

THE CENTRAL BANK OF THE RUSSIAN FEDERATION

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1997

THE CENTRAL BANK OF THE RUSSIAN FEDERATION



A N N U A L **1 9 9 7** R E P O R T

Approved by the Board of Directors of the Bank of Russia on May 28, 1998

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# Contents

<b>Introduction .....</b>	<b>6</b>
<b>I. Russia's Economic and Financial Situation in 1997</b>	
I.1. General Assessment of Russia's Social and Economic Situation .....	10
I.2. World Economic Development Trends .....	17
I.3. Balance of Payments .....	23
I.4. Asian Crisis and Russia .....	28
I.5. Government Finance .....	32
<b>II. Monetary Policy</b>	
II.1. Objectives and Results of Monetary Policy .....	42
II.2. Dynamics of Monetary and Credit Indicators .....	45
II.3. Monetary Policy Instruments .....	49
II.4. Development of Financial Markets .....	54
II.5. Relations with Central (National) Banks of CIS Countries .....	62
<b>III. Foreign Exchange Policy and Foreign Exchange Regulation</b>	
III.1. Bank of Russia Foreign Exchange Policy .....	66
III.2. Foreign Exchange Regulation and Foreign Exchange Control .....	70
III.3. Interaction with International Financial Institutions .....	74
<b>IV. State and Regulation of Russia's Banking System</b>	
IV.1. General Assessment of Russia's Banking System .....	78
IV.2. Licensing Banking Activities .....	84
IV.3. Regulation of Activities of Credit Institutions .....	88
IV.4. Inspection of Credit Institutions .....	90
IV.5. Rehabilitation of Credit Institutions .....	92
IV.6. Banking Audit .....	93
IV.7. Credit Institutions' Participation in Securities Market and Control over Their Activities .....	95
<b>V. State of Russia's Payments System</b>	
V.1. Preparations for Ruble Re-Denomination and Transition to New Charts of Accounts .....	100
V.2. Development and Upgrading of Russia's Payments System .....	102
V.3. Cash and Issue Operations .....	106
<b>VI. Improving the Organisation of the Central Bank     of the Russian Federation</b>	
VI.1. Organisational Structure of the Central Bank of the Russian Federation .....	112
VI.2. Staffing and Personnel Training .....	113
VI.3. Improving Banking Legislation and Procedures for Filing Claims and Suits .....	115
VI.4. Bank of Russia Internal Audit and Inspection .....	119
VI.5. Interaction with Russian Credit and Other Institutions and Russia's Overseas Banks with Bank of Russia Interest .....	120
VI.6. Precious Metals Market .....	123

## **VII. Balance Sheet and Profit and Loss Account of Central Bank of Russian Federation as of January 1, 1998**

VII.1. Central Bank of Russian Federation Balance Sheet as of January 1, 1998, and Explanatory Notes to Some Items .....	126
VII.2. Revenues, Expenditures and Financial Performance of Central Bank of Russian Federation in 1997 Major Actions Undertaken by Bank of Russia in 1997 in Line with Uniform State Monetary Policy .....	129
Major Actions Undertaken by Bank of Russia in 1997 in line with the Government's Uniform Monetary Policy .....	131
<b>Auditor's Report .....</b>	<b>135</b>
<b>Statistical Addendum .....</b>	<b>137</b>

### **List of Figures in Text**

1. Consumer Price Index in 1995 — 1997 .....	12
2. Export and Import Growth Rates .....	15
3. Money Supply and Inflation Dynamics .....	46
4. Claims on Private Enterprises in Total Domestic Credit to Economy .....	47
5. Interest Rate Dynamics .....	50
6. Lombard Credits Extended by the Bank of Russia to Banks in 1997 by Month .....	51
7. Lombard Credits Extended by the Bank of Russia to Banks in 1997 by Quarter .....	51
8. GKO Yield and GKO — OFZ Portfolio Duration Dynamics .....	53
9. All-Term Interest Rates in Russia's Economic Regions in 1997 .....	55
10. Official US Dollar/Ruble Rate and Currency Corridor in 1996 — 1997 .....	67
11. US Dollar Growth Rates Against Ruble and Against Inflation in 1997 .....	68
12. Structure of Foreign Cash Receipts in 1997 .....	72
13. Structure of Foreign Cash Utilisation in 1997 .....	72
14. Assets Concentration in Russia's Banking System as of January 1, 1998 .....	80
15. Dynamics of Credit Institutions Assets Structure .....	81
16. Dynamics of Credit Institutions Liabilities Structure .....	81
17. Credit Institutions Grouped by Problem .....	82
18. Assets of Registered Credit Institutions Grouped by Problem .....	82
19. Number of Credit Institutions Registered by the Bank of Russia in 1994 — 1997 .....	85
20. Number of Operating Credit Institutions .....	85
21. Structure of Operating Credit Institutions by Registered Authorised Capital as of January 1, 1995 .....	86
22. Structure of Operating Credit Institutions by Registered Authorised Capital as of January 1, 1998 .....	86
23. Dynamics of Number of Registered Credit Institutions in 1996 — 1998 .....	86
24. Dynamics of Number of Operating Credit Institutions in 1996 — 1998 .....	86
25. Auditing Firms and Certified Auditors in Russia by Region .....	94
26. Authenticity Structure of Bank Reports .....	94
27. Proportion of Individual Banknotes in Total Sum of Banknotes .....	107
28. Proportion of Individual Banknotes in Total Number of Banknotes .....	107
29. Dynamics of Detection of Counterfeit Bank of Russia Notes .....	108
30. Change of Structure of Principal Methods of Counterfeiting Bank of Russia Notes .....	108
31. Dynamics of Detection of Counterfeit Foreign Banknotes .....	108
32. Dynamics of Detection of Counterfeit US Dollar Notes .....	108
33. Note Structure of Detected Counterfeit US Dollar Notes in 1997 .....	109

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## Introduction

*The Annual Report of the Central Bank of the Russian Federation, which is submitted yearly to the State Duma, enables the general public to better understand the work of the Bank of Russia related to the performance of the functions assigned to it. This ensures transparency of the Bank of Russia's policy and represents a key element of control over its activities.*

*In accordance with the Russian Constitution, the Bank must strengthen and maintain the internal and external purchasing power of the domestic currency, a priority task that compels the Bank to focus its efforts on ensuring the stability of currency circulation and the reliable performance of the country's banking and payments system.*

*However, in addition to tackling these problems, in 1997 the Bank had to carry out large-scale measures designed to elevate the country's monetary system and banking sector onto a new and qualitatively higher level. The most significant of these were preparations for the ruble's re-denomination and the transition to a new price standard, as well as the drafting and introduction of new accounting rules in the banking system.*

*The decision to re-denominate the ruble and switch to a new price standard on January 1, 1998, may be viewed as official recognition of the progress made in stabilising Russia's financial situation. As inflation continued to decline throughout the year, the country's economy functioned against a background of monetary stability and predictability of key parameters of the financial and credit system. At the same time, some of the trends observed in 1996, such as real growth in the money supply, slower velocity of money supply, a non-inflationary increase in the economy's money supply and the exchange rate's fulfilment of its role as the nominal anchor of inflation, continued in 1997.*

*Compared with 1996, the most significant signs of the emergence of realistic opportunities for macroeconomic stabilisation and a transition to sustained economic growth were the reduction of inflation by almost 50% (to an average monthly rate of less than 1%) and the halting of the general economic recession for the first time since the beginning of reforms in Russia.*

*At the same time, the global financial crisis at the end of the year under review posed a threat to the macroeconomic results achieved. The dramatically changed conditions of late 1997 were, in effect, a test of strength for the Russian economy and its banking system. Thanks to the timely measures taken by the Russian Government and the Bank of Russia, the main difficulties were overcome. The international financial crisis had no significant impact on the general economic situation in Russia and on the final results of the country's development in 1997.*

*Nevertheless, some favourable tendencies were disturbed. Faced with the need to react instantly to the changed situation in the financial market, the Bank had to shore up the ruble exchange rate by temporarily raising interest rates.*

*In 1997 the Bank continued to pay great attention to the development and consolidation of the Russian banking system. Falling inflation, the need and opportunity to redirect banking capital to financing the real sector of the economy, the continued internationalisation of financial markets and increased competition in the banking services market all set high qualitative and quantitative requirements before the banking system. To enhance its reliability, in 1997 the Bank took steps not only to improve its supervisory standards, but also upgraded the instruments allowing commercial banks to manage their liquidity more effectively. The predominant trend in the development of the banking sector in the year under review was the consolidation of credit institutions' capital and assets. Vigorous efforts were made to restructure the banking system.*

*In 1997 the Bank continued to develop the country's payments system, introducing new methods of transmitting information and using more sophisticated technology, such as a real-time gross settlements system. These efforts create the conditions necessary for improving the quality of services and more effectively implementing monetary policy.*

*Committed to the principle of greater openness and transparency in its work and seeking to improve the professional level of its employees, the Bank hopes that the objectives set for it, the efforts it is making to attain them and the results of its activity will be appreciated by all groups of the population.*



**RUSSIA'S  
ECONOMIC AND  
FINANCIAL SITUATION  
IN 1997**



## I.1. GENERAL ASSESSMENT OF RUSSIA'S SOCIAL AND ECONOMIC SITUATION

*In* 1997, Russia continued its economic reforms, which are aimed, among other things, at creating conditions for a transition to sustainable economic growth. The main objectives of the Russian Government's monetary policy were met and that largely determined the general direction of the processes that continued in the Russian economy last year.

For the first time since the beginning of Russian reforms, the real GDP volume remained unchanged from the previous year practically throughout 1997. Clear signs of growth were registered in the production of goods and services in many branches of the non-financial sector and indicators characterising people's living standards improved.

As a result of the measures taken to make financial stabilisation an ongoing process the rate of inflation was consistently reduced. In 1997 inflation measured by the consumer price index was 11% compared with December 1996, which represents a monthly average of 0.9%. That was the lowest rate since the beginning of reforms.

The implementation of monetary policy in 1997, which aimed at curbing the aggregate money supply and stabilising the exchange rate, made it possible to create conditions for changing price-setting within established parameters. Continuity in policies regarding state regulation of service charges and prices of products manufactured by the natural monopolies had a favourable

effect on the general dynamics of inflation throughout the year.

As the Bank kept the ruble's real exchange rate stable, the ruble continued to play the role of a price anchor. As a result, the rate of growth in industrial producer prices slowed down significantly in 1997. In 1996 industrial producer prices rose by 25.6%, whereas in 1997 they increased by 7.4%.

The fact that producer prices grew more slowly than consumer prices represented a major improvement of the 1997 price dynamics, testifying to the reduction of the cost inflation potential.

Inflation also declined in the sphere of capital investments and in freight transport. In 1996 prices in capital construction increased by 40% and in 1997 they grew by 5%. For freight transport, prices rose by 20% and 0.9% respectively.

This significant narrowing of the gap between the price index dynamics shows that in 1997 the price-setting mechanism became more resistant to external influences. Specifically, this found its expression in the increased stability of the system of relative producer prices.

The absence of sharp fluctuations in the domestic currency exchange rate last year helped reduce inflationary expectations and enabled all exporters and importers to work out stable targets. As a result of the exchange rate policy pursued by the Bank, the official exchange rate of the ruble to the US dollar at the end of the year

*Note. In compiling its Annual Report, the Bank of Russia used Goskomstat data as of May 15, 1998.*

did not exceed the exchange rate limits set by the joint Statement of the Government of the Russian Federation and Bank of Russia for 1997. Stable and predictable exchange rate dynamics was also a key precondition for the creation of a favourable investment climate for both domestic and foreign investors.

The monetary policy pursued by the Bank in 1997 largely contributed to the creation of conditions conducive to a revival of business activity in all sectors of the Russian economy, without which sustained economic growth is impossible.

Over the year GDP grew by 0.4%; in the manufacturing sector GDP increased by 0.5% and in the services sector it rose by 0.3%.

It is estimated that the proportion of household expenditures on final consumption in the structure of GDP final consumption increased to 49.9%.

Nominal personal money income in the Russian Federation as a whole amounted to 1,618 trillion rubles, an increase of 20.9% compared with 1996. The ratio of personal money incomes to GDP was 60.5%, which represents an increase of 1.2 percentage points from 1996.

The period under review saw the continued positive tendency for the rate of growth in personal money income to exceed the rate of growth in consumer prices, a process indicating personal income growth in real terms. Personal income grew by 5.4% compared with 1996 and the real imputed average monthly per capita wage rose by 3.7%.

There were changes in the structure of personal money income. The proportion of income from property and entrepreneurial activities decreased, while the share of wages and other earnings of hired workers and employees increased. The share of wages and social benefits in the money income of the population grew from 41.9% in 1996 to 42.9% in 1997. The proportion of pensions, allowances, stipends and other social transfers in the money income of the population increased by 0.6 percentage points, compared with 1996, to 14.8%.

Although the income differentiation of the population continued, the gap between the highest- and lowest-income groups narrowed. The 10% of the population with the highest income received 31.7% of money income (about 34% in

1996), while the 10% with the lowest income received 2.4% of all money income (2.6% in 1996).

Although the number of people with incomes below the subsistence level is declining, they still account for 20.8% of the total population against 22% in 1996.

The overall sum of expenditures and savings (consumer expenditures, mandatory payments, foreign exchange purchases, increase in deposits, the purchase of bonds and other securities) totalled 1,590.5 trillion rubles, increasing by 20.6% compared with 1996. The share of consumer expenditures in the total amount of personal money income decreased from 68.8% in 1996 to 67.8% in 1997.

Imports remained a significant factor in consumer market saturation, accounting for 49% of all goods in retail trade. The share of foodstuffs in the structure of retail trade turnover increased from 48% in 1996 to 48.8%, while the proportion of non-food goods decreased from 52% to 51.2%.

The share of paid services in household consumer expenditures increased from 20.7% in 1996 to 23.9% in 1997. The prices and charges for services provided to the population grew faster than consumer goods prices — 22.5% and 8.8% respectively. Attendance fees for cultural events grew by a whopping 32.3%, utility service prices rose by 31.4%, rent increased by 35% in the municipal housing sector, maintenance costs in privatised housing rose 34% and household gas bills doubled.

Last year the purchase of foreign currency accounted for 21.6% of all household money expenditures, an increase of 2.8 percentage points compared with 1996.

The share of household savings in bank accounts and securities in 1997 dropped by 2.7 percentage points compared with 1996, to only 2.2% of total income.

The proportion of growth of cash in hand increased from 1.4% of money income in 1996 to 1.7% in 1997. This increase resulted to some extent from a relative fall in the cost of keeping cash owing to lower interest rates and the maintenance of the ruble exchange rate corridor.

At the same time, many problems that arose in the Russian economy in preceding years re-

CONSUMER PRICE INDEX IN 1995—1997 (as % of previous month)

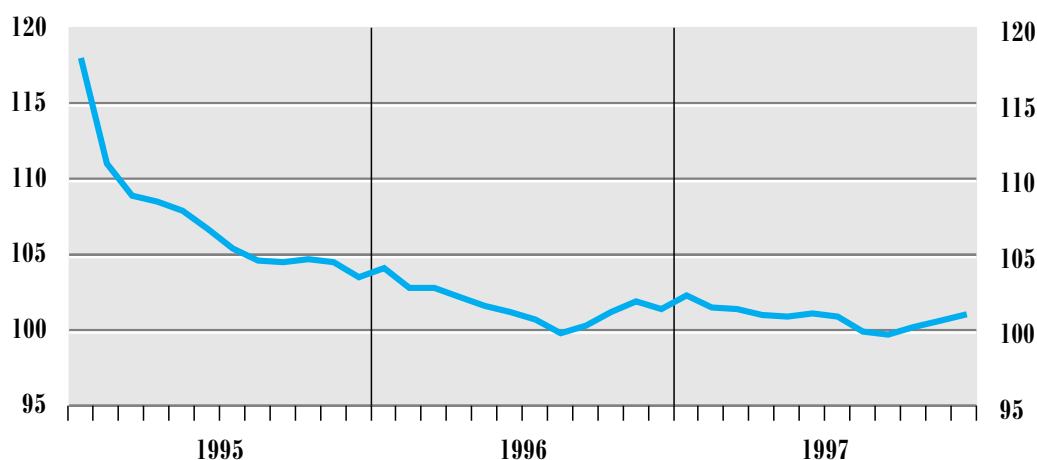


Figure 1

mained unresolved. The state of government finances remained difficult and, although the budget deficit relative to GDP did not exceed the limit established for it in 1997, budget revenues and expenditures did not match the parameters set for the year. The state investment programme was not fulfilled and investments in fixed capital continued to decline.

The government finance system faced serious difficulties in 1997. The failure to meet the budget revenues target required making cuts in budget spendings. Nevertheless, compared with 1996 consolidated budget expenditures increased in comparable prices. As a result of the measures taken during the year to repay wage arrears to public-sector workers and some other factors the share of expenditures on consumer goods and services intended for individual and collective consumption increased in the structure of consolidated budget expenditures. According to the Bank's preliminary estimates, the demand of household-servicing government institutions and non-profit organisations increased by 0.9 percentage points to account for 23.6% of the GDP used for consumption and accumulation.

GDP dynamics and the balance of primary incomes and current transfers from the rest of the world had no significant effect on the structure of the gross disposable national income. Estimates show that its share used for saving in 1997 remained practically unchanged at 30.1%. The bulk of investment resources (72.1%) went to non-financial assets, gross accumulation of fixed as-

sets and tangible working assets (78.3% in 1996).

Compared with 1996, the reserves of tangible working assets in 1997 decreased in real terms, although their share of the GDP intended for utilisation shrank a little to 2.6%.

The dynamics of gross accumulation of fixed capital was affected by the investment situation. In 1997 the volume of investments amounted to 408.8 trillion rubles, a fall of 5% in comparable prices. However, the decline was not as steep as it was in 1996 when investments slid by 18.1%. According to preliminary estimates, the share of gross fixed capital accumulation in the structure of utilised GDP declined by about 1 percentage point to 20%.

Last year saw the continued decentralisation of the sources of investment financing and the share of budget sources of financing declined. The main source of investments in fixed capital was, as before, funds of enterprises, whose share of total investments was 61.5%. Amortization accounted for nearly 58% of enterprises' own funds.

The structure of investments in terms of enterprise ownership did not change from the previous two years. The share of investments in state-owned enterprises continued to decline in 1997 to 22% against 29% in 1996, while the proportion of investments in private and mixed-ownership enterprises increased from 62.1% in 1996 to 69.7% in 1997. The share of investments in municipally-owned enterprises declined by 0.6 percentage points.

An upsurge of investment activity was registered in the power, oil, machine-tool, instrument-making and medical industries, non-ferrous metallurgy, transport and communications.

At the same time, in many branches of the machine-building, chemical, petrochemical, light and other manufacturing industries, which are key to the restructuring of production, investments in fixed capital decreased by 5—30%, while depreciation of fixed assets in these industries was at the level of 45—50%.

According to preliminary estimates, the share of net exports in the final utilisation of GDP declined from 5.5% in 1996 to 3.8% in 1997. Although a favourable balance of goods and services remained in 1997, it was smaller than a year ago.

The decline of aggregate supply of goods and services was halted in 1997. Economic dynamics was determined by the following factors: 28% by growth in industrial output; 7% by stabilisation of agricultural production; 8% by decline in construction; 15% by growth in trade and food catering services; and 13% by reduction of transport services and increase of communications services.

Compared with 1996, industrial production grew by 1.9%.

A number of industries reported a continued increase in production. This applies first and foremost to the export-oriented extractive industries. However, 1997 saw an increase in the number of profit-making manufacturing industries producing goods that are in demand on the domestic market. Production growth was reported in the machine-building sector, chemical and petrochemical industry and also timber, wood-working and pulp-and-paper industries, and this growth brought about some favourable structural changes in industrial production.

For the first time in seven years there was a growth in agricultural production, although it resulted entirely from production growth in crop farming. Gross harvest and crop yields in grain growing increased by more than 25%. Although livestock production continued to decline, the rate of its decline slowed.

Falling demand for the transport of oil and gas by trunk pipelines and the rising share of local consumption for locally produced goods in most regions led to the reduction of freight turnover in transport.

The stabilisation of production in many branches of the sector of non-financial enterprises and further development of the economy's non-governmental sector, especially services, had a significant impact on the employment situation in the Russian economy. There were some improvements in the employment situation, associated with a drop in the total number of jobless.

Over the year the economically active population decreased by 1.8% to 71.4 million in late December, which represents 48% of the country's total population. In accordance with the methodology used by the International Labour Organisation, 6.4 million people, or 8.9% of Russia's economically active population, were classified as unemployed (6.8 million people, or 9.3%, in 1996).

Latent unemployment increased as most sectors of the Russian economy had considerable surpluses of labour. Over two years the accumulated potential of latent unemployment increased by more than 1 million people, from 11.6 million in 1995 to about 13 million in 1997.

At the same time, secondary employment and employment in the informal sector increased. A high level of underemployment, wage arrears and the difficulty of finding work stimulated secondary employment and informal employment. The number of people having second jobs increased from 7 million in 1996 to nearly 8 million in 1997 and the number of informally employed, for whom this kind of employment was the only source of income, was estimated at about 7.5 million.

The level of forced underemployment declined a little. In 1996 the average monthly underemployment rate was 4.5 million, whereas in 1997 more than 4 million workers and employees of big and medium-size enterprises and organisations worked part-time or were on leave at the initiative of management.

The highest rates of underemployment were registered in industry (14.7% of the official average number of workers), transport (15.1%), including railways (30.2%), and research institutions (7.5%). A high level of underemployment is a very dangerous factor, because under certain conditions it may lead to the exacerbation of the situation on the labour market.

The halting of economic recession last year had a favourable effect on the financial state of non-financial enterprises.

The financial results of profit-making enterprises and organisations in industry, construction, transport and agriculture increased 70% (in current prices), while losses of loss-making enterprises grew 30%. As a result, overall profit declined far less than in 1996 (by 0.9% against 57.1%) to 82.1 trillion rubles.

Although growth in the number of loss-making enterprises slowed, the proportion of such enterprises in the total number of enterprises remained large: 79.8% in agriculture, 58.7% in transport, 47.3% in industry and 40.1% in construction. The number of loss-making enterprises increased in all industries except the medical sector.

The problem of mutual non-payments remained acute and was determined by a number of production, financial, price and organisational factors at the macro- and micro-economic level<sup>1</sup>.

According to the Russian State Statistical Committee (Goskomstat), overdue debt on credits received by enterprises and organisations in the four industries surveyed totalled 756.1 trillion rubles, or 59% of the overall amount of debt (55% as of January 1, 1997). This represents a growth of almost 50% over the year.

Industrial enterprises' debts accounted for the lion's share of the overdue debt on credits.

The structure of overdue debt on credits did not change much in 1997. Non-payments to suppliers accounted for the bulk of the overdue debt — 45% to 48%, non-payments to the budgets at all levels made up 21% to 23% and non-payments to the state extrabudgetary funds accounted for 18% to 20%.

Over the course of year the number of enterprises with overdue debts on credits increased to 51,151 and in most cases debts resulted from customers' failure to pay for the products they received.

In 1997 accounts payable exceeded accounts receivable in four key sectors of the economy — industry, construction, agriculture and transport.

The gap was the highest in agriculture (4.2 times), timber, wood-working and pulp-and-paper industry (2 times), light industry (1.7 times) and coal industry (1.4 times).

The "aging" of debt arrears was observed. As of January 1, 1998, debts on credits more than three months past due accounted for 77% of all debts on credits against 73.5% as of January 1, 1997.

Goskomstat data indicate that in mid-1997 the ratio of overdue debt to suppliers to GDP began to decrease. From August to December GDP growth exceeded the growth of overdue debt to suppliers, alleviating the overall debt burden on the economy, but that tendency did not affect the general level of non-payments.

The ratio of working capital to short-term obligations of the economy, which characterises solvency, declined to 104% in industry, 121.5% in construction and 115% in transport against the 200% limit set by the Russian Government in its Resolution No. 498 of May 20, 1994. Only 25% of enterprises in three major sectors of the economy had a ratio that exceeded this limit.

At the macroeconomic level, non-payments largely resulted from the absence of harsh penalties for failure to observe contract obligations. Russia has no developed legal system for protecting owners' rights, it has little experience in settling economic disputes in court and bankruptcy procedures do not work.

Flaws in budget planning continued to have a negative effect on the payments situation.

Whenever production plans are drawn up and contracts are signed with suppliers and customers on the basis of state orders, for which provisions are made in the budget, the state's failure to stand by its budgetary commitments creates a chain reaction of non-payments.

There are also a number of micro-economic causes of non-payments.

Many enterprises have not adapted to market conditions and have failed to switch over to the production of new products. They sell their uncompetitive goods under barter arrangements or for money surrogates or on the condition that

<sup>1</sup> The Central Bank's position is spelled out in "The Proposals by the Bank of Russia on Ways of Solving the Non-Payments Problem in the Russian Federation", which were put forward pursuant to Resolution No. 1634-II GD passed by the State Duma of the Federal Assembly of the Russian Federation on June 24, 1997.

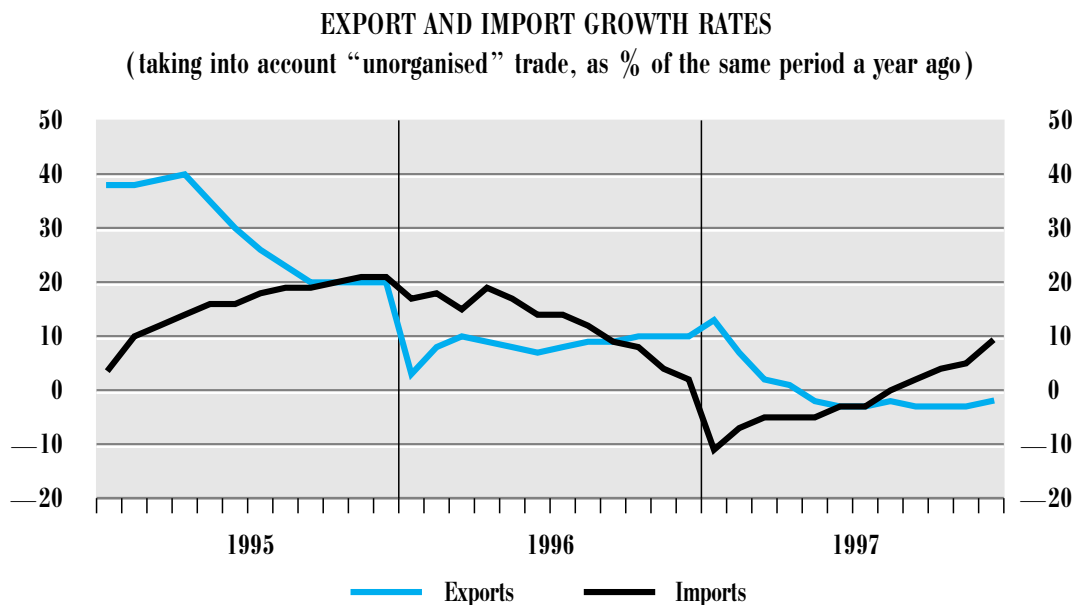


Figure 2

they will be paid sometime in the future. That is why the least competitive sectors of the economy were the primary sources of debt. For such enterprises non-payment is a matter of survival.

The misuse of funds by management at some enterprises, who failed to pay wages and taxes while transferring funds to accounts of their branches and subsidiaries, was another cause of non-payments.

Foreign economic activity continued to play a major role in stabilising the economic situation in Russia last year.

Russia continued to make efforts to become more closely integrated into the international economic community. At the same time, the changed dynamics of foreign trade turnover in 1997 led to an overall weakening of Russia's positions in world trade: Russia's share of world trade decreased from 1.41% in 1996 to 1.38%.

Last year foreign economic activity continued to be of crucial importance for Russia, because its key industries remained highly oriented to the world market. Thus, 37% of all Russian oil and 43% of its natural gas went to export; imports accounted for 49% of the Russian consumer goods market; receipts from foreign economic activity accounted for nearly 30% of all budget revenues; the favourable balance of trade guaranteed repayment of both Russian and Soviet debts.

In 1997, for the first time in several years, the significant growth of Russia's foreign trade turn-

over slowed down. Judging by the balance of payments, Russia's foreign trade turnover in 1997 rose by 1% to \$160 billion, of which trade turnover registered by the State Customs Committee on the basis of customs declarations amounted to \$137.3 billion.

There was also a change of trends in the formation of the key elements of foreign trade turnover. On the one hand, the growth of exports came to a halt; on the other hand, the rate of growth in import of goods accelerated. According to the balance of payments, exports in 1997 decreased by 2% to \$88.7 billion, of which the export of commodities registered by the State Customs Committee amounted to \$84.7 billion. Import of goods amounted to \$71.4 billion, an increase of 6%, of which imports registered by the State Customs Committee totalled \$52.6 billion.

Throughout 1997 the balance of trade remained favourable, although its volume declined considerably compared with 1996.

There was no improvement in the structure of Russian exports in 1997: they were still dominated by raw materials and that predetermines the possibility of abrupt changes in their volume depending on the world market situation.

The negative trends that appeared in the dynamics of Russian exports in 1997 resulted from the worsening of global market conditions for the commodities that formed the basis of Russian exports, especially energy resources. In 1997 the

average annual price of oil fell by 6% compared with 1996, that of gas declined by 7% and the price of two major petroleum products, diesel fuel and fuel oil, fell by 9% and 14% respectively. The expectations of a rebound in the world's non-ferrous metals market in 1997 were not completely justified.

No small role in the reduction of Russian exports was played by restrictive measures taken against Russian products, such as ferrous metals, chemicals, etc. Russia has not yet been recognised as a market-economy country and therefore it is being increasingly discriminated against.

The worsening world market situation in 1997 was compounded for Russian exporters by the fact that even in 1996 many Russian export commodities were sold on the world market at close to their cost price. Any change of effectiveness of foreign trade operations is a major guide for the Bank and its foreign exchange policy. Its calculations show that the average annual efficiency of Russian exports, covering nearly 60% of their volume, fell to the zero mark from 5% in 1996.

Late in 1997 imports started to grow at a faster pace owing primarily to a growth in purchases of engineering products, which was encouraged by improved investment conditions in Russia. In 1997 the share of investment products in total imports rose by 2 percentage points to 42%. The growth in real disposable money incomes in 1997 stimulated demand for imports, while the growth in registered imports resulted, to some extent, from the enforcement of more effective anti-smuggling measures, which forced some importers to legalise their business.

Taking into consideration that the CIS countries accounted for more than 20% of Russia's trade turnover, the halting of growth in trade with this group of countries could not fail to contribute to the overall decline of Russia's foreign trade turnover. Taxation problems, unsettled customs tariffs and debts for earlier deliveries turned some Russian producers away from CIS countries and that also contributed to the reduction of Russia's trade turnover with these countries.

In 1997 the deficit of the balance of services declined a bit owing to a growth in their export.

The balance of goods and services remained favourable in 1997, but it was far less so than in 1996 because of the negative balance of commodities trend.

The downward dynamics of the balance of goods and services was aggravated by unfavourable changes in the balance of returns on investments, the deficit of which grew mainly due to nonresidents' increased earnings from government securities.

As a result, the balance of payments shows that the favourable balance of the current account in 1997 decreased more than three times compared with 1996.

The further development of Russia's international financial relations changed the direction of capital flow. Judging by the balance of payments, the registered foreign capital flow to Russia in 1997 exceeded residents' investments in foreign assets.

Russian foreign trade dynamics, especially exports, were negatively affected to some extent by the financial crisis in the Asia-Pacific region. Asia-Pacific countries comprised a promising market for Russian exporters, so the crisis there undermined demand for Russian exports.

However, the crisis hit hardest the foreign exchange market and the government and corporate securities market. The outflow of foreign capital from these markets caused stock prices to tumble and demand for foreign currency soared.

In that situation the Bank had to raise the refinancing rate, interest rates on Lombard credits and reserve requirements for bank borrowings in foreign currency in order to maintain ruble stability and stick to the targets set in the Guidelines for the Uniform State Monetary Policy in 1997. However, despite the fourth-quarter jump in interest rates, at the end of the year interest rates were lower than they were a year ago. Overall, 1997 saw a growth in the amount of credits extended to the real economy, which slowed the decline in fixed capital investments and had a favourable effect on production dynamics. The crisis had no significant effect on the year's final macroeconomic performance indicators.



## I.2. WORLD ECONOMIC DEVELOPMENT TRENDS

**GDP DYNAMICS.** In 1997 the world's GDP grew by 4.1%, as much as it did in 1996. In the industrialised nations GDP growth accelerated to 3.0% against 2.7% in 1996, while in developing countries GDP growth slowed from 6.4% to 5.8% and countries with transitional economies registered the first increase in GDP since 1990 (+1.7% against -0.1% in 1996). In the last quarter of 1997 the global financial crisis increased differences in the economic situation in various groups of countries. The record-long economic growth in the United States and relatively slow but steady improvement of the economic situation in Western Europe sharply contrasted with the worsening economic situation in Japan, South Korea, some developing countries and countries with transitional economies.

The financial crisis ended a long period of growth in South East Asian countries and dealt a heavy blow to the developing and transitional-economy countries. Overall, the crisis resulted in slower rates of economic growth, a falling price for oil, financial markets' instability, re-orientation of international capital flows, growth in yields on debt instruments of developing and transitional-economy countries and new problems in their relations with international financial organisations and major investors.

In the United States sustained and balanced economic growth continued throughout 1997. Real GDP grew by 3.8%, its highest since 1988 and for the current period of economic growth. Industrial capacity utilisation reached a two-year high owing to active domestic demand. Automobile and computer production posted the highest growth rates. Growth rates were also high in the electrical engineering, chemical, aircraft, wood-working and food industries. Housing construction expanded at a rapid rate, stimulating the production of building materials and household appliances. Owing to high demand for skilled labour, wages rose by 4.1% over the year, almost twice as much as consumer prices. The Federal Reserve kept the discount rate unchanged at 5.0% and in

March raised the federal funds rate by 0.25% to 5.5%. Overall, the international financial crisis has not yet had any negative effect on the US economy.

Economic growth also continued in Western Europe in 1997. Over the year EU countries' GDP rose by 2.6% against 1.7% in 1996 and industrial production increased by 3.0%.

In Japan, fourth-quarter GDP growth rates fell to zero and overall growth in 1997 was 0.9%. The financial crisis in South East Asia exacerbated structural problems in the Japanese financial system, especially an extremely high level of bad debts. The reduction of government investments, dictated by the need to cut the budget deficit, added to Japan's economic woes.

Nonetheless, Japanese producers, especially large industrial enterprises, fared quite well thanks to increased exports. As for small and medium-size industrial enterprises and non-industrial sectors of the economy, they were a great deal worse off. Despite consumer price stability, a high unemployment rate by Japanese standards (3.4%) had a negative effect on personal incomes and prevented consumer demand from growing. Throughout 1997 Japan's foreign trade expanded at an extremely dynamic pace. Returns from exports were high owing to a low exchange rate on the Japanese yen.

**DOMESTIC DEMAND.** Domestic demand rose at a particularly fast rate in 1997 in the United States, United Kingdom and Canada, while Japan showed virtually zero growth.

In EU countries domestic demand grew by 2.0% as compared with 1.4% in 1996. Domestic demand increased in Latin American countries and transitional economies, while in the newly industrialised nations the financial crisis caused it to decline from 6.5% to 4.8%.

Thanks to lower unemployment rates and wage increases, private consumption in the United States rose from 2.6% in 1996 to 3.4% in 1997, while in Germany, France, Japan and the newly industrialised nations it decreased. In Japan, higher unemployment had a negative effect

on personal incomes and checked growth in private consumption. In the EU, private consumption remained practically unchanged from last year.

Growth in government consumption in the industrialised nations slowed down as government spending decreased, especially in the United States, United Kingdom and Italy. The most significant reduction in government consumption was registered in the newly industrialised countries of South East Asia.

The growth in fixed capital investments in the industrialised nations slowed down; in the G7 countries it fell from 5.3% to 3.7%. The steepest decline in fixed capital investments was registered in Japan where the government's capital investment programme had to be suspended and economic growth slowed. A rise in investment demand, especially in the manufacturing sector, contributed to the accelerated economic development of most EU countries. In the newly industrialised countries the growth of investments in fixed capital slowed from 7.0% to 5.1%.

**INFLATION.** Consumer prices in the United States last year rose by 2.3% against 2.9% in 1996. Inflation fell owing to a significant drop in the price of imports, caused by the rise of the dollar. In Japan, consumer prices in 1997 went up by 1.7% against 0.1% in 1996, while most Western European countries managed to keep their inflation rates low. Overall, in 1997 consumer price growth in EU countries was 1.9%, compared with 2.5% in 1996.

In the 1990s developing countries made spectacular progress in fighting inflation and in this sense the gap between them and the industrialised nations narrowed significantly. Inflation in the Asian developing countries declined from 6.7% in 1996 to 3.9% in 1997 and in Latin America it decreased from 22.3% to 13.1%. Prices were mostly stable in Argentina, in Chile prices grew by less than 5% and in Brazil and Peru prices grew by less than 10%. In the African developing countries inflation fell from 26.2% to 10.5%.

Inflation in the transitional-economy countries declined from 41.4% in 1996 to 27.8% in 1997. In Poland it fell from 20.2% to 15.9% and in Hungary from 23.5% to 18.3%. At the same time, inflation rates soared in Bulgaria and Romania.

Inflation decreased in the Baltic states and the Caucasus and Central Asia republics, except Uzbekistan and Mongolia. Armenia, Moldova and Russia kept their inflation rates below 15%.

Some of the major factors behind the reduction of the world inflation rate in 1997 include the purposeful policy and increased independence of central banks, the favourable phase of the world's economic cycle, the reduction in inflationary expectations owing to the successes achieved by the industrialised nations of North America and Europe in cutting their budget deficits, greater production efficiency, and control over unjustified expenditures on wage increases and other production costs owing to the closely inter-related processes of globalisation of the economy and the spread of technological progress.

**EMPLOYMENT.** According to the OECD, the proportion of unemployed in the economically active population in 1997 decreased from 7.3% to 7.1%, largely due to a rise in employment figures in the United States and Western Europe. The United States registered the most significant drop in unemployment, from 5.4% in 1996 to the 25-year low of 4.9%. Unemployment in the EU countries declined mainly as a result of the continued decrease in the number of jobless in the United Kingdom, Ireland and Scandinavian countries. At the same time, unemployment continued to rise in Germany, reaching 11.5% by the end of the year, the closest that country has ever come to its post-World War Two level.

**GOVERNMENT FINANCE.** As a result of economic growth and measures taken by the US Administration to increase federal revenues and cut government spending in 1993 — 1996, the US federal budget deficit for the 1997 financial year was cut by more than half compared with 1996, from \$107.3 billion (1.1% of GDP) to about \$40 billion (0.2% of GDP).

As the governments and business communities of the 15 member-countries of the European Union focused their attention on problems involved in the transition to a single currency, efforts were made to cut the budget deficits of Western European countries to 3% of GDP, as required by the Maastricht agreement. The ratio of budget deficit to GDP declined from 3.4% to 2.7%

in Germany, from 4.1% to 3.0% in France, from 6.7% to 2.7% in Italy and from 4.6% to 1.6% in the UK.

In December 1997 the Japanese government announced a package of measures designed to stimulate the economy, which provided for cutting income taxes by 2 trillion yen (\$15.6 billion) and issuing 10 trillion yen (\$77.8 billion) worth of special government bonds for the purpose of stabilising the country's banking system. The Japanese government also planned to allocate 12 trillion yen (\$91.6 billion) in low-interest loans to small- and medium-sized companies to offset banks' decision to cut credits to them. All these measures would greatly increase Japan's government expenditures.

**WORLD TRADE.** World trade turnover in 1997 grew by 9.4% against 6.6% in 1996. The industrialised nations accelerated growth in their imports from 6.4% in 1996 to 8.6% in 1997, and growth in developing countries' imports increased from 9.3% to 12.1%. In the transitional-economy countries import growth slowed from 7.6% to 5.4%. Export growth accelerated in both industrialised and developing nations — from 5.9% to 9.8% and from 8.7% to 10.8% respectively. As for the transitional-economy countries, their export growth slowed from 4.9% in 1996 to 3.5%.

As was the case in 1996, the driving force of growth in world trade in 1997 was the expansion of domestic demand in the United States and Western European countries.

Last year saw a drop in world prices for all non-ferrous metals, including aluminium (8%), copper (13%), lead (18%), tin (6%), nickel (12%) and zinc (19%). In food exports, wheat prices continued to fall, declining by 13% over the year, while prices for cocoa, coffee and sugar continued to rise, increasing respectively by 31%, 43% and 13% over the year.

At the end of the fourth quarter of 1997 the world price for oil plummeted following OPEC's decision to increase, for the first time in four years, the official quota on oil production by 10%, from 1,252 million tons to 1,375 million tons a year as of December 1997. During the fourth quarter the price for Dubai oil, which is Russian oil's principal competitor, fell from \$147 to \$114 per ton.

Oil production in Iran, Libya, Algeria and Indonesia is below the new quotas so far, but Venezuela, Nigeria and Qatar long ago surpassed them, so that in the last few months oil production for all OPEC countries has totalled nearly 1,400 million tons a year, exceeding the new aggregate quota by about 25 million tons.

The US dollar-denominated world market prices for manufactured goods decreased in 1997 by 9.2% against 3.2% in 1996, oil prices fell by 6.0% after the 18.9% rise in 1996 and the prices for other raw materials declined by 3.7% against 1.3% in 1996.

**FINANCIAL MARKETS.** After March 1997 long-term interest rates in the leading OECD countries had a tendency to fall and the stock price correction made in October boosted this tendency. Thanks to an inflow of capital from more volatile markets the rates on government debt instruments began to fluctuate. The review of real economic growth forecasts in light of the South East Asian financial crisis convinced investors that the inflation rate might decrease further. In many OECD countries interest rates on long-term securities fell to a 30-year low.

World financial markets in 1997 saw the narrowing of the gap between long-term interest rates in Western European countries and the United States and Canada. The only exception was Japan, where interest rates remained very low. The EU countries with the highest interest rates registered the most significant decline in their interest rates as they cut their budget deficits to qualify for admission to the EMU. That created favourable conditions for investment in long-term Western European bonds, whose yields will decrease during the final stage of the EMU's creation.

There was no closing of the gap between short-term interest rates and long-term ones even in the countries which are expected to become members of the EMU. In the UK, short-term interest rates grew for the better part of the year owing to high GDP and employment growth rates. In the United States, the March 1997 hike of the federal funds rates left the short-term interest rates stable.

The situation in the North American and European stock markets in 1997 was so good that even the South East Asian financial crisis could

not reduce stock traders' profits. Over the year the stock market index rose by 20% and on European exchanges the stock market index grew by more than 40% thanks to Europeans' optimistic expectations connected with the forthcoming creation of the European Monetary Union.

The booming securities market resulted from low bank interest rates. In the favourable financial climate of the last few months preceding the crisis, stocks and shares seemed almost a perfect investment. Falling interest rates, which declined for almost the entire year, very low price growth rates, oversaturation of the gold market and dynamic privatisations, mergers and acquisitions made investment in securities a very lucrative business.

The rate correction made in the OECD stock markets in October was accompanied by sharp index fluctuations. At the same time, US and British investors began to return to the domestic markets from those of the developing countries and transitional-economy countries. By the beginning of 1998 most of the stock markets of the OECD countries recovered, except Japan and South Korea, which were the hardest hit by the global financial crisis. The crisis dealt a heavy blow to the stock markets of developing and transitional-economy countries and they will take a long time to recover.

The predominant trend in *the global foreign exchange market* in 1997 was the strengthening of the position of the US dollar. Under the impact of the favourable economic situation in the United States the dollar rate against all leading currencies rose on average by 10.2%. The US Federal Reserve now has to contain the dollar rate growth, postponing its decision to raise interest rates, which might increase foreign capital inflow.

The currency and financial crisis that struck several Asian countries (Thailand, Indonesia and Malaysia) in mid-1997 turned from a regional into a global crisis in October. Capital flight from South East Asian countries caused stock market prices to tumble (they fell by 30% to 40%).

Turmoil in the Hong Kong stock market exacerbated financial problems in Japan and the Japanese yen continued its slide against the US dollar. To shore up the domestic currency, Bank of Japan had to intervene in the foreign exchange market, selling dollars. That, however, gave the

yen little and temporary support. In December it fell to a five-year low of 131.63 yen to the dollar.

The destabilisation of the world financial market did not leave Germany unscathed, although the stock market index there did not fall as low as it did in other countries. Early in October the German Bundesbank raised the REPO rate from 3.0% to 3.3%. It has no intention of further raising interest rates and the German mark exchange rate for fear of worsening prospects for exports. It is believed that the current rate of the German mark to the US dollar suits German exporters.

In 1997 the currency rates of some developing countries of South East Asia were sharply reduced. Persistently attacked by speculators, Thailand's baht, Malaysia's ringgit, the Philippines' peso and Indonesia's rupiah collapsed. In Eastern Europe market speculators attacked the Czech and Slovak currencies. The fall-out of those developments was felt in neighbouring countries. Only Brazil and Russia managed to withstand such attacks.

*World Gold Market.* Gold prices had been declining since February 1996 and in the fourth quarter of 1997 the price of gold plummeted. Late in December a troy ounce of gold cost \$288 — \$290, or \$100 less than a year ago. The main reason for the fall was gold sales from central banks' reserves. Gold was actively sold on the market by Western European central banks in anticipation of monetary union and a single central bank. Gold was also sold by central banks of developing countries, such as Argentina, which recently sold 124 tons of gold, as well as by central banks of gold-producing countries, such as Australia.

The South East Asian crisis dealt a new blow to the gold market: the countries of that region bought up gold in large quantities and as their economic and financial conditions deteriorated, demand for gold sank. Unlike previous financial upheavals, where the role of gold as an investment asset increased, the latest global financial crisis further undermined this role of gold.

*International Capital Market.* The growth of operations on the world capital market, which began three years ago, continued in 1997. Despite the Asian crisis that shook financial markets in October, the volume of operations on the world capital market increased by 10% from 1996 to \$1.8 trillion. As was the case in 1996, the most

dynamic segment of this market in 1997 was the issue of debt securities, which increased from \$709 billion to \$832 billion. Of that sum, fixed-rate bonds accounted for \$545.5 billion and floating-rate bonds for \$213 billion. Low interest rates, which prevailed until the end of the third quarter, and the view that in 1997 economic growth would accelerate and inflation would decrease, encouraged activity in the world capital markets.

During the first three quarters of last year issuing activity in the OECD and developing countries was high. The issue of fixed-rate bonds, which guarantees investors relatively high returns, is the most dynamic segment of the debt instruments market. The issue of syndicated loans increased from \$345 billion in 1996 to \$390 billion in 1997. The issue of medium-term euronotes did not grow that much (\$411 billion against \$374 billion in 1996), while most other types of borrowings declined.

The financial crisis in South East Asia had a negative effect on the financial markets of developing and transitional-economy countries. After the devaluation of Thailand's baht in July, South East Asian countries were dragged into the crisis one by one and their currency rates and stock indices rapidly declined. By September the financial crisis already threatened all Asian countries, although other regions of the developing world were barely affected. However, as the crisis spread and deepened, investors began to withdraw their money from all emerging markets.

In October almost all world stock markets saw a major stock rate correction. In the OECD countries stock prices took a deep plunge and became extremely volatile. In Latin American and transitional-economy countries interest rates soared. Bond issues on the international capital markets in the period between the third and fourth quarters decreased by 40%, while the issue of debt obligations by developing and transitional-economy countries fell by two-thirds, from \$27 billion to less than \$9 billion.

After October the issue of debt obligations by developing and transitional-economy countries, including the countries of Eastern Europe, slowed down and will not likely return to the high levels registered in the first, second and third quarters of 1997 until the financial crisis is overcome.

The Russian Federation first appeared on the world capital market in 1995 and at the end of 1996 the Russian government, regions and leading enterprises and banks began to actively place loans in the eurobond market. In 1997 Russia was granted syndicated loans worth a total of \$3.9 billion. The Asian crisis hurt Russia's currency and financial position and worsened its credit rating, making it increasingly difficult for Russian issuers to place new loans in the world capital market.

The share of OECD borrowers in the world capital market declined from 92% in 1995 to 88% in 1996 and to 87% in 1997, while the proportion of borrowers from other countries increased from 8.3% in 1996 to 10.7% in 1997, owing to investor optimism about developing and transitional-economy countries, which prevailed until the end of the third quarter. The share of international institutions dwindled.

The issue of US dollar-denominated bonds rose sharply, from \$309.3 billion in 1996 to \$407.1 billion in 1997. The US dollar share of the world capital market expanded from 43% in 1996 to 45% in 1997, mainly as a result of growth in the fixed-rate bond issues. The German mark was the second major issue currency in 1997. German-mark bond issues in 1997 increased to DM227 billion from DM150 billion in 1996. The issue of Japanese yen-denominated bond loans in the world market decreased from Y8,410 billion in 1996 to Y5,555 billion in 1997 (80 issues against 145 issues). A downturn was registered in the euroyen loans sector as well as in foreign bonds trade in Tokyo.

The issue of floating-rate bonds increased by 21.6% from 1996 to 1997. Most of these bonds (58%) were issued in US dollars (mostly by American issuers) but also in British pounds, German marks, French francs and Italian liras. An ever growing proportion of floating-rate loans acquire the form of asset-backed loans, which are willingly lent by leading American non-bank financial institutions. Several issues of asset-backed floating-rate bonds were placed by Western European companies in 1997 and more are expected to come as regulation and accounting procedures are being reviewed there.

The floating-rate bonds market in 1997 saw a growth in the issue of subordinated debts, which

attracted many investors due to the possibility of increasing returns on investment. In early 1997 Scandinavian and Japanese banks placed tier-2 capital by issuing termless subordinated bonds.

**BALANCE OF PAYMENTS.** The reduction of cyclical differences helped contain growth in the current account deficit in the United States and EU countries. In Japan, after a decrease to 1.4% of GDP in 1996, the favourable current account balance rose to 2.2% of GDP, because the decline of the yen rate stimulated growth in exports. Rapid growth in domestic demand and the rise of the British pound exchange rate in 1997 created a current account deficit in the United Kingdom, whereas in 1996 it was balanced. The deficit grew in Australia and New Zealand. South Korea's current account deficit, which was registered at 5% of GDP in 1996, was expected to decrease in 1997 owing to a let-up in the rates of import growth. In Singapore, despite the slowing of export growth rates, the favourable current account balance remained at the level of 15% of GDP.

In some developing countries of South East Asia the current account deficit increased in 1997 owing to slower export growth rates. The current account remained balanced in 1997 in the People's Republic of China.

In Latin America, increased domestic demand caused the current account deficit to grow and in Argentina it exceeded 3% of GDP.

In transitional-economy countries the current account deficit remained quite large in 1997. In the Czech Republic it was registered at 7.2% of GDP against 8.2 % in 1996, and in Hungary it amounted to 3.9% of GDP. A surge of domestic demand in Poland caused the deficit to rise from 1.0% in 1996 to 4.9% in 1997. Russia's favourable current account balance continued to decrease.

Net foreign capital flow to developing and transitional-economy countries, which reached a record high of \$240 billion in 1996, kept growing in the first half of 1997. But as the Asian financial crisis deteriorated, it fell to its lowest level since 1992. Overall, in 1997 net foreign capital flow to these countries was \$67 billion less than in 1996, while net foreign capital flow to the developing countries of Asia decreased from \$102 billion in 1996 to \$38.5 billion in 1997.

The international reserves of developing countries grew from \$517.6 billion in 1996 to \$571.9 billion in 1997 and the ratio of international reserves to import of goods and services increased from 44.7% to 45.3%.





### I.3. BALANCE OF PAYMENTS

#### RUSSIA'S BALANCE OF PAYMENTS IN 1997

##### CURRENT ACCOUNT

The favourable current account balance amounted to \$3.3 billion against \$12.1 billion in 1996. In relations with non-CIS countries it decreased from \$14.4 billion to \$2.9 billion. The current account balance with CIS countries changed from a deficit of \$2.3 billion to a surplus of \$500 million.

**Foreign trade turnover** totalled \$160 billion, an increase of 1% from 1996. Exports dropped in value by 2%, while imports grew by 6%. Accordingly, the favourable balance of trade, which means the excess of exports over imports, in the year under review decreased from the previous year's level of \$23 billion to \$17 billion.

The Bank's foreign exchange policy, aimed at ensuring stability of the ruble's exchange rate against the US dollar, had, in effect, a neutral influence on change in commodity export and import operations. The dynamics of these operations last year was chiefly affected by the dramatically changed world market situation, increased domestic demand and structural changes therein.

**The export of goods** was estimated at \$89 billion, of which exports to non-CIS countries accounted for nearly \$70 billion and exports to CIS countries \$19 billion. Deliveries of goods to non-CIS countries decreased by 3% and exports to CIS countries grew by 3%. The decline in the value of exports resulted from the worsening world market conditions for Russian exports. Although raw material prices declined in 1996 too, the fall did not affect the major Russian export commodities, such as crude oil and natural gas. In the year under review the world prices for these commodities also declined. The drop in prices was caused by the excess of supply over demand, resulting from the increased output of energy products by practically all major world producers. In addition, actual world demand was well below the level forecast.

The overall drop in export prices by 5% in 1997 was partly offset by a growth in volume,

which increased by 2%, that is roughly as much as aggregate growth in world demand.

Non-CIS countries accounted for 79% of Russian exports, a drop of 1 percentage point compared with 1996. As was the case in 1996, Russia's leading trading partners in 1997 were Ukraine, which, according to the State Customs Committee, accounted for 8.5% of Russian exports, Germany, which accounted for 8%, and the United States, the Netherlands and Belarus, each accounting for 5% of Russian exports. The growth in Russian exports to Belarus and Belarussian imports from Russia apparently resulted from the functioning of the "Belarusian corridor," through which commodities from third countries moved.

**The import of goods** totalled \$71 billion, of which more than \$52 billion worth of goods came from non-CIS countries and \$19 billion worth of goods from CIS countries. Imports from non-CIS countries grew by 13% in value, while imports from CIS countries declined by 10%. Imports declined the most from Ukraine and Kazakhstan.

The commodity structure of imports characterised changes in domestic demand. The share of imported investment products increased by 2 percentage points to 42% and in some cases the import of raw materials in the structure of imported foodstuffs and raw materials for their production rose at a more rapid rate than the import of final products.

Some changes occurred in the formation of the structure of imports in terms of the channels of their inflow to the country. The tightening of law enforcement measures in foreign trade led to a reduction of imports that had eluded customs statistics. According to the Bank, such imports decreased by 5%.

The leading exporters to Russia were Germany (12.5% of Russian imports), Belarus (9%), the United States (8%) and Ukraine (7.5%). Non-CIS countries accounted for 74% of imports against 69% in 1996.

The negative **balance of services** amounted to \$5.2 billion, decreasing in absolute terms by 9%. The export of services totalled \$13.5 billion, which represents a rise of 4%, and their import remained unchanged from the previous year at \$18.7 billion.

A quarter (\$150 million) of the increase in the value of the export of services was secured by the Russian Space Agency within the framework of the international Alfa Programme, while fully half the increment (\$300 million) resulted from growth in international air traffic.

The services provided to foreigners related to tourism and private or business trips did not change from the previous year. However, the proportion of services provided to residents of non-CIS countries increased from 65% in 1996 to 69% in 1997, while the share of exports to CIS countries dropped accordingly, owing to the reduction in the number of nonresidents from CIS countries who made business and private trips to Russia.

The sectoral structure of the export of services did not change much: transport accounted for more than a quarter of its volume and "Trips" for more than half.

The overall volume of the export of services testifies to its low level of competitiveness on the world market. Thus, in 1997 Russia provided \$1.1 worth of services for \$1 worth of goods it produced and only \$0.15 worth of services to nonresidents for \$1 worth of goods exported.

Fifty-four percent of the import of services were payments for Russian residents' stays abroad. At the same time, the officially registered number of Russians travelling abroad was lower than in 1996, mainly because of a sharp fall in the number of trips to CIS countries and private trips to non-CIS countries. However, the number of Russian tourist visits to non-CIS countries increased by 16%. As a result, the import of services related to "Trips" from non-CIS countries rose by 2% compared with 1996 and that from the CIS countries fell by 23%.

The import of transport services increased by 25% owing to the services provided by nonresidents from non-CIS countries. The import of transport services provided by nonresidents from CIS countries declined by 7%.

As ever, **the balance of remuneration** was negative and amounted to \$300 million.

The number of nonresidents employed on a part-time basis in the Russian economy increased and the average nominal wage in the sectors where most of these nonresidents were employed rose by 4% in its dollar equivalent. As a result, nonresidents' wages grew by 12% to \$600 million. Two-thirds of that amount was paid to workers from CIS countries.

The earnings of Russians employed abroad doubled over the year and amounted to \$200 million.

The negative **balance of returns on investment** amounted to an all-time record of \$8.1 billion in absolute terms. The decline resulted from a 4% drop in the amount of returns against a background of a 33% rise in the amount of payments in the economy.

Incomes to be received were estimated at \$4.1 billion, while incomes to be paid increased to \$12 billion against \$9 billion in 1996. The increase resulted mainly from the payment of interest on government securities owned by nonresidents, especially GKO and OFZs.

The ratio of the incomes paid by all sectors of the economy to GDP in 1997 was 2.6% against 2.1% in 1996. The incomes paid under public-sector obligations in 1997 accounted for 2.1% of GDP against 1.6% in 1996.

**Current transfers** showed a negative balance of \$400 million against the 1996 favourable balance of less than \$100 million. The main reason for the change was that humanitarian and technical aid from abroad declined by almost two-thirds.

## CAPITAL AND FINANCIAL ACCOUNT

### CAPITAL ACCOUNT

The balance of operations between residents and nonresidents, which do not imply counter-flows of economic values and are classified in the balance of payments as capital transfers, was negative at \$800 million.

These are, above all, the transfers of migrants, which reflect the overall cost value of the flows of property, financial assets and obligations accompanying their migration to and from Russia. Migration flows between Russia and other CIS coun-



tries continue to predominate: in 1997 they accounted for almost 100% of the overall amount of transfers received and nearly 50% of transfers paid.

Overall, the cost value of the resources taken out of the country by emigrants (\$2.9 billion) exceeded those brought into the country (\$2.0 billion). Compared with 1996, last year saw a decline in migrants' transfers paid (by 17%) and transfers received (by 24%) by Russia.

### FINANCIAL ACCOUNT

The registered inflow of foreign capital to Russia in 1997 exceeded resident investments in foreign assets by \$6.5 billion (the balance of the financial account of the balance of payments in its analytical presentation). In 1996 the corresponding figure was negative — \$6.3 billion.

On the whole, the foreign capital flow intensified as Russia became increasingly integrated into the system of international financial relations. The inflow of foreign investments to Russia increased 1.7 times and registered investment in foreign assets by Russian residents grew 1.2 times.

The restructuring of Russian indebtedness on the debt of the former USSR to the London club, which largely consisted of the deferral of overdue payments to later periods, improved the term structure of Russia's foreign debt, making some overdue indebtedness a part of the regular debt. Bonds worth \$22.1 billion were issued for the principal and \$6.1 billion worth of bonds were issued for overdue interest (this operation was reflected in the balance of payments as a decrease of the public sector's debt on credits and a corresponding increase in the debt on portfolio investments).

The structure of attracted capital changed significantly compared with 1996. The share of direct and portfolio investments by nonresidents increased, while the proportion of other kinds of investments, mainly provided by foreign credits, declined considerably. It is significant that the proportion of loans lent to the non-financial sector rose in the structure of foreign credits, while that of external borrowings made by the government in this form declined.

The structure of Russian residents' investments in foreign assets changed little: as was the case in 1996, the main form of increase in foreign claims in 1997 was other investments of the non-financial sector.

Compared with 1996, foreign direct investments in the Russian economy rose 2.5 times to \$6.2 billion. Foreign investors preferred to put their money in the financial sector, fuel and energy sector and sectors related to the sphere of circulation and ensuring quick return on investments (food industry, the restaurant business and trade).

Overall, foreign obligations of Russian residents on portfolio investments rose over the year by \$46.4 billion (by \$9.9 billion in 1996). In 1997 the growth in foreign obligations, excluding the bonds issued in connection with the restructuring of the debt to the London club, amounted to \$18.2 billion.

By far the largest amount of foreign capital went to the state-run sector, owing to nonresidents' participation in operations on the Russian government securities market. Overall, net foreign investments in the GKO — OFZ market in 1997 totalled \$10.9 billion. The Russian Ministry of Finance placed \$3.6 billion worth of eurobonds on foreign markets. In addition, Russian regions raised \$900 million using the eurobond mechanism.

As Russia continued to lift restrictions on foreign capital access to the GKO — OFZ market and real interest rates stayed relatively high, foreign investments increased. In the first six months of 1997 net foreign investments in the GKO — OFZ market amounted to \$8.8 billion.

However, instability on global financial markets strongly affected the Russian securities market in July-December 1997. Already in the third quarter foreign capital investments in GKO — OFZ slowed down to \$1.9 billion and in the fourth quarter it fell to as little as \$200 million.

Overall, the nonresident share of the GKO — OFZ market increased from 16% as of January 1, 1997, to 28% as of January 1, 1998.

In 1997 the Ministry of Finance of the Russian Federation placed three eurobond borrowings: in March it issued a 7-year eurobond loan at the par value of DM2 billion and a coupon rate of 9%; in June it issued a 10-year eurobond loan

at the par value of \$2 billion and a coupon rate of 10% and in October it issued the second tranche of a 10-year eurobond loan at the par value of \$400 million and a coupon rate of 10%.

For the first time ever Russian regional governments placed their securities in the international capital market. In May the Moscow government placed \$500 million worth of 3-year eurobonds with a coupon rate of 9.5%, in June the St. Petersburg government placed \$300 million worth of 5-year eurobonds with a coupon rate of 9.5%, and in October the Nizhni Novgorod region raised \$100 million using the eurobond mechanism (the loan was placed for a term of 5 years, coupon rate of 8.75%).

Although foreign portfolio investments in the commercial bank sector almost doubled in 1996, the absolute value was only \$200 million.

It should be noted that nonresidents also became more active in the Russian corporate securities market. The registered growth of foreign obligations on portfolio investments in the non-financial sector amounted to nearly \$2.5 billion against \$2.2 billion in 1996.

A major means of attracting foreign portfolio investment was the financial instrument known as depositary receipts for the shares of Russian enterprises, mainly the American Depositary Receipts, or ADR. By January 1, 1998, this mechanism had been used by more than 20 Russian corporations and several large commercial banks.

In January-September 1997 nonresidents actively invested in Russian corporate securities (\$2.2 billion). The growth in foreign investments is illustrated by a rapid rise in Russian blue-chip share prices during that period (the RTS index jumped more than 2.4 times). In the fourth quarter, however, the stock market crisis in developing countries turned nonresident investors away from the Russian corporate securities market and in October and November massive selloffs of Russian shares by foreign investors provoked a crisis on the stock market. Nevertheless, according to the Bank, overall fourth-quarter foreign obligations of the non-financial sector on portfolio investments rose by \$300 million, mainly thanks to new ADR programmes.

Overall, the state sector in 1997 received more than 85% of all nonresident portfolio investments and this figure serves to show that foreign inves-

tors have too small a set of financial instruments to offer for investment in Russian enterprises.

The negative balance of \$15.2 billion (—\$43.4 billion, taking into account the restructuring of the debt to the London club) on other investments indicates that this form of resident investments in foreign assets exceeded the corresponding inflow of foreign investments.

The inflow of foreign cash to the non-banking sector of the economy in 1996 amounted to nearly \$13.4 billion against \$9.0 billion in 1996. The purchase of foreign currency increased from 18.8% to 21.6% in the structure of money income use by households. People continued to use foreign currency as a major instrument of savings. Demand for foreign currency was stimulated by the black-market economy, which uses cash dollars as a means of circulation.

The changes that occurred in the period under review in the item “Balances on Current Accounts and Deposits” were caused to a great extent by operations conducted by Russian commercial banks, whose foreign assets in this form decreased by \$900 million (in 1996 they increased by the same amount). The obligations of commercial banks in the form of balances on current accounts and deposits grew significantly — by \$4.1 billion (\$1.7 billion in 1996) — owing to an upsurge of investment activity by nonresidents.

The sum of “Trade Credits and Advances,” granted to nonresidents, amounted to \$6.8 billion, of which export credits made up \$5.7 billion. In other words, the results of 1997 showed that almost 6% of export deliveries were made on the basis of deferred payment, which extended beyond the period under review. At the same time, the customs and banking currency control authorities claim that a total of \$4.6 billion of export earnings have not been repatriated by the deadlines set by the legislation and \$6.9 billion dollars worth of goods and services have not been delivered against import advances made earlier.

A decisive role in operations between residents and nonresidents, which are represented in the balance of payments as “Credits and Loans,” is played by the Russian Government’s management of the external government debt and the government’s foreign assets.

Russia’s assets in the form of credits and loans extended (not overdue) decreased by \$7 billion:

some of the debt was repaid (nearly \$2 billion) and some became overdue.

Former Soviet republics repaid nearly \$600 million of the \$1.1 billion debt they owe Russia. Having determined that CIS countries were unable to make payments under the terms of the 1993 — 1994 credit agreements, Russia signed debt restructuring agreements with most of these countries and that found its expression in the first-quarter balance of payments.

There was a favourable balance of \$12.7 billion (\$8.9 billion in 1996) on the credits and loans attracted and this figure testifies to growth in the Russian economy's foreign liabilities. In the period under review the state-run sector of the Russian economy used credits worth a total of \$7.3 billion.

International financial organisations were Russia's major creditors during that period (\$4.8 billion). It is highly significant that for the first time IBRD loans exceeded credits received from the IMF. The Russian Government's debt to the IMF in 1997 rose by \$700 million (a total of \$2 billion of new borrowings were used) and by January 1, 1998, amounted to \$13.2 billion.

In 1997 Russia received \$2.7 billion worth of credits from the IBRD and by the end of the year the debt to this bank had totalled \$5.1 billion. Nearly \$2.5 billion was borrowed under bilateral agreements.

The year under review differed from previous years in that Russian commercial banks actively borrowed funds in the form of syndicated credits and credits from the subsidiaries — the eurobond-issuing finance companies (\$2.1 billion and \$1.2 billion respectively). The inflow of foreign investment in this form was chiefly ensured by large and reliable banks with high international ratings.

As of January 1, 1997, Russia's international reserves totalled \$17.8 billion, an increase of \$2.5 billion over the year. As a result of the operations represented in the balance of payments, foreign exchange reserves in the period under review rose by \$1.8 billion.

In the first half of 1997 the official foreign exchange reserves increased by \$9.4 billion owing to increased foreign capital inflow, whereas from July to December demand for hard currency in the domestic foreign exchange market far exceeded supply and the Bank had to spend nearly \$7.6 billion to offset the negative effects of the crisis.

Overall, in the year under review the Russian monetary authorities managed to maintain the country's international reserves at an acceptable level by international standards: the international reserves accumulated by January 1, 1997, made it possible to finance the 2.4-month import of goods and non-factor services. In 1996 the corresponding indicator was 2.2 months.



## I.4. ASIAN CRISIS AND RUSSIA

*In* **OCTOBER** 1997 the world's financial markets were hit by a crisis, which caused significant changes in international capital flow trends and currency exchange rate proportions that had prevailed in the preceding period.

The global crisis was preceded by a series of local financial crises, which began in June 1997 in Malaysia, Singapore, Indonesia and Thailand and served to show that under some circumstances rapid economic growth based on extensive use of borrowed foreign capital may make the domestic economy too vulnerable.

High returns on investment in the economies of the relatively small Asian developing countries, their rapid economic growth, considerably liberalised foreign trade policies, controlled inflation and political stability had attracted significant investments to these countries. The influx of investments further stimulated economic growth, which in recent years generated upward pressure on the exchange rates of the domestic currencies, causing them to gain considerable strength in real terms.

The massive capital inflow created large current account deficits in many South East Asian countries. Even well capitalised banks began to demonstrate a more rapid growth of assets compared with capital growth. The boom on the real estate and corporate property markets was accompanied by risky lending policies on the part of South East Asian credit institutions and foreign investor speculation. Combined with banking systems' insufficient transparency and inadequate banking supervision, all these factors sharply reduced the quality of banks' credit portfolios.

Since this state of affairs persisted for a long time, the economic situation became increasingly volatile. The current account deficit, which had been growing for several years, represented a particularly serious risk factor. As soon as the fragile equilibrium was upset, the inflow of foreign investment stopped and national currencies began to experience a downward pressure. To minimise their losses foreign investors started to withdraw their money from

Asian markets and that exodus caused the official foreign exchange reserves to dwindle. Asian banks began to sustain heavy losses and eventually the financial systems of the Asia-Pacific region plunged into crisis.

The loss of momentum in carrying out anti-crisis measures made further aggravation of the situation inevitable. National currencies were significantly devalued and interest rates soared. The banking crisis brought the crediting of the real economy to a halt and caused numerous bankruptcies among bank customers. Thus, the financial crisis evolved into a protracted economic crisis.

Overall, during the period preceding the global stock market crisis the situation in the main sectors of the Russian financial market was fairly stable. However, as the Russian economy became more and more open and increasingly involved in the international division of labour and as the Russian financial market became increasingly internationalised, the Russian economy became more and more dependent on the global market situation. The Russian financial market is becoming increasingly sensitive to global financial market fluctuations and, most importantly, financial market crises.

The financial crisis that erupted in South East Asia in October, and which spread to the leading world stock markets by the end of that month, sparked a quick and strong reaction on the Russian financial market.

The most important event perceived by Russian market players as a signal of serious trouble on the global financial market was the sharp fall (by more than 7%) of the Dow Jones index on October 28, which, in turn, was a reaction to the decline of the Asian stock market indices in the preceding period.

The destabilisation of the Russian financial market began as soon as signs of crisis appeared on the global stock market. On October 28 the dollar's exchange rate jumped to an all-time high against the ruble (by 54 points), the corporate stock market tumbled (the RTS index fell by 19% on that day) and annualised yields on government securities (GKO) rose by 3 — 4% dur-

ing one trading session. Later on, the exacerbation of the situation on the global financial markets almost instantly affected the state of the Russian market.

Such a dramatic deterioration of the situation on the Russian financial market may be attributed to the fact that a large proportion of this market is controlled by foreign investors, who regard Russia as one of many countries with emerging markets. Whenever a crisis breaks out in countries with emerging markets, the normal reaction for many foreign investors is to withdraw money from all countries within this group and transfer it to the industrialised nations with the highest credit ratings.

Attracting foreign capital to the domestic government debt market and government borrowings on foreign markets inevitably increase the dependence of Russia and its domestic financial market on external factors, such as global financial market fluctuations.

At the same time, although the crisis in the Russian financial market was provoked by negative external factors, its intensity, duration and aftermath were nevertheless caused by internal factors, connected with the specifics of Russia's social and economic development.

Such specifics include the low rates of recovery in production, the continued decline of investment in the real economy, widespread mutual non-payments between enterprises and the undercollection of taxes and other budget revenues. Although foreign capital investments in the domestic government debt market and government borrowing on foreign markets make it possible to reduce the relative level of expenditures on the servicing of government debt a little, they also make Russia and its financial market more dependent on external factors, such as global financial market fluctuations.

The international financial market crisis compelled the Bank to take a series of steps to protect the domestic currency, minimise the possibility of short-term speculative operations in the financial markets and prevent destabilisation of the country's entire financial system. In that situation the Bank of Russia had two options: it could devalue the national currency or raise interest rates on financial markets. The key indicators on the state of the Russian economy showed that

there was no real reason to devalue the ruble. In addition, a major devaluation of the domestic currency could stimulate inflationary expectations, undermine public trust in the monetary policy pursued by the authorities and in the national currency and, as a result, aggravate the country's macroeconomic situation. That is why the second option was chosen, which was a temporary measure dictated by the situation.

On November 11 the Bank raised its refinancing rate from 21% to 28% and Lombard rates were raised as follows: from 15% to 22% on credits extended for up to 7 days, from 18% to 25% on credits extended for up to 14 days, and from 21% to 28% on credits extended for up to 30 days. On that day the required reserves ratio for credit institutions on balances in foreign-currency accounts was lifted from 6% to 9%. At the same time, to discourage banks from making big cuts in their government securities portfolios the Bank increased the supply of funds in the form of Lombard credits, REPO operations and direct GKO — OFZ deals. From November 10 to 20 the Bank extended more than 13 trillion rubles worth of Lombard credits and lent more than 5 trillion rubles through REPO operations conducted by banks. Overall, compared with the beginning of the month, by November 15 gross credit to banks had grown by 60%. Investors were also given more opportunities for closing the short position on the GKO — OFZ market, limits on REPO operations with the Bank were raised for primary dealers on the GKO — OFZ market and conditions were improved for Lombard crediting (the adjustment ratio used in calculating the value of government securities accepted by the Bank of Russia as collateral when extending Lombard credits to commercial banks was raised). To ease pressure on the currency market the Bank also conducted operations to attract ruble deposits on the interbank market.

In addition, early in November the Bank decided to cut guaranteed yield for nonresident operations on the government securities market and that decision helped slow nonresident capital flight from the Russian market.

The Bank's decisions improved the situation on the Russian financial market and those improvements confirmed that its decisions were

timely, expedient and appreciated by many market participants.

On November 13 investors stopped selling off bonds on the government securities market and the volume of currency forward contracts for cash withdrawal by nonresidents decreased considerably. On November 12 the market value of nonresidents' aggregate GKO — OFZ portfolio stopped falling and nonresidents' share of the overall GKO — OFZ market volume tended to stabilise temporarily. The results of the November 19 GKO auction showed that bidding by market players had become less aggressive: compared with the two previous auctions, bids were closer to the secondary market's prices.

The crisis hit the corporate securities market the hardest. In November share prices fell by more than 20%. The decline was attributable to this market's heavy dependence on nonresidents, the largest of which — Western investment funds — had to sell Russian stocks in order to improve the structure of their portfolios after the fall of the stock market indices in South East Asia and the United States.

The actions taken by the Bank of Russia, Ministry of Finance and Federal Securities Commission of the Russian Federation were commensurate with the situation. To normalise the situation in the corporate securities market, both administrative — suspending trading when the level of quotations offered exceeded the previous day's level by 15% (later on trading was suspended when this indicator exceeded 7%) — and economic measures — raising the Bank's interest rates — were taken.

However, subsequent developments on the corporate securities market and the suspension of trading on the Russian Trading System in November showed that this sector of the Russian financial market was destabilised for a longer time and its reaction to the world stock market crisis was more profound.

By the end of November it had become clear that the Bank's measures and resources were insufficient to simultaneously keep GKO yields below the refinancing rate and maintain a narrow spread between daily fluctuations of the interbank rate of the dollar against the ruble. Investor confidence in Russian financial instruments fell again as the crisis continued in other emerging markets.

To bolster the ruble's exchange rate the Bank had to conduct massive interventions on the foreign exchange market, which sapped its international reserves (in November the Bank's international reserves decreased from \$22.9 billion to \$16.8 billion).

To halt the continued flow of funds from the GKO — OFZ market to the foreign exchange market on December 1 the Bank stopped backing yields on government securities by buying them in the secondary market and simultaneously broadened the daily exchange rate corridor. At the same time, Lombard rates for all terms were raised to 36%, which corresponded to the new level of yields on the market. The new balance in the GKO — OFZ market was attained at the cost of higher interest rates. In the early days of December GKO yields in the secondary market rose to 36 — 39% p.a., but a few days later it fell to 31 — 35%, because the more aggressive investors decided that at this level they could resume buying government bonds. No less an important factor behind the increased attractiveness of government securities was the permission to transfer losses from GKO — OFZ revaluation in 1997 over to the next year, granted by a joint letter of the Bank of Russia, Ministry of Finance and State Tax Service.

Of great importance for the stabilisation of the situation on the GKO — OFZ market was the Government's decision not to place more government securities than was necessary to ensure the current servicing of domestic government debt.

The overall reaction of the Russian financial market to the international financial crisis was not destructive. True, the losses sustained by banks in late 1997 have a negative effect on their performance, but the Russian banking system suffered fairly limited direct losses from the destabilisation of the financial market and its after-effects did not create the risk of a systemic crisis in the Russian banking system.

At the same time, one should not ignore indirect losses, such as a change in the psychological atmosphere on the market. International financial markets have become more sensitive to any negative information about Russia. On the other hand, the behaviour of Russian market participants has become even more dependent on stock index dynamics in the leading industrialised and developing countries.

Yet another indirect effect of the crisis is that Russian banks have lost some of their appeal as partners in international co-operation. The decision by some international rating agencies to downgrade the ratings of the Russian banks that had such ratings will make it even more difficult for all Russian commercial banks to borrow on international markets. Because of that, and also owing to the general deterioration of the situation on international financial markets, many banks had to postpone eurobond issues.

When analysing the aftermath of the global financial crisis, one should see the difference between its impact on the financial markets, the banking system and the Russian economy as a whole. The crisis almost instantly had a negative effect on the situation in the Russian financial market and banking system, but its consequences for the other sectors of the Russian economy were not so immediate. Overall, the main consequences of the crisis for Russia were negative. The crisis (1) increased the cost of servicing domestic government debt; (2) worsened conditions for crediting the real economy by banks due to a general rise in interest rates; (3) diminished the country's foreign exchange reserves, increasing the vulnerability of the Russian financial system; (4) reduced capitalisation of the Russian stock market, which is generally believed to be grossly undervalued; (5) made it more difficult for Russia to attract resources from global financial markets;

(6) increased negative pressure on Russian exports and imports owing to the changed foreign trade dynamics of the Asia-Pacific region.

Demand for major Russian exports in Asia-Pacific countries is expected to fall in the short term.

Russian exports have already declined owing to the unfavourable market situation in Europe and Asia and, partly, because of a drop in demand for oil and petroleum products in Asia-Pacific countries and the switch of their deliveries to more stable markets.

The fall in the exchange rates of Asia-Pacific currencies will make Asian products more competitive in foreign markets and, consequently, stimulate growth in Asia-Pacific countries' exports.

Machine-building products account for nearly 50% and consumer goods make up 3 — 5% of all imports from Asia-Pacific countries. As Asian commodities will become more competitive, Russian producers will find it even more difficult to compete with their foreign rivals in the Russian market even though the Russian government has stepped up its protectionist policies.

As a result of the changes expected in the dynamics of the major components of foreign trade turnover (exports and imports) between Russia and Asia-Pacific countries, negative trends in the balance of trade with these countries are likely to persist in the short term.





## I.5. GOVERNMENT FINANCE

### FEDERAL BUDGET AND DOMESTIC

#### GOVERNMENT DEBT

The budget policy in 1997 was implemented in accordance with the President's Address to the Federal Assembly, "Order in the Power Structures, Order in the Country," the Government Programme "Restructuring and Economic Growth in 1997 — 2000" and the Federal Law "On the Federal Budget for 1997," and aimed to bring about economic growth through investment of budget funds in the sectors that form the modern structure of the economy and the implementation of an active social policy designed to raise the population's living standards. Despite economic growth registered for the first time in many years, favourable structural changes and lower inflation, Russia in 1997 failed to overcome the crisis of government finance caused by weak tax discipline, poor tax collection and widespread use of non-cash settlements with the budget, which led to the failure of budget implementation and government debt.

Federal Law No. 29-FZ of February 26, 1997, "On the Federal Budget for 1997," set federal budget expenditures for 1997 at 529.8 trillion rubles, or 19.4% of GDP, and revenues at 434.4 trillion rubles, or 15.9% of GDP. The maximum level of the federal budget deficit for 1997 was set at 95.4 trillion rubles, or 3.5% of GDP.

According to the Finance Ministry's preliminary data, federal budget revenues in 1997, including monetary offsets and allocations to special-purpose budgetary funds, amounted to 341.5 trillion rubles, or 12.8% of GDP and 78.6% of the revenues set by the Federal Law; expenditures amounted to 427.9 rubles, or 16.0% of GDP and 80.8% of the expenditures set by the Federal Law. The federal budget deficit amounted to 86.4 trillion rubles, or 3.2% of GDP. Calculated by international standards, the federal budget deficit amounted to 174.2 trillion rubles, or 6.5% of GDP. This represents a drop of 1.3 percentage points on 1996.

On the one hand, such a serious failure to implement budget targets resulted from unrealistic budget revenue planning (revenues were planned at 15.9% of GDP although their actual ratio to GDP in 1996 was 12.5%); on the other hand, it was the result of extremely low tax collection.

Tax collection was extremely uneven throughout 1997. The lowest level of tax collection was registered in the first and third quarters (57.1% and 51.6% of the budget projections for the corresponding quarters). It improved in the second quarter (69.8% of the planned volume). In the fourth quarter tax collection increased to 78.6% of the planned target thanks to the repayment of vast amounts of tax arrears by tax delinquents such as AvtoVAZ, Unified Energy Systems and Omsk Oil Refinery, the offsetting of back payments by the Ministry of Finance, the receipt of vast amounts from the State Customs Committee and the traditional increase in tax revenues at the end of the year.

Federal budget revenues came in unevenly because of monetary offsets that were conducted in accordance with Presidential Decrees No. 1452 of October 18, 1996, No. 20 of January 20, 1997 and No. 877 of August 13, 1997, settlements that were effected in accordance with Presidential Decree No. 880 of August 14, 1997, and the Provisions of the Special Procedure for Effectuating Settlements in Implementing Some Federal Budget Expenditures in 1997 (according to the Ministry of Finance, the offsets ensured the collection of 40.5 trillion rubles in federal budget revenues).

The practice of conducting offsets began in the middle of August 1996 after tax exemptions expired. Presidential Decree No. 880 of August 14, 1997 and the Provisions promulgated by the Finance Ministry, State Customs Service and Bank of Russia, dated September 18, 1997, established a new procedure for repaying government debt to suppliers and defaulters' debts to the government, which came to be known as "offsetting back payments".



The new, more stringent system of mutual offsets provided for the routing of budget funds through a Cash Settlement Centre and did not require using promissory notes, while Finance Ministry allocations to budget funds recipients were limited to the latter's debt offsets under each item of the budget. Thus the offset procedures gradually evolved into stiffer government control.

After the suspension of the fourth tranche of the IMF's three-year extended fund facility for Russia in 1997 the Russian Government drew up a Plan of Action to Increase Tax Collection and Reduce Federal Budget Expenditures (No. 4400p-P13 of November 19, 1997) and the President issued a Decree on Measures to Improve Government Finance (No. 1278 of December 11, 1997), which aimed to improve tax collection, tighten tax discipline, speed up payments and enhance control over budget-financed organisations' revenues and expenditures.

Despite the State Tax Service's efforts to improve tax collection, the shortfall on federal budget revenues kept growing in 1997 and, according to the State Tax Service, on January 1, 1998, amounted to 93.9 trillion rubles (not including 9.7 trillion rubles of deferred payments), which represents a growth of 31.8 trillion rubles since January 1, 1997. Of the total shortfall on federal budget revenues, the shortfall on VAT amounted to 66.4 trillion rubles, or 70.7%, the shortfall on income tax amounted to 13.0 trillion rubles, or 13.8%, the shortfall on excise duty amounted to 7.1 trillion rubles, or 7.6%, and the shortfall on fees for the use of natural resources amounted to 4.8 trillion rubles, or 5.1%.

Low tax collection made cuts in federal budget expenditures inevitable. The sequestration procedure was established by Article 76 of the Federal Law on the Federal Budget for 1997 and the Russian Federation Law on the Fundamentals of the Budget Structure and Budget Process in the Russian Federation, which stipulate that budget expenditures are cut on the basis of quarterly results if incoming federal budget revenues fall by more than 10% of the amount set by the law.

Taking the economic situation into consideration and expecting revenues at the level of 331.6 trillion rubles, the Russian Government

on April 30, 1997, issued Instruction No. 647-R, which reduced budget allocations to 421.6 trillion rubles until the end of the year.

However, more rapid growth in revenues (relative to GDP) compared with expenditures made it possible to cut the federal budget deficit to 3.2% of GDP against 3.3% in 1996 and it did exceed its maximum level of 3.5% of GDP, set by the 1997 Federal Budget Law. At the same time, the actual federal budget deficit in relation to total expenditures (21.%) surpassed the limit of 18.01% set by this law.

The Russian Government partly offset the undercollection of taxes with non-tax revenues: above-plan incomes from the sale of state property (14.6 trillion rubles), the Central Bank's profit (2.0 trillion rubles) and borrowing on financial markets.

In 1997, 86.5 trillion rubles (74.3 trillion rubles in 1996) were raised on financial markets as budget revenues. Most of these are returns from the sale of government securities on the domestic and foreign markets (Eurobonds) and loans from international financial organisations.

The quarter-by-quarter analysis of federal budget revenues shows that the Russian Government in 1997 failed to increase the proportion of taxes and other payments in the total amount of budget funds. Over the year it decreased from 77.6% to 75.4%, while the share of borrowings increased. It should be noted that the volume of domestic revenue sources shrank by 8.1 trillion rubles over the year, while that of foreign sources grew by 20.3 trillion rubles and the overall amount of budget borrowing in 1997 rose by 12.2 trillion rubles compared with 1996.

The decrease of domestic borrowing made by the Government to cover the budget deficit also slowed the growth of government borrowing in the total amount of internal credit, increasing the amount of available funds in the economy that could be channelled to the real sector.

Compared with the previous year, 61.8% of the federal budget deficit in 1997 was financed from foreign sources (44.7% in 1996) and only 38.2% of the federal budget deficit was financed from domestic sources (55.3% in 1996), whereas the planned targets were 55% and 45%

respectively. The Government did not exceed the upper limit of government borrowing, set at 95.4 trillion rubles, with the absolute amount of domestic borrowing equalling 33 trillion rubles and foreign borrowing 53.5 trillion rubles. In addition, at the end of 1997 it decided to cut domestic borrowing by 6.6 trillion rubles, raising the volume from foreign sources by the same amount, since the stock market crisis had caused the price of domestic borrowing to soar.

The increase in the share of the foreign sources for financing the budget deficit in 1997 is attributable to the Government's desire to lengthen loan periods, cut the price of borrowing and reduce interest rates in the economy.

As was the case in 1996, the bulk of external borrowing consisted of credits from international financial organisations and credits extended to Russia by foreign governments and commercial banks and companies. It is highly significant that it is the increase in the latter's credits (from 14.5% to 33.1% of the overall amount of budget deficit financing) that ensured most of the growth in foreign resources for the year under review.

As was the case in 1996, returns from the sale of GKO — OFZ accounted for the majority (42.1%) of the domestic sources for financing the budget deficit, although their share in the overall financing of the federal budget deficit decreased compared with the previous year. The share of returns from the sale of state savings loan bonds (OGSZ) in the financing of the federal budget deficit fell significantly (from 8.5% to 5.4%).

Although revenues from the sale of GKO — OFZ remained the primary source for financing the budget deficit in 1997, it became increasingly difficult for the Russian Government to raise the necessary funds on the domestic market: during the first three quarters of 1997 the ratio of (primary) GKO — OFZ placements to their issue constantly declined (from 77.6% to 69.7%) and only in the fourth quarter rose a little to 73%, although the year's total (74.2%) was far below the 1996 level (88.4%). Overall, net transfers to the budget totalled 34.1 trillion rubles during the year, of which 20% came from auctions and 80% from additional GKO — OFZ placements in secondary trading.

As the federal budget deficit remained large in 1997, domestic government debt continued to grow. According to the Ministry of Finance, the overall volume of the Russian Federation's domestic government debt as of January 1, 1998, amounted to 500 trillion rubles against 530 trillion rubles, set as the upper limit by the 1997 Federal Budget Law, and 365.9 trillion rubles as of January 1, 1997.

The fastest growing portion of the domestic government debt was bonded debt (in the form of GKO and OFZ), which had amounted to 435.96 trillion rubles by the beginning of 1998, or 87.2% of the total debt (the market portion of this debt is 384.9 trillion rubles). This debt is comprised of short-term government bonds and federal loan bonds, including the Finance Ministry's debt on credits extended to finance the federal budget deficit in 1992 — 1994 as well as credits extended in 1992 to finance defence industry conversion programmes and investment projects as well as interest on them due in 1997 — 2004, which, according to Article 73 of the 1997 Federal Budget Law, was restructured into fixed-income federal loan bonds with a nominal value of 79.8 trillion rubles. During 1997 GKO volumes increased by 69 trillion rubles and OFZ volumes grew by 126 trillion rubles, with the share of OFZ in the overall amount of the Russian Federation's domestic government debt rising and that of GKO declining.

The Finance Ministry's debt to the Central Bank on direct credits decreased by 57.1 trillion rubles to 0.07 trillion rubles as of January 1, 1998, as a result of restructuring 56.3 trillion rubles of this debt into fixed-income federal loan bonds and the redemption of 0.6 trillion rubles by the Finance Ministry in January-February 1997. In addition, 2.48 trillion rubles of the 2.68 trillion rubles of interest charged and deferred by the Central Bank on the Finance Ministry's debt to it were written off owing to the inclusion of this sum in future income from the restructured fixed-income federal loan bonds and 0.2 trillion rubles were redeemed by the Finance Ministry in January-February 1997. In 1997 the domestic government debt of the former USSR decreased by 0.45 trillion rubles to 0.2 trillion rubles.

Developments in November and December 1997 greatly exacerbated the problem of the bonded portion of the domestic debt, because the destabilisation of the GKO — OFZ market during that period, caused by the global financial crisis, and the deterioration of the debt's time structure considerably increased the cost of servicing it. In December 1997, as a result of measures taken in that period to cushion the effects of the global financial crisis, the cost of servicing the domestic bonded debt exceeded gross returns from the sale of government securities for the first time in the history of the GKO — OFZ market. The Finance Ministry had to make allocations out of the federal budget to service the bonded debt (about 600 billion rubles). Therefore, in the fourth quarter of the year the budget efficiency index (the ratio of net budget revenues from the sale of GKO — OFZ to bonded debt growth) decreased to —13% against 23% in the same period of 1996.

Overall, over the year the budget efficiency index, calculated relative to debt growth, remained practically unchanged from the previous year's level at 23% (21% in 1996), while relative to returns from sales it dropped by 2 percentage points to 8%. The cost of servicing GKO — OFZ in relation to gross returns from this market increased from 89.2% to 92.1%. This means that the Government's borrowing on the debt market began to be used entirely to redeem earlier bond issues and pay coupon income on them.

The reduction of the budget efficiency of domestic borrowing by the end of 1997 resulted mainly from the growth in yields on government debt instruments. In December GKO — OFZ auction yields reached an all-time high (41.3% on December 3) and while throughout 1997 average yield was two or three times lower than in 1996, in December it came close to the December 1996 level of 32.8%.

Instability on the world's financial markets had a negative effect on the time structure of the bonded debt. Although in October 1997 the structure of the bonded debt improved compared with the beginning of the year (the proportion of 3-month GKO and GKO with 3 to 6-month maturities decreased 80%, while the share of GKO with maturities longer than 6 months in-

creased), in December the share of 3-month GKO in the overall volume of GKO and OFZ rose from 19.1% to 22.3% at par, the share of GKO with maturities from 3 to 6 months grew from 19.2% to 21.9%, and that of GKO with maturities of more than 6 months declined from 30.9% to 26.7%.

The banking sector remained the main holder of domestic bonded government debt (in the form of GKO and OFZ) in 1997 (64.4%), while the share of nonresident holders of bonded debt increased over the year from 16.2% to 28.8% (from October to the end of the year it decreased from 29.2% to 28.8%). The share of individuals remained small and practically did not change throughout the year (0.4% — 0.5%). The proportion of non-bank corporate holders of bonded debt had declined to 6.4% by the end of 1997, while from October to the end of the year it kept growing, because yields on government securities remained high.

#### SERVICING OF BUDGET REVENUE ACCOUNTS, BUDGET ACCOUNTS AND GOVERNMENT EXTRA-BUDGETARY FUND ACCOUNTS BY THE BANK OF RUSSIA

In the course of operations with federal budget funds by the end of 1997 356.5 trillion rubles were entered into the federal budget revenue accounts of the Finance Ministry's Federal Treasury Main Administration, transferred to finance federal budget expenditures, excluding 42.2 trillion rubles of federal budget revenues transferred to finance federal budget expenditures at the level of constituent territories of the Russian Federation.

The balances of 1997 federal budget funds in the federal budget accounts of the Federal Treasury and budget recipients amounting to 11.8 trillion rubles were transferred on December 31, 1997, by Bank of Russia institutions and credit institutions, to the federal budget accounts of the Federal Treasury and budget recipients and registered as being entered in the new year.

At the end of 1997 federal budget debts on wages and pensions were repaid and 14.6 trillion rubles were transferred to con-

stituent territories of the Russian Federation as financial aid to pay back wages to employees of budget-financed organisations. At the same time, some territories failed to pay all wage arrears to organisations financed out of regional budgets.

Taking into consideration the difficult situation with regard to the collection of taxes to budgets and government extra-budgetary funds, the Bank and other ministries and government departments in 1997 took part in the federal government's actions to increase the revenues portion of the federal budget.

In line with the decision of the Government Commission on Financial and Monetary Policy, in October and November 1997 the ruble and foreign currency accounts of the Russian Federation's State Customs Committee were transferred from Moscow-based credit institutions to the Bank of Russia's First Operations Department (OPERU-1). It is estimated that in the fourth quarter of 1997 customs payments to the federal budget increased by 8.7 trillion rubles compared with the third quarter of the year.

In 1997 funds continued to be transferred to accounts of tax debtors in accordance with the procedure established by the Finance Ministry, State Tax Service and Bank of Russia in compliance with Presidential Decree No. 1212 of August 18, 1996, "On Measures to Improve the Collection of Taxes and Other Compulsory Payments and Regulate Cash and Non-Cash Circulation."

According to the Bank's regional branches, as of January 1, 1998, the tax authorities registered more than 230,000 accounts of enterprises and organisations in arrears, owing debts to the budgets and government extra-budgetary funds. These accounts were opened in accordance with the aforementioned presidential decree.

Throughout the year the Bank made sure that banks fulfilled their clients' payment orders, including orders to transfer funds to budgets, on time. In 1997 the amount of debt to the federal budget, owing to the absence of funds in credit institutions' correspondent accounts, decreased almost by half to 2.1 trillion rubles against 4 trillion rubles as of January 1, 1997, of which the debt of operating

credit institutions was 0.8 trillion rubles, the debt of credit institutions which had their licence revoked remained at 1.3 trillion rubles, the debt on payments to the budgets of the Russian Federation's constituent territories and local self-governments amounted to 1.1 trillion, 0.3 trillion and 0.8 trillion rubles respectively, and the debt on payments to government extra-budgetary funds (Pension Fund, Social Security Fund and Employment Fund) amounted to 0.8 trillion, 0.3 trillion and 0.5 trillion rubles respectively.

Of the total amount of non-payments to the federal budget owing to the lack of funds in credit institutions' (branches) correspondent accounts, in which federal budget accounts were opened, or owing to the revocation of banking licence, non-payments to the federal budget revenue accounts with Bank of Russia institutions amounted to 4.3 billion rubles as of January 1, 1998.

In 1997 Federal Treasury bodies and financial and tax authorities, in collaboration with Bank of Russia institutions, continued to inspect credit institutions to make sure that they fulfil, in a timely manner, taxpayers' payment orders to transfer taxes and other compulsory payments to budgets of all levels and government extra-budgetary funds.

Overall, 88% of all credit institutions and their branches were inspected for this purpose in 1997. The inspections showed that 43.6% of the credit institutions and branches inspected failed to transfer taxes and other compulsory payments to budgets of all levels and government extra-budgetary funds on time. The number of such delays amounted to 1.2 million and the amount of penalties imposed on credit institutions for these delays totalled 640.4 billion rubles.

To improve the quality of inspections at credit institutions, carried out to make sure that credit institutions conduct proper and timely operations with all budget funds at the instruction of the managers of these funds and transfer taxes and other compulsory payments to all budget revenue and government extra-budgetary fund accounts on time, in December 1997 the Bank worked out Methodological Recommendations on the Inspection of Operations Conducted in

Credit Institutions (Branches) with Federal Budget Revenue Accounts, All Other Budget Accounts and Government Extra-Budgetary Fund Accounts.

Pursuant to Presidential Decree No. 477 of May 12, 1997, "On Measures to Enhance Control over the Use of Federal Budget Funds" and the Government's Resolution No. 1082 of August 28, 1997, "On Measures to Accelerate the Transition to the Treasury System of Federal Budget Execution" and to improve the management of federal budget funds, enhance control over their use and bolster financial discipline, the Bank took part in arrangements designed to speed up the transition to a treasury system of federal budget execution in 1997.

As of January 1, 1998, the regional bodies of the Federal Treasury in 82 constituent territories of the Russian Federation were granted the right to conduct operations with federal budget revenue accounts, and in 85 territories they received the right to handle federal budget accounts.

Seventy-nine constituent territories of the Russian Federation used the procedure (established in June 1995) whereby the corresponding Federal Treasury bodies transferred federal taxes collected in these territories to finance federal budget expenditures in these territories. Overall, in 1997 the Federal Treasury bodies in the Russian Federation as a whole transferred 42.2 trillion rubles of federal budget revenues received from the constituent territories to finance federal budget expenditures in these territories.

In 1997 budget-financed organisations and institutions began the transition to financing through working accounts opened by them with the Federal Treasury bodies.

As of January 1, 1998, 1,926 Federal Treasury bodies financed budget-financed institutions and organisations through working accounts opened by them with these Federal Treasury bodies. Of the total 44,000 budget-financed institutions and organisations, 22,200 adopted this financing procedure wholly, 1,400 adopted it in part and 20,400 had not yet adopted it. In addition, of the 41,900 other institutions and organisations financed from the federal budget, 17,000 switched to the financing procedure

through working accounts opened by them with the Federal Treasury bodies and 24,900 did not.

The transfer of budget-financed organisations to the Federal Treasury system of services is hindered by a lack of legislation to regulate the handling of documents related to the enforcement of payments from Federal Treasury accounts by the decision of a court of law, State Tax Service authorities, Pension Fund and other claimants.

As Bank of Russia institutions transferred the function of maintaining working accounts for budget-financed organisations to Federal Treasury bodies, Federal Treasury bodies in 26 regions of the Russian Federation in 1997 were connected to the Bank of Russia settlement network as customers, using the Bank's telecommunications system; in 21 regions the matter is under consideration.

An experiment was conducted on the basis of the software system "Electronic Exchange of Customers of Bank of Russia Institutions Using a Cryptographic Information Security System Integrated with the Automated Bank Settlements System," created in August 1997 at the Bank's Ryazan regional branch, during which Federal Treasury bodies conducted operations with federal budget revenue accounts and federal budget accounts using an electronic bank settlement system. Two work-stations were installed in the Federal Treasury's Ryazan Department in 1997, from which Treasury operators effected routine electronic payments.

As of January 1, 1998, 1,362 Federal Treasury bodies had federal budget revenue accounts opened with Bank of Russia institutions and 1,393 Federal Treasury bodies had federal budget accounts opened with Bank of Russia institutions; 529 and 568 Federal Treasury bodies respectively had such accounts opened with Sberbank institutions and 239 and 220 Federal Treasury bodies had such accounts opened with other credit institutions and their branches. According to preliminary data, federal budget revenue accounts, whereof working account statements are presented to State Tax Service bodies, were opened for 165 tax inspectorates in Bank of Russia institutions,

11 tax inspectorates had such accounts opened with Sberbank institutions and 55 tax inspectorates had such accounts opened with other credit institutions.

As of January 1, 1998, Bank of Russia institutions in 1997 serviced more than 23,000 federal budget-financed institutions and other organisations with budget accounts and kept more than 39,000 working federal budget accounts, Sberbank institutions serviced 5,200 budget-financed institutions and kept 6,500 working accounts, and other credit institutions and their branches serviced 20,700 institutions and kept 27,800 working accounts.

The Bank participated in the Federal Government's efforts to enhance control over the timely and full payment of insurance contributions to the Pension Fund of the Russian Federation.

The Bank of Russia, Pension Fund, Ministry of Finance and State Tax Service sent a joint letter to their regional branches (No. 405 of February 3, 1997, No. VB-16-28/700 of February 4, 1997, No. 11 of February 4, 1997, and No. BE-4-07/2n of February 4, 1997 respectively), "On Enhancing Control over the Timely and Full Payment of Insurance Contributions to the Pension Fund of the Russian Federation," which established the procedure whereby banks should make sure that the payers' payment orders for the transfer of insurance contributions to the Pension Fund contain the corresponding entries and admonished banks to comply with the established order of transferring insurance contributions not later than the next working day.

Bank of Russia institutions took part in inspections conducted by Pension Fund authorities in 1997 to verify compliance with the above-mentioned joint letter. In addition, in October Bank of Russia institutions conducted an inspection to make sure that credit institutions and Bank of Russia cash settlement centres transferred employers' insurance payments from transit accounts to the main accounts of the regional branches of the Pension Fund of the Russian Federation on time.

In pursuance of parts of Articles 8, 53 and 54 of the 1997 Federal Budget Law on

consolidation in the federal budget of the road tax paid by road users to the Federal Road Fund, the Bank of Russia participated jointly with the Finance Ministry, State Tax Service and Federal Road Service in working out the procedure for transferring the road tax to the Federal Road Fund and regional road funds.

Undercollection of taxes and other payments was also a typical problem for the budgets of the constituent territories of the Russian Federation and local self-governments. According to the Finance Ministry's preliminary data, the budget revenues of the constituent territories of the Russian Federation amounted to 414.9 trillion rubles and expenditures totalled 446.9 trillion rubles, creating a deficit of 32 trillion rubles.

Net balances in the regional and local budget accounts with Bank of Russia institutions on January 1, 1998, amounted to 3.6 trillion rubles against 2.3 trillion rubles on January 1, 1997.

The executive bodies of power and local governments in 66 regions of the Russian Federation borrowed from credit institutions to finance their budget deficits in order to meet urgent municipal needs and pay wages. Loans were issued for these purposes by the decisions of representative and executive bodies of power in 19 regions.

As of January 1, 1998, 281,400 working accounts were opened in the regional and local budget balance accounts and 101,754 budget-financed organisations had 188,800 working accounts opened for this purpose, of which 10,700 working accounts were opened for 4,461 financial bodies and 92,600 working accounts were opened for 87,233 other organisations.

Of the total number of working accounts opened in the balance accounts for recording budget funds of the constituent territories of the Russian Federation and local budgets, 119,600 were opened with Bank of Russia institutions, 38,400 with Sberbank institutions and 123,400 with other credit institutions.

The Pension Fund of the Russian Federation in 1997 borrowed from credit institutions to repay debt on pensions. As of January 1, 1998, its

debt to credit institutions, including Sberbank, amounted to 3.06 trillion rubles.

Some regions in 1997 used credits to cover the shortage of cash in their extra-budgetary funds.

Net balances in the accounts of government extra-budgetary funds with Bank of Russia institutions amounted to 4.8 trillion rubles as of January 1, 1998, against 2.4 trillion rubles as of January 1, 1997.



# MONETARY POLICY





## II.1. OBJECTIVES AND RESULTS OF MONETARY POLICY

**S**TABILISATION of the national currency's purchasing power on domestic and foreign markets is seen as a necessary condition of economic growth and, as was the case in previous years, in 1997 it was the principal objective of Russia's monetary policy.

In accordance with the Bank of Russia's key policy documents (Guidelines for Uniform State Monetary Policy in 1997 and the Joint Statement by the Government of the Russian Federation and the Central Bank on Medium-Term Strategy and Economic Policy for 1997), Russia had to cut the inflation rate to less than 12% a year. Inflation was to be reduced by curbing the rate of growth in the M2 money supply and controlling exchange rate dynamics. The M2 aggregate was to grow by 22 — 30% over the year. The main targets of the exchange rate policy in 1997 were set in the Guidelines for Uniform State Monetary Policy in 1997 and the Central Bank's Statement on Exchange Rate Policy in 1997.

Seeking to attain the ultimate objective of its monetary policy, the Bank controlled the entire set of key monetary indicators in 1997. That is, not only money supply, but also the ruble's exchange rate, the level of interest rates and yields on securities in the money market. In the meantime, as the financial market developed in Russia, the role of qualitative parameters of monetary policy in 1997 increased significantly.

Since exchange rate dynamics have an extremely strong influence on Russian exports and imports and also on price dynamics and money

market stability, the Bank continued to use the currency corridor (setting upper and lower limits for ruble/dollar fluctuations) as a qualitative parameter of its monetary policy in addition to the quantitative parameter of money supply.

Lower interest rates were also expected to play a major role in bringing about economic growth in 1997. The Bank sought to create conditions conducive to a gradual reduction of interest rates in the economy, especially interest rates on credits to its real sector, to a level that would encourage growth in solvent demand for loans. Taking into consideration that interest rate dynamics in the economy depended, to a great extent, on the dynamics of yields on government securities, it was particularly important to reduce the cost of government borrowing.

The implementation of monetary policy in 1997 resulted in the further reduction of inflation and the gradual stabilisation of the ruble's purchasing power. Consumer price growth in 1997 slowed down considerably compared with 1996, to 11% a year, and that, on the whole, met the targets set by monetary authorities.

The M2 money supply in 1997 also increased in accordance with pre-set parameters, growing by 31.5% over the year. As was the case in 1996, money supply continued to grow in real terms. In 1996 real growth in money supply was 10%, whereas in 1997 it was 18.5%.

One of the most significant results of lower inflation in 1997 was the possibility of the further noninflationary supply of the economy

with money, which had a favourable effect on the dynamics of key macroeconomic indicators. The growth in monetisation of GDP, which began in 1996 when the velocity of money supply slowed for the first time since the start of economic reforms, continued in 1997: average annual velocity of supply decreased from 8.7 to 7.8.

Interest rates in the economy fell until the end of October. Yield on government securities declined from 29.1% in January 1997 to 18.3% in October<sup>1</sup>. During that period the Bank repeatedly reduced its refinancing rate, which fell from 48% in January to 21% in October, and rates on the Bank's Lombard credits to credit institutions were also cut. The reduction of the general level of interest rates in the economy was accompanied by a gradual acceleration of the rates of growth in bank credits to private-sector enterprises. In 1996 banks' claims on non-financial enterprises in the private sector grew at the average monthly rate of 1.3%, whereas in 1997 they rose to 3.1% a month.

However, the share of credits to the economy in the assets structure of commercial banks increases too slowly. It should be stressed in this connection that, judging from the experience of 1997, the decline of interest rates in the economy is the essential, but not the only condition of banks' extending credits to the real economy.

Nevertheless, the global financial crisis had a strong impact on the monetary policy pursued by Russian authorities in 1997 and its overall results for the year. The progress Russia made by 1997 in stabilising its domestic currency stimulated foreign capital flow into the Russian economy. The rapid development of the Russian corporate securities market was, to a great extent, the consequence of the influx of foreign capital, while the lifting of restrictions on foreign investors operations in the Russian government securities market encouraged an inflow of foreign capital to this segment of the market too. It is largely thanks to this that in January — October 1997 the Russian monetary authorities managed to cut yields on government securities.

However, the increased dependence of the Russian economy on foreign capital, resulting, to

a great extent, from the state of government finance, and the fact that most foreign investments in Russia were portfolio investments, made the Russian financial market extremely susceptible to global market fluctuations. When nonresidents began to rapidly withdraw from the Russian stock market owing to the global financial crisis in the autumn of 1997, yields on government securities soared, corporate stock prices sank, demand for foreign currency rose and the Bank's international reserves decreased.

That required taking a series of urgent regulatory measures to protect Russia's financial markets and domestic currency. The Bank raised the refinancing rate, Lombard rates and reserve requirements on foreign currency deposits. The Bank's tightening of monetary policy was accompanied by a decline in the price of government securities. In December the yield on government securities rose to 32%, exceeding the level of early 1997. Thus, the strategic task of cutting yield on government securities came into conflict, as it were, with the growth in this yield as a result of the temporary corrections made in the situation on the foreign exchange market.

However, the decision to stop shoring up yields on the government securities market, made to ease tension and prevent destabilisation of the foreign exchange segment of the country's financial market, created conditions for a subsequent decline in yields on government securities.

Since the withdrawal of nonresident funds from the domestic market was not caused by any change in Russia's macroeconomic situation, the measures taken by the Bank to overcome negative trends in the financial market were temporary, tactical, and did not entail any change in its long-term policy.

The development of the Russian economy in 1997 served to show that the monetary policy pursued by the Bank was effective and made it possible to achieve its macroeconomic objectives: inflation continued to decrease, production growth was registered in some sectors for the first time since the beginning of the economic recession and the exchange rate stayed within the limits of the "ruble/dollar corridor". All these factors, for their part, made it possible to re-denomi-

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<sup>1</sup> Term- and volume-weighted average yield on GKO's with maturities of less than 90 days.

nate the ruble and switch to a new price standard as of January 1, 1998, which, to some extent, further stabilised the financial system.

At the same time, developments in the Russian financial market at the end of 1997 confirmed

once again that sustained financial stabilisation is only possible when a uniform state economic policy is pursued on a consolidated basis and when all bodies of state administration participate in its implementation.



## II.2. DYNAMICS OF MONETARY AND CREDIT INDICATORS

**G**UIDED by the objectives of the uniform state monetary policy, the Bank saw to it that money supply dynamics corresponded to the demand for money, while the rate of inflation remained under control. To this end, it took steps to regulate growth in money supply and liquidity of the banking system.

The Bank managed the aggregate money supply by regulating liquidity of the banking system and the size of the monetary base. Overall, broad money, which includes cash in circulation, cash in vaults of credit institutions, required reserves and funds in credit institutions' correspondent accounts with the Bank of Russia, increased by 31.8% over the year, growing at an average monthly rate close to the rate of growth in the money supply.

The monetary base in 1997 expanded owing to the Bank's operations on the money market and the refinancing of banks in the form of Lombard credits and through REPO transactions. In the first half of the year, when a vast amount of foreign exchange flowed in, the expansion of the monetary base resulted from the growth of the monetary authorities' net international reserves, whereas the second half saw growth in their net domestic assets, caused by the increase of net claims on the general government. The trends of the latter half of the year predetermined indicators on the year as a whole: the growth of net domestic assets ensured almost 71% of the expansion of the monetary base, while the growth of the Bank's net credit to the general government made up 56% of the growth of the monetary base.

Despite growth in the volume of banking liquidity, caused by foreign exchange inflow during the year, credit institutions in 1997 borrowed heavily from the Bank. Banks were refinanced through REPO transactions and Lombard credit and as a result of these operations, gross credit to credit institutions in the year under review grew by 3.6 trillion rubles.

Balances in correspondent accounts of credit institutions with the Bank increased significantly

in the structure of the broad monetary base, by 13.7 trillion rubles, while their share of the monetary base increased from 11.9% to 16%. Balances grew especially fast at the end of the year when the Bank used telegraphic transfers instead of the traditional mail transfers to accelerate payments in anticipation of the ruble's re-denomination. Required reserves in the monetary base did not change much over the year, while the proportion of cash in circulation (including cash balances in vaults) decreased from 73% to 69.9%.

The aggregate reserves of credit institutions (cash in vaults of credit institutions, required reserves on ruble-denominated accounts and balances in credit institutions' correspondent accounts with the Bank of Russia, including cash balances in the securities market) amounted to 65.6 trillion rubles as of January 1, 1998, an increase of 20.7 trillion rubles, or 46.1%, over the year.

Throughout the year M2 money supply increased by 31.5%, to 388.2 trillion rubles as of January 1, 1998. During the year money supply dynamics were uneven: until August it had been growing at a rapid rate (over the first seven months of the year the money supply grew by 27.2%), but its rate of growth slowed significantly for the rest of the year. The main reason was foreign capital flow. From February to July foreign capital flowed in quantity to Russia's GKO — OFZ market and stock market and that caused interest rates on government securities and Bank of Russia operations to slide. Late in October, however, when the crisis broke out in international financial markets, nonresident capital began to flee from Russia, residents' demand for ruble-denominated assets declined and pressure on the Russian foreign exchange market increased. In November and December the Bank took steps to protect the domestic currency and prevent the destabilisation of the country's financial system, raising interest rates on the financial markets and harmonising demand for national currency with its supply.

The growth in money supply in 1997, which amounted to 93 trillion rubles, resulted from a

## MONEY SUPPLY AND INFLATION DYNAMICS (%)

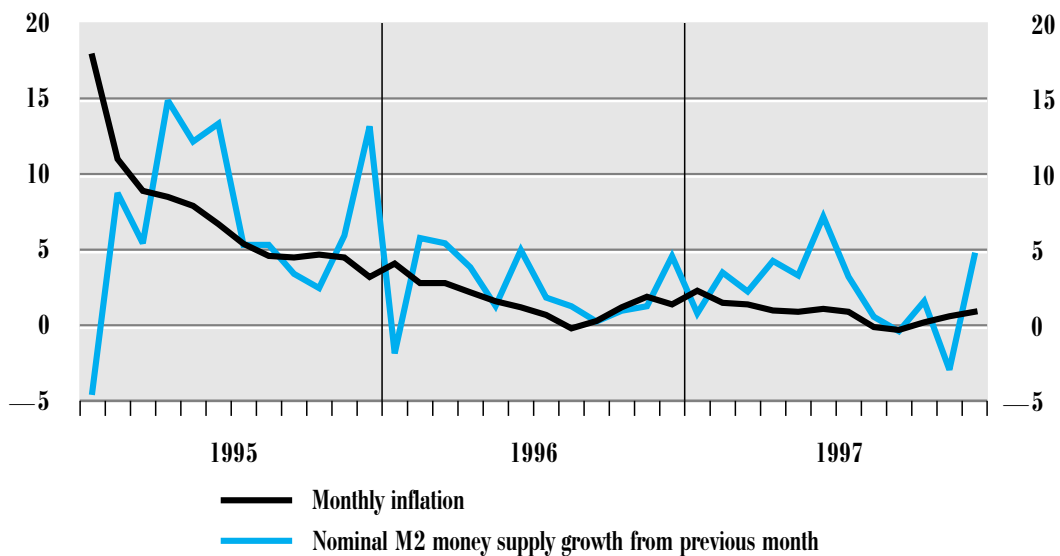


Figure 3

43.6% increase in the Funds of non-financial enterprises and organisations, a 28.6% growth in cash in circulation and 27.8% increase in personal deposits. The structure of the money supply changed in favour of the real economy. Funds in the accounts of non-financial enterprises and organisations increased from 24.4% to 29% of the overall volume of money supply. Borrowing in the form of loans and securities, made by non-financial enterprises and organisations, also grew in 1997. Although the global financial crisis reduced capital flow to non-financial enterprises and organisations a bit, foreign direct and portfolio investments in this sector increased by 0.3 percentage points compared with 1996, to nearly 1% of GDP. A major factor behind the growth of investment in securities of the non-financial sector and bank loans to this sector last year was the reduction of federal budget borrowings on the domestic financial market.

Household funds continued to comprise the bulk of the money supply. In 1997 real disposable personal cash incomes increased by 5% compared with 1996, with cash savings rising at a particularly rapid rate. However, the proportion of bank deposits in the structure of savings decreased, while that of cash increased. The slowing of the personal deposit trend was caused by a fall in deposit interest rates and growth in consumer demand for durable goods in the period preceding the ruble re-denomination. Over the year per-

sonal deposits declined from 40.4% to 37.4% of the M2 aggregate.

Cash in circulation outside banks grew by 25.6% and by January 1, 1998, amounted to 130.4 trillion rubles. During the year cash in circulation increased unevenly: most of the growth (30%) occurred from April to June, while in the second half of the year the predominant trend was an absolute decline in volume. The most significant fluctuations in the structure of the money supply in favour of cash, registered in the second quarter of the year and in December, resulted from the repayment of budget debts on pensions and wages. There were also seasonal fluctuations in the volume of cash in circulation: growth was particularly noticeable in the summer and in December, while January saw a seasonal decline.

The issue of cash in circulation peaked in June when 17.9 trillion rubles were issued. That growth largely resulted from the repayment of all back pensions and the payment of considerable amounts of holiday pay to industrial and office workers, especially schoolteachers, and summer stipends to students. The announcement of the forthcoming re-denomination of the ruble in the third quarter of the year provoked a significant rise in retail trade turnover, which grew by 28% compared with the same period of 1996 and by 37.6% in September. As a result, the issue of cash in circulation in August decreased 90% from the previous month to 1.7 trillion rubles and 6.3 tril-

CLAIMS ON PRIVATE ENTERPRISES IN TOTAL DOMESTIC CREDIT TO ECONOMY  
(in percentages, as of beginning of month)

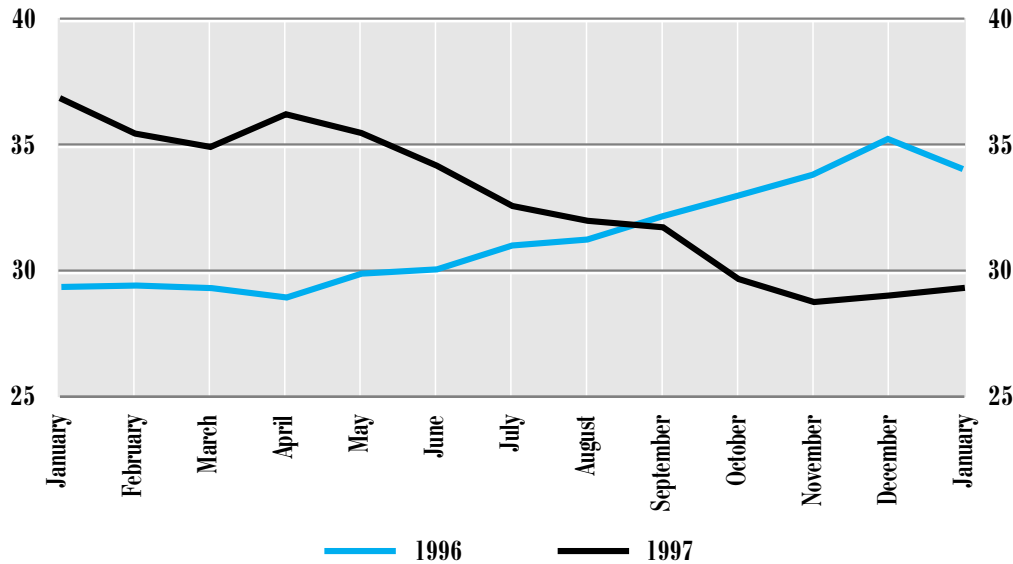


Figure 4

lion rubles were withdrawn from circulation in September. In the fourth quarter there was a 31.4% growth in returns from sales compared with the same period of last year and a threefold increase in short-term cash contributions to personal bank accounts (excluding Sberbank), caused by the conversion of cash rubles into foreign currency through bank accounts after a tax was levied on the purchase of foreign currency, 6 trillion rubles were withdrawn from circulation (for comparison: 7 trillion rubles were issued in circulation in the fourth quarter of 1996).

The main reason for the increase in the money supply in 1997 was bank credit to the private sector, this being a special trend of the year. The structure of credit investments by banks also began to change for the better: first, investments shifted from the interbank market to the real economy; second, most investments were made in rubles, a fact testifying to the strengthening of the domestic currency.

Banks' claims on private enterprises over the year rose by 68 trillion rubles, or 43%. From January to November they grew from month to month and a slight fall was only registered in December. This trend is attributable to the fact that corporate papers became more like government securities in terms of yield to risk ratios and the Government reduced its borrowing on the domes-

tic money market. Although enterprises needed credits for capital investment as badly as before, high risk prevented any significant growth in long-term credit operations.

Money supply dynamics were influenced not only by credit to the private sector, but also by bank operations with the public sector. Compared to 1996, the growth in net bank credit to the government as a whole slowed to 67.4 trillion rubles. The federal budget deficit in its international definition was equal to 6.5% of GDP in 1997, a drop of 1.3 percentage points compared with 1996. The structure of the sources for financing the budget deficit changed significantly: financing from foreign sources grew more than 3 times over, the relative contribution by monetary authorities to the financing of the budget decreased by more than 10 percentage points, while the proportion of budget revenues raised through GKO — OFZ fell by 3 percentage points.

In 1997, for the first time since the launching of market reforms in Russia the Bank ceased to be the main creditor of the government as a whole. That was a favourable change in the structure of domestic credit. By the middle of the year the volume of bank claims on the government equalled the volume of claims by monetary authorities and in subsequent months the former exceeded the latter. That resulted, to a great extent, from con-

siderable foreign capital inflow, which compelled the Bank to conduct ruble interventions on the domestic foreign exchange market and simultaneously carry out open-market operations to sterilise excessive emission. As a result, the Central Bank's government securities portfolio shrank compared with the beginning of the year. The outbreak of the global financial crisis had cut short that tendency by the end of the year: pressed hard by market participants anxious to withdraw their capital from the GKO — OFZ market, the Bank in November bought up government securities in quantity and that was a major factor behind the growth of monetary authorities' credit to the government. Overall, the open-market operations conducted by the Bank in 1997 increased its government securities portfolio by 27%.

One of the chief trends of last year was a change in the structure of domestic credit to the economy in favour of the real sector compared with 1996. Claims on private enterprises in 1996 made up 29.3% and net credit to the general government 57.8%, while in 1997 the respective

proportions were 33.8% and 56.7%. These structural changes show that bank investments are beginning to shift towards the private sector.

The dynamics of monetary authorities and credit institutions' net foreign assets reversed direction during the year and were largely influenced by the global market situation. In the first half of 1997 capital inflow to Russia increased significantly and reached its peak in the middle of the year when monetary authorities' net foreign assets grew from 49.3 trillion to 84.6 trillion rubles. By the beginning of the crisis (in late October) they amounted to 48.7 trillion rubles. In the fourth quarter the Asian market crisis brought heavy pressure to bear on the Russian foreign exchange market and net foreign assets dwindled to 14.2 trillion rubles. To keep the ruble within its exchange rate limits, the Bank had to conduct massive currency interventions in the last quarter of the year, which brought the 1997 growth in monetary authorities' net foreign assets down to about 13 trillion rubles.





## II.3. MONETARY POLICY INSTRUMENTS

### RESERVE REQUIREMENTS

In 1997 the Bank of Russia continued to use reserve requirements as one of the instruments of its monetary policy.

Guided by the objectives of this policy in each particular period and seeking to gradually equalize required reserve ratios on all deposits regardless of the currency in which they were denominated, on May 1, 1997 the Bank reduced required reserve ratios on ruble-denominated demand deposits and time deposits with terms of up to 30 days from 16% to 14%, on time deposits with terms of 31 up to 90 days from 13% to 11%, and on time deposits with terms longer than 90 days from 10% to 8%, raising at the same time the required reserve ratios on foreign currency deposits from 5% to 6% and on November 11 to 9%. Thus the Bank encouraged credit institutions to borrow ruble resources and extend more credit to the economy. At the same time, these measures helped scale down the use of the dollar in the Russian economy.

In the year under review the Bank also made some changes and amendments to the applicable reserve requirements. Specifically, it established a new procedure for representing operations to record underpaid and overpaid sums of required reserves and also the fines charged and received for violations of reserve requirements, and specified the list of accounts included in the calculation of required reserves to be deposited at the Bank.

Owing to the 31.4% growth in the borrowing of credit institutions in 1997 and as a result of the change in required reserve ratios, the sum of required reserves of credit institutions with the Bank in the year under review rose by 40.7%, of which required reserves on ruble accounts increased by 23.3%, while required reserves on foreign currency accounts grew by 150%. As a result, the latter's share of the total amount of required reserves increased over the year from 14.9% to 25.5%.

Using daily and monthly reports, the Bank and its regional institutions made sure that credit in-

stitutions met all reserve requirements fully and on time and took measures to ensure strict compliance with the applicable provisions on required reserves.

The measures taken by the Bank of Russia and credit institutions to ensure compliance with reserve requirements made it possible to significantly reduce the number of credit institutions which fell short of the required reserves and cut the sum of this shortfall. On January 1, 1997, 197 credit institutions had an aggregate shortfall of 547 billion rubles on required reserves, or 3.4% of the total sum that had to be deposited. By January 1, 1998, the number of such institutions decreased to 94 and the shortfall was reduced to 99 billion rubles, or 0.3% of the sum subject to deposit.

The main reason for the failure to comply with reserve requirements was the lack of funds in correspondent accounts of credit institutions owing to their clients' defaults.

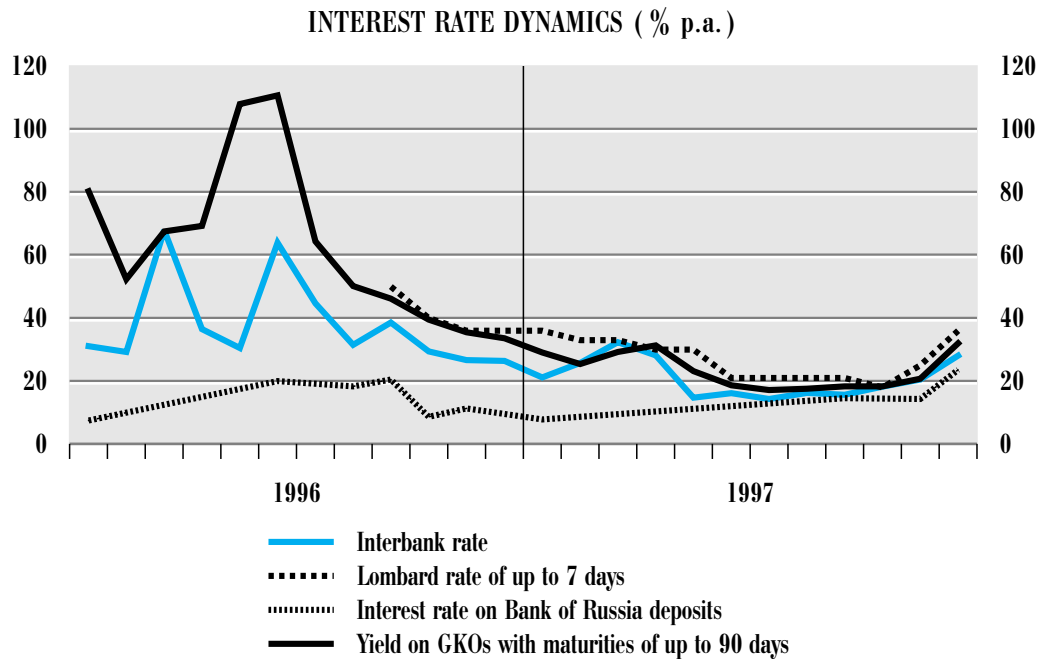
The Bank used sanctions against such credit institutions in order to rehabilitate or re-organise them. Credit institutions which fell short of their required reserves in 1997 paid a total of 4.9 billion rubles in fines.

### INTEREST RATE POLICY

One of the chief instruments of monetary and credit regulation in 1997 was interest rates on Bank of Russia operations, which were fixed in line with the interest rate policy pursued by the Central Bank of the Russian Federation. The Bank regulated the refinancing rate, Lombard rates and deposit rates on banks' spare funds, taking into account the current state of the economy, the inflation rate and the situation in various segments of the financial market.

During the year the Bank of Russia changed the refinancing rate five times, cutting it from 48% in early 1997 to 28% p.a. on January 1, 1997, which represents a decrease of almost 1.7 times. Although from October 6 to November 10, 1997, the refinancing rate was 21% p.a., on November 11 the Bank had to raise it to 28%

Figure 5



p.a. in order to keep the ruble stable and protect it from the influence of the global financial crisis, which worsened at the end of year.

### REFINANCING BANKS

In 1997 the Bank of Russia continued to refinance banks according to strict market principles. The total amount of Lombard and overnight settlement credits extended in 1997 was 112.1 trillion rubles, which represents an increase of 98 trillion rubles, or an eightfold growth, on 1996.

The Bank used Lombard credit as the principal mechanism to provide short-term liquidity to banks. In 1997 the Bank extended a total of 109.9 trillion rubles worth of Lombard credits to 210 banks in 44 Russian regions. This is 96 trillion rubles or almost eight times more than in 1996. As of January 1, 1998, the debt on Lombard credits amounted to 6,482.7 billion rubles. Lombard credits were used most frequently by banks in the Moscow Region, which received nearly 80% of all Lombard credits. Lombard credits were also widely used by banks in the Sverdlovsk, Samara and Kemerovo Regions, the Maritime Territory and the Republic of Bashkortostan.

Lombard credit was extended for terms of up to 7, 14 and 30 calendar days at fixed rates set by

the Bank's Board of Directors. Until December 1 interest rates depended on credit terms.

After December 1, 1997, the Bank extended Lombard credits at a fixed rate of 36% p.a., regardless of the term of credit.

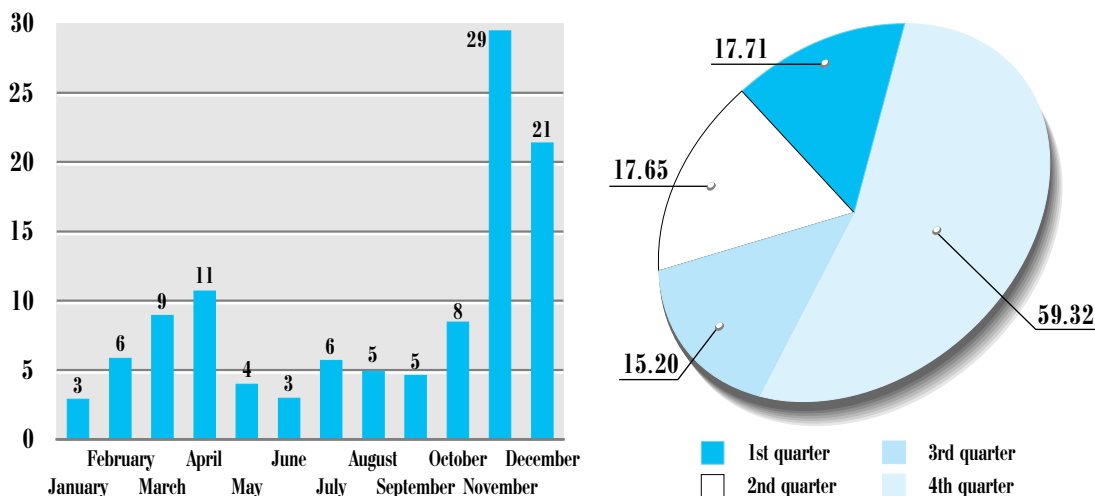
The average weighted interest rate on credits extended in 1997 was 28.1% against 38.9% in 1996.

As the Bank of Russia increased the volume of Lombard credits, banks repaid the principal and interest on time.

In 1997 the Bank continued to extend overnight settlement credits to banks that were primary dealers in the GKO — OFZ markets. As of January 1, 1998, the Bank had 21 agreements on overnight settlement credits with primary dealer banks against 12 agreements for the same day in 1996. During 1997 such credits were extended more than 200 times and amounted to a total of 2.2 trillion rubles. Overnight settlement credits allowed banks to maintain their liquidity at a level necessary to fulfil their obligations to customers and counterparts and that had a favourable effect on the state of settlements in the banking system.

In addition to refinancing banks to maintain their liquidity, the Bank continued to buy MinFin promissory notes of the APK series from banks, issued by the Ministry of Finance in accordance

**LOMBARD CREDITS EXTENDED BY THE BANK OF RUSSIA TO BANKS IN 1997**  
(trillion rubles)



*Figures 6, 7*

with Federal Law No. 46-FZ of April 24, 1995. In 1997 the Bank bought a total of 71.5 billion rubles worth of notes from 13 banks at par value and 43.6 billion rubles were transferred to the correspondent accounts of these banks. The Bank has not yet bought out notes from the banks which had their banking licences revoked and also notes which are used as one of the instruments in the financial market.

In 1997 the Bank continued to take steps to improve the refinancing mechanism.

In line with the decision taken by the Bank's Board of Directors on February 26, 1997, the Lombard list of securities accepted by the Bank as collateral for Lombard credit was extended to include fixed coupon federal loan bonds (OFZ-PD), issued in accordance with Russian Federation Government Resolution No. 458 of May 15, 1995, and OFZ-PD Terms of Issue No. 60, approved by the Ministry of Finance on June 28, 1996.

The terms of extending Lombard credits were amended. In accordance with a decision by the Bank's Board of Directors, on November 18, 1997, the correction price factor of pledged GKO was raised from 0.8 to 0.9 for checking up the collateral adequacy.

To accelerate the granting of Lombard credits against government securities, on November 24, 1997, the Bank established the following procedure for the banks in the Moscow Region: should

a bank request not to unblock papers (if it has repaid the Lombard credit it received earlier and interest on it), the corresponding collateral section of the bank's DEPO account shall not be closed and the pledged government securities shall not be transferred from the section "Blocked in Collateral" to the Main Section of the DEPO account of the borrowing banks. These securities are used as collateral on the new Bank of Russia credit. In early 1998 this procedure was extended to cover all banks.

In accordance with the decisions taken by the Bank's Board of Directors, a portion of bad debts on centralised credits and interest on them and also interest charged on the balance due in banks' correspondent accounts, worth a total of 584.85 billion rubles, were written off from the Bank's balance sheet. At the same time, the debt on interest on centralised credits, worth 584.20 billion rubles, was posted to an off-balance sheet account, while overdue debt on centralised credits, worth 0.60 billion rubles, was written off at the expense of the Bank's reserve fund and 0.05 billion rubles registered as losses.

In accordance with the decision by the Bank's Board of Directors, late in 1997 a portion of the debt, amounting to 117.1 billion rubles, was written down from off-balance sheet accounts owing to liquidation of banks and their exclusion from the State Register of Credit Institutions.

As of January 1, 1998, a portion of the debt on centralised credits (excluding Lombard and overnight credits) and interest on them, worth a total of 2.3 trillion rubles, remained unsettled. These credits were extended by decision of the Government Commission on Financial and Monetary Policy in 1992 — 1994 to enterprises in the fuel and energy sector, timber, light and textile industries, trade and other sectors.

The 1998 Federal Budget Law provides for restructuring this debt into internal government debt.

### DEPOSIT OPERATIONS

In order to regulate banking liquidity and maintain stability in Russia's foreign exchange market, the Bank continued to conduct deposit operations in domestic currency through the Reuter Dealing system on the basis of overnight, tom-next and one-week transactions with primary dealer banks in the GKO and OFZ markets. Twenty-seven banks in the Moscow region participated in such operations in 1997. Deposits were attracted at the rates and in the amounts established by the Bank. Interest rates fluctuated from 5% to 33% p.a. The total sum attracted to deposits amounted to 19,605.0 billion rubles, 99% of which were overnight deposits.

### OPERATIONS ON THE GKO — OFZ MARKET

The Bank's policy in 1997 was aimed at enhancing the efficiency of operations with government securities as an instrument of monetary policy and a source of financing for the budget deficit. The Central Bank and banks with the status of primary dealers in the GKO — OFZ market actively conducted REPO operations. Restrictions were lifted from foreign capital participation, a new agreement with primary dealers was elaborated and put in operation, the system of settlements in the securities market was upgraded, over-the-counter transactions were introduced in the government securities market and the set of government debt instruments was broadened owing to the issue of fixed coupon-income bonds.

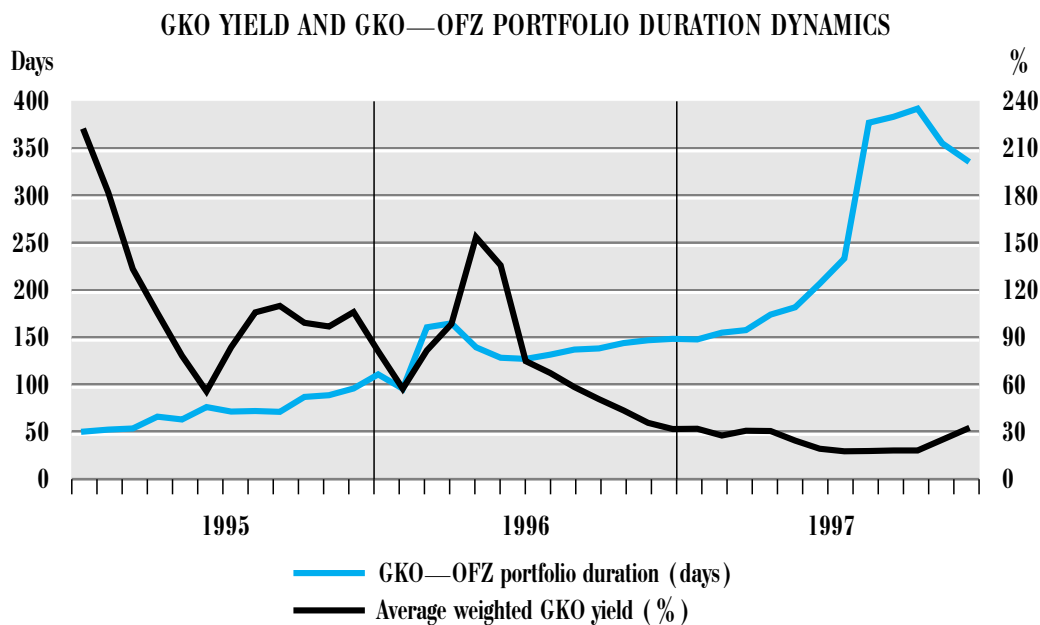
The role of the Bank's operations with GKO — OFZ in regulating banking system liquid-

ity and managing interest rates depended on the state of the financial markets.

From January to July 1997, when GKO — OFZ yields slid from 35 — 40% to 17 — 19% a year (Tables 28 — 30) owing to a considerable and relatively stable inflow of foreign capital and the easing of restrictions on nonresidents, the Bank used open-market operations to absorb surplus banking liquidity and make the decline of interest rates more gradual. To this end, it carried out its plan to gradually liberalise nonresidents' participation in the government securities market and assumed the obligation to consistently reduce the volume of compensatory conversion operations connected with foreign capital investments in GKO — OFZ and abandon them altogether by the beginning of 1998.

From August to the first half of October, when interest rates in the government securities market stabilised within the range of 17.5% to 19% p.a. (that is at a level slightly higher than the inflation rate), investor activity declined, because at such interest rates neither Russian nor foreign participants in the GKO — OFZ market were interested in building up their portfolios at the previous rates. During that period the Bank actively promoted the development of the REPO operations sector of the GKO — OFZ market. In September it established a new REPO operations procedure, allowing primary dealers to attract funds at market rates during the auction before the beginning of the trading day. As a result, the funds attracted by banks through REPO operations sharply increased. Primary dealers received the opportunity to attract funds at lower rates, while the Bank, regulating the rates and volumes of the attracted funds, began to regulate banking system liquidity through REPO operations more actively.

Late in October the situation on the GKO — OFZ market began to deteriorate, owing, above all, to a massive outflow of foreign investment capital, caused by the financial crisis in South East Asia and its fallout the world over. At the same time, the restrictions that were in force at the end of October on the withdrawal of nonresident funds from the GKO — OFZ market partly cushioned the effect of the foreign capital outflow, delaying it for four to six weeks and extending it in time.



*Figure 8*

In the first half of November the Bank pursued a policy of keeping interest rates on government securities at a level close to the pre-crisis level.

On December 1, however, it stopped maintaining yields on government securities at the non-market level by buying them in the secondary

market and widened the currency band limits. At the same time, the Bank raised Lombard rates and second-session REPO rates to 36% p.a., which reflected the new level of yields established on the market. That stabilised the government securities market, with interest rates staying within the range of 30% to 33% p.a.



## II.4. DEVELOPMENT OF FINANCIAL MARKETS

*The* **MAIN RESULTS** of the development of the financial markets in Russia in 1997 were their relative stability and increased role in shaping the general economic situation. The growing volume of operations with financial market instruments and lower cost of borrowing were among the factors that contributed to the improvement of the macroeconomic situation. The financial market also played a large role in financing the federal budget and encouraging the inflow of foreign investment. However, the increased openness of the Russian financial market made it more dependent on world market fluctuations. In that situation, the steps taken by the Bank to limit the impact of external factors, especially the financial crisis that hit the leading international markets at the end of the year, confirmed that in addition to a market infrastructure, the Bank had created an effective system for regulating the main sectors of the financial market.

### CREDIT AND DEPOSIT OPERATIONS WITH THE NONFINANCIAL SECTOR OF THE ECONOMY.

Stabilisation of production and the emergence of sustained ties between credit institutions and creditworthy enterprises stimulated real growth in credits extended by commercial banks to the nonfinancial sector of the economy in 1997. The volume of credits extended to the economy and households<sup>1</sup> in rubles and foreign currency from January 1, 1997, to January 1, 1998, increased from 189.4 trillion to 255.6 trillion rubles. Credits to the economy and households in total bank assets in 1997 also grew from 29.5% to 33.5%.

Credits with terms of up to 1 year continued to dominate the credit portfolio of banks in 1997, increasing over the year by 19% in real terms. Throughout 1997 the terms of short-term credits to the economy and households tended to become longer due, primarily, to the stabilisation of the production cycle at enterprises that had adapted to the new economic conditions and the improved ability of banks to assess the creditworthiness of

their borrowers. The growth in the volume of long-term credits, which increased from January 1, 1997, to January 1, 1998, by 61.1% in real terms, is attributable to similar factors.

A slight reduction of credit risk in 1997 is confirmed by the dynamics of overdue debt on bank loans, which declined by 22.7% in real terms, while its share of the overall volume of commercial credits to the nonfinancial sector decreased from 7.8% on January 1, 1997 to 5.3% on January 1, 1998. The share of bad debts in the credit portfolio of banks fell during that period from 4.6% to 2.7%.

There were two distinct periods in the dynamics of interest rates on credits and deposits in 1997. From January to November interest rates demonstrated a persistent tendency to decline, but the global financial crisis, which caused the shares of the leading Russian corporations and government securities to tumble, compelled the Bank to raise the refinancing rate and Lombard rates and take some other regulatory measures. As a result, market rates on credits and deposits also rose with a slight time lag. Thus, the average rate on ruble credits to corporate borrowers (enterprises and organisations) for all terms decreased for 11 months of the year from 40.6% to 22.5%, but in December rose to 28.3% a year. The growth of rates in December affected both short-term and long-term loans. As a result, the December rates on short-term credits were 28.8% and on long-term credits 23.3% p.a., that is, lower than at the beginning of the year.

The rates on foreign currency credits were more stable in 1997. For example, interest rates on credits to corporate borrowers for all terms changed little over the year and in December were registered at 11.9% p.a. During the year this rate did not fluctuate by more than 2.6 percentage points.

Credits to the real economy in 1997 continued to differ in volume from region to region. Most credits were granted by banks in the Central region and the North-West, Volga and Ural regions.

<sup>1</sup> Here and below this includes overdue debt but not overdue interest.

ALL-TERM INTEREST RATES IN RUSSIA'S ECONOMIC REGIONS IN 1997 (% p.a.)

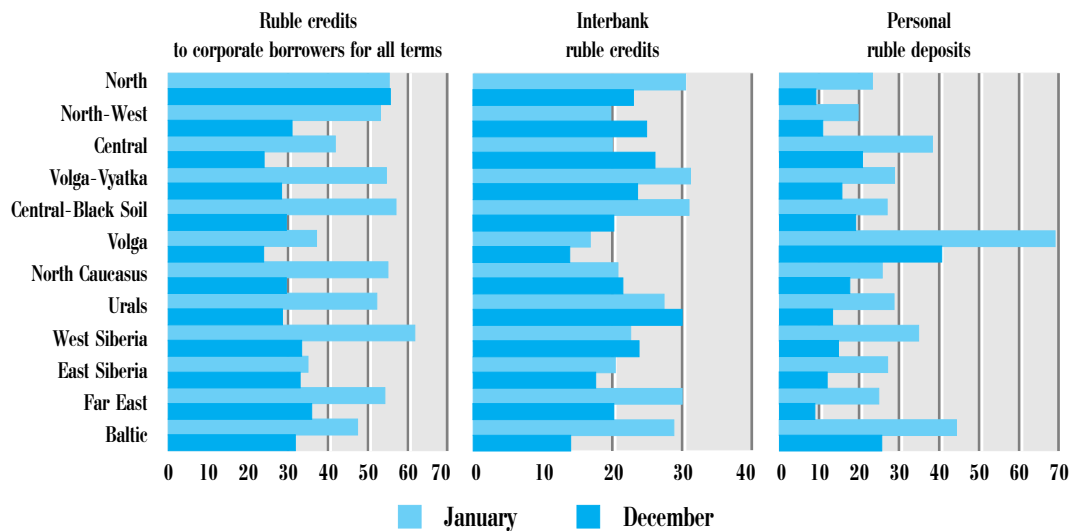


Figure 9

Credit rates in these regions stayed closest to the national average, testifying to the tendency towards the formation of a single credit market. At the same time, credit rates in other regions continued to vary greatly from the average level. Overall, in most regions in 1997 the rates on ruble credits to corporate borrowers topped the Russian average. As before, the notable exception was the Central region, where the developed market infrastructure and a fairly high level of competition kept the cost of credit lower.

The dynamics of bank interest rates on deposits (excluding Sberbank) were affected by the same factors as that of credit rates. However, unlike the latter, deposit rates fell faster for most of the year and their rise at the end of the year was less significant. Thus, from January to July the average rate on ruble-denominated personal deposits for all terms declined from 44.2% to 16%. In subsequent months these rates were subject to considerable fluctuations and in December they were registered at the level of 17.7% p.a. The rates on personal deposits in foreign currency for all terms slid by 17.5 percentage points from January to November to 7.4%, but in December they also rose.

The rates on ruble deposits for corporate customers declined more smoothly during the year, owing to greater elasticity of corporate demand for opening deposit accounts compared with private individuals. Over 1997 the rates on these kinds of deposits for all terms decreased from

30.3% to 12.2% a year. The average interest rate on foreign currency deposits of corporate customers for all terms in 1997 varied from 6% to 8% and in December it was registered at 6.7% p.a.

The margin on credit and deposit operations by banks in 1997 fluctuated considerably, as is always the case when interest rates on both assets and liabilities operations demonstrate high mobility. However, the general trend in the interest margin on ruble credit and deposit operations by banks before the international financial crisis was to decline (from the beginning of 1997 the margin on these operations dropped from about 20 percentage points to 7 — 8 points in October — November). By the end of the year, when the situation on the financial markets deteriorated, the margin showed a tendency to rise (to 13 percentage points in December).

The margin on foreign currency operations by banks in the credit and deposit market fluctuated within a considerably narrower range in 1997 and in December the margin on operations with corporate clients was registered at 5 percentage points.

**INTERBANK CREDIT MARKET.** The interbank credit market carried out its functions without a hitch throughout 1997, even in periods of market volatility. The instability of the interbank credit market noted in March and in November-December was largely the result of instability in the adjacent segments of the financial market. In



the first case the interbank credit market reacted with higher rates to a change in the GKO — OFZ issuer's borrowing needs and in the second case it was a reaction to the behaviour of foreign investors in the Russian financial market as a whole. The major factors behind the inner stability of the interbank credit market were, first, the conservative market strategy of the leading market participants and, second, the Bank's improved refinancing instruments, which influenced the conditions and volumes of interbank credit operations.

The favourable trends that formed in 1996 continued throughout 1997: the interbank credit market remained manageable and predictable, the rates on credits for different terms continued to move closer to each other and the interbank rate did not fluctuate as much. Rates kept falling until July. The average Russian monthly rate on ruble-denominated interbank credits placed for terms of up to 1 month fell from 20% in January to 14% in July. However, in August this rate began to gradually rise (to 17% in October) and in December the Russian average rose to 26%. Although the December level was lower than the 27% high registered in March 1997, the pace of growth in the rates at the end of the year was faster than in March.

In December interbank credit rates exceeded the level recorded in the same period of 1996 (the Russian average rate on ruble interbank credits with terms of up to 1 month was 25%), but overall, the average annual rate in 1997 was lower than the average annual rate in 1996. Smaller interbank credit rate variations in 1997 testify to greater market stability compared with 1996. In December 1996 the average daily rates on 1- to 7-day interbank credits in the Moscow interbank market deviated from the monthly average by 9.1 points, whereas in December 1997, when the general level of rates was higher owing to market instability, the average deviation was 6.6 points and in the middle of the year it was even less.

The narrowing of the gap between rates on credits with different terms reflected the reduction of the inflation component of the interest rates. Thus, late in 1996 the rates on overnight and 30-day interbank credits on the Moscow market were 26% and 40% respectively, whereas in October 1997, before the Russian market felt

the impact of the world financial crisis, they were 18% and 20%.

The average interbank credit term did not change much during the year: varying from 2.7 to 4.4 days, overall, it was lower than at the end of the previous year.

The foreign exchange segment continued to dominate the interbank credit market owing, to a great extent, to its higher credit repayment ratio. Actual rates on US dollar-denominated interbank credits demonstrated greater stability than the rates on ruble credits: from June to October the Russian average monthly rate on interbank credits placed in US dollars for a term of up to 1 month remained unchanged from 6.4%. At the same time, the December 1997 rate (6.7% on credits placed for up to 1 month) was higher than the December 1996 rate (6.3%).

Although the Moscow region remained the centre of interbank credit activity in 1997, the share of Moscow banks in interbank credit volumes decreased a little compared with 1996. Other active participants in the interbank credit market include banks of the North-West, West Siberian, Ural and Volga regions. Interbank credit market rates continued to differ from region to region.

## FOREIGN EXCHANGE MARKET

The state and development of the Russian foreign exchange market in 1997 were determined by favourable changes in the dynamics of some major macroeconomic indicators and the foreign exchange policy pursued by the Bank of Russia.

As was the case in previous years, in 1997 dollar/ruble conversion operations made up the bulk of operations in the domestic foreign exchange market. Conversion operations with the German mark and the currencies of Russia's leading CIS partners (Ukraine, Belarus and Kazakhstan) accounted for a much smaller share of the market.

Most of the year saw growth in the volume of conversion operations, which was mainly caused by more intense foreign capital flow owing to an increase in foreign direct investments, especially portfolio investments. There were no significant changes in that period connected with foreign trade dynamics.



Russia's foreign exchange market was represented by two sectors, exchange and over-the-counter. The over-the-counter sector accounted for more than 99% of overall conversion operations turnover.

In the exchange sector of the currency market foreign currencies were traded daily on the Moscow Interbank Currency Exchange (MICEX), St. Petersburg Currency Exchange (SPCE), Yekaterinburg-based Ural Regional Currency Exchange (URCE), Novosibirsk-based Siberian Interbank Currency Exchange (SICE), Vladivostok-based Asia-Pacific Interbank Currency Exchange (APICE), Samara Currency Interbank Exchange (SCIE), Nizhni Novgorod Currency and Stock Exchange (NCSE), Rostov Currency and Stock Exchange (RCSE) and Krasnodar Interbank Currency Exchange (KICE).

In 1997 the overall volume of operations in the exchange currency market declined by 15% to \$8.7 billion. MICEX accounted for 65% of the total volume of exchange conversion operations in Russia; the SPCE accounted for 15%, the URCE 9%, the APICE 5%, the SICE and SCIE 3% each, and the NCSE and RCSE 1% each.

The Russian ruble was quoted in the exchange currency market in 1997 against the following foreign currencies: the US dollar, German mark, Japanese yen, French franc, British pound, Swiss franc, Italian lira, Finnish markka, Ukrainian hryvnia, Belarusian ruble and Kazakh tenge. US dollar operations accounted for nearly 95% of all conversion operations in the exchange currency market. As for the other currencies traded on the exchanges, only the German mark made up more than 1%.

As Russia improved the infrastructure of its exchange currency market, on June 2 dollar/ruble conversion operations began to be conducted on MICEX in the Electronic Lot Trading System (ELTS); on August 25 the institution of market makers was introduced in MICEX dollar trade effected as per the fixing rules. These new features contributed to the stabilisation of the exchange currency market and intensified operations in it.

In the over-the-counter sector of the foreign exchange market conversion operations are conducted directly between commercial banks which

have the right to conduct operations with foreign currency. Conditions of the deals are established by agreement of the parties.

Over-the-counter market players used the following types of transactions, which differ by settlement terms: cash deals (deals with immediate delivery), which include today, tomorrow and spot transactions, and forward deals (settled 3 business days or more after the deal is struck). The distribution of conversion operation volumes by these terms in 1997 was fairly stable: today operations accounted for about 40%, tomorrow 30%, forward 30% and spot 2 — 3% of the total volume. The large proportion of today and tomorrow conversion operations results from the concentration of the leading over-the-counter exchange market operators in Moscow and the advanced technological infrastructure of this sector, which uses computerised information and dealing systems. The role of the forward segment of the foreign exchange market increased and in the second half of 1997 daily forward trade turnover (by authorised banks) amounted to \$1.4 billion.

Interest in forward conversion operations was demonstrated by both foreign investors, who put their money in Russian securities, and Russian currency market players. However, the former conducted such operations to hedge against exchange rate risk, while the latter used them as a means of currency speculation owing to the decline in the profitability of speculative operations in the spot foreign exchange market.

The set of instruments used in the forward foreign exchange market broadened. Although settlement forward contracts continued to dominate the forward market, delivery forward contracts and currency options were increasingly used. Most forward currency transactions were concluded for less than six months.

As for the participants of the interbank foreign exchange market in Russia, special mention should be made of a group of authorised commercial banks, the leading market operators, which report their conversion operations to the Bank on a daily basis. Their reports make it possible to assess the scale of the Russian interbank currency market. According to these reports, dollar/ruble cash transactions in the interbank market in 1997 amounted to \$759.1 billion and forward transactions \$297.3 billion. The average daily volume

of dollar/ruble operations in 1997 was \$4.13 billion.

## SECURITIES MARKET

The Russian securities market continued to grow rapidly in 1997 and, as was the case in the previous year, rapid rates of growth were registered not only in the GKO — OFZ market, but also in other sectors, especially the corporate stock market and municipal bond market.

**GOVERNMENT SECURITIES.** The GKO — OFZ market was characterised by rapid growth in volumes and the upgrading of infrastructure. The market's structure changed dramatically owing to longer terms of borrowing and the use of a broader range of market instruments. The fall of interest rates in all the main sectors of the financial market made it possible to increase the share of medium-term bonds in the structure of the Finance Ministry's borrowings and subsequently introduce a new instrument, the fixed-income federal loan bonds. In late February the Bank quoted the first issue of the fixed-income federal loan bonds (OFZ-PD), which until then were entirely kept in its portfolio, and in July the Finance Ministry began to actively place OFZ-PD at auctions and in the secondary market.

During the year 76 GKO auctions, 14 OFZ-PK auctions and 12 OFZ-PD auctions were held. GKO made up 89.4% of the primary placement's total volume (93.6% in 1996), OFZ-PK accounted for 5.8% (6.4% in 1996) and OFZ-PD 4.8% (OFZ-PD were not placed in 1996).

As of December 31, 1997, the GKO — OFZ market volume amounted to 384.9 trillion rubles at par value against 237.1 trillion rubles as of January 1, which represents a growth of 62% over the year. Average daily secondary trade turnover in the GKO — OFZ market (not counting over-the-counter and REPO transactions) rose by 28% to 4,280 billion rubles (3,333 billion rubles in 1996).

Throughout the year the issuer's policy in the market was motivated not only by fiscal considerations, but also by the need to ensure stability of price dynamics and reduce bond yields. As the issuer's agent in the GKO — OFZ market, the

Bank carried out a lot of work to develop the market, focusing on upgrading its infrastructure, and introduced new instruments of monetary regulation through operations in the government debt market. The Bank upgraded the settlements system in the regulated securities market, which is now operating on a "same day" basis, thus increasing market participants' liquidity, introduced over-the-counter transactions, improved the mechanism of REPO operations and lifted restrictions on foreign capital participation in the GKO — OFZ market.

To improve the institution of market-makers, the Bank drafted a new standard agreement, which significantly broadened the duties of primary dealers. In June primary dealers were charged with the task of maintaining a quotation spread on some issues during a trading session (by the end of the year the number of quoted issues was raised to 12). The requirement for primary dealers to participate in the auction was complemented with a restriction on the maximum yield of a bid.

At the same time, primary dealers were granted additional rights: they received broader opportunities for attracting funds through REPO operations, the limit on short money position was increased, and primary dealers were given the option to close with money short positions arising during the trading day.

Introduced in May, the so-called "untied REPO" operations enabled primary dealers to use REPO operations for the short-term raising of funds. Nevertheless, the Bank's strict regulation of rates and fixing them above the market level did not allow primary dealers to make wide use of this instrument for increasing their short-term liquidity.

In September an entirely new mechanism of REPO operations was introduced, allowing primary dealers to attract funds before the start of the trading day at market rates in the course of the auction. When the trading session or auction is over, a second REPO session is held for closing short money positions at a fixed interest rate, which is set at a fairly high level. The possibility of attracting funds in the beginning of the day at market rates stimulated demand for this instrument on the part of market participants with access to REPO operations. The new mechanism

also allowed the Bank to use the REPO rate as an urgent means of regulating the banking system's liquidity.

The arrival of large investors on the GKO — OFZ market, especially nonresidents, whose bids had a great influence on the market situation and caused rate imbalances and inequality between primary and ordinary dealers' clients, required some amendments to existing operations. The instrument that partly solved that problem was over-the-counter or off-the-system transactions, introduced by the Bank in late June. Over-the-counter transactions are conducted between dealers and their clients and also between clients of one dealer at bond issue prices within the spread and at average weighted prices upon the close of trading. Such transactions have no effect on the rate structure of the market and, at the same time, make it possible to conduct operations between the dealer and its clients on mutually beneficial terms.

In April 1997 a three-stage plan for the gradual liberalisation of foreign investor participation in the government securities market was officially approved. In accordance with that plan, the proportion of compensation transactions on cash and forward operations and the minimum term of investment were to be gradually reduced. The ultimate objective of the gradual liberalisation plan was to lift all restrictions on repatriation of foreign investors' profits received in the government securities market by the beginning of 1998.

As a result of that policy, foreign investors' share of the GKO — OFZ market volume in the first three quarters of 1997 increased from 17.0% (at par) on January 1 to 29.5% on October 1. The outflow of nonresident funds in the fourth quarter of the year, provoked by the global financial crisis, reduced this indicator to 27.5% as of January 1, 1998.

The chance for foreign investors to participate in the government securities market is seen as a means of reducing yields in the GKO — OFZ market and during the first three quarters of the year yields on all papers kept falling. In early January the GKO portfolio ordinary index was about 35% p.a. and in late September it was 18.5%. The volatility of the last quarter, largely caused by nonresidents' reaction to the financial crisis in South East Asia, led to growth in yields:

at the end of the year GKO yield rose to 28%. However, on the whole the Russian government securities market withstood external influences fairly well.

The net yield curve of GKO issues with different maturities changed during the year. At the end of the second and third quarters the yield curve declined as maturities increased, testifying to expectations of a further drop in yields in the market and to increased confidence in the issuer, whereas at the end of the year it began to climb. Despite overall market yield growth, yields on securities with maturities of less than one month at the end of the year were lower than they were at the end of the second and third quarters, which indicated a shift of investor interest towards shorter-term bonds in order to minimise the risk of losses on the volatile market. Thus, the transformation of the yield curve accurately reflected a change in the market situation.

The state savings loan bonds (OGSZ) market in 1997 expanded compared with 1996. The Finance Ministry issued 12 series to the total sum of 14 trillion rubles at par. Federal budget revenues from OGSZ sales totalled 13.1 trillion rubles. Coupon income payments, including service fees (2.4% at the beginning of the year and 1% at the end), amounted to 3.1 trillion rubles. OGSZ redemptions in 1997 totalled 8 trillion rubles.

The same trends were observed on the regional and municipal bonds (OKO — MKO) market as on the GKO — OFZ market in 1997, but OKO — MKO market indicators, such as yield growth and turnover fall at the end of the year, changed far more significantly.

OKO trade volumes on the stock exchanges of St. Petersburg and the Sverdlovsk and Orenburg regions gradually declined throughout the year, while volumes of trade in Chelyabinsk regional short-term bonds were low all year long.

The crisis that hit world financial markets in late October affected the municipal bonds of St. Petersburg and the Orenburg region, whose markets are the most closely integrated with the Russian stock market, more severely.

In 1997 Russia continued to issue Eurobonds, which it first placed in November 1996. Compared with 1996, issue volumes, maturities and range of Eurobonds were increased. In March Russia

issued its first German mark-denominated Eurobonds with an issue volume of DM2 billion, maturity of 7 years and coupon income of 9% p.a. to be paid yearly. In June Russia placed the second issue of US dollar-denominated Eurobonds with an issue volume of \$2 billion, maturity of 10 years and coupon income of 10% p.a. to be paid twice a year. The favourable market situation allowed Russia to place in October an additional tranche of that issue with a volume of \$400 million. A number of Russian regions and corporate issuers (industrial enterprises and commercial banks) placed their own Eurobond issues for the first time.

In 1997 the government bodies of some constituent territories of the Russian Federation placed their securities on the international capital market for the first time. In May the Moscow government placed \$500 million worth of Eurobonds with 3-year maturity and 9.5% coupon yield, in June the government of St. Petersburg placed \$300 million worth of Eurobonds with 5-year maturity and 9.5% coupon income, and in October the city of Nizhni Novgorod raised \$100 million using the Eurobond mechanism (5-year maturity, 8.75% coupon rate).

**COMMERCIAL BANK PAPERS.** Credit institutions in 1997 significantly increased their volume of operations to issue securities. They issued 8.8 trillion rubles worth of shares, 1.7 times more than in 1996 when 5 trillion rubles worth of shares were issued.

At the same time, the number of credit institutions which increased their authorised capital by issuing shares declined in the year under review: 375 credit institutions increased their authorised capital through share issues, of which 281 credit institutions completed their share issues, whereas in 1996 the respective figures were 414 and 323.

In the year under review credit institutions showed more interest in using bonds as a means of replenishing their resources. Thus, the completed bond issues in 1997 totalled 184.1 billion rubles in volume against 12.6 billion rubles in 1996. Bonds issued included registered, bearer, coupon, discount and convertible bonds. Bonds convertible into shares were especially popular because they made it possible to avoid blocking

considerable amounts of money in the accumulation account.

Certificates of deposit and savings certificates were issued in 1997 by 275 credit institutions against 400 credit institutions in 1996. However, the overall amount of funds raised by issuing certificates of deposit and savings certificates increased by 40% from 1996. Certificates of deposit accounted for more than 92% of the total. Moscow-based credit institutions were particularly active in conducting operations with certificates of deposit and savings certificates, accounting for 72% of overall sales. In the year under review the issue of savings certificates decreased by 8% in volume compared with 1996.

Russian banks also stepped up their operations with promissory notes. Investment in promissory notes in total banking assets increased in 1997 from 3.7% to 5.3%. The bulk of investments in promissory notes (48.6% of total in the banking system) was made by a group of banks (16.1% of all banks) which increased such investments by 210% over the year. At the same time, 46.5% of banks reduced their investments in notes a bit in 1997.

**CORPORATE SECURITIES MARKET.** In 1997 Russia continued to privatise some state-owned enterprises and convert others into joint-stock companies. Market capitalisation increased. In the first half of 1997 trade in industrial enterprises' stocks rose at a rapid rate and the share prices of most issuers tended to grow, notwithstanding considerable fluctuations. Shares of Unified Energy Systems, Mosenergo, LUKoil and Norilsky Nickel accounted for the largest portion of stock trade. Current yield from speculative operations in some periods exceeded 500% p.a. The most rapid rates of stock price growth were posted by regional electricity utilities such as Kubanenergo and Novosibirskenergo and the Gorky Automobile Works.

The global financial crisis in late October not only caused a dramatic change in stock market trends, but also affected the further development of the Russian stock market. Moreover, this segment of the market was the hardest hit by the global financial crisis. Even in the early days of the crisis (October 28 — 30) trade turnovers on exchange floors soared, while stock prices (of the

leading issuers) plummeted on average by more than 20%.

The situation on the stock market remained volatile until the end of the year. Compared with the base level of October 15, trade turnovers fell by half, the price of shares traded on MICEX declined by more than 40% and the instability of price dynamics increased, indicating a high level of investment risk. By the end of the year the MICEX consolidated stock index had sunk by 26.5% from the base level to 396.41 points as of December 30, 1997.

The over-the-counter corporate securities market saw the same situation in the second half of the year. The average price of shares of the main issuers had fallen by more than 35% from the base level by the end of the year. The Russian Trading System stock index slid by 22.4% to 85.04 points as of December 30, 1997.

**FINANCIAL DERIVATIVES MARKET.** Throughout 1997 MICEX forward market players preferred

US dollar futures contracts as this basic asset enjoyed the highest demand.

GKO — OFZ futures dominated trade on the Moscow Central Stock Exchange.

Corporate securities futures took the leading position on the Russian exchange in January 1997 and retained this position till the end of the year.

Russia's regulated exchanges today trade in futures contracts for LUKoil, Mosenergo, Rostelecom, Unified Energy Systems and Gazprom shares as well as forward contracts on stock indices and options.

Since commercial banks have a great role to play in the development of the forward market, the Central Bank, in accordance with its Concept of Futures and Options Market Regulation, is developing a legal framework that will regulate the activities of credit institutions in the forward market and the work of exchange clearing houses and is also monitoring commercial banks' operations with financial derivatives.



## II.5. RELATIONS WITH CENTRAL (NATIONAL) BANKS OF CIS COUNTRIES

*The* **MAIN OBJECTIVE** of the Bank's cooperation with the central (national) banks of CIS countries in 1997 was to improve inter-state and inter-bank settlements and the servicing of state credits extended to CIS countries by the Russian Federation.

It was decided that central banks should discontinue functions incompatible with their duties, such as handling settlements and payments between economic agents in Russia and other CIS countries through correspondent accounts of CIS central (national) banks, opened in the Bank of Russia. Such payments in 1997 amounted to 960.7 billion rubles, a considerable decrease compared with 1996 (1,282.0 billion rubles).

The efforts made to encourage authorised banks to participate in inter-state settlements eventually led to the closing of such accounts on December 31, 1997, and all central (national) banks were invited to open ruble-denominated correspondent accounts with the Bank for settlements on operations that are the exclusive function of central banks.

At the initiative of the Bank, the procedure was changed for servicing state debts extended by the Russian Federation to CIS countries in 1992 — 1997 under inter-governmental agreements. On December 30, 1997 the Central Bank, Ministry of Finance and Vneshekonombank (Russia's Bank for Foreign Trade) signed an agreement, whereby the servicing of the entire CIS debt, set in the Bank's balance sheet at 5.6 trillion rubles, was to be transferred to the balance sheet of Vneshekonombank.

The Bank monitored CIS currency markets and ensured the fulfilment of obligations within its competence and arising from the corresponding inter-state, inter-governmental and inter-bank agreements (on the Inter-State Bank, on payments and customs unions, on measures to ensure mutual convertibility and stabilisation of the rates of national currencies).

There were further developments in the uniformity of the foreign exchange legislation, coordination of actions in the field of foreign exchange regulation and foreign exchange control with the member-states of the customs union.

In 1997 the Bank of Russia established on a daily basis the official rates of the national currencies of Ukraine, Kazakhstan and Belarus on the results of trading in these currencies on currency exchanges and operations in the Russian interbank currency market. The official rates of other CIS currencies were set on a monthly basis, based on their cross rates against the US dollar owing to the absence of sustained demand for these currencies and their supply in the Russian foreign exchange market.

To assist the stabilisation of the Belarusian ruble the Bank of Russia and the National Bank of the Republic of Belarus signed a swap agreement, whereby Belarusian National Bank bought 100 billion Russian rubles from the Bank of Russia as of April 22, 1997, with the obligation to sell them back on July 22, 1997.

The Bank intensified the process of upgrading the regulatory framework of inter-state settlements, in accordance with which authorised banks of the Russian Federation and other CIS countries service foreign trade operations inside the CIS. The replacement of the interbank settlement agreements signed in 1992 — 1994 is designed to create stable conditions for co-operation between CIS banking systems.

In 1997 the Bank of Russia signed the following agreements:

- an agreement between the Government and Central Bank of the Russian Federation and the Government and National Bank of the Republic of Tajikistan on measures to ensure mutual convertibility and stabilise the exchange rates of the Russian ruble and Tajik ruble;
- an agreement between the Government of the Russian Federation and Central Bank of the Russian Federation and the Government and National Bank of Georgia on measures to en-

- sure mutual convertibility and stabilise the exchange rates of the Russian ruble and the Georgian lari;
- interbank agreements on settlements with the National Bank of Georgia, National Bank of the Republic of Tajikistan and National Bank of the Republic of Belarus;
- interbank agreements on banking supervision of credit institutions with the National Bank of Kazakhstan and National Bank of Georgia.



**FOREIGN EXCHANGE  
POLICY AND  
FOREIGN EXCHANGE  
REGULATION**







### III.1. BANK OF RUSSIA FOREIGN EXCHANGE POLICY

*In* 1997 Russia pursued its foreign exchange policy in accordance with the Guidelines for the Uniform State Monetary Policy in 1997 and the Joint Statement by the Government and Central Bank of the Russian Federation “On the Foreign Exchange Policy in 1997”.

The main objective was to ensure the stability of the domestic currency’s exchange rate by continuing the previous eighteen-month policy of setting upper and lower limits on ruble/dollar exchange rate fluctuations, known as the currency corridor regime. The progress made in financial stabilisation allowed the Bank to set the exchange rate corridor for the whole of 1997 from 5,500 — 6,100 rubles to the dollar on January 1, 1997, to 5,750 — 6,350 rubles as of December 31, 1997.

In addition to fulfilling its main goal, the exchange rate policy served to fulfil the following objectives:

- prevent abrupt exchange rate fluctuations owing to short-term imbalances in foreign exchange demand and supply;
- encourage further development of the foreign exchange market by broadening the range of currency operations and instruments;
- curb yields from investments in foreign assets by making ruble-denominated financial instruments more attractive in order to reduce the role of the US dollar in the Russian economy;
- maintain at a sufficient level the Bank’s foreign exchange reserves and upgrade methods for managing them.

In 1997 the nominal rate of the US dollar to the Russian ruble rose by 7.2% (from 5,560 rubles to 5,960 rubles to the dollar), which represented an average monthly rate of 0.6%. In real terms, that is taking into account Russian inflation of 11% a year and US inflation of 1.8% a year in 1997, the Russian ruble gained 1.7% in value.

Ruble exchange rate dynamics in 1997 were smooth and predictable. During the year the rates of the domestic currency’s devaluation were such that all year long the exchange rate of the dollar to the ruble stayed closer to the lower border of the currency corridor.

The domestic foreign exchange market continued to develop at a fast pace. Over the year daily turnovers of foreign cash operations more than trebled and in December their average monthly volume exceeded \$10 billion.

The increased predictability of the Bank’s foreign exchange policy and the reduction of speculative possibilities in the spot market stimulated the growth of the forward currency market. A massive inflow of foreign investments into the Russian securities market also facilitated growth in the volumes of currency forward operations conducted to hedge against exchange rate risk. Daily turnovers in the currency forward market amounted to \$2bn — \$3bn, that is, became commensurate with spot market turnovers.

Most forward operations were conducted in the form of forward settlement contracts, that is, contracts without actual delivery of foreign ex-

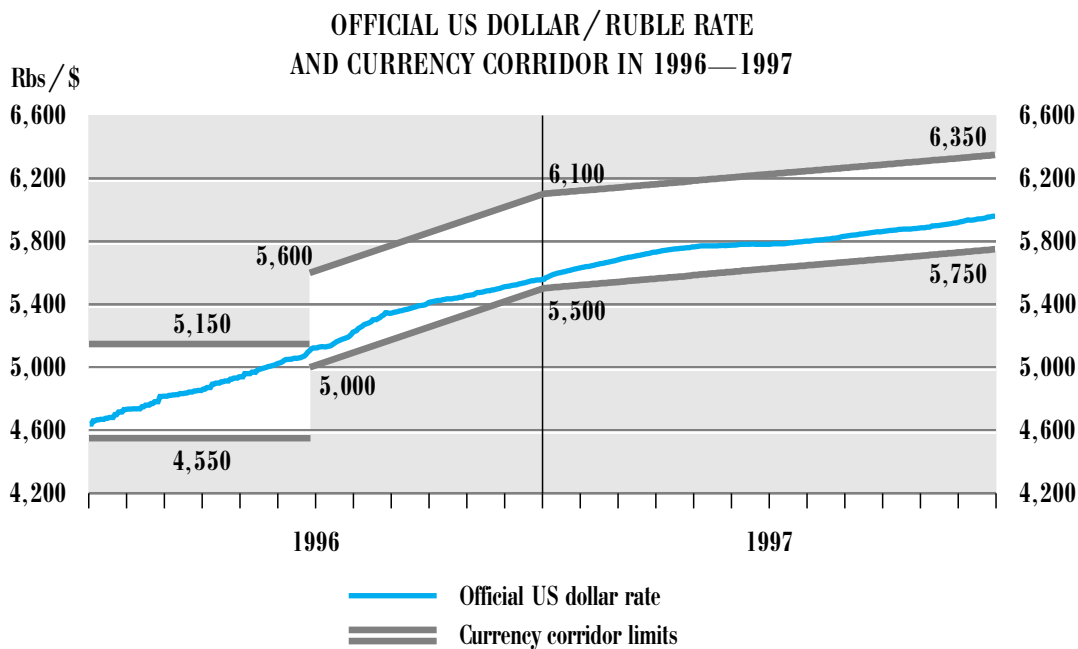


Figure 10

change. The delivery forward market also expanded and currency options operations intensified. The forward market was particularly liquid for contracts concluded for up to 6 months, but longer-term contracts (up to 1 year) were also concluded.

The global financial crisis, which erupted in October 1997, had a very dramatic impact on the domestic foreign exchange market. It provoked an exodus of foreign capital from emerging markets to the government securities markets of the industrialised nations. The Russian market also experienced capital outflow.

The withdrawal of nonresident funds and soaring demand for foreign currency on the part of Russian commercial banks created expectations of the ruble's devaluation and a fall in the price of government securities.

In order to reduce sources of pressure on the currency market and raise the cost of capital withdrawal from the government securities market, the Bank tightened its monetary policy in November. It simultaneously raised the refinancing rate, Lombard rates and reserve requirements on foreign currency liabilities. If the situation on world markets had improved, those measures would have been sufficient. However, in November the crisis continued to affect more and more countries, both industrial and developing, causing new

waves of capital flight from the emerging markets. As the result of these negative trends, the Bank's foreign exchange reserves decreased in November, pressure on the foreign exchange market built up and it became clear that the measures that had been taken were not sufficient.

Whenever the bulk of Russian financial resources move between the currency market and government securities market, the situation on the foreign exchange market depends to a great extent on yields in the securities market. The exacerbation of the crisis on the global and domestic markets in November 1997 made it impossible to simultaneously preserve foreign exchange reserves, keep yields on government securities relatively low and ensure the stability of the ruble's exchange rate. Keeping the exchange rate stable was more important in this situation. That is why in early December 1997 the Bank of Russia slackened its resistance to the decline in the price of government securities, widened the daily spread between ruble exchange rate fluctuations in the interbank market and raised the price of ruble resources by beginning to announce daily bid rates on short-term ruble deposits.

That policy paid off handsomely: the situation in the foreign exchange market and in other sectors of the financial market stabilised. In December foreign exchange reserves grew, and, after a

US DOLLAR GROWTH RATES AGAINST THE RUBLE AND AGAINST INFLATION IN 1997  
(as % of previous month)

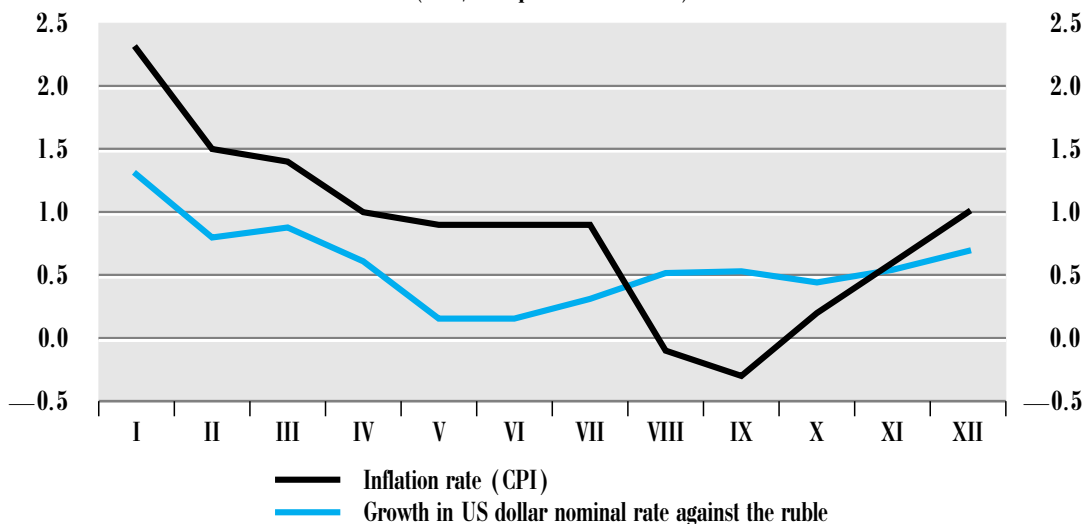


Figure 11

short-term growth at the beginning of the month, yields on government securities fell by an average of 8 — 9 percentage points. Nonresidents began to return a part of funds to the GKO — OFZ market.

The November 10 Joint Statement by the Government of the Russian Federation and Bank of Russia “On Exchange Rate Policy in 1998 and the Next Few Years,” which announced the transition from setting short-term (up to 1 year) limits on ruble exchange rate variations to establishing medium-term targets for ruble exchange rate dynamics, played a stabilising role in the crisis of the Russian financial market in October — December 1997. As a guide for the period of at least 1998 — 2000, the central rate of 6.2 rubles to the dollar was established, with possible deviations of 15% both ways (between 5.25 rubles and 7.15 rubles to the dollar).

The switch to a medium-term exchange rate policy was possible thanks to the financial stabilisation achieved in Russia and a qualitatively new level of development on the domestic foreign exchange market. It was prompted by the need to create preconditions for rapid economic growth and connected with the increased integration of the Russian financial market with the global financial market.

The management of foreign exchange reserves was aimed at preserving their profitability despite an extremely volatile situation in foreign finan-

cial markets and solving a number of methodological and technical issues, such as:

- elaborating investment directives for the foreign reserve operation and investment portfolios;
- selecting yield targets and structuring normative portfolios;
- mastering new instruments and operations in foreign markets;
- upgrading regulatory and accounting standards for Bank of Russia currency operations in foreign markets.

The transfer of a portion of investor funds from the emerging stock and securities markets and from the stock markets of industrial nations led to substantial growth in the price of US and German government bonds, which play the role of safe havens for assets in times of crisis. Throughout 1997 the Central Bank of the Russian Federation consistently built up its presence in the US and German government securities markets, especially after the adoption of investment directives for the foreign exchange reserve operations portfolio (March 1997) and foreign exchange reserve investment portfolio (October 1997) and as the result of favourable reserve dynamics in the first half of the year. As a result, the Bank was able to manoeuvre quickly in these markets, making full use of the investment opportunities created by wide interest-rate variations of the US dollar and German mark.

In this situation, securities portfolios were structured strictly in accordance with the investment directives establishing the procedure for using normative portfolios as benchmarks. This method of managing reserve assets, which is commonly used by other central banks, had never been used by the Bank before.

A major step forward in creating a regulatory and methodological framework for operations with Bank of Russia foreign exchange reserves was the elaboration and introduction of the Provisions on Transactions to Sell Foreign Currency-Denominated Securities with the Buy-Back Obligation, Conducted by the Bank of Russia in Foreign Markets. This document describes and explains in detail REPO operations, which are ac-

tively conducted by the Bank as part of its reserve management activities in US dollars and German marks, and helps the Bank to successfully carry out all direct and reverse REPO operations in use worldwide and modern accounting standards and risk analysis methods with respect to such operations.

In 1997 the volume of the Bank's foreign exchange reserves varied significantly. In the first half of the year they rose by \$8.6 billion, or around 77%, mainly owing to the inflow of non-resident funds to the domestic financial market. During the year as a whole, the Bank managed to increase its foreign exchange reserves from \$11.2 billion to \$12.5 billion, despite the negative after-effects of the global financial crisis.



## III.2. FOREIGN EXCHANGE REGULATION AND FOREIGN EXCHANGE CONTROL

**In** PURSUANCE of the state foreign exchange and monetary policy for 1997, the Bank continued to upgrade the system of foreign exchange regulation and foreign exchange control, the general aims and tasks of which at this stage arise from the present state of the country's economy and prospects for its development, the monetary, fiscal and budget policy pursued and the creation of a legal framework ensuring the functioning of market mechanisms, macroeconomic and financial stability and the stability of the national currency. Foreign exchange regulation and foreign exchange control, which Article 35 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia) defines as one of the instruments and methods of monetary policy, are applied to the main areas of foreign currency circulation and use in the Russian Federation and its foreign trade and also to the maintenance of the internal and external convertibility of the domestic currency.

The objectives of the Bank's foreign exchange regulation and foreign exchange control were as follows: reducing the imbalance of resident foreign currency accounts on current foreign exchange operations by ensuring the repatriation of foreign currency earnings from commodity exports and cutting advance payments on imports, which were not offset by timely delivery of commodities; preventing unjustified capital outflow from Russia, including the return of dividends from invested capital; fighting the laundering of illegally obtained incomes through the banking system; creating favourable conditions for long-term foreign investment and financial capital in the country's economy while restricting the inflow of speculative foreign capital; de-dollarisation of the economy and ensuring on this basis stability of the national currency.

Payments on foreign trade operations conducted by residents were controlled by the system of customs and banking control, created by the Bank jointly with the State Customs Committee. This system does not cover all customs re-

gimes and payments. According to the State Customs Committee, in 1997 the customs and banking control system embraced currency operations of exporters worth a total of \$58.5 billion against \$71.1 billion in 1996. At the same time, the share of operations covered by customs and banking control in the total volume of registered goods exports fell from 84% in 1996 to 69% in 1997. That resulted from the increase in the volume of export operations conducted by residents in the customs regimes and in settlements, including settlements in Russian currency, which are not covered by this system according to the applicable legislation.

In 1997 the customs and banking control system covered in value 58% of all goods imports registered on the basis of freight customs declarations. In 1996 the system covered 54% of all imports.

Prospects for the improvement of the system of customs and banking control over foreign trade operations are linked with progress in two areas.

First, it is necessary to create an efficient system of registration and monitoring of payments made by residents on import operations through authorised banks. To this end, in 1997 the Bank and the State Customs Committee jointly elaborated and issued Instructions Nos. 134-u and 01-23/732 respectively dated January 14, 1998, "On Making Changes and Amendments to the Bank of Russia and State Customs Committee Joint Instruction Nos. 30 and 01-20/10538, dated July 26, 1995, "On the Procedure for Implementing Foreign Exchange Control over the Appropriateness of Foreign Currency Payments for Imported Goods." The envisaged system of information flows regarding payments for imported goods from authorised banks to the Bank's regional institutions will create additional opportunities for effective control over compliance by authorised banks with their status of foreign exchange control agents and the application of appropriate sanctions for violating foreign exchange legislation.

Second, it is necessary to extend the scope of the customs and banking control system. In 1997 this system was expanded to cover foreign trade transactions involving the delivery of goods on government credits.

Throughout the year, much attention was paid to the regulation and control of foreign currency movements in the foreign cash market. The Bank was guided in its actions by the need to constantly monitor foreign cash flows and efficiently control and regulate the use of foreign cash. The foreign cash market in 1997 demonstrated considerable stability, which was largely attributable to the predictability of the dollar/ruble exchange rate within the Bank's currency corridor and the measures taken to restrict the use of foreign exchange in settlements within Russia. On June 1, 1997, the Bank stopped issuing permission to legal entities to sell goods and services to private individuals for foreign currency and on October 10 it published Provision No. 503 of August 15, 1997, prohibiting settlements in foreign currency for goods and services sold by private individuals, except for duty-free shops and a handful of Russia-based offices of foreign airlines.

It should be noted, however, that in 1997 the balance of foreign currency taken into and out of Russia by authorised banks amounted to \$37.1 billion, which represents a rise of 11% on 1996. The excess of foreign cash sold by authorised banks to private individuals and paid out by them from foreign currency current accounts over foreign cash bought from private individuals and entered in current accounts was \$35.2 billion against \$32.3 billion in 1996.

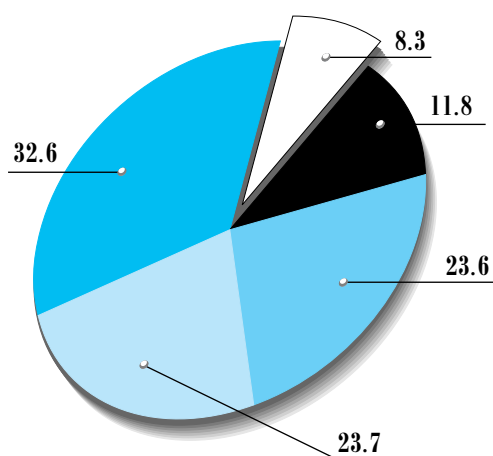
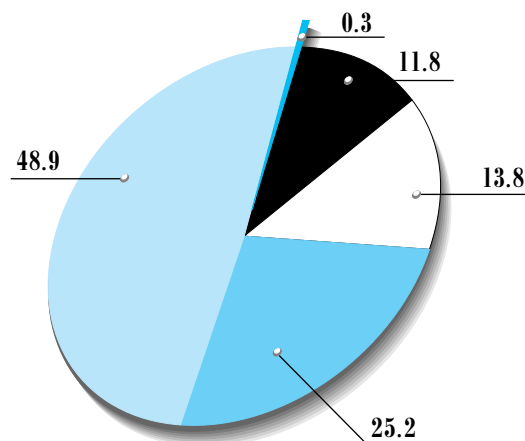
In order to regulate some foreign cash operations the Bank on June 25, 1997, issued Provision No. 62 "On the Procedure for Buying and Paying Out Foreign Currency for Travelling Expenses," which established procedures for buying foreign currency by resident legal entities through authorised banks to meet travelling expenses and also the rules of such operations and mechanisms of control against the misuse of foreign exchange paid out for these purposes.

In another enactment, "The Procedure for Remitting Foreign Exchange from and to the Russian Federation Without Opening Current Foreign Exchange Accounts" (approved by Bank of Russia Order No. 02-371 of August 27,

1997), the Bank allowed resident private individuals to receive any amount of foreign currency from abroad and to transfer foreign currency from the Russian Federation within the limit of \$2,000 in one bank during one business day, unless such transfers are connected with entrepreneurial or investment activity or the purchase of real estate.

In the field of regulation and control of currency operations related to capital flow, rules and regulations were adopted to ease the procedure for conducting some capital import operations by residents, while tightening registration and control over the inflow and outflow of capital. Realising the scarcity of internal investment resources and seeking to create conditions conducive to growth in long-term foreign investment, the Bank abolished the licensing of such operations with its Provision No. 527 of October 6, 1997, "On the Procedure for Attracting and Repaying by Residents of Russian Federation Financial Credits and Loans Received from Nonresidents in Foreign Exchange for a Term of More Than 180 Days," provided that credit agreements met a number of criteria, especially those related to the sum of credit and the level of interest rates.

Taking into consideration the amendments made in the procedure for conducting some kinds of foreign exchange operations in the Russian Federation and the easing of controls over the implementation of some operations related to capital flow and seeking to harmonise the legal framework of foreign exchange regulation and foreign exchange control, the Bank issued Letter No. 488 of July 17, 1997, amending Bank of Russia Instruction No. 7 of June 29, 1992, "On the Procedure for Compulsory Sale by Enterprises, Associations and Organisations of a Portion of Their Foreign Currency Earnings Through Authorised Banks and Conducting Operations on the Domestic Foreign Exchange Market," which considerably broadened the rights of resident legal entities to buy foreign currency. Previously residents of the Russian Federation could buy foreign currency for rubles through authorised banks only in order to fulfil their obligations under foreign trade contracts and repay foreign currency credits, whereas now they received the right to buy foreign currency also in order to conduct currency operations related to capital flow.

STRUCTURE OF FOREIGN CASH  
RECEIPTS IN 1997 (%)STRUCTURE OF FOREIGN CASH  
UTILISATION IN 1997 (%)

Figures 12, 13

Brought into Russia by banks ■ Taken out of Russia by banks

Other receipts ■ Other uses

Entered in personal foreign currency accounts □ Paid out from personal foreign currency accounts

Bought from resident banks ■ Sold to resident banks

Bought from private individuals ■ Sold to private individuals

As the Russian economy became increasingly integrated with international capital markets, the scope of the Bank's licensing of currency operations related to capital flow increased significantly. Such licensing is a key element of foreign exchange control. The Bank delegated a part of this work to its regional institutions.

In 1997 the Bank issued and registered to residents 1,728 licences and permits to conduct foreign currency operations connected with capital flow. Such operations amounted to \$29.8 billion (the value of permitted payments in 1996 was \$11.2 billion). Of the total amount of licensed operations, payments involving the transfer of capital abroad made up nearly \$3 billion, while foreign capital transfers to the Russian Federation accounted for \$22.7 billion. In addition, foreign currency flow worth a total of \$4.1 billion was permitted under certain circumstances against guarantees and sureties. The amount of financial credits permitted to be attracted from nonresidents totalled \$20.3 billion against \$3.3 billion in 1996. This growth testifies to the higher rating of Russian borrow-

ers in international capital markets and greater trust in the Russian economy as a whole. The decrease of permitted capital outflow was linked with a sharp fall in direct and portfolio investments in CIS countries, compared with 1996.

Exercising control over the export of banking capital, the Bank issued 21 permits to authorised Russian banks for the transfer of \$55 million in foreign currency as payments to the authorised capital of credit institutions abroad, of which 15 permits provided for the transfer of \$30 million as stakes in CIS banking institutions.

The Bank's regional institutions stepped up control over the observance of foreign exchange legislation by all parties to foreign currency transactions. Over the year they conducted 27,200 inspections of banks and their branches and other legal entities, which represents an increase of 8% over 1996. As a result of the inspections, 5,700 orders were issued to eliminate the violations discovered and authorised banks and other legal entities paid a total of 27 billion rubles in fines against 12.7 billion rubles in 1996.



To improve the regulatory and legal framework, the Bank participated in drafting system-forming enactments related to the key areas of foreign exchange control and regulation. This applies, in particular, to the draft Federal Law “On Making Changes and Amendments in the Russian Federation Law On Foreign Exchange Regulation and Foreign Exchange Control,” which classifies the currency of the Russian Federation as a foreign exchange value when used in foreign trade settlements. This classification will allow the Bank of Russia and State Customs Committee to extend the system of customs and banking foreign exchange control to payments and settlements between residents and nonresidents, who use national currency as a means of payment.

The draft law specifies precisely the types of operations with currency values and the procedure for conducting them, including operations with securities and precious metals, describes in a more comprehensive way the functions of foreign exchange regulation and control bodies and the rights and duties of authorised banks as foreign exchange control agents, and also sets up a differentiated system of penalties for violations of the foreign exchange legislation committed by authorised banks, residents and nonresidents.

To prevent the infiltration of the Russian banking system by “shadow” capital the Bank participated in drafting the Federal Law “On Measures to Counter the Legalisation (Laundering) of Illegally Obtained Incomes.” At the same time, using applicable legislation, the Bank be-

gan to create a system to protect credit institutions from criminal capital. One of the first steps in this direction was the issue in July 1997 of “Methodological Recommendations on Ways to Organise the Prevention of Infiltration of Banks and Other Credit Institutions by Illegally Obtained Incomes.” In developing this document, the Bank made use of the experience of foreign central banks as well as the recommendations of the Financial Action Task Force (FATF).

In 1997 the Bank attached great importance to establishing closer co-operation with foreign central banks and international financial and economic institutions. In connection with the forthcoming talks on the terms and conditions of Russia’s entry into the World Trade Organisation (WTO), special attention was paid to drafting the Bank’s negotiating position in compliance with the requirements of the General Agreement on Tariffs and Trade as an integral part of the WTO and aimed at forming specific obligations in the financial services sector.

The inter-governmental commissions on trade and economic co-operation between Russia and China and between Russia and India tackled practical issues related to bilateral interbank relations and settlements and payments. To regulate settlements and payments between the CIS member-states of the Customs Union, work continued on the draft “Agreement on Uniform Principles of Foreign Exchange Control in Foreign Trade of the Customs Union Member States” in order to harmonise their foreign exchange legislation.





### III.3. INTERACTION WITH INTERNATIONAL FINANCIAL INSTITUTIONS

**In** 1997 the Bank participated in elaborating and translating into practice Russia's policy with respect to the International Monetary Fund (IMF), the World Bank, the European Bank for Reconstruction and Development (EBRD) and other international financial and credit institutions, aimed at creating favourable conditions for the inflow of foreign financial and investment resources to Russia. Great importance was accorded in this sense to the Bank's participation in the work of the Inter-departmental Commission of the Russian Federation on Co-operation with International Financial and Economic Organisations, the Inter-departmental Commission for the Participation of the Russian Federation in the Big Eight (G-8) and other bodies co-ordinating the activities of Russian ministries and government departments.

A hallmark event from the viewpoint of Russia's co-operation with the IMF and the International Bank for Reconstruction and Development (IBRD) was a Russian delegation's participation in a meeting of the IMF and IBRD Board of Governors, held in Hong Kong in September 1997.

That meeting discussed prospects for the development of the world's economy, globalisation of financial markets, capital flows and other issues. It approved corresponding decisions relating to the 11th general review of quotas by the IMF member-countries, a special SDR issue, progress in the implementation of the foreign debt reduction plan for the poorest nations and an aid programme to the poorest countries (ESAF).

During the year under review the Bank maintained regular ties with the IMF. At quarterly meetings with IMF missions the sides discussed the implementation of the programme in the field of monetary and foreign exchange policy, the development of financial markets, and banking reforms, including the modernisation of the banking supervision and payments systems. These were incorporated in the Statement by the Government and Central Bank of the Russian Federation on Me-

dium-Term Strategy and Economic Policy in 1997. Russia's implementation of this programme facilitated the international financial community's adoption of a decision on the long-term restructuring of the external government debt of the Russian Federation and the placement of Russian Eurobonds in foreign financial markets.

In the course of the implementation of the three-year Extended Fund Facility programme, Russia discussed with the IMF issues related to Russian foreign exchange policy, the state of the GKO market and balance of payments dynamics and forecast.

The Bank worked together with IMF experts to bring Russian monetary statistics closer to international standards, adapt statistical reports to the new chart of accounts, upgrade methods of collecting and compiling statistical data in the banking system and create a statistical database, including a database for the international computer network, the Internet. Using IMF recommendations, the Bank evaluated the quality and time of dissemination of statistical data and worked out a series of measures to ensure that Russian banking statistics matched international standards.

Consultations were held with the IMF within the framework of the technical assistance programme for the Bank on questions such as reserve requirements, liquidity management, consolidated banking supervision, a new chart of accounts for commercial banks and information technology.

Russia took part in discussing and implementing **International Bank for Reconstruction and Development** investment projects, including projects designed to encourage private investment and enhance the efficiency of the banking sector. Thus, the Bank's supervisory units co-operated closely with IBRD and EBRD representatives within the framework of a project for the development of financial institutions and a project to support ventures launched in Russia with funds provided by the IBRD, EBRD and a number of

official foreign donors. That co-operation helped these international financial institutions to improve the selection of Russian banks for participation in the aforementioned projects and monitor their current financial indicators.

The proportion of successful IBRD-funded projects in Russia increased from 39% in 1996 to 84% in 1997.

Issues that Russia discussed with representatives of the IBRD, the major foreign source of long-term credits for the public sector of the Russian economy in 1997, included the elaboration of a sustained long-term borrowing strategy for Russia, grant financing of personnel training, possible areas of co-operation between the Bank and the IBRD and the prospects for Russia's transition to international accounting and audit standards as well as other issues.

In meetings with representatives of the **International Finance Corporation (IFC)**, Russia discussed investment in the development of Russian private businesses (\$340 million have been invested in 19 Russian projects in the last three years), the development of the banking sector, including the granting of IFC credits to the largest Russian commercial banks, and the IFC's provision of information on its activities and plans in this area to the Bank.

Russia intensified its co-operation with the **European Bank for Reconstruction and Development**, which significantly increased its investment in Russian economic reforms. In recent years Russia has become this bank's major client. In 1997 it accounted for nearly 34% of the entire portfolio of the EBRD's agreements with all countries. The overall value of the Russian projects approved in 1997 increased by almost 50% compared with 1996 to 3.5 billion ECUs, of which 1 billion ECUs came from the EBRD's own funds.

In April 1997 a Russian delegation led by the Bank's Chairman, the EBRD Governor from the Russian Federation, took part in the Sixth Annual Meeting of the EBRD Board of Governors in London, which discussed, among other things, investment in the Russian economy and problems of its financial sector.

During the year Russia conducted negotiations on specific issues of co-operation between the

EBRD and Russian commercial banks and financial institutions, long-term strategic partnership between the EBRD and the leading Russian companies on the latter's restructuring and EBRD projects for the development and reform of Russia's regional economies.

Ties between the Central Bank of the Russian Federation and the **Bank for International Settlements (BIS)** intensified and became regular. The Bank's Chairman took part in the March 1997 meeting of central bank governors of the BIS shareholder countries and attended their annual general meeting in June.

In December a Bank delegation participated in a meeting of central bank representatives devoted to the upgrading of payments systems and Bank representatives took part in the drafting of the Fundamental Principles of Effective Banking Supervision, a document of the BIS's Basel Committee on Banking Regulation and Supervisory Practices.

To assist the Bank in training personnel the BIS worked out internship programmes for Bank employees, and Bank representatives were invited to seminars organised by the BIS in collaboration with the Joint Vienna Institute and Bank of England devoted to the management of international reserves and other subjects.

As for co-operation with international regional banks, the Bank participated in activities to launch the **Black Sea Trade and Development Bank**, which was created to assist regional trade and finance regional projects.

The Central Bank of the Russian Federation also took part in work to determine the Russian position on joining the **Asian Development Bank** and creating the **Middle East and North Africa Economic Co-operation and Development Bank**.

It helped normalise the work of the International **Bank for Economic Co-operation (IBEC)** and **International Investment Bank (IIB)**, of which Russia is the largest borrower and shareholder. Bank representatives participated in the comprehensive settlement of the debt claims and obligations of the IBEC and IIB and also in tackling legal problems related to their presence in the Russian Federation.

**STATE AND  
REGULATION  
OF RUSSIA'S  
BANKING SYSTEM**

**IV**



## IV.1. GENERAL ASSESSMENT OF RUSSIA'S BANKING SYSTEM

*The* **MAJOR TREND** in the development of the Russian banking system in 1997 was the expansion of the capital base of banks. In 1997 the aggregate capital of Russian banks increased by 26.5% to 112.3 trillion rubles as of January 1, 1998. Analysis of banks' standing in terms of assets in 1997 shows that the number of credit institutions with negative capital dropped by 42%, the number of credit institutions with capital up to 1 million ECUs declined by 32% and the number of credit institutions with capital from 1 million to 5 million ECUs decreased by 9%, while the number of banks with capital in excess of 5 million ECUs rose by 29%.

Consolidation was another significant trend in the development of the banking system. Thirty leading banks now form the nucleus of the Russian banking system. On January 1, 1998, they accounted for 67% of all banking assets and 55% of aggregate bank capital. On January 1, 1998, Russia's 200 largest banks accounted for 88.4% of all banking assets, which represents a rise of 3.3 percentage points from 1996.

As bank capital and banking assets concentrated, the overall number of credit institutions in Russia continued to decline. In 1997 the rate of decline in the number of credit institutions accelerated to 16.3% against 11.6% in 1996.

The highest rates of decline in the number of credit institutions were registered in the Far East, North Caucasus and Volga-Vyatka Region, where the number of credit institutions declined at the rate of 30.9%, 21.7% and 21.5% respectively; the lowest rate of decline (8.3%) in the number of credit institutions was recorded in the Central-Black Soil Region. In other economic regions the rates of decline in the number of credit institutions did not differ much, varying from 13.1% to 16.7%.

Owing to developments in the banking services market and the Bank's efforts to shape a sound banking system, including more stringent requirements for newly-created institutions, the number of new credit institutions declined significantly. Only 12 new credit institutions were registered in 1997, compared with 26 in 1996, and three of them were 100% controlled by foreign capital.

Asset and capital concentration in the largest banks is accompanied by their expansion to the regions. The structure of the banking system at the regional level is increasingly dominated by branches of banks headquartered in other regions, whose share of regional banks and branches increased in Russia as a whole from 57% as of January 1, 1997, to 67% as of January 1, 1998 (not counting Sberbank branches). It is significant that

the fewer local credit institutions there are in the region, the greater the presence of branches of banks from other regions there.

Banks with foreign interest strengthened their positions in the Russian banking services market and the relative dynamics of assets of such banks confirms this. In 1997 the aggregate assets of the banking system (excluding Sberbank) increased by 10% in real terms, whereas the assets of banks with foreign interest rose by 24%. Most foreign-controlled banks are among the 200 largest banks (12 out of 16 banks are wholly owned by non-residents and 17 out of 26 banks have authorised capital more than half of which is formed from foreign investor funds). Foreign investment in the authorised capital of Russian banks grew by 70% in real volume and on January 1, 1998, made up 4.13% of the aggregate authorised capital of the Russian banking system.

The Savings Bank of the Russian Federation, or Sberbank, continued to play a special role in the Russian banking system. Although its share of aggregate banking assets decreased a little (from 26.5% as of January 1, 1997, to 24.7% as of January 1, 1998), on January 1, 1998, it controlled 79.2% of all personal deposits in rubles and 62.6% of investments in government securities. Its share of the total funds attracted by the banking system to settlement, current and deposit corporate accounts rose from 10.9% as of January 1, 1997, to 12.3% as of January 1, 1998.

The analysis of changes in active operations by credit institutions shows that the banking system is beginning to gradually gravitate towards the real economy.

The growth of credit institutions' aggregate assets in 1997 resulted from most banks' mounting credit activity: the growth in credit investments ensured 50% of the year's increment in aggregate assets. As nominal lending rates kept falling in 1997 (from 66.2% p.a. as of January 1, 1997, to 25.3% p.a. as of January 1, 1998, on commercial 3-month credits), banks increased the crediting of the nonfinancial sector of the economy by 24% in real terms. Bank credits extended to the nonfinancial sector in total banking assets grew by 4 percentage points (from 29.5% to 33.5%). However, despite some signs of growth, the proportion of long-term credits in the overall

amount of credits granted to the economy remained as low as 3%.

The increased functional role of the banking sector in the reproduction process found its expression also in the growth of banking assets relative to GDP (from 20.9% as of January 1, 1997, to 21.5% as of January 1, 1998, excluding Sberbank), while the overall level, calculated with Sberbank included, did not change from 28.5%.

Demand for credits in the sectors which managed to adapt to market conditions rose in 1997, despite a fairly high lending rate. Owing to a high level of profitability in these sectors, their overdue debt is smaller than in other sectors and, consequently, they represent lower credit risk for banks. The share of credits to the fuel and energy sector in total credits rose from 29% as of January 1, 1997, to 31% as of January 1, 1998.

The reduction in the level of overdue debt on credit investments from 6.8% as of January 1, 1997, to 4.7% as of January 1, 1998, and the 33% reduction of overdue interest on credits from 17.7 trillion rubles to 11.9 trillion are attributable to the desire of a portion of the banking sector to get rid of the burden of bad debts. The share of standard and nonstandard loans in overall debt on loans rose in 1997 from 92.9% to 96.2%.

At the same time, banks continued to step up their activity on the securities market. Commercial bank investments in securities increased from 28.6% of all banking assets as of January 1, 1997, to 32.8% as of October 1, 1997, and fell to 31% as of January 1, 1998 (excluding Sberbank — 20.1%, 24.9% and 23.7% respectively).

The significant growth (by 46.5%, excluding Sberbank) of bank investments in short-term government bonds in the first three quarters of 1997 was attributable to the fact that, despite their constant decline, yields remained relatively high. The international financial crisis that broke out in October caused GKO prices to plunge and commercial bank investments in the GKO market dropped by 14.8% in the fourth quarter (excluding Sberbank). The share of bank investments in government securities as a part of total bank assets (excluding Sberbank) fluctuated from 9.4% as of January 1, 1997, to 11.7% as of October 1, 1997, to 9.6% as of January 1, 1998.

ASSETS CONCENTRATION  
IN THE RUSSIA'S BANKING SYSTEM  
AS OF JANUARY 1, 1998 (as % of total)

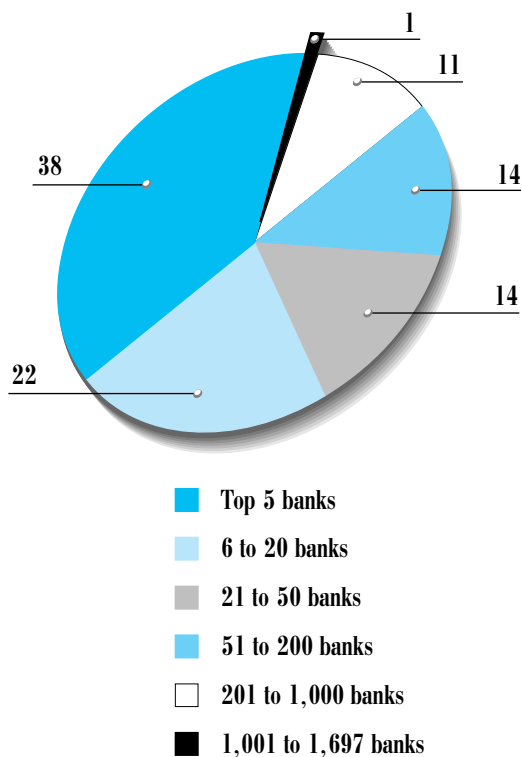


Figure 14

Bank investments in promissory notes rose by 70% over the year to 40.6 trillion rubles as of January 1, 1998, and their share of total banking assets increased from 3.7% as of January 1, 1997, to 5.3% as of January 1, 1998. Operations with promissory notes rose faster than assets in 1997 and that increased exposure to banking risks.

Bank operations in the interbank credit market tended to decline in 1997: bank investments in interbank credits decreased by 6.8% over the year, from 57.3 trillion rubles as of January 1, 1997, to 53.5 trillion rubles as of January 1, 1998. As interbank credit operations in the domestic market dwindled, their share of aggregate banking assets fell from 8.9% as of January 1, 1997, to 7% as of January 1, 1998, and the share of balances in correspondent accounts with banks declined from 4.9% to 4.0% of total assets.

These trends stimulated banks' active operations with the private sector of the economy, the Government and the Bank of Russia.

The share of funds attracted from the non-governmental sector continued to grow in the structure of bank liabilities and in 1997 it increased from 61.2% to 68.1%. Funds of enterprises and organisations accounted for most of the resources attracted by the banking system from the private sector of the economy, with the share of these funds in total liabilities rising from 22.1% as of January 1, 1997, to 26.4% as of January 1, 1998.

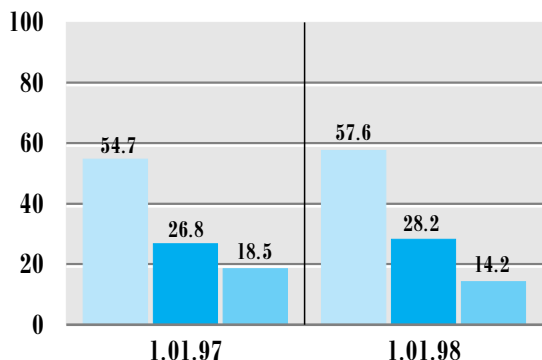
As for the terms of credits attracted from corporate lenders, short-term balances in settlement and current accounts in rubles and foreign currency continued to dominate their structure: 95.3% as of January 1, 1997, 94.6% as of October 1, 1997 and 95.7% as of January 1, 1998 (excluding Sberbank).

In the first half of 1997 ruble-denominated personal deposits in Russian commercial banks (excluding Sberbank) rose by 9.8%, but the financial crisis later brought the figure back down to the level it was at the beginning of the year. It should be noted that the share of household deposits in bank liabilities had a tendency to decrease, falling from 6.3% as of January 1, 1997, to 5.1% as of January 1, 1998. This trend was observed in all groups of banks regardless of the size of their capital. Sberbank increased its share of ruble-denominated household deposits from 76.2% as of January 1, 1997, to 79.2% as of January 1, 1998.

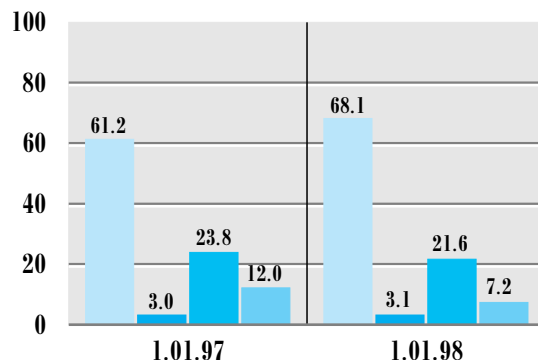
Mention should be made of the favourable tendency of time deposits to grow faster than other deposits in the first half of the year. This particularly applies to time deposits with terms longer than 90 days. However, in the second half of the year the volume of these kinds of deposits began to dwindle and the most dramatic fall in the volume of deposits with terms exceeding 90 days (by 1.8 trillion rubles, or 9%) occurred in the fourth quarter when the financial crisis erupted. As a result, at the end of 1997 the structure of household bank deposits (excluding Sberbank) became even more short-term than it was at the beginning of the year.

The role of interbank credits, including credits extended by nonresidents, as a source of bank resources increased in 1997. Credits received from nonresident banks accounted for 70.8% of all interbank credits in Russia as of January 1, 1998, which represents a growth of more than 1.5 times

**DYNAMICS OF CREDIT INSTITUTIONS  
ASSETS STRUCTURE (as % of total)**



**DYNAMICS OF CREDIT INSTITUTIONS  
LIABILITIES STRUCTURE (as % of total)**



*Figures 15, 16*

Operation with nongovernmental sector of the economy  
 Operations with Government and Bank of Russia  
 Own sources and profit  
 Other assets

over the year. As for the banking system as a whole, the share of interbank credits in liabilities rose from 10.8% as of January 1, 1997, to 14.1% as of January 1, 1998, and in nominal terms their volume grew by 54% to 107.9 trillion rubles as of the end of the year.

On January 1, 1998, debt obligations traded on the market accounted for 6.4% of aggregate liabilities against 5.9% at the beginning of the year and, as of January 1, 1998, the volume of banks' own promissory notes and acceptances in rubles exceeded by 80% the volume of these instruments denominated in foreign currency (the volume of the former rose by 10% and the latter by 100% over the year).

The financial position of banks was characterised by the growing proportion of financially sound banks in the total amount of credit institutions. The temporary increase (by 1.3 percentage points) of the share of problem banks in November 1997 was caused by the financial crisis and by the end of the year the tendency towards growth in the share of financially stable banks had been restored. As of January 1, 1998, 66% of all banks were financially stable banks, of which 39% showed no signs of financial trouble and 27% had some shortcomings in their operations (as of January 1, 1997, 54.3%, 42% and 12.3% respectively). Problem banks

accounted for 32.4% of all credit institutions as of January 1, 1998, and a large part (22.7%) of these banks were in critical condition. However, the assets of this group of banks made up only 2.9% of all banking assets as of January 1, 1998.

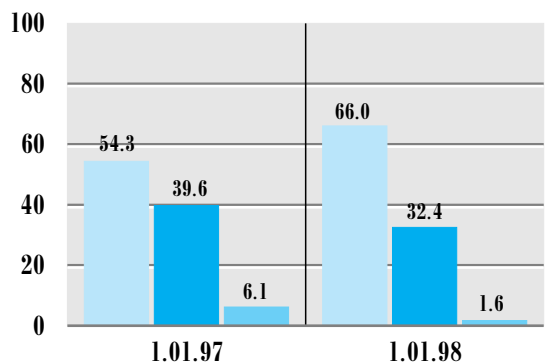
The tendency of banking assets to be concentrated in the financially sound banks, whose share of assets constantly grew, rising from 65.6% on January 1, 1997, to 81.2% on October 1, 1997, was temporarily interrupted in November as a result of the financial crisis (as of December 1, 1997, their share dropped to 69.5%). As of January 1, 1998, 84.7% of all banking assets were concentrated in the financially stable banks.

Overall, the global financial crisis had no significant effect on the systemic stability of the Russian banking sector and Russian banks sustained relatively small financial losses.

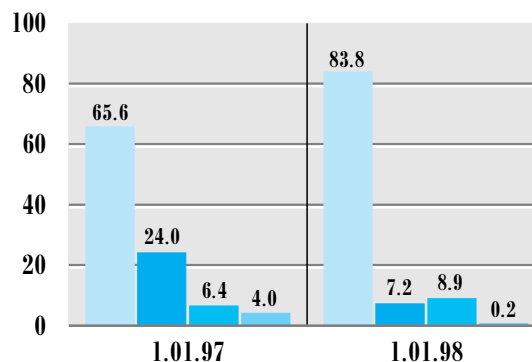
The analysis of the financial position of banks by region shows that, as of January 1, 1998, the most difficult situation was in the Far East, North Caucasus, Urals and East Siberia, where more than a third of credit institutions were in critical condition. A more favourable situation was observed in the Central-Black Soil, Central and North-West regions, where financially troubled banks accounted for 9 — 16% of all credit institutions in these regions.



**CREDIT INSTITUTIONS  
GROUPED BY PROBLEM**  
(as % of total)



**ASSETS OF REGISTERED  
CREDIT INSTITUTIONS  
GROUPED BY PROBLEM**  
(as % of total)



Financially sound credit institutions

Problem credit institutions

Credit institutions whose licences were revoked

Credit institutions which failed to submit full reports

Figures 17, 18

The structure of incomes at credit institutions changed compared with 1996 owing to changed yields and the risk of various banking operations and transactions. The fall in interest rates on credits to end-use borrowers led to the reduction of returns from short-term ruble and foreign currency credits in total bank incomes (excluding Sberbank) from 36.6% as of January 1, 1997, to 26.2% as of January 1, 1998. Losses from the depreciation of government securities in the fourth quarter of 1997 considerably reduced the share of income from operations with government securities, including the share of income from government securities in total income, which fell from 26% as of January 1, 1997, to 16.3% as of January 1, 1998. At the same time, the share of income from operations with corporate securities rose by 5 percentage points, commissions received for services provided to banks' clients grew by 3.1 percentage points and income from exchange rate differences went up by 7.5 percentage points.

Payment of interest on credits accounted for the largest portion (34.5% as of January 1, 1998) of bank expenditures (42.3% in 1996). Administrative costs in total expenditures declined a

little, from 14.8% as of January 1, 1997, to 12.9% as of January 1, 1998. Expenditures on settlement and other corporate ruble-denominated accounts continued to make up a small portion of total expenditures, declining from 3.3% as of January 1, 1997, to 2.5% as of January 1, 1998.

The profitability level of the banking system as a whole, which is calculated as a profit-to-assets ratio, declined from 5.1% as of January 1, 1997, to 2.3% as of January 1, 1998, owing to a growth of assets in 1997 and a fall in profits. Banks' profit (taking into account the retained profit of the preceding years) decreased by 45%, from 32.9 trillion rubles as of January 1, 1997, to 18 trillion rubles as of January 1, 1998.

Trends in bank's commercial activities and financial position in 1997 make it possible to forecast the development of the situation in the banking system until the year 2000.

The quality of Russian banking system will improve as the concentration of capital continues and the services and products offered by banks become more diversified. Banks will increasingly specialise in various segments of the financial market and the reduction in the number of banks



will lead to the relative strengthening of the largest banks' positions in the regions.

From the customer's viewpoint, the process of consolidation in the banking system will have no negative effect on the quality of banking services. On the contrary, big banks will bring to regions more advanced technology and better forms of operations, which local banks would have been unable to introduce owing to a lack of capital, resources and skilled personnel.

Medium-size banks will strengthen their position and their financial stability will depend on the success of their managers' search for effective means of investing capital, especially at the

regional level. The effectiveness of these efforts will be predetermined, to a great extent, by the nature of the region's economic development.

Bank operations with the real economy are expected to keep growing and bank capital concentration and privatisation may have a favourable effect on this process.

The next two years will be crucial for banks' adaptation to new, noninflationary conditions of development. The inevitable dropout of the weaker players will help bolster discipline and a sense of responsibility and, at the same time, encourage expansion in the range of banking services.



## IV.2. LICENSING BANKING ACTIVITIES

*In* THE PERIOD under review the reduction in the number of newly-created credit institutions, which began a few years ago, continued. Of the 12 new credit institutions registered in 1997, five were banks and seven non-bank credit institutions, of which four were clearing houses effecting settlements between interbank foreign currency exchange participants.

Three credit institutions were denied registration because the applications they submitted did not meet the requirements set by legislation and the Bank's regulations.

This trend resulted from the establishment of a more effective procedure for registering credit institutions and licensing their activities after the Federal Law on Banks and Banking Activity came into force and the Bank raised the minimum authorised capital requirement for new credit organisations and strengthened requirements regarding the financial stability of bank founders.

The overall number of credit institutions registered by the Bank dropped from 2,589 to 2,552 over the year and the number of operating credit institutions declined from 2,029 to 1,697.

The reduction in the number of credit institutions was accompanied by a growth in their registered authorised capital, which increased 70% over the year to 33.2 trillion rubles as of January 1, 1998.

It should be noted that the last three years saw significant changes in credit institutions grouped by the size of their registered authorised capital.

The proportion of credit institutions with authorised capital from 1 billion to 5 billion rubles remained practically unchanged at 28 — 29%, whereas the share of credit institutions with authorised capital of 5 billion to 20 billion rubles increased from 5% as of January 1, 1995, to 35% as of January 1, 1998, and that of credit institutions with authorised capital of 20 billion rubles and more grew from 1% to 17%.

The branch structure underwent considerable change. The overall number of branches of credit institutions in Russia at the end of 1997 was 4,425, a drop of 14% on January 1, 1997 (ex-

cluding Sberbank branches). At the beginning of this year Sberbank had 34,000 institutions, of which 1,928 had the status of a branch.

The branch system changed under the impact of two factors. Last year 128 banks set up 276 new branches and in 90 cases requests to open branches were turned down owing to the absence of properly equipped offices and personnel that met the Bank's requirements and also due to the credit institution's unsatisfactory financial condition.

At the same time, the shortage of spare funds, the need to concentrate available resources, minimise management risks and cut expenditures, including administrative and tax costs, and increased competition in the banking services market forced credit institutions to close 352 branches.

While credit institutions based in the North, North-West and Central regions closed branches mainly in other regions of the Russian Federation, other credit institutions closed down branches in regions where they themselves were based rather than those located in other regions.

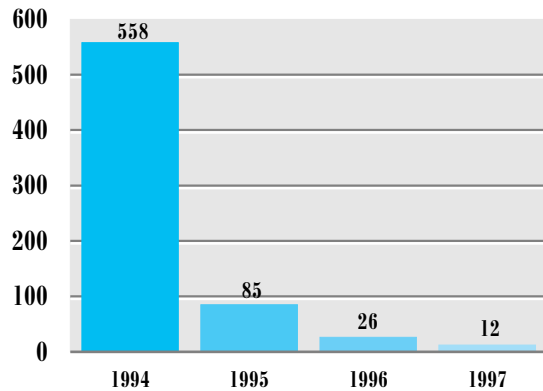
Credit institutions continued to ensure their presence in other regions of the Russian Federation and abroad by opening representative offices. On January 1, 1998, there were 301 representative offices of 147 banks, or 70% more than on January 1, 1997. More than half of all representative offices were located in the Russian Federation and a third were in foreign countries.

Due to the Bank's ever toughening requirements regarding the capital base of credit institutions and tightening of prudential standards in a volatile economic situation, banks had to look for new means of survival, which included reorganisation.

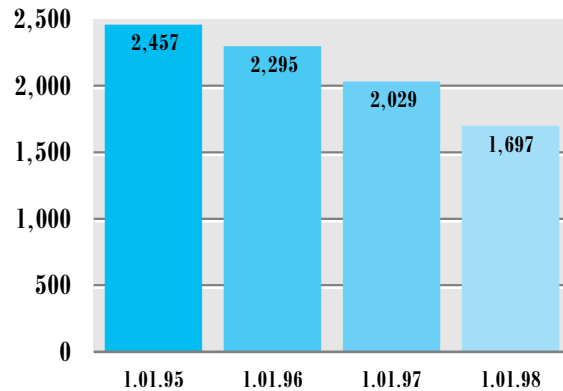
However, the peak of reorganisations (in the form of mergers) occurred in 1992 — 1993 (210 banks); nine banks were struck from the State Register (owing to mergers and conversion into branches) in 1996 and five in 1997.

Eight banks in 1997 were reorganised from limited liability companies into open-end joint stock companies, one bank was converted from a

**NUMBER OF CREDIT INSTITUTIONS  
REGISTERED BY THE BANK OF RUSSIA  
IN 1994—1997**



**NUMBER OF OPERATING  
CREDIT INSTITUTIONS**



*Figures 19, 20*

limited liability company into a closed-end joint stock company and eight banks were converted from closed-end joint stock companies into limited liability companies.

As of January 1, 1998, 43% of operating credit institutions functioned as joint stock companies, accounting for 50.2% of the entire registered authorised capital.

As of the end of the year under review there were 145 banks with foreign interest. These banks were located in 29 constituent territories of the Russian Federation and 99 of them were based in Moscow and the Moscow region. In 26 banks foreign interest exceeded 50% and 16 of these banks were 100% foreign-owned. The overall sum of investment from CIS countries (67 banks have investments from CIS countries) was 45.8 billion rubles, or 2.5% of the entire amount of foreign investment.

On January 1, 1998, 687 credit institutions (40.5%) out of 1,697 credit institutions holding the Bank of Russia licence to conduct banking operations had the right to conduct operations in rubles and in foreign currency, 262 credit institutions (15.4%) had a general licence and 111 banks (6.5%) had the right to conduct operations with precious metals. Ninety percent of banks had the right to attract household deposits (7 banks were granted this right in 1997).

It is highly significant that the number of banks which were granted the right to broaden the range of their operations declined from 236 in 1996 to 130 in 1997. In 1996 the right to conduct opera-

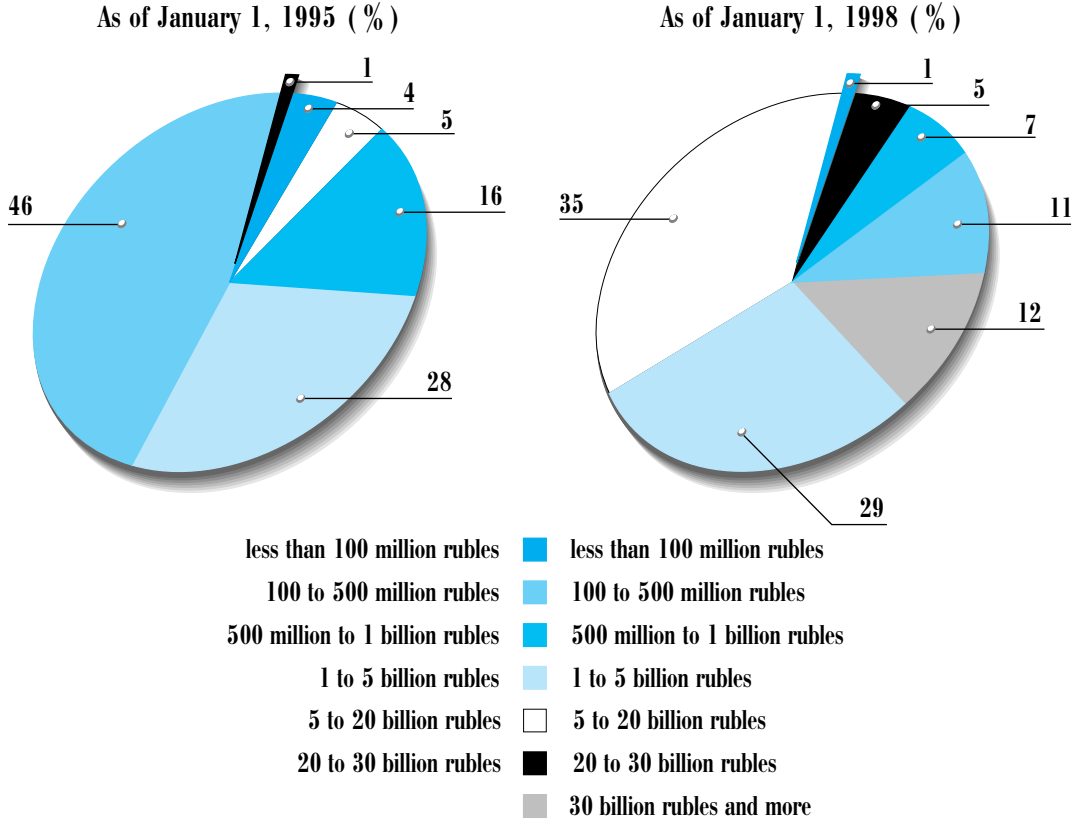
tions with foreign currency was granted to 176 credit institutions and 49 banks received a general licence, whereas in 1997 only 46 credit institutions were granted the right to conduct foreign exchange operations and only 9 banks were issued a general licence.

As the precious metals market gathered momentum, 68 banks were granted a licence to conduct operations with precious metals, of which 31 banks were granted this licence for the first time. The rest received the licence to replace permission to conduct a more narrow range of operations with precious metals.

When deciding whether to give a bank the right to conduct a wider range of banking operations, the Bank took into consideration its financial condition and compliance with the applicable legislation and the Bank's regulations.

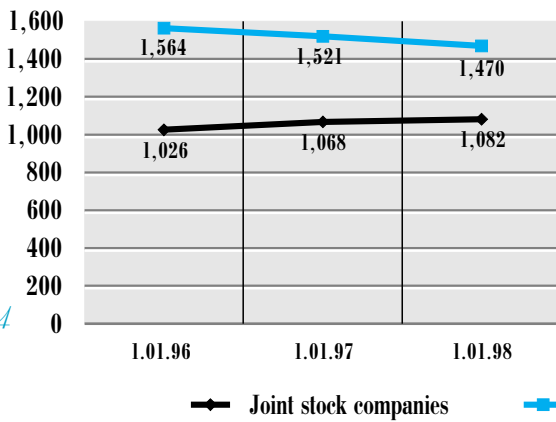
In the year under review the Bank enacted Provision No. 437 of April 23, 1997, "On the Specifics of the Registration of Credit Institutions with Foreign Investments and on the Procedure for Obtaining Bank of Russia Preliminary Permission to Replenish Authorised Capital of a Registered Credit Institution with Nonresident Funds," Instruction No. 493 of July 29, 1997, "On the Procedure for Examining the Documents Submitted to a Regional Branch of the Bank of Russia for Registration of Credit Institutions and Licensing Banking Activities," and Provision No. 12-p of December 30, 1997, "On the Specifics of Re-organisation of Banks in the Form of Merger and Acquisition." These enactments made

**STRUCTURE OF OPERATING CREDIT INSTITUTIONS  
BY REGISTERED AUTHORISED CAPITAL**



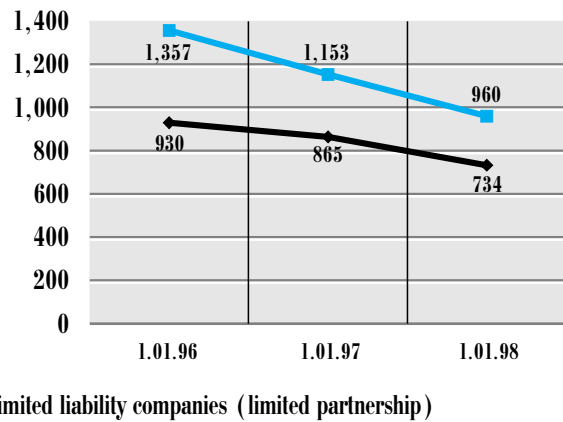
Figures 21, 22

**DYNAMICS OF NUMBER  
OF REGISTERED CREDIT INSTITUTIONS  
IN 1996—1998  
(by form of legal organisation)**



Figures 23, 24

**DYNAMICS OF NUMBER  
OF OPERATING CREDIT INSTITUTIONS  
IN 1996—1998  
(by form of legal organisation)**



it possible to define more precisely the Bank's requirements when credit institutions with foreign investments are registered, when banks are

re-organised through mergers and take-overs and when the granting of licence is considered to broaden the range of banking operations.

In licensing credit institutions as professional participants in the securities market, the Bank carried out its work in accordance with the General Licence granted to it by the Federal Securities Commission. On the basis of this licence the Bank issued the Provision on the Specifics of Licensing Professional Activities of Credit Institutions in the Securities Market of the Russian Federation, in accordance with which more than

450 credit institutions in 1997 were granted a licence to conduct operations in the securities market and information was collected about such credit institutions.

In order to control the activities of the professional participants in the securities market the Bank continued to co-operate with the Federal Securities Commission in drafting rules and regulations on the securities market.



### IV.3. REGULATION OF ACTIVITIES OF CREDIT INSTITUTIONS

**In** ORDER to enhance the soundness of the banking system the Bank carried out a series of organisational and methodological measures in 1997 to improve regulation and supervision of credit institutions. The methods of implementing these measures were prompted by the need to take into account current trends in the development of the banking system, the expanding range of factors whose regulation ensures the financial stability of each bank and the improvement of banking supervision in order to bring it up to international standards.

One of the spheres of the Bank's activity concerned insolvent credit institutions. The Bank asked for rehabilitation plans from all credit institutions in a critical financial condition and, after studying these plans, it decided whether to revoke their licences or not. At the same time, the Bank tried to save financially sound credit institutions regardless of their size. To this end, it reduced the minimum equity capital (own funds) requirement for banks from 5 million ECUs to 1 million ECUs. It also formulated requirements to regulate non-bank credit institutions, into which small banks may be converted whenever they wish to retain their status of an independent credit institution.

In February 1997 the Bank reviewed the procedure for calculating a credit institution's equity capital, taking into consideration some additional risks in the domestic economy and banking system. Therefore, amendments were made in Instruction No. 1 "On the Procedure for Regulating the Activities of Credit Institutions," which stipulated that from October 1, 1997, when a bank's equity capital is calculated, the balance profit of the bank is reduced by the shortfall on the reserve for possible loan losses and depreciation of securities, and the excess of the book value of capital investments over the bank's own sources used for these purposes is excluded from the equity capital count as well as the sum of credits

extended to shareholders and insiders in excess of the quotas set.

As the financial conditions under which credit institutions operate become more difficult and the range of risks assumed by commercial banks increases, the Bank must constantly improve its methods for overseeing the financial position of credit institutions. It is for this purpose that the Bank introduced a number of revamped and upgraded enactments which define procedures for calculating bank ratios and reviewed criteria for evaluating the extent of banks' problems. The reviewed criteria for the assessment of the financial position of banks, specified in Bank of Russia Letter No. 457 of May 28, 1997, create additional opportunities for regular analysis of financial stability of credit institutions and for applying sanctions promptly against them.

The Bank's practice of using sanctions, envisaged by its Instruction No. 59 of March 31, 1997, "On Applying Sanctions Against Credit Institutions Violating Prudential Standards," was aimed at localising financial problems of individual banks and preventing them from spreading to the entire banking system.

The Bank issued Provision No. 509 of July 28, 1997, "On Organising Internal Control in Banks." Internal control is a major means of reducing banking risks. The Provision formulates the aims, tasks and functions of internal control and the rights and duties of the employees who exercise it and explains the Bank's criteria for evaluating the state of internal control in banks. As for the use of risk control systems at banks, the Bank considered it necessary to create conditions for banks to use flexible systems. That is why the current provision on risk control is at present not binding.

The Russian banking system's current stage of development required the application of special supervisory procedures to the banks that have branches. In addition to being exposed to risks common for all banks, these banks are also exposed to high regional and country risks and the

additional risk of becoming unmanageable. Supervision over this group of banks is regulated by Bank of Russia Instruction No. 65 of September 11, 1997, "On the Procedure for Supervising Banks Which Have Branches."

To enhance the stability of the banking system the Bank continued to upgrade the procedure for promptly monitoring the state of large, system-forming banks. It not only created the corresponding structures, such as the Second Operations Division, or OPERU-2, and sections and groups of supervisors of large banks in its regional branches, but also worked out principles of control over banks' compliance with requirements, depending on the size of the bank and the specifics of its operations. Classifying a bank as system-forming does not entitle it to any benefits or privileges just as it does not impose on it any additional obligations to the Bank of Russia. The special system of oversight is designed, above all, to ensure that the situation in large banks is stable and predictable.

The Bank's regulation of credit institutions includes the requirement that banks bring the contents and form of their financial reports into conformity with international banking standards. In 1997 the Bank began to drastically overhaul the contents and form of general financial reports and as a result of its efforts, from January 1, 1998, all credit institutions began to use a new chart of accounts, matching as closely as possible international standards.

To co-ordinate efforts in banking supervision the Bank signed a series of co-operation agreements with other countries' supervisory authorities. It upgraded the national system of banking supervision in order to ensure its conformity with international standards in collaboration with international financial organisations, such as the Basel Committee on Banking Regulation and Supervisory Practices, the International Monetary Fund, the World Bank and the European Bank for Reconstruction and Development.

The 1997 trends in the banking system dictated the need to enhance the Bank's supervision over credit institutions. To create conditions encouraging credit institutions to comply with the applicable banking legislation and the Bank's rules and regulations on accounting, reporting, payments and settlements and to augment stabil-

ity of the banking system, the Bank issued Directive No. 419 of February 28, 1997, "On Measures to Enhance Supervision over the Activities of Credit Institutions." It urged its regional branches to ensure more effective control over credit institutions and their branches' observance of accounting and settlement rules and the authenticity of their reports, analyse these reports regularly and react swiftly to any negative tendencies in the activities of credit institutions.

The Bank was actively engaged in checking banks' accounts and reports and, in accordance with the established procedure, its regional branches applied preventive and compulsory measures against credit institutions that presented false reports.

However, despite the measures taken, banks in 1997 continued to commit numerous violations of legislation and Bank of Russia regulations. The most common violations committed by credit institutions were as follows:

- 1,319 credit institutions failed to comply with economic standards;
- 1,064 credit institutions falsified reports;
- 829 credit institutions failed to meet reserve requirements;
- 776 credit institutions were late in submitting their reports;
- 744 credit institutions pursued risky lending policies;
- 630 credit institutions violated the procedure for creating reserves for possible loan losses;
- 364 credit institutions violated settlement rules;
- 340 credit institutions had inadequate equity capital (own funds);
- 1,326 credit institutions committed other violations.

The following sanctions and penalties were applied against banks: meetings were held with the management of 408 credit institutions to discuss the shortcomings discovered in their work and ways to rectify them; 1,414 credit institutions were instructed to rectify the irregularities discovered in their work; 489 banks were penalised by having some operations restricted, 321 banks were forbidden to conduct certain operations and 169 banks were not allowed to open branches. During the year under review the Bank revoked 334 banking licences.

## IV.4. INSPECTION OF CREDIT INSTITUTIONS

*The* **BANK'S INSPECTION ACTIVITY** in 1997 aimed, above all, to intensify control over credit institutions' compliance with banking legislation and the Bank's rules and regulations, maintain banking system's stability and protect depositor and creditor interests, as it is stipulated by the Federal Law on the Central Bank of the Russian Federation (Bank of Russia).

To enhance the efficiency of the Bank's supervisory and regulating functions, inspection activity in 1997 developed in three main directions: on-site inspections of credit institutions and their branches and the provision of methodological and organisational support for inspections.

Bank inspection activity intensified in 1997 in terms of both the number of inspections conducted and the tasks fulfilled by inspectors. A total of 3,251 inspections were conducted in 1997, of which 1,202 were comprehensive inspections, an increase of 23% on the number of inspections conducted in 1996.

The number of credit institutions inspected at the inter-regional level, with the participation of several of the Bank's regional branches, increased significantly.

In accordance with the Statement by the Government and Central Bank of the Russian Federation on Medium-Term Strategy and Economic Policy in 1997, which stipulates that at least 15 out of the 100 leading banks be inspected each quarter of the year, inspection units of the Bank's regional branches and OPERU-2 inspected 64 of Russia's largest banks.

Bank specialists, in collaboration with foreign experts, continued to inspect large Russian banks within the framework of the international Financial Institution Development Programme (FIDP).

In pursuance of Presidential Decree No. 822 of August 4, 1997, "On Changing the Nominal Value of the Russian Monetary Symbols and Standard of Price" and to carry out organisational measures to introduce a new Chart of Accounts and application rules, the Bank organised and conducted a blanket inspection of Russian credit

institutions in the fourth quarter of 1997. A total of 1,666 credit institutions and branches, or 95.3% of the total, including 195 of the largest banks, were inspected. In the course of inspections efforts were stepped up to provide credit institutions with the Bank's rules and regulations and supervise the transition of credit institutions' software systems to the new Charts of Accounts and the re-denomination of the ruble. Using automated data processing facilities, the Bank conducted an express analysis of the data received, which helped in specifying problems that faced credit organisations as they switched to the new Charts of Accounts and prepared for the re-denomination and finding ways to rectify the shortcomings detected.

To control the effect of the global stock market crisis on the Russian foreign exchange market the Inspection Department and inspection units of the Bank's regional branches monitored, using specially designed information technology, the buying and selling rates of the US dollar in exchange offices of the authorised banks which were particularly active in conducting currency exchange operations with private individuals. The monitoring was conducted in 19 regions of the Russian Federation and in exchange offices of some Moscow banks.

The application of more severe sanctions against credit institutions subjected to inspections in 1997 led to a reduction in the number of violations committed by credit institutions compared with 1996. However, violations are still numerous. Some credit institutions overstated their financial results and equity capital, understated reserves for possible loan losses and required reserves which must be deposited with the Bank. There were banks which mishandled federal budget revenue accounts and the accounts of federal budget funds, delaying payments to budgets at all levels and to government extra-budgetary funds.

There were violations of the procedure for forming authorised capital, the rules of credit, deposit and foreign exchange operations, operations with securities and the regime of using individual balance accounts, which in some cases dis-



torted financial reports and calculations of required ratios.

Inspections showed that some credit institutions failed to ensure co-ordinated management of banking risks, including credit, market and operational risks and the risk of losing liquidity, owing, to some extent, to inadequate control by the management and internal control services of credit institutions and by parent banks over their branches.

During examinations inspectors more and more often explain to employees of the credit institutions they inspect the application of the Bank's rules and regulations and help them work out measures to promptly rectify any improprieties.

In 1997 the Bank organised the methodological support for inspection activity in an entirely new way. It developed a model of methodological support for inspections that comprises not only the methods for inspecting the main operations conducted by credit institutions, but also a set of integral methods, such as inspecting the quality of risk management. The Bank's regional branches arranged more effective co-operation in this area.

In addition, the Bank worked out a package of methodological recommendations for inspecting banks' transition to the new Charts of Accounts and operations after the ruble's re-denomination in 1998.

It compiled and sent down to its regional branches a List of Typical Violations detected by inspectors in credit institutions in 1997.

The Bank continued to give explanations in response to requests by its regional inspectorates and compiled and sent down to regions two collections of answers to inspectors' questions.

Much attention was paid to upgrading and introducing sophisticated information technology for inspectors, as well as to developing and phasing in a single inspection data collection and processing system, based on paperless technologies and extensive use of advanced computers.

For example, information technology using standardised electronic tables made it possible to ensure swift automated processing of inspection data and the provision of summarised final information.



## IV.5. REHABILITATION OF CREDIT INSTITUTIONS

**In** ACCORDANCE with Article 76 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), the Bank in 1997 demanded that financially-troubled credit institutions carry out rehabilitation measures and exercised control over their implementation. It established the form and methods of drawing up rehabilitation plans by credit institutions and the procedure for their appraisal by the Bank's regional branches.

The Bank's regional branches demanded rehabilitation plans from 386 credit institutions owing to their equity capital inadequacy and failure to meet creditors' claims in time (303 credit institutions in 1996).

Organisational measures taken by the Bank helped rehabilitate 149 credit institutions. In some cases, credit institutions' financial recovery was facilitated by regional authorities and local governments. Specifically, local authorities helped improve the financial position of the banks Evraziya in the Udmurt Republic, Sochi in the Krasnodar territory and Sibneftbank in the Tyumen region.

Guided by Article 75 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), the Bank appointed, whenever necessary, temporary administrations to manage problem credit institutions.

In 1997 provisional administrations were imposed on ten credit institutions, of which five were based in Moscow (in 1996, eight and three credit institutions respectively). The temporary administrations were to evaluate the credit institutions' financial positions and their chances for survival. Eight credit institutions where provisional administrations were appointed eventually had their banking licences revoked by the Bank after it became clear that they would not be able to restore their solvency and liquidity.

In accordance with Article 20 of the Federal Law on Banks and Banking Activity, in 1997 the Bank revoked the banking licences of 334 credit

institutions. Most licences (106) were recalled from credit institutions in Moscow. Licences were stripped from unviable credit institutions whose balance sheet currency did not exceed 50 billion rubles, as a rule.

In accordance with Articles 62 and 63 of the Civil Code of the Russian Federation, the Bank exercised control over the liquidation of credit institutions, gave its opinion on the appointment of liquidation commissions and approved interim and final liquidation balance sheets. To enhance control over the credit institutions whose licences were revoked the Bank established a procedure, in accordance with which such credit institutions must present a number of reports to the Central Bank.

As of January 1, 1998, the decision had been made to liquidate 649 credit institutions (349 of them in 1997), which represents 76% of the total number of credit institutions subject to liquidation (58% as of January 1, 1997). Of these, 451 decisions were made in accordance with the procedure established by the Russian Federation Insolvency (Bankruptcy) Law (265 in 1997).

As of January 1, 1998, liquidation commissions were approved or receivers appointed to 468 credit institutions (286 in 1997) and 189 interim and 24 final liquidation balance sheets were approved by the Bank.

Whenever founders (partners) tried to avoid liquidation of the credit institutions whose licences were revoked, the Bank's institutions appealed to arbitration courts to force these credit institutions into liquidation. During the period under review 694 such appeals were made, of which 413 were appeals to rule credit institutions insolvent (bankrupt). This practice helped accelerate bank liquidation procedures and protect creditor and depositor interests.

Entries were made in the State Register that a total of 85 credit institutions had been liquidated, of which entries on 52 liquidated credit institutions were made in 1997.

## IV.6. BANKING AUDIT

*The* NUMBER of auditing firms and certified auditors, licensed by the Bank to conduct banking audits, increased by 3.5% in 1997 to 138 and 13 respectively, as of January 1, 1998. Auditing firms have 10 branches, which conduct banking audits. At the same time, auditing firms and certified auditors are distributed unevenly throughout Russian regions.

The number of auditors possessing a qualification certificate giving them the right to conduct banking audits rose by 26.1% from January 1, 1997, and amounted to 801.

Audits were conducted in 1,707 banks on the results of their activity in 1996. About 15% of banks were not audited because their financial condition was so poor that they could not pay for audits.

Audits confirmed the authenticity of accounting reports for 1996 in 1,702 banks. One in six banks (in all, 282 banks) committed gross violations in compiling accounting reports and the authenticity of their published reports was confirmed only after corrections had been made in their current reports. Auditors failed to confirm the authenticity of reports by five banks.

Established by the Government of the Russian Federation, in accordance with its Resolution No. 482 of May 6, 1994, "On Endorsement of the Normative Documents Regulating Auditing in the Russian Federation," the Bank's Central Auditor Certification and Licensing Commission (TsALAK) stepped up its activity, tackling problems concerning not only the regulation of banking audit, but also the quality of audits. It examined 106 requests from auditing firms and 17 requests from entrepreneurs without the status of a legal entity to issue licences to conduct banking audits and 189 applications for auditor qualification certificates. In all, 102 licences and 166 certificates were issued. Five auditing firms were denied a licence owing to the low standards of their audits of credit institutions and 32 out of 63 auditing firms and certified auditors that received renewals on their licence had its term shortened.

Letters were sent to auditing organisations, pointing to the shortcomings discovered in their audits and urging them in the future to comply unconditionally with banking audit standards and regulations.

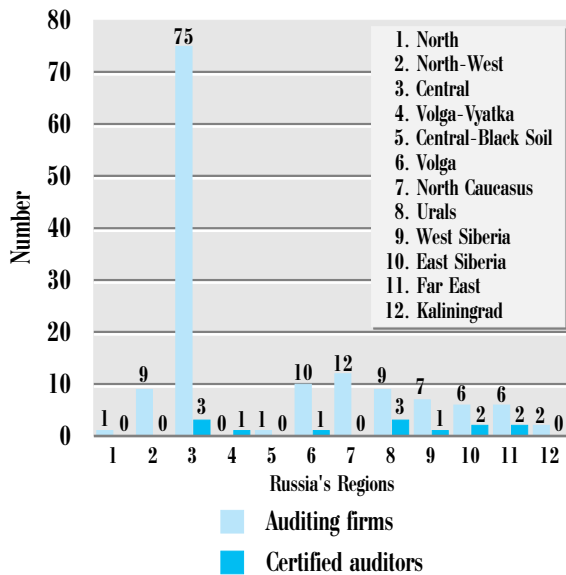
Analysis of the work conducted by the Bank's regional branches with auditors in the year under review revealed an occasional lack of co-ordination between various structures inside a single regional branch, between various regional branches and between the latter and the Bank of Russia. The Bank provided the results of the analysis, indicating typical drawbacks and suggesting ways to rectify them, to its regional branches.

Taking into consideration international experience and discussions concerning ways to improve banking audit with credit institutions and auditing firms, the Bank drafted the following regulations designed to raise the standard of banking audit:

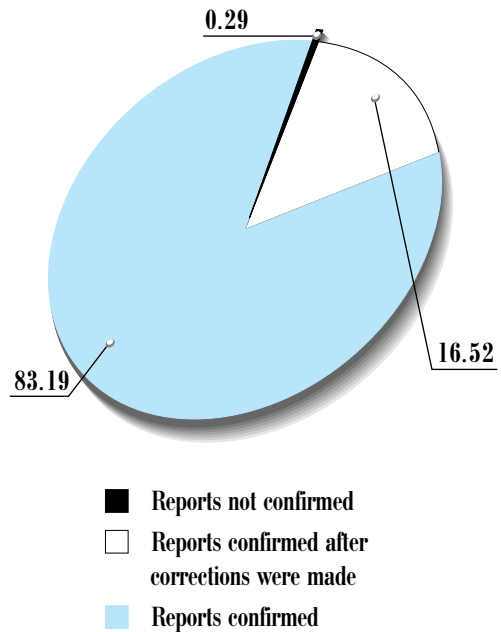
- Provision No. 64 of September 10, 1997, on Auditing Activity in the Banking System of the Russian Federation;
- Provision No. 10-P of December 23, 1997, on the Procedure for Compiling and Submitting to the Bank of Russia Audit Reports on the Results of Inspection of the Activities of a Credit Institution During the Year;
- the Procedure for Extending the Term of the Bank Audit Qualification Certificate;
- the Procedure and Programme for Conducting Qualification Examinations to Extend the Term of the Bank Auditing Qualification Certificate;
- the Procedure for Keeping the State Register of Auditing Firms (Auditors) Licensed to Conduct Bank Audits and the Procedure for Keeping the State Register of Bank Audit Qualification Certificates.

In addition, the Bank drafted and submitted proposals for the Draft Federal Law on Auditing Activity in the Russian Federation to the Audit Commission under the President of the Russian Federation.

**AUDITING FIRMS  
AND CERTIFIED AUDITORS  
IN RUSSIA BY REGION**



**AUTHENTICITY STRUCTURE  
OF BANK REPORTS (%)**



*Figures 25, 26*

In order to improve the standard of bank audits the Bank made preparations for setting up an Expert Committee of the Central Bank of the Russian Federation on Bank Auditing (the order to form the Committee was signed on January 20, 1998) and drafted documents for it. The aim of the Committee, in which the Bank will take an active part, is to draft proposals on the elaboration of bank auditing standards and their adaptation to Russian economic conditions, improve the organisation and methodology of bank auditing, study and disseminate bank auditing information, and submit proposals on the use of the applicable legislation and regulations on bank auditing.

Audit Day was held in St. Petersburg in 1997 and a bank auditing workshop was organised within the framework of the International Banking Congress. The Bank participated in the National Conference on Auditing in Russia and held a series of meetings with auditing firms and representatives of auditors' associations.

In the year under review the Bank co-sponsored the publication of the magazine *Auditorskiye Vedomosti* (Auditing News), which is designed to help improve auditing standards in the Russian Federation, encourage the exchange of views on auditing and swiftly inform users of new bank auditing laws and enactments adopted in Russia.



## IV.7. CREDIT INSTITUTIONS' PARTICIPATION IN THE SECURITIES MARKET AND CONTROL OVER THEIR ACTIVITIES

*In* 1997 the Bank continued to develop an effective system of control over the activities of credit institutions in the financial markets.

The Central Bank's work in this area was carried out in conformity with federal laws on the Central Bank, on Banks and Banking Activity, on Joint-Stock Companies, on the Securities Market, banking standards and the objectives set in the Guidelines for the Uniform State Monetary Policy in 1997. In particular, it rendered assistance with regard to credit institutions' efforts to attract investment to the Russian economy.

In the year under review the Bank received the Federal Securities Commission's General Licence to license credit institutions' activity in the securities market. In accordance with that licence, the Bank's Department for Control over Credit Institutions' Activity in the Financial Markets drafted a Provision on the Specifics of Licensing Professional Activities of Credit Institutions in the Securities Market of the Russian Federation" and on the basis of this provision the Bank in 1997 issued more than 450 credit institutions licences to participate in the securities market.

At present it is mainly large credit institutions that are engaged in stock issuing activity and their shares become increasingly attractive for potential investors, because capital concentration makes them more stable and competitive. Last year, for example, share issues significantly increased the authorised capital of Inkombank, Promstroibank, Avtobank and commercial joint stock bank AK Bars.

At the same time, many credit institutions reduced their stock issuing activity owing, above all, to the difficult economic situation and the serious financial problems of potential investors, caused by settlement delays, mutual debts and non-payments. Eventually, that sapped the spare funds that could have been invested in securities.

In some cases financial troubles, the loss-making activity of credit institutions, threats of licence recall and even liquidation make it impossible to

find new shareholders to participate in the formation of credit institutions' authorised capital.

It should be noted that the share issuing activity of credit institutions was also influenced by a substantial reduction in the number of newly-created credit institutions and the liquidation of small banks as a result of restructuring or revocation of banking licences.

Since by January 1, 1999, all banks must have equity capital equivalent to no less than 1 million ECUs, the problem of restructuring banking capital arises. Small credit institutions, which are unable to meet the new equity capital requirement, must increase their authorised capital by placing new share issues or reorganising themselves through merger or acquisition. This trend was apparent last year.

The Bank took steps to tighten the procedure for forming authorised capital in order to ensure that shareholders paid their stakes properly. This is very important in order to ensure the placement of shares with solvent investors and the formation of authorised capital with liquid assets.

In order to implement a uniform foreign exchange policy and taking into consideration that the ruble/dollar exchange rate had stabilised, from 1997 the Bank placed a ban on the formation of authorised capital of credit institutions in foreign currency, and in the year under review credit institutions began to phase out the foreign-exchange portion of their authorised capital and bring shares with par value denominated in foreign currency into conformity with the Bank's requirements.

The main source of growth for credit institutions' authorised capital in 1997 were monetary funds, which accounted for 74.5% of the total, an increase of 20 percentage points on 1996. At the same time, the share of capitalisation of credit institutions' own funds in authorised capital growth decreased from 40% in 1996 to 24.6% in 1997. This decline shows that the authorised capital of credit institutions is increasingly formed with real money.

In the year under review the increase in authorised capital resulted mainly from the issue of ordinary shares, which are more attractive for investors, because they confer voting rights at general shareholders' meetings on all questions within shareholders' jurisdiction and enable shareholders to participate in managing credit institutions. Preferred shares are of little interest for investors at the moment because the size of dividend tends to decrease, in some cases no dividend is paid at all and this kind of shares is mainly intended for small investors and private individuals. In addition, the Federal Law on Joint-Stock Companies stipulates that preferred shares should not exceed 25% of authorised capital.

In order to inform potential investors about credit institutions issuing shares, the Bank discloses data contained in the issue registration documents in the form of quarterly securities reports and information about major events and actions related to the financial and economic activities of credit institutions. This is done in accordance with the requirements of the Federal Securities Law and the Provision on the Procedure for Disclosing Information about Banks and other Credit Institutions Issuing Securities in the Russian Federation.

It should be noted that some of the Bank's requirements with regard to operations conducted by credit institutions are limited to strictly economic standards and rules. There are some problems which the Bank cannot solve within the purview of its supervisory powers. This makes the role of self-regulating organisations, professional specialised institutions creating conditions for activity in the market through the self-organisation of participants, extremely important.

There are several professional organisations regulating the stock market, such as NAUFOR, NAURAG, PARTAD and AUVER. The Bank was immediately involved in the creation of AUVER (Association of Notes Market Participants).

AUVER was established in order to help create more favourable conditions in the notes market and over the year of its existence it has accomplished several of the tasks assigned to it. It worked in two directions: elaborating notes market standards and building the infrastructure of

the notes market. Up to this point, AUVER in collaboration with the Bank, has prepared three major standards: the notes issue and redemption standard, the notes transfer standard and the standard for disclosure of information about the issue of notes, default of payment on notes, non-acceptance of notes and loss, theft and blocking of notes.

An automated system of securities market research, personnel training and supervision (SMARTS) was put in operation as part of the control exercised over the activities of credit institutions in the financial markets in 1997. Its principal objective is to collect information about trade on the GKO — OFZ market (on the basis of MICEX data). Information supplied by the SMARTS system is used in developing a mechanism to check the diligence of broker credit institutions in fulfilling their clients' instructions.

To protect investors' interests in the securities market the Bank established a procedure for detecting and examining suspicious deals on the part of banks that simultaneously act as dealers on operations with government securities. The main element of this procedure is daily monitoring of the deals struck on MICEX and information on such deals is provided by the SMARTS system in real time. The use of this procedure made it possible to compile weekly reports, listing deals suspected of being unfair to clients.

In 1997 the Bank continued to elaborate the regulatory framework for the securities market infrastructure. Specifically, it agreed to a temporary provision on clearing activity in the Russian securities market, which aims to give professional securities market participants, including credit institutions, maximum guarantees regarding the fulfilment of deals concluded in the securities market in the course of clearing operations and clearing services.

To this end, the Bank developed a system to manage the risk of nonfulfilment of deals on the results of clearing. In order to ensure the fulfilment of obligations on deals a clearing organisation is required, in addition to creating special funds to reduce the risk of nonfulfilment of deals with securities by clearing parties, to use one of the following procedures or more: make a preliminary deposit of securities and cash in the accounts of the clearing parties in the servicing

clearing organisation and depository and/or a recalculation of net obligations and claims by taking unsecured deals out of count and/or use of guarantees and sureties.

When special funds are created in the form of cash and/or securities of the clearing parties, deposited in their bank accounts in the settlement organisation and in the special sections of depository accounts in the servicing depository, which can be managed by the clearing organisation only, these accounts may be used only to close the positions of the settlement participants, if there is not enough cash and/or securities to fulfil obligations on the transactions with the securities subject to clearing.

The task of controlling the creation and use of these special funds when clearing organisations conduct their activity is assigned to both the Federal Securities Commission and the Bank.

Considerable attention was paid to internal control in the credit institutions participating in the financial markets. The Bank issued the Provision on Organisation of Internal Control in Banks in order to protect the interests of investors, banks and their clients through establishing control over bank employees' compliance with the corresponding legislation, regulations and standards, settle conflicts of interests, ensure the proper credibility level corresponding to the nature and scale of operations conducted by a bank and minimise banking risks.

Subsequently, the Bank issued the Instructions on the Procedure for Organising Internal Control in Credit Institutions Participating in the Financial Markets, which established the concrete procedure for organising internal control over operations conducted in the financial markets.

To ensure the implementation of the Provision, the Bank drafted a regulation establishing the procedure for the Bank's certification of the heads of the internal control services of credit institutions.

In addition, an important procedure was established, whereby Bank employees must notify the Bank's Board of Directors in the event that they hold any shares or stakes in the authorised

capital of credit institutions. In the year that has passed since the enforcement of the corresponding regulation three quarterly consolidated reports on the shares and stakes owned by the Bank's employees in authorised capital of credit institutions have been compiled and submitted to the Bank's Board of Directors.

In order to enhance the efficiency of control over the activities of credit institutions in the financial markets and train specialists in the Bank's departments in modern methods of control, in 1997 the Bank set up several regional centres to control the activities of credit institutions in the financial markets. Regional centres were established to control the activities of credit institutions in the financial markets in the following five areas:

- organisation of the system of internal control over credit institutions' compliance with the legislation and standards regulating professional activity in the financial market (Bank of Russia Main Branch for Moscow);
- control over the infrastructure of the professional activity of credit institutions in the financial markets (Bank of Russia Main Branch for St. Petersburg);
- control over the activities of credit institutions in the circulation of promissory notes (Bank of Russia Main Division for the Novosibirsk region);
- trust operations carried out by credit institutions (Bank of Russia Main Division for the Rostov region);
- control over credit institutions' operations in the forward markets (Bank of Russia Main Division for the Maritime territory).

The Bank attached great importance to the drafting of rules and regulations designed to improve the procedure for credit institutions' conducting trust operations. To this end, it issued the Instruction on the Procedure for Conducting and Making the Accounting of Trust Operations by Credit Institutions in the Russian Federation, thus formalising and settling the issue of trust operations which credit institutions had conducted for several years without adequate control on the part of the Bank.

**STATE OF  
RUSSIA'S  
PAYMENTS  
SYSTEM**

**V**





## V.1. PREPARATIONS FOR RUBLE RE-DENOMINATION AND TRANSITION TO NEW CHARTS OF ACCOUNTS

*In* 1997 the Bank of Russia issue and cash operations were aimed mainly at preparing and properly conducting the re-denomination of the national currency in pursuance of Presidential Decree No. 822 of August 4, 1997, "On Changing the Nominal Value of the Russian Monetary Symbols and Standard of Prices."

A series of measures were implemented to prepare the country's banking system for effecting non-cash settlements and keeping accounts of all operations after January 1, 1998, in the re-denominated national currency. Special attention was paid to the provision of methodological support for and efficient organisation of the re-denomination by all participants in the Russian banking system by the deadlines set.

The volume of production of new notes and coins (of the 1997 issue) was established, taking into account the need to replace all currency in circulation and create an optimal reserve of notes and coins, and the possible level of sales of foreign currency kept on hand by private individuals.

By the end of 1997 the required amount of new currency was manufactured and delivered to the regions, and the corresponding divisions of the Bank drafted and supplied all the necessary regulatory documents for the re-denomination to the Bank's institutions.

In the course of preparations for the ruble's re-denomination the Bank used the central and regional mass media to explain to the population

the purposes of the re-denomination and allay public fears about the forthcoming change in the nominal value the currency and standard of prices. The use of sociological studies made it possible to find optimal ways in which to conduct this information campaign. Thanks to the vigorous efforts made to explain the essence and need for the re-denomination, the population reacted calmly to it.

Hot lines were installed in Moscow and at regional institutions to promptly answer people's questions, and more than 15 million booklets with a detailed description of the new notes and coins and conversion tables were issued. Video clips explaining how the re-denomination would proceed were also regularly shown on television.

One of the major elements of the campaign to prepare the public for the re-denomination was close contact with the central and regional mass media, which were regularly provided with finished information products, such as press kits, which included interviews with Bank of Russia managers, analytical surveys, experts' statements and commentaries. By the beginning of 1998 the total circulation of periodicals which published materials provided by the Bank amounted to 12 million copies. These periodicals were distributed in all Russian regions. Thirty-seven intercom press conferences and 47 seminars for journalists were held in various Russian cities.

The measures taken in accordance with the approved plan made it possible, within a short time period, to prepare the banking system and

the public at large for the implementation from the beginning of this year of such a difficult and complex action as re-denomination of the ruble.

In 1997 the Bank and its staff successfully carried out an immense amount of work to transfer **the banking system to the new charts of accounts**. Specifically, fundamentally new charts of accounts, reflecting more precisely the current state of affairs and consistent with international standards, were worked out and on their basis new accounting rules were introduced in the Bank and its self-supporting and non-self-supporting organisations and also in credit institutions located in Russia. Taking into consideration the changes in the regulatory documents drafted by the Bank, its Accounting and Reporting Department (together with various other departments) held 14 group meetings to study these documents.

The successful transition to the new Charts of Accounts was facilitated by so-called support centres, which were set up in Moscow, Krasnoyarsk, Khabarovsk, Perm and the Republics of Ingushetia, Daghestan and Kabardino-Balkaria. All this means that the Bank has begun and is conducting a reform of the accounting system, which

aims to bring Russian bank accounting and reporting practices into conformity with international accounting standards and to meet the requirements of international organisations with regard to financial statistics.

For this reason and owing to some other factors the Bank's rules and regulations were almost entirely renewed, and it is important to note here that those changes put an additional workload on the Bank's entire staff.

Allegations were constantly made in the press questioning the need for switching to the new Charts of Accounts on January 1, 1998, but there is reason to say now that Russian banks on the whole have completed the transition to the new Charts to Accounts and have done so without too many problems, although this matter will require considerable attention this year too.

It is especially important to note that the transition to the new Charts of Accounts and the re-denomination, which are not easy to carry out at any time, were implemented in a period when the Bank had to resolve problems created by the **financial market crisis** and we are now pleased to say that we have coped with the main difficulties.



## V.2. DEVELOPMENT AND UPGRADING OF RUSSIA'S PAYMENTS SYSTEM

*In* ACCORDANCE with the strategy for the development of Russia's payments system, the Bank took steps to improve the settlements systems and the architecture of the settlement network. The Bank also took steps to upgrade the technology and methods of transmitting information and carried out measures to raise the standard of services for credit and other institutions.

The corresponding methodological, organisational and technical base was created. At the same time, an experiment with intra- and inter-regional electronic payments was broadened and a new technique of processing banking information was tested to create conditions for liquidity management by credit institutions.

As was the case in previous years, bank settlements were effected through the following main channels: the Bank's settlement network, correspondent accounts opened with other credit institutions, interbranch settlement accounts and clearing institutions.

Intrabank settlements, especially settlements of multi-branch banks between the parent bank and its branches and between branches of different banks, were developing at a particularly rapid rate in 1997. Settlement operations, represented by interbranch settlement accounts, made up 36.5% of all interbank settlements (28.1% in 1996).

The development of intrabank settlements was facilitated by the continued consolidation of correspondent accounts at the level of parent credit institutions and the regional branches of large credit institutions and by the reorganisation of small banks into branches of other banks.

Settlements by credit institutions on their own payments and on payments of their clients, made through the Bank's settlement network, keep growing owing to the flawless performance of the Bank's settlement network and swifter payment times. However, the rate of growth in payments made by credit institutions through the Bank's

settlement network was slower than the rate of growth in settlement operations on interbranch settlement accounts, and their share of the total fell to 51.7% from 56.3% in 1996.

While the volume of payments made through correspondent accounts opened with other credit institutions increased, their share of the total volume declined to 11.7% against 15.5% in 1996. Banks with an extensive correspondent network can effect settlements in the least possible time, but the development of correspondent relations depends on many different factors, such as mutual payment flows, price and demand in the credit market and the possibility of participating in trading on regional government securities markets. At present, settlements made through correspondent accounts are not as protected from payment risks as settlements effected through the Bank's settlement network and the interbank settlement system.

Just as in 1996, payments made through clearing organisations did not exceed 0.1% of total payments.

As of January 1, 1998, there were 1,325 Bank's settlement units servicing credit institutions and one settlement unit servicing non-credit institutions only.

Cash settlement services were provided to 1,820 credit institutions and 4,200 branches of credit institutions and cash services were provided to 2,437 branches of credit institutions. Correspondent accounts were opened for 442 liquidation commissions.

In addition, cash settlement centres provided services for more than 107,000 non-credit institutions.

Surveys conducted by the Bank's regional institutions show that the favourable trends registered earlier with regard to the change in the structure of settlement operations (by sum), conducted through the Bank's settlement network, continued in 1997: the proportion of postal settlements decreased by 9.8% (mainly owing to the

7% growth in settlements made without using letters of advice), telegraphic settlements rose by 1% and electronic settlements grew by 1.8%.

The share of electronic payments in the structure of interbank settlement documents (by number) rose by 20.6% compared with 1996 and that of postal and telegraphic letters of advice decreased by 14.1% and 6.5% respectively.

The experiment to introduce intra- and inter-regional electronic payments expanded in 59 and 52 regions respectively. In 1996 intra- and inter-regional electronic payments were made in 45 regions.

A new technique has been developed in the Moscow region. Known as the multi-track payments processing system, it is part of an automated system of banking settlements, which gives credit institutions broader opportunities for managing payment flows and regulating liquidity.

In the period under review six private clearing organisations were in operation, of which five organisations used the clearing model with preliminary depositing of funds.

The status of clearing organisations changed in 1997. In accordance with the Federal Law on Banks and Banking Activity, they were granted permanent licences as non-bank credit institutions and their functions were broadened.

To implement the strategy for the development of the Russian payments system, the Bank carried out measures to improve settlement operations and raise them to a more advanced technological level.

The principal methods for modernising settlements consist of creating a real-time gross settlements system, streamlining the Bank's settlement network, developing formats for settlement documents and standardising banking technologies. The real-time gross settlements system has been granted the status of the basic element of Russia's payments system. This will make it possible to standardise settlements and shorten settlement times. The primary aim of the real-time gross settlements system is to swiftly enter the funds received to credit institutions accounts and ensure that they can be used instantly.

This system is designed to enable credit institutions to manage their intraday liquidity, accelerate cash turnover and reduce the volume of bank funds in settlements. It will help make more ef-

fective use of the measures envisaged by the Bank's monetary policy. It will also make it easier for them to service credit, deposit, foreign exchange and other transactions, ensure settlements in the government securities market and foreign exchange market, consolidate the resources of credit institutions for effecting settlements and will centralise the management of operations conducted by the Bank's divisions.

A concept of the real-time gross settlements system, setting prospects for the development of non-cash settlements at the Bank, was elaborated and approved. It presents the aims and tasks of the system, its main principles of operation and architecture, the development of the system and the functions of the Bank's settlement network units, co-operation with other settlement techniques used by the Bank, the implementation stages, and the principles of managing risks and liquidity.

The real-time gross settlements system is considered a one-tier system, in which the accounts of credit institutions and the Bank's customers will be kept in a single specialised settlement division of the Bank, the Federal Settlement Centre, and the aim of the latter will be to ensure the effectuation of settlements and make the accounting of operations between credit institutions and the Bank's clients, as well as some operations conducted by the Bank's divisions.

The introduction of the real-time gross settlements system will significantly change the functions and responsibilities of the Bank's regional institutions and the cash settlement centres accountable to them. The main objective of the cash operations centres will be to exchange information on settlement operations between the Federal Settlement Centre and credit institutions (branches) and legal entities serviced by the Bank in accordance with the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), whose correspondent accounts (subaccounts) and other accounts are opened in the Federal Settlement Centre, and to provide cash services to the Bank's clients.

It should be noted that information on settlement documents will be received from clients of the cash operations centre and information from the Federal Settlement Centre will be transmitted to the Bank's clients by telecommunications

using magnetic and paper carriers and also through the cash operations centre's access centre.

A concept for the development of the Bank's settlement network was approved, which defines the functions of the latter in the payments system, the main factors affecting change in its structure and functions, tasks in the process of development and the stages and practical implementation of measures to streamline the network.

The concept takes into account new trends in the development of the payments system: the introduction of an advanced automated system, working in real time, and a system for the transmission and processing of operation accounting information, based on a new software platform and telecommunications medium.

Taking into consideration the level of development of the electronic technology used in settlements through the Bank's settlement network, the pace of consolidation of correspondent accounts of credit institutions and the development of the Federal Treasury System, the Bank adopted a step-by-step approach to the process of optimising its settlement network in order to avoid snags in settlement operations.

Three stages were established, taking into account the objective trends in the development of the banking system as a whole, the use of uniform criteria to evaluate performance efficiency and the specific conditions of some regions.

During the first stage settlement network divisions will be merged into larger units, and objects will be selected for technical retooling and provision with communications; in the second stage functional tasks will be reviewed and units will be reorganised in order to centralise settlements; in the third stage a settlement network structure will be formed in accordance with up-to-date efficiency requirements to the payments system.

In order to provide information support for efforts to upgrade the payments system, the Bank made preparations for the creation of a data analysis system for its settlement network and drafted a basic version of the statute regulating its functioning.

The Cash Settlement Centre Passport, comprising information necessary for making objective decisions on optimisation issues, was ap-

proved. The use of Passport data for April and July 1997 made it possible to work out optimal requirements for the volume of settlement operations performed by a single cash settlement centre and criteria for closing cash settlement centres at the first stage of the optimisation of the Bank's settlements network.

Analysis of comprehensive indicators made it possible to determine which cash settlement centres were the first to be closed. The lists of such centres were agreed upon with the Bank's regional institutions and approved by the Bank's Board of Directors.

To improve the payments system's performance, measures were carried out to cut settlement times in the Bank's settlements system. Control was exercised over the observance of deadlines in forwarding settlement documents between credit institutions and cash settlement centres, the proper completion and registering of settlement documents at each stage of their passing and the effectiveness of measures taken by the Bank's regional institutions to expedite forwarding inside regions.

The Bank continued to introduce advanced methods and technology in interbank settlements and equip the settlement network with up-to-date computer and communications facilities.

The measures taken made it possible to accelerate operations conducted through the Bank's settlement network. The actual average interbank settlement times were as follows: 55.3% of settlements by number and 22.2% of settlements by sum took 1 day to 3 days (in 1996, 45.9% and 20.1% respectively); 42.7% and 74.5% of settlements took 4 to 7 days (in 1996, 51.6% and 72.5% respectively); 2% and 3.3% of settlements took more than 7 days (in 1996, 2.5% and 7.4%).

A new set of rules was elaborated in the year under review to regulate non-cash settlements.

Regulatory documents were also drafted in connection with the implementation of real-time gross settlements system and the optimisation plan for the Bank's settlements network. Such documents included the draft provisions "On the Real-Time Gross Settlements System," "On the Rules of Exchange of Electronic Documents Between Credit Institutions and Bank of Russia Institutions in the Real-Time Gross Settlements System," "On

the Federal Settlement Centre” and “On the Cash Operations Centre.”

Rules to regulate settlements under the new conditions were being elaborated and the proposal “On Forms of Non-Cash Settlements and the Procedure for Using Them” was drafted.

The provision “On the Effectuation of Non-Cash Settlements by Credit Institutions in the Russian Federation,” regulating settlements on interbranch settlement accounts and correspondent accounts of credit institutions opened with other credit institutions, was approved.

To enhance the effectiveness of control over the passage of settlement documents and their safety, as well as to prevent unsanctioned access to banking information, the Bank approved “The Provision on the Procedure for Forwarding, Completing and Registering Settlement Documents by Units of the Bank of Russia Settlement Network.”

Payment cards were introduced in settlements as part of the strategy for the development of the payments system. The Bank’s possibilities for regulating the payment card market were studied and an enactment defining the procedure for issuing bank cards by credit institutions and implementing settlement operations with their participation was drafted.

In the period under review the sum of funds accumulated by legal entities and private individuals for making settlements with payment cards increased from 1,776 billion rubles at the beginning of the year to 2,471 billion rubles as of January 1, 1998.

A series of measures were also implemented in the field of settlements in pursuance of Presidential Decree No. 822 of September 4, 1997, “On Changing the Nominal Value of the Russian Monetary Symbols and Standard of Price” and to ensure the transition of the Bank and credit institutions in Russia to the new Charts of Accounts.

New regulations were drafted and amendments were made in the applicable regulations on the completion, payment and netting of settlement documents.

To ensure payment on the settlement documents kept in the file until January 1, 1998, a procedure was established for their processing and subsequent routing through accounts.

Changes were made in the formats of payment orders and the procedure for filling them out, and new formats were prepared for other settlement documents and postal letters of advice on printed forms. Changes were also made in the existing formats of interbank settlement documents and other forms used by the Bank’s settlements network and produced by computer.

The structure of the BIC Directory was changed to include information on the correspondent accounts of the participants in settlements in accordance with the new Charts of Accounts.

The Bank took steps to increase the security of the Russian payments system, especially when credit institutions and the Bank prepared for the transition to the new Charts of Accounts and ruble re-denomination. A series of measures were taken to prevent the infiltration of paperwork by fraudulent settlement documents.

In 1997 the Bank’s consistent efforts to protect banking information made it possible to prevent nearly 29 billion rubles from being entered to the accounts of credit institutions and their clients on fraudulent documents and led to a sharp reduction in the number of attempts to steal money.

The Bank saw to it that its system observed the settlement procedure and complied with the corresponding legislation.

It augmented control, by using a special kind of reporting, over the payment of settlement documents of economic agents by credit institutions.

As of January 1, 1998, non-payments on settlement documents, accumulated as a result of the shortage of funds in correspondent accounts (subaccounts) of credit institutions, amounted to 14.7 trillion rubles, or 1% of the total sum of unpaid settlement documents in the consolidated balance sheet of Russian banks. Over the year the sum of the settlement documents unpaid owing to a lack of liquidity in credit institutions decreased by 30%.

### V.3. CASH AND ISSUE OPERATIONS

**CASH AND ISSUE** operations in 1997 aimed, by and large, to meet the objectives set in the Guidelines for Uniform State Monetary Policy in 1997. Therefore, the Bank attached great importance to the regulation of cash in circulation. The amount of cash in circulation in 1997 increased by 27,532.1 billion rubles, or 25.1%. The issue of cash in circulation had no significant effect on inflation growth and mainly met the needs of the economy and population in cash.

As of January 1, 1998, a total of 137,042.3 billion rubles were in circulation<sup>1</sup>, of which 136,908.4 billion rubles were in notes and 133.9 billion rubles were in coins. Banknotes accounted for 99.9% of all cash in circulation, and coins made up 0.1%.

Large-denomination notes continued to replace small-denomination ones in circulation. A 500,000-ruble note was issued in March 1997. As of January 1, 1998, 50,000-, 100,000- and 500,000-ruble notes made up 92.2% of the entire sum of the banknotes in circulation.

Monitoring the note structure of the money supply, the Bank systematically analysed its conformity with requirements of cash turnover and saw to it that the needs of the economy and population in cash were met in time and in full. There were no snags in issuing cash by Bank of Russia institutions through the fault of the Bank.

In compliance with Presidential Decree No. 822 of August 4, 1997, "On Changing the Nominal Value of the Russian Monetary Symbols and Standard of Price," the Bank carried out a lot of preparatory work.

Specifically,

- it organised the orders and production of banknotes and coins of the 1997-issue in the amount that was necessary to replace all old notes and coins in circulation and create an optimal reserve of notes and coins, taking into account the possibility of sale of foreign cash on hand;

- it ensured the delivery of new money to the Bank's institutions throughout the Russian Federation, which made it possible to begin paying out new money to clients without interruption from the first days of 1998;
- it elaborated and forwarded to its regional branches and credit institutions all the regulatory documents necessary for the ruble's re-denomination;
- it organised a nationwide campaign to inform the population about the specifics of the ruble's re-denomination through the mass media and also by publishing booklets and posters and opening hot-lines to answer direct calls from the public, as well as providing answers to many people's letters concerning the re-denomination;
- it set up counselling centres at the Bank of Russia proper and its regional branches in the Perm region, Khabarovsk and Krasnoyarsk territories and in the national banks of the Dagestan and Kabardino-Balkar Republics to provide express consulting to the Bank's institutions and credit institutions;
- it sent descriptions of the new notes and coins and specimens of the new notes to its regional institutions.

In 1997 the Bank's institutions provided cash services to 113,407 customers, of which 82,425 were budget-financed organisations (16,499 of them had working accounts with Federal Treasury bodies), 1,419 Federal Treasury bodies, 7,907 credit institutions and 21,656 other organisations.

The Bank constantly made efforts to improve cash and issue operations conducted by its institutions and credit institutions and the quality of cash services provided to their clients and coordinated the activities of its regional institutions and the Central Depository in supplying the regions with cash and taking out withdrawn money. In June 1997 it enacted "The Procedure for Conducting Cash Operations by Credit Institutions in the Russian Federation."

<sup>1</sup> Including cash in vaults of the Bank and credit institutions.



PROPORTION OF INDIVIDUAL BANKNOTES IN TOTAL SUM OF BANKNOTES (%)

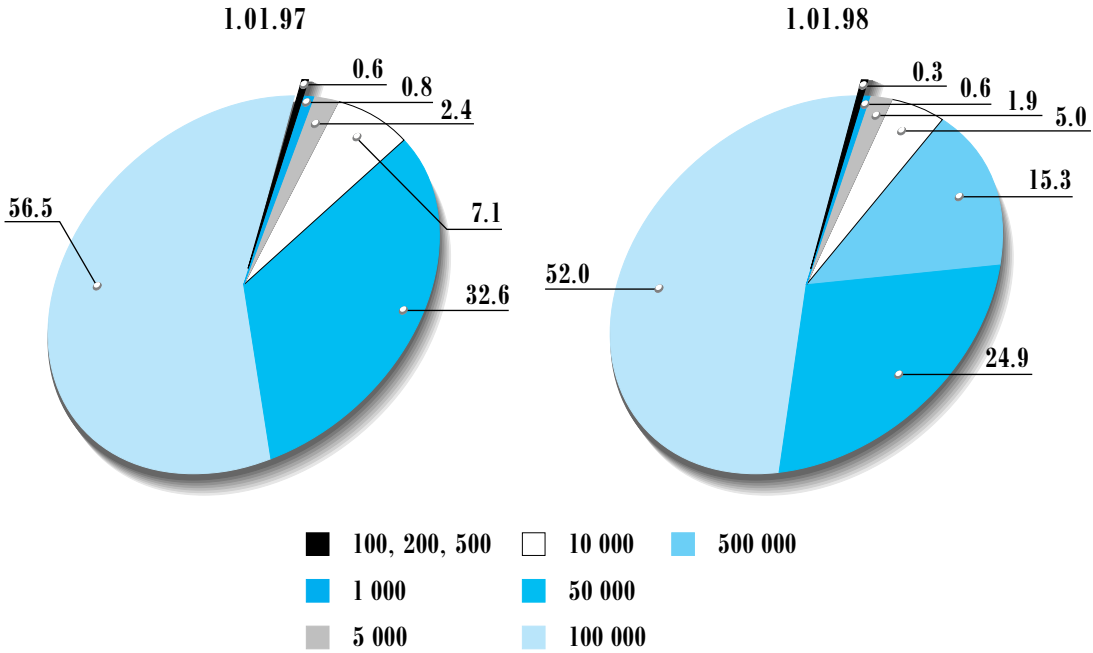


Figure 27

PROPORTION OF INDIVIDUAL BANKNOTES IN TOTAL NUMBER OF BANKNOTES (%)

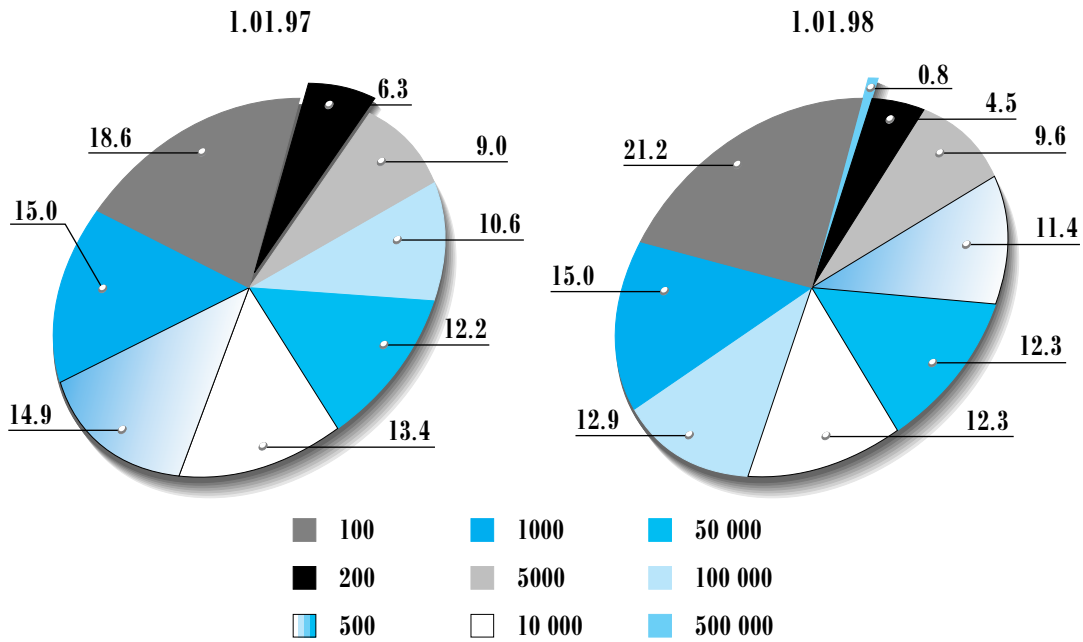


Figure 28

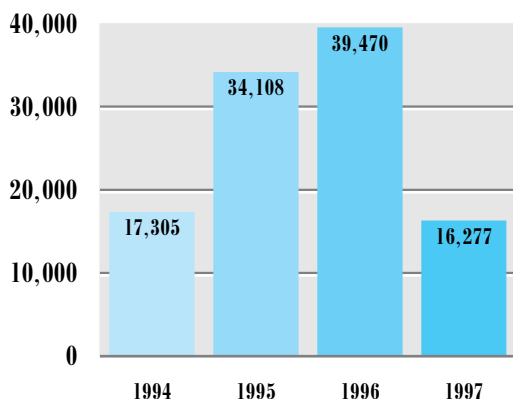
In the year under review cash operators at the Bank's institutions committed 15,488 shortages worth a total of 432.5 million rubles; in 10 cases shortages exceeded 500,000 rubles each and totalled 99.0 million rubles.

The balance of debt to the Bank on cash errors amounted to 14.8 million rubles as of January 1, 1998.

To improve cash services provided to clients and reduce probable errors in paying out cash

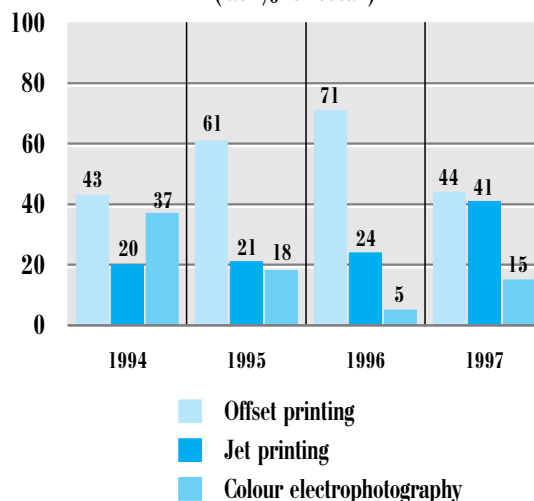


**DYNAMICS OF DETECTION OF COUNTERFEIT BANK OF RUSSIA NOTES (number of notes)**

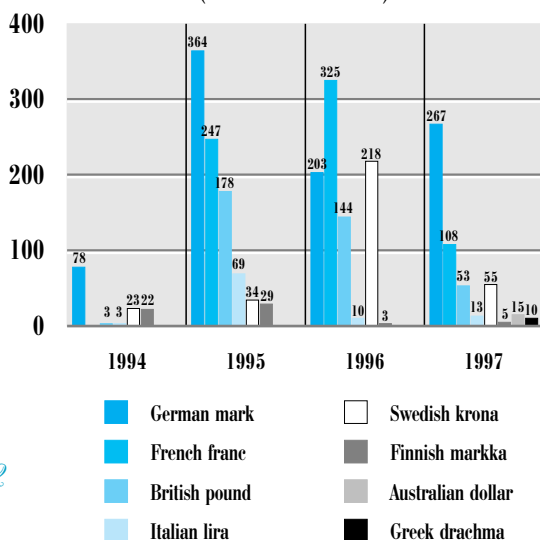


*Figures 29, 30*

**CHANGE OF STRUCTURE OF PRINCIPAL METHODS OF COUNTERFEITING BANK OF RUSSIA NOTES (as % of total)**

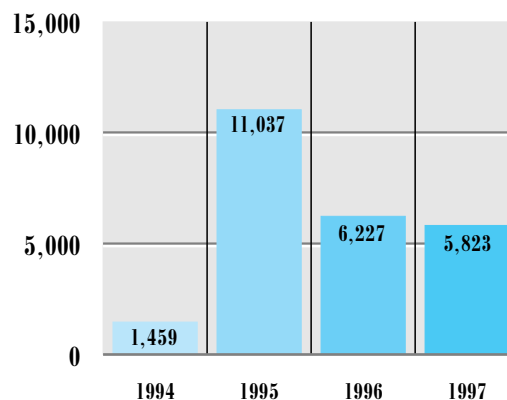


**DYNAMICS OF DETECTION OF COUNTERFEIT FOREIGN BANKNOTES (number of notes)**



*Figures 31, 32*

**DYNAMICS OF DETECTION OF COUNTERFEIT US DOLLAR NOTES (number of notes)**



from the Bank's cash departments, 271 cash settlement centres prepared in advance 21% of the total amount of cash to be paid out to clients. The use of this operation in the work of the cash settlement centres is impeded by the uneven transfer of funds to correspondent accounts of credit institutions and Federal Treasury accounts.

In collaboration with Interior Ministry bodies the Bank made vigorous efforts to detect and withdraw from circulation counterfeit notes. In 1997 the Bank and credit institutions detected 16,277 counterfeit Bank of Russia notes of different denominations to the total sum of 909 mil-

lion rubles, as compared with 39,470 notes worth 1,693 million rubles in 1996. Banknotes of the 1993 issue accounted for 55% of all counterfeit notes discovered.

Most counterfeit Bank of Russia notes are detected in the Moscow region.

In 1997 the share of counterfeit notes made by using jet printing increased significantly compared with 1996, while offset printing remained the most common method of forging Bank of Russia notes.

As was the case in previous years, the US dollar remained the most frequently forged foreign

currency, accounting for 92% of the total amount of all counterfeit foreign notes. In 1997, 5,823 counterfeit US dollar notes worth a total of \$515,400 were discovered. Counterfeit 100-dollar notes accounted for 79.7% of the total amount of forged US dollar notes. Offset printing is the principal method of counterfeiting US notes.

The Bank exchanged money specimens and information on changes in cash circulation with 76 central banks in non-CIS countries and 14 central banks in CIS and Baltic countries.

Experts' reports on the analysis of banknotes in the Bank's regional institutions were used to support and keep operational the data storage and search statistical systems used to account for counterfeit Bank of Russia and foreign notes discovered in the banking system.

Descriptions of new kinds of counterfeit Bank of Russia and foreign notes were compiled and sent to regional institutions.

The Bank also took steps to raise the qualification of experts, providing training in the expert analysis of banknotes to 243 Bank specialists.

It continued to develop new equipment to mechanise and automate the processing of cash in the Bank's institutions and worked on the problem of destroying and recycling banknotes withdrawn from circulation.

In 1997 the Bank's institutions received new types of note counters, counterfeit note detectors and other machines and devices and these institutions installed 780 counting and sorting systems, which count banknotes, separate worn notes from fit ones and automatically check the notes for authenticity.

The Bank's institutions began to be supplied with coin counters, which can process coins of any size within the pre-set range.

In 1997 the Bank issued 55 commemorative coins, 12 gold and 43 silver. Most of them were part of the thematic series "The 850th Anniversary of the Founding of Moscow," "Russian Ballet," "Save Our World" and "The Centenary of Russian Football."

In the year under review much attention was devoted to the development of the domestic commemorative coins market, and as of the end of 1997, 50 Russian credit institutions conducted

NOTE STRUCTURE OF  
DETECTED COUNTERFEIT  
US DOLLAR NOTES IN 1997 (%)

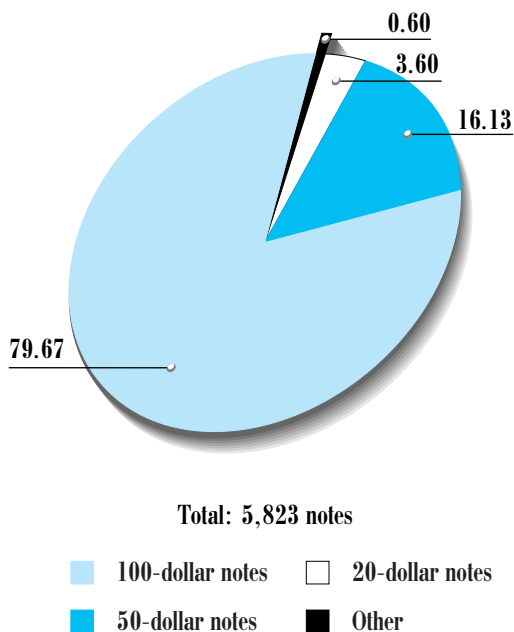


Figure 33

operations with commemorative coins in the domestic market.

In the international markets Russian commemorative coins were distributed through foreign numismatic firms under bilateral agreements and contracts.

In taking measures to ensure the safety of valuables at banks, the Bank worked out new requirements for the design and reinforcement of cash premises in the buildings occupied by credit institutions and their branches. These requirements were included in the form of a supplement in Bank of Russia Provision No. 56, dated March 25, 1997, "On the Procedure for Conducting Cash Operations in Credit Institutions in the Russian Federation."

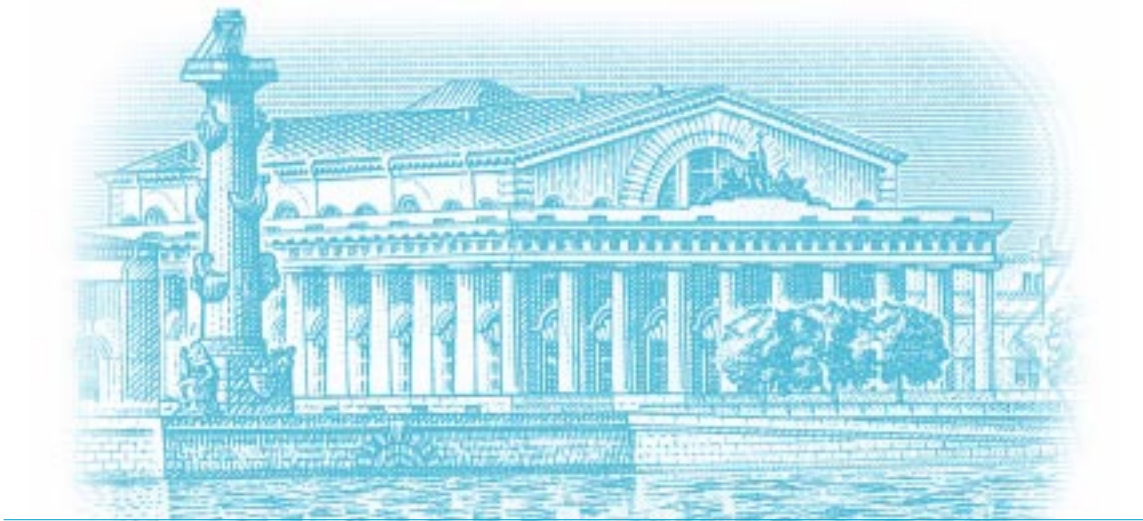
The Bank's regional institutions were provided with recommendations on how to select and use television security and surveillance systems.

Special attention was given to the safety of valuables during preparations for the ruble redenomination.

Specialists at the Bank's institutions conducted more than 3,000 inspections of reinforcement facilities at the cash premises of credit institutions and their branches.

**IMPROVING  
THE ORGANISATION  
OF THE CENTRAL BANK  
OF THE RUSSIAN  
FEDERATION**

**VI**



## VI.1. ORGANISATIONAL STRUCTURE OF THE CENTRAL BANK OF THE RUSSIAN FEDERATION

**As** OF JANUARY 1, 1998, the organisational structure of the Central Bank of the Russian Federation comprised the central apparatus, 60 regional branches, 19 national banks, 1,325 cash settlement centres, 13 banking schools, a centre of training methods in Tver, a personnel training centre at Klyazma and 20 organisations accountable to the Bank.

In 1997 the Bank continued to take steps to improve the structure of its central apparatus.

To enhance the efficiency and quality of its work the Bank restructured the following departments: the Consolidated Economic Department, Banking and Audit Licensing Department, Bank Rehabilitation Department, Prudential Banking Supervision Department, Department for Settlements Methodology and Organisation, Telecommunications Department, Personnel Training Department and Administrative Department.

At the same time, it formed a Statistics Management Division within the Consolidated Economic Department and a Capital Construction and Logistics Expert and Legal Analysis Division within the Administrative Department.

In September 1997, in line with the Board of Directors' decision to improve the effectiveness

of the Bank's information policy, the Central Bank set up a Public Relations Department, opened a Representative Office in the Federal Assembly of the Russian Federation and closed the Press Centre.

In accordance with the Board of Directors' decision of October 18, 1996, the Bank set up a Global Information Systems Centre to run its communications and data transmission systems, which became operational in April 1997. The satellite communications centre was restructured and turned into the "Nudol" Technological Centre.

In addition, the staff structures of some regional branches were upgraded.

Work continued on measuring the time consumed by principal operations and calculating workloads on accountants and cash operators in the cash settlement centres. Workload standards were determined for this category of specialists.

To optimise the number of employees in the Bank's regional institutions, on November 14, 1997, the Board of Directors passed a decision to form a working group to calculate workload standards and required numbers of specialists in the regional branches (national banks) of the Central Bank.

## VI.2. STAFFING AND PERSONNEL TRAINING

*The* **PERSONNEL** of the Central Bank of the Russian Federation and all its institutions constitute a stable and competent work collective with vast professional potential. In 1997 the Provision on Bank of Russia Employees was enacted in accordance with the decision of the Board of Directors, which established the legal status, rights and duties of this category of employees and the main guarantees provided to them.

As of January 1, 1998, the Bank and its central apparatus, regional branches, central bank-controlled organisations and banking schools employed a total of 88,879 people (93,535 according to the official employment tables).

In 1997 the Bank and its institutions took on nearly 5,000 employees, of which 4,000 were employed in the regional branches (national banks), about 900 in the cash settlement centres and less than 300 in the central apparatus.

As of January 1, 1998, the Bank and its institutions had 95.5% of the required staff, the central apparatus was staffed to 87.1%, regional branches (national banks) to 94.5% and cash settlement centres to 98.4%.

The personnel dropout rate fell to 2.8% compared with 1996; of these, the proportion of employees who quit of their own dropped to 2.1%.

In 1997 the qualitative characteristics of Bank personnel, such as age, education, experience and expertise, continued to improve, exerting a favourable influence on the performance of the Bank system as a whole. Employees with higher and specialised secondary education made up 90.8% of all personnel, of whom employees with a higher education made up 54.1%. More than half of all employees were aged 30 to 50; 75.2% of all employees had worked in the sphere of finances and crediting for more than three years and 29% had a work record of more than 10 years. The number of employees holding doctoral and Ph.D. degrees as well as “merited economists” of the Russian Federation and “merited economists” at the republican level increased in the Bank’s central apparatus and regional branches.

New employees were selected on a competitive basis, which involved the use of psychological tests and examination of their competence and managerial skills. The same methods were used in selecting candidates for promotion to high-level positions. Most of the candidates kept in reserve for appointment to top executive positions in the Bank and its regional branches were highly qualified specialists with a long record of work in the banking system. During the year appointments to top executive positions were made, taking into consideration the candidates kept in reserve.

The Board of Directors approved the Diploma of the Central Bank of the Russian Federation to award employees for their contribution to the development of banking and in connection with major anniversaries and red-letter days.

In the year under review the Bank’s employees continued to receive training, especially in the restructuring of the banking system, the introduction of new Charts of Accounts, foreign exchange regulation and control, economic analysis, internal banking audit, etc. The extent and major subjects of training were approved by the Board of Directors.

The targets set by the Board of Directors for training and advanced training of personnel were met. More than 600 Bank employees were enrolled in institutions of higher education and banking schools took on 1,990 students for training; 8,660 people received advanced vocational training, provided on a centralised basis, and 12,000 received training at the regional level.

The system of advanced vocational training received a boost in 1997 when more than 6,200 Bank of Russia specialists, or twice the number in 1996, raised their qualification in banking schools.

Owing to the continued technical modernisation of the Bank’s institutions, the number of specialists receiving training in informational technology, communications and banking information security increased considerably.

To enhance control over the spending of funds allocated by the Bank for personnel training, the Central Bank published and sent to all its institu-

tions a collection of documents regulating the financing of training and advanced training of bank employees.



## VI.3. IMPROVING BANKING LEGISLATION AND PROCEDURES FOR FILING CLAIMS AND SUITS

*The* **BANK OF RUSSIA** made many efforts in 1997 to develop and upgrade banking legislation, drafted proposals on amending the applicable federal laws and issued rules and regulations.

It focused attention on the development of legislation regulating banking supervision, the creation of a system to prevent legalisation (laundering) of criminal incomes, the elaboration of a legal framework to regulate the settlements system, including electronic payments, and the improvement of the foreign exchange legislation.

In 1997 the Bank took steps to upgrade the banking supervision system, formulate more precisely licence recall procedures and the procedure for using required reserve funds, and ensure the safety of property and documents of credit institutions after their licence had been revoked. It also strove to accelerate the procedure for liquidating credit institutions and tackled other problems involved in the restructuring of the banking system.

The State Duma of the Russian Federation has passed the second reading of the Bank's draft of the Federal Law on Amending the Federal Law on the Central Bank of the Russian Federation (Bank of Russia) and the Federal Law on Banks and Banking Activity. This draft law has now been returned because of the need to specify some of the Bank's supervisory functions and improve the methods for handling credit institutions after the revocation of their banking licence. The adoption of this law will strengthen the banking supervision system, which is designed to protect the interests of creditors and depositors.

The draft law defines more precisely the procedure for transferring a credit institution's required reserves, deposited with the Bank, after the revocation of its licence to redeem its debts to creditors. It introduces the institute of authorised Bank representative, who may be appointed to any credit institution after the revocation of its licence and before the creation of the bodies which will liquidate it in order to make sure that the

managers of the bank comply with legislation and honour the rights and legitimate interests of creditors.

The draft law indicates more precisely how a credit institution will function after its licence has been revoked to ensure the safety of the credit institution's property. In addition, it specifies the procedure whereby the Bank exercises the right to demand liquidation of the credit institution as a legal entity after its licence has been revoked and describes in greater detail the mechanism of responsibility of the credit institution's founders (partners) for expediting the organisation of the liquidation procedures.

In addition, the draft law is designed to fill a number of blank spots in the legislation, concerning the justification for licence recall and the use of the sanctions envisaged by the legislation against credit institutions.

In 1997 the Bank continued to work on the Federal Law on Insolvency (Bankruptcy) of Credit Institutions, taking into consideration the specifics of the legal nature of credit institutions and the need to observe parity between the implementation of public-law and private-law interests of individual creditors.

This federal law aims, above all, to create legal conditions for the prevention of bankruptcy at credit institutions and for ensuring the use of civilised procedures for declaring a bank bankrupt and subsequently liquidating it by using receivership proceedings. It lays special emphasis on measures to prevent bankruptcies of credit institutions before their licences have been revoked. According to the document, these measures are as follows: the financial recovery of the credit institution, appointment of a temporary administration to manage the credit institution and re-organisation.

Measures to prevent the bankruptcy of a credit institution should be taken before its licence has been revoked. Once the licence is revoked, liquidation is the only possible procedure unless the decision to revoke the licence has been challenged.



The Bank supports the idea of instituting simplified bankruptcy procedures, which are conducted in the absence of the management of the credit institution. Such procedures are intended for the liquidation of banks which only exist on paper and do not engage in any banking activity.

The Bank accords special significance to the creation and development of a deposit guarantee system and, consequently, to its participation in the work on the Draft Federal Law on Personal Bank Deposit Guarantees, which the State Duma of the Russian Federation has passed in its first reading. The system of third-party bank account and deposit guarantees is well known to contemporary banking law and it is considered a major means of maintaining the banking system's stability. It is clear that such a system should be phased in, along with the rehabilitation of the banking system as a whole, because only financially sound credit institutions should be allowed to participate in the bank deposit protection system. Thus, the adoption of the Federal Laws on Insolvency (Bankruptcy) of Credit Institutions and on Personal Bank Deposit Guarantees and the further upgrading of the legal standards of banking supervision should be interrelated.

The drafting of the Federal Law on the Prevention of Legalisation (Laundering) of Illegally Obtained Incomes is extremely important for the stabilisation of the banking system, for it aims, above all, at creating a federal system to counter the legalisation of criminal incomes, incorporating the Bank and federal government bodies. The draft law also provides for the creation of a government body that would not only co-ordinate actions to fight money laundering, but also collect and process information on suspicious transactions and pass this information to law enforcement bodies. Working on this draft law, the Bank is trying to help lawmakers elaborate an act that would use correct legal terms and definitions, establish an effective system to counteract the use of the Russian banking system by criminal elements and create a comfortable environment for law-abiding economic agents.

The draft of a new version of the Federal Law on Foreign Exchange Regulation and Foreign Exchange Control, which is to be submitted to the State Duma shortly, is of great importance for the stability of Russia's monetary system. This Fed-

eral Law was enacted more than four years ago and since then the Russian Federation has created on its basis an effective foreign exchange control system and issued a great number of foreign exchange regulations. Nevertheless, the passing of new laws and the practice of using this Federal Law required amendments to it.

The draft of the law's new version treats foreign exchange regulation and foreign exchange control as two different notions. It, therefore, stipulates the demarcation of spheres of activities between the bodies of foreign exchange regulation and foreign exchange control, which will enable them to focus on their responsibilities.

It stipulates that the Bank has the exclusive right to exercise control over credit institutions and penalise them for violations of foreign exchange legislation.

In accordance with international practice, the draft divides foreign exchange operations into two strict categories: current operations and capital operations. The current foreign exchange operations, listed in the document, can be conducted by residents and nonresidents without any restrictions, while capital operations, which are used to export capital from the Russian Federation, are conducted on the basis of permission issued by the Government of the Russian Federation, or on its behalf, by other federal bodies of executive power.

The draft law prohibits the use of foreign currency in settlements in the Russian Federation, except in cases stipulated by the Bank.

It defines individual violations of the law, envisages differentiated sanctions, establishes the procedure for applying and disputing them and determines the conditions of release from responsibility.

The Bank was actively involved in refining the Federal Law on Precious Metals and Precious Stones, which is designed to play a major role in the development of the precious metals and precious stones market.

In 1997 the Bank took steps to improve the regulation of bank trust management procedures. Specifically, it participated in drafting a Federal Law on Common Funds of Bank Management, which is designed to complement the investment potential of the Russian economy with a new investment instrument. The Bank also took part in amending Bank of Russia Instruction No. 63 of



July 2, 1997, “On the Procedure for Conducting Trust Management Operations and Making Accounts of Such Operations by Credit Institutions in the Russian Federation.”

The Bank actively participated in drafting the Tax Code of the Russian Federation, paying special attention to the need to precisely define the main institutions of the tax system, such as determining the moment the tax is paid, the taxation of credit institutions, capital incomes and operations with securities and other financial market instruments and the role of credit institutions in the taxation system.

To regulate the Russian market of new payment instruments, the Bank is participating in the working group drafting a Federal Law on Using Payment Cards in the Russian Federation and working on a draft Procedure for Issuing Bank Cards by Credit Institutions and Effecting Settlements on Bank Card Operations.

In 1997 the Bank took part in drafting the Federal Law on Amendments and Additions to the Federal Law on the Central Bank of the Russian Federation (Bank of Russia) and the Federal Law on Amendments and Additions to the RSFSR Law on the Central Bank of the RSFSR (Bank of Russia), which resolved the uncertainty about the Bank’s participation in the capital of Sberbank, Vneshtorgbank and Russian banks abroad.

**In the field of claims and suits**, one of the chief objectives of the legal services of the Bank’s regional institutions was to provide legal protection for the Central Bank’s interests in common courts of law, arbitration courts and bodies of power and administration in connection with the claims and suits filed by credit institutions and other organisations.

It is noteworthy that in recent years the number of claims and suits filed against the Bank’s institutions has been steadily declining. This particularly applies to disputes over violations of settlement rules. This fact is attributable, to a great extent, to improvements in the quality of Bank rules and regulations and a radical change for the better in the work of cash settlement centres.

A total of 178 claims worth 39,375 million rubles and 578 suits worth 2,299,185 million rubles were filed in 1997. Ninety suits to the sum of 376,710 million rubles were settled in favour

of the plaintiffs. Actually, 6,240 million rubles were collected on 32 suits. In 1996, 887 suits to the total sum of 5,060,481.2 million rubles were filed against the Bank of Russia.

A total of 101 claims to the sum of 22,114 million rubles were filed in 1997 on banking operations (one claim to the sum of 3 million rubles was settled in favour of the claimant), of which 67 claims to the sum of 14,356 million rubles were made on settlements. There were 388 suits of this category to the sum of 3,051,916 million rubles, of which only 36 suits to the sum of 373,655 million rubles were settled in favour of the claimant.

Bank of Russia institutions filed 54 complaints, 71 petitions and 29 appeals to higher-instance courts to protest decisions made by lower courts. As a result, almost half of all decisions were repealed and, as reported data indicate, only 4,370 million rubles were collected from Bank of Russia institutions on 18 suits, of which 1,243 million rubles were collected on nine suits on settlements.

Most suits and claims on banking operations were filed against the national banks of the Republic of Daghestan and Republic of Tatarstan and the Bank’s regional branches in the Kemerovo, Orenburg, Saratov, Sverdlovsk and Tyumen regions, the Krasnodar and Krasnoyarsk territories and Moscow and St. Petersburg.

Not a single claim or suit of this kind was filed against the following Bank institutions: the national banks of the Republic of Buryatia, Komi Republic and Republic of Mordovia, the Bank’s regional branches in the Vladimir, Kaluga, Kostroma, Kursk, Orel, Ryazan, Sakhalin, Tula, Ulyanovsk and Chita regions and the Bank’s Second Operations Division.

There was a significant drop in the number of court disputes on entry reversal operations. In the year under review four claims to the sum of 651 million rubles and five suits to the sum of 671 million rubles were filed against the Bank, but only 604 million rubles were actually collected.

Disputes arising from the Bank’s economic activities occurred in 12 regional institutions (the Altai territory, Vologda, Irkutsk, Leningrad, Lipetsk, Penza, Sverdlovsk and Chita regions, Moscow, and the Kabardino-Balkar

Republic, the Republic of Tatarstan and the Udmurt Republic).

Compared with 1996, the total number of claims remained unchanged, but the number of suits increased from 62 to 80.

Although there were few suits and claims of this kind, courts often refused to meet them. To reduce the number of suits filed against the Bank over economic agreements and similar suits filed by the Bank, it is necessary to enhance the effectiveness of pre-contract negotiations with counterparties, as well as draft, write and formalise agreements in accordance with the requirements of the applicable legislation.

Since the question of the Bank's payment of taxes has not yet been settled legislatively, tax inspectorates in 1997 continued to demand that the Bank's institutions pay various taxes. In the period under review tax inspectors made 39 claims totalling 5,458 million rubles and filed 18 suits to the sum of 14,154 million rubles against the Bank in 22 regions of the Russian Federation. However, a very small percentage of claims by tax authorities were satisfied: only two suits to the sum of 1,054,000 rubles were upheld.

In some regions the Bank's institutions were involved in disputes with the local branches of the federal social and medical insurance funds over the amounts paid as insurance premiums.

As for disputes such as protests against the Bank's decisions to refuse to issue licences and apply sanctions against credit institutions in accordance with the procedure established by Article 75 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia) and revoke banking licence, two claims to the sum of 1,000 million rubles and 41 suits to the sum of 2,856 million rubles were filed, of which two suits to the sum of 103 million rubles were upheld and a collection was actually made on one lawsuit.

Last year saw a rise in the number of suits filed against the Bank's regional institutions that ap-

plied sanctions as a result of the implementation of their supervisory functions. Such cases were examined at the Bank's regional branches in the Kirov, Leningrad, Nizhni Novgorod and Tomsk regions as well as in Moscow.

Just as in 1996, no suits were filed against the Bank with regard to its decision to deny a banking licence. However, 10 suits were filed concerning decisions to revoke licence from credit institutions.

Claims and suits were filed against the Bank's regional institutions in connection with the reinstatement of employment and recovery of wages, that is actions arising from labour relations.

Thirty-four employment reinstatement suits to the sum of 497 million rubles were filed, of which 19 suits to the sum of 201 million rubles were upheld. After the Bank's institutions appealed these decisions, 13 of the previously upheld suits were left unchanged and 55 million rubles were actually collected on five suits.

The Bank's regional institutions stepped up their activity in fulfilling the supervisory powers granted to the Central Bank. Mention should be made here of the claims and suits they filed against credit institutions to which penalty sanctions were applied in accordance with Article 75 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia). Thus, 3,492 claims to the sum of 39,964 million rubles and 524 suits to the sum of 3,355 million rubles were filed for that purpose in 1997. A total of 2,595 claims and suits to the sum of 20,622 million rubles were upheld.

Seventy-one appeals were made to arbitration courts to initiate insolvency (bankruptcy) proceedings against credit institutions, of which 60 appeals were upheld. Nine claims and 140 suits regarding forced liquidation of credit institutions were also filed, of which 108 claims and suits were upheld.



## VI.4. BANK OF RUSSIA INTERNAL AUDIT AND INSPECTION

*The* BANK'S Chief Auditor's Service, composed of the employees of the Bank's Internal Audit Department and auditing divisions of the Bank's regional institutions, guided by Bank of Russia Order No. 02-140, dated March 31, 1997, "On the Bank of Russia Chief Auditor's Service" and the Provision for Organising Internal Audits in the Central Bank of the Russian Federation, approved by this Order, in 1997 focused its attention on the inspection of the economic and financial activities of the institutions, enterprises and organisations that make up the Bank system and drafted regulatory and methodological documentation for the Bank's Chief Auditor's Service.

Comprehensive audits of 71 regional branches (national banks), 1,267 cash settlement centres and other banking institutions, 15 banking schools and their branches, and 63 enterprises and organisations providing services to the Bank's institutions were conducted in 1997. The auditing divisions of the Bank's regional institutions conducted more than 800 inspections of individual operations and work sectors on the assignment and at the instructions of the heads of regional institutions and the Bank's Internal Audit Department, and also 12 inspections on the assignments of law enforcement authorities.

The analysis of audit and inspection findings shows that on the whole the Bank's regional institutions guarantee the safety of cash and valuables and fulfil the functions and tasks assigned to them. At the same time, shortcomings were discovered in the work of practically every audited Bank institution, enterprise and organisation — in banking supervision, cash and issue operations, safe-keeping of valuables and information security, accounting of interbank settlements and other operations, financing capital investments, remuneration of bank employees, and so on.

Information collected in the course of inspections served as a major means of controlling the work of the staff of the Bank's institutions and organisations. Auditors' reports were used by all examined institutions and enterprises in drawing up plans to rectify the faults discovered by inspec-

tors, and the implementation of such plans was monitored by heads of the Bank's institutions and organisations and by higher-up bodies.

In 142 out of 314 cases the examination of audit findings required fact-finding trips by heads of higher-level institutions and in 172 cases the heads and chief accountants of the audited institutions were invited to higher-up institutions. After each audit, orders or complaint letters were sent to the corresponding institutions. A total of 166 orders to penalise 1,116 officials were issued upon the examination of auditor's reports in 1997; of these, 216 officials were reprimanded, five were dismissed and six demoted; 889 officials had their bonuses cut and similar sanctions were applied against 1,798 employees.

In 1997 the Bank completed the drafting of the Provision on Internal Audit in the Central Bank of the Russian Federation and the Provision on the Bank of Russia's Internal Audit and Inspections Department, which were approved by the Board of Directors. Taking these documents into consideration, the Bank reviewed the provisions on the divisions of the Internal Audit and Inspections Department, worked out recommendations on the contents of the provision on the audit section (division) of the Bank's regional institutions and on conducting audits of cash settlement centres and other Bank institutions, reviewed the standard audit assignment, taking into account the transition of the Bank's system to the new Charts of Accounts and the re-denomination of the ruble, and drafted documents on the practical implementation of audits of specific expenditures on the emoluments of Bank personnel.

In the year under review the Bank continued to provide advanced training to employees of its Chief Auditor's Service, including study of the experience of central banks in Germany, France, Austria, the Netherlands and other countries, which was taken into account in the organising internal audit at the Bank of Russia.

As of the end of 1997, the Chief Auditor's Service had a staff of 648, which means that it was staffed to 94% of the approved level (91.7% at the end of 1996).

## VI.5. INTERACTION WITH RUSSIAN CREDIT AND OTHER INSTITUTIONS AND RUSSIA'S OVERSEAS BANKS WITH BANK OF RUSSIA INTEREST

*The* **CENTRAL BANK** of the Russian Federation holds interest in the authorised capital of Russian credit institutions, Russia's overseas banks and other organisations in accordance with the Federal Law on the Central Bank of the Russian Federation (Bank of Russia) and Federal Law on Amendments and Additions to the RSFSR Law on the Central Bank of the RSFSR (Bank of Russia). Russian Federation Law No. 34-FZ of March 4, 1998, On Amendments and Additions to the Federal Law on the Central Bank of the Russian Federation (Bank of Russia) and the Federal Law on Amendments and Additions to the RSFSR Law on the Central Bank of the RSFSR (Bank of Russia) consolidated the legality of the Bank's participation in the stock capital of the Bank for Foreign Trade (Vneshtorgbank), Savings Bank (Sberbank) and Russia's overseas banks at the level of not less than 50% plus one voting share. The data on the Bank's stakes in the authorised capital of Russian credit institutions and other organisations are given in the addendum.

The Bank attaches special importance to its participation in the capital of the two largest system-forming banks of the Russian Federation, Sberbank and Vneshtorgbank.

Sberbank is the largest universal credit institution in the Russian Federation, which is traditionally oriented to retail banking.

Its main functions are as follows:

- providing and further expanding banking services to the population on the basis of advanced banking technology. In the year under review Sberbank considerably increased its presence in the plastic card market and took a position of leadership among Russian credit institutions in terms of the amount of funds attracted to ruble-denominated card accounts;
- providing comprehensive services to major corporate clients;

- assisting the development of and crediting small- and medium-size businesses;
- servicing federal budget revenue accounts and federal budget accounts as well as regional budget infrastructures;
- conducting operations in the securities market. Active participation in the government debt market to some extent enabled it to stabilise the government securities market last autumn and in December 1997.

In the year under review Sberbank increased its participation in creating a regional securities market, investing in regional debt instruments, and began to participate in the precious metals market.

In 1997 the international rating agency Fitch IBCA awarded Sberbank the long-term credit rating BB+, the highest rating granted to a Russian credit institution, which is equivalent to a country rating, and Thomson Bank Watch accorded Sberbank its credit rating.

The Bank for Foreign Trade (Vneshtorgbank), a bank which has been traditionally oriented to international financial markets, continued to move its assets from foreign markets to the Russian financial market.

The main activities of Vneshtorgbank are as follows:

- extending foreign currency and ruble credits to the real sector of the Russian economy: 49% of the entire debt on loans were credits extended by the bank to various sectors of the economy (trade, construction, chemicals and non-ferrous metallurgy);
- attracting foreign investment to the Russian economy by receiving credit lines from foreign banks and placing foreign investments in the government securities market through S-type accounts;
- conducting investment and intermediate operations in the securities market and providing depository and custodial services to foreign and Russian customers;

— actively participating in the foreign exchange market and precious metals market.

Vneshtorgbank is recognised by the international banking community and enjoys the reputation of a sound borrower and guarantor.

In 1997 the Bank increased its stake in Vneshtorgbank's authorised capital by 45.1 billion rubles by buying shares of the third Vneshtorgbank issue.

Last year the Bank regularly supervised the general practices of Sberbank and Vneshtorgbank and directly participated in formulating the financial policy of these banks through its representatives in their supervisory boards.

Making use of the advantages of Sberbank and Vneshtorgbank in terms of the balance sheet currency volume, equity capital, high domestic and international ratings and personnel expertise, the Bank of Russia directly influenced the development of the Russian financial market. At its initiative the Sberbank Supervisory Board decided to guarantee household deposits by investing amounts corresponding to these deposits in government debt instruments and admitted the need for Sberbank to create a reserve for possible loan losses in the amount corresponding to the quality of the credits extended.

Taking into consideration the possibility of its immediate involvement in the elaboration of the strategies of these two credit institutions, the Bank regards its co-operation with Sberbank and Vneshtorgbank as necessary for influencing the Russian financial market.

The Bank also holds an interest in the authorised capital of the Interstate Bank (ISB), which was set up to implement settlements between CIS countries. Thanks to profit capitalisation, the ISB in 1997 increased its authorised capital from 5 billion to 20 billion rubles.

The Bank must have a stake in the capital of the Moscow Interbank Currency Exchange (MICEX) in order to be able to regulate its activity through its representatives in the MICEX administrative bodies (Shareholders' Meeting and Exchange Board). At present MICEX is a diversified trading floor and a major integral part of Russia's financial infrastructure. The securities and foreign exchange markets are the most important sectors of the exchange. Aggregate daily

turnovers at MICEX are estimated at several billion re-denominated rubles, which makes the exchange an indisputable leader among Russian financial institutions. In 1997 MICEX increased its authorised capital from 19.4 billion to 54.6 billion rubles owing to capitalisation of 1996 dividends.

To assist in the development of depositary services provided to the markets of short-term government bonds and fixed-income federal loan bonds and to the Bank's operations in these markets, the Central Bank of the Russian Federation in 1997 co-founded a non-profit partnership called the National Depository Centre. Its authorised capital was declared at 50 billion rubles. As of January 1, 1998, the Bank held a 53.4% stake in the virtually paid up capital of the Centre. The objectives of the National Depository Centre are as follows:

- to introduce up-to-date depositary standards and rules, based on international and Russian experience and the Bank's rules and regulations;
- to create an inter-regional depositary network to service Russian organised securities markets, especially the government securities markets;
- to become integrated with foreign and international depositary systems.

In accordance with the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), last year the Bank finally withdrew from the Russian Export-Import Bank (Roseximbank), a closed-end joint stock company, transferring its stake in its capital to the Ministry of State Property.

In 1997 the Bank also withdrew from Vneshekonombank and the joint stock company Sovfintrade.

## RUSSIA'S OVERSEAS BANKS

The system of Russian overseas banks (ROBs) was created throughout the entire Soviet period from centralised sources of financing in order to service foreign trade operations and attract foreign financial resources to the country. Today as well, ROBs act as intermediaries between Russian and Western financial markets, provide settlement and documentary services to Russian

commercial banks and foreign trade organisations and also implement investment projects in Russia. ROBs supply the Bank with information on the situation and trends in the financial markets. The economic reforms in Russia encouraged ROBs to expand their functions. In the new situation they credit Russian and foreign commercial banks and other customers, using government securities as collateral, conduct operations in the sovereign debt market, train specialists for the Russian banking system and introduce new banking technology.

The main aim of interaction with ROBs for the Bank as their shareholder (the Bank's stakes in ROBs' capital are shown in the addendum) was to complete the financial rehabilitation of banks and ensure that they gradually repaid the funds provided to them earlier as financial aid. That became possible also as the result of the completion of reconciliation of mutual financial claims between the Bank of Russia, Finance Ministry and Vneshekonombank, which arose in 1992 — 1993 when operations to rehabilitate ROBs were conducted.

It is important that by now all ROBs are making profit, although in recent years the operating profit they made went to create reserves and cover the losses incurred during the preceding years and that prevented ROBs from paying dividends on invested capital. Successful commercial activity and the restructuring of the Soviet debt by the London club of creditors enabled ROBs to make additional profit in 1997. Last year a dividend for the 1996 financial year was imputed to the Bank by Ost-West Handelsbank (Frankfurt-am-Main). In addition to Ost-West Handelsbank, the Vienna-based Donau-bank is also expected to impute a dividend to the Bank for the 1997 fiscal year.

The Bank's interaction with ROBs includes constant control over their activity and participation (as shareholder) in managing ROBs through Bank representatives in their supervisory boards.

To enhance the efficiency of managing ROBs and co-ordinate their activities, the Bank in 1997 regularly held meetings with representatives of ROBs and Vneshtorgbank and the Bank's senior

executives — members of the supervisory boards of these banks. Those meetings resulted in the elaboration of new strategic objectives in the Bank's co-operation with ROBs. Specifically, the Bank worked out a concept for the management of ROBs by creating two banking groups, the European Group, comprising Mosnarbank, Eurobank and Ost-West Handelsbank, and the Vneshtorgbank Group, consisting of Vneshtorgbank, Donau-bank, the Limassol-based Russian Commercial Bank and Zurich-based Russian Commercial Bank.

Within the framework of this concept, the Bank of Russia transferred the controlling block of shares of Donau-bank to Vneshtorgbank, selling the latter 2% of its shares.

The new scheme for the centralised management of ROBs on the basis of consolidation of their financial reports and risks will make it possible to avoid overlapping in their work, enhance the efficiency of their commercial operations and, consequently, lead to growth in returns on invested capital.

Another area of interaction between the Bank and ROBs is the implementation of measures to encourage foreign investment flow to Russia. In 1997 ROBs helped attract considerable funds to the Russian securities market, including GKO — OFZ.

A major factor in the stabilisation of the Russian financial system was ROBs' crediting of Russian commercial banks against foreign currency-denominated internal state loan bonds, which helped maintain the liquidity of the corresponding market and ensured the refinancing of the banking system.

The results of the work carried out by ROBs allow us to regard them as a major tool of the Bank's policy in the domestic and foreign financial markets. Therefore, to provide the necessary legal framework for their further development, the Bank last year submitted to the State Duma a series of amendments to the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), which provided for its participation in the capital of Vneshtorgbank and three ROBs (Mosnarbank, Eurobank and Ost-West Handelsbank) at the level of no less than 50% plus 1 vote.



## VI.6. PRECIOUS METALS MARKET

**As** RUSSIA'S precious metals market continued to gain ground in 1997, Russian credit institutions increased trading volumes and broadened the range of their operations in this sector of the market.

That became possible thanks to the issue of new regulatory documents, such as Presidential Decree No. 767 of July 22, 1997, "On Some Measures to Liberalise the Export of Gold and Silver from the Russian Federation," Russian Federation Government Resolutions No. 772 of June 30, 1997, "On the Approval of Rules Regulating the Buy/Sell Transactions of Banks with Measuring Ingots of Precious Metals Involving Private Individuals" and No. 773 "On Changing the Procedure for Regulating Prices (Tariffs) of Precious Metals," Bank of Russia Letters No. 02-308 of July 17, 1997, "On Changes in the Procedure for Making the Accounting of Operations with Precious Metals in Credit Institutions" and No. 03-26-2-2/1780 of August 1, 1997, "On Some Specifics of Collateral Operations with Precious Metals and/or Precious Stones and Also Jewellery," and Bank of Russia Instructions No. 12-U of November 3, 1997, "On Amending Bank of Russia Instruction No. 52 "On the Procedure for Making the Accounting of Operations with Precious Metals in Credit Institutions."

Having assumed the obligation to buy all gold in bullion offered by Russian credit institutions, thereby maintaining market liquidity, the Bank bought 26.03 tons of gold from commercial banks.

The pricing policy in the domestic market hinged upon the objectives set in creating international (gold and currency) reserves — to ensure external liquidity and prop up the exchange rate of the domestic currency, and the functions that gold fulfils as an asset used to meet the state's emergency needs and traditionally in increasing trust in the national currency.

Taking into consideration that the degree of gold's liquidity is ultimately determined in the world centres of trade in precious metals (especially the London and Zurich gold markets), the

Bank's purchasing price of gold is tied to its price on the world markets. Traditionally, the price of gold on the regional markets differs from the world price by the cost of overhead (which includes transportation, insurance, packaging, etc.) on the movement of gold between the world and regional markets, and this factor was adopted by the Bank as the benchmark in setting its prices of precious metals. It also took into account the market volatility values determined in the world markets, that is, possible deviations from a fixed price within a certain period of time. Overall, this amounts to around 2% of the metal price and hence the difference between the Bank's buying price and the evening gold price fixed in the London market on the day preceding the transaction date. The Bank takes into account world market price fluctuations in fixing its prices because it has to be cautious in forming its asset portfolio.

Regionally, domestic gold trade was concentrated in Moscow: as of January 1, 1998, Moscow banks accounted for 90.72% of all gold that the Bank bought from Russian credit institutions, 86.79% of gold kept in depositories and 99.98% of balances in resident metal accounts. Gold turnover for the leading Moscow banks in 1997 is estimated at 17 trillion rubles<sup>1</sup>. Operations with precious metals were also actively conducted by banks in St. Petersburg, Krasnoyarsk territory and the Sverdlovsk, Irkutsk and Kemerovo regions.

The analysis of Russian banks' operations in the domestic gold market confirms that the decisive factor behind gold trade is not its proximity to gold-mining enterprises, but the general financial condition of the bank and it is rather the general economic situation in the region that constitutes the geographical factor. The fact that no operations with precious metals are conducted in some gold-mining regions, such as the Republic of Buryatia and the Magadan and Amur regions, bears this out.

To minimise the risks to which credit institutions are exposed when conducting operations

<sup>1</sup> This includes the turnover of Vneshtorgbank (16 trillion rubles), which is an agent of the Russian Government.

with precious metals, the Bank issued Letter No. 124, dated March 14, 1997, “On the Procedure for Regulating Open Positions on Operations with Precious Metals by Banks of the Russian

Federation”, stipulating that the ratio of the overall amount of open positions in precious metals to the bank’s equity capital (own funds) should not exceed 10%.





**BALANCE SHEET AND  
PROFIT AND LOSS ACCOUNT  
OF CENTRAL BANK  
OF RUSSIAN FEDERATION  
AS OF JANUARY 1, 1998**

**VII**



## VII.1. BALANCE SHEET OF CENTRAL BANK OF RUSSIAN FEDERATION AS OF JANUARY 1, 1998, AND EXPLANATORY NOTES TO SOME ITEMS

*The* **CONSOLIDATED** balance sheet shows the operations conducted by the Bank of Russia in order to fulfil its main functions, as they are formulated in Federal Law No. 65-FZ of April 26, 1995, "On the Central Bank of the Russian Federation (Bank of Russia)" and taking into account the amendments made in it. They are designed to ensure the elaboration and implementation of the government's monetary policy, the issue of cash, control over it

and organisation of cash circulation, ensuring the effective functioning of the settlement system and establishing settlement rules in the Russian Federation, registering credit institutions, supervising their activities and ensuring the soundness of the banking system, ensuring foreign exchange control, regulating the exchange rate of the national currency and ensuring its stability against foreign currencies, and making the accounting of some other banking operations.

### CONSOLIDATED BALANCE SHEET OF CENTRAL BANK OF RUSSIAN FEDERATION (million rubles)

Assets			Liabilities		
	1.01.98	1.01.97		1.01.98	1.01.97
1. Gold	36,210,064	30,461,633	1. Authorised capital	3,000	3,000
2. Foreign exchange	85,856,036	72,663,741	2. Reserves and funds	47,918,511	40,117,578
3. Cash in vaults	45,022	936,090	3. Foreign currency accounts	2,627,927	14,465,070
4. Loans to the Ministry of Finance of the Russian Federation	260,634	57,793,581	4. Cash in circulation	137,042,262	109,510,170
5. Operations with securities	159,830,999	75,740,085	5. Funds of credit institutions	66,970,977	42,171,703
6. Credits	13,049,448	10,557,611	6. Budget and customer funds	26,986,584	16,813,588
7. Interstate settlements	4,005,004	4,178,973	7. Funds in settlements	2,611,798	8,976,903
8. Other assets	36,114,574	32,035,045	8. Other liabilities	51,210,722	52,308,747
<b>Balance</b>	<b>335,371,781</b>	<b>284,366,759</b>	<b>Balance</b>	<b>335,371,781</b>	<b>284,366,759</b>

## EXPLANATORY NOTES TO ITEMS OF BANK OF RUSSIA CONSOLIDATED BALANCE SHEET

*Assets*

(million rubles)

<b>1. Gold</b>	<b>36,210,064</b>
<b>2. Foreign exchange</b>	<b>85,856,036</b>
This item comprises Bank operations conducted in foreign currency in Russia and abroad, operations with securities and deposits, which comply with the applicable legislation of Russia and are accepted in international practice, and balances in correspondent accounts.	
<b>3. Cash in vaults</b>	<b>45,022</b>
This item represents the banknotes and coins kept in vaults of the Bank's institutions.	
<b>4. Loans to the Ministry of Finance of the Russian Federation</b>	<b>260,634</b>
This item includes the Finance Ministry's debt of previous years to the Central Bank on Soviet and Russian obligations, included in the internal government debt of the Russian Federation.	
<b>5. Operations with securities</b>	<b>159,830,999</b>
This item represents the Central Bank's operations to invest in government securities and buy assets of joint stock companies and overseas banks in which the Bank owns a stake.	
<b>6. Credits</b>	<b>13,049,448</b>
These include:	
— credits extended to banks .....	6,517,101
— overdue interest on credits .....	2,019,336
— overdue debt on credits .....	317,352
— credits extended to CIS countries out of federal budget funds, including interest on them .....	3,693,255
— credits extended to Bank clients, including credits unredeemed on time and overdue interest on them .....	502,404
<b>7. Interstate settlements</b>	<b>4,005,004</b>
This item represents interstate settlements effected with CIS countries.	
<b>8. Other assets</b>	<b>36,114,574</b>
This item comprises the accounts on fixed and working capital of the Bank's institutions and organisations, settlements effected in the course of economic activity and other Bank operations.	

# Liabilities

(million rubles)

<b>1. Authorised capital</b>	<b>3,000</b>
Article 9 of Federal Law No. 65-FZ of April 26, 1995, "On the Central Bank of the Russian Federation (Bank of Russia)" set its authorised capital at 3 billion rubles.	
<b>2. Reserves and funds</b>	<b>47,918,511</b>
Reserves and funds are formed by the Bank in accordance with Federal Law No. 65-FZ of April 26, 1995, "On the Central Bank of the Russian Federation (Bank of Russia)."	
This item shows reserve fund balances, accumulated exchange rate differentials on foreign currency operations and fees for the right to use the Bank's overnight settlement credit (Bank of Russia Order No. 02-230 of July 9, 1996).	
These funds are intended for covering possible losses on the Bank's operations (to cover expenses on redemption of bad loans and interest on them and foreign exchange and settlement operations and reimburse risks from participation in equity capital of overseas banks and other credit institutions).	
Allocations to the reserve fund are made from profit by the decision of the Bank's Board of Directors and in accordance with Article 65-FZ of April 26, 1995, "On the Central Bank of the Russian Federation (Bank of Russia)."	
The exchange rate differentials accumulated on foreign currency operations are formed as a result of revaluation of the Bank's foreign exchange reserves.	
<b>3. Foreign currency accounts</b>	<b>2,627,927</b>
This item represents the Bank's foreign exchange operations, including operations to place the Finance Ministry's official government foreign exchange reserves.	
<b>4. Cash in circulation</b>	<b>137,042,262</b>
This item shows the sum of banknotes and coins put in circulation by the Bank.	
<b>5. Funds of credit institutions</b>	<b>66,970,977</b>
The funds of credit institutions are represented by the balance of 30,343,307 million rubles in correspondent accounts, required reserves of 36,416,266 million rubles deposited with the Bank and funds worth 211,404 million rubles received as payment for shares of credit institutions prior to the issue prospectus registration.	
<b>6. Budget and customer funds</b>	<b>26,986,584</b>
This item comprises the balances in the accounts opened with the Bank to record the funds of the federal, republic, territorial, regional, district, city district, city, rural and village budgets and also extra-budgetary funds and funds of other customers of the Central Bank of the Russian Federation.	
<b>7. Funds in settlements</b>	<b>2,611,798</b>
This item characterises funds in settlements in the territory of the Russian Federation.	
<b>8. Other liabilities</b>	<b>51,210,722</b>
This item represents the balances in the accounts to record future-period revenues (unpaid interest on the credits extended and centralised resources sold), balances on special-purpose funds and 1961 banknotes put in circulation before July 26, 1993.	

**VII.2. REVENUES, EXPENDITURES  
AND FINANCIAL PERFORMANCE OF CENTRAL BANK  
OF RUSSIAN FEDERATION IN 1997**

**PROFIT AND LOSS ACCOUNT OF CENTRAL BANK OF RUSSIAN FEDERATION**

The revenues, expenditures and profit of the Central Bank of the Russian Federation in 1997 were as follows:

<b>Revenues</b>	(million rubles)
1. Revenues from interest on Bank of Russia credits	2,056,100
2. Revenues from operations with government securities	5,685,067
3. Revenues from foreign exchange operations	4,248,308
4. Received dividend from shares	439,231
5. Commission and other revenues	5,185,607
<b>6. Total revenues</b>	<b>17,614,313</b>
<b>Expenditures</b>	
7. Administrative and staff costs	7,462,825
8. Operating and other expenditures (excluding the interest paid and expenditures on operations with securities and foreign exchange operations)	7,363,353
9. Losses	932
<b>10. Total expenditures</b>	<b>14,827,110</b>
11. Profit	2,787,203

The structure of the Bank's revenues in 1997 was changed compared with the annual reports for preceding years owing to the presentation of revenues from operations with securities and foreign exchange operations as a separate item. Since the revenues in items 1 — 3 are shown excluding the expenditures made on these operations, the corresponding correction was made in the item "Operating and Other Expenditures."

In accordance with Article 26 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), the Bank's Board of Directors on April 10, 1998, approved the distribution of 2,787,203.1 million rubles received by the Bank as profit in 1997 as follows:

	(million rubles)
<b>To federal budget revenues in accordance with the Russian Federation Federal Law No. 45-FZ of February 27, 1997, On Amending the Federal Law on the Central Bank of the Russian Federation (Bank of Russia)</b>	<b>1,393,601.6</b>
<b>To form the Bank's reserves and funds</b>	<b>1,393,601.5</b>
of which:	
— Reserve Fund	793,601.5
— Social Fund	600,000.0

## ON THE PROCEDURE FOR CREATING BANK OF RUSSIA RESERVE FUND AND ITS USES

In accordance with Article 26 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), the Bank forms from its profit reserves and funds for various purposes in order to fulfil its functions and ensure the stability of its performance.

The Reserve Fund is formed in accordance with the Provision on the Procedure for Forming the Reserve Fund and its Uses, approved by the Bank's Board of Directors on December 22, 1995.

As of January 1, 1997, the balance of the Bank's Reserve Fund amounted to 9,190,658 million rubles. In 1997 the Bank's

Board of Directors ordered 200,653 million rubles from the Reserve Fund to be used to write off unsettled sums in interbranch settlements and settlements of previous years, 82,014 million rubles to redeem internal government debt of the former USSR, and 600 million rubles to write off bad debt on loans lent out to banks.

In 1997, 1,537 million rubles were transferred to the Reserve Fund by banks as payment of their debt to the Bank (which were earlier written off from the Bank's balance sheet at the expense of this Fund).

Since the Reserve Fund is too small to cover possible risks on the Bank's operations, the Board of Directors on April 10, 1998, ordered the transfer of 793,601.5 million rubles to the Reserve Fund, which eventually amounted to 9,702,529.5 million rubles.



## MAJOR ACTIONS

### UNDERTAKEN BY BANK OF RUSSIA IN 1997

### IN LINE WITH UNIFORM STATE MONETARY POLICY

#### I. RESERVE REQUIREMENTS, INTEREST POLICY, REFINANCING BANKS AND DEPOSIT OPERATIONS

*In* **THE YEAR UNDER REVIEW** the Bank of Russia reduced required reserve ratios on ruble borrowings funds in rubles attracted by credit institutions and raised reserve requirements on attracted funds in foreign exchange (Bank of Russia Instructions No. 21-97 of March 21, 1997, No. 15-U of November 10, 1997, and No. 44-U of December 1, 1997).

It amended Provision No. 37 of March 30, 1996, "On the Required Reserves Deposited by Credit Institutions with the Central Bank of the Russian Federation" and Provision No. 51 of November 4, 1996, "On the Required Reserves of the Savings Bank of the Russian Federation" (Bank of Russia Instructions Nos. 440 and 441 of April 25, 1997 and Nos. 23-U and 24-U of November 18, 1997).

The Bank sent to its regional institutions "Methodological Recommendations on How to Check the Validity of Calculations by Credit Institutions of the Required Reserves to Be Deposited with the Central Bank of the Russian Federation and Verify the Authenticity of Reports on Such Calculations," which were elaborated taking into account the new accounting rules in Russian credit institutions (Bank of Russia Letter No. 55-T of December 24, 1997).

In 1997 the Bank repeatedly changed its refinancing rate (discount rate):

- as of January 1, 1997, the refinancing rate was 48% p.a. (it was set on December 2, 1996);

- on February 10, 1997, the refinancing rate was cut to 42% p.a. (Bank of Russia Order No. 9-97 of February 7, 1997);
- on February 28, 1997, the refinancing rate was cut to 36% p.a. (Bank of Russia Order No. 38-97 of February 24, 1997);
- on June 16, 1997, the refinancing rate was reduced to 24% p.a. (Bank of Russia Order No. 55-97 of June 13, 1997);
- on October 6, 1997, the refinancing rate was cut to 21% p.a. (Bank of Russia Order No. 83-97 of October 11, 1997);
- on November 11, 1997, the Bank raised the refinancing rate to 28% p.a. (Bank of Russia Order No. 13-U of November 10, 1997) and it stayed at that level until the end of the year under review.

As the refinancing rate changed, from the beginning of the year till December 1997 the fixed interest rate on Lombard credits changed with it, but after December 1 and until the end of the year under review the Lombard rate remained fixed at 36% p.a. regardless of the term of credit (Bank of Russia Order No. 43-U of December 1, 1997), despite the fact that the refinancing rate at that point was 28% p.a.

The Bank sent to its territorial institutions elucidations of the procedure for granting Lombard credits to banks (Instructions No. 03a-13-3-3/389 of February 21, 1997, No. 13-3-3/911 of April 22, 1997, and No. 03a-13-3-3/1451 of June 10, 1997).

The following instructions were sent to the Bank's regional institutions in connection with the introduction of the new Charts of Accounts:

- on the accounting of operations to grant (settle) Bank of Russia Lombard and overnight credits (Bank of Russia Instructions No. 106-U of December 26, 1997, and No. 110-U of December 29, 1997);
- on the accounting in the Bank's balance sheet of the debt on centralised credits extended in 1992 — 1994 to farmers for a term of up to five years and deferred centralised credits extended to enterprises in the fuel and energy sector (Instructions Nos. 03-13-3-2/1095 and 03-13-3-2/1096 of October 27, 1997);
- on the accounting of Finance Ministry promissory notes of the APK series and on the procedure for their revaluation (Instruction No. 03-13-3-1/1592 of December 30, 1997).

The Bank sent to its regional institutions instructions on the procedure for making the ac-

counting of the sums received in repayment of overdue debt on centralised credits, the balance due on banks' correspondent accounts and the interest charged on them, which were previously written off the Bank's balance sheet and transferred to off-balance sheet accounts (Instruction No. 03a-13-3-2/1592).

The Bank continued to upgrade the process of development and introduce a uniform technique for collecting, processing and using banking statistics with the aid of advanced information technology and software systems. To this end, the Bank drew up and sent to its regional institutions Instructions No. 7-U, dated October 24, 1997, "On the Procedure for Compiling Reports by Credit Institutions and Submitting Them to the Central Bank of the Russian Federation" and No. 27-U, dated November 14, 1997, "On the Procedure for Compiling Reports by Bank of Russia Regional Institutions and Submitting Them to the Central Bank of the Russian Federation."

## 2. RELATIONS WITH THE FEDERAL BUDGET

*In* ACCORDANCE with Article 73 of the 1997 Federal Budget Law, the Finance Ministry's debt on credits extended to finance the federal budget deficit in 1992 — 1994, including credits granted in 1992 to finance the defence conversion programme and investment projects, and the interest of 56.5 trillion rubles to be paid on them in 1997 — 2004, in 1997 was re-drafted into fixed-income federal loan bonds worth 79.8 trillion rubles at par.

In 1997 internal government debt of the former USSR decreased by 453 billion rubles to 191.4 billion rubles as of January 1, 1998.

Taking into consideration the difficult situation with the collection of taxes to the budgets and government extra-budgetary funds, the Bank in collaboration with other ministries and government departments took part in the actions of the Government of the Russian Federation to increase the revenues of the federal budget.

In line with the decision of the Government Commission on Financial and Monetary Policy, in October and November 1997 the State Customs Committee's accounts denominated in rubles and

foreign currency were transferred from Moscow-based credit institutions to the Bank's First Operations Division (OPERU-1). According to the latest data, in the fourth quarter of 1997 customs payments to the federal budget rose by 8.7 trillion rubles compared with the third quarter.

In accordance with the 1997 Federal Budget Law, the Bank in February and May 1997 transferred to the federal budget its profit in the amount of 1,985.0 billion rubles to finance the expenditures of the 1997 federal budget.

In accordance with Presidential Decree No. 477, dated May 12, 1997, "On Measures to Enhance Control over the Use of Federal Budget Funds," and Russian Federation Government Resolution No. 1082, dated August 28, 1997, "On Measures to Accelerate the Transition to the Treasury System of Federal Budget Execution," and to improve the management of federal budget funds, enhance control over the use of federal budget funds and bolster financial discipline, the Bank participated in carrying out measures to speed up the transition to the treasury system of federal budget implementation.



In 1997 budget-financed organisations and institutions began to be transferred to financing through working accounts opened for them in Federal Treasury bodies.

As of January 1, 1998, 1,926 Federal Treasury bodies financed budget-financed institutions and organisations through their working accounts opened with these bodies. It should be noted that 22,200 out of 44,000 budget-fi-

anced institutions and organisations made the transition to this financing procedure, 1,400 made a partial transition and 20,400 had not yet made the transition to this procedure. In addition, 17,000 out of 41,900 other institutions and organisations financed from the federal budget switched to financing through working accounts with Federal Treasury bodies and 24,900 did not.

### 3. FOREIGN EXCHANGE REGULATION AND FOREIGN EXCHANGE CONTROL

**To IMPROVE** foreign exchange regulation and foreign exchange control, the Bank implemented the following measures:

- it drew up and put in operation in January 1998 a new scheme of information flows on payments for imported goods from authorised banks to the Bank's regional institutions, creating additional opportunities for implementing effective controls over authorised banks' compliance with their functions as foreign exchange control agents, allowing regional institutions to take appropriate action on violations of the foreign exchange legislation and designed to create a quick-reaction system for registering and monitoring such operations;
- the system of customs and banking control was extended to cover foreign trade transactions, involving the delivery of goods under government credits;
- in order to reduce the use of foreign currency settlements in the Russian Federation the Bank prohibited foreign exchange settlements for goods and services sold to private individuals, making an exception for duty-free shops and a small number of representative offices of foreign airlines;
- it established the procedure for buying foreign exchange by resident legal entities through authorised banks to pay travel expenses, set rules for such operations and established control over the use of foreign currency bought for these purposes;
- it elaborated and established the procedure for effecting transfers of foreign currency by resident and nonresident private individuals from and to the Russian Federation without opening current foreign exchange accounts;
- in order to create conditions that would encourage an inflow of long-term foreign investments, the Bank introduced the registration and simplified the licensing of operations connected with the attraction by Russian residents of financial credits from nonresidents for terms exceeding 180 days;
- residents of the Russian Federation were granted the right to purchase foreign currency to conduct foreign exchange operations connected with capital flow;
- to prevent the infiltration of the Russian banking system by "shadow" capital, the Bank elaborated and issued "Methodological Recommendations on Ways to Prevent the Infiltration of Banks and Other Credit Institutions by Illegally Obtained Incomes."

### 4. SECURITIES MARKET

**C**ONTINUING TO UPGRADE its monetary policy tools, the Bank improved the system of REPO operations between the

Central Bank and primary dealers in the GKO — OFZ market. In May 1997 primary dealer banks were allowed to attract funds through REPO

deals, regardless of whether they had a short money position or not. In August the Bank developed a new REPO operations scheme for the government securities market and drafted a new version of the General Agreement on REPO Transactions, signed between primary dealers and the Bank. The new REPO mechanism enables primary dealers to attract funds at the beginning of the business day at market rates at REPO auctions. After the end of the secondary trading session or auction, REPO deals are used only for closing short money positions at the rate fixed by the Bank. In October coupon bonds were included in the base issues for conducting REPO operations and in November primary dealers received permission to make additional fund transfers to close their short positions.

In April 1997 the Bank's Board of Directors approved a "Plan to Gradually Ease the Procedure for Investing Nonresident Funds in the Russian Government Securities Market" that met the requirement of Article VIII of the IMF Articles of Agreement, which Russia signed in August 1996. The scheme provided for a gradual reduction in the proportion of mandatory conversion deals (both cash and forward) between banks authorised to keep the S-type accounts and the Central Bank. By January 1998 all restrictions had been lifted on the repatriation of incomes received by nonresidents from their investments in GKO — OFZ.

To promote the development of the institution of market-makers, the Bank had drawn up by April 1997 a new model agreement with primary dealers, which included a number of fundamentally new requirements to the professional market participants, such as mandatory purchase of securities at auction, the minimum size of the participant's own portfolio, maintaining quotations of some GKO — OFZ issues, and certain restrictions on the yield of the bids made at an auction and at the beginning of a trading session. Gradually, these restrictions were tightened within the framework of the existing agreement, and as a result the number of primary dealers declined from 43 organisations in early 1997 to 36 organisations by the end of December.

From March 1997 the government securities market players received the opportunity to withdraw their money from the Settlement System right after the closing of the business day. Thus the principle of same day settlement was realised. In May the securities market participants were granted permission to move money between the GKO — OFZ sector and the forward sector of MICEX during the entire business day in order to cover the shortage of funds in one sector with funds in another. However, at present such money movement operations are strictly regulated by the Bank. Each market participant must have special permission from the Bank to conduct such operations.



The UNICON Consulting Group

*Auditor's report***ON THE ANNUAL REPORT  
OF THE CENTRAL BANK OF THE RUSSIAN FEDERATION  
FOR 1997**

*We* audited the Annual Report of the Central Bank of the Russian Federation in accordance with Resolution No. 1834-II GD of the State Duma of the Federal Assembly of the Russian Federation, dated October 24, 1997, "On the Auditor of the Central Bank of the Russian Federation for the Annual Report of the Central Bank of the Russian Federation for 1997." It is the Bank of Russia management that is responsible for the drafting and presentation of the Annual Report and the documents, on the basis of which the Auditor forms its judgement. We have the responsibility to compile an independent Auditor's Report on the Bank of Russia Annual Report, based on the results of the audit of the Bank's Annual Report, which includes financial reports (the Balance Sheet and Profit and Loss Account for 1997), the Balance of Payments of the Russian Federation and indicators characterising its activities.

The inclusion of the Balance of Payments of the Russian Federation in the Annual Report is required by the Law on the Central Bank of the Russian Federation (Bank of Russia). The compiling of the Balance of Payments by the Bank of Russia is regulated by Russian Federation Government Resolution No. 849, dated July 18, 1994, "On the Procedure for Compiling and Presenting the Balance of Payments of the Russian Federation."

During the audit we conducted the necessary procedures and tested the management and internal control systems of the Bank of Russia. As regards the management system, we needed to make sure that it corresponded to the objectives and tasks that faced the Bank of Russia. As for the internal control system, we needed to know that the extent of its organisation and formalisation corresponded to the nature and volume of operations conducted by the Bank of Russia.

We conducted the audit in accordance with the Provisional Audit Rules of the Russian Federation, approved by Presidential Decree No. 2263, dated December 22, 1993, and also taking into account international audit standards. We planned and conducted the audit so that we could be sure that the Balance of Payments of the Russian Federation and financial (accounting) reports presented contained no significant distortions and that the Annual Report's calculations were made in accordance with the Bank of Russia's methodology. Evaluating individual items of the Russian Federation Balance of Payments, we paid attention to the analysis of conformity of the methods used by the Bank of Russia to the International Monetary Fund Balance of Payment Manual (5th ed., Washington, 1993) and also examined the authenticity of calculations regarding individual items and components of the Russian Federation Balance of Payments.

The audit consisted of a selective examination of documentary evidence concerning the figures and explanatory notes contained in the Balance of Payments of the Russian Federation and financial (accounting) reports, as well as the validity of the calculation of the Annual Report indicators, characterising the Bank of Russia's activity in 1997. We did not participate in the inventory of the Bank's assets, but we conducted verification procedures in order to check the results of the inventory. We believe that the work we have carried out allows us to express our opinion about the authenticity of these reports and draw our conclusion.

The following comments need to be made with regard to the information provided to us for conducting audit procedures. Bank of Russia financial reports include numerous sums that are not subject to inspection by independent auditors in accordance with Russian Federation Law No. 5485-1, dated July 21, 1993, "On State Secrets." That is why we were denied access to reports made by some structural divisions of the Bank of Russia and therefore we cannot express an opinion about the authenticity of some items of the Balance Sheet and the Profit and Loss Account, containing information about gold reserves, cash in circulation and some credits, budget funds and funds in settlements, and also about some Annual Report indicators, whose calculation includes data from the closed sections of the Balance Sheet and the Profit and Loss Account items. The examination of the corresponding accounts and operations was conducted by the Accounting Chamber of the Russian Federation on the basis of Resolution No. 1834-II GD of the State Duma of the Federal Assembly of the Russian Federation, dated October 24, 1997, "On the Auditor of the Central Bank of the Russian Federation for the Annual Report of the Central Bank of the Russian Federation for 1997," and therefore we rely on the opinion of the Accounting Chamber of the Russian Federation with respect to this section. In addition, we did not have access to all of the minutes of the meetings of the Bank's Board of Directors, held between January 1, 1998 and the date on which this report was signed, but we rely on the assurances of the Bank's management that the decisions made by the Board of Directors after January 1, 1998, had no effect on the audited financial reports for 1997.

In accordance with the Federal Law on the Central Bank of the Russian Federation, the Bank of Russia independently works out its accounting policy in order to record operations in the Balance Sheet accounts and compile financial reports. The main principles of the Bank of Russia's accounting policy consist of showing the objects of accounting at their initial value (except for revaluation of funds in foreign currency, investments in government securities and revaluation of fixed assets) and showing revenues and expenditures as they are received or paid.

We believe that, presuming that some items and indicators of the Annual Report (containing data to which access was restricted owing to the above-mentioned circumstances) do not contain any significant distortions that can affect the Bank of Russia final reports, the Balance of Payments of the Russian Federation for 1997, Bank of Russia performance indicators in 1997, the Balance Sheet as of January 1, 1998, and the Profit and Loss Account for 1997 are compiled in all their significant aspects in compliance with the requirements of the applicable legislation pertaining to the Bank of Russia's activities.

Director-General

A.Y. Dubinsky

Deputy Director of the Audit Services Department

V.M. Volkov

Moscow 1998

## STATISTICAL ADDENDUM

### *List of tables*

1. Dynamics of Basic Macroeconomic Indicators .....	139
2. Gross Domestic Product .....	140
3. Formation of Gross Disposable Income .....	140
4. Utilisation of Gross Disposable Income .....	141
5. Personal Cash Incomes and Expenditures Balance in the Russian Federation .....	141
6. Formation and Utilisation of Capital Resources .....	142
7. Russia's Foreign Trade .....	142
8. Russia's Trade with Leading Partners Outside CIS in 1997 .....	143
9. Russia's Trade with CIS Countries in 1997 .....	143
10. Russia's Exports Structure .....	144
11. Russia's Imports Structure .....	145
12. CIS Countries' Key Economic Indicators in 1997 .....	146
13. Key World Economy Indicators .....	147
14. Russia's Balance of Payments. Analytical Presentation .....	148
15. Nonresident Investment in GKO — OFZ Market Using Standard S-Type Account Mechanism .....	150
16. Foreign Cash Flow Balance in 1996 — 1997 .....	150
17. Analytical Indicators of Russia's Foreign Government Debt Servicing in 1996 — 1997 ..	151
18. International Consolidated Investment Position of Russian Commercial Banks as of January 1, 1997, and January 1, 1998 .....	152
19. Russia's International Reserve Dynamics in 1997 .....	154
20. Finance Ministry Debt to Central Bank .....	154
21. Money Supply .....	155
22. Money Supply (M2) Structure .....	155

23. Monetary Base and Its Structure .....	155
24. Budget Revenues from GKO — OFZ Issues .....	156
25. GKO — OFZ Primary Market Operations in 1997 .....	157
26. Additional GKO — OFZ Sales and Prior Repurchases in Secondary Market in 1997 .....	158
27. Main Characteristics of GKO — OFZ Market in 1997 .....	159
28. Main Indicators of GKO Market Development in 1997 .....	160
29. Main Indicators of OFZ-PK Market Development in 1997 .....	161
30. Main Indicators of OFZ-PD Market Development in 1997 .....	162
31. REPO Operations in GKO — OFZ Market in 1997 .....	163
32. Foreign Cash Operations by Russia's Authorised Banks .....	163
33. Balance of Foreign Cash Operations by Private Individuals .....	164
34. Exchange Offices of Russia's Authorised Banks and Their Branches .....	164
35. Structure of Licences and Permits Issued by Bank of Russia and Its Regional Branches to Conduct Foreign Exchange Operations Related to Capital Flow .....	165
36. Selective Data on Sberbank's Household Deposits and Investments in Government Securities Market .....	165
37. Banks by Financial Condition .....	166
38. Bank Rehabilitation Activity by Bank of Russia Regional Branches .....	167
39. Control over Liquidation of Credit Institutions Stripped of Licence .....	170
40. Note Structure of Bank of Russia Banknotes in Circulation .....	174
41. Qualification and Other Characteristics of Bank of Russia Personnel .....	174
42. Bank of Russia Stakes in Authorised Capital of Russian Banks and Other Financial Institutions .....	175
43. Bank of Russia Stakes in Authorised Capital of Overseas Banks as of January 1, 1998 ...	175

Table 1

**DYNAMICS OF BASIC MACROECONOMIC INDICATORS  
(as % of previous year)**

	1995	1996	1997
Gross Domestic Product	95.9	95.1	100.4
of which:			
Goods Production	94.9	94.4	100.5
including:			
industry	96.7	96	102.4
agriculture and forestry	91.1	93.2	100.1
construction	91.2	89.1	94.6
other sectors	96.7	96	102.4
Services	97.2	95.8	100.3
including:			
transport and communications	97.5	94.2	97.9
trade and public catering	95.6	94.9	102.0
other market services	96.9	95.3	100.0
non-market services	99.5	99.1	101.0
GDP Deflator Index (against previous year), times	2.78	1.46	1.18
Consumer Price Index (December against previous December), times	2.31	1.22	1.11
Labour productivity	99	96	101
Business activity index	91	93	96
Investment in fixed capital	90	82	95
Retail trade turnover	93	96	102
Average yearly unemployment rate calculated by ILO methodology (as % of economically active population)	8.3	9.1	9.3

*Note: Tables 1 to 6 show Bank of Russia calculations made on the basis of the data provided by the Russian State Statistical Committee (as of May 15, 1998). Tables 7 to 11 are based on the data provided by the Russian State Customs Committee (as of May 15, 1998). Table 12 is based on the data supplied by CIS central (national) banks (as of February 1, 1998). Table 13 is based on World Economic Outlook, IMF, May 1998.*

Table 2

**GROSS DOMESTIC PRODUCT (in current prices, trn rbs)**

	1995	1996	1997
<b>Gross Domestic Product</b>	<b>1,630</b>	<b>2,256</b>	<b>2,675</b>
of which:			
Goods production	750	974	1,067
including:			
industry	497	621	664
agriculture and forestry	113	152	174
construction	131	187	213
other sectors	11	15	16
Services	764	1,093	1,323
including:			
transport and communications	170	293	367
trade and public catering	268	328	383
other market services	145	201	244
non-market services	181	271	329
Net taxes on products and imports	137	201	289

Table 3

**FORMATION OF GROSS DISPOSABLE INCOME (in current prices, trn rbs)**

	1995	1996	1997
<b>Gross Domestic Product</b>	<b>1,630</b>	<b>2,256</b>	<b>2,675</b>
including:			
wages and salaries	708	1,035	1,198
net taxes on production and imports	186	285	411
gross profit and gross mixed income	736	936	1,066
of which:			
fixed capital consumption	414	657	789
Primary income received from "rest of the world"	20	22	25
Primary income transferred to "rest of the world"	35	49	74
Current transfers received from "rest of the world"	3	4	2
Current transfers to "rest of the world"	3	4	4
<b>Gross Disposable Income</b>	<b>1,615</b>	<b>2,229</b>	<b>2,624</b>



Table 4

## UTILISATION OF GROSS DISPOSABLE INCOME (in current prices, trn rbs)

	1995	1996	1997
Gross Disposable Income	1,615	2,229	2,624
Expenditures on final consumption	1,102	1,560	1,835
including expenditures:			
by households	763	1,060	1,246
by government	306	453	535
by non-profit organisations servicing households	34	47	54
Gross Savings	513	669	789

Table 5

## PERSONAL CASH INCOMES AND EXPENDITURES BALANCE IN THE RUSSIAN FEDERATION (bn rbs)

	1996	1997	1997 as % of 1996
Cash Income	1,338,003.9	1,618,001.2	120.9
wages & salaries	560,349.3	694,300	123.9
% share	41.9	42.9	
social transfers	189,615.9	240,000	126.6
% share	14.2	14.8	
other incomes	588,038.7	683,701.2	116.3
% share	43.9	42.3	
Cash Expenditures	1,001,235.3	1,204,865.4	120.3
consumer expenditures	920,848.3	1,096,466.6	119.1
% share	92	91	
taxes and other expenditures	80,387	108,398.8	134.8
% share	8	9	
Growth in bank savings and cash in hand, foreign currency purchases	336,768.6	413,135.8	122.7
organised savings	65,789.1	36,090.3	54.9
% share	19.5	8.7	
foreign exchange purchases	252,177.6	349,556.8	138.6
% share	74.9	84.6	
cash in hand	18,801.9	27,488.7	146.2
% share	5.6	6.7	
For reference:			
Share of Cash Income, %			
consumer expenditures	68.8	67.8	
organised savings	4.9	2.2	
foreign exchange purchases	18.8	21.6	
cash	1.4	1.7	
taxes and other payments	6	6.7	
Disposable Cash Income	1,260,226.6	1,518,059	120.5
of which in %:			
consumer expenditures	73.1	72.2	
organised savings	5.2	2.4	
foreign exchange purchases	20	23	
cash	1.5	1.8	

Table 6

## FORMATION AND UTILISATION OF CAPITAL RESOURCES (in current prices, trn rbs)

	1995	1996	1997
Gross savings	513	669	789
Capital transfers received from "rest of the world"	14	16	12
Capital transfers to "rest of the world"	16	18	17
Total capital resources	512	667	784
Gross fixed capital accumulation	329	462	500
Change of tangible working asset reserves	53	61	65
Net credits, net debts (—)	129	144	219

Table 7

## RUSSIA'S FOREIGN TRADE

		1996			1997			1997 as % of 1996		
		total	countries		total	countries		total	countries	
			Non-CIS	CIS		Non-CIS	CIS		Non-CIS	CIS
Turnover	\$ bn	131	100.8	30.3	137.3	106.7	30.6	104.8	105.9	101.1
Exports		85.1	69.3	15.8	84.7	68.2	16.6	99.6	98.4	104.9
Imports		46	31.5	14.5	52.6	38.5	14	114.3	122.3	97
Turnover	%	100	76.9	23.1	100	77.7	22.3			
Exports		100	81.4	18.6	100	80.5	19.5			
Imports		100	68.5	31.5	100	73.3	26.7			

Table 8

## RUSSIA'S TRADE WITH LEADING PARTNERS OUTSIDE CIS IN 1997

	Turnover		Exports		Imports		Balance	1997 as % of 1996		
	\$ m	%	\$ m	%	\$ m	%	\$ m	Turnover	Exports	Imports
<b>Total</b>	<b>106,724</b>	<b>100</b>	<b>68,184</b>	<b>100</b>	<b>38,540</b>	<b>100</b>	<b>29,644</b>	<b>105.9</b>	<b>98.4</b>	<b>122.3</b>
Germany	13,115.2	12.3	6,526.2	9.6	6,589	17.1	—62.8	109.9	96.9	126.8
USA	8,473	7.9	4,469.1	6.6	4,003.8	10.4	465.3	109.4	92.3	137.7
Italy	6,198.3	5.8	3,559	5.2	2,639.3	6.8	919.8	120	126.1	112.8
Netherlands	5,745.8	5.4	4,545.4	6.7	1,200.5	3.1	3,344.9	132.5	136.7	118.8
China	5,201	4.9	3,947.7	5.8	1,253.3	3.3	2,694.4	90.8	83.5	124.9
Finland	4,639.2	4.3	2,770.3	4.1	1,869	4.8	901.3	107.5	105	111.5
Great Britain	4,303.5	4	2,829	4.1	1,474.5	3.8	1,354.5	99.1	88.1	130.4
Switzerland	4,049	3.8	3,532.7	5.2	516.3	1.3	3,016.4	96.1	94.7	106.8
Japan	3,879.4	3.6	2,912.1	4.3	967.3	2.5	1,944.9	99.6	99.9	98.8
Poland	3,859.2	3.6	2,511.2	3.7	1,348.1	3.5	1,163.1	126.4	118.1	145.6
France	3,196.3	3	1,609.7	2.4	1,586.6	4.1	23	111.5	100.8	125
Other	44,064.1	41.3	28,971.7	42.5	15,092.4	39.2	13,879.3	102	94.7	119.8

Table 9

## RUSSIA'S TRADE WITH CIS COUNTRIES IN 1997

	Turnover		Exports		Imports		Balance	1997 as % of 1996		
	\$ m	%	\$ m	%	\$ m	%	\$ m	Turnover	Exports	Imports
<b>Total</b>	<b>30,581</b>	<b>100</b>	<b>16,558</b>	<b>100</b>	<b>14,023</b>	<b>100</b>	<b>2,535</b>	<b>101.1</b>	<b>104.9</b>	<b>97</b>
Ukraine	11,187.7	36.6	7,230.5	43.7	3,957.2	28.2	3,273.3	80.8	95.7	62.9
Belarus	9,257.5	30.3	4,631.3	28	4,626.2	33	5.1	145.8	135.8	157.5
Kazakhstan	5,202	17	2,466.1	14.9	2,735.8	19.5	—269.7	93.1	96.8	90
Uzbekistan	1,877.3	6.1	870.1	5.3	1,007.1	7.2	—137	107.7	79.9	154
Moldova	1,213.9	4	380.2	2.3	833.7	5.9	—453.6	99.6	97.5	100.5
Azerbaijan	474.3	1.6	219	1.3	255.3	1.8	—36.2	146.7	127.5	168.6
Turkmenia	421.8	1.4	265.3	1.6	156.5	1.1	108.7	149	230.6	93.2
Kirghizia	314.6	1	166.8	1	147.9	1.1	18.9	102.7	104.6	100.6
Georgia	292.5	1	144.5	0.9	148	1.1	—3.4	173.3	143.5	217.3
Tajikistan	184.3	0.6	87.8	0.5	96.5	0.7	—8.7	76.9	57.9	109.6
Armenia	154.4	0.5	95.3	0.6	59.1	0.4	36.2	82.1	92.4	69.7

Table 10

## RUSSIA'S EXPORTS STRUCTURE (%)

	Non-CIS		CIS*		1997 as % of 1996	
	1996	1997	1996	1997	Non-CIS	CIS
Exports, total	100	100	100	100	98.4	104.9
Mineral products,	47	47	53.5	53.5	98.3	104.8
including mineral fuel	46.4	46.2	51.6	51.9	98	105.5
Ferrous and non-ferrous metals and products,	22	23.2	8.6	7.7	103.8	94.1
including:						
— ferrous metals and products	10.7	10.8	6.8	6	99	92.7
— non-ferrous metals and products	11.2	12.3	1.3	1.2	108.4	93.5
Machinery and equipment	8.1	8.1	16.7	19.3	98.4	120.9
Chemicals	8.7	8.4	10.4	9.2	94.9	93
Timber and timber products	3.9	4	3	2.3	101.3	80
Precious and semi-precious stones, precious metals and products	5.4	4.5	0.7	0.1	81.3	13.6
Foodstuffs and raw materials for their production	1.1	1.1	3.7	3.5	101.4	97.8
Non-food raw materials and industrial products	1.2	1.2	2	1.9	100.2	98.8
Other products	2.7	2.6	1.2	2.5	97.2	211.7

\* The re-calculation of the goods structure of exports, taking Belarus into account, was made on the basis of Belarusian statistics.

Table 11

## RUSSIA'S IMPORTS STRUCTURE (%)

	Non-CIS		CIS*		1997 as % of 1996	
	1996	1997	1996	1997	Non-CIS	CIS
Imports, total	100	100	100	100	122.3	97
Machinery and equipment	37.5	37.2	20.5	24.6	121.5	116.2
Foodstuffs and raw materials for their production	24.2	25.2	25.9	22	127.2	82.7
Chemicals	16.2	16	12.5	11.4	121.1	87.9
Ferrous and non-ferrous metals and products	5	4.3	16.5	14.2	104.5	83.6
including:						
— ferrous metals and products	3.1	2.6	14.6	11.9	99.3	79
— non-ferrous metals and products	1.2	1.1	1.4	1.8	107.6	122.1
Mineral products	2.8	2.6	13.2	13.5	115	98.8
including mineral fuel	1.6	1.8	10.6	10.1	137.7	92.6
Non-food raw materials and industrial products	4.3	3.2	5.4	7.6	90.7	134.7
Timber and timber products	3	3	1	1.4	121.8	136.5
Precious and semi-precious stones, metals and products	1.2	0.2	1.4	0.1	23.5	8.6
Other products	5.8	8.2	3.5	5.3	173.1	144.5

\* The re-calculation of the goods structure of imports, taking Belarus into account, was made on the basis of Belarusian statistics.

Table 12

## CIS COUNTRIES' KEY ECONOMIC INDICATORS IN 1997 (as % of the same period of 1996)

	Azerbaijan	Armenia	Belarus	Georgia	Kazakhstan	Kirghizia	Moldova	Russia	Tajikistan	Turkmenia	Ukraine
Gross Domestic Product	105.8	103.1	110	111.3	102	110.4	101.3	100.4	101.7	...	96.8
Industrial output	100.3	100.9	117.6	108.1	104	146.8	100	101.9	97.5	70.8	98.2
Retail goods turnover	117.3	105.2	119.6	127.4	130.8	108.1	96	102.5	108	108	105.9
Consumer Price Index (December as % of previous December)	103.7	114	163.1	107.1	117.4	114.7	112	111	171.7	121.5	115.9
Producer Price Index (December as % of previous December)	99.8	119	190.3	...	115.5	114.8	120	107.4	177.5	149.2	107.7
Official unemployment rate as % of economically active population (end of year)	1.3	11.1	2.8	10.4	3.8	3.1	...	2.8	...	...	2.3
Refinancing rate (end of period), %											
— December 1996	20	60	35	24.3*	35	52.32**	18	48	72	105	40
— December 1997	12	50	40	48.1*	18.5	23.51**	16	28	81	35	35
Official exchange rate to US dollar											
— as of January 1, 1997	4,098 manats	435.07 drams	15,500 bel. rubles	1.2850 laris	73.30 tenge	16.70 soms	4.650 leis	5,560.0 rubles	328.0 taj. rubles	4,070.0 manats	1.89 hrivnas
— as of January 1, 1998	3,888 manats	500.02 drams	30,740 bel. rubles	1.3040 laris	75.55 tenge	17.3750 soms	4.661 leis	5,960.0 rubles	747.0 taj. rubles	4,165.0 manats	1.90 hrivnas
No. of registered commercial banks											
— as of January 1, 1997	136	33	38	61	101	18	21	2576	22	68	230
— as of January 1, 1998	99	30	36	53	82	20	21	2526	26	67	227

\* Credit auction rate.

\*\* After mid-December 1996 when the National Bank of the Republic of Kirghizia suspended credit auctions, its discount rate was the rate on 3-month government securities.

Table 13

## KEY WORLD ECONOMY INDICATORS (% growth from previous year)

		1996	1997*
<b>World GDP</b>		<b>4.1</b>	<b>4.1</b>
Industrialised nations		2.7	3
Group Seven		2.5	2.8
United States		2.8	3.8
Japan		3.9	0.9
Germany		1.4	2.2
France		1.5	2.4
Italy		0.7	1.5
Great Britain		2.2	3.3
Canada		1.2	3.8
Other industrialised countries		3.8	4
EU		1.7	2.6
Developing countries		6.6	5.8
Asia		8.3	6.7
Africa		5.5	3.2
Middle and Near East		4.9	4.4
Latin America		3.5	5
Transitional-economy countries		-0.1	1.7
Central and Eastern Europe		1.5	2.7
Excepting Belarus and Ukraine		3.6	3.1
Russia		-2.8	0.4
Caucasus and Central Asia		1.5	2.2
<b>World trade in goods and services</b>		<b>6.6</b>	<b>9.4</b>
Imports	Industrialised countries	6.4	8.6
	Developing countries	9.3	12.1
	Transitional-economy countries	7.6	5.4
Exports	Industrialised countries	5.9	9.8
	Developing countries	8.7	10.8
	Transitional-economy countries	4.9	3.5
<b>World Market Prices for raw materials and fuel</b>			
Oil	SDRs	24.3	-0.9
	US\$	18.9	-6
Raw materials	SDRs	3.1	1.6
	US\$	-1.3	-3.7
Consumer goods	Industrialised countries	2.4	2.1
	Developing countries	13.7	8.5
	Transitional-economy countries	41.4	27.8
LIBOR rate on 6-month deposits	US\$	5.6	5.9
	Japanese yen	0.7	0.7
	D-Mark	3.3	3.4

\* Estimate.

Table 14

## RUSSIA'S BALANCE OF PAYMENTS. ANALYTICAL PRESENTATION (US\$ million)

	Q1	Q2	Q3	Q4	1997
<b>CURRENT ACCOUNT</b>	<b>3,798</b>	<b>6</b>	<b>—990</b>	<b>528</b>	<b>3,342</b>
Trade balance	6,018	3,507	3,423	4,377	17,325
<i>Exports</i>	<i>21,154</i>	<i>20,654</i>	<i>21,715</i>	<i>25,153</i>	<i>88,676</i>
<i>Imports</i>	<i>—15,136</i>	<i>—17,147</i>	<i>—18,292</i>	<i>—20,775</i>	<i>—71,351</i>
Balance of services	—1,030	—1,155	—1,513	—1,500	—5,198
Exports	2,760	3,314	4,077	3,367	13,519
Imports	—3,791	—4,469	—5,591	—4,867	—18,717
Balance on wages and salaries	—70	—77	—103	—93	—342
Balance on investment income (interest and dividend)	—1,118	—2,151	—2,701	—2,111	—8,082
<i>Receivable from nonresidents,</i>	<i>2,390</i>	<i>592</i>	<i>549</i>	<i>527</i>	<i>4,059</i>
of which due to government sector	2,145	339	156	131	2,772
<i>Payable to nonresidents,</i>	<i>—3,508</i>	<i>—2,743</i>	<i>—3,250</i>	<i>—2,639</i>	<i>—12,140</i>
of which by government sector	—2,435	—2,445	—2,740	—2,139	—9,759
Balance on current transfers	—1	—118	—96	—146	—362
<b>CAPITAL AND FINANCIAL ACCOUNT</b>	<b>201</b>	<b>9,975</b>	<b>486</b>	<b>—4,915</b>	<b>5,746</b>
<b>Capital account (capital transfers)</b>	<b>—114</b>	<b>—317</b>	<b>—186</b>	<b>—179</b>	<b>—797</b>
<b>Financial account (except reserve assets)*</b>	<b>315</b>	<b>10,292</b>	<b>672</b>	<b>—4,737</b>	<b>6,543</b>
<b>Liabilities (— decline, + growth)</b>	<b>7,201</b>	<b>17,240</b>	<b>11,649</b>	<b>7,158</b>	<b>43,247</b>
<i>Government sector operations</i>	<i>6,664</i>	<i>9,030</i>	<i>3,679</i>	<i>491</i>	<i>19,864</i>
Portfolio investments	5,335	7,853	1,708	28,788	43,684
<i>Ruble-denominated securities (GKO — OFZ)</i>	<i>4,013</i>	<i>4,789</i>	<i>1,859</i>	<i>220</i>	<i>10,882</i>
<i>Foreign currency-denominated securities</i>	<i>1,322</i>	<i>3,063</i>	<i>—151</i>	<i>28,569</i>	<i>32,803</i>
federal eurobonds	1,210	1,984	0	415	3,608
local government bonds	0	798	0	100	898
bonds issued under agreement with London club	0	0	0	28,000	28,000
Finance Ministry's internal government foreign currency loan bonds	112	282	—151	54	297



End

	Q1	Q2	Q3	Q4	1997
Credits and loans	1,385	2,129	1,939	-27,285	-21,831
<i>Not overdue</i>	535	1,149	935	215	2,836
used	1,254	2,311	1,552	2,415	7,531
<i>Overdue</i>	850	980	1,004	-27,500	-24,666
Other liabilities	-57	-952	32	-1,013	-1,990
<i>Bank operations</i>	368	2,270	3,670	2,341	8,650
<i>Operations by other sectors</i>	168	5,939	4,300	4,325	14,733
Direct investments	523	1,644	1,957	2,033	6,156
Portfolio investments	858	1,119	184	343	2,504
Credits and loans	-790	3,149	2,038	1,740	6,137
Trade credits and advances	-423	28	120	211	-64
Other liabilities	0	0	0	0	0
<b>Assets, except reserve assets (+ decline, — growth)</b>	<b>-6,885</b>	<b>-6,948</b>	<b>-10,977</b>	<b>-11,894</b>	<b>-36,704</b>
<i>Government sector operations</i>	-1,749	332	-731	1,345	-803
Credits and loans	-1,900	60	287	210	-1,342
<i>Not overdue</i>	2,067	2,795	1,304	1,357	7,522
<i>Overdue</i>	-3,967	-2,735	-1,017	-1,147	-8,865
Other assets	150	272	-1,018	1,135	540
<i>Bank operations</i>	1,706	-1,190	-841	-388	-714
<i>Operations by other sectors</i>	-6,842	-6,090	-9,404	-12,852	-35,188
Direct and portfolio investments	-579	-763	-641	-492	-2,475
Foreign cash	-2,481	-1,336	-3,647	-5,917	-13,381
Trade credits and advances	-861	-910	-1,653	-3,526	-6,950
Non-receipt of export earnings	-1,307	-1,595	-859	-830	-4,590
Non-delivery of goods and services in repayment of import advances	-1,512	-1,437	-1,916	-2,006	-6,870
Other assets	-103	-49	-689	-81	-922
<b>NET ERRORS AND OMISSIONS</b>	<b>-2,668</b>	<b>-1,946</b>	<b>-1,112</b>	<b>-1,547</b>	<b>-7,273</b>
<b>CHANGE OF FOREIGN EXCHANGE RESERVES (+ decline, — growth)</b>	<b>-1,331</b>	<b>-8,034</b>	<b>1,616</b>	<b>5,934</b>	<b>-1,815</b>

\* Without taking into account operations to offset assets and liabilities of the former USSR, which are not balanced.

Table 15

**NONRESIDENT INVESTMENT IN GKO — OFZ MARKET  
USING STANDARD S-TYPE ACCOUNT MECHANISM (US\$ bn)**

	1996	1997				
		Q1	Q2	Q3	Q4	Total
1. Net nonresident capital inflow	5.9	4	4.8	1.9	0.2	10.9
2. Imputed income	0.6	0.7	0.9	0.9	0.9	3.4

Table 16

**FOREIGN CASH FLOW BALANCE IN 1996 — 1997 (US\$ bn)**

	1997					Reference: 1996
	Q1	Q2	Q3	Q4	Total	
1. Brought into the country, total	9.2	8.5	11.6	14	43.2	39.1
— by banking system	8.3	7.3	10	12.8	38.3	34.1
— by immigrants	0.2	0.2	0.2	0.3	0.9	1.2
— by tourists	0.5	0.7	1.2	0.6	3.1	3
— by unregistered traders	0.2	0.2	0.2	0.2	0.8	0.7
2. Taken out of the country, total	6.5	7.2	7.9	8.1	29.7	30.1
— by banking system	0.2	0.2	0.2	0.2	0.8	0.4
— by emigrants	0.1	0.3	0.2	0.2	0.9	1.2
— by tourists	1.5	1.7	2.5	1.7	7.3	7.5
— by unregistered traders	3.9	4.2	4.1	5	17.2	17.6
— other	0.7	0.8	1	1	3.6	3.4
3. Growth in foreign cash kept by residents, total	2.7	1.3	3.7	5.8	13.5	9
— banking sector	0.2	-0.1	0	-0.1	0.1	0
— non-financial sector and households	2.5	1.3	3.6	5.9	13.4	9

Table 17

## ANALYTICAL INDICATORS OF RUSSIA'S FOREIGN GOVERNMENT DEBT SERVICING IN 1996 — 1997 (US\$ bn)

Indicator	1997					Reference: 1996
	Q1	Q2	Q3	Q4	Total	
1. Foreign debt payment schedule	3.7	2.9	3.2	3.7	13.6	18.7
2. Actual foreign debt repayment	1.6	1.6	1.7	2.7	7.5	7.7
3. Gross Domestic Product*	107	108.7	120.6	125.6	461.9	438.4
4. Foreign debt payments as % of GDP						
— by schedule (line 1 to line 3)	3.5	2.7	2.7	3.0	2.9	4.3
— actually (line 2 to line 3)	1.5	1.5	1.4	2.1	1.6	1.8
5. Consolidated budget revenues	19.9	27.4	29.8	41.4	118.5	106.7
6. Foreign debt payments as % of consolidated budget revenues						
— by schedule (line 1 to line 5)	18.8	10.7	10.8	9.0	11.5	17.6
— actually (line 2 to line 5)	7.9	6.0	5.6	6.5	6.4	7.2
7. Export of goods and non-factor services	23.9	24	25.8	28.5	102.2	103.5
8. Foreign debt-servicing ratio, % (line 1 to line 7)	15.7	12.2	12.5	13.1	13.3	18.1
9. Actual foreign debt-servicing ratio, % (line 2 to line 7)	6.6	6.8	6.4	9.4	7.4	7.5

\* In current prices.

Table 18

## INTERNATIONAL CONSOLIDATED INVESTMENT POSITION OF RUSSIAN COMMERCIAL BANKS AS OF JANUARY 1, 1997, AND JANUARY 1, 1998\* (US\$ mln)

Indicator	Balance as of January 1, 1997	Change from operations	Change from revaluation	Other changes	Total changes (2+3+4)	Balance as of January 1, 1998 (1+5)
A	1	2	3	4	5	6
<b>A. ASSETS</b>	<b>10,155</b>	<b>1,181</b>	<b>-202</b>	<b>0</b>	<b>978</b>	<b>11,133</b>
<b>Direct investments abroad</b>	<b>288</b>	<b>8</b>	<b>-10</b>	<b>0</b>	<b>-2</b>	<b>286</b>
<b>Portfolio investments</b>	<b>849</b>	<b>532</b>	<b>-12</b>	<b>0</b>	<b>520</b>	<b>1,369</b>
<b>Other investments</b>	<b>9,017</b>	<b>640</b>	<b>-180</b>	<b>0</b>	<b>460</b>	<b>9,478</b>
<i>Foreign cash and deposits</i>	<i>6,667</i>	<i>-954</i>	<i>-107</i>	<i>0</i>	<i>-1,061</i>	<i>5,605</i>
Foreign cash in vaults	608	109	-10	0	99	707
Current accounts and deposits	6,059	-1,063	-98	0	-1,161	4,898
<i>hard currency</i>	<i>5,937</i>	<i>-1,092</i>	<i>-89</i>	<i>0</i>	<i>-1,181</i>	<i>4,756</i>
long-term	47	16	-2	0	13	60
short-term	5,890	-1,108	-86	0	-1,194	4,696
<i>partially convertible currency</i>	<i>122</i>	<i>29</i>	<i>-9</i>	<i>0</i>	<i>20</i>	<i>142</i>
long-term	0	0	0	0	0	0
short-term	122	29	-9	0	20	142
<i>Credits and loans</i>	<i>1,138</i>	<i>2,226</i>	<i>-26</i>	<i>0</i>	<i>2,201</i>	<i>3,338</i>
long-term	220	555	-4	0	551	771
short-term	918	1,671	-22	0	1,650	2,568
<i>Overdue debt</i>	<i>42</i>	<i>-20</i>	<i>-3</i>	<i>0</i>	<i>-23</i>	<i>19</i>
<i>Other assets</i>	<i>1,171</i>	<i>-612</i>	<i>-44</i>	<i>0</i>	<i>-656</i>	<i>515</i>
<i>hard currency</i>	<i>1,118</i>	<i>-703</i>	<i>-34</i>	<i>0</i>	<i>-737</i>	<i>381</i>
long-term	16	9	-22	0	-13	3
short-term	1,102	-712	-12	0	-549	379
<i>partially convertible currency**</i>	<i>53</i>	<i>91</i>	<i>-10</i>	<i>0</i>	<i>81</i>	<i>134</i>
long-term	0	0	0	0	0	0
short-term	53	91	-10	0	81	134

End

Indicator	Balance as of January 1, 1997	Change from operations	Change from revaluation	Other changes	Total changes (2+3+4)	Balance as of January 1, 1998 (1+5)
A	1	2	3	4	5	6
<b>B. LIABILITIES</b>	<b>9,205</b>	<b>8,831</b>	<b>-254</b>	<b>375</b>	<b>8,952</b>	<b>18,157</b>
<b>Direct investments in Russia</b>	<b>426</b>	<b>85</b>	<b>-8</b>	<b>414</b>	<b>491</b>	<b>917</b>
<b>Portfolio investments</b>	<b>280</b>	<b>345</b>	<b>-28</b>	<b>0</b>	<b>317</b>	<b>597</b>
<b>Other investments</b>	<b>8,499</b>	<b>8,401</b>	<b>-218</b>	<b>-39</b>	<b>8,144</b>	<b>16,643</b>
<i>Current accounts and deposits</i>	<b>3,957</b>	<b>4,152</b>	<b>-97</b>	<b>0</b>	<b>4,055</b>	<b>8,012</b>
<i>hard currency</i>	<b>3,486</b>	<b>4,065</b>	<b>-58</b>	<b>0</b>	<b>4,007</b>	<b>7,493</b>
long-term	66	77	-1	0	75	141
short-term	3,420	3,989	-57	0	3,932	7,352
<i>partially convertible currency</i>	<b>472</b>	<b>86</b>	<b>-39</b>	<b>0</b>	<b>48</b>	<b>519</b>
long-term	0	0	0	0	0	0
short-term	472	86	-38	0	48	519
<i>Credits and loans</i>	<b>2,744</b>	<b>3,731</b>	<b>-70</b>	<b>0</b>	<b>3,661</b>	<b>6,405</b>
long-term	386	821	-25	0	795	1,181
short-term	2,358	2,910	-45	0	2,865	5,223
<i>Overdue debt</i>	<b>0</b>	<b>3</b>	<b>-3</b>	<b>0</b>	<b>0</b>	<b>0</b>
<i>Other liabilities</i>	<b>1,797</b>	<b>516</b>	<b>-49</b>	<b>-39</b>	<b>429</b>	<b>2,226</b>
<i>hard currency</i>	<b>1,672</b>	<b>171</b>	<b>-36</b>	<b>0</b>	<b>135</b>	<b>1,806</b>
long-term	0	23	0	0	23	24
short-term	1,671	147	-36	0	111	1,783
<i>partially convertible currency**</i>	<b>126</b>	<b>346</b>	<b>-13</b>	<b>-39</b>	<b>294</b>	<b>420</b>
long-term	0	0	0	0	0	0
short-term	126	346	-13	-39	294	420
<b>C. NET INVESTMENT POSITION OF COMMERCIAL BANKS (A—B)</b>	<b>950</b>	<b>-7,651</b>	<b>52</b>	<b>-375</b>	<b>-7,974</b>	<b>-7,024</b>

\* Plus means net growth in assets or liabilities; minus means their net reduction. This specific use of the sign differs from its use in balance of payments statistics.

\*\* Including all financial instruments, except current accounts and deposits.

Table 19

## RUSSIA'S INTERNATIONAL RESERVE DYNAMICS IN 1997 (US\$ mln)

Indicator	Balance as of												
	Jan 1 1997	Feb 1 1997	Mar 1 1997	Apr 1 1997	May 1 1997	Jun 1 1997	Jul 1 1997	Aug 1 1997	Sep 1 1997	Oct 1 1997	Nov 1 1997	Dec 1 1997	Jan 1 1998
<b>Reserve Assets (including Finance Ministry assets)</b>	<b>15,324</b>	<b>13,993</b>	<b>15,208</b>	<b>16,495</b>	<b>18,184</b>	<b>20,016</b>	<b>24,549</b>	<b>24,456</b>	<b>23,920</b>	<b>23,105</b>	<b>22,915</b>	<b>16,810</b>	<b>17,784</b>
Monetary gold*	4,047	4,064	4,081	4,066	4,117	4,132	4,153	4,270	4,316	4,368	4,468	4,609	4,889
Special Drawing Rights	5	4	9	1	1	85	5	5	0	3	3	1	122
Reserve position in IMF	1	1	1	1	1	1	1	1	1	1	1	1	1
Other foreign exchange assets	11,271	9,924	11,117	12,427	14,066	15,798	20,389	20,180	19,603	18,733	18,443	12,199	12,771

\* Gold is estimated at \$300 per troy oz.

Table 20

## FINANCE MINISTRY DEBT TO CENTRAL BANK (bn rbs)

	As of Jan 1, 1998
<b>Total</b>	<b>148,195.30</b>
— Debt of farm-sector enterprises and organisations on bank loans, registered as part of Russia's internal government debt in 1991	69.2
— debt securitised as government debt instruments	147,934.67
— internal government debt of former USSR	191.43

Table 21

**MONEY SUPPLY (trn rbs)**

Indicators	Jan 1 1997	Aprl 1 1997	July 1 1997	Oct 1 1997	Jan 1 1998
Money supply (M2), total	295.2	315	363.8	376.2	388.2
— cash in circulation (M0)*	103.8	105.2	136.8	134.8	130.4
— non-cash funds	191.4	209.8	227	241.4	257.8

\* Cash in circulation outside the banking system.

Table 22

**MONEY SUPPLY (M2) STRUCTURE**

Indicators	As of Jan 1, 1997		As of Jan 1, 1998		Growth index for 1997
	trn rbs	%	trn rbs	%	
Money supply (M2), total	295.2	100	388.2	100	1.32
including:					
— cash in circulation*	103.8	35.2	130.4	33.6	1.26
— non-cash funds	191.4	64.8	257.8	66.4	1.35
of which:					
— funds of non-financial organisations	72.2	24.4	112.7	29	1.56
— household deposits	119.3	40.4	145.1	37.4	1.22

\* Cash in circulation outside the banking system.

Table 23

**MONETARY BASE AND ITS STRUCTURE**

	As of Jan 1, 1997		As of Jan 1, 1998		Growth index for 1997
	trn rbs	%	trn rbs	%	
Monetary base	148.7	100	195.9	100	1.32
— cash in circulation including cash balances at credit institutions*	108.6	73	137	70	1.26
— credit institutions' correspondent accounts in Bank of Russia**	17.7	11.9	31.4	16	1.77
— required reserves	22.3	15	27.5	14	1.23

\* Excluding cash in vaults of Bank of Russia institutions.

\*\* Including cash balances in the organised securities market.

Table 24

**BUDGET REVENUES FROM GKO — OFZ ISSUES**

Month	Placement volume	Returns	Redemption	Costs	Net transfers to budget	Net transfers to budget (cumulative)
	billion rubles					
January	41,328.56	35,024.22	29,988.31	31,428.41	3,595.81	3,595.81
February	42,322.69	34,825.23	29,066.91	30,797.22	4,028.01	7,623.82
March	42,995.71	35,787.74	28,517.93	28,893.51	6,894.23	14,518.05
April	44,827.19	37,063.96	34,383.08	35,415.09	1,648.86	16,166.92
May	36,969.52	31,379.32	27,687.56	28,366.14	3,013.18	19,180.09
June	52,959.11	47,759.64	41,876.82	43,605.76	4,153.87	23,333.96
July	48,796.2	43,826.45	38,737.58	39,584.2	4,242.25	27,576.21
August	45,803.92	40,886.39	38,096.81	38,509.43	2,376.96	29,953.17
September	39,357	35,412.27	33,230.69	33,396.14	2,016.13	31,969.3
October	44,723.34	40,082.93	35,486.55	37,747.37	2,335.55	34,304.85
November	32,473.4	29,065.09	27,522.24	28,623.73	441.37	34,746.22
December	29,438.35	25,148.18	24,794.51	25,742.94	—594.77	34,151.45



Table 25

## GKO — OFZ PRIMARY MARKET OPERATIONS IN 1997 (billion rubles)

Month	Auction placements						Redemptions		OFZ-PK coupon payment volumes	OFZ-PD coupon payment volumes	Net transfers to budget from auctions	Net transfers to budget (cumulative)
	GKO		OFZ-PK		OFZ-PD		GKO	OFZ-PK				
	Placement volume at par	Returns	Placement volume at par	Returns	Placement volume at par	Returns	Placement volume	Redemption volume				
January	35,418.93	29,454.78	3,545.45	3,631.47	—	—	29,988.31	0	1,440.11	—	1,657.84	1,657.84
February	40,362.15	33,220.67	0	0	—	—	21,685.44	6,881.48	1,770.3	0	2,883.45	4,541.29
March	34,237.32	27,923.59	1,998.12	2,162.31	—	—	28,517.93	0	375.58	0	1,192.39	5,733.68
April	38,779.35	31,197.62	5,104.16	5,029.23	—	—	34,383.08	0	1,032.01	0	811.75	6,545.43
May	31,105.8	25,736.51	3,647.69	3,579.16	—	—	24,387.84	3,299.72	678.59	0	949.53	7,494.96
June	40,884.24	35,964.95	1,287.44	1,252.71	—	—	34,515.4	0	1,534.67	100	1,067.59	8,562.55
July	28,983.01	24,585.18	7,769.82	7,736.8	1,495.79	1,541.73	28,947.09	3,303.4	854.6	0	758.62	9,321.18
August	34,876.48	30,095.22	2,585.92	2,499.25	1,354.42	1,446.31	32,768.2	0	412.62	0	859.95	10,181.13
September	29,765.75	25,994.9	0	0	4,052	3,788.27	30,582.84	0	165.45	0	—965.11	9,216.02
October	31,655.87	28,243.69	0	0	10,946	9,815.63	35,486.55	0	2,260.82	0	311.95	9,527.96
November	26,483.21	23,813.93	0	0	3,806.25	3,121.56	27,522.24	0	1,101.48	0	—1,688.24	7,839.72
December	28,974.02	24,692.08	0	0	0	0	24,794.51	0	948.43	0	—1,050.86	6,788.87

Table 26

**ADDITIONAL GKO — OFZ SALES AND PRIOR REPURCHASES IN SECONDARY MARKET IN 1997 (billion rubles)**

Month	Additional secondary-market placements						Secondary market repurchases						Net transfers to budget from secondary market	Net transfers to budget (cumulative)
	GKO		OFZ-PK		OFZ-PD		GKO		OFZ-PK		OFZ-PD			
	Placement volume	Returns	Placement volume	Returns	Placement volume	Returns	Redemption volume	Costs	Redemption volume	Costs	Redemption volume	Costs		
January	2,364.17	1,937.97	0	0	—	—	0	0	0	0	—	—	1,937.97	1,937.97
February	1,903.54	1,543.64	57	60.92	—	—	500	460	0	0	—	—	1,144.56	3,082.53
March	5,474.98	4,313.08	1,285.29	1,388.76	—	—	0	0	0	0	—	—	5,701.84	8,784.37
April	419.68	323.94	524	513.17	—	—	0	0	0	0	—	—	837.11	9,621.48
May	854.5	674.23	1,361.53	1,389.42	—	—	0	0	0	0	—	—	2,063.64	11,685.13
June	1,997.28	1,691.92	8,790.14	8,850.06	—	—	0	0	7,361.42	7,455.7	—	—	3,086.28	14,771.41
July	4,312.06	3,693.55	5,694.1	5,708.72	541.41	560.46	300	292.02	6,187.09	6,187.09	0	0	3,483.62	18,255.03
August	1,603.29	1,356.83	4,986.29	5,063.77	397.52	425.02	0	0	5,328.61	5,328.61	0	0	1,517.01	19,772.04
September	305.29	268.2	419.83	406.56	4,814.13	4,954.34	0	0	2,647.86	2,647.86	0	0	2,981.24	22,753.28
October	0	0	45	44.25	2,076.46	1,979.36	0	0	0	0	0	0	2,023.61	24,776.89
November	2,183.94	2,129.6	0	0	0	0	0	0	0	0	0	0	2129.6	26,906.49
December	464.32	456.09	0	0	0	0	0	0	0	0	0	0	456.09	27,362.59

Table 27

## MAIN CHARACTERISTICS OF GKO — OFZ MARKET IN 1997

Month	Volume in circulation at par*	Volume in circulation at market value*	Monthly exchange turnover at par	Monthly exchange money turnover	Monthly over-the-counter turnover at par	Monthly over-the-counter money turnover	Average daily turnover ratio**	Average market portfolio duration***
	billion rubles						%	days
January	248,449	231,605.61	71,562.34	65,251.11	—	—	1.84	145.53
February	262,204.78	244,566.4	71,299.5	65,550.24	—	—	1.74	149.52
March	276,682.56	253,150.96	86,564.26	78,024.99	—	—	2.01	156.53
April	287,126.67	265,590.6	93,044.69	84,965.82	—	—	1.83	163.53
May	296,408.64	278,616.97	82,973.92	76,982.13	—	—	1.89	175.2
June	311,441.76	294,581.36	81,024.41	76,743.79	6.31	6.49	1.67	193.24
July	352,210.38	304,878.44	69,826.01	66,260.5	323.92	314.17	1.22	221.81
August	359,917.48	335,385.17	55,007.76	52,261.29	824.93	782.32	0.92	372.18
September	366,043.79	341,157.74	67,168.72	64,276.52	2,306.66	2,248.93	1.06	382.22
October	375,280.57	344,433.92	86,883.41	81,531.66	4,971.83	4,701.71	1.37	394.81
November	380,231.73	331,182.33	101,276.88	91,839.52	2,691.67	2,547.16	1.84	372.14
December	384,875.56	340,532.75	58,790.5	52,321.91	4,794.21	4,290.23	0.98	343.33

\* Volume in circulation as of last day of month.

\*\* The ratio of daily trade turnover to volume in circulation at par.

\*\*\* Average period to redemption of all GKO and OFZ issues, weighted by volumes in circulation at market value.

Table 28

## MAIN INDICATORS OF GKO MARKET DEVELOPMENT IN 1997\*

Month	GKO volume in circulation		GKO market portfolio index** (monthly average)				GKO Turnover Index*** (monthly average)				% share of GKO in circulation**** (monthly average)	% share of GKO in turnover***** (monthly average)	Average GKO market portfolio duration, days
	at par	at market value	simple		effective		simple		effective				
			on tax-exempt issues	on taxable issues	on tax-exempt issues	on taxable issues	on tax-exempt issues	on taxable issues	on tax-exempt issues	on taxable issues			
	billion rubles		% p.a.										
January	211,377.89	193,008.67	32.11	—	34.99	—	32.8	—	35.29	—	85.7	86.87	114.32
February	231,458.15	212,489.46	27.13	30.9	29.31	32.33	27.31	30.9	29.35	32.3	85.77	87.06	120.06
March	242,652.52	217,514.89	29.58	32.95	32.5	35.13	29.53	33.15	32.22	34.95	88.09	93.54	126.36
April	247,468.47	224,102.25	28.32	32.86	31.17	—	28.21	33.02	30.99	34.53	87.03	89.4	130.72
May	255,040.94	234,888.29	21.3	26.74	23.01	27.87	21.17	27.46	22.89	28.19	85.86	84.14	137.99
June	263,407.06	244,301.38	16.97	20.12	18.13	20.8	17.01	20.51	18.21	20.96	85.16	82.63	143.79
July	267,455.04	248,711.91	15.18	18.24	16.18	18.77	15.23	18.55	16.25	18.9	83.38	79.93	151.46
August	271,166.61	250,808.65	15.24	18.32	16.32	18.85	15.25	18.51	16.35	18.85	75.64	79.39	159.41
September	270,654.81	249,333.5	16.34	18.28	17.7	18.81	16.56	18.27	17.96	18.69	74.69	75.61	170.16
October	266,824.13	244,942.9	15.41	18.24	16.68	18.83	15.41	18.15	16.68	18.7	72.4	65.67	171.41
November	267,969.04	238,608.96	—	25.11	—	26.36	—	24.77	—	25.84	70.49	74.07	160.32
December	272,612.87	245,669.76	—	31.88	—	34.23	—	31.95	—	34.31	70.62	79.81	147.53

\* After January 21, 1997, when the procedure for taxing government securities was changed, average yield was calculated separately for two groups of papers: papers issued before January 21 and tax exempt, and papers issued after January 21.

The last tax-exempt GKO issue made before January 21, 1997, was redeemed on October 8, 1997.

\*\* Average yield weighted by maturity prior to redemption and by volume in circulation at market value.

\*\*\* Average yields weighted by maturity prior to redemption and by volume of the secondary market.

\*\*\*\* Average share of the volume in circulation is calculated as a monthly average share of GKO in circulation at par value in the aggregate volume of the GKO — OFZ market.

\*\*\*\*\* Average share of the turnover is calculated as an average monthly share of the GKO turnover at market value in the aggregate GKO — OFZ market turnover.

Table 29

## MAIN INDICATORS OF OFZ-PK MARKET DEVELOPMENT IN 1997

Month	OFZ-PK volume in circulation		OFZ-PK market portfolio index* (monthly average)				OFZ-PK Turnover Index** (monthly average)				Share of OFZ-PK in circulation (monthly average)	Share of OFZ-PK in turnover (monthly average)	Monthly duration of OFZ-PK market portfolio, days
	at par	at market value	simple		effective		simple		effective				
			on tax-exempt issues	on taxable issues	on tax-exempt issues	on taxable issues	on tax-exempt issues	on tax-able issues	on tax-exempt issues	on tax-able issues			
billion rubles		% p.a.										%	
January	37,071.11	38,596.93	53.19	—	64.01	—	47.68	—	58.05	—	14.3	13.13	310.08
February	30,246.63	31,541.93	33.89	—	34.3	—	33.06	—	37.6	—	14.19	12.92	304.19
March	33,530.04	35,095.33	37.29	—	39.6	—	36.27	—	42.03	—	11.72	6.44	343.54
April	39,158.2	40,936.98	39.48	41.62	43.59	46.36	40.01	41.63	52.75	46.36	12.79	10.6	347.27
May	40,867.7	43,166.05	29.8	34	29.05	37.49	32.57	34.22	49.33	36.55	13.97	15.74	366.35
June	43,583.87	45,754.52	18.58	26.95	17.67	29.26	19.56	26.79	21.48	28.89	14.12	16.09	424.85
July	47,557.3	49,436.85	17.54	24.29	17.68	26.23	17.68	24.56	18.72	26.56	14.22	16.96	512.19
August	49,800.9	51,644.23	17.72	29.25	17.52	32.31	17.77	30.01	18.94	33.31	13.86	16.12	580.31
September	47,572.87	49,703.01	22.7	39.1	19.73	27.51	21.07	45.51	22.88	55.59	13.29	14.44	575.74
October	47,617.87	47,102.96	23.71	38.72	17.95	22.08	23.63	36.7	26.36	42.22	12.81	10.41	552.63
November	47,617.87	44,226.42	40.16	72.24	22.92	34.8	48.45	62.43	63.17	77.68	12.61	9.15	521.38
December	47,617.87	45,374.82	53.25	77.65	32.94	44.23	76.71	76.85	152.83	102.66	12.46	8.04	491.24

\* Average yield to coupon payment, weighted by maturity prior to coupon payment and by volume in circulation.

\*\* Average yield to coupon payment, weighted by maturity prior to coupon payment and by turnover of the secondary market.

Table 30

## MAIN INDICATORS OF OFZ-PD MARKET DEVELOPMENT IN 1997

Month	OFZ-PD volume in circulation		Effective OFZ-PD market portfolio index* (monthly average)	Effective OFZ-PD turnover index** (monthly average)	% share of OFZ-PD turnover index (monthly average)	% share of OFZ-PD in turnover (monthly average)	Average OFZ-PD market portfolio duration, days
	at par	at market value					
	billion rubles		% p.a.		%		
January	—	—	—	—	—	—	—
February	500	535	24.58	24.58	0.19	0.08	830
March	500	540.74	24.9	24.81	0.19	0.02	811.19
April	500	551.36	24.94	24.87	0.18	0	781.06
May	500	562.63	24.94	24.86	0.17	0.11	748.93
June	4,450.83	4,525.46	19.55	19.34	0.72	1.28	801.61
July	37,198.04	30,862.61	19.57	19.58	2.4	3.11	788.87
August	38,949.97	32,932.28	18	19.5	10.5	4.49	1732.4
September	47,816.11	42,121.22	18.1	18.54	12.02	9.95	1,522.25
October	60,838.57	52,388.06	18.19	18.65	14.79	23.92	1,362.83
November	64,644.82	48,346.95	24.85	25.86	16.89	16.78	1,240.93
December	64,644.82	49,488.17	28.96	29.46	16.92	12.15	1,180.52

\* Average effective maturity to redemption weighted by maturity prior to redemption and by volume in circulation.

\*\* Average effective yield to redemption, weighted by maturity prior to redemption and by turnover of the secondary market.

Table 31

**REPO OPERATIONS IN GKO — OFZ MARKET IN 1997**

Month	Ist REPO session rate (monthly average)	2nd REPO session rate	Ist REPO session volume	2nd REPO session volume
	% p.a.		billion rubles	
January	—	22.5	—	210.33
February	—	22.5	—	151.7
March	—	22	—	880.6
April	—	21.82	—	1,153.19
May	—	21.84	—	942.11
June	—	20.25	—	1,359.99
July	—	19.17	—	1,476.57
August	—	19.29	—	1,320.93
September	16.1	20.18	3,599.29	1,512.27
October	15.69	21	23,429.41	1,608.81
November	19.98	26.16	15,875.89	1,365.05
December	31.84	37.48	12,488.54	2,430.15

Table 32

**FOREIGN CASH OPERATIONS BY RUSSIA'S AUTHORISED BANKS\* (US\$ bn)**

Type of Operation	1997					Reference: 1996
	Q1	Q2	Q3	Q4	Year total	
Total foreign cash received,	26.3	25.2	30.4	33	114.9	106.4
of which:						
— brought to Russia by banks and entered to "cash" account	8.3	7.2	10.1	11.8	37.5	33.8
— bought from resident banks	6.1	5.4	7.4	8.2	27.1	25.4
— bought from private individuals and accepted for conversion**	7.1	8	6.6	5.6	27.3	26.5
— accepted from individuals to be entered to their currency accounts**	1.9	2	2.6	3	9.6	6.4
Total foreign currency spent,	26	25.3	30.4	33.2	114.9	106.6
of which:						
— taken out of Russia by banks and written down from cash account	0.1	0.1	0.1	0.1	0.4	0.3
— sold to resident banks	6.2	5.4	8.5	8.8	29	24.3
— sold to individuals and paid out through conversion**	14.9	15.1	14.4	11.8	56.2	58.6
— paid out to individuals from their currency accounts**	1.9	2	3.8	8.1	15.8	6.6

\* According to data contained in I-N form reports, including foreign cash operations in interbranch turnover.

\*\* Including operations with resident and nonresident individuals.

Table 33

**BALANCE OF FOREIGN CASH OPERATIONS BY PRIVATE INDIVIDUALS (RESIDENT AND NONRESIDENT)  
(US\$ bn)**

Operation	1997					Reference: 1996
	Q1	Q2	Q3	Q4	Year total	
Bought by individuals and received through conversion	14.9	15.1	14.4	11.8	56.2	58.6
Withdrawn by individuals from their currency accounts	1.9	2	3.8	8.1	15.8	6.6
<b>Total</b>	<b>16.8</b>	<b>17.1</b>	<b>18.2</b>	<b>19.9</b>	<b>72</b>	<b>65.2</b>
Sold to individuals and paid out for conversion	7.1	8	6.6	5.6	27.3	26.5
Put by individuals in their currency accounts	1.9	2	2.6	3	9.5	6.4
<b>Total</b>	<b>9</b>	<b>10</b>	<b>9.2</b>	<b>8.6</b>	<b>36.8</b>	<b>32.9</b>
Balance on operations conducted by individuals	7.8	7.1	9	11.3	35.2	32.3

Table 34

**EXCHANGE OFFICES OF RUSSIA'S AUTHORISED BANKS AND THEIR BRANCHES**

	1997					Reference: 1996
	Q1	Q2	Q3	Q4	Year total	
No. of exchange offices operating at end of period under review	11,728	11,688	11,372	11,295	11,295	11,705
No. of exchange offices registered during period under review	991	1,014	1,078	1,136	4,219	5,128
No. of exchange offices closed during period under review	968	1,054	1,394	1,213	4,629	4,470



Table 35

**STRUCTURE OF LICENCES AND PERMITS ISSUED BY BANK OF RUSSIA AND ITS REGIONAL BRANCHES  
TO CONDUCT FOREIGN EXCHANGE OPERATIONS RELATED TO CAPITAL FLOW  
(registered in electronic database as of January 1, 1998)**

	1997		Reference: 1996	
	No. of licences and permits issued	Sum of permitted payments, US\$ bn	No. of licences and permits issued	Sum of permitted payments, US\$ bn
Licences and permits to place funds abroad, total	713	2.93	403	5.42
of which:				
— direct and portfolio investments	106	0.18	125	3.46
— commercial (trade) credits	545	1.73	246	1.7
Licences and permits to attract funds from abroad, total	851	22.72	511	4.09
of which:				
— direct and portfolio investments	429	0.78	12	0.03
— financial credits	343	20.28	169	3.26
Licences and permits providing for capital movement under certain conditions, total	164	4.13	62	1.71
of which:				
— guarantees and sureties	32	3.95	10	1.41

Table 36

**SELECTIVE DATA ON SBERBANK'S HOUSEHOLD DEPOSITS  
AND INVESTMENTS IN GOVERNMENT SECURITIES MARKET**

	Jan 1, 1997	Apr 1, 1997	July 1, 1997	Oct 1, 1997	Jan 1, 1998
Investments in government securities, trillion rubles	83.4	90.2	97.3	97.7	92.7
% share of operating credit institutions	65.3	63.3	61.1	60.1	62.6
Household deposits, trillion rubles	94.9	98.7	104.4	106.9	112.1
% share of operating credit institutions	76.2	75.8	76.3	77.2	79.2

Table 37

**BANKS BY FINANCIAL CONDITTON\***

Financial condition	As of May 1, 1997				As of January 1, 1998			
	No.	%	Assets trn rbs	%	No.	%	Assets trn rbs	%
Banks without any signs of financial problems	475	18.3	134.7	18.7	662	25.9	247.2	29.5
Sberbank			182.5	25.3			188.3	22.5
Banks with few shortcomings in their work	503	19.4	199.1	27.7	458	17.9	274.6	32.8
Banks with serious financial problems	349	13.5	110.1	15.3	165	6.5	28	3.3
Banks in critical financial condition	540	20.8	37.5	5.2	385	15.1	24	2.9
Banks which failed to submit financial reports in full	20	0.8	0.1	0	27	1.1	1.3	0.2
Banks registered but not granted licence	1	0			6	0.2		
Banks whose licence was revoked	706	27.2	56.1	7.8	852	33.3	74.9	8.9
<b>Total</b>	<b>2,594</b>	<b>100</b>	<b>720.1</b>	<b>100</b>	<b>2,555</b>	<b>100</b>	<b>838.3</b>	<b>100</b>

\* Criteria for categorising bank problems are established in Bank of Russia Letter No. 457, dated May 28, 1997.

Table 38

**BANK REHABILITATION ACTIVITY BY BANK OF RUSSIA REGIONAL BRANCHES**

Region	No. of operating credit institutions as of 1.01.98	No. of credit institutions which were requested to submit rehabilitation plans in 1997						No. of credit institutions provided rehabilitation plans in 1997		No. of credit institutions which improved financial condition thanks to implementation of rehabilitation plans
		Total	credit institution with capital inadequacy (N1<2) as of 1.01.98 and a backlog of unpaid settlement documents	credit institutions with capital inadequacy (N<2) as of 1.01.98	credit institutions with a backlog of unpaid settlement documents of more than 90 days	credit institutions with N1>2 as of 1.01.98 and without a backlog of unpaid settlement documents of more than 90 days	credit institutions whose licence was revoked as of 1.01.98	Total	of those requested in 1997	
Altai Territory	17	3	0	1	0	2	0	5	3	1
Amur Region	9	7	1	2	3	0	1	6	6	2
Arkhangelsk Region	9	3	0	0	0	3	0	3	2	2
Astrakhan Region	6	2	0	0	0	2	0	2	2	1
Belgorod Region	9	2	0	0	0	2	0	1	1	0
Bryansk Region	4	1	0	1	0	0	0	1	1	0
Vladimir Region	6	1	0	0	1	0	0	2	0	2
Volograd Region	12	3	1	2	0	0	0	4	3	1
Vologda Region	14	2	0	0	1	1	0	2	2	1
Voronezh Region	4	1	0	0	0	1	0	0	0	0
Moscow	706	123	2	14	4	80	18	109	92	30
St. Petersburg	43	7	0	0	0	7	0	9	6	5
Jewish Autonomous Region	2	1	0	0	1	0	0	0	0	0
Ivanovo Region	6	2	0	0	1	1	0	5	2	2
Irkutsk Region	16	5	0	1	0	3	1	4	4	0
Kabardino-Balkar Republic	7	1	0	1	0	0	0	3	1	3
Kaliningrad Region	15	3	0	0	1	2	0	3	3	1
Kaluga Region	6	3	1	0	0	2	0	1	1	0
Kamchatka Region	7	0	0	0	0	0	0	0	0	0
Karachai-Cherkess Republic	9	3	1	0	0	2	0	3	3	2
Kemerovo Region	18	4	2	0	1	1	0	4	4	2
Kirov Region	4	3	0	0	0	2	1	3	2	0
Kostroma Region	9	6	0	1	5	0	0	5	5	2
Krasnodar Territory	42	12	1	3	6	2	0	11	10	1
Krasnoyarsk Territory	17	1	0	0	0	1	0	6	1	3
Kurgan Region	5	1	0	0	0	1	0	5	1	4
Kursk Region	3	1	0	0	0	1	0	1	1	1
Leningrad Region	5	1	0	0	0	1	0	4	1	3
Lipetsk Region	4	0	0	0	0	0	0	0	0	0
Magadan Region	3	2	0	0	0	2	0	2	2	1

Cont.

Region	No. of operating credit institutions as of 1.01.98	No. of credit institutions which were requested to submit rehabilitation plans in 1997							No. of credit institutions provided rehabilitation plans in 1997		No. of credit institutions which improved financial condition thanks to implementation of rehabilitation plans
		Total	credit institution with capital inadequacy (NI<2) as of 1.01.98 and a backlog of unpaid settlement documents	credit institutions with capital inadequacy (N<2) as of 1.01.98	credit institutions with a backlog of unpaid settlement documents of more than 90 days	credit institutions with NI>2 as of 1.01.98 and without a backlog of unpaid settlement documents of more than 90 days	credit institutions whose licence was revoked as of 1.01.98	Total	of those requested in 1997		
Moscow Region	41	7	1	2	1	3	0	6	6	1	
Murmansk Region	5	0	0	0	0	0	0	0	0	0	
Nizhni Novgorod Region	26	4	0	1	2	1	0	7	4	4	
Novgorod Region	4	1	0	0	0	1	0	1	1	0	
Novosibirsk Region	17	2	0	0	0	1	1	3	2	1	
Omsk Region	13	7	0	0	3	1	3	7	7	0	
Orenburg Region	15	0	0	0	0	0	0	7	0	5	
Orel Region	3	0	0	0	0	0	0	1	0	0	
Penza Region	5	2	0	0	0	2	0	2	2	0	
Perm Region	15	1	0	1	0	0	0	1	1	1	
Primorski Territory	16	7	1	2	3	1	0	7	7	0	
Pskov Region	6	0	0	0	0	0	0	0	0	0	
Republic Adygeia	7	4	0	0	2	2	0	4	4	1	
Republic Altai	7	4	0	1	0	3	0	1	1	0	
Republic Bashkortostan	19	6	0	0	0	6	0	6	6	1	
Republic Buryatia	10	7	0	2	1	4	0	7	7	0	
Republic Daghestan	63	10	1	3	2	4	0	0	0	0	
Ingush Republic	4	1	1	0	0	0	0	1	1	0	
Republic Kalmykia	8	3	2	1	0	0	0	3	1	1	
Republic Karelia	2	3	0	0	1	1	1	2	2	0	
Republic Komi	10	3	1	0	1	1	0	1	1	1	
Republic of Marii El	1	2	0	0	0	0	2	2	2	0	
Republic Mordovia	9	1	0	0	1	0	0	1	1	0	
Republic of Sakha (Yakutia)	22	11	0	6	2	3	0	9	9	4	
Republic of North Ossetia — Alania	8	3	0	0	0	3	0	3	3	2	
Republic Tatarstan	29	1	0	1	0	0	0	11	1	9	
Republic Tuva	3	0	0	0	0	0	0	1	0	1	
Republic Khakasia	2	0	0	0	0	0	0	0	0	0	
Rostov Region	32	8	0	4	2	2	0	9	8	6	
Ryazan Region	8	2	0	0	1	1	0	2	2	2	
Samara Region	24	10	0	2	0	4	4	8	8	2	
Saratov Region	25	5	1	0	0	4	0	7	4	3	
Sakhalin Region	7	3	1	1	0	1	0	5	3	2	
Sverdlovsk Region	35	3	0	0	0	3	0	7	3	5	
Smolensk Region	4	0	0	0	0	0	0	0	0	0	

End

Region	No. of operating credit institutions as of 1.01.98	No. of credit institutions which were requested to submit rehabilitation plans in 1997						No. of credit institutions provided rehabilitation plans in 1997		No. of credit institutions which improved financial condition thanks to implementation of rehabilitation plans
		Total	credit institution with capital inadequacy (N1<2) as of 1.01.98 and a backlog of unpaid settlement documents	credit institutions with capital inadequacy (N<2) as of 1.01.98	credit institutions with a backlog of unpaid settlement documents of more than 90 days	credit institutions with N1>2 as of 1.01.98 and without a backlog of unpaid settlement documents of more than 90 days	credit institutions whose licence was revoked as of 1.01.98	Total	of those requested in 1997	
Stavropol Territory	19	10	2	0	1	3	4	9	9	1
Tambov Region	2	0	0	0	0	0	0	1	0	0
Tver Region	11	6	0	0	1	5	0	7	6	2
Tomsk Region	12	5	0	1	4	0	0	5	5	1
Tula Region	11	2	0	0	0	2	0	3	2	2
Tyumen Region	41	17	1	1	0	12	3	18	14	8
Udmurt Republic	17	4	0	3	0	1	0	7	4	3
Ulyanovsk Region	11	4	0	1	1	2	0	4	4	0
Khabarovsk Territory	10	3	0	0	0	3	0	3	3	0
Chelyabinsk Region	13	3	0	1	1	1	0	3	3	2
Chita Region	6	0	0	0	0	0	0	3	0	0
Chuvash Republic	11	7	0	1	1	5	0	7	7	6
Yaroslavl Region	11	0	0	0	0	0	0	2	0	2
<b>Total</b>	<b>1,697</b>	<b>386</b>	<b>21</b>	<b>61</b>	<b>55</b>	<b>205</b>	<b>39</b>	<b>408</b>	<b>313</b>	<b>149</b>

Table 39

## CONTROL OVER LIQUIDATION OF CREDIT INSTITUTIONS STRIPPED OF LICENCE

Region	Licences revoked		Entries on expulsion made in State Register		To be liquidated	of which:								No. of credit institutions whose licence should be revoked as of 1.01.98 as per Bank of Russia Letter No. 517 of September 10, 1997
						decisions on liquidation made		liquidation commissions set up (administrative receivers appointed)		liquidation balance sheets approved				
	total*	1997*	total	1997	total	1997**	total	1997	intermediate		final			
										total	1997	total	1997	
Altai Territory	10	2	0	0	10	10	4	9	6	2	2	0	0	3
Amur Region	2	1	1	0	1	0	0	0	0	0	0	0	0	8
Arkhangelsk Region	5	2	1	0	4	3	1	3	1	2	2	0	0	1
Astrakhan Region	7	3	0	0	7	6	3	5	4	2	2	0	0	0
Belgorod Region	2	0	0	0	2	2	0	2	0	1	1	0	0	0
Bryansk Region	6	3	2	1	4	3	2	3	2	1	0	0	0	1
Vladimir Region	1	0	0	0	1	1	1	1	1	0	0	0	0	3
Volgograd Region	16	4	2	0	14	14	5	12	9	3	3	0	0	4
Vologda Region	6	1	1	1	5	5	1	4	1	4	1	2	2	1
Voronezh Region	3	1	1	1	2	2	0	2	0	2	2	1	1	0
Moscow	282	106	7	3	275	166	119	68	44	7	6	4	4	34
St. Petersburg	15	2	1	1	14	13	5	13	8	4	3	1	1	0
Jewish Autonomous Region	2	2	0	0	2	2	2	1	1	0	0	0	0	1
Ivanovo Region	3	3	0	0	3	2	2	2	2	0	0	0	0	2
Irkutsk Region	7	2	0	0	7	5	2	4	2	2	2	0	0	1
Kabardino-Balkar Republic	5	3	0	0	5	3	1	3	1	2	0	0	0	2
Kaliningrad Region	14	8	0	0	14	11	8	8	7	2	2	1	1	1
Kaluga Region	8	1	0	0	8	7	1	6	1	2	0	0	0	1
Kamchatka Region	5	0	1	1	4	3	0	3	0	3	2	0	0	0
Karachai-Cherkess Republic	5	0	2	2	3	3	3	2	2	0	0	1	1	1
Kemerovo Region	6	2	0	0	6	5	4	4	3	2	2	0	0	3

Cont.

Region	Licences revoked		Entries on expulsion made in State Register		To be liquidated	of which:								No. of credit institutions whose licence should be revoked as of 1.01.98 as per Bank of Russia Letter No. 517 of September 10, 1997
						decisions on liquidation made		liquidation commissions set up (administrative receivers appointed)		liquidation balance sheets approved				
	total*	1997*	total	1997	total	total	1997**	total	1997	intermediate		final		
										total	1997	total	1997	
Kirov Region	7	5	0	0	7	6	4	6	4	4	2	0	0	0
Kostroma Region	4	1	0	0	4	3	0	3	0	3	0	0	0	5
Krasnodar Territory	31	8	5	3	26	24	12	23	15	12	8	1	1	12
Krasnoyarsk Territory	12	3	0	0	12	11	9	8	6	2	2	0	0	2
Kurgan Region	3	1	1	1	2	1	0	1	0	1	1	0	0	3
Kursk Region	3	0	0	0	3	3	0	3	3	0	0	0	0	0
Leningrad Region	3	1	0	0	3	3	2	3	2	1	1	0	0	0
Lipetsk Region	4	1	1	0	3	2	1	1	0	1	1	0	0	0
Magadan Region	5	2	2	1	3	3	2	2	1	0	0	0	0	0
Moscow Region	10	2	2	0	8	4	1	4	2	3	3	0	0	4
Murmansk Region	7	2	0	0	7	7	3	5	3	2	1	0	0	0
Nizhni Novgorod Region	5	2	0	0	5	5	3	5	4	2	2	0	0	7
Novgorod Region	1	0	0	0	1	1	1	1	1	0	0	0	0	0
Novosibirsk Region	20	6	0	0	20	18	5	11	7	2	2	0	0	0
Omsk Region	5	3	0	0	5	2	1	2	2	1	1	0	0	3
Orenburg Region	11	6	2	1	9	9	6	8	7	7	5	0	0	2
Orel Region	0	0	0	0	0	0	0	0	0	0	0	0	0	1
Penza Region	3	0	1	1	2	2	0	2	0	2	1	0	0	0
Perm Region	6	5	0	0	6	4	3	4	3	1	1	0	0	1
Primorski Territory	7	5	0	0	7	6	4	5	3	2	2	0	0	7
Pskov Region	5	2	1	1	4	4	2	4	2	3	2	0	0	0
Republic Adygeia	5	4	0	0	5	3	2	3	2	1	1	0	0	2
Republic Altai	6	1	0	0	6	5	2	5	4	2	1	0	0	1
Republic Bashkortostan	13	2	0	0	13	12	3	11	8	5	5	2	2	1
Republic Buryatia	1	1	0	0	1	1	1	1	1	0	0	0	0	3
Republic Daghestan	43	15	0	0	43	25	13	9	1	0	0	0	0	15

Cont.

Region	Licences revoked		Entries on expulsion made in State Register		To be liquidated	of which:								No. of credit institutions whose licence should be revoked as of 1.01.98 as per Bank of Russia Letter No. 517 of September 10, 1997	
						decisions on liquidation made		liquidation commissions set up (administrative receivers appointed)		liquidation balance sheets approved					
	total*	1997*	total	1997	total	total	1997**	total	1997	intermediate		final			
										total	1997	total	1997		
Ingush Republic	1	0	0	0	1	1	0	0	0	0	0	0	0	0	1
Republic Kalmykia	5	0	0	0	5	5	0	5	0	5	0	1	1	4	
Republic Karelia	4	2	1	1	3	2	1	2	1	1	1	1	1	0	
Republic Komi	6	2	2	1	4	3	2	3	2	3	2	0	0	1	
Republic of Marii El	9	2	1	0	8	8	5	8	6	5	0	0	0	0	
Republic Mordovia	2	0	0	0	2	2	0	2	0	1	0	0	0	1	
Republic of Sakha (Yakutia)	7	6	0	0	7	6	5	5	5	1	1	0	0	10	
Republic of North Ossetia — Alania	3	2	0	0	3	2	1	2	1	1	1	0	0	0	
Republic Tatarstan	13	4	4	3	9	5	1	5	2	2	1	0	0	5	
Republic Tuva	1	0	0	0	1	0	0	0	0	0	0	0	0	0	
Republic Khakasia	3	1	0	0	3	3	1	3	1	2	2	0	0	0	
Rostov Region	23	5	7	4	16	14	5	13	8	5	1	3	3	7	
Ryazan Region	2	1	0	0	2	1	0	1	0	1	1	0	0	1	
Samara Region	16	5	1	0	15	13	3	12	2	10	2	0	0	2	
Saratov Region	11	5	0	0	11	9	6	9	7	2	2	1	1	2	
Sakhalin Region	16	7	2	0	14	13	10	13	12	7	6	0	0	3	
Sverdlovsk Region	21	7	1	0	19	19	9	14	6	6	3	2	2	4	
Smolensk Region	7	2	0	0	7	7	1	7	2	6	3	1	1	0	
Stavropol Territory	16	5	1	0	15	11	8	10	8	1	1	0	0	4	
Tambov Region	3	1	0	0	3	3	1	1	0	1	0	1	1	0	
Tver Region	10	3	2	1	7	7	5	5	3	2	1	0	0	2	
Tomsk Region	7	1	3	0	4	3	1	3	1	1	0	0	0	5	
Tula Region	2	0	0	0	2	2	0	2	0	0	0	0	0	1	
Tyumen Region	26	11	2	1	24	18	8	9	5	5	2	0	0	2	
Udmurt Republic	6	0	1	1	5	5	1	5	3	3	2	0	0	3	



Region	Licences revoked		Entries on expulsion made in State Register		To be liquidated	of which:								No. of credit institutions whose licence should be revoked as of 1.01.98 as per Bank of Russia Letter No. 517 of September 10, 1997
						decisions on liquidation made		liquidation commissions set up (administrative receivers appointed)		liquidation balance sheets approved				
	total*	1997*	total	1997	total	total	1997**	total	1997	intermediate		final		
										total	1997	total	1997	
Ulyanovsk Region	8	3	0	0	8	8	4	7	5	4	2	0	0	2
Khabarovsk Territory	11	8	1	1	10	8	6	8	6	2	0	0	0	1
Central Operations Division	32	6	1	1	31	26	10	15	15	0	0	0	0	0
Chelyabinsk Region	7	2	1	0	6	6	3	6	3	3	2	1	1	2
Chechen Republic	18	11	18	18	0	0	0	0	0	0	0	0	0	0
Chita Region	4	3	1	1	3	3	3	2	2	1	1	0	0	2
Chuvash Republic	5	4	0	0	5	3	3	4	3	1	0	0	0	2
Yaroslavl Region	4	1	1	1	3	3	2	2	1	2	2	0	0	1
<b>Total</b>	<b>939</b>	<b>334</b>	<b>85</b>	<b>52</b>	<b>852</b>	<b>649</b>	<b>349</b>	<b>468</b>	<b>286</b>	<b>182</b>	<b>111</b>	<b>24</b>	<b>24</b>	<b>204</b>

\* Data on the number of credit institutions whose licence was revoked include the joint-stock commercial banks Tveruniversbank and Malakhit, on which licence revocation orders have been suspended.

\*\* These only include liquidation decisions made in 1997 with regard to credit institutions on which no such decisions were made earlier.

Table 40

## NOTE STRUCTURE OF BANK OF RUSSIA BANKNOTES IN CIRCULATION

Banknote denomination, rubles	Total circulation, billion rubles		As % of Jan 1, 1997	% share	
	Jan 1, 1997	Jan 1, 1998		Jan 1, 1997	Jan 1, 1998
500,000	—	20,892.9	—	—	15.3
100,000	61,815	71,228.9	115.2	56.5	52
50,000	35,633.8	34,028.2	95.5	32.6	24.9
10,000	7,830.9	6,788	86.7	7.1	5
5,000	2,615.4	2,653.2	101.4	2.4	1.9
1,000	873	832.9	95.4	0.8	0.6
500	434.1	316.9	73	0.4	0.2
200	74.1	50	67.5	0.1	0
100	108.5	117.4	108.2	0.1	0.1
<b>Total banknotes in circulation</b>	<b>109,384.8</b>	<b>136,908.4</b>	<b>125.2</b>	<b>100</b>	<b>100</b>

Table 41

## QUALIFICATION AND OTHER CHARACTERISTICS OF BANK OF RUSSIA PERSONEL

Characteristics	Bank of Russia		of which:					
			Regional Branches (National Banks)		Cash Settlement Centres		Central Apparatus	
	1996	1997	1996	1997	1996	1997	1996	1997
Staffing Levels	94	95.5	93.2	94.5	98.5	98.4	84.6	87.1
Specialists with higher and special secondary education	88.6	90.8	92.7	94.2	85.4	87.9	89.9	91.4
Specialists with higher education	50.8	54.1	70.7	73.3	31	33.6	79.8	82
Employees with up to 3-year work record	30.6	24.8	39.7	30.1	16	10.9	42.1	30.9
Employees with work records of 10 years and more	29.3	29	27.4	25.7	35	36.4	22.4	23.7
Employees under 30	25.4	23.8	22.1	21.7	30.1	27.5	24.8	24.2
Employees of pension age	4.2	4.1	4.3	4.1	3.9	3.5	5.8	6.4
Discharge rate	2.9	2.8	2.6	2.5	2.7	2.8	6.2	4.2
Quit on their own	2.3	2.1	2.1	2	2.3	1.9	3.6	3

Table 42

**BANK OF RUSSIA STAKES IN AUTHORISED CAPITAL OF RUSSIAN BANKS AND OTHER FINANCIAL INSTITUTIONS  
(mln rbs)**

Name of institution	As of 1.01.97	As of 1.01.98		
	Sum of Bank of Russia shares (stakes) at par	Sum of Bank of Russia shares (stakes) at par	% share of Bank of Russia interest in authorised capital	% share of Bank of Russia interest in voting stock
Sberbank	382,500.05	382,500.05	54.64	58.84
Vneshtorgbank	572,257.00	617,403.00	96.89	97.04
CIS Interstate Bank	2,500.00	2,500.00	50	50
Non-profit Partnership National Depository Centre		7,750.00	53.4	53.4
MICEX	1,286.00	3,858.00	7.06	7.06
Roseximbank	23,000.00	0		
Vneshekonombank	200	0		
Sovfintrade	0.85	0		

Table 43

**BANK OF RUSSIA STAKES IN AUTHORISED CAPITAL OF OVERSEAS BANKS AS OF JANUARY 1, 1998**

Bank	Currency	Sum of Bank of Russia voting shares (stakes) as of Jan 1, 1997	Sum of Bank of Russia voting shares (stakes) as of Jan. 1, 1998	Bank of Russia % share in authorised capital as of Jan 1, 1998	Bank of Russia % share in voting stock as of Jan 1, 1998
Donau-Bank, Vienna	ATS	510,000,000.00	490,000,000.00	49	49
East-West United Bank, Luxembourg	LuxF	605,000,000.00	605,000,000.00	49	49
Ost-West Handelsbank, Frankfurt-am-Main	DM	48,600,000.00	48,600,000.00	48.6	48.6
Eurobanque, Paris*	FrF	945,302,903.65	945,302,903.65	77.8	77.8
Moskovsky Narodny Bank, London**	L	480,309,444.00	480,309,444.00	88.9	88.9
Yurasko (Eurasco) Bank, Zurich	SwF	997,500.00	997,500.00	2.5	2.6

\* By certificate issued by Bank of Russia.

\*\* Excluding the shares of nominal shareholders, taken into account in the Bank of Russia balance sheet.