



April 2006: performance of the MICEX markets and the MICEX Stock Exchange markets.

In May 2006, 4700.8 billion rubles (173.8 billion US dollars) worth of transactions were effected in all of the MICEX Group's markets, up 21.3% on April and 253.8% on May 2005.

The share market on the MICEX SE. In May, strong correction of prices took place in the MICEX SE share market. As a result of the month, the MICEX Index decreased by 13.8% to 1281.5 points. Common shares in Surgutneftegaz fell by 22.2% to 36.9 rubles per 1 share (the strongest decrease), RAO UES fell by 21.3% (16.48 rubles per 1 share), LUKoil fell by 14.7% (2115.7 rubles per 1 share), Sberbank fell by 11.3% (43409 rubles per 1 share), Gazprom fell by 7.2% (287.9 rubles per 1 share) and Norilsk Nickel fell 5.3% (3263 rubles per 1 share). Common shares in Rostelecom grew by 13.1% (to 109.4 rubles per 1 share).

In May, the activity of market participants was record-high. The total turnover in shares amounted to 1.53 trillion rubles. The average daily turnover grew by 32% to 72.8 billion rubles. The turnover in repos with shares amounted to 273.9 billion rubles or 17.9% of the total turnover in shares. The turnover in the negotiated deals mode (address transactions) amounted to 67.14 billion rubles or 5.4% of the turnover in shares in the secondary market.

The market of corporate and regional bonds on the MICEX SE. In the sector of corporate and regional bonds, quotations of the most liquid issues were growing slowly, with traders' activity remaining high. The Corporate Bonds Index RCBI-c (coupon), after growing in April by 0.39%, grew by 0.46% in May and amounted to 138.33 points at the close on 31 May. The MICEX Corporate Bonds Index (RCBI) dropped by 0.07% and amounted to 100.99 points.

As a result of the month, the total value traded in corporate and regional bonds amounted to 388.6 billion rubles, of which 174.5 billion rubles (44.9%) was accounted for by secondary trading, 200.2 billion rubles (51.5%) — by repos, 13.9 billion rubles (3.6%) — by new placements (bonds of National Factoring Company Banka (face value: 1.0 billion rubles), Sobinbank (2.0 billion rubles), Tatfondbank (1.5 billion rubles), Agrarian Group (0.4 billion rubles), TKB (0.8 billion rubles), INPROM (series 03, 1.3 billion rubles), Sibirtelecom (Series 07, 2.0 billion rubles), bonds of Volgograd Region (0.55 billion rubles), Adamant-Finance (Series 02, 2.0 billion rubles), AGroSoyuz (0.5 billion rubles), DZ-Finance (0.4 billion rubles) and Rostvertol (0.8 billion rubles)).

In May, the proportion of corporate bonds in the overall structure of trading amounted to 71.8% of the total turnover (279.2 billion rubles), the proportion of regional securities amounted to 27.5% (107.1 billion rubles), while municipal issues accounted for 0.6% (2.3 billion rubles). As compared with April, the total value traded in corporate and regional bonds grew by 17.3%.

In May, yields on most of liquid issues of corporate and regional bonds decreased slightly. Yield on the bonds of MosGorZaim (the 39th issue) decreased to 6.90% of yearly interest (-0.04 points), yield on the bonds of MosGorZaim (the 44th issue) dropped to 6.92% (-0.09 points), yield on the bonds of Moscow Region (the 4th issue) dropped to 7.09% (-0.16 points), yield on the bonds of Moscow Region (the 5th issue) dropped to 7.16% (-0.22 points), yield on the bonds of Moscow Region (the 6th issue) dropped to 7.43% (-0.24 points), yield on the bonds of Russian Railways (Series 05) dropped to 7.06% (-0.31 points), yield on the bonds of Russian Railways (Series 06) dropped to 7.25% (-0.30 points), yield on the bonds of Russian Railways (Series 07) dropped to 7.34% (-0.21 points), yield on the bonds of Gazprom (Series A4) dropped to 7.09% (-0.17 points), yield on the bonds of Gazprom (Series A6) dropped to 7.03%



(-0.24 points), yield on the bonds of Federal Network Company UES (series 02) dropped to 7.55% (-0.14 points).

The government securities market. In May the Government Bonds Index (RGI) grew by 0.34 points to 116.54 points. The Total Revenue Government Bonds Index (RGI-tr) grew by 1.64 points to 161.41 points. The gross yield to maturity of government bonds (RGIY) decreased by 0.1 points to 6.72% of yearly interest. In the secondary market, the average weighted yield on the most liquid issues (46017, 46018, 46020) decreased by 0.02-0.18 points.

The value of trading amounted to 186.1 billion rubles, down 2.1% on April. The value of secondary trading grew by 52.6% to 32.9 billion rubles. 64% of the market turnover was accounted for by inter-dealer repos and direct repos against the Bank of Russia. Their value amounted to, correspondingly, 100.4 and 17.9 billion rubles. The OFZ-AD sector accounted for 71% of the turnover of the secondary market, OFZ-PD accounted for 18.9%, OBR accounted for 6.6%, while OFZ-FD accounted for 3.6%.

Auctions were held to place additional issues of OFZ 25060, OFZ 46017 and OFZ 46020 and additional issues of OFZ 25059 and OFZ 25060. The total value of placement of OFZ amounted to 23.3 billion rubles. Two auctions were held to sell OBR # 4-02-30BR0-4 with obligatory repurchase, the total value of placement amounted to 11.7 billion rubles, while the average weighted yield amounted to 4.65 and 4.72% of yearly interest.

The foreign exchange market. During the month, the exchange rate of the US dollar to the ruble dropped by 32 kopecks (-1.2%), while the euro grew by 48 kopecks (1.4%): on 31 May, the exchange rate of the US dollar with tomorrow settlements in the UTS amounted to 26.9465 rubles/1 dollar, while the exchange rate of the euro reached 34.6943 rubles/euro.

During May holidays, the volatility of trading grew slightly as a result of uneven sale of expert receipts. The total turnover of the foreign exchange market amounted to 92.4 billion dollars. 99.1% of the value of trading was accounted for by dollar-ruble instruments. The daily average turnover in dollar instruments grew by 10.9% to 4.4 billion dollars. 19.7% was accounted for by deals with today settlements (April: 18.7%), 45.3% — by deals with tomorrow settlements (April: 43.5%). The value of swap trading decreased from 36.8% to 34.1% of the Exchange's turnover. The average daily turnover in the euro decreased by 6% to 32.7 million euros a day. The proportion of euro-ruble operations amounted to 0.9% of the value of trading. The proportion of transactions carried out in the UTS through regional currency exchanges grew from 2.2 to 3.7% of the total value of trading.

The standard contracts market. In May, the total value of trading in the US dollar futures grew considerably over April and amounted to 98.5 billion rubles or 3651720 contracts. The daily average value of trading grew against April by 58% and amounted to 4.7 billion rubles. At the end of May, the open interest reached 1599230 contracts (1.6 billion dollars), having decreased by 8% against the end of April. Of the total number of open contracts, 36.7% was accounted for by June contracts, 6.2% — by July contracts, 8.8% — by August contracts, 25.6% — by September contracts, 1.9% — by October contracts, 1.3% — by November contracts, 12.1% — by December 2006 contracts and 7.5% — by March 2007 contracts.

Trading in the futures on the compounded MosIBOR overnight interest rate and the 3-month MosPrime Rate was launched on 30 May in the MICEX Derivatives Market Section.

Comment on the situation

In May, strong negative correction of prices took place in the MICEX Stock Exchange share

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market, caused by the outflow of funds from emerging markets. The MICEX Index, which at the beginning of May surpassed its historical maximum and exceeded 1600 points, dropped below 1300 points by the end of the month.

The main cause of the drop in prices in the Russian and other emerging markets was investors' growing fears that the USA might further tighten its monetary policy. The statement, made following the Federal Reserve's sitting of May 10, which raised the discount rate to 5%, said, with some reservations, that the US monetary policy might tighten in future. A chance for a pause in the discount raising campaign dwindled after the publication of data on the inflation rate in the USA, which turned out to be higher than expected.

Fears that interest rates in the USA and other developed countries would continue to grow caused the re-distribution of funds in favor of less risky assets. The global character of the trend was confirmed by the fall of the world's main stock indexes. In the USA, DJIA dropped by 1.7%, while NASDAQ Composite dropped by 6.2%. In Europe FTSE 100 decreased by 5.0%, while DAX dropped by 5.3%. Nikkei dropped by 8.5%.

Drop in prices in the world market for raw materials also had a negative effect on the Russian market. In New York, the price for oil, which at the beginning of the month had reached about \$75 per 1 barrel, dropped below \$70 per 1 barrel. Steep fall in prices also took place in the market for non-ferrous metals. Price for copper, which had reached \$8800 per 1 ton in the first half of the month, dropped by about 15%.

Besides, investors' attitudes were negatively affected by the idea that after one year of uninterrupted growth, Russian securities were overvalued.

At the end of May, Russian stocks, after falling during the month, began to edge up thanks to the stabilization of the situation in the world stock market and the market for raw materials and the overall positive domestic news. Good news for the market was information about the planned merger of Arcelor and Severstal, which will create the world's largest steel maker producing 70 million tons of steel and earning 46 billion euros a year.

In May, prices were growing in the sector of corporate and regional bonds; the trend was supported by high ruble liquidity and the strengthening of the ruble against the US dollar.

In May, ruble liquidity in the bank system improved considerably against April. The average overnight rate of MIBOR amounted to 2.97% of yearly interest against 3.86% in April, while banks' average balances in correspondent accounts grew to 355.2 billion rubles from 327.3 billion rubles in April.

During the month, the volumes of free funds in the bank system were large enough to support high demand for ruble-denominated bonds in the secondary market. The absence of large placements in the primary market contributed to the demand. The strengthening of the ruble against the US dollar made investments in ruble bonds more attractive. As a result, some investors, in all probability, decided to increase the proportion of ruble bonds in their portfolios.

Demand for ruble bonds was somewhat limited by the uncertainty in the market for US Treasuries and Russian eurobonds. However, fears that interest rates would continue to grow in developed markets affected, above all, the world share market, while the world bonds market remained stable enough.

Considerable improvement of ruble liquidity and the strengthening of the ruble supported the government securities market. Besides, the market was positively affected by the slowdown of



the growth of consumer prices: in May 2006, inflation rate in Russia amounted to 0.5%, in January-May 2006 — 5.9%, which is 1.4 points lower than the figure for the same period in 2005. Yield on most liquid securities of the 46th series decreased, while at auctions some securities (the additional issue of OFZ 46017) were sold at a discount to the secondary market.

In future, further liberalization of the foreign exchange market (the Bank of Russia's cancellation, beginning from 1 July, of obligatory reservation of funds and the obligatory use of special accounts in certain types of currency operations), may result in the narrowing of spread between the yield on OFZ and the yield on Russian Eurobonds. In May, foreign currency-denominated bonds fell: Eurobonds maturing in 2030 dropped by 1.4 points against a backdrop of expectations that interest rates would continue to grow in the USA and other developed countries. Russian securities lost more than US papers: spread between the yields on Russian and US securities grew by 15.1 points.

Trends in the world market contributed to the appreciation of the ruble against the US dollar in the Russian foreign exchange market. Participants' expectations of reduction of the difference in interest rates in the USA and the Euro area were working against the dollar. The US Federal Reserve is ending the increase of the discount rate, while the European Central Bank is only beginning to raise it. The escalation of tension around Iran's nuclear program and the growth of oil and gold prices were negative factors for the US dollar.

The growth of the euro against the dollar from 1.26 to 1.29 (1.5%) in the world market resulted in the decrease of the dollar in the Russian market. In May, the dollar dropped by 1.2% to 26.95 rubles/1 dollar, while the euro grew by 1.4% to 34.69 rubles/1 euro in transactions with tomorrow settlement in the UTS. May holidays caused certain growth of volatility of trading as a result of the unevenness of sale of export receipts. Daily average turnovers grew by 11% to 4.4 billion dollars, of which 34% was accounted for by swaps.

It is noteworthy that in May the process of lifting restrictions on the convertibility of the ruble was almost completed. It was started 10 years ago (16 May 1996) with the adoption of Decree #721 "On Measures to Provide the Convertibility of the Ruble".

On 10 May 2006, the RF President gave his annual address to the Federal Assembly, in which he proposed completing transition to the convertibility of the ruble by 1 June 2006 and organizing exchange-based trading in oil, gas and other commodities in Russia with settlements in rubles.

On 29 May, the RF CB decided to cancel, beginning from 1 July, the obligatory reservation of funds and the obligatory use of special accounts in certain types of currency operations.

These important events determine the future development of the Russian financial market: liberalization, the achievement of convertibility of the ruble and the management of interest rates. The financial infrastructure contributes its own positive changes. On May 30, trading in the futures on the compounded MosIBOR overnight interest rate and the 3-month MosPrime Rate, calculated by the National Foreign Exchange Association, began in the MICEX Derivatives Market Section. The new instruments enable banks, carrying out operations in the interbank market, to hedge ruble interest rate risk.