The Central Bank of the Russian Federation

Guidelines for the Single State Monetary Policy in 2008

Approved by the Bank of Russia Board of Directors on June 18, 2007

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I. Medium-term monetary policy principles

In line with the country's medium-term social and economic development strategy, the Russian Government and the Bank of Russia set an inflation target for a three-year period. The principal monetary policy objective in the next three years is a gradual reduction of inflation to 5-6% in 2010. The target for 2008 is to reduce inflation to 6-7% on a December-on-December basis.

The principles of the single state monetary policy worked out in the previous years will be used in 2008, but in the medium term the macroeconomic conditions of this policy are expected to change and this will require the shifting of emphasis from monetary supply programming to the use of the interest rate and the transition from the managed floating exchange rate regime to free floating.

The changes in external conditions are largely due to uncertainty about the world prices of energy products, Russia's principal export commodities. According to the social and economic development forecast, a fall in energy prices in 2008 and particularly in the next two years may result in a decrease of the trade surplus and a reduction of foreign exchange inflow. High prices of Russian exports in recent years have been the fundamental factor in the choice of the managed floating exchange rate regime, which required the Bank of Russia to conduct massive currency interventions on the domestic forex market to curb the ruble's excessive appreciation. The changes in the terms of trade will reduce the imbalance between demand and supply on the domestic forex market and the need in Bank of Russia interventions. By 2010 growth in foreign exchange reserves may slow down significantly and the expansion of net foreign assets of the monetary authorities may cease to be the main source of money supply growth.

In this context, to ensure that money supply matches money demand, the Bank of Russia will need to step up its bank refinancing operations. This will also help increase the monetary policy's impact on inflation with the aid of the interest rate.

The change in the principles of compiling the federal budget will be the major internal factor of the monetary policy. The main components of the budget strategy are as follows:

- the federal budget planning for a three-year period and passing the corresponding law;
- budget revenue disaggregation into oil and gas revenues and non-oil and gas revenues with an oil and gas revenue transfer allocated to cover federal budget expenditures to transform the Russian Government's Stabilisation Fund into the Reserve Fund and the Future Generation Fund.

The transition to the 'moving' three-year budget horizon will help the government spend budget funds more evenly during the year and make money supply dynamics less dependent on seasonal fluctuations in the movement of budget funds.

The interest rate policy implemented by narrowing the interest rate band in operations to refinance credit institutions and absorb their excess liquidity makes it possible to influence money market rate fluctuations. The Bank of Russia believes that one of the key objectives of its open-market operations is to lessen the volatility of short-term interbank market rates and create a long-term segment of the money market.

At present, the price of money in the economy is influenced by a high level of liquidity, which is due to a massive inflow of foreign currency earnings and Bank of Russia large-scale currency interventions. As the Bank of Russia scales down its interventions on the domestic forex market, interest rates on market bank refinancing instruments, such as repo operations, will increasingly affect the level of money market interest rates. As the refinance rate decreases in pace with the slowing inflation, the real interest rate will stabilise and the inflationary expectations of market participants will become less. At the same time, the level of interest rates in liquidity absorption operations will affect the domestic and world interest rate differential.

To maintain macroeconomic stability the Bank of Russia will continue to use the elements of inflation targeting, attaching priority to reduction of inflation and setting medium-term targets for it. To be able to use full-scale inflation targeting, the Bank of Russia will have to switch to the free floating exchange rate regime and carry out a series of measures that will enable it to use the interest rate as the main monetary policy instrument signalling imminent changes and affecting the monetary conditions in the economy.

One of the key conditions for success in inflation targeting is the ability of a central bank to influence the economic agents' inflationary expectations. Therefore, the Bank of Russia has set a goal to increase transparency of its plans and actions to boost public confidence in its policy. Dissemination of analytical materials and information on economic development, the money market and the banking sector helps the Bank of Russia to make the public understand its goals and activities.

When taking decisions related to the monetary policy, the Bank of Russia will use a wide range of macroeconomic and financial indicators and the monetary aggregates that characterise the current monetary conditions and signal the future inflationary pressure.

The effectiveness of the monetary policy depends on the Bank of Russia capability to manage banking sector liquidity, which, in its turn, is closely linked with the state of the domestic financial market and payment system. The Bank of Russia activities will be aimed at promoting availability of refinancing instruments for credit institutions, reducing transaction costs, upgrading the market infrastructure and building a real-time gross settlement system.

II. Russia's economic development and monetary policy in 2007

II.1. Inflation and economic growth

GDP increased 7.9% in 2007 Q1. Industrial output grew 7.4% in January-May 2007, as compared with the same period a year earlier. The growth was particularly fast in the manufacturing sector. Some services, especially communications and retail trade, also demonstrated rapid increase.

Production growth was accompanied by a significant increase in domestic demand. Growth in real money income led to a rise in consumer spending, which increased in real terms by an estimated 13% in January-April, as compared with the same period in 2006. Fixed capital investment increased 19.9%.

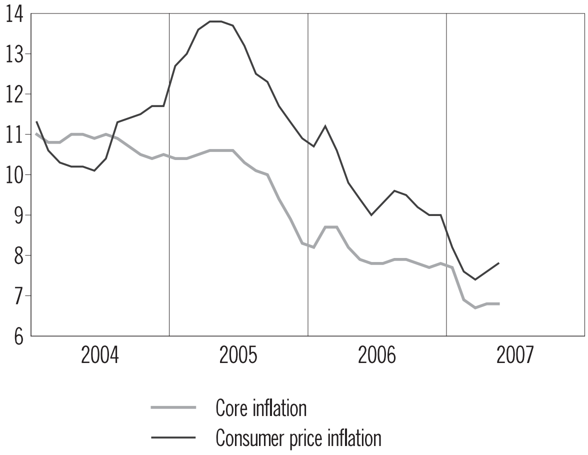
Unemployment continued to decrease and the number of jobs continued to increase at the beginning of the year. By the end of April, the number of the unemployed, calculated using the methodology recommended by the International Labour Organisation (ILO), fell to 7.0% of the economically active population as against 7.6% a year earlier.

According to the Economic Development Ministry's estimates, GDP growth in 2007 may stand at 6.5% and industrial output growth 5.2%. Real disposable money income is expected to increase 9.8%, retail trade turnover 11.6% and fixed capital investment 12.8%.

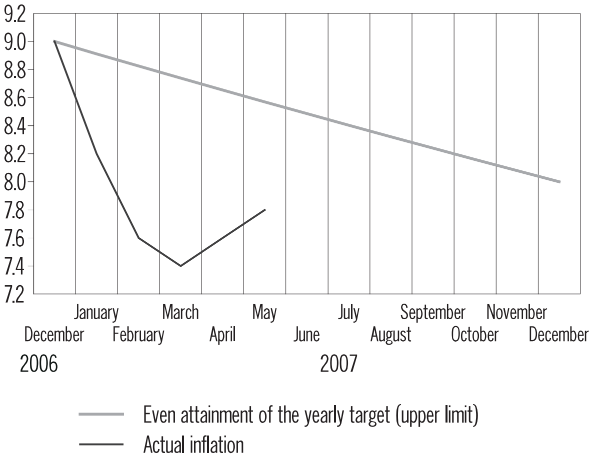
Consumer prices gained 4.7% in May 2007 as compared with December 2006 (in May 2006 they rose 5.9%). May 2007 inflation, measured for the moving 12-month period, was estimated at 7.8%.

The slowing of consumer price growth from the previous year was largely due to a decelera-

Consumer price inflation and core inflation (as % of corresponding month of previous year)



Consumer price inflation (as % of corresponding month of previous year)



Consumer price inflation and core inflation
(since start of year, on accrual basis, %)

	2004		2005		2006		2007	
	core inflation	inflation	core inflation	inflation	core inflation	inflation	core inflation	inflation
January	0.9	1.8	0.9	2.6	0.8	2.4	0.6	1.7
February	1.7	2.8	1.6	3.9	2.0	4.1	1.1	2.8
March	2.4	3.5	2.4	5.3	2.8	5.0	1.7	3.4
April	3.2	4.6	3.3	6.5	3.2	5.4	2.2	4.0
May	3.8	5.3	4.0	7.3	3.6	5.9	2.5	4.7
June	4.3	6.1	4.4	8.0	3.9	6.2		
July	5.1	7.1	5.0	8.5	4.5	6.9		
August	5.8	7.6	5.5	8.3	5.1	7.1		
September	6.8	8.0	6.3	8.6	5.9	7.2		
October	8.1	9.3	7.1	9.2	6.5	7.5		
November	9.3	10.5	7.7	10.0	7.1	8.2		
December	10.5	11.7	8.3	10.9	7.8	9.0		

tion in growth in the prices of goods, which fell to 3.2% in January-May 2007 as against 4.8% in the same period last year.

There was also a slowing of growth in the prices of goods and services included in the core consumer price index. Core inflation stood at 2.5% in May 2007 as compared with December 2006 (3.6% in the same period of 2006). May 2007 core inflation, measured for the moving 12-month period, was estimated at 6.8%, down a percentage point from December 2006. In 2007 core inflation is expected at about 7%.

Prices of paid services provided to the public rose 9.1% in January-May 2007 as against 9.3% in the same period of 2006. Communications prices grew significantly by 10.4%, whereas in the same period a year earlier they were up just 0.1%. Growth in rent and utility service prices in January-May 2007 slowed by 3.1 percentage points from the same period in 2006 and stood at 12.6%.

If inflation continues at the same pace without abrupt surges in the prices of some goods and services and if the administered prices stay within the set limits, the 2007 inflation target of 6.5-8% will be met.

The projected slowing of inflation will boost public confidence in the current monetary policy, lessen inflationary expectations and facilitate transition to inflation targeting in line with the strategy of ensuring long-term price stability.

II.2. Balance of payments

In January-March 2007 the balance of payments was affected by a fall in the world oil prices, which led to deterioration in the terms of trade for Russia.

A significant slowing of growth in exports of goods and an acceleration of growth in imports were the main reason for a decrease in the current account surplus in 2007 Q1 by more than a quarter, to $21.8 billion (as against $30.5 billion in January-March 2006).

Exports of goods were estimated at $69.9 billion, an increase of 3.8% on 2006 Q1's $67.4 billion. The fall in the world oil prices in 2007 Q1 caused the contract export prices of Russian oil and petroleum products to decline from the same period of 2006. Oil exports decreased by $800 million and exports of natural gas were down by $900 million. Meanwhile, other exports, especially ferrous and non-ferrous metallurgical products, increased by $4.2 billion. Export growth in January-March 2007 was due to an expansion of export volumes (by 2.1%) and an increase in contract prices (by 1.7%).

Imports of goods grew from $31.0 billion in January-March 2006 to an estimated $42.1 billion in 2007 Q1. This growth was mostly due to an expansion of import volumes by 26.4% and a 7.4% rise in contract prices. Compared to 2006 Q1, import growth accelerated to 35.8% (from 20.6% in January-March 2006). Import growth was largely determined by an increase in imports of machinery, equipment and transport vehicles.

The deficit in the balance of services was estimated at $2.7 billion (as against $2.6 billion in January-March 2006). Exports of services increased 15.1% to $6.7 billion, while imports of services grew 11.2% to $9.3 billion.

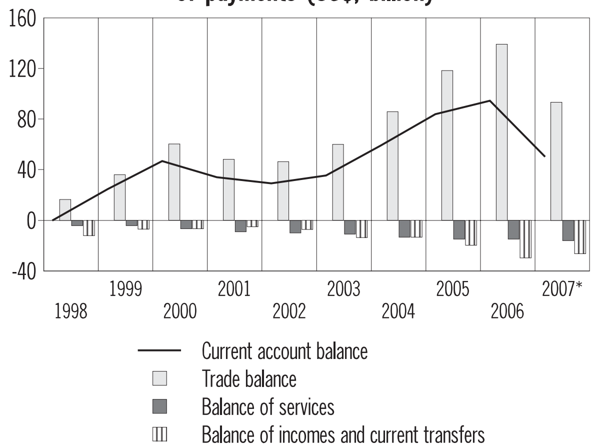
The deficit in the balance of investment incomes was unchanged from January-March 2006 at $2.6 billion. Income receivable was estimated at $10 billion and income payable $12.6 billion. Income received by the government and monetary authorities exceeded the corresponding payments by $3.5 billion (as against $1.2 billion in 2006 Q1). This growth was due to a significant reduction of government foreign debt and an increase in reserves. The deficit in the balance of private sector investment incomes is estimated at $6.0 billion (as against $3.8 billion in January-March 2006).

The economy's foreign liabilities increased by $42.5 billion. The main factor of growth was the active raising of foreign capital by the private sector, whose foreign liabilities increased 2.3 times compared to 2006 Q1 and aggregated $43.8 billion. Government sector and monetary authorities liabilities decreased by $1.3 billion.

Growth in residents' foreign assets (net of foreign exchange reserves) was estimated at $31.1 billion. Bank claims on non-residents increased by $19.2 billion, while foreign assets of other sectors[1] of the economy grew by $11.3 billion.

Net foreign capital inflow to the private sector in 2007 Q1 was estimated at $13 billion (net private capital outflow of $5.8 billion was registered in 2006 Q1).

Key current account parameters of Russia's balance of payments (US$, billion)



** Estimate.*

Russia's international reserves increased by $99.5 billion in January-May 2007. Net of the exchange rate revaluation, their growth stood at $96.2 billion. As of June 1, 2007, Russia's international reserves aggregated $403.2 billion.

If in 2007 the price of oil falls to $55 per barrel, as predicted, the trade surplus may amount to $77.2 billion. Exports of goods are estimated at $313.1 billion. The aggregate share of oil, petroleum products and natural gas in exports of goods may contract year on year: in 2006 it stood at 62.8% and in 2007 it is expected at around 59.2%. Meanwhile, the share of ferrous and non-ferrous metallurgical products may expand from 13.8% in 2006 to 16.0% in 2007. However, metal exports will remain far less important than the exports of major fuel and energy products.

The 2007 current account surplus is expected at $50.7 billion. Net private capital inflow may reach $70.0 billion due to the expected increase in the value of Russian companies' IPOs. Growth in foreign exchange reserves may accelerate year on year: it is expected at $114.9 billion in 2007 as against $107.5 billion in 2006.

II.3. Exchange rate

In 2007, the Bank of Russia continues to pursue an exchange rate policy aimed at curbing inflation and, at the same time, preventing the ruble's excessive appreciation and averting sharp fluctuations in the exchange rate of the national currency. As the external economic conditions have a significant influence on the domestic financial market, the Bank of Russia continues to maintain the managed floating exchange rate regime.

High energy prices and the US dollar's depreciation on the world currency market stimulated a massive inflow of foreign currency earnings, which set preconditions for supply to exceed demand on the domestic forex market. Additional factor of growth in the supply of foreign exchange on the domestic market was massive net private capital inflow connected with active fund raising by Russian companies on international markets.

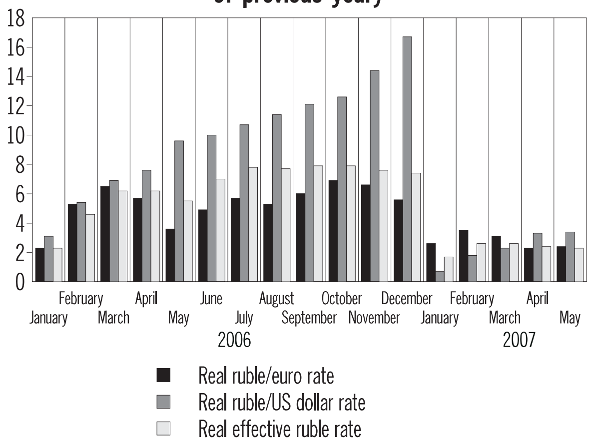
[1] *Other sectors comprise non-financial corporations, financial corporations other than credit institutions, non-profit organisations servicing households and the household sector.*

Official US dollar and euro exchange rates

Bank of Russia net purchases of foreign currency on the domestic forex market in January-May 2007 totalled $93.1 billion, which represents an increase of almost 77.1% on the same period in 2006. Bank of Russia interventions in the ruble/dollar segment of the market had the main influence on the rate-setting process on the domestic forex market.

In February 2007, the Bank of Russia changed the ratio structure of the dollar-euro basket whose ruble value is used as an operating benchmark of the exchange rate policy. It increased the weight of the euro to 0.45 from 0.4 euros and reduced the weight of the dollar to 0.55 from 0.6 dollars. The purpose of the change was to bring the exchange rate policy operating benchmark closer to the medium-term one, the nominal effective rate of the ruble.

Average monthly real ruble/dollar, ruble/euro rates and real effective ruble rate (growth as % of December of previous year)



In January-May 2007, the real effective rate of the ruble gained an estimated 2.3%, while the real rate of the ruble rose 3.4% against the US dollar and 2.4% against the euro.

The nominal US dollar/ruble rate stood at 25.90 rubles as of June 1, 2007, a decrease of 1.6% from January 1, 2007, whereas the nominal euro/ruble rate gained 0.3% to 34.81 rubles. These changes resulted from both internal and external developments, including exchange rate fluctuations on the world currency market.

Overall, the exchange rate policy implemented by the Bank of Russia in January-May 2007 allowed it to lessen fluctuations in the effective rate of the ruble and slow its appreciation.

In 2007 the real effective rate of the ruble may rise 4-5% on a December-on-December basis.

II.4. Monetary policy implementation

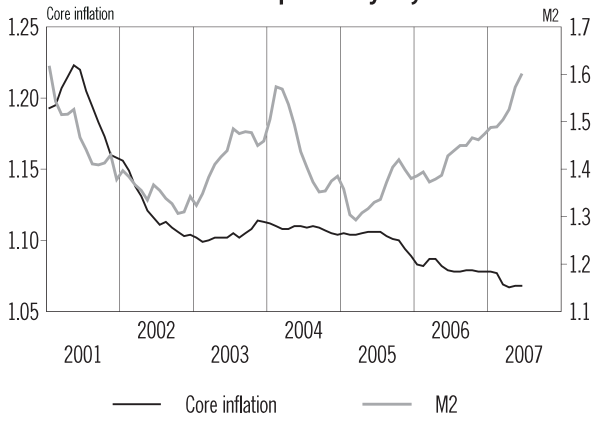
In line with the social and economic development forecast, Guidelines for the Single State Monetary Policy in 2007 envisaged consumer price growth at 6.5-8%. A core inflation of 5.5-7% matched the target set for headline inflation. Depending on the variant forecast for the social and economic development of the Russian Federation, GDP was to grow by 5-6.6% in 2007. This combination of macroeconomic parameters in the conditions of the managed floating exchange rate regime implied growth in money demand (measured by the aggregate M2) in the range of 19%-29%.

As the price of Urals averaged $58 per barrel in January-May 2007, economic growth in Russia approximated the fourth variant of the social and economic development forecast considered in Guidelines for the Single State Monetary Policy in 2007. Rapid economic growth, accelerating domestic demand and the continued dedollarisation of the economy contributed to sustainable high money demand.

In January-May 2007, the monetary aggregate M2 continued to increase on an annualised basis reaching an estimated 60% by June (as against 42.8% a year earlier).

As the velocity of money slowed down significantly compared with January-May 2006, the

M2 and core inflation (growth index against corresponding month of previous year)



Note. M2 data as of June 1, 2007, are preliminary.

inflationary implications of ruble supply growth weakened in 2007. Under the influence of the structural changes in money supply, the velocity of money calculated by the monetary aggregate M2 on an average annualised basis decreased by an estimated 18.2% by June 2007, as compared with the same period last year (in 2006 it slowed by 9.1%). Improvements in the M2 structure are apparent in the contraction of the more liquid component, cash, which decreased by an estimated 27.1% as of June 1, 2007, as against 31.3% a year earlier.

The exchange rate policy pursued by the Bank of Russia promotes further dedollarisation. Economic agents' demand for foreign exchange continued to fall. In January-April 2007, net sales of foreign exchange to households through exchange offices decreased to $40 million from $3.3 billion in the same period of 2006. According to preliminary balance of payments data, foreign exchange outside banks decreased by $1.6 billion in 2007 Q1 (in 2006 Q1 it increased by $50 million).

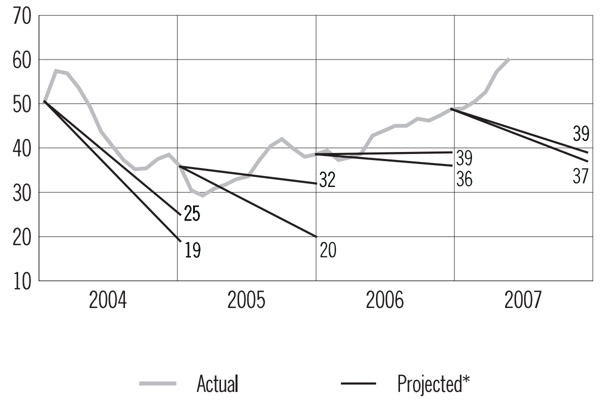
As the dollar continued to lose its positions in household sector savings, there was no marked increase in personal foreign currency bank deposits in January-May 2007. According to preliminary data, these deposits increased less than 1% over the period. The share of foreign currency deposits in money supply in its monetary survey definition[1] contracted to 10.1% as of June 1, 2007, from 15.2% a year earlier.

The main source of growth in money supply in January-May 2007 was an increase in net foreign assets of the monetary authorities, which grew at an estimated 55.4% as of June 1, 2007, as compared with the same date in 2006. Given the massive capital inflow, stimulated by the rising cost of capital assets and the continuing development and deepening of the Russian capital market, the increased foreign exchange purchases by the Bank of Russia and the accelerated growth in money supply reflected the rising transactional demand of economic agents for the national currency.

Another major source of accelerated growth in money supply this year has been an increase in banking sector claims on non-financial enterprises and households, which stood at an annualised 49.4% as of June 1, 2007, as against 45.6% a year earlier.

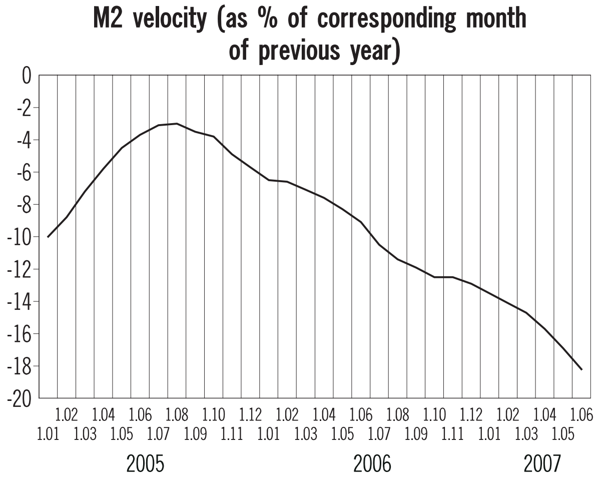
Thus, growth in credit to the real economy continued to impact money supply in 2007. Household loans showed rapid growth soaring 73.1% as of May 1, 2007, year on year (in 2006 they rose 91.2% year on year). These loans accounted for 26.0% of total credit to non-financial enterprises and households as of May 1, 2007 (as against 22.7% a year earlier). Total loans extended to the non-financial enterprise sector increased 44.6% as of May 1, 2007 (as against 30.7% as of the same date in 2006).

Projected and actual M2 growth rates (as % of corresponding month of previous year)



** 2007: updated forecast.*
Note. Data as of June 1, 2007, are preliminary.

[1] Money supply in the monetary survey definition includes foreign currency deposits.



Note. Data as of June 1, 2007, are preliminary.

A consolidation of the balance of payments capital account led to an expansion of Russia's international reserves (in dollar terms), which increased about 50% in January-May 2007, as compared with the same period in 2006, and had a decisive effect on the acceleration of the monetary base. The narrow monetary base expanded by an annualised 38.6% as of June 1, 2007, year on year as against 32.9% as of June 1, 2006.

As a result, the level of banking sector liquidity has risen. The average monthly value of aggregate banking sector reserves[2] increased 74.7% in January-May 2007, as compared with the same period of 2006. This led to a lowering of the upper limit of fluctuations of the overnight ruble MIACR from 8.9% p.a. in January-May 2006 to 7.5% p.a. in the same period this year, while overall MIACR volatility decreased.

If the economic trends of January-May 2007 persist, full-year growth in money supply and monetary base may exceed the projection made in Guidelines for the Single State Monetary Policy in 2007. The increased trend towards lower velocity of money and higher domestic demand due to the accelerated growth of its investment component give grounds to raise the M2 growth projection for 2007 to 37-39%. Therefore, the estimate of the narrow monetary base in the monetary programme has been raised to 4,087 billion rubles. If the impact of the capital inflow and accelerated economic growth registered in January-May increases by the end of the year, M2 may grow even more in 2007. However, if money supply matches the increased money demand, inflation may continue to slow down.

The increase in net international reserves forecast in the second variant of the programme

Estimated monetary programme indicators for 2007 (billion rubles)*

	1.01.2007	1.06.2007	1.01.2008	1.01.2008	2007 growth
	actual	actual	programme**	estimate	estimate
Narrow monetary base	**3,208**	**3,264**	**3,687**	**4,087**	**879**
- cash in circulation (outside the Bank of Russia)	3,062	3,110	3,504	3,896	834
- required reserves	146	154	183	191	45
Net international reserves	**7,998**	**10,517**	**9,574**	**11,009**	**3,011**
- billion US dollars	304	399	364	418	114
Net domestic assets	**-4,789**	**-7,253**	**-5,887**	**-6,922**	**-2,133**
Net credit to general government	-3,696	-4,851	-5,326	-4,951	-1,255
- net credit to federal government	-3,350	-4,186	-5,086	-4,551	-1,201
- balances of consolidated budget accounts of regional governments and government extrabudgetary funds with the Bank of Russia	-346	-664	-240	-400	-54
Net credit to banks	-810	-2,006	-637	-1,542	-732
- gross credit to banks	28	0	5	5	-23
- correspondent accounts of credit institutions, bank deposits with the Bank of Russia and other instruments used to absorb banking sector excess liquidity	-838	-2,006	-642	-1,547	-708
Other net unclassified assets	-283	-397	76	-429	-146

* Programme indicators calculated at the fixed exchange rate are based on the official exchange rate of the ruble as of the beginning of 2007.
** Scenario 2 in Guidelines for the Single State Monetary Policy in 2007 recalculated at the official exchange rate of the ruble as of the beginning of 2007.

[2] *Aggregate banking sector reserves comprise cash balances in cash departments of credit institutions, credit institutions' required reserve accounts with the Bank of Russia, credit institutions' correspondent and deposit accounts with the Bank of Russia and Bank of Russia obligations to repurchase bonds, including Bank of Russia bonds.*

has been raised as a smaller-than-expected current account surplus will be compensated by bigger private capital inflow. In these conditions, net domestic assets of the monetary authorities may decrease by 2.1 trillion rubles, or by 1.0 trillion rubles more than initially forecast in this variant of the programme.

The above factors necessitated correction in some other monetary programme indicators for 2007.

Confronted with a high level of banking sector liquidity, the monetary authorities in 2007 continued to carry out measures to absorb a part of growth in money supply coming from Bank of Russia operations on the domestic forex market.

The budget policy, especially the mechanism used to form the Russian Government's Stabilisation Fund, continued to play a major role in absorbing banking sector liquidity in 2007. Net credit to the general government decreased by 1.2 trillion rubles in January-May 2007 (almost as much as in the same period of 2006) and accounted for 36.0% of the narrow monetary base as of the beginning of 2007.

When implementing its monetary policy in January-May 2007, the Bank of Russia stepped up deposit operations and Bank of Russia bond (OBR) placements. Its debt on deposit and OBR operations with credit institutions rose by 1.4 trillion rubles in that period as against 0.3 trillion rubles in the same period of 2006.

Bank of Russia monetary policy instruments in 2007

Type of instrument	Purpose	Instrument	Term of providing/absorbing liquidity	Interest rate, % p.a.
Open market operations	Providing liquidity	Lombard auctions	2 weeks	Set by auction results (not lower than 7%)
		Repo operations	From 1 day to 7 days, 1 week, 3 months	Set by auction results (from 1 day to 7 days: not lower than 6%; 1 week: not lower than 6.5%; 3 months: not lower than 9%)
		Purchase of government securities and Bank of Russia bonds	Outright operations*	-
		Purchase of foreign exchange	-	-
	Absorbing liquidity	Deposit auctions	4 weeks, 3 months	Set by auction results (4 weeks: not higher than 9%; 3 months: not higher than 10%)
		Bank of Russia bonds	Up to 6 months	Set by auction results
		Sale of government securities	Outright operations*	-
		Sale of foreign exchange	-	-
Standing facilities	Providing liquidity	Loans	Intraday	0
			Overnight	Fixed at 10.0% (before June 19, 2007: 10.5%; before January 28, 2007: 11.0%)
		Lombard loans (extended at the fixed interest rate)	7 days	**
		Currency swaps	Overnight	Fixed at 10.0% (before June 19, 2007: 10.5%; before January 28, 2007: 11.0%)
	Absorbing liquidity	Deposit operations	1 day	Fixed at 2.5% (before April 2, 2007: 2.25%)
			1 week	Fixed at 3% (before April 2, 2007: 2.75%)
			Call	Fixed at 2.5% (before April 2, 2007: 2.25%)

* Sale/purchase of government securities from own portfolio and OBR bonds without an obligation to repurchase/resell.

** At Lombard auction average weighted rate. At the Bank of Russia refinance rate if two consecutive Lombard auctions are declared invalid.

Banking sector liquidity absorption (billion rubles)

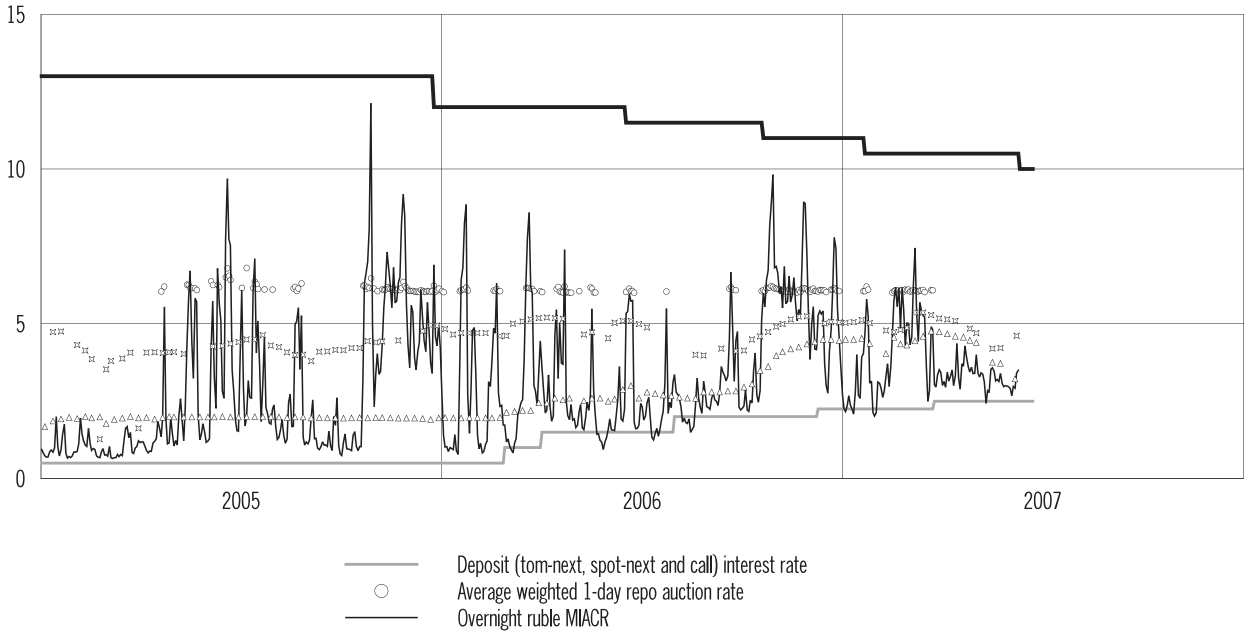
In 2007, the Bank of Russia continued consistently to narrow the interest rate band by raising its lower limit (the fixed rate on deposit operations on standard tom-next, spot-next and call conditions) and lowering its upper limit, the refinance rate and Bank of Russia overnight rate. On January 29, 2007, the Bank of Russia Board of Directors cut the refinance and overnight credit rate from 11% to 10.5% p.a. and on June 19, 2007, from 10.5% to 10% p.a. and on April 2, 2007, it raised the Bank of Russia standard tom-next, spot-next and call deposit rates from 2.25% to 2.5% p.a. and standard 1-week and spot-week deposit rates from 2.75% to 3.0% p.a.

In 2007, the Bank of Russia set interest rates on auction sterilisation instruments to ensure parity between domestic and foreign money market rates, taking into account the ruble exchange rate dynamics.

In 2007, it changed the OBR placement procedure. Instead of selling long-term OBRs with a 6-month offer, the Bank of Russia began to issue short-term bonds with a 7-month maturity and a 6-month put option. Short-term OBRs for a total value of 250 billion rubles were first issued on March 15. As before, OBR placements will be made quarterly and followed by regular additional placements. Auctions to place new OBR issues will be accompanied by offers for an early redemption of the outstanding issue.

To ensure uninterrupted settlements, the Bank of Russia extended intraday loans to banks daily. In January-May 2007, the value of these loans increased 10%, as compared with the same period of 2006, and totalled 4.4 trillion rubles. In early 2007, credit institutions and their branch-

Bank of Russia interest rates and overnight MIACR (% p.a.)



es also actively took overnight loans. In January-May 2007, Bank of Russia overnight loans increased 110%, as compared with the same period of 2006, and totalled 31.0 billion rubles.

By and large, credit institutions did not need to raise too much liquidity from the Bank of Russia in January-May 2007. Total funds provided to credit institutions through repo operations amounted to 304.7 billion rubles in that period as against 395.8 billion rubles in January-May 2006. Lombard loans were also extended in small amounts, although their number increased 50%, as compared with January-May 2006 and the number of credit institutions that took them more than doubled.

The Bank of Russia will continue currency swaps in 2007, if necessary.

Securities on the Bank of Russia Lombard List were used as collateral for Bank of Russia loans and repos. Most of the portfolio securities used by credit institutions in refinancing are federal government bonds, Bank of Russia bonds, resident corporate bonds and bonds issued by credit institutions.

To manage their short-term liquidity, credit institutions frequently used the averaging of the required reserves, that is, fulfilled a part of the reserve requirements by keeping the corresponding average monthly balance in their correspondent accounts and sub-accounts with the Bank of Russia.

In May 2007, the Bank of Russia Board of Directors decided to raise from July 1, 2007, the required reserve ratio for credit institutions' ruble obligations to individuals from 3.5% to 4.0% and the required reserve ratio for credit institutions' ruble and foreign currency obligations to non-resident banks and other ruble and foreign currency obligations from 3.5% to 4.5%. Combined with other measures this will help control growth in money supply and mitigate inflationary implications of this process.

III. Macroeconomic development scenarios

III.1. Variants of macroeconomic forecast for 2008 and for the period until 2010

External conditions for the Russian economy are expected to be favourable in 2008 and in the period until 2010. International financial institutions, such as the IMF and World Bank, predict that world economic growth rates in 2008 will be the same as in 2007. In the period until 2010 world economic growth is expected to continue at rates close to the 2004-2008 annual average, although GDP growth may slow down.

Eurozone short-term interest rates are expected to level off in 2008, while the average annual level of US interest rates may fall. Given the Bank of Russia flexible interest rate policy, the expected correlations between interest rates in Russia and other countries will ensure a balanced cross-border capital movement.

The Bank of Russia has considered three scenarios for the monetary policy implementation in 2008-2010, which fit the Russian Government forecasts. The first two scenarios assume a worsening of the world market prices in the medium term and the third one its improvement.

According to the **first scenario** for the Russian economy in 2008, the price of oil falls dramatically to $44 per barrel. In this case, exports of goods and services decline year on year, while imports rise.

Despite the deterioration in the external conditions for the Russian economy, this does not hamper its further growth. Real disposable money income may rise 7.2% in 2008. A relative fall in export revenues tells on investment activity. Growth in fixed capital investment may stand at about 10%. GDP growth is expected at about 5.4% in 2008.

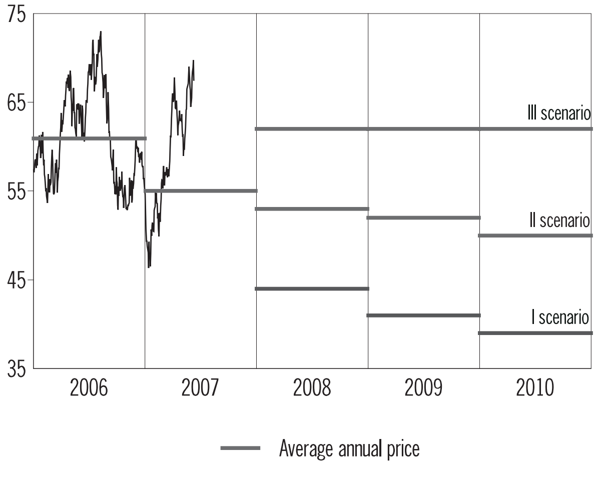
The **second scenario** is the forecast laid at the basis of the draft federal budget. This scenario assumes a hypothetical fall in the price of Russian oil to $53 per barrel in 2008.

Compared to 2007, exports of goods and services in this scenario increase slightly in 2008, whereas the current account surplus decreases. Growth in reserves slows down.

More profound structural changes, such as an improvement of the investment climate, facilitate rapid economic development. According to this scenario, accelerated growth in investment in new technology makes domestic production more efficient and competitive.

Domestic demand is expected to rise fast in 2008. Fixed capital investment may increase 11.9% and real disposable money income 9.1%. In this case, economic growth stands at 6.1%.

Urals price (US$/barrel)



In the **third scenario** the price of Russian oil rises to $62 per barrel in 2008.

Despite an improvement in the world prices, Russia's current account surplus shrinks and growth in foreign exchange reserves will be smaller than in 2007.

Real disposable money income may rise 10.6% in 2008 and fixed capital investment may grow 13.2%. In this case, economic growth accelerates to 6.7%.

According to the medium-term forecast, in 2010 the price of Russian oil in the first scenario may stand at $39 per barrel, in the second $50 per barrel and in the third $62 per barrel. The change in the world prices will affect the Russian economy. In 2009-2010 Russia's GDP may increase by 5.3-6.3% a year.

III.2. Balance of payments forecast

Russia's balance of payments is expected to remain stable in 2008 in all social and economic development scenarios. However, if exports fall or rise at a moderate pace amid rapid growth in imports, the trade surplus will decrease and, as a result, the current account surplus will decrease to $3.6-34.2 billion.

In the first scenario, which assumes the most significant fall in oil prices, exports of goods and services may decrease to $321.9 billion and the trade surplus to $29.5 billion.

In the second scenario, which judges the price of Russian oil to fall slightly in 2008, exports of goods and services may increase to $352.3 billion and in this case the trade surplus may stand at $42.5 billion.

In the third scenario, which assumes high world prices, exports of goods and services are expected to grow faster, to $378.7 billion, but imports are likely to increase even more rapidly. Thus, the trade surplus may decrease to $62.1 billion.

The deficit in the balance of income and current transfers is forecast in the range of $25.9-28.0 billion amid moderate growth in the corresponding receipts and payments.

The financial account surplus is expected to decline to $34.6 billion. The general government foreign liabilities are to decrease, and its overall international investment position may improve by $5.4 billion. As the private sector continues to raise considerable funds abroad, net foreign capital inflow to this sector may amount to $40 billion.

As in 2007, due to the aggregate effect of external economic factors, supply will continue to exceed demand on the domestic forex market. At the same time, the pressure on the exchange rate of the ruble is expected to ease up as a result of a decrease in the current account surplus and the ruble is likely to appreciate less in real terms. Foreign exchange reserves may increase by $37.9-68.4 billion.

According to the medium-term social and economic development forecast for the period until 2010, the adverse impact of external factors on the balance of payments, particularly in foreign trade, will increase. As a result of a significant decrease in the trade surplus in 2009 against the background of a persistent deficit in the balance of services and a significant excess of foreign debt service expenditures over the corresponding revenues, there will be a current account deficit of $33.1 billion or $17.7 billion or the current account surplus will decrease to $4.6 billion depending on the scenario. In 2010, the current account deficit might stand at $56.5 billion $46.4 billion and $31.2 billion depending on the scenario.

Overall macroeconomic stability will be key to Russian economy attractiveness to investors. Net foreign capital inflow to the private sector is expected to reach $45 billion in 2009 and $55 billion in 2010. It will be enough to cover the current account deficit in 2009. Growth in foreign exchange reserves may vary between $8.6 billion and $46.3 billion. In 2010 they may decrease by $4.5 billion or increase by $5.6-20.8 billion.

Russia's balance of payments forecast for 2007-2010 (US$, billion)

	2006 (actual)	2007	2008			2009			2010		
		$55 per barrel	Scenario 1 ($44 per barrel)	Scenario 2 ($53 per barrel)	Scenario 3 ($62 per barrel)	Scenario 1 ($41 per barrel)	Scenario 2 ($52 per barrel)	Scenario 3 ($62 per barrel)	Scenario 1 ($39 per barrel)	Scenario 2 ($50 per barrel)	Scenario 3 ($62 per barrel)
Current account	**94.5**	**50.7**	**3.6**	**15.2**	**34.2**	**-33.1**	**-17.7**	**4.6**	**-56.5**	**-46.4**	**-31.2**
Goods and services	124.3	77.2	29.5	42.5	62.1	-6.4	10.3	32.7	-27.7	-17.5	-2.1
Export of goods and services	*334.3*	*347.8*	*321.9*	*352.3*	*378.7*	*311.2*	*356.0*	*392.5*	*311.9*	*358.6*	*399.3*
Import of goods and services	*-210.0*	*-270.6*	*-292.4*	*-309.9*	*-316.6*	*-317.5*	*-345.7*	*-359.8*	*-339.6*	*-376.1*	*-401.5*
Income and current transfers	-29.8	-26.4	-25.9	-27.2	-28.0	-26.7	-28.0	-28.1	-28.8	-28.9	-29.0
Capital and financial account	**13.0**	**64.2**	**34.3**	**34.3**	**34.3**	**41.7**	**41.7**	**41.7**	**52.0**	**52.0**	**52.0**
Financial account (net of reserves)	12.8	64.5	34.6	34.6	34.6	42.0	42.0	42.0	52.3	52.3	52.3
General government and monetary authorities	*-28.9*	*-5.6*	*-5.4*	*-5.4*	*-5.4*	*-3.0*	*-3.0*	*-3.0*	*-2.7*	*-2.7*	*-2.7*
Private sector (including net errors and omissions)	*41.7*	*70.0*	*40.0*	*40.0*	*40.0*	*45.0*	*45.0*	*45.0*	*55.0*	*55.0*	*55.0*
Change in foreign exchange reserves ("+" signifies decrease, "-" signifies growth)	**-107.5**	**-114.9**	**-37.9**	**-49.5**	**-68.4**	**-8.6**	**-24.0**	**-46.3**	**4.5**	**-5.6**	**-20.8**

IV. Monetary policy targets and instruments in 2008

IV.1. Quantitative targets of monetary policy and the monetary programme

In line with the scenarios' conditions and main parameters of the social and economic development forecast for the Russian Federation in 2008 and for the period until 2010, the Russian Government and the Bank of Russia set a goal of reducing inflation to 6-7% in 2008, 5.5-6.5% in 2009 and 5-6% in 2010 (on a December-on-December basis). To match the general rate of consumer price inflation, core inflation should be at 5-6% in 2008, 4.5-5.5% in 2009 and 4-5% in 2010.

According to the social and economic development forecast for the Russian Federation in 2008, growth in domestic demand may be slightly slower than in 2007 and the ruble is not likely to appreciate as rapidly as in the previous years. As a result, money demand is likely to be less than in 2007. Therefore, the Bank of Russia plans to allow monetary aggregate M2 to expand 24-30% a year depending on the scenario.

Growth in money demand is expected to slow down in 2009 and 2010. M2 growth rates may fall from 20-24% in 2009 to 16-20% in 2010.

The monetary programme for 2008-2010 is written in three versions, each version tailored to the corresponding social and economic development scenario for 2008-2010.

Depending on the scenario, the monetary base may expand 18-24% in 2008, 15-20% in 2009 and 12-17% in 2010.

The main source of growth in the monetary base in 2008-2009, as in the preceding period, will be an increase in net international reserves of the monetary authorities. If in 2008 their growth in all the three scenarios exceeds the expansion of the monetary base permissible from the viewpoint of the attainment of the inflation target which will require the monetary authorities to absorb excess liquidity, from 2009 (in the third scenario from 2010) net domestic assets of the monetary authorities are expected to increase thanks to growth in gross credit to the banking sector. Credit to the banking sector may become the principal source of money supply growth in 2010 in all the three scenarios, as banking sector demand for Bank of Russia refinancing instruments is expected to rise significantly.

The draft federal budget for 2008 and for the period until 2010 provides for an easing of the fiscal policy and scaling down of liquidity absorption amid a significant slowing of growth in the balances of federal government accounts with the Bank of Russia.

In the first scenario, net international reserves may decrease to $37.9 billion in 2008, or about 1 trillion rubles at the fixed US dollar/ruble rate as of January 1, 2007. This is almost three times the amount expected this year. The monetary base is expected to expand by 765 billion rubles at the outside, so the required decrease in net domestic assets will be about 233 billion rubles, largely due to a projected reduction of net credit to the general government by 220 billion rubles (as a result of growth in the balances of accounts with the Bank of Russia).

Monetary programme indicators for 2008-2010 (billion rubles)*

	1.01.2008 (estimate)	1.01.2009			1.01.2010			1.01.2011		
		Scenario 1	Scenario 2	Scenario 3	Scenario 1	Scenario 2	Scenario 3	Scenario 1	Scenario 2	Scenario 3
Monetary base (narrow definition)	**4,087**	**4,852**	**4,969**	**5,022**	**5,609**	**5,840**	**5,946**	**6,315**	**6,627**	**6,858**
- cash in circulation (outside the Bank of Russia)	3,896	4,611	4,722	4,768	5,315	5,534	5,625	5,970	6,261	6,468
- required reserves	191	241	247	254	294	306	321	345	366	391
Net international reserves	**11,009**	**12,007**	**12,312**	**12,810**	**12,233**	**12,944**	**14,029**	**12,115**	**13,092**	**14,577**
- billion US dollars	418	456	468	486	465	492	533	460	497	554
Net domestic assets	**-6,922**	**-7,155**	**-7,343**	**-7,788**	**-6,625**	**-7,104**	**-8,083**	**-5,800**	**-6,464**	**-7,718**
Net credit to general government	-4,951	-5,171	-5,321	-5,721	-5,291	-5,591	-6,291	-5,311	-5,761	-6,661
- net credit to federal government	-4,551	-4,801	-4,951	-5,351	-4,951	-5,251	-5,951	-5,001	-5,451	-6,351
- balances of consolidated budget accounts of regional governments and government extrabudgetary funds with the Bank of Russia	-400	-370	-370	-370	-340	-340	-340	-310	-310	-310
Net credit to banks	-1,542	-1,410	-1,437	-1,457	-617	-774	-978	374	181	-55
- gross credit to banks	5	5	5	5	202	61	5	1,014	861	670
- correspondent accounts of credit institutions, bank deposits with the Bank of Russia and other instruments used to absorb banking sector excess liquidity	-1,547	-1,415	-1,442	-1,462	-818	-835	-983	-640	-680	-725
Other net unclassified assets	-429	-574	-584	-609	-716	-739	-814	-862	-884	-1,002

* Programme indicators calculated at the fixed exchange rate are based on the official exchange rate of the ruble as of the beginning of 2007.

According to the first scenario projections, in 2009 growth in net international reserves is expected to slow down significantly (to 226 billion rubles) and in 2010 they are to decrease by 118 billion rubles in absolute terms. Therefore, net domestic assets will have to be increased to meet money demand. If growth in the balances of general government accounts with the Bank of Russia falls back in 2009-2010, net credit to the banking sector will have to be increased from an estimated 793 billion rubles in 2009 to an estimated 991 billion rubles in 2010. In this case, in 2009 almost the entire amount needed will be ensured by the reduction of liquidity absorbed by the Bank of Russia in the preceding period, whereas in 2010 more than 80% of this amount will have to be supplied by using Bank of Russia instruments to provide liquidity to credit institutions.

According to the second scenario of the monetary programme, in which net international reserves may increase by 1.3 trillion rubles, net domestic assets are forecast to fall by 421 billion rubles. Macroeconomic characteristics matching this scenario, including a rise in world energy prices, predetermine a more significant increase in the balances of federal government accounts with the Bank of Russia than in the first scenario. Net credit to the general government in this scenario is expected to decrease by a total of 370 billion rubles.

According to the second scenario, growth in net international reserves in 2009 and 2010 (by 632 billion rubles and 148 billion rubles, respectively) will be inadequate to ensure the projected rates of growth in money supply by the monetary authorities. Therefore, net domestic assets are judged to increase by 239 billion rubles and 640 billion rubles, respectively. For this purpose, the Bank of Russia will have to increase net credit to banks to the tune of 663 billion rubles in 2009 and 955 billion rubles in 2010 (of which about 84% due to expansion of gross credit).

The third scenario assumes 2008 growth in net international reserves (by 1.8 trillion rubles) to be almost twice as high as the expansion of the monetary base permissible for inflation target meeting. The necessary reduction in net domestic assets in this scenario may stand at 866 billion rubles in 2008. Favourable external economic conditions and accelerated economic growth are likely to ensure considerable tax budget revenues. In view of the projected dynamics of the balances in consolidated budget accounts of regional governments and government extrabudgetary funds with the Bank of Russia, net credit to the general government may decrease by 770 billion rubles in this version of the programme. The remaining increment of net domestic assets is to be ensured by the dynamics of other net unclassified assets.

According to the third scenario, growth in net international reserves in 2009 may exceed the permissible expansion of the monetary base: the necessary reduction in net domestic assets is forecast at 295 billion rubles. The projected decrease in net credit to the general government in 2009 will stand at 570 billion rubles, exceeding by far the reduction in net domestic assets. In this situation, the Bank of Russia will need to increase net credit to banks by 479 billion rubles.

In the third scenario, growth in net international reserves in 2010 may be inadequate for the necessary expansion of the monetary base and net domestic assets will have to be increased by 365 billion rubles. If net credit to the general government decreases by 370 billion rubles, the chief source of growth in net domestic assets will be the expansion of net credit to banks by 923 billion rubles.

The monetary programme parameters are not rigid and may be revised to match the current macroeconomic situation and changing key internal and external monetary factors. When implementing its monetary policy, the Bank of Russia will take into account possible risks and respond adequately, using the instruments at its disposal.

IV.2. Exchange rate policy

In 2008, the Bank of Russia will continue to pursue the monetary policy while maintaining the managed floating exchange rate regime. Its exchange rate policy will aim to mitigate abrupt fluctuations in the exchange rate that are not caused by fundamental economic factors and take into account the necessity of curbing inflation and keeping domestic producer prices competitive.

In the medium term, the Bank of Russia will switch to a more flexible exchange rate setting to facilitate the fulfilment of the monetary policy quantitative targets to maintain price stability by controlling the price of money in the economy mainly by using interest rate policy instruments of the monetary authorities.

To minimise the ruble's rate volatility against major foreign currencies, in 2008 the Bank of Russia will continue to use the bi-currency basket, composed of the euro and the dollar, as an operating benchmark for its currency interventions. This will allow the Bank of Russia to react quickly to mutual changes in the rates of major world currencies and thus cushion fluctuations in the effective rate of the ruble.

A rise in the real effective rate of the ruble in 2008 will depend on external and internal economic developments and it may range from nought to 10%. In the conditions close to those described in the second scenario, the real effective ruble rate may gain about 3%. In all the social and economic development scenarios described above growth in the real effective ruble rate in 2008 will remain moderate. It will not harm competitiveness of domestic producers or undermine balance of payments stability and will facilitate modernisation of the economy. In case of a sharp increase in budget expenditures, growth in administered prices above the permissible level and the surge of oil prices above the level forecast in the third scenario, the rise in the real effective ruble rate may approach the upper limit of the range indicated above. In case of a significant decline in prices of Russian exports and a dramatic reduction of private capital inflow, the real effective ruble rate in 2008 may remain at the end of 2007 level.

IV.3. Monetary policy instruments and their application

In 2008, the Bank of Russia will continue to improve monetary policy instruments and make their use more effective to ensure monetary stability in the different social and economic development scenarios.

It will attach priority to consistent implementation of the interest rate policy and the use of interest rates in the transmission mechanism of the monetary policy as the necessary economic conditions evolve. The key factors are as follows: a significant decrease in the balance of payments surplus predicted in the medium term and an ensuing scaling down of Bank of Russia involvement in operations on the domestic forex market. This is expected to result in the slowing of money supply growth. In this situation interest rates on Bank of Russia operations may increasingly impact interest rates in the Russian economy as a whole.

The strategic goal of the interest rate policy will be, as before, consistently to narrow the Bank of Russia interest rate band on the money market in 2008. Now that restrictions on the movement of capital have been lifted, the lower limit of the interest rate band will be raised bearing in mind the risk of a massive inflow of foreign capital.

The Bank of Russia will continue to use liquidity absorption instruments, particularly regular OBR and deposit operations. However, in 2008 the principal channel of sterilisation in terms of the amount of the funds absorbed will be, as before, the budget mechanism: starting from February 1, 2008, the Government will begin to create the Reserve Fund and the Future Generation Fund.

Auction-based market instruments such as OBR and deposit auctions will have a major role to play in sterilising excess liquidity by the Bank of Russia. The transfer to the issue of short-term OBRs will simplify the use of this sterilisation instrument and, consequently, stimulate money market participants' demand for it. In 2008 the Bank of Russia will also continue to use standing facilities to sterilise liquidity for a short period of time, such as fixed-rate deposit operations on standard terms.

In addition, whenever it is necessary to absorb liquidity on a long-term basis, the Bank of Russia plans to sell government securities from its own portfolio without an obligation to repurchase. In 2008 it may consider changes to the structure of its government securities portfolio by exchanging non-marketable federal loan bonds (OFZ) for more liquid issues to make this sterilisation instrument more effective.

The Bank of Russia will continue to use reserve requirements as a direct banking sector liquidity regulation instrument. In case of a considerable increase in banking sector liquidity, which may be caused by a massive inflow of short-term foreign capital to the Russian economy, the Bank of Russia may, should other absorption instruments fail to produce the desired result, raise the required reserve ratios. At the same time, the Bank of Russia may continue to raise gradually the required reserve averaging ratio to enable credit institutions to manage their own liquidity more efficiently.

The Bank of Russia realises that external shocks may have implications on the level of banking sector liquidity and that there is a risk of a significant reduction in the liquidity level due to continuous uncertainty about the direction of the cross-border capital flow and possible changes in the world prices of Russian exports.

In the event of a fall in the level of banking sector liquidity, including a short-term one, the Bank of Russia is ready to use more actively the instruments to provide liquidity to credit institutions by auction and at fixed interest rates. It will hold to this end repo auctions and Lombard loan auctions and use standing facilities such as fixed-rate Lombard loans and currency swaps. To ensure uninterrupted effectuation of settlements, it will extend intraday and overnight loans to credit institutions on a daily basis.

To enhance the effectiveness of refinancing (extending loans to) credit institutions, in 2008 the Bank of Russia will continue to develop a single refinancing mechanism for the purpose of creating a system that would allow any financially sound credit institution to take out intraday and overnight loans and loans with terms of up to one year against any collateral included in the "single security pool".

The measures aim at giving credit institutions quick and easy access to sufficient funds provided through Bank of Russia operations.

In 2008, the Bank of Russia will continue to include in its Lombard List securities that meet its requirements, broaden the range of counterparties in refinancing operations and increase the number of credit institutions' credited accounts opened in all Bank of Russia regional branches.

As plans are afoot to expand the range of properties accepted as collateral for Bank of Russia loans, in 2008 the Bank of Russia will refine the mechanism to involve specialised institutions, including the Deposit Insurance Agency, in the organisation of public sales of property accepted as collateral for Bank of Russia loans and not traded on the organised market in case of credit institutions defaulting on Bank of Russia loans.

The creation of a repo market with the central counterparty will help enhance the effectiveness of the instruments used to provide and sterilise liquidity. As transactions on this market are anonymous and do not involve counterparty risk, this kind of transactions makes it possible to eliminate segmentation of the interbank market and facilitate liquidity flow within the banking system. In 2008, the Bank of Russia will continue to participate in upgrading the regulatory framework of repo transactions with the central counterparty.

V. Addendum

V.1. Measures to be implemented by the Bank of Russia to upgrade the banking system and banking supervision in 2008

Given the favourable macroeconomic situation, the banking sector in 2008 will continue to develop in all directions: the financing of effective projects, small businesses and regional programmes, retail services diversification, mortgage lending, and banking services accessibility, including in medium and small towns and villages.

The implementation of measures envisaged by the Russian Banking Sector Development Strategy for the Period until 2008 (hereinafter Strategy), Russia's Medium-Term Social and Economic Development Programme (2006-2008) and Russian President directives aimed at improving the legal environment and investment and business climate, enhancing the effectiveness of the deposit insurance system, giving credit institutions better access to financial resources, increasing their capitalisation and strengthening the competitiveness and stability of the banking system will facilitate the further development of the banking sector.

The banking sector will remain attractive to investors and this will help increase its capitalisation by issuing new shares. Foreign-controlled banks will be playing a greater role in Russian banking sector.

In 2008, the Bank of Russia will continue to upgrade the banking sector and banking supervision in line with the Strategy. It will attach priority to the further development of risk-based supervision and improvement of the quality of the financial soundness assessment of credit institutions. It will continue:

- to develop the substantive component of supervision, including consolidated supervision, taking into account international practice. This will help improve the quality of supervisory assessment of the economic situation of banks, detect problems in banks at early stages, further upgrade prudential reporting and take timely and adequate disciplinary measures in respect to credit institutions;
- to regulate risks assumed by credit institutions in conducting lending operations and transactions with affiliated persons and borrowers;
- to upgrade the methods of managing liquidity risk with emphasis on the use of the cash flow concept and evaluation of liquidity risk management systems in credit institutions;
- to prepare the implementation of the principles set out in the Basel Committee's document International Convergence of Capital Measurement and Capital Standards: A Revised Framework (Basel II), including drafting amendments to applicable legislation to harmonise it with this document. The Bank of Russia will develop methodologies to set standards for internal risk management procedures and capital adequacy assessment for banks, evaluation of bank internal capital adequacy practices and capital maintenance strategy and adequacy of intrabank capital adequacy evaluation procedures;
- to upgrade the regulatory base for the purpose of legitimising the composition and making legally binding the disclosure of infor-

mation by credit institutions when extending consumer loans, including mortgage lending, and providing other retail financial products to the public. An important element of this work will be joint efforts of the Bank of Russia and the banking community aimed at disseminating financial literacy and informing the general public about banking services, including elaboration and adoption by banking associations of information disclosure standards and their use by credit institutions;

- to upgrade trust management by legitimising the establishment by credit institutions of joint bank-managed funds and defining the powers of the Bank of Russia to regulate them;

- to improve the monitoring of stability of the banking sector as a whole and of individual credit institutions, including the major components of this monitoring: stress testing, calculation of financial soundness indicators and current risk monitoring.

Amendments to legislation came into force in 2007 and gave Russian and foreign capital equal access to the banking sector. They were aimed to increase capitalisation of credit institutions and encourage competition in the banking sector.

Efforts will continue to be made in 2008 to enhance effectiveness of measures to prevent incompetent or dishonest persons from holding senior positions in credit institutions, specifically:

- a mechanism is to be created to evaluate the business reputation of managers and owners of credit institutions, which will give the Bank of Russia wider supervisory powers to collect the necessary information;

- a mechanism is to be created to bar from the management of credit institutions persons whose actions may lead to breaches of law and harm the financial state of a credit institution.

In 2008, the Bank of Russia will continue to implement additional measures to increase the capitalisation of credit institutions and create favourable conditions for their IPOs. Specifically, it will improve the securities registration procedure introducing the requirement for credit institutions in the form of an open joint-stock company with an authorised capital in excess of 5 million euros to report the results of their share issues while continuing to comply with the requirements of banking legislation on the acquisition of shares (stakes) in credit institutions.

To protect the interests of depositors of credit institutions declared bankrupt and uncovered by the deposit insurance system, the Bank of Russia will continue to ensure compliance with Federal Law No. 96-FZ on Bank of Russia Payments on Household Deposits with Bankrupt Banks Uncovered by the Compulsory Deposit Insurance System.

The Bank of Russia will continue to make efforts to ensure that the banking sector improves its work to counter the legalisation (laundering) of criminally obtained incomes and the financing of terrorism.

To ensure that credit institutions comply with the requirements of the anti-money laundering/terrorist financing laws, the Bank of Russia, bearing in mind the law enforcement practice and bank inspection results, will take steps to upgrade the regulations and methodologies for credit institutions to control operations with money and other property subject to mandatory control.

In 2008, the principal objectives of the Bank of Russia in the field of inspection will be to organise and conduct largely scheduled inspections of credit institutions and their branches, paying special attention to the quality of inspection results.

For this purpose, inspections of credit institutions and their branches will focus on:

- evaluation of the financial situation of credit institutions;

- control over compliance by banks-members of the deposit insurance system with the requirements set by Federal Law No. 177-FZ on Insurance of Household Deposits in Russian Banks;

- detection and assessment of risks involved in activities of credit institutions and their branches;

- evaluation of quality and effectiveness of internal control and risk management systems in credit institutions;

- control over compliance by credit institutions and their branches with the requirements of Federal Law No. 115-FZ on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism and Bank of Russia instructions and regulations issued for the purpose of implementing this law;

- evaluation of credibility of credit institutions' reporting and accounting;

- control over the fulfilment by credit institutions and their branches of the recommendations to correct the violations of federal laws and Bank of Russia regulations detected in the course of supervision.

As rapid expansion of consumer lending leads to growth in risks faced by credit institutions, it becomes extremely important that credit institutions properly account for the level of risk involved in consumer lending. It is also important for the protection of bank customers to pay special attention in the course of inspection to compliance with the requirements that banks make known to their customers the real price of credit.

In 2008, the Bank of Russia will continue to upgrade inspection regulations and methodologies in line with its Action Plan to Implement the Russian Banking Sector Development Strategy for the Period until 2008.

V.2. Measures to be implemented by the Bank of Russia to improve financial markets in 2008

In line with the Russian Financial Market Development Strategy for 2006-2008, approved by Russian Federation Government Decision No. 793-r, dated June 1, 2006, the Bank of Russia continues to participate in the upgrading of financial market legislation, including:

- the upgrading of the regulation of repo transactions on the federal loan bond (OFZ) market, including repo transactions with the central counterparty to make the money market more developed and liquid;

- the drafting jointly with the Ministry of Finance of proposals to improve the regulation of the exchange of outstanding federal loan bond (OFZ) issues for the base bond issues placed by the Finance Ministry with the objective of making the OFZ market more liquid;

- the drafting of proposals for creation of a legal environment for the activities of the central depositories for the purpose of enhancing the effectiveness of settlements on the securities market and the securities rights registration system;

- the upgrading of legislation on clearing for the purpose of enhancing the effectiveness of risk management in transactions conducted by financial market players through a trade organiser;

- the establishment of procedures to provide securities on a returnable basis for the purpose of making the debt instrument markets more stable and liquid;

- the development of the market interest rate indicator system to upgrade the money market and interest rate risk management.

V.3. Measures to be implemented by the Bank of Russia to improve the payment system in 2008

Bank of Russia activities to upgrade the payment system in 2008 will aim to ensure the effective and uninterrupted functioning of the payment system and its further improvement and, as a result, the strengthening of financial stability in the country and the effective implementation of the monetary policy.

The Bank of Russia will take steps to improve the real-time gross settlement system, increasing the number of participants and diversifying the services it provides. This will facilitate growth in the number and volume of payments made through the system and reduce financial risks in the Russian payment system as a whole.

In 2008, the Bank of Russia will continue to upgrade methodological and information support for payment systems, take steps to expand non-cash payments and carry out measures to scale down cash settlements and monitor retail payments effected in the economy in cash and on a non-cash basis. In doing so, it will take into account international standards and foreign central bank practices.

To fulfil the functions assigned to it by Article 80 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), the Bank of Russia intends to complete on the whole the establishment of the procedure for monitoring the private payment systems in which violations of laws and regulations can affect financial system stability in Russia or seriously undermine public confidence in the national currency, the ruble, as an instrument of payment.

V.4. Principal measures planned by the Bank of Russia to upgrade Russia's banking system, banking supervision, financial markets and the payment system in 2008

Measures	Implementation period
Banking system and banking supervision	
1. Participation in drafting amendments to Article 36 of the Federal Law on Banks and Banking Activities to stipulate that a newly-registered bank may take household deposits from the state registration date if its authorised capital is no less than the ruble equivalent of 100 million euros and that financially sound banks may take household deposits before the expiry of the two-year period from their state registration date if their equity capital is no less than the ruble equivalent of 100 million euros.	Q1-Q4
2. Participation in drafting the Federal Law on Amending the Federal Law on the Central Bank of the Russian Federation (Bank of Russia) aimed at creating conditions conducive to greater financial stability of credit institutions and the banking sector as a whole and, particularly, creating an effective mechanism to regulate the risks assumed by credit institutions when conducting credit operations and transactions with affiliated persons.	Q1-Q2
3. Upgrading securities market legislation so that credit institutions in certain cases notify the Bank of Russia of securities issue results and simultaneously changing legislation on the use of disciplinary measures by the Bank of Russia against the shareholders (members) of credit institutions who violated banking legislation when acquiring shares (stakes) in a credit institution.	Q4
4. Participation in drafting proposals for amending banking legislation for the purpose of implementing Basel II recommendations, such as: - giving the Bank of Russia the powers to require credit institutions on the basis of the evaluation of the nature and level of risks they assume to maintain their equity capital adequacy ratio at a level higher than the minimum required one; - setting out (revising) procedures for risk management and internal controls; - adding to Part 2 of Article 74 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia) the list of recommended Basel Committee corrective actions against weak (problem) banks (Supervisory Guidance on Dealing with Weak Banks, March 2002).	Q1-Q4
5. Drafting the Federal Law on Amending Article 5 of the Federal Law on Banks and Banking Activities that would give credit institutions the legal right to set up general bank management funds and define the powers of the Bank of Russia to regulate them.	Q1-Q4
6. Participation in drafting a law to allow the federal postal services to perform certain technological operations connected with the effectuation of banking operations.	Q1-Q4
7. Revising the principles of regulating liquidity risk on the basis of the cash flow concept, taking into account the results of international EC-TACIS project Bank Supervision and Accounting.	Q1-Q2

Measures	Implementation period
8. Continuing the implementation of Basel II recommendations by changing the equity capital adequacy calculation procedure on the basis of the Simplified Standardised Approach to Credit Risk.	Q1-Q4
9. Participation in elaborating a banking quality standard for the use of banking information technology (jointly with banking associations).	Q1-Q4
10. Upgrading banking regulation to create mechanisms to prevent persons with a questionable reputation or unsound financial position from managing credit institutions.	Q4
Financial markets	
11. Continuing to upgrade the regulation of repo transactions on the OFZ market, including repos with the central counterparty.	Q2-Q4
12. Drafting jointly with the Finance Ministry proposals for upgrading the regulation of the exchange of outstanding OFZ issues for the base bond issues placed by the Finance Ministry.	Q2-Q4
13. Participation in drafting proposals to create a regulatory basis for the activities of central depositories.	Q1-Q3
14. Continuing to upgrade clearing legislation.	Q2-Q4
15. Participation in establishing mechanisms to provide securities on a returnable basis.	Q4
16. Assisting the development of the market interest rate indicator system.	Q2-Q4
Payment system	
17. Developing the real-time gross settlement system.	Q1-Q4
18. Completing the establishment of the procedure for monitoring the private payment systems by the Bank of Russia.	Q3