EUROWEEK

The Bank of Moscow Roundtable

DEVELOPMENTS IN RUSSIA'S FINANCIAL SYSTEM

Bank of Moscow

The Bank of Moscow Roundtable panellists

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Anatoly Aksakov, State Duma deputy, member of National Banking Council of Russia

Yuri Danilov, advisor to the chairman of the Federal Service for Financial Markets

Mikhail Dmitriev, director of the Centre for Strategic Research

Evsei Gurvich, head of the Economic Expert Group (EEG)

Alexander Khandruev, first vice president, Association of Regional Banks

Alexei Savatiugin, director of the financial policy department at the Ministry of Finance

Alexey Vedev, director of the Centre of Strategic Investigations, Bank of Moscow

Julian Evans, contributing editor, *EuroWeek*

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Developments in Russia's Financial System

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Russia's banking system is far stronger and more mature today than it was 10 years ago. But how is the global credit crunch affecting it? How difficult is it for banks to access financing, and what could the Russian government do to support them?

EuroWeek brings together some of the top experts on Russia's financial sector, including representatives from the Ministry of Finance, the Ministry of Economic Trade and Development, the Federal Financial Markets Service, the Bank of Moscow, and top Russian think-tanks, to discuss the issues confronting Russia's financial system and the best strategies to ensure its continued success.

Anatoly Aksakov, State Duma deputy, member of the National Banking Council of the Central Bank of Russia.

Yuri Danilov, advisor to the chairman of the Federal Service for Financial Markets, director of the Foundation for Financial Markets Development.

Mikhail Dmitriev, director of the Centre for Strategic Research in Moscow and formerly first Deputy Minister of Economic Development and Trade. The Centre for Strategic Research is a national legal advisory for economic and social development in Russia.

Evsei Gurvich, head of the Economic Expert Group (EEG) in Moscow. Economic Expert Group is an independent Russian company providing consulting services on economic and financial policy issues to government officials on a federal and regional level.

Alexander Khandruev, first vice president of the Association of Regional Banks in Moscow.

Alexei Savatiugin, director of the financial policy department at the Ministry of Finance in Moscow.

Alexey Vedev, director of the Centre of Strategic Investigations at Bank of Moscow in Moscow.

Konstantin Kapiturov, manager of executive relations at ISI Emerging Markets in Moscow and roundtable moderator and translator, and

Julian Evans, contributing editor, *EuroWeek*.

EUROWEEK: How has the global credit crunch affected Russia's financial system?

Mikhail Dmitriev, Centre for Strategic Research: In my opinion, Russia has been considerably affected by the Western crisis, mainly because Russia has become a net importer of FDI at the investment growth stage. Before 2005, Russia was a net exporter of capital in all its forms. Under new conditions our economic growth developed a dependence on global financial markets. If external capital inflow stops, it will seriously damage investment and economic growth. This is due to the fact that population savings are shrinking and consumption is ahead of spending. Besides, the domestic financial sector is not ready to perform investment activities that are vital to implement projects in some sectors. For example, many projects in the energy sector are simply too big for local investors.

Costs and barriers related to domestic IPOs of major Russian companies are huge. So they hold IPOs abroad as they cannot afford them in Russia. The IPOs of that scale are impossible in Russia due to the underdevelopment of domestic financial markets. Thus, there is an absolute disparity in the domestic market between people's savings and a growing need for investment. And there is a structural disparity as well — between the structure of the supply of financial products and demand for them in the domestic markets.

Gurvich, EEG: I would say… not very much yet. In the third quarter 2007 the private capital inflow was substituted by outflow, then in Q4 everything was back to normal. In the first quarter this year the capital outflow was caused mostly by Russian companies and banks taking it out. Currently, net capital inflow restarted again. In other words, the impact was reflected in a small decrease of foreign capital inflow.

Aksakov, National Banking Council of the Central Bank of Russia: The banking sector saw the effect of the global credit crunch particularly in

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November, when there was a steep rise of repo operations. It is calmer now as the central bank reacted to the situation on external markets. Interest rates are rising, obviously. One of the reasons is the growing price of loans abroad. Many cannot afford them any longer. As a result, banks are forced to raise their rates too. And the long term resources of Russian credit organisations are not that strong. They turn to the West, but the prices of loans have risen, and the banks have to raise the price of their loans. Also, cross-border securitisation had been very active in past years. Now it has come to a standstill due to the reasons just mentioned.

Anatoly Aksakov, State Duma deputy, member of the National Banking Council

Savatiugin, Ministry of Finance: I do not think the global credit crunch has affected Russia. Not yet. There were problems with a shortage of banking liquidity caused by international financial problems, i.e. with difficulties of Russian banks financing their liabilities. The liabilities of many banks were received abroad in foreign currency when money was cheap, now they have to cover these liabilities when money is expensive. Many hoped that they would pay this off through refinancing backed by new loans and issuance. All this has grown more expensive now, and for many banks the Western "window" was closed. Or became more expensive. The central bank and the finance ministry took some measures before the end of last year and early this year that helped assuage the negative effect.

EUROWEEK: What sort of measures?

Savatiugin, Ministry of Finance: The central bank has considerably extended the list of instruments it accepts as a deposit, and some non-rated instruments could be accepted without a deposit. This spring the finance ministry launched auctions of budget funds to be placed on to deposit accounts of commercial banks, which was not the case before. About Rb20bn ($800m) is placed at each auction. But only the top 30 banks can have access to that. It is a good instrument though. Plus, the funds of state corporations, such as Vnesheconombank, the 'nanotechnologies' State Corporation, also came to the market.

Soon, in the summer, the money of the Corporation for Residential and Communal Services will be added, too. Those — serious amounts, tens and hundreds of billions of roubles — may be sent to the Russian banking system. This brings down the tension. We saw some apprehensions in April due to considerable tax payments (beginning this year we switched to a quarterly basis of VAT collection). And each VAT payment means a big removal of liquidity from the banking sector and transferring it to the budget. At the end of each month there were some problems with banking liquidity; it shrank, to be exact. Currently, the rates of interbank credits stay on the same level, approximately 3% to 4%. That said, we do not see any serious problems. In the meantime financial markets are growing. Also, due to the initiatives of the government and the prime minister, the tax initiatives [lower expected taxes for oil companies] push the stockmarket up, it is breaking all historical records. And oil prices are not going down.

EUROWEEK: How has liquidity in the banking sector been affected by the global credit crunch?

Khandruev, Association of Regional Banks: The credit crunch definitely had an effect on bank liquidity in Russia. Banks felt the shortage of short term liquidity, and difficulties in accessing foreign markets led to some banks having problems with mid and short term liquidity. These difficulties did not show up visibly. Nevertheless, the tension was in the air from late July until early August last year. There was a danger of a chain reaction: one bank suspends operations and other banks fall out after that. But this did not happen because the Central Bank of Russia reacted very effectively, and to some extent gave up its inflation priorities for the sake of sustaining mid and short term liquidity. At the same time the need for this kind of liquidity is still there as banks are growing their assets fast, and restricted access to foreign markets keep that problem afloat. Now we are on the eve of a continuous period of M&A in the Russian banking system.

Gurvich, EEG: I don't see a fundamental problem with liquidity in Russia. When capital was pouring out there were some problems with liquidity, but they were compensated by the steps of the central bank and the government, including placing the funds of state corporations in the banks. We see that rates on the money market have grown less than inflation. It testifies to the fact that there is no global, macroeconomic problem of liquidity in Russia.

EUROWEEK: How difficult is it for banks to finance themselves at the moment?

Khandruev, Association of Regional Banks: Liquidity is an issue. You cannot always rely on the 'good shepherd' — the central bank — because we very well know, and not just from economists, that central banks must be lenders only of last resort. If the central bank helps banks constantly it will very soon "spoil" them. The regulation of current liquidity must be administered mainly through a fully fledged interbank market. The establishment of a proper interbank market is key. Then, the channel for interest rate money transmission will work to its full capacity. The second issue here is about mid and long term liquidity. This is very serious. It would be very good if the recently established Russian Bank for Development [previously called Vnesheconombank] acted like the German KfW which credits the economy through agent banks. The banks would then get stable liabilities which would enable them to support select industries on a long term basis.

Special public (state) funds, which are being established now to support innovative technologies, can serve the same cause. Besides, taking into account Russia's investment rating, Russian banks — which did not default on their international liabilities — still keep an access to global financial markets. A number of Russian banks are considering IPOs in future. It is also very important that a search for strategic and portfolio investors is in progress now. All that could objectively replenish the resources of Russian banks. Thus, to sort out the second problem (mid and short term liquidity) one has to search for systemic solutions. And the third problem is risk management. I would say Russian banks have several problems with that.

Gurvich, EEG: There are structural, not global, problems here. First, the problem of liquidity for second and especially third tier banks has come to the fore. Large banks don't have such a problem, and they are the foundation of our banking system. We need targeted, pointed measures. On the one hand, more opportunities should be there for small bank refinancings. On the other hand, there should be more incentives for smaller banks to be acquired by larger banks.

Aksakov, National Banking Council of the Central Bank of Russia: Everybody has his own niche. Yes, we need large, powerful, even multinational banks. But private and smaller banks must become one of the pillars of our banking system. They are more innovative. We cannot and must not destroy them.

EUROWEEK: Do you think Russian banks, like Kazakh banks, have become too dependent on international financing?

Vedev, Bank of Moscow: This is a problem for the entire Russian economy, not just the banks. Russia should not be so vulnerable to negative impacts from world financial markets. In principle, the choice is simple — either Russia ramps up its raw materials exports and makes the best of the current situation, while accumulating resources for future development and using them, or else the national economy will grow dependent on foreign investment flows. Eventually, if Russia's economy does become dependent on foreign investment (and not on technologies that may be acquired in exchange for petro-revenues), it must take steps to nurture an attractive investment climate, a competitive business environment, an efficient labour structure and an incentivised taxation regime. Unfortunately, these competitive advantages appear to be melting away.

Today, Russia is failing to use its revenues from resource extraction to boost production, and instead has been accumulating these revenues (all of which are then moved abroad) and neglecting to foster the conditions necessary to promote foreign capital inflows.

As a result, Russia has yet to take advantage of its sizeable financial potential from raw materials exports to promote domestic growth. The aggregate foreign debt of Russian companies and banks is significant and continues to grow, while banks are still saddled with problems stemming from the liquidity squeeze and refinancing foreign debt. All things considered, the word "inaction" is perhaps most appropriate in describing the current situation.

There is a serious deficit of domestic financial resources. And this deficit is becoming more acute from year to year, as corporate and consumer loans are growing at a faster pace than corporate deposits and household savings. Corporate loans outpaced corporate deposits from R1.6tr in early 2006 to R3.4tr in early 2008. In early 2006, the volume of household deposits was 2.4 times the level of consumer loans, whereas in early 2008 household deposits exceeded consumer loans by only 60%.

EUROWEEK: What can be done about this deficit of domestic financial resources?

Vedev, Bank of Moscow: The deficit of domestic savings can be handled in two ways. Either another source of loan financing will be found, or growth in loans to non-financial sector and banking system assets, as well as economic growth, will brake sharply. The government and the CBR have substantial resources at their disposal — the Reserve Fund, the National Well-being Fund, the Investment Fund, balances on federal government accounts, the consolidated budget surplus, development institution funds, the Russian Pension Fund, and official gold and forex reserves. The total volume of these funds today considerably exceeds the potential volume of externally raised funds — at least $250bn is available to be used on the domestic market.

Actually, today's discussion revolves around choosing the course of economic policy — maintaining high rates of economic growth, or witnessing their deceleration due to the deficit of financial resources. Both choices have their strengths and weaknesses. For example, slower economic growth may help combat inflation, strengthen the stability of the banking system (albeit via bankruptcies and acquisitions of certain banks), facilitate balanced growth of financial markets (removing "overheated" elements in a number of segments, primarily the real estate market) and eliminate disproportions in consumption and savings.

Yuri Danilov, advisor to the chairman of the Federal Service for Financial Markets

If the government decides on a policy of sustaining high rates of growth in domestic demand and lending activity in the event of a steep plunge in foreign capital inflows, it can substitute foreign financial resources with its own funds. In practice, that will significantly reduce Russia's dependence on world capital markets and contribute to the development of an independent financial system.

EUROWEEK: Is the financing situation for Russian banks and other Russian companies very tough at the moment?

Danilov, Federal Service for Financial Markets: It is obvious that the conditions of attracting capital in

Western markets are not as beneficial as they were two or three years ago. It was especially hard in the first quarter of 2008. The volume of Russian companies' Eurobond placements went down tenfold on the year. But already in April the situation improved: the Eurobond placement volume reached $5.7bn. That is three times the monthly average last year. IPOs in the global capital market experienced a much stronger impact from the credit crunch, but in the equity markets Russian companies managed to carry out standalone public offerings both in international and domestic markets this year. I think that the aggregate capital attracted by Russian companies in international markets will be lower than the last year results.

Alexander Khandruev, first vice president, Association of Regional Banks

But this is not going to affect the economy critically. The point is that in the last five years the share of external markets in the capital raised in equity markets was going down consistently. Domestic sources of financing gradually substituted external ones. This process is still going on this year, too. April marked a steep rise in capital attraction on the domestic debt market. Borrowers turned to the domestic corporate bonds market when they felt that the period of liquidity shortage was drawing to an end. If the dynamics of attracting domestic capital, which "ruled" the market over the last five or six years is preserved, the total volume of the capital attracted by Russian companies in equity markets will even grow in 2008 compared to 2007, and the share of domestic markets will exceed 50% for the first time in history. But if we look at it under a different angle we will see that problems with attracting foreign capital may to a certain extent negatively influence the real sector of the economy. Nowadays, the Russian economy is in need of investment, and the investment influx slowdown may cause a slight overall decline of the economy growth rate.

EUROWEEK: So domestic debt and equity markets are developing well?

Danilov, Federal Service for Financial Markets: Russian equity and corporate bond markets develop faster than the economy in general. In other words, the ratios connecting the financial market capacity with GDP are growing constantly. The correlation between capitalisation and GDP grew from 17% to 100% in the last eight years. The correlation between the value of corporate bonds in circulation and GDP for the same period grew from 0.5% to 3.7%. The net assets of mutual funds and GDP ratio grew from 0.1% to 2.3%.

At the same time, compared to the countries with well developed financial markets the turnover of practically all segments of the Russian financial market is small, except for the equity market. The capitalisation/GDP ratio in Russia is better than in most countries of Europe falling slightly behind the US, Japan and Spain. This indicator is considerably higher only for five countries with large and developed markets — Canada, Australia, the UK, Sweden and Switzerland.

The Russian financial market has already started to perform the macroeconomic function of turning savings into investments. More and more real sector companies begin to consider the domestic financial market as a source to finance their capital stock and acquisitions of competitors. In 2007 the volume of capital raised in the domestic equity market reached Rb32.7bn, which roughly corresponds to 13% of total investment in the capital stock of all Russian companies in 2007. The characteristic feature of 2007 is that a considerable part of the investment attracted came from the equity market: the issuers raised $14.7bn in the domestic market, and another $18bn in the corporate bond market. In international equity and bond markets Russian companies raised $47.3bn. These figures testify to the fact that the domestic capital market is already a good alternative for external markets. As I said before, the role of domestic markets will grow this year. This growth will make up for the decline in attracting investment in external markets.

EUROWEEK: What could the state do to help the development of local markets?

Danilov, Federal Service for Financial Markets: Currently, the government ordered the Federal Service for Financial Markets to develop the Strategy for the Russian Financial Market Development up to 2020 (the draft document is to be submitted to the government by October 1, 2008). There were 12 primary tasks which were put down by the FSFM in the report 'On the Measures to Improve the Regulation and Stimulate the Development of Equity Market for 2008-2012 and Further':

1) establishing a favorable tax climate for equity market participants
2) lowering administrative barriers and simplifying registration procedures regarding securities emission
3) creating opportunities to securitize assets and offer new financial instruments
4) extend the list of derivatives and develop fixed date (term) market futures
5) implement mechanisms helping private investors participate in financial market operations, and protecting their investments
6) develop mutual funds
7) develop an effective information disclosure system
8) corporate governance improvement
9) prevention and fighting fraud in the financial markets
10) improve regulation
11) promote good image of the Russian financial market
12)) introduce an effective information disclosure system in the financial market

Aksakov, Central Bank of Russia: There is still much to be done by the state: to improve laws and extend the list of instruments. One can issue bonds, but banks cannot issue bonds backed by loans and other assets, in other words they cannot securitize their assets. This creates problems. Entities should be able to pay off bonds before maturity on request of the issuer as well as the bond holder. Our businesses should be able to issue bonds backed by, or paid off, to be exact, by a property equivalent. We have to provide the opportunity to issue risk(y) bonds with special conditions of maturity (payment). Another option is that a bank grants a loan to a client and then issues bonds backed by the client's liability before the bank, i.e. to introduce CLNs.

EUROWEEK: How important is it to re-start pension reform, so that private pension funds play more of a role in the Russian capital markets?

Gurvich, EEG: The first years of managing pension savings showed that the management was not efficient due to several reasons. The opportunities of investment into the economy are not used. On the other hand the actual interest rate turns out to be negative, i.e. the savings of pensioners depreciated. That simply discredits the pension reform, it loses any sense with negative rates. We have to stimulate private funds to participate in managing the resources, and at the same time extend the potential of Vnesheconombank [which manages the State Pension Fund] for investment. At the same time we cannot let the savings of pensioners be invested by rulings of the government or VEB. They may be invested in market instruments, corporate bonds for instance. So that banks and investment companies evaluate risks and respective income, not state officials. This solution does not require another pension reform, it can very well be carried out by correcting the current rules.

Savatiugin, Ministry of Finance: In contrast to developed markets, our insurance, and even retirement organizations are not major institutional investors. The volumes of insurance reserves are small. They are placed on the financial market as well as on bank deposit accounts, but those sums are very small compared to the assets of the banking system. We should develop the pension system so that private pension funds play a bigger role. And we see that an increasing amount of money is being transferred from VEB to private funds.

Mikhail Dmitriev, director of the Centre for Strategic Research

Khandruev, Association of Regional Banks: With all my heart I am all for private retirement funds' development, but I very well remember what happened in Chile in the early 1980s. The financial disaster was caused by a hasty and ill-prepared reform. The legislation and institutions themselves are still very weak, we do not have the required transparency and well-tuned monitoring procedures. If market players are not transparent, if there is scheming, I feel anxious. Here is a simple example: nobody knows what losses Western pension funds incurred from the subprime mortgage crisis. And they were heavily investing in CDOs which lost value. But one thing is losses for a 'fat' economy, and another one for Russia. I fear that our private financial institutions are not ready for those losses because they have no experience with long money where the requirements for risk management are very high.

EUROWEEK: Also it has been recently suggested that the state should use its petro-dollars to support banks' finances. What do you think of this proposal?

Savatiugin, Ministry of Finance: It depends on the situation. There was a situation when a crisis was possible, when there was serious capital leakage. The private sector had considerable payments on external liabilities and taxes. Currently, there is no need for additional injections. There is no serious demand at those auctions. Liquidity is OK now. Managing liquidity is not the direct task of the government.

There is an issue of cash management in the course of the budget execution. And Mr Kostin may be very well understood. As far as using petro-dollars is concerned why not ask the state for money? This is a natural wish of every businessman. But there is another side of the coin. If we supply such a big volume of liquidity, inflation risks grow drastically. There are both inflation risks, and the so-called "moral hazard". If a businessman is sure the state will lend a hand any time, why bother to manage risk?

Aksakov, Central Bank of Russia: It is better to pour those state resources in through the banking system, not through direct budget spending. For instance, to credit infrastructure development. There are other problems the state could solve using the banking system, for example, the problem of the social divide. On the other hand, there is a huge variation in budget spending on Russian regions. This problem is solved through small businesses. And small businesses have one major problem — the high price of financial resources. We estimate that only 25%-30% of businesses can be sure about getting them. For others they are not affordable. Thus, the development of small business will help create the middle class, level social differentiation and develop regions. And to make resources available the banks, their branches, must move into the regions. And this process has begun.

EUROWEEK: How about our independent experts: do you think the state should take a more active role in supporting and financing the financial system?

Dmitriev, Centre for Strategic Research: The rouble appreciation policy is an efficient way to keep capital flowing into the country. A country with a consistently strengthening currency is especially attractive for international investors. They get an income not only from investment operations, but also from the currency rate difference if

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the currency they invest in grows in value. The expectations of the actual rouble appreciation is one of the most important incentives for international players invest money in Russia further on, despite the growing volatility in financial markets. It is the reliability of our currency that helps us avoid negative consequences in case foreign capital suddenly leaves emerging markets. Some other countries suffered a lot from that.

EUROWEEK: But what do you think of using the Stabilisation Fund to support the banking sector?

Dmitriev, Centre for Strategic Research: This is a double-edged sword. This will show financiers in the world that our economic stability tilts. The credit rating of our country will be decreased; its investment attractiveness will deteriorate leading to possible capital leakage from Russia. The situation is already volatile. At the moment, global financial markets are reconsidering investment ratings of CEE and CIS countries for the worse.

Gurvich, EEG: I do not think that the banking sector needs support at all. It is developing very dynamically. But international experience shows that fast development often leads to risky growth, and worse quality of credit portfolios. I am not sure we need to additionally boost that development. Besides, it is obvious that the Russian economy is overheated, that's why I think it would be useful to slow down credit expansion accompanied by improving the quality in choosing projects, in risk management. Another question is that a considerable part of savings is with the public sector now. There is an issue of how to use those savings. Obviously, pension savings are not used properly.

EUROWEEK: The government has embarked on a very ambitious programme to renovate the country's infrastructure. Should the state, and state banks, take the main role in financing this programme?

Savatiugin, Ministry of Finance: The issue of roads was there when the Russian state came to be. The banks should already be interested in investing in this area through private-public partnerships (PPP). The state's Investment Fund is already investing in such projects. But there is an objective problem here: the low mobility of Russian people. They travel mainly on vacation and to Moscow. And for that there is RZD and Aeroflot. This problem cannot be solved only by monetary policies. It is important to highlight that the government does participate in those projects through PPPs. For instance, in the US, the state does not build roads. We believe it is important for the state to stimulate the private sector, to show that such projects may be profitable.

Khandurev, Association of Regional Banks: I can say that at last the government moves from words to implementation. As far as the banking sector is concerned, I think it would be good to have the Russian Bank for Development work with commercial banks. The Bank of Development must be their partner, not an indirect competitor. Also, the Venture Fund and the Fund for Regional Development must direct all their force to help small businesses.

Evsei Gurvich, head of the Economic Expert Group (EEG)

EUROWEEK: So the state must take the lead now?

Khandurev, Assoaciation of Regional Banks: On the contrary, it's the turn of business now. The state must act as judge, not a player.

EUROWEEK: If the government's infrastructure renovation programme is to succeed, there needs to be better availability of long term rouble financing. At the moment, the longest maturity is about 10 years, while some infrastructure projects will be 30 years long. What can the government do to encourage the growth of long term rouble lending?

Danilov, Federal Service for Financial Markets: Today, inflation is the major inner obstacle for the development of long term rouble loans. The unpredictable character of inflation hampers the efficiency of such loans drastically both for the issuer, and investor. The issuer is not sure about future income to pay off the loan. Inflation today is to a great extent related to budget expenses. So, the maximum what the state could do to lend a hand to the long term rouble bond and credit market is to optimize budget spending, to pursue a more conservative policy in this respect. There are other measures which would be wise to implement. Many bankers are lobbying a law preventing the untimely call of deposits [or bank runs]. However, this law has not been passed yet. No doubt, this is a questionable point, and if this law is passed a whole complex set of measures to protect depositors' interests is to be developed. But, if it is passed it will have a beneficial impact on long term credit activities.

EUROWEEK: Let's discuss inflation. Russia, like many other emerging market countries, is in a tricky position at the moment — on the one hand, trying to stimulate rapid economic growth, while on the other trying to lower inflation. Do you think Russia now has a choice between high economic growth and low inflation?

Gurvich, EEG: I would put it differently. Fast growth now or serious macroeconomic risks later. A the short distance sprint or consistent development. And there are steps that can be beneficial both in short and long term. For instance, we must encourage popular savings also by raising deposit rates.

Dmitriev, Centre for Strategic Research: This is not a dilemma yet. But it will become one in two to three years. With the present monetary policy of the central bank, the Russian economy is capable of growing 6%-7% per year in a short term perspective. Even if inflation goes up to 15% a year it is not going to slow down the economy.

EUROWEEK: What factors are causing the high rate of inflation, and what can the government do about it?

Savatiugin, Ministry of Finance: Everything started on the food market. Poor harvests of basic products across the globe happened. The growing food prices stand behind workers' pay increases (and wages are included in the cost of manufacture of nearly all products), and that makes the producers of totally different products raise the prices. Here we see an inflation spiral. It is very important for us to stop this process. Food inflation influenced the aggregate one. We have put some price freezes in place. Price freezing is temporary. They are directed at stabilizing the buying frenzy.

Vedev, Bank of Moscow: To boost investment activity, inflation must be cut to at least 4%—5%, imported inflation must be restricted by an effective taxation policy (changes in import and export duties), and the monetary component should be regulated by the money supply and interest rates.

EUROWEEK: Would you say the central bank is pursuing a policy of allowing the rouble to appreciate, and if so, is this a good policy for the economy?

Aksakov, Central Bank of Russia: The central bank is forced to strengthen the rouble. It is their only tool to contain inflation. And inflation is not defined by monetary factors only. The tools for fighting the monetary sources of inflation are in the hands of the government.


Julian Evans, Contributing editor, *EuroWeek*

Savatiugin, Ministry of Finance: I would not make any serious conclusions about how the rouble rate tells on GDP growth. It is good for some sectors and bad for others.

Gurvich, EEG: I would not say that the central bank has assumed that strategy. The rouble appreciation trend was defined by objective factors: oil prices growth, foreign capital inflow, labour efficiency growth. The central bank, on the contrary, has tried to slow down the rouble appreciation these years by buying as much currency as possible, but safely enough for inflation. That means had it not been for the central bank, the rouble would have strengthened even more. Recently, the nominal value of the currency has been practically the same, and the dollar depreciation against the rouble shows its general weakness against all other currencies. It does not reflect the policies of the central bank. If we speak about the actual rouble appreciation, I do not see any signs of negative consequences. In the last three years the processing industry has grown 8.5% on average, which is pushing the economy forward, and the mining sector (including oil and gas) grew less than 2%, which is holding the economy back. This year the disparity is even more: processing increased up to 10.2%, while mining went down to 0.6%. Thus, the picture is reverse to the 'Dutch disease'. As far as the central bank supporting the nominal exchange rate is concerned, the result is that the rates are becoming in line with the rates in the global markets. Under the conditions of high inflation it means supporting negative rates in real terms. This boosts investment, but at the same time savings diminish, and inflation grows.

EUROWEEK: The government has talked about making Moscow a financial centre for the region. How much of a goal is this, and what can the state do to make it happen?

Danilov, Federal Service for Financial Markets: Let's start with the fact that there are no foreign issuers on the Russian exchanges yet, also due to the regulations. Nevertheless, the CIS players are interested in Russian money. And I must say that some more complex indicators show that there are imminent reasons for this. Moreover, if the process kicks off here, I mean foreign securities placed in Russia, the country will become an attractive zone for quite a few territories — from CEE, CIS, MENA up to South East Asia. And the Russian share in the global turnover is growing exponentially. For example, if we look at competition in the last 10-15 years (and the nature of this competition is fighting for liquidity) we will see that the turnover in the developed countries is growing in contrast to the emerging economies, where we see its decline. But not in Russia.

EUROWEEK: So does Russia need less regulation or more?

Vedev, Bank of Moscow: The key objectives of a financial policy aimed at creating a strong and independent system are the following: reducing dependence on developments in external markets; expanding the banking system's resources to support economic growth; enhancing stability of the banking system; maintaining a rouble exchange rate optimal to support production, investment inflows and financial stability.

Khandurev, Association of Regional Banks: Personally, I want to live in the time when Russian citizens will be spending money to become respectful investors, instead of buying luxury cars. But seriously, if we solve infrastructural problems Russia can be such a centre, no doubt about that.

EUROWEEK: Finally, do you think we will see Russian banks using the weakness of Western financial institutions to buy assets in the West?

Vedev, Bank of Moscow: Yes, I think Russian companies and the state should be more active in the Western market, to purchase assets that correspond with strategic economic interests. ○

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