with the conversion of the Russian banking sector to International Financial Reporting Standards, the Bank of Russia conducted 26 training sessions for Bank of Russia executives and specialists and 21 training sessions for managers and chief accountants of credit institutions (a total of 1,761 people received training).

A total of 124 international training sessions devoted to contemporary banking practices were held in 2003 within the framework of the Bank of Russia’s co-operation with foreign banks and personnel training organisations and centres, while 457 Bank of Russia executives and specialists participated in seminars and consultations in Russia and abroad.

The most significant event in international co-operation was the signing by the European Central Bank, the Bank of Russia and the European Commission’s Office in Russia of a protocol on the implementation of the European Union Technical Assistance Programme TACIS in 2003—2005 “Central Bank Personnel Training. Stage III,” which provides for the training of Bank of Russia supervising executives and specialists in the Bank of Russia’s central office and regional branches.

The project is designed to upgrade co-operation between the Bank of Russia and credit institutions on the basis of foreign experience in banking supervision and improve managerial skills of Bank of Russia supervisors.

In 2003, the Bank of Russia continued to implement the programme for co-operation between the Bank of Russia and CIS and EURASEC central (national) banks in personnel training,

**METHODS AND AREAS OF BANK OF RUSSIA PERSONNEL TRAINING IN 2003**  
(as % of total number of trainees)

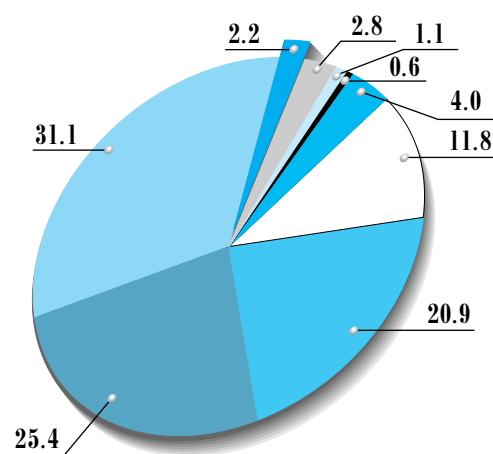


Chart 53

- Thematic seminars
- Computer training
- Advanced training courses
- Training seminars to improve managerial competence
- Vocational retraining
- Foreign language courses
- International seminars
- Seminars held according to Bank of Russia instruction structures' schedules
- Seminars held under centralised agreements

holding 31 training sessions in the form of seminars, internships, training courses, consultations and visits, which involved 212 representatives of CIS central banks.

## II.9.4. BANK OF RUSSIA ACTIVITIES AIMED AT IMPROVING BANKING LEGISLATION. MANAGING SUITS AND CLAIMS IN BANK OF RUSSIA ESTABLISHMENTS

The efforts made by the Bank of Russia to improve banking legislation in 2003 were designed, above all, to implement the Russian Banking Sector Development Strategy, adopted by the Bank of Russia and the Russian Government on December 30, 2001.

The federal laws of greatest importance for the Bank of Russia adopted last year were the law “On Insurance of Personal Deposits in Russian Federation Banks” and the law “On Foreign Exchange Regulation and Foreign Exchange Control.”

**Federal Law No. 177-FZ, dated December 23, 2003, “On Insurance of Personal Deposits in Russian Federation Banks,”** came into force on December 27, 2003.

It establishes the legal, financial and organisational framework for the functioning of the deposit insurance system, the competence and procedure for establishing and operating the organisation fulfilling the functions of compulsory insurance of deposits (hereinafter referred to as the Deposit Insurance Agency) and the procedure for paying compensation on deposits, and regulates relations between banks, the Deposit Insurance Agency, the Bank of Russia and federal executive power structures in respect to personal bank deposit insurance.

The law formulates the core principles of the establishment and functioning of the mandatory personal deposit insurance system in Russia, such as:

- the mandatory participation of banks in the deposit insurance system;
- the reduction of the risk of adverse consequences for depositors in the event of non-fulfilment by banks of their obligations;
- the transparency of the deposit insurance system;
- the accumulative nature of the compulsory deposit insurance fund due to regular insurance contributions made by the participating banks.

The law stipulates that a private individual is entitled to receive compensation from the Deposit Insurance Agency in the following two cases:

- if the Bank of Russia has revoked (cancelled) a bank’s banking licence;
- if the Bank of Russia has imposed a moratorium on upholding claims made with regard to a bank by its creditors.

The adoption of the Deposit Insurance Law required amendments to several other federal laws by adopting the following federal laws:

**Federal Law No. 181-FZ, dated December 23, 2003, “On Making Amendments and Addenda to the Federal Law ‘On Banks and Banking Activities,’”** which enabled the Deposit Insurance Agency to receive statements of personal accounts and deposits when the insured event has occurred and obliged the Agency to guarantee the confidentiality of information containing bank secrets. In addition, the law stipulated that participation in the mandatory deposit insurance system was a necessary condition for banks to take funds on deposit;

**Federal Law No. 180-FZ, dated December 23, 2003, “On Amending Article 69 of the Federal Law ‘On the Central Bank of the Russian Federation (Bank of Russia),’”** which annulled the power of the Bank of Russia to establish the procedure for and the amount of pre-tax reserves (funds) created by banks to guarantee the return of personal deposits in compliance with federal laws;

**Federal Law No. 182-FZ, dated December 23, 2003, “On Making Amendments and Addenda to the Civil Code of the Russian Federation,”** which changed the procedure for meeting the claims of first-ranking creditors of liquidated banks by adding to this ranking the Deposit Insurance Agency’s claims in the amount of the compensation the Agency paid on personal deposits. In addition, the law cancelled the subsidiary liability of the state in the return of deposits by

banks with a government stake of more than 50% in their authorised capital;

**Federal Law No. 178-FZ, dated December 23, 2003, “On Amending Articles 251 and 291 of the Tax Code of the Russian Federation,”** which broadened the definition of targeted financing by including in it banks’ insurance contributions to the deposit insurance fund under the Deposit Insurance Law. In addition, the changes made in Article 291 of the Tax Code allowed banks to account for the insurance contributions they make under the Deposit Insurance Law as expenses they incurred in conducting banking operations;

**Federal Law No. 179-FZ, dated December 23, 2003, “On Amending Article 26 of the Federal Law ‘On Non-commercial Organisations,’”** which provided for complementing the sources of property of state corporations with regular and/or one-off receipts (contributions) from corporate entities which are required to make such contributions by the federal law.

As has been noted above, the second most important event for the Bank of Russia was the adoption of **Federal Law No. 173-FZ, dated December 10, 2003, “On Foreign Exchange Regulation and Foreign Exchange Control.”**

This law specified the term foreign exchange operations, abolishing the division of foreign exchange operations into current foreign exchange operations and operations connected with capital movement. In addition, it divided the authority to regulate foreign exchange operations between the Russian Government and the Bank of Russia.

To liberalise foreign exchange legislation, the law prohibited making it a requirement to obtain individual permits. Foreign exchange operations can only be limited to prevent a significant contraction in international reserves and sharp fluctuations of the ruble’s exchange rate and maintain balance of payments stability.

The law provides for the possibility of requiring provisions to be made for a specified period of time and sets upper limits on provisions.

It stipulates that foreign exchange and cheques, including travel cheques, with a nominal value indicated in foreign currency can be purchased and sold in Russia through authorised banks only.

The law says that from the dates it establishes residents are free to open foreign currency accounts in banks located in foreign countries that are members of the Organisation for Economic Co-operation and Development (OECD) and Financial Action Task Force (FATF). The procedure for opening accounts in banks located in other countries is to be established by the Bank of Russia.

It should also be noted that the Bank of Russia was directly involved in drafting the following federal laws adopted in 2003: **the Russian Federation Customs Code No. 61-FZ, dated May 28, 2003; Federal Law No. 164-FZ, dated December 8, 2003, “On the Fundamentals of the State Regulation of Foreign Trade; Federal Law No. 152-FZ, dated November 11, 2003, “On Mortgage Securities.”**

As for the draft federal laws that were elaborated in 2003 and will be worked on further this year, special mention should be made of the draft laws designed to facilitate the development of the country’s banking sector, to make credit institutions more transparent and create conditions for the expansion of lending to key branches of the economy. The following draft federal laws have been elaborated and are now at various stages of discussion and endorsement: “On Credit Histories,” “On Building Societies” and “On Consolidated Financial Statements.”

In addition to drafting federal laws, the Bank of Russia actively participated in drafting concepts of federal laws, including “On Amending the Federal Law ‘On the Securities Market;’” “On Amending the Federal Law ‘On Banks and Banking Activities;’” “On Making Amendments and Addenda to Article 61 of the Federal Law ‘On the Central Bank of the Russian Federation (Bank of Russia);’” “On Banks and Banking Activities;” “On Making Amendments and Addenda to the Civil Code of the Russian Federation;” “On Pledges;” “On Insolvency (Bankruptcy);” “On Enforcement;” and “On Amending Article 837 of the Civil Code of the Russian Federation.”

The Bank of Russia actively worked on its own rules and regulations. From January 1 to December 31, 2003, it issued 160 regulatory documents (three instructions, 31 regulations and 126 ordinances).

The Ministry of Justice registered during that period 51 Bank of Russia regulations, while declaring that four regulations did not require state registration.

The Bank of Russia also consistently made efforts to eliminate discrepancies in its regulations. In 2003, it issued 38 ordinances which invalidated 97 Bank of Russia regulations and 31 regulations which invalidated some clauses of Bank of Russia regulations and repealed a number of Bank of Russia non-regulatory documents, which clarified Bank of Russia regulations.

### MANAGING SUITS AND CLAIMS

#### IN BANK OF RUSSIA ESTABLISHMENTS

A total of 949 property claims to the amount of more than 363.57 million rubles and 1 million US dollars were made on Bank of Russia regional branches in 2003. Of these, only 66 claims to the amount of 11.57 million rubles were upheld.

These figures show that most of the claims and suits filed against the Bank of Russia in respect to the servicing of credit institutions' correspondent accounts and the recovery of funds at the request of depositors of credit institutions were unjustified and could not be upheld.

Courts of common law considered 124 suits against the Bank of Russia on disputes that arose from labour relations.

There were also disputes concerning the appeals made by credit institutions against the use of sanctions by the Bank of Russia. Only six out of 53 suits to the amount of 14.67 billion rubles were upheld.

Bank of Russia establishments, for their part, made claims and suits in the course of supervising credit institutions. They made 557 claims on banks to the amount of more than 18.15 million rubles and filed 58 suits to the amount of 2.19 million rubles, of which 528 claims and suits to the amount of 17.93 million rubles were upheld.



### II.9.5. BANK OF RUSSIA INTERNAL AUDIT

The Bank of Russia Chief Auditor's Service in 2003 exercised control over the financial and business operations of divisions, establishments and organisations of the Bank of Russia, monitoring their compliance with federal laws and Bank of Russia regulations. Its principal objective, however, was to ensure that there was no misuse or waste of funds.

During the year, 1,423 Bank of Russia establishments and organisations were inspected, of which 597 Bank of Russia establishments were subjected to comprehensive inspections and 826 to various thematic inspections.

When conducting audits (inspections), the Bank of Russia Chief Auditor's Service paid particular attention to the management of internal control in Bank of Russia divisions and establishments. It confirmed that the Bank of Russia internal control system on the whole met the accounting requirements and corresponded to the scale and nature of Bank of Russia activities.

A series of measures were implemented in the year under review to upgrade internal audit procedures and create a control environment. Efforts were made to optimise internal audit management practices, new forms and methods of internal audit were introduced and more stringent requirements were made on the executives in charge of inspections for their effectiveness.

In pursuance of Bank of Russia Order No. R-208, dated April 16, 2003, the implementation of the agreements concluded by the Bank of Russia on capital investments, major repairs and the provision of services was audited to increase control over the spending of funds allocated for capital expenditures.

The Bank of Russia began to control the quality of audit reports on the inspections of Bank of Russia regional branches, made work to rectify the shortcomings discovered during inspections

more effective, improved on-site co-operation between Bank of Russia divisions and inspection services and expanded the representation of the Chief Auditor's Service on Bank of Russia committees and commissions.

The Information System Audit Division was set up within the Internal Audit and Inspection Department to make internal audit more effective.

Audit and inspection results indicate that, on the whole, Bank of Russia establishments complied with banking operation and business practice rules and accounting procedures. An analysis of the results of audits and inspections conducted in 2003 testify to a fall in the number of cases of the misuse of funds allocated for capital construction and repairs of Bank of Russia fixed assets. There is a declining trend in the number of violations in other spheres of Bank of Russia activity.

When considering audit and inspection results, Bank of Russia central office divisions and regional branches and organisations took decisions depending on the nature of the violations and shortcomings discovered.

Great importance was attached to raising auditors' skills and the Bank of Russia took steps to promote co-operation with the internal audit services of European and CIS central banks and some other organisations.

In carrying out its two-year action plan, the internal audit service prepared regulatory and methodological documents pertaining to its activities.

Pursuant to Article 13 of the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)," the National Banking Board in October considered the Bank of Russia Chief Auditor's Report "The General State of the Bank of Russia Internal Control and Audit System."

## II.9.6. BANK OF RUSSIA PARTICIPATION IN THE CAPITAL OF RUSSIAN AND FOREIGN CREDIT INSTITUTIONS AND OTHER ORGANISATIONS

Pursuant to Article 8 of the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia),” in 2003 the Bank of Russia participated in the capital of the Savings Bank (Sberbank) and in the capital of resident organisations that ensured the activities of the Bank of Russia: the Moscow Interbank Currency Exchange (MICEX), the St Petersburg Currency Exchange (SPCEX) and the National Depository Centre (NDC), a non-profit partnership. The Bank of Russia participated in the capital of the above organisations through its representatives in their management and control structures.

The Bank of Russia stake in **Sberbank** remained unchanged in 2003 and stood at 60.57%.

The purpose of the Bank of Russia’s participation in Sberbank’s capital was to optimise conditions for the implementation of the government’s economic policy, including effective government control over Sberbank’s activities. Sberbank’s 2003 annual shareholders’ meeting approved some changes in Sberbank’s charter, which increased the role of the Supervisory Board over Sberbank’s operations to float bonds and other securities convertible into ordinary shares. The shareholders’ meeting ruled that the Sberbank Board should regularly inform the Supervisory Board about the state of the loan portfolio, risk control, financial plan indicators performance and the implementation of Sberbank’s social programmes.

During the period under review, Sberbank continued to retain its leading positions in the principal segments of the Russian financial market, increasing lending to top corporate borrowers, households and small and medium-sized businesses and expanding the volume of operations with government securities. Despite the continued contraction of Sberbank’s share of the retail banking market, it remained significant in the period under review (over 60%).

In 2003, Sberbank recorded a profit of 38.8 billion rubles, an increase of 7.8% on the previous

year. The dividend received by the Bank of Russia in the period under review for Sberbank performance in 2002 amounted to 1.2 billion rubles.

The participation by the Bank of Russia in the capital of **MICEX** and **SPCEX**, thanks to which the Bank of Russia controlled the functioning of the currency and government securities sections of the exchanges, was an effective means of regulating the domestic foreign exchange market and government internal debt market.

The Bank of Russia stake in **MICEX** in 2003 was 28.76%, which means that it increased by 6.53% over the year due to the use by the Bank of Russia of its priority right to buy out shares alienated by other MICEX shareholders. In the year under review, in accordance with a decision taken at the MICEX annual shareholders’ meeting, the authorised capital of MICEX was expanded due to the capitalisation of a part of its profit by increasing the nominal value of shares.

The Bank of Russia participated in the management of MICEX and control over its activities through its representatives on the Exchange Board, which discussed ways to promote the development of the exchange trade system, measures to optimise working conditions for market participants on the currency exchange by increasing the liquidity of individual instruments and reducing operational expenses and other measures designed to stimulate financial market development, including repo operations with GKO and OFZ bonds and deposit operations.

The overall volume of MICEX trade on all segments of the exchange market amounted to \$280.7 billion in 2003, an increase of 140% on the previous year’s \$117.3 billion.

The Bank of Russia has been a **SPCEX** shareholder since 2002. In the year under review, the Bank of Russia stake in SPCEX, the principal exchange of Northwestern Russia, was unchanged at 10%. In the period under review, SPCEX continued to provide opportunities for traders to conduct transactions with different financial instruments within its own trading sys-

tem and on MICEX. SPCEX foreign exchange and securities trade turnover rose to 684.2 billion rubles in 2003 as against 428.4 billion rubles in 2002.

MICEX and SPCEX used the profit they made in 2003 to improve their technological base and to modernise the technical infrastructure of the principal segments of the exchange market, including the maintenance of the interregional system of exchange currency trade and the development of a hi-tech system of trade in securities.

To ensure the effective functioning of the financial market infrastructure, the Bank of Russia holds a stake in the capital of the **National Depository Centre** (NDC). The Bank of Russia stake in the NDC was unchanged in 2003 at 49%.

The NDC is the settlement depository of MICEX and SPCEX, handling every kind of security issued by Russian issuers. The NDC ensured the compulsory centralised safekeeping of global certificates and the depository accounting of all GKO and OFZ issues and most of the corporate and regional bond issues. Since 1996, it has registered, as the authorised depository, the encumbrance of securities by collateral in refinancing operations conducted by the Bank of Russia.

All profit received by the NDC was used to modernise its regional infrastructure, upgrade the electronic exchange of documents to international standards and establish correspondent inter-depository relations with international organisations.

The group of the so-called **Russian overseas banks** comprises the Moscow Narodny Bank (London), Ost-West Handelsbank (Frankfurt am Main), Banque Commercial pour l'Europe du Nord-Eurobank (Paris), Donau-bank (Vienna) and East-West United Bank (Luxembourg). These banks operate in compliance with their host country's legislation and are supervised by the local supervisory authorities, while the Bank of Russia participates in managing these banks through its representatives on their supervisory boards.

The Bank of Russia holds a 15% stake in the Vienna-based Donau-bank and Luxembourg-based East-West United Bank. It has retained its blocks of shares in these banks at the recommendation of the local supervisory authorities. The Bank of Russia has a stake of 51.62% in the Ost-West Handelsbank (Frankfurt am Main),

87.03% in Eurobank (Paris) and 88.89% in Moscow Narodny Bank (London).

Pursuant to Article 8 of the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)," the Bank of Russia agrees all its decisions with regard to these stakes with the Russian Government. Article 13 of this Law stipulates that all matters pertaining to the Bank of Russia's participation in the capital of credit institutions fall within the competence of the National Banking Board, which repeatedly discussed the state of affairs in the Russian overseas banks at its meetings in 2003.

To carry out the decisions of the National Banking Board, the Bank of Russia took consistent steps to create conditions for its withdrawal from the capital of Russian overseas banks. Specifically, it held meetings and consultations with the corresponding host country supervisors, assisted these banks in becoming more financially independent and less dependent on financial support from the Bank of Russia, looked for acceptable investors and studied possible forms of share alienation. In the period under review, efforts continued to be made to secure the Bank of Russia as the rightful owner of Russian overseas banks' shares registered as belonging to "nominee shareholders."

The overall financial condition of the Russian overseas banks was stable and all of them were in profit in 2003.

In the medium term, the Russian Banking Sector Development Strategy, elaborated by the Russian Government and Bank of Russia, provides for the gradual withdrawal of the Bank of Russia from the capital of Russian overseas banks by selling the shares that remain in its possession. At the same time, the Bank of Russia and National Banking Board insist that the sale of Bank of Russia holdings in the Russian overseas banks should not harm the interests of the state.

Within the framework of the above Strategy and in compliance with the decision of the National Banking Board, the Bank of Russia in the period under review invited independent experts to make presale evaluations of the London-based Moscow Narodny Bank and Paris-based Eurobank and the evaluation results were discussed by the National Banking Board at the end of the year.



**BANK OF RUSSIA ANNUAL  
FINANCIAL STATEMENTS  
AS OF JANUARY 1, 2004**



## INTRODUCTION

The annual financial statements show the operations conducted by the Bank of Russia in fulfilling its principal tasks and functions established by Federal Law No. 86-FZ, dated July 10, 2002, “On the Central Bank of the Russian Federation (Bank of Russia).”

The annual financial statements (hereinafter referred to as the financial statements) as of January 1, 2004, comprise:

- the Annual Balance Sheet;
- the Profit and Loss Account;
- the Statement on Profit Received and its Allocation;
- the Statement on Bank of Russia Reserves and Funds;
- the Statement on Bank of Russia Management of Securities and Stakes in the Capital of Organisations that are Bank of Russia Property;
- the Statement on Bank of Russia Personnel Costs;
- the Statement on Capital Investment Budget Performance.

The principal objectives of the Bank of Russia are as follows:

- to protect the ruble and ensure its stability;
- to develop and strengthen the Russian banking system;
- to ensure the effective and uninterrupted functioning of the payment system.

The monetary policy pursued by the Bank of Russia in 2003 designed to reduce the inflation rate coupled with the exchange rate policy, which was implemented under the managed floating exchange rate regime, facilitated continued economic growth, domestic foreign exchange market stability and the accumulation of Russia’s international reserves, which helped maintain the stability and balanced development of the financial market.

The year under review saw an improvement in the qualitative characteristics of the banking sector, increased stability of credit institutions, an expansion of their activities as financial intermediaries and an increased role for the banking sector in the country’s economy. The development and improvement of the Bank of Russia payment system ensured reliable and accelerated settlements between economic agents.

## ANNUAL BALANCE SHEET

### AS OF JANUARY 1, 2004

(million rubles)

	Note	2003	2002
<b>ASSETS</b>			
<b>1. Precious metals</b>		<b>48,738</b>	<b>49,365</b>
<b>2. Funds placed with non-residents and securities issued by non-residents</b>	<b>3</b>	<b>2,205,795</b>	<b>1,427,298</b>
<b>3. Loans and deposits, of which:</b>	<b>4</b>	<b>194,937</b>	<b>216,481</b>
3.1. loans extended to resident organisations		838	1,924
3.2. loans intended for foreign debt service		182,618	197,063
<b>4. Securities, of which:</b>	<b>5</b>	<b>330,008</b>	<b>379,931</b>
4.1. Russian government securities		297,894	348,025
<b>5. Other assets, of which:</b>	<b>6</b>	<b>73,304</b>	<b>71,260</b>
5.1. fixed assets		56,405	55,896
<b>Total assets</b>		<b>2,852,782</b>	<b>2,144,335</b>
<b>LIABILITIES</b>			
<b>1. Cash in circulation</b>	<b>7</b>	<b>1,228,881</b>	<b>817,602</b>
<b>2. Funds in Bank of Russia accounts, of which:</b>	<b>8</b>	<b>1,195,275</b>	<b>820,542</b>
2.1. Russian government funds		326,601	271,301
2.2. funds of resident credit institutions		661,240	420,847
<b>3. Float</b>	<b>9</b>	<b>6,520</b>	<b>8,390</b>
<b>4. Other liabilities</b>	<b>10</b>	<b>123,873</b>	<b>133,070</b>
<b>5. Capital, of which:</b>		<b>298,233</b>	<b>364,731</b>
5.1. authorised capital		3,000	3,000
5.2. reserves and funds		300,489	370,713
5.3. losses incurred in 1998		(5,256)	(8,982)
<b>Total liabilities</b>		<b>2,852,782</b>	<b>2,144,335</b>

Bank of Russia Chairman

S.M. Ignatiev

Bank of Russia Chief Accountant

L.I. Gudenko

## PROFIT AND LOSS ACCOUNT

		<i>(million rubles)</i>	
	Note	2003	2002
<b>INCOME</b>			
Interest income	12	44,862	46,914
Income from operations with securities	13	18,378	17,780
Income from operations with precious metals		4,521	17,534
Income from participation in the capital of credit and other institutions		1,462	1,249
Net income from recovery of provisions	14	11,875	24,046
Other income	15	17,719	5,253
<b>Total income</b>		<b>98,817</b>	<b>112,776</b>
<b>EXPENSES</b>			
Interest expenses	16	3,083	8,189
Expenses on operations with securities	17	7,179	713
Cash turnover management expenses	18	3,139	2,767
Expenses on operations with precious metals		74	437
Other operating expenses	19	18,859	21,915
Personnel costs	20	29,196	28,870
<b>Total expenses</b>		<b>61,530</b>	<b>62,891</b>
<b>Financial result: profit</b>		<b>37,287</b>	<b>49,885</b>



## CAPITAL, FUNDS AND PROFIT ALLOCATION

*(million rubles)*

	Authorised capital	Reserves	Accrued exchange rate differences	Social fund	Fixed assets revaluation fund	Other funds	Losses for 1998	Allocation of profit for 2003	Total
<b>Balance as of January 1, 2003</b>	<b>3,000</b>	<b>28,237</b>	<b>330,956</b>	<b>3,189</b>	<b>8,215</b>	<b>116</b>	<b>(8,982)</b>	<b>—</b>	<b>364,731</b>
Full-year profit								37,287	37,287
Allocation of profit for 2003:									
— taxes and duties paid								(30)	(30)
— to be transferred to the federal budget								(29,806)	(29,806)
— allocated to funds and to cover losses for 1998		3,427		298			3,726	(7,451)	—
Accrued exchange rate differences			(73,461)						(73,461)
Allocated to funds from other sources				1		17			18
Used from funds				(382)	(98)	(26)			(506)
<b>Balance as of January 1, 2004</b>	<b>3,000</b>	<b>31,664</b>	<b>257,495</b>	<b>3,106</b>	<b>8,117</b>	<b>107</b>	<b>(5,256)</b>	<b>—</b>	<b>298,233</b>



## NOTES TO THE ANNUAL FINANCIAL STATEMENTS AS OF JANUARY 1, 2004

### 1. ACCOUNTING AND FINANCIAL REPORTING PRINCIPLES

Accounting and financial reporting is implemented by the Bank of Russia in compliance with the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia),” Federal Law “On Accounting,” Bank of Russia Accounting Rules No. 66, dated September 18, 1997 (with subsequent amendments and addenda) and other Bank of Russia regulations issued in pursuance of the above federal laws.

#### *(a) Accounting principles*

Accounting is conducted in accordance with the principle of accounting for balance sheet items at their initial cost at the purchase of assets or the occurrence of liabilities. The principles of the revaluation of individual items of assets and liabilities are set out below.

#### *(b) Financial reporting principles*

These financial statements have been compiled on the basis of the balance sheet data of the Bank of Russia, including its regional branches and divisions comprising the structure of the Bank of Russia as a corporate entity.

These financial statements have been compiled without including the financial statements of credit and other institutions in whose capital the Bank of Russia participates both in and outside Russia.

These financial statements have been compiled in millions of Russian rubles, hereinafter referred to as rubles and abbreviated as Rbs m.

Whenever necessary, comparative data were readjusted to conform with the changes in the form of presentation of the financial statements for the year under review.

Figures in brackets denote negative values.

#### *(c) Precious metals*

Precious metals are accounted for at their acquisition cost. Precious metals in deposits and impersonal metal accounts in non-resident credit institutions are accounted for at their acquisition cost and included in the balance sheet item “Funds placed with non-residents and securities issued by non-residents.”

#### *(d) Foreign currency assets and liabilities*

Foreign currency assets and liabilities are accounted for in Russian rubles at the official rates of exchange of foreign currencies against the Russian ruble set by the Bank of Russia (hereinafter referred to as the official exchange rates) as of the date of compiling the balance sheet. Foreign currency assets and liabilities are revalued daily at the official exchange rates. Incomes and expenses on Bank of Russia foreign currency operations are accounted for in the balance sheet in rubles at the official exchange rate as of the date of their receipt or conduct.

Unrealised exchange rate differences arising in the course of revaluing the balances in active and passive balance sheet foreign currency accounts are accounted for as “Accrued Exchange Rate Differences” and are not included in the Profit and Loss Account when the official exchange rates change. Realised exchange rate differences are accounted for as Bank of Russia incomes or expenses.

The official rates of exchange used in recalculating foreign currency assets and liabilities on the last business day, December 31, 2003, were as follows: 29.4545 rubles to the US dollar (2002: 31.7844 rubles to the US dollar) and 36.8240 rubles to the euro (2002: 33.1098 rubles to the euro).

*(e) Securities*

Under the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia),” the Bank of Russia has the right to buy and sell government securities on the open market. The following principles of accounting for investments in government securities have been used:

- government securities in the investment portfolio have been accounted for at their acquisition (restructuring) price;
- government securities in the trade portfolio are revalued upon the results of trading if there are market quotations or accounted for at their acquisition price, if there are none;
- Finance Ministry promissory notes are accounted for at their acquisition price.

In addition, the following accounting principles have been used with regard to other securities:

- foreign issuers’ securities are accounted for at their acquisition price;
- credit institutions’ promissory notes are accounted for at their acquisition price.

Promissory notes that have not been retired when due and have not been protested are accounted for at the acquisition price, taking account of the discount and interest.

*(f) Investment*

Bank of Russia investments in the authorised capital of credit and other institutions in and outside Russia are accounted for at their acquisition price.

*(g) Loans extended to credit institutions*

Loans extended to credit institutions are accounted for in the sum of the principal debt.

*(h) Provisions for possible losses on Bank of Russia operations*

To protect its assets against the risk of depreciation, the Bank of Russia, using generally accepted banking practice and Bank of Russia regulations, makes provisions for possible losses on loans extended to credit institutions, for the devaluation of investments in securities and for other active operations it conducts in rubles and foreign currency. Bank of Russia provisions are made from charges accounted for as Bank of Russia expenses. When loans are repaid, deposits returned and promissory notes retired and the quality of assets improves or their risk decreases, the provisions made for them earlier are recovered to Bank of Russia incomes. The provisions made are accounted for as part of other liabilities.

*(i) Fixed assets*

Fixed assets are accounted for at their residual value (acquisition price including revaluation and excluding the sums of accrued depreciation).

Bank of Russia fixed assets are revalued pursuant to the Russian Government’s resolutions. The last revaluation was made as of January 1, 1997.

Depreciation on fixed assets acquired and put into operation before January 1, 2002, is charged at the official rates of depreciation set by USSR Council of Ministers Resolution No. 1072, dated October 22, 1990, “On Standard Rates of Depreciation Charges for the Complete Restoration of Fixed Assets of the National Economy of the USSR”:

	<i>% a year</i>
Buildings	1.0—12.5
Equipment (including computers, furniture, transport vehicles, etc.)	5—20

Fixed assets put into operation after 2002 are subject to the rates of depreciation set by Bank of Russia Order No. OD-239, dated May 8, 2003, “On the Enforcement of the Regulation on the Procedure for Using the List of Depreciated Fixed Assets of the Bank of Russia, Broken down into Depreciation Groups and Indicating Serviceability Periods and the List of Depreciated Fixed Assets of the

Bank of Russia, Broken down into Depreciation Groups and Indicating Serviceability Periods,” based on Russian Federation Government Resolution No. 1, dated January 1, 2002, “On the Classification of Fixed Assets Included in Depreciation Groups.”

	<i>% a year</i>
Buildings	3—14
Equipment (including computers, furniture, transport vehicles, etc.)	4—92

*(j) Cash in circulation*

The Bank of Russia is the sole issuer of cash and organiser of its circulation. The banknotes and coins put into circulation are accounted for in the balance sheet at their face value.

*(k) Funds in Bank of Russia accounts*

Funds in Bank of Russia accounts comprise federal government and credit institution funds in correspondent accounts, required reserves deposited in the Bank of Russia, credit institutions’ deposit accounts in the Bank of Russia and regional and local government budget funds and government extrabudgetary funds.

*(l) Float*

The float as of the end of the year comprises the balances connected with the closing of accounts of intraregional and interregional electronic payments, settlements effected using letters of advice, balances resulting from operations between Bank of Russia establishments and funds to be entered by the Bank of Russia to customers’ accounts.

*(m) Capital*

The capital of the Bank of Russia comprises:

- authorised capital. Under Article 10 of the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia),” the Bank of Russia has an authorised capital of 3 billion rubles;
- various reserves and funds created to enable the Bank of Russia to fulfil the functions assigned to it by the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia).” Information about the sources and uses of reserves and funds is contained in the Statement of Bank of Russia Reserves and Funds.

Since 1999, the balance sheet item “Capital” has been used to account for the amount of uncovered losses incurred in 1998 as a result of the devaluation of the Bank of Russia government securities portfolio.

*(n) Recognition of Bank of Russia income and expenses*

Income and expenses are accounted for in the Profit and Loss Account on a cash basis, i.e., after income has been actually received and expenses have been actually financed.

*(o) Balance sheet profit*

Balance sheet profit is accounted for in the Profit and Loss Account under the heading “financial result: profit” as the difference between the sum of income received and expenses financed on Bank of Russia core and subsidiary activities.

*(p) Taxation of the Bank of Russia*

The Bank of Russia and its divisions pay taxes and duties in compliance with the Tax Code of the Russian Federation. The Bank of Russia has elaborated the accounting policies for the purposes of taxation.

## 2. IMPACT OF ECONOMIC CONDITIONS ON BANK OF RUSSIA FINANCIAL STATEMENTS

As Russia continued to enjoy favourable foreign trade conditions in 2003, the Bank of Russia implemented its monetary policy according to the same principles as in the previous year. Economic developments in Russia and on world financial markets and the efforts made by the Bank of Russia further to reduce inflation and ensure foreign exchange stability affected indicators contained in the Bank of Russia financial statements.

As the inflow of foreign currency to Russia increased, the Bank of Russia pursued an exchange rate policy based on the floating exchange rate regime, preventing the ruble from rising sharply, which could create an obstacle to accelerated economic growth. The Bank of Russia continued to accumulate gold and foreign exchange reserves to maintain a stable and balanced domestic financial market. As a result, foreign currency funds continued to predominate in the structure of Bank of Russia assets, even despite the ruble's nominal rise against the dollar.

Russia's economic growth rates, exporters' high incomes and a federal budget surplus led to the expansion of federal budget funds and growth in credit institutions' accounts in the Bank of Russia.

To prevent inflationary pressure from the growing money supply, the Bank of Russia actively absorbed credit institutions' free liquidity by using sterilisation instruments, such as selling securities from its portfolio.

In 2003, a large part of federal government securities owned by the Bank of Russia were restructured in compliance with the 2003 Federal Budget Law.

The Bank of Russia's 2003 financial result was largely due to income from the investment of gold and foreign exchange reserves against the backdrop of their significant growth during the year under review and incomes from other operations. At the same time, there was an increase in Bank of Russia expenses involved in the use of monetary regulation instruments for sterilising free ruble liquidity.

## 3. FUNDS PLACED WITH NON-RESIDENTS AND SECURITIES ISSUED BY NON-RESIDENTS

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
Foreign issuers' securities	1,144,396	802,528
Balances in correspondent accounts, loans extended to and deposit accounts opened in non-resident banks	1,037,330	585,014
Loans extended to and deposit accounts opened in Bank of Russia subsidiaries abroad	24,069	39,756
<b>Total</b>	<b>2,205,795</b>	<b>1,427,298</b>

Foreign issuers' securities are mainly US treasury bills, government debt obligations of Germany, France, Belgium, the Netherlands, Austria, Spain, Finland and Ireland and debt securities of the extrabudgetary funds and federal agencies of the above countries and international financial organisations. The increase under this balance sheet item was due to growth in foreign exchange reserves.

Growth under the item "Balances in correspondent accounts, loans extended to and deposit accounts opened in non-resident banks" is due to the increase in gold and foreign exchange reserves.

Loans extended to and deposit accounts opened in Bank of Russia subsidiaries abroad (hereinafter referred to as Russia's overseas banks) are intended to maintain the financial stability of these banks.

## 4. LOANS AND DEPOSIT ACCOUNTS

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
Funds provided for government foreign debt service	182,618	197,063
Loans and deposit accounts in resident banks (in foreign currency)	2,945	8,264
Loans extended to resident banks (in rubles)	838	1,924
Other	8,536	9,230
<b>Total</b>	<b>194,937</b>	<b>216,481</b>

Pursuant to Federal Law No. 192-FZ, dated December 29, 1998, “On Budget and Tax Policy Priorities” and Federal Law No. 36-FZ, dated February 22, 1999, “On the Federal Budget for 1999,” in 1998 and 1999 the Bank of Russia provided foreign currency funds to the Finance Ministry through Vneshekonombank to make urgent payments on the redemption and servicing of the Russian Federation’s government foreign debt. Pursuant to Federal Law No. 145-FZ, dated December 25, 2000, “On Making Amendments and Addenda to the 2000 Federal Budget Law in Connection with the Receipt of Additional Revenues,” the term of repayment of the Finance Ministry’s debt to the Bank of Russia on the funds provided through Vneshekonombank in US dollars for urgent payments on the redemption and servicing of the Russian Federation’s government foreign debt was extended until December 1, 2007. The decrease under this item is due to the rise of the official ruble/dollar exchange rate.

The item “Loans and deposit accounts in resident banks (in foreign currency)” is for a deposit account opened in a resident bank to maintain its liquidity.

The principal amount of the debt on ruble loans extended to resident banks is comprised of the funds provided to banks by the Bank of Russia in 1998 by the decision of the Bank of Russia Board of Directors to increase the financial stability of credit institutions. At the beginning of 2004, most of the debt on loans extended to resident credit institutions in rubles had been repaid.

The principal amount of the debt accounted for under the item “Other” is the debt on loans extended to the National Bank of the Republic of Belarus by an open credit line in 2001—2002.

## 5. SECURITIES

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
<b>Russian government securities</b>		
Federal loan bonds (OFZ),	213,402	277,587
of which:		
— trade portfolio;	165,616	40,404
— investment portfolio	47,786	237,183
Internal and external government foreign currency-denominated loan bonds	77,315	59,417
Finance Ministry promissory notes	7,177	11,021
<b>Subtotal</b>	<b>297,894</b>	<b>348,025</b>
<b>Securities issued by credit and other institutions (Bank of Russia stakes)</b>	<b>20,409</b>	<b>19,516</b>
<b>Credit institutions' promissory notes acquired by Bank of Russia</b>	<b>11,705</b>	<b>12,390</b>
<b>Total</b>	<b>330,008</b>	<b>379,931</b>

The OFZ portfolio of the Bank of Russia was formed as a result of the restructuring of government securities and other Foreign Ministry debt to the Bank of Russia in 1999—2001 and the exchange of Vneshtorgbank shares in 2002 in accordance with the federal budget laws. The characteristics of these securities comply with the requirements of the federal laws. Government securities received from the Finance Ministry as a result of the restructuring were accounted for at the balance sheet value of the restructured securities.

Pursuant to Article 134 of the 2003 Federal Budget Law, in 2003 the Finance Ministry restructured permanent coupon-income federal loan bonds (OFZ-PD) in agreement with the Bank of Russia into enlarged issues of debt depreciation federal loan bonds (OFZ-AD) (these are to be redeemed at their nominal value by instalments upon the expiry of the term established for each issue) without changing the existing schedule of payments on the bonds with a breakdown into years.

The structure of the investment portfolio by the amount of coupon income and maturity as of January 1, 2004, is shown below:

<b>OFZ types</b>	<b>Balance sheet value (million rubles)</b>
<hr/>	
<b>0% permanent coupon-income OFZ bonds</b>	
due in 2007—2008	458
<b>1% permanent coupon-income OFZ</b>	
due in 2019—2023	627
<b>2% permanent coupon-income OFZ</b>	
due in 2005—2008	227
due in 2013—2014	1,555
<b>Variable coupon-income OFZ (with current interest rate of 11%)</b>	
due in 2014—2018	24,099
<b>0% coupon-income debt depreciation OFZ</b>	
due in 2025—2029	12,493
<b>1% current coupon-income debt depreciation OFZ</b>	
due in 2029	8,327
<hr/>	
<b>Total</b>	<b>47,786</b>
<hr/>	

The investment portfolio contains OFZ bonds due from 2005 to 2029, most of which (95%) are due from 2014 to 2029.



The structure of the Bank of Russia trade portfolio by the amount of coupon income and maturity as of January 1, 2004, is shown below:

OFZ types	Balance sheet value (million rubles)
<b>0% coupon-income debt depreciation OFZ</b>	
due in 2019—2027	130,000
<b>11%—12% coupon-income debt depreciation OFZ</b>	
due in 2008—2012	6,474
<b>0% permanent coupon-income OFZ</b>	
due in 2016	3,500
<b>6% permanent coupon-income OFZ</b>	
due in 2012	25,642
<b>Total</b>	<b>165,616</b>

OFZ bonds in the trade portfolio are used by the Bank of Russia to regulate the level of credit institutions' liquidity by conducting operations to sell securities with the obligation of reverse repurchase (as of January 1, 2004, their balance sheet value stood at 141,614 million rubles) and operations to sell securities on the open market (as of January 1, 2004, their balance sheet value stood at 24,002 million rubles).

In addition, in 2003 the Bank of Russia trade portfolio changed due to direct repo operations.

In the period under review, Bank of Russia investments in Finance Ministry promissory notes decreased by 3,844 million rubles as the Finance Ministry retired the notes received as a result of the restructuring of the debt on centralised loans and interest on them and Series VI-APK notes into domestic government debt in 1994—1996 in compliance with Russian Federation legislation.

Bank of Russia investments in the shares of credit and other institutions are shown below:

Name of credit institution	Investment amount (at acquisition price)	% share in authorised (capital at par)
Moscow Narodny Bank, London	7,523	88.89
Eurobank, Paris	4,692	87.03
Sberbank	4,563	60.57
Ost-West Handelsbank, Frankfurt am Main	1,312	51.62
Donau-bank, Vienna	401	15.00
East-West United Bank, Luxembourg	169	15.00
Other	1,749	—
<b>Total</b>	<b>20,409</b>	<b>—</b>

Letters of comfort were signed with regard to some Russian overseas banks, in which the Bank of Russia undertook to maintain the stability and liquidity of the above banks.

The increase in the size of Bank of Russia investments in the capital of Russia's overseas banks is the result of the revaluation of foreign currency against the ruble.

The debt accounted for under the item "Credit institutions' promissory notes acquired by Bank of Russia" is mainly comprised of the debt on notes acquired by the Bank of Russia in 1998—2000 from Sberbank, which effected payments on household deposits and on notes restructured in 2001—2002 under amicable agreements concluded with credit institutions' creditors. The decrease in the debt on credit institutions' promissory notes acquired by the Bank of Russia is due to the write-off of the debt of credit institutions struck off the State Register of Corporate Entities and the transfer of part of the debt to the accounts of Bank of Russia claims on other operations.

## 6. OTHER ASSETS

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
<b>Fixed assets</b>		
Buildings	29,234	28,537
Equipment (including computers, information and data storage and retrieval systems, furniture, transport vehicles, etc.)	27,171	27,359
<b>Subtotal of fixed assets</b>	<b>56,405</b>	<b>55,896</b>
Cash in vaults	3,574	3,141
Incomplete construction projects	3,492	3,148
Bank of Russia interest claims	2,232	1,574
Settlements with CIS and Baltic states' banks	1,297	1,297
Settlements with suppliers, contractors and buyers	1,040	1,277
Sundry settlements with Finance Ministry	352	352
Bank of Russia correspondent accounts	40	29
Other	4,872	4,546
<b>Subtotal of other assets</b>	<b>16,899</b>	<b>15,364</b>
<b>Total</b>	<b>73,304</b>	<b>71,260</b>

Data under the item "Fixed assets" are shown at residual value.

The increase in the balance of incomplete construction projects is due to the construction and reconstruction of Bank of Russia office buildings and the installation of security and software systems of the Bank of Russia information and telecommunications system.

The increase under the item "Bank of Russia interest claims" is largely the result of the addition by the Bank of Russia of interest that is not yet due to the funds placed with non-residents.

The item "Settlements with CIS and Baltic states' banks" shows the balance of mutual claims relating to interstate settlements for 1992—1993 of the CIS and Baltic states.

The composition and value of fixed assets net of accrued depreciation:

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
Buildings	32,135	31,047
Computers, office equipment and furniture	17,344	14,385
Equipment	11,475	10,495
Information and data storage and retrieval systems	9,360	8,019
Transport facilities	1,813	1,645
Intangible assets	434	3,052
Other	1,719	1,634
<b>Total</b>	<b>74,280</b>	<b>70,277</b>

The increase in the value of “Buildings” is largely due to the reconstruction of Bank of Russia office buildings.

The increase in the value of “Computers, office equipment and furniture” is due to the purchase of computers and other systems and devices designed to automate the transmission, storage and processing of data in the Bank of Russia payment, operational and information analysis systems and facilities to protect banking information.

“Equipment” includes the cost of cash-processing, security and similar equipment.

The increase under the item “Information and data storage and retrieval systems” is largely due to the installation of the payment and information segments of the Bankir data transmission system.

“Transport facilities” include the cost of special transport used in carrying cash and bank documents.

The decrease in “Intangible assets” was due to the change in the Bank of Russia accounting methods with regard to intangible assets (software systems and licences), which was made on the instructions of the Finance Ministry.

Fixed capital movement:

	<i>(million rubles)</i>
<b>Fixed capital value net of accumulated depreciation</b>	
Balance as of January 1, 2003	70,277
Receipt	7,044
Retirement	(3,041)
<b>Balance as of January 1, 2004</b>	<b>74,280</b>
<b>Accumulated depreciation</b>	
Balance as of January 1, 2003	14,381
Depreciation deductions due to expenses	4,746
Depreciation deductions due to other sources	36
Depreciation deductions for retired fixed assets	(1,288)
<b>Balance as of January 1, 2004</b>	<b>17,857</b>
<b>Residual value as of January 1, 2004</b>	<b>56,405</b>

## 7. CASH IN CIRCULATION

The increase in cash in circulation is due to growth in the money supply.

## 8. FUNDS IN BANK OF RUSSIA ACCOUNTS

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
Federal government funds	326,601	271,301
Credit institutions' funds in correspondent accounts	306,566	172,311
Required reserves deposited with the Bank of Russia	267,388	201,139
Credit institutions' deposit accounts in the Bank of Russia	87,286	47,398
Non-resident banks' funds	70,394	26,266
Other	137,040	102,127
<b>Total</b>	<b>1,195,275</b>	<b>820,542</b>

The increase under the item "Federal government funds" was due to higher balances in federal budget funds.

"Credit institutions' deposit accounts in the Bank of Russia" include the balances of funds drawn from resident credit institutions that have signed general agreements on ruble deposit operations with the Bank of Russia. The increase was due to deposit operations conducted by the Bank of Russia to absorb free banking sector liquidity.

"Non-resident banks' funds" comprise non-resident banks' funds relating to the sale of securities with the obligation of reverse repurchase.

"Other" funds include the balances of regional and local budget accounts and accounts of government extrabudgetary funds and other customers of the Bank of Russia. The increase in the value of "Other" funds is mainly due to growth in the balances of accounts of the Pension Fund, Social Insurance Fund and local budgets.

Pursuant to Article 23 of the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)," the Bank of Russia conducts operations with federal budget funds, government extrabudgetary funds and regional and local budget funds without charging commission.

## 9. FLOAT

The Bank of Russia completed calculations on these operations in January—February 2004. The decrease under this item is due to time saved in effecting settlements owing to electronic systems.

## 10. OTHER LIABILITIES

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
Bank of Russia provisions	52,098	65,137
Additional pension provisions for Bank of Russia employees	20,524	18,176
Deferred income from securities	12,268	13,868
Deferred income from lending operations	5,595	6,619
Other	33,388	29,270
<b>Total</b>	<b>123,873</b>	<b>133,070</b>

“Bank of Russia provisions” comprise the provisions made in 1998—2003:

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
Provisions for foreign currency operations	32,238	39,116
Provisions for promissory notes acquired from credit institutions and against credit institutions’ debt on other operations	12,219	12,597
Provisions for other active operations	2,840	2,840
Provisions for debt owed by National Bank of the Republic of Belarus	2,250	—
Provisions for debts owed by CIS and Baltic states	1,446	1,446
Provisions for loans extended to credit institutions	753	1,841
Provisions for Finance Ministry debt	352	352
Provisions for operations with federal loan bonds (OFZ) and other debts	—	6,945
<b>Total</b>	<b>52,098</b>	<b>65,137</b>

The Federal Law “On the Central Bank of the Russian Federation (Bank of Russia)” allows the Bank of Russia to create a pension fund for paying additional pensions to its employees. The Bank of Russia pension scheme is implemented in compliance with Bank of Russia regulations, which take into account the fact that Bank of Russia employees are not covered by guarantees provided for civil servants, as well as international practices accepted by central banks. The level of funding for the payment of additional pensions to Bank of Russia employees was determined on the basis of the actuarial evaluation made by an independent actuary. In 2003, the Bank of Russia did not increase the additional pension funds despite the actuary’s recommendations on the results of the indicative evaluation of pension obligations as of January 1, 2003. As of January 1, 2004, an independent actuary made an actuarial evaluation of Bank of Russia pension obligations and the Bank of Russia increased additional pension funds.

Deferred incomes from securities mainly comprise deferred incomes from government securities and the Finance Ministry’s other debts restructured under the 1999—2001 federal budget laws.

Deferred incomes from lending operations are mostly debts on interest accrued on foreign currency loans and deposit accounts and on interest accrued on centralised loans restructured into Finance Ministry promissory notes in pursuance of federal laws.

## 11. RELATIONS BETWEEN THE BANK OF RUSSIA AND THE MINISTRY OF FINANCE

In the period under review, relations between the Bank of Russia and the Ministry of Finance were regulated by the 2003 Federal Budget Law (with amendments) and Russian Federation Government Resolution No. 85, dated February 10, 2003, "On Measures to Implement the 2003 Federal Budget Law" (with amendments).

The structure of the Finance Ministry's debt to the Bank of Russia is shown below:

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
<b>Finance Ministry debt to the Bank of Russia in rubles</b>		
Russian government debt obligations	220,579	285,325
Russian government debt obligations acquired by the Bank of Russia through direct repo operations	—	3,283
Debt on overdrafts	352	352
<b>Subtotal</b>	<b>220,931</b>	<b>288,960</b>
<b>Finance Ministry debt to the Bank of Russia in foreign currency</b>		
Bank of Russia funds transferred to Vneshekonombank to extend loans to the Finance Ministry for Russian government foreign debt repayment and service	182,618	197,063
Russian government debt obligations	77,315	59,417
<b>Subtotal</b>	<b>259,933</b>	<b>256,480</b>
<b>Total</b>	<b>480,864</b>	<b>545,440</b>

The decrease in the Finance Ministry's ruble debt to the Bank of Russia in the period under review was due to the retirement of Finance Ministry promissory notes and the sale of federal loan bonds (OFZ) from the Bank of Russia portfolio.

### *Russian government ruble-denominated debt obligations*

- The Russian government ruble-denominated debt obligations comprised as of January 1, 2004:
- permanent and variable coupon-income federal loan bonds received by the Bank of Russia as a result of the 1999—2001 restructuring of government securities and other Finance Ministry debts to the Bank of Russia in pursuance of federal laws, and permanent coupon-income federal loan bonds with a balance sheet value of 30,466 million rubles (2002: 232,706 million rubles), acquired by the Bank of Russia under Article 3 of the 1999 Federal Budget Law;
  - permanent coupon-income federal loan bonds with a balance sheet value of 25,642 million rubles (2002: 41,598 million rubles), received as a result of the exchange of Vneshtorgbank shares under Article 108<sup>1</sup> of the 2002 Federal Budget Law;
  - debt depreciation federal loan bonds received by the Bank of Russia in 2003 as a result of the restructuring of Bank of Russia government securities with a balance sheet value of 157,294 million rubles (2002: nil) in pursuance of Article 134 of the 2003 Federal Budget Law;
  - Finance Ministry promissory notes with a balance sheet value of 5,919 million rubles (2002: 9,136 million rubles), received by the Bank of Russia as a result of the restructuring into Russian government domestic debt in 1994—1996 of the debt on centralised loans and accrued interest

due in 2004—2006 in pursuance of federal laws and Finance Ministry APK Series promissory notes due in 2004—2005 with a balance sheet value of 1,258 million rubles (2002: 1,885 million rubles).

#### *Debt on overdrafts*

The Finance Ministry's debt on overdrafts worth 352 million rubles (2002: 352 million rubles) arose as a result of the transfer of funds by Ukraine, the Republic of Moldova and the Republic of Armenia in 1996—1998 in payment of their debts to the Bank of Russia to Finance Ministry federal budget revenue accounts and is accounted for under the item "Other assets."

#### *Bank of Russia funds transferred to Vneshekonombank to extend loans to the Finance Ministry for Russian government foreign debt repayment and service*

The Finance Ministry's debt to the Bank of Russia on foreign currency funds transferred to Vneshekonombank in 1998—1999 pursuant to Federal Law No. 192-FZ, dated December 29, 1998, "On Budget and Tax Policy Priorities" and Federal Law No. 36-FZ, dated February 22, 1999, "On the Federal Budget for 1999," for extending loans to the Finance Ministry for Russian Federation government foreign debt repayment and servicing amounted to 182,618 million rubles as of January 1, 2004 (2002: 197,063 million rubles), decreasing by 14,445 million rubles over the year due to the ruble's rise against the US dollar.

#### *Russian Federation debt obligations in foreign currency*

The Russian Federation's debt obligations in foreign currencies as of January 1, 2004, comprised domestic government foreign currency loan bonds and external government foreign currency loan bonds.

In addition, the Finance Ministry's debt to the Bank of Russia comprises the debt on the payment of the first coupon income on permanent coupon-income federal loan bonds, received by the Bank of Russia as a result of the exchange of Vneshtorgbank shares pursuant to Article 108<sup>1</sup> of the 2002 Federal Budget Law, which, as of January 1, 2004, amounted to 2,613 million rubles. Under the above Article of the Federal Law, the Finance Ministry must repay this debt within nine years, starting from 2004, in equal instalments.

## 12. INTEREST INCOME

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
Interest income from securities	27,998	23,985
Interest income from foreign currency loans and deposit accounts	16,547	22,478
Interest income from ruble loans extended to credit institutions	233	405
Other	84	46
<b>Total</b>	<b>44,862</b>	<b>46,914</b>

"Interest income from securities" comprises interest received on foreign issuers' debt obligations acquired to manage foreign currency reserves and also interest received from investments in Russian government debt instruments.

"Interest income from foreign currency loans and deposit accounts" includes interest received from funds deposited by the Bank of Russia in non-resident banks and from funds deposited in 1998—1999 in Vneshekonombank to repay and service the Russian Federation's government foreign debt.

## 13. INCOME FROM OPERATIONS WITH SECURITIES

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
Income from operations with foreign currency-denominated securities	9,216	13,182
Income from operations with ruble-denominated Russian government debt instruments	2,800	21
Other	6,362	4,577
<b>Total</b>	<b>18,378</b>	<b>17,780</b>

“Income from operations with foreign currency-denominated securities” comprises income from the sale and redemption of foreign currency-denominated securities.

The increase in “Income from operations with ruble-denominated Russian government debt instruments” is due to the sale of government securities by the Bank of Russia and a positive revaluation of outstanding securities on the market related to the trade portfolio.

The increase in “Other” income is mainly due to income from the retirement of promissory notes by the Finance Ministry.

## 14. NET INCOME FORM THE RECOVERY OF PROVISIONS

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
Decrease in provisions for OFZ operations and other debt	6,945	2,157
Decrease in provisions for foreign currency operations	6,010	19,644
Decrease in provisions for loans extended to credit institutions	1,053	2,290
Decrease/(increase) in provisions for promissory notes acquired from credit institutions	117	(45)
Provisioning for debt owed by the National Bank of the Republic of Belarus	(2,250)	—
<b>Total</b>	<b>11,875</b>	<b>24,046</b>

The recovery (decrease) of provisions for credit institutions and credit institutions’ promissory notes and other debt in foreign currency to Bank of Russia income was due to the termination/fulfilment of credit institutions’ obligations to the Bank of Russia.

Owing to the restructuring by the Bank of Russia of its OFZ-PD portfolio pursuant to Article 134 of the 2003 Federal Budget Law into enlarged OFZ-AD issues in the period under review, it was decided to disband provisions under the item “Provisions for OFZ operations and other debts” and recover them to Bank of Russia income.

Provisions were made in the year under review for loans extended to the National Bank of the Republic of Belarus.



**15. OTHER INCOME**

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
Realised exchange rate differences	15,692	2,811
Income from sale of coins made of precious metals	871	411
Payment for settlement services provided by the Bank of Russia	718	597
Previous years' incomes identified in the year under review	71	534
Fines and penalties received	13	70
Compensation by customers of telegraph and other expenses	8	15
Other	346	815
<b>Total</b>	<b>17,719</b>	<b>5,253</b>

The increase in "Realised exchange rate differences" is due to the receipt of incomes from currency option contracts concluded by the Bank of Russia on foreign markets in 2002—2003 to bring the actual structure of the foreign exchange reserves in conformity with their regulatory structure.

**16. INTEREST EXPENSES**

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
Interest expenses on credit institutions' deposit accounts	2,489	7,373
Interest expenses on borrowing funds against foreign currency-denominated securities	590	770
Interest expenses on loan received from the International Monetary Fund	—	18
Other	4	28
<b>Total</b>	<b>3,083</b>	<b>8,189</b>

The decrease in interest expenses on Bank of Russia deposit operations with resident credit institutions in rubles during the year under review is due to lower interest rates and the use of other instruments to sterilise credit institutions' surplus ruble liquidity.

As of January 1, 2004, the Bank of Russia had no debt obligations to the IMF. The Bank of Russia made the last interest payment on an IMF loan according to schedule in February 2002.

**17. EXPENSES ON OPERATIONS WITH SECURITIES**

The increase under this item is due to the Bank of Russia operations with federal loan bonds (OFZ) in the trade portfolio to sterilise credit institutions' free ruble liquidity by selling securities with an obligation of reverse repurchase, the sale of securities on the open market and the negative revaluation of outstanding government securities traded on the market as part of the trade portfolio.

**18. CASH TURNOVER MANAGEMENT EXPENSES**

This item includes the expenses involved in the manufacture and destruction of banknotes and coins, their protection against counterfeiting and the purchase and delivery of packing and expendable materials and accessories necessary for cash processing.

**19. OTHER OPERATING EXPENSES**

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
Depreciation deductions	4,746	4,063
Repair expenses	2,091	2,216
Security expenses	1,972	1,398
Expenses on the maintenance of computer hardware and software systems and services	1,618	1,597
Expenses on the maintenance of buildings	1,156	957
Postage, telegraph and telephone expenses and expenses on the lease of communication lines and channels	1,091	1,073
Expenses on the delivery of bank documents and valuables	1,052	882
Expenses on operations with foreign exchange	351	304
Taxes and duties paid	64	559
Expenses on legal services (stamp tax and legal costs)	—	6
Other	4,718	8,860
<b>Total</b>	<b>18,859</b>	<b>21,915</b>

“Other” operating expenses reflect an addition of 2,464 million rubles to pension provisions for Bank of Russia employees made in accordance with the indicative actuarial evaluation of Bank of Russia pension obligations by an independent actuary.

**20. PERSONNEL COSTS**

For the explanatory note to “Personnel costs,” see the Statement on Bank of Russia Personnel Costs.

## STATEMENT ON PROFIT RECEIVED AND ITS ALLOCATION

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
1. Actual full-year profit	37,287	49,885
2. Taxes and duties paid from Bank of Russia profit in compliance with the Tax Code	30	40
3. To be transferred to the federal budget under Article 26 of the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)"	29,806	24 923
4. Retained profit, total	7,451	24 922
Of this:		
— used to cover Bank of Russia losses for 1998	3,726	12,461
— transferred to the Reserve Fund	3,427	11,465
— transferred to the Social Fund	298	996

Under Article 11 of the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)," the full-year profit of the Bank of Russia is calculated as the difference between the income from banking operations and transactions conducted pursuant to Article 46 of the above law and income from participation in the capital of credit institutions and the expenses involved in the fulfilment by the Bank of Russia of the functions assigned to it by Article 4 of this law.

The profit made by the Bank of Russia in 2003 was 37,287 million rubles (2002: 49,885 million rubles), mainly due to the investment of foreign currency reserves and operations with currency option contracts, conducted by the Bank of Russia to bring the actual structure of its foreign exchange reserves in conformity with their regulatory structure. At the same time, the interest income from Bank of Russia operations unrelated to the investment of gold and currency reserves and income from the sale of precious metals decreased significantly as compared with 2002.

Profit received by the Bank of Russia for the year is allocated in accordance with the procedure established by Article 26 of the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)," which stipulates that after the approval of the Bank of Russia annual financial statements by the Bank of Russia Board of Directors, the Bank of Russia transfers to the federal budget 50% of its actual full-year profit that remains after the payment of taxes and duties in accordance with the Tax Code of the Russian Federation. Profit remaining at the disposal of the Bank of Russia is transferred by the Board of Directors to reserves and various funds.

Article 21 of Federal Law No. 186-FZ, dated December 23, 2003, "On the Federal Budget for 2004," suspended part 1 of Article 26 of the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)" from January 1 to December 31, 2004, and required the Bank of Russia to transfer to the federal budget 80% of its actual profit for 2003 remaining after the payment of taxes and duties in accordance with the Tax Code of the Russian Federation.

## STATEMENT ON BANK OF RUSSIA RESERVES AND FUNDS

*(million rubles)*

	Reserve	Social fund	Accrued exchange rate differences	Fixed assets revaluation fund	Other funds	Total
Balance as of January 1, 2003	28,237	3,189	330,956	8,215	116	370,713
Transferred to reserves and funds as a result of profit allocation	3,427	298	—	—	—	3,725
Transferred from other sources	—	1	—	—	17	18
Reserves and funds used	—	(382)	(73,461)	(98)	(26)	(73,967)
<b>Balance as of January 1, 2004</b>	<b>31,664</b>	<b>3,106</b>	<b>257,495</b>	<b>8,117</b>	<b>107</b>	<b>300,489</b>

Pursuant to Article 26 of the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia),” the Bank of Russia, following the approval of its annual financial statements by the Board of Directors, at the latter’s decision, transfers to reserves and various funds the profit that remains at its disposal after the payment of taxes and duties in accordance with the Tax Code of the Russian Federation. The procedure for allocating this profit is established by the corresponding Bank of Russia regulation, approved by the National Banking Board on April 9, 2003.

The Bank of Russia Reserve Fund is designed to ensure the stable functioning of the Bank of Russia in fulfilling the functions assigned to it by law. In accordance with the Bank of Russia Regulation “On the Procedure for Creating and Using the Bank of Russia Reserve Fund,” the Reserve Fund is formed from Bank of Russia profit. By the decision of the Bank of Russia Board of Directors, money may be transferred to the Bank of Russia Reserve Fund from other funds and reserves that are part of the Bank of Russia’s own assets (capital). The principal uses of the Reserve Fund are covering losses incurred from conducting settlement and cash operations.

In accordance with the approved procedure for allocation of profit remaining at the disposal of the Bank of Russia and by the decision of the Board of Directors, 3,427 million rubles (2002: 11,465 million rubles) were allocated to the Reserve Fund from Bank of Russia profit for 2003.

The Social Fund is chiefly intended for making one-off payments to Bank of Russia employees to finance their everyday needs. It is formed from Bank of Russia profit.

The procedure for creating the Social Fund and allocating money from it is established by the corresponding Bank of Russia regulation.

In accordance with the approved procedure for allocating the Bank of Russia’s retained profit and by the decision of the Bank of Russia Board of Directors, 298 million rubles or 4% of the Bank of Russia’s retained profit (2002: 996 million rubles, or 4%) were transferred to the Social Fund from the Bank of Russia’s profit for 2003.

The accrued exchange rate differences are the result of the revaluation of the balances of active and passive foreign currency balance sheet accounts of the Bank of Russia due to the change of the official exchange rates of foreign currencies against the ruble. As a result of the revaluation of Bank of Russia foreign currency assets and liabilities, the negative unrealised exchange rate differences in 2003 exceeded positive ones by 73,461 million rubles and this led to a decrease in accrued exchange rate differences.

The fixed assets revaluation fund includes growth in the value of property as a result of fixed assets revaluations made by the decision of the Russian Government as of the beginning of 1992, 1994, 1995, 1996 and 1997.

**STATEMENT ON BANK OF RUSSIA MANAGEMENT OF SECURITIES  
AND STAKES IN THE CAPITAL OF ORGANISATIONS  
THAT ARE BANK OF RUSSIA PROPERTY**

**BANK OF RUSSIA INVESTMENTS IN DEBT INSTRUMENTS AND PROMISSORY NOTES**

	<i>(million rubles)</i>	
	<b>2003</b>	<b>2002</b>
<b>Foreign issuers' debt obligations</b>		
denominated in US dollars	966,504	663,740
denominated in euros	177,892	138,788
<b>Subtotal</b>	<b>1,144,396</b>	<b>802,528</b>
<b>Russian government debt obligations</b>		
Ruble-denominated bonds, trade portfolio	165,616	40,404
Ruble-denominated bonds, investment portfolio	47,786	237,183
Foreign currency-denominated bonds	77,315	59,417
Promissory notes	7,177	11,021
<b>Subtotal</b>	<b>297,894</b>	<b>348,025</b>
<b>Credit institutions' promissory notes</b>	<b>11,705</b>	<b>12,390</b>
<b>Total</b>	<b>1,453,995</b>	<b>1,162,943</b>

## BANK OF RUSSIA INVESTMENTS IN THE CAPITAL OF BANKS AND OTHER ORGANISATIONS

*(million rubles)*

Investment	2003		2002	
	Balance sheet value	% share in capital (at par)	Balance sheet value	% share in capital (at par)
<b>Investment in residents' shares, of which:</b>	<b>4,866</b>	—	<b>4,715</b>	—
Sberbank	4,563	60.57	4,563	60.57
Moscow Interbank Currency Exchange (MICEX)	300	28.76	149	22.23
St Petersburg Currency Exchange (SPCEX)	3	10.00	3	10.00
<b>Investment in non-residents' shares, of which:</b>	<b>15,543</b>	—	<b>14,802</b>	—
Moscow Narodny Bank, London	7,523	88.89	7,330	88.89
Eurobank, Paris	4,692	87.03	4,219	87.03
Ost-West Handelsbank, Frankfurt-am-Main	1,312	51.62	1,180	51.62
Donau-bank, Vienna	401	15.00	361	15.00
East-West United Bank, Luxembourg	169	15.00	152	15.00
Bank for International Settlements, Basel	1,143	0.55	1,233	0.57
Intelsat	303	0.53	327	0.53
<b>Other investments in residents' capital, of which:</b>	<b>25</b>	—	<b>25</b>	—
National Depository Centre (non-profit partnership)	25	49.00	25	49.00
<b>Other investments, of which:</b>	<b>10</b>	—	<b>10</b>	—
Interstate Bank	10	50.00	10	50.00

The Bank of Russia manages securities and its stakes in the capital of organisations in accordance with the purposes, tasks and functions established by the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia).”

The Bank of Russia participates in the capital of resident organisations pursuant to Article 8 of the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia).”

In the period under review, Bank of Russia investments in the capital of resident organisations increased by 151 million rubles due to the acquisition of MICEX shares alienated by exchange shareholders. The Bank of Russia stake in MICEX expanded 6.53% to 28.76% as of January 1, 2004.

The Bank of Russia participates in the capital of Moscow Narodny Bank (London), Eurobank (Paris), Ost-West Handelsbank (Frankfurt-am-Main), Donau-bank (Vienna) and East-West United Bank (Luxembourg) in compliance with Article 8 of the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia).”

Under Article 9 of the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia),” the Bank of Russia participates in the capital of the Basel-based Bank for International Settlements and Moscow-based Interstate Bank.

The change in the balance sheet value of the Bank of Russia stakes in non-resident organisations (in rubles) is due to the change in the official exchange rates of the currencies in which the shares of the above non-resident banks are denominated against the ruble.

Investments in foreign issuers’ securities denominated in foreign currency are made as part of the management of Bank of Russia foreign exchange reserves in compliance with point 7 of Article 4 of the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia).”

The principal objective of the foreign exchange reserve management by the Bank of Russia is to ensure the optimal combination of the safety, liquidity and profitability of reserves. The Bank of Russia invests in the most secure and liquid securities of foreign issuers.

Foreign issuers’ securities are mostly US treasury bills, government debt obligations of Germany, France and the Netherlands and debt securities of extrabudgetary funds and federal agencies of these countries. In addition, these are securities issued by the governments of Austria, Belgium, Spain, Finland and Ireland and several international financial organisations, such as the International Bank for Reconstruction and Development, European Investment Bank, Inter-American Development Bank and Asian Development Bank and German mortgage and land banks’ securities backed by government loans.

The value of Bank of Russia investments in foreign issuers’ debt obligations in 2003 increased by 341,868 million rubles. The main factor of growth was the significant expansion of Bank of Russia foreign exchange reserves in the period under review. In addition, the change in the balance sheet value of investments in foreign issuers’ debt instruments was the result of the revaluation of foreign currency against the ruble.

As of January 1, 2004, Russian government debt obligations comprised federal loan bonds, internal foreign currency loan bonds, external foreign currency loan bonds and Finance Ministry promissory notes.

Pursuant to Article 134 of the 2003 Federal Budget Law, the Bank of Russia in 2003 restructured a large part of the OFZ-PD portfolio into enlarged OFZ-AD issues.

## STATEMENT ON BANK OF RUSSIA PERSONNEL COSTS

Items of expenditure	<i>(million rubles)</i>	
	2003	2002
Wages and salaries	21,790	21,683
Charges on payroll and on other payments to employees	5,232	5,166
Other payments to employees	2,174	2,021
<b>Total Bank of Russia personnel costs</b>	<b>29,196</b>	<b>28,870</b>

The average number (payroll) of Bank of Russia employees in 2003 stood at 82,094 (2002: 82,712). This represents a decrease of 618, or 0.7%, over the year, which is due to the efforts made by the Bank of Russia to improve its organisational structure.

The average monthly income per Bank of Russia employee in 2003 stood at 24,325 rubles (2002: 23,882 rubles).

As compared with 2002, Bank of Russia personnel costs increased by 326 million rubles, or 1.1%.

“Charges on payroll and on other payments to employees” represent the flat social tax paid at the regressive rate in the year under review. The average percentage stood at 21.6% (2002: 21.6%).

As the Bank of Russia continued to optimise its settlement network, in 2003 the Bank of Russia Board of Directors decided to close more than 200 cash settlement centres by the end of 2004. In line with this decision, in 2003 the Bank of Russia closed 44 and ordered the closure of 49 cash settlement centres.’



## STATEMENT ON CAPITAL INVESTMENT BUDGET PERFORMANCE

*(million rubles)*

<b>Capital investment</b>	<b>Approved for 2003</b>	<b>Actual amount in 2003</b>	<b>Actual amount in 2002</b>
Fixed capital investment	9,413	7,041	9,115
Capital investment in intangible assets, computer software systems and licences	915	760	1,005
<b>Total</b>	<b>10,328</b>	<b>7,801</b>	<b>10,120</b>

The expenses included in “Fixed capital investment” are as follows:

- expenses on the reconstruction, construction and maintenance of Bank of Russia facilities in accordance with the capital construction plan approved by the Board of Directors and plans to purchase large-size appliances, equipment, furniture and transport vehicles. In 2003, these expenses decreased by 12%, while their share in total capital investment expanded to 38% (2002: 34%);
- cash turnover management expenses: the purchase and modernisation of technical facilities to mechanise the processing of cash (banknote counting and sorting machines and coin counters) and auxiliary workplace equipment for depositories and cash counting units and the manufacture and modernisation of special vans to carry valuable items. In 2003, these expenses increased by 1.9 times and accounted for 9% (2002: 3%) of the total value of capital investment;
- expenses to ensure the functioning of the Bank of Russia payment, accounting, operational and information analysis systems: the purchase of computer and telecommunications equipment, information security systems, computer centre maintenance systems and applied and system software. In 2003, these expenses decreased almost by half as compared with 2002 and their share contracted from 46% to 34% in the total value of capital investment. This significant decrease is due to the suspension of some development projects related to the payment and accounting and operational systems;
- expenses on maintaining the security of and guarding Bank of Russia facilities: the development, modernisation and upgrading of security systems, and the purchase of special labour safety and civil defence equipment and security facilities for Bank of Russia personnel and valuable items. In 2003, these expenses increased by 6% and accounted for 10% of Bank of Russia capital investment (2002: 7%).

“Capital investment in intangible assets, computer software systems and licences” represent expenses on the purchase of software products for use in information technology and information protection and security systems. In 2002 and 2003, these expenses accounted for about 10% of the full-year value of capital investments.



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## AUDITOR'S REPORT

### on the Annual Financial Statements as of January 1, 2004

#### To the Management of the Central Bank of the Russian Federation:

- 1 We have audited the attached Annual Financial Statements of the Central Bank of the Russian Federation (hereinafter referred to as the Bank of Russia) for the period from January 1, 2003, to December 31, 2003, inclusive. Pursuant to Article 25 of Federal Law No. 86-FZ, dated July 10, 2002, "On the Central Bank of the Russian Federation (Bank of Russia)," the Bank of Russia Annual Financial Statements comprise: the annual balance sheet, profit and loss account, including the statement on profit received and its allocation, the statement on Bank of Russia reserves and funds, the statement on Bank of Russia management of securities and stakes in the capital of organisations that are Bank of Russia property, the statement on Bank of Russia personnel costs and the statement on capital investment budget performance (hereinafter all these statements are referred to as the Annual Financial Statements). The Annual Financial Statements have been prepared by the Bank of Russia management on the basis of accounting data compiled in compliance with the requirements of Russian Federation legislation and Bank of Russia regulations. The Annual Financial Statements prepared on this basis differ significantly from financial statements compiled to International Financial Reporting Standards, especially in respect to the evaluation of assets and recognition of liabilities.
- 2 The responsibility for compiling and presenting the Annual Financial Statements is borne by the Bank of Russia management. Our responsibility is to express our opinion on the basis of the audit we have conducted on the authenticity of the data contained in the Annual Financial Statements in all substantial respects and on the compliance of the accounting procedure with the requirements of Russian Federation legislation and Bank of Russia regulations in all substantial respects for the purposes of compiling the Annual Financial Statements.

The company is an authorised user of PricewaterhouseCoopers name and trademark.



3 We have conducted an audit in compliance with:

- Federal Law No. 119-FZ, dated August 7, 2001, “On Auditing;”
- Federal Law No. 86-FZ, dated July 10, 2002, “On the Central Bank of the Russian Federation (Bank of Russia);”
- Federal Audit Rules (Standards), approved by Russian Federation Government Resolution No. 696, dated September 23, 2002 (with amendments made as of July 4, 2003);
- Audit Rules (Standards), approved by the Audit Commission under the President of the Russian Federation;
- other audit regulations;
- International Audit Standards;
- intracompany audit standards.

In compliance with the requirements of Russian Federation legislation, we planned and conducted our audit so as to be able to say with a fair degree of certainty that the Annual Financial Statements do not contain any significant distortions. In accordance with the Audit Rules (Standards), the aim of the audit of the Annual Financial Statements we conducted was not to pronounce a judgement on the full compliance of Bank of Russia activities with the requirements of Russian Federation legislation. Pursuant to Russian Federation legislation, we have conducted our audit on a sample basis, including in it a test study of the evidence that confirmed the significance and disclosure in the Annual Financial Statements of information on the financial and business activities of the Bank of Russia, the evaluation of the accounting principles and methods and the rules used in preparing the Annual Financial Statements, the establishment of major estimated values obtained by the Bank of Russia management and also the evaluation of the general presentation of the Annual Financial Statements and the state of internal control in the Bank of Russia in respect to the preparation of the attached Annual Financial Statements. We believe that taking into consideration the limitations imposed on the scope of our work, described below in paragraph 4, the audit we have conducted in compliance with the requirements of Russian Federation legislation provides sufficient grounds for expressing our opinion on the credibility of the Annual Financial Statements in all material respects and on the compliance of the accounting procedure with the requirements of Russian Federation legislation and Bank of Russia regulations in all material respects for the purposes of compiling the Annual Financial Statements.

- 4 The scope of our work and our audit were limited with regard to some balance sheet and profit and loss accounts and operations, access to which was limited owing to Russian Federation Law No. 5485-1, dated July 21, 1993, “On State Secrecy” (with subsequent amendments). Pursuant to Article 25 of the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia),” these data, included in items of the balance sheet and profit and loss account, have been confirmed by the Audit Chamber of the Russian Federation. As of January 1, 2004, these operations and items comprise:



- assets totalling 69,272 million rubles, including:
  - precious metals to the amount of 8,551 million rubles;
  - funds deposited with non-residents and securities issued by non-residents to the amount of 9,178 million rubles;
  - loans and deposit accounts to the amount of 98 million rubles;
  - securities to the amount of 50,968 million rubles;
  - other assets to the amount of 477 million rubles;
- liabilities totalling 711 million rubles, including:
  - funds in accounts in the Bank of Russia to the amount of 5,443 million rubles;
  - a debit balance on float to the amount of 4,734 million rubles;
  - a debit balance on other liabilities to the amount of 4 million rubles;
  - capital to the amount of 6 million rubles;
- income totalling 7,829 million rubles, including:
  - interest income to the amount of 4,774 million rubles;
  - income from operations with precious metals to the amount of 3,050 million rubles;
  - other income to the amount of 5 million rubles;
- expenses totalling 4,312 million rubles, including:
  - interest expenses to the amount of 4 million rubles;
  - expenses on operations with securities to the amount of 19 million rubles;
  - expenses on the management of cash turnover to the amount of 2,949 million rubles;
  - expenses on operations with precious metals to the amount of 53 million rubles;
  - other operating expenses to the amount of 267 million rubles;
  - personnel costs to the amount of 1,020 million rubles.

The above items of the balance sheet and profit and loss account have been confirmed by the Audit Chamber of the Russian Federation in its Report on the Results of the Audit of the Accounts and Operations of the Central Bank of the Russian Federation for 2003, which are covered by Russian Federation Law No. 5485-1, dated July 21, 1993, "On State Secrecy" (approved by the decision of the Collegium of the Audit Chamber of the Russian Federation, dated April 23, 2004).

- 5 The comparative data for 2002, presented in the Bank of Russia Annual Financial Statements as of January 1, 2004, were confirmed by ZAO "BDO Unicon Ruf" in the auditor's report of April 30, 2003, on the Bank of Russia Annual Financial Statements as of January 1, 2003. However, the auditor's report of ZAO "BDO Unicon Ruf" of April 30, 2003, contained the proviso that



some accounts and operations shown in the Bank of Russia Annual Financial Statements as of January 1, 2003, were confirmed by the Audit Chamber of the Russian Federation in its Statement of April 24, 2003, on the results of an audit of Bank of Russia accounts and operations for 2002 covered by the Russian Federation Law "On State Secrecy." We have not conducted any work with regard to the comparative data for 2002.

- 6 We believe that if we set aside any readjustments that would have been necessary if there had been no limitation on the scope of our work, indicated in paragraph 4 of this Auditor's Report, the attached Bank of Russia Annual Financial Statements reflects truly and fairly in all material respects the financial standing of the Bank of Russia as of January 1, 2004, and the financial results of its performance for the period from January 1, 2003, to December 31, 2003, taking into consideration the provisions of the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)" and the Federal Law "On Accounting" and the Accounting Rules of the Central Bank of the Russian Federation (Bank of Russia) No. 66 of September 18, 1997.
- 7 Without changing our opinion about the authenticity of the Bank of Russia Annual Financial Statements, we draw your attention to the fact that, as Note 5 to the Bank of Russia Annual Financial Statements as of January 1, 2004, indicates, the Bank of Russia securities portfolio includes Russian Federation federal loan bonds (hereinafter referred to as OFZ) with a balance sheet value of 213,402 million rubles, of which about 69% of the OFZ portfolio have a coupon income of 0%, while 84% of the OFZ portfolio is due in 2014—2029.

The fair value of these securities differs significantly from their balance sheet value. According to our estimate, the balance sheet value of these OFZ bonds as of January 1, 2004, exceeded their fair value by about 75,000 million rubles.

In addition, as of January 1, 2004, the Bank of Russia had obligations of reverse repurchase of OFZ bonds on transactions to sell with an obligation of reverse repurchase with a nominal value of 32,967 million rubles. According to our estimate, the value of the obligations of reverse repurchase of these OFZ bonds as of January 1, 2004, exceeded their fair value by nearly 15,000 million rubles.

Thus, as of January 1, 2004, the excess of the balance sheet value of the Bank of Russia OFZ portfolio and the value of the obligations of reverse repurchase of OFZ over the fair value of these securities amounted to about 90,000 million rubles.

May 12, 2004

Director of the Close Joint-Stock Company  
PricewaterhouseCoopers Audit

Y.V. Filippova

Auditor  
Certificate of Competence No. K 008368,  
issued on November 12, 2003, for an indefinite term

T.A. Klyuchkina



THE AUDIT CHAMBER  
OF THE RUSSIAN FEDERATION

**AUDITOR**

Zubovskaya St. 2, GSP-2, 119992 г. Москва

April 23, 2004

No. 06-165/06-3

To Sergey M. Ignatiev

Chairman  
of the Central Bank  
of the Russian Federation

### STATEMENT

**on the results of an audit of the accounts and operations of the Central Bank of the Russian Federation for 2003 covered by Russian Federation Law No. 5485-1, dated July 21, 1993, "On State Secrecy" (approved by the decision of the Collegium of the Audit Chamber of the Russian Federation, dated April 23, 2004 [minutes No. 13 (383)]).**

Pursuant to Article 25 of Federal Law No. 86-FZ, dated July 10, 2002, "On the Central Bank of the Russian Federation (Bank of Russia)," and in accordance with its working schedule for 2004 (point 4.4.11), the Audit Chamber of the Russian Federation has audited the accounts and operations of the Central Bank of the Russian Federation covered by Russian Federation Law No. 5485-1, dated July 21, 1993, "On State Secrecy."

The responsibility for including information in the category of data covered by the Russian Federation State Secrecy Law and, consequently, for separating the competencies of the auditor of the Central Bank of the Russian Federation and the Audit Chamber of the Russian Federation with regard to the Bank of Russia Annual Report for 2003 is borne by the Bank of Russia management.

The Audit Chamber of the Russian Federation has considered:

Bank of Russia (balance and off-balance) accounts and operations covered in 2003 by the Russian Federation Law "On State Secrecy" and operations which fall into this category by virtue of the entirety of data thereon;

regulations and instructions establishing the procedure for conducting operations covered in 2003 by the Russian Federation Law "On State Secrecy" and accounting for them in the corresponding accounting records;

the soundness of data contained in the annual balance sheet, profit and loss account and other annual financial statements of the Central Bank of the Russian Federation and its divisions and establishments in respect to operations covered in 2003 by the Russian Federation Law "On State Secrecy;"

the completeness and conformity of Bank of Russia analytical accounting data to synthetic accounting data on accounts and operations covered in 2003 by the Russian Federation Law "On State Secrecy;"

the state of internal control of the audited Bank of Russia divisions with the sole aim of determining the amount of work that needed to be done to form a judgement on the authenticity of accounting records that fall within the competence of the Audit Chamber of the Russian Federation pursuant to Article 25 of Federal Law No. 86-FZ, dated July 10, 2002, "On the Central Bank of the Russian Federation (Bank of Russia);"

the compliance by the Bank of Russia with the applicable legislation of the Russian Federation in conducting operations covered by the Russian Federation Law "On State Secrecy" and operations which fall into this category by virtue of the entirety of data thereon.

It has been established that the audited operations covered by the Russian Federation Law "On State Secrecy" and operations which fall into this category by virtue of the entirety of data thereon were conducted by the Bank of Russia in all material respects in conformity with the applicable legislation.

The Audit Chamber of the Russian Federation has not found any serious violations of the Bank of Russia accounting and financial reporting procedures established by Bank of Russia regulations which could significantly affect the authenticity of accounting data.

The responsibility for preparing the Annual Financial Statements is borne by the Bank of Russia management.

The responsibility of the Audit Chamber of the Russian Federation is to express its opinion on the authenticity of these statements in all material respects (the part thereof that falls into the competence of the Audit Chamber).

The audit was conducted on a sample basis by confirming numerical data contained in the Annual Financial Statements in order to receive sufficient certainty that the accounting forms did not contain any significant distortions. The results of the audit provide sufficient grounds for expressing an opinion on the authenticity of these statements.

In the opinion of the Audit Chamber of the Russian Federation, the Bank of Russia Annual Financial Statements for 2003, attached to this Statement (the part thereof that falls into the competence of the Audit Chamber of the Russian Federation), are true and fair, i.e., they are compiled in such a way as to reflect in all material respects Bank of Russia assets and liabilities as of January 1, 2004, and Bank of Russia income and expenses on accounts and operations for 2003, which are covered by the Russian Federation Law "On State Secrecy" and conducted in accordance with Bank of Russia regulations establishing the accounting and reporting rules for the Bank of Russia.

The above operations and items of the Bank of Russia consolidated balance sheet as of January 1, 2004, total 69,272 million rubles in assets and 711 million rubles in liabilities.

According to the profit and loss account for 2003, Bank of Russia income (the part thereof that falls within the competence of the Audit Chamber of the Russian Federation) total 7,829 million rubles and expenses 4,312 million rubles.

The Audit Chamber of the Russian Federation confirms the data contained in the consolidated annual balance sheet of the Central Bank of the Russian Federation as of January 1, 2004 (in respect to second-order and off-balance accounts), profit and loss account as of January 1, 2004 and other statements included in the Bank of Russia Annual Financial Statements for 2003 in respect to the accounts and operations covered by the Russian Federation Law "On State Secrecy."

According to Bank of Russia accounting data for the period from January 1 up to December 31, 2003, the Bank of Russia issued banknotes and coins to the amount of 2,293,297.4 million rubles and redeemed banknotes and coins to the amount from 1,882,018.4 million rubles. As a result, in the period under review the amount of cash in circulation increased by 411,279.0 million rubles.

S. O. Shokhin

**DATA FROM THE BANK OF RUSSIA CONSOLIDATED BALANCE SHEET  
AS OF JANUARY 1, 2004, CONFIRMED BY THE AUDIT CHAMBER  
OF THE RUSSIAN FEDERATION**

**ASSETS**

	<i>million rubles</i>
1. Precious metals	8,551
2. Funds placed with non-residents and securities issued by non-residents	9,178
3. Loans and deposit accounts, of which:	98
3.1. loans extended to resident organisations	14
4. Securities, of which:	50,968
4.1. Russian government securities	50,968
5. Other assets, of which:	477
5.1. fixed assets	363
<b>Total:</b>	<b>69,272</b>

**LIABILITIES**

	<i>million rubles</i>
2. Funds in accounts in Bank of Russia, of which:	5,443
2.1. Russian government funds	6
2.2. resident credit institutions' funds	88
3. Float	—4,734
4. Other liabilities	—4
5. Capital, of which:	6
5.2. reserves and funds	6
<b>Total:</b>	<b>711</b>



**INCOME AND EXPENSE OPERATIONS FROM THE PROFIT AND LOSS  
ACCOUNT FOR 2003 CONFIRMED BY THE AUDIT CHAMBER  
OF THE RUSSIAN FEDERATION**

**INCOME**

	<i>million rubles</i>
Interest income	4,774
Income from operations with securities	0
Income from operations with precious metals	3,050
Income from capital participation in credit and other institutions	0
Net income from recovery of provisions	0
Other income	5
<b>Total income:</b>	<b>7,829</b>

**EXPENSES**

	<i>million rubles</i>
Interest expenses	4
Expenses on operations with securities	19
Cash turnover management expenses	2,949
Expenses on operations with precious metals	53
Other operating expenses	267
Personnel costs	1,020
<b>Total expenses:</b>	<b>4,312</b>
<b>Financial result: profit</b>	<b>3,517</b>



**ADDENDA**

**IV**

## PRINCIPAL MEASURES CARRIED OUT BY THE BANK OF RUSSIA IN 2003 TO IMPLEMENT THE SINGLE STATE MONETARY POLICY

### I. REQUIRED RESERVES, INTEREST RATE POLICY, REFINANCING OF BANKS AND BANK OF RUSSIA DEPOSIT OPERATIONS

**REQUIRED RESERVES.** To improve provisioning regulations, the Bank of Russia issued Official Clarification No. 28-OR, dated April 8, 2003, “On the Application of Some Provisions of Bank of Russia Regulation No. 37, dated March 30, 1996, ‘On the Required Reserves of Credit Institutions Deposited with the Central Bank of the Russian Federation’ and Regulation No. 51, dated November 14, 1996, ‘On the Required Reserves of the Savings Bank of the Russian Federation Deposited with the Central Bank of the Russian Federation.’”

The Bank of Russia issued Operating Ordinance No. 168-T, dated December 8, 2003, on the transfer by January 1, 2004, of fines imposed for violations of the required reserve procedure from Bank of Russia regional branches’ accounts to the local budget where the body or official that took the decision to impose the fine is registered in compliance with Article 46 of the Budget Code of the Russian Federation.

**INTEREST RATES.** In 2003, the Bank of Russia Board of Directors took decisions to change the Bank of Russia’s key interest rates.

The *refinancing rate* was cut from 21% to 16% p.a.: it was set at 18% p.a. by Bank of Russia Ordinance No. 1250-U, dated February 14, 2003, and at 16% by Bank of Russia Ordinance No. 1296-U, dated June 20, 2003.

*Overnight loan and currency swap interest rates* were announced daily. By the decision of the Bank of Russia Board of Directors, the refinancing rate and overnight loan and currency swap rates have been set at the same level since February 17, 2003.

In the year under review, the Bank of Russia Board of Directors also took decisions to set the highest possible cut-off rates at the *deposit auc-*

*tions and exchange modified repo auctions* and the lowest possible cut-off rates at the *direct repo* and *Lombard loan auctions* held by the Bank of Russia.

The highest possible cut-off rates were as follows:

*deposit auctions:*

- 8% p.a. (from February to the first half of May) and 7% p.a. (from the second half of May to December) for a 2-week term;
- 10% p.a. (June—December) for a 3-month term;

*exchange modified repo auctions:*

- 10% p.a. (from February to the first half of May) and 9% p.a. (from the second half of May to December) for a term of 28 calendar days;
- 11% p.a. (June—December) for a 6-month term.

The lowest possible cut-off rates were as follows:

*direct repo auctions:*

- 7% p.a. (from February to the first half of May) and 6% p.a. (from the second half of May to December) for terms from 1 day to 7 days;
- 6.5% p.a. (October—December) for a 1-week term;
- 9% p.a. (October—December) for a 3-month term;

*Lombard loan auctions:*

- 7% p.a. (October—December) for a 2-week term.

In 2003, the Bank of Russia Board of Directors changed *fixed interest rates on deposit operations conducted on standard terms*, such as overnight, tom-next, spot-next, 1 week, spot-week and on call, using the Reuters Dealing System. The rates on deposit operations conducted

on standard terms overnight, tom-next, spot-next and on call were reduced during the year from 3% to 0.5% p.a. and 1-week and spot-week rates were cut from 3% to 1% p.a.

Interest rates on Bank of Russia loans extended in compliance with Bank of Russia Regulation No. 122-P, dated October 3, 2000, "On the Procedure for Extending Bank of Russia Loans to Banks Secured by Collateral and Guarantees" were reduced by the decision of the Bank of Russia Board of Directors from 12.5% to 11% p.a.

**DEPOSIT OPERATIONS.** To systematise regulations on Bank of Russia deposit operations, the Bank of Russia issued the following documents:

- Bank of Russia Ordinance No. 1259-U, dated March 20, 2003, "On the Procedure for Conducting the Accounting by Credit Institutions of Deposit Operations Conducted by the Central Bank of the Russian Federation;"
- Bank of Russia Ordinance No. 1286-U, dated June 2, 2003, "On the Procedure for Conducting the Accounting of Deposit Operations in the Central Bank of the Russian Federation;"
- Bank of Russia Ordinance No. 1287-U, dated June 2, 2003, "On Invalidating Bank of Russia Regulations," such as Bank of Russia Regulation No. 67-P, dated January 13, 1999, "On the Procedure for Conducting Deposit Operations by the Central Bank of the Russian Federation with Resident Banks in the Russian Federation Currency" with amendments and addenda.

To provide methodological support for deposit operations conducted in the MICEX Electronic Trade System, the Bank of Russia issued the following regulations:

- Bank of Russia Ordinance No. 1310-U, dated June 21, 2003, "On Introducing Amendments and Addenda to Bank of Russia Regulation No. 203-P, Dated November 5, 2002, 'On the Procedure for Conducting Deposit Operations by the Central Bank of the Russian Federation with Credit Institutions in the Russian Federation Currency;'"
- Bank of Russia Operating Ordinance No. 165-T, dated November 27, 2003, "On the Form of the Agreement on the Fulfilment

by the Organised Securities Market Settlement Centre of the Functions of the Organised Securities Market's Authorised Settlement Centre in Effecting Settlements on Deposit Transactions Conducted by the Bank of Russia with Credit Institutions Using the MICEX Electronic Trade System;"

- Bank of Russia Operating Ordinance No. 166-T, dated November 27, 2003, "On the Form of the General Deposit Agreement on Deposit Transactions Conducted in the Russian Federation Currency Using the MICEX Electronic Trade System."

In accordance with the decisions of the Bank of Russia Board of Directors, the Bank of Russia issued Ordinance No. 1252-U, dated February 17, 2003, and Ordinance No. 1285-U, dated May 30, 2003, which changed fixed interest rates on deposit operations conducted on standard terms.

**REFINANCING BANKS.** To improve refinancing mechanisms, the Bank of Russia drafted and issued the following regulations:

- Bank of Russia Ordinance No. 1281-U, dated May 19, 2003, "On Fixing the Interest Rate on Bank of Russia Loans Secured by Collateral and Guarantees";
- Bank of Russia Regulation No. 236-P, dated August 4, 2003, "On the Procedure for Extending Bank of Russia Loans to Credit Institutions against Securities Used as Collateral;"
- Bank of Russia Operating Ordinance No. 147-T, dated October 7, 2003, "On Holding Lombard Loan Auctions."

In compliance with a decision of the Bank of Russia Board of Directors to increase the correction factors used to correct the market value of securities accepted as collateral for Bank of Russia loans, the Bank of Russia drafted and issued Ordinance No. 1272-U, dated April 17, 2003, "On the Bank of Russia Correction Factors Used to Correct the Market Value of Securities Accepted as Collateral for Bank of Russia Loans."

To improve co-operation between Bank of Russia establishments and divisions in conducting refinancing operations, the Bank of Russia drafted and issued Ordinance No. 1266-U, dated April 4, 2003, "On Changing Bank of Russia Ordinance No. 1132-U, dated April 5, 2002, 'On the Procedure for Co-operation between the Bank

of Russia Consolidated Economic Department and Bank of Russia Regional Branches in Extending and Repaying Bank of Russia Loans.”

To bring the provisions of Bank of Russia Ordinance No. 1149-U, dated May 8, 2002, “On the Procedure for Co-operation between Bank of Russia Establishments and Divisions in Recovering Funds from Correspondent Accounts/Sub-accounts of Credit Institutions Opened in a Division (Divisions) of the Bank of Russia Settlement

Network” into conformity with Bank of Russia regulations on monetary policy operations, including the extension of the list of Bank of Russia overdue claims redeemed by the recovery procedure established by Bank of Russia Ordinance No. 1149-U, dated May 8, 2002, (in respect to direct repo and foreign exchange purchase and sale operations), the Bank of Russia issued Ordinance No. 1342-U, dated November 12, 2003, and Order No. OD-619, dated November 12, 2003.

## 2. THE GKO—OFZ MARKET AND FINANCIAL MARKET OPERATIONS

To improve the GKO—OFZ market infrastructure and diversify financial instruments, the Bank of Russia issued the following regulations:

- Bank of Russia Regulation No. 219-P, dated March 25, 2003, “On the Service and Circulation of Federal Government Securities,” which created the opportunity to conduct transactions with deferred delivery and established a new procedure for redeeming government bonds and making coupon income payments outside the MICEX Trading System;
- Bank of Russia Regulation No. 220-P, dated March 25, 2003, “On the Procedure for Concluding and Executing Repo Transactions with Federal Government Securities,” which allowed GKO—OFZ market dealers to strike repo deals with one another, including deferred-delivery deals struck without the participation of the Bank of Russia.

To promote the development of the domestic foreign exchange market, the Bank of Russia carried out the following measures:

- ruble/dollar trades for tomorrow settlements were introduced at the Single Trading Session of several interbank currency exchanges (STS) on the initiative of the Bank of Russia in April 2003. At the same time, the Bank of Russia changed the procedure for setting the official US dollar/ruble rate on the results of STS trading, switching to the use of the average weighted exchange rate in trades for tomorrow settlements as it was at 11:30 a.m. of

the business day. This procedure for setting the exchange rate helps reduce the effect of some fluctuating factors, such as short-term fluctuations of market players’ current liquidity level on the exchange rate (Bank of Russia Letter of April 14, 2003);

- the Bank of Russia introduced changes in the standard agreement with contractors on conversion transactions on the domestic foreign exchange market to make intraday settlements more flexible. Specifically, the conditions of the agreement increased the time period for accepting prepayment from Bank of Russia contractors on conversion transactions and provided for the netting of deals with the same delivery dates (Bank of Russia Ordinance No. 1299-U, dated June 25, 2003).

To improve the procedure for conducting open-market operations, the Bank of Russia implemented the following measures:

- part of the Finance Ministry’s debt to the Bank of Russia was restructured into 14 OFZ bond issues with a nominal value of 282.4 billion rubles. Four OFZ issues with a nominal value of 32.4 billion rubles were to be sold directly on the open market and the rest were intended for exchange modified repo operations;
- operations to sell OFZ issues in secondary trade without an obligation of reverse repurchase were launched;
- 28-day exchange modified repo auctions began to be held on a regular basis;
- 1-week and 3-month direct repo auctions began to be held on a regular basis;

- Russian Government Resolution No. 799, dated December 30, 2003, “On the Specifics of the Procedure for Issuing Bonds of the Central Bank of the Russian Federation,” was drafted to enable the Bank of Russia to use Bank of Russia bonds as a means of managing market players’ current liquidity levels;
- a draft law to amend the Federal Law “On the Securities Market” and Federal Law “On the Protection of the Rights and Legitimate Interests of Investors” was submitted to the Finance Ministry. The document allows the Bank of Russia to issue its own bonds without state registration and use operations with these bonds more flexibly in monetary regulation.

To liberalise the regulation of non-resident operations on the GKO—OFZ market, the Bank of Russia issued the following documents:

- Ordinance No. 1253, dated February 25, 2003, “On Introducing Amendments and Addenda to Bank of Russia Instruction No. 96-I, Dated December 28, 2000, “On Non-residents’ Special C-Type Accounts,” which reduced the period of depositing non-resident funds in C-type transit accounts to 30 days and the period of depositing securities was cut to 60 days;
- Bank of Russia Ordinance No. 1319, dated August 25, 2003, “On Introducing Amendments and Addenda to Bank of Russia Instruction No. 96-I, Dated December 28, 2000, “On Non-residents’ Special C-Type Accounts,” which permitted a free transfer of securities to the main sections of deposit accounts, reduced the period of depositing funds in transit accounts to two days and granted all GKO—OFZ market dealers with a general banking licence the right to keep C-type accounts.

To promote the development of money market instruments, the Russian authorities registered 100 prospectuses of certificates of deposit and 10 prospectuses of savings certificates. As in 2002, credit institutions based in the Moscow Region accounted for most of the share issue value (443 billion rubles). The value of certificates sold in the Moscow Region increased by 2.3 times year on year.

### 3. RELATIONS WITH FEDERAL BUDGET

In 2003, the Bank of Russia carried out measures to facilitate the implementation of the Concept of the Single Federal Budget Revenue and Funds Account of the Finance Ministry’s Federal Treasury, approved by Russian Federation Government Directive No. 107-r, dated January 23, 2000.

To accelerate the transfer of tax and other payments to the federal budget and lower-level budgets and extrabudgetary funds and to increase the automation level of budget accounting and allocation at all levels of the Russian budget system, the Bank of Russia changed the formats of the settlement documents and payment warrants to include margins for information necessary for the tax, customs and federal treasury authorities when tax and other compulsory payments are transferred to revenue and other budget accounts at all levels of the Russian budget system. The changes in the formats of settlement

documents and the procedure for handling them were approved by Bank of Russia Ordinance No. 1256-U, dated March 3, 2003, “On Introducing Amendments and Addenda to Bank of Russia Regulation No. 2-P, Dated October 3, 2002, “On Non-Cash Settlements in the Russian Federation” (registered with the Ministry of Justice on March 21, 2003, under No. 4300).

The Bank of Russia agreed with the Rules to Provide Information in the Margins of Settlement Documents on the Transfer of Taxes, Duties and Other Compulsory Payments to the Budget System, approved by the Ministry of Taxes and Duties, State Customs Committee and Finance Ministry by Order No. BG-3-10/98/197/22n, dated March 3, 2003 (registered with the Ministry of Justice on March 19, 2003, under No. 4289) and by Operating Ordinance No. 50-T, dated March 2, 2003, and sent them to its regional branches and credit institutions.

Taking into account the changes made in the formats of the settlement documents and payment warrant, which required providing departmental information when transferring taxes, duties and other compulsory payments to the budget system, the Bank of Russia issued the Ordinance “On the Specifics of the Use of the Settlement Document Formats in Effecting Electronic Payments through the Bank of Russia Settlement System” (approved by the Bank of Russia on April 24, 2003, under No. 1274-U and registered in the Ministry of Justice on May 7, 2003, under No. 4514).

To speed up settlements in transferring funds to federal treasury accounts, on January 31, 2003, the Bank of Russia issued the Order “On Carrying out Measures in the Bank of Russia to Ensure the Exchange of Electronic Documents between the Bank of Russia and the Finance Ministry’s Federal Treasury Bodies in the Conditions of the Transfer of the Revenue Part of the Federal Budget to the Single Federal Treasury Account.” This document set the closing time for the receipt of electronic payment documents from clients in all regions, including federal treasury bodies, whose funds are to be entered to or written down from federal treasury accounts opened in the Bank of Russia regional branches at no earlier than 17:00 local time. In the fourth quarter of 2003, Bank of Russia regional branches carried out organisational and technical measures in their divisions for the use at the intraregional level from January 1, 2004, of full-format electronic payment documents when transferring funds to federal treasury accounts in the divisions of the Bank of Russia settlement network, effecting settlements for collection and making partial payments on settlement documents.

To convert as soon as possible federal budget-financed enterprises and organisations to financing through personal accounts opened in the federal treasury’s accounting registers, the Bank of Russia at the request of the Finance Ministry twice conducted the monitoring of federal budget accounts opened in Bank of Russia establishments and credit institutions (Bank of Russia Ordinance No. 31-T, dated March 4, 2003, and Ordinance No. 169-T, dated December 8, 2003). On the instructions of the Russian Government, the Bank of Russia passed information to the Finance Ministry on the balances of funds in budget accounts

at all levels of the budget system and funds in accounts from entrepreneurial and other gainful activities, opened in Bank of Russia establishments and credit institutions in rubles and in foreign currency as of January 1, 2003.

Pursuant to Article 138 of the 2003 Federal Budget Law, the Bank of Russia drafted and issued in collaboration with the Finance Ministry the Regulation on the Procedure for Completing Operations on 2003 Federal Budget Accounts Opened in Bank of Russia Settlement Divisions and Credit Institutions or Branches of Credit Institutions (registered with the Ministry of Justice on December 9, 2003, under No. 5315).

The Bank of Russia participated in drafting the instructions of the Central Election Commission on the procedure for opening and managing accounts and accounting for, reporting on and transferring funds allocated from the federal budget to the Central Election Commission and other election commissions, as well as the procedure for raising and spending the election campaign funds of candidates, political parties and election alliances when electing deputies to the State Duma and to the presidency of the Russian Federation.

Federal budget funds were appropriated to authorised credit institutions to finance investment projects and conversion programmes of the defence industry, creation of a special fund for soft bank lending of seasonal costs in the agro-industry, and record-keeping accounts opened by enterprises and organisations in these institutions. In connection with the need to close these accounts while transferring by credit institutions the rights of claim to these appropriated funds to the Finance Ministry, the Bank of Russia issued Ordinance No. 1302-U, dated July 3, 2003 (registered under No. 5086 with the Ministry of Justice on September 18, 2003).

To ensure the receipt of foreign exchange cash from customs bodies, the Bank of Russia issued Ordinance No. 1264-U, dated March 28, 2003, “On the Procedure for Accepting Foreign Exchange from the Customs Bodies of the Russian Federation by the First Operations Department of the Central Bank of the Russian Federation (Bank of Russia)” (registered with the Ministry of Justice on April 16, 2003, under No. 4424).

To improve the prediction and analysis of the flow of funds through budget accounts at all lev-



els of the budget system and government extrabudgetary funds, which are used to compile banking sector liquidity forecasts, the Bank of Russia issued Ordinance No. 1249-U, dated February 14, 2003, which required Bank of Russia

establishments to fill in on a daily basis Reporting Form No. 915 “Current Reporting of Balances of Budget Accounts at All Levels of the Budget System of the Russian Federation and Government Extrabudgetary Funds.”

#### 4. FOREIGN EXCHANGE REGULATION AND FOREIGN EXCHANGE CONTROL

To improve the system of foreign exchange regulation and foreign exchange control, the Bank of Russia carried out the following measures in the year under review:

- to promote the market principles of the domestic foreign exchange market’s operation and create more favourable conditions for its participants, the Bank of Russia reduced from July 10, 2003, the share of residents’ foreign currency earnings from exports of goods (works, services and the results of intellectual activity) subject to compulsory sale from 50% to 25%;
- to further liberalise foreign trade, the Bank of Russia cancelled the permit system and established a free procedure for:
- effecting settlements between residents and non-residents on transactions to buy goods abroad without bringing them to the customs territory of Russia for their subsequent sale outside Russia (Bank of Russia Regulation No. 214-P, dated January 29, 2003, “On the Procedure for Effecting Settlements between Resident Corporate Entities and Non-residents on Foreign Trade Transactions to Purchase and Subsequently Sell Goods Abroad without Bringing Them to the Customs Territory of the Russian Federation”);
- switching from one authorised bank to another for the servicing of export and import contracts (Bank of Russia and State Customs Committee Regulation No. 244-P and No. 01-100/2, dated December 25, 2003, “On the Procedure for Transferring Contracts on Exports or Imports of Goods from the Authorised Banks which Signed the Transaction Passports on these Contracts to Other Authorised Banks”);
- to encourage the development of the organised securities market, residents were granted the right to effect, without special permits and through authorised banks in the Russian and foreign currency, settlements on the acquisition and alienation on the organised market of foreign currency-denominated securities issued by residents, including bonds issued on behalf of the Russian Federation (Bank of Russia Ordinance No. 1325-U, dated August 26, 2003, “On Amending Bank of Russia Regulation No. 39, Dated April 24, 1996, ‘On the Procedure for Conducting Some Kinds of Foreign Exchange Operations in the Russian Federation and Accounting for and Reporting Some Kinds of Foreign Exchange Operations’”).

## PRINCIPAL MEASURES CARRIED OUT BY THE BANK OF RUSSIA IN 2003 TO IMPROVE BANKING REGULATION AND SUPERVISION

The Bank of Russia carried out principal measures to upgrade banking regulation and supervision in 2003 in line with the Russian Banking Sector Development Strategy and taking into account the measures envisaged by Guidelines for the Single State Monetary Policy in 2003. At the same time, the Bank of Russia was guided by international best practices, especially those set out in the recommendations of the Basel

Committee on Banking Supervision, including recommendations on the regulation of typical banking risks and the methodologies of evaluating the performance of credit institutions and organising current supervision and inspection. The Bank of Russia also bore in mind the recommendations of the Financial Sector Assessment Programme for Russia, completed by the IMF and World Bank jointly with the Bank of Russia in 2003.

### I. MEASURES TO IMPROVE THE PROCEDURE FOR OFF-SITE SUPERVISION AND INSPECTION OF CREDIT INSTITUTIONS

In the year under review, the Bank of Russia paid particular attention to developing ways to control the quality of banking capital and prevent the use of fictitious bank capitalisation schemes. The following Bank of Russia regulations were issued to this end: Regulation No. 215-P, dated February 10, 2003, "On the Methodology of Determining a Credit Institution's Own Funds (Capital)" and Ordinance No. 1246-U, dated February 10, 2003, "On Actions in Response to the Detection of Evidence (Signs) of the Use of Inappropriate Assets in Creating Sources of Own Funds (Capital) (or a Part Thereof)."

To improve the regulation of corporate governance in credit institutions, the Bank of Russia issued Regulation No. 242-P, dated December 16, 2003, "On Organising Internal Control in Credit Institutions and Banking Groups," which was designed to eliminate flaws and discrepancies in legislation on internal control in credit institutions and convert Russian banking practices to internationally accepted standards.

To implement the provisions of banking legislation and make supervision more effective, the Bank of Russia issued a number of regulations on the compiling of statements by credit institutions, submitted to the Bank of Russia for supervision. Specifically, it issued Ordinance No. 1270-U, dated April 14, 2003, "On Statements Published by Credit Institutions and Banking/Consolidated Groups."

The Bank of Russia drafted proposals for optimising and improving prudential reporting forms, which were formalised in Bank of Russia Ordinance No. 1376-U "On the List, Forms and Procedure for Compiling and Submitting Credit Institutions' Reporting Forms to the Central Bank of the Russian Federation."<sup>1</sup>

In addition, the Bank of Russia issued Regulation No. 246-P "On the Procedure for Compiling Consolidated Statements by a Parent Credit Institution/Consolidated Group" and Operating Ordinance No. 1-T "On Methodological Recommendations for Compiling Consolidated Statements."<sup>2</sup> To make banking supervision more ef-

<sup>1</sup> Bank of Russia Ordinance No. 1376-U, issued on January 16, 2004.

<sup>2</sup> Bank of Russia Regulation No. 246-P and Bank of Russia Operating Ordinance No. 1-T issued on January 5, 2004.

fective, the Bank of Russia issued Operating Ordinance No. 110-T, dated July 18, 2003, “On Auditing Credit Institutions and Banking/Consolidated Groups.” Along with this Ordinance it sent Finance Ministry Letter No. 28-01-20/1402/AP, dated July 8, 2003, to its regional branches for use in their work, which was written on the basis of proposals drafted by the Bank of Russia.

To standardise the procedure for receiving statements from credit institutions, the Bank of Russia sent its regional branches Operating Ordinance No. 109-T, dated July 16, 2003, “On Forms of Control over Statements Made by Credit Institutions.”

Bank of Russia Ordinance No. 55-T, dated April 15, 2003, “On Disclosure of Information by Credit Institutions” recommended Bank of Russia regional branches to carry out additional work to persuade credit institutions, especially those of importance for the banking sector as a whole or for the region where they are based, to place turnover-sheet data from their Form 101 accounts and Form 102 profit and loss account on the Bank of Russia Internet homepage.

The Bank of Russia drafted a number of regulations to ensure the implementation of the provisions of Article 44 of the Federal Deposit Insurance Law: the Ordinance “On the Assessment of Financial Stability of a Bank for the Purpose of Acknowledging its Adequacy for Participation in the Deposit Insurance System”<sup>1</sup> and the Regulation “On the Procedure for Considering by the Bank of Russia a Bank’s Request to Make a Statement on the Bank’s Compliance with the Requirements for Participation in the Deposit Insurance System”<sup>2</sup> and the Regulation “On the Procedure for Considering by the Bank of Russia of an Appeal against the Bank of Russia’s Negative Decision on a Bank’s Compliance with the Requirements for Participation in the Deposit Insurance System.”<sup>3</sup>

The Bank of Russia drafted and agreed with the corresponding divisions the Regulation “On the Procedure for Making Provisions for Possible Loan Losses and for Debt on Loans and Similar

Debts”<sup>4</sup> (a new version of Bank of Russia Instruction No. 62a, dated June 30, 1997, “On the Procedure for Creating and Using a Reserve for Possible Loan Losses”), which is designed to promote further the use of the principle of professional judgement when evaluating credit risks.

To comply with the requirements of Federal Law No. 86-FZ, dated July 10, 2002, “On the Central Bank of the Russian Federation (Bank of Russia)” on the registration of Bank of Russia regulations with the Ministry of Justice and realising the need to update supervisory standards, the Bank of Russia drafted the following documents:

- Instruction No. 110-I “On Banks’ Required Ratios” (a new version of Bank of Russia Instruction No. 1, dated October 1, 1997, “On the Procedure for Regulating Banks’ Activities”), which reduced the number of required ratios and established the requirement for the observance of the remaining ratios on a permanent (daily) basis<sup>5</sup>;
- Draft Instruction “On Setting Limits on Open Currency Positions, the Methodology of Calculating Them and the Specifics of Supervision of the Compliance with Them by Credit Institutions” (a new version of Bank of Russia Instruction No. 41, dated May 22, 1996, “On Setting Limits on the Open Currency Position and Monitoring Their Observance by Authorised Banks of the Russian Federation”).

The Bank of Russia drafted Operating Ordinance No. 54-T, dated April 11, 2003, “On the Second Edition of the Code of Conduct on the Financial Markets,” issued by the Paris-based International Financial Market Association (ASI).

The Bank of Russia issued Operating Ordinance No. 70-T, dated May 7, 2003, “On Recommendations on the Information Content and Management of Credit Institutions’ Web Sites.”

Work continued to improve the legislative framework regulating trust management operations conducted by credit institutions.

To keep the public and banking community informed about court rulings, the Bank of Russia

<sup>1</sup> No. 1379-U, issued by the Bank of Russia on January 16, 2004.

<sup>2</sup> No. 248-P, issued by the Bank of Russia on January 16, 2004.

<sup>3</sup> No. 247-P, issued by the Bank of Russia on January 16, 2004.

<sup>4</sup> This draft Regulation was discussed by the Bank of Russia Board of Directors on March 19, 2004.

<sup>5</sup> Instruction No. 110-I, issued by the Bank of Russia on January 16, 2004.

drafted the Order “On Ensuring Publicity in Respect to Court Rulings in Cases Involving the Bank of Russia and Credit Institutions.”

To improve co-operation with credit institutions, the Bank of Russia continued to phase in the institute of curators of credit institutions in supervisory practice. Ten Bank of Russia regional branches were involved in an experiment conducted on the basis of the Bank of Russia recommendations “On the Experiment to Introduce the Institute of Curators of Credit Institutions in Supervisory Practice.” The results of the experiment were discussed in June 2003 at a meeting with the concerned Bank of Russia regional branches and the results of the meeting were laid at the basis of Bank of Russia draft Regulation “On the Curator of a Credit Institution.”

In 2003, the Bank of Russia continued to refine the methods of evaluating the performance of credit institutions and drafted Ordinance “On the Assessment of the Activities of Credit Institutions,” which was approved by the Bank of Russia Banking Supervision Committee on November 12, 2003 (minutes No. 28) and is currently being finalised to bring it into compliance with the provisions of Bank of Russia Ordinance No. 1379-U.

The Bank of Russia continued to improve the recommendations worked out in 2000 for analysing the financial condition of credit institutions and modernise the software system “The Analysis of the Financial Condition of a Bank.” Methodologies were drawn up in the year under

review to develop software designed to fulfil the following purposes:

- “The Analysis of Banks with Branches,” which gave supervisors additional opportunities to exercise control over the risks assumed by a group of banks, the extent of their concentration and the impact of operations conducted by branches on the financial stability of the bank as a whole;
- “The Analysis of Consolidated Statements,” which allowed supervisors to identify the areas of increased risk in the activities of banking/consolidated groups and evaluate their influence on the financial stability of the participating credit institutions.

Using an analysis of foreign expertise, the Bank of Russia elaborated “The Principles of Stress Testing of Credit Institutions.” It is a set of recommendations drawing credit institutions’ attention to the major aspects of this method of evaluating possible losses in the event of an economic downturn, which is widely used in international banking practices. In December 2003, these recommendations appeared on the Bank of Russia Web site, so now they can be used by both Bank of Russia regional branches and credit institutions.

In 2003, the Bank of Russia continued to improve the conditions and forms of co-operation with foreign supervisors. In January 2003, it signed a new version of the Agreement on Co-operation in the Field of Banking Supervision with the Central Bank of Armenia.

## 2. MEASURES TO IMPROVE INSPECTION PRACTICES

In 2003, the Bank of Russia issued a number of new regulations aimed at upgrading inspection practices:

- Instruction No. 105-I, dated August 25, 2003, “On the Procedure for Conducting Inspections of Credit Institutions (Their Branches) by Authorised Representatives of the Central Bank of the Russian Federation;”
- Instruction No. 108-I, dated December 1, 2003, “On Organising Inspections by the Cen-

tral Bank of the Russian Federation (Bank of Russia);”

- Bank of Russia Ordinance No. 1324-U, dated August 25, 2003, “On Invalidating Bank of Russia Instruction No. 34, Dated February 19, 1996, ‘On the Procedure for Conducting Inspections of Credit Institutions and Their Branches by Authorised Representatives of the Central Bank of the Russian Federation (Bank of Russia);’”

— Bank of Russia Ordinance No. 1347-U, dated December 1, 2003, “On Eliminating Discrepancies in Some Bank of Russia Regulations.”

The above documents established a single procedure for conducting inspections of credit institutions, at the same time taking into account the specifics of inspections carried out to verify compliance with reserve requirements or the correctness of foreign exchange operations, and other matters. The Bank of Russia introduced standard forms of documents compiled at various stages of

inspections, designed to improve the quality of documenting inspection results.

The Bank of Russia established a procedure for interaction between the divisions of its central office and regional branches in organising and conducting inspections of credit institutions, settling such problems as planning inspections and conducting unscheduled and repeat inspections, and stipulated in detail the powers of Bank of Russia executives who have the right to take decisions and sign orders to conduct inspections.

### 3. MEASURES TO IMPROVE THE DECISION-MAKING PROCESS RELATING TO THE REGISTRATION OF CREDIT INSTITUTIONS, LICENSING OF BANKING OPERATIONS AND REGISTERING CREDIT INSTITUTIONS’ SECURITIES ISSUES

The Bank of Russia issued Regulation No. 218-P, dated March 19, 2003, “On the Procedure and Criteria for Evaluating the Financial Condition of Corporate Founders (Members) of Credit Institutions,” which introduced a methodology of evaluating financial condition by assessing the essential results of a comprehensive analysis of absolute and relative performance indicators on the acquirer, taking into account the nature and scale of his business and sectoral and regional affiliation.

Bank of Russia Operating Ordinance No. 134-T, dated September 16, 2003, “On the Application by Bank of Russia Regional Branches of Bank of Russia Regulation No. 218-P, dated March 19, 2003, ‘On the Procedure and Criteria for Evaluating the Financial Condition of Corporate Founders (Members) of Credit Institutions,’” contained recommendations for detecting the use of inappropriate assets in creating authorised capital by credit institutions and analysing the adequate ability of a credit institution’s evaluation of the risk of sustaining possible losses.

To control the ownership structure of credit institutions, the Bank of Russia issued Regulation No. 227-P, dated May 14, 2003, “On the Procedure for Accounting of and Providing Information on the Affiliated Persons of a Credit Institution.”

Bank of Russia Regulation No. 230-P, dated June 4, 2003, “On the Re-organisation of Credit Institutions in the Form of Merger and Acquisition” spelled out the specifics of the licensing of credit institutions’ activities when they are re-organised in the form of mergers or acquisitions and simplified the re-organisation procedures.

The Bank of Russia issued Ordinance No. 1288-U, dated June 3, 2003, “On Introducing Amendments and Addenda to Bank of Russia Instruction No. 102-I, dated July 22, 2002, ‘On the Rules of Issue and Registration of Securities by Credit Institutions in the Russian Federation,’” designed to create equal conditions for investment decision-making with regard to credit institutions’ publicly traded issues and securities of other issuers by stipulating on the basis of applicable legislation that all issuers are required to disclose the same amount of information.

Bank of Russia Ordinance No. 1292-U, dated June 19, 2003, established a procedure for presenting documents by a non-bank credit institution to the Bank of Russia for the latter to make the decision on granting it the status of a bank.

Bank of Russia Ordinance No. 1346-U, dated December 1, 2003, established the minimum amount of authorised capital needed to create a

credit institution, the amount of own funds (capital) for operating credit institutions wishing to open a subsidiary and/or branch in a foreign country and the amount of own funds (capital) for non-bank credit institutions applying for the status of a bank.

To ensure the transparency of the share ownership structure in credit institutions, the Bank of Russia issued Operating Ordinance No. 107-T, dated July 11, 2003, which explained the term “a group of corporate entities and/or private individuals that are parties to an agreement.”

#### 4. MEASURES TO IMPROVE BANK BANKRUPTCY-PREVENTION PROCEDURES, THE REVOCATION OF BANKING LICENCES AND CONTROL OVER LIQUIDATION PROCEDURES IN CREDIT INSTITUTIONS

Realising the need to strengthen the legal and organisational framework for the activities of the provisional administrations of credit institutions, the Bank of Russia issued a new version of Regulation No. 241-P, dated November 26, 2003, “On the Provisional Administration of a Credit Institution,” which introduced some changes designed to make provisional administrations more efficient and tighten control over the activities of operating credit institutions as well as credit institutions after the latter had their banking licences revoked.

Bank of Russia Ordinance No. 1260-U, dated March 24, 2003, “On the Procedure for Matching the Authorised Capital of Credit Institutions with Their Own Funds (Capital)” established a procedure for reducing the authorised capital of a credit institution to an amount no bigger than that of its own funds (capital) and making the corresponding changes in its founding documents within 45 days from the receipt of the corresponding order.

Bank of Russia Ordinance No. 1311-U, dated July 25, 2003, “On the Procedure for Revoking a Banking Licence from a Credit Institution for Essentially False Reporting” defined the term “essentially false reporting” and specified for what kind of false reporting a credit institution may have its banking licence revoked.

The publication of Procedures for Co-operation between the Bank of Russia and Ministry of

Taxes and Duties when the Bank of Russia Considers Tax Authorities’ Requests for the Revocation of Banking Licences from Credit Institutions No. 01-33-4/2454, dated July 7, 2003, and No. BG-18-24/4, dated June 25, 2003, was prompted by the need to respond quickly to the requests of the Ministry of Taxes and Duties to revoke banking licences from credit institutions failing to fulfil their obligations to the budget.

Owing to the changes in the legal framework regulating the registration of credit institutions, the Bank of Russia issued Regulation No. 234-P, dated July 10, 2003, “On the Procedure for Considering the Report by a Bank of Russia Regional Branch on the Results of the Liquidation of a Credit Institution and Taking the Decision by the Bank of Russia on the State Registration of a Credit Institution in Connection with Its Liquidation.”

The Bank of Russia issued Ordinance No. 1241-U, dated January 21, 2003, “On the List of Data and Documents Necessary for the State Registration of a Credit Institution Owing to Its Liquidation and the Procedure for Presenting Them to the Bank of Russia.”

In 2003, the Bank of Russia issued 33 regulatory documents relating to the licensing and financial rehabilitation of credit institutions: six regulations, 18 ordinances and nine operating ordinances.

## 5. MEASURES TO COUNTER THE LEGALISATION OF CRIMINALLY OBTAINED INCOMES AND THE FINANCING OF TERRORISM

To make the banking sector's efforts to counter money laundering and terrorist financing more effective, the Bank of Russia issued several documents in 2003.

Pursuant to Article 2 of Federal Law No. 131-FZ, dated October 30, 2002, "On Introducing Amendments and Addenda to the Federal Law 'On Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism,'" on bringing Bank of Russia regulations into conformity with its provisions, the Bank of Russia issued Operating Ordinance No. 6-T, dated January 16, 2003, "On Introducing Amendments and Addenda to Bank of Russia Operating Ordinance No. 137-T, dated November 28, 2001, 'On Recommendations for Credit Institutions to Work out Internal Control Rules against the Legalisation (Laundering) of Criminally Obtained Incomes,'" which gave further recommendations to credit institutions in respect to internal control rules against money laundering and terrorist financing.

In compliance with point 2 of Russian Federation Government Resolution No. 6, dated January 8, 2003, "On the Procedure for Approving Internal Control Rules in Organisations Conducting Operations with Money or Other Property," the Bank of Russia issued Order No. OD-201, dated April 21, 2003, "On Agreeing Internal Control Rules Worked out and Approved in Credit Institutions to Prevent the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism," which regulated the procedure for agreeing the above internal control rules by credit institutions with Bank of Russia regional branches.

To upgrade the methods of monitoring credit institutions' compliance with anti-laundering and terrorist financing requirements, the Bank of Russia issued the following operating ordinances:

— No. 103-T, dated July 9, 2003, "On Methodological Recommendations for Conducting Inspections to Verify Credit Institutions' Compliance with the Requirements of Russian Federation Legislation and the Bank of Russia

Regulations against the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism;"

— No. 115-T, dated July 25, 2003, "On Bank of Russia Control over the Observance by Credit Institutions (Their Branches) of the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism;"

— No. 117-T, dated August 11, 2003, "On Using Measures of Coercion against Credit Institutions for Violations of the Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism."

To provide methodological assistance to credit institutions in implementing measures provided for by the law against money laundering and terrorist financing, the Bank of Russia issued the following operating ordinances:

— No. 7-T, dated January 20, 2003, "On the Implementation of the Federal Law 'On Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism,'" which contained recommendations on the procedure for identifying persons who sign a bank account (deposit) agreement with a credit institution;

— No. 12-T, dated January 24, 2003, "On Tightening Control when Establishing Correspondent Relations with Non-resident Credit Institutions," containing recommendations on how credit institutions should deal with banks registered in the Republic of Nauru and banks that are not physically present in any country;

— No. 15-T, dated January 31, 2003, "On Cooperation between Authorised Banks and Non-residents Registered in the Republic of Montenegro," which recommended credit institutions to end correspondent relations with banks registered in the Republic of Montenegro whose legal status had not been confirmed by a licence from the Central Bank of Montenegro;

- No. 53-T, dated April 8, 2003, “On Changes in and Amendments to the Wolfsberg Principles,” which provided credit institutions with the text of the new version of the Global Anti-Laundering Guidelines for Private Banking (Wolfsberg Principles);
- No. 171-T, dated December 11, 2003, “On the Offshore Banking Sector of the Republic of Nauru,” which informed credit institutions that the Ministry of Foreign Affairs of the Republic of Nauru had notified the Russian Federation about the termination of the operation of the offshore banking sector in the Republic of Nauru, the revocation of all banking licences and the list of banks registered in the Republic of Nauru whose banking licences had been revoked;
- No. 179-T, dated December 24, 2003, which recommended credit institutions to tighten control over money transfers conducted without opening bank accounts and operations involving the use of prepaid financial products.



## STATISTICAL TABLES

### *List of tables*

1. Dynamics of major macroeconomic indicators .....	179
2. Consumer price dynamics by group of goods and services .....	179
3. Consumer price inflation structure .....	180
4. GDP production structure in basic prices .....	180
5. Structure of GDP calculated by income use method in current market prices .....	181
6. Dynamics of GDP consumption elements in comparable prices .....	181
7. GDP formation structure by source of income .....	181
8. Balance of household money income and expenses in Russia .....	182
9. Income differentiation of population .....	183
10. Dynamics of major corporate financial performance indicators in 2003 .....	184
11. Payments for products shipped by major taxpayers and industrial monopolies .....	185
12. Russia's foreign merchandise trade .....	186
13. Commodity structure of Russian exports .....	187
14. Commodity structure of Russian imports .....	188
15. Russia's exports to major trading partners .....	189
16. Russia's imports from major trading partners .....	190
17. Russia's foreign trade in services by group of countries in 2002—2003 .....	191
18. Structure of Bank of Russia clients other than credit institutions and number of accounts opened for them .....	192
19. Domestic government debt structure as of January 1, 2004 .....	192
20. Finance Ministry debt to Bank of Russia as of January 1, 2004 .....	193
21. Volumes of resident operations with non-residents to buy and sell outstanding Russian government foreign currency debt obligations on secondary market in 2003 .....	193
22. GKO—OFZ market structure by group of bondholders .....	194
23. Institutes of financial intermediation .....	194

24. Outstanding Russian government foreign currency bonded loans as of January 1, 2004 ....	195
25. Russia's balance of payments for 2003 .....	196
26. Structure of foreign investment in Russia in 2003 .....	199
27. Structure of Russian resident investment in foreign assets in 2003 .....	199
28. Russian banking sector's international investment position .....	200
29. Russian banking sector foreign assets and liabilities on interbank operations by group of countries as of January 1, 2004 .....	202
30. Dynamics of Russian debt to international financial organisations in 2003 .....	203
31. Dynamics of Russia's international reserves in 2003 .....	203
32. Major ruble exchange rate dynamics indicators in 2003 .....	204
33. Russia's foreign debt in 2003 .....	205
34. Major economic development indicators for foreign countries in 2001—2003 .....	207
35. Major money and credit indicators for CIS countries in 2003 .....	209
36. Money supply (national definition) .....	211
37. Average monthly money supply growth rates in 2003 .....	211
38. M2 structure .....	211
39. Monetary base and its structure .....	212
40. Monetary survey .....	212
41. Credit institutions' analytical accounts .....	213
42. Sanctions used against credit institutions in 2003 .....	214
43. Major Russian payment system indicators .....	215
44. Note structure of 1997 Bank of Russia banknotes in circulation .....	218
45. Structure of 1997 Bank of Russia coins in circulation .....	218
46. Bank of Russia stakes in Russian and foreign credit institutions and other organisations .....	219

*Table 1*

**DYNAMICS OF MAJOR MACROECONOMIC INDICATORS (as % of previous year)**

	2001	2002	2003
Gross domestic product	105.1	104.7	107.3
of which:			
Output of goods	106.5	103.6	107.6
of which:			
industry	104.9	104.0	107.3
agriculture	111.4	102.9	102.7
construction	109.9	102.7	114.4
Output of services	103.6	105.5	107.1
Market services	104.3	106.0	108.0
of which:			
transport	103.2	103.4	106.7
communications	117.9	116.7	124.7
trade, public catering and procurements	103.9	108.1	109.7
Non-market services	99.4	102.5	102.0
GDP deflator index, times	1.165	1.157	1.143
Consumer price index (December to December of previous year), times	1.186	1.151	1.120
Labour productivity	104.7	102.3	107.8
Fixed capital investment	110.0	102.8	112.5
Retail trade turnover	110.9	109.2	108.4
Unemployment rate according to ILO methodology, as % of economically active population, annualised average	9.0	8.0	8.3

*Table 2*

**CONSUMER PRICE DYNAMICS BY GROUP OF GOODS AND SERVICES  
(% growth, December to December of previous year)**

	2002	2003
<b>Consumer prices, total</b>	<b>15.1</b>	<b>12.0</b>
of which:		
goods and services included in calculation of base consumer price index (BCPI)	10.2	11.2
food	11.0	10.2
of which:		
food excluding vegetables and fruit	8.5	11.8
vegetables and fruit	33.3	-4.2
non-food products	10.9	9.2
paid services to the public	36.2	22.3

*Note. Tables 1 to 11 are based on Goskomstat data and Bank of Russia calculations (as of April 21, 2004).*

Table 3

## CONSUMER PRICE INFLATION STRUCTURE

	2002		2003	
	Growth in percentage points	% contribution to growth	Growth in percentage points	% contribution to growth
General rate of inflation (December to December)	15.1	100	12.0	100
Inflation growth due to:				
change in prices of goods and services included in BCPI calculation	8.4	55.6	9.1	75.9
change in prices of goods and services not included in BCPI calculation	6.7	44.4	2.9	24.1
of which:				
change in vegetable and fruit prices	1.8	11.7	−0.2	−1.8
change in regulated service and fuel prices	4.9	32.7	3.1	25.9

Table 4

## GDP PRODUCTION STRUCTURE IN BASIC PRICES (%)\*

	2001	2002	2003
Gross domestic product	100	100	100
of which:			
Output of goods	43.0	40.6	40.3
of which:			
industry	28.2	27.0	27.1
agriculture	6.6	5.7	5.2
construction	7.4	7.0	7.1
Output of services	57.0	59.4	59.7
Market services	47.7	48.4	48.8
of which:			
transport	7.4	7.4	7.3
communications	1.6	1.8	2.0
trade, public catering and procurements	22.3	22.3	22.2
Non-market service	9.3	11.0	10.9

\* Unlike GDP calculated in market prices, GDP in basic prices does not include food taxes but includes food subsidies.

Data in basic prices are shown without excluding indirectly measured financial intermediation services.

*Table 5*

**STRUCTURE OF GDP CALCULATED BY INCOME USE METHOD IN CURRENT MARKET PRICES (%)**

	2001	2002	2003
GDP calculated by income use method	100	100	100
Expenditure on final consumption	65.7	69.2	67.7
of which:			
households	48.2	50.4	49.6
government sector and non-profit organisations providing services to households	17.5	18.8	18.1
Gross capital formation	21.9	20.3	20.8
of which:			
gross fixed capital formation (including net acquisition of valuables)	18.8	18.0	18.4
change in inventories	3.1	2.3	2.4
Net exports of goods and services	12.4	10.5	11.5

*Table 6*

**DYNAMICS OF GDP CONSUMPTION ELEMENTS IN COMPARABLE PRICES (as % of previous year)**

	2001	2002	2003
GDP	105.1	104.7	107.3
of which:			
Expenditure on final consumption	107.3	107.3	106.6
by household sector	110.1	108.8	107.9
by government agencies	99.2	102.6	102.2
by non-profit organisations	101.9	100.8	102.1
Gross capital formation (including net acquisition of valuables)	116.7	97.8	113.5
Net exports of goods and services	85.5	102.2	103.0

*Table 7*

**GDP FORMATION STRUCTURE BY SOURCE OF INCOME (%)**

	2001	2002	2003
Gross domestic product	100	100	100
of which:			
wages and salaries of hired workers and employees (including undiscovered earnings)	43.0	46.6	46.2
net taxes on production and imports	15.7	14.1	13.3
gross profit and gross mixed incomes	41.3	39.3	40.5

Table 8

**BALANCE OF HOUSEHOLD MONEY INCOME AND EXPENSES IN RUSSIA (million rubles)**

	2002	2003	2003 as % of 2002
<b>Money income</b>	<b>6,790,704.5</b>	<b>8,770,777.4</b>	<b>129.2</b>
Wages and salaries	4,512,500.5	5,850,044.5	129.6
% share	66.5	66.7	
Social transfers	999,232.0	1,258,103.0	125.9
% share	14.7	14.3	
Income from entrepreneurial activities	821,860.0	999,426.0	121.6
% share	12.1	11.4	
Income from property	326,653.0	470,570.0	144.1
% share	4.8	5.4	
Other income	130,459.0	192,633.9	147.7
% share	1.9	2.2	
<b>Money expenses</b>	<b>5,592,073.2</b>	<b>6,809,559.1</b>	<b>121.8</b>
— consumer expenses	4,968,588.0	6,076,337.7	122.3
— compulsory payments and contributions	623,485.2	733,221.4	117.6
<b>Growth in savings and cash in hand, purchase of foreign exchange</b>	<b>1,198,631.3</b>	<b>1,961,218.3</b>	<b>163.6</b>
— savings*	707,751.9	1,076,001.1	152.0
of which:			
— deposits and securities	249,009.0	489,337.3	196.5
— purchase of foreign exchange	371,645.0	643,999.7	173.3
— cash in hand	119,234.4	241,217.5	202.3
<b>For the record:</b>			
<b>% share in money income</b>			
— consumer expenses	73.2	69.3	
— compulsory payments and contributions	9.2	8.4	
— savings	10.4	12.3	
of which:			
— deposits and securities	3.7	5.6	
— purchase of foreign exchange	5.5	7.3	
— cash in hand	1.7	2.7	
<b>Disposable money income</b>	<b>6,169,969.3</b>	<b>8,038,634.8</b>	<b>130.3</b>
% share in			
— consumer expenses	80.5	75.6	
— savings	11.5	13.4	
of which:			
— deposits and securities	4.0	6.1	
— purchase of foreign exchange	6.0	8.0	
— cash in hand	1.9	3.0	

\* Savings include increase (decrease) in deposits, purchase of securities, change in accounts of self-employed entrepreneurs, change in debt on loans and purchase of real estate.

Table 9

**INCOME DIFFERENTIATION OF POPULATION**

	2001	2002	2003
Funds ratio, times*	14.0	14.0	14.3
Gini coefficient, units**	0.398	0.398	0.400

\* The funds ratio is the ratio between income averages within the population groups compared or between their proportions of total income.

\*\* The Gini coefficient (income concentration index) shows the extent to which the actual distribution of household income deviates from the even distribution line. In the even distribution of income, the Gini coefficient tends towards zero; the greater the income differentiation of the population, the closer the Gini coefficient to 1.

Table 10

## DYNAMICS OF MAJOR CORPORATE FINANCIAL PERFORMANCE INDICATORS IN 2003 (as % of 2002)

	Profit net of loss	Profitability of production in 2003	Working assets			Payables		Receivables	
			total	of which:		total	of which overdue	total	of which overdue
				short-term financial investments	cash				
<b>Total</b>	<b>142.5</b>	<b>8.5</b>	<b>121.5</b>	<b>138.8</b>	<b>101.9</b>	<b>109.3</b>	<b>91.2</b>	<b>113.0</b>	<b>96.2</b>
Industry	123.4	8.4	124.9	143.6	100.2	113.4	88.9	118.1	98.7
of which:									
electric-power industry	139.0	2.4	141.3	133.2	132.2	107.4	87.7	104.0	95.7
fuel sector	107.4	15.8	116.9	84.0	82.2	132.9	99.7	137.5	127.1
ferrous metallurgy	242.4	12.9	141.7	236.5	115.1	96.9	61.4	124.9	83.1
non-ferrous metallurgy	149.6	18.7	113.4	215.5	55.4	94.7	75.9	116.1	89.4
chemical and petrochemical industry	148.6	4.7	132.9	108.1	107.5	100.0	76.7	113.7	86.9
machine-building and metalworking	86.4	3.7	122.1	165.2	101.5	110.8	92.5	114.4	100.2
timber, woodworking and pulp-and-paper industry	67.0	2.7	128.1	144.4	163.4	106.2	82.5	115.8	109.6
building materials	122.0	5.4	126.9	137.7	138.0	100.5	83.8	106.2	86.1
light industry	... *	-1.4	122.7	203.7	122.8	102.4	85.1	123.5	112.7
food industry	109.5	5.7	130.4	198.9	115.2	118.5	88.5	123.5	100.9
Agriculture	120.9	2.4	114.0	164.2	120.5	99.1	92.4	117.4	104.1
Transport	186.9	7.5	124.6	104.8	117.2	101.1	90.7	113.9	88.4
Communications	176.5	22.4	138.5	166.9	142.4	146.9	101.3	142.3	94.7
Construction	101.0	4.5	112.1	131.6	135.4	84.1	83.4	110.3	85.4
Trade and public catering	203.0	9.8	119.4	127.5	85.4	113.7	67.2	107.8	91.2
Housing and communal amenities sector	88.1**	-1.5	117.0	104.8	125.3	103.1	97.6	107.1	103.6

\* The industry's performance in 2003 was loss, in 2002 profit.

\*\* Rate of change in losses.



Table 11

## PAYMENTS FOR PRODUCTS SHIPPED (WORK PERFORMED AND SERVICES PROVIDED) BY MAJOR TAXPAYERS AND INDUSTRIAL MONOPOLIES\*

	2002		2003		Change	
	billion rubles	structure of payments, %	billion rubles	structure of payments, %	structure (percentage points)	% change of 2002
Value of products shipped	5,741.7		7,070.2			123.3
of which:						
paid-for products	5,190.2	100.0	6,481.1	100.0		124.8
of which products paid for with:						
money	4,255.2	82.0	5,562.0	85.8	3.8	130.4
promissory notes	327.6	6.3	302.8	4.7	-1.6	92.4
securities	1.4	0.0	0.2	0.0	0.0	12.7
transfer of right of claim on pecuniary obligations	17.5	0.3	13.7	0.2	-0.1	80.3
netting	371.9	7.2	425.5	6.5	-0.7	114.4
barter arrangements	78.4	1.5	43.3	0.7	-0.8	57.7
other kinds of settlements	138.2	2.7	133.7	2.1	-0.6	97.6

\* In structure and according to methodology of years under review.

Table 12

**RUSSIA'S FOREIGN MERCHANDISE TRADE**  
(calculated by balance of payments methodology)

	Billion US dollars							Growth rate as % of previous year						
	1997	1998	1999	2000	2001	2002	2003	1997	1998	1999	2000	2001	2002	2003
<b>All countries</b>														
Turnover	158.9	132.5	115.1	149.9	155.6	168.3	211.4	100.7	83.4	86.9	130.2	103.8	108.1	125.6
Exports	86.9	74.4	75.6	105.0	101.9	107.3	135.9	96.9	85.7	101.5	139.0	97.0	105.3	126.7
Imports	72.0	58.0	39.5	44.9	53.8	61.0	75.4	105.7	80.6	68.1	113.5	119.8	113.4	123.7
Balance	14.9	16.4	36.0	60.2	48.1	46.3	60.5	69.1	110.2	219.2	167.1	80.0	96.3	130.6
<b>Non-CIS countries</b>														
Turnover	121.2	102.4	92.7	122.2	127.3	139.7	174.8	102.4	84.4	90.6	131.8	104.2	109.7	125.1
Exports	67.8	58.7	63.6	90.8	86.6	90.9	114.6	95.4	86.5	108.4	142.8	95.4	105.0	126.0
Imports	53.4	43.7	29.2	31.4	40.7	48.8	60.2	112.9	81.9	66.7	107.8	129.6	119.9	123.4
Balance	14	14.9	34.4	59.3	45.9	42.1	54.3	60.5	103.6	230.3	172.5	77.3	91.8	129.0
<b>CIS countries</b>														
Turnover	37.7	30.1	22.4	27.7	28.3	28.5	36.5	95.6	79.9	74.3	123.7	102.3	100.8	128.1
Exports	19.1	15.8	12.0	14.2	15.3	16.4	21.4	102.7	82.8	76.0	118.8	107.2	107.2	130.4
Imports	18.6	14.3	10.4	13.4	13.0	12.2	15.2	89.3	76.9	72.6	129.4	97.1	93.2	125.0
Balance	0.5	1.5	1.6	0.8	2.2	4.2	6.2	—*	305.9	108.3	50.9	271.1	189.5	146.1

\* In 1996 the balance was negative.

Note. In Tables 12, 13, 15 and 25, total exports for 2003 include the value of crude oil which was exported in the year under review and whose customs registration was completed in January 2004.

Table 13

## COMMODITY STRUCTURE OF RUSSIAN EXPORTS

	Structure, %							Growth rates as % of previous year						
	1997	1998	1999	2000	2001	2002	2003	1997	1998	1999	2000	2001	2002	2003
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100	84	102	141	97	107	126
Minerals	48.3	42.8	44.8	53.8	54.7	55.2	57.6	100	74	107	170	98	108	131
of which:														
fuel, energy	47.4	41.6	44.0	53.1	54.1	54.6	57.0	100	74	108	171	99	108	131
of which:														
oil	17.4	14.4	19.4	24.5	25.0	27.3	28.9	93	69	138	179	99	116	133
natural gas	19.3	18.8	15.6	16.1	17.8	14.9	14.9	112	82	85	147	107	89	126
Metals, metal products	20.3	21.6	20.1	16.9	14.7	14.2	13.8	104	89	95	119	84	103	123
Machinery, equipment, transport vehicles	10.5	11.5	10.8	8.8	10.4	9.5	8.8	109	92	96	115	115	96	119
Chemicals, rubber	8.5	8.6	8.5	7.2	7.5	6.9	6.8	97	85	101	120	101	99	124
Timber, pulp-and-paper products	4.2	5.0	5.1	4.3	4.4	4.6	4.2	100	100	103	120	99	111	114
Gemstones, precious metals and articles made of them	3.8	5.9	6.0	4.8	4.1	4.5	3.9	82	131	104	113	83	116	109
Food products, agricultural raw materials (except textiles)	1.9	2.0	1.3	1.6	1.9	2.6	2.5	89	88	70	164	117	148	121
Textiles, textile goods, footwear	1.1	1.1	1.1	0.8	0.8	0.8	0.7	90	89	101	101	98	111	107
Leather, furs and articles made of them	0.5	0.6	0.3	0.3	0.2	0.3	0.2	100	100	52	130	85	117	123
Other goods	0.9	0.9	2.0	1.5	1.3	1.4	1.5	67	88	184	116	87	114	132
<b>For the record:</b>														
Total exports, billion US dollars (data compiled by State Customs Committee and State Statistics Committee)	85.0	71.3	72.9	103.1	100.0	106.7	134.3							

Table 14

## COMMODITY STRUCTURE OF RUSSIAN IMPORTS

	Structure, %							Growth rates as % of previous year						
	1997	1998	1999	2000	2001	2002	2003	1997	1998	1999	2000	2001	2002	2003
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	115	82	70	112	124	110	124
Machinery, equipment, transport vehicles	35.1	35.8	33.1	31.4	34.0	36.4	37.3	127	84	64	106	134	118	128
Foodstuffs, agricultural raw materials (except textiles)	25.1	24.6	26.6	21.8	22.0	22.5	21.1	116	80	75	91	125	113	116
Chemicals, rubber	14.3	15.1	16.1	17.9	18.2	16.7	16.8	115	87	74	125	126	101	124
Metals, metal products	7.0	6.9	7.2	8.1	7.2	6.3	7.2	95	81	73	126	110	97	141
Textile, textile products, footwear	4.5	4.1	5.2	5.9	5.5	5.2	4.9	109	75	88	126	115	106	114
Timber, pulp-and-paper products	3.6	3.9	3.6	3.8	4.0	4.1	4.2	127	89	63	120	130	114	125
Mineral products, of which:	5.8	5.5	4.0	6.3	4.1	3.7	3.8	111	77	50	177	80	101	125
fuel, energy products	4.3	4.1	2.6	4.3	2.5	2.2	2.3	115	78	43	188	71	100	129
Leather, furs and articles made of them	0.4	0.2	0.3	0.4	0.5	0.4	0.3	116	50	87	146	175	94	109
Gemstones, precious metals and articles made of them	0.2	0.1	0.2	0.2	0.1	0.1	0.2	19	34	129	161	35	143	173
Other goods	4.0	3.8	3.7	4.2	4.4	4.6	4.2	105	81	64	128	141	110	111
<b>For the record:</b>														
Total imports, billion US dollars (data compiled by State Customs Committee and State Statistics Committee)	53.0	43.6	30.3	33.9	41.9	46.2	57.3							

Table 15

## RUSSIA'S EXPORTS TO MAJOR TRADING PARTNERS

	Structure, %							Growth rates as % of previous year						
	1997	1998	1999	2000	2001	2002	2003	1997	1998	1999	2000	2001	2002	2003
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100</b>	<b>84</b>	<b>102</b>	<b>141</b>	<b>97</b>	<b>107</b>	<b>126</b>
of which:														
CIS countries	19.5	19.2	14.7	13.4	14.6	14.7	15.3	105	82	78	129	106	107	131
Non-CIS countries	80.5	80.8	85.3	86.6	85.4	85.3	84.7	99	84	108	144	96	106	125
EU countries	32.9	32.5	34.1	35.8	36.7	35.4	35.3	102	83	107	148	100	103	125
Central and Eastern European countries (excluding Baltic states)	12.0	11.5	11.3	12.6	12.7	11.1	10.9	103	80	101	157	98	94	123
Baltic states	3.7	3.2	3.9	4.8	3.8	3.8	3.5	117	72	126	174	78	107	114
North America	5.5	7.5	6.7	4.7	4.4	3.9	3.4	95	113	92	99	90	96	109
Other countries	26.4	26.1	29.3	28.7	27.8	31.1	31.6	92	83	114	139	94	119	129
<b>For the record:</b>														
OECD countries	56.9	58.2	59.4	59.3	58.7	57.6	56.6	118	86	104	141	96	105	124
APEC countries	16.1	17.0	17.5	15.1	15.1	15.3	14.4	157	89	105	122	97	108	119
Germany	7.7	8.0	8.5	9.0	9.2	7.6	7.8	97	88	108	149	100	88	130
The Netherlands	5.4	5.5	5.0	4.2	4.7	7.0	6.6	137	87	93	118	108	158	119
Italy	4.2	4.5	5.2	7.0	7.4	7.0	6.5	126	90	117	193	102	101	117
China	4.7	4.4	4.8	5.1	5.6	6.4	6.2	84	80	111	149	107	122	122
Ukraine	8.5	7.8	6.6	4.9	5.3	5.5	5.7	96	77	86	105	105	111	130
Belarus	5.5	6.5	5.2	5.4	5.3	5.5	5.6	133	100	81	148	96	110	128
Switzerland	4.2	4.4	4.6	3.7	2.3	5.0	4.3	95	88	107	115	60	232	108
Turkey	2.3	2.7	2.2	3.0	3.2	3.2	3.6	118	98	84	190	105	103	145
Poland	3.0	3.1	3.6	4.3	4.2	3.5	3.4	118	87	120	171	94	89	124
Finland	3.3	2.9	3.3	3.0	3.1	2.8	3.2	105	75	117	129	100	94	148
USA	5.3	7.2	6.5	4.5	4.2	3.7	3.1	93	114	92	99	90	95	105
UK	3.3	4.2	4.0	4.5	4.3	3.6	3.0	89	104	98	162	92	89	105
France	1.9	2.0	1.7	1.8	2.3	2.5	2.6	102	90	83	157	118	118	132
Kazakhstan	2.9	2.7	1.7	2.2	2.8	2.3	2.4	97	77	65	183	124	86	136
Japan	3.5	3.1	2.9	2.7	2.4	1.7	1.8	101	74	98	130	88	74	135
Other	34.3	31.0	34.2	34.7	33.7	32.7	34.2	94	76	113	143	94	104	131
<b>For the record:</b>														
Total exports, billion US dollars (data compiled by State Customs Committee and State Statistics Committee)	85.0	71.3	72.9	103.1	100.0	106.7	134.3							

Table 16

## RUSSIA'S IMPORTS FROM MAJOR TRADING PARTNERS

	Structure, %							Growth rates as % of previous year						
	1997	1998	1999	2000	2001	2002	2003	1997	1998	1999	2000	2001	2002	2003
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>115</b>	<b>82</b>	<b>70</b>	<b>112</b>	<b>124</b>	<b>110</b>	<b>124</b>
of which:														
CIS countries	26.8	26.0	27.5	34.3	26.7	22.0	23.0	98	79	74	139	97	91	129
Non-CIS countries	73.2	74.0	72.5	65.7	73.3	78	77	123	83	68	101	138	117	123
EU countries	36.9	36.1	36.9	32.9	36.9	39.7	38.6	123	80	71	100	138	119	121
Central and Eastern European countries (excluding Baltic states)	8.1	7.3	6.0	6.2	6.3	6.8	7.1	129	74	57	116	126	119	129
Baltic states	1.9	1.6	1.0	1.0	1.0	1.2	1.3	162	67	44	112	130	130	128
North America	8.4	10.1	8.5	13.0	8.5	7.0	5.8	136	99	59	170	81	92	102
Other countries	17.9	18.9	20.1	12.6	20.6	23.3	24.2	113	88	74	71	201	124	130
<b>For the record:</b>														
OECD countries	58.0	58.7	55.2	51.6	56.7	59.5	58.7	142	83	65	105	136	116	122
APEC countries	16.2	18.9	15.9	16.1	18.5	19.1	19.8	124	96	58	113	142	113	128
Germany	12.5	12.6	13.9	11.5	13.9	14.3	14.1	128	83	77	93	149	114	123
Belarus	9.0	10.6	10.6	11.0	9.5	8.6	8.6	158	96	70	115	107	101	123
Ukraine	7.5	7.5	8.3	10.8	9.2	7.0	7.7	63	82	77	144	105	84	137
China	2.4	2.7	3.0	2.8	3.9	5.2	5.8	126	92	77	106	174	146	137
USA	7.7	9.4	7.9	8.0	7.8	6.5	5.2	140	101	58	113	121	92	99
Kazakhstan	5.2	4.3	4.6	6.5	4.8	4.2	4.3	90	69	74	157	92	96	127
Italy	5.0	4.2	3.8	3.6	4.1	4.8	4.2	113	69	64	105	141	130	108
France	3.0	3.7	4.1	3.5	3.7	4.1	4.1	126	100	77	96	130	123	124
Japan	1.9	1.9	1.5	1.7	2.1	2.1	3.3	101	83	56	125	152	113	191
Finland	3.5	3.3	3.1	2.8	3.1	3.3	3.2	112	77	66	101	134	118	122
Poland	2.6	2.4	2.0	2.1	2.3	2.8	3.0	146	77	58	119	134	135	132
UK	2.8	2.8	2.2	2.5	2.4	2.4	2.5	131	82	55	127	117	112	128
The Netherlands	2.3	2.1	2.3	2.2	2.0	2.3	2.2	119	76	75	107	114	125	118
Turkey	1.5	1.2	1.0	1.0	1.2	1.6	1.6	138	65	61	112	149	140	127
Switzerland	1.0	1.0	1.0	0.8	0.9	0.9	0.9	108	81	73	88	144	107	128
Other	32.1	30.3	30.7	29.2	29.1	29.9	29.3	121	78	70	107	123	112	122
<b>For the record:</b>														
Total imports, billion US dollars (data compiled by State Customs Committee and State Statistics Committee)	53.0	43.6	30.3	33.9	41.9	46.2	57.3							

Table 17

## RUSSIA'S FOREIGN TRADE IN SERVICES BY GROUP OF COUNTRIES IN 2002—2003 (million US dollars)

	Turnover			Exports			Imports			Balance		
	2002	2003	growth rate, %	2002	2003	growth rate, %	2002	2003	growth rate, %	2002	2003	growth rate, %
<b>Total</b>	<b>37,108</b>	<b>43,153</b>	<b>116</b>	<b>13,611</b>	<b>16,030</b>	<b>118</b>	<b>23,497</b>	<b>27,122</b>	<b>115</b>	<b>-9,886</b>	<b>-11,093</b>	<b>112</b>
of which:												
CIS countries	6,664	7,038	106	2,885	3,071	106	3,779	3,967	105	-894	-897	100
Non-CIS countries	30,444	36,114	119	10,726	12,959	121	19,718	23,155	117	-8,992	-10,196	113
EU countries	10,869	13,352	123	4,164	5,071	122	6,704	8,281	124	-2,540	-3,210	126
Central and Eastern European countries, excluding Baltic states	1,508	1,737	115	529	609	115	980	1,128	115	-451	-518	115
Baltic states	820	991	121	381	522	137	439	469	107	-58	53	—
North America	3,152	3,770	120	1,067	1,323	124	2,085	2,447	117	-1,019	-1,124	110
Other countries	10,363	11,831	114	3,795	4,539	120	6,568	7,292	111	-2,773	-2,754	99
Services not broken down into countries	3,731	4,432	119	790	895	113	2,941	3,537	120	-2,151	-2,643	123
<b>For the record:</b>												
OECD countries	18,969	23,250	123	7,023	8,424	120	11,945	14,826	124	-4,922	-6,402	130
APEC countries	5,824	6,570	113	2,161	2,544	118	3,663	4,027	110	-1,503	-1,483	99

Table 18

**STRUCTURE OF BANK OF RUSSIA CLIENTS OTHER THAN CREDIT INSTITUTIONS AND NUMBER OF ACCOUNTS OPENED FOR THEM (thousand)**

	Number of clients			Number of accounts		
	As of 1.01.2003	As of 1.01.2004	2003 change	As of 1.01.2003	As of 1.01.2004	2003 change
Total	66.4	62.7	—3.7	136.8	118.9	—17.9
Federal treasury	1.4	1.3	—0.1	5.9	5.5	—0.4
Regional and local budget managing bodies	5.3	5.3	0.0	9.1	8.8	—0.3
Organisations financed from budgets of all levels	45.7	43.4	—2.3	102.7	85.6	—17.1
Government extrabudgetary funds	4.0	2.9	—1.1	6.5	5.3	—1.2
Other organisations	10.0	9.8	—0.2	12.6	13.7	1.1

Table 19

**DOMESTIC GOVERNMENT DEBT STRUCTURE AS OF JANUARY 1, 2004 (billion rubles at par)**

Debt instruments	Total in domestic government debt	Of these, traded on organised securities market
Debt depreciation federal loan bonds (OFZ-AD)	375.4	125.4
Fixed coupon-income federal loan bonds (OFZ-FD)	199.3	163.9
Permanent coupon-income federal loan bonds (OFZ-PD)	50.5	22.6
Variable coupon-income federal loan bonds (OFZ-PK)	24.1	—
Short-term couponless government bonds (GKO)	2.7	2.7
Other debt accounted for as part of domestic government debt	29.5	—
<b>Total</b>	<b>681.5</b>	<b>314.6</b>



Table 20

**FINANCE MINISTRY DEBT TO BANK OF RUSSIA AS OF JANUARY 1, 2004 (million rubles)**

	At balance-sheet value of debt obligations
<b>Total debt</b>	<b>480,864</b>
of which:	
1. Russian government debt obligations	297,894
of which:	
— OFZ-PD, OFZ-PK and OFZ-AD received as a result of restructuring Bank of Russia-owned government securities, Vneshtorgbank shares and other debts and acquired by Bank of Russia in 1999	213,402
— Finance Ministry promissory notes	7,177
— other debt obligations	77,315
2. Bank of Russia funds transferred to Vneshekonombank for extending loans to Finance Ministry to repay and service Russian Federation government foreign debt	182,618
3. Debt on overdrafts	352
In addition, debt on first coupon income payment on OFZ-PD bonds received due to exchange of Vneshtorgbank shares pursuant to Article 108 <sup>1</sup> of 2002 Federal Budget Law	2,613

Table 21

**VOLUMES OF RESIDENT OPERATIONS WITH NON-RESIDENTS TO BUY AND SELL  
OUTSTANDING RUSSIAN GOVERNMENT FOREIGN CURRENCY DEBT OBLIGATIONS ON SECONDARY MARKET IN 2003  
(at market prices, billion US dollars)**

	Q1	Q2	Q3	Q4	2003
Eurobonds floated by open subscription	2.41	4.79	3.83	2.82	13.86
Eurobonds issued as a result of GKO restructuring	0.38	0.82	0.75	1.53	3.48
Eurobonds issued as a result of restructuring debt to London Club of commercial bank creditors	10.87	14.75	19.30	13.23	58.15
OVGVZ and OGVZ bonds of 1999 issue	5.26	5.84	3.60	5.16	19.85

Table 22

## GKO—OFZ MARKET STRUCTURE BY GROUP OF BONDHOLDERS (as of end of year, %)

	2002	2003
Dealers	74.68	73.93
Resident investors	16.74	16.40
Non-resident investors	7.01	1.17

Table 23

## INSTITUTES OF FINANCIAL INTERMEDIATION

	1.01.2004	For the record: 1.01.2003
<b>Credit institutions</b>		
Operating credit institutions, total	1,329	1,329
of which:		
— banks	1,277	1,282
— non-bank credit institutions	52	47
Operating credit institutions with foreign interest, total	128	126
Branches of credit institutions operating in Russia	3,219	3,326
Representative offices of operating Russian credit institutions, total	219	205
<b>Insurance companies*</b>		
Operating insurance companies, total	1,397	1,408
of which:		
— operating insurance companies with foreign interest	no data	48
<b>Unit investment funds**</b>		
Operating unit investment funds, total	136	60
of which:		
— open-end	87	32
— interval	35	25
— close-end	14	3
<b>Non-governmental pension funds***</b>		
Operating non-governmental pension funds, total	283	284

\* According to Finance Ministry data.

\*\* According to the National Managers' League, which has the Federal Securities Commission's permission to conduct operations as a self-regulating managers' organisation.

\*\*\* According to the Labour Ministry Inspectorate for non-governmental pension funds.

Table 24

**OUTSTANDING RUSSIAN GOVERNMENT FOREIGN CURRENCY BONDED LOANS AS OF JANUARY 1, 2004**

Date of issue	Maturity	Currency	Volume in circulation at par in original currency, million units of currency	Coupon interest rate, % p.a.
<b>Eurobonds placed by open subscription (4 issues)</b>				
25.03.1997	25.03.2004	Deutsche mark (DEM)	2,000	9
26.06.1997	26.06.2007	US dollar (USD)	2,400	10
31.03.1998	31.03.2005	Deutsche mark (DEM)	1,250	9.375
24.06.1998	26.06.2028	US dollar (USD)	2,500	12.75
<b>Eurobonds issued in restructuring GKO bonds (2 issues)</b>				
24.07.1998	25.07.2005	US dollar (USD)	2,969	8.75
24.07.1998	24.07.2018	US dollar (USD)	3,466	11
<b>Eurobonds issued in second restructuring of debt to the London Club of commercial bank creditors (2 issues)</b>				
31.03.2000	31.03.2010	US dollar (USD)	2,719	8.25
31.03.2000	29.03.2030	US dollar (USD)	19,529	5
<b>Domestic government foreign currency loan bonds (Series 5, 6, 7 OGVZ bonds) and government foreign currency loan bonds issued in 1999 (OGVZ)</b>				
14.05.1993	14.05.2008	US dollar (USD)	2,837	3
14.05.1996	14.05.2006	US dollar (USD)	1,750	3
14.05.1996	14.05.2011	US dollar (USD)	1,750	3
1.02.2000	14.11.2007	US dollar (USD)	887	3

Table 25

## RUSSIA'S BALANCE OF PAYMENTS FOR 2003 (analytical presentation, million US dollars)

	Q1	Q2	Q3	Q4	2003	For the record: 2002
<b>Current account</b>	<b>11,619</b>	<b>8,513</b>	<b>8,423</b>	<b>7,350</b>	<b>35,905</b>	<b>29,116</b>
Balance of trade	15,250	13,643	15,542	16,059	60,493	46,335
<i>Exports</i>	<i>31,080</i>	<i>31,749</i>	<i>34,945</i>	<i>38,156</i>	<i>135,929</i>	<i>107,301</i>
crude oil	9,346	8,378	10,958	10,998	39,679	29,113
petroleum products	3,594	3,333	3,706	3,427	14,060	11,253
natural gas	5,411	4,814	4,305	5,452	19,981	15,897
other	12,730	15,224	15,977	18,279	62,209	51,037
<i>Imports</i>	<i>-15,830</i>	<i>-18,106</i>	<i>-19,403</i>	<i>-22,097</i>	<i>-75,436</i>	<i>-60,966</i>
Balance of services	-2,069	-2,203	-3,569	-3,252	-11,093	-9,886
<i>Exports</i>	<i>3,054</i>	<i>3,981</i>	<i>4,700</i>	<i>4,295</i>	<i>16,030</i>	<i>13,611</i>
transport services	1,233	1,582	1,653	1,651	6,119	5,487
travel	737	1,085	1,680	999	4,502	4,167
other services	1,084	1,313	1,366	1,646	5,409	3,956
<i>Imports</i>	<i>-5,123</i>	<i>-6,184</i>	<i>-8,269</i>	<i>-7,547</i>	<i>-27,122</i>	<i>-23,497</i>
transport services	-626	-722	-843	-911	-3,103	-2,836
travel	-2,293	-2,892	-4,511	-3,183	-12,880	-11,283
other services	-2,204	-2,569	-2,914	-3,452	-11,139	-9,377
Wage balance	28	-18	-34	-119	-144	197
Balance of investment incomes (interest, dividends)	-1,434	-2,838	-3,287	-5,428	-12,988	-6,780
Income receivable	2,064	973	760	877	4,674	4,973
Income payable	-3,498	-3,812	-4,047	-6,306	-17,662	-11,753
<i>Federal government</i>	<i>-694</i>	<i>-477</i>	<i>-1,587</i>	<i>-638</i>	<i>-3,396</i>	<i>-3,422</i>
Income receivable	1,336	308	105	104	1,853	2,614
Income payable	-2,031	-784	-1,692	-742	-5,250	-6,036
<i>Regional and local governments (income payable)</i>	<i>-6</i>	<i>-55</i>	<i>-4</i>	<i>-52</i>	<i>-116</i>	<i>-84</i>
<i>Monetary authorities</i>	<i>191</i>	<i>226</i>	<i>212</i>	<i>234</i>	<i>863</i>	<i>637</i>
Income receivable	239	267	249	269	1,023	870
Income payable	-48	-40	-37	-35	-160	-233

Cont.

	Q1	Q2	Q3	Q4	2003	For the record: 2002
<i>Banks</i>	—53	—49	—91	—44	—238	—39
Income receivable	172	193	144	230	738	565
Income payable	—225	—242	—235	—274	—976	—604
<i>Non-financial enterprises</i>	—872	—2,484	—1,816	—4,928	—10,101	—3,872
Income receivable	317	206	262	275	1,060	924
Income payable	—1,189	—2,690	—2,078	—5,203	—11,160	—4,796
Balance of current transfers	—155	—70	—229	91	—363	—750
<b>Capital and financial accounts</b>	<b>—2,449</b>	<b>1,157</b>	<b>—7,681</b>	<b>6,633</b>	<b>—2,340</b>	<b>—11,240</b>
<b>Capital account (capital transfers)</b>	<b>40</b>	<b>—560</b>	<b>—119</b>	<b>—354</b>	<b>—993</b>	<b>—12,388</b>
<b>Financial account (except reserve assets)</b>	<b>—2,489</b>	<b>1,717</b>	<b>—7,563</b>	<b>6,987</b>	<b>—1,347</b>	<b>1,148</b>
<b>Liabilities (+ signifies increase, — signifies decrease)</b>	<b>2,419</b>	<b>3,240</b>	<b>4,722</b>	<b>10,700</b>	<b>21,081</b>	<b>3,277</b>
<i>Federal government</i>	—2,431	—3,464	—1,125	1,822	—5,197	—11,870
Portfolio investments (debt securities)	—917	—2,956	87	2,169	—1,617	167
issue	22	6	0	0	28	1,457
maturity (schedule)	—684	—3,284	—578	—343	—4,889	—2,388
principal amounts	—28	—2,831	—76	—124	—3,058	—298
coupons	—656	—453	—503	—220	—1,831	—2,090
reinvestment of income	620	566	504	509	2,200	2,690
secondary market	—875	—245	161	2,003	1,044	—1,592
Loans	—1,294	—552	—1,293	—457	—3,595	—9,596
disbursement	165	146	181	293	785	673
maturity (schedule)	—1,934	—697	—1,500	—750	—4,881	—11,944
restructuring	475	0	27	0	501	1,675
Overdue debt	—243	39	75	99	—30	—2,451
accumulation	61	47	95	104	308	1,096
repayment/restructuring	—304	—8	—20	—6	—338	—3,547
Other liabilities	23	5	6	11	45	9
<i>Regional and local governments</i>	—23	—63	41	54	9	—69
<i>Monetary authorities</i>	256	—424	496	—594	—265	—2,767
IMF loans	—416	—458	—549	—478	—1,902	—1,494
Other liabilities	672	35	1,045	—116	1,636	—1,273

End

	Q1	Q2	Q3	Q4	2003	For the record: 2002
<i>Banks</i>	641	2,740	1,898	5,968	11,248	3,636
Direct investments	150	92	47	215	503	291
Loans and deposit accounts	690	2,350	2,460	5,749	11,249	2,797
Other liabilities	—199	299	—609	5	—504	547
<i>Non-financial enterprises</i>	3,975	4,450	3,412	3,449	15,287	14,348
Direct investments	1,242	1,568	—611	—1,557	641	3,170
Portfolio investments	—497	—86	—684	842	—425	2,824
Loans	3,228	2,967	4,707	4,226	15,128	8,334
Other liabilities	2	1	0	—61	—58	19
<b>Assets, except reserve assets (+ signifies decrease, — signifies increase)</b>	<b>—4,908</b>	<b>—1,522</b>	<b>—12,285</b>	<b>—3,713</b>	<b>—22,429</b>	<b>—2,129</b>
<i>Federal government</i>	—1,293	187	105	403	—598	16,990
Loans	478	827	322	419	2,045	—1,254
Overdue debt	—1,812	—641	—218	13	—2,659	16,002
Other assets	42	1	1	—28	16	2,242
<i>Monetary authorities</i>	—246	—58	—1,713	1,486	—532	671
<i>Banks</i>	219	645	—4,208	2,392	—952	—1,107
Direct investments	—8	80	—25	3	51	26
Loans and deposit accounts	1,585	611	—4,199	2,436	433	—258
Other assets	—1,359	—47	16	—47	—1,436	—875
<i>Non-financial enterprises and households</i>	—3,588	—2,296	—6,468	—7,994	—20,347	—18,683
Direct and portfolio investments	—896	—1,468	—1,112	—1,067	—4,544	—3,516
Foreign currency cash	791	3,073	1,145	1,570	6,580	—817
Commercial loans and advance payments	—41	723	—2,009	—2,685	—4,012	—1,697
Debt on commodity deliveries under intergovernmental agreements	89	37	31	9	165	—197
Unreturned proceeds from exports, undelivered goods and services in return for money transferred under import contracts, transfers on fictitious operations with securities	—3,357	—3,977	—3,612	—4,488	—15,435	—12,244
Other assets	—174	—684	—911	—1,332	—3,101	—212
<b>Net errors and omissions</b>	<b>—1,580</b>	<b>—1,619</b>	<b>—3,364</b>	<b>—636</b>	<b>—7,199</b>	<b>—6,501</b>
<b>Change in foreign exchange reserves (+ signifies decrease, — signifies increase)</b>	<b>—7,589</b>	<b>—8,052</b>	<b>2,623</b>	<b>—13,347</b>	<b>—26,365</b>	<b>—11,375</b>

Table 26

**STRUCTURE OF FOREIGN INVESTMENT IN RUSSIA IN 2003 (billion US dollars)\***

Type of investment	Q1	Q2	Q3	Q4	2003	For the record**:	
						2003	2002
Direct	1.4	1.7	-0.6	-1.3	1.1	1.1	3.5
Portfolio	-1.8	-2.7	-1.1	3.3	-2.3	-2.3	2.4
Financial derivatives	0.0	-0.1	-0.1	-0.1	-0.4	-0.4	-0.1
Other	2.8	4.4	6.6	8.9	22.7	22.9	4.6
<b>Total</b>	<b>2.4</b>	<b>3.2</b>	<b>4.7</b>	<b>10.7</b>	<b>21.1</b>	<b>21.4</b>	<b>10.4</b>

\* Net increment of debt obligations to non-residents according to balance of payments data. — signifies decrease in residents' foreign liabilities.

\*\* These data do not take account of debt forgiveness and netting operations.

Table 27

**STRUCTURE OF RUSSIAN RESIDENT INVESTMENT IN FOREIGN ASSETS (NET OF RESERVE ASSETS) IN 2003 (billion US dollars)\***

Type of investment	Q1	Q2	Q3	Q4	2003	For the record**:	
						2003	2002
Direct	0.6	1.2	1.2	1.2	4.1	4.1	3.5
Portfolio	1.7	0.1	1.1	-0.4	2.5	2.5	0.8
Financial derivatives	-0.1	-0.1	-0.2	-0.5	-1.0	-1.0	-0.1
Other	2.7	0.3	10.3	3.4	16.8	17.4	16.9
<b>Total</b>	<b>4.9</b>	<b>1.5</b>	<b>12.3</b>	<b>3.7</b>	<b>22.4</b>	<b>23.1</b>	<b>21.1</b>

\* Net increment of non-residents' assets according to balance of payments data. — signifies decrease in residents' foreign assets.

\*\* These data do not take account of debt forgiveness and netting operations.

Table 28

**RUSSIAN BANKING SECTOR'S INTERNATIONAL INVESTMENT POSITION**  
(as of January 1, 2003, and January 1, 2004, million US dollars)

	Balance as of 1.01.2003	Changes as a result of operations	Changes as a result of revaluation	Other changes	Total changes	Balance as of 1.01.2004
<b>Assets</b>	<b>19,532</b>	<b>951</b>	<b>1,183</b>	<b>-175</b>	<b>1,960</b>	<b>21,491</b>
<b>Direct investment abroad</b>	<b>679</b>	<b>-51</b>	<b>44</b>	<b>-1</b>	<b>-9</b>	<b>670</b>
Participation in capital and reinvested income	321	64	68	-1	131	452
Other capital	358	-115	-25	0	-140	218
<b>Portfolio investment</b>	<b>1,057</b>	<b>686</b>	<b>155</b>	<b>-92</b>	<b>749</b>	<b>1,806</b>
Participation in capital	7	21	-4	0	17	24
Debt securities	1,050	665	158	-92	732	1,782
long-term	840	304	231	156	691	1,531
short-term	210	360	-72	-248	40	251
Financial derivatives	...	-520	575	0	55	55
<b>Other investment</b>	<b>17,796</b>	<b>837</b>	<b>410</b>	<b>-82</b>	<b>1,165</b>	<b>18,961</b>
Foreign currency cash and deposit accounts	12,479	-450	322	-8	-136	12,343
Foreign currency cash in tills	1,188	669	44	-3	710	1,898
Current and deposit accounts	11,291	-1,118	278	-5	-846	10,445
long-term	278	-115	1	0	-114	164
short-term	11,013	-1,003	277	-5	-731	10,282
Loans	4,521	684	73	-9	748	5,269
long-term	1,803	536	9	-9	536	2,339
short-term	2,718	148	64	0	212	2,930
Overdue debt	167	40	3	-33	10	177
Other assets	628	562	13	-31	544	1,172
long-term	9	8	1	-5	4	14
short-term	619	554	12	-27	539	1,158



	Balance as of 1.01.2003	Changes as a result of operations	Changes as a result of revaluation	Other changes	Total changes	Balance as of 1.01.2004
<b>Liabilities</b>	<b>16,012</b>	<b>11,248</b>	<b>1,083</b>	<b>—829</b>	<b>11,502</b>	<b>27,514</b>
<b>Direct investment in Russia</b>	<b>1,267</b>	<b>503</b>	<b>86</b>	<b>—17</b>	<b>573</b>	<b>1,839</b>
Participation in capital and reinvested income	1,202	471	86	—16	541	1,744
Other capital	64	32	0	—1	31	96
<b>Portfolio investment</b>	<b>2,420</b>	<b>—424</b>	<b>207</b>	<b>—84</b>	<b>—301</b>	<b>2,119</b>
Participation in capital	652	56	178	15	249	901
Debt securities	1,768	—480	29	—98	—550	1,218
long-term	732	—214	20	—98	—292	440
short-term	1,036	—266	8	0	—258	778
Financial derivatives	...	—377	408	0	31	31
<b>Other investment</b>	<b>12,326</b>	<b>11,546</b>	<b>383</b>	<b>—730</b>	<b>11,199</b>	<b>23,525</b>
Current and deposit accounts	5,984	3,736	198	—283	3,651	9,635
long-term	818	526	18	—11	534	1,352
short-term	5,166	3,210	180	—272	3,117	8,283
Loans	5,256	7,514	193	—16	7,691	12,946
long-term	2,706	3,536	138	1	3,675	6,381
short-term	2,550	3,978	55	—16	4,016	6,566
Overdue debt	375	—4	0	—366	—370	5
Other liabilities	711	300	—8	—65	227	938
long-term	77	—24	14	0	—11	67
short-term	634	325	—22	—65	237	871
<b>Net international investment position</b>	<b>3,520</b>	<b>—10,297</b>	<b>100</b>	<b>655</b>	<b>—9,542</b>	<b>—6,023</b>

## Notes.

1. + denotes net growth in assets and liabilities, — denotes their net decrease. This use of the sign differs from its use in balance of payments statistics.
2. This table presents data compiled by credit institutions, including Vneshekonombank. It does not comprise data on operations with government foreign debt and government foreign assets conducted by Vneshekonombank as the Russian Government's agent.
3. "Other changes" include assets and liabilities of credit institutions which had their banking licences revoked in the period under review.

Table 29

## RUSSIAN BANKING SECTOR FOREIGN ASSETS AND LIABILITIES ON INTERBANK OPERATIONS BY GROUP OF COUNTRIES AS OF JANUARY 1, 2004 (million US dollars)

	Foreign assets			Foreign liabilities			Balance of foreign assets and liabilities
	short-term	long-term	total	short-term	long-term	total	
<b>Total</b>	<b>13,141.6</b>	<b>538.9</b>	<b>13,680.5</b>	<b>9,604.7</b>	<b>6,671.5</b>	<b>16,276.2</b>	<b>—2,595.8</b>
of which:							
CIS countries	578.5	13.8	592.3	868	65.9	933.9	—341.6
Non-CIS countries	12,563.1	525.1	13,088.2	8,736.8	6,605.6	15,342.3	—2,254.1
EU countries	4,591.3	422.7	5,014.1	5,139.8	5,421.6	10,561.4	—5,547.3
Central and Eastern European countries (excluding Baltic states)	109.7	60.0	169.7	345.0	244.8	589.8	—420.1
Baltic states	133.9	0.3	134.3	647.9	20.2	668.1	—533.8
North America	5,623.2	1.5	5,624.7	194.1	167.2	361.4	5,263.3
Other countries	2,088.5	40.6	2,129.1	2,394.6	751.7	3,146.40	—1,017.3
International financial organisations	16.4	0.0	16.4	15.3	0.0	15.3	1.1
<b>For the record:</b>							
OECD countries	10,909.7	519.2	11,428.9	5,769.2	5,919.2	11,688.4	—259.5
APEC countries	5,763.2	6.5	5,769.6	285.7	227.2	512.9	5,256.7

Note.

Data in the above table only include balances on interbank operations in the form of loans, deposit and correspondent accounts and foreign currency cash in credit institutions' tills.

Table 30

## DYNAMICS OF RUSSIAN DEBT TO INTERNATIONAL FINANCIAL ORGANISATIONS IN 2003 (billion US dollars)

Financing facility	Debt as of 1.01.2003	Used	Repaid	Growth due to exchange rate revaluation	Debt as of 1.01.2004
<b>IMF loans:</b>	<b>6.5</b>	<b>0.0</b>	<b>1.9</b>	<b>0.5</b>	<b>5.1</b>
Systemic Transformation Facility	0.5	0.0	0.4	0.0	0.1
Extended Fund Facility	5.4	0.0	1.2	0.4	4.7
Standby Loan	0.6	0.0	0.3	0.0	0.3
<b>IBRD loans</b>	<b>6.6</b>	<b>0.2</b>	<b>0.7</b>	<b>0.2</b>	<b>6.3</b>
<b>EBRD loans</b>	<b>0.2</b>	<b>0.1</b>	<b>0.0</b>	<b>0.0</b>	<b>0.3</b>

Table 31

## DYNAMICS OF RUSSIA'S INTERNATIONAL RESERVES IN 2003 (million US dollars)

Indicator	Balance as of												
	2003												2004
	1.01	1.02	1.03	1.04	1.05	1.06	1.07	1.08	1.09	1.10	1.11	1.12	1.01
Reserve assets (including Finance Ministry assets)	47,793	49,274	53,061	55,525	59,847	64,882	64,430	64,454	62,752	62,073	64,928	68,169	76,938
Foreign exchange assets	44,054	45,534	49,326	51,790	56,111	61,144	60,691	60,710	59,011	58,330	61,183	64,415	73,175
Monetary gold*	3,739	3,740	3,735	3,735	3,736	3,738	3,739	3,744	3,741	3,743	3,744	3,754	3,763

\* Monetary gold is accounted for at US\$300 per troy oz.

Table 32

## MAJOR RUBLE EXCHANGE RATE DYNAMICS INDICATORS IN 2003

	January	February	March	April	May	June	July	August	September	October	November	December	2003
US dollar/ruble nominal rate at end of period, rubles per dollar	31.82	31.58	31.38	31.1	30.71	30.35	30.26	30.50	30.61	29.86	29.74	29.45	29.45
US dollar/ruble average nominal rate for period, rubles per dollar	31.82	31.70	31.45	31.21	30.92	30.48	30.36	30.35	30.6	30.16	29.81	29.44	30.68
Euro/ruble average nominal rate for period, rubles per euro	33.81	34.21	33.90	33.87	35.65	35.63	34.55	33.88	34.26	35.29	34.91	36.11	34.66
<b>Increment as % of previous period*</b>													
Ruble/US dollar nominal rate	0.1	0.4	0.8	0.8	1.0	1.4	0.4	0.0	-0.8	1.4	1.2	1.3	2.2
Ruble/US dollar real rate	2.0	1.2	1.3	2.0	1.9	2.1	1.0	-0.7	-0.8	2.6	2.5	2.5	13.6
Ruble/euro real rate	-1.8	0.0	1.4	1.0	-4.2	0.8	3.8	1.4	-1.0	-2.0	2.1	-2.5	-4.7
Effective real ruble rate	-0.7	0.6	1.7	1.1	-2.1	1.1	2.5	0.7	-1.2	-0.6	1.7	-0.9	0.8
<b>Increment as % of same period of 2002*</b>													
Ruble/US dollar nominal rate	-4.2	-2.8	-1.2	-0.1	1.1	3.0	3.8	4.0	3.4	5.1	6.7	8.1	2.2
Ruble/US dollar real rate	6.7	8.3	10.1	12.1	12.6	15.0	15.8	15.4	14.5	16.6	18.0	18.9	13.6
Ruble/euro real rate	-10.3	-11.9	-9.7	-8.1	-10.0	-5.9	1.5	1.4	0.9	-1.8	0.7	-1.1	-4.7
Real effective ruble rate	-4.4	-4.6	-2.4	-0.7	-2.1	0.5	4.5	4.6	3.8	2.6	4.6	4.1	0.8
<b>Increment as % of December 2002*</b>													
Ruble/US dollar nominal rate	0.1	0.4	1.2	2.0	3.0	4.5	4.9	4.9	4.1	5.6	6.8	8.1	
Ruble/US dollar real rate	2.0	3.2	4.6	6.7	8.7	11.0	12.1	11.3	10.4	13.2	16.0	18.9	
Ruble/euro real rate	-1.8	-1.8	-0.4	0.6	-3.6	-2.8	0.9	2.3	1.4	-0.6	1.4	-1.1	
Real effective ruble rate	-0.7	-0.1	1.6	2.7	0.6	1.7	4.2	5.0	3.9	3.3	5.1	4.1	

\* + signifies appreciation of the Russian ruble against foreign currencies, — signifies depreciation of the Russian ruble against foreign currencies.

Table 33

## RUSSIA'S FOREIGN DEBT IN 2003 (owed to non-residents in billion US dollars)

	1.01.2003	1.04.2003	1.07.2003	1.10.2003	1.01.2004
<b>Total</b>	<b>153.2</b>	<b>155.4</b>	<b>160.1</b>	<b>166.7</b>	<b>182.1</b>
<b>General government</b>	<b>97.7</b>	<b>96.2</b>	<b>95.1</b>	<b>94.4</b>	<b>99.2</b>
<b>Federal government</b>	<b>96.7</b>	<b>95.1</b>	<b>94.0</b>	<b>93.3</b>	<b>97.9</b>
<i>New Russian debt</i>	<i>41.0</i>	<i>39.9</i>	<i>38.0</i>	<i>37.9</i>	<i>39.8</i>
loans from international financial organisations*	6.8	6.7	6.7	6.6	6.6
<i>IBRD</i>	<i>6.6</i>	<i>6.5</i>	<i>6.4</i>	<i>6.3</i>	<i>6.3</i>
<i>other</i>	<i>0.2</i>	<i>0.2</i>	<i>0.2</i>	<i>0.2</i>	<i>0.3</i>
other loans (including loans from members of the Paris Club of creditor nations)	5.7	5.3	5.1	5.0	4.9
foreign currency-denominated securities	26.7	26	24.5	24.6	26.8
<i>eurobonds placed by open subscription</i>	<i>7.1</i>	<i>7.1</i>	<i>5.7</i>	<i>5.4</i>	<i>5.7</i>
<i>eurobonds issued in restructuring GKO</i>	<i>1.4</i>	<i>1.3</i>	<i>1.3</i>	<i>1.4</i>	<i>2.0</i>
<i>eurobonds issued in 2nd restructuring of debt to the London Club of commercial bank creditors</i>	<i>16.3</i>	<i>15.9</i>	<i>15.8</i>	<i>16.0</i>	<i>16.8</i>
<i>6th and 7th tranches of OVGZ bonds and OGVZ bonds issued in 1999</i>	<i>1.8</i>	<i>1.6</i>	<i>1.7</i>	<i>1.8</i>	<i>2.4</i>
ruble-denominated securities (GKO and OFZ bonds)	0.5	0.5	0.4	0.3	0.1
other debt	1.3	1.3	1.4	1.3	1.4
<b>Soviet-era debt</b>	<b>55.7</b>	<b>55.2</b>	<b>56.0</b>	<b>55.5</b>	<b>58.1</b>
loans from members of the Paris Club of creditor nations	39.2	39.3	41.0	40.2	42.7
debt to former socialist countries	4.2	3.9	3.8	3.6	3.6
3rd, 4th and 5th tranches of OVGZ bonds	2.2	2.0	0.9	1.3	1.4
other debt	10.2	10.1	10.2	10.3	10.4
<b>Regional and local governments</b>	<b>1.1</b>	<b>1.1</b>	<b>1.1</b>	<b>1.1</b>	<b>1.2</b>
loans	0.9	0.9	1.0	0.9	1.0
foreign currency-denominated securities	0.1	0.1	0.1	0.1	0.1
<i>eurobonds</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>
ruble-denominated securities	0.0	0.0	0.0	0.1	0.2

End

	1.01.2003	1.04.2003	1.07.2003	1.10.2003	1.01.2004
<b>Monetary authorities</b>	<b>7.5</b>	<b>7.9</b>	<b>7.6</b>	<b>8.2</b>	<b>7.8</b>
loans	7.3	7.6	7.3	7.9	7.5
<i>IMF**</i>	6.5	6.1	5.8	5.3	5.1
<i>other***</i>	0.8	1.5	1.5	2.5	2.4
cash rubles and deposit accounts	0.2	0.3	0.3	0.3	0.4
<b>Banks (without participation in capital)****</b>	<b>14.2</b>	<b>13.9</b>	<b>16.8</b>	<b>18.7</b>	<b>24.8</b>
debt obligations to direct investors	0.1	0.1	0.1	0.1	0.1
loans	5.3	5.7	7.1	7.9	12.9
current and deposit accounts	6.0	5.9	7.1	8.7	9.6
debt securities	1.8	1.3	1.6	1.0	1.2
other debt	1.1	0.9	0.9	1.0	0.9
<b>Non-financial enterprises (without participation in capital)</b>	<b>33.8</b>	<b>37.5</b>	<b>40.6</b>	<b>45.4</b>	<b>50.3</b>
loans received by direct investment enterprises	6.0	6.8	7.1	7.4	7.7
debt on financial lease	1.3	1.3	1.3	1.3	1.3
debt securities	1.6	1.2	0.9	0.7	0.7
other loans	24.8	28.2	31.3	36.0	40.5

\* *IMF loans are accounted for as part of the monetary authorities' obligations.*

\*\* *General government debt to the IMF.*

\*\*\* *Funds received by the Bank of Russia from non-resident banks through repo transactions.*

\*\*\*\* *These data include debt obligations of credit institutions, including Vneshekonombank. Foreign debt accounted for by Vneshekonombank as the Russian Government's agent is shown as part of general government debt obligations.*

*Note.*

*These data include foreign debt denominated in national and foreign currency. Government securities are accounted for as part of the debt owed to non-residents and evaluated at their face value.*

Table 3A

## MAJOR ECONOMIC DEVELOPMENT INDICATORS FOR FOREIGN COUNTRIES IN 2001—2003\*

	Real GDP, % growth on previous year			Consumer prices, growth as % of previous year			Current account balance, as % of GDP**			International reserves, billion US dollars***		
	2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003
USA	0.5	2.2	3.1	2.8	1.6	2.3	-3.9	-4.6	-4.9	57.6	68.0	74.9
Canada	1.9	3.3	1.7	2.6	2.2	2.8	2.4	2.0	2.1	34.0	37.0	36.2
Japan	0.4	-0.3	2.7	-0.7	-0.9	-0.3	2.1	2.8	3.2	395.2	461.2	663.3
European Union****	1.7	1.1	0.8	2.2	2.1	2.0	-0.3	0.6	0.2	—	—	—
United Kingdom*****	2.1	1.7	2.3	2.1	2.2	2.8	-2.4	-1.7	-1.7	37.3	39.4	41.9
Economic and Monetary Union*****	1.6	0.9	0.4	2.3	2.3	2.1	-0.2	0.9	0.4	234.5	246.5	222.7
Germany*****	0.8	0.2	-0.1	1.9	1.3	1.0	0.2	2.8	2.4	51.3	51.2	50.7
France*****	2.1	1.2	0.2	1.8	1.9	2.2	1.7	1.8	0.8	31.7	28.4	30.2
Italy*****	1.8	0.4	0.3	2.3	2.6	2.8	-0.1	-0.6	-0.9	24.4	28.6	30.4
Hong Kong	0.5	2.3	3.3	-1.6	-3.0	-2.6	6.1	8.5	11.0	111.2	111.9	118.4
Singapore	-1.9	2.2	1.1	1.0	-0.4	0.5	18.7	21.4	30.9	75.4	82.0	95.7
Taiwan	-2.2	3.6	3.2	0.0	-0.2	-0.3	6.4	9.1	10.0	122.2	161.7	206.6
South Korea	3.8	7.0	3.1	4.1	2.8	3.5	1.7	1.0	2.0	102.8	121.3	155.3
China	7.5	8.0	9.1	0.7	-0.8	1.1	1.5	2.8	2.1	215.6	291.1	425.4
Indonesia	3.5	3.7	4.1	11.5	11.9	6.6	4.8	4.5	3.9	27.2	31.0	35.0
Malaysia	0.3	4.1	5.2	1.4	1.8	1.1	8.3	7.6	11.1	30.5	34.2	44.5
Thailand	2.1	5.4	6.7	1.7	0.6	1.8	5.4	5.5	5.6	32.4	38.0	41.1
Philippines	3.0	4.4	4.5	6.1	3.1	3.1	1.9	5.5	2.1	13.4	13.1	13.5
Australia	2.5	3.8	3.0	4.4	3.0	2.8	-2.4	-4.3	-6.0	18.0	20.7	32.2
South Africa	2.7	3.6	1.9	5.7	9.2	5.8	-0.3	0.3	-1.2	6.0	5.9	6.5
Israel	-0.9	-0.8	1.3	1.1	5.7	0.7	-1.6	-1.3	-0.2	23.4	24.1	26.3
Argentina	-4.4	-10.9	8.7	-1.1	25.9	13.4	-1.6	10.5	5.7	14.6	10.5	14.2
Brazil	1.3	1.9	-0.2	6.8	8.5	14.7	-4.6	-1.7	0.8	35.7	37.7	49.1
Mexico	-0.2	0.7	1.3	6.4	5.0	4.5	-2.9	-2.2	-1.5	44.7	50.6	59.0

End

	Real GDP, % growth on previous year			Consumer prices, growth as % of previous year			Current account balance, as % of GDP**			International reserves, billion US dollars***		
	2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003
Chile	3.4	2.2	3.3	3.6	2.5	2.8	-1.6	-1.3	-0.8	14.4	15.3	15.8
Turkey	-7.5	7.9	5.8	54.4	45.0	25.3	2.2	-0.8	-2.9	18.9	27.1	34.0
Hungary	3.8	3.5	2.9	9.2	5.3	4.7	-3.3	-4.1	-5.5	10.7	10.3	12.7
Poland	1.0	1.4	3.7	5.5	1.9	0.8	-2.9	-2.6	-2.0	25.6	28.6	32.6
Czech Republic	3.1	2.0	2.9	4.7	1.8	0.1	-5.7	-6.1	-6.5	14.3	23.6	26.8
Belarus	4.7	5.0	6.8	61.1	42.6	28.4	-3.5	-2.6	-2.6	0.4	0.6	0.6
Ukraine	9.2	5.2	9.3	12.0	0.8	5.2	3.7	7.5	6.0	3.0	4.2	6.7
Moldova	6.1	7.8	6.3	9.8	5.3	11.7	-4.9	-6.0	-7.9	0.2	0.3	0.3
Kazakhstan	13.5	9.5	9.5	8.3	5.9	6.4	-4.0	-2.8	2.4	2.0	2.6	4.2
Armenia	9.6	12.9	12.0	3.1	1.1	4.8	-10.0	-6.6	-7.7	0.3	0.4	0.5
Georgia	4.7	5.5	8.6	4.7	5.6	4.8	-6.5	-6.0	-7.9	0.2	0.2	0.2
Azerbaijan	9.9	10.6	11.2	1.5	2.8	2.2	-0.9	-12.3	-25.8	0.9	0.7	0.8
Kyrgyzstan	5.4	0.0	5.2	6.9	2.1	2.7	-3.3	-3.9	-3.5	0.3	0.3	0.4
Tajikistan	10.2	9.1	10.2	38.6	12.2	16.4	-7.1	-2.7	-1.3	0.1	0.1	0.1
Uzbekistan	4.1	3.2	0.3	47.5	44.3	14.8	-1.0	2.5	7.0	no data	no data	no data

\* According to official sources of statistical information of the corresponding countries, the EUROSTAT agency and IMF as of April 30, 2004.

\*\* + denotes a surplus, — denotes a deficit.

\*\*\* As of end of year (China and Belarus as of November 2003); including monetary authorities' foreign currency assets and SDRs and reserve position in the IMF (a country's reserve share and credit position in the IMF).

\*\*\*\* Austria, Belgium, the United Kingdom, Germany, Greece, Denmark, Ireland, Spain, Italy, Luxembourg, the Netherlands, Portugal, Finland, France and Sweden.

Consumer prices are shown as the harmonised consumer price index. Current account balance is based on IMF data.

\*\*\*\*\* Consumer price increment excluding mortgage interest; unemployment rate is according to ILO methodology.

\*\*\*\*\* Austria, Belgium, Germany, Greece, Ireland, Spain, Italy, Luxembourg, the Netherlands, Portugal, Finland and France. Consumer prices are the harmonised consumer price index. Current account balance is based on ECB data.

\*\*\*\*\* Consumer prices are the harmonised consumer price index.



Table 35

## MAJOR MONEY AND CREDIT INDICATORS FOR CIS COUNTRIES IN 2003\*

	Azerbaijan	Armenia	Belarus	Georgia	Kazakhstan	Kyrgyzstan	Moldova	Russia	Tajikistan	Turkmenistan	Ukraine
Official central (national) bank rate (refinancing rate), as of end of year, %:											
2002	7	13.5	38	22.4	7.5	4.43	—	21	20	12	7.1
2003	7	7.0	28	18.7	7.0	3.97	—	16	15	10	7.0
Official (central bank) exchange rate (units of national currency) as of end of year											
against US dollar:											
2002	4,893	584.89	1,920	2.09	155.60	46.0949	13.8220	31.7844	3.0000	5,200	5.3324
2003	4,923	566.00	2,156	2.075	144.22	44.1902	13.2215	29.4545	2.9565	5,200	5.3315
against Russian ruble:											
2002	153.94	18.28	60.41	0.0658	4.89	1.4499	0.4329	—	0.09437	163.54	0.168
2003	167.14	19.22	73.19	0.0704	4.93	1.5110	0.4493	—	0.10109	176.54	0.181
Money supply in national currency (rate of increment by beginning of year, %)	28.0	6.8	71.0	14.1	38.9	33.5	24.4	50.5	36.3	—	46.9
Interbank rate on loans in national currency	18.0	6.3	30.4	20.0	5.26	—	16.28	1.4	14.20	6.9	9.3
Yield on government debt instruments	6.53	9.68	26.5	42.59	6.18	3.79	17.64	7.81	—	—	10.94
Interest rate on loans denominated in national currency:											
short-term loans	17.01	20.93	31.0	25.89	14.90	22.29	19.11	12.4	20.47	—	18.3
long-term loans	11.16	15.38	12.4	19.20	14.95	22.76	19.53	13.6	18.25	—	15.6

End

	Azerbaijan	Armenia	Belarus	Georgia	Kazakhstan	Kyrgyzstan	Moldova	Russia	Tajikistan	Turkmenistan	Ukraine
Interest rate on household deposit accounts in national currency:											
demand deposit accounts	1.16	2.0	4.0	2.2	0.9	0.34	5.2	0.5	0.0	—	3.7
short-term deposit accounts	12.58	8.66	23.7	10.74	8.24	8.39	15.44	11.0	16.01	—	15.5
long-term deposit accounts	8.49	8.88	27.1	13.40	12.95	11.80	17.19	11.1	17.36	—	16.9
Number of registered commercial banks:											
2002	46	25	32	25	38	20	16	1,773	17	13	182
2003	46	21	34	22	36	21	16	1,612	19	12	179

\* According to official CIS sources of statistical information.

*Notes.*

1. The financial market indicators for Russia have been calculated as weighted averages for December 2003. The interbank interest rate on loans in the national currency has been calculated on the basis of overnight loans. The yield on government securities is the average monthly GKO—OFZ market portfolio indicator; interest rates on long-term deposit accounts and loans in the national currency have been calculated for terms longer than 1 year (including the Savings Bank [Sberbank]).
2. The interbank lending rates in CIS countries have been calculated as follows: 180 days in Azerbaijan, 15 to 360 days in Armenia, 1 day in Belarus and Ukraine, up to 30 days in Kazakhstan, and all terms in Georgia, Kyrgyzstan, Moldova, Tajikistan and Turkmenistan. The yields on government securities in Azerbaijan and Kyrgyzstan have been calculated on the basis of papers with a term of 3 months, Armenia 9—12 months, Belarus all terms up to one year, Kazakhstan 60 days, Moldova and Ukraine all terms.

Table 36

**MONEY SUPPLY (national definition, billion rubles)**

Indicator	1.01.2003	1.04.2003	1.07.2003	1.10.2003	1.01.2004
Money supply (M2), total	2,134.5	2,226.4	2,626.8	2,752.8	3,212.7
cash in circulation (M0)*	763.2	749.5	917.0	957.1	1,147.0
non-cash funds	1,371.2	1,476.9	1,709.8	1,795.7	2,065.6

\* Cash in circulation outside the banking system.

Table 37

**AVERAGE MONTHLY MONEY SUPPLY GROWTH RATES IN 2003 (%)**

Indicator	Q1	Q2	Q3	Q4	Full-year
Money supply (M2), total	1.4	5.7	1.6	5.3	3.5
cash in circulation (M0)*	-0.6	7.0	1.4	6.2	3.5
non-cash funds	2.5	5.0	1.6	4.8	3.5

\* Cash in circulation outside the banking system.

Table 38

**M2 STRUCTURE**

Indicator	1.01.2003		1.01.2004		Growth index for 2003
	billion rubles	%	billion rubles	%	
Money supply (M2), total	2,134.5	100.0	3,212.7	100.0	1.51
of which:					
cash in circulation (M0)*	763.2	35.8	1,147.0	35.7	1.50
non-cash funds	1,371.2	64.2	2,065.6	64.3	1.51
of which:					
non-financial institutions' funds	711.4	33.3	978.0	30.4	1.37
household deposits	659.8	30.9	1,087.6	33.9	1.65

\* Cash in circulation outside the banking system.

Table 39

## MONETARY BASE AND ITS STRUCTURE

Indicator	1.01.2003		1.01.2004		Growth index for 2003
	billion rubles	%	billion rubles	%	
Monetary base (broad money)	1,232.6	100.0	1,914.3	100.0	1.55
of which:					
cash in circulation, including balances in credit institutions' tills*	813.9	66.0	1,224.7	64.0	1.50
credit institutions' correspondent accounts in Bank of Russia**	169.7	13.8	304.9	15.9	1.80
required reserves***	201.1	16.3	267.4	14.0	1.33
credit institutions' deposit accounts in Bank of Russia	47.4	3.8	87.3	4.6	1.84
Bank of Russia obligations of reverse repurchase of securities	0.5	0.0	30.1	1.6	by 67 times

\* Excluding cash in Bank of Russia establishments' tills.

\*\* Ruble-denominated accounts, including cash balances on organised securities market and in ARCO correspondent account.

\*\*\* For ruble and foreign currency funds attracted to accounts.

Table 40

## MONETARY SURVEY (million rubles)

	1.01.2003	1.01.2004	2003 change
Net foreign assets of monetary authorities and credit institutions	1,577,818.1	2,096,852.4	519,034.3
Domestic credit	2,895,015.7	3,662,240.7	767,224.9
Net credit to general government	821,783.2	688,931.1	—132,852.0
Claims on non-financial public-sector enterprises	122,996.2	143,023.9	20,027.7
Claims on non-financial private-sector enterprises and households	1,917,288.9	2,774,724.7	857,435.9
Claims on other financial institutions	32,947.5	55,560.9	22,613.3
Money supply (according to monetary survey methodology)	2,859,987.9	3,962,084.3	1,102,096.4
Money	1,498,464.1	2,181,933.5	683,469.3
Quasi-money	1,361,523.7	1,780,150.8	418,627.1
Temporarily inaccessible deposit accounts	43,759.2	30,360.2	—13,399.0
Money market instruments	399,866.3	545,463.6	145,597.3
Capital accounts	1,035,179.6	1,209,709.9	174,530.3
Other (balance)	134,040.8	11,475.1	—122,565.7

Table 41

**CREDIT INSTITUTIONS' ANALYTICAL ACCOUNTS (million rubles)**

	1.01.2003	1.01.2004	2003 change
Reserves	471,563.4	768,915.1	297,351.8
Foreign assets	604,953.3	608,528.5	3,575.2
Claims on general government	696,007.0	742,776.3	46,769.3
of which:			
claims on regional and local governments	52,313.8	98,844.2	46,530.4
Claims on non-financial public-sector enterprises	122,938.2	142,968.6	20,030.4
Claims on non-financial private-sector enterprises and households	1,915,107.9	2,772,460.9	857,353.0
Claims on other financial institutions	32,947.5	55,560.9	22,613.3
Demand deposit accounts	706,693.4	1,003,197.7	296,504.4
Time and savings deposit accounts and foreign currency deposit accounts	1,361,494.6	1,780,146.2	418,651.6
of which:			
foreign currency deposit accounts	726,442.8	748,239.9	21,797.1
Temporarily inaccessible deposit accounts	43,759.2	30,360.2	—13,399.0
Money market instruments	399,866.3	545,463.6	145,597.3
Foreign liabilities	409,782.7	682,134.1	272,351.5
General government deposit accounts	67,891.8	85,483.6	17,591.7
of which:			
regional and local government deposit accounts	36,787.0	56,057.1	19,270.1
Debt obligations to monetary authorities	226,102.8	200,868.3	—25,234.5
Capital accounts	670,448.2	910,983.3	240,535.1
Other (balance)	—42,521.8	—147,426.8	—104,905.0

Table 42

## SANCTIONS USED AGAINST CREDIT INSTITUTIONS IN 2003

No.	Description of sanctions	Number of banks
<b>Preventive actions</b>		
1	Notifying in writing the management and/or board of directors (supervisory board) of a credit institution about shortcomings in its work and recommending remedial actions	1,188
2	Calling a meeting	367
3	Other (recommendations to draw up a plan of remedial actions, increase control over reporting, realistically assess credit risk, avoid distortions in statements, etc.)	261
<b>Penalties</b>		
4	Fines*	595
	of which:	
4.1	finances for non-compliance with reserve requirements	378
4.2	finances for violation of other prudential regulations	342
5	Imposing restrictions on individual banking operations conducted by credit institutions, such as:	78
5.1	taking household savings on deposit	60
5.2	effecting settlements on behalf of corporate entities involved in the transfer of funds to budgets of all levels and government extrabudgetary funds	14
6	Prohibiting credit institutions from conducting certain banking operations,* such as:	41
6.1	taking household savings on deposit	23
6.2	other	37
7	Prescriptions*	936
	of which:	
7.1	prescription to comply with Bank of Russia required standards	149
7.2	prescription to replace management	7
7.3	other	923
8	Prohibiting credit institutions from opening branches	51
9	Appointing provisional administrations to credit institutions	5
10	Revoking banking licence	16

\* The number of credit institutions in sub-points 4, 5, 6 and 7 differs from the number of credit institutions in the respective sub-points because several sanctions may be applied to a single bank.

*Note.*

As of January 1, 2004, the restriction on settlements on behalf of legal entities, such as the transfer of funds to budgets of all levels and government extrabudgetary funds was in effect with regard to two credit institutions. As of January 1, 2004, of all operating credit institutions, only one bank had a backlog of unexecuted settlement documents on payments to budgets of all levels.

Table 43

## MAJOR RUSSIAN PAYMENT SYSTEM INDICATORS

	2002	2003
Number of payment system participants	5,829	5,689
of which:		
— Bank of Russia establishments	1,172	1,139
— credit institutions	1,331	1,331
of which:		
— settlement non-bank credit institutions	41	46
— branches of credit institutions	3,326	3,219
Number of additional offices of credit institutions (branches)	6,387	7,408
Total number of ruble accounts opened by payment system participants for (resident and non-resident) customers, million	271.4	283.7
of which:		
— personal accounts, million	267.2	279.1
— corporate accounts, million	4.2	4.6
Number of payments, thousand	737,921.9	855,339.1
of which:		
— payments effected through Bank of Russia payment system, thousand	350,755.9	411,737.8
— payments effected through private payment systems, thousand	387,166.0	443,601.3
of which:		
— payments effected between divisions of one credit institution, thousand	115,613.6	135,991.5
— payments effected through credit institutions' correspondent accounts opened in other credit institutions (branches), thousand	17,280.9	24,940.8
— payments effected through settlement non-bank credit institutions, thousand	2,566.2	3,301.8
— payments effected within one division of a credit institution, thousand	251,705.3	279,367.2
Value of payments, billion rubles	130,087.4	182,156.9
of which:		
— payments effected through Bank of Russia payment system, billion rubles	76,345.1	108,164.5
— payments effected through private payment systems, billion rubles	53,742.3	73,992.4
of which:		
— payments effected between divisions of one credit institution, billion rubles	12,126.7	15,975.3
— payments effected through credit institutions' correspondent accounts opened in other credit institutions (branches), billion rubles;	10,290.8	12,887.7
— payments effected through settlement non-bank credit institutions, billion rubles	748.4	2,039.5
— payments effected within one division of a credit institution, billion rubles	30,576.4	43,089.9
Number of payments effected using various instruments of payment (taking account of transit payments effected through private payment systems), thousand	871,845.9	1,019,256.0
of which:		
— payment orders, thousand	671,939.7	793,385.6
— payment requests and collection orders, thousand	14,903.1	18,269.0
— letters of credit, thousand	602.3	388.3
— cheques, thousand	995.2	927.9
— other instruments of payment, thousand	183,405.6	206,285.2

Cont.

	2002	2003
Value of payments effected using various instruments of payment (taking account of transit payments effected through private payment systems), billion rubles	151,170.0	210,515.7
of which:		
— payment orders, billion rubles	136,943.2	190,622.9
— payment requests and collection orders, billion rubles	867.8	2,907.1
— letters of credit, billion rubles	60.6	46.7
— cheques, billion rubles	154.4	33.0
— other instruments of payment, billion rubles	13,144.0	16,906.0
Number of electronic payments, thousand	533,324.0	662,693.1
Value of electronic payments, billion rubles	109,307.8	158,165.4
Number of payments conducted on paper, thousand	204,597.9	192,646.0
Value of payments conducted on paper, billion rubles	20,779.6	23,991.5
Number of intraregional payments, thousand	671,370.8	769,803.9
Value of intraregional payments, thousand	109,376.5	154,327.8
Number of interregional payments, thousand	66,551.1	85,535.2
Value of interregional payments, billion rubles	20,710.9	27,829.1
Number of bank cards issued in Russia as of end of year, million	15.5	24.0
Total number of operations conducted in Russia with bank cards, million	281.3	410.5
Total value of operations conducted in Russia with bank cards, billion rubles	731.0	1,235.6
<b>Bank of Russia Payment System</b>		
Number of clients served, thousand	69,492	65,838
of which:		
— credit institutions	1,331	1,331
— branches of credit institutions	1,773	1,805
— clients other than credit institutions	66,388	62,702
of which:		
— Federal Treasury bodies	1,384	1,340
Number of payments, thousand	350,755.9	411,737.8
of which:		
— payments conducted through accounts of credit institutions (branches)	288,974.6	342,122.5
— payments conducted through accounts of clients other than credit institutions	57,453.5	65,058.5
of which:		
— payments conducted through Federal Treasury accounts	28,587.3	32,733.8
— payments conducted through accounts connected with Bank of Russia establishments' financial and business activities	4,327.8	4,556.8
Value of payments, billion rubles	76,345.1	108,164.5
of which:		
— payments conducted through accounts of credit institutions (branches)	60,687.7	89,558.5
— payments conducted through accounts of clients other than credit institutions	15,117.8	17,743.9
of which:		
— payments conducted through Federal Treasury accounts	10,821.8	12,656.1
— payments conducted through accounts connected with Bank of Russia establishments' financial and business activities	539.6	862.1



*End*

	2002	2003
Number of electronic payments, thousand	325,155.0	396,892.8
Value of electronic payments, billion rubles	70,347.9	102,408.9
Number of Bank of Russia establishments participating in intraregional electronic settlements	1,138	1,111
Number of Bank of Russia establishments participating in interregional electronic settlements	1,083	1,088
Total number of clients participating in exchange of electronic documents	3,355	3,659
of which:		
— credit institutions (branches)	2,771	2,897
— clients other than credit institutions	584	762
of which:		
— Federal Treasury bodies	399	498
Number of payments effected by communication channels, thousand	300,013.1	367,013.9
Number of payments effected on paper, thousand	25,600.9	14,845.0
Value of payments effected on paper, billion rubles	5,997.2	5,755.6
Number of intraregional payments, thousand	312,495.7	361,463.0
Value of intraregional payments, billion rubles	62,712.4	90,302.5
Number of interregional payments, thousand	38,260.2	50,274.8
Value of interregional payments, billion rubles	13,632.7	17,862.0
Sum of settlement documents unpaid due to lack of funds in correspondent accounts (sub-accounts) of credit institutions (branches), million rubles	8,512	3,345
of which:		
— credit institutions whose licences were revoked, million rubles	5,034	3,256
— operating credit institutions, million rubles	3,478	89

Table 44

**NOTE STRUCTURE OF 1997 BANK OF RUSSIA BANKNOTES IN CIRCULATION**

Denomination, rubles	Total in circulation, million rubles		As % of 1.01.2003	% share	
	1.01.2003	1.01.2004		1.01.2003	1.01.2004
1 000	248,194.4	531,216.3	214.0	30.7	43.6
500	401,920.6	533,811.9	132.8	49.6	43.8
100	121,175.2	116,987.9	96.5	15.0	9.6
50	31,759.3	29,755.9	93.7	3.9	2.4
10	6,471.3	7,172.6	110.8	0.8	0.6
5	32.9	37.2	113.1	0.0	0.0
Total number of banknotes of 1997 issue according to currency issue balance sheet	809,553.7	1,218,981.8	150.6	100.0	100.0

Table 45

**STRUCTURE OF 1997 BANK OF RUSSIA COINS IN CIRCULATION\***

Denomination	Total in circulation, million rubles		As % of 1.01.2003	% share	
	1.01.2003	1.01.2004		1.01.2003	1.01.2004
1 kopek	34.6	40.8	117.9	0.5	0.5
5 kopeks	114.8	137.7	119.9	1.7	1.6
10 kopeks	516.8	655.5	126.8	7.4	7.4
50 kopeks	635.2	770.3	121.3	9.1	8.7
1 ruble	1,641.1	1,971.5	120.1	23.5	22.4
2 rubles	1,158.2	1,403.2	121.2	16.6	15.9
5 rubles	2,235.2	2,905.3	130.0	32.0	32.9
10 rubles	639.0	937.2	146.7	9.2	10.6
Total number of coins of 1997 issue according to currency issue balance sheet	6,974.9	8,821.5	126.5	100.0	100.0

\* Excluding coins made of precious metals.

Table 46

## MONETARY PROGRAMME IMPLEMENTATION INDICATORS IN 2003 (billion rubles)\*

Name of organisation, place of registration	Currency	Nominal value of Bank of Russia-owned shares		Bank of Russia % share as of 1.01.2004	
		1.01.2003	1.01.2004	in authorised capital	in voting capital
Moscow Narodny Bank, London*	Pound sterling	128,242,622	128,242,622	88.89	88.89
Eurobank, Paris*	euro	161,297,826	161,297,826	87.03	87.03
Ost-West Handelsbank, Frankfurt am Main**	—	671 single shares	671 single shares	51.62	51.62
Donau-bank, Vienna	euro	10,900,500	10,900,500	15.00	15.00
East-West United Bank, Luxembourg	euro	4,589,749	4,589,749	15.00	15.00
Bank for International Settlements, Basel***	gold franc, SDR	7,500,000	15,000,000	0.55	0.55
Interstate Bank, Moscow****	thousand rubles	10,000	10,000	50.00	50.00
Sberbank, Moscow	thousand rubles	605,693	605,693	60.57	63.76
Moscow Interbank Currency Exchange	thousand rubles	25,661	99,582	28.76	28.76
St Petersburg Interbank Currency Exchange	thousand rubles	302	302	10.00	10.00
National Depository Centre, Moscow	thousand rubles	24,500	24,500	49.00	44.55

\* Excluding the shares of "nominee" shareholders accounted for in the Bank of Russia balance sheet.

\*\* Since 2000, the Bank of Russia stake in Ost-West Handelsbank has been represented by registered single shares without a nominal value.

\*\*\* The gold franc was the accounting unit of the Bank for International Settlements until April 1, 2003. Since then the BIS has used the SDR as its accounting unit.

\*\*\*\* The Bank of Russia stake is represented by its contribution to the authorised capital of the Interstate Bank.

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